Weekly economic Briefing

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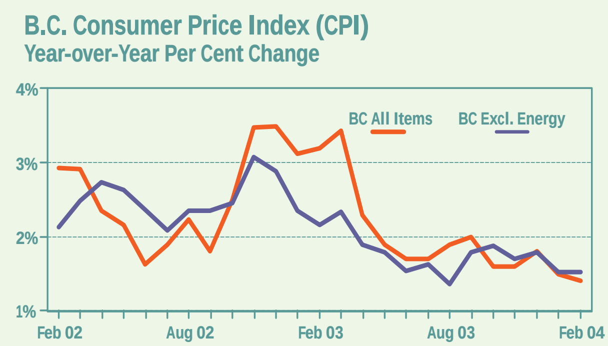
Consumer price inflation remains low

B.C.'s inflation rate in the year ending February 2004 was 1.4%, according to the latest Consumer Price Index (CPI) from Statistics Canada. The latest month-over-month change came in at 0.4%, up sharply from January's –0.1% decrease. Higher prices for gasoline, clothing, meat, beer and other alcohol in February outpaced lower prices for most common foods.

Excluding energy, B.C.'s inflation rate in the year ending February 2004 was 1.5%, on par with January's year-over-year rate. The latest month-over-month change was just 0.3%, as the excluded energy prices, particularly gasoline, rose at above-average rates.

Consumer price inflation is very low



Source: Statistics Canada.

Near-term inflation is on a downward trend. The higher U.S.-Canada currency exchange rate will help to restrain some CPI components, such as food, and the decline in mortgage interest rates and weaker rental markets will contain shelter costs. Energy prices are a wild card and recent price gains put crude oil prices at their highest level since March 2003. The higher Loonie does provide some offset to imported crude, which is priced in U.S. dollars. The OPEC cartel pledged earlier this year to cut production, but demand will fall as the weather warms. However, the price could well stay above $30 U.S. per barrel.

Our forecast for B.C.'s average CPI inflation rate is 1.5% for this year and 1.8% next year. The B.C. budget released in February forecasts 1.6% and 1.9%, respectively. CPI increased by 2.1% in 2003.

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Credit Union Central BC

Life left in U.S. housing market

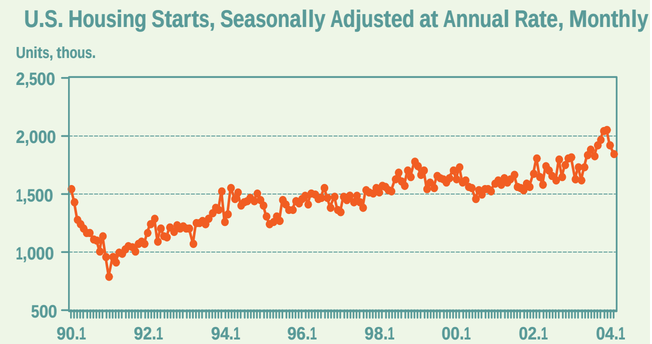
Recent data on the U.S. housing market show that there's still life in this sector even after a longer-than-normal expansion. February housing starts and the weekly Mortgage Applications Index signalled robust housing activity and no signs of any significant deterioration. In fact, the Purchase Index of that weekly index hit a nine-week high. Existing single-family housing MLS® sales remain near all-time highs, and housing prices are at their highest level ever.

Some analysts have been predicting the end of the U.S. housing expansion and a few have gone further by predicting a housing price collapse. The Economist magazine recently reported: "the United States in particular had seen the biggest rise in house prices in its history since the mid-1990s and a sharp fall in the market in the largest global economy would tip the world into recession. The trigger for a house price crash could be a relatively modest uptick in interest rates as total levels of household debt are at record highs fuelled by borrowing and housing equity withdrawal on the back of historically low rates." Sales and prices have set records in each of the past three years and the market could be headed for a fall, since no market rises indefinitely.

Should the U.S. housing market undergo a correction or enter a recession phase, there would be negative impacts for the B.C. economy. A decline in housing prices would prompt a drop in housing starts and trigger lower production and prices in the lumber sector. It would also have a negative impact on the U.S. economy in general, because consumer spending would lose one of its drivers.

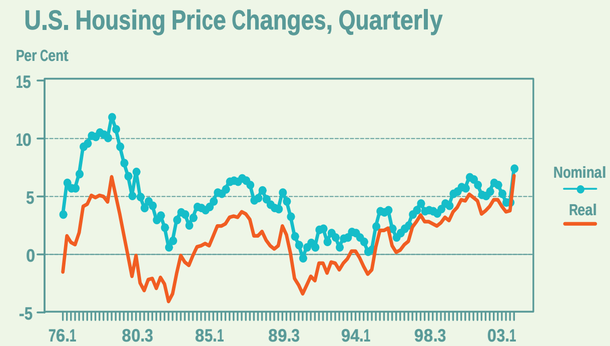
The housing market operates under demand and supply forces and those fundamentals are behind the run-up in housing sales and prices. Low mortgage rates, new household formation, the desire to become a homeowner, and the increased ability to adjust housing consumption in an active market all contribute to rising sales and prices. Housing supply is relatively fixed in the short-term and also contributes to higher prices. Nonetheless, we cannot be sure that recent increases are fully justified by the prevailing fundamentals. The deviation of current housing prices from their fundamental value can't be measured, since the latter is unobservable.

Housing starts remain high, no major recession since 1991



Source: U.S. Department of Commerce. Latest: Jan.

U.S. house price bubble?



Source: OFHEO, U.S. Federal Reserve Board. Latest: Q4 2003.

The telling sign of any asset price bubble is the amount of the speculation in the market. How many properties are being bought and flipped? Is this activity growing or lessening? Unfortunately, a lack of hard data prevents a methodical analysis, but anecdotal evidence suggests that speculation is at least not rampant. One can look back to the high-tech equity market boom-bust to see an extreme example of such speculation, though at the time it was difficult to make such an assessment and not get caught up in the frenzy.

One should be careful not to equate the housing market with the equity market, since there are key differences. Transaction costs are much higher in the housing market. Also, the underlying demand for housing is much more predictable than are the prospects for any particular firm. As well, lenders have tight criteria for advancing loans and become more cautious when unsold homes or local unemployment increase.

Historically, a housing recession and price correction has occurred when demand fundamentals turn negative in a major way. The typical scenario involves high mortgage rates, often accompanied by a period of rising unemployment and falling income. The likelihood of that happening any time soon in the U.S. is low. Interest rates will be rising in 2005 from their current abnormally low levels, but the increase in long-term rates will probably be about one percentage point and there will be some offsetting effects from a stronger economy. The Federal Reserve Board would not be tightening when there is economic weakness.

On the basis of fundamentals, the U.S. housing market is not at the end of its expansion. A stronger economy, population growth, and new household formation will partly offset the negative impact of higher mortgage rates and housing prices on housing affordability and demand. Housing prices are more likely to erode than to collapse, as supply catches up to demand.

Helmut Pastrick, Chief Economist . David Hobden, Economist . Judy Wozencroft, Economic Services Coordinator