# Keep calm and carry on? A brief snapshot of household debt in Canada

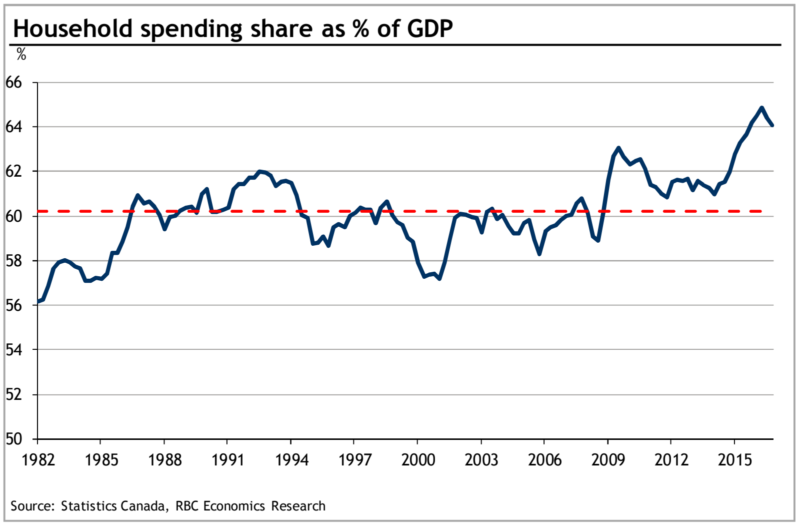
March 2017

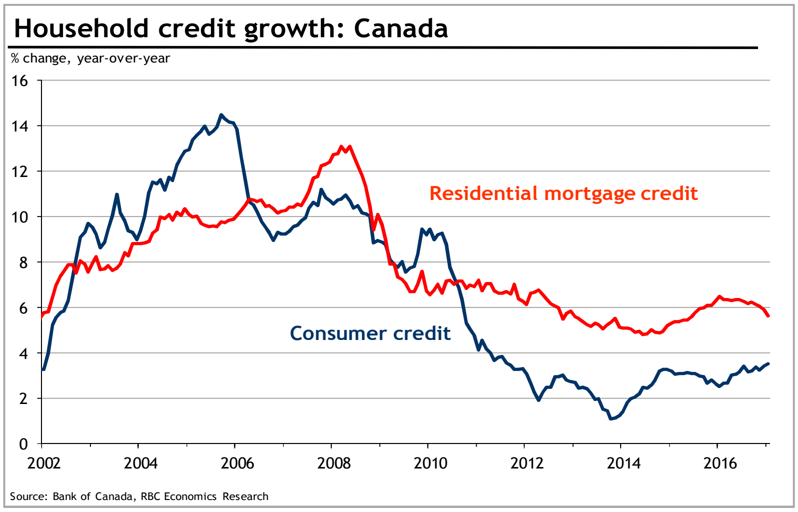
***Household debt levels are rising**—a phrase that ostensibly solicits shrugs in Canada instead of raised eyebrows now. Outstanding household credit balances surpassed $2 trillion to close out 2016, a 5.2% bump from the level recorded a year earlier. Low borrowing rates have helped to dampen the alarm bells emanating from increasingly indebted households, but as upward pressure on market rates intensifies, households will have to adjust to higher costs associated with servicing their debt. Their ability to do so in a smooth fashion is key to containing any potential spillover risks to consumer spending. With rising debt levels certainly a factor in supporting household spending that now accounts for close to a record 2/3 of economic activity, is it time for the bells to ring louder or should we just keep calm and carry on?*

## Debt dependency?

Canadian households have amassed a record level of debt against a backdrop of ultra-low borrowing rates, resilient job growth and rising home prices. Households accumulated $99 billion in mortgage loans and consumer credit through 2016 with outstanding balances surpassing $2 trillion to end the year. Income gains were unable to keep up with this pace resulting in Canadian households, in aggregate, owing $1.67 for every $1 of income as of the third quarter of 2016.

Consumers' ability to tap into credit sources has no doubt played a role in bolstering household spending as a share of the economy to an all-time high in 2016. Going forward, under the weight of rising costs, the capacity of the consumer to continue to drive economic growth is increasingly at risk.



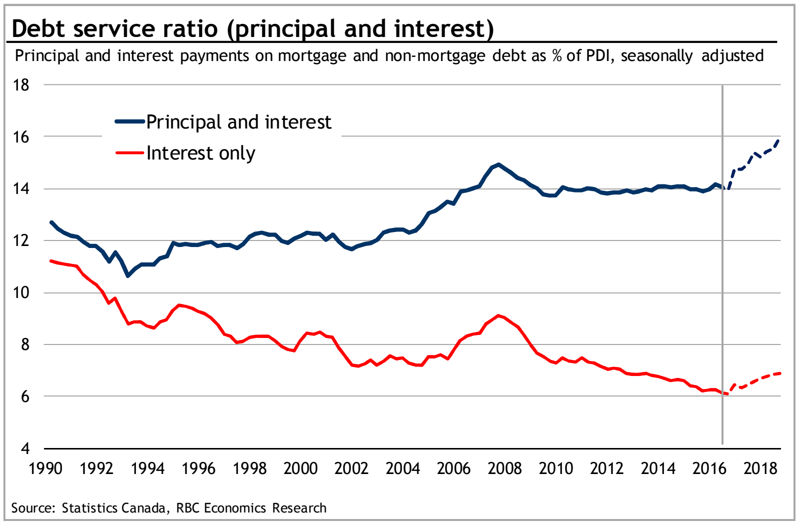




## Positive: A slowdown in credit growth

The introduction of regulatory measures as a means to cool housing market activity is spilling over into demand for mortgage loans. A downward trend in mortgage loan growth prevailed since June 2016, with the 5.6% annual increase this January marking the slowest pace since June 2015. With mortgage loans accounting for more than 70% of outstanding debt balances, the slowing is an encouraging development and is helping to dampen overall household debt accumulation.

Conversely, consumer credit growth has trended sideways since mid-2016, tracking within a 3.2% to 3.5% annual growth range over the period. A renewed uptick in balances on personal lines of credit has offset a slowdown in demand for personal loans. Non-bank borrowing continues to account for about 1/3 of consumer credit accumulation.

**Laura Cooper**
Economist | 416-974-8593 | laura.cooper@rbc.com




Regulatory changes are likely to show up more meaningfully in housing market activity in the near-term, with mortgage loan growth slowing accordingly. This should be sufficient to slow the pace of household debt accumulation in Canada with our estimates for growth to clock in at a mid-4% pace by year-end.

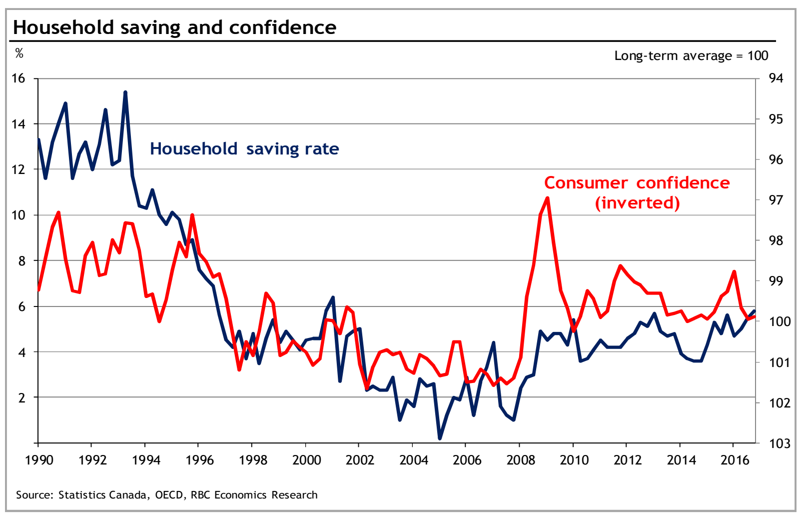
## Negative: Paying for current debt balances

Even with households paring back their reliance on credit, the costs associated with the existing $2 trillion in outstanding balances are expected to rise. The required payments on rising debt loads have remained broadly stable as a share of disposable income in recent years as declining interest rates offset the costs associated with higher debt balances. Interest rates are expected to rise gradually and still remain at historically low levels, but our estimates indicate debt servicing costs could rise to 16 cents for every $1 of income by 2018 from 14 cents currently. This would represent a record high with two thirds of the increase attributed to rising interest payments as borrowing rates climb.

Households could feel an additional squeeze from rising energy costs—which currently sit at a near record low 6% of household spending. This confluence of factors together suggest the contribution of household spending to economic growth will ease, albeit only modestly in the near-term. Sustained job market growth and attendant income gains are expected to keep the risks emanating from elevated household leverage contained; however, headwinds facing households could see consumer spending growth slip to its slowest pace in 2018 since the 2008/09 recession.

## Keep calm and carry on...for now

A cautious tone of the Bank of Canada has been an ongoing theme of central bank communication as households have increasingly taken on larger debt burdens. Rightfully so. Canada has the highest household debt (as a share of the economy) amongst G7 countries, the proportion of new mortgages with loan-to-income ratios exceeding 450% was as high as 49% in Toronto in Q3/16[1] and the pace of offsetting asset value increases are likely unsustainable in a number of major housing markets.




The costs associated with servicing elevated debt levels will act to limit consumer spending growth as interest rates rise. Even beyond this, a deterioration in consumer confidence about the economic outlook could spur households to become more prudent and reduce their expenditures, even in the absence of a sharp rise in borrowing rates or a labour market shock. The saving rate climbed to a 16-year high of 5.8% in Q4/16, but households are likely adjusting to the Child Tax Benefit income boost as opposed to being a precautionary move. Consumer confidence in Canada reached its highest level in more than seven years in February suggesting few are feeling the pinch just yet. Don't be surprised though if consumers pull back in 2018 as interest rates drift higher. The key question is how consumers will react as the cost to finance their debt embarks on a (hopefully steady) upward march.

1. Bank of Canada. "Financial System Review—December 2016".