TORONTO

STAFF REPORT
ACTION REQUIRED

Economic Dashboard

Date:	May 4, 2012
To:	Economic Development Committee
From:	General Manager, Economic Development and Culture
Wards:	All
Reference Number:	P:/2012/Cluster A/EDC/ECON DEV/May/ed1205-018

SUMMARY

This report updates the Toronto Economic Dashboard. It provides a summary of the most recent data available at the time this report was prepared for key economic indicators benchmarking the City's economic performance.

The Economic Dashboard this month starts with a few slides that highlight changes in house prices in the last several years, since the potential for a major house price correction has been identified as a significant threat to Canada's economy.

RECOMMENDATION

The General Manager, Economic Development & Culture recommends that:

1. The Economic Development Committee direct staff to update the Labour Force charts in the attached presentation posted on the City's website, when April Labour Force Survey (LFS) data are available.

Financial Impact

There are no financial implications resulting from the adoption of this report.

DECISION HISTORY

At the January 28, 2011 meeting of the Economic Development Committee (EDC), staff made a presentation providing an overview of various trends and issues affecting Toronto's economy. After discussion among the committee members, the Committee

Chair requested staff to submit a report updating the key indices that benchmark Toronto's economic health at each subsequent EDC committee meeting.

COMMENTS

In the last several months a number of economic observers have indicated concern about the potential for a housing bubble in Canada. Maclean's magazine announced that it is "Time to panic about the housing market" (Feb 28, 2012). The National Post ran a column (Apr 13, 2012) calling for a ban on foreigners buying Canadian houses. There is even a website called "canadabubble.com", which is devoted to news about the housing bubble in Canada.

Several economic observers have drawn particular attention to Toronto's potentially "overheated" condo market, pointing out that condominium sales have been setting new records in Toronto and that house prices are up by 10 percent in the last year. This month we have added 6 slides that look into these issues.

House Prices

Slide 3 in the Appendix to this report shows that house prices have doubled in the Toronto Census Metropolitan Area (CMA) in the last 12 years. At the same time, average wages have increased by only 40 percent. This situation would have created an unprecedented affordability problem, but for unprecedented low interest rates. Even with today's very low interest rates, it is increasingly difficult for families with modest incomes to afford to buy a house in Toronto.

Two series of data portray house prices. The smoother line is the Teranet-National Bank house price index. This Canadian index is similar to the Case-Schiller index in the United States, which is considered superior to most house price indexes, because it is compiled from matched pairs of sales of the same house over time. The Teranet house price index lags MLS data published by the Toronto Real Estate Board by several months, because it captures sales information from the land registry after the deal is closed. The MLS index may also be have a small upward bias, because the average quality of housing in the Toronto CMA is rising over time.

Slide 4 compares the change in house prices in 11 major CMAs in Canada over the last 12 years. If one looks at a longer timeframe than one or two years, it is clear that house prices have increased much more modestly in Toronto than elsewhere in Canada. In the last ten years, house prices have increased by 72% in Toronto, which is slightly higher than Hamilton (68%), but it is a lot lower than all other nine Canadian cities. For example, Winnipeg house prices are up by 152% in the last 10 years. See slide 5, which shows the change in house prices over the last 10 and 12 years in each CMA. There is also evidence that the resale prices of condominiums in Toronto have increased less quickly than the price of grade-related housing. Based on house prices, it seems more likely that Quebec City or Winnipeg is experiencing a housing bubble than Toronto.

Slide 6 is a longer timeseries, which shows the change in house prices from 1966 to 2011 in the Toronto Region. These data are the TREB MLS data, because the Teranet House Price Index does not go back this far. This chart shows the dramatic drop in Toronto house prices that occurred in 1989 and that coincided with the worst recession we have experienced in last 70 years. Clearly, there was a housing bubble in Toronto in 1989.

In slide 7, we show the ten years leading up to (and after) the 1989 housing bubble in blue and the ten years leading up to 2011 in red. House prices increased by 151% in the four years leading up to the house price crash in 1989. By comparison, in the last four years, Toronto house prices are up by 24%.

The period leading up to the 1989 was a higher inflation period than the last ten years, so it might be reasonable to expect that house prices would have increased at least at the rate of inflation. In slide 8, we have adjusted house prices for inflation, using the Toronto Consumer Price Index. Slide 8 shows that, even after adjusting for inflation, the run up of house prices before 1989 was much more dramatic than today.

In growing urban areas, over long periods of time, one would expect house prices to increase faster than inflation, because house prices (like wages and productivity) tend to be higher in big cities than in small cities. The population of the Toronto CMA increased from 3.9 million in 1989 to 5.8 million in 2011.

It is clear that Toronto's housing market in 2012 is not comparable to 1989. There is no housing bubble; however, it is possible and may even be likely that house prices will correct, and given today's very low inflation rate, a correction is likely to result in nominal dollar decreases in house prices. In December 2011, the International Monetary Fund (IMF) calculated that house prices were 10-15% over-valued in Ontario. http://www.imf.org/external/pubs/ft/scr/2011/cr11365.pdf .

Housing Starts

The record number of cranes in downtown Toronto is often also cited as an indicator of over-building. While it is true that the number of cranes in Toronto is the highest in North America, that by itself does not demonstrate overbuilding. The Toronto region is one of the fastest growing regions in North America. Between 2006 and 2011, we added an average of 100,000 people to the Toronto CMA each year.

The average number of persons per housing unit in the Toronto CMA was 2.68 in 2011; however, it is much lower for new condos, which contain a disproportionate share of bachelor and one bedroom units. Assuming an average of 2.5 persons per household, the region needs an additional 40,000 housing units each year just to keep up with population growth.

In the last twelve months (April 2011-March 2012), total housing starts in the Toronto CMA were 42,050 and over 20,000 of those were in the City of Toronto. However, one has to subtract demolitions to get net new units. There were over 1,000 residential demolition permits issued in the City of Toronto alone in the last 12 months. Therefore, it looks like we are building almost exactly the right number of new units. Furthermore, total annual CMA housing starts have exceeded 40,000 units in 6 of the last 12 years. This does not look like a housing bubble.

There are a lot of condos under construction in the City of Toronto and elsewhere in the region, but the number of low-rise starts has been reduced significantly. Fifteen years ago the City of Toronto accounted for 25% of housing starts in the CMA; today the City's share is almost 50%.

There is no sign of the pace of condo sales slowing down. The most recent data from Urbanation show that 6,070 new condos were pre-sold in 2012q1, which is an increase of 17% over 2011q1, and 12% higher than 2010q1, the previous record high first quarter. The City of Toronto's share of 2012q1 condo pre-sales was 80%. The total number of unsold units also increased in 2012q1, not because of a lack of demand but rather because the number of new projects increased even faster than sales.

Personal Debt

Another risk that is often cited in conjunction with the increase in house prices is the increase in household debt held by Canadians. Canadians have assumed more debt, in response to very low interest rates and rising house prices. As long as interest rates remain low, these debt levels are manageable; however, the worry is that when interest rates return to more normal levels, many Canadians will find themselves in fiscal distress.

In 1980, the ratio of household debt to disposable (ie. after-tax) income stood at 66% in Canada; it is now 151% of disposable income. As expected, household debt is strongly correlated with house prices, income and education as well as a household's stage in life. As expected, homeowners have more debt than tenants. In 2009, Ontario residents carried slightly more debt than the Canadian average. Ontario represented 37% of the population, but 40% of outstanding debt held by Canadians. Alberta and British Columbia residents carried the highest debt loads in 2009.

Environics Analytics released a study on April 24, 2012, which examines how the assets, debt and net worth of Canadian households changed from 2007 to 2010. This study shows that Canadians' assets, debts and net worth all increased between 2007 and 2010. It also shows that the composition of wealth has shifted, as households have increased their holdings of lower risk financial assets, while decreasing their holdings of riskier assets.

In 2010, City of Toronto residents had an average debt burden (total debt divided by total assets) of 17.2%, which compares to 25.1% in the rest of the Toronto CMA and 23.2% nationally. Between 2007 and 2010, City of Toronto residents increased their household debt burdens by 14.1%, slightly more than 905 residents (13.2%) and substantially less than all Canadians (19.1%).

The Environics study also points out that, between 2007 and 2010, City of Toronto residents increased their holdings of bank deposits and bonds by $32,000 (+29.2%) and decreased their holdings of mutual funds and stocks by $18,000 (-8.9%). This reduction in the risk profile of City residents' investments serves to offset (at least in part) the impact of increased debt levels on the financial security of City residents.

Averages can and do hide outliers. Most City of Toronto residents, like most Canadians, are in good shape financially; however, some people are over-extended and they will be in trouble if interest rates increase quickly. On balance, it seems that City residents are less likely to face financial difficulties than other Canadians. The most recent national data also show that household debt is now growing more slowly (4% per year), than a year ago (10% per year).

Investor Owned Condos

Another concern raised about the Toronto condo market is the anecdotal evidence that a large share (some estimates are over 50 percent) of new Toronto condos are being purchased by off-shore investors. Many of these condos, purchased by investors at the beginning of the sales process, are resold at the time of building occupancy, often to owner-occupiers.

Canada Mortgage and Housing Corporation reported that 22% of all condos in the Toronto region were rented in October 2011. CMHC also reported that demand for these condo rental units is increasing, with vacancy rates dropping from 1.6% in October 2010 to 1.1% in October 2011. Vacancy rates for purpose built rental units also declined, from 2.1% in October 2010 to 1.4% in October 2011, which is the lowest rate in ten years.

Since there is very little purpose-built rental housing being produced in Toronto, condo rentals are necessary to supplement the supply of primary rental units. As long as we do not produce more units than there are households that want to live in them, the investor owned condo story does not seem to present a credible threat.

Province of Ontario's Deficit

Another major economic event during the last month is the decision by Moody's to downgrade Ontario's debt on April 26, 2012. The reasons cited were as follows:

"The province's 2012 Budget, released on March 27, 2012, maintained the timeframe back to a balanced budget at 2017-18. Given a subdued growth outlook, the fiscal plan rests largely on significant expenditure restraint. Spending growth is expected to average 1.9% per year over 2012-13 to 2014-15, then projected to decline to 1.1% over 2015-16 to 2017-18. Expense growth targets appear particularly ambitious in light of growth in expenses averaging 7% annually in the five years to 2011-12 and continued pressures on health expenses, the province's largest expense item, due to demographic pressures. Given the extended period of consolidation and the ambitious expenditure targets, in Moody's view, there are significant risks surrounding the province's ability to achieve their medium-term fiscal targets and stabilize and then reverse the recent accumulation in debt." http://www.moodys.com/printresearchdoctopdf.aspx?docid=PR_244056

Other External Factors

The news from Europe continues to be depressing. The interest rates that investors are demanding to hold Spanish bonds are still rising, and there is evidence that several European countries have fallen back into recession, which of course makes it more difficult for them to balance their budgets. This process has the worrisome potential of setting off a downward spiral.

In March 2012, Spain's youth unemployment rate rose to 51%, roughly the same rate as in Greece. Portugal and Italy are not far behind, with youth unemployment rates around 36%.

In the United States, the federal government is also facing seemingly intractable fiscal imbalances. The U.S. economy is expanding; albeit slowly, The April 2012 seasonally adjusted unemployment rate in the United States was 8.1%, which is a considerable improvement over a year ago; however, the reduction in U.S. unemployment rate occurred because labour force participation rates have declined sharply

As a major trading nation, changes in global circumstances impact Toronto, Ontario and Canada. Ontario exports $181.5 billion annually and $142.5 billion of that goes to the United States. The Canadian dollar remains well above most estimates of purchasing power parity and above historical levels vis-à-vis the American dollar. Notwithstanding the challenge posed by the high Canadian dollar, it will be necessary to expand exports over the next several years. Governments at all levels are retrenching, the high level of consumer indebtedness in Canada and the potentially overheated housing market, all leave us with few other options.

The Bank of Canada, Business Outlook Survey (April 9, 2012) indicates that the investment intentions of firms remain "firmly positive". Some 46% of firms surveyed expect to increase their investment on machinery and equipment versus 22% who anticipate decreases, while 55% expect to increase their employment over the next 12 months by comparison to 12% anticipating decreases

The diversity of Toronto's economy is a key factor contributing to the city's continued relatively strong performance. The Financial Services, Food & Beverage, Information Communication &Technology, Renewable Energy, Professional & Business Services, Biotechnology, Education & Training, Design, Film & Digital Media, and Culture sectors, all make a strong positive contribution to Toronto's economy as individual industry sectors and create synergies that enable other industries to succeed as well.

The rest of the attachment to this report provides updated economic indices available at the date of this report. Highlights include:

Gross Domestic Product

Two firms (Moody's and the Conference Board of Canada) produce quarterly economic forecasts for the Toronto CMA. Since the beginning of 2012, both forecasts have been downgraded for the Toronto CMA's real growth rate in 2012 and 2013, which seems counter-intuitive when we consider that the news from Europe has improved significantly.

The reason that the forecasts have been downgraded, while the economic outlook seems to be improving, is that large downside risks are described as "risks" to the base case forecast and are not usually factored into the forecast. The default of several European countries followed by the collapse of most of the European banks is a large downside risk to any current forecast, and most observers think the risk is lower today than it was six months ago; however, that risk was not factored into the forecasts in the first place.

Moody's is projecting real GDP growth of 2.1% in 2012 for the Toronto CMA and the Conference Board of Canada is forecasting 2.3%. Population is projected to increase by 1.6% in 2012; therefore, real GDP per capita is likely to increase modestly as well. Increasing output per capita supports rising incomes; however, these projected increases are rather modest.

Labour Force

April 2012 labour force survey data were not available at the time of writing this report. April data will be released on May 11, 2012.

The seasonally adjusted monthly unemployment rate for City of Toronto residents fell from 9.4% in February to 8.8% in March 2012, bringing this important indicator back to where it was in September, 2011.

It now appears that the brief spike in the seasonally adjusted unemployment rate for City residents was just a statistical anomaly. Normally, when one sees a spike that lasts more than one month, it may appear to be a trend however this is an artifact of the survey methodology. The labour force survey follows each household surveyed for six months; therefore, each month's sample is not independent from the preceding month, which is why these random spikes in LFS data last more than one month.

Even at 8.8%, however, the unemployment rate for City residents remains more than one percent above the levels currently faced by 905, Ontario and all Canadian residents.

Since last summer the City's labour force participation has been trending upwards, and the March numbers reinforce this trend. Today, 27,000 more City of Toronto residents are employed than were employed a year ago.

Building Activity

The City of Toronto continues to lead all North American municipalities in the number of high-rise buildings under construction (189). Mexico City (88) and New York City (81) are the closest municipalities to Toronto with the largest number of high-rise buildings currently under construction.

The total value of building permits issued by the City of Toronto in March 2012 was $840 million. The value of Industrial, Commercial and Institutional (ICI) permits issued in the City of Toronto in March 2012 was $571.0 million, and one project (Humber River Regional Hospital) accounted for over half of the ICI total in March.

The timing of permit issuance for large projects produces large fluctuations from month to month. Therefore, the data in the building permit charts are presented as three month averages. On a three month average basis, the value of all permits issued in the city stands slightly lower today than a year ago, but ahead of the rest of the Toronto region.

Office Market

The overall office vacancy rate within the City of Toronto has been trending downward for the last two years and is now stands at 5.5% (2012q1), despite the recent completion of several large office buildings downtown. Vacancy rates downtown and along the Yonge St Core are below five percent.

According to Colliers there is almost 2.5 million square feet of office space under construction in the GTA at present and 1.5 million of that is south of Union Station.

Housing

The Toronto Real Estate board reported 3,925 house sales in April 2012 in the City of Toronto at an average price of $568, 436 – up by 7.6% compared to a year earlier.

Total housing starts in the City of Toronto in 2012q1 was 5,021 units, which is 47% of all housing starts in the Toronto region, and it is 1,588 units higher than 2011q1 .

Retail Sales

Total retail sales in 2011q4 in the Toronto region were $17.9 billion, which is a small increase from the same period the previous year. Retail sales in January and February 2012 are also higher than the same months a year ago.

CONCLUSION

There is no housing bubble in Toronto; however, house prices may have over-shot their appropriate level, so we could see a modest correction in house prices over the next year. Total housing starts in the region are not above historic levels and are supported by substantial population growth. Unless regional population growth slows significantly or housing preferences shift back towards the detached house at the urban fringe, there does not seem to be an oversupply of housing in Toronto.

Employment in the City is expanding, more City residents are finding jobs, TTC ridership is setting new records, retail sales are expanding, and Canadians have started to reduce the rate of increase in their indebtedness, as well as reducing the riskiness of their holdings of non-real estate assets.

On the down side, Europe's sovereign debt problems are still with us, there is no plan in place to reduce the US federal deficit, and bondrating agencies are beginning to lose faith that the deficit reduction plan set out in Ontario's 2012 budget will be realized.

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ATTACHMENTS

Attachment: Economic Indices Presentation