ECONOMIC NEWS

Canada: Rising Debt and Borrowing Costs in Q2 a Sign of Things to Come

By Randall Bartlett, Senior Director of Canadian Economics

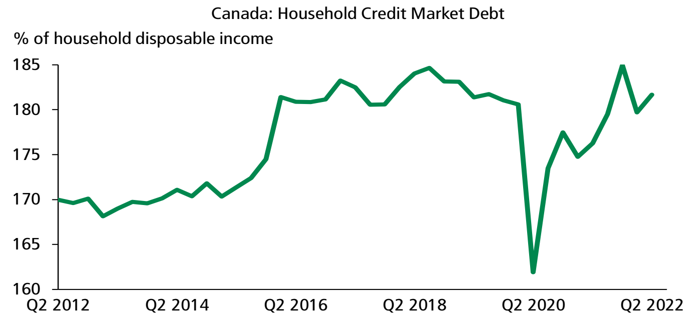
HIGHLIGHTS

- Canada's national net worth increased by a very modest 0.2% q/q in the second quarter of 2022 – the slowest advance since Q2 2020 – to reach a high of $17.6 trillion. The weakness in Q2 is the result of sharp declines in the value of both real estate and Canada's international investment position offset by continued hefty gains in natural resource wealth.
- After strong growth in asset values throughout the pandemic, equity, bond and housing markets all posted declines in Q2. And after hitting record levels of flows into mutual funds and exchange trade funds over the last couple of years, households recorded $11.0 billion in net redemptions of mutual funds shares in Q2.
- Meanwhile, household borrowing continued to advance at a torrid pace in Q2, as Canadians added a near-record of $56.3 billion in debt. This was the result of sustained demand for mortgages ($48.7 billion) and a second consecutive quarter of elevated non-mortgage borrowing ($7.7 billion). Consequently, household credit market debt as a proportion of household disposable income increased to 182% in Q2 from 180% in Q1. While not the record reached in the final quarter of 2021, it is certainly moving in the wrong direction.
- Looking to the national income statement, Canada's savings rate fell to 6.2% in Q2 from 9.5% in the prior quarter. This was the result of a 1.0% gain in disposable income that was dwarfed by the 4.3% advance in nominal household consumption. This in part reflects the sharp rise in household borrowing costs on higher rates.

COMMENTS

While the Q2 numbers could have been worse, they could have been a lot better. For instance, the modest advance in net national wealth followed a string of strong quarterly gains which saw it increase by $5.1 trillion since the end of 2019, roughly equivalent to the gain chalked up in the preceding decade. The Q2 results reflect the weakness in asset values that is evident across the board, and the elevated level of liabilities that is likely to stick around for some time. And with inflation still high, any hiccups in household income growth could lead to a further decline in the savings rate with possible implications for non-mortgage borrowing and further financial asset redemptions.

GRAPH
After a brief reprieve, household debt resumes its upward trajectory



Sources: Statistics Canada and Desjardins, Economic Studies

IMPLICATIONS

It is clear that rate hikes by central banks the world over are taking a bite out of household finances. With asset values falling, liabilities increasing and the savings rate trending lower, Q2 is likely the last gasp for the surge in national net wealth seen during the pandemic. While we don't think the Bank of Canada is blind to these considerations, it made clear last week that its focus in on ensuring inflation expectations remain anchored at 2%. So don't expect relief coming anytime soon on the rates front. In fact, we've baked in another 50 bps hike in October, so national net worth is likely to look worse before it starts to look better.