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Consumer Debt Dynamics: An Update

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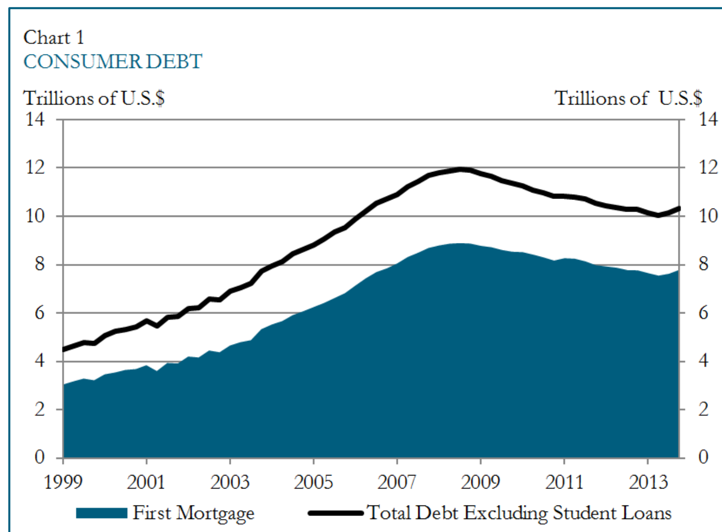
Consumer debt contracted sharply in the Great Recession and recovery, though the trend appears to be turning. Outstanding consumer debt increased in the second half of 2013, and the fraction of consumers increasing their debt balance relative to a year earlier continued to trend higher. Much of the gain, however, is from consumers with the lowest credit scores borrowing to purchase automobiles.

The trend in consumer debt is showing more convincing signs of shifting. Following the crisis and Great Recession, consumers pared debt, a process known as consumer deleveraging. Deleveraging occurred through a combination of aggressively paying down existing debt, defaults, and reluctance by consumers to take on new debt. Excluding student loans, consumer debt peaked in mid-2008 and then trended lower for nearly five years. Chart 1 shows in the second half of 2013, however, aggregate consumer debt increased for two consecutive quarters by a total of nearly $300 billion, the largest such increase since early 2008. The fourth quarter saw the second-strongest growth of consumption in seven years, suggesting consumers may be entering a period when they are more comfortable about increasing spending and accumulating new debt.

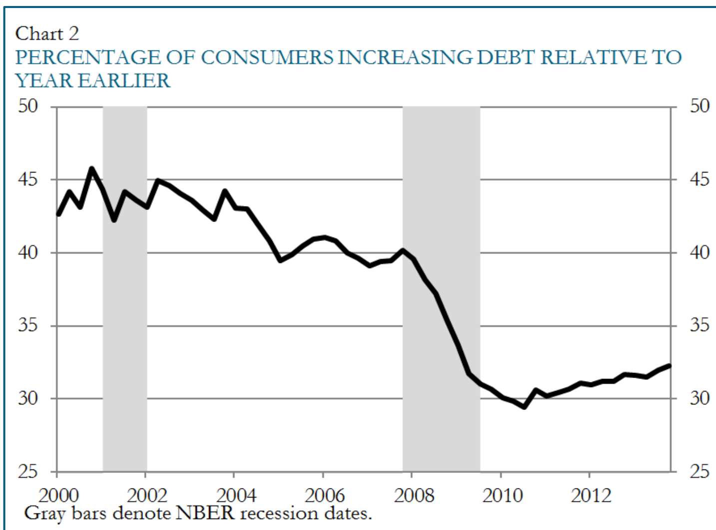


Whether an increase in debt is beneficial or not for the broader economy rests on a range of factors. Borrowing by creditworthy households to buy a long-lived asset, such as a house or automobile, or to smooth through a temporary shock is often beneficial for borrowers, lenders, and broader economic activity. Many examples exist, however, of episodes when credit standards slip and households take on a burdensome level of debt. While these periods often accompany strong economic growth, they often end in a disruptive manner.

Determining when credit growth accelerates beyond what supports longer-run, sustainable economic activity is always a challenge for policymakers. As a result, looking at aggregate totals like those in Chart 1 is only a starting point. Assessing the procession of credit growth across a range of household credit profiles is a useful complement in evaluating risks associated with credit growth.

A valuable resource in assessing broader trends in consumer credit is the Federal Reserve Bank of New York's Consumer Credit Panel (FRBNY-CCP). The FRBNY-CCP is a nationally representative sample of individual credit records maintained by Equifax that follows the same consumers each quarter. The data track debt histories of individual consumers and include all consumer debt, such as mortgages, home equity loans, auto loans, and credit card balances. Student loans are excluded from this analysis due to difficulties in matching

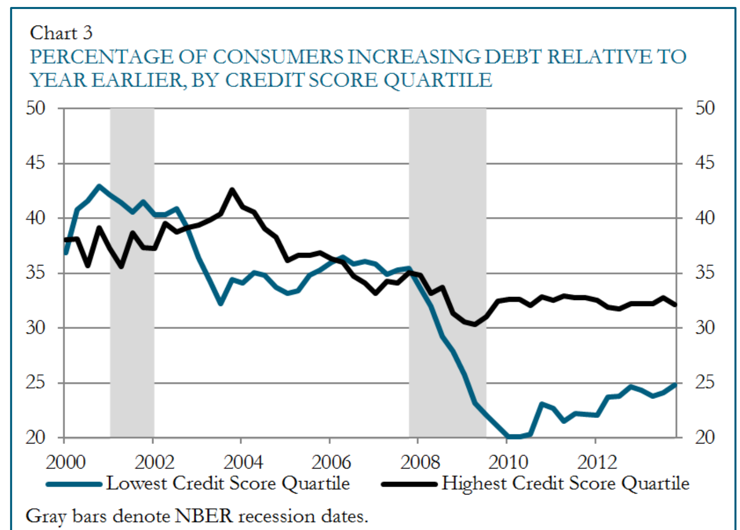
borrowers and loans over time. A beneficial aspect of the data is it allows researchers to identify if total consumer credit is growing because only a few households are acquiring large amounts of debt or many households are assuming modest amounts of debt.* The data also identify how debt levels are changing across households with different credit histories and risk profiles. For example, the data can identify the percentage of households with relatively low credit scores that increased their outstanding debt over the past year.



Gray bars denote NBER recession dates.

Across all consumers, Chart 2 shows the percentage of consumers that increased debt relative to a year earlier was between 40-45 percent prior to the crisis, before falling sharply to about 30 percent in 2009. Over the past few years, slightly more consumers have acquired more debt, but overall the percentage of consumers raising their debt levels remains well below pre-crisis levels. Observing the percentage of consumers increasing debt is a useful tool for analyzing aggregate conditions, but obscures the source of the increase. For example, this measure does not distinguish between consumers with high credit scores and low credit scores.

We identify consumers behind the increase in debt by grouping consumers into quartiles according to their credit score. Chart 3 shows a larger share of consumers with low credit scores recently increased outstanding debt, while there was little change in the percentage of consumers with the highest credit scores who took on more debt. Digging deeper into the data reveals consumers with the lowest credit scores mostly increased outstanding debt through auto loans. The share of low-credit-score consumers who increased their borrowing for automobiles grew from 7 percent in the third quarter of 2010 to nearly 12 percent in the fourth quarter of 2013. Consumers with low credit scores have also modestly increased credit card debt, as well as consumer finance and retail borrowing. The bottom line is the most creditworthy households continue to be cautious about assuming additional debt, while consumers with lower credit scores show an increased willingness to borrow.



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** For more, see Knotek II, Edward S. and John Carter Braxton, 2012. "What Drives Consumer Debt Dynamics?" Federal Reserve Bank of Kansas City, Economic Review, fourth quarter. The views expressed are those of the authors and do not necessarily reflect the positions of the Federal Reserve Bank of Kansas City or the Federal Reserve System.*