PRESS RELEASE

Canadian Mortgage News - National Archive 2010

Canadian Consumers - Willing but not so able: CIBC World Markets Inc.

Bank of Canada needs to take a moderate approach to interest rate hikes

TORONTO, Ontario, April 01, 2010 — While consumer confidence in Canada has bounced back in the last year, CIBC World Markets Inc.'s new Consumer Capability Index finds that weak consumer fundamentals and an interest rate hike will see Canadians start to put the brakes on spending.

After reaching a 15-year low in late 2008, consumer confidence, as measured by the Conference Board's Consumer Confidence Index, has improved by 60 per cent, and is now back to its long-term average, although still nearly 20 per cent below its 2007 peak. This increase in confidence saw more Canadians at the cash register last quarter, with personal purchases climbing nearly four per cent on an annualized basis.

The CIBC Consumer Capability Index is designed to measure the ability of Canadian consumers to spend as opposed to their willingness to do so. What it found was a consumer that positively responded to the Bank of Canada's monetary policy of low interest rates and is spending again. But it also found a consumer that is very sensitive to any increases in those low rates.

"A closer look at the data reveals that Canadian consumer fundamentals are weaker than they have been in almost 15 years. In fact, the "V-Shaped" recovery in consumer confidence that we have seen throughout the second-half of 2009, has actually coincided with a drop in the ability of households to spend. Growth in real disposable income has been trending downward over the past year, and to a certain extent debt is replacing income as a major driver of consumer purchases."

The report found that the household debt-to-income ratio in Canada has continued to climb and as of December 2009 stood at a new all-time record of 147 per cent. Mr. Tal notes that this ratio is accelerating at a rate not seen since the mid-1990s. The rising importance of debt as a determinant of consumption can be seen in the fact that the 2008-09 recession was the first economic contraction on record to show overall expansion in real household credit, again demonstrating the effectiveness of Canadian monetary policy. As of February 2010, overall household credit rose by over seven per cent on a year-over-year basis - more than three times faster than income growth. However, with historically low interest rates, the Canadian debt-service ratio fell throughout the recession, despite these rising debt loads.

Mr. Tal notes that 70 per cent of the increase in the debt-load comes from mortgages and only an estimated one-fifth of the increase in non-mortgage consumer credit (the other 30 per cent) is used to finance daily purchases.

Canadians' debt-to-asset ratio (as reported in Statistics Canada's National Balance Sheet Account) also trended upwards during the recession. Despite the rebound in stock valuations and the recent surge in home prices, over the past two years Canadians have seen their liabilities rising twice as fast as their assets. Recent quarters have seen some stabilization in this ratio but its level remains relatively elevated.

With growth in personal income softening up over the past few years, Mr. Tal notes that the gap between real estate gains and income growth is widening, with the ratio of house prices to income hovering at a 20-year high.

"On the other side of the equation, the recent improvement in the saving rate since 2008 is a positive development, since savings can act as a buffer between the economic downturns and individual finances," says Mr. Tal. "Likewise, the long-term unemployment rate is also an important ingredient in our resiliency index. While this measure has trended upwards over the past year, it is still relatively low in relation to past cycles. Also, of note is the recent slowdown in the pace of consumer bankruptcies in Canada. However, this measure is still well above its 15-year average."

When Mr. Tal compared his Consumer Capability Index with the Conference Board's Confidence Index he found that during the 1990s the average gap between the two measures was minimal, suggesting no deviation between sentiment and capability. However, for most of the past decade increased reliance on credit and surging real estate prices saw capability lag confidence. That changed during the recession as confidence plunged to match capability, but recently headed back once again to pre-recession levels.

"The practical implication of the reduced consumer capability is that consumer spending will disappoint in the coming twelve months. While most of the recent focus of the potential impact of higher interest rates has been on the risk that this move will trigger a new wave of debt defaults, given the vulnerable starting point of the consumer, the Bank of Canada will soon find that even a moderate monetary squeeze will be sufficient to drive a material deceleration in consumer spending."

CIBC's Consumer Capability Index looks at seven key macro-economic factors to measure the ability of Canadian consumers to continue spending.

- Debt-to-income ratio
- Debt-to-asset ratio
- Real income growth
- Long-term unemployment rate
- House price to income ratio
- Personal saving rate
- Personal bankruptcies