NATIONAL BALANCE SHEET ACCOUNTS

September 2015

Chart 1

Household debt-to-income ratio

Credit market debt as a % of personal disposable income

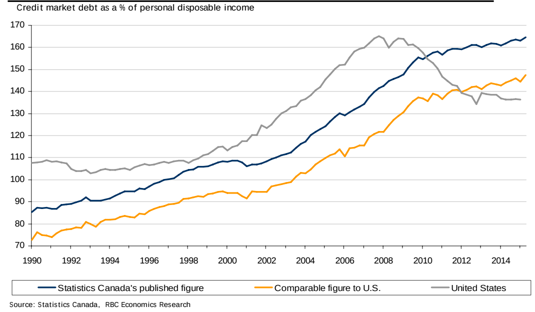


Chart 2

Household credit market debt growth

Year-over-year % change

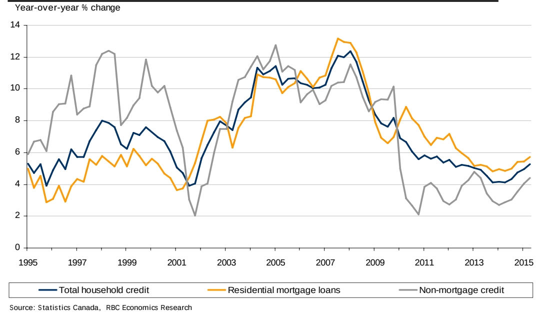
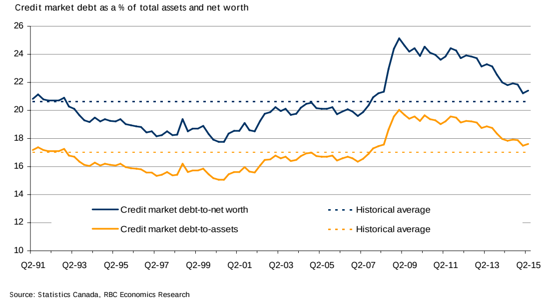


Chart 3

Household debt ratios

Credit market debt as a % of total assets and net worth



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In the release of the Q2/15 National Balance Sheet Accounts, a strong seasonal bounce in residential mortgage borrowing contributed to the debt-to-income ratio rising to a new record high over the three-month period at 164.6% from 163.0% in Q1/15. This rearview glimpse into the degree of household leverage, while highlighting elevated household indebtedness in Canada, is unlikely to alter the Bank of Canada's current policy stance, however, with the recent statement noting that the risks to financial stability, which encompasses household indebtedness, are "evolving as expected".

A seasonal strengthening of residential mortgage accumulation and to a slightly lesser extent, consumer credit borrowing outpaced slower growth in personal disposable incomes in the second quarter of 2015 to thrust the debt-to-income ratio to a new record high. Importantly, the data is not seasonally adjusted and mortgage debt growth typically rises in the second quarter reflecting a seasonal pickup in housing activity. With that said, accounting for seasonal factors, the debt-to-income ratio still jumped by 0.9ppts, which will do little to quell policymakers concerns about the degree of leverage in the Canadian household sector.

On an annual basis, residential mortgage balances expanded by 5.7% while consumer credit growth recorded a 4.4% increase. These marked the fastest rates of increase since Q3/12 and Q2/13, respectively. Collectively, this propelled overall credit market debt growth to its fastest pace since Q1/2012 at 5.3% compared to 5.0% in Q1/15 and marked the 4th consecutive quarter of acceleration. (Of note, the comparable debt-to-income measure to the U.S. - based on adjustments suggested by Statistics Canada - rose to 147.5% in Q2/15 from 144.6% in the previous quarter).

The stock of debt relative to the flow of income measure only encompasses one side of household balance sheets and thus, is not our preferred metric for assessing the financial position of Canadian households - with the debt-to-net worth and debt-to asset ratios likely better indicators. In today's release, Canadian household asset balances increased by 1.1% to $10.65 trillion led by higher valuations for nonfinancial assets with average home prices strengthening over the three month span. Financial asset values also edged higher in Q2/15, although the 0.5% advance represented the slowest rate of growth since Q2/13 as weak performance in the S&P/TSX composite index tempered the gain. Overall, growth in the value of assets held by Canadian households was marginally outpaced by that of liabilities resulting in the debt-to-asset metric edging up to 17.6% in the quarter from 17.5% previously.

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 $8.75 trillion in Q2/15. That said, the rise in household net worth was the lowest in two years and fell short of credit market debt growth, resulting in the debt-to-net worth ratio rising from 21.4% in Q1/15 to 21.6%.

The strengthening accumulation of outstanding household credit balances is occurring against a backdrop of factors that are supportive of the Canadian consumer acting as the key support to economic activity. Labour markets have held up despite weak energy-led performance in the broader economy, low gasoline prices are providing a modest lift to real household incomes and importantly, monetary policy stimulus is working its way through the economy. These conditions set the stage for the solid household spending that underpinned economic activity in Q2/15 to continue. Further, Canada's housing market is on track to post one of its best years on record in 2015 and auto sales continue to boom. Consequently, sustained increases in household borrowing and another record high for the oft-cited debt-to-income ratio are not unexpected given current conditions.

The risks to the stability of the financial system do not stem from the rising stock of household liabilities themselves but rather the ability of indebted households to sustain the costs associated with servicing balances on a month-to-month basis. Various indicators – notably, the debt service ratio, mortgage and credit card delinquencies – point to households being able to manage their increasingly high debt levels. That said, concerns about the impact of an unanticipated jump in interest rates or unexpected deterioration in labour conditions warrants the caution surrounding elevated household debt balances. Our baseline view, as we previously noted, is that upward pressure on debt servicing costs will gradually materialize as the strengthening in the economy and attendant rise in inflation result in the Bank of Canada starting to reduce policy stimulus by raising the overnight rate. The Bank of Canada is unlikely to be in a position to do so until the latter part of next year, however, providing further scope for strengthening household borrowing trends to persist.

Canadian household balance sheets

	Market value ($billions)					Historical
End of period	**Q1-15**	**Q2-15**	**Q/Q % change**	**Q/Q $ change**	**% share**	**share***
Total assets	**10,534**	**10,647**	**1.1**	**112**		
Financial Assets	5,873	5,903	0.5	30	55.4	54.5
Cash & deposits	1,325	1,338	1.0	13	12.6	14.4
Equities & bonds	2,327	2,335	0.3	8	21.9	17.2
Life insurance & pensions	2,106	2,117	0.5	11	19.9	20.4
Other	115	113	(1.3)	(1)	1.1	2.6
Nonfinancial assets	4,662	4,744	1.8	82	44.6	45.5
Real estate	4,054	4,122	1.7	68	38.7	36.9
Durable goods	573	591	3.1	18	5.5	8.0
Other	34	32	(8.3)	(3)	0.3	0.6
Total liabilities	**1,866**	**1,900**	**1.8**	**34**		
Credit market debt	1,840	1,874	1.8	34	98.6	98.4
Mortgages	1,196	1,219	1.9	22	64.1	62.7
Consumer credit & loans	644	655	1.7	11	34.5	35.7
Other	26	26	1.5	0	1.4	1.6
Total household net worth	**8,668**	**8,746**	0.9	79		

Financial ratios			**Q/Q change (percentage points)**
Credit market debt-to-PDI	163.0	164.6	1.6
Credit market debt-to-assets	17.5	17.6	0.1
Credit market debt-to-net worth	21.2	21.4	0.2
Debt service ratio (SA)	6.39	6.37	(0.0)

Source: Statistics Canada, RBC Economics Research

* Average since 1990