Economics

IN FOCUS

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Household credit quality — what's in the pipeline

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The Bank of Canada is in the 9th inning of its easing trajectory, and the policy rate is still higher than it has been over the past decade and a half, aside from during the post-pandemic tightening cycle. Ditto for the long-end of the curve. The mortgage refinancing payment shock will reach its zenith in 2026 in terms of the share of borrowers facing payment shock of more than 40% — all in an environment of an elevated jobless rate. Should we worry?

Insolvencies — stabilizing

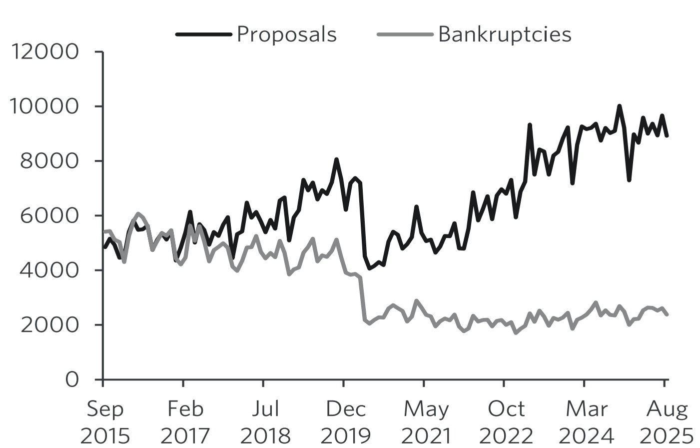
So far insolvencies statistics haven't shown much stress. Yes, the insolvency rate is notably higher than the historically low level seen in 2020, but it's currently stabilizing at a pre-covid rate, and hardly rising on a year-over-year basis. The relative stability in the insolvency trajectory has been masking a significant substitution between rising proposals and falling bankruptcies (Chart 1) — a trend that has been in place for several years. This is a positive development since the legal cost and the losses per proposal are lower for lenders than in bankruptcies, while the recovery rate is much higher.

Beyond insolvencies

Now, the insolvency rate might tell us about the past but it's silent about the future. For that we need to monitor what's in the pipeline in a search for early signs of vulnerability

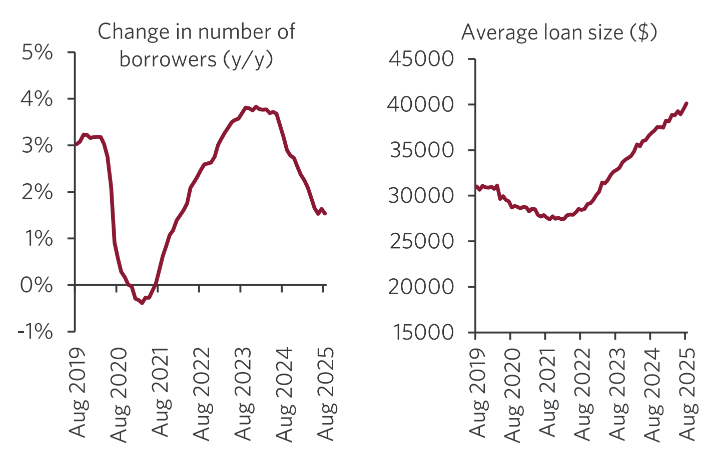
Granted, household credit is no longer rising at the nose-bleeding pace seen during covid, but at around 4% y/y, it is more or less where it was pre-covid. That pace of growth is less due to increased number of borrowers and more due to an increase in the average loan size (Chart 2). While the number of borrowers is currently 12% higher than it was in 2019, the average loan size has risen by 27% since then and by a whopping 46% since early 2022.

Chart 1: Proposals and bankruptcies diverging



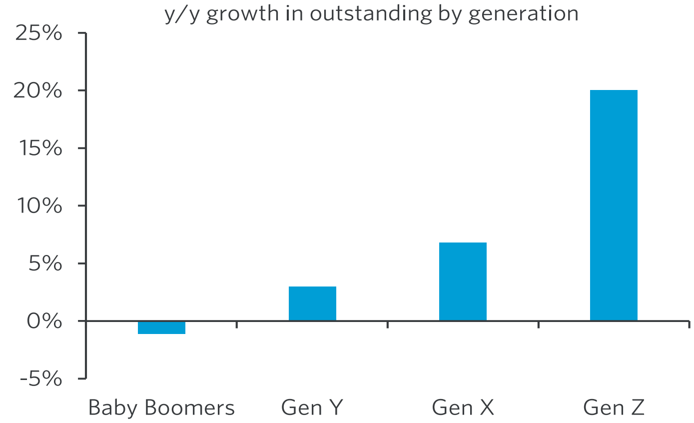
Source: Statistics Canada, CIBC

Chart 2: Credit growth largely due to increase in average loan size



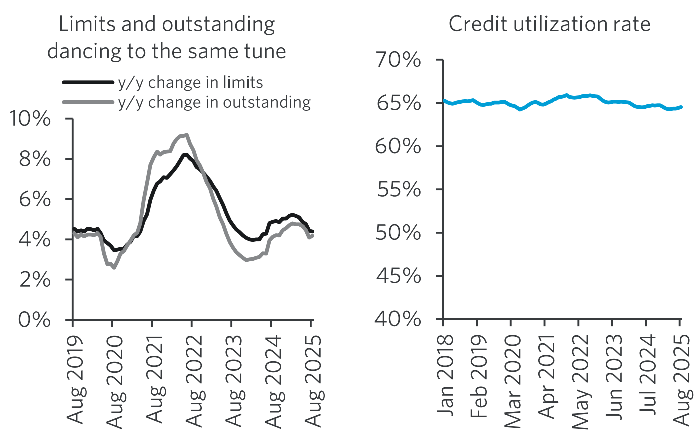
Source: Trans Union, CIBC

Chart 3: Credit growth: Gen Z leads the way



Source: Trans Union, CIBC

Chart 4: Credit utilization: stable



Source: Trans Union, CIBC

Chart 3 makes a lot of sense — the older you are the lower your credit demand is.

In fact, credit growth among baby boomers is now in negative territory. Note the rapid growth in credit demand among Gen Z. this portfolio however accounts for only 6% of total outstanding and again, more than half of that increase is due to a larger average loan size.

Furthermore, despite the slowing economy and a weakening labour market, there is no sign of a notable change in credit supply, with limits largely dancing to the tune of outstanding, keeping the credit utilization rate remarkably stable at 65% (Chart 4).

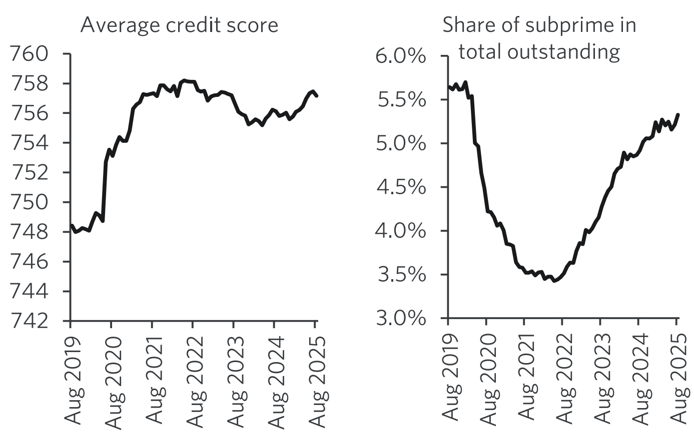
Zooming in on the aggregate risk profile of borrowers, things continue to look reasonably ok. The average credit score was able to sustain the gain it made during covid, and it is now notably higher than the level seen in 2019 (Chart 5 left). While the share of sub-prime borrowers has risen recently, it is still at a level consistent with a well balanced credit market (Chart 5 right), although we still need to look at how those loans are actually performing.

Digging deeper

So far so good. But risk is at its usual place — at the margins. So we have to dig deeper. Charts 6 illustrates an interesting development. While recent quarters have seen a surge in the 30-60 day delinquency rate (Chart 6 left), that trend did not carry into the 60-90 days bucket with pre-emptive actions by lenders preventing further bleeding (Chart 6 right). This is very different than the situation pre financial crises, when the correlation between the 30-60 days and 60-90 days buckets was much higher.

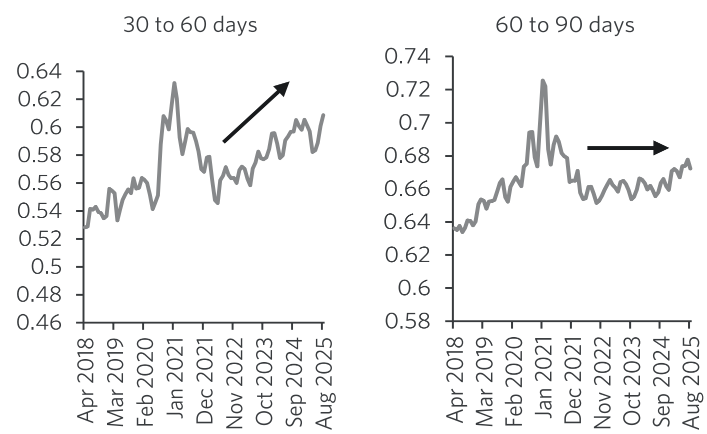
While that's the case for the portfolio as a whole, it's usually not the case for subprime borrowers where the 30+ day delinquency rate is still a good indicator of the future default rate. Zooming in on the margin of the margin (30+ day

Chart 5: Average credit score still elevated (L) subprime share back to 2019 level (R)



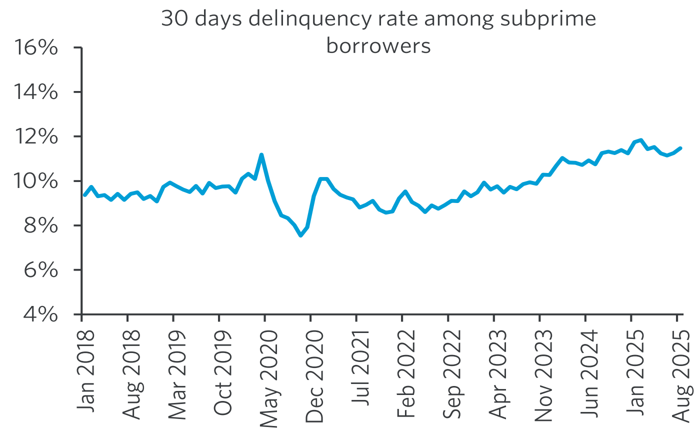
Source: Trans Union, CIBC

Chart 6: Delinquencies moving from...



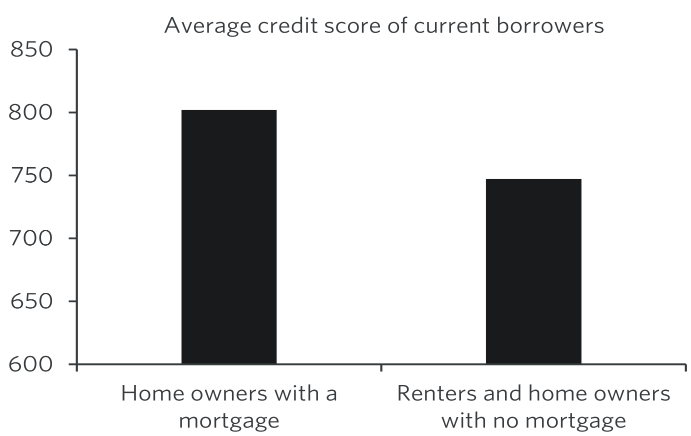
Source: Trans Union, CIBC

Chart 7: Margin of the margin



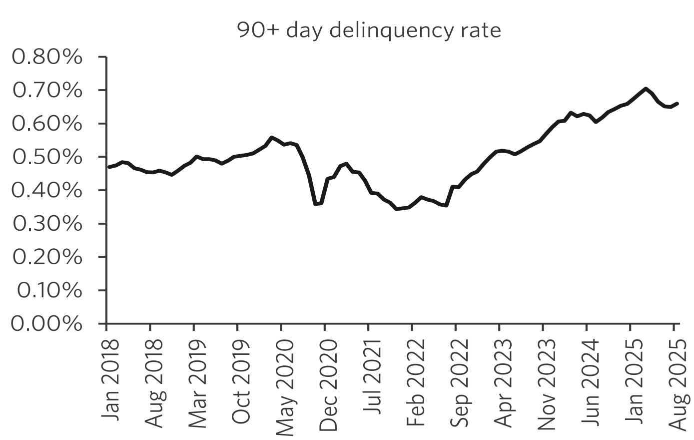
Source: Trans Union, CIBC

Chart 8: Average credit score



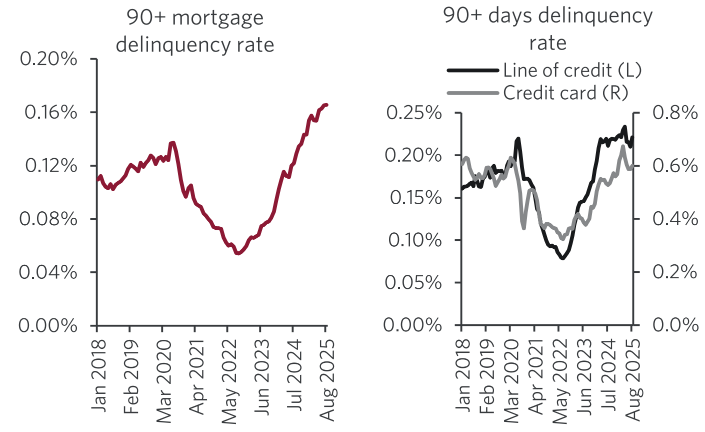
Source: Trans Union, CIBC

Chart 9: Delinquency rate among non-mortgage holders above 2019 level



Source: Trans Union, CIBC

Chart 10: Delinquency rate among homeowners with a mortgage



Source: Trans Union, CIBC

delinquency rate among subprime borrowers) reveals some signs of distress (Chart 7) with that rate standing at 11.5% — notably higher than pre-covid levels.

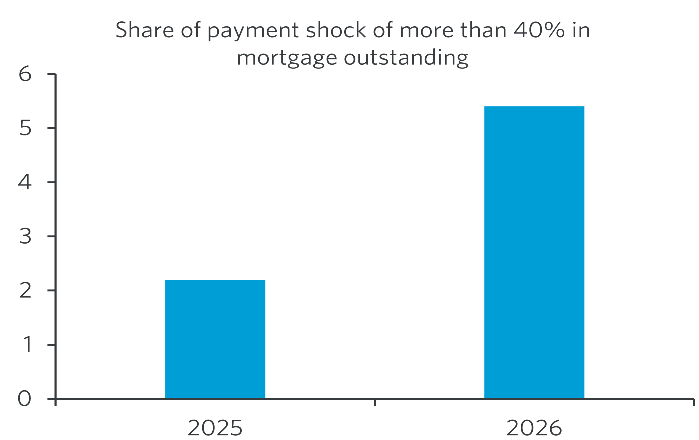
Another metric to focus on is the debt payment behaver of borrowers with a mortgage and those without a mortgage.

The debt pool of borrowers with no mortgage is dominated by renters. Not surprisingly, their average credit score is notably lower than that of borrowers with a mortgage where 75% are above prime credit rating (Chart 8).

Zooming in first on none-mortgage borrowers (Chart 9), the trend is clear. After reaching a cyclical low in late 2022, the 90+ day delinquency rate of that portfolio has been trending upward and it's now a full 0.2% higher than it was pre-covid. Given where we are in the economic cycle, we doubt that that rate will start trending downward any time soon. In fact, the opposite is the case.

Turning to the mortgage portfolio, the 90+ day delinquency rate has risen notably since its covid period trough to reach

Chart 11: Mortgage payment shock



Source: CIBC

a level that is marginally higher than seen in 2019 (Chart 10 left). We believe that most of that increase in arrears was due to economic reasons such as job-loss as opposed to payment shocks, given that the vast majority of the increase in mortgage arrears this year accrued well after borrowers adjusted their payments.

Chart 10 right can be seen as a leading indicator of future change in mortgage arrears given that most mortgage borrowers facing difficulties will first stop payments on other credit vehicles such as credit cards and more so lines of credit. And the message here is that some pressure on mortgage delinquencies is likely to persist and in fact, might intensify, mostly in the second half of 2026 when we expect the share of borrowers facing payment shocks of more than 40% to reach 5%-6% of the mortgage portfolio — more than double the share seen in 2025 (Chart 11).

Adding it all up, household credit quality indicators do not look too alarming at the moment. Yes, insolvencies are rising but from an extremely low base, and are still within the range seen in 2019. But a closer look at the margins suggests that the current trend is not your friend. Early-stage delinquencies in the below-prime space are on the rise and are already well-above 2019 levels. Renters are clearly feeling the impact of a slowing labour market with delinquency rates in both the credit card and lines of credit portfolios comfortably above the 2019 level. Non-mortgage debt held by homeowners with mortgages is showing early signs of stress — mainly in the line of credit portfolio. This does not bode well for the mortgage portfolio, mainly in the second half of 2026 when we expect the impact of mortgage refinancing payment shocks to be much more visible.

So the upward trajectory in delinquency rates is likely to continue in the coming quarters. However, our assessment that we are already very close to peak unemployment for the current cycle, along with a reasonable starting point and increased pre-emptive activity by lenders suggests that future credit losses should be consistent or even better than what might be priced in by the market.

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