BNY

iFlow

MACRO MORNING BRIEFING

October 9, 2024

Household Saving and Leveraging for Growth

Developed market private sector to continue driving growth

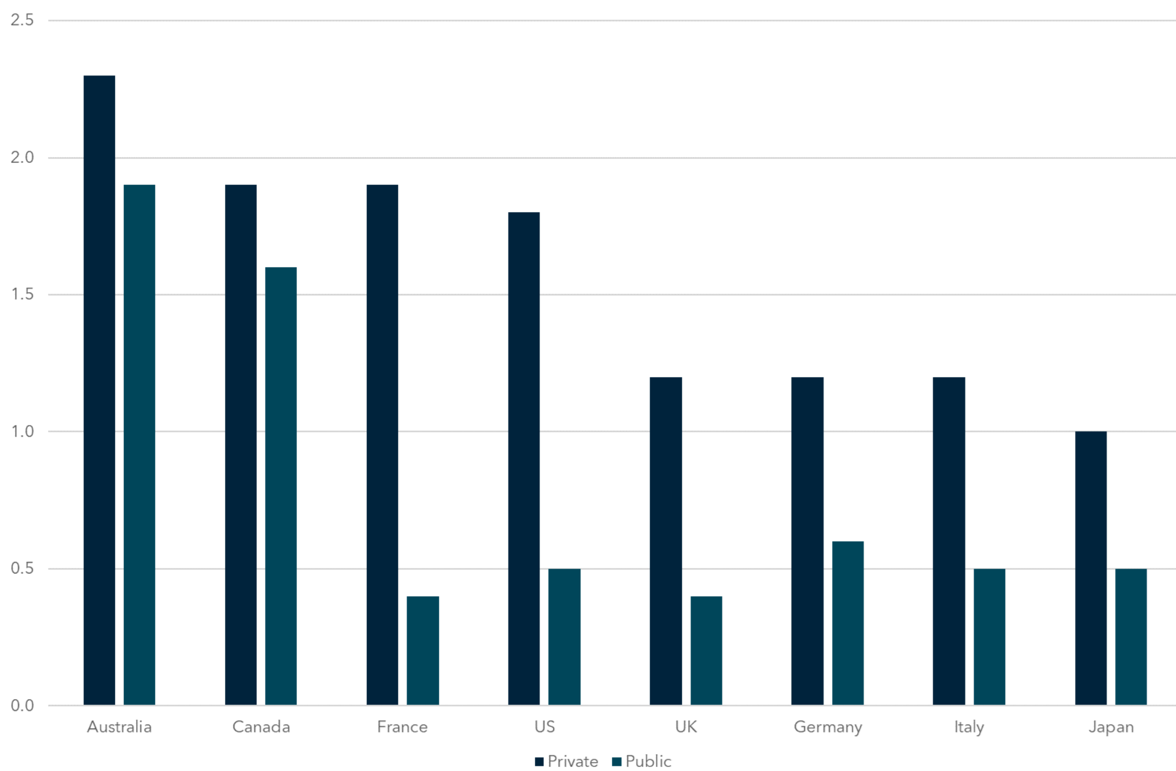
- Initial signs of government debt constraints coming through
- Despite weaker public spending, private demand has strong buffers
- Debt servicing and savings ratio remain supportive for households

Healthy household balance sheets to buttress fiscal restraint

One topic that appears to be less top of mind in the current US electoral discourse is the need for fiscal consolidation. While Fed expectations remain the cornerstone of asset price formation, because the Fed tracks growth and given the role of government spending for US and global growth in recent years, any variation relative to baseline expectations should at least play a role in economic assumptions. For example, the RBNZ’s 50bp rate cut today would usually be seen as detrimental for a currency, but one of the key drivers behind weaker growth and inflation is material fiscal restraint. Given the high multiplier of government spending, a fall in public demand will lead to downside risk for private sector demand. Even so, if inflation consequently slows at a fast pace, there is a case for real rates to remain resilient and support local currency and bond markets.

Even without firm commitments on fiscal consolidation, the OECD’s 2025 growth forecasts for key economies next year for the most part expect a sharp decline in public sector demand. Apart from Australia and New Zealand, “public consumption” is not expected to grow significantly more than 0.5% in real (volume) terms. There is strong realization that excessive fiscal impulse contributed to supply issues in the aftermath of the pandemic, so some degree of normalization was necessary in the first place. Furthermore, as central banks have generally been cautious in easing and adopted more restrictive conditions, we cannot deny that bond markets have generated some discipline – with memories of the “mini-budget” in the UK in 2022 especially painful, even though monetary conditions and the trajectory of policy were very different at the time. Given these forecasts for weak public sector demand, there will be some degree of downside risk to inflation in 2025 and help accelerate policy trajectories. However, we also take note that the OECD’s forecasts also point to private consumption remaining high (Exhibit #1). In an era when the share of government in growth and household cashflow continues to increase, it is difficult to envisage such a large divergence; ECB President Lagarde stated in 2023 that public sector wage growth (but without productivity growth) was dominant in overall Eurozone wage growth. At the same time, we would not automatically assume that household demand will also naturally converge with government spending. Despite the perceived surge in household demand over the last two years and upward pressure on debt servicing, household balance sheets remain in surprisingly healthy shape.

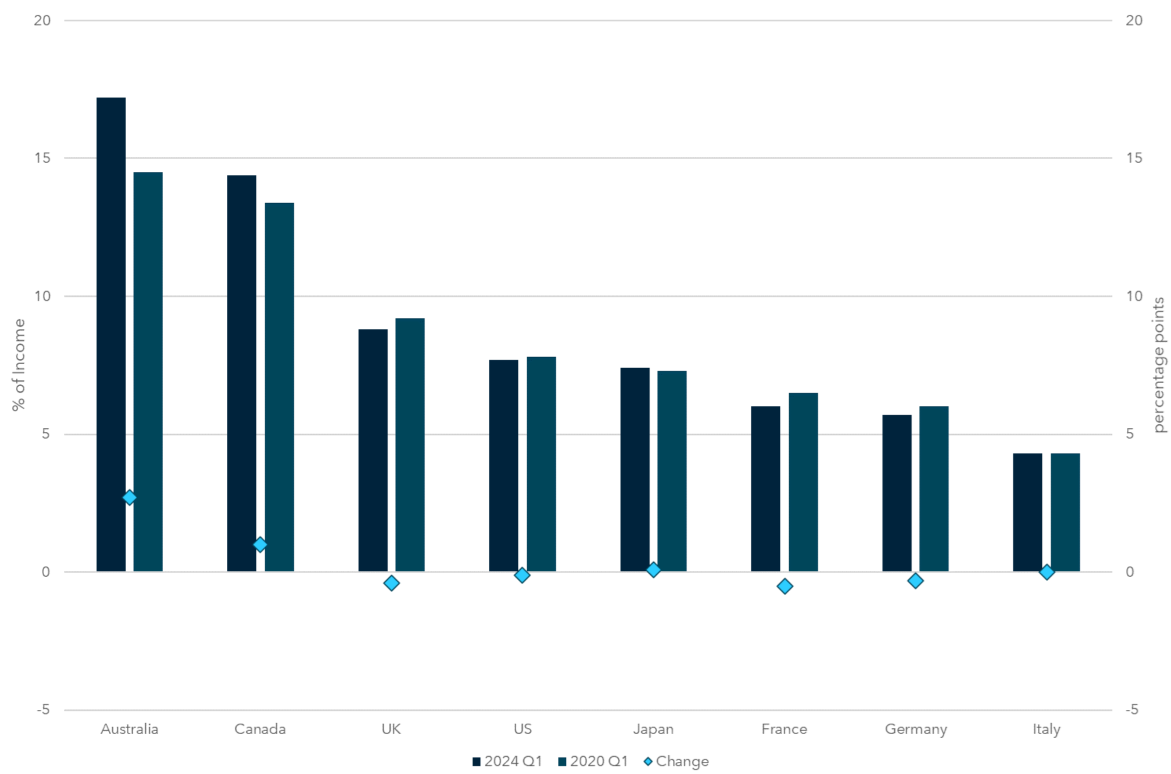
Exhibit #1: Growth Drivers for 2025



Source: OECD, BNY

Exhibit #2 shows the current state of debt servicing ratios. Once again, Australia and Canada are outliers, with a meaningful rise in the level of debt servicing as a share of income over the last four years. In contrast, all other G7 economies have had stable or falling debt servicing ratios during the same period. Furthermore, debt servicing in absolute terms was not as prohibitive for these economies in the first place. The situation in the UK and US is particularly notable, given that the terms of debt servicing for non-revolving credit (especially mortgages) are very different, with the former enjoying a far shorter period of fixed rates. To cut debt servicing ratios, household income growth in nominal terms must be stronger than the rise in outlays, and this is the general message the hawks at the Bank of England are sending. On a flow basis, income gains have materialized through wage gains, the strength of which continues to point to caution by hawks at central banks across Europe.

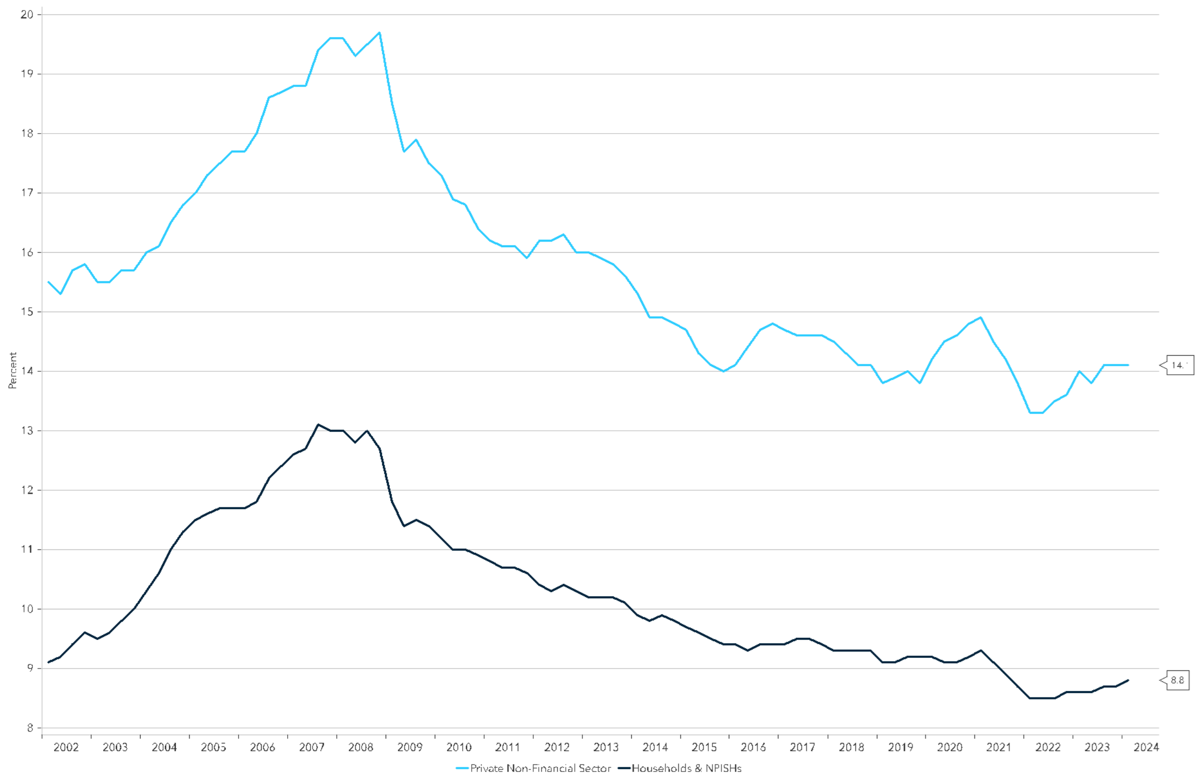
Exhibit #2: Household Debt Servicing Ratio



Source: Macrobond, BNY

Similarly, we can see that overall debt financing costs for corporates have also not picked up aggressively. For example, BIS data for the UK (Exhibit #3) show how trends in debt servicing between the private non-financial sector and households have been coincidental. Within iFlow, we have tracked weakness in global corporate paper over the last two years as rates have increased. Spreads may have widened but barring one or two episodes during earlier periods of central bank tightening, credit markets have remained very calm, especially considering the official sector has faced greater stress. Inflation driven by supply bottlenecks has allowed corporates to engage in margin expansion, not dissimilar to the rise in pricing power by labor. Now that rates are also softening, the non-household private sector can find additional support from falling financing costs in absolute terms. Assuming the central bank view on a soft landing remains viable, corporates are very well-positioned to release investment growth once again and this could be another factor that is generally supporting private demand forecasts.

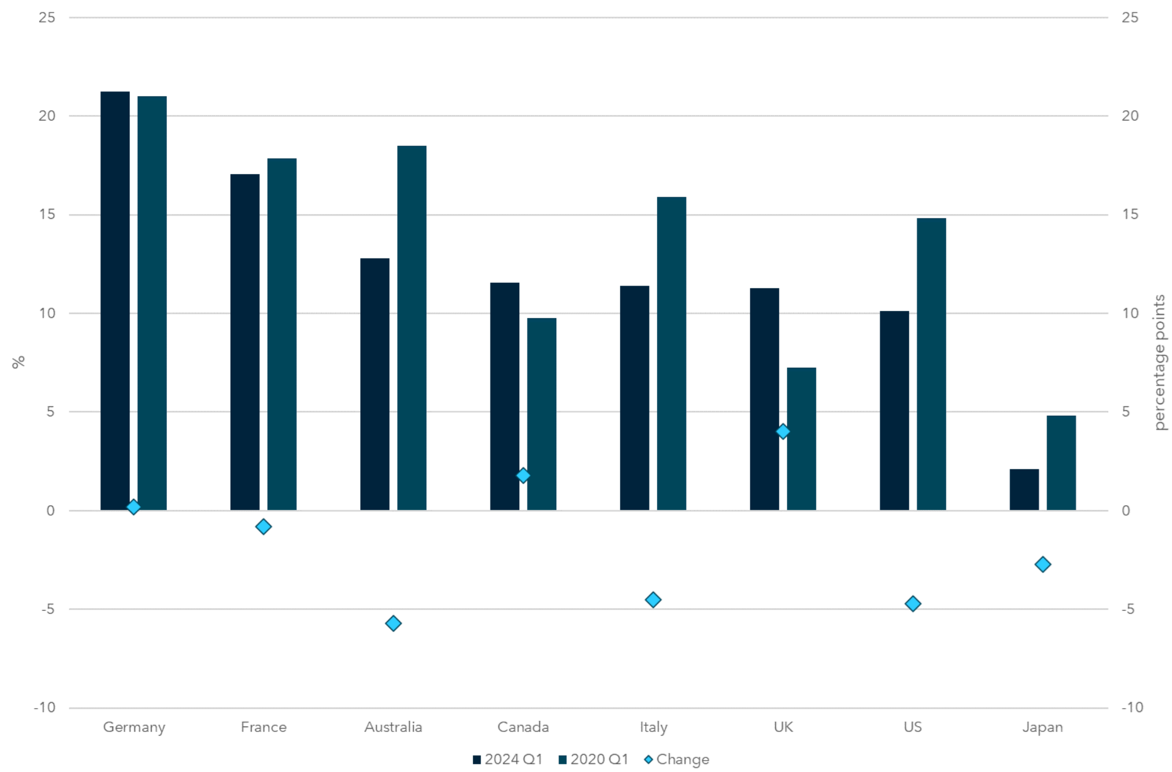
Exhibit #3: Private Sector Debt Servicing Breakdown



Source: Macrobond, BNY

Even though debt servicing remains manageable, economic expectations are softening, and the prospect of fiscal restraint in government-dominated economies will also soften wage expectations. Private companies may also face pressure on costs from government contracts, even though public investment growth is usually more long-term and less cyclical compared to the general business cycle. Even so, compared to previous cycles, one of the other key characteristics of the last few years is wage growth, and margin expansion in the private sector has been so strong such that even with higher outlays, cash retention has been strong. For example, revolving credit in Canada and the UK has shorter fixed-rate periods and is exposed to the recent tightening cycle, but income growth has been strong enough that savings rates have also increased. However, savings rates in the US and Australia have fallen more aggressively (Exhibit #4), which suggests that incremental household cashflow improvements have been spent in the form of strong private sector demand. This explains why the RBA remains relatively hawkish, while the Fed will need to exercise caution based on the pace at which the data continue to soften.

Exhibit #4: Savings Rate Change



Source: Macrobond, BNY

Heading into any election, fiscal consolidation or austerity generally do not feature prominently as electorates tend not to vote against their own cashflow. Even so, debt ratios are approaching alarming levels and the relatively new governments in the UK and France, for example, have already made spending cuts a cornerstone of their respective messages. However, current data suggests that private sector balance sheets on a stock and flow basis are heading into the next phase of the business cycle in good shape. This does create some room for additional fiscal restraint. If properly managed, the prospect of inflation falling faster than expected and supporting real rates would be highly conducive for government bond performance. In time, such flows can even create fiscal space for countercyclical adjustments.

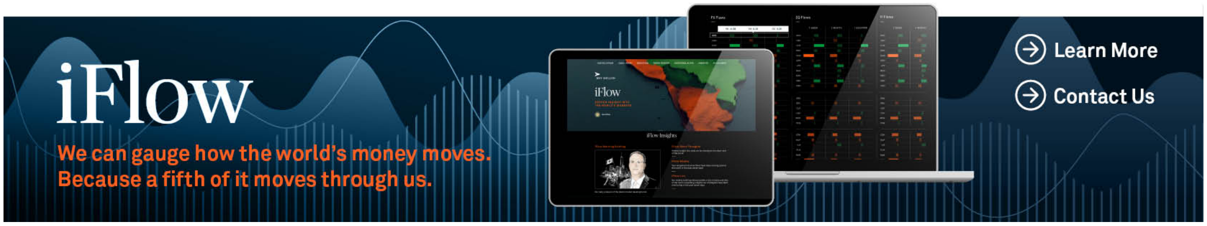
Disclaimer & Disclosures

Please direct questions or comments to: iFlow@BNY.com

Geoff Yu

EMEA MACRO STRATEGIST

CONTACT GEOFF



This message was sent from an unmonitored email box. Please do not reply to this message.