

The Canadian Housing Industry Economic Update



Monthly Report

June 2011

The Commodity Cycle

Financial market volatility can be expected this summer as the sovereign debt crisis in Greece worsens and the brinkmanship over the U.S. government debt ceiling intensifies. The interruption of Japanese supply chains could also have a short-term effect on North American automotive production. However, the global economy has performed better than expected through the first half of this year and the global commodity cycle is still solidly in place.

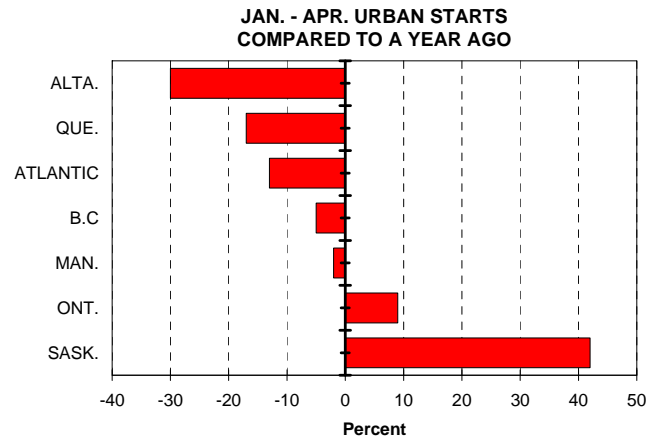
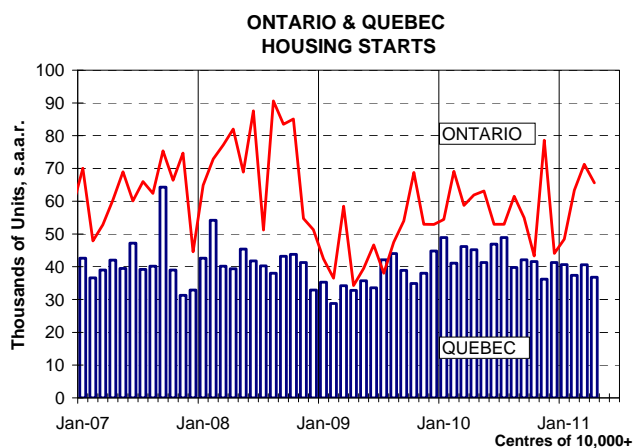
Both Canada and the U.S. are expected to show accelerating output and income growth in the second half of this year and in 2012. Business sector balance sheets are in very good shape. Businesses are planning for expansion. This will create the employment and income growth needed to support housing markets. The problems facing Canada's new home builders and renovators are likely to be commodity prices and materials costs rather than insufficient demand.

Stable Canadian Housing Starts

Housing starts have been reasonably stable in Canada. They have fluctuated within a relatively narrow band between 170,000 and 185,000 units at annualized rates over the past five months. The starts rate has averaged 176,600 units over this period. We have edged our annual starts forecast for Canada upwards to 179,000 units in 2011.

Under the surface, there is a big contrast between single-detached starts and multiple-unit starts. Single starts show large percentage declines compared with the spring of last year, while multiple starts show large percentage increases.

There are also contrasting movements between regions. Total starts show sustained declines in Atlantic Canada but have edged higher in Ontario, thanks to high-rise condo construction in Toronto. Starts have been basically flat in Quebec at a respectable pre-recession level.



In Saskatchewan, starts have fluctuated around a rising trend over the past two years. Manitoba has recovered from 2009 recession lows and is running in line with 2007 levels.

Alberta lacks the strength in high-rise condo construction in Ontario and starts there are running well below year-earlier levels. They show better performance in B.C. but are basically flat with year-earlier performance. Looking ahead, a sustained commodity cycle is expected to provide major economic support to B.C., Alberta and Saskatchewan.

Economic News

The best economic news since the CHBA's February conference in Banff, is the pick-up in private sector job creation in the United States. This will produce the spin-off effects that will create a self-sustaining expansion. It will also help revive U.S. new housing construction.

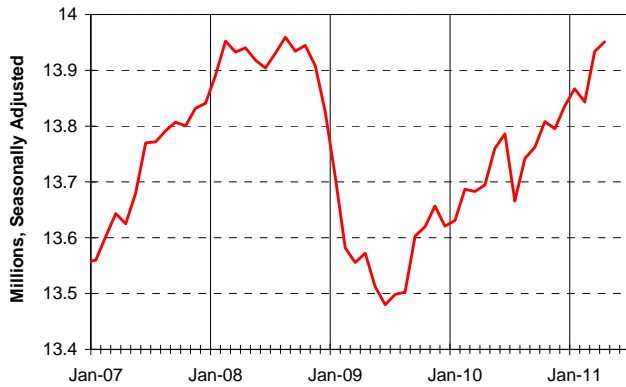
Private sector payroll job creation in the U.S. has averaged 253,000 per month over the three months ending in April. This compares with a monthly average of only 130,000 over the previous three months.

The U.S. business sector is experiencing solid sales growth, wide profit margins, and is activating expansion plans. Real GDP growth in the U.S. is expected to be above potential, in the 4% range, in the 2nd Half of this year and in 2012. This is good news for Canada's economy as one of the weak links in our recovery so far has been weak export performance.

Full-Time Job Growth in Canada

Full-time job growth is producing the income gains and homebuyer confidence that will support Canada's housing demand at a relatively high level. Do not believe anyone who says that the employment recovery in Canada has been concentrated in part-time jobs. Over the past 12 months, more than 90% of Canada's job gains have been in full-time positions. Total employment is up by 283,100 and full-time

**CANADA
FULL-TIME EMPLOYMENT**



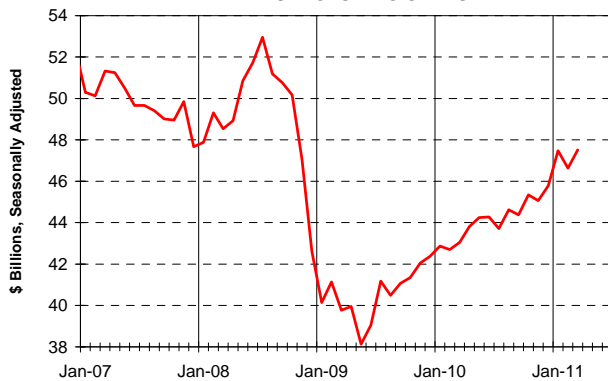
shows an increase of 256,300. In comparison, part-time employment shows a gain of 26,800 over the past 12 months. The full-time job gains in Ontario are even more impressive. Ontario's employment growth of 157,000 over the 12 months ending in April was all in full-time positions.

At the national level, full-time employment has experienced a strong surge since last fall. This is important for the new housing and renovation outlook as it means that the economic fundamentals are getting better. We continue to believe that supply issues and input costs will be the main issue for Canada's new home builders, rather than demand.

The split between private and public sector job growth also indicates economic health. Private sector employment gains over the past 12 months (177,500) outnumber public sector job gains (98,700) by a ratio of almost 2 to 1. Manufacturing job creation over this period (57,400) is running well ahead of public administration (26,300).

Canada's Manufacturing Recovery

**CANADA
MANUFACTURING SALES**



Canada's manufacturing recovery has picked up speed. Manufacturing sales rebounded in the 1st Quarter. Unfilled order bookings are very strong, pointing to more sales gains.

This improved outlook for Canada's manufacturing sector reflects higher levels of demand for automotive and aerospace exports. It is also a spill-over effect of the manufacturing revival in the United States. This improved performance in manufacturing is good news for the Ontario economy and Ontario's residential construction outlook.

The elevated and over-valued Canadian dollar is not having an adverse effect on the volume of export demand faced by Canadian manufacturers, as most products are priced in U.S. dollars. The initial effect is on profit margins as USD export revenues are converted back to Canadian funds.

Interest Rates

The low interest rate environment will not last much longer. The Fed will begin a series of rate increases next year and will begin to hint at this policy shift in its press releases this summer and fall. This will create expectations which will quickly flow into medium-term and longer-term interest rates before the end of this year.

Mortgage rates in Canada will move higher through the rest of this year. Five-year mortgage rates are already on the move. On a "special offer" basis, they have increased from 4.09% at the beginning of March to 4.54% now. They will probably be over 5.00% by year-end.

The Bank of Canada will begin to increase its target for the overnight interest rate ahead of the Fed. Rising commodity prices, supply shocks from the Middle East and Japan, and stronger than expected U.S. economic growth, will heighten the risk of spill-over price effects into general inflation. We expect at least two Bank of Canada rate increases before the end of this year. The first may be at its July 19th interest rate announcement date and the second might be at the October 25th announcement date.

Costs and Prices

Key commodity prices – lumber, copper, crude oil and even natural gas – have slipped since the end of the 1st Quarter. However, we believe that an accelerating U.S. economy and continuing high output growth in China and India, will produce commodity price pressure for Canada's new home builders before the end of this year. We also expect lumber prices to move higher again as the likelihood of an upturn in U.S. residential construction is increasing.

The initial upturn will be in U.S. multi-family construction. Foreclosures have pushed households into the rental market. Rental vacancy rates are down to a 3-yr low. Rents are up. Job growth is stimulating household formation from a 60-yr recession low. U.S. housing starts are capable of moving up to annualized rates in the 800,000 unit range in the 2nd Half of this year. They slumped to only 586,800 units last year.

FORECAST SUMMARY

		4Q10	1Q11	2Q11	2010	2011
CPI	(% ch. from yr. ago)	2.3	2.6	2.7	1.8	2.6
PRIME RATE	(end of period)	3.00	3.00	3.00	3.00	3.50
HOUSING STARTS	(000's annualized)	178.7	178.2	178.0	189.9	179.0