



Household Credit Analysis

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Jeffrey Rubin
(416) 594-7357

Avery Shenfeld
(416) 594-7356

Benjamin Tal
(416) 956-3698

Peter Buchanan
(416) 594-7354

Warren Lovely
(416) 594-7359

David Bezic
(416) 956-3219

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Data Sources:

Bank of Canada
Statistics Canada
Industry Canada
CBA
CMHC
CREA
CIBC World Markets

Benjamin Tal
Senior Economist

HIGHLIGHTS

- Unlike the sharp slowing in the pace of household borrowing south of the border, household credit in Canada is still rising fast, with recent months seeing only a moderate slowing. Having said that, there are clear signs that the credit cycle has already peaked, and we are at the early stages of a slowing trajectory.
- Importantly, when adjusted for inflation, credit growth during this cycle was not as strong as in previous cycles. This means that the slowing in the pace of household borrowing in 2007 will not be as dramatic as in the past. Look for total household credit outstanding to rise by 9% next year, down from 11% in 2006.
- Mortgage credit is now rising by roughly 11% on a year-over-year basis. Any slowing in the mortgage market in 2007 will be mitigated by strong growth in non-conforming (high-risk) loans as well as a surge in new products available to home-buyers.
- The softening growth in non-mortgage consumer debt reflects a notable slowing in the pace of growth in personal lines of credit and a decline in the direct (term) loans portfolio.
- During the third quarter of 2006, overall household debt rose by 2.3% while personal disposable income rose by 1.4%. This led to a moderate increase in the debt-to-income ratio during the quarter.
- At the same time, the debt service ratio, as measured by debt interest payments as a share of disposable income is on the rise, and is at its highest level in two years.
- The cumulative number of consumer bankruptcies fell by 5% during the year ending September 2006. Note, however, that bankruptcies in Alberta fell by 28%.
- Third quarter GDP growth was disappointing. The negative growth seen in September suggests a weak start for the fourth quarter. The manufacturing sector is already in recession and construction activity is clearly slowing. Overall economic growth is projected to average 2.4% in the coming six months, a bit slower than the first half of 2006. Note that we expect consumer spending to soften in the first and second quarters of 2007, reflecting a delayed reaction to higher interest rates and continued softening in the housing market.
- Having said that, we continue to expect the Canadian economy to outperform the US economy in 2007 — largely due to the fact that Canadian households are not as reliant on real estate compared to their American counterparts.
- Overall, we believe that short-term rates in Canada have peaked and the next move will be a rate cut.

RESIDENTIAL MORTGAGES

Outstanding

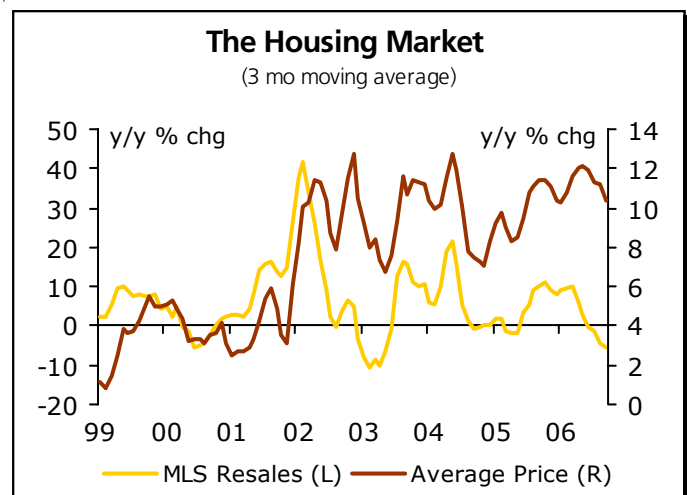
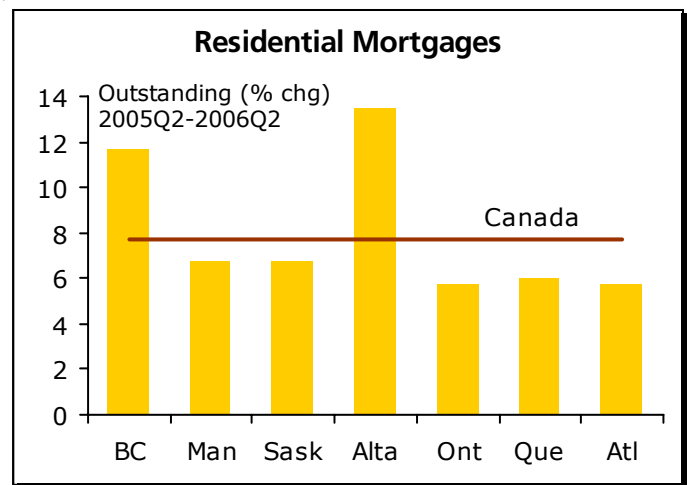
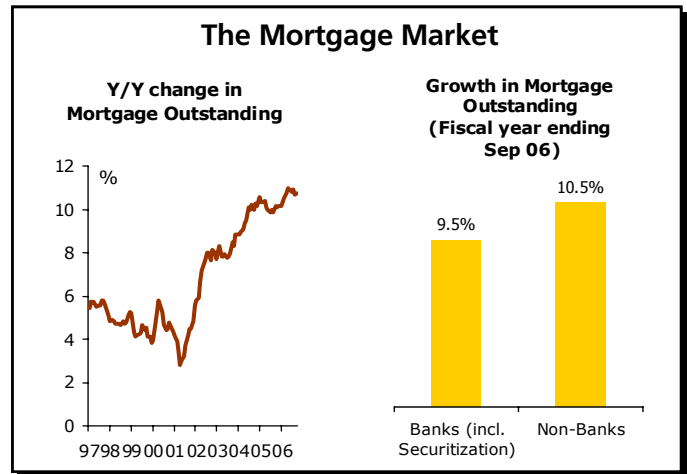
Total residential mortgage outstanding rose by 10.8% during the year ending September 2006 — roughly the same performance seen for most of 2006. Note that currently one-fifth of mortgage holders use variable rate mortgages.

As for credit quality, our recent research regarding the non-conforming mortgage market reveals that the sub-prime market in Canada is now rising by no less than 50% on a year-over-year basis. This market now accounts for 5% of all new mortgages vs. 22% in the US. We expect non-conforming mortgages to be the fastest growing segment in the mortgage market and to double in size in the coming five years. For more information about the growth in the sub-prime market, please refer to our "Consumer Watch Canada", titled "Sub-Prime As Prime Target—The Surging Non-Conforming Mortgage Market in Canada" dated October 10, 2006.

Overall, we expect total mortgage outstanding in Canada to rise by 9% in the coming 12 months, down from the current 11% pace. This projection reflects our assessment that the housing market will decelerate in the coming 12 months, with both housing starts and MLS activity falling by roughly 5%. As well, average house price is projected to rise by roughly 6% in the coming 12 months — almost half the rate seen in the past year. Here again, the regional divergence is likely to be very apparent. Note, for example, that the MLS market in Alberta is rising six times faster than the national average. In Ontario, resale activity was little changed over the past year.

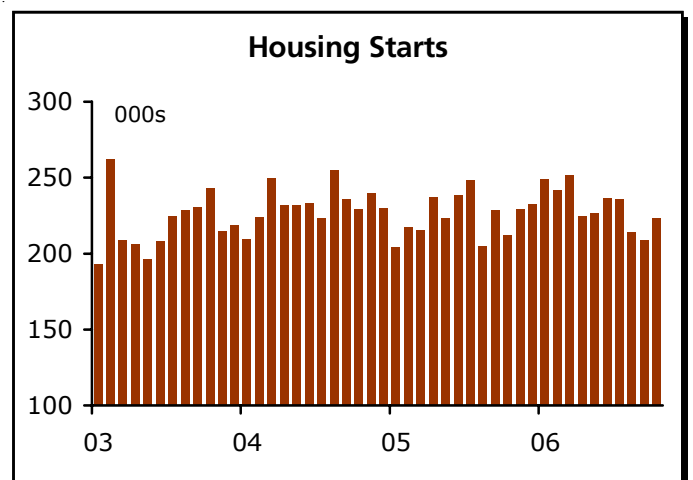
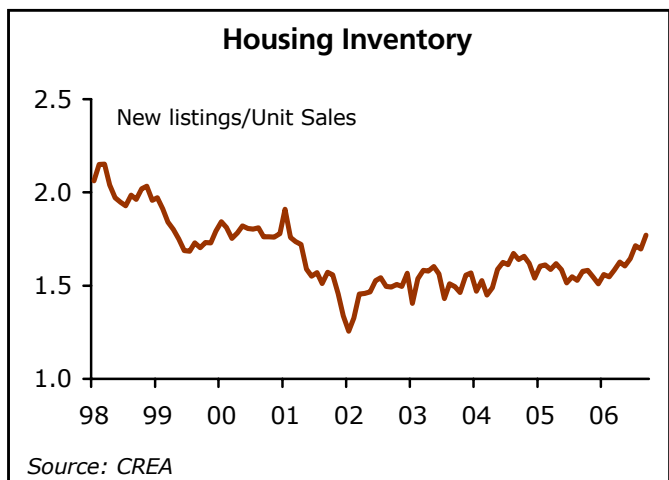
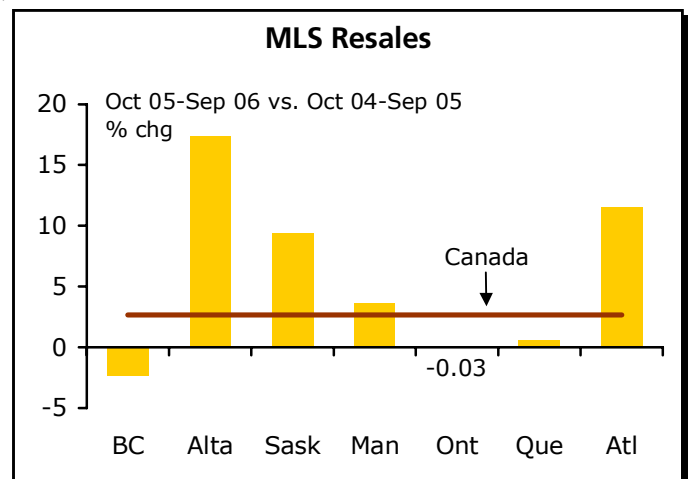
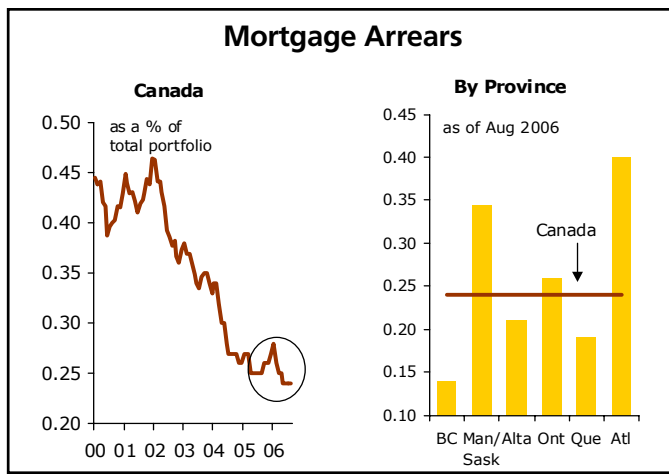
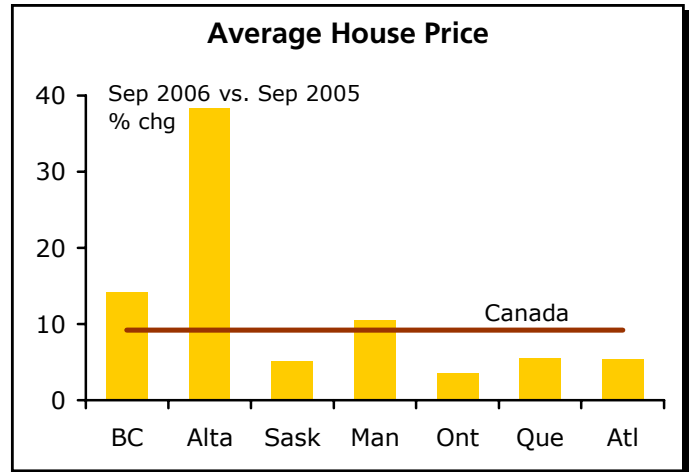
Arrears

The arrears rate has seen some volatility lately but at 0.24% it is currently at a record low. Note that this trend is very different than the situation in the US, where delinquency and foreclosure rates have risen notably in recent months. There is little doubt that low interest rates played a role here, but even more important was the fact that the labour market has been relatively healthy in recent years. We believe that the next 6-12 months will see some upward trend in arrears. But since we do not expect a significant



Residential Mortgages

deterioration in overall labour market conditions, the upward pressure on this rate will be limited at best. Despite ultra expensive real estate prices in British Columbia, the arrears rate in that province is now the lowest in the nation. At the same time, the arrears rate in Atlantic Canada is currently at 0.4% — the highest rate in the country.



Residential Mortgages

National Residential Housing Data by Province (MLS Market)

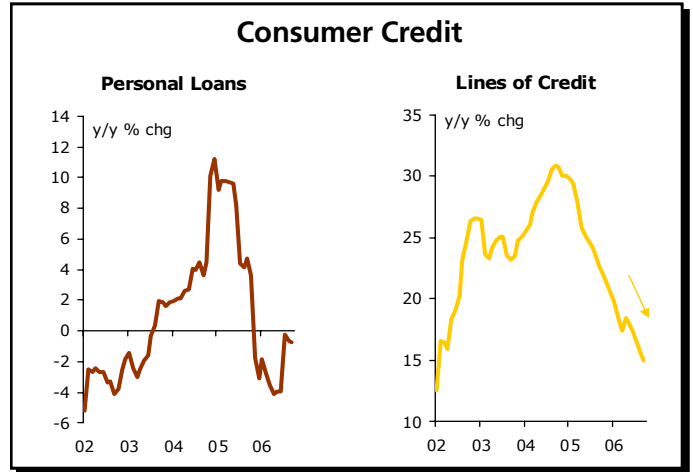
For September 2006

<i>seasonally adjusted</i>	Dollar Volume (\$000s)	Unit Sales	New Listings	Average Price (\$)	Ratio of New Listings to Unit Sales
Canada	10,796,310	38,890	68,872	277,611	1.8
Atlantic	287,629	1,890	3,630	152,185	1.9
Quebec	1,195,618	6,057	11,615	197,394	1.9
Ontario	4,359,674	15,862	29,689	274,850	1.9
Manitoba	161,609	1,074	1,472	150,474	1.4
Saskatchewan	112,101	840	1,024	133,453	1.2
Alberta	1,766,243	5,791	9,165	304,998	1.6
British Columbia	2,898,656	7,321	12,224	395,937	1.7

Source: CREA

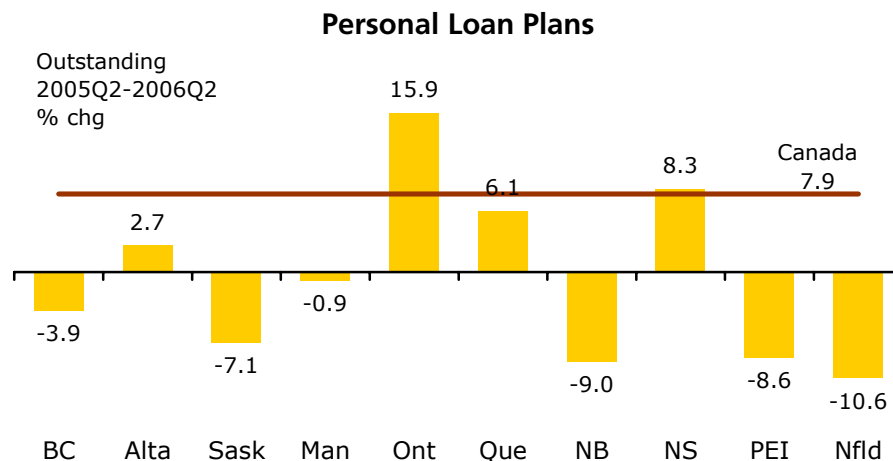
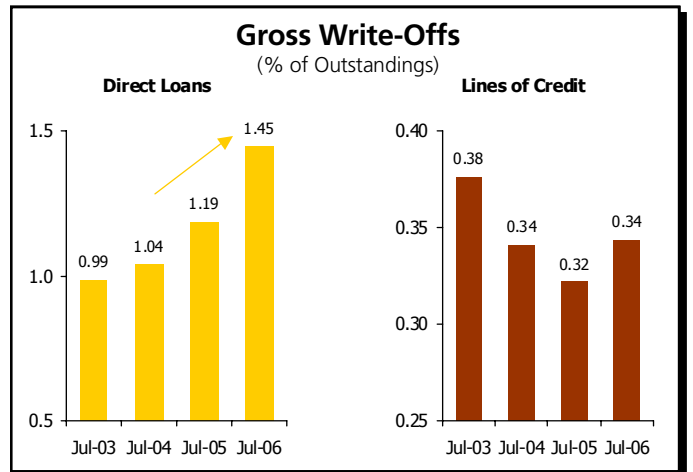
NON-CREDIT CARD PERSONAL LOANS

Overall growth in consumer credit is slowing. While the Personal Lines of Credit portfolio (PLCs) continues to dominate, its growth rate has moderated significantly since 2005. As of October 2006, PLCs outstanding rose by 12.4% (year-over-year) — significantly below the 30% seen in early 2005. At the same time, growth in the Direct Personal Loans portfolio (term loans) is still in negative territory with total outstanding falling by 0.3% in the year ending October 2006.



Write-Offs

Despite rapid growth in the PLCs portfolio, data as of July 2006 revealed no particular trend in the write-offs rate. At the same time, the write-offs rate in the Direct Loans portfolio is on a clear upward trend.

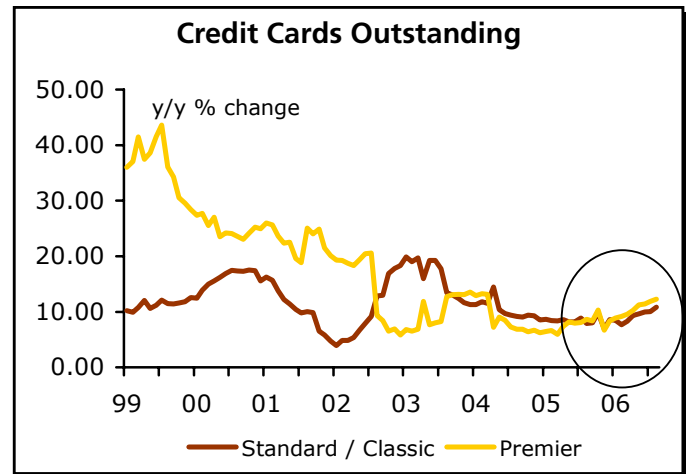


Source: Bank of Canada

CREDIT CARDS

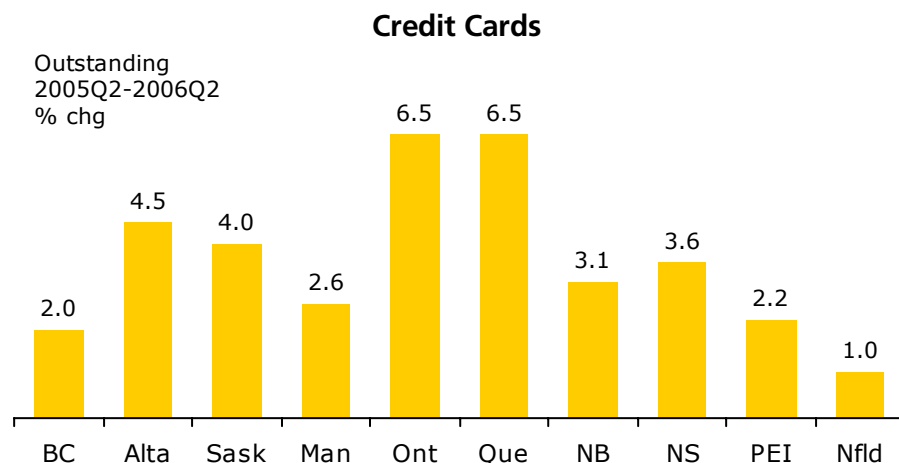
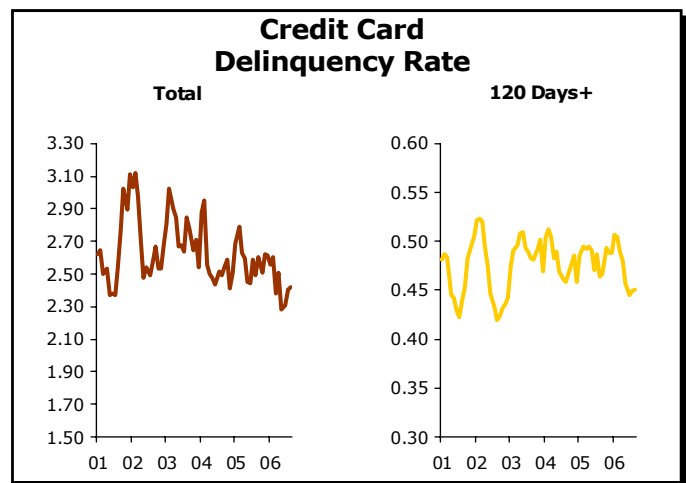
Outstanding

Growth in the Credit Card portfolio has improved a bit in recent months, but the upside potential of this portfolio is relatively limited. Overall, we expect credit cards outstanding to rise by 9%-10% in the coming 12 months. Note also that the rates of growth of the different types of cards (classic vs. premier) have converged.



Delinquencies & Write-Offs

Recent months have seen a modest softening in the overall delinquency rate which at the current 2.4% is close to 0.2% points below the rate seen earlier in the year. Furthermore, the delinquency rate among accounts that were in arrears for more than 120 days has softened notably over the past six months. As for 2007, we expect a moderate upward trend in credit cards' write-offs — not necessarily due to the direct impact of higher interest rates, but rather due to some softening in the labour market.

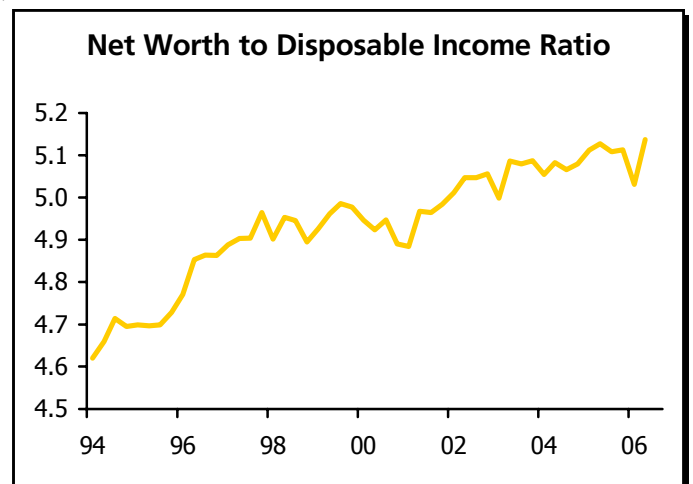
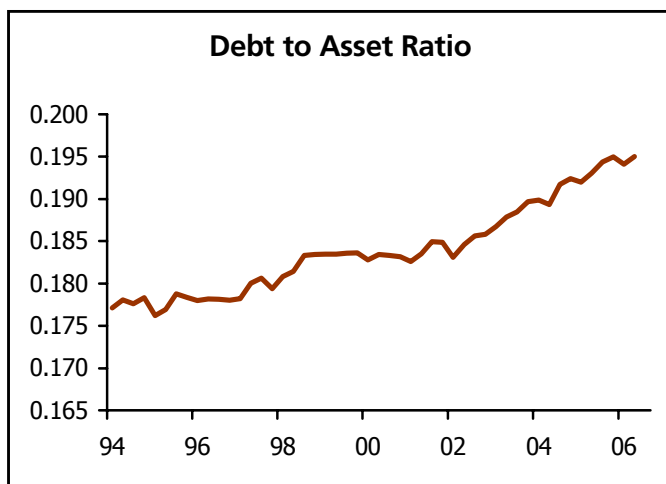
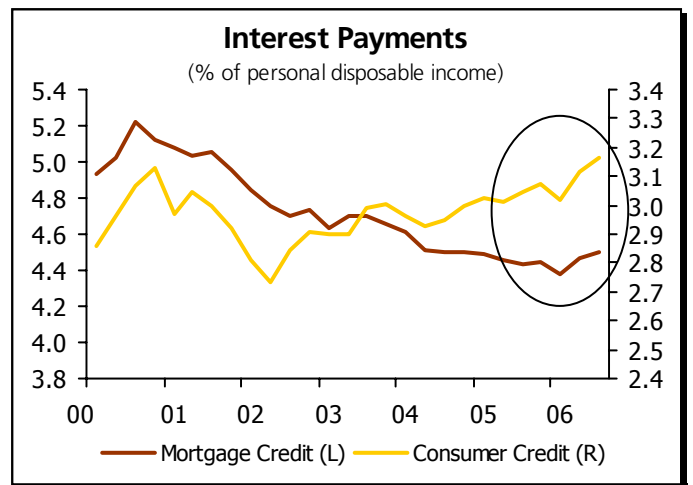
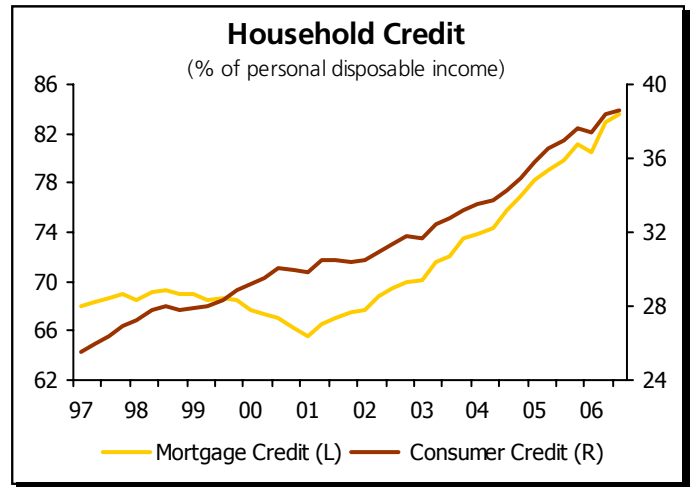


Source: Bank of Canada

HOUSEHOLD DEBT AND ASSETS

During the third quarter of 2006, overall household debt rose by 2.3% while personal disposable income rose by 1.4%. This led to a moderate increase in the debt-to-income ratio during the quarter. Over the past year, the debt-to-income ratio rose from 117% to 122%. Note that the combination of improving income growth and a softening credit growth has resulted in a notable slowing in the pace of growth in the debt-to-income ratio.

At the same time, the debt service ratio, as measured by debt interest payments as a share of disposable income is on the rise, and is at its highest level in two years.



Household Balance Sheet Data

	Total Household Assets (\$Mill)	Non-Financial Assets (\$Mill)	Financial Assets (\$Mill)	Debt to Asset Ratio	Net Worth (\$Mill)	Net Worth to Disposable Income Ratio
1999:1	3,522,794	1,524,314	1,998,480	0.1835	2,876,345	4.925
1999:2	3,607,488	1,560,918	2,046,570	0.1835	2,945,592	4.961
1999:3	3,663,567	1,576,774	2,086,793	0.1836	2,990,952	4.986
1999:4	3,702,843	1,597,248	2,105,595	0.1836	3,022,826	4.978
2000:1	3,774,638	1,617,353	2,157,285	0.1828	3,084,672	4.946
2000:2	3,832,914	1,638,201	2,194,713	0.1835	3,129,738	4.924
2000:3	3,890,225	1,651,809	2,238,416	0.1833	3,176,969	4.947
2000:4	3,931,907	1,675,911	2,255,996	0.1832	3,211,592	4.890
2001:1	3,988,405	1,705,543	2,282,862	0.1826	3,259,998	4.884
2001:2	4,039,357	1,749,296	2,290,061	0.1835	3,297,972	4.968
2001:3	4,079,566	1,766,693	2,312,873	0.1849	3,325,130	4.965
2001:4	4,130,868	1,791,113	2,339,755	0.1849	3,367,175	4.984
2002:1	4,210,031	1,845,680	2,364,351	0.1831	3,439,187	5.012
2002:2	4,266,289	1,890,850	2,375,439	0.1846	3,478,760	5.047
2002:3	4,314,316	1,916,058	2,398,258	0.1856	3,513,436	5.047
2002:4	4,373,955	1,952,214	2,421,741	0.1858	3,561,287	5.056
2003:1	4,405,648	1,969,822	2,435,826	0.1867	3,582,987	4.999
2003:2	4,482,863	2,019,097	2,463,766	0.1879	3,640,615	5.086
2003:3	4,544,772	2,058,939	2,485,833	0.1885	3,688,246	5.079
2003:4	4,575,338	2,092,522	2,482,816	0.1897	3,707,404	5.087
2004:1	4,622,981	2,122,582	2,500,399	0.1899	3,745,114	5.054
2004:2	4,733,709	2,193,241	2,540,468	0.1893	3,837,437	5.082
2004:3	4,764,367	2,220,658	2,543,709	0.1917	3,850,948	5.065
2004:4	4,825,927	2,252,145	2,573,782	0.1924	3,897,512	5.079
2005:1	4,887,060	2,275,341	2,611,719	0.1920	3,948,816	5.112
2005:2	4,966,286	2,322,828	2,643,458	0.1931	4,007,511	5.127
2005:3	5,033,340	2,362,189	2,671,151	0.1944	4,055,063	5.108
2005:4	5,094,268	2,401,095	2,693,173	0.1950	4,100,957	5.112
2006:1	5,184,570	2,444,551	2,740,019	0.1941	4,178,206	5.034
2006:2	5,266,764	2,497,660	2,769,104	0.1950	4,239,616	5.133

Household Debt Figures and Ratios

	Consumer Credit (\$Mill)	Mortgage Credit (\$Mill)	Total Household Debt (\$Mill)	Pers. Disp. Income (\$Mill)	Interest Payments (\$Mill)	Consumer Credit (% of PDI)	Mortgage Credit (% of PDI)	Total Pers. Debt (% of PDI)	Interest Payments (% of PDI)
2001:1	199,408	437,806	637,214	667,516	53,740	29.87	65.59	95.46	8.05
2001:2	202,126	441,591	643,717	663,872	53,604	30.45	66.52	96.96	8.07
2001:3	204,355	448,557	652,912	669,772	53,900	30.51	66.97	97.48	8.05
2001:4	205,530	456,232	661,763	675,624	53,196	30.42	67.53	97.95	7.87
2002:1	208,837	464,632	673,468	686,216	52,504	30.43	67.71	98.14	7.65
2002:2	213,417	474,629	688,047	689,240	51,600	30.96	68.86	99.83	7.49
2002:3	218,271	483,978	702,249	696,156	52,536	31.35	69.52	100.88	7.55
2002:4	223,526	492,522	716,048	704,428	53,800	31.73	69.92	101.65	7.64
2003:1	227,055	502,155	729,210	716,772	53,988	31.68	70.06	101.74	7.53
2003:2	231,910	511,962	743,871	715,796	54,396	32.40	71.52	103.92	7.60
2003:3	237,726	523,204	760,930	726,116	55,828	32.74	72.06	104.79	7.69
2003:4	242,271	535,230	777,500	728,864	55,848	33.24	73.43	106.67	7.66
2004:1	248,102	547,176	795,278	741,032	56,160	33.48	73.84	107.32	7.58
2004:2	254,531	561,582	816,113	755,072	56,196	33.71	74.37	108.08	7.44
2004:3	260,961	575,986	836,946	760,288	56,620	34.32	75.76	110.08	7.45
2004:4	268,215	590,691	858,906	767,332	57,532	34.95	76.98	111.93	7.50
2005:1	276,666	603,933	880,598	772,444	58,052	35.82	78.18	114.00	7.52
2005:2	285,201	617,770	902,971	781,652	58,392	36.49	79.03	115.52	7.47
2005:3	293,634	633,666	927,300	793,836	59,412	36.99	79.82	116.81	7.48
2005:4	301,946	650,597	952,542	802,164	60,296	37.64	81.11	118.75	7.52
2006:1	310,164	667,727	977,892	829,968	61,316	37.37	80.45	117.82	7.39
2006:2	316,533	684,918	1,001,451	825,920	62,608	38.32	82.93	121.25	7.58
2006:3	323,293	700,491	1,023,784	837,456	64,204	38.60	83.65	122.25	7.67

CONSUMER BANKRUPTCIES

The cumulative number of consumer bankruptcies declined by 5% during the year ending September 2006. The 3-month moving average figure is now declining by a year-over-year pace of 7% — the best performance in more than 8 years. Note that all provinces are now witnessing declining bankruptcies, with the exception of Quebec.

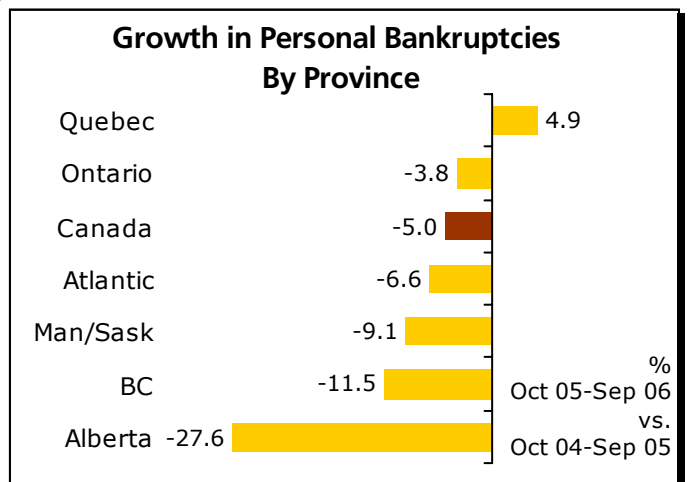
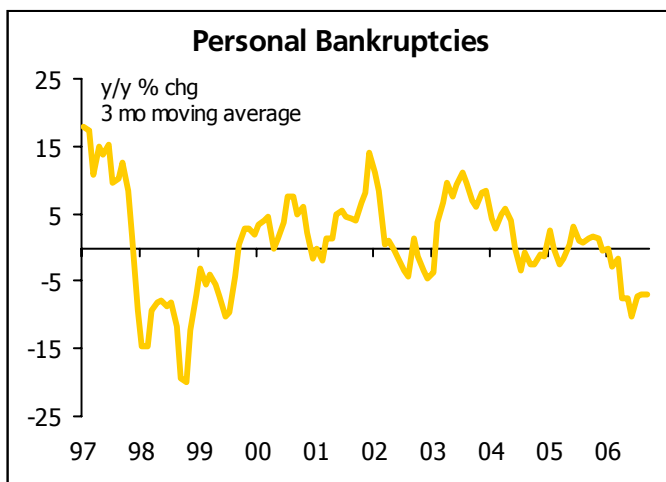
The number of bankruptcies in Ontario is now falling by close to 4% — a significant improvement from the performance seen earlier in the year. While the strong Canadian dollar is clearly hurting the manufacturing sector in the province, the unemployment rate, at 6.4%, is still relatively low (despite a recent modest increase). The ability of the province's labour market to offset the pain in the manufacturing sector reflects, in part, the above average performance of some of the largest cities in the province, such as Ottawa and Toronto, with the bankruptcy rates in these cities well below the national average. At the same time, the bankruptcy rates in cities like Sudbury and Windsor are much higher, reflecting the vulnerability of those cities to the strong dollar.

Not surprisingly, the largest drop in bankruptcies was in Alberta, where they fell by almost 28% in the past year. The national number of bankruptcies excluding Alberta fell by 2.7% during the same time period.

Note, however, that data as of 2005 show that the average dollar amount of liabilities among those who declared personal bankruptcy has risen by 8.3% from 2004, to almost \$61,000.

Personal Bankruptcies

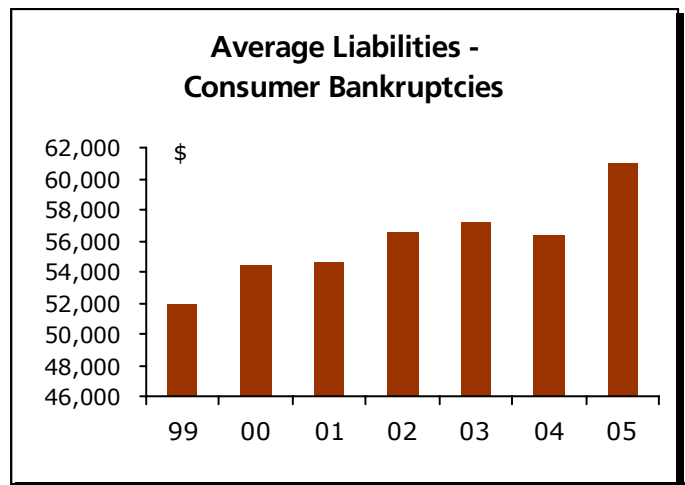
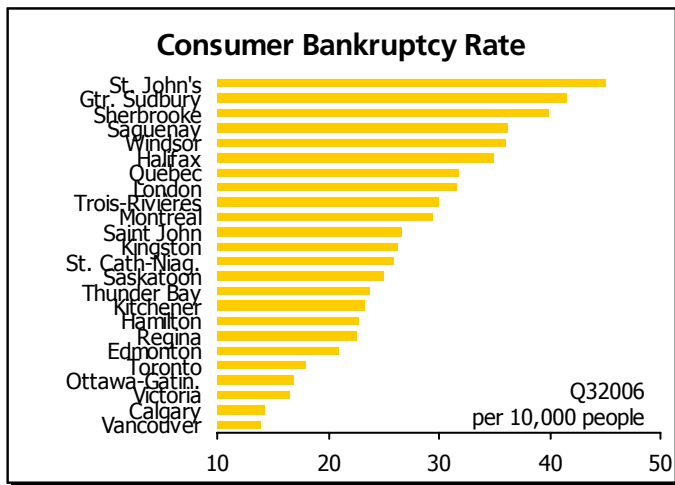
	Monthly Data	y/y % chg
2004:01	6,110	-2.9%
2004:02	7,115	2.0%
2004:03	8,521	15.2%
2004:04	7,578	0.4%
2004:05	7,026	-3.9%
2004:06	7,477	3.0%
2004:07	6,330	-9.1%
2004:08	6,639	3.7%
2004:09	7,075	-1.9%
2004:10	7,098	-9.7%
2004:11	7,359	8.0%
2004:12	6,146	-1.9%
2005:01	6,194	1.4%
2005:02	7,098	-0.2%
2005:03	7,749	-9.1%
2005:04	7,939	4.8%
2005:05	7,431	5.8%
2005:06	7,403	-1.0%
2005:07	6,219	-1.8%
2005:08	6,941	4.5%
2005:09	7,171	1.4%
2005:10	7,045	-0.8%
2005:11	7,580	3.0%
2005:12	5,905	-3.9%
2006:01	6,234	0.7%
2006:02	6,701	-5.6%
2006:03	7,727	-0.3%
2006:04	6,602	-16.8%
2006:05	7,021	-5.5%
2006:06	6,799	-8.2%
2006:07	5,711	-8.2%
2006:08	6,625	-4.6%
2006:09	6,571	-8.4%



Consumer Bankruptcies

Looking at developments in the pipeline, it appears that there is little risk of any significant deterioration in the bankruptcy situation in the near future. The delinquency rate in credit cards, a good barometer of possible future difficulties, is not showing any upward trend. Additionally, the share of cardholders who did not pay the minimum amount for more than 120 days is still relatively low, and is basically trend-less. Mortgage arrears are currently at a record-low, while the write-off rate in personal lines of credit (PLCs) has been stubbornly stable over the past year. The write-off rate in personal loans is the only indicator showing some upward trend.

Overall, it seems that the number of personal bankruptcies in 2006 will fall by 5%-6%. As for 2007, the slowing US economy will impact overall growth in Canada, especially in Ontario and Quebec, with negative consequences for personal bankruptcies. However, our assessment is that the Bank of Canada was able to avoid monetary overshooting this time around, and by keeping rates low, and potentially easing policy in 2007, the Bank will be able to prevent a significant deterioration in the bankruptcy situation. We expect only a moderate 3%-4% increase in the number of personal bankruptcies next year — a very solid performance relative to past swings.



ECONOMIC DRIVERS AFFECTING THE CONSUMER

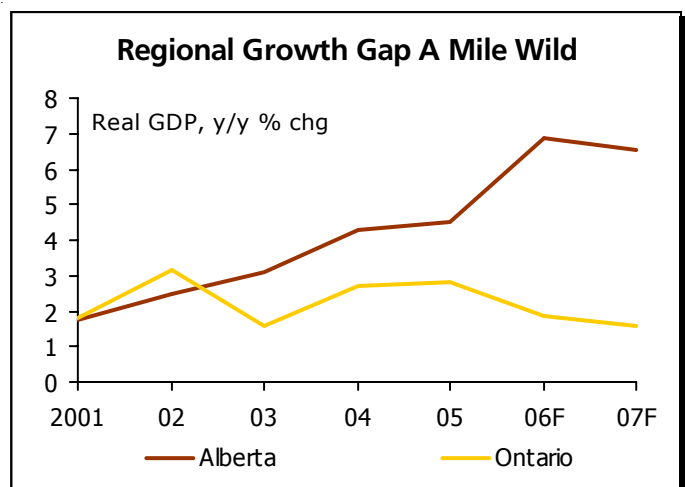
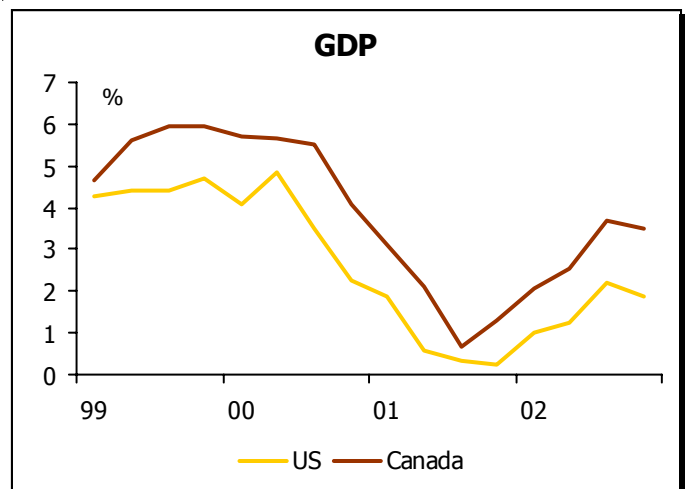
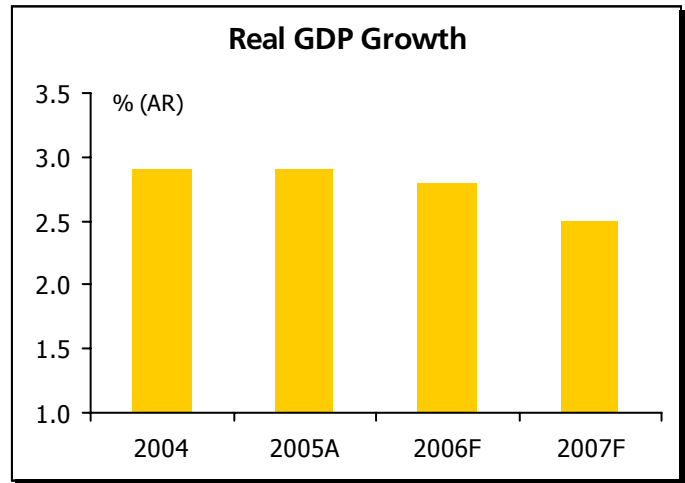
It is widely believed that when the US sneezes, Canada catches pneumonia. That's a very catchy notion but it's simply wrong.

In 2001, the US economy fell into an IT-led recession but Canada was able to avoid one and, in fact, out-performed the US economy in both 2001 and 2002. The relative resiliency of Canada was due to the fact that when compared to the US, Canada was not as heavily invested in Information Technology, so the Internet crash was not as painful in this side of the border.

Fast-forward to today's situation, and the picture is not very different — simply replace IT with real estate. The slowing housing market in the US is the main catalyst behind the softening US economy — and it's going to be painful due to the unprecedented role that housing has played in the American economy over the past few years. In Canada, the situation is very different. Yes, we have also experienced a booming housing market, but Canadian households reliance on real estate is currently half of the rate seen south of the border. This means that once again, Canada will be able to out-perform the US during a year of slowing economic activity — with positive implications for Canadian equities vs. US equities.

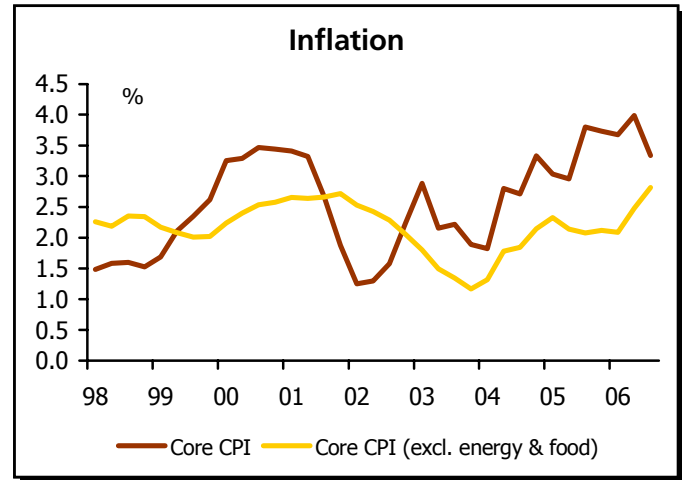
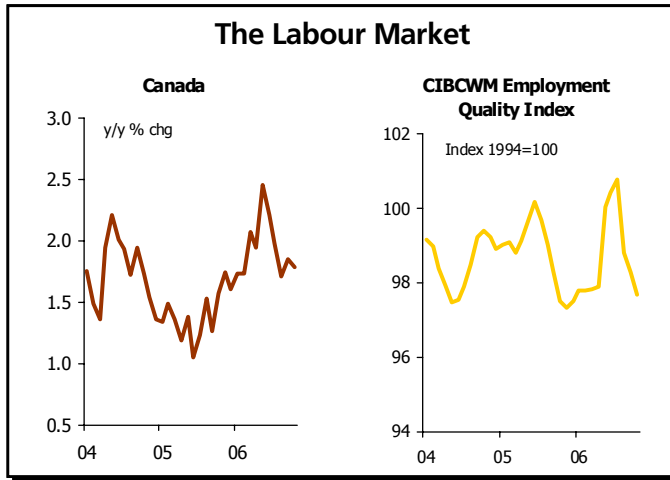
The likelihood is that economic growth in the coming 6 months will average 2.4% (annual rate) — a bit slower than the pace seen in the first half of the year. As for 2007, look for economic growth to average 2.5%. Also, the engine of growth in the coming 12 months is going to change. The ongoing softening in housing market and our expectations that the labour market will soften a bit suggest that consumer spending will weaken somewhat in the coming 12 months. This should lead to some moderation in demand for credit. At the same time, we expect business investment to remain relatively healthy in the foreseeable future.

As for inflation, with core inflation at 2.3%, it appears that the Bank of Canada is facing a dilemma — rising inflation in an environment of slowing economy. However, there are many reasons to believe that the Bank will not raise rates despite the recent acceleration in inflation. First, inflation is a lagging indicator while



the impact of higher rates will be felt in the economy only 12-18 months after the act. Second, the slowing economy will take care of inflation in 2007. And most importantly, Alberta is an important contributor to

overall inflation in Canada. In fact, excluding Alberta, the inflation numbers are more or less in line with the Bank of Canada's target.



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