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Canada's housing sector stalling

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By Cameron French

TORONTO (Reuters) - Canada's housing sector, for the last few years a key pillar of the economy, is finally starting to show real cracks, suggesting further economic weakness that some say could factor heavily into the Bank of Canada's rate-setting timetable.

The strength of Canada's real estate market has contrasted sharply with the past run-up in U.S. prices, and thus any downturn is also expected to be shy of the steep slowdown in the United States.

But after seven straight interest rate hikes by the Bank of Canada -- between Sept 2005 and this past May -- higher mortgage costs and job losses in provinces that rely heavily on hard-hit manufacturing industries are finally eating into housing demand.

"I think the numbers we have been seeing suggest that clearly the party is over," said Benjamin Tal, senior economist CIBC World Markets.

While the pace of overall housing starts has remained strong, data for November shows that new construction is beginning to tilt heavily away from higher-priced single family homes to lower-cost multiples, such as condominiums.

At the same time, a report on Monday showed new home prices rose in October at the slowest monthly pace since July 2005, suggesting, if not outright weakness, then at least the frothiness is starting to abate.

In Calgary, the center of Canada's oil patch and the market that has most closely resembled the runaway prices seen in the United States, prices actually declined month-on-month, suggesting less western-based strength to offset the weaker markets in central and eastern Canada.

"You've got Alberta's (economy) probably slowing off the heated pace we've seen, so less employment growth, and less migration into that province," BMO Nesbitt Burns economist Bart Melek said.

In the Ontario and Quebec, home to about 60 percent of the country's population, and its industrial heartland, starts have been flagging, as the stronger Canadian dollar has ravaged the manufacturing sector.

BANK OF CANADA PAYING ATTENTION

The trend will be closely watched by the Bank of Canada, which has repeatedly noted the upside economic potential of the housing sector as a balance to the downside risks of a sagging export sector in forecasting growth and inflation.

Bank of Canada Governor David Dodge said this week that overall growth will be weaker than expected in the fourth quarter, and possibly in the first quarter of next year.

Analysts note housing weakness hits the economy in one area that has been a strong of late -- consumer spending -- as easing or flattening home prices curb household wealth.

"I think that the slowing housing market, to the extent that it's leveling off, might slow the consumer more than people expect, and therefore will speed up the process of cutting rates," said Tal.

The central bank has left rates unchanged since May, and economists are now debating when they will come off the sidelines. Most expect a rate cut near the midpoint of next year, but any unexpected weakness could speed up that timetable.

"I think the effects are that you're going to see some drag, and that there's going to be some association in weaker demand in the real estate sector for other areas of the economy," said HSBC Canada strategist Stewart Hall.

However, analysts note that any weakness will not act as a brake on the economy in the same way as in the U.S. market, where sales of existing homes are expected to be down 8.6 percent this year.

Just as the pace of growth has not been as strong in Canada as in the United States, the weakening of demand will not be as severe.

"It's not going to provide the boost that it has in the past, but certainty this is what we should have been looking for," said Hall.

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