

# ECONOMIC VIEWPOINT



## Is Higher Consumer Spending Growth in Canada Still within Reach?

Canadian household consumption spending has slowed significantly in the last few months. This is partly explained by the decline in furniture sales, dragged down by the housing market’s pullback, and slower growth in automobile sales after several years of strong growth. Gradually climbing interest rates are another important factor, while the savings rate is very low from a historical standpoint, which reduces the financial flexibility in households. Thankfully, some bright spots remain. Moreover, strong job creation is giving a boost to households’ disposable income. Under these conditions, consumer spending should continue to grow in the next few quarters, but at a moderate pace.

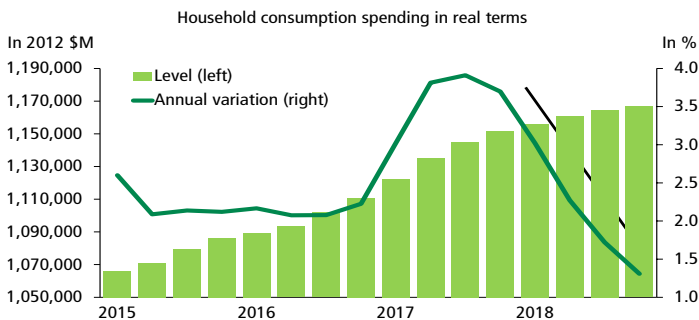
Canada’s economic growth in the last few years has largely relied on robust household spending. In recent quarters, however, household spending has hit a few snags. On one hand, residential investment is declining while the combined effects of tighter mortgage measures (including the Office of the Superintendent of Financial Institutions’ [OSFI] Guideline B-20) and gradually climbing interest rates are being felt. Considering the frenzy in Canada’s real estate sector in the last few years, this type of slowdown is good for the long-term health of Canada’s economy. On the other, household consumption spending has been advancing at a much slower pace since the end of 2017 (graph 1). This raises some concerns about

the contributions consumer spending will make to Canada’s economic growth in the quarters ahead.

### Rate Hikes Being Felt

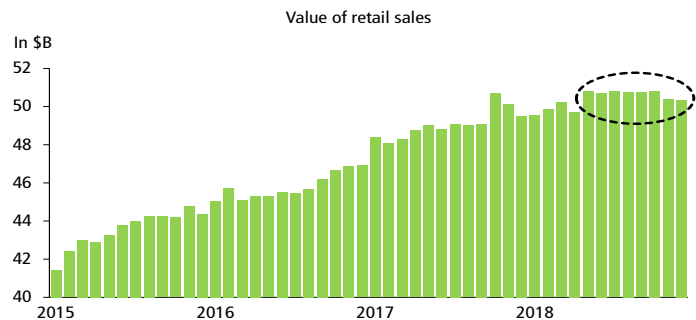
Weak consumer spending is also reflected in the value of retail sales, which has fallen slightly since mid-2018 (graph 2). The sharp decline in gas prices—from an average of ¢140.1 per litre for regular gas across Canada during the week of May 22<sup>nd</sup>, 2018, to only ¢105.3 per litre the week of February 5, 2019—has greatly contributed to reducing the value of service station sales in recent months. That said, some other sectors also had difficulties (graph 3 on page 2), i.e.,

**GRAPH 1**  
Consumer spending is growing more slowly



Sources: Statistics Canada and Desjardins, Economic Studies

**GRAPH 2**  
The value of retail sales has been flat for several months

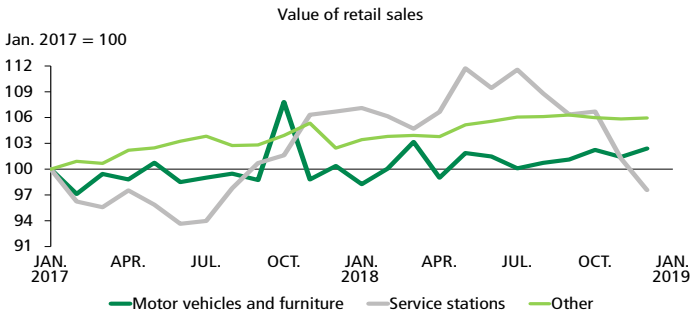


Sources: Statistics Canada and Desjardins, Economic Studies

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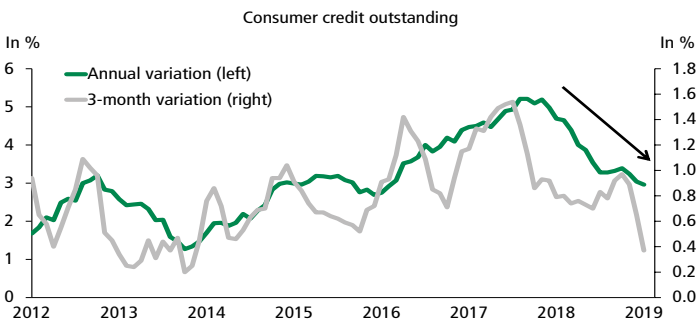
**GRAPH 3**  
Some retail sectors are lagging



Sources: Statistics Canada and Desjardins, Economic Studies

motor vehicles and furniture. These two sectors have something in common—both are particularly sensitive to interest rate fluctuations. Climbing interest rates, which have been ticking up since mid-2017, have clearly put the brakes on sales growth in these sectors. In fact, consumer credit growth has slowed sharply in the last few months (graph 4).

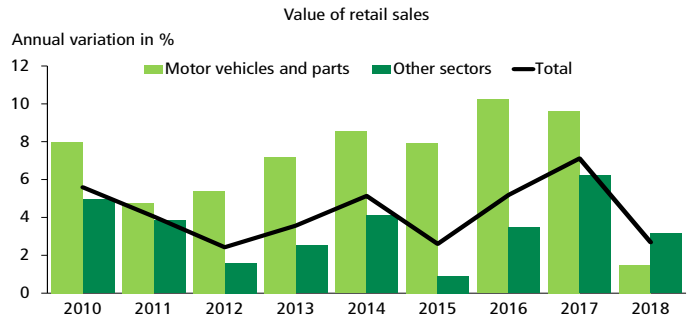
**GRAPH 4**  
Consumer credit growth is slowing



Sources: Statistics Canada and Desjardins, Economic Studies

However, other sectors that are also sensitive to interest rate fluctuations are doing better, such as electronics and appliance stores. Besides interest rate hikes, other factors seem to be at play here. The current slowdown in the housing market is undeniably taking a bite out of furniture sales. With regard to motor vehicles, the last few years have been exceptional for this sector, with sales growth outpacing the average for overall retail sales by far (graph 5). The recent weakness in motor vehicle sales can therefore be seen as a temporary consolidation within the sector after several years of sharp growth. In addition, the automobile industry is undergoing several technological changes at the moment, pushing some buyers to put off their purchases and wait for new technological features that will soon be available.

**GRAPH 5**  
Automotive product sales growth has stood out in recent years

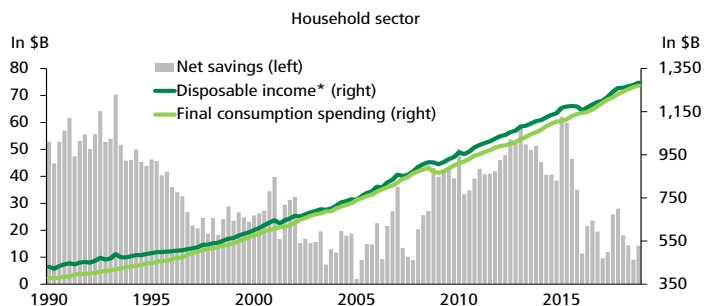


Sources: Statistics Canada and Desjardins, Economic Studies

**Less Wiggle Room**

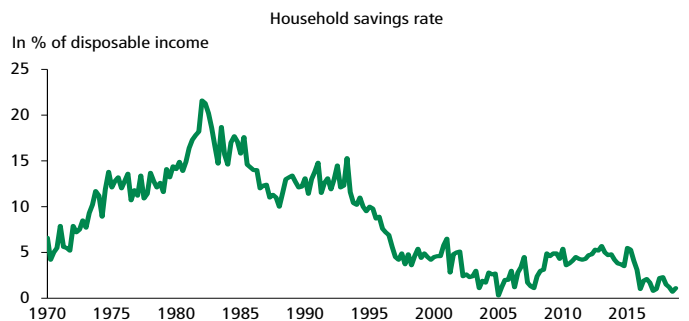
That said, some of the underlying fundamentals that influence changes in consumer spending have also been less favourable in the last few quarters. Household net saving—the difference between a household’s income and expenses—is lower (graph 6). This has greatly contributed to reducing the household savings rate, which stayed at a particularly low level in the fourth quarter of 2018, historically speaking (graph 7). The financial

**GRAPH 6**  
Household savings have declined in recent quarters



\* Including changes in pension rights.  
Sources: Statistics Canada and Desjardins, Economic Studies

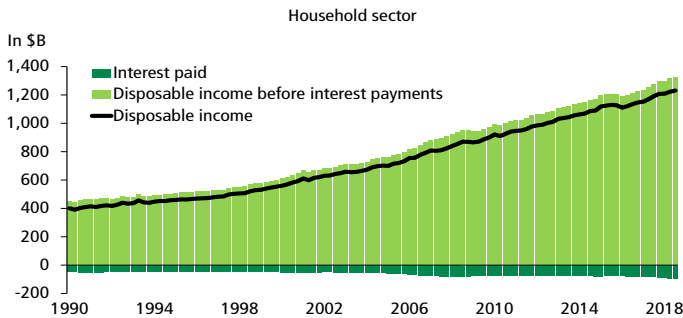
**GRAPH 7**  
The household savings rate is very low, historically speaking



Sources: Statistics Canada and Desjardins, Economic Studies

leeway in households seems to be fairly weak. This conclusion is obviously closely linked to the high debt levels in households, while the interest paid on their loans erodes a growing share of their income (graph 8). In such conditions, households are far more sensitive to interest rate hikes than in the past.

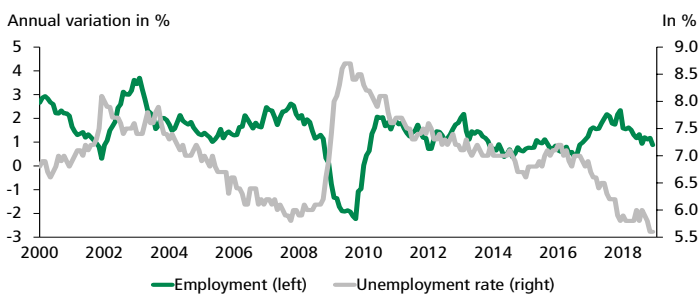
**GRAPH 8**  
Interest payments eating up a larger share of household income



Sources: Statistics Canada and Desjardins, Economic Studies

There is, however, every reason to believe that there is still room for consumer spending to keep rising in the coming quarters. The employment market remains strong, and job creation is still very solid (graph 9). Even though wage growth is still moderate, the rise in the number of workers should help lift the disposable income for all households. Assuming that previous increases in the target for the overnight rate will continue to be gradually incorporated into the average effective interest rate for household borrowing and that outstanding credit will continue to increase, albeit at a slightly slower pace, we can make predictions on changes in consumer spending using different scenarios for the savings rate.

**GRAPH 9**  
The labour market remains very strong



Sources: Statistics Canada and Desjardins, Economic Studies

Based on our assumptions, maintaining a savings rate at the current level (1.1%) would be consistent with average consumer spending growth of about 1.5% (annualized) in the coming quarters. This is almost consistent with the increase recorded since the beginning of 2018, or the status quo.

On the other hand, if we assume that households are dipping into their financial margins by pushing their savings rate to almost zero, this would help consumer spending grow at a rate of about 2%. But even if this more extreme scenario were to take place, consumer spending growth would still have a tough time reaching the same heights seen in recent few years.

In contrast, it goes without saying that if households increase their savings rate in the next few quarters, this will significantly curtail consumer spending growth. For example, a savings rate of about 2% at the end of 2019 would be consistent with virtually zero growth in consumer spending in the next few quarters.

The main observation in all three scenarios is crystal clear. Consumer spending growth will remain relatively modest in the quarters ahead.

**Consumer Spending Growth Set to Moderate**

Our baseline scenario uses a relatively stable savings rate for the next few quarters, which assumes that consumer spending will grow in line with disposable income. Under these conditions, consumer spending could maintain a growth rate between 1% and 2% in the next few quarters. Since household consumption spending accounts for nearly 60% of Canada’s total real GDP, this will have a significant impact on Canada’s economic growth, which should remain below 2% on average until the end of 2019.

That said, given households’ weak financial leeway, the risks associated with lower-than-expected consumer spending growth are high. The next few months will be decisive on this score. The Bank of Canada will have to be patient and not raise its key interest rates for an extended period. This long pause will help it better understand and note the real impact of higher interest rates on consumer spending. Should the restrictive effect of the previous rate hikes turn out to be greater than expected, the current pause could become the end of the monetary tightening cycle.

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