When we hear about household debt stress, David Chaston wonders whether we are looking at the most relevant data. Household budgets will only be stressed when the servicing costs rise

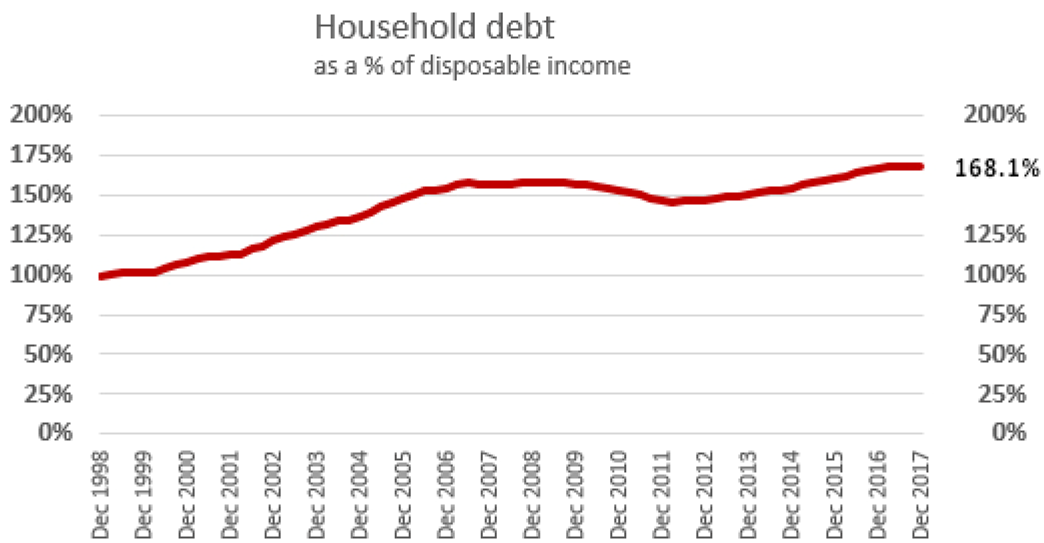
Posted in News March 05, 2018 **David Chaston**

The latest update to the widely referred-to series "Household-debt-to-disposable-income" has been released and that shows it stable at 168%.

It has been at that level for four straight quarters, and is a record high. It is the source of public angst. Its most quoted source is **here**.

But actually, it is not as dire as it is sometimes made out to be.

The data is used as evidence about how stressed households are under the load of housing debt. It is often compared to similar metrics in other countries* to confirm how elevated this stress is in New Zealand.

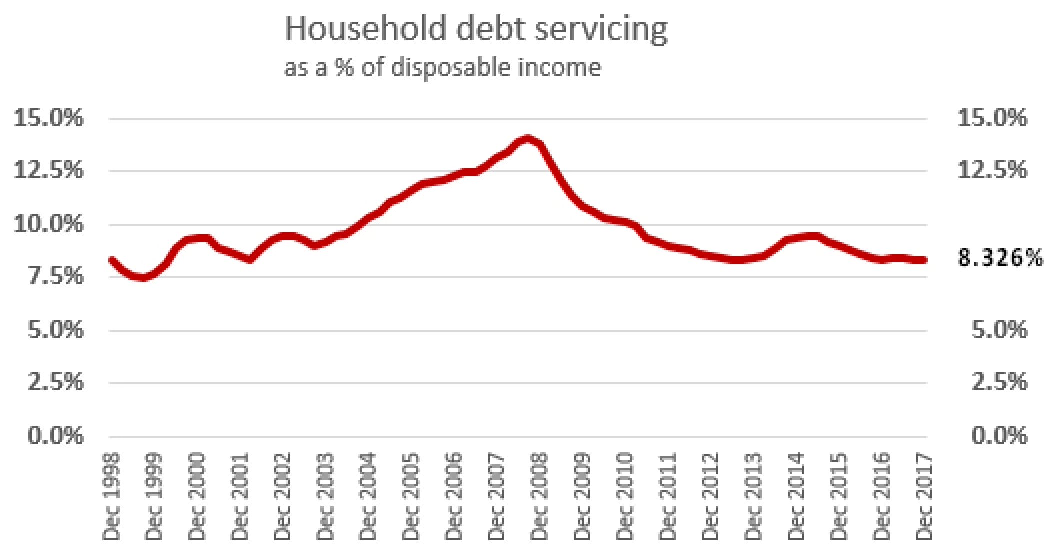


However, many readers may not realise the debt figure includes property investment debt and not just owner-occupier housing debt. That extra debt is in there because it is not possible to separate out the liabilities of these unincorporated businesses from standard household finances.

This distorts the understanding of what this 'household' data is revealing.

And there is another issue, one glossed over by many. The 168% is seen as a proxy for household budget stress. But household budgets don't use their 'income' to purchase houses. They actually use their income to make loan payments, mainly for interest. Real stress will come when these loan payments eat up increasing proportions of disposable incomes.

But not only is that not occurring, the load is getting lighter. The optics of the debt-to-income ratio may look bad, but inside households themselves, the debt-servicing-to-income ratio gives a completely different picture.

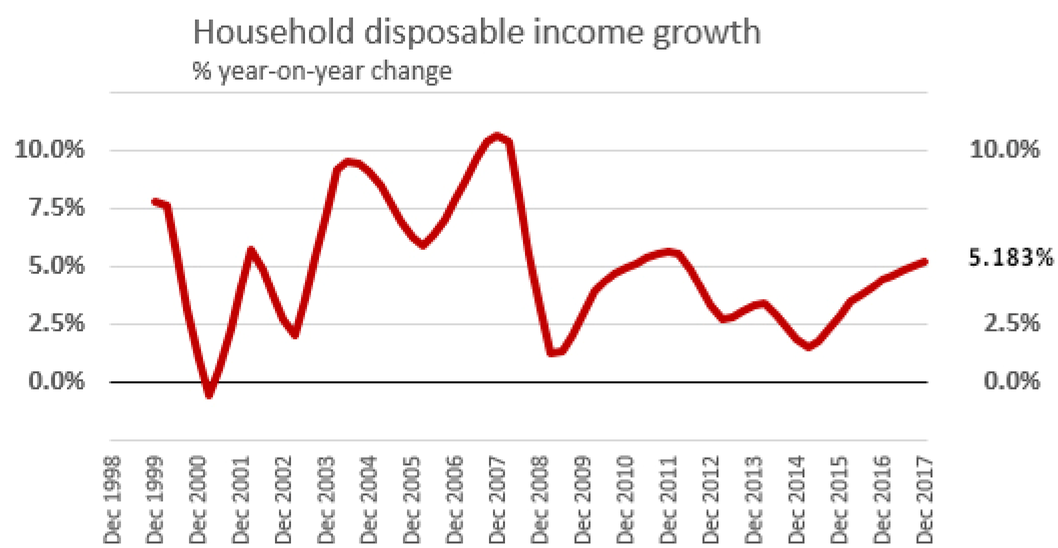


So, even after including the national business liabilities of household ownership of rental properties, the servicing load on household budgets is near its lowest level in 17 years.

The servicing load rose from 1999 to 2008, and has been generally in decline since, and by the end of 2017 reached its lowest point since 1999.

This is a narrative quite at odds with the normal public discussion about household debt levels.

One reason why the servicing load is getting easier is that incomes are rising steadily, and the rate has been increasing in the past three years.



Another point worth noting is that household liabilities are not only for housing; they include consumer loans as well.

Household debt stress	Dec-2007	Dec-2012	Dec-2017
	$ bln	*$ bln*	*$ bln*
Consumer loans (C22)	13.9	12.9	16.5
Housing loans - owner occupier (C22)	110.0	126.8	175.5
Housing loans - investment properties	54.6	64.1	84.3
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Total household debt (C21)	178.5	203.8	**276.3**
- Household debt to disposable income ratio	156.7%	147.2%	168.1%
- same ratio excluding investment properties	108.8%	100.9%	116.8%
Annual household disposable income	113.9	138.4	**164.4**
Annual household debt servicing	14.5	12.0	13.7
- Debt servicing to household income ratio	13.105%	8.525%	8.326%

This table points out clearly how much lower the servicing load is at the end of 2017 than it was ten years ago.

As a marker for household debt stress we should talk more about the servicing ratio rather than the debt-to-income ratio. The servicing ratio is the pointy end of where we will observe real stress, whereas the debt-to-income ratio is academic.

1

What? Wait, under Labour, household debt servicing cost went up from 7.5% to 14% of income, and under National it went DOWN from 14% to 8.3%? What have we done? Bring back Bill English!

Is having mortgage debt in a lower percentage of households,undoubtedly more affluent households,who should have the financial capability to adjust if necessary, better ? Does the concentration in debt as seen by the fall in home ownership rates provide possibly a better outcome if interest rates were to rise significantly.

Isn't all of this to say that households/borrowers have hit the prudential and affordability 'stops' in the system?

Those "wealthy" enough to borrow have borrowed heavily to buy property (owner occupied and investments).
Those not "wealthy" enough to borrow spend a significant proportion of their income servicing their landlord's mortgage.

How is the debt concentrated? (i.e. Auckland mega mortgages).
Where does interest only borrowing figure in all of this?
How has the length of mortgages changed over the period shown?
How would a 100 basis point increase in wholesale rates (~20% increase in servicing) impact?
How would an increase in unemployment figure in all this?
If 168% isn't stressful then why don't we try our luck with 180% 200% 300%?

Australia is seeing increasing levels of mortgage stress despite record low rates. Caps to interest only lending are now flowing through the banking system and it is starting to hurt. Not to mention that Australian house prices are falling.