5 Reasons Why Canada Is in Serious Trouble

Description

Earlier this year, **Deutsche Bank's** chief international economist Torsten Sløk circulated a presentation that painted a fairly dire portrait of the Canadian economy. The presentation shows that debt levels are hitting record levels and sky-high home prices are cooling off, increasing pressures on the Canadian financial system and labour markets.

Let's take a look at the five most important headwinds facing the Canadian economy today.

1. Canadian household debt is higher than ever

In the early 1990s both U.S. and Canadian households started to take on an ever-increasing amount of debt. Starting at roughly 80% in 1990, household debt increased to 125% of household income in both countries by 2009. After the financial crisis, however, U.S. household debt to income decreased dramatically to its current level of 100%. Canadian household debt continues to increase dramatically to today's nosebleed level of 150%. With the U.S. economy still reeling from its massive deleveraging cycle, Canada's economy has the potential to be even worse.

2. Multiple forms of debt are hitting all-time highs

Since 2000 almost every form of consumer debt has rapidly outgrown the rise in incomes. The outstanding debt for personal lines of credit are up 800% since the turn of the century. Mortgage debt is up 400% and credit card loans are up 500%. Disposable income, meanwhile, has grown less than 200%.

3. The mortgage credit market is slowing down

Banks have been giving out less and less credit for mortgages since the American credit crisis hit in 2009. Unfortunately, this rate has trickled even lower. While total outstanding mortgage credit was growing at an annual 7% rate from 2010 to 2012, that rate has dipped to a 14-year low of only 5%. As mentioned earlier, household debt is at all-time highs. A slowing mortgage credit market may indicate that housing prices won't rise as quickly in the future due to lower demand. If consumer's houses don't grow in value quickly enough to cover rapidly rising debt levels, there could be major trouble. And, as we'll see in the next section, housing values could actually begin to fall.

4. Home prices are significantly overvalued

Not only are Canadian's taking out excessive amounts of leverage to buy homes and other items, but the value of their main asset may be ready to fall. Deutsche Bank estimates that home prices across Canada are roughly 63% overvalued. This is greater than the 50% overvalued levels found in Australia and Norway.

5. If housing stumbles, the Canadian economy crumbles

A massive 7% of all Canadian workers are employed in the housing sector. This is nearly twice the rate of the U.S. This means that any trouble in the Canadian housing market could bleed over into the larger economy fairly easily. Canada's biggest real estate market (Toronto) is nearing a five-year low. If this is any indication for what could happen in other parts of the country, the rate of employment could be headed for a tumble.

Reassess your portfolio's risk

While the market might not roll over this year, there are numerous factors that could make a slowdown hurt across all sectors of the economy. Some stocks have a greater exposure to the Canadian housing market than others.

Similar to what happened during the U.S. credit crisis, the first companies to feel the pain will likely be the major banks. These include **Royal Bank of Canada** (TSX:RY)(NYSE:RY), **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD), **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS), **Bank of Montreal** (TSX:BMO)(NYSE:BMO) and **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM).

While many will point to their long dividend-payment history as a sign of stability, none of Canada's major banks have previously faced such a dire and systemic situation. As an investor, it's important to double-check your direct exposure to the Canadian economy, especially those that derive a majority of their revenues domestically. Aside from investments, it may be time to make sure your own personal financial situation is in proper condition should the overall economy hit a snag.

CATEGORY

1. Bank Stocks

TICKERS GLOBAL

1. NYSE:BMO (Bank of Montreal)
2. NYSE:BNS (The Bank of Nova Scotia)
3. NYSE:CM (Canadian Imperial Bank of Commerce)
4. NYSE:RY (Royal Bank of Canada)
5. NYSE:TD (The Toronto-Dominion Bank)
6. TSX:BMO (Bank Of Montreal)
7. TSX:BNS (Bank Of Nova Scotia)
8. TSX:CM (Canadian Imperial Bank of Commerce)
9. TSX:RY (Royal Bank of Canada)

10. TSX:TD (The Toronto-Dominion Bank)

Category

1. Bank Stocks

Date
2025/08/27
Date Created
2015/06/17
Author
rvanzo