

# Toronto Employment and Housing Outlook

## Fourth Quarter 2007

**Synopsis: I've dropped my forecasts, partly due to the recent rise in the dollar and commodity costs, but also because recent data is showing deterioration in the local economic situation. Economic and housing market prospects are better in many other areas of Canada, which are less affected by the strong dollar and high prices for raw materials (including oil). I still expect a large downward adjustment for condo apartments, but it probably won't start until mid-2008.**

### Is this the Tipping Point?

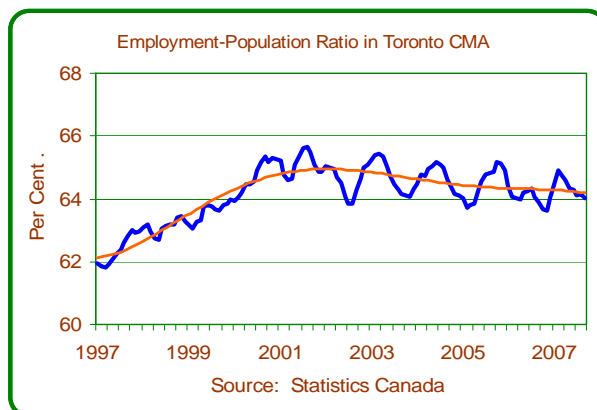
Two main themes have been developed in past issues of TEHO and Housing Market Digest.

One theme is that the world economy is very strong - on the verge of "re-inflation" - and that some deceleration is in order. The process could involve higher interest rates, downward adjustments of values for financial and real estate assets (to reduce the wealth effects that are driving the show), rising commodity prices, changes in exchange rates, or some combination of these factors. Correspondingly, I've made some pessimistic assumptions about these factors. The question now is whether the US economic slowdown will generate a world-wide slowing.

The other major theme is that in the mix of economic influences, the biggest negative factors at present are the strong Canadian dollar and high commodity prices, and that the GTA is more affected by these than most other areas of Canada. This has caused GTA employment to rise less rapidly than its population, causing (1) the employment-to-population ratio to fall and (2) bringing a slowdown of population growth, as fewer people move into the GTA.

As can be seen in the next chart, while the reported data for the employment-to-population ratio in Toronto CMA is highly volatile (which is the consequence of generating data by a sample survey), the ratio has been trending downwards.

Until very recently it had appeared that the positive influences in the GTA (wealth effects from housing and the stock market plus still-low interest rates) more-or-less offset the negative factors (and maybe even exceeded the negative factors for the short-term). This resulted in forecasts of continued moderate strength in the economy and housing market. Recent data, including the continued surge of the dollar and commodity prices, combined with the past few months of weakening data for Toronto employment, are now suggesting that the balance has tipped to the negative.



The result is that this issue of TEHO is introducing – rather suddenly – a more negative view of the housing market outlook for the GTA. I need to emphasize two points:

- This change of opinion is based in large part on the recent negative data for employment – and as I've said many times, the data might be wrong. This current data – if it's right – suggests that the negative factors are now outweighing the positive, indicating that there is further weakness ahead. I think the current employment data is probably not bad, but if we now get three months showing stronger employment growth, the next round of forecasts could very well move up again.
- The second point is to repeat that the GTA has one of the weakest economic outlooks in Canada – there are better economic and market prospects elsewhere in Canada.

A further issue that has influenced my current thinking is that during the past few years, job creation in the Toronto area may have been weaker than the data has indicated. The explanation is a bit technical:

- Statistics Canada uses a sample survey to generate its employment data for Toronto CMA (and elsewhere). The survey produces estimates in percentages – the per cent of people who are employed, etc. These percentages are combined with estimates of

the size of the adult population to come up with numbers (the number of people employed and the growth thereof, etc.).

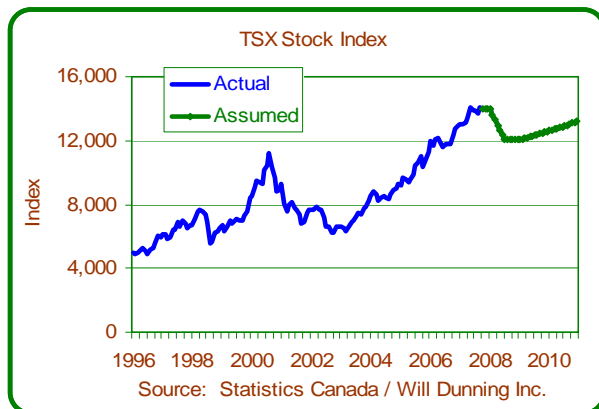
- If the population estimates are off, so are the employment numbers.
- 2006 Census data shows that the adult population of Toronto CMA grew by an average rate of 2.0% per year during May 2001 to May 2006, but the Labour Force Survey (“LFS”) had assumed a growth rate of 2.4% per year.
- The consequence is that employment estimates were probably over-estimated by a similar magnitude (for 2001 to 2006). While the LFS showed average job growth of 2.1% per year for Toronto CMA, it may be that actual growth was more like 1.7%, and the average annual rate of job creation might have been 45,000 per year, versus the published estimates of 54,000 per year.
- The implication is that during 2001 to 2006 the Toronto CMA economy was weaker than has been thought.
- Unfortunately, Statistics Canada won’t be publishing its “post-Censal” revisions of employment growth until early in 2010.

In this issue I am developing one scenario. It assumes that the evolving US economic slowdown will reduce the upward pressure on interest rates and commodity prices. The combination of events would cause a stock market correction.

### Economic Assumptions

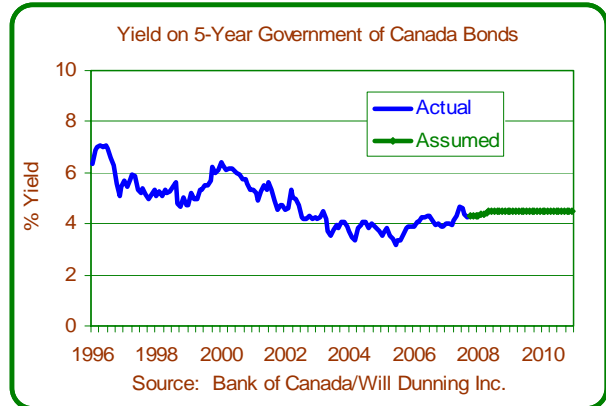
I use five key variables to forecast employment growth (plus mortgage rates in the housing forecasts).

The TSX stock index is assumed to be flat until the end of this year, then drop by about 15% during the first half of 2008. Modest increases resume at mid-year and continue during 2009 and 2010.

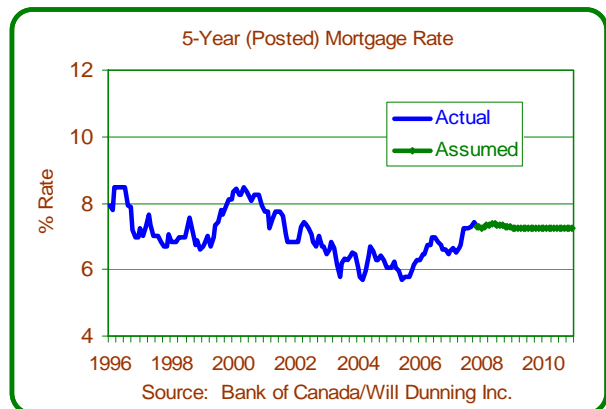


Bond yields (5 year Government of Canada) are assumed to stay at current levels (about 4.30%)

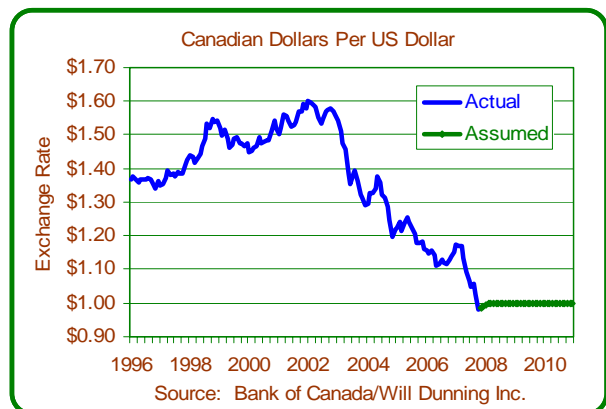
until year end and then rise to 4.5% by mid 2008. The yield stays at that level until the end of 2010.



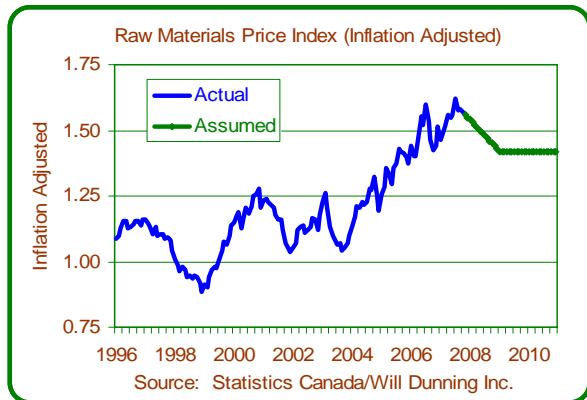
Similarly, the 5-year mortgage rate (posted) does not vary much from the current level.



The Canadian dollar is assumed to average “par” with the US dollar. With the dollar currently about \$1.03 US, this assumes that the Canadian dollar has over-shot, and would settle back a few cents in the coming months. The very large move in the dollar that happened during the spring and summer is the main cause of the downward revisions that have been made to the forecasts.



Prices of raw materials have continued to rise. The assumption is that (after adjustment for inflation) they will soon reverse direction, erasing about one-half of the increase that has happened during the past three years.



Wealth creation through rising house prices is a very positive factor at present, as the average annual increase was 7.5% per year during 2001 to 2005. The rate slowed to 4.6% in 2006 but is projected to exceed to 6.0% this year. The forecast indicates that price growth should slow further, to 3% in 2008, and that values may be flat or falling in 2009 and 2010. The economic stimulus from housing wealth should diminish during 2009 and 2010.

### The Employment Forecasts

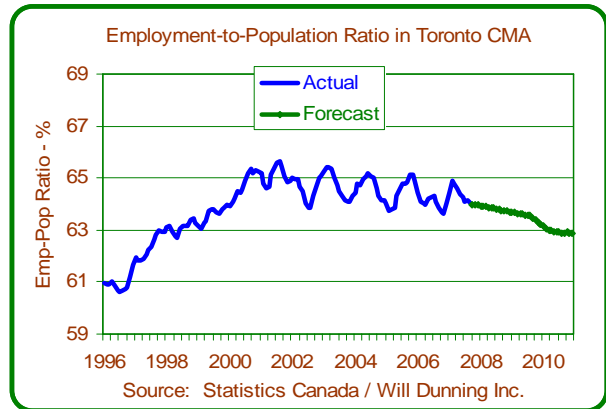
The following chart shows the forecast employment rate for Toronto CMA. This next bit might not make any sense to you.

- My technical analysis suggests that the employment rate should climb during the coming year, which would be the consequence of recent wealth generation in the stock market and housing market.
- However, as noted, the very recent data shows that employment has weakened – the technical analysis isn't yet able to deal with that recent shift.
- Therefore, I am assuming that my own model is wrong, and I've adjusted the forecast.

The modeling does say that - eventually - the negative factors will outweigh the positive and the employment rate will start to fall by 2009. During 2010, the employment rate would drop to about 63%, lower than has been seen so far this decade (to the lowest level since 1998). It would still be slightly higher than the average for the 1990s (62.5%). The consequence of a falling employment rate would be that job creation (measured in thousands) would be quite low during 2008 to 2010.

The prior forecast showed an expansion of employment during the coming year, followed by a drop in the employment rate for 2009 and 2010. This revised forecast represents a large shift in expectations for the short-term economic outlook.

Since job growth affects the housing market with a lag, there are negative implications for the housing market for 2009 and 2010.

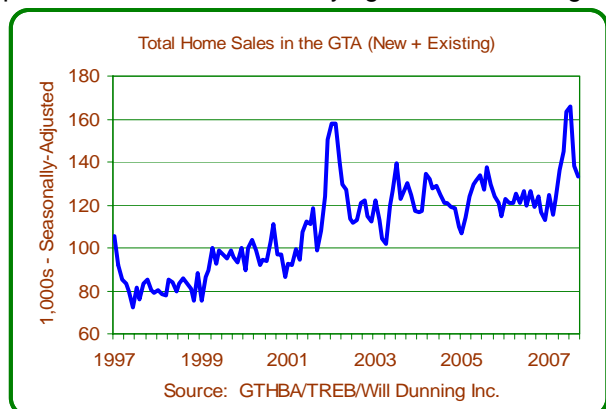


Year	Employment Rate	Level of Employment (1,000s)	Growth of Employment (1,000s)
2004	64.7	2,707	58.7
2005	64.5	2,763	56.1
2006	64.0	2,801	37.9
2007	64.3	2,861	59.5
2008	63.8	2,890	29.4
2009	63.5	2,926	35.7
2010	62.9	2,951	25.3

Source: Will Dunning Inc.

### Housing Market Overview

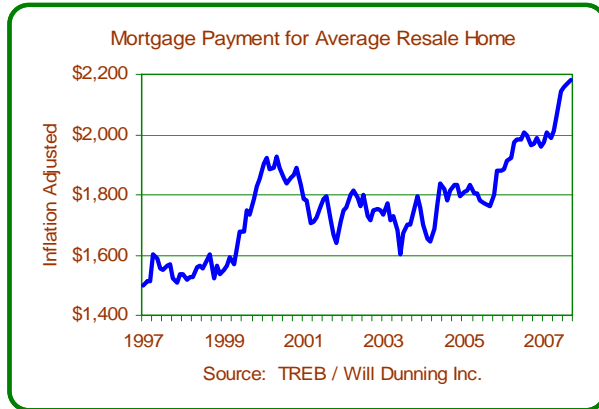
Total housing activity (total sales of resale and new homes) spiked for three months but has fallen back during the last two months. It appears that the spike was the consequence of rising interest rates, which caused consumers to accelerate their purchases. That wave of buying is now subsiding.



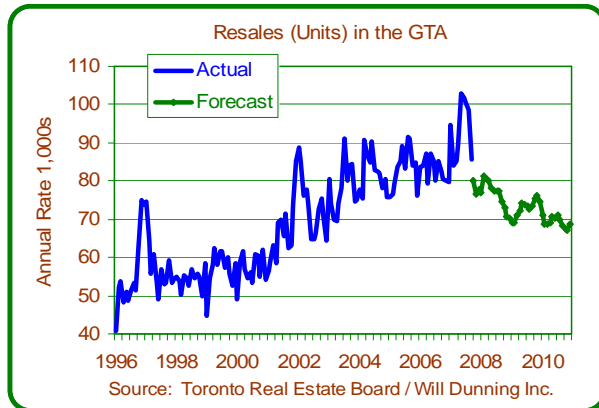
### Resale Market

Housing affordability continues to deteriorate, through the combination of slightly higher interest rates and rapidly rising prices. The mortgage

interest cost for an average-priced resale (after adjustment for inflation) is now 10% higher than it was a year ago, and 25% higher than the average for 2001 to 2004. However, affordability is a minor factor in the market outlook – the big issue is job creation.



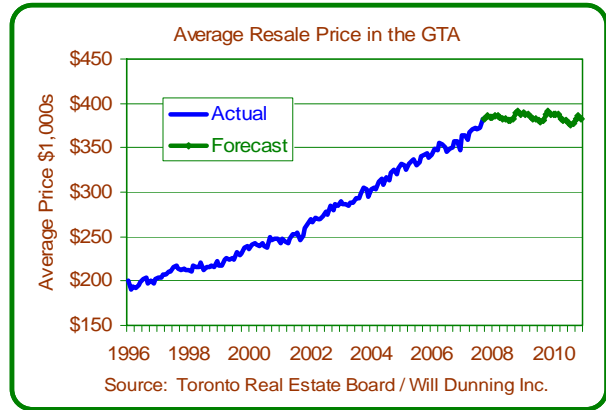
The housing demand spike that happened earlier this year was concentrated mainly in the resale sector, and as can be seen in below, the subsequent slowing has likewise been mainly for resales. The forecast suggests that there is a further drop coming, as the consequence of the evolving slowdown of job creation, the small impact of reduced affordability, and also as a payback for above-trend sales in the recent past. After setting a huge record this year, resale activity could drop by as much as 15% in 2008.



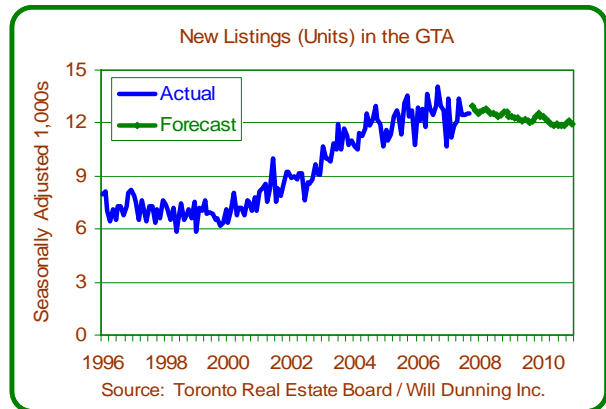
As for prices, the rate of increase has accelerated. The average price for this year will be 6-7% higher than in 2006. With sales already slowing, and with a further slowing forecast for next year, price growth should decelerate. For 2008, the average price is expected to rise by 3% - above the overall inflation rate, but markedly less than has been seen over the past decade. For 2009 and 2010, the forecast shows little change in the average price, meaning that prices are expected to fall "in real terms".

But, price growth has exceeded expectations for several years now, and therefore price growth

could be stronger than expected. However, in the past, there have been "bullish" expectations in the housing market, which caused price growth to exceed what might be justified technically. It is highly possible that during the next year expectations will become less bullish, which could reduce the upward pressure on prices.



Resale supply (new listings) expanded during 2005 and 2006. With reduced buying interest, the volume of listings would drop gradually during the forecast period.



The resale market forecast is shown below. Compared to the prior issue of TEHO, forecasts for sales and price growth have been raised for 2007 and 2008, but reduced for 2009 and 2010.

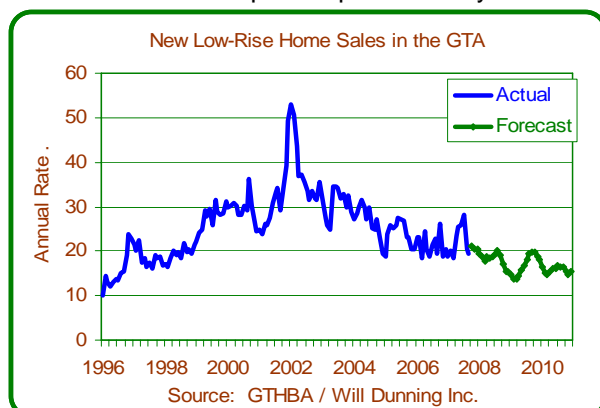
<b>Forecasts for GTA Resale Market Activity</b>			
Year	Sales (Units)	Average Price	Price Change
<b>Base Scenario</b>			
2004	84,887	\$315,278	7.6%
2005	85,710	\$336,190	6.6%
2006	84,859	\$352,416	4.8%
2007	92,212	\$374,619	6.3%
2008	78,644	\$386,271	3.1%
2009	74,630	\$385,911	-0.1%
2010	70,995	\$383,661	-0.6%

Source: Will Dunning Inc.

## New Homes Market

Activity has also turned up in the new homes market.

During the past year the trend for low-rise sales has stabilized. There was a short-lived increase that coincided with the spike in the resale market. Unlike the resale market, which increased to all-time records, sales of new low-rise homes remain well below levels seen earlier in this decade. The forecast suggests that the recent period of (relative) stability for low-rise sales is now coming to an end and there would be gradual reductions each year during 2008 to 2010, as slower job creation reduces the pool of potential buyers.



In a world of its own, the high-rise sector continues to surge. I've been expecting (wrongly) a downturn for years now. I still believe that as large numbers of investor-purchased units become available for occupancy, a shortfall of rental demand will lead to sell-offs, price adjustments, and eventually a sharp drop in sales, as other potential investors catch on to the changed market environment. This process will require at least 6 months after there are large volumes ready for occupancy. With completions starting to ramp-up now, this means that the market correction would begin around the middle of next year.



The table below summarizes sales forecasts for new low-rise, high-rise and total new home sales.

The forecast suggests that sales may drop by one-quarter in 2008 (with a larger drop for high-rise and a smaller drop for low-rise).

Compared to the prior issue of TEHO, the forecasts have been raised for 2007 and 2008 (slightly) and dropped (sharply) for 2009 and 2010.

Year	Low-Rise	High-Rise	Total
2004	27,689	13,600	41,289
2005	24,504	17,704	42,208
2006	21,781	17,579	39,360
2007	22,032	22,525	44,557
2008	18,634	14,879	33,512
2009	17,020	9,427	26,448
2010	15,953	8,737	24,690

Source: Will Dunning Inc.

## Housing Starts

Housing starts have been quite low so far in 2007 (about 33,000 at an annual rate). Since late last year, starts have been well below the levels that should be occurring based on reported sales. The forecast indicates that the rate of starts should soon pick up.

During 2008, there should be a very high volume of starts for high-rises, followed by a sharp reduction during 2009 and 2010. For low-rises, gradual erosion is expected. Based on actual and projected sales of new homes, the following table provides housing starts forecasts for the Toronto CMA.

Year	Low-Rise Ownership	High-Rise Ownership	Rentals	Total
2004	28,424	12,450	1,241	42,115
2005	25,569	14,184	1,843	41,596
2006	22,181	13,338	1,561	37,080
2007	23,784	10,461	1,257	35,503
2008	20,676	19,681	1,268	41,625
2009	18,157	13,879	1,179	33,215
2010	18,383	8,302	1,131	27,816

Source: Will Dunning Inc.

## **Conclusion**

For some time, I've been describing the GTA as on a knife edge – it has seemed that the positive and negative effects were roughly in balance. My judgment of that balance has tipped to the negative. This is the result of further strength of the dollar and rising oil prices. It also is influenced by recent data that says the GTA economy is slowing.

I've said many times that people don't get jobs and immediately buy homes. A corollary is that when the rate of job creation changes (for better or worse) the housing market doesn't immediately follow.

The consequence is that we should expect housing demand to erode gradually during 2008 to 2010. Let's emphasize "gradually".

Could the housing market suddenly hit a wall? It's possible, but that would require a much bigger negative shock than I'm expecting.

## **How to Reach Will Dunning Inc.**

Telephone: 416-236-5115  
Email: [wdunning@sympatico.ca](mailto:wdunning@sympatico.ca)  
Web site: [www.wdunning.com](http://www.wdunning.com)

## **Disclaimer of Liability**

This report has been compiled using data and sources that are believed to be reliable. Will Dunning Inc. accepts no liability for any data or conclusions contained herein.

## **Copyright: Will Dunning Inc. 2007**

This report has been provided to the subscriber for its exclusive internal use and may not be reproduced or redistributed in any form without the written consent of Will Dunning Inc.

<b>Forecast Summary – 2007-Q4</b>											
	<i>Employment</i>		<i>Resale Market</i>		<i>New Homes Market</i>			<i>Housing Starts</i>			
Annual	(1,000s)	Emp:Pop Ratio	Sales	Average Price	Low-Rise	High-Rise	Total New Home Sales	Low-Rise Home Ownership	High-Rise Home Ownership	Rentals	Total Housing Starts
1996	2,128	61.0	55,779	\$198,150	15,525	4,986	20,511	15,768	2,302	146	18,216
1997	2,224	62.5	58,014	\$211,306	18,985	7,811	26,796	22,382	2,940	252	25,574
1998	2,290	63.1	55,344	\$216,814	19,525	8,495	28,020	21,272	4,463	175	25,910
1999	2,355	63.7	58,957	\$228,372	27,848	9,149	36,997	26,181	8,270	453	34,904
2000	2,455	64.9	58,349	\$243,255	30,040	11,052	41,092	28,726	9,981	275	38,982
2001	2,538	65.1	67,612	\$251,508	31,233	11,025	42,258	27,323	12,738	879	40,940
2002	2,591	64.6	74,759	\$275,371	38,534	15,791	54,325	33,212	9,081	1,368	43,661
2003	2,649	64.7	78,898	\$293,067	30,931	12,234	43,165	30,005	13,487	1,983	45,475
2004	2,707	64.7	84,887	\$315,278	27,689	13,600	41,289	28,424	12,450	1,241	42,115
2005	2,763	64.5	85,710	\$336,190	24,504	17,704	42,208	25,569	14,184	1,843	41,596
2006	2,801	64.0	84,859	\$352,416	21,781	17,579	39,360	22,181	13,338	1,561	37,080
2007	2,861	64.3	92,212	\$374,619	22,032	22,525	44,557	23,784	10,461	1,257	35,503
2008	2,890	63.8	78,644	\$386,271	18,634	14,879	33,512	20,676	19,681	1,268	41,625
2009	2,926	63.5	74,630	\$385,911	17,020	9,427	26,448	18,157	13,879	1,179	33,215
2010	2,951	62.9	70,995	\$383,661	15,953	8,737	24,690	18,383	8,302	1,131	27,816
<i>% Change</i>											
2007	2.1%	0.3%	8.7%	6.3%	1.2%	28.14%	13.2%	7.2%	-21.6%	-19.5%	-4.3%
2008	1.0%	-0.7%	-14.7%	3.1%	-15.4%	-33.9%	-24.8%	-13.1%	88.1%	0.8%	17.2%
2009	1.2%	-0.5%	-5.1%	-0.1%	-8.7%	-36.6%	-21.1%	-12.2%	-29.5%	-7.0%	-20.2%
2010	0.9%	-0.9%	-4.9%	-0.6%	-6.3%	-7.3%	-6.6%	1.2%	-40.2%	-4.1%	-16.3%

Source: Will Dunning Inc.