Thursday, August 31, 2006

NO HOUSING BUBBLE TO BURST BUT WARNING SIGNS IN SOME WESTERN CITIES: TD ECONOMICS

(TORONTO) A TD Economics report published today concludes that housing activity in Central and Atlantic Canada has cooled down without prompting a price correction. However, select urban centres in Western Canada are "flashing warning signs" that suggest the recent pace of price gains has been unsustainable.

"Canada's real estate markets appear to be in good shape and market conditions are becoming more balanced. Key exceptions are Vancouver, Calgary and Edmonton," said Craig Alexander, Deputy Chief Economist of TD Economics, who co-authored the report with fellow economist Steve Chan. "The recent dramatic price gains in Calgary and Vancouver are unsustainable over the long-term, and both cities are vulnerable to significant moderation. Edmonton is also experiencing explosive price growth, but affordability remains surprisingly good."

The report's release coincides with mounting concern about the sharp slowdown in the U.S. housing market and its potent adverse impact on the overall economy. However, there are few parallels with the Canadian market. Canadian housing markets have boomed in recent years with extremely high levels of starts, sales and price gains, but the report's authors state "the country's real estate markets have generally lacked the degree of speculation that dominated past boom-bust cycles and the excesses have been far less than those evident in the U.S."

Canada's housing market at the national level is delivering a robust performance. Sales of existing homes are on track for another record year and strong demand has created upward pressure on prices. Resale home prices rose by 12.9 percent in the second quarter of 2006 from a year earlier, which is marginally faster than the 12.0 percent gain posted in the first three months of the year and far exceeds the long-term national average of 5.6 percent.

However, the national story is being badly distorted by regional developments according to TD Economics. Excluding Alberta and British Columbia, the average rise in resale prices across the other provinces is a more moderate 7.3 percent. Alberta is also responsible for almost half of the gain in the national average of new home prices. "Moreover," Alexander said "the dominant trends in housing markets outside of the West have been weaker unit sales, greater new listings and more moderate price growth – all of which point to more balanced market conditions and declining real estate risks."

The report identifies key developments affecting local housing markets across Canada. A summary of findings are below:

Victoria: Demand conditions are clearly softening. Unit sales have fallen in five of the last seven months on a year-over-year basis, which indicates the housing market has become more balanced. However, with 50 percent of household income going to home ownership costs (mortgage interest, principal payments, property taxes and utilities), affordability is still a major issue. Price gains need to slow more in the months ahead to create a more sustainable market.

Vancouver: Demand for housing has been softening since the beginning of 2006, though it remains a seller's market. In six of the last seven months, unit sales have been virtually flat or negative on a year-over-year basis. This may reflect the fact that the average resale house is now priced at over half a million dollars and home ownership costs have climbed to about 50 percent of household income. The recent trend towards weaker unit sales and rising listings is a positive development that might augur for a soft-landing if it continues. Close monitoring of this market is clearly called for.

Calgary: Although the Calgary housing market has begun to open up with a substantial increase in new listings in June and July, it remains a seller's market, particularly for new homes. The low level of available housing units is keeping the new and resale markets very hot. This has led resale home prices to accelerate from 25.5 percent year-over-year in the first quarter to an outsized 43.3 percent in the second quarter.

Despite it being a seller's market, housing in Calgary still remains affordable. For instance, it is still less expensive than Toronto or Montreal. In the second quarter of 2006, home ownership costs were only 24 percent of household income in Calgary. If the trend towards weaker unit sales and greater new listings continues, it should help to dampen price growth eventually, although there is little doubt that price gains in the coming months will remain extremely elevated and far greater than in other cities. Given that the market overheated at the moment, a bubble may be forming, or could easily develop, but the hope is that the trend towards a more balanced market continues.

Edmonton: Robust demand and tight supply has fuelled dramatic price growth, with resale prices surging by 31 percent in July from a year ago. However, housing remains surprisingly affordable, with housing-related expenses accounting for 18 per cent of household income. The message is the same as for Calgary. The strength in the real estate market is supported by economic fundamentals, but prices cannot continue to go up at their recent rate indefinitely. If the pace doesn't soften, a bubble could form.

Saskatoon: On the whole, the outflow of workers to Alberta has largely been balanced by an influx of people moving from rural Saskatchewan into the city. With houses remaining reasonably affordable, the market should become more balanced and prices will not rise as quickly.

Winnipeg: The city's housing market remains solid and the pace of price gains remains well above its historical average. With home ownership costs representing only about 14 percent of household income, Winnipeg remains one of the most affordable cities in the country to own a home.

Greater Toronto Area: The Greater Toronto housing market has cooled. While demand for housing remains robust in Toronto, unit sales appear to have reached a plateau in the past few months. At the same time, supply has increased slightly. As a result of these and other trends, the housing market has moved into a balanced position favouring neither seller nor buyer.

Ottawa: Resale home prices have appreciated at a considerably slower pace, dropping from a 6.2 percent year-over-year increase in April to 1.4 percent in July. This can be partly explained by an increase in new homes, which has put a damper on price growth.

Montreal: The city's housing market remains strong. Over the last couple of months both unit sales and new listings have increased at a slower pace, but the sales-to-new listings ratio shows that the market remains well balanced. However, in the May-July period, the number of unsold new homes was at its highest recorded three-month average of 3,946 units, with the majority being in condos and lofts. This suggests that price growth may moderate in the months ahead.

Atlantic Canada: Supply and demand conditions suggest that the markets in St. John's, Saint John, and PEI are balanced. Conditions in Halifax are tighter and are tipped towards a seller's market. Halifax should also continue to benefit from strong activity at the port. As a result, Halifax's housing market is likely to outperform the regional average, but the odds of a bubble are limited.

The TD Economics report "Housing Bubble Watch" can be found at www.td.com/economics.

- 30 -

For more information, please contact:

Craig Alexander
Vice President and Deputy Chief Economist
TD Economics
416-982-8064