



CURRENT ANALYSIS

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Forecast in brief

Canada, % change

	2010f	2011f	2012f
Housing resales	-3.9	-0.2	0.3
Home prices*	8.3	0.5	1.3

*for a detached bungalow

Forecast assumptions

%, annual average

	2010	2011f	2012f
BoC overnight rate	0.7	1.6	3.1
5-year bond yield	2.4	3.1	3.8
Population growth (y/y)	1.2	1.1	1.1
Unemployment rate			
Canada	8.0	7.6	7.2
British Columbia	7.6	7.1	6.6
Alberta	6.5	5.6	5.3
Saskatchewan	5.2	5.0	4.7
Manitoba	5.3	5.0	4.9
Ontario	8.7	8.0	7.6
Quebec	7.9	7.8	7.6
Atlantic	10.5	10.4	9.8

Canadian home resale market outlook: moderation, moderation, moderation

After gyrating wildly since 2008, Canada's housing market is now expected to display greater stability going forward. The evolution in the past two years was shaped by truly exceptional events and factors: a global financial crisis, a major recession that destroyed nearly 430,000 jobs in Canada, cuts in policy interest rates to the lowest levels of our generation, the introduction of a harmonized sales tax (HST) in Ontario and British Columbia (and a rate increase in the HST in Nova Scotia), and two rounds of mortgage rule tightening. These phenomena generated similarly exceptional movements on the part of home buyers and sellers—from a mass exodus from the market in late 2008 to a crowded return into it in 2009, and then to a stepping back to the sidelines again in the first half of 2010. Since reaching their most recent lows this past summer, home resales have picked up again, although to levels that still remain well below recent peaks.

With the economy (both global and national) on a more solid footing now, the road ahead will be less bumpy. However, we may not be quite home-free yet. On January 17, Finance Minister Jim Flaherty announced a third round of mortgage rule tightening – which will, among other things, reduce from 35 to 30 years the amortization period permissible for government-back insured mortgages (see our commentary *Canada's mortgage rule to tighten* published January 17) – that is likely to generate some volatility in the coming months but on a much smaller scale than the wild swings of the last two years. In our opinion, the Canadian housing market is on path towards mostly flat levels of resale activity and minimal price increases this year and next. We assume that the upcoming mortgage rule changes (effective in March in the case of the shortening in the amortization period) will bring forward some sales that would have occurred later in the year and their overall impact on housing demand for the year, at the margin, will be negative.

Going forward, we see nearly perfectly offsetting forces driving Canada's housing market. On the upside, the economic recovery will gather strength in 2011 (real GDP is forecasted to accelerate to 3.2% from 2.9% in 2010) thereby continuing to boost employment and family incomes. On the downside, interest rates are expected to rise—with the Bank of Canada resuming its rate hiking campaign around spring time, adding 100 basis points to the overnight rate by the end of this year and a further 150 basis points next year—which will raise the cost of homeownership. The net effect of these forces is expected to be close to nil, thereby leaving resale activity largely flat. In this context, the upcoming changes to the mortgage rules, having a minimal negative effect overall, are likely to tip the scale toward a marginal decline in resale activity this year. We, therefore, project a small 0.2% decline in Canadian home resales in 2011 to 446,200 units following a more meaningful 3.9% drop to 447,000 units in 2010. Growth in resale activity is forecasted to turn slightly positive in 2012 (at 0.3% to 447,700 units).

After displaying tremendous volatility of its own since 2008, the sales-to-new listings ratio has returned to levels that are consistent with balanced conditions in the overall Canadian housing market. Such a balance is expected to persist in the period ahead. In our view, any moderation in demand will be matched by moderation in supply of similar magnitude. As a result, home prices are forecasted to rise very modestly at a rate of only 0.5% in 2011 (for the detached bungalow benchmark), compared with a strong increase of 8.3% in 2010 (although the gain entirely took place early in the year when the market was especially tight). The pace of increase is projected to pick up a little in 2012, accelerating to 1.3%.

Solid expected growth in resale activity in the Prairie Provinces will contrast with declines east of Manitoba. With Saskatchewan, Alberta and Manitoba leading economic growth (alongside Newfoundland and Labrador) among the provinces in 2011 according to our most recent *Provincial Outlook*, demand for housing will similarly outpace that of other provinces. In the case of Alberta, strong home resale growth this year will only partially reverse a substantial drop in 2010. In Ontario and Quebec, resale activity is projected to decline modestly in 2011 although this will reflect an unfavourable base effect in the year-over-year comparison arising from the market sizzle that prevailed in the early part of 2010. Relative to recent levels, 2011 is expected to be mostly flat in both provinces. In Atlantic Canada, slower than average economic growth projected for this year (except for Newfoundland and Labrador) will be insufficient to offset the negative effect of higher interest rates and reverse the declining trend in home resales of the last three years. A small increase, however, is forecasted in 2012. Finally, in British Columbia, poor affordability will significantly limit any upside to demand following last year's steep fall. Although home resales in 2010 were at levels last seen in 2001 (except for the deeply depressed tally in 2008 at the worst of the housing downturn), they are projected to increase only very modestly this year and next.

Home prices (on an annual average basis) are forecasted to rise in all provinces but at a very slow pace in most cases in 2011. Substantial gains in 2010 propelled property values to historically elevated levels across Canada, and with the balanced market conditions expected to prevail throughout this year, this will leave little room for any further significant increases being sustained in 2011. Price gains of 0.6% or less are projected for all provinces except Saskatchewan and Manitoba where increases of a little more than 2% are expected. The pace, however, will pick up modestly for the majority of provinces in 2012—led by Alberta—although the rate in Ontario will remain unchanged and diminish slightly in Quebec.

British Columbia

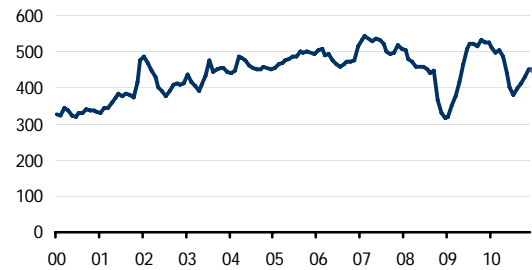
Sales – The B.C. resale market has been the most volatile in the country in the past two years. After nearly breaking record highs at the end of 2009, seasonally-adjusted resales slumped throughout spring and summer last year, hitting a trough mid-summer that, compared to performance of the last decade, exceeded only the deeply depressed levels of late-2008. Activity strengthened progressively during the fall but, at a little more than 73,000 units on an annualized basis in the fourth quarter of 2010, still remained well below the average of 99,000 units in the five-years prior to the housing downturn in 2008.

Although home resales are expected to increase further from recent levels, we believe that they will continue to be soft from a historical perspective. A key factor playing against the B.C. market in the period ahead will be very poor affordability. In the province's biggest market, Vancouver (accounting for 42% of provincial resales), sky-high property values have raised the bar to unreachable levels for a large number of households. These values will make demand for owned residential properties in the area, at current prices, heavily dependent on a constant inflow of wealthy foreign buyers.

Overall, in British Columbia, we forecast home resales to rise by only 1.1% to 75,400 units in 2011 followed by a 2.5% increase to 77,300 units in 2012.

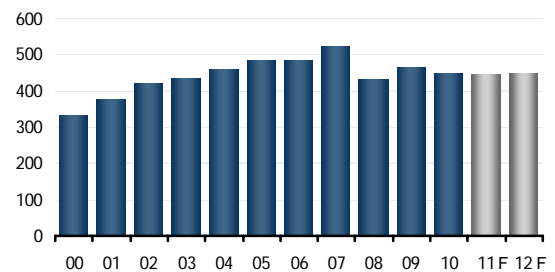
Canada home resales - monthly

Thousands, S.A., annualized



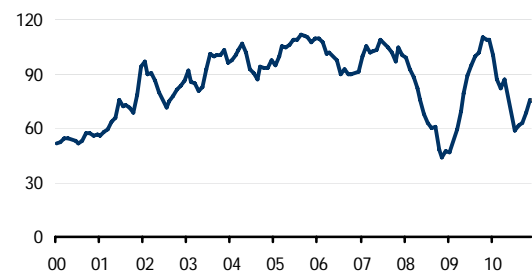
Canada home resales - annual

Thousands



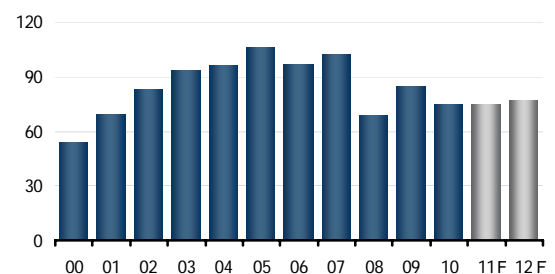
B. C. home resales - monthly

Thousands, S.A., annualized



B.C. home resales - annual

Thousands



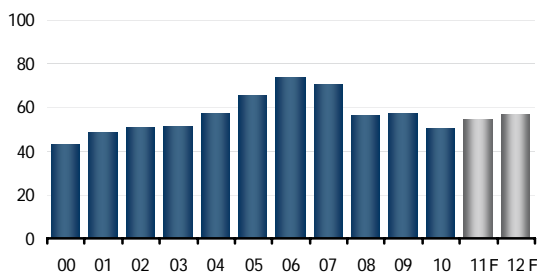
Alberta home resales - monthly

Thousands, S.A., annualized



Alberta home resales - annual

Thousands



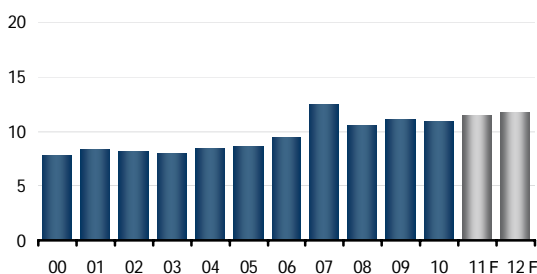
Saskatchewan home resales - monthly

Thousands, S.A., annualized



Saskatchewan home resales - annual

Thousands



Prices – Despite being the most-expensive market in Canada, home prices have generally continued to trend higher in the province. In 2010, the price of a typical detached bungalow rose by an estimated 12.1%, although the quarter-to-quarter pace eased considerably during the year. Further price increases, however, are likely to be minimal at best this year. Poor affordability will exert downward pressure, but a sustained balance between demand and supply will keep a floor under prices. All things considered, home prices (on an annual basis) are projected to be essentially flat in 2011, rising marginally by 0.2%, and then appreciate a little more rapidly by 2% in 2012. That being said, given the degree to which markets such as Vancouver are unaffordable, there is a material risk that prices could decline. In particular, any slowing in the pace of foreign buying would remove substantial support to the currently elevated prices.

Alberta

Sales – Resale market activity has picked up since summer 2010 in Alberta, but it still has some way to go before we can confidently declare it out of its lethargy. After showing signs of renewed vigour in 2009, home resales fell back to near decade-low levels mid-year 2010 (which were just modestly higher than those reached at bottom of the 2007–2008 market downturn). Demand has gradually strengthened in the past several months, thanks to a provincial economy that finally gained traction and stronger net migration (especially from abroad). Attractive affordability—Alberta’s market is among the more affordable in the country according to RBC’s Affordability Measures—also likely contributed. With growth in the Alberta economy expected to accelerate this year and the job market to improve more substantially, we believe that demand for housing will rise meaningfully in the province. We project resales to increase by a nation-leading rate of 9.5% to 54,400 units in 2011 and by a further 4.2% in 2012 to 56,700 units. While such gains would shake off the provincial market’s lethargy, they would still leave levels well short of the average of more than 72,000 units in 2006–2007 at the climax of Alberta’s housing boom.

Prices – The softening in market conditions during the spring and summer cut short any kind of upward momentum that home prices might have gathered following the meaningful tightening of supply relative to demand late in 2009. As a result, Alberta home prices moved mostly sideways in the past year, showing the smallest annual increase (3.1%) among the provinces in 2010. Although a rebound in the sales-to-new listings ratio in recent months indicates that market conditions have tightened a little, this development is unlikely to alter the directionless trend significantly in 2011. Our view is that neither sellers nor buyers will emerge with the upper hand, therein leaving prices little changed with a marginal gain of 0.2% projected for the year. A stronger increase of 4.2%, however, is forecasted for 2012.

Saskatchewan

Sales – Notwithstanding some softening at the end of 2010, the Saskatchewan resale market displayed solid forward momentum in the second half of 2010. This momentum reversed much of the slowing that took place in the previous year and re-established historically healthy levels. The market is benefiting from a rebound in economic growth in the province and, especially, continued strong migration inflows—including the largest net gains in international migration of the

last 60 years. Since 2008, Saskatchewan’s population has been growing at its fastest rate in 35 years. These positive fundamentals are expected to drive activity higher this year and next. We forecast resales in the province to rise by 5.5% to 11,500 units in 2011 and by 1.7% to 11,700 units in 2012.

Prices – After rising strongly when we entered 2010, home prices in Saskatchewan have since switched to a much more moderate pace, even showing small temporary declines on occasions. This slower trend is consistent with balanced conditions that emerged last year and which are expected to persist in the period ahead. Home prices in the province are forecasted to gain 2.3% in 2011 and 3.1% 2012, which would mark a notable deceleration from the estimated 6.0% appreciation in 2010; yet it would rank high in comparison to other provinces and the national average of only 0.5%.

Manitoba

Sales – Manitoba’s resale market went through a significant lull this past summer but rebounded impressively in the second half of 2010. In fact, sales of existing homes, on a seasonally-adjusted basis, returned very closely to historical peaks by December. Housing demand is being boosted by the strongest net international immigration in the province since the mid 1950s—which has handily outweighed continued net out-migration to other provinces. With Manitoba now boasting the lowest unemployment rate in Canada (as of the fourth quarter of 2010) and expected to continue to do so in 2011, firm demand for housing will be also sustained by improved job prospects. Home resales are forecasted to increase by 4.5% to 13,800 units this year and by 1.4% to 14,000 units next year. This result would be the highest level on record since the early 1980s.

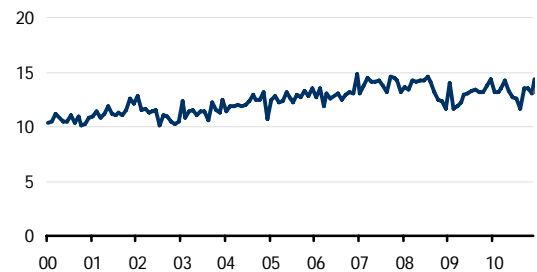
Prices – After surging by more than 10% in 2010, home prices are expected to post more moderate gains of 2.1% and 2.6% in 2011 and 2012, respectively; yet this would still rank among the stronger rates of appreciation in the country. Market conditions are likely to remain a little tight in the province—although much less so than they had been during the better part of the last decade—with the availability of home for sales somewhat lagging the increase in homebuyers. Also, home-ownership is generally affordable in Manitoba (the latest RBC Affordability Measures for the province were still slightly below their long-term average), and this, in our view, will attenuate resistance to property appreciation compared with other provinces.

Ontario

Sales – Tracking the evolution of the Ontario market in the past year has been complicated by the role played by special factors, such as the introduction of the HST in July that likely shifted activity around as 2010 unfolded. Nonetheless, we believe that the effect of those factors receded in the fall and that the market outcomes late in the year were a better reflection of underlying demand and supply. After plunging from record-high levels (on a seasonally-adjusted basis) last winter to their second-lowest point since the middle of 2002 by mid summer 2010, home resales in Ontario steadily regained ground in the fall. In the fourth quarter of 2010, seasonally-adjusted provincial resales strengthened to levels just a touch softer than their average from 2004 to 2006, which in our view is in line with the current economic, demographic

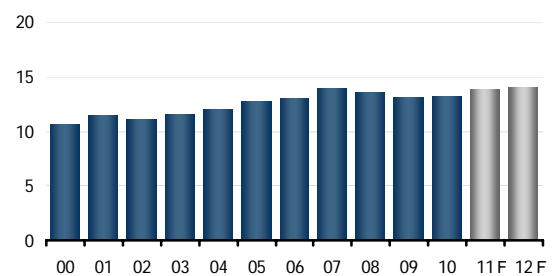
Manitoba home resales - monthly

Thousands, S.A., annualized



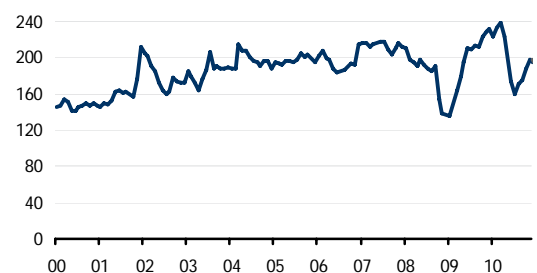
Manitoba home resales - annual

Thousands



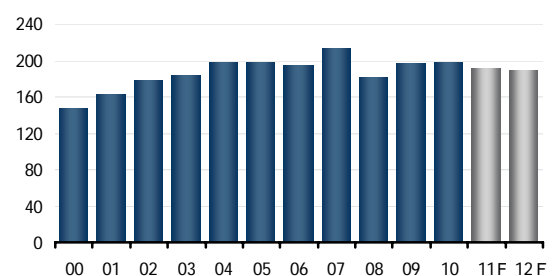
Ontario home resales - monthly

Thousands, S.A., annualized



Ontario home resales - annual

Thousands

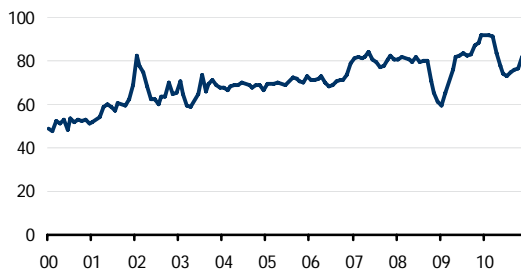


and market fundamentals—including slow but sustained improvement in Ontario’s labour market, a moderate pick-up in net immigration into the province and reasonable housing affordability overall (although segments of such markets as Toronto can be rather unaffordable for most buyers). Going forward, we expect resales to come under pressure later this year, when the upcoming mortgage rule changes will weigh on the province’s first-time homebuyers (who are more vulnerable to Ontario’s relatively high home prices than buyers in most other provinces). Overall, we project that 191,000 existing housing units will be sold in Ontario in 2011, a decline of 2.4% compared with 195,600 units in 2010. A further easing of 1.2% to 188,800 units is forecasted in 2012.

Prices – Reflecting the wide swings in demand during the past year, home prices displayed a fair degree of volatility in 2010—posting hefty gains at the start of the year, then falling a little during the spring and early summer before returning to a mild-upward trend in the closing months. Thanks to the earlier strength, however, the average for the year was up substantially by 7.7% relative to 2009, the strongest annual increase since 2002 in the province. With resale activity contracting modestly this year and next, we expect pricing momentum to slow considerably in the period ahead from last year’s pace. We forecast rises of only 0.5% in both 2011 and 2012. Being so close to the zero line will necessarily raise the risk of falling below it (a distinct possibility at the local market or market segment level); however, we believe that this risk will be mitigated by generally balanced market conditions. At the moment, market conditions in the province even appear a little tight following the rise in the sales-to-new listings ratio in the past several months.

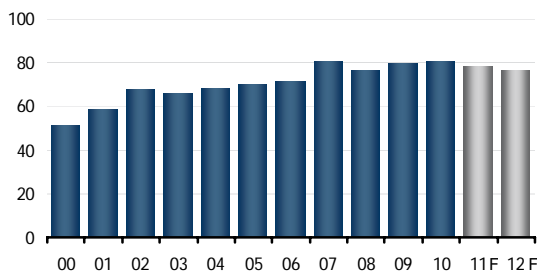
Quebec home resales - monthly

Thousands, S.A., annualized



Quebec home resales - annual

Thousands



Quebec

Sales – Looking through the monthly gyrations of the past two years, the Quebec home resale market managed to maintain a slight-upward trend in activity. It was, in fact, the only provincial market in Canada to show back-to-back full-year resale increases in 2009 and 2010. The likelihood of seeing this trend extended to 2011 is slim, however. We expect demand for housing to cool slightly in the province this year and next, in the face of higher forecasted interest rates and deteriorating affordability. Demand will also be weighed down, at the margin, by the changes to mortgage lending rules that will take effect this spring. These factors will more than offset the positive effect of rising net immigration into the province and an expected further strengthening in Quebec’s job market. Overall, we project Quebec home resales to decline by 2.9% to 78,100 units in 2011 and by 1.7% to 76,800 units in 2012.

Prices – Home prices in Quebec demonstrated tremendous resilience in the recent years’ turbulence. The upward trend barely missed a beat since 2008, and the average rate of increase during this period exceeded the national mark. Particularly tight market conditions in the latter part of 2009 and the start of 2010 even led, early last year, to the strongest percentage gains in property values in the province since 2004—the downside of which was an erosion of affordability. A drop in demand during the spring, however, greatly relaxed the tightness and set the stage for much more subdued price increases for the remainder of 2010 (small declines were also registered in some areas). Balanced market conditions are expected to continue to prevail this year and

next. Combined with affordability levels that are slightly worse than Quebec's historical norms, this, in our view, will contain any further price gains. We project home prices to rise by only 0.6% in 2011 and 0.2% in 2012—the weakest rates of appreciation since 1997.

Atlantic Canada

Sales – Atlantic Canada's housing market showed signs of softening in the closing months of 2010, therein reversing some of the gains registered in the summer and early fall. Resale activity ended last year on a weak note in New Brunswick, and Newfoundland and Labrador, although rebounds in Nova Scotia and Prince Edward Island provided some offset. The Atlantic region's market benefited from a mild strengthening in the job market in the early part of 2010, but this improvement stalled or slipped back late in the year (except for Newfoundland and Labrador). Perhaps more importantly for housing demand, migration flows have recently deteriorated in the region. All Atlantic Provinces experienced a net population outflow to other parts of Canada in the last few quarters. In the case of Newfoundland and Labrador, this outflow came in sharp contrast to strong migratory gains in 2009—while not as stark, similar reversals also took place in New Brunswick and Nova Scotia. We expect the economic recovery to continue in the region this year and next, and that this will support further moderate gains in employment and help stabilize the loss of population to other provinces. Nonetheless, these factors, this year, are unlikely to stem the declines completely in the region's home resales that have taken place in each of the last three years. We forecast a further fall of 2.2% to a total of 22,000 units in the four Atlantic Provinces in 2011. Resales, however, are projected to bounce back mildly by 0.9% in 2012 to 22,200 units.

Prices – The steady upward trend in home prices in Atlantic Canada in recent years has been supported by market conditions that often favoured sellers. The weakening of demand late last year, amid a plentiful supply of homes available for sale, however, sharply swung the pricing power pendulum closer to the buyers' side. This weaker demand significantly reduced price increases in the latter part of 2010 and even triggered outright declines in some markets. In our opinion, pricing power will be almost equally shared between buyers and sellers in the period ahead, thereby leaving limited room for home prices to rise. We project prices to gain just 0.4% overall in Atlantic Canada in 2011, followed by a 0.9% increase in 2012. It is important to note that this regional average could well mask absolute price declines in some areas. For instance, we find that current market conditions favouring buyers in Newfoundland and Labrador raise the spectre of a near-term drop in property prices in that province—although its strong medium-term economic prospects will likely limit the extent and duration of any lull.

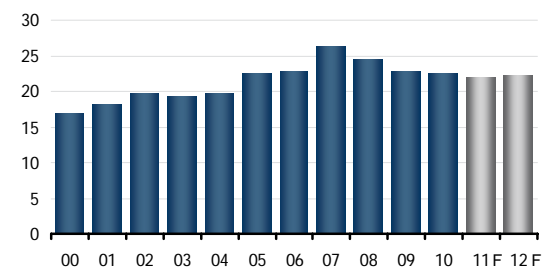
Atlantic home resales - monthly

Thousands, S.A., annualized



Atlantic home resales - annual

Thousands



Home resales forecast – units

	2007	2008	2009	2010	2011f	2012f
Canada*	521,100	431,800	465,100	447,000	446,200	447,700
	<i>7.9</i>	<i>-17.1</i>	<i>7.7</i>	<i>-3.9</i>	<i>-0.2</i>	<i>0.3</i>
British Columbia	102,800	68,900	85,000	74,600	75,400	77,300
	<i>6.3</i>	<i>-33.0</i>	<i>23.4</i>	<i>-12.2</i>	<i>1.1</i>	<i>2.5</i>
Alberta	71,000	56,000	57,500	49,700	54,400	56,700
	<i>-4.1</i>	<i>-21.1</i>	<i>2.7</i>	<i>-13.6</i>	<i>9.5</i>	<i>4.2</i>
Saskatchewan	12,500	10,500	11,100	10,900	11,500	11,700
	<i>31.6</i>	<i>-16.0</i>	<i>5.7</i>	<i>-1.8</i>	<i>5.5</i>	<i>1.7</i>
Manitoba	13,900	13,500	13,100	13,200	13,800	14,000
	<i>6.9</i>	<i>-2.9</i>	<i>-3.0</i>	<i>0.8</i>	<i>4.5</i>	<i>1.4</i>
Ontario	213,400	181,000	195,800	195,600	191,000	188,800
	<i>9.5</i>	<i>-15.2</i>	<i>8.2</i>	<i>-0.1</i>	<i>-2.4</i>	<i>-1.2</i>
Quebec	80,600	76,800	79,100	80,400	78,100	76,800
	<i>12.6</i>	<i>-4.7</i>	<i>3.0</i>	<i>1.6</i>	<i>-2.9</i>	<i>-1.7</i>
Atlantic Canada	26,300	24,500	22,800	22,500	22,000	22,200
	<i>14.8</i>	<i>-6.8</i>	<i>-6.9</i>	<i>-1.3</i>	<i>-2.2</i>	<i>0.9</i>

* Includes sales in the Territories.

Annual percent changes are in italics.

Source: Canadian Real Estate Association, RBC Economics Research

Home price forecast – annual average value of a detached bungalow

	2007	2008	2009	2010f	2011f	2012f
Canada*	289,800	304,000	301,400	326,500	328,200	332,500
	<i>11.5</i>	<i>4.9</i>	<i>-0.9</i>	<i>8.3</i>	<i>0.5</i>	<i>1.3</i>
British Columbia	475,700	508,400	495,100	554,800	555,400	566,600
	<i>11.8</i>	<i>6.9</i>	<i>-2.6</i>	<i>12.1</i>	<i>0.1</i>	<i>2.0</i>
Alberta	376,200	354,100	330,200	340,500	341,200	355,400
	<i>30.4</i>	<i>-5.9</i>	<i>-6.7</i>	<i>3.1</i>	<i>0.2</i>	<i>4.2</i>
Saskatchewan	239,600	298,700	293,200	310,800	317,900	327,700
	<i>45.8</i>	<i>24.7</i>	<i>-1.8</i>	<i>6.0</i>	<i>2.3</i>	<i>3.1</i>
Manitoba	201,600	217,200	227,000	249,900	255,200	261,900
	<i>7.6</i>	<i>7.7</i>	<i>4.5</i>	<i>10.1</i>	<i>2.1</i>	<i>2.6</i>
Ontario	301,600	317,700	314,400	338,700	340,400	342,000
	<i>6.6</i>	<i>5.3</i>	<i>-1.0</i>	<i>7.7</i>	<i>0.5</i>	<i>0.5</i>
Quebec	183,400	193,200	201,200	220,200	221,600	222,000
	<i>6.3</i>	<i>5.3</i>	<i>4.1</i>	<i>9.4</i>	<i>0.6</i>	<i>0.2</i>
Atlantic Canada	167,300	179,900	188,100	196,100	196,900	198,600
	<i>9.8</i>	<i>7.5</i>	<i>4.6</i>	<i>4.3</i>	<i>0.4</i>	<i>0.9</i>

* Weighted average, using provincial population as weights.

Annual percent changes are in italics.

Source: Royal LePage, RBC Economics Research

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