

Financial situation in Québec households Vulnerability depends heavily on borrowers' profiles

Debt loads have grown very quickly in the last 10 years in Québec. However, a recent *Economic Viewpoint*¹ showed that the value of assets in households, which are also indebted, grew as well during this period. The debt-to-asset ratio (DAR) has not fluctuated much since the early 2000s, indicating that the risks of a default on payment have not apparently increased for borrowers overall. Nonetheless, some households may be more vulnerable than others.

Beyond the overall picture, it is important to identify the characteristics of borrowers who are more likely to end up in financial difficulties. This will make it possible to answer a number of questions. Is the situation for some age groups more delicate? Is the debt load harder to handle for households in certain income brackets? Analyzing the debt-to-asset ratio (DAR) makes it possible to assess the indebted households' financial vulnerability according to various profiles. Scrutinizing household debt and assets based on age groups and income levels will provide a clearer picture and, in particular, make it possible to identify the categories that are more financially vulnerable. The risk associated with a major, persistent drop in the value of assets has notched up since summer, making a precise diagnosis of indebted households' balance sheets very important.

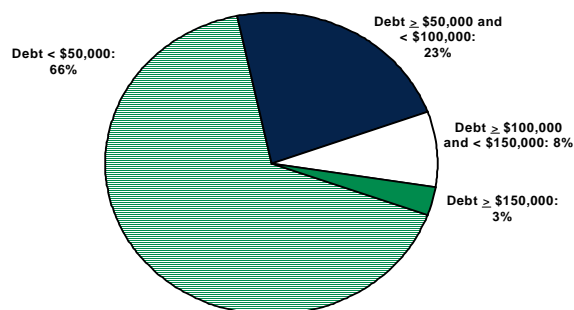
¹ "Taking stock: Québec households' financial position. Debt vs. household assets." June 17, 2011.

MORE HOUSEHOLDS CARRYING AT LEAST \$150,000 IN DEBT

Indebted households (see definition in box 1 on page 2) cannot all be put into the same basket. The amount of borrowing is moderate for some and sizeable for others. For more than half of households—58%—total debt is less than \$50,000. However, debt loads exceed \$100,000 in about 25% of households, with 15% above \$150,000. At the start of the decade, about 3% of borrowers had debt loads this high (graphs 1 and 2). The rise

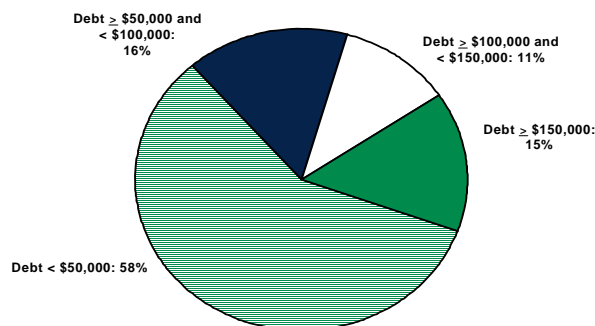
in home prices during the last decade, reflected in the amount of mortgage credit, explains why the proportion of heavily indebted households has risen so much. The increase in average debt, which went from about \$40,000 to nearly \$65,000 from 2000 to 2010, is essentially due to the increase in the number of households carrying over \$150,000 in debt. The average price for a property has gone up 125% in 10 years, so the rise in property values has contributed to increasing the mortgage debt contracted by households.

Graph 1 – Distribution of indebted households' debt in 2000



Sources: Ipsos Reid and Desjardins, Economic Studies

Graph 2 – Distribution of indebted households' debt in 2010



Sources: Ipsos Reid and Desjardins, Economic Studies

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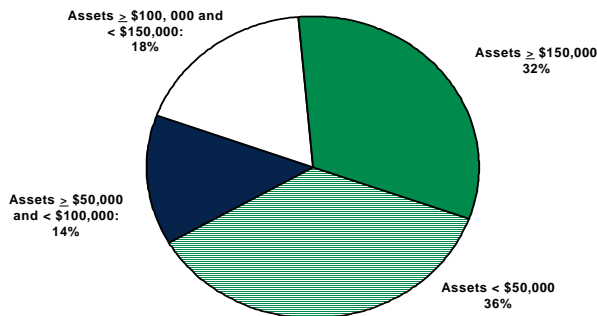
BOX 1

ABOUT 70% OF HOUSEHOLDS ARE IN DEBT

While the spectre of debt is hanging over several households, others have little reason to worry. According to the *Canadian Financial Monitor* survey, about 30% of households in Québec have no debt whatsoever. These people either have no credit products or they have the means to systematically pay off their monthly balances (this applies mainly to those with credit cards or personal lines of credit). Generally speaking, those who are free of all debt are usually further along in their life cycle and closer to 60 years of age. Many homeowners have already paid off their mortgages, giving them considerable financial leeway. This *Economic Viewpoint* will take an exclusive look at households that can resort to debt, or about two million homes. Households with no debt whatsoever have been excluded, since their financial position is not an issue.

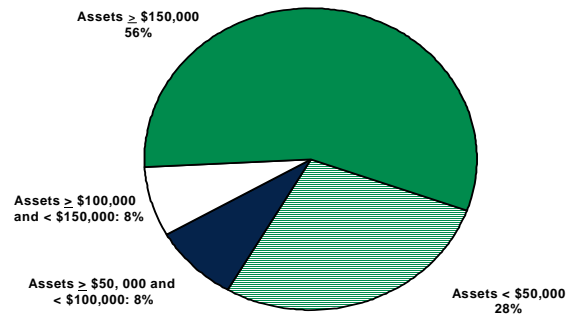
The value of indebted households' average assets has practically doubled in 10 years, even exceeding \$250,000 in 2010. The breakdown of households according to assets held has therefore also changed a lot in the last 10 years. In 2000, about one third of indebted households had more than \$150,000 in assets (graph 3). In 2010, over half of households were in this situation (graph 4), which helped to improve the overall picture. The lightning rise in property prices in the last decade has not only helped increase debt loads but has also made the value of assets balloon, changing the asset distribution.

Graph 3 – Distribution of indebted households' assets in 2000



Sources: Ipsos Reid and Desjardins, Economic Studies

Graph 4 – Distribution of indebted households' assets in 2010

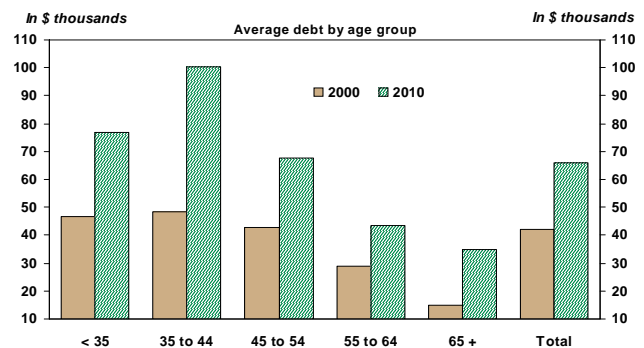


Sources: Ipsos Reid and Desjardins, Economic Studies

DEBT LOADS HAVE GONE UP IN ALL AGE GROUPS

According to the data from the Ipsos Reid² survey compiled for Québec, household debt was around \$40,000 on average in 2000, rising gradually to more than \$65,000 last year. However, debt rose more quickly in some age groups. The biggest growth (in terms of level and change) occurred in the 35 to 44 age group (graph 5). Contrary to a widespread idea, borrowing by those under 35 did not increase more than other age groups. This debunks a myth: young people are not primarily responsible for the rise in overall household debt in the last 10 years. However, this age group's average debt, over \$75,000, is the second largest, following the 35 to 44 year olds. Of course, the average debt of the categories aged 45 and up is much smaller, as the balance on the mortgage, frequently a household's largest loan, usually drops over time.

Graph 5 – Change in indebted households' average debt in Québec over the last 10 years



Sources: Ipsos Reid and Desjardins, Economic Studies

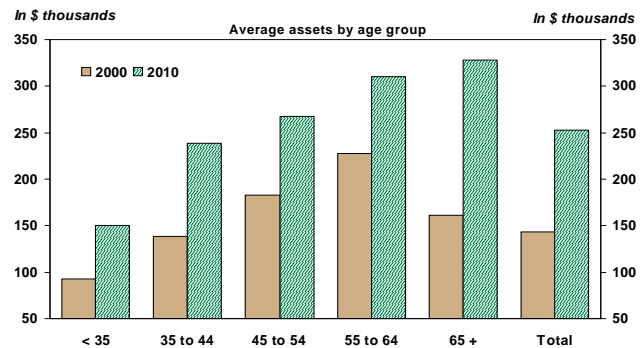
² The Ipsos Reid Canadian Financial Monitor survey, which compiles information on 1,000 households per month and, as a result, about 12,000 households per year in Canada, provides for a complete picture of the financial situation.

The fact that debt has gone up in all age groups is not enough to establish whether they have become more financially vulnerable in the last 10 years, as the change in the value of assets must also be considered. Assets include both financial and non-financial assets, such as homes, cars, furniture and personal items. Financial assets³ can include chequing and savings accounts and investments (bonds and other guaranteed investments, guaranteed investment certificates, mutual funds and stock). Household debt is distributed over home mortgage loans, various types of personal loans, lines of credit, credit cards and car loans (including leases).

If the increase in the debt load is due to an increase in the value of assets in each age group, their balance sheet has not necessarily deteriorated. For young people under the age of 35, their assets were worth an average of \$95,000 in 2000 and are now worth more than \$150,000 (graph 6). The change in the percentage of assets (+62%) was even similar to that of debts (+64%), indicating that greater borrowing was based on asset accumulation.

For indebted households in the 35 to 44 age group, asset growth has been much slower than the rise in debt. However, the value of their assets grew by \$100,000 in 10 years to around \$240,000 in 2010. As we will see later, the debt-to-asset ratio (DAR) in this age group has deteriorated in the last decade but, overall, this group's situation is not an issue.

Graph 6 – Change in indebted households' average assets in Québec over the last 10 years



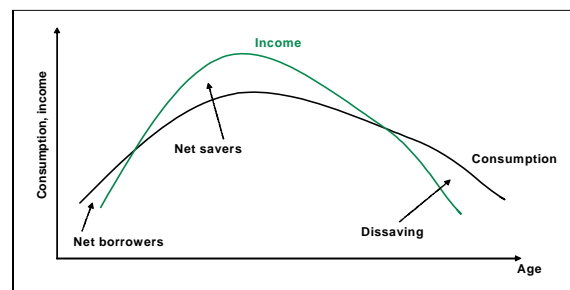
Sources: Ipsos Reid and Desjardins, Economic Studies

The assets of households in the 45 to 54 and 55 to 64 age groups have increased a little more slowly than borrowing. On average, the value of their assets reached \$270,000 and \$310,000 in 2010 respectively. Unsurprisingly, the 65 and over age group saw the fastest asset accumulation (in terms of level and change). In 2010, they had a total of \$330,000 in financial and non-financial assets, more than twice the total 10 years earlier. Although debt has increased since 2000, the debt-to-asset ratio has remained low. This confirms that seniors are in a much stronger financial situation than other age groups. These households are of course well along in their life cycle (see box 2), a situation usually characterized by substantial asset accumulation and a small debt load.

BOX 2 LIFE CYCLE INFLUENCES THE FINANCIAL PICTURE

Households' financial position, i.e. where they stand in terms of savings, borrowing and consumption, varies enormously according to age (graph 7). Young households usually use loans to build their wealth, as their expenses usually exceed their income. The debt load compared with assets is also higher for households under 35 than for other age groups. At this point in life, mortgage loans are relatively heavy and, frequently, student loans are still on young households' balance sheets. Over time, individuals' incomes increase, generally peaking at the end of their career, a few years before they retire. Income is then higher than expenses and debts are relatively small, making it easier to amass savings. At the end of their lives, the elderly consume less but their income drops substantially as they gradually use up their capital. The life cycle therefore influences household balance sheets, a situation that can be seen in the various indicators in this *Economic Viewpoint*. Some financial vulnerability can be expected to

Graph 7 – Life cycle of households' financial situation



Sources: Organisation for Economic Co-operation and Development and Desjardins, Economic Studies

characterize young households, decreasing with age in keeping with the various stages of life. However, regardless of age group, some households are likely to run into financial difficulties.

³ Assets held in a pension fund were not factored in, as this type of asset cannot be used to pay off debt while the employee is working.

THE DEBT-TO-ASSET RATIO IS REVEALING

The big increase in debt since 2000 has not necessarily translated into a heavier financial burden, since assets have grown just as fast in all age groups. Analyzing the debt-to-asset ratio (DAR) provides for an in-depth realization here. According to Statistics Canada, “The debt-to-asset ratio shows the value of a household’s debts compared to the value of its assets. A high debt-to-asset ratio can indicate that debts are not adequately backed by assets.” According to a recent study by this federal organization⁴, a DAR of 0.8 or 80% is considered high. This ratio, which assesses how able households are to cover debts with assets, can also be associated with a discomfort zone (DAR of ≥ 0.8 and ≤ 2) and an insolvency threshold (DAR of > 2). Work by the Bank of Canada and Statistics Canada has helped establish these criteria for the debt-to-asset ratio in order to better pinpoint how vulnerable households are. According to insolvency statistics, consumers who declare bankruptcy or submit a proposal to creditors to settle their debt generally have twice as much debt as assets. However, households in this situation are not all experiencing financial difficulties.

In Québec, for most age groups, the debt-to-asset ratio has fluctuated very little since 2000 (graph 8); in the 35 to 44 age group, however, it has gone up more. In this category, debts have doubled in 10 years, while assets have not risen as fast. A number of factors are involved in this erosion. On one hand, over a 10-year period, the ownership rate has shot up in this age group. In Canada, it was around 70% during the 2006 census, and approximately 65% 10 years earlier. The results of the 2011 census, to be published at a later date, should confirm

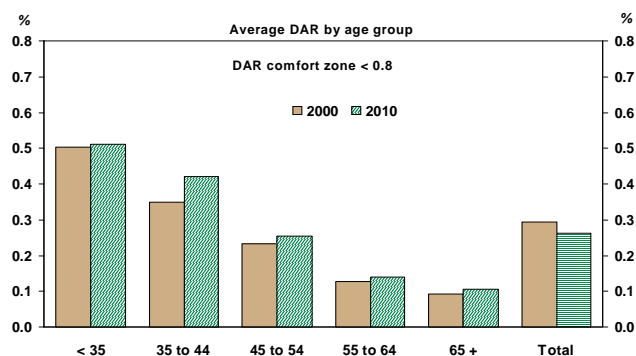
the upward trend in the homeownership rate for 35 to 44 year olds. Moreover, several households seem to have capitalized on the low interest rates, which hit a record low at the end of the last decade, and the looser credit rules brought in by the federal government to acquire a more expensive property than they already owned. This made average mortgage debt balloon in this age group and contributed to the erosion of their debt-to-asset ratio. For all indebted households aged 35 to 44, the DAR was 0.4 in 2010, an average level that is well into the comfort zone.

According to the same indicator, young indebted households’ financial situation did not deteriorate during this time, at least overall. The fact that their debts have risen at the same pace as their assets kept the DAR stable for the last 10 years. However, those under 35 still have the highest ratio of all age groups, a situation that is consistent with the life cycle. The 0.5 ratio is nonetheless in the financial comfort zone (DAR ≥ 0.8), which is fairly reassuring. Overall, household debt loads compared with assets have remained sustainable in Québec in each age category for the last 10 years, staying below the threshold of 0.8%. However, in each age group, the balance sheets of a portion of households are worrisome.

Beyond the overall trend for the medium debt-to-asset ratio, the distribution of households according to three risk zones makes it possible to better pinpoint how many of them may fail to meet their financial commitments. Last June’s *Economic Viewpoint* showed that 85% of indebted households had enough assets to cover their loans in 2010 (RDA < 0.8). However, about 10% were in the discomfort zone (RDA ≥ 0.8 and ≤ 2), and less than 5% were already at the critical threshold (RDA > 2). Let us see whether the distribution by age group is different, in order to determine which category contains the largest proportion of households in a vulnerable financial situation.

About 70% of indebted households under 35 are in the financial comfort zone (graph 9 on page 5). This proportion is 80% in the 35 to 44 age group, which is still reassuring, given how much their debt loads have grown in the last 10 years. For older age groups, the proportion of households in the comfort zone (DAR < 0.8) is much larger than it is for all households, even hitting 95% in the 65 and older age category. For households in the critical zone, the results are similar. Nearly 10% of households under 35 are above the threshold that could lead to financial insolvency (DAR > 2). Once households are older than 35, the proportion of households with a more critical financial situation comes down rapidly. It drops from 4% for the 35 to 44 age group to less than 1% for those aged 65 and older.

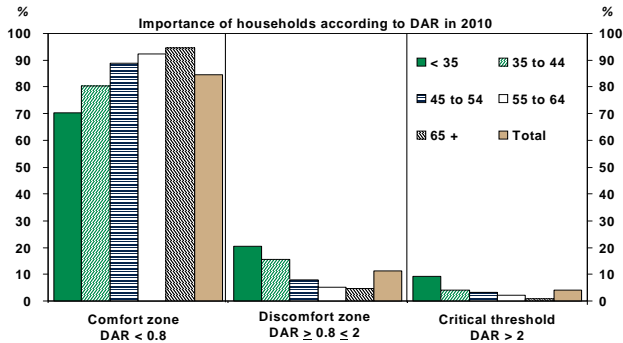
Graph 8 – The debt-to-asset ratio (DAR) of indebted households under age 35 remains higher than others



Sources: Ipsos Reid and Desjardins, Economic Studies

⁴ HURST, Matt, “Debt and Family Type in Canada,” Statistics Canada, Canadian Social Trends, catalogue no. 11-008-X, 21 April 2011.

Graph 9 – Distribution of indebted households by age group according to debt-to-asset ratio (DAR)



Sources: Ipsos Reid and Desjardins, Economic Studies

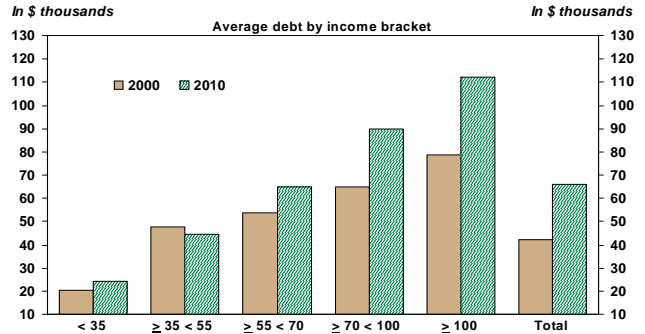
The distribution of indebted households according to the debt-to-asset ratio is consistent with what the life cycle theory points to. Young households not only have a harder time dealing with their debt loads, but a relatively substantial proportion of them already have a DAR that exceeds the critical threshold. With age however, gradually paying loans back and progressively accumulating financial assets puts the situation back in balance.

THE MOST HEAVILY INDEBTED GENERALLY HAVE GREATER INCOMES

Households’ capacity to borrow and then meet their financial obligations is largely dependent on income. If the most indebted households are those with greater incomes, the situation is less worrisome. The risk of default may be higher in certain unforeseen situations, such as in the event of a job loss, serious illness or separation that could result in a sudden drop in the inflow of cash. Despite this possibility, the distribution of debt per income quintile is fairly reassuring.

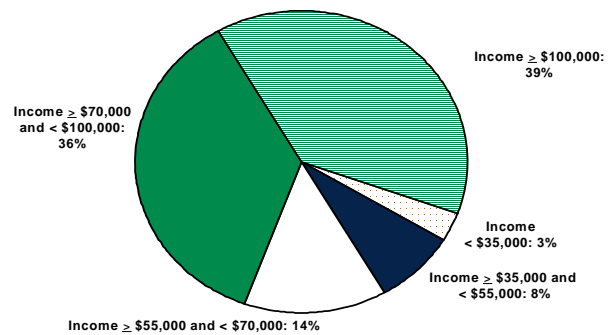
Beyond the average debt of \$65,000 per household in 2010, the breakdown shows huge differences. Those with gross annual incomes of less than \$35,000 have average debt loads around \$25,000 (graph 10). The debt load closes in on \$45,000 for households with incomes ranging from \$35,000 to \$55,000. Average debt then climbs to more than \$65,000 for households with annual incomes of \$55,000 to \$70,000. Those with incomes that range from \$70,000 to \$100,000 have loans totalling nearly \$90,000. The fact that the financial burden is proportional to income indicates that the most heavily indebted households are not primarily those that have trouble making both ends meet. Moreover, households with more than \$150,000 in debt are concentrated in the two top income quintiles (graph 11).

Graph 10 – Change in indebted households’ average debt over the last 10 years



Sources: Ipsos Reid and Desjardins, Economic Studies

Graph 11 – Distribution of households carrying more than \$150,000 in debt according to income brackets in 2010



Sources: Ipsos Reid and Desjardins, Economic Studies

Since 2000, average debt has risen more quickly (in terms of level and change) in higher income brackets. For example, growth was about 20% for households with gross annual incomes below \$35,000, and 40% for those in the \$70,000 to \$100,000 income bracket. The rise in borrowing also edged closer to 40% for households with incomes greater than \$100,000. In the past 10 years, the increase in average debt in all households is therefore largely based on the higher income categories. The change in the value of assets will determine the degree to which their asset accumulation has supported the growth of their debts.

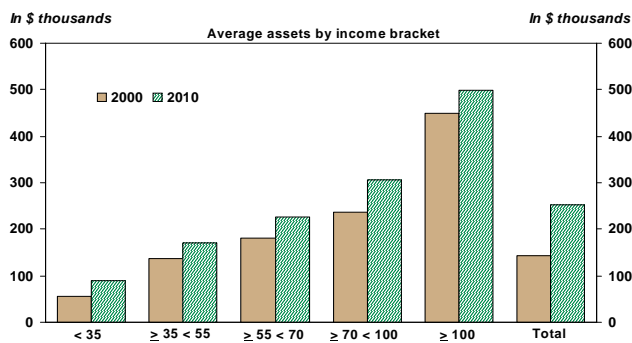
The distribution of average debt per income level shows that, in general, households with the biggest loans have the financial resources to meet their commitments. Regardless of income quintile, however, some households may run into financial trouble and even be unable to meet their payment obligations. This distribution is thus not an indicator of borrower solvency. It only provides a snapshot of the debt vs. income profile.

ASSET ACCUMULATION IS ALSO TIED TO INCOME

While household borrowing capacity is closely linked to income, this is not the only factor in borrowers' ability to pay. Those with adequate savings, particularly in the form of financial assets, are generally at lower of risk of default in the event of an unforeseen personal event or abrupt change in the economic situation (see box 3 on page 7). With their value often associated with the value of a property, non-financial assets are important but not available to pay off debts without losing the primary residence or other valuable property.

According to the data from the Ipsos Reid survey for Québec, the average assets of indebted households were around \$145,000 in 2000, rising gradually to more than \$250,000 in 2010. Of course, the ability to amass assets is directly related to income level. The higher the income, the easier it is to save. For households with higher incomes, the value of assets is much higher (graph 12). In 2010, the assets of indebted households were around \$90,000 in the lowest income quintile (<\$35,000), while those with incomes above \$100,000 had, on average, accumulated more than \$500,000 in assets.

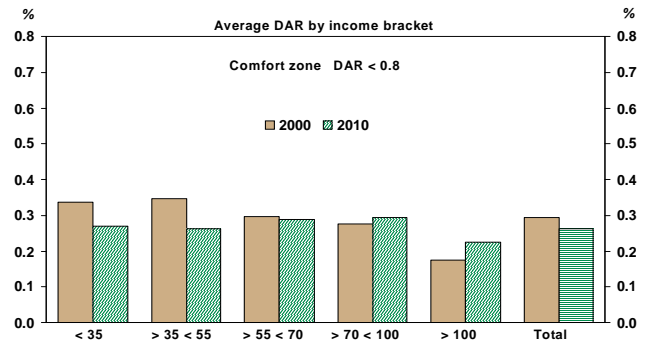
Graph 12 – Change in indebted households' average assets over the last 10 years



Sources: Ipsos Reid and Desjardins, Economic Studies

Given that borrowing and savings capacity is heavily dependent on income, we have to look further to assess indebted households' financial vulnerability. The debt-to-asset ratio (DAR) according to income bracket provides some insight. The DAR for each category has only fluctuated a little since 2000 in Québec (graph 13). The ratio of debts to assets has declined in households with incomes below \$70,000, however, while it increased in the higher income quintiles.

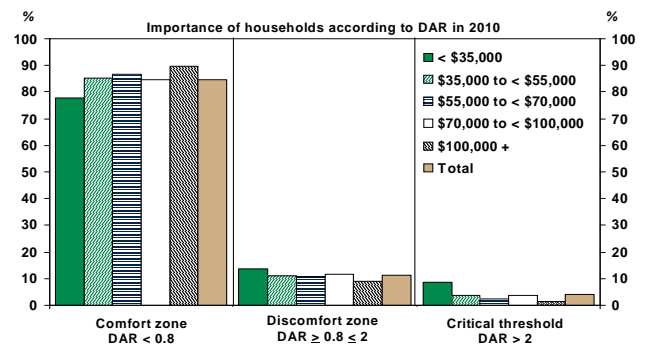
Graph 13 – Debt-to-asset ratios (DAR) of indebted households in different income brackets do not vary much



Sources: Ipsos Reid and Desjardins, Economic Studies

Beyond the overall trend for the debt-to-asset ratio, the distribution of households according to three risk zones makes it possible to better pinpoint how many of them may fail to meet their financial commitments. The proportion of households with a debt-to-asset ratio in the comfort zone (DAR < 0.8) is significantly greater in the higher income brackets (graph 14). 90% of households with incomes above \$100,000 are in a sound financial situation, while 8% are in the discomfort zone and 1% have reached the critical threshold. A larger proportion of households in the first income quintile are in the critical zone (8%) or discomfort zone (14%). As a result, about 78% of households with incomes under \$35,000 are in the comfort zone. There is thus more financial insecurity due to debt in low-income households; financial insecurity declines as income rises.

Graph 14 – Distribution of indebted households by income bracket according to debt-to-asset ratio (DAR)



Sources: Ipsos Reid and Desjardins, Economic Studies

BOX 3 RISKS THREATEN SOME HOUSEHOLDS

Households with high debt loads generally have a less problematic financial profile: higher income and a good nest egg that helps to lessen the spectre of excess debt. However, this is a general picture. Some households are still at risk of default in the event of an economic shock. An economic contraction that would rattle the labour market and the residential real estate market is a threat. Other situations, such as a serious illness or loss of a job that could impact the income of the affected household, can sometimes lead to a deterioration in an individual's balance sheet.

A sudden rise in interest rates, which would make the debt load heavier, could also touch off financial problems. The fall 2010 *Economic Viewpoint*⁵ has already analyzed the impact of an increase in borrowing costs on vulnerable households. This risk has since dissipated, at least in the immediate future. The upheaval in the financial markets and worsening global economic outlook will prompt central banks to keep key rates at low levels, thus keeping rates at low levels over the medium and long terms.

The greater a household's debt is in relation to its assets, the more sensitive that household is to events that can influence the value of those assets. A sudden, persistent devaluation of assets, such as a plunge by home prices or severe correction by the stock markets, could erode some households' balance sheets. Since July 2011, stock markets in North America have already suffered a correction, with a decline of about 10%. The drop in value of stock market assets in 2007 and 2008 following the eruption of the financial crisis temporarily pushed up the debt-to-asset ratio. Between the fall of 2007 and spring 2009, the stock market in the U.S. tumbled by about 60% while the market in Canada fell by 50%. For households overall, the impact of the stock market correction was contained, but the most vulnerable households felt the tremors. In today's environment, their already fragile financial situation should be watched carefully.

⁵ "How vulnerable are Québec households to interest rate increases?" November 2, 2010.

PROFILE OF AT-RISK BORROWERS

In short, the financial situation of indebted households varies according to age group and income quintile. The overall financial situation of people under 35 has not deteriorated in the last 10 years, as debt has risen at the same pace as assets. The debt-to-asset ratio is higher than it is for other age groups, however. Nearly 10% of households under 35 are already in a delicate financial situation, compared with 4% for all households. For the 35 to 44 age group, debt has increased twice as fast as assets, making the DAR rise substantially since the start of the decade. The average ratio is still in the financial comfort zone, however. The proportion of households in this age group that could find themselves in a precarious situation stayed at 4%, a percentage similar to the situation for all households. As a result, the number of households likely to fail to meet their financial commitments declines as of age 35. There are fewer concerns about the financial situation of older households overall. Younger households must therefore receive closer scrutiny, as they clearly have a higher risk of financial difficulty. These conclusions for Québec match Statistics Canada's conclusions for the country as a whole, as well as the OECD's findings for the major industrialized countries.⁶

The balance sheets of lower-income households have improved a little in the last 10 years, while they have deteriorated for big earners. It appears that high-income households have seen their debt rise a little too quickly in relation to their assets. In each income bracket, overall, indebted households' financial situation has remained sound, since the debt-to-asset ratio (< 0.8%) is still in the comfort zone. The proportion of households with a sound balance sheet is high in the higher income quintiles and lower in the others. The proportion of households showing some financial vulnerability thus declines as income increases. The Statistics Canada study released in April 2011 reaches the same conclusion for the Canadian figures. While this outcome was predictable, the figures from the Ipsos Reid survey for Québec help pinpoint the percentage of households that are at risk in each age and income category. Beyond the overall picture, which does not raise any concerns, closer analysis shows that some groups require particular scrutiny.

⁶ "Has the Rise in Debt Made Households More Vulnerable?" OECD Economic Outlook, 2006.

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