

# Financial Insights

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## What's 'Driving' Changes in Household Debt?

by Preston Ash, Lexie Ford and Thomas F. Siems

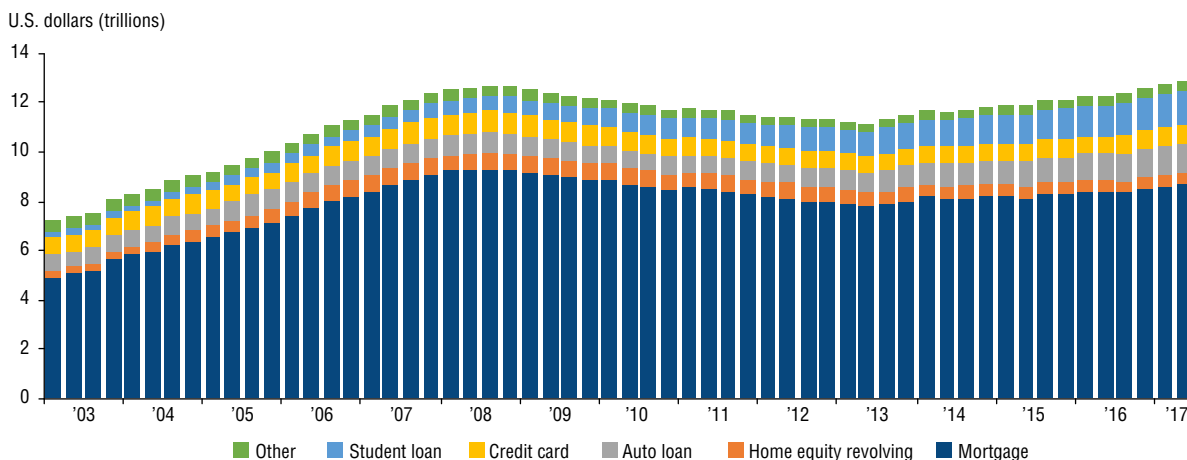
Around the time of the Great Recession, total household debt peaked at \$12.7 trillion, and now, nearly a decade later, it has reached a new high of \$12.8 trillion. Since the number of households has increased and incomes are much higher today, the overall debt burden and servicing of this debt is not nearly the problem it was then. But how has the composition and volume of household debt changed since the Great Recession? And are there any troublesome lending areas as households resume borrowing?

This article investigates these questions and looks deeper into automobile debt and delinquencies for both the U.S. and the Eleventh Federal Reserve District by analyzing data from the New York Fed Consumer Credit Panel/Equifax. Since the Great Recession, auto debt has been one of the key drivers of overall household debt, and there is evidence that delinquencies on subprime auto loans are worsening nationally and in the three states included in the Eleventh District.<sup>1</sup>

### Total Household Debt on the Rise, but Consumer Balance Sheets Improving

Chart 1 displays total household debt by its major components on a quarterly basis since 2003. As shown, overall household debt rose rapidly from 2003 to 2008, driven mainly by large increases in mortgage debt. After the Great Recession, total household debt and mortgage debt declined, with household debt reaching a trough of \$11.15 trillion in second quarter 2013. Since 2013, household debt has rebounded, which is both an encouraging sign—as it may reflect improving household income, wealth and confidence—and a potential discouraging trend in that credit quality might be deteriorating.

**Chart 1** Quarterly Total Household Debt and Its Composition



NOTE: Data are quarterly through second quarter 2017.  
SOURCE: New York Fed Consumer Credit Panel/Equifax.

Total mortgage debt, while increasing, remains below its 2008 peak. Yet, households have taken on more student debt and auto debt in recent years, and delinquencies in these loan categories are worse than the years immediately before the Great Recession. Since third quarter 2008, student debt has roughly doubled from \$611 billion to \$1.3 trillion, and auto loans have increased by approximately 50 percent, to \$1.2 trillion. And it appears that exposure in auto lending might be more pronounced in the Eleventh District; in Texas, auto loans make up 15 percent of total household debt, compared with 9 percent nationwide. This higher share in auto debt is most likely as Texans have less mortgage debt because houses are generally less expensive than other parts of the nation.

Despite these increases in loan volume, the average household in the U.S. does not have a higher relative debt burden than it did in 2008. At roughly 67 percent, the ratio of household debt to gross domestic product is much lower than its peak of 87 percent in first quarter 2009. The ratio declined quickly after the Great Recession as households repaired their balance sheets and has hovered around 67 percent since 2013. While this is an improvement, it is not without some risks.

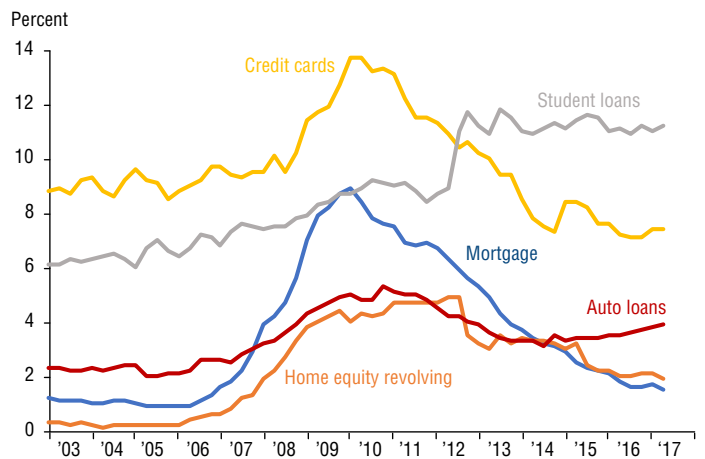
Of course, debt becomes a more immediate problem when consumers take on more debt than they can afford. And if they then go into default, financial markets could sustain significant losses if securities are mispriced or too much debt goes bad unexpectedly, as mortgages did almost a decade ago. Overall, the percentage of all debt 30-plus days late is higher than it was precrisis, with 4.8 percent of household debt delinquent in second quarter 2017 compared with 4.3 percent on average from 2003 through 2006. Additionally, 67 percent of late debt is seriously delinquent, defined as 90-plus days late, compared with an average of 53 percent over the aforementioned precrisis period. Chart 2 shows that while mortgage, home equity and credit card serious delinquencies have declined since 2010, student loan serious delinquencies have stabilized (but at a high level), and auto loan serious delinquencies have been rising.

Student loan delinquencies spiked around 2013 and subsequently stayed at relatively high levels.<sup>2</sup> While the overall picture of auto loan delinquencies appears to be less dramatic—only 3.9 percent of auto loans were seriously delinquent in second quarter 2017—serious delinquencies have generally increased since 2014, a period over which all other types of loans saw decreasing or mostly stable serious delinquencies.

To illustrate what is contributing to the delinquencies, Chart 3 shows auto loans broken down by credit score at origination

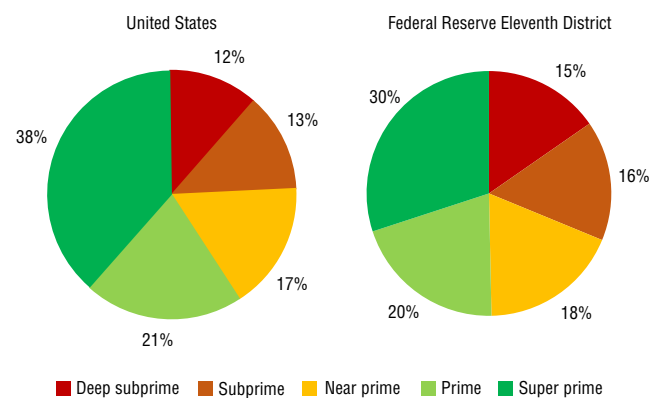
for both the U.S. and the Eleventh District. For subprime auto loans, the Eleventh District is in a worse position than the U.S. as a whole. In second quarter 2017, 31 percent of Eleventh District auto loans were considered subprime or deep subprime, with only 50 percent prime or super prime, compared with 25 percent and 59 percent, respectively, in the U.S.

**Chart 2** Balance 90+ Days Delinquent by Loan Type



NOTE: Data are quarterly through second quarter 2017.  
SOURCE: New York Fed Consumer Credit Panel/Equifax.

**Chart 3** Auto Loan Volume by Credit Score at Origination, Second Quarter 2017



NOTE: Values may not add up to 100 percent due to rounding.  
SOURCE: New York Fed Consumer Credit Panel/Equifax.

## Where Are Subprime Auto Loans Heading?

With more subprime auto loans written in the Eleventh District, the recent increase in already historically high subprime serious delinquency rates, depicted in Chart 4, could become a more serious problem for underwriters of this debt. Most of these loans are underwritten by automobile finance companies.<sup>3</sup>

In Texas, Louisiana, New Mexico and the U.S., subprime serious auto loan delinquencies never returned to precrisis levels of below 10 percent, and all are back on the rise. According to the most recent data, Texas, Louisiana and New Mexico are experiencing subprime serious auto loan delinquency rates of 15.4 percent, 16.8 percent and 18.6 percent, respectively—all higher than the U.S. rate of 15.0 percent. Among the 50 states and the District of Columbia, New Mexico currently has the second-highest rate of subprime serious auto delinquencies, behind Minnesota. Louisiana ranks sixth and Texas is 18th.

In Texas and New Mexico, subprime serious auto delinquencies remain below their 2010–11 highs of 18.2 percent, 21.9 percent and 18.7 percent, respectively, but Louisiana has surpassed its previous peak of 14.7 percent.

Several factors might be contributing to these increases. The main reason is the oil bust of 2015–16, which led to deep layoffs in the oil and gas sectors in these states as well as rising unemployment rates. In general, refinancing is becoming more difficult, as borrowing becomes more expensive due to recent

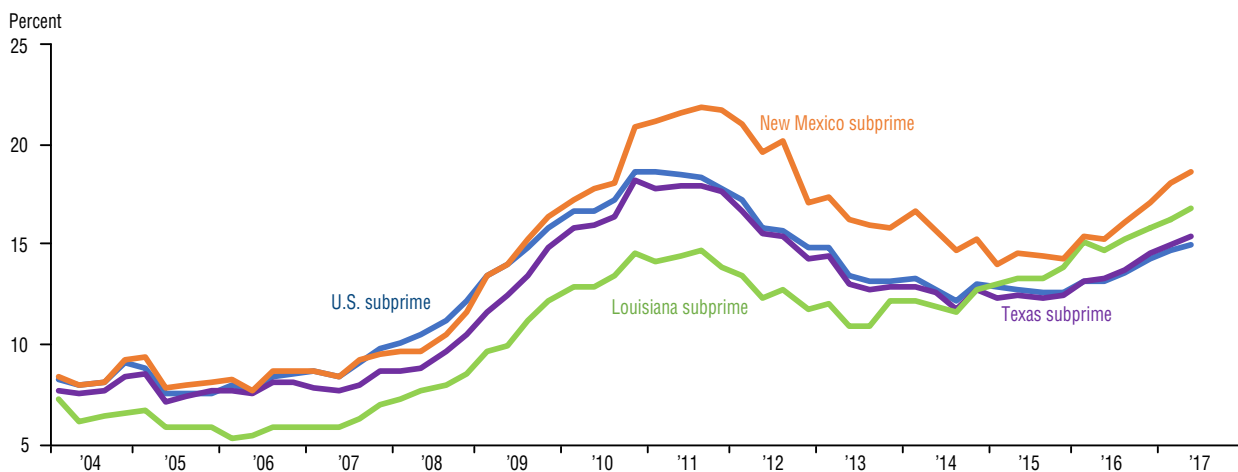
and expected increases in interest rates and overall economic optimism.<sup>4</sup> While this might not be a new phenomenon, subprime buyers may be less creditworthy than they claim—1-in-5 borrowers admitted in a recent survey to including inaccuracies in their applications. Another report found that a large provider of subprime auto loans verified incomes of 8 percent of borrowers whose loans were packaged into a \$1 billion bond issue.<sup>5</sup>

Moreover, the packaging of subprime loans as asset-backed securities and the rise in defaults are reminiscent of behaviors seen in the period leading up to the subprime mortgage crisis. Some analysts claim that yield-starved investors are increasingly demanding subprime asset-backed securities, which in turn is decreasing the risk premium on top-rated subprime auto bonds compared with benchmark swap rates.<sup>6</sup>

## Possible Risks in Auto Lending Merit Scrutiny

While the volume of automobile debt is less than one-seventh the size of the mortgage market, the rising trends in serious auto loan delinquencies and the volume of auto loans written as subprime or deep subprime are worth watching carefully, both nationally and for the three states included in the Eleventh Federal Reserve District. Moving forward, however, one trend that might ease these concerns is that banks and finance companies reported tightening their auto loan underwriting in recent months.

**Chart 4** Auto Loans Seriously Delinquent by Region



NOTES: Data are quarterly through second quarter 2017. Subprime lines include both subprime and deep subprime.  
SOURCE: New York Fed Consumer Credit Panel/Equifax.

Broad access to credit and a healthy financial system are essential to economic growth, but there can be costs when borrowers take on more debt than they can repay and when defaults unexpectedly rise. As households continue to take on higher levels of total debt, it will become increasingly important for lenders to ensure that borrowers have the creditworthiness and capacity to manage debt wisely.

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## Notes

<sup>1</sup>The Eleventh District of the Federal Reserve System includes Texas, northern Louisiana and southern New Mexico.

<sup>2</sup>"High Texas Student Loan Delinquency Rates Underscore Deeper Challenges," by Wenhua Di and Stephanie Gullo, Federal Reserve Bank of Dallas *Southwest Economy*, Third Quarter, 2017.

<sup>3</sup>Note that auto loans are partly secured by an asset, and auto loans issued in one part of the country might be securitized and/or held elsewhere. Moreover, auto lenders can more easily repossess the underlying asset, which might mitigate some concerns arising from higher subprime serious auto loan delinquency rates, <http://libertystreeteconomics.newyorkfed.org/2017/11/just-released-auto-lending-keeps-pace-as-delinquencies-mount-in-auto-finance-sector.html>.

<sup>4</sup>"Trump's America Is Facing a \$13 Trillion Consumer Debt Hangover," by Matt Scully, Bloomberg, June 6, 2017, [www.bloomberg.com/news/articles/2017-06-06/trump-s-america-is-facing-a-13-trillion-consumer-debt-hangover](http://www.bloomberg.com/news/articles/2017-06-06/trump-s-america-is-facing-a-13-trillion-consumer-debt-hangover).

<sup>5</sup>"Subprime Auto Loans Up, Car Sales Down: Why This Could Be Good for Gold," by Olivier Garret, Forbes, July 13, 2017, [www.forbes.com/sites/oliviergarret/2017/07/13/subprime-auto-loans-up-car-sales-down-why-this-could-be-good-for-gold/#2a5d848e1c5c](http://www.forbes.com/sites/oliviergarret/2017/07/13/subprime-auto-loans-up-car-sales-down-why-this-could-be-good-for-gold/#2a5d848e1c5c).

<sup>6</sup>"Wells Fargo, JPMorgan Wary of Auto Loans, but Pack Them in Bonds," by Matt Scully, Bloomberg, April 27, 2017, [www.bloomberg.com/news/articles/2017-04-27/wells-fargo-jpmorgan-wary-of-auto-loans-but-pack-them-in-bonds](http://www.bloomberg.com/news/articles/2017-04-27/wells-fargo-jpmorgan-wary-of-auto-loans-but-pack-them-in-bonds).

## Noteworthy Items

### **Eleventh District Banking Conditions Survey Results**

October 2017

Over the past six weeks, the Eleventh District financial sector has strengthened but at a slower pace compared with the previous period.

### **Dallas Fed President and CEO Rob Kaplan's Essay on the Impact of Hurricane Harvey and Key Structural Drivers Affecting U.S. Monetary Policy**

Oct. 17, 2017

In his latest essay, Dallas Fed President and CEO Rob Kaplan provides a synopsis of his current views regarding the economic impact of Hurricane Harvey as well as economic conditions and U.S. monetary policy.

### **Dallas Fed President and CEO Rob Kaplan Discusses Technology-Enabled Disruption**

Sept. 27, 2017

In a new series of videos, Dallas Fed President and CEO Rob Kaplan discusses technology-enabled disruption and its likely impact on inflation, labor markets and the skills gap in the United States.

### **Federal Reserve Releases Federal Open Market Committee Statement**

Sept. 20, 2017

# Dallas Fed Resources

## Calendar of Upcoming Events



**Oct. 20**  
Louisiana Tech Bankers Day  
RUSTON, LOUISIANA



**Nov. 2**  
Banker Roundtable  
JUNCTION, TEXAS



**Nov. 8–9**  
Banking On the Leaders of Tomorrow (BOLT) Program  
HOUSTON, TEXAS



**Dec. 1**  
Dialogue with the Dallas Fed  
MCALLEN, TEXAS

## Did You Know?

Congress has charged the Federal Reserve with supporting job creation, keeping inflation low and fostering a stable financial system.

## Economic Updates

### Texas—“Hurricane Harvey Unlikely to Throw Texas Off Course”

Research suggests that the longer-term impact of the hurricane is expected to be limited. Houston will rebound because of its importance as the energy capital of the U.S. and as a center for business and trade. Other parts of the coast will gradually recover as well, although some small-business owners may find it difficult to reopen.

### U.S.—“National Economy on Solid Footing Before Arrival of Hurricanes Harvey and Irma”

Hurricanes Harvey and Irma, if taken together, would rank among the costliest weather-related disasters in U.S. history based on the estimated value of destroyed or damaged property and infrastructure. Moreover, the back-to-back storms in late August and early September have introduced substantial uncertainty into the economy’s near-term outlook.

### International—“Global Outlook Improves”

Recent data on global gross domestic product growth point to a modest and broad-based increase in real economic activity.

## Publications

### Community Banking Connections

Community Banking Connections is a nationwide Federal Reserve System resource for community banks.

### Dallas Beige Book—Oct. 18, 2017

A summary of anecdotal information about recent economic conditions and trends in the Eleventh District.

## About Financial Insights

*Financial Insights* is published periodically by FIRM—Financial Institution Relationship Management—to share timely economic topics of interest to financial institutions. The views expressed are those of the authors and should not be attributed to the Federal Reserve Bank of Dallas or the Federal Reserve System.

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### Economic Letter—“Global and National Shocks Explain a Large Share of State Job Growth”

Global and U.S. national shocks on average appear to equally explain more than half of the fluctuations in state employment growth, an important measure of assessing real economic activity. The overall assessment, however, conceals a wide variation among states.

### Southwest Economy—“Texas Taxes: Who Bears the Burden?”

The third quarter 2017 issue looks at who bears the tax burden in Texas, Texas student loan delinquency rates and the health of Texas retail.

## Surveys and Indicators

### Agricultural Survey

The Dallas Fed conducts the quarterly *Agricultural Survey* to obtain a timely assessment of agricultural credit conditions in the Eleventh Federal Reserve District.

### Texas Business Outlook Surveys—Manufacturing, Service Sector, Retail

The Dallas Fed conducts recurring surveys of over 900 business executives in manufacturing and services across Texas.

### Eleventh District Banking Conditions Survey Results

The Dallas Fed conducts the Banking Conditions Survey twice each quarter to obtain a timely assessment of activity at banks and credit unions headquartered in the Eleventh Federal Reserve District.

### Texas Economic Indicators

The Texas economy expanded in August.