



BANK OF ENGLAND

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Puzzles in Today's Economy – The Build Up of Household Debt - Speech by Sir Andrew Large to the Association of Corporate Treasurers' Annual Conference

Speaking today to the Association of Corporate Treasurers in Newport, Sir Andrew Large, Deputy Governor of the Bank of England, says a key economic debate of the day is whether we, as a society, should be concerned about the level of debt borne by families, businesses and, indeed, governments.

"On the whole the increasing availability of debt is beneficial. Debt helpfully allows households, companies and even countries to smooth their spending patterns. But as with many things in life, there are potential downsides." The Bank, he notes, considers debt from the point of view both of financial and monetary stability.

After briefly discussing sovereign and corporate debt, Sir Andrew focuses on household debt. In relation to income gearing - the ratio of debt to income - he says "I feel, however, that since there are at present relatively high levels of debt and these are rising faster than income, it is likely that potential vulnerabilities from increased gearing are rising. And we know from experience that unexpected shocks from one source or another can upset individuals' predictions and behaviour".

Sir Andrew discusses two schools of thought on the risks from debt, the optimistic and the pessimistic. He says "While there are elements of truth in both schools of thought, the balance of probability lies with the optimists. The optimistic school reflects the central case, whereas the pessimists are more inclined to focus on the risks - the tail of the distribution if you like. But even if the probabilities of things going wrong in the near future may not be high, there are nonetheless credible threats, and over time the risks might mount."

Sir Andrew then examines the issue of debt from the point of view of financial stability, the oversight of which is one of the Bank's key responsibilities. He says "From the point of view of lenders I detect that there is on the whole a feeling of confidence, with few overall concerns about the asset portfolios of secured and unsecured household debt." However, he also notes some potential hazards and comments on the importance of effective risk management for financial institutions.

Turning to monetary policy, he says the key focus is the extent to which vulnerabilities from the debt build-up could trigger changes to demand or supply in the economy with direct implications for monetary stability and meeting the inflation target. "Sudden unexpected shocks of course could threaten monetary stability and might make keeping to the target trickier. We need to ensure that threats of instability from such a shock do not call this into question."

"With this in mind, each month when we on the MPC make our policy decision I am conscious of the debt situation and the possibility that the potential vulnerabilities stemming from higher debt levels do in fact crystallise at some point and trigger a sharp demand slowdown that could have an adverse impact on monetary stability and make it more difficult to meet the inflation target over time."

"So in considering the whole gamut of demand and supply data that we receive and evaluate, I do allow these factors to weigh in the difficult balance all of us face each month in relation to the monetary policy decision. I mentioned my tendency to think about the risks, however conscious I am of the central case. And this explains why on several occasions over recent months I have found myself voting for a rise; with a view to discharging our mandate to stabilise inflation at the target level, with stability in the monetary arena."

Key Resources

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<http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2004/speech217.pdf>