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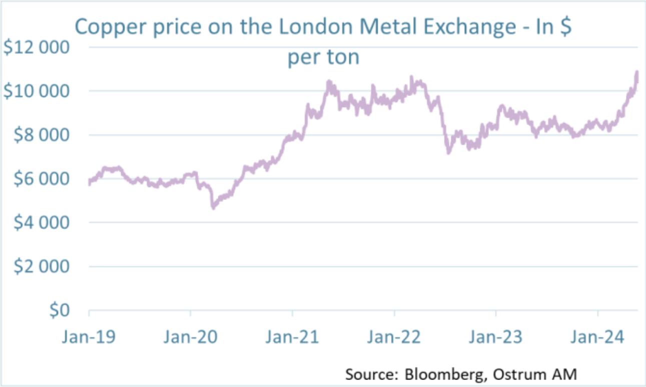
Topic of the week: US credit cards: higher card delinquencies but no stress for now
by Axel Botte

- The rise in delinquencies and a contraction in credit card lending in the first quarter is notable;
- Credit card delinquencies are highest among households whose credit card balances are close to the limit;
- Delinquencies outside credit cards remain muted;
- Credit standards on credit card loans have been tightened by banks;
- Credit card losses remain very low at large banks, as smaller institutions bear the brunt of the deterioration.

Market review: Nvidia, a distraction from the bigger picture?
by Axel Botte

- Nvidia leads tech higher but equities hit by higher rates;
- Fed minutes show some FOMC participants policy Is not restrictive enough;
- Stronger US PMI spark bond selloff, with Bund yields above 2.60%;
- Sovereign and credit spreads remain stable.

Chart of the week



The price of copper is at an all-time high. A ton of metal is trading at more than $10,400.

The energy transition metal par excellence is facing both high demand and recurring production problems, especially as the productivity of the deposits has been decreasing for several years.

Figure of the week

1.8

1.8-billiondollars. This represents global investment spending in clean energy last year. Investment rose 17% from a year prior.

Source: Bloomberg

Topic of the week

US credit cards: higher delinquencies but no stress for now

The US consumer is the largest source of global demand. The financial health of US households is therefore key to the economic outlook. The notable rise in delinquencies and a contraction in credit card lending in the first quarter could foreshadow a softening in consumption.

Living in debt

Will US household spending finally cool?

The consumer is the bedrock of the US economy. Household consumption has been hectic for years. The spending down of pandemic savings was indeed quite fast in the US compared with Europe. The latest reading on retail sales suggests private expenditure came to a halt in April. The control group retail sales series, which excludes volatile items and building materials, even declined by 0.3% last month. Though other retail indicators including the Redbook report paint a more nuanced picture, a moderation in household spending was long overdue. With a healthy labor market, tentative signs of weaker demand may be found in the consumer credit market, and credit card lending in particular.

Credit card delinquencies on the rise

The US consumer is a debt junky. Total housing debt balances grew by $206 billion in the first quarter, as reported by the New York Fed. Mortgage balances stood at $12.44 trillion at the end of March (+$190 billion). Outstanding balances of home equity lines of credit (HELOC) now amount to $376 billion, after a further $16 billion increase last quarter. The monetization of housing wealth to fund household expenditure appears to be back in fashion.

Household Debt and Credit Developments as of Q1 2024

CATEGORY	QUARTERLY CHANGE * (BILLIONS $)	ANNUAL CHANGE** (BILLIONS $)	TOTAL AS OF Q1 2024 (TRILLIONS $)
MORTGAGE DEBT	(+) $190	(+) $398	$12.442
HOME EQUITY LINE OF CREDIT	(+) $16	(+) $37	$0.376
STUDENT DEBT	(-) $6	(-) $9	$1.595
AUTO DEBT	(+) $9	(+) $54	$1.616
CREDIT CARD DEBT	(-) $14	(+) $129	$1.115
OTHER	(-) $11	(+) $31	$0.543
TOTAL DEBT	**(+) $184**	**(+) $640**	**$17.69**

*Change from Q4 2023 to Q1 2024
** Change from Q1 2023 to Q1 2024
Source: New York Fed

In turn, non-housing balances fell by $22 billion to $4.87 trillion. Credit card balances, which total $1.12 trillion, decreased by $14 billion during the first quarter but are still up 13.1% from a year ago. The first-quarter drop is mostly a seasonal pullback from year-end spending. Auto loan debt rose steadily by $9 billion to $1.62 trillion. Other balances, which include retail cards and other consumer loans, declined by $11 billion. Student loan balances were down a modest $6 billion to $1.6 billion outstanding.

Making sense of higher delinquency rates on credit cards

The higher delinquency rate on household debt across the board has caught the attention of market participants looking for early signs of a downturn in consumer spending. The situation is most acute for credit cards.

An increasing number of borrowers have indeed fallen behind on credit cards. The aggregate delinquency rate has now risen above 10%, well past its pre-covid average close. About 7% of credit card balances have transitioned into 90-day delinquency status in the first quarter.

Flow into Serious Delinquency (90 days+ delinquent)			
CATEGORY	Q1 2023	Q1 2024	YOY CHANGE
MORTGAGE DEBT	0.59%	0.92%	0.33%
HOME EQUITY LINE OF CREDIT	0.48%	0.52%	0.04%
STUDENT LOAN DEBT	0.94%	0.80%	-0.14%
AUTO LOAN DEBT	2.33%	2.78%	0.45%
CREDIT CARD DEBT	**4.57%**	**6.86%**	**2.29%**
OTHER	4.35%	5.43%	1.08%
ALL	**1.08%**	**1.54%**	**0.46%**
Source: New York Fed			

Credit card delinquencies began rising in 2021 from historically low levels. Lower spending amid covid lockdowns (and hence credit card usage), unprecedented mortgage refinancing and relief from federal government transfers had facilitated households' deleveraging.

The New York Fed's micro-level data[1] reveals that a greater proportion of maxed-out borrowers have indeed transitioned into delinquency status in the first quarter of 2024. Maxed-out borrowers refer to credit card holders using 90-100% of their borrowing limit. The delinquency rate is close to 33% for this group which represent less than a tenth of credit card users and 16% of the credit card balance outstanding. Furthermore, the Generation Z (those born between 1995 and 2011) is overrepresented in the maxed-out category given their median credit limit of just $4.5k, short credit history and lower-than-average income.

In sum, new credit card delinquencies appear mainly traceable to maxed-out borrowers. The impact on spending from consumer deleveraging (via larger reimbursements of balances) should therefore be limited.

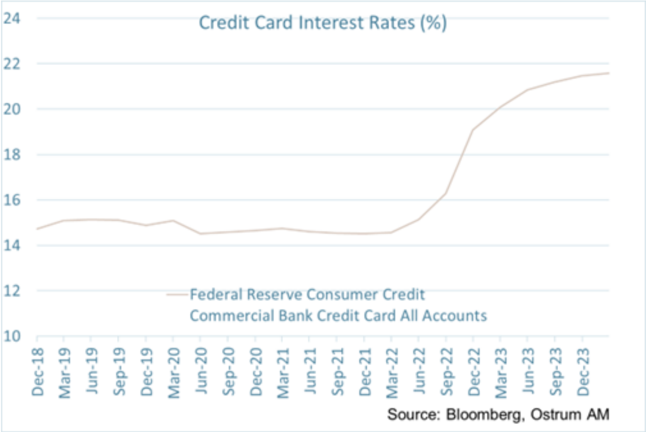
Credit card lending: evidence from the SLOOS survey

The Federal Reserve conducts a quarterly survey of bank lending conditions. A majority of banks report a broad-based cumulative tightening in credit standards since 2023. Banks increased the required credit score, cut the borrowing limit, and increased spreads over their cost of funding in the first quarter. The only tightening measure left unchanged is the minimum required

[1] Andrew F. Haughwout, Donghoon Lee, Daniel Mangrum, Joelle Scally, Wilbert van der Klaauw, and Crystal Wang, "Delinquency Is Increasingly in the Cards for Maxed-Out Borrowers," Federal Reserve Bank of New York Liberty Street Economics, May 14, 2024, https://libertystreeteconomics.newyorkfed.org/2024/05/delinquency-is-increasingly-in-the-cards-for-maxed-out-borrowers/.

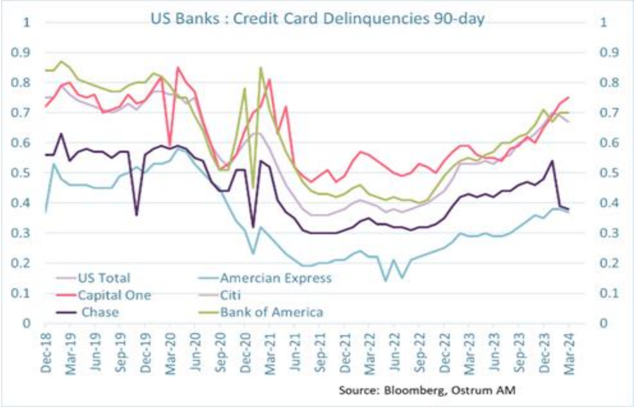
balance to be repaid each month.

The tighter bank lending conditions must be evaluated in the context of high interest rates and interest margin. The Federal reserve data show that average interest rates on credit card loans have jumped from around 14.5% at the start of the Fed's rate cycle to almost 22% at present. Credit card pricing has therefore overshot the rise in Fed rates by a considerable margin.

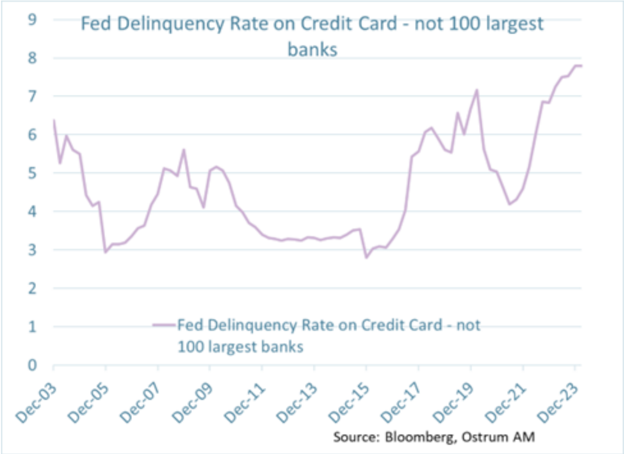


Given high interest rates on credit cards, households could be making a rational choice in paying down expensive credit card debt by raising cheaper debt linked to housing wealth. HELOC borrowing could thus improve US households' ability to pay in aggregate, as long as home prices keep rising. That is not to say that tapping housing wealth would improve the financial situation of young maxed-out borrowers who are less likely to own their homes. Delinquencies for this category of borrowers may worsen further. A repeat of the 2006 housing debt binge would not be desirable either.

Furthermore, the largest banks are less prone to attracting less creditworthy borrowers. As can be seen in the next chart, large players in the credit card business still report very low delinquency occurrences. For our sample of 5 large US banks, 90-day delinquency rates on credit cards range between 0.4 and 0.8%. Furthermore, net charge-off rates hover around 2.5-3% in the first quarter of 2024 which still leaves a significant margin given prevailing funding interest rates. For instance, spreads on AAA credit card ABS remain within 50 bps of SOFR swap rates.



Comparatively, Fed estimates suggest that banks not among the 100 largest US lenders record much higher delinquencies on their card businesses. The 7.79% delinquency rate in the three months to March is unheard-of. The 2008 crisis brought down Wall Street banks, the next banking crisis could primarily hit smaller/regional institutions.



Conclusion

The increase in credit card delinquencies in the US over the past two years has not gone unnoticed. The deterioration in consumer credit quality could hint at slower spending growth ahead. However, higher delinquencies appear to be concentrated in younger, lower-income individuals. Furthermore, the broader picture of US household credit quality is reassuring. Default rates remain low historically on housing debt as government relief programs lowered delinquencies on student loans to virtually zero.

Axel Botte

Market review

Nvidia, a distraction from the bigger picture?

Nvidia's results did not disappoint, but stock markets are worried about a prolongation of the monetary status quo.

It is rare for a company's results to overshadow a Fed publication. However, that was the case last week with Nvidia's release, which overshadowed the FOMC minutes from May 1st. The rebound in the US PMI brings monetary policy back into focus. The upward pressure on bond yields is resurfacing, particularly on the 2-year yield, which is once again approaching the 5% threshold. Wage increases in the Eurozone (4.7% in Q1 2024) will also complicate the ECB's communication on June 6th, after announcing a rate cut. Spreads, both on sovereign debt and credit, remain stable at levels close to the year's lows. High yield still benefits from the search for yield. The Nvidia effect, with its stock price tripling in a year, is fading, and small-cap stocks like the S&P are declining for the week. The European stock market is lagging behind.

On the financial markets, the 10-year Bund has reached the level of 2.60% (+8 bp in five sessions) while the T-note is still hovering around 4.50%. The European market even seems to overreact to the American services PMI. The Schatz rises to 3.10%. This is undoubtedly a sign that the market doubts a decoupling of monetary policies if the Fed leaves its rate at 5.50% for longer. The inversion of yield curves becomes more pronounced as real yields rise. The 2-10 year spread is trading below -50 bp in the euro area and -46 bp in the United States.

Sovereign bond spreads are unchanged despite movements in risk-free rates. The new issues (€18 billion placed) are still meeting high demand, with reduced yield premiums as on the Portuguese 30-year subscribed 3 times (4 bp, at 115 bp against swap). 10-year swap spreads are falling below 30 bp.

As for credit, spreads against swap on IG are stable at 77 bp. Financials tend to outperform, thanks to subordinates. By extension, riskier debts rated high yield shrink compared to investment grade. Credit derivatives confirm the return to compression with a Crossover around 290 bp.

Equity markets are in decline in Europe (-1%). Quality and growth factors are beating the market to the detriment of small caps (-1.5%). In the United States, sectors sensitive to long-term rates reacted as expected, despite the exception of Nvidia which is dragging technology in its wake.

Axel Botte

Main market indicators

G4 Government Bonds	27-May-24	1wk (bp)	1m (bp)	2024 (bp)
EUR Bunds 2y	3.09%	+9	+10	+68
EUR Bunds 10y	2.58%	+5	+1	+56
EUR Bunds 2s10s	-50.6bp	-4	-9	-12
USD Treasuries 2y	4.95%	+12	+2	+70
USD Treasuries 10y	4.47%	+5	-18	+59
USD Treasuries 2s10s	-48.5bp	-8	-20	-11
GBP Gilt 10y	4.26%	+13	-7	+72
JPY JGB 10y	1.03%	+4	+0	-25
€ Sovereign Spreads (10y)	**27-May-24**	**1wk (bp)**	**1m (bp)**	**2024 (bp)**
France	47bp	+0	+0	-7
Italy	129bp	+1	-4	-38
Spain	76bp	+0	-1	-21
Inflation Break-evens (10y)	**27-May-24**	**1wk (bp)**	**1m (bp)**	**2024 (bp)**
EUR 10y Inflation Swap	2.23%	-2	-5	+10
USD 10y Inflation Swap	2.57%	-2	-7	+16
GBP 10y Inflation Swap	3.74%	-2	-4	+20
EUR Credit Indices	**27-May-24**	**1wk (bp)**	**1m (bp)**	**2024 (bp)**
EUR Corporate Credit OAS	109bp	-1	-3	-29
EUR Agencies OAS	56bp	-1	-4	-14
EUR Securitized - Covered OAS	59bp	-1	-6	-20
EUR Pan-European High Yield OAS	335bp	-9	-33	-64
EUR/USD CDS Indices 5y	**27-May-24**	**1wk (bp)**	**1m (bp)**	**2024 (bp)**
iTraxx IG	51bp	+1	-4	-7
iTraxx Crossover	289bp	+2	-23	-24
CDX IG	49bp	+1	-2	-7
CDX High Yield	328bp	+3	-17	-28
Emerging Markets	**27-May-24**	**1wk (bp)**	**1m (bp)**	**2024 (bp)**
JPM EMBI Global Div. Spread	372bp	+8	+30	-12
Currencies	**27-May-24**	**1wk (%)**	**1m (%)**	**2024 (%)**
EUR/USD	$1.085	-0.166	1.137	-1.7
GBP/USD	$1.274	0.189	1.425	0.1
USD/JPY	JPY 157	-0.472	-0.631	-10.1
Commodity Futures	**27-May-24**	**-1wk ($)**	**-1m ($)**	**2024 (%)**
Crude Brent	$82.3	-$1.4	-$5.9	7.7
Gold	$2 340.8	-$85.9	-$2.1	13.5
Equity Market Indices	**27-May-24**	**-1wk (%)**	**-1m (%)**	**2024 (%)**
S&P 500	5 305	0.03	4.01	11.2
EuroStoxx 50	5 035	-0.77	0.57	11.4
CAC 40	8 095	-1.23	0.08	7.3
Nikkei 225	38 900	-0.43	2.54	16.2
Shanghai Composite	3 125	-1.45	1.18	5.0
VIX - Implied Volatility Index	11.93	-0.50	-20.63	-4.2

Source: Bloomberg, Ostrum AM

Additional notes

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