The Evolving U.S. Economy and Household Debt

Remarks for Household Debt Tipping Points Research Symposium
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Notes for the slides can be found at the end of the presentation.
PART 1

MACRO TRENDS AND HOUSEHOLD DEBT TIPPING POINTS
Some trends that may have made U.S. households more vulnerable to hitting tipping points
Income growth has been limited across much of the distribution.
Changes in the workplace imply less predictable incomes

Source. Katz and Krueger (2016); 2015 figures are the "alternative weights" estimates.
More students are borrowing to attend colleges that tend to add little to earnings prospects.
Why these trends potentially matter for households’ vulnerability to tipping points

**Limited income growth**

- More borrowing to “keep up with the Jones’s”? 
- More political incentive to favor easy credit policies

**Less predictable incomes**

- More dependence on short-term credit

**Growth in enrollment at colleges with poor outcomes:**

- More people likely to struggle to pay off student debt
Some trends that make it more difficult for policymakers to mitigate the immediate macro fallout from reaching tipping points
Nominal interest rates have trended down
Government debt has risen (and is projected to rise further)
Why these trends make it harder to mitigate the short-run harms of reaching tipping points

Lower nominal interest rates

Fed will hit the zero lower bound more often

Inflation falls short of Fed target more often, so less scope for inflation to erode nominal debt burdens

High levels of government debt

Limits scope for countercyclical fiscal policy
Some trends that mean the longer-term effects of hitting tipping points are more consequential than in the past
Productivity growth has been low

![Bar chart showing productivity growth](chart)

**Productivity Growth**
(Percent change, annual rate)

- **1950-1973**: 2.8%
- **1974-1995**: 1.6%
- **1996-2003**: 3.3%
- **2004-2017**: 1.3%

Note: Nonfarm business sector. Time ranges correspond to different "eras" of productivity growth; width of each bar corresponds to the duration of time.

Business dynamism has fallen

Activity Measures for Young Firms (Age 5 or Less)

Share of firms that are young (left axis)

Share of employment from young firms (right axis)

Why these trends mean that the longer-term effects of hitting tipping points are more consequential

Hitting tipping points causes households and businesses to lose access to credit

Access to credit is a key determinant of productivity growth and business dynamism

- People need to borrow to invest in human capital
- People need to borrow to invest in new businesses
PART 2

SOME BETTER NEWS
The current state of household balance sheets
The traditional indicators show enormous improvement

**Household Debt to Income Ratio**

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<tr>
<th>Percent of disposable income</th>
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<td>140</td>
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<td>120</td>
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<th>Source. Federal Reserve Board.</th>
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**Household Debt Service Ratio**

<table>
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<th>Percent of disposable income</th>
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The share of underwater mortgages has fallen substantially.

Share of Mortgages with Negative Equity

Source: Zillow.
Delinquencies rates (broadly speaking) have largely normalized

Overall Household Debt Delinquency Rate

Percent of balances that are 90 or more days delinquent

Source: Federal Reserve Bank of New York.
But one area to watch is student loans

**Student Debt as a Share of Overall Household Debt**

- **Student Debt Delinquency Rate**
  - Source: Federal Reserve Bank of New York.

**Student Debt Delinquency Rate**

- Percent of balances 90+ days delinquent

Source: Federal Reserve Bank of New York.
To summarize, the current state of household balance sheets is, on the whole, good.

The odds of reaching a household debt “tipping point” in the near future are low.

We should be concerned about some aspects of student loans, but the immediate risk to the macroeconomy is limited.

There are a few problem areas (e.g. subprime auto lending) but they are not large by macro standards.
More good news—there has been important progress in regulation and other areas

Banks are lending more prudently and they are better capitalized

The Consumer Financial Protection Bureau should better protect households from reaching debt tipping points

In conducting mortgage interventions in the last crisis, the federal government learned valuable lessons about how to best design such programs
CONCLUSION

AREAS WHERE MORE WORK NEEDS TO BE DONE
Important unfinished policy business

Mortgage finance reform

Better regulation for student loans: top priority should be taking steps to hold higher education institutions more accountable for the quality of the services they deliver
Other agenda items

Potential for “fintech” innovations to improve household debt management

Scope to develop new mortgage products that better protect households from tipping points

More publicly available data for researching and tracking household debt tipping points
Endnotes

Slide 3: Source—Congressional Budget Office, *The Distribution of Household Income and Federal Taxes, 2013*. Market income consists of labor income, business income, capital gains (profits realized from the sale of assets), capital income excluding capital gains, income received in retirement for past services, and other sources of income. Shaded vertical bars denote recessions.


Slide 5: Source—Brookings (2015) “Media Summary of ‘Students loan debt a selective crisis; Majority of recent borrowers and defaulters attend for-profit and non-selective schools’ by Adam Looney and Constantine Yannelis.”

Slide 8: Source—Federal Reserve Board.


Slide 17: Source—Federal Reserve Board. The last data point for the household debt to income ratio is 2017:Q1, and the last data point for the household debt service rate is 2016:Q4.

Slide 18: Source—Zillow. The last data point is 2016:Q4.
