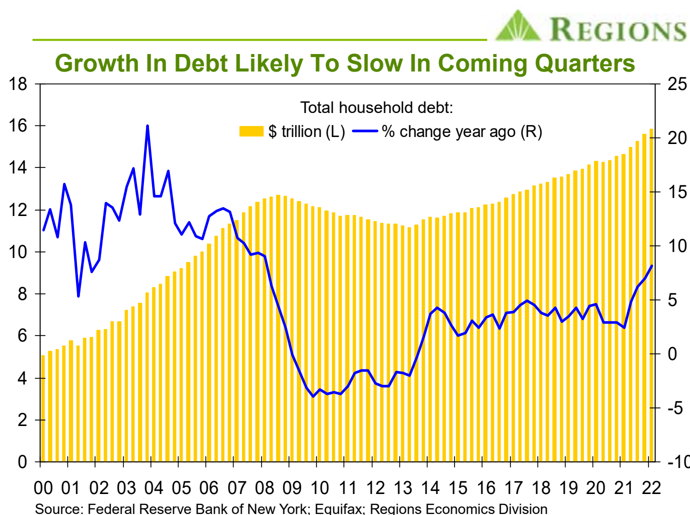
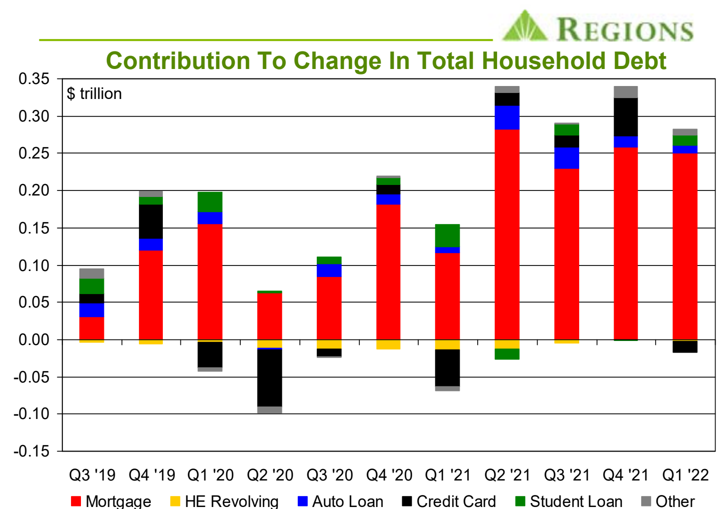
This Economic Outlook may include opinions, forecasts, projections, estimates, assumptions, and speculations (the "Contents") based on currently available information which is believed to be reliable and on past, current and projected economic, political, and other conditions. There is no guarantee as to the accuracy or completeness of the Contents of this Economic Outlook. The Contents of this Economic Outlook reflect judgments made at this time and are subject to change without notice, and the information and opinions herein are for general information use only. Regions specifically disclaims all warranties, express or implied, with respect to the use of or reliance on the Contents of this Economic Outlook or with respect to any results arising therefrom. The Contents of this Economic Outlook shall in no way be construed as a recommendation or advice with respect to the taking of any action or the making of any economic, financial, or other plan or decision.

Q1 2022 Household Debt and Credit: Mortgage Debt Still The Driver, But For How Long?

- Total household debt rose to $15.842 trillion in Q1 2022, an increase of $266 billion from Q4 2021
- Mortgage balances rose by $250 billion in Q1, non-mortgage debt increased by $16 billion
- As of Q1, 2.72 percent of outstanding household debt was in some stage of delinquency, unchanged from Q4 2021

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 $15.842 trillion in Q1 2022, an increase of $266 billion from Q4 2021. Mortgage debt increased by $250 billion, accounting for almost the entire increase in total household debt, while at the same time outstanding credit card debt declined in Q1, in keeping with typical seasonal patterns. On an over-the-year basis, total household debt was up 8.2 percent in Q1, with mortgage debt up 10.0 percent and credit card debt up 9.2 percent, with smaller increases in the other components of total debt. After adjusting for inflation, however, the over-the-year increase in total household debt was just 1.8 percent. At 2.72 percent, the overall delinquency rate on household debt was unchanged in Q1 2021, which marked the fourth consecutive quarter with an overall delinquency rate of less than 3.0 percent.



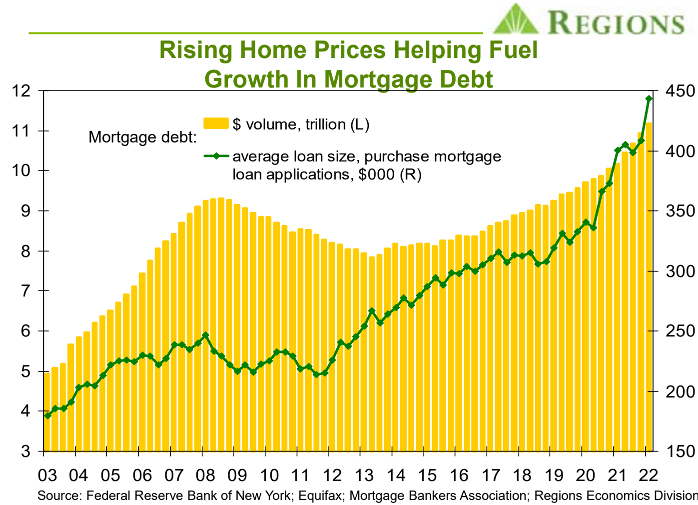


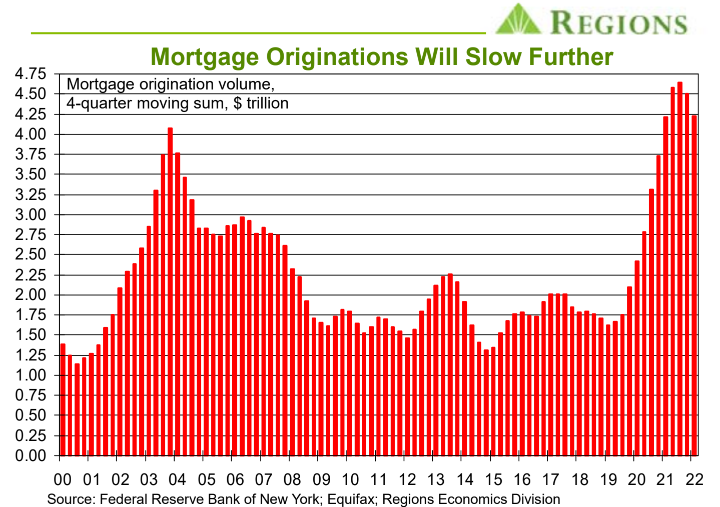
As seen in the first chart above, growth in total household debt has accelerated sharply over the past few quarters, having broken out of what since mid-2014 had been a fairly narrow range. As can be seen in the second chart above, however, the acceleration in the growth of total household debt has largely been a function of faster growth in outstanding mortgage debt. With mortgage rates having risen sharply over recent weeks and now back above 5.0 percent for the first time since Q4 2018, it is reasonable to assume that the growth in mortgage debt will slow, perhaps sharply. We know that mortgage refinancing activity has dropped off sharply as mortgage interest rates have risen, and higher mortgage interest rates will, in conjunction with the robust pace of house price appreciation seen over the past several months, curb demand for home purchases. As such, mortgage originations are set to decline, and while prepayment activity will also tail off, the level of mortgage debt could start to flatten out, or at the least the growth in mortgage debt outstanding will slow. To the extent this is the case, it will in turn lead to slower growth in total household debt, perhaps pushing it back into the range that prevailed from mid-2014 to mid-2021. While we do expect growth in credit card debt to accelerate, that will not fully offset what should be slower growth in mortgage debt in terms of the rate at which total household debt will grow.

We think the following two points on the rapid growth in mortgage debt over the past few quarters to be worth noting. First, for as rapidly as mortgage debt has grown over recent quarters, that growth would have been even faster were it not for the rising share of existing home sales accounted for by all-cash transactions. According to data from the National Association of Realtors, all-cash sales accounted for 19.7 percent of all existing home sales in 2019, with that share slipping to 18.2 percent in 2020 but rising to 22.8 percent in 2021. That share rose even further in Q1 2022, with all-cash sales accounting for 26.7 percent of all existing home sales in the first three months of 2022, with the share rising to 28.0 percent in March. To be sure, investor/institutional purchases account for a good portion of all-cash transactions, but by no means do they account for all of them and, in a significantly supply-constrained market in which bidding wars have seemed more the rule than the exception, all-cash offers have been a key competitive advantage for those

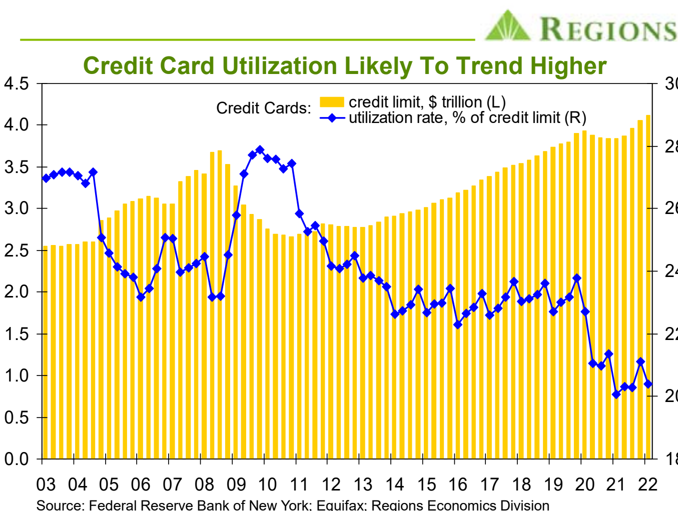
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com

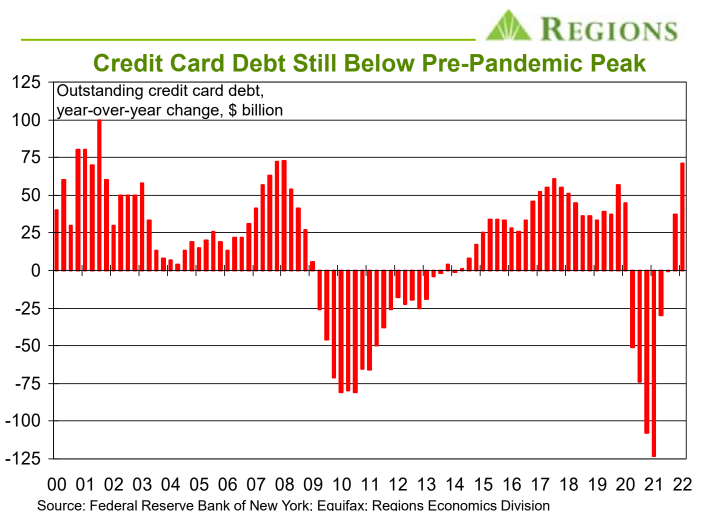
buyers capable of making them. All-cash offers free sellers from concerns over mortgage financing being approved and appraisals matching sales prices, and for buyers trading homes, selling their previous house at an often significant premium over what they paid for it has helped facilitate all-cash sales. All of this could, and likely will, change as the demand side of the housing market cools off, but all-cash sales will likely continue to account for a meaningful share of total existing home sales, which will continue to weigh on the growth rate of mortgage debt.





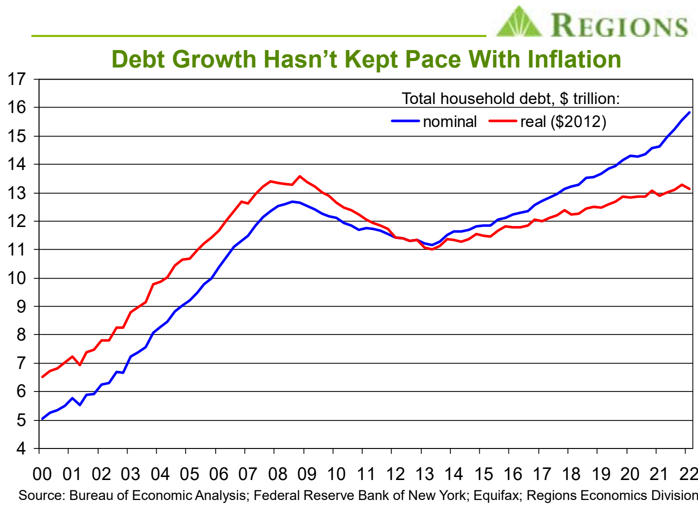
The second point we think worth making is the extent to which rapidly rising house prices have contributed to the acceleration in the growth of mortgage debt. As seen in the first chart above, the average loan size on applications for purchase mortgage loans has risen sharply since mid-2020, hitting $443,033 in Q1 2022, a year-on-year increase of 10.7 percent. According to the New York Fed, the number of new purchase mortgage accounts, culled from the Equifax data, was lower over the past two years than in any two-year period between 2000-06. To some extent, this ties into the above discussion on the rising share of all-cash sales. Again, though, to the extent that higher mortgage rates curb the demand for home purchases while at the same time we see some relief on the supply side of the market, we expect a considerable deceleration in the pace of house price appreciation which in turns means growth in average loan sizes on purchase mortgage applications will also slow. This is one reason we think it highly likely that the rate of growth in mortgage debt, and in turn total household debt, will slow over coming quarters.

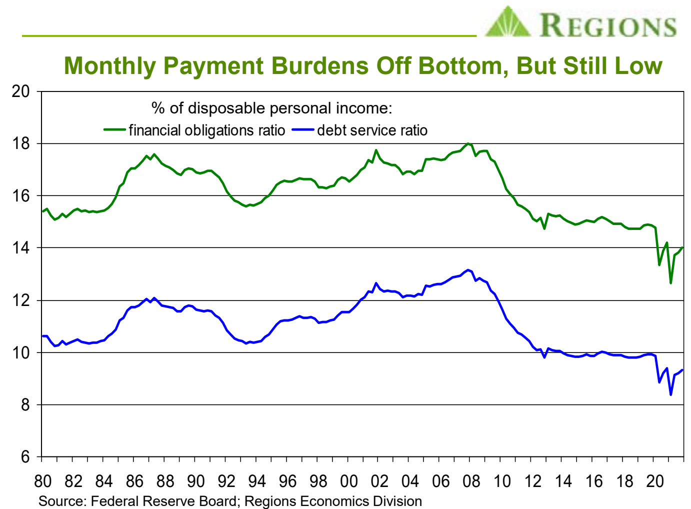




Recall that in Q4 2021 we saw the largest quarterly increase in outstanding credit card debt in the life of the New York Fed/Equifax data. Some of that increase was given back in Q1 2021, when the level of outstanding credit card debt fell by $15.0 billion. At least directionally, these swings are in line with normal seasonal patterns of credit card utilization, as in any given year utilization rises in the fourth quarter, followed by a decline in the first quarter of the subsequent year. What stands out over the past two quarters, however, is the magnitude of these seasonal swings; the percentage increase in outstanding credit card debt in Q4 2021 was substantially larger than the typical Q4 increase, while the percentage decrease in outstanding credit card debt in Q1 2021 was markedly smaller than the typical Q1 decrease. To some degree, likely a large degree, this is a reflection of higher prices, which would have amplified the increase in credit card debt in Q4 2021 and mitigated the extent of the decline in Q1 2022. Higher prices are one reason we expect outstanding

credit card debt to rise further over coming quarters, particularly as financial buffers built up during the pandemic, reflecting sizable transfer payments, thin out, which has likely already happened for lower-income households. These factors – higher prices and thinner financial buffers – no doubt contributed to what in March was the largest monthly increase on record in the Federal Reserve's series on consumer credit, with credit card debt the driving force behind that record increase (note the monthly series is not the same series used by the New York Fed in their quarterly reports). The four-quarter increase in credit card debt for the period ending in Q1 2022 was the largest such increase since Q1 2008, but the four-quarter changes are likely to get larger and larger over coming quarters.

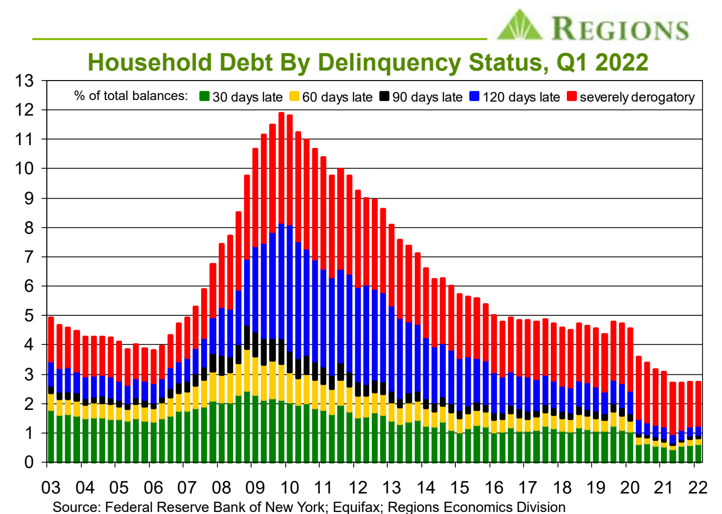




It is interesting to note that, while higher prices are helping drive nominal debt balances higher, on an inflation-adjusted basis the level of total household debt has barely budged over the past several quarters, as shown in the chart to the side. To that point, the level of real (i.e., inflation-adjusted) household debt actually declined in Q1 2022 and was, as noted earlier, up just 1.8 percent year-on-year. It should be noted, however that, while mortgage debt has been the primary driver of growth in total household debt, house prices do not directly enter into measured inflation, instead entering indirectly via measures of owners' equivalent rent, and even then typically with a lengthy lag. Were house price appreciation directly accounted for in measures of inflation, the disparity between the levels of nominal and real household debt would be even larger than that shown in the first chart above.

After being notably stable between 2012 and Q1 2020, thanks mainly to a prolonged period of low interest rates, monthly payment burdens fell even lower after the onset of the pandemic. This reflected an outright decline in the level of household debt in Q2 2020, even lower interest rates than had prevailed prior to the onset of the pandemic, and generous fiscal transfers that bolstered disposable personal income. As pandemic-related transfer payments began to run their course and the level of debt began to increase, monthly payment burdens began to tick higher over the second half of 2021 and into early-2022 and will rise further now that interest rates have risen sharply. Still, given the preponderance of fixed-rate debt on household balance sheets, particularly mortgage debt, higher rates will not trigger the same magnitude of payment resets as has been seen in past cycles, while at the same time robust growth in labor earnings is underpinning growth in disposable personal income. So, while monthly payment burdens will rise, they will likely remain below longer-term averages.

Low payment burdens and a prolonged period of stringent mortgage underwriting standards have helped push delinquency rates on household debts down to the lowest in the life of the New York Fed/Equifax data. The overall delinquency rate on household debt held steady at 2.72 percent in Q1 2022, and what have been notably low early-stage delinquency rates over recent quarters will mean lower inflows into serious delinquency in the quarters ahead. It is worth noting that mortgage lending has become increasingly concentrated amongst higher credit quality borrowers; Q1 2022 was the eight consecutive quarter in which at least two-thirds of all mortgage originations were to borrowers with credit scores of 760 or higher. To be sure, credit conditions will begin to normalize, and with that will come an upturn in delinquencies. That said, delinquency rates will likely remain below historical norms over coming quarters, with the obvious caveat that a recession would trigger a sharper increase in delinquency rates than we now anticipate.



Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com