

Recent Financial and Economic Developments and B.C.'s Economic Outlook

B.C. Expropriation Association 2007 Fall Seminar

Friday, October 26, 2007

Helmut Pastrick
Chief Economist
Credit Union Central of British Columbia



Outline

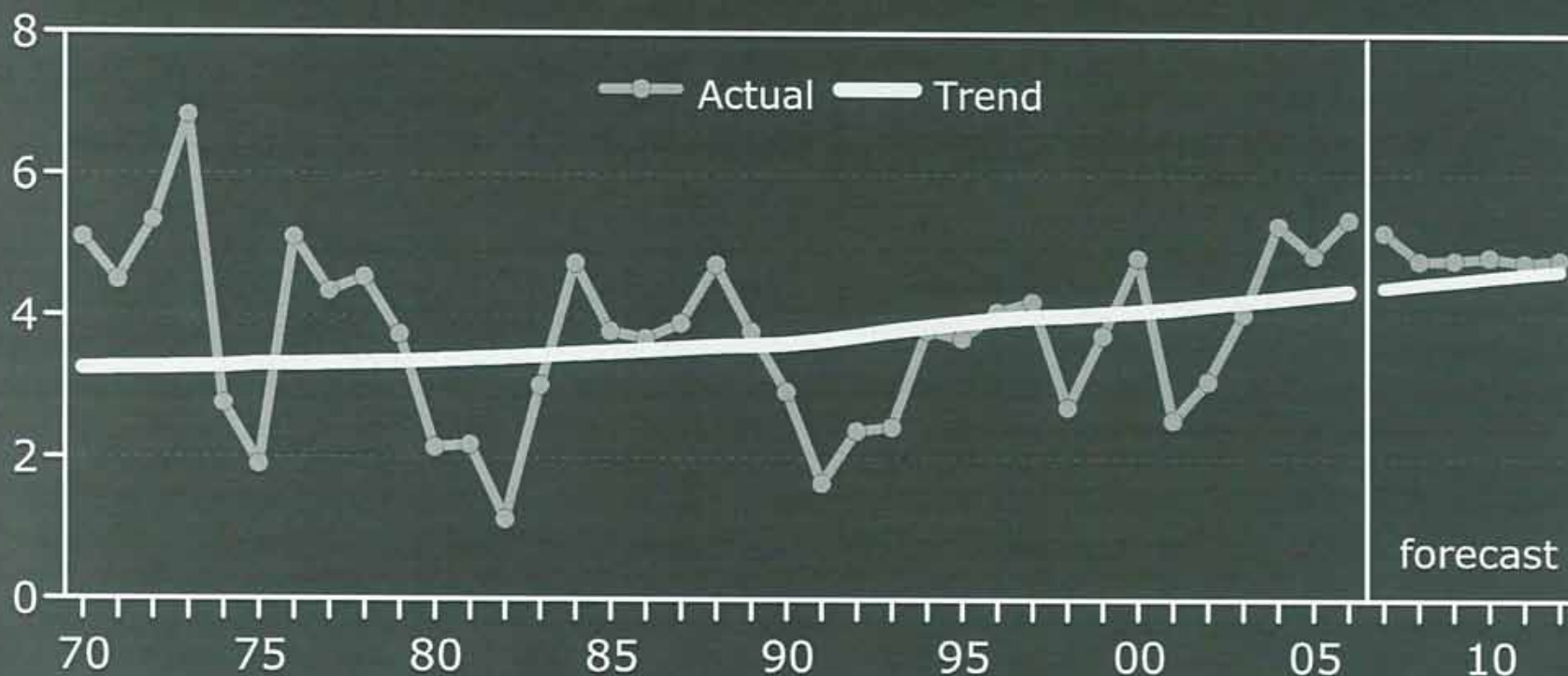
- U.S. housing and economy
- ABCP in Canada and Canadian currency
- Outlook for interest rates and currency
- B.C. economic outlook
- Summary



High growth expected next five years

World Real GDP Growth

Per cent



Source: International Monetary Fund.

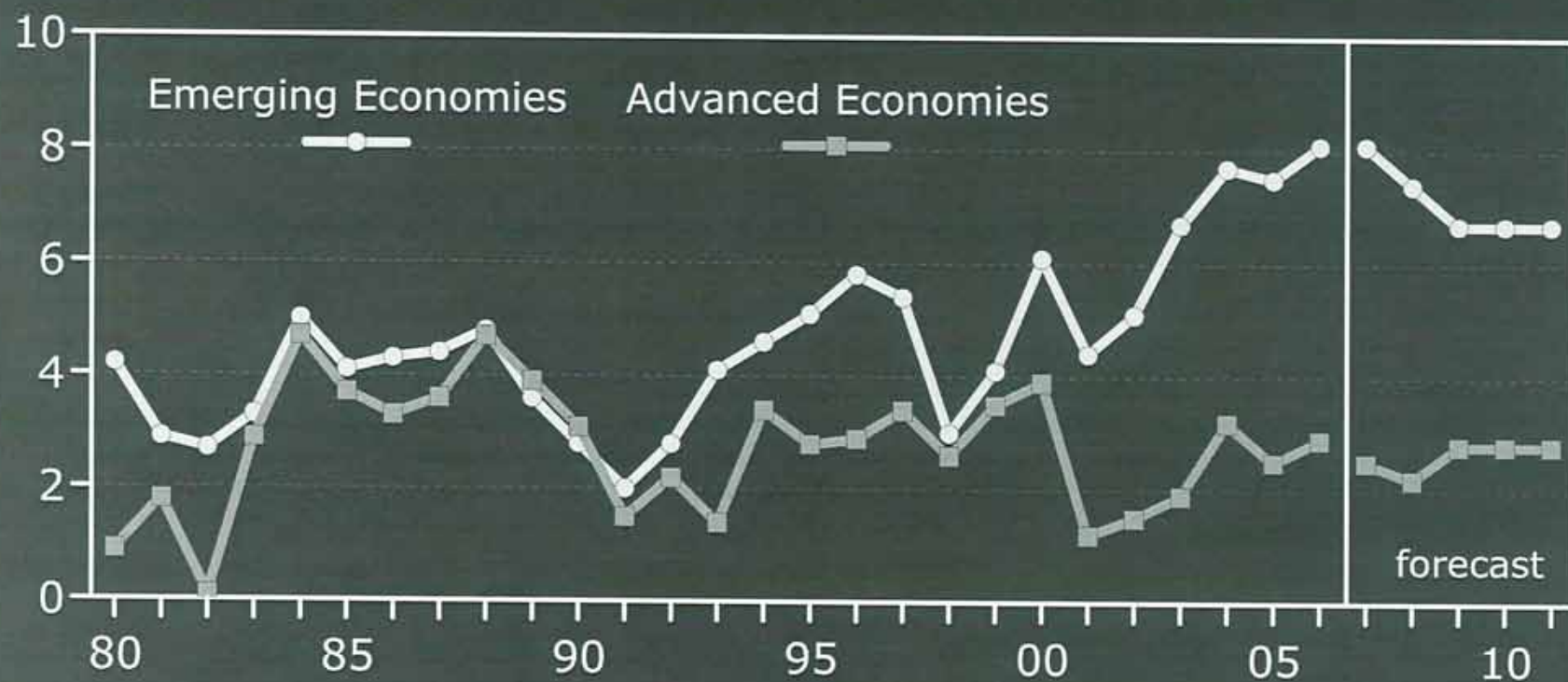
Forecast period: 2007 to 2012.



Faster growth in emerging economies

Economic Growth by Country Grouping

Per cent



Source: International Monetary Fund.

Forecast period: 2007 to 2012.



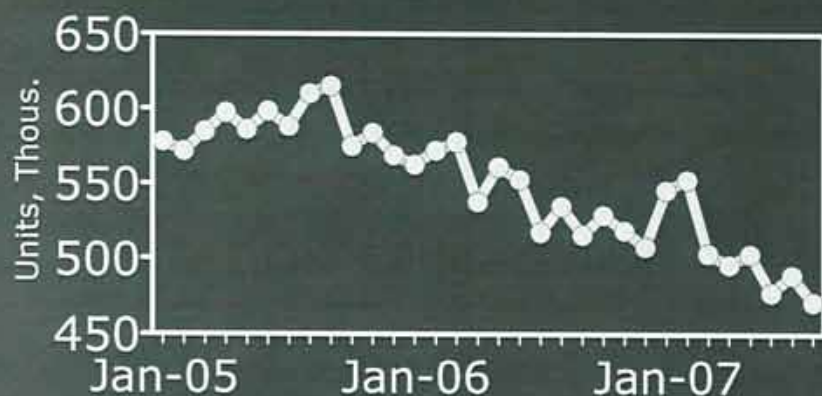
Risks to the Global Outlook:

- High or higher oil prices slows growth and cost inflation passes through to broader economy
- Savings-investment imbalances lead to market disruptions, run on U.S. dollar
- U.S. housing collapse causes recession
- Geo-political events: middle-east tensions increase, terrorist attack, oil supply disruption
- Trade protectionism disrupts markets

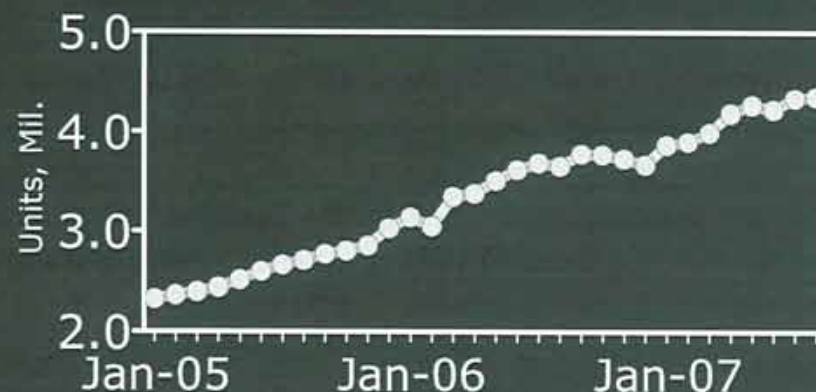


U.S. housing recession underway

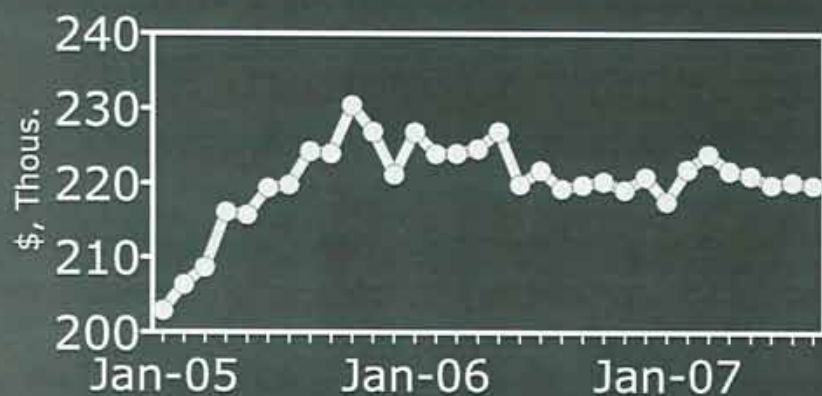
Existing Home Sales



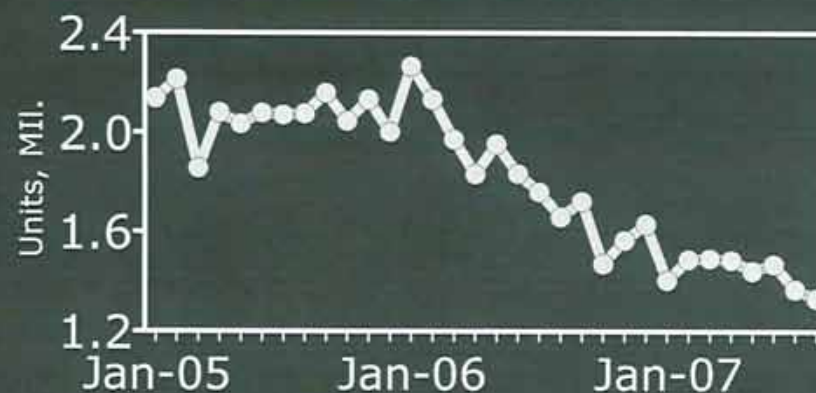
Unsold Inventory



Median Price



Housing Starts, SAAR



Source: National Association of Realtors, US Census Bureau.

Latest: Aug. 2007



Rising subprime mortgage delinquencies

U.S. Mortgage Delinquencies

	05 Q3	05 Q4	06 Q1	06 Q2	06 Q3	06 Q4	07 Q1	07 Q2
Prime								
Fixed Rate Mortgage	2.1	2.2	2.0	2.0	2.1	2.3	2.2	2.3
Adjustable Rate Mortgage	2.3	2.5	2.3	2.7	3.1	3.4	3.7	4.2
Subprime								
Fixed Rate Mortgage	8.8	9.7	9.6	9.2	9.6	10.1	10.3	11.0
Adjustable Rate Mortgage	10.6	11.6	12.0	12.2	13.2	14.4	15.8	17.0

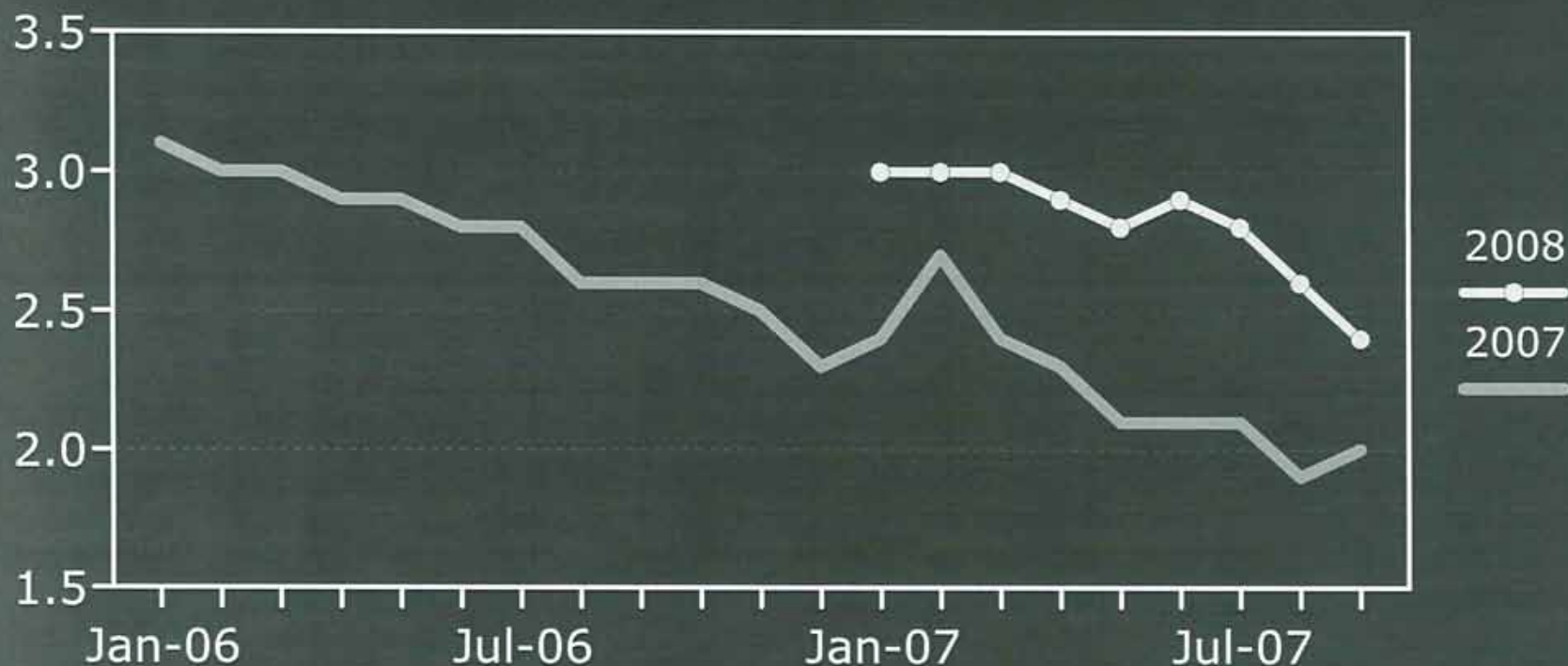
Source: Mortgage Bankers Association of America



Sharper downgrade in U.S. economic outlook since June

Consensus (Mean) Forecast of U.S. Real GDP Growth

Per cent



Source: Consensus Forecasts.

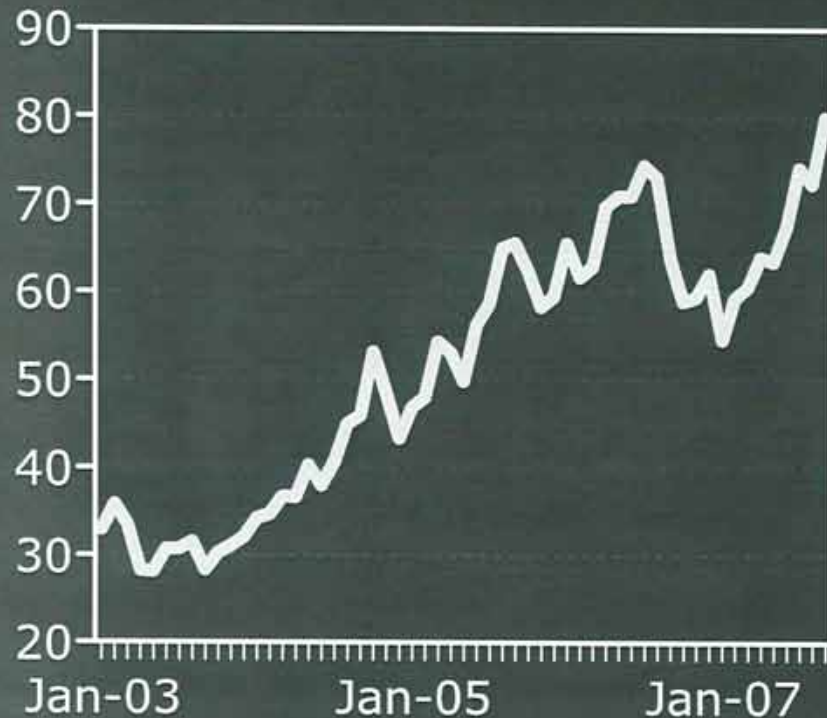
Latest: Sept. 2007



Oil prices up sharply this year

Spot Oil Price, WTI, Monthly

U.S. dollars per barrel



Source: U.S. Federal Reserve

Spot Oil Price, WTI, Daily

U.S. dollars per barrel



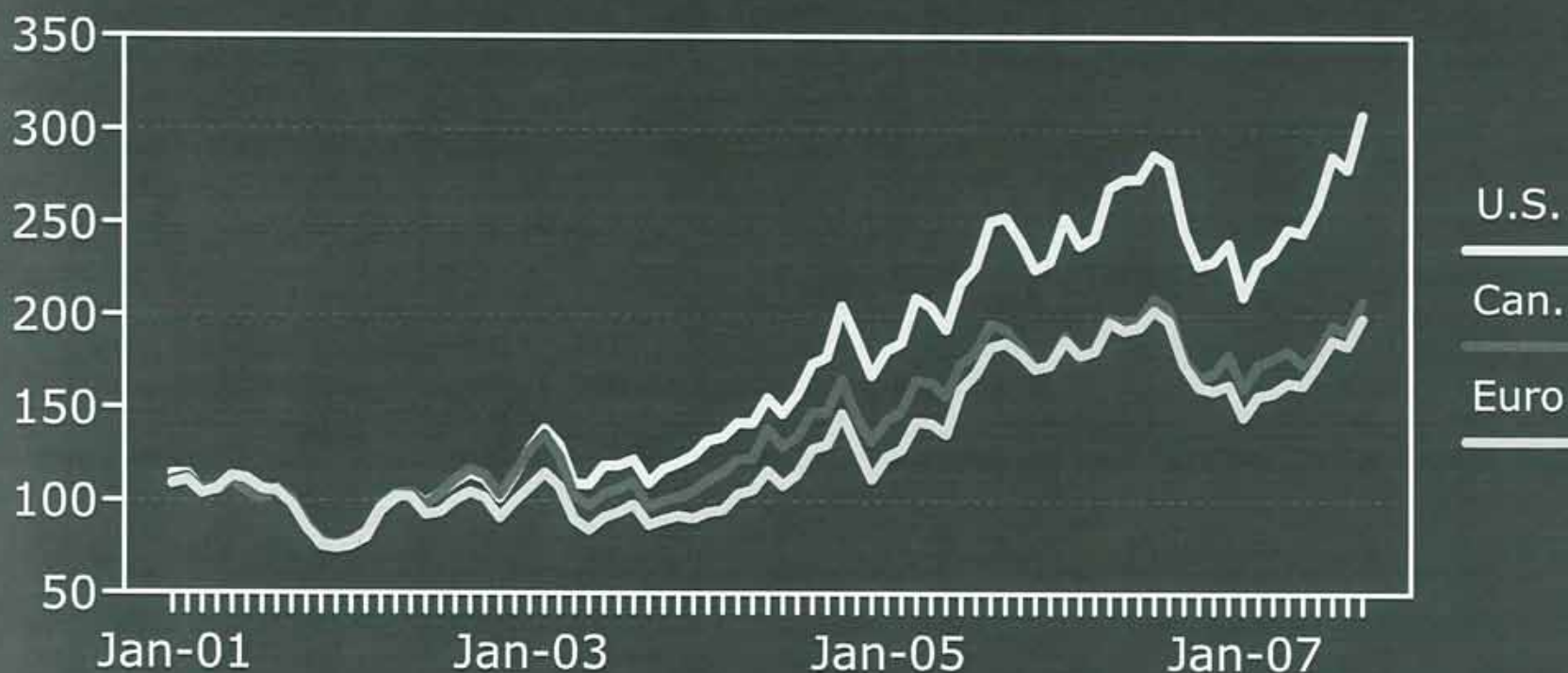
Source: U.S. Dept. of Energy. Latest: Oct. 23



Cost of oil lower in Euro and Canadian currencies than in U.S. dollars

Oil Prices in Selected Currencies

2001=100



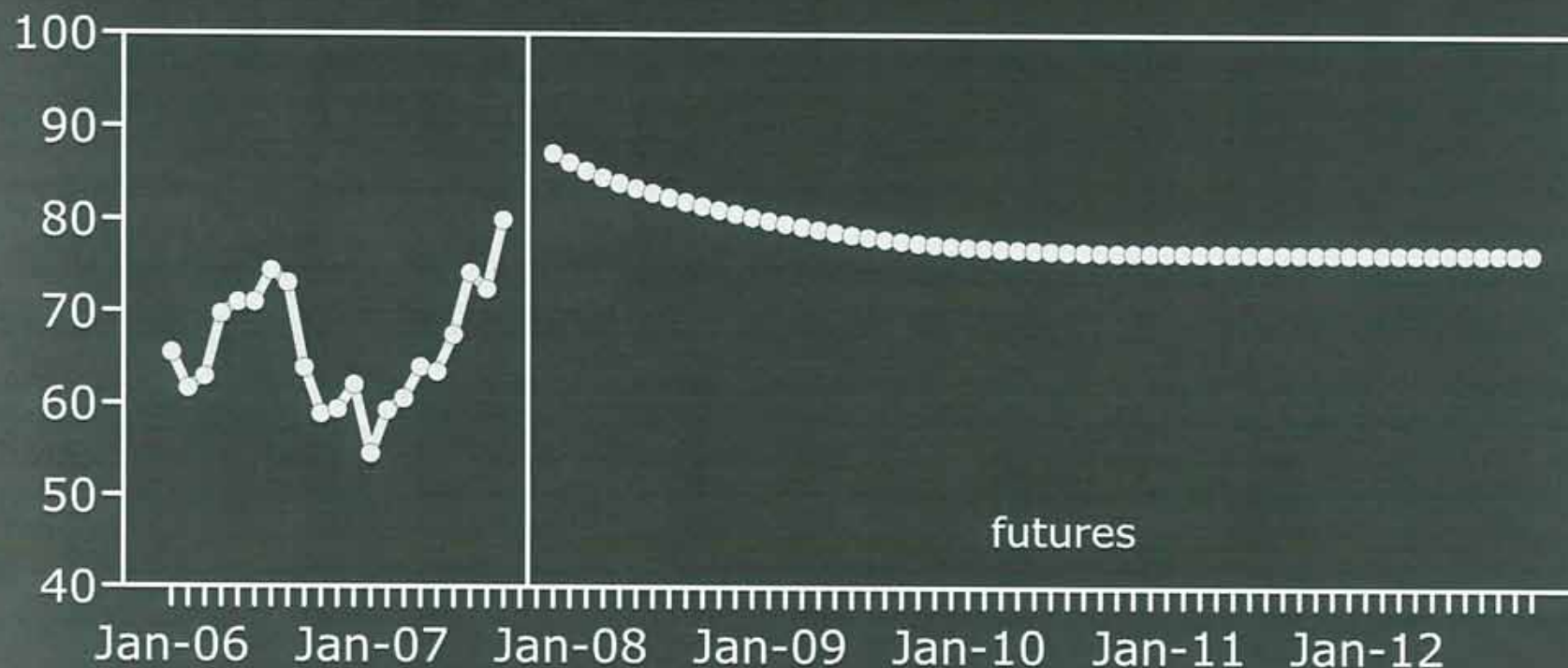
Source: Bank of Canada.



High oil prices to stay, some easing ahead

Spot and Futures Oil Price, Monthly

U.S. dollars per barrel



Source: U.S. Federal Reserve Board, NYMEX. Futures as of Oct. 23



Sharply wider credit spreads with ABCP crisis, gradual narrowing underway

Canada Three Month Interest Rates, Daily

Per cent



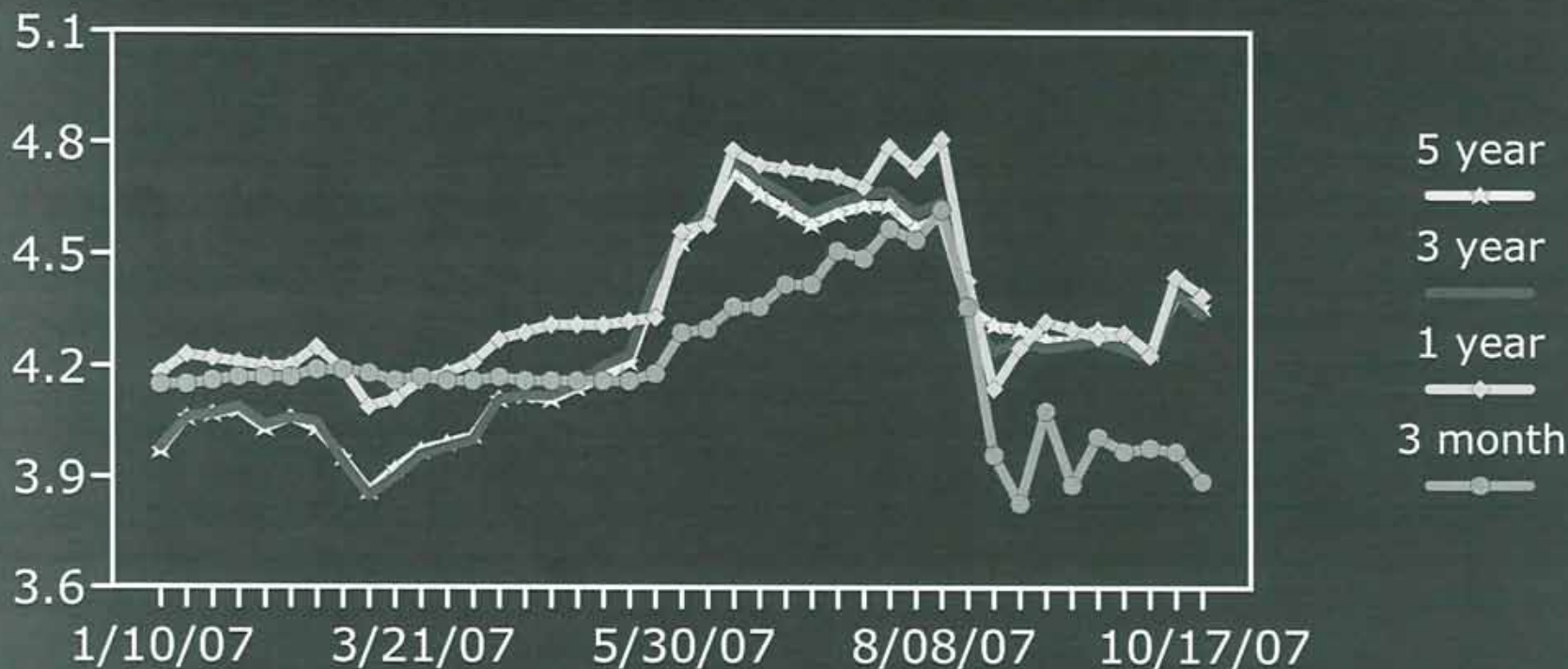
Source: Bank of Canada.



Recent decline in government yields and rates, ABCP induced flight to safety/quality

Government Bond Yields and T-Bill Rates, Weekly

Per cent



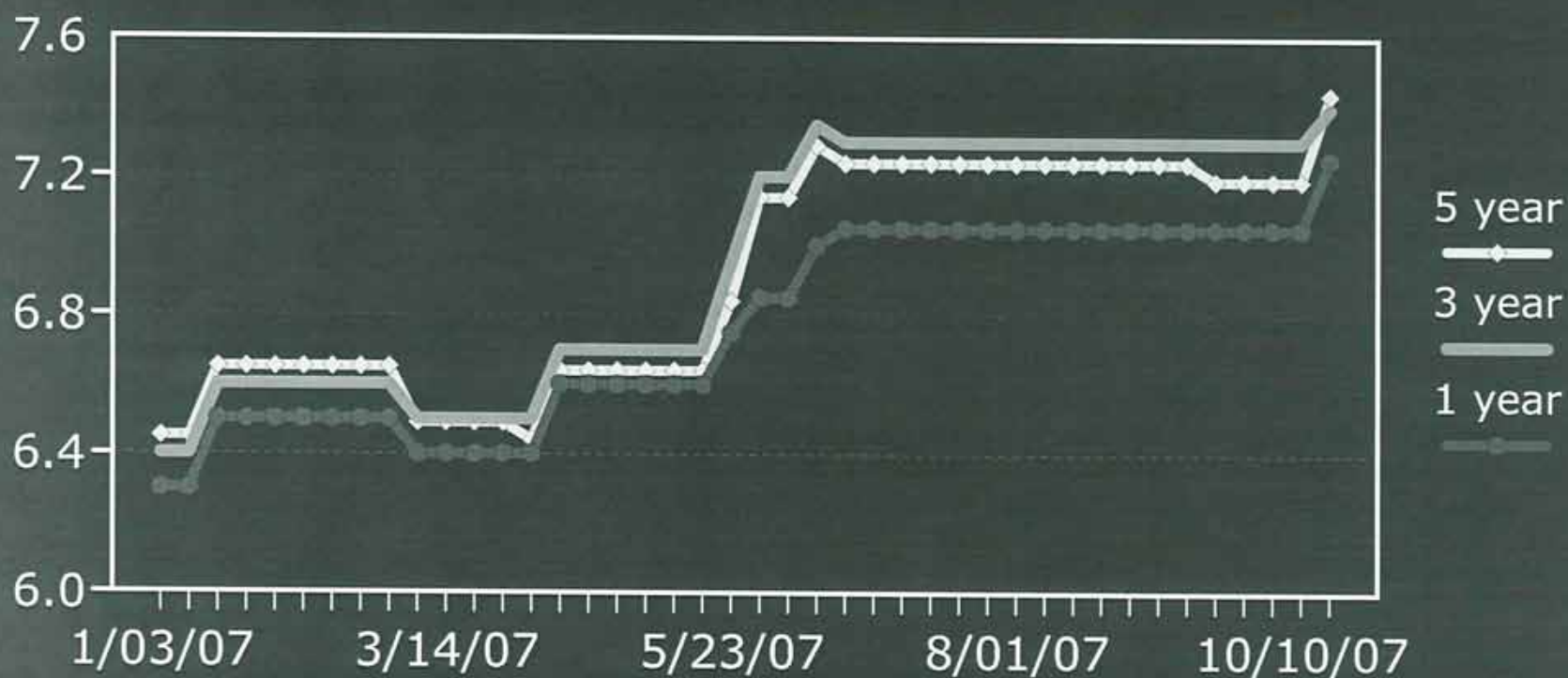
Source: Bank of Canada.



Mortgage rates up last week

Posted Mortgage Rates by Term, Weekly

Per cent



Implications of ABCP credit crunch:

- Lenders face higher cost of raising new funds in capital markets
- Mortgage securitization costs higher
- Supply of new funds to lend reduced
- Lenders could shrink discounts and keep posted rates unchanged
- Net effect is higher borrower rates and lower supply of new mortgage funds
- Potential negative impact on consumer confidence



Implications of ABCP credit crunch:

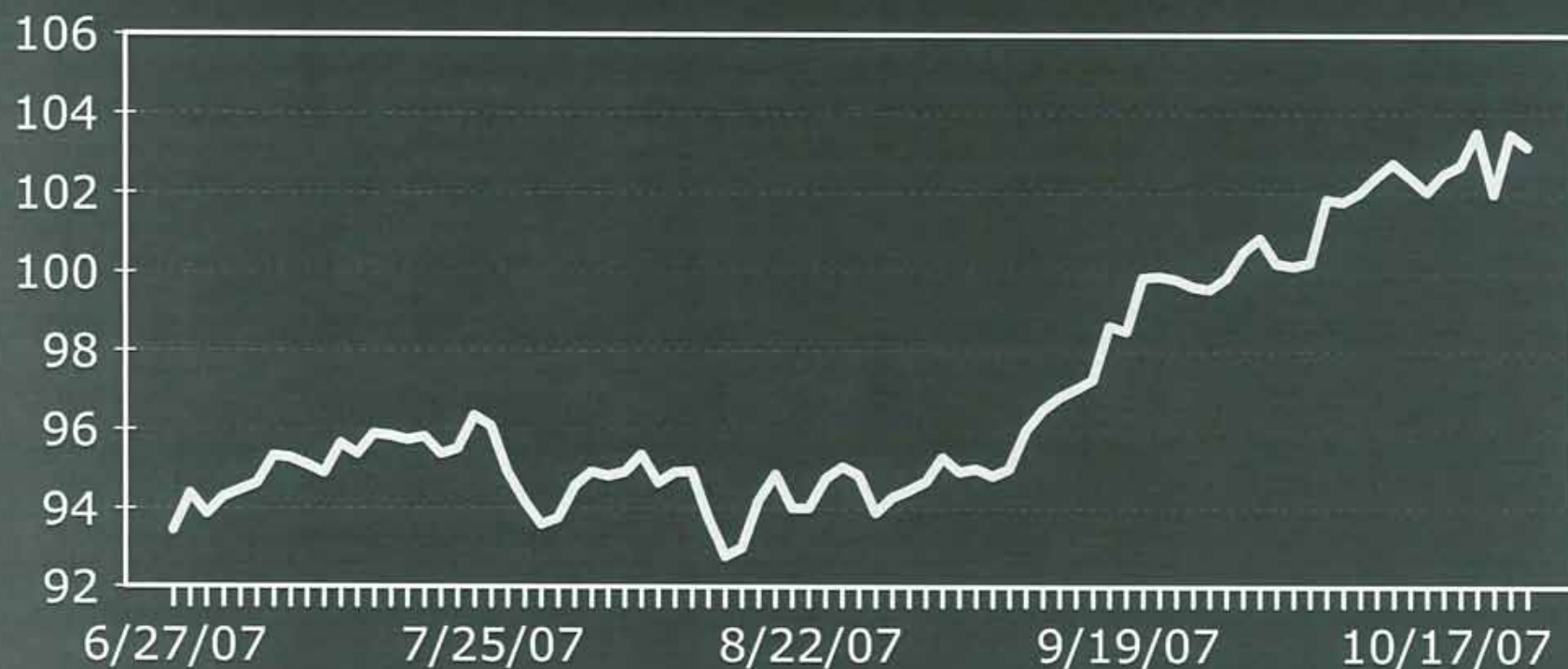
- Mortgage lenders in B.C. adequately capitalized
- Some companies holding ABCP could suffer losses
- Net impact on B.C. economy and housing market relatively minor
- ABCP credit crunch not over and new negative surprises are possible



U.S.-Canada exchange rate sharply higher last six weeks

U.S-Canada Exchange Rate, Daily

U.S. cents per Canadian dollar



Source: Bank of Canada.

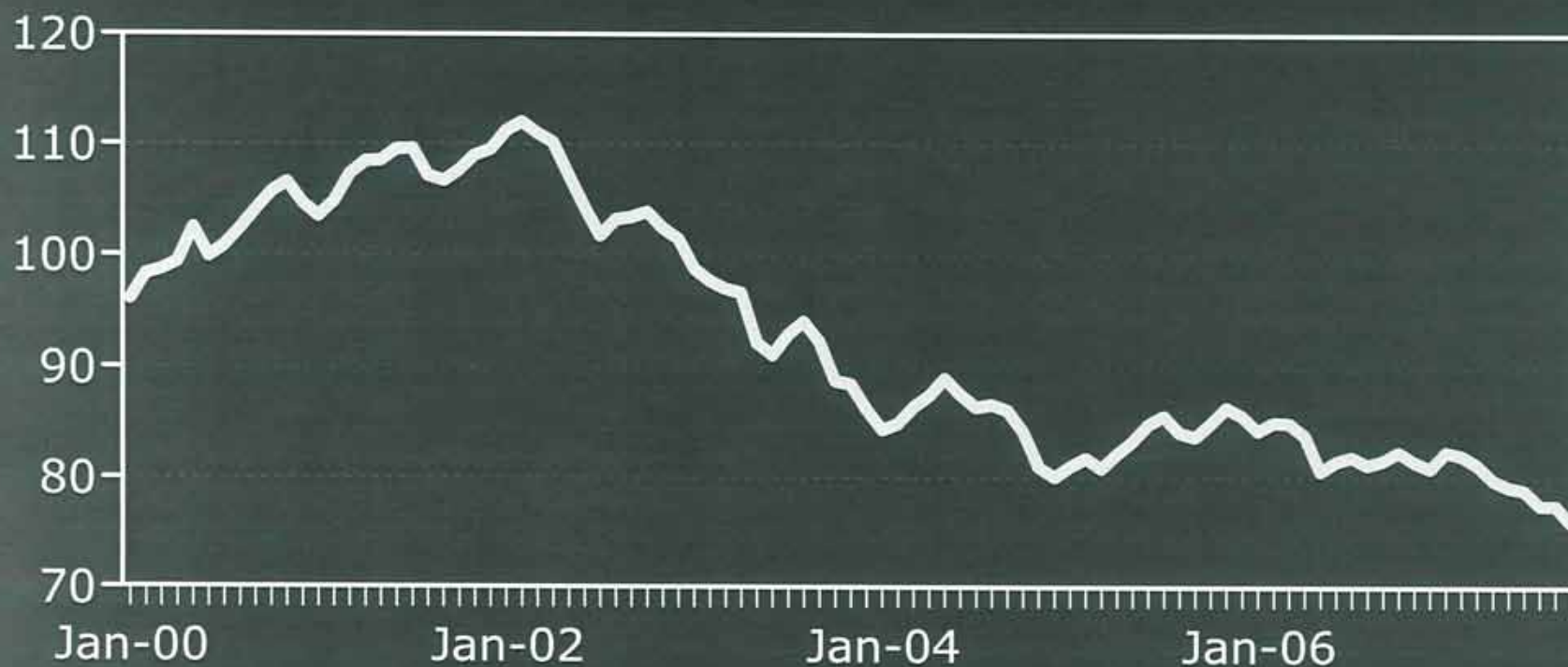
Latest: Oct. 24, 2007



U.S. dollar down 30% since early 2002

U.S. Dollar, Trade Weighted Index, Major Currencies

March 1973=100



Source: U.S. Federal Reserve

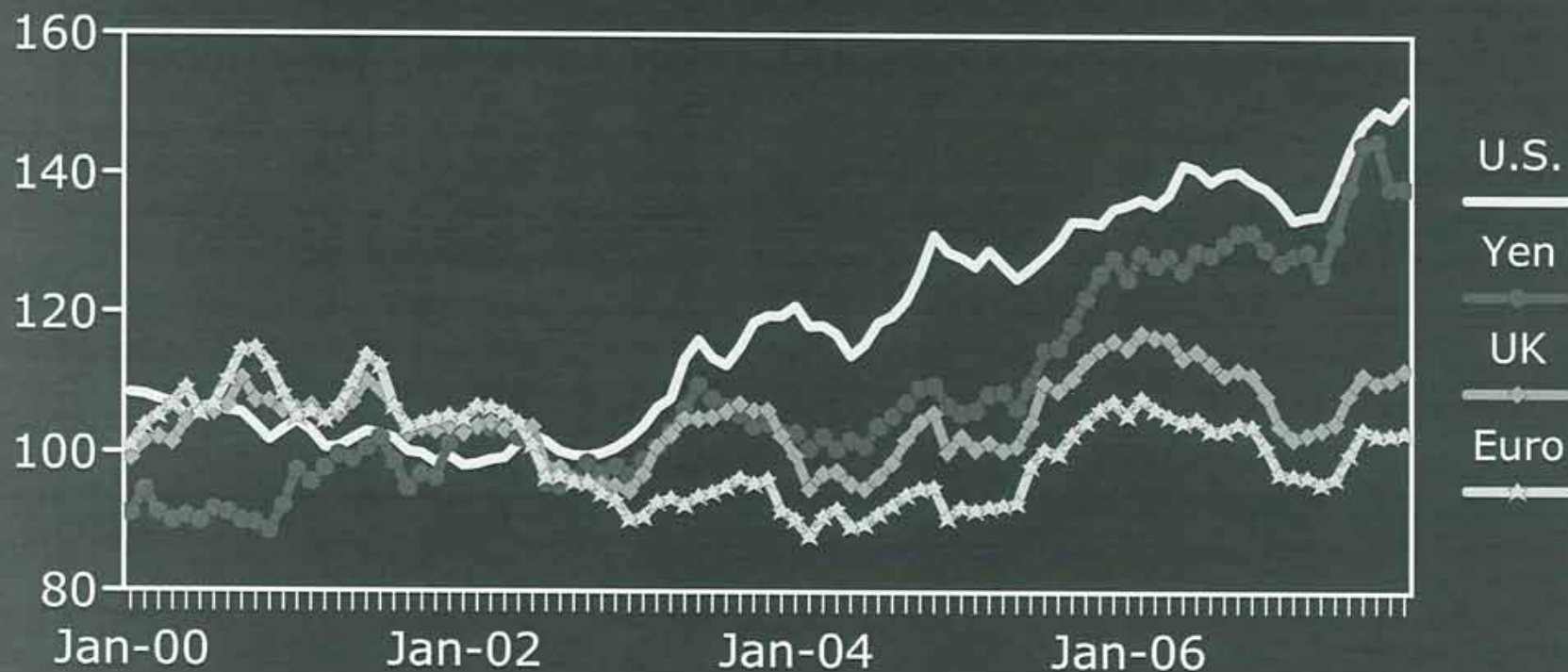
Latest: September 2007



Canadian dollar up mainly against U.S. and Japanese currencies

Canadian Dollar, Selected Exchange Rates

2002=100



Source: Bank of Canada, CUCBC.

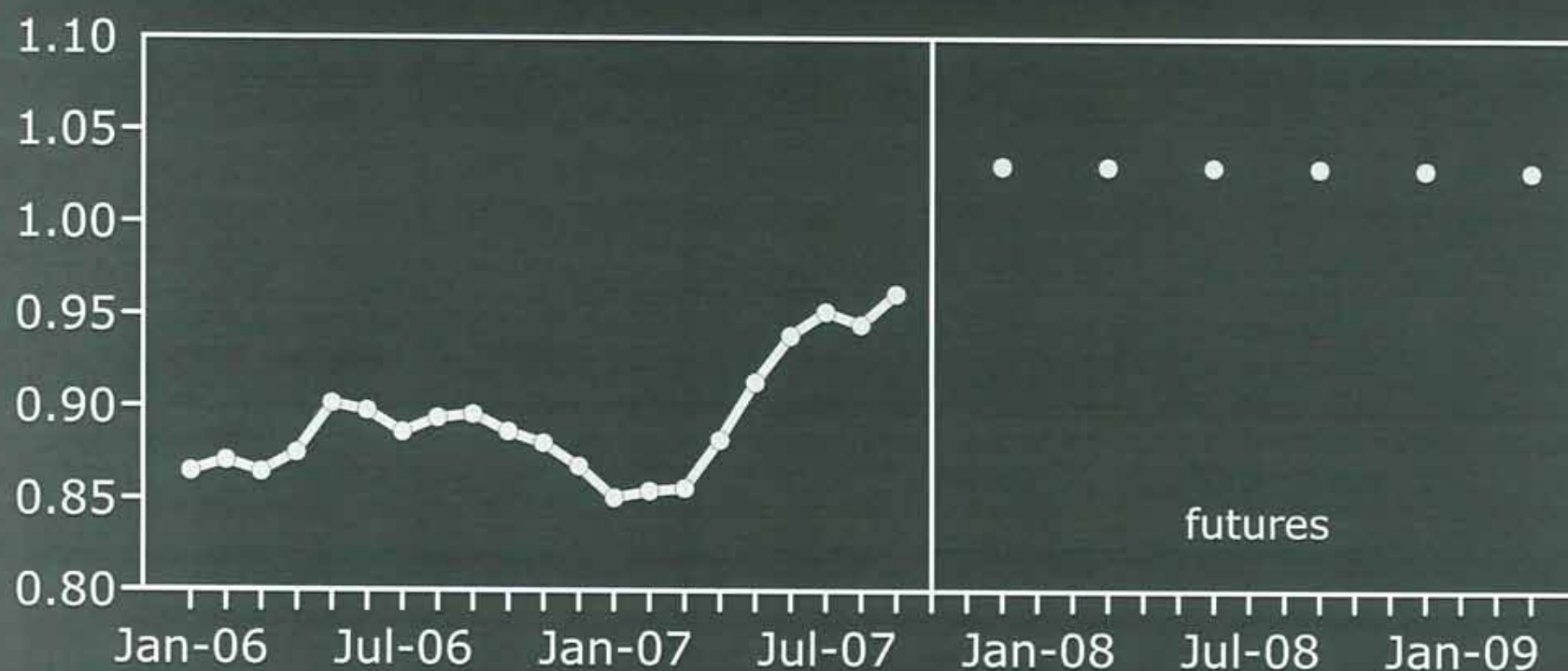
Latest: Sept. 2007



Market unsure of currency's path ahead

U.S.-Canada Exchange Rate, Monthly

U.S. cents per Canadian dollar



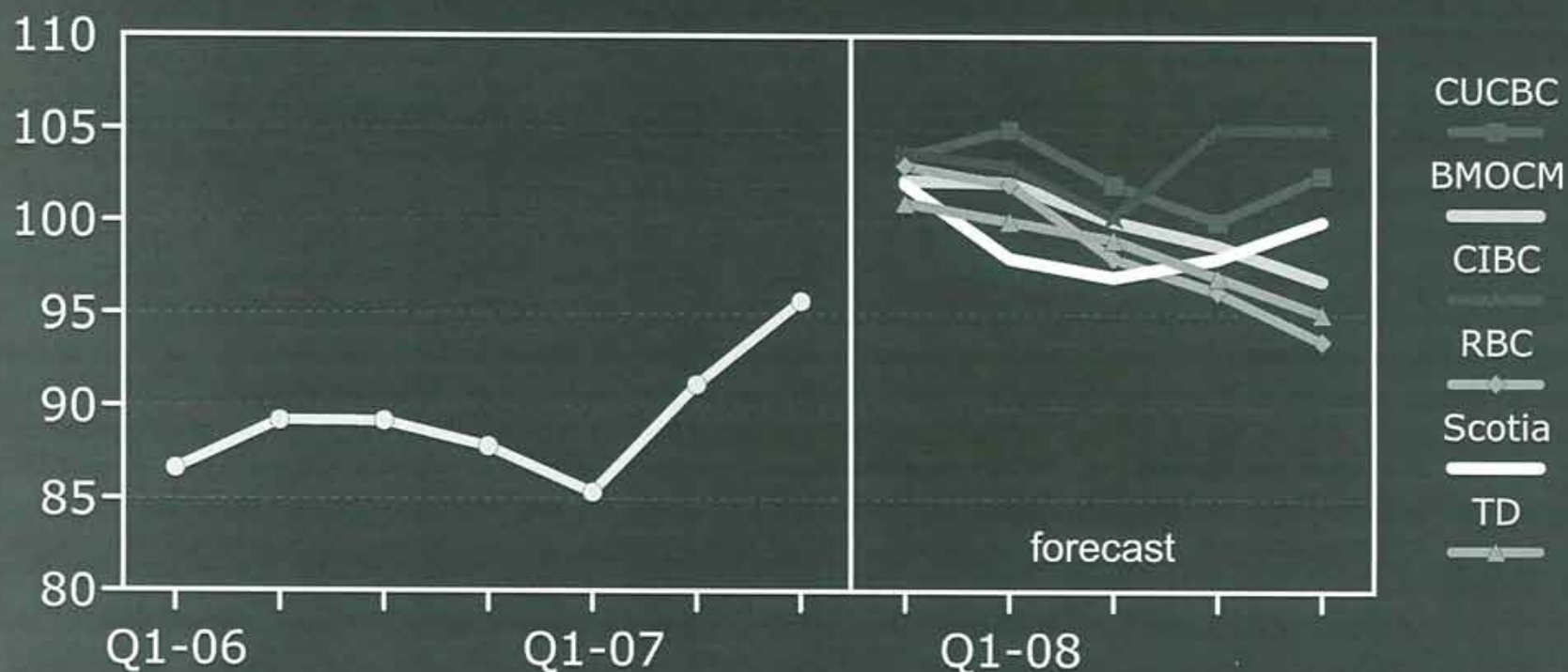
Source: Bank of Canada, Chicago Mercantile Ex., Futures as of Oct. 24, latest: Mar. 09



Forecasters see near-term gain in U.S.-Canada exchange rate followed by weakness

U.S.-Canada Exchange Rate, Quarterly

U.S. cents per Canadian dollar



Source: Bank of Canada, BMO, CIBC, CUCBC, RBC, Scotiabank, TD.



Canada's 2008 economic outlook lowered

Consensus (Mean) Forecast of Canada Real GDP Growth

Per cent



Source: Consensus Forecasts.

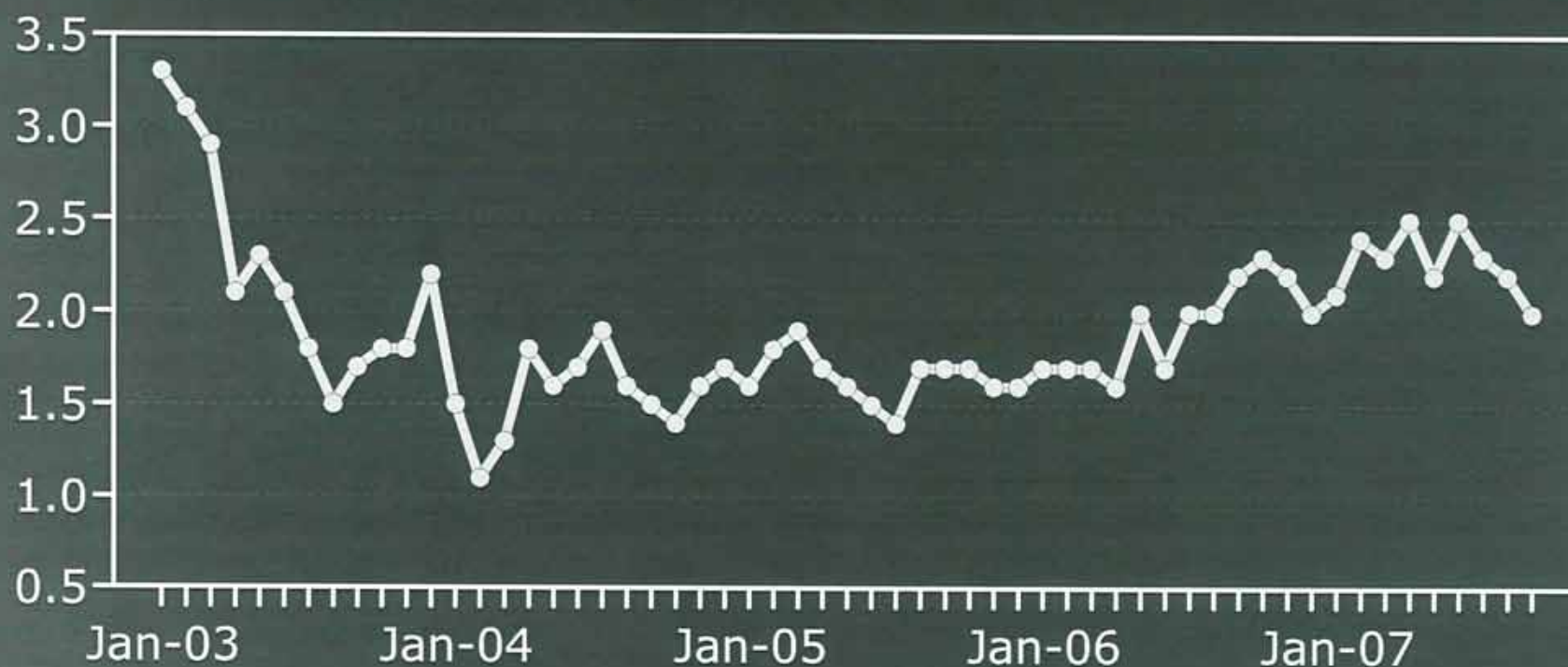
Latest: Sept. 2007



Inflation pressures slightly above Bank of Canada's 2% target, September's dip is temporary

Core Inflation Rate, Canada

Percentage change year-over-year



Source: Statistics Canada.

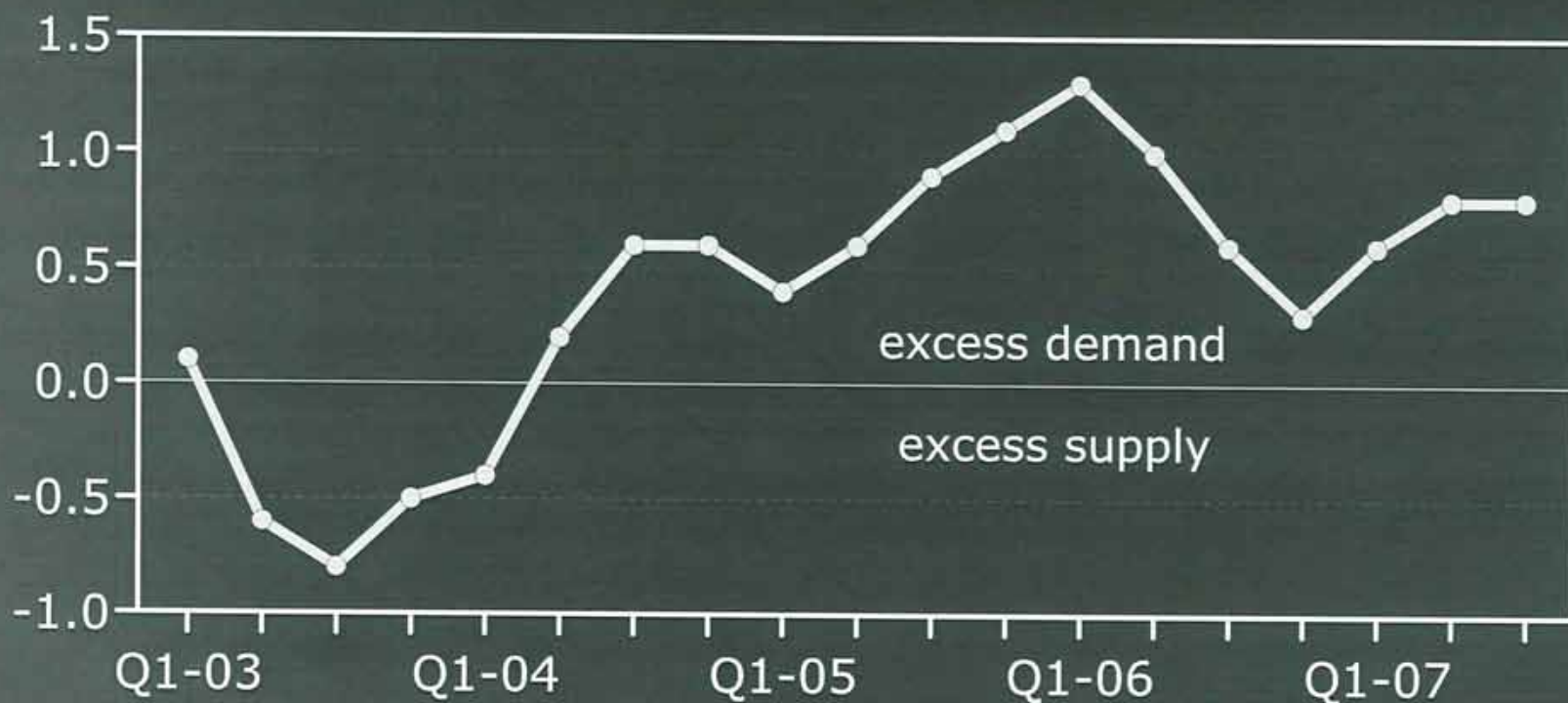
Latest: Sept. 2007



Canadian economy operating above its production potential

Canada's Output Gap, Bank of Canada Estimates

Per cent of potential GDP



Source: Bank of Canada.

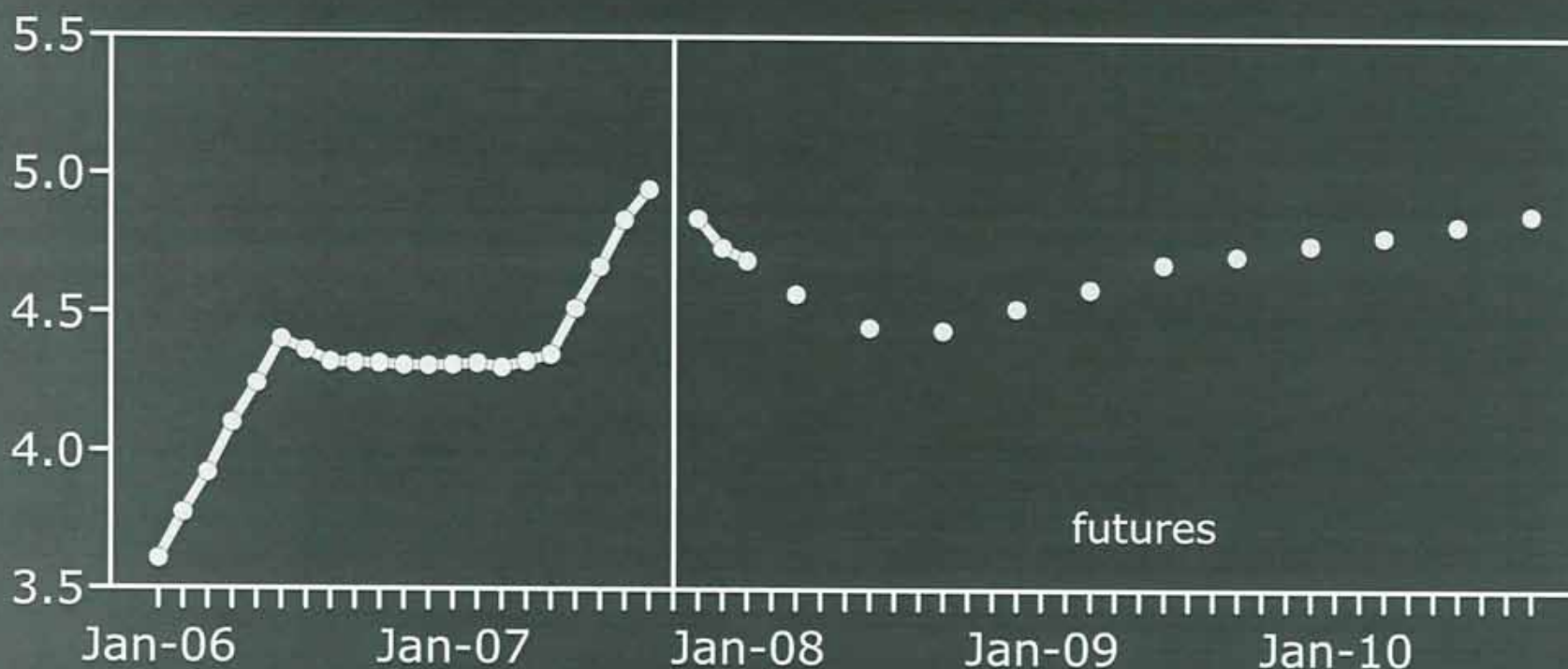
Latest: Q3-2007



Futures market expecting a return to normal market functioning not a Bank of Canada rate cut

Three Month Canadian Bankers' Acceptances

Per cent



Source: Bank of Canada, Montreal Exchange.

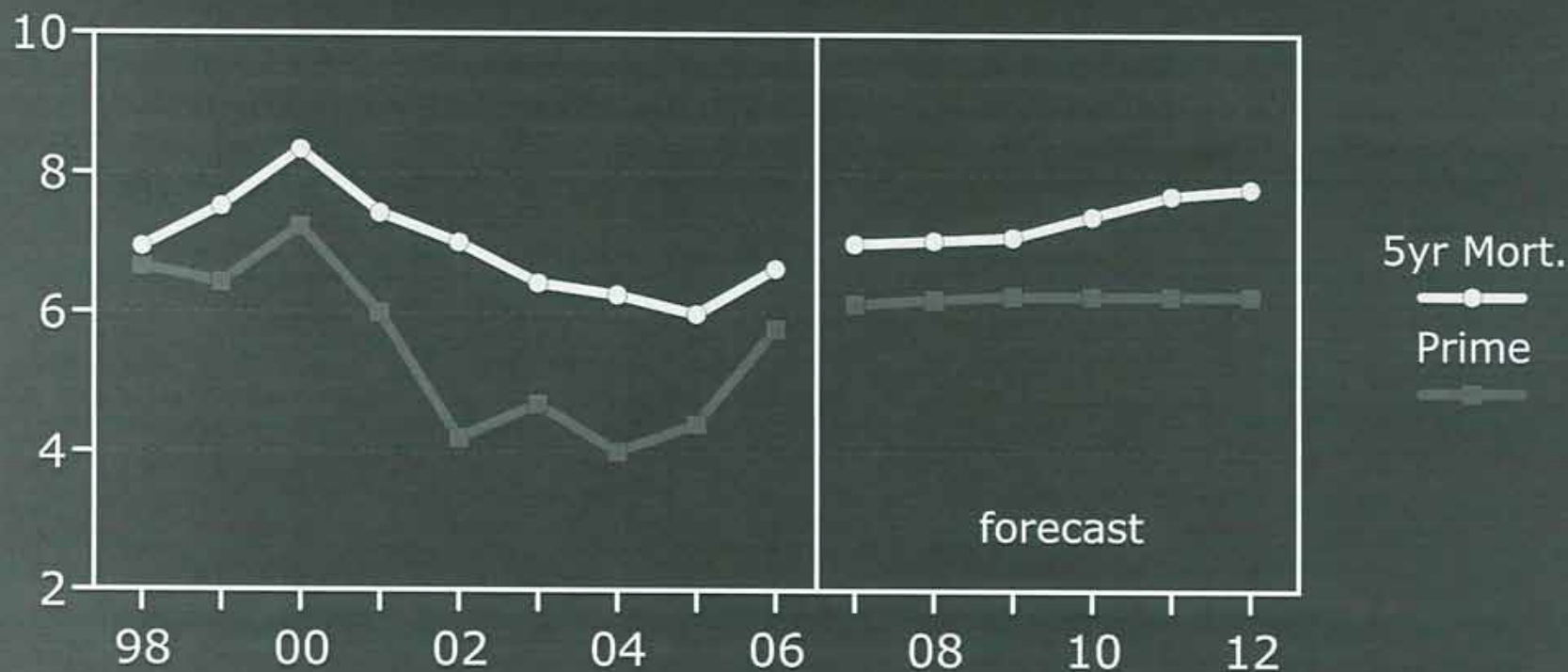
Futures as of Oct. 23



Interest rates to remain in normal or neutral range, some increase in longer term rates

Interest Rate Forecast

Per cent



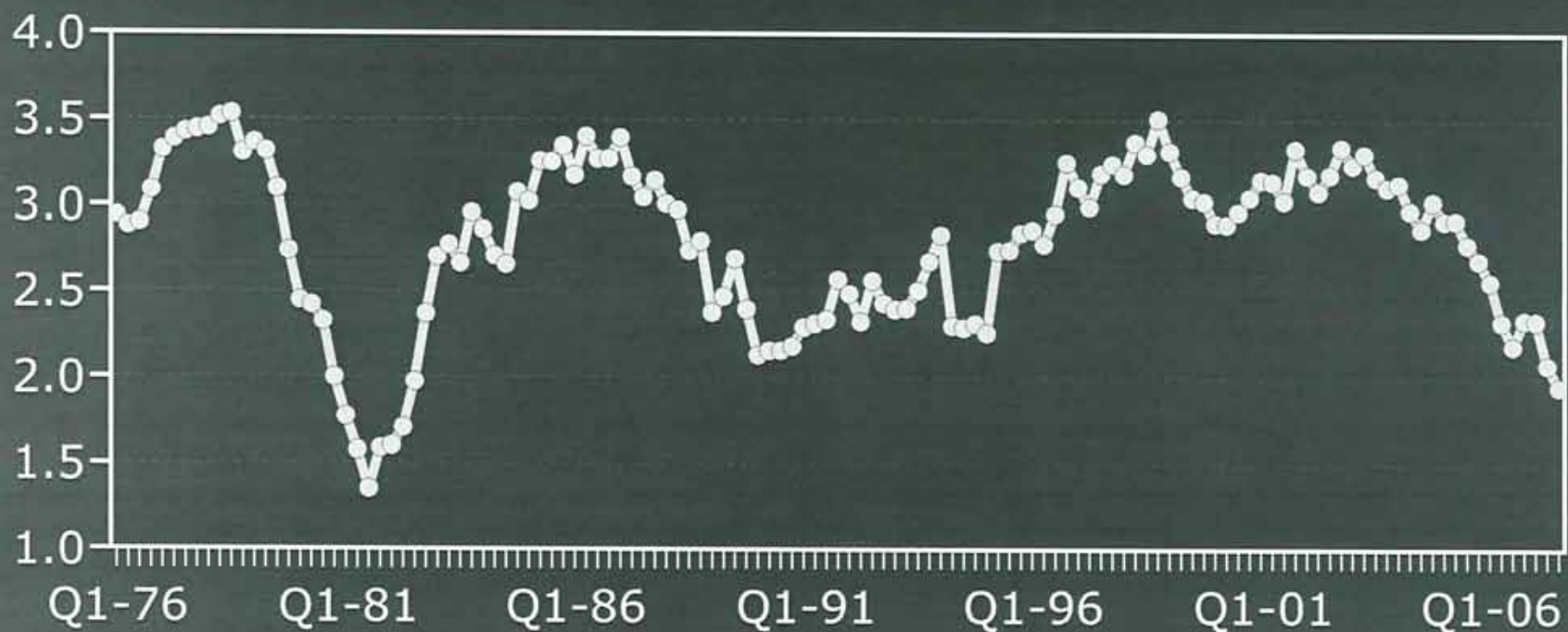
Source: Bank of Canada, CUCBC. Note: annual averages



Affordability poor for low-equity buyers

B.C. Home Purchase Affordability Index, Quarterly

Ratio - Income/P&I



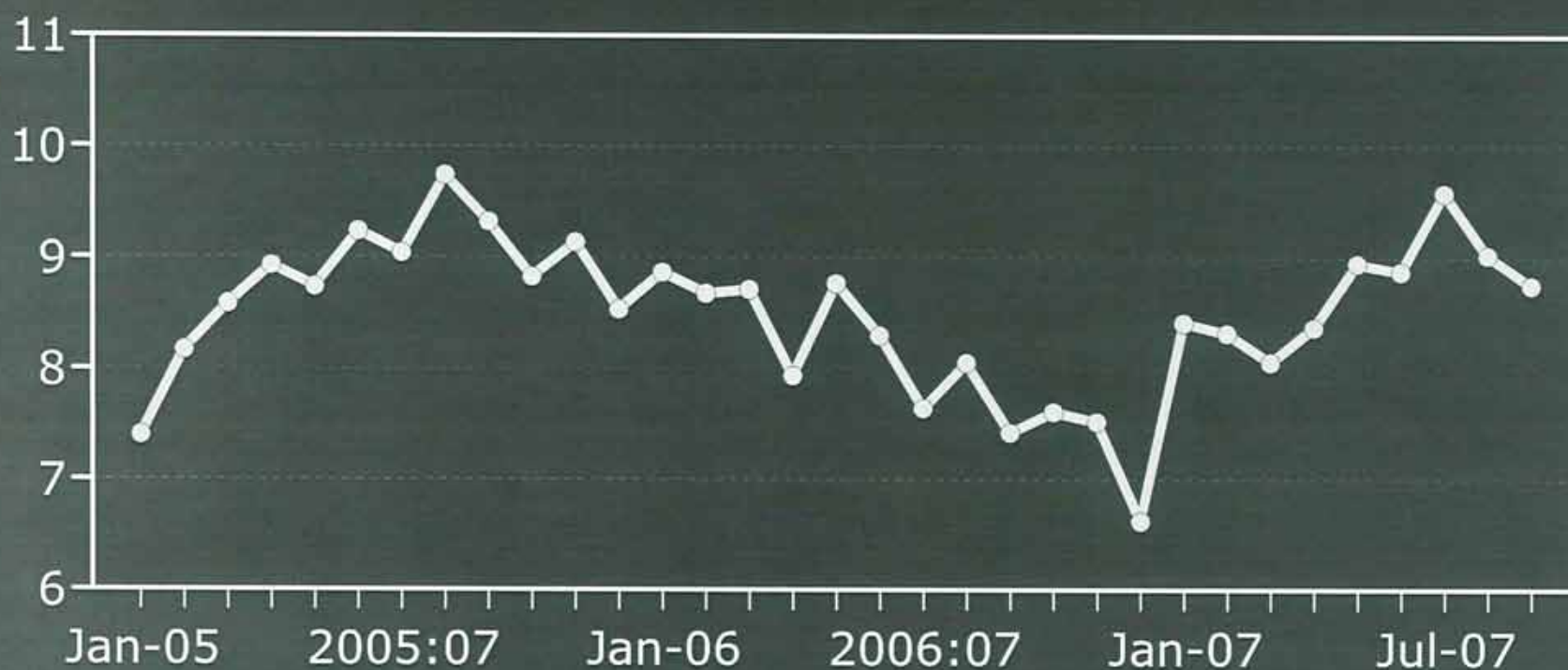
Source: CUCBC. Based on median sales price, 5 year mortgage rate, average weekly wages.
Note: A rise/fall indicates improving/deteriorating affordability. Latest: Q3-2007



Housing sales lower recently

B.C. MLS Residential Sales, Seasonally Adjusted, Monthly

Units - thousands



Source: CREA, CUCBC.

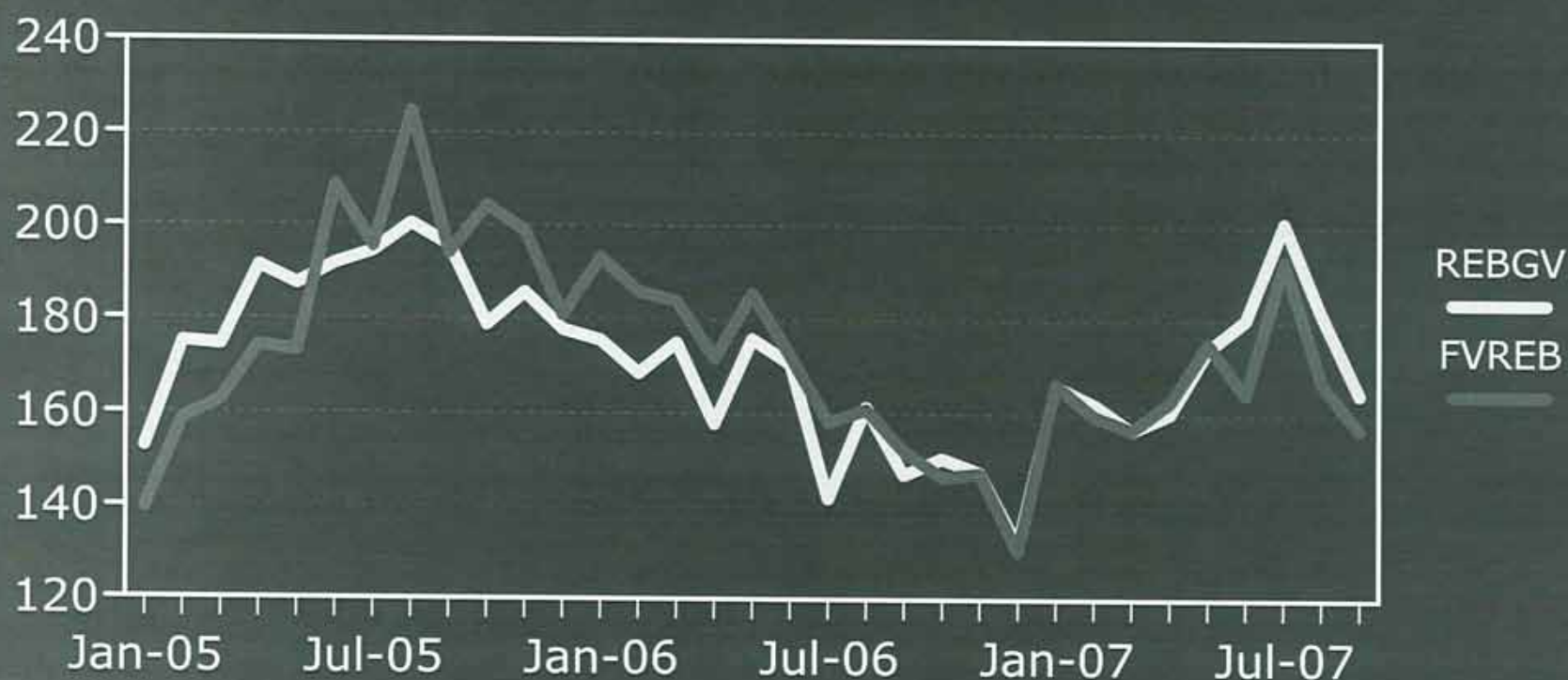
Latest: Sept. 2007 (estimate)



Housing sales down last two months

Residential MLS Sales, Seasonally Adjusted, REBGV and FVREB

Index 1980-2000=100



Source: REBGV, FVREB, CUCBC.

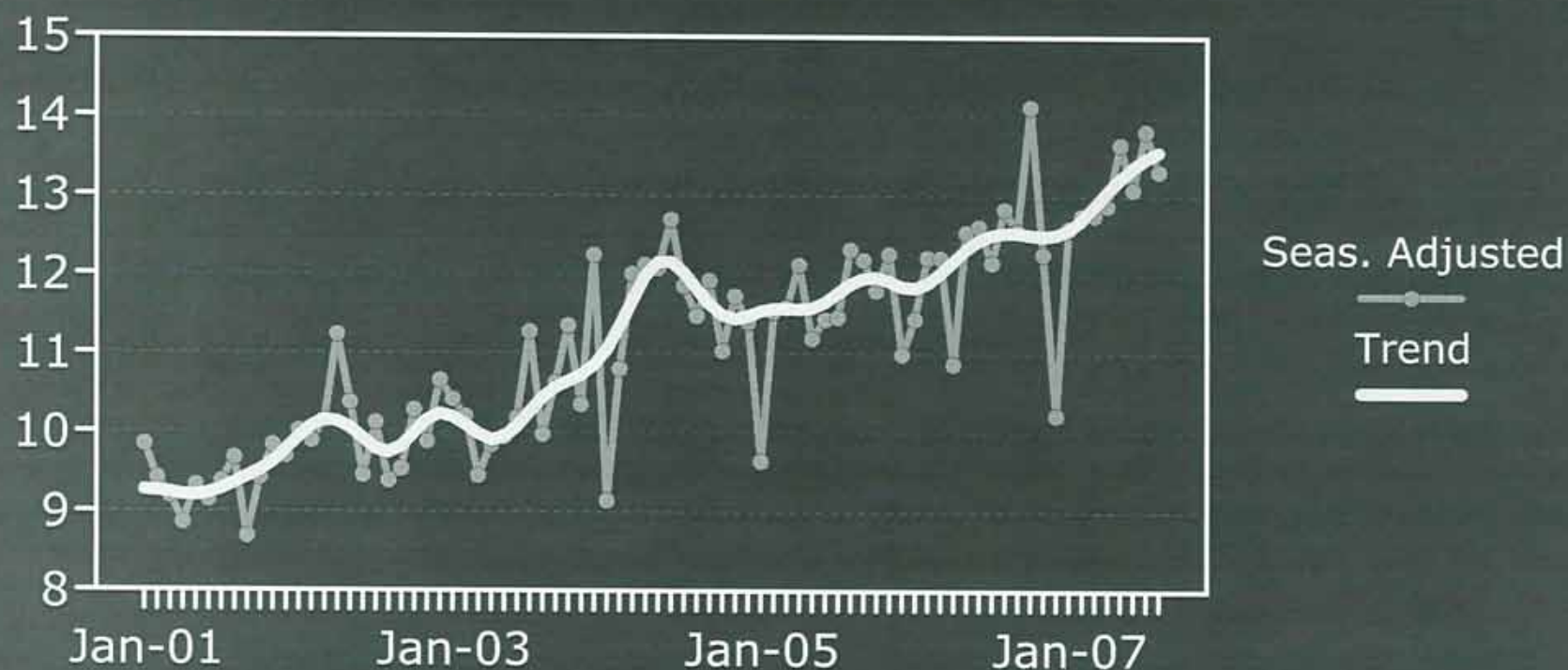
Latest: Sept. 2007



Listings trending higher, more supply coming onto market

New Listings, MLS Residential, B.C.

Units - thousands



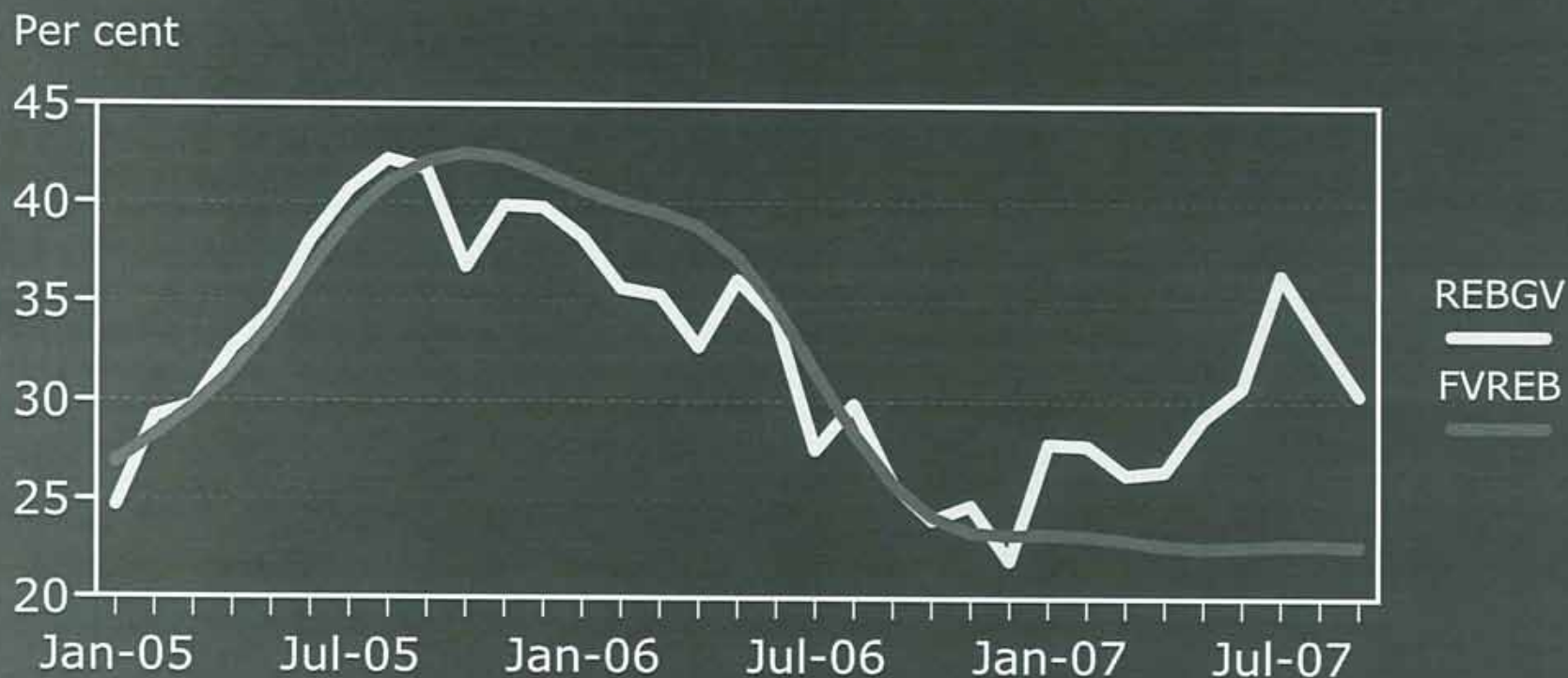
Source: CREA, CUCBC.

Latest: Aug. 2007



Tighter market conditions in Greater Vancouver than in Fraser Valley

Residential MLS Sales-to-active Listings Ratios,
Seasonally Adjusted, REBGV and FVREB



Source: REBGV, FVREB, CUCBC.

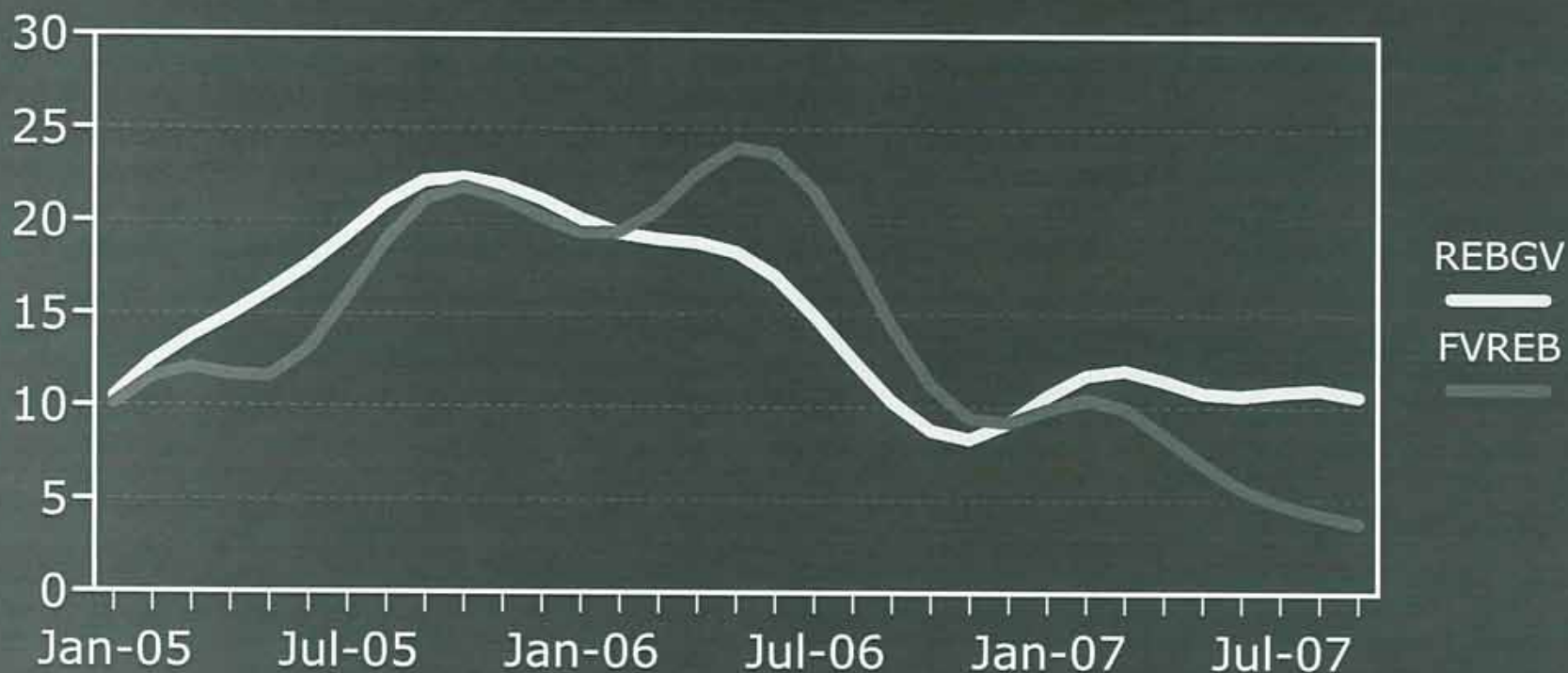
Latest: Sept. 2007



Prices increasing at slower pace in Fraser Valley, holding steady in Vancouver

Change in Housing Price Index, REBGV and FVREB

Percentage change at annual rate



Source: REBGV, CUCBC.

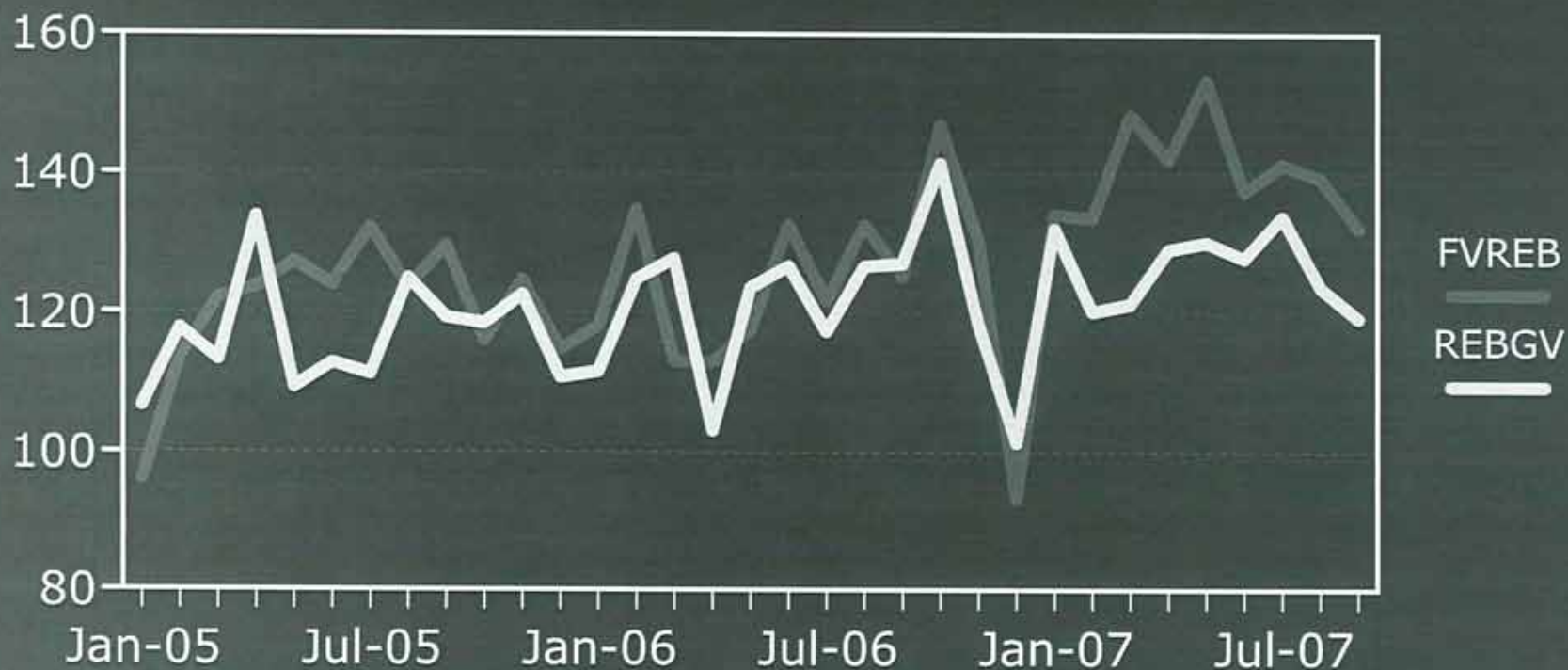
Latest: Sept. 2007



Higher supply levels in Fraser Valley

Residential MLS New Listings, Seas. Adj., REBGV and FVREB

1980-2000=100



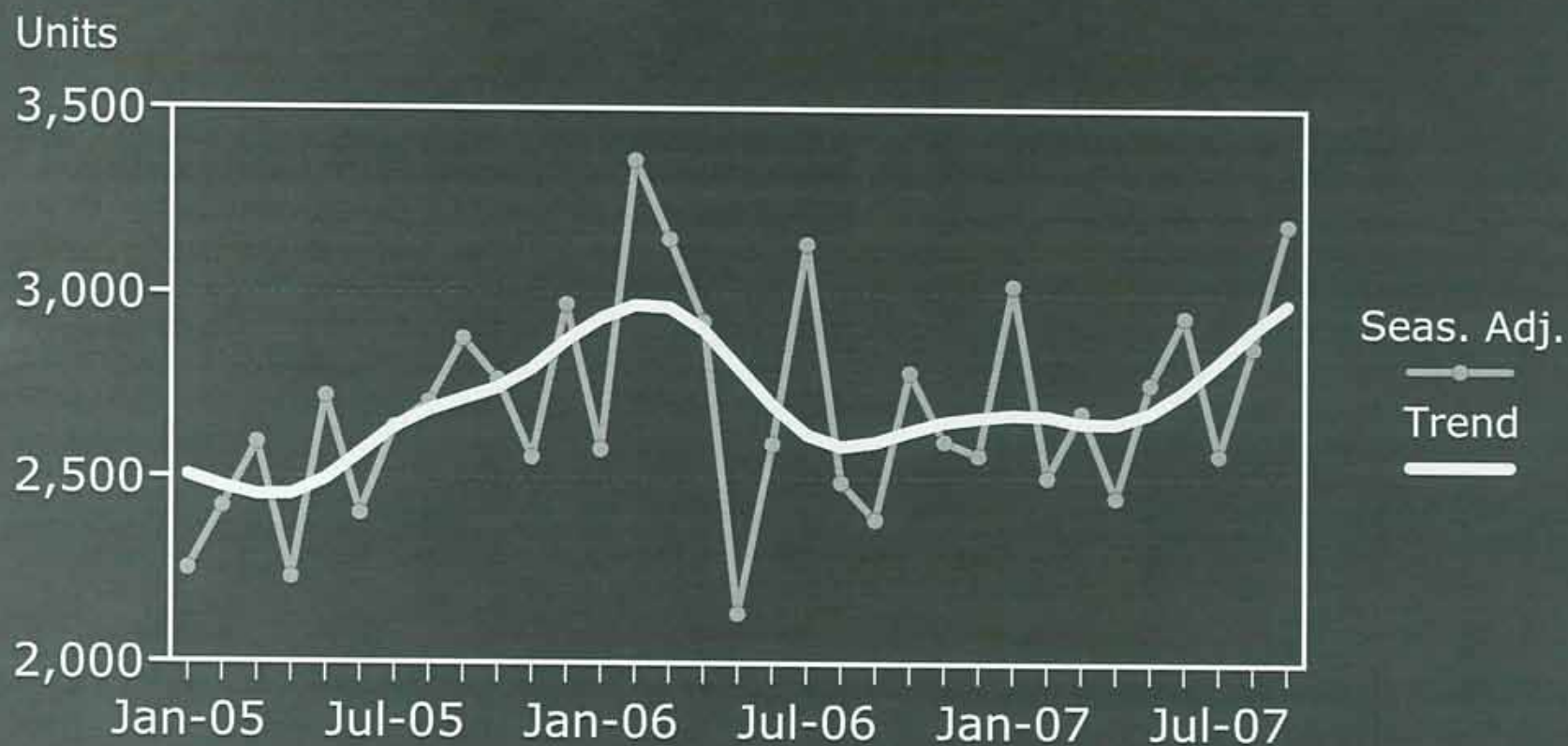
Source: REBGV, FVREB, CUCBC.

Latest: Sept. 2007



Housing starts on recent upturn

Housing Starts, Urban B.C.



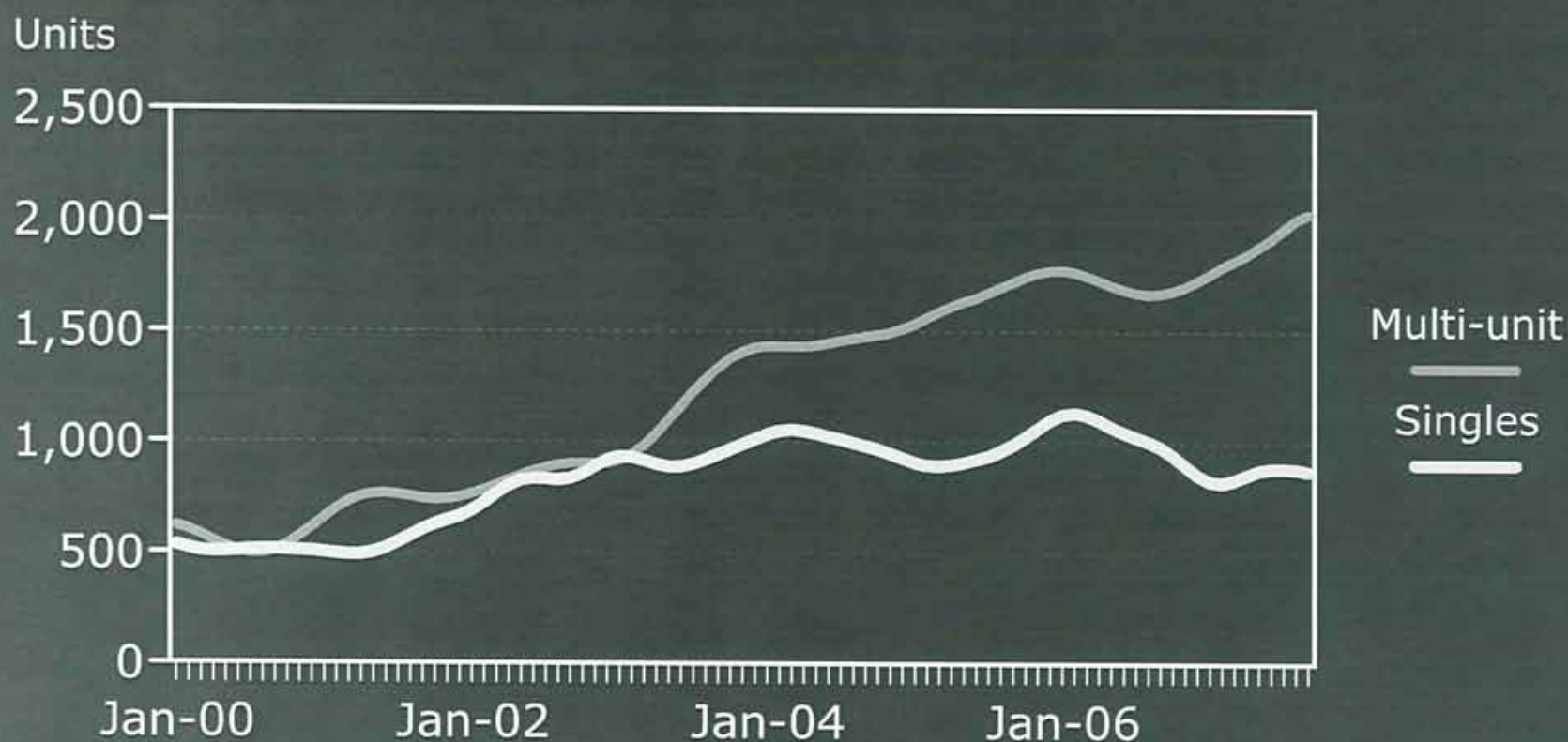
Source: CMHC, CUCBC.

Latest: Sept. 2007



Multi-unit housing starts surge, single detached starts languish

Housing Starts Trends by Dwelling Type, Urban B.C.



Source: CMHC, CUCBC.

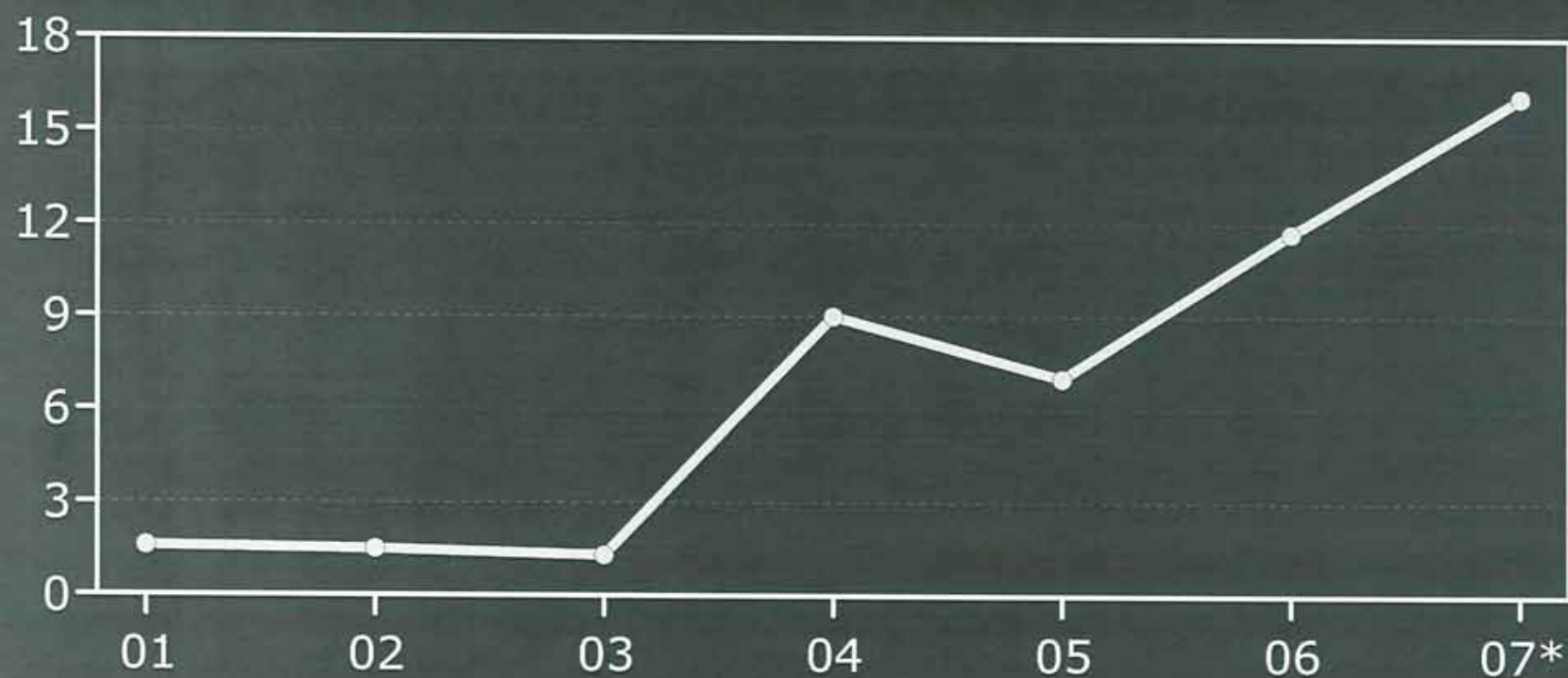
Latest: Sept. 2007



Construction costs accelerating

Apartment Construction Cost Increases, Vancouver CMA

Per cent



Source: Statistics Canada.

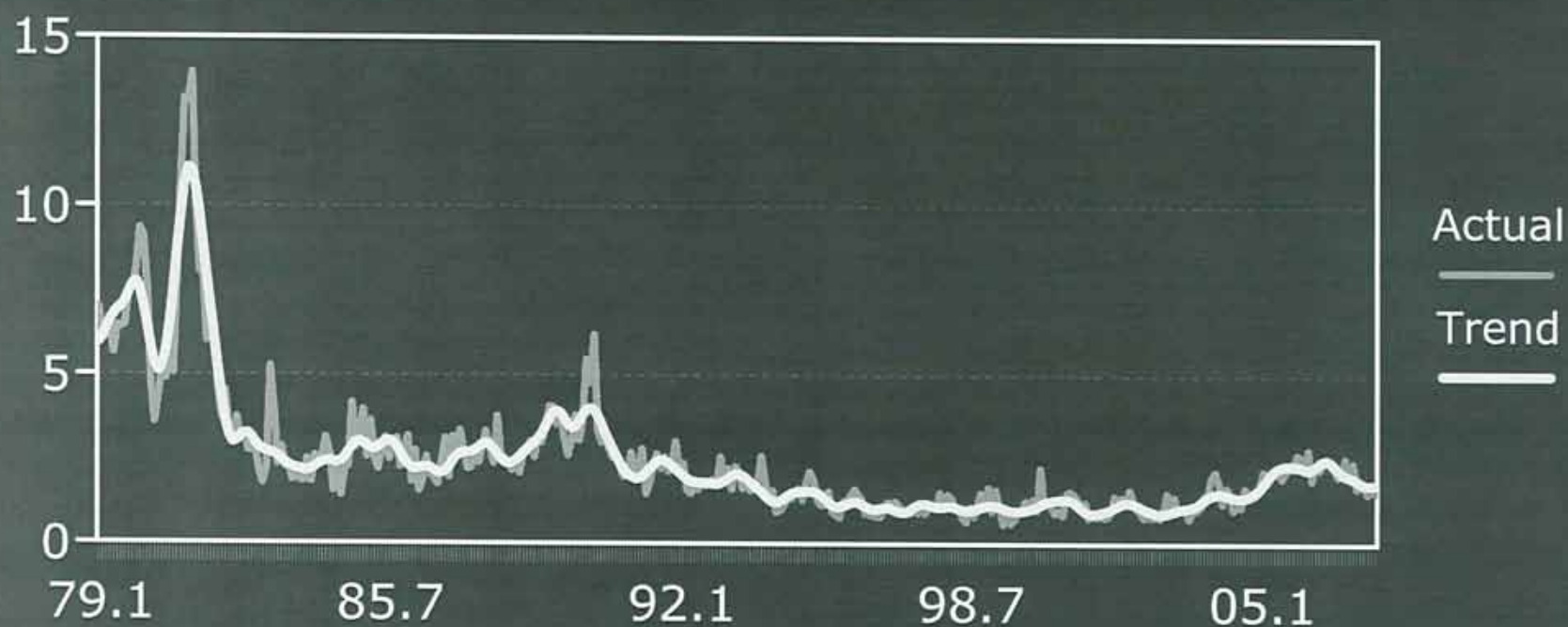
*Year-to-date June.



Flipping activity no longer rising

B.C. Housing Sales Held Less Than Three Months

Per cent of total sales



Source: Landcor Data Corp, CUCBC.

Latest: Aug. 2007

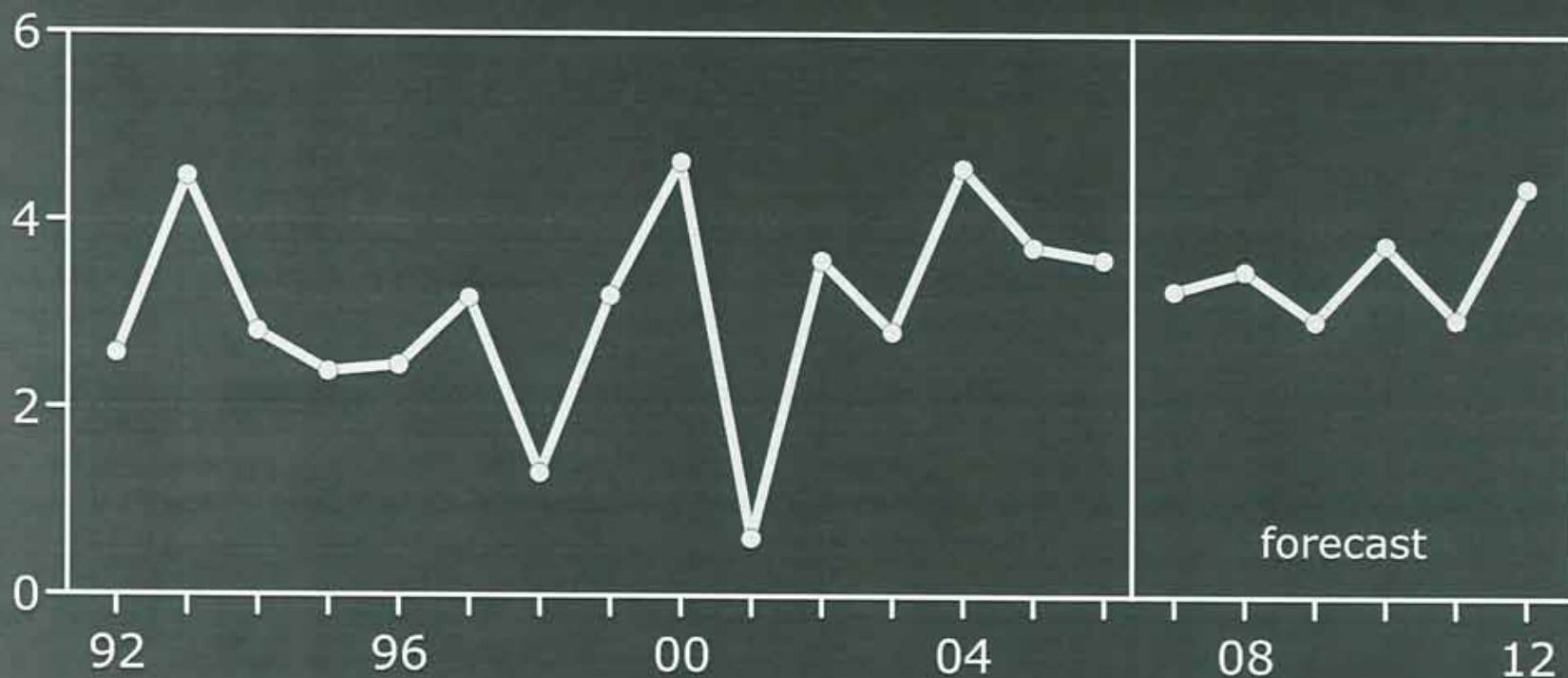
Note: Excludes presales prior to construction completion.



B.C.'s growth phase continues

B.C. Real GDP Growth

Per cent



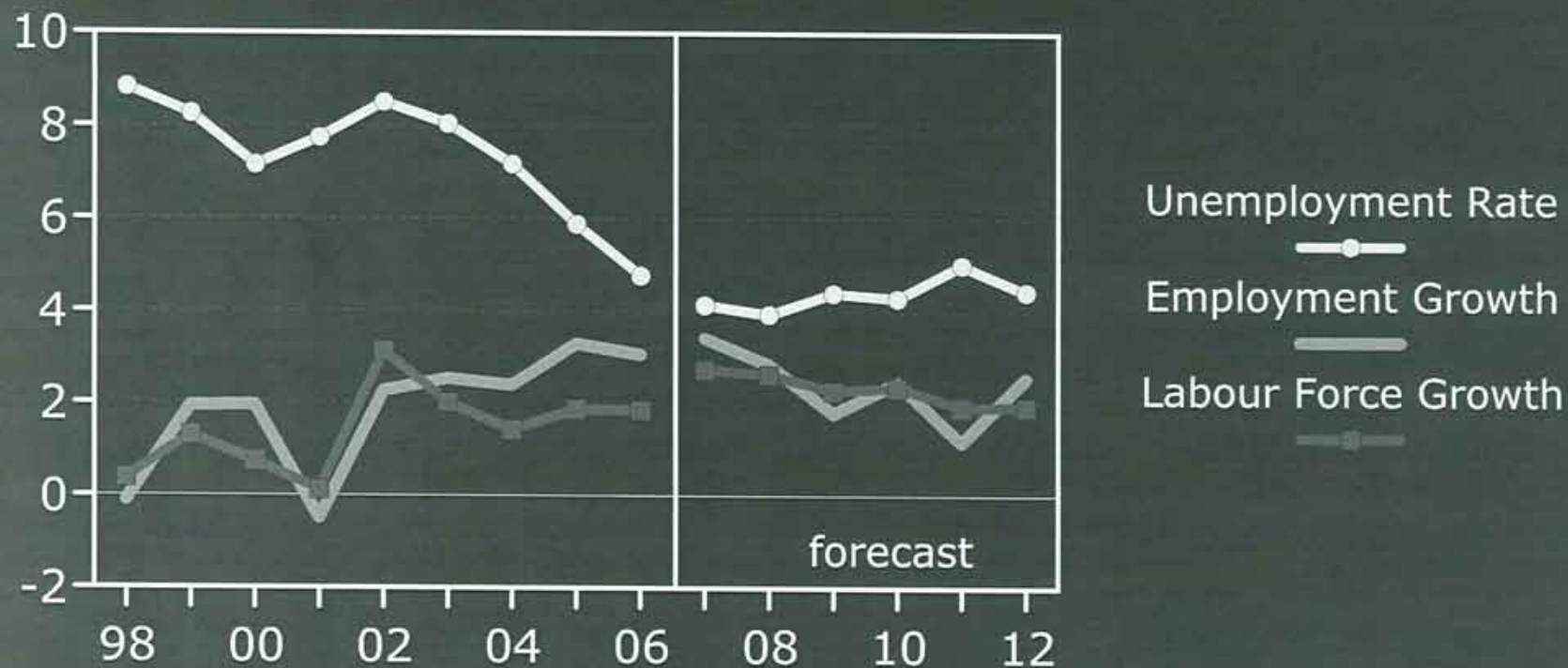
Source: Statistics Canada, CUCBC.



Tighter labour market, unemployment rate falls to below 4% in 2008

B.C. Labour Market

Per cent



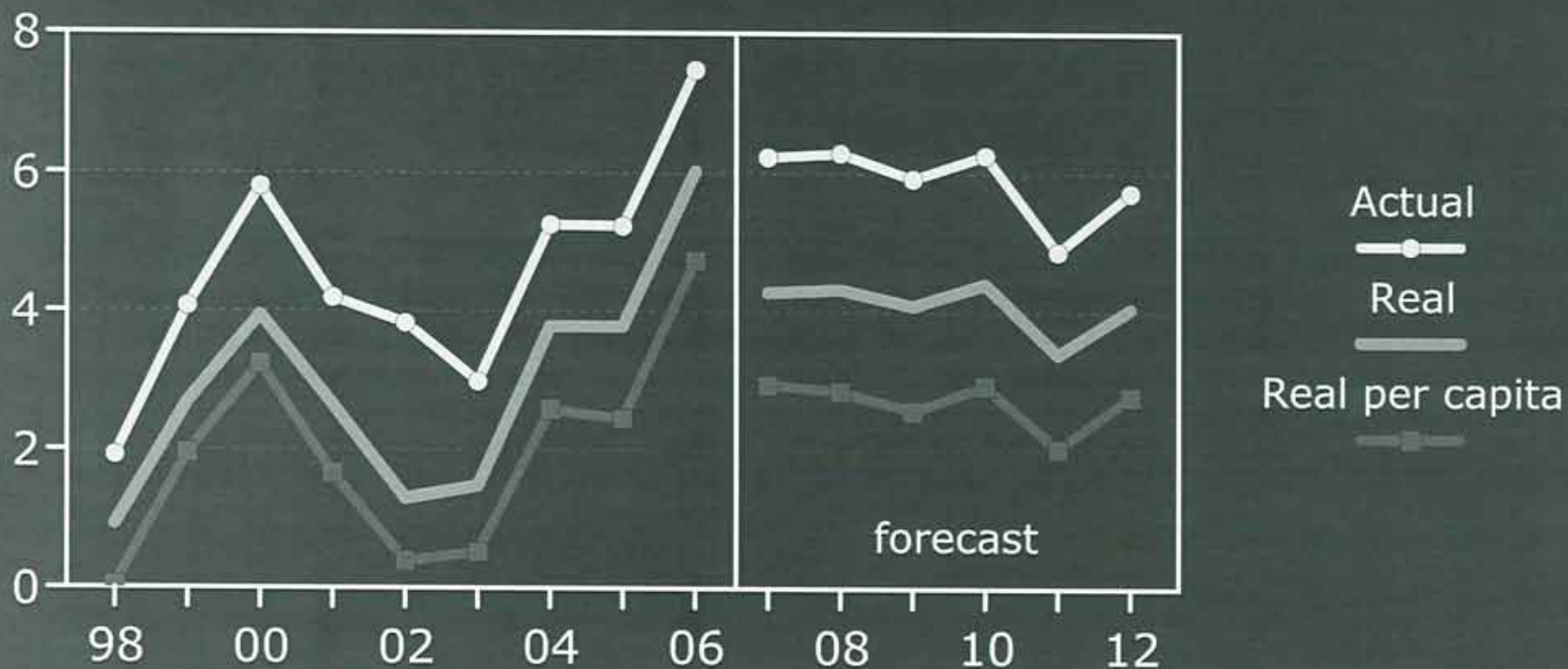
Source: Statistics Canada, CUCBC.



Substantial income growth since 2004, forecast to continue

B.C. Personal Disposable Income Growth

Per cent

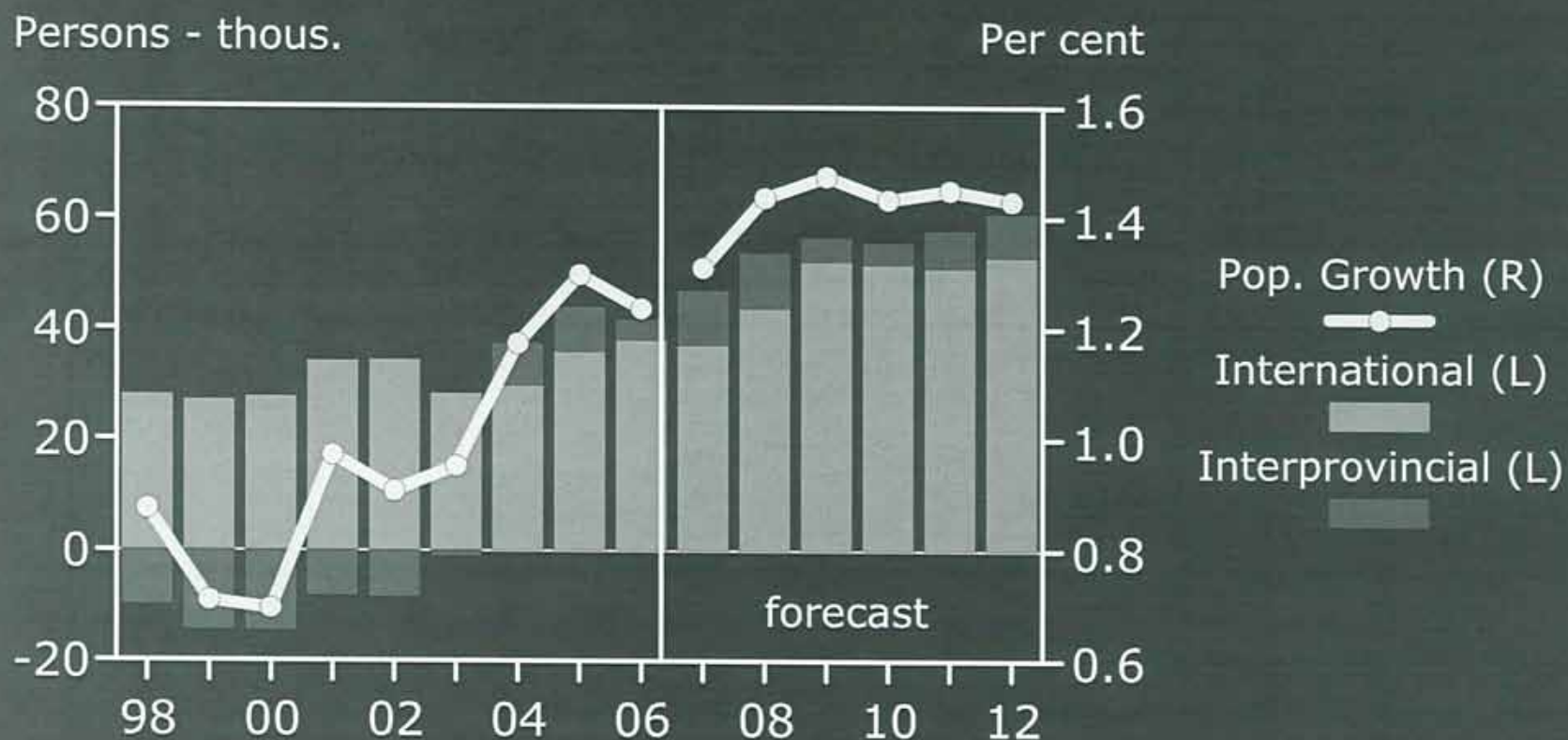


Source: Statistics Canada, CUCBC.



Modest population growth ahead

B.C. Net Migration by Type and Population Growth Rate



Source: Statistics Canada, CUCBC.



Current B.C. housing market cycle:

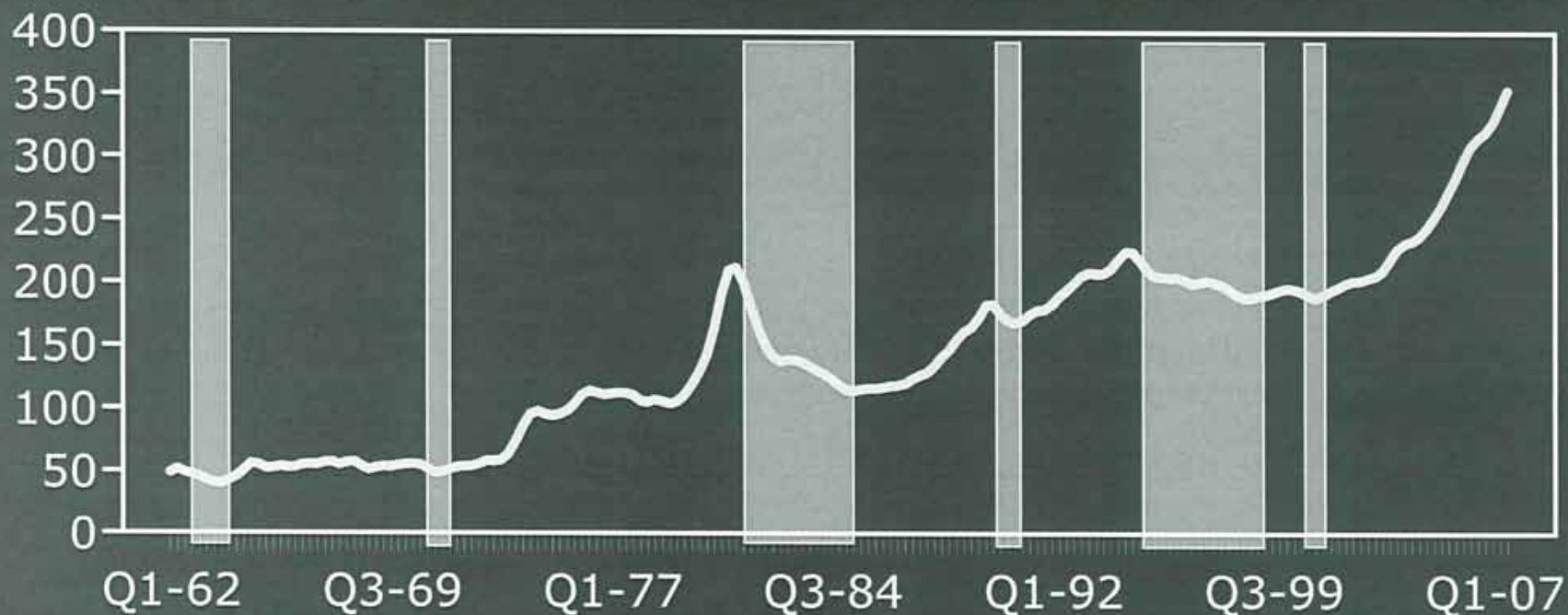
- Longest on record due to favourable economic fundamentals
- Housing price rise largest in current dollars, behind 1979-81 expansion in real dollars
- Housing volumes high though below previous peaks on a per capita basis
- Speculation activity lower than in 1979-81 market



Housing price cycles in B.C.

Real Residential MLS Average Sales Price, B.C., Quarterly

1992 Dollars - thous.



Source: CREA, CUCBC. Actual deflated by BC consumer prices. Latest: Q3-07
Shaded areas represent housing price recessions.



B.C. housing market downturns:

- Most often due to external factors
- Usual causes are a substantial and sustained negative change to demand drivers: large increase in mortgage rates, falling income and rising unemployment, lower in-migration
- B.C.'s economic recessions usually export driven resulting in rising unemployment, lower incomes followed by lower in-migration



End-of-cycle scenario #1:

- Negative external event (eg. oil price shock, SARS, geo-political, run on U.S. dollar, etc.) hits economy and financial markets
- Housing volumes and prices drop sharply
- Most difficult to predict, no lead time
- Probability < 10%



End-of-cycle scenario #2:

- Economic recession or rising interest rates
- Housing volumes and prices drop moderately
- Housing contraction lasts about one to two years
- More predictable, some lead time
- Probability - 25%



End-of-cycle scenario #3:

- Normal market adjustment process
- Supply grows at faster pace, new investment more costly
- Sales volume shrinks due to affordability price squeeze and less short-term investor activity
- Moderate decline in volumes
- Modest decline in prices



End-of-cycle scenario #3:

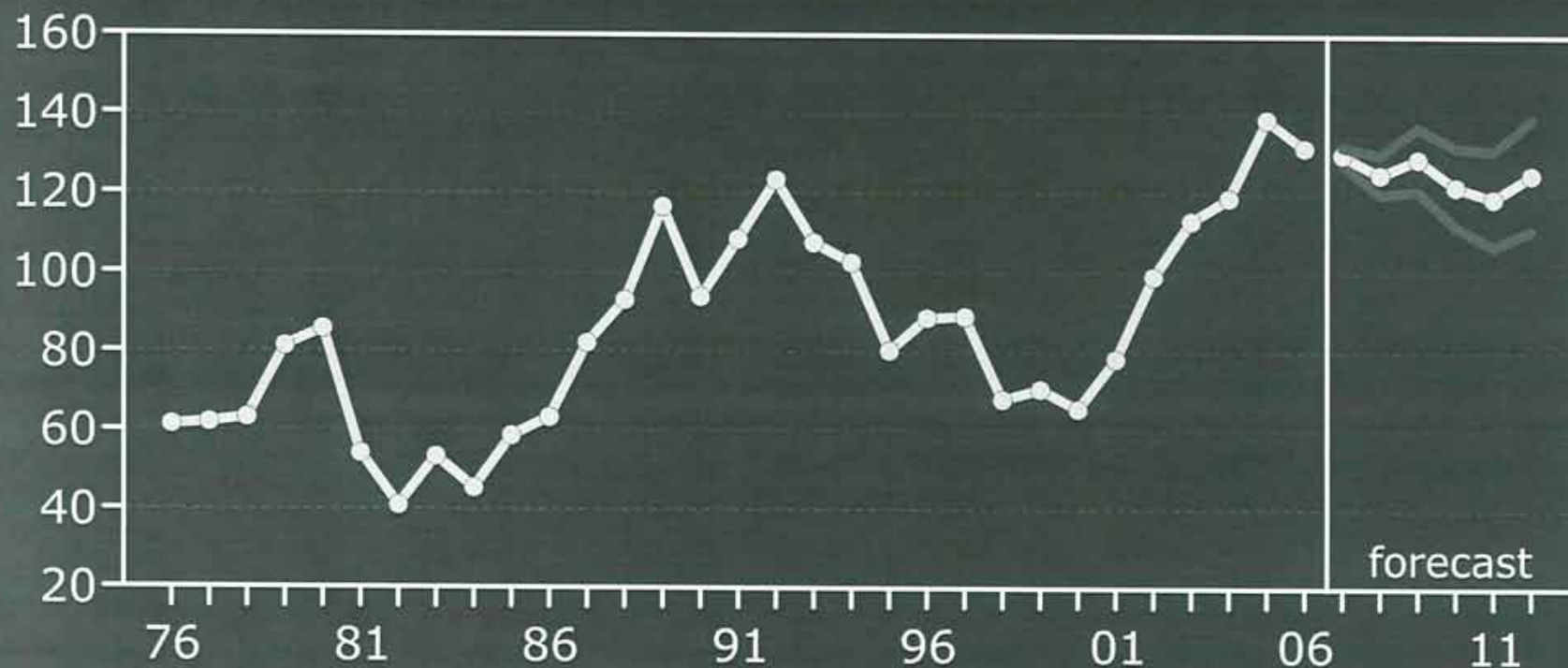
- Long adjustment process possibly two to five years
- Probability - 65%
- No prior precedence



Housing sales to remain at high level, slide lower next five years

Housing Sales, B.C.

Units - thous.



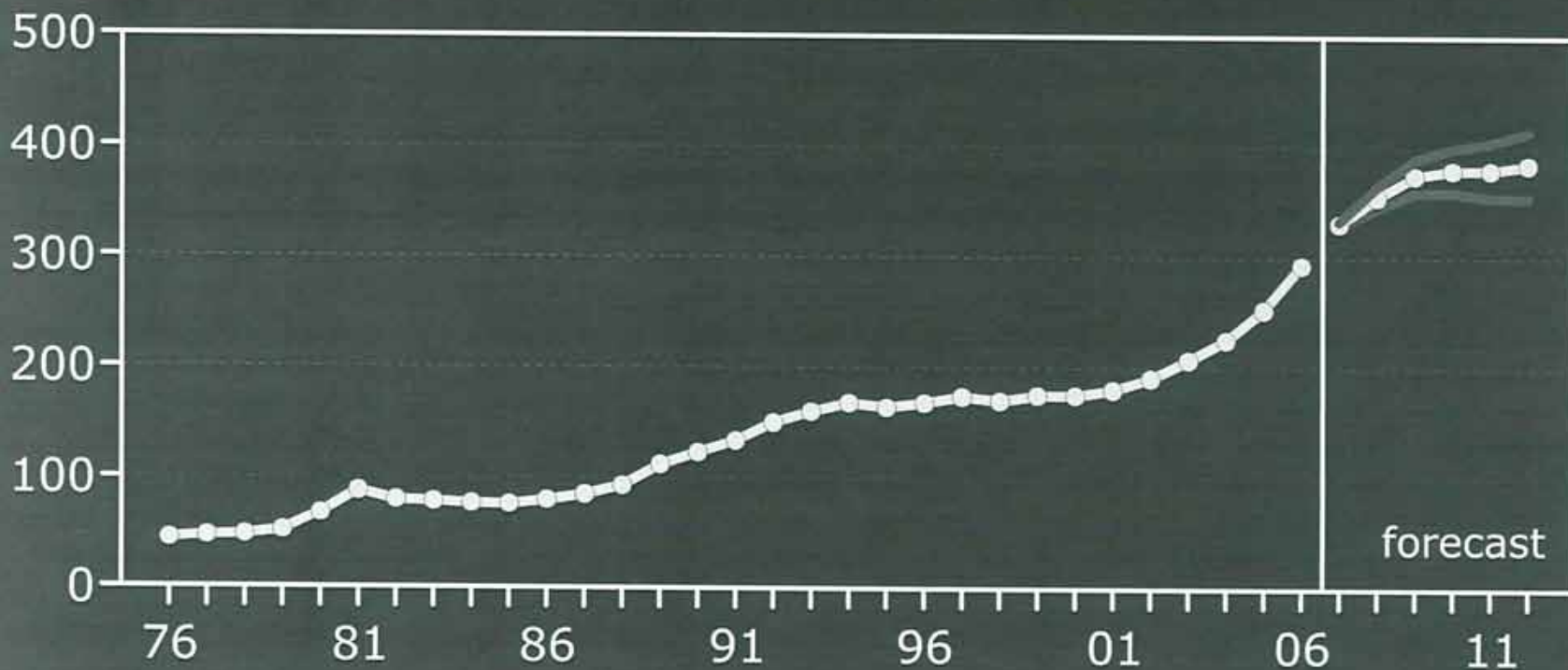
Source: Landcor Data Corp., CUCBC.



Housing prices to level out, small probability of outright decline, rate of increase declines

Housing Median Sales Price, B.C.

Dollars - thous.



Source: Landcor Data Corp., CUCBC.



Summary:

- Subprime problem worsens, U.S. housing in recession until mid-2008, no economic recession
- ABCP crisis in Canada subsides in 2008
- Slightly higher cost of mortgage funds, negative in near term
- Loss in consumer confidence is a risk
- Oil prices stay high
- U.S.-Canada exchange rate rises further in medium term



Summary: *(continued)*

- Interest rates remain favourable, no significant increase or decrease in 2008, modest increase in longer term rates thereafter
- B.C.'s economic expansion continues
- Domestic sectors drive economic growth
- Tight labour market
- Housing price increases continue easing
- Housing 'soft landing' scenario most likely outcome

