The Impact of Personal Debt on Macroeconomic Stability

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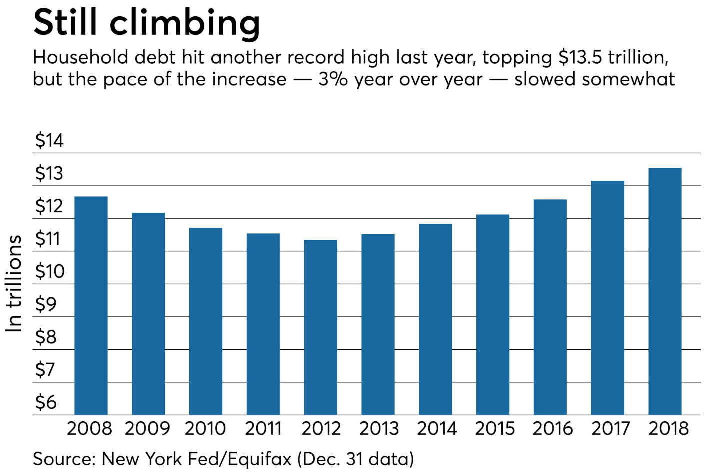
Overview

- The U.S. has always had a history of being a debtor nation. Many have associated living the standard American Dream as spending above their means and financing it through debt.
- However, many economists warn that this type of behavior creates long-run economic instability, and have cited past examples of debt damaging the country
- I aim to explore the relationship between consumer debt and economic stability, and how we can address it moving forward.



Statistics on Personal Debt

Definition: Personal Debt is used in economics to denote the outstanding debt of consumers as opposed to businesses of governments. Unlike public and business debt, personal debt is amassed mainly through consumption over investment.

Total Debt

American consumers now have a record $13.95 trillion in debt from 2019, Debt held by the U.S. public has dramatically risen since 2008,

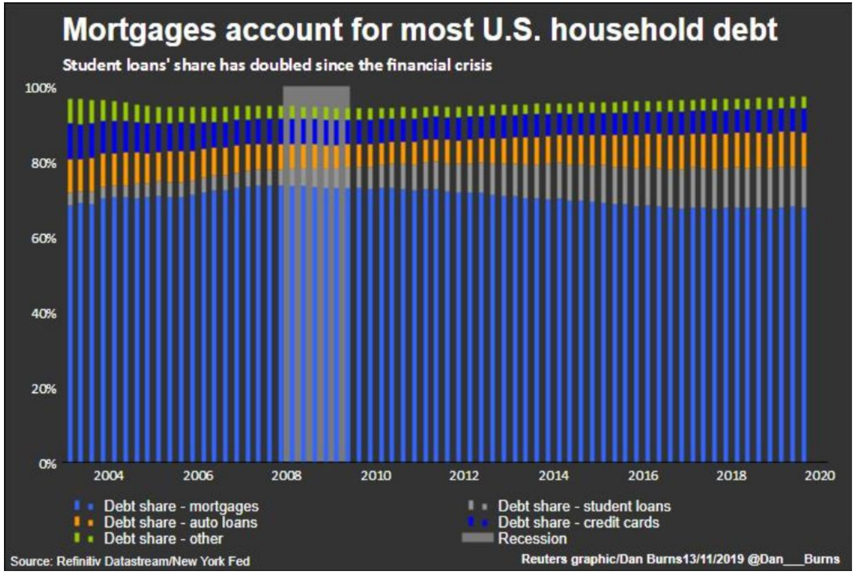
Percentage of GDP

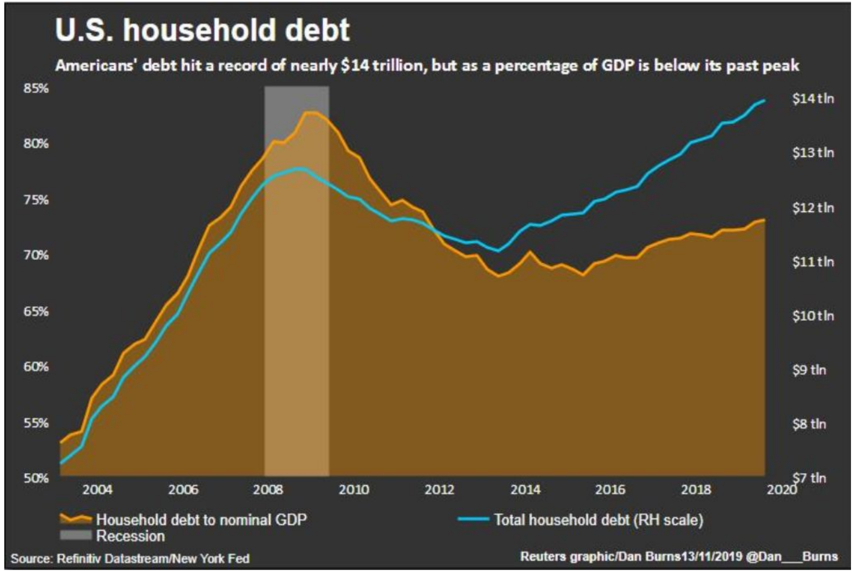
However, it's growth as a fraction of GDP has fallen. Household debt is now about 73% of GDP versus around 83% a decade ago.

Service Payments

In the third quarter of 2019, household debt service payments constituted approximately 9.69 percent of the disposable personal income in the United States.

Categorical Breakdown of Personal Debt





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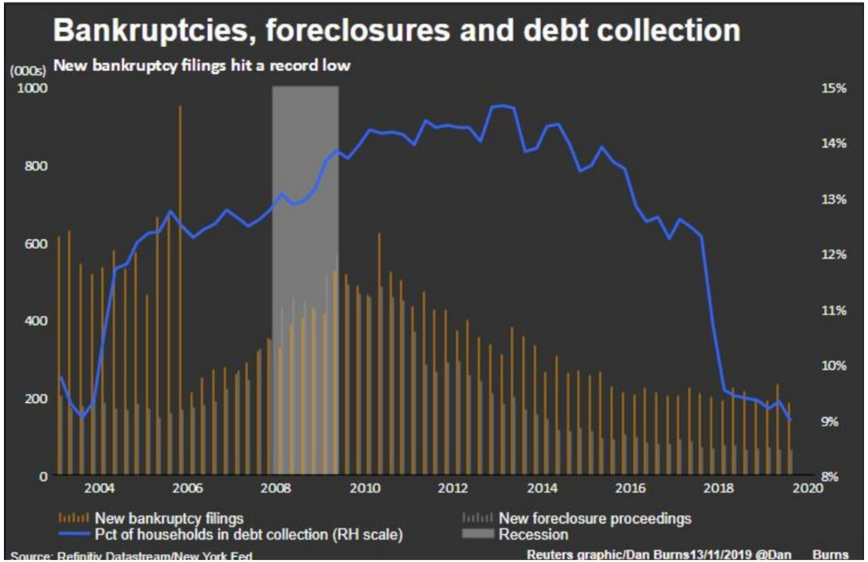
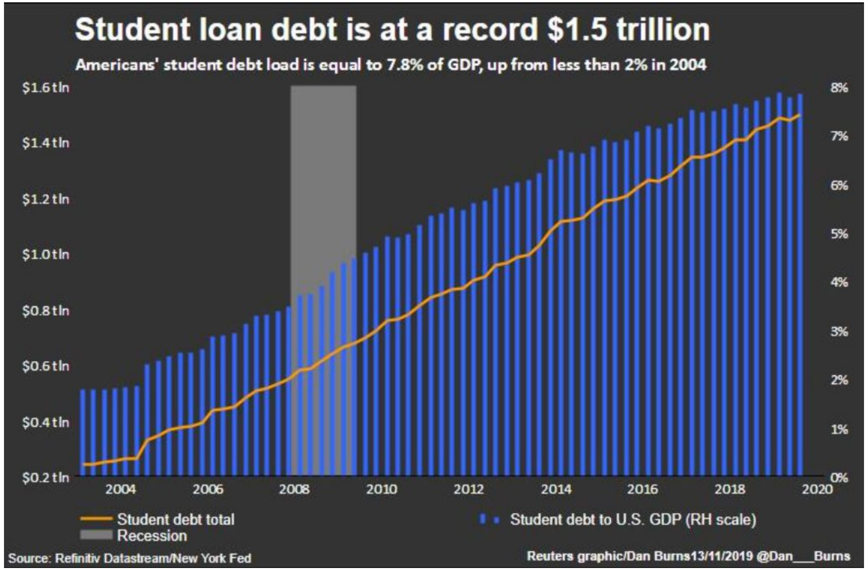
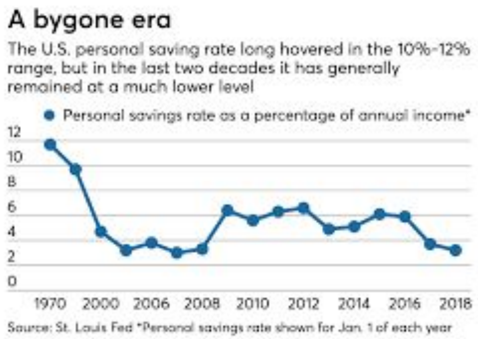




Macroeconomic Effects of Personal Debt



1 Benefits from Consumption

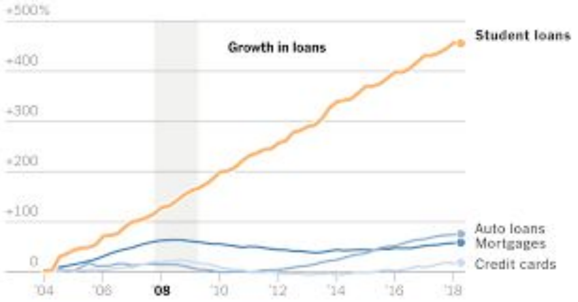
Higher debt results in more consumption by households and a larger share of economic output coming from consumption.

2 Consequences of Excess

At the same time, higher debt levels could reveal financial stress as families use debt to finance consumption of necessities. It could create new waves of delinquencies and, eventually, defaults that displace these kinds of investments.

3 The Threat of Collapse

Large accumulations of personal debt leaves many to default on loans when economic strife hits after a long run of inflated growth. This creates a domino effect of economic retractions that deepens recessions further.



Modern Historical Examples

1929 - Great Depression

The early 20th century saw the normalization of buying on credit in American culture. Many started to accumulate personal debt to participate in the increased commercialization of the era. When the economy began contract in 1929, deflation increased the real burden of debt and left many firms and households with too little income to repay their loans. Bankruptcies and defaults increased, which caused thousands of banks to fail, catapulting the world into economic ruin.

2000 - Dot Com Bust

The increasing popularity of the Internet triggered a massive wave of speculation in "new economy" businesses. As a result, hundreds of dotcom companies achieved multi-billion dollar valuations as soon as they went public. As more and more people went into debt during this prosperity based on the assumption of good tidings in the future, they were forced to default on loans when the NASDAQ Index crashed, causing a deeper recession than what would have occured.

2008 - Great Recession

In the 2000's, as house prices were increasing at a record pace, there were mounting signs of an unsustainable crisis: rampant mortgage fraud, condo flipping, houses being bought by subprime borrowers, and an increase in consumer debt. The market then commenced a slide that resulted in the average U.S. house losing one-third of its value, and a global economic catastrophe followed as banks collapsed, loans defaulted, and bankruptcies ensued.

Advocating for Change

1	**Raising Awareness**	• Many do not know about the aggregate effect of dangerous amounts of debt in the economy. • Introducing this issue into public discourse can be simple, due to the high degree of individual risk associated with it: it is something that affects everyone.
2	Increasing Urgency	• Promoting historical examples of debt crises can show that this could be our future. • Explaining the effects of these debt bubbles can create urgency to those who are unaware of this mundane topic.
3	**Creating Engagement**	• Increasing financial literacy programs in schools and in communities can help lower the level of personal debt. • Debt-easement programs also offer promise towards large amounts of debt, especially in regards to students. • Creating a cultural atmosphere through debt avoidance can guide the future towards a more budgeted economy
4	**Understanding Nuances**	• Many citizens are struggling financially, and do not have the privilege to be economically mindful of this issue. • Recognizing that this type of change is not available to everyone, and realizing that moderate debt can be economically beneficial is key to this issue.

Main Takeaway

While personal debt can have a positive inflationary effect on economic growth, dangerous increases in consumer debt that cannot be payed off during economic retractions can decrease economic stability.

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The creation of financial literacy programs in communities, the acceptance of cultural practices that do not entice buying on credit, and the promotion of debt-assistance programs can all help decrease dangerous amounts of personal debt.

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Finding the right balance of debt and frugality can ensure that the economy continues to grow in a stable manner, and will protect against future economic collapses like the ones that have occurred in the past. This subject is not interesting, contested, or flashy. But it is an issue that affects everyone in the country, and if we learn from our past mistakes, we can create a better future. So please manage your debt.

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