

TYCHOS

U.S. Commentary 9-16-20

Commentary:

This U.S. data predates most of the COVID issues, and all will merit closer examination as second quarter data is released.

All concern noted in this commentary is 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 provided no concern. Within that, household debt to GDP was declining, while non-financial corporation debt growth rose to a level that borders on moderate concern. Both household and non-financial corporation debt to GDP ratios have risen to what we estimate to be at least 80% and 83%, respectively, as compared to 78% and 81% at 3/31/20.

Sectors now of greatest concern within non-financial corporations and households are communication services, consumer discretionary (including high-yield debt), IT (including high-yield debt), and equity derivatives. Areas of moderate concern are consumer auto loans and healthcare. An area of concern that has shown moderating relative volume growth is student lending. All are comparatively small and do not create systemic national risk.

The financial institution types that elicit concern are GSEs, credit unions, federal loans to students, and foreign loans to US businesses. 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 continues to grow rapidly, now reaching 110% of GDP.

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:

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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.