IIF Weekly Insight

COVID-19 exacerbates household debt burdens

March 26th, 2020

Emre Tiftik, Director of Sustainability Research, etiftik@iif.com
Paul Della Guardia, Financial Economist, pdellaguardia@iif.com

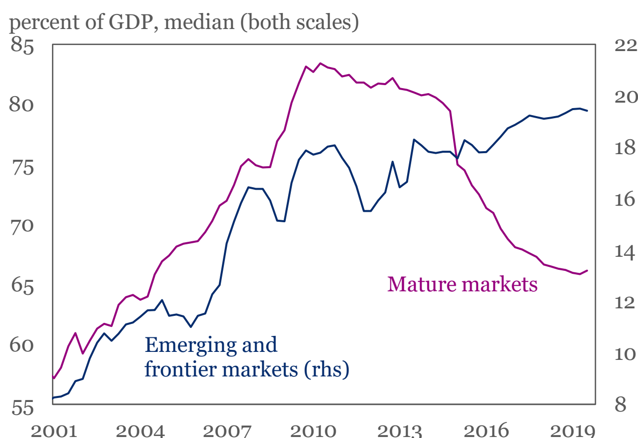
Editor: Sonja Gibbs, Managing Director and Head of Sustainable Finance, sgibbs@iif.com

- Global household debt tops $47 trillion—over $12 trillion higher than in the run-up to the 2008 global financial crisis
- More than three-fourths of the 75 countries in our sample now have higher household debt-to-GDP ratios than in 2007
- Anticipated COVID-19-related job losses imply a massive jump in household debt relative to income and assets. This could trigger a sharp drop in private consumption, particularly among lower-income, high-debt households
- Importantly, unequal wealth distribution and debt burdens among households could amplify the impact of the COVID-19 shock, exacerbating financial and socio-economic vulnerabilities
- The risk of a wave of home loan defaults casts a shadow over housing markets as lender appetite wanes

Growing risk of debt distress for more vulnerable households: With global household debt already at a record high of over $47 trillion (60% of GDP), mounting job losses and reduced working hours as social distancing takes hold raise concerns about household solvency. Since 2007, households globally have added over $12 trillion to the mountain of global debt, though the corporate and general government sectors have accounted for much more of the buildup ($31 trillion and $34 trillion respectively). While the median household-debt-to-GDP for mature markets is now much lower than a decade ago (Chart 1), aggregate data mask wide variation both across and within countries (see below). Struggling to fund the gap between earnings and spending, many low-income households could rapidly find debt burdens unsustainable, particularly if a fast "V-shaped" recovery fails to materialize, with unemployment levels elevated over a longer period of time.

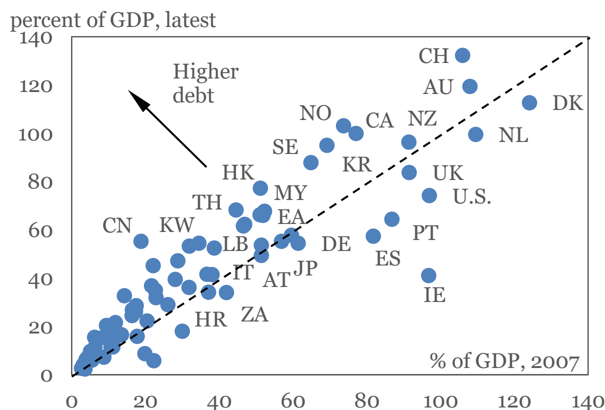
Most emerging and frontier market households have seen a rise in debt ratios: Even before the COVID-19 crisis, more than three-fourths of 75 countries in our sample had higher household debt-to-GDP ratios than before the 2008 financial crisis (Chart 2). Emerging and frontier markets accounted for most of this buildup in debt, with households in China, Korea, Thailand, Bahrain, Kuwait, Lebanon, Oman, Malaysia and Tunisia all seeing a jump of over 15 percentage points in debt ratios. Across 53 emerging and frontier countries, only nine have seen household debt fall since 2007. In this group, household deleveraging has been sharpest (-10pp of GDP) in Ukraine, Hungary and Kazakhstan. A few mature markets—notably Ireland, Spain, the US and Portugal—have also seen over 20pp declines in household debt-to-GDP. However, household debt ratios are at or near record levels in Belgium, Canada, Finland, France, Luxembourg, New Zealand, Norway, Sweden and Switzerland.

Chart 1: While mature market household debt/GDP is well below pre-crisis levels, EM households are more in debt



Source: IIF, BIS, National sources

Chart 2: Households in many countries are more leveraged



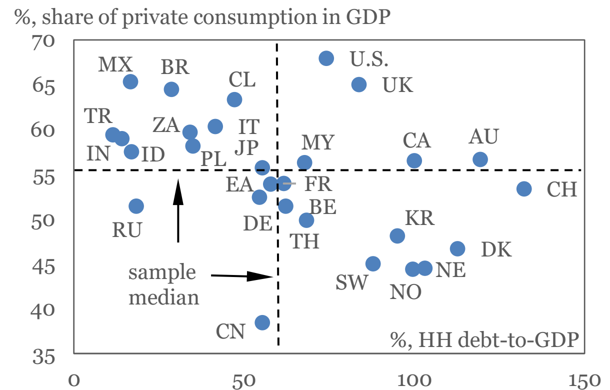
Source: IIF, BIS, National sources

High levels of household debt threaten a recovery in consumption: The anticipated decline in household gross disposable income in the context of massive job losses will bring debt ratios to record highs this year. Indeed, a new International Labour Organization report estimates global job losses of almost 25 million, with income losses in the range of $860 billion to $3.4 trillion. While much of this will likely be temporary, already-high household debt levels will amplify the adverse impact of COVID-19 and could exacerbate socio-economic and financial vulnerabilities. In particular, a big increase in household debt relative to income or assets could prompt a significant reduction in current consumption, including durable goods. While high-debt households are more sensitive to income shocks, the abnormal degree of uncertainty around the outlook for COVID-19 will likely prompt many low-debt households to slash expenses in favor of more precautionary savings. Rising debt burdens and the likely hit to consumption could prove to be a significant drag on growth in many emerging and mature markets, particularly in those where private consumption accounts for over half of economic activity. This group includes Australia, Canada, Malaysia, the UK and the U.S. (Chart 3).

The unequal burden of household debt and assets could amplify the adverse impact of COVID-19: In many emerging and mature markets, debt tends to be concentrated in low-wealth households. For instance, the bottom 90% of households by net wealth accounts for over 72% of outstanding debt in the U.S. but controls less than 15% of outstanding financial assets (excluding primary residences). Similarly, households outside the top 10% have significantly less direct and indirect exposure to stock markets, accounting for less than 20% of market capitalization. With the bottom 90% of families accounting for half of U.S. disposable income, middle- and low-income households will be much more sensitive to COVID-19 income shocks (Chart 4).

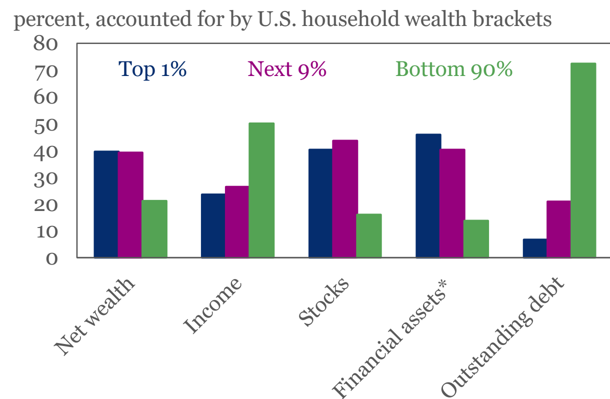
Rising mortgage default risk: Residential mortgages constitute the largest component of household debt in many mature markets, varying from 65% in Japan to over 95% in Norway, the Netherlands and Spain. While a significant portion of these mortgages are provided by retail banks in many countries, over 60% of housing finance in the U.S. originates from non-banks, largely by government-sponsored lenders. Although low borrowing costs should help to keep consumer debt obligations broadly stable, deferred and late mortgage payments are set to rise sharply amid widespread job losses, pressuring the balance sheets of both private and public lenders. This could particularly impact banking systems that have a high proportion of residential loans to total bank loans (Chart 5)—in turn reducing banks' appetite to extend new household lines of credit. In the U.S., such concerns have already prompted the Fed to announce unlimited purchases of mortgage-backed securities to ensure the orderly functioning of the U.S. housing market—the largest asset market in the world.

Chart 3: High household debt burdens could prove to be a major drag on the post-COVID recovery



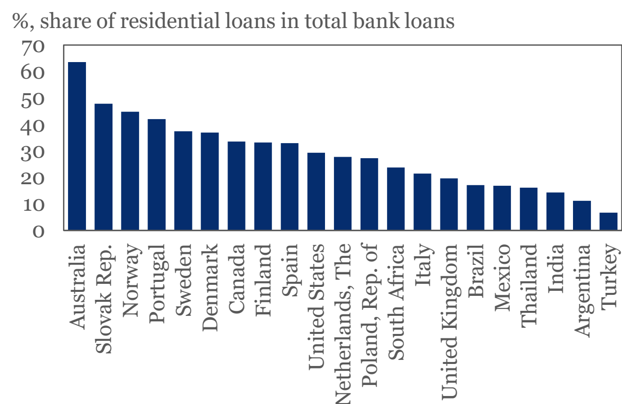
Source: Haver, IIF

Chart 4: Unequal burden: the bottom 90% of U.S. households have over 72% of all U.S. household debt



*Source: NBER, IIF; *excludes primary residence*

Chart 5: Banking sector exposure to households—and to mortgage default risk—varies considerably by country



Source: IMF, IIF

iif.com © Copyright 2020. The Institute of International Finance, Inc. All rights reserved.

Recent reports:

- Weekly Insight: COVID-19 Drives Dash for Cash (03/19/2020)
- Weekly Insight: COVID-19 Infects Corporate Debt Markets (03/12/2020)
- Green Weekly Insight: Is Your Business Strategy "Climate Resilient"? (03/05/2020)
- Sustainable Finance In Focus: New Approaches to Private Sector Funding for Sustainable Development (03/02/20)
- Sustainable Finance Policy & Regulation: The Case for Greater International Alignment (03/02/20)
- Green Weekly Insight: The Race for Better ESG Disclosure (02/27/20)
- Green Weekly Insight: What if? A closer look at climate scenarios (02/20/20)
- Frontier Market Debt Monitor: Rising Debt and Climate Risk (02/19/20)
- Sustainable Finance in Focus: Back to Basics – The Pyramid (02/18/20)
- Green Weekly Insight: Mind the climate finance gap! (02/13/20)
- Green Weekly Insight: The Davos after party (01/30/20)
- IIF/EBF Global Climate Finance Survey (01/28/20)
- Green Weekly Insight: Roaring Twenties (01/23/20)
- Global Debt Monitor: Sustainability Matters (01/13/20)
- Green Weekly Insight: Carrots and Sticks: the EU's Green New Deal (12/19/19)
- Green Weekly Insight: Materiality matters (12/12/19)
- Green Weekly Insight: Climate Science is the New Rocket Science (12/05/19)
- IIF Sustainable Finance Working Group Report: The Case for Simplifying Sustainable Investment Terminology (11/06/19)

iif.com © Copyright 2020. The Institute of International Finance, Inc. All rights reserved.