Instalment Credit Expansion

CONSUMER INSTALMENT CREDIT outstanding continued to rise in the first quarter of 1963. The seasonally adjusted annual rate of increase was somewhat lower than in the fourth quarter of 1962 but substantially above the rate for 1962 as a whole.

The volume of new-car sales has been an important factor in the recent increase in instalment credit. Sales of new domestic and imported automobiles were at a seasonally adjusted annual rate of about 7.7 million units in the first quarter of this year, while automobile credit outstanding increased at a rate of $2.8 billion. Both of these rates are higher than those for the year 1962.

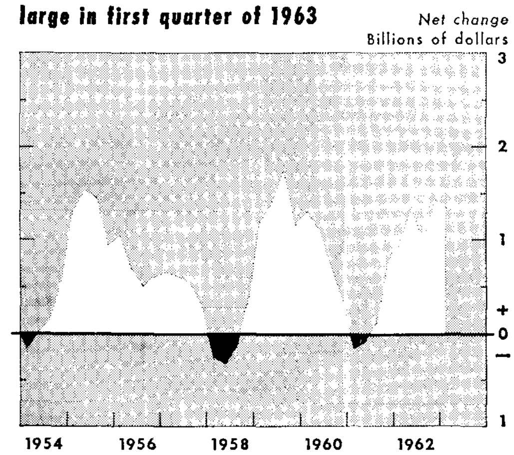
The expanding volume of automobile credit has been accompanied by increasing competition among lenders. There has been downward pressure in some areas on the interest rates charged car buyers and moderate liberalization in the terms on which some financial institutions are buying automobile paper from dealers.

Throughout the country most lenders continue to observe the 36-month maturity as a maximum on new-car contracts. However, the proportion of contracts written with this maturity has been rising gradually.

The increase in nonautomotive consumer goods paper in the first quarter of 1963, at an annual rate of about $1.1 billion, was less than in the preceding quarter but was at a slightly faster rate than during 1962 as a whole. Personal loans expanded at about the same rate, $1.5 billion, as during 1962.

The proportion of disposable personal income that consumers are using to repay short- and intermediate-term instalment debt has increased slightly in recent months. The repayment-income ratio, which has fluctuated within a relatively narrow range around

INCREASE in instalment credit continues large in first quarter of 1963



NOTE.—Seasonally adjusted figures for net changes in outstanding credit. Latest figures shown, first quarter 1963.

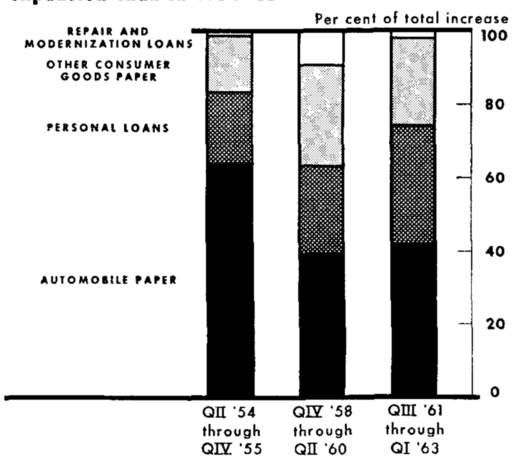
13 per cent since 1956, reached a new high of 13.4 per cent in the last 2 quarters of 1962 and then increased to 13.6 per cent in the first quarter of 1963. Some delinquency rates have risen this year, but most remain below their levels in recent years.

CHANGES BY TYPE OF CREDIT

The increase in instalment credit outstanding during 1962 was the third largest on record. Only in 1955 and 1959 were the dollar increases larger. In percentage terms, the 1962 increase—11 per cent—was two-thirds as large as in 1959 and half as large as in 1955.

During the 7 quarters of the current cyclical expansion in instalment credit, automobile credit has accounted for 42 per cent of the increase in the total. Credit for consumer goods other than automobiles has accounted for 24 per cent, and personal loans for 33 per cent.

AUTO CREDIT contributes less in current expansion than in 1954-'55



NOTE.—Based on seasonally adjusted figures for net changes in instalment credit outstanding.

The current period of credit expansion resembles that of 1954-55 in that both have been marked by substantial increases in the number of new cars sold. However, the contribution of auto credit to the current rise is considerably smaller than it was in 1954-55. In the earlier period, unlike the present one, maximum maturities on new-car contracts were generally lengthened and downpayments were substantially reduced, with consequent large increases in the average size of instalment notes. The 1954-55 period was also marked by a rise in the proportion of new-car purchases financed on instalment credit.

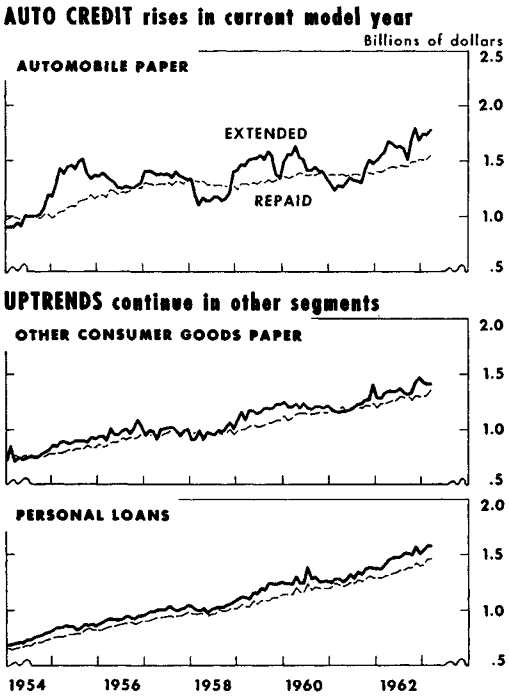
Automobile paper. After declining during most of 1961, outstanding instalment credit on automobiles rose in the fourth quarter and continued up in 1962, as sales of new domestic and imported cars topped the 7 million mark. The 1962 increase totaled $2.2 billion, or 13 per cent. In the first quarter of 1963, with continued high rates of sales, auto credit rose at a seasonally adjusted annual rate of $2.8 billion.

The proportion of new-car sales financed on instalments has changed little, averaging about 60 per cent in each of the last 3 years. Most of the increase in automobile credit in 1962 and 1963 has been the result of higher unit sales, although there also has been a moderate increase in the average size of instalment contracts. Contracts on new cars in early 1963 were about 2 per cent larger than in early 1962 and 6 per cent larger than in early 1961.

List prices of new cars continued to be little changed in the 1962 and 1963 model years, after allowance for differences in standard equipment. But during both model years consumers favored more equipment and more expensive body styles. Downpayments may have been reduced slightly, also adding to the average contract size.

In recent months competition among lenders for automobile paper has been keen in many parts of the country. Some financial institutions have moderately liberalized the terms on which they purchase instalment contracts from automobile dealers; they have lowered the discount rate on automobile paper somewhat or reduced the dealers' liability in case of default. And there have been some reductions in interest rates charged car buyers, particularly in parts of the Middle West and South.

The average maturity of new-car instalment contracts has continued to rise slowly, with an increasing proportion of contracts being written at the prevailing maximum maturity of 36 months. In the first quarter of



NOTE.—Seasonally adjusted. Latest figures shown, Mar. 1963.

1963, for example, about 75 per cent of all contracts that commercial banks and sales finance companies purchased from dealers carried maturities of 36 months, as did about 55 per cent of all new-car loans that banks made directly to buyers. The corresponding figures for 1961 were about 70 and 45 per cent; for 1955, about 25 and 10 per cent.

Rather widespread publicity has been given recently to instances in which automobile dealers and lenders have offered 42-month, and occasionally 48-month, maturities on new-car loans. It has sometimes been implied that the maximum maturity of 36 months, which has prevailed generally since the 1954-55 breakthrough from the previous 30-month maximum, has been breached.

The available evidence suggests, however, that the 36-month maximum is still being observed by the great majority of dealers and lenders. For a number of years there have been some new-car contracts with longer maturities. But except for isolated cases involving special circumstances, only a few lenders appear to have offered these longer maturities. And in instances where they have, downpayment requirements or other conditions have often been such that relatively few buyers could qualify. In the first quarter of 1963 the volume of these longer-term contracts was on the order of 1 per cent or less of all new-car contracts—not significantly different from earlier periods.

On used car contracts, average maturities have continued to lengthen. The proportion with maturities of over 24 months has been rising for several years. Recently many contracts on late-model used cars have carried 36-month maturities.

Other consumer goods paper. Instalment credit outstanding for the purchase of consumer goods other than autos rose by $1 billion, or about 8 per cent, in 1962 and at a slightly faster rate in early 1963. This type of credit began to increase in the third quarter of 1961, somewhat before the upturn in automobile credit.

Such instalment credit originates in a wide variety of purchases. Until a few years ago it was used mainly to finance furniture and major appliances. But with the rapid growth of revolving credit and similar retail credit plans in the last 4 or 5 years, it is now widely used for other purchases also. Typically, customers are permitted to finance purchases of all types of goods and services offered by the retailer, subject to a maximum line of credit. Many retailers offer option plans, under which customers may pay for purchases either at first billing with no service charge, or in monthly instalments with a charge on the outstanding balance.

Longer-term credit—used to finance purchases of mobile homes, boats, and other high-priced goods—also has become a more important component of nonautomotive consumer goods paper.

In late 1962 several large retailers lengthened the maximum maturity on instalment purchases of major household appliances, radios, and television sets from 24 to 36 months. Downpayment requirements on these and other household goods had been reduced substantially or dropped altogether by these retailers about a year earlier.

Residential repair and modernization loans, which represent about 7 per cent of total instalment credit, increased by $100 million in 1962 after a similarly small rise in 1961. This type of credit had increased at an annual rate of about $300 million in the 1956-60 period. The average maturity of outstanding credit of this type continued to lengthen gradually.

Personal loans. Personal loans rose by $1.5 billion, or 13 per cent, in 1962 and continued to rise at about the same rate in the first quarter of 1963.

Personal loans are made for a wide variety of purposes—including consolidation of debt; payment of medical, dental, and hospital bills; and financing of vacation, education, and current living expenses. This category also includes some credit that arises from purchases of consumer goods and from residential repair and modernization that cannot be separately identified.

DEBT REPAYMENTS

Repayments of consumer instalment credit, which had totaled $50.7 billion in 1962, were at a record annual rate of $53 billion in the first quarter of 1963. They were also at a record high—13.6 per cent—relative to disposable personal income.

Delinquency rates on consumer loans at commercial banks in early 1963 were little changed from 1962 rates and remained below 1960-61 rates. At major sales finance companies delinquency rates on auto loans rose early this year, but repossession rates continued at historically low levels.

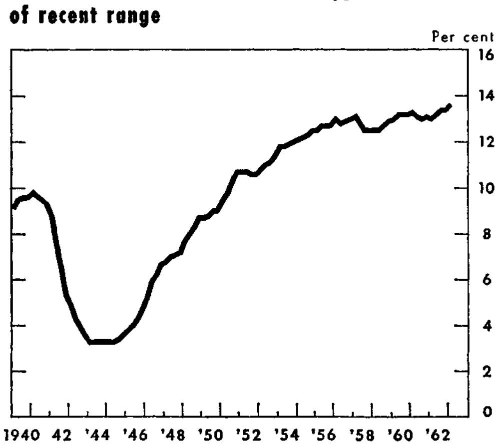
The ratio of aggregate repayments to disposable personal income has received considerable attention in recent months as a possible indicator of the ability and willingness of consumers to incur additional debt. This ratio, which reflects changes both in repayments and in disposable income, fell to a very low level during World War II. It then rose steadily until 1956, when it reached 12.7 per cent. Since 1956 it has varied within a narrow range around 13 per cent, most recently moving upward.

Recent changes in this ratio have led some observers to suggest that repayments may have approached a limit in relation to income beyond which consumers may not be able or willing to add to their indebtedness, and that this may tend to dampen sales of automobiles and other consumer goods in the future. Analytical considerations, however, do not suggest any special reason why a figure in the neighborhood of 13 per cent of disposable income should necessarily represent a limit on instalment debt repayments.

Much of the rise in the ratio of repayments to disposable personal income in earlier postwar years may be explained by an increase in the proportion of consumers using instalment credit. From 1952 to 1956, for example, while the ratio of aggregate repayments to aggregate income rose from 10.6 per cent to 12.7 per cent, the proportion of spending units who reported owing some instalment debt rose from 38 to 45 per cent, according to data from the Survey of Consumer Finances. But since 1956, both ratios have been relatively stable.

The changing composition of the population over the next few years could cause a renewed rise in the proportion of consumers using instalment credit and an associated rise in the repayment-income ratio for the economy as a whole. According to Bureau of the Census projections for 1965 and 1970, the most rapid rate of growth in number of households will be in those whose heads are under 25 years of age. These are mainly the families that will be formed as the young people born during the 1940's reach marriage age. Such young families are likely to be frequent users of instalment credit because their needs for household goods and automobiles generally exceed their ability to acquire these goods for cash.

REPAYMENT-INCOME RATIO at upper end of recent range



NOTE.—Based on seasonally adjusted data for instalment credit repayments (F.R.) and disposable personal income (Dept. of Commerce). Latest figure shown, first quarter 1963.

Also, in recent years consumers have been making more use of revolving credit and similar instalment plans to finance purchases of nondurable goods and services. It seems likely that in the future they will make still greater use of such plans.

Thus, over the coming years both demographic and institutional factors may tend to raise further the share of aggregate income used to repay instalment debt. A continued upward drift in the repayment-income ratio would not necessarily restrict new consumer purchases unless the ratio increased because of a decline in incomes. Should incomes decline, the existence of heavy commitments to repay debt would accentuate downward pressures on demand.

LENDERS' SHARES

Commercial banks and other major lenders have participated in the current credit expansion in about the same proportion as their holdings at the beginning of the upswing. But the distribution of types of paper has changed moderately.

The commercial bank share of automobile credit has increased somewhat, to 50 per cent, while that of sales finance companies has declined to 38 per cent. The sales finance share has fallen each year since 1955, when these companies acquired a relatively large proportion of the then rapidly expanding volume of automobile paper.

The sales finance company shares of other consumer goods paper and of personal loans have been rising irregularly over the same period, while the share of consumer goods paper at retail outlets has declined moderately. This reflects both the growing importance of sales finance subsidiaries of large retail organizations and the trend among other companies toward diversification into nonautomotive types of credit. Credit unions have increased their share of the personal loan market to 20 per cent, but their relative gain in 1962 was smaller than in other recent years.