

Financial position of households

Quebecers are getting into debt, but also accumulating assets

A number of recently published studies on the financial situation of Québec households took stock of their indebtedness, but showed only one side of the coin, as assets accumulated over time were not taken into consideration.

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A number of unresolved questions have since been answered. Has the rising debt of Quebecers been based on an increase in their assets? Is their overall situation more at risk now than in the early 2000s? Has the number of households likely to have trouble fulfilling their financial commitments grown over the years?

The data from an Ipsos-Reid Canadian Financial Monitor investigation helped provide a complete picture of the financial situation of Qu ebec households in 2010. About 30% of households are debt free, while 70% resort to borrowing. To

better evaluate how likely these indebted households are to have trouble meeting their commitments, both their debts and assets must be taken into consideration. Loans averaged a total of around \$65,000 per household in 2010, but hovered near \$40,000 in 2000. This represents an increase of nearly 60% in ten years. However, the total assets of indebted households averaged \$145,000 in the early 2000s, and then grew to \$250,000 last year, which represents a jump of over 70%.

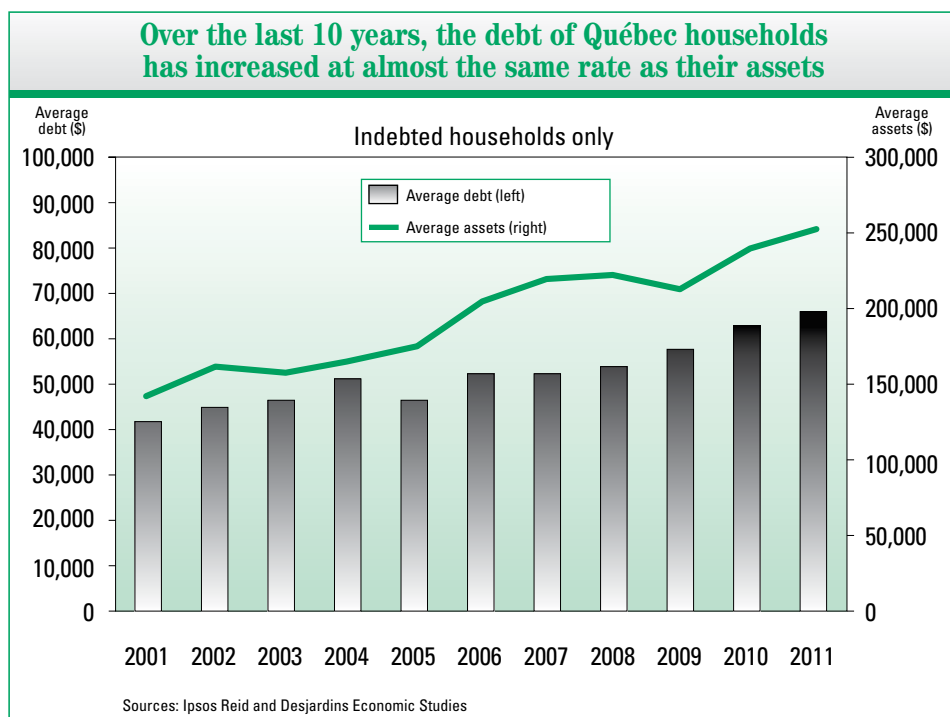
The value of financial assets held in the form of chequing and savings accounts

and according to types of investments (bonds and other guaranteed investments, guaranteed investment certificates, mutual funds, and shares) moderately increased from an average \$45,000 in the early 2000s to over \$70,000 in 2010. Assets include both financial and non-financial property such as homes, vehicles, furniture, and personal property. The hike in the average price of properties from about \$110,000 in 2000 to nearly \$250,000 last year is therefore the main explanation for the growth of household borrowing and non-financial assets.

The higher the debt of a household, the more sensitive it is to certain events that may affect the value of its assets. A sudden and persistent devaluation of assets, such as a drop in the price of homes or a stock market correction, may sometimes lead to major financial problems for certain households. Other situations (e.g. a serious illness or job loss) likely to affect household income may harm the personal balance sheet. A sudden jump in interest rates—which increases debt load—may also trigger financial problems.

Discomfort zone and critical threshold

The debt-asset ratio (DAR) helps determine the ability of households to cover their debts with their assets. Consumers who have taken out loans without having sufficient guarantees may be more vulnerable from a financial standpoint. According to a recent Statistics Canada study, a ratio of 0.8 or 80% is considered high. Beyond this threshold, households enter a discomfort zone. Overall the weight of household debt versus assets has remained bearable in Qu ebec for the past ten





years, because it has ranged from 0.2 to 0.3. However, the drop in the value of financial assets in 2008 following the onset of the financial crisis temporarily raised the DAR. For all indebted households, the effect of the stock market correction was therefore contained. The most vulnerable households, however, were hit harder.

What is the critical threshold for the DAR, i.e. the level that generally leads to major financial difficulty? According to Office of the Superintendent of Bankruptcy (OSB) statistics on insolvency, Québec consu-

mers who declare bankruptcy or make proposals to their creditors to settle their debts usually have debts that are double their assets. This does not necessarily mean that all households in this category are having financial difficulties, but rather that those who have become insolvent generally have twice as much debt as they do assets.

85% of indebted households have sufficient assets

Beyond the general DAR trend, the distribution of the DAR is what helps better

determine the proportion of households that could default on their payments. The vast majority of Québec households, —85%— are financially secure ($DAR < 0.8$), which is quite reassuring. About 1.9 million households are in this situation. The percentage of households in the discomfort zone ($DAR \geq 0.8$ and ≤ 2) is, however, considerable (11%) and deserves special attention. Those whose DAR is equal to or greater than the critical threshold of 2 are clearly in the minority. More specifically, 4.2% of households exceeded this insolvency threshold in 2010, compared to 7.6% in 2000. The percentage of households at risk is therefore lower than it was ten years ago. The perception that a growing proportion of indebted Québec households is in a weaker financial position than it was ten years ago does not therefore hold water, at least when the values of both debts and assets are taken into consideration.

In short, the diagnosis is reassuring in several regards. First, the sharp rise in personal loans in the past ten years is based on a sustained increase in the value of assets. The debt-asset ratio (DAR), which helps determine whether a household's assets are sufficient to limit the risk of default on payment and ultimately avoid bankruptcy, has changed little since 2000. The DAR has remained in a tight bracket, which points to an overall healthy financial situation. Quebecers have, in fact, increased their debt load in the past few years, but they have also accumulated assets. Contrary to popular belief, the overall balance sheet for households is not really worse than it was ten years ago. ■