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by Sean Clarke and Dave Krochmalnek

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Introduction

As interest rates rise to curb inflation, so too do risks associated with higher levels of debt. While much has been written about elevated levels of household debt, less attention has been paid to the growth in Canadian corporate debt and its implications for the business and financial sectors.

Elevated debt balances coming out of the COVID-19 pandemic remain a key source of uncertainty for many businesses, especially as the costs of servicing debt rise. According to the most recent *Canadian Survey on Business Conditions*, one quarter of businesses are unable to take on more debt, with many citing unfavourable interest rates as a contributing factor.[1] Almost four in ten businesses in the third quarter of 2023 anticipated that rising interest rates and debt costs will be an obstacle in the coming months. The Bank of Canada's third quarter *Business Outlook Survey* suggests that many businesses are scaling back their planned outlays on machinery and equipment (M&E) as financing costs rise.[2] Indeed, real outlays on industrial M&E and on computers and peripheral equipment have both declined in three of the last four quarters and are currently below pre-pandemic levels.

Business investment will need to recover to help arrest Canada's deteriorating productivity performance. After compositional changes in the workforce artificially boosted labour productivity during the initial stage of the COVID-19 pandemic, productivity has fallen off markedly, edging lower in eleven of the last twelve quarters. Business productivity has now been below pre-COVID levels since the third quarter of 2022. Given the strong, long-run correlation between productivity and living standards, strategies aimed at bolstering productivity, whether through improvements in capital intensity or labour quality, are likely to continue to be important determinants of economic prosperity. In that context, factors that can be expected to influence investment behaviour, including basic changes in the composition and costs of debt, warrant careful examination.

This paper provides an overview of how Canadian corporate borrowing has evolved in recent decades and what this may mean for risk going forward. A second paper, to be released in the coming months, will take a more detailed look at the buildup of debt on Canada's corporate balance sheet, as companies continue to adjust to higher borrowing and debt-servicing costs in the wake of the pandemic.

1. The Daily — Canadian Survey on Business Conditions, third quarter 2023 (statcan.gc.ca).
2. Business Outlook Survey—Third Quarter of 2023 - Bank of Canada

Canadian corporate debt levels are the third highest in the G7

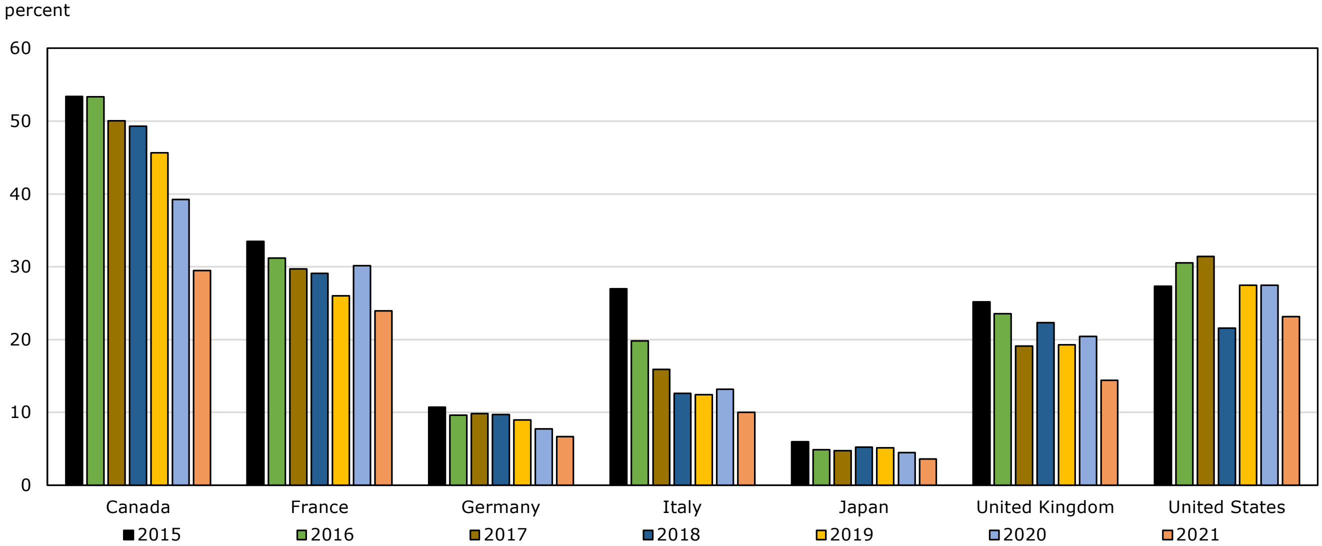
Canadian corporations carry large amounts of debt on their balance sheets. The **total credit liabilities** of private non-financial corporations (hereafter referred to as corporate debt) reached just over $2 trillion in July 2023, including debt securities and arm's-length loans.[3] While this measure of credit market debt is preferred when focusing on risk and trends in Canada, it is not possible to use it for international comparisons. Another broader measure of corporate debt is **total financial liabilities excluding equity**, which in Canada was closer to $4 trillion in the second quarter of 2023. Total financial liabilities excluding equity represented roughly 160% of Canada's gross domestic product (GDP) as of the second quarter of 2023, above the 125% average for the period from 2000 to 2019. By the end of 2022, Canadian corporations had the third-highest debt-to-GDP ratio in the G7, after France (206%) and Japan (170%).[4]

Credit liabilities and total financial liabilities are correlated, and the most important difference between the two is that the latter includes loans between parents and subsidiaries, as well as other accounts payable.

While Canadian corporations had the third-highest debt-to-GDP ratio in the G7, they have also had the top interest expense to disposable income ratios in the G7 since 2013 (Chart 1). This ratio measures the ability of corporations to meet their debt obligations, take on new financing and maintain profitability. Corporations with higher ratios tend to have greater difficulty generating sustainable profits, which could require reducing other expenses to strengthen their financial position. In 2015 and 2016, when declines in crude oil prices influenced incomes for oil and gas extraction corporations, the interest expenses of Canadian non-financial corporations accounted for over half of their disposable income. Afterwards, the ratio trended lower and reached 29.5% in 2021, mainly reflecting lower interest rates. By contrast, corporations in the United Kingdom, Italy, Germany and Japan had ratios below 15% in 2021, while corporations in France (23.9%) and the United States (23.1%) had ratios closer to that of Canadian corporations.[5]

3. Private non-financial corporations are defined as "corporations not engaged in the production of financial services as their principal activity and which are not controlled by government (i.e., exclude government business enterprises). Additionally, the corporate sector will only include incorporated entities and some types of partnerships, but will exclude unincorporated businesses, which are classified to the household sector." (Statistics Canada, 2020). Non-financial corporations accounts for about one-third of total corporate assets and one-third of corporate financial liabilities.
4.. These results are based on the Organization for Economic Co-operation and Development's non-consolidated financial balance sheets by economic sector (quarterly table 0720). Canada was second to France from 2015 to the end of 2021, when it was edged out by Japan.
5.. In 2022, the rate for Canadian corporations rose to 31.0% as interest rates increased. Germany's rate grew to 7.3%, while Italy's picked up to 10.7%.

Chart 1
Non-financial corporations' ratio of interest to disposable income

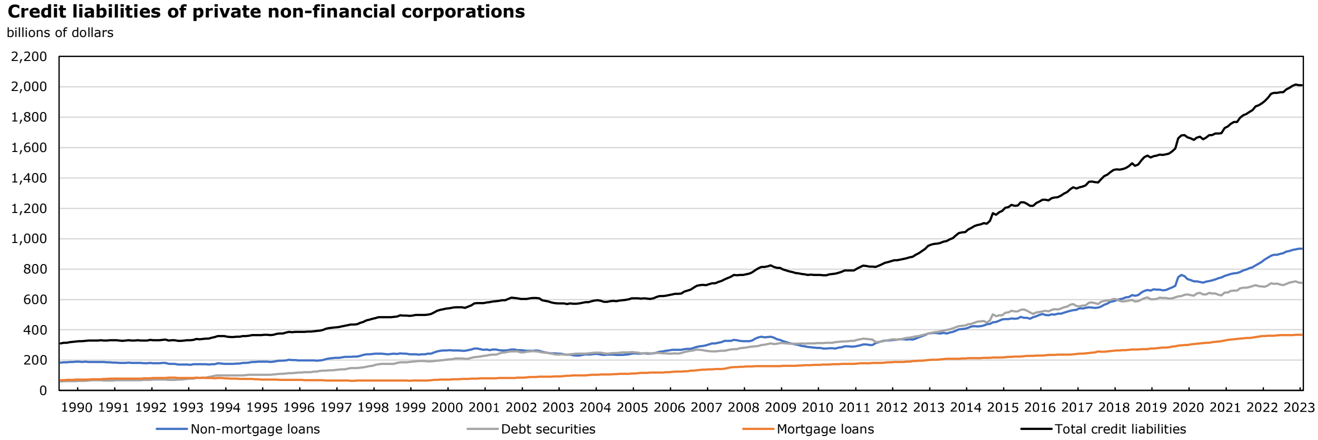


Source: OECD. Stat, dataset 14A. Non-financial accounts by sectors.

Majority of Canadian corporate debt in the form of bonds and bank loans

Canada's corporate debt has grown steadily since the early 1990s, except for a few brief periods, including the 2008-2009 recession and the COVID-19 pandemic. During the 1990s, corporate debt expanded by about 5% per year, and then slowed slightly from 2000 to 2009 (Table 1). Corporate debt grew rapidly from 2010 onwards (increasing on average by 7.4% per year from 2010 to 2019), with a slight acceleration more recently (rising over 8% in 2021 and 2022). A considerable amount of this growth came from service industries, especially real estate.

Chart 2
Credit liabilities of private non-financial corporations



Source: Statistics Canada, table 36-10-0640-01.

A sizable portion of Canada's corporate debt (about 47%) consists of **non-mortgage loans,** which amounted to more than $935 billion as of July 2023. Almost three-quarters (over $660 billion) of these loans are with chartered banks. The remainder consists of loans from non-banks, such as governments (including Canada Emergency Business Account loans), non-bank financial corporations (such as credit unions), and other resident and non-resident lenders (i.e., syndicated loans involving foreign banks).

While annual growth in non-mortgage loans was relatively slow throughout the 1990s and into the early 2000s (about 3.0%), the pace of borrowing accelerated after 2010. Average growth was 8.6% per year from 2010 to 2020. In 2021, growth was over 10%, and, in 2022, growth accelerated again to 14%.

Debt securities, predominantly corporate bonds, are the second most common form of corporate debt. These accounted for roughly $710 billion in July 2023 (about 35% of total outstanding corporate debt). Debt securities were the fastest-growing form of corporate debt in the 1990s, averaging nearly 13% growth per year. The pace slowed considerably in the 2000s, with annual growth averaging 5.1% from 2000 to 2009. Growth picked up after 2010 but did not match the pace of the 1990s.

The third most common form of corporate debt in Canada (less than 20% of total debt) is **mortgage loans**. This type of loan includes both non-residential loans and residential loans. Residential loans accounted for slightly more than one-quarter of all mortgage loans, up from roughly 14% in the 1990s, while non-residential loans made up the remainder. This type of debt grew substantially in the early part of the 2000s, with growth averaging nearly 10% per year from 2000 to 2009. Growth eased to nearly 6% after 2010 but was considerably stronger in 2020 (10.1%) and 2021 (9.5%). Moreover, this form of debt is generally concentrated in specific industries, such as real estate and construction.

Table 1
Canadian private non-financial credit liabilities average annual growth

	Average annual growth						
	1990 to 1999	2000 to 2009	2010 to 2019	2020	2021	2022	January to July 2023
	percent						
Total credit liabilities	4.9	4.6	7.4	6.7	8.9	8.4	2.4
Debt securities	12.8	5.1	7.1	4.5	7.0	3.1	1.5
Mortgage loans	-0.1	9.5	5.7	10.1	9.5	5.7	1.0
Non-mortgage loans	2.9	2.7	8.6	7.1	10.2	14.0	3.7

Source: Statistics Canada, table 36-10-0640-01.

Conclusion

Canadian corporations maintain high levels of debt on their balance sheets. High debt burdens with rising interest rates pose risks to the economy, including corporate insolvencies and bankruptcies, which could lead to higher unemployment, financial sector instability and slower economic growth. These risks, in turn, put strains on the banking sector, potentially leading to even higher borrowing rates or reduced access to financing. High debt loads may also result in the proliferation of zombie corporations (Alexander Amundsen et al. 2023) such as businesses that struggle to generate enough income to simply make required debt payments and that act as a potential drain on productivity and capital allocation.

A recent Bank of Canada Senior Loan Officer Survey found that overall business lending has tightened over the last three quarters and is approaching conditions reported in the second quarter of 2020. This, however, remains well off the peak reported in the fourth quarter of 2008 during the Great Recession. The International Monetary Fund reported similar findings in a recent World Economic Outlook, noting that banks in advanced economies have tightened lending standards, curtailed the supply of credit, and that high interest rates will likely lead to even tighter credit conditions. While the ratio of interest expenses to disposable income for Canada's corporate sector has been declining, it is still elevated compared with the country's G7 peers. Similarly, corporate debt levels are also high relative to those of other G7 countries. These two important indicators of debt burden warrant close scrutiny as the economic and financial landscape evolves.

Authors

Sean Clarke is with the Strategic Analysis, Publication, and Training, Statistics Canada. Dave Krochmalnek is with the National Economics Accounts Division, Statistics Canada.

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