TD Bank Financial Group

TD Economics

Special Report

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FINANCING BY CANADIAN BANKS

HIGHLIGHTS

- **Canadian bank financing to households and businesses remained strong even as global financial conditions deteriorated in the wake of the Lehman Brothers collapse.**
- **Household credit from Canadian banks advanced at a strong pace of more than 12% year-over-year in November. On a monthly basis, borrowing slowed in November, but this likely reflected weaker demand in response to a softening economy.**
- **Business credit from Canadian banks picked up in recent months, accelerating to a year-over-year increase of 13.4% in November. There were robust gains in business loans, nonresidential mortgages and issuance of Bankers' Acceptances. This was probably due to weaker lending by non-bank institutions and greater demand for credit that is typical in the early stages of an economic downturn.**

The Special Report entitled, "Credit Flows During the Credit Crunch" (available at www.td.com/economics) examined borrowing and lending in the U.S. and Canada during the credit crunch. It was based on the most recent official financial flows data that show a considerable reduction in net new financing in the United States. However, the comparable Canadian data revealed that credit was still flowing to households and non-financial businesses at a solid pace. One of the underlying trends within external sources of financing was a moderation in credit growth from non-bank financial institutions and a shift towards net new financing from banks. The major limitation of the financial flows data is that it is quarterly and, therefore, only provides guidance on the trends up to the end of September.

One could make a strong case that the credit crunch really intensified after the failure of Lehman Brothers in mid-September. For example, the spread between the London Interbank Offer Rate (LIBOR) and Overnight Index Swaps (OIS), which is a key indicator of changes

FINANCING BY BANKS TO CANADIAN HOUSEHOLDS

	Personal Loans	Credit Cards	Lines of Credit	Other	Consumer Credit	Total Mortgages*	Household Credit
Outstanding Amount (CDN millions)							
Aug-2008	46,953	49,932	160,112	23,546	280,543	656,132	936,675
Sep-2008	47,084	51,243	162,917	23,306	284,550	661,384	945,934
Oct-2008	47,475	51,621	165,639	22,873	287,608	665,973	953,581
Nov-2008	47,593	51,141	167,877	21,609	288,220	666,720	954,940
Month-over-Month Percentage Change							
Aug-2008	2.4%	0.9%	1.3%	-1.4%	1.2%	1.1%	1.1%
Sep-2008	0.3%	2.6%	1.8%	-1.0%	1.4%	0.8%	1.0%
Oct-2008	0.8%	0.7%	1.7%	-1.9%	1.1%	0.7%	0.8%
Nov-2008	0.2%	-0.9%	1.4%	-5.5%	0.2%	0.1%	0.1%
Year-over-Year Percentage Change							
Aug-2008	9.0%	15.7%	18.3%	4.4%	14.9%	13.9%	14.2%
Sep-2008	8.8%	15.7%	18.8%	5.1%	15.3%	13.6%	14.1%
Oct-2008	8.9%	13.7%	19.4%	0.7%	14.8%	12.5%	13.2%
Nov-2008	9.1%	10.4%	19.6%	-6.3%	13.7%	11.5%	12.1%

* Mortgages include both those on banks' balance sheets and securitized by banks
Source: Bank of Canada, Canadian Mortgage and Housing Corporation (CMHC)

in the short-term cost of funding for financial institutions, widened sharply in September and did not reverse its widening in the following months. Similarly, the spread between 5-year bank bond yields relative to 5-year government bond yields (a reference for the medium-term cost of funds to banks) rose considerably in the wake of the Lehman failure. The increased relative cost of funding for banks raises the question of whether it diminished available financing to the Canadian economy? In order to tackle this issue, one can use the monthly data published by the Bank of Canada in their financial statistics publications. We'll focus specifically on bank financing to households and businesses from August to November of 2008.

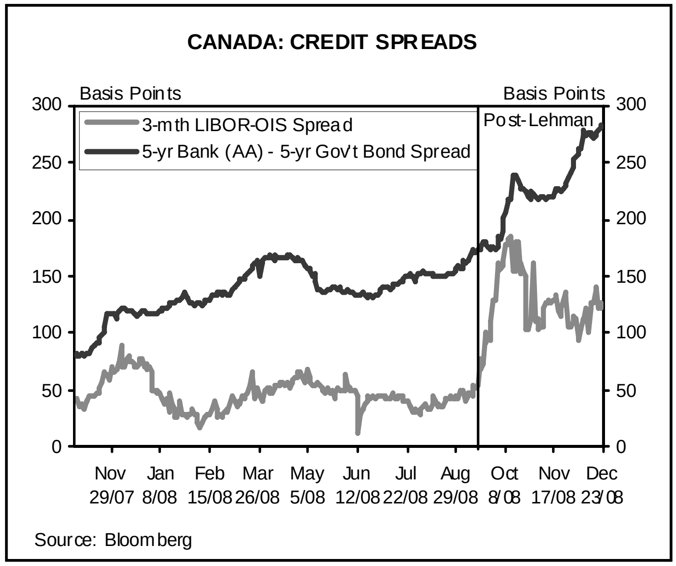
Households continue to tap bank financing

Household borrowing from banks rose at close to a 1% pace in August, September and October that lifted borrowing 13-to-14% above year-earlier levels. There was a clear moderation in November, when household credit was virtually unchanged in the month, but this still left borrowing 12.1% above year-earlier levels.

In terms of the details, mortgage loans dominate personal borrowing at more than two-thirds of total household credit. The trends in mortgages followed a similar pattern to the total, with solid increases from August to October but only a slight increase in November. In annual terms, mortgage loans were up a strong 11.5% last month.

Non-mortgage borrowing by households is referred to as consumer credit and it encompasses personal loans, credit card loans, lines of credit and other financing. The basic story is the same as the overall trends in household borrowing, with solid monthly gains in August, September and October -- but a flattening out in November. Lines of credit have been particularly popular, with above 1% monthly gains over the past four months. Interestingly, the year-over-year growth in lines of credit accelerated from 18.3% in August to 19.6% in November. Growth in personal loans (i.e. traditional bank loans) moderated after August, but hovered roughly 9% above year earlier levels. Credit card loans cooled in October and dipped lower in November, bringing their annual growth down to 10.4% from 15.7% in August. The other loans category was the only area to show a significant retreat, but this category represents less than 10% of consumer credit.

So, bank financing to households remained strong, but there was some moderation in November. This is not terribly surprising given the deteriorating economic climate. 70,600 jobs were lost in November and talk of recession became widespread. Retail spending was down 0.9% in October and likely remained weak through the holidays. The cooling in mortgage borrowing coincided with a 29% month-over-month drop in home sales and a 9.9% year-over-year decline in home prices in November.



Source: Bloomberg

Business increases borrowing from banks

Turning to businesses, bank financing accelerated in October and November. Total borrowing picked up from 0.5% growth in August, to 1.1% in September and then jumped to 3.9% in October and 3.0% in November.

Business loans, the largest category, rose sharply in the last two months. The early stages of the increase were in Canadian dollar-denominated loans, but the increase in November was in the foreign currency-denominated category. The depreciation of the Canadian dollar lifted the value of the foreign currency loans expressed in domestic currency, but this still doesn't detract from the conclusion that bank loans were rising.

Nonresidential mortgages also posted solid gains over the past four months, with a year-over-year growth rate of more than 16%, matching the performance of business loans. The strong performance in this area might reflect a weakening of nonresidential mortgage credit from non-bank lenders that dominated this category in the past.

Leasing receivables have been volatile and dipped lower by 1.6% in November.

One particularly dramatic shift occurred in financing through Bankers' Acceptances (BAs). BAs are a commitment to pay in the future, like a post dated cheque. When a bank 'accepts' the commitment, it is responsible for payment to the purchaser if the issuer does not live up to their promise. This makes BAs effectively a substitute for traditional loans. The data show that BAs were trending slightly lower in September and October, but then jumped by 3.1% in November.

The question is why businesses are borrowing more from banks? The answer is partly that non-bank lenders have become more restrictive in the credit flows and demand for business credit typically increases in the early stages of an economic slump. As earning growth slows, or starts to contract, business demand for financing will often increase in order to finance inventories, shipments or investment. Then, as economic conditions deteriorate, businesses eventually start to run down their inventories, push back investment plans, and generally tighten their belts. As this happens, demand for financing will wane.

Conclusions

The main observation from the monthly Bank of Canada's statistics is that financing from Canadian banks has continued to flow even as the credit crunch intensified after the Lehman collapse. Credit rose in September through November, with household credit increasing 12.1% year-over-year and business credit accelerating to a gain of 13.4%.

Looking ahead, demand for bank financing is expected to diminish. This is already starting to appear on the household front, as weaker real estate markets and softened consumer spending is starting to temper borrowing. This trend is likely to continue and intensify in the coming months. Business borrowing may also advance at a slower pace, as firms respond to weaker economic conditions. Ultimately, the flow of funds in the economy will adjust to this softening in demand for credit.

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FINANCING BY BANKS
FOR BUSINESSES RESIDENT IN CANADA

	Bus. Loans * (ex. inter-bank)	Non-Res. Mortgages	Leasing Receivables	Bankers' Acceptances	Total
Outstanding Amount (CDN millions)					
Aug-2008	211,216	23,728	7,556	66,176	308,676
Sep-2008	214,416	24,104	7,582	66,033	312,135
Oct-2008	226,561	24,441	7,667	65,765	324,434
Nov-2008	234,143	24,741	7,541	67,806	334,231
Month-over-Month Percentage Change					
Aug-2008	0.2%	1.9%	2.4%	0.5%	0.5%
Sep-2008	1.5%	1.6%	0.3%	-0.2%	1.1%
Oct-2008	5.7%	1.4%	1.1%	-0.4%	3.9%
Nov-2008	3.3%	1.2%	-1.6%	3.1%	3.0%
Year-over-Year Percentage Change					
Aug-2008	7.3%	16.6%	5.2%	8.9%	8.2%
Sep-2008	8.8%	17.0%	6.9%	4.0%	8.3%
Oct-2008	14.1%	17.9%	7.0%	1.7%	11.4%
Nov-2008	16.3%	16.4%	4.4%	4.6%	13.4%

* Includes loans to Canadian businesses in Canadian dollars and in foreign currencies
Source: Bank of Canada