

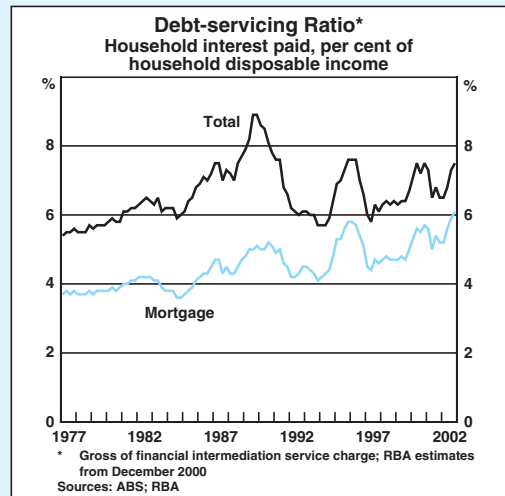
## Box C: Measuring Household Debt Servicing Costs

As has been discussed in recent articles published in the *RBA Bulletin*, the sustainability of debt levels depends importantly on the share of borrowers' incomes required to service the debt, that is, the payment of the associated interest costs.<sup>1</sup>

In assessing the level of debt service, the RBA makes two adjustments to the measure of household interest payments published by the ABS in the national accounts. Firstly, the ABS deducts a portion of the interest paid as being payment by households for the financial intermediation services provided by financial institutions. The spread between the interest rates at which financial intermediaries borrow from the public and the interest rates at which they lend is assumed to represent the price of intermediation services to households. The service charges imputed from the interest spread, referred to as Financial Intermediation Services Indirectly Measured (FISIM), are attributed to both borrowers and depositors to capture this means of recovering the costs of financial intermediation. A series of actual (gross) interest payments on debt, which adds back the imputed service charge, can be constructed based on unpublished ABS data.

Secondly, even taking account of the above adjustment, recent levels of interest payments appear too low given the levels of debt and prevailing interest rates. To account for this, from the December quarter 2000, the gross interest payments data have been adjusted so that the implied average interest rate maintains a margin over the cash rate consistent with that observed in recent years.

Graph C1



The resultant series is shown as the upper line on Graph C1; it has fluctuated with the interest rate cycle around a gradual upward trend. The lower line in Graph C1 shows the equivalent series for the debt-servicing requirement for mortgage debt alone. This series shows a clearer upward trend, with more moderate cyclical swings.

Currently mortgage interest payments account for around 6 per cent of household disposable income, around 1 percentage point higher than in 1990. The increase in the mortgage debt-servicing ratio has occurred because the ratio of outstanding mortgage debt to income has risen substantially since 1990, which has more than offset the effect of lower mortgage interest rates.

Allowing for required principal repayments as well as interest payments would increase

1. See 'Recent Developments in Housing: Prices, Finance and Investor Attitudes', *RBA Bulletin*, July 2002, 'Innovations in the Provision of Finance for Investor Housing', *RBA Bulletin*, December 2002, 'Housing Equity Withdrawal', *RBA Bulletin*, February 2003, 'Household Debt: What the Data Show', *RBA Bulletin*, March 2003, and 'Do Australian Households Borrow Too Much?', *RBA Bulletin*, April 2003.

the current level of the debt-servicing ratio by an additional 2½ percentage points or so, an amount which is likely to have increased in recent years along with rising debt levels. It is also worth noting that because the majority of households have no mortgage debt, the servicing cost for those households that do is a good deal higher than indicated by the aggregate figure.

While following the same general trend as mortgage interest costs for much of the past two decades, total interest costs peaked in the late 1980s. Personal loans, which carry a relatively high interest rate, were a much larger share of total household debt at that time than they are now, and the average interest rate on personal loans rose more in the late 1980s than did mortgage rates. ↗