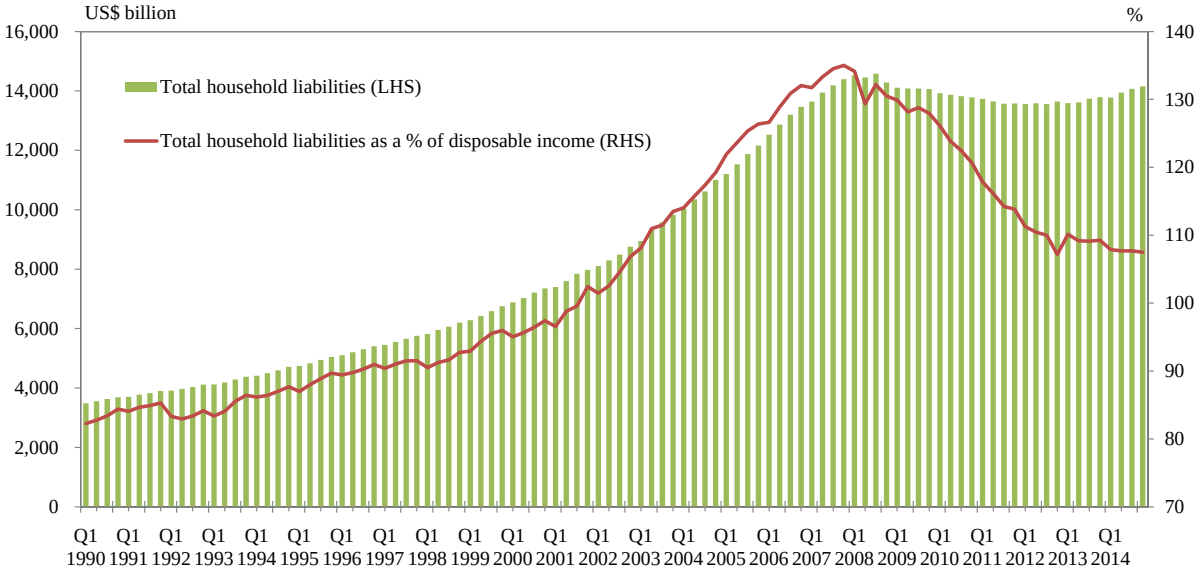
Box 2.2

Recent situation of US household deleveraging

This note examines the recent situation of household debt in the US and its implications for the outlook of the US economy.

Right after the outburst of the sub-prime mortgage crisis, the total liabilities of US households reversed the multi-year uptrend and fell notably. The cumulative decline between mid-2008 and early 2013 approached US$1 trillion (***Chart 1***). The ratio of household debt to disposable income, a common measure of leverage, also dropped significantly during the period. The phenomenon is often known as "household deleveraging".

Chart 1 : US household debt fell after the outburst of the sub-prime mortgage crisis



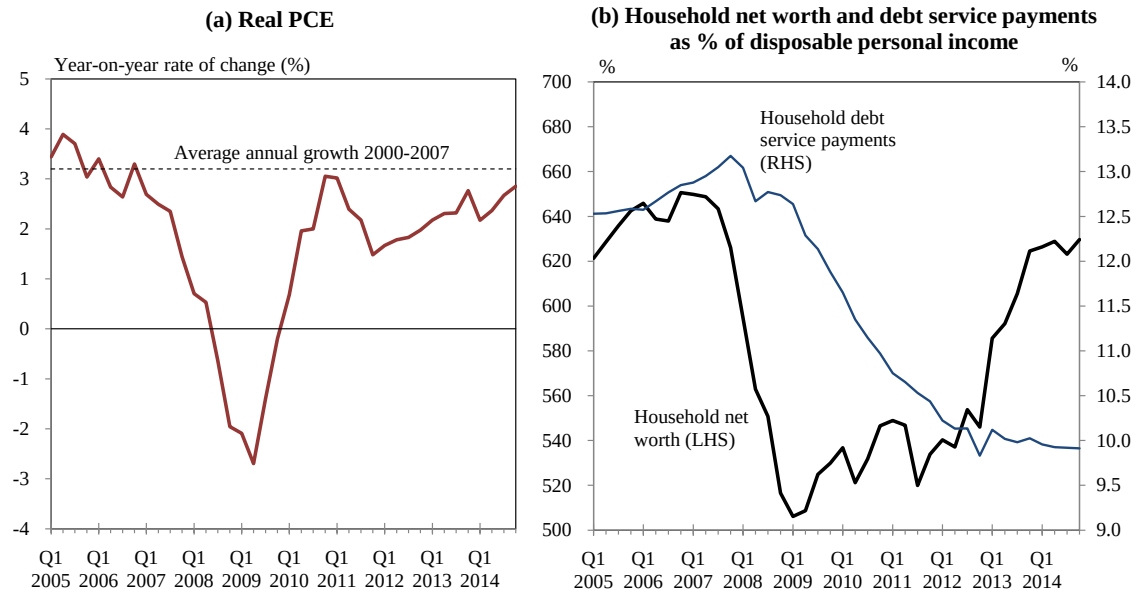
Source: Financial Accounts of the United States, Federal Reserve Board.

The high degree of household leveraging before the financial crisis of 2008-2009 is widely believed to be unsustainable, and the subsequent deleveraging contributed to the slow rebound in private consumption expenditure (PCE) as well as private residential investment in the early phase of economic recovery in the US. As the household sector reduced debts, they raised the personal saving rate and made less income available for spending, especially on those durable items that the purchase could be postponed. PCE grew only at an average annual rate of 2% between 2010 and 2012, becoming a drag on economic growth, given its nearly 70% share of GDP in the US (***Chart 2a***).

However, there are hopeful signs that the deleveraging process has largely come to an end in recent periods. Indeed, the level of household debt reversed course and has staged a mild uptrend since the second quarter of 2013. The turnaround came on the heel of improving macroeconomic situation, as the US economy gained more traction and unemployment rate fell. Besides, soaring stock prices and housing market recovery in the US, partly buttressed by the massive monetary policy stimulus, accelerated the balance-sheet repair of the household sector, thereby further solidifying the capability of consumers to borrow. Indeed, the net worth in the balance sheet of the household sector climbed up from a recession low of about five times the disposable income to over six times by the fourth quarter of 2014. Besides, the ratio of debt service payments to disposable income also fell below 10% in the latest quarter (***Chart 2b***), thanks to earnings increases, low interest rates, and household deleveraging in the preceding period. On the loan supply, financial institutions also showed increased willingness to lend to households in light of the macro improvement, with surveys showing easier credit standards since mid-2010.

Box 2.2 (Cont'd)

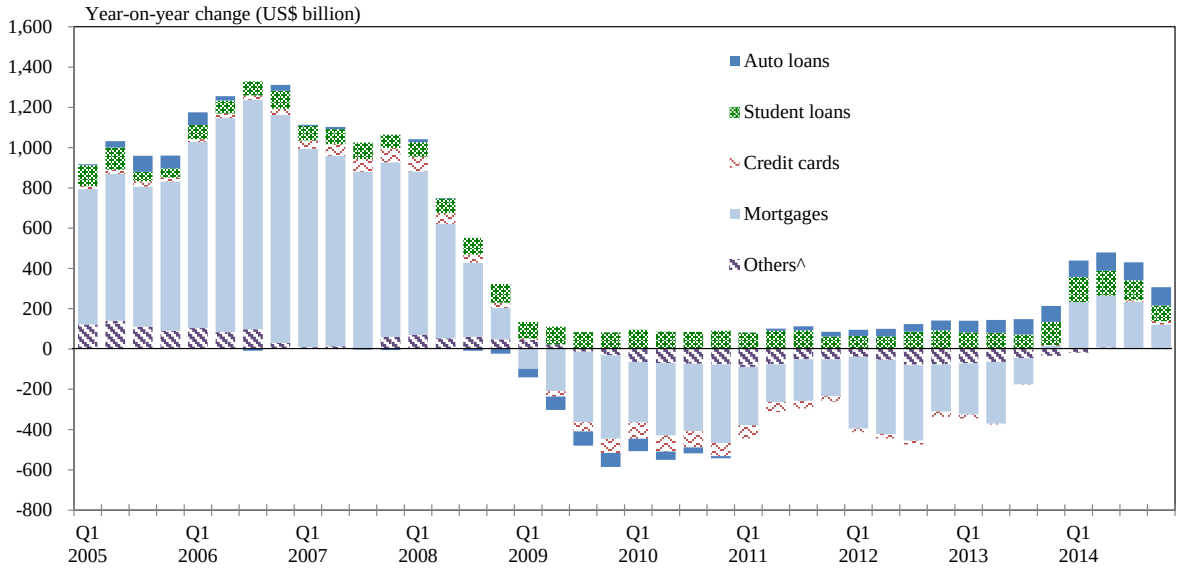
Chart 2 : Consumption growth muted after the crisis as households repaired balance sheet



Sources: Bureau of Economic Analysis; Financial Accounts of the United States, Federal Reserve Board.

More detailed breakdown shows that the recent increases in household debt had been underpinned by the pick-up in consumer credits such as auto loans and student loans (***Chart 3***). Moreover, the drag from mortgage debt also waned and reverted to growth. It was due partly to falling mortgage charge-offs as delinquencies and foreclosures receded. Also, mortgage net originations, with fluctuations from quarter to quarter, turned positive in 2014 as a whole because new mortgage issuance exceeded pay-downs, largely reflecting rising home prices and easier mortgage underwriting amid abundant liquidity.

Chart 3 : Mortgage debts rebounded and consumer credits picked up in recent period



Note: (^) "Others" include home equity revolving accounts, consumer finance (sales financing, personal loans), and retail loans.
Source: Federal Reserve Bank of New York Consumer Credit Panel.

In sum, the process of deleveraging in the US household sector seems to have largely come to an end. Looking ahead, the healthier household balance sheet, together with the recent oil price slump, should lend support to PCE growth in the US. However, such a likely positive development is still subject to some uncertainties, given the prospective US interest rate hikes and the slow recovery of the housing sector. Furthermore, some market analysts have recently cautioned about the swelling student loans in the US, as their possible defaults could threaten the stability of the credit market. We need to stay alert to all these developments.