

The Distribution of Debt and Wealth in Australia

Charlie Nelson
director foreseechange
February 2003

The amount of household debt has increased substantially in Australia over the past 12 years or so. The amount of debt, relative to household disposable income has doubled. Servicing costs, as a proportion of household disposable income, are below the level of the late 1980's, when interest rates were very high, but not by much.

In discussing the potential problems this increased debt burden could cause, it is often pointed out that relative to the value of assets, debt has increased only modestly. In other words, it is assumed that the household sector can withstand financial shocks, such as rising unemployment, interest rates, consumer prices, or a fall in house prices, despite the high debt because assets can be liquidated to repay some debt if necessary.

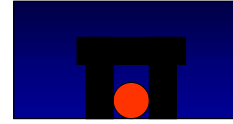
But this argument is only valid if debt and assets are both equally distributed across the population. This is certainly not the case as shown below.

In an address to the 2003 CEDA Economic and Political Overview on 13 February 2003, Glenn Stevens, a Deputy Governor of the Reserve Bank of Australia (RBA) asked "...who owns the assets and who owns the debt?" And then said "I think we are only in the early stages of coming to an understanding of these things, and there will be much discussion of them in the years ahead."

It is good that the RBA is, belatedly, recognizing the need to understand the distribution of debt and wealth. Much economic theory is based on the absurd assumption that all consumers are identical – a "representative consumer". This is discussed by Steve Keen in "debunking Economics" (in Chapter 2) and he states that economists model an entire economy as if there is only one person in it. This is due to the impossibility of aggregating individual demand functions to form a market demand function.

But we have known for a long time that wealth and debt are not uniformly distributed. I have been arguing since 1994 that the assumption that wealth and debt are uniformly distributed is false and that this could lead to mistakes in monetary policy (my research paper can be downloaded at www.foreseechange.com/perverse.htm).

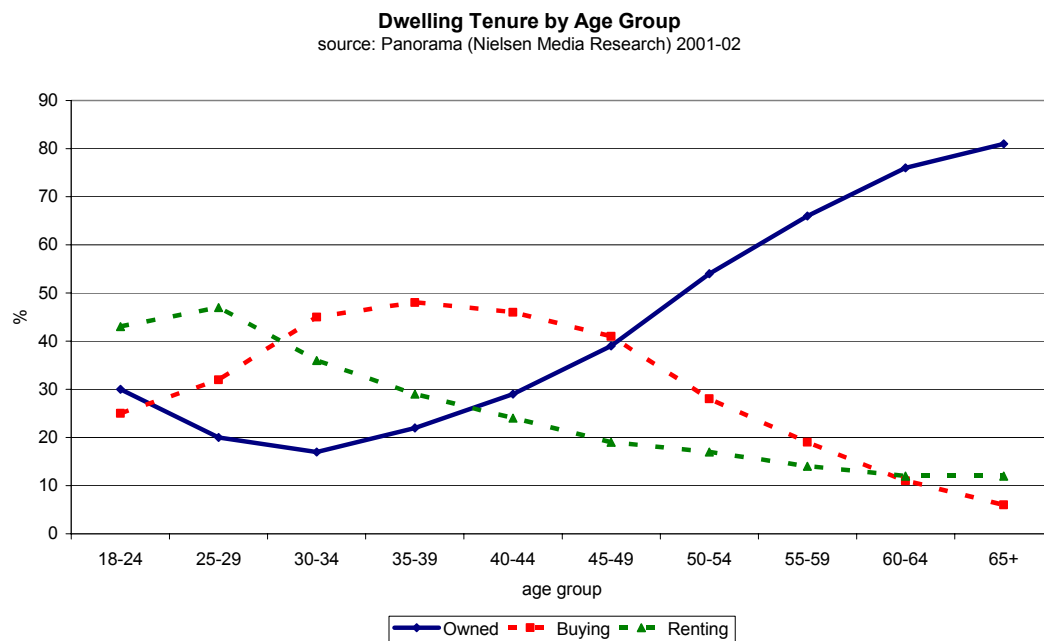
Large-scale surveys by the Australian Bureau of Statistics and market research companies have provided data on the distribution of assets and debt. Here are some highlights. We will publish more detail progressively in our newsletter **Prophets Profit** (www.foreseechange.com/prophet.htm).



The Distribution of Debt

The debt is not shared equally across consumers. Borrowing for housing is by far the largest form of debt. As shown in Chart 1, the incidence of having a mortgage peaks at age 35 to 39 and then declines as outright ownership increases. The age of 50 is important, because this is when more people own outright than are buying. This is based on a sample survey by Nielsen Media research of over 50,000 households in 2001-02.

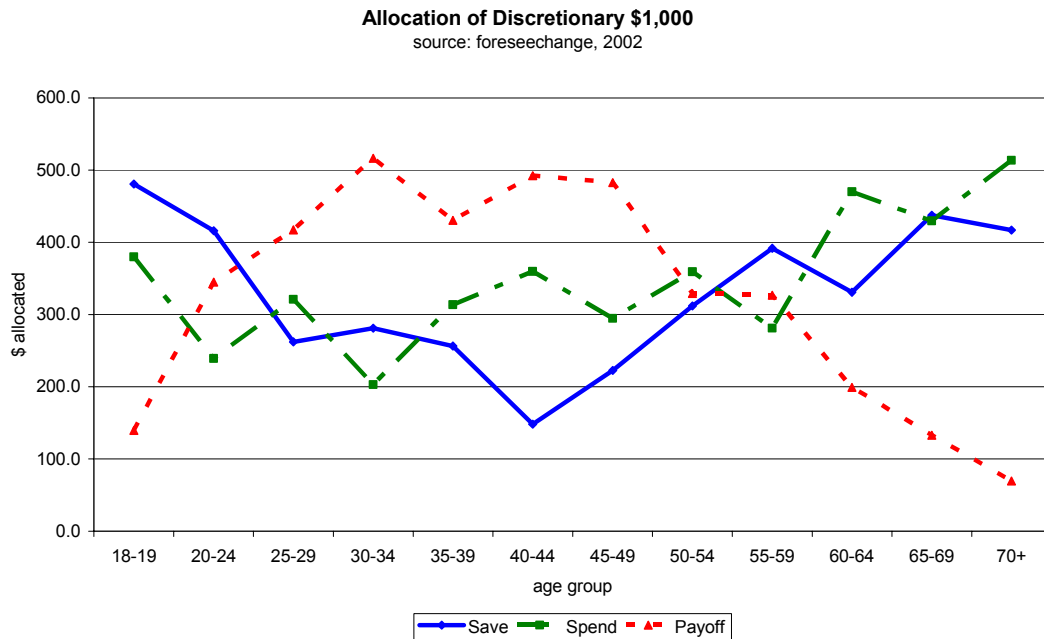
Chart 1



An indirect measure of indebtedness is propensity to repay debt in preference to spending or saving. Based on a question about how a discretionary \$1,000 would be allocated, propensity to repay debt drops steeply after the age of 50 (Chart 2). This is based on a sample of 1,200 adults in 2002.

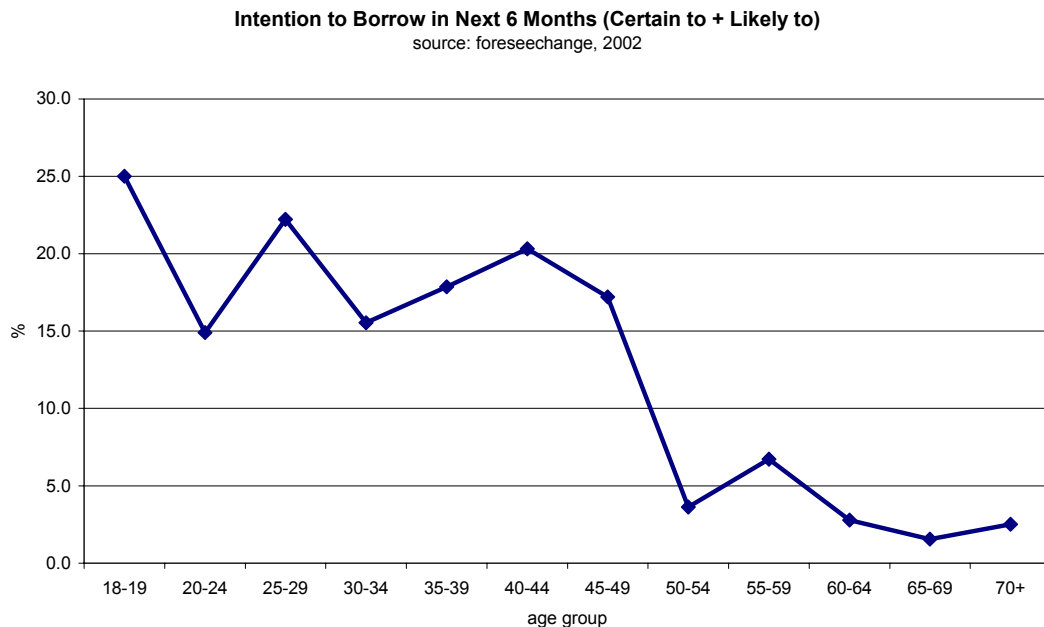


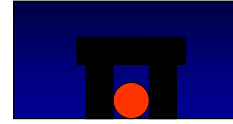
Chart 2



Intention to borrow drops markedly after the age of 50 (Chart 3). This is based on a question about intentions to borrow in the next six months, including the use of credit cards without prompt repayment, so that interest is incurred. The sample was 1,200 adults in 2002.

Chart 3





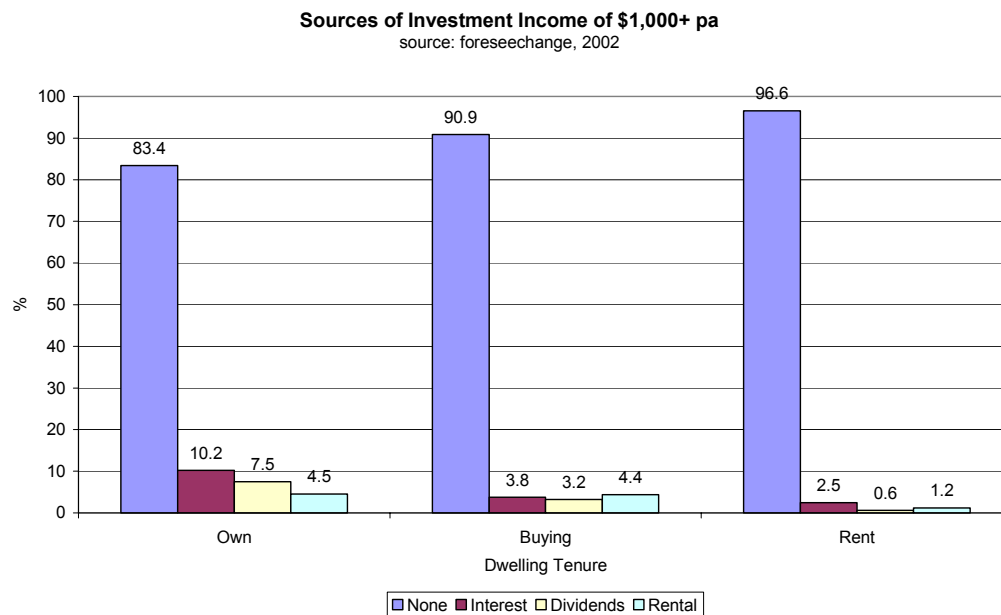
Clearly, after the age of 50 debt is under control or non-existent for most people.

Another fast growing source of debt is HECS, which will reach \$9 billion this year and is concentrated in a relatively small proportion of the population – about one million recent tertiary students, who can start their working life with a debt of \$20,000 to \$40,000.

Distribution of Investment Income

Surveys conducted by foreseechange provide information on sources of income greater than \$1,000 per year (based on 1,200 interviews with adults per year). Given current interest rates, dividend yields, and rental yields, an income of \$1,000 from one of these sources requires an investment of well over \$20,000. As shown in Chart 4, over 90% of people with a mortgage do **not** have any investments of this magnitude.

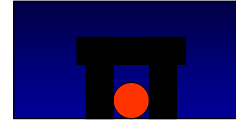
Chart 4



Indeed, few people have investments of this magnitude, but 69% of those who do own their home outright.

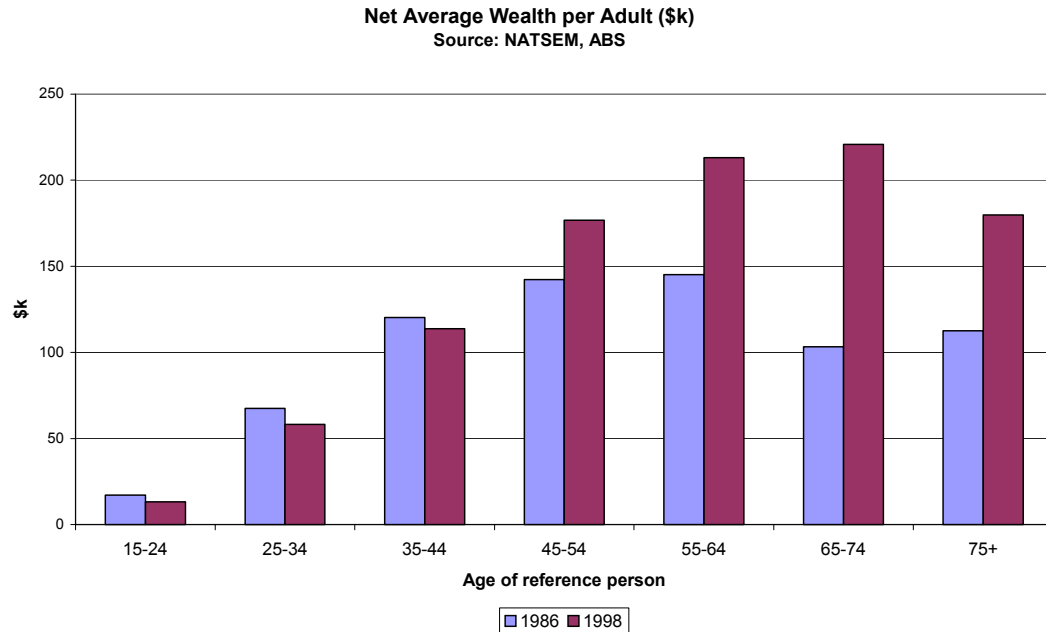
Distribution of Net Wealth

A recent report by NATSEM analysed the 1998/99 and previous ABS Household Expenditure Surveys (sample size about 8,000) and found that the average wealth of older Australians almost doubled from \$106,000 to \$204,000 between 1986 and 1998.



This was in sharp contrast to the fall in the average wealth holdings of Australians aged less than 45 years over the same period (Chart 5). The average picture for older Australians masked major differences among them, as the after-inflation incomes of the bottom 25% of older Australians fell over the 12 years, while the incomes of the top 25% rose.

Chart 5



This picture reflects a number of factors in addition to age, such as generational differences in attitudes to home ownership, saving, and interest rates. Nonetheless, we can expect the older population to continue getting richer for some time yet.

The share of total net wealth increased for people aged 65 and over (Chart 6).

The amount of net assets held in deposits by older Australians increased from an average of \$19,400 to \$38,700 over the period. Even greater increases occurred for assets in the forms of equities and superannuation (Chart 7).

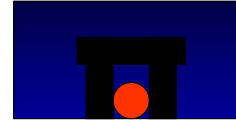
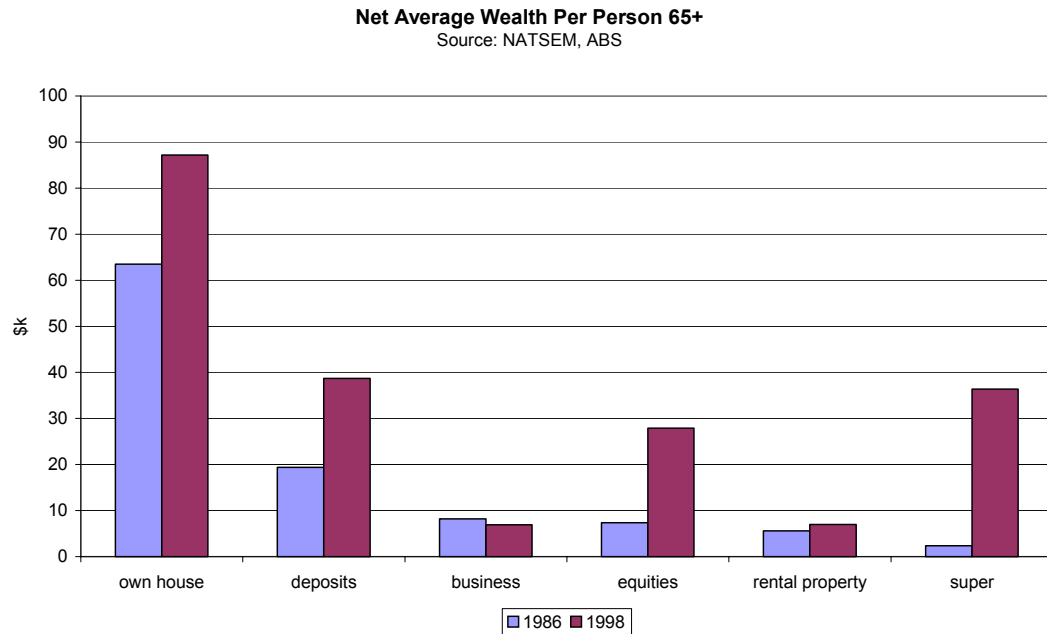
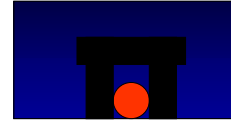


Chart 6



Chart 7





Distribution of Interest Rate Preferences

Another way of looking at the distribution of debt and interest-bearing assets is to ask people whether they would prefer interest rates to rise or fall. This has been done by foreseechange on three occasions recently (Chart 8). In summary, during 2002, over 20% of adults wanted interest rates to rise (net recipients of interest), while just under 30% wanted rates to fall (net payers of interest). Some 50% did not want rates to change or could not express an opinion and presumably these people have little debt or savings, or a balance between interest paid and received. This is based on 600 interviews per wave, or 1,200 interviews in 2002.

Chart 8

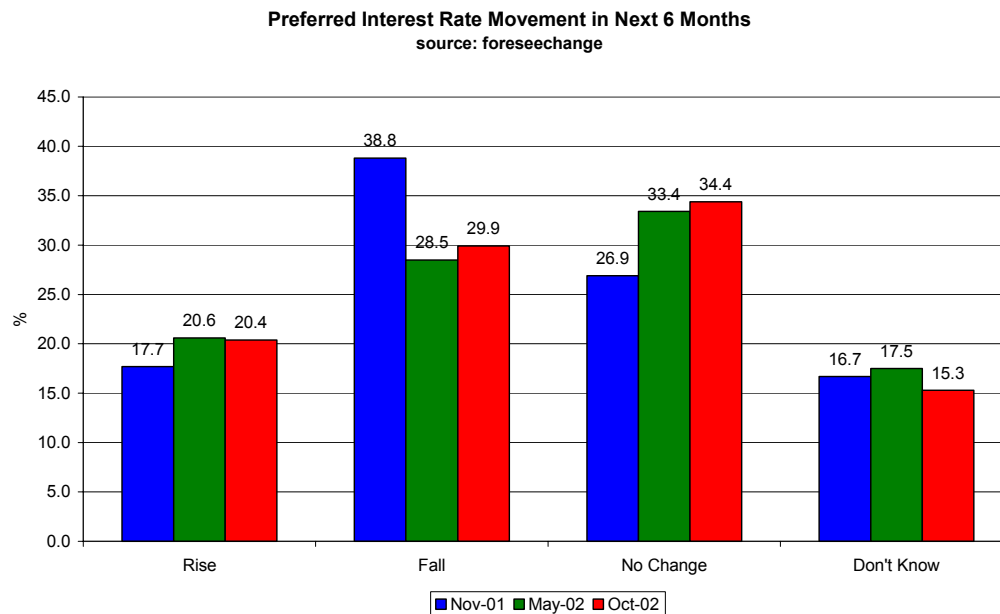


Chart 9 looks at the age distribution of these preferences. The preference for lower rates is concentrated amongst people aged less than 50, while the preference for higher rates increases rapidly after the age of 50. Very few people over the age of 55 want lower interest rates.

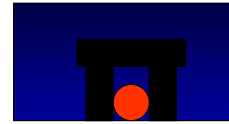
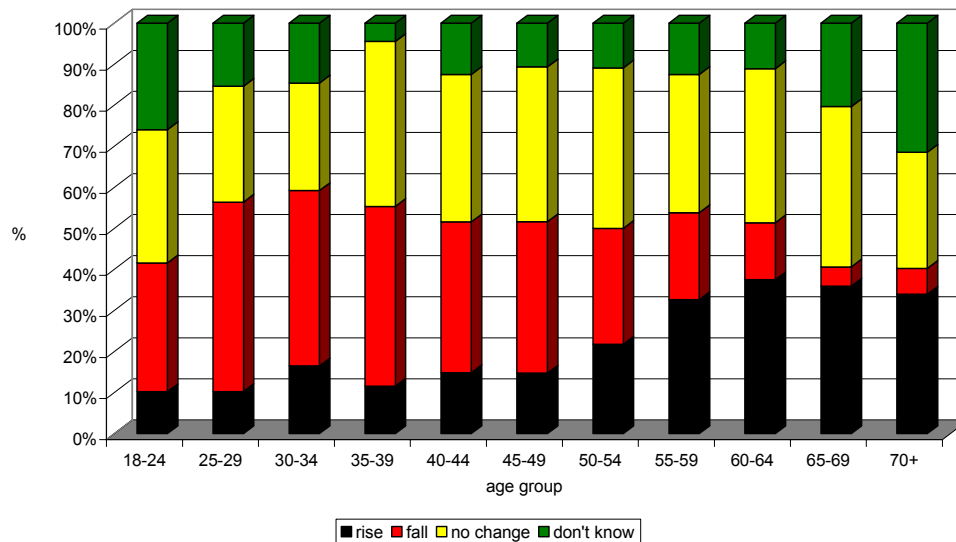


Chart 9

Preferred Movement in Interest Rates in Next Six Months
 source: foreseechange, 2002



Conclusions

This analysis of several different data sources leads to very clear conclusions about the distribution of assets and debt between age groups.

Debt is heavily concentrated amongst people under the age of 50, while assets are heavily concentrated amongst people over the age of 50. People over 50 have little propensity to repay debt; are very unlikely to intend to borrow in the future and tend to prefer higher, rather than lower, interest rates.

This “magic” age of 50 is very important given the rapidly changing demographics in Australia and other countries. The leading edge of the large Baby Boomer generation started turning 50 in the late 1990’s and is now passing 55.

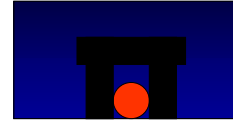
Since 1997, more than 250,000 people turn 50 each year, up from 160,000 ten years earlier. This number will peak at over 300,000 in 2010. In the mid-1980’s one-third of adults were aged over 50 but by 2003, this proportion had increased to 38%. By 2010 it will be 42% and by 2020, it will be 47%.

Clearly, the distribution of debt and wealth is likely to continue to polarize – and an increased proportion of people will prefer higher interest rates.

The large numbers of people passing the age of 50 means that discretionary spending can grow faster than incomes – because home loans are paid off but income remains the same for people in their 50’s. This has enabled the recent boom in discretionary consumer spending that has held Australia’s economy together through the Asian

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economic crisis and recession in the USA and Japan. For more on the spending power of older people, see our article at www.foreseechange.com/forgotten_but_not_gone.htm.

Future analysis will examine other demographic breakdowns and will aim to more finely identify those most exposed to debt.