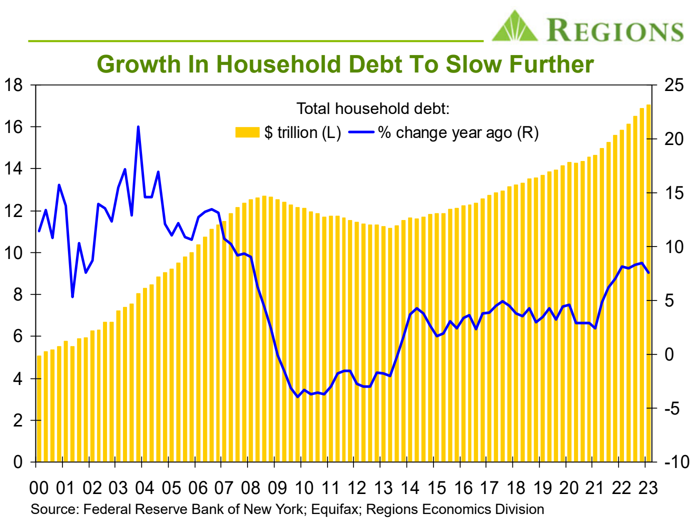
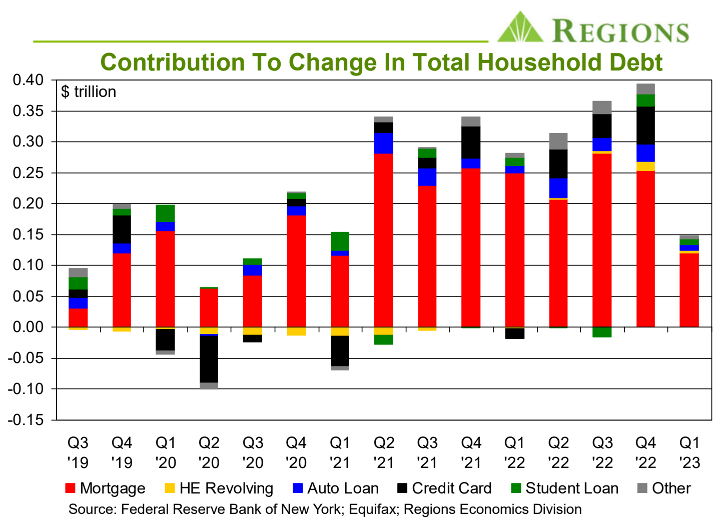
ECONOMIC UPDATE
REGIONS
May 17, 2023

Q1 2023 Household Debt and Credit: Growth In Household Debt To Slow Further

- Total household debt rose to $17.047 trillion in Q1 2023, an increase of $148 billion from Q4 2022
- Mortgage balances rose by $121 billion in Q1, credit card debt was unchanged
- As of Q1, 2.61 percent of outstanding household debt was in some stage of delinquency, up from 2.50 percent in Q4 2022

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 $17.047 trillion in Q1 2023, an increase of $148 billion from Q4 2022. Mortgage debt outstanding increased by $121 billion, driving the increase in total household debt but nonetheless the smallest quarterly increase in two years. Perhaps the bigger story is that credit card debt outstanding was unchanged in Q1 2023, noteworthy in that the first quarter of any given year typically sees a significant decline in outstanding card balances (the data are not seasonally adjusted). Recall that Q4 2022 saw the largest quarterly increase in credit card debt in the life of the data series, so that there was not the typical decline in Q1 has added to worries about the level of credit card debt and what that might say about the state of U.S. consumers. On an over-the-year basis, total household debt was up 7.6 percent in Q1, with mortgage debt outstanding up by 7.7 percent and credit card debt outstanding up 17.2 percent, the third straight quarter in which year-on-year growth topped fifteen percent. Elevated inflation has clearly driven some of the growth in household debt over recent quarters, particularly credit card debt. But, with inflation easing, even if not in a straight-line fashion, mortgage originations likely to remain weak, and growth in consumer spending clearly slowing, growth in total household debt will slow further in the quarters ahead even without allowing for further tightening of bank lending standards. The overall delinquency rate on household debt rose to 2.61 percent in Q1, leaving it far below pre-pandemic norms.





As indicated above, mortgage debt remains the biggest driver of growth in total household debt but, at $121 billion, the increase in outstanding mortgage debt in Q1 was the smallest quarterly increase in two years. There are a few factors at play here, starting with there being fewer homes sold (combined new and existing, not seasonally adjusted) in Q1 2023 than in Q4 2022 while sales prices were virtually flat between the two quarters. At the same time, higher mortgage interest rates have dampened refinancing activity. To that point, researchers at the Federal Reserve Bank of New York noted that a decline in mortgage interest rates of roughly two hundred basis points between November 2018 and November 2020 had already sparked a refinancing boom, but that boom picked up pace as mortgage rates fell even further into early-2021. They refer to the "COVID refinance boom" as running from the second quarter of 2020 through the fourth quarter of 2021, with borrowers taking advantage of historically low mortgage interest rates and rapidly rising equity positions, courtesy of robust house price appreciation, to extract equity, which would have helped push originations volume up.

Though home sales began to decline in mid-2021, that the mortgage refinancing wave persisted for several more months helped support growth in mortgage debt. That COVID refinance boom, however, came to a sudden and inglorious end as the FOMC embarked on an aggressive course of Fed funds rate hikes and market interest rates rose in concert. Coupled with what became an even more pronounced slide in home sales as mortgage rates rose, the end of the refinance boom led to a significant slowing in the pace of new mortgage originations in 2022 that continued into Q1 2023. To that point, the $323.5 billion in total mortgage originations in Q1 2023

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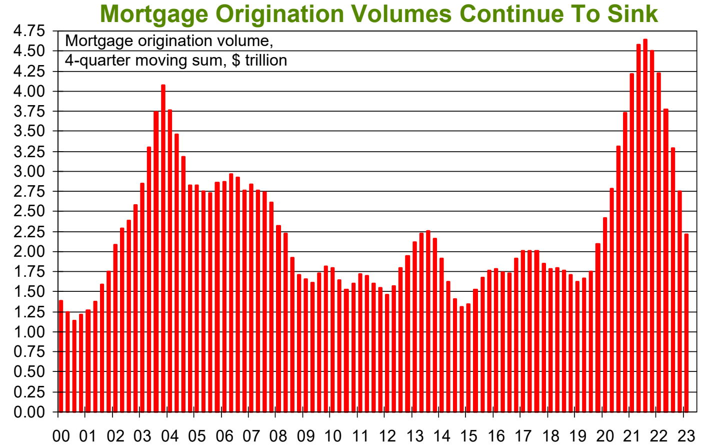
is the lowest quarterly total since Q2 2014, and the four-quarter moving sum slipped to $2.212 trillion, the lowest such total in over three years. Even if, as we expect, home sales continue to increase gradually over coming months, it will take far more significant declines in mortgage rates than those seen to date (recall mortgage interest rates peaked at over seven percent in October 2022) to spark a meaningful rebound in refinancing activity. As such, the volume of mortgage originations is not likely to pick up much over coming quarters. That core inflation is proving to be more persistent than many had anticipated means it is far too soon to conclude the FOMC is through raising the Fed funds rate, and further hikes would trigger similar moves in market interest rates, which would have implications for both purchase and refinance mortgage loan originations.

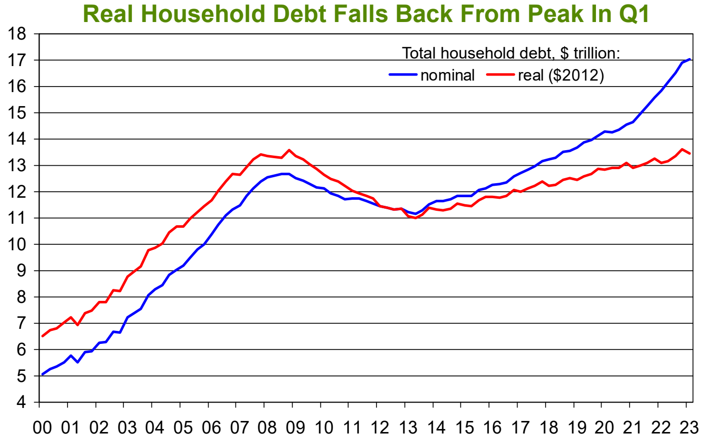
At the same time, however, house prices are proving to be more resilient than many had expected would be the case when interest rates first began rising. This is consistent with what all along had been our basic premise that, even though higher mortgage rates had taken the steam out of demand for home purchases, the housing market remained notably undersupplied, which would act as a support for prices. That does not rule out house price declines, but it does argue for smaller declines than many had been forecasting, with some forecasts calling for peak-to-trough declines of twenty to twenty-five percent. To that point, data from the Mortgage Bankers Association show an average loan size of $421,480 for purchase mortgage loan originations in Q1, the highest since Q2 2022. As long as house prices remain resilient, this will help stem the decline in mortgage origination volumes. It is interesting to note that, despite marking the sixth straight decline, the four-quarter moving sum of mortgage originations in Q1 2023, again at $2.212 trillion, was still higher than any total posted in the six years prior to the onset of the pandemic. What remains to be seen, however, is whether the slide in origination volumes has fully run its course.

Mortgage Origination Volumes Continue To Sink



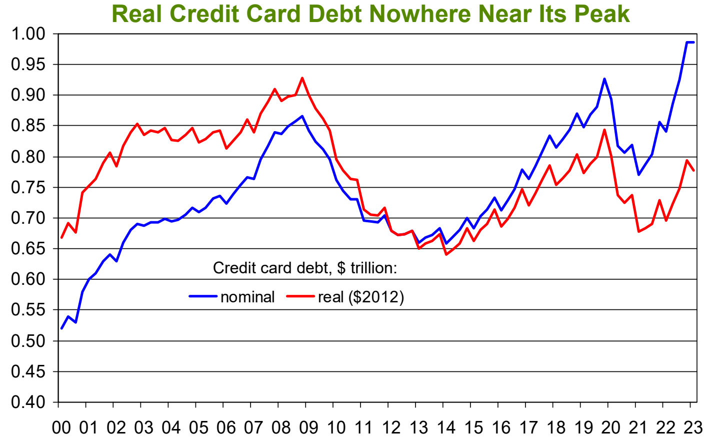
Source: Federal Reserve Bank of New York; Equifax; Regions Economics Division

Real Household Debt Falls Back From Peak In Q1



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

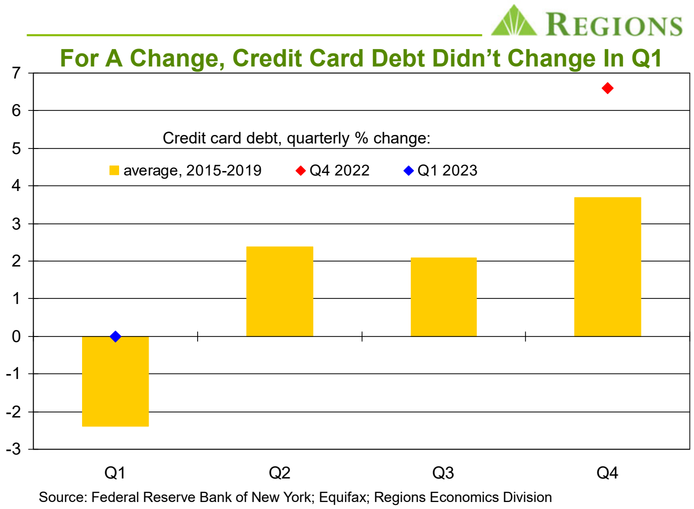
Real Credit Card Debt Nowhere Near Its Peak

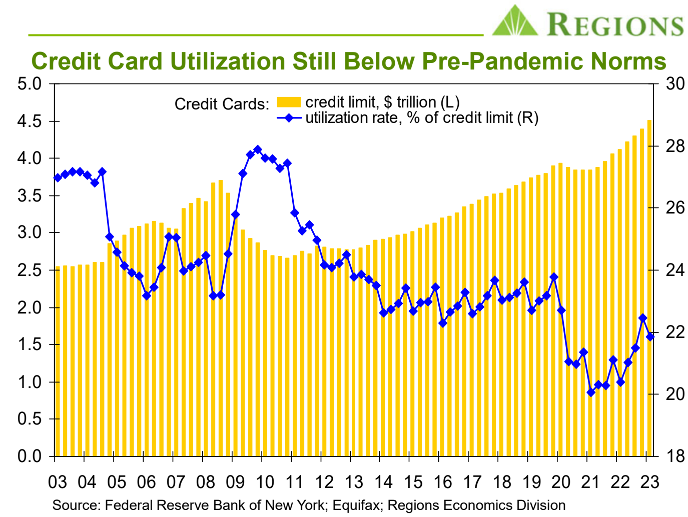


Source: Bureau of Economic Analysis; Federal Reserve Bank of New York; Equifax; Regions Economics Division

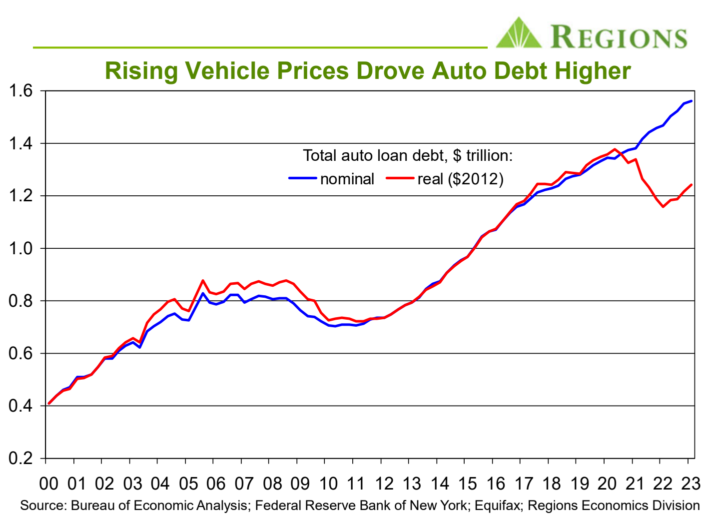
The link between changes in prices and growth in debt is of course not confined to house prices and mortgage debt, even if this point seems to often go overlooked. As we've consistently noted in these write-ups, despite each quarter bringing screaming headlines of new record levels of household debt, the reality was that real (or, inflation adjusted) household debt had still not surpassed the peak reached in Q4 2008. That peak was finally surpassed in Q4 2022, when the third largest quarterly increase in household debt in the life of the New York Fed's data offset elevated inflation and pushed real household debt to a new peak. But, with growth in household debt falling short of inflation in Q1 2023, the level of real household debt declined. We've also argued that rapid inflation was a primary factor in the rapid growth in credit card debt outstanding seen over the past several quarters, and while inflation-adjusted credit card debt had been increasing, the level was still nowhere near the peak hit in Q4 2008. With nominal credit card debt outstanding having been flat in Q1 2023, real credit card debt declined.

That higher prices have helped fuel rapid growth in credit card debt can also be seen in sizable deviations from typical seasonal patterns in credit card debt balances over recent quarters. Again, the data on household debt are not seasonally adjusted and, at least in the case of credit card debt, display clear seasonal patterns. As we noted in our review of the Q4 2022 data, while credit card debt tends to rise sharply in the fourth quarter of any given year, the increase seen in last year's fourth quarter was the largest quarterly increase on record. It is also the case that, as seen in the first chart below, credit card balances tend to decline in the first quarter of any given year. That is why this year's first quarter stands out, with credit card balances flat from the level of Q4 2022, which is even more striking given that the not seasonally adjusted data show control retail sales (total sales minus motor vehicles, gasoline, building materials, and restaurants) declined by 12.6 percent in Q1 from the level in Q4 2022. To be sure, higher services spending would have been a support for credit card balances but putting the pieces (of data) together suggests much lower repayment activity in Q1 2023 than is normally seen in the first quarter of any given year.

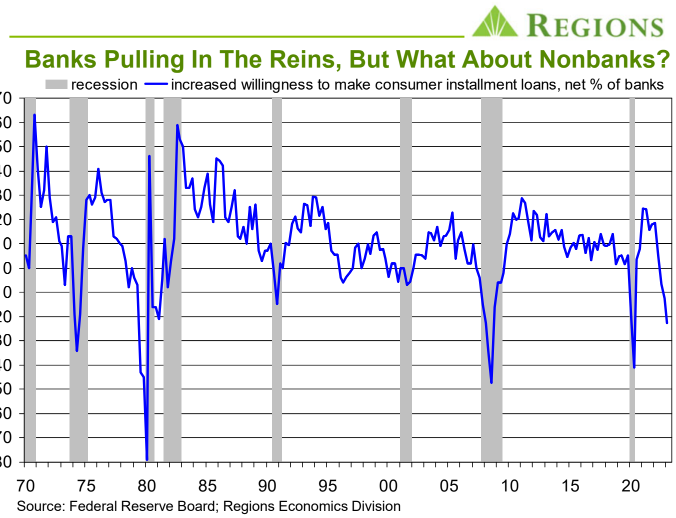


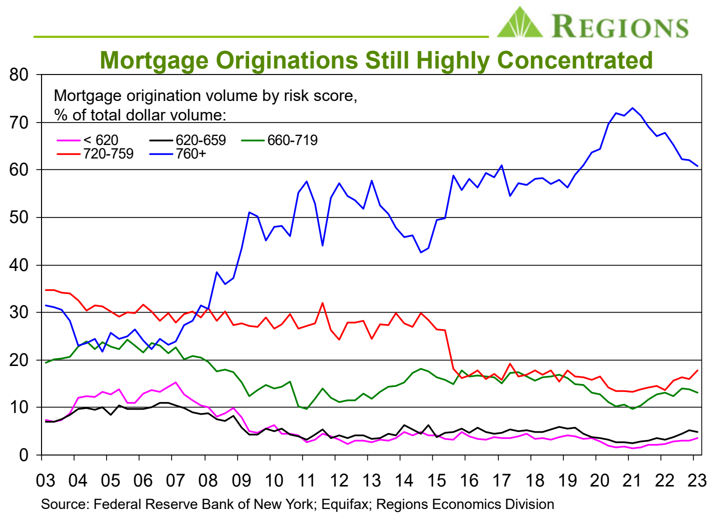


It is worth noting that, as seen in the first chart above, credit card debt typically rises significantly during the second quarter of any given year. But, with balances not having declined in Q1 this year, unlike a typical Q1, it is highly likely that Q2 2023 growth in card balances will be smaller, perhaps much smaller, than is typically the case in the second quarter of any given year. Aside from the general rule that a break in seasonal patterns in any given month/quarter tends to lead to a break in the opposite direction in the subsequent time period, it is reasonable to expect this given that consumers are scaling down spending, particularly on discretionary goods and services. While one notable exception seems to be motor vehicle purchases, that will turn up in the data on auto loan debt, but softening discretionary spending will weigh on growth in credit card debt. As would be expected given the typical decline in outstanding balances, credit card utilization rates tend to decline in the first quarter of any given year, and that was indeed the case in Q1 2023. To be sure, the decline in the (aggregate) utilization rate in Q1 2023 was much smaller than the typical Q1 decline, but that the utilization rate fell at all stands out given outstanding balances were flat. The decline in the utilization rate, therefore, was totally driven by an increase in credit card limits. Moreover, aggregate credit card limits increased by 2.7 percent in Q1 2023, which is the largest Q1 increase in the life of the data series. While this may seem at odds with banks having been raising lending standards on credit card loans since Q3 2022, keep in mind that nonbank card issuers can and often do march to a different beat. It seems that Q1 2023 was one such occasion.

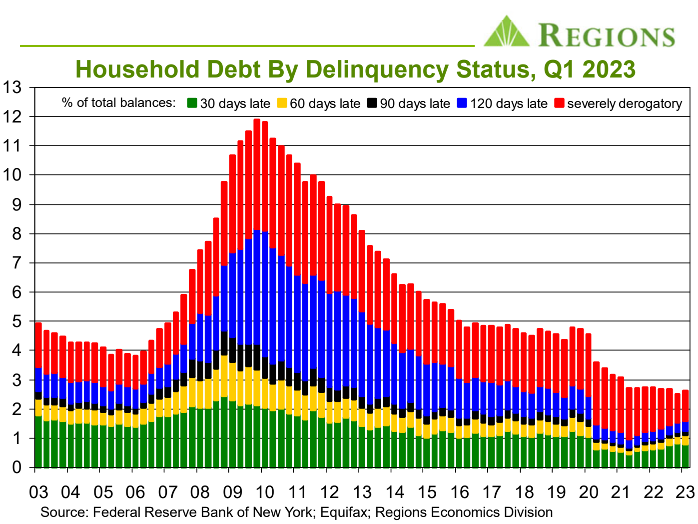


Another instance in which rising prices have clearly fueled growth in debt is auto loan debt. As seen in the chart to the side, while nominal auto loan debt has risen steadily over the past several quarters, adjusting for price changes, using the CPI series on prices for new and used motor vehicles, shows real auto loan debt still far below the peak seen in Q2 2020 despite having turned higher over the past three quarters. Recall that prices for used motor vehicles surged during the pandemic, as production of new vehicles being hamstrung by supply chain constraints and a sharp decline in the use of public transit combined to push demand for used vehicles sharply higher. To the extent that new vehicles were being produced and sold, prices rose rapidly given limited supplies. This accounts for the yawning gap in nominal and real auto loan debt over the past several quarters. One potential risk to lenders is that should vehicle prices come back down to earth, collateral values could be meaningfully below loan balances, giving borrowers in financial distress incentives to give up their vehicle. This isn't to suggest anything on the order of borrowers mailing house keys to lenders during the housing market collapse associated with the 2007-09 recession, but borrowers opting to default on auto loans and walk away from vehicles could be more common over coming quarters were we to see falling vehicle values at a time when labor market conditions were deteriorating and unemployment rising more sharply than is now generally expected.





In light of what has been considerable discussion about the potential economic fallout from banks tightening lending standards in the wake of recent bank failures, we think it worth making a few points. First, though many seem to have only recently discovered the Fed's quarterly survey of commercial bank loan officers, the reality is that the quarterly survey has been around for decades. And, while banks did indeed raise lending standards on consumer loans (and on C&I and CRE loans) in Q1 2023, this comes on top of what were already rising lending standards. In other words, as we've repeatedly noted over the past several weeks, whatever tightening was seen in Q1 was a continuation of trends already in place, and the incremental change in Q1, at least in the case of consumer loans, was not nearly as dramatic as implied in much of the recent coverage of the survey. To that point, not a single bank reported they were "much less wiling" to make consumer installment loans or that they had "considerably" tightened lending standards on credit card loans in Q1, any such tightening was characterized by "somewhat." It also helps to recall, as noted above, that the Fed's survey does not account for nonbank lenders, so the extent of tightening reported by banks, illustrated in the first chart above, would not necessarily imply the same changes in consumer spending at present as would have been the case in past decades when nonbank lenders were not nearly as prominent as they now are. Additionally, as we have frequently discussed in these write-ups, mortgage lending standards were made far more stringent in the wake of the housing market debacle in the 2000s and have not been meaningfully relaxed in the intervening years. This is one reason why so few banks reported tightening mortgage lending standards in the Fed's most recent surveys of bank loan officers, i.e., standards were already notably elevated. This is seen in the second chart above in the share of mortgage originations going to borrowers with credit scores of 760 or above. Though this share had fallen some over the past several quarters, it is still significantly elevated, but it could be that the recent decline will be reversed in the quarters ahead. None of this is to say that there will not be fallout in the broader economy from banks raising lending standards, but simply that in order to fully gauge any such effects one has to take into account that lending standards were being raised, and loan demand was softening, over much of 2022, which is context missing in most of the discussion of this issue we've seen over the past several weeks.



A little context also goes a long way in processing the increase in delinquency rates seen in Q1. That increase came off of what in Q4 2022 was the lowest delinquency rate in the life of the New York Fed's data series, and still leaves delinquency rates below those of other quarters since the onset of the pandemic and much further below pre-pandemic norms. Where there are pockets of distress are amongst some younger borrowers and in the subprime segments of auto and credit card loans. While further increases in delinquency rates seem likely in coming quarters, the question is whether this would simply reflect delinquency rates normalizing or whether we would be in for a more significant, and sustained increase. Barring a significant deterioration in labor market conditions, the former seems more likely than the latter. To be sure, we are fully aware that dealing with aggregate measures can mask underlying issues amongst certain groups of borrowers, but the inverse is also true, i.e., highlighting cases of distress is far from a complete picture of the overall situation. Again, even a little context can go a long way.

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