



Where Does the Money Go:

The Increasing Reliance on
Household Debt in Canada

By the Certified General Accountants
Association of Canada



Certified General
Accountants Association
of Canada

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Foreword

The study of economic theory and its corresponding social behaviour are not new phenomenon or an emerging preoccupation. In fact, economists and statisticians from around the world have been collecting data, studying trends and anticipating patterns for decades. Having the quality of lending an interpretive comprehension, the study of economics also harnesses a certain predictive capacity which bestows invaluable guidance to policy makers, decision makers and the general populace. Moreover, it serves as a key determinant of individual and collective prosperity and enjoins the human condition and individual influence onto the whole.

Governments and their duly appointed designates rely on economic findings and forecasts to steward fiscal policy which moderates fiscal behaviour. Not so surprisingly though, pronounced policy does not always achieve the fullest desired ends. The reasons are relatively simple to conceptualize, and as the following pages will reveal, the views, actions or behaviours of individuals are seldom perfectly congruent to the academic logic of stated public goals. As humans, we search for a desired state of immediate wellbeing which may interfere with the optimum long-term state. In short, we want things. And with the advent of a deliberate and relatively eased access to credit, we can obtain them. This is a good thing, but only in so far as it does not unnecessarily threaten an individual's long term financial wellbeing. The trade-offs can be life changing where individual discipline is ignored or collective over-spending normalized.

With a particular curiosity around how Canadians view their financial condition, sentiment to spending and financial prowess, the Certified General Accountants Association of Canada (CGA-Canada) commissioned a consumer survey in the spring of 2007. Forming the basis of our findings and supplemented also by the works of others, our goal is to impart insight to Canadians. We would acknowledge that Canada is not on the brink of a distressing financial crisis and as such are not sounding an alarm. And while we do not purport to enlighten economists or other experts, we do anticipate that this report can be of significant value to the Canadian public.

Much of what we see in the literature and the media assesses macro and micro-economic condition or events which necessitate some level of aggregate analysis. As such, the primary aim of this paper is to present an individual perspective within that landscape. Financial condition and prospect,

oftentimes analysed within some form of aggregation, may well skew the real life experiences and expectations of individuals. Without intent to misrepresent, some distortions may be introduced with indicators that necessarily rely on means and averages which can vary from the individual scenarios of constituents. It is our sense that Canadians can be advantaged to recognize these actualities so that they may plan correspondingly.

Anthony Ariganello, CPA (Delaware), FCGA
President and Chief Executive Officer
The Certified General Accountants Association of Canada

Introduction

There are multiple forces competing for household resources in the modern world: typical living expenses associated with housing and sustenance, retail shops looking to increase sales and profits, service industries offering new products, credit and loan institutions delivering competitive financial products, and investment opportunities to name but a few. The tenets of the economic theory suggest that competition improves consumer experience and outcome. With reason, some do nevertheless wonder if households and their inherent finances have become the collateral damage in the battle of the mighty forces.

A number of surveys and studies have revealed that Canadians are increasingly worried about their financial wellbeing at retirement and into the golden years. Some suggest that “economic insecurity is now a fact of life for most workers, regardless of where they fit into the income spectrum.”¹ Counter-intuitive as it may seem however, we witness that the household savings rate continues to plunge as we take on more and more debt. Moreover, we are spending more than ever on discretionary goods and services that detract from wealth accumulation or saving.

We are spending more than ever on discretionary goods and services that detract from wealth accumulation or saving

With the regularity of the statistical updates of the national economic accounts showing the level of indebtedness of the household sector come anecdotal concerns relating to the run-up in household debt. With equal fervour, those concerns are counterweighted and sometimes altogether dismissed by analysis suggesting that vigorous borrowing has been well supported by the attainment of household assets and overall wealth.

Canada’s 15-year recession-free economy featuring steady income growth, high demand for labour and expanding economic activity has given us confidence that the good times are here to stay; at least in the immediate future. We cannot deny that the Canadian economy is fairing relatively well compared to other developed countries and that we have witnessed positive gains.

The significant caveat however is that national financial health of the household sector is commonly assessed at the aggregate level. This precondition can sometimes conceal that the debt burden is borne by each household individually making reliance on aggregates, means and averages sometimes misleading. Although debt instruments are a positive attribute of the market economy and can be significantly productive in generating increased capital, the steadily

¹ Rich-poor gap becomes a chasm, The Toronto Star, January 10, 2007

Increasing indebtedness
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increasing indebtedness of households does heighten vulnerability to different types and intensities of shock. The diversity which is well imbedded in our ethnical and cultural profile and in our industrial and geographical allocation of resources may help Canada as a nation to withstand moderate negative economic shocks. We must concede however that those shocks will have different effects on the multitude of households contained in that population depending on respective socio-economic and demographic profiles.

Consumer spending has for some time been very important for Canada's economic growth. In fact, it's been an important driving force for the last three decades. Financial market deregulation and softening of the requirements for first-time home buyers are modern examples of public policy aimed at broadening market accessibility and stimulating participation. We know however that it remains consumers' responsibility to bear the consequences of the potentially excessive debt or poor financial management. There is little that is 'collective' in a consumer bankruptcy or a cash deprivation of a particular household.

A natural and ultimate goal of our economic activity is to increase the prosperity and quality of living standards. The challenge that we face however is that this premise has different meaning to different people. Ultimately we will determine whether our living standards are higher tomorrow than today based on our level of contentment with our level of income/assets/wealth and our expectations around current and future standards of living. An individual may perceive living standards as deteriorating just because he or she cannot purchase a new TV or a car with the same frequency they may have in the past. However, this perception will most probably not be reflected in the numbers appearing on the households' and country's balance sheets.

Always, there were those who were willing to take on more debt and those who were more likely to condemn indebtedness. So, have Canadians borrowed too much? There are several ways to approach the query but we are likely to either adopt an individualistic or a homogeneous collective perspective. From the collective perspective, there is no commonly accepted benchmark or threshold indicating a critical level of household indebtedness and history shows us that even the Great Depression has been survived. From the individual perspective, one answer does not fit all Canadians as none of us is really an "average household" whose financial health is being considered when examining household indebtedness.

While our goal is not to espouse alarm recognizing that the level of debt is rightfully a personal decision, we do feel compelled to raise the reader's awareness of the potential risks of increasing individual household debt. Lulled by positive homogeneous collective prosperity, most of us have at one

time or another reflected that we had been reckless or otherwise unrealistic given our personal circumstances. We all prefer to count on favourable economic conditions and that asset values will continue to rise while interest rates will remain modest. The reality though is that, even in positive collective times, we are not all affected in the same way or to the same degree by economic events. Our unique circumstances will dictate our opportunity, or alternatively, our exposure to risk.

In the following text, we begin our discussion by presenting the key findings of the public opinion survey commissioned by CGA-Canada and administered by Synovate between April 25th and May 22nd of 2007. Building on the identification of these perspectives of Canadians on the changing level of their indebtedness, wealth, and attitudes towards spending and savings, we then examine some of our findings in the context of publicly available facts and figures. We conclude by highlighting the more salient aspects of our findings along with some practical recommendations.

Importantly, the questionnaire was designed by CGA-Canada in collaboration with the senior staff of Synovate and pre-tested for comprehension, relevance and data quality. Sampling was configured to accommodate on-line interviews with households consisting of a representative sample of Canadian adults over 25 years of age.

The survey sample was drawn using Synovate's online panel which includes approximately 110,000 individuals which is deemed representative of the overall Canadian population. A total of 1,000 on-line interviews were conducted with households living in the ten Canadian provinces. With this sample size, sampling error of plus or minus 3.1% at a 95% confidence level (19 times in 20) is produced. Results for specific geographical regions and/or socio-demographic groups assume greater margin of error than the results for the total sample. The data has been statistically weighted to accurately reflect the composition of Canadians by region, age and gender based on Statistics Canada's 2006 information.

Before embarking on the following analysis however, it is deemed desirable to render clear that the definition of debt or indebtedness as referred to in the body of this paper shall be construed to embody all forms of legal obligation to capital creditors. As such, references to indebtedness and to wealth are deemed to include all financial instruments and holdings inclusive of residential realty property. No account has been made however for prospective future obligations resulting in cash flow obligations flowing from non-capital future enjoyment (i.e. lease, utilities, etc.).

Even in positive collective times, we are not all affected in the same way or to the same degree by economic events

Executive Summary

1

Total household debt has been increasing steadily over recent years reaching a record high of \$1 trillion in 2006. It is commonly accepted that debt is a natural and healthy feature of a well functioning market economy. But we must nevertheless recognize that steadily increasing indebtedness of Canadian families may increase their exposure to shocks and may prevent households from achieving their financial goals. During the course of our study, some interesting discrepancies between the perceptions of households and the reality as borne out by empirical data were observed while some unenthusiastic trends were confirmed. Given the mismatch in some areas, we are compelled to explore potential risks of increasing household debt.

Based on the public opinion survey commissioned by CGA-Canada, a modern literature review, and analysis of other publicly available statistical information, the body of this paper elaborates the following key findings.

Level of Household Debt

Perception of Canadians:

- Canadians are more likely to believe that their debt is decreasing or remaining stagnant. Only 14% of all respondents reported that their debt had markedly increased while another 16% reported that their debt had modestly increased.

Facts and Figures:

- Household debt adjusted for inflation and population growth has been steadily increasing since 1984 with only a brief insignificant decline in 1991.
- Although household debt measured in terms of debt-to-assets and debt-to-net worth ratios has only slightly deteriorated since 1990, the growth of asset values and net worth adjusted for inflation has not rivalled rising household debt throughout the 1990s or in the present.
- The measures commonly used for gauging the level of household debt should be interpreted with caution as they are reasonably incapable of fully capturing all aspects of the household financial condition.
- Consumer credit, which is not backed by enduring assets (i.e. immediate consumption, modest relative salvage or resell value, items declining in value from date of purchase) are often considered to be a pure debt and have been steadily increasing both in absolute terms and as a share of the household debt portfolio over the last decade. Although the share of consumer credit has not yet reached an unprecedented level, the run-up in

consumer debt has not been well supported by the accumulation of either consumer durables or financial assets.

- International comparison reveals that the level of indebtedness of Canadian households is neither among the best, nor among the worst when compared to that of other industrialized countries. The results of the international comparison should nevertheless be considered with caution as some discrepancies exist in the way that the household sector is defined in different countries.

Perception of Canadians:

- Respondents having lower household income are much more likely to report their debt as increasing compared to respondents in higher income groups.

Facts and Figures:

- The median measure of household debt grew faster than the average between 1999 and 2005 suggesting that the rising household indebtedness was caused by increasing debt load of a typical Canadian family rather than by rising debt of affluent households. Moreover, asset appreciation of a typical household has lagged behind debt increases.
- The Bank of Canada finds that “the proportion of low income households devoting a large fraction of their income to debt payments is higher than that of households with higher incomes.”²
- Between 1999 and 2005, the least wealthy 20% of households experienced the second fastest rate of debt growth when compared to all other wealth groupings. This least wealthy grouping has been able to increase its access to credit at a more rapid pace than other families.
- Lower income individuals experienced an accelerated increase in their debt-to-asset ratio between 1999 and 2005 when compared to other income groups. This is worrisome as the income of low-income households does not typically reflect productivity gains and vocational advancement to the same extent as might be expected in other income groups correspondingly enjoying a greater rate of real growth.

Increased Household Exposure

Perception of Canadians:

- Some 27% of Canadians do not think that changes in interest rates, housing prices, wages or reduced access to credit would negatively affect their financial wellbeing. Nearly all respondents reporting residential real estate among their personal assets did not believe that a 10% decline in housing market prices would negatively affect their financial wellbeing.

² An Analysis of the Financial Position of the Household Sector Using Microdata, Highlighted Issue, Financial System Review, December 2006, Bank of Canada.

Facts and Figures:

- Rising debt increases households' sensitivity to income interruption, decline in asset values and hikes in interest rates. Income interruption may affect households' ability to maintain debt service obligations. A reduced value of assets may disproportionately erode a household's net equity or wealth and its ability to secure further borrowing, and in the worst cases even trigger distress asset liquidation. Without belabouring the point, a rise in interest rates (with other factors hold constant) will naturally increase the debt-service load.
- For the greater part, Canadian households rely most on income from salaries and wages. Although the pan-Canadian unemployment rate struck a 30-year low in 2006, not all regions benefited uniformly from positive developments in the labour market. The likelihood of cash flow shocks may increase due to poor performance of the manufacturing sector, changes in economic conditions of the US – Canada's main trading partner, and slowdown in business expansion in western provinces.
- Independent of the income and wealth structure or class echelons, certain groups of households (e.g. single parents, unattached individuals, self-employed, multiple and seasonal job holders) are exposed to a higher risk of income instability. The number of Canadians falling within these categories has been increasing in the recent years.
- The least wealthy 20% of Canadians have almost no housing equity to back up their mortgage debt and do not typically have an adequate level of other non-financial asset values (e.g. vehicles, durable goods, valuables and collectibles) to support the debt load.
- While the western provinces have all enjoyed expansion of the housing market, Canada's two largest provinces – Ontario and Quebec – have experienced a 6% decrease in housing starts in 2006.
- As the proportion of the Canadian population over the age of 55 years increases, the rate of growth in new homeownership may slow, ultimately affecting the number of transactions in the realty market and dampening the price/value of housing assets.
- The Bank of Canada estimates that a combination of increasing interest rates and debt growth exceeding income growth may push the debt-service ratio up by some 3 percentage points within the next four years.

Tapping into Future Resources for Current Consumption

Perception of Canadians:

- Some 40% of adult Canadians believe that the depth of their debt negatively affects their ability to attain financial security for unexpected circumstances. 28% of indebted respondents feel that household debt negatively affects their ability to achieve their retirement goals.

Facts and Figures:

- The personal saving rate that measures the active component of household savings (i.e. part of disposable income put aside) has been subject to a declining trend since the early 1980s dropping from its highest of 20.2% in 1982 to its lowest of 1.2% in 2005. Housing equity is often considered to be a viable alternative to outright saving and one third of non-retired Canadians count on their home equity as a source of retirement income. Interestingly (alarming for some) however, home equity per home owner was 5% lower in 2005 than in 1997.
- An increase in aggregate spending and value of household financial assets was not accompanied by increased participation in the capital markets. Even with strong stock market performance, the number of investors has noticeably decreased since 2000 while the number of tax-filers having capital gains has yet to reach its pre-2000 level.
- As a larger proportion of the Canadian population enters the phase of life when they have typically sought to intensify accumulation of their retirement savings (i.e. 45-64 years of age), the proportion of people receiving investment income could reasonably be expected to grow. Ironically, this has not been the case, even in the provinces that have been enjoying considerable earnings amplification and very strong economic growth.
- Inclusion in employer-sponsored pension plans is declining and not being offset by compensatory boosts in private pension savings. The proportion of young people having private pension savings is also decreasing. Surprisingly also, there is tendency for a great number of people to tap into their RRSP savings prior to retirement; using funds primarily for day-to-day living purposes.

What Canadians Think About Household Debt

2

We have come to recognize that Canadians have become indebted more than ever before and that social attitude towards debt and the stigma of debt have changed. Whereas, being in debt in the mid 1900s was oftentimes condemned and determined by some to be shameful, borrowing today has become a commonly accepted and a deeply imbedded actuality of our day-to-day lives – the norm. To better understand the attitudes of Canadian households as they manifest themselves today, CGA-Canada commissioned a public opinion survey that sought to identify the perspectives of Canadians respecting the changing levels of their indebtedness and wealth and their attitudes towards spending and savings. Based on respondents' perception rather than absolute balance sheet dollar amount or financial condition, the survey asked Canadians to reflect on the changes in their household that had transpired over the past 3 years within the following four broad themes:

1. *Amount or level of household debt.*

This component of the survey sought to identify how and why household debt has changed, the attitudes towards having debt and respondents' points of view on whether indebtedness prevents them from attaining their financial pursuits.

2. *State of income, assets and wealth.*

The second component intended to determine whether the increase in debt was accompanied by increasing income and/or wealth. Respondents were asked to describe the changes in their income, assets and wealth, and to identify negative economic shocks that may affect their financial wellbeing.

3. *Nature of household spending.*

Through the third component of the survey, we attempted to understand if changes in debt and wealth led to changes in household spending and attitude. The survey sought respondents' opinion on changes in their expenditures and the underlying reasons for those changes in addition to determining respondents' level of comfort of having to potentially deal with unexpected expenditures.

4. *Prospect of saving and retirement.*

This final component of the survey intended to understand respondents' expectations about the main anticipated source of pension income and their current level of confidence in their financial situation at retirement. Respondents were also asked to reflect on their savings goals for retirement and for other purposes.

Throughout this section, we present the key findings of the survey while Appendix A provides a richer discussion of survey results. Following is what Canadians told us.

Overall, Canadians are more likely to gauge their debt as decreasing; however, not all groups of household share this optimism

Contrary to the statistical evidence that household debt is rising, Canadians are more likely to gauge their debt as decreasing. Only 14% of all respondents claimed that their debt increased substantially while another 16% disclosed that their debt modestly increased.

The seemingly low reported increase in household debt was not equally distributed between Canadian families. Those with annual household incomes of under \$35,000, households with one or more children under the age 18 years, and younger respondents were much more likely to acknowledge that their debt had noticeably increased.

Consumption rather than asset accumulation is the primary cause of rising debt

Consumption in the form of day-to-day expenses and the purchase of durable goods rather than asset accumulation represents the main cause for the increasing debt. Outlays that could potentially attract a return such as purchasing of a residence, enrolling in an educational program, or spending on healthcare were among the least likely disclosed causes for increasing debt.

The vast majority of those with increasing debt reported concern with this pattern. Yet, more than 80% of Canadians feel that they manage their debt well and nearly 1 in 5 think that a greater debt would still be manageable.

Although most respondents reported being confident in their ability to manage debt, the majority of respondents (6 in 10) feel that debt limits their ability to reach goals in at least one of the critical areas of education, retirement, leisure and travel, or financial security in unexpected circumstances.

Few Canadians realize that negative economic shocks may affect their financial wellbeing

Nearly all respondents reporting residential structures among their assets did not feel that a 10% decline on the housing market would represent a threat to them. More than one quarter of those surveyed did not think that a moderate increase in interest rates, decrease in housing or stock market, cuts in salary or reduced access to credit would noticeably affect their financial wellbeing.

For many Canadians, Canada's strong economic performance in recent years has not translated into increases in real income or wealth accumulation

Canadians are not very optimistic about the growth of their income. Two in 5 respondents saw their income unchanged or decreasing, and the majority (78%) of those whose income did increase, said it did so only modestly. Individuals with higher household incomes are more likely to see a meaningful change in their income than those with medium or lower incomes.

Very few Canadians think that the value of their assets decreased in the past 3 years; however, not everyone perceives their wealth as increasing. Only 57% of respondents felt wealthier today as compared to 3 years ago. Respondents reporting no debt and those whose income increased were somewhat more likely to feel wealthier.

Despite the booming housing market, home ownership did not influence respondents' perception of wealth to the degree that might be expected. While 60% of respondents owning personal residential property reported feeling wealthier, some 28% of respondents who claimed that the value of their homes increased materially in the past 3 years still did not feel wealthier today.

Increasing income and wealth do not necessary lead to perceived increased spending

Supporting the notion that we are becoming a culture of consumption, one half of Canadians report their expenditure as having increased in the past 3 years. However, only a small proportion (13%) would agree that their spending increased significantly. Consumption of day-to-day living necessities was seen to be the primary cause for rising expenditure.

Despite the generally accepted notion that wealth leads to increased spending, the survey showed that an increase in household income or wealth did not necessarily transpire into increased spending. Moreover, those who felt wealthier today compared to 3 years ago were less likely to report increased spending.

Savings are not in favour amongst Canadians although one in five would not be able to handle unforeseen expenditures

One quarter of non-retired Canadians commit no resources to any type of regular savings; not even for retirement. Savings for vacation and entertainment get higher priority among non-retired households compared to savings for education and down payments or balloon payments on personal realty. This is equally true for those who rent housing. And even one fifth of those whose expenditures are usually less than household income say they do not make regular savings.

Even with the temporary relief of a credit card or line of credit, 1 in 5 Canadians would not be able to handle an unforeseen expenditure of \$5,000 and 1 in 10 would face difficulty in dealing with a \$500 unforeseen expense.

Four in ten Canadians do not feel confident that their financial situation at retirement will be adequate

Four in ten Canadians do not feel confident that their financial situation at retirement will be adequate, with younger (and not older) respondents being more likely to feel insecure about their retirement. The level of confidence expectedly tends to be higher among those with increasing income and wealth.

As may be expected, government transfers are recognized as an important source of retirement income by all respondents. However a noticeable shift from favouring defined benefit plans to increased importance of RRSP savings was observed among respondents who are not yet retired.

Only half of non-retired respondents have a clear idea of the amount of personal savings and resources they need to achieve an adequate financial scenario at retirement. Nearly 4 in 10 non-retired respondents expecting to rely on savings which include RRSP or inheritance do not have any clear idea of how much they need to accumulate to render their retirements financially comfortable.

The results of the survey confirm several worrisome assertions that have gained momentum over recent time:

- saving in its traditional form is not a high priority for Canadians;
- a rash of consumption has taken hold of our society; and,
- the least wealthy are the most vulnerable to disproportionate debt practices.

Interestingly, the way we perceive the changes in our indebtedness seems to differ from what statistical data tells us, and few of us appear to fully appreciate the harmful long-term consequences of swelling or compounding debt. In the following pages, we will turn our focus to providing insights into the empirical facts and figures collected on household debt and the risk exposure that it confers onto individuals and society.

Household Debt – Facts and Figures

3

The issue of rising household debt has attracted significant attention from media, the banking and finance industry, government, think-tanks, and a variety of interest groups in recent years. Although the purpose, focus and motivation for examining the issue may differ between stakeholders, the underlying question is often the same: Have we borrowed too much?

This question has a number of facets and the response is highly dependent on whether we examine a homogeneous household sector or assess particular individuals within the sector and whether we tolerate a certain margin of financial failure and hardship. Or perhaps we should take a purer stance in the face of disturbing signs which may be sufficient to alert us to possibly deteriorating financial situations of households. The following pages focus on facts and figures of household debt as they emanate from the household sector as well as the individual households which make up the whole.

In 2006, Canadian household debt reached a record high of \$1 trillion

3.1. Debt of the Household Sector

Survey results

Canadians are more likely to think their debt is decreasing or staying the same

3.1.1. Overall Level of Debt

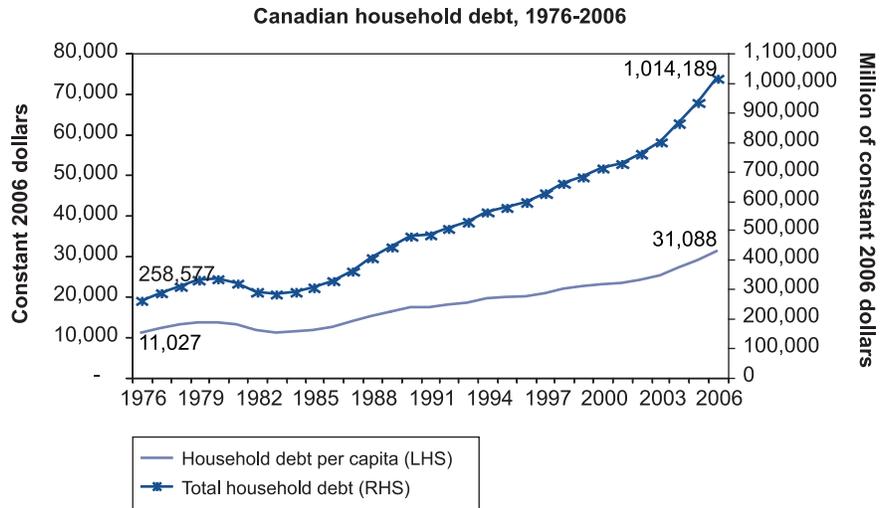
In 2006, Canadian household debt³ reached a record high of \$1 trillion or the equivalent of \$31,088 per Canadian (see graph of Figure 1). This record level results from a continuous long-term expansion of debt which has grown at an average pace of 4.7% per annum for the past 30 years (in real terms). This outstanding growth is well ahead of other important economic indicators of household wellbeing such as personal disposable income, total household assets and net worth, and gross domestic product (GDP) growth.

Admittedly, the total numbers may be deceptive as they do not account for population growth. Taking this dimension into account, the growth in Canadian

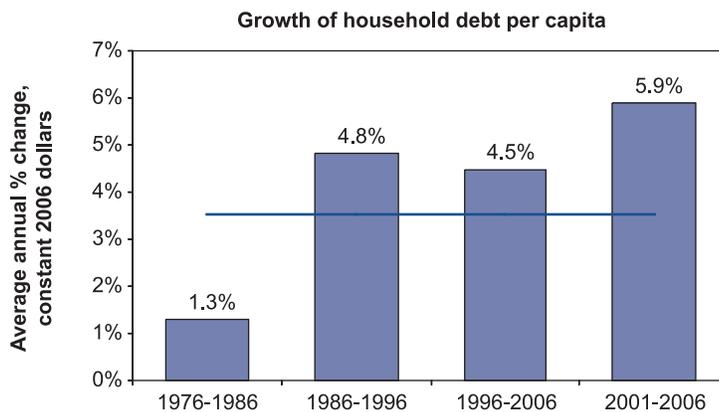
³ Household debt is defined as the outstanding balance of household credit held by financial institutions participants of the Canadian financial system (i.e. chartered banks, trust and mortgage loan companies, credit unions and caisses populaires, life insurance companies, pension funds, special purpose corporations and non-depository credit intermediaries and other financial institutions). Outstanding balance of household credit, in turn, consists of outstanding balances of consumer credit and residential mortgages.

household debt remains nevertheless remarkable. Per capita household debt increased 2.8 times over the past three decades with the growth particularly accelerating in the past 5 years (5.9%) moving well above its long-term average. Notably however, debt increases during the 1996-2006 decade (4.5%) was still slower than the 1986-1996 decade (4.8%) as is visually depicted by the bar chart in Figure 1.

Figure 1 – Canadian Household Debt, 1976-2006



The dollar amount in itself does not truly reflect the state of households' financial health or its ability to marshal resources



Source: CANSIM Tables 176-0032, 326-0002, 051-0001; CGA-Canada calculation

Regardless of the size of the debt, the dollar amount in itself does not truly reflect the state of households' financial health or its ability to marshal resources. Only a relative comparison of the debt to the other elements of the household's balance sheet (assets and liabilities) can reveal household net worth, the depth of its indebtedness and its ability to service that debt.

3.1.2. Indicators of Household Indebtedness

Currently, experts tend to apply one or a combination of the following four measures of household debt: (i) Debt-to-Income ratio, (ii) Debt-to-Assets ratio, (iii) Debt-to-Net Worth ratio, and (iv) Debt-Service ratio. None of these measures are however free of limitation.

Debt-to-Income Ratio (DIR) is the percentage of household's disposable income that would be needed to extinguish the debt. It is a useful measure when comparing households across different regions, socio-demographic groups or timelines. The main shortcoming of DIR is that it compares current inflows against longer-term outflows. That timing irregularity is a natural outcome *given* that we are comparing the flow of household's income over a given period of time to a stock of debt which may be repaid over *several* periods of time. DIR further ignores the condition that some of the debt may be deployed to increase household wealth in the form of investment or capital acquisition. Due to these restraints, DIR provides limited guidance in the determination of households' ability to service debt. DIR is nevertheless considered to be a good measure of financial vulnerability.

Debt-to-Assets Ratio (DAR) is the percentage of total household assets that are being financed through debt. It shows how well debt is secured by assets. The shortcoming with DAR is that it does not take into account the liquidity of the assets and consequential impediments to liquidation. Moreover, the ratio does not account for additional charges which may be incurred to affect the asset transaction (e.g. legal fees, brokerage commissions, taxes, etc.). This may lead to understatement of the household indebtedness. Also, a simple switch in the assumptions around measurement of underlying assets such as moving from book value to market value may significantly affect the ratio and its interpretation.

Debt-to-Net Worth Ratio (DNWR) is a percentage of household net worth leveraged by debt. It measures how well households can meet their total obligations from existing equity. Because net worth is defined as household assets less household liabilities, DNWR shares shortcomings similar to those of debt-to-assets ratio discussed above.

Debt-Service Ratio (DSR) is a percentage of household disposable income that must be spent to honour interest payments on the existing debt. Similar to the ratios already discussed, debt-service measurement likewise possesses its own shortcomings. For instance, it does not reflect principal payments. It also does not account for changes in home ownership thus ignoring the fact that in some cases 'after-mortgage' disposable income may be very similar to 'after-rent' disposable income. Instead, when a household moves from renting to owning, the debt-service ratio will account for the amount of mortgage interest payment as an increased debt burden.

For the purpose of our analysis we first consider household debt as it relates to income, assets and net worth. Then, we look at the debt-service ratio.

Debt Relative to Income, Assets and Net Worth

As seen from the graph contained in Figure 2, the three debt ratios respectively reached their record high levels in 2006; albeit that there are noticeable difference in their development over time. Debt-to-income ratio followed a strong upward trend suggesting that households borrowed increasingly more than the growth in their incomes. However, household debt position measured in terms of debt-to-assets and debt-to-net worth ratios has deteriorated very little since 1990 with the run-up in debt being largely offset by the strong performance of the housing and capital markets which have successfully pushed the asset values up.

The growth in assets and net worth has never fully caught up with climbing household debt

It is generally assumed that as long as net worth grows faster than liabilities, an increasing level of the overall household debt is sustainable. Although debt-to-assets and debt-to-net worth do not seem to deteriorate rapidly, the numbers show that the average growth rate of asset and net worth adjusted for inflation was dragging behind the rising household debt throughout the 1990s and into the present (bar chart of Figure 2). Intensive run-up in the debt seen in 2001-2003 due to bursting of the high-tech bubble and tumbling stock market was somewhat offset by recovery of the stock value and strong appreciation of the housing wealth in the recent years. However, the growth in assets and net worth has never fully caught up with climbing household debt.

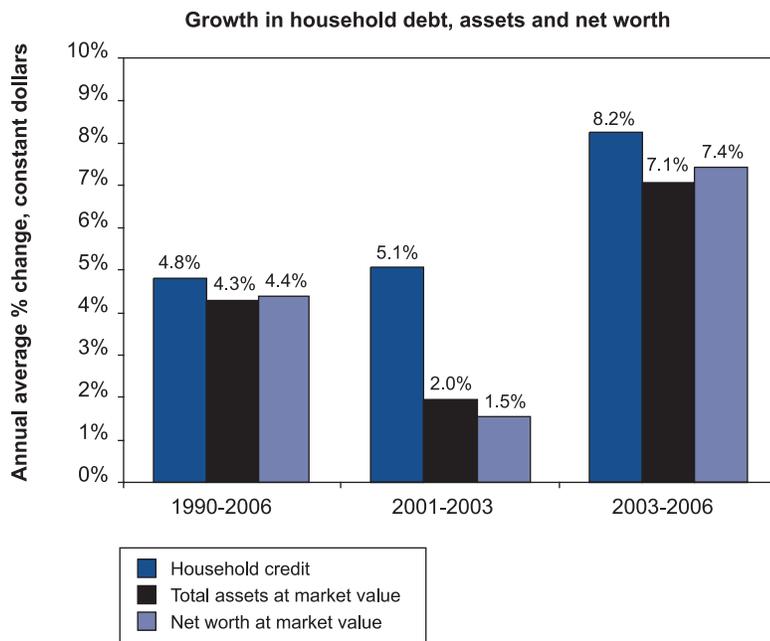
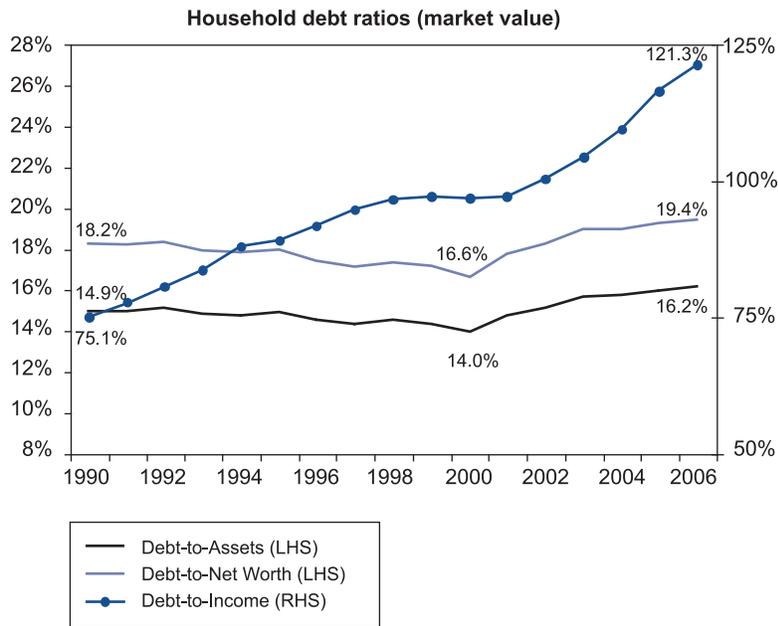
A word of caution is in order when applying the debt-to-assets and debt-to-income ratios to the aggregate numbers for all households. The numbers for household assets and net worth collected by Statistics Canada include both persons and unincorporated business, while household debt monitored by the Bank of Canada includes only loans for personal purposes. Constructing the ratios of personal debt to assets or net worth that include both personal and business component may artificially enlarge the denominator and decrease the ratio. In this way, the overall indebtedness of the household sector may be somewhat underestimated.

Another measurement pitfall lays in the fact that the data on income, assets and net worth represent the total for all Canadian households while the data on debt reflect indebted households only. At least 3 in 10 Canadian families do not hold any debt.⁴ This means that the ratios discussed above may be acceptable for analysing the household sector as a whole but may poorly reflect the wellbeing of those who in fact are in debt. The caveat in all instances is that households will typically fall on either side of these averages

4 Statistics Canada's Survey of Financial Security and Income in Canada 2005 (catalogue number 75-202-XWE)

and that the extremes will, at least in part; nullify each other to arrive at the ratio. Said differently, particular households may be significantly better or worst off than the figures discussed above purport.

Figure 2 – Measures of Household Debt



Source: CANSIM Tables 176-0032, 378-0009, 380-0019, 326-0002; CGA-Canada calculation

Servicing of Debt

The construction of a debt-servicing ratio is less straightforward than the ratios considered above. One of the ways of calculating the relationship would be to apply average interest rates to the amount of consumer credit and residential mortgages as they are reported by the Bank of Canada. However, this would require making a number of assumptions and estimations which can prove to be a fairly difficult and volatile task. These assumptions would have to include the proportion of mortgages with fixed vs. flexible interest rate terms; the split of the total amount of fixed mortgages between the mortgage contracts with different duration; the level of discounts offered by lending institutions compared to their posted interest rates; and, the proportion of debt that is rolled over at market rates each year.

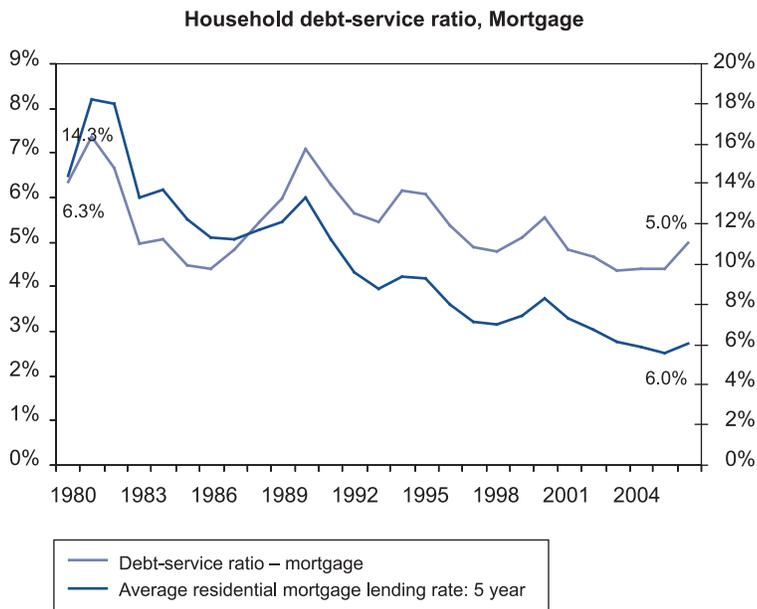
Although we recognize that the debt-service ratio is a useful indicator for evaluating household indebtedness, the level of detail required for the construction of the ratio would go beyond the scope of this report. Moreover, the Bank of Canada provides estimation of the debt-service ratio in its periodical issues of the Financial System Reviews. Instead, Figure 3 shows the general trend of the debt-service ratio rather than precise level of the indicator. This trend is based on the historical interest rates provided by the Bank of Canada which are used as a proxy for calculating interest payments on debt.

As seen from the top graph of Figure 3, the average residential mortgage lending rate was at its historical low throughout the early and mid 2000s. Also, at least 1 in 5 mortgages is estimated to be financed with variable interest rates which trend to be lower than fixed rates as mortgage rates are going down. Keeping in mind the strong income gains in recent time, we could expect that the mortgage debt burden (principal or balance outstanding) would follow the decreasing trend of the falling interest rates. While that downward trend can be identified, it is not as intense as could be expected.

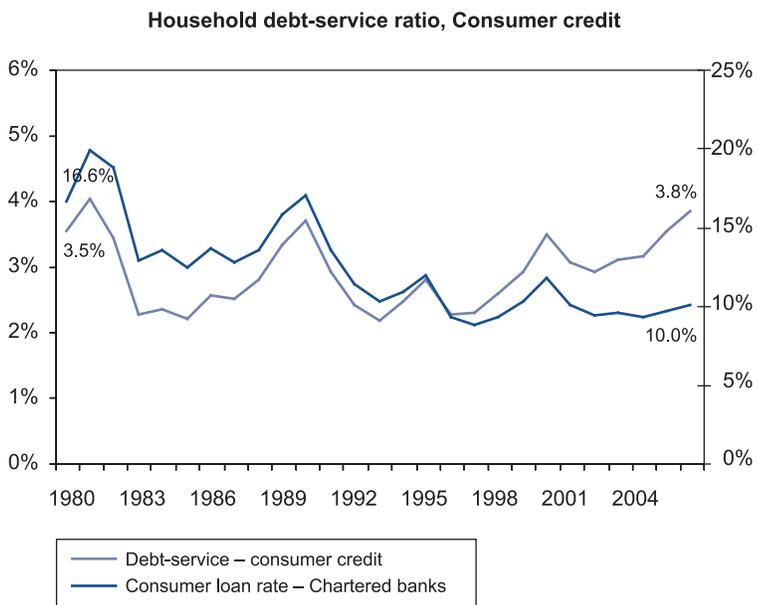
Contrary to the mortgage debt burden, the debt-service load created by consumer credit has been on the rise despite the fairly stable level of the interest rate which stood within 9%-10% range between 2001 and 2006 (bottom graph of Figure 3). In this situation, even if the growth in income and debt remains constant, the rise in interest rates may put additional strain on the income flows of households. The situation will further worsen if the debt continues outgrowing income as it did since the early 2000s.

Even if the growth in income and debt remains constant, the rise in interest rates may put additional strain on the income flows of households

Figure 3 – Household Debt-Service Ratio



Mortgages make up the major part of household debt but their relative share has slowly been declining since the early 1990s



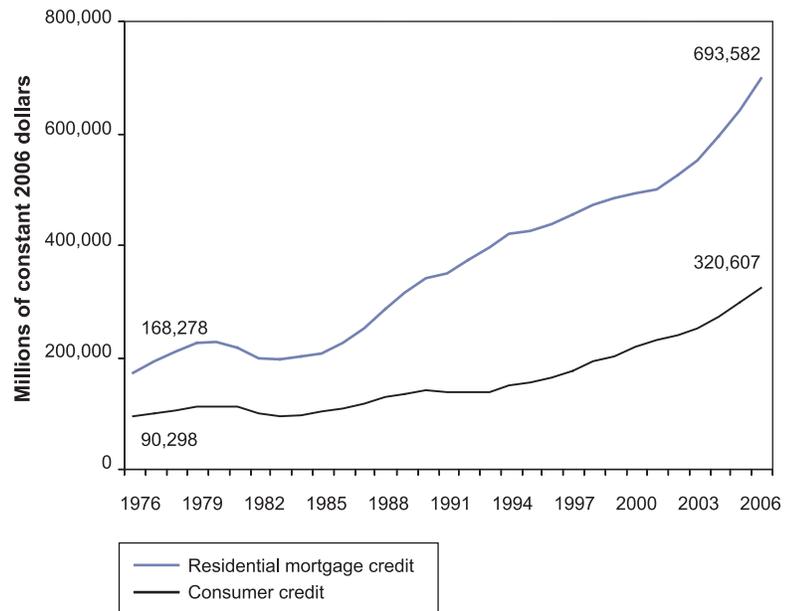
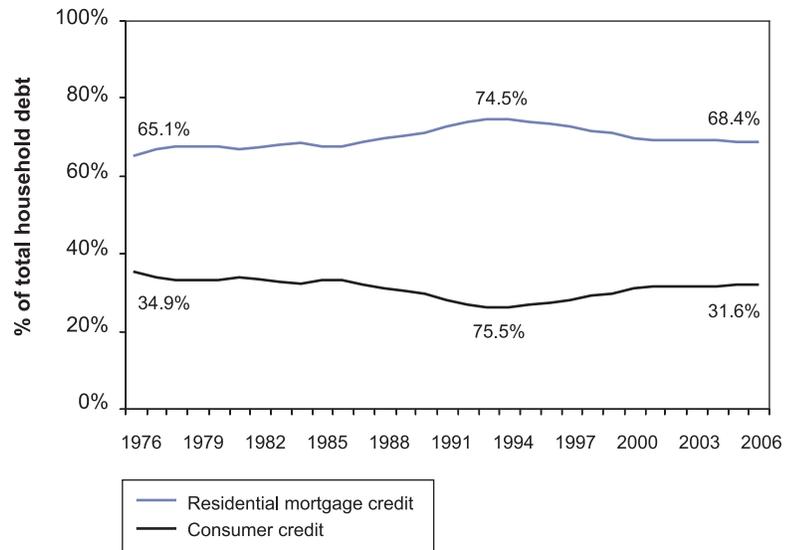
Source: CANSIM Tables 176-0043, 378-0032; CGA-Canada calculation

3.1.3. Composition of Household Debt

Household debt consists of residential mortgage credit and consumer credit which includes personal loan plans, credit card loans and personal lines of credit. Mortgages make up the major part of household debt but their relative share has slowly been declining since the early 1990s (top graph of Figure 4).

Although the share of consumer credit has been rising for more than a decade, its current level is not unprecedented. For instance, in 1976 consumer credit accounted for nearly 35% of the total household credit; 3 percentage points higher than today. Although households have been expanding their consumer debt at faster pace than the mortgage debt, both reached a record high in 2006 (bottom graph of Figure 4).

Figure 4 – Composition of Household Debt, 1976-2006

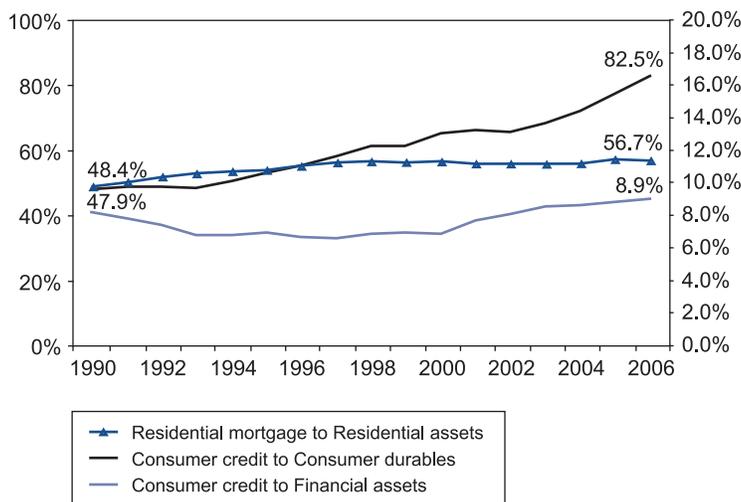


Source: CANSIM Tables 176-0032, 232-0002, 051-0001; CGA-Canada calculation

It is worth noting that the development of new financial instruments such as home-equity loans have made it more difficult to classify the end use of the loan and credit defined as residential mortgages may in fact be partially used for consumption purposes.

Mortgage borrowing is secured against residential assets and, thus, rising mortgage credit is usually of a lesser concern to experts than an increase in consumer debt, oftentimes defined as “pure” household debt, which is not backed by appreciable assets. While the hot housing market has helped Canadian households to maintain a stable and even slightly improving balance between mortgage debt and residential assets, the run up in consumer debt was not well supported by accumulation of either consumer durables or financial assets, suggesting that we deploy borrowed funds for consumption rather than for accumulation of wealth (Figure 5).

Figure 5 – Debt Components to Assets, Market Value, 1990-2006



The development of new financial instruments have made it more difficult to classify the end use of the loan

Note: Consumer durables are at book value

Source: CANSIM Tables 378-0009, 176-0032; CGA-Canada calculation

As seen from the above discussion, the overall situation of the Canadian household sector and its indebtedness does not currently appear to be disastrous, nor does it from a historical point of view. It does not seem to be rapidly deteriorating either. However, the measures commonly used for the debt analysis are not perfect and may not be sensitive enough to pick up the deteriorating financial health of the household sector.

Moreover, as the growth of debt and asset values continue to appreciate at the current pace, the household indebtedness will slowly, but steadily, exert increasing pressure on the economy and on financial wellbeing. Conversely, a

slowing of the appreciation of assets or growth in income, and/or an interest rate increase, could likewise force the current pace of debt accumulation to swell causing households increased challenge to service debt.

The economy will survive it as will the aggregate household populace but the households carrying disproportionate levels of debt will suffer the harshest consequences.

Our indebtedness is not so much related to the rising debt of more affluent households, but rather to increasing debt load of more typical Canadian families

3.2. Debt of Individual Households

Survey results

Respondents with lower household income are much more likely to report their debt as increasing compared to respondents in higher income groups

Although household debt is spiralling, households do not uniformly contribute to the run-up. In 2005 for example, some 30.6% of Canadian families had no debt.⁵ As envious as that may be however, noticeably more and more families have entered into debt. While the overall number of Canadian families increased by 9.5% between 1999 and 2005, the number of indebted families during this period grew even faster (12.8%) reaching a 9-million mark in 2005.⁶

3.2.1. Debt of a Typical Household

The level of debt of a typical household (measured by the median amount⁷) reached \$44,500 in 2005. More interesting, though, is the growth rate of that debt. Between 1999 and 2005, the median household debt increased by 37.8% surpassing the growth of the average amount of household debt (31%). This is worth noting because the median measure is usually expected to be more stable over time. As such, it is less sensitive to extremely high or low levels of debt carried by relatively fewer households. The more rapidly increasing median level of debt suggests that our indebtedness is not so much related to the rising debt of more affluent households, but rather to increasing debt load of more typical Canadian families.

Recognition that appreciation of assets has lagged behind the debt increases further accentuates the increasing indebtedness of a typical household. Contrary to the anecdotal evidence of real estate and investment instrument success, the median amount of assets increased by 24.5%; far behind the mentioned above 37.8% increase in debt.

5 The term "family" includes families of two and more, and single individuals.

6 Statistics Canada's Survey of Financial Security; Income in Canada 2005 (catalogue number 75-202-XWE); CGA-Canada computation

7 Median amount of debt is obtained by sorting the values of debt for each household in descending order and selecting the middle value.

3.2.2. Debt Distribution Across Households

The variability in the way that debt is distributed across households and the particular characteristics of the households holding debt plays an important role in determining the ability of the household sector to handle erratic or unpredictable economic shocks. For instance, households with higher incomes may be less exposed to rising unemployment but may be more sensitive to fluctuations in asset prices. Similarly, households with lower incomes or having less collateral may be more sensitive to changes interest rates.

As a general rule of thumb, economists assume that increasing borrowing among households with lower net worth poses a higher risk for the economy than increasing debt of households having higher asset values. Similarly, concentration of debt among a small number of households is considered to be of a lesser concern than the distribution of rising debt evenly across all households.⁸

Based on these ideologies, the best way to gauge the true magnitude of household vulnerability would naturally be to analyse the debt and asset composition of each particular household. This way, the analyst would be able to observe the debt-serving capacity of people affecting the run-up in debt and whether the increase in debt is caused by financial constrains of households or otherwise supported by increasing wealth.

For obvious reasons, this is impractical but The Bank of Canada did however recently conduct an analysis of the financial position of the household sector looking at indebted households only.⁹ This is not a substitute for the rigour of individual household assessments but the approach does as a minimum remove the positive and somewhat misleading effect caused by the inclusion of the debt-free populace. While it knowingly distorts the condition of the household economy as a whole, it does render an appreciation of the performance of debt for those who actually rely on it. Overall, the analysis concludes that “the Canadian household sector seems to be in good financial health and, thus, should not pose a major threat to the stability of the Canadian financial system.” However, the bank also highlighted that:

- “The proportion of low income households devoting a large fraction of their income to debt payments is higher than that of households with higher incomes”
- The proportion of vulnerable households has increased since 2004.¹⁰

8 Guy Debelle, Macroeconomic Implications of Rising Household Debt, Working Paper No. 153, Bank for International Settlements

9 An Analysis of the Financial Position of the Household Sector Using Microdata, Highlighted Issue, Financial System Review, December 2006, Bank of Canada. Also, Financial System Review, June 2007, Bank of Canada

10 Vulnerable households are those whose debt more than twice exceeds their total assets. This vulnerability threshold is considered important as it coincides with the average debt-to-asset ratio of insolvent household between 1987 and 2004

Least wealthy 20% of households experienced the second fastest rate of debt growth between 1999 and 2005

Statistics Canada also conducts a periodic ‘Survey of Financial Security’ examining the relationships of assets, debt and net worth of family units. The published results of the survey do not provide analysis of indebtedness of particular households; however does impart insights into the debt load of families possessing different characteristics.

Household Debt and Net Worth

Net worth (or wealth) represents the difference between household assets and liabilities. A simple concept, it is an important element of household financial wellbeing. There is little argument that the existence of a sufficient cushion of net worth may allow a household to mitigate unexpected expenses or income losses by liquidating financial or real assets. Lower or negative values of net household worth necessarily exert a higher dependence on current and future income. We would caution that low net worth does not necessarily denote that the household has insufficient means (e.g. income) preventing it from accumulating wealth (positive net worth). Low net worth may have resulted from one or a combination of factors such as excessive borrowing, sudden drops in asset values, poor financial planning or recklessness in the presence or absence of sufficient income.

As observed from Table 1, the least wealthy 20% of households (i.e. the lowest net worth quintile¹¹) experienced the second fastest rate of debt growth between 1999 and 2005 when compared to all other wealth groups. At the same time, these households represent the only group to experience decline in their median net worth dropping by 40% during the same period. Young families with a major income recipient aged 25 to 34 years of age experienced an even deeper drop (50%) in their median wealth.¹²

Table 1 – Average Annual Growth in Median Debt and Net Worth, 1999-2005

Net worth quintile	Median debt	Median net worth
Lowest 20%	4.4%	-2.3%
Second 20%	3.8%	1.1%
Third 20%	3.7%	3.5%
Fourth 20%	5.7%	4.6%
Highest 20%	0.2%	4.3%
All family units	5.5%	3.5%

Source: Survey of Financial Security, on-line statistical tables, Statistics Canada, available at: <http://www40.statcan.ca/01/cst01/famil116a.htm>, CGA-Canada calculations

As indebtedness of the least wealthy has increased, it is not surprising to witness that debt of those having negative wealth also increased over time. In 1999, the proportion of families having more debts than assets stood at 12.3%, but by 2005 had gone up to 14.1%.¹³

11 The lowest quintile represents the 20% of the population whose net worth is lowest. Similarly, the highest quintile represents the 20% of the population whose net worth is highest.

12 Rene Morissette and Xuelin Zhang, Revisiting wealth inequality, Perspectives, December 2006, Statistics Canada, Catalogue no. 75-001-XIE

13 Rene Morissette and Xuelin Zhang, Revisiting wealth inequality, Perspectives, December 2006, Statistics Canada, Catalogue no. 75-001-XIE

Having low net worth leaves households with fewer options to moderate negative shocks and creates a higher exposure to risk of debt default. As we can appreciate, the proclivities of borrowers coupled with the copiousness of lending institutions ultimately determine the level of household indebtedness. As lending institutions possess the power to approve or reject applications for financing, we have all heard the chronicles of the good, the bad and the ugly. Some allege that lenders are too liberal while others suggest that lending institutions are too stingy. The truth of the matter is that lending institutions inevitably attempt to achieve a balance based on their own proclivity for risk when making credit decisions. They are running a business for profit and the responsibility is in fact shared between the lender and the borrower. What is possibly more perplexing is that those with the least amount of net worth had been able to increase their access to credit at a much steeper pace than that of other families. While the strategy may have originated from very altruistic motivation at a time when lower-income families did not receive an equivalent benefit of generous access to credit, the liberty of banking institutions may to some extent explain the rise of indebtedness and consumer attitude towards credit. Or it may simply reveal that low income and low net worth customers were previously treated inequitably and without special consideration of their particular needs. It is also conceivable that lines of credit have become more common as a commercial product, but ignoring magnitude, we wonder which other types of debt might have been dampened by this advent. Regardless of one's view, it is startling that the numbers of low net-worth families have tripled their access to lines of credit by 202% between 1999 and 2005. This sharply contrasts with the 77% increase experienced by the total of all families at all wealth levels. The situation is similar, however more modest in scale, to other types of debt (Table 2).

The numbers of low net-worth families have tripled their access to lines of credit by 202% between 1999 and 2005

Table 2 – Increase in Number of Families Holding Household Debt, 1999 to 2005

Type of household debt	Lowest net worth quintile	All net worth quintile
Mortgage on principal residence	47%	17%
Line of credit	202%	77%
Credit card and installment debt	29%	13%
Vehicle loans	41%	36%
Student loans	10%	10%
Total debt	10%	13%

Source: Survey of Financial Security, on-line statistical tables, Statistics Canada, available at: <http://www40.statcan.ca/01/cst01/famil116a.htm>, CGA-Canada calculations

Household Debt and Income

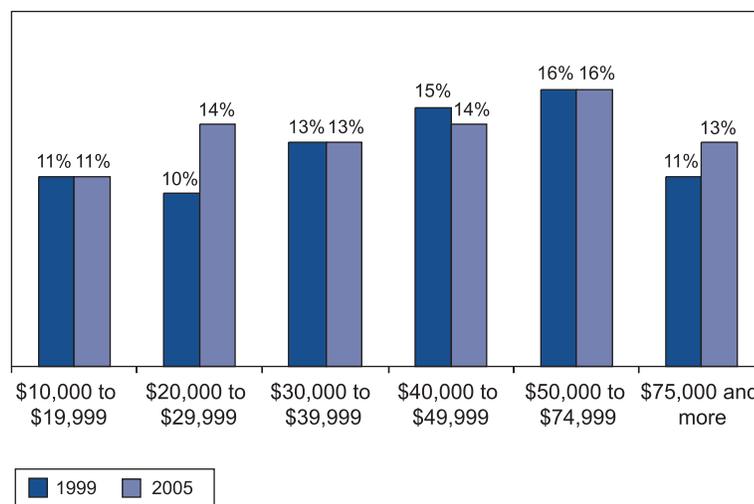
As previously discussed, a low net worth position of a household does not necessarily connote that the household has a low income. It only indicates the degree to which the assets of a particular household exceed its liabilities. Low income simply suggests that a household has a reduced ability to accumulate assets in the first place as the household is required to expend a higher

proportion of its income on basic necessities such as food, clothing and shelter. Low income individuals also tend to have most of their wealth in a relatively illiquid housing asset.

The increase in the debt-to-asset ratio for households with annual income between \$20,000 and \$30,000 was the highest between 1999 and 2005.

Figure 6 reveals that the increase in the debt-to-asset ratio for households with annual income between \$20,000 and \$30,000 was the highest amongst all income groups between 1999 and 2005. Although the ratio itself stood just on par with the Canadian average, a rapidly increasing negative imbalance between the level of debt and the value of assets collateralizing the debt will put this group of households at a higher exposure to negative shocks.

Figure 6 – Debt to Assets Ratio by After-tax Income Group, 1999 and 2005



Source: Survey of Financial Security, on-line statistical tables, Statistics Canada, available at: <http://www40.statcan.ca/01/cst01/famil112e.htm>, CGA-Canada calculations

Low income households rely heavily on government transfers as a source of income. For instance, government transfers constituted 48.1% of the after tax income of the constituency falling within Canada’s population with the lowest incomes.¹⁴ One may reasonably anticipate that income of such families will grow slower than those of other families as government transfers simply do not reflect productivity growth nor do they necessarily invoke rising income by virtue of career promotion. In this case, increasing debt holdings among families relying on the government transfers may be less sustainable.

Summing up the above discussion, there are certain indications that the financial situation of certain groups of households may be deteriorating more

¹⁴ Source: on-line statistical tables, Statistics Canada, available at: <http://www40.statcan.ca/01/cst01/famil88a.htm>

aggressively than analysis of the overall household sector bears out. More and more families enter into debt and the debt of a typical household is rising. Low income families are not exempted from the rising debt burden but accumulation of their assets tends not to fair as well as that of other families. Those with low wealth continue sinking into debt and to experience further deteriorating in their net worth positions. Moreover, an increasing number of households reach the level of indebtedness that is typical of a household filing for bankruptcy. And lending institutions, having an ultimate power of approving or rejecting debt applications seem to be content to maximize lending. These are all natural features of our capital market system. Likewise, taken together they are not deemed to pose a threat to our immediate economy.....but the same claim can not be boasted for each and every individual household; financially or psychologically.

3.3. International Comparison¹⁵

Rising household debt has been a distressing issue for many industrialized countries. US consumers are well known for their willingness to stretch borrowing capacity to maximal limits. UK households have been the cause of rising concern to policy makers due to a steep increase in consumer debt in recent years. And many other OECD (Organization for Economic Development and Cooperation) countries are experiencing similar trends while considering potential tribulations and prospective diversions.

The level of indebtedness of Canadian households is neither among the best nor among the worst of other industrialized countries. As the top bar chart of Figure 7 shows, debt-to-income ratio¹⁶ of Canadian households is far better than those of the United Kingdom and the United States; however, Canada's debt-to-assets ratio is the highest among the considered countries. Canada's liabilities-to-assets ratio stood at 19% in 2005, higher than that experienced in Japan and the United Kingdom, where consumers more intensely out-borrow their incomes (bottom bar chart of Figure 7).

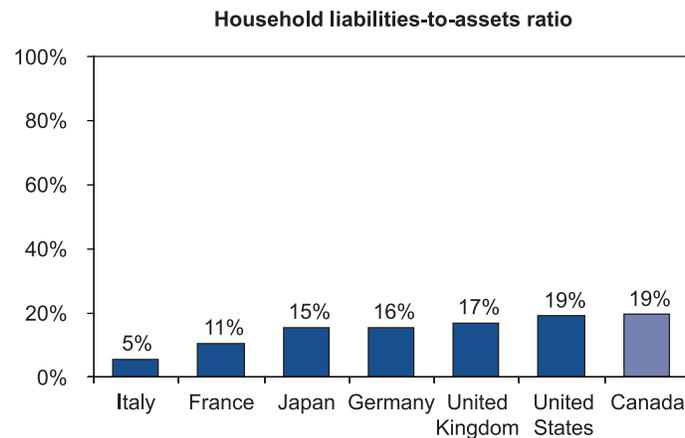
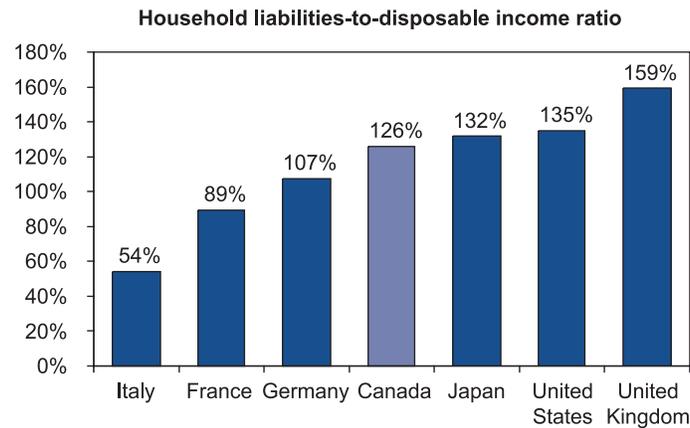
The results of international comparison need be interpreted with some caution. Discrepancies exist in the ways that household sectors are defined in different countries. For instance, in Canada, Japan and France, the household sector includes also unincorporated enterprises while in the US, the UK and Germany, debt and assets of unincorporated businesses are considered separately from the household sector. Differences in tax treatments of mortgages can also be expected to account for some observed households'

The level of indebtedness of Canadian households is neither among the best nor among the worst of other industrialized countries

¹⁵ The choice of countries considered in this section was solely based on the availability of statistical data

¹⁶ As mentioned in Section 3.1, throughout the report household debt is understood as a sum of outstanding balances on residential mortgage and consumer credit held by financial institutions that are part of the Canadian financial system. However, for the international comparison household liabilities are used as a proxy of household debt. This was determined by the data available for other countries.

Figure 7 – Household Liabilities in Selected Countries, 2005



Note: 2004 for Italy and Japan

Source: Top chart recreated from OECD Economic Survey – United States, Volume 2007/9, May 2007 using the data available at <http://dx.doi.org/10.1787/010078731613>; bottom chart derived from the data available at the mentioned link

decisions respecting the pace at which debt is extinguished. For instance, households in the Netherlands tend to refrain from principal payments over the life of the loan to minimize their tax payment. Alternatively, they deflect the freed funds to accumulate other assets.¹⁷

As we have seen throughout the preceding discussion, the facts and figures presented in this section do not lead us to conclude that the Canadian household sector, as a whole, is in imminent danger as a result of debt it has accumulated. Disturbing though, are the findings that indebtedness is increasing among households whose financial conditions provide fewer options to cushion negative shocks.

17 Household Debt: What the Data Show, Reserve Bank of Australia Bulletin, March 2003

Should We Care That Debt is Rising?

4

Canada's steady economic growth and our perceptions of increasing wealth are the two most often cited justifications for increasing household indebtedness. However, sustainability of our spending behaviour depends critically on the realization of the expectations that formed the basis of our borrowing decisions (i.e. how well our income and wealth will grow in the future). Where expectations are overoptimistic or past consumption behaviour too reckless, damaging and enduring consequences may be experienced by borrowers.

One of the most relevant concerns is that the results of the survey presented in Section 2 suggest that many Canadians have relatively low awareness of the possible negative consequences of increasing debt. As a result, we now focus on how increasing debt creates higher household exposure to negative economic shocks and jeopardizes our ability to consume in the future.

4.1. Threat of Today – Increased Household Exposure

Survey results

Some 27% of Canadians do not think that changes in interest rates, housing prices, wages or reduced access to credit would negatively affect their financial wellbeing

As previously identified, the nominal level of household debt tells us little about the financial fragility of households. What really matters is the debtor's ability to honour its debt payments under changing social, economic or personal circumstances.

Aggressive borrowing makes households more vulnerable to such adverse economic developments as increasing instability of the job market, hikes in interest rates and weakening asset prices/values. Unsurprisingly, the shock's impact would most seriously be felt by households the most vulnerable to that shock. But as anyone having experienced it can vouch, economic shocks seldom occur in isolated manner and usually serve as triggers to one or each other. For instance, an increase in interest rates may discourage homebuyers from assuming increased mortgage credit at the same prior pace, which, in turn, slows housing starts and triggers a more sluggish appreciation of house values. Sequentially, this may affect the construction industry, the incomes of workers employed within it, and the ancillary industries and economies of which respectively support and benefit from housing activity.

No one is entirely certain of when a negative shock may happen, of its magnitude, and of the type of spill-over it can provoke

No one is entirely certain of when a negative shock may happen, of its magnitude, and of the type of spill-over it can provoke. In fact, these effects are interrelated and outcomes are contingent on how that interrelation will behave within a multitude of broader economic events. Expert opinions on the matter are insightful but can often offer little more than an educated guess or an exercise of logical correlation. Behaviours, attitudes and reactions are relatively predictable in good time but become increasingly hard to anticipate in bad. We are simply not as rational as the applications of formulas might imply. Encouragingly, Canada has shown a strong resilience to, and flexibility in, adapting to the types of shocks (changes) that have shaken the world over the last decade (i.e. the late 1990s crisis on the Asian financial markets, collapse of the high-tech bubble in the early 2000s, intensified competition from China and India, etc.). However, it seems that we too often have tendency to base our normalized judgements on the simulated constructs of ‘average’, ‘normal’ or ‘overall’; failing to take into account the differences caused by geographical location, industry affiliation and wealth distribution. In the following pages, we attempt to further explore these deficiencies.

4.1.1. Cash Flow Shock

Survey results

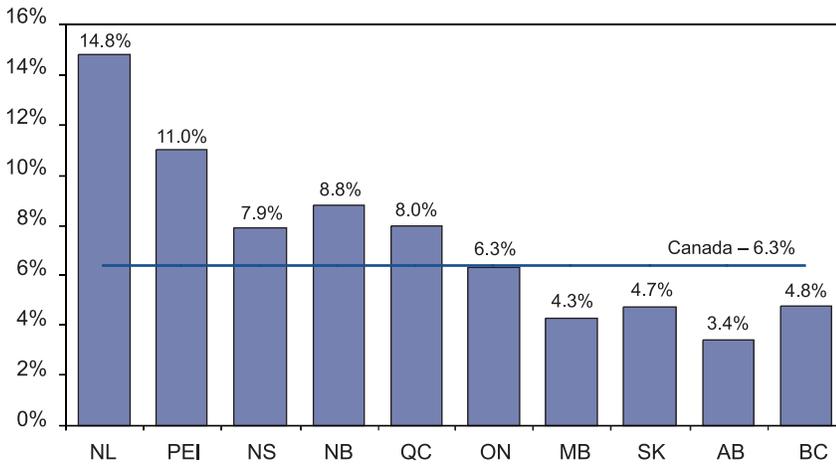
28% of those who hold debt and rely on wages and salaries as their main income source do not feel that a moderate salary decrease would affect their financial wellbeing

Rising debt makes households more sensitive to reductions in income or income interruption

Canadians are modestly diversified in terms of primary sources of revenues or incomes. Employment income has historically been, and still remains, the principle source of household income. Overall, 67% of Canadian household income comes from salaries and wages. For some groups, reliance is even higher: employment income accounted for 79% of the total income for couple families and 70% for single parent families in 2005.¹⁸ Although household assets serve as collateral for debt, it would be safe to assume that debt-service payments are largely made from the household income. In this case, rising debt makes households more sensitive to reductions in income or income interruption. Even small interruptions can negatively affect households’ ability to maintain habitual debt payments. And this too can lead to a domino effect with other regular obligations causing the spiral to be more intensely felt than might otherwise have been forecast. Moreover, by taking on higher debt today, households commit themselves to a high level of the debt-service in the future, whether or not the expectations of income sustainability and growth materialize.

¹⁸ Family Income 2005, The Daily, Statistics Canada, May 29, 2007

Figure 8 – Unemployment Rate by Province, 2006



Source: CANSIM Tables 282-0002, 282-0026

Canadians have enjoyed very positive developments in the labour market over recent years. Unemployment rates struck a 30-year low in 2006 reaching 6.3% of the labour force while unemployment adjusted for discouraged searchers dropped noticeably compared to previous years. Other signs of a tightening labour market include decreasing numbers of part-time jobs which is well compensated by a shift to full-time employment, increasing average workweek for full-time employees, rising proportion of people working overtime, and increased work stoppages due to strikes.¹⁹ However, not all provinces have equally benefited from positive developments in the labour market (Figure 8).

The differences between unemployment rates in different geographic areas have been increasing between 2000 and 2006

The differences between unemployment rates in different geographic areas have been increasing throughout the period from 2000 to 2006 with best performing labour markets concentrated in the Prairies and worst ones in the Atlantic Provinces. Ontario – the most populated province in Canada – was the epicentre of deteriorating labour markets accounting for 9 of the 16 areas where unemployment rate ranking deteriorated between 2000 and 2006.²⁰

Regional labour market differences are influenced by the uneven distribution of industries among the provinces. Richness in natural resources such as oil, gas and metals has helped western provinces to prosper in recent years. The situation was somewhat different in Ontario and Quebec where heavily concentrated manufacturing industries have been disadvantaged by the strength of the Canadian dollar, the heightening of labour costs and the

¹⁹ P. Cross, Emerging Patterns in the Labour Market: A reversal from the 1990s, Canadian Economic Observer, February 2006, Statistics Canada, Catalogue no. – 11-010

²⁰ Ernest B. Akyeampong, Canada's unemployment mosaic, 2000 to 2006, Perspectives, January 2007, Statistics Canada, Catalogue no. 75-001-XIE

In May 2007 alone, the manufacturing sector lost 12,300 jobs adding to the 103,000 jobs lost in 2006

corollary decrease in US demand. Accounting for one fifth of provincial gross domestic product and some 14% of all employed, the manufacturing sector has reported negative 2006 growth in both provinces.

The poor performance of the manufacturing sector may affect some local labour markets, increasing the number of lay offs and restricting wage increases. Although Canada's economic growth is forecasted to be around 2.7%-2.8% in 2007-2009,²¹ there are reasons to believe that misfortune of the manufacturing sector will prevail. The Bank of Canada is expected to continue to raise its overnight lending rate which of course increases the borrowing costs of business (see Section 4.1.3 for further discussion on interest rates). Another blow, partially prompted by the rising interest rate, comes in the form of the strengthening Canadian dollar which has already eroded the export capacity of manufacturers. In May 2007 alone, the manufacturing sector lost 12,300 jobs adding to the 103,000 jobs lost in 2006.²²

Moreover, the economic wellbeing of the US – Canada's main trading partner consuming 81.6% of its merchandise exports²³ – is constantly under watchful financial vigil. Our neighbour to the south is running a massive fiscal deficit created by the 2001 recession, generous tax cuts, increased expenditure on warfare in Iraq, and investment in homeland security and welfare²⁴. It is also running a trade deficit importing more than it is exporting and is heavily dependent on foreign investors to financing that trade deficit. Having two simultaneous deficits has fashioned uneasiness among international investors and the strength of the US dollar has been contracting despite rising interest rates.

The possible decline of the manufacturing sector is reflected in the business leaders' confidence in Canada's economy. The optimism among mid-size manufacturers and distributors in Ontario was 53% as compared to the 64% Canadian average.²⁵

And while there is good news for workers in Canada's economically flourishing west, they should not be considered to be immune to cash flow shocks. For instance, employment gains in Alberta and British Columbia were greatly dominated by growth in occupations related to professional, scientific and technical services (e.g. lawyers, engineers, architects, computer specialists). The demand for this type of labour force is indicative to early stages of the business planning process.²⁶ However, the *growing* business environment may easily switch to a *keeping-the-status-quo* business environment should the

21 Financial System Review, June 2007, Bank of Canada, ISSN 1705-1290

22 Monthly Survey of Manufacturing, The Daily, Statistics Canada, July 14, 2006 and Factory Jobs Won't Be Back, Says Dodge, The Ottawa Citizen, July 13, 2007

23 Canada's State of Trade: Trade and Investment Update – 2007, Foreign Affairs and International Trade Canada, Catalogue no. IT1-3/2007

24 Niall Ferguson, Reasons to Worry, The New York Times, June 11, 2006

25 Canadian manufacturers must get leaner: report, New Brunswick Telegraph-Journal, June 1, 2007

26 P. Cross, The year in Review: The Revenge of the Old Economy, Canadian Economic Observer, Statistics Canada, April 2006, Catalogue no. 11-010

signals of slowing energy demand appear in the world economy. In this case, a large proportion of the newly created jobs may come under threat, not necessarily due to slowing down of the economy but because of changing needs of businesses. And what of the cost of living which is likewise swelling in the west to keep pace with demand?

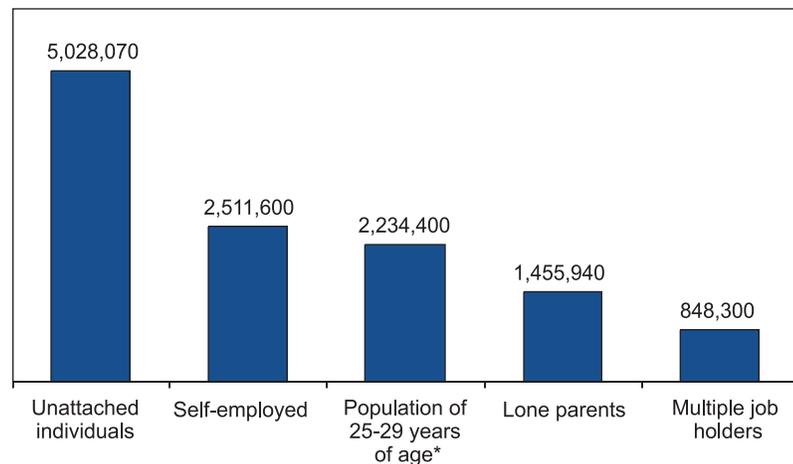
Some Groups are More Vulnerable to Cash Flow Shocks

Although almost everyone has a certain degree of exposure to loss of income or to facing unexpected expenditures, some types of households seem to be particularly sensitive to income interruption.

A recent Statistics Canada's study²⁷ finds that single parents and unattached individuals are particularly vulnerable to earnings instability as they have less income smoothing options as compared to families with multiple earners. Moreover, job prospects of single parents may be further constrained by reduced flexibility of geographical mobility and working hours. The study notes that earnings instability of single parents, particularly young ones, increased noticeably between 1984 and 2004.

Individuals holding contract jobs and seasonal work are more vulnerable to uncertainties of the job market while multiple job holders may not be able to dedicate necessary time and be limited in their reallocation and scheduling options when looking for a second or third job. Self-employed are also considered an 'at-risk' category as their set of skills and experience may be less

Figure 9 – Number of Vulnerable Individuals, 2005



* for 2006

Source: CANSIM Table 282-0012, On-line summary tables in Canadian Statistics, Statistics Canada, available at: <http://www40.statcan.ca/01/cst01/famil106a.htm>, accessed on July 5, 2007

Single parents and unattached individuals are particularly vulnerable to earnings instability

27 Rene Morissette, Yuri Ostrovsky, Earnings Instability, Perspectives, October 2006, Statistics Canada, Catalogue no. 75-001-XIE

marketable than those of employed counterparts. Young people, in turn, who are at the beginning of their wealth accumulation trajectory, may be less able to smooth income interruption by increased borrowing or consuming assets.

The vulnerable category appears to be capturing more Canadians in recent years. For instance, the proportion of unattached individuals increased by 6.2% between 2001 and 2005, while the number of multiple job holders grew by 19.2% within the same years – a much faster increase than the 6% growth in the labour force. And even if the proportion of single parents and self-employed had not been on the rise, the total numbers of individuals in vulnerable groups are fairly visible (Figure 9).

4.1.2. Housing Market Shock

Survey results

Nearly all respondents reporting residential structures among their assets did not feel that a 10% decline in the housing market would negatively affect their financial wellbeing

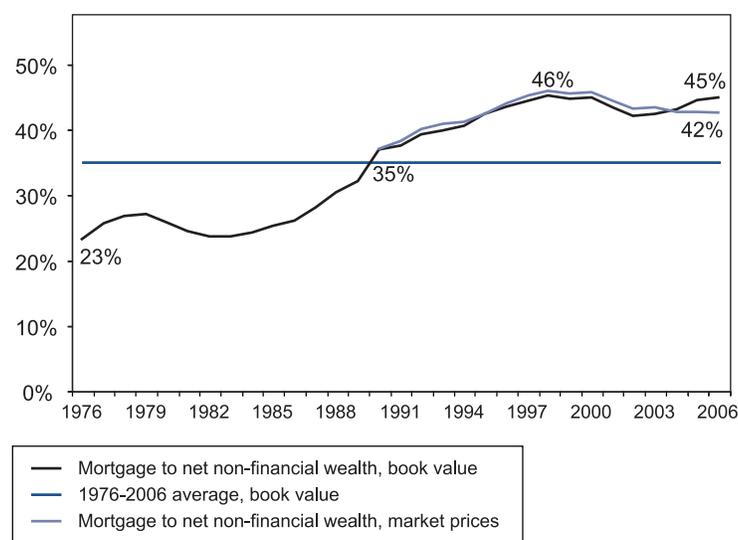
Housing is something which an average household does not buy and sell everyday. The long-term nature of the housing transaction and its longevity may have created a misconception that there are only two points in time when housing values really matter: the time at which the property is purchased and the subsequent time at which it is sold. However, the dynamic of the housing market is such that it may have a much deeper implications for households, even if the asset is not on the market for sale. Specifically, decreasing or stagnating housing prices may restrain households' consumption as the result of two main conditions:

- (i) When erosion of their balance sheet position occurs – as the nominal value of debt remains fixed over the life-time of the debt while the value of the asset against which it is secured might decline – leading to a dampening in the households' ability for additional or future borrowing.
- (ii) By setting off a compensatory increase in savings to counterbalance gains which can no longer be expected to accrue through a simple appreciation of residential assets.

Furthermore, the initial decrease in values and prices may even trigger a distress selling of assets, leading to further deterioration of the asset values and net resale prices.

A brief investigation of the aggregate household sector shows that the financial condition of the household sector as a whole has not deteriorated significantly. The ratio of residential mortgages to non-financial assets is considered to be a good indicator of household vulnerability to the decline in asset prices. Although in recent years the ratio stood well above its historical average (e.g. it reached 45% in 2006 compared to the 30-year average of 35%), the ratio has been hovering at the above-40% level for more than a decade (Figure 10). Moreover, if the assets are measured at market prices, the ratio can be considered to have been declining since its peak in 2000 due to the strong appreciation of housing values.

Figure 10 – Residential Mortgage to Net Non-Financial Wealth, 1976-2006



The least wealthy 20% of Canadians have almost no housing equity backing up their mortgage debt

Note: Data on market value of household assets are available only starting from 1990

Source: CANSIM Tables 384-0004, 378-0009, 376-0032; CGA-Canada calculation

As earlier noted however, the household sector comprises of a diverse group of people and the magnitude of the real estate assets in the total household assets, as well as the level of debt that is used to finance housing, differs significantly depending on the overall wealth position of households. As shown in Table 3, the least wealthy 20% of Canadians have almost no housing equity backing up their mortgage debt and do not have other non-financial assets (e.g. vehicles, durable goods, valuables and collectibles) to back up their mortgage debt. A decline in housing prices may have a devastating effect on the equity positions of such households that are the most sensitive to softening of the market.

Table 3 – Residential Mortgage Leverage by Net Worth Quintile, 2005

Net worth quintile	Mortgage on principle residence to value of principal residence	Residential mortgages to net non-financial assets
Lowest 20%	93.2%	-75.3%
Second 20%	68.0%	128.5%
Third 20%	47.6%	73.3%
Fourth 20%	28.3%	32.9%
Highest 20%	9.5%	10.9%
All families	25.9%	27.8%

Note: Net non-financial assets understood as non-financial assets minus total debt

Source: Survey of Financial Security, on-line statistical tables, Statistics Canada, available at: <http://www40.statcan.ca/01/cst01/famil115f.htm>, CGA-Canada calculations

Although there are macroeconomic determinants (e.g. dynamic of interest rates), the housing market tends to have very strong correlation with regional features that are shaped by local demographic trends, rates of migration, labour market conditions, pace of income and job growth, land constraints, development restrictions, etc. This is why the regional consideration becomes particularly important when evaluating the propensity of negative shocks to the housing market.

Canada is noticeably divided into West and East in terms of the prospects of housing market

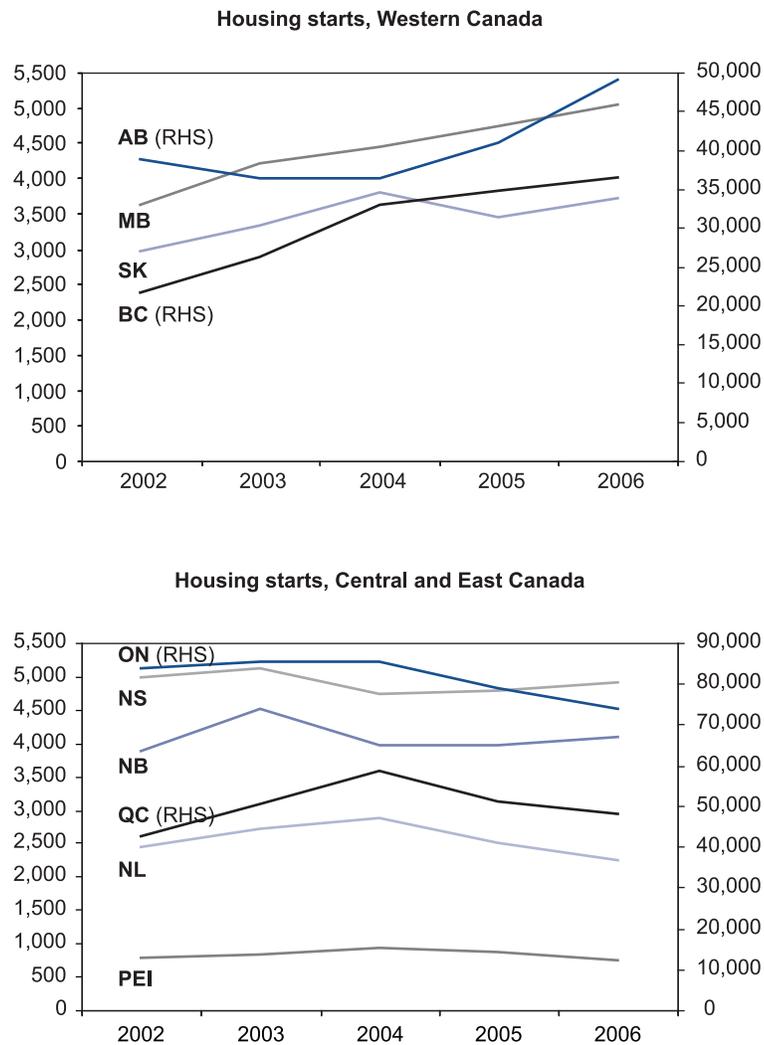
A downward trend in housing starts may be a reflection of a waning economy, pessimistic prospects about household income and an unstable labour market. It may also be an early sign of stabilizing or declining housing prices. As Figure 11 reveals, Canada is noticeably divided into West and East in terms of the prospects of housing market. While the western provinces have all enjoyed an increase in housing starts, Canada's two largest provinces – Ontario and Quebec – experienced a 6% decrease in 2006 residential construction start-ups.

And even in the regions where the housing market is on the rise, the potential threat comes from a decreasing housing affordability. In 2006, a 30-40% increase in housing values was not uncommon (i.e. Calgary, Saskatoon, and Vancouver). However, such an annual growth rate may soon exhaust households' capacity to borrow adequate funds to afford high-price, sometimes modest-square-footage, homes.

Compounding these challenges, aging of the population may also impart its dynamic onto the slowdown of the housing market(s). The likelihood of entering the housing market as an owner is known to decline with age as too is the proclivity to continue to own standalone housing. The Canadian population is aging fast with the number of individuals aged 55 to 64 already increasing at a pace 5 times faster than that of the total population. The population projections suggest that the growth of elderly population will

further accelerate starting in 2011.²⁸ As the proportion of the Canadian population above the age of 55 years increases, the rate of growth in new home ownership may slow down negatively affecting the number of transactions on the market and thus the underlying value of housing assets. Regions known for out-migration of young population (e.g. Atlantic Canada and rural areas across Canada) may be further distressed by this trend.

Figure 11 – Housing Starts by Province, 2002-2006



Source: On-line summary tables in Canadian Statistics, Statistics Canada, available at: <http://www40.statcan.ca/l01/cst01/manuf05.htm>, accessed on July 3, 2007

28 2006 Census: Age and Sex, The Daily, Statistics Canada, July 17, 2007

4.1.3. Interest Rate Shock

Survey results

67% of those having consumer credit do not feel that a 2% increase in interest rates would negatively affect their financial wellbeing

At the current pace of economic development, the increase in interest rates is likely. The Bank of Canada recently raised its overnight lending interest rate by a quarter percentage point, elevating it to 4.5%, after keeping the rate unchanged for more than a year.²⁹ The increased risk of persisting inflation was the primary motivation for the increase.

Inflationary pressure has been promoted by a number of factors. A tight labour market has created pressure on wages and a low unemployment rate has further accentuated the hardening of the market. Low productivity growth, driven mainly by increasing number of hours worked, rather than boosted capital intensity contributes to increasing labour costs.³⁰ Raising energy prices and still rising housing prices in some regions are two important sources of rising inflation expectations. Although most of these factors are concentrated in the western provinces, they seem to be strong enough to influence the pan-Canadian inflation outlook. And as none of these factors show relenting or reversing tendencies, most analysts expect that the Bank of Canada will boost interest rates again during the remaining months of 2007.

Whether households will experience positive or negative consequences to rising interest rates will largely depend on the combination of their debt and assets

Whether households will experience positive or negative consequences to rising interest rates will largely depend on the combination of debt and assets held by the particular household. For instance, increasing rates may increase the return on the household's financial asset holdings; however, it may also increase the costs of servicing debt. Furthermore, those, at the early stage of their debt and particularly mortgage repayment, may have even higher exposure to the hikes in interest rates as the interest component of payments is much higher than at the beginning of the loan life which leads to higher monthly payments or lower principal payments and slower equity accumulation.

The change in the Bank of Canada's lending rate directly affects variable mortgage rates and other floating loan rates such as lines of credit and personal loans. Fixed mortgages rates may also be affected, however through a much more complex mechanism of changing rates on the bond markets which do not diametrically follow the changes in the Bank of Canada's lending rate. An

29 Bank of Canada raises overnight rate target by 1/4 percentage point to 4 1/2 per cent, Press Release, Bank of Canada, July 10, 2007

30 A more elaborated discussion on productivity may be found in the recent CGA-Canada report titled "Fading Productivity: Making Sense of Canada's Productivity Challenge" available at <http://www.cga.org/canada>

estimated one quarter of Canadian families hold consumer debt, and about 15% have mortgages with flexible interest rate terms and thus may expect to face rising debt-service costs due to the increases in interest rates.³¹

The Bank of Canada, in its recent review, suggested that a combination of increasing interest rates and debt growth surpassing income growth may push the debt-service ratio up by some 3 percentage points within the next four years.³² Meanwhile, calculations of the Scotiabank Group suggest that a “one percentage point increase in the average effective interest rate over five years, assuming steady income and credit growth, would lift debt servicing costs as a share of after-tax income” by approximately 1.5 percentage points.³³ Rising interest rates may have a stronger negative effect on the already fragile position of the less wealthy households, particularly because these households are the least likely to hold financial assets which may experience a positive boost should the hike in interest rate occur (Table 4).

Table 4 – Consumer Credit Leverage by Net Worth Quintile, 2005

Net worth quintile	Consumer credit to financial assets	Financial Assets as % of total assets
Lowest 20%	457.3%	16.9%
Second 20%	56.9%	21.8%
Third 20%	27.3%	24.9%
Fourth 20%	9.9%	37.2%
Highest 20%	3.0%	44.0%
All families	8.5%	39.4%

Note: Consumer credit is estimated as total debt less mortgages; financial assets include private pension assets

Source: Survey of Financial Security, on-line statistical tables, Statistics Canada, available at: <http://www40.statcan.ca/01/cst01/famil115f.htm>, CGA-Canada calculations

As a short recap of the above discussion, two points are worth repeating. First, the promising pan-Canadian picture of strong economic growth, tight labour market and rapidly appreciating housing assets may obscure some important regional differences between ‘west’ and ‘the rest’ which, to a great extent, are driven by differences in industry concentration across Canada. Second, given groups of households (e.g. single parents, unattached individuals, self-employed, and individuals with modest wealth) may be particularly sensitive to income instability, increasing interest rates and changes in the housing market.

31 For consumer credit, the estimate is based on the proportion of households holding vehicles loans; for mortgages, it is assumed that 1 in 5 mortgages are with flexible rate. The proportion of families holding vehicle loans and mortgage credits is based on The Wealth of Canadians: An Overview of the Results of the Survey of Financial Security, 2005, Statistics Canada, Catalogue no. 13F0026MIE – No. 001

32 Financial System Review, June 2007, Bank of Canada

33 Adrienne Warren, Aron Gampel, An Assessment of North America Household Balance Sheet, Special Report, Scotiabank Group, January 5, 2004

4.2. Threat of Tomorrow – Tapping into Future Consumption

Survey results

40% of adult Canadians holding debt think that debt negatively affects their ability to reach goals in the area of financial security for unexpected events

4.2.1. Overall Savings

Savings allow individuals to allocate their consumption over time. The advent of current behaviour to save little puts households at risk of having insufficient financial cushion against adverse economic developments. The practice undermines the asset-building process and increases reliance on current income and borrowed funds to consume and invest. More importantly, insufficient savings may jeopardize household's financial situation through the life continuum and at retirement leading to a decline in optimum living standards.³⁴

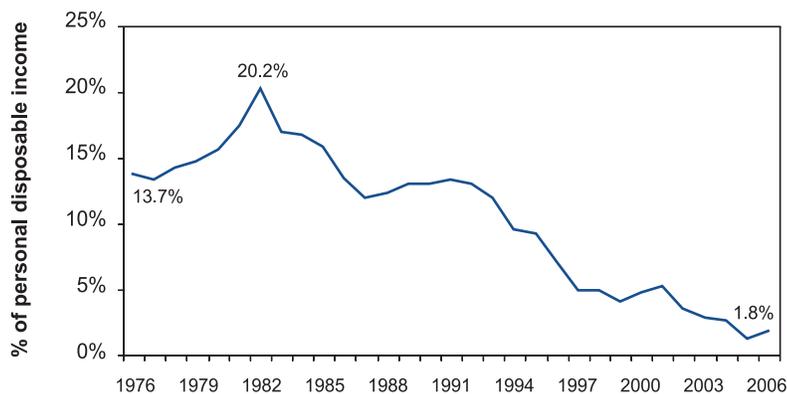
Households' personal saving rate dropped from its highest level of 20.2% in 1982 to its lowest of 1.2% in 2005

Over the course of the last decade, household debt and personal consumption have been outgrowing (on average) gains in personal disposable income leaving less money for traditional saving. Households' personal saving rate, as reported by the Statistics Canada, has been on a declining trend since the early 1980s dropping from its highest level of 20.2% in 1982 to its lowest of 1.2% in 2005 (Figure 12). The most often cited factors propelling the decline in savings include (i) asset value appreciation that boosts households net worth, (ii) low interest rates levels that make savings less attractive and borrowing costs initially easier to bear, (iii) an aging population that triggers dis-saving of retirement funds, (iv) growing importance of government policy and transfer payments which reduce the incentive to save, (v) slower pace of growth in personal income that leaves lesser funds after personal consumption, and (vi) increased/improved access to credit that lowers the need for a "savings cushion".

Interestingly, the personal saving rate reported by Statistics Canada has been widely criticized due to its inability to adequately reflect changes in the value of household's assets, capital gains/losses, and personal expenditure on education and training which are in fact investment in human capita. To correct this shortcoming, economists have come to distinguish between two types of savings. The "active" component which is reflected in the system of national accounts and refers to the part of personal disposable income left after all personal outlays are made and the "passive" component which consists of

³⁴ It should be noted that a high level of saving is not necessary an indicator of the economic prosperity. High saving rates may, for instance, be a sign of a deep recession or high nominal interest rates when personal saving are pushed up by the increased income insecurity and labour market uncertainty. Such unwillingness of the consumers to spend money would, in turn, be holding back the economic growth.

Figure 12 – Personal Saving Rate, 1976-2006



Source: CANSIM Tables 380-0019

capital gains on existing assets; with the latter usually following the dynamic of the housing and capital markets.³⁵

When pondering low savings rates of Canadian households, debate participants tend to acknowledge that the decrease in active savings have been fairly well compensated, or offset, by passive savings through appreciation of housing equity and increasing value of financial assets. The observations presented below do however seem to be disproportionately ignored by proponents of this line of thinking.

Housing as Passive Savings

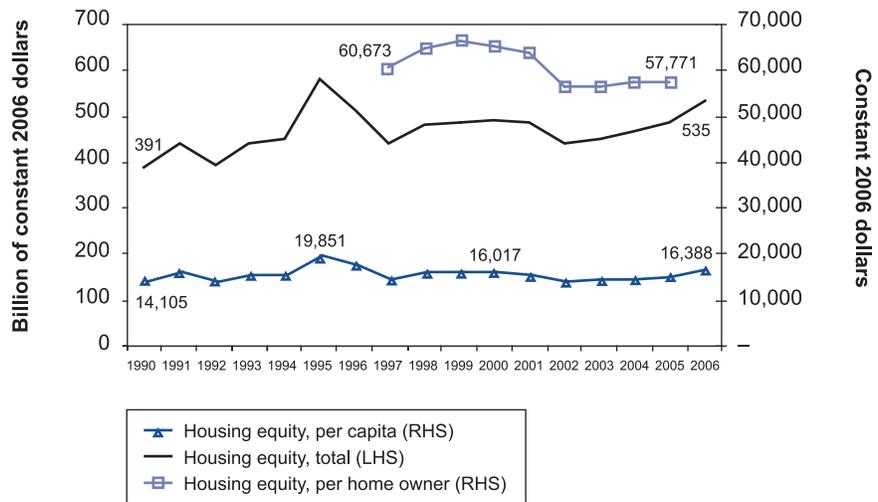
Some passive savings did indeed take place as the aggregate net worth adjusted for population growth and inflation increased at an average rate of 6.4% between 2003 and 2006. However, housing equity, which is the main component of wealth for many households, has been growing very slow when considered on a per capita basis or decreased in some instances if calculated on a per home owner basis (Figure 13). This suggests that not all home owners benefited uniformly from the appreciation of housing assets.

The reliance on appreciation of housing value as a form of savings has another shortcoming. Some 62% of Canadian families hold housing assets which reasonably means that substitution of active savings with passive ones happens across most of the income and age groups and geographical regions affecting those households; some of which are the least able to handle negative shocks without adequate active savings.

Housing equity has been growing very slow when considered on a per capita basis or decreased if calculated on a per home owner basis

35 D. Maki, M. Palumbo, Disentangling the Wealth Effect: A Cohort Analysis of Household Saving in the 1990s, Board of Governors of the Federal Reserve System, Finance and Economic Discussion Series No. 2001-21

Figure 13 – Dynamic of Housing Equity, Market Value, 1990-2006



Note: Housing equity is defined as residential assets less residential mortgage credit

Source: CANSIM Tables 378-0009, 176-0032, 377-0003, 051-0001, 203-0019; CGA-Canada calculation

Another shortcoming of housing as passive savings is that house ownership entails such expenses as property taxes, home and mortgage insurance, and implicit rental cost of housing. Usually, these expenses rise together with the housing values and are naturally not recoverable upon sale of the asset. The benefits of renovation expenses that are often considered as value increasing improvements may also be questionable as the perception of the quality and necessity of improvements may change over time. Oftentimes these value enrichments are simply not generically borne out in a fashion that is consistent with the universal faith around these improvements.

34% of Canadians who are not yet retired count on their home equity as a source of retirement income

Taking into account the shortcomings of accumulating savings in the form housing equity, it is worrisome that this type of savings alone seems to have become a well imbedded and predominant part of financial planning. According to a recent poll conducted by Royal Bank of Canada (RBC), one third (34%) of Canadians who are not yet retired count on their home equity as a source of retirement income. Not surprisingly then, Canadians are more likely to view home ownership, and not retirement savings, as their most important financial goal: 61% of respondents claimed that their number one financial goal is home ownership while 56% concurrently indicated that it is retirement savings.³⁶

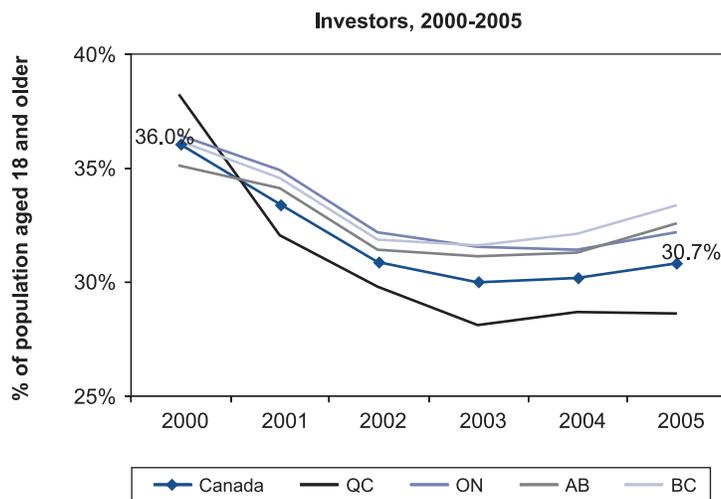
Financial Assets as Passive Savings

Although accumulation of net financial assets picked up since its plunge in the early 2000s, it seems that the increase in the aggregate value of assets has not been accompanied by an increasing number of people sharing in the

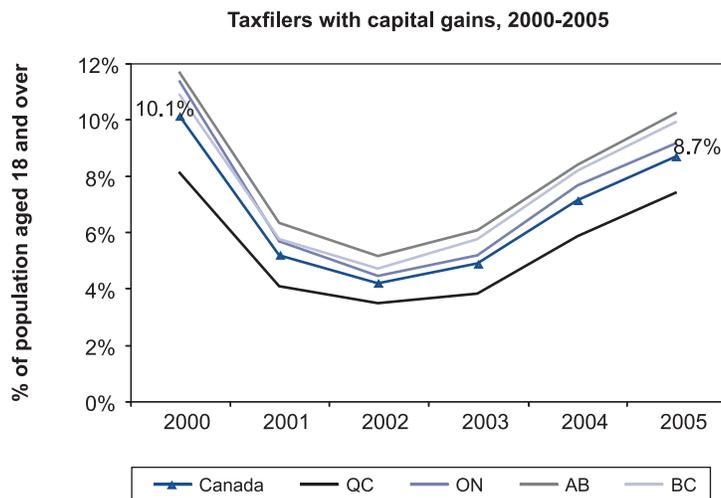
³⁶ Live for today, save for tomorrow – RBC polls shows Canadians can have it all, with a little planning, RBC Financial Group News Release, December 18, 2006

strong performance of the stock market. For instance, the number of investors – individuals who report investment income on their tax-returns³⁷ – has noticeably decreased since 2000 (top graph of Figure 14). Although in Alberta and British Columbia, the trend showed slight improvements starting from 2004, the strong economic growth experienced by these provinces has not transformed itself into the corresponding increase in the number of investors. Similarly, the number of tax-filers having capital gains³⁸ has yet to reach the level seen prior to the burst of the high-tech bubble in 2001 (bottom graph of Figure 14).

Figure 14 – Proportion of Investors and Those with Capital Gains, 2000-2005



The increase in the aggregate value of financial assets has not been accompanied by an increasing number of people sharing in the strong performance of the stock market



Source: CANSIM Tables 111-0038, 111-0042; CGA-Canada calculation

37 Investment income is understood as income from dividends (reported on Line 120 of the tax return), or interest (reported on Line 121), or both. Interest and other investment income include interest from Canada Savings Bonds, bank accounts, treasury bills, investment certificates, term deposits, earnings on life insurance policies, and foreign interest and dividend income.

38 A capital gain is a profit or loss from the sale of investments or property reported on Line 127 of the personal income tax return

4.2.2. Savings for Retirement

Survey results

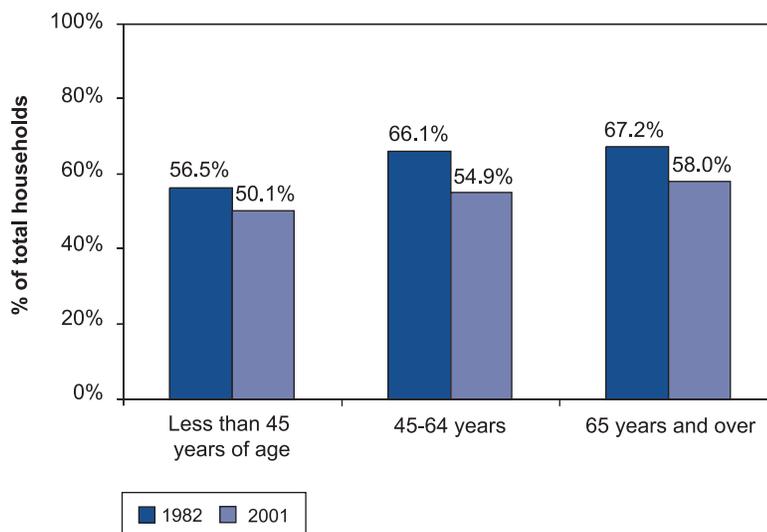
28% of those holding debt feel that household debt negatively affects their ability to reach personal retirement goals

When contemplating the economic practices of households, economists typically categorize a household's longevity into three distinct evolutionary phases: (i) borrowing (less than 45 years of age), (ii) accumulation /saving (between 45 and 64 years of age), and (iii) retirement/dis-saving (65 years of and over).³⁹

While recognized as not being purely accurate, the categorizations are reflective of the trajectory and do reasonably facilitate meaningful insight. Based on this modelling, one might convincingly assume that the proportion of savers (those whose expenditures are equal to or less than income) would be higher during the accumulation phase. Interestingly though, the data shows us that the proportion of savers among people of 45 to 64 years of age actually decreased by more than 11 percentage points between 1982 and 2001 (Figure 15). Such an increased propensity to outspend income among the households approaching their retirement signals a certain absence of adequate readiness to retirement.

The proportion of savers among people of 45 to 64 years of age decreased between 1982 and 2001

Figure 15 – Proportion of Savers, 1982 and 2001



Source: Spenders and Savers, Statistics Canada, Catalogue no. 75-001-XIE

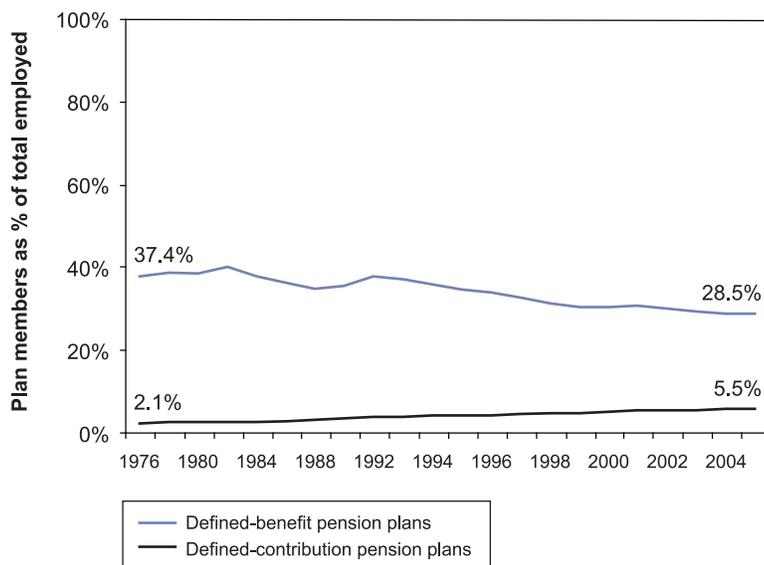
³⁹ R.K. Chawla and T. Wannell, Spenders and Savers, Perspectives, Statistics Canada, March 2005, Catalogue no. 75-001-XIE

Encouragingly, a fairly substantial cohort of young people plan for retirement. For instance, recent RBC's poll suggests that 67% of those aged 35-44 years and 48% of those 18-34 years of age are planning for retirement years.⁴⁰ Less flattering though is the finding that planning does not seem to be transforming into solid actions or numbers. The proportion of young Canadians (single individuals and family units with major income recipients younger than 35 years of age) who have private pensions decreased from 4.8% in 1999 to 3.1% in 2005. For those between 35 and 45 years of age, the proportion went down to 11.8% from 14.4% in 1999.⁴¹

The overall employer-sponsored pension coverage notably decreased in the last 30 years

Consistent with predictions by CGA-Canada in its 2004 and 2005 works on defined benefit pension plans, results of a survey commissioned by the Conference Board of Canada show that one third of the surveyed companies have already switched from defined-benefit to defined-contribution pension plans or will do so in the next year.⁴² Although the decline in the number and coverage of defined benefit plans was somewhat counterbalanced by a growing number of defined contribution pension plans, the overall employer-sponsored pension coverage notably decreased in the last 30 years settling at the level of 34% of all employed Canadians in 2006 compared to 40% in 1976 (Figure 16).

Figure 16 – Registered Pension Plans, 1976-2005



Note: Data on registered pension plans are available biennially from 1974 to 1992 and annually afterwards.

Source: CANSIM Tables 280-0015, 282-0002; CGA-Canada calculation

40 Life for today, save for tomorrow — RBC poll shows Canadians can have it all, with a little planning, RBC Financial Group, News Release, December 18, 2006

41 Survey of Financial Security, Statistics Canada, on-line statistical tables, available at: <http://www40.statcan.ca/101/cst01/famil100a.htm>

42 Firms jettison defined-benefit pension plans; Shift means many will work longer, The Toronto Star, May 10, 2007

With this mindset securely anchored in employer behaviour, a greater proportion of future retirees will be called upon to rely on their private pension savings.

Inopportunistly, Registered Retirement Savings Plans (RRSPs), as tax-reducing pension savings vehicle, have not been rising to compensate for the declining coverage offered by employer-sponsored pension plans. The median amount of RRSP investments held by Canadians increased a mere 4% between 1999 and 2005 (adjusted for inflation) while total household assets grew by 25%.⁴³

In addition to the slow accumulation of those RRSP funds, Canadians do tend to frequently use them prior to retirement. In 2001, the proportion of tax-filers dipping into their RRSPs was twice higher than 8 years prior. Some 39% of those who contributed to RRSP between 1992 and 2001 withdrew funds at least once, but only 40% of those who withdrew, replenished their withdrawal within the 8 years considered by the study.⁴⁴

Canadians tend to use retirement savings for lifestyle reasons prior to retirement

Canadians are known to view RRSP savings as an important source of their retirement income.⁴⁵ Nevertheless, Canadians tend to use retirement savings for lifestyle reasons prior to retirement. One quarter (24%) of those who made an RRSP withdrawal was observed to pay down debt while 20% opted to stream it into day-to-day living expenses. This is despite the finding that 53% of non-retired investors are concerned that they will outlive their retirement funds.⁴⁶ Furthermore, 3.9 million of Canadian families – some 29% of all households – had no private pension assets in 2005.⁴⁷

Summing up the discussion above, the fact that savings are decreasing is worrisome, particularly taking into account that the number of Canadians entering the phase of life when they are expected to accumulate their retirement savings (aged 45-64) is increasing. Although the lack of active savings (i.e. part of disposable income put aside) was noticeably compensated by passive savings in the form of housing assets appreciation, this wealth was not, nor can it be, distributed evenly amongst homeowners.

43 B. Tal, Retirement: Ready or Not?, CIBC World Markets, Special Report, February 6, 2007

44 P. Giles and K. Maser, Using RRSPs before retirement, Canadian Economic Observer, January 2005, Statistics Canada, Catalogue no. 11-010

45 See, Section 2 of this report and Media Release of the Investors Group, February 21, 2007 available at: <http://www.investorsgroup.com/english/default.shtml>

46 Scotiabank Press Release, January 8, 2007

47 Private pension assets include employer-sponsored pension plans, Registered Retirement Savings Plans, Locked-in-Retirement Accounts, Registered Retirement Income Funds, Deferred Profit Sharing Plans, annuities and other miscellaneous pension assets. Source: The Wealth of Canadians: An Overview of the Results of the Survey of Financial Security, 2005, Statistics Canada, Catalogue no. 13F0026MIE – No. 001

The gradual but steady switch from defined-benefit to defined-contribution pension plans also shifts the burden of responsibility for accumulating sufficient retirement funds to households. However, this have not been reflected in the increasing number of individuals receiving investment income or capital gains, not even in those provinces enjoying the strongest economic growth and the accompanying solid increases in earnings.

Although it is difficult to claim that rising household debt is solely responsible for these changes, increasing indebtedness may leave Canada's aging society sandwiched between having already committed yet unearned income to debt-servicing and the necessity to accelerate accumulation of pension funds for rapidly approaching retirement.

A Glimpse at Bankruptcy

5

Modern society recognizes that insolvency is a typical option of last resort for dealing with the financial distress. Traditional doctrine of insolvency posits that consumer bankruptcies will rise when economic conditions deteriorate, and alternatively decline in times of strong economic growth. Canada's experience has borne out these principles: strong labour markets have brought unemployment to a three-decade low, stable economic growth, and relatively low interest rates have contributed to a decreasing number of consumer bankruptcies which fell by 6.4% over 2006. Encouragingly, the number of bankruptcies per capita has been steadily decreasing in the last three years plummeting down by 7.3% in 2006. Traditional measures such as the magnitudes of bankruptcies, the average dollar value liabilities declared, and the ratio of bankruptcy liabilities to total household debts have also been showing positive performance.

So one probably wonders why we might produce this entire paper on the indebtedness of Canadians to simply hypothesise that depth of Canadian insolvency contradicts the positions of the dozens of pages preceding this one. More bluntly, why all the noise and forewarning if it isn't broken? We respond by saying that financial responsibility is good for all Canadians and should be reasonably pursued as any other health habit. Secondly, we are convinced that many Canadians are challenged, and may be assisted, by the very types of issues discussed in this paper. Lastly, we are of the mind that, while disclosed, there is an unintentional dampening distortion, in the reported bankruptcy figures.

The 1997 peak in the number of bankruptcies coincided with a timely introduction of amendments to the Bankruptcy and Insolvency Act which reduce debtor-friendliness of the consumer bankruptcy regulations and make the process more onerous for prospective bankrupts.⁴⁸ Thus, what may at first look like a decrease in the number of financially distressed consumers is most probably caused to a notable extent by changes to regulations that redefine the eligibility for, and exercise of, a bankruptcy than to improved solvency per se. In short, fewer individuals were able to file for bankruptcy (Figure 17).

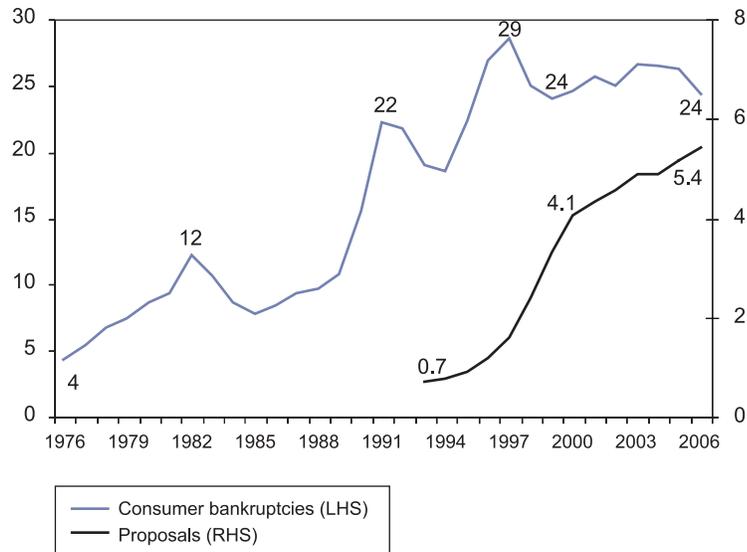
Prior amendments of the Bankruptcy and Insolvency Act taking place in 1992 introduced a so-called "consumer proposal" which has since become an attractive alternative to bankruptcy. Filing a proposal permits a debtor to make a proposal to creditors to modify the debt payments conditions while avoiding seizure of

The number of bankruptcies per capita has been steadily decreasing in the last three years

48 Charles J. Tabb, "Lessons from the Globalization of Consumer Bankruptcy". Illinois Law and Economic Working Paper, LE 05-013

underlying assets. As seen from Figure 17, consumer proposals have been rising ever since their introduction with the annual growth averaging at 18.1%.

Figure 17 – Consumer Insolvency per 10,000 Population, 1976-2006



Source: CANSIM Table 177-0001, Monthly bankruptcy statistics, Office of Superintendent of Bankruptcy Canada (available at: http://strategis.ic.gc.ca/epic/site/bsf-osb.nsf/en/h_br01548e.html)

Regulatory amendments, taken together, at least intuitively push down the actual numbers of consumer bankruptcies

These regulatory amendments, taken together, at least intuitively push down the actual numbers of consumer bankruptcies. If we were to presume that all those opting to exercise a ‘proposal’ would have at the time or subsequently filed for bankruptcy, the total number of 2006 bankruptcies ignoring those disqualified by 1997 amendments would have been seen to remain relatively identical to the 1997 high of 29 per 10,000 capita. At time of writing, and beyond the scope of this paper, CGA-Canada has inadequate data to extrapolate the dampening effect of the 1997 amendments.

Consistent with speculation expressed above, and further exacerbating the incongruence of the numbers to be compared, the Office of the Superintendent of Bankruptcies (OSB) suggests that some of the anticipatory changes announced prior to the introduction or effective date of the altered regulations in 1997 influenced the behaviour of indebted students. Specifically, under new law, student loans became non-dischargeable for 10 years after completion of studies stimulating many students to file for insolvency in a pre-emptive way. The OSB suggests that “this phenomenon is the main reason for the increase in insolvency noted in 1996 and 1997, and the drop in 1998”.⁴⁹ Elimination of the 1996-1997 peaks may actually change the way we

⁴⁹ Richard Archambault, Dominic Laverdière, “A Macroeconomic Model for Analysing and Forecasting Levels of Business and Consumer Insolvency in Canada”, Office of the Superintendent of Bankruptcy, Industry Canada, 2005

perceive the trend in post-1998 consumer bankruptcies from “high but fairly stable” to “high and increasing”.

Researchers suggest that there is much more than just cyclical change in economic conditions that affect the level of consumer bankruptcies. For instance, an increasing debt-to-income ratio is one of the widely recognized drivers of consumer insolvencies. The number of bankruptcies is also sensitive to fluctuations in permanent and temporary income, level of non-discretionary expenses, disproportionately high credit card debt, people’s overall propensity to file a bankruptcy when financial situations deteriorate, and perhaps even as the result of the consumer’s strategic consideration.⁵⁰

One of the few of Canada-specific studies examining consumer insolvencies⁵¹ concluded that among non-cyclical factors (i.e. those that are not directly triggered by the economic growth), the total debt-to-income ratio had the greatest permanent effect on the number of consumer insolvencies. In this regard, the continuous rise in the debt-to-income ratio of Canadian households poses certain concerns of the future increase in consumer bankruptcies.

While pleasing, the progressive economic growth of Alberta also makes the pan-Canadian approach to analysing consumer bankruptcies more problematic than before. For instance, the all-Canada growth rate in consumer bankruptcies was virtually zero between 1999 and 2006; however, if Alberta is excluded, the rest of Canada has been facing a more than 1% of annual average increase over this time (Figure 18). Noting that Alberta accounts for only one tenth of Canada’s population, regional differences seem to be an important factor which needs to be taken into account when using bankruptcies to judge consumers’ financial wellbeing.

It should be noted that in addition to rising debt, other factors such as unemployment, changes in income, divorces and health issues may trigger consumer bankruptcies. However as these factors have been either stable (e.g. number of divorces) or declining (e.g. unemployment), it is believed that increasing household debt does impart a higher risk of financial distress and insolvency for Canadian households even if the bankruptcy numbers do not bear it out quite so plainly.

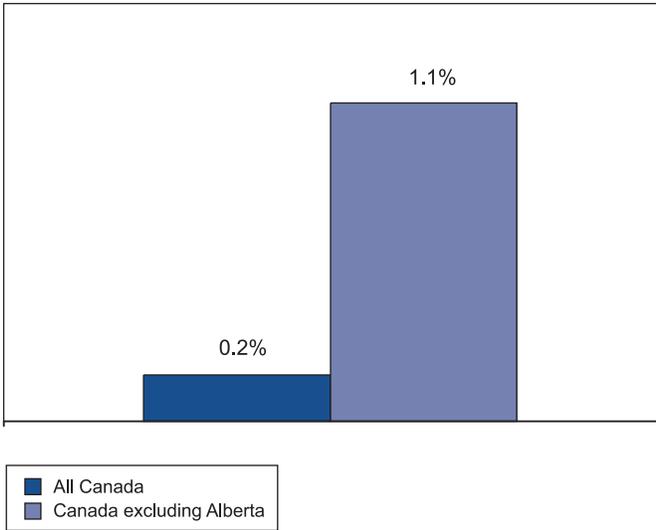
The progressive economic growth of Alberta makes the pan-Canadian approach to analysing consumer bankruptcies more problematic than before

50 Based on the literature review presented by R. Archambault and D. Laverdière in “A Macroeconomic Model for Analysing and Forecasting Levels of Business and Consumer Insolvency in Canada”, Office of the Superintendent of Bankruptcy, Industry Canada, 2005

51 R. Archambault and D. Laverdière in “A Macroeconomic Model for Analysing and Forecasting Levels of Business and Consumer Insolvency in Canada”, Office of the Superintendent of Bankruptcy, Industry Canada, 2005

Figure 18 – Number of Consumer Bankruptcies Per Capita

Number of consumer bankruptcies per capita
Average annual growth, 1999-2006



Source: CANSIM Tables 177-0001, 051-0001, CGA-Canada calculations

The analysis of the preceding sections has provided valuable insight into the level of debt held by Canadian households and the inherent individual risks to bearing a steadily burgeoning accumulation of debt. By consolidating these Canadian views and the statistical information available on household debt in Canada, a number of deductions have been exposed.

The combination of rapidly increasing household debt with an only slightly deteriorating financial condition of the household sector should not be relegated to a non-issue for Canadians.

The numbers presented in this and other reports show that the overall financial condition of the household sector does not appear to be distressful from a historical point of view, nor does it seem to be rapidly deteriorating. However, maintaining the current pace of debt encumbrance to asset growth will slowly but steadily increase household indebtedness creating higher pressure on the economy and the financial systems which support it. Moreover, the measures commonly used for the debt analysis do not fully incorporate all the facets of the changing status quo between household debt, income, assets and wealth and may lead to overestimation of the growth in household assets and net worth. In short, the performance of individual households may fall significantly outside the norms purported by the sector's statistical data.

Focusing on the overall household sector conceals the fact that an increasing number of Canadian households face higher financial stress.

The financial situation of certain groups of households is deteriorating much faster than the financial condition of the household sector may suggest. More and more families enter into debt and the debt of a typical household is rising. Low income families are neither exempted from, nor immune to the rising debt burden while the appreciation of their assets does not necessarily mirror those of other income groups. Those with already low wealth continue sinking into debt and further deteriorating their net worth position. An increasing number of households reach the level of indebtedness that is typical for a household filing for bankruptcy.

Regardless of income level and financial condition, individuals and their families are well heeded to consider their own personal conditions within the context of the whole population rather than to simply adopt an impression of collective reassurance which may not apply equally to their own condition.

The inclination of lending institutions, fulfilling a valuable service to society, should not be the societal proxy for respective debt-load tolerance.

Households have increased access to credit, with those having the least amount of net worth having experienced the highest paced increase access to credit. Despite a relatively vigorous housing market and an apparently welcome access to mortgage credit, the share of residential mortgage credit is yielding place to unsecured consumer credit. While the use of consumer credit for day-to-day expenditures does have a place in modern life and can support warranted investment in consumer durables or financial assets, it does in many instances, promote discretionary spending. That discretionary spending has and can be ill-afforded by some in the broader pursuit of loftier goals. And while lending institutions afford a beneficial service to society and its constituents, the risk tolerances of those institutions should not be exercised as a substitute for the judgement of individuals who must discern, based on their own pre-condition, between good and bad debt.

Many Canadians do not seem to fully appreciate how increasing debt may affect their ability to handle negative economic shocks.

Although statistical data shows an unprecedented run-up in household debt, many Canadians tend to perceive their debt as decreasing. This may be one of the reasons why only few households realize that certain economic shocks may negatively affect their consumption and the general ability to maintain the level of living standards they are accustomed to. This is particularly worrisome as the pan-Canadian picture of strong economic growth, tight labour markets and rapidly appreciating housing assets may obscure some important regional disparities. Moreover, particular groups of households (e.g. single parents, unattached individuals, self-employed, and individuals with low wealth) may be particularly sensitive to income instability, increases in interest rates and regressive changes in the housing market.

Increasing debt, accompanied by declining savings, may wedge households between the need to address a rising debt-service burden and the necessity to accelerate a build-up of pension resources.

Although Canadians are seemingly worried about their financial situation at retirement and start planning for retirement early in life, this is not reflected in the amount and level of household saving. The finding that active savings are decreasing is worrisome, particularly when taking into account that the number of Canadians entering the phase of life when they are expected to accumulate their retirement savings (aged 45-64) is rising. Although the lack of active savings (i.e. part of disposable income put aside) was noticeably corrected by passive savings in the form of asset appreciation, this wealth is not distributed uniformly amongst households.

The development and pronouncement of effective public policy affecting and mitigating the presence of household debt is a difficult task to say the least. With a need to balance overlapping and sometime conflicting essentials, we must honour an individual's freedom of choice, an interest in maintaining strong levels of household spending driving Canada's economic growth, and the necessity to uphold the stability and viability of the financial system. In an attempt to reconcile these pursuits, we direct our attention to two broad lines of public policy: those which target household financial behaviour and those that enable the Canadian economy to prosper.

7.1. Consumer Education

Improve Financial Capability

The lending market has become a very sophisticated environment filled with new technological applications, complex information and a wide variety of products. With extreme regularity, Canadians encounter aggressive promotional and branding activities that offer new and attractive borrowing options, investment devices, and life-planning instruments. Moreover, the challenge of keeping up with product information influences greatly ability to navigate the marketplace and can confuse or exhaust the even the most financially knowledgeable.

It may seem that lending institutions are guarding borrowers' interests by avoiding potential default of debtors, and as such confer only the most manageable of debt-service levels. Following this logic, households may have come to accept that banks and other financial organizations are the best advisors when it comes to the question of how much they can borrow. We should remind ourselves however that lenders actions and their resultant decisions are made within a very competitive environment and are made with the pre-determined benefit of a societal largess to recover their lending. As such, reputable lending institutions commonly relying on standardized procedures and financial pre-conditions do not necessarily take into account unique characteristics of a particular household (e.g. health of the borrower, quality of the relationship within the household, possible addition of a new family member etc.); nor could they account for every conceivable facet of a person's life. Without fault, the motivations of the lending institutions and of borrowers can simply not be purely, or even coincidentally, aligned.

Households' knowledge and skill to understand their own financial circumstances and the motivation to borrow, to spend and to save become crucial to marshalling households' financial security and wellbeing. Unfortunately, possessing knowledge and self-confidence in the ability of making decisions alone are not enough. To survive and prosper in the modern financial world, Canadian households need to have **financial capability**.

Financial capability includes three elements:

- (i) Financial knowledge and understanding which gives households the ability to make academic sense of the financial landscape and to effectively manipulate money;
- (ii) Financial skills and competences which fosters an ability to apply financial knowledge in predictable and unpredictable situations; and,
- (iii) Financial responsibility which is the ability to appreciate the impact of financial decisions on personal circumstances, the family and the community.⁵²

In short, financial capability embodies understanding, creativity and discipline.

Government and academia should seek to integrate financial capability into educational and community programs. This may, for instance, include introduction of courses on money management, spending and shopping habits, warning signs of financial difficulties, and obtaining and using credit. While business schools and government-sponsored programs rightfully do exceptional jobs at shaping aspiring entrepreneurs and business people, there is strikingly little to shape objectivity in consumer behaviour. Arguably, it is reasonable to concede that this orientation ought to be given in the home but this may be out of vogue given the nature of our society today.

Life is an ever evolving journey and folks benefit from different information and stimulus at different times while being subject to transition phases (e.g. marriage, starting or extending a family, divorce, harshness of the labour market, loss, retirement, etc.). There may be those who would particularly benefit from courses and supports. Given our global migration to a 'service' oriented 'knowledge-based' economy, we can expect to witness the emergence of promising opportunity in the areas of financial modelling and guidance that may not have been prominent some ten short years ago. Availability of a high-quality generic financial advice services, extending beyond credit counselling, accessible to a wide range of households (through a national telephone hot line or computer interface for example) may assist Canadians to make effective decisions about their money and to become more financially capable.

52 Why Financial Capability Matters, Synthesis Report on Canadians and Their Money. A National Symposium on Financial Capability, June 9-10, 2005, Ottawa

Improve General Literacy

It is now a well accepted fact that literacy (and not so much the number of years of schooling) is a better indicator of individual's ability to succeed in the labour market and to contribute to productivity growth. However, a solid reading comprehension and numerical abilities have also become a pre-condition to navigating the sophisticated contemporary marketplace.

Literacy skills of 42% of Canadians aged 16 to 65 years do not allow them to meet everyday reading requirements and about 6% of adults have serious difficulty dealing with *any* printed material.⁵³ Yet, these individuals are required to make independent decisions about types of borrowing and investments they intend to undertake and to assume the consequences of their financial decisions. Also, literacy skills obtained through the formal education system begin to erode after the age of 30 years,⁵⁴ the age when many individuals increase their borrowing by entering into home ownership and starting families, all-the-while expected to commence investment and retirement planning. Moreover, many low-income Canadians now having a wider access to the credit market are known to have low literacy skills and thus may have limited ability to make informed borrowing and spending decisions.

7.2. Personal Savings

Accumulation of appreciable financial assets, building of a larger more diversified financial cushion, and retirement investment should remain important long-term goals for Canadians. More importantly, these goals must be put into action to be effective.

Encourage Private Pension Savings

There is little doubt as to the effectiveness and importance of a Registered Retirement Savings Plan (RRSP) as a widely used private retirement instruments currently available to Canadians. RRSPs offer an immediate, albeit deferred tax relief and the deferred tax-free compounding of interest on investments may seem a perfect incentive to accumulate retirement savings. Disappointing as it may be, less than half of all eligible Canadians make contributions.⁵⁵ The recent policy measures that included an extension of types of instruments in which RRSP funds can be invested, a year-after-year increase of the maximum allowed contribution amount, and a carrying over of the unused RRSP room over to subsequent years has interestingly not compelled Canadians to noticeably increase their contributions.

53 Adult Literacy and Life Skills (ALL) Survey, Statistics Canada and the Organization for Economic Co-operation and Development, 2005

54 J. Douglas Willms, T. Scott Murray, Gaining and Losing Literacy Skills Over the Lifecourse, Statistics Canada, Catalogue no. 89-552-MIE - No.16

55 Boris Palameta, Profiling RRSP contributors, Perspectives, January 2003, Statistics Canada, Catalogue no. 75-001-XIE

Past research of RRSP contributors found that employees with employer-sponsored pension plans (both defined-benefit and defined-contribution plans) are more likely to make RRSP contributions.⁵⁶ Encouraging employers to incorporate pension plans in their recruitment and retention strategies may be one of the key elements for improving private pension savings for retirement while concurrently aiding in recruiting and retaining talent.

Although being an important incentive for accumulating retirement savings, we are compelled to recognize that the RRSP concept does not work for everyone. Tax deductions that are at the core of RRSP incentives are insignificant for individuals with lower income whose marginal income tax rates are low or even zero. More importantly, private pension savings that are sufficient to provide a significant stream of retirement income for low-income individuals will be clawed back from the support programs such as Old Age Security and Guaranteed Income Supplement or other social benefits.⁵⁷ Tax pre-paid pension savings plan specifically designed for lower income individuals may be one of the best solutions to this problem.

Encourage Non-pension Household Savings

As individuals and families do not always make optimal decisions regarding consumption and saving, incentives provided by public policy could be directed at accumulating not only retirement savings but also savings for security motive. The accumulation of such savings encourages building of assets and thus, may be considered as a more effective policy measure than the precarious social programs that provide income used for short-term consumption.

Currently existing asset building programs (e.g. Registered Retirement Savings Plan, Registered Education Savings Plan) can be broadened or be extended to include, for instance, medical savings accounts and investment tax benefits. Savings accounts with matching or supplementary contribution may be particularly used for encouraging savings among low-income earners while tax relief might be afforded to middle to high-income income earners on non-sheltered investment income. While it may seem disproportionately generous to grant such tax relief, we should recognize that inclusion in taxable income, attracting comprehensive taxation does serve as a social disincentive to saving.

56 Boris Palameta, Profiling RRSP contributors, Perspectives, January 2003, Statistics Canada, Catalogue no. 75-001-XIE

57 Richard Shillington, New Poverty Traps: Means-Testing and Modest-Income Seniors, Backgrounder, C.D. Howe Institute, No. 65, April 2003

7.3. Productivity Growth

The future increase in real income plays a critical role in the household sector's ability to service the high level of debt it has accumulated. Some 86% of our personal income comes from wages, salaries, interest and dividends and unincorporated business and, thus, depends greatly on performance of the business sector. Productivity, in turn, is one of the fundamental factors allowing business to compete and prosper both on local and international markets.

CGA-Canada has recently undertaken a deeper look into the causes of Canada's lagging competitiveness and productivity presenting its 2007 research findings in a paper entitled "Fading Productivity: Making Sense of Canada's Productivity Challenge" (available at www.cga.org/canada). As the report identifies, investments in human capital, encouraging efficiency and innovation in SMEs, and improvement of institutional efficiency in government would be key measures necessary for improving Canada's productivity and assuring the growth of income for the household sector.

Appendix A: Findings from the Survey of Households' Attitudes to Debt

Methodology

CGA-Canada commissioned this public opinion survey in the spring of 2007. Administered by Synovate between April 25 and May 22, 2007, the questionnaire was designed by CGA-Canada in collaboration with senior staff of Synovate and pre-tested. The sampling methodology was designed to accommodate an on-line interview process with households making up a representative sample of Canadian adults over the age of 25 years.

The survey sample was drawn using Synovate's online panel which includes approximately 110,000 individuals and is representative of the overall Canadian population. A total of 1,000 on-line interviews were conducted with households living in the ten Canadian provinces. With this sample size, a sampling error of plus or minus 3.1% is produced at a 95% confidence level (19 times in 20). While the results for specific geographical regions and/or socio-demographic groups assume greater margin of error than the results for the total sample, the data was statistically weighted to accurately reflect the composition of Canadians by region, gender and age based on Statistics Canada's 2006 information. The profile of the survey respondents is presented in Table 1 below.

Table 1 – Profile of the Survey Respondents

Characteristics	Number of respondents	% of total sample	Characteristics	Number of respondents	% of total sample
Sex			Income		
Male	499	49.9%	Under \$15,000	60	6.0%
Female	501	50.1%	\$15,000-\$24,999	110	11.0%
Age			\$25,000-\$34,999	118	11.8%
25-34 years old	198	19.8%	\$35,000-\$49,999	153	15.3%
35-44 years old	225	22.5%	\$50,000-\$74,999	174	17.4%
45-54 years old	224	22.4%	\$75,000-\$99,999	157	15.7%
55-64 years old	163	16.3%	\$100,000 or more	156	15.6%
65 years of age and over	191	19.1%	Don't know	72	7.2%
Household size			Employment status		
One	202	20.2%	Employed	589	58.9%
Two	434	43.4%	Unemployed	44	4.4%
Three	148	14.8%	Retired	265	26.5%
Four or more	217	21.7%	Not in Labour Force – other than retired	102	10.2%
Geography			Education		
Atlantic Provinces	76	7.6%	High school or less	324	32%
Quebec	258	25.8%	Community college/ Technical school	310	31%
Ontario	366	36.6%	Some university	114	11%
Manitoba & Saskatchewan	71	7.1%	University degree and above	252	25%
Alberta	96	9.6%			
British Columbia	133	13.3%			

Survey Findings

The public opinion survey commissioned by CGA-Canada sought to identify perspectives of Canadians on the changing levels of their indebtedness and wealth, and their attitudes towards spending and savings. The survey asked Canadians to reflect on the changes that had occurred in their household's over the past 3 years by examining four broad elements of (i) household debt, (ii) income, assets and wealth, (iii) household spending, and (vi) savings and retirement. While the findings of the survey are presented in this appendix under the four main themes identified above, these results have likewise been relied upon in developing the brief summary of key findings presented in Section 2 of this paper.

Only a relatively small proportion of respondents felt that their debt had increased over the past 3 years

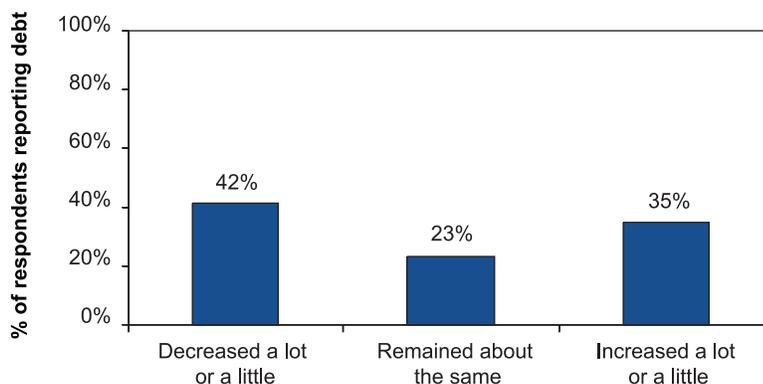
1. Household Debt

The survey sought to identify how and why household debt has changed, the level of comfort in having debt and the respondents' point of view on whether indebtedness prevents them from reaching some of their financial goals.

Changes in Household Debt Over the Past 3 Years

Overall, 84% of the survey respondents reported having some type of debt. However, contrary to the common perception of rapidly raising household debt, only a relatively small proportion of respondents felt that their debt had increased over the past 3 years (Chart 1). In fact, the number of those identifying that their household debt decreased (42%) exceeded the number of those reporting a debt increase (35%).

Chart 1 – Changes in Household Debt Over Past 3 Years

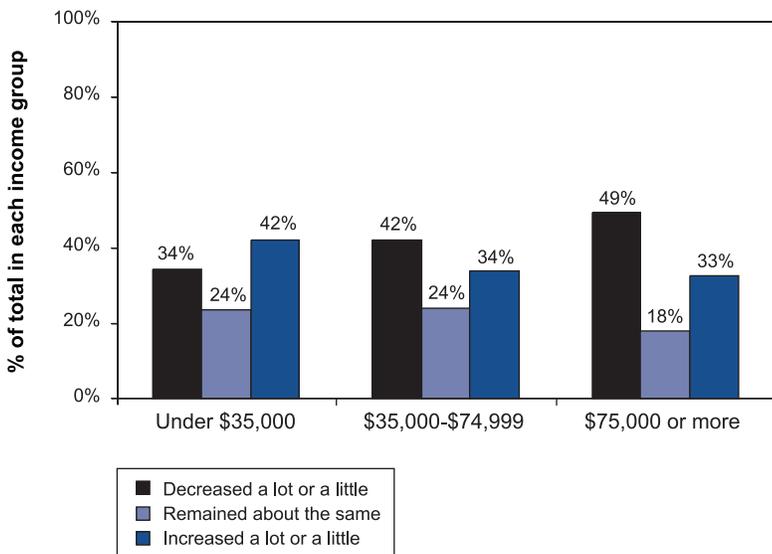


As would reasonably be expected, younger respondents were more likely to view their debt increasing as compared to their older counterparts. Specifically, 38% of respondents younger than 55 years of age reported their debt as increasing which contrasts with 28% of those 55 years of age and older. The more detailed breakdown by age produced similar results showing

that the younger the respondents, the more likely they are to report that their debt increased in the past 3 years. When respondents were grouped by the retirement criterion, the results were very similar to those generated by age grouping.

Changes in debt varied depending on respondents' income level. Those with annual household income under \$35,000 were much more likely to report increasing debt compared to respondents in other income groups (Chart 2). Also, almost half of those with household income of \$75,000 and over said their debt decreased while this proportion accounted for only one third among those with household income under \$35,000.

Chart 2 – Changes in Household Debt by Income Group



A larger proportion of households with one or more children under age 18 tended to see their debt rising when compared to those with no children. While debt increased for 32% of those with no children under age 18, the proportion climbed to 42% for those who had at least one child. When respondents were grouped by the size of household (independent from the number of children), the households consisting of two people were the least likely to report their debt increasing.

Those with annual household income under \$35,000 were much more likely to report increasing debt

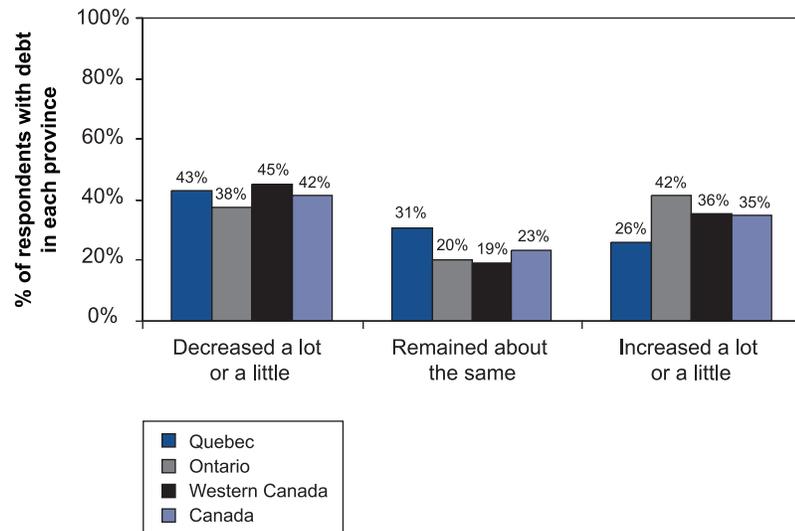
Some regional differences existed in the proportions of respondents reporting changes in their household debt (Chart 3).⁵⁸ For instance, as little as 26% of Quebec residents, but as many as 42% of Ontarians, told us their debt increased compared to the Canadian average of 35%. Also, a noticeably larger

⁵⁸ The Atlantic Provinces were not included in the regional analysis as the relatively small sample size in the region makes it difficult to drop any particular conclusion.

than average proportion of Quebec residents (31%) maintained an unchanged debt level compared to 23% of the total of all respondents who said their debt remained about the same.

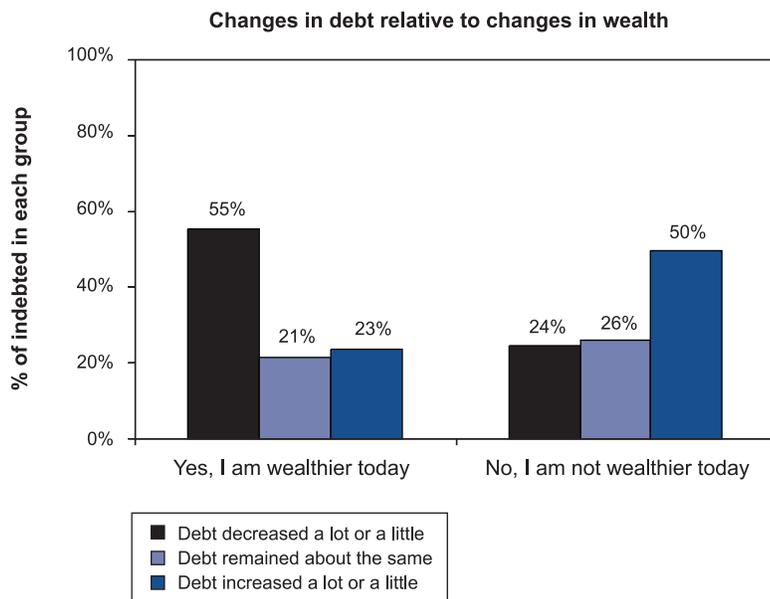
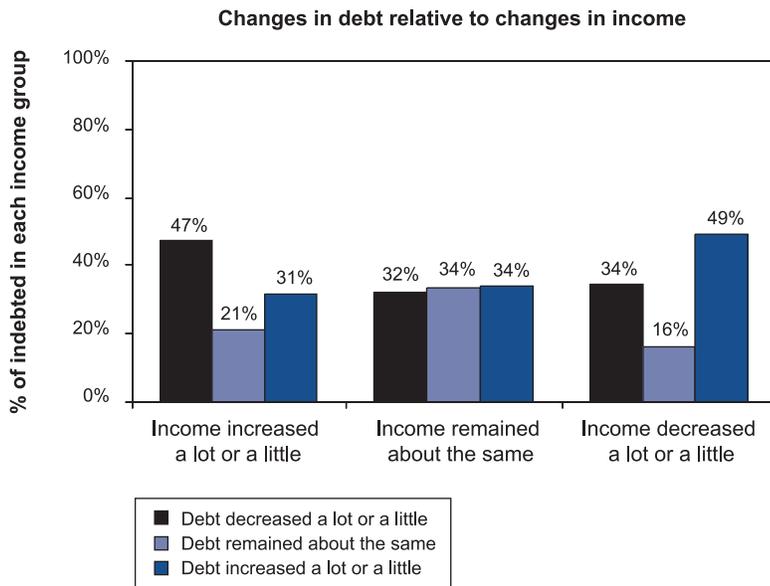
Increasing debt was not associated with an increase in income or wealth

Chart 3 – Changes in Household Debt by Region



Increasing debt was not associated with an increase in income or wealth (Chart 4). Nearly half (47%) of indebted respondents whose income increased over the past 3 years and 55% of those who felt wealthier today said their debt decreased. At the same time, individuals who saw their income decrease and/or did not feel wealthier today were also more likely to report their debt increasing. This relationship holds true when only non-retired respondents are considered.

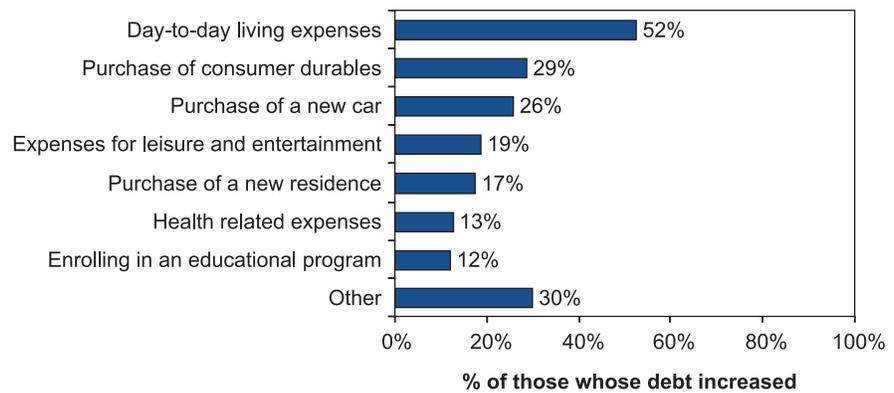
Chart 4 – Changes in Debt Relative to Changes in Income and Wealth



Meeting day-to-day living expenses and purchasing durable goods were the two main causes for the increasing debt

The majority of those with increasing household debt were either very concerned (36%) or somewhat concerned (45%) with the fact that their debt has increased. Meeting day-to-day living expenses and purchasing durable goods were identified as the two main causes for the increasing debt (Chart 5). It is considered interesting also that respondents are more likely to increase their indebtedness due to spending on leisure and entertainment rather than on purchasing a new home.

Chart 5 – Reasons for Increasing Debt



A much smaller proportion of retired respondents held debt than non-retired survey participants

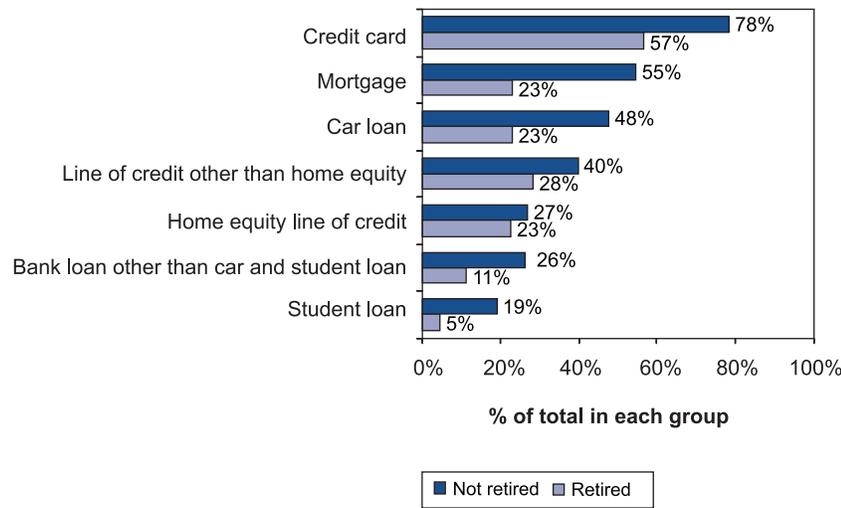
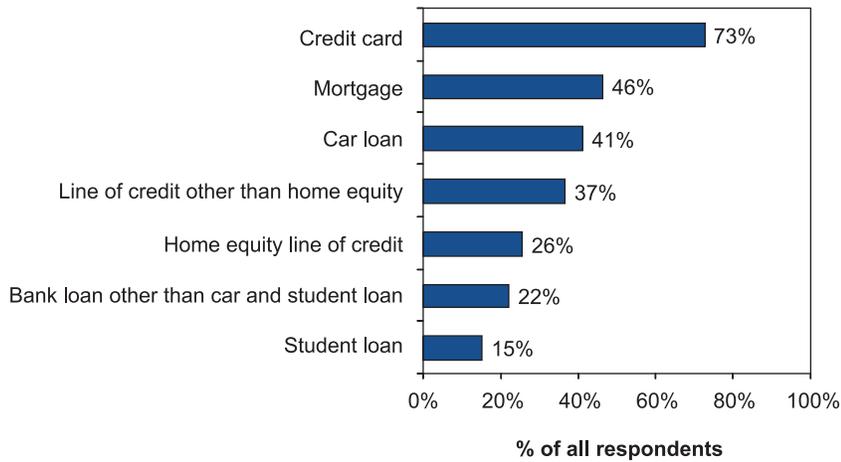
Type of Debt Held

To identify the composition of respondents’ debt portfolio, surveyed individuals were offered a list that included seven types of debt: mortgage, credit card, car loan, student loan, home equity line of credit, line of credit other than home equity, bank loan other than car and student loan.

Some 73% of all respondents had a credit card outstanding debt. Outside of credit cards, the two most popular types of debt are mortgages and car loans held by 46% and 41% of respondents respectively (Chart 6).

As may be expected, a much smaller proportion of retired respondents held debt than non-retired survey participants, especially relating to mortgages, car loans, student loans and other bank loans. However, the differences between retired and non-retired respondents were substantially less noticeable for home equity credit lines: 23% of retired participants and 27% of non-retired participants indicated having this type of debt.

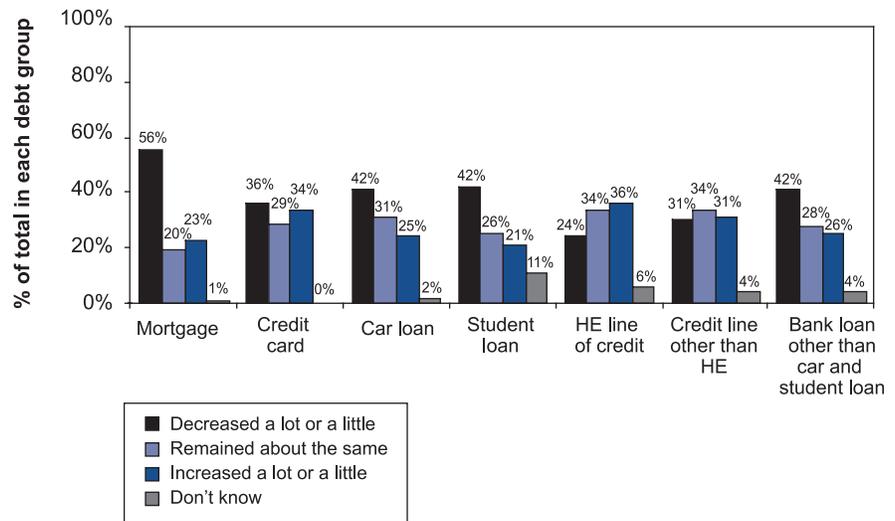
Chart 6 – Type of Debt Held by Households



The general perception regarding decreasing debt seemed to be more related to an even reduction in different types of debt rather than a significant decrease in any one type of debt. More specifically, surveyed individuals were more likely to reveal that their debt decreased rather than increased for five out seven types of debt listed in the questionnaire (Chart 7). For each type of debt, at least 20% of respondents said their outstanding balance remained about the same over the past 3 years.

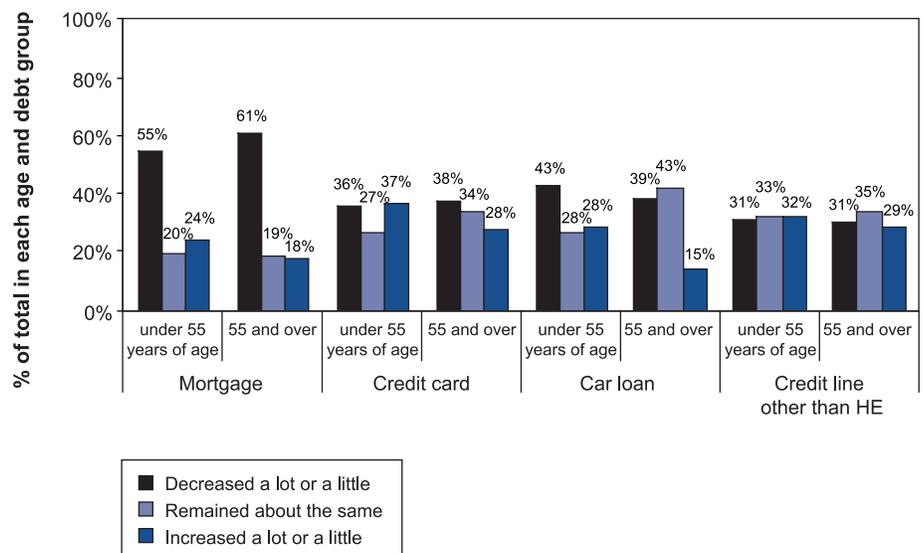
For all types of debt with the exception of credit cards, more than half of those reporting a decrease in the outstanding balance said that the debt decreased a little rather than a lot. For credit card debt, 68% of those whose outstanding balance decreased said it decreased a lot.

Chart 7 – Changes in Selected Types of Debt



Following the expected path of life-time accumulation of wealth, older respondents (55 years of age and over) were more likely to tell us that outstanding balances on their mortgages decreased (Chart 8). At the same time, a much smaller proportion of them said that their car loans and credit cards increased. When respondents were grouped by the retirement criterion, retired individuals were even less likely to report an increase in the outstanding balance on their credit cards and car loans.

Chart 8 – Changes in Household Debt by Respondents' Age Group



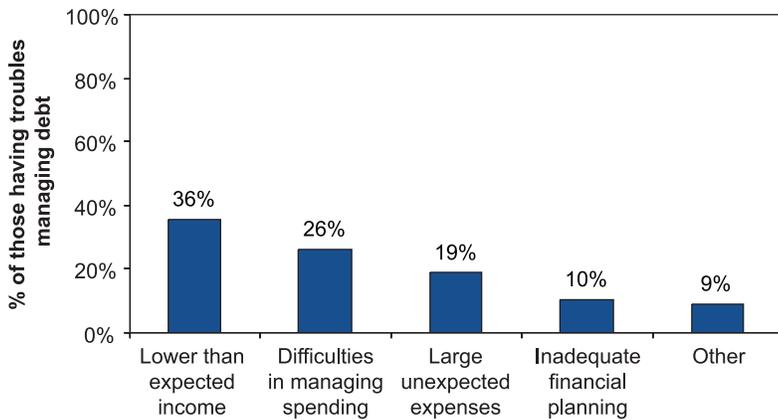
Households' Ability to Manage Debt

Only 17% of indebted respondents said they have too much of debt and have trouble managing it. The majority of respondents (65%) felt they could manage their household debt well, and some 19% suggested they could take on more debt and still manage their finances well.

For 62% of those experiencing problems in managing debt, lower than expected income or difficulties in managing their spending were two main causes cited (Chart 9). The “Other” category allowed individuals to type in their answer; however, very few respondents used this option, and responses of those who did were to a large extent related to a worse than expected income situation.

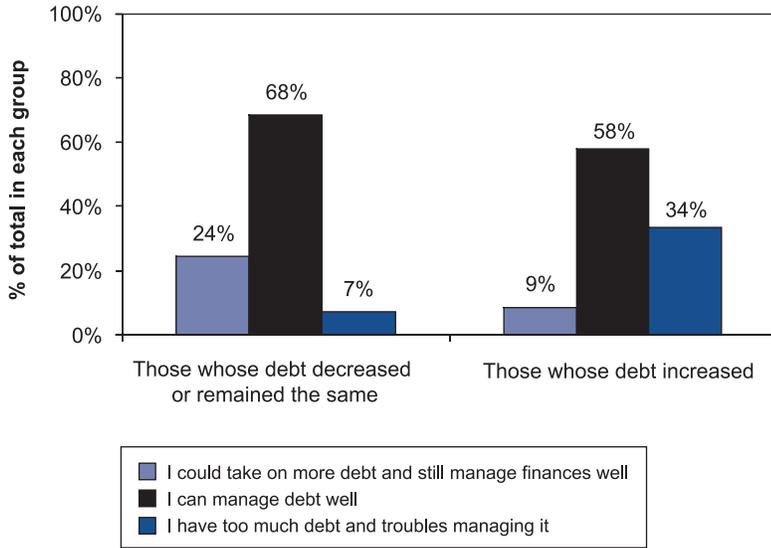
Those whose debt increased were much more likely to report troubles managing it

Chart 9 – Reasons for Having Troubles Managing Debt



Those whose debt increased were much more likely to report troubles managing it (Chart 10). Roughly one third (34%) of respondents reporting rising debt felt that way compared to only 7% of respondents whose debt decreased or remained the same over the past 3 years. However, the majority of respondents (58%) whose debt had increased still felt they could manage it well.

Chart 10 – Attitude Towards Debt

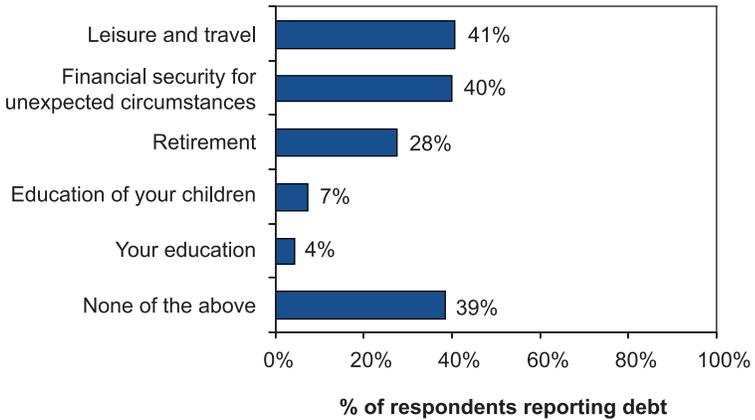


39% of indebted individuals did not feel that debt prevents them from reaching their goals

Negative Influence of Debt

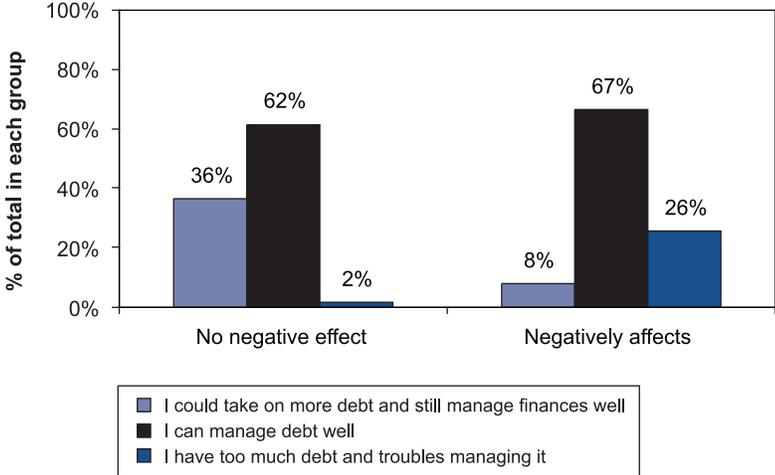
Respondents were asked whether debt negatively affects their ability to attain goals in such areas as education, retirement, leisure, travel, and financial security for unexpected circumstances. Some 39% of indebted individuals did not feel that debt prevents them from reaching goals in any of those areas (Chart 11). Among those who felt the negative influence, the two most often cited areas were leisure and travel, and financial security for unexpected circumstances: 41% and 40% of respondents indicated so respectively.

Chart 11 – Does Your Household Debt Negatively Affect Your Ability to Reach Your Goals in the Area of..



Respondents considering that household debt prevents them from reaching their goals were also much more likely to say that they have too much debt and have difficulties managing it (Chart 12). Some 26% of those negatively affected by debt told us that they have trouble managing debt while only 2% of those who felt no negative effect of debt said they have trouble managing their debt.

Chart 12 – Attitudes Towards Debt by Respondents Negatively Affected by Having Debt



Respondents Supported by Others in Their Day-to-day Living

All survey participants were at least 25 years of age. Nevertheless, some 7% of respondents said their parents or other individuals provide a substantial financial and/or in-kind support of their household’s day-to-day living. This group of respondents was dominated by younger individuals (38% were in the 25-34 year old age group); however, one quarter of the group was composed of 35-44 year old.

7% of respondents said their parents or other individuals provide a substantial financial and/or in-kind support of their household’s day-to-day living

The supported individuals were nearly as likely to be in debt as other respondents. Nine in 10 respondents receiving support also had at least one type of household debt. The overwhelming majority (94%) of these respondents had debt other than credit cards (which are known to be the most common type of debt held).

Respondents receiving support were somewhat more likely to be renters compared to the overall survey sample; however, still the majority (66%) of supported individuals either owned or were intent to buy their primary residence.

The supported respondents tended to have lower income; however, the tendency was not overwhelming. Slightly more than one third of respondents receiving support (37%) had annual household income of less than \$35,000 compared to 27% mark of all survey respondents. Interestingly, 29% of respondents receiving support reported household income of \$75,000 and higher.

Debt-free Households

16% of respondents said they did not have any debt⁵⁹. Additionally, 2% of respondents indicated “Do not have” for each of the seven types of debt listed in the questionnaire; however these individuals did not identify themselves as not having any debt.

16% of respondents
said they did not
have any debt

The debt-free respondents were much more likely to be 65 years of age or older when compared to respondents reporting debt: 49% of debt-free respondents belonged to the older age group compared to only 13% of indebted individuals. Not surprising then that 88% of debt-free respondents lived in one or two-person households and are significantly less likely to have children under the age of 18 years.

The debt-free respondents were more likely to be Quebec residents, but were somewhat under-represented in Alberta and Prairie provinces when compared to Canadian average.

Not having debt was not associated with renting. Renters accounted for only 23% among debt-free individuals while constituted 32% of those reporting debt. Similarly, debt-free respondents had a comparable to indebted individuals' likelihood of being supported by parents or other individuals in their day-to-day living.

Debt-free respondents were slightly over-represented in the lower income group (those with less than \$35,000 in household income in 2006) and somewhat under-represented in the higher income group (those with household income of \$75,000 and over). However, these differences fall within the sampling margin of error.

Those not having debt were more likely to make savings on a regular basis. This was valid for both retired and non-retired respondents.

⁵⁹ Here on, this group of respondents will be referred as “debt-free” respondents.

2. Income, Assets and Wealth

A second objective of the CGA-Canada survey was to ascertain whether the increase in debt was accompanied by a commensurate increase in income and/or wealth. Respondents were asked to describe the changes in their income, assets and wealth, and to identify negative economic shocks that may affect their financial wellbeing.

Household income

For 80% of non-retired respondents, wages and salaries were the main source of income. Only 7% relied on business income, another 6% considered government transfers as their principal source of income, and not more than 1% of non-retired respondents lived off of investment income.

As may be expected, the overwhelming majority (85%) of retired individuals had retirement income as their main income source. A slightly larger proportion of retired respondents (5%) relied on investment income compared to only 1% of non-retired respondents.

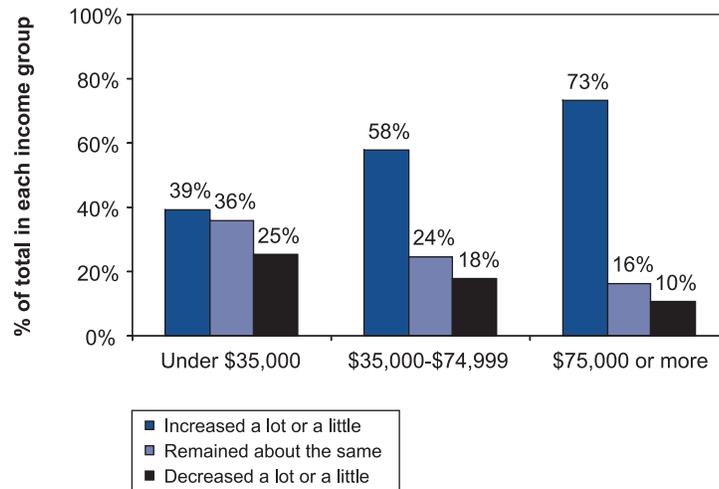
More than half of respondents (57%) said that their income increased; however, more than three quarters of those (78%) reported that their income increasing by only a little. Some 26% of respondents said their income remained about the same over the past 3 years and a relatively small number of surveyed individuals (17%) saw their household income going down in the past 3 years.

Respondents whose main source of income was government transfers other than pension were the most likely to report a decrease in household income compared to respondents with other income sources. At the same time, respondents with main income coming from business activities and those with retirement income were more likely to say that their household income decreased compared to individuals who relied on employment income; however, the difference was not very noteworthy.

Changes in income varied significantly depending on the overall income level of the respondent (Chart 13). Individuals with higher household income were more likely to see a positive change in their income compared to those with medium or lower income. Nearly three quarters (73%) of respondents with household income of \$75,000 and higher saw their income increasing over the past 3 years. This contrasted with 39% of respondents whose household income was under \$35,000. Similarly, not more than 1 in 10 respondents in the higher income group saw their income decreasing while this proportion was more than twice higher in the lower income group.

Changes in income varied significantly depending on the overall income level of the respondent

Chart 13 – Changes in Household Income



Some 22% of Canadians with household income of \$75,000 and higher felt the increase in their incomes was a significant one. This was different for lower income respondents where only 6% thought the increase in their income was significant.

Interestingly, Quebec residents tended to be more pessimistic in assessing changes in their income compared to residents of other provinces. Only 8% of Quebec participants reported their income to have increased a lot. This contrasted with 15% for those of Western Canada (SK, MB, AB, BC), and the 12% Canadian average. Quebec residents were also more likely to say that their income remained about the same or decreased compared to the Canadian average.

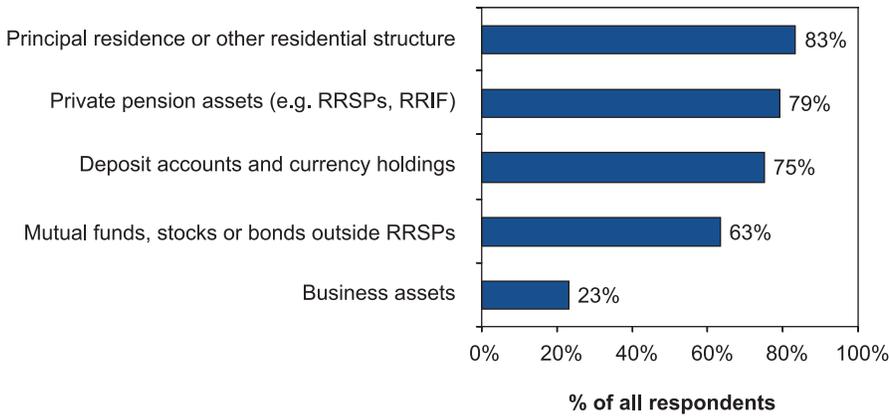
Household Assets

To identify the composition of the asset portfolio of surveyed households, respondents were offered a list of major types of assets: principal residence or other residential structure; mutual funds, stocks or bonds outside of RRSPs; private pension assets (e.g. RRSPs, RRIF); assets associated with business; deposit accounts and currency holdings.

Some 93% of respondents reported holding at least one type of assets. 83% reported having a principal residence or other residential structure, 79% said they had private pension assets and 63% held mutual funds, stocks or bonds outside RRSPs. Some 4% told us that their only assets consisted of deposit accounts and currency holdings (Chart 14).

Quebec residents tended to be more pessimistic in assessing changes in their income compared to residents of other provinces

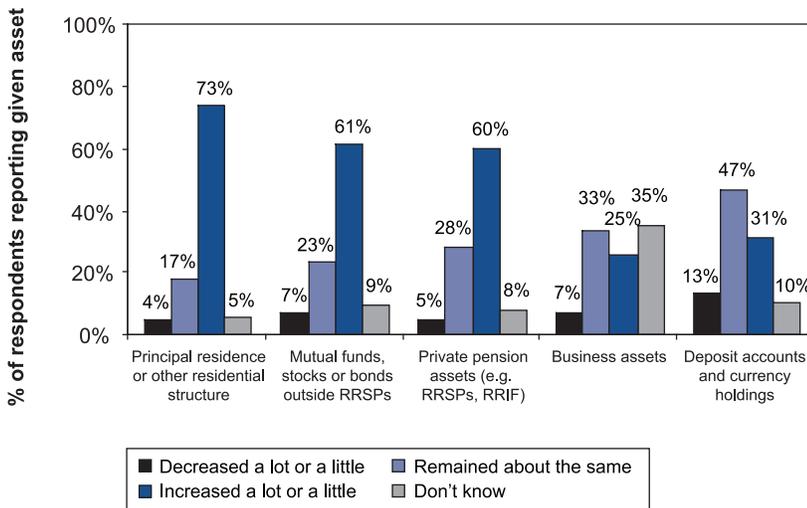
Chart 14 – Assets Held by Households



Very few respondents thought the value of their assets decreased in the past 3 years (Chart 15) with nearly three quarters (73%) of survey participants assessing that the value of their residential structures increased. Meanwhile, at least 3 in 5 respondents felt that the values of their holdings in mutual funds, stocks and bonds outside of RRSPs and private pension assets increased over the past 3 years.

Very few respondents thought the value of their assets decreased in the past 3 years

Chart 15 – Changes in Household Assets



Quite surprisingly, more than one third of respondents reporting having business assets could not say if assets values had increased, decreased or remained the same in recent years. Although of lesser magnitude, it was also revealing to learn that a noticeable proportion of respondents (10%) did not know what had happened with the value of their investments in stocks, bonds, and private pension assets.

Changes in Household Wealth Over the Past 3 Years

Despite chronicles frequently observed of the hot housing market and the overall strong economic performance in the recent years, only 57% of all surveyed respondents felt that they are wealthier today as compared to 3 years ago. The lowest level of enthusiasm was observed in Quebec where only 49% of respondents said their wealth had increased. Alberta, in turn, was the leading province with nearly 7 in 10 respondents (69%) saying they were wealthier today.

Only 57% of all surveyed respondents felt that they are wealthier today as compared to 3 years ago

As may be expected, retired respondents tended to be less optimistic about their wealth with 47% of current retirees, compared to 60% of non-retired respondents, reporting increased wealth.

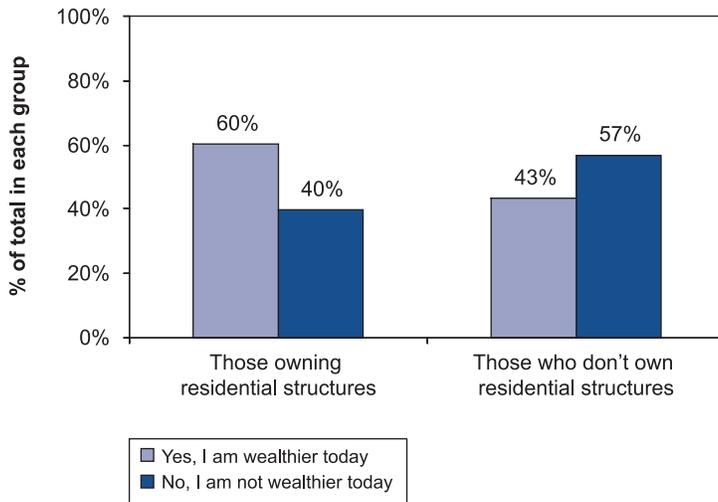
Changes in income influenced significantly respondents' perception of changes in their wealth. 72% of those whose income increased felt wealthier while only 28% of those whose income decreased felt the same way.

Debt, in turn, did not seem to influence the perception of wealth. When only non-retired respondents are considered, an almost identical proportion of indebted and debt-free respondents agreed they are wealthier today.

Respondents who save on a regular basis tended to more often agree that their wealth increased: 66% of those who saved regularly felt that way while only 36% of those who did not save felt wealthier today.

Home ownership seemed to be reflected in the respondents' perception of wealth; however not to the degree that may be expected given the recent strong performance of the housing market. Among those reporting residential structures as part of their assets, only 60% felt their wealth increased over the past 3 years. This proportion accounted for 43% of those who did not own residential structures (Chart 16). Furthermore, some 28% of respondents who said the value of their residential structures increased a lot still did not feel wealthier today.

Chart 16 – Changes in Respondent’s Wealth



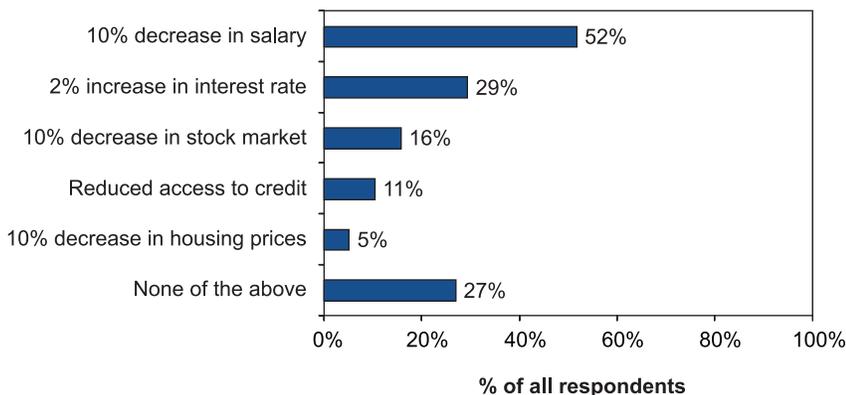
Household Sensitivity to Shocks

Survey respondents were asked which of the following events would have noticeable negative implications for their financial wellbeing: a 2 percentage point increase in interest rates, a 10% decrease in housing prices, a 10% decrease in the stock market, a reduced access to credit, and a salary decrease of 10%.

The most often cited sensitivity point was changes in salary with more than half of all respondents (52%) believing that their financial wellbeing would be noticeably affected by a 10% salary decrease (Chart 17). Nearly one third of those surveyed (29%) felt vulnerable to hikes in interest rates while but only 1 in 20 (5%) respondents felt that a 10% decrease in housing value would affect their financial wellbeing. Of those who owned residential structures, more than 94% did not feel that a moderate decline in the housing market would negatively affect them.

94% of homeowners did not feel that a moderate decline in the housing market would negatively affect them

Chart 17 – Household Sensitivity to Negative Shocks



27% of respondents saw no threat to their financial wellbeing if a moderate economic shock was to take place

Slightly more than one quarter of all respondents (27%) saw no threat to their financial wellbeing if any of the mentioned events were to take place. These respondents were primarily from the lower income group (under \$35,000), had lower educational attainment (43% had completed high schools or less), were 3 times more likely to be 65 years of age or over, somewhat more likely to be renters rather than owners/buyers of a primary residence, much more likely to be female, and less likely to report increase in household income and expenditure.

Although respondents could indicate multiple sources of vulnerability, 45% of respondents felt that their financial wellbeing may be noticeably affected by only one of the mentioned events. Another 19% thought they are vulnerable more than one threat.

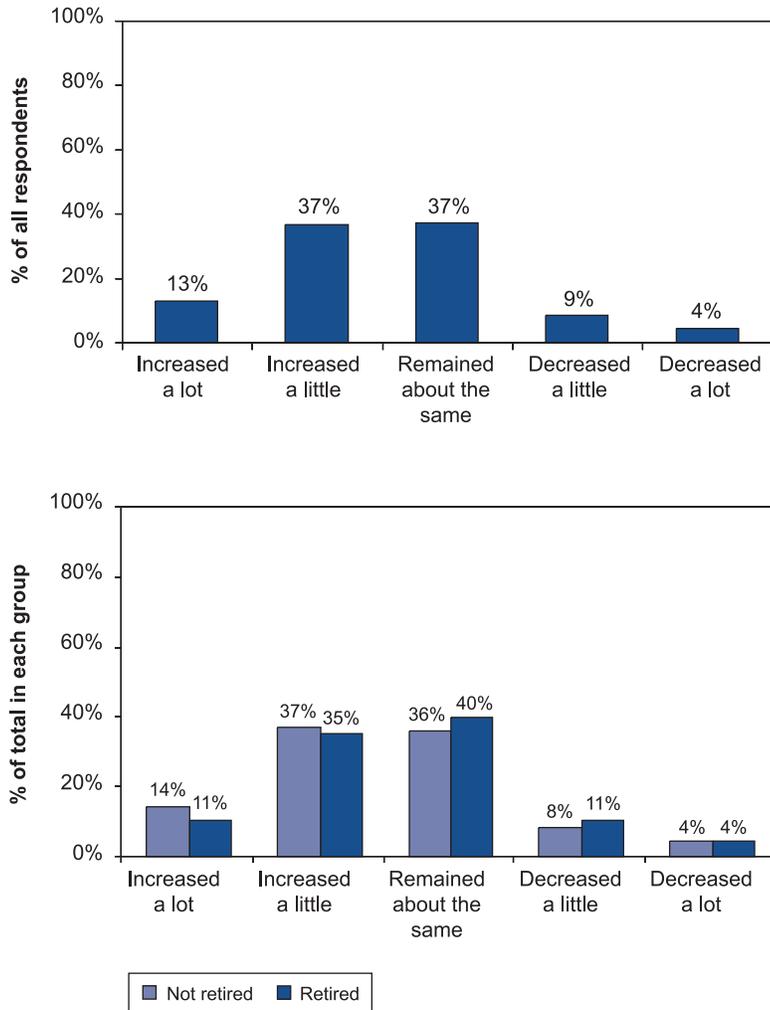
3. Household Spending

The survey went on to understand if changes in debt and wealth led to changes in household spending. The survey sought respondents' opinion on changes in their expenditures and the underlying reasons for that as well as the respondents' level of comfort in dealing with unexpected expenditures.

Changes in Household Spending Over the Past 3 Years

Only a small proportion of respondents felt that their expenditure outlays increased significantly over the past 3 years. The overwhelming majority (74%) of surveyed reported their expenditure remaining either about the same or increasing a little. When retired and non-retired respondents were considered separately, no significant difference was observed in the pattern of changing expenditure (Chart 18).

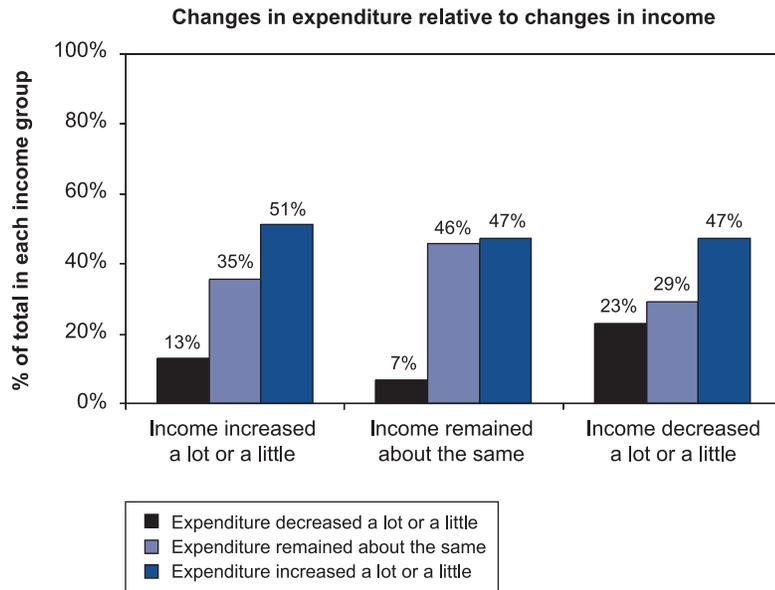
Chart 18 – Changes in Household Expenditure



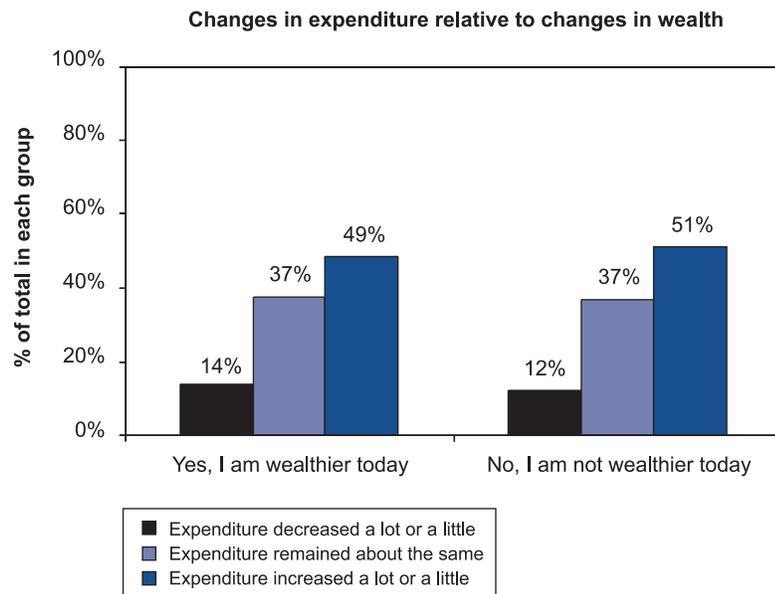
An increase in household income was not necessarily transmuting into increasing expenditure. No matter if respondents' income increased, decreased or remained about the same, very similar proportions of surveyed (between 51% and 47%) reported their expenditure to have increased over the past 3 years (top part of Chart 19). Those who told us that their incomes increased a lot were only somewhat more likely to see their expenditure increased compared to all other respondents.

An increase in household income was not necessarily transmuting into increasing expenditure

Chart 19 – Changes in Expenditure Relative to Changes in Income and Wealth



Change in wealth did not seem to affect changes in household expenditure



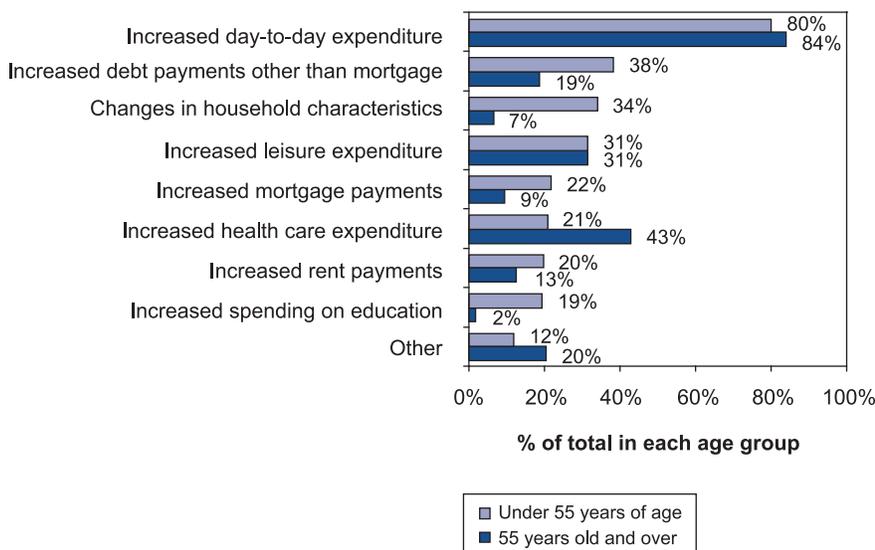
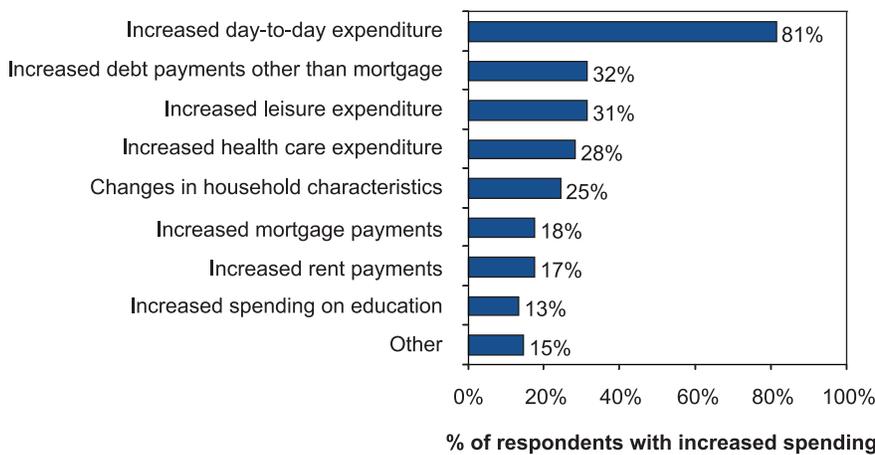
Change in wealth did not seem to affect changes in household expenditure either. Conversely, those who felt their wealth had increased over the past 3 years were actually less likely to say that their expenditure increased over the same period of time (bottom part of Chart 19).

The overwhelming majority of respondents (88%) said that their household expenditures were usually contained to or less than their household income. The remaining 12% of respondents felt that their spending exceeds their income.

The survey respondents were offered a list of nine items indicating possible reasons for increasing household expenditure. An overwhelming majority (81%) of individuals whose expenditures increased over the past 3 years said it was caused by rising day-to-day spending (top part of Chart 20). Only one third of respondents felt that increased non-mortgage debt payments and leisure expenditure contributed to the rise in spending.

81% of individuals whose expenditures increased over the past 3 years said it was caused by rising day-to-day spending

Chart 20 – Reasons for Increased Household Spending



One in five Canadians would not be able to handle an unforeseen expenditure of \$5,000

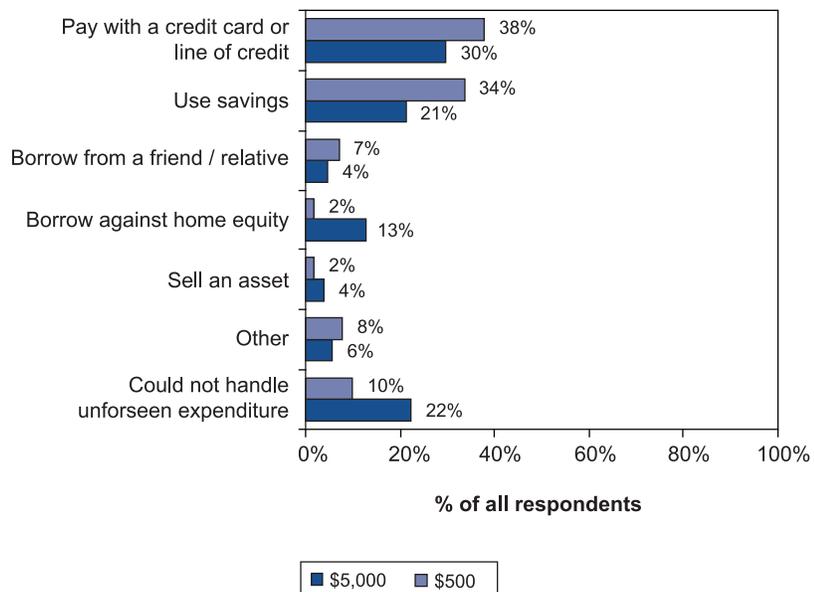
Dividing respondents into two age groups of under and over 55 years of age showed differences in the causes of increasing spending. A much larger proportion of young respondents felt that their spending was affected by an increase in mortgage and non-mortgage debt payments, changes in household characteristics and increased spending on education. Older respondents, in turn, were much more likely to say that their expenditures were affected by increasing healthcare spending (bottom part of Chart 20).

Respondents' Ability to Handle Unforeseen Expenditure

In the event of unforeseen expenditure, Canadians would most often rely on credit cards or lines of credit to cover costs with 38% of respondents dealing with a \$500 unexpected outlay. Meanwhile 30% would do so if they were required to pay an unpredicted \$5,000 (Chart 21). The second most popular way of covering an unexpected expense was by dipping into savings. Such options as borrowing from a friend, selling assets or using home equity were not often chosen by respondents. However, the likelihood of using home equity was considerably more enticing for an expense of \$5,000 than for the smaller \$500 expense.

One in five Canadians would not be able to handle an unforeseen expenditure of \$5,000. More disturbing though is that 1 in 10 Canadians would not be able to manage a \$500 unforeseen expense - an amount which hardly could be seen as a large one by many.

Chart 21 – Ways of Handling Unforeseen Expenditure of \$500 and \$5,000



Some 33 survey respondents (3.3% of the total sample) said they could not handle an unforeseen expense of \$500 but could handle an unforeseen expense of \$5,000. Ten of these respondents would handle the \$5,000 expense by tapping into the home equity; another 7 would use credit cards or lines of credit while 8 respondents would use a way other than those listed in the questionnaire.

Indebted households were more likely to say they could not handle an unforeseen expenditure of \$5,000 compared to those who reported not having any debt. Also, those who could not handle an unforeseen expenditure were more likely to report that their debt increased a lot or a little over the last 3 years and tended to have higher level of concern regarding the rising debt. They were about three times more likely to feel that they have too much debt and that they have difficulties in managing it.

Younger and middle age respondents tended to have more difficulties in handling both small and large unforeseen expenditures. In either instance of the smaller or larger unanticipated outlay, the proportion of respondents over the age of 55 years was lower among those who could not handle unforeseen expenditure compared to those who could. Respondents with one or more children under 18 years of age were more likely to have difficulties in handling unforeseen expenditure.

Females were much more likely to tell us that they are not able to handle an expense of \$500 (62% females vs. 38% of males). The same was valid for an expense of \$5,000; however, the tilt towards females was less noticeable (56% females vs. 44% males).

Respondents with household income under \$35,000 and those not saving on a regular basis were at least twice more likely of not being able to handle an unforeseen expenditure.

4. Savings and retirement

The final objective of the survey intended to understand respondents' expectations about the main source of their pension income and their level of confidence in their financial situation for retirement. The respondents were also asked to reflect on their savings goals for retirement and for other purposes.

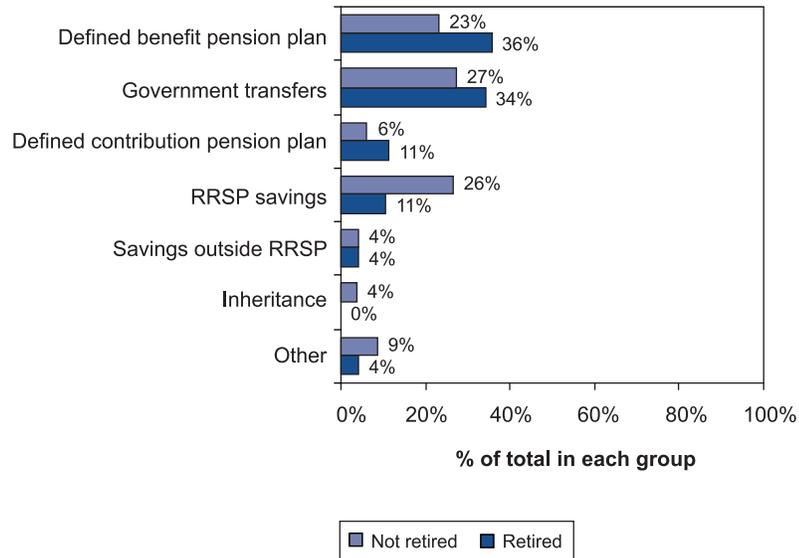
Expected Sources of Pension Income

There were noticeable differences in opinion between retired and non-retired respondents regarding the expected main source of pension income. Government transfers were important for both groups of respondents, though slightly less for non-retired individuals. A much smaller cohort of non-retired respondents (23%) said they would rely on defined benefit pension plans compared 36%

26% of non-retired respondents expect RRSPs to be the main source of retirement income

of already retired respondents. Conversely, only 11% of retired Canadians rely on RRSP savings while a more than twice larger proportion of non-retired respondents (26%) expect RRSPs to be the main source of retirement income (Chart 22).

Chart 22 – Primary Source of Pension Income



As may be expected, non-retired respondents with low household income (under \$35,000) showed much higher reliance on government transfers as the source of pension income when compared to other income groups. Similarly, among all income groups those with household income of \$75,000 and higher were more likely to expect that their retirement income will mainly come from RRSP savings.

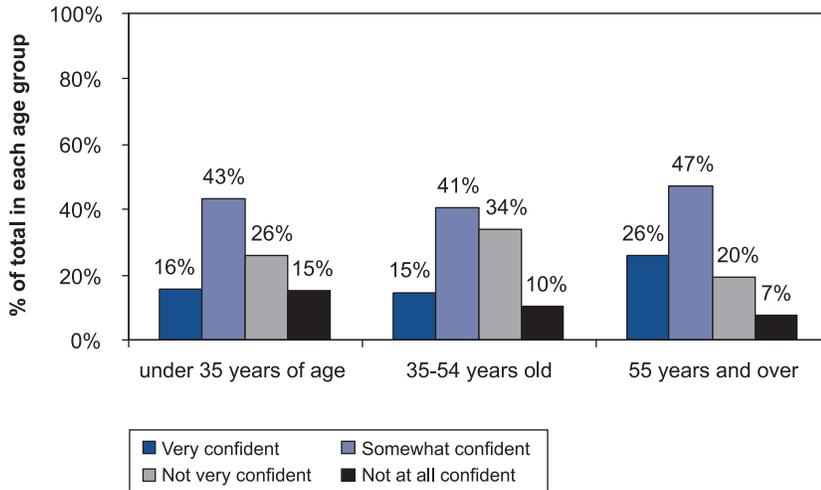
4 in 10 respondents did not feel confident that their financial situation at retirement will be adequate

Confidence Regarding the Financial Situation at Retirement

Nearly 4 in 10 respondents (38%) did not feel confident that their financial situation at retirement will be adequate. Older respondents were the most positive with nearly three quarters of them (73%) being either very or somewhat confident about their financial condition at retirement. However, some 21% of those who has already retired were still not at all or not very confident that their situation will be adequate.

Expectedly, wealth perception affects significantly respondents’ assessment of their readiness for retirement. While 77% of those who thought they are wealthier today were very or somewhat confident about their financial situation at retirement while this proportion was only 44% among those who did not feel their wealth has increased.

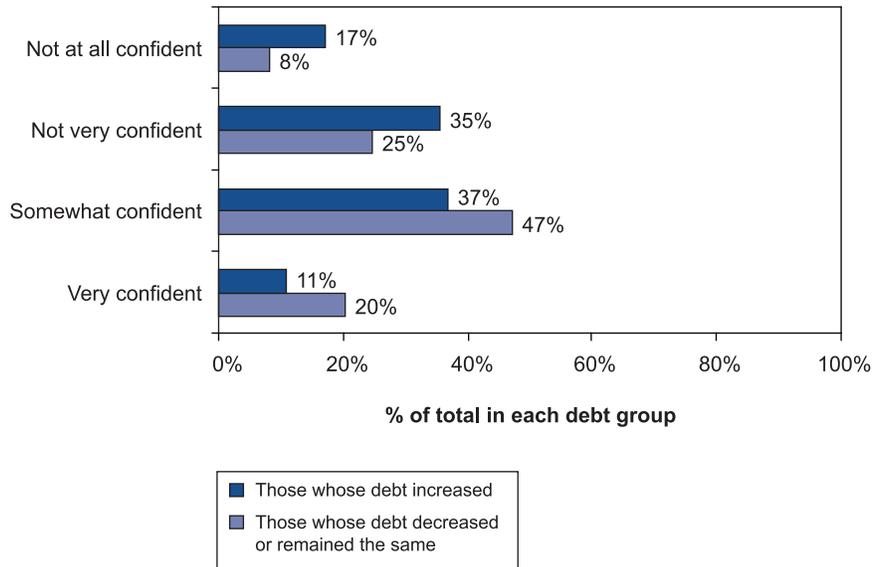
Chart 23 – Level of Confidence Regarding the Adequacy of Financial Situation at Retirement, by Age Group



Level of confidence regarding financial situation at retirement was also influenced significantly by the level of income. The proportion of non-retired respondents (32%) with household income under \$35,000 who felt at least somewhat confident on this matter was more than twice lower than the proportion of non-retired respondents (72%) with household income of \$75,000 and higher.

More than half (52%) of those with increasing debt did not feel confident that their financial situation at retirement will be adequate (Chart 24). This, however, may also be influenced by the fact that respondents with increased debt tended to be younger than the overall survey population, and that younger respondents overall tended to have lower level of confidence regarding their situation at retirement.

Chart 24 – Level of Confidence Regarding the Adequacy of Financial Situation at Retirement, by Debt Situation

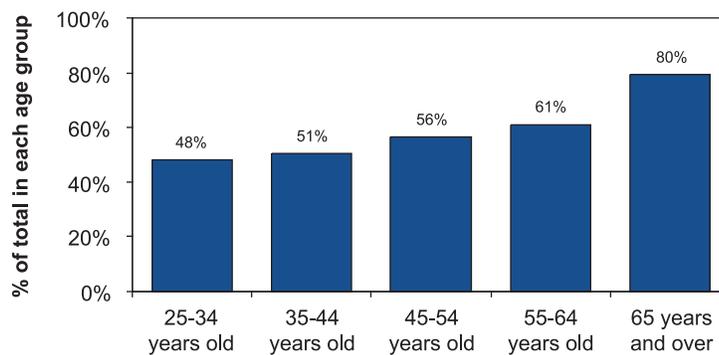


Clear Idea of Necessary Pension Savings

Non-retired respondents were almost equally divided in their responses when asked if they had a clear idea of personal savings needed to achieve an adequate financial condition at their retirement. Some 52% said that they knew how much they needed to save while 48% did not know. For already retired respondents, 24% still did not have a clear idea of what level of personal savings would provide them with a financially adequate retirement.

The clarity of the idea regarding the amount of private pension savings seems to be crystallizing with age. Slightly less than half (48%) of young respondents had a clear idea of what amount of retirement savings they need to accumulate. This proportion went up to 80% for individuals of 65 years of age and older (Chart 25).

Chart 25 – Respondents With a Clear Idea of the Amount of Retirement Savings They Need to Accumulate



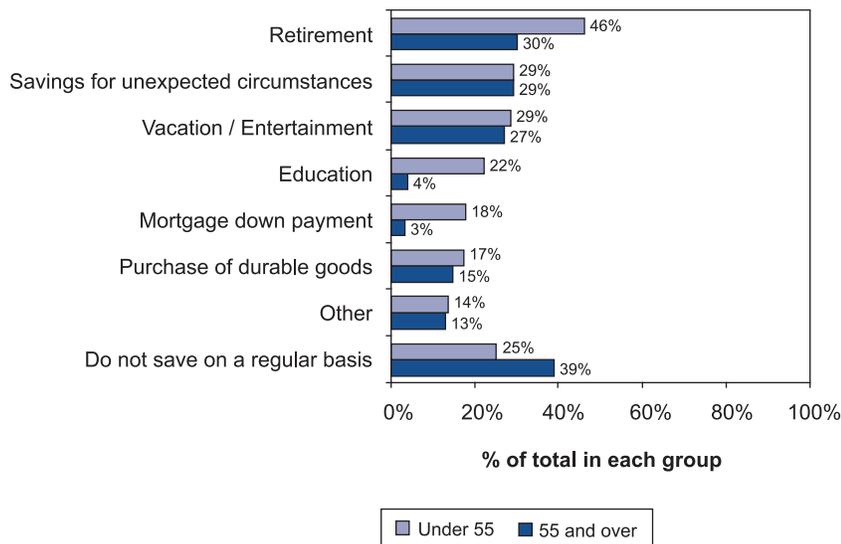
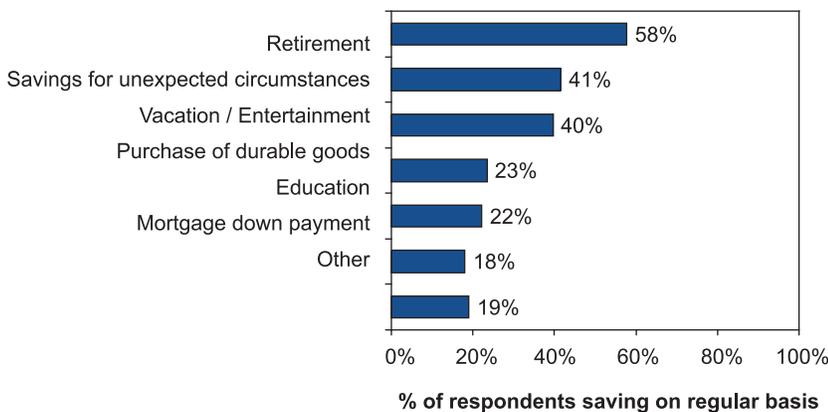
Among non-retired respondents who expected to receive their pension income from either RRSPs, from savings outside of RRSPs, and/or from inheritance, some 38% did not have a clear idea of how much they need to earmark to render their retirements financially comfortable.

30% of the survey respondents do not place any type of regular savings

Respondents' Regular Savings

Some 30% of the survey respondents do not place any type of regular savings. Moreover, 21% of respondents whose household expenditure are usually less than household income still do not make regular savings. Those who save, do so mainly for retirement, financial security for unexpected circumstances and vacation /entertainment activities (Chart 26)

Chart 26 – Purpose of Regular Saving



Respondents not yet having retired and renting their principal residence are more likely to make regular savings for vacation than for mortgage down payment

The stated purpose of regular savings is affected by the age of respondents. For instance, when respondents were divided into two age groups of less than 55 years of age and 55 years of age and older, the younger group was much more likely to make regular savings for education and mortgage payments. Similarly, younger respondents were more likely to save for retirement and to make regular savings overall. It is worth noting that 24% of retired respondents indicated that they still regularly save for retirement; however, only a very minor number of these individuals did not feel confident about the adequacy of their financial situation at retirement.

We find it interesting also that respondents not yet having retired and renting their principal residence are more likely to make regular savings for vacation than for mortgage down payment. Some 20% of renters said they save regularly for entertainment purposes, while 10% save for a down payment.

Appendix B: Survey Questionnaire

9

Q.1 Thinking of the level of your overall household debt over the past 3 years, would you say it has... (Please select one)

- a. Decreased a lot
- b. Decreased a little
- c. Remained about the same
- d. Increased a little
- e. Increased a lot
- f. I don't have any debt

[Prog: if I don't have any debt in Q1, skip to Q8]

[Prog: if decreased a lot, decreased a little or remained about the same in Q1, skip to Q4]

Q.2 Which of the following best describes the level of your concern regarding the increasing debt? (Please select one)

- a. Very concerned
- b. Somewhat concerned
- c. Not very concerned
- d. Not at all concerned

Q.3 Which of the following best describe the main reasons for the increase in your household debt? (Please select all that apply)

- a. Purchase of a new residence
- b. Purchase of a new car or other motor vehicle
- c. Enrolling in an educational program (you or any other member of your household)
- d. Health care related expenses
- e. Expenses for travel, leisure and entertainment
- f. Purchase of consumer durables (e.g. appliances, electronic equipment, furniture, recreational/sporting goods, etc.)
- g. Day-to-day living expenses (e.g. food, clothing, transportation)
- h. Other

Q.4 Please describe any changes in the level of outstanding debt for the following types of your household's loans and credits over the past 3 years: (Please select one response for each item)

[Prog: grid]

- a. Decreased a lot
- b. Decreased a little
- c. Remained about the same
- d. Increased a little
- e. Increased a lot
- f. Do not have
- g. Don't know

[Prog: list]

- a. Mortgage
- b. Credit card
- c. Car loan
- d. Student loan
- e. Home equity line of credit
- f. Line of credit other than home equity
- g. Bank loan other than car and student loan

Q.5 Which of the following best describes the way you feel about your household debt level? (Please select one)

- a. I could take on more debt and still manage my finances well
- b. I can manage my debt well
- c. I have too much debt and am having trouble managing it

[Prog: if I could take on more debt or I can manage my debt well in Q5, skip to Q7]

Q.6 Which of the following best describes the reasons for having troubles managing your debt? (Please select one)

- a. Lower than expected income
 - b. Large unexpected expenses
 - c. Inadequate financial planning
 - d. Difficulties in keeping spending within planned limits
 - e. Other (please type in)
-

Q.7 Would you say that your household debt negatively affects your ability to reach your goals in any of the following areas? (Please select all that apply)

- a. Your education
- b. Education of your children
- c. Retirement
- d. Leisure and travel
- e. Financial security for unexpected circumstances
- f. None of these apply

Q.8 What would best describe the main source of your household income? (Please select one)

- a. Wages, salaries and commissions
- b. Business income
- c. Investment income
- d. Government transfer payments other than pension (e.g. employment insurance, social assistance, workers compensation benefits, child tax benefits, etc.)
- e. Retirement income
- f. Other

Q.9 Thinking of the level of your household income over the past 3 years, would you say it has... (Please select one)

- a. Increased a lot
- b. Increased a little
- c. Remained about the same
- d. Decreased a little
- e. Decreased a lot

Q.10 Which of the following would have noticeable negative implications for your financial wellbeing? (Please select all that apply)

- a. An increase in interest rates of 2 percentage points
- b. A decrease in housing prices of 10 percent
- c. A decrease in the stock market of 10 percent
- d. A reduced access to credit
- e. A salary decrease of 10 percent
- f. None of these

Q.11 Please describe any changes in the value of your household assets over the past 3 years... (Please select one response for each item)

[Prog: grid]

- a. Decreased a lot
- b. Decreased a little
- c. Remained about the same
- d. Increased a little
- e. Increased a lot
- f. Don't know
- g. Do not have this household asset

[Prog: list]

- a. Principal residence or other residential structures
- b. Mutual funds, stocks or bonds that are not part of RRSPs
- c. Private pension assets (e.g. RRSPs, RRIF)
- d. Assets associated with your business
- e. Deposit accounts, currency holdings

Q.12 Which of the following best describes changes in your household expenditures over the past 3 years? My household expenditures have... (Please select one)

- a. Decreased a lot
- b. Decreased a little
- c. Remained about the same
- d. Increased a little
- e. Increased a lot

[Prog: if decreased a lot, decreased a little or remained about the same in Q12, skip to Q14]

Q.13 Which were the reasons for the increase in your household expenditures? (Please select all that apply)

- a. Increased mortgage payments
- b. Increased rent payments
- c. Increased spending on health and medical services
- d. Increased spending on education
- e. Increased day-to-day expenditures (e.g. food, clothing, transportation)
- f. Increased leisure and travel expenses
- g. Increased credit/loan payments other than mortgage
- h. Changes in household characteristics (e.g. addition of a new member, moving to another location, etc.)
- i. Other

Q.14 Would you say your household expenditures usually... (Please select one)

- a. Exceed your household income
- b. Equal your household income
- c. Are less than your household income

Q.15 How would you handle an unforeseen expenditure of... (Please select one for each expenditure level)

[Prog: grid]

\$500
\$5,000

[Prog: list]

- a. Pay with a credit card or line of credit
- b. Borrow against home equity
- c. Borrow from a friend / relative
- d. Sell an asset
- e. Use savings
- f. Other
- g. Could not handle unforeseen expenditure

**Q.16 What do you expect will be the main source of your pension income?
(Please select one)**

- a. Government transfers (e.g. CPP / QPP, OAS, GIS)
- b. Defined benefit pension plan provided by employer
- c. Defined contribution pension plan
- d. RRSP savings
- e. Savings outside RRSP
- f. Inheritance
- g. Other

Q.17 How confident you are that your financial situation at retirement will be adequate? (Please select one)

- a. Very confident
- b. Somewhat confident
- c. Not very confident
- d. Not at all confident

**Q.18 For which of the following purposes would you say you make regular savings (e.g. bi-weekly, monthly, every paycheque, etc.)
(Please select all that apply)**

- a. Retirement
- b. Education (yours or your children)
- c. Mortgage down payment
- d. Purchase of durable goods (e.g. furniture, appliances, electronic equipment, sporting goods, etc.)
- e. Vacation / entertainment
- f. Financial security for unexpected circumstances (e.g. unexpected loss of income, unexpected health care expenses, etc.)
- g. Other purpose(s)
- h. I do not save on a regular basis

Q.19 Please indicate which of the following statements applies to you...

[Prog: grid]

Yes

No

[Prog: list]

- a. I have a clear idea of the amount of personal savings I need to accumulate in order to assure that my financial situation at retirement will be adequate
- b. I am wealthier today compared to 3 years ago
- c. My parents or other individuals provide a substantial financial and/or in-kind support of my household's day-to-day living

These last questions are for classification purposes only.

Ask all:

Q.20 Please tell us, altogether, including yourself, how many people live in your household? (Please select one answer only)

- a. One
- b. Two
- c. Three
- d. Four
- e. Five
- f. Six or more

[Prog: if Q20 is one, skip to Q22]

Q.21 And, how many people in your household are under 18 years? (Please select one)

- a. None
- b. One
- c. Two
- d. Three
- e. Four
- f. Five
- g. Six or more

Q.22 Which of the phrases listed below best describes your current living situation? (Please select one)

- a. Single/Not living with a partner
- b. Married/Living with a partner
- c. Separated
- d. Divorced
- e. Widowed

Q.23 Which of the following best describes your employment status? (Please select one answer only)

- a. Employed full time
- b. Employed part time
- c. Self employed
- d. Full time student
- e. Homemaker
- f. Retired
- g. Temporarily unemployed
- h. Other

Q.24 Which of the following best describes your ++total++ annual household income, in 2006? (Please select one answer only)

- a. Under \$15,000
- b. \$15,000 - \$24,999
- c. \$25,000 - \$34,999
- d. \$35,000 - \$49,999
- e. \$50,000 - \$74,999
- f. \$75,000 - \$99,999
- g. \$100,000 or more
- h. Don't know

Thank and close interview

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