

# CANADA ECONOMIC WEEKLY



August 25, 2006

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# Canada Economic Perspectives

## Housing Update: A Soft, Not Severe, Slowdown

With a new set of Canadian housing data out, it is worthwhile to review our thesis for this sector.

Generally, our contention has been that the slowdown in Canadian housing would be steady but slow—at least relative to the slowdown in the United States. We noted as early as last year that the housing market was moderating. But this has been masked by the big jump early this year in construction and homes sales due to the mild winter. The Canadian consumer is in reasonable shape, so there is unlikely to be a downward spiral in spending as the appreciation of home prices slows, or even reverses mildly. At the same time, Western Canada continues to boom, so the sharp decline in the data for the overall market is unlikely.

We think housing is the key sector for Canada watchers to focus on. Why? Because housing has become the clear focus of the US market, as the debates of the past week have made clear. We expect that the divergence between the two countries will lead the market to expect rate cuts by the US Federal Reserve before the Bank of Canada begins to lower rates north of the border. The bottom line: The Canadian dollar will stay strong.

Taking a closer look at the new Canadian data, we see that overall housing starts tumbled in July, falling 4.8% (**Display 1**). This was a sharper fall than the 1% decline in the second quarter, which came after a strong 16% advance in the first.

However, the composition of the data has changed. Single-family home starts had led the overall numbers down through late 2005. But after declining 5% year on year in the second quarter, they rebounded somewhat in July and were down only a shade under 1% year on year (**Display 2**). Multifamily unit starts were much lower, down

more than 11% year on year in July after a nearly flat second quarter.

We do not know whether this shift in the mix will last. But we think it might because the single-family starts data have been weak since the fourth quarter of 2004 (with the exception, of course, of the first quarter of this year.) Some adjustment already appears to have taken place. And the West, of course, remains quite strong.

The good news is that this looks to us like the proverbial “soft landing” for consumers. If so, that means the eventual hit to consumption from the housing slowdown should be muted—and indeed there is already evidence of this. Retail sales were down in June for the second consecutive month, but this followed a very strong March and April. Ex-autos, the June number was up slightly. We do not argue that these are great numbers. But coming after an extended period of softness in the single-family housing market, they do seem to suggest that the toll on consumer spending was very severe.

The bad news is that an extended period of weakness in larger construction projects could affect construction jobs. While we have yet to see evidence of this—construction employment grew 7% year on year in July—this will likely slow if multifamily starts stay weak for several consecutive months.

On balance, a soft landing appears the most likely scenario at this point. This meshes with our forecast of 2.8% GDP growth this year, which is in line with the Bank of Canada’s forecast. It is also consistent with our thesis that the Bank will remain on hold for the rest of the year. And with the US housing market clearly decelerating faster than the Canadian, it is also consistent with a strong Canadian dollar.

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August 25, 2006*

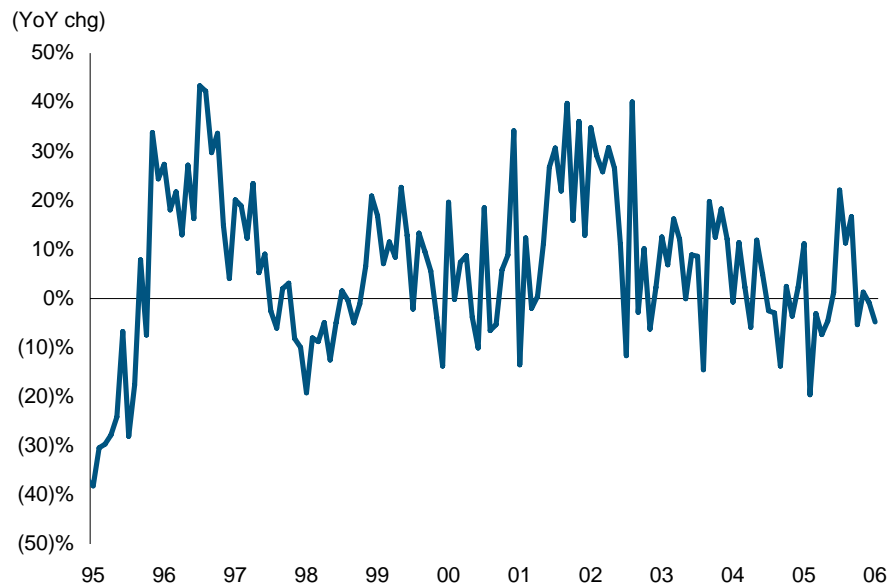
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## Display 1: Canadian Housing Starts Continue to Cool

### Housing Starts: All Areas

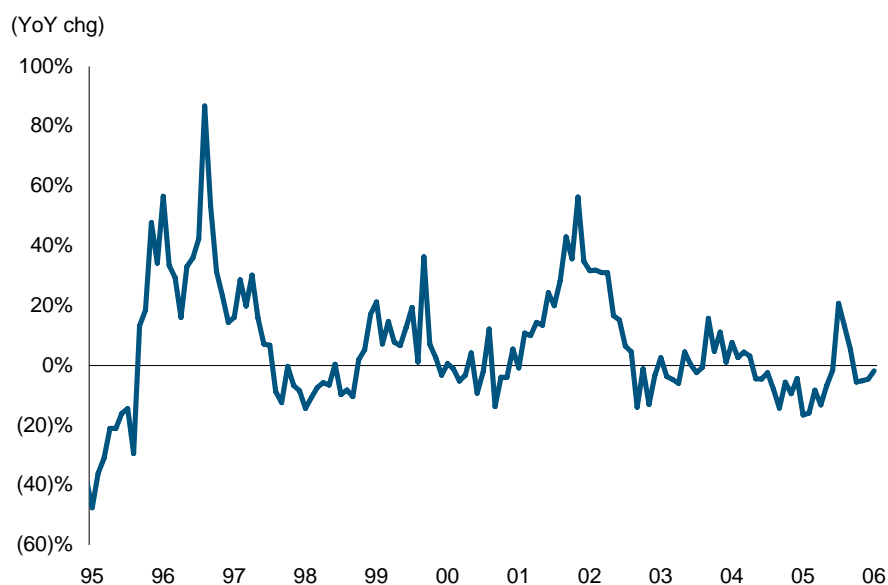


Source: Canada Mortgage and Housing Corporation and Haver Analytics

***With the exception of the abnormally strong first quarter—when a record mild winter drove starts—there has been a cooling trend in this data for some time.***

## Display 2: Single-Family Starts Bottoming? Single-Unit Housing Starts

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Source: Canada Mortgage and Housing Corporation and Haver Analytics

***However, the composition of the data may be changing. Single-family starts—which had led the housing sector down—have rebounded, at least temporarily. Multiunit dwelling starts numbers are falling faster.***