TD Bank Financial Group

TD Economics
Observation
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CANADIAN BANK LENDING TO HOUSEHOLDS AND FIRMS IN JUNE

In June 2009, Canadian bank credit to households and non-financial firms expanded at 9.9% Y/Y and 1.0% Y/Y, respectively. Household credit rose robustly on a monthly basis, buoyed primarily by a strong housing market in June. House prices and sales are showing surprising resilience during the recession; however, we regard the current average prices and pace of sales for existing housing as unsustainable, likely representing a bringing forward of future demand. These factors point to a moderation of demand for mortgage credit in the months ahead.

Given the economic climate, businesses are clearly easing their overall borrowing and, with corporate bond yields falling, larger firms are returning to financial markets for credit. Faced with lower sales, businesses are clearly curbing their purchases of new machinery and equipment (M&E) and drawing down inventories, rather than accumulate new stock. While bank credit filled the financing gap during the credit crunch and early stages of the recession, we expect bank business credit to contract over the coming months, owing to these demand-side factors.

HIGHLIGHTS

- **Bank credit to households and firms grew by 9.9% Y/Y and 1.0% Y/Y in June, respectively.**
- **Household credit growth was particularly supported by borrowing through mortgages and lines of credit, consistent with the June uptick in real estate sales. However, since June's housing sales are unsustainable and new home construction will be weak during 2009, demand for mortgage credit should wane in the months ahead.**
- **Bank business credit growth has continued to slow, consistent with inventory pressures, diminished investment intentions, and slower non-residential construction. Moreover, yields on corporate bonds continued to fall through June, encouraging firms to lock in long-term debt and pay down bank credit facilities.**

Credit to Households

Despite pressures on the Canadian consumers, household credit from banks rose robustly at 1.0% M/M in June. The growth was strongly concentrated in bank loans secured on real estate, with mortgages growing 8% Y/Y and Lines of Credit – which included Home Equity Lines of Credit (HELOCS) – accelerating to 21% Y/Y. While having risen from lows during April and May, interest rates on fixed-term mortgages in June remained at near 30-year record lows. Encouraged by these low rates, homebuying has been brought forward. Indeed, nation-wide sales of existing houses were up 18% Y/Y in June while the national average resale price was up 3.6% Y/Y. To be clear, we do not believe that the Canadian housing will maintain its recent strength and point out that, since it does not control for quality or geography, the average resale price is a somewhat distorted measure of the value of housing nation-wide (see "TD HPI – An Update" May 6). However, it is clear that more real estate was transacted in June, and potential homebuyers were purchasing homes now rather than later. As well, although housing starts rose in June, residential construction still remains well below household formation, and we expect a much slowed pace of homebuilding during 2009 and 2010 (125K and 130K starts, respectively, compared with an average 221K from 2002-2008). These factors point to cooling mortgage demand in the latter half of 2009. And, even as banks gain mortgage market share, we expect the pace of bank mortgage growth to slow.

In other household credit categories, bank personal loans and credit card balances have continued to rise strongly despite overall declines in the retail sales. Personal loan plans are typically used for consumer goods and services, and repaid on an installment basis. With the continued rapid contraction of securitized consumer credit, banks are gaining market share in such loans. However, we do expect growth of these lending categories to moderate as consumer demand further weakens during the coming quarter.

Overall, Canadian households face pressures to rebuild their net worth and, with personal savings rising during 2009-10, households will shift to a lower clip of borrowing.

Bank lending to businesses

As demand for short-term business credit moderates, bank business credit decelerated to 1.0% Y/Y in June. All indicators point to diminished demand for business credit. The Bank of Canada's Business Outlook Survey showed a strongly negative balance of opinion for firms' M&E investment intentions in Q2/2009, and, with most of Canada's M&E capital sourced from abroad, M&E imports were down 12% Y/Y in May. Moreover, financing for inventories and receivables comprises much of bank business lending, and the elevated inventory-to-sales ratios for Canadian wholesalers and manufacturers highlight continuing inventory pressures, compelling businesses to draw-down stock and cut new orders. Continuing draw-down of inventories will drag on overall business credit growth.

The diminished demand is witnessed in non-bank business credit: despite the narrowing of interest rate spreads in the Commercial Paper (CP) market, non-financial CP fell by 12.7% Y/Y in June. Similarly, Bankers' Acceptances – typically in order to finance short-term trade transactions – which had risen rapidly during the autumn owing to the rush for intermediated credit, have now fallen year-over-year.

As well, Canadian bond markets have strongly revived since their depths in December, and June witnessed a record in net non-financial corporate issuance of $8.3 billion. Larger borrowers drew heavily on bank-provided credit lines during the credit crunch; but, with corporate spreads having eased significantly and the inflation premium having subsided, borrowers are now locking in long-term debt at low nominal interest rates. With bond markets revived, larger borrowers would logically be paying down the credit lines on which they had drawn during the turbulent autumn, and shifting their capital structure towards longer-term debt.

The monthly drop in banks' non-residential mortgages reflects both diminished non-residential investment and a revitalization of long-term debt markets. Banks have strongly gained market share in non-residential mortgages, as such lending by life insurers and non-depository institutions have stagnated and shrunk. However, with commercial and industrial construction slowing by 4.7% in Q2/2009, non-residential mortgage demand would be expected to slow.

During 2009, we forecast nominal non-farm inventories to contract by $20 billion and for business investment to fall by almost 15%. This logically leads to an expection of a fall in Canadian businesses' demand for credit.

Looking Ahead

Bank credit to households and firms remained strong as Canada plunged into recession. However, even as Canada moves towards a still nascent recovery, diminished demand for credit will prove a strong check on new lending. For households, home purchases have been "brought forward" but, along with slowed residential construction, this recent strength implies diminished homebuying in the latter half of the year. For businesses, their inventories remain worryingly high and their draw-downs have not completed. Moreover, even as recovery takes hold during late 2009 and 2010, the business investment climate will remain tepid, with consequent stagnation in new business lending.

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FINANCING BY BANKS TO CANADIAN HOUSEHOLDS							
	Personal Loans	Credit Cards	Lines of Credit	Other	Consumer Credit	Total Mortgages*	Household Credit
Outstanding Amount (CDN millions)							
Mar/2009	48,190	51,278	178,777	20,895	299,140	666,013	965,153
Apr/2009	48,500	51,683	181,015	20,765	301,963	673,321	975,284
May/2009	49,201	52,423	184,624	20,601	306,849	677,241	984,090
Jun/2009	49,952	52,849	188,323	20,807	311,931	682,352	994,283
Month-over-Month Percentage Change							
Mar/2009	0.1%	-0.7%	2.0%	2.0%	1.2%	-0.5%	0.0%
Apr/2009	0.6%	0.8%	1.3%	-0.6%	0.9%	1.1%	1.0%
May/2009	1.4%	1.4%	2.0%	-0.8%	1.6%	0.6%	0.9%
Jun/2009	1.5%	0.8%	2.0%	1.0%	1.7%	0.8%	1.0%
Year-over-Year Percentage Change							
Mar/2009	9.1%	8.3%	20.6%	-8.3%	13.9%	8.6%	10.2%
Apr/2009	8.1%	8.9%	20.4%	-6.6%	14.0%	8.8%	10.3%
May/2009	9.4%	9.3%	20.4%	-11.1%	13.9%	8.1%	9.9%
Jun/2009	9.9%	8.5%	21.1%	-10.6%	14.3%	8.0%	9.9%

* Mortgages include both those on banks' balance sheets and estimated securitization by banks
Source: Bank of Canada, Canadian Mortgage and Housing Corporation

FINANCING BY BANKS FOR BUSINESSES RESIDENT IN CANADA					
	Bus Loans* (ex. Interbank)	Non-Res. Mortgages	Leasing Receivables	Bankers' Acceptances	Total
Outstanding Amount (CDN millions)					
Mar/2009	230,921	25,042	8,110	67,007	331,080
Apr/2009	224,192	25,210	8,143	68,929	326,474
May/2009	215,303	25,284	8,142	66,392	315,121
Jun/2009	212,395	25,229	8,098	64,382	310,104
Month-over-Month Percentage Change					
Mar/2009	0.2%	0.2%	-1.4%	-2.1%	-0.3%
Apr/2009	-2.9%	0.7%	0.4%	2.9%	-1.4%
May/2009	-4.0%	0.3%	0.0%	-3.7%	-3.5%
Jun/2009	-1.4%	-0.2%	-0.5%	-3.0%	-1.6%
Year-over-Year Percentage Change					
Mar/2009	10.2%	12.1%	4.2%	-1.9%	7.5%
Apr/2009	7.0%	12.1%	4.5%	2.8%	6.4%
May/2009	3.3%	11.3%	4.5%	-1.0%	3.0%
Jun/2009	1.1%	9.7%	3.4%	-2.5%	1.0%

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