Economics

IN FOCUS

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Savings grace: Is a higher savings rate protecting homeowners from upcoming mortgage renewals?

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While growth within the Canadian economy has been mediocre and rather boring in recent quarters, an interesting sub-plot within the GDP data has been the continued rise in the household savings rate. At 7.2% in Q2, up from 6.7% in the prior quarter, and well above the 2% average recorded in 2019, the elevated savings rate is being seen in some quarters as a sign that homeowners are putting money aside to help with upcoming mortgage renewals.

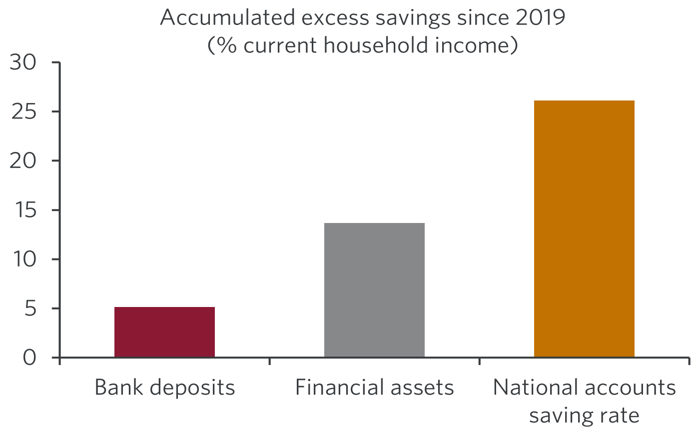
We have doubts about that narrative. The household savings rate within the quarterly GDP reports is far from a perfect gauge of excess liquidity, and alternative measures suggest a lower level of accumulated excess saving (Chart 1). Moreover, detailed breakdowns suggest that it is not the most vulnerable households (i.e. homeowners in BC and Ontario with large mortgages) that are driving most of the excess savings activity. Because of that the wall of mortgage renewals looming next year and in 2026 remains a downside risk to the economy, even as interest rates move lower.

Wide goalposts

The quarterly household savings rate is a very naive measure, as it is simply the gap between after tax income and consumption. This raises a number of complications in trying to judge how much households are actually saving.

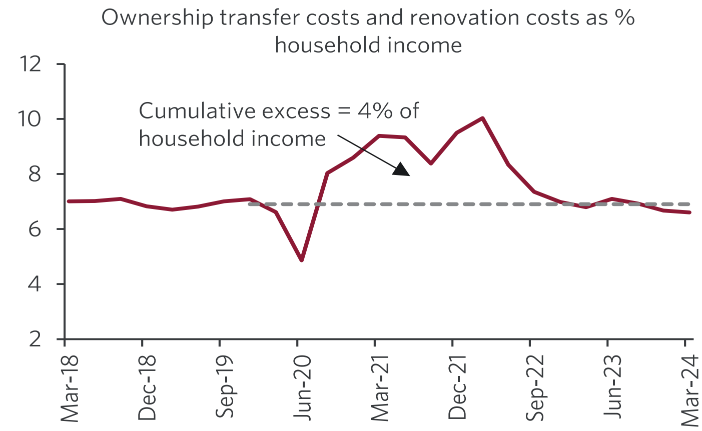
First is that consumer spending in the national accounts doesn't cover everything that households may spend their income on. During the pandemic, when many avenues of spending were closed, housing resale and renovation activity spiked. However, expenditures in these areas are classified under residential investment rather than consumer spending. While spending in these areas are now back to pre-pandemic norms as a percentage of personal income, and as such are not a cause of the current elevated savings rate (Chart 2), this is a reason to believe that the accumulated savings during the pandemic were not as large as the quarterly national accounts data would suggest.

Chart 1: Bank deposits suggest much smaller excess savings than national accounts data



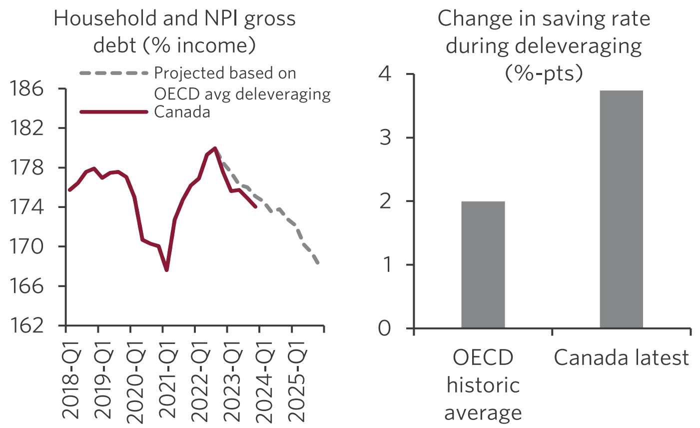
Source: Haver, Statistics Canada, CIBC

Chart 2: Households spent excess cash on housing during the pandemic



Source: Statistics Canada, CIBC

Chart 3: Rise in savings rate linked to declining debt-to-income



Source: OECD, CIBC

The quarterly household saving rate will also be influenced by how consumer spending is being funded i.e. whether it is actually through income earned or borrowing. During periods of rising debt, the household savings rate will generally be lower. In the current situation, where debt-to-income is declining, the savings rate will naturally look higher. So far the reduction in debt-to-income in Canada, and the rise in the savings rate, has gone beyond the average of what other OECD countries have seen during periods of deleveraging (Chart 3). This suggests a degree of excess savings, although our starting point for debt-to-income was also higher than the OECD average at the start of deleveraging periods.

However, a reduction in debt as a proportion of income doesn't necessarily mean that households are actively paying down debt. Rather it's typically a sign of reluctance to take on additional credit. This certainly appears to be the case currently in Canada, given that mortgage principal payments have fallen to their lowest level since 2012 as a proportion of income, despite overall mortgage debt being much higher (Chart 4).

This largely reflects the fact that households on variable rate, fixed payment, mortgages have seen a greater proportion of their payments diverted to interest rather than principal payments. While some households have raised monthly payments or made lump sum contributions as an offset, on average there is still a lower proportion of principal being paid down.

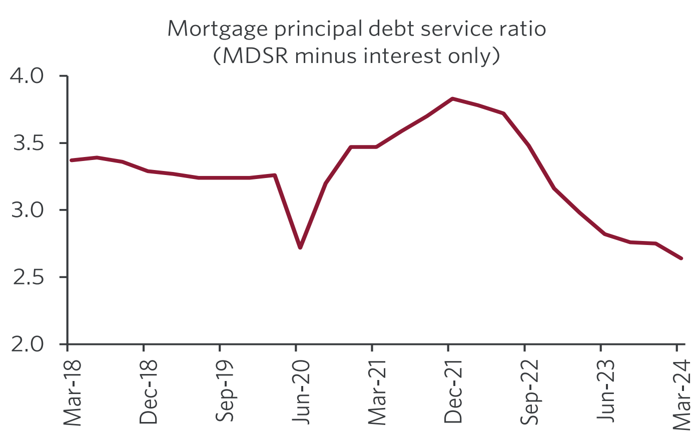
Another issue, related to whether spending is being driven by debt accumulation or not, is the way some durable goods are treated in the quarterly GDP figures. A car purchase, for example, will be added to consumption in the quarter that the transaction is finalised, even if the purchase is financed. In periods such as today where unit auto sales are low relative to their long-run trend, consumption appears weaker and the savings rate higher. Definitional issues related to how homeowner costs are imputed (through equivalent rents) and how capital gains are treated in income also influence the quarterly savings rate.

Because of the factors listed above and others, any attempt to calculate accumulated savings from the quarterly national accounts data should be done with caution. Bank deposit, or wider household financial asset data, may be a better way to view excess household saving. These data suggest that some excess liquidity does exist, but at between 5% and 13% of current household income it is much lower than the 25% suggested by the national accounts figures (see chart 1 again).

From how much to who

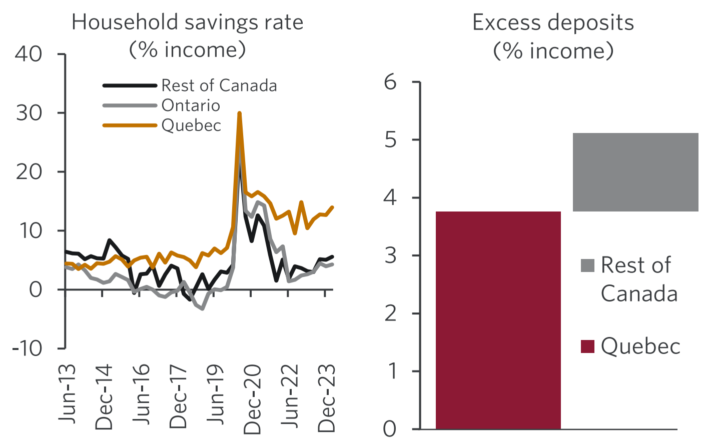
Whichever measure of excess savings you prefer, each suggests that the excess savings may not be held by those households most at risk from upcoming mortgage renewals. Geographically, the rise in the national savings rate (Chart 5, left) and excess bank deposits has been much more pronounced in Quebec than in the rest of the country. Indeed, of excess bank deposits, almost three-quarters is held in Quebec (Chart 5, right). Unfortunately, it was areas of the country where house prices were already most expensive (Ontario and BC) that saw the

Chart 4: Less income being diverted to mortgage principal payments



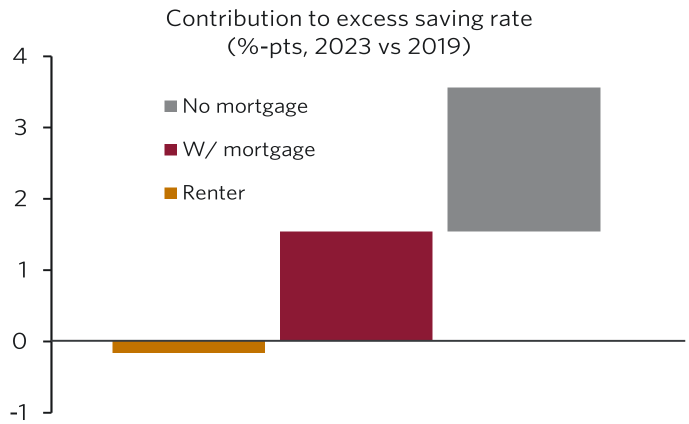
Source: Statistics Canada, CIBC

Chart 5: Quebec has been driving much of the excess savings



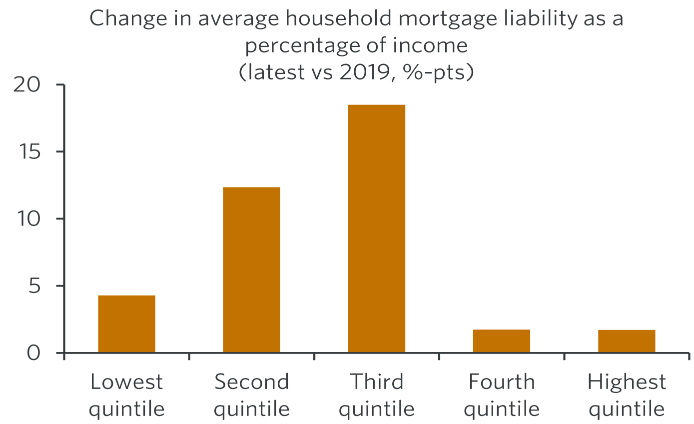
Source: Statistics Canada, Provincial governments, Haver, CIBC

Chart 6: Higher saving rate in 2023 mainly driven by homeowners with no mortgage



Source: Statistics Canada, CIBC

Chart 8: Middle income earners took on proportionately more mortgage debt during the pandemic



Source: Statistics Canada, CIBC

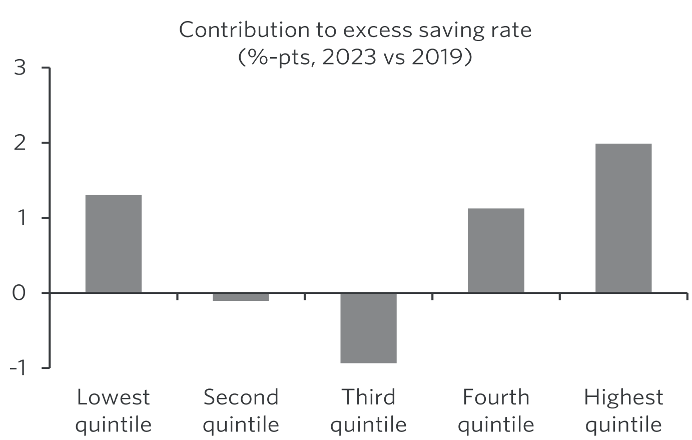
largest growth in mortgages during the pandemic, and it is those mortgages that will be up for renewal in the coming years.

Breakdowns of the national accounts savings rate by homeowner status and income groups also suggest potentially lower liquidity amongst the most vulnerable households. The latest available annual data are for 2023, and show that around 60% of the increased savings relative to 2019 was driven by homeowners without a mortgage — a group that accounts for around a quarter of the population (Chart 6).

By income group, the highest and lowest have driven most of the increase in the savings rate (Chart 7). The lowest quintile will include households more likely to be renters, or potentially retirees. Meanwhile, the highest quintile, despite having quite large mortgages on average, are unlikely to be those most stretched by payments relative to their income.

Interestingly, the savings of the second and third quintile were actually down relative to 2019, and it was households in these areas that took on proportionally more mortgage debt during the pandemic years (Chart 8) and who may need to make cutbacks to spending when their mortgages are renewed at higher rates.

Chart 7: Excess savings mainly driven by highest income earners



Source: Statistics Canada, CIBC

Savings grace?

The higher household savings rate seen post-pandemic appears to be no saving grace for homeowners with upcoming mortgage renewals. Not only may the true amount of excess savings in the economy be less than implied by this simple measure, but the distribution appears to be tilted towards the least vulnerable households.

There is a saving grace for the economy as a whole. As interest rates come down, those households that have been incentivized to save more and take on less debt may up their spending and help drive an acceleration in household consumption and residential investment. However, the wall of mortgages coming up for renewal next year and in 2026 remains a threat, and the Bank of Canada may have to take interest rates slightly below neutral to mitigate the risk at that time.

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