TYCHOS

U.S. Commentary 6-30-21

Commentary:

All concern noted in this commentary in merely indicative and should serve simply as a predicate for more complete analysis.

As of the end of the first quarter, overall country-level private debt growth continues to provide no concern. Within that, household debt to GDP has remained relatively flat, while non-financial corporation debt growth dropped to a level of low concern. We estimate household and non-financial corporation debt to GDP ratios to be at least 77% and 81%, respectively, as compared to 79% and 85% at 12/31/20.

Sectors that continue to be of greatest concern within non-financial corporations and households are equity derivatives, margin debt, high yield debt and home equity withdrawals. Areas of moderate concern remain communication services, consumer discretionary, information technology and healthcare. An area of concern that continues to show moderating relative volume growth is student lending. All are comparatively small to the total economy and do not individually create systemic national risk.

The financial institution types that elicit concern are federal student loan servicers, credit unions, foreign loans to US businesses, and margin accounts at brokers and dealers. None of the debt increases of these institutions have reached a level that represents systemic national risk, but all are worth watching, because in the history of financial crisis and credit risk, problems most often arise in secondary types of institutions since these generally have lower levels of regulatory scrutiny.

There are no notable cross border exposures of US lending institutions.

U.S. Federal debt to GDP has declined from last quarter, dropping to 128% of GDP, which includes both debt held by the public and intragovernmental loans.

Country net worth

Overall U.S. country financial net worth to GDP, which among other things is a measure of liquidity, is the lowest among the Big Seven and falling. Household financial net worth to GDP is the highest among the Big Seven and rising, Non-financial corporation financial net worth is lowest among the group and falling, and government financial net worth is close to the lowest but stable.

Background:

Accelerating private debt for a country is normally a signal for some level of economic boom, which is then often followed by some type of economic reversal or calamity. The same is also true for rapid debt growth within an economic sector. At the point credit growth becomes excessive, the result is credit problems for that country or sector. The reason is this: rapid growth in credit, while usually favorable in the short run, if sustained can lead to oversupply or overcapacity—e.g. too many houses or too much oil extraction capacity—at the country level, or within a given industry or sector. In fact, overcapacity is only possible through rapid debt expansion. Significant overcapacity is generally followed by two events—a drop in sector activity and the necessity of sector layoffs during the period while demand catches up, along with high credit losses for lenders in that sector.

There is no hard and fast measure for the level of growth that leads to overcapacity, since the nature of policy responses and other qualitative variables have a significant influence on how events play out. Nevertheless, what has been a useful threshold measure is that if overall private debt to GDP increases by 20% in a five-year window, and reaches 150% in that time frame, credit problems are a likely result. Within a given sector, if sector debt to GDP increases over 40% within five years, credit problems of increased likelihood within that sector. If the sector is large enough, e.g. the real estate sector, that sectors problems can spill over into other sectors bringing systemic national risk.

Disclaimer:

All data in this report is as current as is readily available. Certain data is less timely than desirable, especially sector level data. However, most adverse volume trends must hold for more than a year or two to create significant credit concerns, so this lag in data, while unfortunate, does not preclude of significant trends.