

Interest Rate Weekly

John E. Silvia, Chief Economist
john.silvia@wellsfargo.com • (704) 410-3275
Harry Pershing, Economic Analyst
harry.pershing@wellsfargo.com • (704) 410-3034

Is Consumer Credit a Concern with Rates on the Rise?

Consumer credit as a percent of disposable income is at an all-time high. With the Fed expected to continue hiking rates, readers may be concerned that an uptick in defaults could have an outsized impact in this cycle.

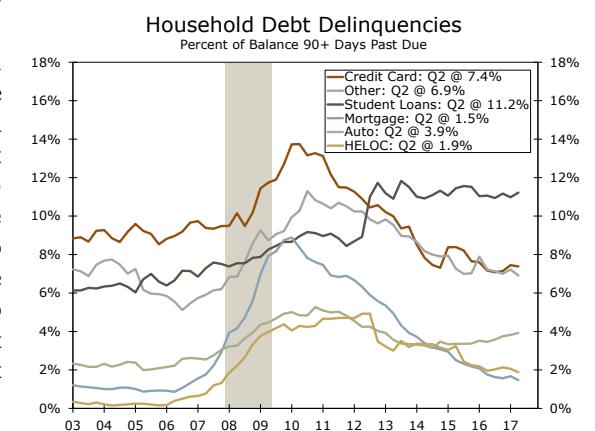
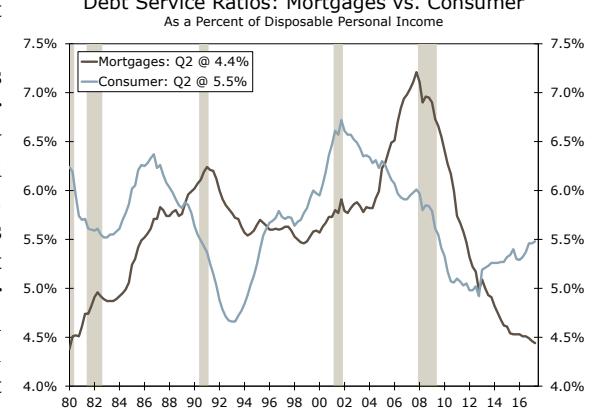
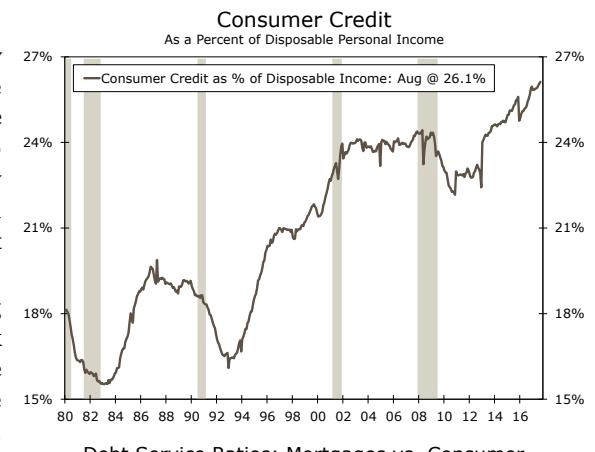
Dig a Little Deeper

At first blush, the top graph may raise concerns among those who correctly notice that the outstanding amount of consumer credit is at an all-time high as a percent of personal income. This concern is perhaps more amplified against the backdrop of a Federal Reserve that is prepared to raise the fed funds rate in December and continue tightening policy through 2018. And although not all consumer credit is attached to a floating rate, delinquency rates may be expected to pick up as new credit becomes more expensive to pay back.

However, while the ratio in the top graph does have some interesting implications, it must first be acknowledged that this ratio includes a stock number (consumer credit) being divided by a flow number (disposable personal income). A stock refers to the value of a series at a point in time while a flow refers to the total value of the series over a period of time. Thus, stocks and flows are not easily comparable and therefore are not always useful in deriving conclusions.

Instead, we turn to the debt service ratio (middle chart), which compares the flow of consumer credit to the flow of disposable personal income over the same period. In this instance, the most recent data point is well below the all-time series high reached in late 2001. Despite the relatively subdued debt service ratio, the recent upward trend since 2013 is worth monitoring. The growing amount of auto and student loans being financed with credit is partially responsible for this trend as payments for these consumer debt categories continue to become due. Interestingly, the debt service ratio for mortgages has not seen an increase despite a modest rise in the federal funds rate. The fact that fixed-rate mortgages are much more common than adjustable-rate mortgages is perhaps partially responsible for the recent trend difference. Mortgage payments are consistent regardless of the interest rate environment, whereas credit card rates are largely floating.

Household debt delinquencies, largely, are still continuing their downward trend (bottom graph). The exceptions to this are student loans, which have been essentially flat since 2013, and auto loans, which have slowly climbed for 12 consecutive quarters. As we have stated in past pieces, we do not think the auto loan market poses a threat to household finances, as auto loans comprise just 9.2 percent of total household debt. Additionally, as the Federal Reserve continues to tighten policy we would not be surprised to see delinquency rates modestly tick up and loans with floating rates become marginally more difficult to pay back. However, if the Fed continues to raise rates in the 'slow and steady' manner in which they have over the past year, then a sharp uptick in consumer debt delinquencies will likely not occur, all else equal, as Fed policy would likely lag income gains.



Wells Fargo U.S. Interest Rate Forecast

	Actual				Forecast							
	2017				2018				2019			
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
Quarter End Interest Rates												
Federal Funds Target Rate	1.00	1.25	1.25	1.50	1.50	1.75	1.75	2.00	2.00	2.25	2.25	2.50
3 Month LIBOR	1.15	1.30	1.33	1.65	1.65	1.90	1.90	2.15	2.15	2.40	2.40	2.65
Prime Rate	4.00	4.25	4.25	4.50	4.50	4.75	4.75	5.00	5.00	5.25	5.25	5.50
Conventional Mortgage Rate	4.20	3.90	3.81	3.89	3.95	4.02	4.05	4.10	4.12	4.16	4.17	4.24
3 Month Bill	0.76	1.03	1.06	1.30	1.45	1.60	1.67	1.85	1.95	2.10	2.15	2.30
6 Month Bill	0.91	1.14	1.20	1.40	1.55	1.70	1.77	1.95	2.05	2.20	2.25	2.40
1 Year Bill	1.03	1.24	1.31	1.55	1.68	1.80	1.87	2.05	2.15	2.25	2.30	2.45
2 Year Note	1.27	1.38	1.47	1.72	1.83	1.93	2.00	2.15	2.23	2.33	2.38	2.50
5 Year Note	1.93	1.89	1.92	2.20	2.29	2.39	2.45	2.58	2.65	2.75	2.80	2.90
10 Year Note	2.40	2.31	2.33	2.49	2.57	2.66	2.71	2.78	2.82	2.88	2.91	3.00
30 Year Bond	3.02	2.84	2.86	3.19	3.29	3.41	3.49	3.58	3.62	3.68	3.71	3.80

Forecast as of: October 11, 2017

Wells Fargo U.S. Economic Forecast and FOMC Central Tendency Projections

	<u>2017</u>	<u>2018</u>	<u>2019</u>
Change in Real Gross Domestic Product	2.2	2.5	2.6
Wells Fargo	2.2 to 2.5	2.0 to 2.3	1.7 to 2.1
FOMC			
Unemployment Rate	4.3	4.0	3.8
Wells Fargo	4.2 to 4.3	4.0 to 4.2	3.9 to 4.4
FOMC			
PCE Inflation	1.5	1.6	2.0
Wells Fargo	1.5 to 1.6	1.8 to 2.0	2.0 to 2.0
FOMC			
"Core" PCE Deflator	1.4	1.8	1.9
Wells Fargo	1.5 to 1.6	1.8 to 2.0	2.0 to 2.0
FOMC			

Forecast as of: October 11, 2017

NOTE: Projections of change in real gross domestic product (GDP) and in inflation are from the fourth quarter of the previous year to the fourth quarter of the year indicated. PCE inflation is the percentage rate of change in the price index for personal consumption expenditures (PCE). Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated.

Fed Data as of: September 20, 2017

Source: IHS Global Insight, Bloomberg LP, Federal Reserve Board and Wells Fargo Securities

Wells Fargo Securities Economics Group

Diane Schumaker-Krieg	Global Head of Research, Economics & Strategy	(704) 410-1801 (212) 214-5070	diane.schumaker@wellsfargo.com
John E. Silvia, Ph.D.	Chief Economist	(704) 410-3275	john.silvia@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Jay H. Bryson, Ph.D.	Global Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Currency Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Eugenio J. Alemán, Ph.D.	Senior Economist	(704) 410-3273	eugenio.j.aleman@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 410-3270	azhar.iqbal@wellsfargo.com
Tim Quinlan	Senior Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Eric Viloria, CFA	Currency Strategist	(212) 214-5637	eric.viloria@wellsfargo.com
Sarah House	Economist	(704) 410-3282	sarah.house@wellsfargo.com
Michael A. Brown	Economist	(704) 410-3278	michael.a.brown@wellsfargo.com
Jamie Feik	Economist	(704) 410-3291	jamie.feik@wellsfargo.com
Erik Nelson	Currency Strategist	(212) 214-5652	erik.f.nelson@wellsfargo.com
Michael Pugliese	Economic Analyst	(704) 410-3156	michael.d.pugliese@wellsfargo.com
E. Harry Pershing	Economic Analyst	(704) 410-3034	edward.h.pershing@wellsfargo.com
Hank Carmichael	Economic Analyst	(704) 410-3059	john.h.carmichael@wellsfargo.com
Ariana Vaisey	Economic Analyst	(704) 410-1309	ariana.b.vaisey@wellsfargo.com
Abigail Kinnaman	Economic Analyst	(704) 410-1570	abigail.kinnaman@wellsfargo.com
Shannon Seery	Economic Analyst	(704) 410-1681	shannon.seery@wellsfargo.com
Donna LaFleur	Executive Assistant	(704) 410-3279	donna.lafleur@wellsfargo.com
Dawne Howes	Administrative Assistant	(704) 410-3272	dawne.howes@wellsfargo.com

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