Special Commentary — November 27, 2023

Credit Check: Is It Time to Worry About Credit Card Debt?

Summary

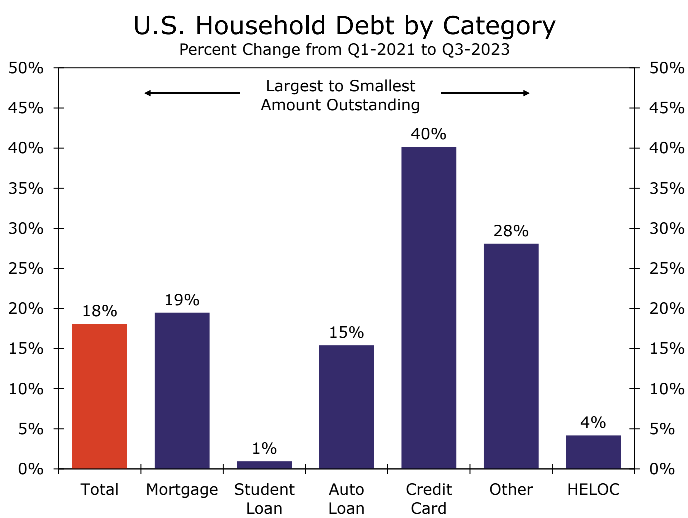
After paying off credit card debt during the COVID lockdown period, households have levered up at a pace seven times as fast as they did in the prior cycle. Revolving consumer credit, which mostly consists of credit card debt, sits at an all-time high of $1.3 trillion today. Credit card delinquencies are starting to tick higher as well amid the highest average annual percentage rate on credit card debt in data going back to the early 1980s. So, is it time to start worrying about credit card debt? In this note, we summarize the explosion in credit reliance over the past few years and put it into context of the still-relatively healthy financials of the household sector.

Economist(s)

Tim Quinlan
Senior Economist | Wells Fargo Economics
Tim.Quinlan@wellsfargo.com | 704-410-3283

Shannon Seery Grein
Economist | Wells Fargo Economics
shannon.grein@wellsfargo.com | 704-410-0369

Figure 1



Source: Federal Reserve Bank of New York and Wells Fargo Economics

Running Tab

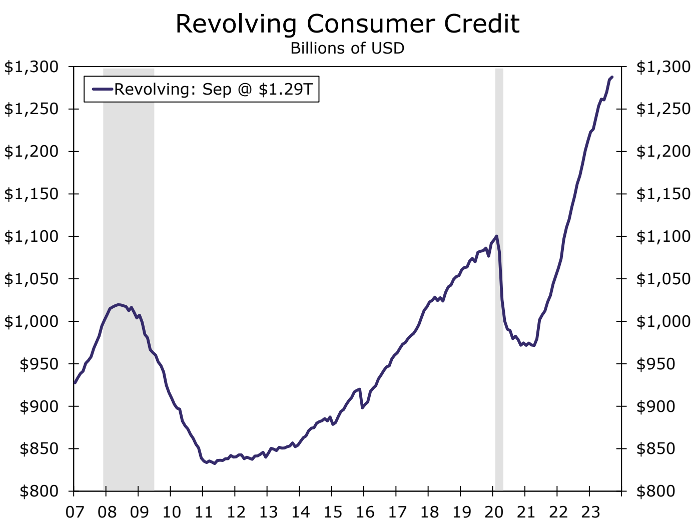
The staying power of the U.S. consumer has been enabled by more than just "excess" savings. As a result of consumers reaching for their credit cards to sustain spending, the category that includes credit cards has risen faster on a percentage basis than any other major category of debt over the past two years. Among the various categories of household debt, credit cards have ballooned by more than 40%; that is more than double the 19% gain in mortgages, the next fastest major category (Figure 1).[1]

In the prior cycle, broader revolving credit, which is mostly credit card debt, peaked in 2008, a level to which it did not return for more than nine years before ultimately rising to a new plateau just before COVID arrived in early 2020 that was $80 billion higher. When COVID lockdowns caused consumers to go into hiding, households finally got a chance to catch up on credit card payments. Revolving debt shed all the gains of the prior cycle in a matter of months; on a peak-to-trough basis, just over $128 billion in revolving debt vanished. But spending came back with a vengeance starting in early 2021. Instead of taking more than nine years to reach its pre-recession peak as it did in the prior cycle, revolving debt returned to pre-recession levels of debt in just 26 months and hasn't looked back. Through September, revolving debt is now $187 billion above its February 2020 peak (Figure 2).

Plastic Explosives

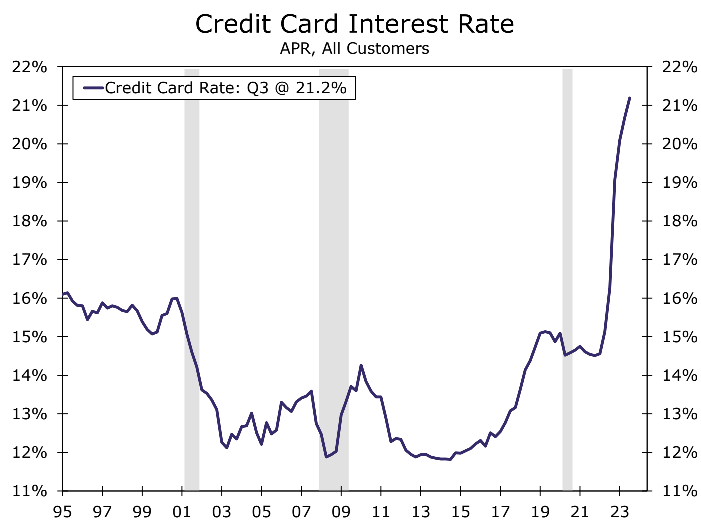
In the prior cycle, it took 12 years (2008-2020) for revolving credit to increase by $80 billion, or about $6.7 billion per annum. In this cycle, it took less than four years for consumer credit to grow $187 billion, or about $46.8 billion per annum. In the simplest terms possible: credit card debt has grown seven times faster in this cycle than it did in the prior cycle.

Figure 2



Source: Federal Reserve Board and Wells Fargo Economics

Figure 3

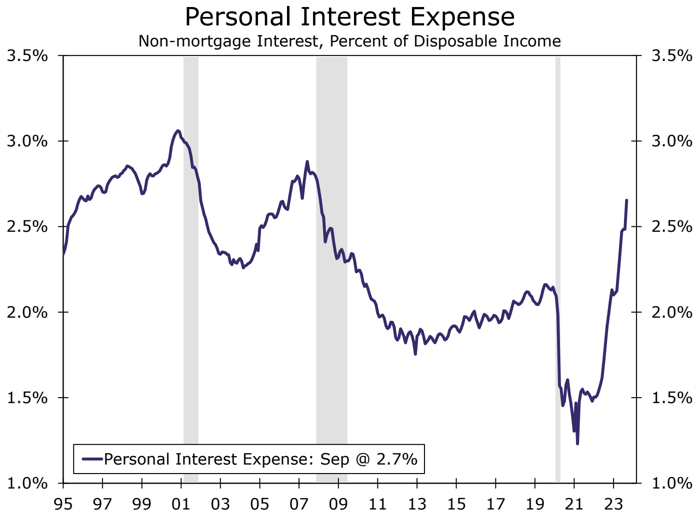


Source: Federal Reserve Board and Wells Fargo Economics

That increase in borrowing would be associated with higher financing costs even if rates were unchanged, but credit card rates have shot much higher, going from less than 15% as recently as last year to 21.2% as of the third quarter of this year (Figure 3). It bears noting here that at no point in the prior 27 years had the average interest rate on a credit card ever crested above 17%, meaning that today's cost of credit is more than four percentage points higher than the average consumer has paid to finance credit card debt in recent memory.

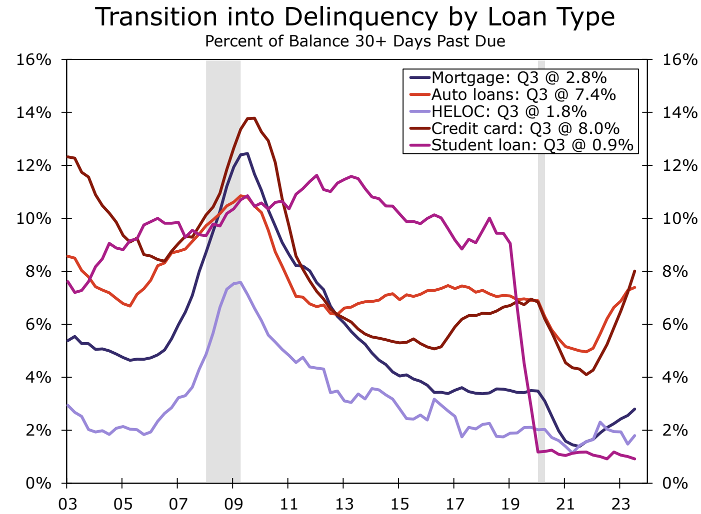
Higher rates haven't stopped consumer spending yet. Milton Friedman famously observed that monetary policy acts with a long and variable lag. While the Fed's tightening cycle may not yet be fully materialized in credit markets, Figure 4 of personal interest expense shows that the cost-of-carry is as high as it has been since the 2008 financial crisis, and it seldom has been as high as it is now without recession coming soon after. Meanwhile, credit card delinquencies are rising sharply (Figure 5). This is particularly true for younger and lower-income borrowers, according to a recent analysis from the New York Fed, which also showed that credit card delinquencies are rising sharpest for those who have other forms of debt such as student and auto loans.[2] The tick higher in delinquencies generally demonstrates increasing challenges to stay current and some vulnerability starting to surface among households.

Figure 4



Source: U.S. Department of Commerce and Wells Fargo Economics

Figure 5



Source: New York Fed Consumer Credit Panel, Equifax and Wells Fargo Economics

Credit Worthy: Debt in the Context of Rising Income

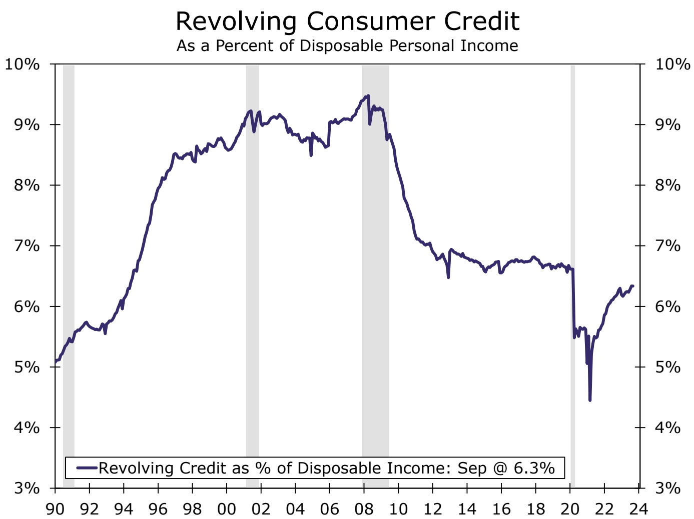
The run-up in revolving debt over the past few years may indeed reflect a devil-may-care attitude on the part of some consumers, but it is also simply a function of inflation that has flared up in ways that haven't been seen in decades. When your expenses are growing faster than your paycheck, credit cards are not an indulgence, they're a lifeline.

To the extent that there is good news in all of this, it is that while incomes have struggled at times to keep up with prices, slowing inflation had given way to some considerable gains in real income recently. So even though credit card borrowing has been growing fast, so too has income.

In looking back over the past 35 years, even at the worst of times, revolving credit has never comprised more than a 10% share of disposable personal income. Through September, consumer credit card debt accounts for only a 6.3% share of disposable personal income, a figure that is actually quite low by historical standards (Figure 6). This suggests that these outsized revolving balances are still somewhat manageable in the context of rising incomes.

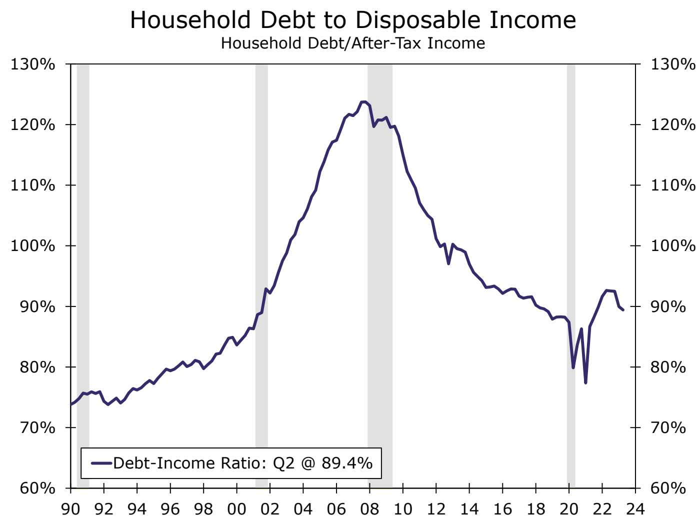
It also bears noting that while revolving credit accounted for an outsized share of the growth in household debt in recent years, credit cards account for only 6.2% of household debt today. In other words, it remains a comparatively small category. Broader household debt burdens also look relatively contained as well. Overall household debt as a share of income is higher than where it stood prior to the pandemic, but it is well below the levels that prevailed on the eve of the 2008 financial crisis, suggesting households are not yet overly levered (Figure 7).

Figure 6



Source: Federal Reserve Board, U.S. Department of Commerce and Wells Fargo Economics

Figure 7



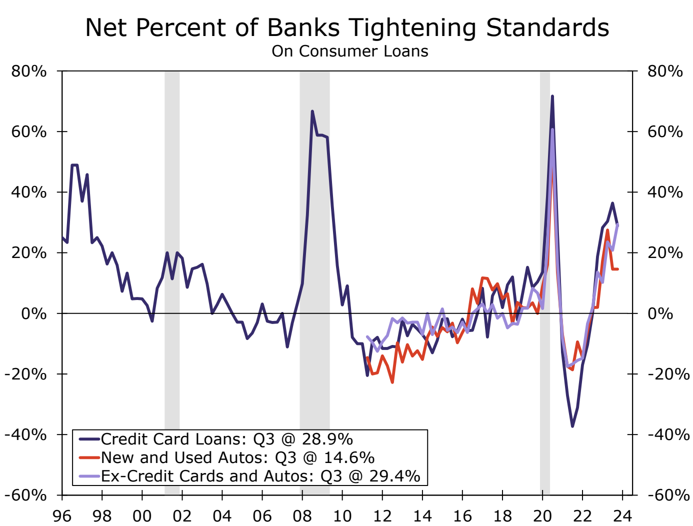
Source: Federal Reserve System and Wells Fargo Economics

Credit Standards on Consumer Loans Are Tightening

By any reckoning, the rise in consumer credit card debt is disconcerting, but taken in the broader context of households' financial position, it suggests a credit crunch is not imminent. That said, relying on credit is never a sustainable source of purchasing power for the household sector, and it's likely to be increasingly challenging in the year ahead amid still-elevated financing costs and tighter borrowing conditions.

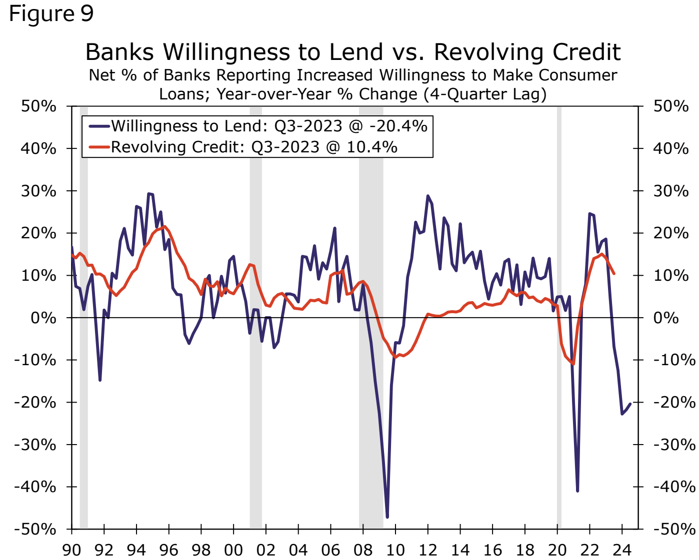
To that end, banks are also wise to the risk presented by rising delinquencies and not keen to over-extend consumer credit. The share of banks that have tightened their lending standards on an array of consumer loans is already at levels historically consistent with contraction (Figure 8). There is good and bad in this. Consumers are less apt to get in over their heads if the access to credit is curtailed. For the broader economy though, the diminished access to credit could be a headwind to sustained consumer spending going forward. Banks' willingness to lend tends to lead overall revolving credit, which portends trouble ahead for continued reliance on this form of purchasing power (Figure 9).

Figure 8



Source: Federal Reserve Board and Wells Fargo Economics

Figure 9



Source: Federal Reserve Board and Wells Fargo Economics

Credit Cards, We're in Your Debt

The pandemic-induced recession was ultimately not a balance sheet one for households, and that allowed consumers to spend at elevated rates in recent years. Beyond just excess savings, consumers have also been putting more on the credit card to fund purchases. As we look ahead, a repeat performance would be more costly and thus less likely. Interest rates on credit cards are running more than eight percent above the average that prevailed ahead of the pandemic, and banks are tightening their standards on consumer loans at levels historically consistent with recession. Consumers are seeing real income growth start to sputter, and even as balance sheets remain in relatively decent shape, credit reliance is growing more challenging. So, is it time to worry about credit card debt?

The fact that lenders are tightening standards suggests it is at least time to be circumspect. Still, consumer credit levels and payments are both manageable as a share of income, for now at least. Should income falter, that could change. Rising delinquencies warrant attention, but a credit crunch is not imminent. Less reliance on credit, while a necessary development, looks set to bite spending momentum by the middle of next year. If households shun the warning signs and continue to lever up instead, that may extend the current expansion, but it would do so at the cost of increasing vulnerabilities in the household sector; that would certainly be cause for worry.

Endnotes

1 - In the New York Fed's Household Debt and Credit Report, the “other” category includes retail cards and other consumer loans. It represents just about 3% of total household debt as of the third quarter. (Return)

2 - "Credit Card Delinquencies Continue to Rise - Who is Missing Payments?" Liberty Street Economics. Federal Reserve Bank of New York. November 2023. (Return)

Subscription Information

To subscribe please visit: www.wellsfargo.com/economicsemail

Via The Bloomberg Professional Services at WFRE

Economics Group

Jay H. Bryson, Ph.D.	Chief Economist	704-410-3274	Jay.Bryson@wellsfargo.com
Sam Bullard	Senior Economist	704-410-3280	Sam.Bullard@wellsfargo.com
Nick Bennenbroek	International Economist	212-214-5636	Nicholas.Bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	704-410-3283	Tim.Quinlan@wellsfargo.com
Sarah House	Senior Economist	704-410-3282	Sarah.House@wellsfargo.com
Azhar Iqbal	Econometrician	212-214-2029	Azhar.Iqbal@wellsfargo.com
Charlie Dougherty	Senior Economist	212-214-8984	Charles.Dougherty@wellsfargo.com
Michael Pugliese	Senior Economist	212-214-5058	Michael.D.Pugliese@wellsfargo.com
Brendan McKenna	International Economist	212-214-5637	Brendan.Mckenna@wellsfargo.com
Jackie Benson	Economist	704-410-4468	Jackie.Benson@wellsfargo.com
Shannon Grein	Economist	704-410-0369	Shannon.Grein@wellsfargo.com
Nicole Cervi	Economist	704-410-3059	Nicole.Cervi@wellsfargo.com
Patrick Barley	Economic Analyst	704-410-1232	Patrick.Barley@wellsfargo.com
Jeremiah Kohl	Economic Analyst	704-410-1437	Jeremiah.J.Kohl@wellsfargo.com
Aubrey George	Economic Analyst	704-410-2911	Aubrey.B.George@wellsfargo.com
Delaney Conner	Economic Analyst	704-374-2150	Delaney.Conner@wellsfargo.com
Anna Stein	Economic Analyst	212-214-1063	Anna.H.Stein@wellsfargo.com
Coren Burton	Administrative Assistant	704-410-6010	Coren.Burton@wellsfargo.com

Required Disclosures