Assessing Ontario Households' Debt Burden and Financial Vulnerability

Key Points

- Since 2010, low interest rates have supported economic growth in Ontario by boosting consumer spending and housing market activity. However, this has also contributed to a significant increase in household debt. In 2016, the average Ontario household owed nearly $154,000, up from $119,000 in 2010. As a share of disposable income, household debt reached 171 per cent in 2016 – 21 percentage points higher than 2010 and 8 percentage points higher than households in the rest of Canada.
- As interest rates increase, the share of households' income spent on debt payments is expected to rise from 13.9 per cent in 2016 to 15.3 per cent by 2021, the highest share recorded since at least 1990[1]. In particular, low-income households, which spend nearly a third of their income on debt payments, will be disproportionally impacted from the rise in interest rates.
- For the average household, the FAO projects annual debt payments will increase by $3,000 to $15,500 by 2021. This increase is equivalent to 1.4 per cent of household disposable income and reflects money that households could have otherwise spent on goods and services.
- High debt loads increase the vulnerability of households to financial risk. A sharper than expected rise in interest rates would further increase household debt payments, forcing households to scale back spending on goods and services. This could have potentially significant negative implications for the broader economy.

Household Debt Burdens Have Increased Significantly in Ontario

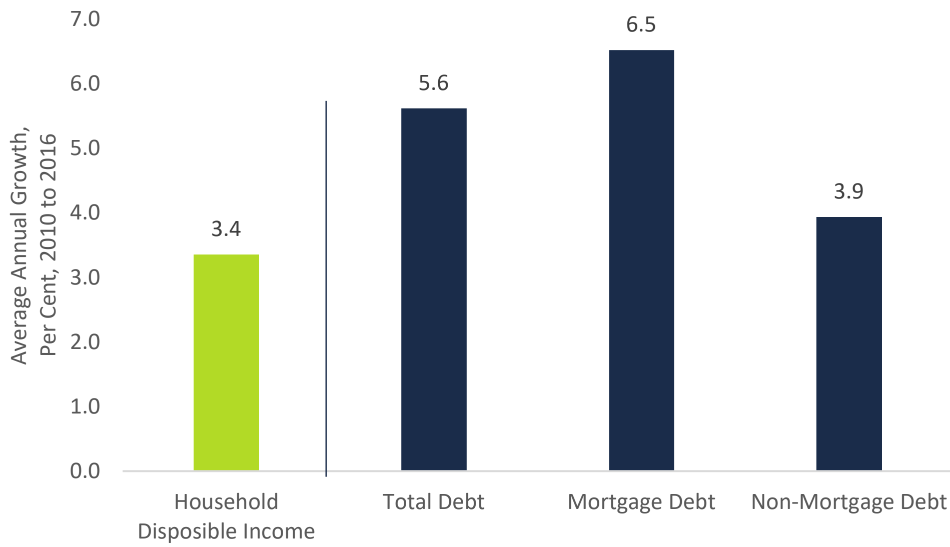
Over the past six years, strong gains in consumer spending and residential housing investment activity have supported economic growth in Ontario. However, increases in household spending and residential investment combined with only tepid income growth have resulted in a significant rise in household debt.

In 2010, the average Ontario household held almost $119,000 in debt, split between about $76,000 in mortgage debt and $43,000 in non-mortgage debt. In total, Ontario household debt represented 150 per cent of household disposable income in 2010.

From 2010 to 2016, household debt grew by 5.6 per cent per year on average, 2.2 percentage points faster than the growth in household disposable income. This rapid accumulation of household debt was primarily driven by residential mortgages, which grew by 6.5 per cent each year over this period or close to double the rate of growth in disposable income. However, non-mortgage liabilities, such as lines of credit and personal loans, also outpaced household incomes, rising by 3.9 per cent per year on average from 2010 to 2016.

[1] Statistics Canada data on household debt service by province is only available from 1990.

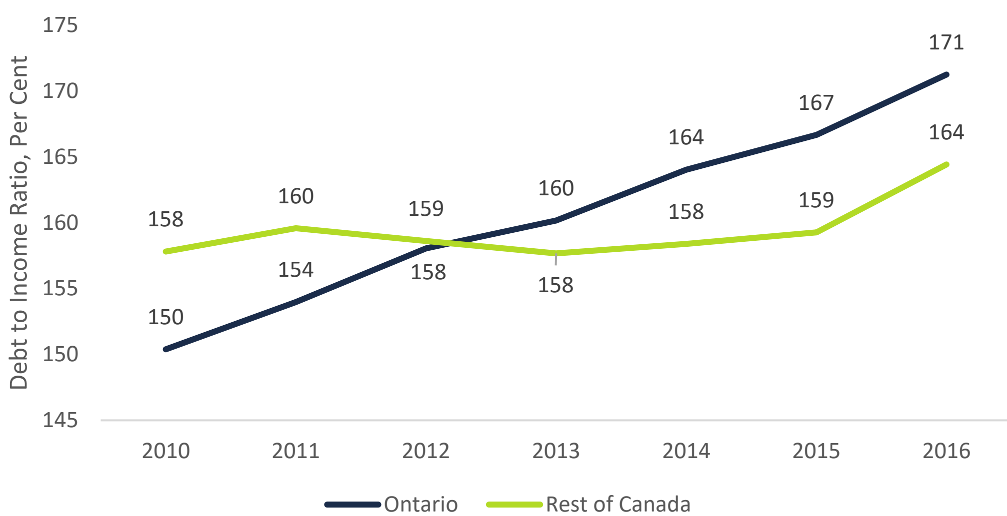
Ontario Household Debt Increased Significantly Faster than Disposable Income from 2010 to 2016



Source: FAO and Statistics Canada (Table 378-0151 and Table 384-0042)

By 2016, the average Ontario household held nearly $154,000 in debt, with $103,000 in mortgage debt and $51,000 in other debt. Ontario household debt represented 171 per cent of disposable income in 2016 – an increase of 21 percentage points in six years. The rise in Ontario's household debt to income ratio outpaced the rest of Canada where the debt-to-income ratio increased by only seven percentage points over the same period. Ontario's household debt to income ratio is third highest among provinces, behind Alberta and British Columbia (see Appendix).

Ontario Households Owed $1.71 for Every Dollar of Income in 2016



Source: FAO and Statistics Canada

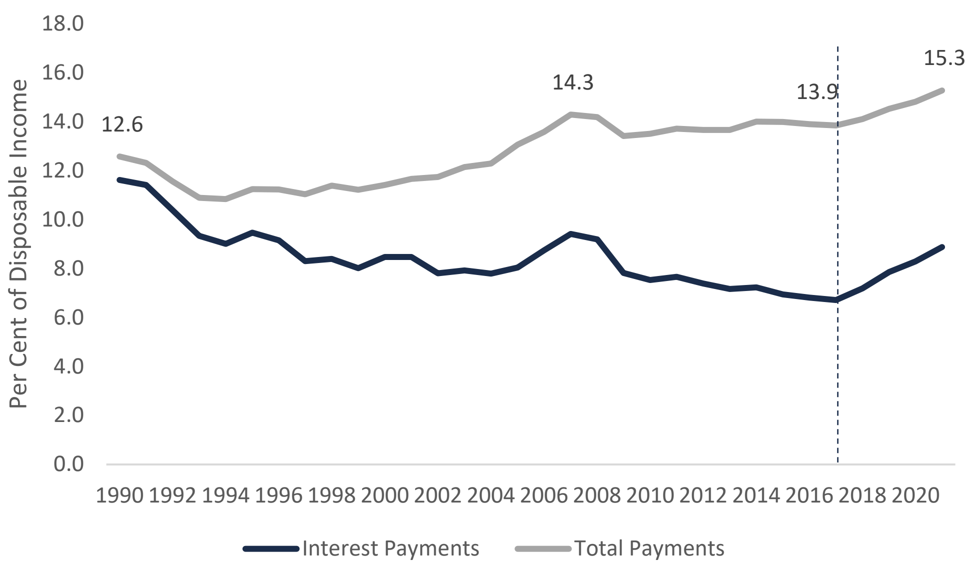
Household Debt Payments Expected to Rise

Despite the sharp increase in the level of debt, historically low interest rates have kept household debt payments relatively stable since 2010[2]. In 2016, the average Ontario household spent $12,500 in debt payments – accounting for 13.9 per cent of household disposable income.

The FAO is projecting a gradual increase in the Bank of Canada's policy interest rate over the next three years, which will lead to a steady rise in consumer and mortgage interest rates. Specifically, the FAO estimates the effective interest rate on Ontario household debt will rise from 4.0 per cent in 2016 to 5.1 per cent by 2021 (see Appendix).[3]

Higher interest rates are expected to increase debt payments as a share of income from 13.9 per cent in 2016 to 15.3 per cent in 2021. This is the highest debt service share since at least 1990. The significant projected increase in debt payments will reduce the discretionary income of households. In particular, low-income households, which spend nearly a third of their income on debt payments, will be disproportionally impacted from the rise in interest rates (see Appendix).

Household Debt Payments to Rise to Highest Share of Income Since 1990



Source: FAO and Statistics Canada

Note: Historical total DSR estimated by the FAO using Statistics Canada's methodology from *Household debt service ratio–Interest and principal (2015).*

For the average household, annual debt payments are expected to increase from $12,500 in 2016 to $15,500 in 2021, the result of higher interest rates and the continued accumulation of household debt. This $3,000 reduction in discretionary income, which accounts for about 1.4 per cent of household disposable income on average, represents money that households could have otherwise spent on goods and services.

[2] Statistics Canada only publishes historical data on debt interest payments by province, which excludes debt principal payments. The FAO estimated total debt payments for Ontario households based on Statistics Canada's published methodology. See *Statistics Canada, Household debt service ratio–Interest and principal (2015).*

[3] The effective interest rate represents the weighted average interest rate on households' debt, calculated by dividing total interest payments by total household debt.

However, high debt levels expose households to financial risk. [4] A sharper than expected rise in interest rates would further erode households' discretionary income. The FAO estimates that, if interest rates were to rise 100 basis points higher than projected by 2021, average debt payments would increase by a further $1,000 per household, equivalent to about 1 per cent of household disposable income. This would likely force households to scale back spending on goods and services, and could have significant negative implications for the broader economy.

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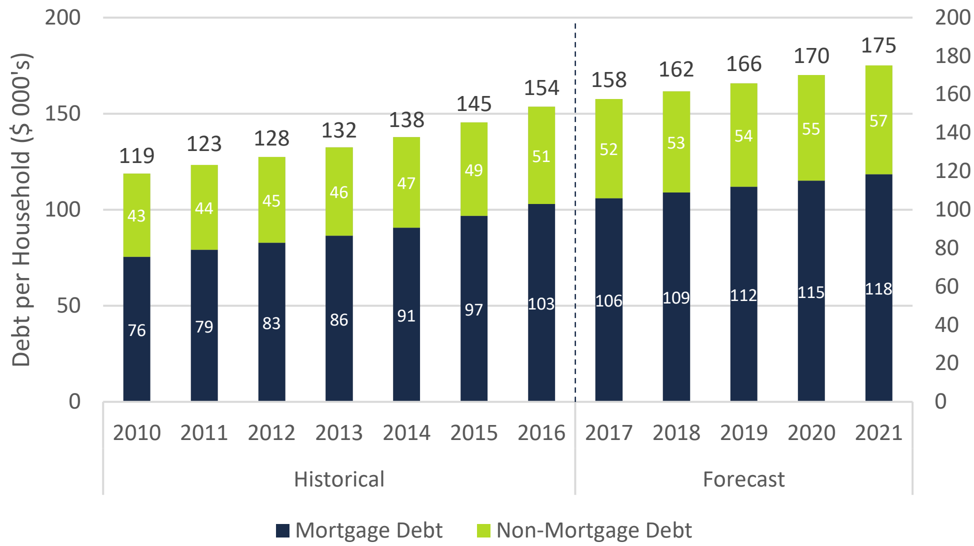
The data and calculations used in this analysis are available upon request.

[4] See Financial System Review, November 2017, Bank of Canada, and Global Financial Stability – Is Growth at Risk?: Household Debt and Financial Stability, International Monetary Fund, October 2017

Appendix

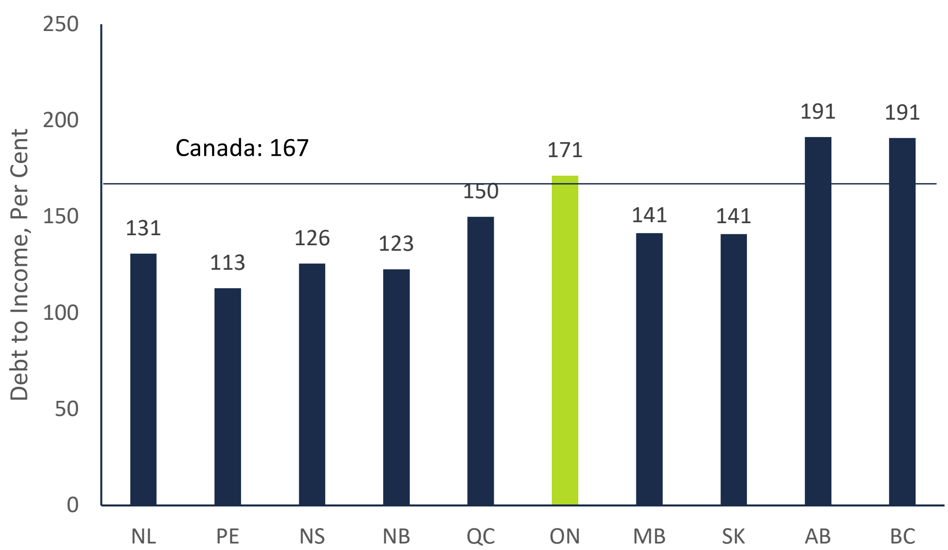
Summary Graphs on Household Debt

Average Household Debt by Type (Mortgage and Non-Mortgage)



Source: FAO and Statistics Canada

Average Household Debt to Disposable Income Ratio by Province (2016)



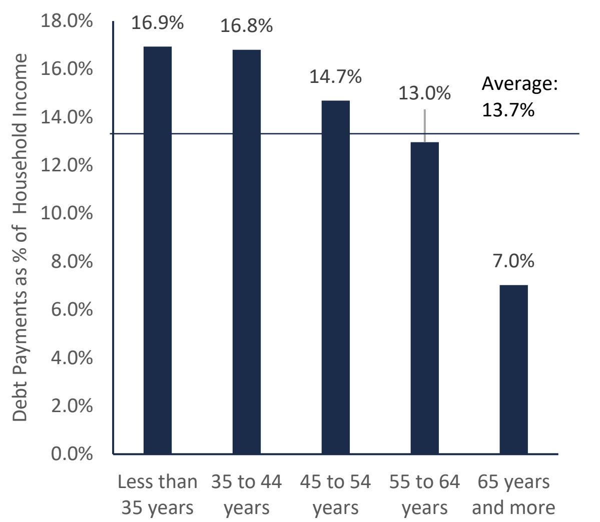
Source: FAO and Statistics Canada
Note: The Alberta household debt to income ratio increased by 21 points in 2016 due to the recession experienced in that province.

Household Debt by Age and Income Group, Canada

The average share of debt payments to household disposable income in Canada[5] was 13.7 percent in 2016. However, households whose major income earner is younger than 44 years old spent roughly 17 per cent of their income on debt payments while low-income households spent nearly a third of their income on debt payments.

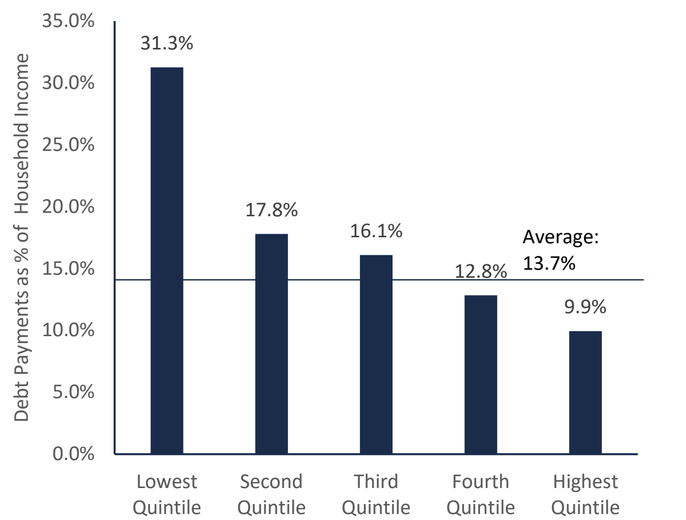
Breakdown of Household Debt Payments as Share of Disposable Income (Canada 2016)

By Age of Head of Household



Source: FAO and Statistics Canada

By Household Income Group[6]



Source: FAO and Statistics Canada

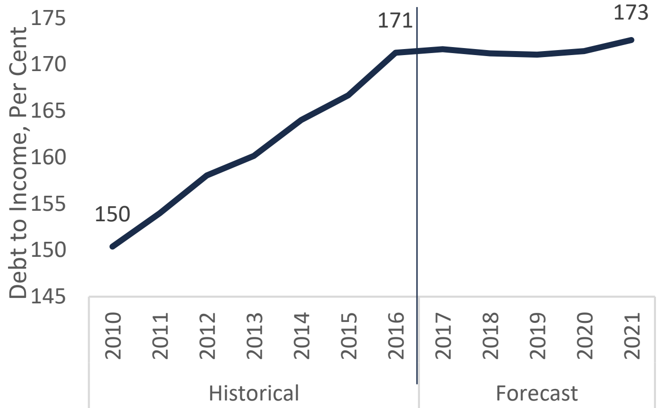
FAO Projection of Household Debt and Interest Rates

The FAO developed projections of household debt based on econometric analysis and the economic forecast published in the FAO's 2017 Fall Economic and Fiscal Outlook (EFO)[7]. Mortgage debt is projected using housing market indicators including home completions and Statistics Canada's New Housing Price index[8]. Based on the EFO forecast for slower residential investment growth, the FAO projects mortgage debt per household to grow by 2.8 per cent per year from 2017 to 2021, down from 5.3 per cent average annual growth from 2010 to 2016.

Non-mortgage debt is forecast using household income and outlays.[9] Growth in non-mortgage debt per household is expected to slow slightly from 2.7 per cent per year from 2010 to 2016 to 2.3 per cent on average from 2017 to 2021, reflecting the EFO forecast for more moderate growth in household consumption expenditures.

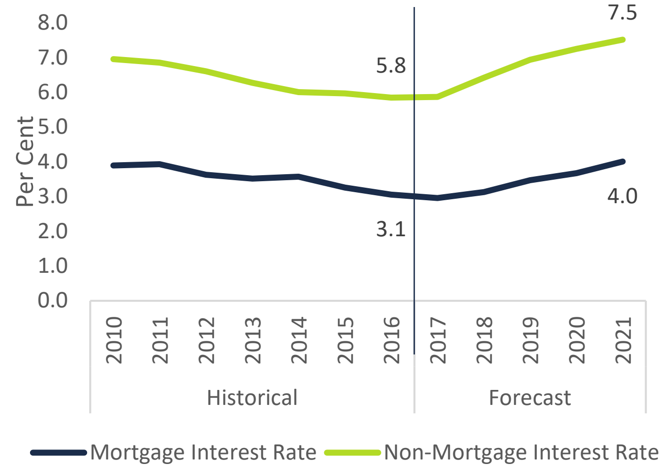
[5] Only Canada-wide data is broken down in more detail. The FAO assumes that Ontario families by age and income share similar patterns to the Canadian average.
[6] Lowest quintile represents $0 to $30,600, second quintile is $30,600 to $47,300, third quintile is $47,300 to $69,200, fourth quintile is $69,200 to $97,100 and highest quintile represents families with incomes above $97,100.
[7] 2017 Fall Economic and Fiscal Outlook, Financial Accountability Office of Ontario, 2017
[8] Home resale price and real residential investment forecasts from the 2017 Fall EFO were used as proxies for housing completions and the house price index, respectively.
[9] Compensation of employees and household consumption from the 2017 Fall EFO were used as proxies for total household income and household outlays, respectively.

FAO Projection of Household Debt to Income



Source: FAO and Statistics Canada

FAO Projection of Interest Rates



Source: FAO and Statistics Canada

The FAO projection for mortgage and non-mortgage interest rates is based on the EFO forecasts for the yields on three-month Canadian Treasury bills and 10-year Government of Canada bonds. By 2021, the FAO projects the effective interest rate for non-mortgage debt to increase by 1.7 points to 7.5 per cent.

The multi-year terms of many residential mortgages limit the immediate impact of rising interest rates on mortgage payments. As a result, the FAO projects that the effective mortgage interest rate will rise more moderately than the non-mortgage interest rate, increasing from 3.1 per cent in 2016 to 4.0 per cent by 2021.