OBSERVATION

TD Economics

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CANADA'S AGING HOUSEHOLD DEBT BURDEN

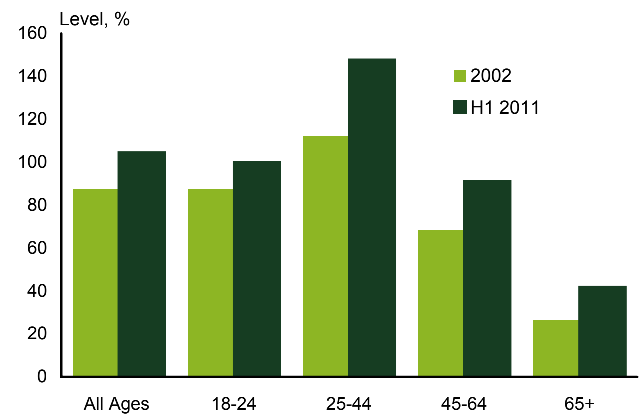
Highlights

- Significant household debt accumulation has been recorded right across the age spectrum over the past decade. The bigger surprise is that older Canadians have been growing their debt-loads at a considerably faster rate than their younger counterparts.
- The fact that those in the 65+ age segment have been active participants in the run-up in debt could lessen the risk of a severe negative adjustment down the road. This is because those older Canadians tend to carry lower debt balances and have larger asset bases on which to fall back on.
- Overall household financial vulnerability has still increased. While much of the debt across age groups has been used to finance an offsetting real estate asset, the fact of the matter is that asset values go up and down but debt only declines when principle payments are made.
- At the same time, however, this trend of towards entering retirement years with debt raises questions about the long-term financial security of these households.

This report represents the third in a series by TD Economics examining Canadian household debt. Our earlier studies looked at the issue from both a national and regional perspective. In this analysis, we examine trends in debt by age cohort with help from data compiled by Ipsos Reid in its comprehensive Canadian Financial Monitor Survey. The results confirm that there has been significant debt accumulation right across the age spectrum over the past decade, both in absolute terms and relative to income. What's more, all age groups have posted a significant acceleration in the pace of borrowing since 2007. Younger Canadians, many of whom enter the housing market for the first time, continue to record the largest debt burdens. However, the bigger surprise surrounds the increasing indebtedness of those in or nearing retirement. In particular, the 65+ age group racked up debt at three times the average pace.

There has been much ink spilt about the growing vulnerability of Canadian households (and the overall economy) as a result of rising household debt. On a positive note, the fact that Canadians in older age groups are significant contributors to the run-up in debt could lessen the risk of a severe balance sheet adjustment down the road. This is because older Canadians are better positioned to withstand an unanticipated event, such as a sharp decline in home prices or disruption in income, since they tend to have

HOUSEHOLD DEBT-TO-INCOME RATIO



Source: Ipsos Reid
*Uses pre-tax income as the denominator

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lower debt balances and larger asset bases which to fall back on. At the same time, however, the fact that Canadians are entering retirement with more debt raises questions about their long-term financial security.

Canadians are retiring more indebted than ever

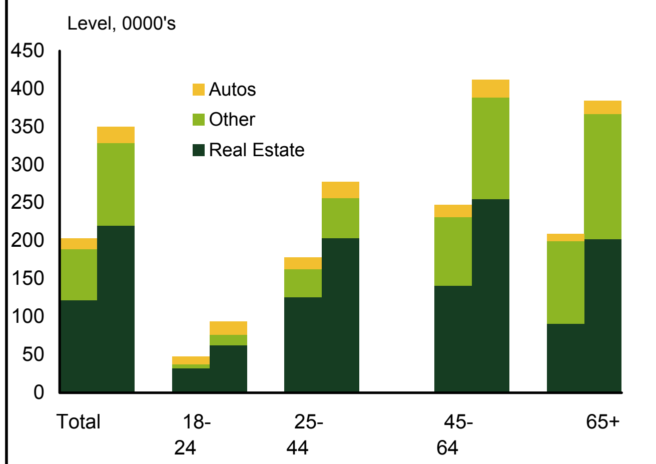
The 10-year trends in debt by age group appear to pour some cold water on the traditional life-cycle hypothesis. Typically, as an individual prepares for retirement they tend to ease up on the debt accelerator and build up their assets in order to ensure adequate replacement income once they leave the work force. Over the past decade, while average debt-loads in Canada increased at twice the pace of income, the debt-loads of those 65 and older grew at three times the rate and contributed as much as half to the overall debt growth. What's more, Canadians approaching retirement (i.e., those aged 45-64) also showed an above-average penchant to accumulate debt, suggesting that the trend to holding debt later in life has some staying power.

Bulking up on real estate

A closer look shows that a large part of the growing debt burden among older Canadians reflects investment in real estate. Indeed, the trend toward real estate has been more prominent than average among the 65+ group, where average holdings have doubled since 2002. Like others, older Canadians have been lured by the attractive combination of low interest rates and home price appreciation. And for those in or close to retirement, low returns on interest-bearing securities and sharp equity losses in recent years have provided an added incentive to diverisfy portfolios into real estate. We've argued in earlier reports that debt used to fund asset accumulation (rather than consumption) is more sustainable.

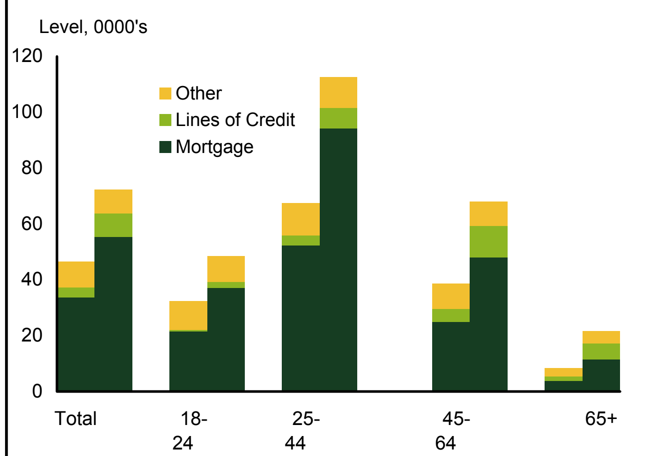
That said, those aged 44-64 and 65+ years are the only age groups where debt growth has outstripped asset growth over the last decade. For those aged 65+ years, debt grew at a pace that was double that of assets. Accordingly, most broad metrics of household financial health – ratios of debt-to-income, debt-to-assets and debt-to-homeowner's equity – have been on a deteriorating trend since 2002. Moreover, the share of income earmarked towards servicing debt has edged up for these age groups despite record-low interest rates. In contrast, Canadians under the age of 44 years have posted rising debt-to-income ratios, but other metrics have remained relatively stable.

HOUSEHOLD ASSETS 2002 vs. 2011



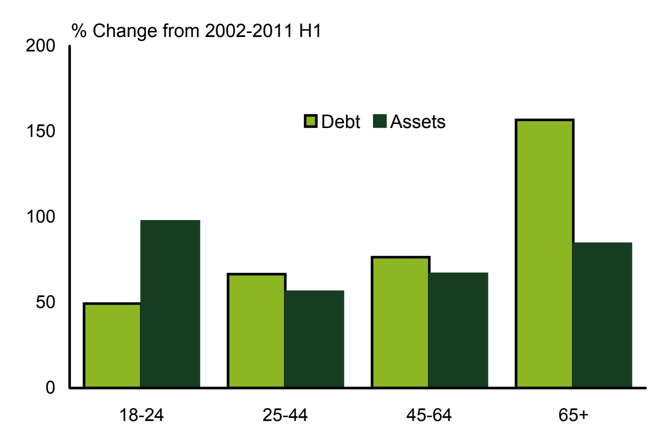
Source: Ipsos Reid

HOUSEHOLD DEBT: 2002 VS. 2011



Source: Ipsos Reid

ASSET AND DEBT GROWTH



Source: Ipsos Reid

Not just a real estate story

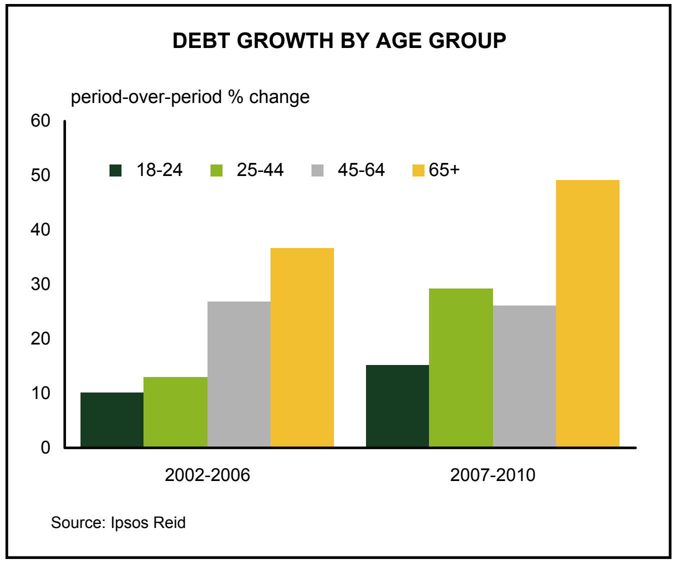
While real estate acquisition has been the number-one driver of household debt across the age spectrum in recent years, it is not the whole story. While the Ipsos Reid data do not provide information on overall consumption patterns, we can use survey results on automobile asset values as a general guide. The data indicate that Canadians on average have either increased the number of cars they own or are driving a more expensive car. In 2006, the average household had automobile assets worth $15,000. The comparable figure has since increased to $20,000. During this period, the cost of owning or leasing a vehicle has actually fallen more than 10%, so rising prices is not an explanation. Among the age groups, larger-than-average increases in automobile assets were posted by young Canadians (18-24 years) and older Canadians (65+ years).

Lines of credit see largest growth

Another trend that has been witnessed in recent years is the growing popularity among all age groups of personal lines of credit. Mortgage debt still accounts for about three quarters of the average household debt-load. But lines of credit have been the growth leader, especially since 2007. Households have been attracted to lines of credit, since the variable-rate pricing of these products has enabled households to reap the benefits of extraordinarily low level of short-term interest rates. Furthermore, they come with more flexible repayment options compared to other lending products. The latter has been a particularly attractive feature for Canadians aged 18-24 and those 65+, where growth in borrowing by way of lines of credit has been most pronounced. For example, for younger Canadians, lines of credit have been widely used to finance post-secondary education. Like their younger counterparts, older segments of the population have been active users of credit lines for investment purposes, particularly in real estate. Less clear is how credit has been used as a tool for income replacement during a period of low porfolio returns.

Debt growth has slowed since 2009

In past reports, we have heeded the warning that household debt accumulation has become excessive. On the plus side, there have been indications that growth in household borrowing has begun to moderate, especially within the younger (18-24 years) and older (65+ years) areas of the age spectrum. Three rounds of tightening in mortgage insurance rules since 2008 may help explain part of the simmering down in the pace of borrowing. We expect a further slowdown over the next few months, as recent financial market turmoil and economic worries lead to increased caution among households. Still, the jury is out whether this trend will be sustained over the medium term. And from a longer-term perspective, a continued appetite for debt among the fastest-growing age segment (65+ years) would support average borrowing rates in Canada.



Implications

Household debt in absolute terms and relative to income have been rising across the age spectrum over the past decade. This highlights the growing vulnerability of household balance sheets to unanticipated events. While much of the debt has been used to finance an offsetting real estate asset, the truth of the matter is that asset values go up and down in value but debt only declines when principle payments are made. What's more, there is a good argument that despite the recent slowdown, households will continue to add to their debt burdens over the medium term in a low interest rate environment.

Notwithstanding the rising household vulnerability, the fact that a substantial share of the new borrowing has been tilted towards the older age segments might lessen the overall risk compared to what would be the case if concentrated in the younger age groups. That is because older Canadians tend to have lower debt balances and larger asset bases which to fall back on.

Lastly, the trend towards retiring with debt increases uncertainty with respect to these households' longer-term financial outcomes. In a June 2010 TD Economics report

"Retirement Income Security Reform: Rush Prudently, Don't Run Blindly", we argued that a significant share of Canadians are facing the prospects of a declining standard of living in retirement due to lower savings rates, volatility in asset markets, pension fund deficits and declining employment pension coverage. A sustained trend toward rising debt burdens among older Canadians could significantly exacerbate this financial challenge.

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