

# Intelligence MEMOS



From: Steve Ambler, Jeremy Kronick, and Farah Omran  
To: Canadians Worried About Debt  
Date: April 30, 2019  
Re: **HOUSEHOLD INSOLVENCY**

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Canadian consumer insolvencies rose 5.4 percent in February compared to a year earlier, according to new figures from the Office of the Superintendent of Bankruptcy (OSB).

Canadians are constantly barraged with warnings about rising debt levels and a looming debt crisis. And it is true that the ratio of household debt to GDP has increased from approximately 75 percent in 2007 to 100 percent today. Increasing indebtedness is usually fingered as the culprit in insolvency.

However, data on net worth paint a slightly different picture. Before the financial crisis, Canadians' household net worth was a little over seven times disposable income. It dipped during the financial crisis, bottoming out at 6.25 times disposable income. Since then, with low interest rates boosting housing prices, household net worth has followed a mostly continuous upward trend, and in the fourth quarter of 2018 was more than eight times disposable income. Moreover, while debt to GDP has increased, debt to net worth is almost identical, at around 20 percent.

A common explanation for these contradictory stories is the unequal distribution of the gains from rising housing prices, with the rich benefiting the most. However, both the top and bottom income quintiles held about [the same percentage of total net worth](#) in 2017 as they did in 2010, consistent with an [earlier study](#) showing that between 1999 and 2012 total net worth in Canada for households in both the top and bottom income quintiles grew at approximately the same rate. Inequality is, therefore, not a sufficient explanation.

An alternative account is that the OSB data, consistent with the *Bankruptcy and Insolvency Act*, include both “balance sheet insolvency” and “cash flow insolvency” but, unfortunately, does not distinguish between the two.

Under the definition of balance sheet insolvency, a Canadian household is considered to be insolvent if upon selling their assets, the householders were still unable to pay off their entire debts. Imagine selling your house, and still being in debt.

On the other hand, cash flow insolvency, commonly referred to as illiquidity, indicates the inability to meet payments on one's gross debt because of the difficulty selling one's assets.

The OSB data, however, do not distinguish between these two very different forms of insolvency. They only distinguish between bankruptcies and consumer proposals, which are formal agreements renegotiating the terms of the debt repayment between creditors and debtors, where the debtor will pay part or all of the debt at a reduced rate over a specified period of time. Although consumer proposals increased by 14.3 percent in February 2019 compared to a year earlier, actual bankruptcies decreased by 5.7 percent.

Without a breakdown between balance sheet and cash flow insolvency it is difficult to know how loudly the alarm bell is ringing. And with consumer proposals up across the country, the Bank of Canada and financial regulators are right to be concerned. But with stable debt to net worth and two-thirds of Canadian households owning homes, perhaps we can all take a deep breath... for now.

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