

# The Canadian Housing Industry Economic Update



Monthly Report

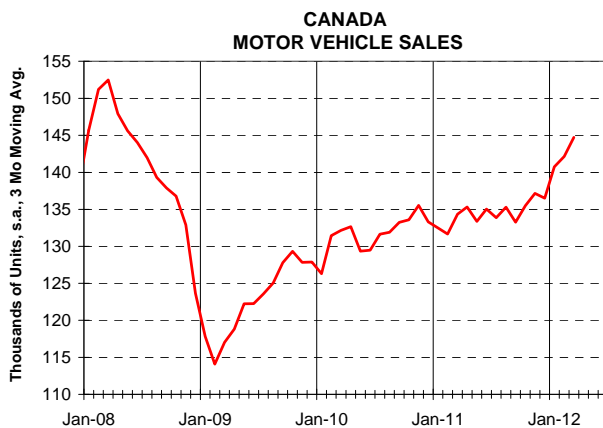
May 2012

## A Good Spring Selling Season

The spring selling season will be basically over by the May 24<sup>th</sup> weekend. It is shaping up to be a good one. Existing home sales have done well. They are running at a 2-year high. New home sales have held up well. Low-rise sales have offset lower high-rise sales. The sales pipeline will keep high-rise construction at high levels for some time though.

## Homebuyer Confidence

Confidence has improved. More Canadians think it is a good idea to buy a house now, instead of waiting. Housing affordability has remained stable over the past year and is not far above its long-term average. New house prices show an average yr/yr increase of 2.3% which is basically in line with the 1.9% increase in the consumer price index.



In general, there is an increased willingness to make big-ticket purchases. Auto sales were up in March from the same month a year ago. Passenger car sales were up by 6.5% yr/yr. This is proxy for consumer confidence and is good news for Canada's new home builders as well as renovators.

## The Interest Rate Outlook

The Fed will keep interest rates low. The FOMC stated in its March 13<sup>th</sup> press release that economic conditions "are likely to warrant exceptionally low levels for the federal funds rate at least through late 2014". There are two important parts of this statement – the "at least" and also "late 2014". The Fed is saying it may not raise rates until 2015.

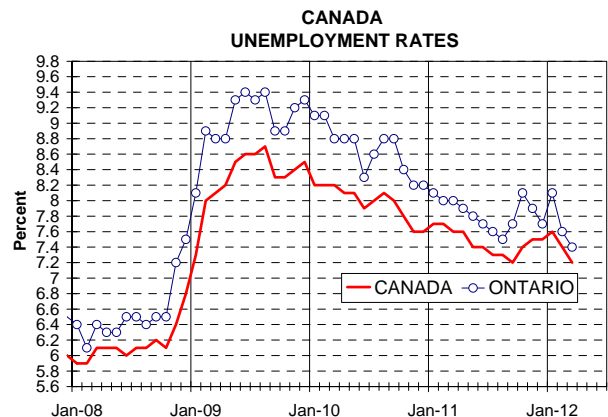
However, the Bank of Canada has recently raised the likelihood of higher rates. The Bank's April 17<sup>th</sup> press release states that "some modest withdrawal of the present considerable monetary policy stimulus may become appropriate, consistent with achieving the 2 per cent inflation target over the medium term".

The two parts of this statement that stand out are "modest withdrawal" and "over the medium term". The Bank of Canada seems to be saying that it might begin to increase rates ahead of the Fed. The medium term would not be this year but it could be later in 2013. In any case, it would seem to be before 2015. If the BOC were to widen the short-term interest rate differential with the U.S. even more, the Canadian dollar would likely go higher. This would be a problem as the BOC itself acknowledges Canada's poor export performance and an uncompetitive Canadian dollar.

Our interpretation is that the "medium term" is not anytime soon. The slow economic recovery in both the Canada and the U.S. should keep the unemployment rate relatively high and provide enough productive capacity to keep inflation at acceptable levels. The prospect of higher interest rates "over the medium term" could in fact give home buyers the message that it is a good idea to buy now rather than wait.

## Unemployment Still High

Job growth is strong enough to support housing demand but Canada's unemployment rate is still at a relatively high level. The latest figures show that it has only declined from 7.6% to 7.2% over the past 12 months.

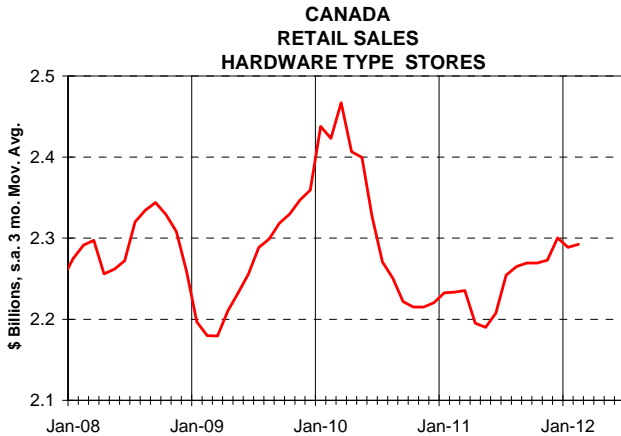


This is still a long way from where the unemployment rate stood at the beginning of 2008 when the recession was just getting started. It is not expected to move close to 6.0% until mid-decade. Given this slack in the job market, wage inflation is hard to find and inflation remains low.

Average hourly earnings of permanent workers show yr/yr increases of only around 2.5%. The consumer price index for March shows a yr/yr increase of 1.9%. The Bank of Canada's core CPI index also shows a yr/yr increase of 1.9%. The elevated unemployment rate and the modest CPI increases mean that the Bank of Canada does not feel pressure to raise rates this year.

## Renovation

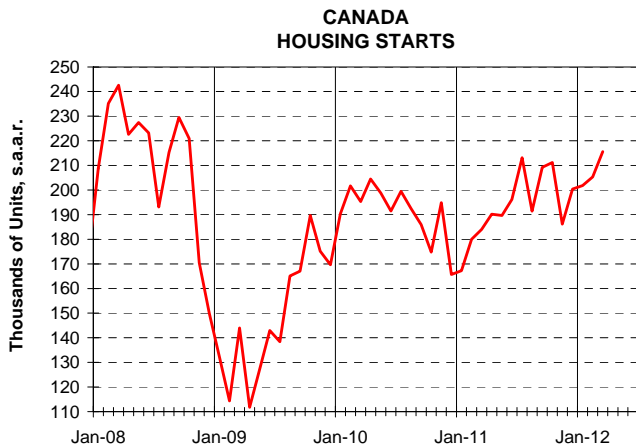
Residential renovation is trending higher. Retail sales of hardware-type stores are a proxy for renovation. They declined in 2010 after the effect of the Home Renovation Tax Credit (HRTC) wore off. However, hardware store sales have been rising since last summer.



The improvement in existing home sales will help the renovation market. People renovate when they move. Resale housing activity showed a substantial increase in March and reached its highest level in two years. The home sales pick-up is widespread across the country. As a result of on-going increases in house prices, home owners view renovation as a good investment.

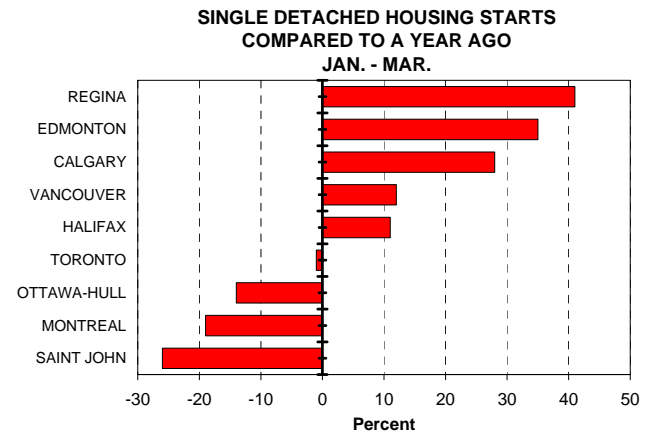
## Housing Starts

Housing starts have consistently exceeded expectations and have defied predictions of a downturn. In March, housing starts rose to a seasonally adjusted annual rate of 215,600 units. Forecasts for 2012 are now being revised upwards. It now looks like starts could total at least 200,000 for 2012.



March housing starts were the highest since 2008. They averaged 207,600 units in the 1<sup>st</sup> Quarter. In 2011 annual starts totaled 193,950 units. Actual sales of condos have begun to edge lower but the sales pipeline will keep such starts at a high level for some time yet. Some improvement in low-rise sales has been noted and given a lag this should be reflected in single-detached starts this summer.

Through the first three months of this year, urban area starts are up by 20% from the same period last year. Single-detached starts are up by 7% and multiple-unit starts, by 26%. The largest increases in single-detached starts are in the four western provinces. The composition of starts is noticeably skewed in Ontario – single starts are only up by 1% and multiples, by 45%.



Despite the heavy weighting of multiple units (mainly condos), the number of such units that are completed but unabsorbed is down by 4% from last year. However, the number under construction is up by 19%. Given the construction lags, it will be a busy summer for builders. The rental vacancy situation for condos will be released soon and it will be an important indicator. The condo rental market was relatively tight last fall.

## Commodity Prices

The strong Canadian dollar and the deepening slump in the price of natural gas are keeping many important building materials costs in check. Many building products are imported and their Canadian dollar prices are dampened by Canada's strong currency. In addition, energy is used in the manufacture of building products such as drywall. Natural gas prices at historical lows have made a difference to pricing here as well. However, lumber prices have been moving higher as evidence accumulates showing a U.S. housing recovery. New home sales in the U.S. have been trending higher since the summer of last year. The lumber price has moved up by about 7% since the end of 2011.

### FORECAST SUMMARY

		4Q11	1Q12	2Q12	2011	2012
CPI	(% ch. from yr. ago)	2.7	2.3	2.2	2.9	2.2
PRIME RATE	(end of period)	3.00	3.00	3.00	3.00	3.00
HOUSING STARTS	(000's annualized)	199.0	207.6	205.0	194.0	200.0