

FOCUS ON CANADA'S HOUSEHOLD DEBT

April 3, 2018

Alberta households will feel the most pressure from interest rate hikes

Interest rates are on their way up, as a Canadian economy that's nudging up against capacity limits reduces the need for policy stimulus. But not all parts of the country will be affected equally. Given expensive housing markets in BC and Ontario, it would be natural to assume that households in those provinces would be the most vulnerable. However, our research shows that Albertans would see the biggest increase in debt-service payments in Canada—more than \$1,200 a year, on average—if interest rates rose by 1 percentage point. Households in BC and Ontario are also more indebted than the national average, but Albertans carry the heaviest debt loads. A booming provincial economy and strong income gains between 2011 and 2014 emboldened households in Alberta to buy homes (sales growth averaged over 10% per year in that period) and accumulate significant debt, leaving them with high debt loads when incomes dropped following the plunge in global oil prices. Albertans are also holding more shorter-term mortgage debt than other Canadian households, although higher-than-average incomes offer them some breathing room.

How much debt are we talking about? Albertans' total liabilities rose from \$164,000 per household on average in 2010 to \$192,000 in 2016. These numbers include households who are debt-free, so actual outstanding balances for those carrying debt are even higher. Mortgages took up the lion's share of Albertans' household debt. The average household was carrying a mortgage of \$124,000 in 2016, up from \$96,000 in 2010. Other debt such as term loans, lines of credit and leases amounted to \$68,000 in 2016, unchanged from 2010.

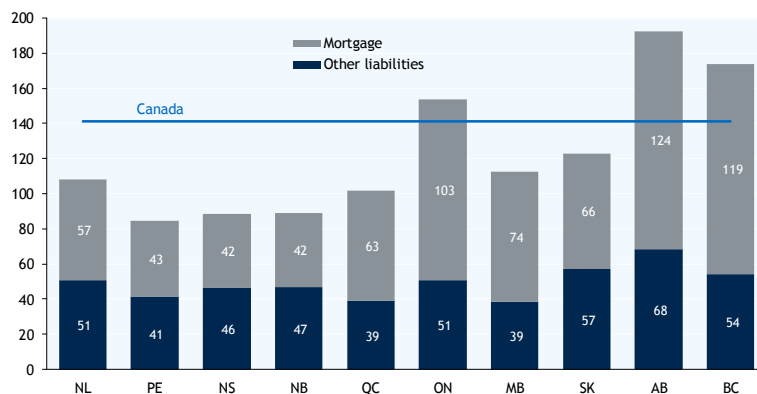
BC households carried the second-heaviest average debt load in the country in 2016 at \$174,000, followed by Ontario households at \$154,000. Mortgages made up 69% and 67% of those totals, respectively, and accounted for three-quarters of the increase since 2010.

In all other provinces, smaller mortgage liabilities substantially lighten total debt loads, and average liabilities per household are well below the national average of \$141,000.

Albertans face the biggest increase in debt-service payments. Albertans already spend the most among all Canadians to service their (relatively larger) debt. In 2016, the average debt-service payment was \$15,300 per Alberta household (including both principal and interest). This exceeded the \$13,700 paid by British Columbians, the \$12,600 paid by Ontarians and the average of \$11,600 by Canadians on average. We estimate that, everything else remaining constant, a 1-percentage-point rise in interest rates ultimately would raise

Average liabilities per household*

Thousand \$, 2016

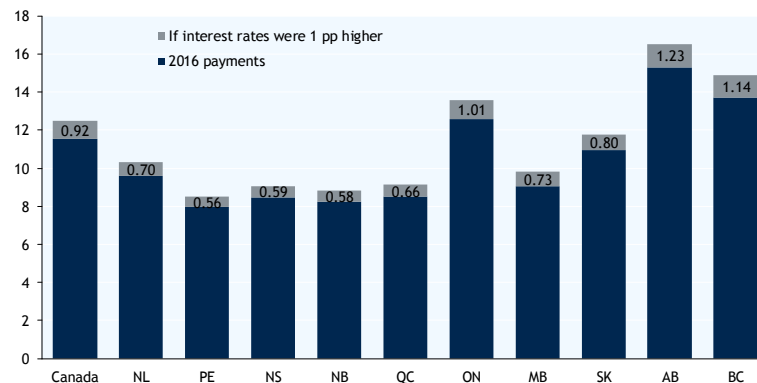


* Including debt-free households.

Source: Statistics Canada, RBC Economics Research

Effect of 1 pp rise in interest rates on debt service payments

Average annual debt service payments per household*, in thousands of \$



* Including debt-free households.

Source: Statistics Canada, RBC Economics Research



annual debt service payments by more than \$1,200 on average for Alberta households. This compares to estimated increases of \$1,100 in BC, \$1,000 in Ontario, and \$800 or less in all other provinces.

These amounts aren't pocket change. In Alberta, for example, the \$1,200 no longer available for spending on everyday goods and services—or saved for future consumption—would exceed what households spend on entertainment (\$1,000) or furniture (\$800) each year.

Albertans' higher incomes are a mitigating factor. Alberta households earn higher incomes than other Canadians, which provides them with a little more room to service heavier debt loads. In 2016, debt-service payments represented 15.2% of disposable income in Alberta—just marginally more than in BC (15.1%). This means that the effect of a 1-percentage-point rise in interest rates would be the same in Alberta and BC—a boost of 1.2 percentage points to their debt service ratios, assuming that everything else remained constant. The effect would be slightly less in Ontario. The ratio in that province would increase by 1.1 percentage points. These debt-service ratios provide an overall sense of vulnerability; however, more detailed data is needed to better ascertain vulnerability of households at a more granular level in each province.

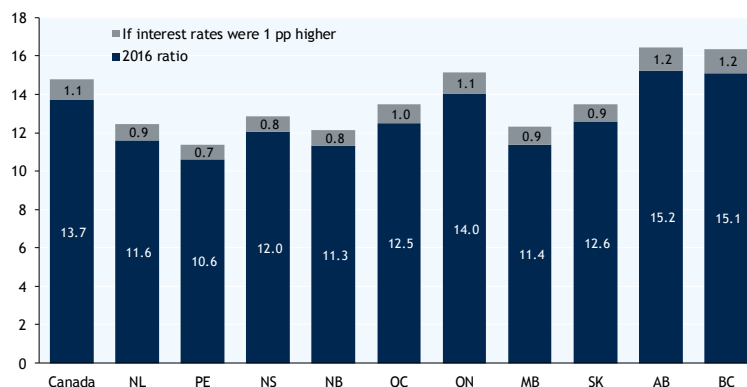
Albertans might feel the impact sooner than other Canadians. A higher proportion of households in Alberta hold shorter mortgage terms. The effect of a rise in interest rates on existing borrowers is staggered over time. The first borrowers to be affected are those with variable-rate loans, followed by borrowers with fixed-rate loans—like three-quarters of mortgages in Canada—who gradually see the increase as their term matures. While the proportions of variable- versus fixed-rate loans don't vary dramatically across Canada, 18% of mortgage borrowers have terms of two years or less in Alberta, which is by far the highest proportion in Canada. The proportion of mortgage holders facing an interest rate reset each year is in fact considerably higher than this because it also includes holders of variable-rate mortgages and maturing fixed-rate mortgages with longer terms. The Bank of Canada estimates that 47% of mortgages in Canada have less than 1 year until interest rates reset (it does not publish provincial figures).

Conclusion

The fact that Albertans—along with British Columbians and Ontarians—carry the heaviest debt loads on a per household basis in Canada inherently makes them more sensitive to interest rate increases. Their debt-service bills will get bigger, and possibly sooner than elsewhere in the country, when interest rates rise. It's bound to cause many households to spend more cautiously on other goods and services. That could potentially restrain economic growth more in Alberta—and in BC and Ontario—than in other provinces. How much more? That's hard to say because the net economic impact of higher rates will also reflect the benefits received by saver-households on the asset side of the balance sheet.

Household debt service ratio

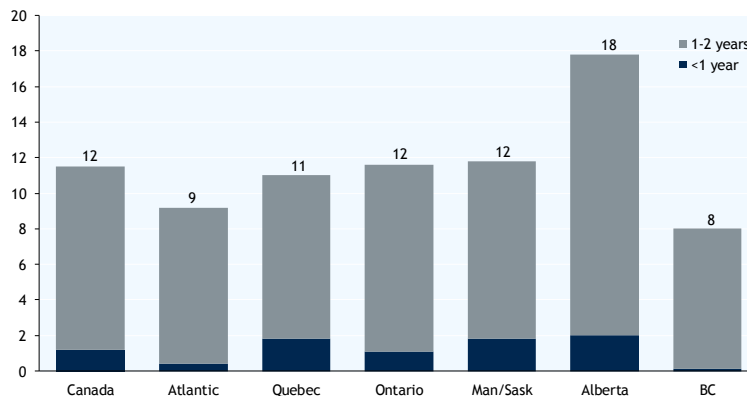
Debt service payments as % of household disposable income, 2016



Source: Statistics Canada, RBC Economics Research

Mortgages with terms of 2 years or less

As a % of all mortgages, 2017



Source: Ipsos Canadian Financial Monitor, RBC Economics Research

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