

HOUSING IN CANADA AND THE US - TALE OF TWO SOLITUDES

The US housing situation is very difficult and showing trends previously seen only during the depths of the 1930s. Residential real estate in Canada, on the other hand, is much healthier. In this week's edition of the Marker we compare and contrast the two markets outlining differences and potential consequences for the broader economy.

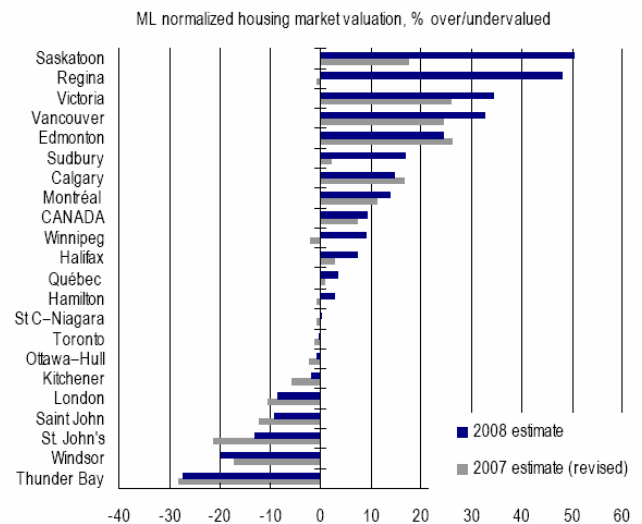
UNITED STATES RESIDENTIAL REAL ESTATE - THREE YEARS AFTER THE PEAK

US home prices peaked toward the end of 2005. Aggressive lending practices however worsened in the ensuing 12 months. This combination helped produce a toxic brew of falling home prices, borrower defaults, foreclosures, and losses in the financial system that have reached some \$500 billion to date. The S&P/Case-Shiller Home Price Index is down over 20% from the peak and measures of affordability point to the need for a further 15% + fall before long-term averages of price/affordability are re-established. The US housing market must overcome three key challenges before this crisis can end: mortgage rates must move lower; lending practices must revert to pre-2005 levels, and the backlog of unsold existing homes must fall (see chart).

CANADA - JUST REACHING ITS PEAK

The economies of Canada and the US are interrelated for obvious reasons. Trends often move from south to north. Is Canada's housing market about to collapse as has been the case for our neighbours? A recent study by Merrill Lynch¹ sheds some light on this important question. While the authors come to a relatively bearish conclusion, our perspective is one of a fully valued real estate market on a national basis that is nowhere near as fragile as that of the US. As with every measure of economic activity regional disparities exist of course. The table illustrates a major city by city outline of prices relative to a proprietary measure of value. While home prices have appreciated in Canada since the turn of the millennium along with improving employment income trends and economic growth the type of excess seen in the US simply does not seem prevalent on a national basis. The main explanation may well reside in the fact that mortgage lending practices in Canada were never 'liberalised' in the way that occurred south of the border. Traditional and securitized lending standards remained much tighter in Canada and a recent policy change by the Federal government eliminating zero down and 40 year amortization mortgages will ensure they remain that way.

A city-by-city look at estimated housing market valuations



NATCAN WEEKLY MARKER

Difficulties in the housing sector appear to be infecting the broader US economy by propagating through the banking system. Investors must take note of the fact Canada's housing sector - while appearing fully valued - is not at risk of correcting in any magnitude of similar proportion. The next question to ask is whether slowing appreciation of Canadian housing will lead to lower consumer spending. While housing appreciation did create significant consumer wealth, studies show there is a lag of several months between housing price trends and consumer spending. Canadians appear safe from a housing value correction.

Michael Quigley, CFA
Senior vice president, Distribution

FINANCIAL MARKETS

RETURNS AS AT SEPTEMBER 12, 2008 (%)	MTD	QTD	YTD	RATES AS AT SEPTEMBER 12, 2008	
S&P/TSX	-7.20	-11.29	-5.97	CAD/USD	1.06
S&P 500	-2.40	2.26	-7.59	CAD/Euro	1.51
S&P/TSX Small Cap	-10.36	-16.53	-16.85	US Treasuries yield 10-yr/30-yr	3.71/4.33
Russell 2000	-2.63	8.96	1.31	GOC bond yield 10-yr/30-yr	3.60/4.06
MSCI EAFE	-5.96	-8.77	-16.49	Fed Fund Rate (target)	2.00
MSCI World	-4.20	-3.74	-11.50		
DEX Universe Bond	-0.35	1.25	3.49		

Note: Returns in Canadian dollars, London 4h exchange rates. Source: Datastream, PC Bond, MSCI-Barra, and Bloomberg. PC-Bond, a business unit of TSX Inc. Copyright © TSX Inc. All rights reserved.

This publication is intended for your private information. The information and opinions herein are provided for informational purposes only and are subject to change based on market and other conditions. The views expressed should therefore not be relied upon as the basis of your investment decisions. Past performance is not necessarily indicative of future performance. This document is not and should not be construed as a solicitation or offering of units of any fund or other security in any jurisdiction. No part of this publication may be reproduced in any manner without the prior written permission of Natcan Investment Management Inc.

¹ Merrill Lynch, Economic Analysis; August 07, 2008