CURRENT ANALYSIS

January 2014

Chart 1

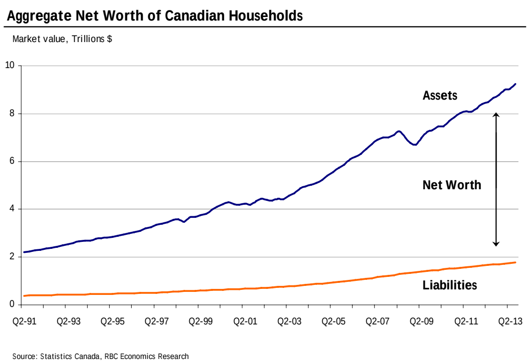


Chart 2

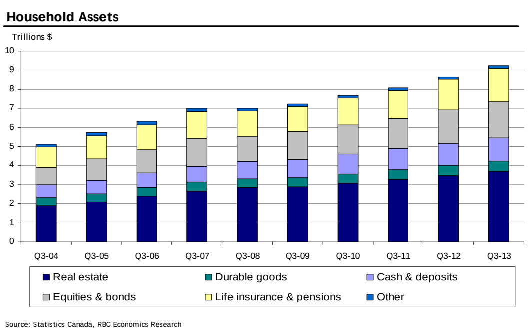
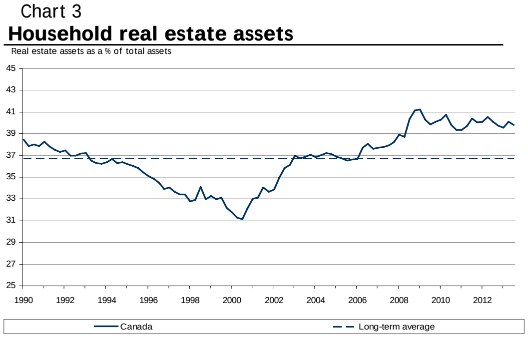


Chart 3



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Canadian households' financial positions show mild improvement

The aggregate wealth of Canadian households climbed to a record high in the third quarter of 2013. The National Balance Sheet Accounts (NBSA) indicated that the total market value of Canadian household assets less liabilities (net worth) rose 7.3% from a year earlier to $7.5 trillion dollars. On a per capita basis, net worth gained 6.0% to $212,200, also a record high. (Strengthening household asset values outpaced debt accumulation and the debt-to-income ratio rose to a record high of 163.7% in Q3/13). With debt levels remaining historically elevated and continuing to rise, the vulnerability of Canadian households to potential economic shocks poses a key risk to the Canadian economy. This note takes a broad look at the measures of Canadian indebtedness, incorporating both sides of the balance sheet, to provide an overall picture of the financial position of households.

Household asset values continue to climb

The market value of assets held by Canadians continued to grow in the third quarter, rising 6.7% on a year-over-year basis to $9.2 trillion. Even though robust housing activity and accompanying price gains continued to support appreciating real estate assets, household balance sheets remain well diversified. Non-financial assets have maintained a relatively constant share of total assets (46% in the third quarter compared to longer-term average of 45%) despite real estate assets taking a slightly larger share relative to its historical average (40% vs. 37%). Financial assets also maintained their longer-term average share of total assets with equities and bonds accounting for an increased share of household assets at 21% (compared to longer-term average of 17%); conversely, pensions and life insurance (19%) and cash and deposits (13%) represented a smaller proportion of total asset holdings compared to their respective longer-term shares (21% and 14%). Overall, the continued diversification provides some degree of insulation for Canadian households, particularly against the risk of declines in the real estate class going forward.

Mortgage debt contributing to rise in liabilities

On the other side of the ledger, household liabilities grew by 4.5% on a year-over-year basis to $1.77 trillion in Q3/13, representing a modest easing from the 4.7% pace in Q2/13. Credit market debt outstanding (which includes mortgages, consumer credit and loans) rose $77 billion in the quarter from a year earlier led by a $57 billion expansion in mortgage balances. The pace of increase in mortgage debt accumulation held steady on a year-ago basis, matching the 5.3% growth in the previous quarter and representing the slowest year-over-year pace since 2001. Growth in consumer credit & other non-mortgage loans slowed to an annual pace of 3.2% from 4.1% in the previous quarter helping to temper the overall pace of total household credit growth. Overall, the year-over-year pace of household debt accumulation continued along its firmly entrenched downward trend in the third quarter.

Chart 4

Household debt-to-income ratio

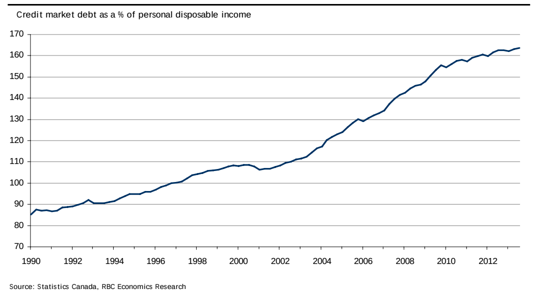


Chart 5

Household debt ratios

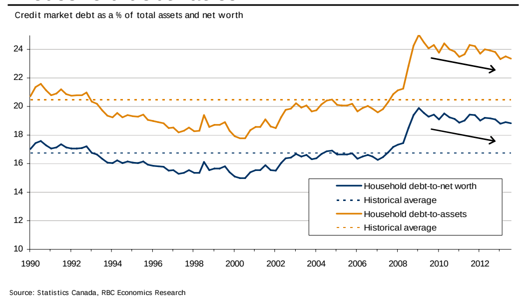


Chart 6

Household debt service costs

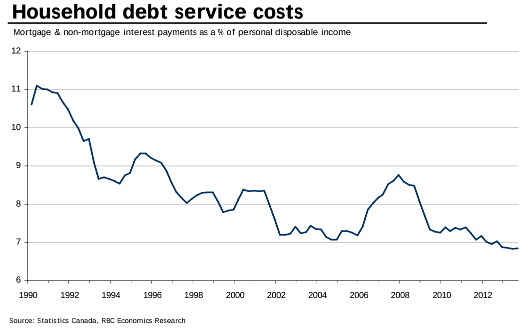
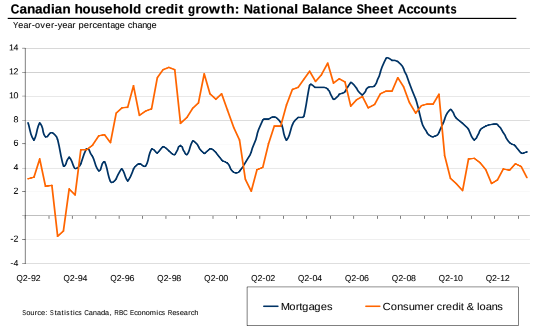


Chart 7

Canadian household credit growth: National Balance Sheet Accounts



Measures of household indebtedness

Despite its moderation, household debt accumulation grew faster than household disposable income in Q3/13, pushing the oft-cited debt-to-income ratio to 163.7% from 163.1% recorded in Q2/13. That said, broader metrics that show how debt is being used by consumers are preferable to measure the degree of household indebtedness. These measures indicate a gradual improvement in households' financial positions. Growth in asset values and net worth outpaced that of credit on a percentage basis in the third quarter, resulting in the household credit market debt-to-asset and net worth ratios declining to 19.0% and 23.5%, respectively. These measures remain elevated, however, relative to their respective pre-recessionary norms of 16% and 19%. That said, they have sustained mild downward trends since reaching their respective peaks in Q1 2009 and indicate a declining proportion of household assets are being funded by credit.

The persistence of a low interest rate environment has helped Canadian households manage the interest costs associated with elevated levels of debt. The debt service ratio[1] is a measure of the interest payments on household debt relative to personal disposable income and has held steady at a historically low 6.9% for four consecutive quarters. With approximately two-thirds of mortgage debt having a fixed-rate (as opposed to variable), this has helped to shelter some households from the recent rise in mortgage rates. Over time, the normalization of interest rates will place upward pressure on interest costs; however, the slowing in debt accumulation and sustained income growth bode well for the debt service ratio to remain historically low in the near-term.

Elevated debt…but pace of growth is easing

The release of the *National Balance Sheet Accounts* showed that a record market value of assets on Canadian household balance sheets in the third quarter helped to lift aggregate net worth to an all-time high. At the same time, the level of debt rose; however, the year-over-year pace of debt accumulation eased slightly in the third quarter and remained below the pace of asset growth. The sustained moderation in credit growth is likely a welcome development for Canadian policymakers, particularly as the indebtedness of households was cited as one of the "most important domestic sources of risk to financial stability" along with imbalances in the housing market in the Bank of Canada's *Financial Stability Review*. With housing activity expected to moderate to a more sustainable pace, we expect that the slow pace of household credit growth will persist in 2014. Further, by maintaining a diversified portfolio of assets, Canadian households are in position to weather a modest easing in real estate prices. Overall, we expect the improving economy to generate stronger income growth which will help to sustain asset gains and offset any additional increases in debt accumulation. The persistence of an historically low interest rate environment will also help to keep debt service costs low and support the stability of the financial position of Canadian households, despite elevated levels of households indebtedness.

Note

1. The debt service ratio used in this analysis is slightly different from the rate published by Statistics Canada (found in CANSIM Table 380-0073) reflecting adjustments made to the personal disposable income measure that were used to make the debt-to-income ratio internationally comparable.

Canadian household balance sheets

End of period	Market value ($billions) Q3 2013	% share	Historical share*
Total assets	**9,232**		
Financial Assets	4,967	53.8	54.7
Cash & deposits	1,226	13.3	14.2
Equities & bonds	1,900	20.6	17.4
Life insurance & pensions	1,733	18.8	20.5
Other	140	1.5	3.2
Nonfinancial assets	4,265	46.2	45.3
Real estate	3,692	40.0	36.7
Durable goods	540	5.9	8.0
Other	32	0.3	0.6

	Market value ($billions) Q3 2013	% share	Historical share*
Total liabilities	**1,773**		
Credit market debt	1,751	98.7	98.4
Mortgages	1,132	63.9	62.6
Consumer credit & loans	618	34.9	35.8
Other	22	1.3	1.6
Total household net worth	**7,459**		

Source: Statistics Canada, RBC Economics Research

* Average since 1990