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Market Commentary

Can the Consumer Continue to Drive Growth?

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Can the Consumer Continue to Drive Growth?

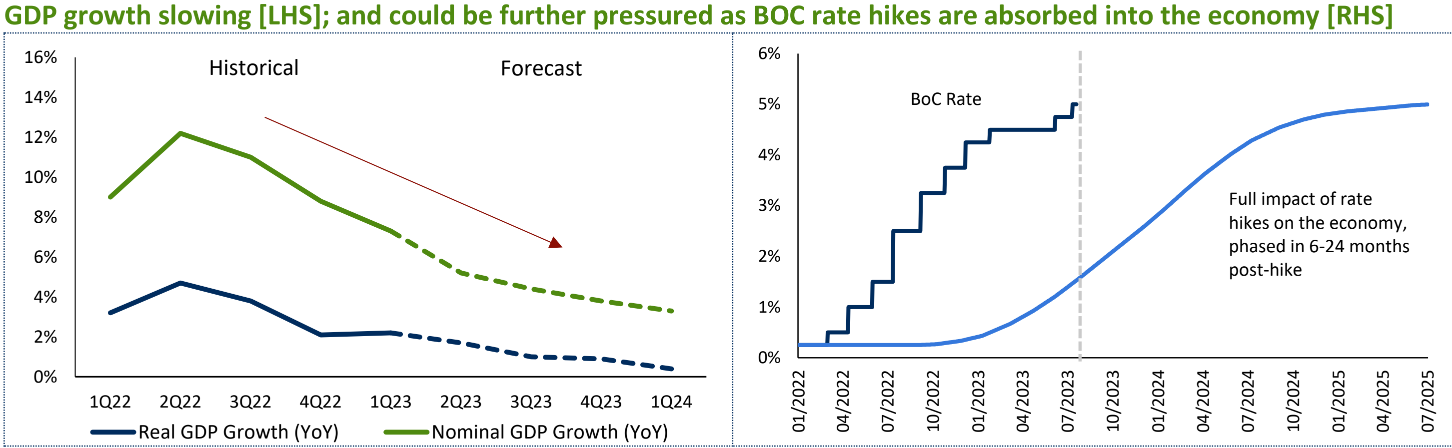
As we continue to debate if Canada, the U.S., and/or the rest of the world, is in, going in, or able to avoid recession, we would like to examine a key driver of economic growth: consumer spending. Household final consumption expenditure is a measure of spending on all goods and services by a country's citizens. In Canada, it represents ~56 per cent of the measure of gross domestic product (GDP), so has significant weight in recession determination, but also in how many companies will see their revenues, profits, and ultimately share prices be affected. What we really want to know here, is how much capacity does the consumer still have to support economic growth, as we consider previous pandemic-era fiscal stimulus efforts, against a global economy being slowed by generally tighter monetary policies.

How did we get here?

In order to protect Canadians and the economy from the negative impacts of the COVID pandemic, the federal government sent out $211 billion in aid to businesses and individuals. In addition, during the pandemic, lockdowns and other precautionary measures restricted spending on goods and services of approximately $180 billion. The Bank of Canada (BoC) estimated that Canadians had used some of these funds to pay down debts or do home improvements, but by the end of 2020, over $100 billion was still sitting in personal bank accounts than would otherwise have been expected. As pandemic restrictions eased this pent-up spending capacity was unleashed on an economy that was struggling to keep up with demand as goods supply chains were disrupted and many services had trouble find employees as workers had retired or shifted to other areas.

As we progress through 2H23, we see a generally acknowledged global economic slowdown. Locally, we have interest rate increases implemented to slow the economy to tackle inflation, specifically by bringing demand in balance with supply. While these efforts have been somewhat successful so far, still strong wage growth, with a tight labour market, low unemployment, and 'excess savings' left over from government aid programs have surprised many recession watchers, pushing forecasts of a decline in GDP first from late 2022 into 2023, and now into late 2023 and perhaps 2024. How much will consumers continue to spend as headwinds mount?

GDP growth slowing [LHS]; and could be further pressured as BOC rate hikes are absorbed into the economy [RHS]



Source: Capital Economics; Bank of Canada; Raymond James Ltd.; Date as of July 31, 2023.

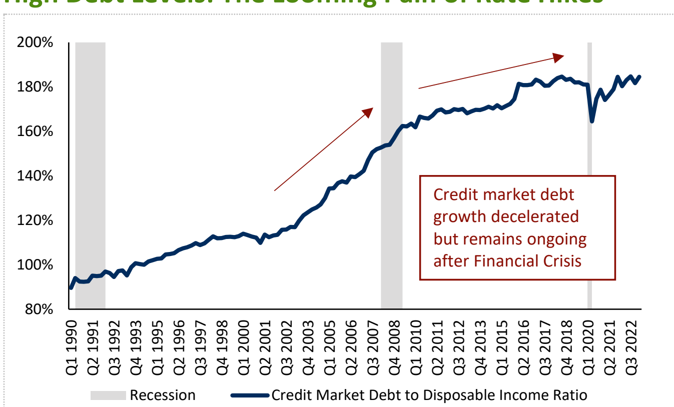
Headwinds are mounting

The BoC rate hikes continue to be absorbed by the economy, impacting a broader cross-section of the population and more of their spending decisions. As mortgages come up for renewals at higher rates, and as Canadians consider loans to replace things like cars or major appliances, the cost of borrowing can become a significant consideration. Additionally, inflation can factor into the cost of a vacation or even a night out, while consumers might also be evaluating the security of their employment. Fiscal stimulus measures may have somewhat muted these concerns, but as the impacts of the global economic slowdown start to become more apparent, and as interest rate increases and savings start to have more influence on spending patterns, we could start to see an impact on GDP figures.

Canadian consumers maintaining high debt levels

Canadians have generally been holding high levels of total debt (including loans and mortgages), representing 184 per cent of their annual disposable income. This is higher than the 137 per cent average in the U.S., although we have been fluctuating around this level since 2016. The difference now is that the cost of carrying this debt is becoming more painful as borrowing costs rise.

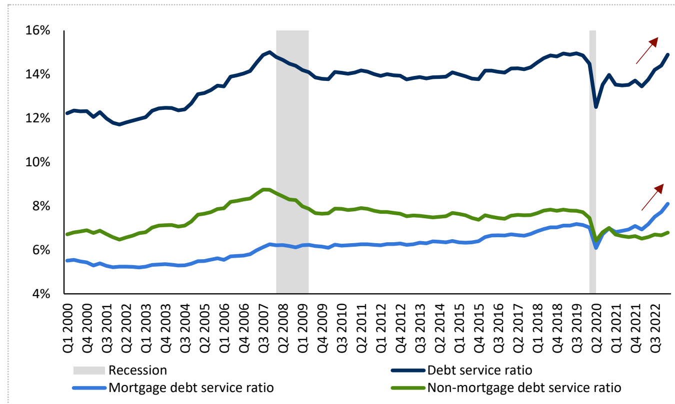
High Debt Levels: The Looming Pain of Rate Hikes



Source: Statistics Canada; Raymond James Ltd.; Data as of March 31, 2023.

As we pointed out already, government support payments and lack of spending opportunities through the pandemic resulted in consumer credit balances declining. This measure went from just over $600 billion in 4Q19 to as low as $560 billion in 2Q21. At the end of 1Q23 we were back up to $594 billion, but still below where we would otherwise have expected to be if the pandemic had not occurred. Overall, this has helped to keep non-mortgage debt service costs from increasing materially despite the increases in mortgage costs. If we consider that total debt service costs are now reaching previous highs, we could see more reluctance to take on more consumer debt for items such as vehicles, and we could expect more cautiousness in other discretionary spending habits.

Total Debt Servicing Rising for Canadians

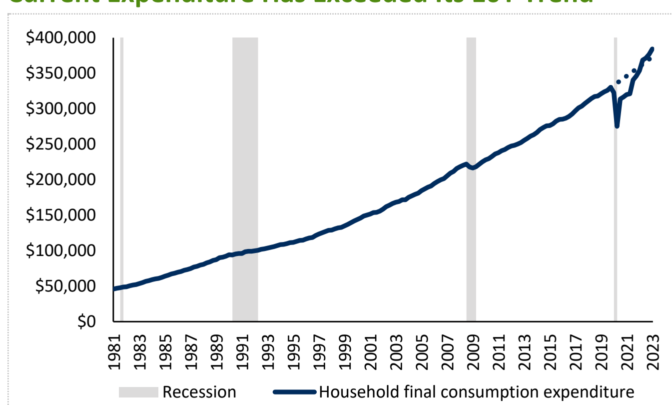


Source: Statistics Canada, Raymond James Ltd.; Data as of March 31, 2023.

We do also want to consider how household spending may have been thrown off by the pandemic. As such, we tracked the major components of household final consumption expenditure, which works into the GDP calculation, to see how each segment fared against expectations had the pandemic not occurred.

Over the 10-year period preceding the pandemic, we had consumption growing at an average annualized pace of ~3.8 per cent. As we can see in the following chart, that spending dropped dramatically at the onset of the pandemic but has now recovered back to expected spending levels.

Current Expenditure Has Exceeded Its 10Y Trend



Source: Statistics Canada; Raymond James Ltd.; Data as of March 31, 2023; in millions of CAD

What is of particular interest is if certain categories of spending over the past couple of years have grown at an excessive rate, we should expect them to come back down to more normalized rates. Similarly, other sectors recovered more slowly, such that we should expect relative strength out of certain sectors as behaviour normalizes.

Recovery of Expenditures Varies Across Different Categories

Expenditure Category	% Weight As of 03/2023	% Change (12/2019 vs. 06/2020)	Annualized % Change (06/2020 vs. 03/2023)	Compare to Pre-Covid Trend
Household final consumption expenditure	100.0%	-16.7%	12.9%	Dipped but then exceed the trend line
Food, beverage and accommodation	7.3%	-52.2%	38.6%	Dipped but then exceed the trend line
Clothing and footwear	3.9%	-43.6%	29.9%	Dipped but back to the trend line
Transport	14.7%	-43.2%	29.0%	Dipped but back to the trend line
Health	4.2%	-23.4%	15.2%	Dipped but back to the trend line
Recreation and culture	8.0%	-19.5%	15.2%	Dipped but then exceed the trend line
Miscellaneous goods and services	5.1%	-23.2%	15.1%	Dipped but back to the trend line
Furnishings and household equipment	5.5%	-6.1%	9.7%	Dipped but then exceed the trend line
Housing, water, electricity, gas and other	25.1%	1.0%	6.6%	Exceed the trend line
Education	1.7%	-2.3%	5.5%	Dipped but back to the trend line
Food and non-alcoholic beverages	9.6%	8.1%	4.9%	Exceed the trend line
Communications	2.5%	-1.6%	3.7%	Follow the trend line
Insurance and financial services	8.4%	0.4%	3.7%	Exceeded but back to the trend line
Alcoholic beverages, tobacco and cannabis	3.6%	5.1%	3.1%	Follow the trend line

Source: Statistics Canada; Raymond James Ltd.; Data as of March 31, 2023. Ranked by annualized percentage change (06/2020 vs. 03/2023), descending.

Using available data from Statistics Canada, we can see in the above table how significant of a pullback we saw through the beginning of the pandemic to mid-2020. In the almost three years since, we rank the annualized growth and how overall spending fares against the previous trend line. Of note, housing has increased as rental costs have climbed, food & beverage has been encountering inflation that is not only higher than that of other categories but also higher than its own previous level, and furnishings have exceeded the trend line but is seeing modest signs of slowdown, as is overall retail sales.

Watching for a slowdown

We are now starting to see growing signs that the long-awaited economic slowdown will occur through the end of 2023 and into 2024, as those previous rate hikes take hold on consumer behaviour. Looking at retail sales values in Canada, May numbers were relatively flat from April, up only 0.2 per cent, and volumes were only up 0.1 per cent. This was a downward revision from the preliminary estimate of 0.5 per cent. The preliminary estimate implies that retail sales values in June will be unchanged from May, although given that gasoline prices picked up over that time, we could be looking at retail sales volumes declining. Overall, we remain cautious as we watch the data come out.

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