

Getting Squeezed

The Impact of Rising Prices for Housing and Energy, Interest Rates and Costs on Canadian Consumers and Businesses

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Canadian
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Commerce

Chambre de
Commerce
du Canada



Business
Data Lab

Laboratoire de données
sur les entreprises

Contents

Overview and Key Findings **3**

Trends in Inflation, Interest Rates,
Housing and Energy Prices **5**

Key Economic Mechanisms **17**

Impact on Consumers **19**

Impact on Businesses **25**

Looking Ahead **33**



Research Questions

This report investigates the impact of rising housing and energy prices on consumers, businesses and Canada's economy.

We address the following questions:

- How have recent increases in housing and energy costs affected consumer spending?
- Are there notable differences in the impact on consumer spending across regions?
- Are these trends systematically related to business sales and sentiment across regions?



Key Findings

Long-run price dynamics

- Over the past two decades, we find that housing and energy costs have increased at a faster rate than overall prices in all regions of the country.

Consumer impact and the affordability crisis

- With these longer-run trends, amplified by the pandemic, Canadians now face an affordability crisis, featuring the highest housing costs relative to income in over 30 years, and the second most unaffordable housing market among the OECD countries.
- There are notable differences in the impact of price pressures on consumer spending across regions. Specifically, we find that consumers in more unaffordable housing markets (such as Ontario and British Columbia) have pulled back more on their spending.
- Carbon emissions regulations are contributing to the cost of living in Canada and may increase household expenses by \$2,087 in 2030 for gasoline and natural gas consumption.

Business costs and sales challenges

- Businesses are also quite concerned about broad-based cost pressures. Small businesses in particular are struggling with fuel and energy costs, wages as well as taxes and regulations. The rapid rise in interest rates has added borrowing costs as a growing concern.
- We trace the follow-on impact of restrained consumer spending and increased costs on businesses. We find that business optimism has faded, suggesting real GDP growth in Canada is likely to fall further.
- Much like consumers, we find that businesses operating in regions with more unaffordable housing markets have a weaker outlook for their near-term sales, and are also less optimistic about the outlook for their businesses over the next year.

Looking ahead

- Going forward, several factors may exacerbate the squeeze on consumer spending, including an upcoming wave of mortgage renewals at higher interest rates, rising carbon emission costs, clean fuel and electricity regulations, and electric vehicle mandates.

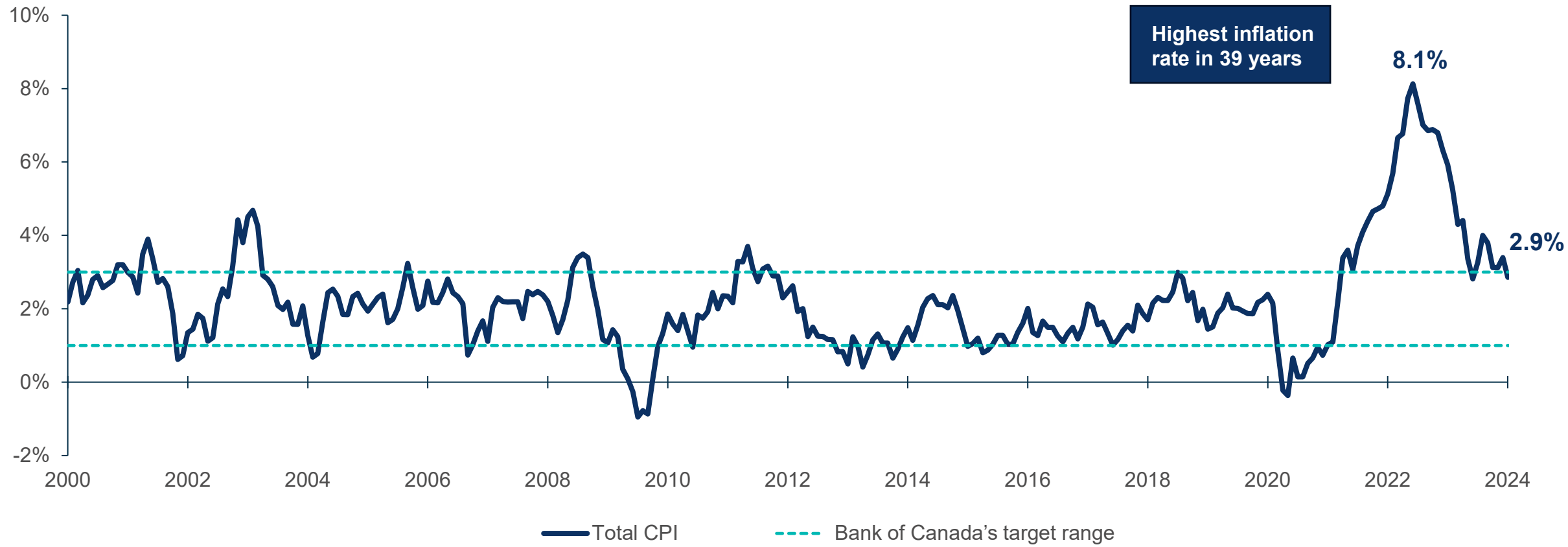


Trends in Inflation, Interest Rates, Housing and Energy Prices



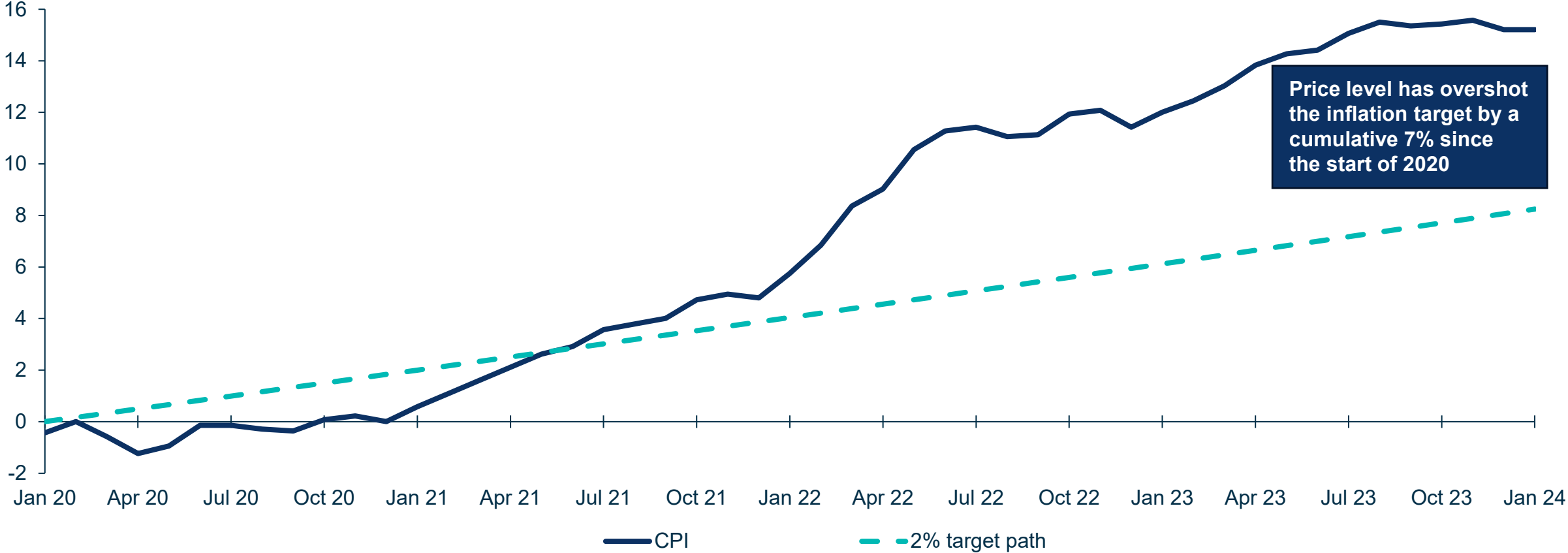
In the wake of the pandemic, inflation spiked at over 8%; it has since slowed due to higher interest rates and a weakening economy, entering target range.

Canadian consumer price index (CPI)
% change, year-over-year



As a result of overshooting inflation, consumer prices are now 7% higher than if inflation had grown at target since the start of the pandemic.

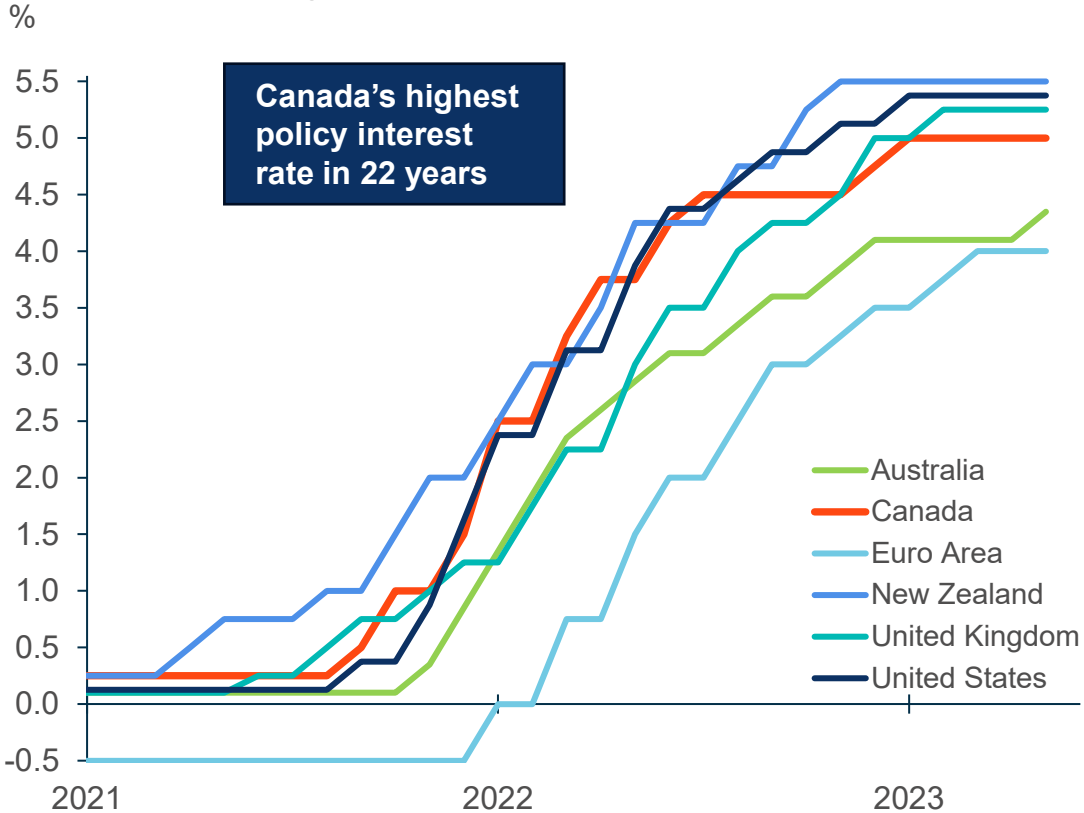
Canadian consumer price index (CPI)
% change in the level of the CPI versus February 2020



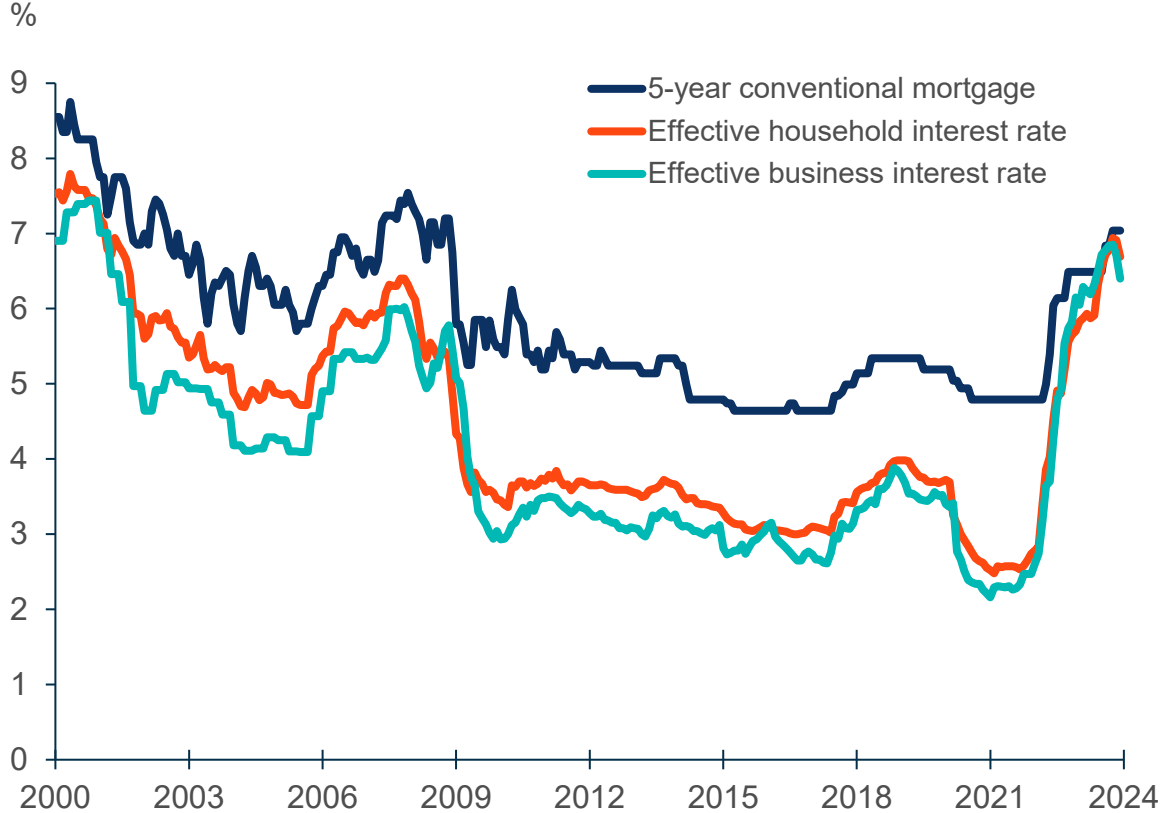
Source: Statistics Canada

In the last few years, central banks across the developed world aggressively raised interest rates to control inflation. This has rapidly increased borrowing costs for consumers, mortgage holders and businesses.

Central bank policy rates



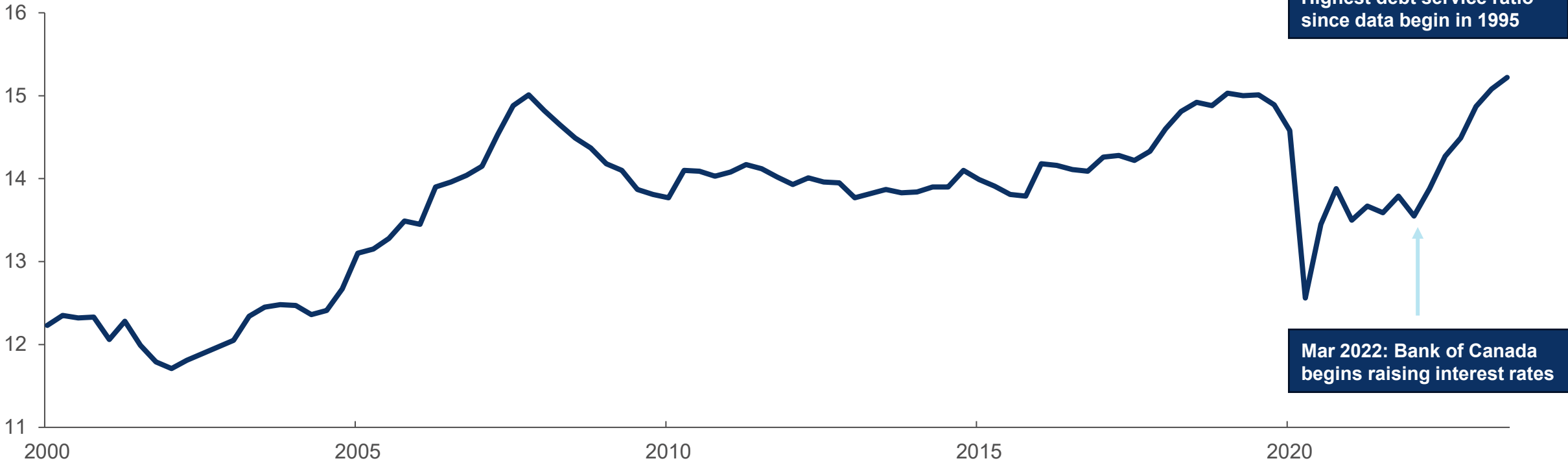
Various interest rates, Canada



Canadian households are paying more for outstanding debt, worsened by higher interest rates and an overheated housing market.

Canadian debt service ratio

%, share of debt payments relative to disposable income



Highest debt service ratio since data begin in 1995

Mar 2022: Bank of Canada begins raising interest rates

Since the start of the Bank of Canada's hiking cycle began in March 2022, mortgage interest payments have increased 90%. Homeowners are now renewing at much higher interest rates, driving up their debt service costs. Higher financial obligations means less money to spend on other necessities or more generally in the economy.



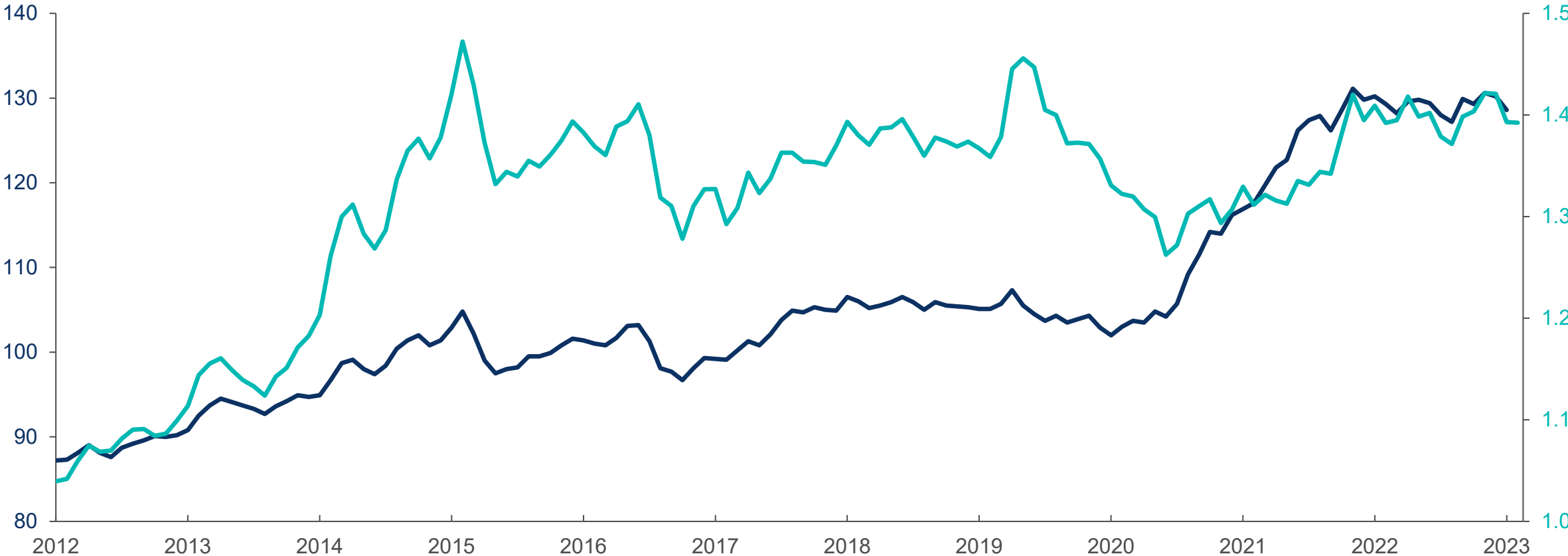
Note: Debt service ratio is total obligated payments of principal and interest on credit market debt as a proportion of household disposable income.

Sources: Haver Analytics, Business Data Lab analysis using Canadian Real Estate Association data.

The Canadian dollar has depreciated relative to the U.S. dollar since 2021. Higher global commodity prices have contributed to elevated import prices for Canadian businesses.

Import price index
Index, 2017 = 100

U.S. dollar exchange rate
CAD/USD

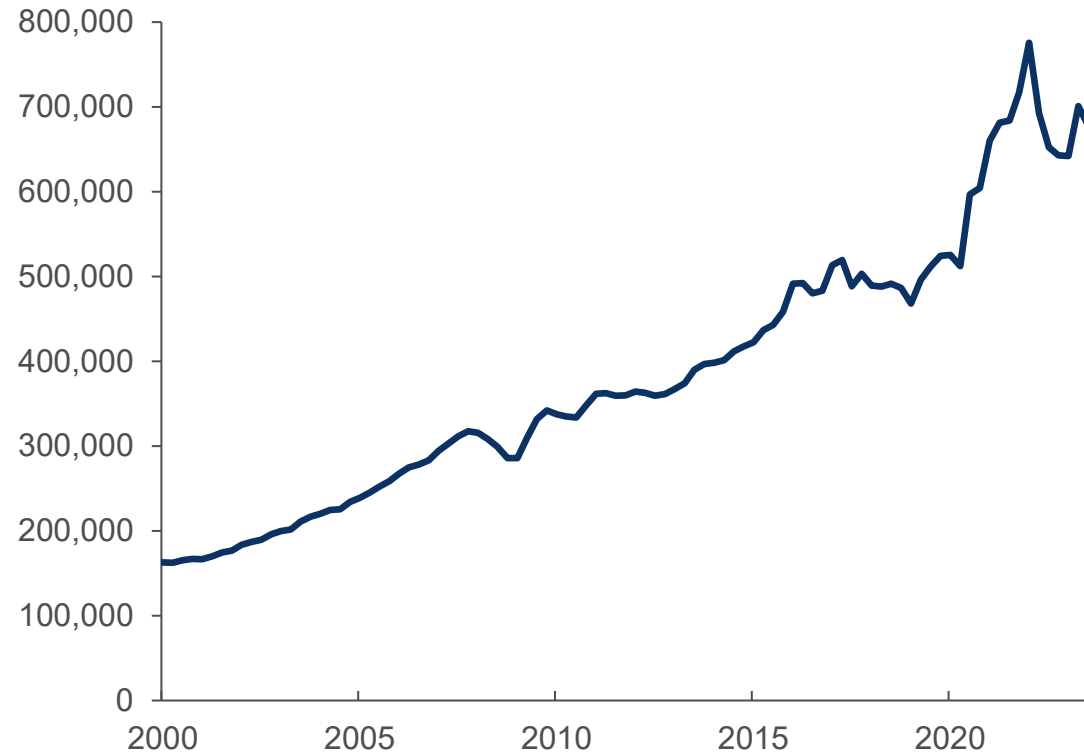


Source: Haver Analytics

Canada is suffering from a housing affordability crisis.

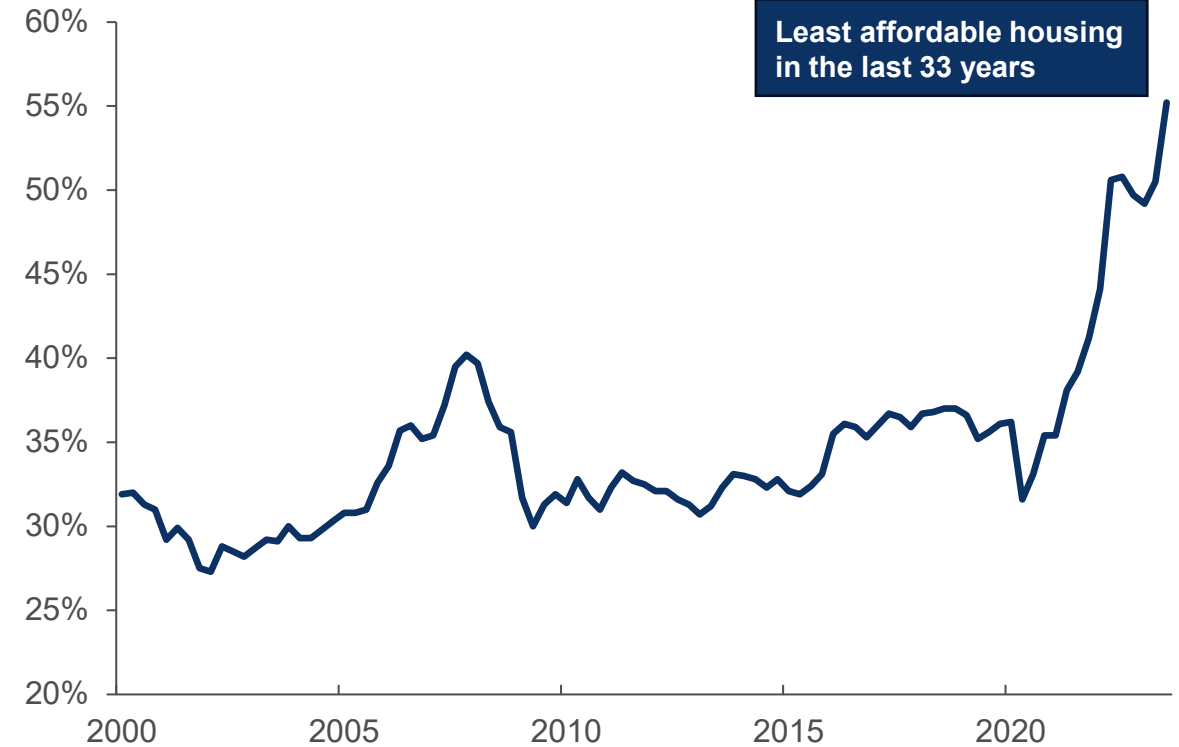
Canadian housing prices

Weighted average residential resale prices, current dollars



Canadian housing affordability*

% of average household disposable income for housing-related expenses



The rapid shift to remote work in the pandemic significantly increased demand for single-family homes, particularly in suburban areas farther from the downtowns of the largest cities. With constrained housing supply, coupled with increased immigration, the result has been much higher housing prices.



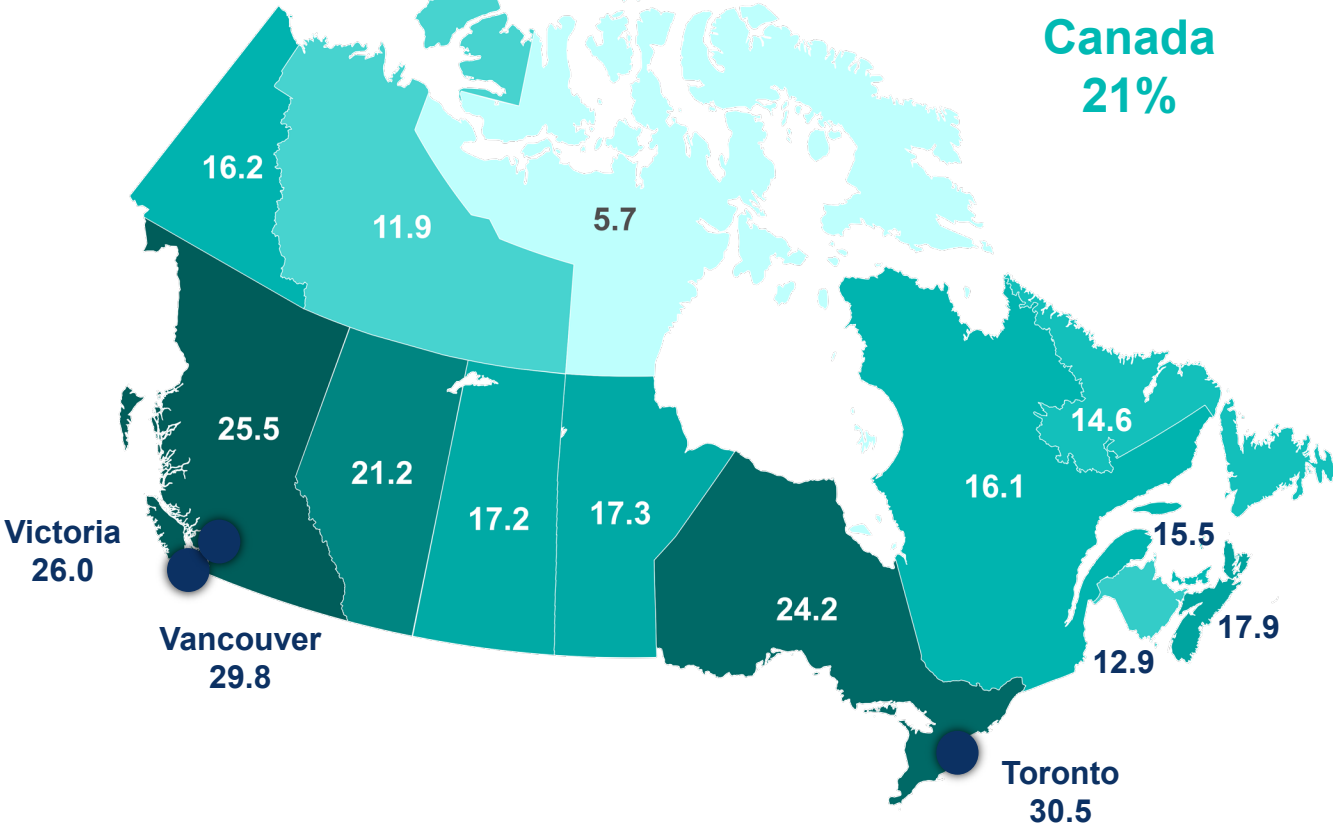
*Housing-related costs (includes mortgage payments and utility fees) relative to average household disposable income.

The higher the ratio, the more difficult it is to afford a home.

Sources: Business Data Lab analysis using Canadian Real Estate Association and Bank of Canada data.

Regional comparisons: Vancouver and Toronto are the most expensive housing markets in Canada.

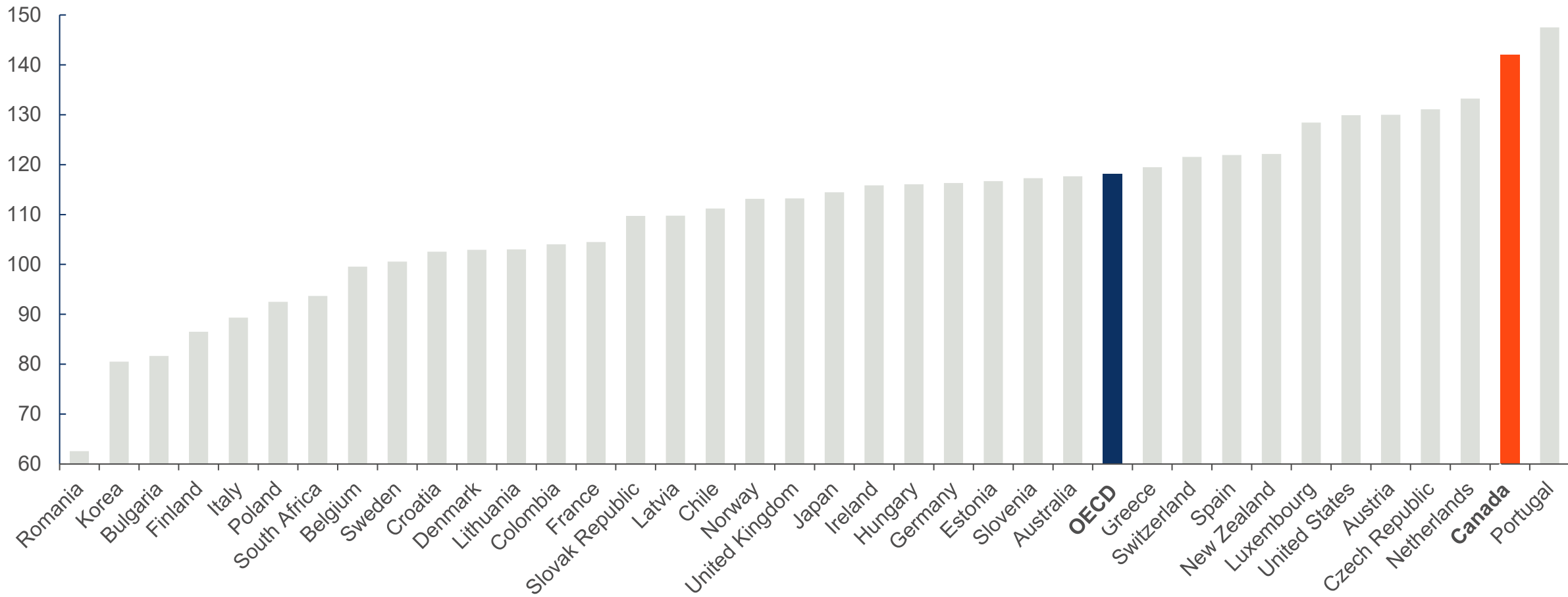
Unaffordable housing
% of households spending 30% or more of their total income on shelter



Sources: Business Data Lab analysis using Statistics Canada 2021 Census data.

International comparisons: Canada has the second most unaffordable housing market in the OECD.

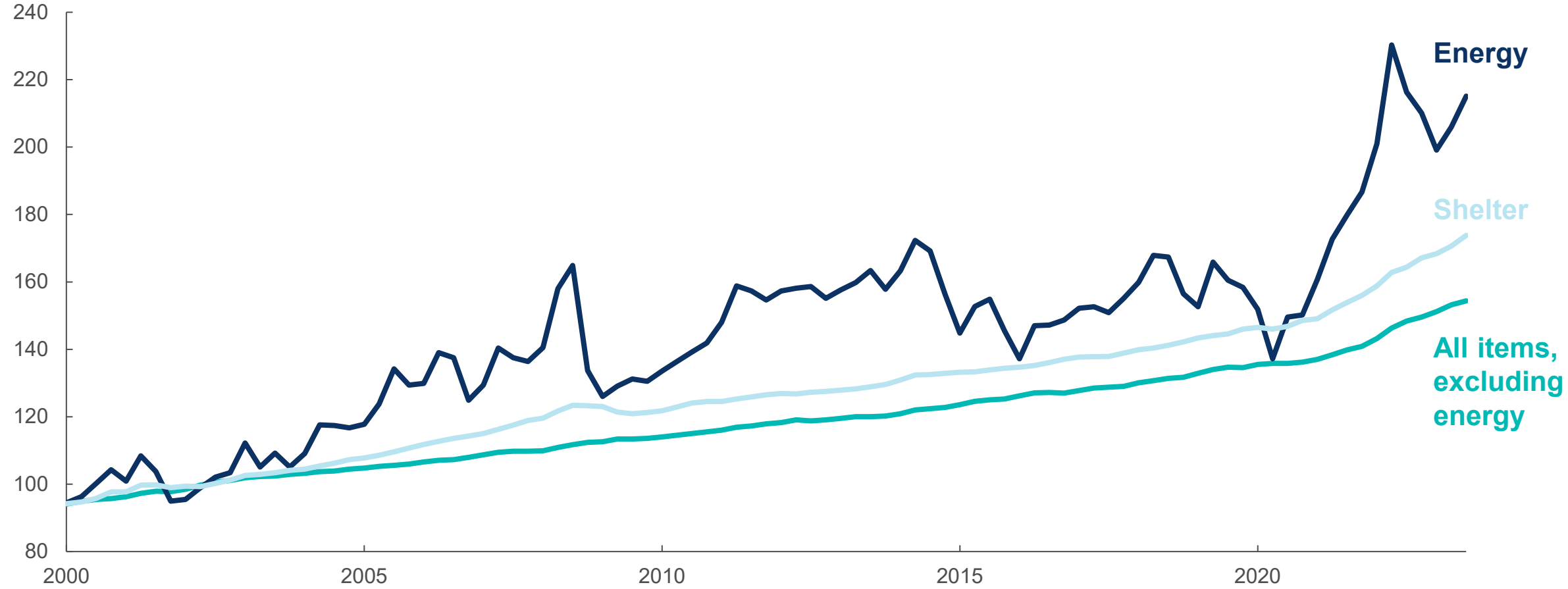
Housing price to income ratio*
Index, 2015=100



*The nominal house price index divided by the nominal disposable income per person, which is a common affordability measure. The higher the ratio, the more difficult it is to afford a home.
Sources: Business Data Lab analysis using OECD Analytical Housing Price Indicators.

Like shelter, energy costs have also risen faster than other consumer items over the long run, and have been more volatile.

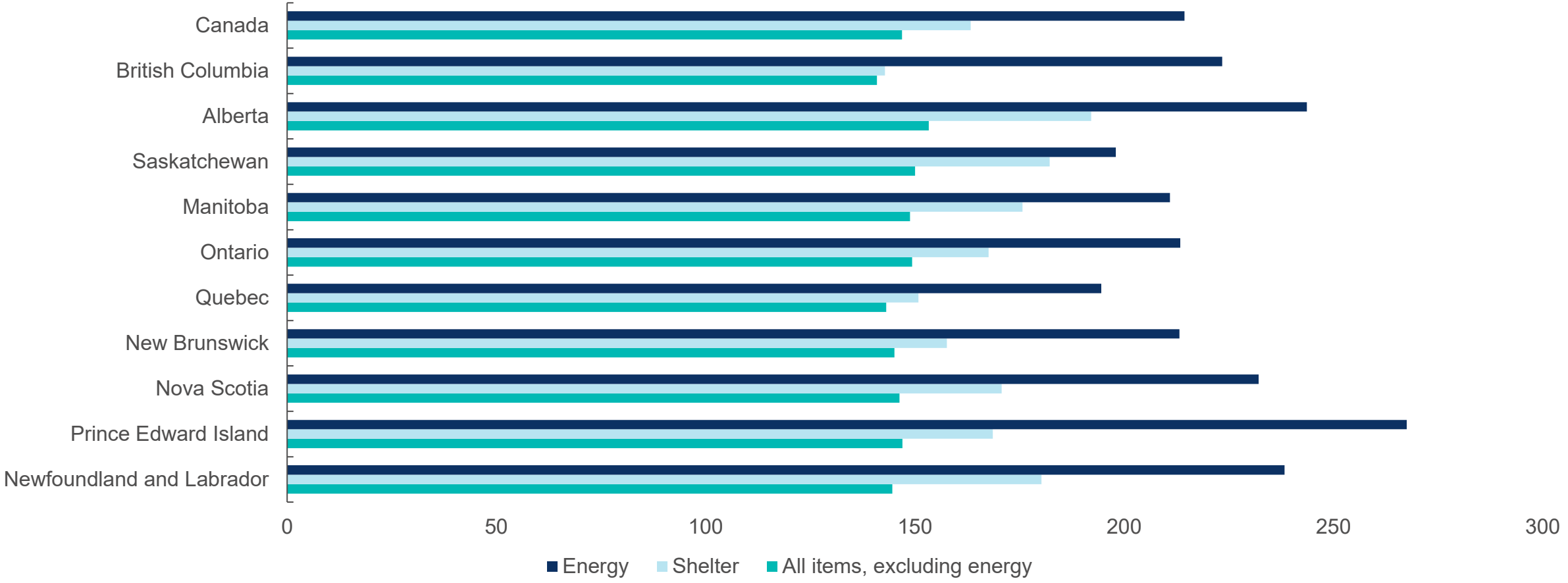
Consumer price indexes, Canada
Index, 2002 = 100



Source: Statistics Canada

Energy and shelter costs have increased faster than overall prices across all provinces over the past two decades.

Consumer price indexes, Canada and provincial
2022 annual average, Index, 2002 =100



Federal carbon pricing is increasing the cost of living.

Researchers at the University of Calgary estimate that the carbon tax raised prices in British Columbia by an average of 0.3%, with a higher impact on carbon-intensive categories such as air travel (+0.9%) and auto costs (+0.5%). The indirect impact of emissions pricing feeds into intermediate goods and services, while climate incentive rebates help offset additional costs. To illustrate, the Greenhouse Gas Pollution Pricing Act (carbon tax), and Clean Fuel Regulations (CFR) are used.

We estimate additional direct costs to households of \$2,087 in 2030, from two categories:

- 1) Additional annual cost to fill up a tank of gasoline each week for a typical car.
- 2) Additional annual cost to heat a home using natural gas for the winter months.

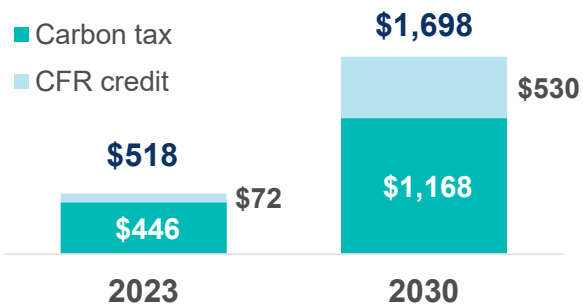


+\$1,698 in gasoline costs in 2030

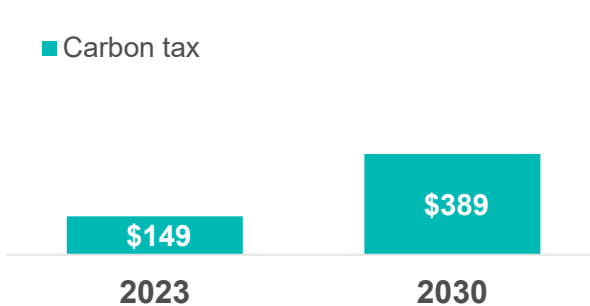


+\$389 to heat a home with natural gas in 2030

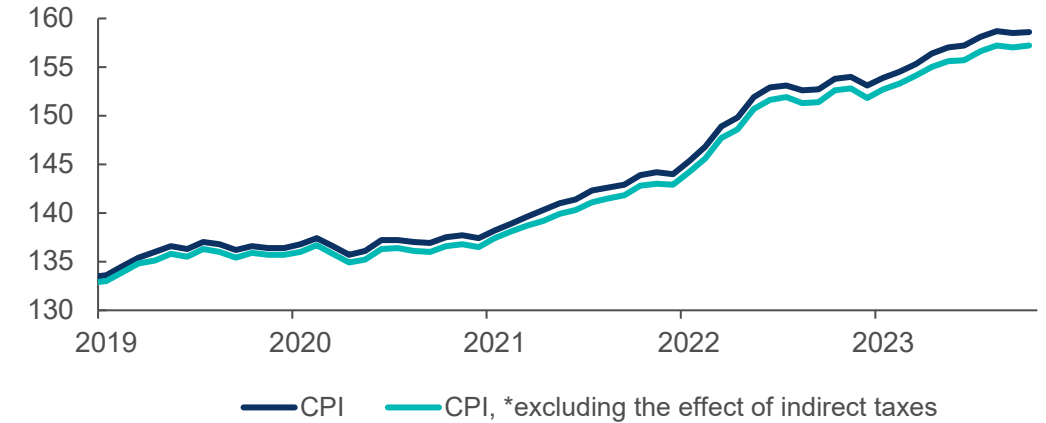
Annual estimated impact on typical gasoline consumption



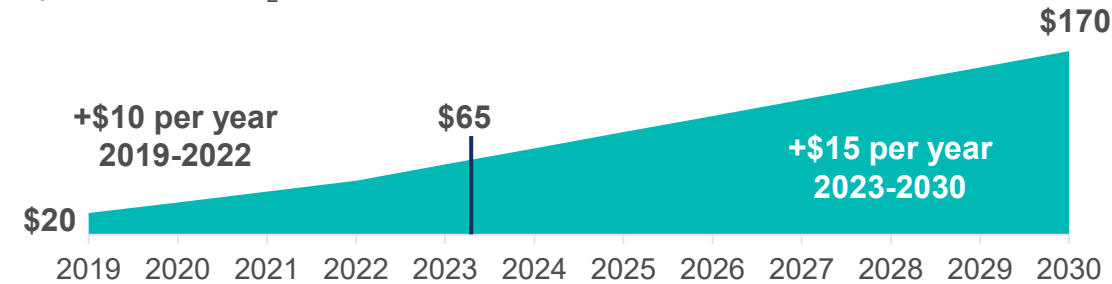
Annual estimated impact on typical natural gas winter consumption



Canada's Consumer Price Index (CPI)
Index 2002=100



Carbon tax rate schedule
\$ per tonne of CO₂e



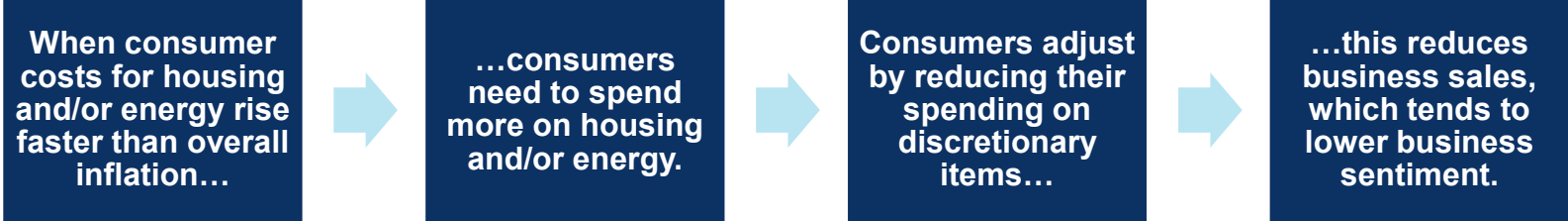
Sources: BDL calculations based on the Federal fuel charge rates, *Update to the Pan-Canadian Approach to Carbon Pollution Pricing 2023-2030*, *Clean Fuel Regulations (CFR)*, *Emissions pricing and affordability: lessons from British Columbia (Tombe and Winter)*
Notes: This estimate is based on available government data, doesn't consider inflation, or the indirect effect of the carbon tax.
*Indirect taxes includes sales and carbon tax.

Key Economic Mechanisms



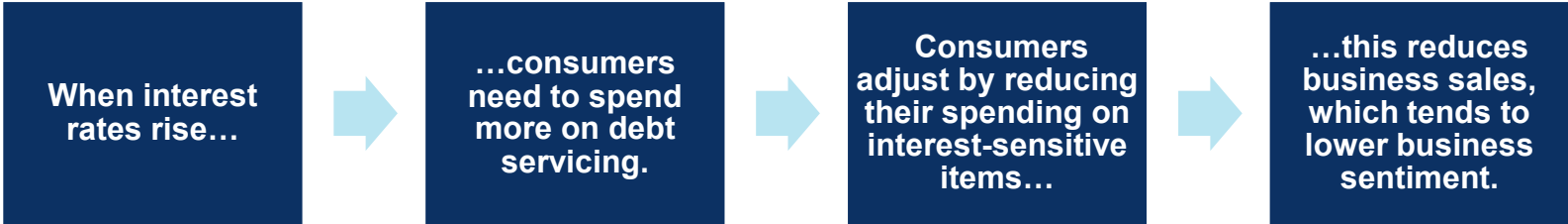
These are two key economic mechanisms at work.

Inflation



More discretionary ("wants")	Less discretionary ("needs")
<ul style="list-style-type: none"> - Travel - Entertainment - Luxury goods - Hobbies - Food, beverages at restaurants and bars 	<ul style="list-style-type: none"> - Housing - Utilities - Groceries - Child care - Health care - Transportation

Interest rates



More interest-sensitive	Less interest-sensitive
Big ticket items typically purchased by borrowing: <ul style="list-style-type: none"> - Housing - Home furnishings - Autos 	<ul style="list-style-type: none"> - Services - Non-durable goods

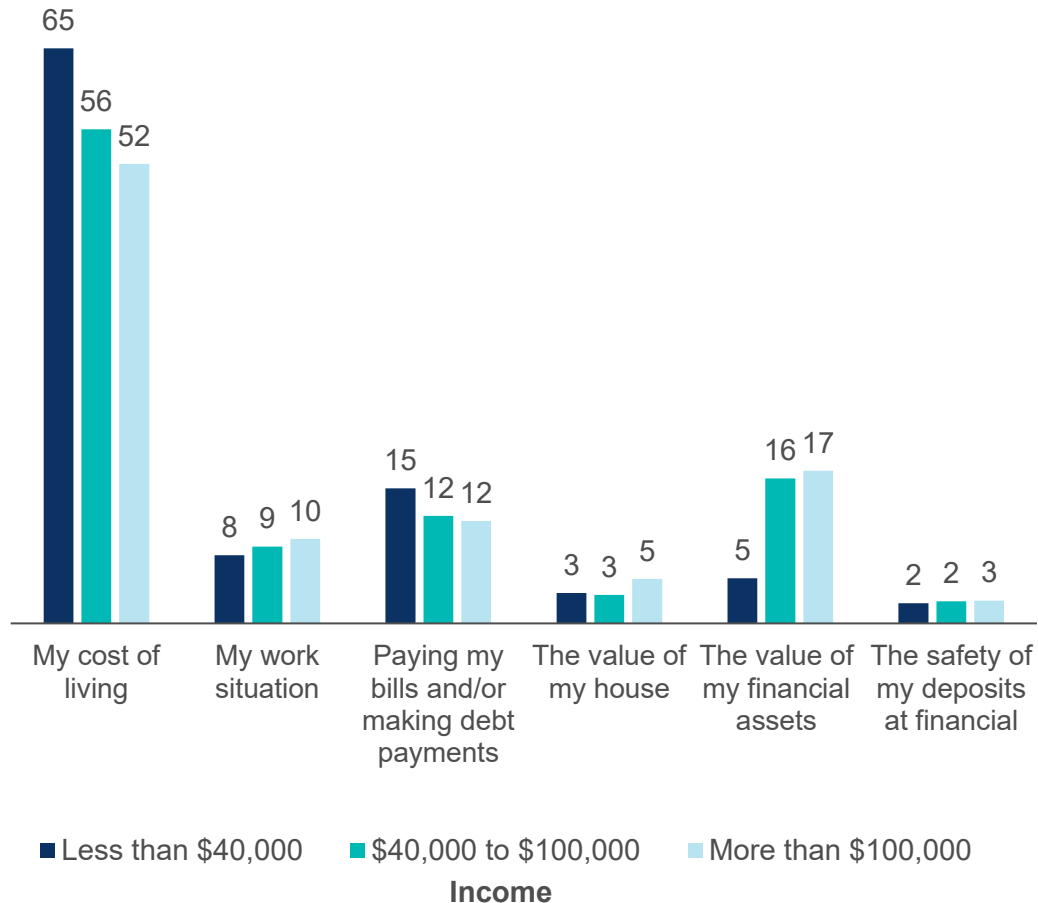


Impact on Consumers

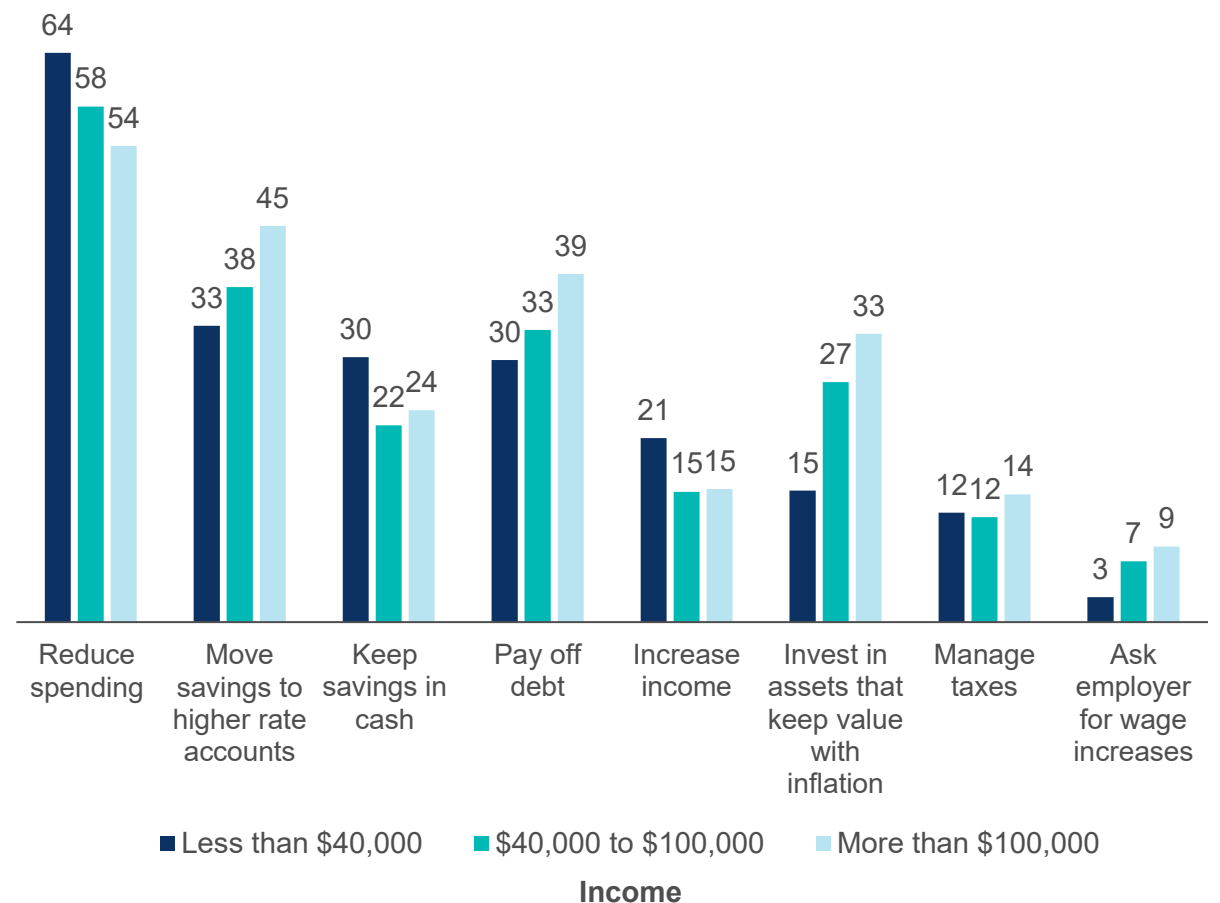


Cost of living concerns are widespread, causing most consumers to reduce their spending, especially lower-income households.

Concerns about your personal financial situation
Percent of responses by income



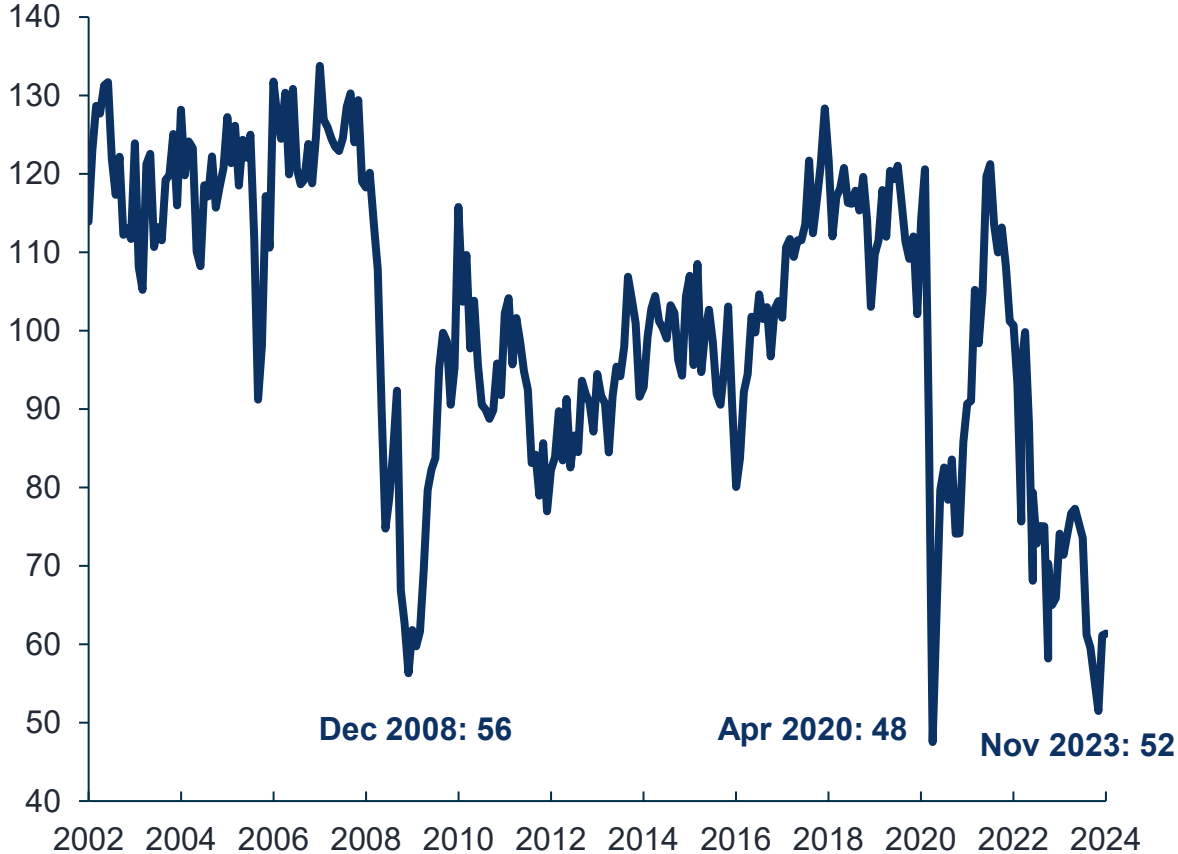
Actions taken to protect against high inflation
Percent of responses by income



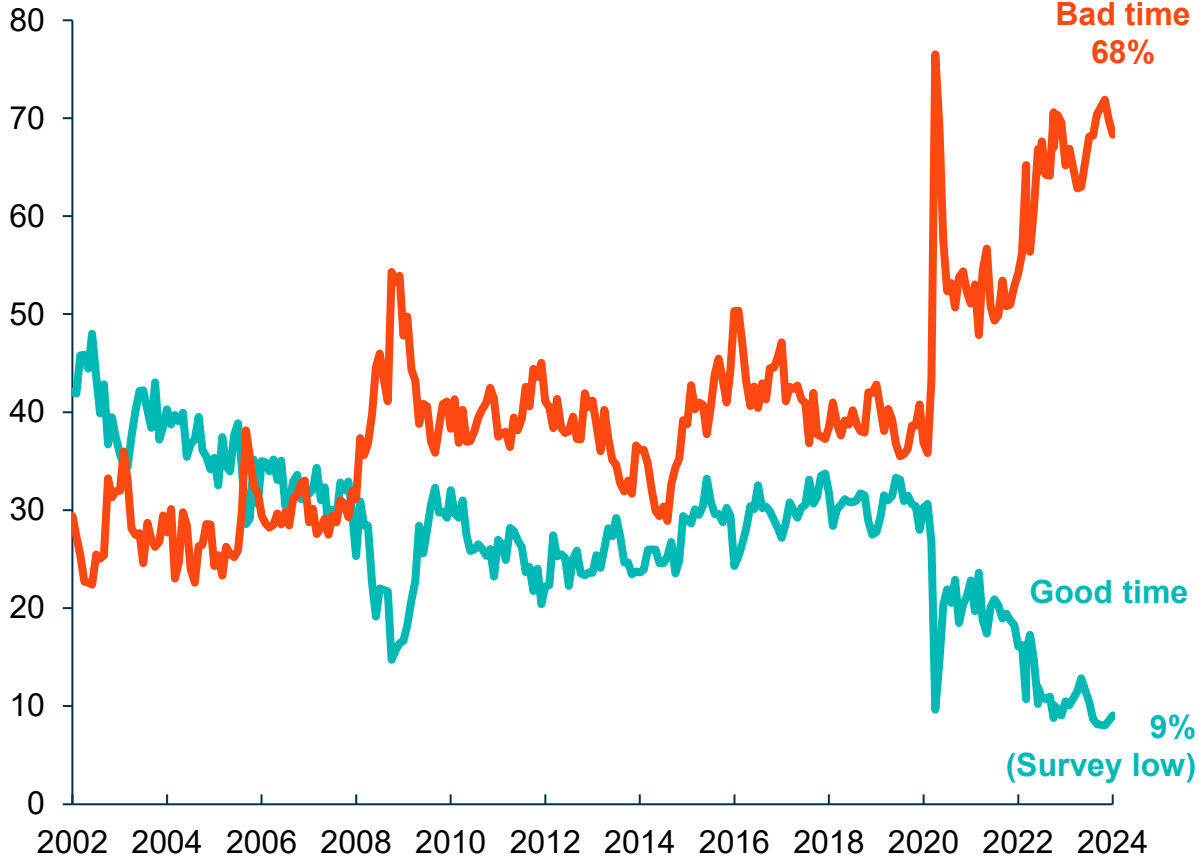
Sources: Bank of Canada, Canadian Survey of Consumer Expectations, 2023 Q3

Consumer confidence is at its lowest level outside the pandemic; most think it is a bad time to make a major purchase.

Canadian consumer confidence
Index, 2014=100

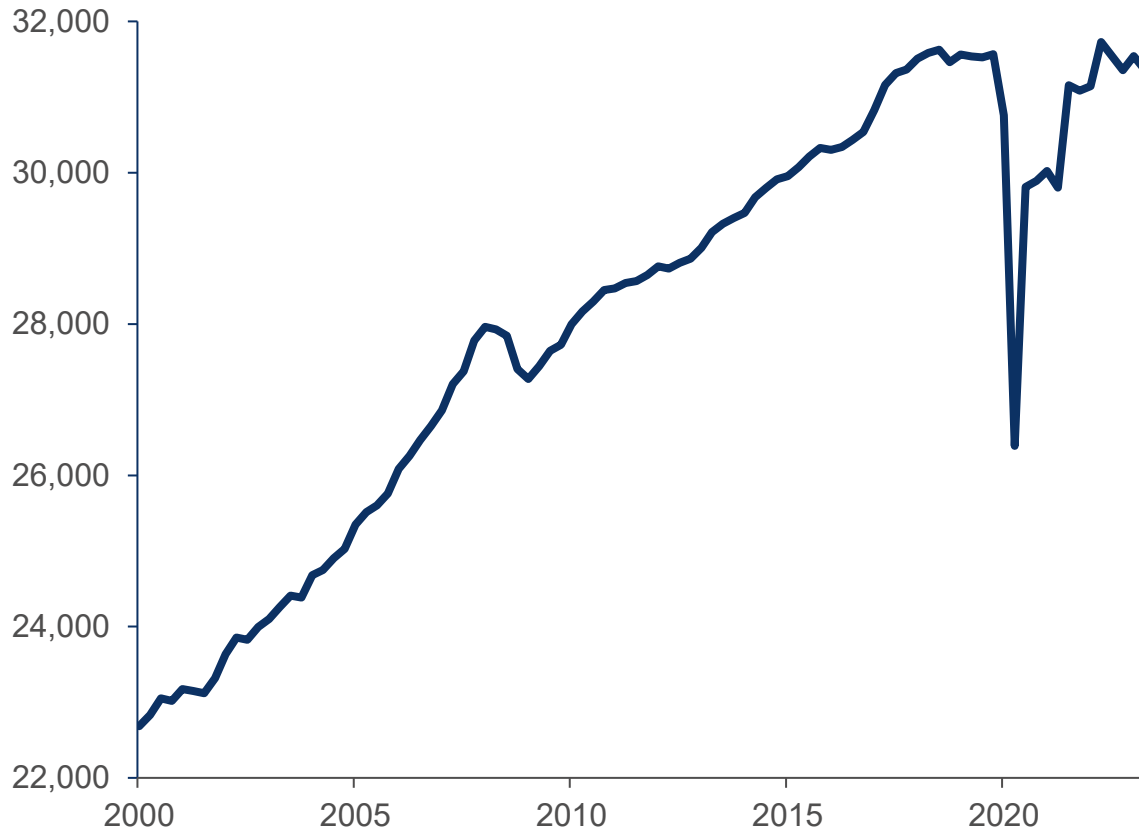


Canadian consumer confidence to make a major purchase
% of respondents

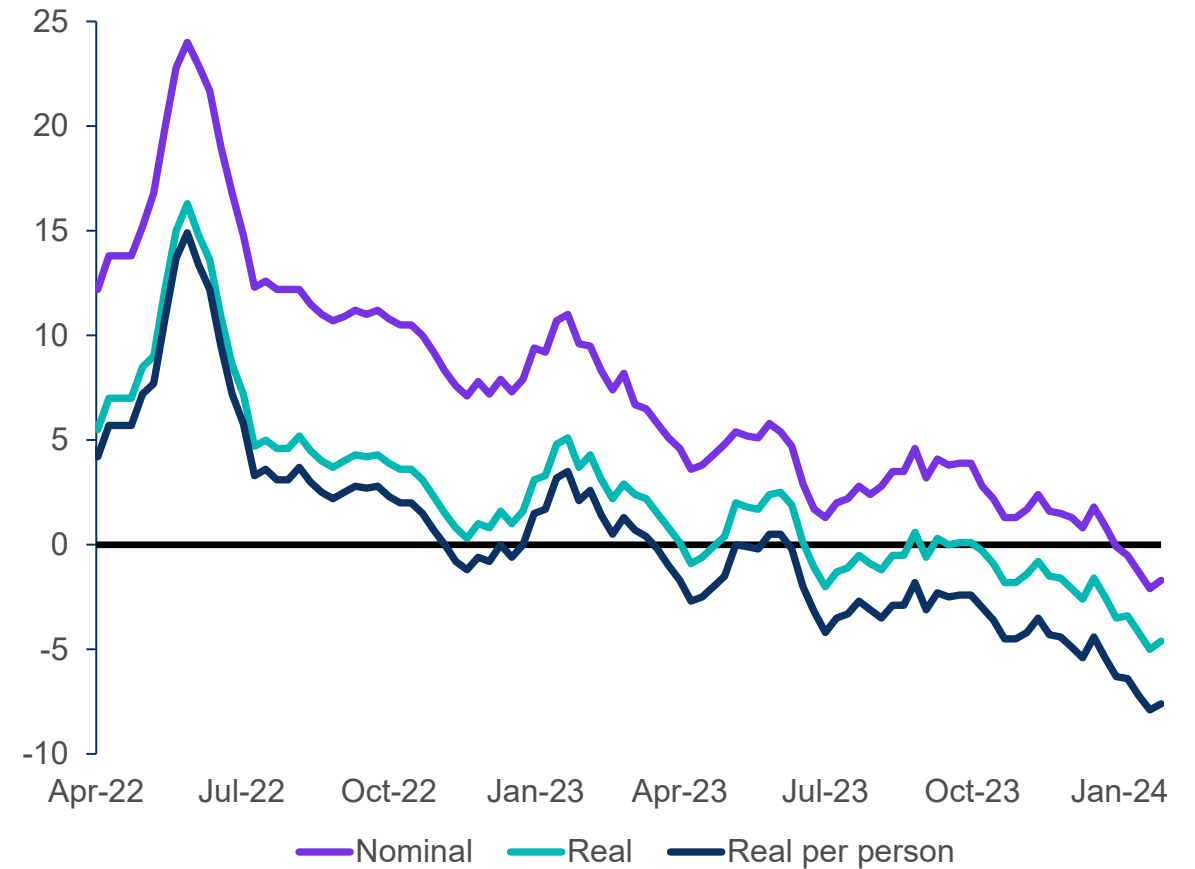


Over the longer-term, real consumer spending per person is down from its pre-pandemic peak; while high-frequency data show negative annual growth since March 2023.

Canadian real consumer spending per capita
Chained 2012 dollars, seasonally adjusted at annual rates



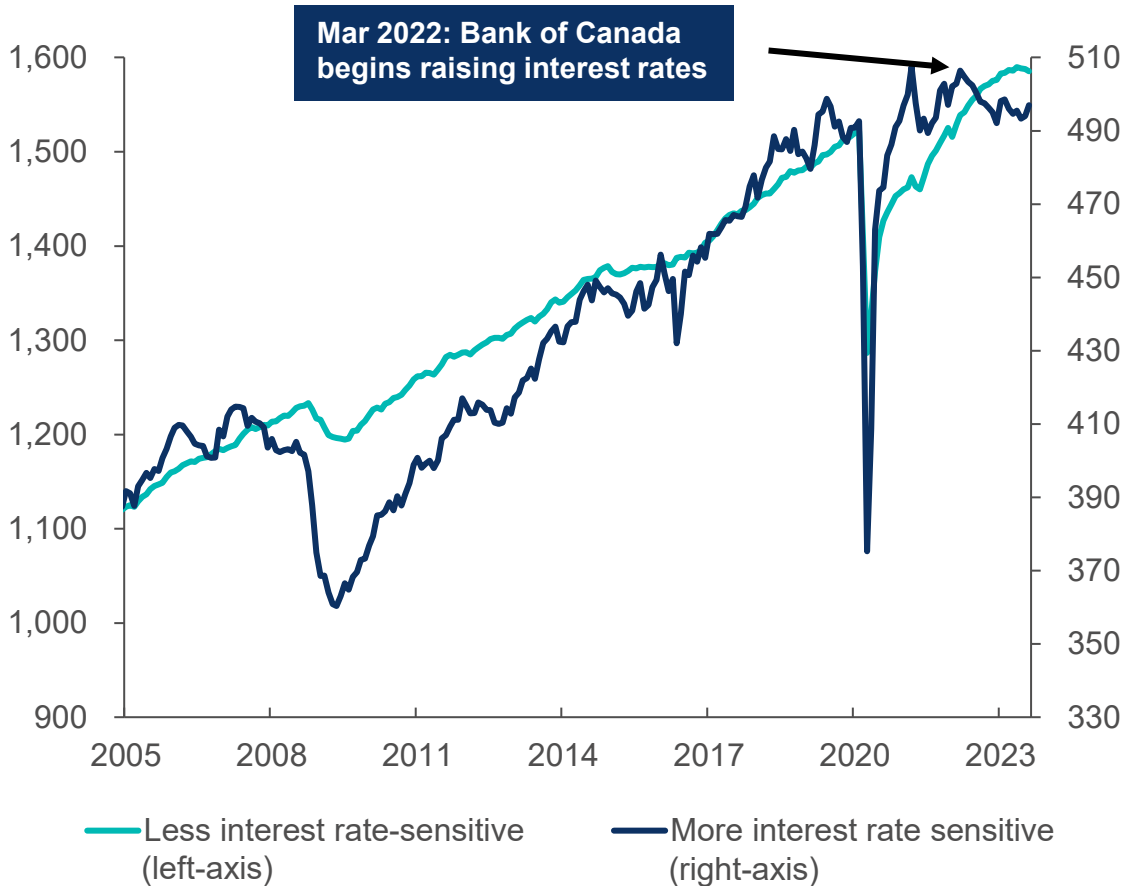
High-frequency consumer spending growth indicators*
% change, year-over-year



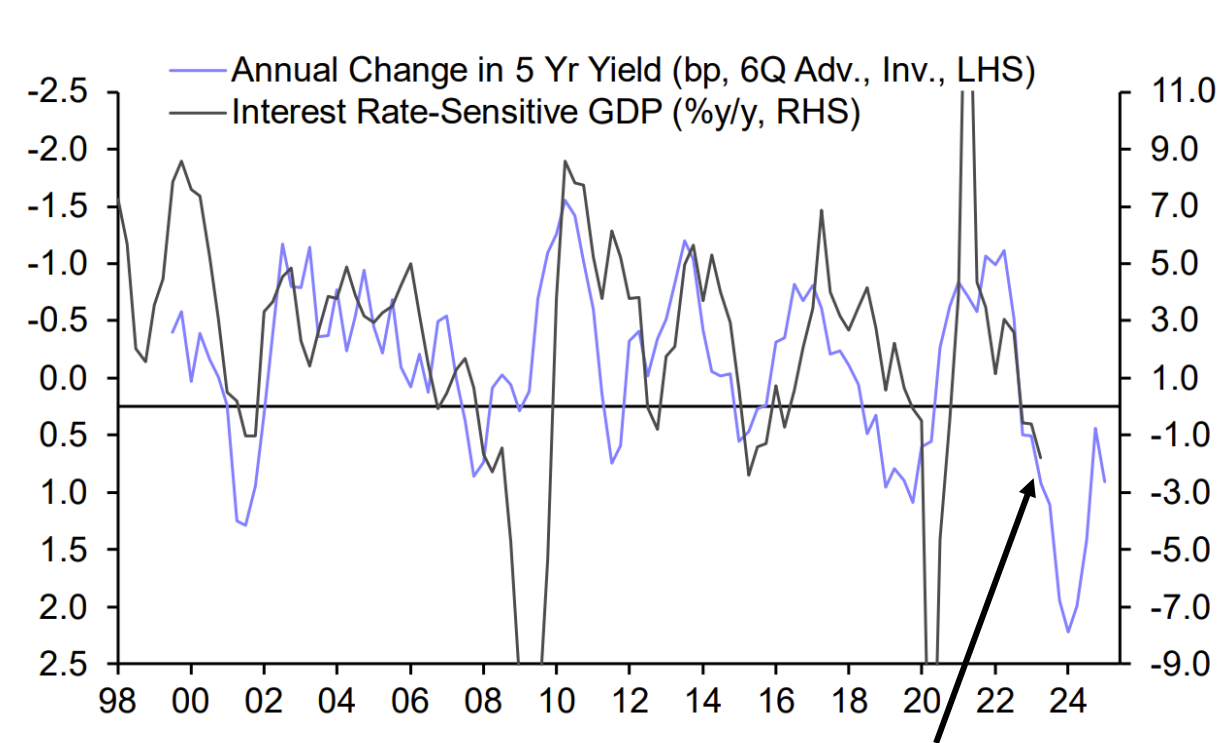
*Nominal = current dollar spending; real = adjusted for inflation; real per person = adjusted for inflation and population growth
Sources: Haver Analytics, Canadian Chamber of Commerce Business Data Lab calculations using Moneris and Statistics Canada data

High borrowing costs have slowed activity in interest-sensitive sectors and there's potential for further weakening.

Canadian GDP
Billions of 2012 chained dollars, seasonally adjusted at annual rates



Interest rate-sensitive GDP and change in bond yields



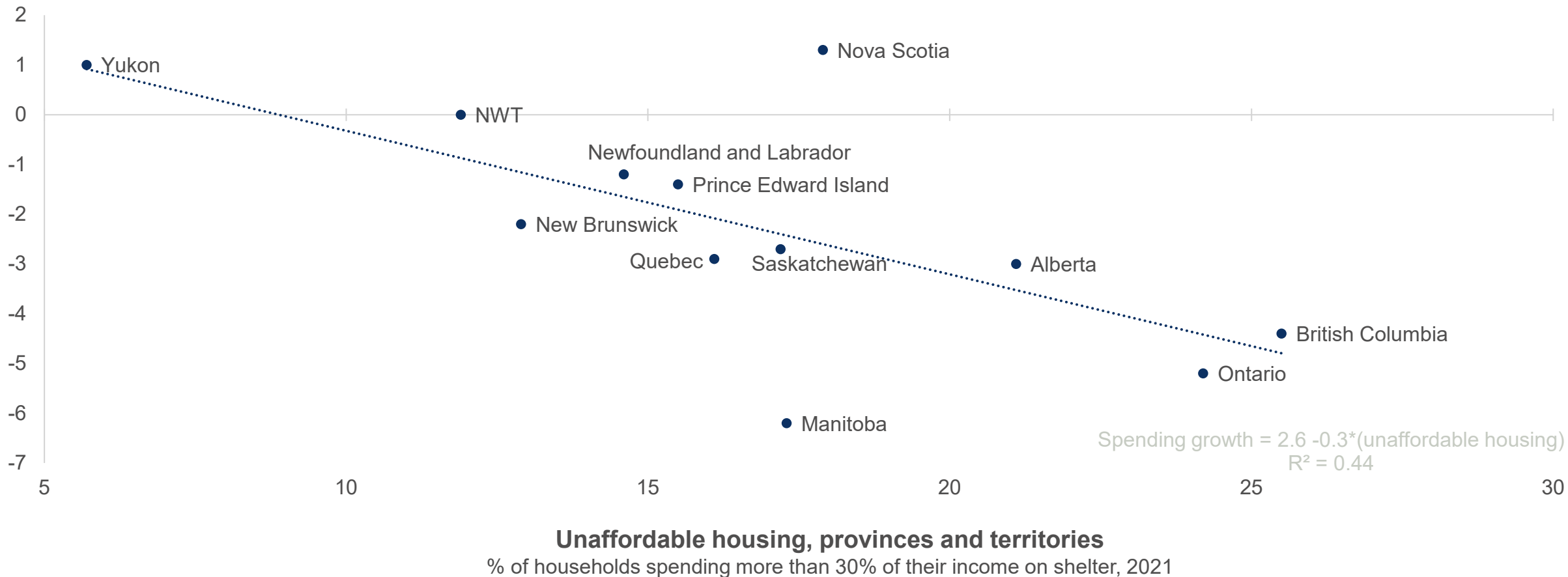
As the recent rapid tightening of financial conditions has its delayed effect, interest rate-sensitive spending is likely to fall further.

Source: Capital Economics
Note: The seven interest-sensitive sectors are: Forestry and Logging; Oil and gas extraction; Residential Construction; Durables manufacturing; Wholesale trade; Retail trade; Real estate agents and brokers.

In regions with bigger housing affordability challenges, consumers have cut back more on their spending.

Real consumer spending growth per person, October 2023

% change year-over-year



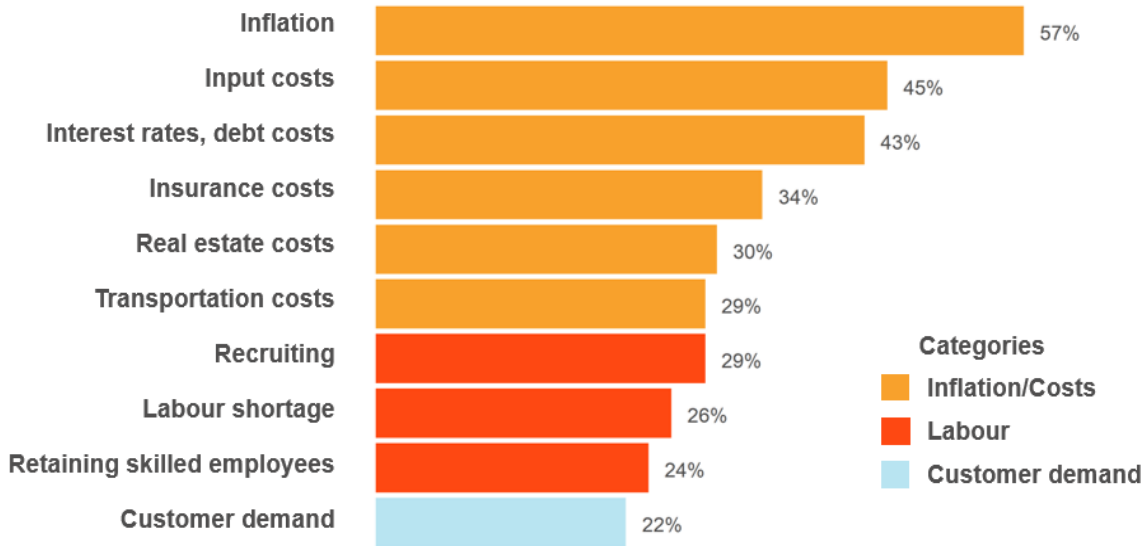
Source: Business Data Lab analysis, based on Statistics Canada census and Moneris data.

Impact on Businesses

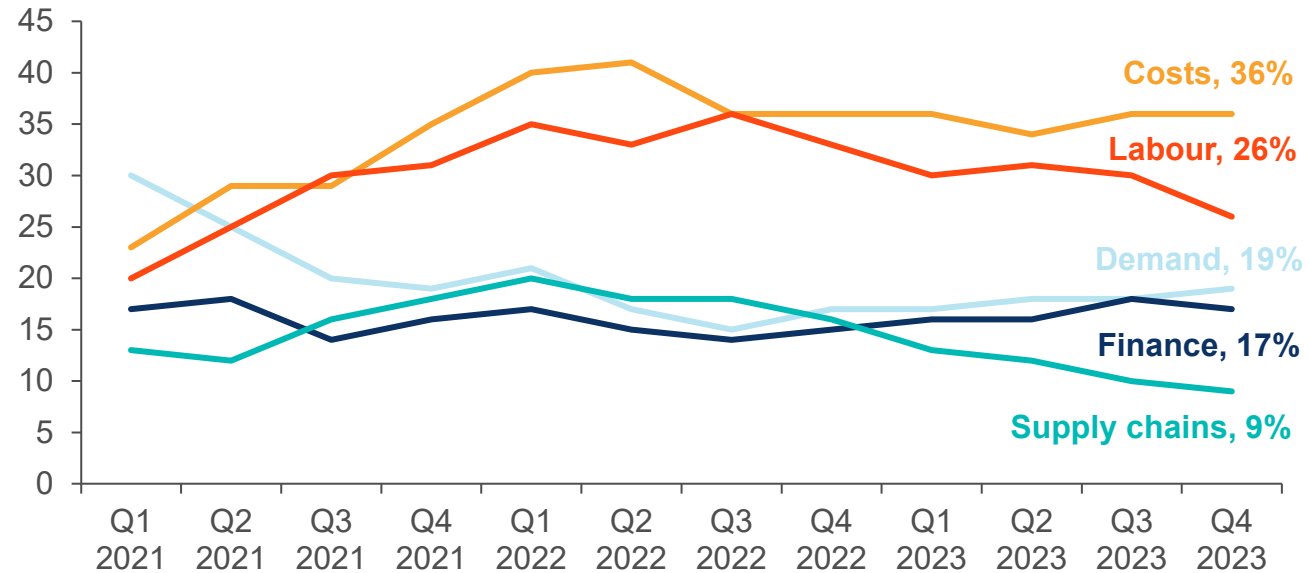


Canadian businesses are concerned about broad-based, rising costs.

Top 10 business obstacles expected, next three months
% of respondents, 2023 Q4



Business obstacles expected, next three months
% of respondents, grouped by category*, 2023 Q4



The top six near-term business obstacles are all cost related.

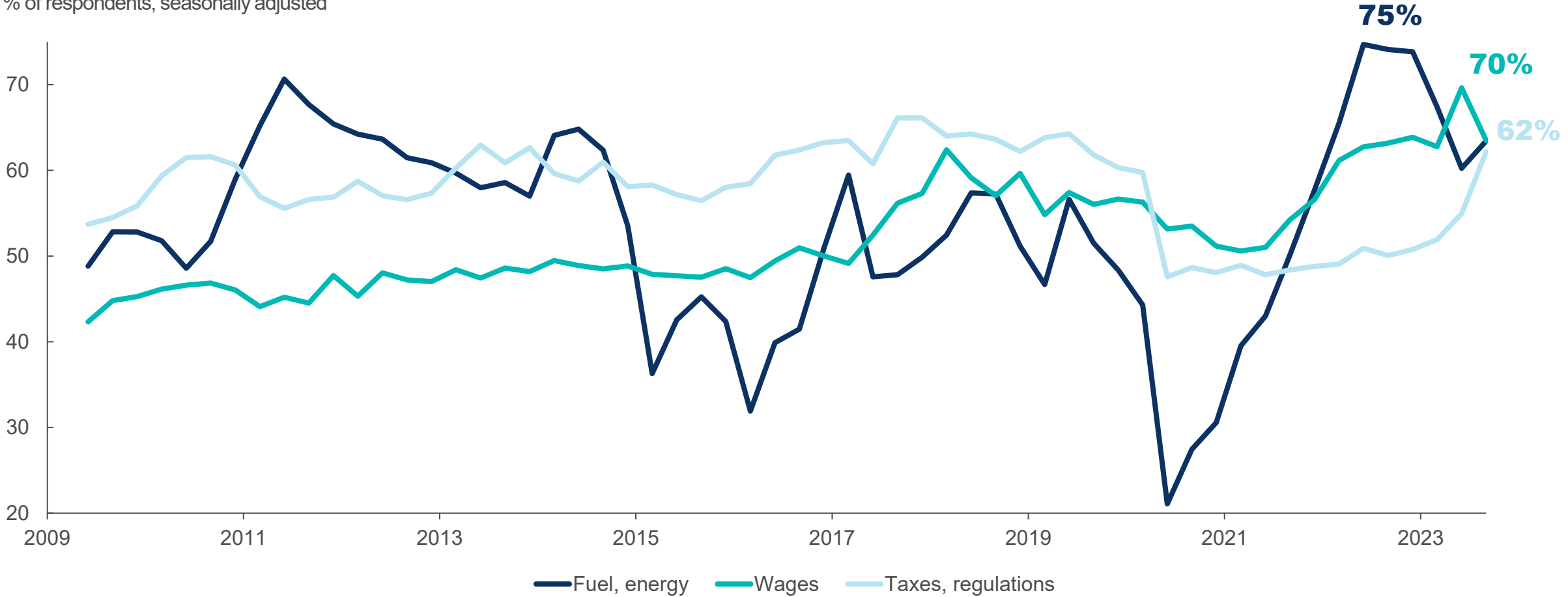
Over the past two years, firms have consistently reported that costs are their top near-term business obstacle.



Source: Business Data Lab analysis, based on Statistics Canada, Canadian Survey on Business Conditions
* Average response within categories, based on consistent options over surveys.

Small businesses are struggling with fuel and energy costs, wages as well as taxes and regulations.

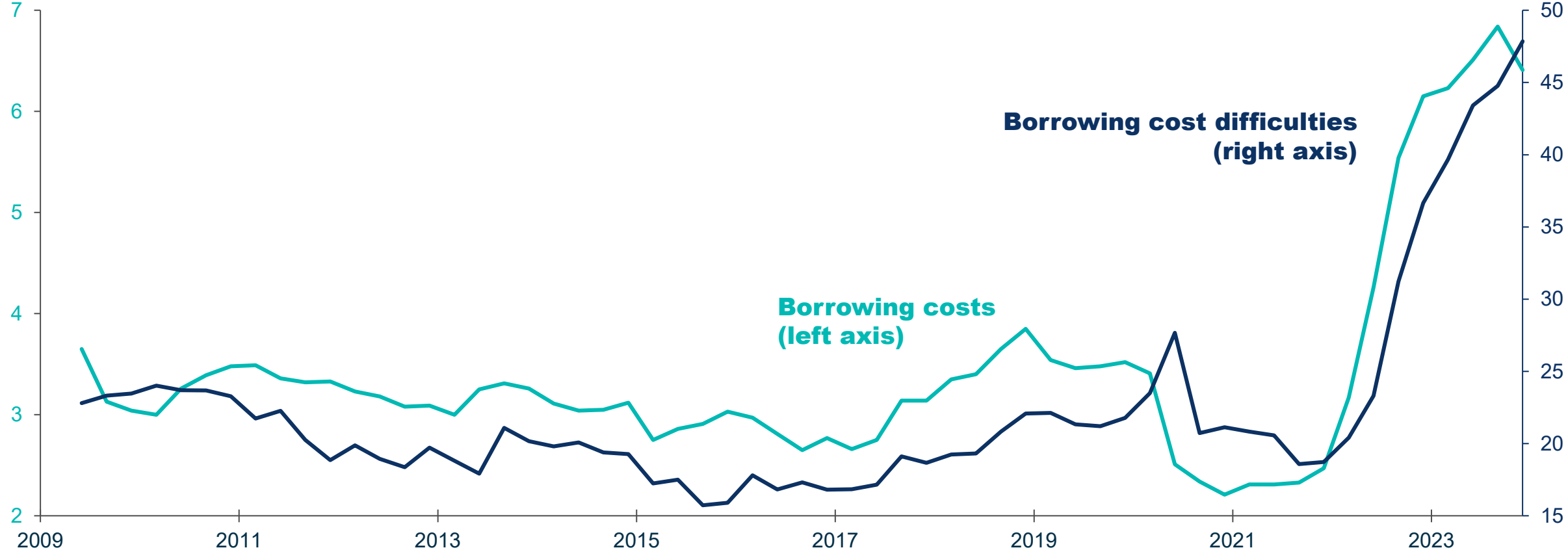
Top 3 input costs that are causing difficulties for small businesses
% of respondents, seasonally adjusted



Sources: Business Data Lab analysis; CFIB Business Barometer.

Borrowing costs have also become a growing concern for small businesses after interest rate hikes from the Bank of Canada to control inflation.

Effective business interest rate and share of small businesses reporting borrowing cost difficulties
Quarterly (left axis %; right axis % of respondents)



Sources: Business Data Lab analysis; Bank of Canada; CFIB Business Barometer.

The weak business outlook suggests real GDP growth may soon fall into negative territory on an annual basis.

12-month ahead small business outlook
% of respondents

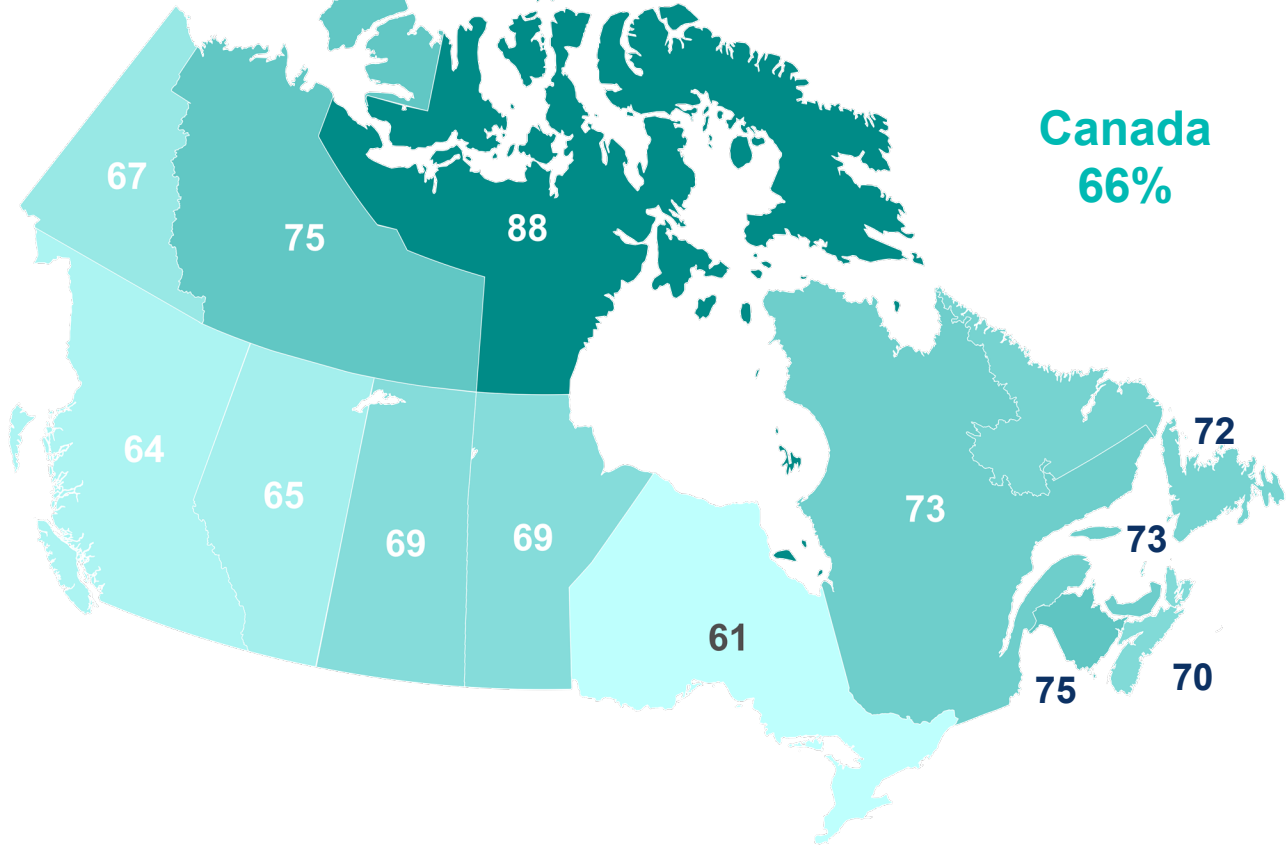
Real GDP growth
year-over-year % change, advanced one quarter



Source: Business Data Lab analysis, based on Statistics Canada, CFIB Business Barometer

Business optimism is lowest in Ontario and British Columbia.

Businesses with an optimistic outlook, next 12 months
% of respondents

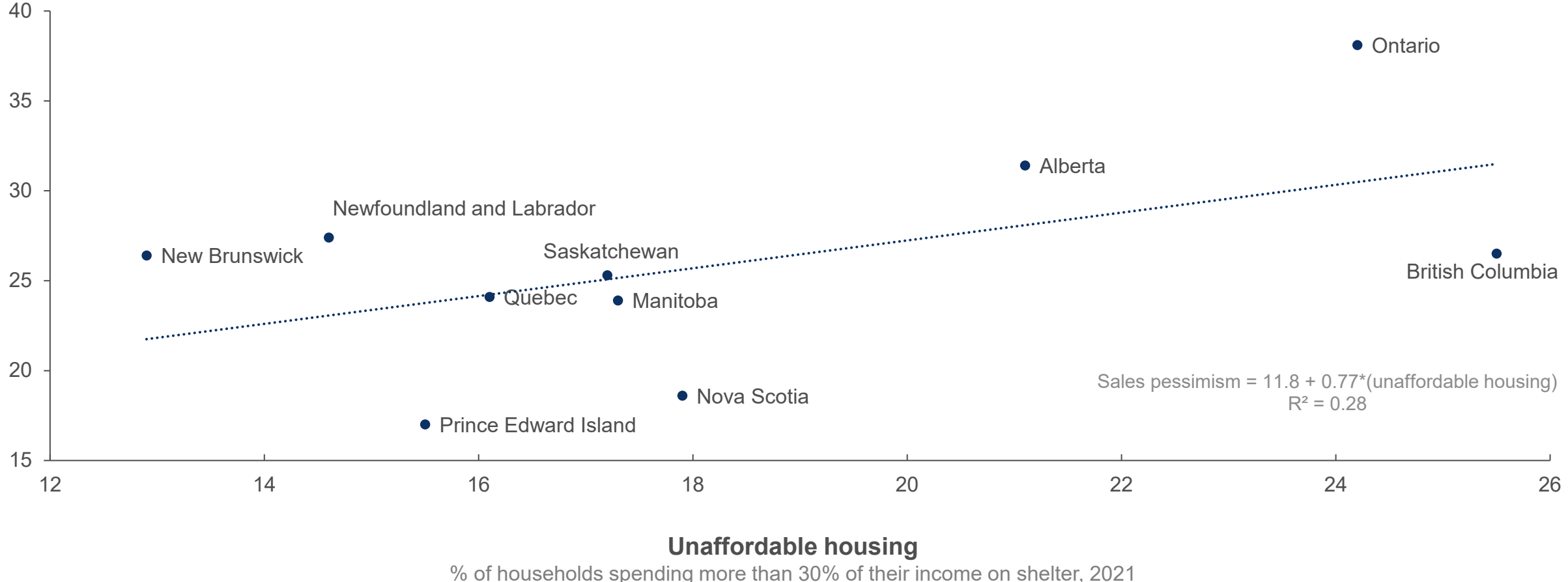


Source: Business Data Lab analysis based on Statistics Canada's Q4 2023 Canadian Survey on Business Conditions; 15,976 business responses in October and November 2023.

Businesses located in more unaffordable housing markets are more pessimistic about their sales over the next quarter.

Pessimistic sales outlook, 2023 Q4

% of respondents who expect sales to decrease over the next three months

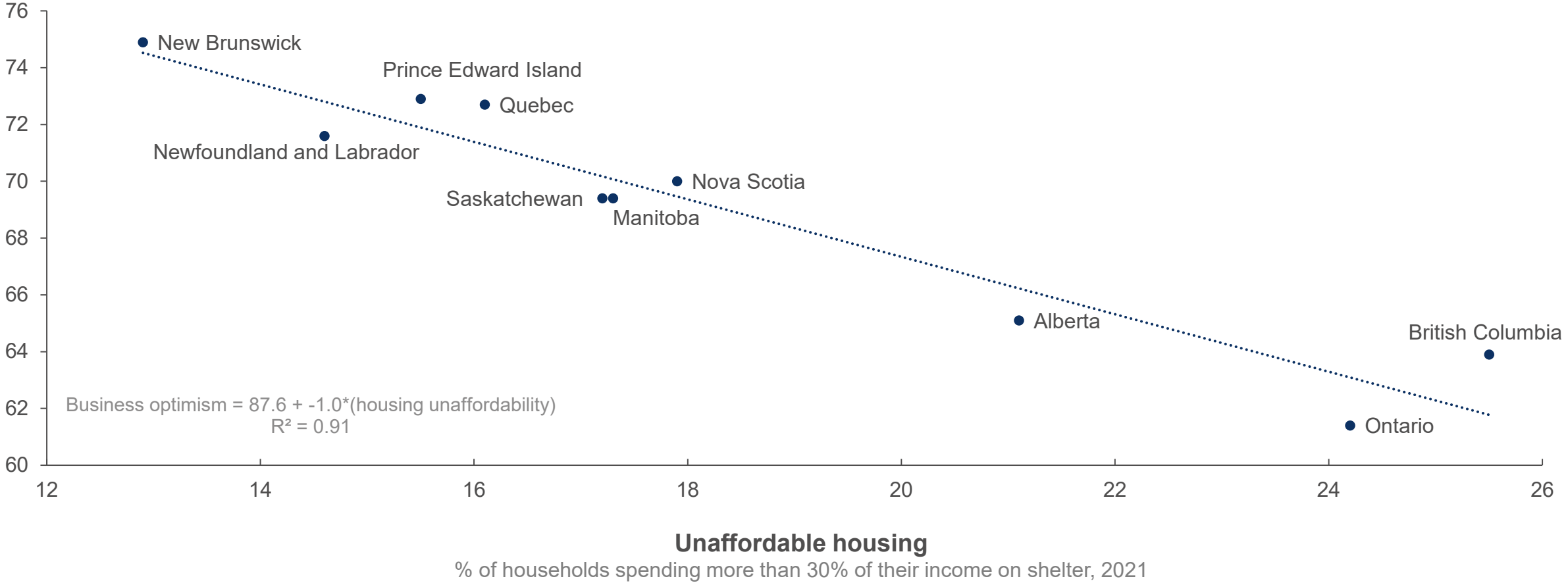


Source: Business Data Lab analysis, based on Statistics Canada, Canadian Survey on Business Conditions and census data.

Businesses located in more unaffordable housing markets are also less optimistic about their outlook for the year ahead.

Business optimism, 2023 Q4

% of respondents with an optimistic outlook for their business over the next 12 months



Source: Business Data Lab analysis, based on Statistics Canada, Canadian Survey on Business Conditions.

Looking Ahead



Looking ahead

Several issues could further exacerbate the squeeze on consumers' discretionary spending in the future, including:

- **Mortgage renewals at higher interest rates.**
- **A structural housing supply deficit.**
- **Additional legislation focused on carbon emissions reductions and the ability of households, businesses and the energy industry to adapt.**

The drafted Clean Electricity Regulations will have a disproportionate impact on Ontario, with the electricity operator warning that 2035 compliance is not achievable without risking the reliability of the electricity system, electrification of the broader economy and economic growth.

Additionally, the announced 2035 electric vehicle mandate has raised concerns from the Canadian auto industry on the lack of electrification infrastructure and its implications for rural and low-income Canadians.

Announced regulations

- Clean Fuel Regulations
- Clean Electricity Regulations
- Oil and Gas Sector Greenhouse Gas Emissions Cap
- Oil and Gas Methane Reduction Plan
- 2035 Electric Vehicle Mandate
- Carbon Pricing Regime
- Carbon Contracts for Differences

Upcoming regulations

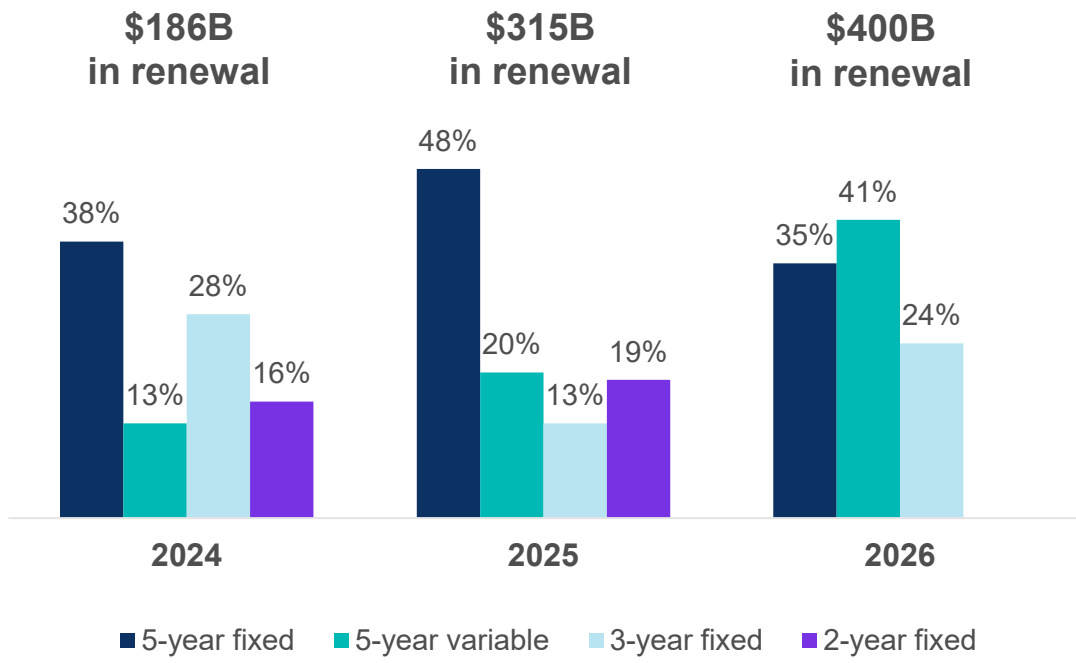
- Bill C-50 (Sustainable Jobs Act)
- Bill S-243 (Climate Aligned Finance)
- Updated Impact Assessment Act



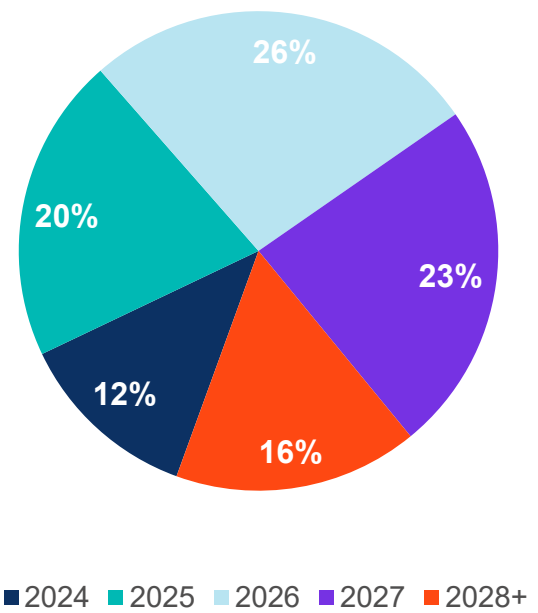
The worst may be yet to come with mortgage renewals.

Mortgage renewals are expected to have the largest impact on households. Nearly 60% of all outstanding mortgages, representing \$900 billion, will be up for renewal in the next three years, with the largest amount due in 2026. The 5-year fixed mortgage rate has risen significantly, from 1.9% in 2021 to now more than 5.5%.

Distribution of mortgage renewals, by term



Share of renewal, by year



For **fixed-rate mortgages**, the average increase in payments at renewal will be greatest in 2025–26, at between 20% and 25%.

For **variable-rate mortgages**, the average increase depends on the payment type:

- Variable payment borrowers already experienced an increase of close to 50%, with the bulk occurring in 2022.
- Fixed payment borrowers will need to increase their payments by roughly 40% to maintain their original amortization schedule, if they renew in 2025 or 2026.



Source: RBC, *Canadian Banks: A review of mortgage payment shock*, October 30, 2023