

Another batch of mixed economic reports on the province's economy was released this week. There is inherent noise or erratic movement in monthly economic numbers, regardless of how diligently statisticians process the data. Trying to distinguish between the noise and the beginning of a meaningful turn in the data is ultimately a judgment call. Based on this week's releases, which included weaker housing and retail sales, Ontario's economic recovery is intact, in our view.

MLS® housing sales stalled in January, though at a high level. More important is the pattern over the past three to four months, which points to a near-term top in sales activity. To some extent the rebound following a shock-triggered plunge always runs out of steam in every market, and that could be at play here. Another reason could be a downshift in MLS® market share, since it declines when the market improves and vice-versa. Unfortunately, there is no other timely data source on housing transactions. Demand factors could be responsible as well, since housing prices are well up from their lows and are squeezing out more potential low-equity buyers.

The federal government's latest moves on mortgage insurance rules to contain excesses in the housing market might not have been necessary, if the market was slowing in any case. Nonetheless, the year-over-year comparisons – sales up 62% in January and prices up 19.5% -- may have carried the day. The move to have low-equity borrowers qualify at the posted five-year fixed term rate versus the posted three-year rate adds about 13% to the monthly principal and interest payment and to qualifying income, thereby reducing credit to those buyers. The government's stated intent is to prepare such buyers for the inevitable rate increases.

Another move was to reduce credit for small investors. Non-owner occupied purchasers are now required to make a 20% downpayment rather than 5%, and the amount of rental income from those properties going towards debt

service is reduced to 50% from 80%. The intent is to reduce speculation. Without going into a long piece on this, this regulatory change will do little to stop speculation – a better policy tool would be to use the tax system – but it will reduce the supply of rental units provided by small investors. While rental housing vacancy rates are high and there is no overall supply shortage now, in two to four years a tighter rental market is likely and more supply will be required.

The impact of these changes and the pending HST on housing sales will distort first-half activity by bringing forward sales that would normally have occurred later. Housing prices are likely pushed higher than otherwise in the first half, but will slow down thereafter. For those focused on year-over-year comparisons, the average sales price would have slowed to less than 10% by the end of the year, even without those new mortgage insurance measures. A housing slowdown after mid-year will contribute to less economic activity later on.

Turning to other indicators, the **Consumer Price Index** (CPI) jumped to 1.9% in January from one year ago, up from 1.2% in December and 1.0% in November. The base effect is greatly influencing the figure for these and prior months, mainly due to the large drop in energy prices with the financial crisis, and this creates a distraction from the underlying inflation trend. Inflation is rising but at a moderate pace. Energy prices are up from their lows and costs of other services such as health care, home insurance, and shelter costs are up, though the higher dollar is bringing down costs of imported goods such as clothing, footwear, and some food items. CPI inflation rose 0.4% in 2009 but an increase of 1.6% is likely this year.

Retail sales slipped lower in December, for the second month in a row. This is likely noise rather than a trend change, since there was no noticeable shift in consumer demand drivers in those months. On a positive note, December retail sales edged up when adjusted for inflation. With December completing the year's data, retail sales



declined 2.5% in 2009 compared with a gain of 3.5% in 2008. This year's forecast is for 4.0%.

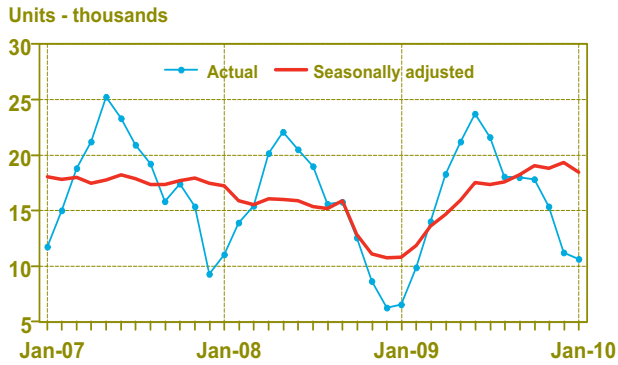
The **manufacturing** sector turned in a better performance in December with total sales up 2.3% over November, led by a 4.6% increase in transportation equipment sales. Motor vehicle manufacturing posted a 4.9% gain while motor vehicle parts manufacturing saw a 1.2% increase. For the year, manufacturing sales were down 18.6%, with the **auto sector** down about 25%. Prospects in 2010 are much improved with a growing North American economy, but the higher Canadian dollar remains a constraint.

The latest **Employment Insurance (EI) data** signal further improvement in the labour market. EI initial and renewal claims declined in December to their lowest monthly level in more than a year. The downtrend since the mid-2009 high is well established and looks to continue into 2010. Most of the decline was in initial claims received, which is a positive sign. Renewal claims are also declining, but the expiry time factor could be influencing this number. In any case, the labour market is on the mend but, just as with the economy and manufacturing in particular, it has a long way to go before achieving full and complete recovery.

(graphs on page 3)

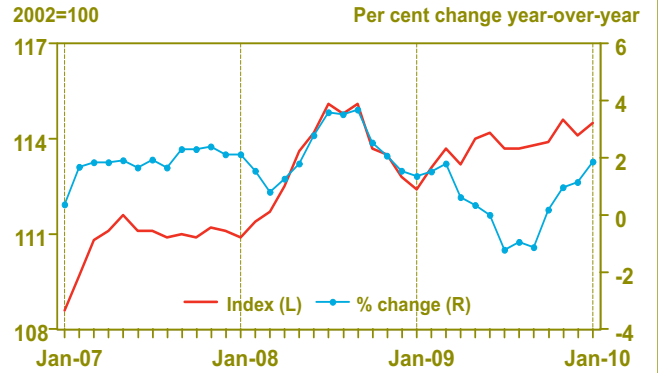
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MLS® Residential Sales, Ontario



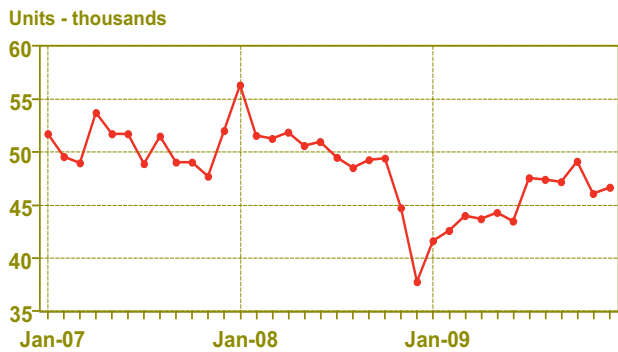
Source: CREA, C1CU.

Consumer Price Index, Ontario



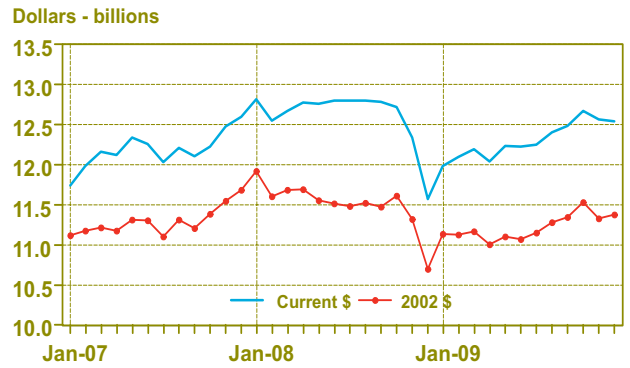
Source: Statistics Canada.

New Motor Vehicle Sales, Ontario



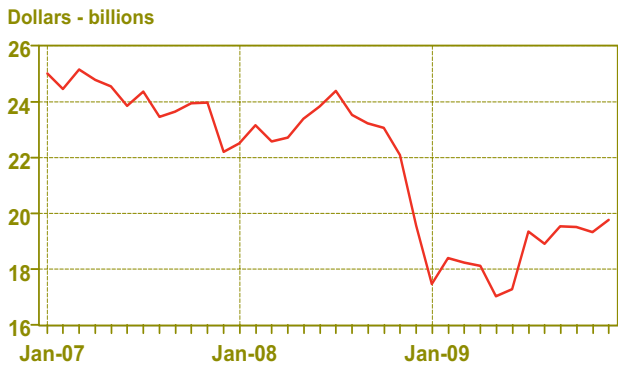
Source: Statistics Canada. Note: Seasonally adjusted. Latest: Dec-09

Retail Sales, Monthly, Ontario



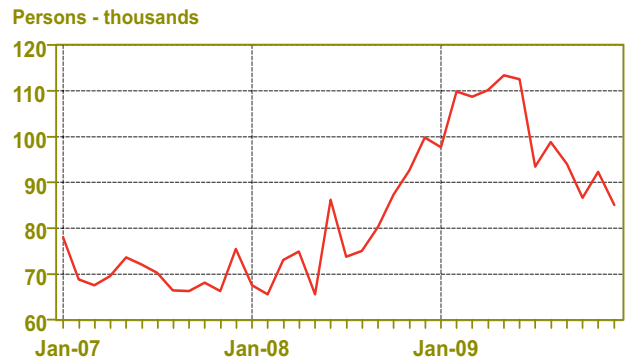
Source: Statistics Canada, C1CU. Note: Seasonally adjusted. Latest: Dec-09

Manufacturing Sales, Ontario



Source: Statistics Canada. Note: Seasonally adjusted. Latest: Dec-09

Employment Insurance Initial and Renewal Claims Received, Ontario



Source: Statistics Canada. Note: Seasonally adjusted. Latest: Dec-09