Factors Influencing Household Debt: A Brief Analysis of Existing Research

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ABSTRACT

Undoubtedly, the increase in household debt is one of the primary concerns of policymakers. The factors influencing household debt have been the subject of numerous previous studies. Although household debt is crucial for sustaining financial well-being, the rapid growth of household debt jeopardizes the rapid expansion of a nation's economy. It raises questions about the household's ability to maintain financial stability. The fact that more individuals have obtained consumer credit and that households have taken out substantial credit loans suggests that households are now experiencing higher financial difficulties. Macroeconomic conditions, financial market trends, demographic characteristics, social norms, and individual borrowing behaviors are among the factors that influence household debt. It is essential to comprehend the primary factors contributing to household debt to create effective strategies for managing and reducing financial obligations. This study aims to synthesize insights from the existing literature to offer a brief understanding of the factors contributing to household debt. This study employs a qualitative method and is based on the findings of previous research. It is anticipated that this study will contribute to the current body of literature regarding the factors that affect household debt.

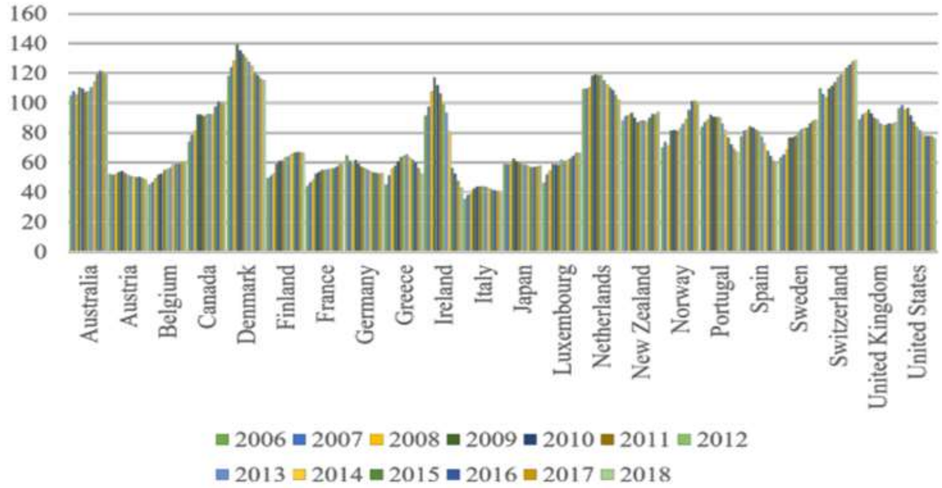
Keywords: Household debt, Borrowings, Determinants, Existing research

INTRODUCTION

In theory, the credit system of the economy transforms surplus cash balances into funds that may be lent out, which then enter the market and provide credit to households and businesses. Credit allows households to finance their preferred consumption habits over time, serving to smooth out consumption. The facilitation of households' ability to acquire assets can contribute to the accumulation of wealth (Kolios, 2021). Household debt is a critical element of the modern economy, as it substantially impacts individuals' financial well-being by influencing their decisions regarding spending and saving (Kolios, 2021).

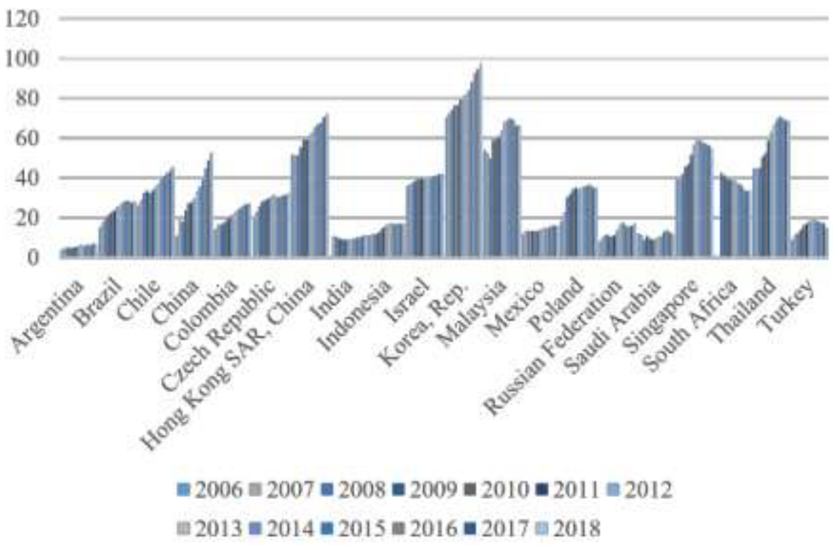
Nevertheless, debt increases financial vulnerability; thus, it must be used carefully and moderately. Assessing a household's financial condition carefully before taking on any debt is essential. Understanding a household's ability to repay borrowed funds and implementing a reasonable repayment plan are critical aspects of responsible borrowing (Kolios, 2021). Individuals can maintain financial stability and secure their future economic well-being by using credit wisely and avoiding excessive debt. Borrowing should be a tool to achieve financial goals, not a means of living beyond one's earnings (Che Yahya et al., 2023).

Figure 1
Trend of Household Debt in Developed Countries



Source: Samad et al. (2023)

Figure 2
Trend of Household Debt in Developing Countries



Source: Samad et al. (2023)

Household debt is defined by the Organisation for Economic Co-operation and Development (OECD) as "all liabilities of households (including non-profit institutions serving households) that require payments of interest or principal by households to the creditors at a fixed date in the future" (OECD, 2024). The total of two debt categories, loans (mostly home loans and consumer credit) and other accounts payable, is used to determine the amount of household debt. The indicator is expressed as a percentage of net household disposable income (OECD, 2024).

It is worth noting that many countries have recorded high levels of household debt, and the amount as a percentage of gross domestic product (GDP) keeps increasing yearly (Che Yahya et al., 2023; Samad et al., 2023). As such, higher household debt is evidenced in Malaysia (Che Yahya et al., 2023; Nizar, 2015), Botswana (Zimunya & Raboloko, 2015), OECD countries (Dumitrescu et al., 2022), and South Africa (Meniago et al., 2013). Meanwhile, the increasing trend of household debt is observed by Kolios (2021) for Australia; Lean-Ee Lee et al. (2021), Che Yahya et al. (2023), and Mohd Zain et al. (2019) for Malaysia; and Zimunya and Raboloko (2015) for Botswana.

Figure 3

Malaysia's Household Debt to GDP from 2006 to 2024

Source: tradingeconomics.com

Samad et al. (2023) prove that household debt to GDP has risen in many developed economies, with many countries recording a ratio of more than 60%(see Figure 1). A similar trend with household debt exceeding 40% of GDP is evidenced in emerging nations (see Figure 2). Specifically for Malaysia, it is observed that between 2006 and 2024 (in 19 years), household debt is on a rising trend, with over 75% of GDP in the year 2021 (see Figure 3).

Household debt can somewhat support economic development if the ratio stays between 36% and 70% of GDP (Samad et al., 2023). On this note, it is worth noting that a higher household debt can affect a family's social standing significantly. Household debt has several adverse effects, including stress, damaged relationships, and possible legal problems. Internal conflicts occur frequently in homes when the head of the family experiences emotional and/ or overwhelming stress when trying to repay loans. Higher debt levels have been linked to worse outcomes for mental health (Mohd Zain et al., 2019). It is more critical when assets are at risk of being lost owing to financial difficulties. Sweet et al. (2013) highlight that higher diastolic blood pressure, worse self-reported general health, and higher levels of stress and sadness are all linked to excessive financial debt relative to accessible assets.

In light of the abovementioned issues, this study aims to determine the factors that affect household debt. This study applies qualitative approaches by reviewing the findings and discussions of prior studies. The findings of this study are anticipated to enhance the current literature on the factors influencing household debt.

LITERATURE REVIEW

Low household debt is correlated with a financially sound economy (Meniago et al., 2013). In order to maintain low household debt levels, financial institutions, which serve as the primary source of credit in many nations, must be highly restrictive and discriminating when granting loans. This is due to the fact that the household sector may be overexposed to many unfavorable surprises due to rising debt, including shocks related to income, asset prices, and unemployment (Meniago et al., 2013).

Generally, households borrow for various purposes, such as long-term savings requirements or financing for a house purchase. By pushing forward investment and consumption, debt can raise living standards and facilitate more effective resource allocation (Mohamad Azmin et al., 2019). Nevertheless, debt may pose a risk for the future. Fast-rising household debt levels may cause solvency issues, and these weaknesses may develop into significant challenges, particularly in times of crisis (Dumitrescu et al., 2022). When there is a surge in lending and an increase in asset prices, such as in real estate, the problem is much more severe (Dumitrescu et al., 2022).

Therefore, understanding the factors that impact household debt is essential to making informed decisions regarding financial stability and planning for the future. Most research in the current literature examines household debt determinants for various economies by applying various econometric techniques to datasets made up of diverse debt determinants throughout different periods (Kolios, 2021). In the previous research, numerous determinants of household debt have been identified. Among others are household consumption, availability of credit, household income, unemployment rate, household savings, cost of living, house price, working population, inflation rate, interest rate, financial development, money supply, and GDP (Abd Samad et al., 2020; Kolios, 2021; Lean-Ee Lee et al., 2021; Mohamed et al., 2020; Zimunya & Raboloko, 2015).

DISCUSSION

The previous research this study has focused on is discussed in this section. The topic of discussion included variables impacting household debt in a few countries, including Malaysia. The information is shown in Table 1, which is arranged in the order of the most recent study to the one that came before it.

Table 1
Findings from the Previous Studies

No.	Authors	Objective	Method	Findings
1.	Che Yahya et al. (2023)	Investigated the elements that determine household debt in Malaysia.	Quantitative approach with secondary data (1991-2021; 31 years) using structural equation modeling procedures.	The unemployment rate and GDP significantly and positively influenced household debt, while interest rates, inflation rates, and housing price indexes negatively impact household debt. However, their relationship with household debt is insignificant.
2.	Dumitrescu et al. (2022)	Investigated the macroeconomic determinants of household debt in	Quantitative approach with quarterly secondary data (2002q1-	The relationship between macroeconomic factors and household debt can be summarized as follows:

		developed economies (26 OECD countries).	2020q4; 19 years) using unconditional quantile regression.	i. Economic growth initially reduces household debt, but this effect diminishes as household debt levels increase. ii. Inflation decreases household borrowing only when debt levels are high. iii. Higher house prices increase household debt, especially when debt levels are already high. iv. Increased investments lead to higher borrowing levels, even in the presence of high household debt. v. Mortgage credit interest rates are positively associated with household debt, especially at higher debt levels. vi. A rising unemployment rate leads to lower household debt, but this link weakens as debt levels increase. vii. Higher public expenditures are generally linked with lower household debt.
3.	Lean-Ee Lee et al. (2021)	Analyzed the variables affecting household debt accumulation, which has been separated into housing loans and consumption loans in Malaysia.	Used 16 years of quarterly time series data (2003q1-2018q4) and employed econometric methodology for data analysis.	The impact of savings, cost of living, and house prices on the accumulation of housing loans and consumption loans varies. Savings have a positive relationship with housing loans, while the cost of living is positively related to the accumulation of consumption loans. House prices also show a negative correlation with consumption loans.
4.	Kolios (2021)	Examined how the Australian context's monetary policy and employment market conditions affect household debt, categorizing it into housing debt and personal debt.	Used quarterly, nominal observations from 1959q3-2018q2 (60 years) using cointegrated value at risk (VAR) and vector error correction model (VECM) for data analysis.	Personal debt is closely tied to consumption, with income and unemployment showing an insignificant impact, while monetary policy has an inverse effect on personal debt. Regarding housing debt, the study observed that income and monetary policy play a significant positive effect, while consumption and unemployment significantly and negatively affect housing debt levels.
5.	Abd Samad et al. (2020)	Investigated the factors affecting household debt in developing nations.	Used panel data for 19 emerging economies from 1995 to 2018 (24 years), using overlapping averages of five years. The Generalized Method of Moment	Financial development, house prices, and lending interest rates positively and significantly impact household debt. Conversely, the effect of the unemployment rate and inflation on household debt is negative.

			(GMM) was used for the robustness test.	
6.	Mohamed et al. (2020)	Analyzed how macroeconomic factors affect household debt in Malaysia.	Used annual secondary data from 1984 to 2018 (33 years) and econometric method, including Descriptive Analysis, Augmented Dickey Fully (ADF), Unit Root Test, Philips-Perron (PP) Unit Root Test, Normality Test and Regression Analysis.	The variables GDP, unemployment rate, and inflation have positive relationships with household debt, with the unemployment rate having the most substantial impact, followed by GDP. Only GDP and unemployment rate are significant factors, while inflation is not.
7.	Mohamad Azmin et al. (2019)	Determined the factors influencing household debt in Malaysia.	Used five years of monthly time series data (2012-2016) and employed the ordinary least square (OLS) regression for the data analysis.	While the findings show an insignificant but positive association between inflation and household debt, the interest rate, unemployment rate, and consumption are all positively and significantly correlated with household debt.
8.	Mohd Zain et al. (2019)	Examined the effect of macroeconomic variables on household debt in Malaysia.	Used eight years of quarterly time series data (2010-2017) and employed the ordinary least square (OLS) regression for the data analysis.	The study found that household debt is positively correlated with GDP, base lending rate, and housing price, while unemployment is negatively correlated with household debt. The explanatory variables have all demonstrated a significant relationship, except for GDP. Housing price is the most significant factor positively correlated with household debt.
9.	Ma'in et al. (2016)	Investigated the variables influencing household debt in Malaysia.	Used eight years of time series data (2008q1-2015q4) and employed the OLS regression for the data analysis.	The most significant factor is the house price index, followed by the GDP, base lending rate, and unemployment. The GDP and the house price index are positively correlated with household debt, while the base lending rate and unemployment have negative impacts.
10.	Nizar (2015)	Investigated the influencers of Malaysian household debt by classifying it as consumer debt and mortgage debt.	Used quarterly data from 1994q4-2013q4 (18 years) using an autoregressive distributed lag model (ARDL) for data analysis.	In the short and long run, personal disposable income and house prices significantly affect mortgage debt; meanwhile, GDP, consumption, and interest rates significantly affect consumer debt.
11.	Zimunya and Raboloko (2015)	Determined the variables that significantly impact Botswana's	Used quarterly data from 1994q1-2012q2 (19 years) using VECM.	Household debt is positively and significantly impacted by consumption, money supply, and interest rates, while GDP exhibits

		household debt increment.		a significant negative relationship with household debt. Household debt and inflation have an insignificant negative association.
12.	Meniago et al. (2013)	Examined the causes of the increase in South Africa's household debt levels.	Used quarterly time series data from 1985q1-2012q1 (28 years) using VECM.	Changes in the GDP, household consumption, and consumer price index significantly influenced the rise in household debt. Although property prices and household savings positively contributed to the increment in household debt, the association is insignificant. The study also discovered that the negative changes in the prime rate and household income had an insignificant and significant impact on household debt, respectively.

CONCLUSION

This study identified various factors affecting household debt, as the discussion above signifies. The findings of these previous studies indicated that the unemployment rate, GDP, household consumption, cost of living, household savings, inflation, financial development, interest rates, money supply, and a few other factors are among the influencers of household debt.

Consequently, it is recommended that the abovementioned factors be considered in all efforts to promote responsible household debt management. Furthermore, demographic characteristics, social norms, and individual borrowing behaviors should not be overlooked.
Although conceptual, this research provides essential information to the body of knowledge, particularly in the context of household debt, by summarizing the findings of the previous studies. Ideally, this work will guide future researchers who intend to conduct the study empirically. Furthermore, it is anticipated that this study may assist pertinent stakeholders in motivating individuals to manage their debts and effectively decrease their levels of indebtedness.

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