US Daily: Higher Interest Rates and Riskier Lending Are Driving the Rise in Credit Card Delinquencies (Peng)

- Consumer credit card delinquency rates have risen sharply in recent quarters. Some measures of delinquency rates have overshot their pre-pandemic levels, raising concern about whether consumers, in particular low-income households, are experiencing financial distress.
- We see three likely reasons for the increase in delinquency rates. First, the borrower pool appears to have become riskier. Fiscal stimulus and reduced spending inflated some households' credit scores in 2020, leading banks to lend to riskier borrowers who are now delinquent on 2020 vintage cards at elevated rates. Second, interest rates on credit cards have risen by about 40% (or 6pp) since 2019. While middle- and high-income households paid down their balances enough to offset the impact of higher interest rates, low-income households did not and now face significantly higher monthly interest payments. Third, the resumption of student loan payments in October 2023 delivered a roughly 7% hit to income for the average household with student loans in the bottom income quintile and has likely made it difficult for some to pay their credit card bills.
- Reassuringly, the recent rise in the delinquency rate does not appear to have been caused by distress in the labor market or unsustainable spending. Real household incomes have remained firm across the distribution, and credit card data indicate that households have pulled back their spending from elevated peaks in 2021 to be more in line with their incomes.
- Looking ahead, higher interest costs and student loan payments are likely to keep delinquency rates elevated in early 2024, especially for low-income households. We expect the new (30+) delinquency rate for credit cards to rise gradually from the current level of 8% in 2023Q3 to 9.5% in 2024H1, before falling to around 9% at the end of 2024 as interest rates moderate and income grows.

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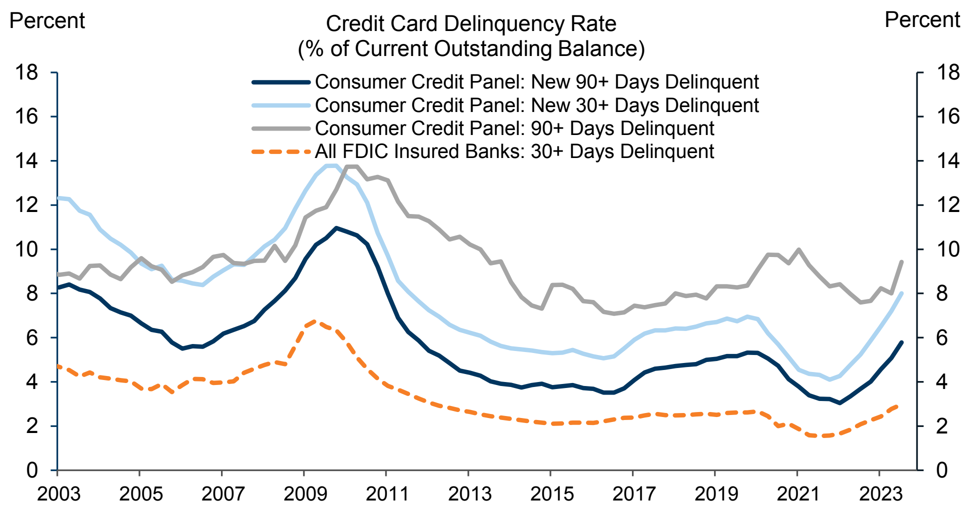
Higher Interest Rates and Riskier Lending Are Driving the Rise in Credit Card Delinquencies

Consumer credit card delinquency rates have risen sharply in recent quarters and some measures have modestly overshot their pre-pandemic levels (Exhibit 1). In particular, our recent consumer dashboard highlighted a noticeable rise in delinquency rates among low-income households. This has led to concerns about whether consumers, in particular those at the low end of the income distribution, are experiencing financial distress.

Exhibit 1: Credit Card Delinquency Rates Have Risen Sharply in Recent Quarters, and Some Measures Have Modestly Overshot Their Pre-pandemic Levels

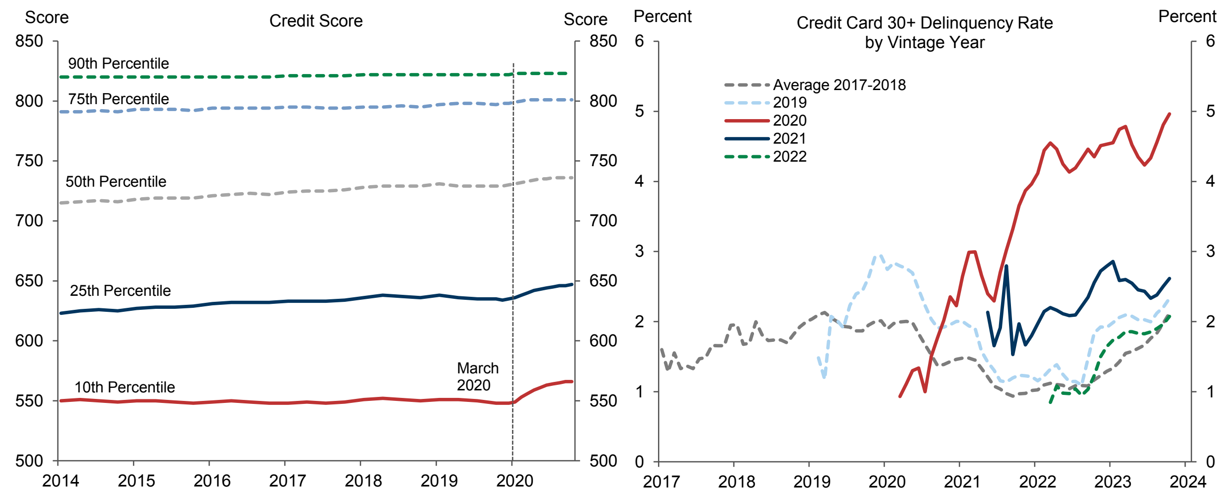


Source: Federal Reserve

We see three possible reasons why delinquency rates may have risen or might rise above pre-pandemic levels.

First, we suspect that fiscal support and reduced spending at the start of the pandemic might have inflated some households' credit scores, leading to riskier lending in 2020. Consistent with this, we find that credit scores jumped by 15-18 points for households at the bottom 25th and 10th percentiles in 2020, after having been flat for the prior 5 years (left-hand side of Exhibit 2). As a result, riskier borrowers might have become eligible for new credit cards or larger credit limits. Data from credit card backed securities show that cards originated in 2020 have a higher delinquency rate over time compared to cards originated in other years (right-hand side of Exhibit 2).

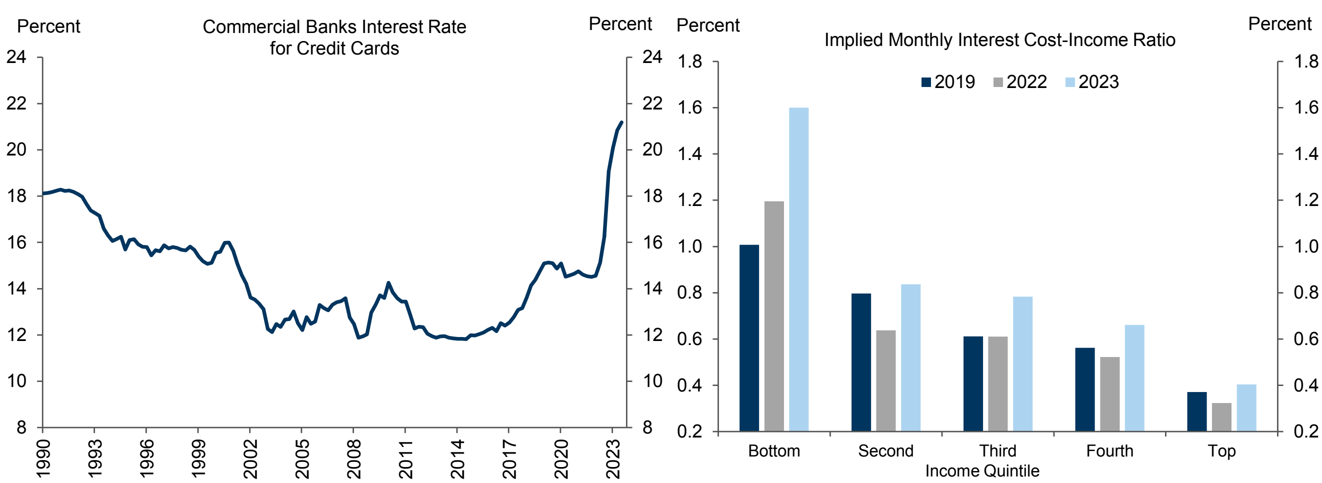
Exhibit 2: Fiscal Support and Reduced Spending at the Start of the Pandemic Inflated Credit Scores, Leading to Riskier Lending in 2020 and Higher Delinquency Rates on 2020 Vintage Card Asset Backed Securities



Source: Federal Reserve, Intex, Goldman Sachs Global Investment Research

Second, the rapid rise in credit card interest rates has weighed heavily on households that are already debt-burdened. Unlike auto loans or mortgages that lock in fixed rates at origination, credit cards tend to have variable interest rates. The left-hand side of Exhibit 3 shows that the average interest rate charged on credit cards rose from 15% in 2019 to 21% in 2023. While middle- and high-income households paid down their balances enough to offset the impact of higher interest rates, low-income households did not and now face 60% higher interest payments (right hand-side of Exhibit 3).

Exhibit 3: Credit Card Interest Rates Rose From 15% to 21%, Helping to Raise Monthly Interest Costs by Around 60% for Low-income Households That Did Not Reduce Their Balances as Much as Middle- and High-Income Households



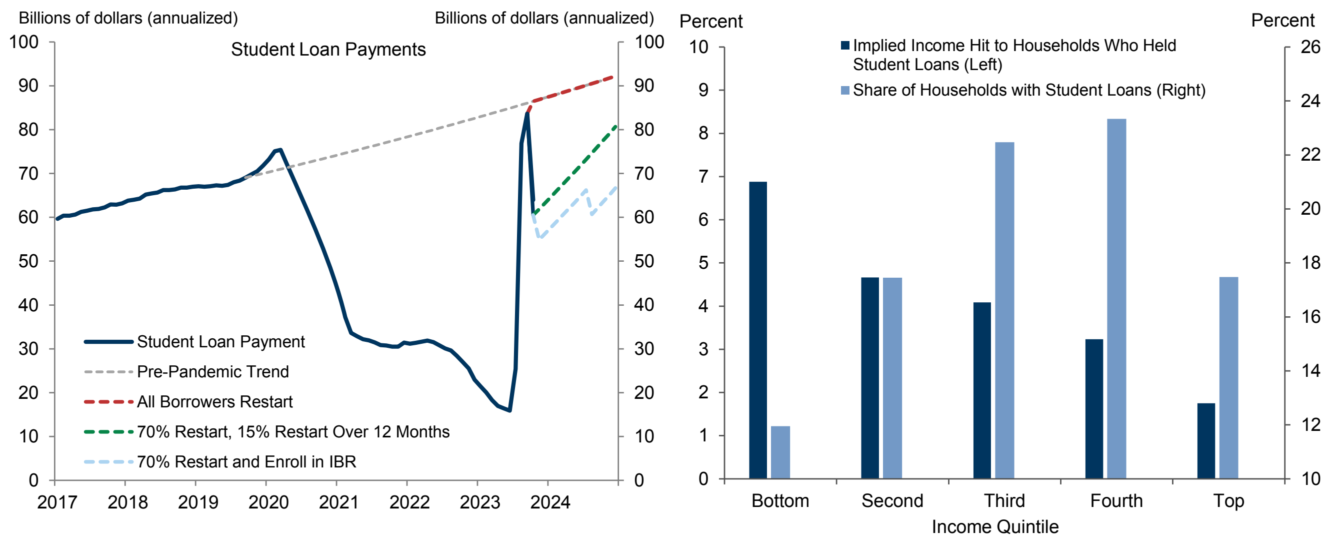
Note: We use the credit card debt in 2019 for each income quintile group to compute the interest cost for 2019 and use 2022 credit card debt to compute interest payment for 2022 and 2023.

Source: Federal Reserve, Survey of Consumer Finance, Goldman Sachs Global Investment Research

Third, the resumption of student loan payments in October 2023 has likely caused a moderate income hit to low-income households with outstanding loans. Recent data suggest that student loan borrowers may be facing challenges in meeting scheduled payments, as the average monthly payment has fallen to about 65% of the scheduled amount after a surge in early repayments (left-hand side of Exhibit 4), and an announcement from the Department of Education indicates that only 60% of borrowers have started repayments. We estimate that the resumption imposes an average hit of 7% of income on households in the bottom income quintile, which may have caused some borrowers to miss their credit card payments.

However, we do not expect the resumption to have a large effect on aggregate consumption because only about one-fifth of households have student loans and a large share of outstanding student loans are held by middle- and high-income households for whom the hit to income is relatively small.

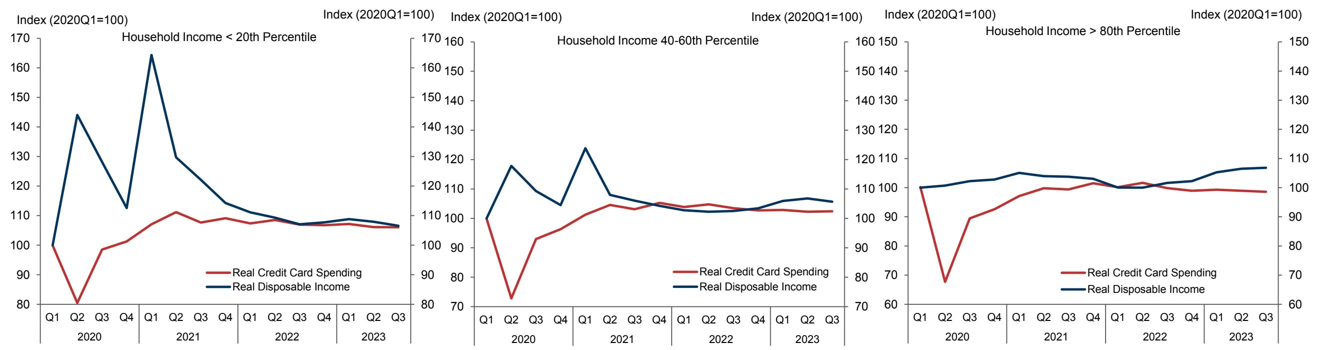
Exhibit 4: The Resumption of Student Loan Payments Imposes a 7% Hit to Income for the Average Household in the Bottom Income Quintile and Has Likely Caused Some to Miss Credit Card Payments



Source: Treasury, Survey of Consumer Finance, Goldman Sachs Global Investment Research

Reassuringly, the recent rise in the delinquency rate does not appear to be caused by distress in the labor market or unsustainable spending. Credit card data indicate that households have pulled back their spending from elevated peaks in 2021 to be more in line with their incomes, and real household incomes have stayed above spending trends across the income distribution (Exhibit 5).

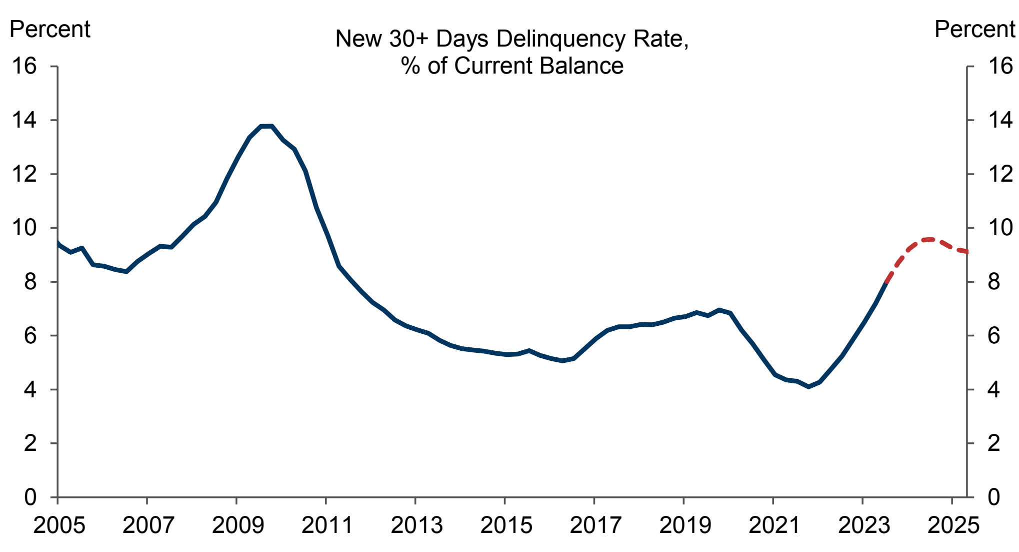
Exhibit 5: Low-Income Households Reduced Their Spending From Elevated Levels as Disposable Income Normalized, Suggesting That Unsustainable Spending Is Not a Major Reason for Higher Delinquency Rates



Source: Bureau of Economic Analysis, Opportunity Insights, Goldman Sachs Global Investment Research

Looking ahead, higher interest costs and resumed student loan payments are likely to keep delinquency rates elevated in early 2024, especially for low-income households. We expect the new (30+) delinquency rate for credit cards to rise gradually from 8% in 2023Q3 to 9.5% in 2024H1, overshooting its 2019 level by 2.5pp. However, as interest rates moderate and incomes continue to grow, we expect the delinquency rate to fall back to 9% in 2024H2.

Exhibit 6: We Expect the New Credit Card Delinquency Rate to Rise From 8% in 2023Q3 to 9.5% in 2024H1 Before Falling to 9% at the End of 2024, as Interest Rates Fall and Income Grows



Source: Federal Reserve, Goldman Sachs Global Investment Research

Elsie Peng

Disclosure Appendix

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We, Jan Hatzius, Alec Phillips, David Mericle, Spencer Hill, CFA, Ronnie Walker, Manuel Abecasis, Tim Krupa, Elsie Peng and Jessica Rindels, hereby certify that all of the views expressed in this report accurately reflect our personal views, which have not been influenced by considerations of the firm's business or client relationships.

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