

## When Will Canada's Housing Market Turn?

Canada's housing market continues to defy expectations. Excluding the sharp falloff in Vancouver that simply brought sales in that market back to more sustainable levels, national home sales are still near record highs. Homebuilders have yet to show any sign of scaling back activity, with housing starts and permit demand topping 200,000 annualized units in early 2017. Canadian household spending on home renovations hit a new record in the final quarter of 2016.

There appear sufficient underlying supports—including low interest rates, solid job gains and increased immigration—to sustain the momentum in residential investment through 2017. Meanwhile, tight resale supply will likely keep upward pressure on home prices in a number of local markets, notably in and around Toronto.

### ECONOMIC FUNDAMENTALS ARE STILL FAVOURABLE ...

Several near-term supports are likely to continue to support historically elevated housing activity in 2017. The domestic economy is showing signs of underlying improvement, supported by resilient consumer activity, firmer commodity prices, and strengthening US demand for Canadian goods and services. Regional growth disparities are expected to narrow as oil price gains fuel recoveries in Alberta and Saskatchewan.

Consumer confidence and income growth are getting a lift from the sharp acceleration in job growth over the past six months, as well as the rollout of the new Canada Child Benefit that provides families that have children under 18 with an additional \$375 in monthly income per child. These payments are tax free and can be included in mortgage applications. Wealth gains from rising home and equity values also are bolstering household sentiment and purchasing power.

Ultra-low interest rates are still highly stimulative, with the Bank of Canada expected to remain on hold through early 2018. Mortgage debt servicing costs as a share of disposable income are in line with the long-term average at a national level (chart 1). While longer-term borrowing costs are forecast to drift modestly higher in the coming year alongside rising US bond yields, the fixed-rate nature of the majority of outstanding mortgages provides important rate insulation.

Foreign capital inflows into global real estate are expected to remain elevated with high net worth investors seeking diversification and perceived safety of capital. Canadian home prices are less stretched when measured against other major global cities. CBRE ranked Vancouver and Toronto as the 11<sup>th</sup> and 19<sup>th</sup> priciest housing markets in 2016 across a sample of 33 international cities, based on the average price of an apartment. For US investors, a weaker Canadian dollar increases the attractiveness of Canadian real estate.

### ... AS ARE DEMOGRAPHIC TRENDS ...

Canada's population is expected to grow at an average annual rate of close to 1% through the end of the decade, only modestly lower than the prior 10-year period, and retaining title to the fastest growing population among the G7 (chart 2).

### CONTACTS

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Chart 1

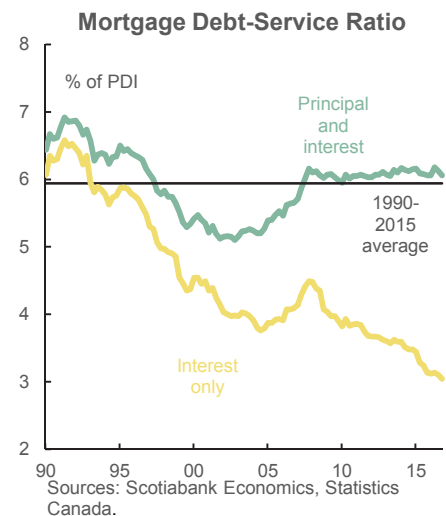
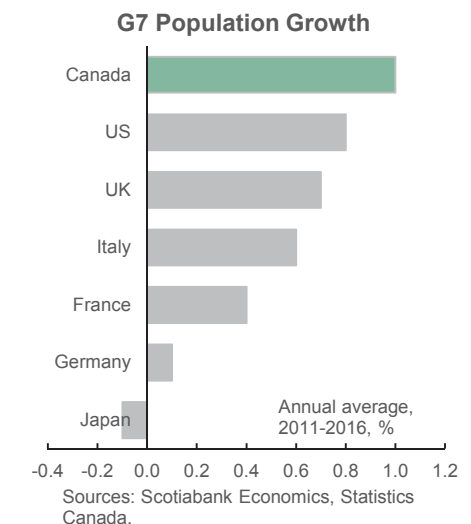


Chart 2



Population growth is a key driver of household formation and housing demand, and has historically been correlated with local housing market outcomes.

Millennials continue to age into their prime first-time homebuying years. TREB estimates that first-time buyers accounted for just over half of Greater Toronto Area (GTA) home sales last year. The largest cohort of millennials is currently aged 25-26 (chart 3), several years younger than the average age of a first-time buyer of around 30, suggesting this group will remain a major homebuying force through the end of the decade.

Increased immigration also is fuelling housing demand. Immigration to Canada likely totaled at least 300,000 last year, the highest level in more than a century and up from an average of 260,000 over the prior five year period (chart 4). Ottawa has reaffirmed its 300,000 immigration target for 2017, with the potential to raise this target in coming years. Recent US policy developments, including increased restrictions on non-resident visa and refugee admissions, could potentially result in even higher international in-migration on this side of the border. Given an average household size of recent immigrant families of just over three people, this level of immigration requires an additional 100,000 new dwellings to be added to Canada's housing stock annually.

While the majority of immigrants to Canada typically first move into rental units, they have homeownership rates similar to native-born Canadians 10 to 15 years after landing, with the largest increase occurring in the first 5 to 10 years. High levels of immigration would be expected to impact the housing market more broadly, especially when supply conditions are tight.

Large urban centres and surrounding suburbs stand to benefit the most, as they attract the majority of new arrivals to Canada. More than half of immigrants who arrive in Canada settle in the three largest census metropolitan areas (CMAs)—Toronto, Montreal and Vancouver. At the same time, some mid-sized centres and smaller communities have welcomed an increasing share of new immigrants, most notably in Atlantic Canada, Quebec, and the Prairies, a reflection of targeted provincial government immigration policies and better affordability.

Over the medium- and longer-term, immigration will increasingly drive housing demand. Net immigration accounted for two-thirds of Canada's population growth from 2011 to 2016 (chart 5). This share is projected to rise to 70% over the coming decade, and to 75% during 2026–36 due to Canada's aging population and relatively low fertility rate.

### ... BUT SOME HEADWINDS ARE DEVELOPING

While Canada's housing market continues to outperform expectations, several developing headwinds should gradually cool home sales and price appreciation later in the year and into 2018. Affordability is becoming increasingly stretched in a number of local markets, primarily in BC's Lower Mainland and southern Ontario. In Vancouver and Toronto, mortgage carrying costs are near historic highs as a share of income. Together, these two markets account for more than a quarter of national home sales.

Recent policy measures, including tougher loan qualification criteria for insured mortgages and new restrictions on mortgage portfolio insurance, combined with moderately higher borrowing costs, are expected to dampen home sales more broadly.

Chart 3

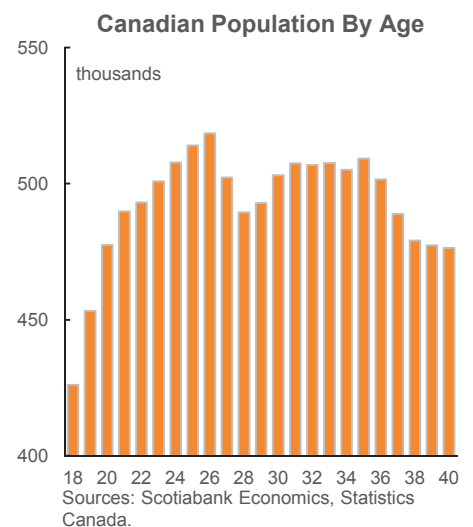
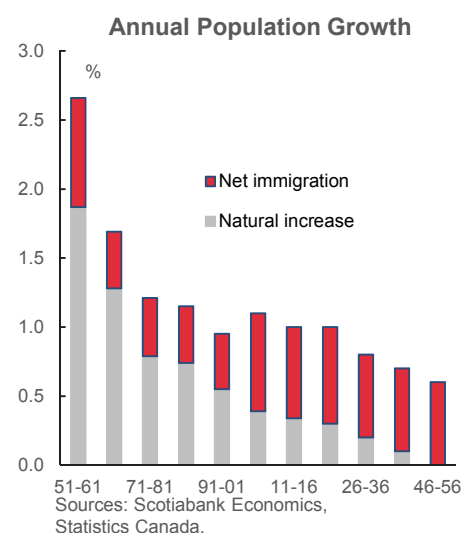


Chart 4



Chart 5



Previous rounds of macroprudential tightening measures enacted since 2008 were accompanied by falling interest rates which muted their overall impact. We forecast mortgage carrying costs as a share of household income will rise from an estimated 33½% in 2016 to around 36% in 2018 (chart 6).

Builders will likely slow the pace of new construction somewhat later this year and next in response to steadier resale market conditions and the recent uptick in unsold inventory. The current level of starts is well above annual household formation rates estimated at only 150,000 from 2011–16.

Indeed, achieving further gains on several housing indicators in a very mature cycle becomes increasingly difficult. Housing investment accounts for a near record 7½% share of nominal GDP (chart 7), the highest among the G7 economies and roughly double the comparable US ratio. Mortgage debt is at a record share of disposable income, and is approaching prior cycle peaks as a share of total household liabilities. Canada's homeownership rate, at roughly 69%, exceeds ownership rates in the US, the UK, and Australia.

This in turn will have knock-on effects on a range of industries, including manufacturing, retail and wholesale trade, and financial and professional services. Studies based on input-output tables have typically yielded an industry output multiplier of around 1.5, implying a \$1 billion reduction in residential investment would reduce overall output across the economy by about \$1.5 billion, or 0.1% of GDP.

Third-round impacts stemming from a reduced pace of housing wealth creation could have a further dampening effect on growth. Housing assets have generated \$2.6 trillion in additional household net worth since 2000. Assuming a wealth effect of 5 cents on the dollar, this may have added upwards of \$7 billion (or 0.7 percentage points) annually to household spending.

### TORONTO HOME PRICES HEADED EVEN HIGHER IN 2017

Worsening affordability has so far done little to dent enthusiasm for Toronto real estate. Buoyed by strong first-time homebuyer activity, home sales remained near record levels through February and benchmark prices soared a staggering 24% year-over-year. While previously largely contained to single-family homes, the strong momentum in sales and prices has spilled over to the relatively more affordable condominium market as well as to surrounding communities, including Hamilton, Oshawa, and Barrie.

The rapid erosion in affordability combined with stricter lending guidelines should lead to some softening in GTA home sales this year. For a family making the median income in Toronto, the carrying cost on an average priced single-family home already exceeded the 39% gross debt-service ratio cap at the average contract rate before the rule change. At the higher posted 5-year 'stress test' mortgage rate, the typical buyer is pushing up against this threshold for a condominium. Single-family homes in many mid-priced cities, including Hamilton, Kitchener, and Barrie, also are moving out of reach of the average buyer.

Even so, prospective buyers are unlikely to see significant price relief. Resale housing inventory is expected to remain historically tight, with active listings in Toronto at a decade and a half low. The high cost of moving and limited selection are likely deterring some potential move-up buyers, while many older households may be choosing to age

Chart 6

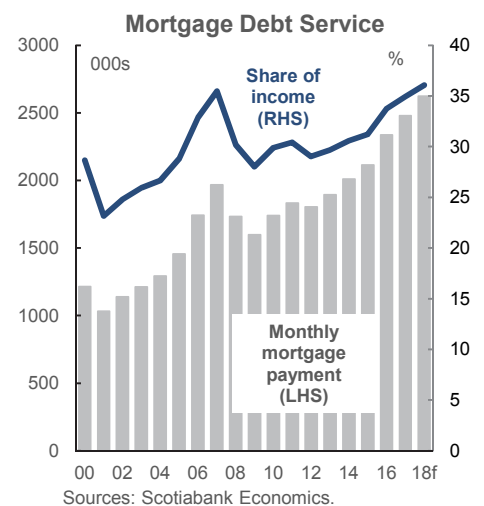


Chart 7

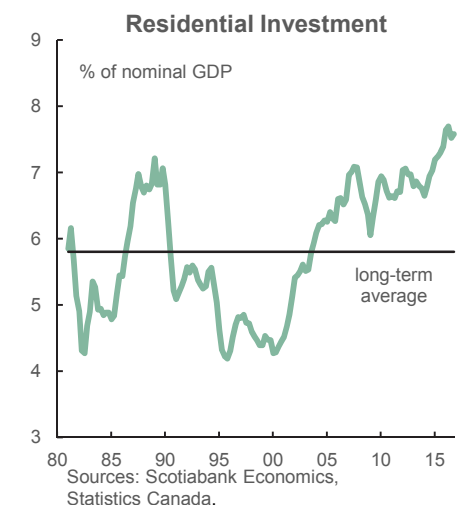
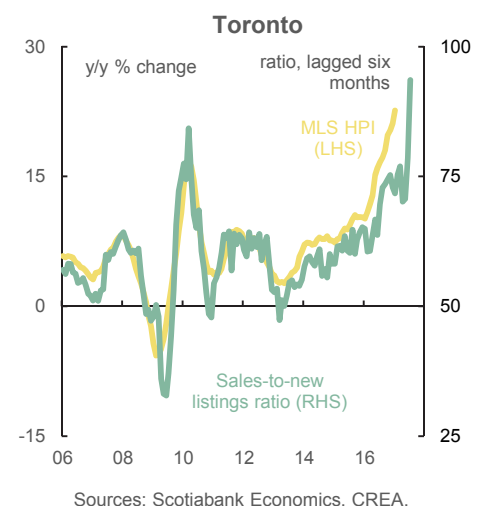


Chart 8



in place rather than downsize. Geographical constraints and development restrictions will continue to limit new housing supply in sought after areas and segments of the market, putting ongoing pressure on the resale market.

GTA house prices are largely tracking the ratio of sales-to-new listings, typically a good leading indicator, though there appears some evidence of speculative activity (chart 8). A 10% drop in Toronto home sales alongside a stable pool of new listings would still leave in place strong sellers' market conditions, consistent with double-digit y/y price increases. Supply constraints appear less acute in the new home market, with a near record level of units under construction and unsold inventory of completed new homes in line with historical trends. From a longer-term perspective, rising population density, foreign capital inflows, and constrained supply will remain highly supportive of valuations.

### A MORE STABLE OUTLOOK FOR VANCOUVER HOUSING

Severe affordability challenges coupled with provincial policy changes have led to an abrupt cooling in Vancouver's housing market. Home sales have plunged more than 40% from their February 2016 peak, while benchmark prices have begun to edge down. In addition to the federal policy measures raising downpayment requirements on homes priced over \$500,000, the BC government in February 2016 imposed a new luxury tax on homes over \$2 million. The falloff in sales and softening in prices have been most pronounced at the high-end of the market, suggesting the policy moves are having the desired effect.

Domestic buyers and investors are leading the pullback in sales, which began several months before the August imposition of an additional 15% land transfer tax on non-resident purchases in Metro Vancouver (chart 9). Following an initial steep dropoff, foreign purchases have stabilized at lower levels at around 4% of total residential sales in Metro Vancouver and province wide (chart 10). Even so, assuming foreign buyers are less price sensitive than domestic purchasers, their reduced level of activity has likely contributed to the cooling in prices.

It is too early to quantify the longer-term impact of the foreign buyers tax. We expect it will help to curb some speculative foreign investment flows, as could stricter capital controls in China aimed at stemming currency outflows. Ultimately, however, demand should remain supported by elevated immigration levels.

Sales may begin to stabilize in the months ahead, with overall activity having returned to more historically normal levels. Demand also could get a boost from the BC government's recently launched interest-free loans program for first-time buyers. The program caps the maximum allowed purchase price at \$750,000, effectively limiting it to condominiums and townhomes. We anticipate a further modest downward adjustment in prices with the emergence of sellers' market conditions in the single-family segment. At the same time, limited resale supply—February new listings were at their lowest since 2003—should keep a floor under prices.

Chart 9

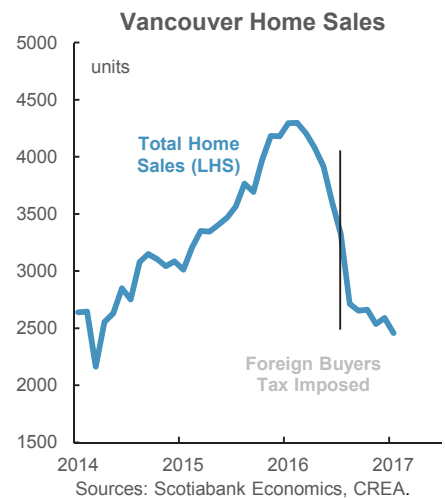
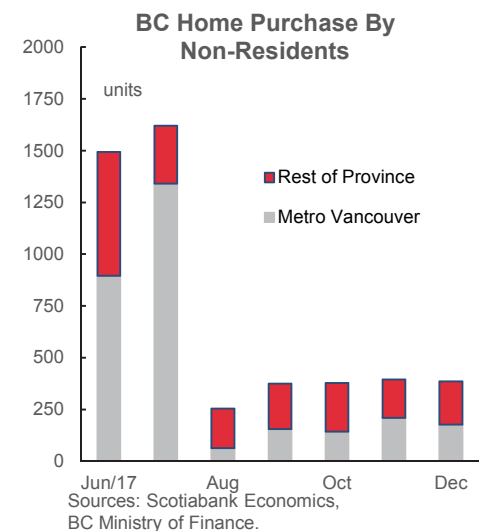
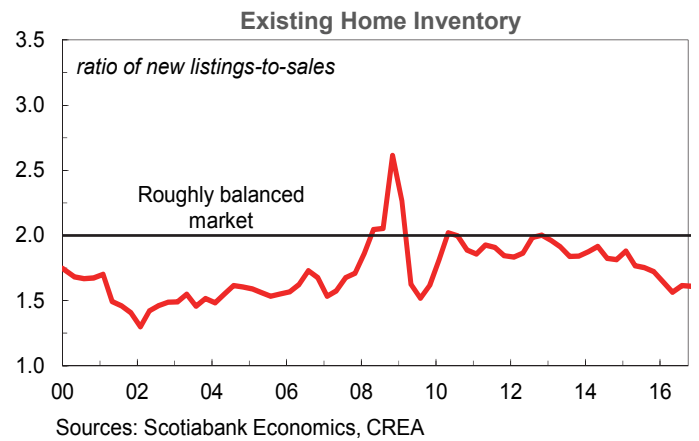
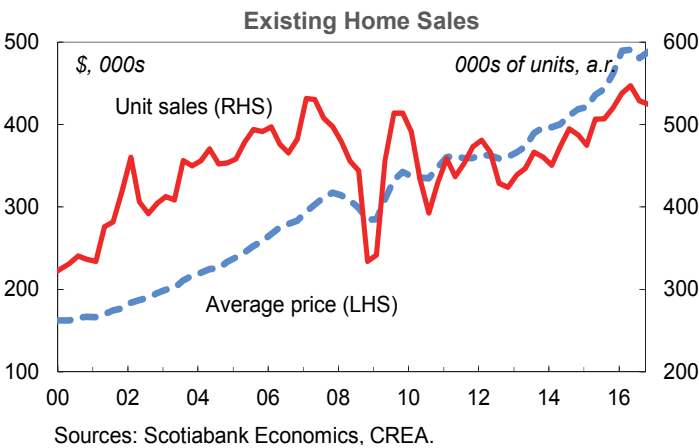
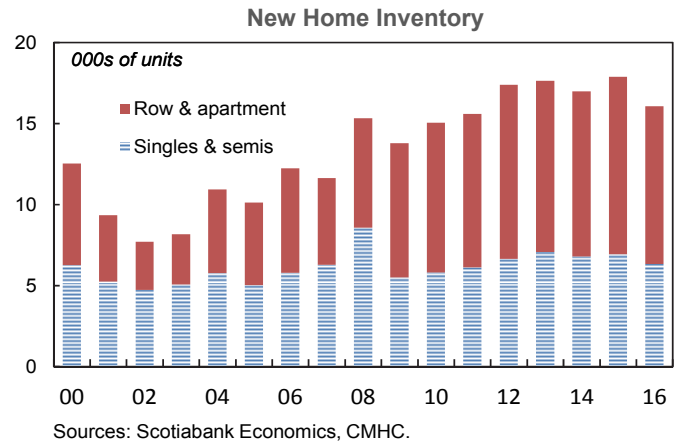
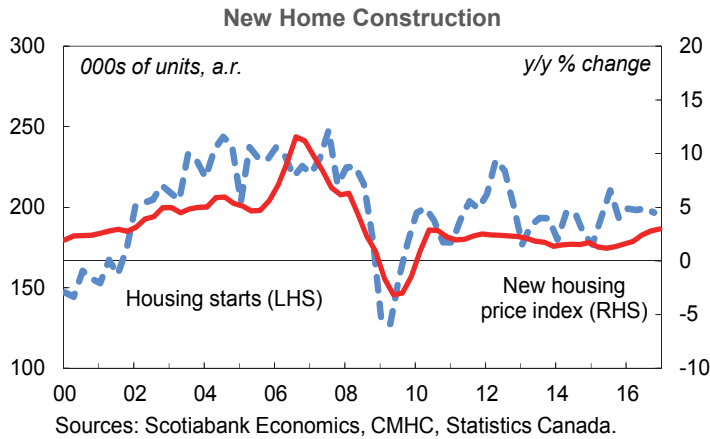


Chart 10



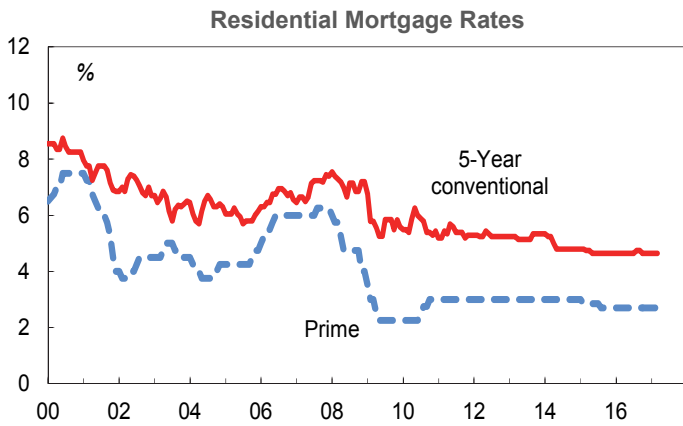
**CANADIAN RESIDENTIAL MARKETS**



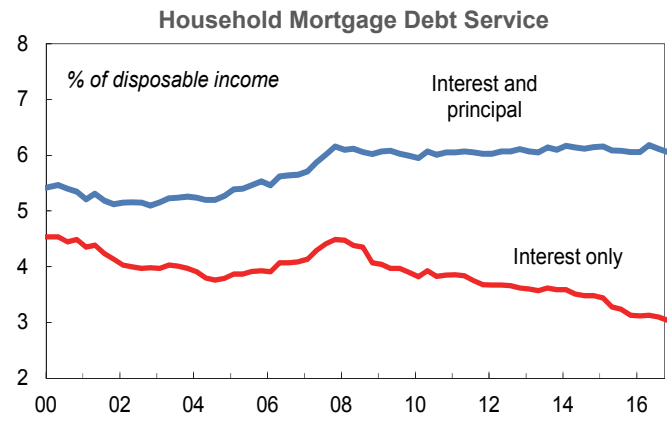
Housing Starts								
	Canada	B.C.	Alberta	Sask.	Manitoba	Ontario	Quebec	Atlantic
<i>(000s units, sa)</i>								
2010	190	26	27	6	6	60	51	13
2011	194	26	26	7	6	68	48	13
2012	215	27	33	10	7	77	47	13
2013	188	27	36	8	7	61	38	10
2014	189	28	41	8	6	59	39	8
2015	196	31	37	5	6	70	38	8
2016	198	42	25	5	5	75	39	8
2017ytd	210	30	23	5	8	94	42	8
2017f	192	36	25	4	6	74	40	7
2018f	185	35	26	4	6	70	37	7
<i>(units, nsa)</i>								
	Vancouver	Calgary	Edmonton	Toronto	Ottawa	Montreal	Halifax	St. John's
2010	15,217	9,262	9,959	29,195	6,446	22,001	2,390	1,816
2011	17,867	9,292	9,332	39,745	5,794	22,719	2,954	1,923
2012	19,027	12,841	12,837	48,105	6,026	20,591	2,754	2,153
2013	18,696	12,584	14,689	33,547	6,560	15,632	2,439	1,734
2014	19,212	17,131	13,872	28,929	5,762	18,672	1,757	1,230
2015	20,863	13,033	17,050	42,287	4,972	18,744	2,599	985
2016	27,914	9,245	10,036	39,027	5,298	17,834	2,305	833
2017ytd	17,174	5,887	10,140	45,694	8,473	16,894	2,304	566

Sources: Scotiabank Economics, CMHC. Year-to-date data are expressed at seasonally adjusted annual rates.

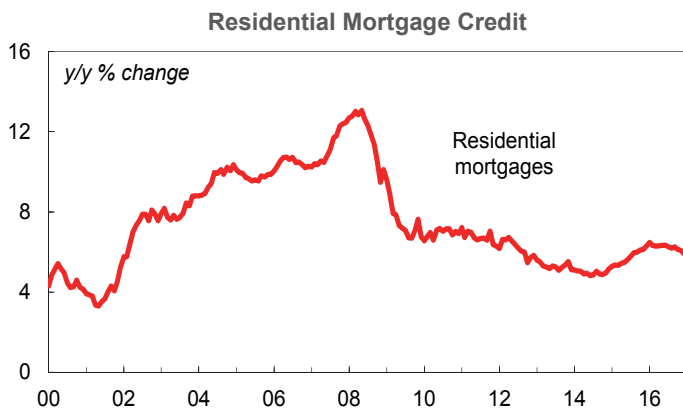
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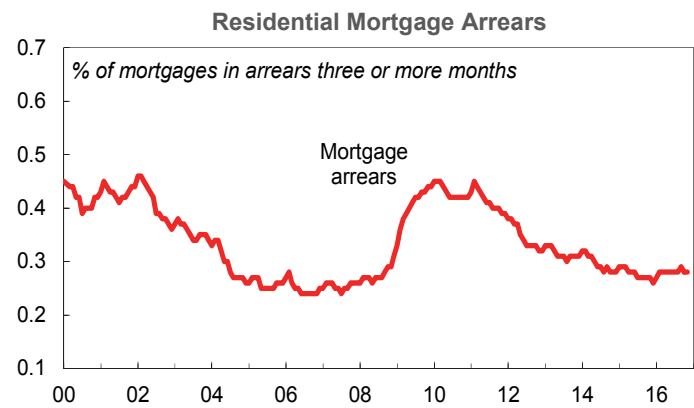
Sources: Scotiabank Economics, Bank of Canada.



Sources: Scotiabank Economics, Statistics Canada.



Sources: Scotiabank Economics, Bank of Canada.



Sources: Scotiabank Economics, CBA.

**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
2010	339,618	436,748	505,519	74,555	352,301	49,723	231,833	23,978	343,668	185,594	242,257	80,024	192,403	22,441
2011	362,168	455,173	561,270	76,724	353,394	53,756	247,160	26,977	364,653	197,212	254,207	77,164	200,897	22,897
2012	363,174	450,215	514,849	67,634	363,208	60,369	261,534	27,671	383,934	193,937	264,096	77,372	208,274	22,774
2013	382,323	453,216	537,428	72,936	380,969	66,080	274,401	27,213	402,491	194,195	267,646	71,194	209,599	21,162
2014	407,628	476,647	568,379	84,057	400,590	71,773	282,335	27,487	430,510	201,475	271,212	70,620	209,199	20,777
2015	442,330	502,259	636,620	102,511	393,138	56,477	283,014	26,266	464,260	220,567	275,207	74,123	207,936	21,814
2016	490,033	534,709	691,111	112,211	394,576	52,169	285,499	26,249	535,187	242,031	283,306	78,195	206,015	23,244
2017ytd	484,306	516,984	619,822	90,348	396,112	56,004	286,705	26,100	583,351	244,380	291,657	77,832	201,924	21,552

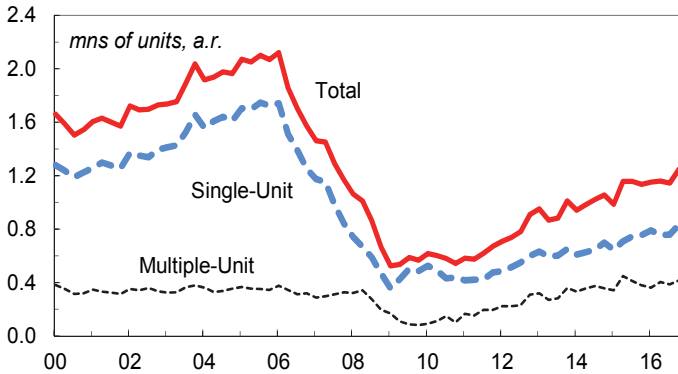
  

	Vancouver		Calgary		Edmonton		Toronto		Ottawa		Montreal		Halifax	
	Avg. Price	Units	Avg. Price	Units	Avg. Price	Units	Avg. Price	Units	Avg. Price	Units	Avg. Price	Units	Avg. Price	Units
2010	675,853	31,144	398,764	20,996	328,803	16,403	432,264	88,214	328,439	14,586	294,602	42,298	250,871	5,782
2011	779,730	32,936	402,851	22,466	325,595	16,963	466,352	91,760	343,995	15,022	309,341	40,354	258,755	5,989
2012	730,063	25,445	412,315	26,634	334,318	17,641	498,973	88,157	352,293	14,717	322,148	40,086	268,692	6,081
2013	767,765	28,985	437,036	29,954	344,977	19,552	524,089	88,946	358,382	14,046	324,141	36,491	273,082	5,044
2014	812,653	33,693	460,584	33,615	362,657	19,857	566,491	93,278	362,689	14,093	331,772	35,753	273,983	4,749
2015	902,801	43,145	453,814	23,994	369,536	18,227	622,046	101,846	368,767	14,847	338,072	37,935	282,620	4,844
2016	1,017,228	40,880	463,047	22,522	369,365	16,990	729,591	113,725	373,719	15,767	349,793	39,926	286,878	5,164
2017ytd	851,384	29,484	466,964	23,688	360,199	18,036	803,455	115,848	389,875	16,140	360,177	39,060	274,873	4,752

Sources: Scotiabank Economics, CREA, QFREB. Year-to-date data are expressed at seasonally adjusted annual rates.

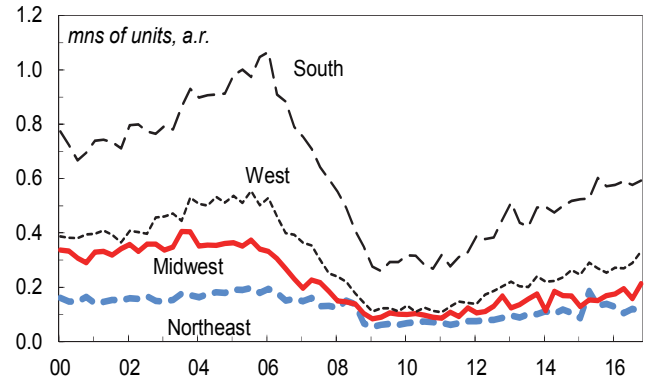
**US RESIDENTIAL MARKETS**

**Housing Starts**



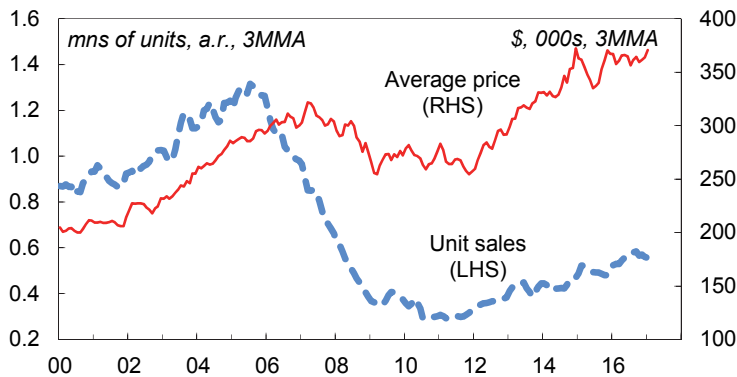
Sources: Scotiabank Economics, US Census Bureau.

**Housing Starts by Region**



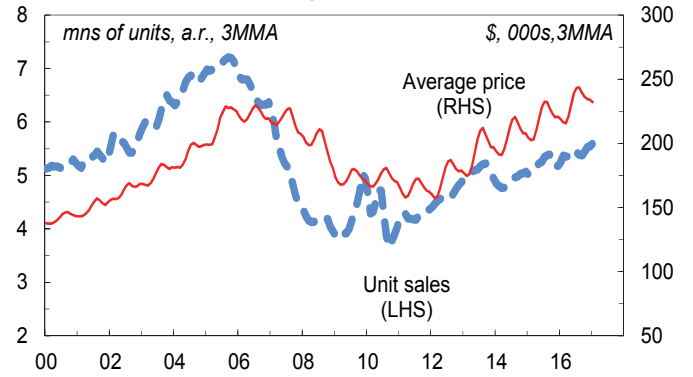
Sources: Scotiabank Economics, US Census Bureau.

**New Home Sales**



Sources: Scotiabank Economics, US Census Bureau.

**Existing Home Sales**



Sources: Scotiabank Economics, National Association of Realtors (NAR).

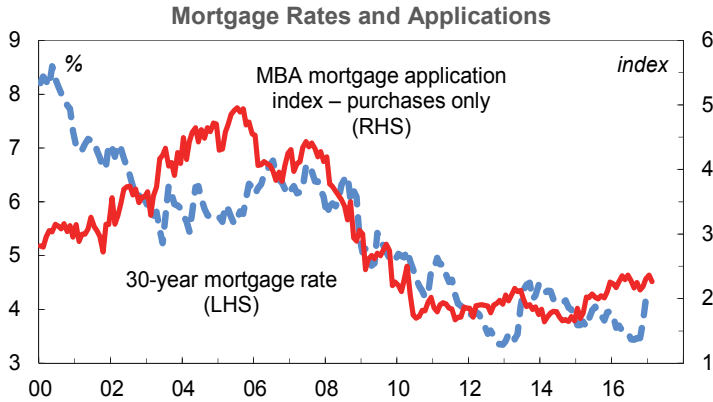
**Housing Starts**

**Permits**

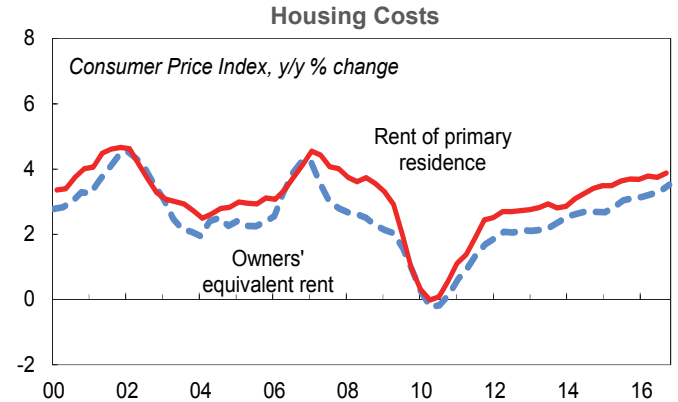
	Total	Singles	Multis	West	South	Midwest	North East	Total	Singles	Multis
	<i>(millions of units)</i>							<i>(millions of units)</i>		
<b>2010</b>	0.587	0.471	0.116	0.120	0.298	0.098	0.072	0.605	0.447	0.157
<b>2011</b>	0.609	0.431	0.178	0.133	0.308	0.101	0.068	0.624	0.418	0.206
<b>2012</b>	0.781	0.535	0.245	0.175	0.398	0.128	0.080	0.830	0.519	0.311
<b>2013</b>	0.925	0.618	0.307	0.215	0.464	0.150	0.097	0.991	0.621	0.370
<b>2014</b>	1.003	0.648	0.355	0.235	0.496	0.163	0.110	1.052	0.640	0.412
<b>2015</b>	1.112	0.715	0.397	0.266	0.556	0.153	0.138	1.183	0.696	0.487
<b>2016</b>	1.174	0.782	0.393	0.290	0.585	0.183	0.116	1.190	0.746	0.445
<b>2017ytd</b>	1.246	0.823	0.423	0.225	0.690	0.188	0.143	1.285	0.808	0.477
<b>2017f</b>	1.260									
<b>2018f</b>	1.340									

Sources: Scotiabank Economics, US Census Bureau. Year-to-date data are expressed at seasonally-adjusted annual rates.

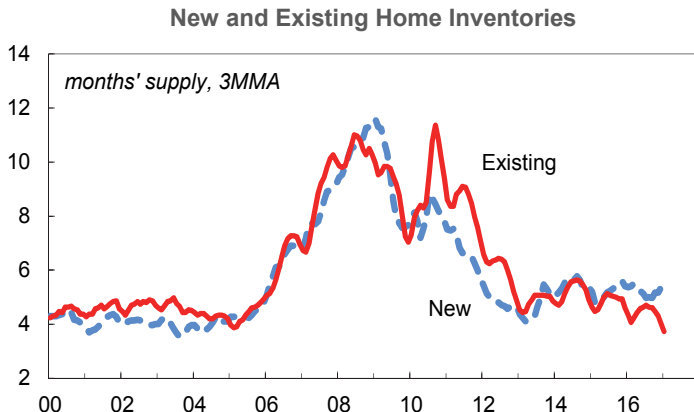
**US RESIDENTIAL MARKETS**



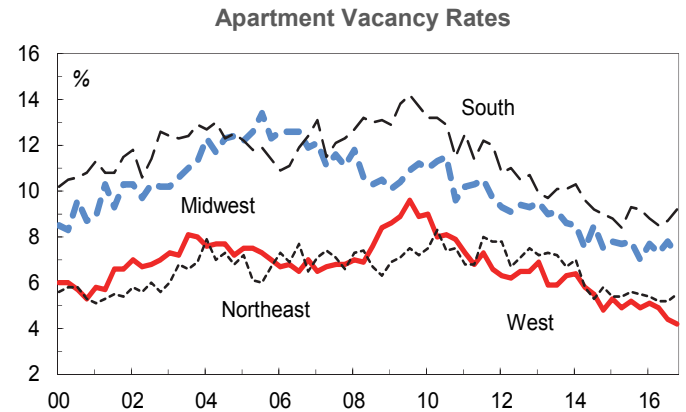
Sources: Scotiabank Economics, Mortgage Bankers Association (MBA), FHLMC.



Sources: Scotiabank Economics, US Bureau of Labor Statistics.



Sources: Scotiabank Economics, US Census Bureau, National Association of Realtors (NAR).



Sources: Scotiabank Economics, US Census Bureau.

	Existing Home Sales							New Home Sales		
	Total	Avg Price	Months' Supply	West	South	Midwest	North East	Total	Avg Price (\$000s)	Months' Supply
	(sa)	(nsa)	(nsa)	(million units, saar, unless otherwise noted)						
<b>2010</b>	4.190	220.0	9.4	1.080	1.630	0.910	0.570	0.321	271.5	8.0
<b>2011</b>	4.260	214.0	8.3	1.130	1.680	0.910	0.540	0.306	263.4	6.6
<b>2012</b>	4.660	225.4	5.9	1.160	1.840	1.070	0.590	0.368	285.4	4.8
<b>2013</b>	5.090	245.5	4.9	1.190	2.050	1.200	0.660	0.430	319.3	4.7
<b>2014</b>	4.940	255.3	5.2	1.100	2.050	1.140	0.640	0.440	343.2	5.5
<b>2015</b>	5.250	266.4	4.8	1.170	2.160	1.240	0.700	0.502	352.5	5.2
<b>2016</b>	5.450	276.0	4.4	1.190	2.220	1.300	0.740	0.559	363.4	5.2
<b>2017ytd</b>	5.690	271.0	3.6	1.290	2.310	1.290	0.800	0.555	360.9	5.7

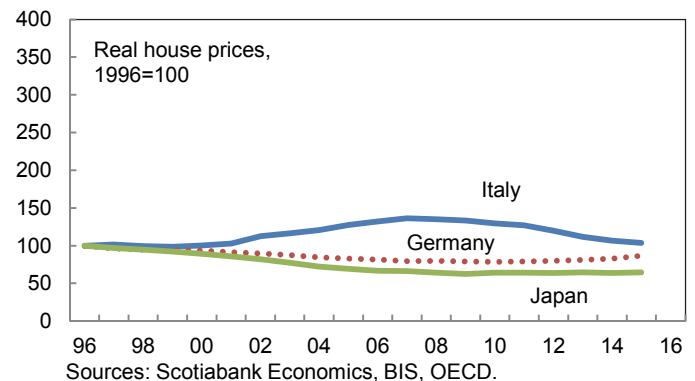
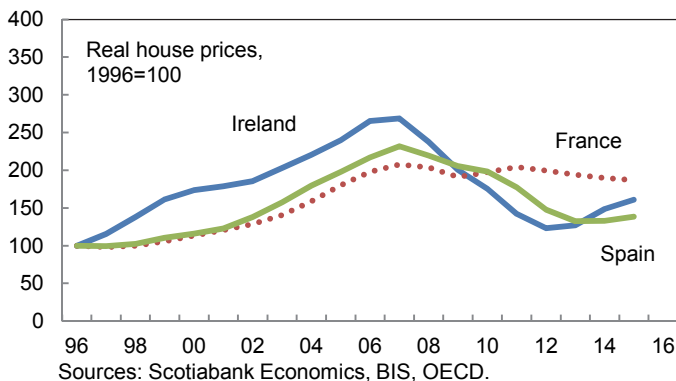
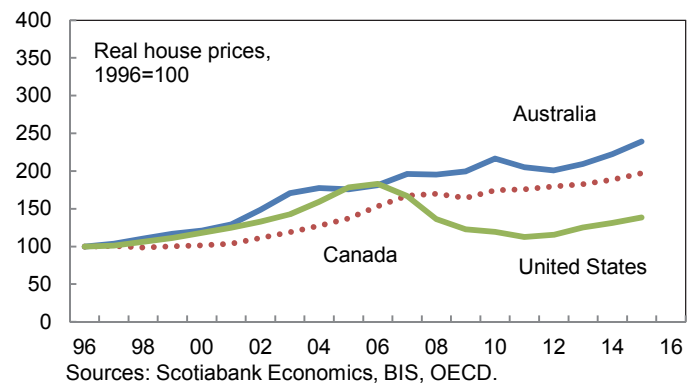
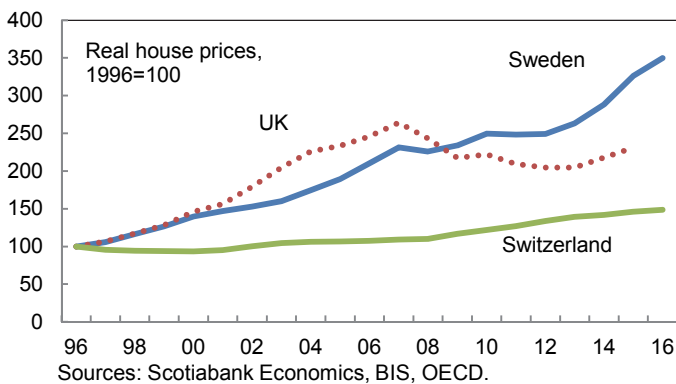
Sources: Scotiabank Economics, National Association of Realtors (NAR), US Census Bureau. Year-to-date data are expressed at seasonally-adjusted annual rates.



**INTERNATIONAL RESIDENTIAL MARKETS**

	2008	2009	2010	2011	2012	2013	2014	2015	2016	16Q1	16Q2	16Q3	16Q4
<b>Australia</b>	-0.3	2.2	8.5	-5.3	-2.1	4.1	6.4	7.4	---	5.4	3.0	2.2	---
<b>Canada</b>	1.7	-3.2	6.1	0.7	2.1	1.6	3.2	4.7	---	6.9	10.4	13.1	---
<b>France</b>	-1.9	-6.3	3.2	3.6	-2.4	-2.7	-2.1	-1.5	---	0.3	0.7	1.5	---
<b>Germany</b>	0.4	-0.7	-0.6	0.5	1.0	1.7	2.2	4.3	---	4.5	6.2	5.9	---
<b>Ireland</b>	-11.6	-15.7	-12.4	-18.9	-13.4	3.0	16.9	8.3	---	5.7	4.7	7.5	---
<b>Italy</b>	-0.7	-1.3	-2.9	-2.0	-5.7	-6.9	-4.6	-2.7	---	-1.0	-0.4	-0.9	---
<b>Japan</b>	---	-4.6	2.2	0.3	-0.8	1.3	-1.2	1.6	---	1.6	3.3	2.2	---
<b>Spain</b>	-5.3	-6.4	-3.5	-10.5	-16.8	-10.4	0.5	4.1	---	7.0	4.8	4.2	---
<b>Sweden</b>	-2.3	3.5	6.8	-0.4	0.3	5.5	9.6	13.2	7.2	11.7	7.8	6.0	3.6
<b>Switzerland</b>	0.9	6.2	4.2	4.2	5.2	4.2	1.8	3.1	1.6	2.2	1.1	1.5	1.5
<b>United Kingdom</b>	-7.8	-10.8	2.3	-5.7	-2.3	0.0	6.5	5.9	---	7.5	8.3	6.4	---
<b>United States</b>	-18.4	-9.8	-2.8	-5.8	2.6	8.4	4.8	5.3	---	4.1	4.2	4.8	---
<b>Russia</b>	9.1	-10.9	1.3	-27.0	9.5	-2.7	-6.0	-12.3	---	-13.1	-12.5	-11.3	---
<b>Brazil</b>	15.8	19.3	18.9	11.8	6.6	3.3	-1.2	-12.2	---	-19.1	-20.2	-21.7	---
<b>Chile</b>	-8.9	1.5	6.0	2.0	2.4	6.3	1.8	---	---	1.2	-0.5	---	---
<b>Colombia</b>	9.4	4.9	5.5	4.1	7.3	7.6	4.9	4.7	---	6.6	3.9	2.5	---
<b>Mexico</b>	-0.5	0.1	-0.3	0.8	0.7	0.0	0.4	3.8	---	5.2	5.3	5.8	---
<b>Peru</b>	20.7	14.0	9.3	13.2	17.5	13.7	9.2	2.6	---	5.4	-0.2	1.2	---
<b>China</b>	0.2	1.9	5.4	-1.2	-3.2	3.2	0.6	-5.2	---	0.0	3.1	6.2	---
<b>India</b>	---	---	8.5	11.3	15.5	7.8	7.8	8.3	---	-1.9	1.6	2.8	---
<b>Indonesia</b>	-7.7	-2.7	-2.2	-0.7	0.6	5.3	0.6	-0.8	---	-0.2	-0.1	-0.3	---
<b>South Korea</b>	-0.6	-2.5	-0.5	1.2	0.7	-1.7	0.2	2.6	1.6	3.1	2.1	1.3	0.1
<b>Thailand</b>	---	6.1	-0.5	0.5	0.3	5.5	3.8	3.5	1.7	0.4	4.6	1.1	0.9

Sources: Scotiabank Economics, BIS.



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