ECONOMIC VIEWPOINT

United States: Does Credit Still Pose Risks to the Economy?

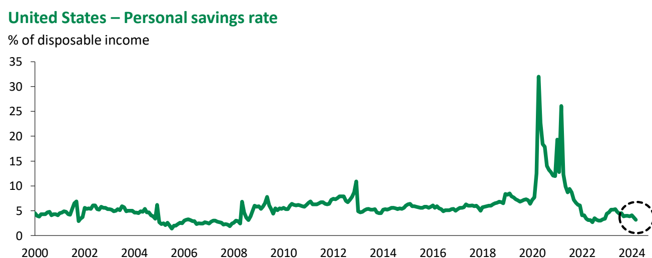
By Francis Généreux, Principal Economist

US consumer spending is holding up well despite a number of constraints such as high interest rates. Consumption has proven resilient despite a slowdown in credit, according to the latest monthly data on consumer credit. It's no surprise that credit is cooling, since financial institutions continue to impose strict credit conditions. But now that savings are running out, could the credit trajectory become cause for concern? If companies keep hiring and wages keep rising, the situation doesn't pose much of a threat, even though higher-for-longer rates could create more issues.

Real GDP growth slowed in the first quarter of 2024, compared to the rapid expansion seen in the second half of 2023. The US economy is nevertheless still booming, as reflected by buoyant domestic demand, which climbed by an annualized 2.8% in the first quarter. This was partly due to quarterly growth in real spending on services, which was the strongest it's been since 2014 (except for upticks due to the end of lockdowns). Even April hiring, which was down slightly from previous months, isn't that much of a concern.

A number of factors explain the resilience of domestic demand and household consumption. One is rising salaries. The wealth effect—amplified by soaring stock indexes, higher interest income and rising home prices—has also boosted consumer spending. The substantial surplus savings consumers built up during the pandemic also allowed them to keep spending. In addition, the savings rate has dropped sharply in recent quarters, falling to only 3.2% in March (graph 1). That's the lowest it's been since 2008, if we exclude the spring and summer of 2022, when inflationary pressures and the end of certain government assistance programs took a big bite out of household disposable income. But researchers at the San Francisco Fed believe pandemic-era savings have now been spent (graph 2), leaving households with less of a cushion against economic uncertainty. They point out that "consumers could use debt—such as credit cards and personal loans—to further support their current spending habits, although the current elevated interest rate environment means that the cost of using credit is higher than in the decade preceding the pandemic recession."

Graph 1
The US Household Savings Rate Has Fallen



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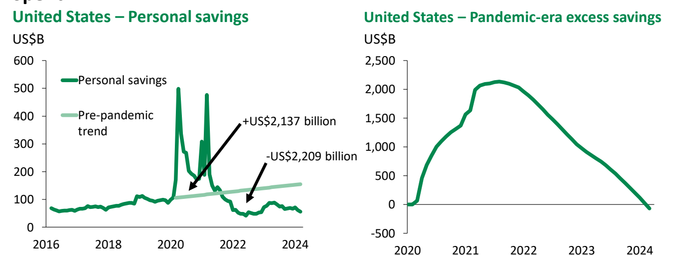
Graph 2
The Excess Savings Built Up During the Pandemic Have Probably Been Spent



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Of course, credit could prove useful for consumers who want to spend more than they currently earn. Last week saw the release of fresh data on changes in consumer credit, as well as attitudes to credit on the part of financial institutions, households and businesses.

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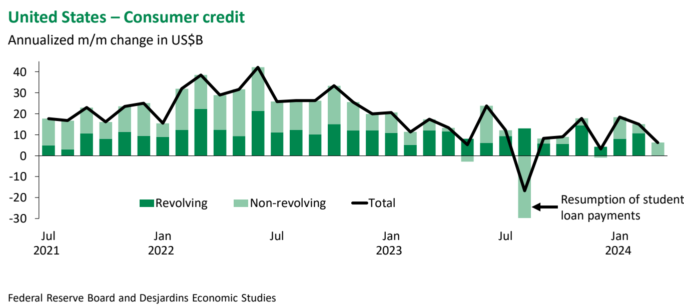
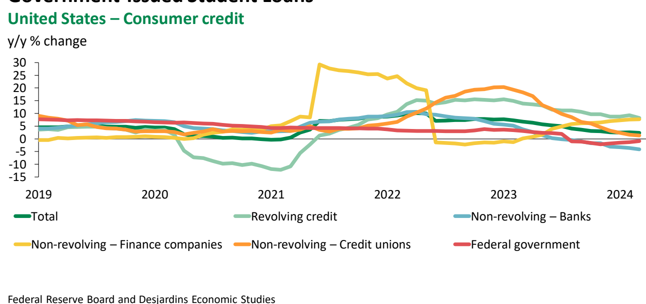
First, compared to 2022, consumer credit growth has significantly cooled since the fall of 2023 (graph 3). That's no surprise, as that's generally what happens when interest rates go up. Until February, the slowdown was most obvious in term loans. However, the monthly gain in revolving credit (cards and lines of credit) was particularly low in March. It remains to be seen whether this recent soft patch is just a passing phase or the sign of a lasting trend toward weaker growth. In terms of the year-on-year change, term loans granted by banks slackened the most (graph 4). Tighter credit conditions, especially after the banking turmoil in March 2023, likely pushed households with bad credit to turn elsewhere, especially finance companies. Consumers also took out bigger loans due to higher car prices.

Graph 3
Consumer Credit Has Cooled



Graph 4
The Pullback in Term Loans Was Mostly Driven by Bank Loans and Government-Issued Student Loans

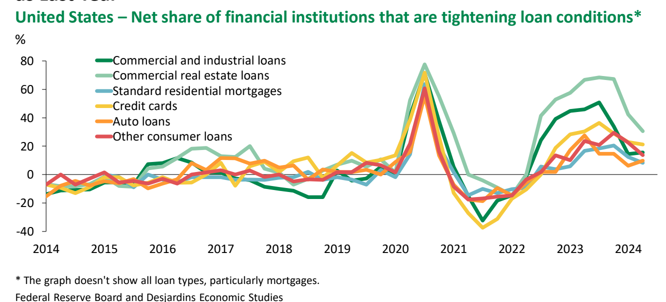


A key factor in how the credit market develops over the coming months will obviously be the interest rate trajectory. The recent lack of progress on inflation should prompt caution among Federal Reserve (Fed) officials at their next few meetings. The upcoming elections will likely limit what the Fed can do, since it probably won't want to pivot on interest rates in the midst of the election campaign unless it's absolutely necessary. We therefore don't expect the central bank to begin monetary easing until November. Higher-for-longer rates should keep a lid on credit in the US, and possibly here in Canada as well, even though the Bank of Canada will likely start cutting rates soon.

Obviously, interest rate movements are key, but the willingness of financial institutions to extend credit is nevertheless an important factor. Once again, last week we got new information to chew on with the publication of the Fed's quarterly Senior Loan Officer Opinion Survey.

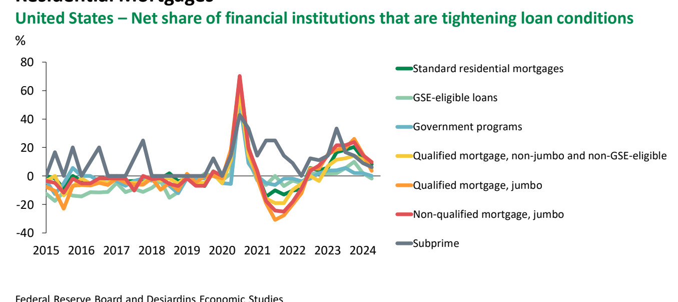
What stands out the most is that financial institutions haven't relaxed their credit conditions for most types of loans to individuals or businesses. But there's a smaller share of institutions that keep tightening their conditions (graph 5). For example, the net percentage of institutions that further tightened conditions on commercial and industrial (C&I) loans was 15.6% in April. This was much lower than it was a year ago (46%), right after the March 2023 banking turmoil. Meanwhile, the percentage of banks that tightened conditions on commercial real estate (CRE) loans fell from 66.7% to 30.6% over the same one-year period. The same institutions reported that customer demand for C&I and CRE loans remains negative (but less so than a year ago).

Graph 5
Financial Institutions Keep Tightening Credit Conditions, but Not As Much as Last Year



As for consumers, we feel that conditions for government-backed mortgages are starting to ease (graph 6). This is the only kind of debt for which conditions have really improved. For all other debt, including other kinds of mortgages, auto loans, credit card debt and other consumer loans, conditions have tightened, but not as much as during the market tensions of March 2023. These

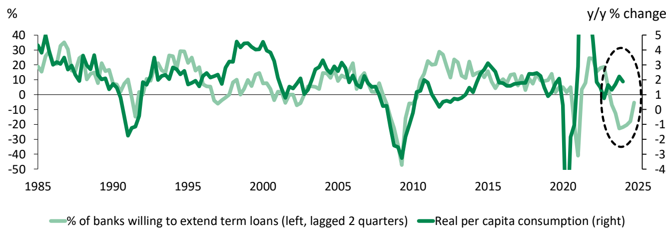
Graph 6
Credit Conditions Are No Longer Tightening for Certain Types of Residential Mortgages



were sparked by the difficulties of certain regional banks, but were defused by the Fed.

The fact that financial institutions are no longer so unwilling to issue term loans should boost consumer spending and the economy. That said, the March 2023 banking crisis didn't hit the economy that hard, even though credit conditions tightened considerably (graph 7). A San Francisco Fed research paper estimates that the credit tightening that followed the banking turmoil nevertheless impacted the economy: "unexpected changes to credit supply conditions—including the March 2023 bank closures—can account for 0.4 percentage point of unemployment by the end of 2023, meaning that unemployment in that quarter would have been 3.3% without the credit supply shock."

Graph 7
Credit Tightening After the 2023 Banking Crisis Didn't Really Affect Consumption Growth
United States



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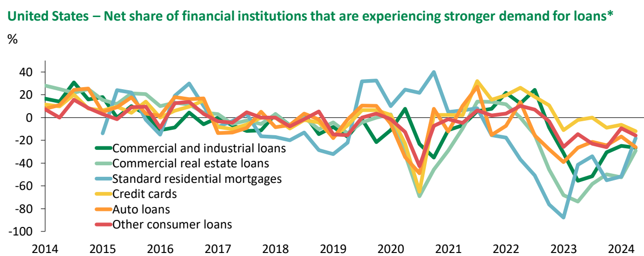
Institutions continue to see weak demand for credit (graph 8), which is to be expected as long as market interest rates remain high. At least the situation isn't getting worse.

Graph 8
Demand for Loans Is Still Slowing, but Not As Much as in 2023

United States – Net share of financial institutions that are experiencing stronger demand for loans*



* The graph doesn't show all loan types, particularly mortgages.
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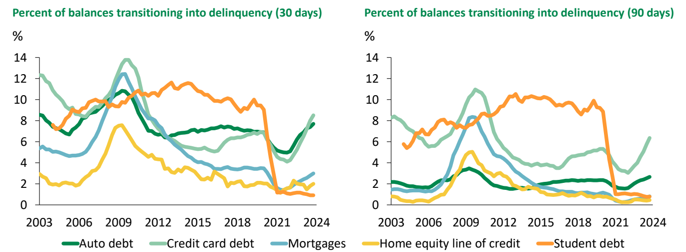
That said, there are still quite a few risks. Late payments on credit cards and—to a lesser extent—car loans are mounting. The situation seems relatively under control for late payments on student loans and mortgages (graph 9), and personal bankruptcies are currently at a historic low in the United States

Graph 9
Credit Card and Car Loan Payment Delinquencies Are Climbing



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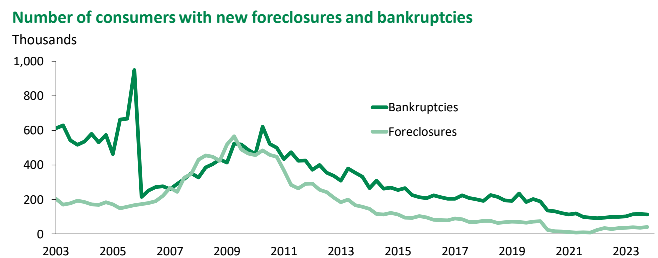
Graph 10
The Number of Bankruptcies in the United States Is Low

Number of consumers with new foreclosures and bankruptcies



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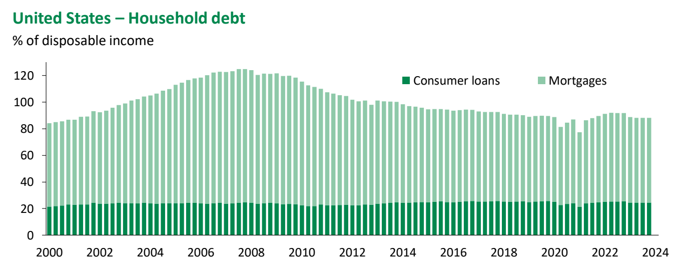
(graph 10). A faltering job market and persistently higher unemployment could nevertheless worsen the situation.

Concern over deteriorating credit quality has also been eased by how well US households seem to be managing their debt. The household debt-to-income ratio is quite low, especially compared to the peaks reached just before the 2008 financial crisis (graph 11). From this standpoint, you could even say that consumer credit is on extremely solid ground. This is reflected in the relatively low cost of household debt service, even though interest rates—and home and auto prices—have soared over the past few years (graph 12 on page 4).

Graph 11
US Consumers Aren't Overly Indebted

United States – Household debt



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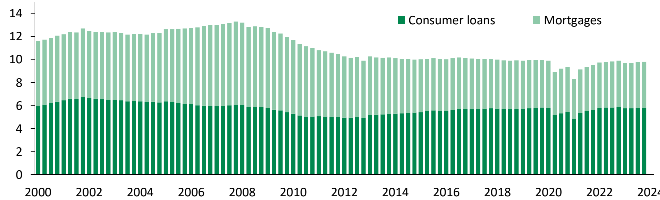
Graph 12
US Household Debt Service Remains Historically Low

United States — Debt service ratio
% of disposable income



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A more marginal risk, which is nevertheless increasing, is the growing popularity of "buy now/pay later" payment plans. These plans have made it possible for consumers to keep spending despite the higher cost of living, even for goods and services that aren't normally purchased using traditional term loans. According to the New York Fed, these plans are mostly used by financially fragile consumers who either don't have much money or don't have a great credit history. Bloomberg claims that late payments are on the rise (resulting in penalties and interest) and that credit rating agencies, financial supervisory authorities, forecasters and investors don't have a clear picture of the impact of the growing popularity of these plans.

Although this isn't our baseline scenario, sticky or even rising inflation that would force the Fed to start hiking rates again also poses major risk. This would drive market and retail rates back up. Until now, the economy has shown surprising resilience in the face of high rates. But a further tightening of financial conditions could be the straw that breaks the camel's back and triggers the downturn that the United States has managed to avoid. This could disrupt a soft landing.

All of these factors suggest that the credit trajectory isn't cause for major concern. However, as long as interest rates stay relatively high, risks remain for the US economy.