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Household Credit Analysis

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Highlights

by Benjamin Tal

- Household credit growth is no longer decelerating. Third quarter growth was the strongest since early 2013 — but still miles below the long-term average.

- Consumer credit is accelerating — rising at the fastest pace in almost two years. Supply-driven increases in credit card balances are largely behind this trend. Auto loans are still strong and lines of credit activity is no longer falling.

- Mortgage market activity is much weaker than suggested by current levels of housing activity. The gap between real activity and credit growth can be explained by factors such as increased principal payments; reduced refinancing activity and home equity withdrawal; a lower share of high-ratio mortgages; and possibly increased average down payments due to a growing role of foreign investors in the market and a rising share of home buyers that are already home owners.

- Another factor that might contribute at the margin to this phenomenon is the possibility that unregulated alternative lenders are playing a more significant role in the market than currently perceived. This might mean that more mortgages are simply not included in the official statistics.

- The debt-to-income ratio has stabilized. Interest payments are at a record low relative to income. Principal payments are much larger than officially estimated by the Bank of Canada. Net worth position is at a record high.

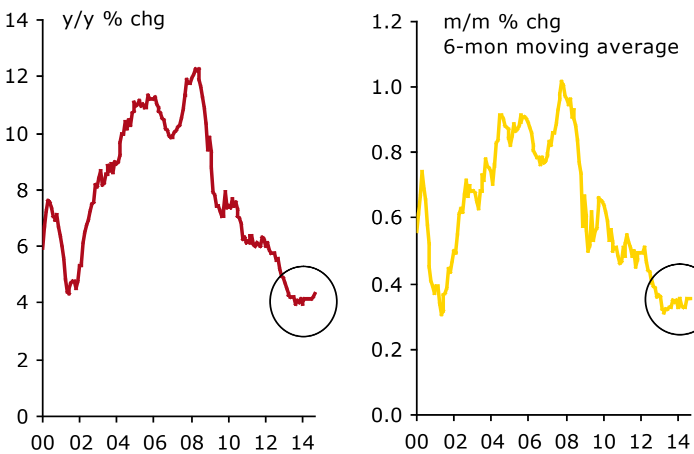
- The negative correlation between personal bankruptcies and interest rates might break in the coming cycle.

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

Household Credit

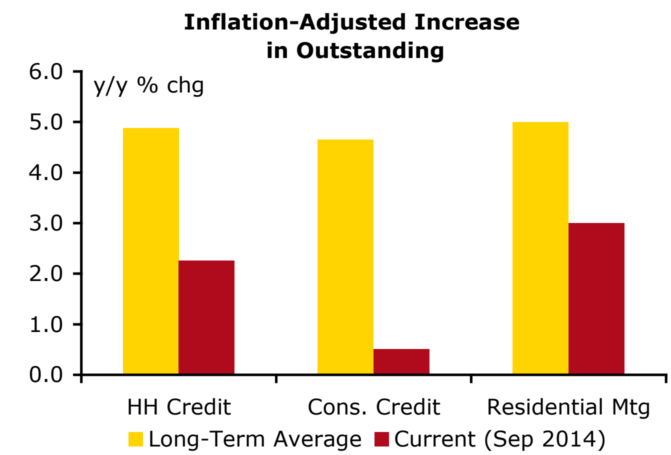
Household credit growth is no longer decelerating. During the third quarter of the year, total household debt outstanding rose by 4.3% on a year-over-year basis — a touch above the pace seen in the second quarter and the fastest pace of growth since early 2013. The monthly figures reveal the same trend. This is not the first time in recent years that the decelerating trajectory in credit growth was interrupted, but at close to 4% (y/y) growth, the likelihood is that growth in household credit has reached a floor for the current cycle. Note that at the current level of activity, the pace of debt accumulation is still notably lower than its long-term average.

*Chart 1—**Household Credit***



Source: Bank of Canada, CIBC

*Chart 2—**Household Credit***



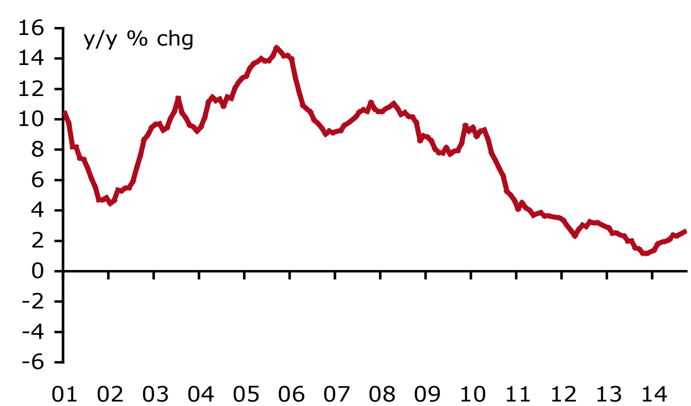
Source: Bank of Canada, Statistics Canada, CIBC

Consumer Credit

The key here is the recent acceleration in the pace of growth in consumer credit. During the third quarter of the year, consumer credit rose by 2.4% (y/y) — the fastest pace in close to two years.

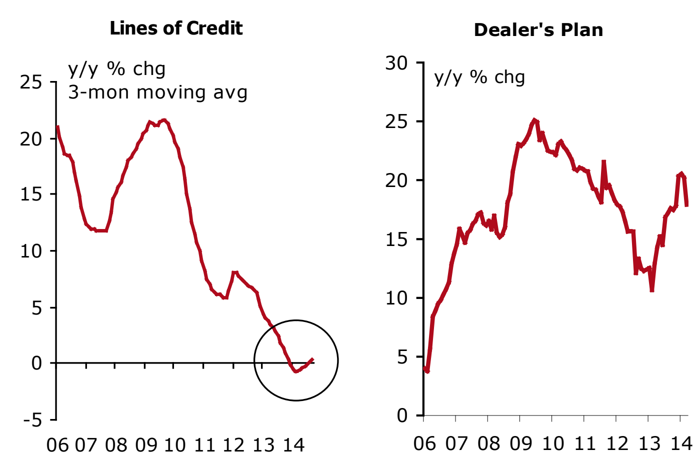
Auto loans continue to rise strongly, expanding by close to 8% on a year- over-year basis. This however is not a new development.

*Chart 3—**Consumer Credit***



Source: Bank of Canada, CIBC

*Chart 4—**Lines of Credit and Auto Loans***

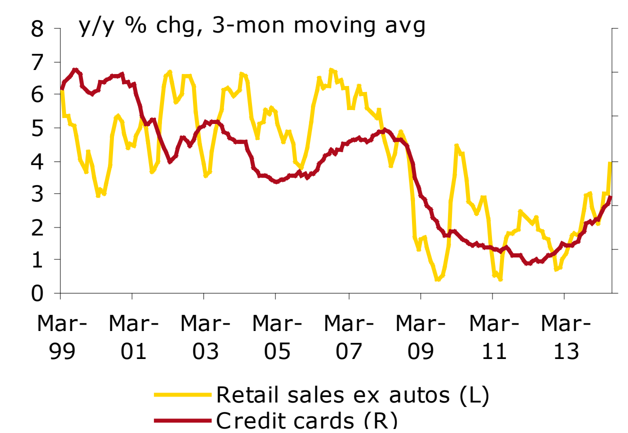


Source: Bank of Canada, Statistics Canada, CIBC

What's new is the recent acceleration in the pace of growth in credit card balances. After declining for most of 2013, growth in this portfolio has returned and accelerated notably in the first half of 2014. Note that this growth is highly correlated with the rebound seen in non-auto retail sales in Canada. In all likelihood the recent improvement in credit utilization here is due to a significant supply push by credit providers. Accordingly, the recent improvement in retail sales might be more leveraged than perceived.

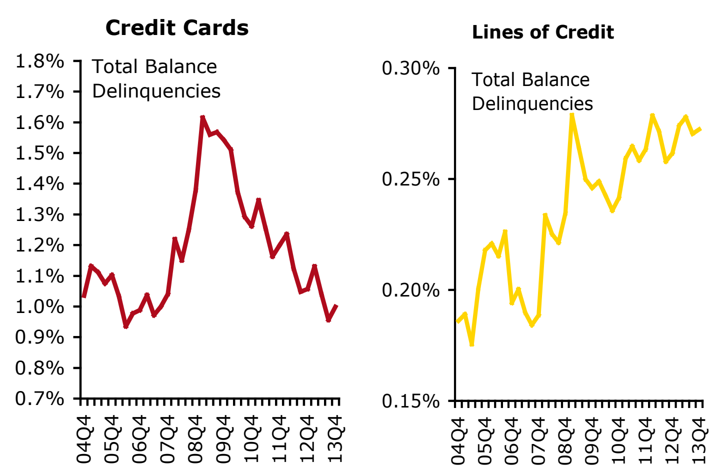
In this context, the recent rise in credit card balances might suggest that the process of debt transfer from cards to lines of credit is slowing. If so, that might lead to some increase in the risk profile of the card portfolio in the coming year. Note that the earlier process of debt transfer to lines of credit had also resulted in risk transfer. Delinquency rates in the lines of credit portfolio have risen in the past few years while the delinquency rate in the credit card portfio has fallen.

Chart 5—***Retail Sales vs. Credit Cards***



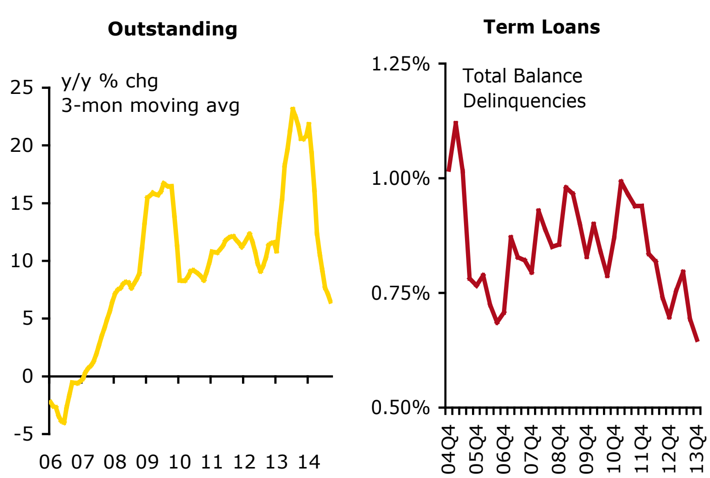
Source: Statistics Canada, CIBC

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



Source: Equifax, CIBC

Chart 7—***Personal Term Loans***



Source: Bank of Canada, Equifax, CIBC

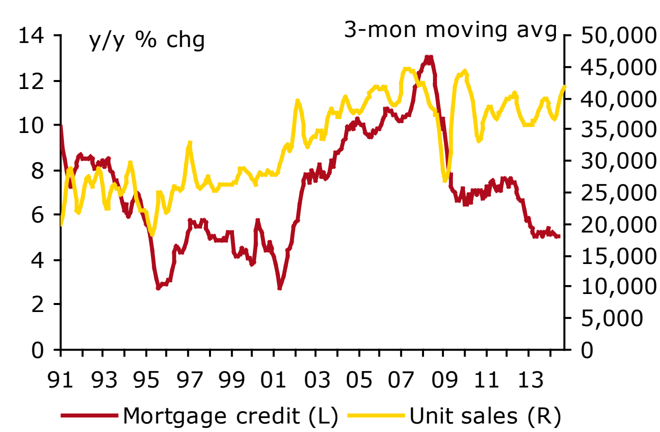
The Housing and Mortgage Markets

In the mortgage market the most significant observation is the fact that mortgage activity has been slowing, but so far we have not seen a similar trend in real housing activity. Many factors might explain this divergence. They include, increased principal payments, reduced refinancing activity and home equity withdrawal, a lower share of high ratio mortgages, and possibly increased average down payments due to a growing role of foreign investors in the market and a rising share of home buyers that are already home owners.

Another factor that might contribute at the margin to this phenomenon is the possibility that unregulated alternative lenders are playing a more significant role in the market than currently perceived. If so, that would mean that more mortgages are simply not included in the official statistics.

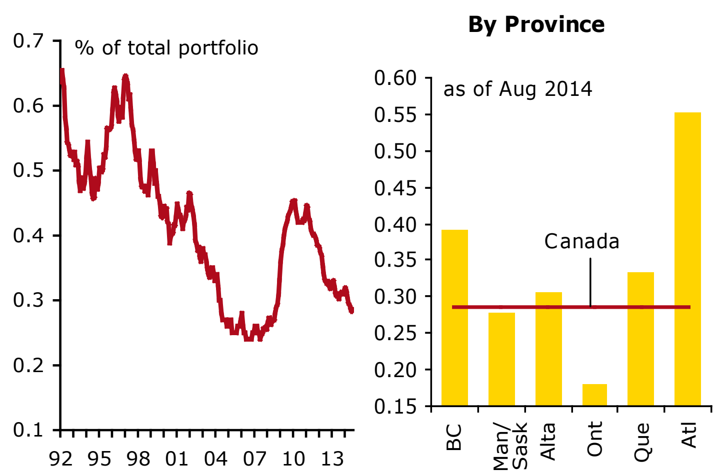
Mortgage arrears continue to trend downward, and at just south of 0.3% they are at a six-year low. Arrears in Atlantic Canada are almost double the national average, while Ontario enjoys the lowest arrears rate in the nation.

*Chart 8—**Housing Sales Stable, Mortgage Activity Slowing***



Source: Bank of Canada, CREA, CIBC

*Chart 9—**Mortgage Arrears***



Source: CBA, CIBC

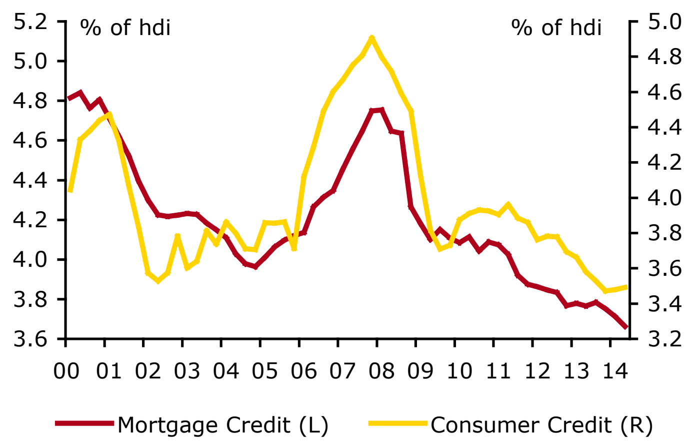
Debt Levels, Affordability and Net Worth Position

The widely watched debt to income ratio has been relatively stable over the past year at close to 164%. The recent acceleration in credit growth suggests that this ratio might head up in the coming months.

At 7.2% of disposable income, interest payments on total debt are at record low. Mortgage interest payments account for roughly half of this ratio. Alongside falling interest payments as a share of income, principal payments are now rising faster than income. Furthermore, we estimate that Canadians pay back principal much faster than officially estimated by the Bank of Canada (see October 15, 2014 issue of our Economic Insights titled "Resisting Temptation").

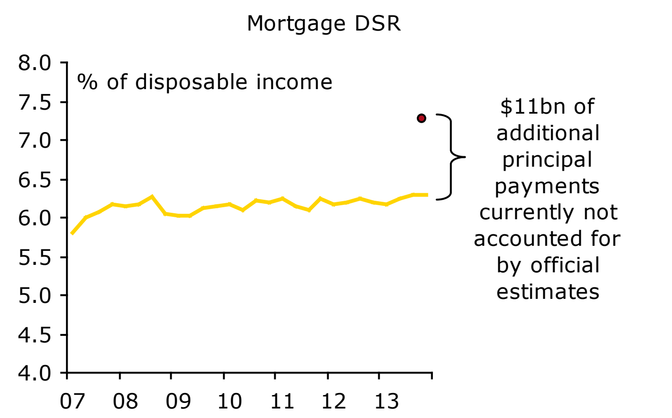
At 18.4% the share of total debt to total assets is the lowest since early 2008. Net worth as a share of disposable income is currently at a record high.

Chart 10—***Interest Payments***



Source: Statistics Canada, CIBC

Chart 11—***Principal Payments Rising Faster Than Perceived***



Source: Bank of Canada, Statistics Canada, CIBC

Table 1—***Consumer Debt Figures and Ratios***

	Household Debt ($Mil)	Consumer Credit** ($Mil)	Mortgage Credit** ($Mil)	Household Disposable Income+ ($Mil)	Interest Payments ($Mil)	Household Debt* (% of HDI)	Consumer Credit (% of HDI)	Mortgage Credit (% of HDI)	Interest Payments (% of HDI)
2010:1	1,435,251	443,061	896,021	928,359	73,888	154.6	47.7	96.5	8.0
2010:2	1,467,999	445,355	923,029	940,217	75,444	156.1	47.4	98.2	8.0
2010:3	1,490,010	452,619	937,766	945,776	75,412	157.5	47.9	99.2	8.0
2010:4	1,512,714	459,193	952,665	956,311	76,620	158.2	48.0	99.6	8.0
2011:1	1,525,624	464,996	960,762	969,748	77,376	157.3	48.0	99.1	8.0
2011:2	1,552,701	470,525	981,468	976,983	78,028	159.0	48.2	100.5	8.0
2011:3	1,581,622	475,834	1,004,772	988,996	77,196	159.8	48.1	101.6	7.8
2011:4	1,605,563	478,982	1,023,901	999,704	77,332	160.5	47.9	102.4	7.7
2012:1	1,613,998	474,557	1,033,893	1,008,142	76,872	160.0	47.1	102.6	7.6
2012:2	1,644,695	480,791	1,056,230	1,017,078	77,600	161.5	47.3	103.8	7.6
2012:3	1,674,033	488,364	1,074,803	1,029,483	78,368	162.8	47.4	104.4	7.6
2012:4	1,690,293	490,433	1,086,439	1,041,318	77,712	162.6	47.1	104.3	7.5
2013:1	1,700,637	494,694	1,094,068	1,051,948	78,276	162.1	47.0	104.0	7.4
2013:2	1,725,576	500,514	1,112,019	1,061,218	77,956	163.2	47.2	104.8	7.3
2013:3	1,752,014	505,785	1,133,082	1,071,668	78,356	164.1	47.2	105.7	7.3
2013:4	1,765,607	508,090	1,146,111	1,080,866	78,092	163.9	47.0	106.0	7.2
2014:1	1,773,164	506,073	1,154,061	1,090,866	78,452	163.1	46.4	105.8	7.2
2014:2	1,796,523	513,200	1,169,760	1,100,918	78,752	163.6	46.6	106.3	7.2

* *On Oct 15, 2012, revisions by StatCan on household credit market debt to disposable income ratio was revised upward.*

** *Consumer and Mortgage credit quarterly data are now sourced from StatCan*

+ *Redefinition of household disposable income as part of StatCan historical revision of the national GDP by income and by expenditure accounts*

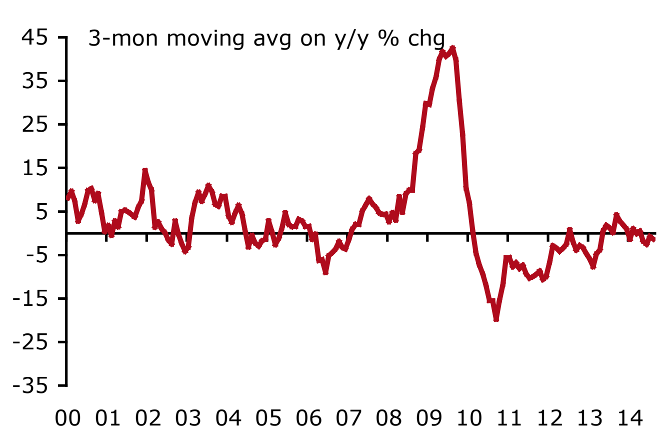
*Table 2—**Household Balance Sheet Data***

	Household Assets ($Mil)	Non-Financial Assets ($Mil)	Financial Assets ($Mil)	Debt to Total Assets (%)	Net Worth ($Mil)	Net Worth as a Share of HDI
2010:1	7,459,113	3,524,656	3,934,457	19.50	6,004,822	6.47
2010:2	7,471,125	3,568,326	3,902,799	19.95	5,980,967	6.36
2010:3	7,684,555	3,588,715	4,095,840	19.66	6,173,825	6.53
2010:4	7,847,503	3,627,160	4,220,343	19.55	6,313,315	6.60
2011:1	8,015,599	3,694,769	4,320,830	19.31	6,467,723	6.67
2011:2	8,099,701	3,756,451	4,343,250	19.45	6,524,588	6.68
2011:3	8,074,788	3,810,197	4,264,591	19.85	6,471,613	6.54
2011:4	8,213,365	3,849,215	4,364,150	19.83	6,584,869	6.59
2012:1	8,413,422	3,929,964	4,483,458	19.46	6,776,093	6.72
2012:2	8,485,024	3,999,642	4,485,382	19.66	6,816,489	6.70
2012:3	8,651,600	4,036,058	4,615,542	19.61	6,954,744	6.76
2012:4	8,774,342	4,062,078	4,712,264	19.52	7,061,867	6.78
2013:1	8,970,641	4,119,378	4,851,263	19.21	7,247,195	6.89
2013:2	9,058,110	4,203,061	4,855,049	19.29	7,310,382	6.89
2013:3	9,243,721	4,283,560	4,960,161	19.20	7,469,148	6.97
2013:4	9,481,209	4,340,848	5,140,361	18.87	7,691,908	7.12
2014:1	9,683,775	4,419,203	5,264,572	18.56	7,886,402	7.23
2014:2	9,890,683	4,511,341	5,379,342	18.42	8,069,216	7.33

Insolvencies

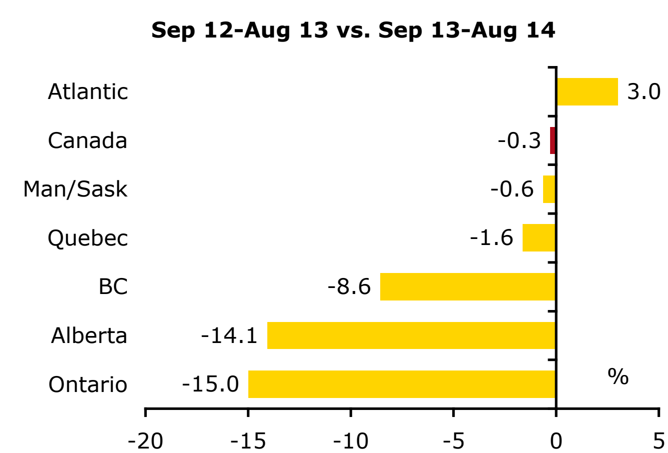
The number of personal bankruptcies in the economy is no longer falling. In fact it was hardly changed over the past year. At this point it is safe to assume that the bankruptcy situation will not change much in the coming year or so. However, it is possible that the coming bankruptcy cycle might be different than previous ones. In the past, the number of personal bankruptcies was negatively correlated with interest rates, since higher rates coincided with improved job market conditions. This time around, given the current debt load, the likelihood is that the impact of higher rates on debt financing (at the margin) might lead to a reversal of the typical correlation, and we might see bankruptcies rising alongside interest rates.

*Chart 12—**Personal Insolvencies***



Source: Industry Canada, CIBC

*Chart 13—**Personal Insolvencies by Province***



Source: Industry Canada, CIBC