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The Quarterly Debt Monitor

Trends in Consumer Debt in St. Louis, Little Rock, Louisville, Memphis—and Beyond

FEDERAL RESERVE BANK OF ST. LOUIS

Auto Debt Expansion Continues to Slow While Subprime Delinquencies Rise

By Lowell R. Ricketts

While real per capita consumer debt growth rose across the country in the fourth quarter of 2016, it declined or remained unchanged in most of the largest metropolitan statistical areas (MSAs) in the Eighth Federal Reserve District.[1] Declines in mortgage debt continued to temper overall debt growth. Lending in both the auto and student debt sectors rose, but was uniformly lower on a year-over-year basis when compared with our previous report for the nation and for the District MSAs of Little Rock, Ark., Louisville, Ky., Memphis, Tenn., and St. Louis.[2] Over the past few years, strong lending of auto and student debt has buoyed total debt, accounting for the majority of credit expansion. This report offers a closer look at auto lending, including the factors that contributed to the expansion in this sector.

This report uses the latest release of the Federal Reserve Bank of New York and Equifax Consumer Credit Panel with data as of the fourth quarter of 2016. The figures in this report help to provide a focused narrative of the latest developments in consumer debt across the District and nation. For a more extensive collection of figures updated each quarter, see the QDM appendix.[3]

Changes in Per Capita Debt Levels and Serious Delinquency Rates

Year-over-Year Percent Change from 2015:Q4 to 2016:Q4

2016:Q4	United States	St. Louis MSA	Little Rock MSA	Louisville MSA	Memphis MSA
% Change in Per Capita Consumer Debt					
Total	0.4	0	1.5	–1.5	–0.8
Mortgage	–0.9	–1.8	–0.5	–3.5	–4.3
HELOC	–5	–6.7	–11.5	–2.8	–6.8
Auto	5.1	4.2	4	5.4	5.5
Credit Card	2.9	1.4	3.8	0.9	3.4
Student	5.3	5.6	6.7	4.8	6.6
Change in Serious Delinquency Rate					
Mortgage	–0.5	–0.2	–0.6	–0.1	–0.7
HELOC	0.1	–0.2	0.1	0.1	0.2
Auto	0.4	0.1	0.6	0.5	1.2
Credit Card	–0.2	–0.1	0	–0.4	–0.1
Student	–0.2	0.4	0.1	0.1	–0.1

SOURCE: Federal Reserve Bank of New York/Equifax Consumer Credit panel.

NOTES: Serious delinquency rates are the shares of outstanding debt that is over 90 days past due. Changes to those rates are given as the differences in percentage points. Figures are rounded.

Latest Developments in Consumer Debt

1. In the fourth quarter of 2016, real per capita mortgage debt declined across the United States and the four District MSAs. The steepest declines were in Louisville and Memphis, where per capita mortgage debt declined by 3.5 percent and 4.3 percent, respectively.
2. The serious delinquency rate for mortgage debt fell both nationally and across the District MSAs, with the MSAs reaching their lowest levels since before the Great Recession. Meanwhile, although the national rate has fallen, it still remains above its pre-recession low.
3. Per capita HELOC, or home equity line of credit, debt declined across the nation and all of the District MSAs. HELOC debt, an important source of consumer debt growth prior to the recession, continues to show a pattern of consistent deleveraging.[4]

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4. Growth in per capita student debt slowed for the nation and all District MSAs. The average growth rate across the four MSAs fell to 5.9 percent in the fourth quarter, down from 7.2 percent in the third quarter.
5. Per capita credit card debt continued to grow for the nation as well as for all District MSAs. At the same time, rates of serious delinquency fell or remained unchanged. Credit card debt remains well below pre-recession levels and rates of serious delinquency.
6. For the third quarter in a row, growth in per capita auto debt slowed across the District MSAs. While auto debt remains a significant contributor to overall growth, the robust growth observed over the past few years continues to abate. With the exception of Louisville, the slowdown has been more pronounced across the District MSAs than the nation.
7. Repayment difficulty among auto loan borrowers continued to worsen and at a faster pace since our previous report. Serious delinquency rates in Louisville and Little Rock were 3.4 and 4.3 percent, respectively. Those rates match or exceed the previous peak seen after the recession.
8. Subprime auto debt comprised 38 percent of outstanding auto debt in Memphis and 28 percent in Little Rock during the fourth quarter of 2016. Subprime debt has been growing fastest in both MSAs and exceeds the amount of prime debt in those markets.[5]
9. Serious auto delinquency rates were higher and increasing faster for subprime borrowers in all four MSAs. Given the growing share of subprime debt within these MSAs, this may contribute to further increases in overall serious delinquency rates. Much of this lending was originated by auto financing companies rather than banks or credit unions.

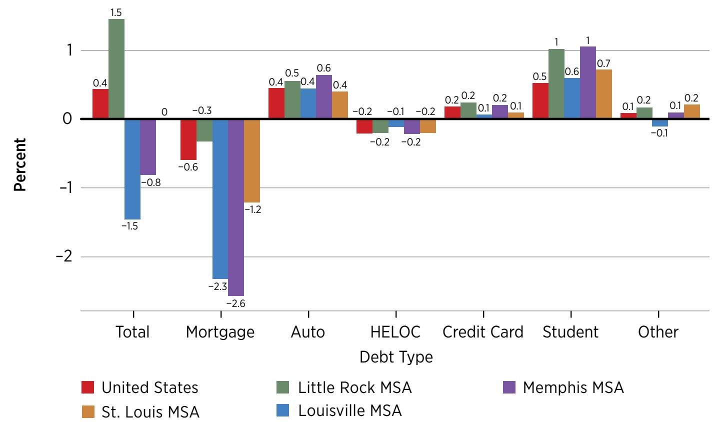
Waning Momentum for Consumer Debt

Almost all consumer debt growth continues to be driven by strong growth in a few categories of debt. Without the contributions of new student and auto debt over the past few years, the deleveraging seen after the Great Recession would likely have continued. Since mortgage debt comprises a majority share of consumer debt, changes within this category have a considerable impact on total debt. Figure 1 shows the growth of various types of debt as a contribution to the change in total per capita debt.[6] This figure provides a clear picture of the drivers of overall growth. Continued deleveraging of mortgage debt continues to curb overall growth.[7] Deleveraging has been particularly strong in both Louisville and Memphis. In Memphis, despite the strongest growth in student and auto debt among the District MSAs, total debt has fallen because of the sizeable reduction in mortgage debt. Very low serious delinquency rates for mortgage debt suggest that defaults are less of a contributing factor to these reductions.

FIGURE 1

Contribution to Percent Change in Total Per Capita Debt

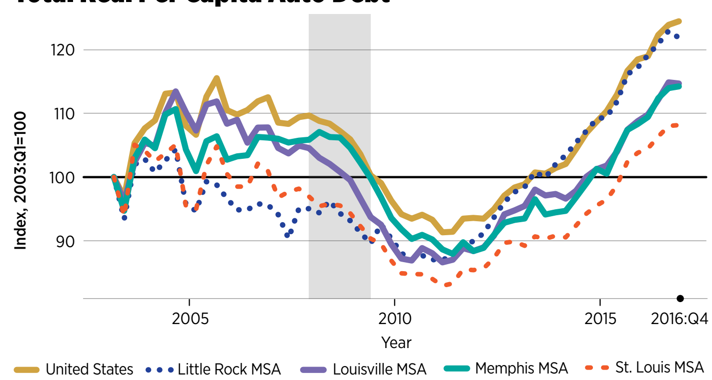
Year-over-Year Change from 2015:Q4 to 2016:Q4



SOURCE: Federal Reserve Bank of New York/Equifax Consumer Credit panel.
NOTES: Growth in each type of debt is relative to total debt. All data labels have been rounded.

FIGURE 2

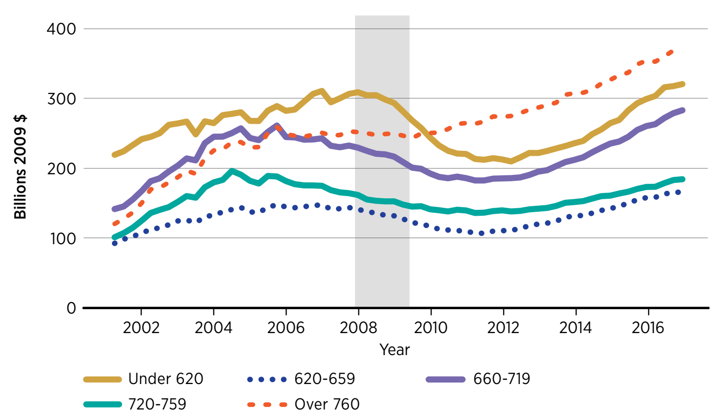
Total Real Per Capita Auto Debt



SOURCE: Federal Reserve Bank of New York/Equifax Consumer Credit Panel.
NOTES: "Real" data are inflation-adjusted. The gray bar indicates recession.

FIGURE 3

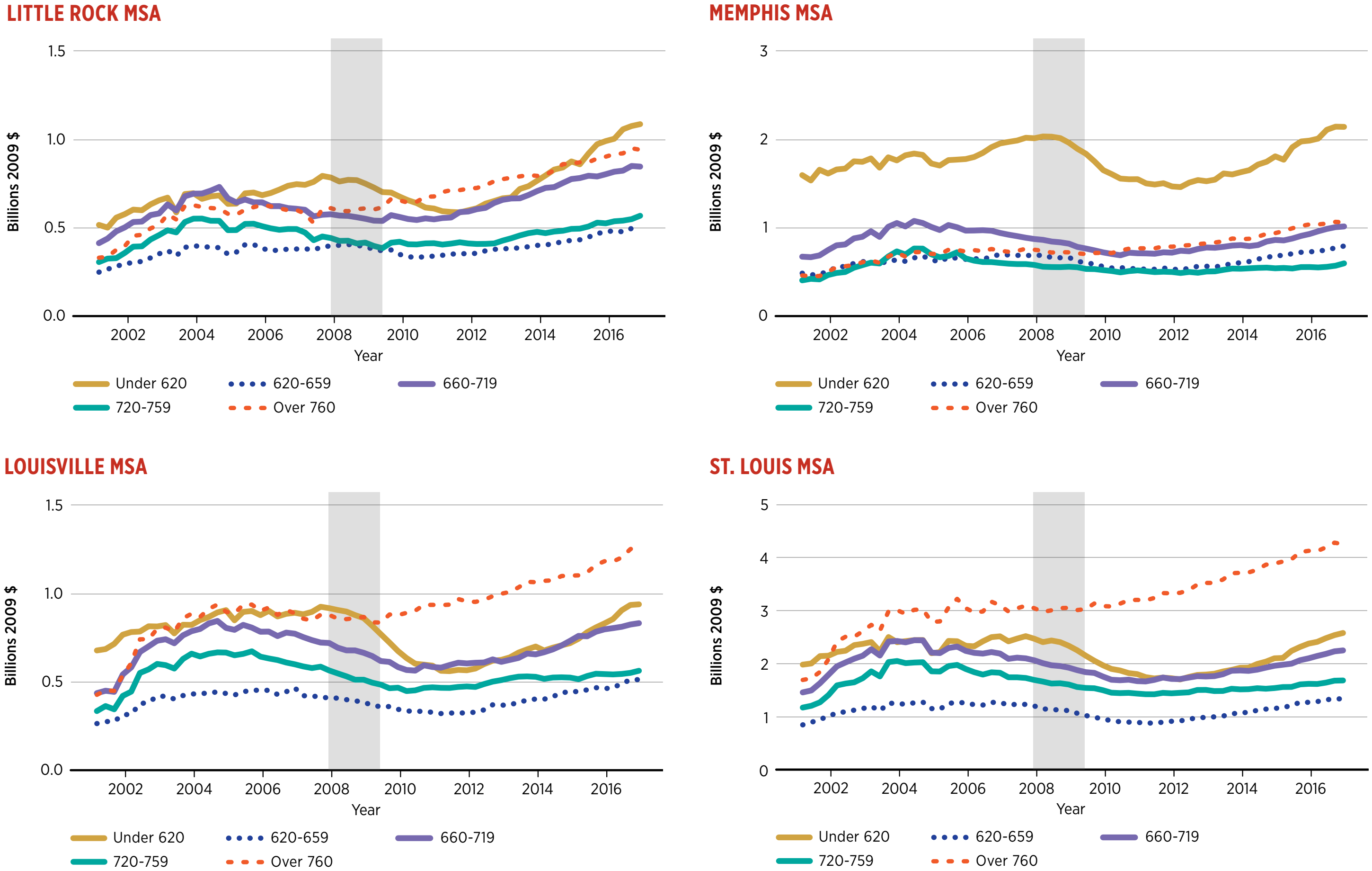
U.S. Outstanding Auto Balances by Equifax Risk Score at Origination



SOURCE: Federal Reserve Bank of New York/Equifax Consumer Credit Panel.
NOTES: For inflation adjustment, 2009 dollars are used, in line with the Bureau of Economic Analysis' personal consumption expenditures chain-type price index. Equifax developed the score to measure lending risk. Typically, credit scores below 620 are considered subprime. A score below 500 would qualify as deep subprime. These lower scores indicate that the borrower is more likely to have problems repaying the loan.

FIGURE 4

Outstanding Auto Loan Balances by Equifax Risk Score at Origination



SOURCE (ALL 4 FIGURES): Federal Reserve Bank of New York/Equifax Consumer Credit Panel.

The Rise of Auto Debt in the Nation and District MSAs

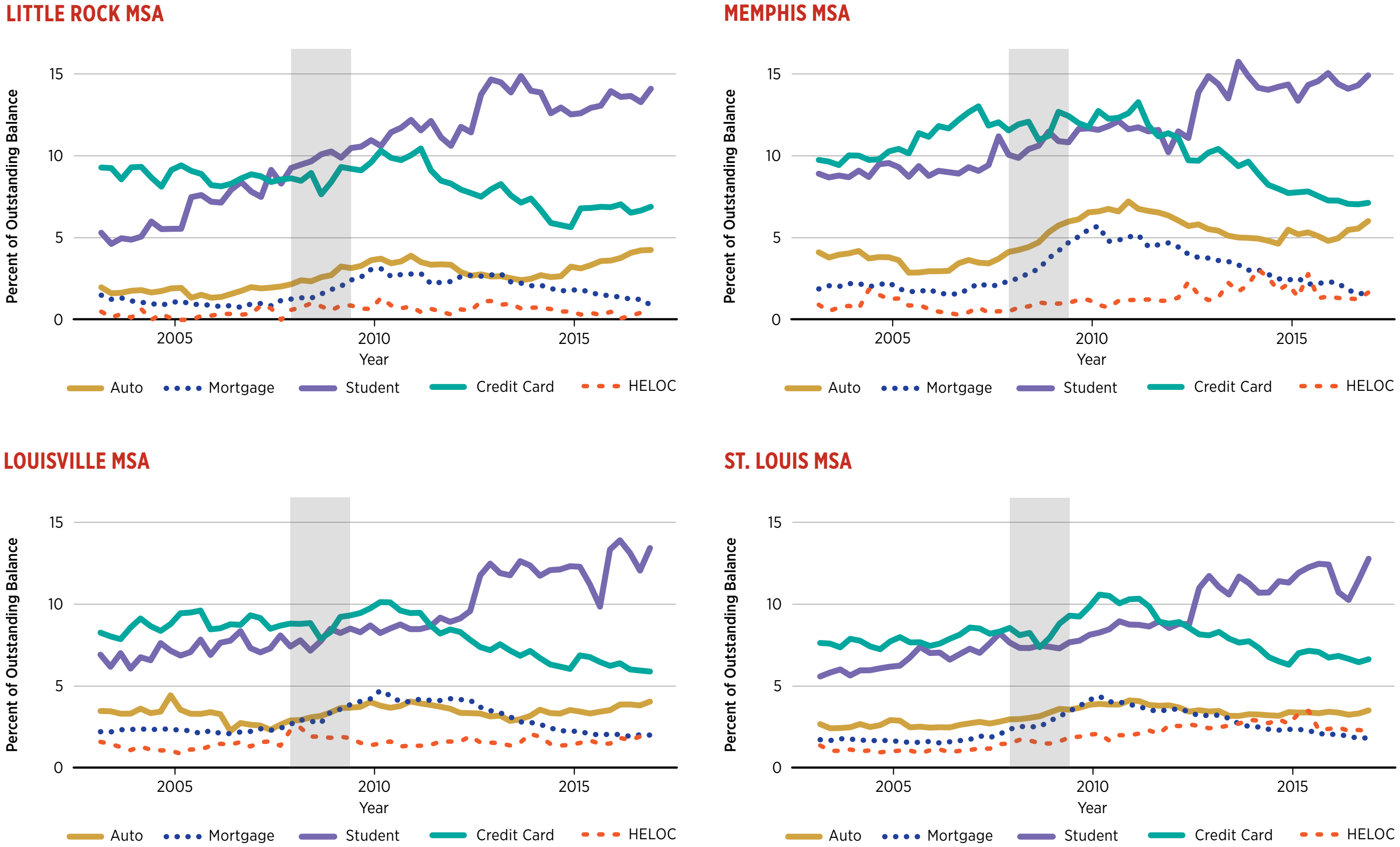
The steep upward trend seen in Figure 2 demonstrates that auto lending has been a substantial source of growth in consumer debt. While still positive, the year-over-year growth rate for the nation slowed for the second quarter in a row, representing a drop of 3.2 percentage points from the second quarter of 2016. The slowdown has been more persistent among the District MSAs, with three successive quarters of diminished growth. Between the first and fourth quarters of 2016, growth rates for per capita auto debt slowed by 4.9 percentage points in Little Rock; 4.1 percentage points in St. Louis; 3.4 percentage points in Memphis and 2.5 percentage points in Louisville. Figure 2 shows that the level of per capita auto debt in the fourth quarter plateaued for each of the District MSAs except Little Rock, where it sharply declined. Auto debt remains a source of relatively strong growth in consumer debt. However, if the recent deviation from trend is persistent, it may be a more modest source of growth moving forward.

The robust growth in auto lending has been fueled in part by a combination of low interest rates, low fuel prices and a strengthening economy following the recession. The interest rate on a 48-month loan from a commercial bank for a new automobile purchase dropped from close to 8 percent prior to the Great Recession to an average of 4.3 percent since the second quarter of 2014.[8] Meanwhile, auto finance company rates for new car loans averaged around 5 percent during this same period.[9] Between May 2011 and June 2014, gas prices averaged around $3.50 per gallon. Since then, the average price per gallon has been about $2.40.[10] In addition, the unemployment rate dropped to 4.7 percent in December 2016 from 9.1 percent in January 2011.[11] Taken together, these developments have provided greater incentives for consumers to take out loans to make car purchases.

Figure 3 shows how this credit expansion has included consumers across the credit spectrum, including those with records considered subprime. Softened underwriting standards have raised concerns regarding the risk associated with the robust growth in auto debt. On that note, the Office of the Comptroller

FIGURE 5

Serious Delinquency Rates by Debt Type



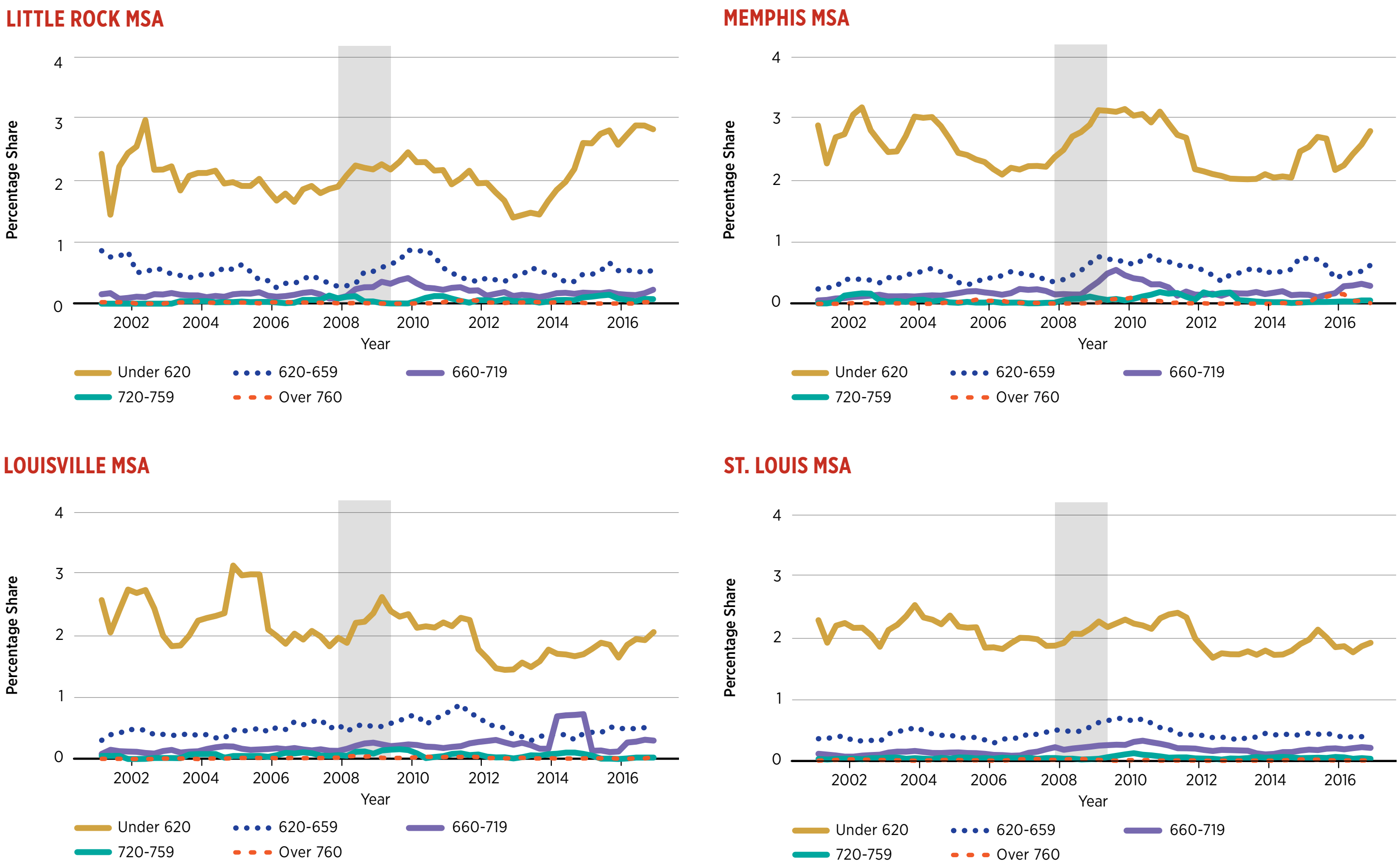
SOURCE (ALL 4 FIGURES): Federal Reserve Bank of New York/Equifax Consumer Credit Panel.

of the Currency has issued repeated warnings in its semiannual risk perspective reports. The most recent report noted that delinquencies have increased, as have non-seasonal losses.[12] It also noted that lenders have stretched repayment terms and offered higher advance rates, resulting in greater loan-to-value ratios.[13] These developments have prompted some lenders to tighten underwriting standards and/or reduce lending activity.[14, 15] This may be reflected to some degree in the growth slowdown seen in the nation and the District MSAs.

Figure 4 shows that the auto credit expansion has differed substantially across District MSAs in terms of lending to prime and subprime borrowers.[16] Debt originations to subprime borrowers encompassed a much greater share of overall debt in Little Rock and Memphis. In the fourth quarter of 2016, subprime debt accounted for 38 percent of outstanding auto debt in Memphis and 28 percent of outstanding auto debt in Little Rock. In comparison, subprime debt accounted for 23 percent of outstanding auto debt in Louisville and 21 percent in St. Louis. This isn't a historical deviation for Memphis. Since 2001, the share of subprime-to-total auto debt has averaged around 39 percent. Memphis also has a greater share of this debt generated by auto financing companies, which include financial services provided by car manufacturers or dealerships, as opposed to other lenders, such as banks or credit unions. In the fourth quarter of 2016, close to 65 percent of outstanding auto debt in Memphis was financed by auto finance companies. In comparison, financing companies were lenders for 56 percent of auto debt in Little Rock, 51 percent of auto debt in Louisville and 47 percent of auto debt in St. Louis. Auto financing companies often originate a greater share of subprime loans than traditional financial institutions. This is consistent in the data: Auto financing companies originated close to 87 percent of subprime auto debt in Memphis and 83 percent of subprime debt in Little Rock. In Louisville, they generated 77 percent of the subprime auto debt and in St. Louis, 71 percent. The greater shares of subprime debt in Memphis and Little Rock represent greater risks of rising repayment delinquencies.

FIGURE 6

Serious Delinquency Rate for Auto Debt by Equifax Risk Score at Origination



SOURCE (ALL 4 FIGURES): Federal Reserve Bank of New York/Equifax Consumer Credit Panel.
NOTE: Four-quarter moving average.

Continued Signs of Stress in Auto Serious Delinquency Rates

Our previous report for the third quarter of 2016 highlighted rising serious delinquency rates for auto debt in the nation and all District MSAs except for St. Louis. That trend accelerated in the fourth quarter of 2016, with serious delinquency rates increasing for the nation and all District MSAs. They also increased by a greater margin than in the previous quarter.

Figure 5 shows the serious delinquency rates across all types of debt for the District MSAs. Little Rock and Memphis show the most pronounced upward trend in serious delinquency of auto debt. This is consistent with the greater proportion of subprime auto debt within those markets. In general, Memphis has had greater rates of serious delinquency over much of the period shown in the figure, which is the first quarter of 2003 to the fourth quarter of 2016. The rates correspond with its higher level of subprime auto debt.

The link between overall serious delinquency rates for auto debt and subprime auto debt is best illustrated by again partitioning debt into groups based on the Equifax Risk Score at origination. Figure 6 shows the risk score is an effective predictor of repayment difficulty, and that the majority of repayment difficulty is concentrated among the two groups with the lowest scores. Recall that in Figure 4, Memphis and Little Rock had the greatest growth in subprime lending. This, coupled with the fact that these borrowers are more likely to experience repayment difficulties, helps explain the increase in the overall serious delinquency rates in these MSAs. In addition, serious delinquency rates among subprime borrowers are more cyclical, which means these borrowers are more likely to fall behind on payments during an economic downturn. This can be seen within the recession shading within Figure 6.

Serious delinquency rates among subprime borrowers in Little Rock and Memphis have now markedly increased during two years of an economic expansion. Nationally, some lenders have reduced their originations and tightened underwriting standards. It remains to be seen if other lenders will expand lending in response. The response will have important implications for potential growth and delinquency in auto debt, and the growth prospects for overall consumer debt.

Endnotes

1 We adjust debt for both inflation and population growth; these are two factors which contribute to a general upward trend in debt levels.

2 The Eighth Federal Reserve District comprises all of Arkansas and portions of Illinois, Indiana, Kentucky, Mississippi, Missouri and Tennessee. An MSA consists of multiple counties and includes the core urban area, as well as any adjacent counties that have a strong social and economic attachment to the urban core.

3 https://www.stlouisfed.org/~/media/publications/quarterly%20debt%20monitor/issue_4/2016Q4%20QDM%20appendix.pdf

4 Deleveraging is the process where consumers pay down debt or shed it in bankruptcy or foreclosure.

5 We define debt with an Equifax Risk Score less than 620 as subprime and debt with a Risk Score over 760 as prime. The Equifax Risk Score, like a credit score, is a measure of lending risk with higher scores indicative of a lower likelihood of repayment difficulties.

6 Total debt is averaged across the population to account for population growth.

7 It's important to note that the rate of change is a net flow; it reflects the sum of debt creation and destruction. The change in mortgage debt is the difference between new debt creation from borrowing activity (e.g. for home purchases financed via new mortgage); and debt destruction in the form of repayments and debt default.

8 Board of Governors of the Federal Reserve System, Finance Rate on Consumer Installment Loans at Commercial Banks, New Autos 48 Month Loan [TERMCBAUTO48NS], retrieved from FRED, Federal Reserve Bank of St. Louis, https://fred.stlouisfed.org/series/TERMCBAUTO48NS, February 14, 2017.

9 Board of Governors of the Federal Reserve System, Average Finance Rate of New Car Loans at Finance Companies, Amount of Finance Weighted [RIELPCFANNQ], retrieved from FRED, Federal Reserve Bank of St. Louis, https://fred.stlouisfed.org/series/RIELPCFANNQ, February 14, 2017.

10 U.S. Energy Information Administration, U.S. Regular Conventional Gas Price [GASREGCOVM], retrieved from FRED, Federal Reserve Bank of St. Louis, https://fred.stlouisfed.org/series/GASREGCOVM, February 14, 2017.

11 U.S. Bureau of Labor Statistics, Civilian Unemployment Rate [UNRATE], retrieved from FRED, Federal Reserve Bank of St. Louis, https://fred.stlouisfed.org/series/UNRATE, February 14, 2017.

12 Office of the Comptroller of the Currency. "Semiannual Risk Perspective from the National Risk Committee." Fall 2016, Washington D.C., Pg. 26. www.occ.treas.gov/publications/publications-by-type/other-publications-reports/semiannual-risk-perspective/semiannual-risk-perspective-fall-2016.pdf

13 An advance rate is the maximum percentage of the value of collateral that a lender is willing to extend for a loan. A higher advance rate will translate into a larger loan offered to the borrower and less insurance for the lender.

14 Wack, Kevin. "Why these big banks are retreating in auto lending." *American Banker*, February 13, 2017. www.americanbanker.com/news/why-these-big-banks-are-retreating-in-auto-lending

15 McLannahan, Ben. "Santander Consumer continues to put the brakes on originations." *The Financial Times*, January 25, 2017. www.ft.com/content/347f77fc-e320-11e6-8405-9e5580d6e5fb

16 Auto debt is partitioned by the Equifax Risk Score at time of origination. Debt that didn't have a valid Risk Score was omitted from these totals.