INSIDE THE VAULT

An Economic Education Newsletter from the Federal Reserve Bank of St. Louis

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Extra Credit: The Rise of Short-term Liabilities

According to the 2004 Survey of Consumer Finances (SCF), the percentage of families holding debt rose from 72.3 percent in 1989 to 76.4 percent in 2004. Among families holding debt, the median value of the debt more than doubled during that time from $22,000 to $55,300 (in 2004 dollars). These numbers reflect both a rise in collateralized debt (e.g., mortgages) and uncollateralized debt (e.g., credit cards).

This shift toward more debt appears to have long-term ramifications for the U.S. economy, as evidenced by the growing number of personal bankruptcies over recent decades. Perhaps playing a role in this rise is the increase in debt accumulated via credit cards and payday loans.

Paper or Plastic?

In 1989, a total of 55.8 percent of American families owned at least one credit card; in 2004, a total of 74.9 percent owned at least one card. According to several economic studies, the characteristics of credit card holders have changed over time to include people who are riskier for the lenders. For example, a higher percentage of single people and renters now have a credit card. Also, workers with less job seniority, lower incomes and unskilled jobs are now more likely to hold a credit card. Attitudes toward borrowing have changed as well; for example, people increasingly borrow to finance things like vacations and living expenses.

Although credit card usage has increased across the income spectrum, the largest increases occurred among lower-income groups. (See the accompanying table.) Among those in the lowest 20 percent of the income distribution, the fraction with credit card debt nearly doubled between 1989 and 2004, and their median credit card debt increased to $1,000 from $400. For those in the next lowest 20 percent, the fraction with credit card debt

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Credit Card Debt by Income Distribution

	Percentage with credit card debt			Median credit card debt (2004 dollars)		
	1989	2004	Difference	1989	2004	Difference
All families	39.7	46.2	6.5	$1,300	$2,200	$900
Percentiles of income < 20 percent	15.0	29.1	14.1	$400	$1,000	$600
20 – 39.9 percent	28.2	42.5	14.3	$900	$1,800	$900
40 – 59.9 percent	48.8	55.0	6.2	$1,200	$2,200	$1,000
60 – 79.9 percent	57.4	56.2	–1.2	$1,500	$3,000	$1,500
80 – 100 percent	49.0	48.1	–0.9	$2,600	$3,400	$800

SOURCE: 2004 Survey of Consumer Finances. See www.federalreserve.gov/pubs/oss/oss2/2004/scf2004home.html.

Q&A

Q. What is a credit score?

A. When someone wants to borrow money, the lender checks the person's credit score. A credit score is a number that predicts the likelihood that a borrower will be able to repay the loan as agreed. Credit-reporting agencies are businesses that collect information about consumers' loan and bill payment histories. Credit agencies keep these records and, upon request, provide information to creditors in the form of a credit report. When a creditor requests a borrower's credit report, a credit score can be generated based on the information in the credit report. This score can also be purchased by lenders. Credit scores are one of the factors used by lenders to determine not only the amount of credit (if any) to extend to a borrower, but also the terms of the loan, e.g., the interest rate charged.

Q. What are FICO scores?

A. FICO scores are the most widely used credit scores. FICO stands for Fair Isaac Corp., the company that developed the FICO scores system of evaluation. Fair Isaac develops scores based on the information that is provided by three major credit-reporting agencies: TransUnion, Equifax and Experian. Fair Isaac sells the scores to the credit-reporting agencies. Lenders buy FICO scores from one or all three of the major credit-reporting agencies. FICO scores vary, but generally the scores are between 500 and 850. FICO scores between 700 and 850 indicate that a borrower is very likely to repay loans and other debts. FICO scores lower than 600 indicate that a borrower may not be a good credit risk.

Q. How are FICO scores determined?

A. FICO scores are determined using an equation that evaluates information from a consumer's credit report and that compares the results to the result of many other consumers' credit reports over time. The information from a credit report that is used to determine a FICO score can be grouped into five categories: payment history, amounts owed, length of credit history, new credit and types of credit used.

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Economic Snapshot

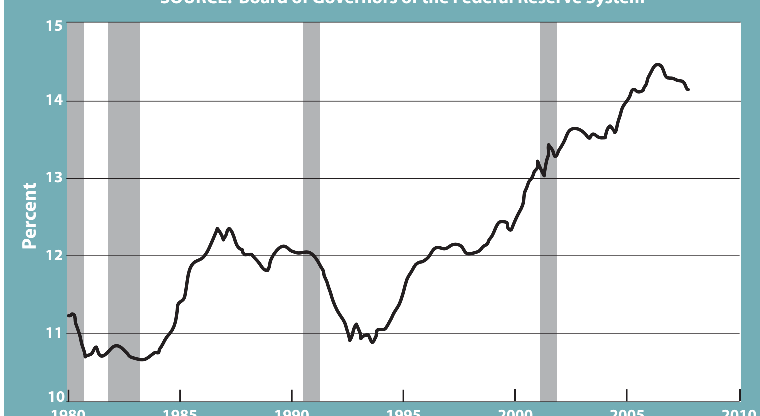
Second Quarter 2008

(Percent change at an annual rate from the preceding period)

	Q3-'07	Q4-'07	Q1-'08	Q2-'08
Growth rate — Real Gross Domestic Product	4.8%	-0.2%	0.9%	1.9%*
Inflation rate — Consumer Price Index	2.8%	5.0%	4.3%	5.0%
Civilian Unemployment Rate	4.7%	4.8%	4.9%	5.3%

*Advance estimate

Household Debt Service Payments as a Percent of Disposable Personal Income (TDSP)
SOURCE: Board of Governors of the Federal Reserve System



Shaded areas indicate U.S. recessions as determined by the NBER.
2008 Federal Reserve Bank of St. Louis: research.stlouisfed.org

What is the household debt service ratio?

The household debt service ratio (DSR) is an estimate of the ratio of debt payments to disposable personal income. Debt payments consist of the estimated required payments on outstanding mortgage and consumer debt.

What is disposable personal income?

In the United States, personal income includes all income received by U.S. residents in a given year from all sources. Personal income is the sum of wage and salary payments, other labor income, rental income, dividend and interest income, and transfer payments to individuals, such as welfare and unemployment insurance. Disposable personal income is the amount of personal income that remains after personal taxes are subtracted. It is the amount of personal income available to people for spending and saving.

Approximately what percent of disposable personal income were household financial obligations in 1980?

In 1980, household financial obligations represented slightly more than 11 percent of disposable personal income.

What is the trend for household financial obligations as a percent of disposable personal income since 1995?

Since 1995, household financial obligations as a percent of disposable personal income have been increasing.

NEW! Curriculum and Materials

FROM THE FEDERAL RESERVE BANK OF ST. LOUIS

Available December 2008

GDP and Pizza: An Online Instructional Module for High School Classrooms
This is a two-class-period instructional program including online pre- and post-test and a complementary in-class activity for pre- and post-assessment. The program is appropriate for high school social studies classes. Students learn economic content and its relevance.

Twenty-five Cents' Worth of History
Activity Book and Teachers Guide
This is the second activity book in our Piggy Bank Primer series for elementary classrooms. The booklet focuses on states and coins in the Eighth District.

It's Your Paycheck
This is a set of active lessons for high school personal finance classrooms. The lessons focus on: human capital, wages, taxes, budgeting, saving, credit rights and responsibilities, payday loans, rent-to-own contracts, credit cards, and credit reports.

Cards, Cars and Currency
This is a set of active lessons for high school personal finance classrooms. These lessons focus on three specific areas of personal finance: credit cards, debit cards and car purchases.

To schedule workshops based on these materials for your school or school district, or for additional information, contact:

Little Rock: Billy Britt—501-324-8368 or billy.j.britt@stls.frb.org

Louisville: Dave Ballard—502-568-9257 or david.b.ballard@stls.frb.org

Memphis: Jeannette Bennett—901-579-4104 or jeannette.n.bennett@stls.frb.org

St. Louis: Mary Suiter—314-444-4662 or mary.c.suiter@stls.frb.org

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Federal Reserve Bank of St. Louis

The Great Depression Curriculum Workshop

A one-day professional development workshop for 9th-to-12th-grade educators

When and Where:
Tuesday, Nov. 18, 2008
8:30 a.m. – 2:30 p.m.
Federal Reserve Bank of St. Louis
One Federal Reserve Bank Plaza
St. Louis, MO 63102

To register or for more information:
There is no fee, but registration is required. Register online at www.stlouisfed.org/education/conferences/2008Nov18StLouis.html. To learn more, contact Mary Suiter at 314-444-4662 or mary.c.suiter@stls.frb.org.

Federal Reserve Bank of St. Louis—Memphis Branch

Personal Finance from A to Z

A two-day St. Louis Fed conference for K-12 educators sponsored by the Federal Reserve Bank of St. Louis—Memphis Branch

When and Where:
The ABCs of Personal Finance: Wednesday, Nov. 5, 2008
Personal Finance to XYZ: Thursday, Nov. 6, 2008
8:30 a.m. to 4 p.m.
Marriott East
2625 Thousand Oaks Blvd.
Memphis, TN 38118

To register or for more information:
There is no fee, but registration is required. Register online at www.stlouisfed.org/education/conferences/2008Nov5-6Memphis.html. To learn more, contact Jeannette Bennett, 901-579-4104 or 1-800-333-0810, ext. 79-4104, or jeannette.n.bennett@stls.frb.org.

Federal Reserve Bank of St. Louis—Little Rock Branch

Economic Summits

Grades 5-12

Building Excellence in Economic and Financial Literacy in the Social Sciences

When and Where:
University of Central Arkansas
Oct. 17, 2008, from 8 a.m. to 4 p.m.

To register or for more information:
Register online at www.stlouisfed.org/education/conferences.html. To learn more, contact Julie Kerr at 501-324-8296 or julie.a.kerr@stls.frb.org.

Going Green: Benefits and Costs

When and Where:
University of Arkansas at Fayetteville
Nov. 7, 2008, from 8 a.m. to 4 p.m.

To register or for more information:
Register online at www.stlouisfed.org/education/conferences.html. To learn more, contact Julie Kerr at 501-324-8296 or julie.a.kerr@stls.frb.org.

Essay Contest

Hot Topics in the News

The Little Rock, Louisville and Memphis branches of the Federal Reserve Bank of St. Louis are sponsoring an essay contest for students in grades 9-12. Each office will select the winning essays from area students.

Prizes (awarded in each location) are:

First place	$500 savings bond
Second place	$300 savings bond
Third place	$200 savings bond
Fourth place	$100 savings bond

For more information or to register for the contest, visit www.stlouisfed.org/education/essay.

Federal Reserve Bank of St. Louis—Louisville Branch

Econ Camp South

A two-day conference for high school economics teachers, sponsored by the Federal Reserve Bank of St. Louis—Louisville Branch, the Indiana Department of Education, and the George and Frances Ball Foundation

Learn more about the economics concepts identified in the Indiana Economics Standards while sharing best teaching practices and helping to promote economics in the high school curriculum. Hear from economics professors and St. Louis Fed speakers—and enjoy a unique experience, complete with an evening campfire and refreshments.

When and Where:
The program is being held in Princeton, Ind., beginning at 4 p.m. on Oct. 21 and ending at 2:45 p.m. on Oct. 22.

To register or for more information:
Go to www.econed-in.org/econcamps.asp. Register online by Oct. 7, 2008. Registrations are first-come, first-served.

Bank Contacts

Little Rock – Billy Britt 501-324-8368
Louisville – David Ballard 502-568-9257
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Extra Credit

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increased by 51 percent, and their median debt doubled to $1,800.

Between 1992 and 2006, the total dollar amount of credit card loans nearly tripled, while the dollar amount of loans that are 90 days delinquent more than tripled. At the end of 2006, FDIC-insured institutions had $385 billion in credit card loans to individuals, and $6.5 billion were past due 90 days or more (1.7 percent of the total).

In addition to carrying a balance, borrowers do not appear to rush to pay off their credit cards. Several economists have found that some consumers carry credit card balances even though they have sufficient funds in the bank to pay off their high-interest debt.

What's in the Balance?

In addition to carrying a balance, borrowers do not appear to rush to pay off their credit cards. Several economists have found that some consumers carry credit card balances even though they have sufficient funds in the bank to pay off their high-interest debt. Economist Irina Telyukova found that about 28 percent of those surveyed had at least $500 both in credit card debt and liquid assets. This group held an average credit card debt of $5,766 and an average of $7,237 in liquid assets. Furthermore, the average interest rate on the debt was 13.7 percent, compared with a rate of only about 1 percent on their liquid assets.

Telyukova hypothesized that households keep liquid assets for payments where cash is required. While many of these expenses are predictable, others may arise in an emergency. To protect themselves in the event such a case arises, households may forgo paying off credit card debt in order to keep cash available.

I Want It All, and I Want It Now

Another increasingly common form of short-term debt is the payday loan. According to the Center for Responsible Lending (CRL), from 2000 to 2003, the industry quadrupled in size to $40 billion. Payday loans are designed to lend small amounts of money for short amounts of time, usually two weeks. Typical interest rates for two weeks can range from 15 to 18 percent, which translates into about a 400 percent annual interest rate. Payments are due on the borrower's payday, but the loan may be renewed with additional fees.

Similar to credit cards, payday loans have become popular among lower-income households. A CRL report asserts that 90 percent of lenders' revenue comes from borrowers who have five or more loans per year. To demonstrate, an average borrower renews a loan eight times and ends up paying back $793 for a $325 loan. The CRL estimates that Americans paid $4.2 billion in payday loan fees in 2005.

Economists Paige Skiba and Jeremy Tobacman found that applicants for payday loans from a particular lender in Texas had an average monthly income of $1,699 and $235 in their checking account. Additionally, 77 percent of the applicants were black or Hispanic and 62 percent were women. The results of the study suggest that access to loans can be habit-forming. Within one year, a consumer whose first-time application for a payday loan was approved would apply for another loan an average of 8.4 more times; in comparison, a consumer whose first-time application was rejected would apply 1.8 more times on average.

You Get What You (Don't) Pay For

Americans appear willing to trade substantial interest payments for access to short-term credit markets. But does this new behavior have detrimental long-term effects? According to a study by economist Michelle White, an increase in the amount of revolving debt (for example, credit card debt) per household coincided with an increase in personal bankruptcy filings from the 1980s to 2005. There were 5.4 times more bankruptcies in 2004 than in 1980, and revolving debt per household was 4.6 times larger in 2004 than in 1980.

White discussed other possible explanations for the increase in bankruptcy filings, such as job loss and medical bills. These types of adverse events, however, have not increased since 1980. She concluded, therefore, that the rise in personal bankruptcies can be attributed in large part to the rise in credit card debt.

Similarly, the payday loan applicants in Skiba and Tobacman's study were six times more likely to file for bankruptcy between January 2001 and June 2005 than the general population in Texas.

Credit cards and payday loans can be convenient for some people as a means to borrow money for a relatively short period of time. However, the recent rise in short-term liabilities—especially by lower-income households—may have long-term implications for the economy, as demonstrated by the apparent correlation with bankruptcy filings.

This article was adapted from "Extra Credit: The Rise of Short-term Liabilities," which was written by Kristie M. Engemann, a research analyst, and Michael T. Owyang, an economist, both of the Federal Reserve Bank of St. Louis, and was published in the April 2008 issue of The Regional Economist, *a St. Louis Fed publication.*

Classroom Discussion

1. Why don't households that have cash in savings use the cash to pay existing credit card debt?
2. What are payday loans?
3. How does the increase in revolving debt seem to be related to bankruptcy filings?

For a **lesson plan** to accompany this article, go to www.stlouisfed.org/education/itv_lesson_plan.html.

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Q. **Does a high FICO score guarantee that a consumer will get a loan?**

A. No score guarantees that a consumer will get a loan. A score is one of the factors in a lender's credit decision. Although FICO scores are important to lenders, every lender has its own strategy for lending, including the level of risk it finds agreeable for a given credit record. There is no single "cutoff score" used by all lenders.

Q. **How do borrowers get a better FICO score?**

A. There is no quick fix. Raising a FICO score takes time. Types of credit in use, payment histories, amounts owed, length of credit histories and new credit are all factors in creating a consumer's FICO score. The best way for a consumer to ensure a good FICO score is to manage his or her credit responsibly over time.

The content for Q & A was compiled by Billy Britt, economic education specialist at the St. Louis Fed's Little Rock Branch, and was largely adapted from Fair Isaac Corp.'s "Understanding Your FICO Score." To learn more about credit scoring, visit Fair Isaac Corp.'s web site www.myfico.com/crediteducation. For a free credit report, visit www.federalreserveconsumerhelp.gov and click on the "Credit Report" tab.

Let Us Know What You Think!

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