

FOCUS ON CANADA'S HOUSEHOLD DEBT

June 17, 2019

Efforts to deleverage households are starting to pay off

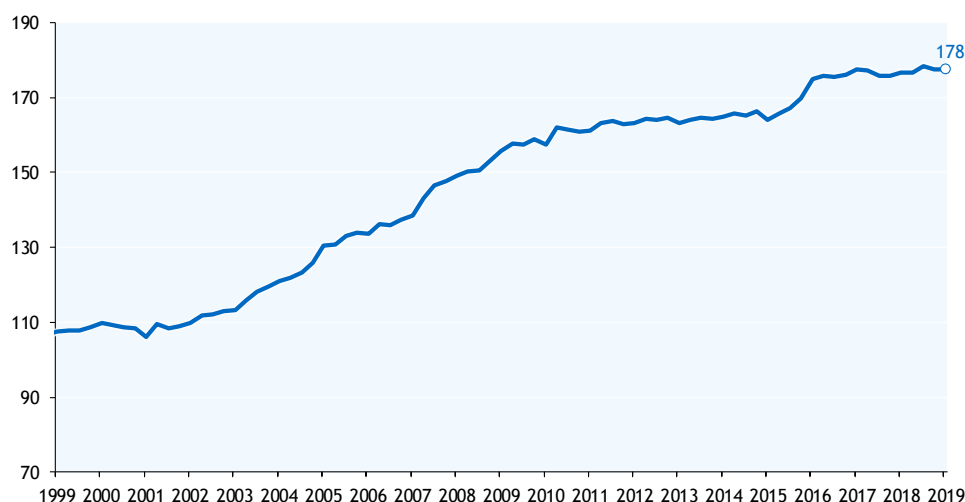
Canadian households owe a record \$1.78 for every dollar earned after tax. So it's not surprising that the topic household debt receives a lot of attention in this country. The good news is that signs are emerging that households are getting their situation under control. For one, the debt-to-income ratio is no longer rising. It has stabilized since 2017 after ballooning in the previous 15 years. And second, household debt is now increasing at its slowest rate in at least a generation. Total credit market debt rose by just 3.7% y/y in the first quarter of 2019. That's down from 4.8% a year ago and 5.7% three years ago. Much of that slowing has been engineered by policy makers. The introduction of more stringent mortgage qualification rules, measures to cool key housing markets and earlier interest rate hikes clearly had the desired effect to curb debt accumulation.

Other encouraging signs in the first quarter included modest improvement in the debt-to-asset ratio (down 0.3 percentage points to 16.8%) and the debt-to-net worth ratio (down 0.5 percentage points to 20.2%). A rebound in equity markets and more stable residential real estate values gave a nice boost to households' assets (up 2.2% q/q). This helped reverse the decline in households' net worth that occurred in the fourth quarter. Net worth rose by 2.7% in the first quarter.

Pressure on households isn't letting up, however. Servicing still-elevated debt levels took up a slightly bigger chunk of income in the first quarter. The debt service ratio climbed for a sixth-consecutive quarter to 14.9%. This matched the all-time high set at the end of 2007. Pressure will persist in the near term. Though with the Bank of Canada staying on the sidelines for a while, the debt service ratio is poised to stabilize in the period ahead. Surging interest payments added almost a full percentage point to the ratio in the past year and a half.

Household debt-to-income ratio: Canada

Credit market debt as a % of household disposable income, seasonally adjusted



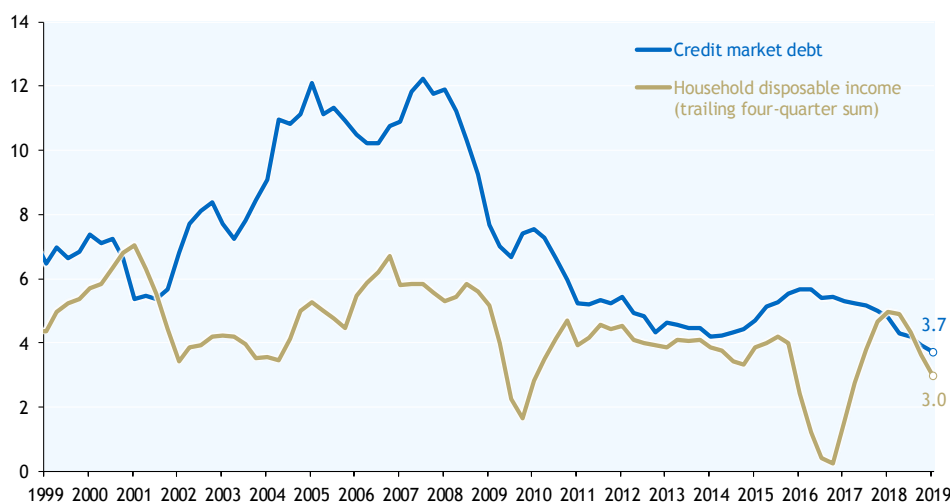
Source: Statistics Canada, RBC Economics Research



Household debt and disposable income have both grown at roughly similar—and moderating—rates in the past year. This has stabilized the debt-to-income ratio at a record 178%. Credit market debt increased by just 3.7% y/y in the first quarter—a generational low. But that was still stronger than the 3.0% rise in household disposable income. We see some scope for the latter to pick up in the near term given Canada's labour market strength.

Household debt and disposable income: Canada

Annual % change

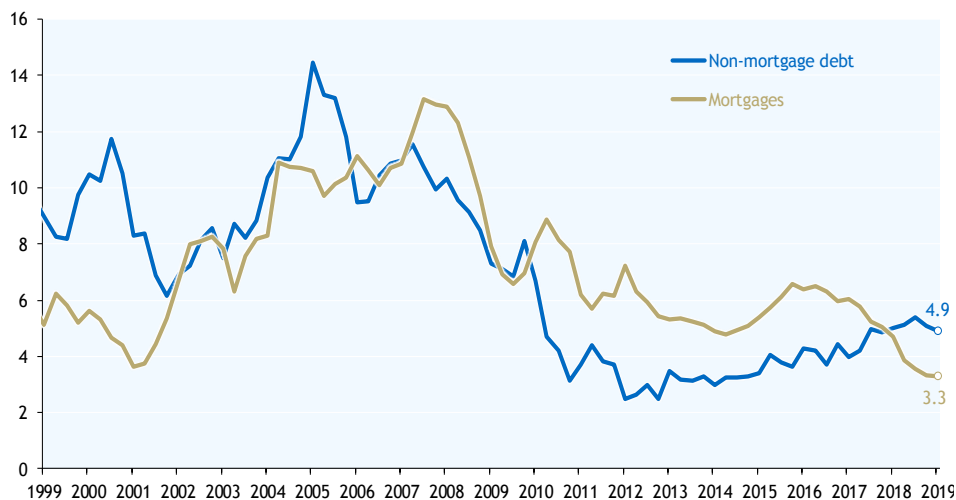


Source: Statistics Canada, RBC Economic Research

Policy action (including the B-20 stress test) and cooling housing market contributed significantly to the slower rate of household debt accumulation. Mortgages outstanding grew at a 23-year low rate of 3.3% y/y in the first quarter. Non-mortgage debt is rising comparatively faster but also eased last quarter to 4.9%. With a cyclical bottom now forming for home resales in Canada, we expect household debt growth to flatten shortly.

Household debt: Canada

Annual % change

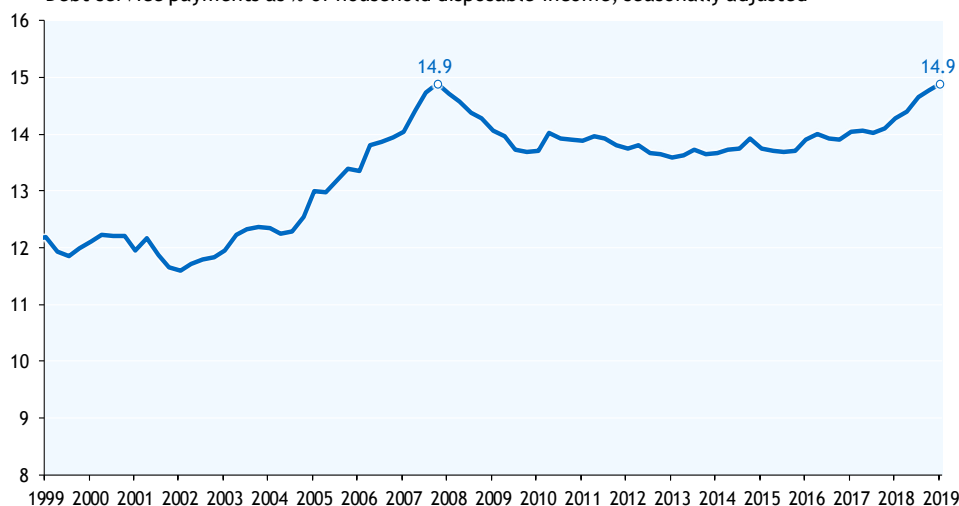


Source: Statistics Canada, RBC Economic Research

Despite the relative stability of their indebtedness, Canadian households are under increasing pressure to service their debt. The debt service ratio rose for a sixth consecutive time in the first quarter to 14.9%. This matched the peak reached in the fourth quarter of 2007.

Debt service ratio: Canada

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

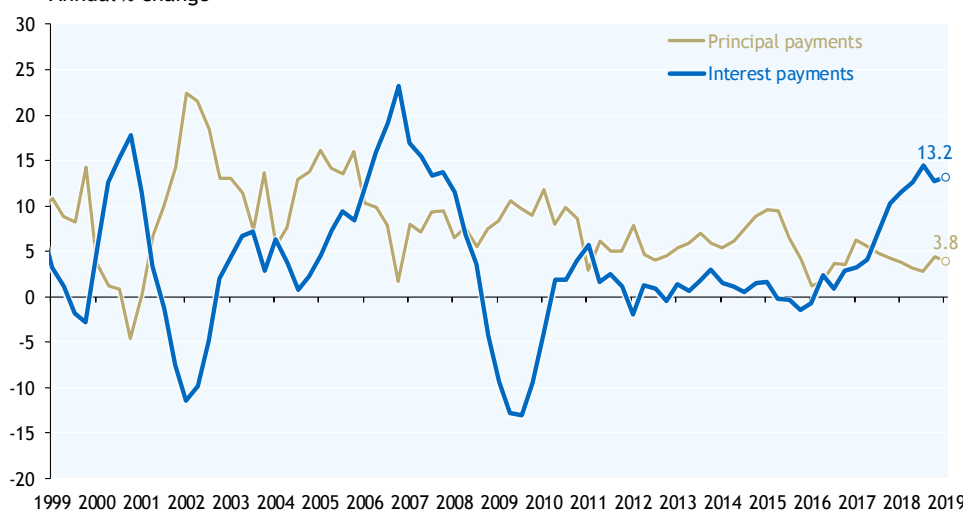


Source: Statistics Canada, RBC Economic Research

Rapidly rising interest payments (up 13.2% y/y in the first quarter) have been the main factor driving the debt-service ratio higher since 2017. Principal payment obligations have grown much more slowly (3.8% in the first quarter)—in line with moderating debt accumulation. We expect interest rates to be largely stable over our forecast horizon, which would dampen growth in interest payments and help stabilize the debt service ratio.

Debt service payments: Canada

Annual % change

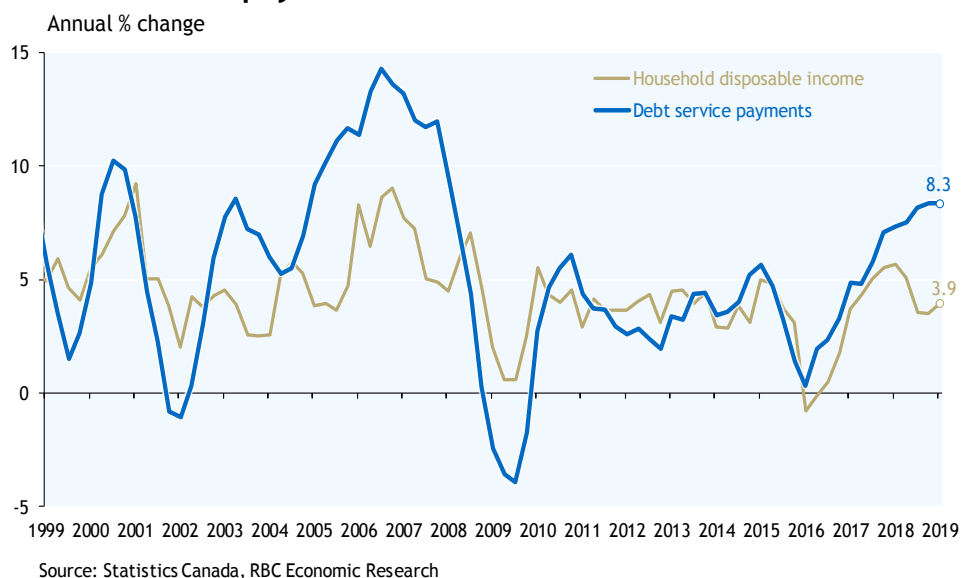


Source: Statistics Canada, RBC Economic Research



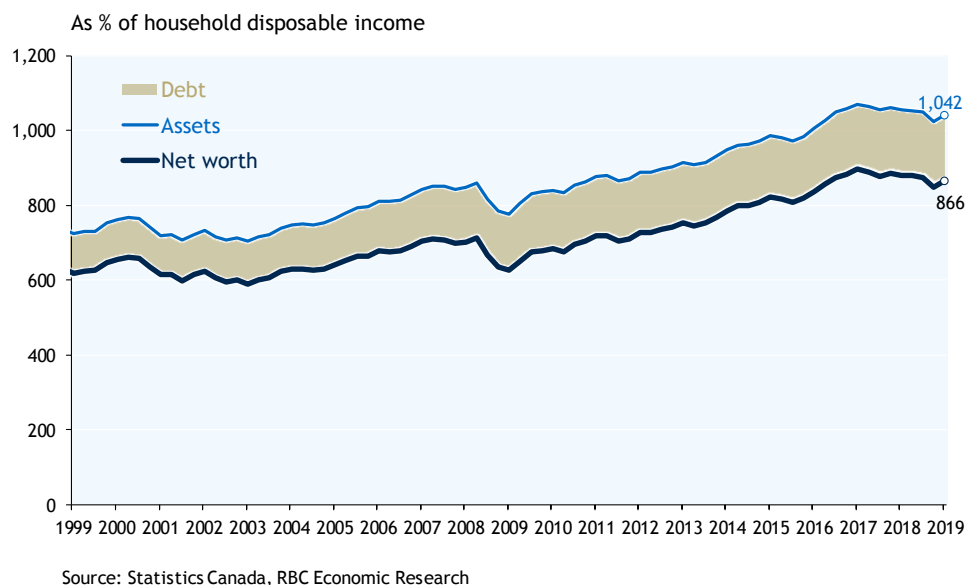
Total debt service payments grew by a decade-high rate of 8.3% in the first quarter. This far outpaced growth in household disposable income (3.9%), despite the latter accelerating from 3.5% in the fourth quarter.

Debt service payments: Canada



Measured as a percentage of disposable income, households' net worth rose for the first time in five quarters to 866%. This almost entirely reflected an increase in asset values (to 1,042% of disposable income).

Household balance sheet: Canada

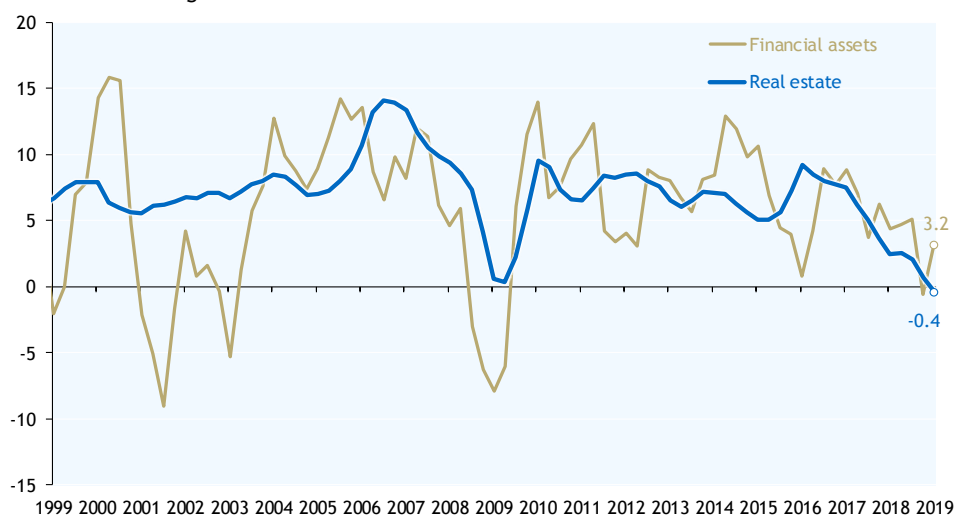




A sharp appreciation in financial assets propelled households' asset values higher in the first quarter. Rebounding equity markets boosted the value of households' financial assets by 3.2% y/y. The value of real estate holdings however fell by 0.4% on year-over-year basis (though it increased slightly on a quarterly basis). We expect real estate holdings to recover in the near term.

Household assets: Canada

Annual % change

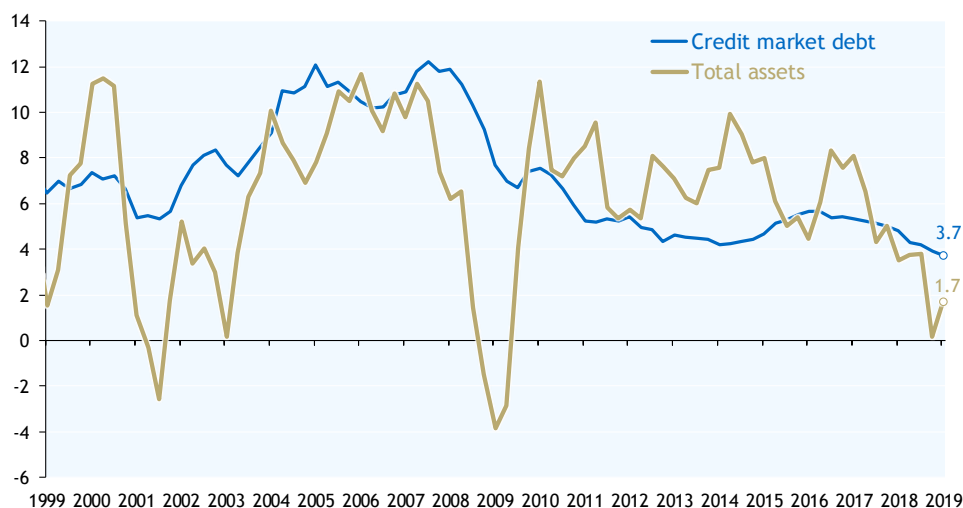


Source: Statistics Canada, RBC Economic Research

In all, total assets have appreciated by 1.7% last quarter. While this is smaller than the 3.7% rate of increase in credit market debt, assets' dollar increase (\$220 billion) far exceeded the rise in debt (\$80 billion) due to assets' much larger size. This resulted in households' net wealth rising materially in the first quarter.

Household balance sheet: Canada

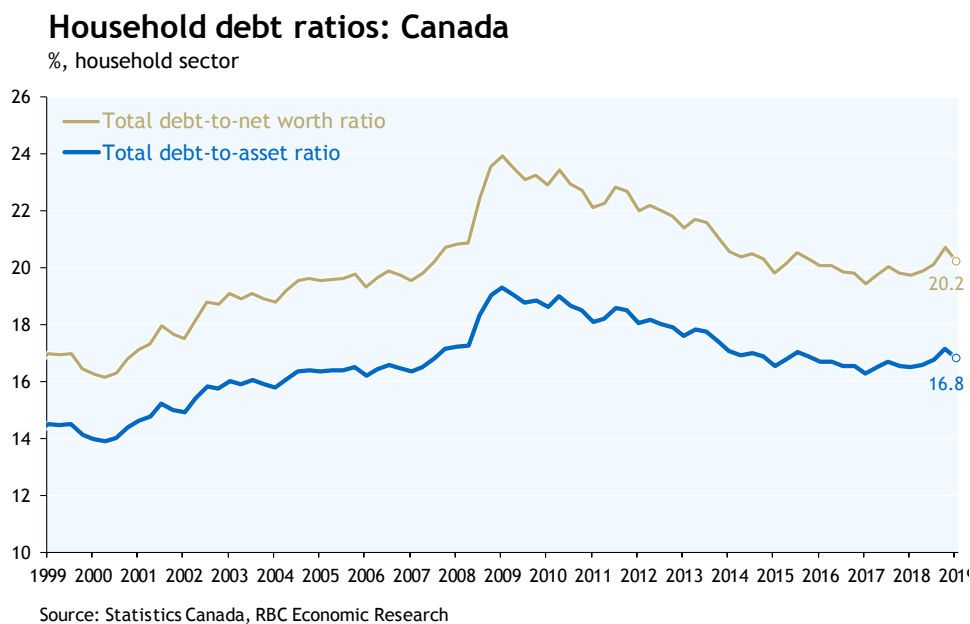
Annual % change



Source: Statistics Canada, RBC Economic Research



Both the debt-to-asset and debt-to-net worth ratios improved slightly, after deteriorating in the previous three quarters. We see scope for further improvement in the near term as real estate holdings recover gradually and debt accumulation remains subdued.





Canadian household balance sheet accounts

Balance sheet

	Market value at end of period (\$billions)					Q/Q change, %				
	Q1-18	Q2-18	Q3-18	Q4-18	Q1-19	Q1-18	Q2-18	Q3-18	Q4-18	Q1-19
Total assets	13,141	13,253	13,280	13,069	13,362	0.7	0.8	0.2	-1.6	2.2
Financial Assets	6,895	6,982	7,020	6,836	7,113	0.2	1.3	0.5	-2.6	4.0
Cash & deposits	1,416	1,432	1,456	1,493	1,498	1.3	1.1	1.7	2.6	0.3
Equities & bonds	2,783	2,813	2,843	2,649	2,849	-1.3	1.1	1.1	-6.8	7.6
Life insurance & pensions	2,607	2,643	2,622	2,593	2,660	1.5	1.4	-0.8	-1.1	2.6
Other	89	94	99	101	106	-5.8	6.2	4.9	2.3	4.5
Nonfinancial assets	6,246	6,271	6,261	6,233	6,249	1.2	0.4	-0.2	-0.4	0.3
Real estate	5,527	5,540	5,514	5,482	5,505	1.5	0.2	-0.5	-0.6	0.4
Durable goods	671	685	695	700	696	-0.4	2.2	1.4	0.7	-0.5
Other	48	45	51	51	48	-7.1	-6.1	13.0	-0.7	-4.9
Total liabilities	2,168	2,199	2,226	2,244	2,248	0.4	1.4	1.2	0.8	0.2
Credit market debt	2,140	2,171	2,198	2,215	2,220	0.4	1.4	1.3	0.8	0.2
Mortgages	1,403	1,416	1,432	1,443	1,449	0.4	0.9	1.1	0.8	0.4
Consumer credit & loans	737	755	766	772	771	0.4	2.4	1.5	0.8	-0.1
Other (including account payables)	28	28	28	28	29	0.1	0.6	-1.4	1.9	1.1
Total household net worth	10,973	11,054	11,054	10,826	11,114	0.8	0.7	0.0	-2.1	2.7

Financial ratios

	Percent (unless otherwise indicated)					Q/Q change, percentage points				
	Q1-18	Q2-18	Q3-18	Q4-18	Q1-19	Q1-18	Q2-18	Q3-18	Q4-18	Q1-19
Credit market debt-to-household disposable income (s.a.)	176.8	176.7	178.3	177.6	177.6	1.1	-0.1	1.6	-0.7	0.0
Credit market debt-to-assets	16.3	16.4	16.6	16.9	16.6	0.0	0.1	0.2	0.4	-0.3
Credit market debt-to-net worth	19.5	19.6	19.9	20.5	20.0	-0.1	0.1	0.2	0.6	-0.5
Financial assets-to-credit market debt (quick ratio)	3.2	3.2	3.2	3.1	3.2	0.0	0.0	0.0	-0.1	0.1
Net worth-to-total assets (equity ratio)	83.5	83.4	83.2	82.8	83.2	0.1	-0.1	-0.2	-0.4	0.3
Debt service ratio	14.3	14.4	14.7	14.8	14.9	0.2	0.1	0.3	0.1	0.1
Debt service ratio - interest payments	6.9	7.0	7.2	7.3	7.5	0.1	0.1	0.2	0.1	0.1
Debt service ratio - principal payments	7.4	7.4	7.5	7.4	7.4	0.1	0.0	0.0	0.0	0.0
Owners' equity as a % of residential real estate	74.6	74.4	74.0	73.7	73.7	0.3	-0.2	-0.4	-0.4	0.0
Nonfinancial assets as % of total assets	47.5	47.3	47.1	47.7	46.8	0.2	-0.2	-0.2	0.5	-0.9
Real estate as a % of nonfinancial assets	88.5	88.3	88.1	88.0	88.1	0.2	-0.1	-0.3	-0.1	0.1
Financial assets as % of total assets	52.5	52.7	52.9	52.3	53.2	-0.2	0.2	0.2	-0.5	0.9
Cash & deposits as % of financial assets	20.5	20.5	20.7	21.8	21.1	0.2	0.0	0.2	1.1	-0.8
Market-exposed (ex cash & other) assets as % of financial assets	78.2	78.1	77.9	76.7	77.4	-0.1	0.0	-0.3	-1.2	0.8
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