ECONOMIC UPDATE

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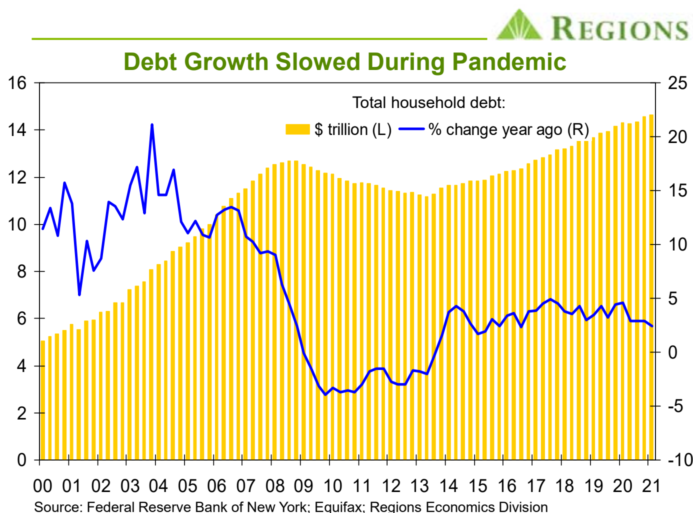
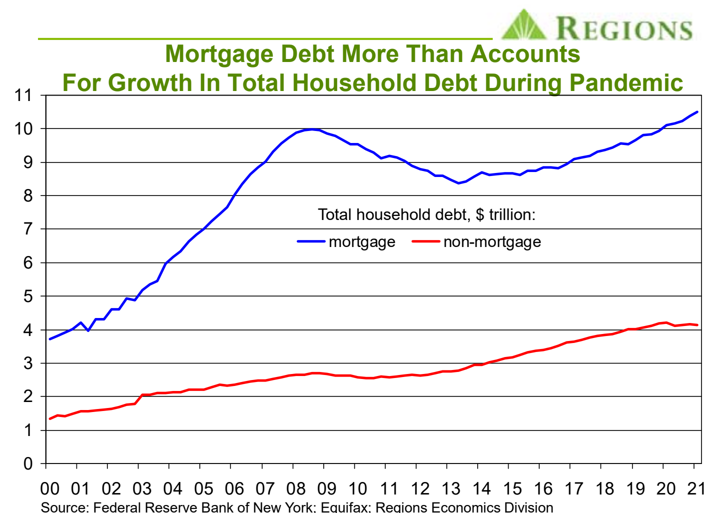
Q1 2021 Household Debt and Credit: Debt Inches Higher, Payment Burdens Sink

- Total household debt rose to $14.644 trillion in Q1 2021, an increase of $85 billion from Q4 2020
- Mortgage balances rose by $114 billion in Q1, more than accounting for the entire increase in total debt outstanding
- As of Q1, 3.05 percent of outstanding household debt was in some stage of delinquency, compared to 3.17 percent in Q4 2020

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 $14.644 trillion in Q1 2021, an $85 billion increase from Q4 2020 and the third straight quarterly increase after total debt declined slightly in Q2 2020. Mortgage debt more than accounted for the entire increase in total household debt in Q1, rising by $114 billion, fueled by strong refinancing activity and further increases in home sales. Indeed, over the course of the pandemic, growth in mortgage debt has more than accounted for the entire increase in total household debt, with credit card debt outstanding having fallen significantly. Recall that in Q4 2019, i.e., the last quarter before the pandemic took hold, credit card debt posted its largest quarterly increase since Q4 2000. The overall delinquency rate on household debt fell to 3.05 percent in Q1 from 3.17 percent in Q4 2020.





Growth in total household debt has decelerated over the course of the pandemic, with the 2.41 percent year-on-year increase in Q1 2021 the smallest such increase since Q2 2015. By way of comparison, total household debt increased by 4.44 percent in 2019. To our earlier point, mortgage debt outstanding increased by 4.60 percent year-on-year in Q1 while total non-mortgage debt outstanding fell by 2.25 percent, the third consecutive over-the-year decline. Relative to Q4 2019, total mortgage debt is 6.31 percent higher as of Q1 2021, with total non-mortgage debt 2.27 percent lower. Student loan debt was up 3.19 percent year-on-year in Q1, with auto loan debt up 2.67 percent year-on-year, but outstanding home equity lines were down 13.21 percent and credit card debt outstanding was down 13.77 percent. Declining home equity line balances are by now old news, with Q1 2021 marking the 45th consecutive year-on-year decline, declining credit card balances are a more recent development, with quarterly declines in four of the past five quarters and year-on-year declines in each of the past four quarters. The $49 billion decline in credit card balances in Q1 is the second largest quarterly decline in the life of the data, which date back to 1999.

On the surface, this string of declines in outstanding credit card balances may seem surprising. After all, as of April the level of nonfarm employment was still 8.215 million jobs below the level as of February 2020, the last month before the economy began to shut down in response to the pandemic and the efforts to stem its spread. But, the effects of lost labor income have been more than negated by an unprecedented degree of fiscal transfers, including three rounds of Economic Impact Payments (EIP) and expanded unemployment insurance (UI) benefits. As a result, as of Q1 2021 the level of disposable (or, after-tax) personal income was 18.63 percent above the level as of Q4 2019, but disposable personal income excluding transfer payments was only 1.42 percent above the Q4 2019 level. There is a body of survey evidence showing that the majority of EIP funds were either saved or used to pare down debt, and that was the case across all household income buckets. Additionally, when they have spent over the past several quarters, consumers have made increased use of debit cards and have become meaningfully less reliant on credit cards to facilitate spending.

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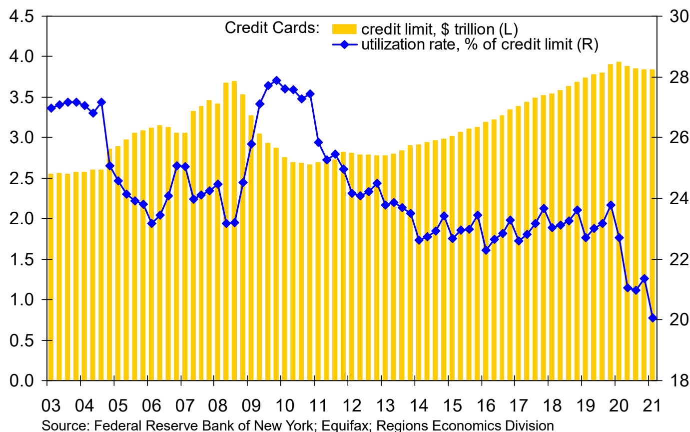
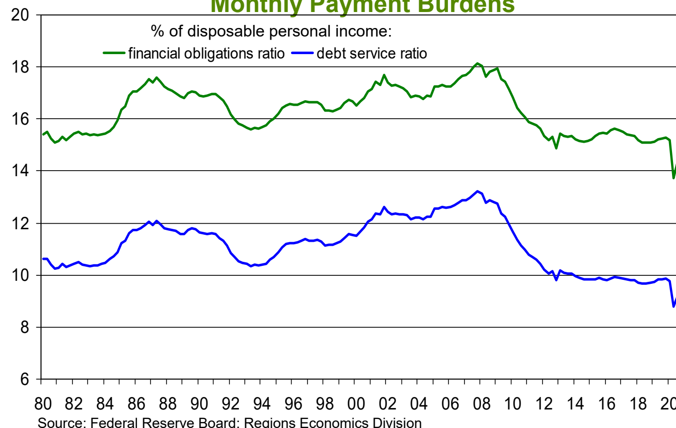
Will Credit Card Utilization Rebound?



Recall that in the early stages of the pandemic when the economy was shutting down and nonfarm payrolls fell by over 20 million jobs in the span of less than two months, many expected consumers would turn to credit cards to help make ends meet and that a surge in credit card debt would be accompanied by a substantial wave of delinquencies. Neither turned out to be the case which, again, mainly reflects the aggressive fiscal response but also reflects forbearance programs that enabled borrowers to pause payments on other forms of debt. With outstanding balances having declined substantially and credit limits only slightly lower, credit card utilization rates have plummeted over the course of the pandemic, hitting a series low in Q1 2021.

What remains unknown is whether, or to what extent, this shift away from credit cards will persist. This is part of the broader question of whether the pandemic will have triggered lasting changes in the financial behavior of households, such as the level and/or composition of consumer spending and whether the "equilibrium" personal saving rate in the post-pandemic world will be higher than the pre-pandemic rate (around 7.5 percent of disposable personal income). In part, the diminished reliance on credit card debt over the past several quarters reflects significantly depressed spending on discretionary services such as travel, entertainment, and recreation, spending that was largely facilitated via credit cards and very little of which was done via debit cards. As the more and more people are vaccinated and the economy more fully reopens, such spending is expected to rebound strongly, which suggests credit card utilization will begin to increase. At the same time, however, utilizing credit cards and carrying credit card balances are not necessarily the same thing. Our estimate puts the level of "excess saving" on household balance sheets, or, saving in excess of the level had pre-pandemic saving patterns prevailed throughout, at just over $2.2 trillion as of March. So, it could be that, at least over the next several months, credit cards will be utilized to facilitate transactions but that consumers will use some portion of this excess saving to pay off/pay down credit card balances at a faster rate than was the case prior to the pandemic. It could be that, for many consumers, the experience of the pandemic was a sort of wake-up call to the costs of carrying large card balances, with the wave of pandemic-related transfer payments offering a chance to wipe the slate clean. In such cases, there could be lasting changes in behavior that result in diminished credit card usage in the future. While we do think the most likely outcome is that credit card utilization, including the incidence of carrying balances, will increase, it could be a few more quarters before that happens on a widespread basis.

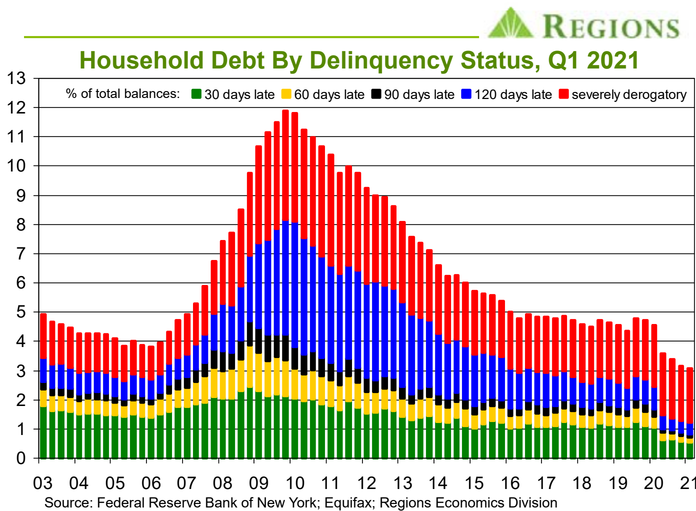
Low Interest Rates, Fiscal Transfers Holding Down Monthly Payment Burdens

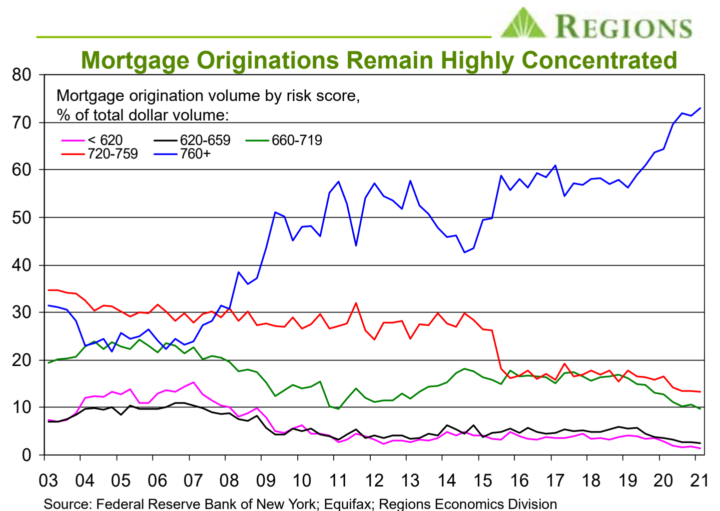


Another effect of the unprecedented degree of fiscal transfers is that, by supporting disposable personal income, these transfers have helped push monthly household payment burdens even lower. Prior to the pandemic, monthly debt service burdens (or, total principal and interest payments as a percentage of disposable personal income) and financial obligations burdens (a more comprehensive measure of household financial payments) were hovering at all-time lows, mainly reflecting the effects of a prolonged period of low interest rates, but payment burdens have diminished further over the past several quarters. Note that the data shown in the chart to the side run only through year-end 2020, and as such do not capture the second and third round of Economic Impact Payments. With disposable personal income having risen at an annualized rate of 67.0 percent in Q1, there will be a dramatic decline in household payment burdens. To be sure, there will be some payback in the Q2 data, as disposable personal income will decline significantly due to the drop-off in transfer payments. Of more relevance is that with what has been restrained growth in debt, particularly non-mortgage debt, household payment burdens will remain very manageable over coming quarters, particularly to the extent further improvement in labor market conditions leads to firmer growth in labor earnings, far and away the largest single component of personal income.

Another development over the past several quarters has been a meaningful decrease in early-stage delinquencies on household debt which has in turn pulled down overall delinquency rates. In Q1 2021, the overall delinquency rate on household debt fell to 3.05 percent, which is 151 basis points below the delinquency rate in Q1 2020. Delinquency rates have declined across all forms of debt, which in part reflects the effects of fiscal transfers and in part reflects forbearance programs and voluntary efforts on the part of lenders to work with borrowers facing the loss of labor income. Reporting standards vary as to whether suspended payments are reported as delinquencies, and it is likely that as forbearance programs expire there will be an uptick in delinquencies/defaults. The magnitude of

any such increases, however, is likely to be much less than would have been the case absent the substantial fiscal transfers, and also much lower than what many envisioned in the early phases of the pandemic.





In terms of mortgage debt, data from the Mortgage Bankers Association (MBA) show early-stage delinquency rates (or, the sum of the 30-day and 60-day delinquency rates) have fallen to all-time lows (the MBA data go back to 1979). One reason for this is that mortgage lending standards were much more stringent in the years following the 2007-09 recession than they had been in the years leading up to that recession. That has been the case to an even greater degree over the course of the pandemic, as seen in the second chart above. In 2020, borrowers with credit scores of 760 or higher accounted for 69.83 percent of all mortgage loan originations, and this share hit 73.01 percent in Q1 2021. While it could be that increased refinancing activity accounts for some of this increase in the most recent quarters, the broader point is that more stringent lending standards have clearly contributed to the long-running decline in early-stage mortgage delinquencies. Whether or not this is an equitable or an optimal allocation of mortgage credit is another discussion for another day.

Clearly, household financial behavior has been altered by the effects of the pandemic, including the policy response. It will be some time, perhaps a substantial period of time, before we know whether there will be lasting changes, and the degree to which this is the case. For instance, we do expect the personal saving rate to settle at a higher rate than had prevailed in the years leading up to the pandemic, as the experience of the pandemic has likely reinforced the importance of precautionary saving. In other words, while we may not see another incidence of a 100-year pandemic any time soon, the potential for sudden, unexpected disruptions in household income flows is suddenly very real, far more so than was the case at the beginning of 2020. We have seen some make the case that, having seen the aggressive fiscal policy response to the pandemic, households will behave in quite the opposite manner. In other words, thinking that the policy response to the pandemic has set a new precedent, households will not worry about carrying precautionary saving and instead rely on generous transfer payments to carry them through unforeseen periods of financial distress. We do not, however, find this to be an at all compelling argument.

Time will tell whether there are lasting changes in the financial behavior of households stemming from the experiences of the pandemic. The New York Fed's quarterly reports on household debt and credit will be a useful guide to whether, or to what extent, this is the case. One thing that is clear, however, is that monthly payment burdens and delinquency rates on household debt are much lower than anyone would have dared to imagine at the onset of the pandemic. While there are still pockets of financial distress in the household sector, which will be the case until the labor market is more fully healed, lower debt burdens leave most households on firmer financial footing as the economy more fully reopens in the months ahead.

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