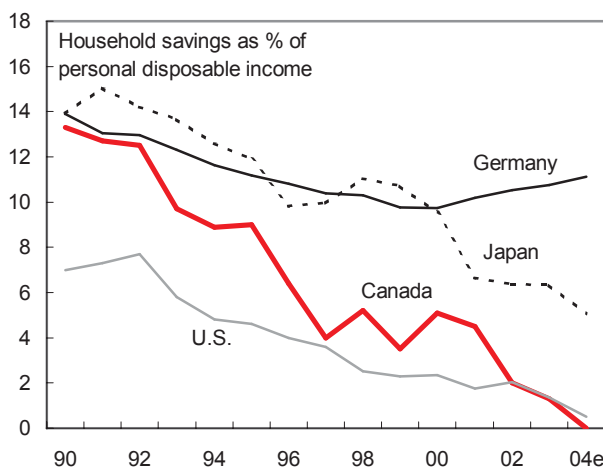


One of the headline grabbing economic statistics as 2004 drew to a close was that Canadians were no longer saving. The bellwether national rate of savings — the difference between current personal income and expenditures measured as a share of disposable income — had effectively plunged to ‘zero’ in the July-September period. This marks the low point in a 22-year declining trend from the highwater savings rate of 20% set in 1982.

Canadians are not alone in spending more and saving less out of every dollar an individual earns. The propensity to save less has been led by ‘big-spending’ Americans, where the savings rate is also hovering around zero. But the rate of personal savings also has been progressively declining in Europe and Japan as well, though the respective rates remain well above the rock bottom levels that are increasingly the norm in North America.

Should we be concerned over the disappearing rate of savings? Our preoccupation reflects concern that Canadians may not have a sufficient ‘rainy day’ financial cushion to protect them from adverse economic developments, not only from the usual twists and turns of business cycles, but from random shocks as well. This concern has been magnified by the significant increase in household indebtedness in recent years, and the potential squeeze on debt servicing from any financial setback stemming from, for example, an erosion in employment conditions and/or sharply higher borrowing costs. Demographic factors are also at play, with an ageing population raising financial concerns over retirement readiness. And from a national perspective, an increasing pool of personal savings is an important, and generally lower cost, source of funding for domestic investment spending by businesses and governments alike.

Canadians don’t appear to be worried that they are saving less of their incomes now than in the past. Economic conditions in Canada have improved consistently over the past decade, with this lengthy period of comparatively solid and uninterrupted growth producing a G7-leading pace of job creation that has raised house-



“Official” savings rates have apparently disappeared in the fastest growing G7 economies

hold incomes and net worth substantially. Ottawa's recurring budget surpluses have helped bolster the nation's longer-term economic prospects. At the same time, low and well anchored inflation expectations have improved the ability of Canadians to plan their retirement goals.

Another key reason may be that during a prolonged period of pint-sized returns in money, bond and stock markets, Canadians have been taking advantage of generational low interest rates and rising home values to invest more in real estate than financial assets. This development is particularly relevant to the issue of saving, since real estate investments, home buying as well as renovations, are not included in the conventional methodology for determining the national savings rate.

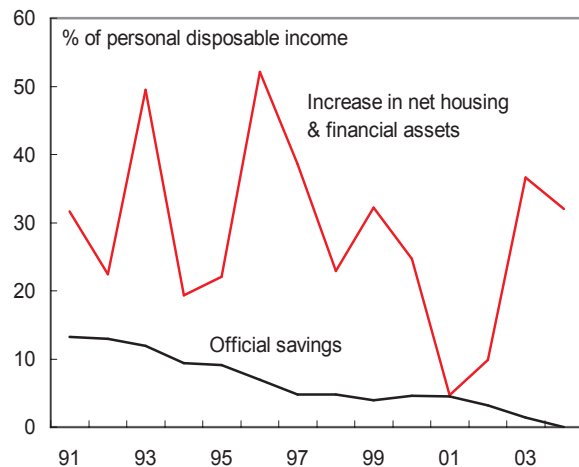
While many Canadians perceive the equity in their home as savings, statisticians consider this a form of consumption. According to the traditional, narrowly defined savings rate calculation, they subtract these investments from income flows, further reducing the residual incomes allocated to savings. Capital gains, both realized and unrealized, accruing from investments in both real estate and financial assets are also not counted. For that matter, the conventional savings rate also excludes contributions of Canadians to social insurance and employee pension plans, non-discretionary savings that are deducted directly from paycheques. Simply adding back these deductions would lift the measured savings rate above 8%.

No wonder Canadians may not be as surprised as statisticians over the rate at which they are building up their savings nest egg, especially when one adds back personal real estate investments as well as non-discretionary savings. It should be clear that the multi-year declining trend in the propensity of Canadians to save out of income still persists, but the rate at which they accumulate assets is considerably higher than the widely followed, yet narrowly defined national income based savings rate.

Looking at the performance of household balance sheets presents a much brighter snapshot of the financial well being of Canadians, owing in part to rising home prices and rising home ownership rates. Specifically, total assets have climbed to record levels, pushing the collective net worth of households (ie. total assets minus total liabilities) to an all-time high of almost six times annual personal disposable income in 2004. The increase in net real estate and financial assets as a share of after-tax income — an alternative

Sources of retirement income:

Canadians draw on a number of sources of traditional retirement savings, in addition to real estate equity and non-registered financial assets. According to Statistics Canada, the total value of retirement assets totalled over \$1.1 trillion in 2002. Of these, employer-sponsored pension plans were the largest component, with estimated assets of \$770 billion, or about two-thirds of the aggregate pool of retirement income of Canadians. Personal savings in registered retirement savings plans (RRSPs) accounted for another \$302 billion, or just over a quarter of the total, while government-sponsored social security plans (the Canada and Quebec Pension Plans) had assets of \$67 billion.



Increase in Canadians' net worth not fully captured in the "official" savings rate

broader measure of savings — has averaged roughly 35% in 2003-04, above its long-term trend of close to 30%.

These broader measures highlight that, collectively, Canadians are not in the dire financial straits suggested by the precipitous drop in savings out of current income. Canadians have been actively diversifying their asset portfolio in recent years, preferring to invest in real estate and stocks/mutual funds at the expense of non-registered financial assets such as money market deposits and bonds. Real estate assets accounted for 35% of total household assets in the third quarter of 2004, up from 29% four years earlier. Non-pension financial asset holdings, on the other hand, have dropped from 41% to 37% of total assets, while pensions continue to hover just above 20%. Clearly, the current high values for real estate and equity-related assets provide Canadians with added wherewithal to spend, borrow and save beyond the limitations imposed by less buoyant income growth.

However, not everyone in Canada is financially set for retirement. Incomes and wealth vary widely across the country. While the incidence of home-ownership has rocketed to a new high above 66%, many Canadians still do not own a home. Not every financial asset held by investors has generated consistently strong returns. And while the nation's longer-term economic performance is expected to remain relatively good, there are no shortages of competitive factors and random shocks that can undercut growth and the job market. A meaningful slump in real estate values, for example, would have serious consequences, not only for consumer purchases, but also for the equity and capital gains that are the foundation for the discretionary savings of the majority of Canadians.

Demographic factors alone will not be sufficient to resuscitate the conventional savings rate, because the increasing number of retiring baby boomers who will save more will likely be counterbalanced by an increasing number of the oldest people who will save less. In this environment, building a larger and more diversified savings cushion should remain an important longer-term goal for Canadians.

Canadians and their RRSPs:

Canadians are not taking full advantage of their RRSP room. In the 2003 tax year (the latest data available), 5.9 million Canadians made a contribution to an RRSP, down from 6.3 million in 2000 and representing just 34% of eligible taxfilers. Moreover, total contributions of \$27.6 billion represented only 9% of the total room available to these taxfilers. The median contribution has remained steady at roughly \$2,600 since the beginning of the decade, despite expanded contribution limits.

