



ECONOMIC & HOUSING OUTLOOK

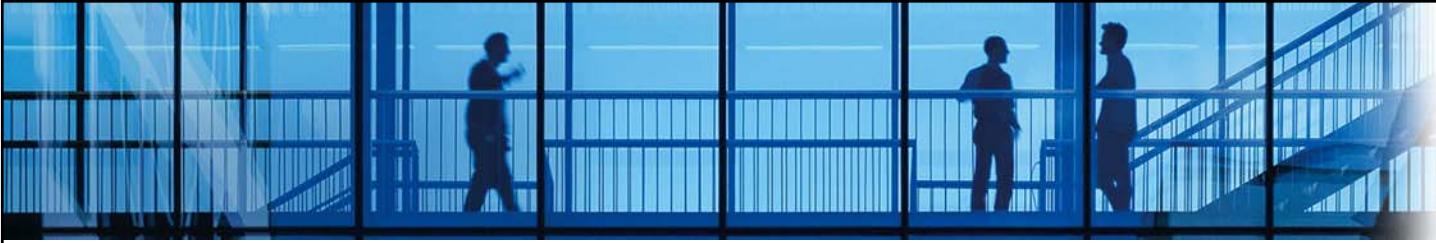
“Back to the Fundamentals”

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Agenda

- **Global economic forces: deleveraging the US economy**
- **Canadian economic outlook: an externally driven recession**
- **Real estate outlook: prices must reflect fundamentals**
- **Implications and conclusions**



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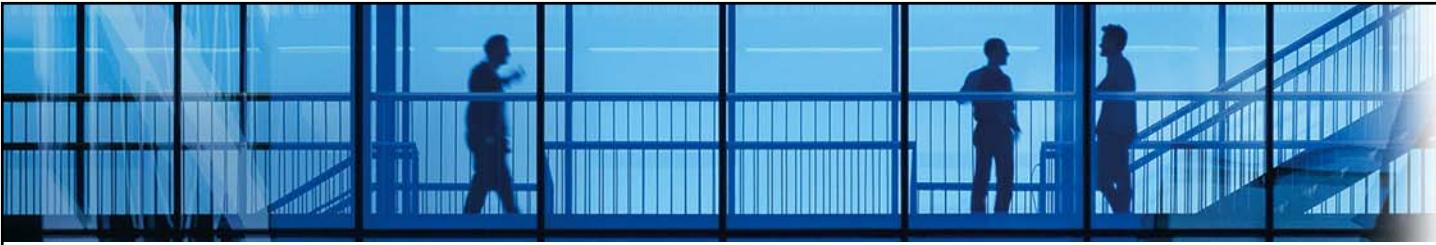
Credit crisis “morphs” into...

- Bear, Lehman gone
- Bailouts: Citi, AIG, Fannie, Freddie, GM, Chrysler
- BoA Merrill Lynch
- Goldman Sachs now a commercial bank
- Morgan Stanley-Smith Barney

- US corporate default rate soars to 16% in 09

- Global economic sees the most severe contraction in a generation





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US MACRO OUTLOOK

U.S. GDP and Employment



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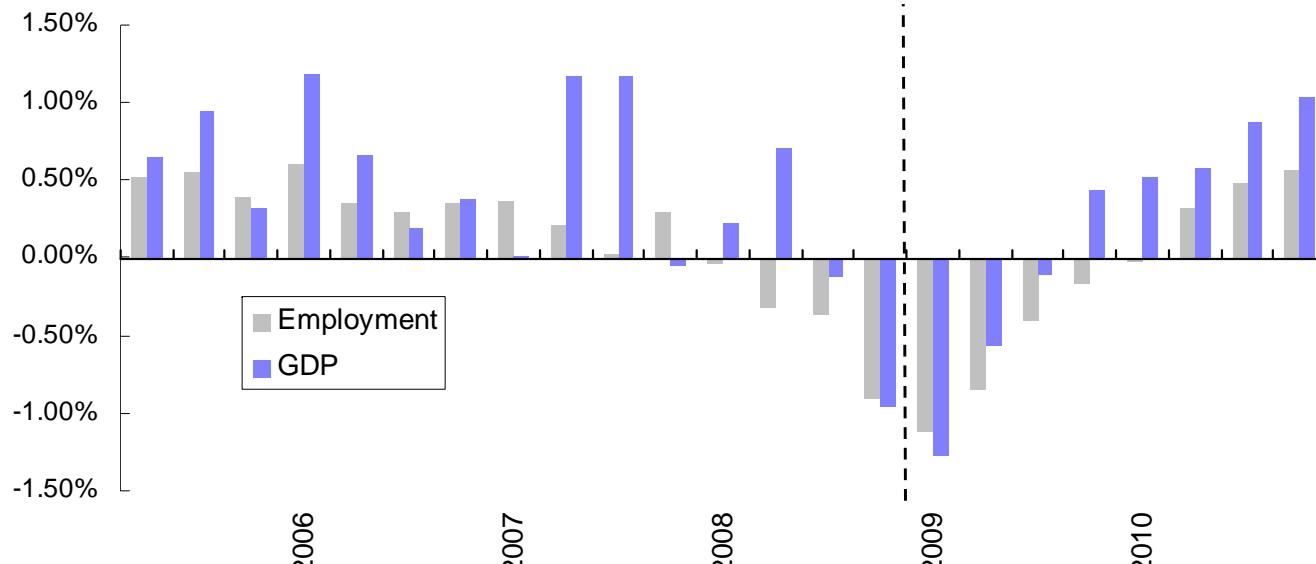
US recession started at the end of 2007

- GDP is expected to contract through third quarter of 2009

Job losses started at the end of 2007 and are expected to continue through 2009

- Expected total job losses are 6 million – about 4% of total employment
- Unemployment is expected to reach a peak of 10%

Likely to be longest and deepest recession since the Great Depression



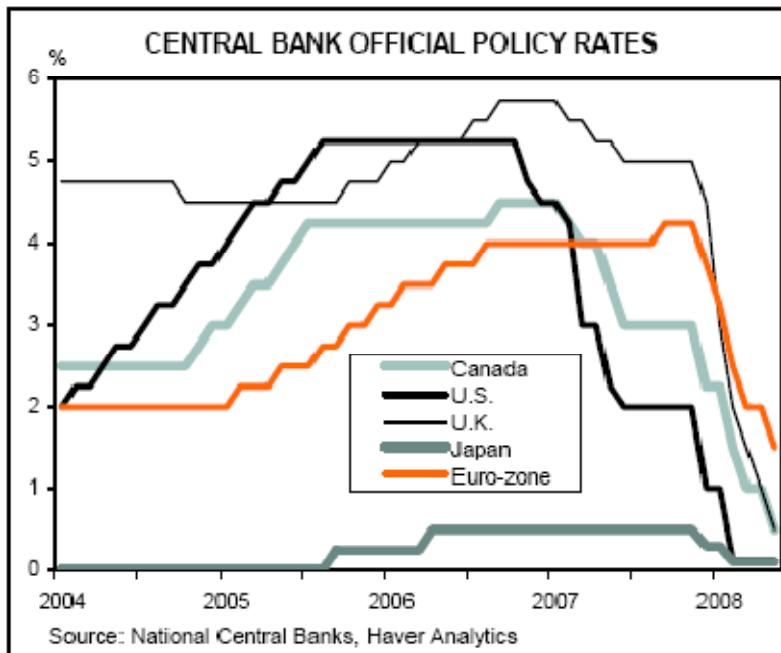
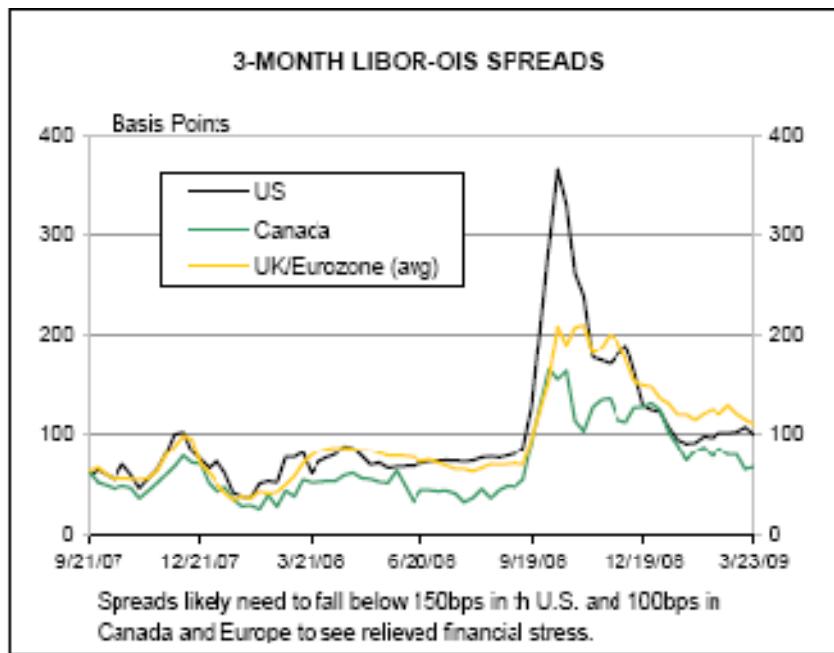
Source: Economy.com



Trust and Confidence

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- At the heart of the problem is the seizure in credit markets – this is an atypical “Balance Sheet” driven recession
- Recovery cannot begin until credit begins to flow without gov’t intervention (ie., trust among lending institutions returns) and the extent of the required repair to balance sheets is ultimately known





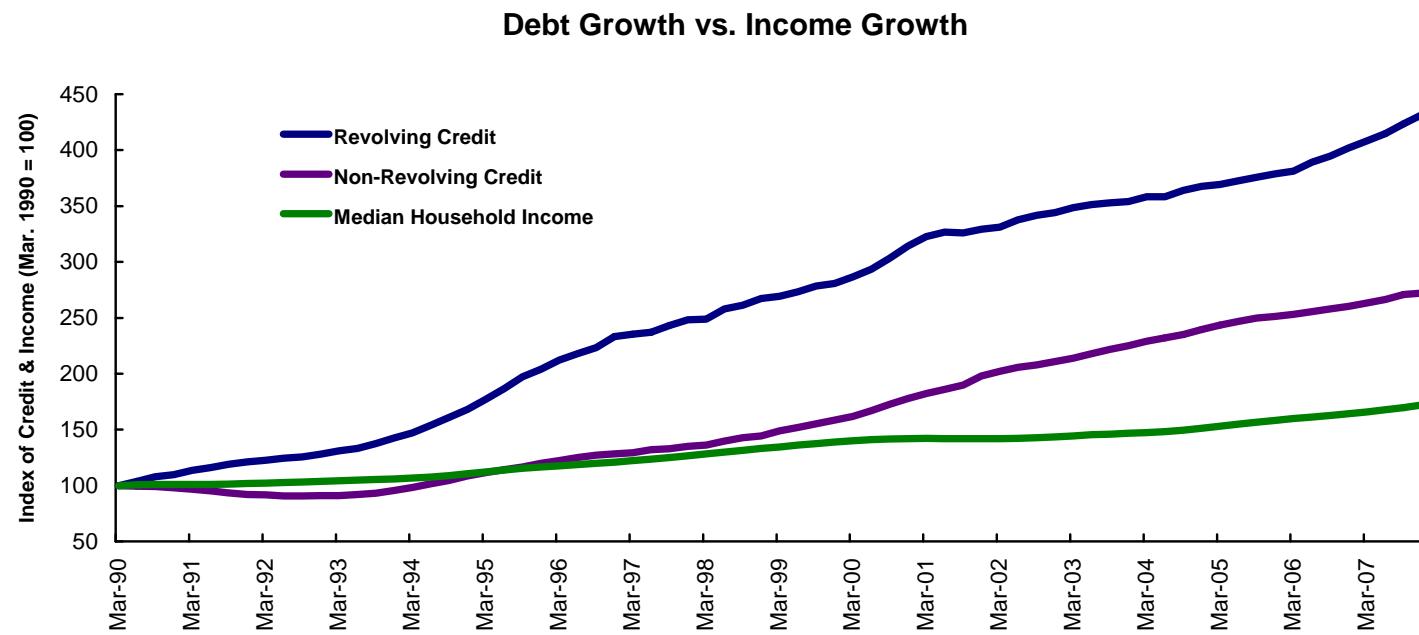
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U.S. Consumer Debt Burden

Rising debt burdens and ebbing confidence have been the “one-two knockout punch” to the U.S. consumption-driven economy.

- Average outstanding debt burden of each person 19+ years old is \$14,000. This is a 64% increase over 10 years ago.
- Average outstanding revolving credit (credit cards and home equity lines) for the same group is \$5,300 per person. This is a 52% increase over 10 years ago.

Consumer deleveraging will reduce consumption, slow imports and increase savings and net worth – the result is a tepid recovery



Sources: Federal Reserve Board, Census, Economy.com



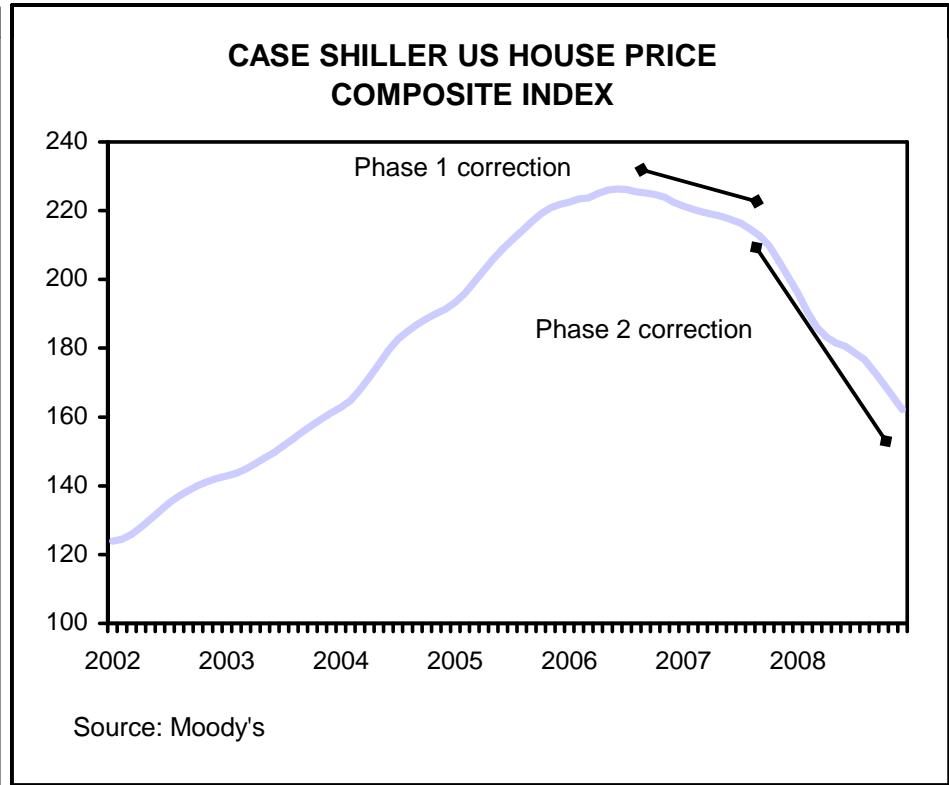
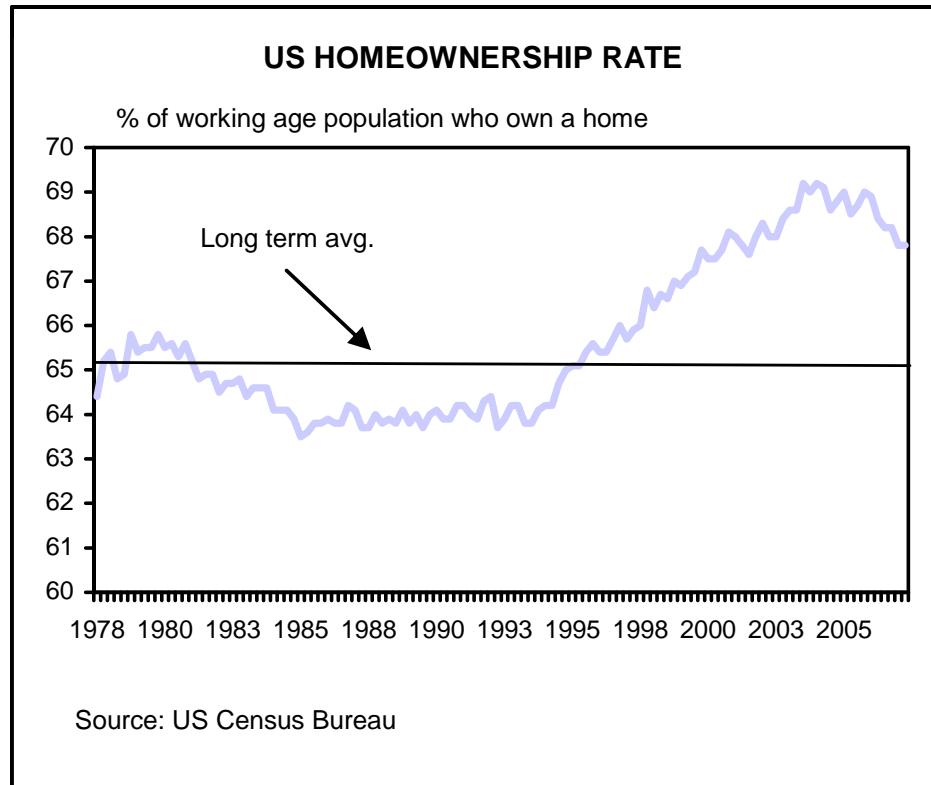
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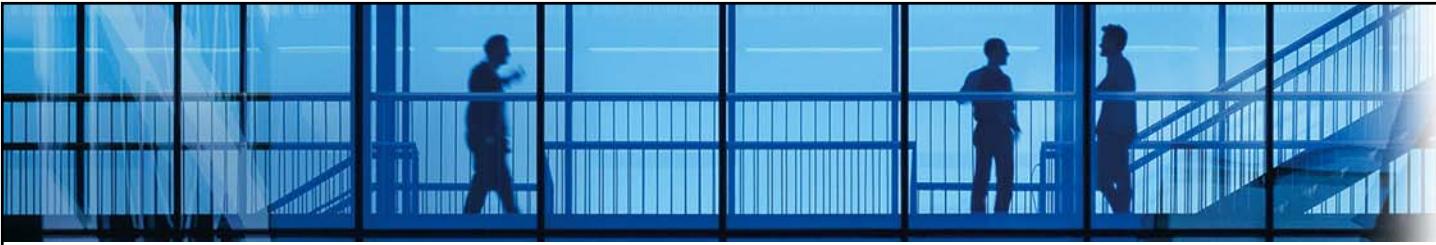
The US Housing Burden

Easy lending/subprime mortgages encouraged excessive consumption of housing resulting in historically high ownership rates.

The correction has occurred in two phases – phase 1 was moderate but phase 2 more severe (ie., distress has intensified the downward momentum)

- Until housing markets stabilize – price discovery cannot occur for toxic securitized assets





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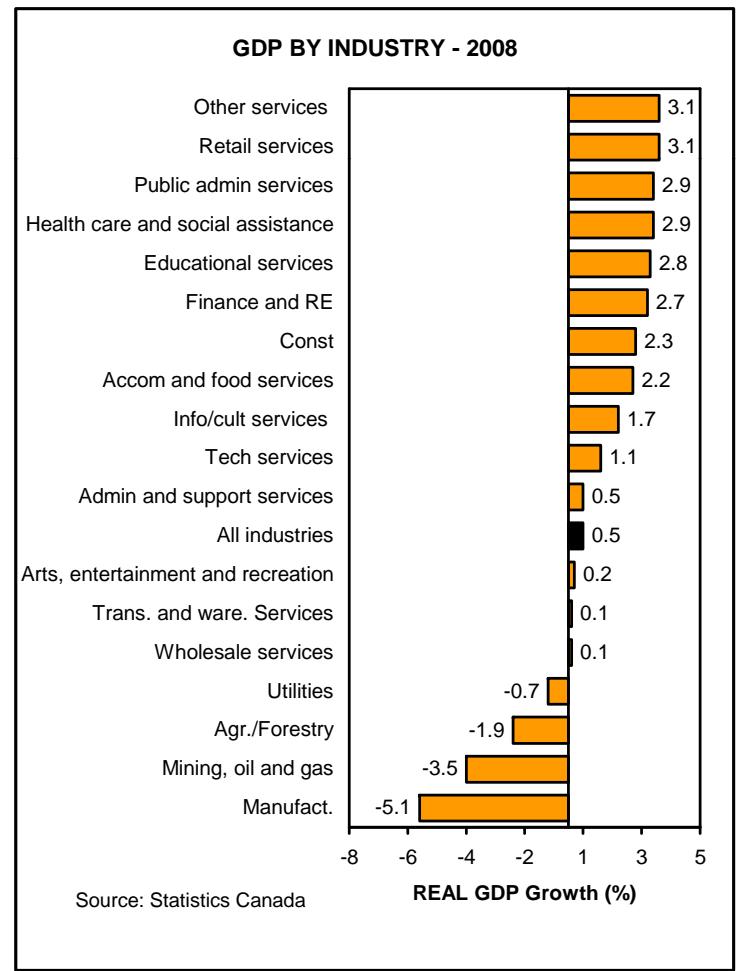
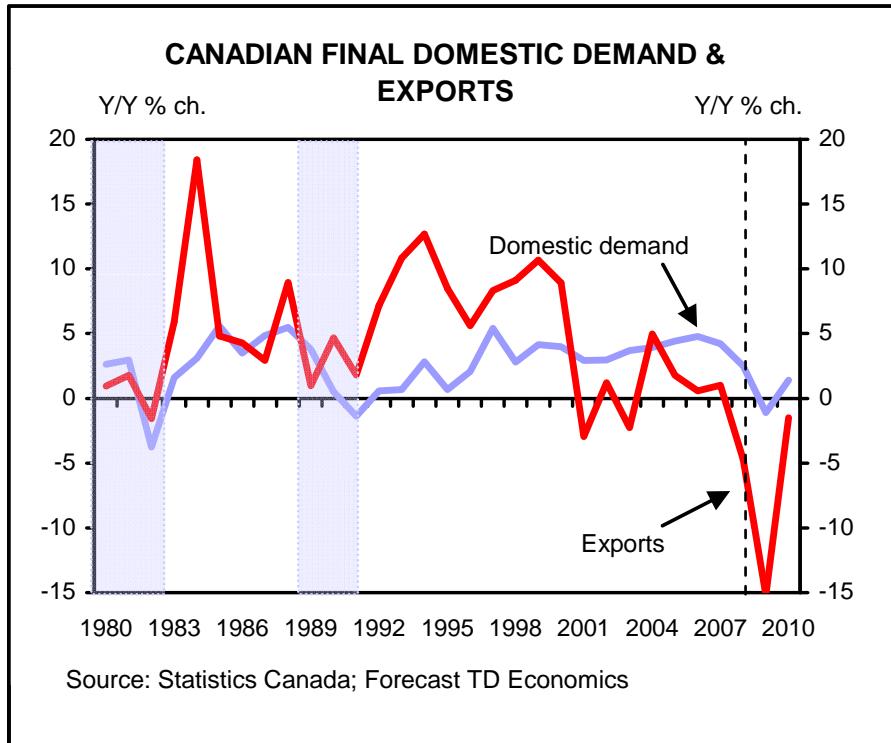
CANADIAN ECONOMIC OUTLOOK



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An export-led recession in Canada

- Much of the drag on the Canadian economy will come from the external side
- The domestic side of the economy will also suffer but is better positioned than both the early 1990s and the early 1980s recessions

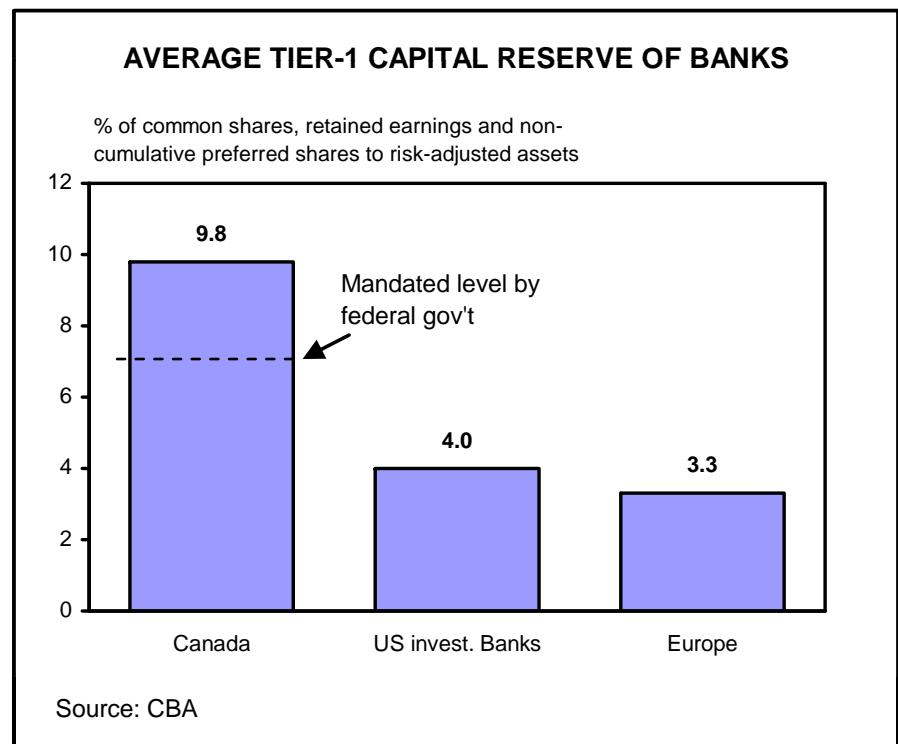
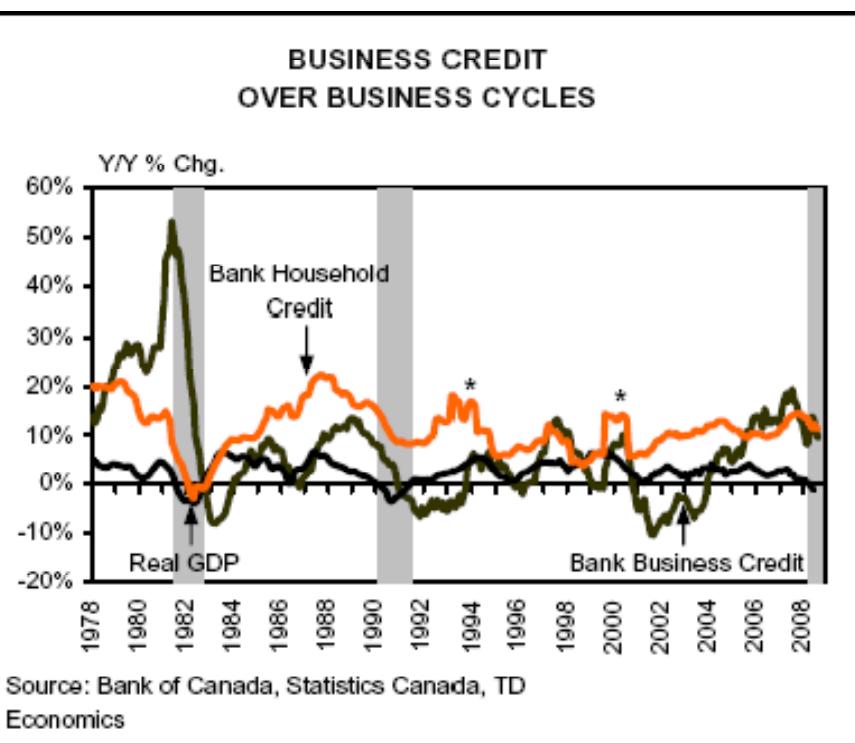


Credit still flowing in Canada



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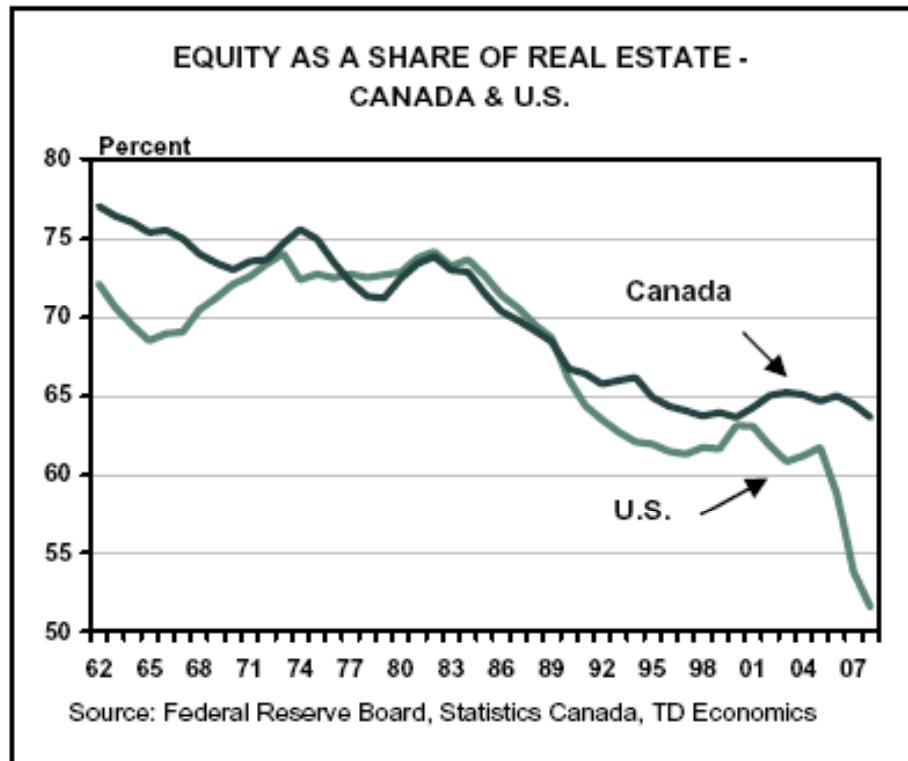
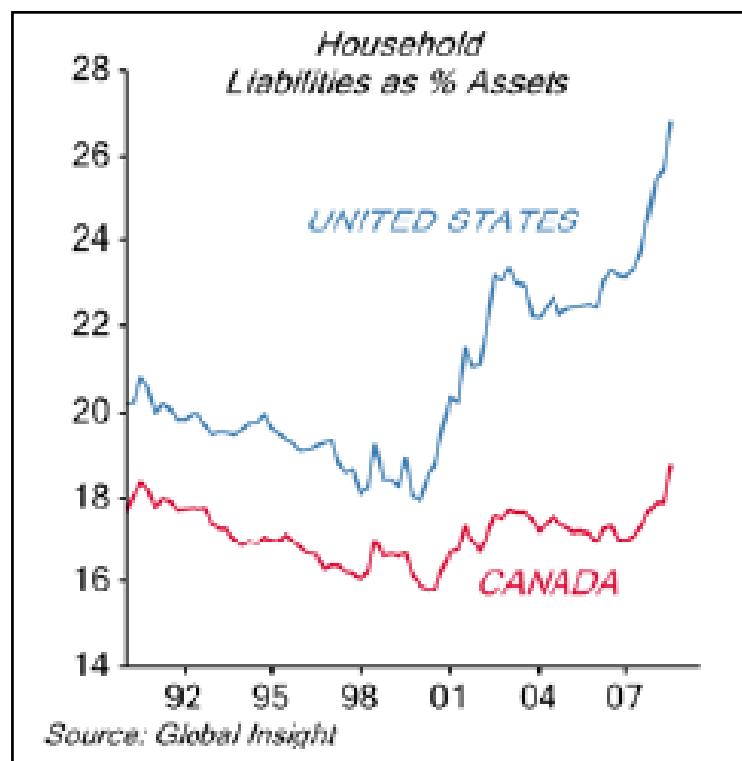
- Contrary to what is purported in the media – credit continues to flow in Canada (gov't intervention has primarily been preventative rather than “curative”)



Deleveraging not as much of an issue for Canada



- Canadians are nowhere near as over-extended as their American/European counterparts – interest deductibility in the US provides an incentive to “over-consume” housing



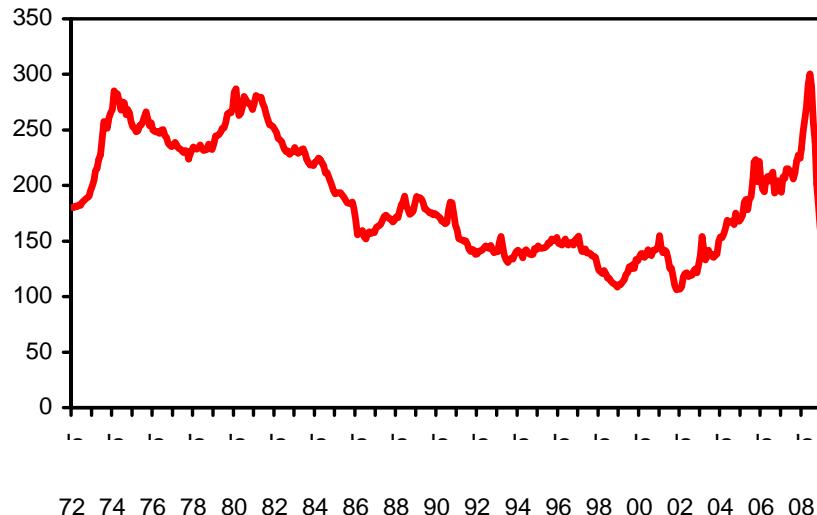
Canada's largest concern is the threat to National Income



- The biggest economic driver for Canada has been the income/profits generated by strong commodity prices
- Weaker commodity prices will severely reduce national income – nominal GDP will contract for the first time in Canada's history

BANK OF CANADA COMMODITY PRICE INDEX

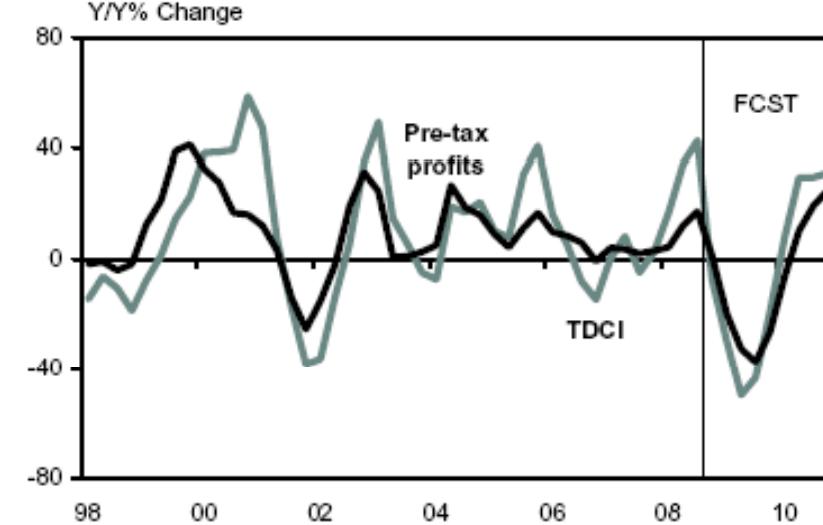
Real 2008 USD\$



Source: Bank of Canada

Commodity Price Growth drives Canadian Profit Growth

Y/Y% Change



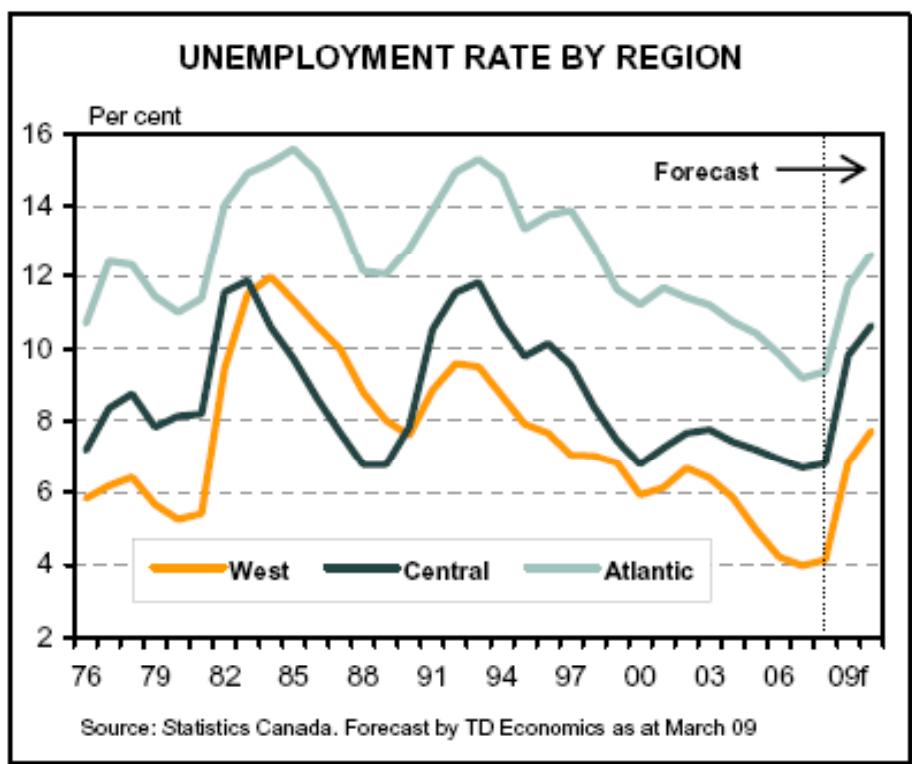
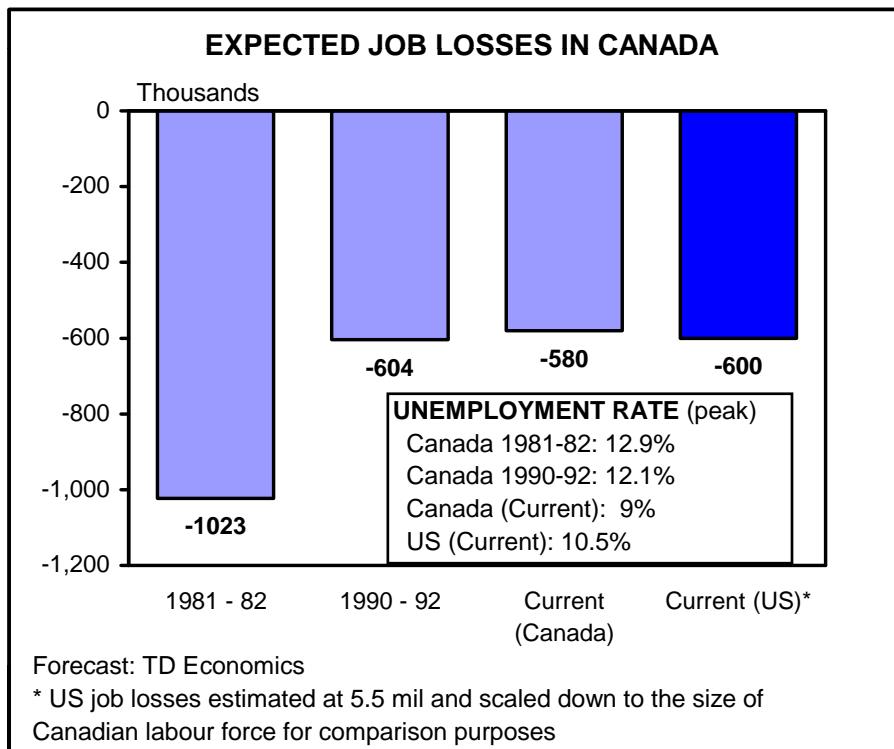
Source: Statistics Canada, Haver Analytics, TDCI and Forecast by TD Economics as of February 2009

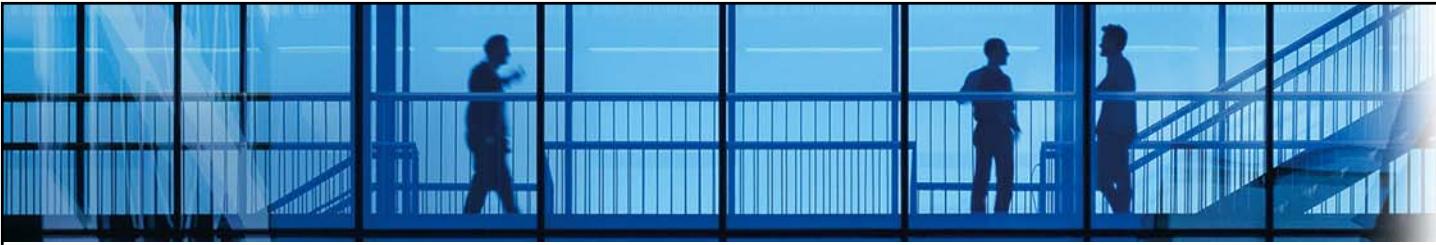


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Jobs under pressure

- The weak profit picture has put firms under pressure and job losses have increased
- Estimated job losses will rival the scale of losses seen in the US but not as bad as the job losses Canada saw in the early 1980s





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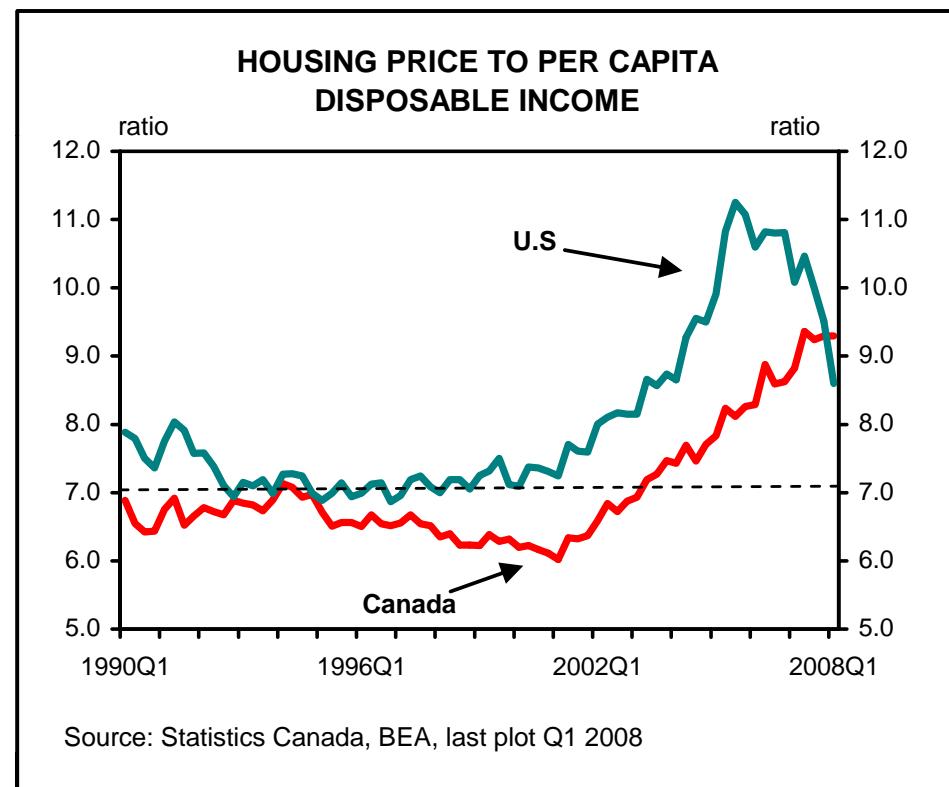
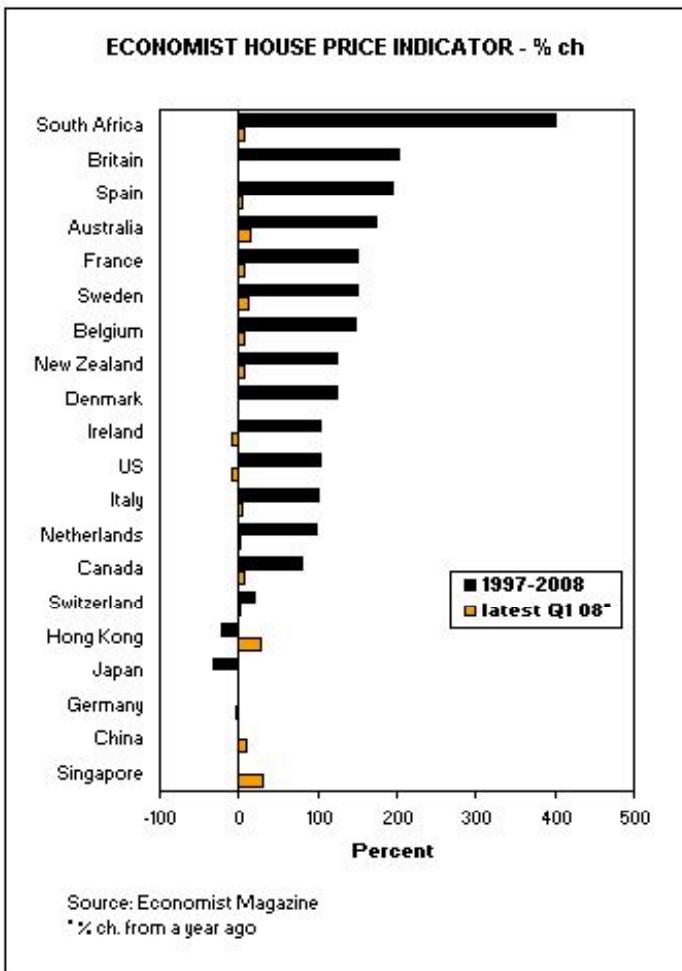
PROSPECTS FOR THE HOUSING MARKET

Canada and the rest of the world



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- Canada's housing market was less over-valued than others across the world but a modest correction (10%) was still necessary



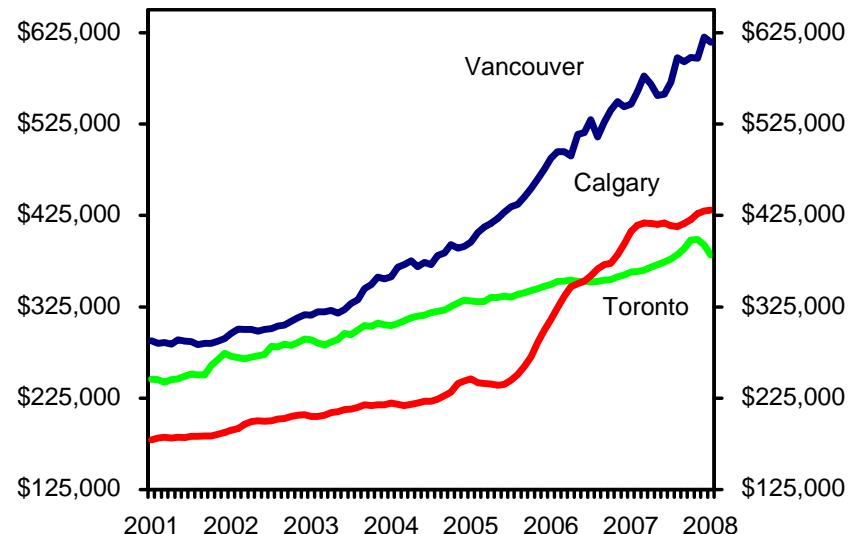
All housing markets are local



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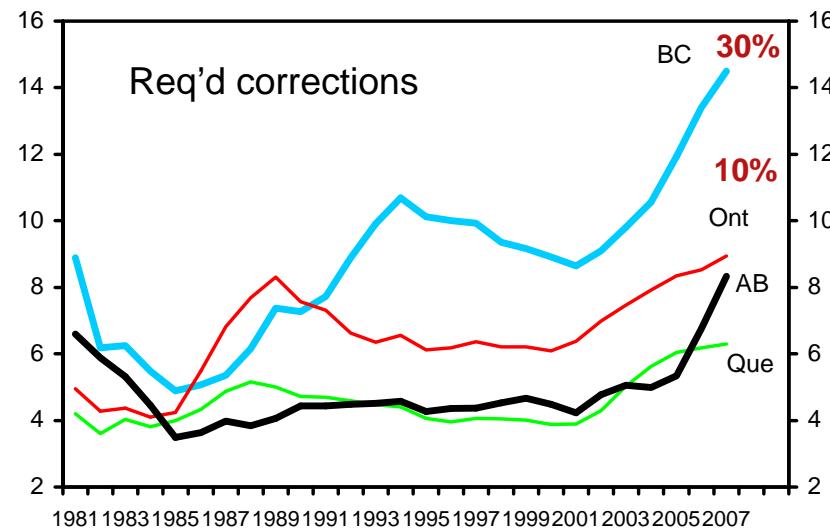
- The most rapid price growth in this cycle was in Western Canada. Not all of the growth was driven by fundamental drivers like income (ie., leverage did play a major role)

HOUSE PRICES DURING THE 2001:2008 CYCLE



Source: CREA

RATIO: PROVINCIAL HOUSE PRICES TO PER CAPITA DISPOSABLE INCOME

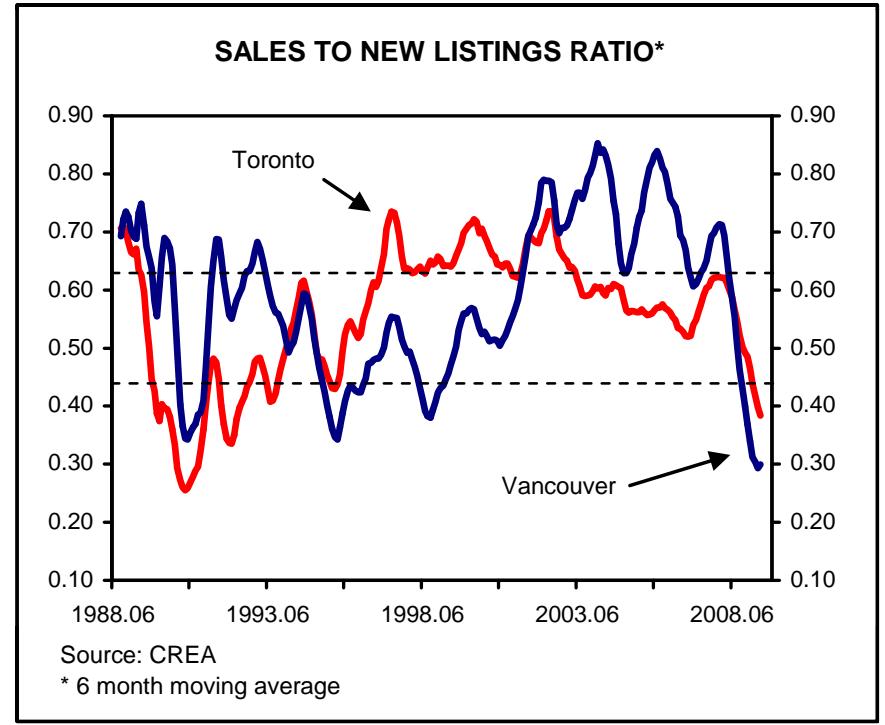
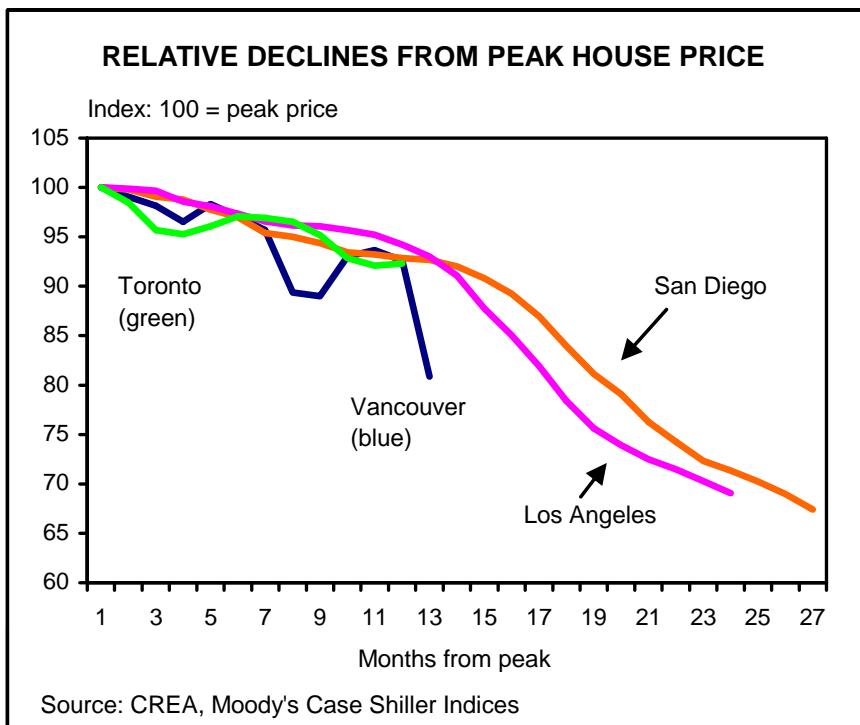


Source: CREA, Statistics Canada

Regional corrections



- The downturn in confidence in 2008 blew much of the “foam” off all regional markets
- Corrections occurred in spite of the lack of “subprime” activity in Canada – what ultimately drives prices is supply and demand





Where does the housing market go from here?

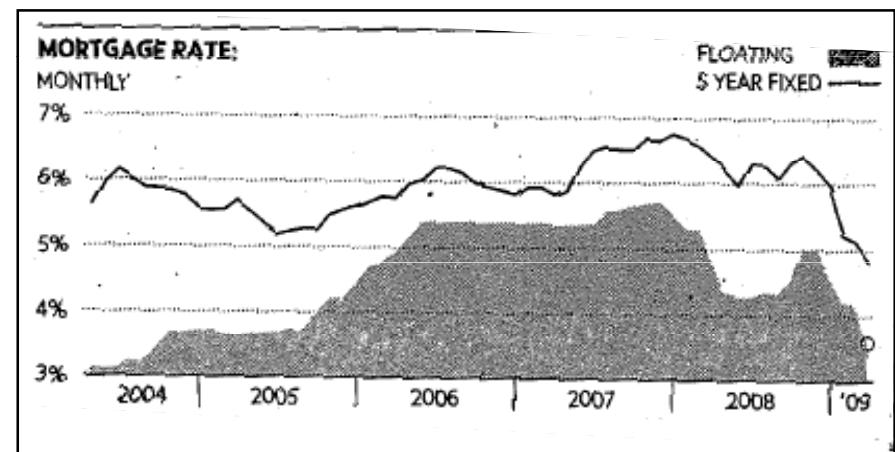
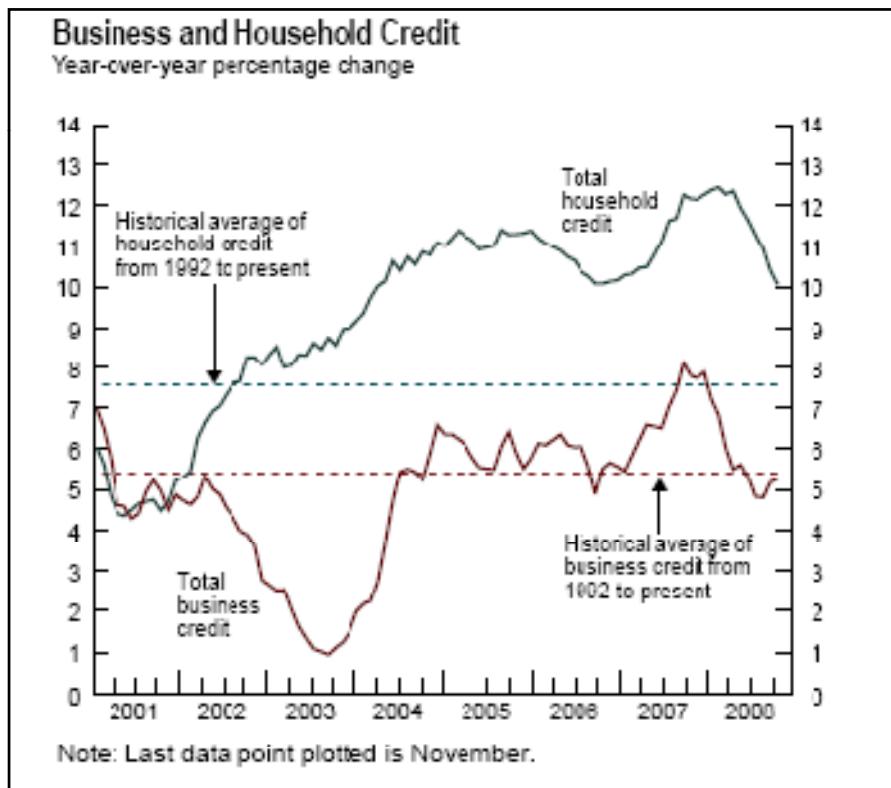


- **After the froth, the fundamentals of supply and demand matter again.....**
- **On the demand side:**
 - Look at credit markets/mortgage rates; job and income growth; demographics
- **On the supply side:**
 - New housing construction; distressed sales?

Credit / Mortgage rates are very supportive



- Credit continues to flow in Canada and mortgage rates are at historic lows
- Risk of rates rising appreciably in the near term very low

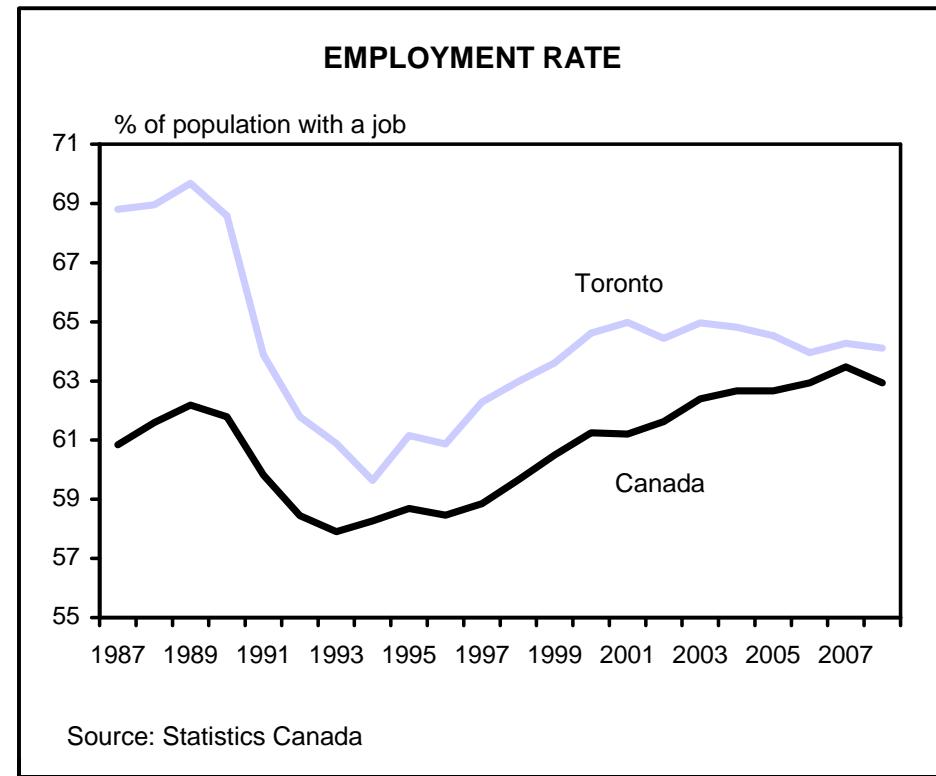
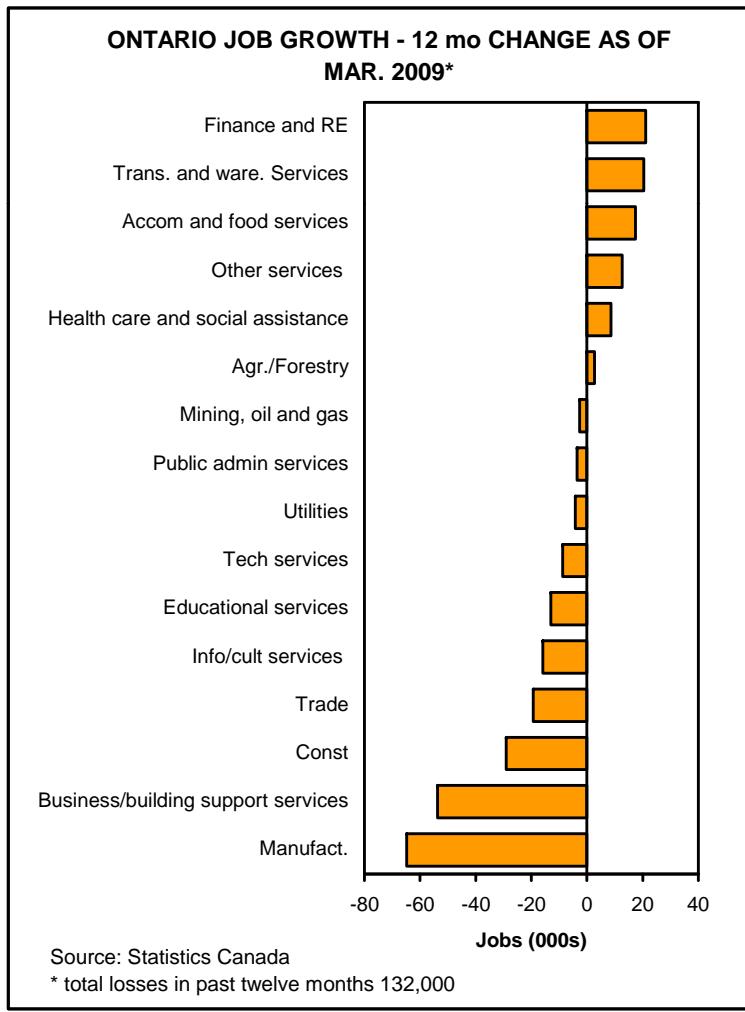


Job outlook a definite negative



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- Southwestern Ontario hit hard by manufacturing job losses
- Toronto job growth holding up thanks to FIRE but unlikely to continue

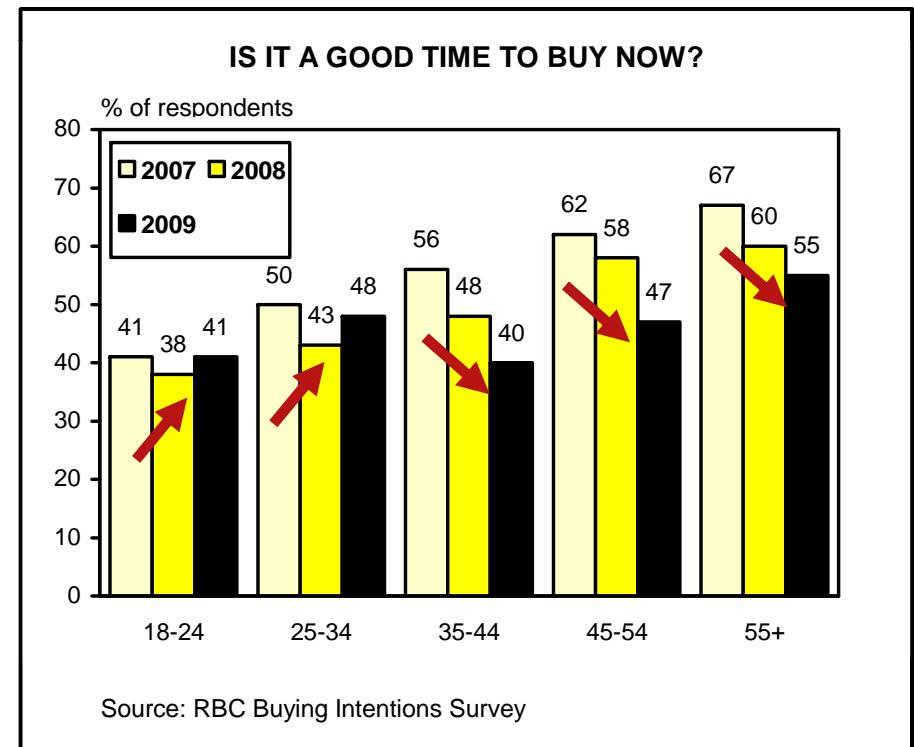


Demographics



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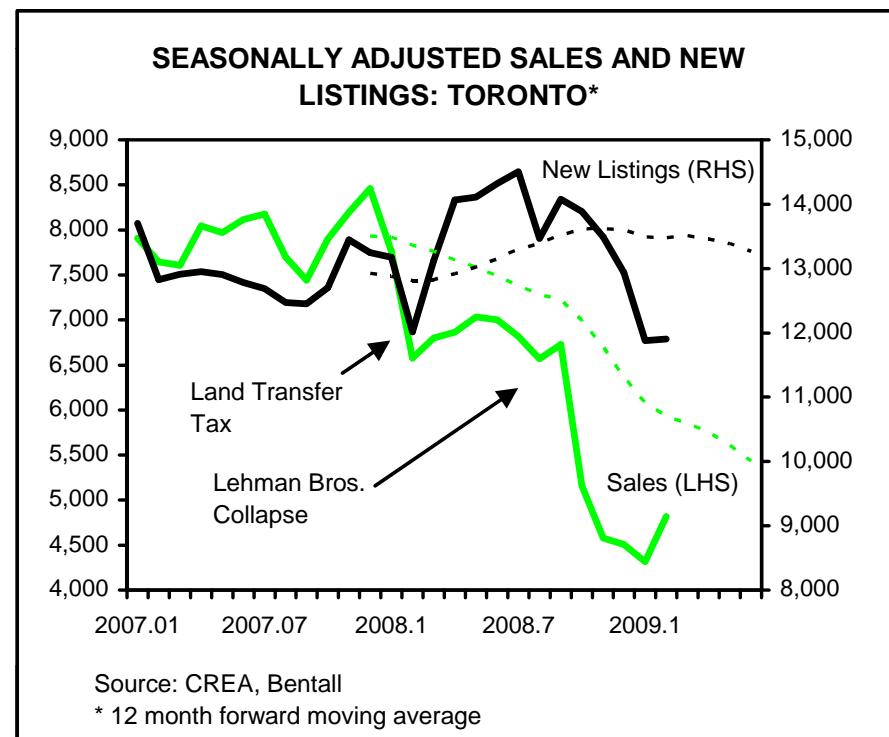
- Equity losses stemming from the stock market meltdown have hit the high end quite hard
- The lower end (ie., younger buyers) are more optimistic about buying this year, presumably because of the improvements in affordability



Supply factors – keep a lid on price growth



- No shortage of new home supply – building moving back in line with replacement levels
- Both sales and listings fell off after Lehman Bros. collapse, but both likely to move back in line with trend levels – suggest flat to slightly negative average price growth over the rest of this year

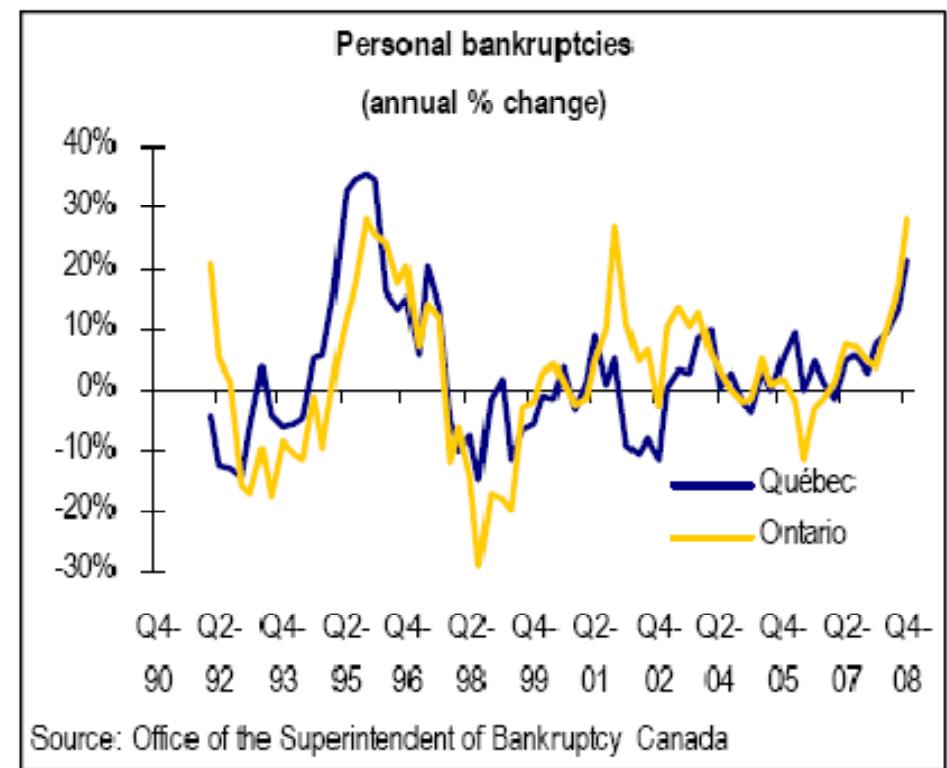
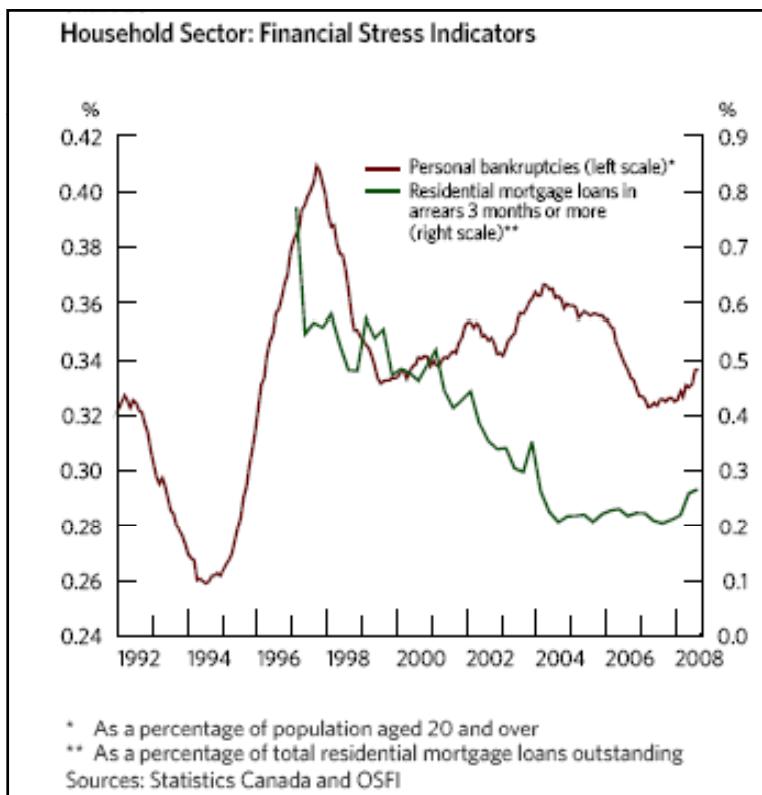


Distressed selling?



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- Mortgages in arrears near all time lows, but turning up
- Bankruptcies picking up appreciably (particularly in the industrial belt) – suggests some increase in distress in the months ahead

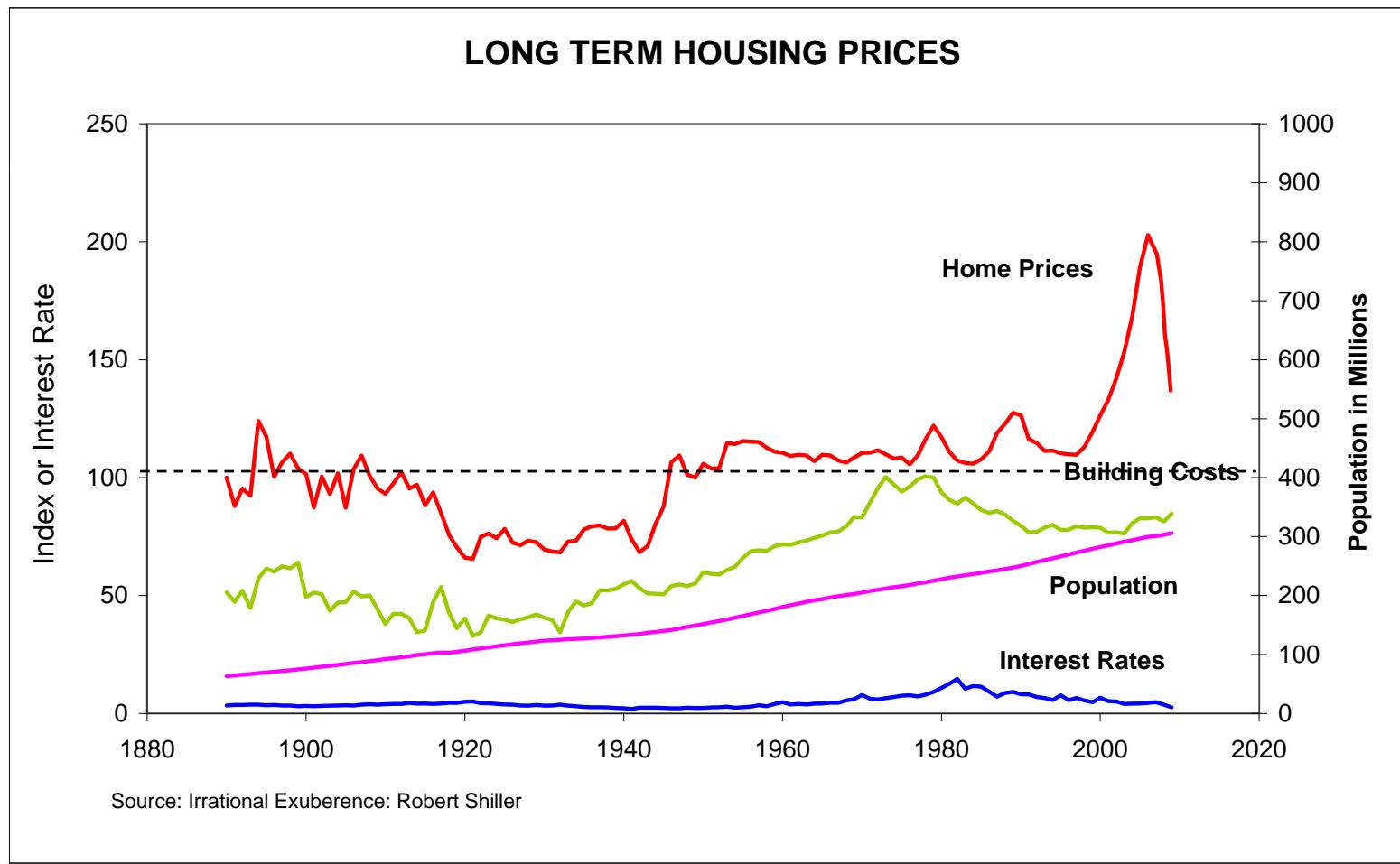


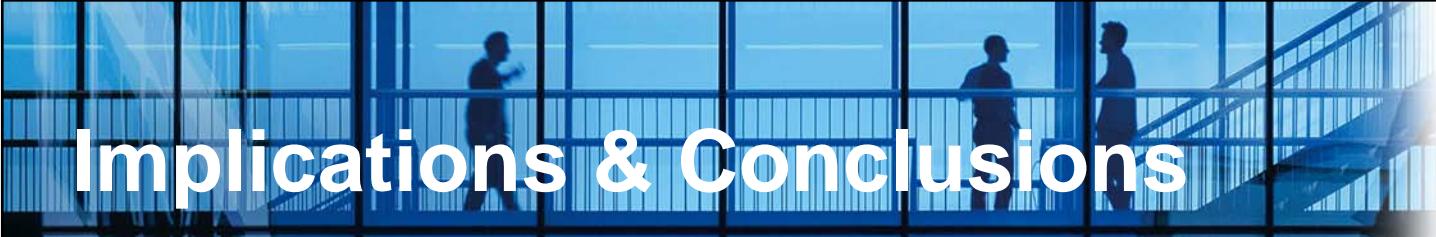
The Big Picture



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- In the long-run, housing prices do not rise by much more than the inflation rate





Implications & Conclusions



- Tight credit markets and deleveraging of the US consumer will result in a sluggish and tepid recovery for the global economy
- Canada slides into a deep recession, but this time its mostly externally driven. Recovery will also be externally driven.
- Some underlying fundamentals in Canada remain comparatively better than the rest of the world (especially the US)
- Housing markets have reached a turning point: the first phase of price declines have occurred as the froth has been blown off...
- ...but there is likely to be a second phase of modest price declines reflecting deteriorating economic fundamentals
- In the long run, always buy housing for “income” not for capital appreciation