Household Credit Analysis

May 9, 2012

CIBC

Economics

Avery Shenfeld
(416) 594-7356
avery.shenfeld@cibc.ca

Benjamin Tal
(416) 956-3698
benjamin.tal@cibc.ca

Peter Buchanan
(416) 594-7354
peter.buchanan@cibc.ca

Warren Lovely
(416) 594-8041
warren.lovely@cibc.ca

Emanuella Enenajor
(416) 956-6527
emanuella.enenajor@cibc.ca

Andrew Grantham
(416) 956-3219
andrew.grantham@cibc.ca

http://research.cibcwm.com/res/Eco/EcoResearch.html

Highlights

by Benjamin Tal

- The pace of growth in household credit is no longer a reason for the Bank of Canada to move from the sidelines any time soon. Households should get credit not only for notably slowing the pace at which they accumulate debt in an environment of historically low interest rates, but also for managing their debt in the most optimal way on record. As of March 2012, household credit was rising at the slowest pace since 2002.

- Consumer credit outstanding actually declined in March, and on a smoothed basis it is now rising at the slowest monthly pace since the early 1990s.

- For the first time in more than a decade consumer credit in Canada is rising more slowly than in the US.

- Soft credit card activity is largely behind the softening in overall growth in consumer credit. And here, we see increased optimization of the debt burden with active transfer of balances from credit cards to lines of credit. Term loans are still healthy due to strong demand for auto loans.

- Recently we have seen some increase in the delinquency rate in the lines of credit portfolio, in part probably due to a transfer of risk from the card portfolio. Overall, however, the delinquency rate is still very low.

- As of March 2012, mortgage outstandings rose by 6.3% on a year-over-year basis — a rate that is well below the average rate of growth seen in the past two years (7.3%), and well below the pace seen during the past decade.

- The recent modest softening in mortgage activity is coinciding with a reduction in the mortgage arrears rate, which as of January 2012, stood at under 0.4% after reaching close to 0.5% during the recession.

- There is no debate about the fact that the housing market is overshooting. The only question is what will be the nature of the adjustment. It appears that we are at a turning point in the real estate market. Recent signals from the market suggest that activity is slowing down. We continue to call for a gradual softening in the market, with prices potentially falling by around 10% in the coming year or two.

- With personal disposable income rising by 1.3% in the fourth quarter and household credit rising by 1.3%, the debt-to-income ratio in the fourth quarter of 2011 was little changed. Interest payments on debt have accounted for 7.3% of disposable income, roughly the same ratio seen in the previous two quarters. And in all likelihood this ratio will be little changed in the first quarter. Note that mortgage interest payments as a share of disposable income are at the lowest point since late-2004.

- The number of consumer insolvencies continues to fall. As of November 2011 personal insolvencies fell by 9.5% (year-over-year).

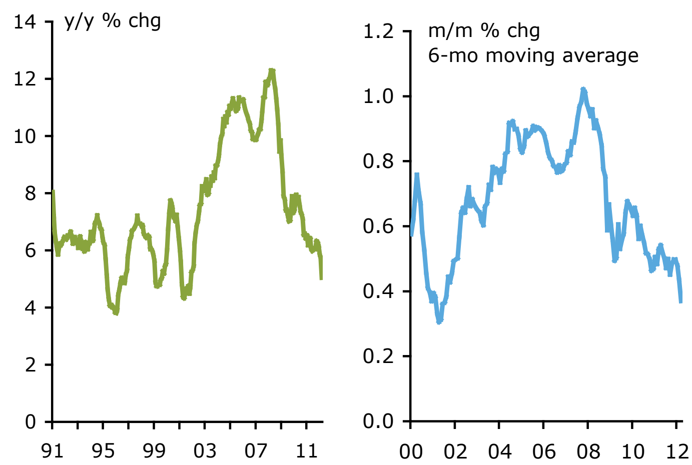
- Looking ahead, it is difficult to get too excited about the consumers' near-term prospects.

Source:
Bank of Canada
Statistics Canada
Industry Canada
CBA
CREA
CIBC World Markets Inc.
Equifax Canada

Household Credit

Regardless of how you measure it, there is a clear slowing trend in the pace of growth in household credit. On a year-over-year basis, credit is now rising by just over 5% — the slowest pace since 2002. Ditto for the (smoothed) month-over-month rate that is now rising by only 0.4% — the slowest rate since mid-2001 (Chart 1).

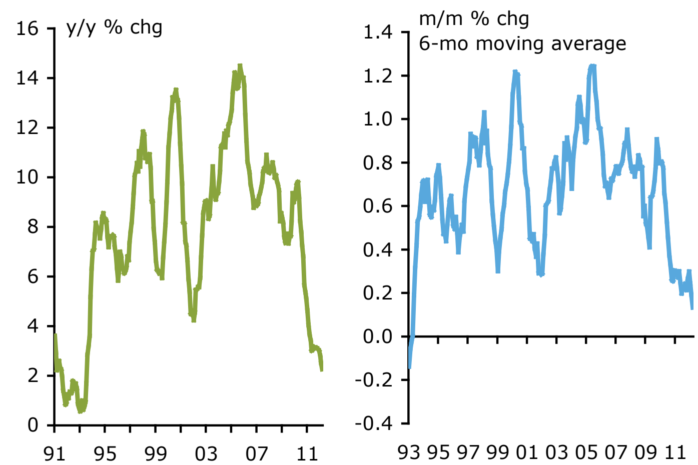
*Chart 1—**Household Credit***



Consumer Credit

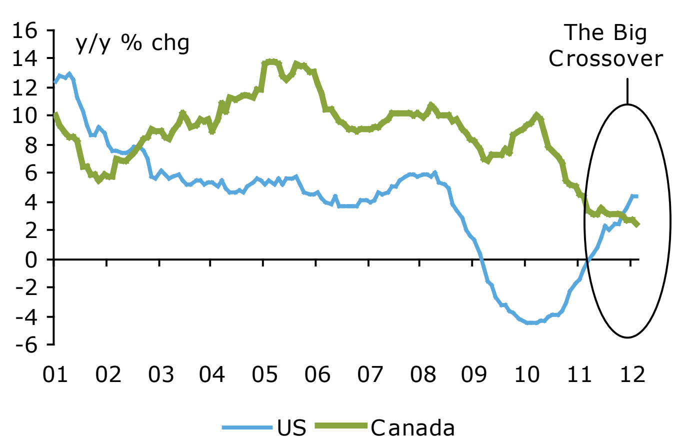
Key here is the rapid softening in the pace of consumer credit. As of March 2012, overall consumer credit outstanding rose by only 2.3% on a year-over-year basis — the slowest pace since the early 1990s. On a month-over-month basis, credit was actually down in March — the slowest showing since May 2011, and on a smoothed month-over-month basis consumer credit is now rising by only 0.1% — the slowest pace since 1993 (Chart 2).

*Chart 2—**Consumer Credit***



Interestingly, for the first time since 2002 consumer credit in Canada is rising more slowly than in the US (Chart 3). Note that as opposed to popular perception, consumer credit in Canada rose much faster than in the US during the past decade. In fact, during the leveraged period of between 2002 and 2008, consumer credit in Canada rose twice as fast as in the US. After the crisis, with growth in consumer credit in the US reaching negative territory, consumer credit in Canada continued to expand and, in fact, accelerated. Recently, however, these dynamics have changed dramatically. While US consumer credit is now expanding at its pre-recession rate of 4.3% year-over-year, growth in consumer credit in Canada has softened dramatically.

*Chart 3—**Consumer Credit: Canada vs. US***



The slowing in consumer credit is largely due to the softening performance of the credit cards market. Overall growth in card balances is now marginally in negative territory, with both classic and premier cards showing a similar performance (Chart 4). While the dramatic softening in activity during the recession was in part due to supply factors, today's slowing is driven more by demand considerations, as well as an active shifting of card balances to lines of credit.

This trend is very visible in the most recent uptick in activity in the lines of credit portfolio, which we believe is mostly a transfer of balances from the credit card portfolio (Chart 5).

*Chart 4—**Credit Cards Outstanding***

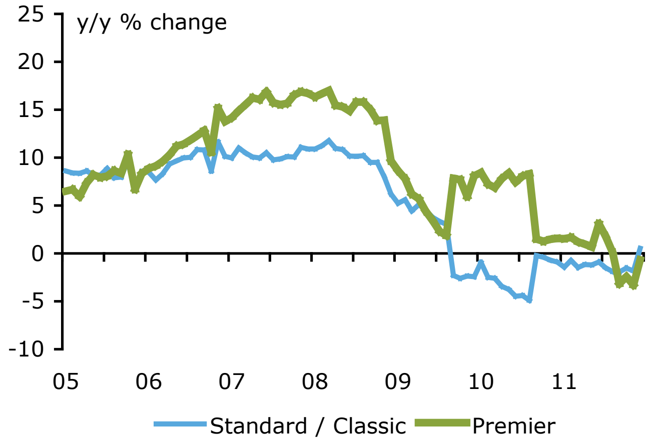


*Chart 6—**Delinquency Rates: Credit Cards vs. PLCs***

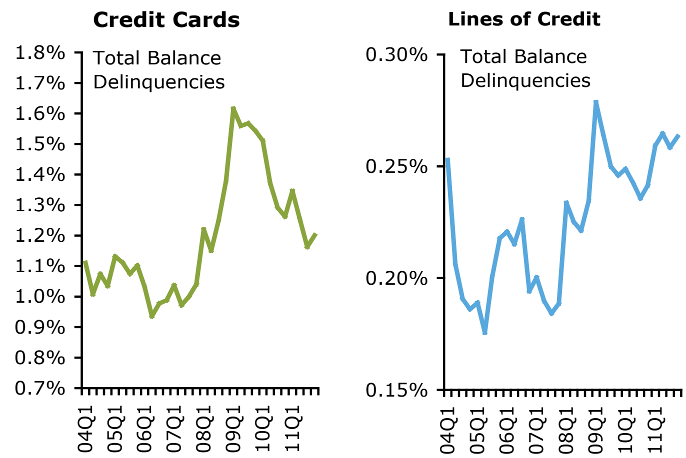


*Chart 5—**Lines of Credit***

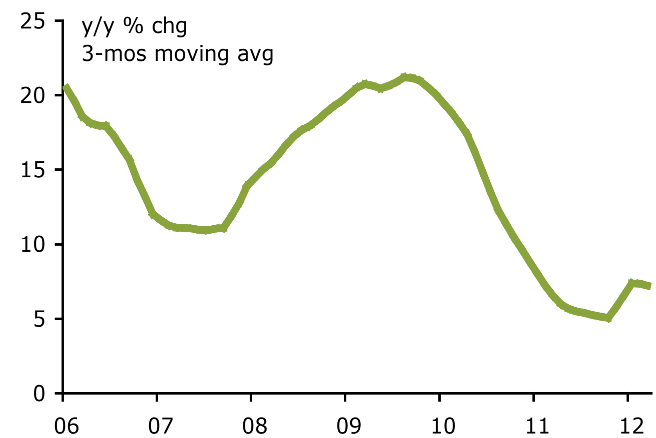
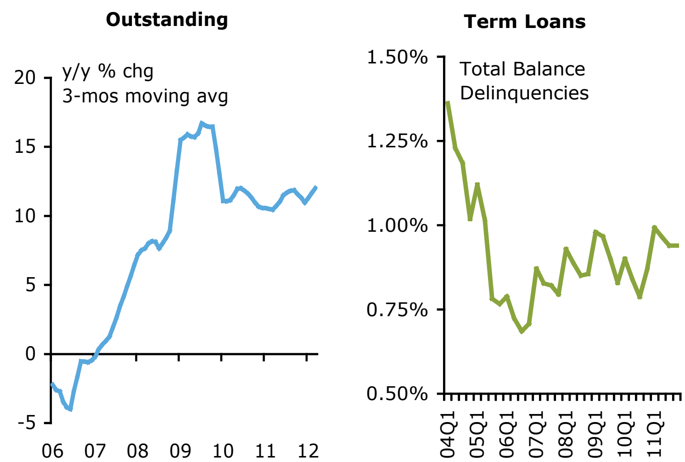


*Chart 7—**Personal Term Loans***



This fact helps to explain the recent increase in the delinquency rate in the lines of credit portfolio, against a background of falling delinquency rates in the card portfolio (Chart 6).

Note that growth in balances outstanding on personal term loans has stabilized at just over 10% (y/y) over the past year or so, largely reflecting strong demand for auto loans. This strong growth was accompanied by a relatively stable delinquency environment (Chart 7).

THE HOUSING AND MORTGAGE MARKETS

Turning to the mortgage market, here as well, we are starting to see some early signs of moderating activity. As of March 2012, mortgage outstanding rose by 6.3% on a year-over-year basis — a rate that is well below the average rate of growth seen in the past two years (7.3%), and well below the pace seen during most of the decade. The softening trend is much more evident in the smoothed month-over-month growth rate, which at 0.5% is the slowest since late 2001 (Chart 8).

The recent modest softening in mortgage activity is coinciding with a reduction in the mortgage arrears rate, which as of January 2012, stood at under 0.4% after reaching close to 0.5% during the recession. Note that the current rate is still double the rate seen before the recession but is significantly below rates we have seen in previous recessions. Note that the arrears rate in Alberta is by far the highest in the nation. This reflects the fact that, on average, homeowners in Alberta are younger and less established. As well, the pre-recession period in Alberta had seen activity surging rapidly — leading to a higher percentage of consumers overextending themselves to speculative investment activity and excess (Chart 9).

As for the housing market (Table 1), there is no debate about the fact that the market is overshooting. The only question is what will be the nature of the adjustment. It appears that we are at a turning point in the real estate market. Recent signals from the market suggest that activity is slowing down. The number of unit sales is now rising by a smoothed year–over-year rate of just over 3% — the softest showing since mid-2011 while the smoothed average price (y/y) is rising by only 1% — the slowest rate of increase since late 2010. Preliminary numbers for April suggest that this trend of softening is intact (Chart 10). The most visible slowing in MLS activity is in Manitoba, followed by Quebec and BC respectively (Chart 11).

In the absence of a trigger for a violent correction, we do not see such an outcome in the near future. We continue to call for a gradual softening in the market, with prices potentially falling by around 10% in the coming year or two. Other factors that will work to soften activity in the market are ongoing changes in the mortgage market with increased scrutiny from regulators regarding risk management practices, as well as the increased use of full-scale appraisals as part of the adjudication process. Accordingly we see mortgage market growth softening

*Chart 8—**The Mortgage Market***

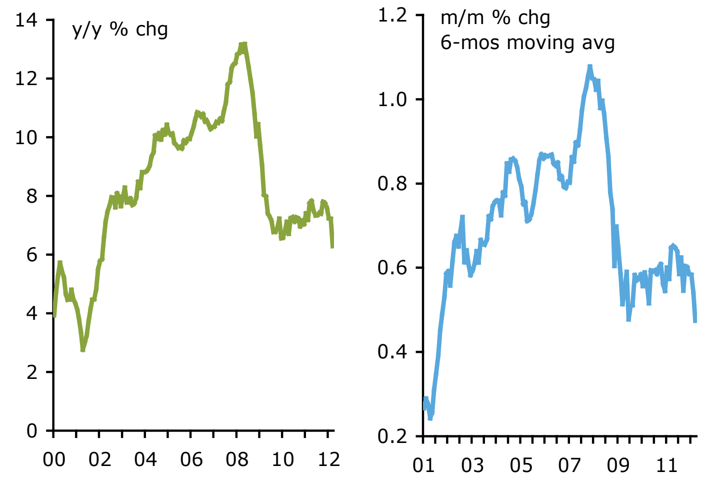


*Chart 9—**Mortgage Arrears***

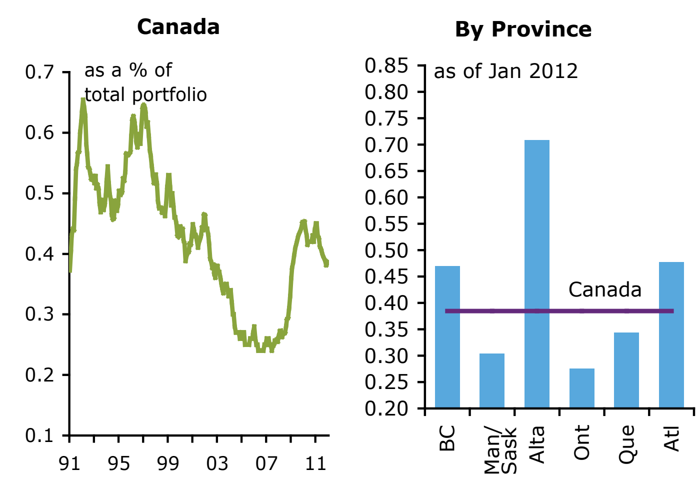
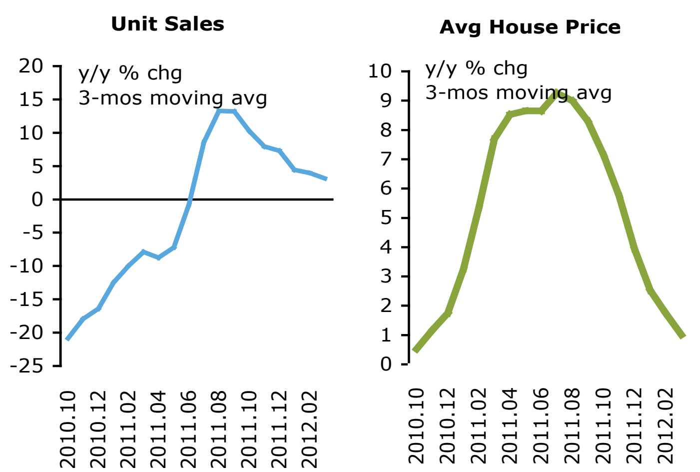


*Table 1—**National Residential Housing Data by Province***
For March 2012

(sa)	Dollar Volume ($000s)	Unit Sales	New Listings	Average Price ($)	Ratio of Unit Sales to New Listings
CANADA	14,843,767	40,356	73,220	367,821	0.55
ATLC	417,748	1,975	4,095	211,518	0.48
QUE	1,791,311	6,817	13,372	269,008	0.51
ONT	6,958,713	17,873	30,214	389,342	0.59
MAN	282,579	1,187	1,646	238,062	0.72
SASK	334,647	1,216	2,040	275,203	0.60
ALTA	1,831,198	5,101	8,904	358,988	0.57
BC	3,214,378	6,150	12,881	522,663	0.48

Source: CREA

*Chart 10—**The Housing Market***



Interest payments on debt have accounted for 7.3% of disposable income in the fourth quarter of 2011, roughly the same ratio seen in the previous two quarters. And in all likelihood this ratio will be little changed in the first quarter. This relative stability, however, masks two diverging trends; with interest payments on mortgage debt still falling, only to offset the ongoing increase in interest payments on consumer credit (Chart 13). Note that mortgage interest payments as a share of disposable income are at the lowest points since late-2004.

After rising rapidly during the recession, the debt-to-asset ratio has stabilized at 20% in the past two years (Table 3). With credit softening and asset value rising in the first quarter of the year, we expect to see this ratio improving — a fact that should see the ratio of net worth gradually to around 5% (year-over-year) during the course of the year, down from the current 6.3% rate.

*Chart 11—**MLS Resales***

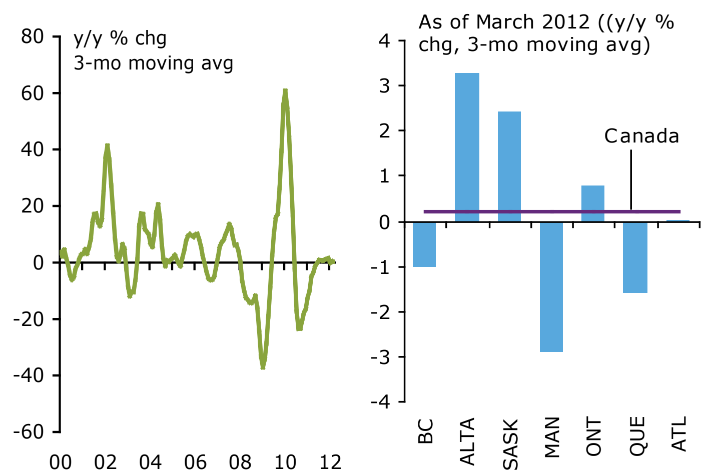
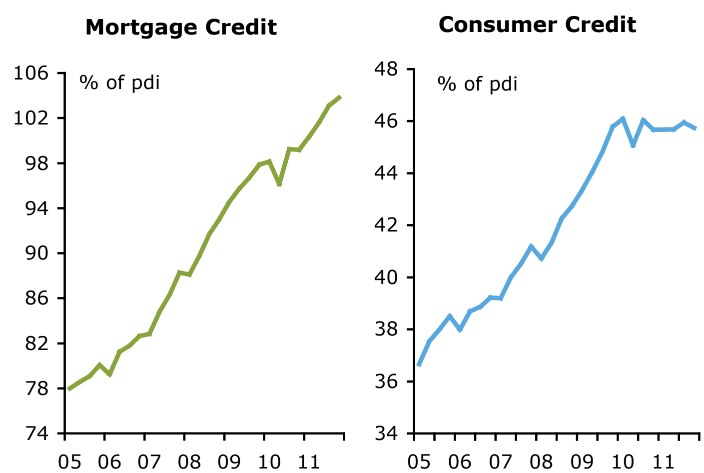


*Chart 12—**Household Credit***



Debt Levels, Affordability and Net Worth Position

With personal disposable income rising by 1.3% in the fourth quarter and household credit rising by 1.3%, the debt-to-income ratio in the fourth quarter of 2011 was little changed (Chart 12, Table 2). As for the first quarter, with debt rising by only 1% and income estimated to have risen by 0.5%-0.7%, the increase in the debt service ratio is likely to be minimal.

*Chart 13—**Interest Payments***

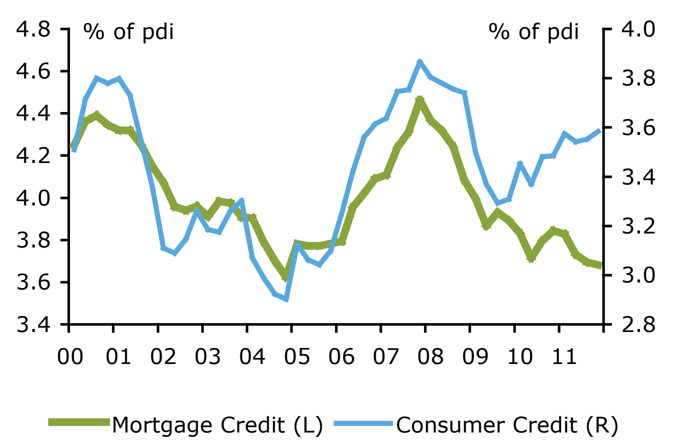


*Table 2—**Consumer Debt Figures and Ratios***

	Consumer Credit ($Mill)	Mortgage Credit ($Mill)	Total Personal Debt ($Mill)	Household Debt (BoC*) ($Mill)	Household Debt (StatsCan+) ($Mill)	Pers. Disp. Income ($Mill)	Interest Payments ($Mill)	Consumer Credit (% of PDI)	Mortgage Credit (% of PDI)	Total Personal Debt (% of PDI)	Household Debt (BoC*) (% of PDI)	Household Debt (StatsCan+) (% of PDI)	Interest Payments (% of PDI)
2006:1	320,093	667,611	987,704	1,028,858	1,042,496	842,600	59,364	37.99	79.23	117.22	122.11	123.72	7.05
2006:2	326,239	684,979	1,011,218	1,059,332	1,073,650	843,172	62,216	38.69	81.24	119.93	125.64	127.33	7.38
2006:3	333,355	701,377	1,034,732	1,081,808	1,097,479	857,632	65,024	38.87	81.78	120.65	126.14	127.97	7.58
2006:4	340,975	718,327	1,059,302	1,109,400	1,124,144	869,356	66,968	39.22	82.63	121.85	127.61	129.31	7.70
2007:1	348,947	737,428	1,086,375	1,130,101	1,144,023	890,240	68,964	39.20	82.83	122.03	126.94	128.51	7.75
2007:2	357,529	758,226	1,115,754	1,164,324	1,180,438	894,012	71,376	39.99	84.81	124.80	130.24	132.04	7.98
2007:3	367,640	782,907	1,150,546	1,197,759	1,212,356	907,220	73,184	40.52	86.30	126.82	132.03	133.63	8.07
2007:4	376,862	807,781	1,184,643	1,220,888	1,237,556	915,064	76,208	41.18	88.28	129.46	133.42	135.24	8.33
2008:1	384,978	832,929	1,217,907	1,240,477	1,257,543	945,488	77,264	40.72	88.10	128.81	131.20	133.00	8.17
2008:2	394,371	856,459	1,250,830	1,272,967	1,291,183	954,120	77,248	41.33	89.76	131.10	133.42	135.33	8.10
2008:3	403,950	876,352	1,280,303	1,304,348	1,324,008	955,620	76,444	42.27	91.71	133.98	136.49	138.55	8.00
2008:4	409,833	892,003	1,301,836	1,327,948	1,347,222	959,044	75,044	42.73	93.01	135.74	138.47	140.48	7.82
2009:1	415,984	907,332	1,323,317	1,338,066	1,356,323	959,588	71,924	43.35	94.55	137.90	139.44	141.34	7.50
2009:2	423,919	921,138	1,345,057	1,367,862	1,388,811	962,296	69,640	44.05	95.72	139.78	142.15	144.32	7.24
2009:3	434,322	936,802	1,371,124	1,394,339	1,413,847	968,896	69,984	44.83	96.69	141.51	143.91	145.92	7.22
2009:4	446,082	953,466	1,399,548	1,416,524	1,435,999	974,296	70,144	45.79	97.86	143.65	145.39	147.39	7.20
2010:1	455,350	969,336	1,424,686	1,432,765	1,451,804	987,796	71,948	46.10	98.13	144.23	145.05	146.97	7.28
2010:2	462,426	986,359	1,448,785	1,458,309	1,480,467	1,025,996	72,692	45.07	96.14	141.21	142.14	144.30	7.09
2010:3	465,965	1,004,359	1,470,324	1,482,614	1,503,334	1,012,152	73,656	46.04	99.23	145.27	146.48	148.53	7.28
2010:4	470,061	1,020,666	1,490,727	1,504,110	1,525,583	1,029,168	75,420	45.67	99.17	144.85	146.15	148.23	7.33
2011:1	474,065	1,041,508	1,515,573	1,520,763	1,543,985	1,037,980	76,844	45.67	100.34	146.01	146.51	148.75	7.40
2011:2	477,051	1,060,857	1,537,908	1,548,689	1,572,097	1,044,100	75,948	45.69	101.60	147.30	148.33	150.57	7.27
2011:3	480,586	1,078,579	1,559,165	1,574,691	1,597,585	1,046,004	75,808	45.94	103.11	149.06	150.54	152.73	7.25
2011:4	484,504	1,099,397	1,583,901	1,594,824	1,619,181	1,059,224	76,940	45.74	103.79	149.53	150.57	152.86	7.26

** Bank of Canada's Household debt (referred as Credit Market Debt by Statistics Canada) = Total liabilities less Trade accounts payable*

+ Statistics Canada's Household debt = Total liabilities

*Table 3—**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
2006:1	6,190,678	2,591,377	3,599,301	0.168	5,148,182	6.110
2006:2	6,267,139	2,676,646	3,590,493	0.171	5,193,489	6.159
2006:3	6,403,506	2,740,378	3,663,128	0.171	5,306,027	6.187
2006:4	6,624,510	2,795,558	3,828,952	0.170	5,500,366	6.327
2007:1	6,757,479	2,865,115	3,892,364	0.169	5,613,456	6.306
2007:2	6,913,568	2,952,598	3,960,970	0.171	5,733,130	6.413
2007:3	7,026,245	3,008,995	4,017,250	0.173	5,813,889	6.408
2007:4	7,068,291	3,046,249	4,022,042	0.175	5,830,735	6.372
2008:1	7,089,471	3,089,589	3,999,882	0.177	5,831,928	6.168
2008:2	7,261,717	3,149,269	4,112,448	0.178	5,970,534	6.258
2008:3	7,114,037	3,209,985	3,904,052	0.186	5,790,029	6.059
2008:4	6,834,893	3,192,805	3,642,088	0.197	5,487,671	5.722
2009:1	6,791,926	3,171,273	3,620,653	0.200	5,435,603	5.665
2009:2	7,032,833	3,191,273	3,841,560	0.197	5,644,022	5.865
2009:4	7,372,156	3,279,950	4,092,206	0.195	5,936,157	6.093
2010:1	7,437,736	3,317,684	4,120,052	0.195	5,985,932	6.060
2010:2	7,423,135	3,372,524	4,050,611	0.199	5,942,668	5.792
2010:3	7,640,747	3,423,589	4,217,158	0.197	6,137,413	6.064
2010:4	7,809,469	3,451,383	4,358,086	0.195	6,283,886	6.106
2011:1	7,967,092	3,518,848	4,448,244	0.194	6,423,107	6.188
2011:2	7,971,645	3,565,122	4,406,523	0.197	6,399,548	6.129
2011:3	7,847,489	3,593,888	4,253,601	0.204	6,249,904	5.975
2011:4	7,927,661	3,611,769	4,315,892	0.204	6,308,480	5.956

to disposable income rising in the first quarter. Note that an average household in Canada currently carries a debt load of $102,000 versus an asset position of over $350,000 (of which $250,000 is real estate).

Insolvencies

The number of consumer insolvencies continues to fall. As of November 2011 personal insolvencies fell by 9.5% (year-over-year) (Chart 14). On a cumulative basis the number of insolvencies fell by close to 9% during the year-ending November 2011 versus the same period in the preceding year. All provinces have seen a decline in the number of insolvencies, with the largest drop being in Manitoba and Saskatchewan, followed by Ontario (Chart 15).

*Chart 14—**Personal Insolvencies***

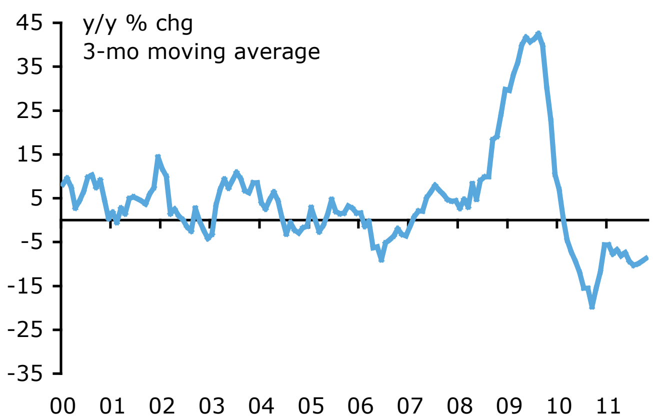
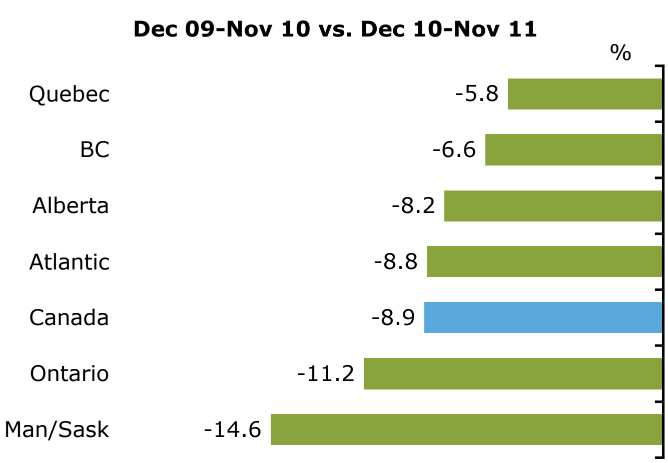


*Chart 15—**Personal Insolvencies by Province***



What's next for the insolvency rate in Canada? The answer does not lie only with the highly quoted unemployment rate. Clearly, a sharp rise in the unemployment rate can lead to a surge in the insolvency rate (see the most recent recession), but from a long-term perspective we find the unemployment rate to be a relatively weak explanatory variable of the insolvency rate — with the unemployment rate showing no (and at times negative) correlation with the insolvency rate.

In fact, between 2008 and 2010 unemployment was accountable for less than 19% of insolvencies while insufficient income relative to debt accounted for more than 33% of insolvencies. In this context, the ongoing increase in the share of low-paying jobs in the Canadian labour force can be seen as a more important indicator to focus on. And looking ahead, the likelihood is that the share of low-paying jobs in the Canadian economy will rise during the course of the year. The soft economic environment suggests that growth rates in forced self-employment and part-time jobs are likely to accelerate in the coming quarters. As well, a projected net decline in public sector employment in 2012 and a much weaker hiring pace in the construction sector will act as a negative for overall income growth in the economy. Accordingly, we project that the insolvency rate in Canada will start trending upward, if only mildly, over the course of the year.

Consumer Spending

Looking ahead, it is difficult to get too excited about the consumer's near-term prospects. With consumer credit growth slowing to a crawl, the housing market leveling off and potentially losing some ground, Canadian consumers will lose two of the main pillars of strength that made them the champion of the recent economic cycle. And while the volatility in the job market statistics will continue to confuse observers, the trend is clear: the pace of job creation in Canada is slowing from 22,000 jobs a month in 2011 to probably around 15,000 in 2012. And the changing composition of employment is likely to work to lower the quality of employment in the country along with the bargaining power of workers — limiting gains in labour income.