RBC ECONOMICS | RESEARCH

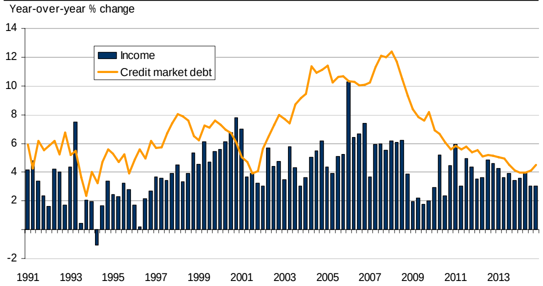
NATIONAL BALANCE SHEET ACCOUNTS

March 2015

Chart 1

Household income and loan growth

Year-over-year % change

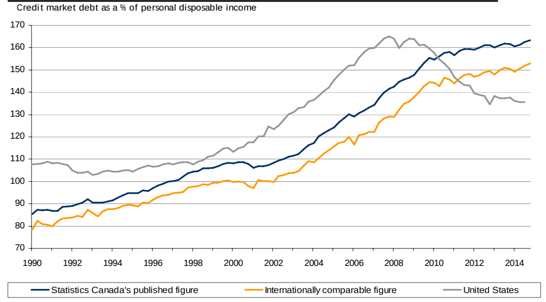


Source: Statistics Canada, RBC Economics Research

Chart 2

Household debt-to-income ratio

Credit market debt as a % of personal disposable income

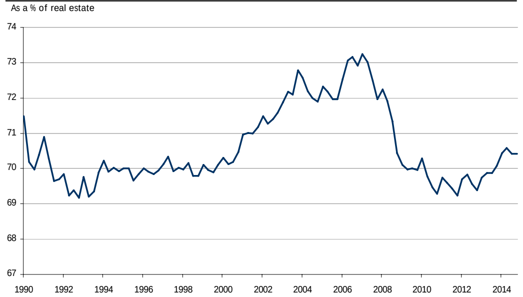


Source: Statistics Canada, RBC Economics Research

Chart 3

Owner's Equity

As a % of real estate



Source: Statistics Canada, RBC Economics Research

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In the release of the Q4/14 National Balance Sheet Accounts, the oft-cited credit market debt-to-income ratio set another record high, rising to 163.3% from 162.7% in Q3/14, which will do little to quell concerns that household imbalances are creeping ever closer to a tipping point. Given the lagged timing of the data, however, we do not foresee this as sparking a change in the Bank of Canada's current policy stance. The full impact of the flow-through of weak energy prices to the economy likely has yet to materialize with the Bank expecting the bulk of the negative impact to be front-loaded in the first half of this year. Moreover, today's data release follows the Bank's caution that while "the precise magnitude" of the crude oil price decline on household imbalances is "highly uncertain", further increases in the debt-to-income ratio are likely.

Slower growth in personal disposable incomes in the final quarter of 2014 along with ongoing accumulation of mortgage and non-mortgage credit propelled the debt-to-income ratio higher in the quarter to an all-time high. Despite a seasonal slowing in mortgage growth, household debt accumulation over the three–month period accounted for much of the ratio's increase with mortgage growth contributing 1.2pp to the unadjusted quarterly increase while a rise in non-mortgage borrowing added a further 0.6pp. Partial offset of 1.2pp came from positive, albeit relatively tepid growth in personal incomes. On an annual basis, the 4.5% y/y increase in credit market debt growth marked the fastest pace since Q3/13 and compared to 4.1% in Q3/14. (Of note, the comparable debt-to-income measure to the U.S. - based on adjustments suggested by Statistics Canada - rose to 152.8% in Q4/14 from 151.8% in the previous quarter).

The debt-to-income measure is not our preferred metric for examining the financial position of Canadian households, most notably as it accounts for only one side of household balance sheets - the debt-to-net worth and debt-to asset ratios are likely better indicators. In today's release, Canadian household asset balances increased by 0.9% to $10.18 trillion with both financial and nonfinancial asset values edging up over the three month span, albeit at the slowest rates of growth since Q2/13 and Q4/12, respectively. A softening in home values over the period—existing home prices declined by 0.8% q/q in Q4/14—and weaker performance in the S&P/TSX composite index tempered the gains contributing to the debt-to-asset metric remaining unchanged in the quarter at 17.9%. Notably, owners' equity as a share of residential real estate assets held steady at 70.4%, down from a recent peak of 70.6% in Q2/14, as mortgage growth matched the appreciation of real estate assets in the quarter. The dollar value increase in assets was sufficient to more than offset the rise in household liabilities resulting in Canadian household net worth reaching an all-time high of $8.3 trillion in Q4/14. This rise in household net worth was matched by credit market debt growth resulting in the debt-to-net worth ratio holding at 21.9%.

It would be premature to cite the deterioration in the financial position of Canadian households, as evidenced by the above household debt metrics, as cause for concern that the risks posed by household imbalances are intensifying. In characterizing a “constructive evolution” of household imbalances, the stabilization and decline in the debt-to-income ratio is only one factor considered by the Bank of Canada. Housing activity in line with demographic fundamentals and home price increases "in line with" or below income growth are two additional trends that the Bank cites as needed for the gradual unwinding of household imbalances.

Moreover, in its March policy statement, the Bank stated that the oil price shock “had a modest early impact on aggregate demand and a larger effect on income”; although concluded financial stability risks were “evolving as expected”. As a result, it implicitly shifted its policy stance noting that the monetary policy action in January contributed to a material easing in financial conditions. With the Bank’s expectation that these conditions will “mitigate the negative effects of the oil price shock”, the rise in the oft-cited debt-to-income ratio in Q4/14 is unlikely to alter their view.

Ongoing developments in household borrowing trends will continue to be monitored closely by the Bank of Canada as it balances the risks posed by elevated household imbalances against the impact of the sharp decline in crude oil prices. A period of softer income growth alongside an upward trend in household credit accumulation will likely keep the debt-to-income ratio elevated over the coming quarters and as a result, the warnings stemming from elevated debt balances - with household indebtedness remaining the key vulnerability to the financial system — are unlikely to subside. If anything, the sudden nature of the oil price plunge brings to bear how quickly a shock could materialize and reduce the ability of highly indebted households to service their debts, which in turn, could spark broader deterioration across the financial system and Canadian economy. Our baseline view, however, remains that the Canadian economy will weather the decline in oil prices as benefits, including anticipated savings for Canadian households, largely offset the drag from the oil & gas industry.