



# PERSPECTIVES

ON LABOUR AND INCOME

## Personal debt

Although the U.S. economy and population are almost 10 times the size of Canada's, the two countries show several similarities. Both have relatively high per-capita income and living standards. Given geographic proximity to the U.S. and a smaller economy, Canada is affected more than other countries by changes in the U.S. economy and in its commercial and financial institutions—especially when such institutions have branches in Canada. Since the U.S. is Canada's major trading partner (taking 81% of total exports in 2005 compared with 64% in 1980, and accounting for 67% and 64% of imports), the U.S. recessions of the early 1980s and 1990s, as well as the boom beginning in the late 1990s, spread to Canada within short order. Both countries have also experienced almost the same rate of inflation—goods and services worth \$1.00 in the respective currencies in 1980 cost \$2.43 in Canada and \$2.37 in the U.S. in 2005.

Population characteristics are also similar. Two-thirds of persons 16 years old and over in each country participate in the labour force. A greater proportion of

women were working in 2005 than in 1980. Both populations are aging, the median age increasing between 1980 and 2005 from 28.9 to 38.0 in Canada and from 29.8 to 35.9 in the U.S. Since both countries have large immigrant populations, the median age is affected by the mix of native-born persons, the age of immigrants and emigrants, and fertility and mortality rates by age. Over the last 25 years, the proportion of persons 65 and over has risen from 9.4% to 13.1% in Canada and from 11.2% to 12.3% in the U.S. In both countries, the proportions of persons living alone and female lone-parent families have risen.

Age is a key determinant of personal consumption expenditure, income and saving, but spending is also much affected by key monetary variables such as disposable income and access to credit. The following charts highlight various aspects of Canadian and American income, spending, saving and debt over the last 25 years.

### Definitions

#### Personal income

Sum of income from labour, unincorporated business, interest and investments, and government transfers received by individuals and non-profit or fraternal organizations.

#### Personal disposable income

Personal income less income taxes and other mandatory deductions paid to government.

#### Personal consumption expenditure

Sum of expenditure on food and beverages, clothing, housing, furniture, medical care, transportation, communications, and recreation.

#### Personal saving

Personal income less consumption expenditure, taxes, and transfers to government, corporations and non-residents.

#### Consumer debt

Amounts outstanding on credit cards, vehicle loans, other personal loans, instalment or revolving debts, and unpaid bills.

#### Per-capita debt

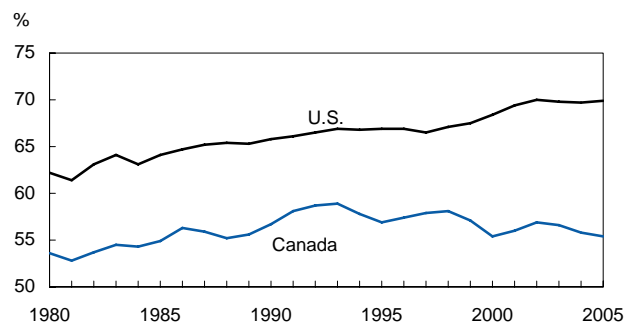
Total debt (consumer debt plus mortgages) divided by the population. Per-capita disposable income and expenditure are derived in the same fashion. Comparisons of per-capita amounts are in Canadian dollars after converting the U.S. data by purchasing power parities.

#### Personal savings rate

Personal savings as a percentage of personal disposable income.

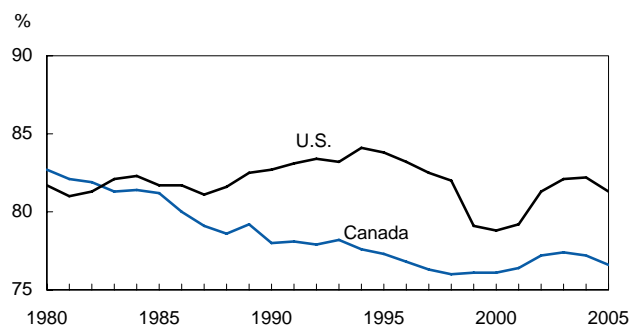
## Personal consumption expenditure constitutes a larger share of GDP in the U.S.

Consumer spending is a key contributor to a country's economic health. Consumer spending as a percentage of GDP is much lower in Canada, ranging from 52.8% to 58.9% over the last 25 years, compared with 61.4% to 70.0% in the U.S. In other words, consumer spending has boosted the economy more in the U.S. than in Canada.



Sources: Statistics Canada, National Income and Expenditure Accounts; U.S. Department of Commerce

## Canadians pay more income taxes and transfers to government



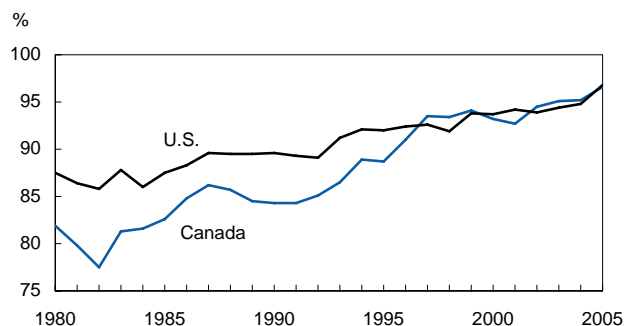
Sources: Statistics Canada, National Income and Expenditure Accounts; U.S. Department of Commerce

Even though both countries have a progressive income tax system, their marginal tax rates, methods of taxation, and allowable deductions vary considerably. In Canada, a relatively larger share of personal income goes for federal and provincial income taxes, Canada or Quebec Pension Plan contributions, and Employment Insurance premiums (17.3% in 1980 and 23.4% in 2005). Americans, on the other hand, paid 18.3% and 18.7% of their income for federal and state income taxes, social security contributions, and unemployment insurance.<sup>1</sup> The gap between total and disposable income has widened over time in Canada while remaining almost unchanged in the U.S. However, the mix of deductions in the U.S. has changed considerably: Income taxes accounted for 79.4% of deductions in 1980 compared with 57.7% in 2005.

### Note

1 The higher rate of transfers to governments in Canada can be attributed partly to the funding of universal health care and security benefits. In the U.S., Medicaid is available only to people with limited income, while Medicare is available to those 65 and older.

## Canadians and Americans spend a similar proportion of their income



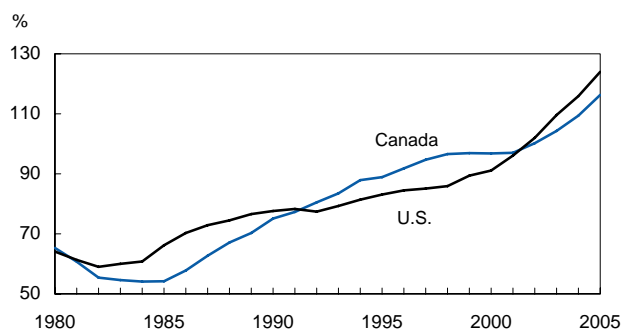
Sources: Statistics Canada, National Income and Expenditure Accounts; U.S. Department of Commerce

Until the mid 1990s, both Canadians and Americans managed to spend less than their disposable income. However, from 1996 onwards, they spent almost all of it, leaving very little for saving.

## Both Canadians and Americans have increased their debt-to-income ratios

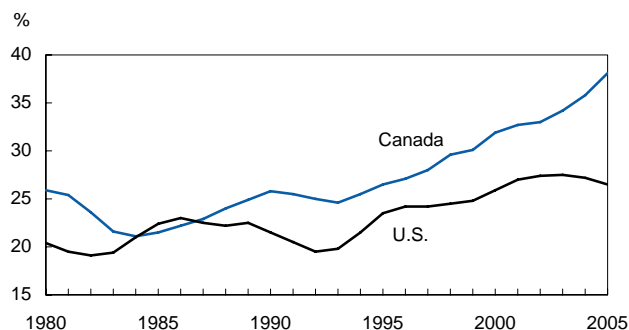
Credit can be used to meet regular or unexpected consumption needs, or even to acquire assets. Debt load, measured by the ratio of total debt to disposable income was almost the same for Canadians and Americans at the beginning of the 1980s. After that, they parted ways: Americans had the greater debt load between 1983 and 1991 and Canadians between 1992 and 2000. From 2001, debt grew steadily in both countries and by 2002 had surpassed disposable income. By 2005, for each dollar of disposable income, Canadians owed \$1.16 and Americans \$1.24.

Some of the increased indebtedness between 2001 and 2005 may be attributed to relatively low rates of interest, easy credit through home equity loans, and increased limits and incentives on credit cards issued by competing financial institutions.



Sources: Bank of Canada, Public Information Service; U.S. Federal Reserve, Financial and Business Statistics

## Canadians use more consumer credit for their personal spending



Sources: Bank of Canada, Public Information Service; U.S. Federal Reserve, Financial and Business Statistics

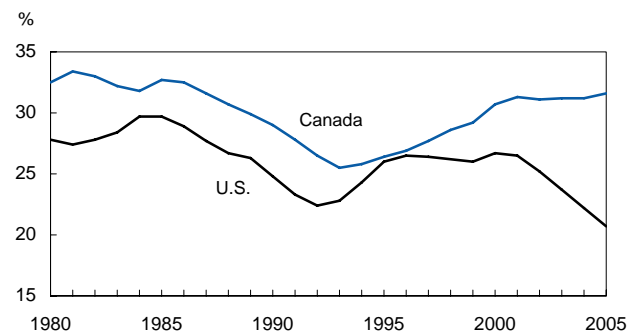
Between 1980 and 2005, consumer credit represented between 21 and 38 cents of each dollar of personal spending in Canada. In the U.S., the amount was between 19 and 27 cents. Since 1986, when the Reagan administration cancelled tax deductibility for interest paid on consumer loans, Americans have been using less of this kind of credit. Consequently, since 1988, the gap between the U.S. and Canada in the use of consumer credit has widened.

Non-homeowners in both countries, who have neither mortgage debt nor access to home-equity line of credit, can increase limits on their credit cards or use personal loans to finance unexpected needs or other budgetary shortfalls.

## Consumer credit is still a relatively small share of total household debt in both countries

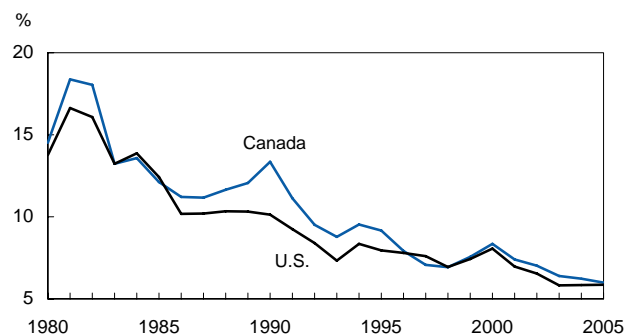
In Canada, consumer credit fluctuated between 26% and 33% of total household debt over the 1980-to-2005 period. These proportions indicate two distinct trends: a steady fall between 1985 and 1993 and a rise thereafter. A drop in the share of consumer credit means an increase in the share of mortgages. The increase in mortgage debt during this period in Canada was largely due to baby boomers purchasing their first home. However, the increasing use of consumer credit since 1992 is likely due to a combination of factors, including stagnant incomes in the 1990s, easier credit in the early 2000s, and changing demographics and lifestyles.

With Americans also experiencing stagnant incomes in the 1990s, their use of consumer credit rose between 1992 and 1996. Tax deductibility for mortgage interest on the principal residence may encourage Americans to mortgage or re-mortgage their home, using such funds for consumption, investment, home renovation, paying off loans, or some other purpose.



Sources: Bank of Canada, Public Information Service; U.S. Federal Reserve, Financial and Business Statistics

## The conventional mortgage rate is usually higher in Canada than in the U.S.



Note: Five-year mortgage rate charged by banks in Canada; rate charged by institutions on commitments for fixed-rate, first mortgages in the U.S.

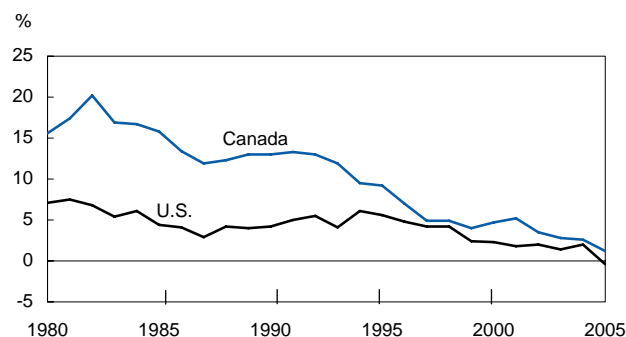
Sources: Bank of Canada, Public Information Service; U.S. Federal Reserve, Financial and Business Statistics

Because of the size of the market and competition among financial institutions and private lenders, the conventional five-year mortgage rate in the U.S. is usually lower than in Canada. The gap in rates was at a maximum during the economic recessions of 1981–1982 and 1989–1991. In both countries, mortgages were highest in 1981—18.4% in Canada and 16.6% in the U.S. By 2005, they had dropped to less than 6%. Since 1996, conventional mortgage rates in the two countries have been quite close (higher in Canada by half a percentage point or less).

## The personal savings rate has been falling

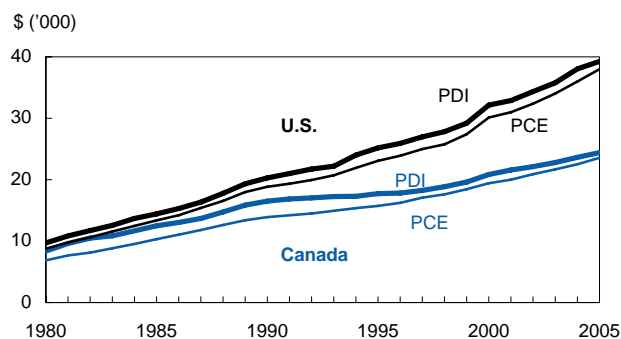
While the personal savings rate in Canada has consistently been higher than in the U.S., rates in both countries have been falling. Rates peaked at 20.2% in Canada in 1982 and at 7.5% in the U.S. in 1981. The high rates of interest during those years likely spurred saving and investing; on the other hand, those who borrowed paid dearly. By the late 1990s, however, the two rates were converging, reaching 1.2% in Canada and -0.4% in the U.S. in 2005.

The reasons for the decline are the same in both countries: more personal consumption and higher mandatory transfers (income taxes and contributions for security programs). In 1982, Canadians spent 63.4 cents of each income dollar on consumption and 20.0 cents on transfers; Americans spent 73.7 cents and 20.7 cents. By 2005, Canadians were spending 74.0 cents on consumption and 25.1 cents on transfers, Americans 78.6 cents and 21.7 cents.



Sources: Statistics Canada, National Income and Expenditure Accounts; U.S. Department of Commerce

## On a per-capita basis, consumption expenditure outpaced disposable income in both Canada and the U.S.



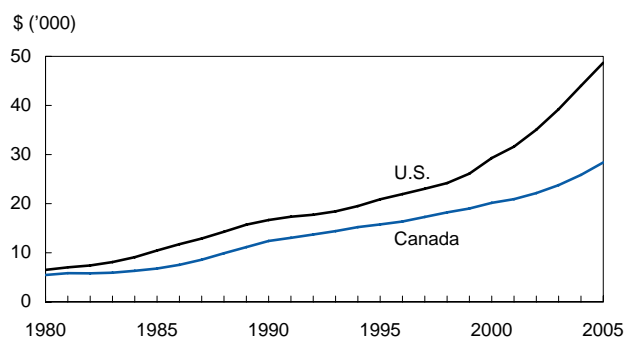
Note: Amounts in Canadian dollars after converting U.S. data on personal disposable income (PDI) and personal consumption expenditure (PCE) based on purchasing power parity.

Sources: Statistics Canada, Demography Division, National Income and Expenditure Accounts; U.S. Bureau of the Census and Department of Commerce

Over the 1980-to-2005 period, per capita consumption expenditure in Canada more than tripled from \$6,870 to \$23,560, while disposable income rose proportionally less—\$8,390 to \$24,400 (2.9 times). In the U.S., expenditures and disposable income rose more steeply—from CAN\$8,770 to \$37,980 (4.3 times) and from CAN\$9,710 to \$39,260 (4.0 times). The disparity between Canada and the U.S. in both per-capita spending and disposable income has increased and, as consumer spending has outgrown disposable income, both Canadians and Americans have had to finance their spending through credit.

## Per capita, Americans have more debt than Canadians

The per-capita debt of Canadians has risen 5.2 times over the last 25 years, from \$5,470 in 1980 to \$28,390 in 2005. For Americans, it jumped 7.5 times, from CAN\$6,510 to \$48,700. Per-capita debt has been increasing steadily in both countries, but the disparity between the two countries, almost non-existent at the beginning of the 1980s, began to increase sharply from 1999 onwards. This is partly due to Americans opting to take on more mortgage debt (including refinancing). Increasing mortgage debt for refinancing purposes or taking out home-equity loans implies that homeowners in both countries are using their homes as a source of cash to finance their spending rather than as an investment.



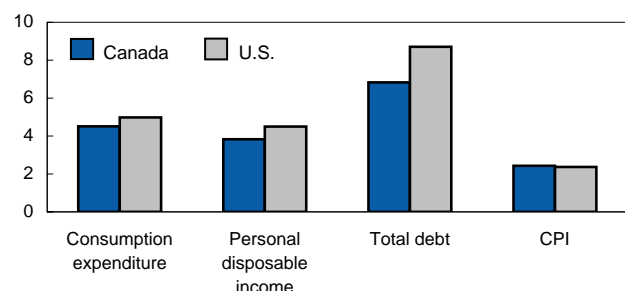
Note: Amounts in Canadian dollars after converting U.S. data on total household debt based on purchasing power parity.

Sources: Statistics Canada, Demography Division; Bank of Canada, Public Information Service; U.S. Federal Reserve, U.S. Bureau of the Census and Financial and Business Statistics

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## In both countries, total household debt outgrew consumer spending as well as disposable income

2005/1980 ratio



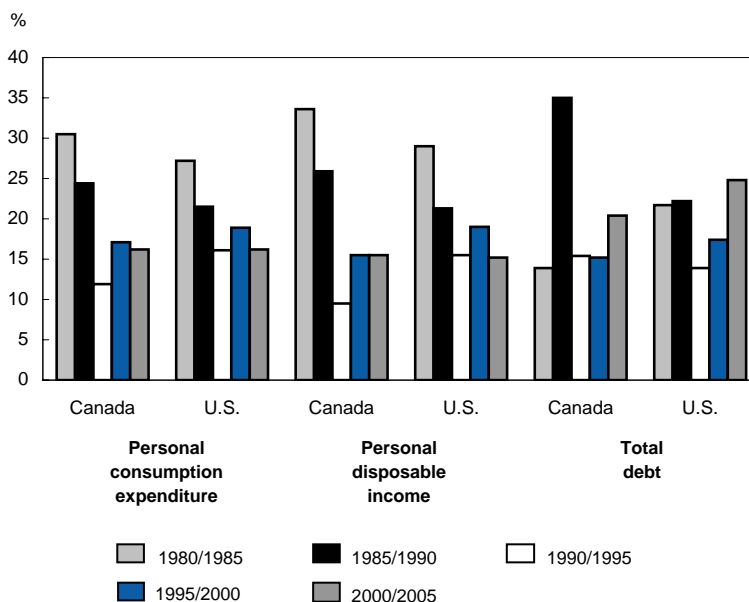
Sources: Statistics Canada, National Income and Expenditure Accounts; Bank of Canada, Public Information Service; U.S. Federal Reserve, U.S. Department of Commerce and Financial and Business Statistics

In terms of aggregates in their respective currencies, household debt rose in Canada from \$134 billion in 1980 to \$916 billion by 2005 (6.8 times), and in the U.S. from \$1.3 trillion to 11.2 trillion (8.6 times). Even though inflation was almost the same in both countries, consumer spending and disposable income increased less in Canada. Consumer spending, for instance, rose from \$168 billion to \$760 billion in Canada and from \$1.8 trillion to \$8.7 trillion in the U.S.

## Growth in household debt, consumer spending and disposable income varied with economic activity in both Canada and the U.S.

Of the total growth in household debt between 1980 and 2005, 35.0% occurred between 1985 and 1990 in Canada compared with 22.2% in the U.S. This was a period when baby boomers in Canada were likely purchasing their first home. The largest growth in debt for Americans (24.8%) occurred between 2000 and 2005 compared with 20.4% for Canadians. This was a period of economic prosperity with lower rates of unemployment and inflation accompanied by lower interest rates and easy access to credit.

Since consumer spending and disposable income (in current dollars) are highly sensitive to the rate of inflation, they showed relatively more growth during the 1980-to-1985 period of high inflation—30.5% of the growth in consumer spending in Canada and 27.2% in the U.S. During the 2000-to-2005 period of low inflation, these rates fell to 16.2% in both Canada and the U.S. A similar pattern is seen in the overall growth of disposable income.



Sources: Statistics Canada, National Income and Expenditure Accounts; Bank of Canada, Public Information Service; U.S. Federal Reserve, U.S. Department of Commerce and Financial and Business Statistics

### Perspectives