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Economics Group

Interest Rate Weekly

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Household Balance Sheets Continue to Improve

In recent quarters, the U.S. consumer has played a vital role in spurring economic growth. With this in mind, we examine the state of household balance sheets seven years into the expansion.

Household Balance Sheets Seem Relatively Healthy

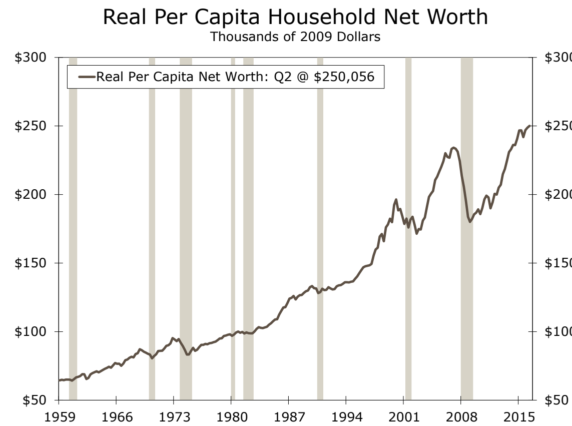
U.S. economic growth has been powered by personal consumption over the past few quarters. Given this, and being more than seven years into the current expansion, we examine household balance sheets for signs of overleverage or financial stress that could weigh on the outlook.

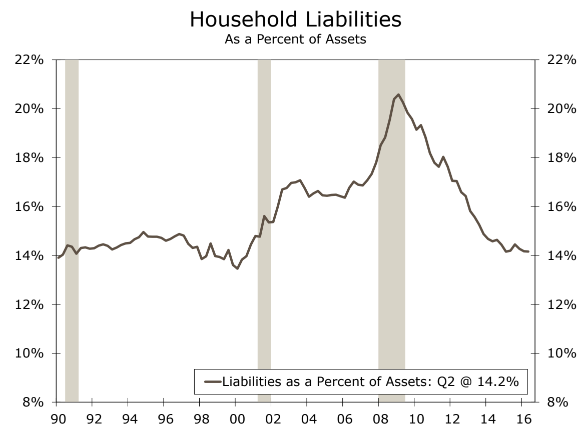
The Federal Reserve Board's report on the Financial Accounts of the United States offers a detailed look at household balance sheets in the aggregate. The data suggest that household balance sheets are in far better shape today than they were late in the last cycle. Real per capita net worth has grown steadily and is currently at an all-time high (top chart). Financial asset growth has slowed in recent quarters, weighed down by more limited equity market gains. Continued steady growth in home prices, however, has offset some of this slowdown and boosted real estate assets. Household deposit holdings remain elevated after shooting up during the Great Recession. As a percentage of total assets, deposits are at their highest level since the mid-1990s, suggesting households remain somewhat cautious and are well positioned to deal with new developments, such as higher interest rates or a slowdown in employment growth.

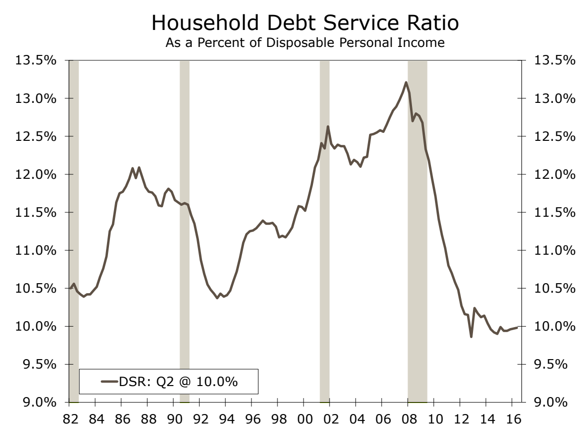
On the liability side, households remain underleveraged relative to the previous expansion. Household liabilities, as a percentage of both total assets and disposable income, are well below levels seen during the last expansion (middle chart). The slow growth in residential mortgage debt has played a large role in bringing this measure down. Residential mortgage debt was up 1.5 percent over the past year in Q2 and was negative for a striking 26 consecutive quarters starting at the end of 2008. Non-mortgage debt has shown more robust growth, led by student and auto loans. Student loans have decelerated of late but, unlike many other forms of household borrowing, have grown steadily throughout the entirety of this expansion.

Interest Rates Remain Accommodative

Interest rates have remained accommodative through 2016, which has supported household borrowing. Household liabilities are up 2.8 percent over the past year, the fastest pace of this expansion. That said, this would mark the slowest year-ago pace in the 1950-2007 period, suggesting households remain cautious about overleveraging after their experience during the housing boom. In addition, low rates have kept the household debt service ratio, or the ratio of total required household debt payments to total disposable income, near record lows (bottom chart). Even with the recent consumer spending gains, U.S. household balance sheets remain relatively healthy in the aggregate, particularly when compared to where they were on the eve of the last recession. As such, we expect continued low interest rates and a modest rebound in economic growth to drive consumer borrowing gradually higher.







Source: Federal Reserve Board and Wells Fargo Securities

Wells Fargo U.S. Interest Rate Forecast

	Actual			Forecast								
	2016				2017				2018			
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
Quarter End Interest Rates												
Federal Funds Target Rate	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.50	1.75
3 Month LIBOR	0.63	0.65	0.85	1.05	1.05	1.25	1.25	1.50	1.50	1.75	1.75	2.00
Prime Rate	3.50	3.50	3.50	3.75	3.75	4.00	4.00	4.25	4.25	4.50	4.50	4.75
Conventional Mortgage Rate	3.69	3.57	3.46	3.88	3.90	3.91	3.93	3.95	3.97	4.00	4.02	4.16
3 Month Bill	0.21	0.26	0.29	0.49	0.57	0.78	0.84	1.02	1.10	1.25	1.30	1.55
6 Month Bill	0.39	0.36	0.45	0.60	0.67	0.88	0.94	1.12	1.20	1.35	1.40	1.65
1 Year Bill	0.59	0.45	0.59	0.77	0.82	1.04	1.10	1.41	1.48	1.61	1.65	1.79
2 Year Note	0.73	0.58	0.77	0.93	1.04	1.23	1.30	1.57	1.64	1.76	1.80	1.92
5 Year Note	1.21	1.01	1.14	1.38	1.43	1.50	1.57	1.77	1.83	1.94	1.97	2.08
10 Year Note	1.78	1.49	1.60	1.85	1.88	1.91	1.95	1.99	2.02	2.06	2.09	2.24
30 Year Bond	2.61	2.30	2.32	2.48	2.50	2.52	2.55	2.57	2.59	2.61	2.63	2.67

Forecast as of: October 12, 2016

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

	2016	2017	2018
Change in Real Gross Domestic Product			
Wells Fargo	1.7	2.2	2.2
FOMC	1.7 to 1.9	1.9 to 2.2	1.8 to 2.1
Unemployment Rate			
Wells Fargo	4.9	4.6	4.5
FOMC	4.7 to 4.9	4.5 to 4.7	4.4 to 4.7
PCE Inflation			
Wells Fargo	1.4	2.0	2.0
FOMC	1.2 to 1.4	1.7 to 1.9	1.8 to 2.0
"Core" PCE Deflator			
Wells Fargo	1.8	1.8	2.0
FOMC	1.6 to 1.8	1.7 to 1.9	1.9 to 2.0

Forecast as of: October 12, 2016

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 21, 2016

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

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