US Macroeconomics

August 8, 2023

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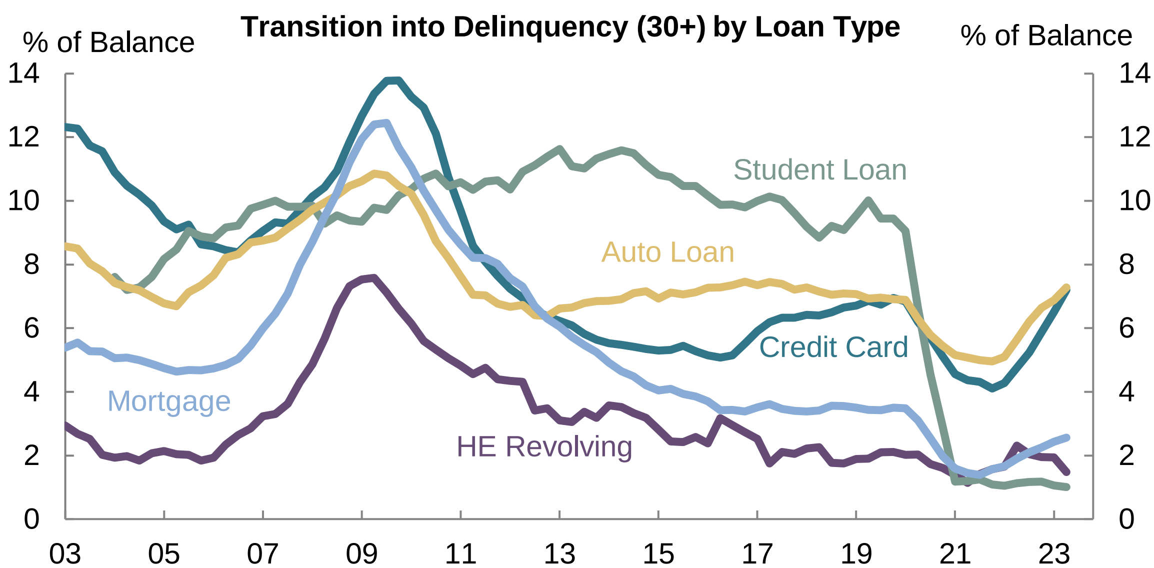
Delinquencies Rising Despite Ultra Low Unemployment

In a trend that we see accelerating, loan repayments are increasingly running late, according to the New York Fed's Household Debt and Credit report. We detailed one reason for this in our June 27th note. Through June (the most recent data), real disposable personal incomes (incomes adjusted for inflation and taxes) are down 9.1% versus the end of April 2020. Although there has been some improvement in this area because inflation has subsided, **consumers' real purchasing powers are still $867B below trend**, according to our calculations. This is an issue because the sustainability of consumers' pandemic debt-binge was partially predicated upon their incomes steadily rising. Instead, the opposite occurred, and now the rate at which borrowers are running late on their debt payments is back to pre-Covid levels. This could be the newest challenge facing embattled commercial banks.

As charted below, the universe of loans transitioning into delinquency (30 days late or more without a payment) has increased broadly since Q1 2022, especially for autos and credit cards. This too is occurring for mortgages, albeit not as sharply. **Today, we received data for Q2 2023, which showed continued degeneration**. Auto delinquencies (7.28%) reached their highest rate since Q1 2018, credit cards (7.2%) reached their highest since Q1 2012, and for mortgages (2.56%) the highest since Q2 2020. In response, expect further tightening in bank lending standards.

The pandemic suspension of student loan payments has led to the percentage of loans running delinquent to a record low of just 1%. Not paying student loans has allowed borrowers to pay down other types of debt (and spend on discretionary items). This artificially supported the performance of other loans. But, **beginning October 1st, student loan payments restart, which we estimate presents a near 1% of GDP tax hike for borrowers.** Assuming student loan delinquencies rise to their pre-pandemic levels, we are likely to see a resulting rise in delinquencies across the spectrum, which are already mostly back to pre-Covid levels. In turn, future credit is likely to decrease while loan losses should increase. **Keep in mind this is happening alongside the lowest unemployment in over 50 years.**



Sources: New York Fed Consumer Credit Panel, Equifax, SMBC Nikko

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