www.pwc.com/ca/banking

PwC analysis of consumer lending in Canada and what it means for banks

Maxed out Canadians ready to cut debt

pwc

Executive Summary

In March 2012, the Bank of Canada (BoC) stated that "Canadian household spending is expected to remain high relative to GDP as households add to their debt burden, which remains the biggest domestic risk." [1]

63%

Want to decrease the amount of debt they carry over the next year

4.5%

Increase in the number of respondents who wanted to reduce their level of debt from 2011

According to our annual consumer lending survey, Canadians seem to be listening to the BoC and its governor, Mark Carney, who has often warned them about rising debt levels.

Canadian consumers are generally comfortable with their debt. Our survey of 1,200 Canadians, which was conducted by Leger Marketing, found that almost two-thirds of respondents think their debt level is about right. This comfort is likely due to our high real-estate values and low interest rates which make the debt seem minor in relation to the value of the property and easy to carry month to month. Respondents were also optimistic about their job prospects, with almost 80% reporting that they were confident or very confident in their job security.

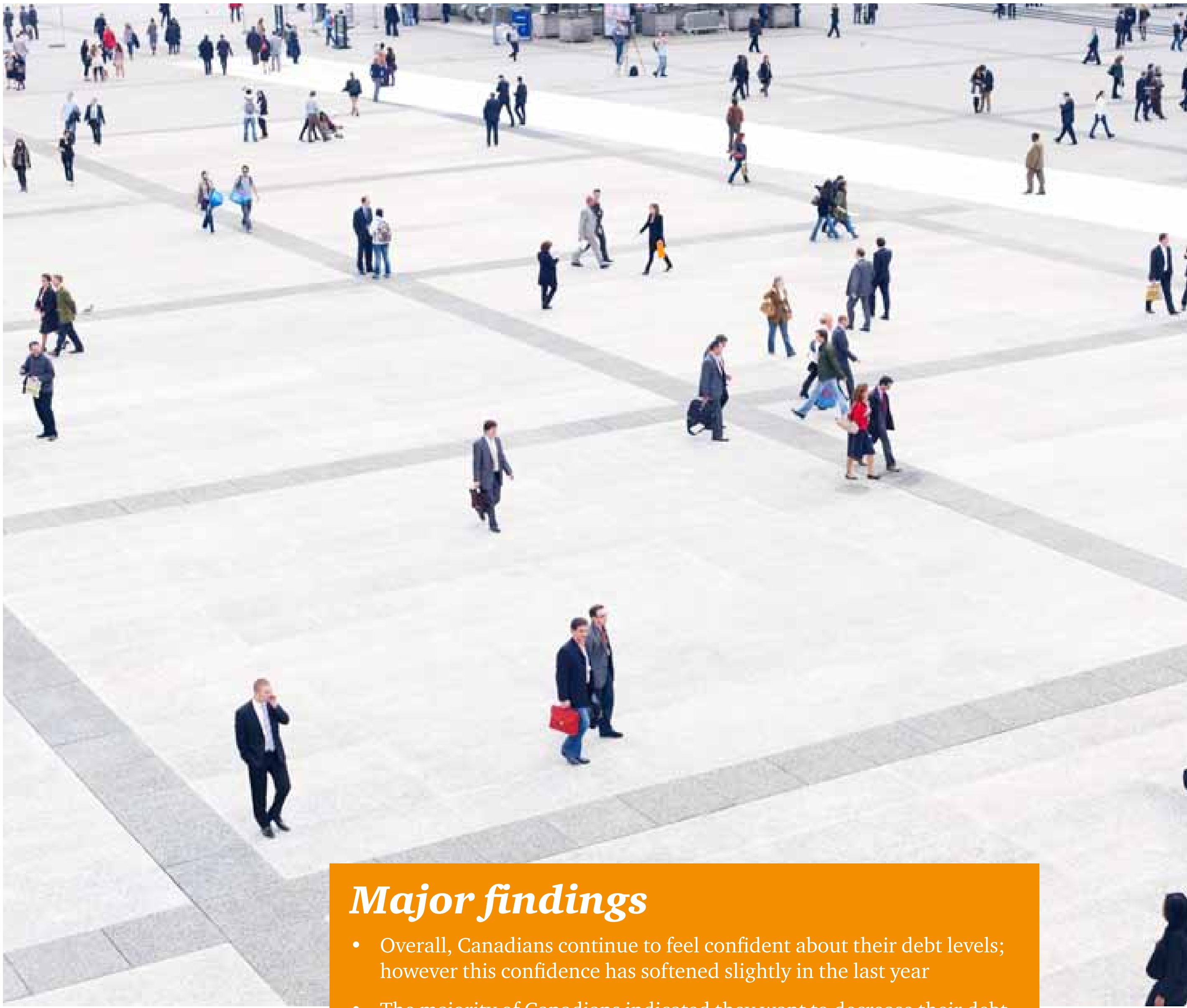
Notwithstanding their comfort with their debt levels, Canadian consumers have indicated that they still intend to reduce their debt over the next year; almost two-thirds of those surveyed want to decrease the amount of debt they carry. Interestingly, the intent to reduce debt was present regardless of whether or not they were comfortable with their debt.

The way they plan to reduce their debt is to cut back on discretionary spending. Compared to last year, consumers are more willing to postpone purchases in all categories. Sixty-nine percent said they would be willing to delay the purchase of a new car, 62% would delay buying a new house or upgrading to a bigger home, and 61% would forego buying new electronics.

Interestingly, the majority of respondents feel that their financial institution should help them manage their level of debt. Eighty-two percent of respondents say banks should play a role in both determining the maximum amount of debt someone can responsibly take on and hold them to that limit. This was especially true of those with household incomes of more than $100,000 a year compared to those making less (85% vs. 71%).

Based on what Canadians have told us, we believe that banks will experience a slowdown in lending growth over the next 12 months, which will only serve to intensify competition for the declining volumes. Given the prolonged low-interest rate environment, banks may not have much leeway to compete for customers on price so they will have to focus their attention on customer experience and product innovation as means of differentiation.

1 Bank of Canada press release, March 8, 2012



Major findings

- Overall, Canadians continue to feel confident about their debt levels; however this confidence has softened slightly in the last year
- The majority of Canadians indicated they want to decrease their debt level over the next year, and are planning to delay discretionary and big ticket purchases like homes and cars
- The sentiment toward debt reduction seems to be driven by prudence rather than major concerns about income or the economy
- Respondents believe that banks have a role in helping them manage their debt level

2012 PwC consumer lending survey results

Background

Consumer lending is a cornerstone of Canada's banks. It accounts for 27% of their assets and 26% of their revenue. The largest driver of the personal lending market is real estate lending in the form of mortgages and home equity lines.

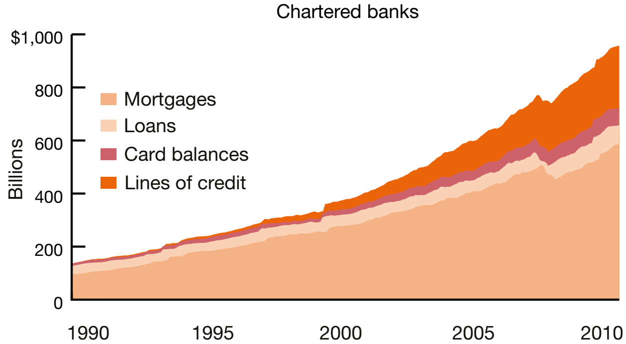
Meanwhile interest rates are near historic lows, and with the rapid rise in real estate prices, consumers are taking on an unprecedented amount of debt.

Nationally, the average price of housing to average disposable income is on the rise. The average ratio over the past 25 years was stable, but it has jumped significantly above that level in recent years as housing prices rose but salaries stayed about the same.

Canadian household debt relative to assets has also jumped above the long-term average and recently surpassed the level in the United States[2]. But lower interest rates and a rise in the value of household assets have helped reduce the debt service ratio and made this debt more manageable.

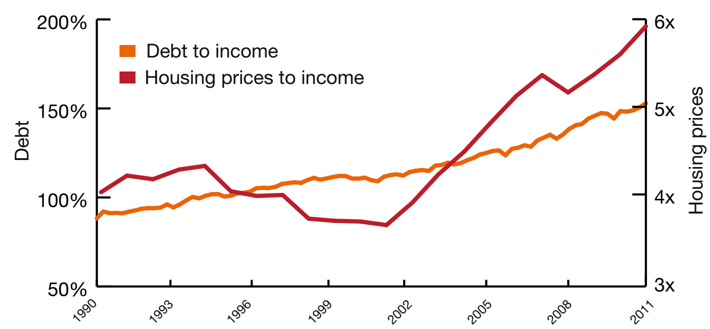
Figure 1: Personal lending – average balances

Chartered banks



Source: Bank of Canada

Figure 2: Canadian debt and housing prices to disposable income

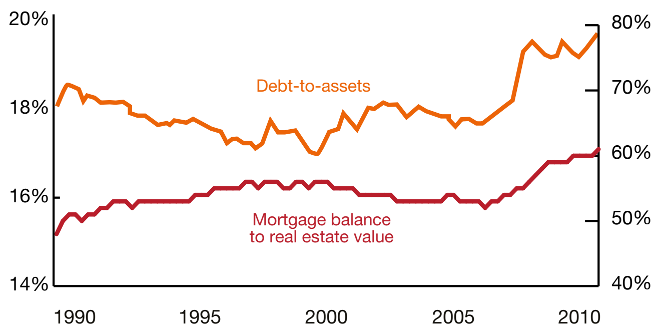


Source: Statistics Canada, Canadian Real Estate Association, PwC analysis

2 Globe and Mail, February 13, 2012

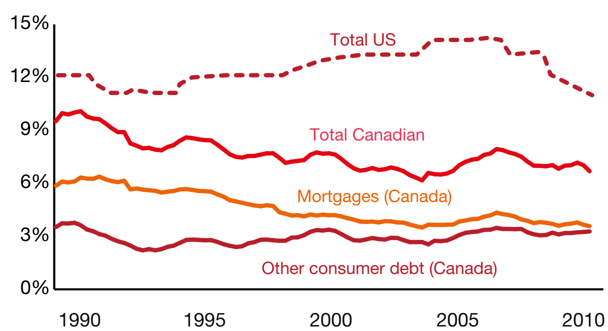
High asset prices and a low-interest rate environment have kept debt manageable... so far

Figure 3: Select Canadian debt ratios



Source: Statistics Canada, PwC analysis

Figure 4: Debt service ratios



Source: Statistics Canada, US Federal Reserve, PwC analysis

Given the importance of consumer lending to the banking industry and economy, PwC conducted our annual consumer lending survey to gauge the attitudes of Canadians toward borrowing.

Levels of debt

When asked about debt, the majority of Canadians indicated they carry some level of debt. Surprisingly, this is also true of 58% of retired respondents.

	All respondents	*Retired*	
I have no debt	19%	35%	
Less than $100K	35%	**40%**	
Between $100K and $250K	22%	**15%**	**58%**
Between $250K and $500K	13%	**3%**	
More than $500K	3%	0%	
Don't know/prefer not to answer	8%	7%	

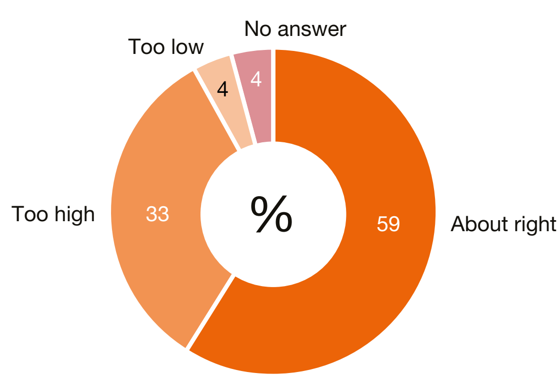
Overall Canadians continue to feel confident about their debt levels; however this confidence has softened slightly in the last year.

Characteristically, the level of confidence also varies by demographic.

Respondents aged 25 to 55 (core working age) were the most concerned group as 41% believed that their debt level was too high, however the level of concern decreased with age. Having dependants was a factor in confidence: 36% of people with children thought that their debt level was too high as opposed to 26% of people with no children. Unsurprisingly, people with higher incomes were more confident. 64% of respondents with a household income of more than $100,000 were comfortable with their debt level.

Significantly, we observed a three percentage point shift between the number of people who thought their debt level was about right to the group that thought their debt level was too high.

Figure 5: Feelings about level of debt



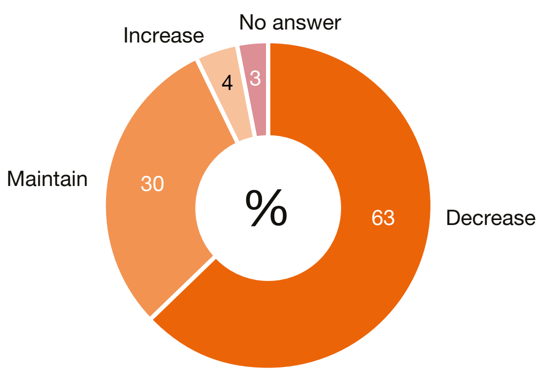
Managing their debt

Expectedly, given all the press over the last year, and the fear of rising interest rates, the majority of Canadians indicated they want to decrease their debt level over the next year.

Their intent to manage debt was present regardless of the respondent's comfort level with their debt. What surprised us was the gap between high- and low-income earners' intentions to reduce debt as 68% of high earners wanted to decrease debt as opposed to 58% of the lower-income households, but intentions may be tempered by ability.

As we would expect, people in the core working age with children and a house seemed more inclined to want to reduce their debt. Naturally, this indication is more pronounced among younger respondents and gradually subsides as they age and make more progress in reducing their debt obligations. Compared to last year, we observed a 4.5 percentage point increase in the number of high income respondents who indicated that they want to reduce their debt level.

Figure 6: Debt levels intentions



Discretionary spending

Canadians were more willing to delay discretionary purchases and big-ticket items to help lower their debt levels.

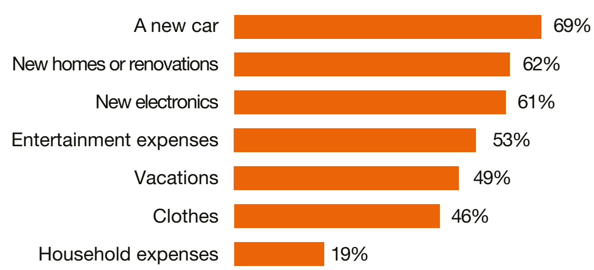
When asked about their willingness to delay a number of purchase types to reduce debt, the top three were: new cars, a new home/home renovations and electronics.

A comparison against last year's data indicates that higher income Canadians were more willing to postpone purchases in all categories:

- A new car: 69%, up from 64% last year
- A new house or renovations: 62%, up from 56%
- New electronics: 61%, up from 59%
- Entertainment expenses: 53%, up from 49%
- A vacation: 49%, up from 47%

Of all the respondents surveyed, two-thirds say they had the capacity to borrow more money. However, of those that think their debt is too high, 48% believe they can responsibly borrow more if needed compared to 33% who say they cannot.

Figure 7: Willingness to postpone purchases

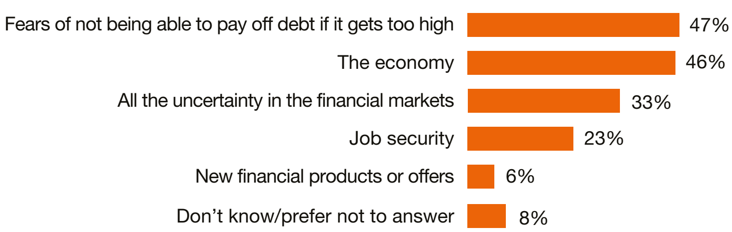


Cautious optimism

Similar to our observation last year, people indicated that fear about unmanageable debt and the economy were their top motivators for reducing debt.

Compared to last year, people showed increased concern about fear of not being able to pay debt off, the economy and job security which is a sign of increased sensitivity to the overall economic outlook

Figure 8: What factors influence you most as a motivator to reduce your debt?



These concerns seem to be tempered by optimism in the overall prospects for the next 12 months.

Interestingly, there is no evidence that Canadian consumers are overly concerned about the economy, and they seem to be generally confident about their jobs. Working Canadians were also optimistic about their income gains or businesses as 51% of them believed that their income will be better while an additional 22% expected steady incomes.

Figure 9: Expectations of the economy

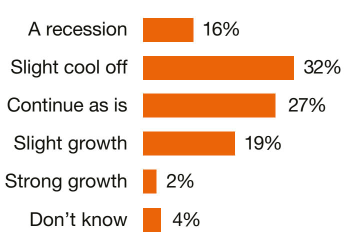
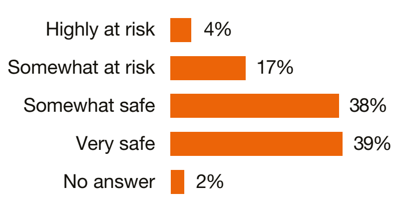


Figure 10: Job security sentiment

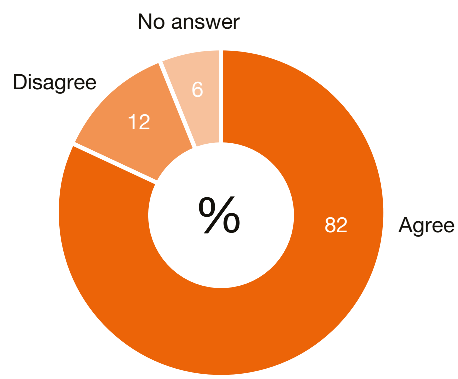


Responsibility

The majority of respondents feel that the responsibility of keeping debt levels under control isn't theirs alone. They believe banks have a role in helping them manage their level of debt.

Most (82%) believe banks should play a role in determining the maximum amount of debt someone can responsibly take on, and then holding them to that limit. This is especially true of those making $100,000+ per year (85% vs. 71% among those making less).

Figure 11: Bank's role in managing debt



Implications for the banks

We believe the banks will experience a slowdown in lending growth over the next 12 months, which will only serve to intensify competition for volume.

This competition, combined with the fear of increasing debt levels of Canadians, will result in increased regulatory oversight and tightening credit guidelines to ensure that the housing market does not become overheated.

As discussed in this paper, consumers' needs are changing too. They told us they expect the banks to help them manage their debt levels. That means providing access to tools that assist them with planning and taking action, such as interest rate forecasting as part of a mortgage calculator, clear options for how to change loan repayments, or convert some or all of their debt to a fixed rate. For more sophisticated borrowers, they may want to know how to set an amortization schedule for their lines-of-credit. Banks are doing a good job of adding online functionality to transaction accounts; now it's time to focus that effort on lending accounts.

The portion of retirees who still have debt also creates potential opportunities: banks traditionally sell products aligned to various life stages. Now that customers' financial situations are becoming more complex, their need for relevant advice is increasing. Customers have both loans and investments, and cash-flow allocation decisions with uncertain markets is already very challenging. Lending sales processes, front-line training, and the opportunity to develop appropriate targeted offers all impact the customer experience.

Increased competition, tightening credit guidelines, additional rules from regulators, and more demanding customers will create challenges for the banks. However, it also provides the banks with the opportunity to move ahead of the competition by customizing their customers' experiences by taking into account their product needs, life stages and demographics.

Methodology

- The survey was completed on-line using Leger Marketing's online panel, *LegerWeb*.
- A sample of 1,200 Canadians, 18 years of age or older, were surveyed. This sample was stratified into two equal sized groups:
  - I. Homeowners or aspiring homeowners with household incomes of $100K or more
  - II. Members of the general population who did not fit into the above category
- A probability sample of the same size would yield a margin of error of +/-2.8%, 19 times out of 20.

Who to call

John MacKinlay
National Financial Services
Consulting & Deals Leader
416 815 5117
john.mackinlay@ca.pwc.com

Paula Pereira
Partner, Banking and Capital Markets
416 941 8460
paula.x.pereira@ca.pwc.com

Andrew Smee
Consumer Lending Practice Leader
416 815 5128
andrew.a.smee@ca.pwc.com

Sasan Parhizgari
Manager, Banking and Capital Markets
416 947 8903
sasan.parhizgari@ca.pwc.com