

# CONSUMER QUARTERLY

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## Trends Update

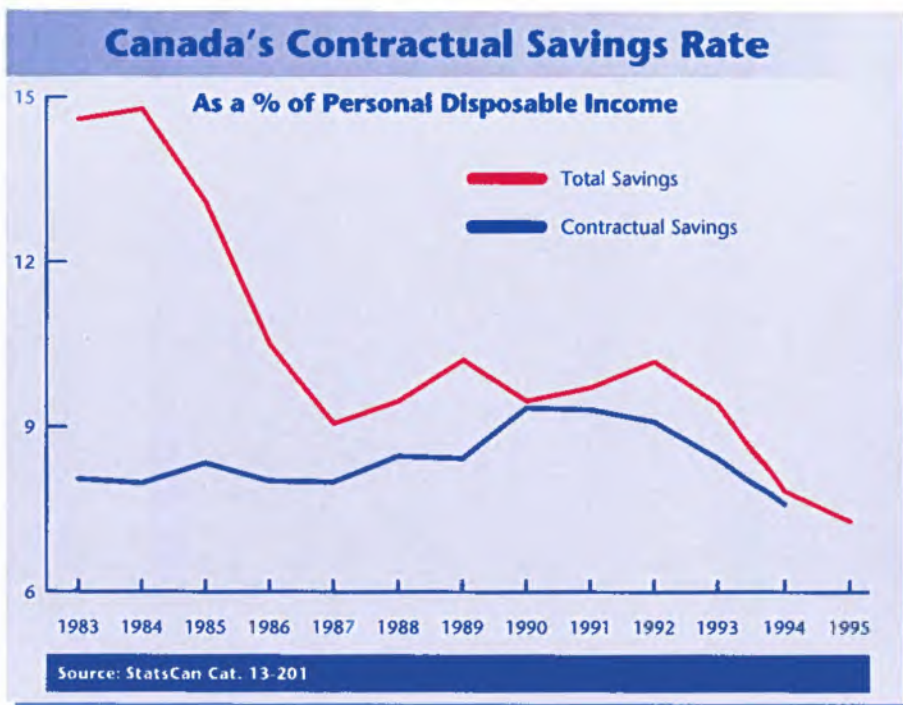
### IN THIS EDITION

- an update on consumer trends
- a special feature on consumer bankruptcy
- an experiment in providing bank services to welfare recipients
- evidence that Canadians are financing consumption with their mortgages

**W**hile real net worth per capita continues to rise and individual Canadians and unincorporated businesses (the personal sector) remain net suppliers of funds to the economy, many middle-class consumers are experiencing hard economic times. Our Trends Update reviews economic indicators of these times.

### Economic Growth and Consumer Expenditures

Canada's Gross Domestic Product expanded by 0.51% from the second to the third quarter of 1995 with consumer spending contributing 0.36% to total growth. Lower interest rates were an important factor supporting consumer demand, but so also was a sharp increase in personal sector borrowing. The sum of consumer credit, bank and other loans rose at an annualized rate of \$8.2 billion in the third quarter compared to \$4.9 billion in the second quarter and \$7.3 billion in all of 1994. Survey evidence suggests that a growing, although still small, part of this debt is in the form of unpaid credit card balances.



The increase in borrowing is evidence that, for many, consumption is being constrained by stagnant incomes. The reason for this is that a relatively large proportion of personal savings is not discretionary, but rather is contractual; these funds are mostly contributions to life insurance and pension plans, or are principal payments on mortgages.

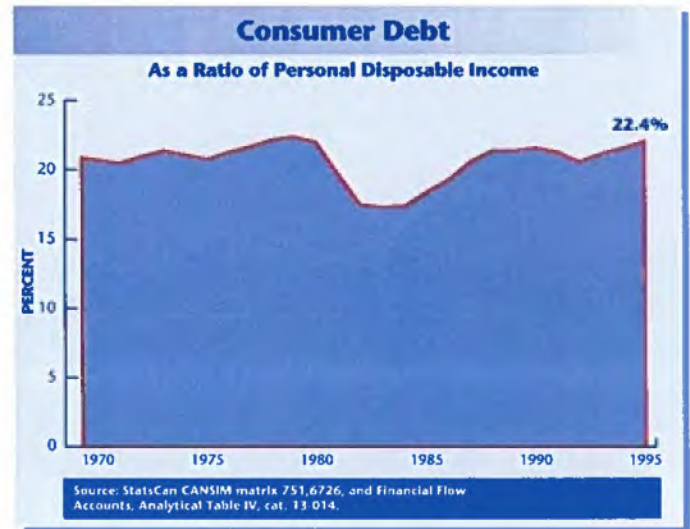
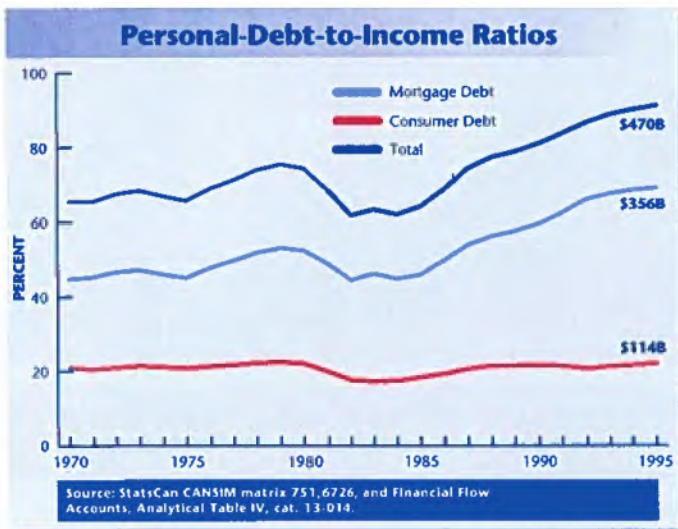
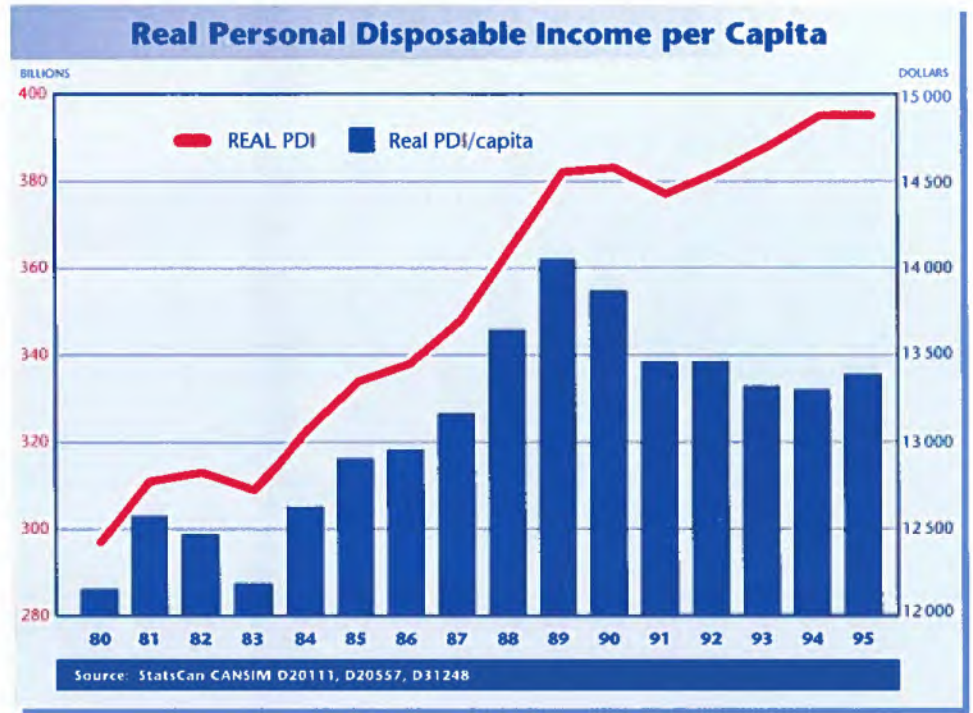
Since the contractual savings rate has been about 8% for more than a decade (see chart), there is no room left for additional discretionary savings or for increased consumption out of current income. In the third quarter of 1995, the personal savings rate dropped to 6.3% from 7.5%.

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Real disposable income per capita fell sharply in 1991 and again in 1993. The 1995 level remained below that of 1992, based on figures for the first three quarters of the year. Aggregate real disposable income slipped 0.7% in the third quarter following a 0.2% fall in the second quarter.

Rising mortgage debt has been the principal cause of higher personal-debt-to-income ratios. For the one third of Canadian households with mortgages, paying interest charges may be a serious problem if they are faced with falling incomes and higher interest rates.

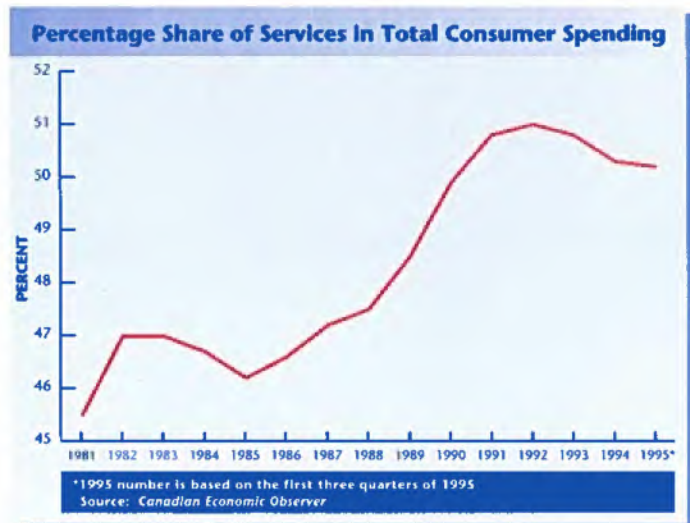
While the ratio of consumer debt to personal income has averaged 21.6% over the last two decades, it has slowly been rising since 1993, reaching 22.4% in the third quarter of 1995 and paralleling the 1980 record.



## Service Sector Growth Stalls

Analysts often talk of the service economy and how consumers are spending more on services. Yet, as the chart at right shows, the services share of consumer expenditures peaked at 51% in 1992 and since then has shown a declining trend. The share of consumer spending on services as a proportion of total consumer spending was unchanged in the third quarter from the second quarter of 1995.

Research also shows that consumer spending on services is linked to the level of real income. Thus when real incomes per capita decline, the proportion of consumer spending on services falls, as many consumers retreat to buying just the basics.



# Personal Bankruptcy Rates at Record Levels

Consumer insolvencies for 1995 had reached 54 184 by October, a new record. These failures make up more than 82% of all insolvencies, a departure from the pattern prior to 1972 when business insolvencies outnumbered those of individual consumers. In fact, the consumer bankruptcy rate (per capita) has doubled since 1984, reflecting the increase in indebtedness among Canadians.

From January to October, consumer bankruptcies were up about 20% over the same period in 1994. We estimate that for each month of 1995 consumer bankruptcies represented a deficiency (assets minus liabilities) of about \$135 million, totalling about \$1.6 billion for the year. Furthermore, the rate is expected to continue to rise due to flat household incomes and rising debt levels, making individuals more susceptible to an interruption in income or an increase in interest rates.

In 1992, the *Bankruptcy Act* was amended to become the *Bankruptcy and Insolvency Act* (BIA).

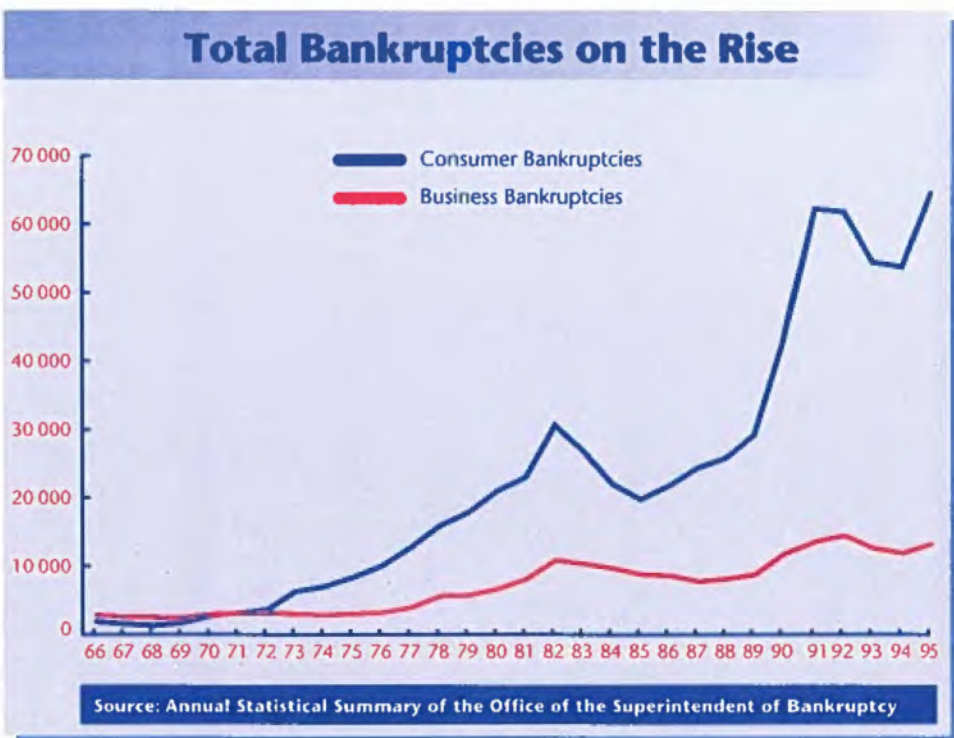
With these changes, the legislation, rather than being centred on liquidation, now encourages reorganization and rehabilitation. These amendments provide individuals filing for insolvency with an alternative to the straight liquidation of assets. Since 1992, more than

1,800 consumers per year have opted to make "proposals" to their creditors. Almost 70% of these are underway and have received both creditor and court approval.

The legislative changes included the requirement to assess the BIA's performance in three years (by 1995). Following extensive stakeholder consultations, further legislative refinements were proposed in December 1994. The majority of these recommendations form the basis

of Bill C-109, which was tabled in November 1995.

Coupled with the 1992 reform, this series of amendments is intended to promote fairness in Canada's insolvency law. An additional benefit is that debtors would be encouraged to take greater responsibility for the repayment of their debts when feasible, and to opt for a proposal.



## Bill C-109's changes to the *Bankruptcy and Insolvency Act* would do the following:

- maintain income-support benefits for families, such as the GST refundable credit, by exempting them from seizure
- grant priority status for spousal and child support payments — previously, spouses were not considered creditors
- make non-dischargeable the penalties that result from judgements for sexual and physical assault charges
- increase control of student bankruptcies that are filed to avoid repaying student loans
- require individuals to remit to the bankruptcy estate a portion of their "surplus income" that is deemed to exceed a minimum cost of living
- allow spouses to make a joint consumer proposal
- permit counselling for persons related to the debtor.

# Questioning Common Beliefs

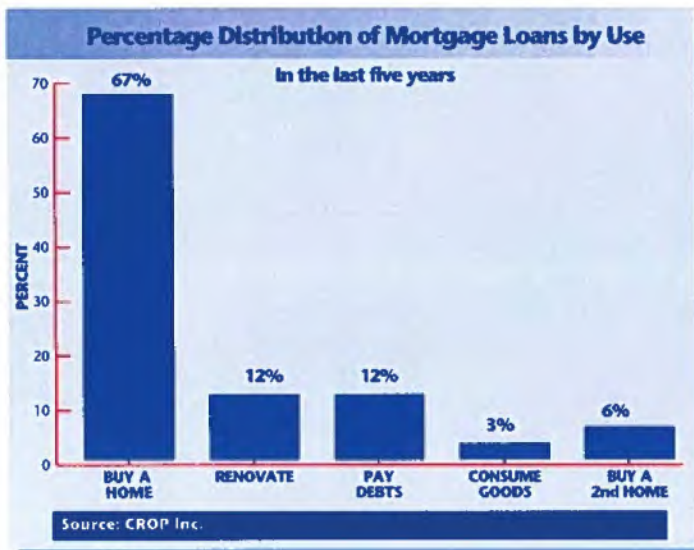
## Mortgages to Support Consumption?

Throughout the 1990-1992 recession, Canadian consumers' debt levels, as compared to their income, grew, which is an unusual occurrence during a recession. The principal causes of the increase were steady expansion of mortgage debt and declining incomes. This raises the question, "To what extent are individuals borrowing on their mortgages to finance current consumption, and/or to consolidate their debt?"

Lacking official statistics and following a fruitless telephone survey of the big six commercial banks, which hold close to 55% of all residential mortgages, we put this question on the 1995 CROP omnibus survey of consumers.

CROP found that close to one third of survey respondents took out a mortgage between 1990 and 1994. Surprisingly, 15% of that group used their mortgages to consolidate personal debts and to finance current expenditures during the period (see chart below).

If confirmed, these results, along with rock-bottom savings rates, paint a picture of highly constrained consumers with a significant proportion resorting to using the equity in their homes to finance current consumption.



## Bank Challenges Welfare Stereotype

Are welfare recipients more likely than others to commit bank fraud? A recent pilot project conducted by the Van Horne-Victoria branch of the Bank of Nova Scotia in Montreal suggests that they are not. The branch issued automatic teller cards to 100 recipients of social assistance and provided them with a bank account. The card could only be used with the one account, and the study participants could only withdraw funds by waiting for one day for their assistance cheques to clear. After more than three months, no fraud was detected among the 100 trial accounts. Subsequently,

the size of the test group was increased to 265 accounts and again no fraud was detected. The bank has recently increased the number of these accounts by another 100. The result: the branch's customer base has increased by some 500 new accounts and another stereotype has been successfully challenged.

## Knowing Credit Card Interest Costs

Officials from the Office of Consumer Affairs (OCA) met with the Standing Committee on Industry in December to report on developments since its 1992 inquiry on credit card costs. The committee requested the meeting following proposals by Liberal MP Paul DeVillers in a private member's bill to cap credit card interest rates and service charges. OCA officials reported several developments to the committee:

- Cost disclosure by card issuers has been much improved. Further improvements would occur from current efforts to harmonize federal and provincial credit disclosure laws.
- Two factors suggest a competitive Canadian credit card market: the number and variety of new cards launched and the relatively small spread between VISA and MasterCard rates.
- Credit card debt represents a growing segment of consumer credit, but the high debt-to-income ratio (up from 60% to 90% in 10 years) is mainly due to mortgages.

OCA will continue its work on the causes and structure of consumer debt.

John Godfrey, the Industry Committee Chair, announced that he would propose to the Canadian Bankers Association that December statements to card holders should show the total amount of interest that they had paid on their credit cards over the course of the year. Consumers would then have more complete information on their credit card interest costs.

## Suggestions and requests

for additional information about the *Consumer Quarterly* may be sent to Bernard A. Keating, Senior Economist, Office of Consumer Affairs, Industry Canada Ottawa K1A 0H5

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