ECONOMIC UPDATE

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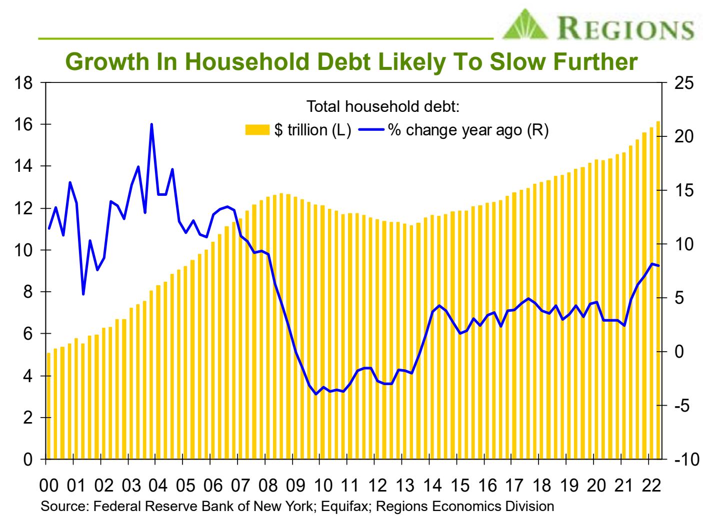
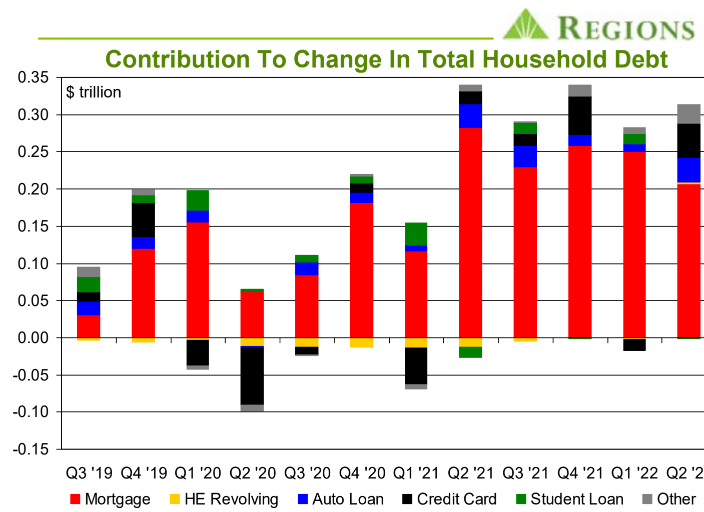
Q2 2022 Household Debt and Credit: What's Behind The Jump In Credit Card Debt?

- Total household debt rose to $16.154 trillion in Q2 2022, an increase of $312 billion from Q1 2022
- Mortgage balances rose by $207 billion in Q2, credit card debt increased by $46 billion
- As of Q2, 2.69 percent of outstanding household debt was in some stage of delinquency, down slightly from 2.72 percent in Q1

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 $16.154 trillion in Q2 2022, an increase of $312 billion from Q1. Mortgage debt increased by $207 billion, the smallest quarterly increase since Q1 2021, while credit card debt increased by $46 billion after having declined in Q1. Normal seasonal patterns tend to yield declines in outstanding credit card debt in the first quarter and a rebound in the second quarter of any given year, so the patterns seen over the first half of 2022 are in a sense consistent with typical seasonal patterns, but the magnitude of the increase in Q2 also in part reflected higher prices. On an over-the-year basis, total household debt was up 8.0 percent in Q2, with mortgage debt up 9.1 percent and credit card debt up 12.7 percent, with smaller increases in outstanding auto loans and student loans, while home equity line balances logged a 50th consecutive year-on-year decline despite a small sequential increase.





Though at 8.0 percent the over-the-year increase in total household debt was slightly smaller than the 8.2 percent increase seen in Q1, it was still considerably higher than the gains seen over the prior several years, when growth in household debt was fairly range bound. The acceleration in the growth of household debt that began in mid-2021 primarily reflected the sharp acceleration in the growth of mortgage debt, which was a function of rapidly rising home sales and stepped-up refinancing activity. Increasing home sales coupled with double-digit price appreciation led to a significant increase in the volume of purchase mortgage originations at a time when notably low mortgage interest rates were driving refinancing volume. By the end of Q2 2022, however, housing market conditions had softened significantly thanks to rapidly rising mortgage interest rates. Higher mortgage interest rates took a toll on home sales and sent refinancing activity tumbling. One thing that had not yet changed, however, was the pace of house price appreciation, with the CoreLogic HPI up 19.1 percent year-on-year in Q2. That price appreciation remained so substantial helped offset falling sales volumes, with the result being another increase in total mortgage debt outstanding but, as noted above, the increase in Q2 was the smallest quarterly increase since Q1 2021, while the dollar volume of mortgage originations in Q2 was the lowest since the first quarter of 2020.

We look for an even lower volume of mortgage originations in Q3 as home sales fall further and the pace of house price appreciation begins to slow. It is worth noting that the monthly data reported for repeat sales measures of house price appreciation, such as CoreLogic and Case Shiller, actually reflect three-month moving averages. As such, they will be slow to fully reflect the decelerating pace of house price appreciation actually occurring, but the data on mortgage originations will provide a more timely view of changing patterns in house prices. For instance, data from the Mortgage Bankers Association (MBA) shows that after climbing to $443,033 in Q1 2022, the average loan size on applications for purchase mortgage loans slipped to $438,015 in Q2, and the MBA data show a further decline in July, with an average loan size on purchase mortgage loan applications of $410,800. Again, with further declines in the number of home

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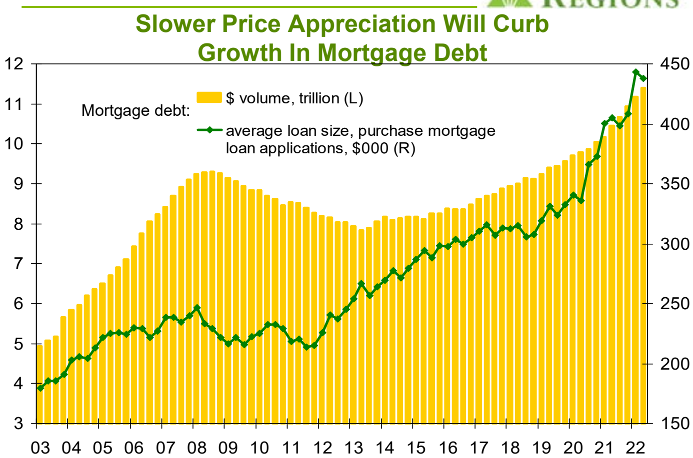
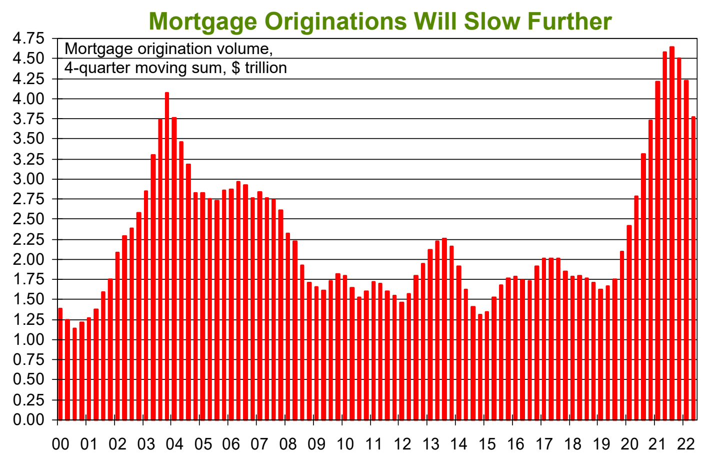
sales (new and existing) and some softening in prices, the dollar volume of mortgage originations will likely be lower in Q3 than was the case in Q2, which will act as a drag on the growth in total household debt.



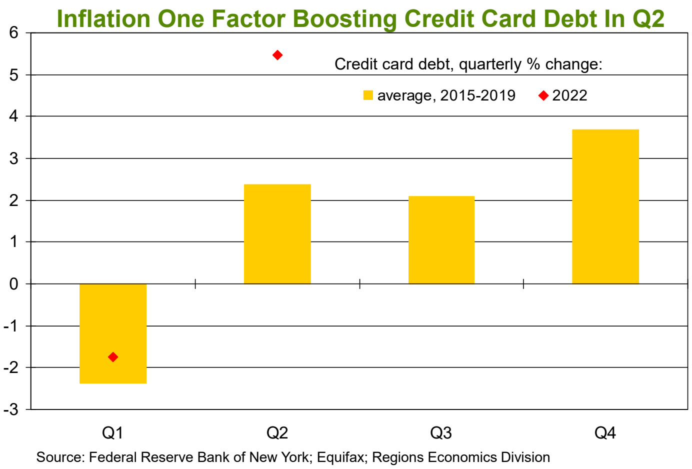


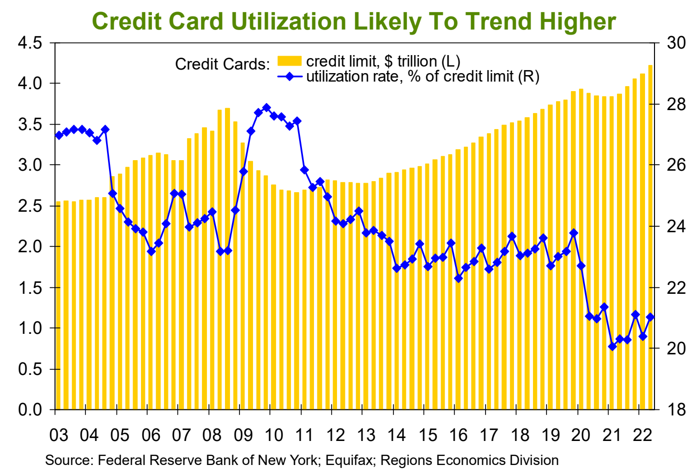
At the same time, growth in credit card debt outstanding could accelerate further. In our write-up of the Q1 data on household debt, we noted that we expected the Q2 data to show faster growth in credit card debt, with rapidly rising prices one source of this faster growth. Higher prices were one factor in the 12.7 percent year-on-year increase in credit card debt in Q2, the largest such increase since Q3 2001. This has gotten considerable attention since the release of the data, with some weaving it into tales of pending disaster. Literally. We came across a post pointing to the growth in credit card debt as proof that consumers were relying on credit cards to "maintain their pre-pandemic lifestyles," which the author labeled as a "disaster in the making" before going on to say that the FOMC was "walking into a debt trap" which would leave them no choice but to stop raising the Fed funds rate after their September meeting. Though not to that, somewhat curious, degree, many accounts of the growth in credit card debt follow this same general theme.

This isn't to dismiss or downplay the link between inflation and growth in credit card debt, as there are households for whom taking on more credit card debt is the only way to maintain spending, including spending on necessities. And, with interest rates having moved higher over recent months, interest rates on credit card debt have risen, making it much more costly for those who carry card balances from month to month. It is not, however, clear the extent to which the growth in credit card debt seen in Q2 reflects financial distress in the household sector. The New York Fed data show that even after rising sharply in Q2, the level of outstanding credit card debt is still below the pre-pandemic peak hit in Q4 2019. It is also worth noting that the $46 billion increase in credit card debt in Q2 is smaller than the $52 billion increase in Q4 2021, the largest quarterly increase in the life of this series. It is true that the Federal Reserve's seasonally adjusted monthly data on consumer credit show that total revolving credit was 2.3 percent higher than the pre-pandemic peak as of June. Looking at the not seasonally adjusted data, which is the correct basis on which to compare it to the New York Fed data, which are not seasonally adjusted, the monthly data on consumer credit show the level of revolving debt outstanding was still below the pre-pandemic peak. Moreover, while credit card is by far the largest single component, revolving debt includes other types of consumer debt, so even on a not seasonally adjusted basis, the data on consumer credit are not strictly comparable to the New York Fed data. Again, though, the broader point here is that there is more to the growth in credit card debt in Q2 than high inflation and consumer distress.

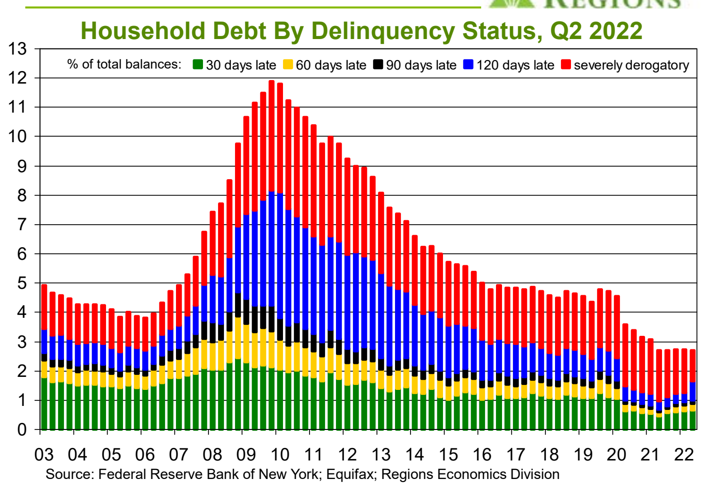
It also helps to recall that there are clear seasonal patterns in credit card debt, and as noted at the outset, in a typical year credit card debt falls in the first quarter then rebounds in the second quarter, with the largest quarterly increase in any given year coming in the fourth quarter. To be sure, the 5.5 percent increase seen in Q2 (quarter/quarter) is well above the average Q2 increase over the 2015-2019 period – we've omitted 2020 and 2021 in our calculation of the average quarterly increases given the extent to which typical patterns in credit card utilization were thrown off by the pandemic – but higher prices aren't necessarily the only factor in play here. For instance, the pace of consumer spending on services, such as travel, tourism, dining out, recreation, and entertainment, picked up sharply in Q2, reflecting consumers unleashing considerable pent-up demand for such activities. It is likely that a considerable portion of such spending was facilitated via credit cards, which would account for at least some of the growth in credit card debt in Q2. To the extent this is the case, it will also be reflected in the Q3 data, as services spending has remained solid, but we continue to expect growth in services spending to slow sharply once summer ends.

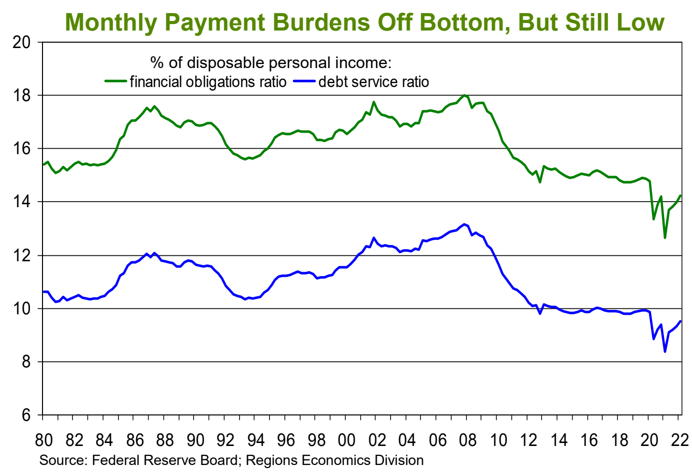
So, while higher prices will contribute to further growth in credit card debt in Q3, they won't be the only factor. It is interesting to note that, while credit card utilization rates rose in Q2, the extent to which they did so is not out of line with typical seasonal patterns despite the jump in outstanding balances. This simply reflects credit card lines having been raised further in Q2, thus checking the increase in utilization rates. Recall that credit card providers pulled back on limits over the final three quarters of 2020 amid considerable uncertainty as to the financial and economic fallout from the pandemic, but limits have risen strongly in each of the past four quarters. We won't be surprised, however, to see more restrained growth in credit card limits in the quarters ahead given fears over the course of the economy, and should there be meaningful deterioration in labor market conditions, we'd expect to see credit card limits begin to decline again. As such, the rising credit card utilization rates we expect in the quarters ahead would reflect the combination of rising balances and more restrained growth, if not outright declines, in credit card limits.





In addition to contributing to growth in mortgage debt and credit card debt, rapidly rising prices have contributed to growth in auto loan balances over recent quarters, but while nominal auto loan debt hit a new high in Q2 2022, the level of real, or, inflation adjusted, auto loan debt remains well below the prior peak. This is also true of total household debt; as of Q2 2022, the level of real household debt was 2.8 percent below the peak level reached in Q4 2008. Between inflation being as elevated as it now is and receding only slowly, at least we expect that to be the case, and with consumers likely cutting down on spending, particularly services spending, in coming quarters, we think it will be some time yet before real household debt returns to its prior peak. More significantly, however, the combination of elevated inflation, rising interest rates, and the potential that a slowdown in the broader economy may lead to material deterioration in labor market conditions is raising concerns that loan performance in the consumer space may weaken significantly.





Thus far, there is nothing in the data to suggest any such deterioration. At 2.69 percent, the overall delinquency rate on total household debt was little changed from the Q1 rate of 2.72 percent. Early-stage delinquency rates have risen off the series lows seen in 2021 but nonetheless remain far below pre-pandemic norms, but 90-day and 120-day delinquency rates remain near their series lows. One area in which delinquencies are increasing is in the sub-prime space, for both credit card and auto loans. While delinquency rates are likely to move higher over coming quarters, some of this would likely have occurred as part of delinquency rates normalizing, though with the economy set to slow further and at least some softening in labor market conditions, it won't be possible to segregate normalization from financial distress in the aggregated data. We do know that households started from a stronger position than has been the case for some time, as reflected in debt-to-income ratios, monthly payment burdens, deposit balances, and housing equity positions. To a large extent, whether, or to what extent, rising delinquencies spread beyond the sub-prime space will depend on how well labor market conditions hold up, but at present there is little reason to think delinquencies will approach the severity of the 2007-09 recession.