

FOCUS ON CANADA'S HOUSEHOLD DEBT

December 14, 2018

Interest payments surged in the third quarter as Canadian household's indebtedness looked heavier than previously reported

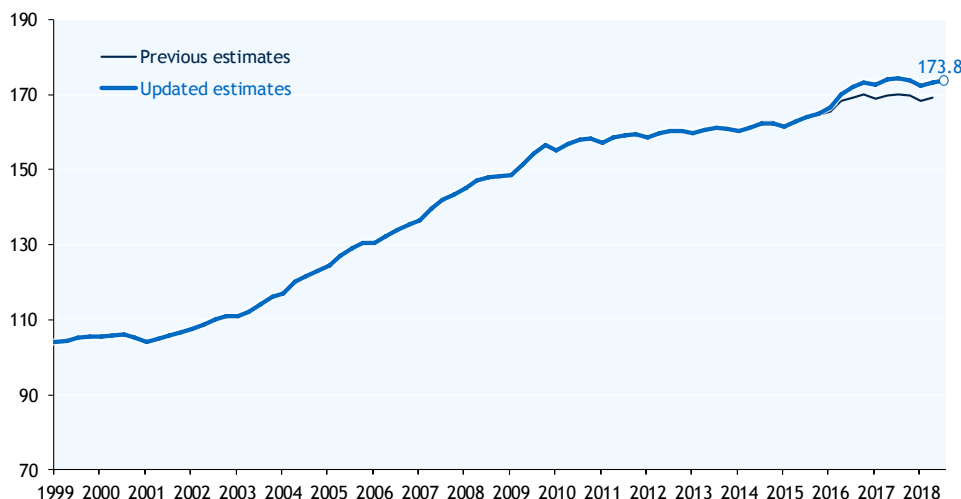
Household indebtedness held relatively steady in Canada in the third quarter as credit market debt and household income grew at a similar pace. This steadiness took place at a higher level of indebtedness than previously reported, however. Downward revisions to household income over the past couple of years—prompted by new information from income tax filings in 2016—boosted the value of indebtedness metrics measured against income. The revisions in particular led to increases of more than 4 percentage points in the debt-to-disposable income ratio in 2017 and 2018. The updated ratio stood at 173.8% in the third quarter of 2018, still down from a peak of 174.3% reached a year ago (previously reported as 170.0%).

On the other hand, metrics measuring indebtedness against households' assets and net worth were little changed in the third quarter as growth in financial and real estate assets continued. Trends in the debt-to-asset ratio and debt-to-net worth ratio have been mostly flat in the past three to four years and therefore aren't flashing any sign of imminent trouble.

Another measure affected by income revisions was the debt service ratio, which tracked slightly higher than previously reported with an earlier start to the current uptrend. At 14.5% in the third quarter, the ratio still suggests that servicing debt is manageable for most Canadians at this stage. That said, the likelihood of further sharp increases in interest payments in the period ahead will intensify the financial challenges facing households. We expect the debt service ratio to rise materially in the coming year. This could pose a risk because Canadian households appear to have little cushion in their budgets. Canadian households' saving rate fell to a 13-year low of 0.8% in the third quarter.

Household debt-to-income ratio: Canada

Credit market debt as a % of household disposable income, not seasonally adjusted



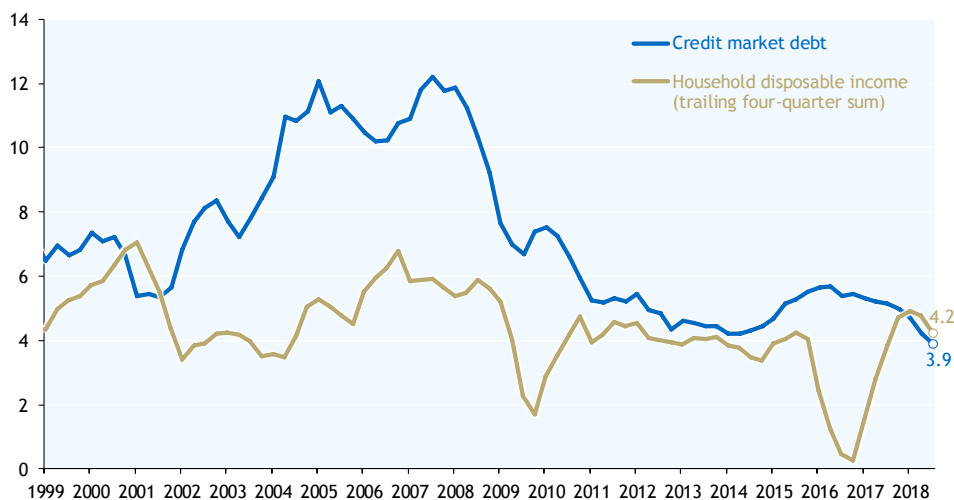
Source: Statistics Canada, RBC Economic Research



Growth in households' credit market debt eased further to a multi-decade low of 3.9% in the third quarter. This was a marginally weaker pace than that of household disposable income (4.2% y/y). We expect that tight labour markets will support steady income gains in Canada.

Household debt and disposable income: Canada

Annual % change

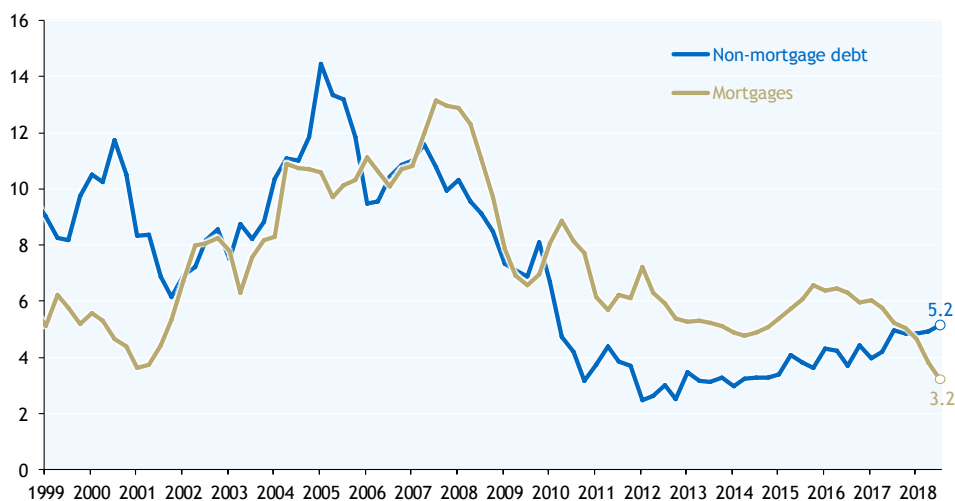


Source: Statistics Canada, RBC Economic Research

Significant deceleration in mortgage growth still entirely accounts for the easing pace of debt accumulation. Macro prudential measures, rising interest rates and a cooling in Canada's housing market restrained growth in mortgages outstanding to its weakest rate (3.2%) in 22 years in the third quarter. By contrast, growth in non-mortgage debt accelerated further to 5.2%.

Household debt: Canada

Annual % change

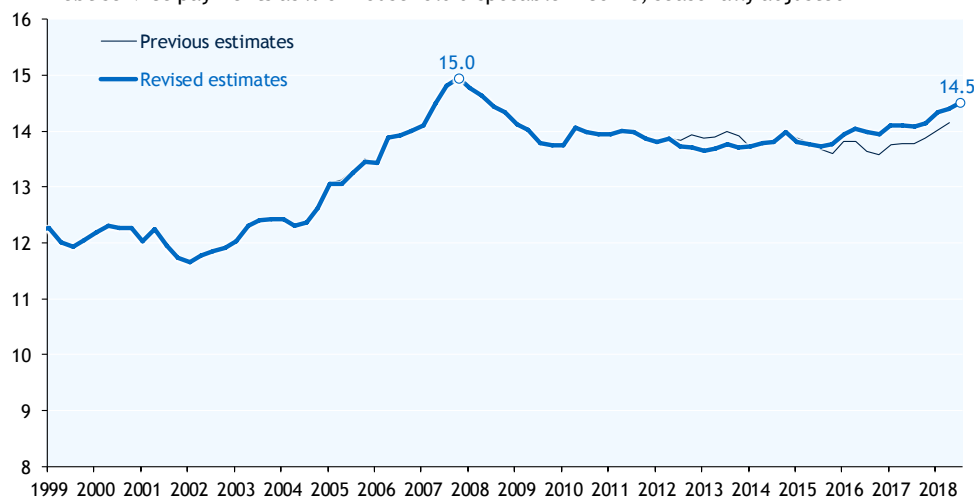


Source: Statistics Canada, RBC Economic Research

The debt service ratio reached 14.5% in the third quarter from 14.4% in the second quarter (was 14.2% previously) and a cyclical low of 13.7% in the third quarter of 2015. We're likely to see this ratio climb further in the period ahead. Interest rate increases to date haven't entirely filtered down to all borrowers and the likelihood of additional hikes over the next year will keep interest payments on a decidedly upward track. Income gains will soften the blow.

Debt service ratio: Canada

Debt service payments as % of household disposable income, seasonally adjusted

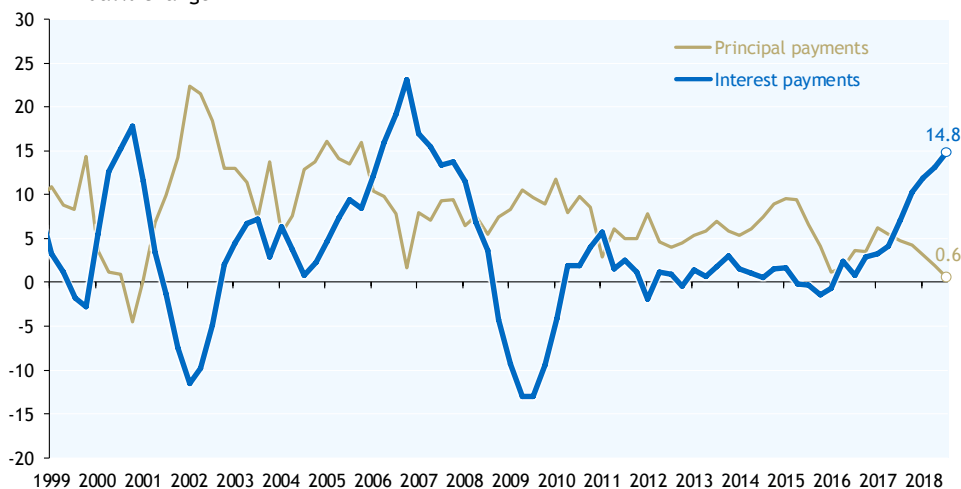


Source: Statistics Canada, RBC Economic Research

The debt service ratio's increase is mostly attributable to a surge in interest payments in the past year and a half. Interest payments rose at their fastest rate (14.8% y/y) since 2007. Principal payments meanwhile decelerated to 0.6%. In a rising interest rate environment, interest payments are poised to accelerate even more in the period ahead. We believe that the rate of increase could get close to the 2006 peak of 23%.

Debt service payments: Canada

Annual % change

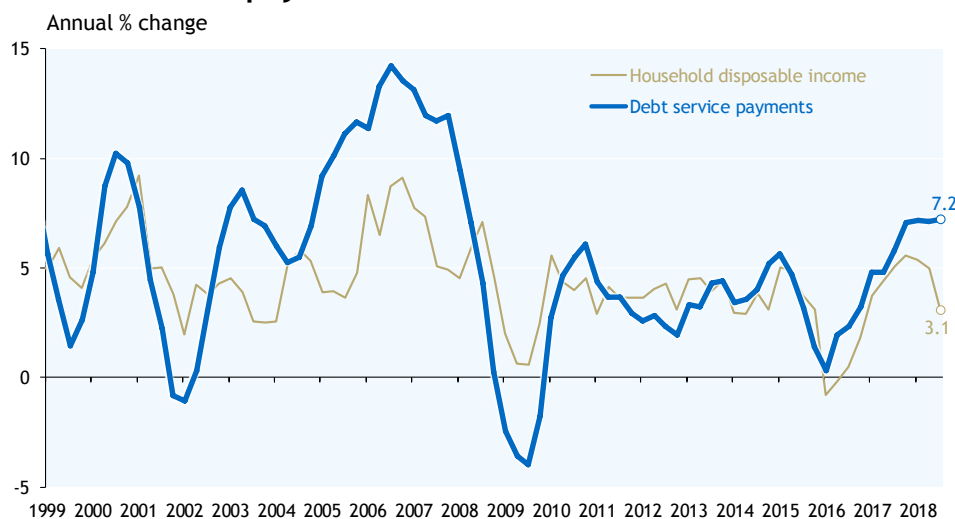


Source: Statistics Canada, RBC Economic Research



Gains in household disposable income are no longer keeping up with increases in total debt service payments. While the latter continued to grow at a solid 7.2% rate in the third quarter, disposable income decelerated from 5.4% at the start of 2018 to a rate of 3.1% most recently.

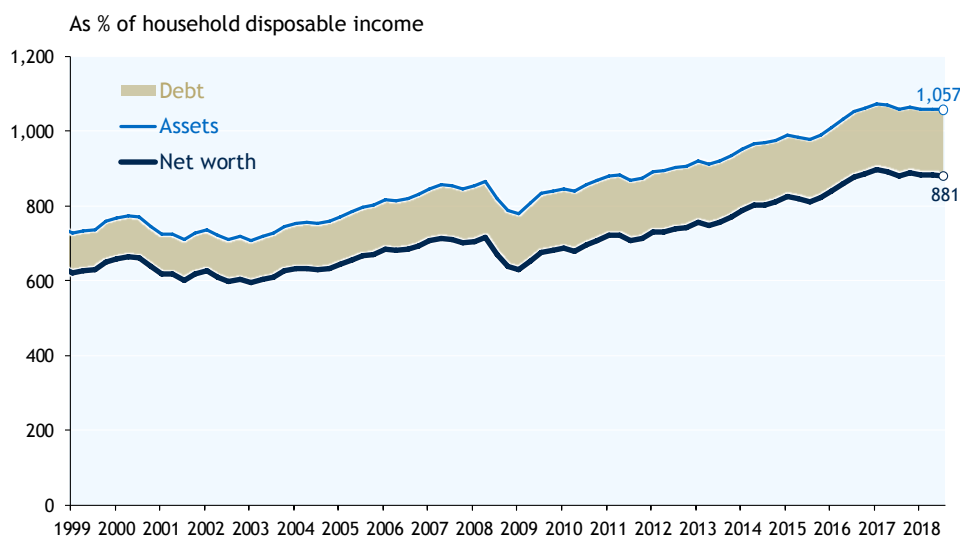
Debt service payments: Canada



Source: Statistics Canada, RBC Economic Research

Canadian households' net worth was little changed for a fifth consecutive quarter—albeit at a historically high level. Net worth represent 881% of household disposable income. While this is down from an all-time high of 899% set in early 2017, it is still 125 percentage points above the figure five years ago.

Household balance sheet: Canada

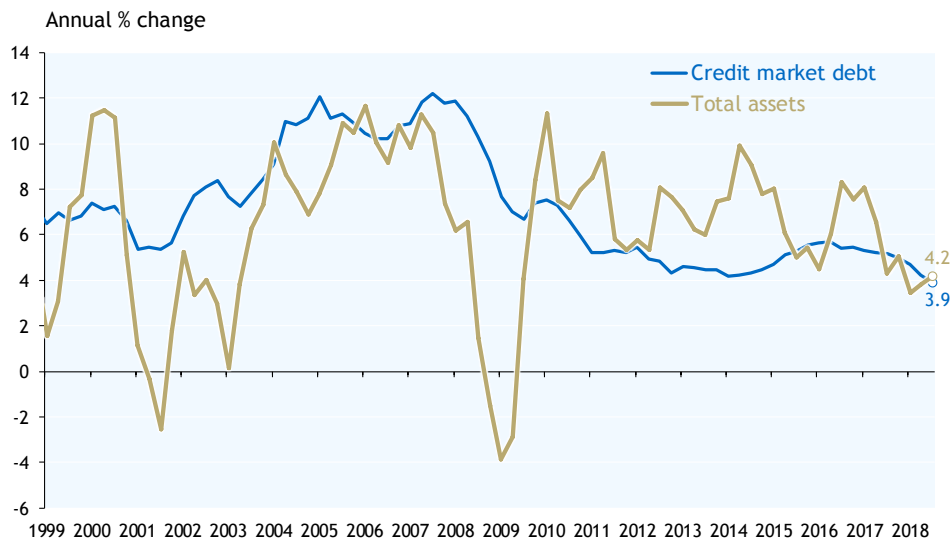


Source: Statistics Canada, RBC Economic Research



The relative stability of households' net worth in the third quarter reflects a similar pace of growth in their debt and assets. Credit market debt rose by 3.9% year over year while household assets grew by 4.2%, which was up from a nine-year low of 3.0% in the first quarter.

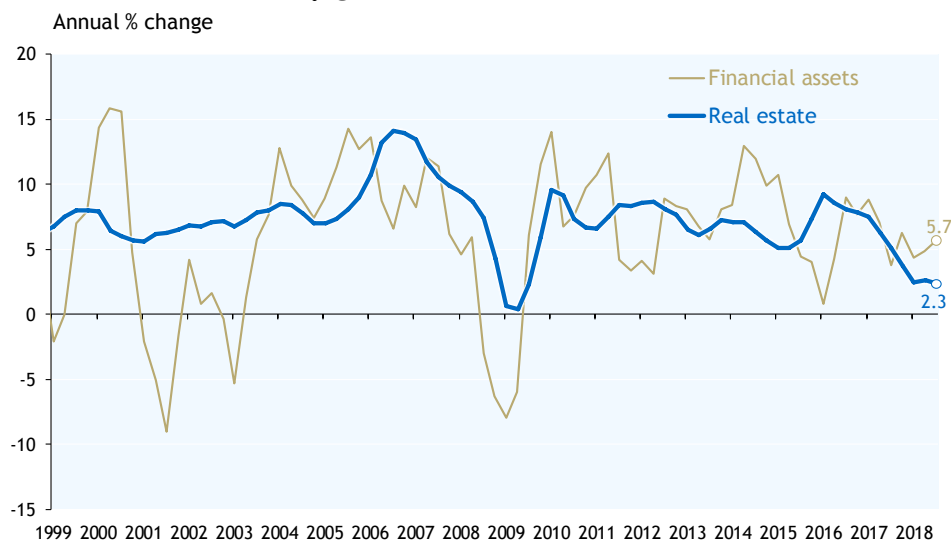
Household balance sheet: Canada



Source: Statistics Canada, RBC Economic Research

The cooling in Canada's housing market curbed the growth of real estate assets significantly. The third quarter's rise in households' real estate holdings was just 2.3%—the weakest increase since the 2008-2009 recession.

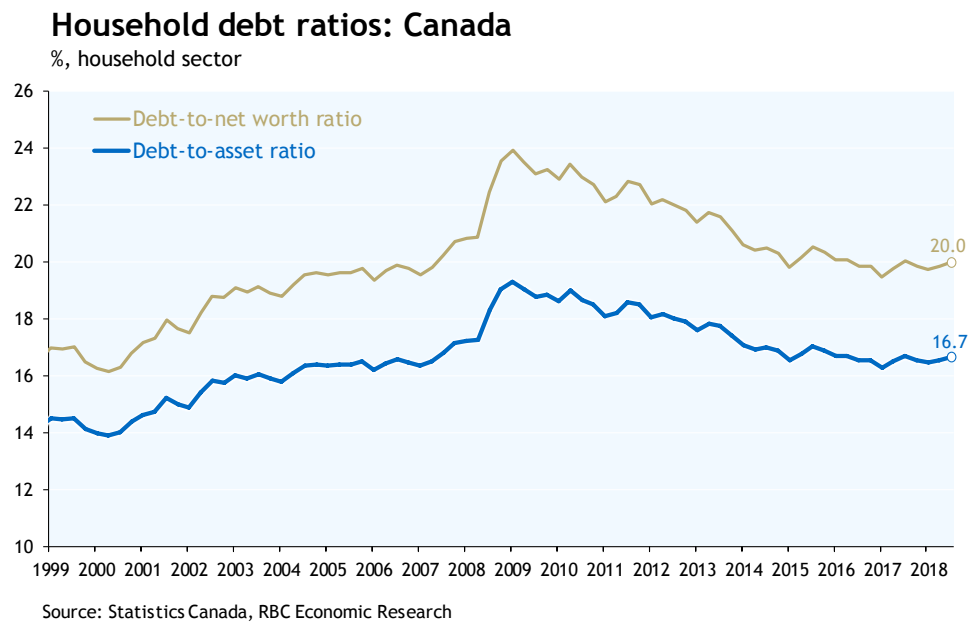
Household assets: Canada



Source: Statistics Canada, RBC Economic Research



Other ratios sizing household debt in Canada have stabilized near decade-low levels in the past two to three years. Both the debt-to-asset and debt-to-net worth ratios were little changed in the last three quarters.





Canadian household balance sheet accounts

Balance sheet	Market value at end of period (\$billions)					Q/Q change, %				
	Q3-17	Q4-17	Q1-18	Q2-18	Q3-18	Q3-17	Q4-17	Q1-18	Q2-18	Q3-18
Total assets	12,795	13,051	13,139	13,264	13,330	0.1	2.0	0.7	1.0	0.5
Financial Assets	6,677	6,879	6,893	6,989	7,056	0.1	3.0	0.2	1.4	0.9
Cash & deposits	1,382	1,398	1,415	1,432	1,453	0.7	1.1	1.2	1.2	1.5
Equities & bonds	2,721	2,820	2,791	2,831	2,860	1.6	3.7	-1.0	1.4	1.0
Life insurance & pensions	2,478	2,568	2,596	2,629	2,640	-1.7	3.6	1.1	1.3	0.4
Other	96	94	91	98	103	2.3	-1.9	-3.6	7.9	4.7
Nonfinancial assets	6,119	6,171	6,246	6,275	6,274	0.2	0.9	1.2	0.5	0.0
Real estate	5,402	5,446	5,525	5,542	5,526	0.0	0.8	1.4	0.3	-0.3
Durable goods	667	673	671	686	695	0.8	1.0	-0.3	2.2	1.3
Other	50	52	50	47	53	10.3	3.7	-4.5	-6.2	13.3
Total liabilities	2,137	2,160	2,166	2,197	2,219	1.4	1.1	0.3	1.4	1.0
Credit market debt	2,109	2,132	2,138	2,169	2,192	1.4	1.0	0.3	1.4	1.0
Mortgages	1,383	1,397	1,402	1,416	1,428	1.4	1.0	0.4	1.0	0.8
Consumer credit & loans	726	734	736	753	764	1.2	1.1	0.2	2.4	1.4
Other (including account payables)	27	28	28	28	28	2.9	2.3	0.1	0.6	-1.4
Total household net worth	10,658	10,891	10,973	11,067	11,110	-0.1	2.2	0.7	0.9	0.4

Financial ratios	Percent (unless otherwise indicated)					Q/Q change, percentage points				
	Q3-17	Q4-17	Q1-18	Q2-18	Q3-18	Q3-17	Q4-17	Q1-18	Q2-18	Q3-18
Credit market debt-to-PDI	174.4	173.8	172.3	173.2	173.8	0.2	-0.6	-1.4	0.8	0.6
Credit market debt-to-assets	16.5	16.3	16.3	16.4	16.4	0.2	-0.2	-0.1	0.1	0.1
Credit market debt-to-net worth	19.8	19.6	19.5	19.6	19.7	0.3	-0.2	-0.1	0.1	0.1
Financial assets-to-credit market debt (quick ratio)	3.2	3.2	3.2	3.2	3.2	0.0	0.1	0.0	0.0	0.0
Net worth-to-total assets (equity ratio)	83.3	83.5	83.5	83.4	83.3	-0.2	0.2	0.1	-0.1	-0.1
Debt service ratio	14.1	14.2	14.3	14.4	14.5	0.0	0.1	0.2	0.1	0.1
Debt service ratio - interest payments	6.5	6.8	6.9	7.0	7.2	0.0	0.2	0.2	0.1	0.2
Debt service ratio - principal payments	7.5	7.4	7.4	7.4	7.3	0.0	-0.1	0.0	-0.1	-0.1
Owners' equity as a % of residential real estate	74.4	74.4	74.6	74.5	74.2	-0.4	-0.1	0.3	-0.2	-0.3
Nonfinancial assets as % of total assets	47.8	47.3	47.5	47.3	47.1	0.0	-0.5	0.3	-0.2	-0.2
Real estate as a % of nonfinancial assets	88.3	88.3	88.5	88.3	88.1	-0.1	0.0	0.2	-0.1	-0.2
Financial assets as % of total assets	52.2	52.7	52.5	52.7	52.9	0.0	0.5	-0.3	0.2	0.2
Cash & deposits as % of financial assets	20.7	20.3	20.5	20.5	20.6	0.1	-0.4	0.2	0.0	0.1
Market-exposed (ex cash & other) assets as % of financial asse	77.9	78.3	78.2	78.1	78.0	-0.1	0.5	-0.2	0.0	-0.2
Credit market debt as a % of total liabilities	98.7	98.7	98.7	98.7	98.7	0.0	0.0	0.0	0.0	0.0

Source: Statistics Canada, RBC Economic Research

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