Box B

Measuring Household Debt

The existing level of household debt has a significant bearing on how the household sector responds to changes in interest rates and other factors that affect their disposable incomes. In particular, the existing level of household debt affects both the proportion of income that households must devote to interest payments and households' willingness or ability to take on additional debt. Household debt (and its distribution) is also one important consideration in assessing risks to financial stability. Other things equal, more indebted households are more likely to experience financial stress when facing adverse shocks to their incomes and to reduce their expenditure accordingly.

There are various measures of household debt. It has been common to focus on the debt owed to the financial sector by households excluding unincorporated enterprises. However, unincorporated enterprises, which are primarily small businesses and farms that are wholly owned by households, are likely to be an important input into household decisions about expenditure, saving and borrowing. Moreover, for unincorporated enterprises, liabilities are incurred personally by the owners, their expenditure is included in the national accounts measure of consumption and the sensitivity of their debt to changes in interest rates is close to that of debt held directly by private households.[1] Unincorporated enterprises are less indebted than private households on average.

Households' decisions about consumption, saving and borrowing are also likely to be influenced by debt they owe to non-financial entities. The national accounts measure of household debt includes debt owed to: the financial sector, which includes Authorised Deposit-taking Institutions and mortgage securitisers; the state and federal governments, which is primarily HECS-HELP debt[2]; and overseas banks and governments, which is mostly owed by recent migrants. It also includes other accounts payable to these sectors and a range of smaller entities, including to pension funds. These other components of debt tend to be less responsive to domestic interest rate changes than debt owed to the financial sector. Debts to the non-financial sector and other accounts payable currently comprise 14 per cent of the household sector's overall debt (Table B1).

Table B1: Household Debt
March quarter 2015

Debt owed to	Share Per cent[(a)]	Year-ended growth
Financial sector	86	6.9
Australian government sector[(b)]	2	15.1
Rest of the world	3	10.8
Other accounts payable	9	7.5

(a) Of total household liabilities
(b) State and federal governments
Source: ABS

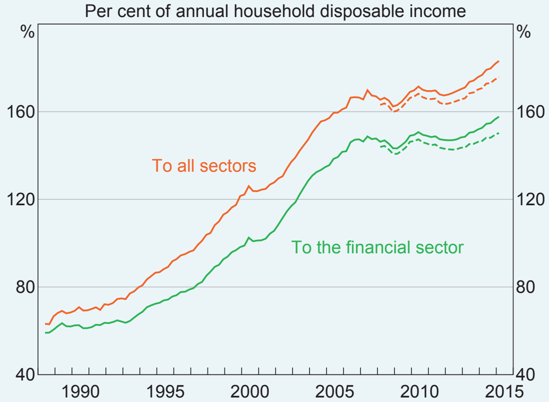
Household debts to the financial and non-financial sectors, measured as a share of household disposable income, have moved roughly in line over recent decades. Over the past few years, however, household debt to the non-financial sector has grown more rapidly (Graph B1). This has largely been caused by debt owed to the government sector and the rest of the world growing at a faster

1 Enterprises that have become a corporation under the *Corporations Act (2001)* are legally separate to their owners.

2 The Higher Education Loan Program (HELP) replaced the Higher Education Contribution Scheme (HECS) in 2005.

rate than debt to the financial sector. These trends have been driven by an increase in the number of government-funded university places for Australian students and a high level of net overseas migration in recent years.[3]

Graph B1
Household Debt*
Per cent of annual household disposable income



* Includes unincorporated enterprises; dashed lines exclude offset balances; disposable income is after tax and before the deduction of interest payments

Sources: ABS; RBA

A comprehensive measure of household debt should also be net of balances in offset accounts because they effectively reduce the household sector's net debt position (see 'Box E: Offset Account Balances and Housing Credit'). Since offset account balances have been growing faster than housing debt, this netting reduces the increase in the household debt-to-income ratio somewhat, but not by enough to offset the growth in debt to the government and to the rest of the world. Overall, all measures point to a moderate increase in household debt relative to income in recent years. ✠

3 Since migrants' incomes have always been included in the household income measures, including overseas debt held by migrants necessarily increases the debt-to-income ratio.