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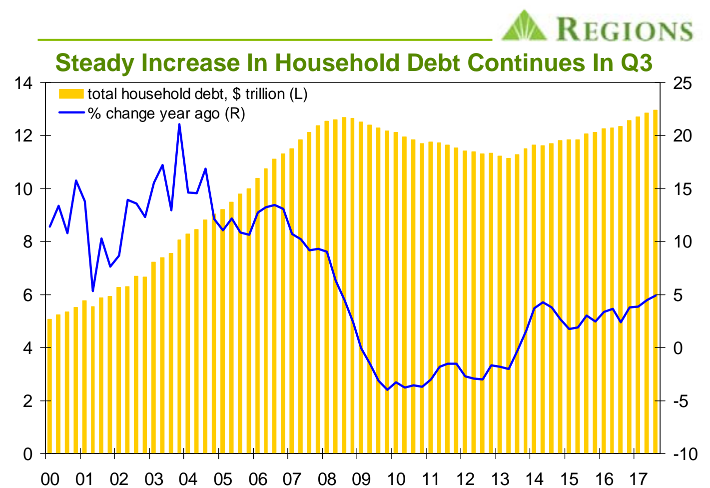
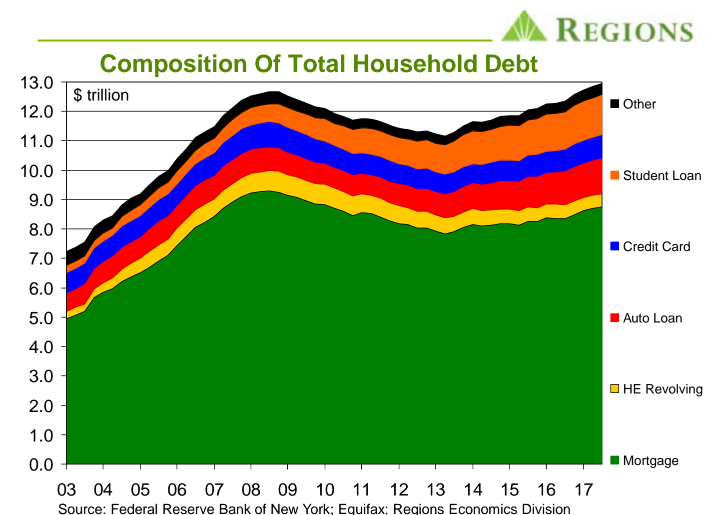
Q3 2017 Household Debt and Credit: Rising Delinquencies Stealing The Spotlight

- Total household debt rose to $12. 559 trillion in Q3 2017, an increase of $116 billion from Q2 2017.
- Mortgage debt, auto loans, and credit cards accounted for most of the growth in overall debt in Q3; HELOC balances declined.
- As of Q3, 4.86 percent of outstanding household debt was in some stage of delinquency.

Well, that didn't take long – when it comes to household debt, new records are apparently old news. 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 $12.955 trillion in Q3 2017, an increase of $116 billion from Q2 and the 13th consecutive quarterly increase in total household debt. The $12.955 trillion of household debt is another new record high, but, unlike in Q2 when what was at the time a new record high level of debt attracted all sorts of fanfare (except in this space, where our reaction was "so what?"), that Q3 saw another record high has hardly been mentioned. Sure, hitting a new record every time out eventually becomes passé, but it usually takes longer to get to that point.



In any event, outstanding mortgage debt rose by $52 billion in Q3, with credit card debt increasing by $24 billion, auto loans increasing by $23 billion, student loan debt rising by $13.0 billion, and the ever popular "other" household debt rising by $8.0 billion. Outstanding balances on home equity lines of credit fell by $4.0 billion in Q3, the 32nd decline in the past 34 quarters. Total household debt was up 4.90 percent year-on-year in Q3, the fastest over-the-year growth since Q2 2008. Growth in mortgage debt (up 4.71 percent year-on-year) and credit card debt (up 8.17 percent) accelerated in Q3, while growth in auto debt (up 6.87 percent) and student loan debt (6.10 percent) decelerated. Revolving home equity balances were down 5.08 percent year-on-year. As seen in the chart to the side, mortgage debt is far and away the largest single component of total household debt, accounting for 67.49 percent in Q3 2017, though this share is well below the peak share of 73.66 percent in Q1 2008. Student loan debt accounted for 10.47 percent of the total in Q3, with auto loans accounting for 9.36 percent, credit card debt for 6.24 percent, revolving home equity lines for 3.46 percent, and other consumer debt making up the remaining 2.98 percent.



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

Rather than the newest latest record level of household debt, it is the delinquency rate on outstanding debt that has captured the bulk of the attention from the New York Fed's Q3 report. As of Q3 2017, 4.86 percent of all outstanding household debt was in some stage of delinquency, up from 4.77 percent in Q2 but down from 4.93 percent in Q3 2016. As of Q3 2017, 3.19 percent of all outstanding household debt was seriously delinquent, i.e., 90-or-more days delinquent. This is actually the lowest rate of serious delinquencies since Q3 2007 which, oddly enough, we've not heard or seen mentioned anywhere. What has gotten considerable attention is that, as of Q3, 3.97 percent of auto loan debt was seriously delinquent, a five basis point increase from Q2 and a 39 basis point increase from Q3 2016, while 7.47 percent of credit card debt was seriously delinquent, up nine basis points from Q2 and up 39 basis points from Q3 2016. Conversely, serious delinquency rates on mortgage debt and home equity lines fell further in Q3, with the former at 1.38 percent and the latter at 1.53 percent. The serious delinquency rate on mortgage debt is the lowest since Q4 2006 and figures to fall further over coming quarters. As we've noted in our quarterly analysis of the mortgage delinquency data published by the Mortgage Bankers Association, early-stage delinquency rates have actually fallen below their longer-term (i.e., pre-crisis) norms which has flowed through to declining late-stage delinquency rates.

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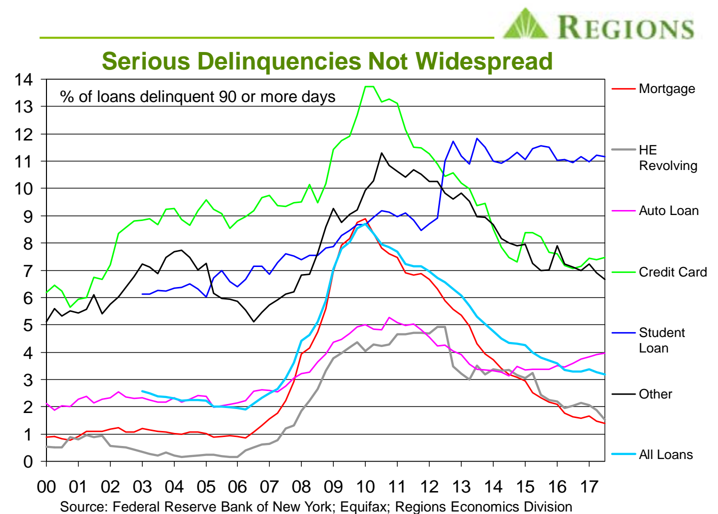
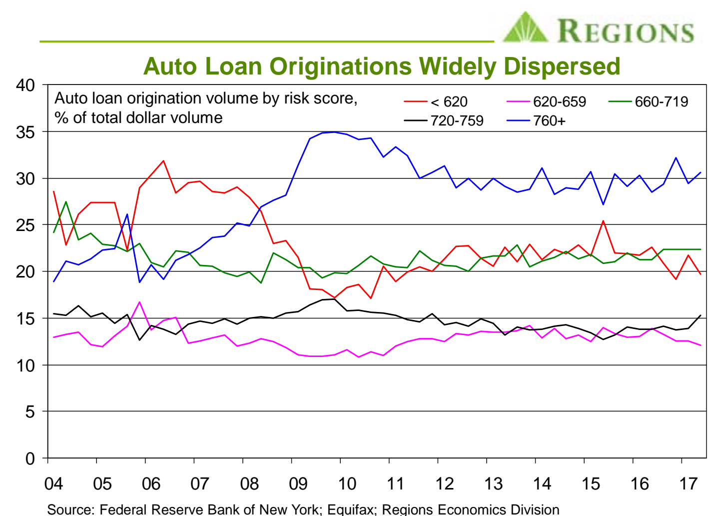
As seen in the chart to the side, serious delinquency rates for most types of household debt continue to drift lower yet in many accounts of the Q3 data the focus has been on the rates for credit cards and auto loans. To a large extent, however, rising delinquencies in these spaces reflect subprime loans, the considerable majority of which were originated by nonbank lenders. In a discussion of the Q3 results, analysts at the New York Fed noted that auto finance companies had originated about two-thirds of all outstanding subprime auto loans, with banks and credit unions having originated the remaining one-third. Additionally, as banks have, at least according to quarterly Federal Reserve survey of senior commercial bank loan officers, been tightening lending standards, the average credit score of auto borrowers has risen. In Q3 the New York Fed's data show the median credit score among auto borrowers was 705 while originations to borrowers with credit scores of less than 660 declined. The same general pattern is apparent in data on credit card debt, i.e., rising delinquencies are concentrated amongst subprime borrowers with greater exposure amongst nonbank lenders.

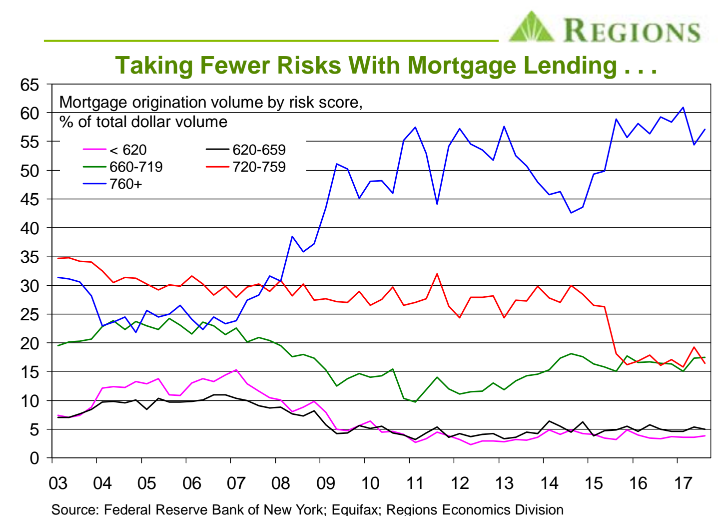


This is by no means to simply dismiss concerns over rising rates of serious delinquency in the credit card and the auto spaces. After all, pushing risk out of the banking system is not the same as pushing risk out of the system. With over 23 million outstanding subprime auto loans, both consumers hamstrung by financial difficulties and lenders potentially having to write off significant amounts of bad debt would not go unnoticed throughout the financial system or the broader economy. That said, the potential for subprime auto or credit card debt to contaminate the financial system seems fairly limited, particularly with what remains improving performance of what is far and away the largest single component of household debt, i.e., mortgage debt.



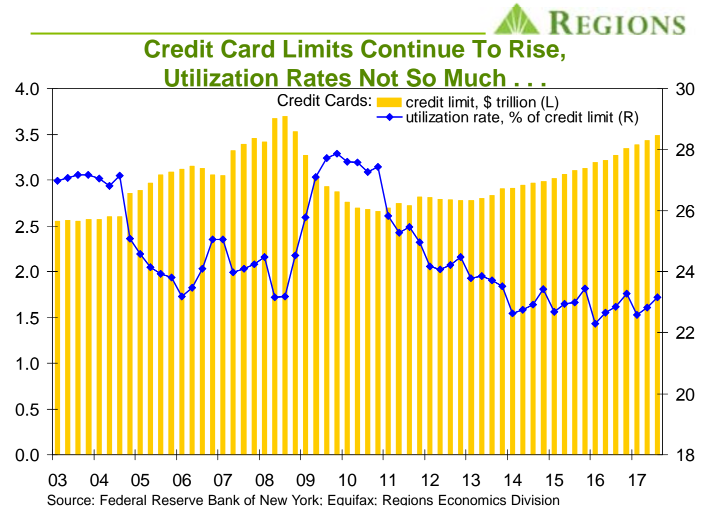
To a large degree, steadily improving performance of mortgage loans reflects higher underwriting standards in the post-recession years. As seen in the chart to the side, mortgage originations have been heavily concentrated amongst borrowers with credit scores of better than 760 in the post-recession years. But, it should be noted that the Federal Reserve's quarterly survey of lending conditions shows that over the past several quarters banks have been easing mortgage lending standards, which presumably means a wider swath of prospective homebuyers have access to mortgage credit.

One way to reconcile this with the data shown in our chart to the side is by taking into account what for several quarters now has been rapid house price appreciation across much of the U.S., in large part due to notably lean inventories of homes, new and existing, for sale. To the extent that prospective home buyers, particularly first-time buyers, are being priced out of the market as more and more sales take place in the higher end of the price distribution, it would follow that credit scores of those borrowers able to afford these higher priced homes would be higher. In other words, while on the surface the data illustrated in the chart to the side may seem like an indictment of mortgage lending practices in the post-recession years, going beneath the surface one can see this more as a reflection of how supply constraints are pushing up house prices, thereby limiting the pool of potential borrowers.

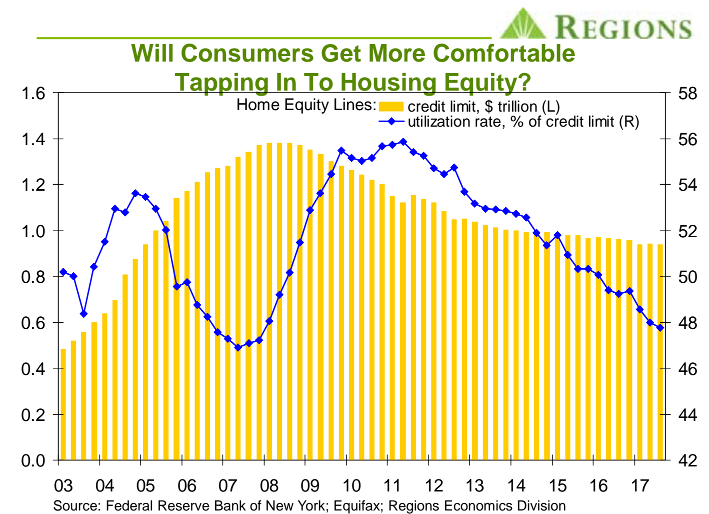


One can make a plausible case that when it comes to mortgage debt, constraints on growth come not from the demand side but from the supply side, in this case the supply of homes for sale. In other segments of household debt, constraints on the growth of debt stem more from the demand side. True, banks and even some nonbank lenders are raising lending standards on auto loans, but motor vehicle sales are clearly past their cyclical peak (the post-hurricane jump in demand notwithstanding) and will settle into a more sustainable pace of 16.0-to-16.5 million units on an annualized basis. In terms of credit card debt and home equity debt, consumers have considerably more capacity to take on debt but are choosing not to utilize it. We can see this on utilization rates based on the New York Fed's quarterly reports.

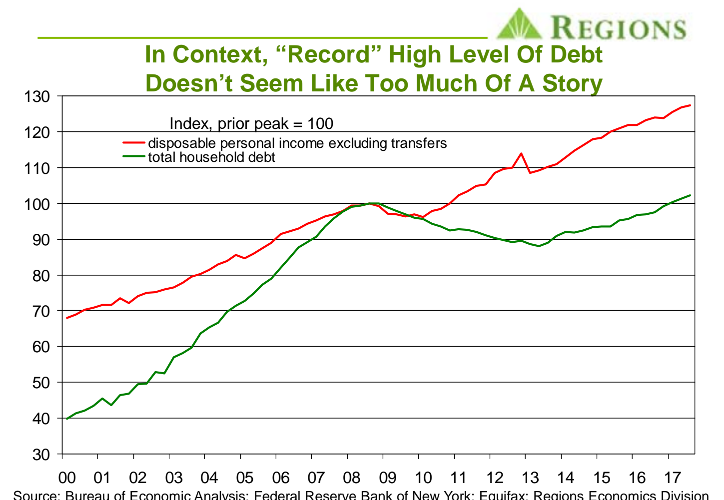
For instance, credit card utilization rates have settled back into a familiar pattern in which utilization rates rise noticeably in the final quarter of a given year then fall sharply in the first quarter of the next year then rise modestly in the middle two quarters of the year. This pattern, as seen in the chart to the side, has held through the first three quarters of 2017 and we expect the Q4 data will show a jump in card utilization – perhaps a sizeable jump given our forecast for a strong holiday sales season. Still, the seasonal peak in card utilization rates hasn't really changed much in recent years – true, rising credit limits still mean we see growth in outstanding credit card debt despite no meaningful change in utilization rates, but for the most part consumers have remained fairly disciplined in the use of credit card debt.



Consumers clearly have little appetite for tapping into housing equity, however, even though rapid house price appreciation has given an increasingly large number of homeowners increasing wherewithal to do just that. Available lines have been flat to slightly lower while utilization rates continue to decline, hence the persistent decline in outstanding balances on home equity. To be sure, there has been growth in home equity loans, but those loans are lumped into the broader mortgage debt category. The broader point, however, remains the same – consumers simply are not, at least at this point, willing to utilize available home equity more intensively. Whether, or to what degree, that will change over coming quarters remains to be seen.



As we noted in our analysis of the Q2 data on household debt, that the level of household debt has hit a new record high in and of itself tells us very little. "New record high" has, for many a negative, if not dire, connotation, given the prior record high accompanied the 2007-09 recession, as though we're somehow doomed to have another recession of the same magnitude simply because the level of debt now is pretty much the same as it was back then. But, while the level of debt is marginally higher than the prior record, pretty much everything else is much different. The size and relative health of the economy, the income pool out of which debt is serviced (disposable income excluding transfer payments, seen in the chart to the side), the level of interest rates, the composition of the outstanding debt, and the standards to which much of today's outstanding debt was underwritten are all materially different, one can argue to the good in each case, now than was the case prior to the 2007-09 recession.



While we don't see any ominous undertones to what in Q3 2017 was a new record high level of household debt, we do have some concerns. For instance, the level of and the stubbornly high delinquency rate on student loan debt and the deterioration, though still modest, in the performance of auto loans and credit card debt bear watching, and we see more downside risk from higher interest rates than do many other analysts. That said, given that income growth, as opposed to debt growth, has been the main fuel for growth in consumer spending during the current cycle, the ride may not be as fast this time around, but it won't feel nearly as bad when it comes to an end, as it ultimately will.

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