Better Dwelling – May 4, 2023

# Canadians Are Falling Behind On Debt, Mortgage Issues Brewing

**RBC MAY 4, 2023**

Canada's largest bank is seeing signs of stress, as the cheap money binge haunts borrowers. RBC wrote to investors this week to warn households are beginning to fall behind on credit payments. As the economy begins to slow and job losses mount, the bank is forecasting things are going to get a lot worse over the next few years.

## Canadians Are Piling On Debt—A Lot of It

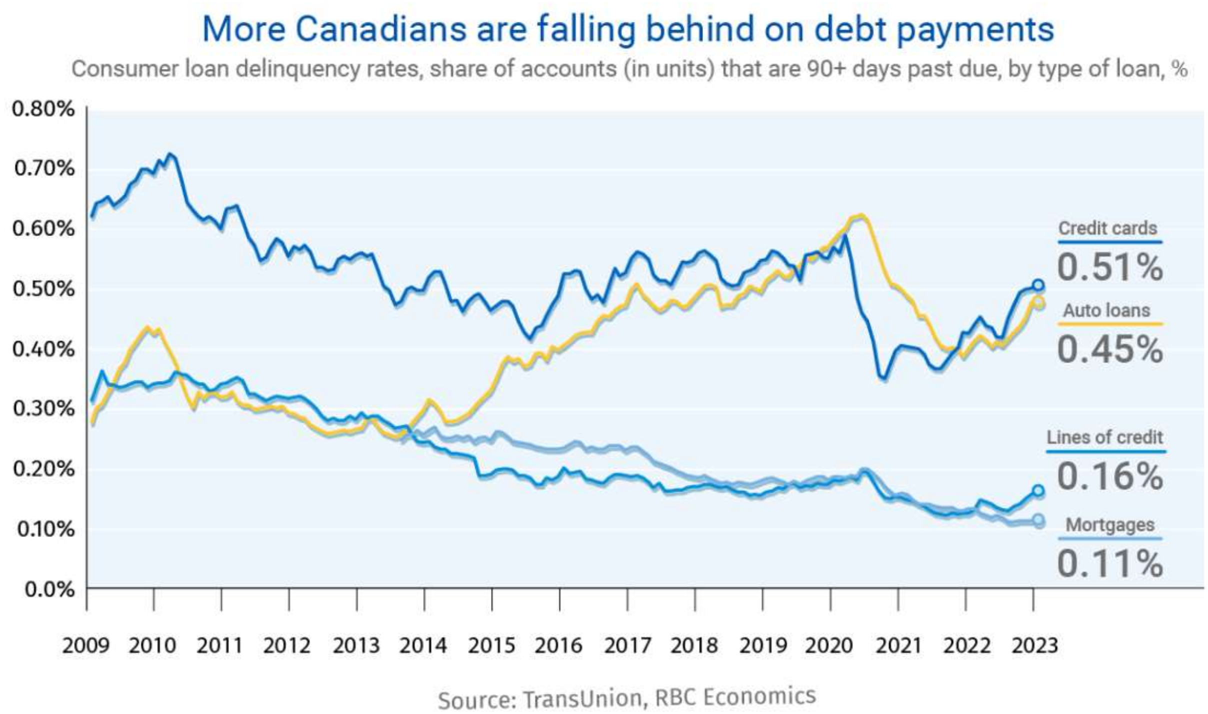
Highly indebted households entered 2020 in a risky position, but there was no "financial armageddon," says RBC. Unprecedented debt measures and stimulus helped to mitigate even typical levels of risk, and created moral hazard.

Consequently, rather than using the measures to lower the risk they began the pandemic with, households were encouraged to borrow more. Few households saw any risk, and they began to borrow at an accelerated rate.

"Indeed, a booming housing market put mortgage debt on a fast track. By late-2021, Canada's household debt-to-income ratio had exceeded pre-pandemic levels. And it's remained elevated ever since," says Robert Hogue, assistant chief economist at RBC.

## Canadian Households Are Falling Behind On Payments

Hogue warns that mortgage delinquencies might be at record lows, but other segments are climbing. The mortgage delinquency rate was just 0.15% in February, just off the record low hit last summer. But installment loans, credit cards, auto loans, and basically every other segment of credit are seeing late payments rise. That isn't typical of an economy with a booming population, showing economic growth, and has unemployment just off a record low.




*Source: RBC.*

Delinquencies haven't returned to pre-2020 volumes, but the worst is yet to come, warns the bank. "A looming recession and the ongoing effect of higher interest rates will only add stress in the period ahead," says Hogue.

## Canadian Unemployment Rate Forecast To Rise, Leading To Higher Credit Delinquencies

We recently highlighted that aggressive population growth isn't preventing GDP from slowing. RBC's forecast sees the economy slowing even further, falling into recession later this year. They anticipate this will push unemployment from the current 5% to 6.6% in Q1 2024. That works out to ~342k more unemployed Canadians in less than a year from now.

Highly indebted households with cashflow can always squeeze to make payments and borrow. A significant disruption to that cashflow is where things begin to get messy. "Historically, the loss of a job has been one of the principal factors contributing to loan delinquencies and consumer insolvencies in Canada," he warns.

The fallout will be significantly more debt problems. Mortgage delinquencies are expected to see the rate reverse half the decline over the next year. It'll be accompanied by consumer insolvencies rising nearly 30% over the next 3 years.

Canadian business insolvencies are already on the climb, and back to typical levels.

## Higher Debt Loads Can Slow The Economy Even Further

A threat that's often under discussed is household debt service. RBC expects households to spend another point of income on debt payments in the next year, hitting a historical high of 15.5% by Q4 2024. As long as they're making payments, right?

The threat of higher debt loads often isn't obvious to policymakers and even many economists. However, the extra point of income to service debt is diverted from other areas. Savings, consumption, or investment—in any case, the loss of cash flow results in more vulnerable households, or more vulnerable businesses. In general, this makes the economy more vulnerable to economic shock, and slows prospects of future growth.

## Canadian Mortgage Debt Problems Will Get Worse Over The Next Few Years

Canada's economic fallout from soaring debt isn't expected to be catastrophic. The bank sees it largely manageable in the short-term, and some of those stats are still better than pre-pandemic. At the same time, they don't see this as a short-term event that will be mitigated quickly.

Borrowers of variable rate interest products have taken an immediate hit from higher rates. However, that's a relatively small share of outstanding debt in Canada. Most borrowers opt for fixed-term interest rates, and haven't been impacted—yet.

"Record indebtedness has made Canadians more interest rate-sensitive than ever. And the impact of past rate increases will continue to pressure mortgage borrowers for years to come as they renew their mortgage terms (most commonly of five-year length) at what may be much steeper rates," warns Hogue.

Adding, "This poses a particular risk in 2025-2027 for a specific group of borrowers: those who bought a home between late-2020 and early-2022—when the market was at its peak and interest rates hit rock bottom."

Buyers prior to 2020 that renewed their mortgage that year, will also see higher payments. However, they typically have much smaller mortgages with higher payments more easily absorbed. At the very least, they'll have significant equity and could refinance or lengthen their amortization to help manage payments.