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Financial Focus

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Rising Cost of Debt

By Clinton Orr

Canadians, on average, are heavily indebted. According to the Organization for Economic Co-operation and Development (OECD), household debt levels in Canada are amongst the highest in the world. This fact is not new, Statistics Canada tracks debt levels and reports the numbers every quarter. Household debt in Canada has been elevated for many years and interest rates were low for the majority of that time. As rates climb all that debt can start to be a burden. I thought it would be helpful to take an in-depth look at Canada's debt load and pass along a few debt management strategies.

Canadian households carry a total of $2.1 Trillion of debt. To provide some context we usually compare debt to income. The latest numbers from Statistics Canada show that for every dollar of disposable income the average Canadian household has $1.69 in debt. About 20 years ago that ratio was 1:1. It has increased 70% in the last 20 years – we have piled on the debt. What happened? In a nut shell, interest rates hit rock bottom and real estate values increased. About 65% of the household debt is mortgages. In a few Canadian cities, house prices increased significantly and folks now need a big mortgage to buy a home. To get an idea of the geographic variance in household debt Canada Mortgage and Housing Corporation did a study. They found that the city with the highest average household debt is Vancouver with $539,467, the second highest was Toronto, there the average household carries $466,062 of debt. According to the study Winnipeg is ranked 22nd with an average household debt of $295,647.

The prime interest rate increased to 3.95% last week and is expected to continue to climb. As interest rates climb all that debt can become a burden. Debt management is an important part of an overall financial plan. As a starting point, I encourage everyone to have a rainy day fund. Ideally you would have enough money set aside to handle a few months of living expenses. Having a financial cushion can be helpful in numerous situations, for debt management it can shoulder the burden of increased payments.

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If you are one of the many Canadians with a mortgage, and have not locked in your rate, consider a fixed rate mortgage. In a rising rate environment, a fixed mortgage can save you money.

Credit cards form a small portion of Canadians' overall debt burden. Unfortunately, credit cards have a high interest rate, so a carrying a balance can lead to large payments. When reducing your debt, a good strategy is to tackle debt with the highest interest rate first, which is usually your credit card.

If you are finding it difficult to manage your debt and owe money to several companies, consider consolidating your debt. Many financial institutions offer consolidation services. Consolidation can make your debt easier to manage and lower your interest rate.

The cost of debt is rising and in this environment it is important to have an effective strategy in place to manage your debt. Talk to your financial professional and get a plan in place.

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