Invesco

Economic Insights
A closer look at US corporate and household balance sheets

May, 2018

John Greenwood
Chief Economist
Invesco Ltd.

Key takeaways

- US banks are mostly healed
- Consumers exhibit some willingness to borrow again
- Government debt ratio likely to increase further

Following over eight years of balance sheet repair since the crisis of 2008-09, US household and financial sector balance sheets have healed substantially. Deleveraging is largely completed for these two sectors in absolute terms, but not relative to GDP. We will examine how US private sector debt and government debt have fared in recent years.

Private sector - US banks are mostly healed

US private sector debt – which includes the debt of the household sector, non-financial business sector and financial sector -- peaked at 318% of GDP in 2009 Q1, marking the end of leveraging up (2000 – 2008).

Since then the private sector leverage ratio has declined to 235% as of 2017 Q4, a cumulative decline of 82 percentage points. This means that the private sector leverage ratio has returned to the level of 2001 Q4, unwinding three quarters of the leverage built up since the start of 2000.

Most of the deleveraging has been achieved by balance sheet repair in the financial sector (banks and shadow banks), with the household sector contributing to a smaller degree.

Although US banks are healthy again, following two years of buoyant bank lending (2014-16), loan growth has slowed since October 2016. Securitization markets and shadow banking activity are still broadly flat, not expanding.

The non-financial corporate business sector, which did not become over-leveraged before the crisis, has taken advantage of low interest rates to increase its borrowings since 2009. While the debt ratio has risen to 72% (equal to the peak in 2009), corporate earnings are now much stronger, enabling companies to repay this debt more easily.

Household sector - consumer exhibits some willingness to borrow again

Turning to the household sector, it appears to have completed de-leveraging in absolute terms as evidenced by the small rise in overall debt, but relative to GDP further deleveraging seems likely, especially as interest rates rise. Consumer credit has been growing steadily (at 5-8%), but mortgage debt is growing much more slowly (at 3%).

The household sector debt-to-GDP ratio has declined from 97.6% in 2008 Q1 to 77.3% in 2017 Q4, while the financial sector ratio has declined from 124.4% in 2009 Q1 to 80.1% in 2017 Q4. Not surprisingly, since the build-up in financial sector leverage was greatest going into the crisis, the financial sector has had to do most deleveraging after the crisis.

As long as household debt grows more slowly than nominal GDP no great harm can be done, but clearly the economy has passed a significant turning point. For the present household spending is being financed primarily out of after-tax income and accumulated savings, but the consumer at last appears to be exhibiting some willingness to borrow again.

Taking the private sector as a whole all three subsectors – the household, financial and business sectors – have ceased deleveraging in absolute terms. However, since the rate of their combined debt accumulation remains slightly slower than the rate of growth of nominal GDP, we cannot yet say that the private sector has ceased de-leveraging relative to GDP. As interest rates rise in 2018 and beyond it seems plausible that further declines in leverage may occur relative to nominal GDP.

Government debt ratio likely to increase further under President Trump

Finally, we also look at US government balance sheet. The federal government deficit narrowed sharply in 2013 under the ''sequester'', but after levelling off at around 3% of GDP in 2014-16, has started to widen again, and will increase further as a result of President Trump's tax cuts. At the same time, the household surplus (of savings over investment) has turned negative, while the corporate sector has reverted to a 2% surplus. As a result, the federal fiscal deficit is being financed by the overseas sector surplus (or foreign capital inflow) and the corporate sector surplus.

The US public sector debt ratio -- which includes federal, state and local government debt -- began rising in 2008 soon after the start of the US recession in 2007 Q4. So far the all-government debt ratio has risen from 62.6% of GDP in 2008 Q2 to 99% in 2017 Q4 and is likely to increase further under President Donald Trump.

Important information

This document is produced by Invesco Hong Kong Limited (景順投資管理有限公司). All information is sourced from Invesco as at April 23, 2018, unless otherwise stated. All data are in pound sterling, unless otherwise stated.

This document has been prepared only for those persons to whom Invesco has provided it for informational purposes only. This document is not an offering of a financial product and is not intended for and should not be distributed to retail clients who are resident in jurisdiction where its distribution is not authorized or is unlawful. Circulation, disclosure, or dissemination of all or any part of this document to any person without the consent of Invesco is prohibited.

This document may contain statements that are not purely historical in nature but are "forward-looking statements", which are based on certain assumptions of future events. Forward-looking statements are based on information available on the date hereof, and Invesco does not assume any duty to update any forward-looking statement. Actual events may differ from those assumed. There can be no assurance that forward-looking statements, including any projected returns, will materialize or that actual market conditions and/or performance results will not be materially different or worse than those presented.

The information in this document has been prepared without taking into account any investor's investment objectives, financial situation or particular needs. Before acting on the information the investor should consider its appropriateness having regard to their investment objectives, financial situation and needs.

You should note that this information:

- may contain references to amounts which are not in local currencies;
- may contain financial information which is not prepared in accordance with the laws or practices of your country of residence;
- may not address risks associated with investment in foreign currency denominated investments; and
- does not address local tax issues.

All material presented is compiled from sources believed to be reliable and current, but accuracy cannot be guaranteed. Investment involves risk. Please review all financial material carefully before investing. The opinions expressed are based on current market conditions and are subject to change without notice. These opinions may differ from those of other Invesco investment professionals.

The distribution and offering of this document in certain jurisdictions may be restricted by law. Persons into whose possession this marketing material may come are required to inform themselves about and to comply with any relevant restrictions. This does not constitute an offer or solicitation by anyone in any jurisdiction in which such an offer is not authorised or to any person to whom it is unlawful to make such an offer or solicitation.