4 Debt Traps and Strategies to Overcome Them

Avoiding debt pitfalls that affect your financial well-being today, and tomorrow.

With interest rates in Canada deliberately kept low in an effort to support the economy and stimulate spending, it's all too easy to embrace credit as a way of life. A recent BMO Wealth Institute Report revealed common 'bad debt' traps that stand in the way of your financial success, and how 'good debt' can strengthen your financial position.

1 Debt Trap: Thinking all debt is the same

Debts can be loosely defined as being good or bad based on whether they enhance your net wealth or destabilize your household's financial situation. When contemplating the word "debt", the survey reveals that 43% of Canadians consider it to be bad (or ugly), and most feel nervous or insecure when thinking about it.

The Opportunity: Borrowing is not ill-advised as long as the focus is on "good debts" like mortgages and what they will allow you to achieve instead of "bad debts" like high interest rate credit card spending and what these allow you to have. The focus should be on funds that will enhance your wealth in the long run and include a plan to pay off credit balances where possible.

56% of Canadians strive to pay off credit balances when possible

2 Debt Trap: Leveraging low interest rates to buy a more expensive home

Using low interest rates to get a larger loan on more expensive houses is a risky strategy. Incremental increases in mortgage lending rates can add hundreds of dollars per month to your payments which can lead to further use of credit to maintain your lifestyle.

The Opportunity: Low interest rates are the perfect opportunity to make a big impact on paying down debt. Given that interest rates are likely to increase in the foreseeable future, there's no better time to put together a detailed debt management plan.

16% of Canadians would be unable to afford a $500 increase in their mortgage payment from rising interest rates.

3 Debt Trap: Not having an emergency fund in place

When you don't have an emergency fund in place, illness, job loss or other unforeseeable circumstance can be financially devastating. You may feel you have no choice but to turn to credit to keep you afloat while you weather the storm.

The Opportunity: A pool of money that is set aside to cover the cost of unexpected expenses or the loss of income is an important component of any wealth plan. While your emergency fund may not be large enough to maintain your standard of living for the entire time your income is reduced in the case of a major crisis, your rainy day savings will put you ahead in the long run.

4 Debt Trap: Maintaining your lifestyle with borrowed funds

It is remarkably easy to borrow to help you enjoy a standard of living that cannot be supported by earnings alone. But when you habitually use credit to fill gaps in your earnings rather than for building equity, you could be setting yourself up for a lifetime of paying down debt.

The Opportunity: Households carrying a high debt load are the most vulnerable to an interruption in income or an increase in interest rates. Striving to pay down all debt, prioritizing 'bad debt' and making lifestyle adjustments that allow you to live within your means will help you achieve a stronger and more stable financial position.

How can BMO help?

Debt makes many Canadians uncomfortable but as part of a sound financial plan, it can enhance household financial stability and create wealth. A BMO professional can work with you to understand your debt needs. **They can help you plan for tomorrow while meeting your goals today.**

Call 1-888-389-8030
or click here for more information.

A plan for a **stronger** financial future

"Household debt in Canada — the good, the bad, and the ugly."

Read the full report: bmo.com/wealthinstitute/debt

BMO Financial Group
We're here to help.™

Source: BMO Wealth Institute, Household debt in Canada – the good, the bad, and the ugly.", September, 2015.