



# Household Credit Analysis

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## Data Sources:

Statistics Canada  
 Industry Canada  
 CBA  
 CMHC  
 CREA  
 CIBC World Markets

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## HIGHLIGHTS

- Overall household credit is still expanding strongly with total outstanding rising by just over 10% during the year ending August 2004.
- Mortgage credit is now growing by roughly 10% (year-over-year) with non-bank providers continuing to gain market share. Mortgage refinancing activity remains strong — accounting for an estimated 30%-35% of total growth in mortgage outstanding over the past six months.
- Consumer debt is also rising strongly — just over 10% — helped by a strong growth in personal lines of credit and double-digit growth in credit cards debt.
- The likelihood is that this strong pace of activity reflects a sense of urgency among many borrowers who fear that the window of low interest rates is fast closing. This also means that, at least to some extent, the current acceleration in borrowing is “stealing” activity from 2005.
- **During the first half of 2004**, overall household debt rose by just under 5% while personal disposable income rose by 3.6%. This led to further increase in the debt-to-income ratio, from 108% to 109%. With credit growth likely to outpace income growth in the coming six months, the debt ratio will continue to rise. Note, however, that given recent improvement in the pace of growth in disposable income, the growth rate of the debt-to-income ratio is moderating.
- The cumulative number of consumer bankruptcies rose by 2.6% during the year ending September 2004. This represents a significant improvement from the situation seen earlier in the year. In fact, on a year-over-year basis, the number of personal bankruptcies is now falling.
- The labour market continues to perform well with the economy generating an average of 19,000 new jobs a month since the beginning of the year. Furthermore, despite recent softening, the overall quality of employment has been trending upward – a fact that is reflected in the recent improvement in disposable income.
- Real GDP growth in 2004 is likely to average 3% in 2004. As for 2005, we see the economy expanding by only 2.8% with the impact of the strong dollar and higher energy prices limiting growth.
- This projection is consistent with a very limited hike in interest rates in the coming twelve months, with the combined drag from higher energy prices and an appreciating currency substituting for higher interest rates.

# RESIDENTIAL MORTGAGES

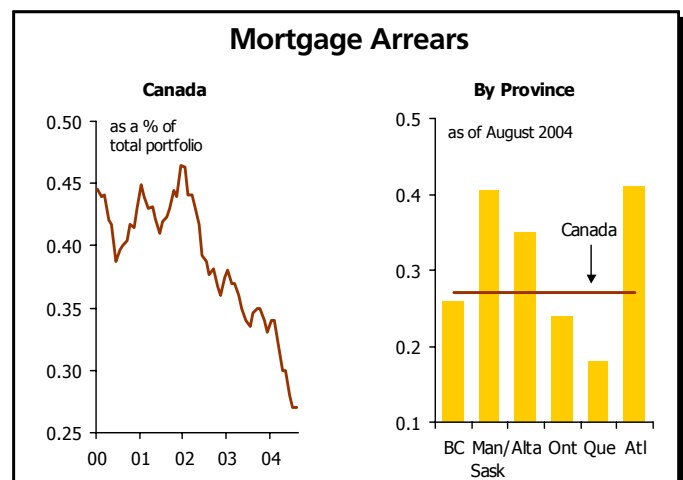
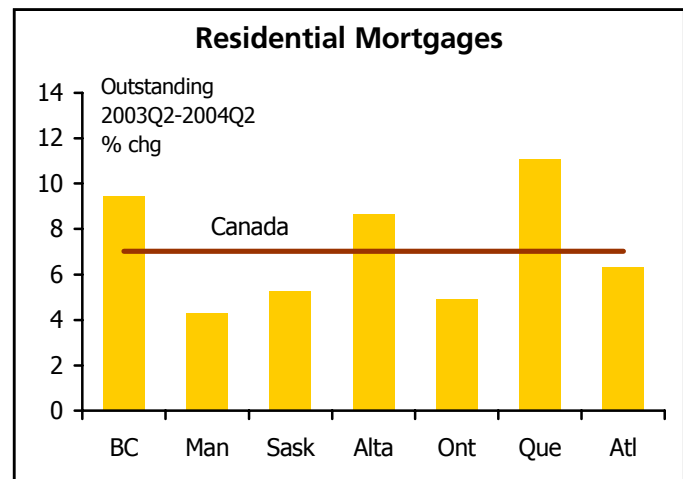
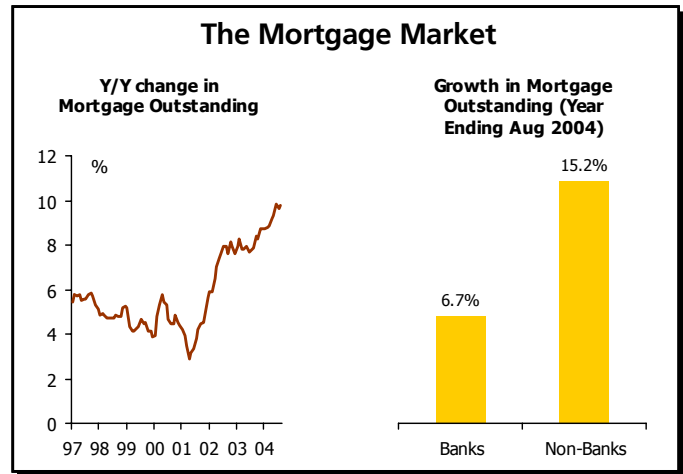
## Outstanding

Total residential mortgage outstanding rose by 9.7% during the year ending August 2004. Note that non-bank mortgage providers continue to gain market share, seeing their total mortgage outstanding rising by over 15% during the past year. At the same time, total mortgage credit provided by banks rose by only 6.7% during the year. Banks now account for just over 60% of the overall Canadian mortgage market.

The recent increase in short-term credit is probably working to accelerate the pace of growth in mortgage credit. With many Canadians starting to fear that the window of low interest rates is closing, those who sat on the fence until now are entering the market. Since we expect the Bank of Canada to be very cautious regarding the speed at which it raises rates, the damage to the bond market is likely to be minimal. Accordingly, we expect the mortgage interest rate curve to flatten a bit over the coming months — a fact that probably will lead to some shifting from variable rate mortgages to fixed-term mortgages. Note that variable rate mortgages currently account for an estimated 25%-30% of total outstanding.

Over the past two years, more than 40% of mortgage holders in Canada refinanced their mortgages and one-third of them borrowed against the increase in their home equity. In total, we estimate that cash-out mortgage refinancing accounted for 30%-35% of total growth in total mortgage outstanding during the past six months.

Quebec continues to outperform the rest of the nation with mortgage outstanding in the province rising by 11% during the year ending June 2004. This is consistent with the overall economic environment in the province in general, and its housing market, in particular. A similar trend is observed in British Columbia.



# Residential Mortgages

## Arrears

The number of mortgages that are in arrear continues to trend downward. As of August 2004, the arrear rate stood at an all-time low of 0.27%. Note that in 2002, the arrear rate averaged around 0.43%, so the recent improvement is impressive. There is little doubt that low interest rates played a role here, but even

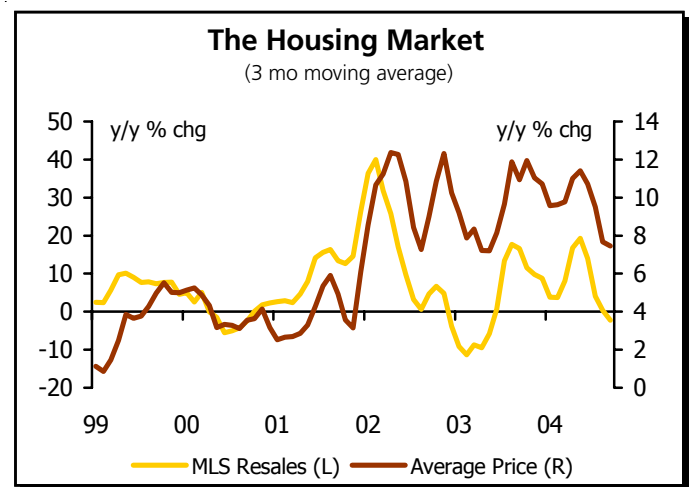
more important was the fact that the labour market has been relatively healthy in recent years. We doubt that this very low rate of arrears is sustainable. However, since we do not expect a significant deterioration in overall labour market conditions, any upward pressure on this rate will be limited. The arrear rate in Quebec is still the lowest in the nation.

# THE HOUSING MARKET

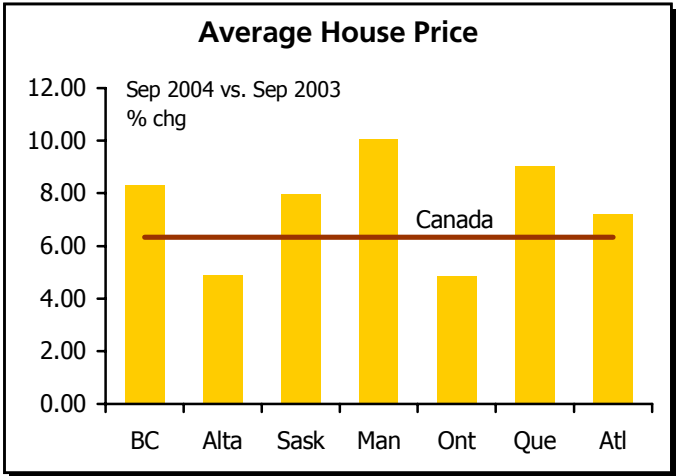
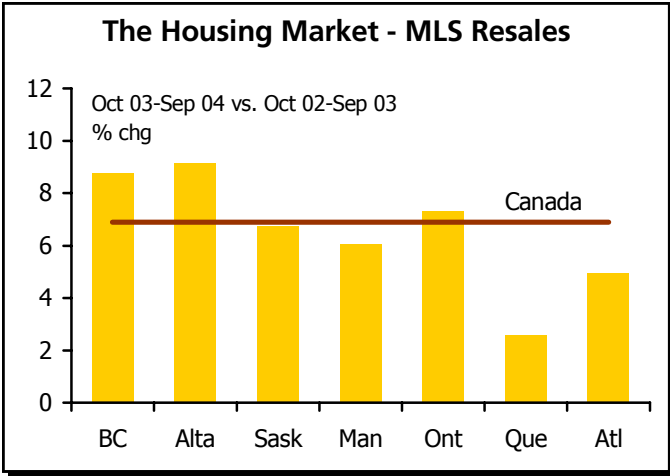
The past few months have seen a notable softening in the rate of growth of both MLS resale activity and house prices. The number of units sold in the resale market is, in fact, falling — the first time since early 2003. The year-over-year rate in house prices is now at around 8% — it's lowest level since February 2003. At the same time, housing starts are also showing some softening with starts falling by 5.4% in October.

This is not to suggest that the housing market is collapsing. We still believe that the fundamentals of the housing market are relatively healthy. However, it is very likely that we are entering a period in which overall housing market activity will stabilize at the current high level, with further price gains likely to be limited at best. Note also that the inventory of housing is on the rise and it is now at its highest level since 2001 — another reason to believe that house prices have a relatively limited upward potential. Overall, we expect house prices to rise by around 6%-8% in 2004 and by 3%-4% in 2005.

Western Canada continues to lead the way with both BC and Alberta seeing MLS resales rising by two percentage points faster than the national average. The pace of growth in MLS activity in Quebec is decelerating rapidly.



# The Housing Market



## National Residential Housing Data by Province (MLS Market)

For September 2004

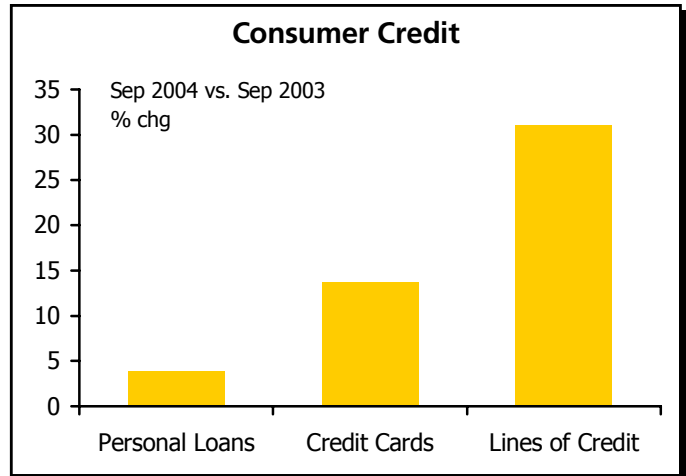
<i>seasonally adjusted</i>	Dollar Volume (\$000s)	Unit Sales	New Listings	Average Price (\$)	Ratio of New Listings to Unit Sales
Canada	8,544,413	37,812	62,481	225,971	1.7
Atlantic	217,450	1,629	3,106	133,487	1.9
Quebec	1,001,500	5,848	10,457	171,255	1.8
Ontario	3,933,831	16,069	27,429	244,809	1.7
Manitoba	125,921	1,051	1,386	119,811	1.3
Saskatchewan	78,380	690	1,062	113,595	1.5
Alberta	904,988	4,617	6,763	196,012	1.5
British Columbia	2,276,493	7,875	12,240	289,078	1.6

Source: CREA

# NON-CREDIT CARD PERSONAL LOANS

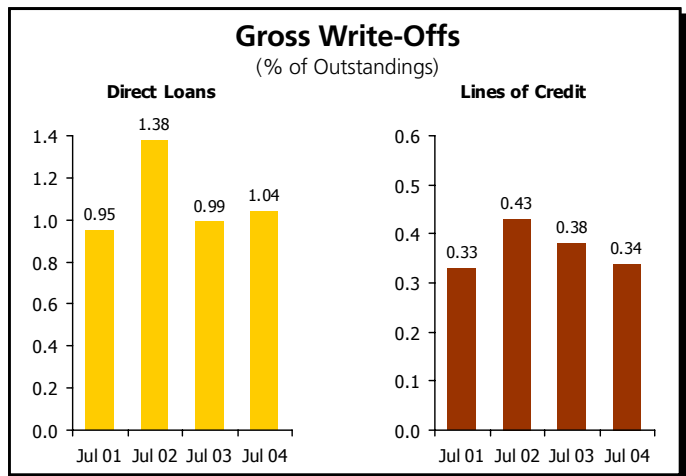
## Outstanding

Non-credit card consumer credit is currently rising by an annual rate of around 13%. This, however, masks two very different trends. The main driver here is the Personal Lines of Credit portfolio (PLC), which is rising by a dazzling pace of 31% (year-over-year). PLCs are now by far the most popular borrowing vehicle in the market. More than half of this portfolio is secured against real estate, clearly reflecting the increased tendency among Canadians to borrow against the 40% increase in their home equity since 1997. At the same time, the more traditional Direct Loans portfolio is currently rising by an annual rate of around 4% with a very limited upward potential. With the expected softening in the housing market in 2005, secured PLC activities will probably slowdown. Overall, this is still a young borrowing vehicle and is likely to continue to expand at a double-digit rate for the next 2-3 years.

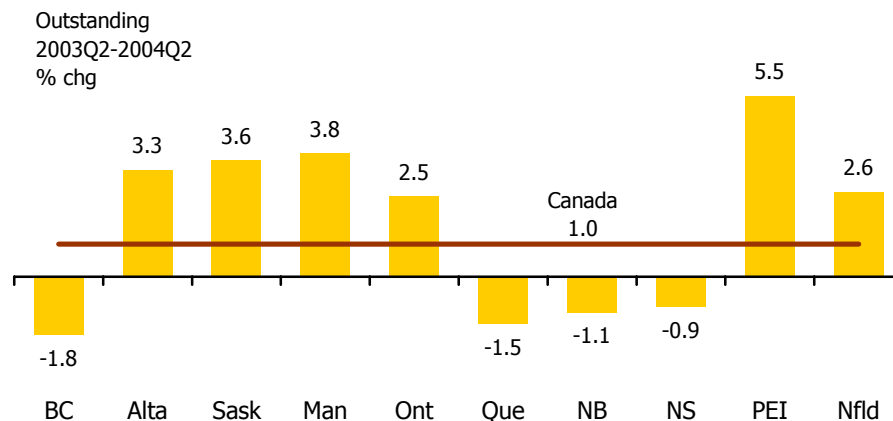


## Write-Offs

Despite rapid growth in the PLC portfolio, data as of July 2004 reveal a downward trend in the write-off rate. The write-off rate in the Direct Loans portfolio is a bit higher than it was last year. Overall, the quality of these two portfolios has not changed in any significant way over the past few months.



## Personal Loan Plans

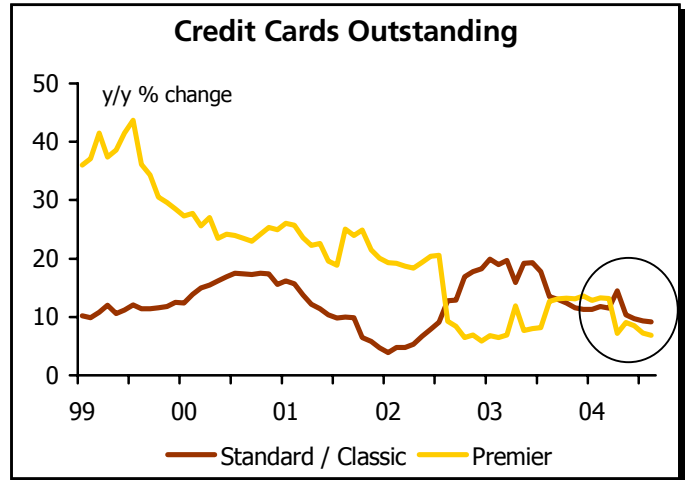


Source: Statistics Canada

# CREDIT CARDS

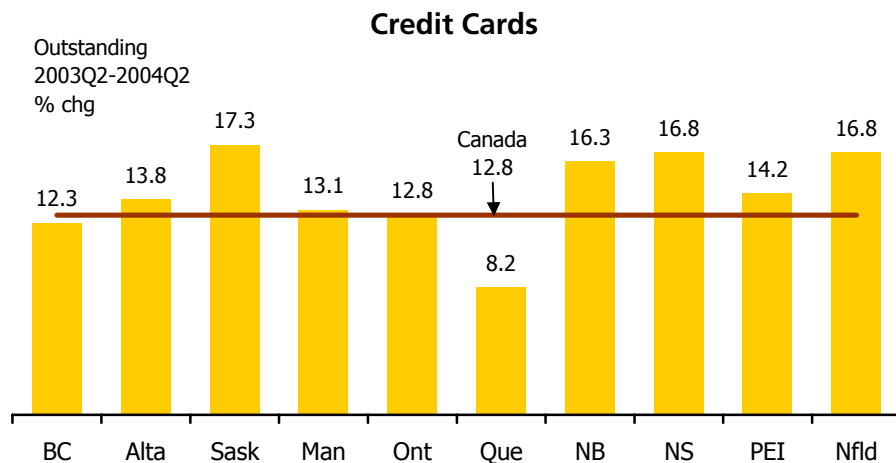
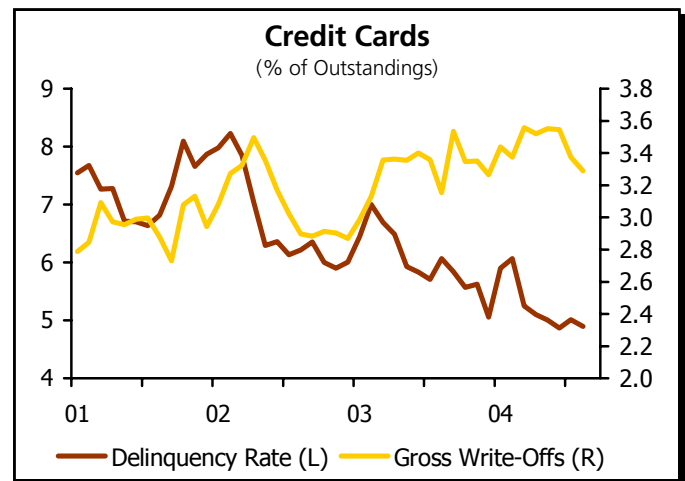
## Outstanding

Growth in the Credit Cards portfolio has moderated in recent months — likely the flip side of the accelerating Lines of Credit portfolio. Note also that the rates of growth of the different types of cards (classic vs. premier) have converged. The current pace of credit cards outstanding is sustainable during the coming six months.



## Delinquencies & Write-Offs

Following the example of the delinquency rate, the write-off rate in the Credit Cards portfolio has changed direction in recent months, falling by more than 2 points since June 2004. This is consistent with the recent trend we have seen in the bankruptcy numbers.

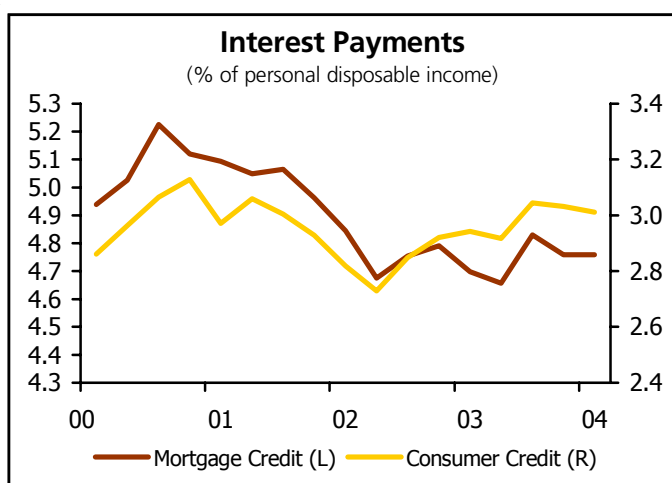
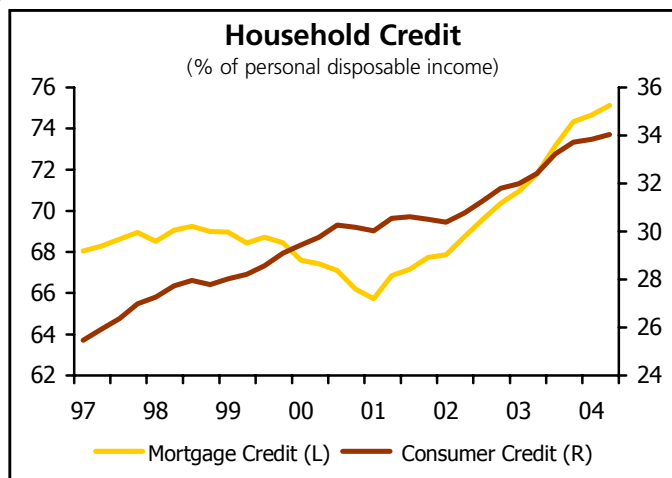


Source: Statistics Canada

# DEBT AND INTEREST PAYMENTS

During the first half of 2004, total household debt grew by 4.6% — a full percentage point faster than income. As a result, the debt-to-income ratio rose from 108% to 109% during that period. However, the pace at which the debt-to-income ratio is rising has been moderating lately, reflecting primarily a stronger rate of income growth. With income growth likely to continue to rise at an annual rate of 6% in the coming twelve months, and credit growth likely to soften somewhat, we expect the debt-to-income ratio to rise even slower in the coming quarters.

At the same time, the debt service ratio, as measured by debt interest payments as a share of disposable income has been trending downward recently. As of June 2004, this ratio stood at 7.7% — its lowest rate in a year. Again, the recent improvement in income growth outpaced the speed at which debt interest payments are rising.



## Consumer Debt Figures and Ratios

	Consumer Credit (\$Mill)	Mortgage Credit (\$Mill)	Total Household Debt (\$Mill)	Pers. Disp. Income (\$Mill)	Interest Payments (\$Mill)	Consumer Credit (% of PDI)	Mortgage Credit (% of PDI)	Total Pers. Debt (% of PDI)	Interest Payments (% of PDI)
2000:1	183,584	421,600	605,184	623,656	48,644	29.44	67.60	97.04	7.80
2000:2	189,146	428,672	617,818	635,664	50,780	29.76	67.44	97.19	7.99
2000:3	194,282	430,919	625,201	642,172	53,232	30.25	67.10	97.36	8.29
2000:4	198,109	434,701	632,811	656,776	54,172	30.16	66.19	96.35	8.25
2001:1	199,979	437,929	637,907	666,244	53,728	30.02	65.73	95.75	8.06
2001:2	202,056	442,104	644,160	661,292	53,612	30.55	66.85	97.41	8.11
2001:3	204,605	448,923	653,528	668,324	53,916	30.61	67.17	97.79	8.07
2001:4	205,553	456,581	662,135	674,048	53,184	30.50	67.74	98.23	7.89
2002:1	208,031	464,677	672,708	684,688	52,472	30.38	67.87	98.25	7.66
2002:2	212,450	474,592	687,042	690,316	51,104	30.78	68.75	99.53	7.40
2002:3	217,566	484,042	701,608	695,748	52,896	31.27	69.57	100.84	7.60
2002:4	222,569	492,594	715,163	700,012	53,976	31.80	70.37	102.16	7.71
2003:1	226,236	501,784	728,020	707,264	54,036	31.99	70.95	102.93	7.64
2003:2	231,058	511,644	742,702	712,876	53,984	32.41	71.77	104.18	7.57
2003:3	237,450	522,763	760,212	714,548	56,260	33.23	73.16	106.39	7.87
2003:4	242,575	534,787	777,362	719,504	56,052	33.71	74.33	108.04	7.79
2004:1	247,389	545,766	793,155	731,080	56,800	33.84	74.65	108.49	7.77
2004:2	253,735	559,872	813,607	745,344	57,152	34.04	75.12	109.16	7.67

# CONSUMER BANKRUPTCIES

The pace of growth of personal bankruptcies in Canada is slowing. After reaching 10% in mid-2003, year-over-year growth figure has been moderating, and as of September 2004, it was very just under zero. The cumulative number of bankruptcies rose by just over 2% in the year ending September — a notable improvement from the growth rate seen earlier in the year.

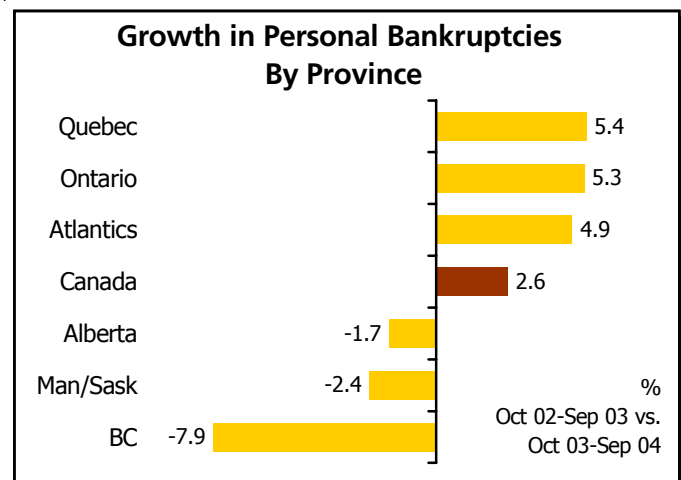
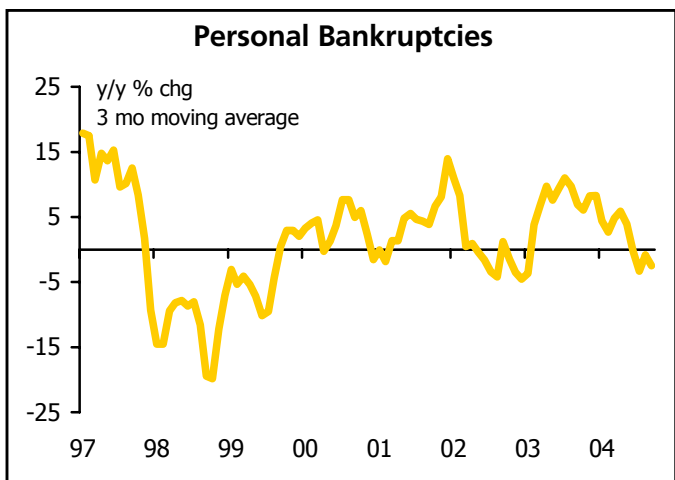
The bankruptcy performance, however, is not uniform. Quebec is the country's new bankruptcy queen, followed closely by Ontario. Note that until recently, Quebec was the only province that experienced declining bankruptcies, so the current deterioration is from a relative low level. For the first time in more than a year, the number of personal bankruptcies in Alberta is falling, probably reflecting the positive spin-offs from the oil boom that is boosting the province's economy.

The recent rise in interest rates cannot be good news for personal bankruptcies. Historically, personal bankruptcies started trending upward 6-8 months following the beginning of a tightening cycle. Higher interest rates impact bankruptcies directly via increased debt service burden, and indirectly via their negative implications for the labour market.

To the extent that the combination of higher rates, a strong dollar and high energy prices are successful in slowing down the economy, this will result in a higher unemployment rate and a longer duration of unemployment. The latter is one of the most important

## Personal Bankruptcies

	Monthly Data	y/y % chg
2002:01	6,447	7.2%
2002:02	6,288	1.0%
2002:03	6,621	-6.7%
2002:04	7,092	8.5%
2002:05	6,986	-3.0%
2002:06	6,191	-10.2%
2002:07	6,263	2.9%
2002:08	6,358	-5.2%
2002:09	6,630	5.9%
2002:10	7,228	-5.0%
2002:11	6,355	-11.3%
2002:12	5,751	2.8%
2003:01	6,293	-2.4%
2003:02	6,975	10.9%
2003:03	7,397	11.7%
2003:04	7,551	6.5%
2003:05	7,308	4.6%
2003:06	7,256	17.2%
2003:07	6,967	11.2%
2003:08	6,405	0.7%
2003:09	7,209	8.7%
2003:10	7,859	8.7%
2003:11	6,814	7.2%
2003:12	6,263	8.9%
2004:01	6,110	-2.9%
2004:02	7,115	2.0%
2004:03	8,521	15.2%
2004:04	7,578	0.4%
2004:05	7,026	-3.9%
2004:06	7,477	3.1%
2004:07	6,330	-9.1%
2004:08	6,639	3.7%
2004:09	7,075	-1.9%



# Consumer Bankruptcies

factors contributing to any increase in bankruptcies. The excessive borrowing by many households over the past few years suggests a reduced degree of freedom to absorb economic shocks such as a notable worsening in employment conditions.

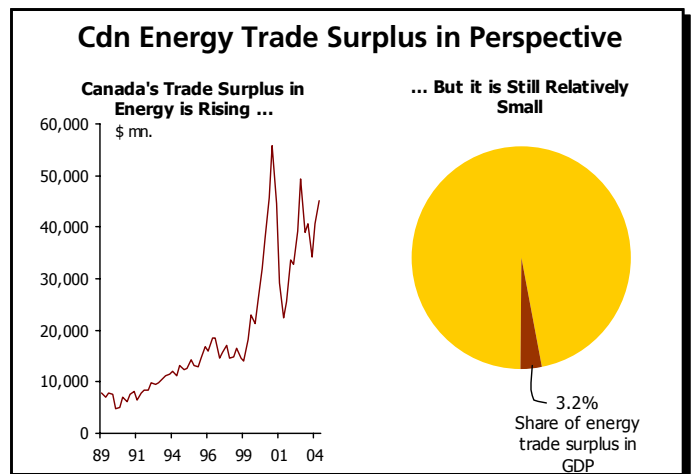
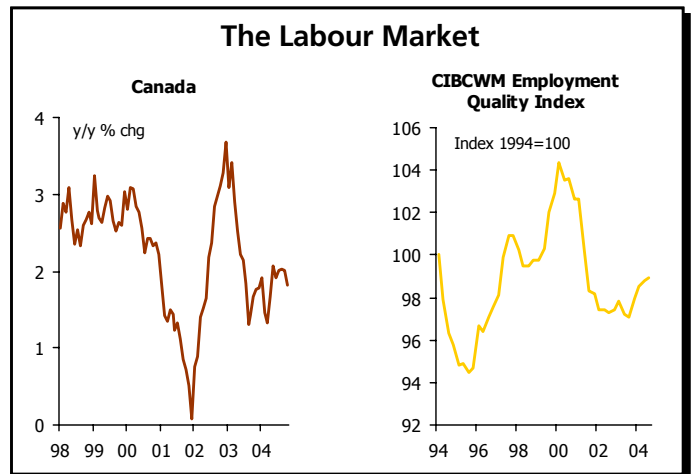
The bottom line is that personal bankruptcies are unlikely to continue their downward trend for much longer. In fact, we predict that the number of personal bankruptcies will rise by an additional 5%-6% in 2005.

## ECONOMIC DRIVERS AFFECTING THE CONSUMER

The likelihood is that overall economic growth in 2004 will average around 3.0%. Growth in 2005 is projected to be a bit weaker — 2.8%, as growth will be constrained by two powerful forces: the strong dollar and high energy prices.

As for energy, the real story about oil prices is not that they are elevated now, but that they will remain elevated 6-12 months from now. Geopolitical events have no doubt contributed to the upward pressure on energy prices, but what really makes them market movers is the fundamental gap between growing global demand for energy and limited global supply. Far from a temporary spike, relatively high oil prices are here to stay, at least as long as the world economy in general, and China in particular, continues to grow at today's robust pace.

What is the impact of higher energy prices on the Canadian economy? Canada is a large exporter of energy. More than half the country's production of oil and natural gas is exported, almost all to the US. But Canada is also an oil importer — mostly from North Sea sources, to satisfy its own refinery feedstock requirements. Add all that up and you end up with an energy trade surplus of roughly 3% of GDP — nice to have, but not sizeable enough to radically alter the economy's destiny.



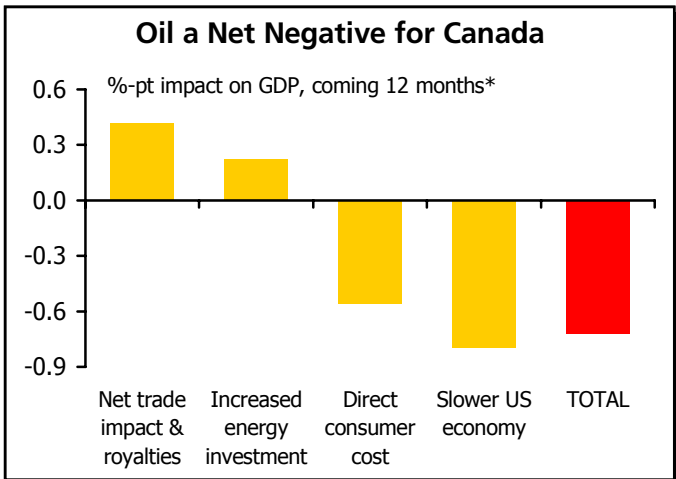
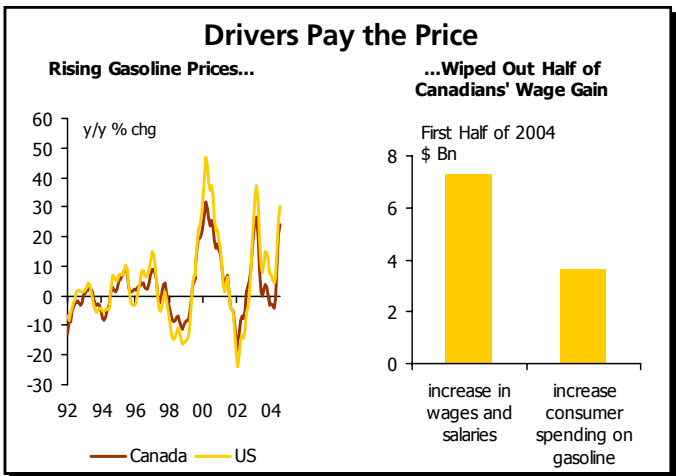
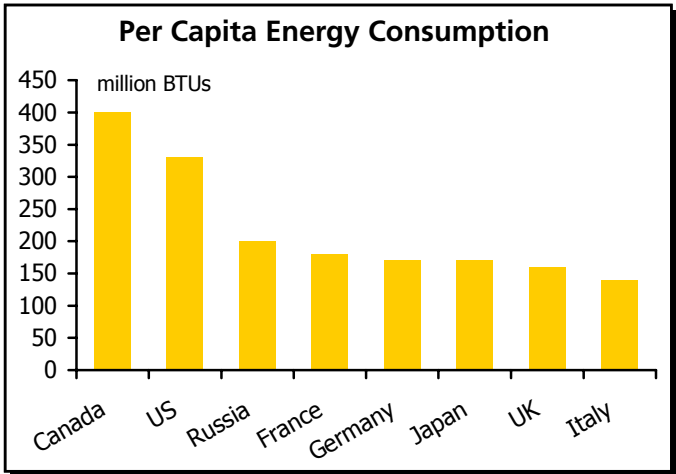
# Economic Drivers Affecting the Consumer

Increased investment in the energy sector is another potential positive resulting from high oil prices. Overall energy capital spending in 2003 amounted to just under \$30 billion, with investment in conventional oil accounting for three quarters of that amount, and oil sands-related investment for the rest. However, despite the significant increase in energy prices, overall investment in the Canadian energy sector in the first three quarters of the year is estimated to have risen by an annual rate of only 6-7%. Oil executives have to be fully convinced that higher oil prices are here to stay before they commit mega dollars to extra drilling. Furthermore, long planning lead times, and a severe shortage of both skilled labour and natural gas needed for the construction of new projects, almost guarantee that any increase in activity in the oil sands in 2005 would be constrained.

Against the backdrop of the limited economic lift from higher oil prices, the downside potential is much more sizeable. Canada, after all, is a major consumer of energy. It's cold here, distances between major urban centres are relatively large, and the country's resource sectors use a lot of energy. Indeed, per capita energy consumption in Canada is double that of the G-7 average and roughly 20% higher than in the US. During the first nine months of the year, Canadians spent an estimated \$5.5 billion of extra cash just to fill their gas tanks — an amount that taxed away half their wage growth. If energy prices remain near current levels, drivers would be forced to increase their spending on gasoline by an additional \$6-7 billion in the coming twelve months, with reduced buying elsewhere trimming GDP growth by more than half a percentage point.

So Canada's position as a net exporter of energy provides only a thin shield from the damaging blow of elevated energy prices. The high-energy intensity of the country's manufacturing sectors, the direct cost to households and the sensitivity of the Canadian economy to oil-induced weakness south of the border will far outweigh the positives narrowly enjoyed by Western Canada.

As for the currency, some in the market suggest that the fact that the economy did not collapse under the weight of a 75-cent dollar indicates that the

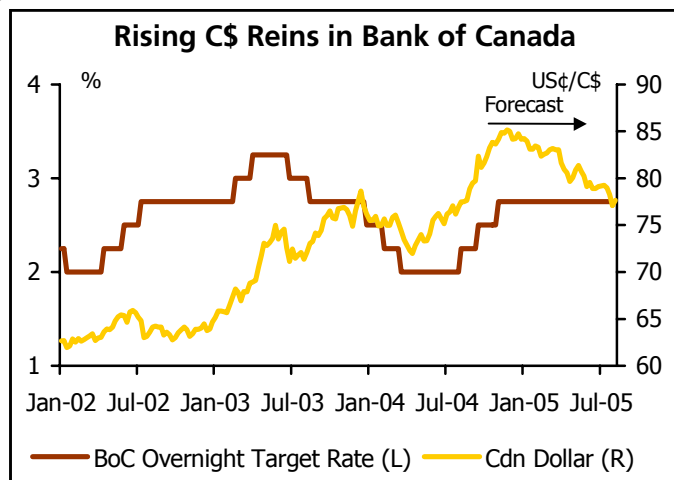


\* Based on energy prices remaining at current level

## Economic Drivers Affecting the Consumer

manufacturing sector is adjusting fast to the rising value of the currency. We are not so sure about that. Note that the currency is now close to 84 cents and, at one point, the actual level of the currency should matter. It is naive to believe that an appreciation from 70 to 75 cents is equivalent to an appreciation from 75 to 80 cents. Many studies show that the impact of currency appreciation is non-linear and asymmetrical.

The Bank of Canada will have to keep a close eye on the dollar and conduct monetary policy accordingly. While we believe that the Bank will tighten policy by 25 basis points in December, we also expect the Bank to be much more cautious after that.



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