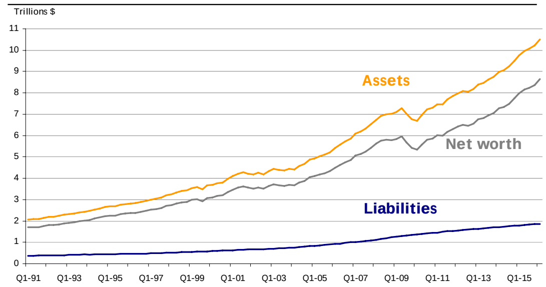
NATIONAL BALANCE SHEET ACCOUNTS

June 2015

Chart 1

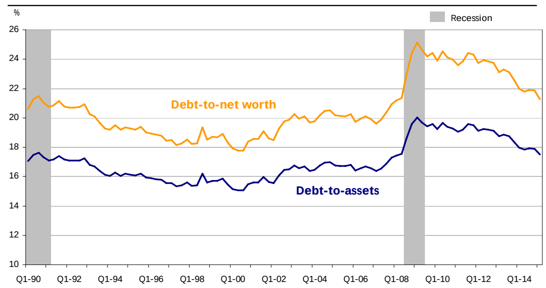
Canadian Household Balance Sheet Accounts



Source: Statistics Canada, RBC Economics Research

Chart 2

Household financial ratios



Source: Statistics Canada, RBC Economics Research

Chart 3

Household credit market debt

Source: Statistics Canada, RBC Economics Research

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In the Q1/15 National Balance Sheet Accounts, the first release since the surprise cut in the Bank of Canada's overnight rate in January 2015, outstanding debt balances edged upward to $1.87 trillion; although, rising asset valuations more than offset the increase to thrust the aggregate net worth of Canadian households to yet another record at $8.65 trillion.

The asset side of Canadians' balance sheets in the first quarter of 2015 was once again boosted by robust housing price gains (real estate assets up 1.4% to $4.1 trillion) with actual average existing home prices recording the highest quarterly increase since last spring in the recent quarter. Real estate assets account for close to 40% of total assets. (Of note, the potential for a sharp correction in housing market activity has been on the Bank of Canada's radar and was highlighted as "the most important domestic" risk to the stability of the financial system in the June release of the *Financial Systems Review*. While the Bank of Canada reiterated its concern of housing market overvaluation and the potential for a disorderly unwinding of household imbalances should a correction occur, in the context of a broadening recovery, the Bank noted that gradual price stabilization is the most likely outcome).

A record $246 billion increase in the value of financial assets (up 4.4% to $5.9 trillion) exceeded real estate gains in the first quarter of 2015, as equity markets bounced back following two consecutive quarters of decline. This boosted the ratio of financial to non-financial assets to 126% after sustaining a steady trend during the past year. Emerging beneath this trend are some developments that are notable: households' market exposed assets (ex-cash and deposits) as a share of financial assets are the highest since 2000 (at 75.5%), and real estate as a share of non-financial assets is at a record high (at 87%).

At the time of the January rate cut, the Bank cautioned that the ramifications of the oil price shock on household imbalances would depend on the extent of the negative hit to income and employment. While the first quarter of 2015 was marked by an outright decline in economic activity with consumer spending restrained, labour markets remained resilient, household disposable income recorded its largest annualized gain since 2011, and easy financial conditions persisted. Against this backdrop, households ramped up their borrowing during the three-month period, with credit market debt rising 5.0% on a year-over-year basis to mark the fastest pace of increase in two years. The emergence of an upward trend in both residential mortgage borrowing and consumer credit growth was evident with both sources of borrowing accelerating on an annual basis in the first quarter of 2015 (with 5.5% and 4.1%, respectively, marking multi-year highs).

An oft-cited metric of household indebtedness, the debt-to-income ratio, edged downward in the first quarter of 2015, as the pronounced lift to incomes outpaced the quarterly increase in debt accumulation. Of note, household balance sheet data are unadjusted for seasonal patterns; thus, a seasonal slowing in housing market activity during the winter months and subsequent lagged slack in mortgage growth contribute to the oft-cited metric easing in the first three months of 2015. (Of note, the comparable debt-to-income measure to the US--based on adjustments suggested by Statistics Canada--eased to 151.9% in the first quarter of 2015 from 153.0% in the previous quarter.)

Households' ability, in aggregate, to meet their debt obligations was bolstered, albeit modestly, in the first quarter of 2015 as indicated by the debt-to-asset and debt-to-net worth ratios. The former edged downward to 17.5% in the first quarter of 2015 from 17.9% in the fourth quarter of 2014, which was the lowest level since the start of the 2008 to 2009 recession. This indicated that the value of household assets exceeds outstanding debt balances by a measure of nearly six to one. With respect to net worth, this ratio also eased to a seven-year low of 21.3% from 21.9% in the fourth quarter of 2014. A less-cited metric, although likely as important given the prominence of household vulnerability, is the measure of financial assets to credit market debt. At a pre-recession high of 3.2, the liquid assets of households exceeded their credit market debt balances by more than three to one, indicating that there exists a degree of buffer for households should debt repayments rise sharply.

The evolution of data since the surprise rate cut in January prompted the Bank of Canada to assess that vulnerability in the financial system stemming from elevated household indebtedness is "edging higher" relative to six months ago, owing to the effects of the oil price shock. In the post- *Financial System Review* press conference, Governor Poloz acknowledged that the rise in household debt was a "side effect" of the January policy change; although, despite today's reported acceleration, credit growth continues to trend well below the double-digit increases recorded a decade ago. Moreover, today's reported improvements in the household debt-to-asset and net worth ratios to pre-recession lows are encouraging and, while tentative at this stage (given the seasonal slowing in debt accumulation), are supportive of the Bank of Canada's expectation that household imbalances will gradually ease as economic conditions improve and interest rates begin to normalize.

The speed bump encountered by the Canadian economy in the first quarter of 2015 was viewed by the Bank as transitory and is "still expected to rebound in the coming quarters." While any lingering deleterious effects on oil-producing regions in the coming quarters would prevent the cautionary tone of the Bank from abating, a stronger US economy, a weaker Canadian dollar, and stimulative monetary policy are expected to provide sufficient offset to weakness in oil-producing regions. Against a strengthening economic backdrop, the Bank will continue to monitor developments in household borrowing and inflation trends to gauge the appropriate timing for a shift in monetary policy. We expect economic conditions will warrant the next move being an increase in the overnight rate although not until mid-2016.

Canadian household balance sheets

End of period	Market value ($billions) Q4-14	Q1-15	Q/Q % change	Q/Q $ change	% share	Historical share*
Total assets	**10,217**	**10,519**	**3.0**	**302**		
Financial Assets	5,612	5,858	4.4	246	55.7	54.5
Cash & deposits	1,303	1,323	1.5	20	12.6	14.4
Equities & bonds	2,212	2,334	5.5	121	22.2	17.2
Life insurance & pensions	1,986	2,087	5.1	101	19.8	20.4
Other	110	115	4.0	4	1.1	2.6
Nonfinancial assets	4,605	4,661	1.2	55	44.3	45.5
Real estate	4,000	4,054	1.4	55	38.5	36.9
Durable goods	571	573	0.4	2	5.4	8.0
Other	35	33	(4.2)	(1)	0.3	0.6
Total liabilities	**1,854**	**1,867**	**0.7**	**13**		
Credit market debt	1,828	1,841	0.7	13	98.6	98.4
Mortgages	1,188	1,197	0.8	9	64.1	62.7
Consumer credit & loans	641	644	0.6	4	34.5	35.7
Other	25	26	2.1	1	1.4	1.6
Total household net worth	**8,364**	**8,652**	3.4	288		

Financial ratios			Q/Q change (percentage points)
Credit market debt-to-PDI	163.6	163.3	(0.3)
Credit market debt-to-assets	17.9	17.5	(0.4)
Credit market debt-to-net worth	21.9	21.3	(0.6)
Debt service ratio (SA)	6.85	6.74	(0.1)

Source: Statistics Canada, RBC Economics Research

* Average since 1990