ECONOMIC UPDATE

REGIONS

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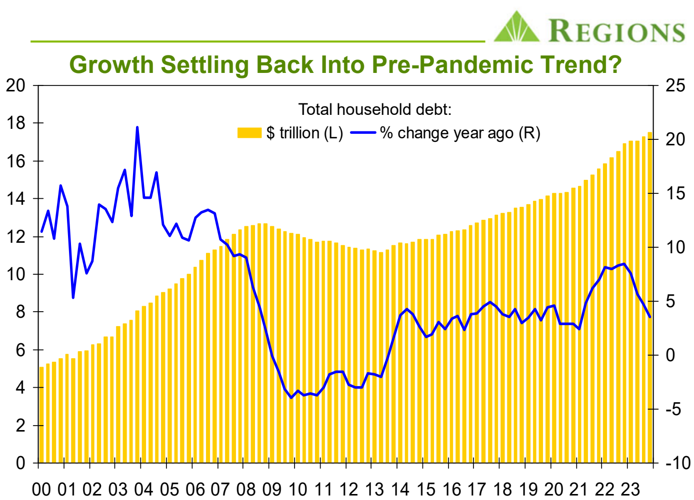
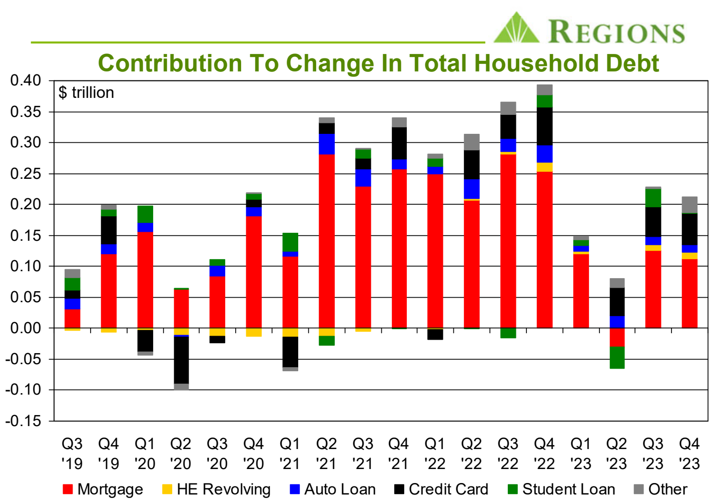
Q4 2023 Household Debt and Credit: Growth Slows, Delinquency Rates Rise Further

- Total household debt rose to $17.503 trillion in Q4 2023, an increase of $212 billion from Q3
- Mortgage balances rose by $112 billion in Q4, credit card debt increased by $50 billion
- As of Q4, 3.13 percent of outstanding household debt was in some stage of delinquency, up from 2.99 percent in Q3

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 $17.503 trillion in Q4 2023, an increase of $212 billion from Q3. Total mortgage debt outstanding rose by $112 billion in Q4, a second straight quarterly advance after the decline posted in Q2. Outstanding credit card debt rose by $50 billion in Q4, the third largest quarterly increase on record behind Q4 2021 and Q4 2022, and while the $143 billion increase over the last year is the smallest such increase over the past year, it is nonetheless substantially larger than what would have been considered typical prior to the rapid acceleration in credit card debt that began in 2022. On an over-the-year basis, total household debt was up by 3.6 percent in Q4, the smallest such increase since Q1 2021, and while growth appears to be settling back in line with the pre-pandemic trend rate, part of the moderation in the year-on-year percentage change reflects base effects – recall that in Q4 2022 the year-on-year increase in total household debt was 8.5 percent, the largest such increase since 2008. Credit card debt was up 14.5 percent year-on-year, the seventh straight quarter with a double-digit year-on-year increase, while the 2.8 percent year-on-year increase in mortgage debt was the smallest such increase since Q4 2018. Outstanding balances on home equity lines of credit were up 7.1 percent year-on-year, the sixth straight over-the-year increase after a run of fifty straight quarters in which balances had fallen year-on-year. The overall delinquency rate on household debt rose to 3.13 percent in Q4 from 2.99 percent in Q3, with another sizable increase in early-stage delinquencies. Still, the increase in newly delinquent balances and the overall delinquency rate remain easily 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

The thirteen basis point increase in the overall delinquency rate in Q4 was much smaller than the thirty-seven basis point increase seen in Q3, but this nonetheless left the overall delinquency rate up by sixty-three basis points over the past four quarters, the largest such increase since Q1 2010. At 3.13 percent as of Q4 2023, the overall delinquency rate on household debt is well above the trough of 2.50 percent seen in Q4 2022, but still well below the 4.90 percent average rate seen over the five years prior to the pandemic. What everyone wants to know, however, is where the increase in the delinquency rate ends, i.e., will the delinquency rate settle at a rate higher than, lower than, or in line with that longer-term pre-pandemic average. The answer to that question will only come with time, but for now it seems likely that the delinquency rate will push higher in the near term. Looking at the various components of household debt, the New York Fed's data shows the rates at which auto loan and credit debt are transitioning into delinquency are above pre-pandemic norms and higher than at any point since the 2007-09 recession and its aftermath. To be sure, current transition rates are well below those seen back then, but that isn't surprising given the magnitude of the damage done to the labor market during that time.

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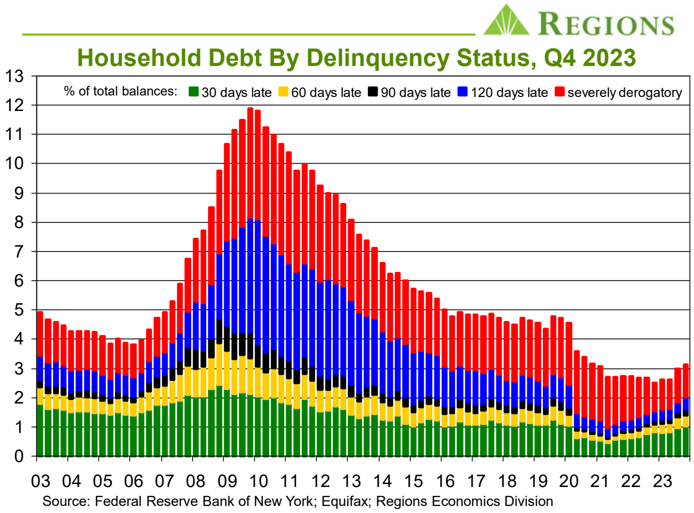
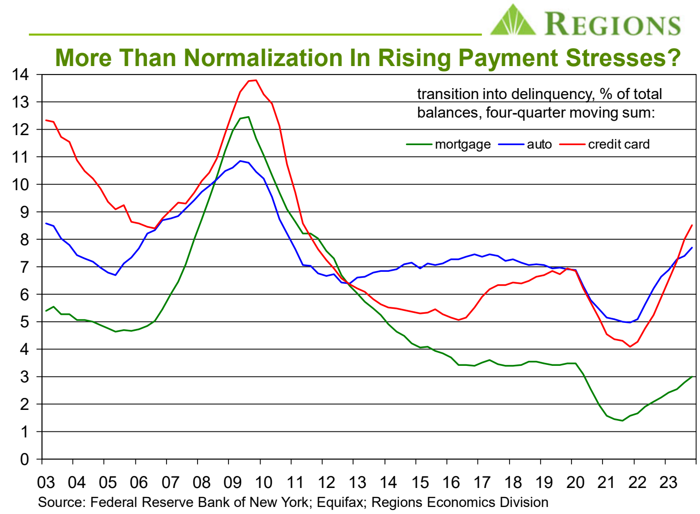
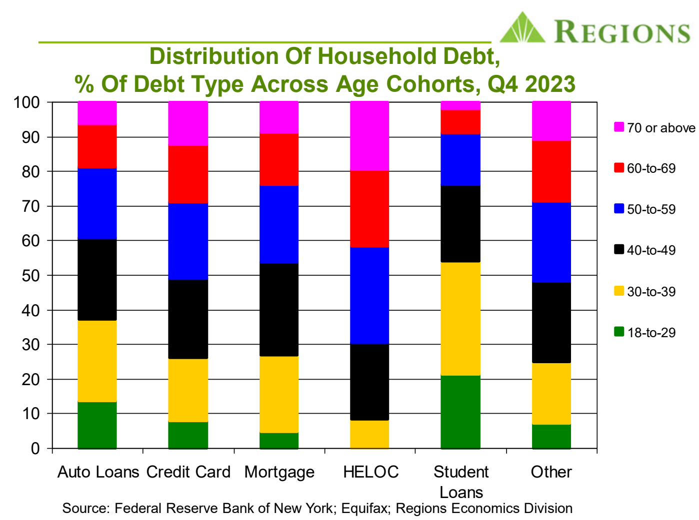
That we are seeing these transition rates increase to the extent they have against the backdrop of a labor market which is still quite healthy is somewhat unsettling, and to some degree reflects the combination of pandemic-related transfers to the household sector having run their course at a time when both inflation and interest rates have been much higher than we had become accustomed to.



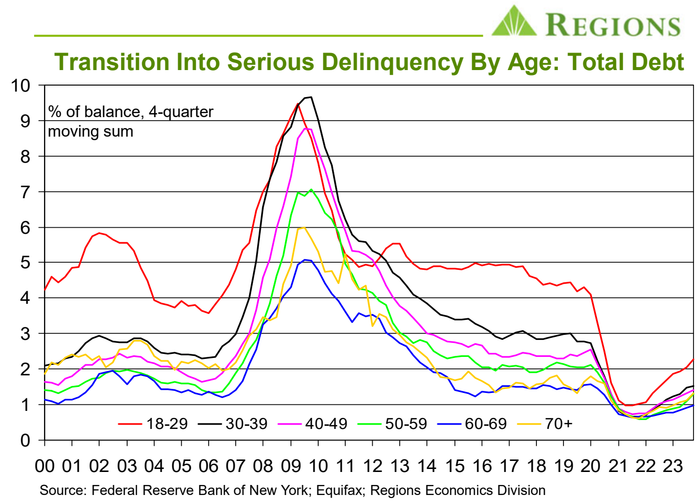


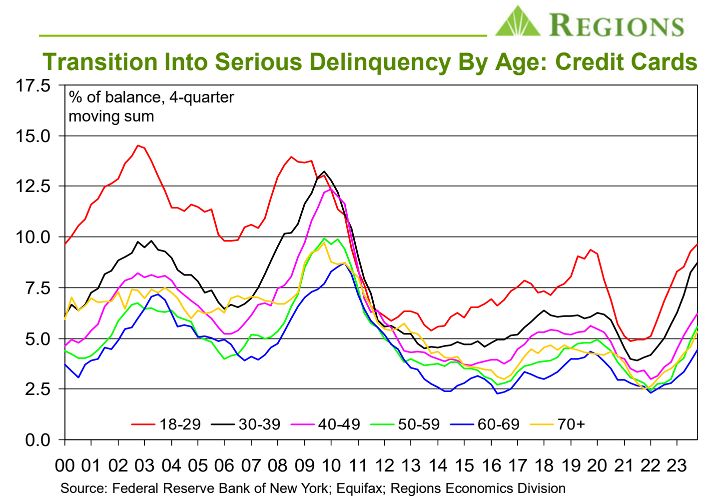
The second chart above shows transitions into delinquency on a percentage of balances basis, which the New York Fed reports on a four-quarter moving sum (i.e., annualized) basis. While transitions into delinquency for mortgage debt have risen over recent quarters, they nonetheless remain below the rate that prevailed in the years leading up to the pandemic, a period in which early-stage mortgage delinquencies fell to what at the time were all-time lows. To our earlier point, however, the rates at which auto loan debt and credit card debt are transitioning into delinquency are above pre-pandemic rates, significantly so in the case of credit card debt. The New York Fed has noted that while financial stress has increased generally, the most acute increases have come amongst younger and lower-income households. Though not providing detailed cuts of the data on the basis of income, researchers at the New York Fed report that while delinquency rates are at least slightly ahead of pre-pandemic norms across all income levels, the most pronounced increase has come amongst the lowest income levels. This would be consistent with our premise that much of the increase in financial stress over recent quarters stems from the combination of the end of pandemic-related transfers, the expiration of various payment moratoria, and a prolonged period of elevated inflation, which likely led to lower-income households working through whatever savings buffers they had built up in 2020 and 2021. That said, higher-income households have not been immune, but for different reasons. The New York Fed has in recent quarters offered that higher-income households incurred significant increases in outstanding credit card debt tied to discretionary spending in areas such as travel, tourism, recreation, and entertainment. Still, the increase in delinquency rates amongst higher-income households has been much more modest than the increase seen amongst lower-income households.

The New York Fed does provide more detailed data on the basis of age cohorts. Before discussing that, we'll note that borrowers aged 18-to-29 accounted for 7.3 percent of total household debt in Q4 2023, those aged 30-to-39 for 22.5 percent, those aged 40-to-49 for 25.7 percent, those aged 50-to-59 for 21.7 percent, those aged 60-to-69 for 14.5 percent, and those of age 70 or older for 8.4 percent. The chart to the side shows the age breakdown of borrowers across the various forms of household debt. Those aged 18-to-29 account for 21.4 percent of student loan debt outstanding, with those aged 30-to-39 accounting for 32.7 percent. Those in the youngest age cohort account for 13.7 percent of all outstanding auto loan debt and for 7.9 percent of all outstanding credit card debt. Those aged 30-to-39 account for 23.6 percent of outstanding auto loan debt and 18.4 percent of outstanding credit card debt. Those aged 40-to-59 account for the largest blocks of mortgage and home equity debt. As of Q4 2023, those aged 30-to-39 had seen the largest increase in outstanding debt since Q4 2019, up 31.2 percent, while those aged 50-59 saw a 16.6 percent increase, the smallest of any of the age cohorts.



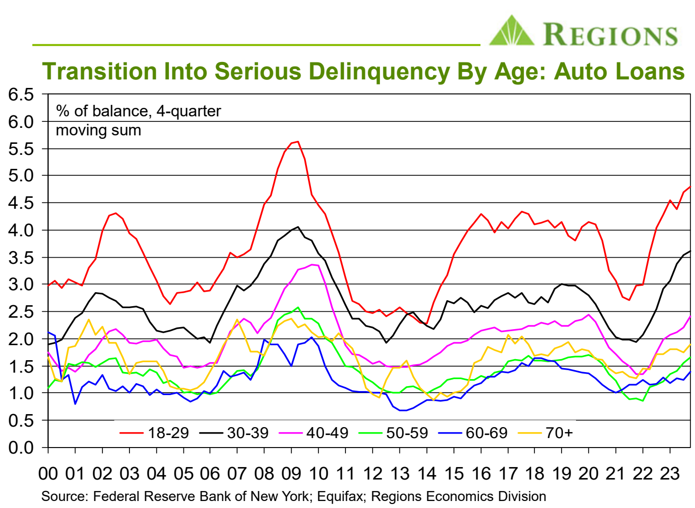
Interestingly enough, those aged 70 and above saw total debt increase by 29.7 percent over this period, the second largest of any of the age cohorts, mainly accounted for by higher mortgage debt. These shifts, however, to some extent simply reflect the aging of the population, as some borrowers advance to the next age cohort, taking their debt with them as they go.

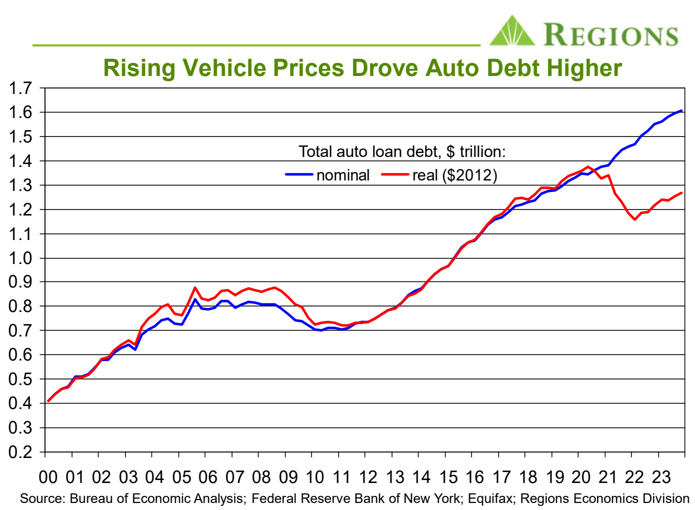




The first chart above shows the transition of total household debt into serious delinquency (or, debt delinquent for 90 days or more) broken down by age cohorts, again reported on an annualized basis. As seen in the chart, the incidence of serious delinquency has risen amongst borrowers in all age cohorts, but the most pronounced increase has come amongst those aged 18-to-29, with a rate of 2.27 percent as of Q4 2023. With a rate of 0.98 percent, those aged 60-to-69 had the lowest rate as of Q4 2023. As seen in the chart, it is not uncommon for the youngest borrowers to have the highest rate of serious delinquency, and that the rate of serious delinquency fell sharply across all age cohorts after the onset of the pandemic. It is also the case that these rates were, as of Q4 2023, still easily below pre-pandemic norms. That said, it is the direction and rate of change that is the main concern at present, amid considerable uncertainty as to how much further these rates will rise.

The second chart above is perhaps more telling, as it shows the transition into serious delinquency of credit card debt. In Q4 2023, total credit card debt transitioned into serious delinquency at a rate of 6.36 percent, the highest rate since Q2 2011. Transition rates for the two youngest age cohorts are significantly above the overall average, with a rate of 9.65 percent amongst those aged 18-to-29 and a rate of 8.73 percent amongst those aged 30-to-39, with those aged 60-to-69 posting the lowest rate, at 4.42 percent. As seen in the chart, the rate at which credit card debt is transitioning into serious delinquency is above the pre-pandemic rate for each age cohort, though only barely so in the case of those aged 60-to-69.

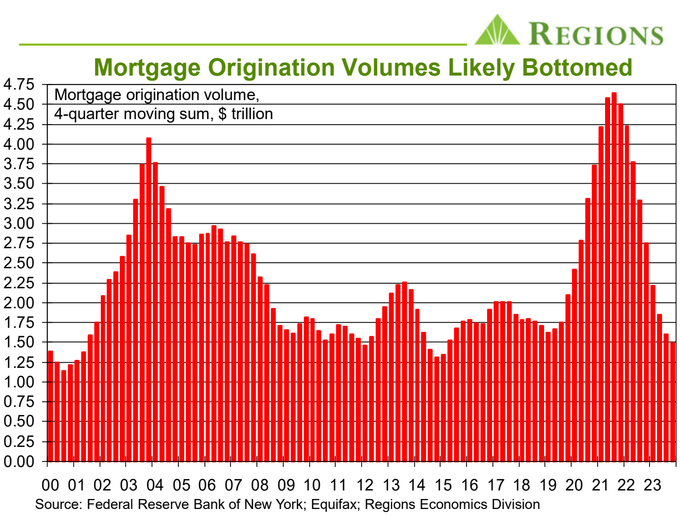




The first chart above shows the rate at which auto loan debt has transitioned into serious delinquency, broken down by age cohorts. In Q4 2023, total auto loan transitioned into serious delinquency at an annual rate of 2.66 percent, up from a low of 1.56 percent in Q4

2021 and above the rate that prevailed over the years leading up to the pandemic. As seen in the chart, however, it is the younger age cohorts which have seen the most pronounced increases in transition rates into serious delinquency, particularly those aged 18-to-29. It is interesting that the New York Fed notes that those loans originated since 2022 are thus far performing worse than loans of earlier vintages. In part, this can be accounted for by the extent to which motor vehicle prices had risen after the onset of the pandemic and the extent to which interest rates on auto loans had risen, a combination which resulted in meaningfully higher loan amounts and, in turn, meaningfully higher monthly auto loan payments compared to auto loans of earlier vintages. The chart showing the paths of nominal (not adjusted for price changes) and real (adjusted for price changes) auto loan debt goes to this point. In real terms, auto loan debt outstanding as of Q4 2023 was still below the peak level seen in Q2 2020, while since that point the level of nominal auto loan debt outstanding had risen by 19.7 percent. This isn't to say the level of nominal debt does not matter, but instead that the rate at which prices for new and used motor vehicles has risen has been a far more significant contributor to the growth in auto loan debt than has the increase in the number of vehicles that have been sold. That younger and/or lower-income households have struggled more with higher monthly payments as pandemic-related savings buffers have been whittled down and the cumulative effects of inflation have led to increased financial stress isn't surprising. The question here, however, is whether, or to what extent, the increasing incidence of auto loan delinquency amongst other age/income cohorts will continue over coming quarters. While lenders do have some degree of protection in the case of auto loans, as they at some point can repossess vehicles if it comes to that, they run the risk that declines in vehicle prices leave them with a loss on their hands to the extent that vehicle values would fall below outstanding loan amounts.

Returning to an earlier point, the main question most people have right now is the extent to which rising delinquency rates on household debt reflect a normalization to pre-pandemic rates or whether delinquency rates will continue to push higher. In the case of credit card debt, we're already past that point. At the same time, however, it is still two specific groups, i.e., younger and lower-income households, which have accounted for most of the increase in delinquencies. Though these cohorts account for smaller shares of overall outstanding debt, the marked deterioration in loan performance has pushed overall delinquency rates higher. It will come as no surprise when we say that, going forward, the extent to which the labor market holds up will be a key factor in how much further delinquency rates rise, particularly rates on credit card loans and auto loans. Though we expect slower rates of job and wage growth over coming quarters, we expect growth in aggregate labor earnings will continue to outpace inflation, as has been the case over this entire cycle. The aggregate, however, does not account for the distribution across workers of different earnings levels, and those amongst the lower levels will continue to feel the most stress. At the same time, however, recent layoff announcements across the tech sector are a reminder that those in higher wage brackets are not immune to disruptions in the labor market. Moreover, the recent upturn in continuing claims for unemployment insurance benefits (a measure of the number of people actually drawing, rather than simply applying for, benefits) suggests that those losing jobs more recently are having a harder time finding new jobs than has been the case over the past few years. While we continue to expect that any increase in the unemployment rate over coming quarters will be fairly modest, even a modestly higher jobless rate will put at least some upward pressure on delinquency rates.



Before closing, we wanted to make a few brief comments about patterns in mortgage loan originations. As the chart to the side shows, the annualized level of mortgage loan originations fell to $1.497 trillion as of Q4 2023, the lowest such total since Q1 2015. Recall that total home sales – combined new and existing – fell by 16.1 percent in 2023 after having fallen by 17.8 percent in 2022. At the same time, higher mortgage interest rates squashed mortgage refinancing activity, also weighing on originations. But, with quarterly origination volumes having risen in each of the past two quarters after having fallen in Q2 2023, our sense is that the slide in the annualized rate of originations has run its course. Lower mortgage interest rates will support purchase mortgage originations and mortgage refinancing, even if we see only modest increases in each. It is also worth noting that mortgage loan performance remains notably strong, which to some extent is a reflection of the extent to which mortgage loan originations over the past several years have been so highly concentrated amongst borrowers with the highest credit scores. To that point, in 2023 borrowers with credit scores of 760 or higher accounted for sixty-two percent of all mortgage originations, which is actually the lowest annual share since 2019. This is one reason that, despite having moved higher over recent quarters, the rate at which mortgage loan debt is transitioning into serious delinquency remains far below pre—pandemic rates. While any deterioration in labor market conditions would put stress on mortgage loan performance, the degree of any such stress would likely be less than seen with auto loan and credit card debt.

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