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ASSET MANAGEMENT

USA, Flow of Funds Account – Households' wealth at record-high levels. Solid balance sheets for businesses as well.

29th September 2021

Households' wealth at record-high levels, driven by the stock market and by property prices. Solid balance sheets for businesses as well: earnings on the rise and financial leverage down to below pre-Covid levels.

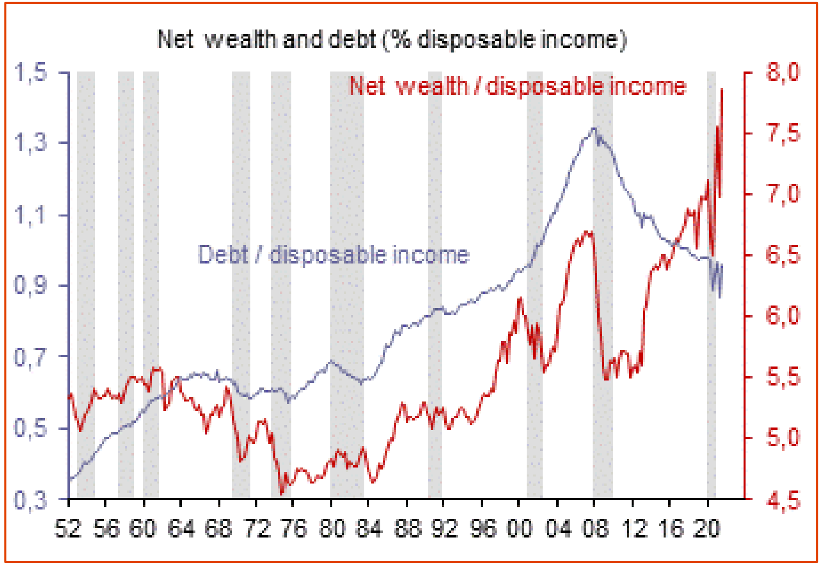
Data on financial flows provided by the Federal Reserve's Financial Accounts outline, in 2Q 2021, a sharp increase in the wealth of households, to new record-breaking levels, whereas debt in relation to disposable income (also thanks to fiscal stimulus) is below pre-Covid levels.

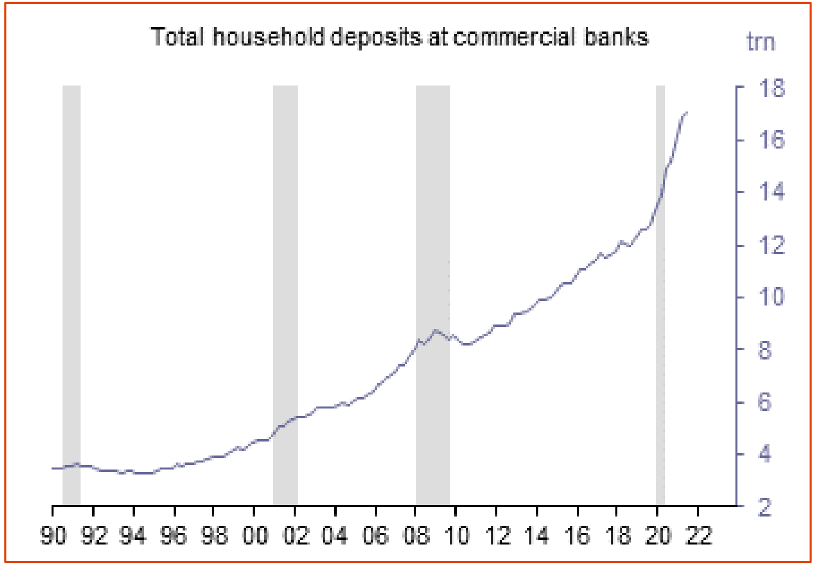
The picture for businesses is also improving significantly: financial leverage (debt/earnings) has continued to drop, falling below pre-pandemic levels.
Furthermore, the drop into negative territory of the financing gap indicates that businesses are in the position to fully finance potential new investments using own funds. The solidity of corporate balance sheets is mostly the result of the recovery of earnings, within a context of favourable financial conditions.

Households exiting the crisis showing record-high wealth levels.

In 2Q 2021, the net wealth (wealth minus debt) of households reached a new high of USD 142 trillion, thanks to the sharp rise of stock indices and to a record-breaking rise of property prices.
The net wealth of households increased by a hefty compared to pre-Covid levels (Q4 2019). Of the increase, 80% stems from financial wealth growth, and almost all the residual 20% from the rise of property prices. Savings (supported by large doses of fiscal stimulus) were largely deposited in deposit accounts. The increase of wealth mostly benefited the already more affluent part of the population (owners of stocks and properties). However, **the level of concentration of wealth** (that over the past 30 years has increased sharply after every recession) **has not changed significantly.**
Data provided by the Fed, that monitors the distribution of wealth, show that the balance sheets of the less wealthy households are also proving resilient.
By grouping the US population in percentiles based on wealth (top 1%, 90-99% percentile, 50-90% percentile, and bottom 50%), over the 2020-21 period wealth emerges as having grown much more rapidly than debt across percentiles, whereas fiscal stimulus increased the level of savings of lower-income households. With previous recessions, on the other hand, the time taken by the lower-income percentile (bottom 50%) to recover previous net wealth was very long both in absolute terms (as a result of high debt) and compared to the other percentiles.

Households exiting the crisis showing record-high wealth levels.





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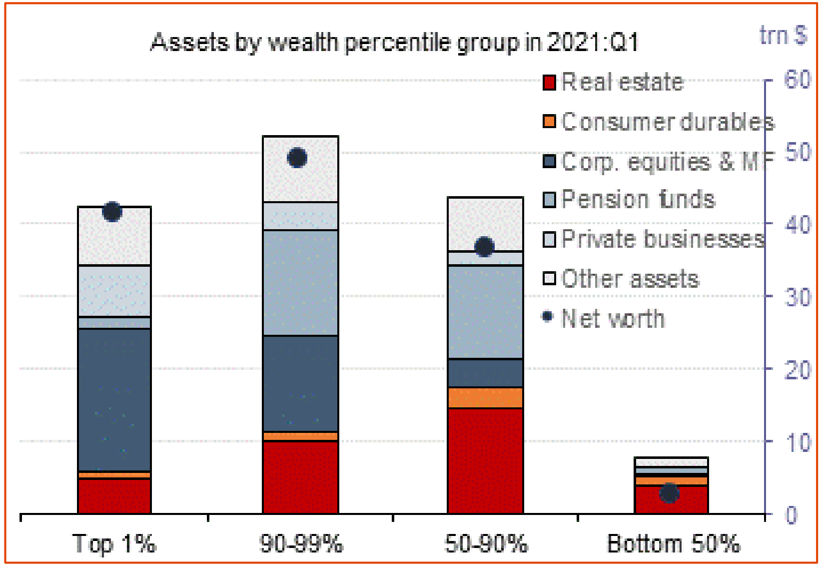
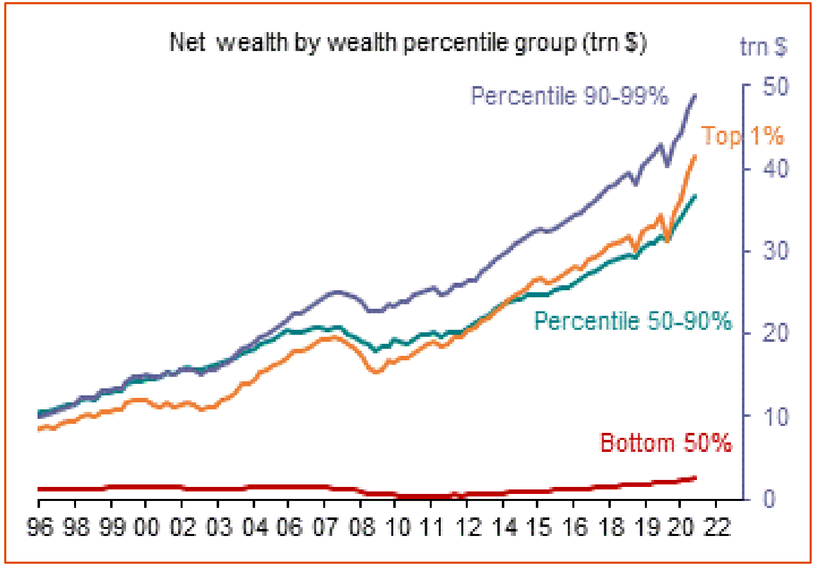
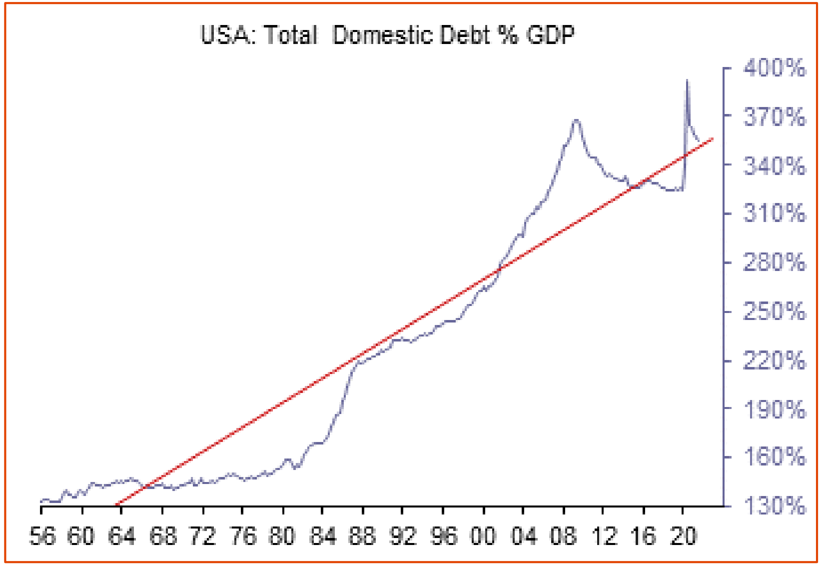


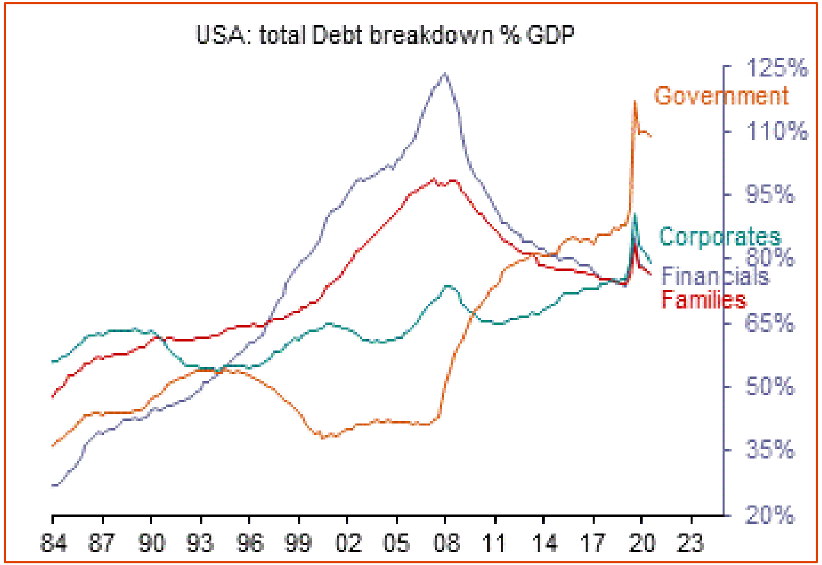


Debt/GDP: post-pandemic-peak decline continues

Overall debt in the US continued to grow in absolute terms at a solid rate (in excess of 6% in both the two opening quarters of 2021), but well below the accelerated pace in the fist half of 2020.
In relation to nominal GDP, debt has continued to decrease, reaching 354% from a peak of 392% in 2Q 2020, but is still 30 percentage points higher than before the pandemic (when debt was at its lowest in 12 years).
In the quarter, **strongest debt growth was once again reported by the Federal Government** (9.6%), followed by **households** (7.9%), the debt of which was fuelled not only by mortgages (as a result of very low rates), but also by consumer credit (business reopenings were concentrated in the quarter in question).
The debt of non-financial firms slowed again (+1.4%): while still at historically high levels in relation to GDP (79%), it dropped to close to pre-Covid levels (75%).
Public debt in relation to GDP decreased slightly from the peak hit a year ago, while staying high as a result of the massive fiscal measures put in place to contain the effects of the pandemic. The ratio of Treasuries (marketable) and GDP dropped from the 100% peak but remains well above pre-Covid levels (by 77%).

Debt/GDP: post-pandemic-peak decline continues





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Businesses: financial leverage below pre-Covid levels thanks to earnings

After surging during the pandemic, **the debt of businesses slowed starting in the second half of 2020.** Most importantly, **financial leverage** (i.e. the ratio of debt and earnings) **decreased significantly, actually dropping below pre-pandemic levels**. This was **made possible by the acceleration of earnings.**

Evidence of the solidity of corporate balance sheets is also provided by the **ratio of debt and net wealth,** that has dropped towards the lower end of the range outlined in the past 12 years.

Debt remains historically high in absolute terms; it was high already before the pandemic, and it is even higher in post-Covid times. However, it is accompanied by a strong increase of wealth and earnings, as opposed to a declining cost of debt.

Going forward, **companies are potentially in the position to fully finance any new investments with their own funds,** as signalled by the drop into negative territory o the financing gap (that measures the needs of businesses to resort to external financing).

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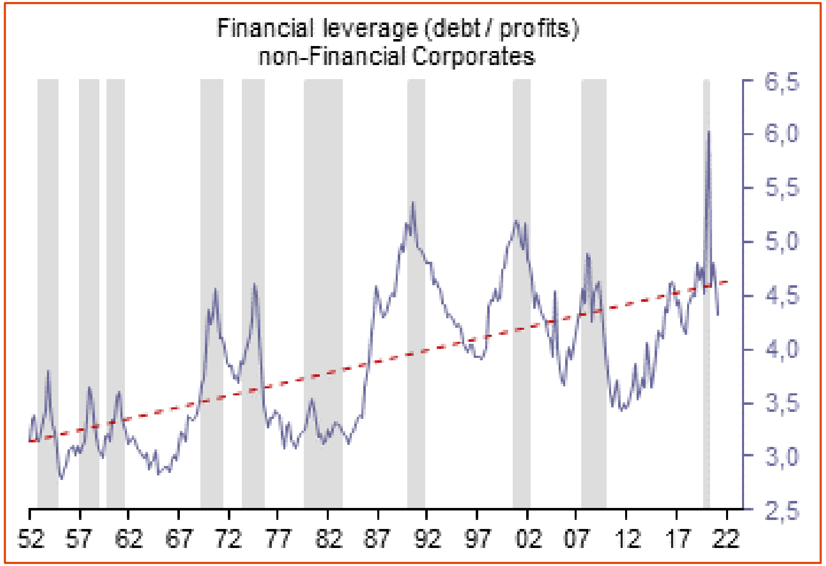

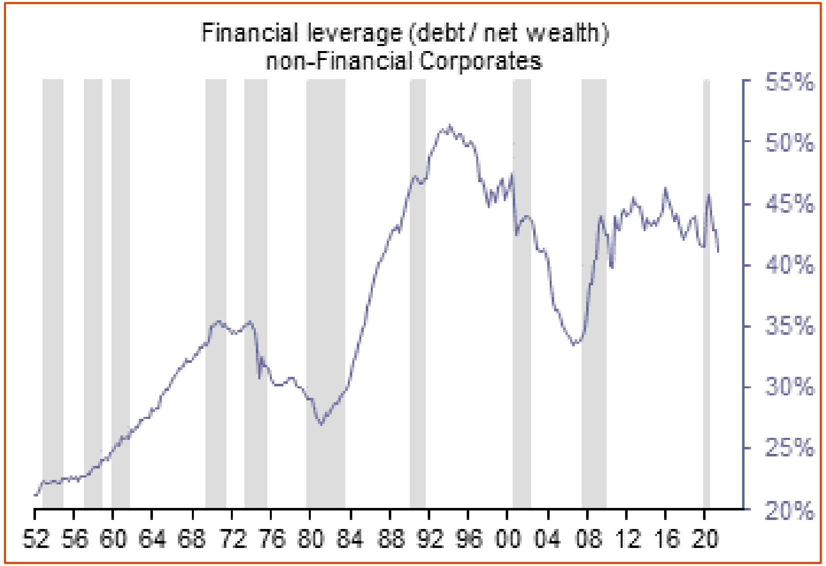

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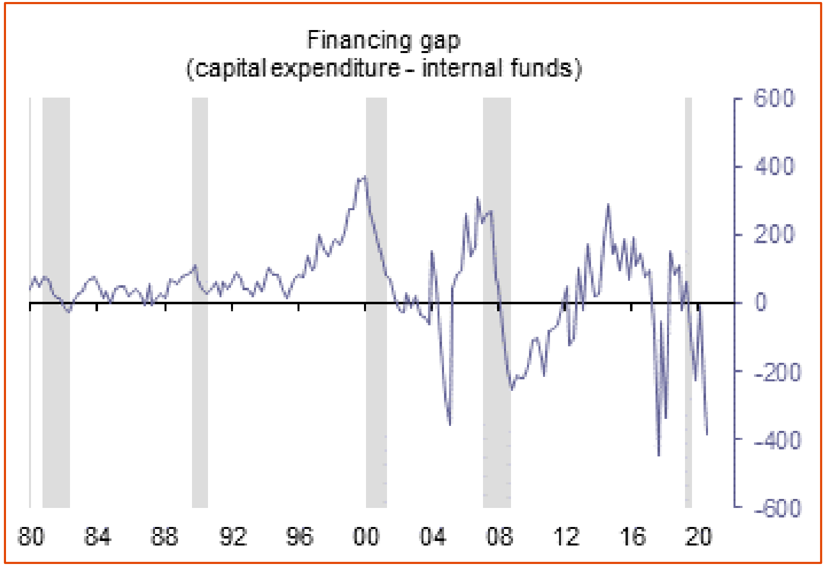
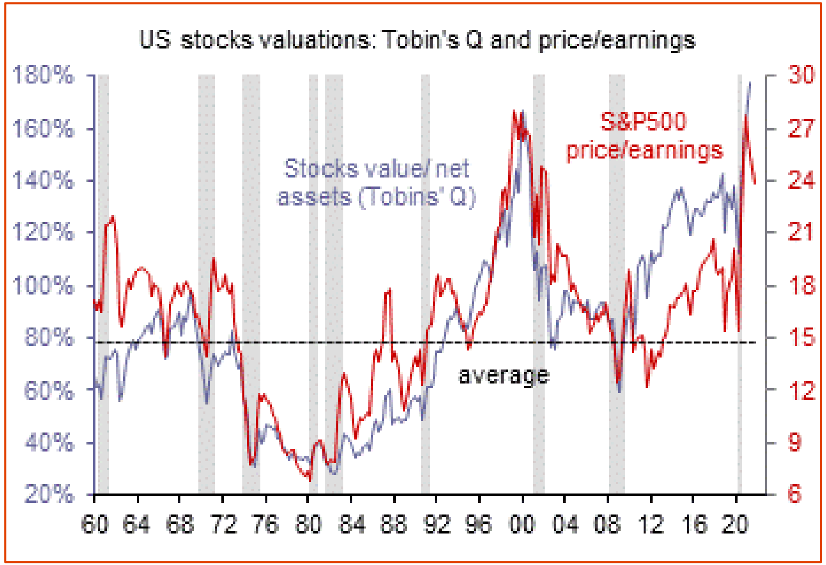


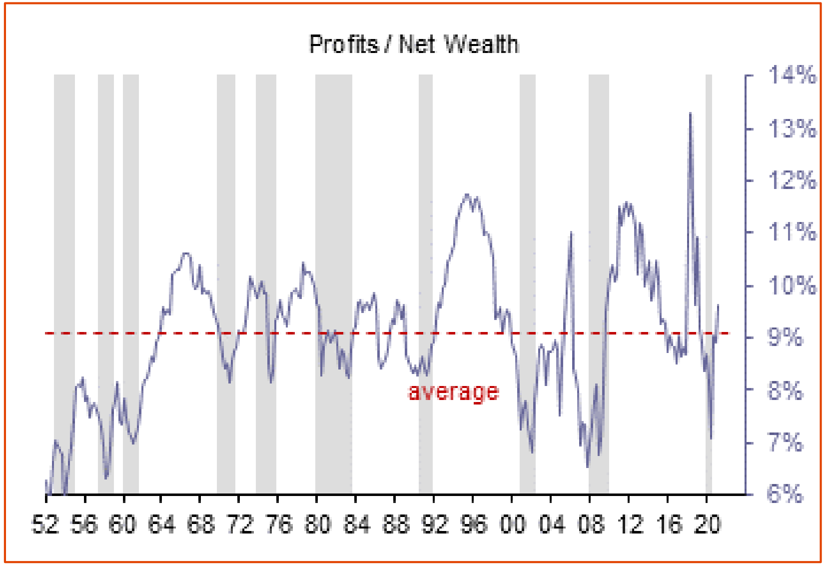
Valuations high, but supported by earnings

The rise of stock market prices has driven wealth to peak levels but has also resulted in a sharp increase of valuations.
Tobin's Q, that measure the valuation of an enterprise as **the ratio of the market value of a company and its net wealth (total assets minus debt), has surged to new record highs.**
However, this is taking place within the context of an economic recovery with ongoing earnings growth that, as shown by updated bottom-up metrics, are by contrast holding back the rise of valuations.

Focus towards the end of the year, therefore, will be on the earnings trend as well as on the tapering of economic stimulus: after the boost to valuations deriving from massive monetary and fiscal stimulus, the spotlight is now on the gradual removal of the emergency measure put in place to counter the pandemic-induced crisis, and most importantly on the taxation of earnings to finance fiscal stimulus.

Valuations high, but supported by earnings





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