



Canada's house of cards?

By Warren Lovely & Daren King

Statistics Canada's summary of the multi-faceted national balance sheet accounts can only touch on so much. Best to target a key issue. And what's more topical than household leverage/housing as we contend with rapid-fire BoC rate hikes? Four NBS-inspired observations:

Chart 1 – It would be hard to overstate the importance of housing/real estate to today's Canadian economy. As of Q1, the value of dwellings and land owned by Canadian households was around \$8½ trillion dollars! That's equivalent to >580% of household disposable income, far and away the highest ratio on record (despite solid disposable income growth of late).

Chart 2 – Compare household risk metrics to where things stood at the start of earlier BoC tightening cycles. Households are as heavily indebted as ever. Sure, debt-to-disposable income isn't that far removed from mid-2017. But the BoC was moving more deliberately back then, hiking a cumulative 125 bps over 15 months. Fast forward to 2022 and the Bank has done that much in three months and has at least another 150 bps to go over the next three announcements. Meanwhile, non-financial assets account for larger share of wealth these days. Stands to reason that an increasingly unsettled housing market risks leaving an indelible imprint on the average consumer's psyche.

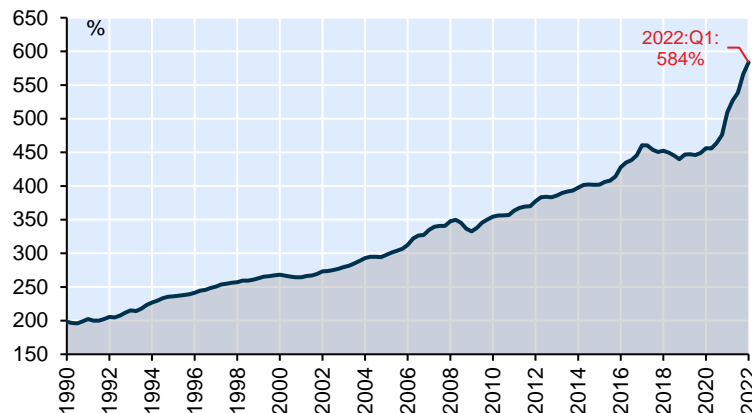
Chart 3 – Perhaps we can take comfort in the fact that interest charges consumed less than 6% of disposable income as of Q1. But that's going to change, given the violent jump in interest rates in Q2. True, the majority of mortgages are fixed and many variable mortgages have fixed payments. So while the adjustment takes time, incremental debt servicing risks exacerbating a growing household affordability crisis.

Chart 4 – Importantly, we were still seeing solid growth in employee compensation and disposable incomes through Q1. And as illustrated here, households remain flush with excess cash. At roughly \$1.9 trillion, currency/deposits are equivalent to a still-outsized share of financial liabilities. That's one of the single biggest differences vs. 2017-18 and could be a vital buffer given how wrenching rate hikes are apt to be.

If all this sounds scary/risky, it is. It's why we're of the view the BoC may not ultimately wade in truly restrictive territory, Canada's target rate perhaps topping out at 3% vs. the 3.5-4% increasingly discounted by the market. Of course, much will depend on the evident momentum in consumer prices, which we concede has been unsettling of late (and will likely remain so when May data arrive next week).

Chart 1: A lot of eggs in housing basket these days

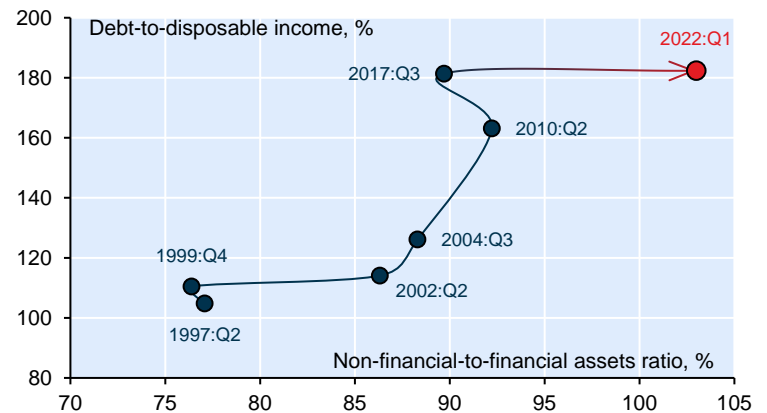
Cdn households: Real estate assets-to-disposable income ratio



Source: NBF, StatCan

Chart 2: How do we compare to prior BoC tightenings?

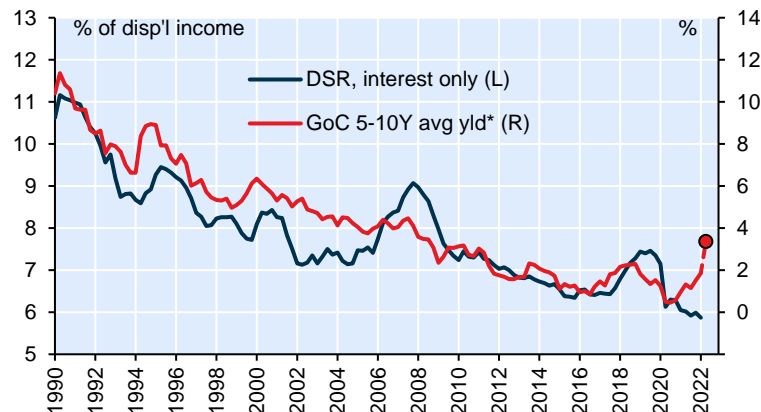
Cdn household debt & asset ratios at start of BoC tightening cycles



Source: NBF, StatCan, BoC | Note: Based on quarter of first BoC rate hike

Chart 3: Debt service relief no more

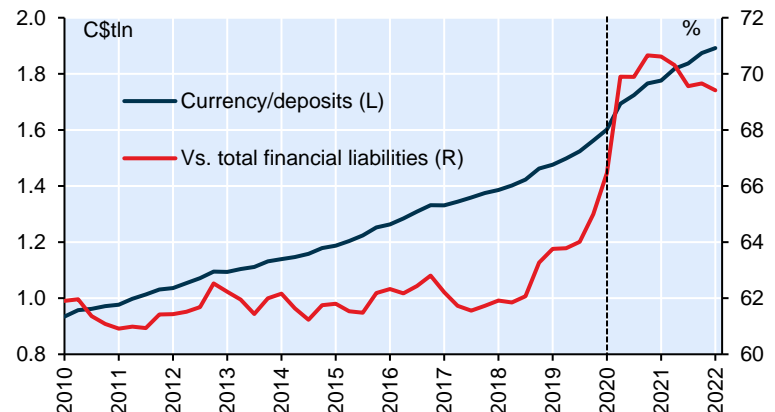
Cdn household debt servicing ratio (interest only) & avg GoC bond yields



Source: NBF, StatCan | Note: Red bullet denotes current bond yield level (Jun-22)

Chart 4: Thankfully, still ample liquid assets available

Cdn household holdings of currency & deposits: Level & relative to liabilities



Source: NBF, StatCan



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