Economics

IN FOCUS

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Canadian consumer spending: A greater springboard ahead?

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The if, when, and by how much Canadian consumers will use excess savings to fund future spending is becoming an important topic once again for policymakers. Having assumed in its last projections that a relatively small proportion of excess savings would be spent, Governor Macklem last week admitted that a bigger flood of spending is an upside risk and could result in greater persistence of inflation.

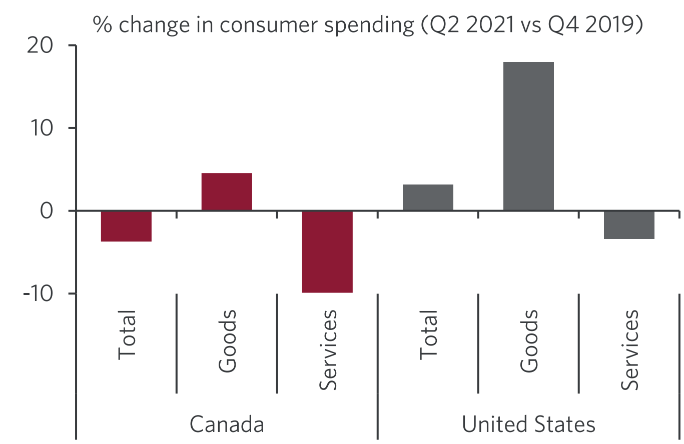
In just about everyone's forecast, Canadian consumer spending will be a big driver of growth next year and in 2023. But, as they say, size matters. Cautious spending behaviour to date relative to the US, even in areas not directly impacted by pandemic restrictions, combined with increased mortgage debt and potentially a desire not to return to the sparse savings seen pre-pandemic suggests that the recovery in consumer spending here will continue to lag that seen stateside.

Where Canada Has Lagged so far

Relative to the US, Canada has seen longer periods in which high touch indoor services — including bars, restaurants, theatres and other entertainment — were subject to shutdowns or capacity restrictions. And, with some of the larger Canadian provinces seeing third waves of the virus which kept public restrictions in place well into the spring, it is no surprise that real services spending had seen a much weaker rebound in Canada than the US as of Q2. However, the story goes beyond services, as goods consumption was also much less robust north of the border (Chart 1).

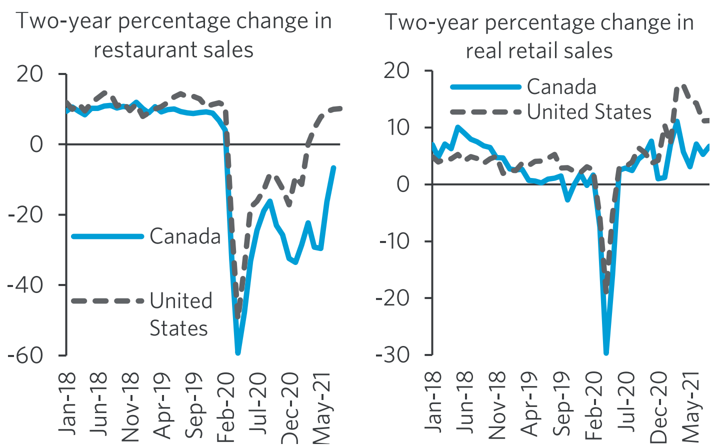
Canadian provinces had lightened up on services restrictions by the summer of 2021, and that has seen a catch-up acceleration in food services spending in Canada just as the US saw a plateau (Chart 2, left). However, Canadian restaurants were still lagging pre-pandemic sales. And, added to that, goods retailing still hasn't been as strong as it has been in the US, even as bricks-and-mortar retailers reopened (Chart 2, right). Indeed, the two-year growth rate for Canadian real retail sales isn't much stronger than its pre-pandemic average. In other words, there's less evidence of spending being directed away from services and towards goods in Canada as there is in the US.

Chart 1: Canadian real consumer spending lagging US in goods as well as services



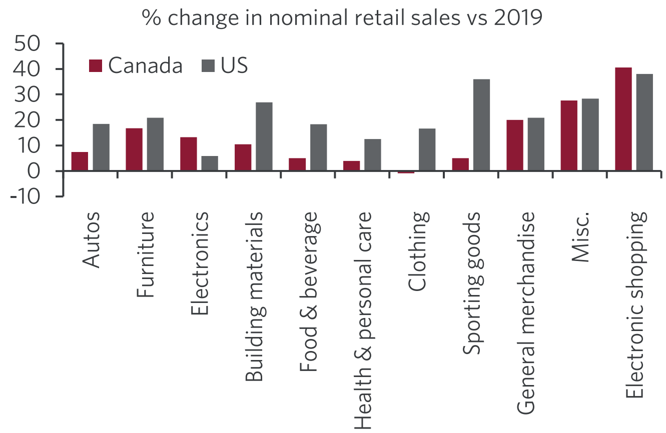
Source: Statistics Canada, BEA, CIBC

Chart 2: Fuller recovery for restaurants stateside (L); Canadian retail sales have continued to lag into Q3 (R);



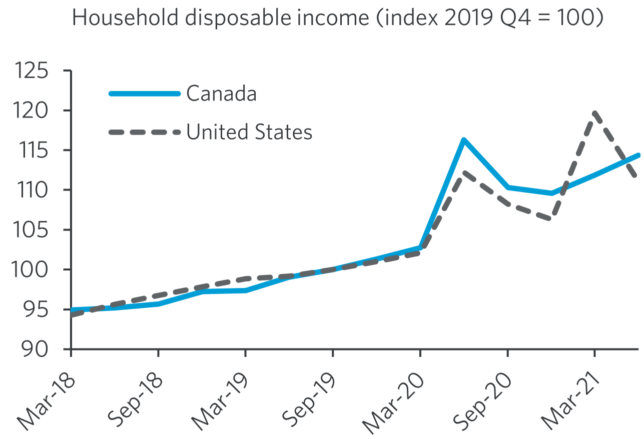
Source: Statistics Canada, BEA, CIBC

Chart 3: Most retail categories seeing a stronger recovery in the US than Canada



Source: Statistics Canada, CIBC

Chart 4: Household income growth well above pre-pandemic trend in both Canada and US



Source: Statistics Canada, BEA

It's true that public health restraints, and cautious behaviour in the face of the virus, likely explain some of the gap on the goods side too. Canadians have been less likely to return to full daily life, particularly relative to what we've seen in southern states in the US and those under Republican governments. Note that gasoline sales, for example, have shown firmer growth in the last two years in the US than in Canada.

Staying at home, and working from home, has reduced purchases in a number of goods categories, including clothing. Who in Canada needs a new suit these days? Continued capacity restrictions for malls and other retailers could also be cutting into discretionary spending, which is a key source of sales for clothing stores as well.

However, there are other categories of goods spending that are also lagging in Canada (Chart 3). Sporting goods sales could be the result of fewer opportunities for organized team sports, up until fairly recently, due to pandemic-related restrictions. But furniture and building material sales are a little harder to explain, given how strong residential investment has been north of the border.

A Springboard for 2022-23?

Does all of this self-denial position Canada for an outsized consumer spending spree in 2022/23?

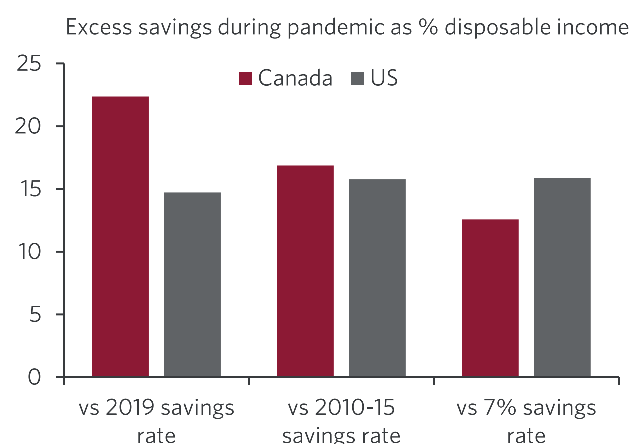
Certainly, consumers in both the US and Canada have plenty of firepower to drive economic growth in the next couple of years. While Canadians didn't get the broadly-based one-time payments from Ottawa that Americans reaped in both the Trump and Biden stimulus packages, they were the beneficiaries of unusually generous and lasting support payments for those who were unemployed or facing sharply reduced incomes. On average, Canada's smoother path for after-tax/benefit incomes was roughly in line with that seen stateside (Chart 4).

Since Canadians went on less of a spending spree as the economy recovered, the result is that Canada's savings rate, while at similar levels to that of the US, is further above its pre-pandemic trend. Therefore, excess savings, relative to the situation prior to the pandemic, are greater in Canada than in the US, suggesting more ammunition for spending (Chart 5).

That might be a misleading conclusion, however. The pre-pandemic savings rate in Canada was unusually low and we were already starting to see evidence of slowing consumer spending even before Covid-19 hit these shores. Judging the savings rate relative to where it stood earlier in the last cycle, or relative to something closer to the US rate, would result in "excess" savings being either similar in the two countries or even larger stateside.

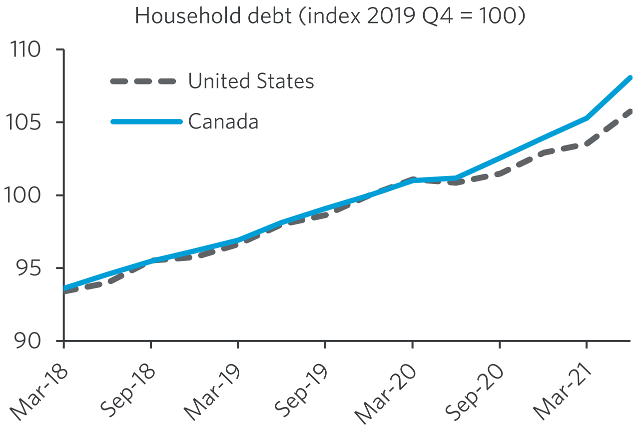
The impending end of pandemic era income supports, coupled with an expected rise in interest rates over the next couple of years, could also explain some of the apparent caution in consumer spending. Indeed, five-year mortgage rates are already creeping higher in Canada, to be joined by variable rate debt when the Bank of Canada begins hiking in Q4 next year.

Chart 5: Level of excess savings in Canada vs US depends on judgement of where savings rate should be



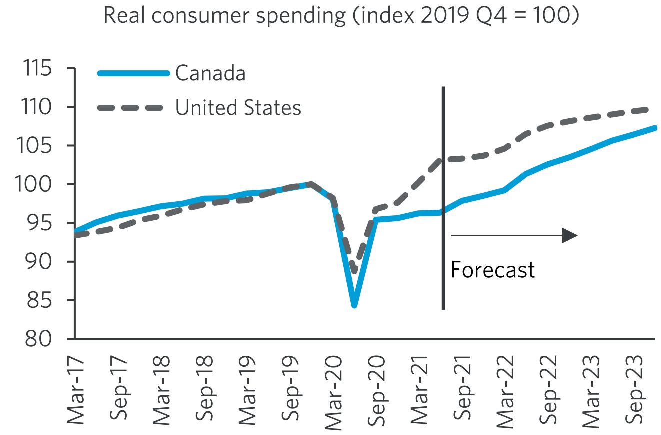
Source: Statistics Canada, BEA, CIBC

Chart 6: Canadian household debt accumulation has accelerated during pandemic, unlike US



Source: Haver, CIBC

Chart 7: Canadian consumer spending to close gap, but not catch-up, with US



Source: BEA, Statistics Canada, CIBC

Canadian household debt was already higher relative to incomes than the same ratio in the US before the pandemic hit. And a strong real estate market has meant that debt has seen a steeper climb in Canada during the pandemic (Chart 6). As we frequently point out, unlike what's true in the US, mortgage debt, which is the majority of what's on the books, is not locked into a fix rate for decades, but is typically reset every one to five years.

So while our forecast looks for healthy growth contributions from consumers in both the US and Canada in 2022/23, we're not ascribing much more of a lift in the latter due to its lagging performance since the pandemic hit. While the gap in consumer spending will have narrowed somewhat in the second half of this year, as Canadian services spending returned and US goods consumption has waned, we expect that the recovery in Canadian household spending will continue to lag that seen in the US (Chart 7). In turn, that doesn't support the current market view that the Bank of Canada can outgun the Fed on rate hikes, and count on greater room to run for consumers to make up the difference.

But Canada's future consumption growth could present a more balanced picture than what we will see stateside. In the US, growth will be more heavily tilted to services and non-durables, as Americans have gone on an orgy of goods consumption that will cut into the room for further gains. The exception will be in autos where this year's sales were hampered by the lack of supply. In Canada, there might be a bit more room for goods retailers to share in the improvement, particularly in items like clothing and sporting goods where pandemic era behaviour and restraints on shopping mall visits have limited demand.

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