

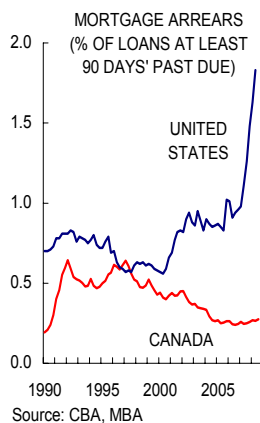


Real Estate Trends

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Reversal of Fortune

Canada's longest housing boom of the post-war period has come to an end. Sales, home prices and residential construction in 2008 are all running below their recent highs. The reversal of fortune has been most pronounced in the previously hottest markets of Western Canada, including Calgary, Edmonton and Vancouver. Nonetheless, conditions in virtually all regions are tilting back in favour of buyers for the first time in years.



We argue against taking an overly alarmist view to domestic housing prospects. This is not a 'U.S.-style' bust caused by overbuilding, speculative buying and imprudent lending, but rather a cyclical slowdown accompanied by a valuation adjustment in several large centres where booming demand conditions and temporary supply constraints led to an overshooting in prices. The adjustment is now being hastened by the sharp downgrading in global economic prospects and severe turbulence in financial markets in the wake of the U.S.-subprime meltdown.

As we have detailed in several recent commentaries, Canada's mortgage market is significantly different than its U.S. counterpart, with a much smaller sub-prime exposure, less interest rate reset risk, lower use of home equity withdrawal and investor mortgages, and more conservative lending criteria. Canadian households are far less leveraged than those in the United States, and less exposed to any erosion in underlying asset values. The continuing low levels of mortgage arrears domestically are a case in point (see chart).

Mortgage and balance sheet considerations aside, there are key differences in the fundamentals of Canada's housing market relative to the United States. For one, the inventory of for-sale homes in both the new and resale market, while moving up, is still well contained relative to prior cycles (see chart). With builders in most jurisdictions beginning to slow the pace of new construction, and with a low risk of widespread foreclosures, the Canadian market does not face the massive inventory glut underlying record-setting U.S. price declines.

Scotia Economics

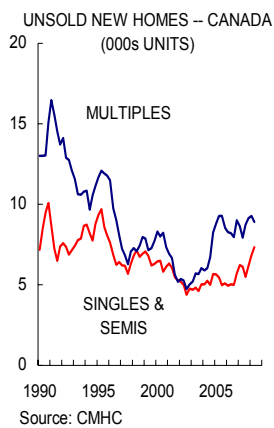
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A Global Context

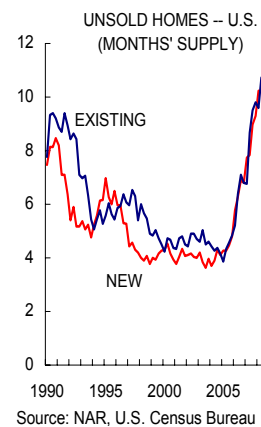
We have tracked real house prices across a number of major developed nations over a 10-year period — coinciding with the latest global housing cycle — to provide some international context to Canadian price trends (see appendix). Home price appreciation in both the United States and Canada has actually been relatively modest by international standards, totaling a cumulative 50% and 61%, respectively. While real prices have declined in Japan and Germany, the 10-year cumulative price run-up was considerably larger in Ireland, the U.K., Spain, France and Australia, all of which have experienced increases upward of or exceeding 100%. While available data for 2008 varies, real price growth appears to have decelerated sharply or turned negative in all 10 countries considered, including Canada.



Real price trends are not a particularly useful guide to future price movements, at least over the short-term. The driving forces behind the price appreciation as well as current supply and credit conditions are more important. Record unsold housing inventories (see chart), mounting foreclosures, overbuilding and credit constraints are bigger factors behind the continuing and steep slide in U.S. home prices than overvaluation, none of which are major concerns in Canada.

We have compared a number of other international house price metrics, which taken together may provide a measure of price risk (see appendix). These should be interpreted with some caution given differences in coverage and valuation methods across countries. Canada has a relatively high price-to-rent ratio, but ranks in the

middle of the pack in terms of price-to-income measures as well as in overall household leverage. Based on the IMF's housing valuation model, which estimates the extent to which house price increases are unexplained by fundamentals (e.g. income growth, interest rates, population growth), Canada's housing market is the least overvalued. Ireland and the U.K. retain the biggest 'price gaps', followed by Australia, France and Spain, while U.S. house prices are estimated to be only moderately overvalued following recent price declines.

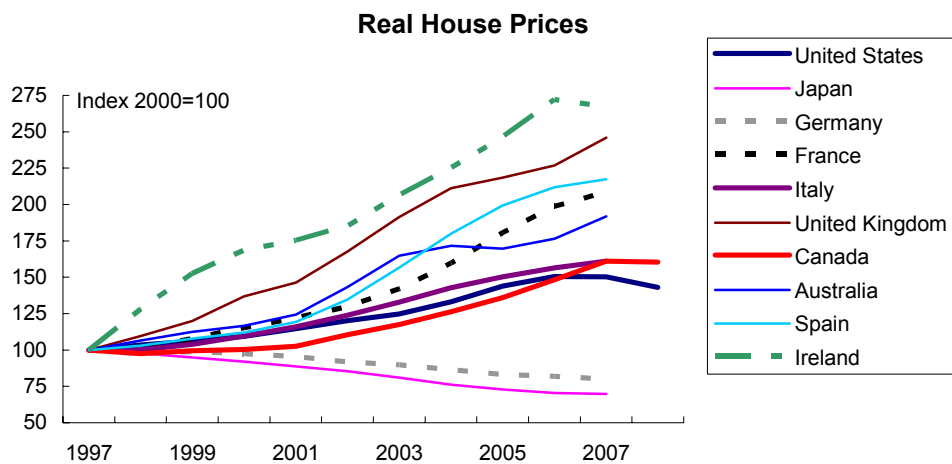


There is further downside risk to home prices in Canada, especially in light of reduced growth and employment prospects. We expect, however, that the correction in national average prices from their late-2007 peak will probably be in the range of 10-15%, well below the ongoing U.S. retrenchment. Much of

this realignment will occur in Canada's three Western-most provinces, and will leave intact most of the significant price appreciation of recent years. Longer-term, the process of gradual housing price deflation globally may well be more pronounced outside of North America, including Ireland, Spain, the U.K. and Australia.



APPENDIX — INTERNATIONAL HOUSING PRICE COMPARISONS



Source: OECD. Scotia Economics estimate for 2008H1

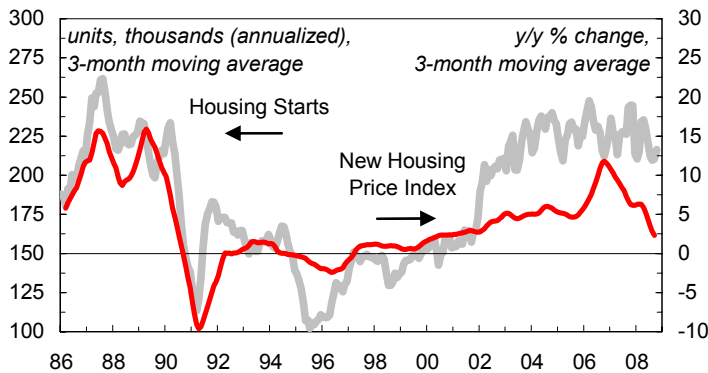
	Real house prices, % chg 1997-2007	IMF house price gap, % 1997-2007	Price-rent ratio, % 2007	Price-income ratio, % 2007	Household debt, % PDI (latest data)	Trough-Peak housing cycle
U.S.	50	11	128	110	141 (2007)	1996-2006
Japan	-30	12	69	66	131 (2006)	
Germany	-20	2	71	65	105 (2006)	
France	108	22	160	141	89 (2006)	1998-2007
Italy	61	12	127	116	69 (2006)	1999-2007
U.K.	146	28	171	149	177 (2007)	1996-2007
Canada	61	-3	190	134	134 (2007)	1999-2007
Australia	92	24	177	145	173 (2005)	1997-2007
Spain	117	17	198	156	107 (2004)	1997-2007
Ireland	167	32	138	135	141 (2005)	1993-2006
Ranking						
1	Ireland	Ireland	Spain	Spain	U.K.	
2	U.K.	U.K.	Canada	U.K.	Australia	
3	Spain	Australia	Australia	Australia	U.S.	
4	France	France	U.K.	France	Ireland	
5	Australia	Spain	France	Ireland	Canada	
6	Canada	Italy	Ireland	Canada	Japan	
7	Italy	Japan	U.S.	Italy	Spain	
8	U.S.	U.S.	Italy	U.S.	Germany	
9	Germany	Germany	Germany	Japan	France	
10	Japan	Canada	Japan	Germany	Italy	

Source: OECD, IMF, Scotia Economics calculations.

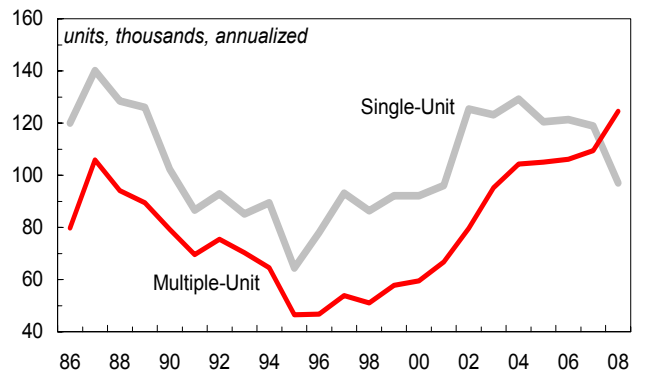


Canadian Residential Markets

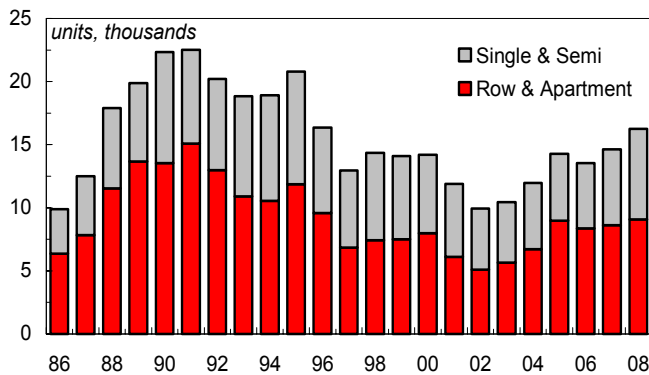
New Home Markets



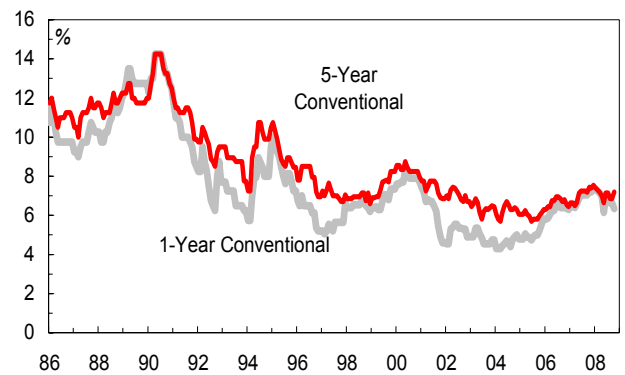
Housing Starts



Inventories of Unsold New Homes



Mortgage Rates



Housing Starts

	Canada	B.C.	Alberta	Sask.	Manitoba	Ontario	Quebec	Atlantic
<i>(000s units, sa)</i>								
2003	218	26.2	36.2	3.3	4.2	85.2	50.3	13.1
2004	233	32.9	36.3	3.8	4.4	85.1	58.4	12.5
2005	225	34.7	40.8	3.4	4.7	78.8	50.9	12.1
2006	227	36.4	49.0	3.7	5.0	73.4	47.9	12.0
2007	228	39.2	48.3	6.0	5.7	68.1	48.6	12.4
2008ytd	221	37.2	31.6	7.2	5.7	78.2	48.0	12.8
2008f	216	36	31	7	6	77	47	12
2009f	185	32	30	4	4	65	40	10

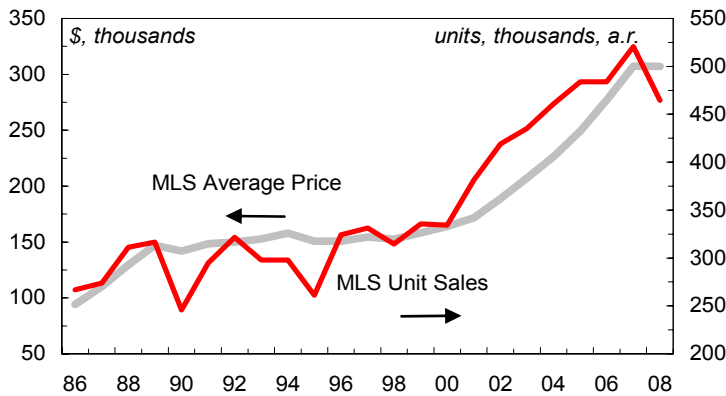
	Vancouver	Calgary	Edmonton	Toronto	Ottawa	Montreal	Halifax	St. John's
<i>(units, nsa)</i>								
2003	15,626	13,642	12,380	45,475	9,182	24,321	3,066	1,604
2004	19,430	14,008	11,488	42,115	10,470	28,673	2,627	1,834
2005	18,914	13,667	13,294	41,596	7,105	25,317	2,451	1,534
2006	18,705	17,046	14,970	37,080	8,808	22,813	2,511	1,275
2007	20,736	13,505	14,888	33,293	9,294	23,233	2,489	1,480
2008ytd	21,012	12,552	7,214	44,142	10,030	21,960	2,243	1,786

Source: Canadian Mortgage and Housing Corporation (CMHC), Scotia Economics calculations and forecasts. Year-to-date data are expressed at annual rates.

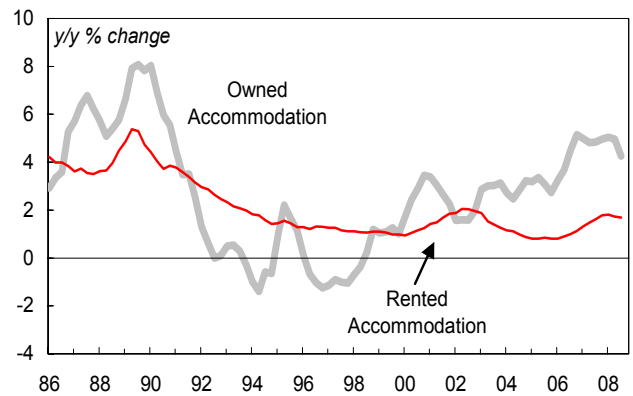


Canadian Residential Markets

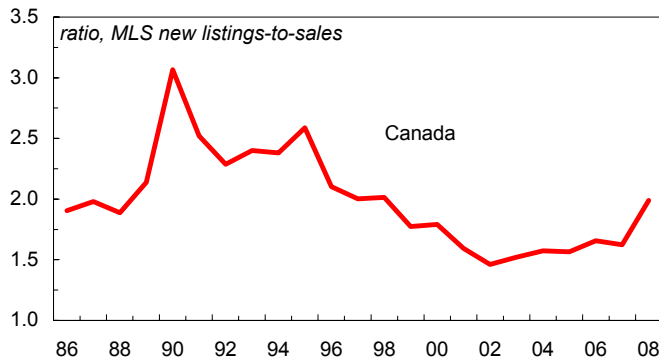
Existing Home Sales & Prices



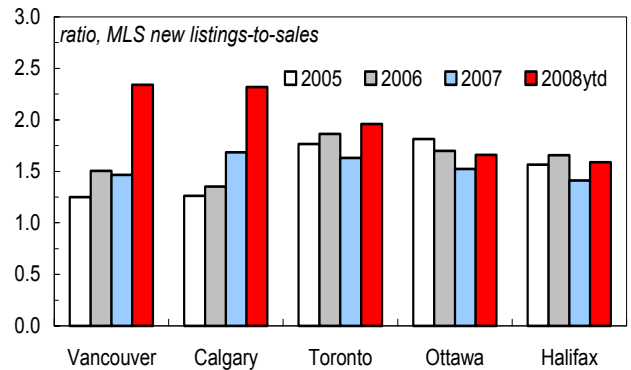
Housing Cost Trends



Existing Home Inventories



Existing Home Inventories



MLS Home Sales

	Canada		British Columbia		Alberta		Man.-Sask.		Ontario		Quebec		Atlantic	
	Avg. Price	Units	Avg. Price	Units	Avg. Price	Units	Avg. Price	Units	Avg. Price	Units	Avg. Price	Units	Avg. Price	Units
2003	207,111	435,070	259,968	93,095	182,845	51,334	106,070	19,221	226,824	184,457	151,881	67,130	122,398	19,352
2004	226,337	460,790	289,107	96,385	194,769	57,460	115,850	20,270	245,230	197,353	171,099	69,296	130,844	19,631
2005	249,165	483,927	332,224	106,310	218,266	65,866	129,480	21,073	262,949	197,140	184,583	70,649	142,177	22,444
2006	276,883	484,027	390,963	96,671	285,383	74,350	142,742	22,158	278,364	194,930	194,024	72,520	148,277	22,851
2007	307,265	520,747	439,123	102,812	356,235	71,430	171,609	25,982	299,544	213,379	208,240	80,338	158,589	26,258
2008ytd	307,150	464,451	458,366	76,700	357,141	60,572	203,491	25,085	303,706	192,552	211,605	83,639	169,537	25,384

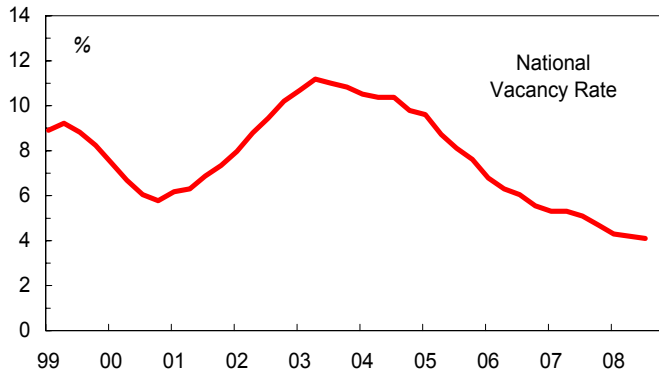
	Vancouver		Calgary		Edmonton		Toronto		Ottawa		Montreal		Halifax	
	Avg. Price	Units	Avg. Price	Units	Avg. Price	Units	Avg. Price	Units	Avg. Price	Units	Avg. Price	Units	Avg. Price	Units
2003	329,447	39,022	211,155	24,359	165,541	16,277	293,308	79,366	219,713	12,877	166,930	47,436	162,486	5,813
2004	373,877	37,972	222,860	26,511	179,610	17,652	315,266	84,854	238,152	13,457	189,050	48,564	175,132	5,516
2005	425,745	42,222	250,832	31,569	193,934	18,634	336,176	85,672	248,358	13,300	203,720	49,506	189,196	6,698
2006	509,876	36,479	346,675	33,027	250,915	21,984	352,388	84,842	257,481	14,003	215,659	50,106	203,178	6,462
2007	570,795	38,978	414,066	32,176	338,636	20,427	377,029	95,164	273,058	14,739	229,902	56,151	216,339	7,261
2008ytd	592,658	27,160	406,267	24,726	337,194	18,338	376,153	80,039	288,197	14,260	na	na	230,302	6,697

Source: Canadian Real Estate Association (CREA), Scotia Economics calculations. Year-to-date data are expressed at seasonally adjusted annual rates.

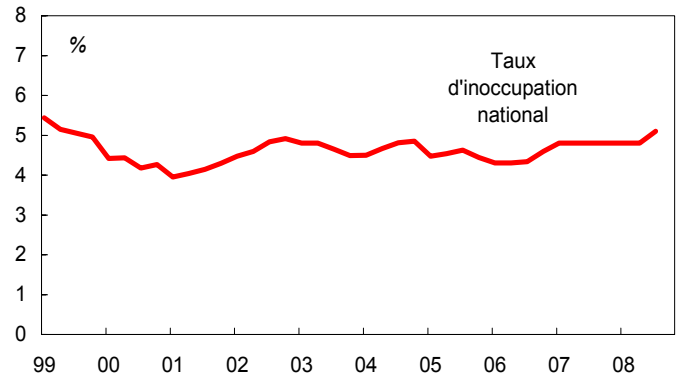


Canadian Non-Residential Markets

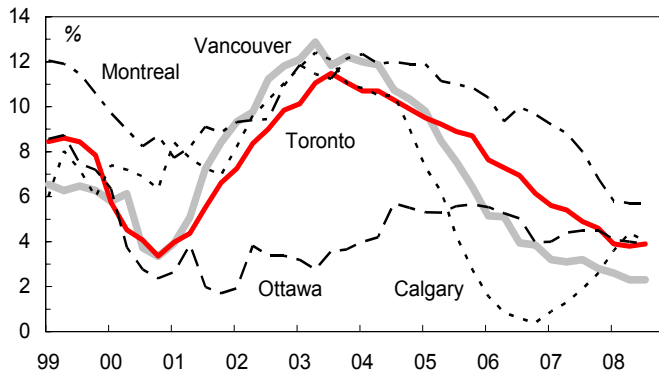
Office Markets



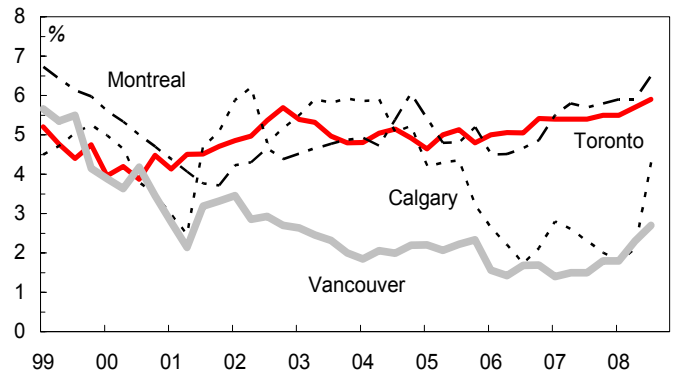
Industrial Markets



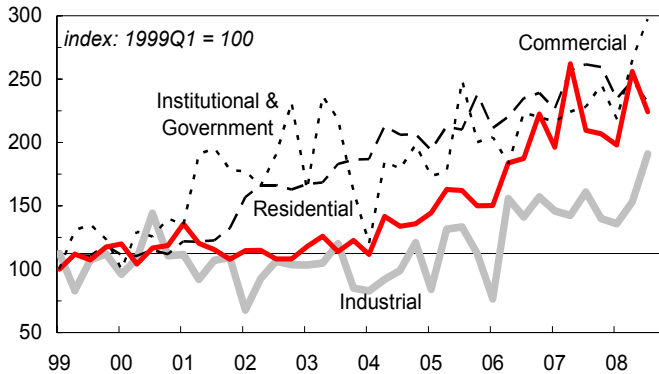
Office Vacancy Rates
Largest Five Markets



Industrial Vacancy Rates
Largest Four Markets



Building Permits



Building Permits

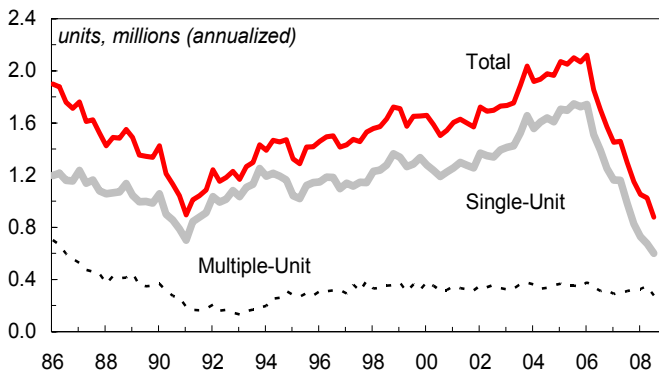
	Total	Res.	Indust.	Comm.	Inst. & Gov't
	(C\$ billions)				
2003	50.8	32.0	3.6	9.3	5.9
2004	55.6	36.8	3.5	10.1	5.1
2005	60.8	38.7	4.0	12.0	6.0
2006	66.3	41.1	4.5	14.4	6.2
2007	74.4	45.5	5.0	17.0	6.9
2008ytd	74.0	43.2	5.4	17.5	7.8

Source: Statistics Canada. Year-to-date data are expressed at seasonally adjusted annual rates.

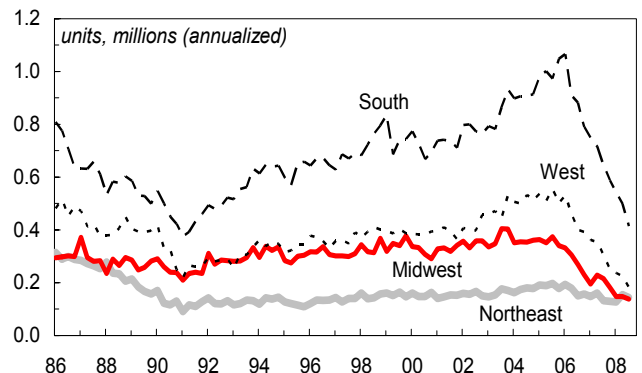


U.S. Residential Markets

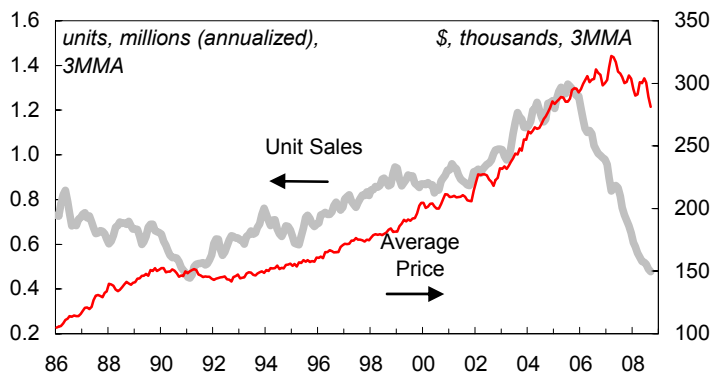
Housing Starts



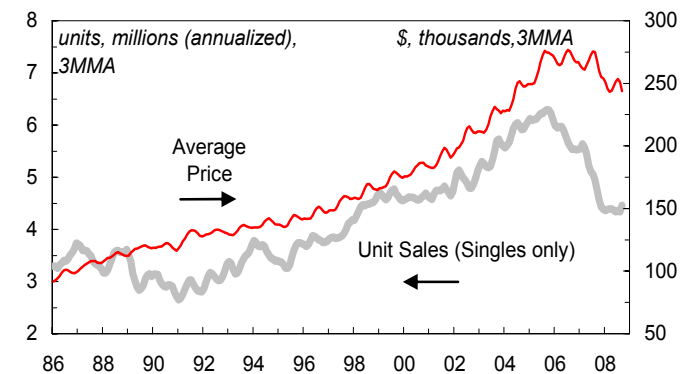
Housing Starts by Region



New Home Sales



Existing Home Sales



Housing Starts

Permits

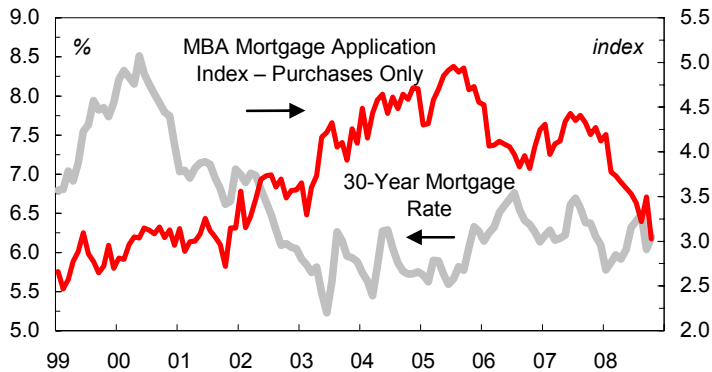
	Total	Singles	Multiples	West	South	Midwest	North East	Total	Single	Multiple
	<i>(millions of units)</i>							<i>(millions of units)</i>		
2003	1.848	1.499	0.349	0.473	0.839	0.374	0.163	1.889	1.461	0.428
2004	1.956	1.611	0.345	0.516	0.909	0.356	0.175	2.070	1.613	0.457
2005	2.068	1.716	0.352	0.525	0.996	0.357	0.190	2.155	1.682	0.473
2006	1.801	1.465	0.335	0.444	0.910	0.280	0.167	1.839	1.378	0.461
2007	1.355	1.046	0.309	0.321	0.681	0.210	0.143	1.369	0.970	0.399
2008 ytd	0.986	0.668	0.317	0.214	0.485	0.145	0.142	0.960	0.612	0.348
2008f	0.95									
2009f	0.88									

Source: U.S. Census Bureau, Scotia Economics calculations and forecasts. Year-to-date data are expressed at seasonally-adjusted annual rates.

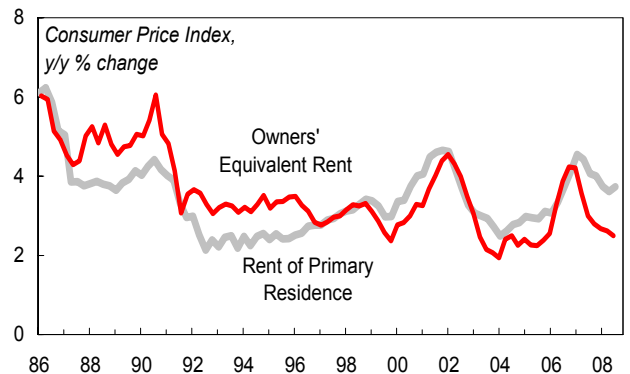


U.S. Residential Markets

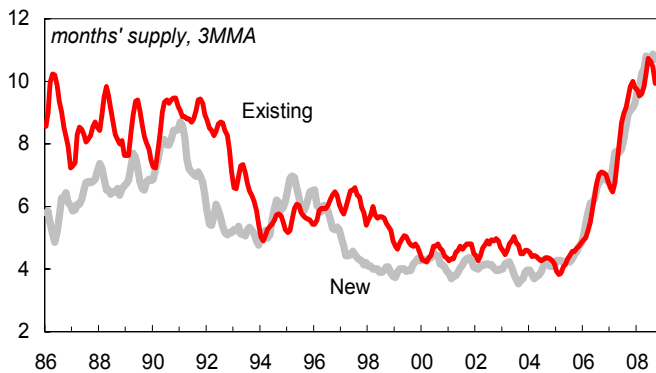
Mortgage Rates and Applications



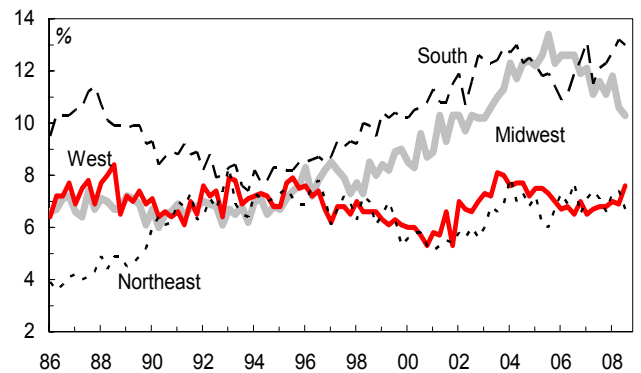
Housing Cost Trends



New and Existing Home Inventories



Apartment Vacancy Rates



Existing Home Sales

New Home Sales

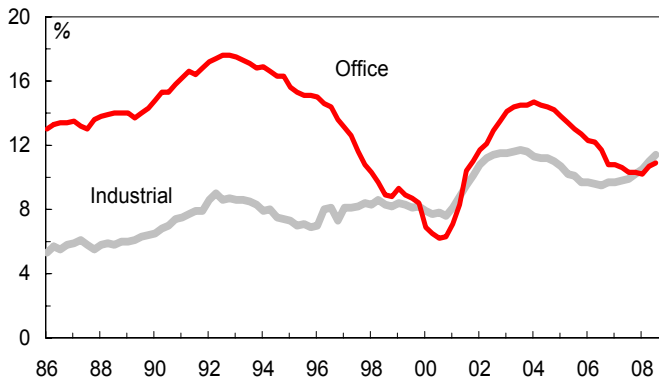
	Existing Home Sales				New Home Sales					
	Total	Avg Price (\$000s)	Months' Supply	West	South	Midwest	North East	Total	Avg Price (\$000s)	Months' Supply
	(sa)	(nsa)	(nsa)	(million units, saar, unless otherwise noted)						
2003	6.178	223.0	4.7	1.405	2.284	1.469	1.020	1.091	243.7	3.9
2004	6.778	243.0	4.3	1.575	2.540	1.550	1.113	1.201	271.5	4.0
2005	7.076	266.1	4.4	1.617	2.702	1.588	1.169	1.279	290.0	4.5
2006	6.478	269.5	6.4	1.346	2.563	1.483	1.086	1.049	303.5	6.4
2007	5.652	263.8	8.7	1.084	2.235	1.327	1.006	0.773	307.8	8.4
2008ytd	4.967	246.1	10.1	1.032	1.907	1.161	0.870	0.519	292.1	10.5

Source: National Association of Realtors (NAR), U.S. Census Bureau, Scotia Economics calculations.

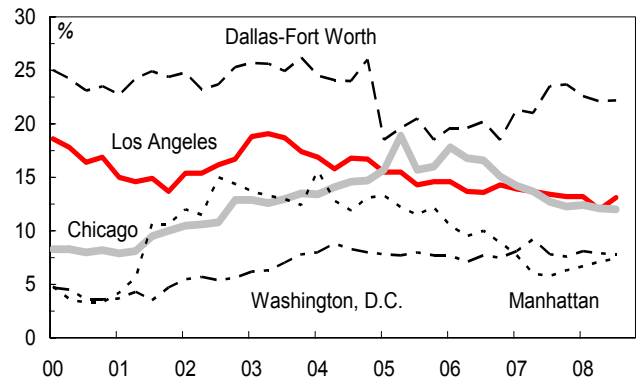


U.S. Non-Residential Markets

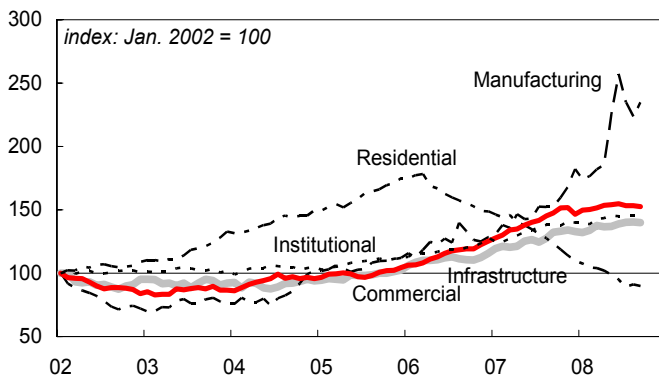
National Vacancy Rates



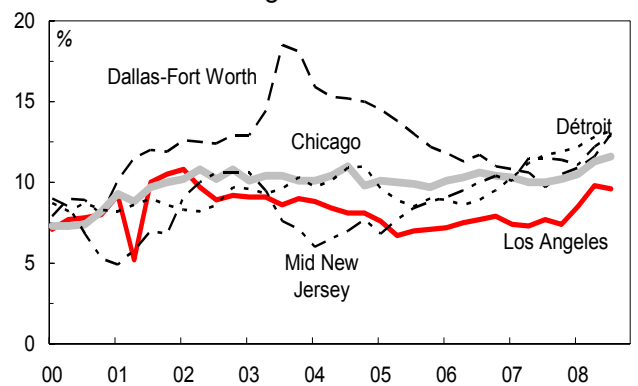
**Office Vacancy Rates
Largest Five Markets**



Construction Investment



**Industrial Vacancy Rates
Largest Five Markets**



Construction Investment

	Total	Residential	Manu- facturing	Office & Commercial	Institutional	Infra- structure	Private	Public
	<i>(US\$ billions)</i>							
2003	921.4	481.2	21.5	111.7	136.2	170.9	705.3	216.1
2004	1023.5	570.3	23.8	121.8	138.3	169.2	803.3	220.2
2005	1132.1	647.0	30.0	128.8	144.4	181.9	898.0	234.2
2006	1192.2	647.4	34.5	148.2	159.3	202.9	937.0	255.2
2007	1161.7	532.5	38.0	180.2	181.1	229.9	875.0	286.7
2008ytd	1077.2	375.4	59.6	197.2	191.0	254.0	774.5	302.7

Source: U.S. Census Bureau, Scotia Economics calculations. Year-to-date data expressed at seasonally adjusted annual rates.