

The Canadian Housing Industry Economic Update



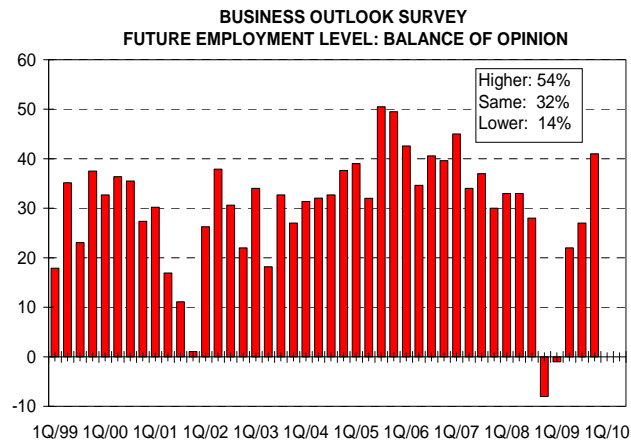
Monthly Report

March 2010

The Shape of the Recovery

We have put worries about a double-dip recession on the backburner. After an initial surge reflecting government policy stimulus and a swing in inventories, the economy is expected to settle down to a moderate pace of advance through most of 2010. This will provide a positive environment for new home builders and renovators.

The economy will be growing but not fast enough to produce disruptive increases in interest rates. The leading indicators for Canada's economy have become much more positive since last fall. Household spending is the main source of strength in the composite leading indicator index.

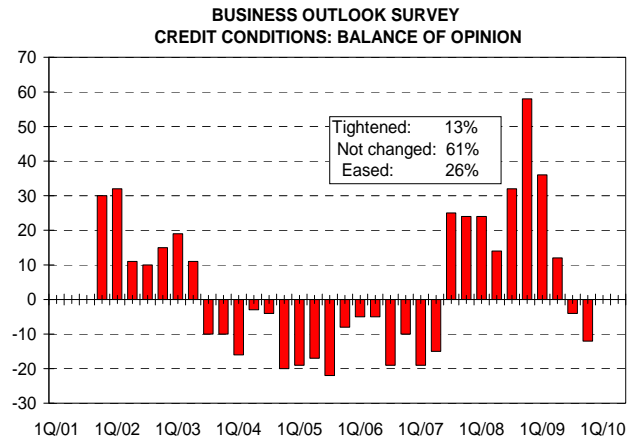


Business optimism has shown a record rebound, hiring intentions are upbeat and credit conditions are easing. Normally the economy rebounds at an above-average growth rate after a deep recession. The reason we don't think it will this time is the challenged U.S. economy. Our biggest customer is facing headwinds and they will have an impact on Canada.

The U.S. Economy

Most American forecasters are now predicting a moderate recovery in 2010. The latest survey by the National Association of Business Economists shows real GDP growth averaging 3.0% this year. In our view, this is on the high side. Household finances are being repaired but the personal saving rate is not expected to peak until the 4th Quarter 2010. There will be no clear-cut economic driver this year.

In order to have a sustained recovery, after the government stimulus fades and the temporary inventory effect subsides, employment will have to begin to grow again. We expect it will by the summer. Leading indicators are positive. Hours worked are increasing; demand is up for temporary workers; and there is also a pick-up in help-wanted advertising.



U.S. Housing Outlook

It will be the return of job growth that will turn the U.S. housing sector around. Business confidence has been steadily improving for larger companies and we do expect renewed hiring. We just do not think it will be strong enough in 2010 and 2011 to provide a big recovery push to U.S. housing.

Housing starts in the U.S. are expected to increase to 700,000 units in 2010, up from 554,500 last year. U.S. starts are not expected to reach what could be described as normal levels (in the 1.4 to 1.7 million unit range) until 2012.

Policy measures directed at housing can help but only job-creation can provide a final solution. There has been recent improvement in U.S. house prices and sales, but it is basically all attributable to government help such as the homebuyer tax credit and low interest rates stemming from the Fed's purchases of mortgage backed securities. Fortunately, there is more federal help coming.

In February, President Obama announced an additional \$1.5 billion to help the housing market in five key states - California, Florida, Nevada, Michigan and Arizona.

The funds will probably be used to help financially stressed homeowners make their mortgage payments and to help banks write off losses on homes worth less than the outstanding mortgages. The objective is to help homeowners stay current on their mortgages, and also to prevent homeowners who can afford to pay from walking away from "underwater" mortgages.

The Employment Cycle

In the past, the steeper the recession and the greater the job losses, the faster and steeper the job gains that followed in the months after the economic cycle bottomed-out. A good example would be the early 1980's when the steep 1980-82 recession was followed by a robust job recovery in the

following years. Some are expecting that history will repeat itself and that we will be surprised by the employment turnaround this year and next.

Structural Changes

Unfortunately, we think it is unrealistic to be this optimistic. The structure of the economy has changed over the past two decades. Long-term unemployment is much more of a problem today. Approximately 6.3 million Americans have been unemployed for six months or longer. This is more than double the number in the early 1980's. Women aged 45 to 64 have been particularly hard-hit. They accounted for 7% of the long-term unemployed in 1983 and are now up to 14%.

A number of factors suggest that people out of work so long may never successfully re-enter the workforce. Jobs will now be much harder to find for older and less-educated people.

Large companies are increasingly owned by institutional investors who demand quick profits, which can be achieved by squeezing payrolls. There has been a dramatic increase in the importance of private equity firms and leveraged buy-outs since the 1990's. The pressure to increase shareholder value has never been greater.

Since 2000, American manufacturers have eliminated 5.6 million jobs with the help of automation. These were the sort of jobs that provided good incomes to lower-skilled workers. The declining influence of unions makes it easy for employers to shift work overseas and to part-time and temporary positions. Globalization is even moving white-collar jobs to low-cost Asian and Latin American countries.

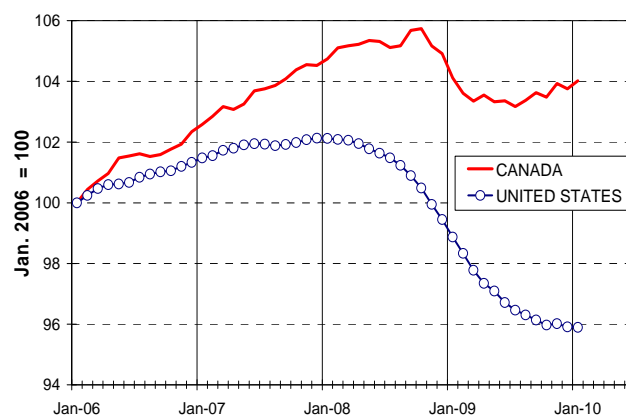
In past U.S. economic recoveries, the auto industry, home building, banking and small business used to be the employment drivers. They are not helping as much anymore. Auto companies are downsizing because of structural problems; U.S. home building is held back by foreclosed properties; the expansion in banking will slow as government support is withdrawn; and small business expansion is being held back by the on-going credit squeeze.

Canada's Housing Outlook

Canada faces some but not all of these employment headwinds. Key differences are Canada's accommodative credit conditions, our healthy banking sector and a more stable housing sector. In contrast to the U.S., employment has already started to increase again. Given these relative advantages, our forecast for Canadian housing starts is 190,000 units in 2010 and 200,000 in 2011.

Our forecast assumes that rising mortgage rates do not become a disruptive factor for housing demand. Tighter mortgage standards for mortgages could to some extent be a substitute for Bank of Canada rate increases.

CANADA AND UNITED STATES EMPLOYMENT GROWTH INDEX



All borrowers will be required to meet lending standards for 5-year mortgages regardless of whether they are seeking a loan with a lower rate and a shorter term. This will ease pressure on the Bank of Canada for early interest rate increases. Interest rates are not expected to show significant increases until 2011. Even then, they are more likely to reflect an adjustment to more normal levels rather than outright monetary tightening.

Our housing forecast also expects a revival in high-rise condo construction in 2011 as market conditions for this type of product improve and development financing becomes more available. The upturn in new housing activity to this point has largely reflected a rebound in low-rise sales and starts. The inventory of newly constructed condos remains at high levels. In some cities high-rise demand has been largely in the entry-level and low-income part of the market.

These buyers have been attracted by low interest rates and competitive pricing. Tighter lending standards will have some negative effect on this type of purchaser. No one really knows what the impact of the increased minimum down-payment on investment properties from just 5% to 20% will be. However, a broader economic recovery by 2011 could revive baseline owner/occupier condo demand. We expect to see a number restarts of the condo projects that were put on hold in the midst of the 2008 financial crisis.

Renovation

The renovation market basically moved sideways at a high level during the recession, rather than declining. The Home Renovation Tax Credit is estimated to have contributed \$4.4 billion to renovation spending in 2009. It allowed homeowners to get up to \$1,350 in tax relief for projects worth up to \$10,000. We do not expect a renovation slump following the end of the program on January 30th. Strong existing home sales mean a backlog of renovation work.

FORECAST SUMMARY

		2Q09	3Q09	4Q09	2009	2010
CPI	(% ch. from yr. ago)	0.1	-0.9	0.8	0.3	1.4
PRIME RATE	(end of period)	2.25	2.25	2.25	2.25	2.75
HOUSING STARTS	(000's annualized)	130.7	150.4	171.0	149.1	190.0