Where Has All the Money Gone?

Increasing debt of all kinds – individual and consumer debt, corporate debt, and government debt – has become a growing source of concern for Canadians at both a personal and a larger, macroeconomic level. It is no secret that the amount of debt taken on, especially by individuals and families, during the growth years from 2000 to 2006 exceeded all previous experience. Having taken on record levels of debt, many individuals and companies were ill-prepared to cope with the combined effects of the U.S. housing crisis of 2007-2008, the subsequent financial market crash, and the current global recession.

In the spring of 2007, the Certified General Accountants Association of Canada undertook a survey of Canadian household spending and debt patterns, the results of which, entitled "Where Does the Money Go: The Increasing Reliance on Household Debt in Canada", was published later that year. Following the series of economic and financial shocks that took place beginning in the summer of 2007 and, especially, in the late summer and fall of 2008, the CGA again embarked on a survey, this time seeking to understand the extent to which the economic and financial crisis had affected the financial position of Canadians.

The CGA recently published the results of that survey, aptly titled "Where Has the Money Gone: The State of Canadian Household Debt in a Stumbling Economy". The full report is available on the CGA Web site at http://www.cga-canada.org/en-ca/ResearchAndAdvocacy/AreasofInterest/DebtandConsumption/Pages/ca_debt_index.aspx). One of the conclusions drawn by the CGA from that survey is that "(I)ronic 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'."

Overall, the CGA reported the following conclusions from the survey results:

• Household debt is at an all-time high, reaching $1.3 trillion in 2008, and the escalation of debt is primarily caused by consumption motives rather than asset accumulation.
• 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.
• Canadian households are financing consumption activity and fuelling gross domestic product growth with unearned money as families increasingly reach for credit to finance day-to-day living expenses.
• The majority (58%) of survey respondents with rising debt said that day-to-day living expenses are the main cause of the increasing debt. This was higher than the 52% reported in 2007.
• Lines of credit and credit cards account for the largest proportion of consumer debt, with 85% of indebted Canadians reporting that they have outstanding debt on a credit card.

The statistics cited in the report bear out those conclusions, particularly when it comes to consumer credit issued by Canadian chartered banks, which would include personal loan plans, credit card loans, personal lines of credit, and other personal loans. Overall, the survey found that, in 2008, consumer credit issued by the chartered banks grew at a much faster rate (11.4%), even when adjusted for inflation and population growth, than it had during 2007 (10.1%) or during the boom years of 2000–2006 (8.2%). Perhaps more significantly, the growth in consumer credit during 2008 arose primarily from the expansion of personal lines of credit. By the end of 2008, personal lines of credit accounted for just under 60% of consumer credit issued by chartered banks. Of equal significance was the fact that while the use of credit cards is usually associated with the purchase of day-to-day needs (gasoline, consumable household supplies, restaurant meals, etc.), personal lines of credit and personal loan plans are more often used to acquire what are called consumer durables – cars, furniture, and the like. However, as the CGA report points out, sales of such goods declined during 2008, in some cases by significant amounts, at the same time as the use of personal lines of credit rose. The report suggests that one of the reasons for that may be that, as households face increased financial constraints, day-to-day consumption may have been increasingly financed by credit rather than by income.

While the use of credit to finance daily living expenses would be a concern in and of itself, the CGA notes that the form of credit that seems to be used amplifies that concern. Unlike personal loans (for instance, a car loan), in which the amount and frequency of payments are fixed so as to ensure that the entire amount of both principal and interest is paid off over a specified period of time, personal lines of credit, such as credit cards, constitute what is called revolving credit. With revolving credit, only a minimum payment (or, in the case of many line-of-credit arrangements, only interest payments) are required to be paid each month. In effect, the repayment of the principal amount of debt held under a personal line of credit or credit card may be put off almost indefinitely, as long as the minimum payments, or interest payments, continue to be made. And, as the study points out, a consumer who regularly makes the minimum payment required under a line of credit can maintain an acceptable credit rating, making them "good" candidates (at least on paper) for further borrowing.

There has been some recognition at the government level of the dangers posed to Canadian consumers, and indirectly to the Canadian economy as a whole, by the increasing amount of debt held by Canadians and the forms that that debt takes. The federal government recently announced a number of changes to the regulations governing credit cards. One of those changes will require credit card companies to provide, on each monthly statement, information on just how long it would take the card holder to pay off the entire balance on the card if only the minimum monthly payment is made. That figure will undoubtedly come as a surprise to many card holders.

The reasons for the ever-increasing amount of debt held by Canadian consumers are complex and varied, and the recent economic downturn is certainly among them. It will be interesting to see whether, when the hoped-for economic recovery materializes, those debt patterns change.