

“Living On the Edge”
– The worsening household debt problem in Canada

Opening remarks By Roger Sauvé
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To

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Regarding Bill S-19.

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About a year ago, *The Current State of Canadian Family Finances* report¹ concluded that a growing number of households were “living on the edge” and that they needed to act now before it was too late. In our new report², released last week, we continue to hold that view. Even more so than a year ago, we believe that households need to reign-in some of their spending, pay off some debt and build a bigger cushion against the possibility of a slowing economy and/or rising interest rates. This is not a doomsday scenario but one of caution and reassessment.

REAL INCOMES HAVE STALLED

Real (after government transfers and income taxes and excluding inflation) personal disposable incomes per household have, on average, remained near the \$54,000 level during each of the last four years. From a longer-term perspective, real incomes are up by less than 4% since 1980. Rather miniscule by any standard. This flattening out has occurred in spite of the record number of dual-earner households bringing in this income. In addition, income inequality is worsening with the richest families gaining ground at the expense of the rest. According to the latest census, there are now about 1.5 million

¹ Roger Sauvé, *The Current State of Canadian Family Finances – 2003 Report* published by The Vanier Institute of the Family, February 17, 2004.

² The 2004 report was released on January 27, 2005.

full-year, full-time workers with before tax earnings of \$20,000 or less ... these are Canada's working poor³.

TWO LOST DECADES FOR THOSE UNDER 45

Family employment incomes were flat from 1980 to the mid 1990s for those aged 25-34 and those aged 35-44. Those aged 45-54 also had no growth in earnings from the late 1980s to the mid 1990s. These trends are not only interesting; they have also had significant and measurable impacts on the well being of different generations.

- Home ownership rates advanced strongly for those aged 55 and over from 1981 to 2001. In contrast, home ownership rates fell for all age groups below the age of 55.
- Net worth also declined for all age groups, except those aged 55 and over, during the 1984 to 1999 period.
- The poverty rate soared for those aged 25 and under and fell sharply for those aged 65 and over from 1980 to 2002.

THE SAVINGS RATE HAS DROPPED TO ZERO

Some 20 years ago, the typical household was saving about 20% of its disposable income. The personal savings rate dipped to zero in the third quarter of 2004. Even worse, households in half of the provinces had negative savings in 2003, with British Columbians recording the biggest negative saving rate of -6%. Many people are now living in expensive housing where they may be “house rich but cash poor.” Not everyone is even this “lucky”.

THE DEBT LOAD IS GROWING TOO QUICKLY

Households now hold, “on average”, about \$66,800 of debt. Total household debt is now equal to 121% of disposable incomes compared to 86% in 1980. (If only mortgage and

³ *Profiling Canada's Families III* published by the Vanier Institute of the Family, December 2004.

consumer debt is included, then the debt to disposable income ratio is now equal to 105% of disposable incomes compared to 74% in 1980.) Record low interest rates have made this debt manageable, for most but not all, households. In our *2003 Report*, we estimated that, if interest rates rose by just 2 percentage points, the level of interest and principal payments on household debt would have returned to the 1990 peak and brought many more household that much closer “to the edge.”

BANKRUPTCIES REMAIN NEAR RECORD HIGHS

About 84,000 people went bankrupt in 2004, which is close to the record set in 1997 and compares to “only” 21,000 personal bankruptcies in 1980. Those in the age group 25-44 are the most prone to go bankrupt. In 2003, there were 611 bankruptcies per 100,000 people aged 25-44, or more than triple the rate in 1987.

THE COUNTER-ARGUMENTS

There are two main arguments used to counter the opinions of those who believe that households are getting closer and closer “to the edge” of the precipice.

- The first argument suggests that, “on average” households have been able to manage their finances due to record low interest rates. As noted above, we agree with this statement ... but as we also warn, it would not take much of an increase in interest rates to bring about a return to the onerous debt burdens experienced in the early 1980s and 1990s.
- Secondly, so the argument goes, the ratio of debt to net worth of households actually improved a bit over the 1990 to 2004 period. This is also true and is discussed in our *2004 report*. Much of this improvement is due to a recovery in the stock market and rising house prices. It is good to remember that the ownership of stocks, directly or indirectly, continues to be very unevenly distributed. Relative to housing, and noted above, the home ownership rate has fallen for everyone under the age of 55. The younger (and not so young) generations are already struggling to buy the “overpriced homes” of the 55 and over crowd. This will be even more difficult when interest rates rise.

Conclusion: Too much debt is indeed a big and growing problem for more individuals, households and families. The “debt problem” is due to a growing imbalance between incomes, spending, savings and debt. This is especially so for those on the “disadvantaged” side of each of the pillars of financial health. Unless, there is a better balance between the pillars, a growing number of Canadians will be borrowing because they have to and not because they want to. In total, there will be more marginal or high-risk borrowers among the Canadian population.

Thank you and I look forward to your questions.

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