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Economics@ANZ

Economic Update

The state of household debt

- Australia's household debt servicing ratio is the highest since 1991
- New South Wales' households have the highest mortgage debt servicing obligations
- Consumer debt servicing is highest in Queensland
- Debt servicing costs amongst unincorporated enterprises is similar for most states
- Households in Western Australia, New South Wales and Queensland appear to be the most vulnerable to higher interest rates

Strong borrowing, for housing and 'personal' use over the last decade has seen Australia's household debt servicing ratio increase sharply to 9.5% (chart 1). This is the highest level of household debt servicing since 1991 (when interest rates were more than double present levels). With the RBA widely expected to raise interest rates again this year, probably as early as next month, debt-servicing obligations are set to increase further over 2005. Monetary policy is a blunt tool, such that, unlike fiscal policy, the impact of a rise in interest rates cannot be 'targeted' to impact only certain industries/individuals/regions in an economy. This paper considers which of Australia's states, from a household debt perspective, are the most the vulnerable to tighter monetary policy.

Chart 1: Debt obligations highest since 1991

Household debt servicing ratio

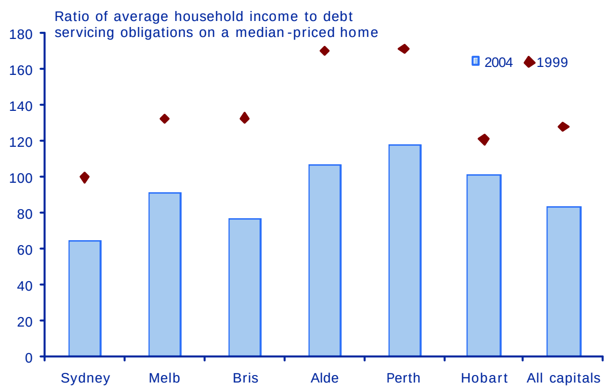
Source: ABS, RBA, Economics@ANZ

Mortgage debt

Mortgage debt servicing obligations make up around 76% of aggregate household debt costs. *Prima facie*, we would thus expect that those states with the highest relative housing costs, or the lowest housing affordability, would also have the highest household debt servicing costs. ANZ's latest estimates show that housing affordability amongst Australia's capital cities is the lowest in Sydney and Brisbane. Perth and Adelaide, in contrast, are the most affordable capital cities for housing (Chart 2).

Chart 2: Sydney and Brisbane least affordable

ANZ measure of housing affordability

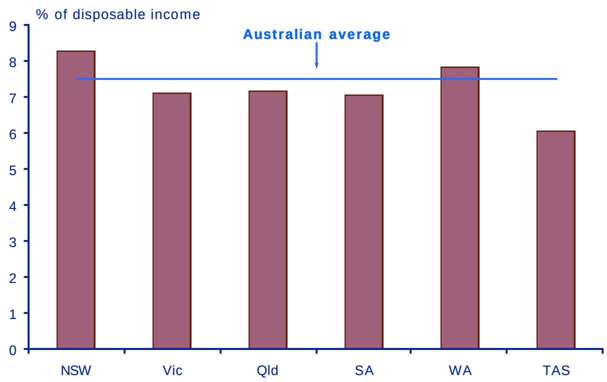


Source: ABS, Economics@ANZ estimates

It is no surprise then to see that households in Australia's least affordable state for housing, NSW, also have the highest mortgage debt servicing obligations (Chart 3). Surprisingly however, the only other state in which the household mortgage debt-servicing ratio is higher than the Australian average is Western Australia.

Chart 3: Mortgage obligations highest in NSW

Household mortgage debt servicing obligations, 2003-04



Source: ABS, Economics@ANZ estimates

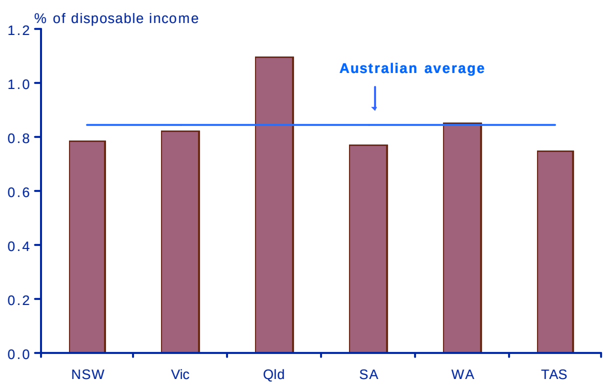
At first, this seems counterintuitive, given that, as Chart 2 illustrated, Perth has the most affordable housing of all the capital cities. Why, despite relatively cheaper housing, are households more high-geared (ie. taking out relatively bigger home loans) in the west? Most likely it is a by-product of Western Australia's booming economy. Economic growth in this state was more then twice as fast as the Australian average last year, clocking a breakneck speed of 7.5% and the unemployment rate has fallen to 4.6%, the lowest rate in the country. This strongly performing economy is in turn spurring population growth, which in Western Australia last year was the second-highest of all the states (after Queensland). With an economy and population growing so fast, it is no wonder that households in the west are 'buying' more into the dream. Furthermore, in this environment the conditions are highly favourable for first home-owners, who generally have to borrow a greater proportion of the house price, to enter the market. As such, around 19% of housing finance approvals are going to first-home owners in Western Australia, above the national average of 17%.

Consumer debt

As well as having relatively higher mortgage debt-servicing obligations, households in Western Australia also have relatively higher servicing obligations for consumer debt. However, while higher than the national average, these debt obligations are still much smaller than in Queensland (Chart 5).

Chart 5: Qld tops consumer debt servicing

Household consumer debt servicing obligations, 2003-04



Source: ABS, Economics@ANZ estimates

That servicing of consumer debt is the highest in Queensland of all the states comes as little surprise, given the strength of household spending in this region in recent years. Queensland retail sales, for example, were up a strong 9% in 2004, following on from a rise of 10% in 2003. This compares with a rise in total Australian retail sales of 6% and 7% respectively. The strong growth in household spending in Queensland together with the apparent increased willingness of households in the sunshine state to take on higher levels of consumer debt both no doubt reflect the strong performance of the Queensland economy and in particular the labour market in recent times. Queensland economic growth has averaged 4.8% per annum over the last five years, well above the Australian average of 3.3%, and unemployment in the state dropped to 4.9%, below the national average of 5.1%.

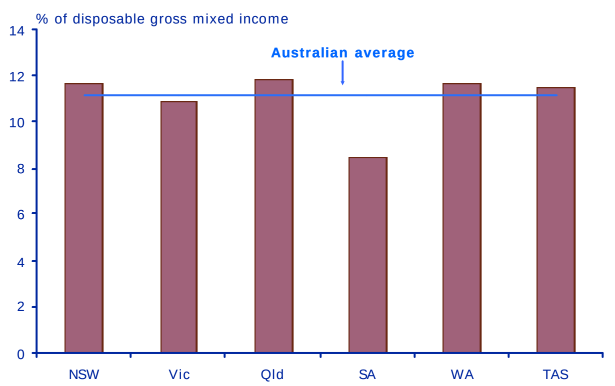
Another interesting point to note is that consumer debt servicing costs in New South Wales are well below the national average. This likely reflects a combination of relatively high mortgage debt servicing obligations and slow economic growth in this state. That is, the highest mortgage debt servicing costs in the country is no doubt constraining New South Wales' household borrowing for and spending on other purchases. This in turn is an important driver of the relatively lacklustre performance of the New South Wales' economy in recent times. Economic growth in NSW has averaged just 2.8%pa over the last five years, below the national average of 3.3%, with household consumption growth the lowest of all the states during this period.

Unincorporated debt

As well as leading consumer debt servicing, debt servicing obligations amongst unincorporated enterprises (ie. small businesses and farms) is also the highest in Queensland. Unincorporated enterprises' debt servicing is also higher than the national average in New South Wales, Western Australia and Tasmania. That said the debt-servicing ratio of unincorporated enterprises is at a pretty similar level (around 11%) in most states (Chart 6).

Chart 6: Unincorporated debt servicing lowest in SA

Unincorporated enterprises' debt servicing obligations, 2003-04



Source: ABS, Economics@ANZ estimates

What is probably of more interest for this indicator is the relatively low debt servicing obligations amongst unincorporated businesses in South Australia. South Australia's position does not reflect a lower willingness to take on debt *per se*, with interest payments by unincorporated enterprises growing at a similar rate amongst the different states in recent times. Rather, the low debt-servicing ratio in South Australia reflects relatively stronger income growth. Gross mixed income in South Australia has increased at an annual average rate of 7.4%pa over the last five years, the highest of all the states and well above the national average growth rate of 5%. This largely reflects the relatively strong performance of South Australia's farm sector with recent strong cropping seasons underpinning growth in agricultural income of 10.4%pa over the last five years, much higher then national growth of 7.5%pa.

Borrowing is an important driver of business growth. With the economy performing solidly and business balance sheets in good shape, it would therefore appear that there is plenty of scope for unincorporated enterprises in South Australia to lift debt-servicing obligations to be more in line with the national average (ie. borrow more to fuel growth!). However, to the extent that relatively stronger income flows in South Australia are being fuelled by the often-volatile farming sector, it is reasonable to expect that participants will be a little more risk-averse and seek to keep debt-servicing within a lower range during 'good times'.

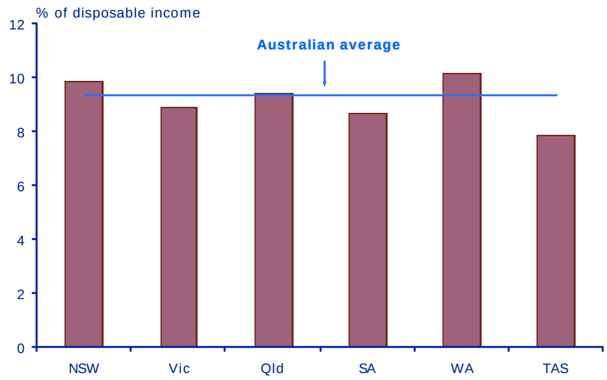
Household debt-servicing highest in the West

Putting together interest paid on mortgage debt, consumer debt and by unincorporated enterprises reveals that aggregate household debt-servicing obligations are remarkably similar across all of Australia's states (Chart 7). A look through history shows that this is not a new phenomenon, with household debt servicing 'bunching' together across the states over the last decade. At the very least, this indicates that household attitudes to debt do not tend to vary across the different regions.

That said, there are some marginal differences between the states with household debt-servicing obligations the highest in Western Australia. This reflects relatively higher servicing costs on both mortgage and consumer debt in the west. Relatively higher debt-servicing on mortgages means the NSW ratio is the second-highest of all the states while relatively higher servicing obligations on consumer debt pushes the Queensland ratio slightly higher then the national average. In contrast, households in Victoria and South Australia have lower then average debt-servicing obligations. Tasmanian households have the lowest debt-servicing ratio, reflecting the lowest mortgage debt obligations in the country.

Chart 7: Total debt servicing highest in WA

Household debt servicing obligations, 2003-04



Source: ABS, Economics@ANZ estimates

This analysis suggests that households in Western Australia, New South Wales and to a slightly lesser extent Queensland appear, in aggregate, to be the most sensitive to a rise in interest rates. It is important to note that this fairly simple analysis does not take into account a range of other factors that will affect vulnerability to monetary policy, such as the distribution of debt amongst different households in each state or the expected economic and income growth in each state over the coming period. Nevertheless, it does provide a good snapshot of household indebtedness across the different states, and does give industries exposed to the household sector some guide as to the likely impact of tighter monetary policy to their business across the different states.

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