

# The Canadian Housing Industry Economic Update



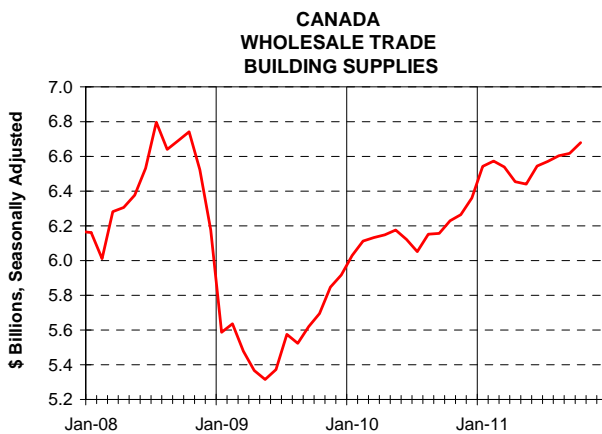
Monthly Report

January 2012

## Spring Selling Season

Get ready for the spring selling season. It will be here before you know it. It starts in February in some parts of Canada. Despite heightened worries for the world economy and international financial markets, the outlook for Canada's new home builders and renovators is still relatively positive.

The New Year has begun with a reasonable amount of economic momentum. The composite leading indicator index shows a substantial monthly increase. Consumers are confident enough to make big-ticket discretionary purchases. Motor vehicle sales have turned upwards.

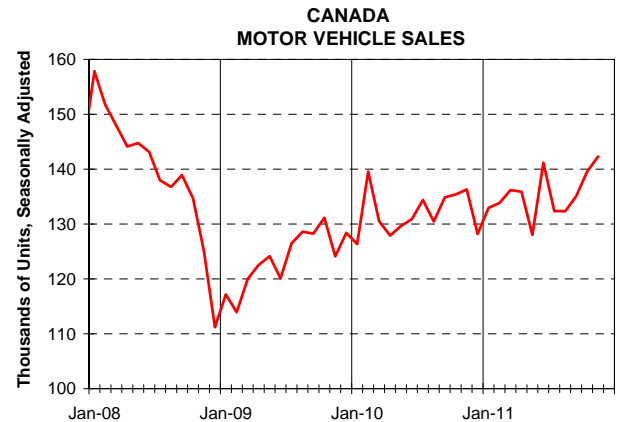


Earlier forecasts for renovation spending were too pessimistic. It is expanding at a faster rate now. Wholesale trade in building supplies has turned upwards again. The majority of housing markets report "sellers-market" conditions and the remainder are in a balanced position. In addition, the economic indicators for the U.S. economy have been stronger than expected. It could be the calm before the storm, however.

## The European Threat

Europe's debt crisis could become a problem for Canada's economy after mid-year. Homebuyer confidence could be shaken by alarming headlines and a stock market plunge. A good business strategy would be to take advantage of current market conditions and build up cash reserves. Even though interest rates will stay low, even the Canadian banks are likely to make credit conditions tighter for companies.

Italy, Portugal, Ireland and Greece have now hit the fiscal wall. Italy is the pivotal country because of the size of its outstanding obligations. Extraordinary measures are still needed to avoid sovereign defaults. We will have to prepare ourselves for the possibility of a failed roll-over and an Italian fiscal solvency crisis in 2012.



European banks do not have enough capital to absorb big investment losses on their bond portfolios. We are counting on Mario Draghi, the new President of the ECB, to provide even more support to the European bond market if the crisis intensifies. The ECB might step in with a commitment to make unlimited sovereign bond purchases in the primary new issue market.

## Mild European Recession Tolerable

The U.S. and Canada can tolerate a mild recession in Europe. One has already started there. A severe recession would be another matter. We will have to follow events overseas very carefully for the next few months. Canada's economy is still on an expansion path, albeit a moderate one. It will not compare well with other cyclical recoveries that have followed previous recessions.

## A Growth Slowdown in Canada

Our 2012 growth forecast for Canada has been revised downward. We are now forecasting an increase in real GDP of 1.8%, a slowdown from an estimated 2.3% advance in 2011. Fiscal tightening will show up earlier in Canada than in the United States. A slowdown in the world economy and in world trade will also affect Canada negatively. In addition, the overvalued CAD has produced a wage-cost disadvantage with the United States. Slow growth in the U.S. will continue to dampen Canada's energy and non-energy exports.

## Tighter Lending Practices

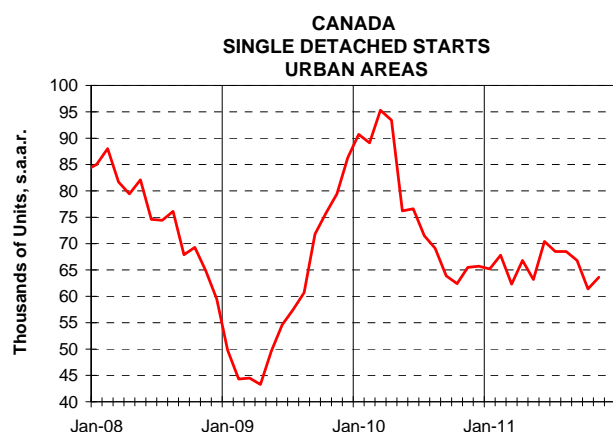
Even though interest rates will remain low, lending standards and practices will become more conservative in response to financial stress in Europe and the banks' desire to enlarge capital. Corporate bond markets and equity financing already reflect higher risk premiums and reduced financial flows.

New home builders can expect to see a tighter credit approach by their bankers. Collateral requirements could

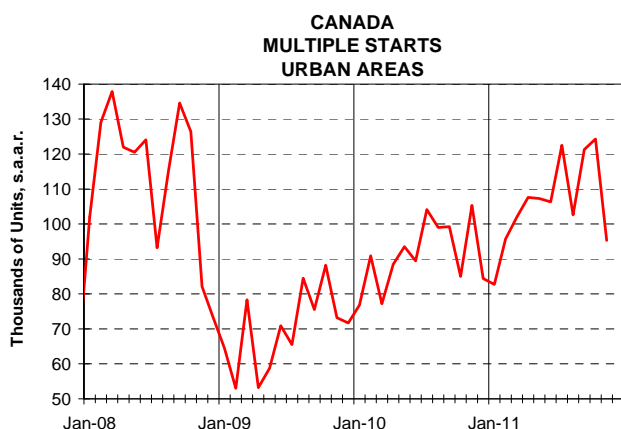
increase and loan covenants could become stricter. Lines of credit could be reduced and more pre-sales may be required for bank loans to be approved. Banks will become increasingly nervous as a result of the stress that European banks will face. In addition, the Fed's bank stress tests in the U.S. will have an influence on bankers' attitudes in Canada. Our banks will be putting an enhanced priority on building and protecting capital.

## Housing Starts

Housing starts are likely to decline in 2012 as high-rise condo starts adjust to lower levels. The re-start of projects cancelled in 2008 and 2009 seems to have been partly responsible for the surge in high-rise starts this year. This effect can be expected to unwind in 2012.

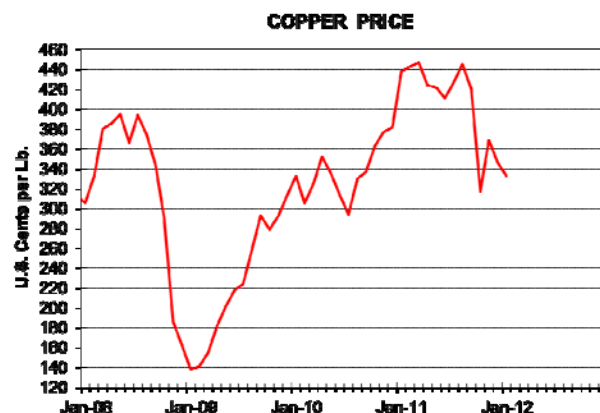


Low-rise single-detached starts are expected to remain relatively stable. They have basically been moving sideways since the fall of 2010. Unsold inventories of low-rise new homes are relatively low, indicating a balanced market. In contrast, high-rise inventories have been quite high for some time, suggesting the possibility of over-building.



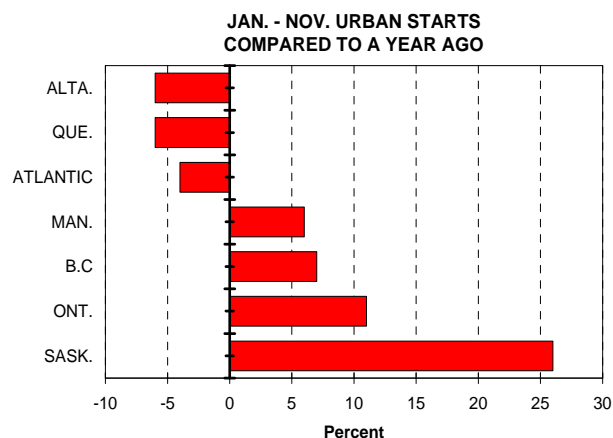
## Commodity Prices

Lumber is one of the few commodities that could move against the declining trend in overall commodity prices. Lumber may have bottomed. Housing construction in the U.S. shows early signs of revival (building permits and mortgage purchase applications) and lumber inventories are very low. More weakness is expected in energy prices though and also in base metals prices, including copper.



## Regional Outlook

Alberta and Saskatchewan will be Canada's growth leaders in 2012. Both will benefit from on-going natural resource investment projects. Newfoundland also is in an energy and resources megaproject boom that will extend through 2012.



A positive decision on the Keystone XL pipeline project would provide a confidence boost for Alberta's oil-sands prospects, even though construction would not be completed for some time. Ontario's large budget deficit (estimated at C\$16 billion in the current fiscal year) has raised warnings of a credit rating downgrade. Previous fiscal stimulus measures in Ontario will be replaced by government belt-tightening that will become increasingly evident in 2012 and 2013.

### FORECAST SUMMARY

		1Q10	2Q11	3Q11	2011	2012
CPI	(% ch. from yr. ago)	2.6	3.4	3.0	2.9	1.7
PRIME RATE	(end of period)	3.00	3.00	3.00	3.00	2.50
HOUSING STARTS	(000's annualized)	177.8	192.5	204.6	192.0	178.0