March 7, 2024

Global Credit Weekly:

A (still) resilient consumer

BlackRock.

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Key takeaways

- The resilience of the U.S. economy – despite the Federal Reserve's swift rate hiking cycle – surprised many market participants to the upside in 2H2023, and the pace of 1Q2024 real GDP appears to be tracking at a still solid 2.5%. The U.S. consumer – which represents approximately 68% of U.S. gross domestic product (GDP) – has been and will remain key to the persistence of this economic resilience.
- Some market observers have pointed to a sharp increase in auto loan and credit card delinquency rates among subprime consumers as evidence of a broad-based weakening in the consumer. We take a more nuanced stance. Like the dispersion that is evident in the corporate credit and commercial real estate markets, within consumer credit there is significant variation across credit *type* (i.e., auto, credit card, mortgage) and credit *risk* (i.e., subprime, near prime, prime). Additionally, as we detail within, the delinquency trends *within* the subprime cohort may also be somewhat overstated, due to the impact of "credit score migration."
- The trends in the subprime consumer will be important to monitor, going forward, given the implications for economic momentum (and by extension, risk asset valuations). For the time being, we expect a moderating (but not severely deteriorating) U.S. consumer to prevail, given the ongoing strength in the labor market (Exhibit 1). Our company-level reviews of 4Q2023 earnings call transcripts in the U.S. retail sector also (generally) highlighted a selective consumer that remains focused on value, but one that is also resilient and willing to spend for the products and brands that matter most. Please see the Appendix on pages 8 and 9 for more detail.

Exhibit 1: In aggregate, labor demand continues to notably exceed labor supply in the U.S.

The ratio of U.S. job vacancies to U.S. unemployed workers, both seasonally adjusted

Source: BlackRock, Bureau of Labor Statistics. Captures data through January 31, 2024.

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The U.S. consumer remains key to economic resilience

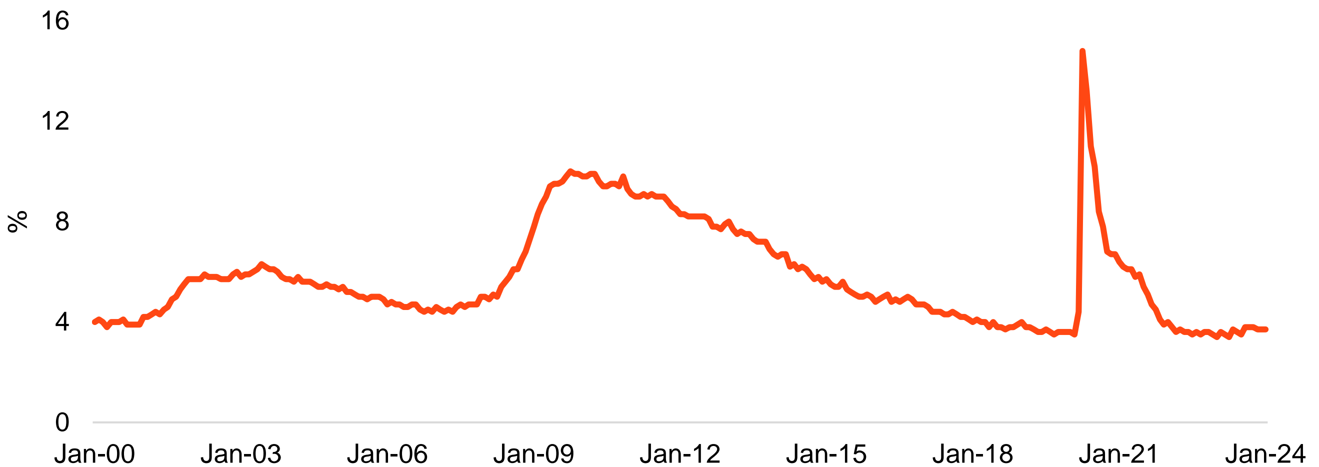
The resilience of the U.S. economy – despite the Federal Reserve's swift rate hiking cycle – surprised many market participants to the upside in 2H2023, with 3Q2023 real GDP of 4.9% (quarter-over-quarter, annualized) and 3.2% in 4Q2023. And while still early in the year, 1Q2024's pace looks to be tracking at a solid 2.5%, per the Atlanta Fed's "GDPNow" forecasting model (as of March 6th).

The U.S. consumer – which represents approximately 68% of U.S. gross domestic product (GDP) – has been and will remain key to the continuation of this economic resilience. So far, the consumer (in aggregate) has benefited from a rebalancing-but-still-healthy labor market. Exhibit 1 illustrates this by capturing the ratio of job vacancies to unemployed workers (often referred to by Federal Reserve officials and market participants as the "jobs-workers gap"). While this measure has moderated from the peak level of early 2022 – when there were *two jobs for every one unemployed worker* – it nonetheless reflects more labor demand than labor supply. As of January 2024, there were 8.86 million job openings vs. 6.12 million unemployed workers (for a ratio of 1.45x).

The solid U.S. labor market is also reflected in an unemployment rate that remains low by historical standards (3.7% as of January 2024; Exhibit 2), and a pace of job creation that was tracking at +289k on a three-month basis (Exhibit 3).

Exhibit 2: The U.S. unemployment rate has been below 4% since early 2022

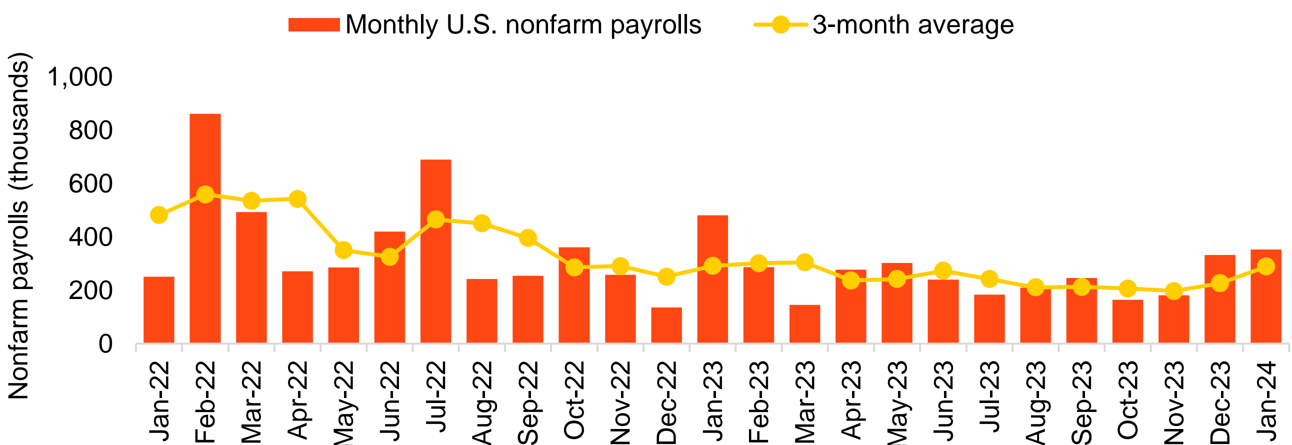
U.S. monthly unemployment rate (%), seasonally adjusted



Source: BlackRock, U.S. Bureau of Labor Statistics, St. Louis Federal Reserve Bank database (FRED). As of January 31, 2024.

Exhibit 3: Job creation has shown notable strength in the last few months

Monthly U.S. nonfarm payrolls and the three-month moving average of job creation



Source: BlackRock, Bloomberg, Bureau of Labor Statistics. Captures data through January 31, 2024.

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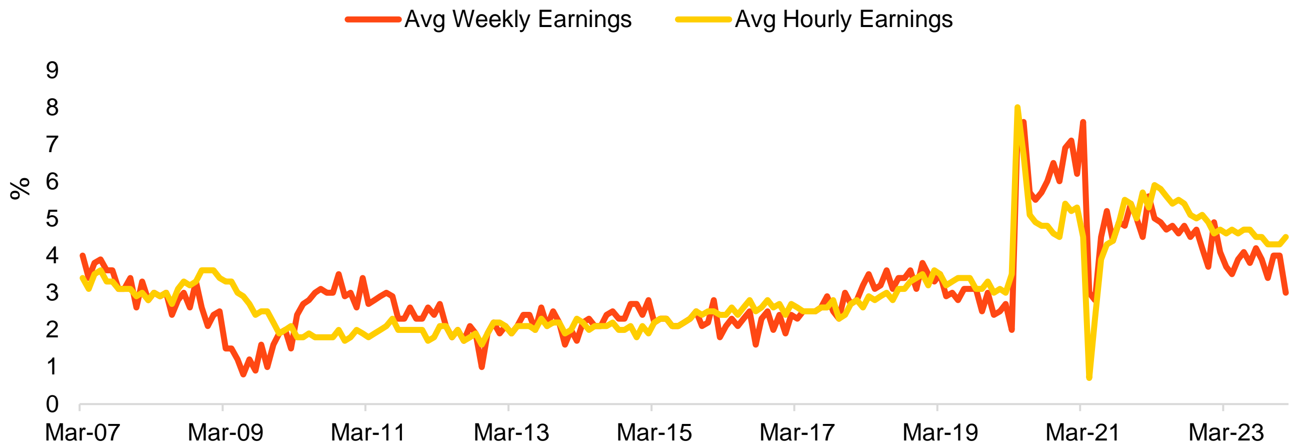
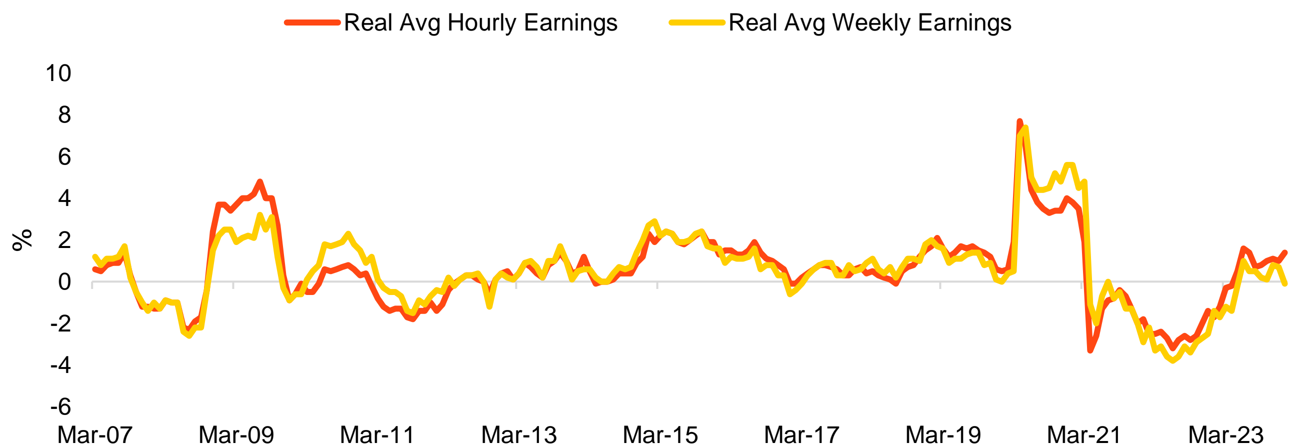
Another key support for the U.S. consumer has been the wage backdrop. While nominal wages have been moderating, they remain above the pre-pandemic trend (Exhibit 4). And perhaps more important for consumers' purchasing power in the economy, real (i.e., inflation adjusted) wages have improved since mid-2022 as the rate of inflation has been moderating (Exhibit 5).

Exhibit 4: Nominal wage growth remains above the pre-pandemic trend
Year-over-year growth (%, seasonally adjusted) in U.S. nominal average hourly and weekly earnings



Source: BlackRock, Bureau of Labor Statistics. Captures data through January 31, 2024.

Exhibit 5: Consumers' real (inflation adjusted) wages have improved vs. mid-2022
Year-over-year growth (%, seasonally adjusted) in U.S. real average hourly and weekly earnings



Source: BlackRock, Bureau of Labor Statistics. Captures data through January 31, 2024.

Dispersion under the surface

That said, while the U.S. consumer has demonstrated notable resilience in *aggregate*, there are signs of vulnerability in certain segments of the consumer credit market. This is not dissimilar, in our view, to the dispersion evident across the various subsets of the corporate credit and commercial real estate markets.

Recent data from the Federal Reserve Bank of New York (FRBNY) highlights some areas of deterioration. For example, consumer credit card balances, which totaled $1.13 trillion outstanding in 4Q2023 according to FRBNY, experienced a 14.5% year-over-year increase from 4Q2022. Credit cards tend to have variable interest rates, meaning consumers' debt service burdens rose as the Federal Reserve increased interest rates from March 2022 through July 2023, and left rates on hold since. Indeed, the average interest rate charged on credit cards rose from 16.2% in 1Q2022 to 22.8% in 3Q2023, according to data tracked by the Federal Reserve Board of Governors.

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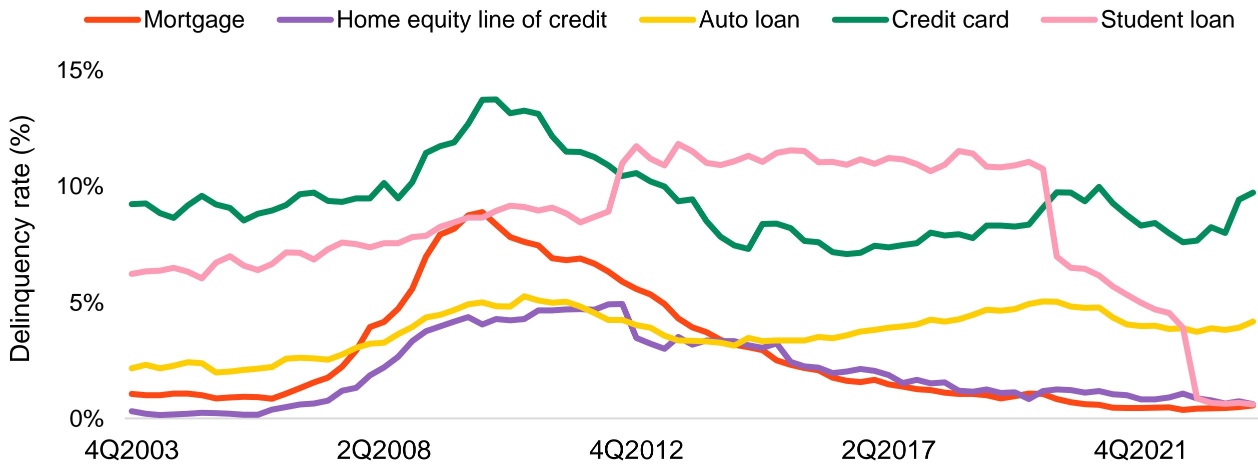
This has had an impact on delinquency rates. Credit card delinquencies lasting 90 days or longer, known as "serious delinquencies", rose to 9.7% in 4Q2023, their highest levels since 1Q2021, according to the FRBNY (Exhibit 6).

Auto loans totaled $1.61 trillion outstanding in 4Q2023 according to the FRBNY, a 3.5% increase from 4Q2022. As shown in Exhibit 6, the percentage of auto loans reaching serious delinquency status has risen modestly over the past few quarters and stood at 4.2% as of 4Q2023. Meanwhile, mortgage and home equity line of credit delinquencies remain very low – likely driven by the significant home price appreciation over the past few years, which has benefited those consumers who are homeowners (instead of renters).

Beyond the dispersion across credit *types* (i.e., credit card, auto, mortgage, etc.), there is also significant dispersion across consumer credit *risk* categories. Exhibits 7 and 8 illustrate this by plotting the delinquency rates for auto loans and credit cards *within* each risk cohort (i.e., subprime, near prime, and prime). The takeaway is clear: the subprime consumer has experienced a significant increase in delinquency rates and is tracking worse than the pre-pandemic trend. While some of this directional trend is intuitive given the developments in the post-pandemic economy (i.e., higher interest rates and a fading impact from pandemic support payments), we do believe there are some nuances to consider.

Exhibit 6: Serious delinquencies have increased across credit card loans

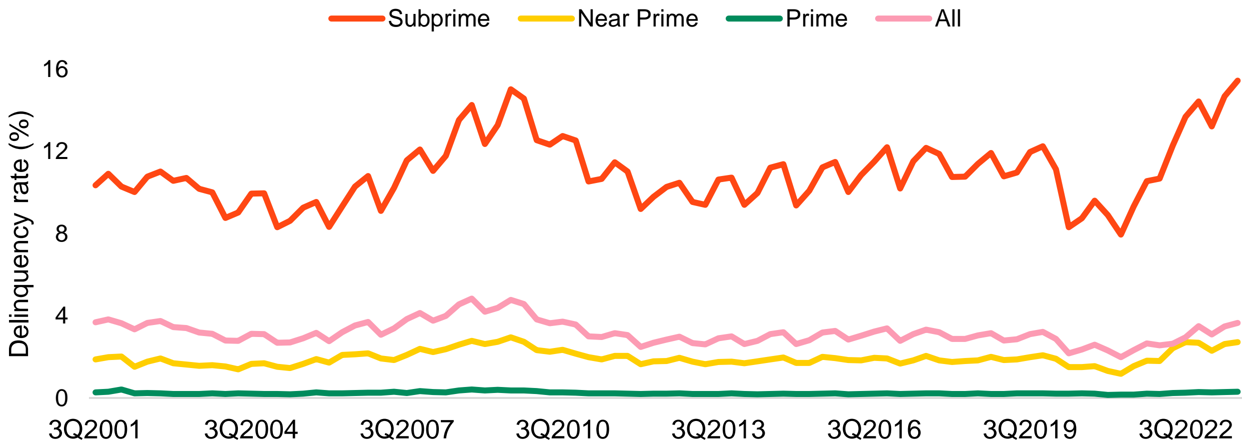
Percent of balance 90+ days delinquent by loan type



Source: BlackRock, New York Fed Consumer Credit Panel/Equifax. As of December 31, 2023.

Exhibit 7: Delinquency rates on subprime auto loans have reached two-decade highs

Auto delinquency rates (30+ days past due) as a percent of total, by credit risk category



Source: BlackRock, Federal Reserve Bank of New York Consumer Credit Panel/Equifax. Note: Share of credit scored-individuals in indicated credit risk category. Prime refers to credit scores above 719, near prime between 620 and 719, and subprime below 620. As of September 30, 2023.

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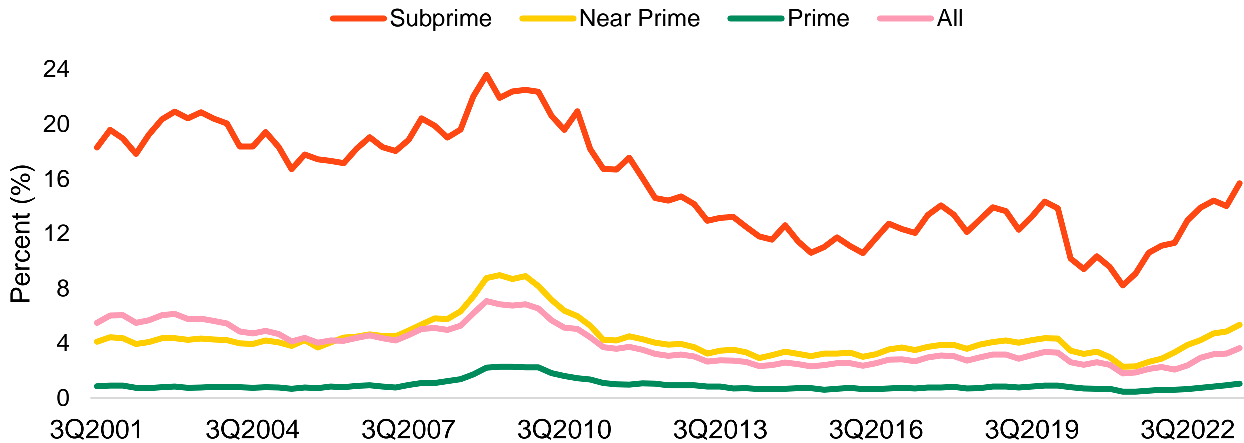
Exhibit 8: Delinquency rates for credit cards have also increased
Credit card delinquency rates (30+ days past due) as a percent of total, by credit risk category



Source: BlackRock, Federal Reserve Bank of New York Consumer Credit Panel/Equifax. Note: Delinquency measures the fraction of balances that are at least 30 days past due, excluding severely derogatory loans. Prime refers to credit scores above 719, near prime between 620 and 719, and subprime below 620. As of September 30, 2023.

Is the subprime consumer as weak as it appears?

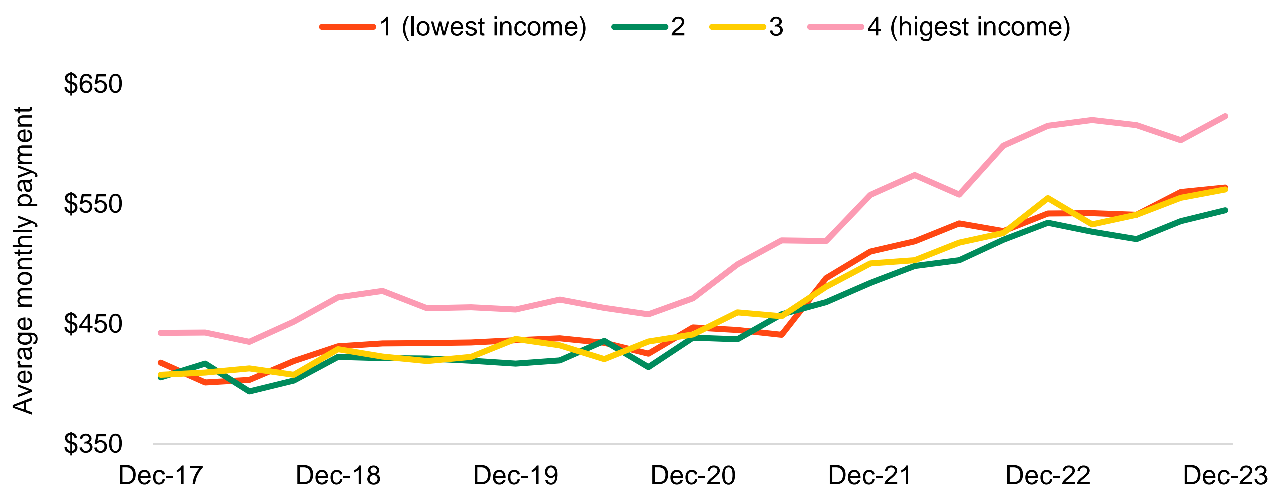
In our view, much of the increase in delinquency rates at the low-end of the consumer income spectrum can be attributed to some well-telegraphed developments, including:

(1) The fading of the post-pandemic fiscal transfer payments (i.e., stimulus checks mailed to households), which temporarily boosted consumers' financial flexibility,

(2) the resumption of student loan payments (in October 2023), which Goldman Sachs Global Investment Research estimates will result in a 7% decrease in income for the average household with student loans in the bottom income quintile[1], and

(3) higher interest costs and new/used car prices, which together have resulted in a notable increase in monthly car loan payments (Exhibit 9)

Exhibit 9: Payments on newly opened auto loans climb sharply
Average monthly payment (in U.S. dollars), by month originated and income quartile



Source: BlackRock, New York Fed Consumer Credit Panel/Equifax; IRS Statistics of Income. Note: Borrowers are categorized into income quartiles by ranking zip code average income from lowest to highest and splitting zip codes into four equally sized groups by population. As of December 31, 2023.

1) See "US Daily: Higher Interest Rates and Riskier Lending Are Driving the Rise in Credit Card Delinquencies," December 21, 2023.

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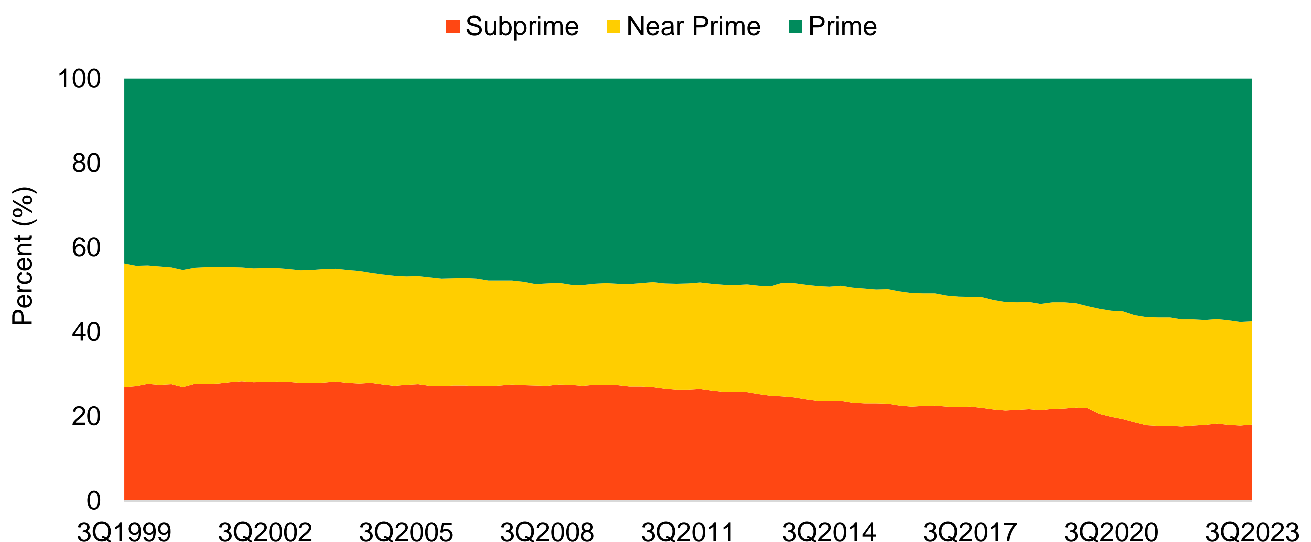
The impact of “credit score migration”

That said, another (more nuanced) driver of the deterioration in the subprime consumer cohort, in our view, is related to “credit score migration,” which may be optically raising delinquency rates *within* the subprime cohort of consumers – at least somewhat. Over the course of the pandemic, many borrowers experienced an increase in credit scores, due in part to pandemic fiscal support and forbearance programs, according to the Federal Reserve. As part of this broader “credit score migration” or shift in the credit score distribution during the pandemic, the Federal Reserve notes that the share of borrowers with subprime scores decreased to the lowest level seen since the late 1990s (Exhibit 10).

From this, riskier borrowers may have gained access to new borrowing privileges, such as additional credit cards or higher credit limits. As some of the “higher quality” borrowers within the subprime category migrated (higher) into other risk classifications, the subprime category was reduced in size. Therefore, the subprime delinquency rate may be *optically* higher, as the portion of delinquent consumers (i.e., the numerator of the delinquency rate calculation) is considered against a smaller underlying subprime population (i.e., the denominator). That said, *overall* delinquency rates (across all risk cohorts) would not be affected by this dynamic.

The trends in the subprime consumer will be important to monitor, going forward, given the implications for economic momentum (and by extension, risk asset valuations). For the time being, we expect a moderating (but not severely deteriorating) consumer to prevail, given the ongoing strength in the labor market. This is largely consistent with the commentary we have observed from our company-level reviews of 4Q2023 earnings call transcripts in the U.S. retail sector. In general, the public company commentary we reviewed highlighted a selective consumer that remains focused on value, but one that is also quite resilient and willing to spend for the products and brands that matter most. Please see the Appendix on pages 8 and 9 for more detail.

Exhibit 10: The share of subprime borrowers has fallen since the pandemic
Distribution of borrowers, by credit risk category



Source: BlackRock, Federal Reserve Bank of New York Consumer Credit Panel/Equifax. Note: Share of credit scored individuals in indicated credit risk category. Prime refers to credit scores above 719, near prime between 620 and 719, and subprime below 620.

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Appendix

Note: Reference to the company names mentioned herein (pages 8-9) is for illustrative purpose only and should not be construed as investment advice or investment recommendation of those companies.

Notable consumer related commentary from 4Q2024 U.S. retail sector earnings:

Nordstrom (March 5th):

- "We continue to see a cautious consumer that is mindful of discretionary purchases in light of inflation, higher interest rates, and the resumption of student loan payments."
- "We really are not seeing an elevated promotional environment. We didn't see it through Q4. We're not seeing it right now. So as best as we can tell, we don't anticipate an unusually elevated promotional environment."
- "Active, beauty, and women's apparel were our best-performing categories in the fourth quarter with strong growth versus the prior year."

Target (March 5th):

- "Discretionary declines moderated. Traffic trends rebounded. Our Q4 comps were the high end of our guidance."
- "…outlook on the consumer, which remains mixed. While there are some encouraging signs in the economy, there are also stubborn pressures impacting families and retails. Consumers say they still feel stretched. They are balancing a lot and having to make trade-offs to meet their needs of their families while sprinkling in the occasional luxury. And yet, their affinity for style and newness, plus early signs of disinflation, contributed to a sequential uptick in discretionary category performance over the last two quarters, something we aim to build on and accelerate. At the same time, we expect consumers will remain highly value conscious, hunting for great promotions and seeking comprehensive value in their purchases."

Macy's (February 27th):

- "Throughout the year, our consumer proved to be more resilient than expected. While there was pressure from ongoing reallocation of spends and non-discretionary items. Our focus on new and relevant private and national brands enabled us to effectively compete. The likelihood of a recession and now lower than it was a year ago. Inflation has slowed but so has labor and wage growth. As such, we expect our consumer to remain under pressure."
- "Over the next three years, we plan to take advantage of our leadership position, to aggressively grow our luxury nameplates. While cognizant of luxury brand headwinds with the aspirational customer stepping back…"
- "The first thing is that the consumer remains under pressure and as a result, what we're seeing across the industry. Our higher credit card balances and higher delinquencies really returning to more normalized levels…the last few years had an abnormally…low level of net credit losses, delinquencies…But now we're back to more normal times…what's reflected in our credit card revenues…is really the increase in net credit losses as we are more in a normalized environment."

Source: BlackRock, Bloomberg, company earnings call transcripts for the most recent earnings period (4Q2023).

Walmart (February 20th):

- "Across countries, we continue to see a customer that's resilient, but looking for value."
- "We're seeing more customers. We're seeing them more often. We're seeing a lot of new customers."
- "…customers are being choiceful and our customers are smart, and they recognize value really well."
- "In the quarter, we gained share in virtually every category. But notably, one of the biggest contributors in the quarter was in this income demographic from households that make more than $100,000 a year. So general merchandise as an example, two-thirds of the share gain that we had in the quarter was through this income demographic and digital channels. And what that illustrates, I think, broadly is that our value for convenience is every bit as much -- every grade is what it is for price. And that resonates to people regardless of the size of your paycheck. And so that's one of the reasons we think that we're gaining share. Our value proposition is resonating with customers and they're clearly shopping us in new ways versus how they have historically."

Lowe's (February 27th):

- "DIY customers continued to remain cautious with their home improvement spend and harsh weather impacted large parts of the U.S. in January."
- "Microeconomic factors like persistent inflation and a stagnant housing market continue to make DIY customers and consumers hesitant to spend on big-ticket purchases for their homes. And those who did engage in home improvement activities took on smaller non-discretionary projects with a heightened focus on value."
- "Overall, the consumer is financially healthy, but in this post-pandemic timeframe, customers are still showing a preference for spending on services with elevated demand for travel, restaurants, and other experiences. And while we anticipate these trends will normalize, the timing the timing is uncertain."
- "While softer DIY demand trends continue this quarter, we remain focused on highlighting value and convenience, both in our stores and online to a price conscious consumer…"
- "And while some consumers remain budget conscious, we are seeing others trade up for innovation…"
- "But if you think about the DIY consumer for a second, the consumer is healthy. And we feel good about the financial wherewithal of that consumer. They're simply choosing to leverage their spend in different places…"

Home Depot (February 20th):

- " We saw a continuation of a trend that we've been observing throughout the year with softness in certain big-ticket discretionary type purchases. Our customers continue to take on smaller projects while still deferring larger projects…However, we continue to see our customers trading up for new and innovative products."
- "And while there are signs that the economy is on the way towards normalization, the home improvement market still faces headwinds as we look ahead to fiscal 2024."
- "The interest rate environment is still one where, while we see our customers have the means to spend, they are taking more of a deferral stance with respect to large project demand. And we believe there was some pull forward of certain spend during the period of 2020 to 2022 that we're working out."
- "…as it relates to the promotional cadence, we haven't seen any difference, if you go back pre-pandemic to the promotional activity. We are in a very normalized environment. We do feel that pricing has kind of settled."

Source: BlackRock, Bloomberg, company earnings call transcripts for the most recent earnings period (4Q2023).

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