ECONOMIC UPDATE

REGIONS

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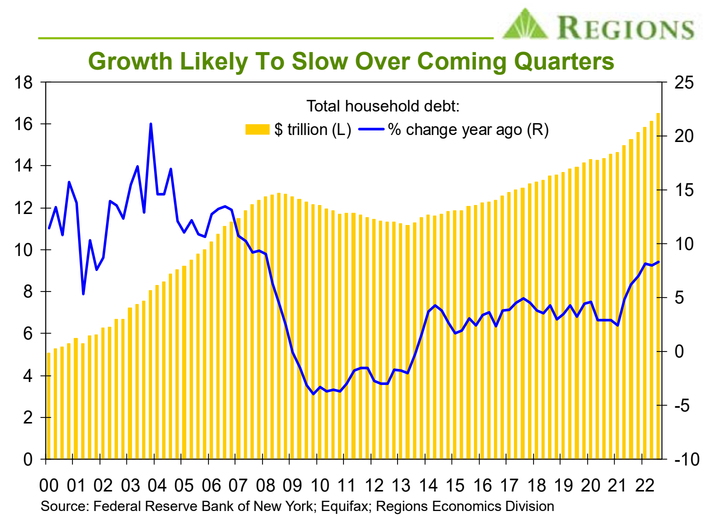
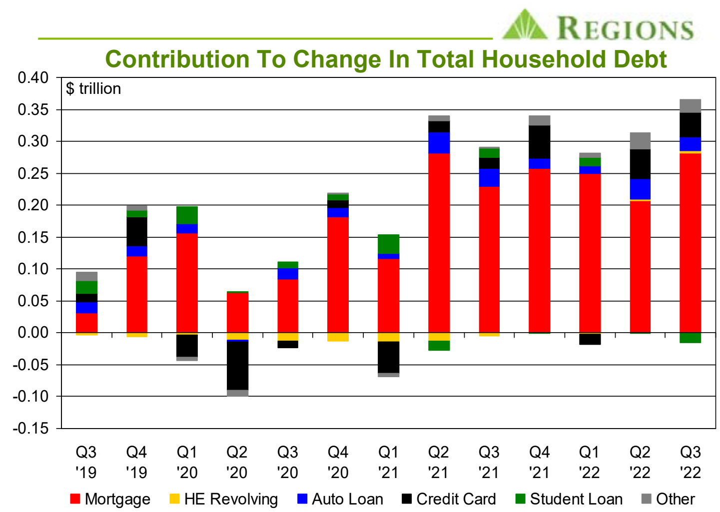
Q3 2022 Household Debt and Credit: Another Quarter Of Rapid Growth In Credit Card Debt

- Total household debt rose to $16.505 trillion in Q3 2022, an increase of $351 billion from Q2 2022
- Mortgage balances rose by $282 billion in Q3, credit card debt increased by $38 billion
- As of Q3, 2.69 percent of outstanding household debt was in some stage of delinquency, unchanged from Q2

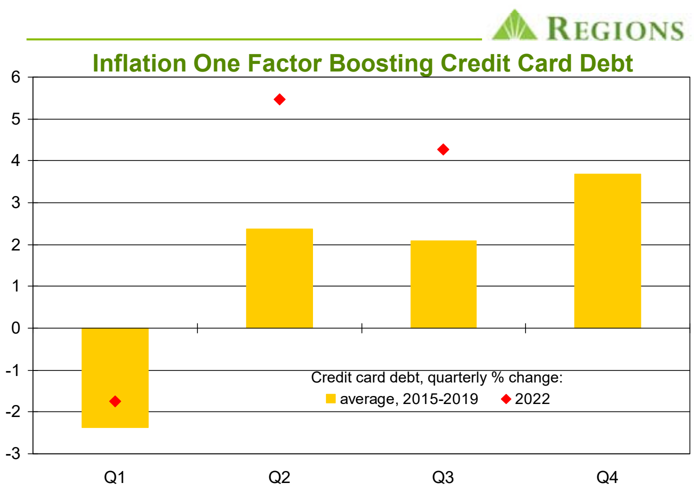
The Federal Reserve Bank of New York (New York Fed), in conjunction with Equifax, has released their latest quarterly report on trends in household debt, which shows total household debt rose to $16.505 trillion in Q3 2022, an increase of $351 billion from Q2. Mortgage debt increased by $282 billion which, somewhat surprisingly, is larger than the increase in Q2, while credit card debt rose by $38 billion after having advanced by $46 billion in Q2. Normal seasonal patterns tend to yield declines in outstanding credit card debt in the first quarter, a sizable increase in the second quarter, and a smaller increase in the third quarter of any given year, so the patterns seen over the first three quarters of 2022 are in a sense consistent with typical seasonal patterns. That said, the magnitude of the increases in credit card debt over the past two quarters commands notice. On a percentage change basis, the quarterly increases in credit card debt have been larger than the increases in mortgage debt in each of the past two quarters, while the 15.1 percent year-on-year increase in credit card debt in Q3 is the largest such increase since Q3 2001. The tendency seems to be to attribute this growth to consumers struggling in the face of elevated inflation and rising interest rates having no choice but to turn to their credit cards to facilitate spending on basic necessities. While that is no doubt true to some extent, there are other possible explanations that don't paint as dour a picture of the financial health of U.S. consumers.



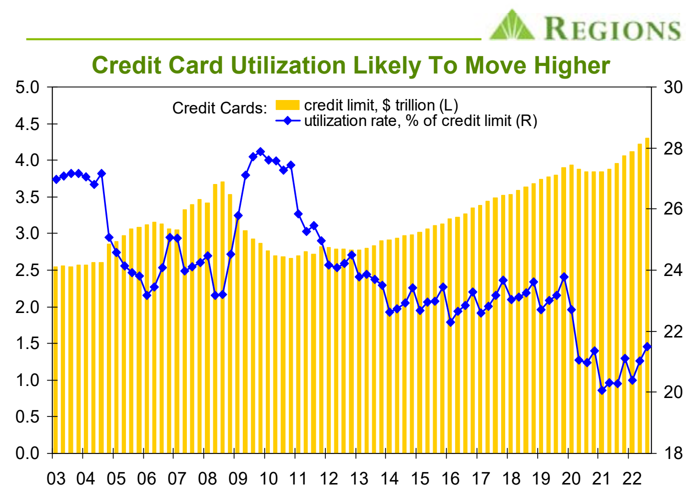


Total household debt was up 8.3 percent year-on-year in Q3, marking the third consecutive quarter in which total debt outstanding was up by 8.0 percent or better year-on-year, the first such instance of this since Q3 2007-Q2 2008. Sequential growth in mortgage debt outstanding picked up pace in Q3, yielding a year-on-year increase of 9.3 percent following a 9.0 percent increase in Q2. If the rapid growth in mortgage debt despite a sharp decline in home sales seems surprising, keep in mind that Q3 saw double-digit over-the-year increases in house prices, both new and existing, which helped prop up the dollar volume of mortgage loans even though unit sales fell. With further declines in home sales and house prices declining on a month-to-month basis, growth in outstanding mortgage debt will likely slow considerably in Q4. To that point, the average loan size on a purchase mortgage loan applications made in October was $399,875, down twelve percent from the peak of $454,275 reached in March. It is worth noting that the run of fifty consecutive quarters of year-on-year declines in outstanding home equity line balances outstanding home equity lines came to an end in Q3, with balances rising 1.6 percent compared to Q3 2021. Outstanding auto loan debt was up 5.6 percent year-on-year in Q3, with much of this growth reflecting higher vehicle prices with little change in unit sales on either a quarter/quarter or year/year basis. To that point, when adjusting for increases in vehicle prices, "real" auto loan debt outstanding declined in Q3 2022 and has declined on an over-the-year basis in each of the last eight quarters.

While we devoted much of our write-up of the Q2 data on household debt to the rapid growth in credit card debt, that is again the biggest story in the Q3 data. Recall that in the first few quarters after the onset of the pandemic, outstanding credit card debt actually declined, and it was not until Q3 that the level of credit card debt returned to its pre-pandemic peak. As noted above, many have interpreted the rapid year-on-year growth in credit card debt as a sign of growing financial distress in the household sector, with consumers having to resort to credit card debt to contend with the effects of a prolonged period of significantly elevated inflation. One could point to quarterly growth patterns over the first three quarters of 2022 to support this contention. Again, there are clear seasonal patterns in credit card debt (note that the data on household debt are not seasonally adjusted, so it is fitting to comparing the same quarters over different years), with balances falling in the first quarter of any given year then rising in each of the next three quarters, with the Q2 increase generally larger than the Q3 increase and the Q4 increase larger than those in Q2 and Q3. The first chart below shows the average quarterly percentage change in outstanding credit card debt for the five years prior to the pandemic and overlays the quarterly changes in the first three quarters of 2022. Note that we exclude 2020 and 2021 from our calculation of the longer-term average changes as typical seasonal patterns were significantly disrupted by the pandemic and the policy response to it, not only for credit card debt but for overall economic activity. As can be seen in the chart, the decline in outstanding credit card debt in Q1 was smaller than the longer-term average while the increases in Q2 and Q3 were meaningfully larger than the longer-term average for each quarter. Some have pointed to this as evidence of how higher prices have fueled the growth in credit card debt.



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



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

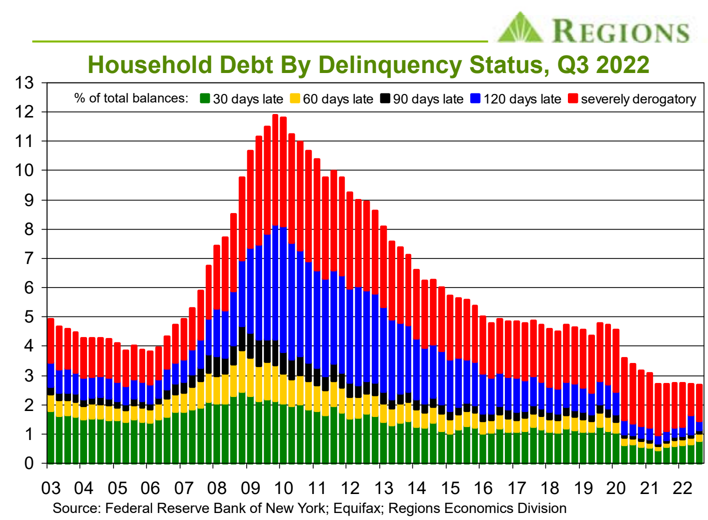
While not totally discounting the effects of higher inflation on growth in outstanding credit card debt, we do think there are a few points worthy of mention to put this growth in proper context. First, we always look at credit card utilization rates (outstanding balances as a percentage of available lines) to help give context to the growth of outstanding balances. As the second chart above shows, while credit card utilization is off the lows seen over the past two years, it nonetheless remains well below where it was prior to the pandemic. We'd argue that were there growing financial distress in the household sector, increases in utilization rates would be much more pronounced than those we've seen to date in 2022. To be sure, the data reflected in the above chart are aggregates, and it could be that some borrowers are closer to tapping out available credit card lines than is reflected in this chart, but were that the case to a significant degree we'd still expect the overall utilization rate to be higher.

It could be that recent shifts in consumer spending patterns have helped push outstanding credit card balances higher over the past few quarters. In 2020 and much of 2021, households were flush with cash, much of it stemming from generous financial transfers to the household sector after the onset of the pandemic, while much of the services sector was either shut down or operating at limited capacity. As such, consumer spending on goods shot higher but cash-heavy consumers did not need to resort to credit to facilitate this spending to the extent they otherwise would have. Over the past several months, however, consumer spending has shifted away from goods and toward services, such as travel, tourism, entertainment, recreation, and dining out. These types of expenditures are more likely to be funded by credit than by cash, meaning rising credit card debt could, at least to some degree, reflect the underlying shifts in consumer spending patterns.

Another point to keep in mind, even if it is largely overlooked, is that rising credit card balances need not be solely a function of increased spending, as a slower pace of paydowns could also be a contributing factor. Or, put differently, changes in outstanding credit card balances reflect a combination of new spending and repayment of existing balances. It could be that households still sitting on sizable buffers of savings stemming from pandemic-related transfers and/or benefitting from meaningfully faster wage growth than had prevailed prior to the pandemic had been paying down credit card balances more aggressively through year-end 2021. To be sure, interest rates were lower in 2021 than they have been in 2022 but, as interest rates on credit card debt are generally well above other market interest rates, it still would have been in the interest of households to be more aggressive in paying down credit card balances given the extra funds at their disposal. With inflation higher in 2022 than had been the case in 2021, leading to further stress on household finances, and growing unease over the course of the economy, it could be that some households have simply become less aggressive in paying down credit card balances, even reverting to minimum monthly payments.

To be clear, we're not suggesting rapidly rising credit card debt is simply a reflection of slower repayment rates, but that slower repayment rates could be one factor contributing to growth in outstanding balances. The aggregated data simply do not allow us to segregate higher spending from slower paydowns to assess the effects on outstanding balances. Some would argue that slower rates of paydowns by households who continue to sit on elevated deposit balances are simply not rational, given the relative rates of interest on credit card debt and various types of savings accounts. While you can't argue with the math (as a general rule, one never wins an argument with the math), there are other factors that could be in play, such as the psychological benefit of maintaining these elevated deposit balances, particularly in an increasingly downbeat and uncertain economic environment with headlines of layoffs and hiring freezes becoming more and more common. Indeed, a recent analysis by the Federal Reserve shows households in all income buckets continue to sit on deposit balances that are significantly higher than was the case prior to the pandemic, and at the same time the New York Fed's analysis of the Equifax data show rising credit card balances across all income buckets. Whether any such paring makes sense to an outside observer likely isn't all that relevant to the households making those decisions.

So, while we do not doubt that persistently elevated inflation has contributed to the increases in credit card debt seen over the past two quarters, we do not believe it is the only factor, and one should not immediately conclude that these increases in credit card debt are evidence of growing financial distress amongst U.S. consumers. Also, keep in mind that long-running seasonal patterns show that the biggest quarterly increase in outstanding credit card debt in any given year comes in the fourth quarter, reflecting holiday season shopping patterns (refer back to the chart on the prior page to see this). There is no reason to think this year will be an exception to that general rule, particularly if the mix of holiday season spending is more skewed toward services spending and less skewed toward goods spending than has typically been the case during the holiday season. As such, it is reasonable to expect another sizable increase in outstanding credit card debt in Q4, though it will be some time before we have the data to show that. And, looking ahead even further, one gauge of the extent of financial distress across the household sector will be the magnitude of the decline in balances in Q1 2023, where a smaller than normal decline in outstanding credit card balances could be an indication of distress.



Thus far, there is little in the data to suggest widespread financial distress in the household sector. The overall delinquency rate on total household debt was 2.69 percent in Q3, unchanged from the Q2 rate. There were some shifts in the buckets that comprise the overall delinquency rate, which are delineated in the chart to the side. For instance, 30-day and 60-day delinquency rates rose in Q3 2022 while later-stage delinquency rates fell. The increase in early-stage delinquency rates seems to fit nicely into the narrative of growing financial distress in the household sector, save for one not so trivial detail. As we routinely note in our discussions of this data set, the data on household debt and credit are not seasonally adjusted, and there are clear seasonal pattens in the data. Those patterns are present in the data on delinquencies. For instance, in the life of the data, there is only one instance in which the 30-day delinquency rate did not rise in the third quarter of a given year, and that was Q3 2004, when the 30-day delinquency rate was unchanged from that year's second quarter. Moreover, the increase in the 30-day delinquency rate in Q3 2022 – eleven basis points – matches the average Q3 increase over the life of the data; were this year's increase meaningfully larger than the average Q3 increase, that could be taken as a sign of financial distress, but that is not the case.

This is not to imply there are no pockets of financial distress across the household sector; there are, particularly in the subprime space. Instead, the point is that while changes in headline numbers may seem to fit nicely and neatly within a seemingly obvious narrative, seemingly obvious narratives don't always match reality. To be sure, it does seem that with delinquency rates having been unusually low over the past several quarters, there's only one way for them to go from here, and that is up. To the extent that the combination of elevated inflation and higher interest rates lead to a few quarters of stagnant real GDP, as our baseline forecast anticipates, that would be accompanied by at least some deterioration in labor market conditions, which in turn would push delinquency rates higher. But, as we noted in our recent write-up of the Q3 data on mortgage delinquencies, the question is whether delinquency rates will simply fall back in line with historical averages or will push past those, even if not approaching the heights associated with the 2007-09 recession and its aftermath. We think increases in delinquency rates in this cycle will come closer to the former than to the latter.

Between at least some boost from holiday season shopping and further growth in services spending, Q4 may bring another sizable increase in credit card debt, but at the same time growth in mortgage debt is likely to slow sharply, thus weighing on the increase in total household debt. Beyond that, we expect a meaningfully slower pace of growth in consumer spending, including spending on services, in 2023, which should curtail growth in credit card debt, particularly if inflation continues to decelerate as we expect it will. As such, longer-term growth in household debt should come closer to the fairly sedate range established over the 2014-2019 period than to the faster pace seen over the most recent quarters.

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