ECONOMIC UPDATE
REGIONS
May 20, 2019

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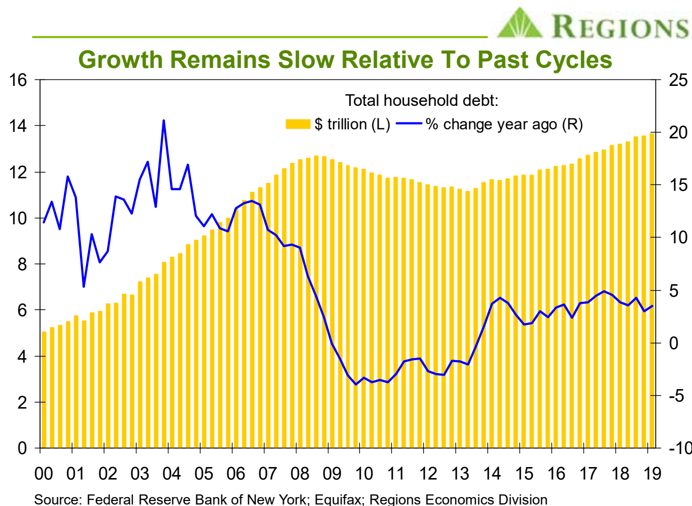
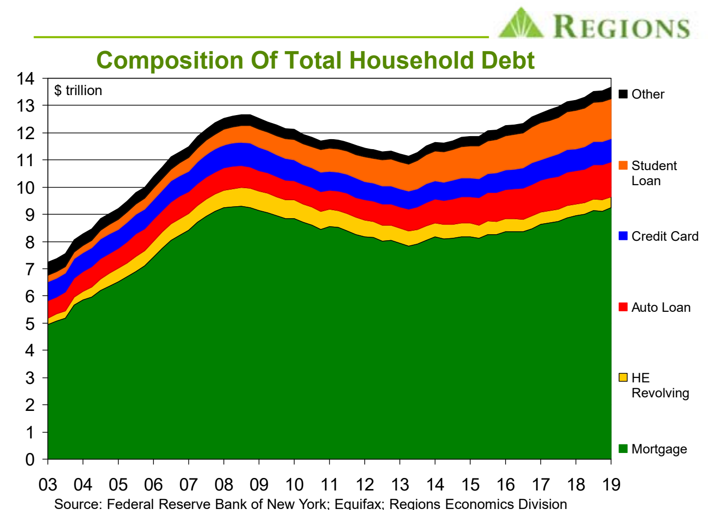
Q1 2019 Household Debt and Credit: Household Balance Sheets Are Notably Strong

- Total household debt rose to $13.668 trillion in Q1 2019, an increase of $124 billion from Q4 2018
- Mortgage balances rose by $120 billion in Q1, accounting for almost all of the increase in total debt outstanding
- As of Q1, 4.56 percent of outstanding household debt was in some stage of delinquency, down from 4.65 percent in Q4 2018

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 $13.668 trillion in Q1 2019, a $124 billion increase from Q4 2018, marking the 19th consecutive quarterly increase in outstanding household debt. After having fallen in Q4 2018, outstanding mortgage balances rose by $120 billion in Q1 2019, with student loan balances up by $29 billion and auto loan balances up $6 billion while outstanding balances on credit cards, home equity lines, and other forms of household debt fell. While Q1 saw (yet) another record-high level of total household debt, the novelty seems to have worn off, at least judging by the lack of screaming headlines about another record-high level of household debt. What all along has been the more relevant story is that the aggregate household debt-to-income ratio continues to fall, household debt service burdens remain near historical lows, and delinquencies on household debt remain notably low. The bottom line is that, while by no means pristine, household balance sheets are in better condition than has been the case for quite some time.



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



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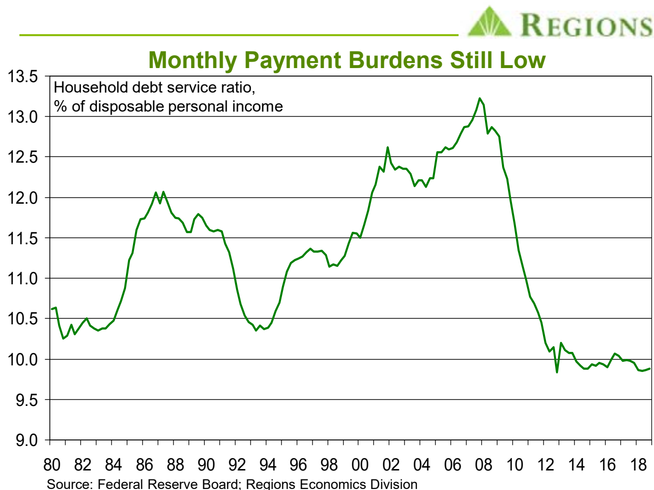
Total household debt was up 3.46 percent year-on-year in Q1, and growth in total household debt over the course of this cycle has been significantly slower than that seen in prior cycles. While this is hinted at in the first chart above, the New York Fed data series has a somewhat limited life, but the *Flow of Funds* data published by the Federal Reserve Board date back to the 1950s and affirm how relatively slow growth in household debt has been during the current cycle. 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, soon to become the longest expansion on record. 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. It is worth noting that while growth in mortgage debt has picked up a bit over recent quarters, growth in student loan and credit card debt has decelerated. Outstanding balances on home equity lines of credit continue to decline; only twice in the past forty quarters has there been a quarter-to-quarter increase in outstanding home equity line balances (the most recent being Q4 2016), and home equity line balances were down 6.88 percent year-on-year in Q1.

As of Q1, mortgage debt accounted for 67.63 percent of total household debt, with student loan debt accounting for 10.87 percent, auto loan debt accounting for 9.36 percent, credit card debt accounting for 6.20 percent, revolving home equity lines accounting for 2.97 percent, and the ever popular "all other" category accounting for 2.96 percent. Before going further, it is worth noting that the New York Fed survey is based on a relatively small sample of Equifax credit files. As such, the broader trends in the New York Fed data are of more value than the specific numbers reported in any given quarter, in terms of metrics such as delinquency rates and changes in balances. The broader trends are in keeping with what an examination of the entire universe of Equifax credit files would show.

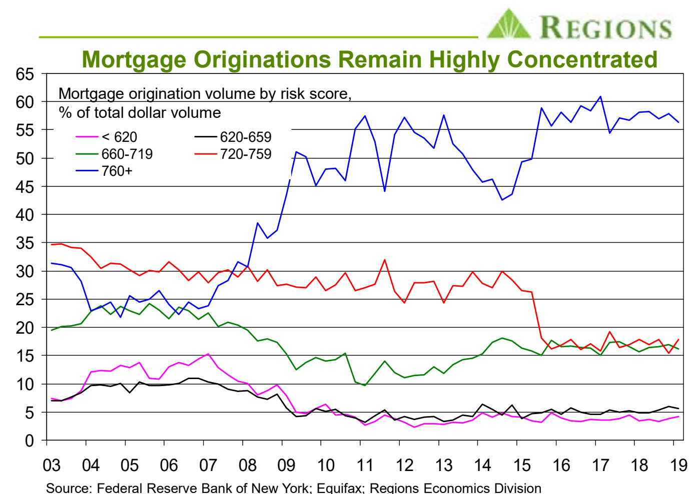
Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com



At $13.668 trillion, the level of outstanding household debt stands 7.83 percent above the prior cyclical peak of $12.675 trillion seen in Q3 2008. As we have pointed out on a number of occasions, while each passing quarter brings with it a new "record high" level of total household debt, that has no meaning without being put into proper context, though you'd never know that based on much of the analysis of and reporting on the New York Fed's quarterly reports. The most meaningful context we can think of is the ability of households to service their outstanding debt. We view disposable (or, after-tax) personal income excluding transfer payments as the most relevant measure of the pool of income available to households to meet debt service obligations. As of Q1 2019, the level of disposable personal income excluding transfer payments stood 41.79 percent above its prior cyclical peak while, again, the level of total household debt stood 7.83 percent above its prior cyclical peak. This is another way of saying that the household debt-to-income ratio has fallen sharply over the course of this expansion.

Of even more significance is that household debt service burdens, or, monthly principal and interest payments as a share of disposable personal income, remain stable and have settled around the lowest shares in the four-decade history of this series (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). 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 also worth noting that expectations of how much higher interest rates will go over coming quarters have been scaled back considerably in recent months, which would mean that payment resets on what variable rate debt there is won't be as sizeable as had previously seemed likely.

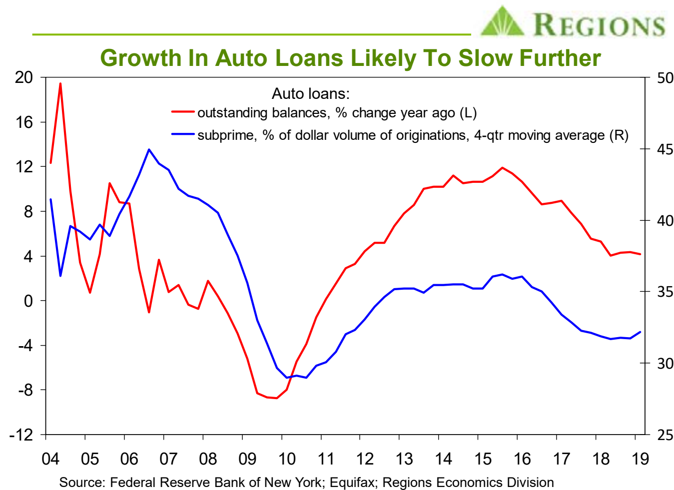
As noted above, growth in outstanding mortgage debt has picked up a bit over the past several quarters. That said, growth remains well below rates seen over past cycles, and we do not look for this to change over the remainder of the current expansion. At the same time, mortgage loan performance remains notably strong, with the New York Fed data affirming the patterns seen in the Mortgage Bankers Association's (MBA) quarterly reports on mortgage delinquencies and foreclosures. The MBA data show early-stage mortgage delinquency rates have fallen below longer-term historical norms, and there has been follow through in the form of declining late-stage delinquency rates and foreclosure starts. The New York Fed data show the percentage of outstanding mortgage loan balances delinquent for 90-or-more days fell to 1.00 percent in Q1, the lowest rate since Q2 2006. To some degree, steadily improving mortgage loan performance is a reflection of ongoing improvement in labor market conditions and steadily rising house prices over the course of the current expansion. What cannot be discounted, however, is the degree to which much more stringent mortgage underwriting standards in the post-recession years have contributed to notably strong mortgage loan performance.



This is illustrated in the chart to the side showing the distribution of mortgage loan originations by credit score buckets. After accounting for 57.78 percent of the dollar volume of total mortgage originations in 2018, borrowers with credit scores of 760 or higher accounted for 56.30 percent of originations in Q1 2019. At the other end of the spectrum, borrowers with credit scores below 620 accounted for 3.55 of total mortgage originations in 2018, with this share rising to 4.16 percent in Q1 2019. Note that borrowers in this group accounted for an average share of 12.68 percent of mortgage loan originations from 2004 through 2007. What will be interesting to watch over coming quarters is whether, or to what extent, the efforts of homebuilders to broaden the base of new home sales by targeting lower price points will be impeded by financing constraints, particularly to the extent younger, first-time buyers would make up the bulk of prospective buyers. While the origination data reported by the New York Fed may seem to suggest this could be an issue, the Federal

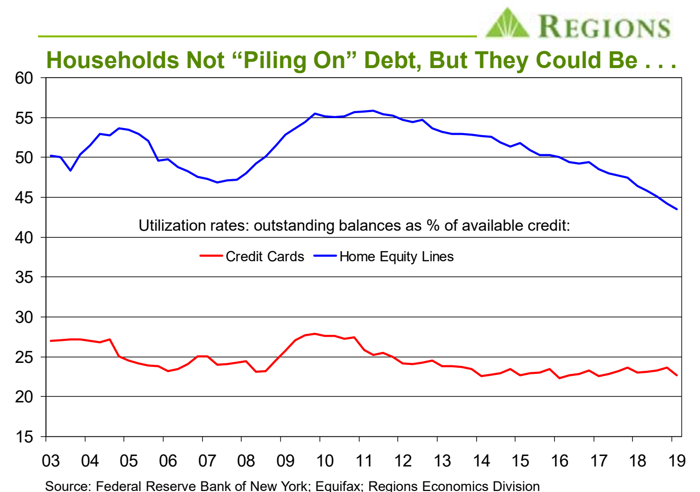
Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com

Reserve's quarterly surveys of commercial bank senior loan officers show mortgage lending standards have been relaxed over the past several quarters, but demand for mortgage loans has been somewhat tepid. This could simply reflect data on new and existing home sales showing many prospective first-time buyers have been priced out of the market and, as such, not even applying for mortgage loans. By the same token, however, these prospective buyers could be quite receptive to greater inventory in their price points, with nonbank lenders very likely filling any financing void left by commercial banks being unwilling to ease lending standards any further.



Growth in auto loan balances continues to slow, with the 0.47 percent increase between Q4 2018 and Q1 2019 the smallest quarterly increase since Q1 2012. On an over-the-year basis, auto loan balances were up 4.15 percent in Q1 2019 and, as seen in the chart to the side, growth has steadily decelerated over the past three years. That is not, however, an unexpected development, as the pace of motor vehicle sales peaked in 2016 and has slowed gradually since then. We look for unit motor vehicle sales to continue to drift lower over coming quarters, which will be reflected in further deceleration in growth of outstanding auto loan balances. It is also worth noting that the share of originations accounted for by subprime borrowers (credit scores below 660) has fallen since 2016 (we show a four-quarter moving average in the chart to the side to smooth out the volatility in this series). Lenders were fairly quick to respond to the deterioration in auto loan performance in 2016, and while the incidence of late-stage delinquency on auto loans has risen over recent quarters, new inflows into delinquency have slowed, suggesting a limit as to how much higher late-stage delinquency rates will rise. With commercial banks having raised auto loan lending standards over the past several quarters and the pace of unit motor vehicle sales likely to slow further, it seems very likely that growth in auto loan balances will slow further over coming quarters. One thing to consider, however, is that growth in outstanding balances will likely prove more resilient than growth in the number of auto loans, which simply reflects the marked shift in the mix of sales between lower priced automobiles and higher priced SUVs/light trucks, the latter carrying significantly higher sticker prices than the former.

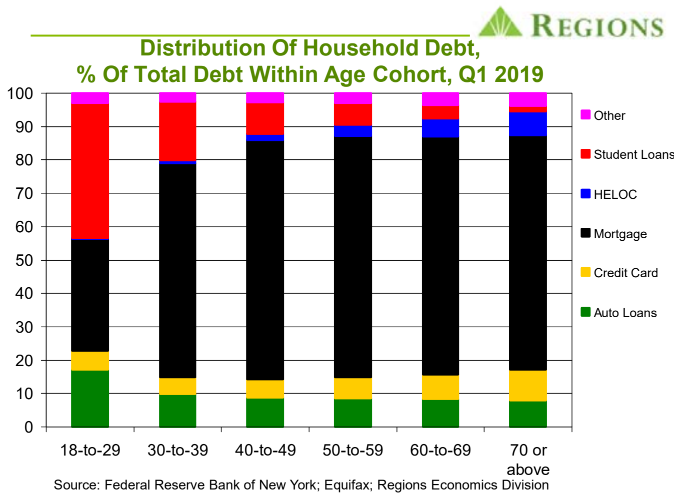
Outstanding credit card balances fell by $22 billion in Q1 2019 and were up 4.05 percent year-on-year, the smallest such increase since Q2 2016. It is interesting to note that the decline in outstanding balances comes despite further growth in the number of outstanding cards. Indeed, the outstanding balance per card open credit card stood at roughly $2,072 as of Q1, which is 21.71 percent below the peak per-card balance seen in Q3 2010. Utilization rates on outstanding credit card lines continue to drift lower, which in part could reflect households being less reliant on utilizing credit cards to pay other bills. Credit card delinquencies have risen over recent quarters, though it appears that the subprime segment is mainly behind this increase. Another more recent development is that delinquencies on cards issued by retailers have risen, which could reflect holders of cards issued by retailers who have gone bankrupt not realizing they are still obligated to make payments on these accounts (they kind of are). Commercial banks were fairly quick to begin raising lending standards on credit card loans as the deterioration in loan performance became apparent. It is also worth noting that the Federal Reserve's quarterly survey of commercial bank loan officers shows demand for credit card loans having weakened considerably over the past two quarters.

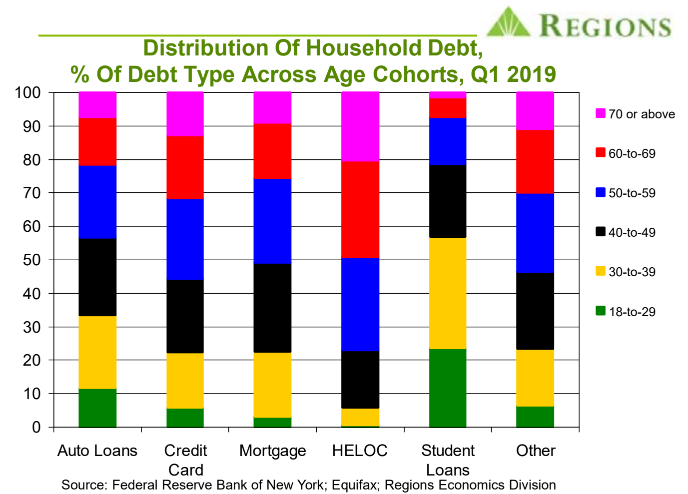


Though having slowed modestly over recent quarters, growth in student loan debt continues to outpace growth on other types of household debt. Total student loan debt increased by 1.99 percent in Q1 2019, leaving it up 5.61 percent year-on-year. Early-stage delinquency rates on student loans have fallen over the past several quarters but remain materially higher than rates on other forms of debt. As the New York Fed notes, however, delinquency rates are based on the entire universe of student loan debt, but given that a significant portion of student loan debt is in deferral, the calculated delinquency rate understates the actual delinquency rate on student loan debt. It should come as no surprise that amongst younger borrowers, student loan debt accounts for the largest share of total debt; student loan debt accounted for 40.37 percent of total debt for borrowers in the 18-to-29 year-old age cohort as of Q1. For borrowers in this age cohort, auto loan debt accounted for 17.26 percent of total debt and credit card debt accounted for 5.68 percent of total debt. For those in the 30-to-39 year-old age cohort, student loan debt accounted for 17.69 percent of total outstanding debt, topping the combined share of auto loan debt (9.93 percent) and credit card debt (5.00 percent). Especially when considering the share

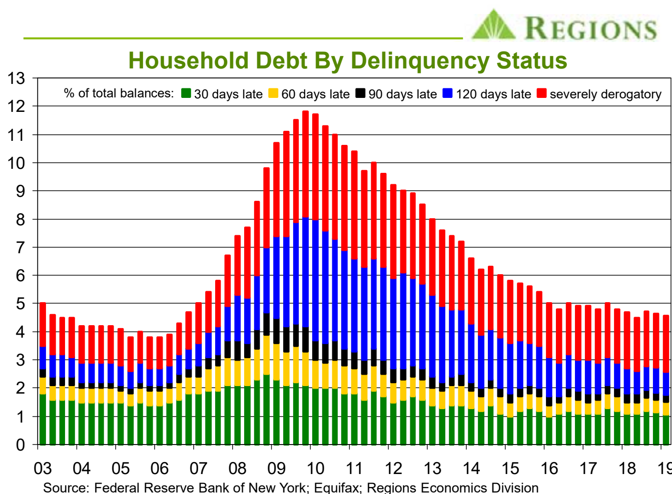
Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com

of student loan debt currently in deferral, repayment of student loan debt is likely to weigh on younger households for some time to come and can obviously impact when, if not whether, some of these households take on mortgage debt.





This point can be seen in the second chart above, which shows the distribution of the various forms of household debt by age cohorts. While student loan accounts for the largest share of total debt amongst those in the 18-to-29 year-old age cohort, those in the 30-to-30 year-old age cohort account for 33.43 percent of all student loan debt, easily the largest share of any age cohort, while another 21.62 percent of all student loan debt is accounted for by those in the 40-to-49 year-old age cohort. The 18-to-20 year-old cohort accounts for 23.56 percent of all student loan debt. Those in the 40-to-49 year-old age cohort accounted for 25.09 percent of total household debt in Q1, the highest of any age cohort, while those in the 50-to-59 year-old age cohort accounted for 23.64 percent; those in the 18-to-29 year-old age cohort accounted for 6.33 percent of total household debt in Q1, while those aged 70 and above accounted for 8.60 percent, easily the two smallest shares across age cohorts.



Loan performance improved modestly in Q1, with 4.56 percent of all outstanding debt in some stage of delinquency, compared to 4.65 percent as of Q4 2018. In terms of dollar volume, there was $623 billion of delinquent household debt as of Q1, which is lower than the totals in the prior two quarters but is up 3.01 percent from Q1 2018. At 1.07 percent as of Q1, the 30-day delinquency rate is well below longer-term norms, and this suggest that inflows into later-stage delinquencies will slow over coming quarters. It is hard to look at overall loan performance and come to any other conclusion that household credit conditions are in better shape than has been the case in many, many years.

It is, however, less difficult to sift through the loan performance data and craft a story around a data point that implies a more significant issue than is actually the case. The latest example is the inflow into serious delinquency (i.e., delinquent at least 90 days) of credit card debt amongst the 18-to-29 year-old age cohort. About 8.1 percent of credit card debt balances held by those in this age cohort were seriously delinquent, easily higher than the rate in any other age cohort and up 37 basis points from the rate in Q4 2018 (this is a large jump for a single quarter, and raises the question of whether the limited sample size of the New York Fed survey plays a role here). This has spawned a wave of stories about what dire financial straits those in this age cohort are. To be sure, serious delinquency rates on credit card debt amongst all age cohorts have risen over recent quarters. At the same time, however, these rates are below the rates that prevailed during the last expansion and, as has been noted above, inflows into early-stage delinquencies have slowed, which tells us so too will inflows into serious delinquency over coming quarters. It seems to us that this was a headline in search of a story, particularly given that the 13,980 people in this age cohort who filed for bankruptcy in Q1 2019 is the smallest number of any quarter in the life of this data set, which goes back to Q1 2000. This follows the recent commotion over there being more than seven million borrowers more than 90 days delinquent on auto loan payments, which was not actually the case despite the degree of attention this topic garnered. In any event, there are elements of the data on household debt that merit attention. One area that we don't have great data on is the distribution of debt across lower-to-middle income households, who are more than likely having harder times meeting debt service obligations than implied by the aggregate data. That said, the broader point is that household balance sheets are strong, and when this cycle does come to an end, it is highly unlikely that credit conditions in the household sector will be the trigger.

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