Economic Insights

September 17, 2014

I'll Take Manhattan

by Avery Shenfeld

Economics

Avery Shenfeld
(416) 594-7356
avery.shenfeld@cibc.ca

Benjamin Tal
(416) 956-3698
benjamin.tal@cibc.ca

Peter Buchanan
(416) 594-7354
peter.buchanan@cibc.ca

Warren Lovely
(416) 594-8041
warren.lovely@cibc.ca

Andrew Grantham
(416) 956-3219
andrew.grantham@cibc.ca

Nick Exarhos
(416) 956-6527
nick.exarhos@cibc.ca

Where I live, calls for house prices to come down to earth are like predictions for a Stanley Cup win by the Toronto Maple Leafs. We hear them every year, followed in short order by the "wait until next year" refrain. Are the current prophets of house price doom any different?

Research by my colleague Benjamin Tal (see pages 8-11) does suggest a vulnerability to a correction in some elements of the housing market. New supply in condos, borrower fatigue, and eventually, higher mortgage rates, are the likely catalysts. But unless one were to call for, say, a 30% national price correction, we'll never reach the levels that we were worried about a few years back, when a 20% tumble was feared from an initially lower starting point.

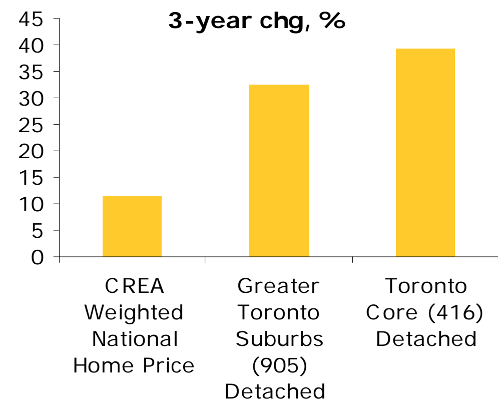
One reason is that it's increasingly clear that we are in an era of lower interest rates. The present value of the steady stream of rental payments avoided through home ownership is twice as high if discounted by a rate half its historic level. Still, from current low levels, even a 100-bp rise in rates would be a meaningful hit to affordability.

"...central Toronto and Vancouver increasingly look like Manhattan,..."

But our analysis at the micro level reveals another key factor. The lion's share of the appreciation has been delivered by the upper end of the price spectrum: not only in the costliest cities (Vancouver, Toronto) but in their urban cores, rather than lower priced alternatives in the burbs or elsewhere in Canada (Chart).

While perhaps stretched to the limit, that gap actually provides a rationale for the puzzling durability of the price rally: central Toronto and Vancouver increasingly look like Manhattan. The nearest available room to expand the single family housing stock is sufficiently distant, entailing a sufficiently troublesome commute, to be a very weak substitute for the core. Development land beyond the "905" or in its furthest corners doesn't effectively compete with or limit prices in Toronto's Rosedale or the Annex. Vancouver's surrounding mountains and waterways impose their own limits on single family house supply. For similar reasons, the price for a rare single family house in Manhattan is even more astronomical relative to average incomes earned in the city. And let's not even talk about central London.

Condo supply, even at the high end and in good locations, can still be expanded by densification. Luxury homes in central locations could be at some risk, as Tal notes, from the inability of those in middle level houses to move up. But land scarcity, and poor transport from distant suburbs, helps make the insanity of Canada's house price climb look just a bit less insane.



http://research.cibcwm.com/res/Eco/EcoResearch.html

MARKET CALL

- We're largely standing pat with the projections included in our September 4th issue of Forecast, but note that the timing of the moves we have between now and March is in play. How soon bond yields move to higher levels, and when the Canadian dollar breaks out to the weak side, will depend on when the Fed shows its cards on the timing of a first rate hike. While we expect that move in March, the Fed has not had a consistent pre-hike warning period in the past.
- The C$ has softened slightly in part due to concerns over global growth and the resulting weakening in crude oil, both of which could reverse a bit in upcoming months. But we see a lot more pressure on the Canadian currency emerging as the Fed jumps well ahead of the Bank of Canada in the timing of rate hikes next year.
- In the rate space, we continue to expect bond yields to overshoot in the first half of 2015 as the Fed pulls the trigger. Even in what ends up being modest tightening cycles, the market's tendency when it sees the first hikes is to add substantially to its expectations for subsequent moves. In this case, that will set up a pleasant surprise when central bankers subsequently take a cautious approach to tightening.

INTEREST & FOREIGN EXCHANGE RATES

		2014		2015				2016			
END OF PERIOD:		**16-Sep**	**Dec**	**Mar**	**Jun**	**Sep**	**Dec**	**Mar**	**Jun**	**Sep**	**Dec**
CDA	Overnight target rate	1.00	1.00	1.00	1.00	1.25	1.50	1.50	1.50	1.50	1.50
	98-Day Treasury Bills	0.92	0.95	1.00	1.05	1.20	1.45	1.45	1.45	1.40	1.45
	2-Year Gov't Bond	1.14	1.20	1.65	1.90	2.20	2.20	1.95	1.85	1.95	2.00
	10-Year Gov't Bond	2.21	2.20	2.70	3.00	3.05	2.80	2.75	2.70	2.75	2.80
	30-Year Gov't Bond	2.74	2.75	3.40	3.50	3.55	3.35	3.25	3.20	3.25	3.35
U.S.	Federal Funds Rate	0.10	0.10	0.25	0.75	1.25	1.25	1.25	1.25	1.25	1.50
	91-Day Treasury Bills	0.01	0.10	0.40	0.60	0.85	1.10	1.35	1.25	1.20	1.40
	2-Year Gov't Note	0.53	0.60	1.05	1.60	1.80	1.70	1.65	1.65	1.70	1.90
	10-Year Gov't Note	2.57	2.60	3.10	3.60	3.45	3.25	3.25	3.30	3.35	3.45
	30-Year Gov't Bond	3.33	3.35	3.65	4.15	4.10	3.70	3.65	3.70	3.75	3.80
Canada - US T-Bill Spread		0.91	0.85	0.60	0.45	0.35	0.35	0.10	0.20	0.20	0.05
Canada - US 10-Year Bond Spread		-0.36	-0.40	-0.40	-0.60	-0.40	-0.45	-0.50	-0.60	-0.60	-0.65
Canada Yield Curve (30-Year — 2-Year)		1.60	1.55	1.75	1.60	1.35	1.15	1.30	1.35	1.30	1.35
US Yield Curve (30-Year — 2-Year)		2.80	2.75	2.60	2.55	2.30	2.00	2.00	2.05	2.05	1.90
EXCHANGE RATES	CADUSD	0.91	0.92	0.89	0.85	0.85	0.86	0.85	0.87	0.87	0.86
	USDCAD	1.10	1.09	1.12	1.17	1.18	1.16	1.17	1.15	1.15	1.16
	USDJPY	107	106	106	106	108	108	107	105	106	107
	EURUSD	1.29	1.26	1.25	1.25	1.25	1.27	1.28	1.30	1.32	1.34
	GBPUSD	1.62	1.63	1.64	1.66	1.67	1.67	1.66	1.67	1.69	1.68
	AUDUSD	0.90	0.89	0.88	0.87	0.86	0.87	0.88	0.90	0.91	0.93
	USDCHF	0.93	0.97	0.98	0.98	0.98	0.97	0.97	0.95	0.95	0.93
	USDBRL	2.34	2.48	2.56	2.52	2.53	2.45	3.20	3.28	3.35	3.40
	USDMXN	13.22	12.70	12.85	12.90	13.05	13.13	13.15	13.18	13.23	13.29

Grow Ontario, Grow

Avery Shenfeld and Warren Lovely

Growth disappointments, particularly for nominal GDP which is the foundation for government revenues, have been a sizeable challenge for Canada's largest province. But Ontario is poised to be the single biggest beneficiary from the combination of sturdy US growth and a weaker Canadian dollar, with implications for its ability to rise to its fiscal challenges and, as a result, for its relative bond performance.

Not Number One, But…

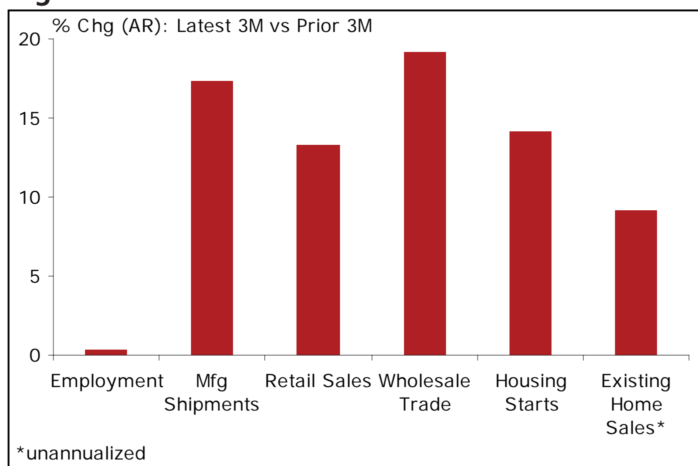
Momentum indicators point Ontario's way. While flattered somewhat by a comparison to a weather-damaged Q1, from manufacturing shipments, to domestically driven signposts in retailing, wholesaling and homebuilding, Ontario has seen a notable resurgence, shifting from a perennial trailer to among the better performing regions of the country (Chart 1). Employment hasn't caught fire, but should respond at some point to firming output.

Historically, Ontario's real GDP has had the tightest correlation to US activity. But after years of plant exits, capacity use has actually tightened in the face of demand gains. Ontario needs to cultivate growth sectors, rebuild capacity and win the battle for new facilities.

Our call for the Bank of Canada to significantly lag the US Fed in rate hikes next year, and a resulting depreciation of the loonie to roughly 85 cents US, should reposition the province as a more cost-competitive location. Lower federal/provincial corporate tax rates, the shift to the HST, and a $2.5 bn fund set up by the province to court direct investment, could be further enticements.

Chart 1

Signs of Recent Ontario Acceleration



Source: Statistics Canada, CREA, CIBC

That's not to say that Canada's energy-centred western provinces are rolling over and playing dead. In addition to their resource blessings, Alberta, Saskatchewan and British Columbia do not face as much need for government spending restraint, given their absence of deficits and modest or non-existent debts. So while first place is well out of reach, in a break from an underperformance trend that dates all the way back to the 2002-07 pre-crisis period, Ontario could slightly nose out the national average growth rate in 2015 (Table 1).

Table 1

Ontario Finally in Line With National Average GDP

Y/Y % Chg	Real GDP Growth 2013E	2014F	2015F	2016F	Reference Periods Pre-Crisis[1]	Recession[2]	Recovery[3]
BC	2.0	2.2	2.8	2.6	3.7	-0.7	2.4
Alta	3.9	3.6	3.5	3.0	4.2	-1.2	3.9
Sask	4.8	2.0	2.8	2.5	2.9	0.3	3.3
Man	2.2	2.0	2.4	2.3	2.6	1.8	2.2
Ont	1.2	2.3	2.8	2.4	2.1	-1.6	2.2
Qué	1.1	1.9	2.3	2.0	1.7	0.6	1.8
NB	0.0	1.2	1.8	1.6	1.7	-0.1	0.8
NS	0.8	1.5	2.1	2.5	1.0	1.2	1.5
PEI	1.4	1.8	2.0	1.9	2.5	0.6	1.7
N&L	7.9	0.9	0.5	-2.0	4.4	-5.6	1.6
Cda	**2.0**	**2.3**	**2.7**	**2.3**	**2.6**	**-0.8**	**2.4**

Note: Provincial growth rates for 2013 based on GDP by industry data

1. 'Pre-Crisis' refers to five-year average annual growth rate from 2002 to 2007

2. 'Recession' refers to two-year average annual growth rate from 2007 to 2009

3. 'Recovery' refers to seven-year average annual growth rate from 2009 to 2016

Source: Statistics Canada (actual), CIBC (forecast)

Pleasant Surprises

The catch-up to others could look even more significant in nominal GDP terms, an important distinction since prices and volumes combine to lift the government's base for most taxes. Earlier weakness in manufacturing, and strength in crude oil, worked to boost GDP deflators for the oil exporting provinces relative to Ontario. But resource prices appear to have levelled off, while some of Ontario's factory sector prices could head higher, particularly for goods that are exported at US$ prices. Note that in Q1 2014, much of the over-4% growth in Ontario nominal GDP came from a sturdy reading for the deflator.

The result is that nominal GDP growth looks headed for 4½% growth in 2014 and just under 5% in 2015. That would handily top the relatively conservative forecasts built into the 2014 budget plan (Chart 2).

Decimal places matter. All told, Ontario could have an additional $4-5 bn accumulated over two years (i.e. about $2-2.5 bn per year) that could be used to either exceed targets for deficit reduction or avoid the full burden of what rating agencies have judged to be tough-to-meet spending constraints. The extra room captures published budget sensitivities to nominal GDP divergences, and obviates the need to dip into the $1 bn in reserves and $0.5 bn in contingencies set aside this year, and the $1.2 bn reserved for 2015/16.

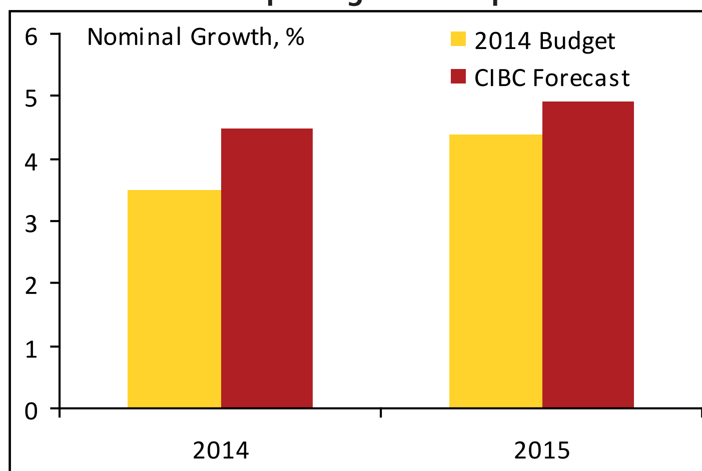
Room for Bond Outperformance

Despite the province running ahead of budget targets, earlier downgrades in the economic outlook, and risks of a corresponding move by rating agencies, weighed on Ontario's bond performance in recent years. A successively softer outlook implied even tighter spending plans or the further use of tax-hike room to meet the targeted date for a balanced budget. Having avoided a credit downgrade, Ontario bought itself some time, and the revenues associated with a better-than-expected nominal GDP outlook should be of value in protecting its rating.

We see conditions a year from now as comparable to late-2010 and early-2011. As was the case back then, Ontario real growth will be topping 2.5% and 10-year Canadas will be near 3.0% (Chart 3). If that analogy extends to spreads, a year from now, 10-year Ontarios could tighten in to that earlier period's 70-bp spread over Canadas. That result would also be consistent with our model that draws on relationships to sovereign yields and US corporate spreads. So bond investors have reason to cheer "grow Ontario grow" as gains in nominal GDP support some bond outperformance against Canadas.

Chart 2

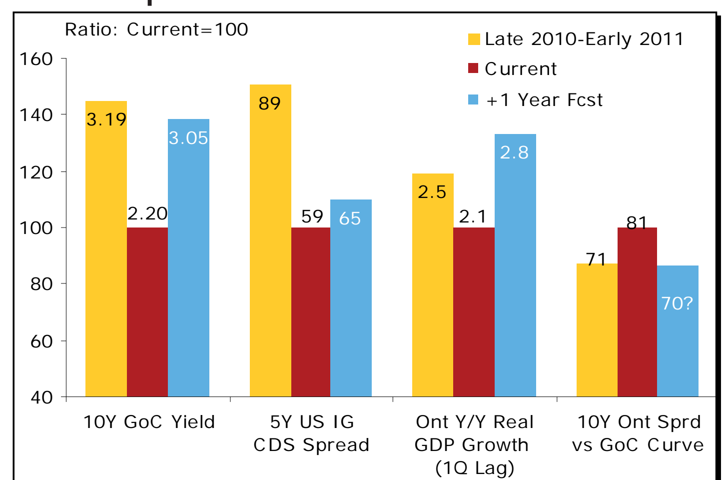
Nominal GDP to Top Budget Assumptions



Source: Government of Ontario, CIBC

Chart 3

Fundamentals Support Return to Narrower Ontario Spread vs Canada



Source: Bloomberg, CIBC

Commodities: A Perfect Storm Upends Promising Rally

Peter Buchanan

After a hot spring and summer for resource markets, a perfect storm of growth disappointments, a rising greenback and rate fears has sent investors running for cover, taking currencies like the C$ in tow. We now expect the global economy to expand by about 3.2% this year, averaging 3.6% in 2015 and 2016 (Table 1). That's a half-point shy of earlier expectations, continuing the uneven performance seen since the Great Recession's end. With the US pacing the larger, advanced economies—and a narrowing growth gap between those entities and emerging markets—the backdrop should be somewhat more constructive for energy than other resources (Chart 1).

While the TSX's resource sectors have slipped in the rankings, the news for Canadian resource producers hasn't been all bad. Reduced transport and processing bottlenecks and changes in project guidance have seen WCS-WTI spreads narrow by over $10 from the summer's highs, offsetting the drop in global oil prices, and those factors should restrain differentials, going forward. The C$'s slide has cushioned producers in a range of industries, bolstering revenue and foreign remittances, converted into loonies. In other sectors, like the golds, prices remain above North American producers' cash costs, even with recent erosion.

Table 1

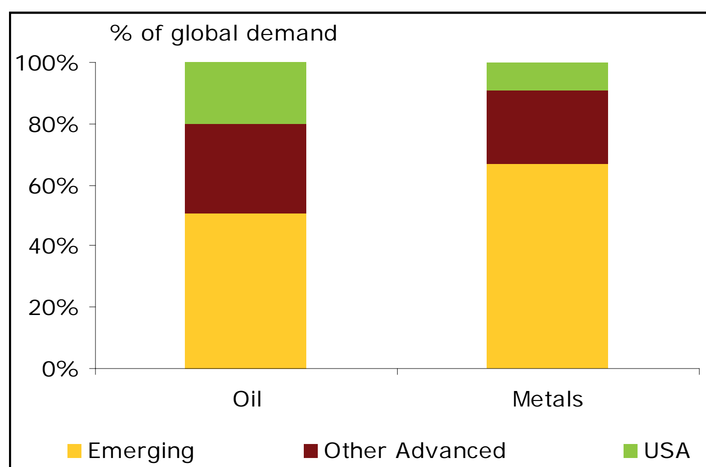
Growth of Main Commodity-Using Economies, %

	2011A	2012A	2013A	2014E	2015E	2016E
US	1.6	2.3	2.2	2.1	2.9	2.4
China	9.3	7.7	7.7	7.5	7.0	6.8
Eurozone	1.6	-0.6	-0.4	0.8	1.6	1.9
World	3.9	3.5	3.2	3.2	3.7	3.5

Sustained global growth of 4% or more catalyzed vibrant resource rallies in the 1990s and oughts. Such healthy performance is not in the cards currently. We expect prices for industrially sensitive products to slip by 5% or so, in the next four-six months, given the still uneven growth outlook, capacity additions in some sectors, and a projected 2-4% rise in the USD (Chart 2). The following year should see a modest recovery, on improving fundamentals. While central banks are poised to raise rates, modest growth and inflation could nonetheless bring benefits of its own, limiting the need for the aggressive policy braking that has dented prices in the past. Despite the official emphasis on GDP quality, China's renewed slowdown reflects a deepening housing slump rather than official policy. With the 2014 growth target in doubt, commodities could benefit in the likely event of more infrastructure stimulus.

Chart 1

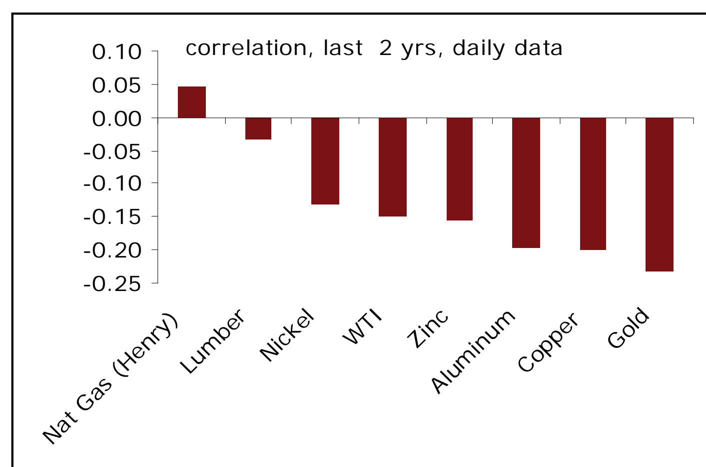
Advanced Economies Drive Oil More Than Metals



Source: BP, CRU, CIBC

Chart 2

Gold Most Levered, Lumber & Gas Least Sensitive to US$



Source: Bloomberg, CIBC

Adding Alpha Via Commodity Exposure

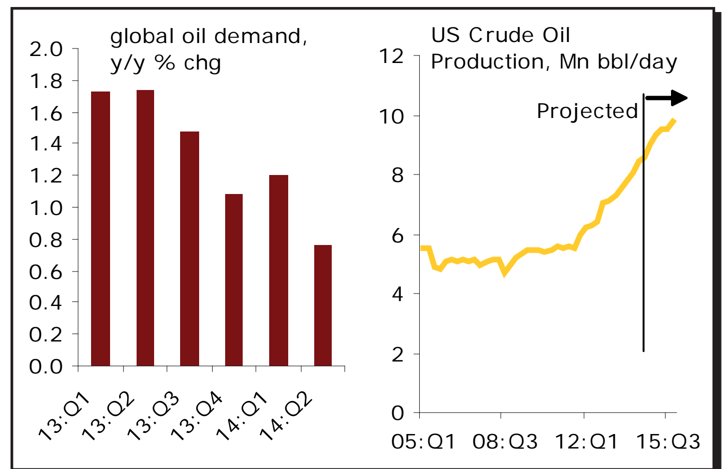
Six weeks ago we recommended investors dial back on risk a bit, arguing that oil and some other commodities lacked upside in a world of middling growth. That continues to be our view. From an alpha perspective, one notable development has been the striking de-coupling between resources and other risk assets, including stocks, in recent months (Chart 3). That mimics the pattern of the 1980s and 1990s and suggests there may, once again, be a good case for at least some exposure to commodities and allied producer stocks, for diversification purposes.

Oil: Lots Now But Potential Long-term Tightening

Oil prices, somewhat surprisingly, have hit year-to-date lows recently even as turmoil and uncertainty have enveloped Iraq, Russia and some other important producers. While some of oil's recent decline mirrors supply-side factors, it also reflects lacklustre demand. The combination has prompted us to slightly scale back our estimates for WTI prices to $98/bbl next year and $100/bbl in 2016 (Table 2), even with a continuing above-average level of supply outages tied to turmoil in a number of key producing countries. Lacklustre growth in Europe and China saw global demand ease sharply to a sub-1% pace in Q2 (Chart 4). At the same time, US production has hit 28-year highs recently, en route to the half-century mark in 2015. Saudi Arabia's mid-September price cuts also suggest OPEC's largest producer and key swing supplier is unlikely to cut output further to maintain prices.

Chart 4

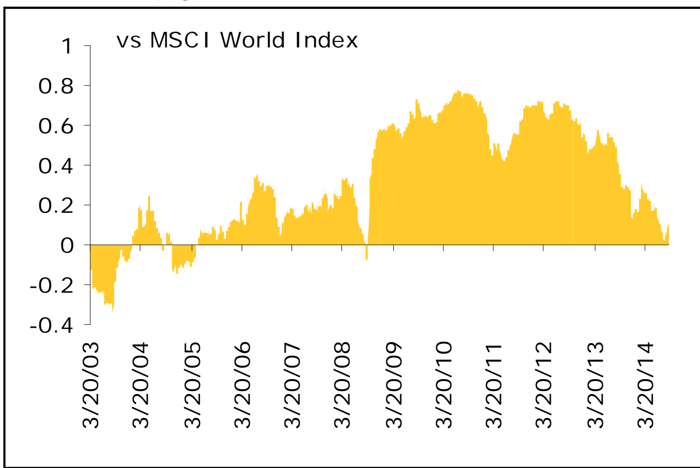
Weakness in Europe, China Slows Global Oil Demand (L) as US Production Surge Continues (R)



Source: IEA, DOE, CIBC

Chart 3

Commodities Correlation with Other Assets Has Fallen Sharply



Source: Bloomberg, CIBC

Table 2

Commodity Forecast

		15-Sep	2011	2012	2013	2014 (f)	2015 (f)	2016 (f)
Oil (WTI)	$/bbl	93	95	94	98	99	98	100
Natural Gas (Henry)	$/Mn Btu	3.91	3.99	2.75	3.72	4.40	4.20	4.25
Gold	$/troy oz	1234	1531*	1657*	1204*	1200*	1300*	1325*
Silver	$/troy oz	18.68	27.80*	31.10*	19.47*	18.00*	19.50*	19.75*
Copper	$/lb	3.12	4.01	3.62	3.33	3.15	3.20	3.25
Aluminum	$/lb	0.89	1.09	0.92	0.84	0.85	0.90	0.90
Nickel	$/lb	8.17	10.38	7.97	6.82	8.00	9.00	10.00
Zinc	$/lb	1.02	1.00	0.89	0.87	0.98	1.10	1.25
Lumber**	$/'000 bd ft	349	255	288	346	355	390	375
Potash	$/tonne	287	412	430	383	300	300	300

** end of period, **1st CME Futures*

Notwithstanding bearish demand and supply developments, we see a number of forces lending support to oil prices, and by extension earnings for Canadian firms, in coming years. Russia and Iraq account for 14 mn barrels of daily supply and were, until recently, expected to contribute disproportionately to supply growth. Recent developments will likely slow future investment markedly in both countries.

Strong inventory builds and the effect of a mild summer on generator demand have seen natural gas prices fall by more than half from last winter's highs. Injections of gas into storage have exceeded the long-term average in the US for 21 consecutive weeks, cutting the deficit to the five-year average from over 50% last April to 14% currently. Even with that, working storage levels will likely start the heating season slightly below year-ago levels according to DOE estimates.

Shale gas, while prolific, is not cheap, with annual decline rates of 60-70% implying the need for continuous re-drilling and development. Consistent with several studies, we believe average prices of over $4 will be needed to cover producers' full-cycle costs. The permitting of two US plants for LNG exports to potentially lucrative markets in Europe and Japan means Canada will have to move quickly to take full advantage of export opportunities.

Base Metals: Rediscovering Supply

Base metals prices have diverged on sector-specific fundamentals. Chinese smelter cuts and firmer automaker demand lifted aluminum to 18-month highs in early September. Notwithstanding the recent gains, we believe high inventories and supply increases are likely to present challenges in the medium term. Copper has also sagged on Chinese growth anxieties. Both zinc and nickel face supply deficits (Chart 5) at the global level in the next two-three years, and we favour those metals for potential upside. New zinc mine capacity has lagged demand. Markets are likely to tighten even with modest economic growth. Nickel should draw support from rising stainless steel demand and export bans by Indonesia as well as, potentially, by the Philippines.

Gold: Not Glistening Just Yet

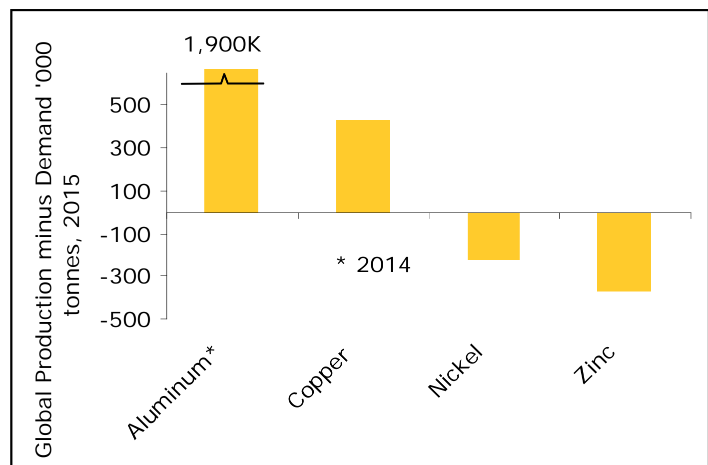
As we expected, the dollar's renewed bid, muted inflation pressures and a modest reduction in geopolitical and systemic risk have also seen gold cede some of the late spring's gains. Recent data showing a fall-off in physical demand for investment purposes in China have weighed on the metal while India's new government has yet to validate hopes for a reduction in its tax on imports. On a supportive note, physical ETF holdings appear to be stabilizing (Chart 6). While contained inflation, a potential lessening in geopolitical risk and rate hike concerns suggest modest downside, we believe prices are not currently far from the cyclical lows.

Non-Cyclical Resources for Challenging Times

Those concerned about near-term growth challenges with cash to invest might also contemplate an exposure to less cyclically levered resources. Fertilizer investors have had to grapple lately with shuttered cartels, new mines and lower crop prices. Cost-cutting nonetheless has the potential to lift returns. The factors underlying the recent growth of fertilizer demand, including a demand for protein foods, remain intact. Looking past recent challenges, a case for longer term exposure can be made.

Chart 5

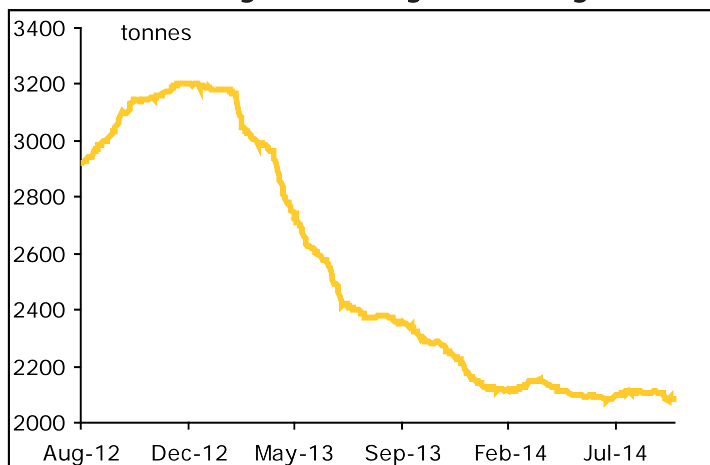
Fundamentals Best for Zinc and Nickel



Source: CRU, CIBC

Chart 6

Gold: ETF Holdings Stabilizing After Plunge



Source: Bloomberg, CIBC

Staying Put

Benjamin Tal

For most Canadians, the following narrative is well known. You graduate from school, land your first job, get married, buy your first house, start a family, and after a number of years, move up to a larger house to accommodate your growing family. However, there are many indications that this cycle that dominated the Canadian housing market for decades, is breaking.

Gravity-defying home valuations, exacerbated by tighter mortgage insurance regulations, have worked to price out a notable portion of the first-time homebuyers' market. At the same time, an asymmetrical trajectory of price appreciation is starting to paralyze the "move up" market. The value of bigger and pricier properties is rising notably faster than less expensive properties—widening the gap between starter home and dream house. These dynamics go a long way in explaining the current stage of the housing market in Canada and provide some hints regarding the nature and trajectory of any future market adjustment.

Hidden Behind The Average

When it comes to housing activity in Canada, average numbers hide more than they reveal. The 5% increase in the average annual home price over the past year masks many tales such as falling prices in Saint John, Québec and Victoria, and still very strong markets in centres such as Toronto, Vancouver and Calgary. More than one-quarter of the sales are now in cities that see prices rising by less than the current rate of inflation (Chart 1).

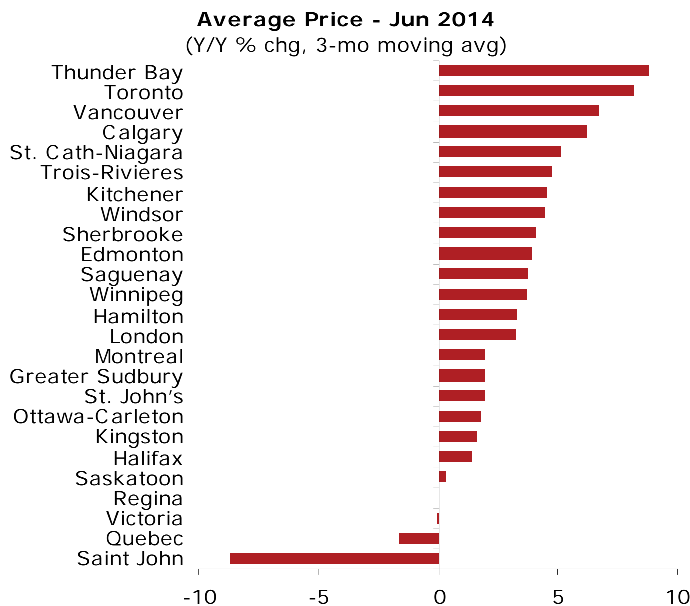
More robust activity in cities with above-average prices also works to bias the widely quoted average price. In fact, the spread between the simple average price measure and the weighted measure (which compensates for changes in provincial sales activity by taking into account provincial proportions of privately owned housing stock) has been widening over the past eighteen months, suggesting that a growing proportion of price increases in Canada are due to activity in large and more pricey cities (Chart 2).

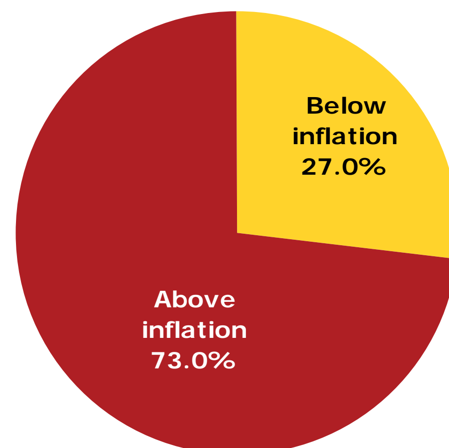
Asymmetrical Sales Picture

The multi-dimensional nature of Canadian housing goes way beyond geography. Despite the speculation and trepidation regarding home valuations, resale activity in Canada has been relatively stable over the past few years. Unit sales have fluctuated at a relatively narrow range

Chart 1

The Canadian Housing Market

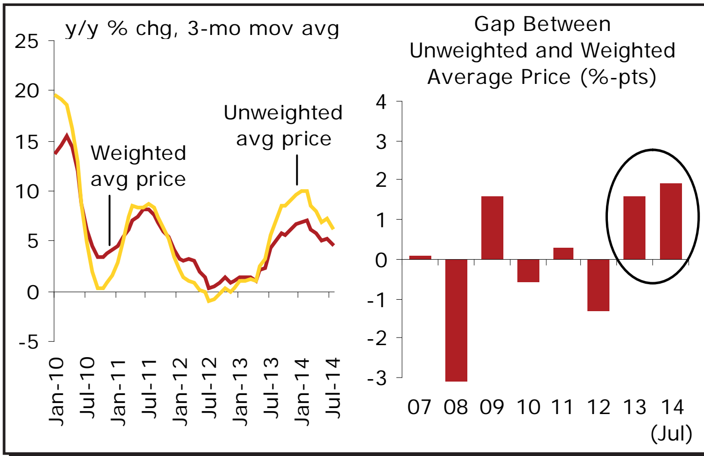




Source: CREA, CIBC

Chart 2

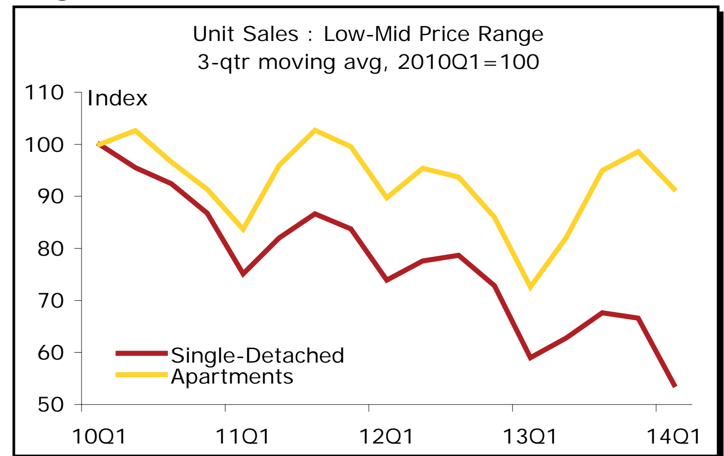
Robust Activity in Pricey Centres Bias Average Price



Source: CREA, CIBC

Chart 4

Soft First-time Buyers Activity Mainly in Single-detached Units



Source: CIBC calculations based on CREA's unpublished tabulations

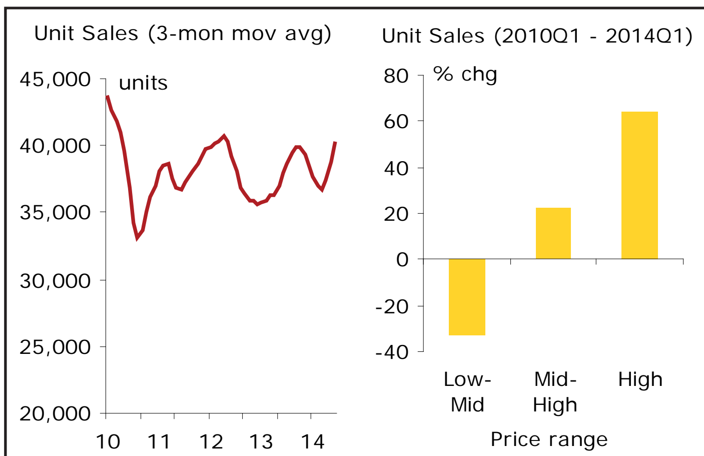
of between 35,000 and 40,000 units per month (Chart 3, left). But again, this apparent stability masks a more complex story. Sales of units at the low-to-mid price range fell notably since 2010[1]. Sales rose modestly for the mid-to-high price range, and advanced rapidly for units in the upper end of the market[2]. In other words, over the past few years, sales have been positively correlated with price levels (Chart 3, right).

Zooming in on the decline in sales at the low-to-mid price range, most of the decline is in the single-detached category (Chart 4). In fact, total sales at the lower and mid-price range would have been much more dismal if it were not for the more robust activity in the condo market. This activity is driven largely by investors and first-time homebuyers who see condo ownership as a cheaper alternative to unaffordable low-rise units. That's a good illustration of the important stabilizing force played by the condo market in recent years.

This picture of soft sales at the low-to-mid price range of the single-detached market has affordability written all over it. Tightening mortgage regulations in general, and the reduction in amortizations from 40 years to 25 years for high-ratio mortgages in particular, alongside rising prices worked to price out many first-time homebuyers that dominate activity in this price range[3]. The homeownership rate among Canadians aged 25-35 (first-time homebuyers) has fallen from 55% in 2012 to the current 50% (Chart 5). For those over the age of 35, the homeownership rate remained stable.

Chart 3

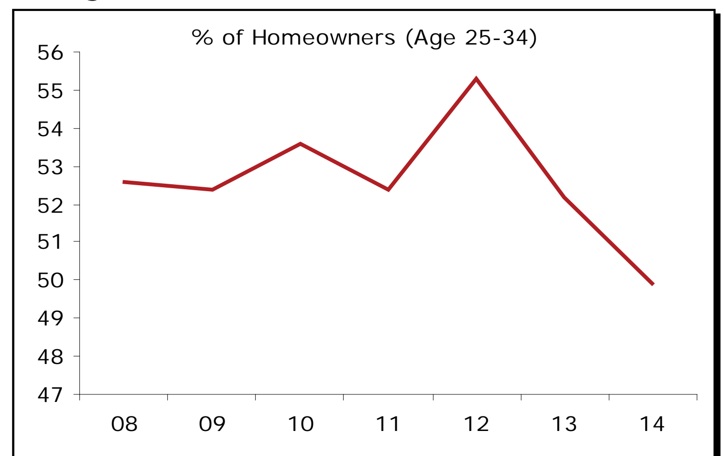
Stable Unit Sales (L) Mask Diverse Activity by Price Level (R)



Source: CIBC calculations based on CREA's unpublished tabulations

Chart 5

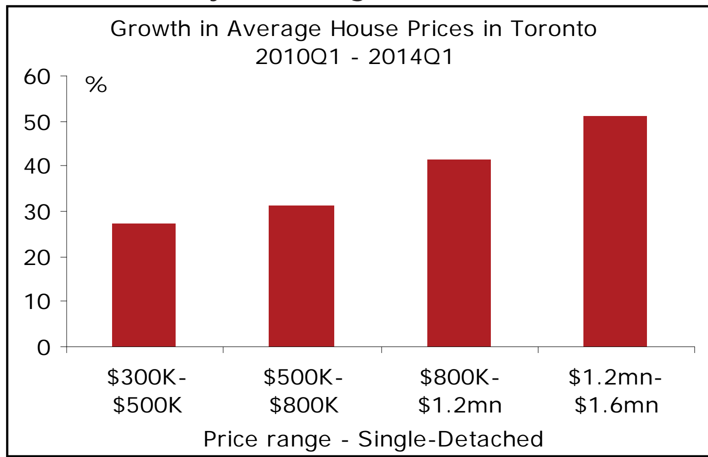
Lower Homeownership Rate Among Young Canadians



Source: Canadian Financial Monitor, CIBC

Chart 6

Toronto—Pricey is Getting Pricier



Source: CIBC calculations based on Brookfield's unpublished tabulations

Not Moving Up

That asymmetrical sales activity is evident in the price trajectory. Zooming in on the Toronto market (Chart 6), we can easily see that the more expensive the property is, the faster its price rises. That is, a household that owned a single-detached property valued at say $600K and would like to move up, would have to pay extra not only for the jump in category (say $900K) but also for the fact that the price of the move up property has risen faster than the price of their own property. In other words, regardless of what your starting point is, and by how much your property has appreciated, the desired move up target is getting further and further out of reach. Ditto for other cities such as Ottawa, Calgary and Edmonton where the move up category has risen notably faster than the start-up category.

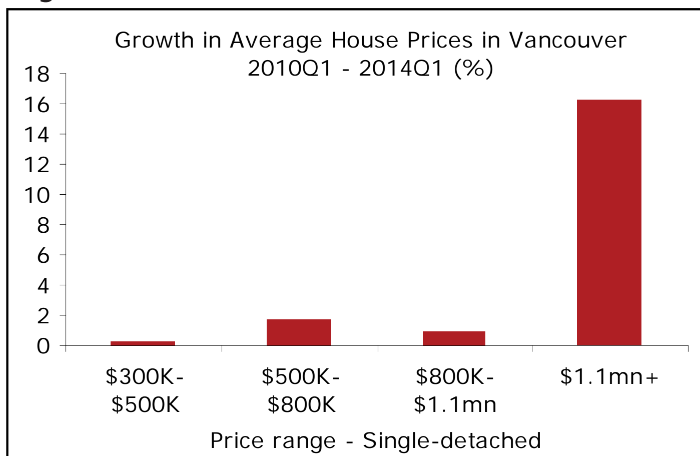
In Vancouver, almost all of the increase in the average price of single-detached units since 2010 was due to a run-up in the value of properties over the $1.1 million mark (Chart 7). However, given that the average price of single-detached units in the first-time homebuyer category is north of $1 million—upgrade options in the city are becoming even less affordable.

With limited move up options, it's no surprise then that many Canadians choose to renovate their existing homes. Over the past five years, spending on home renovations as a share of total residential investment averaged close to 46%—by far the largest share on record (Chart 8).

The picture that emerges is of a much more static market than perceived by many. Worsening affordability clearly hurts demand, mainly among first-time buyers, but the impact on the market is being offset by three powerful forces: the stabilizing role played by the condo market in major urban centres to provide a cheaper alternative to single-detached units and to accommodate the shift from ownership to rental activity; the significant constraints on land availability which works to limit the supply of new housing; and the asymmetrical nature of the price trajectory that works to distract and limit the natural flow of move up activity in the resale market. The only segment of the market where move up related supply factors are not at play is naturally the high-end portion, which is the only market that has seen the number of existing listings rise (Chart 9).

Chart 7

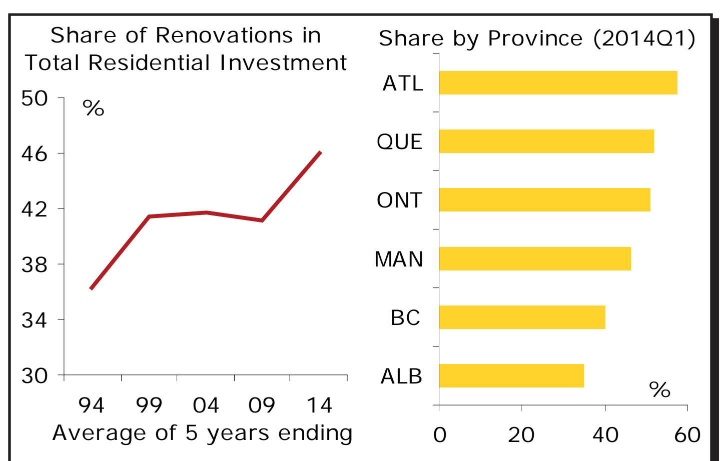
Vancouver—Most Price Activity is in the High-end Market



Source: CIBC calculations based on CREA's unpublished tabulations

Chart 8

Do It Yourself



Source: Statistics Canada, CIBC

Implications:

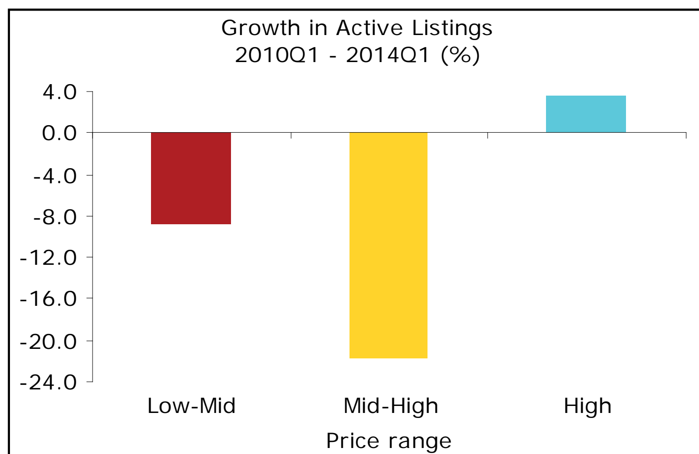
- For the market as a whole, downward pressure on prices are limited by supply factors in both new and existing markets.

- The static "move up" market in the single-detached space and its impact on supply will work to limit downward pressure on prices—mostly in the low and mid-range of the price spectrum. The higher-end segment of that market appears to be more vulnerable to price adjustments.

- Same goes for the condo market. Excess supply will challenge valuations in the market as a whole, and higher interest rates might lead to increased supply of units at the low-to-mid price range. This, however, would be partly offset by reduced sales by potential move up condo owners due to the significant widening in the price gap between single-detached and condo units. However, the high-end of the condo market is more vulnerable, in part, due to the fact that this segment of the market is not part of the stabilizing force played by the low-to-mid price range condo space.

Chart 9

Signs of Excess Supply at the Upper End of the Market



Source: CIBC calculations based on CREA's unpublished tabulations

- The supply restrictions in both the new and existing units along with affordability factors suggest that the homeownership rate in Canada at close to 70% is probably at its peak for the current cycle.

- Renovation activity will remain robust and, in fact, might accelerate in the coming years.

Note:

1) Naturally part of the decline in this category was due to a smaller stock of properties at the price range.

2) The aggregate measure is based on data for Vancouver, Toronto, Calgary, Edmonton and Ottawa. Each price range was adjusted to reflect the price spectrum in each city in the following way:

	Low-Mid	Mid-High	High
	$	$	$
Vancouver	<600K	600K - 1.1 mn	1.1 mn+
Toronto	<500K	500K - 1.1 mn	1.1 mn+
Calgary	<350K	350K - 600K	600K+
Edmonton	<300K	300K - 550K	550K+
Ottawa	<275K	275K - 525K	525K+

3) Other factors such as the Land Transfer Tax in Toronto also played a role here.

ECONOMIC UPDATE

CANADA	14Q2A	14Q3F	14Q4F	15Q1F	15Q2F	15Q3F	15Q4F	2013A	2014F	2015F	2016F
Real GDP Growth (AR)	3.1	3.2	1.9	2.8	3.1	2.7	2.0	2.0	2.3	2.7	2.3
Real Final Domestic Demand (AR)	3.0	2.2	1.6	1.6	2.3	1.9	2.1	1.4	1.4	2.0	1.8
All Items CPI Inflation (Y/Y)	2.2	2.0	2.3	2.2	1.8	2.2	2.5	0.9	2.0	2.1	2.3
Core CPI Ex Indirect Taxes (Y/Y)	1.7	1.8	2.0	2.0	2.0	2.1	2.4	1.2	1.7	2.1	2.0
Unemployment Rate (%)	7.0	7.0	6.9	6.7	6.6	6.7	6.6	7.1	7.0	6.7	6.6

U.S.	14Q2A	14Q3F	14Q4F	15Q1F	15Q2F	15Q3F	15Q4F	2013A	2014F	2015F	2016F
Real GDP Growth (AR)	4.2	3.0	3.1	2.8	2.8	2.7	2.3	2.2	2.1	2.9	2.4
Real Final Sales (AR)	2.8	3.4	3.2	2.8	2.9	3.0	2.5	2.2	2.1	3.0	2.5
All Items CPI Inflation (Y/Y)	2.1	2.0	2.6	2.4	1.9	2.1	2.2	1.5	2.0	2.1	2.2
Core CPI Inflation (Y/Y)	1.9	1.9	2.1	2.3	2.2	2.3	2.2	1.8	1.9	2.2	2.1
Unemployment Rate (%)	6.2	6.1	6.0	5.8	5.8	5.7	5.7	7.4	6.2	5.7	5.6

CANADA

Though employment continues to seriously disappoint, the economy appears to be expanding at a solid clip. Growth is poised to post two consecutive quarters of growth above 3%, with available data pointing to upside risks to our current 3.2% Q3 call. Canadians are, however, tapped out on credit, and having already dipped into savings, a moderation in consumer spending could temper Q4 growth. But Canada's exports are coming alive, with reasons to hope that related business investment is on its way. So with real growth of 2.7% in 2015, look for meaningful work to be done in pushing the unemployment rate beneath 7% by the end of next year.

UNITED STATES

The US economy appears to be maintaining much of the momentum built up in Q2 during the third quarter, despite a soft start for consumer spending and a weak August payrolls figure. Robust growth during the second half of this year is expected to carry on in 2015, driven by resurgent business investment and housing construction. Inflation has been tamer than expected recently, but could start to pick up again next year as growth rates around 3% start to work down the amount of slack in the economy.

This report is issued and approved for distribution by (a) in Canada, CIBC World Markets Inc., a member of the Investment Industry Regulatory Organization of Canada, the Toronto Stock Exchange, the TSX Venture Exchange and a Member of the Canadian Investor Protection Fund, (b) in the United Kingdom, CIBC World Markets plc, which is regulated by the Financial Services Authority, and (c) in Australia, CIBC Australia Limited, a member of the Australian Stock Exchange and regulated by the ASIC (collectively, "CIBC") and (d) in the United States either by (i) CIBC World Markets Inc. for distribution only to U.S. Major Institutional Investors ("MII") (as such term is defined in SEC Rule 15a-6) or (ii) CIBC World Markets Corp., a member of the Financial Industry Regulatory Authority. U.S. MIIs receiving this report from CIBC World Markets Inc. (the Canadian broker-dealer) are required to effect transactions (other than negotiating their terms) in securities discussed in the report through CIBC World Markets Corp. (the U.S. broker-dealer).

This report is provided, for informational purposes only, to institutional investor and retail clients of CIBC World Markets Inc. in Canada, and does not constitute an offer or solicitation to buy or sell any securities discussed herein in any jurisdiction where such offer or solicitation would be prohibited. This document and any of the products and information contained herein are not intended for the use of private investors in the United Kingdom. Such investors will not be able to enter into agreements or purchase products mentioned herein from CIBC World Markets plc. The comments and views expressed in this document are meant for the general interests of wholesale clients of CIBC Australia Limited.

This report does not take into account the investment objectives, financial situation or specific needs of any particular client of CIBC. Before making an investment decision on the basis of any information contained in this report, the recipient should consider whether such information is appropriate given the recipient's particular investment needs, objectives and financial circumstances. CIBC suggests that, prior to acting on any information contained herein, you contact one of our client advisers in your jurisdiction to discuss your particular circumstances. Since the levels and bases of taxation can change, any reference in this report to the impact of taxation should not be construed as offering tax advice; as with any transaction having potential tax implications, clients should consult with their own tax advisors. Past performance is not a guarantee of future results.

The information and any statistical data contained herein were obtained from sources that we believe to be reliable, but we do not represent that they are accurate or complete, and they should not be relied upon as such. All estimates and opinions expressed herein constitute judgments as of the date of this report and are subject to change without notice.

This report may provide addresses of, or contain hyperlinks to, Internet web sites. CIBC has not reviewed the linked Internet web site of any third party and takes no responsibility for the contents thereof. Each such address or hyperlink is provided solely for the recipient's convenience and information, and the content of linked third-party web sites is not in any way incorporated into this document. Recipients who choose to access such third-party web sites or follow such hyperlinks do so at their own risk.

© 2014 CIBC World Markets Inc. All rights reserved. Unauthorized use, distribution, duplication or disclosure without the prior written permission of CIBC World Markets Inc. is prohibited by law and may result in prosecution.