Figure 2.2. First- and Second-Round Effects of the Buildup of Household Debt on Financial Stability

Source: IMF staff.

Note: This figure depicts the interactions between household debt, the financial sector, and the real economy. The balance sheet view (panel 1) shows assets and liabilities (debt) at the household level, whereas the cash flow view (panel 2) shows household income and expenses in the form of consumption and debt service. The two main channels through which household debt and consumption interact are deleveraging and debt overhang. Debt overhang may adversely affect aggregate demand through deleveraging or a crowding out of consumption by the debt service burden. Deleveraging can occur through forced or accelerated repayment of debt, reduction in new credit, and increased defaults or personal bankruptcies. From a legal standpoint, default follows from a situation in which assets and income are insufficient to cover debt-servicing costs, and bankruptcy from lack of sufficient assets and income to repay the debt. There may be second-round effects, such as Fisher-type debt-deflation dynamics, that may be caused by downward asset price spirals.