Canadians Now Have More Debt Than Ever

Description

On Tuesday Statistics Canada reported that the debt-to-disposable income ratio for the average Canadian is 165%, near record highs. For every $1 of disposable income, the average person now has $1.65 in debt. Canada has seen the largest increase in household debt relative to income of any major developed country since 2000.

Worryingly, the parliamentary budget office also recently released a report predicting that debt levels will continue to rise over the next five years as interest rates normalize. “Household debt-servicing capacity will become stretched further as interest rates rise to ‘normal’ levels over the next five years,” the report said. “Based on PBO’s projection, the financial vulnerability of the average household would rise to levels beyond historical experience.”

High debt levels aren’t the only issue either. Is the Canadian economy teetering on the edge of ruin? If so, how should you invest?

A mortgage crisis waiting to happen

Total household debt last quarter, including both consumer credit and loans, now totals $1.9 trillion. However, most of that ($1.3 trillion) is mortgage-related debt. That could present a major headwind should the growth in home prices start to slow.

According to real estate company Royal LePage, “Demand for expensive luxury homes in [Vancouver and Toronto] is at the highest on record so far this year.” Average housing prices across Canada are up 60% since 2008 with the hottest markets seeing prices rise over 100%.

According to **Bank of Montreal** (TSX:BMO)(NYSE:BMO), the rapidly rising real estate market will end poorly for consumers, lenders, and the economy as a whole. “Odds are that if this kind of price growth continues, it will end badly,” a bank analyst said in a research note. Bank of Canada governor Stephen Poloz has said that over 720,000 households could struggle to make debt payments during a downturn.

For now, newly implemented federal regulations designed to slow down price gains has helped delay a collapse. These rules, which were introduced in February, require higher minimum down payments on certain properties. The minimum down payment for new mortgages above $500,000 doubled to 10%. The minimum down payment for homes over $1 million remains unchanged at 20%.

Still, the average mortgage interest rate has fallen from 6.7% in 1999 to just 3.1% this year, fueling the rampant accumulation of mortgage-related debt.

The question is when, not if

Every housing bubble comes to an end; it's just a matter of when. According to *CBC News*, the Canadian central bank "has argued that the likelihood of household debt levels becoming a serious problem remains low and the situation is likely to improve once the economy starts to recover."

That's hard to believe, however, given that in the same report, it highlights numerous "potential hazards linked to high household debt—particularly if the country were hit by a severe recession or a prolonged period of increasing unemployment."

As an investor, take a look at where your real estate exposure is. Many banks such as Bank of Montreal and **Royal Bank of Canada** (TSX:RY)(NYSE:RY) are overexposed to specific regions. Understanding where your risks are will be important no matter what the real estate market does.

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