The demographics of Canada's debt binge

By David Parkinson

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The Bank of Canada has long known that, collectively, we Canadians are carrying an awful lot of debt. Now, it has a better idea of what the worst Canadian debtors look like, how many we're looking at and where we'll find them.

That knowledge will help shape policy that is already emerging to start repairing what has been a nagging threat to Canada's economic well-being for years. It implies something that the central bank has long been saying – that surgical precision, rather than the exceedingly blunt instrument of interest rates, will be the path to reining in the most dangerous elements of Canada's household debt boom.

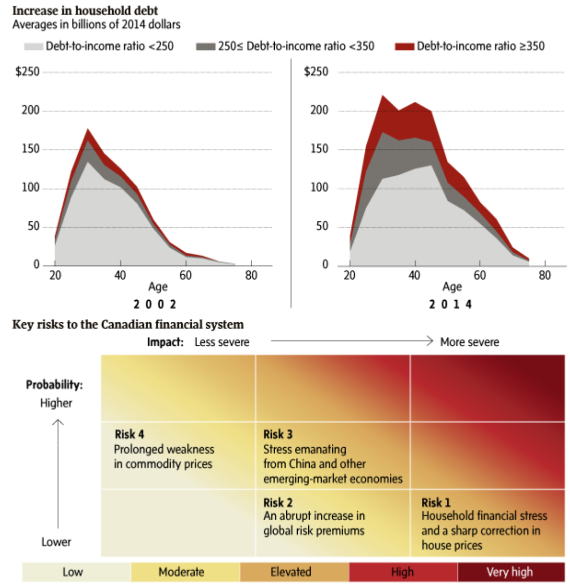
The Bank of Canada's latest Financial System Review – a twice-a-year publication that has become essential reading for housing-bubble and household-debt watchers – contained an eye-opening special report dissecting Canada's most indebted households. It focused on people whose debt exceeded 350 per cent of annual disposable income – a level at which, research shows, the likelihood of falling behind on payments spikes dramatically.

The share of Canadian households falling into this group has doubled from their pre-financial-crisis levels to 8 per cent from 4 per cent.

That would be more than a million households, and they hold more than one-fifth of the country's total household debt. It's a big deal.

So who are these heavily indebted Canadians? The Bank of Canada's research has identified some characteristics:

- They are more likely to be young. The incidence of heavily indebted households for those under 35 is almost double that of those over 65.



JOHN SOPINSKI/THE GLOBE AND MAIL › SOURCE: BANK OF CANADA (IPSOS REID, STATISTICS CANADA AND BANK OF CANADA CALCULATIONS)

- They are more likely to be lower- to middle-income. The median income of highly indebted households in the 2012-14 period was $51,000 a year, or 35 per cent lower than the median of $79,000 for everyone else. The proportion of middle-income high debtors has more than doubled from their pre-crisis levels, making the middle class the biggest boom segment for heavy debt loads.
- They are slightly more likely to be less educated, if only slightly. The proportion of highly indebted people with at least a bachelor's degree is 34 per cent, compared with 37 per cent of the less-indebted people.
- They are more likely to be westerners. Nearly 14 per cent of British Columbia households are highly indebted, as are 11 per cent of Alberta households. Ontario is next at 8.5 per cent. Every other region of the country is under 5 per cent.

That last point is no coincidence; those are the three provinces that have accounted for the bulk of the housing boom, especially the markets of Vancouver, Toronto and Calgary (which, as a result of the oil slump, may serve as a case study for what happens to indebted households when a market goes south). And home mortgages are by far the biggest component of household debt (77 per cent).

Critically, real estate makes up about 90 per cent of these heavy debtors' total assets – a reminder that the household debt problem is joined at the hip with the housing market boom. A substantial correction in the housing market would obviously be a big problem; and given their regional distribution, the bulk of the most-at-risk households are in places that either look susceptible to a correction (Toronto, Vancouver) or already in the midst of one (Calgary).

The growth of high indebtedness over the past decade also means that, as a nation, we are much more exposed to high debtors going under water with their payments than we used to be. A simulation run by the bank's researcher found that in the event of "shocks that lower income or increase debt payments," the incidence of debtors in arrears after one year would be 16 per cent higher than they would have been a decade ago; after three years, arrears would be 27 per cent higher. That illustrates the snowball effect that the rise of high indebtedness could have on the economy in the event of a downturn.

Given the vulnerabilities in the household-debt area, then, policies aimed at easing their burden – such as, say, a middle-income tax cut – might not be the most progressive thing a government could do, but might be a prudent valve to ease the pressure. Similarly, Ottawa's new mortgage-lending restrictions, announced last week, only affect a small portion of the overall mortgage market, but effectively restrain the most at-risk fringes of home buyers in the most overpriced markets. In a tentative economic recovery, such surgical measures to tighten rules and lend support to the most exposed households is preferable to the clumsy hand of interest rate increases – an argument that the Bank of Canada has long made. Now it is producing the kind of data to not only back that up, but shine a light on the possible paths out of the household debt quagmire.