››› Consumer loans in the USA: be vigilant but not afraid

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Attention has recently been focused time and again on reports about the alarming development of consumer loans in the USA. On closer inspection, several warning signs are indeed apparent, for instance with regard to credit dynamics or the quality of student and auto loans. But based on the majority of the figures, the warnings of a new serious financial crisis are not justified.

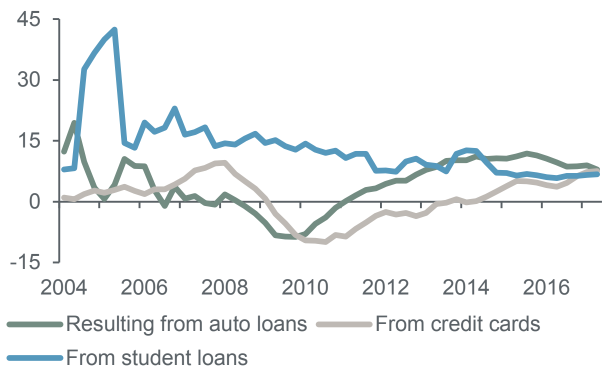
There is growing concern over a new financial crisis emerging from the US credit market. This time it is consumer loans that are coming under increased scrutiny. The pace of lending is increasing, credit quality is falling, and the sub-prime segment is becoming more popular while the securitisation market is gaining momentum. At the same time, the US economy is in a phase of interest rate increases which could gradually put more and more pressure on borrowers. But how serious is the situation really?

Student loans are becoming more important

Consumer lending has indeed grown strongly in the past years and, in part, also at the current margin. The various types of consumer loans have grown at similar rates (Figure 1). Conspicuously, student loans have recorded high annual growth rates, especially up to the first half of 2014 (15 % p.a. on average from 2004 to 2013), achieving precisely the momentum which mortgage loans displayed ahead of the crisis. In the course of this expansion, student loans have become the most prominent group within the consumer loan segment, growing from a good 10 % (2003) to a share of currently around 35 % (Figure 2).

Figure 1: US household consumer debt

Debt outstanding on previous year in per cent



Source: Federal Reserve Bank of New York, own calculations.

However, the growth rates of credit card and auto loan debt, which currently stand at 7 to 8 %, are now also on or above the respective (pre-)crisis momentum.

Credit quality is starting to deteriorate

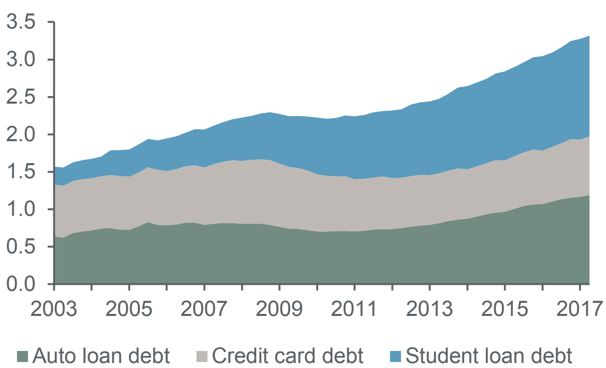
In the past years, the stronger lending dynamic has combined with worsening credit quality and rising lending growth in the sub-prime segment. What is also playing a role is that the role of banks in consumer lending is declining.

For student loans, the state is almost the sole risk bearer. Budget consolidations in the aftermath of the crisis have led to funding cuts for universities and, consequently, rising tuition fees. This, in turn, has driven credit demand. In auto finance, only around half the loan volume outstanding is owed to the classic banking system, the other half to finance companies, which account for a remarkable three fourths of the sub-prime segment.

The delinquency rates (with the exception of credit cards) are therefore trending upward again and remain on high levels (Figure 3).[1] Business in the sub-prime segment is growing, with student lending up around 13 % in the first half of 2017, the highest growth rate since the crisis. Accordingly, sub-prime quotas are rising slightly again at the current margin (Figure 4) but are still nowhere near the levels in the years before the crisis.

Figure 2: Composition of consumer loan debt

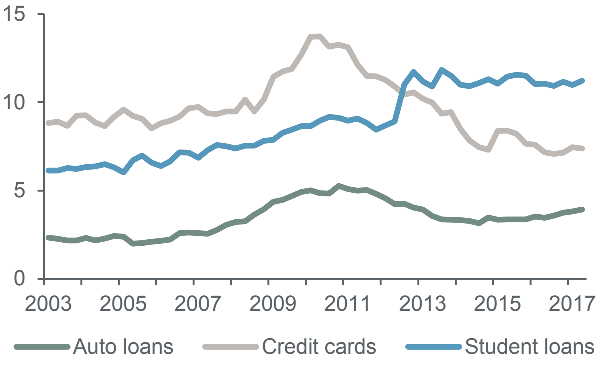
Debt outstanding in USD trillion



Source: Federal Reserve Bank of New York.

Figure 3: Delinquency rates

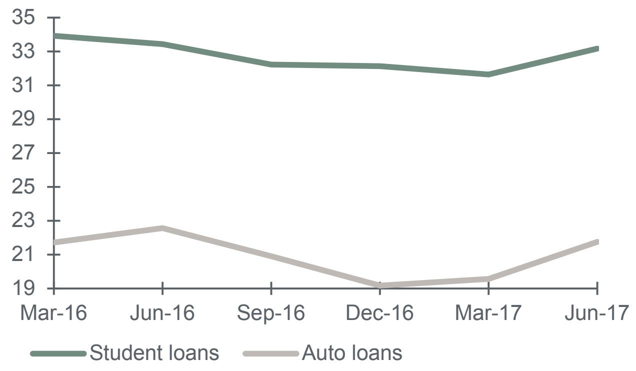
Delinquencies (>90 days) in per cent of the corresponding loan volume outstanding



Source: Federal Reserve Bank of New York.

Figure 4: Sub-prime loans

Share of sub-prime lending in total corresponding originations in per cent



Source: Federal Reserve Bank of New York, CFPB, own calculations.

Still: the concerns are exaggerated

Based on the indicators described above, the current situation is being associated with the financial market crisis triggered by the mortgage market ten years ago. But these fears are exaggerated:

- Consumer loans make up only around one fourth of US household debt. Mortgages remain the heavyweights with around 70 %, but they currently show no worrying signs.

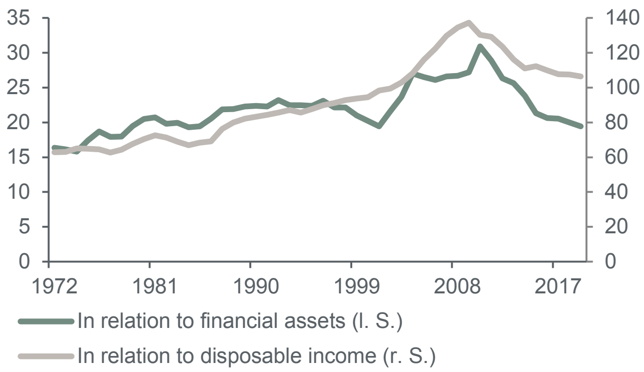
- The financial resilience of US households has improved in the past years. The ratio of debt to assets and disposable income peaked during the crisis but has been on the decline since then (Figure 5).

- Before the financial market crisis, lenders took insufficient credit quality deliberately into their books because these risks subsequently left their balance sheets through securitisations. This potential hardly exists anymore today. Securitisation volumes are currently nowhere near pre-crisis levels, even though the ABS volume was around 30 % higher in the first half of 2017 than in the same period of 2016 (Figure 6).

- There is no danger of distortions from the Federal Reserve's ongoing upward move in key interest rates. Most student and auto loans have fixed interest rates, and besides, the Fed is raising interest rates at a very moderate pace. A sudden, strong increase in interest obligations of US households is therefore not to be expected.

Figure 5: US household debt

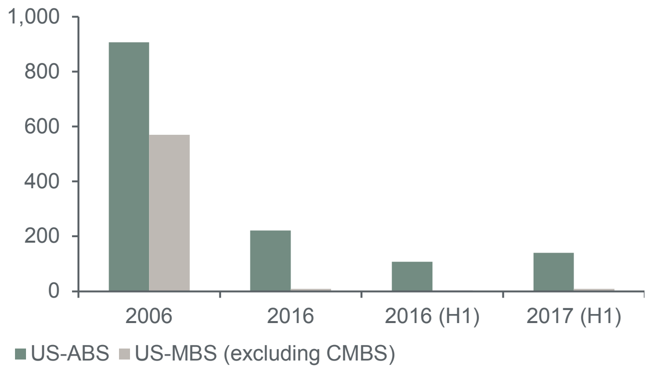
In per cent



Source: Bloomberg, own calculations

Figure 6: Securitisation volume

In USD billion



Source: Asset-Backed Alert, own calculations.

Conclusion

The market for US consumer loans (especially student loans, but also auto loans) is showing warning signs that are reminiscent of the previous crisis mix (strong growth rates, declining credit quality, revival of the sub-prime segment). It cannot be ruled out that this will put pressure on lenders and risk bearers. However, the weight of consumer debt in the USA is relatively low. Besides, US households are today in a more financially sound position. Moreover, the (global) integration of the financial industry through securitisation chains is not as strong anymore. So there is little potential for a crisis similar to that of 2007–2009. ■

[1] The significant increase in the delinquency rate on student loans, particularly in Q3/2012, is due to the fact that from that moment on, loan defaults were counted that were incorrectly omitted in the previous statistics. The delinquency rate on student loans has remained unchanged since then, but it has not recovered after the crisis either.