Living on the Edge: Somewhere Between Wing & Prayer

February, 2016

The Canadian middle class is living on the edge of a cliff. Low inflation rates are creating a false sense of security and low interest rates are enticing consumers to take on bigger amounts of debt. Adding insult to injury, real estate prices in Vancouver & Toronto are inflating net worth values.

"Consumer debt creates jobs"

Debt allows us to buy a bigger house, drive a newer car, and buy new products. If you are a borrower, easy access to credit is great as long as you can service your payments. It's safe to say that financial institutions are earning record profits, and as long as we continue to borrow and pay our debts, the banks and credit card companies will remain happy, silent giants.

So, what's the problem? The problem is that Canadians are buying into the hype and failing to pay attention to key economic indicators. Many factors like job loss, divorce, or medical crisis, could sweep many over the edge into the drowning waters of insolvency.

Insolvency - the inability to pay or service one's debts and
in some cases, a precursor to bankruptcy.

Job Loss

The first leading cause of insolvency/bankruptcy in Canada is job loss, or reduced income. Losing your job or having your income reduced can make it increasingly difficult for you to make debt payments. Alberta is an example of how quickly the tide can turn.

If we look at the effect of dropping oil prices on the province, we see how close we actually are to the edge. Analysts predict that as oil and company stock prices drop, more energy firms will have to cut staff. Note the rise in their unemployment rate, up to 7% at the end of 2015 from 4.7% in 2014 (Statistics Canada). Consequently, the number of consumer insolvencies in Alberta jumped almost 30% in July 2015 from the July 2014 level. (Office of the Superintendent of Bankruptcy Canada, OSBC)

As one sector starts to feel the economic pain of dropping prices, the effects ripple through the rest of the sectors. Some Albertans are already feeling the hurt in the housing market. Real estate sales in Calgary have slowed for 13 straight months, especially among million-dollar homes, and in recent months prices have begun to fall.

As workers are laid-off, there are fewer people eating out at restaurants, less disposable income available for buying cars, furniture, or electronics; and reduced consumer activity as a whole. Closing the circle, as lay-offs continue, we will see a greater number of credit and loan defaults.

Marriage, Separation, & Divorce

Another leading contributor is marital separation or divorce. In some cases job loss or income reduction can be a significant factor in a separation or divorce. Approximately one third of all people filing personal bankruptcy in Canada are either separated or divorced at the time of filing (OSBC).

If you have debts when you separate, your increased expenses may make it difficult to continue to service your debts. As a couple you only have to pay rent once, only have one set of household bills, and you share most other expenses. Once you are separated however, you are each paying your own bills, so your expenses increase, but your income (usually) remains the same.

Medical Issues

The third leading cause of bankruptcy in Canada, are medical issues; they often can and do lead to a lot of financial problems. If you get sick or injured and must be off work for a number of months - even with employee benefits - your income is reduced and that makes it more difficult to service your debts.

But How

How can one move away from the edge of the cliff? The answer is relatively simple, a process requiring discipline, regular maintenance, and review.

Step 1: Stop being in denial and accept that there is a danger of falling into insolvency. Interest rates are low but what happens when they increase? The cost to service that debt will increase and for some, it will mean “game over”. History tells us that interest rates (inevitably) will rise. Rather than anticipated, job loss can be sudden due to corporate failure and there may be no severance package to rely upon.

Step 2: Immediate curtailing of spending and a re-allocation of finances into debt reduction. Eliminate the most expensive debt first.

Step 3: Creation of insurance solutions to deal with death, disability and critical illness. In some cases you may need to top-up benefits at work. It’s amazing how many executives or high income earners never realize the huge shortfall on their company benefit plans until they have to make a claim. Unfortunately, by then it’s too late. Planning should never start at claim time.

Step 4: Establishment of an emergency fund equal to 3 or 4 months of salary to help deal with a sudden unexpected job loss or reduction in income.

As certified financial planners, we are here to help you move away from the edge of the cliff. We help you plan for the worst: death, disability, critical illness, divorce, and job loss and business failure. Some things are unavoidable and need professional help to minimize the pain.

Anybody can plan for the good times but it’s the tough times that define us.

To have a deeper conversation about how this subject will affect you or your business, please contact us directly:

Mandie La Montagne MA, CHRP
mandie@theintuerigroup.com
C: 604 644 0177

Sean Farrell BA, CFP, CHS
sean@theintuerigroup.com
C: 604 760 7205

www.theintuerigroup.com