ECONOMIC UPDATE

REGIONS

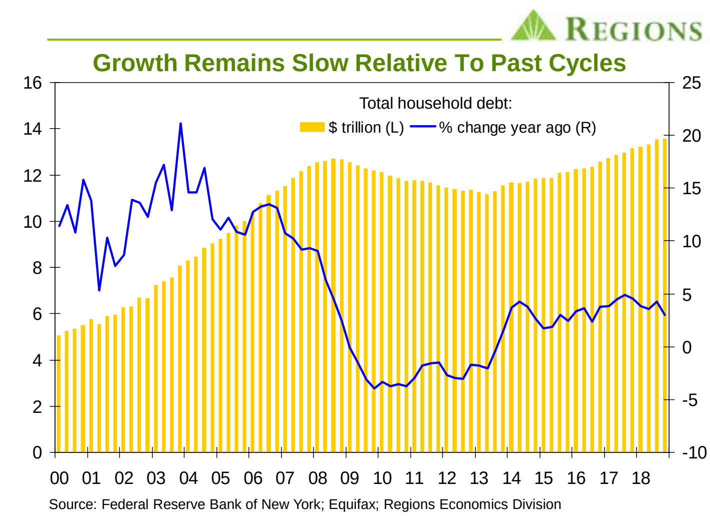
February 14, 2019

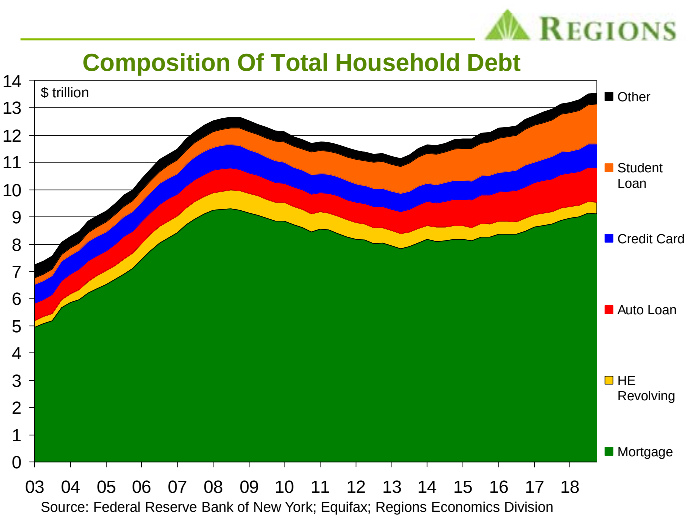
This Economic Outlook may include opinions, forecasts, projections, estimates, assumptions, and speculations (the "Contents") based on currently available information which is believed to be reliable and on past, current and projected economic, political, and other conditions. There is no guarantee as 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.

Q4 2018 Household Debt and Credit: Record High Debt Not Much Of A Burden Thus Far

- Total household debt rose to $13.544 trillion in Q4 2018, an increase of $32 billion from Q3 2018
- Credit card debt, auto loans, and student loans accounted for most of the growth in household debt in Q4
- As of Q4, 4.65 percent of outstanding household debt was in some stage of delinquency, down from 4.72 percent in Q3

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 $13.544 trillion in Q4 2018, a $32 billion increase from Q3 2018, marking the 18th consecutive quarterly increase in outstanding household debt. Still, the $32 billion increase in total household debt in Q4 is the smallest quarterly increase in the level of outstanding debt since Q2 2015, and what is noteworthy is that outstanding mortgage debt actually fell in Q4 – the first quarter-on-quarter decline since Q3 2016 – which acted as a drag on growth in overall debt as mortgage debt is easily the largest single component of household debt. Credit card debt, auto loans, and student loans all increased in Q4, while revolving home equity line balances declined for the 36th time in the past 39 quarters. Total household debt was up 3.01 percent year-on-year in Q4 2018, and as seen in the first chart below, growth in household debt remains far below rates of growth seen in the years prior to the 2007-09 recession. The overall delinquency rate on household debt fell by 7 basis points between Q3 and Q4.



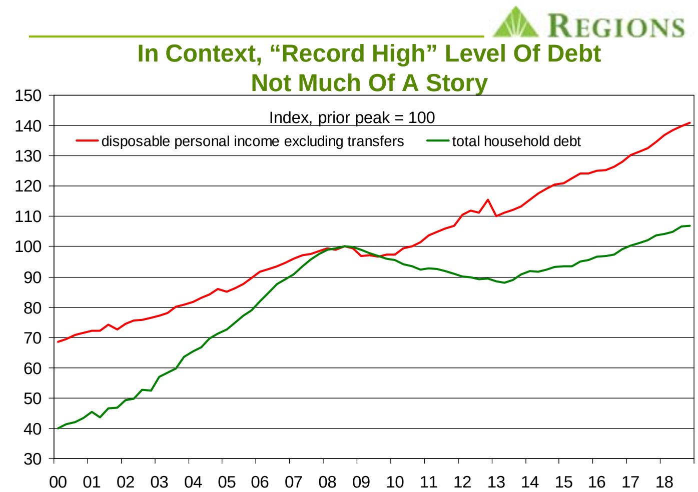


While outstanding mortgage debt declined between Q3 and Q4, it was nonetheless up 2.72 percent year-on-year. Non-mortgage debt grew by 1.5 percent on a quarter/quarter basis and by 4.87 percent on a year/year basis in Q4 2018, with auto loans up by 4.34 percent year-on-year, credit card debt up by 4.32 percent, and student loan debt up 5.73 percent. As noted above, growth in household debt in the post-recession years has been far below historical norms. While the series reported on by the New York Fed has a fairly limited history, there is a much longer series on total household debt in the Federal Reserve's "*Flow of Funds*" data. This longer series shows that over the 1961-2007 period, average growth (year-on-year) in total household debt grew was 9.33 percent – there is considerable volatility around that average, but, even allowing for this greater volatility, growth in debt during recent years pales in comparison to historical norms. Our view is that this reflects what, in the post-recession years, has been a greater degree of discipline on the part of both borrowers and lenders. What will bear watching is the extent to which this discipline will hold up as we move even further into the current expansion, now in its tenth year. It is, after all, typically in the final stages of a cycle that discipline starts to break down. That said, starting points matter, and that both borrowers and lenders have been somewhat restrained over the course of this expansion should mean that any breakdowns in discipline won't result in excesses as egregious as seen in some past cycles.

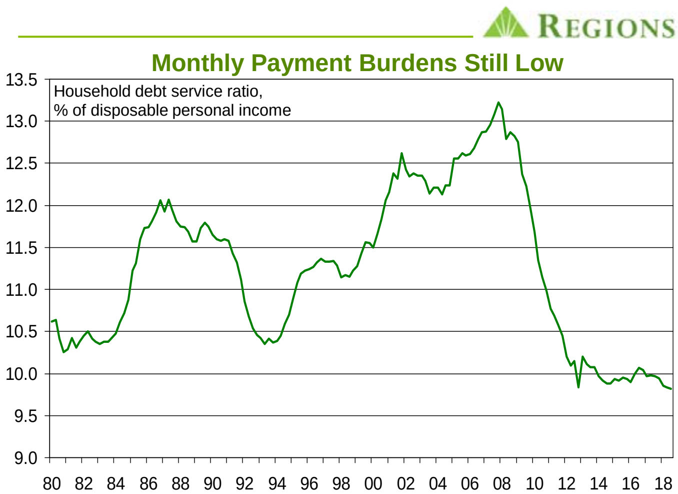
As seen in the second chart above, mortgage debt comprises the largest single block of total household debt, accounting for 67.37 percent as of Q4 2018, with revolving home equity lines accounting for an additional 3.04 percent of the overall total. Student loan debt accounts for 10.76 percent, auto loan debt for 9.41 percent, credit card debt for 6.42 percent, while all other forms of household debt account for a combined 3.01 percent of the overall total. By way of comparison, in Q1 2003, the first quarter for which full historical information is available for all forms of household debt in the New York Fed series, mortgage debt accounted for 68.34 percent of total household debt with revolving home equity lines accounting for an additional 3.35 percent, while credit card debt accounted for 9.51

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

percent, auto loan debt accounted for 8.86 percent, student loan debt accounted for 3.33 percent, with all other forms of household debt accounting for 6.60 percent of the total. At the time, however, mortgage debt and revolving home equity lines were easily the fastest growing components of total household debt, and at their peaks mortgage debt accounted for 73.60 percent of total household debt and revolving home equity lines accounted for 5.61 percent.



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



Source: Federal Reserve Board; Regions Economics Division

As is the case with each quarterly release of the New York Fed data on household debt and credit, the Q4 2018 data have been accompanied by the usual screaming headlines and shoddy "analysis" emphasizing the latest "record high" level of household debt. That we knew this was coming makes it no less annoying but, really, there was simply no preparing for some of the "highlights" of this round – "Americans are more indebted than ever," "Americans continue to pile on debt," and, this quarter's winner, lenders "will soon regret" having lent so liberally over the past several quarters. As to the emphasis on a, or, yet another, record high level of debt, sure, household debt hit an all-time high in Q4, at least in nominal terms but, in real (or, inflation adjusted) terms, not so much, as household debt is still 7.83 percent shy of the peak seen in Q4 2008.

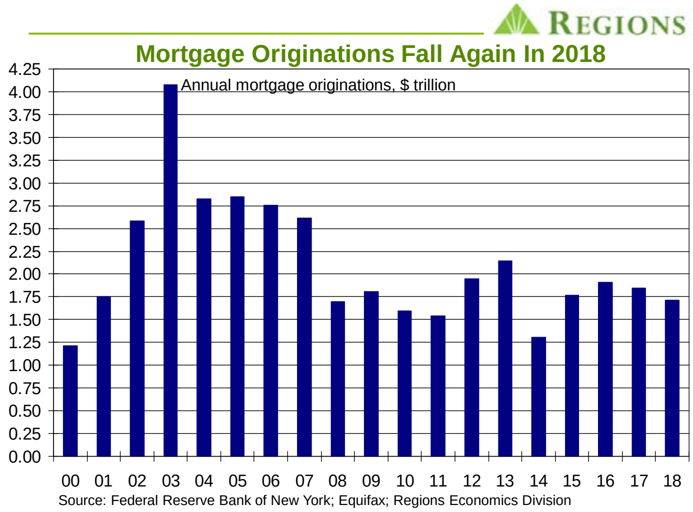
Sure, we get it, economists tend to be more fixated on that whole real vs. nominal thing than is the case with normal people but, even leaving that aside, here are a few other relevant metrics that are also at all-time highs: GDP (real or nominal), disposable personal income, disposable personal income excluding transfer payments, and household net worth. Just a thought, but, might it perhaps possibly make sense to put the "record high" level of household debt in the context of these other metrics that are also at record highs? We think so, and to us the most relevant comparison is between household debt and disposable personal income excluding transfer payments, which is shown in the first chart above. As we've noted on many occasions, we see disposable personal income excluding transfer payments as the best measure of income available for meeting debt service and other financial obligations. So, while as of Q4 2018 total household debt stood 6.85 percent above the prior peak, disposable personal income excluding transfer payments stood at just over 40 percent above the prior peak. This is simply another way of saying that the ratio of debt to disposable personal income excluding transfer payments is significantly lower now than was the case when the 2007-09 recession started.

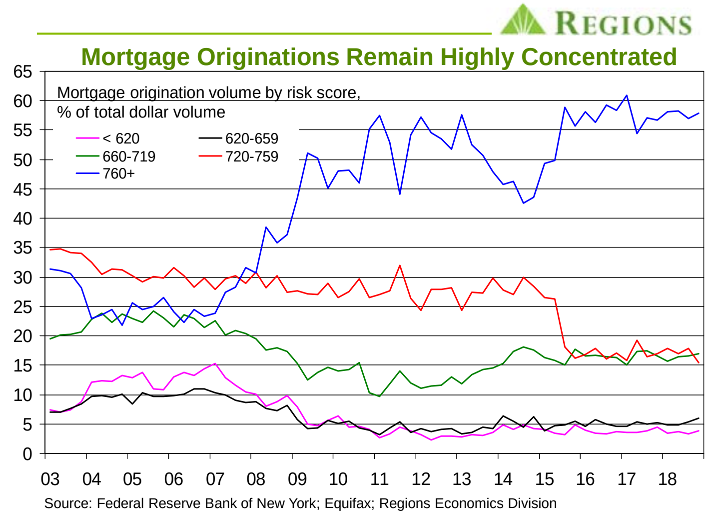
A common, not to mention glaring, omission from accounts focusing on the absolute level of debt is any discussion of the ability of households to service their debt. The second chart above shows monthly household debt service burdens, or, monthly principal and interest payments as a share of disposable personal income (note – the Federal Reserve's calculation is based on disposable personal income including transfers, were ex-transfers disposable personal income used as the base, the level of the ratio would be higher but the patterns would be the same). As seen in the chart, debt service burdens are the lowest they've been in the life of this series (which only goes back to 1980). To be sure, just as there are issues around the distribution of household debt and disposable personal income that bias the debt-to-income ratio either higher or lower for any given individual, so too is the case with monthly debt service burdens. The reality, however, is that the aggregate measures are what we have to work with, and there is some signaling value in these aggregate measures, such as the debt service burden climbing rapidly in the years leading up to the 2007-09 recession.

While a prolonged period of abnormally low interest rates has contributed to the debt service burden being at an all-time low, it does not necessarily follow that higher interest rates will lead to significant increases in monthly debt service burdens. What is a preponderance of fixed-rate debt on household balance sheets will mitigate the effects of rising interest rates on monthly debt service burdens, so 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. It is the case, however, that higher interest rates figure, at least at some point, to curb growth in demand for new debt on the part of households which, rather than deterioration in the performance of outstanding loans, may be the biggest impact of higher interest rates over the remaining life of the current expansion. It is also worth noting that expectations of how much higher interest rates will go over coming quarters have been scaled back considerably of late, meaning that payment resets on what variable rate debt there is won't be as sizeable as seemed likely only a couple of months ago.

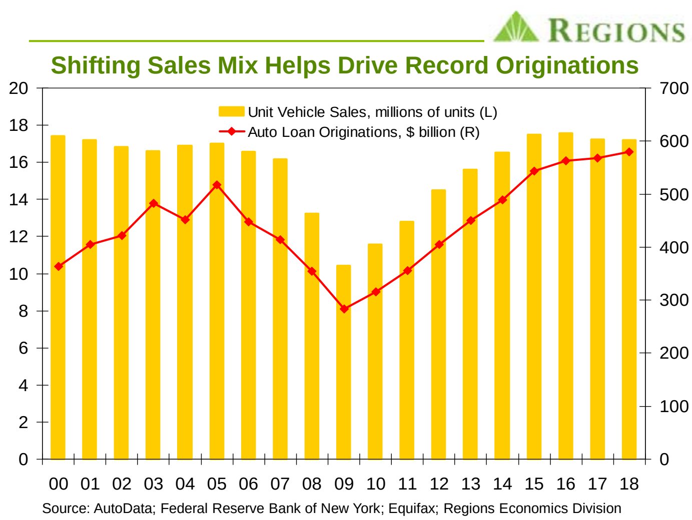
Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com

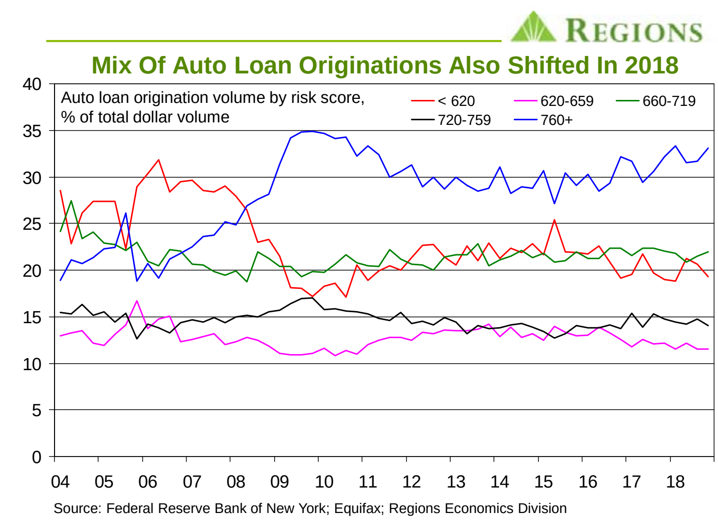
Total mortgage originations declined in 2018, the second consecutive annual decline. Refinancing activity sagged as mortgage interest rates rose, and the combination of higher mortgage interest rates and a prolonged spell of robust house price appreciation resulted in diminished affordability that curbed demand for home purchases. Both of these effects were especially pronounced in Q4 2018. For 2018 as a whole, the $1.712 trillion of mortgage originations reflects a 7.13 percent decline from 2017, but the Q4/Q4 decline was more pronounced, with originations down 11.08 percent.





As has been the case in the post-recession years, mortgage originations remained highly concentrated in 2018, as seen in the second chart above. In terms of the dollar volume of originations, borrowers with credit scores of 760 or higher accounted for 57.78 percent of total mortgage originations in 2018 – the last year in which this share was below 50 percent was 2010. At the other end of the spectrum, borrowers with credit scores below 620 accounted for 3.55 of total mortgage originations in 2018. This is in line with the share seen in the post-recession years, but is in sharp contrast to the average share of 12.68 percent of originations from 2004 through 2007.

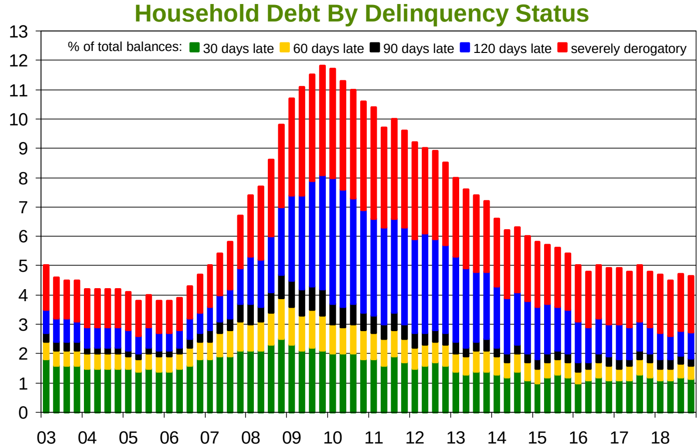




While mortgage originations fell in 2018, auto loan originations hit the highest level in the life of the New York Fed data (again, based on the dollar volume of originations). The $584 billion in auto loan originations in 2018 reflects a 2.18 percent increase over 2017, and one thing that stands out is that the volume of auto loan originations has kept increasing even as unit motor vehicle sales declined in both 2017 and 2018. A key point to consider here is that while unit sales have fallen modestly, there has been a pronounced shift in the mix of sales away from lower priced automobiles to higher priced SUVs/light trucks, such that on a dollar volume basis, motor vehicle sales have continued to rise. This is what is reflected in auto loan originations. It is likely, however, that the dollar volume of auto loan originations will slip in 2019, at least based on our expectation of a more pronounced decline in unit motor vehicle sales combined with what should, at least at some point, be a stabilization in the mix of sales between autos and SUVs/light trucks.

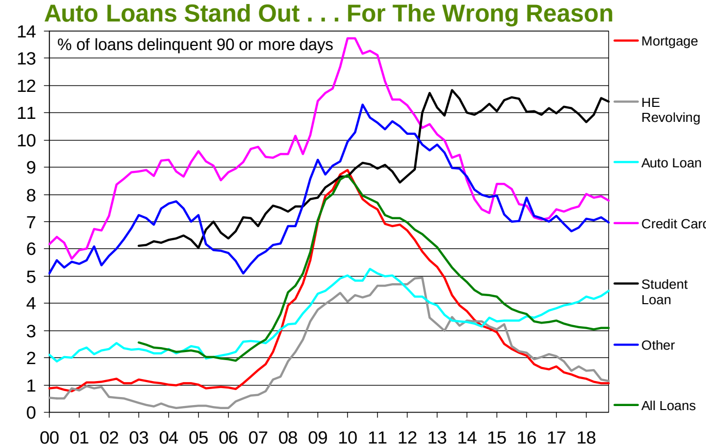
It is of note that auto loan originations did become a bit more concentrated amongst borrowers with a credit score of 760 or higher in 2018, with this group accounting for 32.34 percent of the total dollar volume of originations, up from 30.93 percent in 2018. This increase, however, did not come at the expense of those with credit scores below 620, who accounted for 20.07 percent of the dollar volume of auto loan originations in 2018, matching the 2017 share of this group. There were declines in the share of originations accounted for by those with credit scores between 620 and 659 (from 12.16 percent in 2017 to 11.70 percent in 2018) and those with credit scores between 660 and 719 (from 22.09 percent in 2017 to 21.53 percent in 2018). With a marked deterioration in auto loan performance amongst subprime borrowers in 2018, it will be interesting to see whether, or to what extent, the mix of loan originations across credit buckets changes in 2019.

Household Debt By Delinquency Status



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

Auto Loans Stand Out . . . For The Wrong Reason

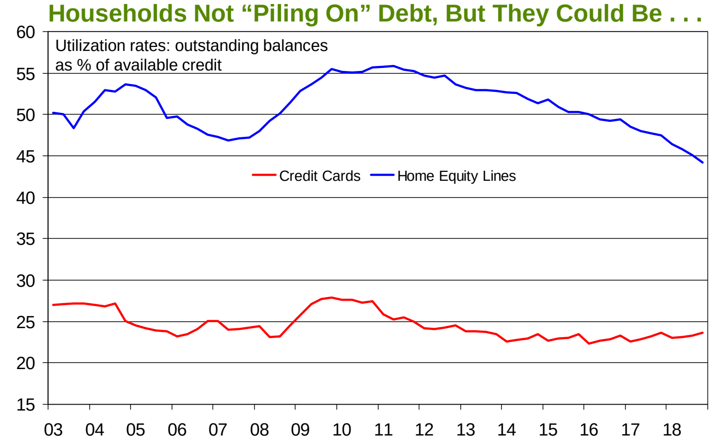


Source: Federal Reserve Bank of New York; Equifax; Regions Economics Division

On the whole, loan performance remained stable in Q4 2018; on a dollar volume basis, 4.65 percent of all outstanding household debt was in some stage of delinquency, little changed from the 4.72 percent share in Q3 2017 and the 4.71 percent share in Q4 2017. Across loan types, mortgage loans remain the best performing loan type which, in the context of the distribution of loan originations across credit score buckets, is not at all surprising. In terms of "serious" delinquencies, i.e., loans delinquent at least 90 days, as of Q4 11.42 percent of outstanding student loan balances fell into this category, but as seen in the above chart this share has been fairly stable over the past few years. In contrast, the past two years have seen a steady increase in the percentage of outstanding auto loan balances in the seriously delinquent category, which stood at 4.47 percent as of Q4 2018. Again, this largely reflects a marked deterioration in loan performance amongst subprime borrowers, but this is nonetheless striking given steadily improving labor market conditions and what has been a steady, even if frustratingly slow, acceleration in wage growth across jobs of all skill levels. As a side note, the New York Fed reports that much of the deterioration in loan performance amongst subprime borrowers comes in loans originated by finance companies and other nonbank lenders.

As a final point, the chart to the side shows utilization rates on credit cards and revolving home equity lines, the behavior of which contradicts those bleating on about households "piling on" debt. Utilization rates, or, outstanding balances as a percentage of available limits, on home equity lines continue to fall and utilization rates on credit card lines are little changed. There are clear seasonal patterns in credit card utilization rates, with the peak in any given year coming in Q4, but note the utilization rate in Q4 2018 was slightly below that of Q4 2017. Year-on-year growth in credit card balances has been steadily slowing over the past several quarters while home equity line balances have been trending lower for years. With credit card/home equity limits steadily increasing, patterns in utilization rates go to our earlier point about consumers being more disciplined in the current cycle than has been the case in the past.

Households Not "Piling On" Debt, But They Could Be . . .



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 "record high" household debt is not one of them. 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.

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