TD Bank Financial Group

TD Economics

Observation

August 31, 2009

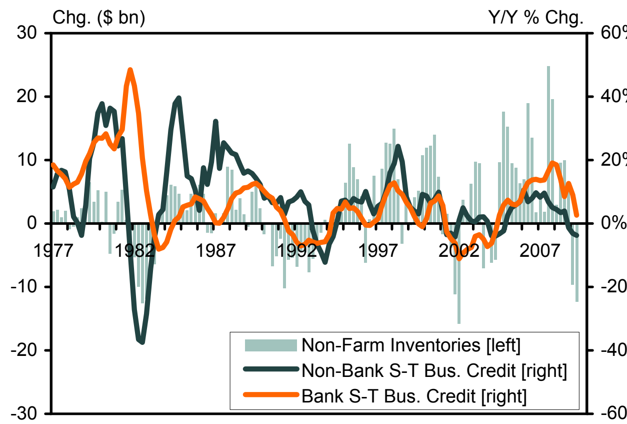
CANADIAN BANK LENDING TO HOUSEHOLDS AND FIRMS IN JULY

HIGHLIGHTS

- **Bank credit to households grew by 9.7% Y/Y in July and that to firms declined by 1.7% Y/Y.**
- **Household credit growth owes to very robust expansion of mortgages and lines of credit. While resale volumes have been impressive, this appears an absorption of delayed home-buying, and mortgage growth should slow during the fall.**
- **While bank credit to businesses has been much stronger than that from non-banks, business lending has experienced diminished demand as firms draw down inventories rather than accumulate new stock. Non-residential mortgage growth is also slowing as commercial and industrial construction slow.**

In July 2009, Canadian bank credit to households expanded by 9.7% Y/Y and that to non-financial firms declined by 1.7% Y/Y. Household credit rose strongly at 1.3% M/M, owing to strong growth in traditional mortgages and home equity lines of credit. Despite the recession, home-buying has been extremely buoyant with the total monthly value of transacted resale homes up 27.3% Y/Y in July. The decline in business credit is its first year-over-year decrease since June 2004, and demonstrates weakening demand for short-term business credit, as firms cleaved inventories and curtailed production. While demand for goods appears to be stabilizing, inventories-to-sales (I/S) ratios for manufacturers and wholesalers remain elevated, and firms are likely to continue to draw down inventories rather than restarting production just yet. Even with the glimmers of recovery, these factors points to a continuing moderation in business borrowing over the quarters to come. Indeed, in the wake of past recessions, overall short-term business credit (including non-bank sources) continued to decline as non-farm inventories contracted.

SHORT-TERM BUSINESS CREDIT AND NON-FARM INVENTORIES



Source: Statistics Canada, Bank of Canada

Credit to Households

Canadian homebuyers continue to drive astonishing levels of home sales and bank credit secured on residential real estate has continued to advance at a very robust pace. Sales of existing housing rose 18.2% Y/Y in July and the average resale price gained 7.6% Y/Y. As well, while the average price of resale houses is skewed by geography and quality, the Teranet-National Bank quality-adjusted housing index also has advanced since May, indicating a possible bottoming of nation-wide home values. However, home sales have been spurred by low mortgage rates and the prior softness in prices. The pace of home-buying should begin to wane during the autumn in response to the shift to a sellers' market and consequent weakening affordability.

Owing to this robust home-buying, bank mortgages rose by $9.2 billion or 7.9% Y/Y in July. Much of the bank mortgage portfolio is now securitized under the National Housing Act Mortgage Backed Security (NHA MBS) program. All NHA MBS are insured against default and, therefore, are riskless for the ultimate holder of the MBS. Banks will often securitize such insured mortgages to boost short-term liquidity and the federal government's mortgage purchase program has been a very positive measure in this respect. Banks are the originators of 86.5% of NHA MBS and NHA MBS represents 34% of all bank mortgage lending (compared with 25% last July).

Household credit growth has owed strongly to the popularity of home equity lines of credit (HELOCs), with lines of credit – the bulk of which are secured on residential real estate – growing at 21.1% Y/Y in July. Heightened HELOCs likely also reflects a spur to home renovations, following from the boost to homebuying and tax incentives. Bank personal loan plans – representing term loans made to finance consumer purchases – are also strongly increasing year-over-year. While purchases of vehicles and furniture have been depressed, banks appear to be rapidly picking up market share, as consumer lending by non-depository intermediaries and through non-NHA MBS securitization continues to contract. In addition, while still at low levels, purchases of both new autos and furniture appear to have improved in June, with the respective year-over-year declines slowing. The pick-up in year-over-year growth in personal loans since June is consistent with banks' heightened market share and the stabilization in durable good purchases. In contrast, the year-over-year growth in credit card balances now appears to be slowing – consistent with a more moderate pace of overall retail sales.

Credit to Businesses

Bank credit to businesses fell 1.7% Y/Y in July, reflecting diminished demand for short-term business credit. On a monthly basis, bank credit declined by 2.5% M/M and business borrowing from banks has declined since January 2009, reflecting the slowdown in demand for credit. Indeed, non-bank short-term business credit fell by a much more severe 4.1% Y/Y in July, and the decline in commercial paper issued by non-financial corporations steepened to 18.2% Y/Y. Demand from borrowers has diminished, as evidenced by the steep and continuing contractions in the inventories of wholesalers and manufacturers. Despite signs of a bottom in manufacturing sales, elevated I/S ratios will continue to draw down present inventories rather than accumulating new stock. Overall, non-farm inventories fell by $12.3 billion (SAAR) in the second quarter. We expect a total $20 billion contraction of non-farm inventories during 2009 and an additional $12 billion contraction in 2010. We therefore anticipate a continued contraction in short-term business credit. Consistent with this picture, bank business loans declined by 2.2% Y/Y and bankers' acceptances (BAs) declined by 4.9% Y/Y in July. Part of the fall in bank loans also owed to the revaluation of foreign-denominated loans, following the 8% appreciation of the Canadian dollar from the end of June to the end of July.

Bank credit to businesses does continue to advance through non-residential mortgages, albeit at a slowing pace. Such mortgages grew at 9.2% Y/Y in July. In comparison, non-bank non-residential mortgages grew only 2.1% Y/Y in June (July data for non-banks is not yet available). However, non-residential mortgages also advanced month-over-month in July and a monthly pick-up in commercial building permits during June points to the possible of stabilization in non-residential mortgage demand. While we expect a rebound in business investment in non-residential construction during later 2009, we expect a continuing slowing of non-residential mortgage growth. Favourable conditions in bond markets would encourage financing construction investment through longer-term market debt by large businesses.

Outlook

Household credit from banks has continued to grow at a robust pace. However, we regard much of the robust sales volumes as an absorption of pent-up demand for home-buying. We do expect a moderation of household credit growth in the months ahead. On the business side, bank credit is now declining, but borrowing from banks is still much stronger than from non-banks – a "reintermediation" trend that we expect to continue. Nonetheless, inventory draw-down means diminished demand for short-term business credit and we forecast the aggregate inventory adjustment to persist for some time. Moreover, business investment in structures has fallen and, while looking to rebound in late 2009, remains at a diminished level. Although banks have rapidly gained market share in non-residential mortgages, its year-over-year growth will continue to slow in the quarters ahead – especially as firms issue bonds to finance construction.

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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)							
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
Jul/2009	50,626	52,911	191,321	20,572	315,430	691,566	1,006,996
Month-over-Month Percentage Change							
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%
Jul/2009	1.3%	0.1%	1.6%	-1.1%	1.1%	1.4%	1.3%
Year-over-Year Percentage Change							
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%
Jul/2009	10.4%	6.9%	21.1%	-13.0%	13.9%	7.9%	9.7%

* 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)					
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
Jul/2009	206,207	25,432	8,106	62,610	302,355
Month-over-Month Percentage Change					
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%
Jul/2009	-2.9%	0.8%	0.1%	-2.8%	-2.5%
Year-over-Year Percentage Change					
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%
Jul/2009	-2.2%	9.2%	6.6%	-4.9%	-1.7%

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