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TD Economics

Data Release: Indebtedness rises, but low rates and rising asset values offer some offset

- National net wealth rose 1.4% in the third quarter of 2016, to $9,730 billion, as improving equity markets and continued gains in real estate prices helped drive up the value of Canadian's assets. While asset values grew faster than debt across most sectors, government and households indebtedness continued to inch higher.
- The pace of household borrowing moderated in the third quarter. Still, the household debt-to-income ratio nudged up to 166.9%, from 166.4% in the prior quarter, as debt (+5.2% y/y) growth outpaced incomes (+4.0%). However, by most other measures, the household balance sheets appeared to be improving. Household assets were up 7.3% from year ago levels, and it was not all a real estate story. Financial assets rose a hardy 8.7% from a year ago. As such, the debt-to-asset rate dipped to 16.7%, from 16.9% in the prior quarter. The homeowner's equity ratio has been somewhat volatile, and while falling in the quarter, has average around 74% since the fourth quarter of 2014, a marked improvement from the 72% low during 2010. The total debt service ratio edged lower, with the interest only debt service rate falling to a new low. As such, the household savings rate jumped to 5.8%, from 4.8% in the prior quarter.
- Adjusting the Canadian household debt-to-income ratio to be more comparable to the U.S. methodology, actually showed a marked improvement in the Canadian ratio, to 154%, from 155% in the prior quarter. The Canadian ratio remains twelve percentage points below the peak reached in the U.S. prior to their housing crisis.
- Debt rose among all levels of government, with the federal net debt-to-GDP ratio rising by 0.1 percentage points (pp) to 30.9% and the ratio for all other levels of government moving up by 0.25 pp to 28.7%.
- In contrast, consistent with the pull-back in business investment, non-financial businesses borrowed less. The debt-to-equity ratio fell to 73 cents of debt for every dollar of equity, compared to 74 cents in the prior quarter.

Key Implications

- Despite the rise in the household debt-to-income ratio, the third quarter marked an overall improvement in the household balance sheets, as rising asset values and low interest rates helped offset higher credit balances.
- Asset values will continue to rise sharply with the recent rebound in the TSX/S&P index and continued growth in home prices, but households are starting to lose the support of a low interest rate environment. The 5-year government bond yield has jumped 50 basis points since the U.S. election and borrowers have so far passed nearly 20 basis points of that increase onto consumers. The Federal Reserve is expected to raise rates at today's meeting, which could push interest rates up further, depending on how the FOMC telegraphs its 2017 intentions.
- Meanwhile, the debt-to-income ratio is likely to edge higher in the near-term. The rise in the debt-to-income ratio was modest, when set against activity in the resale market, as debt growth remains much slower than the 10% to 11% pace recorded during the 2004 to 2007 boom. However, credit growth is estimated to clock in at 5.6% in 2016, the sharpest gain since 2011. This pace of credit growth is likely to push the debt-to-income ratio up a further three percentage points by the end of next year, to near 170%.
- Lofty debt levels and rising interest rates are likely to put some downward pressure on both consumer spending and housing activity, holding economic growth below the 2% pace through 2017 and 2018.

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