

U.S. housing woes may pinch Canada

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CALGARY -- The dive in the U.S. housing market leaves the American consumer more vulnerable to higher oil prices, says a leading Canadian economist.

With Canadian exports other than energy already wilting, any slowdown in U.S. consumer spending would only add to the woes of this country's manufacturers.

For years, rising real estate prices have allowed U.S. consumers to endure the pain of both rising interest rates and the soaring cost for heating and driving, giving them both the psychological comfort of rising wealth and the concrete aid of converting home equity into cash.

"The U.S. housing market has been the great buffer," said Jeff Rubin, chief strategist at CIBC World Markets.

But the recent drop in the U.S. housing market has erased that buffer, meaning U.S. consumers -- already paying out a quarter of disposable income on debt-servicing and energy costs -- are now fully exposed to any new price spike. "It only makes energy that much more of a brake," said Mr. Rubin, who said crude prices could easily soar past \$80 (U.S.) a barrel if a hurricane hits U.S. refineries and oil fields in the Gulf of Mexico.

There are already signs that the American consumer is in retreat. Last week, a major index of U.S. consumer spending showed a marked slowdown in August. An index of sales at major chain stores open at least a year rose 2.8 per cent from the previous August, well below the 3.7-per-cent growth in the first half of 2006.

Mr. Rubin is forecasting that the benchmark crude oil traded on the New York Mercantile Exchange will average \$78 a barrel in the fourth quarter, up from the \$69.19 mark on Friday, a prediction that is predicated on some disruption in U.S. production during the hurricane season.

Even if the U.S. escapes a hit from a hurricane, he expects that crude prices will rise toward \$75 a barrel through to the end of the year as global demand continues to rise. The growth of crude demand in China has pushed back into double digits, he noted.

But other observers say commodity prices are likely to fall further from current levels, easing some of the pressure on the U.S. economy.

Douglas Porter, deputy chief economist at BMO Nesbitt Burns Inc., said he is forecasting "a bit of moderation" in crude prices, which he expects to range between \$60 and \$70 a

barrel in 2007. At those prices, Canadian growth of 2.9 per cent will outpace the United States slightly, where he expects the economy to expand by 2.7 per cent.

He said energy prices are weighing on consumer spending, but that the larger problem for U.S. growth is the drop in the housing market and the resulting fall in the ability of consumers to tap into the value of their homes. "Mortgage equity withdrawals are about to become a major headwind for the U.S. economy," he said.

Other analysts think that high prices are largely a function of speculative pressures. Crude prices could fall significantly if a significant period of time goes by without a significant production disruption or a flare up in the Middle East rattling commodity markets, said Kyle Cooper, director of research at IAF Advisors in Houston. "If we can go just six weeks without a major event, we have the opportunity to go lower," he said.