

## How Canadian Consumers & Businesses Are Managing Debt Challenges

On the eve of the Bank of Canada's decision, a key consideration entails monitoring the impact of rising borrowing costs upon indebted consumers and also businesses. Below is some perspective on the recent evidence that indicates that households and the Canadian financial system are thus far successfully managing the challenges and demonstrating the flexibility of the Canadian marketplace. In addition, continued job growth at the break-neck pace of late could make concerns about credit quality challenges arguably moot.

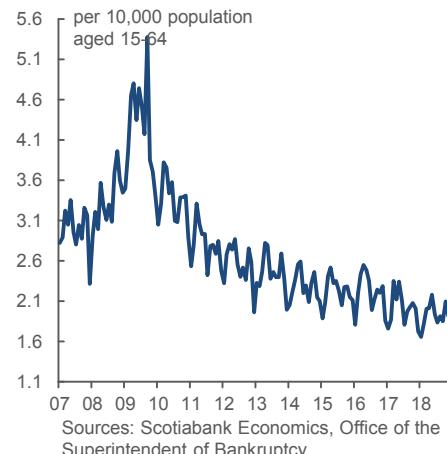
- Insolvencies are made up of both actual bankruptcies and proposals for restructuring that may or may not turn into bankruptcies. Charting their total can be exceptionally misleading as they can be driven by very different considerations.
- Breaking them apart indicates that consumer bankruptcies remain very well behaved. As the first accompanying chart demonstrates, they've never been lower than they've trended around over the recent past.
- The second accompanying chart shows that consumer proposals have increased. Recall that a proposal is "an offer to creditors to settle debts under conditions other than the existing terms." Indeed, proposals have been rising for years while bankruptcies have not. Recall that a rise in proposals was expected post OSFI's B20 stress testing changes as renewals would be more difficult in the tails of indebtedness. It is misleading to attribute the rise in proposals as just a function of higher rates. It is also misleading to infer that a rise in proposals equates to a rise in outright bankruptcies.
- Indeed, I would also contend that what we are seeing here is a reflection of one of the great relative strengths of the Canadian banking system versus, say, the US system. Proposals are worked out through a willingness to restructure payments and debt without necessarily forcing the client into bankruptcy and seizing uncertain net asset values minus related costs. One extreme example of the difference is that strategic defaults generally don't exist in Canada; walking away with impunity is generally not an option, versus working out one's obligations in a mutually satisfactory way. This is not a new phenomenon. It has been rising for years. It can be an attractive way of working out challenges on both sides of the borrower-lender relationship. For instance, lowered payments can be accompanied by longer amortizations or more efficient debt pooling to the mutual advantage of borrower and lender especially relative to the alternative US system that proved to be utterly incapable of flexibly addressing challenges.
- The third accompanying chart demonstrates how business bankruptcies are also very well behaved toward cycle lows, but this fact tends not to make headlines. Business *proposals* have increased over the latest month, but we're talking one month here and against a long-term declining trend. There have been plenty of single month jumps in the past along an extremely volatile path so it would be prudent to monitor the trend over possible noise.

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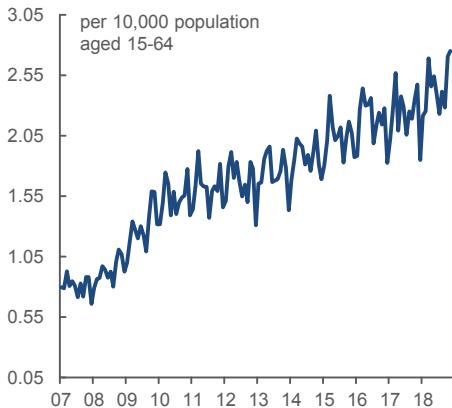
Chart 1

Consumer Bankruptcies



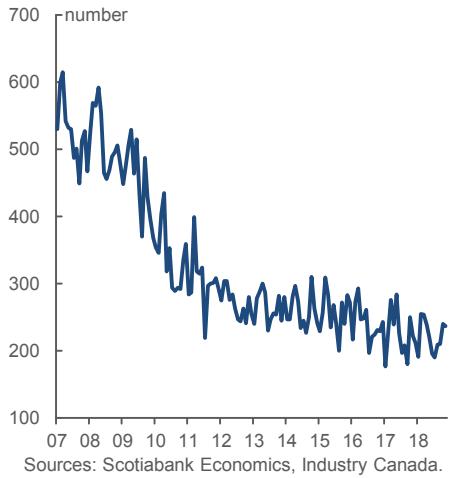
Sources: Scotiabank Economics, Office of the Superintendent of Bankruptcy.

Chart 2

**Consumer Proposals**


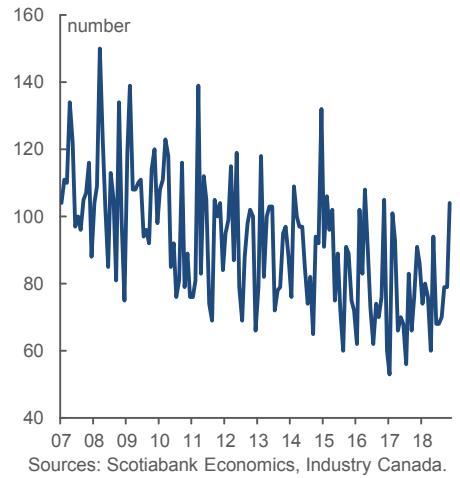
Sources: Scotiabank Economics, Office of the Superintendent of Bankruptcy.

Chart 3

**Business Bankruptcies**


Sources: Scotiabank Economics, Industry Canada.

Chart 4

**Business Insolvency Proposals**


Sources: Scotiabank Economics, Industry Canada.

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