ECONOMIC UPDATE

REGIONS

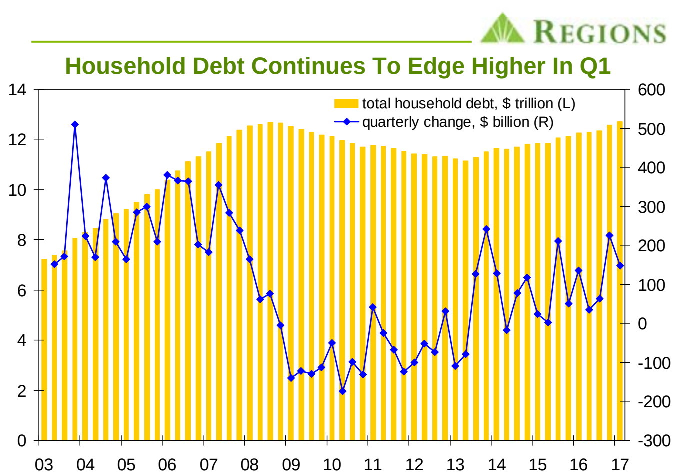
May 18, 2017

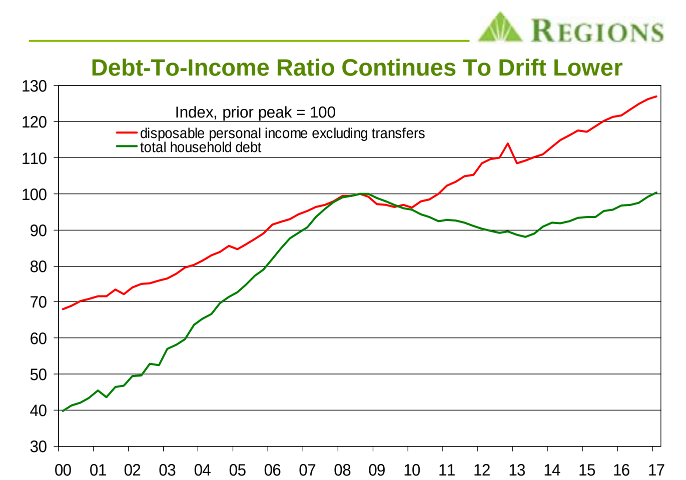
This Economic Outlook may include opinions, forecasts, projections, estimates, assumptions, and speculations (the "Contents") based on currently available information which is believed to be reliable and on past, current and projected economic, political, and other conditions. There is no guarantee as to the accuracy or completeness of the Contents of this Economic Outlook. The Contents of this Economic Outlook reflect judgments made at this time and are subject to change without notice, and the information and opinions herein are for general information use only. Regions specifically disclaims all warranties, express or implied, with respect to the use of or reliance on the Contents of this Economic Outlook or with respect to any results arising therefrom. The Contents of this Economic Outlook shall in no way be construed as a recommendation or advice with respect to the taking of any action or the making of any economic, financial, or other plan or decision.

Q1 2017 Household Debt and Credit: Household Debt Continues To Edge Higher

- Total household debt rose to $12.725 trillion in Q1 2017, an increase of $149 billion from Q4 2016.
- Mortgage debt and student loan debt were the primary drivers of growth in overall debt, HELOC and credit card balances declined.
- Aggregate delinquencies were basically flat in Q1, with 4.8 percent of outstanding debt in some stage of delinquency.

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. The main headline, though we're not entirely sure why, is that the level of outstanding household debt hit $12.725 trillion in Q1 2017, thereby surpassing the pre-recession peak. Total household debt grew at a year-on-year rate of 3.86 percent in Q1, slightly ahead of the 3.80 percent pace in Q4 2016 and marking the fastest year-on-year growth since Q2 2014. Growth in total debt was almost entirely driven by an increase in mortgage debt, which increased by $147 billion from Q4 2016, with student loan debt rising by $34 billion and auto loan debt rising by $10 billion. At the same time, outstanding balances on home equity lines of credit fell by $17 billion, outstanding credit card debt fell by $15 billion, and the ever popular "other" forms of household debt fell by $10 billion.





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

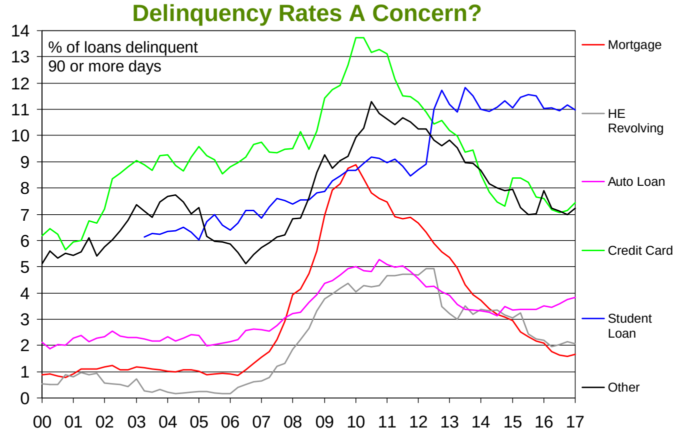
As noted above, that the aggregate level of household debt has passed its prior cyclical peak has been a source of considerable discussion. What one takes away from that, however, depends on one's point of view. Within the last week we've seen one story in which the author wondered what it would take to get consumers to make greater use of their credit cards in order to facilitate more consumption, and we've seen another author bemoaning the fact that a record level of household debt shows what dire straits U.S. consumers are in.

While there seems to be considerable fascination with a given variable, pick one, surpassing a prior peak, the level of debt and of itself tells us very little. Particularly when, as can be seen in the details of the quarterly New York Fed reports, there is so much variation amongst the individual components of household debt. We do, however, think it useful to put the growth of household debt in the context of growth in income, and to us the proper measure of income is disposable personal income excluding transfer payments. Disposable income reflects what households have left after accounting for taxes, and we think it proper to remove transfer payments for two reasons – first, even though they are booked as personal income, not all forms of transfer payments reflect actual cash payments to individuals, and, second, those transfer payments that are cash payments, such as Social Security or Unemployment Insurance benefits, are typically spent entirely, mostly on necessities. As such, disposable personal income excluding transfer payments more properly measures the pool of funds out of which debt service payments will be made.

As seen in the chart to the side, while it is true that household debt surpassed its prior cyclical peak in Q1 2017, at the same time disposable personal income ex-transfers stands almost 130 percent above its prior peak. In other words, the debt-to-income ratio in the household sector is much lower today than at its peak. During and after the 2007-09 recession, households went through a prolonged period of deleveraging (to be sure, in the early phases this mostly reflected lenders writing off bad debt); while household debt has been growing again for several quarters now, the rate of growth has not come close to the rate seen prior to the recession nor do we expect it to do so any time soon. Aside from a sharply lower debt-to-income ratio, a prolonged period of low interest rates has meant that monthly debt service obligations and the broader measure of overall financial obligations have been hovering at historical lows. In the aggregate, there is little to suggest debt is acting as a meaningful stress on household finances.

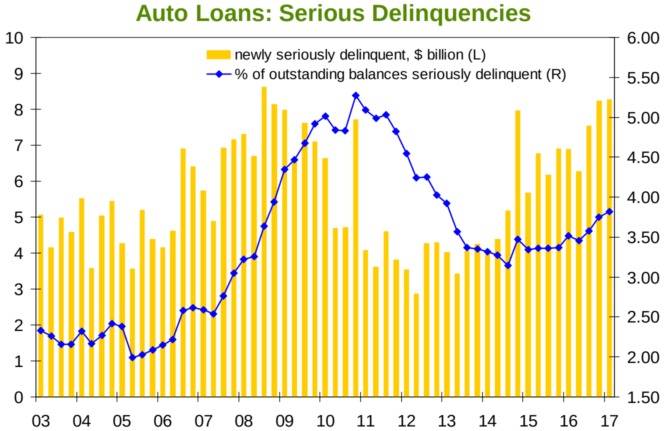
Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com

Delinquency Rates A Concern?



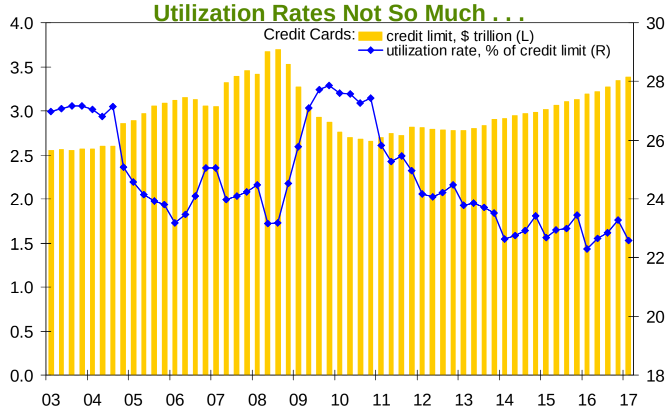
Source: Federal Reserve Bank of New York; Equifax; Regions Economics Division

Auto Loans: Serious Delinquencies



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

Credit Card Limits Continue To Rise, Utilization Rates Not So Much . . .



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

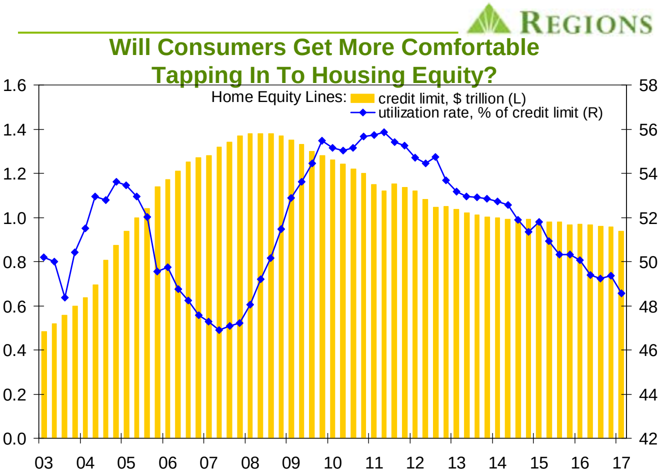
Another measure of financial stress is the delinquency rate on household debt. As of Q1 2017, 4.83 percent of total household debt was in some stage of delinquency, with 3.37 percent seriously delinquent (i.e., delinquent 90 or more days). The overall delinquency rate was unchanged from Q4 2017. That is not, however, to say there are no concerns, which can best be seen by looking at rates on the different components of household debt. Serious delinquency rates on credit card debt and "other" forms of household debt ticked higher in Q1, but in the case of credit card debt the rate remains well below the rate that prevailed in the years prior to the 2007-09 recession. The serious delinquency rate on auto loans has risen over the past few quarters, standing at 3.82 percent as of Q1, and new flows into delinquency on auto loans have also been trending higher.

To some extent, the rising auto loan delinquency rate reflects the incidence of subprime lending in the auto space. Since 2012, auto loans originated to borrowers with credit scores below 620 have accounted for just over 21 percent of all auto loans, which is a higher share than loans to those in the 660-719 and 720-759 score buckets. While commercial banks have pulled in the reins on auto loans, the extent to which nonbank lenders have done so is not clear, and delinquency rates on auto loans are likely to continue rising over coming quarters. At the same time, less borrower friendly credit terms, particularly to the extent nonbank lenders pull back, is one factor that will contribute to what we expect to be a gradual downshifting in the pace of motor vehicle sales in the quarters ahead.

Outside of the auto space, delinquency rates on student loans remain uncomfortably high. New inflows into delinquency on mortgage loans remain low, lower even than in the years before the housing boom that turned bust, but it is worth noting that a still-high incidence of late-stage, or, serious, delinquencies on mortgage loans has helped keep overall delinquency rates on mortgage debt somewhat elevated. Unlike the auto space, however, underwriting standards on mortgage loans have been more restrained and, barring a downturn in the broader economy, inflows into mortgage delinquency figure to remain fairly tame over coming quarters.

It is worth noting that while many accounts attribute slow growth in overall household debt to lenders being unwilling to lend (admittedly, we're not experts, but this would seem to make it difficult for lenders to actually make a profit), borrowers do actually have a say in this. One way to look at this is utilization rates, i.e., outstanding balances as a percentage of credit limits. For instance, the chart to the side shows aggregate credit limits on credit card loans which, per the New York Fed/Equifax data, stood at roughly $3.4 trillion as of Q1 2017, on which the utilization rate was 22.59 percent. As can be seen in the chart, there are clear seasonal patterns in utilization rates, i.e., they will be higher in Q4 of any given year then dip in Q1 of the following year, but even allowing for this leaves utilization rates notably low. Again, utilization is at the discretion of the consumer, but the motivating factor behind these low utilization rates is not clear. For instance, does this reflect discipline or despair on the part of card holders; i.e., still scarred by the severe economic downturn and having been burned by high levels of debt, are consumers now more disciplined, or are they simply lacking confidence in future job and income prospects and, as such, unwilling to take on additional debt. We think it more the former than the latter. But, new inflows into delinquency rates on credit card debt have been ticking higher, which could suggest that those most intensively utilizing credit card debt are doing so more out of necessity than choice.

The same pattern can be seen in the data on revolving home equity lines of credit (unlike home equity installment loans, the borrower chooses when and how much to borrow, up to a given limit, on a home equity line). Outstanding balances on revolving home equity



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

lines have declined in 29 of the past 32 quarters which was understandable in the earlier periods but less so in the past several quarters in which house price appreciation has kicked into a higher gear. In any event, as of Q1 2017 the utilization rate on home equity lines stood at 48.6 percent, the lowest utilization rate since Q1 2008. Unlike credit card loans, however, credit limits on home equity lines have trended lower, but it would seem likely that this will reverse given that robust house price appreciation over the past several quarters has markedly improved the equity position of homeowners. One caveat here, however, is that price appreciation has not been uniform across individual metro areas, meaning improved equity positions have to some degree been concentrated amongst a group of larger metro areas. In any event, it could be that both lenders and borrowers are still somewhat uncomfortable about tapping to whatever equity there is in a given house.

While different analysts will have different takes on what it means that household debt hit a record high in Q1 2017, our take is that some records merit more attention than others, and this one doesn't merit all that much. It is interesting to note that while the new record level of debt is barely higher than the old record level of debt, which was set in Q3 2008, almost everything else is much different. The size and relative health of the economy, the income pool out of which the debt is serviced, the level of interest rates, and the composition of the stock of debt are all vastly different today than was the case back in the day. Not to mention both lenders and borrowers were badly burned the last time around. To be sure, there are pockets of concern, such as the level of and stubbornly high delinquency rate on student loan debt, and the deterioration in the performance of auto loans, and things to keep an eye on, such as the performance of credit card debt. But, both borrowers and lenders have been more disciplined this time around, even if that hasn't always been the choice of either. On the whole, consumers have been more judicious in their use of debt, and a prolonged period of job and income growth along with notably low interest rates have left consumers better able to service their debt. It is hard for us to fathom those who long for the days when debt growth, as opposed to income growth, was the main fuel for growth in consumer spending. Sure, the ride may not be as fast, but it won't feel nearly as bad when it comes to an end.

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