Non-technical summary for 'Do Australian Households Borrow to Keep up with the Joneses?'

By Kim Nguyen

Inequality has become an increasingly important topic among researchers and policymakers, both in terms of what causes inequality and what effects it can have on growth and the economy more generally. One channel through which inequality could affect the economy is by influencing the amount of borrowing, and its allocation across households. In particular, some have argued that in local areas where incomes are very unequal, households may try to 'keep up' with their more affluent neighbours by borrowing more. This has important potential implications for both financial and economic stability if it leads households to borrow too much and become more sensitive to negative shocks.

How important might this channel be? While nationwide income inequality in Australia is similar to other countries and has been stable over the past decade, income inequality within local areas often changes over time, and the gap between people with the highest and lowest incomes can differ substantially across areas. As households may make their borrowing decisions using their neighbours as a reference point, this suggests that local income inequality could have a moderate effect on household debt.

As such, I ask the following questions:

1. Do Australian households borrow more as income inequality in their local area increases?
2. What do they borrow more for? For instance, to buy property or other assets, or to consume more?
3. Which types of households borrow more? What are their demographic and financial characteristics, and does this have implications for financial and economic stability?

Key findings:

- Households tend to borrow more for investment (e.g. to buy shares) or to buy cars, but not for housing, as income inequality in their local area rises.
- In both cases, additional debt tends to be taken out by middle-income households who are financially comfortable. This has a number of important implications:
    - For investment debt, it suggests that these middle-income borrowers are trying to close the 'income gap' with their rich neighbours through investment that can raise future income.
    - For car debt, it suggests that households may be taking out debt to keep up with their richer neighbours through 'conspicuous consumption'.
    - These households are unlikely to have difficulty repaying their debt. As such, there is limited financial stability concern.