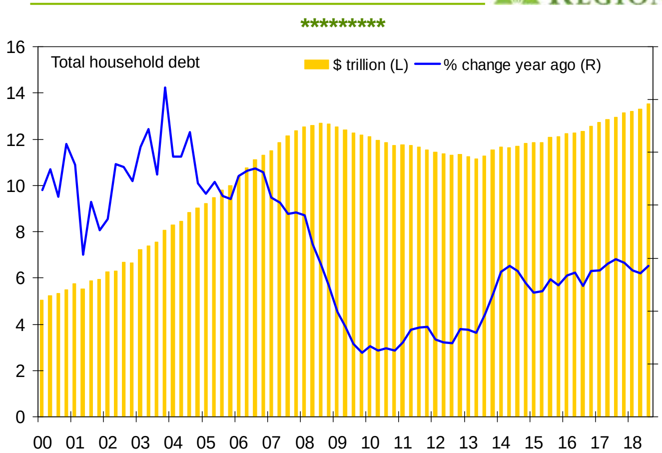
ECONOMIC UPDATE REGIONS
November 19, 2018

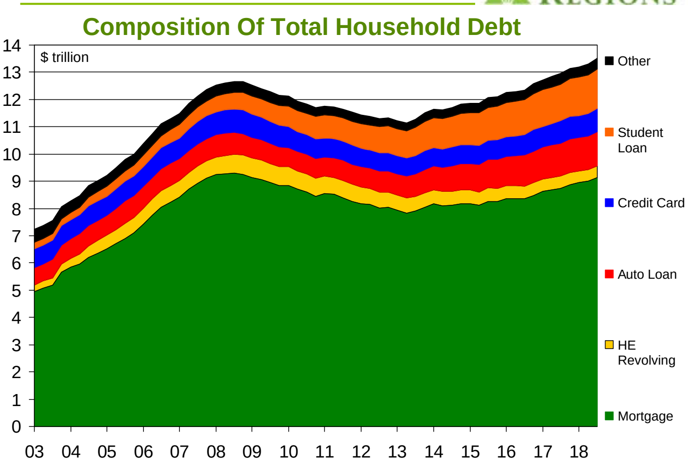
Q3 2018 Household Debt and Credit: "Record" Household Debt: Old News, Or No News?

- Total household debt rose to $13.512 trillion in Q1 2018, an increase of $219 billion from Q2 2018
- Mortgage debt accounted for most of the growth in overall debt in Q2; HELOC balances continued a long-running decline
- As of Q2, 4.72 percent of outstanding household debt was in some stage of delinquency, up from 4.50 percent in Q2

The Federal Reserve Bank of New York (New York Fed), in conjunction with Equifax, has released their latest quarterly report on trends in household debt. Total household debt rose to $13.512 trillion in Q3 2018, a $219 billion increase from Q2 2018, marking the 17th consecutive quarterly increase in outstanding household debt. And, in the "oh, by the way" category, $13.512 trillion marks a new, or, yet another, record-high level of household debt. The difference between Q3 and the last several quarters, however, is the fascination with "record high" seems to have waned, at least judging from the lack of "new record-high household debt" headlines atop media accounts of the Q3 data. Growth in household debt picked up slightly in Q3 but nonetheless remains far below rates of growth seen over past expansions, while the overall delinquency rate on household debt rose by 22 basis points between Q2 and Q3.



Source: Federal Reserve Bank of New York; Equifax; Regions Economics Division



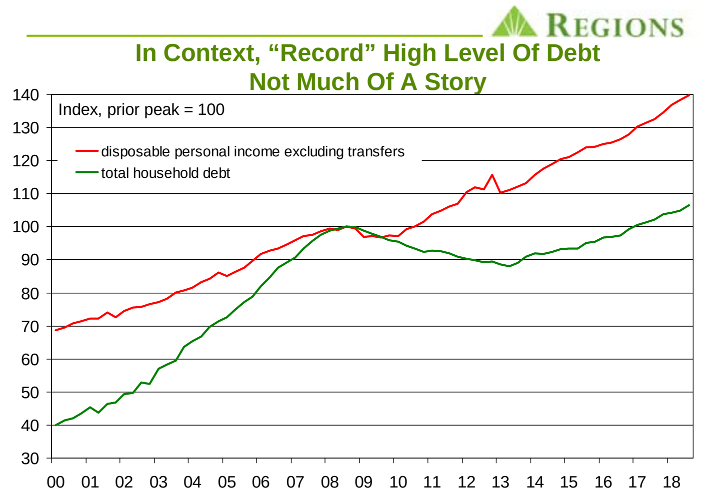
Source: Federal Reserve Bank of New York; Equifax; Regions Economics Division

Overall household debt grew by 4.30 percent year-on-year in Q3, ending a run of three consecutive quarters in which year-on-year growth in debt had slowed. As always, mortgage debt accounts for far and away the largest share of household debt, 67.64 percent as of Q3, and, at 4.54 percent, year-on-year growth in mortgage debt topped growth in total household debt. That said, the level of outstanding mortgage debt as of Q3 – $9.140 trillion – remains below the prior cyclical peak (and, sure, record-high) of $9.294 trillion seen in Q3 2008. Mortgage debt accounted for $141 billion of the $219 billion increase in total household debt in Q3. Student loan debt increased by $37 billion in Q3, reflecting year-on-year growth of 6.26 percent. Outstanding auto loan balances rose by $27 billion, good for a year-on-year increase of 4.29 percent, which is well below rates of growth seen over most of the current expansion. Credit card debt rose by $15 billion in Q3, leaving it up 4.46 percent year-on-year. The long-running decline in outstanding revolving home equity line balances continued in Q3, with a decline of $10 billion, leaving outstanding balances down 5.80 percent year-on-year.

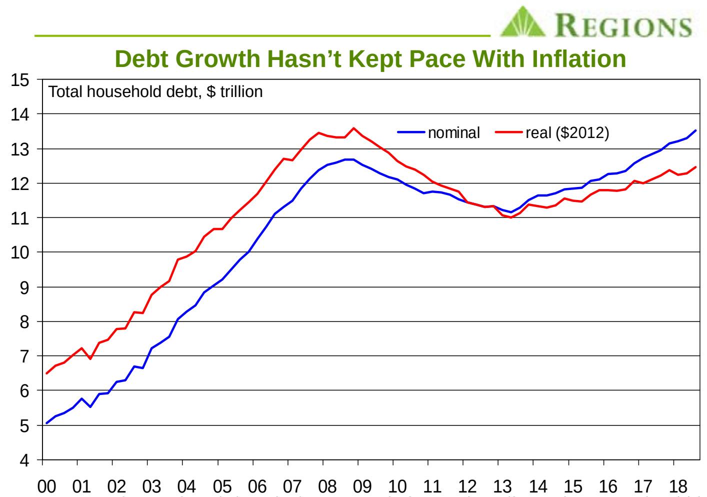
Over the past several quarters, the release of the New York Fed's reports on household debt has triggered a rash of stories focusing on that quarter's new record level of household debt which, as regular readers of our write-ups can attest, was a source of considerable annoyance to us. The Q3 report, however, didn't generate nearly as much attention, and while we're not sure why this was the case, we at least appreciate it. After all, we've characterized each record-high as a headline in search of a story, and pointed out that when put into proper perspective, there was nothing all that noteworthy about the level of debt. One account of the Q3 report we saw did just that, i.e., noted that in terms of the debt-to-income ratio, indebtedness is nowhere near as severe now than was the case before and during the 2007-09 recession. We've consistently made this point, even if in a slightly different manner, by comparing relative rates of growth of household debt and disposable personal income excluding transfer payments. So, while $13.512 trillion is indeed a new record-high level of household debt, that leaves household debt 6.60 percent above the prior cyclical peak (12.675 trillion in Q3 2008) while at the same time the level of disposable personal income excluding transfer payments stands 39.72 percent above its prior cyclical peak. In other words, income growth has easily outpaced growth in debt, leaving the debt-to-income ratio far below where it was

Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com

leading up to and during the 2007-09 recession. The disparity in growth rates of debt and income can be seen in the first chart below. It is a totally fair point that these aggregate numbers tell us nothing about the distribution of either household debt or personal income, and it could well be that growth in household debt is more heavily concentrated amongst those who have seen less growth in income. We would never dismiss this story line out of hand, but the lack of timely data on the distribution of debt makes it hard to assess the degree to which this is the case. What is likely is that growth in different types of debt has been more concentrated amongst specific income groups – for instance, growth in mortgage debt has likely been more concentrated amongst higher income households while growth in credit card debt has likely been more concentrated amongst lower income households.

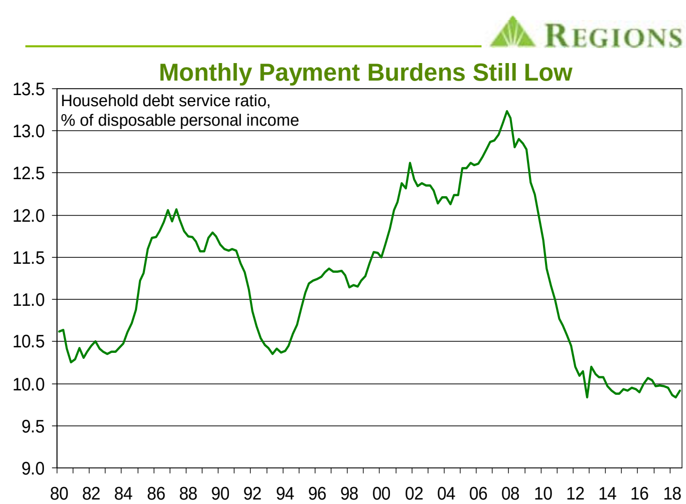


Source: Bureau of Economic Analysis; Federal Reserve Bank of New York; Equifax; Regions Economics Division



Source: Bureau of Economic Analysis; Federal Reserve Bank of New York; Equifax; Regions Economics Division

As a side note, we use disposable (or, after-tax) personal income excluding transfer payments as the relevant measure of income as this is a better measure of the pool of income available for servicing debt than measures of income which include transfer payments. We say this because while transfer payments are booked as personal income, most transfer payments do not actually reflect cash payments to individuals but instead reflect government payments to service providers in programs such as Medicare and Medicaid. This distinction matters when assessing the potential for growth in consumer spending or the ability of consumers to service debt, and in both of these instances, we think ex-transfers income to be the appropriate base. The second chart above offers another perspective on the level of household debt by comparing the level of debt on a nominal basis (i.e., not adjusted for inflation) and the level of debt on a real basis (i.e., adjusted for inflation). As can be seen in the chart, on an inflation adjusted basis, household debt is still far short of the prior cyclical peak. At $12.464 trillion as of Q3, real household debt is still 8.26 percent below the all-time high of $13.586 trillion seen in Q4 2008. Keep in mind how mild inflation has been over most of the current expansion, yet real household debt remains so far below its prior peak, which reinforces our earlier point about how slow growth in nominal household debt has been in the current cycle.

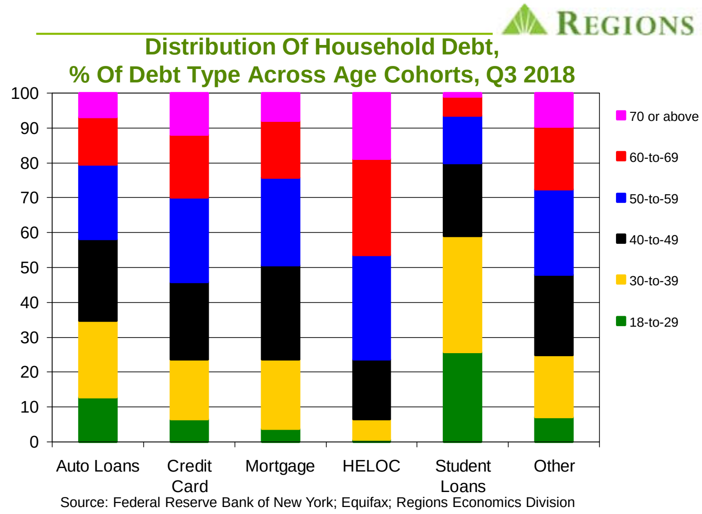


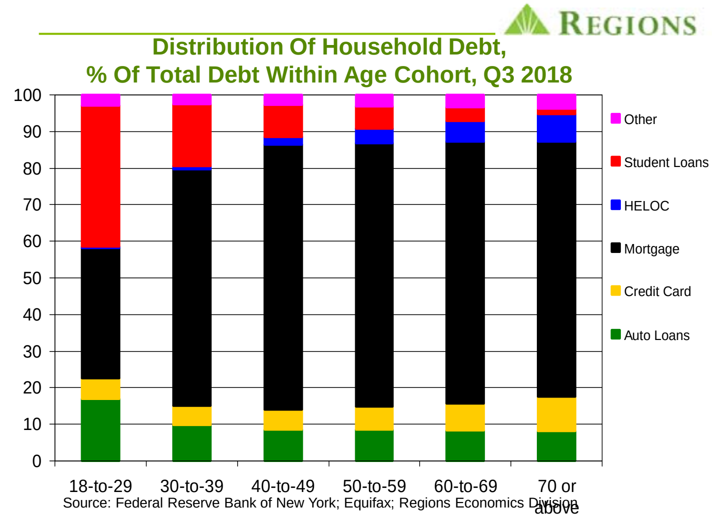
Source: Federal Reserve Board; Regions Economics Division

Record or not, the level of debt is not as significant as the ability of consumers to service their debt, an issue taking on greater significance as interest rates rise. As seen in the chart to the side, household debt service burdens, or, monthly principal and interest payments as a percentage of disposable personal income, remain low relative to historical norms. To be sure, were an equivalent measure based on disposable personal income excluding transfer payments available, the level of the ratio would be higher than that based on the broader measure of disposable personal income, but would still be much lower than historical norms. Additionally, debt service burdens are not uniform across income groups, but, again, lack of consistent and timely data makes a more detailed analysis of this point difficult. In any event, debt service burdens are still highly manageable, and even should interest rates continue to rise, what is a preponderance of fixed-rate debt on household balance sheets means that payment shocks triggered by higher interest rates should not be nearly as big of a threat to consumers, and in turn to lenders, in the current cycle than has been the case in past cycles. That said, higher interest rates figure, at least at some point, to curb growth in demand for new debt on the part of households which, as opposed to deterioration in the performance of outstanding loans, may be the biggest impact of higher interest rates over the remaining life of the current expansion.

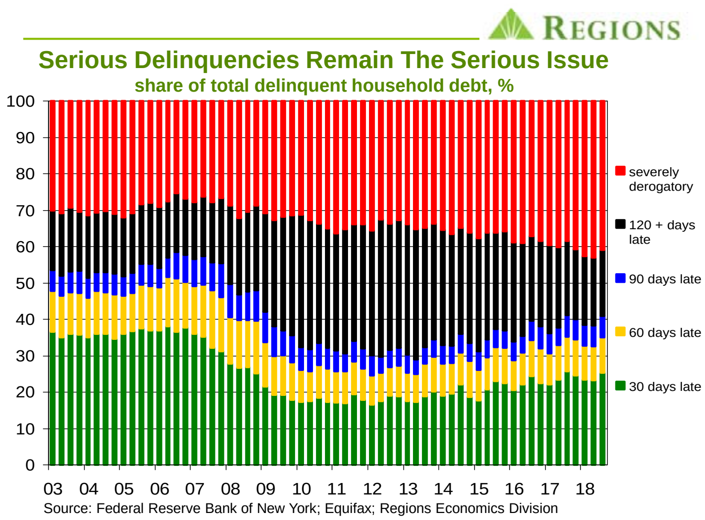
Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com

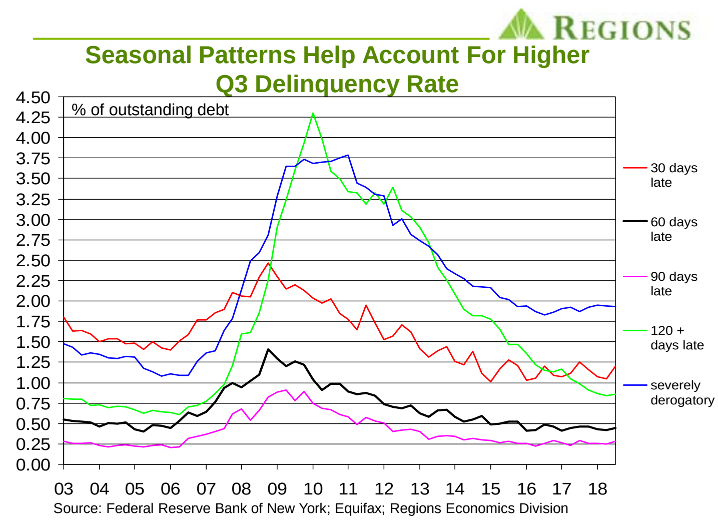
One new element of the quarterly reports on household debt is that the Q3 report included data on the distribution of debt by the age of borrowers. Borrowers between 40 and 49 years old accounted for 25.25 percent of all outstanding household debt in Q3, the largest share of any age cohort, with those between 50 and 59 years old accounting for the second largest share (23.60 percent). Those aged 50 or above accounted for 46.81 percent of all outstanding household debt as of Q3, and this share has steadily risen over time (as of Q1 2000, this share was 34.07 percent) which to some extent simply reflects the aging of the population. With the exception of the 18-to-29 year-old age cohort, mortgage debt accounted for the largest share of total household debt for each age cohort. Mortgage debt accounted for 72.29 percent of total debt amongst those between 40 and 49 years old, and for over 70 percent of total debt for those in the 50-to-59 and 60-to-69 age cohorts. For those in the 18-to-29 age cohort, student loan debt accounted for 38.50 percent of total household debt as of Q3 2018, topping the 35.65 percent share accounted for by mortgage debt. Credit card debt accounted for 9.50 percent of total debt for those aged 70 or above which, interestingly, is the largest such share for any age cohort.





As of Q3 2018, 4.72 percent of all outstanding household debt was in some stage of delinquency, up from 4.50 percent as of Q2. It is worth noting, however, that there are clear seasonal patterns in the data on 30-day delinquencies, resulting in Q3 typically being the intra-year peak for the 30-day delinquency rate, and this flows through to the overall delinquency rate. As such, while not totally discarding the increase in the 30-day delinquency rate in Q3, neither are we going to draw any sweeping conclusions from it. While the 30-day delinquency rate rose from 1.05 percent in Q2 2018 to 1.20 percent in Q3, the 15-basis point increase is in line with the increases normally seen in the third quarter of any given year. Given the strong seasonal patterns in the data, it is relevant to compare Q3 from one year to the next, and the 1.20 percent 30-day delinquency rate in Q3 2018 is lower than the 1.25 percent rate logged in Q3 2017.



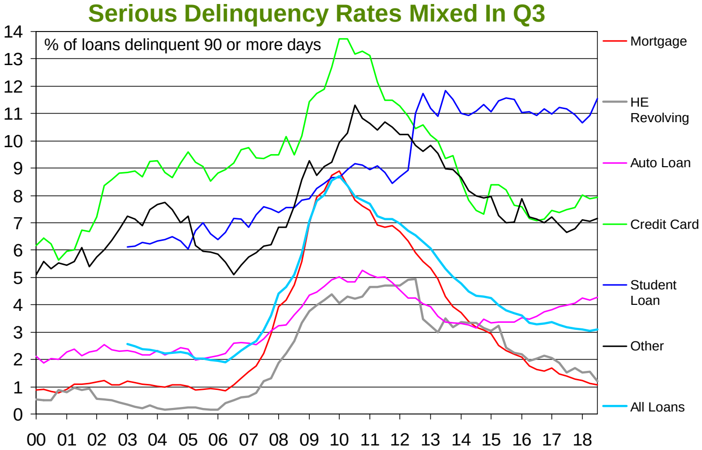


Of the $638 billion of household debt in some stage of delinquency as of Q3, $415 billion was "seriously" delinquent, i.e., delinquent for at least 90 days or seriously derogatory, up from $403 billion in Q2 (seriously derogatory means debt in some stage of delinquency combined with reports of a repossession, charge-off to bad debt, or foreclosure). Inflows from credit card debt and student loan debt were key drivers of flows into serious delinquency in Q3. Early-stage credit card delinquencies rose over the second half of 2017, reflecting deterioration in the subprime space, and this is helping account for the transition into 90-day and 120-day delinquencies. Of

Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com

all student loan debt outstanding as of Q3, 11.53 percent was seriously delinquent, up from 10.94 percent as of Q2. It should be noted that roughly half of all outstanding student loan debt is in deferment, in a grace period, or in forbearance and, as such, not currently in the repayment cycle. This means that the delinquency rate on that student loan debt actually in the repayment cycle is roughly twice as high as the reported rate, which is calculated based on all student loan debt outstanding regardless of repayment status.

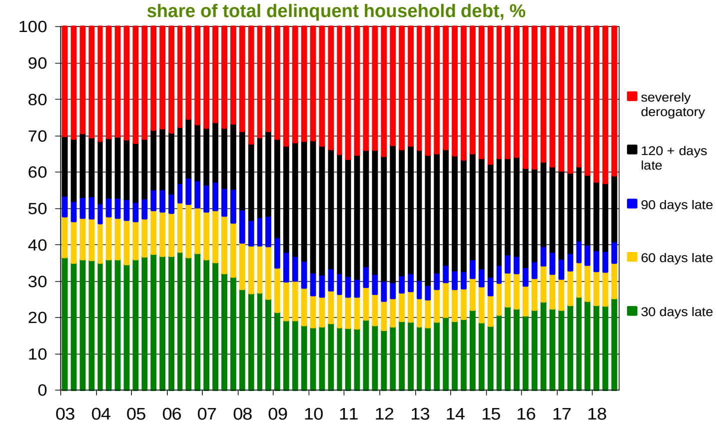
Serious Delinquency Rates Mixed In Q3



Source: Federal Reserve Bank of New York; Equifax; Regions Economics Division

Serious Delinquencies Remain The Serious Issue

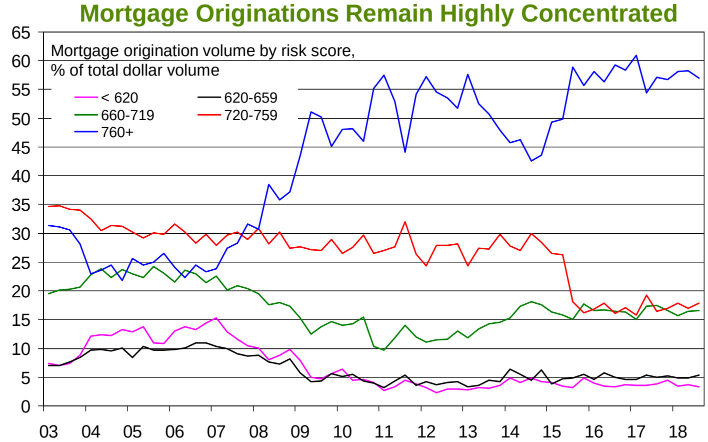
share of total delinquent household debt, %



Source: Federal Reserve Bank of New York; Equifax; Regions Economics Division

The serious delinquency rate on mortgage debt is back in line with pre-crisis norms, which to some extent reflects more stringent underwriting standards in the post-recession years. With early-stage mortgage delinquency rates actually below longer-term historical norms, it follows that inflows into serious delinquency will have also fallen off. Still, while the Federal Reserve's quarterly survey of commercial bank lending conditions shows banks have been easing lending standards on mortgage loans over the past several quarters, the share of mortgage originations (amongst all lenders, bank and non-bank) remains notably concentrated amongst borrowers with credit scores at or above 760. We think it worth repeating a point we've made in this space before to help account for why mortgage originations remain so highly concentrated amongst borrowers with the highest credit scores despite the easing seen in mortgage lending standards. The last several quarters have seen notably robust rates of house price appreciation, in part due to extraordinarily lean inventories of existing homes for sale, particularly at lower price points, and in part due to builders of new homes having concentrated on building in the upper price ranges. To the extent many prospective buyers, particularly first-time buyers, have been priced out of the market and greater shares of total home sales have taken place in the higher price ranges, it follows that credit scores of borrowers who can afford these higher priced homes would also be higher. So, while there are those who interpret the above chart as an indictment of mortgage loan practices, the reality is that the chart is as much, if not more, a reflection of underlying conditions in the housing market than it is mortgage lending practices. Along those lines, the monthly home sales data show signs, albeit still early signs, that conditions are beginning to change; listings of existing homes for sale have turned higher, which should take some of the edge off of house price appreciation, and lower-priced homes (those selling for less than $300,000) have accounted for a higher share of total new home sales. If our interpretation of the concentration of mortgage originations is correct and if home purchases are becoming more accessible to a greater pool of prospective buyers, coming quarters should see a greater dispersion of mortgage originations across credit score buckets.

Mortgage Originations Remain Highly Concentrated



Source: Federal Reserve Bank of New York; Equifax; Regions Economics Division

Clearly, there are elements of the data on household debt that merit attention but, while we love a new record high just as much as anyone else, the reality is that each quarter's new record level of household debt doesn't mean all that much when put in proper context. And, in the context of what in general have been more stringent underwriting standards over the life of the current expansion, lenders will on the whole be better positioned when (yes, it's "when" not "if") the next recession comes. It has been income growth, not growth in debt, that has been the bigger driver of growth of consumer spending in the post-recession years, even though this point is routinely missed by those who somehow think it a bad thing that growth in consumer spending during this expansion has been slower than in the years leading up to the 2007-09 recession. The flip side of that is that when this cycle does come to an end, there won't be nearly as much collateral damage as was the case last time around. There's something, a lot, actually, to be said for that.