ECONOMIC UPDATE
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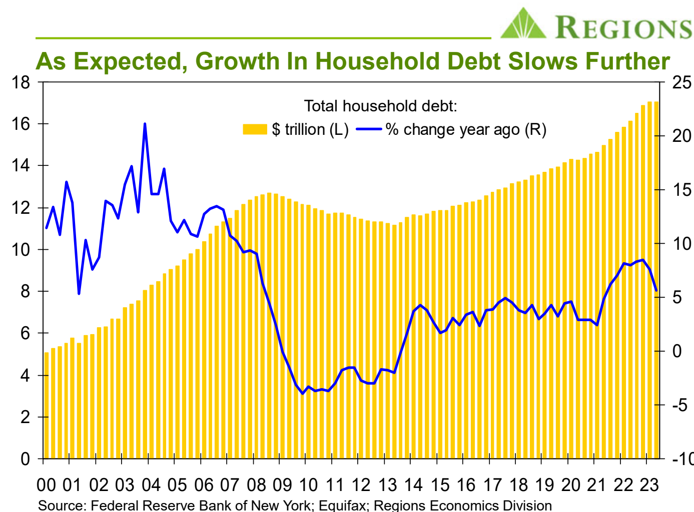
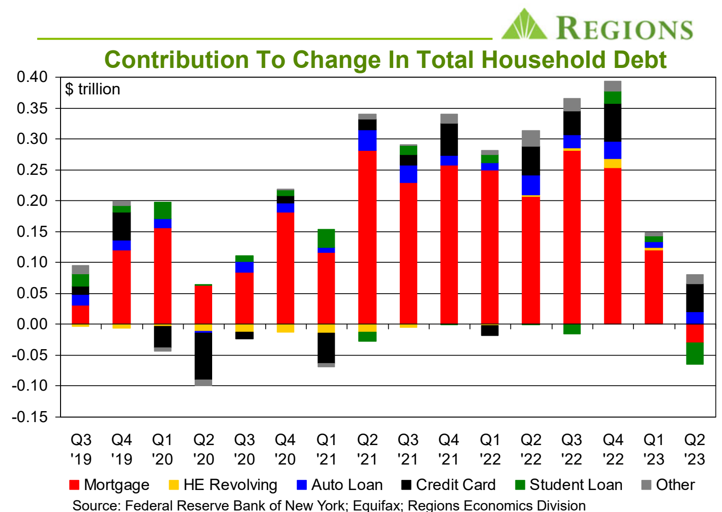
Q2 2023 Household Debt and Credit: Growth In Household Debt Slows Further

- Total household debt rose to $17.063 trillion in Q2 2023, an increase of $16 billion from Q1
- Mortgage balances fell by $30 billion in Q2, credit card debt increased by $45 billion
- As of Q2, 2.62 percent of outstanding household debt was in some stage of delinquency, up from 2.61 percent in Q1

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 $17.063 trillion in Q2 2023, an increase of $16 billion from Q1 which, outside of the decline in the early stages of the pandemic, is the smallest quarterly increase since Q2 2015. A decline in mortgage debt outstanding, the first since Q4 2018, weighed on growth of household debt in Q2, while outstanding credit card debt rose by $45 billion as the level of credit card debt topped the $1 trillion mark for the first time. That was the dominant theme of media coverage of the Q2 data with, perhaps unsurprisingly, little effort spent on putting that figure in any sort of context. On an over-the-year basis, total household debt was up by 5.6 percent in Q2, with mortgage debt up 5.5 percent and credit card debt up 16.2 percent, a fifth straight double-digit increase, while outstanding balances on home equity lines of credit were up 6.6 percent, a fourth straight over-the-year increase after a run of fifty straight quarters in which balances had fallen year-on-year. The data on household debt have over the past several quarters reflected the cumulative effects of elevated inflation, a driver of growth in credit card debt, and higher interest rates, a driver of rapidly shrinking mortgage origination volumes. At the same time, more stringent bank lending standards have also contributed to slowing growth in total household debt. We look for growth in household debt to slow further in coming quarters, particularly to the extent growth in total consumer spending does the same, but with food and energy prices again on the rise, rapidly so in the latter instance, growth in credit card debt will continue to easily outpace growth in total household debt. The overall delinquency rate on household debt rose sightly in Q2 but, at 2.62 percent, remains far below pre-pandemic norms.

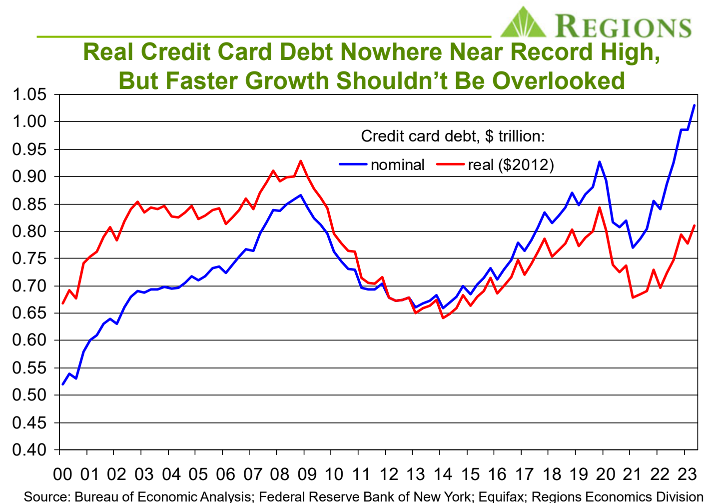


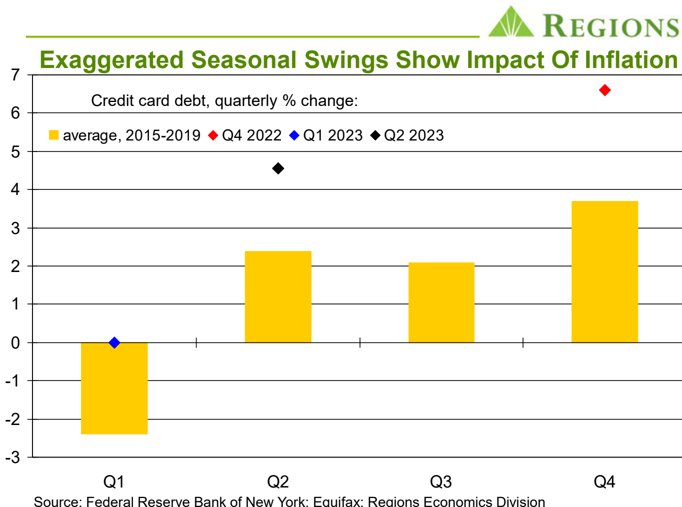


As noted above, the level of credit card debt topping the $1 trillion mark was the most widely reported element of the Q2 data on household debt. To be sure, a trillion – dollars or anything else – is a big number, and it's easy to take a trillion dollars of credit card debt as a sign of economic stress. The most common theme in discussions, at least those we've seen and heard, of the growth in credit card debt over the past several quarters is that this growth reflects households struggling in the face of elevated inflation and increasingly turning to credit cards to help keep pace with rising prices, particularly for food, energy, and other necessities. While we have no doubt that this is true of many households, there is much more to the story than that. To help put the link between rising prices and rising credit card debt in context, while nominal (i.e., not adjusted for price changes) credit card debt did top the $1 trillion mark in Q2 and set a new record-high, real (i.e., adjusted for price changes) credit card is nowhere near its all-time high. Adjusted for inflation, the highest level of credit card debt outstanding is $928 billion, a mark hit in Q4 2008; as of Q2 2023, the level of real credit card debt outstanding was $810 billion, which is the seventh highest level on record. In other words, rising prices have been a key contributor to the growth in nominal credit card debt over the past several quarters. That said, growth in real credit card debt has also picked up pace over recent quarters, which is indicative of greater reliance on credit cards to finance expenditures. To that point, real credit card debt

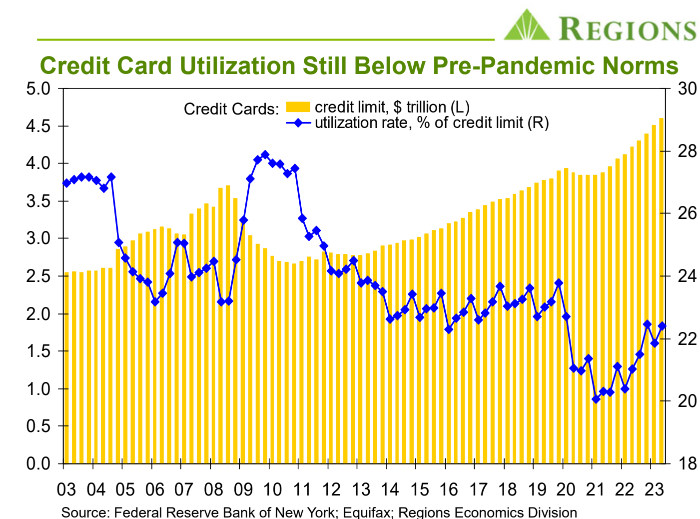
Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com

has put up double-digit year-on-year increases in each of the past two quarters, with the 12.1 percent increase in Q2 2023 the largest such increase in the life of the New York Fed's data.





Another way to see the link between growth in credit card debt and elevated inflation is to look at what have been sizable deviations from typical patterns in credit card balances over recent quarters. Keep in mind that the data on household debt are not seasonally adjusted and, particularly in the case of credit card debt, display clear seasonal patterns. For instance, credit card debt tends to rise sharply during the fourth quarter of any given year, reflecting holiday season spending, and then fall sharply in the first quarter of the subsequent year, as balances are paid down during a time when consumer spending tends to slow markedly. As seen in the second chart above, the increase in credit card debt in Q4 2022 (the percentage change from Q3) was much larger than the typical Q4 increase, which mainly reflected the extent to which higher prices inflated holiday season sales (which we discussed in the March 2023 edition of our *Monthly Economic Outlook*). Along those same lines, credit card balances were flat between Q4 2022 and Q1 2023, contrary to the large decline typically seen in the first quarter of any given year, which was also a reflection of higher prices propping up the level of nominal credit card debt. The New York Fed data show a much larger increase in credit card debt in Q2, up 4.6 percent from Q1, than is typically seen in the second quarter of any given year. We will, however, note that not all of these atypical quarterly patterns stem from higher inflation. For instance, consumer spending on discretionary services has been stronger over the past two-plus quarters than had been the case since the onset of the pandemic. To the extent that consumers have used credit card debt to facilitate spending in higher-ticket categories, such as travel, that would help account for the run-up in nominal card balances seen in the New York Fed data.

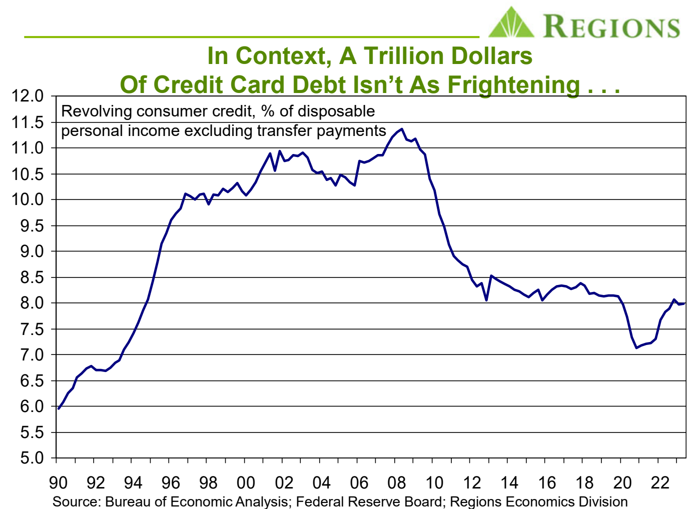


As seen in the chart to the side, though the (aggregate) credit card utilization rose in Q2, it nonetheless remains far below pre-pandemic norms. It is worth noting, however, that part of this gap between current and pre-pandemic utilization rates is what has been faster growth in credit card limits. While limits tend to rise during the second quarter of any given year, the past two years have seen much larger Q2 increases in credit card limits than has historically been typical for the quarter, which in part reflects rapid growth in the number of new cards issued. Based on the New York Fed's analysis of the data, one key difference in the past two years is that after subprime borrowers saw a surge in credit card issuance in 2022 (and in 2021, for that matter), issuance to such borrowers slowed over the first half of 2023 as card issuance to borrowers with credit scores of over 760 was expanding rapidly. This is consistent with the tightening in lending standards reported amongst credit card lenders, including commercial banks, and with the New York Fed's *SCE Credit Access Survey* showing an increase in credit application rejection rates, particularly for those with lower credit scores.

So, at least to some extent, growth in credit card debt over the first half of 2023 reflected rising balances amongst those for whom higher credit card debt is less of a financial burden. More broadly, when assessing the burden of debt, be it credit card debt or total household debt, one also has to account for growth in income, whether that takes the form of debt-to-income ratios or monthly debt service burdens (principal and interest payments as a share of after-tax income). One way that we frequently illustrate this point is to

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

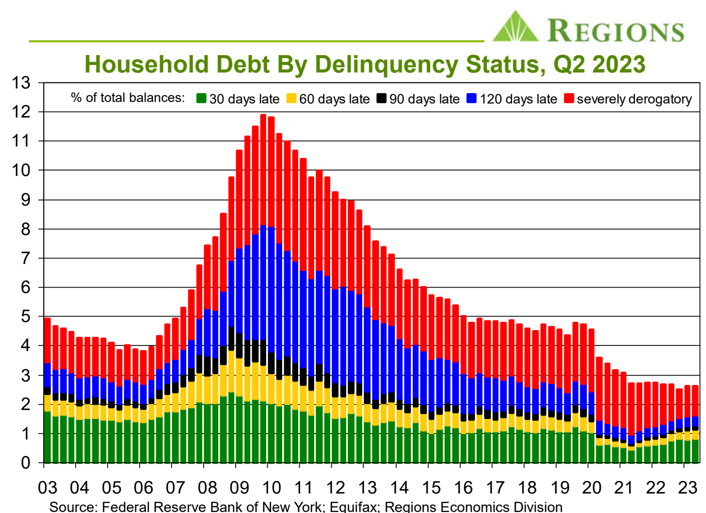
look at outstanding credit card debt as a percentage of disposable personal income excluding transfer payments. Rather than the New York Fed series on credit card debt, we use the series on revolving consumer credit outstanding from the Federal Reserve's monthly reports on consumer credit. We use this series, the bulk of which is accounted for by credit card debt, primarily because of its long history – the series goes back decades while the New York Fed's series only dates back to 1999. Either way, the patterns would be the same. Additionally, in our discussions of debt burdens we use after-tax income exclusive of transfer payments as the relevant measure of income, as this is what we see as the most meaningful gauge of funds available for servicing debt. While transfer payments in the form of Social Security and unemployment insurance benefits do put cash in consumers' hands, those funds are typically used for spending on necessities with little, if any, of these payments available for debt service. At the same time, transfer payments in the form of Medicare and Medicaid are booked as personal income but take the form of direct payments from the government to service providers so, again, offer no support in terms of servicing debt.



All of that being said, as the chart to the side shows, even with the level of credit card debt topping the $1 trillion mark, this is equivalent to just 7.9 percent of disposable personal income excluding transfer payments. Aside from the dip seen early in the pandemic, this is the lowest share since the mid-1990s. To be sure, looking at aggregate measures such as this raises questions pertaining to the distributions of debt and income. Keep in mind, however, that over the past several quarters wage growth has been the fastest amongst what have historically tended to be lower-skill, lower-wage industry groups, helping support faster overall income growth amongst lower-income households. While this of course does not make distributional issues go away, it does at least mitigate them, especially in light of the data showing a significant portion of the recent growth in credit card debt has come amongst those households with higher incomes and higher credit scores.

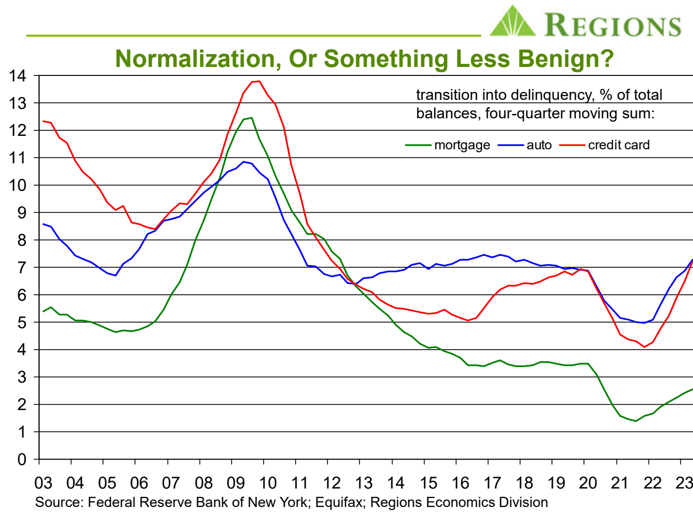
It is also worth noting that data from the Federal Reserve Bank of Philadelphia show more than one-third of all credit card borrowers pay their entire balance each month, a share that as of Q1 2023 was higher than was the case prior to the pandemic. There is likely some overlapping in reporting, in that some portion of reported credit card debt is captured after the debt is incurred but before it is paid off each month. While we do not have a way of quantifying this, it does at least suggest that the reported level of credit card debt is overstated, and while that will have always been the case, it is more so now with a higher share of borrowers paying off card balances in full each month. It is also important to note that it is not only lower-income borrowers who carry balances forward rather than paying them off in full each month. Bankrate data show over seventy percent of cardholders with credit card balances and annual household incomes of $100,000 or more have carried credit card debt for more than a year, a share that drops to fifty-three percent for those with credit card balances and annual household incomes of less than $50,000. To our earlier point about a link between discretionary services spending and credit card debt, the Bankrate data show over one-fifth of households with credit card balances and household incomes of $100,000 or more cite vacation and/or entertainment expenses as the primary factor behind their outstanding card balances.

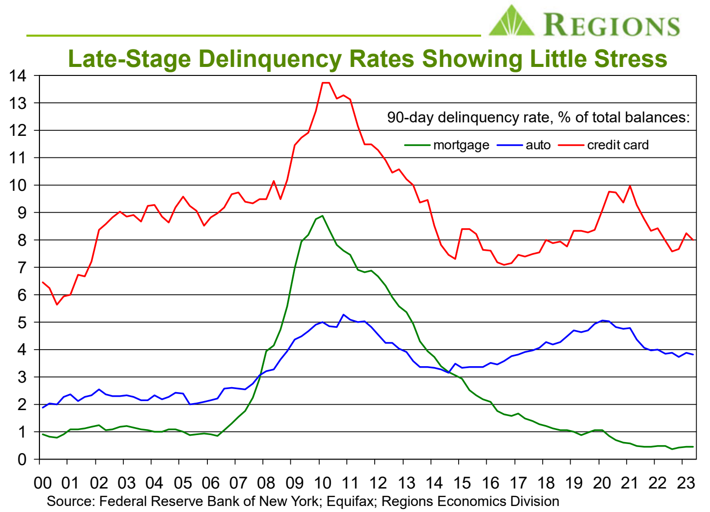
Again, while no one is suggesting that higher credit card balances are not a challenge or an increasing burden for some households, it is hard to argue with the New York Fed's assessment that there is little evidence of widespread financial distress for consumers despite a new record level of credit card debt and what in each and every quarter is a new record level of total household debt. To be sure, that could easily, and quickly, change. For instance, the resumption of student loan repayments could be a source of financial stress for and could lead to an increase in defaults amongst those impacted by this change. More broadly, a deterioration in labor market conditions would pose a more serious threat to household financial conditions, either in the form of a sharp deceleration in wage growth, particularly amongst lower-skill, lower-earnings industry groups, or in the form of significant layoffs.



As things stand now, however, there are few signs of widespread financial distress. The overall delinquency rate on household debt ticked up from 2.61 percent in Q1 2023 to 2.62 percent in Q2, but this still leaves the delinquency rate well

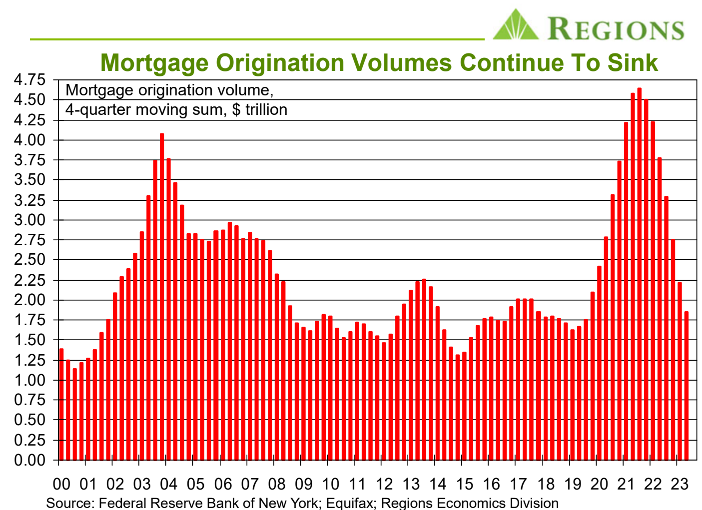
below pre-pandemic norms. The same is true of early-stage delinquencies, with the 30-day delinquency rate at 0.83 percent as of Q2 according to the New York Fed data. This is up considerably from the series low of 0.46 percent in Q1 2021, but delinquency rates at that time were pushed lower by the considerable financial support provided to households after the onset of the pandemic. To us, the more relevant comparison would be the trend rate that prevailed prior to the pandemic; in the eight quarters prior to the onset of the pandemic, the 30-day delinquency rate averaged 1.12 percent. Later-stage delinquency rates have yet to show any signs of pushing back up to pre-pandemic norms. Again, the resumption of student loan repayments could put upward pressure on delinquency rates and a meaningful deterioration in labor market conditions clearly would do so.





Looking across loan types, the first chart above shows transitions into delinquency, with the data reported on a percentage of balances basis, as opposed to a number of loans basis, and reported on a four-quarter moving sum (or, annualized) basis, both of which are the reporting conventions of the New York Fed. As of Q2 2023, the flows into delinquency for auto loans and credit card loans are back to pre-pandemic rates, while the flow of mortgage loans into delinquency remains easily below pre-pandemic norms, which themselves were notably low. It is worth noting that while the percentage of balances measure has risen sharply over the past several quarters, the number of borrowers with delinquencies has not increased in step. This to some degree reflects the effects of higher prices. For instance, with vehicle prices significantly higher than was the case prior to the pandemic, a single auto loan slipping into delinquency will have a greater impact on a percentage of balances basis now than had previously been the case, and the same point could be made to the extent that higher prices have led to higher credit card balances. Much, but not all, of the deterioration in the credit card and auto loan spaces has come from subprime borrowers, with no discernable change in flows into delinquency amongst borrowers in the highest credit score bucket.

That latter point helps account for the performance of mortgage loans over the past several years, as borrowers with credit scores of 760 and above have accounted for an increasing share of total mortgage loan originations. That share rose even further after the onset of the pandemic, to the point that borrowers in this group have accounted for two-thirds of all mortgage originations since mid-2021. It also helps to recall that the vast majority of mortgage debt now on household balance sheets is fixed-rate, not variable-rate, in nature, which has acted as an important buffer against higher mortgage interest rates over the past year-and-a-half, thus helping preserve loan performance.



While higher mortgage interest rates have not had a meaningful impact on mortgage loan performance, their impact on the volume of mortgage loan originations is unmistakably clear. Both purchase loan originations and refinancings have fallen sharply, as shown in the chart to the side, to the point that the four-quarter moving sum of mortgage loan originations slipped to its lowest level since Q3 2019 in Q2. We expect mortgage loan originations will fall further over coming quarters, thus remaining a drag on growth in total household debt.

Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
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