ECONOMIC UPDATE

REGIONS

February 12, 2020

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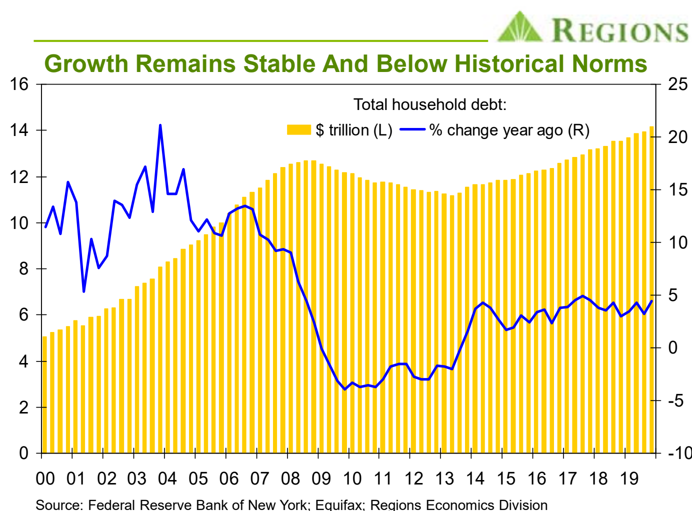
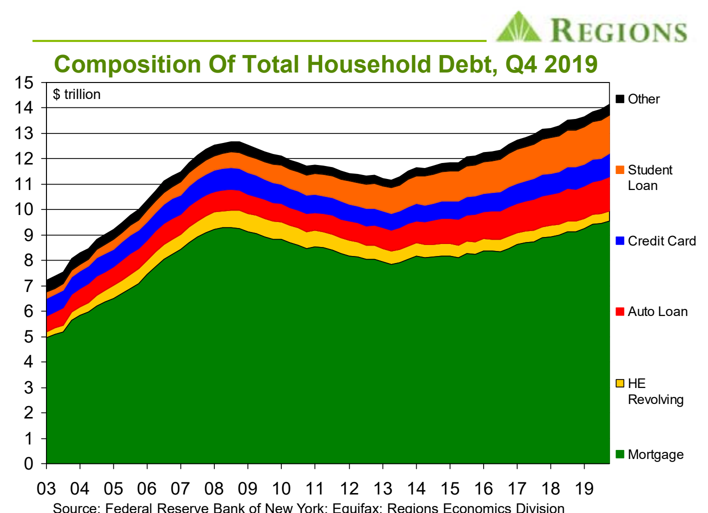
Q4 2019 Household Debt and Credit: Overall Debt Burden Still Highly Manageable

- Total household debt rose to $14.145 trillion in Q4 2019, an increase of $193 billion from Q3 2019
- Mortgage balances rose by $120 billion in Q4, accounting for 62 percent of the increase in total debt outstanding
- As of Q4, 4.73 percent of outstanding household debt was in some stage of delinquency, compared to 4.78 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. Total household debt rose to $14.145 trillion in Q4 2019, a $193 billion increase from Q3 2019, marking the 22nd consecutive quarterly increase in outstanding household debt. Mortgage debt was once again the main driver of growth in total household debt in Q4; the $120 billion increase in outstanding mortgage balances accounted for 62.2 percent of the increase in total household debt. A wave of refinancings touched off by lower mortgage interest rates helped fuel the growth in mortgage originations in Q4. Outstanding credit card balances logged their largest quarterly increase since Q4 2000, with outstanding auto loan and student loan balances also rising. In contrast, outstanding home equity line balances posted a 12th straight decline and the 32nd decline in the last 33 quarters. The overall delinquency rate on household debt eased to 4.73 percent in Q4 from 4.78 percent in Q3.





On an over-the-year basis, total household debt increased by 4.44 percent in Q4, following a 3.26 percent increase in Q3. As we have routinely noted, growth in total household debt over the course of this cycle has been significantly slower than in prior cycles. While this is hinted at in the first chart above, the New York Fed data series has a somewhat limited life, but the *Flow of Funds* data published by the Federal Reserve Board date back to the 1950s and affirm how relatively slow growth in household debt has been during the current cycle. Our view is that this mainly reflects what, in the post-recession years, has been a greater degree of discipline on the part of both borrowers and lenders. What will bear watching is the extent to which this discipline will hold up as we move even further into the current expansion, now the longest U.S. expansion on record.

Though in most discussions of household debt the focus tends to be on the level of debt, or, should we say what with each quarter is the new record level of household debt, we stubbornly insist on putting the level of household debt in proper context, and have a few ways of doing so. One is to note that while the level of household debt in nominal, or, not adjusted for inflation, terms stands 11.6 percent above its prior peak as of Q4 2019, in real, or, inflation adjusted, terms the level of household debt remains 5.1 percent below its prior peak. That real household debt remains so far below the prior peak (seen in Q3 2008) with inflation as mild as it has been over much of the current expansion reinforces our point about how slow growth in nominal household debt has been during this cycle. Even if we focus on the level of nominal household debt standing 11.6 percent above its prior peak, that should be put into the context of disposable (or, after-tax) personal income excluding transfer payments, which we routinely argue is the income stream from which debt service payments are made. As of Q4 2019, the level of disposable personal income excluding transfer payments stood 48.88 percent above its prior peak. In other words, income growth has easily outpaced growth in household debt over the course of the current expansion, resulting in a significant reduction in the household debt-to-income ratio. Finally, a prolonged period of low interest rates combined with income growth significantly outpacing growth in household debt has left monthly debt service burdens (or, monthly

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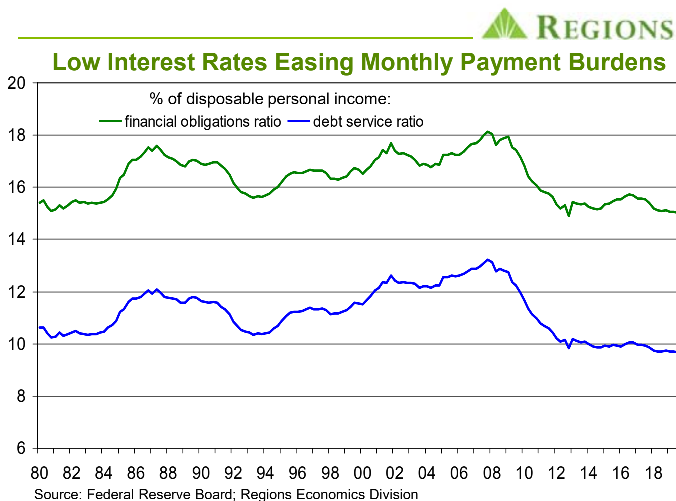
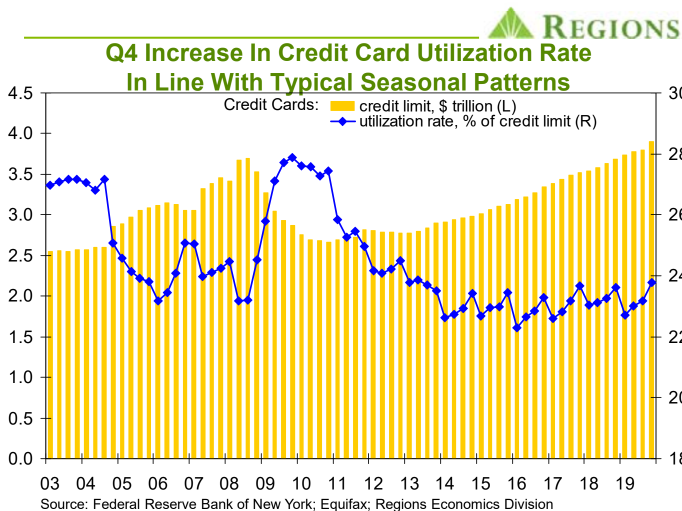
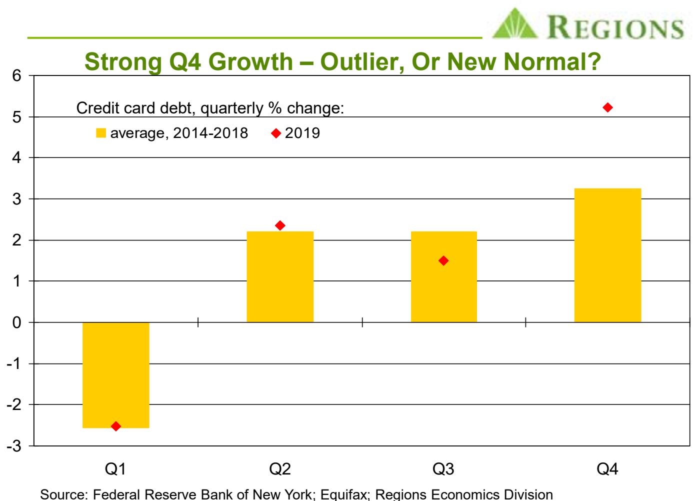
principal and interest payments as a percentage of disposable income) hovering at all-time lows. Or, if one prefers the broader financial obligations ratio, which accounts for rent and lease payments, that too is hovering near all-time lows.



In all fairness, focusing on aggregate ratios masks what can be significant distribution issues, such that the debt service burden for any given individual can vary, perhaps dramatically, from the aggregate measure. Lacking sufficiently detailed data, we are unable to draw meaningful distinctions across various cuts of household income, but we nonetheless think there is signaling value in the aggregate ratios such as the debt-to-income ratio and the debt service ratio. These measures were sending clear warning signs ahead of the 2007-09 recession; that many opted to ignore these signs is a different discussion for a different day. So, while it would be unreasonable to think there are no pockets of financial stress in the household sector, households have been adept at managing balance sheets, including taking on greater shares of fixed rate debt, during the current expansion, leaving household balance sheets in better condition than has been the case for quite some time.

Still, some point to the rapid growth in credit card debt over the final months of 2019 as evidence that households, and lenders, have begun to abandon discipline. To that point, some of the coverage we've seen about the New York Fed's latest report is focused on the new record level of credit card debt, with the same lack of context we've grown accustomed to in discussions of overall household debt. Outstanding credit card balances increased to $927 billion in Q4 2019 which, yes, is the highest level on record. The $46 billion increase in credit card balances in Q4 reflects a 5.22 percent increase from Q3 2019, and leaves credit card balances up 6.55 percent year-on-year. The New York Fed does report that the percentage of credit card debt in serious delinquency, or, delinquent for 90-or-more days, rose to 8.36 percent in Q4 2019, up from 7.77 percent in Q4 2018, and the transition rate of credit card debt into serious delinquency rose to 5.32 percent in Q4 2019, the highest transition rate since Q1 2012. We have noted over the past several quarters that the deterioration in credit card performance has largely been confined to the subprime space, and there is little to suggest that has changed.

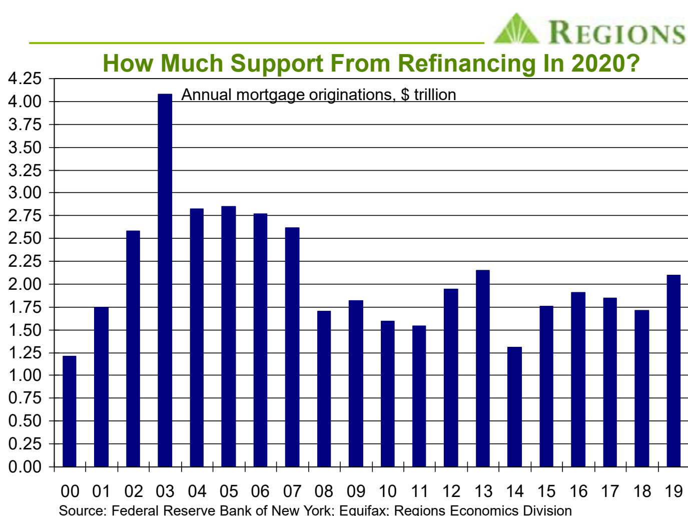




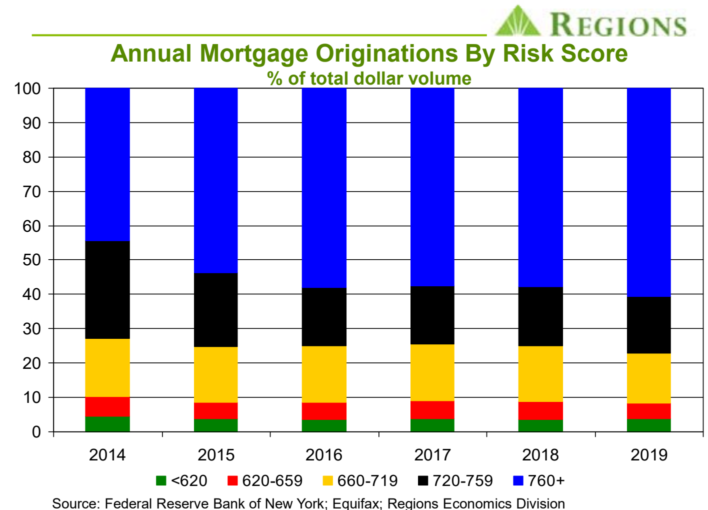
The broader point, however, is that just as with total household debt, "new record level" of credit card debt is meaningless without context. Part of the strong growth in credit card balances reported for Q4 2019 reflects reporting changes. Typically, retail store cards fall into the ever popular "other" household debt category. With some of these balances having been reclassified as credit card debt in the Q4 data, measured growth in outstanding credit card debt will have gotten a one-off boost. More significantly, as with virtually any economic data series, there are clear seasonal patterns in credit card debt. We've discussed this in past editions of these write-ups in terms of utilization rates on available credit card lines, which we again show in our first chart above. In any given year, utilization rates tend to rise in Q4 then decline in Q1 of the subsequent year. Another way to address the seasonality issue is to look at the change in credit card debt in each quarter of any given year relative to historical norms for that quarter over time, which we show in the second chart above, comparing the quarterly percentages in each quarter of 2019 to the average for each quarter over the 2014-2018 period. To be sure, the outsized growth in Q4 2019 jumps out, meaning that Q4 growth in credit card debt in 2019 was stronger than is normal for the quarter. But, that follows weaker Q3 growth than is normal for the quarter, while growth in both Q1 and Q2 was in line with historical seasonal norms.

Reporting changes and payback for seasonally weak Q3 growth help account for some of the jump in credit card debt in Q4 2019, but not all of it. Though one would be hard-pressed to find evidence in the monthly retail sales data published by the Census Bureau, all other accounts – such as reports from credit card companies and companies tracking online sales transactions – point to robust growth in holiday season spending in 2019. In any given year, holiday season spending obviously fuels the strong Q4 growth in credit card debt, and from all indications, well, other than the monthly retail sales data, 2019 holiday season spending was very strong. There is little in the data, however, to suggest that either lenders or consumers suddenly abandoned discipline when it comes to either issuance or utilization of credit cards, and there is less drama in "new record level of credit card debt" than the blaring headlines suggest. In this sense, the Q1 data will be interesting to watch. As we show in the charts above, credit card balances and utilization rates historically tend to fall in the first quarter of any given year, and we have no reason to expect Q1 2020 will be any different. And, sure, a decline in credit card balances in Q1 would mean bye-bye record level of credit card debt, but, come on, look on the bright side, that would just set up a new round of blaring headlines on top of stories that provide absolutely no context when credit card balances ultimately turn up again in a subsequent quarter.

The jump in mortgage originations in Q4 put full-year 2019 mortgage originations at $2.098 trillion, the highest annual total since 2013. As noted above, a surge in mortgage refinancings in response to lower mortgage interest rates boosted overall mortgage originations in 2019. Refinancings accounted for 50.4 percent of all mortgage loan applications in 2019, up from 39.8 percent in 2018, and also accounted for 50.4 of the dollar volume of all mortgage loan applications, up from 36.0 percent in 2018. That pattern has continued thus far in 2020, with refinancings accounting for over 60 percent of all mortgage loan applications, in terms of both the number and the dollar volume of loans How much longer this refinancing run can continue is uncertain, and when it does begin to fade growth in mortgage debt will slow, perhaps significantly. With extraordinarily lean inventories acting as an increasingly binding constraint on existing home sales, refinancing activity has played a key part in the continued growth of mortgage debt, but we expect little, if any, improvement on the inventory front in 2020. To be sure, there is upward room for new home sales, but not nearly to the extent that would make up for the shortfall in existing home sales.



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

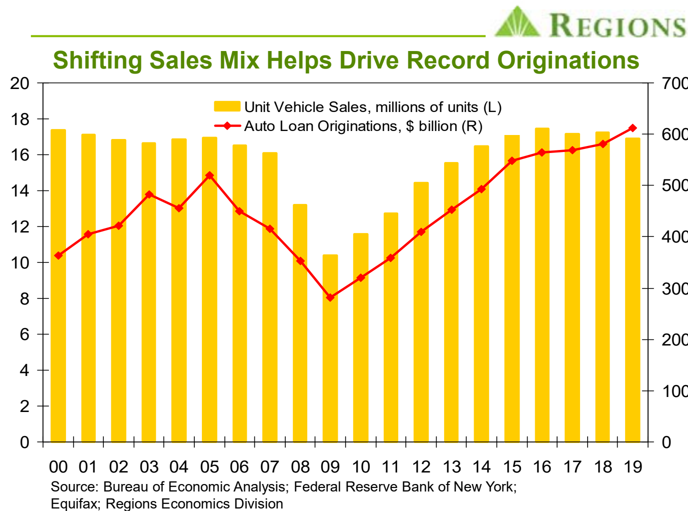


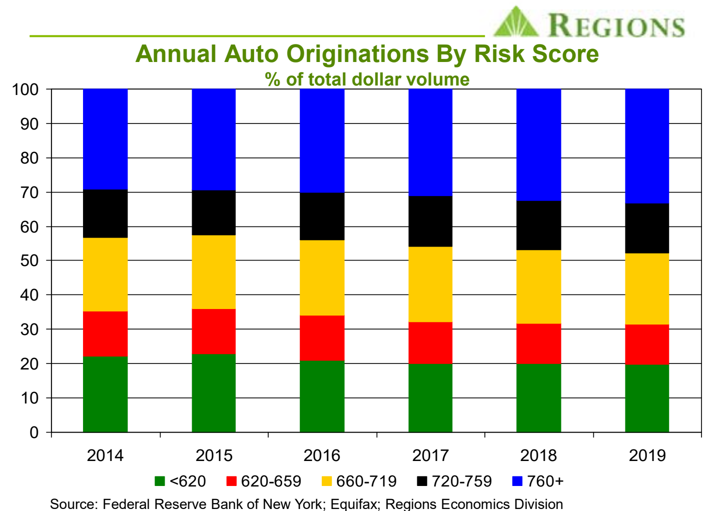
Source: Federal Reserve Bank of New York; Equifax; Regions Economics Division

As shown in the second chart above, mortgage originations remain highly concentrated amongst those with credit scores of 760 or higher. Those in this group accounted for 60.72 percent of the dollar volume of total mortgage loan originations in 2019, up from 57.78 percent in 2018. Though it is neither surprising nor particularly noteworthy that those with credit scores below 620 accounted for only 3.71 percent of total mortgage originations in 2019, it is an interesting contrast to the 2004-2007 period, when those in this credit score bucket accounted for 12.69 percent of all mortgage originations. Though we do not know from the Equifax/New York Fed data, it is likely that if looked at on a number of loans basis, the distribution of mortgage originations across credit score buckets would be more widely dispersed than is the case on a dollar volume basis. The median credit score on mortgage loans originated during Q4 2019 was 770, up from 758 in Q4 2018 but still below the post-recession high of 781 in Q1 2012.

Auto loan originations totaled $612 billion in 2019, a 4.85 percent increase from 2018 even though unit sales of new motor vehicles slipped from 17.214 million in 2018 to 16.890 million in 2019. In part, the shifting sales mix helped push the dollar volume of auto loan originations higher, as SUVs/light trucks, which carry significantly higher sticker prices than do automobiles, accounted for 72.2 percent of total unit sales in 2019, the highest share on record. Additionally, purchases of used motor vehicles do not turn up in the BEA's data on unit motor vehicle sales but do turn up in the data on auto loan originations. Though those with credit scores of 760 or above account for the largest shares of auto loan originations, the concentration is not nearly as high as is the case with mortgage loan originations. In 2019, those with credit scores of 760 or above accounted for 33.18 percent of total auto loan originations (on a dollar volume basis), while those with credit scores below 620 accounted for 19.87 percent of total originations. There has been a gradual, but steady, shift in originations towards the higher credit score buckets over the past few years. We anticipate that unit sales of new motor vehicles will slip further in 2020, but should the mix of sales remain heavily weighted in favor of higher-priced SUVs/light trucks, as we anticipate

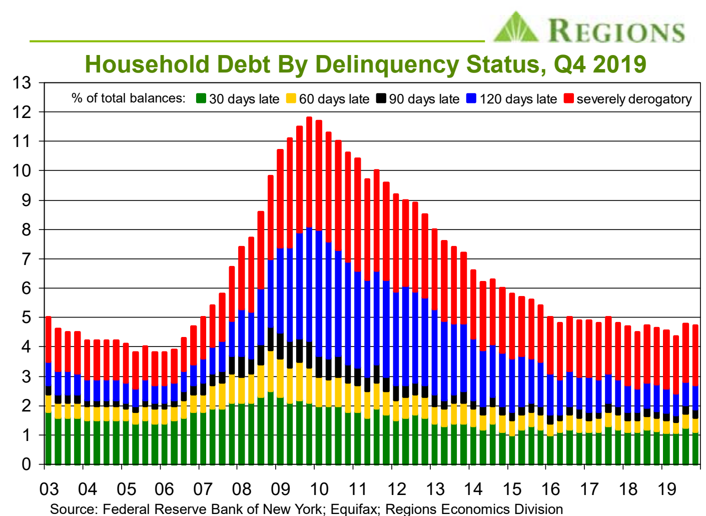
will be the case, and price considerations could lead to a shift from new to used vehicles, then the dollar volume of auto loan originations could post another increase. The median credit score on auto loans originated in Q4 2019 was 715, up from 710 in Q4 2018.





As noted earlier, the overall delinquency rate on household debt fell to 4.73 percent in Q4 2019 from 4.78 percent in Q3, but stood 13 basis points higher than was the case at year-end 2018. There are, as we discussed in last quarter's update, clear seasonal patterns in delinquency rates on household debt; for instance, delinquency rates tend to rise in the third quarter of any given year and fall in the fourth quarter. As such, we were not as alarmed by the jump in the delinquency rate in Q3 as were some others. The five basis point decline in the delinquency rate in Q4 was, however, smaller than is typical for the quarter, which reflects increases in late-stage delinquencies. It is worth noting that the seasonal patterns are most apparent in the 30-day delinquency rate; the 30-day delinquency rate rose to 1.24 percent in Q3 2019 then fell to 1.11 percent in Q4, both consistent with typical seasonal patterns, but the 1.11 percent rate in Q4 2019 is lower than the 1.15 percent rate in Q4 2018 and the 1.16 percent rate in Q4 2017.

The serious delinquency rate (loans delinquent for at least 90 days) on total household debt rose to 3.15 percent in Q4 2019, up from 3.04 percent in Q3 and 3.10 percent in Q4 2018. The share of household debt in the seriously derogatory category, which includes some debts that have been taken off of lenders' books but upon which they continue to attempt collection, rose to 2.02 percent, the highest rate since Q3 2015. The serious delinquency rate on student loans rose to 11.06 percent in Q4 from 10.90 percent in Q3, but is below the 11.42 percent rate in Q4 2018. As the New York Fed notes, however, in any given quarter the reported delinquency rate on student loans is understated, as roughly half of student loans are in deferment, in grace periods, or in forbearance and, as such, not currently in the repayment cycle. This suggests that, amongst loans actually in the repayment cycle, delinquency rates could be roughly twice as high as the reported rate. The serious delinquency rate on credit card debt rose to 8.36 percent in Q4 2019, and the serious delinquency rate on auto loans rose to 4.94 percent.



While there may be pockets of concern in household credit performance, there is nothing in the Equifax/New York Fed data to suggest a broad based deterioration. That said, one glaring hole in the data is that there is no distinction between banks and non-bank lenders in terms of lending standards, distributions across credit scores, and other metrics. While loan performance amongst banks is routinely reported, that is not the case across the spectrum of non-bank lenders. One can make inferences from patterns seen in the aggregated data reported by the New York Fed, but our worry is that should there be a meaningful deterioration in economic conditions, particularly labor market conditions, it could be that delinquency rates rise faster and by more than would be expected. This is by no means to suggest anything on the order of what we saw around the 2007-09 recession will occur during the next downturn, but instead to simply raise the possibility that there may be problems lurking beneath the surface that are not apparent in the aggregate data. The reality is that there is only one way we're going to find out, and, in all honesty, we're not in all that much of a hurry to learn the answer. Still, it is highly unlikely that household debt, record level or not, poses a material risk to the broader economy, a welcome and obvious contrast to the last cycle.

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