Household debt continues to rise

After slowing down for two quarters, the data published this morning by Statistics Canada suggest that household debt has deepened once again. The market value of mortgage loans rose by 1.7% between the first and second quarters while the value of consumer loans grew by 1.0%. Household disposable income advanced by only 0.8% for the period. The level of debt contracted on the credit market vs. disposable income reached a new peak in Q2, or 163.4%.

This result is stirring concerns about the too high debt levels of Canadian households. The situation is not creating too many problems at the moment, rather, the possibility that a good number of households might have difficulty meeting their financial obligations if interest rates were to rise is more worrisome, especially for the Bank of Canada and the Finance Minister.

The lively real estate market is clearly the root of the problem. Mortgage credit increased by $18.5B in the second quarter, accounting for nearly 70% of the total increase in household loans. That the real estate market continued its ascent in Q2 is worth noting. The number of housing starts jumped by 8.6% compared with the previous quarter. Sales of existing properties advanced by 6.3% for the period while average prices edged upward by 1.5%.

Implications: For household balance sheets to improve, the real estate market has to stabilize or even pull back slightly. Most forecasters in fact agree that we are currently on the cusp of a downturn. Even if the national averages remain high, several regions are already caught in a downturn. Moreover, in addition to the four series of measures introduced by the federal government since 2008 to limit access to mortgage credit, the Canada Mortgage and Housing Corporation (CMHC) recently put a limit on its securitization program and mortgage rates are on the rise. New rate increases are also expected in the quarters ahead.

That said, the situation will continue to be watched closely. For the Bank of Canada, the option to increase key rates to counter high debt levels is not in the cards for the time being. Not only would this have a fairly limited impact on mortgage rates—variable and short-term rates would be mostly affected—the effect would ripple through overall domestic demand. Such a scenario is hard to imagine in the current context of weak growth. This, however, will not prevent the monetary authorities from continuing to warn Canadians that rates will eventually rise and that caution is in order. On the other hand, Canada’s Finance Minister could wade in again at any time if the real estate market fails to cool down in the next few months. We can think of other measures that would restrict mortgage credit or tighten securitization further. Stay tuned.