

Borrowing Trends and Household Debt Burdens

Prof. Michael E. Staten
Director, Credit Research Center
McDonough School of Business
Georgetown University

At the end of 1999, mortgage credit owed by U.S. consumers totaled about \$4.4 trillion including both first and second mortgages and home equity lines of credit. Non-mortgage consumer credit (including credit card balances, auto loans and other personal installment loans) totaled an additional \$1.4 trillion. Whether or not these sums are large given the size of the U.S. population, perhaps the more impressive numbers relate to the rapid growth in both types of credit over the current expansion. During just the four years between December, 1995 and December, 1999, non-mortgage consumer credit outstanding rose by \$300 billion and mortgage balances outstanding rose by nearly \$1 trillion. Coupled with alarming upward trends in delinquencies, chargeoffs and personal bankruptcies beginning in 1995, the debt buildup naturally raises ongoing concerns about current household debt burdens. These concerns are all the more pressing early in 2000 as we see consumer spending on all products but especially durable goods (usually financed with credit) continue to surge.

Any attempt to assess household debt burdens should begin with the Federal Reserve Board's triennial Surveys of Consumer Finances. The most recent was conducted in mid-1998. The surveys provide the most detailed inventory of household finances of any nationally representative survey, but their drawback is their infrequency. The latest data are now nearly two years old, but still provide an extremely helpful profile of the distribution of debt across families and how that distribution was changing through the past decade.

Debt Growth

First, it is clear that U.S. families increased their debt holdings relative to their incomes during the mid to late 1990s across all income groups. The proportion of households using credit was almost the same in 1998 (74.1%) as it was in 1995 (74.5%).¹ This is true as well across groupings of families by income, age, race/ethnicity, housing status or net worth. Consequently, unlike earlier periods (most notably the 1980s), the most recent buildup in total debt has not been due to deeper penetration into population groups (e.g., lower income and minority households). Instead, the proportion of each population group that holds debt chose to hold more of it. Table 1 illustrates the change in the median value of total debt held by families between 1995 and 1998, by income and age of the family head.

¹ These and many other statistics from the 1998 Survey of Consumer Finance can be found in Kennickell, Starr-McCluer and Surette, "Recent Changes in U.S. Family Finances: Results from the 1998 Survey of Consumer Finances," *Federal Reserve Bulletin*, January, 2000, pp 1-29.

Interestingly, despite all we've heard in the popular press about credit cards driving people into financial difficulties and bankruptcy, the Surveys of Consumer Finances reveal that credit card balances actually lagged behind growth in other consumer debt holdings between 1995 and 1998. The percent of families who said they had a balance on their credit cards after they last paid their bills actually fell from 47.3% to 44.1%. For those who did revolve a balance on one or more of their cards, the median card balances (across all cards) rose just 6% (\$1,600 to \$1,700) from 1995 to 1998. In contrast, installment loan balances per family rose 36% from \$6,400 to \$8,700 over the same period.

Debt Burden

The dollar buildup in outstanding household debt since 1995 overstates its impact on the *affordability* of debt. One of the defining characteristics of the current economic expansion has been the dramatic rise in personal incomes across all population groups. Also, the largest increase in debt has been in mortgage debt, which carries a much longer maturity than consumer installment loans. A \$10,000 increase in the size of a family's 30-year mortgage has a much smaller impact on the monthly budget than a \$10,000 increase in an outstanding automobile loan. Consequently, evidence from the Surveys of Consumer Finances reveals that across all families with debt, the median ratio of debt payments to family income rose from 15.9 percent in 1989 to 16.1 percent in 1995 to 17.6 percent in 1998, a much less dramatic increase than suggested by the growth in total debt. The sharpest increase between 1995 and 1998 was for families with annual incomes (in 1998) of less than \$10,000. The median rose from 15.4 percent to 20.3 percent.²

Perhaps the more revealing measures of financially troubled households are the percent of families with monthly payment-to-income ratios greater than 40% and those families who had a serious delinquency (payment 60 days or more past due) at least once during the previous year. Figure 1 illustrates that the proportion of families with high payment-to-income burdens increased across every income category between 1995 and 1998. The sharpest increases were among households with annual incomes less than \$50,000. It is worth noting that this measure has been trending upward since 1989, but accelerated between 1995 and 1998. In addition, the proportion of families who admitted at least one serious delinquency in the previous year (not shown) also rose across all income groups, but the increase was generally smaller, suggesting that the higher debt burdens had not triggered significantly more repayment problems.

Several conclusions can be drawn from the 1998 survey. First, and most importantly, the remarkable economic climate of the mid-to-late 1990s allowed U.S. families to engage in a dramatic buildup in total debt, especially mortgage debt, while simultaneously increasing their net worth. Simply put, the strong equity markets and broader

² Keep in mind that this group comprised only about 12.6% of the population in 1998. Moreover, only 41.7% of this group held some type of debt, compared to 74.1% of all families.

participation across different demographic groups caused asset holdings for most families to rise even faster than liabilities. That said, for families with debt in 1998, debt payments took a larger fraction of income than they did in 1995, although the large majority of households continued to maintain manageable payment-to-income ratios. However, a relatively small but growing proportion of families find themselves in an increasingly vulnerable position with respect to servicing their debt. Their high debt service burdens may trigger a sharp increase in serious repayment problems when the economic climate turns less favorable.

Trends Since 1998

Because the Federal Reserve Board will not conduct the next Survey of Consumer Finances until 2001, we must rely on other data sources to track borrowing patterns in the interim. One of the three major U.S. credit bureaus, Trans Union, LLC, has developed a unique database suitable for examining consumer borrowing trends on a quarterly basis. Dubbed TrenData ®, this new tool is based on a series of quarterly random samples of U.S. consumer credit histories beginning with the first quarter of 1992. From an underlying sample of approximately 30 million depersonalized credit reports, variables have been built to describe consumer borrowing and payment activity each quarter at the county, state and national level.³

What has been happening with borrowing patterns since 1998? TrenData indicates that for most of the past two years, consumers were helping themselves by scaling back on their use of non-mortgage debt. Certainly credit card issuers have noticed higher payment rates and slower growth in outstandings over the past two years. TrenData confirms that consumers reduced their holdings of revolving debt through all of 1998 and most of 1999, even as mortgage debt continued to grow. This moderation in the growth of consumer debt probably contributed to the decline in personal bankruptcies (down 8.3%) that we witnessed in 1999.

Debt per borrower continued to grow steadily during 1998 and 1999 but mostly because of mortgage debt. A red-hot housing market propelled mortgage debt per borrower upward by 9.9% from the first quarter of 1998 through the first quarter of 1999. Rising mortgage interest rates through 1999 put the brakes on mortgage borrowing, as it grew only 5.0% for the year. In contrast, non-mortgage debt per borrower actually fell on a year-over-year basis for most of the period. Figure 2 reveals that the most dramatic drop was in revolving debt per borrower. As of third quarter, 1999, revolving debt per borrower had fallen compared to the same quarter the previous year for 6 consecutive quarters.

Of course, this does not necessarily mean that consumers shelved their credit cards. Much of the decline in revolving balances was likely due to the wave of mortgage

³ The Credit Research Center at Georgetown University's McDonough School of Business has partnered with Trans Union to explore the predictive value of TrenData variables. Since January, 1999, CRC staff has been reporting trends at various geographic levels via a monthly newsletter, *Monthly Statements*, distributed by Trans Union.

refinancings that occurred while interest rates were low during 1998. Consumers transferred billions of dollars of credit card balances to their mortgage and home equity lines to obtain lower interest rates and lower monthly payments. Even so, the rate at which balances were rolled off exceeded the speed with which consumers chose to rebuild them by taking on new revolving debt.

Prior research by the Credit Research Center and others has found a 12-24 month lag between the growth in non-mortgage account balances and repayment problems manifested as serious delinquency or bankruptcy. Consequently, the dramatic decline in bankruptcies during 1999 is not surprising. However, this respite may be brief. Figure 2 also reveals that non-mortgage credit growth rebounded sharply in the third and fourth quarters of 1999. Closed-end debt per borrower increased by 7.0% in the fourth quarter, 1999 compared to one year earlier. Revolving credit lagged far behind, but did rise 0.9% compared to a year earlier, reversing its downward drift.

Given the continued strength of the economy and buoyant consumer confidence we expect to see additional growth in debt per borrower well into this year. TrenData reveals that consumers have the capacity to service greater amounts of debt. The moderate rise in debt per borrower during 1999 occurred with virtually no change in debt payment burdens, thanks mostly to strong income growth and the longer maturities on the rising mortgage debt. Moreover, consumers overwhelmingly expect continued improvements in their personal finances. In January, 2000 the University of Michigan's Index of Consumer Confidence hit the highest level recorded in its 50-year history. Just 3 percent of all surveyed households in January expected their financial position to worsen during the year ahead, the lowest proportion ever recorded. On average, household incomes were expected to rise by 3.2% during the year, the highest expectation in a decade. If these expectations materialize through the year, then consumers can indeed take on more debt without raising their payment burdens.

As we peer into the future, all of this seems to suggest an extraordinarily optimistic consumer population that is increasingly comfortable taking on debt, especially debt secured by real estate. For more than a decade, credit has been increasingly accessible down the income spectrum. Economic conditions have allowed consumers even in the lower half of the income distribution to shoulder higher debt burdens and continue to service it without payment difficulties. Have consumers become too optimistic? Creditors would be well advised to give these data long and careful thought as they review their underwriting standards for the coming year.