RBC Economics
Daily Economic Update

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Lower net worth, higher debt payments, to further squeeze household spending

- Canadian household net worth down a record $990 billion in Q2 as pull-back in housing, bond and equity markets cut into pandemic gains
- More declines to come as housing markets continue to retrench
- Pandemic mortgage run-up and rising interest rates are making debt-servicing more costly
- More pain ahead – inflation, rising borrowing costs to squeeze household real earnings - with the overnight rate expected to reach 4% by the end of this year

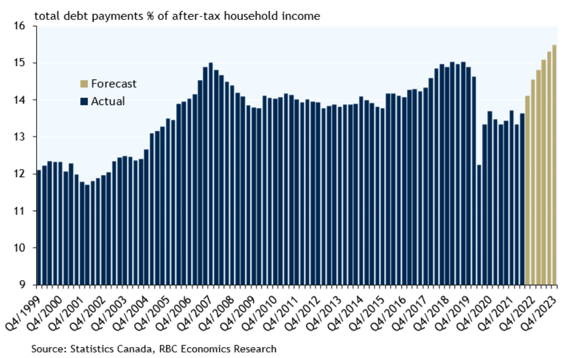
The decline in household net wealth in Q2 was the largest on record and the first in two years. Lower property values together with lackluster equity market performance subtracted $920 billion from households' total assets. That however only partially retraced pandemic gains – household net worth was still up almost $3 trillion from the end of 2019. Total liabilities rose by $69 billion with both mortgage loans and consumer credit posting near-record increases, despite rising interest rates. Overall, the faster pick-up in debt relative to income growth pushed the debt-to-income ratio slightly higher to 181.7. Still, household wealth will fall further in the months ahead – the pullback in home prices we expect alone looks set to lower household equity in real-estate by more than a trillion dollars from peak pandemic levels.

Higher interest rates are making households look and feel less wealthy, and will also increasingly cut into purchasing power. But it takes time for that to happen. Fixed mortgage rates, for example, only reset when contracts are renewed. In Q2, an average household spent 13.6% of their current income to service debt payments (also referred to as the debt servicing ratio), a tick higher than the 13.3% in Q1 but still well-below the ~15% average rate pre-pandemic. But that ratio is set to increase substantially into 2023 as central bank interest rate hikes gradually push borrowing costs even higher.

Our base case forecast now assumes the Bank of Canada will hike the overnight rate to 4% by December. And that suggests the debt servicing ratio will eclipse its pre-pandemic peak by Q1 2023, before rising further to a record high at around 15.5% by the end of next year. We expect labour markets will continue to soften at the same time and look for consumer demand to weaken significantly as lower income, higher borrowing and debt servicing costs squeeze their spending. That will help to lower inflation pressures but at the cost of a 'mild' recession in Canada in the middle quarters of 2023.

Levels	*Q2-22 (NSA EOP Bil C$)*	*Growth Q/Q*	*Growth from pre-pandemic*
Assets	**$ 18,011.1**	**$ (920.4)**	**$ 3,325.1**
Nonfinancial assets	$ 9,209.1	$ (389.8)	$ 2,484.9
Housing & land	$ 8,239.0	$ (418.9)	$ 2,339.5
Financial assets	$ 8,801.9	$ (530.6)	$ 840.2
Currency & deposits	$ 1,946.0	$ 45.7	$ 383.8
Equities	$ 3,711.5	$ (353.4)	$ 370.4
Liabilities	**$ 2,795.8**	**$ 69.8**	**$ 392.4**
Loans	$ 2,760.3	$ 69.1	$ 386.8
Nonmortgage	$ 718.0	$ 15.8	$ (6.8)
Mortgages	$ 2,042.4	$ 53.3	$ 393.6
Net worth	**$ 15,215.3**	**$ (990.1)**	**$ 2,932.6**
Ratios	*Q2-22*	*Growth Q/Q*	*Growth from pre-pandemic*
Debt-to-income	181.7	1.9	0.6
Debt service ratio	13.6	0.3	-1.3
Mortgage	7.0	0.1	-0.1
Non-mortgage	6.6	0.2	-1.2

Canada Household Debt Service Ratio to rise further



Source: Statistics Canada, RBC Economics Research

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