

# Canadian Economy & Housing Market Outlook w/ Carl Gomez

Presented November 2010 Exclusively to the Members of REIN™

**“Boring is good!”**  
*Outlook for the Canadian economy & housing market*



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Vice President, Investment Research

 Bentall

## Outline

1. Economic outlook
2. Lending market developments
3. Housing market trends and outlook

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**Sign of the times?**



**THE 2000s...**

SHOP 'TIL YOU DROP!

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## Sign of the times?



**THE 2000s...**

SHOP 'TIL YOU DROP!

**2010...**



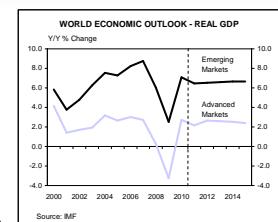
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**Economic & lending market outlook**

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## Global economic themes

- Global economy is firmly in recovery mode and risk of a double dip is low
- But there is significant variance in regional economic performance unfolding
- Emerging markets are growing strongly while the developed world will see slower growth than is usual as it face considerable challenges related to fiscal deficits and the rebalancing of monetary conditions
- With significant economic slack/deleveraging and high unemployment in much of the developed world, the risk of deflation (or more likely “disinflation”) is higher than inflation over the next few years



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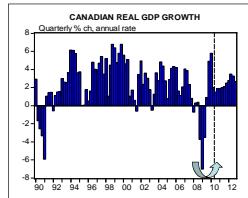
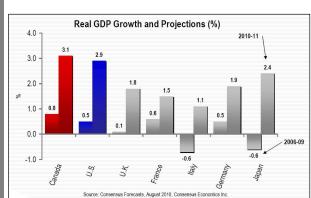


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### Canadian economic outlook

- Canada's initial recovery was very strong but growth is beginning to slow
- Previously rapid growth on the domestic side of the economy is unsustainable while a soft external environment and a high C\$ is holding back exports



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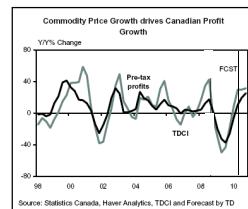
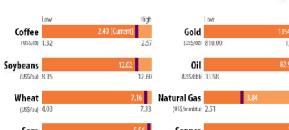


### Fundamental drivers of the Canadian economy

- Canada's domestic outperformance is partly driven by its orientation to commodities
- Stronger commodity prices support profits, incomes, jobs and net worth in Canada

Commodity Price Range (since January 2000; as of November 1, 2010)

Foodstuffs      Metals & Energy

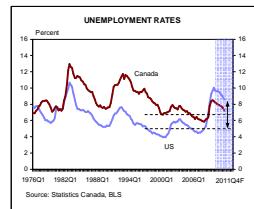
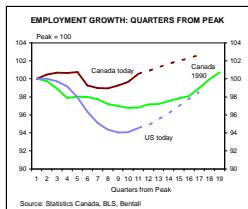


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### Canadian employment situation

- Canadian jobs are already back to pre-recession levels but the US is not likely to get there until at least 2013
- There is less slack in Canada's labour market - it will return to "full employment" levels faster than the US - will mean greater support for Canadian income growth

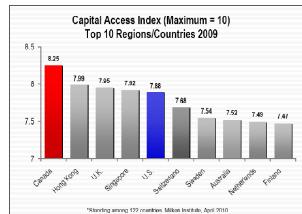
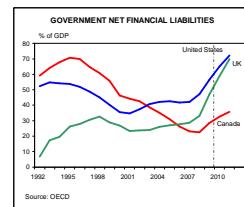


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### Canada's fiscal and financial stability

- Canadian government is less burdened by recent fiscal spending
- Access to capital remains vibrant in Canada

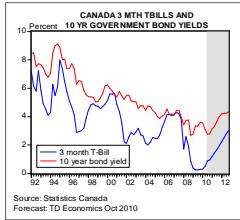


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### Residential lending market – credit availability

- Interest rates should remain near historical lows for an extended period of time given weak global recovery and QE2
- Unlike the US, most consumers in Canada can access this low cost of credit at very attractive rates

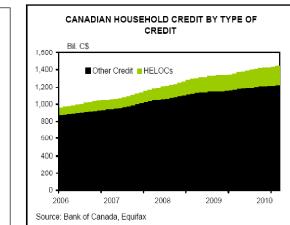
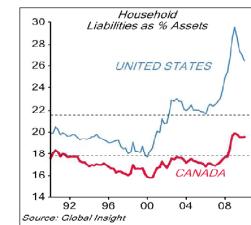


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### Consumer credit risks

- Cheap and easily accessible credit has pushed consumer debt to record levels
- Much of this debt is related to housing and further growth is unsustainable



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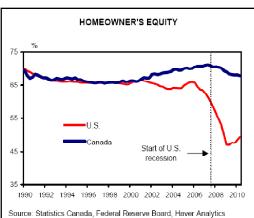
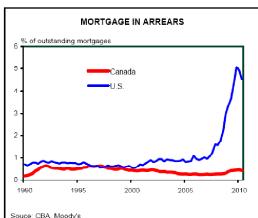


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## Residential lending is stable in Canada

- Some stress has appeared in Canada's residential lending market
- But Canada's mortgage market is on a much more stable footing than the US – little chance of a US-style implosion here



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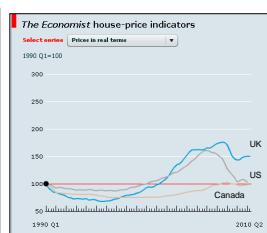


## Housing market outlook



## Canada's housing market in a global context

- Canadian house prices are at record levels
- But recent growth in Canada pales to the bubbles seen in the rest of the world

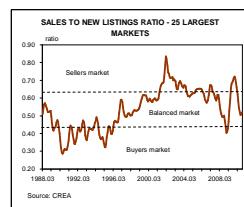


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## Canadian housing market conditions

- After an impressive rebound, home sales have trended lower and so have listings
- The net result is a housing market that has moved back into balanced conditions, and in some cases – a buyers market is emerging

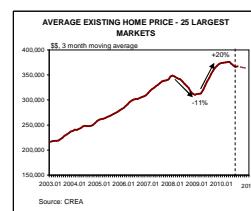


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## Canadian housing market conditions...cont'd

- Supply and demand (sales and listings) dictate where prices go
- The rebalancing of supply and demand conditions is likely to result in flat to slightly declining prices going forward

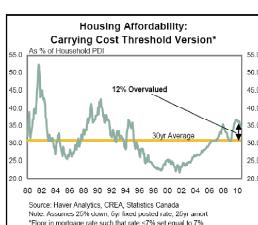
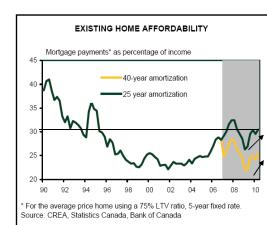


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## Housing (un)affordability?

- Housing affordability was a major reason for stronger housing demand last year and it still remains historically attractive
- But housing markets/prices are slightly vulnerable if (and when) rates reset



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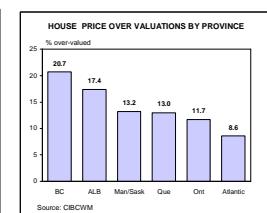
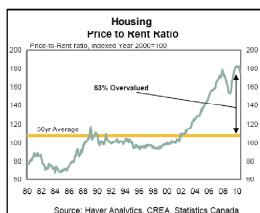


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## Is housing over-valued?

- On other metrics that exclude the cost of debt, housing is grossly over-valued (but there is also significant measurement error)
- All markets in Canada require some degree of correction to restore equilibrium, particularly the West

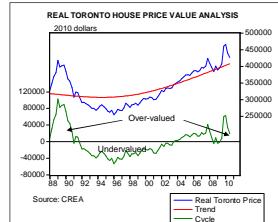


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## Is there a bubble in Toronto?

- After a momentary correction in 2008, Toronto home prices have reached another record high
- But compared to the late 80s, the market does not appear to be in a bubble although it is over-valued and a modest correction is warranted

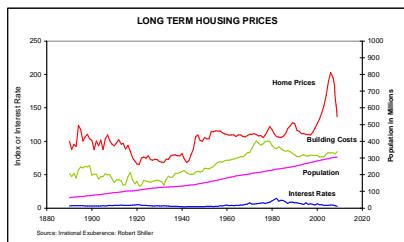


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## The big picture

- Over the long run, home prices do not grow by much more than the general rate of inflation
- As such, real estate's fundamental investment appeal should be mainly from the income/cash flow it produces



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## Conclusion: "Boring is good!"

- The global and financial environment is consistent with interest rates and inflation remaining low for an extended period of time - expect asset prices to be supported by this
- While underlying fundamentals are sound in Canada, growing consumer debt and a lack of pent up demand is likely to be an offset to higher house prices - a modest correction is likely but there is almost no threat of a US-style implosion
- This suggests a rather "boring" period for Canada's housing market over the longer term, where a balanced situation between demand and supply should persist and prices will likely grow by no better than the rate of inflation
- For real estate investors, not having to worry about a fluctuating "terminal value" in a discounted cash flow model for a potential investment means that they can fully concentrate on the stability of that property's earnings - boring is good!
- Investors should keep their focus on fundamentals of rental demand: employment and income of potential tenants and other micro-level factors that might directly affect property cashflow

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