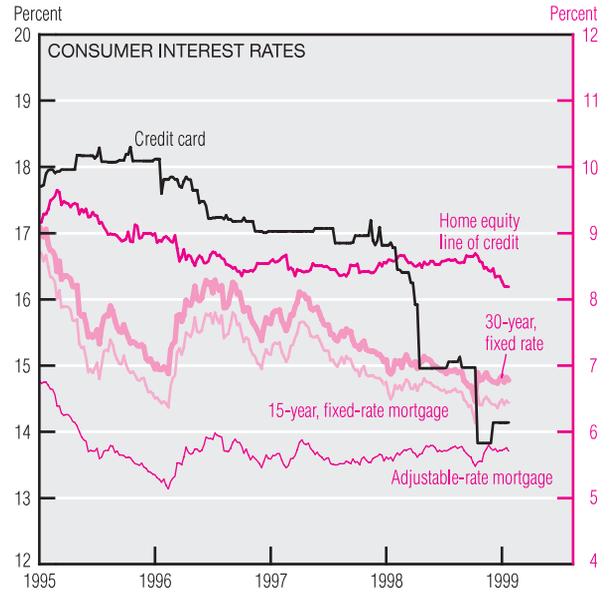
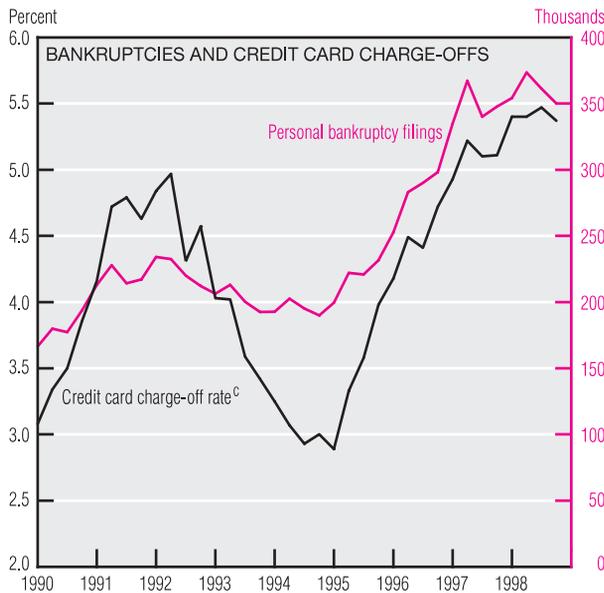
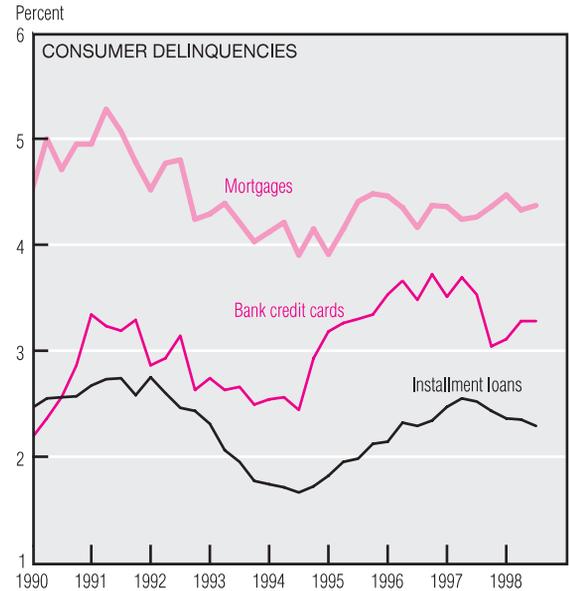
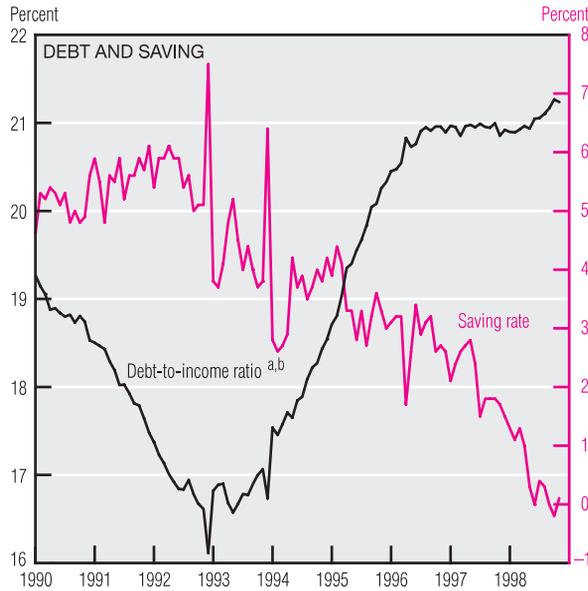


Household Financial Conditions



a. Ratio of total consumer credit to disposable personal income.
 b. Seasonally adjusted.

c. Net charge-off rate is the percentage of total credit card debt that banks remove from their balance sheets because of uncollectibility, less amounts recovered on credit cards previously charged off, expressed as an annual rate.

SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; Board of Governors of the Federal Reserve System; Federal Deposit Insurance Corporation, *Quarterly Banking Profile*; American Bankers Association, *Consumer Credit Delinquency Bulletin*; American Bankruptcy Institute; Mortgage Bankers Association of America, *National Delinquency Survey*; and *Bank Rate Monitor*.

Household consumer debt levels rose again (to 21.24% of disposable personal income last November), after remaining stable since the beginning of 1996. This renewed acceleration in household debt burdens is all the more striking when viewed against the backdrop of a domestic personal saving rate that turned negative, the only time this has occurred since the figure was first calculated.

Such trends concern many ana-

lysts because personal consumption expenditures account for nearly two-thirds of the GDP. As a result, the story goes, if household accounts get too far out of balance, consumption growth may taper off and pull the economy into a recession.

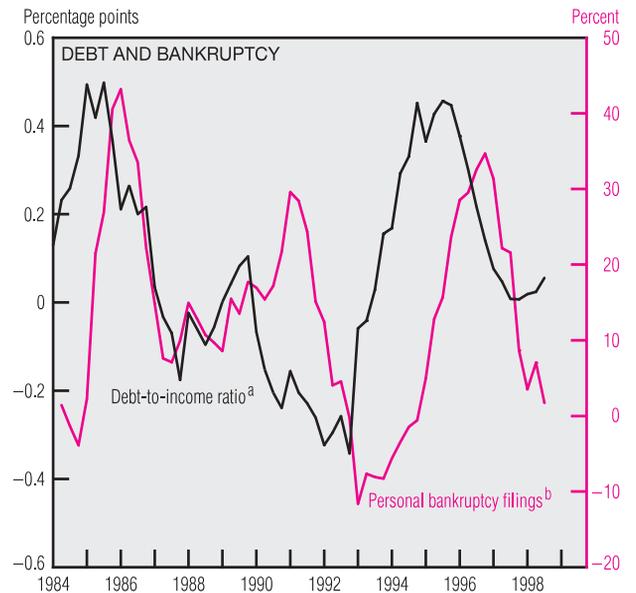
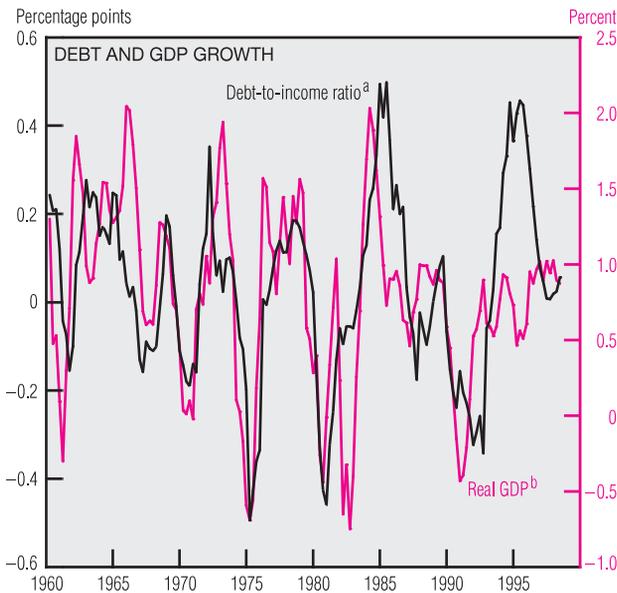
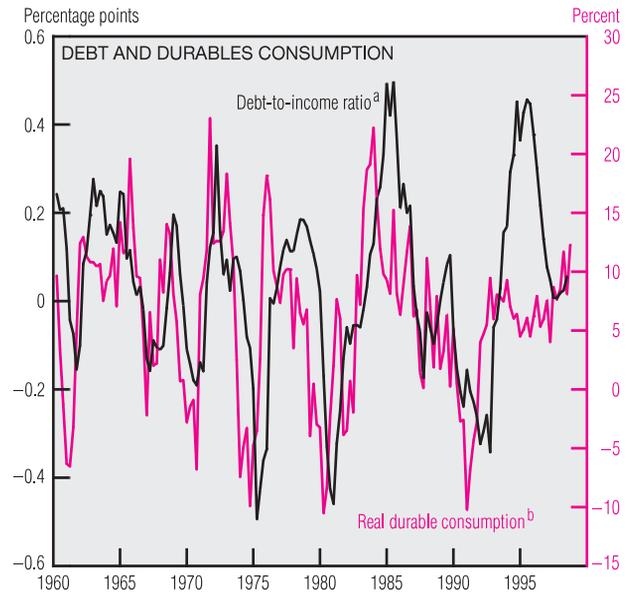
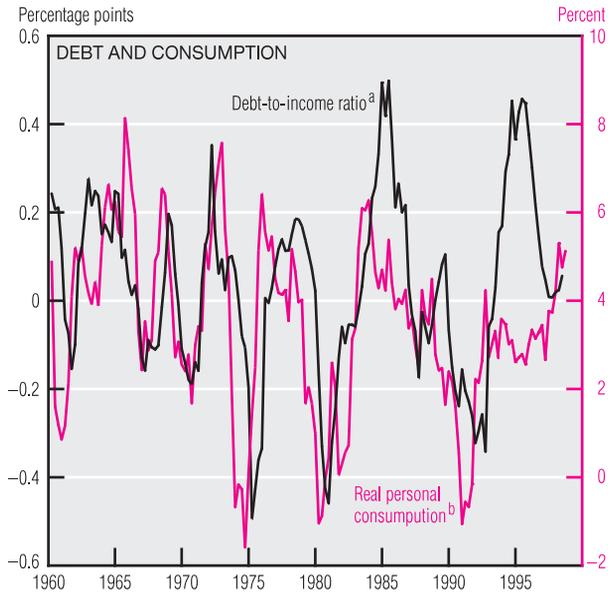
Beyond the raw debt numbers, however, other indicators of household financial distress do not appear to foreshadow impending doom. For example, after rising dramati-

cally through the middle part of the decade, delinquency rates on various types of consumer and mortgage debt have held steady or even fallen since 1996. Similarly, the growth in personal bankruptcy filings and credit card charge-off rates that was so notable beginning in 1994 has slowed over the past two years.

In addition, the steady decline of mortgage rates since early 1997, not

(continued on next page)

Household Financial Conditions (cont.)



a. Ratio of total consumer credit to disposable personal income.

b. Annualized percentage change.

NOTE: All data are four-quarter moving averages of quarter-over-quarter changes.

SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; Board of Governors of the Federal Reserve System; and American Bankruptcy Institute.

to mention the dramatic drop in average credit card rates over last year, has served to lower the overall fraction of household income needed to service these higher debt levels. As a consequence, households may rationally desire to hold higher debt balances than they did during periods of higher interest rates.

A more fundamental reason to question the above story about the danger of high debt burdens is that it assumes a causal link between debt levels and real economic vari-

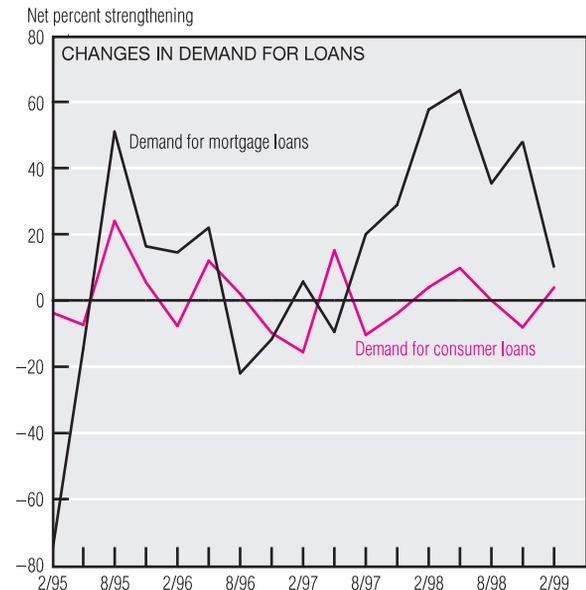
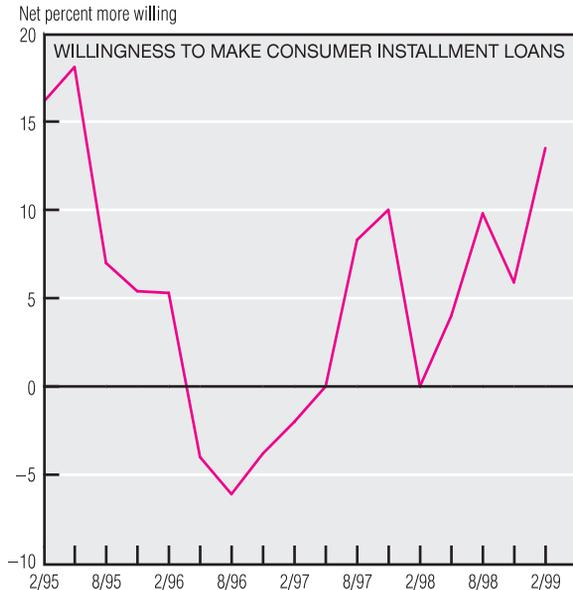
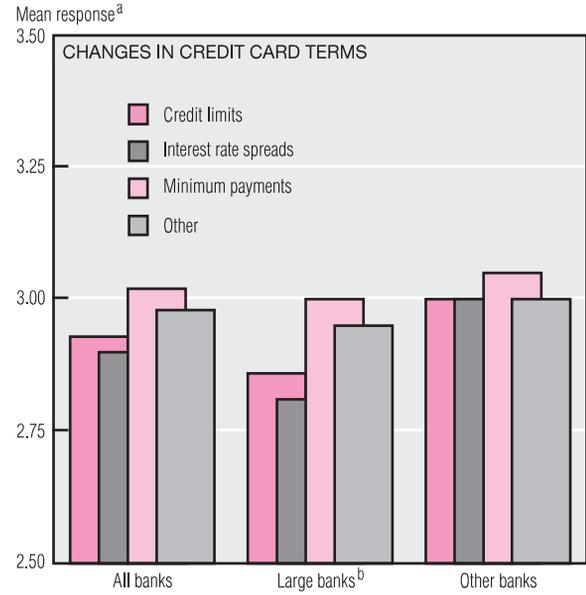
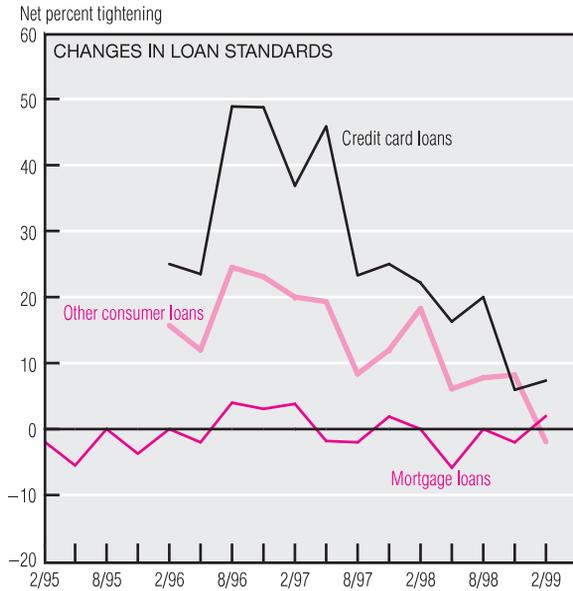
ables that doesn't appear to exist. In particular, those who are concerned about increases in the debt-to-income ratio implicitly assume that debt burdens either cause or predict future consumption expenditures.

Historical experience, however, calls this assumption into question. In fact, changes in real economic variables such as personal consumption expenditures, durable goods consumption, and GDP typically precede changes in the debt-to-income ratio by as much as two or three quarters. In other words,

changes in consumption output tend to predict changes in consumer debt levels, not the other way around.

An alternative story can be told to demonstrate the reasonableness of such a pattern. When households experience a negative shock to their incomes, the debt-to-income level naturally rises for two reasons: First, of course, is the direct effect of lower disposable personal incomes. Simultaneously, however, households may increase
(continued on next page)

Household Financial Conditions (cont.)



a. Mean response of banks using the following scale: 1 = tightened considerably, 2 = tightened somewhat, 3 = remained basically unchanged, 4 = eased somewhat, and 5 = eased considerably.
 b. Total domestic assets over \$15 billion.
 SOURCE: Board of Governors of the Federal Reserve System, *Senior Loan Officer Opinion Survey on Bank Lending Practices*.

their indebtedness in order to smooth their consumption patterns, if they perceive the shock to be temporary. Such smoothing is not complete, however, so that consumption expenditures, particularly for durables, decline in the face of this income shock. As a result, the real economic variables of interest decline in advance of, not following, a decline in household debt levels. Most importantly, by the time we observe changes in debt levels that might portend lower economic growth, that lower growth already has occurred.

Additional insight into household financial conditions can be gleaned from the Federal Reserve's quarterly *Senior Loan Officer Opinion Survey on Bank Lending Practices*. According to the latest survey, conducted last month, the trend toward tighter loan standards that has prevailed over the last three years for credit card lending and other consumer loans appears to be moderating, while mortgage loan standards continue their steady track.

The same patterns are evident in the changing terms of credit card

loans. Although credit limits and interest rate spreads are slightly less favorable than they have been in the past (due primarily to the influence of large banks), minimum payment requirements and other credit card terms are virtually unchanged.

Despite this tightening of standards, senior loan officers continue to report a strong and growing willingness to make consumer installment loans. Taken together, these trends suggest that creditworthy borrowers are having little trouble in gaining access to credit.