

ANALYSIS OF TOTAL CREDIT MARKET DEBT

- 1) This analysis relates to the often-cited statistic that "Total Credit Market Debt" in the U.S. has reached 300% of Gross Domestic Product (GDP), a historically high level.
- 2) The data is accurate; the details are revealing. The often cited implication is that credit market leverage has soared and that the system is vulnerable to implosion or inflation as a result of a leverage bubble. Those comments and conclusions don't fully consider the underlying details.
- 3) The attached schedule includes the details related to the "Credit Market Debt" data. It drills down to the segments that comprise the totals. As well, it provides data points at the start of the plateau (1952), at the inflection point before the surge (1981), and at the recent peak (2003).
- 4) The so-called surge has resulted for a number of reasons, many of which pose relatively low risks to the system.
 - a) Substantial mortgage debt has been added to the ratio, especially after 1981
 - b) A significant number of workers were added to the economy in the 1970's
 - c) A growing economy with retained net worth can sustain higher debt levels
 - d) The substantial decline in the cost of debt encouraged and supported higher debt levels
 - e) Several developments (i.e. FNMA, FHLMC, GNMA, asset-backed securities, etc.) facilitated efficient leverage.
- 5) Home mortgage loans increased from 16% of GDP in 1952 to 66% of GDP in 2003, almost one-third of the increase in "Total Credit Market Debt."
- 6) The civilian workforce increased by 30% in the 1970's, over twice the level for any decade before or after the 1970's. This provided the foundation for a surge in borrowings in the early 1980's.
- 7) Several elements of debt are often overlooked. The most significant is that asset-backed debt has a different implication for on the economy than income-supported debt. An example can be presented in terms of Mr. Smith and Mr. Jones, both of which have annual incomes of \$50,000. Mr. Smith has \$50,000 in credit card debt and Mr. Jones has \$150,000 in home mortgage debt. Who is more leveraged and who represents the greatest credit risk to the system? Mr. Smith is dependent upon his income to repay his debt; Mr. Jones could sell the asset to cover most or all of his debts. Since a significant part of the increase in "Total Credit Market Debt" has been asset-backed debt, the risk to the system is less than it would be if all had been income-dependant. Very important to note as well, the families that bought homes substituted mortgage payments for rents--their monthly costs generally stayed the same. However, the mortgage loan adds substantial debt to the total credit market debt ratio. And rather than losing income to rentals, families built significant equity net worth through home ownership.
- 8) When the cost of debt (interest rates) fell from well over 10% to well less than 10%, borrowers could sustain greater debt levels for the same cost. Debt levels that were artificially suppressed during the high interest rates of the late 1970's, were made up as rates declined in the 1980's.
- 9) As financial markets become more efficient in the 1980's and after, consumer and business debt increased. The efficiency and lower debt costs from mortgage-backed securities, consumer debt pools, and other structures took consumers directly to the credit markets.
- 10) Debt and leverage should be considered across several measures. Many of these conditions have improved over the past decades and reduce the significance of the "Total Credit Market Debt" ratio. First, debt that is backed by assets (e.g. mortgage loans, car loans, etc.) has less risk to the system than income-dependent debt (THUS, look at debt-to-assets). Second, lower interest costs justify higher borrowings (THUS, currently lower interest rates, compared to the double-digit era around 1980, facilitates higher total debt levels). Third, net debt, after considering asset collateral, should be considered in relation to the net worth/equity of the borrower (THUS, two borrowers with the same income level but different net worths can support different levels of debt).

CONCLUSION: The often cited chart reflecting a surge in Total Credit Market Debt as a % of GDP is distorted by a number of factors. One of the most significant reasons is that many families have substituted mortgage payments for rents and, without changing their costs, increased the debt ratio. Ironically, the shift built significant equity value. Further, when the long-term series is viewed on a standard logarithmic scale to show percentage gains over time, the chart becomes much less dramatic (see lower left chart). On a real basis, adjusting for inflation, the rate of growth has been relatively constant over the past 50 years (see lower right chart).

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	1952			1981			2003			DEBT % OF GDP			ASSETS % OF GDP		
	DEBT	ASSETS	EQUITY	DEBT	ASSETS	EQUITY	DEBT	ASSETS	NET	1952	1981	2003	1952	1981	2003
Total Credit Markets	485	485	-	5,269	5,269	-	34,029	34,029	-	135%	168%	309%	135%	168%	309%
Domestic nonfinancial sectors	458	164	(294)	4,366	990	(3,376)	22,299	3,706	(18,593)	128%	139%	203%	46%	32%	34%
Rest of the world	15	5	(10)	221	217	(4)	651	3,956	3,305	4%	7%	6%	1%	7%	36%
Financial sectors	11	316	305	682	4,063	3,381	11,079	26,367	15,288	3%	22%	101%	88%	130%	240%
Domestic nonfinancial sectors	458	164	(294)	4,366	990	(3,376)	22,299	3,706	(18,593)	128%	139%	203%	46%	32%	34%
Federal government	221	19	(202)	820	188	(632)	4,033	286	(3,747)	62%	26%	37%	5%	6%	3%
Nonfederal sectors	237	145	(92)	3,546	802	(2,744)	18,266	3,420	(14,846)	66%	113%	166%	40%	26%	31%
Household sector	94	105	11	1,513	444	(1,069)	9,281	2,201	(7,080)	26%	48%	84%	29%	14%	20%
Nonfinancial corporate business	85	26	(59)	1,027	109	(918)	4,986	289	(4,697)	24%	33%	45%	7%	3%	3%
Nonfarm noncorporate business	16	3	(13)	457	24	(433)	2,232	78	(2,154)	4%	15%	20%	1%	1%	1%
Farm business	11	-	(11)	178	-	(178)	206	-	(206)	3%	6%	2%	0%	0%	0%
State and local governments	31	12	(19)	372	226	(146)	1,560	852	(708)	9%	12%	14%	3%	7%	8%
Financial sectors	11	316	305	682	4,063	3,381	11,079	26,367	15,288	3%	22%	101%	88%	130%	240%
Banks, S&Ls, Credit Unions	1	186	185	184	2,202	2,018	951	7,769	6,818	0%	6%	9%	52%	70%	71%
Insurance Companies	-	75	75	-	552	552	8	3,128	3,120	0%	0%	0%	21%	18%	28%
GSEs & Federal Mortgage Pools	2	4	2	324	218	(106)	6,061	2,583	(3,478)	1%	10%	55%	1%	7%	23%
Asset-Backed Securities	-	1	1	-	130	130	2,396	3,488	1,092	0%	0%	22%	0%	4%	32%
Money Market & Mutual Funds	-	3	3	4	146	142	214	3,153	2,939	0%	0%	2%	1%	5%	29%
Finance companies	7	-	(7)	142	-	(142)	939	2,100	1,161	2%	5%	9%	0%	0%	19%
Private & public pension funds	-	13	13	-	348	348	-	1,549	1,549	0%	0%	0%	4%	11%	14%
Other	1	34	33	28	467	439	510	2,597	2,087	0%	1%	5%	9%	15%	24%

