Economic Monthly
[US]

How should we view the corporate sector's growing debt?

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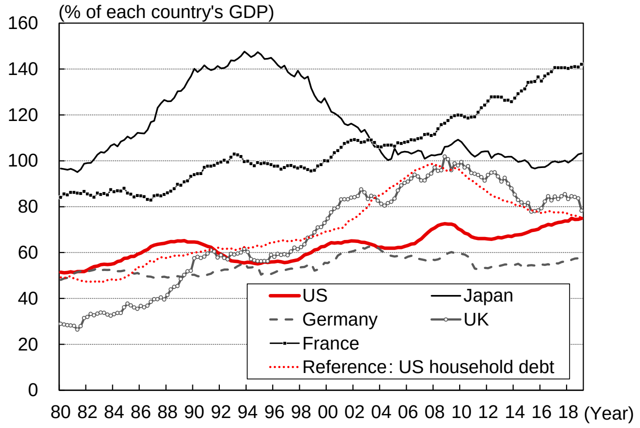
16 OCTOBER 2019
(ORIGINAL JAPANESE VERSION RELEASED ON 30 SEPTEMBER 2019)

The level of debt in the US' corporate sector continues to rise. The Federal Reserve Board's (FRB) flow of funds data shows the level of non-financial corporate debt as a percentage of nominal GDP fell temporarily after recording a peak of 73.6% at the end of March 2009, but it is rising once again and the latest data shows a new record high of 73.8% at the end of June. Some are voicing their concerns about the rise of financial imbalances in response to this growing corporate debt; in its Financial Stability Report, the FRB highlighted the risk that "the debt loads of businesses are historically high".

Although the ratio of US corporate debt is at record-high levels when compared to historical data as mentioned above, this image changes when compared with other countries. A comparison of major developed countries' debt as a percentage of GDP (using Bank for International Settlements data to ensure a fair comparison) reveals the US' is 73.8%, higher than Germany's (58.0%) but lower than Japan's (103.2%), the UK's (78.2%) and France's (142.0%) (Chart 1). While it is important to bear in mind the structural difference between these economies, there is still the question of at what point the growth of US corporate debt will reach its limit as a developed economy. In addition, there is also the issue of not only the scale of the rise in financial imbalances, but also the speed of the rise. However, the rise in imbalances currently observed in the US is on an entirely different level compared with the Japan's business sector during its bubble era (late 1980s to the start of 1990s) and the US household sector before the global financial crisis. Furthermore, by looking at stock market indices as a representation of listed companies in developed countries, it seems the assets-to-equity ratio (net assets ÷ total assets) of US corporations is higher than during the global financial crisis and its current level (around 23%) is not only high compared with the assets-to-equity ratio of other countries' corporations, it is also at an historically high level (Chart 2). Therefore, it could also be said that US corporations' finances are correspondingly robust.

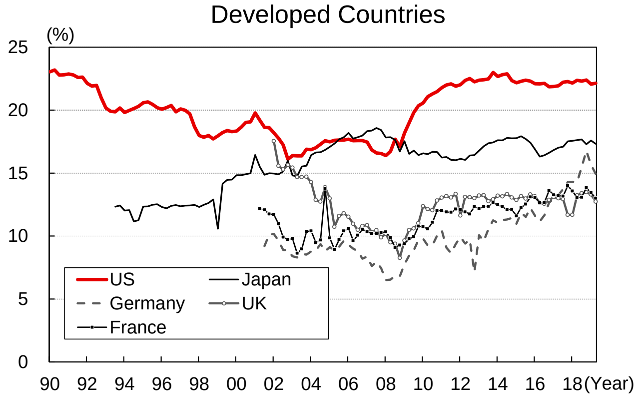
Looking ahead, it will be important to keep an eye on the possibility that risks are unevenly distributed between individual sectors and that the deceleration in the real economy (particularly in manufacturing) will have an adverse effect on corporate profits and cash flow as a repayment fund. In addition, the risk that the FRB's "preventive" shift towards an easier monetary policy will encourage the rise of excessive debt in the future should also be monitored. Despite these risks, it does not appear that the current rise in large financial imbalances in the US corporate sector is at the point where it may cause an economic recession in the long term.

Chart 1: Non-Financial Corporate Debt in Major Developed Countries



Source: BIS, MUFG Bank Economic Research Office

Chart 2: Assets-to-Equity Ratio of Major Developed Countries



Note: Statistical population is corporations listed on each country's major stock market index. US=S&P500, Japan =TOPIX, Germany=DAX, UK=FTSE350, France=CAC40

Source: Bloomberg, MUFG Bank Economic Research Office

Translation by Elizabeth Foster

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