

More Canadians struggled with debt in 2019

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Highlights

- Canada's consumer insolvency rate hit a nine-year high in 2019 driven by proposals
- Actual bankruptcies fell for the tenth consecutive year
- Ontario, Newfoundland & Labrador, and Alberta saw the largest percentage increases
- Outside Alberta, insolvencies were not necessarily driven by labour market conditions
- Higher debt servicing costs were likely a bigger headwind for borrowers
- Rising insolvencies don't signal a recession but should be monitored closely—particularly if labour markets worsen

Consumer insolvencies rose last year...

Consumer insolvencies rose an eye-catching 9.5% in 2019, the largest annual increase since the 2008-09 recession. That translated into 44.6 insolvencies per 10,000 working age Canadians, up from 41.4 in 2018 but still well short of the 55.8 rate seen in 2009. Last year's increase reflected a rise in the number of "proposals"—offers to pay creditors a percentage of what is owed and/or extend the repayment schedule, a remedy available to individuals with up to \$250,000 in unsecured debt. Actual bankruptcies declined for a tenth straight year after legislative changes in 2009 made consumer bankruptcy more punitive.

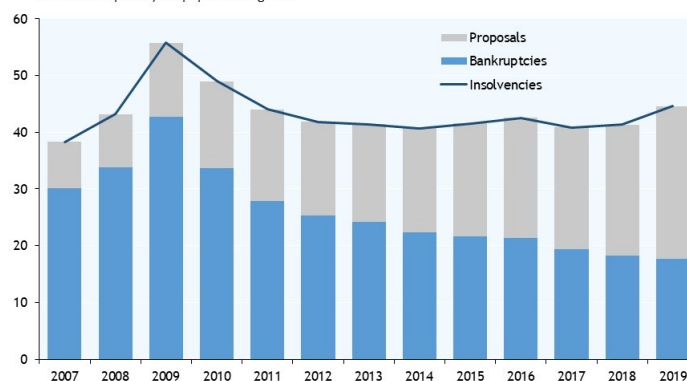
With proposals only addressing unsecured debt, it's not surprising that the rise in insolvencies reflects an increase in non-mortgage delinquencies. Indeed, the latest data from the Canadian Bankers Association shows just 0.23% of mortgages were more than 90 days in arrears as of August 2019, matching the lowest rate since 1990. That is not to say mortgage debt isn't a source of stress for some households—mortgages account for 45% of the average household's debt servicing costs. But those having trouble making debt payments are likely prioritizing their mortgages over credit cards and auto loans. There has also been an increase in insolvencies among individuals without mortgage debt. Even there, the rising cost of housing (higher rent in the case of non-homeowners) is likely squeezing some households.

...despite a strong labour market

The surprising (or worrying) feature of the recent rise in insolvencies is that it comes amid a robust job market. Canada's unemployment rate averaged 5.7% in 2019, the lowest since 1974. Employment rose by 2.1% last year—the fastest increase in twelve years—and average hourly wages grew at a healthy 3.4% pace. Ontario recorded the largest percentage increase in insolvencies in 2019 despite its unemployment rate hitting a 30-year low (the province's overall insolvency rate is still among the lowest in the country, though). Newfoundland & Labrador saw the second-biggest increase, even as its jobless rate fell by nearly 2 percentage points—easily the largest decline in the country. Only in Alberta did an increase in insolvencies (the third-largest in the country) seem to reflect deteriorating labour market conditions.

Canadian consumer insolvencies

insolvencies per 10,000 population age 15+



Source: Office of the Superintendent of Bankruptcy Canada, RBC Economics



Higher debt payments likely troubled some borrowers...

Rather than changing labour market conditions, we think an increase in debt servicing costs was a key factor in rising insolvencies. Canada’s aggregate debt service ratio—principal and interest payments as a share of household disposable income—hit a record-high 15.0% in Q3/19, having climbed steadily from 14.0% in Q3/17 when the Bank of Canada began raising interest rates. That debt servicing costs hit a record level despite a relative modest 125 basis point increase in the policy rate says a lot about households’ sensitivity to interest rates amid record high debt loads (something the BoC warned about when it started raising rates).

Among the provinces, Ontario saw the largest increase in interest payments as a share of disposable income between 2017 and 2018. British Columbia, which faced the second-largest increase (and has the highest interest-only DSR among the provinces), also saw a double-digit rise in insolvencies last year, though its overall insolvency rate is still the lowest in Canada. And while Alberta’s increase in insolvencies can be blamed on higher unemployment, rising debt servicing costs (the province’s debt-to-income ratio is the highest in the country) were also a contributing factor.

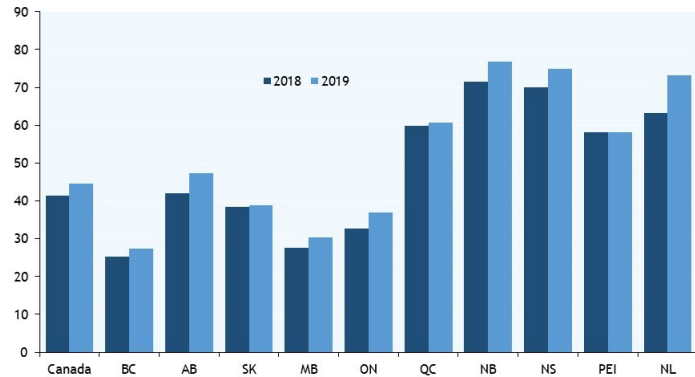
...something we’ve seen before

The last time household debt servicing costs were this high was in the second half of 2007 when the Bank of Canada’s overnight rate hit 4.50% (a 200 basis point increase from two years earlier). The insolvency rate subsequently rose from 37.9 per 10,000 working age Canadians in Q3/07 to 40.9 in Q2/08. That was despite the unemployment rate edging up only slightly from a cycle-low 5.9% to 6.0%.

So there is some precedent for an increase in debt servicing costs contributing to a rise in insolvencies, even in a healthy labour market. But that’s where the parallels end. The further, sharp increase in insolvencies in late-2008 and 2009 was driven by rising unemployment amid a global economic downturn (not a made-in-Canada recession emanating from stressed households). We don’t think last year’s increase in insolvencies presages a recession. With the Bank of Canada potentially cutting interest rates this year, and market rates remaining low, we think upward pressure on debt servicing costs will ease in 2020. Barring an unexpected deterioration in Canadian labour markets, we don’t expect to see another nearly-10% increase in insolvencies this year.

Consumer insolvencies by province

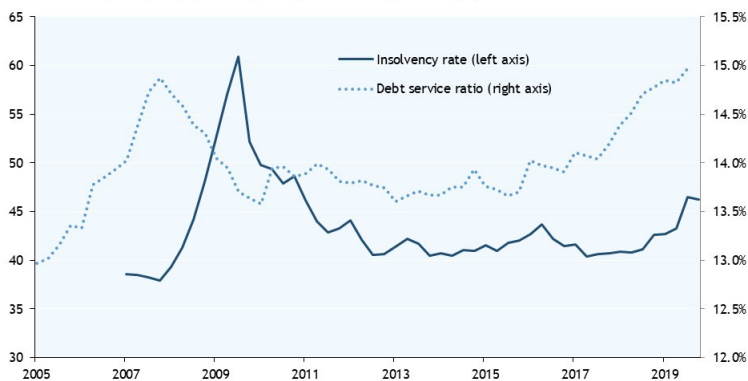
per 10,000 population age 15+



Source: Office of the Superintendent of Bankruptcy Canada, RBC Economics

Consumer insolvencies and household debt service ratio

insolvencies per 10,000 population age 15+ (annualized rate) and debt payments as a share of income



Source: Statistics Canada, Office of the Superintendent of Bankruptcy, RBC Economics

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