

FOCUS ON CANADA'S HOUSEHOLD DEBT

September 14, 2018

Debt service took a bigger bite out of household income in the second quarter

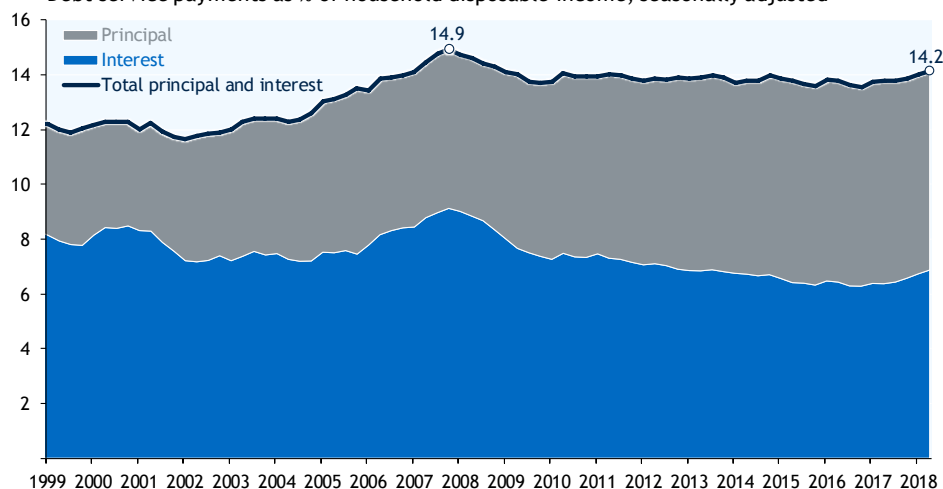
As a sign of things to come, Canadian households allocated more of their income toward servicing their debt in the second quarter of this year. The debt service ratio rose to 14.2% from 14.0% in the first quarter and a cyclical low of 13.6% at the end of 2016. The situation is still manageable for most Canadians at this stage but, little by little, we're likely to see this ratio climb further in the period ahead. Interest rate increases to date haven't entirely filtered through to all borrowers yet and the likelihood of additional hikes over the next year will keep interest payments on a decidedly upward track. Solid income gains will soften the blow though all they will do is slow down the pace of the debt service ratio's ascension. After nearly a decade of remarkable stability in the ratio, many households will face increasing pressure as they handle their financial affairs. A still-positive economic backdrop should nonetheless keep family budgeting manageable overall despite being tighter.

The good news is that household indebtedness has leveled off over the past couple of years, albeit at elevated levels. As is typically the case in the second quarter, the household debt-to-income ratio inched slightly higher to 169.1% from 168.3% in the first quarter primarily because of seasonal factors—spring is the peak period for mortgages. Relative to a year ago, the ratio is down marginally by 0.6 percentage points. Other measures of indebtedness (e.g. debt-to-asset ratio and debt-to-net worth ratio) also point to relative stability over the past couple of years that carried through to the first half of this year. Marked deceleration in household credit growth—to 4.3% in the second quarter from 5.0% a year ago—bodes well for some easing in household indebtedness in the period ahead.

On the other side of the ledger, household assets increased at a slightly firmer rate in the second quarter thanks to an acceleration in both real estate and financial assets. This left households' net worth little changed as a share of income—still near record high levels.

Debt service ratio: Canada

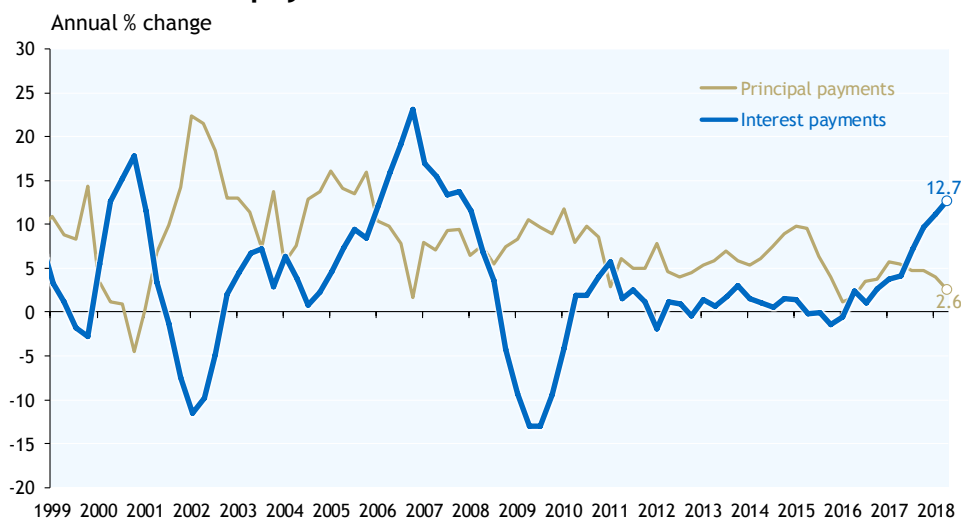
Debt service payments as % of household disposable income, seasonally adjusted



Source: Statistics Canada, RBC Economics Research

The debt service ratio's increase in the second quarter is mostly attributable to a surge in interest payments. Interest payments rose at their fastest rate (12.7% year over year) since 2007. Principal payments meanwhile decelerated to 2.6%. In a rising interest rate environment, interest payments are poised to accelerate even more in the period ahead. Could the rate of increase get close to the 2006 peak of 23%? We wouldn't rule it out.

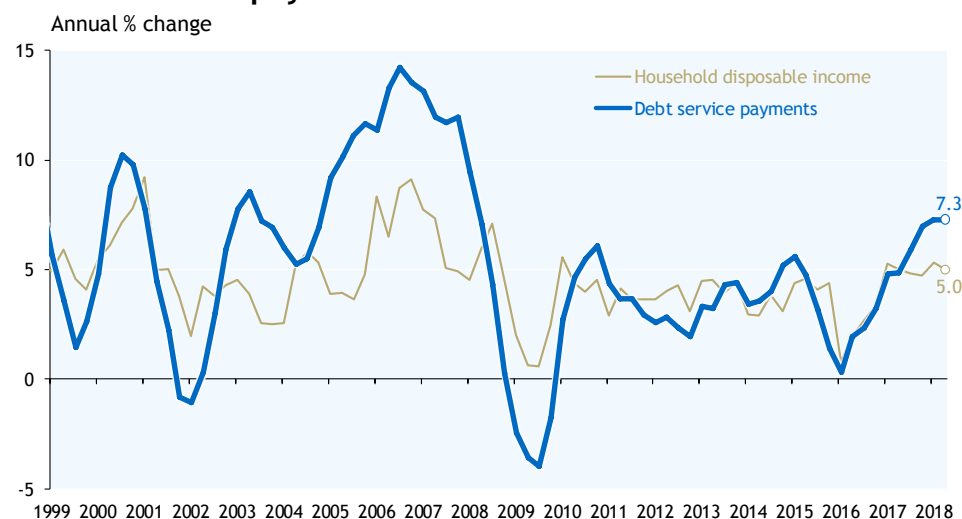
Debt service payments: Canada



Source: Statistics Canada, RBC Economics Research

Our eyes are also trained on household disposable income. This has been a good news story lately because it's been growing at a very solid rate (5.0% year over year in the second quarter). This provides significant (though partial) offset to the sharp rise in total debt service payments. We expect this to continue to be the case in the short term. We expect that tight labour markets will support steady income growth in Canada.

Debt service payments: Canada



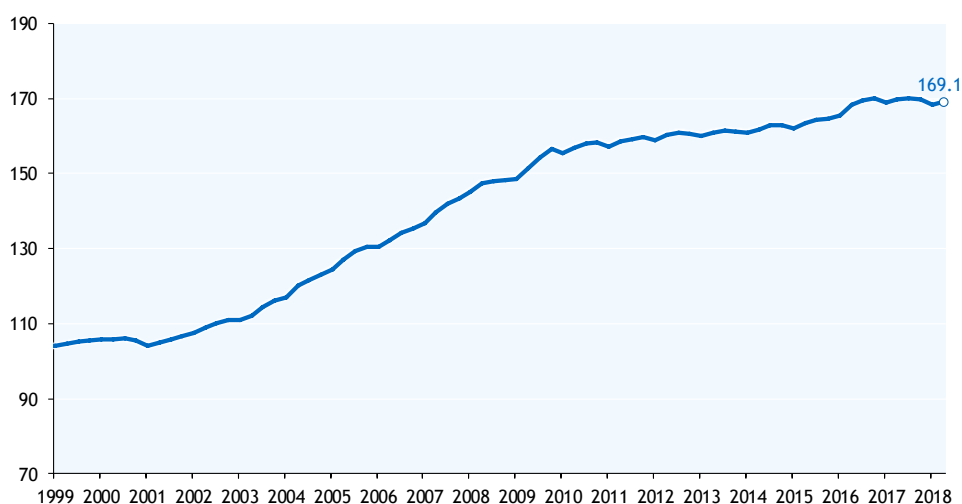
Source: Statistics Canada, RBC Economics Research



Seasonal factors are behind the slight increase in the household debt-to-income ratio to 169.1% in the second quarter from 168.3% in the first quarter. Relative to a year ago, the ratio has eased slightly for three consecutive quarters now, including a 0.6 percentage point drop in the second quarter. Nonetheless, the ratio remains near record-high levels and continues to flag elevated vulnerabilities in the household sector.

Household debt-to-income ratio: Canada

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

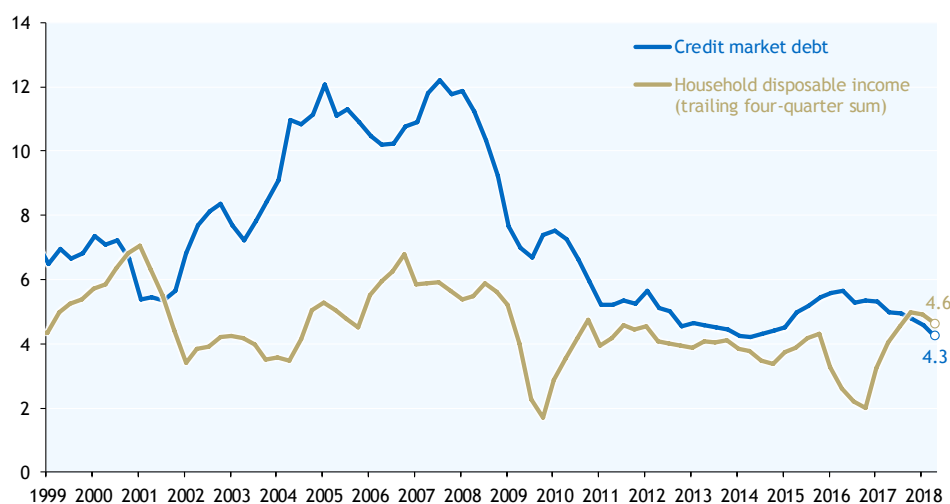


Source: Statistics Canada, RBC Economics Research

Canadian households continue to accumulate debt at a slower pace. Growth in their credit market debt eased further to 4.3%—a four-year low. This was just a little slower than growth in disposable income (calculated as a four-quarter trailing sum).

Household debt and disposable income: Canada

Annual % change



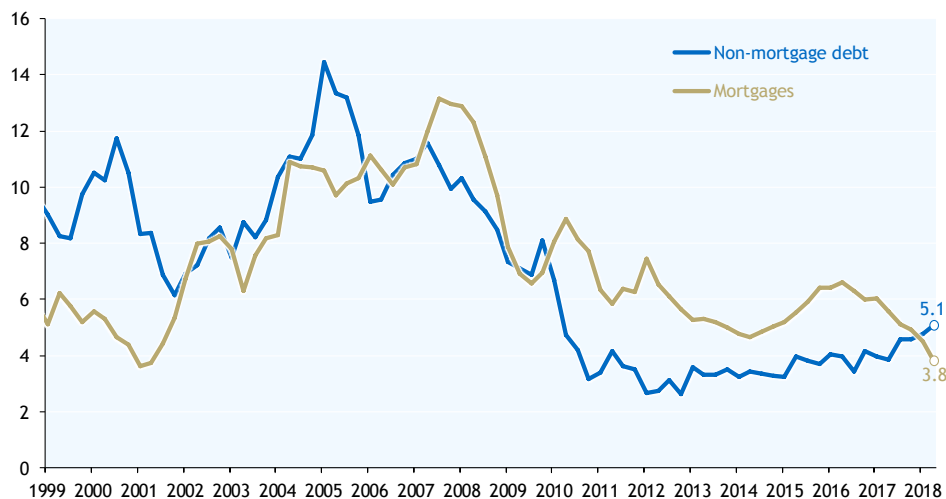
Source: Statistics Canada, RBC Economics Research



Significant deceleration in mortgage growth 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 (3.8%) in 17 years in the second quarter. By contrast, growth in non-mortgage debt accelerated further to 5.1%.

Household debt: Canada

Annual % change

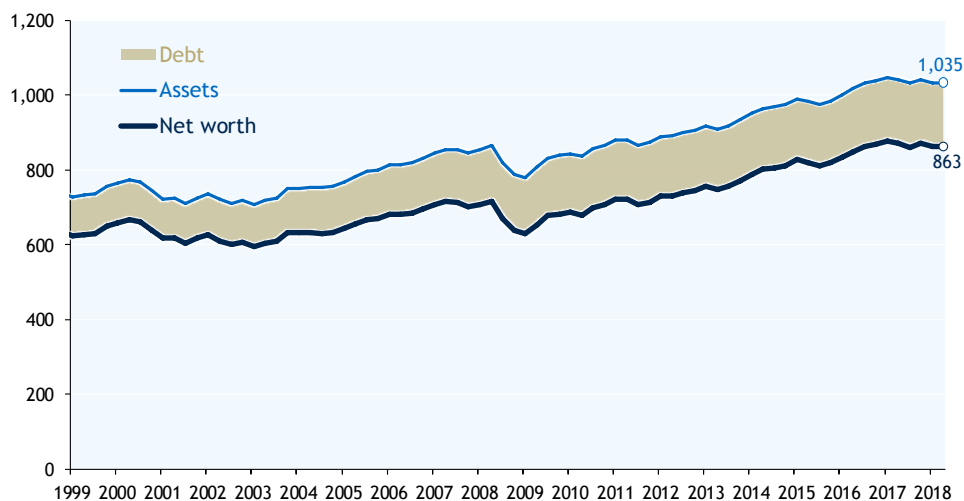


Source: Statistics Canada, RBC Economics Research

Canadian households' net worth was little changed in the second quarter at a historically high level. Net worth represent 863% of household disposable income. While this is down from an all-time high of 878% set in early 2017, it is still 100 percentage points above the figure five years ago.

Household balance sheet: Canada

As % of household disposable income

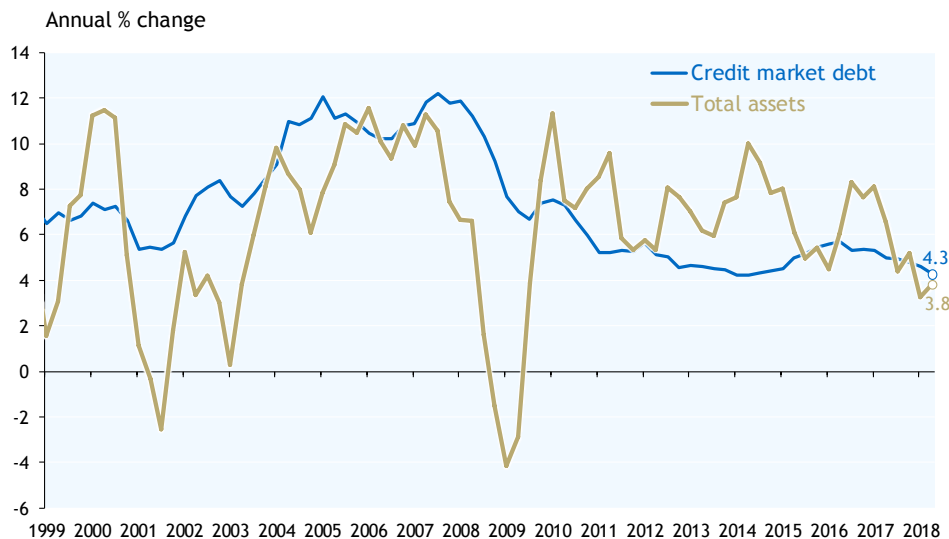


Source: Statistics Canada, RBC Economics Research



The relative stability of households' net worth in the second quarter reflects a similar pace of growth in their debt and assets. Credit market debt rose by 4.3% year over year and household assets grew by 3.8%, which was up from a nine-year low of 3.0% in the first quarter...

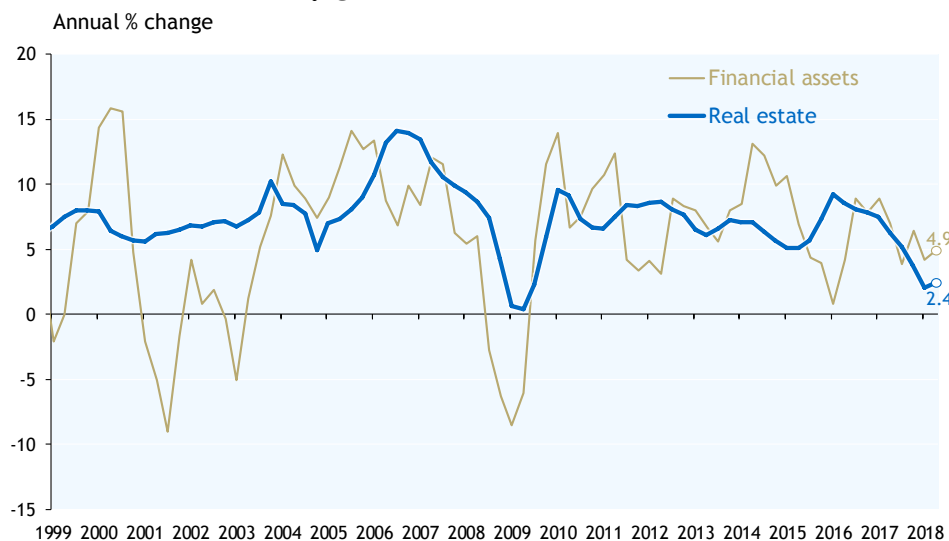
Household balance sheet: Canada



Source: Statistics Canada, RBC Economics Research

...as a cooling in Canada's housing market curbed the growth of real estate assets significantly. The first quarter rise in households' real estate holdings was just 2.0%—the weakest increase since the 2008-2009 recession—though this compared to a year-ago level that coincided with the cyclical peak for Canada's housing market. The rate accelerated slightly to 2.4% in the second quarter as the base effect eased somewhat.

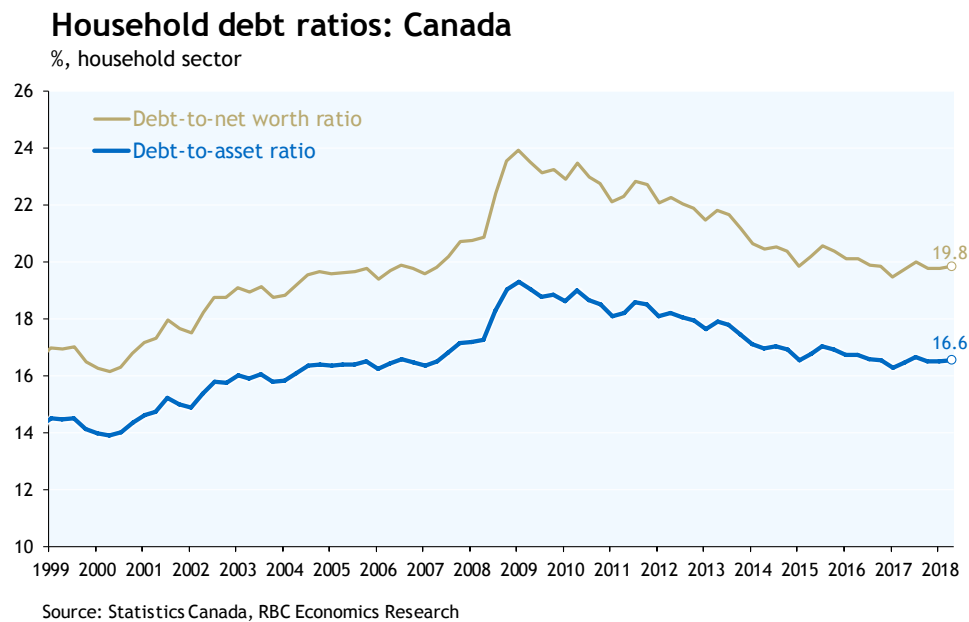
Household assets: Canada



Source: Statistics Canada, RBC Economics Research



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





Canadian household balance sheet accounts

Balance sheet	Market value at end of period (\$billions)					Q/Q change, %				
	Q2-17	Q3-17	Q4-17	Q1-18	Q2-18	Q2-17	Q3-17	Q4-17	Q1-18	Q2-18
Total assets	12,768	12,797	13,067	13,107	13,252	0.6	0.2	2.1	0.3	1.1
Financial Assets	6,657	6,675	6,891	6,880	6,982	0.8	0.3	3.2	-0.2	1.5
Cash & deposits	1,373	1,382	1,397	1,415	1,432	1.2	0.7	1.1	1.2	1.2
Equities & bonds	2,676	2,724	2,817	2,768	2,817	0.6	1.8	3.4	-1.7	1.8
Life insurance & pensions	2,515	2,472	2,583	2,606	2,638	0.8	-1.7	4.5	0.9	1.2
Other	94	96	94	91	95	1.9	2.3	-1.9	-3.3	4.4
Nonfinancial assets	6,111	6,122	6,175	6,227	6,270	0.3	0.2	0.9	0.8	0.7
Real estate	5,404	5,405	5,449	5,504	5,534	0.2	0.0	0.8	1.0	0.5
Durable goods	661	667	673	674	689	2.0	0.8	1.0	0.1	2.3
Other	46	51	53	49	47	-6.5	11.0	3.8	-6.6	-5.7
Total liabilities	2,104	2,133	2,156	2,164	2,194	1.7	1.4	1.1	0.4	1.4
Credit market debt	2,078	2,106	2,128	2,136	2,166	1.7	1.4	1.1	0.4	1.4
Mortgages	1,363	1,383	1,397	1,402	1,416	1.6	1.4	1.0	0.4	1.0
Consumer credit & loans	714	723	731	734	750	1.9	1.2	1.2	0.4	2.2
Other (including account payables)	27	27	28	28	28	0.9	2.9	2.3	0.1	0.6
Total household net worth	10,664	10,664	10,910	10,943	11,058	0.4	0.0	2.3	0.3	1.1

Financial ratios	Percent (unless otherwise indicated)					Q/Q change, percentage points				
	Q2-17	Q3-17	Q4-17	Q1-18	Q2-18	Q2-17	Q3-17	Q4-17	Q1-18	Q2-18
Credit market debt-to-PDI	169.7	170.0	169.7	168.3	169.1	0.9	0.2	-0.3	-1.4	0.8
Credit market debt-to-assets	16.3	16.5	16.3	16.3	16.3	0.2	0.2	-0.2	0.0	0.0
Credit market debt-to-net worth	19.5	19.8	19.5	19.5	19.6	0.3	0.3	-0.2	0.0	0.1
Financial assets-to-credit market debt (quick ratio)	3.2	3.2	3.2	3.2	3.2	0.0	0.0	0.1	0.0	0.0
Net worth-to-total assets (equity ratio)	83.5	83.3	83.5	83.5	83.4	-0.2	-0.2	0.2	0.0	0.0
Debt service ratio	13.8	13.8	13.9	14.0	14.2	0.0	0.0	0.1	0.2	0.1
Debt service ratio - interest payments	6.4	6.4	6.6	6.7	6.9	0.0	0.1	0.1	0.2	0.1
Debt service ratio - principal payments	7.4	7.4	7.3	7.3	7.3	0.0	-0.1	-0.1	0.0	0.0
Owners' equity as a % of residential real estate	74.8	74.4	74.4	74.5	74.4	-0.4	-0.4	0.0	0.2	-0.1
Nonfinancial assets as % of total assets	47.9	47.8	47.3	47.5	47.3	-0.1	0.0	-0.6	0.2	-0.2
Real estate as a % of nonfinancial assets	88.4	88.3	88.2	88.4	88.3	-0.1	-0.1	0.0	0.1	-0.1
Financial assets as % of total assets	52.1	52.2	52.7	52.5	52.7	0.1	0.0	0.6	-0.2	0.2
Cash & deposits as % of financial assets	20.6	20.7	20.3	20.6	20.5	0.1	0.1	-0.4	0.3	-0.1
Market-exposed (ex cash & other) assets as % of financial assets	78.0	77.9	78.4	78.1	78.1	-0.1	-0.1	0.5	-0.2	0.0
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 Economics Research

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