Retirees: This $100 Billion Time Bomb Could Wreck your RRSP!

Description

Canadians depend on RRSPs to carry them through retirement. That's the conclusion of Statistics Canada data for 2016, which showed that 65% of Canadians households contributed to an RRSP that year.

Although the *number* of RRSP contributors has declined slightly (possibly due to the rise of TFSAs), the amount contributed is up, suggesting that some Canadians are increasing their retirement savings to stay afloat in the future.

This trend coincides with the decline of defined-benefit pension plans, leaving fewer and fewer Canadians with substantial retirement income.

The conclusion for retirees is obvious:

If you think you need a well funded RRSP to retire comfortably, you're probably right.

Although CPP enhancement is set to increase payouts from 1/4th to 1/3rd of income, it will be decades before these benefits kick in. For those already nearing retirement age without a public service pension, RRSPs are becoming increasingly necessary.

Unfortunately, there is a major development looming on the horizon that threatens many Canadians' RRSP holdings.

Canadian consumer debt

It's no secret that Canadian consumer debt is on the rise. What's less well known is just how quickly it has risen. According to a recent TransUnion report, Canadian credit card debt hit $100 billion in the third quarter of 2019.

An all-time high, the figure coincided with increases in bank Provisions for Credit Losses (PCLs) and Canadians reporting that their debt is unmanageable.

Why it could be disastrous for RRSPs

The reason why rising consumer debt is alarming is because many RRSP portfolios are heavily weighted in banks. Banks make up about 32% of the **TSX**'s market cap, and an even greater percentage of the **TSX 60.**

While some Canadian banks, like **TD** and **Scotiabank,** are diversified across various countries, most aren't diversified to any significant degree.

Consider **Royal Bank of Canada** (TSX:RY)(NYSE:RY). In its most recent quarter, $4.2 billion of its revenue came from Canadian personal & commercial banking, compared to just $247 million for U.S. and Caribbean banking.

U.S. and global wealth management together made up about $2.2 billion, bringing the international total higher, but overall, the vast majority of Royal Bank's revenue came from Canadian borrowers.

What this means is that the Royal Bank is highly vulnerable to any weakness in Canadian consumer credit quality–and we're seeing ample evidence that Canadian consumer credit quality is declining.

Not only are Canadian banks reporting higher PCLs, but the credit unions themselves are also sounding the alarm about unmanageable debt, making it quite likely that defaults will rise in the years ahead.

What to do

If you're concerned that declining consumer credit quality could harm your RRSP portfolio, you have a few options available to you. One is to buy government bonds, which are generally considered safe during economic downturns or even banking crises.

Another option to buy U.S. funds, such as the **Vanguard S&P 500 Index Fund**, as they're much less weighted in financials than Canadian ETFs.

A final option is to consider Canadian utility stocks, which, like the big banks, are pretty reliable dividend payers, only much less vulnerable to the consumer credit market. Whatever you do, make sure you diversify, and as always, do your research before buying anything.

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