Where Has the Money Gone:

The State of Canadian Household Debt in a Stumbling Economy

By the Certified General Accountants Association of Canada

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Certified General
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Table of Contents

Foreword 9

Introduction 11

1. Executive Summary 15

2. The Magnitude of the Fall – The Canadian Economy Before and After the Fall of 2008 21

3. Households' Attitudes to Debt, Spending and Savings: 2007 vs. 2008 25

4. Indebtedness of Canadian Households – What has Changed? 29
   - 4.1. Level and Composition of Debt 30
     - 4.1.1. Residential Mortgage Credit vs. Consumer Credit 30
     - 4.1.2. A Closer Look at Consumer Credit 33
     - 4.1.3. Debt of Individual Household 35
   - 4.2. Measuring Household Indebtedness 37
     - 4.2.1. Debt Relative to Income, Assets and Net Worth 37
     - 4.2.2. Debt-Service Ratio 40

5. The Implications of Economic Shocks 45
   - 5.1. Income Shock 45
     - 5.1.1. Income Interruption 45
     - 5.1.2. Decline in Income 47
   - 5.2. Assets Price Shock 50
   - 5.3. Interest Rate Shock 55

6. What has Not Changed? – The Dilemma Regarding Spending and Saving 59

7. Glimpse at Consumer Insolvency 63

8. Conclusions 67

9. Steps Forward 71

10. Appendix A: Detailed Findings From the Survey of Household Attitudes to Debt and Consumption 75

11. Appendix B: Survey Questionnaire 113

12. References..125

List of Figures

Figure 1: Canadian Household Debt, 2000-2008 31
Figure 2: Growth of Components of Household Debt (Adjusted for Inflation and Population Growth), 2000-2008 32
Figure 3: Annual Average Growth of Consumer Credit Components – Chartered Banks (Adjusted for Inflation and Population Growth), 2007 and 2008 33
Figure 4: Composition of Consumer Credit – Chartered Banks 35
Figure 5: Measures of Household Debt 38
Figure 6: Debt Components to Assets..39
Figure 7: Household Debt-Service Ratio – Mortgage Credit 41
Figure 8: Household Debt-Service Ratio – Consumer Credit 42
Figure 9: Selected Labour Market Indicators, 1976-2008 46
Figure 10: Income of Individuals 48
Figure 11: Per Capita Income of Individuals, 1976-2006 49
Figure 12: Stock Market Performance, 1976-2008 53
Figure 13: New Housing Price Index, 1976-2008 54
Figure 14: Selected Interest Rates..57
Figure 15: Household Saving Rate and Consumer Confidence Index 60
Figure 16: Consumer Insolvency, 2000-2008 65

List of Tables

Table 1: Selected Economic Indicators (Average Annual Growth Rate Unless Otherwise Specified) 23
Table 2: Household Exposure to Asset Price Shocks 52
Table A: Profile of the Survey Respondents 76

List of Charts (Appendix A)

Chart 1: Changes in Household Debt Over the Past 3 Years 77
Chart 2: Changes in Household Debt by Income Group 78
Chart 3: Changes in Household Debt by Region 79
Chart 4: Changes in Debt Relative to Changes in Income and Wealth 80
Chart 5: Reasons for Increasing Debt 81
Chart 6: Type of Debt Held by Households 82
Chart 7: Changes in Selected Types of Debt..83
Chart 8: Reason for Having Troubles Managing Debt 84

Chart 9: Attitude Towards Debt 85
Chart 10: Does Your Household Debt Negatively Affect Your Ability to Reach Your Financial Goals in the Area of.. 85
Chart 11: Changes in Overall Debt of Respondents Negatively Affected by Having Debt 86
Chart 12: Change in Household Income Over the Past 3 Years 88
Chart 13: Changes in Household Income by Respondent's Income Group 89
Chart 14: Assets Held by Households 90
Chart 15: Change in Household Assets 91
Chart 16: Changes in Respondent's Wealth 93
Chart 17: Household Sensitivity to Negative Shocks 94
Chart 18: Changes in Household Expenditures...95
Chart 19: Changes in Expenditures Relative to Changes in Income and Wealth 96
Chart 20: Reasons for Increased Household Spending 98
Chart 21: Ways of Handling Unforeseen Expenditures of $500 and $5,000 99
Chart 22: Respondents Who Could Not Handle Unforeseen Expenditure 100
Chart 23: Primary Source of Pension Income 102
Chart 24: Level of Confidence Regarding the Adequacy of Financial Situation at Retirement 103
Chart 25: Do Respondents Have a Clear Idea of The Amount of Retirement Savings Needed to Accumulate 105
Chart 26: Purpose Of Regular Saving 106
Chart 27: Use of Different Financial Instruments in Respondents' Savings Portfolios 107
Chart 28: Participation in Tax-Preferred Savings Plans 108
Chart 29: Awareness Regarding TFSAs 110
Chart 30: Regional Differences In Respondents' Awareness Regarding TFSAs 111
Chart 31: Respondents' Intentions Regarding TFSAs.............................112

Foreword

Multiple forces continue to compete 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 economic theory suggest that competition improves consumer choice and outcome. And as Canada's economic evolution can confirm, consumer spending has been very important to the real economy. In fact, it's been an important driving force for the last three decades. With reason, some do nevertheless wonder if households and their inherent finances have become the collateral damage in the battle of the mighty forces and whether there is any measurable limit to supply side economics.

With purposeful frequency, organizations and media have exposed that Canadians are increasingly worried about their financial wellbeing. Some suggest that economic insecurity is now a fact of life for most, regardless of where they fit into the income spectrum. 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 discretional goods and services that detract from wealth accumulation or saving.

With a particular curiosity around how Canadians viewed their financial condition, sentiment to spending and financial prowess, the Certified General Accountants Association of Canada (CGA-Canada) commissioned an initial consumer survey in the spring of 2007 resulting in our 2007 publication of "Where Does the Money Go". In the winter of 2008, CGA-Canada again embarked on a second consumer survey relating to this topic seeking to understand the extent to which the emerging financial crisis had impacted the household sector. This publication, while anchoring certain conclusions in our earlier findings, represents the outcome of that work.

We begin our analysis with brief overview of the magnitude of the economic changes taking place in late 2008 and correspondingly rely on this backdrop to further articulate key findings of the more recent public opinion survey. Building on the survey findings, main indicators of household indebtedness are considered followed by a discussion of implications of the current economic shocks on indebted households. We conclude by highlighting the more salient aspects of our findings along with some practical recommendations. Forming the basis of our

findings and supplemented also by the works of others, it is our sense that Canadians can be advantaged to understand their economic environment and to recognize their actuality within it so that they may manoeuvre with a view to individual financial optimization.

Anthony Ariganello, CPA (Delaware), FCGA
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The Certified General Accountants Association of Canada

Introduction

The world's economy experienced a devastating blow in the fall of 2008. In what appeared to be within the blink of an eye, financial markets collapsed, mighty economies previously relied on as global economic engines retreated, and the scale of governments' interventions made some wonder if we were to witness the end of capitalism. The magnitude of this blow served to mark a sharp contrast between the recent past and the present; and when addressing just about any economic or social matter today, most of us are compelled to reference the 'before' and the 'after' of the economic meltdown.

In Canadian context, the 'before' consisted of a 17-year recession-free economy featuring modest yet steady income growth, high demand for labour, expanding business activity, favourably high commodity prices and a strong demand for Canadian exports. The 'after' is still in the making and continues to challenge world economies as experts wrestle with its evolution. This uncertainty leaves hope that the economic recovery will be miraculously short and easy, but it also leaves ample room for gloomy forecasts that underscore persisting depression and prompt chilling economic notions such as deflation, stagflation or hyperinflation.

In the current economic situation, the topic of household indebtedness is rapidly becoming a more critical area

Ironic as it may be, the dynamic of the Canadian households' use of financing is one of the few things that did not, at least to the end of 2008, noticeably adjust to the changing economic reality. Debt had been growing fast during the 'before' era and continued doing so as we began to navigate the 'after'.

Increasing debt of Canadian households has been a subject of intense discussion for a good number of years. However, in the current economic situation, the topic of household indebtedness is rapidly becoming a more critical area. The importance of the level of household debt is fostered not only by the deteriorating situation within the household sector but also by rapidly weakening buffers in other sectors of the economy. Softer labour markets, declining business activity, further downgrading of asset values, and rising public debt will make it much more difficult for other sectors to absorb the negative developments in the household sector if its decline continues to deepen.

A shift in the focus of the discussion of household debt may also be observed. In the past, the alarming facts of increasing debt burden were fairly well balanced by not less factual arguments of rapidly growing wealth that could, at least theoretically, support the pressure of indebtedness. At present, the

argument of increasing wealth is no longer held to be valid whereas the recognition of the rapidly deteriorating situation of the household balance sheet is supplemented by a new and paradoxical concern that tightening credit conditions will put a further repressive pressure on the economy by constraining the access of households to resources and credit which limits the ability to consume.

Personal motivation and responsibility associated with borrowing are increasingly counter-balanced by the high importance of personal consumption to the Canadian economy

Despite the rising importance and changing focus of the debate around the issue of household indebtedness, the old caveats of analysing indebtedness of Canadians do hold constant. The national financial health of the household sector is commonly assessed at the aggregate level. This approach may conceal that the debt burden is borne by each household individually making reliance on aggregates, means and averages sometimes misleading.

Another challenge lies in choosing the lens through which to examine the issue of household indebtedness. A monetary policy-maker may be more inclined to emphasize that the banking sector may suffer significant loss of assets from the rising vulnerability in the household sector. Lending institutions might more likely be concerned with their decreasing profitability due to losses in loan portfolios. Meanwhile, households may be much more concerned with the increasing build up and difficulty in servicing regular debt payments. However, the type of financial stress relating to the latter may not be effectively reflected in the financial ratios of the household balance sheet while more modestly conveyed when converted into aggregate statistics on household indebtedness.

The importance of borrowing is fully recognized. It permits households to smoothen consumption and enables consumers to spread the cost of significant purchases over longer periods. Driven primarily by personal needs and wants, borrowing is rightfully a personal choice. Correspondingly, it remains an individual's responsibility to bear the consequences of the potentially excessive debt or poor financial management. Then again, personal motivation and responsibility associated with borrowing are increasingly counterbalanced by the high importance of personal consumption to the Canadian economy wherein consumer spending has been and remains a major driving force of economic growth. In this current situation of the sharp economic slowdown, consumer spending seems to remain one of the 'hopes of last resort' that may yet rescue the economy from a prolonged recession.

In early 2007, the Certified General Accountants Association of Canada (CGA-Canada) undertook a research initiative aiming to analyze the level of debt of Canadians and the risks associated with the rising level of the debt burden. That was done by integrating the results of a public opinion survey commissioned by CGA-Canada with an analysis of available statistical

information.[1] The overarching conclusion of our 2007 analysis was that the combination of rapidly increasing household debt with a slightly deteriorating financial condition of the household sector should be regarded as an emergent issue for Canadians.

In the winter of 2008, CGA-Canada again embarked on this topic seeking to understand the extent to which the economic and financial crisis worsened financial positions of Canadians having already experienced some financial strains. In the following text, we begin our analysis with brief overview of the magnitude of the economic changes that took place in the fall of 2008. Using this as a backdrop for further discussion, we then present the key findings of the public opinion survey commissioned by CGA-Canada in 2008.[2] Building on the survey findings, main indicators of household indebtedness are considered followed by a discussion of implications of the current economic shocks on indebted households. We conclude by highlighting the more salient aspects of our findings along with some practical recommendations.

1 For detailed description of the research findings and survey results, see CGA-Canada report titled "*Where Does the Money Go: The Increasing Reliance on Household Debt in Canada*" (www.cga.org/canada).

2 Unless otherwise specified, the survey findings presented throughout this report are based on the survey conducted in 2008. A comparison to the 2007 survey is provided only in cases where noticeable differences existed between respondents' perceptions revealed in 2007 and 2008.

Executive Summary

1

In the fall of 2007, the Certified General Accountants Association of Canada (CGA-Canada) set out to analyze the level of debt of Canadians and the risks associated with the rising level of the debt burden. The primary aim of the research was to identify perspectives of Canadians on the changing level of their indebtedness and their wealth, and to examine these findings in the context of publicly available facts and figures.

Given the abrupt collapse of the financial markets and seriously deteriorating economic conditions that unfolded in the fall of 2008, CGA-Canada saw fit to examine the extent to which the economic and financial crisis worsened financial positions of Canadians. For that purpose, CGA-Canada re-commissioned the public opinion survey that sought to identify changes in households' perspectives on the level of their indebtedness and their responsiveness to the shifting economic reality. The results of the survey were then examined in the context of publicly available statistical information.

Recognizing, at the time of writing, that the elevated level of uncertainty and the high volatility on the markets lead to a constantly changing economic outlook, the analysis presented in this report is limited to the examination of the situation of household debt as it stood at the end of 2008. The paragraphs that follow present key research findings by establishing the link between the worrisome trends revealed by Canadians with those evident from publicly available statistics.

Concern #1 – Household Debt is Rising

Survey results

More and more Canadians gauge their debt as rising. While in 2007, those with decreasing debt outnumbered the respondents with increasing debt, the situation reversed in 2008 when 42% of Canadians reported their debt as increasing. Those with annual household income under $35,000, households with children and retirees were much more likely to acknowledge that their debt had noticeably increased. The proportion of individuals who think they have too much debt and that have trouble managing debt increased as well.

Evidence in facts and figures

- The level of household debt adjusted for inflation and population growth continued an upward trend over the 2000s. The average annual rate of debt growth over the turmoil years of 2007-2008 was higher than that observed

during the years of strong economic growth (i.e. 2003-2006) and that registered during the previous financial turbulence of 2000-2002.

- The credit expansion during the meltdown on the financial markets in the fall of 2008 slowed down only briefly, whereas the year-to-year growth rate remained well above the longer-term average of 5.5%.
- The growth rate in mortgage lending did not noticeably adjust to the collapsing housing market in the US. The slowdown in consumer credit was in no way similar to that seen in the early 2000s during the burst of the IT bubble.
- Personal lines of credit and personal loan plans – two forms of consumer credit typically used to purchase consumer durables – grew faster in 2008 than in 2007. However, sales of new vehicles and furniture declined, while the growth in sales of used cars, home appliances and electronics, and the overall personal consumption slowed down considerably in 2008 compared to 2007.
- The share taken by the revolving credit (i.e. personal lines of credit and credit cards) within total consumer credit issued by chartered banks grew from 44.3% in 2000 to 75.0% in 2008.
- The least wealthy 20% of households experienced the second fastest rate of debt growth between 1999 and 2005. These households represented the only group that experienced a decline in their median net worth.

Concern #2 – Household Balance Sheet is Deteriorating

Survey results

At least 4 in 10 respondents reported a decline in the value of their holdings in mutual funds, stocks, bonds and private pension assets over the past 3 years. Nearly one third (30%) of respondents felt that increased non-mortgage debt payments contributed to the rise in their expenditures. More than half (51%) of respondents saw their income unchanged or decreasing, while the majority (83%) of those whose income did increase said it did so only modestly.

Evidence in facts and figures

- Total debt to annual disposable income stood at 136.5% at the end of 2008. Measures of household debt relative to assets and net worth saw a switch from a gradual or no growth period during the early 2000s to a sharp spike in 2008. Debt-to-assets reached 19.0% and debt-to-net worth peaked at 23.7% at the end of 2008 while the averages for 2000-2006 stood at 15.4% and 18.5% respectively.
- Although the average annual rate of decline in the value of household assets registered in 2007-2008 was similar to that of 2000-2002, the increase in debt-to-assets and debt-to-net worth ratios was much more subtle in the early 2000s when compared to that seen in 2007-2008.

- Rapidly increasing mortgage credit still seems to be fairly well supported by residential assets, whereas the amount of outstanding consumer credit for each dollar of household financial assets nearly doubled between 2000 and 2008.
- Mortgage debt-service burden has increased from 6.0% in 2000 to 8.0% in 2007 showing no sensitivity to the decline in the average mortgage lending rate. As well, debt-service burden imposed by consumer debt has been growing despite the fairly stable level of the interest rate.

Concern #3 – Debt is Used for Consumption Rather than for Asset Accumulation

Survey results

The rising debt continues to be primarily caused by consumption motives rather than by asset accumulation. Some 58% of respondents said that day-to-day living expenses are the main cause for the increasing debt. The majority of respondents (65%) felt that debt limits their ability to reach financial goals.

Evidence in facts and figures

- The structure of personal consumption of Canadian households has changed over the past several years shifting towards higher importance of non-durable consumer goods.
- The amount of outstanding consumer credit per each dollar of consumption of goods has increased significantly over the past years suggesting that households are either using increasingly larger amounts of credit to buy the same quantity of durable goods, or that households may have increasingly adopted a practice of using consumer credit for purchasing non-durable goods.

Concern #4 – Prospects for Improving Household Financial Security are Low

Survey results

An increasing proportion (43%) of respondents does not feel confident in their financial situation at retirement; however, an increasing number of non-retirees (32%) commit no resources to any type of regular savings, not even for retirement. Some 78% of respondents said they would not change their saving patterns in response to the changing economic situation.

Evidence in facts and figures

Little hope exists that Canadian household income will be increasing or at least remaining stable over the next several years.

- Canadians are modestly diversified in terms of their primary source of income; some 75% of the total income of individuals is derived through employment.

- The experience of past recessions shows that the unemployment rate nearly doubled during the recession in the early 1980s and went up by some 50% in the early 1990s. The average duration of unemployment also tends to increase during recessionary times.
- More than half (55%) of all employees are compensated by the hour. During the past two recessions, each employee paid by the hour worked, on average, one hour less per week compared to the number of hours in the pre-recession years.
- Individual income from wages and salaries displays a noticeable sensitivity to economic cycles. The inflation adjusted per-capita level of wages and salaries registered in the pre-recession 1989 was once again achieved only in 2000. Other sources of income hardly compensated for the fall in wages and salaries during the previous recessions.
- Changes in personal income taxation introduced during the 2000s allowed disposable income to grow faster than total household income. However, a similar boost to the disposable income can hardly be expected in the current environment of swelling budget deficits.

The loss in the value of assets may take years to recover.

- Household assets sensitive to financial market fluctuations constitute 38.6% of total household assets and are spread across a wide segment of Canadian households.
- Over the past three decades, the Canadian stock market experienced five corrections resulting in more than 20% drop in the S&P/TSX index. The correction with the shortest recovery time took 1.6 years for the index to recover to the pre-correction value. During the latest correction of a similar magnitude to that of the fall 2008, more than five years had to pass before the index reached its pre-correction level once again.
- Unlike the previous incidences of substantial corrections in the financial markets, housing assets of households cannot be counted on in order to compensate, at least partially, for the declining value in financial assets.

Declining interest rates may in fact represent a negative shock for the debt burden, at least in the near future.

- Low or negative inflation may increase the real debt-service burden of households with fixed-rate debt. For those with variable rate debt, the overall declining trend in interest rates may have a limited positive effect as the decline in mortgage lending rates and consumer credit rates has been disproportionally smaller compared to the decline in cost of lending for financial institutions.

The facts and figures presented above, when considered in combination with the attitudes and perspectives of Canadians, reasonably support the following four conclusions. First, the rapidly deteriorating situation of household sector's

balance sheet should be viewed as an alarming matter. Second, the risk tolerances of the financial institutions should not be exercised as a substitute for individual financial prowess or judgment. Third, prospects of improving households' financial situation in the near future are low. And fourth, a balanced approach to spending, saving and paying down debt may be a desirable feature of households financial behaviour in the near future.

The Magnitude of the Fall – the Canadian Economy Before and After the Fall of 2008

2

In October 2007, about the time when CGA-Canada released its first report on household debt of Canadians, the Bank of Canada concluded that:

> *"Against a backdrop of robust global economic expansion and strong commodity prices, growth in the Canadian economy has been stronger than projected with considerable momentum in domestic demand. The economy is now operating further above its production potential than had been previously expected."*[3]

Between then and now – the spring of 2009 – the outlook for Canadian and global economy has changed dramatically. What started as 'financial market turbulence' caused by defaults on the U.S. sub-prime market in the early summer of 2007, turned into a subsequent fall of asset-backed commercial paper (ABCP). By the end of 2008, the 'turbulence' changed its magnitude evolving first into tightening of credit conditions, then into seizure of money and credit markets, then into historic collapse of prices on equity markets, and finally into a global economic recession which is most commonly referred to as the worst since the second world war. In addition to the global financial meltdown, the Canadian economy is also incrementally gripped by two other moderators. One is caused by the continuous weakening of the US economy – Canada's most important export partner – having murky prospect of short-term recovery. The second shock is rooted in the steep decline in prices of certain commodities, energy in particular, that constitute the bulk of Canada's export.

Current economic instability and uncertainty were preceded by a relatively prolonged period of prosperity characterised by strong global economic growth, low interest rates and easier access to credit. The Canadian economy has been recession-free for 17 years prior to the events of 2008. This 180-degree change in the economic outlook brings an additional dimension to the analysis of household indebtedness. Judgement has to be made not only on how the level of indebtedness has changed over time, but also on how this level fares against the altered economic conditions and uncertainty of further resultant developments.

The change in the economic outlook brings an additional dimension to the analysis of household indebtedness

Recognising the importance of this shift, it seems reasonable to precede the discussion on the level of indebtedness of Canadian households with a brief overview of selected economic indicators as they stood before and after the

3 Bank of Canada (2007). *Monetary Policy Report*, October 2007, p. 5.

financial meltdown. From the large variety of indicators typically used to gauge the health of the economy, attention is focused on those that are relevant to the household sector's ability to build wealth, earn income and consume. Three time periods are considered: 2003-2007 shows the five most recent years of strong economic growth; the year 2008 portrays the turning year from a long-term economic growth into the recessionary situation; whereas the fourth quarter of 2008 reflects the most recent period for which statistics are available for all indicators.

Wealth-related economic indicators have deteriorated significantly over 2008

As seen from Table 1, wealth-related indicators have deteriorated significantly over 2008. Both the Canadian and the US stock markets were declining at a two-digit annual rate compared to a sound growth over the 2003-2007 periods. Although the Canadian real estate market did not experience an analogous drop in 2008, the new housing price index grew at a near zero rate in 2008.

Income-related indicators showed a somewhat mixed picture: the unemployment rate was fairly low during the years of strong economic growth and continued to decline in 2008. The positive dynamic though, did not transpire into a parallel actual number of hours worked which increased only slightly in 2008 compared to a robust 1.9% growth during 2003-2007. Perhaps, working fewer hours may not sound like a bad idea, but in economic terms, the decline in this indicator reflects cuts in working hours and can oftentimes precede employee lays-offs.

Although not a direct source of household income, corporate profits are linked to the household sector through two main conduits: they influence employment and investment income received by individuals, and they message also the upcoming changes in demand for labour. As seen from Table 1, corporate profits dropped drastically in the fourth quarter of 2008 pushing the overall growth in 2008 to a level twice lower than that of the preceding years.

Consumer-behaviour indicators reflect households' willingness to spend and are indicative of people's perception of current and future economic conditions. All three indicators – personal consumption, consumer confidence index and retail trade were noticeably lower in 2008 when compared to the previous 5 years and were, not surprisingly, accentuated most heavily in the fourth quarter of 2008.

While real gross domestic product (GDP) does not reflect directly the households' ability to build wealth, earn income and consume, this indicator is the most common measure of the nation's wellbeing. Although real GDP still experienced a positive growth in 2008, each Canadian became $749 poorer compared to 2007 as Canada's per capita real GDP declined from $40,350 in 2007 to $39,601 in 2008.[4]

4 Based on CANSIM Tables 380-0002 and 051-0001. CGA-Canada computation

Table 1 – Selected Economic Indicators (Average Annual Growth Rate Unless Otherwise Specified)

	2003-2007	2008	Q4 2008*
Wealth-related indicators			
S&P/TSX	15.9%	-35.0%	-28.2%
US S&P 500	10.8%	-38.5%	-24.4%
New housing price index	8.3%	0.4%	-1.8%
Income-related indicators			
Unemployment rate (period average)	6.8%	6.1%	6.0%
Total actual hours worked	1.9%	0.6%	-10.4%
Corporation profit before taxes**	4.5%	2.4%	-54.6%
Consumer behaviour-related indicators			
Consumer confidence rate (period average)	1.04	0.89	0.75
Personal consumption**	2.7%	0.6%	0.7%
Retail trade**	4.1%	2.9%	-6.1%
Real GDP	2.4%	0.5%	-3.4%

* Annualized growth
** Adjusted for inflation

Source: CANSIM Tables 080-0016, 176-0047, 282-0001, 282-0017, 282-0028, 326-0020, 327-0005, 380-0002, 380-0003, 380-0005, OECD.Stat web portal. CGA-Canada computation.

A word of caution is in order when considering the dynamic of economic indicators that influence wellbeing of the household sector. The noticeably different magnitude and the direction of changes in the indicators discussed above should not be interpreted as a limited spill-over of the economic slowdown. The timeframe within which different economic indicators respond to changes in the economy varies. Some indicators (e.g. stock market) are considered to be leading indicators and change before the economy changes; other indicators (e.g. unemployment) are lagging and do not necessarily change direction until a few quarters after an economy changes its course. Yet other indicators (e.g. GDP) are coincident and do move at the same rhythm as the economy does.

The noticeably different magnitude and the direction of changes in the wealth-related indicators should not be interpreted as a limited spill-over of the economic slowdown

A recession is commonly defined as two consecutive quarters of negative growth of real GDP. Adhering to this definition, the indicators presented above have not yet revealed a uniform portrayal of a recession as of the end of 2008. However, at the time of writing, hardly an expert was in doubt that the Canadian economy entered a recessionary period in the fourth quarter of 2008 and that a ‘technical’ confirmation would only be a matter of time with the availability of statistical data. The history of the past decades offers two points of reference emphasizing similar circumstances. The most recent recession took place over a 12-month period between April 1990 and March 1991, while the one prior started in June 1981 and lasted 18 months until December 1982.

Having contrasted the ‘before’ and the ‘after’ of the Canadian economy, the pages that follow will rely on this information as a backdrop when presenting

key findings of the public opinion survey and when analysing the levels of household indebtedness as they are characterized by the official statistics.

3 Households’ Attitudes to Debt, Spending and Savings: 2007 vs. 2008

The survey was conducted in the fall of 2008 repeating, to a large extent, a similar survey commissioned by CGA-Canada in the spring of 2007. Based on respondents’ perception rather than absolute balance sheet dollar amounts, the survey invited Canadians to reflect on the changes in their household that transpired over the past 3 years. The survey addressed four broad themes: (i) level of household debt, (ii) state of income, assets and wealth, (iii) nature of household spending, and (iv) prospects of saving and retirement. Throughout this section, we present the key findings of the survey and highlight the main changes in perceptions of Canadians. Appendix A, in turn, provides a richer authentication of the survey results.

More and more Canadians gauge their debt as rising

Although the overall proportion of indebted Canadians did not materially change between 2007 and 2008, more Canadians now report that their debt is increasing. While in 2007, those with decreasing debt outnumbered the respondents with increasing debt, the situation reversed in 2008 when 42% of Canadians acknowledged their debt as going up. The number of those who reported their debt as increasing a lot went up as well.

Certain socio-economic groups were particularly susceptible to increasing debt. Those with annual household income under $35,000, households with children and younger respondents were much more likely to acknowledge that their debt had noticeably increased. Moreover, the number of retired respondents with increasing debt went up at a faster pace than among non-retirees.

The level of concern over increasing household debt is rising. Consumption rather than asset accumulation remains the primary cause of the debt run up

The number of Canadians with increasing debt reporting concerns with this pattern is on the rise (84% in 2008 vs. 81% in 2007) with the most noticeable increase noted among those who are very concerned about their ballooning indebtedness. The proportion of individuals who think they have too much debt and have trouble managing it went up as well. However, the majority of households (79%) are still confident that they can either manage their debt well or take on more debt load.

The rising debt continues to be primarily caused by consumption motive rather than by asset accumulation. Some 58% of respondents said that day-to-day living expenses are the main cause for the increasing debt (this was higher than the 52% reported in 2007). In turn, 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 causes for increasing debt.

Although most respondents reported being confident in their ability to manage debt, the majority of respondents (65%) felt that debt limits their ability to reach financial goals in at least one of the critical areas of retirement, education, leisure and travel, or financial security in unexpected circumstances.

Fewer Canadians report positive changes in their income, assets and wealth; however many report an increase in household spending

Not many Canadians surveyed in 2007 were optimistic regarding the growth in their income, whereas they were even less likely to report positive changes during the 2008 survey. In 2008, more than half (51%) of the survey respondents saw their income unchanged or decreasing over the past 3 years, while the majority (83%) of those whose income did increase said it did so only modestly.

The dynamic of the value of assets seemed to mirror the market conditions. At least 4 in 10 respondents reported a decline in the value of their holdings in mutual funds, stocks, bonds and private pension assets; however, some 60% of those with real estate assets gauged the value of these assets as increasing. This contrasted with the 2007 survey when very few respondents thought that the value of any type of assets decreased over the past 3 years.

Similar to income and assets dynamic, respondents' perception of wealth has also changed. In 2008, less than half (44%) of all survey respondents felt they are wealthier today as compared to 3 years ago which was lower than the 57% reporting an increase in wealth in 2007. However, this shift seems to be fairly modest given the severity of the financial crisis that took place in 2008.

Despite a sense of deteriorating incomes, assets and wealth positions, nearly half (47%) of Canadians conclude that their expenses have increased over the past 3 years. An overwhelming majority (83%) of Canadians indicated increased day-to-day expenditures as a reason for ballooned spending, while nearly one third of respondents felt that increased non-mortgage debt payments contributed to the rise in their expenditures.

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

Nearly one quarter (24%) of those surveyed did not think that a moderate decrease in housing or stock market, an increase in interest rates, cuts in salary, or reduced access to credit would noticeably affect their financial wellbeing.

A much larger proportion of 2008 survey respondents considered themselves vulnerable to changes on the stock and housing markets compared to those surveyed in 2007. However, an overwhelming majority (87%) of those who owned residential structures still did not feel that a moderate decline in the housing market would negatively affect them. Nearly 7 in 10 respondents holding private pension assets or mutual funds, stocks and bonds outside of RRSPs were insensitive to changes in the stock market.

One quarter of Canadians would not be able to handle unforeseen expenditures but yet Canadians save even less than before

Even with the temporary relief afforded by a credit card or line of credit, one quarter of 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. Respondents who do not save on a regular basis were much more likely to tell us that they are not able to handle an expense of either $500 or $5,000.

The increasing challenge of handling unforeseen expenses does not seem to be a sufficient reason for increasing household savings. One third (32%) of non-retired Canadians commit no resources to any type of regular savings, not even for retirement. This was a noticeable increase compared to a 25% level reported in 2007. Savings for vacation and entertainment get higher priority among non-retired households compared to savings for education or mortgage retirement.

The worsening economic conditions did not seem to affect respondents' savings habits either. The majority (78%) of surveyed said they would not change their saving patterns in order to build or rebuild the financial cushion to the size they believed right for them. Only 16% told us they would accelerate the usual pace of saving in response to the changing economic situation.

The introduction of new tax incentives for savings (in the form of Tax-Free Savings Accounts – TFSAs) seems to have produced limited effect as well. Some 63% of respondents were either unfamiliar with the incentive or had limited understanding while 38% of those who had at least general knowledge and understanding of TFSAs admitted not planning to contribute to these

investment vehicles. If all the reported intentions are realized, not more than one quarter of Canadians may be expected to use TFSAs.

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

Some 43% of respondents do not feel confident that their financial situation at retirement will be adequate. Respondents' confidence declined even further compared to 2007. Younger (and not older) respondents were more likely to feel insecure about their retirement. The level of confidence expectedly tended to be higher among those with increasing income and wealth, or decreasing debt.

Less than half (44%) of non-retired respondents had a clear idea of the amount of personal savings and resources they need to accumulate in order to assure an adequate financial situation at retirement. Compared to the 2007 survey, this constituted a noticeable shift towards not knowing how much to save.

Nearly 4 in 10 non-retired respondents expecting to derive their pension income from RRSPs or inheritance did not have a clear idea of how much they need to accumulate to render their retirements financially comfortable. Moreover, 1 in 10 of non-retired respondents who thought that RRSPs would be their main source of pension income did not have an RRSP.

The results of the survey show several worrisome trends. These trends are not new; however, their importance has changed with the current conditions of financial instability and economic downturn. These trends comprise of:

- A rash of consumption as a prevailing behaviour of our society.
- A continuing low prospect of improved savings habits.
- An appreciation of vulnerability to economic shocks takes place primarily during, but not prior to, the shock.
- The least wealthy households being particularly vulnerable to distending debt are unsupported by increasing income or wealth.

In the following pages we will turn our focus to providing insights into the empirical facts and figures collected on household debt and the implications of economic shocks on the increasingly indebted households.

4 Indebtedness of Canadian Households – What has Changed?

While collecting information on household attitudes and perceptions regarding their indebtedness is a fairly straightforward exercise, analyzing the level of debt and its dynamic at the level of the household sector is a more difficult task at present. There are essentially two main reasons. First, there is a natural lag between the rapidly bursting out financial crisis and its spill over into the different sectors of the real economy. Second, even where the spill-over has already occurred or begun to surface, there is another delay associated with collecting statistical information which becomes available only after several months of lag. Moreover, the elevated level of uncertainty, the high volatility on the markets and the constantly changing economic outlook increases the risk for the research findings to rapidly become obsolete.

Recognizing these challenges, the analysis that follows aims to examine the situation of household debt as it stood at the end of 2008 – the latest period for which the desired benchmark information is available at the time of writing. As well, the analysis will seek to compare the evolution of household debt during the period of financial instability (i.e. 2007 and 2008) and the preceding seven years. Considering years 2007 and 2008 permits the capture of the financial turmoil from its inception caused by the fallout of the asset-backed securities market to the most dramatic meltdown to date of the financial system that took place in September and October of 2008. The 2000-2006 periods, in turn, represents four years (i.e. 2003-2006) of stable economic and financial growth but also reflects a financial market meltdown of the early 2000s caused by a bursting of the technology bubble.

For the purpose of our analysis we first consider level and composition of household debt; followed by examination of measures of household indebtedness and the level of debt of individual households.

4.1. Level and Composition of Debt

Survey results

The proportion of respondents with rising debt went up from 35% in 2007 to 42% in 2008

Household debt measured in absolute terms reached a new record high of $1.3 trillion in 2008

Household debt[5] measured in absolute terms reached a new record high of $1.3 trillion in 2008; but this should hardly be a surprise. Constantly growing population and positive levels of inflation create natural preconditions for debt to grow in absolute terms. However, even when the level of debt is adjusted for inflation and population growth, household debt still shows a continuous upward trend over the 2000s (top graph of Figure 1). More interesting, though, the average annual rate of debt growth of 7.9% over the turmoil years (i.e. 2007-2008) was higher than 7.1% observed during the years of economic growth (i.e. 2003-2006) or 2.8% registered during the previous financial instability of 2000-2002.

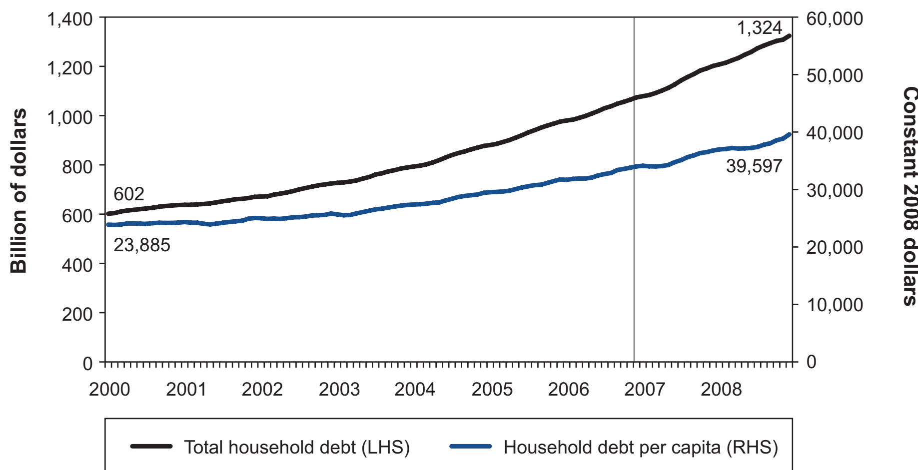
A closer look at the monthly changes in household debt reveals additional information regarding the debt dynamic over the past two years. Coinciding with the meltdown on financial markets, the household credit flow noticeably slowed in August – October of 2008, but bounced back at the end of 2008. Despite this slowdown in credit expansion, the year-to-year growth rate remained well above the longer-term average of 5.5%. This differed significantly from the situation observed in the early 2000s when the year-to-year growth rate of household credit became negative. The deteriorating economic and market conditions of 2007-2008 did not provoke a similar response (bottom graph of Figure 1).

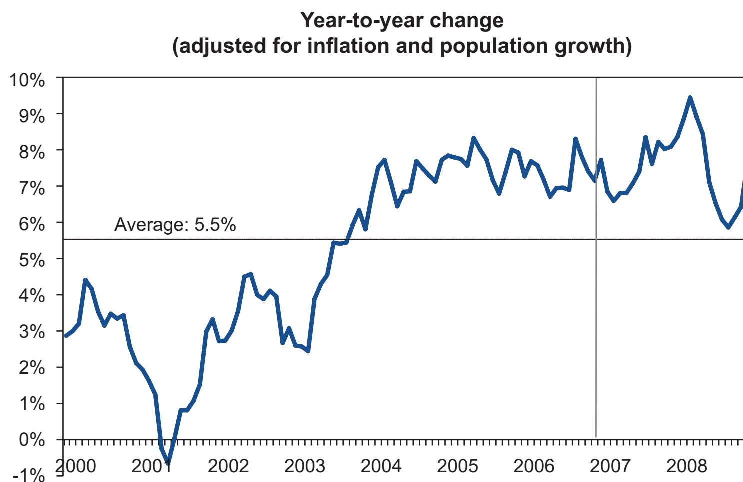
4.1.1. Residential Mortgage Credit vs. Consumer Credit

Household debt consists of residential mortgage credit and consumer credit. Mortgage borrowing is secured against residential assets and, thus, raising mortgage credit is usually of a lesser concern than an increase in consumer credit which is not backed by appreciable assets. The rapid expansion of consumer credit in the early 2000s brought concern that the composition of household debt was shifting too much in favour of unsecured consumer credit. The changing economic conditions of the past two years have not materially departed from this situation; other than coincidentally. That is, while subtle improvements were observed as the proportion represented by consumer credit

5 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 mortgage credit.

Figure 1 – Canadian Household Debt, 2000-2008





Source: CANSIM Tables 176-0032, 051-0005 and 326-0020. CGA-Canada computation.

Despite some slowdown in credit expansion, the year-to-year growth rate remained well above the longer-term average

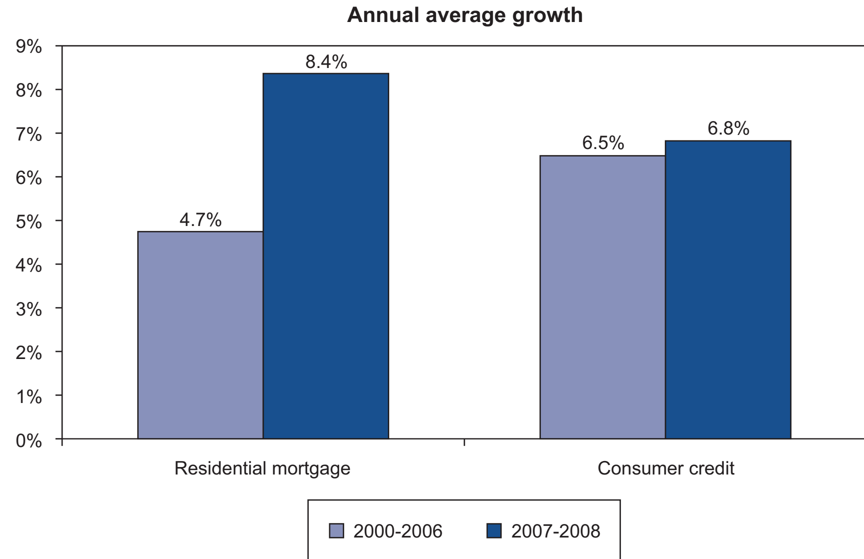
decreased from the decade's peak of 32.5% in 2005 to 31.5% at the end of 2008, as seen from the top chart of Figure 2, the shift in the composition of household debt was primarily achieved by a more rapid expansion of residential mortgages rather than by a slowing growth in consumer credit.

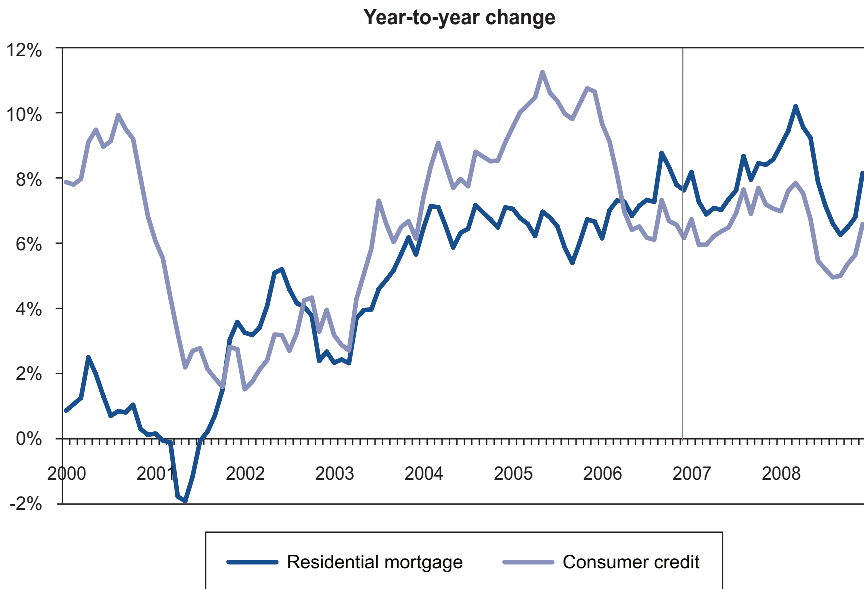
Although the average growth rates of consumer credit during 2000-2006 and 2007-2008 were close to identical, the credit dynamic within each period is fairly different. After a very strong expansion at the beginning of the century, the growth in consumer credit slowed in the aftermath of the high-tech bubble, then skyrocketed to double-digit levels in 2005 and 2006 and assumed more moderate growth rates in the past two years. In turn, mortgage credit experienced a gradually increasing pace of growth that peaked at 10.2% in March of 2008 (bottom graph of Figure 2). This dynamic is interesting as it shows that mortgage

lending did not noticeably adjust to the collapsing housing market in the US. As well, the slowdown in both mortgages and consumer credit was in no way similar to that experienced in the early 2000s, and the unprecedented financial market meltdown commencing in 2008 had only a very brief effect on the rate at which households continued to take on debt.

The slowdown in both mortgages and consumer credit was in no way similar to that experienced in the early 2000s

Figure 2 – Growth of Components of Household Debt (Adjusted for Inflation and Population Growth), 2000-2008





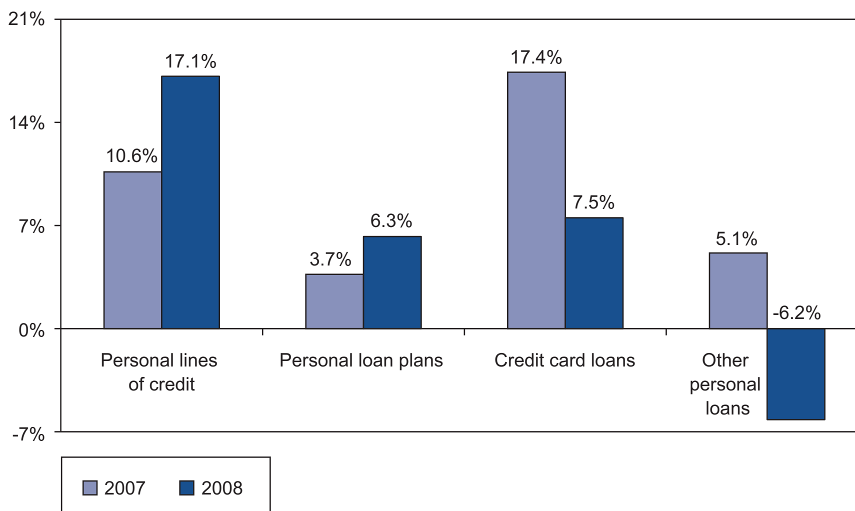
Source: CANSIM Tables 176-0032, 051-0005 and 326-0020. CGA-Canada computation.

4.1.2. A Closer Look at Consumer Credit

> ***Survey results***
> *58% of respondents said that meeting day-to-day living expenses is the main reason for increasing debt*

Consumer credit includes personal loan plans, credit card loans, personal lines of credit and other personal loans. Although the overall growth rate of consumer credit was not exceptionally high over the past two years, the dynamic of different components of consumer credit renders a dissimilar inference. It should be noted that statistics collected by the Bank of Canada on components of consumer credit provides information on credit issued by chartered banks only. This limits the analysis somewhat as it leaves out consumer credit issued by such financial institutions as credit unions, caisses populaires, trust and mortgage companies, life insurance companies, special purpose corporations and non-depository credit intermediaries. Still, chartered banks hold approximately 70% of the outstanding balance of consumer credit of Canadians and, in the absence of a better empirical alternative, it is reasonable to assume that the dynamic of different types of consumer credit issued by chartered banks is fairly representative of total consumer credit.

Figure 3 – Annual Average Growth of Consumer Credit Components – Chartered Banks (Adjusted for Inflation and Population Growth), 2007 and 2008



Source: CANSIM Tables 176-0011, 051-0005 and 326-0020. CGA-Canada computation.

In 2008, consumer credit issued by chartered banks was growing at a much faster rate of 11.4% (adjusted for inflation and population growth) than that of 10.1% in 2007 and the annual average of 8.2% during 2000-2006.[6] However, not all components of consumer credit contributed equally to this growth. The boom in growth observed in 2008 was primarily achieved due to increasingly fast expansion of personal lines of credit; however, a more rapid growth in personal loan plans contributed as well (Figure 3).

Using higher levels of credit to buy lesser amount of goods may be indicative of increasing households' financial constraints that force households to substitute consumption from income with consumption from credit

The fast growth in personal lines of credit and personal loan plans would not necessarily cause concern if not for the deteriorating economic conditions. Unlike credit cards which are mainly used for day-to-day consumption, personal lines of credit and personal loan plans are typically used to purchase consumer durables such as cars, furniture and home appliances. However, in 2008, consumers were not as predisposed to traditional shopping as in previous years. For instance, sales of new vehicles declined by 5.8% while sales of furniture stores went down by 0.7% in 2008 when compared to 2007 (adjusted for inflation).[7] Moreover, the growth in sales of used cars, home appliances and electronics, and overall personal consumption also slowed down considerably in 2008. And yet, personal lines of credit and personal loan plans accelerated their expansion. Using higher levels of credit to buy lesser amount of goods may be indicative of increasing households' financial constraints that force households to substitute consumption from income with consumption from credit.

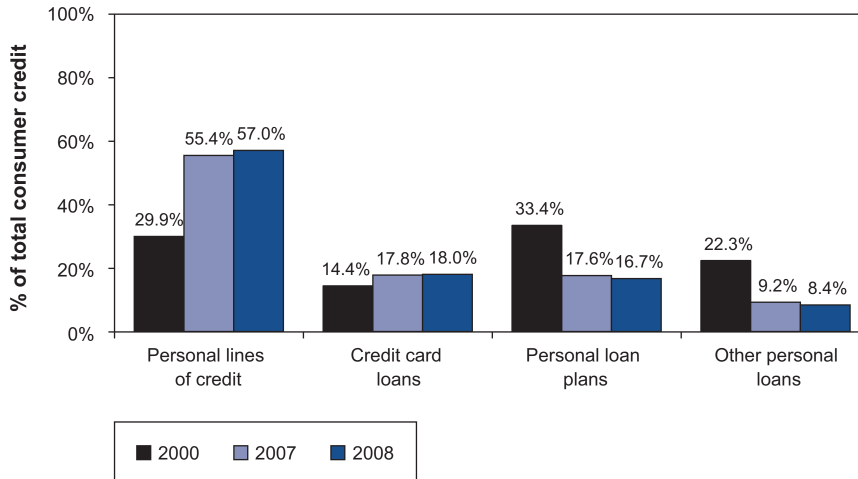
The fast expansion of personal lines of credit in 2008 was consistent with a longer term trend. Over the past years, Canadian households have noticeably changed their preferences for certain types of consumer credit. In the early 2000s, consumer credit was somewhat evenly divided between its four main components (i.e. personal loan plans, credit card loans, personal lines of credit and other personal loans) with credit cards slightly lagging behind. By the end of 2008, however, personal lines of credit had become an apparent favourite absorbing some 57% of consumer credit issued by chartered banks. At a distance, this was followed by credit card loans (Figure 4). This change in preferences is the result of a gradual but steady shift which has not noticeably slowed in either 2007 or in 2008.

The reason for concern over the increasing use of lines of credit and credit cards lies in the fact that both of these types of credit are a form of so-called revolving credit where only a minimum payment (or payment of only interest) is required each period. With a backdrop of deteriorating economic conditions and higher financial stress, households may increasingly decide to postpone repaying principal, and resultantly increasing the danger of the borrowing

6 The fast growth in consumer credit issued by chartered banks was partially counterbalanced by a slow and declining growth rate of consumer credit issued by financial institutions other than chartered banks.
7 Based on CANSIM Tables 078-0003, 080-0014 and 326-0020. CGA-Canada computation.

turning into a debt spiral. Moreover, making the required minimum payment on revolving credits allows the individual to maintain a healthy credit rating and thus expanding opportunity for augmented borrowing.

Figure 4 – Composition of Consumer Credit – Chartered Banks



Source: CANSIM Table 176-0011. CGA-Canada computation.

With a backdrop of deteriorating economic conditions, households may increasingly decide to postpone repaying principal on revolving credit, and resultantly increasing the danger of the borrowing turning into a debt spiral

4.1.3. Debt of Individual Household

Survey results

Respondents with lower income were much more likely to report increasing debt compared to respondents in other income groups

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 as a whole to handle economic shocks. 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-servicing capacity of people affecting the run-up in debt and whether the increase in debt is caused by financial constraints of households or otherwise supported by increasing wealth. However, hardly any set of statistical data would feature information with this level of detail.

The best available source of data enabling a closer look at the composition of the balance sheet of particular households is the Survey of Financial Security administered by Statistics Canada. The published results of the survey contain

fairly comprehensive information sets on debt load, composition of assets and categorization of net worth of families possessing different characteristics. CGA-Canada's 2007 report relied extensively on this source in analysing debt of a typical household and debt distribution across households.

More and more families enter into debt and the debt of a typical household is rising. Low-income families are not exempt from the rising debt burden

Although an update to this analysis would be of value to the current discussion, the 2005 Survey of Financial Security continues to be the most recent release, and as such limits the information on debts and assets of individual households to pre-financial crisis and pre-recession times. As such, we limit our discussion in this section to reiterating the conclusions derived during the 2007 analysis. Namely, there are clear indicators that the financial situation of certain groups of households may be deteriorating quite aggressively. More and more families enter into debt and the debt of a typical household is rising. Low-income families are not exempt from the rising debt burden but accumulation of their assets tends to not fare as well as that of other families. Those with low wealth continue to sink into debt and to experience further deteriorating in their net worth positions.

A number of factual highlights that substantiate the above conclusions seem worthy also of repeating:

- While the overall number of Canadian families increased by 9.5% between 1999 and 2005, the number of indebted families grew by 12.8% during this period.

- Between 1999 and 2005, median amount of household debt grew faster than the average amount of debt suggesting that rising household indebtedness is caused by increasing debt load of a typical Canadian family rather than by more affluent households.

- The proportion of families having more debt than assets increased from 12.3% in 1999 to 14.1% in 2005.

- The least wealthy 20% of households experienced the second fastest rate of debt growth between 1999 and 2005. These households represented the only group that experienced a decline in their median net worth.

- The number of low net-worth families having access to personal lines of credit tripled between 1999 and 2005. In turn, for the total of all families, the increase stood at 77%.

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

As seen from the above discussion, the past two years have been characterized by a mixed but persistently deteriorating economic outlook. And yet, household debt grew faster in these years than in those preceding years marked by a strong economic growth. The expansion of consumer credit, on the backdrop of decreasing sales of big-ticket consumer products, leaves little margin to doubt that the level of financial stress of households has increased. Revolving credit has become a prevailing part of the consumer credit and poses an increased risk of turning into a debt spiral given the tightening economic conditions. This is of a particular concern given that the low net-worth cohort has significantly increased its reliance on personal lines of credit. Moreover, the financial situation of the least wealthy Canadians may be deteriorating quite assertively.

4.2. Measuring Household Indebtedness

Currently, experts tend to apply one or a combination of the following four measures to gauge household debt: (i) Debt-to-Income ratio, (ii) Debt-to-Assets ratio, (iii) Debt-to-Net Worth ratio, and (iv) Debt-Service ratio. For the purposes 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.

The three main indicators of household indebtedness – debt-to-income, debt-to-assets and debt-to-net worth ratios – deteriorated significantly in the past two years

4.2.1. Debt Relative to Income, Assets and Net Worth

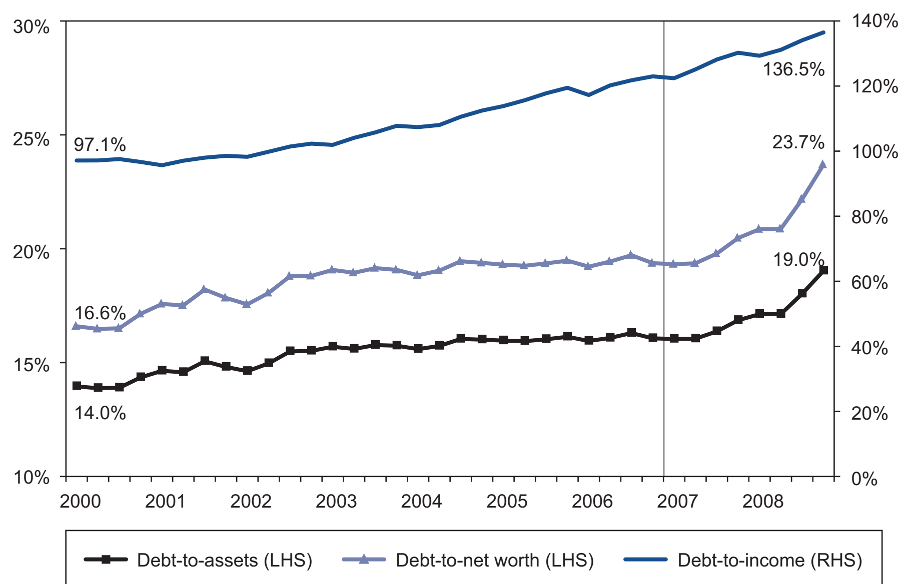
Survey results

51% of survey respondents said their income either decreased or remained the same. At least 4 in 10 respondents reported decrease in the value of their financial assets.

As may be expected in the environment of worsening economic conditions, the three main indicators of household indebtedness – debt-to-income, debt-to-assets and debt-to-net worth ratios – deteriorated significantly in the past two years and particularly during 2008. The debt-to-income ratio reached a new record high of 136.5% at the end of 2008; however, this was a mere continuation of a long-term upward trend observed over the past decades. In turn, measures of household debt relative to assets and net worth saw a switch from gradual or no growth during the early 2000s to a sharp spike in 2008. For instance, debt-to-assets reached 19.0% and debt-to-net worth peaked at 23.7% at the end of 2008 while their averages for 2000-2006 stood at 15.4% and 18.5% respectively (Figure 5).

It seems fairly obvious that increasing household debt alone may not be blamed for the worsening composition of the household sector's balance sheet. The decline in the value of assets (adjusted for inflation) averaged 0.2%

Figure 5 – Measures of Household Debt



Source: CANSIM Tables 176-0032, 380-0004 and 378-0009. CGA-Canada computation.

A similar decline in asset value that took place in the early 2000s did not result in a comparable deterioration of the household financial position

over 2007-2008 and contributed greatly. It is worth mentioning though, that a similar decline in asset value took place in the early 2000s, however did not result in a comparable deterioration of the household financial position. The collapse of the high-tech bubble in the early 2000s triggered a stock market correction of a similar magnitude to the one seen in 2008 (see Figure 12 on page 53 for more details). As well, total household assets declined at a very comparable annual average rate of 0.3% over 2000-2002. However, as seen from Figure 5, the increase in debt-to-assets and debt-to-net worth ratios was much more subtle in the early 2000s than those seen in 2007-2008.

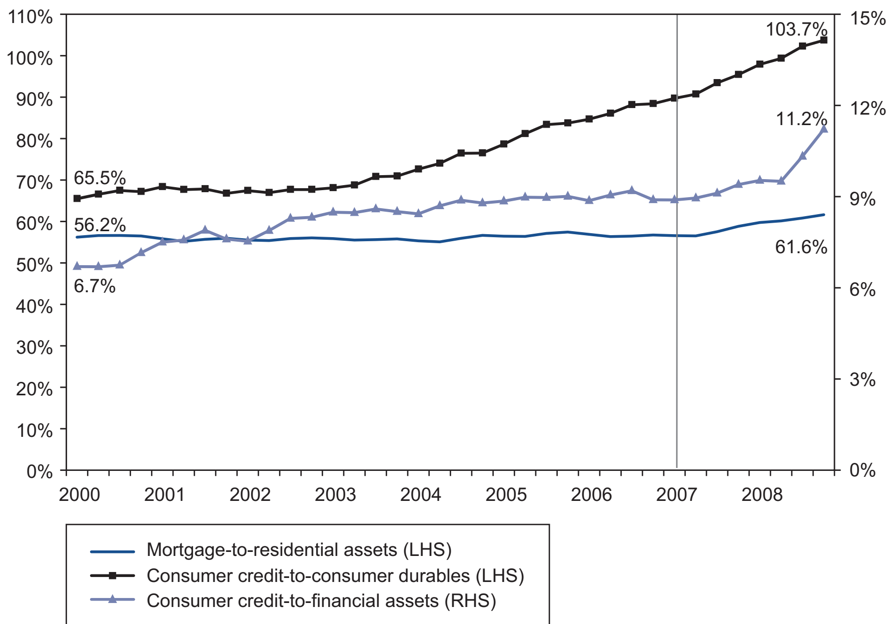
The decline in the value of assets also affected the degree to which different debt components are backed by corresponding assets; however, the scale of influence varied. Rapidly increasing mortgage credit still seems to be fairly well supported by residential realty assets; although a nearly constant level of the ratio observed in 2000-2006 turned into a slightly increasing trend in 2007-2008. Specifically, the ratio of residential mortgage credit to residential assets was pushed up to 61.6% at the end of 2008 compared to 56.2% in 2000 (top graph of Figure 6).

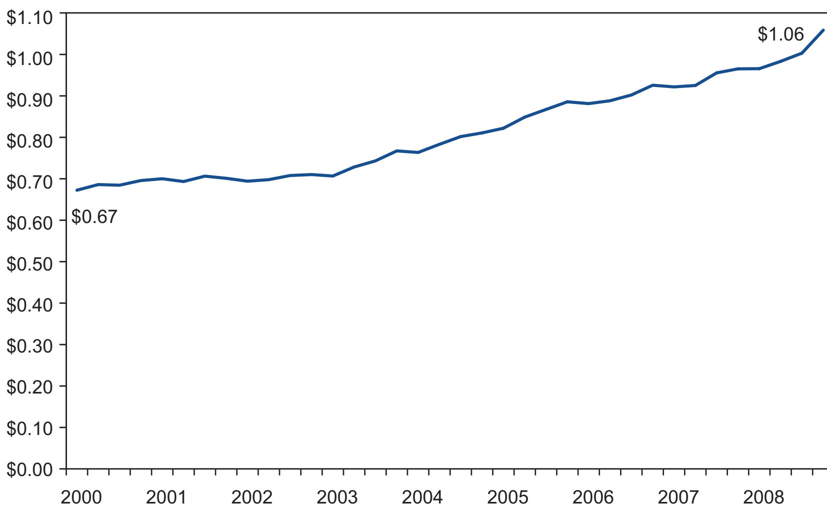
For consumer credit, the situation was quite the opposite. The amount of outstanding consumer credit for each dollar of household financial assets nearly doubled between 2000 and 2008 (from 6.7% to 11.2%). Naturally, the large part of this increase may be attributed to the meltdown on the financial

markets that caused the plunge in assets value. However, a similar argument would not be valid when it comes to the ratio of consumer credit to durable goods. Durable goods do not appreciate over time and market fluctuations have very limited influence on the value of stock of durable goods held by households. Nevertheless, at the end of 2008, consumer durables could support the accumulation of consumer credit to a much lesser degree than was the case in the early 2000s (top graph of Figure 6).

At the end of 2008, consumer durable could support the accumulation of consumer credit to a much lesser degree than was the case in the early 2000s

Figure 6 – Debt Components to Assets





Source: CANSIM Tables 176-0032, 378-0009 and 380-0002. CGA-Canada computation.

It is worth reiterating that the structure of personal consumption of Canadian households has somewhat changed over the past several years. While in the early 2000s, consumption of non-durable goods[8] constituted 51.2% of the total value of goods consumed by individuals, this proportion climbed to 54.7% in 2008. This shift occurred primarily at the expense of durable goods with its share decreasing from 30.0% in 2000 to 27.3% in 2008. The pertinence of this finding to the current discussion lies in the fact that the amount of outstanding consumer credit per each dollar of consumption of goods has increased significantly over the past years (bottom graph of Figure 6). One or a combination of the following two factors may be a driving force behind this phenomenon. First, households may be using increasingly larger amounts of credit to buy the same quantity of durable goods – the trend also confirmed by the dynamic of consumer credit components discussed in subsection 4.1.2. Second, households may have increasingly adopted a practice of using consumer credit for purchasing non-durable goods. In either case, this further confirms that Canadians increasingly deploy borrowed funds for consumption rather than for accumulation of wealth.

Canadians increasingly deploy borrowed funds for consumption rather than for accumulation of wealth

4.2.2. Debt-Service Ratio

Survey results

27% of survey respondents with increasing debt identified interest charges as the main causes for run up in debt

The debt-service ratio is typically computed as a percentage of household disposable income that must be spent to service interest payments (or both interest and principal payments) on existing debt. Constructing a debt-service ratio is not an easy exercise. It usually requires making a number of assumptions related to the type of interest rate term used, the duration of different credit contracts, the level and types of discounts offered by lending institutions, and the proportion of debt rolling over annually.

In addition to these analytical challenges, the debt-service ratio is often criticized for its inability to account for changes in home ownership. The ratio ignores the fact that in some cases, 'after-mortgage' disposable income may be very similar to 'after-rent' disposable income because mortgage payments on the newly purchased home replace rent payments made prior to becoming an owner. Instead, when the household moves from renting to owning, the debt-service ratio reflects the amount of mortgage payments as a new financial obligation that increases the overall debt burden.

8 Statistics Canada divides the variety of goods consumed by individuals into three category: (i) non-durable goods which can be used only once, such as food, beverages, and household supplies, (ii) semi-durable goods which can be used on multiple occasions and have an expected lifetime of one year or so, such as clothing and footwear, and (iii) durable goods which can be used repeatedly for more than one year, such as motor vehicles and major appliances.

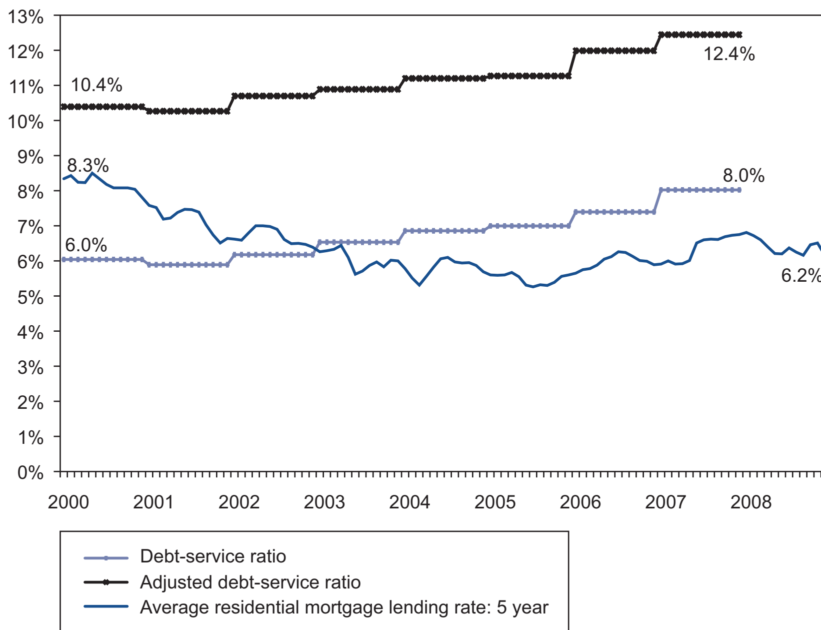
Addressing this shortcoming becomes particularly important when we acknowledge that a noticeable shift indeed took place in recent years, from renting to owning of a primary residence. For instance, some 38.9% of households were making regular mortgage payments in 2007, a much higher level than the 34.9% observed in 2000. In turn, the proportion of households making rent payments went down from 37.3% in 2000 to 34.8% in 2007.[9]

To mitigate the discussed shortcomings, an adjusted debt-service ratio for mortgages was constructed. The adjusted ratio shows the percentage of after-tax income that is apportioned for rent, regular mortgage payments and mortgage insurance premiums. Instead of estimating mortgage payments based on information regarding outstanding household debt and making assumptions about the level of mortgage rates, data on rent and mortgage payments are based on the Statistics Canada's Survey of Household Spending that provides information on actual household spending during the reference year.

The adjusted mortgage debt-service ratio has been slowly but steadily increasing from 10.4% in 2000 to 12.4% in 2007

As seen from Figure 7, the adjusted debt-service ratio has been slowly but steadily increasing from 10.4% in 2000 to 12.4% in 2007 (the latest year for which statistics are available). When only mortgage payments are considered (i.e. rent payments are not taken into account), the results are fairly similar: mortgage debt-service burden increased from 6.0% in 2000 to 8.0% in 2007.

Figure 7 – Household Debt-Service Ratio – Mortgage Credit



Source: CANSIM Tables 203-0003, 202-0602 and 176-0043. CGA-Canada computation.

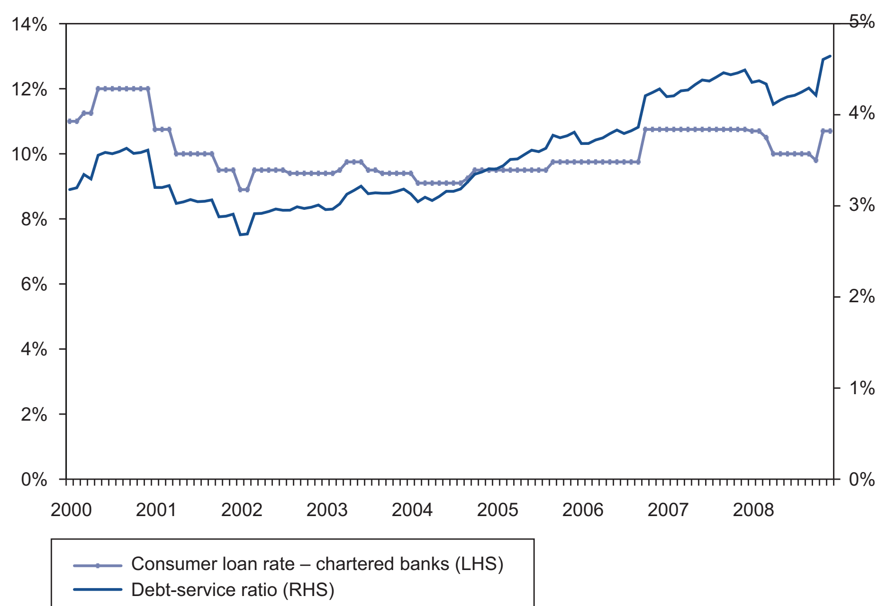
9 Based on CANSIM Table 203-0003.

It is usually assumed that decreasing interest rates allows households to lower their debt-service burden by either directly benefiting from the rate decline in case of variable-rate mortgage contract or by renegotiating the fixed-rate mortgage contract. During the early to mid 2000s, the average mortgage lending rate declined from 8.3% to as low as 5.3%; however, the debt-service ratios did nevertheless seem insensitive (Figure 7). Although the dynamic of the 2008 ratios have yet to be formalized (upon Statistics Canada publishing 2008 household spending data), the experience of previous years leaves little doubt that household debt-service burden will further increase in 2008.

The debt-service burden imposed by consumer credit has been growing despite the fairly stable level of interest rates

The approach used to construct the debt-service ratio for mortgages cannot be applied for consumer credit as publicly available statistics do not specify payments made by households to honour their consumer debt. As such, in Figure 8, the historic consumer credit rate is used as a proxy for calculating interest payments on consumer debt. It can be seen that the debt-service burden imposed by consumer credit has been growing despite the fairly stable level of interest rates. However, the increasing popularity of revolving credit (see section 4.1.2 for more details) further erodes the accuracy of the presented debt-to-service ratio. Because revolving credit may allow households to postpone interest payments, the debt-service ratio may be overstating the actual amount of income spent by households in order to honour consumer debt. However, this only speaks to the overall imperfection of the debt-service ratio which is unable to capture the burden of postponed obligations.

Figure 8 – Household Debt-Service Ratio – Consumer Credit



Source: CANSIM Tables 176-0032 and 176-0043. CGA-Canada computation.

As observed from the above discussion, the measures of financial wellbeing of the household sector have deteriorated significantly over 2007 and particularly in 2008. This deterioration is much more severe than that of the 2000s when the value of household assets declined by a comparable magnitude. The weakening of the household balance sheet is further aggravated by rising preference for using credit for consumption rather than for wealth accumulation. The elevated financial stress is also observed through the increasing burden of servicing debt but the current decline in the interest rates has modest effect in easing the debt service burden.

The facts and figures presented in this section reveal a rapidly deteriorating situation of the household sector's balance sheet; which given the current economic situation, has modest prospect of improving in the immediate future. However, the task of arriving at a specific conclusion regarding the gravity of the situation still remains both arduous and highly inferential. "Deterioration" is a highly relative notion; basing judgements of imminent danger or disaster in relation to deduced thresholds. In the case of indebtedness of the household sector, neither economic theory nor the practice of public policy-making has defined clearly such a threshold. Nevertheless, we judge the current level of indebtedness of Canadian households as a highly disturbing matter, particularly given the extent of the economic shocks discussed throughout this paper.

CGA-Canada judges the current level of indebtedness of Canadian households as a highly disturbing matter, particularly given the extent of the economic shocks

The Implications of Economic Shocks

5

In our 2007 report, we discussed how increasing debt creates higher household exposure to negative economic shocks and jeopardizes households' ability to consume in the future. While that discussion at the time was largely a theoretical exercise, those hypothetical shocks have now become a reality. As such, the 2007 work can be advanced by focusing on the magnitude of the three economic shocks – income shock, assets price shock and interest rate shock – and their implications for Canadian households.

For the purposes of deliberating income shock, the parallels will be drawn with the impact caused by the two most recent recessions (1981-82 and 1990-91). For the assets price shock, in turn, the previous noticeable falls on the stock market will be the primary reference point. However, it should be recognized that such comparison is an imprecise exercise. The Canadian economy has evolved significantly since the last recession of the early 1990s and even since the last financial market meltdown of the early 2000s. A higher labour mobility, easier transferability of skills, higher speed of information dissemination and easier access to it, freer access to international financial markets and more open economy are just few features that may in some circumstances improve, but in others worsen, households' ability to handle economic shocks compared to the situation of some ten or twenty years ago. However, recognizing that no one can accurately and completely predict the future, past experience will likely serve as a reliable source of factual information regarding potential impacts.

Canadians are modestly diversified in terms of their primary sources of income. Some 75% of the total income of individuals is derived through employment

5.1. Income Shock

In broad terms, two sources of income shock may be identified: interruption of income due to unemployment and decline in real income due to overall slowdown in the economy.

5.1.1. Income Interruption

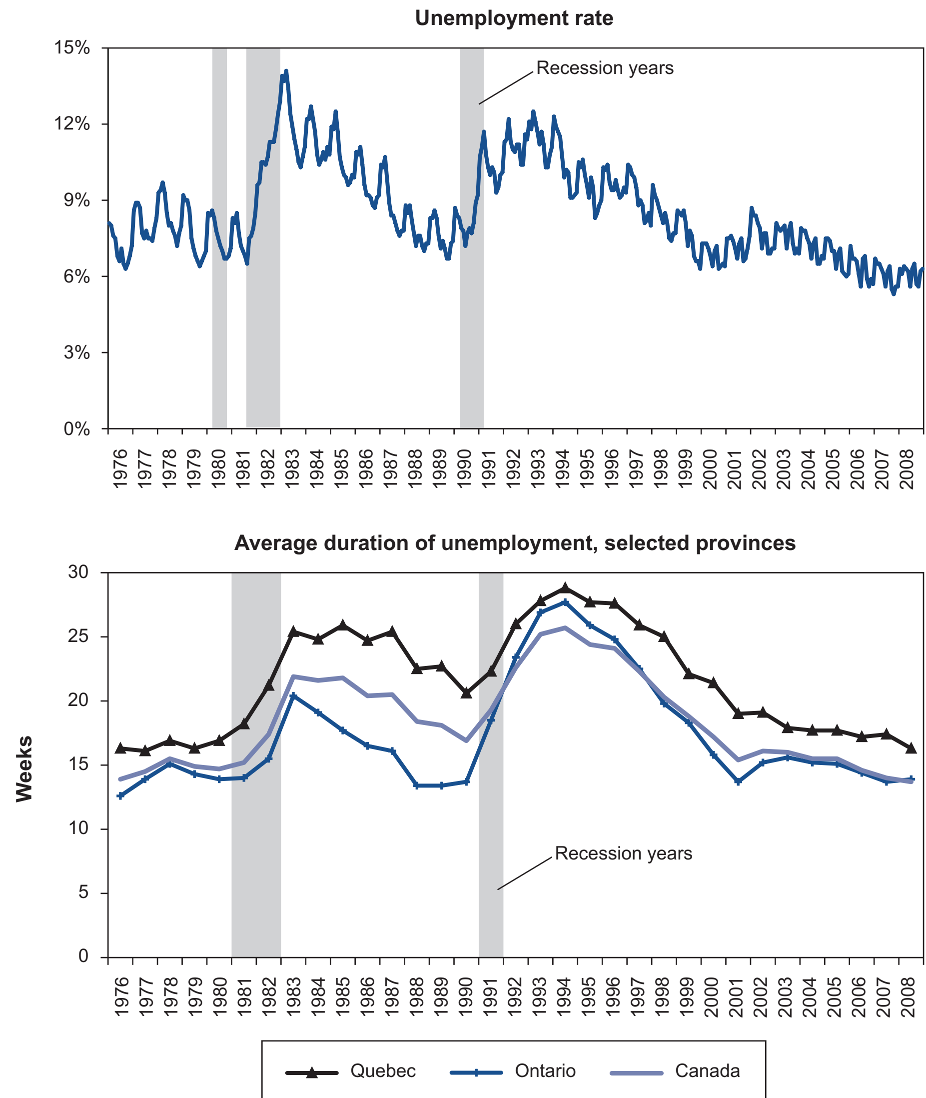
> ***Survey results***
> *Respondents with lower income were much more likely to report increasing debt compared to respondents in other income groups*

Canadians are modestly diversified in terms of their primary sources of income. Employment income has historically been and still remains the principle source

of household income and some 75% of the total income of individuals is derived through employment. Despite the deteriorating economic conditions, the unemployment rate of 2008 averaged 6.1% – one of the lowest levels over the past three decades. However, the mere fact that unemployment is lagging other indicators implies that it has yet to be fully impacted by the changes that have already taken place in the real economy. If we are to rely on the experiences of past recessions, there is little room to doubt this phenomenon. For instance, unemployment rates nearly doubled during the recession in the early 1980s and went up by one half in the early 1990s (top graph of Figure 9). Given the size of today's labour force, a one percentage point increase in unemployment rate would leave some 182,000 people without regular employment income.

Unemployment rates nearly doubled during the recession in the early 1980s and went up by one half in the early 1990s

Figure 9 – Selected Labour Market Indicators, 1976-2008



Source: CANSIM Tables 282-0001, 282-0048 and 380-0002.

The duration of unemployment also tends to increase during recessionary times. In the 1980s, the average duration of unemployment jumped up from 14.7 to 21.9 weeks within the two recession years. In the 1990s, the spike was not less impressive (from 16.9 to 22.6 weeks), but the duration of unemployment continued to rise for another two years after the recession was 'formally' over (bottom graph of Figure 9).

Naturally, the pan-Canadian numbers conceal regional differences. For instance, as a result of the recession in the early 1990s, the average duration of unemployment in Ontario doubled between 1990 and 1994 and a full decade had to pass before the duration of unemployment returned to its pre-recession level. The magnitude of the spike in Quebec was not as remarkable as in Ontario; however, for most of the years during the past decades, the average duration of unemployment in this province has been the highest in Canada (bottom graph of Figure 9).

It should be recognized that the Employment Insurance Program provides temporary financial assistance to smoothen income interruption resulting from loss of employment. As such, it plays an important role in Canadian welfare. However, the current maximum Employment Insurance payment is $447 per week[10] – an amount only somewhat higher than the average weekly mortgage payment of $270[11] paid by Ontarian households in 2007.

The duration of unemployment tends to increase during recessionary times

5.1.2. Decline in Income

While loss of employment represents a very dramatic event for an individual or family, on the national scale, the number of unemployed always represents only a fairly small segment of the population. Even in 1983, when the unemployment rate was the highest in the past 30 years, nearly 9 in 10 of those wanting to be employed were employed. However, being employed does not always mean having the same level of income as before. More than half (55%) of all employees are compensated by hour of work. Some of them may find themselves working less hours and thus, experience a decrease in income although maintaining their employment status. For instance, during the past two recessions, each hourly-paid employee worked, on average, one hour less per week when compared to the number of hours worked in the pre-recession years (top graph of Figure 10). While this may not sound as a significant change, at an average hourly rate of 20$ this may well form a sum of money usually used to partially service or to stave off debt.

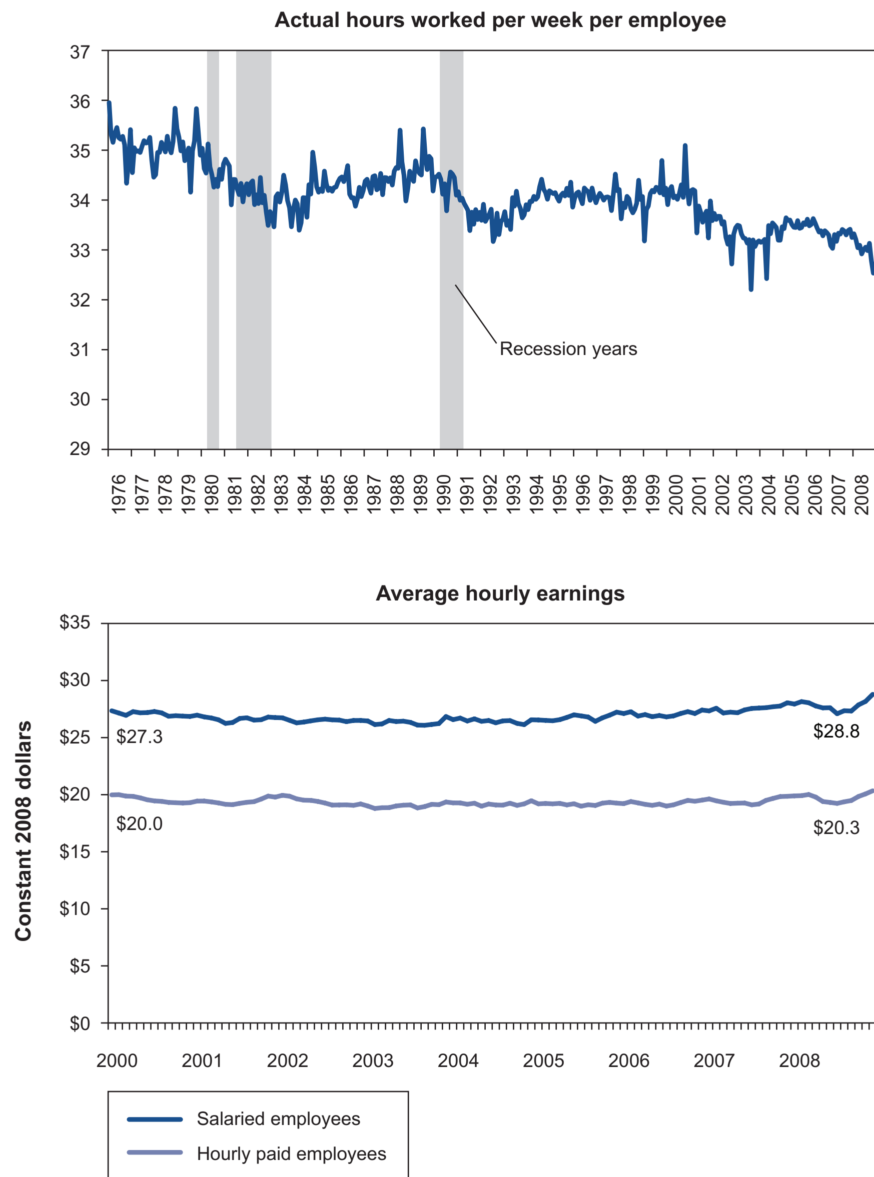
Among those who are employed, more than three quarters (77%) work either as salaried employees or are hourly-paid. As seen from the bottom graph of Figure 10, the strong economic growth registered in the mid 2000s had very

10 Source: Employment Insurance (EI) and Regular Benefits, Service Canada (available at http://www.servicecanada.gc.ca/eng/ei/types/regular.shtml)
11 Estimated based on CANSIM Table 203-0003.

limited, if any, impact on earnings of those employed. Adjusted for inflation, average hourly earnings of salaried employees and those paid by the hour hardly changed over the past eight years, while the very minor increase registered at the end of 2008 may rather be attributed to the seasonal variations than to a true increase. If no noticeable wage and salary increase was registered during the time of economic prosperity, it may only be logical to assume that meaningful increases should not be over-optimistically relied on during the current economic slowdown.

No noticeable wage and salary increase was registered during the time of economic prosperity. It may only be logical to assume that meaningful increases should not be relied on during the current economic slowdown

Figure 10 – Income of Individuals

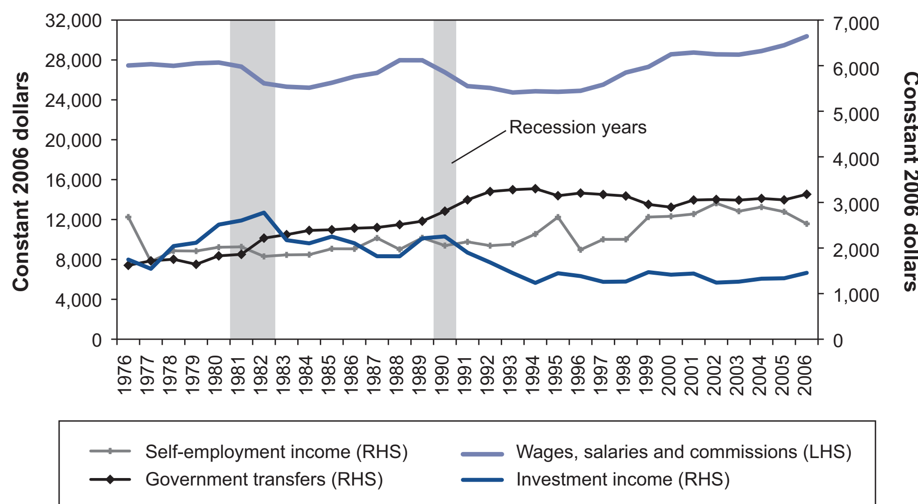


Source: Top graph: CANSIM Tables, 282-0087, 282-0092 and 380-0002.
Bottom graph: 281-0035, 281-0029, and 326-0020. CGA-Canada computation.

Although an important source of earnings, employment is not the only way Canadian households derive income. In addition to wages and salaries, households' income is also derived from self-employment, commissions, investments, pensions, and government transfers. When looking at the evolution of different types of household income over the past three decades, two points are worth noting. First, income from wages and salaries showed a noticeable sensitivity to economic cycles. This type of income declined noticeably and abruptly during the two previous recessions, but the recovery to pre-recession levels took years. For instance, the inflation adjusted per-capita level of wages and salaries seen in the pre-recession 1989 was once again achieved only in 2000 followed by another 4 stagnant years before it finally picked up in 2005. The second point worth mentioning is that other sources of income were hardly compensating for the fall in wages and salaries during the recessions. Government transfers, as may be expected, constitute an exception; however, their growth was far from offsetting losses in other sources of income (Figure 11).

Other sources of income were hardly compensating for the fall in wages and salaries during the past recessions

Figure 11 – Per Capita Income of Individuals, 1976-2006



Note: The age structure of the reference population used to derive per capita income varies depending on the type of income. Per capita wages, salaries and self-employment are based on the population of 20 to 65 years of age, investment income – on the population aged 25 and over, whereas per capita government transfers are determined based on the total population. The age brackets for the reference population were chosen based on the criterion that at least 95% of income is earned by this age group.

Source: CANSIM Tables 202-0407 and 051-0001. CGA-Canada computation.

When speaking about household income, it is important to underline the difference between the total income received by individuals and disposable income – or that which actually remains in the pockets of Canadians for consumption, for saving, or for payment of debt. Total income largely depends on the conditions of the labour market, the performance of income generating

assets, and on government policy relating to transfer payments. Disposable income, in turn, is largely influenced by the level of personal income taxation and other compulsory deductions such as contributions to social insurance.

Over the past decade, several significant changes have been introduced to personal income taxation at both the federal and provincial levels. The measures at the federal level included restoration of the full indexation of the tax system, increasing the amount of income individuals can earn tax-free, reducing the middle income tax rate, increasing amounts of income at which the middle and top tax rates begin to apply, and eliminating the federal surtax. Changes in the provincial tax systems grant provinces the right to establish income tax brackets and rates independent of the federal income tax rates. These changes translated into reductions in marginal effective income tax rates across all provinces, particularly for middle-income Canadians[12] and, as a result, into different disposable income growth rates. Specifically, during 2001-2006, total income of individuals (adjusted for inflation and population growth) increased at an average annual rate of 1.0% while disposable income grew at an average rate of 1.2% during the same period of time.

There is little room for optimism that Canadian households will see their incomes increasing, or of even remaining stable, for years to come. The lowering of personal income taxes should hardly be relied on either

A similar boost to disposable income can hardly be expected in the current economic environment. With large budget deficits being projected on both the federal and provincial levels, it is unlikely to expect that the government will undertake policy measures leading to reduction in personal taxes other than short-term temporary or targeted measures which may be part of the stimulus packages aiming to ease economic flow or increase consumption.

As seen from the discussion above, stagnant hourly earnings during the period of fast growing economy, the declining income from wage and salaries during the past recessions and a low likelihood of filling in the gap from other sources of income leaves little room for optimism that during the current recession Canadian households will see their incomes increasing, or of even remaining stable, for years to come. The lowering of personal income taxes – another potential source of increasing household disposable income – should hardly be relied on given recent relaxations and the current state of public finance.

5.2. Assets Price Shock

Typically, household assets, like assets of any other sector, are divided into two broad categories – financial and non-financial. Financial assets of households include stock, bonds, mutual funds and cash deposits, whereas non-financial assets comprise of residential structures, land, vehicles and collectables. Such a characterisation of assets may, though, be deceptive when it comes to the

12 See CGA-Canada report titled "*51 and Counting – Is it Time to Remodel RRSPs?*" (www.cga.org/canada) for more detailed discussion regarding the outcomes of the tax reform for different income groups.

analyses of asset price shocks. The asset's sensitivity to market fluctuations differs significantly depending on the asset and on the market. Turmoil on the financial markets, for instance, would do little harm to the value of cash and bank deposits which are part of the financial assets. Similarly, value of vehicles that are part of non-financial assets would have limited exposure to changes on either financial or non-financial markets.

It then seems reasonable to consider households' exposure to asset price shocks by grouping assets into three categories.[13] First are assets sensitive to changes of the financial markets. These include stocks, mutual and investment funds, income trusts, pension assets and other financial assets such as mortgage-backed securities, registered savings plans, etc. Second are assets sensitive to the real estate market such as principal residence, land, and other real estate. And third are other assets that are not sensitive to market dynamic. These include deposits in financial institutions, bonds, vehicles, valuables and collectables, copyrights and patterns.

The employer-sponsored pension plan (EPP) is a type of household asset that necessitates special consideration. Although EPPs make up nearly one fifth of total household assets, households do not directly manage these assets and often have little control and ability to manipulate or manoeuvre them in case of an asset shock. Nevertheless, these assets are affected by economic shocks and may necessitate compensative actions on the side of households in order to achieve the pre-shock level of wealth.

As seen from Table 2, some 81.8% of household assets may be affected by changing prices on either financial or housing markets. If EPPs are taken into account, the exposure becomes even higher with some 38.6% of total household assets being potentially sensitive to financial shocks while 46.9% of assets sensitive to corrections on the real estate market. This exposure is spread across a wide segment of Canadian population. As many as 58.0% of Canadian families may be affected by the meltdown of the financial markets, while the balance sheet of 61.9% of all Canadian families may be impacted by changes in housing prices.

Some 81.8% of household assets may be affected by changing prices on either financial or housing markets

13 Two main sets of statistical data exist that allow us to see the detailed composition of household assets – the Income and Expenditure Accounts and the Survey of Financial Security, both produced by Statistics Canada. However, neither source is without shortcoming. The data collected by the Income and Expenditure Accounts consolidate assets of persons with those of all business transactors whose legal form of organization is not a corporation (e.g. independent business operators, self-employed farmers, fishermen and professionals and unincorporated landlords). Such an amalgamation distorts somewhat the breakdown of asset owned by households only. The Survey of Financial Security corrects this shortcoming by focusing on assets and debts of Canadian families only; however, the survey is conducted occasionally and the most recent data available are from 2005. Possibly a subjective call, but for the analysis of the composition of household assets we chose to rely on the somewhat dated but a better focused Survey of Financial Security.

Table 2 – Household Exposure to Asset Price Shocks

	Assets excluding EPPs	Assets including EPPs
Assets sensitive to financial markets	22.7%	38.6%
Assets sensitive to real estate markets	59.1%	46.9%
Other assets (not sensitive to market dynamic)	18.2%	14.5%
Total assets	100.0%	100.0%

	% of households holding assets
Assets sensitive to financial markets	
RRSPs, LIRAs, RRIFs and other	58.0%
EPPs	48.6%
Mutual funds, investment funds, income trusts	12.3%
Stocks	9.9%
Other financial assets	17.4%
Assets sensitive to real estate markets	
Principal residence	61.9%
Other real estate	16.0%

Source: Survey of Financial Security, Statistics Canada, 2005. CGA-Canada computation.

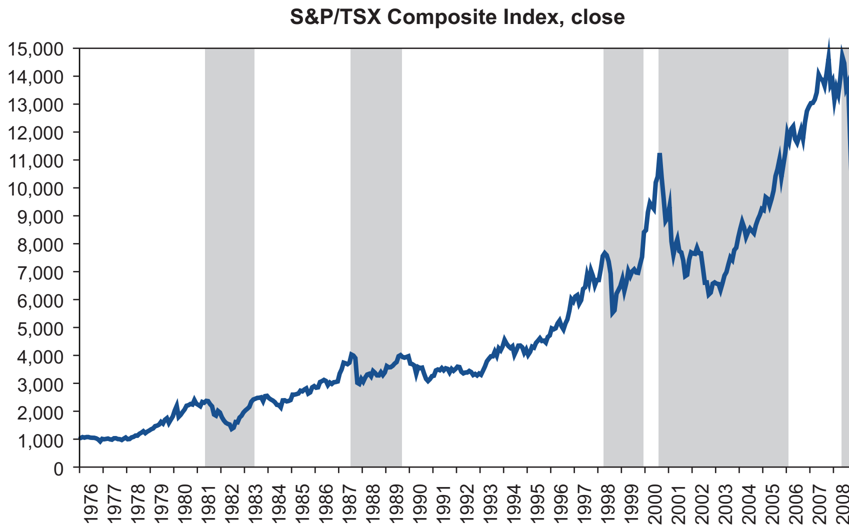
After the most recent market correction of a magnitude similar to that of the fall of 2008, five years passed before the S&P/TSX index was able to reach its pre-correction level

The financial markets are renowned for bullish and bearish market movements; and abrupt falls are not unheard off. For instance, in the past three decades, the Canadian stock market has faced five corrections that resulted in a more than 20% drop in the Standard and Poor's/Toronto Stock Exchange (S&P/TSX) Composite Index.

More important, though, is the recovery time to recover from such corrections. As seen from Figure 12, the correction having the shortest recovery time relates to that provoked by the 1998 crisis on the Asian financial markets. At that time, the S&P/TSX index dropped 27.8% within four months and although the recovery was the shortest in the recent history, it still took 1.6 years for the S&P/TSX index to reach the pre-correction value. In turn, the most recent market correction of a magnitude similar to that of the fall of 2008 was triggered by a burst of the IT bubble in the middle of 2000. At that time, the S&P/TSX index dropped by 45.1% and more than five years passed before the index was able to reach the level first registered in 2000.

In most cases, a financial market correction represents favourable buying opportunities. For instance, once the S&P/TSX index bottomed in the mid 2002, it was growing at an annual average rate of 21.9% till it recovered to its pre-correction value at the beginning of 2006. However, the ability of households to benefit from the buying opportunities depends greatly on households' age and the type of financial vehicles forming their investment portfolios.

Figure 12 – Stock Market Performance, 1976-2008



Peak month of TSX index	Magnitude of correction	Recovery time (years)
May 1981	-42.4%	2.0
July 1987	-26.1%	2.1
April 1998	-27.8%	1.6
August 2000	-45.1%	5.4
May 2008	-38.9% by end 2008	Not yet known

Note: Only those corrections that resulted in a more than 20% decline in the S&P/TSX index were considered. The magnitude of the correction is defined as the percentage difference between the peak value of the S&P/TSX index and its value at the nearest bottom. The recovery time is defined as the period of time that passed between the peak month of the index and the month when the index first surpassed its peak value.

Source: CANSIM Table 176-0047. CGA-Canada computation.

Canadian households may find themselves waiting years to regain the financial wealth possessed prior to the financial markets turmoil of 2008

As household's ability to work and to earn income in the later stages of life decreases, personal savings often become an important source of income for retirees. For such individuals, the presence of buying opportunities that necessitate a waiting period for investment to grow may be of a lesser utility than their day-to-day need for income. Similarly, unless the individual's investment portfolio is well diversified within money market vehicles such as savings account and guaranteed investment certificates (GICs), the mere lack of fluid funds available for investment may reduce the individual's ability to benefit from buying opportunities. Although there might be ways around these constraints, the main point remains the same: Canadian households may find themselves waiting years to regain the financial wealth possessed prior to the financial markets turmoil of 2008.

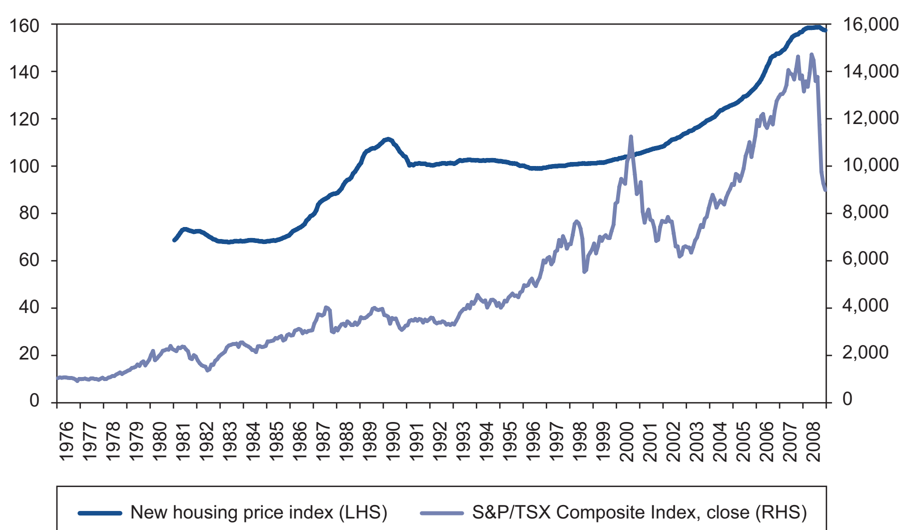
Not so long ago (i.e. in the early 2000s), concerns were raised regarding shifting composition of household wealth towards less liquid real estate holdings as appreciating home prices, rising homeownership rates and a boom in renovation activity were improving the outlook for the housing market. And indeed, the proportion of residential assets within total household assets increased from 17.4% in 2000 to 21.1% by the end of 2008.[14]

In the current recession, households will be simultaneously exposed to a deep decline on the financial markets, and at best a stagnant or modest growth of realty assets

To date, as ironic as it may be, households have benefited from higher exposure to less liquid assets as the real estate market has not experienced a meltdown of a magnitude as profound as that of the financial markets. However, it is widely expected that the housing market will undergo a certain degree of correction; more in some regions than in others and the already registered declines in housing starts and resale prices signal such correction.

Over the past several decades, the real estate market and financial market have experienced somewhat opposite dynamics. For instance, a fairly sluggish housing market activity during most of the 1990s was somewhat compensated for by strong gains on the financial markets. In turn, the meltdown of the IT bubble and the corresponding crash on the financial markets in the early 2000s was counterbalanced by a rapidly appreciating value of housing assets (Figure 13). The current recession will most probably change this trend with households being simultaneously exposed to a deep decline on the financial markets, and at best a stagnant or modest growth of realty assets.

Figure 13 – New Housing Price Index, 1976-2008



Source: CANSIM Tables 377-0003 and 176-0047.

14 Based on CANSIM Table 378-0009. CGA-Canada computation.

Relying on the discussion above, the loss in the value of assets may take years to recover from, during which time income may have to become the primary source of resources for household consumption.

5.3. Interest Rate Shock

For the past number of years, the discussion around interest rate shock primarily focused on the consequences of an increase in interest rates. The situation has reversed dramatically over the past year with the Bank of Canada lowering its target for the overnight lending interest rate from 4.5% to 0.25% over 17 months between December 2007 and April 2009. Would falling interest rates then mean a positive shock? The answer is: it remains to be seen. Two points taken together – low inflation but not so low interest rates – bring some concern that the interest rate shock may be negative rather than positive.

For indebted households whose regular debt payments are fixed, negative inflation may mean a net increase in the burden of debt

The sensitivity of households to interest rate changes depends on whether the interest rate is predominantly fixed or variable over the life of the loan. The direction of the change in interest rate would also matter. A fixed-rate debt may protect households from the risk of increasing debt-service costs when interest rates are rising. Conversely, the same fixed-rate debt may increase the real burden of servicing debt in the situation of falling rates.

In its Monetary Policy Report Update released in January 2009, the Bank of Canada projected that inflation is expected to fall abruptly in the next two years dipping below zero in the second and third quarters of 2009.[15] As the Bank's most recent interest announcement suggests, an even lower profile for inflation may be expected due to potential delays in stabilizing the global financial system and larger-than-anticipated confidence and wealth effects on domestic demand.[16] A lower level of inflation, and particularly its negative growth, may be welcomed by many when shopping for household necessities or planning a large purchase; however, for indebted households whose regular debt payments are fixed, negative inflation may mean a net increase in the burden of debt.

Typically, inflation decreases purchasing power of money over time making money in hand today more valuable than an identical amount of money in the future. For a debtor making regular fixed payments (for instance, mortgage payments), this implies that the value of each consecutive payment is slightly lower than the value of the prior payment even though the monetary amount of the payment remains unchanged. In more formal terms, this is usually articulated by the concept of nominal and real interest rates where nominal

15 Bank of Canada (2009). *Monetary Policy Report Update*, January 2009, p. 9.
16 Bank of Canada (2009). *Bank of Canada lowers overnight rate target by ¼ percentage point to ¼ per cent and conditional on the inflation outlook, commits to hold current policy rate until the end of the second quarter of 2010*, Press release, April 21, 2009.

rate is the rate quoted in the loan agreement while the real rate is obtained by adjusting the nominal rate for decreasing purchasing power of money.

However, in the case of negative inflation, the purchasing power of money increases over time. A numerical example may help to illustrate. For instance, in 2007, an average annual mortgage payment of an Ontarian household with a mortgage credit was $14,022.[17] The same nominal payment of $14,022 made in 2008 was already of a lesser value (by $327) to the household due to 2.3% inflation registered in 2008. If instead, the inflation had been only 0.2% (the same as projected for 2009), the value of the payment would be reduced by $25 only. Taking it one step further, should inflation fall below zero (let's say to -1.0%) the same annual payment of $14,022 will become actually more expensive to the household by $154 – nearly half a thousand dollars of foregone value compared to the scenario having the usual 2.3% inflation factor.

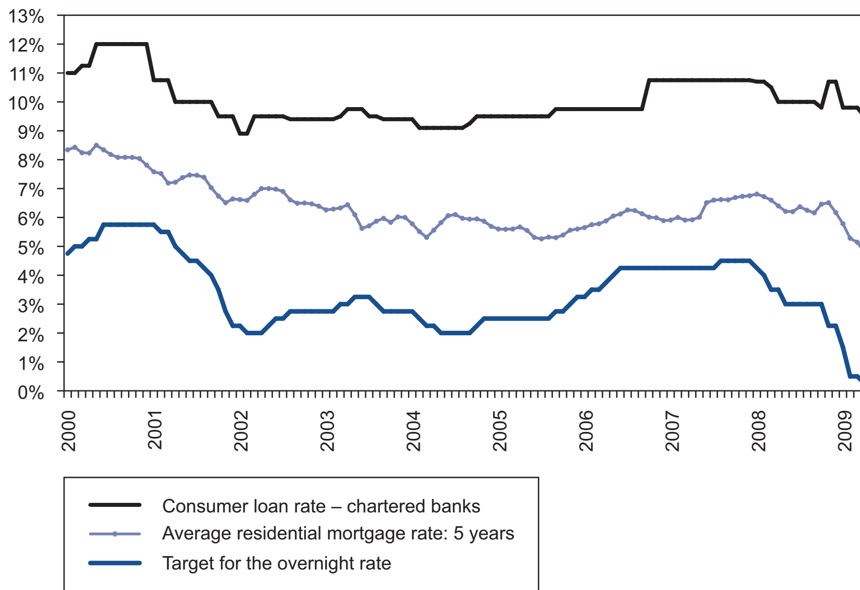
The overall downward trend in interest rates observed in the early 2000s lowered the number of households carrying fixed-rate debts and the proportion of household debt with variable rates increased from 14% in 1997 to 25% in 2007.[18] However, this still leaves a large number of indebted households vulnerable to low inflation.

As variable rates may be applied to different types of debt (e.g. mortgages, leases, consumer loans), it is fair to assume that most households would have a combination of variable and fixed rate loans in their debt portfolio. As such, the increasing real debt burden on fixed-rate debt may be hoped to be partially mitigated by the lower costs of servicing variable-rate debts. However, as will be seen below, this type of mitigation may be limited.

Well known, one of the primary functions of the Bank of Canada is inflation targeting. To prevent the inflation rate from moving outside the target, the Bank changes the target for the overnight rate – the rate at which major financial institutions borrow and lend one-day funds among themselves. The changes in the overnight rate are typically expected to translate into similar changes in other interest rates, including prime lending rates of chartered banks. However, the drastic lowering of the overnight rate in 2007-2009 translated into only modest changes in consumer credit and mortgage rates. For instance, a 4.25 percentage point drop in the Bank's overnight rate between December 2007 and April 2009 translated into a 1.9 percentage point drop in the average residential mortgage rate and a 1.3 percentage point drop in the lending rate for consumer credit (Figure 14). This only partial adjustment of interest rates at the consumer's end makes variable-rate debt nearly equivalent to fixed-rate debt when it comes to the negative consequences of low inflation.

17 Estimated based on CANSIM Table 203-0003.
18 Faruqui, U. (2008). *Indebtedness and the Household Financial Health: An Examination of the Canadian Debt Service Ratio Distribution*, Bank of Canada, Working Paper 2008-46, p. 10.

Figure 14 – Selected Interest Rates



Source: CANSIM Tables 176-0043 and 176-0048.

The drastic lowering of the overnight rate in 2007-2009 translated into only modest changes in consumer credit and mortgage rates

Although speculating on the possible trajectory of inflation growth in Canada goes beyond the scope of this report, currently observed rapidly slowing inflation puts our evaluation of declining interest rates on the cautious side. The example of Japan naturally comes to mind: nearly zero interest rates but also the negative inflation growth in the 1990s resulted in a decade of stagnation for Japan's economy.

Summing up the discussion above, stagnant or even declining income, slow and lengthy process of rebuilding financial wealth and increasing real debt-service burden are probably the main features of the financial outlook of the household sector in the near future. As economic theory suggests, over the lifetime, the household can consume no more than the sum of the present discounted value of its labour income and its current net worth. As the prospects for both future income and wealth have deteriorated, it may simply be irresponsible to continue consuming at the same rate as we did when the prospects for income and wealth were much more positive.

What Has Not Changed? – The Dilemma Regarding Spending and Saving

6

Survey results

78% of respondents will not change their saving patterns due to financial and economic instability

A hundred different ways may come to mind when thinking of how a sum of money may be used. Economists, though, funnel down this variety to two basic concepts: spending and saving. At any point in time, households' primary goal is to satisfy their current needs by allocating a portion of their disposable income to spending. The part which is not spent is saved to be used for consumption in the future. Household spending (or, as Statistics Canada puts it, "personal expenditures on consumer goods and services") has been and remains a very important driving force of the Canadian economy. In 2008, more than half (55.7%) of Canada's GDP was generated by personal consumption contrasting sharply with 22.8% brought in by government spending and 19.8% generated by business gross fixed capital formation.[19]

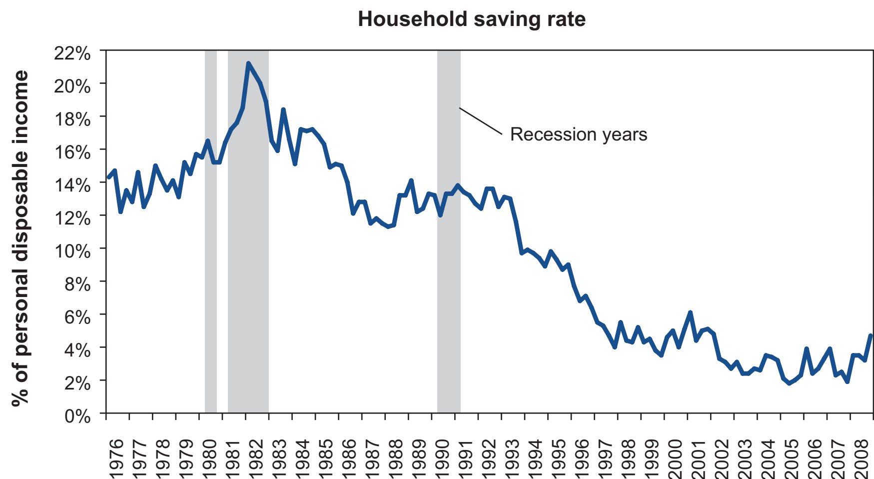
Household spending has been and remains a very important driving force of the Canadian economy

The experience of the previous recessions shows that households tend to increase their conventional savings (i.e. part of the disposable income that is not spent) during the economic downturns. This, in turn, decreases funds available for consumption at present. For instance, during the recession in the 1980s, the household saving rate went up by nearly 6 percentage points. Hikes, although of a lesser magnitude were also observed during the recession in the early 1990s and the economic slowdown caused by the burst of the IT bubble in the early 2000s (top graph of Figure 15).

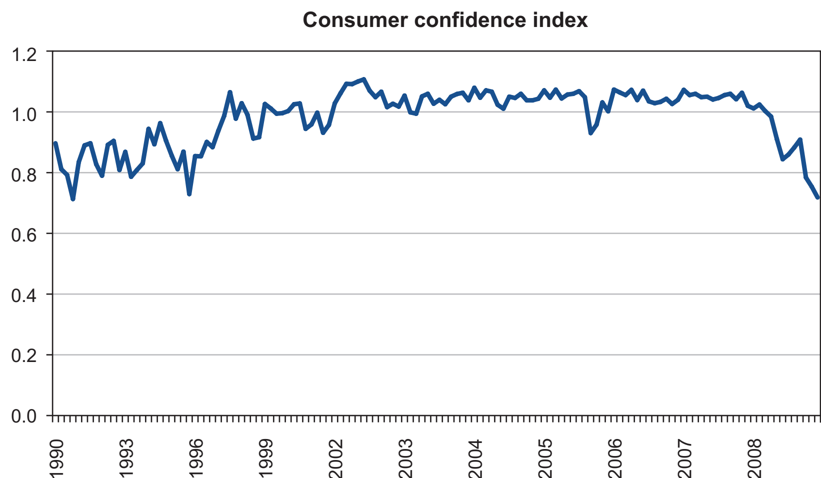
The household saving rate saw already a slight increase at the end of 2008 when it went from 2.7% in 2007 to 4.7% at the end of 2008. In addition, the Canadian Consumer Confidence Index that reflects households' willingness to spend and is based on the people's perception of current and future economic conditions sustained an unprecedented fall of 29.6% in 2008. This plunge was at least twice deeper than any other fall in the index value since the early 1990s (bottom graph of Figure 15).

19 Based on CANSIM Table 380-0017. CGA-Canada computation.

Figure 15 – Household Saving Rate and Consumer Confidence Index



Some observers have become increasingly worried that households may change their moods from 'culture of consumption' to excessive precarious savings



Note: In the bottom graph, data for 1990-2000 are quarterly, whereas for 2001-2008 are monthly.

Source: Top graph: CANSIM Table 380-0004. Bottom graph: OECD.Stat.

Naturally, in this environment of murky business prospects, some observers have become increasingly worried that households may change their moods from 'culture of consumption' to excessive precarious savings which, in turn, will put additional downward pressure on GDP. As a result, an increasing number of observations are made by private experts and government officials regarding the importance of measures that should assure continued access of households to credit.

The push to prevent tightening credit conditions takes place in the environment when the marketplace is rapidly becoming a buyer's market for many lines of products. Aggressive advertizing, inventive promotion packages and creative

financing schemes are becoming more and more popular. Conventional logic suggests that households may find themselves caught between three competing forces: the well developed habits of unrestricted consumption, the rapidly deteriorating situation of family finances, and yet an easy access to credit.

The sustainability of spending behaviour depends critically on the realization of expectations that formed the basis of borrowing decision, particularly those regarding the growth of income and wealth in the future. There is little doubt that prior to the meltdown of 2008, the multi-year recession-free economy featuring steady income growth, high demand for labour and expanding economic activity encouraged borrowing behaviour of households. It has now become clear that the assumptions used for those decisions will no longer materialize, at least not in the near future. At the same time, the assumptions used to make the current borrowing decisions have to be adjusted to the economic shocks to which the household sector is currently exposed.

One of the important functions of savings (apart from pooling the resources away from current consumption) is that they allow individuals to apportion their consumption over time. Insufficient savings, thus, may jeopardize household's financial situation throughout the life continuum and at retirement leading to a decline in optimum living standards. The low and decreasing savings rate is not a new phenomenon for the Canadian household sector. What is worth mentioning though is that the current economic slowdown is well positioned to amplify even further some of the factors that are the most often cited as propelling the decline in savings. For instance, low interest rates that make savings less attractive and borrowing costs initially easier to bear will most probably further persist. As well, the slower pace of growth in personal income will only further diminish the funds available after basic personal consumption needs are satisfied. Moreover, government transfer payments also tend to increase during the unfavourable economic times. Although a positive element of Canadian welfare and an important building block of economic stability, availability of government transfers may also transpire into lower incentives to save.

A balanced approach to spending, saving and paying down debt may be a more desirable option than trying to promote consumer spending as a solution for the current economic downturn

The fact is that Canadian behaviour to save has been declining and was identified as a worrisome trend in 2007 when CGA-Canada first undertook the analysis of household indebtedness. That was so, 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) was increasing. Although at that time 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, that wealth was not distributed evenly among households. Two years later (i.e. now), the demographic trend of an aging population has not improved, while all other economic preconditions have

deteriorated sharply leaving little effective means of conserving other than through active savings. Although we recognize the importance of consumer spending for business development and for economic growth, a balanced approach to spending, saving and paying down debt may be a more desirable option than trying to promote consumer spending as a solution for the current economic downturn.

Glimpse at Consumer Insolvency

7

Survey results

21% of respondents with debt said they have too much debt and have trouble managing it

Consumer insolvency is normally considered as an option of last resort for dealing with financial distress. As such, it may be an important indicator of growing social and financial problem. At the same time, the number of consumer insolvencies has a somewhat limited ability to reflect a decrease of living standards of individual households or deterioration of financial situation of the household sector as a whole.

The number of consumer insolvencies has a somewhat limited ability to reflect a decrease of living standards of individual households or deterioration of financial situation of the household sector as a whole

For instance, some research suggests that consumer bankruptcy may be a result of a strategic decision rather than a consequence of unforeseen events that reduce individual's ability to repay. Households become more likely to file for bankruptcy when their net financial benefits from filing (the difference between the value of debt discharged and the value of non-exempt assets) increases.[20] Yet another research shows (using US data as the basis) that there are no reliable indicators confirming that an increase in consumer bankruptcies is a result of the deterioration of the financial conditions of households or an increase in frequency or severity of financial shocks to which households are exposed.[21]

Confirming, to an extent, these conclusions, recent Canadian history offers a number of examples when the change in the growth pattern of consumer bankruptcies coincided with changes in the bankruptcy legislation rather than with the changes in economic prospects. This, for instance, was the case in 1997 when the drop in the number of bankruptcies concurred with an introduction of amendments to the Bankruptcy and Insolvency Act that reduced debtor-friendliness of the consumer bankruptcy legislation. The drop in the bankruptcies that took place in 1992 is another example. That year, an option to file a consumer proposal was introduced and became an attractive alternative to bankruptcy.[22]

20 Fay, S. et al (2002). *The Household Bankruptcy Decision*, American Economic Review, Vol. 92, n. 3.
21 Zywicki, T.J. (2005). *An Economic Analysis of the Consumer Bankruptcy Crisis*, Northwestern University Law Review, Vol. 99, no. 4.
22 See CGA-Canada report titled "*Where Does the Money Go: The Increasing Reliance on Household Debt in Canada*" (www.cga.org/canada) for a somewhat more detailed discussion on the influence of legislative changes on consumer bankruptcies in Canada.

Acknowledging these limitations of consumer insolvency to reflect the deteriorating conditions of financial wellbeing of Canadian households, we constrain our discussion in this section to an only brief glimpse at the recent dynamic of consumer insolvency.

It should be recognized that the end of 2008 may yet be too early a point in time to render a proper judgement on the spill-over of the financial turbulence into the incidences of personal insolvency

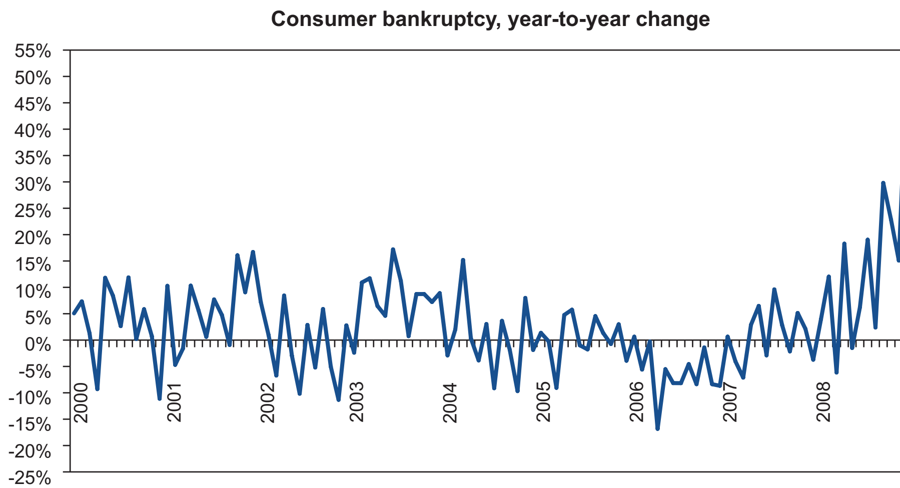
Consumer insolvencies consist of bankruptcies and proposals. While the system of consumer bankruptcy has been in place for many decades, consumer proposals were first introduced in 1992 but have been exhibiting a tremendous growth since then, particularly over the 1990s. In fact, between 1993 and 2008, the average annual growth rate of proposals was five times higher than the 3.5% registered for bankruptcies. As a result, there were 34 bankruptcies and 10 insolvencies per 10,000 adult Canadians in 2008.[23]

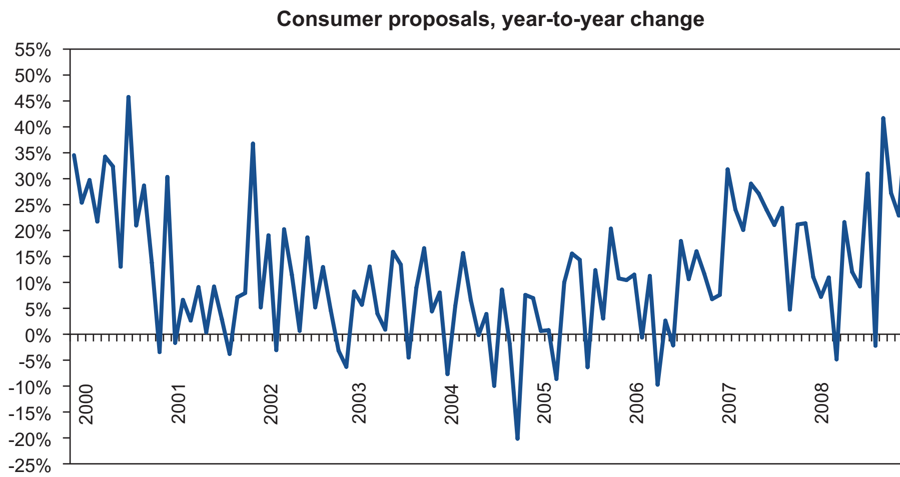
Focusing on 2007-2008 – the timeframe that is more pertinent to the current discussion – reveals a somewhat different dynamic. Consumer bankruptcies skyrocketed at the end of 2008 registering year-to-year increases of as high as 29.8% in September and 50.6% in December. This contrasted greatly with a much more moderate growth seen at the beginning of 2008 and other years prior to that (top graph of Figure 16). The year-to-year growth in proposals also intensified at the end of 2008; however, the elevated levels were seen throughout 2007 as well and were not unprecedented compared to the historic growth rates (bottom graph of Figure 16).

The more rapid growth in bankruptcies compared to proposals may suggest that the financial and economic turbulence boosted the number of individuals who are viewed by creditors as not suitable to qualify for debt rescheduling under consumer proposal rules. At the same time, it should be recognized that the end of 2008 may yet be too early a point in time to render a proper judgement on the spill-over of the financial turbulence and economic downturn into the incidences of personal insolvency.

23 Based on CANSIM Tables 177-0001 and 051-0001. CGA-Canada computation.

Figure 16 – Consumer Insolvency, 2000-2008





Source: CANSIM Table 177-0003 and Office of the Superintendent of Bankruptcy Canada, Insolvency Statistics in Canada. CGA-Canada computation.

Conclusions

8

The analysis of the preceding sections has intended to provide valuable insight into the recent changes of the level of debt held by Canadian households and the implications of economic shocks onto individuals who may have to endure under the combination of burgeoning accumulation of debt and rapidly deteriorating economic situation. By consolidating Canadian views and the statistical information available on household debt in Canada, a number of contentions have been exposed.

The rapidly deteriorating situation of household sector's balance sheet should be viewed as an alarming matter

Some observers may welcome the strong growth in the credit flow to households registered in 2008, and particularly in the third and fourth quarter of that year. Such a credit expansion proves that households continue to have access to funds and that these consumers may fully participate in the marketplace as active economic agents.

The numbers presented in this report though, show that household debt grew faster during the two years of financial and economic turbulence than during preceding years of strong economic growth. The indicators used to gauge the financial health of households have reached historic highs and are further deteriorating. Moreover, the expansion of household debt, and particularly of consumer credit, is not well supported if the virtues of net household wealth or security are examined. Rather, we are faced with a reality that we are financing our consumption activity and that we are fuelling gross domestic product growth with unearned money. And it seems that this is what we are intent to do. As major financial institutions, corporate giants, financial markets, different levels of government, and others have revealed of late, much to their chagrin, there is an upper limit to the optimism we can lend an industry or sector. This holds true on an individual basis and leaves little room to doubt that the level of financial stress of households increased and a further run up in household debt without a corresponding growth in assets and/or income will continue to exert a circular pressure on the economy and on the financial systems.

The risk tolerances of the financial institutions should not be exercised as a substitute for the judgment of individuals

The fact that revolving credit has become a prevailing part of the consumer credit poses an elevated risk of forming a debt spiral. This is particularly so given the tightening economic conditions and the fact that the financial situation of certain groups of households may be deteriorating much faster than the aggregate balance sheet of the household sector. The increasing use of revolving credit is further aggravated by the rising preference to use credit for consumption rather than for wealth accumulation.

Regardless of income level or of financial condition, individuals need exercise financial discipline and judgement when using revolving credit rather than bluntly maximizing different financial options associated with such vehicles.

Prospects of improving households' financial situation in the near future are low

Stagnant or even declining wage and salaries, low likelihood of filling in the gap from increases in other sources of income, lengthy process of rebuilding financial wealth, elevated uncertainty regarding possible changes in the value of residential assets, and increasing real debt-service burden are probably the main features of the financial outlook of the household sector in the near future.

As the prospects for both future household income and wealth have deteriorated it may be irresponsible to continue consuming at the same pace as we did during the time when individuals' income and wealth seemingly enjoyed strong economic prospects.

A balanced approach to spending, saving and paying down debt may be a desirable feature of households financial behaviour in the near future

It has now become clear that the assumptions regarding growth in income and wealth used to make borrowing decisions prior to 2008 will no longer materialize, at least not in the near future. At the same time, the assumptions used to make the current borrowing decisions need be adjusted to account for economic shocks to which the household sector is currently exposed.

The case for accumulation of savings has not changed much; however, the choice of saving options has narrowed significantly shifting the emphasis to old-fashioned active savings. Although the importance of consumer spending is recognized for business development and economic growth, a balanced

approach to spending, saving and paying down debt may be a more desirable option than trying to promote consumer spending as a solution for the current economic downturn. This seems to be particularly important knowing the increasing tendency of households to use credit for current consumption rather than for asset accumulation.

Steps Forward

9

As we have seen, the outlook for household debt in Canada has changed significantly over the past two years. However, this is not so much the case for the socio-economic culture revolving around increasing household indebtedness. The reason lies in the existence of a continuous need to reconcile and to balance the three main intersecting and sometime conflicting essentials: (i) borrowing is legally and rightfully a personal choice, (ii) strong household spending is essential for the growth of the Canadian economy, and (iii) build up of savings is a critical element for achieving high level of living standards in the future. In this regard, most of the policy recommendations offered in our 2007 report are as valid today as they were two years ago.

9.1. Improving 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 offers that avail new and attractive borrowing options, investment devices, and life-planning instruments; some of which are hard to understand or to fully appreciate. Oftentimes motivated to do the 'responsible' thing, we enrol in these programs without a clear and comprehensive understanding of their effective merit or of their inherent conditions.

As the recent developments on the financial market show, lending institutions are not in and of themselves necessarily guarding borrowers' interests by avoiding potential default of debtors. Given that financial institutions are mandated to maximize profitability and market share, we can reasonably expect that capitalism and commercial venture theory influence their product lines and merchandising tactics. As such, consumers should not confer their financial responsibility solely onto banks and other financial institutions or their intermediaries when determining individual levels of manageable debt or the net benefits of service offerings. That is, while valuable in availing requisite services, products, and counsel, the individual has an important role to play and should seek to not substitute the judgement of others for their own.

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 to make decisions alone are not enough. To survive and to prosper in the modern financial world, Canadian households need to have financial capability. Households need to have knowledge and understanding that gives them the ability to effectively control money, apply financial knowledge in predictable and unpredictable situations, and appreciate the impact of financial decisions on their personal circumstances. 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. Availability of a high-quality generic financial advice services offered by agencies not operating on financial market may assist Canadians to make effective decisions about their money and to become more financially capable. Improving general literacy particularly among low-income individuals becomes an important element in developing financial capability and ability to navigate the sophisticated contemporary marketplace.

The efforts of the federal government to establish an independent task force to make recommendations on a cohesive national strategy on financial literacy[24] is commendable. Expedience in affecting action is strongly supported.

9.2. Increasing 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.

In the current recessionary economy, many Canadians may be facing challenges of job insecurity, low investment returns, and murky prospects of business growth. None of these characteristics is of great help, or of great encouragement, in accumulating personal savings. Moreover, the tax incentives which were greatly relied upon as public policy instruments aiming to boost private savings in the past have somewhat lost their appeal. For instance, as discussed in CGA-Canada's recent report,[25] individuals' responsiveness to tax incentives offered by registered retirement savings plans (RRSPs) appears to be weak and is not straightforward. Over the past decade, declining RRSP contributions and participation rates persisted even despite the presence of certain factors that could increase the possibility of RRSP expansion

24 Department of Finance Canada (2009). *The Budget Plan*, p. 89.
25 CGA-Canada (2009). *51 and Counting – Is it Time to Remodel RRSPs?* (available at www.cga.org/canada)

(e.g. strong growth in income, declining coverage of employer-sponsored plans, strong economic growth).

Although, the recently introduced Tax-Free Savings Accounts (TFSAs) are often referred to as the most revolutionary savings instrument in Canada since the introduction of RRSPs, the results of the survey presented in this report suggest that the success of TFSAs in boosting private savings may be somewhat limited. For instance, not more than one quarter of respondents may be expected to use TFSAs and some of this would be at the expense of RRSPs.

In the environment of declining importance of tax incentives, it may be reasonable to consider a supplementary but more assertive approach of encouraging private savings, particularly those for retirement. The approach that relies on people's natural inertia – where the initial enrolment into a private pension plan is compulsory but where opting out within a limited period of time is available – may be worth a more thorough consideration.

Other measures that government may consider reside in the prospective implementation of matching, to some extent, the saving contributions, particularly of low income individuals. This type of measure is not new and is, for instance, currently deployed through Registered Education Savings Plans (RESP). Currently existing asset building programs (e.g. RRSP, TFSA, and RESP) can also be broadened or extended to include, for instance, medical savings accounts and investment tax benefits.

Increasing awareness and understanding of importance of savings should also be a vital part of public policy. In some cases, barriers to savings may exist due to a lack of knowledge and information, distrust in the financial sectors, or finding the investment process overwhelming and complicated. Increasing awareness would be particularly important for younger Canadians as, when it comes to savings, time is a precious commodity in itself.

9.3. Improving Competitiveness of Canadian Businesses

Borrowing allows households to smoothen their consumption over time; however, income and income prospects are often more important determinants of consumers' confidence and willingness to pay. Although boosting consumer spending and encouraging demand in the economy are important, it may be more appropriate for overall longer-term sustainability to concentrate effort in addressing the fundamentals such as labour demand, which largely defines households' level of income.

The Canadian economy is an increasingly open economy with approximately 40% of its GDP generated through exports. As such, the demand for Canadian goods and services could be further developed in many markets; both domestically and internationally. In turn, households' employment income sources which are much less geographically diversified and are primarily linked to the Canadian labour market can be expanded or otherwise enriched. Increasing competitiveness and bolstering the abilities of Canadian businesses to compete successfully will only become more important as the global economy continues to evolve and to morph into an efficiency-seeking cosmos.

A number of measures may serve that purpose. Promoting innovation and technological growth, increasing the rate of technology diffusion and productivity growth, increasing infrastructure investments and boosting support for employer-sponsored training are only few of them. Ensuring access to credit for businesses would of course continue to carry high importance as well....

Appendix A: Detailed Findings From the Survey of Household Attitudes to Debt and Consumption

10

Given the abrupt collapse of the financial markets and seriously deteriorating economic conditions that unfolded during the fall of 2008, CGA-Canada saw a fit to examine changes in households' attitudes and perceptions and their responsiveness to the shifting economic reality. With a particular curiosity around how Canadians view their financial conditions, CGA-Canada commissioned a public opinion survey that sought to identify the perspectives of Canadians on the changing level of their indebtedness and attitudes towards spending and saving. The survey was conducted in the fall of 2008 repeating, to a large extent, a similar survey commissioned by CGA-Canada in the spring of 2007.

Methodology

The survey was administered by Synovate from November 3 to 14, 2008. The interview 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 respondents making up a representative sample of Canadian adults aged 25 years and over.

The survey sample was drawn using Synovate's online panel which includes approximately 110,000 individuals. A total of 2,014 on-line interviews were conducted with households living in the ten Canadian provinces. With this sample size, sampling error of plus or minus 2.18% is produced at a 95% confidence level (19 times in 20). The data was statistically weighted to accurately reflect the composition of Canadians by region, gender and age based on Statistics Canada's 2007 information. The profile of the survey respondents is presented in Table A.

The 2008 survey questionnaire preserved the structure and the content of the 2007 questionnaire; however several additional questions were included in order to provide a broader perspective on households' savings habits. The 2008 survey questionnaire is presented in Appendix B, whereas details regarding the 2007 survey (including description of the methodology, respondents' profile, survey questionnaire and key findings) can be found in the CGA-Canada's report titled *Where Does the Money Go: The Increasing Reliance on Household Debt in Canada* (available at www.cga.org/canada).

Table A – Profile of the Survey Respondents

Characteristics	Number of respondents	% of total sample
Sex		
Male	982	48.8%
Female	1031	51.2%
Age		
25 – 34 years old	395	19.6%
35 – 44 years old	426	21.1%
45 – 54 years old	456	22.7%
55 – 64 years old	342	17.0%
65 years of age and over	393	19.5%
Household size		
One	458	22.8%
Two	885	44.0%
Three	265	13.2%
Four or more	404	20.2%
Geography		
British Columbia	270	13.4%
Alberta	199	9.9%
Saskatchewan and Manitoba	127	6.3%
Ontario	791	39.3%
Quebec	481	23.9%
Atlantic Provinces	145	7.2%
Income		
Under $15,000	144	7.1%
$15,000 – $24,999	221	11.0%
$25,000 – $34,999	250	12.4%
$35,000 – $49,999	278	13.8%
$50,000 – $74,999	377	18.7%
$75,000 – $99,999	294	14.6%
$100,000 or more	314	15.6%
Don't know	136	6.8%
Employment status		
Employed	1162	57.7%
Unemployed	83	4.1%
Retired	531	26.4%
Not in Labour Force – other than retired	236	11.7%
Education		
High school or less	591	29.4%
Community college/Technical school	679	33.8%
Some university	228	11.3%
University degree and above	514	25.5%

Unless otherwise specified, the survey findings presented below are based on the survey conducted in 2008. A comparison to the 2007 survey is provided only in cases where noticeable differences existed between respondents' perceptions revealed in 2007 and 2008.

Detailed Findings

The survey asked Canadians to reflect on the changes that had occurred in their household finances over the past 3 years by examining four broad elements of (i) household debt, (ii) income, assets and wealth, (iii) spending and (iv) savings. 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 3 of this paper.

1. Household Debt

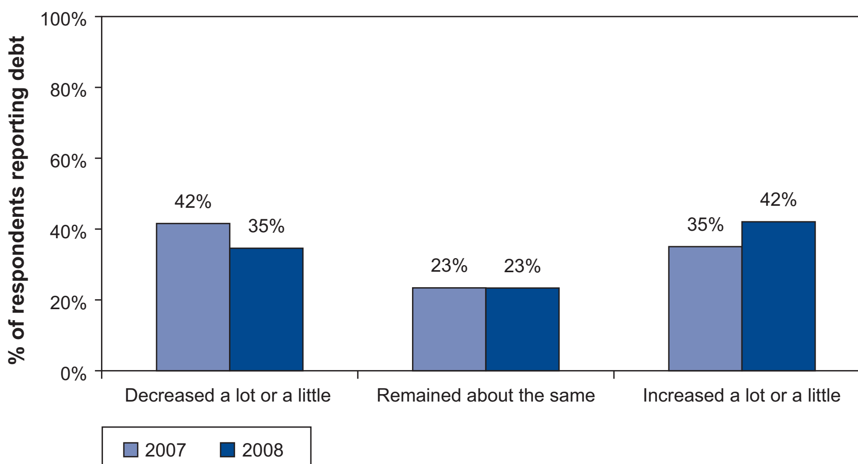
The survey sought to identify how and why household debt has changed, the level of comfort in having debt and the respondents' point of view on whether indebtedness prevents them from reaching some of their financial goals.

A much larger proportion of respondents surveyed in 2008 felt that their debt increased compared to households' perceptions in 2007

Changes in household debt over the past 3 years

Overall, 85% of the survey respondents reported having some type of debt – a proportion nearly identical to that registered in 2007. However, a much larger proportion of respondents surveyed in 2008 felt that their debt increased compared to households' perceptions in 2007. In 2007, those with decreasing debt outnumbered respondents with increasing debt. The situation reversed in 2008 with 42% of respondents saying their debt has increased a lot or a little over the past 3 years compared to only 35% of those whose debt load decreased (Chart 1). The proportion of survey participants reporting their debt to have increased a lot saw the largest increase shifting from 16% in 2007 to 20% in 2008.

Chart 1 – Changes in Household Debt Over the Past 3 Years



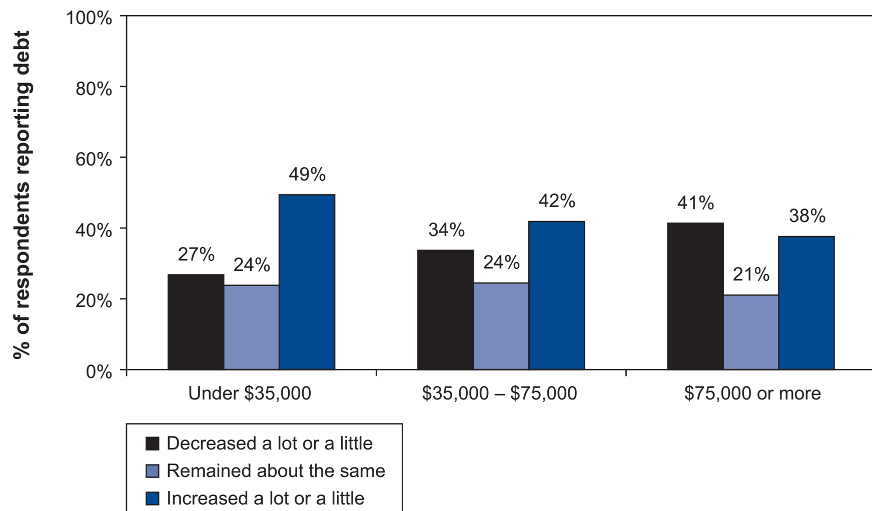
As would reasonably be expected, younger respondents were more likely to view their debt as increasing when compared to their older counterparts. Specifically, 52% of respondents younger than 35 years of age reported their debt as increasing. This contrasted with 43% of those aged 35 to 55 and 34% of respondents older than 55 years of age who also thought their debt went up.

When respondents were grouped by retirement criterion, the results for 2008 showed an even split of 36% between retired Canadians whose debt increased and those with decreasing debt. This contrasted with the situation in 2007 when a noticeably larger proportion of retired respondents (46%) reported their debt as decreasing compared to only 28% of those for whom debt was on the rise.

Those with annual household income under $35,000 were much more likely to report increasing debt compared to respondents in other income groups

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. In turn, a noticeably larger proportion of respondents with household income of $75,000 and over reckon their debt as decreasing compared to lower-income survey participants (Chart 2).

Chart 2 – Changes in Household Debt by Income Group

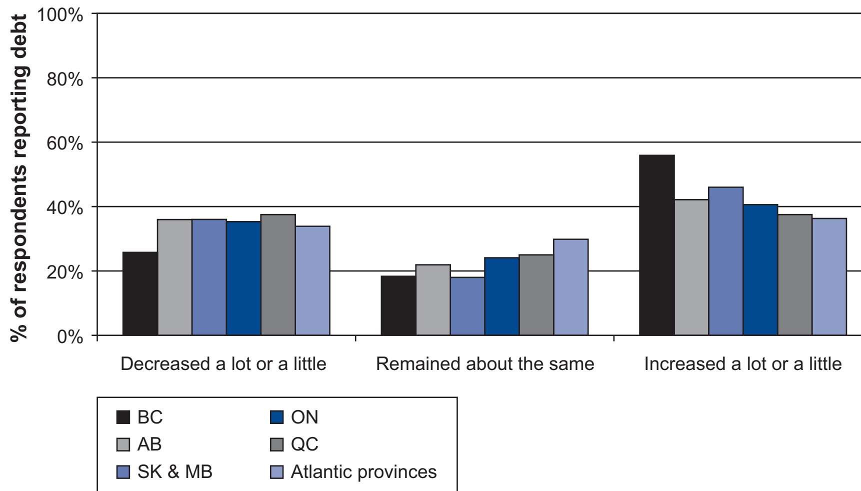


Households with one or more children under age 18 tended to report their debt as rising more often than those with no children. While debt increased for 38% of those with no children under age 18, the proportion climbed to 49% for those who had at least one child.

Some regional differences existed in the proportions of respondents reporting changes in their household debt. For instance, as little as 36% of residents in Atlantic provinces, but as many as 56% of British Columbians, told us their debt increased compared to the Canadian average of 42%. Also, a noticeably larger than average proportion of residents in the Atlantic provinces (30%) maintained an unchanged debt level compared to 23% of the total of all respondents who said their debt remained about the same (Chart 3).

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

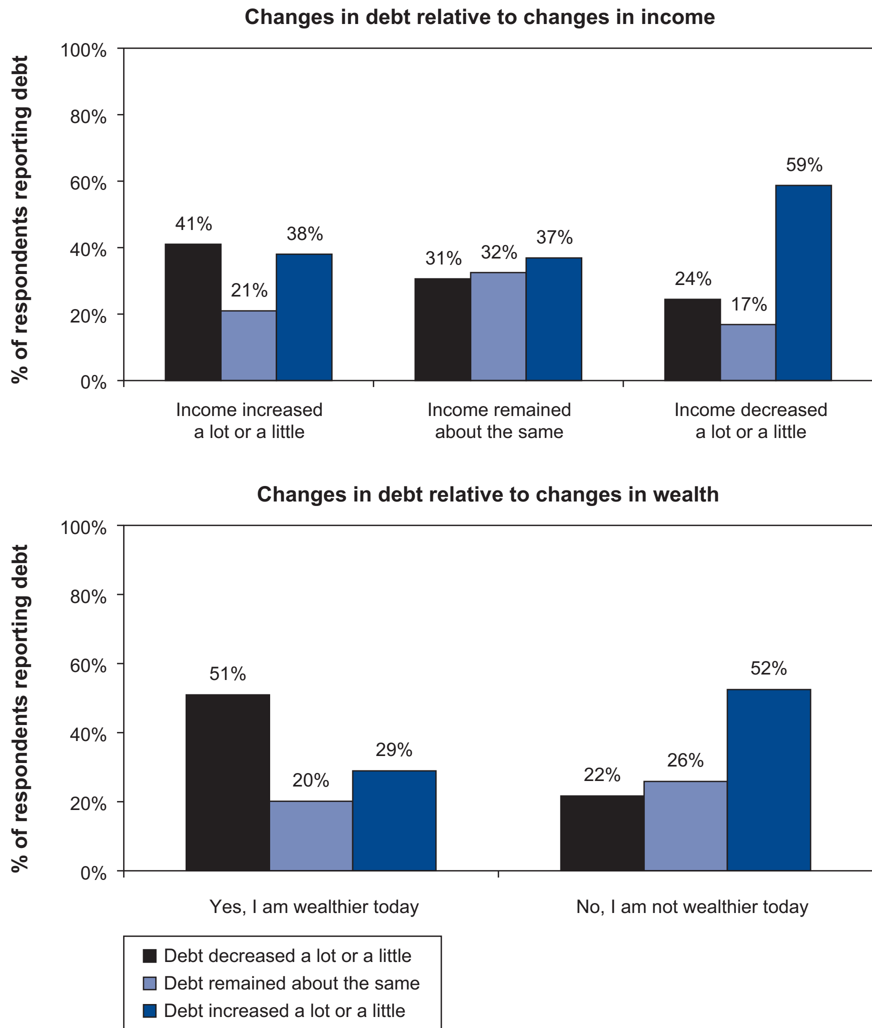
Chart 3 – Changes in Household Debt by Region



Unlike the common logic, increasing debt was not associated with an increase in income or wealth. Those whose income increased over the past 3 years and those who felt wealthier today were more likely to say that their debt decreased rather than increased. The opposite was also true: individuals that reported decreased income and/or did not feel wealthier today were also more likely to report their debt increasing (Chart 4). This relationship also holds true when only non-retired respondents are considered.

The majority of individuals with increasing debt were either very concerned (41%) or somewhat concerned (43%) with the fact that their debt has increased

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

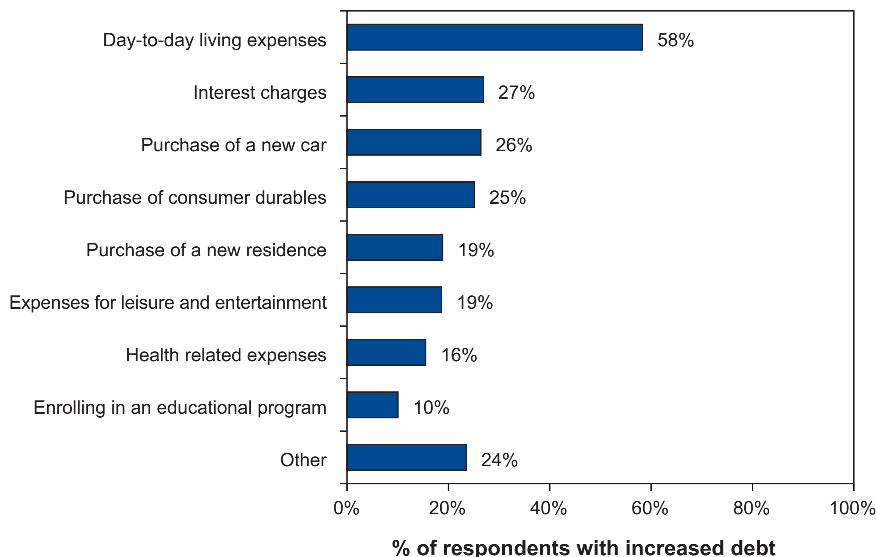


Some differences were observed in the extent to which income dynamic influenced changes in debt in 2007 and 2008. In 2007, nearly half (47%) of respondents with increasing income felt their debt declined compared to only 31% of those who thought their debt increased. In 2008, in turn, respondents with raising income were nearly equally divided (41% vs. 38%) on those with increasing and decreasing debt. Moreover, some 59% of individuals whose income went down reported a run up in their debt in 2008 compared to 49% in 2007.

The majority of individuals with increasing household debt were either very concerned (41%) or somewhat concerned (43%) with the fact that their debt has increased. The proportion of those very concerned noticeably increased from its 36% level in 2007. Meeting day-to-day living expenses was far the most often cited reason for the increasing debt followed, at a distance, by

interest charges and a purchase of a new car (Chart 5). This ranking of reasons for increasing debt was very similar to that in 2007 with one noticeable exception: day-to-day expenses answer option was chosen by 58% of respondents in 2008 compared to 52% in 2007.

Chart 5 – Reasons for Increasing Debt



Respondents of all ages ranked day-to-day living expenses as number one among the reasons for increasing indebtedness

Respondents of all ages ranked day-to-day living expenses as number one among the reasons for increasing indebtedness. However, importance of other reasons varied noticeably depending on the respondent's age and retirement status. For younger survey participants (those under 35 years of age), purchasing of a new residence and consumer durable goods ranked as 2nd and 3rd most important reason for increasing debt. In turn, for retired respondents, expenses for travel and leisure and health expenses were among the top 3 activities that caused the run up in debt. Interestingly, respondents aged 35 to 55 years were more likely to increase their indebtedness due to reasons related to consumption (e.g. day-to-day expenses, purchasing of a new car or durable goods) as opposed to accumulation of physical or human capital through purchasing real estate or attending an educational programs.

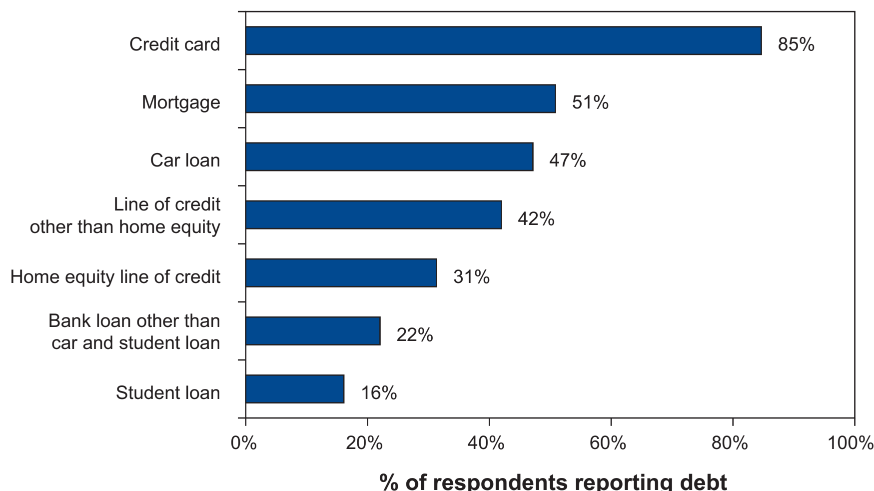
Type of debt held

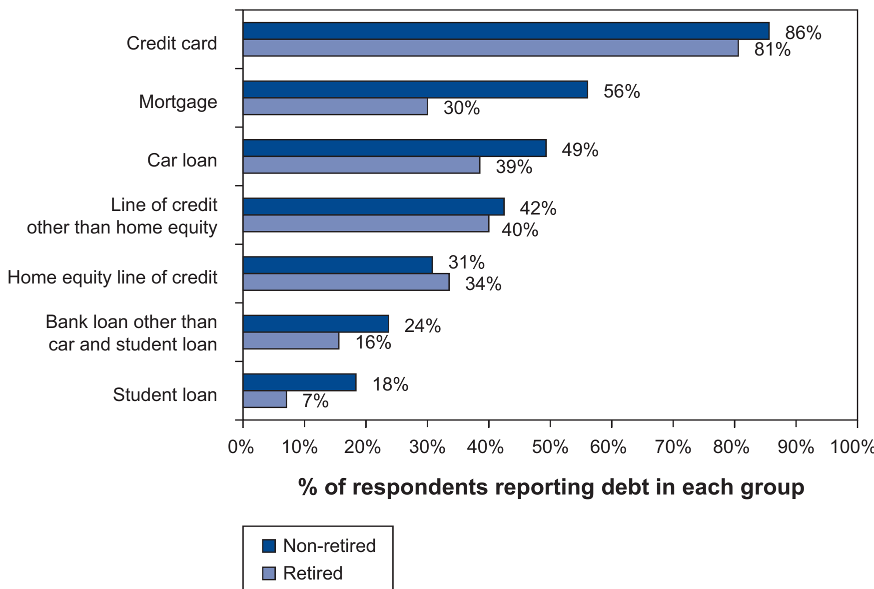
To identify the composition of respondents' debt portfolio, surveyed individuals were offered a list that included seven types of debt: mortgage, credit card, car loan, student loan, home equity line of credit, line of credit other than home equity, and bank loan other than car and student loan.

Some 85% of respondents with debt had a credit card outstanding debt. Outside of credit cards, the two most popular types of debt were mortgages and car loans held by 51% and 47% of respondents respectively (top part of Chart 6). For all types of debt but bank loans other than car and student loans, the proportion of respondents reporting that type of debt increased compared to 2007. The largest increase was observed for credit cards. Nearly three quarters (73%) of respondents reported credit card debt in 2007 whereas this proportion reached 85% in 2008.

For all types of debt but bank loans other than car and student loans, the proportion of respondents reporting that type of debt increased compared to 2007

Chart 6 – Type of Debt Held by Households



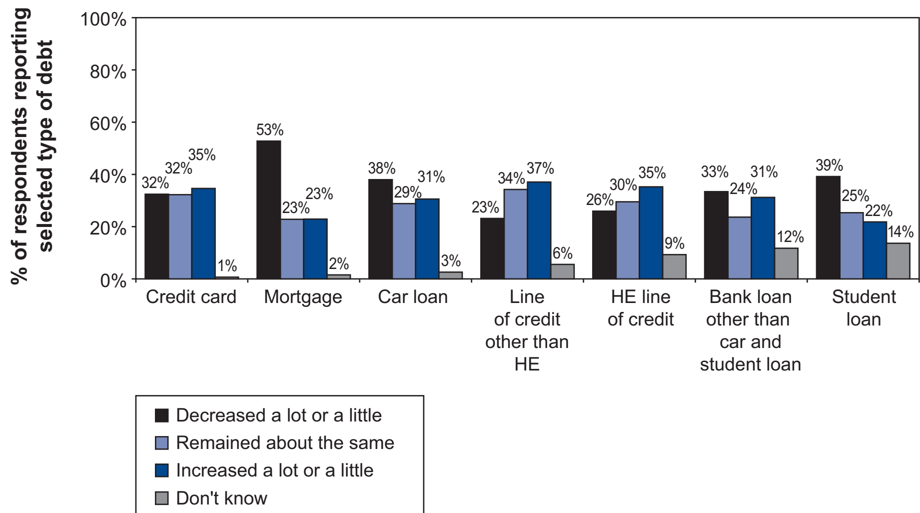


Contrary to what may be expected, the retirement status did not radically influence the type of debt held by the survey participants. Mortgage and student loans were two noticeable exceptions: mortgages were reported by 56% of non-retired respondents compared to 30% of retired survey participants. Similar, student loans were a burden for 18% of non-retired individuals whereas a twice lower proportion of retirees reported this type of loan (bottom part of Chart 6). In 2007, the situation was somewhat different as most types of debt were reported by a noticeably higher proportion of non-retired respondents compared to survey participants who already retired. This was true for all types of debt but home equity line of credit.

There seem to be certain disconnect between the general perception of the increasing indebtedness and the changes in specific types of debt. As was seen from Chart 1, 42% of Canadians perceived their debt as increasing rather than decreasing or remaining the same. At the same time, when speaking about particular types of debt, respondents were more likely to report the level of outstanding debts as decreasing rather than increasing. More specifically, surveyed individuals revealed that their debt decreased rather than increased for four out of seven types of debt listed in the questionnaire. Among those are mortgages and car loans – the two types of debt that typically constitute the largest part of household indebtedness (Chart 7).

21% of indebted respondents said they have too much of debt and have trouble managing it

Chart 7 – Changes in Selected Types of Debt



Interesting to note that for credit lines and bank loans, a relatively large proportion of respondents (between 6% and 14% depending on the type of debt) could not tell whether their debt increase, decreased or remained the same.

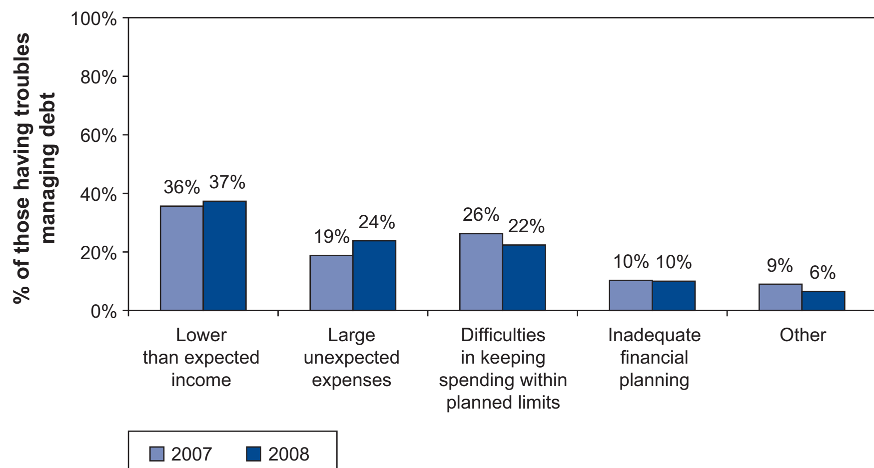
Households' ability to manage debt

The majority of respondents (61%) felt they could manage their household debt well, and some 18% suggested they could take on more debt and still manage their finances well. However, 21% of indebted respondents said they have too much of debt and have trouble managing it. This was a slight increase from a 17% level registered in 2007.

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

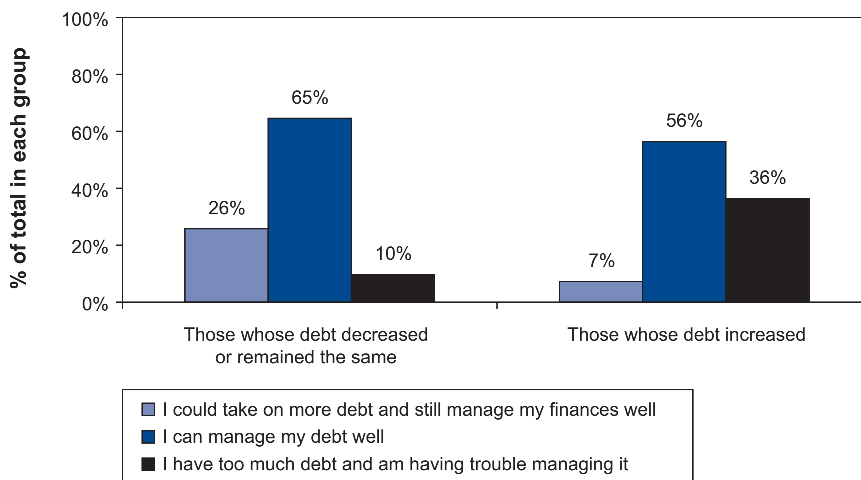
Among individuals experiencing problems in managing debt, 3 in 5 named lower than expected income or larger than expected expenses as two main factors causing difficulties. In 2008, unexpected expenses were affecting a larger proportion of respondents (24%) compared to 19% in 2007. At the same time, fewer respondents had difficulties in managing their debt due to poor financial discipline in 2008 compared to a year before (Chart 8).

Chart 8 – Reason for Having Troubles Managing Debt



Those whose debt increased were much more likely to report troubles managing it. Roughly one third (36%) of respondents reporting rising debt felt that way compared to only 10% of respondents whose debt decreased or remained the same over the past 3 years. However, the majority (63%) of respondents with increasing debt still felt they could either manage it well or even take on more debt (Chart 9).

Chart 9 – Attitude Towards Debt

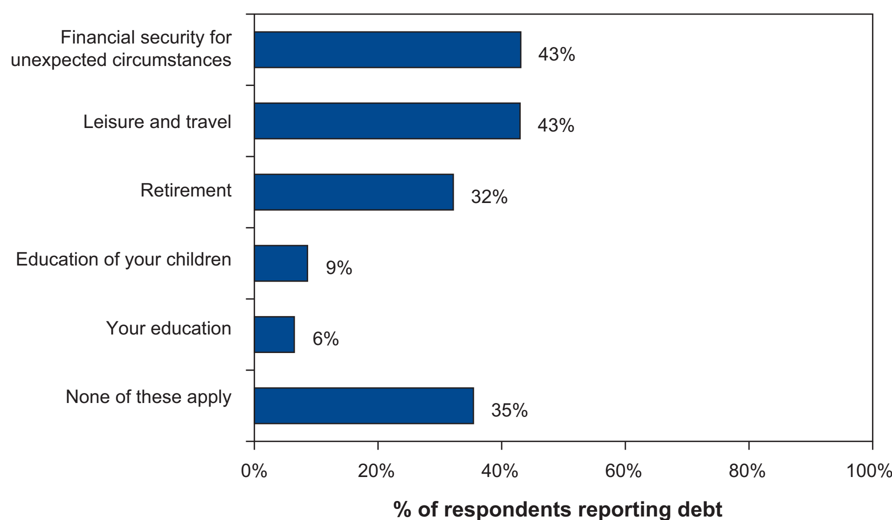


65% of indebted individuals felt that debt prevents them from reaching their goals

Negative influence of debt

Respondents were asked whether debt negatively affects their ability to attain goals in such areas as retirement, education, leisure, travel, and financial security for unexpected circumstances. Some 65% of indebted individuals felt that debt prevents them from reaching goals in at least one of those areas. Among those who felt the negative influence, the two most often cited areas were financial security for unexpected circumstances and leisure and travel: 43% of respondents indicated so for both areas (Chart 10).

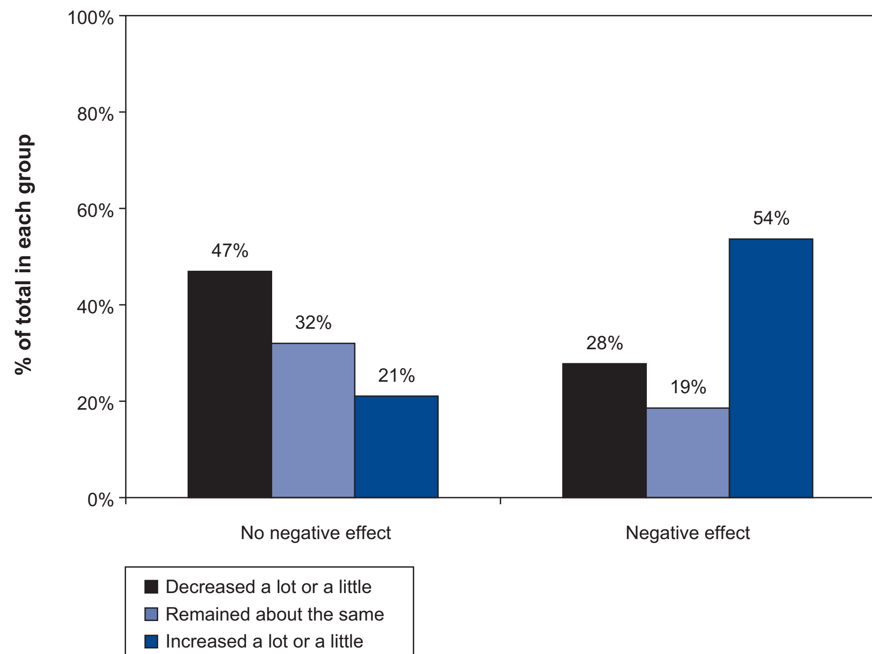
Chart 10 – Does Your Household Debt Negatively Affect Your Ability to Reach Your Financial Goals in the Area of...



Respondents suggesting that household debt prevents them from reaching their financial goals were also much more likely to say that their debt has increased in the past 3 years. More than half (56%) of those negatively affected by debt told us that their debt has increase a lot or a little. Respondents reporting no negative effect had an opposite tendency as nearly half of them (47%) said their debt decreased in the past 3 years (Chart 11). Those who felt that debt prevents them from achieving their goals were also much more likely to say that they have difficulties managing it. Some 31% of those negatively affected by debt had troubles managing it while only 2% of those who felt no negative effect were in a similar situation.

Respondents suggesting that household debt prevents them from reaching their financial goals were also much more likely to say that their debt has increased in the past 3 years

Chart 11 – Changes in Overall Debt of 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 8% 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: 32% were 25 to 34 years of age while 33% were in the 35 to 44 age group.

The supported individuals were slightly more likely to be in debt compared to other respondents. Nine in 10 respondents receiving support also had at least one type of household debt while this proportion stood at 84% for all other respondents. The overwhelming majority (78%) of supported 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 (56%) of supported individuals were either owning or buying their primary residence.

The supported respondents tended to have lower income: closer to a half of supported respondents (45%) had annual household income of less than $35,000 compared to 29% mark for all survey respondents. Interestingly, one in five respondents receiving support reported household income of $75,000 and higher.

Debt-free households

Some 16% of respondents said they did not have any debt.[26] The debt-free respondents were much more likely to be 65 years of age or older when compared to respondents reporting debt: 51% of debt-free respondents belonged to the older age group compared to only 14% of indebted individuals. Not surprising then that 88% of debt-free respondents lived in one or two-person households and were significantly less likely to have children under the age of 18 years.

Some 16% of respondents said they did not have any debt

The debt-free respondents were more likely to be Ontario residents, but were somewhat under-represented in Alberta when compared to the 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. Debt-free respondents had a slightly lower likelihood than indebted individuals (5% vs. 9%) of being supported by parents or other individuals in their day-to-day living.

Debt-free respondents were slightly over-represented among lower income group. Debt-free respondents with less than $35,000 in household income accounted for 36% of all debt-free respondents while for indebted respondents this proportion stood at 30%. Similarly, debt-free respondents were under-represented in the higher income group (those with household income of $75,000 and over) accounting for 24% of all debt-free respondents compared to 31% for indebted survey participants.

Those not having debt were as likely to make savings on a regular basis as their indebted counterparts; however, among non-retired respondents, debt-free individuals tended to report saving on a regular basis more often than those indebted.

26 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. For that, respondents were asked to describe the changes in their income, assets and wealth over the past 3 years, and to identify negative economic shocks that may affect their financial wellbeing.

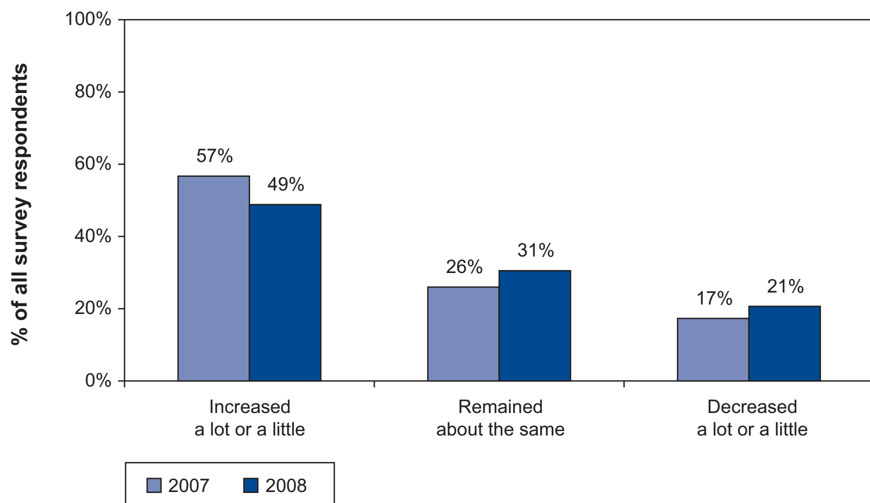
Household income

For 76% of non-retired respondents, wages and salaries were the main source of income. Only 7% relied on business income, another 8% considered government transfers as their principal source of income, and not more than 1% of non-retired respondents lived off of investment income.

The overall income dynamic was somewhat worse in 2008 compared to 2007 with more people reporting their income to remain the same or decrease

Nearly half of all respondents (49%) said that their household income increased over the past 3 years; however, the overwhelming majority (83%) of those reported that their income increased by only a little. Although only a relatively small number of survey respondents (21%) saw their income going down, the overall income dynamic was somewhat worse in 2008 compared to a year ago with more people reporting their income to remain the same or decrease while fewer experienced positive changes (Chart 12).

Chart 12 – Changes in Household Income Over the Past 3 Years

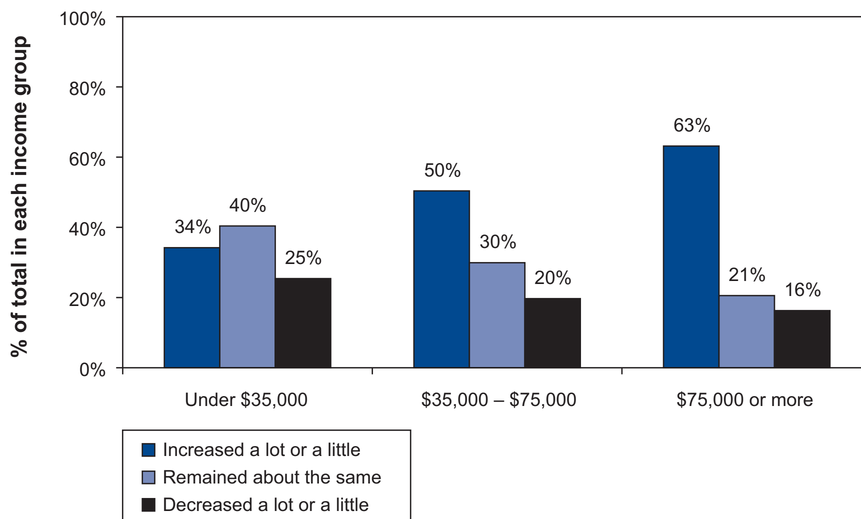


In 2008, the source of income was a more important factor for the income dynamic than a year prior to that. In 2007, respondents in all income source categories (except "other") were more likely to say their income increased rather than decreased or remained the same. In 2008, in turn, only those relying on wages, salaries, and business income were more likely to report their income as increasing.

Changes in income varied significantly depending on the overall income level of the respondent. Individuals with higher household income were more likely to see a positive change in their income compared to those with medium or lower income. More than half (63%) of respondents with household income of $75,000 and over saw their income increasing over the past 3 years. This contrasted with only one quarter (34%) of respondents with household income under $35,000. Similarly, not more than 3 in 20 respondents in the higher income group saw their income decreasing while this proportion stood at 5 in 20 in the lower income group (Chart 13). The overall deterioration of the income dynamic between 2007 and 2008 was true for all income groups.

Some 93% of respondents reported holding at least one type of assets

Chart 13 – Changes in Household Income by Respondent's Income Group



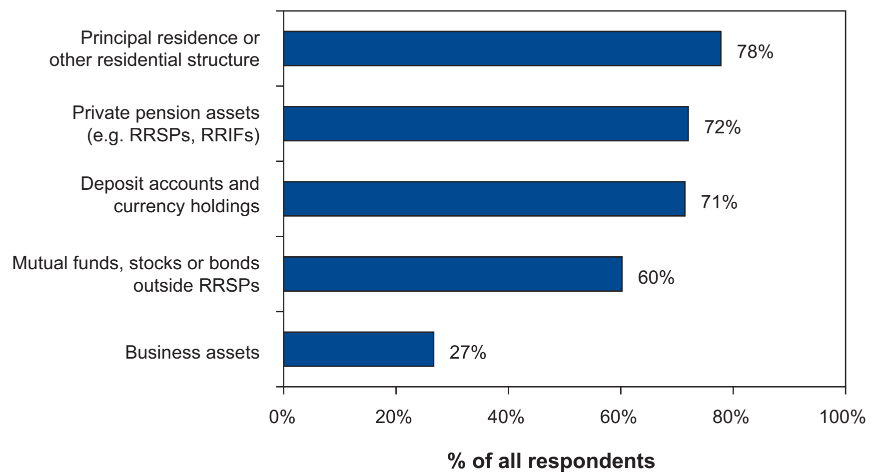
Interestingly, Quebec residents tended to be more cautious in assessing changes in their income compared to residents of other provinces. Only 45% of Quebec participants reported their income to have increased. This was the lowest among other provinces and contrasted sharply with 57% in Atlantic Canada and 54% in Alberta. Quebecers were also the least likely to say that their income decreased with only 16% choosing this answer option compared to the Canadian average of 21%.

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, RRIFs); assets associated with business; deposit accounts and currency holdings.

Some 93% of respondents reported holding at least one type of assets. 78% reported having a principal residence or other residential structure, 72% said they had private pension assets and 60% held mutual funds, stocks or bonds outside RRSPs (Chart 14). Some 5% of respondents told us that their only assets consisted of deposit accounts and currency holdings.

Chart 14 – Assets Held by Households



In 2007, very few respondents thought the value of their assets decreased. In 2008, the situation was quite the opposite, especially for financial assets

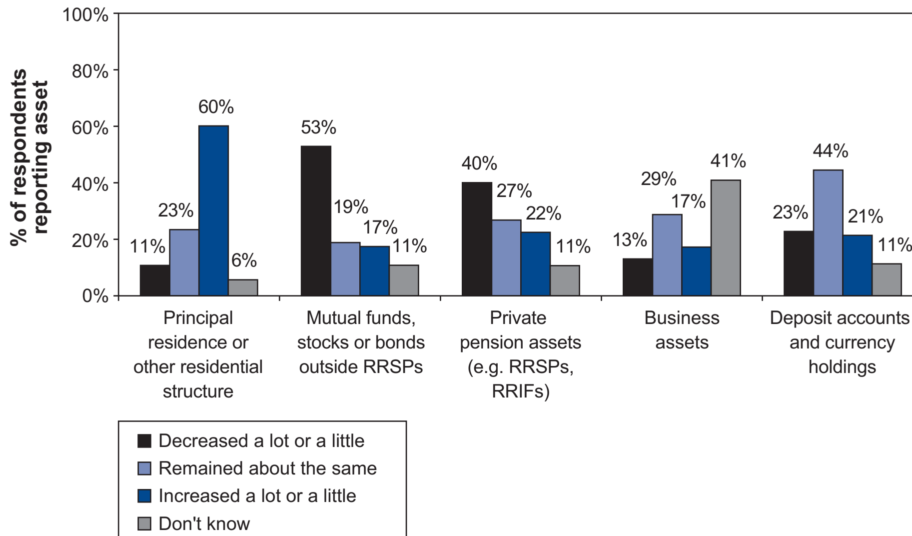
The survey asked respondents to reflect on the changes in value of their assets over the past 3 years. The perceptions respondents revealed in 2008 were noticeably different from those expressed in 2007.

In 2007, very few respondents thought the value of their assets decreased in the past 3 years. Nearly three quarters (73%) of survey participants assessed that the value of their residential structures increased, while some 60% of respondents felt that the values of their holdings in private pension assets, mutual funds, stocks and bonds outside of RRSPs increased over the past 3 years. For all types of assets but deposit accounts and currency holdings, less than 7% of respondents reported the value of assets to have decreased (for deposit accounts this proportion reached 13%).

In 2008, the situation was quite the opposite, especially for financial assets. More than half (55%) of those holding mutual funds, stocks and bonds outside of RRSPs, and 40% of respondents holding private pension assets assessed the value of their assets as decreasing over the past 3 years. While this dynamic may easily be explained by the crush on the financial markets that took place in the fall of 2008, the noticeable proportion (25%) of respondents reporting a decrease in their currency deposits may rather be viewed as a sign of the overall worsening in respondents' financial wellbeing. Respondents' residential structures were the only type of assets that tended to increase in value for

the majority of respondents – some 60% of survey participants felt that way (Chart 15).

Chart 15 – Change in Household Assets



Surprisingly, some 41% of respondents holding business assets could not say whether asset values increased, decreased, or remained the same in recent years. Although of a lesser magnitude, it was also revealing to learn that a noticeable proportion of respondents (11%) did not know what had happened to the value of their financial assets (pension and non-pension) and currency holdings.

The proportion of 2008 respondents who viewed their wealth as increased was not radically different from that revealed in the 2007 survey

Changes in household wealth over the past 3 years

In 2008, nearly half (44%) of all survey respondents felt they are wealthier today as compared to 3 years ago. This proportion may be viewed as relatively high given the unprecedented fall in the financial markets and the rapidly deteriorating economic situation that occurred in the fall of 2008. During the survey conducted in 2007, the market dynamic was quite the opposite mirroring several years of strong growth in the housing market and solid economic fundamentals. However, the proportion of 2007 respondents who viewed their wealth as increased was not radically different from that revealed in the 2008 survey. In 2007, some 57% of respondents thought they are wealthier today compared to 3 years ago.

As may be expected, retired respondents tended to be less optimistic about their wealth. Only 33% of the current retirees reported increased wealth compared to 48% of non-retired respondents.

Changes in income influenced significantly respondents' perception of changes in their wealth. 62% of those whose income increased felt wealthier while only 21% of those whose income decreased felt the same way.

Debt also seemed to influence individuals' perceptions regarding wealth. When only non-retired respondents were considered, 47% of indebted individuals felt wealthier today compared to 57% of their debt-free counterparts. Not surprising then, that respondents whose debt decreased in the past 3 years were much more likely to feel wealthier than those reporting their debt to have increased. 70% of respondents with declining debt reported being wealthier today, while this proportion stood at only 34% for those whose debt ran up in the past 3 years.

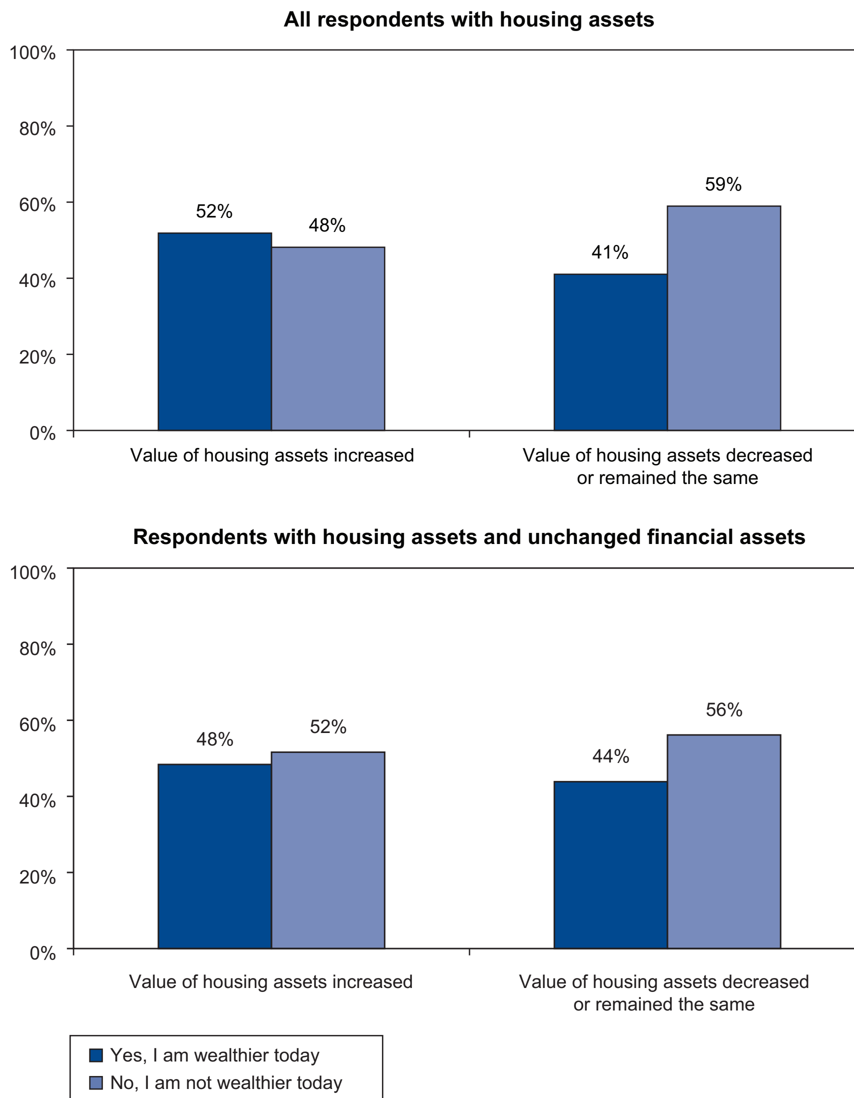
70% of respondents with declining debt reported being wealthier today, while this proportion stood at only 34% for those whose debt ran up

Respondents who save on a regular basis tended to more often agree that their wealth increased: 55% of those who saved regularly felt that way while only 25% of those who did not save on a regular basis felt their wealth increased.

Changes in the value of real estate assets seemed to be reflected in the respondents' perception of wealth; however, not to the degree that may be expected. Among those reporting an increase in value of their residential structures over the past 3 years, only 52% felt their wealth increased (top part of Chart 16). In 2007, some 66% of survey participants who reported an increase in the value of their residential assets also said they felt wealthier.

Changes in the value of housing assets influenced the respondents' perception of wealth even less for individuals whose financial assets (i.e. mutual funds, stocks, bonds and private pension assets) remained the same over the past 3 years. The majority (52%) of such respondents felt that their wealth decreased no matter what happened to the value of their housing assets (bottom part of Chart 16).

Chart 16 – Changes in Respondent's Wealth



Half of all respondents believe that their financial wellbeing would be noticeably affected by a 10% salary decrease

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%.[27]

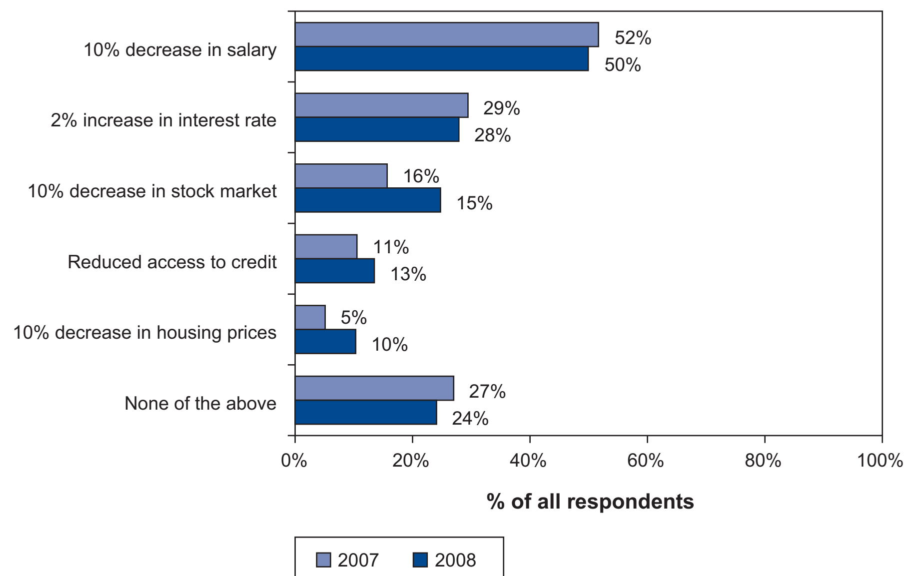
The most often cited sensitivity point was changes in salary with half of all respondents believing that their financial wellbeing would be noticeably affected by a 10% salary decrease. Some 28% of those surveyed felt vulnerable

27 Some caution should be exercised when interpreting the survey results regarding the sensitivity to shocks. To allow for a proper comparison, the wording of the 2008 questionnaire was identical to that used in the 2007 survey. As such, respondents were asked to reflect on their sensitivity to *moderate* shocks. At the same time, some of the actual economic shocks that started to unfold in the fall of 2008 were of a higher magnitude than those mentioned in the questionnaire. This leaves a room for guesswork that some respondents might have perceived a moderate shock mentioned in the questionnaire as a better outcome compared to the actual shock happening in the economy.

to hikes in interest rates while one quarter of respondents felt that a 10% decrease in the stock market would affect their financial wellbeing. Slightly less than one quarter of all respondents (24%) saw no threat to their financial wellbeing if any of the mentioned events were to take place. These responses were quite similar to the results of the 2007 survey with two noticeable exceptions. In 2008, a much larger proportion of respondents felt being vulnerable to changes on the stock and housing market (Chart 17).

In 2008, a much larger proportion of respondents felt being vulnerable to changes on the stock and housing market

Chart 17 – Household Sensitivity to Negative Shocks



Of those who owned residential structures, more than 87% did not feel that a moderate decline in the housing market would negatively affect them. A lower, but still substantial proportion of those holding private pension assets or mutual funds, stocks and bonds outside of RRSPs were insensitive to changes in the stock market. 68% of those with private pension assets and 66% of those with mutual funds and stocks did not think that a 10% decrease in the stock market will negatively affect their financial wellbeing.

Respondents who saw no threat to their financial wellbeing were primarily from the lower income group (under $35,000), had lower educational attainment (40% had completed high schools or less), were twice more likely to be 65 years of age or over, somewhat more likely to be renters rather than owners/buyers of a primary residence, and almost twice more likely to be debt-free.

Although respondents could indicate multiple sources of vulnerability, 44% of all respondents felt that their financial wellbeing may be noticeably affected by only one of the mentioned events.

3. Household Spending

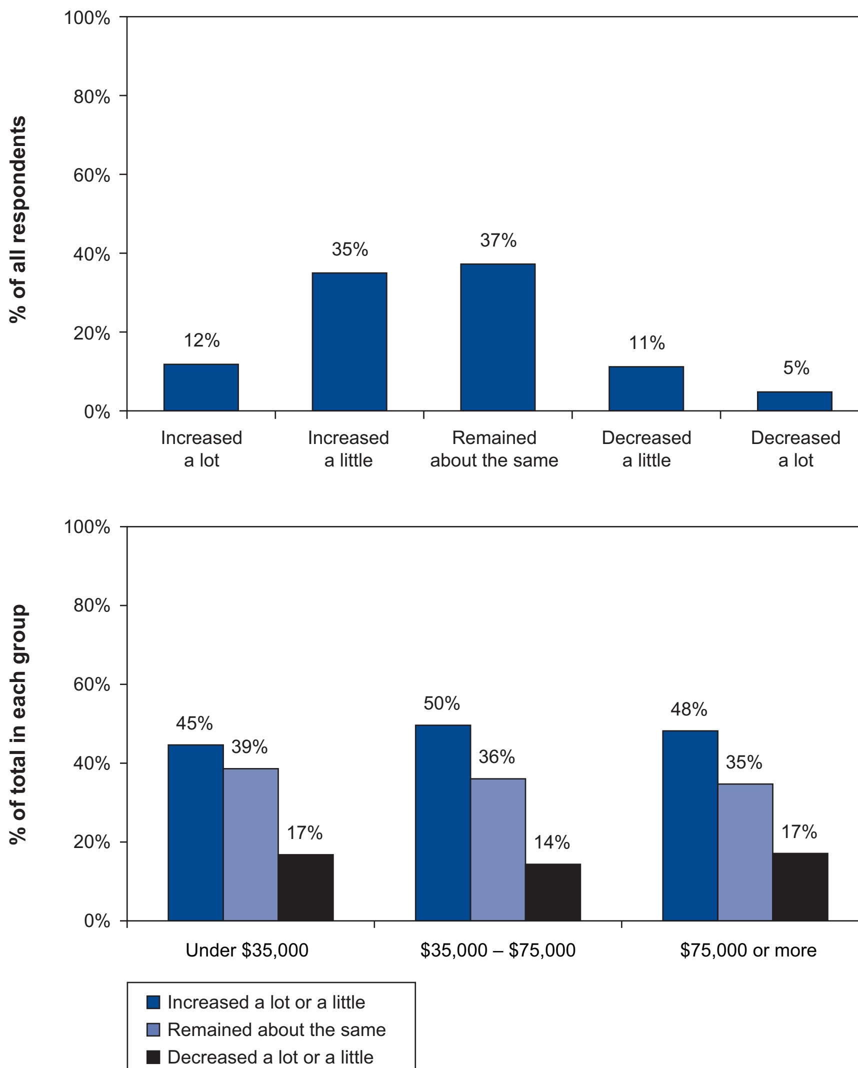
The survey went on to understand if changes in debt and wealth led to changes in household spending. The survey sought respondents' opinion on changes in their expenditures and the underlying reasons for that as well as the respondents' level of comfort in dealing with unexpected expenditures.

Changes in household spending over the past 3 years

Only a small proportion of respondents (16%) felt that their expenditure outlays decreased a lot or a little in the past 3 years. In turn, nearly half of all surveyed (47%) felt that their expenditure increased in recent years. All income groups experienced a similar trend (Chart 18).

47% of respondents felt that their expenditure increased in recent years

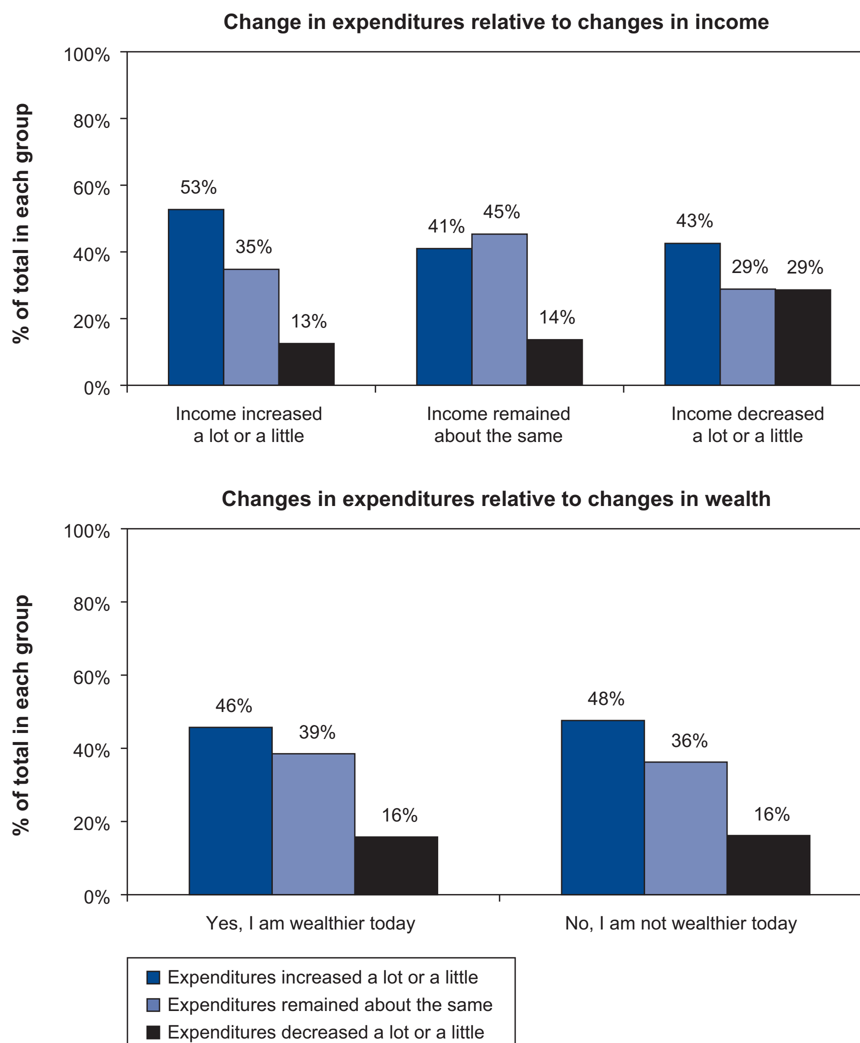
Chart 18 – Changes in Household Expenditures



An increase in household income was of some influence to the dynamic of expenditure. More than half (53%) of those reporting increased income in the past 3 years also said that their expenditures went up. This proportion was somewhat higher (58%) among those whose income increased a lot. Respondents with stable or decreasing income were less likely to see their spending to rise: not more than 43% of these respondents were reporting higher spending. At the same time, the proportion of individuals reporting decreased expenditures was twice higher among those whose income has deteriorated (top part of Chart 19).

In turn, change in wealth was not necessary transmuting into increasing expenditure. Conversely, those who felt their wealth had increased over the past 3 years were slightly less likely to say that their expenditure increased over the same period of time (bottom part of Chart 19).

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



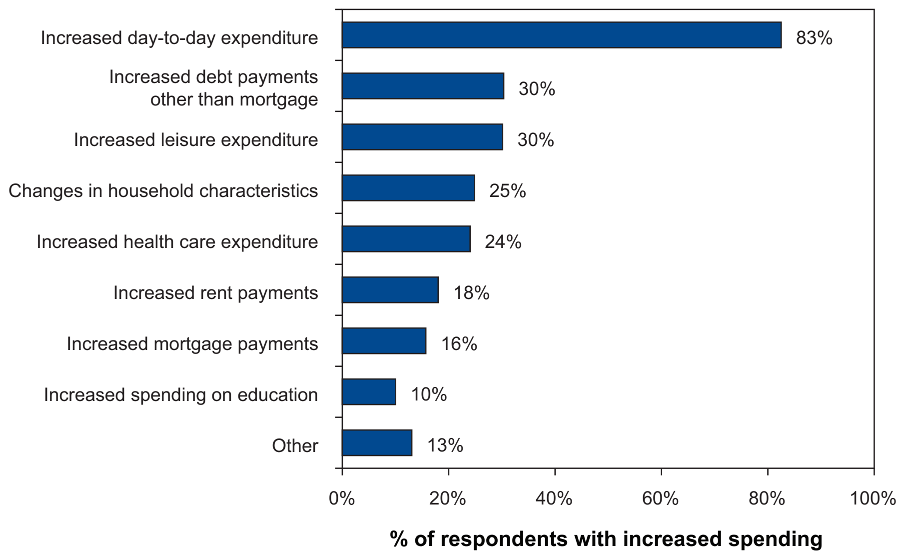
The overwhelming majority of respondents (85%) said that their household expenditures were usually contained to or less than their household income. The remaining 15% of survey participants felt that their spending exceeds their income. Indebted respondents were about four times more likely to say that their household expenditures usually exceed their household income.

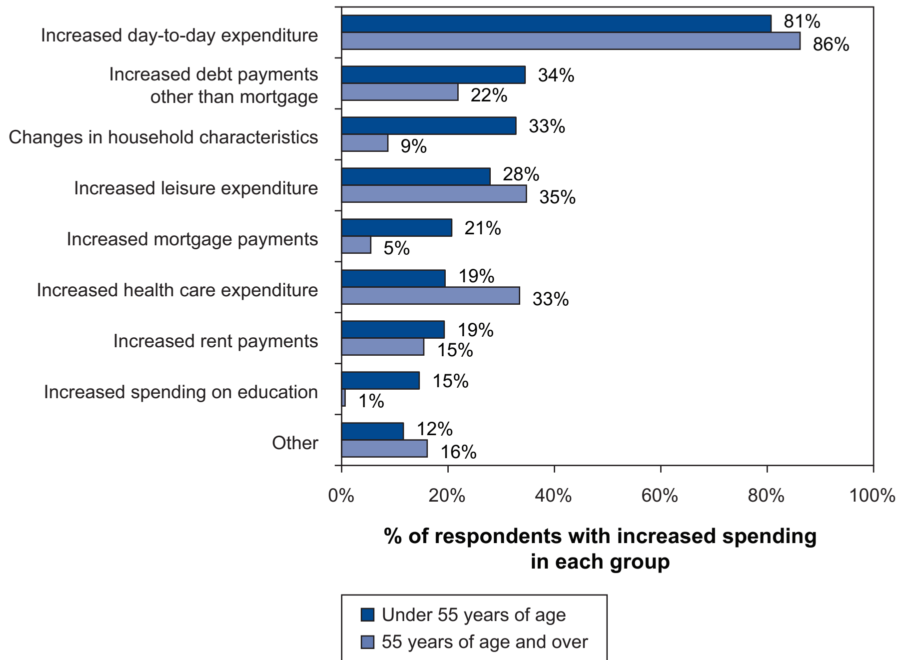
The survey respondents were offered a list of nine items indicating possible reasons for increasing household expenditures. An overwhelming majority (83%) of individuals whose expenditures increased over the past 3 years said it was caused by rising day-to-day spending. Slightly less than one third of respondents felt that increased non-mortgage debt payments and leisure expenditure contributed to their ballooning spending (top part of Chart 20).

30% of respondents felt that increased non-mortgage debt payments and leisure expenditure contributed to their ballooning spending

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 and leisure spending (bottom part of Chart 20).

Chart 20 – Reasons for Increased Household Spending



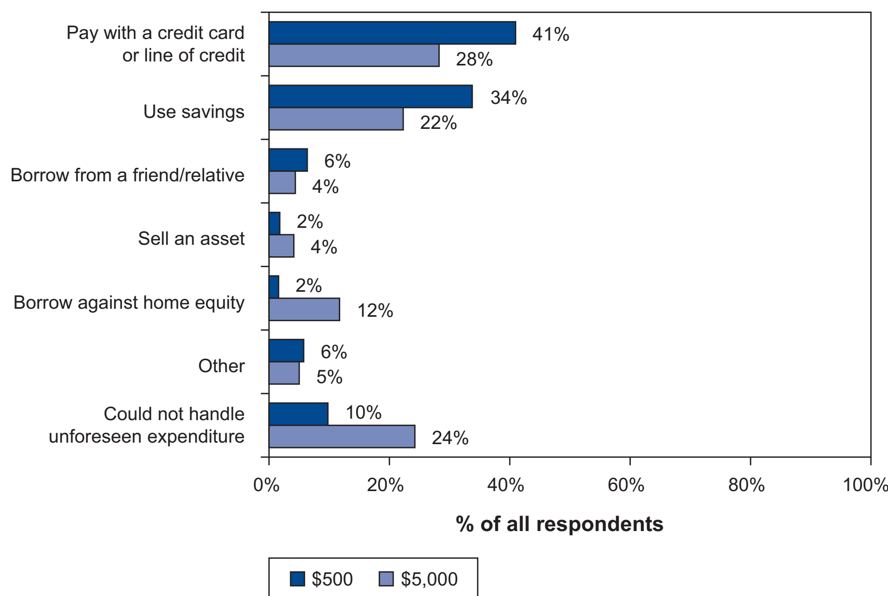


Respondents' ability to handle unforeseen expenditure

In the event of unforeseen expenditure, Canadians would most often rely on credit cards or lines of credit to cover costs. 41% of respondents would deal with a $500 unexpected outlay that way, while 28% would do so if they were required to pay an unexpected $5,000. The second most popular way of covering an unforeseen 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 (Chart 21). Higher income individuals (those with annual household income of $75,000 and over) tended to have a stronger preference for using credit cards and savings in handling unexpected expenses than respondents in other income groups.

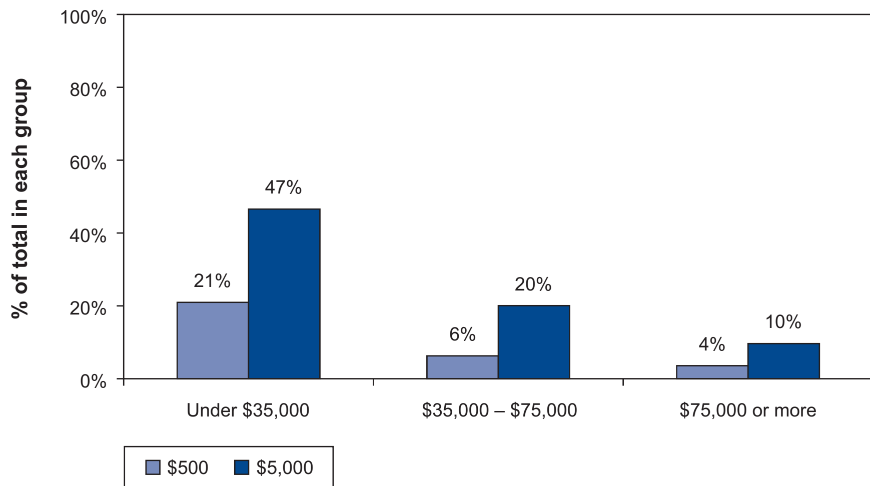
24% of Canadians would not be able to handle an unforeseen expenditure of $5,000. 10% of Canadians would not be able to manage a $500 unforeseen expense

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



One in four 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. As maybe expected, respondent's level of household income was a significant factor in the perceived ability to handle unforeseen expenses. Nearly one fifth (21%) of lower-income individuals would have difficulties handling unforeseen expense of $500 while this proportion was a mere 4% in the higher income group (those with household income of $75,000 and over). Nearly half (47%) of all lower-income respondents would not be able to handle an unforeseen expenditure of $5,000 (Chart 22).

Chart 22 – Respondents Who Could Not Handle Unforeseen Expenditures



Respondents reporting debt were nearly twice more likely to say they could not handle a $5,000 unforeseen expense compared to debt-free respondents

Some 49 survey respondents (2.4% of the total sample) said they could not handle an unforeseen expense of $500 but could handle an unforeseen expense of $5,000. The preferences of these on how to handle such an expense were fairly even distributed among all options discussed above.

Individuals' indebtedness had virtually no effect on their ability to handle a $500 unexpected expense. However, when it comes to an unforeseen expenditure of $5,000, respondents reporting debt were nearly twice more likely to say they could not handle such an expense compared to debt-free survey participants.

Also, those who could not handle an unforeseen expenditure were much more likely to report that their debt as increased over the last 3 years and tended to have higher level of concern regarding the raising debt. They were twice more likely to feel that they have too much debt and that they have difficulties in managing it.

Middle age respondents (those 35 to 55 years old) 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 in this age group who could not handle unforeseen expenditure was nearly twice higher compared to other age groups. Respondents with one or more children under 18 years of age were more likely to have difficulties in handling unforeseen expenditure.

Those not saving on a regular basis were much more likely to tell us that they are not able to handle an expense of either $500 or $5,000 (63% of respondents with no regular saving habits vs. 37% of those saving regularly).

4. Saving 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. Respondents were also asked to reflect on their savings habits and participation in the tax-preferred savings plans.

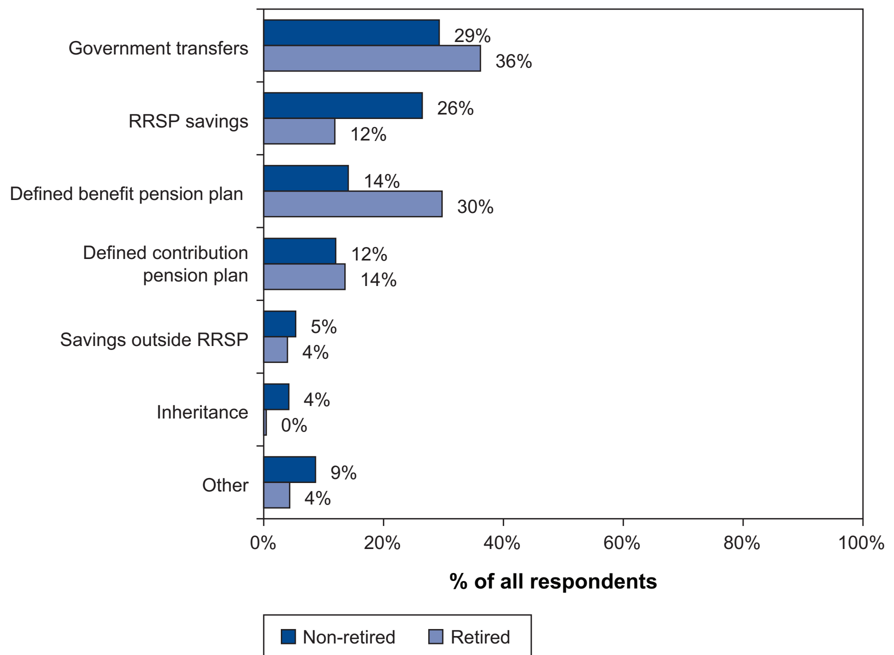
Expected sources of pension income

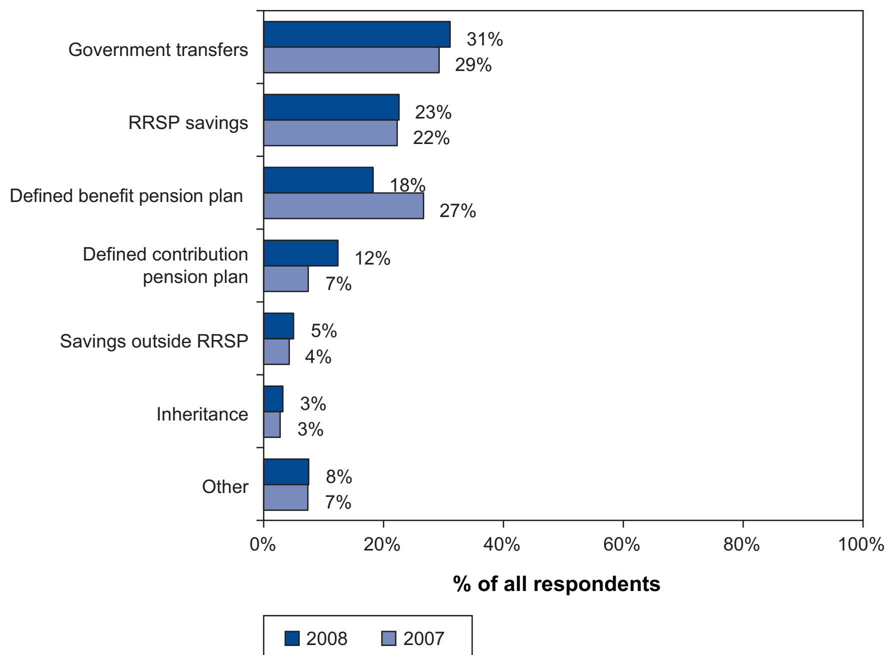
There were noticeable differences in opinion between retired and non-retired respondents regarding the expected primary source of pension income. Government transfers were important for both groups of respondents, though slightly less for non-retired individuals. 36% of retired respondents named government transfers as their main source of pension income compared to 29% of non-retired individuals. Roughly 1 in 10 of current retirees received their retirement income primarily from RRSPs; however, a much larger proportion (26%) of those who are not yet retired thought RRSPs will be their main source of retirement income. Conversely, already retired participants tended to rely on defined benefit pension plans to a much greater extent than their non-retired counterparts (top part of Chart 23).

27% of respondents surveyed in 2007 believed defined benefit pension plans would be their primary source of pension income. This proportion dropped to 18% in 2008

Compared to the 2007 survey, there was a noticeable shift in respondents' reliance on defined benefit pension plans. While 27% of respondents surveyed in 2007 believed defined benefit pension plans would be their primary source of pension income, this proportion dropped to 18% in 2008. A reverse trend was observed for defined contribution pension plans (bottom part of Chart 23). These intertemporal differences were also present when retired and non-retired respondents were considered separately.

Chart 23 – Primary Source of Pension Income



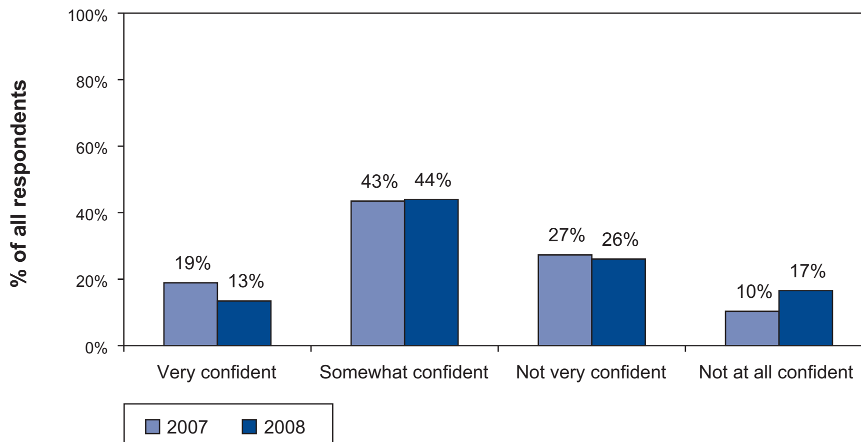


As may be expected, non-retired respondents with low household income (under $35,000) showed much higher reliance on government transfers as the source of pension income when compared to other income groups. Similarly, those with household income of $75,000 and higher were more likely to expect that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

Confidence regarding the financial situation at retirement

Only 57% of respondents felt confident that their financial situation at retirement will be adequate. The level of respondents' confidence declined compared to 2007, with the most noticeable changes being among those who are very confident or not at all confident in their financial wellbeing at retirement (Chart 24).

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



The level of respondents' confidence regarding the financial situation at retirement declined compared to 2007

Those who are already retired were much more optimistic: more than three quarters (77%) of them were either very confident or somewhat confident that their financial situation will be adequate. Among non-retirees, this proportion stood at 50%. Among non-retired respondents, age was one of the factors that affected respondents' confidence regarding the financial situation at retirement. Some 54% of those under 35 years of age were confident in their financial wellbeing, whereas this proportion declined to 48% among mid-age respondents (aged 35 to 55).

Level of confidence was also significantly influenced by the level of income. 69% of non-retired lower-income Canadians (income under $35,000) were not confident in the adequacy of their financial situation at retirement; however, this proportion stood at only 35% for those with annual household income of $75,000 and over.

As may be expected, wealth perception was another factor affecting respondents' assessment of their readiness for retirement. Some 70% of non-retired respondents who thought they are wealthier today were confident about their financial situation at retirement while only 32% of those whose wealth did not increase felt confident about their financial wellbeing at retirement. For retired respondents, nearly everyone (94%) of those whose wealth has increased in the past 3 years felt confident in their retirement readiness.

Slightly more than half (51%) of non-retired respondents with debt did not feel confident that their financial situation at retirement will be adequate. For debt-free respondents this proportion was as low as 38%. 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. Respondents whose debt increased a lot or a little over the past 3 years were even less confident in their readiness for retirement: 62% of those with raising debt said they do not feel confident in their pension finances.

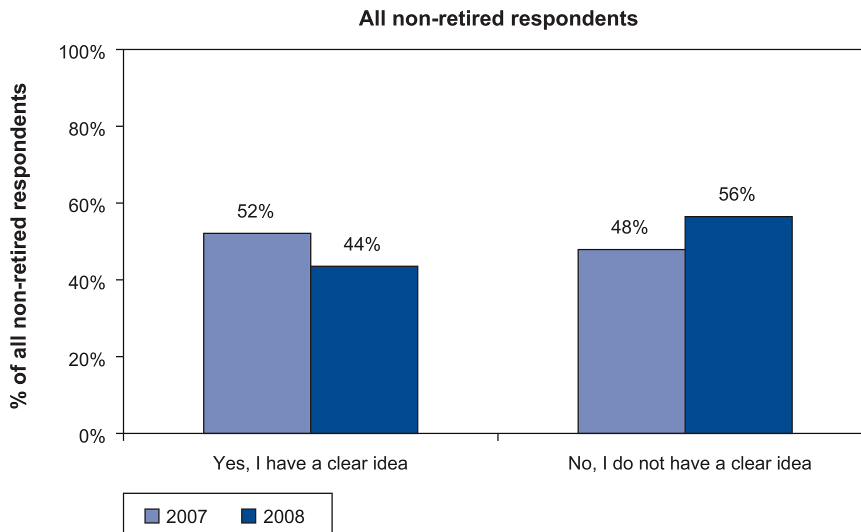
51% of non-retired respondents with debt (but only 38% of debt-free respondents) did not feel confident that their financial situation at retirement will be adequate

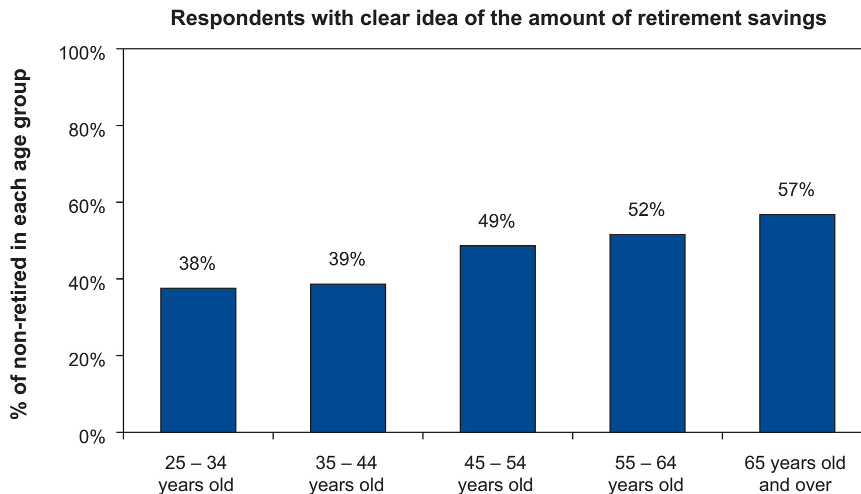
Clear idea of necessary pension savings

The survey asked respondents to reflect on whether they have a clear idea of the amount of personal savings they need to accumulate in order to assure that their financial situation at retirement will be adequate. Less than half (44%) of non-retired respondents said they knew how much they needed to save while 56% did not. Compared to the 2007 survey, this split of opinions constituted a noticeable shift towards not-knowing how much to save. In 2007, more than half (52%) of non-retired respondents had a clear idea of how much savings they need to accumulate for retirement (top part of Chart 25). Interestingly, about a quarter of retired respondents still did not know how much savings they would need for retirement. This was true for both 2007 and 2008.

The clarity of the idea regarding the amount of private pension savings seemed to be crystallizing with age. Some 38% of young respondents had a clear idea of what amount of retirement savings they need to accumulate. This proportion went up to 57% for individuals of 65 years of age and older (bottom part of Chart 25). Although a very similar trend was observed in 2007, a much higher proportion (85%) of older non-retired respondents told us that they have a clear idea regarding the amount of savings they need at retirement.

Chart 25 – Do Respondents Have a Clear Idea of the Amount of Retirement Savings Needed to Accumulate





56% of non-retired respondents said they did not know how much they needed to save for retirement

Among non-retired respondents who expected their primary source of pension income to be private pension savings such as RRSPs, savings outside of RRSPs or inheritance, some 42% did not have a clear idea of how much they need to earmark to render their retirements financially comfortable.

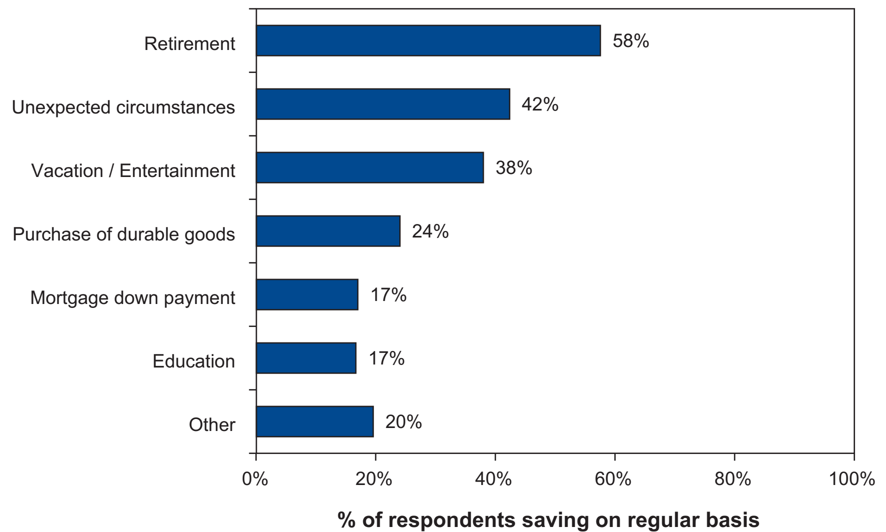
Respondents' regular savings

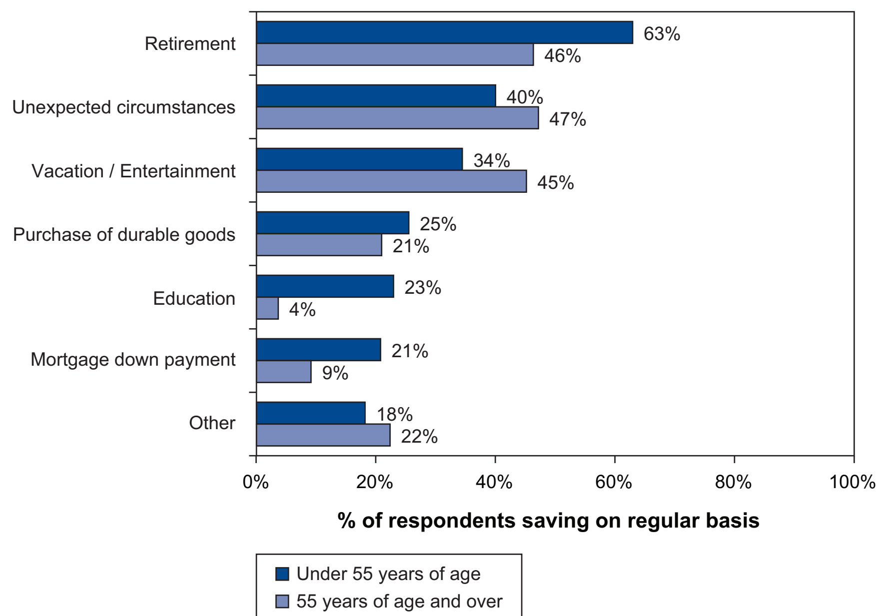
More than one third (36%) of the 2008 survey respondents do not place any type of regular savings. This was somewhat higher compared to 30% of respondents surveyed in 2007. Moreover, one quarter (25%) of respondents whose household expenditure are usually less than household income still were not making regular savings in 2008. Those who save, do so mainly for retirement, financial security for unexpected circumstances and vacation/ entertainment activities (top part of Chart 26).

18% of retired respondents indicated that they still regularly save for retirement

The stated purpose of regular savings was 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 (bottom part of Chart 26). When respondents were grouped by retirement criterion, similar differences in motivation for savings were observed. It is worth noting that 18% 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.

Chart 26 – Purpose of Regular Saving





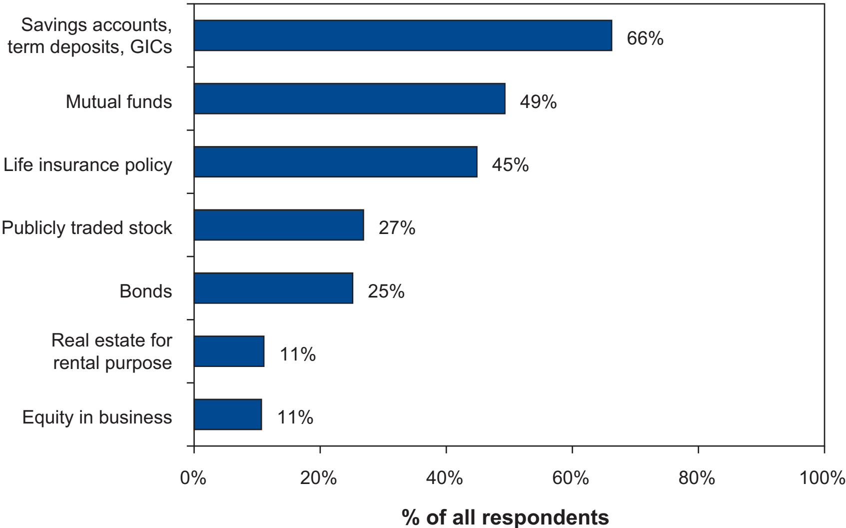
Respondents that have not yet retired and rent their principal residence were more likely to make regular savings for vacation than for mortgage down payment. Some 18% of non-retired renters said they save regularly for entertainment purposes, while 9% save for a down payment.

The timing of the 2008 survey coincided with the sudden and serious worsening of the economic conditions and a significant fall on the financial markets around the world. The respondents were asked to reflect on the impact this financial and economic instability may have on their savings habits. The majority (78%) of surveyed suggested that they do not plan to change savings habits in order to build (or rebuild) the financial cushion to the size they believed is right for them. Another 16% told us they would accelerate the usual pace of saving, whereas a small group of respondents (6%) thought they would decrease the usual rate of savings as their confidence in the financial markets and growth opportunities decreased.

78% of surveyed suggested that they do not plan to change savings habits in order to build (or rebuild) their financial cushion

In terms of financial instruments used to form the savings portfolio, survey respondents clearly favoured savings accounts, mutual funds and life insurance policies. Respectively, 66%, 49% and 45% of the surveyed individuals said these instruments are part of their savings portfolio (Chart 27). However, respondents' investment portfolios seemed to be well diversified as for the majority of respondents each of these investment instruments constituted less than 20% of their savings portfolios.

Chart 27 – Use of Different Financial Instruments in Respondents' Savings Portfolios

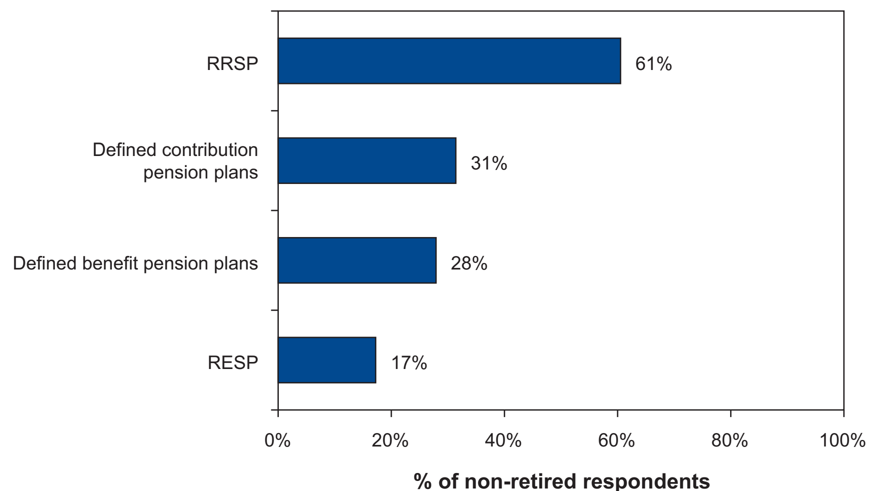


Participation in tax-preferred savings plans

The 2008 survey was extended to incorporate several questions regarding respondents' participation in tax-preferred savings plans. Although only about a quarter of non-retired respondents expected RRSPs to be their primary source of retirement income, some 61% of respondents said they use this saving tool. More than a quarter of non-retired respondents told us they participate in defined benefit and/or defined contribution employer-sponsored pension plans (Chart 28).

10% of non-retired respondents who thought that RRSPs would be their main source of pension income did not have an RRSP

Chart 28 – Participation in Tax-preferred Savings Plans



Interestingly, 10% of non-retired respondents who thought that RRSPs would be their main source of pension income did not have an RRSP. Another noticeable inconsistence lies in the large proportion of respondents reporting participation in defined contribution pension plans. While the national statistics shows that only 6% of employed Canadians are covered by defined contribution pension plans,[28] some 31% of survey respondents indicated their participation in this type of pension plans. One of the possible explanations may lie in the fact that Canadians in general have a low level of awareness when it comes to the type of pension arrangements offered by their employers.[29]

Respondents' indebtedness had some impact on their propensity to participate in tax-preferred savings plans; however, the influence varied depending on the type of savings plans. Indebted individuals were somewhat less likely to participate in plans where the individual has a full control over the contribution decision (i.e. RRSPs and RESPs). For instance, 67% of debt-free non-retired

28 Statistics Canada (2008). *Pension Plans in Canada*, The Daily, July 4, 2008
29 See, for instance, Morissette, R. and Zhang, X. (2004). *Retirement Plan Awareness*, Statistics Canada, Perspectives on Labour and Income, Vol. 5, no. 1.

individuals contributed to RRSPs while only 60% of indebted respondents did so. A reverse trend was true for employer-sponsored pension plans: the proportion of indebted respondents tended to be higher among those covered by these pension plans.

As may be expected, participation in RRSPs depended greatly on respondent's income. Slightly more than a quarter (27%) of lower-income respondents (less than $35,000) reported RRSPs while some 65% of higher-income Canadians (those with household income of $75,000 and over) did so. A similar situation was observed for respondents contributing to RESPs. Only a small fraction (7%) of lower-income Canadians benefited from this saving tool while higher-income survey participants were four times more likely to participate in RESPs.

Some of the respondents used their RRSP savings prior to retirement. Nearly one quarter (24%) of non-retired indebted respondents said they have withdrawn money from their RRSPs for reasons other than purchasing an annuity, participating in Home Buyers' Plan or participating in Lifelong Learning Plan. The majority of them (78%) did not repay this money back. Respondents with debt were three times more likely to withdraw money from RRSPs and not to pay back.

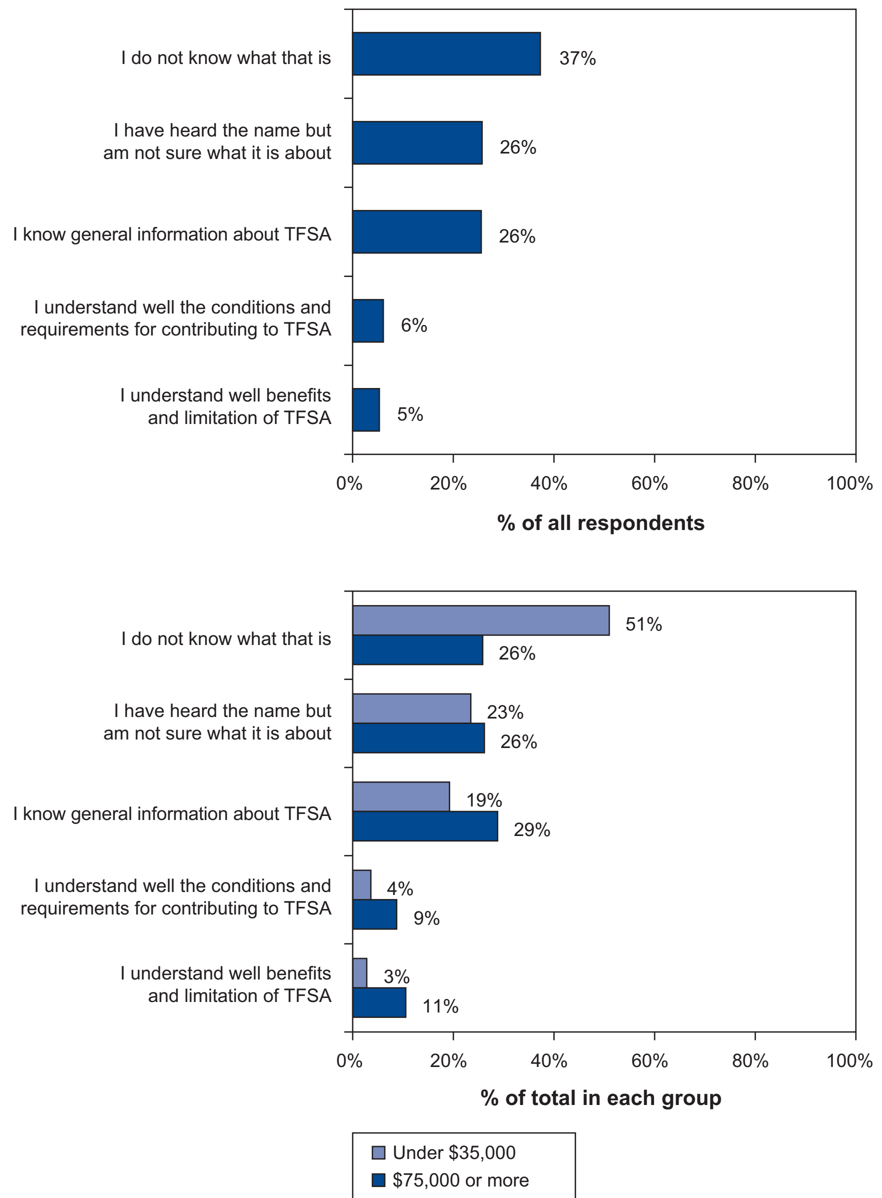
63% of all respondents did not know at all what is TFSA, or were familiar with the name but not sure what it is about

Attitudes to Tax-Free Savings Accounts (TFSAs)

A new savings instrument – TFSAs – was made available to Canadians as of January 2, 2009. The survey respondents were asked to reflect on their awareness and attitudes to this new type of accounts. With less than two months remaining prior to launching TFSAs, some 63% of all respondents did not know at all what is TFSA, or were familiar with the name but not sure what it is about. Only 11% of all respondents agreed that they understand well the conditions of contributing to TFSAs and could appreciate the benefits associated with using these accounts (top part of Chart 29).

Participants' level of income influenced their awareness regarding TFSAs; however, not to the extent that may be expected. More than half (52%) of those who may be thought of having financial means to contribute to TFSAs (i.e. high-income respondents with household income of $75,000 and over) did not know or were not sure what is TFSAs (bottom part of Chart 29).

Chart 29 – Awareness Regarding TFSAs



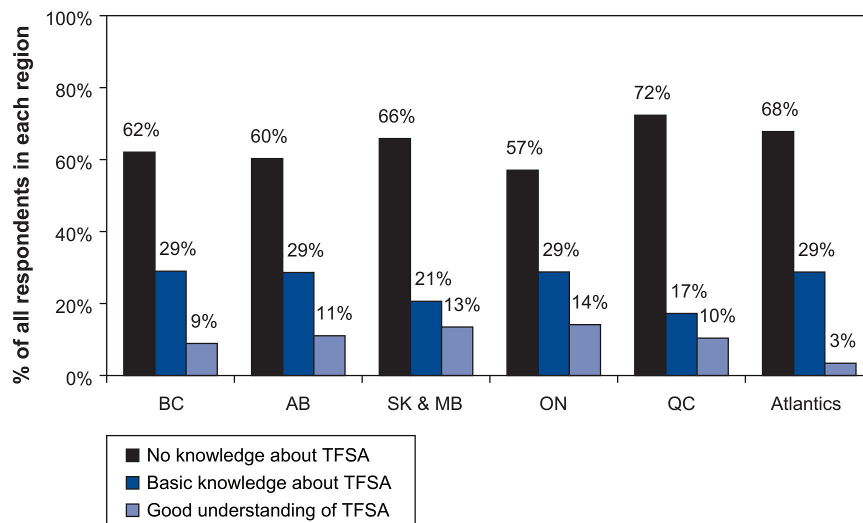
A noticeably higher proportion (69%) of younger survey participants tended to be unaware of TFSAs when compared to 55% of older respondents

The participants' age had a limited influence on the level of awareness regarding the TFSA. The comparison of young survey participants (those under 35 years of age) with those aged 55 and over revealed that the proportion of younger respondents (10%) who are well aware of the benefits and conditions for contributing to TFSAs was very similar to that of older respondents (13%). However, a noticeably higher proportion (69%) of younger survey participants tended to be unaware of TFSAs when compared to 55% of older respondents who did not know or were not sure what TFSAs is about.

As may be expected, saving regularly, having income or wealth to increase in the past 3 years and being debt-free contributed positively to respondents' awareness regarding TFSAs.

Certain regional differences existed in the level of awareness about TFSAs. As many as 72% of Quebecers but as little as 57% of Ontarians did not know or were not sure what is TFSAs compared to the Canadian average of 63%. Very few (3%) respondents residing in Atlantic provinces felt they had a good knowledge and understanding of TFSAs. This noticeably contrasted with 11% for all Canadians (Chart 30).

Chart 30 – Regional Differences in Respondents' Awareness Regarding TFSAs

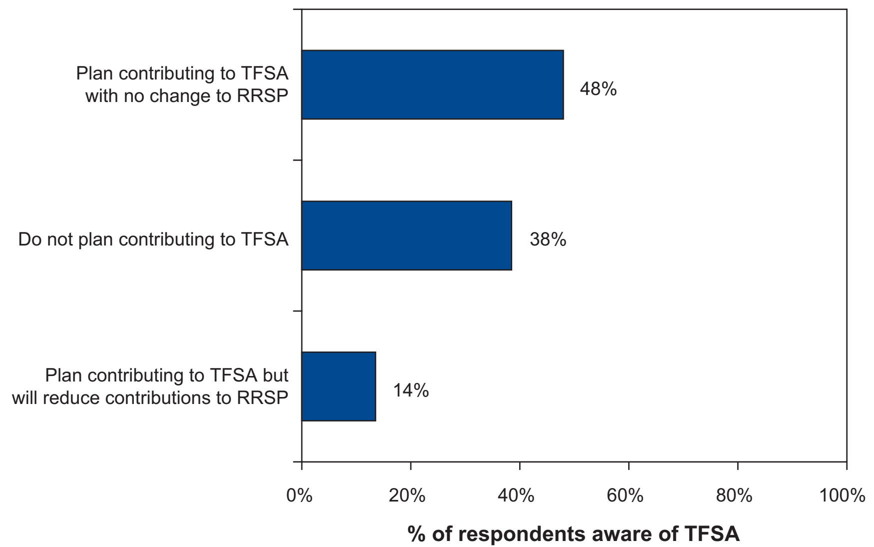


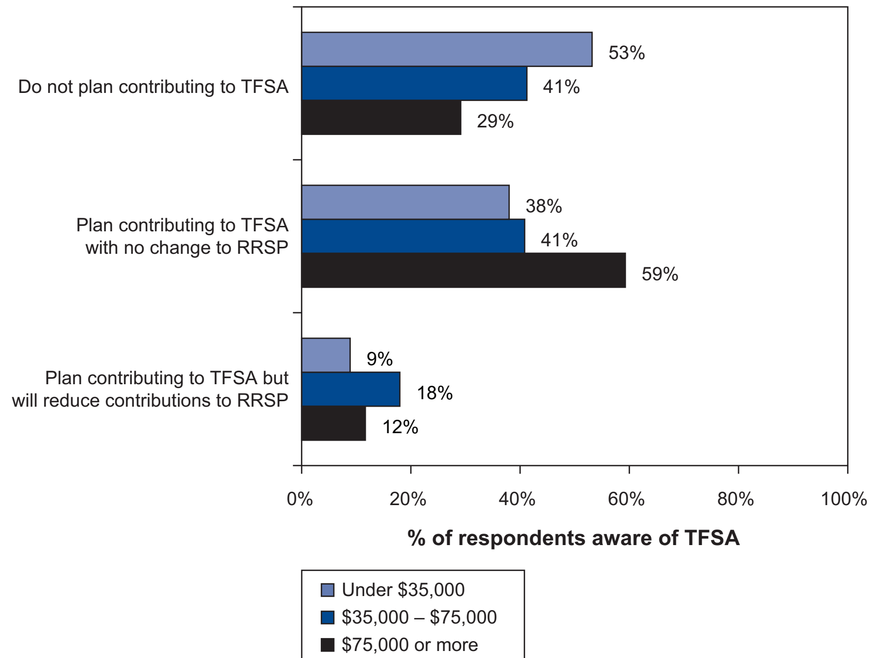
38% of respondents who had at least general knowledge and understanding of TFSAs said they do not plan contributing to these accounts

Although TFSAs offer some tax advantages, survey respondents were fairly reserved in their intentions of using TFSAs. Nearly 4 in 10 respondents who had at least general knowledge and understanding of TFSAs said they do not plan contributing to these accounts. Another 14% said they would contribute, but at the expense of reducing their contributions to RRSPs (top part of Chart 31). Overall, only 23% of all survey respondents may be expected to use TFSAs in their savings strategies (with or without tapping into their RRSPs for that reason).

Income was an important factor influencing individual's attitude to TFSAs. More than half (53%) of Canadians with household income under $35,000 did not plan contributing to TFSAs, whereas only 29% of higher-income respondents (those gaining $75,000 or over) had similar intentions (bottom part of Chart 31).

Chart 31 – Respondents' Intentions Regarding TFSAs





As may be reasonably expected, the level of awareness regarding TFSAs affected individuals' decision on whether to use these new savings accounts. Some 73% of those who had good understanding of the account's attributes and potential benefits told us they will contribute to TFSAs (with or without tapping into their RRSPs for that reason). In turn, only 56% of those who had only general knowledge about TFSAs said they would use this savings instrument.

Appendix B: Survey Questionnaire

11

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 Q.1, skip to Q.8]
[prog: if "Decreased a lot", "Decreased a little" or "Remained about the same" in Q.1, skip to Q.4]

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 describes 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. Interest charges
i. 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 Q.5, skip to Q.7]

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

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 household assets

[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 Q.12, skip to Q.14]

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 Do you participate in any of the following savings plans? (Please select one response for each plan)

[prog: grid]

Yes
No

[prog: list]

a. Registered Retirement Savings Plan (RRSP)
b. Defined-benefit pension plan provided by employer
c. Defined-contribution pension plan provided by employer
d. Registered Education Savings Plan (RESP)

[prog: if "No" for "Registered Retirement Savings Plan (RRSP)" and "Registered Education Savings Plan (RESP)" in Q.19, skip to Q.21]

Q.20 Which of the following best describes your situation? (Please select one response for each item)

[prog: grid]

Yes, but I repaid them back
Yes, but I have not repaid them back
No
Don't have this savings plan

[prog: list]

a. I have withdrawn money from my RRSP for reasons other than purchasing an annuity (or a RRIF), participating in the Home Buyers' Plan, or participating in the Lifelong Learning Plan
b. I have withdrawn money from RESP to which I contribute as a subscriber for reasons other than transferring money to my RRSP

Q.21 How familiar you are with the Tax-Free Savings Account? (Please select one)

a. I don't know what that is
b. I have heard the name but am not sure what it is about
c. I know general information about this account
d. I understand well the conditions and requirements for contributing to this account
e. I understand well benefits and limitation of this account for my finances

[prog: if "I don't know what that is " or "I have heard the name but am not sure what it is about" in Q.21, skip to Q.23]

Q.22 Which of the following would best describe your attitude to Tax-Free Savings Account? (Please select one)

a. I plan to contribute to RRSP at the same rate as before and supplement this with additional savings through the Tax-Free Savings Account
b. I plan to reduce my contributions to RRSP but start contributing to the Tax-Free Savings Account instead
c. I don't have RRSP but plan to contribute to the Tax-Free Savings Account
d. I don't plan to contribute to the Tax-Free Savings Account

Q.23 Which of the following would best describe the impact the current (recent) instability on the financial markets may have on your savings habits? (Please select one)

a. I plan to accelerate the usual pace of saving in order to build/ rebuild the financial cushion to the size I believe is right for me
b. I plan to decrease the usual pace of saving as my confidence in the financial markets and growth opportunities decreased
c. I don't plan to change my saving habits

Q.24 Thinking of the importance of different investment instruments to your savings portfolio, which proportion describes the level of each of the following investment instruments in your overall savings? (Please select one response for each item)

[prog: grid]

a. Less than 20%
b. 20% to 39%
c. 40% to 59%
d. 60% to 79%
e. 80% or more
f. Don't Use

[prog: list]

a. Savings account, term deposit and guaranteed investment certificates (GIC)
b. Publicly traded stock
c. Bonds and other debt obligations
d. Mutual funds
e. Real estate for rental purpose
f. Equity in business
g. Life insurance policy

Q.25 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.26 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 'One' in Q.26, skip to Q.28]

Q.27 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.28 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.29 Which of the following best describes your total annual household income, in 2007? (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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12

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