Economic and Market Insights

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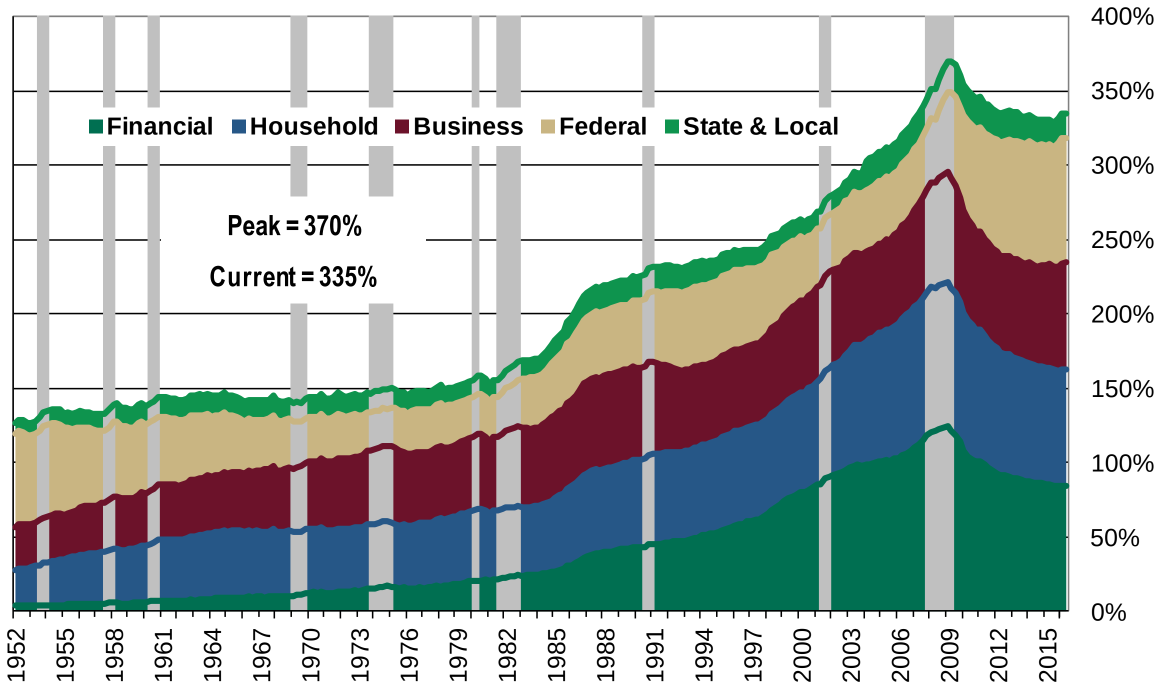
"Deleveraging" Debt As a Society: What It Tells Us About the Health of the U.S. Economy As We Leave the Great Recession Behind

U.S. Total Domestic Debt vs. GDP



Source: Flow of Funds Accounts, Federal Reserve. Gray bars indicate recessions.

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The illustration above summarizes all U.S. domestic debt in aggregate and compares it to the size of the economy. Note that debt relative to the size of the economy had been expanding for a considerable period of time. From 2000 to 2007, debt accelerated at an exceptionally fast pace, driven primarily by the explosion in household mortgage debt and bank debt.

By 2007, total debt had reached 3.5 times the size of our economy, and as we entered into the Great Recession, it became too costly for overextended households and over-levered banks to maintain their aggregate borrowing.

With too much debt, we have had to "deleverage" as a society. The deleveraging process has slowly come now to an end, but this process has acted as the strong headwind limiting economic growth, resulting in our subpar recovery.

Typically, deleveraging processes from other global debt crises have taken on average about 7 to 10 years to run their course. We are now more than seven years into the cycle and likely close to the end as the new presidential administration begins in 2017.

As the deleveraging process comes to an end, we would expect domestic growth to eventually accelerate slightly. Fortunately, ultra-low interest rates have elevated cash flow coverage ratios despite elevated levels of borrowing.

Takeaways:

- The reason our current economic recovery is subpar is that we as a society are shedding the debt that helped bring about the Great Recession.
- We are close to the end of this cycle, which spells some promise for future growth for the next generation.
- The Federal Reserve may feel it is in good position to boost interest rates a quarter point when it meets in December.

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