

ANALYSIS

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Household Debt: Don't Worry, Be Happy

Introduction

There has been much hand-wringing about the financial health of American households. A recent [Washington Post piece](#) on auto lending claiming that 7 million borrowers are behind on their loan payments supercharged the concerns. Not to worry. Household credit conditions have arguably never been better. Household debt is low, and delinquencies and defaults are about as low as they have ever been. There are things to be nervous about in the U.S. economy, but household debt is not one of them.

Household Debt: Don't Worry, Be Happy

BY MARK ZANDI

There has been much hand-wringing about the financial health of American households. A recent [Washington Post piece](#) on auto lending claiming that 7 million borrowers are behind on their loan payments supercharged the concerns. Not to worry. Household credit conditions have arguably never been better. Household debt is low, and delinquencies and defaults are about as low as they have ever been. There are things to be nervous about in the U.S. economy, but household debt is not one of them.

This upbeat conclusion is based on data using all of the credit files in the country from credit bureau Equifax. For more than a decade, a joint venture with Equifax has allowed Moody's Analytics to carefully examine the credit performance of all American households almost in real time. This assessment of household credit conditions is based on monthly credit file data available to Moody's Analytics through April of this year.

Other data sources stand in contrast. The widely followed [Federal Reserve Bank of New York's Consumer Credit Panel](#), upon which the Post piece is based, is derived from a small sample of Equifax credit files that is quarterly and more lagged. There are other significant differences between Moody's Analytics data and that provided by the New

York Fed, which Deniz Tudor and Michael Brisson of Moody's Analytics provide in their paper "A Comparative Analysis of Household Credit Data From the New York Fed and Moody's Analytics."

Total household indebtedness has fallen sharply since the financial crisis. At the peak of household leverage in the lead-up to the crisis, household debt surged to a record 110% of after-tax household income (see Chart 1). But the surge in defaults during the severe recession and the resulting more cautious borrowing and lending have pushed debt-to-income down to about 80%, where it has remained for more than five years. [Household debt service](#)—the share of income that households must pay to stay current on their obligations—has also declined

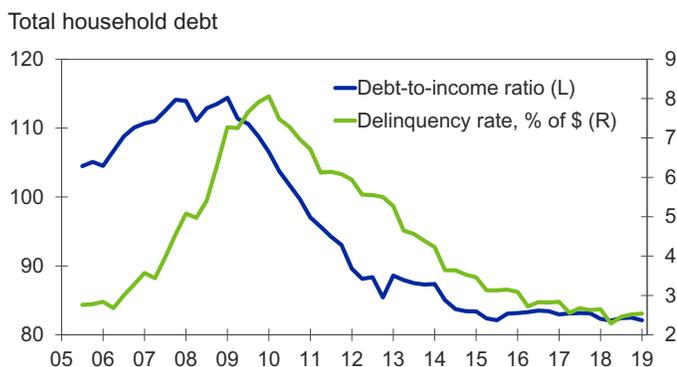
and is currently stable and as low as it has been over the 40 years of available historical data from the Federal Reserve.

As households have deleveraged, household credit quality has steadily improved and, in aggregate, is about as good as it has ever been. In April, the delinquency rate (30 days and over) on all \$13 trillion in household liabilities was close to 2.3%. For context, this is lower than it was in the very best of times leading up to the financial crisis and compares with a peak of more than 8% during the height of the last recession.

Pristine mortgage quality

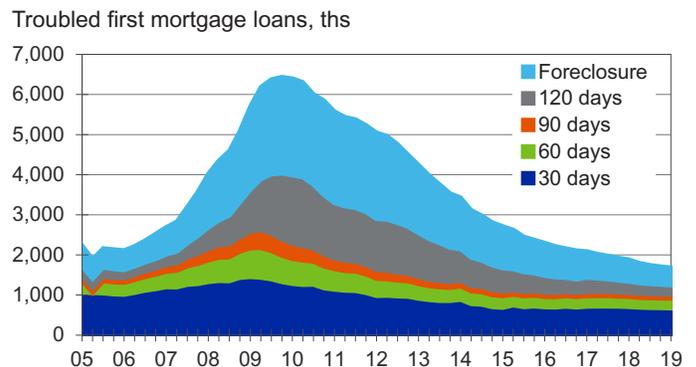
Residential mortgage loan quality has arguably never been better. Of the \$9 trillion in first mortgage loan debt outstanding,

Chart 1: Pristine Household Credit



Sources: Equifax, Moody's Analytics

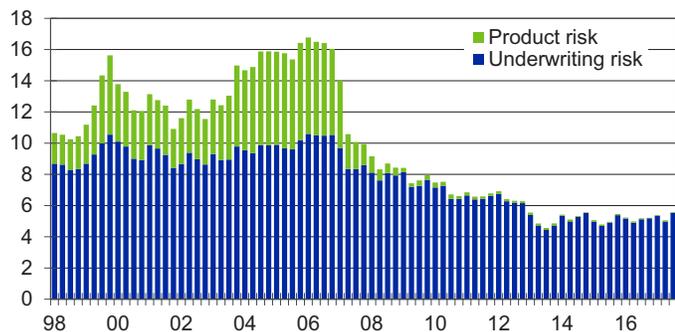
Chart 2: First Mortgage Quality High



Sources: Equifax, Moody's Analytics

Chart 3: Mortgage Credit Conditions Tight

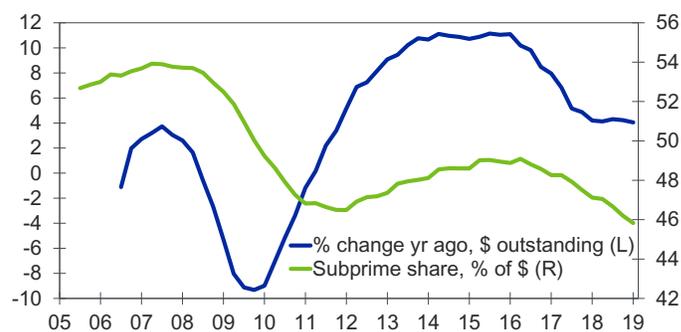
Expected severe delinquency rate for single-family originations, %



Sources: Urban Institute, Moody's Analytics

Chart 4: Auto Lenders Pull Back Subprime

Auto loans & leases



Sources: Equifax, Moody's Analytics

close to 2% is delinquent. At the peak of the housing bust, 9% of mortgage debt was in delinquency. The number of loans in foreclosure has also fallen sharply, to near 450,000, which is similar to the pre-crisis inventory of foreclosed properties (see Chart 2). The foreclosure overhang that plagued the housing market for much of the past decade has been completely worked off.

This pristine mortgage credit quality is the result of low unemployment, consistently strong house price gains over the last eight years, and—perhaps most importantly—tight underwriting standards. The Urban Institute calculates the expected severe delinquency rate on loan originations based on the credit score and debt-to-income ratio of the borrower and the loan-to-value ratio on the property. According to this [measure of underwriting](#), standards tightened sharply during the housing bust and have yet to ease (see Chart 3). This may overstate the case. Measuring debt-to-income is difficult, and this is where most of the easing in standards has occurred in recent years. Regardless, underwriting standards remain strong.

Home equity loan quality is also excellent. A record low 1.5% of the \$500 billion in home equity lines and closed-end second loans are delinquent. Homeowners continue to shy away from the use of second mortgages, as home equity debt outstanding continues to decline. At its peak prior to the crisis, there was \$1 trillion in outstanding home equity debt. Last year's tax law change, which scaled back the use of the mortgage interest deduc-

tion, will weigh further on the use of home equity loans.

Cautious auto lenders

Auto lenders have their hands firmly on the credit steering wheel. Concerns had mounted over the nearly double-digit growth in outstanding auto loans and leases earlier in the economic expansion. Adding to the worries was that much of the outside loan growth was to subprime borrowers—those with credit scores below 660—and loans with increasingly long maturities (see Chart 4). Delinquencies began to increase, particularly when measured as a percent of the number of loans and leases outstanding.

Auto lenders were the first household lenders to ease up on their lending standards coming out of the recession. They were emboldened because they had navigated through the downturn substantially less scathed than mortgage or credit card lenders. Behind their better performance was firmer used-vehicle prices, as the dramatic collapse in new-vehicle purchases during the downturn led to a subsequent dearth of used cars for sale.

However, lenders were also quick to tighten their underwriting in response to weak-

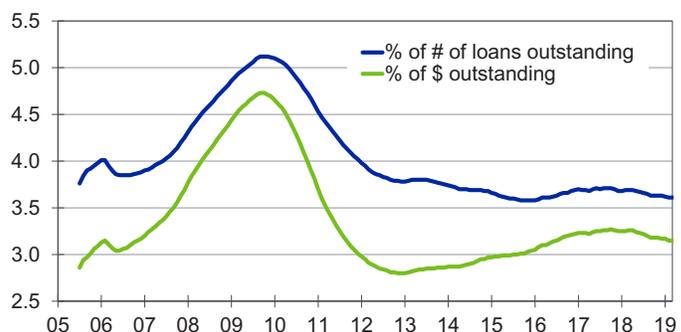
ening credit quality. The share of borrowers who are subprime has fallen significantly over the past three years, and debt outstanding has slowed to the middle single digits. Delinquencies subsequently rolled over and are now low by any historical standard. Indeed, as measured as a percent of the \$1.25 trillion in auto loans and leases outstanding, auto delinquencies are about as low as they have ever been (see Chart 5).

Student lending moderates

Ballooning student loan borrowing has been the most worrisome development in household lending post-crisis. Outstanding loans doubled during this expansion to more than \$1.2 trillion. Payments are deferred on \$450 billion of these loans, while former students are making payments on the remaining \$750 billion. Powering this rapid growth in student lending were more people going to school given the tough economy, rapidly

Chart 5: High Auto Loan Quality

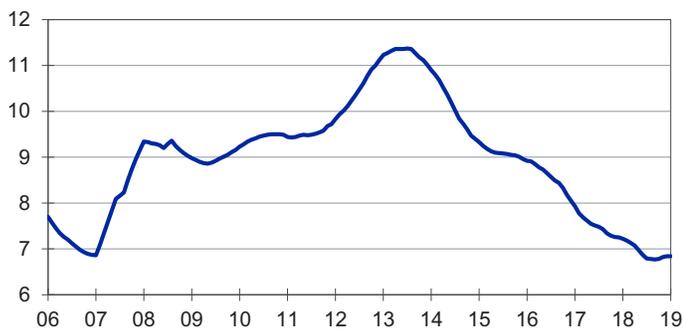
Troubled auto loans & leases



Sources: Equifax, Moody's Analytics

Chart 6: Student Loan Quality Improved

90 days-plus delinquency rate on nondeferred loans, 12-mo MA, %



Sources: Equifax, Moody's Analytics

increasing tuition costs, and the collapse in home equity borrowing, which had been the principal way students raised cash to pay their bills before the housing collapse. That the bulk of student loans are government-backed, and not underwritten based on the creditworthiness of borrowers, likely also supported growth.

The financial stress on student loan borrowers is evident in their difficulty paying on time. The delinquency rate on nondeferred student loans peaked well into the double digits in the early years of the expansion (see Chart 6). The stress is also evident in millennials delaying marriage, starting a home, and becoming homeowners. There is also evidence that student loan debt is one reason for the falloff in new business startups since the recession.

The good news is that student loan borrowing has cooled substantially, and debt outstanding is now growing in the mid-single

digits. Borrowers are also deferring less of their debt, as deferred loans outstanding have been unchanged for several years. Most encouraging is that delinquency rates across all nondeferred student loans have fallen substantially and are now back to where they were pre-crisis.

That said, student loans will continue to be a significant financial problem, particularly for millennials and Generation Z, which is only now beginning to enter college. This stress is evident in the credit problems already showing up in recently originated student loans. The cumulative default rate on loans originated in the third quarter of 2016, for example, is just over 2%, 2½ years after origination. This is nearly double the cumulative default rate on loans originated in the third quarter of 2010, when underwriting was at its tightest, at the same point in their life cycle (see Chart 7). Overall student loan delinquency thus appears likely to soon begin rising.

Card lenders hold a good hand

Bank and retail card lenders have been on edge as they watch delinquency rates increase from post-crisis lows, but they have managed things well, turning more cautious

in their underwriting. According to the Fed's senior loan officer survey, lenders have tightened their standards over the last two years. This has slowed growth in the \$800 billion in outstanding card loans, with bankcard growth now in the mid-single digits and retail card growth at a standstill.

Delinquency rates appear to be stabilizing in response and remain low by historical standards (see Chart 8). Pre-crisis, bankcard delinquency hovered near 4.5%, but it is now closer to 3.5%. Retail card delinquency has pushed up to 6.5%, but this too is well below the pre-crisis norm of 7.5%. Complicating things for retail card lenders has been the rash of retailer bankruptcies due to the onslaught of online retailing. Borrowers must still make payments on the cards of bankrupt retailers, but they either did not know this or have pretended not to.

Also encouraging is that utilization rates on cards remain low. Balances per card were as high as \$2,000 during the recession but have since fallen back and, after accounting for inflation, have remained close to \$1,500 in recent years (see Chart 9). This is a good sign that households are not reliant on their cards to pay their bills.

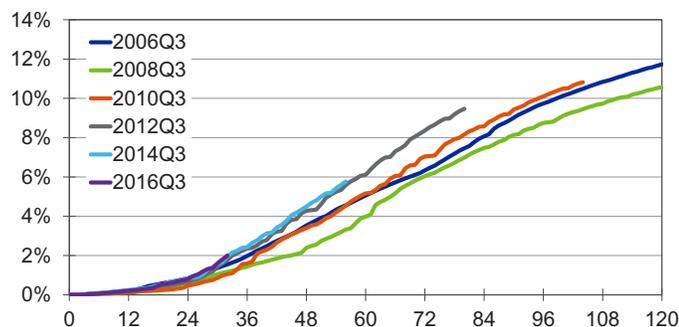
There are several hundred billion dollars in additional consumer finance and other loans owed by households, but credit quality on these liabilities also looks great. Delinquency rates are very low and stable.

Don't worry, be happy

There is no other conclusion from the credit file data than that household

Chart 7: New Student Loan Vintages Weak

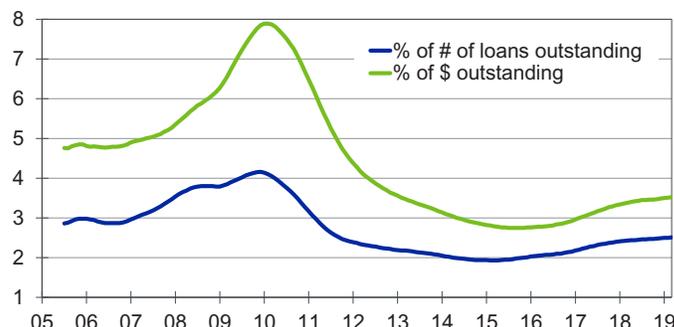
Cumulative default rate on loans at origination by origination qtr



Sources: Equifax, Moody's Analytics

Chart 8: Bankcard Delinquencies Still Low

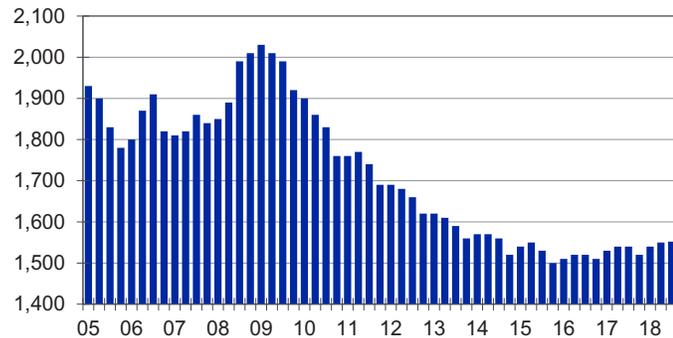
Bankcard delinquency rate, 12-mo MA



Sources: Equifax, Moody's Analytics

Chart 9: Bankcard Balances Low, Stable

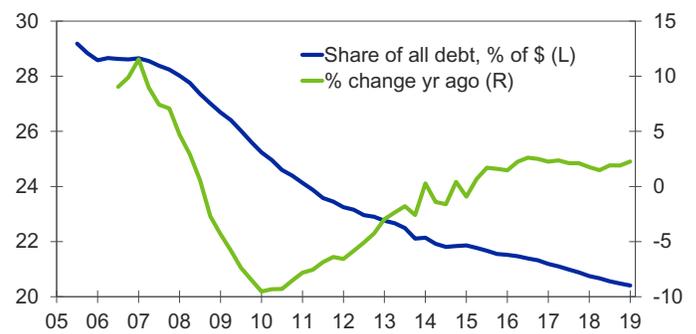
Real bankcard balance per card, 2019Q1, \$



Sources: Equifax, Moody's Analytics

Chart 10: Tighter Underwriting Standards

Debt owed by borrowers with score below 660



Sources: Equifax, Moody's Analytics

credit conditions are in excellent shape. The hand-wringing about a serious developing problem with household debt is misplaced. Household leverage was ground zero for the financial crisis and the Great Recession, but households have deleveraged, and borrowers and lenders remain cautious. The next recession, if it is any time in the foreseeable future, will not come because households are overly indebted.

All indications are that household credit conditions should remain good, even if the economy were to falter and unemployment to rise. Delinquency and default would surely increase, but not to the extent of past downturns. Behind this optimism is the improving creditworthiness of borrowers. The percent of loans originated to subprime

borrowers has steadily fallen for more than a decade. Prior to the financial crisis, nearly 30% of loans went to subprime borrowers, whereas today it is closer to 20% (see Chart 10). The growth in loans to subprime borrowers remains in the low single digits and is stable. Credit scores may not mean the same today as in times past—a 700 score today in a strong economy is easier to achieve than a 700 score in a tough economy—but these measurement issues do not obviate the significant improvement in the creditworthiness of borrowers.

This assessment of household credit conditions is focused on the aggregate statistics and has glossed over the financial problems that exist among lower- and middle-income American households. Indebtedness remains

higher and credit problems much more significant for these groups. According to the new [Distributional Financial Accounts](#) constructed by the Fed, those in the bottom half of the income distribution hold only 6% of all the assets owned by households but owe 37% of the liabilities. And the difference in these shares has grown steadily and substantially wider over the past 30 years.

This is no doubt a serious problem, and represents a significant macroeconomic and societal vulnerability, but it does not diminish the broader point that households are managing their debt and other financial obligations extraordinarily well. Household credit quality is about as good as it has ever been. The U.S. economy has its problems, but household debt is not one of them.

About the Author

Mark Zandi is chief economist of Moody's Analytics, where he directs economic research. Moody's Analytics, a subsidiary of Moody's Corp., is a leading provider of economic research, data and analytical tools. Dr. Zandi is a cofounder of Economy.com, which Moody's purchased in 2005.

Dr. Zandi is on the board of directors of MGIC, the nation's largest private mortgage insurance company, and is the lead director of Reinvestment Fund, one of the nation's largest community development financial institutions, which makes investments in underserved communities.

He is a trusted adviser to policymakers and an influential source of economic analysis for businesses, journalists and the public. Dr. Zandi frequently testifies before Congress and conducts regular briefings on the economy for corporate boards, trade associations, and policymakers at all levels. He is often quoted in national and global publications and interviewed by major news media outlets, and is a frequent guest on CNBC, NPR, *Meet the Press*, CNN, and various other national networks and news programs.

Dr. Zandi is the author of *Paying the Price: Ending the Great Recession and Beginning a New American Century*, which provides an assessment of the monetary and fiscal policy response to the Great Recession. His other book, *Financial Shock: A 360° Look at the Subprime Mortgage Implosion, and How to Avoid the Next Financial Crisis*, is described by the New York Times as the "clearest guide" to the financial crisis.

Dr. Zandi earned his BS from the Wharton School at the University of Pennsylvania and his PhD at the University of Pennsylvania.

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