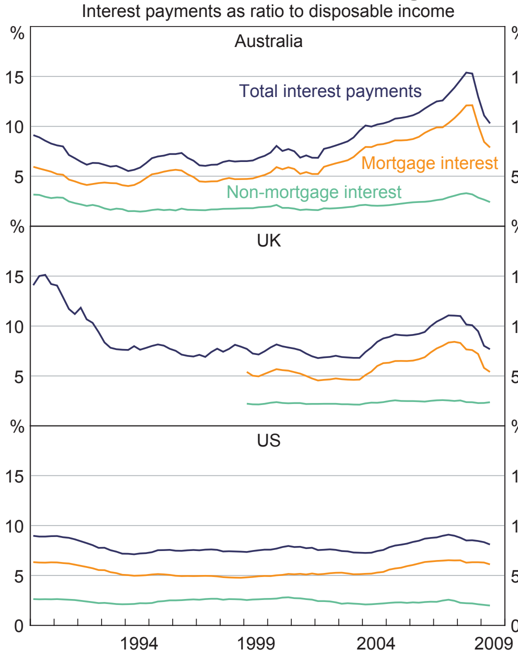
Box B: The Effect of Policy Rate Changes on Household Debt Servicing

Graph B1

Household Debt Servicing

Interest payments as ratio to disposable income



Sources: ABS; Bureau of Economic Analysis; Office for National Statistics; RBA; central banks

The responsiveness of household debt servicing to changes in central bank policy rates depends in part on the prevalence of variable rate loans. In Australia and the United Kingdom, where mortgage-related interest payments are a large share of debt servicing and home loans are predominantly extended on variable rate terms, the recent policy easings have significantly lowered household debt servicing (Graph B1). However, in countries such as the United States where mortgages are mainly at long-term fixed rates, household debt servicing has fallen by relatively little.[1]

In Australia, household debt servicing fell by around 5 percentage points over the 12 months to June 2009 (Table B1). This reflects the sharp decline in mortgage rates in response to policy easing and, to a lesser extent, the decline in interest payments on non-mortgage debt. Total levels of mortgage and non-mortgage debt outstanding were little changed over this period, while nominal household disposable income grew modestly. Similarly, in the United Kingdom, household debt servicing has fallen by around 3 percentage points since peaking in the fourth quarter of 2007. Again, this mainly reflects the decline in mortgage rates over this period and moderately higher disposable income.

1 *In Australia and the United Kingdom, three-quarters and one-half of outstanding housing loans are at variable rates; in the United States, all but a quarter of loans are at long-term fixed rates.*

Table B1: Household Debt Servicing

Percentage point change of ratio to disposable income, since recent peak

	Australia (peak: June 2008)	United Kingdom (peak: December 2007)	United States (peak: September 2007)
Debt-servicing ratio	–5.1	–3.1	–1.0
Contributions from			
Mortgage interest	–3.9	–2.6	–0.1
Non-mortgage interest	–0.8	0.0	–0.5
Disposable income	–0.4	–0.5	–0.4

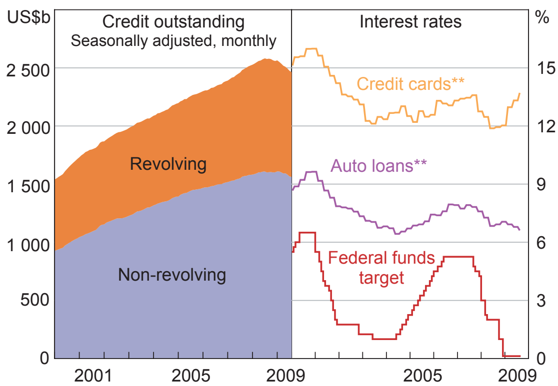
Sources: National Sources; RBA

Recent developments in the United States have been somewhat different. There was a much more subdued rise in household debt servicing prior to the onset of the financial crisis and a relatively modest decline of 1 percentage point since its peak in the third quarter of 2007. In further contrast to Australia and the United Kingdom, the decline in household debt servicing in the United States has been predominately driven by a decline in non-mortgage related interest payments on credit cards, auto loans and other non-real estate related debt. Although mortgage interest payments in the United States are also the largest component of household debt servicing, mortgage rates have fallen by significantly less than in other countries, despite the policy easing of more than 500 basis points.[2] Furthermore, even though mortgage rates have declined to some extent in the United States, households have not been able to take full advantage of this, as the decline in house prices has hindered refinancing of existing mortgages.

The fall in non-mortgage interest payments in the United States can be attributed to a decline in the level of debt outstanding, a change in the composition of this debt and slightly lower interest rates on some types of credit. The level of non-mortgage related consumer credit outstanding has declined steadily since mid 2008, led by a fall in revolving credit (mainly credit card debt), while non-revolving credit (mainly auto loans) has remained little changed (Graph B2). The decline in credit card debt in the United States can partly be attributed to an increase in the household saving rate and is likely to have been influenced by the sharp rise in the delinquency rate on credit card repayments that has led

Graph B2

United States – Consumer Credit*



* Non-mortgage related

** Data are released quarterly

Source: Board of Governors of the Federal Reserve System

2 *For more information see 'Box B: An International Comparison of Pass-through of Policy Rate Changes to Housing Loan Rates',* Statement on Monetary Policy, *February 2009, pp 57–58.*

to an increase in charge-offs, which are almost 10 per cent of outstanding balances. As the composition of consumer credit has shifted away from credit card debt, on which a relatively high interest rate is payable, towards auto loans where interest charges are lower and falling, debt servicing has declined.