CIBC

In Focus

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ECONOMICS

Insolvencies—Rising Slowly

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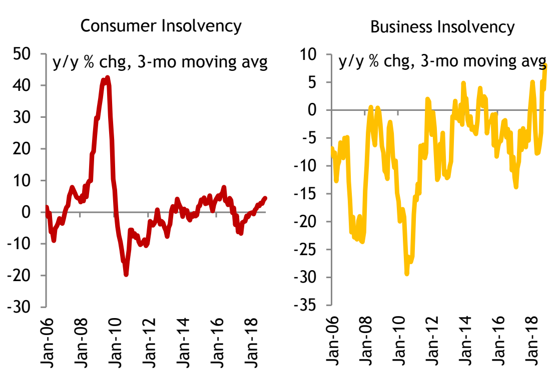
Alongside higher interest rates, the insolvency rate in Canada is starting to rise. On a year-over-year basis, consumer insolvencies are rising by 4.5%—the fastest pace since mid-2016. On a cumulative basis during the year ending November 2018, they advanced by 2.0%. At the same time, after being in negative territory for most of the decade, business insolvencies are now rising by more than 8% on a year-over–year-basis, led by the construction and retail industries (Chart 1).

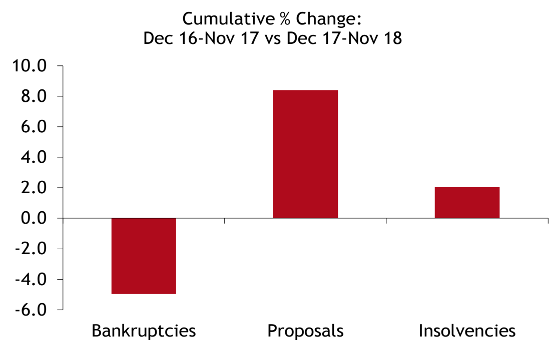
In taking a closer look at consumer insolvencies, this recent upward trend masks two different trajectories of the components that comprise the insolvency rate. The number of personal bankruptcies—the first component—fell by a cumulative 5.0% over the past year. In contrast, the second component; the number of proposals (a situation in which a consumer negotiates to repay only a portion of his/her debt) has, in fact, risen by no less than 8.4% during the same period (Chart 2).

Chart 1
Insolvencies Starting to Rise



Source: Industry Canada, CIBC

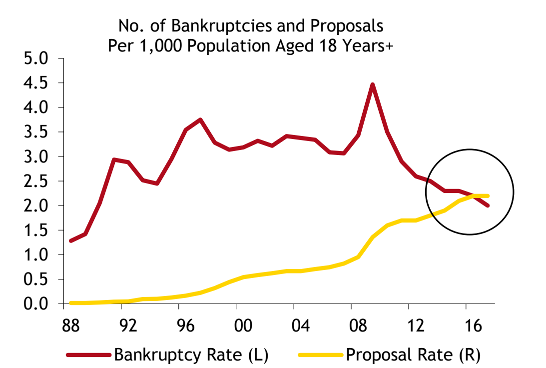
Chart 2
Rising Proposals Offset Falling Bankruptcies



Source: Office of the Superintendent of Bankruptcy Canada

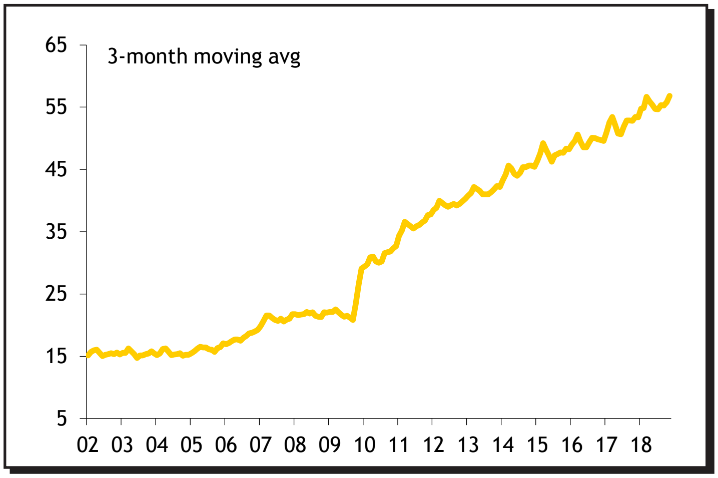
Note that while proposals rose alongside bankruptcies during the recession, they stayed high during the recovery. In fact, recently the number of proposals has surpassed the number of bankruptcies (Chart 3). This trend was largely due to changes in the Bankruptcy Insolvency Act (BIA) in 2008, with the most significant modification being the increase in the limit of non-mortgage debt for qualifying for a proposal from

Chart 3
Bankruptcies and Proposals—Diverging Trends



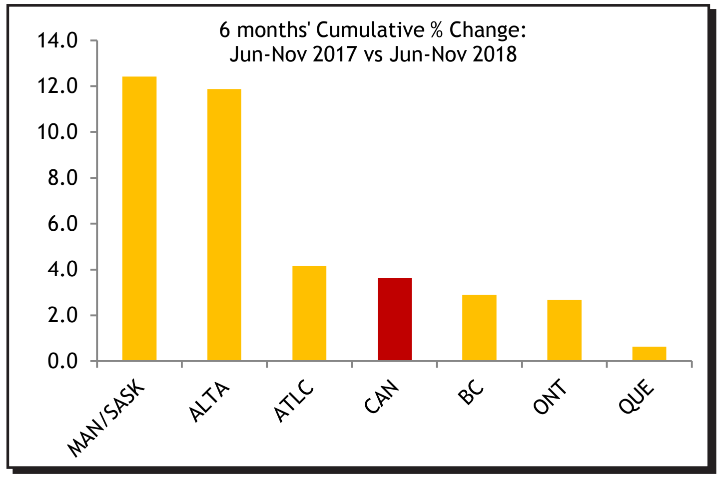
Source: Office of the Superintendent of Bankruptcy Canada

Chart 4
Rising Share of Proposals in Insolvencies



Source: Office of the Superintendent of Bankruptcy Canada, CIBC

Chart 5
Increase in Consumer Insolvencies by Province



Source: Office of the Superintendent of Bankruptcy Canada, CIBC

$75,000 to $250,000—making proposals more attractive relative to the bankruptcy route.

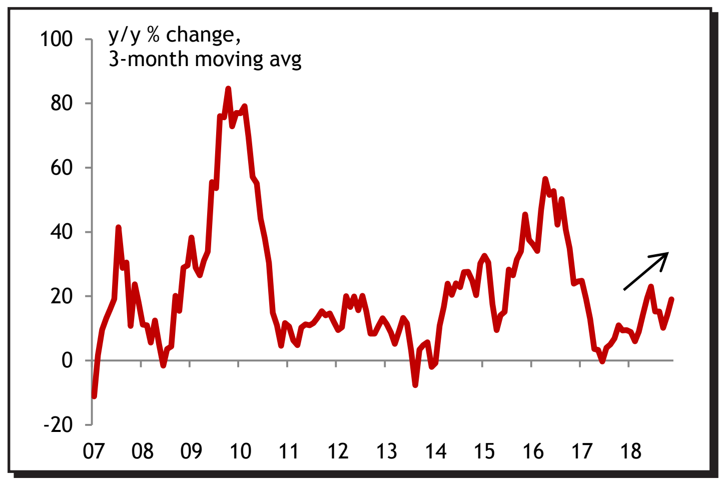
In the past, growth in the number of proposals was of little importance given their relatively small size. That, however, is changing. The opposing trajectories of proposals and bankruptcies have led to a situation in which proposals now account for a record-high 55% of total insolvencies (Chart 4).

And the damage from lower oil prices is beginning to show. The cumulative number of insolvencies in Alberta rose by 12% during the six months ending November 2018, Manitoba and Saskatchewan have seen roughly the same increase. At the same time, the number of insolvencies in Ontario rose by close to 3%. The same is true for BC (Chart 5).

Focusing on Alberta, while the number of proposals is quickly rising, that pace is much slower than what the province had experienced following the oil price correction of 2015 thus far (Chart 6). And given that the share of proposals in bankruptcies is the highest in Alberta (Chart 7), this trend is likely to lead to a higher insolvency rate in the province in the coming quarters.

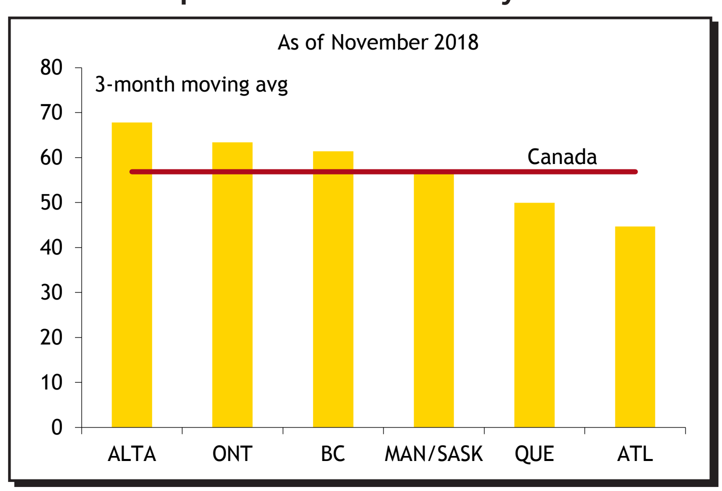
Upon closer examination of what's in the pipeline by focusing on trends in major delinquencies of various credit products, reveals very little stress. At just 0.9%, the delinquency rate in the credit cards portfolio is at a record-low, after trending downward since the recession. The same is true for term loans and mortgages. Note, however, that despite a clear downward trend since 2012, the delinquency rate in the lines of credit portfolio is still higher than its pre-recession level—most likely reflecting

Chart 6
Proposals in Alberta are On the Rise



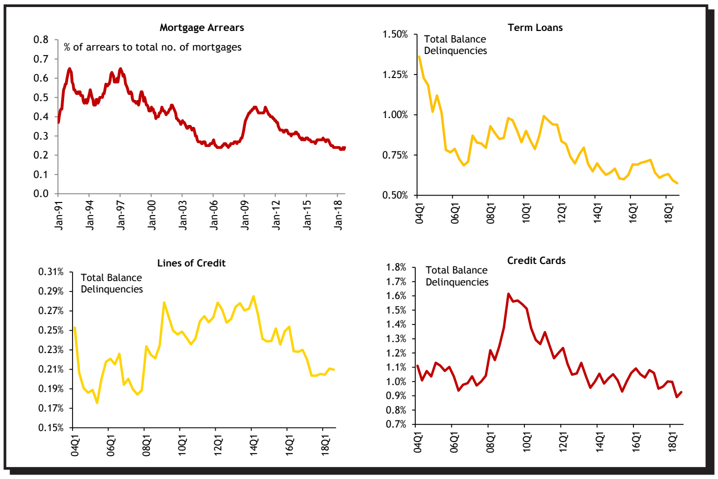
Source: Office of the Superintendent of Bankruptcy Canada, CIBC

Chart 7
Share of Proposals in Insolvencies by Province



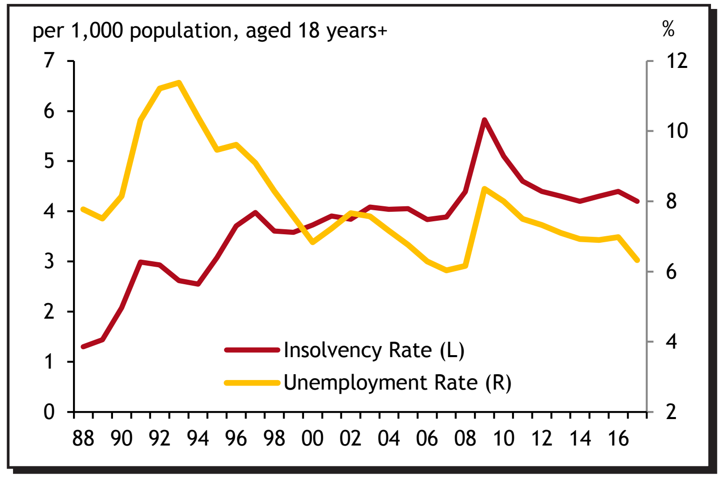
Source: Office of the Superintendent of Bankruptcy Canada, CIBC

Chart 8
Major Delinquencies by Product



Source: Equifax, CBA, CIBC

Chart 9
Unemployment Not Behind Rise in Insolvencies



Source: Office of the Superintendent of Bankruptcy Canada, CIBC

transfer of risk from credit cards to lines of credit (Chart 8).

So, what's next for the insolvency rate in Canada? A quick look at Chart 9 suggests that the answer does not lie only in the highly quoted unemployment rate. Clearly, a sharp rise in the unemployment rate can lead to a surge in the insolvency rate (see the 2009 recession), but from a long-term perspective, we find that the unemployment rate provides only a partial explanation to changes in the insolvency rate. In fact, only one-third of insolvent debtors are unemployed. Other factors, such as employment quality, play an important role here, with more than 60% of insolvents being in unskilled or semi-skilled occupational classifications. Increased self-employment activity is also important, with no less than 20% of insolvents stating that they operated a business within a five-year period prior to becoming insolvent. More than half of insolvencies occur due to the combination of over-extension of credit, financial mismanagement and unexpected expenses.

Given the increased sensitivity of Canadian households to higher interest rates, it is reasonable to expect that the recent interest rate hikes by the Bank of Canada will lead to further moderate increases in the insolvency rate, as the negative impact of increased debt financing costs will offset any positives on the unemployment front.