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INSIGHTS & VIEWS

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Defying the Doomers

CANADA RISKS TALKING ITSELF INTO DECLINE

- **Canadians are grappling with a sense of discontent about almost everything these days. Pessimism pervades issues spanning the economy, government, and society. Life satisfaction has taken a toll (chart 1).**
- **The roster of challenges is legitimately long—and the economic slowdown reinforces these concerns—but unpacking the data shows remarkable resilience.**
- **Indicators of financial health from net worth to real disposable income suggest most Canadians across the income spectrum are better off compared to their pre-pandemic positions (chart 2).[1] Even spending on essentials as a share of income is largely reverting back to pre-pandemic norms despite inflationary pressures.**
- **A range of cognitive biases may be subtly shaping sentiment. This includes potentially benchmarking expectations to past (unsustainable) peaks or pegging performance to peers (or parents). Intra- and intergenerational equity debates could be amplifying—and polarizing—the sense of dissatisfaction.**
- **Perception matters. Pessimism can erode consumer and investment confidence with immediate and longer-term consequences for the economy. While distinct vulnerabilities and structural shortfalls persist in Canada, it is not clear today's widespread pessimism is fully warranted. It could even be counterproductive as sentiment can be self-fulfilling.**
- **Canada needs a sentiment check, otherwise it risks talking itself into decline. Without a shift towards a more constructive conversation about Canada's future, this could be as good as it gets.**

THERE IS A CRACK IN EVERYTHING

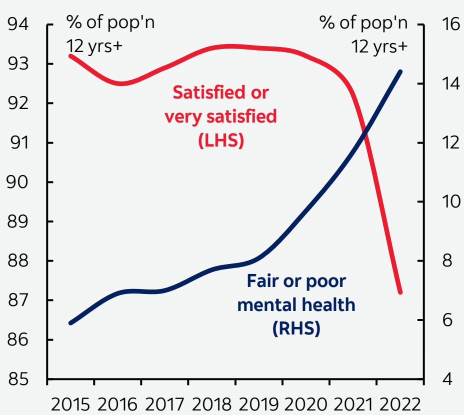
Many Canadians feel pretty lousy these days. The nation has been grappling with generational-high inflation, alongside soaring interest rates and housing costs to name just a few economic preoccupations. Most forecasters had been heralding a recession for over two years—with media amplifying the missive—only to reluctantly (and quietly) back away from that call as economic activity vastly eclipsed expectations. Last year, for instance, Canada's economic output was twice as high as early-year predictions; in the United States, output was eight times greater. While economic activity is clearly slowing and risks still lurk on the horizon, negative signals continue to grab the headlines.

Pocketbook sentiment is mirroring this pessimism. The Conference Board of Canada's *Confidence Index* portrays a level of gloominess matched only by the global market meltdown in 2008 or the onset of the pandemic in 2020 (chart 3). Bloomberg's *Economic Mood Index* has started to show some signs of recovery this year but sentiment is still substantially subdued. The Bank of Canada's *Canadian Survey of Consumer Expectations* corroborates these views with perceived financial stress still high—though down from last year's peak. The economic outlook is at the forefront of people's worries (chart 4).

Business is also idling its engines. A variety of surveys, including the Bank of Canada's *Business Outlook Survey*, the CFIB's *Business Barometer*, and the *Ivey Purchasing Managers Index*, suggest the private sector outlook remains tepid and volatile (chart 5).

Chart 1

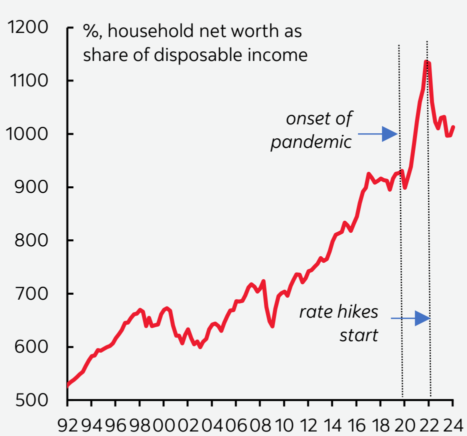
Perceived Well-Being Plummets



Sources: Scotiabank Economics, Statistics Canada.

Chart 2

Canadians Feel Less Wealthy



Sources: Scotiabank Economics, Statistics Canada.

[1] *This report uses balance sheet data from the System of National Accounts (SNA) given its timeliness (latest 2024-Q1) versus alternative household income (Canadian Income Survey, latest 2022) and financial security (Survey of Financial Security, latest 2019) sources. It is suitable data to analyse macroeconomic trends whereas the latter sources are preferable for microeconomic perspectives on individuals and households.*

Uncertainty tops the list of concerns (and, relatedly, trepidation around taxes and regulations), according to the Bank of Canada. Meanwhile, forward-looking markets continuing to march upward (or at least sideways) and other measures of globally exogenous forces are relatively benign, if not optimistic, from uncertainty to volatility to risk appetite.

LIFE, THE UNIVERSE AND EVERYTHING

Mood matters. Sentiment essentially acts as the grease—or the sand—to consumption and investment decisions. When households have job security and a positive view of the economy, they tend to spend and invest more. 'Wealth effects' are also well-documented: *feeling* wealthy (i.e., through asset appreciation) can drive demand. Businesses that anticipate future growth are more inclined to expand and invest, riding the wave of expected opportunities. Consequently, sentiment can be self-prophesizing (or self-destructive).

Perception is not always rational. Even households in a stable financial position may feel less secure than they are. Social comparison theories—like the idea of "*keeping up with the Joneses*"—suggest people measure their success against peers, a tendency that can be amplified by social media. Hedonic adaptation implies that desires grow with acquisitions (*the more one gets, the more one wants*). Cognitive biases, such as feeling the sting of losses more sharply than the joy of equivalent gains or giving undue weight to recent events, can skew one's perspective. Additionally, the unpredictability of the future can heighten feelings of financial insecurity. These concepts are particularly relevant in the current economic (and political) context.

Fears run deeper than finances. There has been a marked decline in overall life satisfaction, a trend that is especially evident among marginalized communities and, increasingly, younger Canadians. While the pandemic may have influenced latest statistics, the decline in mental health began well before its onset. Dated-but-still-relevant **analysis** by the Centre for the Study of Living Standards finds that mental and physical well-being are much more significant determinants of happiness than financial status. Moreover, public trust in institutions—which is linked to both mental and physical health as well as economic stability—has **eroded** across a range of entities from government to media to educational systems in recent years, according to Statistics Canada.

Do data corroborate this dour view of life in Canada? In short, it might be a stretch for most. Or, at least, it's all relative. There is no universally accepted definition of welfare and quality of life, but one can peel away a few of the layers for a data-driven perspective.

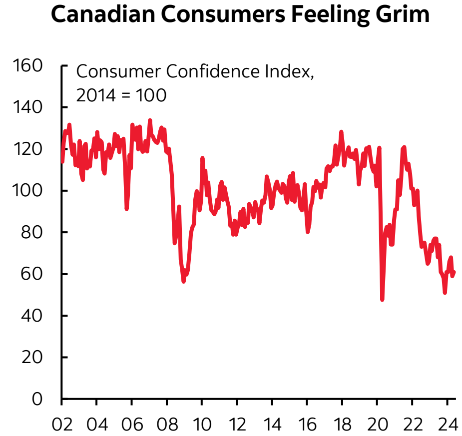
DEFLATING EXPECTATIONS

Net worth is a good starting point. It provides a comprehensive snapshot of a household's financial health and stability. It reflects consumption and investment potential, as well as economic resilience and financial security over the longer term.

Household net worth currently exceeds pre-pandemic figures by over 25%. It had surged by a third before aggressive interest rate hikes took off some of the sheen. Household net worth had been compounding at an average annual rate of 13% from lockdown to its zenith versus about 5% in the decade preceding the pandemic. Today, average household gains are roughly $20 k above what would have been projected based on trend growth since 2019 (using the CAGR from 2010 to 2019 as a baseline).

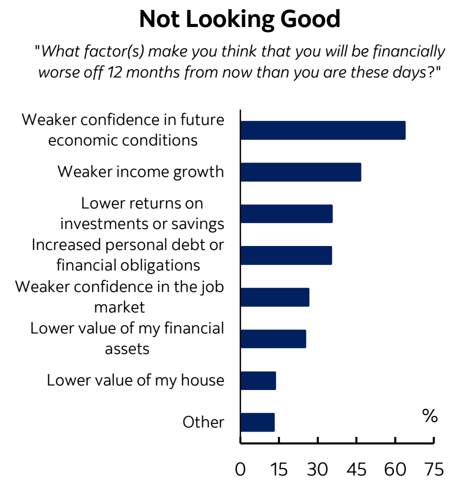
Gains have been broad-based. For instance, net wealth of households in the lowest income quintile is almost 50% higher than pre-pandemic levels, with the second income quintile

Chart 3



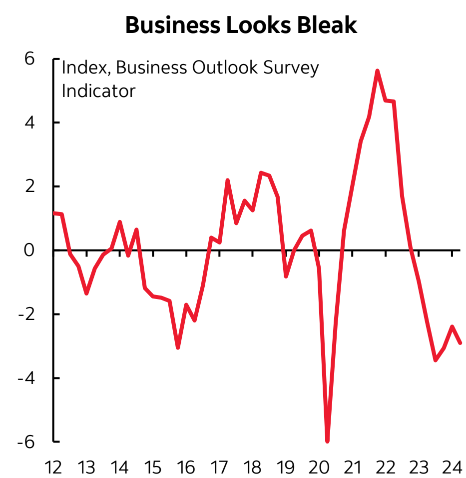
Sources: Scotiabank Economics, Conference Board of Canada.

Chart 4



Sources: Scotiabank Economics, Bank of Canada.

Chart 5



Sources: Scotiabank Economics, Bank of Canada.

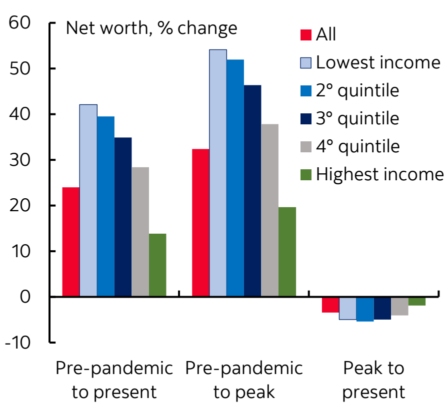
close behind (chart 6). The over-65-years cohort distorts this snapshot (e.g., lower income needs), but a similar analysis by wealth quintiles shows the lowest quintile is also better off (or less-worse) than pre-pandemic levels (net worth is still modestly negative after popping briefly into the black in 2021). Moreover, wealth gains have spanned all age groups with those under 35 years leading the way—albeit from lower initial values—aligning with the typical pattern of wealth accumulation over a lifetime (chart 7).

Real estate has played a prominent role. Driven by ultra-low interest rates and increases in income, among other factors, Canadians piled into housing markets. At the peak of the frenzy, national sales were up by over 50%, in turn, propelling home prices up by about 55%. Markets have since cooled but the average home price still sits about 33% above pre-pandemic levels. Households across the income spectrum capitalized on the boom with asset accumulation outpacing mortgage liabilities (charts 8 & 9). Measured as a share of pre-pandemic assets, the largest relative gains accrued to lower income groups. While real estate is generally considered illiquid (outside a crisis), growing equity is an important, but oft-overlooked source of resilience (chart 10). Whether precautionary- or propensity-driven, there are also still considerable savings building up on the sidelines (chart 11).

In short, data depict a relatively positive picture. Admittedly, balance sheet data would mask acute pockets of vulnerability, but it provides a timely global snapshot of household finances. That said, it is not hard to zoom in on any of these metrics to find fault with a particular frame of reference. And a lot of commentary has.

Chart 6

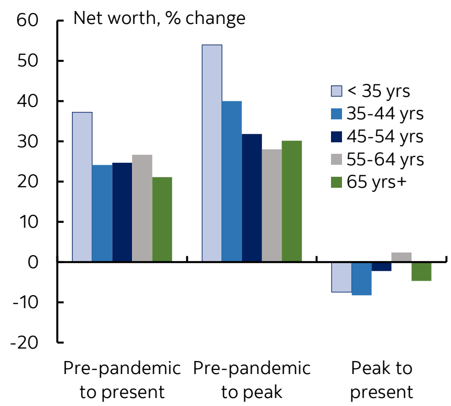
Sharing the Wealth Around



Sources: Scotiabank Economics, Statistics Canada.
Pre-pandemic 2019-Q4; peak 2022-Q1; present 2024-Q1.

Chart 7

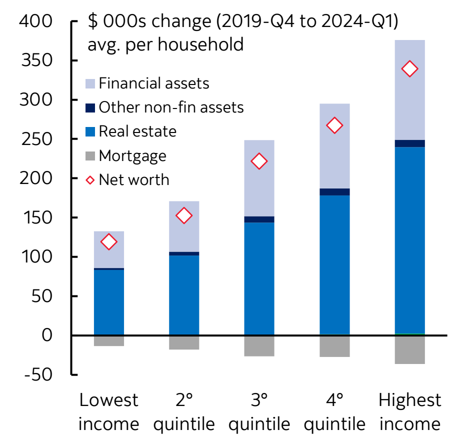
Across the Ages



Sources: Scotiabank Economics, Statistics Canada.
Pre-pandemic 2019-Q4; peak 2022-Q1; present 2024-Q1.

Chart 8

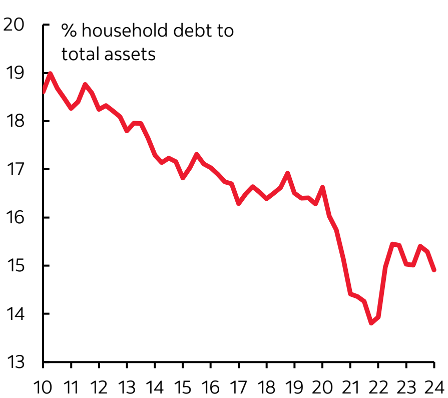
Drivers of Wealth Accumulation



Sources: Scotiabank Economics, Statistics Canada.

Chart 9

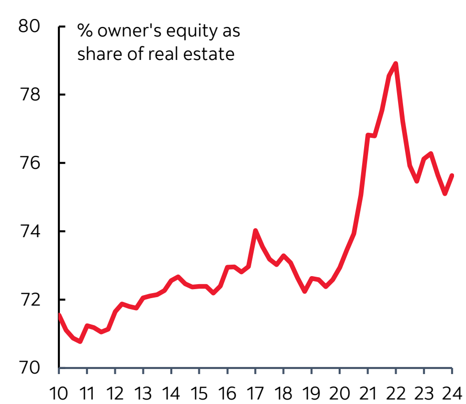
Household Assets Growing Faster Than Debt



Sources: Scotiabank Economics, Statistics Canada.

Chart 10

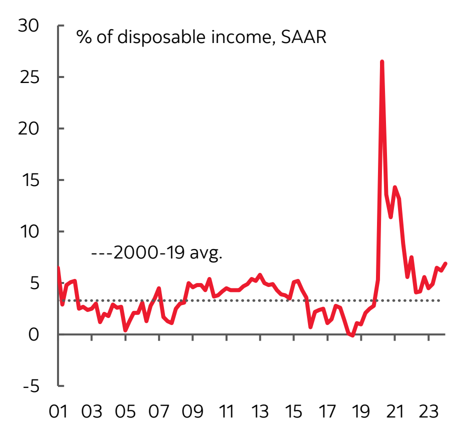
Canadians Owning "More" Home



Sources: Scotiabank Economics, Statistics Canada.

Chart 11

Saving Some on the Side



Sources: Scotiabank Economics, Statistics Canada.

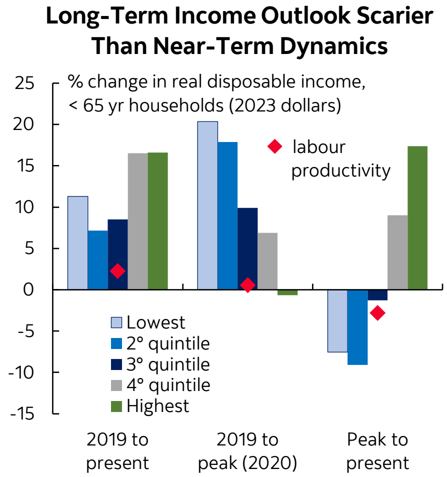
REALITY CHECK FOR PAYCHECKS

Household income is another important check-point. Income provides the cashflow to support spending, savings and investment. Historically, real income growth has run in the order of 1% annually, broadly reflecting productivity improvements that ultimately enable wages to outpace inflation.

Pandemic effects have scrambled income trends in recent years. Exceptional pandemic-related transfers to Canadian households drove a material uptick in income—in the double digits for lower income Canadians—in 2020. It has been on a path to normalisation since then, but any comparison pales to those unsustainable peaks. Lower income working-age households have experienced a decline in real disposable income (i.e., adjusted for inflation) in the order of 8% since that 2020 pandemic-driven peak (chart 12).

The picture looks more benign—if not hot—from a wider vantage point. Real disposable income sits above 2019 levels for working-age Canadians across all income brackets. More recent momentum, if anything, raises eyebrows. Over the past year (through Q1-2024), disposable income has expanded at an average annualised pace of 1.7% versus the pre-pandemic pace of 0.9%—disconcertingly eclipsing productivity gains with implications for welfare over the long run.

Chart 12



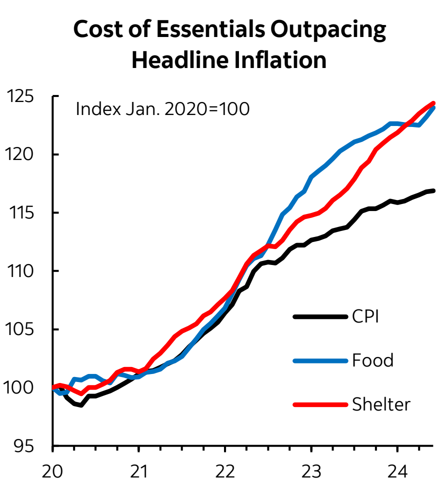
Sources: Scotiabank Economics, Statistics Canada.

STICKER SHOCK

Affordability could be the dominant anchor weighing down the collective psyche. Tackling the cost of living crisis has become a rallying cry across political parties and levels of government. Since 2022, the prices of non-discretionary items such as housing and food have been climbing faster than headline inflation (chart 13). While rate hikes (and other factors) have tempered overall price increases, ongoing geopolitical, demographic, and structural challenges offer little relief for the cost of necessities.

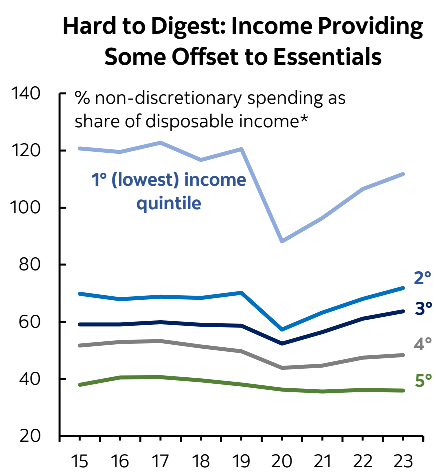
Sticker shock is real. Price *levels* can have a bigger psychological impact than price *changes* especially for everyday items. Even as food inflation cooled earlier this year, two-thirds of Canadians felt it was getting worse according to a Leger **survey**. Price tags on staple goods also shape consumers' perceptions about the overall price environment. Canadians could very well be (subconsciously) discounting income gains against food (and other necessities) inflation. Even though outlays on essentials as a share of disposable income are mostly reverting back to pre-pandemic norms—and still better than pre-pandemic times for the lowest income quintile (chart 14)—income deflated against food prices would look much weaker (chart 15).

Chart 13



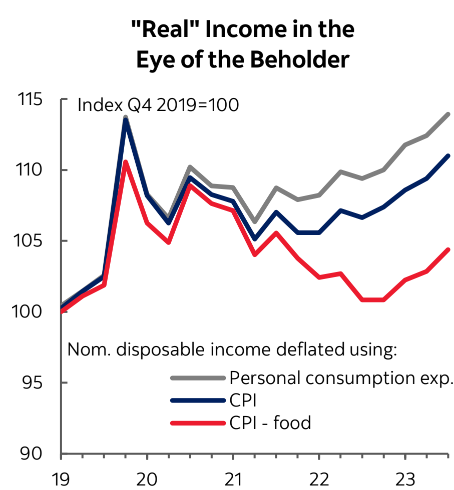
Sources: Scotiabank Economics, Statistics Canada.

Chart 14



Sources: Scotiabank Economics, Statistics Canada.
**Includes food, shelter, health, education & transportation. Adjusted for household size.*

Chart 15



Sources: Scotiabank Economics, Statistics Canada.

High housing costs are also likely front of mind for many Canadians. The impacts of declining affordability touch more than non-homeowners. Even though Canada's home prices (relative to income) rank middle-of-the-pack among peers (chart 16), this offers little consolation for those vying to get into the market. The whiplash pace of price ascents—fueled by chronic supply and acute demand drivers—taints the picture further as the goal posts keep getting pushed out in real-time. Adding salt to the wound, escalating rental costs provide little reprieve.

Younger generations are coming of age into this new reality. Homeownership rates have been on a decade-long decline (66.5% in 2021 from 69% in 2011) with the most pronounced declines among younger cohorts. It is taking increasingly longer (or a warm hand) for them to achieve the same milestones as their parents. Canada is not alone—advanced countries around the world are grappling with intergenerational housing tensions—but again this offers little solace even if Canada's relative performance is respectable (chart 17).

A reckoning is still down the road. There are a host of measures in the pipeline to build out supply, but there are likely limits—at least in the near-term—to material improvements for those looking to buy or rent on the margin. Affordability is also a product of regulatory and financial market constructs that have yet to adapt to today's new reality. Canada will need to re-evaluate risks and re-base expectations. Intergenerational comparisons aren't likely realistic or constructive. Until then, this mood dampener may be around for awhile.

HARD RAIN

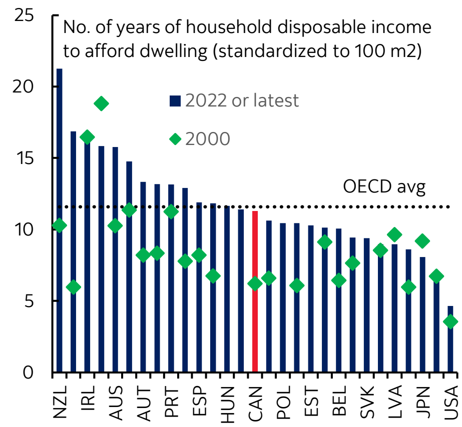
Some Canadians are undoubtedly facing hardships. The national poverty rate is 9.9%, and 10.1% of households live in core housing need. Last year saw a significant increase in severe food insecurity, rising by four percentage points to 16.9%. These statistics align closely with the Bank of Canada's estimates that around 10% of households are financially vulnerable based on credit performance data. *Self-reported* financial stress levels are higher: the Bank of Canada's various survey metrics range from 15% to 45%. Although national accounts data may not effectively capture specific vulnerabilities, other official sources offer a relatively focussed and consistent identification of those most vulnerable.

However, the discourse on inequality can be misleading and potentially counterproductive. Income inequality (as measured by the after-tax GINI coefficient) has given back some of the temporary pandemic-related gains but it remains more favourable than pre-pandemic levels. In 2019, income inequality reached a multi-decade low, supported by significant growth in government transfers to households—from 9.8% to 11.7% of GDP over the last ten years (chart 18). High-quality and accessible education systems also underpin strong intergenerational social mobility in Canada, according to earlier OECD analysis—though this means one can more easily move up *or down* the socio-economic ladder (chart 19).

Zero-sum politics has polarized the debate over wealth. There are growing calls (and actions) to tax wealth even though the distribution of wealth in Canada has been relatively stable for decades. The share of wealth held by the top 10% in Canada, for example, has stood at about 58% for

Chart 16

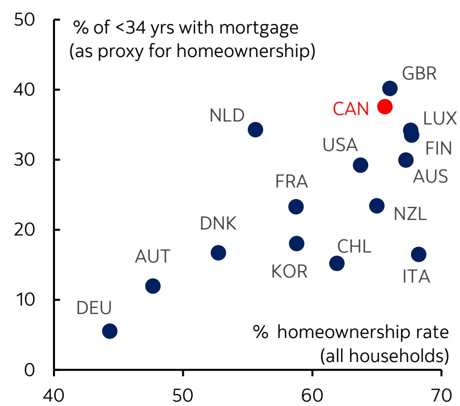
Welcome to the World of High Home Prices



Sources: Scotiabank Economics, OECD.

Chart 17

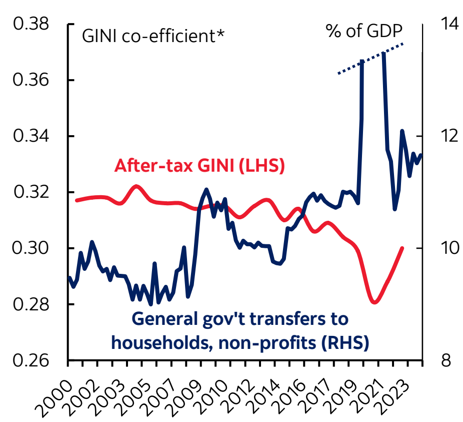
First Rung is the Hardest: Home Ownership Around the World



Sources: Scotiabank Economics, OECD.

Chart 18

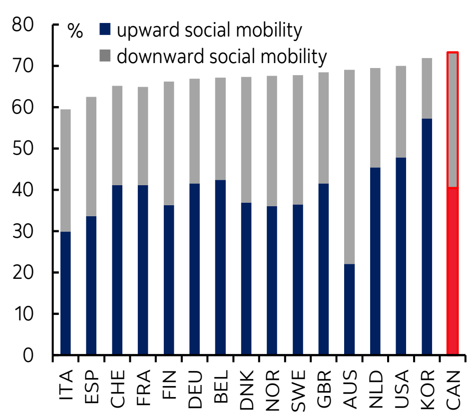
Ripe for a Rethink on Redistribution



Sources: Scotiabank Economics, Statistics Canada. (*A higher co-efficient reflects higher inequality.)

Chart 19

Moving Up in the World



Sources: Scotiabank Economics, OECD (% of 25-64 yr olds whose social class is higher or lower than their parents, 2014).

the past two decades. While the appropriate level is subjective, Canada hardly stands out relative to peers—and fares much better than most regions—in a world where capital is highly mobile (chart 20). Canada already has among the highest (and stealthiest) wealth taxes across advanced countries in the form of property taxes, but its highly decentralized federation has led to mismatches between revenue and expenditure responsibilities with sub-optimal outcomes for Canadians (chart 21).

The focus on redistributive politics is overshadowing the imperative for growth. It is also polarizing parts of society. ("*If you try to please all, you please none*" comes to mind.) Policies aimed at economic expansion and equity can complement each other within a positive-sum policy framework. More constructive approaches could prioritize enhancing market income and financial security for middle class Canadians, while ensuring government support effectively targets society's most vulnerable.

HOW THE LIGHT GETS IN

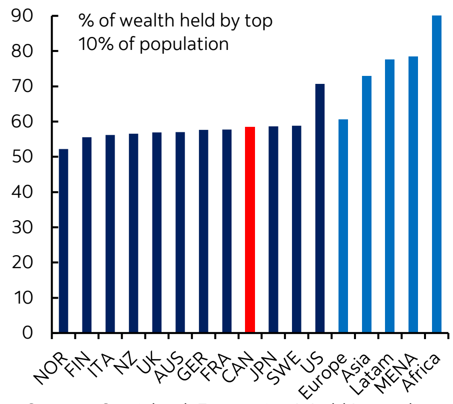
Canada is a pretty good place to call home. One need not venture far beyond its borders to recognize this. The nation boasts stable institutions, robust social safety nets, and a relatively equitable economic and social landscape. It is ranked as one of the happiest countries in the world according to the World Happiness Report and performs well on various OECD Better Life indicators. It is second only to the US as a preferred destination for foreign direct investment, as per Kearney's FDI Confidence Index, a coveted position in an increasingly polarized world.

The nation no doubt faces enormous challenges ahead. However, resorting to alarmism in response to its polycrisis is not yielding results. The discourse has shifted toward a divisive and gloomy view of Canada's outlook and individuals' sense of well-being. There is risk that near-term pessimism morphs into medium term paralysis. A zero-sum culture hinders anything but minor tweaks at a time when sweeping transformations are necessary—such as overhauls in tax and transfer systems, extensive reforms in health and education, right-sizing governments, or a revitalization of cooperative federalism. As fiscal pressures mount, status quo will likely become even more polarizing.

Canada needs a new narrative that fosters rational optimism. This dialogue should promote progress, foster opportunities, celebrate success, and reward risk-taking, all while being anchored in factual realities on the ground. An inclusive vision is crucial, one that promotes empowerment rather than entitlement. Buy-in from Canadians will only be earned through rigorous accountability.

Chart 20

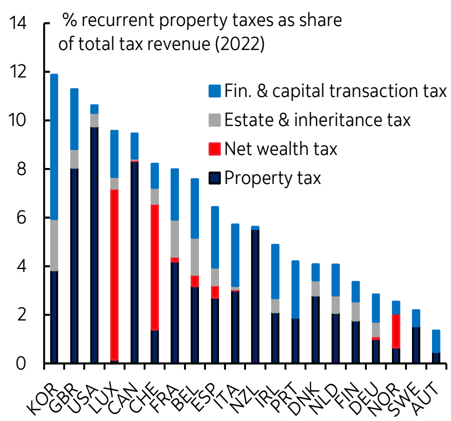
Wealth Distribution Around the World



Sources: Scotiabank Economics, World Inequality Database.

Chart 21

Asset Taxation Around the World



Sources: Scotiabank Economics, OECD.

The alternative—and the path we're on—is continuing to talk ourselves into decline. In that case, it may not get much better than this. All the more reason for Doomers to chin up.