ECONOMIC UPDATE

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Key points

- **There regularly is talk about the amount of debt outstanding in the world;**
- **The debt load varies between countries;**
- **And between sectors within countries;**
- **In Australia' case it is the level of household debt that has gains attention;**
- **Mostly the Australian household sector is in good shape to handle its debt burden.**

Summary

A question often asked is whether there is too much debt in the world. While there was a (modest) decline in debt (relative to the size of the global economy) in the June quarter 2021 that debt ratio remains near record highs. There has been a particularly steep rise in the global debt-to-GDP ratio since the start of the pandemic. Mostly that was down to governments (particularly in countries like Australia and the US) running big budget deficits.

What worries analysts is less the absolute size of any debt rise but whether it is sustainable. For this reason most analysis is conducted looking at debt relative to the size of a country's national income. By this benchmark Australia did very well with only a modest rise in that debt ratio between the end of 2019 and June 2021up to June 2021. That ratio will deteriorate a little in the September quarter given the certainty of a fall in national income growth in Australia and a rise in government borrowing.

The level of the debt to GDP ratio in Australia is low by developed country standards (only Germany of the countries below is lower) at under 300% of GDP. By contrast, total debt is over 5 times the size of national income in Japan and the Netherlands.

An obvious question to ask is how much debt is too much? The answer differs between countries. One reason is that wealthier countries can sustainably borrow more than poorer ones. For example, while China is the second largest economy in the world (and at some stage will become the largest) its income per person is still relatively low by developed country standards. So the size of China's debt is not unusually large relative to the size of its economy. But it is large for the income level of its citizens. The Chinese Government is very aware that this the amount of debt in its economy (most acute amongst its corporate and parts of its financial sector) is a significant issue.

Of the developed countries (plus China), only Austria, Finland and Germany do not have any sectors of the economy that have high debt ratios (by developed country standards). Most countries have at least one (in Australia's case, household debt). And some countries have two sectors with high ratios (Belgium, Canada, France, Ireland, Netherlands and the UK).

Most sectors in Australia have low debt by developed country standards. But we do have high household debt (New Zealand is similar). In a recent speech, RBA Assistant Governor Bullock highlighted that much of the rise in the household debt ratio took place in the 1990s and early 2000's, a time when the economy was adjusting to low interest rates and changes to the taxation system. Over the past fifteen years household debt ratio (measured against household disposable incomes) has been broadly flat.

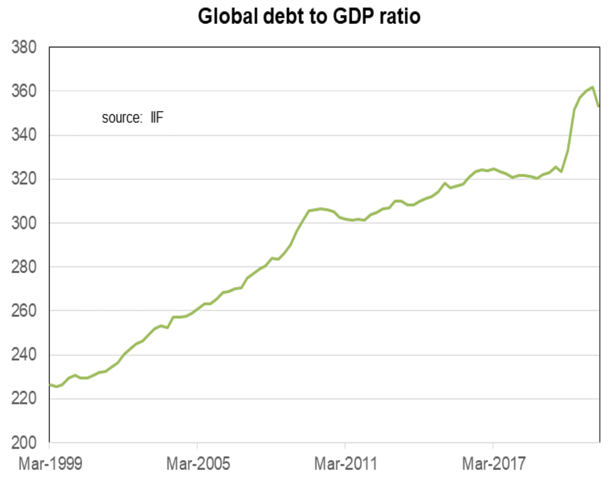
By global standards Australia's income per capita is high. This means Australian households should be able to afford a relatively high debt level. This is further helped by the extremely low level of interest rates. Nonetheless, the debt-income ratio of Australian households still looks high by global standards even after taking into account higher incomes. It is the reason why regulators are keeping a careful watch on the pace of credit growth.

Global debt – the mountain is no molehill

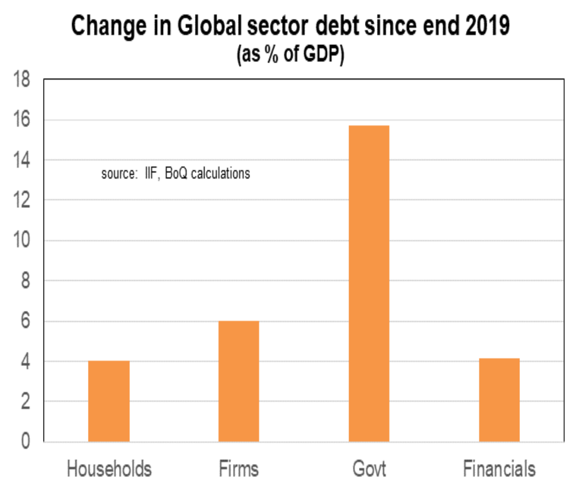
Recently there has been discussion about the level of debt on three continents. In China it was the concern that Evergrande (a big property development company) would default on its mountain of debt. In the US, financial markets are casting an increasingly wary eye on whether Congress will increase the restrictions on how much the government can borrow. And in Australia there has been discussion as to whether household credit is rising too quickly.

This leads to a question that is often asked as to whether there is too much debt in the world. The International Institute of Finance (IIF) provides a regular report on global debt trends. The first chart (sourced from the IIF) is the sort of thing that gets the debt-worrywarts going. While there was a (modest) decline in debt (relative to the size of the global economy) in the June quarter 2021 that debt ratio remains near record highs. There has been a particularly steep rise in the global debt-to-GDP ratio since the start of the pandemic. Mostly that was down to governments (particularly in countries like Australia and the US) running big budget deficits to absorb the hit to household and company incomes.

The global debt to GDP ratio continues to rise.



Mostly that was governments' running big budget deficits to support the economy through the COVID-recession.



Some countries have more debt than others

As you would expect a big slab of the increase in debt occurred in the largest economic regions (the US, China, Europe and Japan). China had the largest percentage rise in debt, with big percentage increases also occurring in Sweden and New Zealand. The rise of debt in Australia was in the top half of developed countries (plus China).

What worries analysts is less the absolute size of any debt rise but whether it is sustainable. For this reason most analysis is conducted looking at debt relative to the size of a country's national income. Using this benchmark means that it is not so much the increase in debt matters but how much debt rises relative to the (hopefully) rise in national income.

By this benchmark Australia did well up to June 2021. Certainly there has been a decent rise in the amount borrowed in Australia since the end of 2019. But Australia's economy bounced back strongly after its COVID-driven decline (at least up to June) meaning the rise in the debt-to-GDP ratio was modest. The ratio will deteriorate a little in Australia in the September quarter given the certainty of a decent fall in national income growth and a rise in government borrowing.

In the Netherlands and Denmark the debt to income ratio actually fell since 2019. By contrast, in some countries (such as Japan, Greece and Spain) the percentage rise in the debt ratio was bigger than the percentage rise in the amount of debt borrowed. This reflected weaker GDP growth in those countries.

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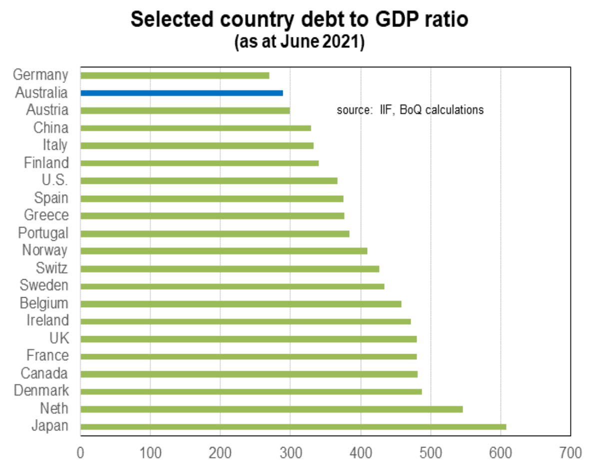
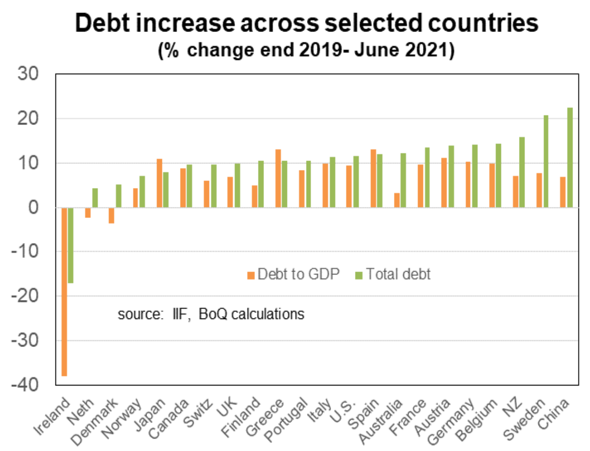
An obvious question to ask is how much debt is too much? The answer differs between countries. One reason is that wealthier countries can sustainably borrow more than poorer ones. For example, while China is the second largest economy in the world (and at some stage will become the largest) its income per person is still relatively low by developed country standards. So the size of China's debt is not unusually large relative to the size of its economy. But it is large for the income level of its citizens. The Chinese Government is very aware that this the amount of debt in its economy (most acute amongst its corporate and parts of its financial sector) is a significant issue. The Government's moves to reduce leverage in the economy (at a time of slowing national income growth) is the reason why Evergrande has had its recent troubles.

Australia's debt ratio is low by global standards.



The rise in debt in Australia since 2019 has been quite large. The increase in the debt-to-GDP ratio was not.



And some sectors of the economy have more debt than others

For many emerging countries looking at national debt to GDP ratios is usually fine to gauge what (if any) debt challenges the economy faces. These countries often have under developed financial systems, meaning the debt owed by households, firms and banks is often quite low (relative to the size of income in the economy). For those countries looking the size of national debt outstanding is often the same as looking at the size of government debt owed.

But for developed countries more disaggregated analysis is necessary. They have more developed financial systems allowing all sectors of the economy to borrow. Indeed, of the developed countries (plus China), only Austria, Finland and Germany do not have any sectors of the economy that have high debt ratios (by developed country standards). Most countries have at least one (in Australia's case, household debt). And some countries have two sectors with high ratios (Belgium, Canada, France, Ireland, Netherlands and the UK).

In a number of countries the size of government debt to GDP ratio is inversely related to the debt ratios in other sectors of the economy. In Greece, Government debt is very high (and led to the government defaulting some years ago). But debt in the other sectors of the Greek economy is low. By contrast, in Denmark, Norway, Sweden and Switzerland while the government debt ratio is very low the debt-to-GDP ratio of all other sectors is above 100% of GDP. It must be more than coincidence that each of these economies ranks very high on the income per capita global list.

Sector debt to GDP ratios by country (as at June 2021)

Country	Household	Corporate	Government	Financials
Australia	121	69	56	43
Austria	53	98	90	59
Belgium	66	160	141	92
Canada	108	128	110	135
China	61	158	65	45
Denmark	108	129	45	206
Finland	69	109	66	97
France	66	163	131	120
Germany	58	72	77	63
Greece	53	64	251	10
Ireland	32	172	60	208
Italy	44	74	165	50
Japan	64	144	61	240
Netherlands	101	144	61	240
Norway	109	147	48	106
Portugal	68	103	154	58
Spain	61	104	163	47
Sweden	94	180	42	117
Switzerland	135	137	27	127
US	79	81	126	81
UK	89	74	125	192

Source: IIF, BoQ calculation. Red is my view of a high debt ratio, green is low.

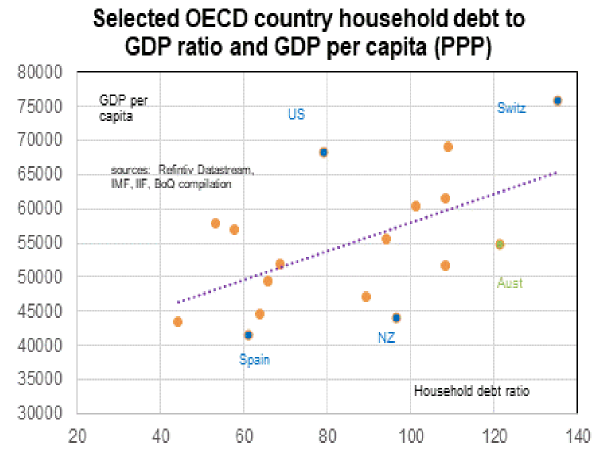
Most sectors in Australia have low debt by developed country standards. But we do have high household debt (New Zealand is similar). The structure of debt in the Australian economy has been driven by a number of factors, including the factors driving high house prices and that a fair bit of the funding required in the previous decade was mining companies seeking equity to fund the building of new mines.

In a recent speech, RBA Assistant Governor Bullock highlighted that much of the rise in the household debt ratio took place in the 1990s and early 2000's, a time when the economy was adjusting to low interest rates and changes to the taxation system. Over the past fifteen years the household debt ratio (measured against household disposable incomes) has been broadly flat. This is particularly the case once offset accounts are taken into account. The extremely low level of interest rates means that the household debt servicing ratio (the ratio of interest payments to disposable income) is at its lowest level in almost forty years.

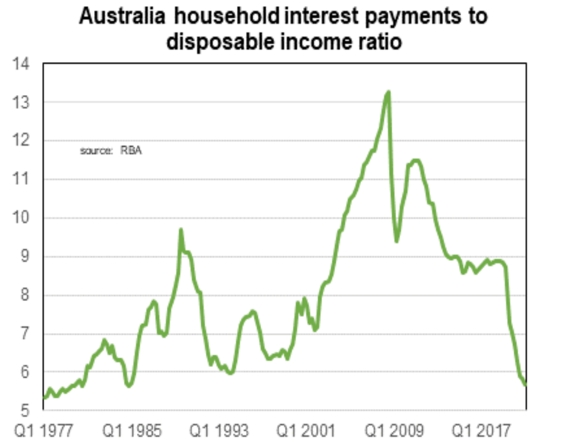
The aggregate household debt picture looks even rosier if the significant rise in deposits (especially during COVID) is included in the analysis. But using that approach would understate the riskiness of household debt in Australia. According to data from the HILDA report, Australians' over the age of 65 have the largest deposit holdings and the smallest amount of debt outstanding.

By global standards Australia's income per capita is high. This means Australian households should be able to afford a relatively high debt level. And the very low interest rates and decent shape of the jobs market means most Australians are able to handle their debt burden. Nonetheless, the debt-income ratio of Australian households still looks high by global standards even after taking into account higher incomes. It is the reason why regulators are keeping a careful watch on the pace of credit growth.

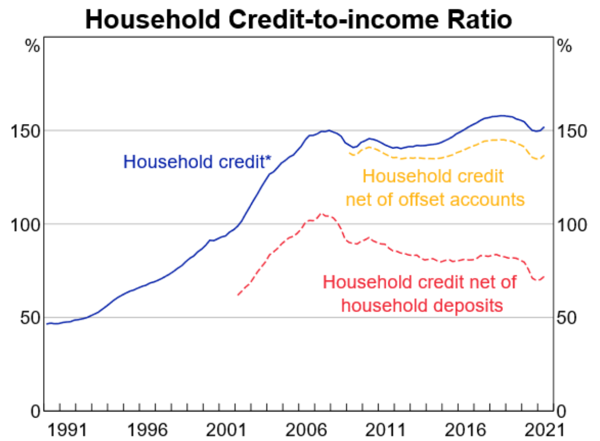
Australian household debt does appear to be high relative to the size of incomes.



But the current very low level of interest rates means that debt level is affordable.



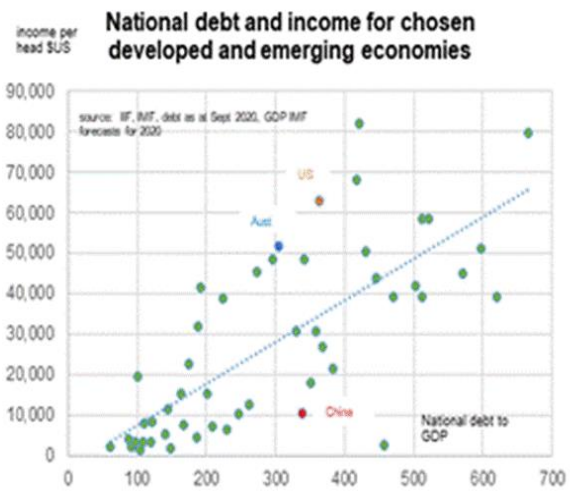
Much of the rise in Australia's household debt ratio took place in the 1990's and early 2000's.



* Sum of housing credit and personal credit; housing credit nets out amounts in redraw facilities

Sources: ABS; APRA; RBA

China does have a high debt level relative to its income per person.



We live in interesting times.

Regards
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