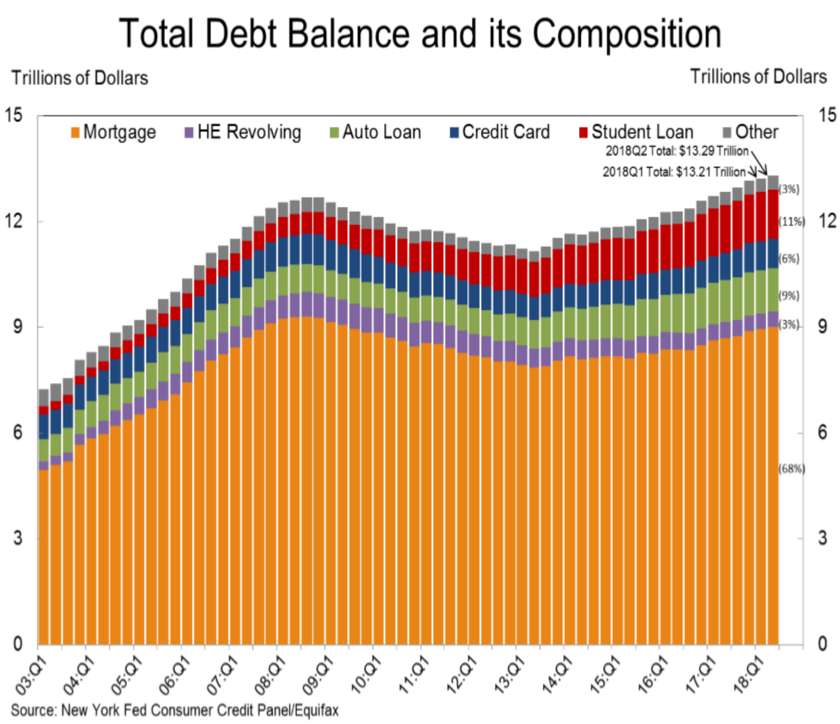
Key Takeaways

- U.S. household debt rose to $13.3 trillion as of the second quarter of 2018, according to the Federal Reserve Bank of New York – higher than the previous peak of $12.68 trillion in the third quarter of 2008.
- The growing level of debt is a direct reflection of the solid job market and rising optimism about economic growth among both banks and lenders, allowing Americans to improve their credit and qualify for loans.
- While household debt surpassing previous high points may sound worrisome, it's not necessarily cause for concern. The total number of Americans borrowing relative to the size of the U.S. GDP – as well as the household debt-to-income ratio – remains well below prior peaks, which could reflect improved management of household debt and a stronger economy.

How much do Americans owe today?

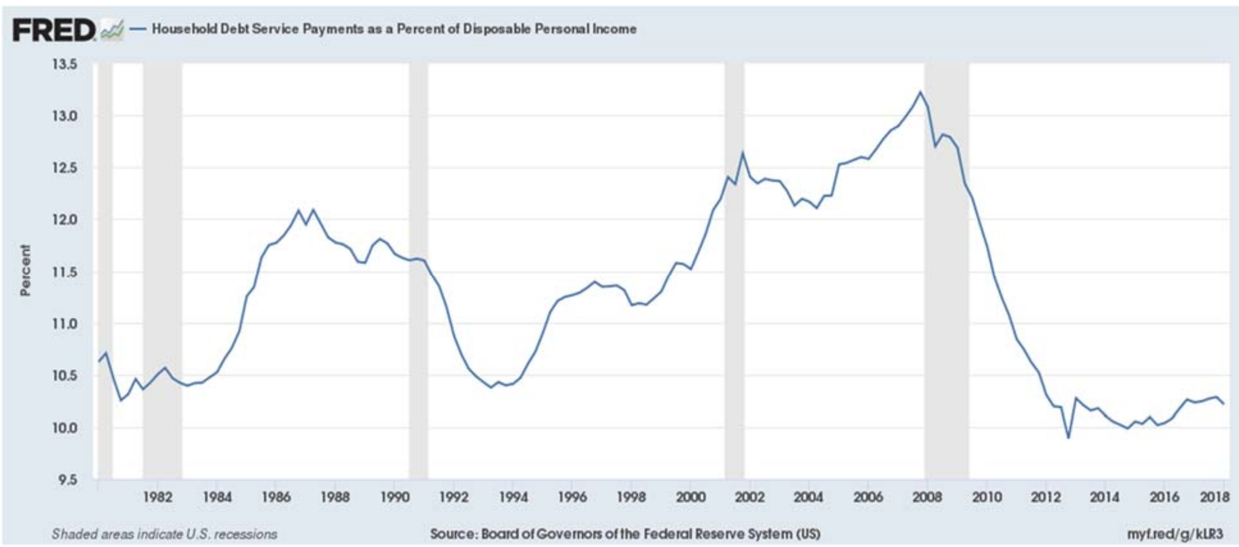
Debt can fuel consumer spending, which accounts for nearly 70% of all economic activity in the United States. Debt also allows Americans to make large investments in education and housing, which can help build personal wealth and improve financial stability.

According to the Federal Reserve Bank of New York, aggregate household debt increased in the second quarter of 2018 for the 16th consecutive quarter. The total amount of borrowings by Americans is now $13.3 trillion, which is $618 billion higher than the previous peak of $12.68 trillion during the third quarter of 2008. The growing level of debt shows that many millions of Americans who struggled during the recession have sufficiently repaired their credit to qualify for loans. As of the second quarter of 2018, mortgage debt remains the largest percentage of total household borrowing, followed by student and auto loans, respectively.

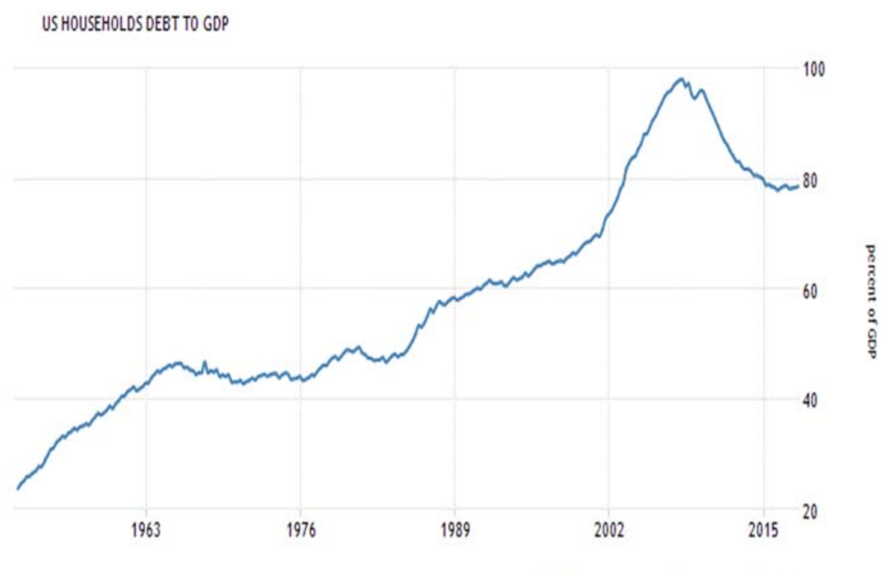


What's different this time?

Since World War II, total household debt has been increasing, especially during the housing bubble years of the 2000s, when it was normal for the ratio of debt to income to rise as many households went from being renters to homeowners. The problem was that, during the bubble years, new buyers were making smaller down payments on homes and were given loans greater than what their incomes supported. In the end, debt-to-income ratios peaked at a record high of 131% in the fourth quarter of 2007 as the recession was about to begin. Today's situation paints a different picture: The ability to service debt payments as a percent of disposable personal income has steadily declined and remains well below the levels seen during the crisis.



Mortgage debt, which remains the largest portion of total household debt, has been growing at a steady pace. However, it does not show the same level of exuberance seen during the housing bubble and, more importantly, it has not been growing as quickly as the rest of the economy when compared as a percentage of U.S. GDP. Household and mortgage debt as a percentage of GDP continues to decline even 10 years into the expansion.



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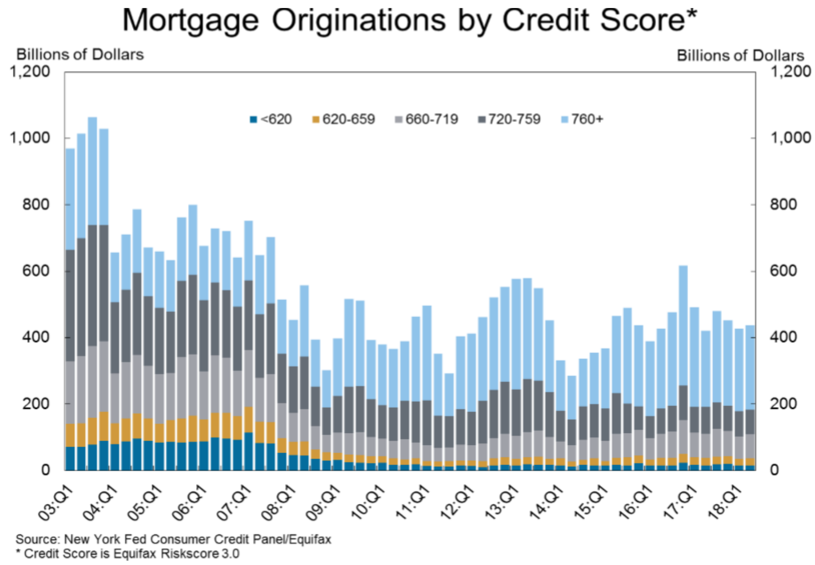
Looking at the health of the loans paints a different picture as well. According to the second quarter report on household debt and credit by the Federal Reserve Bank of New York, more than half of new mortgages went to borrowers with a top credit score (greater than 760) – a far cry from the previous expansion where most mortgages were given to people with much lower credit scores. The credit quality of the new mortgages being taken out has greatly improved, which helps explain why new delinquencies have significantly dropped off not just in mortgages, but in student loans as well. This paints an overall healthy credit picture so far.



Source: New York Fed Consumer Credit Panel/Equifax
* Credit Score is Equifax Riskscore 3.0

Conclusion

The growth in household debt above prior peaks may sound worrisome, but it's not necessarily so. Debt in and of itself is neither too high nor too low – it can only be judged relative to the capacity to service the debt. Income is a gauge of the capacity to service debt. The total number of Americans borrowing relative to the size of the economy and the household debt-to-income ratios remain well below prior peaks. In addition, the improvement in the overall credit quality of the new mortgages being taken may reflect improved management of household debt and a healthier and stronger economy.