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HIGHLIGHTS

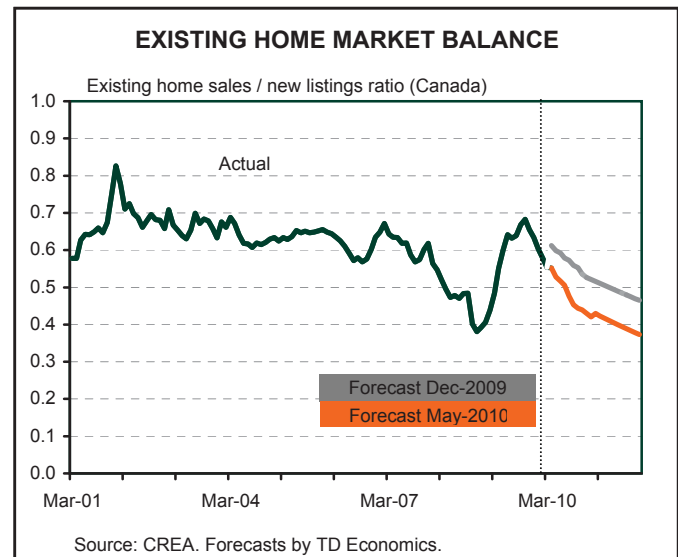
- Our existing home sales and average price forecast for 2010 is largely unchanged since December 2009. We still expect 475K transactions to take place, with an average annual price nearing \$350K, an increase of 9% over 2009.
- However, this hides an underlying shift occurring over the course of this year. While we anticipated sales and prices to be strong in the first half and to cool in the second half, we now expect this contrast between the two halves will be sharper.
- A surprisingly robust economic recovery provides some offset in the form of higher employment and income, but a combination of factors suggests a weaker handoff to 2011 than previously expected.
- One crucial factor is the supply-side response (listings) to higher home prices. While it was slow to appear, it is now stronger than had been expected. Housing starts have also been slightly higher than anticipated at 200K units in Q1/2010.
- While we previously expected the average home price to gain a modest 1.6% in 2011 (stagnating in real, or inflation-adjusted, terms), we now expect a modest pullback of 2.7% at the national level, with 7 out of 10 provinces experiencing lower prices.

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CANADA TO EXPERIENCE A MODEST HOME PRICE CORRECTION IN 2011

In our December 1, 2009 publication entitled “*Canadian Housing: First In, First Out, But Where to From Here?*”, we expected home sales to reach 475K units in 2010. With Q1/2010 data now available, we still expect the same level of transactions to take place for the year as a whole. While sales in Q1 were slightly higher than our late-2009 forecast, we view the strength as borrowing from future sales in a move by buyers and sellers to preempt regulatory and interest rate changes. This is evidenced by the fact that much of the strength emanates from B.C. and Ontario, where the perception is that the upcoming implementation of the harmonized sales tax (HST) in July will raise transaction costs. Nationwide, however, the anticipation of higher interest rates has also played an important role in the currently observable strength in activity. Our price forecast for 2010 as a whole also remains largely unchanged, with the average home transacted expected to appreciate by 9% from last year to reach an annual average just shy of \$350K.

Our outlook for next year has changed, however, due to a number of factors. The first is that government bond yields, which anchor longer-term (e.g. 3-year, 5-year) mortgage rates, have risen faster than expected in response to a stronger and quicker economic recovery in Canada, and a consequent anticipation of Bank of Canada (BoC) interest rate hikes. Back-to-back annualized growth rates of real GDP in Canada of 5%+ in Q4/2009 and Q1/2010 and relatively strong employment figures at this early stage of the economic recovery are illustrations of this. Indeed, in its April communiqué, the BoC did away with its conditional commitment to leave the overnight rate unchanged at 0.25% until the end of Q2/2010. Whereas we had expected the BoC to start gradually increasing its overnight rate on July 20, we now anticipate it will do so more than six weeks earlier, starting on June 1st. Over the course of March and April, we also note that the benchmark Government of Canada 3-year bond yield rose by 83 basis points while the 5-year bond yield rose by 50 basis points. Chartered bank posted mortgage rates for similar durations rose by 100 basis points. The resulting erosion in affordability – roughly a 3 percentage point increase in the ratio of typical mortgage payment to gross income – tends to





EXISTING HOME SALES					
Thousands of units					
	2007	2008	2009	2010F	2011F
CANADA	521.1	431.8	465.3	475.0	420.0
N. & L.	4.5	4.7	4.4	4.5	4.0
P.E.I.	1.8	1.4	1.4	1.4	1.3
N.S.	11.9	10.9	10.0	10.1	9.5
N.B.	8.2	7.6	7.0	7.2	6.2
Québec	80.6	76.8	79.3	80.0	72.3
Ontario	213.4	181.0	195.8	210.0	175.0
Manitoba	13.9	13.5	13.1	12.2	11.7
Sask.	12.1	10.2	10.9	10.0	9.5
Alberta	71.4	56.4	57.8	52.0	55.0
B.C.	102.8	68.9	85.0	87.0	75.0

F: Forecast by TD Economics as at April 2010
Source: Canadian Real Estate Association

EXISTING HOME SALES					
Per cent change					
	2007	2008	2009	2010F	2011F
CANADA	7.8	-17.1	7.7	2.1	-11.6
N. & L.	26.4	5.0	-5.9	1.9	-11.1
P.E.I.	18.6	-20.1	-0.6	1.1	-8.5
N.S.	10.8	-8.3	-7.8	0.8	-5.9
N.B.	14.5	-7.4	-7.3	2.8	-13.9
Québec	12.6	-4.8	3.3	0.9	-9.6
Ontario	9.5	-15.2	8.2	7.2	-16.7
Manitoba	7.0	-2.9	-3.2	-6.8	-4.1
Sask.	31.9	-15.4	6.5	-7.9	-5.0
Alberta	-3.9	-21.0	2.5	-10.0	5.8
B.C.	6.3	-33.0	23.4	2.3	-13.8

F: Forecast by TD Economics as at April 2010
Source: Canadian Real Estate Association

AVERAGE EXISTING HOME PRICE					
Thousand C\$					
	2007	2008	2009	2010F	2011F
CANADA	307.1	305.0	320.3	349.0	339.7
N. & L.	149.3	178.5	206.4	233.2	228.5
P.E.I.	133.5	139.9	146.0	143.0	142.5
N.S.	181.0	189.9	196.7	212.0	209.0
N.B.	136.6	145.8	154.9	158.0	157.0
Québec	207.5	215.3	225.4	242.2	239.7
Ontario	299.5	302.4	318.4	356.6	346.0
Manitoba	169.2	190.3	201.3	215.0	216.0
Sask.	174.4	224.6	233.7	242.0	245.0
Alberta	356.2	352.9	341.2	355.0	357.0
B.C.	439.1	454.6	465.7	500.0	483.0

F: Forecast by TD Economics as at April 2010
Source: Canadian Real Estate Association

AVERAGE EXISTING HOME PRICE					
Per cent change					
	2007	2008	2009	2010F	2011F
CANADA	10.8	-0.7	5.0	9.0	-2.7
N. & L.	7.0	19.6	15.6	13.0	-2.0
P.E.I.	6.4	4.9	4.4	-2.1	-0.3
N.S.	7.3	4.9	3.6	7.8	-1.4
N.B.	7.7	6.7	6.3	2.0	-0.6
Québec	6.3	3.7	4.7	7.4	-1.0
Ontario	7.6	0.9	5.3	12.0	-3.0
Manitoba	12.6	12.5	5.8	6.8	0.5
Sask.	32.0	28.8	4.1	3.6	1.2
Alberta	24.8	-0.9	-3.3	4.0	0.6
B.C.	12.3	3.5	2.4	7.4	-3.4

F: Forecast by TD Economics as at April 2010
Source: Canadian Real Estate Association

weaken sales in ensuing quarters. Hence, while our forecast for 2010 as a whole remains largely the same as the one we published five months ago, this hides a trade-off between what we now expect to be a stronger first half and weaker second half of the year.

We still expect annual sales to decline by 10-12% next year, reaching a still decent 420K units. Canadian home affordability, as measured by the percentage of typical mortgage payments to household income, is expected to move from 30% as of Q1/2010 up to 33% by Q4/2011 - which is similar to the affordability level experienced in late 2007 when the market started to cool. While interest rates will rise, they will not do so in a vacuum but within the context of a strengthening labour market and economy. The absolute level of borrowing rates is also expected to remain favourable to affordability on a historical basis, and should limit the slippage in sales activity. In all, we made no major revisions to our demand (sales) side of the market. The quicker rise in interest rates has a natural offset in the

form of a stronger and quicker economic recovery. Indeed, a surprisingly robust economic recovery provides some offset in the form of higher employment and income. But a combination of factors suggests a weaker handoff to 2011 than previously expected.

One crucial factor is the supply-side response (listings) to higher home prices. While it was slow to appear, it is now much stronger than had been expected. Housing starts have also been slightly higher than anticipated at 200K units in Q1/2010. As a result of the stronger supply response, the market balance is now expected to be somewhat softer next year, consistent with market conditions more favourable to potential buyers and a mild depreciation in home values.

Taking into account the typical lags between home affordability, sales and price behaviour, the impact of all these combined changes is that we now project a modest price pullback for 2011. At the national level, while we previously expected home prices to post a sluggish 1.6% increase, we now expect the annual average home price to



slip lower by 2.7% to \$340K in 2010. Within Canada, the pullback is expected to be broadly-based, but more modest outside of B.C. (-3.4%) and Ontario (-3.0%). While price gains should be meagre (0.5%-1.2%) in the Prairie provinces, we nonetheless expect them to sidestep price drops on an annual average basis. In closing, a few more things are worth noting.

First and foremost, a strong supply-side response in the existing home market is a sign that Canada's home markets are functioning well. Distressed selling remains rare. This is helping to rebalance markets previously characterized by a dearth of available units, which was creating an unsustainable push in prices evidenced by frequent bidding wars. The sharp rebound in existing home market sales and prices initiated in Q1/2009 – and still going strong – is also testament to the stimulative impact of monetary policy, a healthy rebound in consumer confidence, and well functioning credit markets. Many Canadian households are in fact crystallizing very favourable long-term capital gains that previously only existed on paper. Combined with the sharp rebound in equities experienced since March 2009, this implies a notable balance sheet improvement compared to just a year ago.

In the current economic environment, there is little to

suggest that Canadian bond yields and borrowing rates will surge in the medium-term or that a U.S.-style price correction is in the making. We estimate that at their peak in the first half of this year, average home prices will be roughly 15% overvalued when benchmarked against long-term economic fundamentals, such as income growth. If our forecast unfolds, roughly a third of this excess would be unwound by year-end 2011, leaving our estimate of valuation at roughly 10% above fundamentals, back to what it was in late 2007. As in our last forecast, we still expect the bulk of the re-adjustment to occur over a medium-term time frame of 2-3 years whereby average home prices rise roughly at the rate of inflation – after having climbed by over 8% annually over the last 8 years. Meanwhile, household incomes will be allowed to catch up and close the gap, which is concentrated in the country's most expensive markets (e.g. Toronto, Vancouver).

As with any forecast, there are both upside and downside risks to our baseline view. In particular, one cannot rule out sharper appreciations followed by sharper corrections in the near-term. In choppy waters, keeping an eye on the shore and reading through this near-term volatility, much of which results from needed policy decisions taken to prevent a steeper economic downturn, will be important.