ECONOMIC VIEWPOINT

Quebecers' Rising Debt at the Beginning of the Pandemic Affected Some Borrowers More than Others

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Although Quebecers' financial situation has improved overall since the start of the pandemic, significant disparities have deepened when it comes to debt. Some categories of borrowers used more debt and now appear to be more vulnerable in terms of their ability to meet their financial obligations. In a context of rising interest rates and slowing residential real estate activity, it is important to develop a profile of the borrowers most at risk. An in depth analysis of debt according to various segments of the population helps shed some light in that respect.

Beyond the Bigger Picture

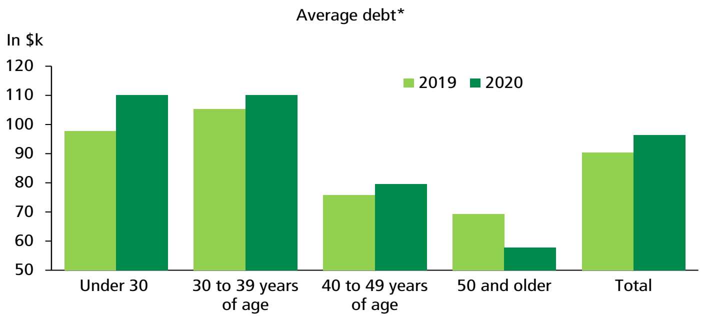
As discussed in a recent *Economic Viewpoint*, the first year of the pandemic had widespread positive effects on Quebecers' financial situation. Income was up owing to government support measures and consumer spending was down due to the temporary closure of some types of businesses. Broadly speaking, households accumulated significant savings in the form of cash or investments. Financial and real estate assets grew faster than debt, increasing households' net worth. This improvement was observed in all age groups and income brackets for both tenants and homeowners.

Although Quebecers have saved a lot since the start of the pandemic overall, some borrowers contracted more debt without necessarily having a better financial cushion. Not all have large sums of money to deal with unforeseen events. The surge in the average price of homes is also inflating their value, but all of that accumulated capital is accessible only upon sale. Although real estate assets have appreciated substantially, not all homeowners have greater financial flexibility in the immediate future to pay back their loans. Monthly debt payments are usually based on the borrower's income. All these factors will be considered in the analysis by age group, by income bracket and for all Quebecers overall.

Young People Contracted More Debt

While average debt grew in most age groups in 2020, people under 30 were more affected by the increase (graph 1). The strong movement toward home ownership a few months after the start of the pandemic of course led to growth in mortgage debt among young borrowers (graph 2 on page 2). However, the size of mortgages grew in other age groups as well. Many repeat buyers made the leap to more expensive properties or purchased a secondary residence. The highest growth in mortgage loans was among those 40 years of age and older, many of whom accelerated their plans to buy in cottage country.

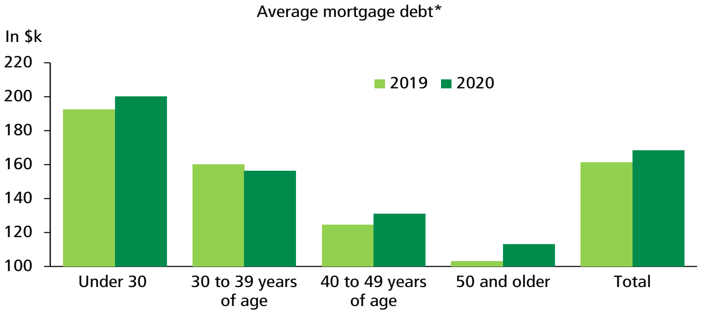
GRAPH 1
Quebecers' total debt by age group



* Indebted individuals only.
Sources: Ipsos and Desjardins, Economic Studies

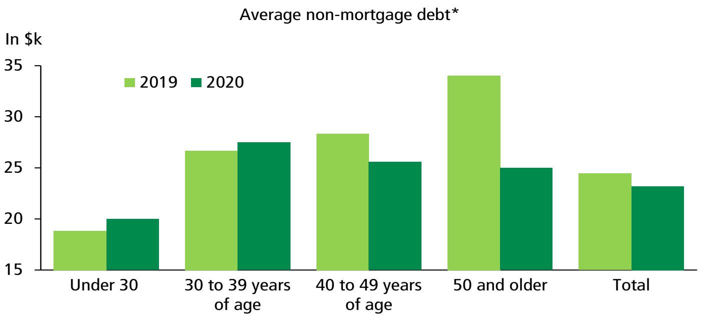
The trend was different for other types of debt (credit cards, lines of credit and personal loans). Borrowers 40 years of age and older largely used a portion of the additional savings to pay down their non-mortgage debt (graph 3 on page 2). Younger age groups saved more overall, but without paying down their debt. For those who ventured into home ownership, some or all of the money set aside since the start of the pandemic could be

GRAPH 2
Quebecers' mortgage debt by age group



* Indebted individuals only.
Sources: Ipsos and Desjardins, Economic Studies

GRAPH 3
Quebecers' consumer debt by age group



* Indebted individuals only.
Sources: Ipsos and Desjardins, Economic Studies

used as a down payment. According to a recent report, many first-time home buyers also received financial help from their parents.

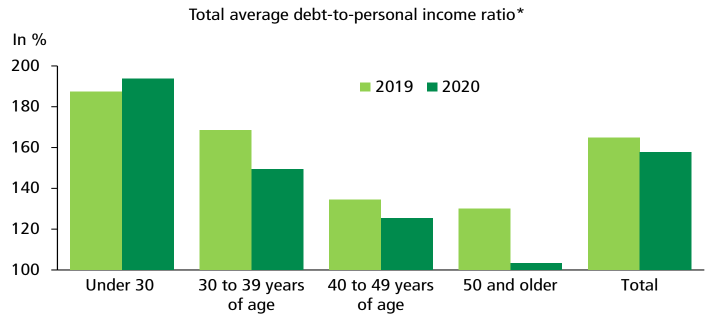
In short, people under 30 saw an increase in both their mortgage debt and other types of loans in 2020. This is in line with the early stage of financial life. Young people usually have lower incomes, a more limited ability to save and sometimes student debts to pay back. Expenses add up as well: buying or renting their first car, buying durable goods to furnish their home and, in some instances, buying a property. Therefore, debt at the beginning of adult life is expected to be higher than it is for those further along in the life cycle, who have higher incomes and lower borrowings because they have paid them down over the years.

Debt Ratio

The amount of debt relative to income is a way of identifying categories of borrowers who seem most at risk. This indicator, the debt ratio, does have its limits, however. Debt repayment typically spans a number of years, which makes the comparison with annual income imperfect. Aside from the ratio itself, its recent developments give rise to some observations. The year 2020 was a peculiar one because income grew to a greater extent, overall, than total loans, such that the debt ratio decreased. However, the situation was not widespread for all age groups.

Those under 30 saw their debt rise faster than their income in 2020, which may have weakened the financial situation of many in that age group. As a matter of fact, the ratio of total debt to income rose only in this group in 2020 (graph 4). Although loans increased for other age groups, faster income growth more than made up for this and the debt ratio dropped significantly. Those 50 years of age and older saw their loans fall considerably and had a markedly lower debt-to-income ratio than the others. According to this barometer, young people under 30 are generally more financially vulnerable than they were before the start of the pandemic. For the others, the situation has improved. However, other factors come into play in making an assessment.

GRAPH 4
Quebecers' debt ratio decreased at the beginning of the pandemic, except people under 30



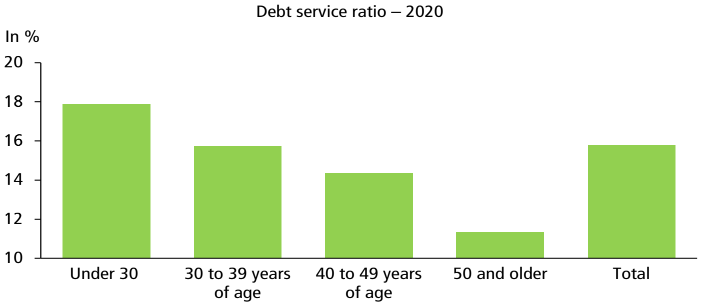
* Indebted individuals who reported income only.
Sources: Ipsos and Desjardins, Economic Studies

Repayment Capacity

It turns out that the weight of monthly payments relative to income is much more telling than the classic debt ratio. This indicator, the debt service ratio (DSR), is more comprehensive because it takes into account both the principal and interest to be repaid every month as well as the borrower's income. Data by age group are not available for 2019, however, which prevents us from assessing the impact of the pandemic. Unsurprisingly, monthly debt repayment takes up a much larger share of young borrowers' income, but then decreases with age (graph 5 on page 3). At first glance, those under 30 therefore appear to be more vulnerable to unforeseen events.

However, other factors must be considered, including disposable cash in chequing and savings accounts and some types of investments that can be easily drawn. Consequently, it is not just the debt ratio and the DSR that influence the degree of financial vulnerability. The value of financial assets can be decisive, but real estate assets have little effect on borrowers' financial flexibility to repay their debt. The paid-up capital and the value of the capital gain are only accessible once the residence is sold.

GRAPH 5
Weight of principal and interest payments relative to income among Quebecers: major disparities by age group

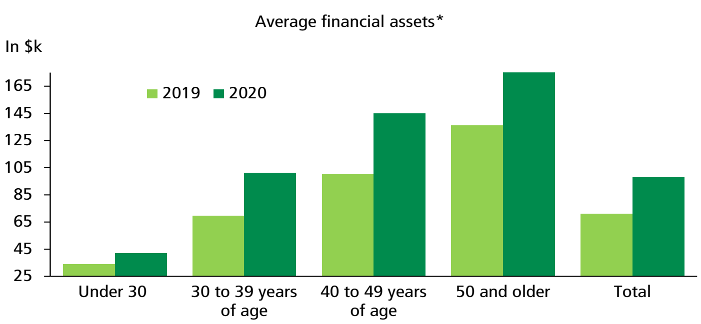


* Indebted individuals only.
Sources: Ipsos and Desjardins, Economic Studies

The Financial Cushion Changes Everything for Young People

Financial assets grew in all age groups during the first year of the pandemic. This is due primarily to the additional savings deposited in financial institution accounts or directed toward new investments and, to a lesser extent, investment returns. Financial asset growth was significant for those under 30 (graph 6), who accumulated over $40,000 on average, an increase of around 25% in the space of one year. Financial assets even rose twice as fast as debt. In light of this, young people seemed to be in better shape than in the past to deal with the unexpected, even though they had higher debt in 2020. However, the value of these additional savings was partly eroded by the effects of high inflation in 2021.

GRAPH 6
Quebecers' financial assets by age group

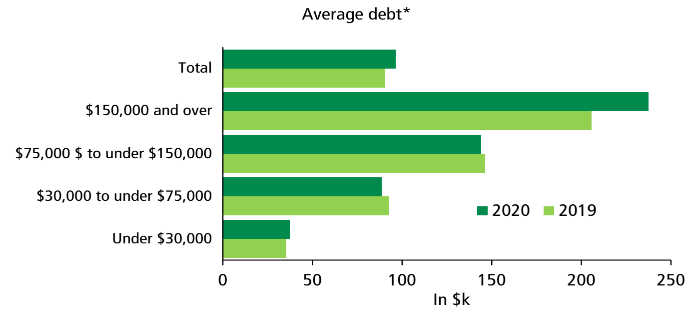


* All individuals.
Sources: Ipsos and Desjardins, Economic Studies

Debt by Income Bracket

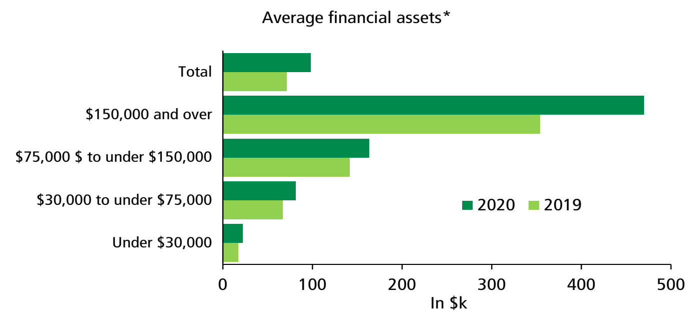
Besides age groups, there were differences in how debt changed depending on borrowers' income. The highest increase, around 15%, was among individuals with an annual income before taxes of $150,000 or more (graph 7). Their average debt was approximately $235,000 in 2020, compared to $96,000 for all borrowers. Given that financial assets are generally higher

GRAPH 7
Quebecers' total debt by income bracket



* Indebted individuals only.
Sources: Ipsos and Desjardins, Economic Studies

GRAPH 8
Quebecers' financial assets by income bracket



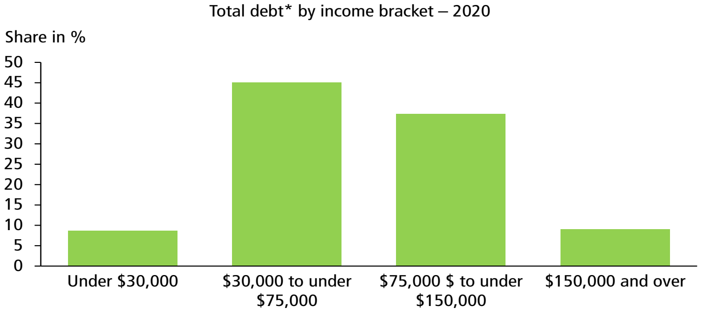
* All individuals.
Sources: Ipsos and Desjardins, Economic Studies

when income is higher (graph 8), this group's financial flexibility is usually sufficient if unexpected circumstances arise. On the whole, high earners are therefore not necessarily more vulnerable than they were before the pandemic.

Those with an income below $30,000 annually also had more debt than the year before. The roughly 10% increase raised the level to close to $40,000 in 2020. This debt level seems to be concerning with regard to the ability to pay, particularly among those with little savings. Some had to temporarily suspend their debt payments with the relief provided by financial institutions. Their borrowings therefore did not decrease as would normally have been the case. However, some borrowers in all income brackets have found themselves in this situation.

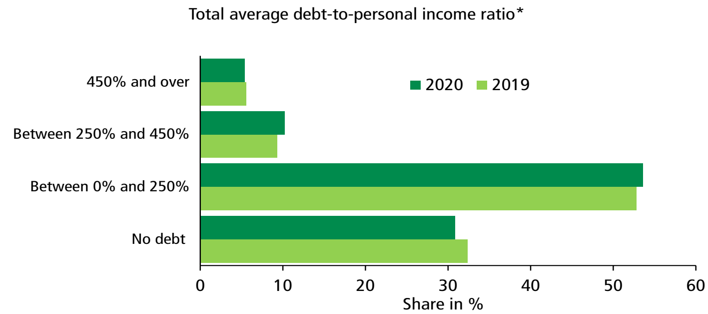
Quebecers with an income between $30,000 and $150,000 managed to reduce their debt in 2020. Given that the majority of Quebecers' loans are concentrated in this income range (graph 9 on page 4), this is good news. Nevertheless, this was not enough to offset the increase in the other groups, meaning that average debt rose overall.

GRAPH 9
Most of Quebecers' debt is held by those with incomes between $30,000 and $150,000



* Indebted individuals only.
Sources: Ipsos and Desjardins, Economic Studies

GRAPH 11
Distribution of Quebecers by debt ratio

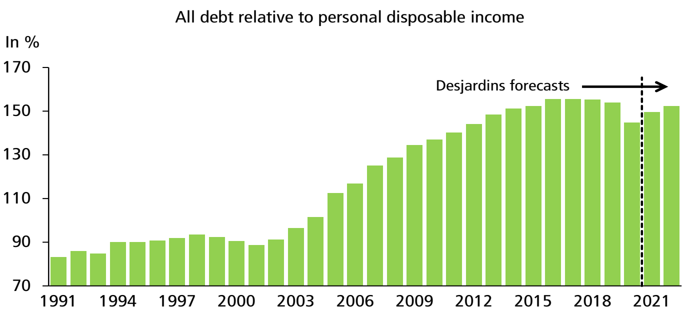


* Excludes individuals who reported no income.
Sources: Ipsos and Desjardins, Economic Studies

Overall Picture and Higher Risk Borrowers

The year 2020 was a peculiar one because income grew to a greater extent, overall, than total loans. Quebecers' incomes saw an unprecedented jump of close to 10% in 2020 owing to government support. This caused the debt ratio to decline temporarily (graph 10). However, debt accelerated in 2021, whereas income growth was far weaker as a result of the gradual withdrawal of federal government assistance programs. The debt ratio seems to be on track to reach about 150% in 2021, lower than the pre-pandemic level.

GRAPH 10
Quebecers' debt ratio decreased in 2020, but bounced back in 2021



Sources: Statistics Canada, Canada Mortgage and Housing Corporation, Bank of Canada, Institut de la statistique du Québec and Desjardins, Economic Studies

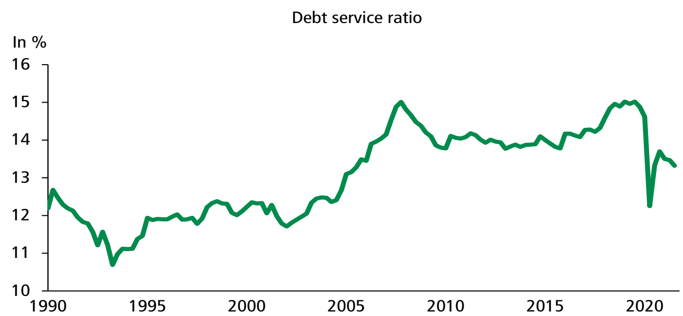
The distribution of the population according to the level of debt relative to income is a better indicator of risk than the overall ratio. This makes it easier to identify the proportion of Quebecers likely to have repayment difficulties in the event of a significant drop in income and an increase in interest rates. First, approximately 30% of Quebecers have no debt, meaning that they are not very vulnerable financially. Second, more than half of people have a debt ratio below 250%, a fairly low level (graph 11). Roughly 10% of the population has a ratio between 250% and 450%, which typically represents a fairly moderate risk. The Bank of Canada (BoC) considers the 450% threshold to be high, at least for mortgage debt. Only 5% of Quebecers have a total debt ratio above this threshold.

This 2020 distribution is similar to the 2019 one. Consequently, the proportion of at-risk borrowers remained relatively stable during the first year of the pandemic. According to the BoC, the share of new mortgage loans with a loan-to-income ratio above 450% increased significantly in the second half of 2020 across the country. While 2021 statistics are not yet available, the rebound in the overall debt ratio suggests that the situation of many Quebecers has deteriorated and that a growing share now have a higher debt-to-income ratio.

A More Comprehensive Assessment

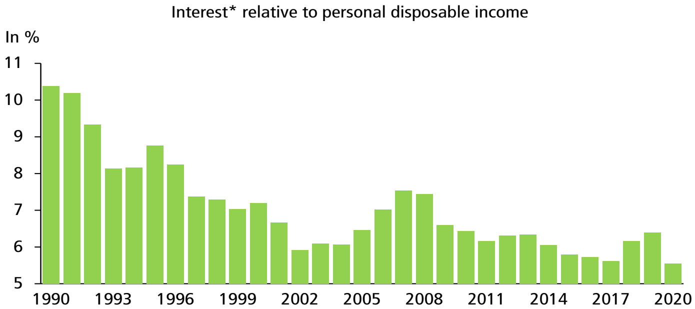
The amount of debt relative to income is a way of identifying categories of borrowers who seem most at risk. The weight of monthly payments (principal and interest) relative to income is, however, more telling. Statistics Canada compiles this figure for the entire country, but the trend in Quebec is likely similar. The DSR, which reached a record high just before the start of the pandemic, dropped in 2020 owing mainly to the decrease in interest rates (graph 12). Interest paid has been eating into even the smallest share of income since the early 1990s (graph 13 on page 5).

GRAPH 12
Weight of principal and interest payments relative to income among Canadians



Sources: Statistics Canada and Desjardins, Economic Studies

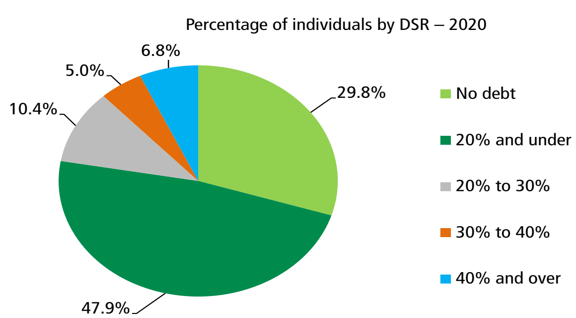
GRAPH 13
The weight of interest on Quebecers' debt reached a low in 2020



* Interest paid on mortgage loans and all other consumer loans.
Sources: Statistics Canada and Desjardins, Economic Studies

Despite this improvement, the distribution of individuals according to the DSR makes it possible to estimate the share of Quebecers most at risk. The critical threshold is assessed at 40%, with over 5% of borrowers already finding themselves in this delicate situation. Those with a DSR between 30% and 40% are also at risk, but less so. A significant share of the population is in a much more favourable position because principal and interest payments are fairly low relative to income (graph 14). Approximately 30% of individuals have no debt and, therefore, no monthly payments.

GRAPH 14
Distribution of Quebecers by debt service ratio



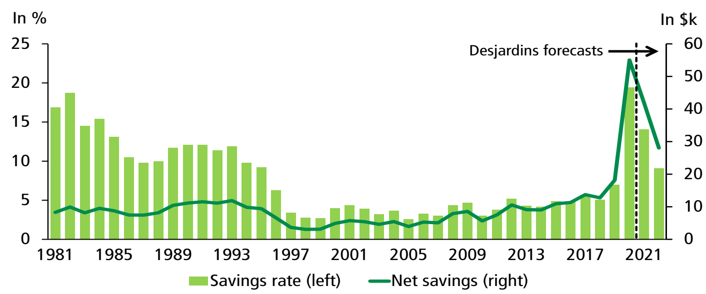
DSR: debt service ratio
Sources: Ipsos and Desjardins, Economic Studies

The Past Is No Indication of the Future

Despite a rise in debt during the first year of the pandemic, the surge in income improved debt indicators, at least for borrowers overall. In addition, the proportion of more vulnerable individuals has remained relatively small, at just above 5%. However, debt among those under 30, top earners and low-income earners has increased rapidly. The accumulation of savings and financial assets has nevertheless given many more financial flexibility to respond to unforeseen events.

Despite a positive picture for 2020, the situation has already changed in 2021. Debt growth has picked up, but income has risen only slightly due to more targeted government assistance and the discontinuation of many programs on October 23. The starting point for 2021 is different with a higher debt ratio and a share of at-risk borrowers likely a bit higher than in 2020. Moreover, the significant accumulation of savings has begun to slow (graph 15). The adjustment will continue as spending on services picks up with the economy reopening. The moderation in savings will therefore keep financial assets from growing as significantly as they did in 2020. Investment returns are high, but new investments are more limited in 2021. Flexibility in the event of unforeseen circumstances will not increase as much as in 2020, which is worrisome given the acceleration in debt.

GRAPH 15
Quebecers' savings reached a record high in 2020, but began to decrease in 2021



Sources: Statistics Canada and Desjardins, Economic Studies

Households are not immune to a correction in financial markets or in residential real estate prices after a few years of considerable appreciation. The wealth effect would therefore be substantially reduced, which could make borrowers more vulnerable. The capacity of some to make debt payments will also be affected by the increase in key interest rates starting in 2022. The increases will have an impact on variable rate mortgages and personal lines of credit. Fixed-rate mortgages, where changes depend on bond markets, will be affected upon renewal if rates turn out to be higher than those of the term coming to an end. In closing, the end of low interest rates will increase borrowers' vulnerability. Unlike in 2020, debt growth in 2021 was faster than income growth, which also raised the risk level.