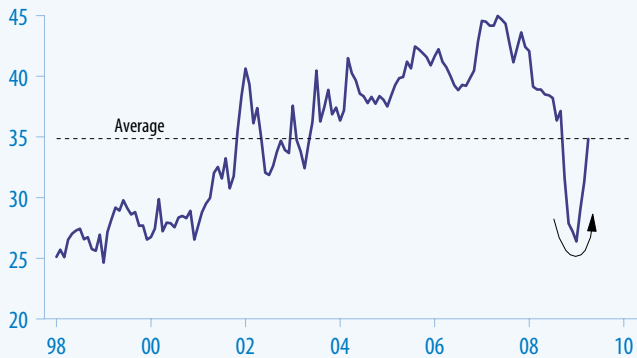


**CHART 1
OUT OF THE BASEMENT**

Canada (000s : s.a.)

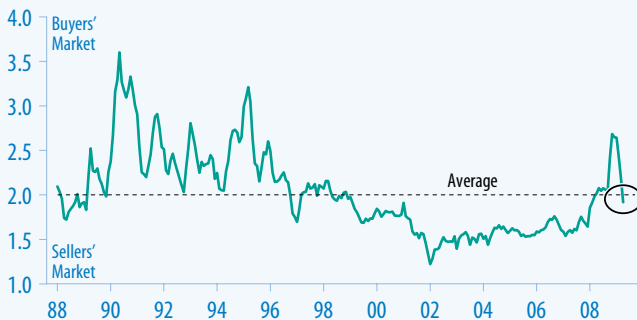
Existing Home Sales



**CHART 2
A BETTER BALANCE**

Canada

New Listings Per Existing Home Sale

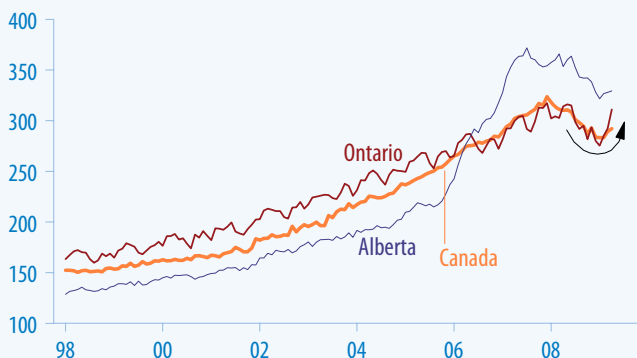


Source: Canadian Real Estate Association

**CHART 3
PRICES HAVE HOOKED UP**

(C\$000s : s.a.)

Existing Home Average Prices



Canadian Housing: Spring Fling

Sal Guatieri, Senior Economist

After a harsh winter, spring has come surprisingly early to Canada's housing market. Sales have rebounded from a lengthy slumber and prices have firmed. An earlier *Feature* article (*Canada's Housing Correction: Halfway Home*, March 13, 2009) suggested the slump would persist until the recession ended later this year. While it's doubtful that the housing train has left the station without a recovery on board, the data support our long-held view that the Canadian market is merely correcting not busting.

Existing home sales have risen three straight months, even accounting for the usual spring boost, and preliminary figures from several large cities point to further gains in May. Sales have retraced almost one-half the 40% plunge from record highs in 2007, taking demand closer to normal levels (*Chart 1*). Despite massive job losses, demand has firmed even in Ontario and British Columbia, and to a lesser extent in boom-bust Alberta. The surprising upturn in sales, coupled with fewer listings, has tilted the market back towards balance from the buyers' haven of last year (*Chart 2*). Multiple offers have even been reported in some choice neighbourhoods in Toronto. In response to the tighter market, resale prices nationwide have surprisingly turned up after sliding steadily last year (*Chart 3*). Prices in hard-hit Ontario have retraced a good part of their 13% decline, while those in Quebec, Saskatchewan, Manitoba and Nova Scotia have forged new highs.

There's little mystery why sales are rising: record-low mortgage rates have unleashed pent-up demand that accumulated last year when previously soaring prices closed the door on first-time buyers. Fixed mortgage rates fell two percentage points in the past six months, courtesy of the central bank's near zero-rate policy and the government's Insured-Mortgage Purchase Program (*Chart 4*). Mortgage payments have dropped by one-third since late 2007, with payments on an average-priced home now consuming 31% of household income, down from a long-run norm of 34% and a whopping 47% in late 2007 (*Chart 5*). Despite firmer prices, affordability improved to a five-year best in April.

CHART 4
SUPER CHEAP MONEY...

Canada (percent)

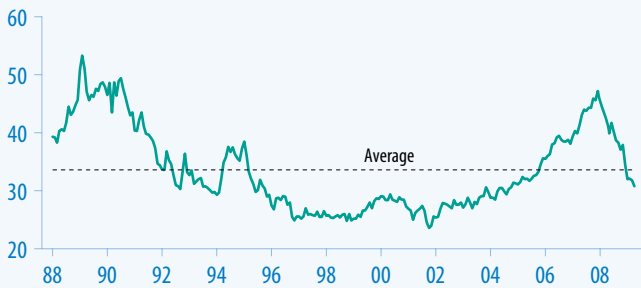
Fixed Mortgage Rates



CHART 5
...HAS RESTORED AFFORDABILITY

Canada (percent)

Mortgage Payment as a % of Household Disposable Income

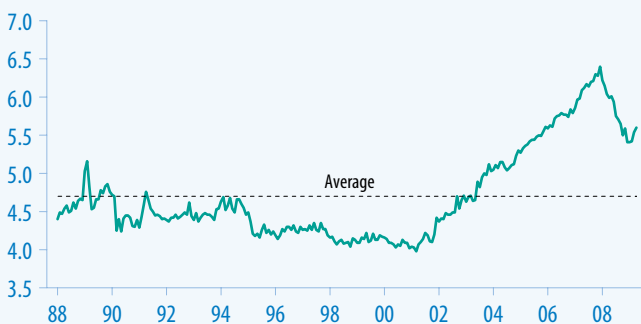


Mortgage Payment = based on average price of an existing home, a roughly 20% downpayment, 25-year amortization, and an average of the 1-year and 5-year conventional fixed mortgage rate
Household Disposable Income = disposable income per labour force member

CHART 6
PRICES STILL LOFTY

Canada

Average House Price as Ratio to Household Disposable Income



Household Disposable Income = disposable income per labour force member

Besides falling mortgage rates, three other factors have helped demand. First, the central bank's conditional pledge to hold overnight rates near zero until mid-2010 has reduced (though not eliminated) the risk of a backup in variable mortgage rates. Second, a less-chilly economic climate and a 40% jump in stocks have lifted consumer spirits. Third, the federal budget provided first-time buyers with a \$750 tax credit to defray closing costs and an extra \$5000 of tax-free RRSP savings room to purchase a home.

Still, the housing market could cool this summer in the wake of further job losses and less pent-up demand. In addition, rising long-term bond yields owing to signs of economic life and the financing of big fiscal deficits have lifted fixed mortgage rates recently. Further, because home prices remain high relative to incomes, affordability could become an issue again if prices (or rates) rise too fast (*Chart 6*). For this reason, prices are expected to climb only moderately in the year ahead. Homebuilders also appear sceptical of the recent sales revival, with starts sitting at 11-year lows and about one-quarter below levels consistent with demographic demand.

That said, housing markets should revive again when the recession ends later this year. Interest rates are expected to climb just moderately next year, with economic slack restraining inflation. As well, expected higher energy prices should recharge Alberta's market.

Far from cracking like the U.S. housing egg, Canada's market has withstood the financial and economic storm in relatively good form. This reflects better fundamentals such as more conservative lending/borrowing practices (as Michael Gregory noted in an earlier *Feature* article, *Canada To Avoid U.S.-Style Mortgage Mess, October 31, 2008*). Despite record affordability, U.S. home sales have merely stopped falling, while prices continue to decline due to record foreclosures.

Bottom Line: Super-low mortgage rates and fading job insecurities have pulled nervous first-time buyers off the sidelines. While Canada's market may cool in the face of further job losses this summer, a better economy and historically low interest rates should provide a good foundation for growth in 2010.

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