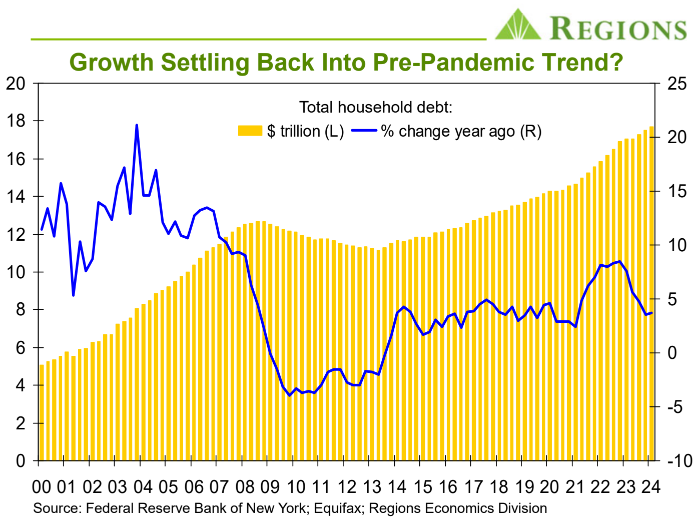
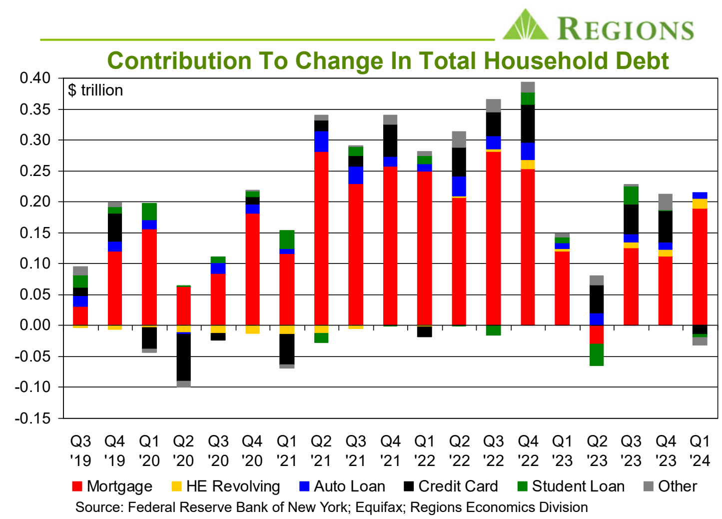
Q1 2024 Household Debt and Credit: Rising Delinquency Rates Raising Concerns

- Total household debt rose to $17.687 trillion in Q1 2024, an increase of $184 billion from Q4 2023
- Mortgage balances rose by $190 billion in Q1, credit card debt fell by $14 billion
- As of Q1, 3.25 percent of outstanding household debt was in some stage of delinquency, up from 3.13 percent in Q4 2023

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 $17.687 trillion in Q1 2024, an increase of $184 billion from Q4 2023. Total mortgage debt outstanding rose by $190 billion in Q1, a third straight quarterly advance after the decline posted in Q2 2023. Outstanding credit card debt fell modestly in Q1, but do not read too much into this as seasonal patterns typically yield a decline in credit card debt in the first quarter of any given year. What matters here is that the decline in Q1 2024 is smaller than the typical Q1 decline. What does stand out in the Q1 data is the increase in outstanding home equity line of credit (HELOC) debt; the 4.44 percent increase in Q1 is the largest quarterly increase since Q2 2005 and left outstanding HELOC balances up 10.91 percent year-on-year, the largest such increase since 2006. This now marks seven straight quarters of year-on-year increases in outstanding HELOC balances after what had been a run of fifty straight quarters of year-on-year declines. On an over-the-year basis, total household debt was up by 3.75 percent in Q1 which puts growth in total household debt back into the range that prevailed in the years prior to the onset of the pandemic. The overall delinquency rate on household debt rose to 3.25 percent in Q1 from 3.13 percent in Q4 2023, with a particularly large increase in severely derogatory accounts, i.e., those accounts in some stage of delinquency on which there has been either a report of repossession, a charge-off to bad debt, or a foreclosure action. Though having moved higher over recent quarters, early-stage and overall delinquency rates remain below pre-pandemic norms.





As we've discussed in prior editions of these write-ups, overall delinquency rates remain well below pre-pandemic norms; over the five years prior to the onset of the pandemic, the overall delinquency rate averaged 4.90 percent and as of Q4 2019 stood at 4.73 percent. Recall that the generous financial transfers to the household sector, primarily in the form of three rounds of Economic Impact Payments, boosted disposable income and afforded many households the opportunity to either pay down debt or to refinance higher-rate debt into fixed-rate debt with lower interest rates while simultaneously adding to savings buffers. One manifestation of household balance sheets being reconfigured was the 16.9 percent decline in outstanding credit card debt between Q4 2019 and Q1 2021, and another was that fixed-rate debt accounted for a significantly larger share of total household debt than had previously been the case. A robust recovery in the labor market helped drive growth in after-tax income which, combined with low interest rates and declining levels of non-mortgage debt, pushed monthly debt service burdens (interest and principal payments as a percentage of disposable income) to all-time lows in 2021, while delinquency rates on household debt also fell to new lows.

To the extent 2021 was as good as it was going to get for household balance sheets and credit performance, that meant there was only one direction for things to go, and there was bound to be some normalization in credit performance, the question being when we would

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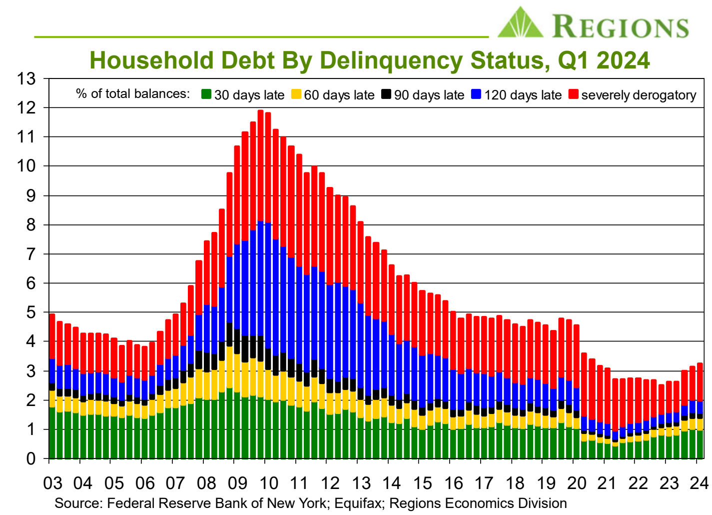
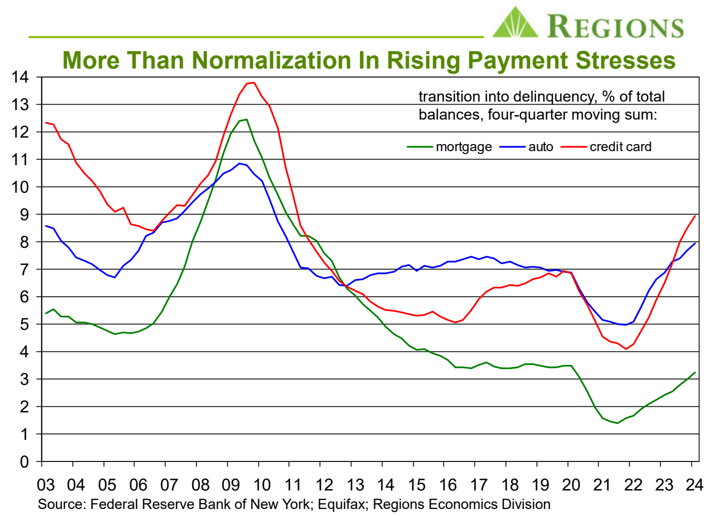
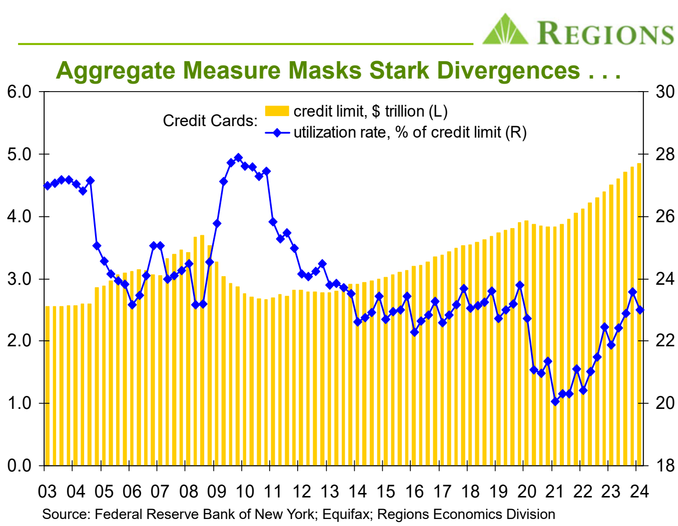
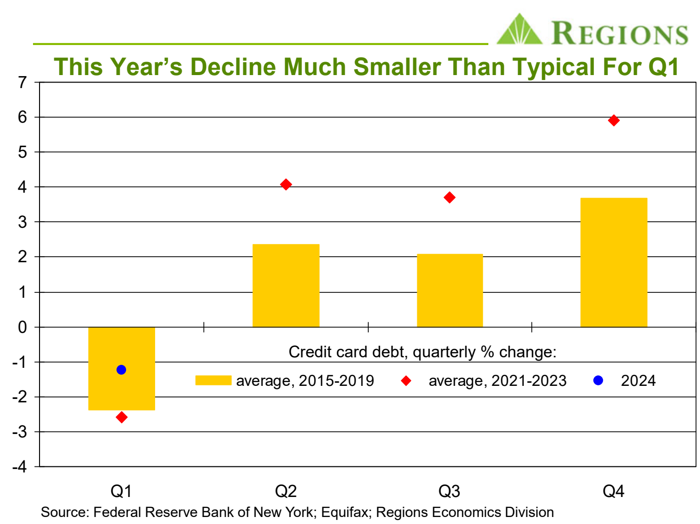
begin to see it. That inflation began to shoot higher in 2021, ultimately hitting a more than four-decade high, meant the normalization in credit performance began sooner, and proceeded at a faster pace, than would otherwise have been the case. Rapidly rising prices began to deplete savings buffers, with lower-income households with smaller buffers being more impacted, while higher interest rates began pushing debt service burdens higher. To be sure, the preponderance of fixed-rate debt on household balance sheets mitigated the extent of any payment adjustment shocks, but variable-rate debt, primarily credit card debt, and newly originated debt were sources of upward pressure on debt service burdens. The longer inflation endured and the higher interest rates went, the greater the stresses on household finances, stresses not limited to only the lowest-income households, hence the upward movement in delinquency rates on household debt seen over the past few quarters. Again, the overall delinquency rate on household debt remains below pre-pandemic norms, but that masks pockets of more significant stresses across age and income buckets and across debt categories.





The second chart above shows credit card and auto loan debt transitioning into delinquency at rates faster rates than had been seen prior to the onset of the pandemic. The transition rate is defined as the newly delinquent balance in one quarter expressed as a percentage of the previous quarter's balance that was not delinquent, and the New York Fed reports transition rates on a four-quarter moving sum, or, annualized, basis to remove the effects of clear seasonal patterns in the data. On an annualized basis, 8.93 percent of credit card balances and 7.94 percent of auto loan balances transitioned into delinquency in Q1, marking the highest transition rate for credit card debt since Q1 2011 and the highest transition rate for auto loan debt since Q4 2010. As of Q1, 10.69 percent of credit card balances were seriously delinquent, the only debt category for which the serious delinquency rate was above the pre-pandemic rate.

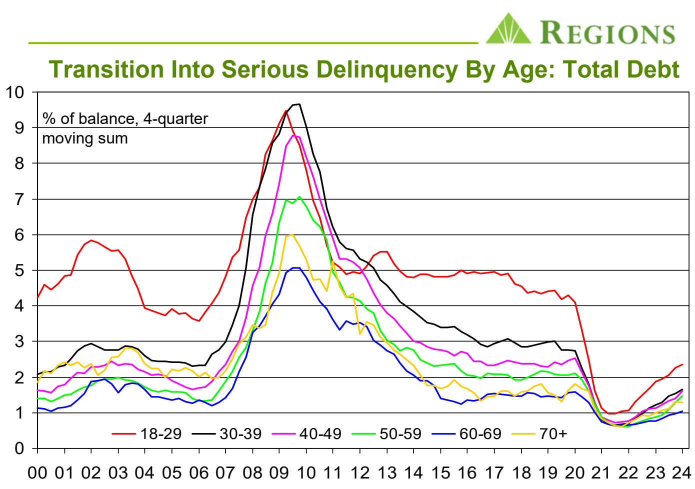


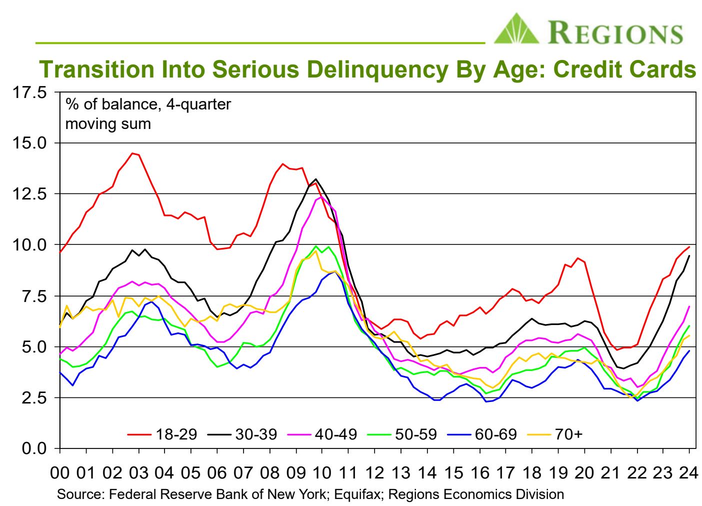


The further increase in credit card delinquencies in Q1 may seem at odds with the decline in balances and the decline in card utilization rates that also occurred in Q1. This is simply another illustration of how the aggregate data can, and often do, mask sharp divergences amongst the various cohorts that make up the aggregate, which in this case would be age and income cohorts. It is also worth noting that it is normal for credit card balances to decline in the first quarter of any given year when looking at the not seasonally adjusted data, such as the New York Fed data. Card balances tend to get run up during the fourth quarter of any given year, largely reflecting holiday shopping patterns, and balances then decline in the first quarter of the next year as those balances are at least partially paid down. When analyzing not seasonally adjusted data, what is relevant is not the sequential change, i.e., month/month or quarter/quarter, but how the change in a given month/quarter compares to the change typically seen in that period. As seen in the above chart, the decline in credit card debt in Q1, down 1.24 percent from Q4 2023, is well smaller than the typical Q1 decline. As a side note, the larger than normal average decline over the 2021-2023 period is heavily skewed by the 5.98 percent decline in Q1 2021, which goes to the discussion above about patterns in household balance sheets at that time. By the same token, declining balances in the first quarter of any given year are accompanied by declines in the credit card utilization rate (outstanding card balances expressed as a percentage of card limits), and as with the decline in balances, the decline in the utilization rate in Q1 2024 was smaller than the typical Q1 decline.

In their commentary around the Q1 2024 data, the New York Fed notes significant changes in utilization rates across different groups of borrowers. According to the New York Fed, fifty-two percent of borrowers were using less than twenty percent of their available card limit in Q1, with nineteen percent utilizing between twenty and sixty percent of their available limit, and eleven percent utilizing between sixty and ninety percent of their available limit. Perhaps more strikingly, however, is that eighteen percent of borrowers were utilizing at least ninety percent of their available limit, a group referred to as "maxed-out borrowers." It is perhaps not surprising that the New York Fed researchers find a strong correlation between utilization and delinquencies; borrowers current on all of their credit cards in Q1 2024 had a median utilization rate of thirteen percent, while those borrowers who became newly delinquent in Q1 had a median utilization rate of ninety percent. The data show that transition rates for borrowers with utilization rates of sixty percent or below were, as of Q1, at pre-pandemic norms while transition rates for those with utilization rates above sixty percent are easily past that marker, and it is these borrowers who have accounted for most of the increase in overall credit card delinquency rates. To that point, about one-third of card balances associated with maxed-out borrowers have transitioned into delinquency over the past year, which compares to a pre-pandemic norm of about twenty-five percent per year.

It helps to note that card utilization rates are a function of balances and credit limits, and those with lower card limits tend to have higher utilization rates. The New York Fed researchers note that maxed-out borrowers had a median card limit – total across all cards – of $5,000 in Q1, while those with utilization rates of twenty precent or less had a median limit of $21,000. In that sense, utilization rates can convey some information of underlying income and credit quality characterizations of borrowers, for instance, borrowers with higher incomes and higher credit scores tend to have higher card limits and lower utilization rates. There has been some speculation that the transfer-fueled jump in disposable income and decline in non-mortgage debt in 2021 led to credit scores amongst certain groups of borrowers being, well, inflated, which in turn may have led to credit being extended to these borrowers than otherwise would have been the case. Absent the support to income and the paring down of savings buffers, some of these borrowers may be struggling with debt service burdens under the weight of cumulative price increases, particularly for necessities such as food, energy, and transportation. While we do not have the capacity to make such determinations based on the data available to us, we'd think that to the extent this has been the case, it is a secondary, not a primary, driver of the rising credit card delinquency rate over recent quarters.





The New York Fed's analysis shows younger and lower-income borrowers are more likely to be maxed-out (credit card) borrowers, which is consistent with the second chart above showing the two youngest age cohorts with the highest transition rates. It is also worth noting that transition rates amongst those in the youngest two age cohorts began to increase earlier in the cycle than did rates for older borrowers, which could reflect younger borrowers with lower incomes running through savings buffers faster than those in the older age cohorts as they dealt with the stresses of higher inflation and higher interest rates. Clearly, payment stresses are being felt across age and income cohorts, but those stresses are significantly more acute amongst younger and lower-income borrowers. It is also worth noting that payment stresses rates have been rising despite a still-healthy labor market, such that a meaningful deterioration in labor market conditions could have an outsized impact on credit performance, particularly amongst younger and lower-income borrowers.

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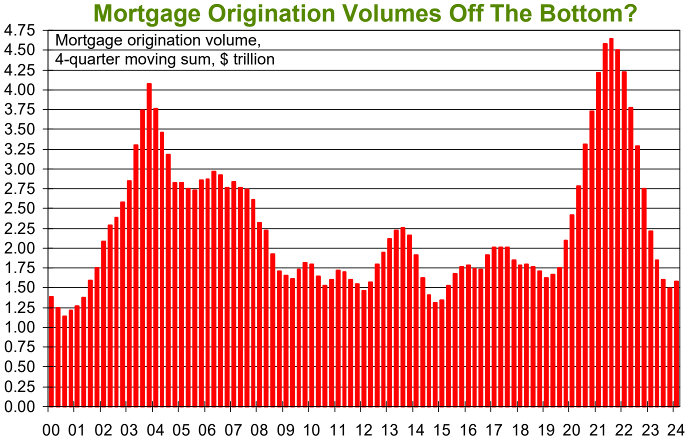
Mortgage Origination Volumes Off The Bottom?



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

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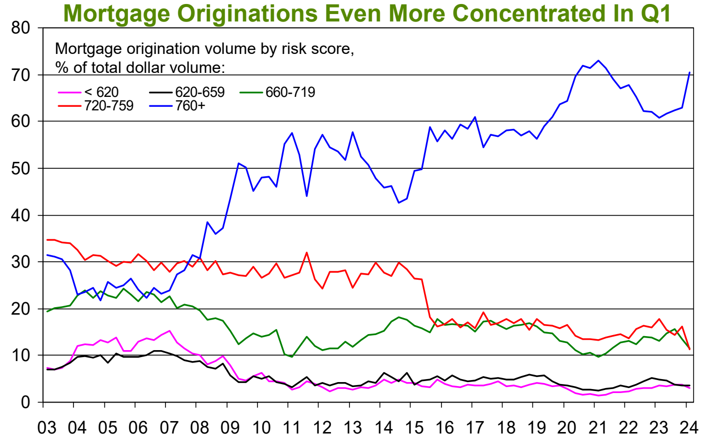
Mortgage Originations Even More Concentrated In Q1



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

Though having edged higher, the rate at which mortgage debt is transitioning into delinquency is still below pre-pandemic norms. We've noted in our write-ups of the quarterly data on mortgage delinquencies that early-stage mortgage delinquency rates had fallen to the lowest on record prior to the onset of the pandemic, and they subsequently fell even further. In that sense, some normalization was to be expected, and there is nothing to suggest that what we are seeing in the data at present goes beyond that. The primary factor behind the stellar performance of mortgage loans has been that underwriting standards were tightened considerably in the wake of the 2007-09 recession, which is illustrated in the second chart above. The concentration in mortgage originations amongst those with credit scores of at least 760 became more pronounced in Q1, though in addition to tighter lending standards this could also reflect increasingly binding affordability constraints pushing more and more prospective buyers to the sidelines, leaving those with higher incomes, and in turn higher credit scores, to capture a larger share of originations. To the extent this was, and remains, the case, there is no guarantee that the modest increases in mortgage loan originations seen over the past three quarters will be sustained. It is also worth noting that at least some of the recent growth in revolving home equity lines of credit (HELOC) could reflect borrowers substituting this debt for higher-rate credit card debt. This could take the form of drawing on HELOC lines to pay down existing card balances or simply drawing on HELOC lines to fund expenditures that otherwise would have been funded via credit card. Either way, going-on rates on HELOC lines are around one-third of rates on credit card debt and many banks have been promoting home equity lines. While posing little threat to equity positions for most borrowers, the rising use of HELOCs has likely left credit card balances lower than they otherwise would be for certain groups of borrowers.

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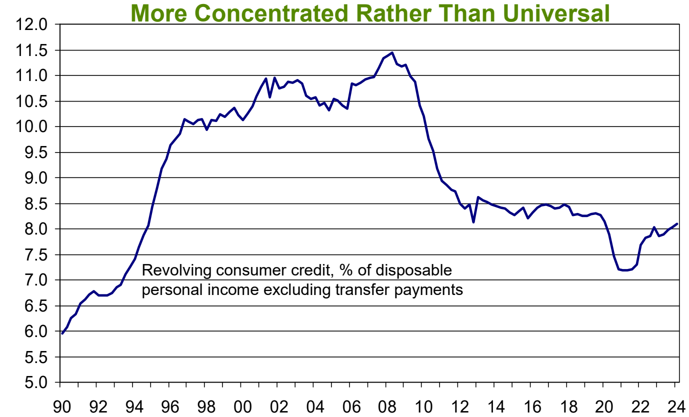
Stresses From Rising Credit Card Debt More Concentrated Rather Than Universal



Source: Bureau of Economic Analysis; Federal Reserve Board; Regions Economics Division

Lost in the focus on the level of credit card debt and rising rate of credit card delinquencies is that the level of credit card debt as a share of after-tax income excluding transfer payments, which we consider the most meaningful measure of funds available for debt service, remains well below historical norms. Granted, this is an aggregate measure, but this does go to the point that payment stresses are more localized than universal. We can make the same point about overall debt service burdens which, though up from the "artificial" lows seen in 2021, also remain low by historical standards. We will note that monthly mortgage debt service burdens remain near all-time lows while debt service burdens for non-mortgage debt have returned to pre-pandemic levels. That debt service burdens remain this low despite interest rates being meaningfully higher than has been the case over the past fifteen years is an indication of the degree to which fixed-rate debt has insulated many households from the payment reset shocks seen in prior cycles.

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