Delinquencies Rising Despite Ultra Low Unemployment

In a trend that we see accelerating, loan repayments are increasingly running late, according to the New York Fed's Household Debt and Credit report. We detailed one reason for this in our June 27th note. Through June (the most recent data), real disposable personal incomes (incomes adjusted for inflation and taxes) are down 9.1% versus the end of April 2020. Although there has been some improvement in this area because inflation has subsided, **consumers’ real purchasing powers are still $867B below trend**, according to our calculations. This is an issue because the sustainability of consumers’ pandemic debt binge was partially predicated upon their incomes steadily rising. Instead, the opposite occurred, and now the rate at which borrowers are running late on their debt payments is back to pre-Covid levels. This could be the newest challenge facing embattled commercial banks.

As charted below, the universe of loans transitioning into delinquency (30 days late or more without a payment) has increased broadly since Q1 2022, especially for autos and credit cards. This too is occurring for mortgages, albeit not as sharply. **Today, we received data for Q2 2023, which showed continued degeneration.** Auto delinquencies (7.28%) reached their highest rate since Q1 2018, credit cards (7.2%) reached their highest since Q1 2012, and for mortgages (2.56%) the highest since Q2 2020. In response, expect further tightening in bank lending standards.

The pandemic suspension of student loan payments has led to the percentage of loans running delinquent to a record low of just 1%. Not paying student loans has allowed borrowers to pay down other types of debt (and spend on discretionary items). This artificially supported the performance of other loans. But, **beginning October 1st, student loan payments restart, which we estimate presents a near 1% of GDP tax hike for borrowers**. Assuming student loan delinquencies rise to their pre-pandemic levels, we are likely to see a resulting rise in delinquencies across the spectrum, which are already mostly back to pre-Covid levels. In turn, future credit is likely to decrease while loan losses should increase. **Keep in mind this is happening alongside the lowest unemployment in over 50 years.**
Disclaimers

This document is provided by SMBC Nikko Securities America, Inc. ("SMBC Nikko"), the US-registered broker-dealer affiliate of Sumitomo Mitsui Banking Corporation, for informational purposes only. This document was prepared by SMBC Nikko's economist(s). The views, statements, assumptions and forecasts expressed herein are those of the author(s) and do not reflect the judgment of any other person or of SMBC Nikko, it does not constitute an offer, or solicitation of the sale or purchase, of securities or other investments. The information contained herein is obtained or derived from sources believed to be reliable, but SMBC Nikko and the author(s) make no representations as to its accuracy or completeness. In some cases, such information may be incomplete or summarized. This document has been prepared based on assumptions and parameters determined by the economist(s) in good faith. The assumptions and parameters used are not the only ones that could have been selected, and therefore no guarantee is given as to the accuracy, completeness, or reasonableness of any such quotations, disclosures, or analyses. Past performance is not a reliable indicator of any future results.

This document has been prepared for and is directed at institutional investors and other market professionals and is not intended for use by retail customers. It does not take into account any specific investment objective, financial situation, or particular need of any recipient. The information contained herein should, for whatever purpose, be used solely at the discretion and responsibility of the recipient. SMBC Nikko and its affiliates do not accept any liability or responsibility for any results in connection with the use of such information. Recipients are responsible for making final investment decisions and should do so at their own discretion after conducting a careful examination of all documentation delivered prior to execution, explanatory documents pertaining to listed securities, prospectuses, and other relevant documents, and their own independent analysis and assessment of the merits of any transaction. The financial instruments discussed may be speculative and may involve risks to principal and interest.

Conflicts of Interest Disclosures

The views, statements, assumptions and forecasts expressed herein may differ from those expressed in globally branded research produced by SMBC Nikko or its affiliates. The trading desks of SMBC Nikko and its affiliates trade or may trade as principal in the financial instruments that are the subject of this material, and the author(s) of this document may have consulted with the trading desks while preparing this document. The proprietary interests of SMBC Nikko and its affiliates may conflict with those of the recipient. SMBC Nikko and its affiliates may seek to do business with the companies mentioned in this material and the trading desks may have accumulated, be in the process of accumulating, or accumulate long or short positions in the financial instruments mentioned and may have acquired them at prices no longer available. The trading desks may also have or take positions inconsistent with the views expressed in this document or may have already traded on those views.

This material is not a research report, and neither this material nor its author(s) is subject to SMBC Nikko policies and procedures that apply to the globally branded research reports and research analysts of SMBC Nikko and its affiliates or to legal requirements designed to promote the independence of investment research. It is not subject to any prohibition on dealing ahead of the dissemination of investment research. This means that on the date of this document, SMBC Nikko, its affiliates, and their respective directors, representatives, or employees, may have a long or short position in any of the instruments mentioned in this document and may make a market or trade in instruments economically related to the securities, derivatives or other underlying assets mentioned herein, in each case either as principal or as agent.

No part of the author(s) compensation was, is, or will be, directly or indirectly related to the specific recommendations or views expressed herein. The personal views of authors may differ from one another.

Distribution, possession or delivery of this document in, to or from certain jurisdictions may be restricted or prohibited by law. Recipients of this document are required to inform themselves of and comply with all such restrictions or prohibitions.