

The Canadian Housing Industry Economic Update

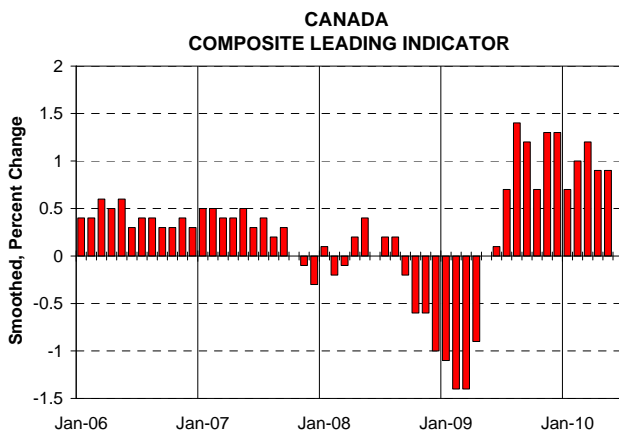


Monthly Report

July 2010

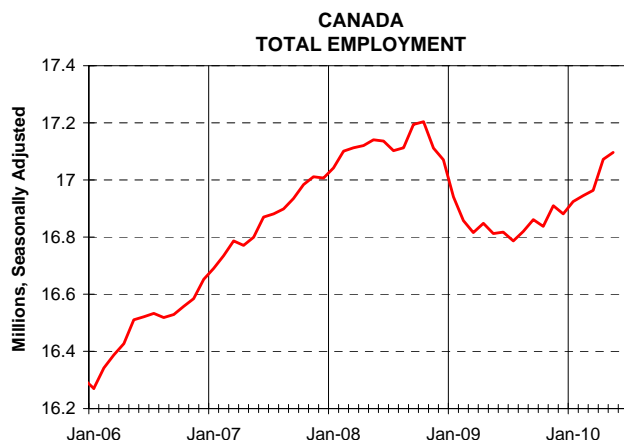
Renewed Expansion

Canada's economy is setting G-7 performance records for output and income growth. The latest leading indicator news is telling us that the expansion has staying power. This is good news for new home builders and renovators. Rising incomes will give underlying support for housing affordability and put to rest fears of a housing bubble. It will be income growth, not house price declines that brings house price to income ratios back into line.



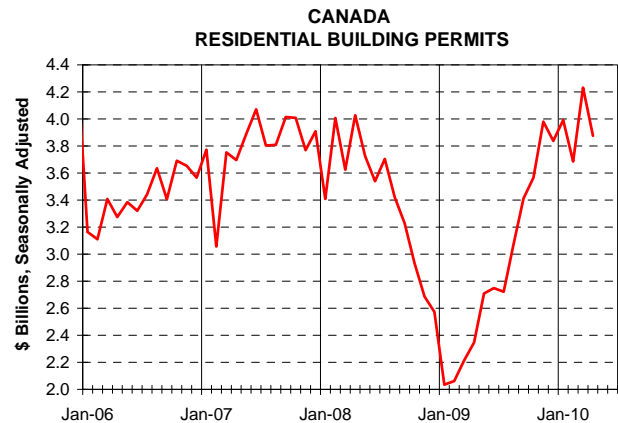
Canada's real GDP growth has been much stronger than expected. The 6.1% annualized rate of advance in the 1st Quarter was double the growth rate in the United States. The surge in employment through the 2nd Quarter indicates that economic growth in Canada will remain well above its longer-run trend through to mid-year.

It is clear that a meaningful pick-up in hiring has been underway in Canada for almost a year now. Since last July, 3/4 of the jobs lost during the recession have been recovered. Virtually all of the employment gains have been in full-time work.



The Housing Outlook

The impact on confidence and personal income growth will provide a powerful support to new housing and renovation activity. Unlike other forecasters, we expect a sustained housing sector recovery through the remainder of this year and in 2011.



Residential building permit data imply a significantly higher level of housing starts than shown in the April and May starts figures. Builders are still catching up with earlier sales. The recent pick-up in high rise condo sales will also sustain housing starts over the next year.

Up to now, the recovery in new housing activity has been limited to low-rise construction. This is now changing as credit conditions improve for high-rise developers; confidence stabilizes; and condo sales pick-up.

Canada is increasingly looked on as a safe-haven for international investors and condo sales to foreigners has picked up in Toronto and Vancouver. A number of condo construction projects were put on hold during the 2008-2009 financial crisis and a number of these will be reactivated this year and next.

The Global Economy

The global economy appears to be strong enough to weather Europe's debt crisis and a possible European recession. Developing countries now account for a larger share of the world economy than the mature G-7 industrialized countries. The emerging and developing countries have decoupled from the trends in Europe and North America.

China, India and Brazil all show yr/yr increases in industrial production of around 17%. The latest figures for real GDP show yr/yr increases of 11.9% in China and 8.6% in India. This is good news for Canada. Emerging and developing countries are key players in commodity markets.

Europe's Debt Problems:

Europe's sovereign debt crisis is the key worry. It has the potential to damage Europe's financial system and choke European credit growth. The direct trade effect on the U.S. and Canada would be relatively modest.

However, there could be a significant indirect effect through the stock market. A stock market crash in Europe would be felt around the world. If the Dow Jones Index were to plunge by several thousand points, upper-income American consumers would be immediately affected. High income households in both the U.S. and Canada are very sensitive to stock market volatility. They cut back sharply on spending during the recession.

In June, the European situation appeared to be stabilizing and a more confident attitude became noticeable in financial and foreign exchange markets. The European Union will stress test Europe's banks and publish the results in July. This could be an important step towards a confidence turnaround and a revival in credit flows. If Europe's problems have now reached their peak of intensity, then we could see a steady re-acceleration in the U.S. from a 3% real GDP growth rate to 4% in 2011 and 5% in 2012.

Canada's Household Finances:

Canadian households did not experience the kind of wealth destruction that took place in the United States. Real estate assets held their value and began to appreciate again when the panic ended. Financial institutions have not seen their capital eroded by a wave of bad loans. As a result credit flows have been maintained.

Unlike Americans, households have not felt the need to replace lost wealth and repair balance sheets. Household debt outstanding has therefore continued to climb in Canada. However, household assets have matched debt growth.

The household debt to net worth ratio has remained unchanged since Q4/2008. Also, the household debt service ratio has remained stable for the last four quarters at 7.4% - a relatively low level. Household debt levels in Canada would only be a problem if interest rates and unemployment rose sharply and asset values collapsed. This does not appear to be likely anytime soon.

Bank of Canada Rate Increases

There are four more BOC interest rate announcement dates this year - July 20th, September 8th, October 19th and December 7th. We think that the BOC will increase its short-term rate target by 25 b.p. at each one of them. Governor Carney has said that he will react to the incoming economic indicators and that rate increases are not "preordained".

However, we already have enough information to know that the 2nd Quarter report, to be released on August 31st, is likely to show another quarter of well above average real GDP growth.

The Canadian Dollar:

Volatility in the EUR is also enhancing the CAD as a reserve asset. Russia announced last year that it would diversify its reserve base and add to its holdings of Canadian dollars. This now appears to be happening. Russia has large reserve holdings. A relatively small shift could add upward pressure to the CAD. The Gulf oil spill could also have a positive effect on the Canadian dollar. In the aftermath of the BP environmental oil disaster, crude from Canada's oil sands will probably be looked on as a safer and more desirable alternative to deepwater oil from the Gulf of Mexico.

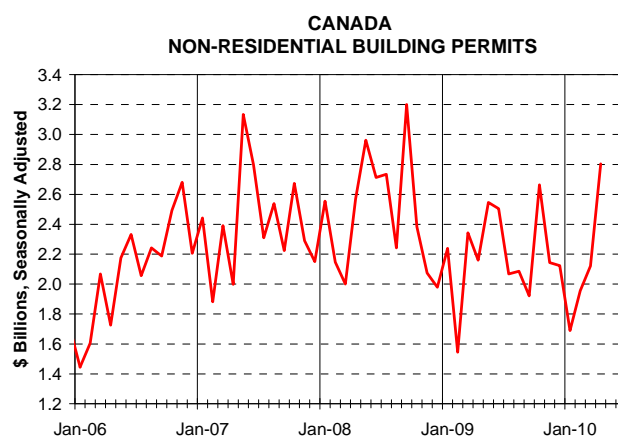
Regional Developments:

Alberta is expected to emerge as the growth leader by the end of the year as capital spending in oil sands projects ramps up again. The world oil market is tightening. Petroleum consumption growth should outpace non-OPEC supply. OPEC will again have pricing power. Alberta will be able to count on crude oil prices sustained in excess of US\$75 per barrel. This will be a confidence booster for the Province.

For now, Ontario is showing the most pronounced turnaround. Employment in Toronto has held up remarkably well and is now close to its previous peak 2008 levels. In other parts of Ontario, outside of Toronto, employment has recently shown solid monthly gains. Retail sales in Ontario have soared and have reached new post-recession highs.

Non-Residential Construction:

The recent jump in non-residential building permits is a big surprise. It reflects institutional and commercial building projects in Ontario, Alberta and Nova Scotia



FORECAST SUMMARY

		4Q09	1Q10	2Q10	2009	2010
CPI	(% ch. from yr. ago)	0.8	1.6	1.7	0.3	2.4
PRIME RATE	(end of period)	2.25	2.25	2.50	2.25	3.25
HOUSING STARTS	(000's annualized)	178.4	198.9	195.5	149.1	205