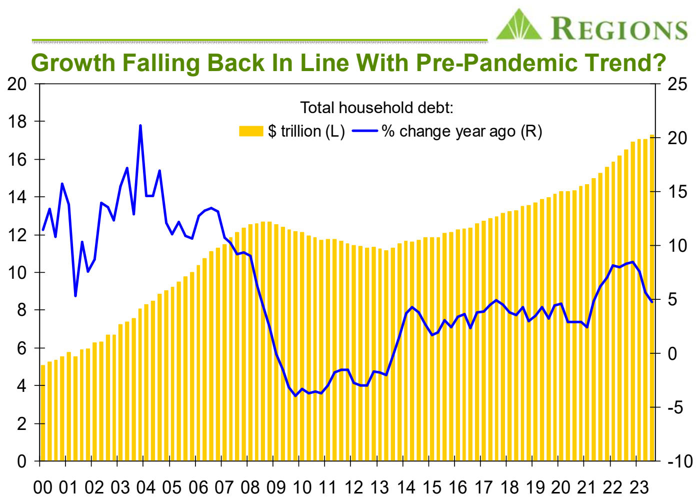
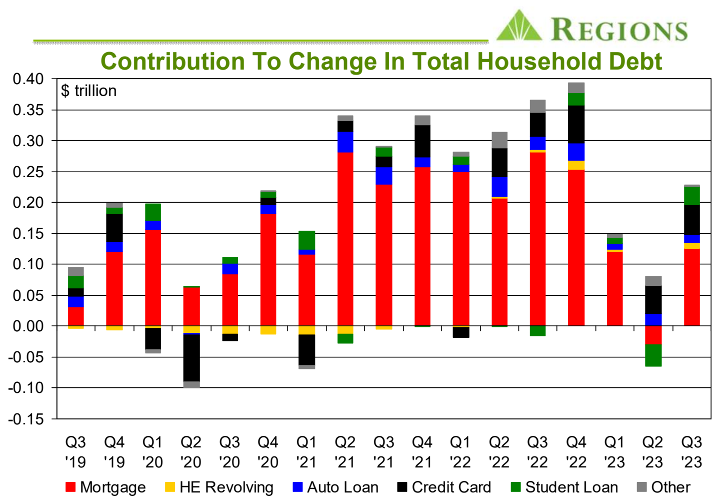
Q3 2023 Household Debt and Credit: Credit Card Delinquencies Rising Rapidly

- Total household debt rose to $17.291 trillion in Q3 2023, an increase of $228 billion from Q2
- Mortgage balances rose by $126 billion in Q3, credit card debt increased by $48 billion
- As of Q3, 2.99 percent of outstanding household debt was in some stage of delinquency, up from 2.62 percent in 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 $17.291 trillion in Q3 2023, an increase of $228 billion from Q2. After having declined in Q2, mortgage debt outstanding rose by $126 billion in Q2. Outstanding credit card debt rose by $48 billion in Q3, the third largest quarterly increase on record, while the $154 billion increase over the last year is the largest annual increase in the life of the New York Fed's data series, which goes back to 1999. On an over-the-year basis, total household debt was up by 4.8 percent in Q3, the smallest such increase since Q2 2021 as growth appears to be settling back in line with the pre-pandemic trend rate. Credit card debt was up 16.6 percent year-on-year, the sixth straight quarter with a double-digit year-on-year increase, while the 4.0 percent year-on-year increase in mortgage debt was the smallest such increase since Q2 2020. As if making up for lost time, outstanding balances on home equity lines of credit were up 8.4 percent year-on-year, the fifth straight over-the-year increase after a run of fifty straight quarters in which balances had fallen year-on-year. To some extent, rapidly rising credit card debt over the past several quarters has been a reflection of the cumulative effects of elevated inflation, but at the same time stronger growth in discretionary services spending has also played a role. The Q3 data also show a significant increase in credit card delinquencies, though the New York Fed data show a fairly limited pool of borrowers to be primarily responsible, as opposed to rising delinquencies being more broadly based across age and income cohorts. The overall delinquency rate on household debt rose to 2.99 percent in Q3 from 2.62 percent in Q2, with rising early-stage delinquencies the biggest driver. Overall delinquency, however, remains well below pre-pandemic norms.



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



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

As noted above, the $48 billion increase in outstanding credit card debt in Q3 is the third largest quarterly increase on record in the New York Fed's data and continues a run of sizable quarterly increases. In past editions of these write-ups, we've noted that the marked acceleration in the growth of credit card debt came during a time of significantly elevated inflation, and while inflation has slowed that simply means prices are rising at a slower pace. As such, the cumulative increases in prices, particularly for food, shelter, and energy, have added stress to household budgets, particularly as pandemic-related financial supports have run their course. Additionally, over the summer months increases in discretionary services spending also contributed to rapid growth in credit card debt. Still, outside of deteriorating performance amongst subprime borrowers, there was in Q2 little evidence of payment stresses across a broader range of borrowers. To that point, in their discussion of the Q2 data, researchers at the New York Fed concluded that there was "little evidence of widespread distress on households." And, while delinquency rates on credit card debt and auto loans were rising, they were still shy of pre-pandemic norms, with the question being whether they would return to those prior norms or push past them.

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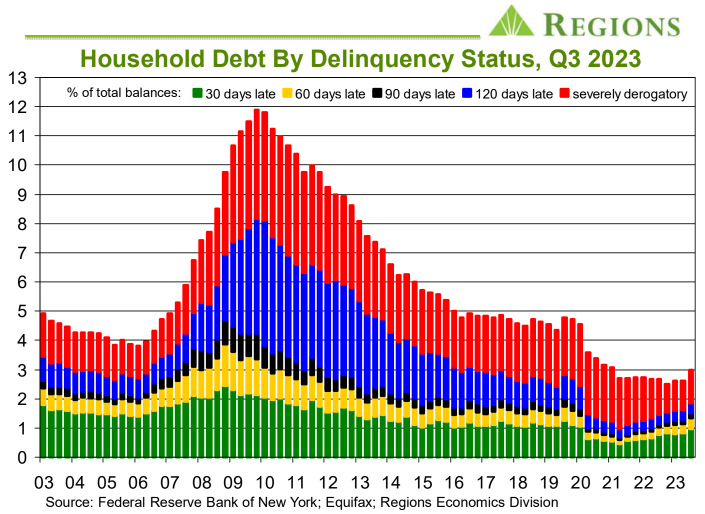
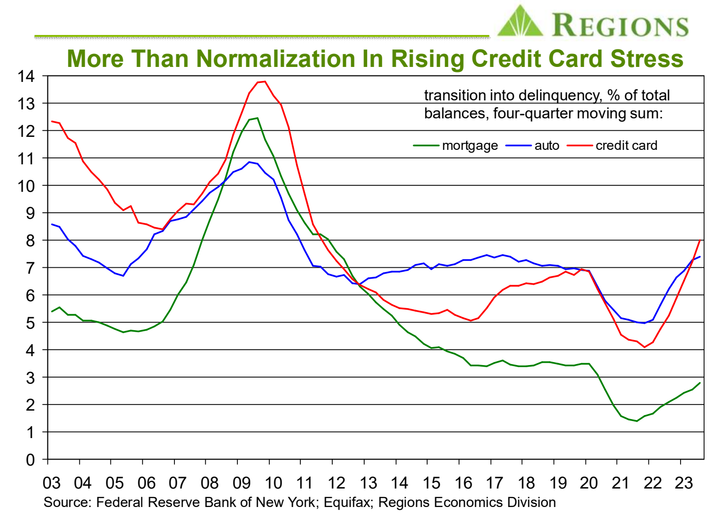
Of all household debt, 2.99 percent was in some stage of delinquency as of Q3 2023, up thirty-seven basis points from Q2 but still easily below pre-pandemic norms. The 30-day delinquency rate rose to ninety-eight basis points in Q3, an increase of sixteen basis points from Q2 but, again, still well below pre-pandemic norms. That said, between the resumption of student loan payments and what we expect will be further cooling in labor market conditions – the trend rates of job and earnings growth have been slowing – it seems likely that early-stage delinquencies will increase over coming months, which will ultimately filter through to late-stage delinquencies. Note that delinquencies on student loan debt will not be reported until Q4 2024, which will hold down reported delinquency rates, but to the extent that the resumption of student loan repayment leads to higher degrees of financial stress amongst certain borrowers, that could lead to upward pressure on overall delinquency rates.





Breaking the data down, however, reveals a marked increase in credit card delinquencies in the third quarter, while a higher share of prior early-stage delinquencies aged into late-stage credit card delinquencies. The second chart above shows transitions into delinquency on a percentage of balances basis, which under the reporting conventions of the New York Fed are reported on a four-quarter moving sum (i.e., annualized) basis. While flows into delinquency across different forms of debt are off the lows seen in 2021/2022, the rate at which auto loan debt transitioned into delinquency moderated in Q3 and, at least for now, is back in line with pre-pandemic rates, while the rate at which mortgage debt is transitioning into delinquency remains well below pre-pandemic norms. The increased flow of credit card debt into delinquency, however, stands out, with the annualized rate rising to 8.0 percent in Q3, the highest rate since Q3 2011. As in credit card utilization, there are seasonal patterns in transitions into delinquency, which typically peak in the fourth quarter of any given year, which suggests the Q4 data will see another meaningful increase in the annualized rate.

In order to more fully understand the Q3 data, researchers at the New York Fed broke the increase in credit card delinquencies down into several cuts, including income, age, and outstanding balances, and in the course of this decomposition some clear variances emerged. For instance, while other demographic cohorts (Baby Boomers, Gen X, Gen Z) have credit card delinquency rates (measured on a number of borrowers basis as opposed to percentage of balances) in line with pre-pandemic norms, the New York Fed found that the delinquency rate amongst Millennials has pushed above the pre-pandemic norm, with the most significant increase in delinquencies amongst those between 30 and 39 years of age. And, while delinquency rates have risen across all income buckets, the increase has been the most pronounced amongst low income borrowers, which is the group that has seen most or all, depending on whose estimate one goes by, of any excess savings built up in 2020 and 2021 evaporate, leaving them less capacity for spending and debt service.

It is also the case that those borrowers with higher total credit card balances have been more prone to transition into delinquency. The New York Fed's analysis shows those with combined credit card balances of over $20,000 – who account for about six percent of all credit card holders – have had the highest transition rate in terms of both the level and rate of increase. Conversely, delinquency transition rates amongst borrowers with balances below $5,000 – who account for about sixty-eight percent of all credit card borrowers – are in line with pre-pandemic trends. Finally, credit card borrowers with auto loans and those with both auto loans and student loans were more likely to slip into delinquency on their credit card loans, with transition rates above pre-pandemic norms. Again, those with student loan debt are more vulnerable to financial stress now that student loan repayments are back in force. It is interesting to note that credit card delinquencies amongst those borrowers who also have mortgage loans are basically in line with pre-pandemic norms. This to some degree reflects a trend we have for some time been highlighting in these write-ups, which is how heavily concentrated mortgage loan originations have been amongst borrowers with credit scores of 760 or above.

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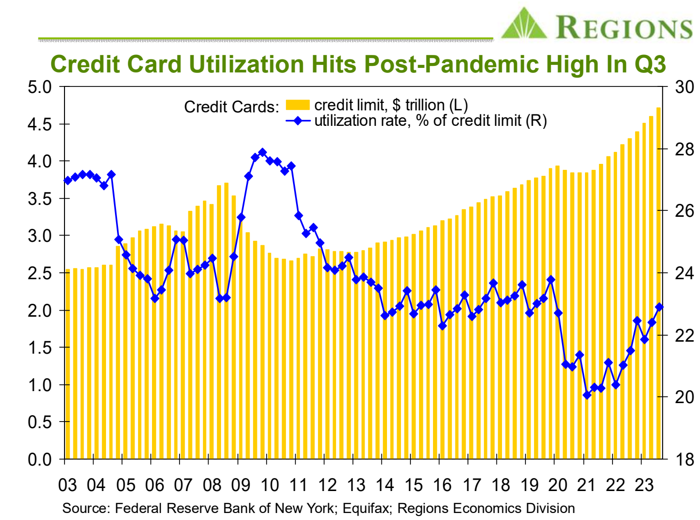
That those with lower incomes and larger balances are transitioning into delinquency at faster rates than are other borrowers is not surprising. That the rate at which credit card accounts are transitioning into delinquency is faster for those borrowers who also have auto loans could reflect borrowers making a choice to remain current on their auto loans while letting their credit card debt slide. Recall that in the mid-2000s there was evidence of borrowers prioritizing auto loans over mortgage loans and credit card debt, so we could simply be seeing a repeat of that same behavior, at least in terms of choosing between remaining current on either auto loans or credit card debt when a borrower is unable to remain current on both. That Millennials with student loan debt, auto loans, and credit card debt slipped into delinquency on their credit card debt at faster rates than other borrowers could simply reflect overextended borrowers making the choice we just outlined, but the presence of student loan debt as a factor in credit card delinquencies during a period in which student loan repayment had been suspended is harder to account for. It could be that such borrowers were bracing for the resumption of student loan repayment in October and felt they'd be unable to remain current on all forms of debt, and more or less pre-emptively fell into delinquency on their credit card debt.

More broadly, it is striking that credit card payment performance deteriorated to the extent it did in the third quarter given still healthy labor market conditions and given that inflation-adjusted income continued to grow. It could be that a significant number of borrowers simply became overextended and were caught out when higher interest rates pushed up monthly credit card payment obligations, particularly for those borrowers who had exhausted any financial surpluses built up on the basis of pandemic-related supports. That could be particularly true of those who engaged in "revenge spending" on discretionary services such as travel, tourism, recreation, entertainment, and dining out, making up for opportunities lost since the onset of the pandemic and simply found themselves unable to keep pace with higher credit card payments. It may also seem striking that credit card delinquencies have been rising in a period in which banks have been tightening standards on credit card loans, as indicated in the Federal Reserve's quarterly surveys of bank loan officers. We will, however, note that banks did not begin to, on net, tighten credit card standards until Q3 2022, and will further note that the degree to which banks have been tightening standards on all forms of consumer loans, including credit card loans, has been much more moderate than the extent they have been doing so on C&I and CRE loans. Moreover, just because banks have been tightening credit card standards does not mean that nonbank lenders have been doing the same, or have been doing so to the same degree as have banks.

To that point, available credit card limits have continued to rise during a time when credit card delinquencies have been increasing, and, in the third quarter, were increasing at a faster pace. Available credit card lines rose by 2.5 percent during the third quarter; there are seasonal patterns in changes in credit limits, and the 2.5 percent increase seen in this year's third quarter is the largest third quarter increase since 2005. Obviously, available limits are not rising uniformly across all groups of borrowers but, at least in the aggregate, lenders had not yet begun to exhibit a sense of urgency in adjusting credit limits. It is interesting to note that over the past few quarters, lowering credit limits has been one form of tighter lending standards, though the number of banks reporting lowering credit limits has in each quarter been smaller than the number reporting tighter lending standards, with other mechanisms such as higher required payments and higher interest rates also employed by those banks tightening credit card standards.



The accompanying chart can also help put the rapid growth in overall credit card debt over recent quarters in context. While credit limits have been steadily rising after the reins had pulled in during the early phases of the pandemic, card utilization has also increased. To that point, at 22.89 percent, the utilization rate in Q3 was the highest since Q4 2019. We will once again note the clear seasonal patterns evident in the data on card utilization, which in any given year tends to rise sharply during the fourth quarter, in no small measure due to holiday season shopping. In each of the past four quarters, the change in utilization has been significantly stronger than the typical change for that quarter, i.e., utilization rose more sharply in the third quarter of 2023 than is typically seen during a third quarter. What will be interesting to see is whether that pattern holds again in Q4. As we discussed in our annual holiday sales outlook, we're expecting only a so-so holiday sales season this year, in part because U.S. consumers have been feeling anything but festive about economic and financial conditions over the past several months. If added to those worries are, at least for some groups, pressing financial constraints, holiday season spending could fall short of our not so great expectations, and to the extent that would prove to be the case, growth in credit card debt during this year's fourth quarter could fall short of what we typically see in a fourth quarter. Though the data are not reported in that context, for us that is the proper way to put any quarter's growth in credit card debt into proper perspective.

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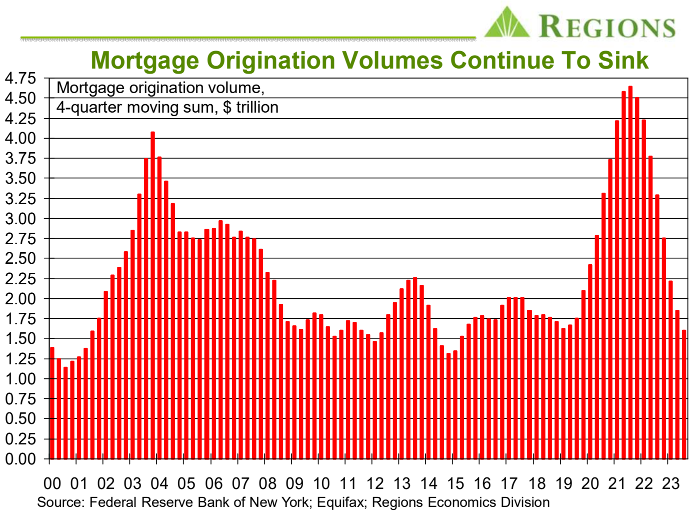
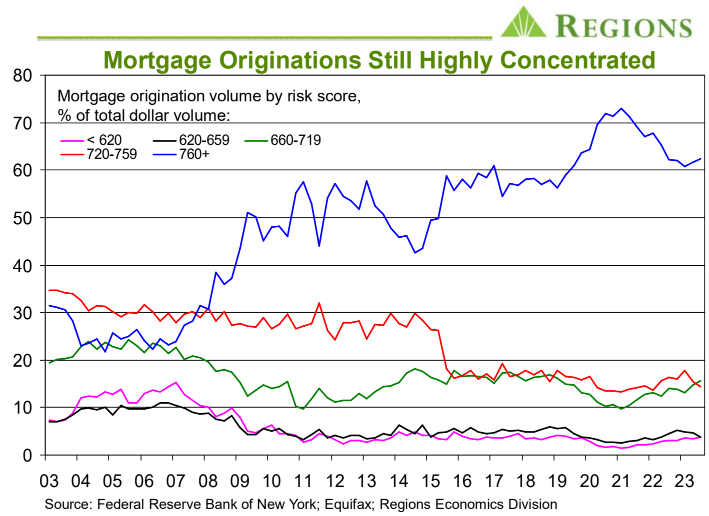
After an out of character decline in Q2, mortgage debt outstanding rose in Q3, advancing 1.1 percent from Q2 which translated into a year-on-year increase of 4.0 percent, the smallest such increase since Q2 2020. Higher mortgage interest rates have clearly weighed on origination volume, for both purchase loans and refinances, and while house prices wobbled during the second quarter of 2023, they firmed up again in the third quarter, lending at least some support to the dollar volume of originations. Still, on a four-quarter moving sum basis, the dollar volume of mortgage originations stood at $1.601 trillion as of Q3 2023, the lowest such total since Q2 2015. As have other market interest rates, mortgage interest rates have been quite volatile of late, pushing sharply higher, even briefly topping eight percent, in October before falling over the early part of November, but nonetheless remaining far above levels that prevailed over the prior several years. That inventories of existing homes for sale remain so lean has pushed more and more prospective buyers into the market for new homes, but new homes cannot entirely fill the void given the relative shares of sales accounted for by new and existing homes. It is unclear how much capacity there is for existing home sales to rise given the extent to which so many current owners are "locked in" by favorable mortgage interest rates, often over a few hundred basis points lower than are current mortgage interest rates. As such, it is unclear how much capacity there is for mortgage origination volumes to rise over coming quarters.





While higher mortgage interest rates have clearly weighed on origination volumes, they have not had an appreciable impact on payment performance, which is a function of the preponderance of fixed rate mortgages on household balance sheets. Unlike prior cycles, higher mortgage interest rates have not triggered significant payment reset shocks in the current cycle. Moreover, as seen in the second chart above, mortgage loan originations over the past several years have been highly concentrated amongst borrowers in the highest credit score bucket. Early-stage mortgage delinquency rates continue to hover near all-time lows, still well below pre-pandemic norms. As a side point, the Federal Reserve's quarterly surveys of bank loan officers continue to show only small fractions of banks tightening lending standards on mortgage loans, in stark contrast to standards on other forms of loans. This is simply a reflection of the extent to which mortgage lending standards were ratcheted higher in the wake of the housing market debacle in the mid-2000s, standards which were in the intervening years never really eased to any meaningful degree. This is not to say that early-stage delinquencies won't continue to move back toward pre-pandemic norms, themselves already low, but it does suggest a lower ceiling than seen in past cycles.

To be sure, the jump in credit card delinquencies seen in Q3 came as a surprise. That said, from the information provided by the New York Fed, that jump was more in the form of certain segments of borrowers exhibiting significant degrees of financial stress, as opposed to a wider swath of borrowers exhibiting less severe financial stress. Obviously, should labor market conditions ease further, resulting in slowing rates of job and earnings growth, financial stress may become more broadly based. At the same time, however, cooling labor market conditions would come in conjunction with slowing in the broader economy, which would exert downward pull on inflation and, in turn, interest rates. Lower interest rates would presumably offer relief to borrowers in terms of monthly debt service burdens, which could mitigate financial stress that would lead to further increases in delinquencies. At the same time, if we are correct in our expectation that growth in consumer spending will slow over coming quarters, that would take some of the steam out of the demand for credit from the household sector, resulting in further slowing in the growth of household debt. Still, that credit card delinquencies rose to the extent they did in Q3, a quarter in which real GDP grew at a notably robust rate and in which the unemployment rate remained below 4.0 percent, points to the need to monitor the household sector for signs of increased financial stress.

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