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Bank warns mortgage delinquencies could rise by more than one third as homeowners struggle to make payments

Report from RBC forecasts delinquencies to rise by a third over the coming year, while consumer insolvencies could increase by nearly 30 per cent over the next three years.

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Mortgage delinquencies could rise by more than a third over current levels during the coming year, as pandemic-related support measures are largely over and living costs continue to soar, a recent RBC report warns.

The bank forecasts the household debt-to-service ratio could rise more than a percentage point over the next year, to a historical high of 15.5 per cent by the fourth quarter of 2024. And, consumer insolvencies could increase by nearly 30 per cent over the next three years, returning to pre-pandemic levels and likely remaining on an upward trajectory.

“What we saw over the last year was a significant increase in interest rates directly impacting mortgage holders with variable rates or fixed rates looking to renew their terms in the coming years,” said Robert Hogue, senior RBC economist and co-author of the report. “There will be a sizable impact on these households.”

Financial institutions are “keeping a close eye” on homeowners who bought a property between late-2020 and early-2022 when the market was at its peak and interest rates hit rock bottom. Many will be renewing around 2025 to 2027, Hogue added, and could be under considerable financial stress with higher rates.

Pandemic relief programs such as CERB didn’t stop Canadians from loading on more debt. The real estate boom put mortgage debt on a “fast track” so that by late 2021, Canada’s household debt-to-income ratio had exceeded pre-pandemic levels and it has remained elevated ever since, the report says.

Yet the share of mortgages in arrears hasn’t increased by much, Hogue said.

“Households have been stress tested, so the majority can handle the increased interest rates,” he said. “Most won’t end in delinquency or insolvency.” In a stress test, buyers must prove they’re able to afford a mortgage rate two per cent higher than the qualifying mortgage rate.

However, the number of consumers who are more than 90 days late on their debt service payments has risen for instalment loans (typically used for one-off purposes like home renovations, unexpected emergencies and debt consolidation), credit cards, auto loans, and more recently, for lines of credit, the report added.

The biggest unknown factor in the next year, which could drastically impact delinquencies, is unemployment.

The bank forecasts a “modest contraction” for Canada’s economy which would trigger job losses. The report expects the national unemployment rateto hit 6.6 per cent by the first quarter of 2024 from the current five per cent.

“Employment really is the biggest factor because as long as people have jobs most households will be OK, and we’ve been surprised by the strength of employment so far,” said Philip Cross, a senior fellow at the Macdonald-Laurier Institute and former chief economic analyst at Statistics Canada.

“Delinquencies and insolvencies haven’t risen too much and even if they rise by another third we’ll just be at pre-pandemic levels. But how long can it last?”

There’s still confusion on how much debt and savings households have, Cross said, making it difficult to forecast how long households will be able to absorb interest rate hikes.

“Households must have dipped into savings much more than they wanted to in order to cushion themselves against rising rates,” he added. “We really don’t have a clear picture of household finances.” People relying on savings, Cross added, are left in a vulnerable position over debt payments.

And there has been a noticeable increase of forced sales in the private lending space, but not with major banks where prospective home buyers are put through a stress test.

“So far, everything has held together pretty well,” said Cross. “But there is a lot of stress on households, and we’ve seen more stress on the banking system recently. At some point something has to give. We can’t continue on this trajectory forever.”