State of the U.S. credit markets
At last, signs of a real recovery
Executive summary
The economy’s recovery from the Great Recession may have started slowly, but it is accelerating — and it’s genuine. Economic indicators tell the story of improving business prospects. For credit issuers, the message is real, too. Now’s the time to look with fresh eyes at your post recession lending strategies. It’s time to rethink your approach to growth in this market and reassess the profile of the consumer prospect in relation to profitability and market share gains. As the recovery begins to take shape, many consumers are now turning the corner with it and will present as viable candidates to grow your portfolio profitably.

It’s difficult to find any solace in a recession, yet it can serve as an opportunity. Marathon runners and Tour de France bicyclists recognize that it’s in the uphill stage of the race that the lead changes.

Economic indicators improving
The nation’s economic rebound from the Great Recession is real. While economic conditions haven’t quite returned to pre-downturn levels, the rate of recovery, which first emerged in June 2009, accelerated at the end of 2011 and that improvement continues.

Economic indicators underscore the recovery. No one driver is propelling the economy, but moderate gains define many sectors. While it’s no boom, it’s also little gloom and no doom.

Consider how these indicators improved in 2011:¹

- Corporate profits rose 12.2 percent to a record high, and investment in engineering and scientific endeavors climbed a robust 10.2 percent
- Exports rose 6.8 percent and set a new record
- Production has expanded steadily, increasing 3.5 percent in 2011, while capacity utilization also has risen substantially, climbing another 1.6 percent last year

As a result of increased business investment and improved production, unemployment levels — a major lagging indicator in all recoveries — are starting to show real signs of improvement, with over-the-year declines in every state but New York as of January 2012.²

The national unemployment rate also has dropped or stayed the same for seven consecutive months and stood at 8.2 percent in March, below the year-earlier 8.9 percent and March 2010’s 9.8 percent.

Employment levels also have climbed in recent months, averaging 212,000 in the first quarter. The gains would have been higher except for layoffs in the local and state government sectors, which nearly offset gains in manufacturing, retail and professional services.

¹U.S. Bureau of Economic Analysis
²U.S Bureau of Labor Statistics
The unemployment number nationally is not expected to return to normalized levels until housing comes back in a significant way, which likely will not be until 2014. However, the increase in the nation’s gross domestic product will continue to contribute to increased private-sector hiring. This will slowly and consistently begin to affect the national number, which has hovered near 10 percent for close to 24 months from when the recovery officially began.

Consumer spending has been steadily increasing. Retail sales, up more than 8 percent over 2010, showed strong gains through the last half of 2011 and the early reports for 2012 see that trend continuing. Much of the increase can be attributed to new auto sales, but a good portion also is the result of discretionary spend on both clothing stores and restaurants — areas of the retail sector that took a big hit through 2009 into 2010. The rebound in discretionary purchases by many consumers shows a return to confidence for much of the country as the economic recovery begins to take hold in major markets.

**Consumers continue to manage significant debt obligations**

On the debt front, overall burdens still remain high for many consumers despite further declines in outstanding loan balances as 2011 ended. Total outstanding consumer debt has fallen more than $1 trillion since its peak in 2008 but still stands at $10.5 trillion as of Q4 of 2011.

Total consumer debt saw further declines in Q4 of 2011, by $387 billion from the prior year’s quarter end. That decline was at a slower pace than the previous year but still high as a result of continued consumer bankruptcy filings in states where the recovery was slow to take hold and the recession hit the hardest.

Not all consumers, however, reduced their debt burdens last year. Super-prime VantageScore® consumers — those with scores of 901 to 990 — increased their debt by a $100 billion from Q4 of 2010, notably in new mortgage, bankcard and auto debt.

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1[^Mihaylo College of Business and Economics, California State University, Fullerton]
2[^U.S. Census Bureau]
3[^Experian’s File One™]
4[^VantageScore® is owned by VantageScore Solutions, LLC.]
Lending activity quickens

New lending has picked up, although 2011 brought a mixed story for that indicator. Automotive loans and bankcard originations were the biggest positives, as consumer confidence began to recover in response to improving economic factors.

Auto loan originations hit a prerecession level of $97 billion in Q4 of 2011. It was the fourth consecutive quarter where auto origination volumes reached $90 billion or greater. This volume is expected to continue through 2012 as pent-up demand for auto lending continues — note that the average age of a car on the road today is 10 years. In addition, the continued demand for vehicles will boost manufacturing, and this will improve the outlook for jobs in auto-producing states such as Michigan.

Bankcard lending also showed signs of an accelerated recovery in 2011, with new bankcard originations reaching $62 billion in Q4. The volumes at Q4 were the strongest realized since Q4 of 2008, when bankcard originations were near $70 billion. New card growth has been steady since, with a year-over-year growth rate of 30 percent in dollars originated in Q4 of 2011. The latest trends signal that a return to confidence for many consumers — which climbed in April to a four-year high\(^7\) — is being matched to some degree by lenders’ confidence in boosting loan originations.

\(^7\)The Bloomberg Consumer Comfort Index (COMFCOMF) in the period ended April 1, 2012
The story for new mortgage lending is very different, however. New mortgage lending remained weak as 2011 closed out, but the origination volumes of $407 billion in Q4 represent both an increase from the previous three quarters in the year and a heavy weighting toward refinance activity. More than 75 percent of dollars originated for single-family home purchases in Q4 of 2011 were refinance volumes. Additional refinancing activity is expected into early 2012 as interest rates remain low, providing a silver lining to the persistently slow activity in this sector. The latest wave of refinance activity indicates that many homeowners are still striving to stay in their homes and smooth out their cash flow through refinancing.

Figure 2: Origination volumes by product, in $Billions
Delinquencies continue to trend lower
Loan delinquencies continue to show signs of improvement for most lines of business. Tighter lending standards and a change in payment hierarchy have sparked substantial improvements in the performance of newer originations in auto and bankcard loans.

Overall bankcard delinquency rates are down significantly from the levels realized in 2009 through 2010. The 30-plus days past due (DPD) delinquency rate at Q4 of 2011 for bankcard was 3.8 percent, down from 5.3 percent a year earlier. Total 30-plus DPD exposure levels also are down given the decline in delinquency behaviors, despite the increase in balances from the prior year. Total exposure for 30-plus DPD delinquency is $23 billion out of the $614 billion in total outstanding bankcard balances as of Q4 of 2011.

As noted earlier, auto loan obligations appear to have risen to the top of the payment hierarchy for many consumers, as indicated by the low delinquency rates through the downturn. However, a slight increase in delinquency levels for auto loans materializing in late 2011 can be attributed to continued economic stress in some markets. While many consumers continue to make their auto debt obligation a priority, unemployment levels in each individual state will influence payment behaviors for this portfolio.

For instance, Mississippi, the state with the highest auto loan delinquency rate in Q4 of 2011 (6.9 percent), also has one of the highest unemployment rates (10.4 percent as of December 2011). The state with the lowest auto loan delinquency rate, North Dakota (2.1 percent), has the lowest state jobless rate (3.3 percent).

*As a percentage of balances outstanding
"Delinquency rate represents 30 days past due, through charge-off as a percentage of trades; Experian’s File One"
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Figure 3: 30-plus DPD delinquency rates as a percentage of balances by product

Housing will continue to struggle through 2012

Housing remains a major stumbling block for the economy, and it promises to be some time before the housing market produces a real rebound from the 2008 bust. Mortgage-lending volumes remain at extremely low levels, despite record low interest rates. A new round of declines in home prices in key markets as 2011 ended compounded troubles in this sector of the economy. The national home price index fell by 4 percent from a year ago, with many major markets seeing further price declines in excess of 10 percent from a year earlier.11

Mortgage delinquency exposure remains high, but 30-plus DPD balances have decreased for 10 consecutive quarters, falling to $565 billion in Q4 of 2011. Regionally, mortgage delinquencies represent 6 percent to 8 percent of all mortgage debt, except in California and Florida, which were especially hard hit by the credit crunch and recession and continue to see such delinquencies representing at least 10 percent of mortgage loan outstanding balances.

11S&P/Case-Shiller Home Price Indices, December 2011
Further economic gains anticipated
Economists, for the most part, anticipate further improvement in key business barometers over the next few years. They foresee inflation-adjusted gross domestic product for the United States rising this year and in the next two years by a moderate amount, with consumer spending also increasing, but not into troublesome territory.

Until housing rebounds, the nation’s unemployment rate is expected to stay relatively flat from its March 2012 level of 8.2 percent. The increase in gross domestic product will continue to contribute to increased private-sector hiring, which will slowly have a notable effect on the overall number. As the economic expansion continues in 2012, expectations put the national unemployment rate at just above 7 percent as we close 2013, normalizing at just under 6 percent by 2015.

Final considerations
The nation’s economic recovery shows signs of real momentum. While it may be slow, it will be steady. Consumers continue to exhibit signs of increased confidence, and this is helping to bring discretionary spending back online.

As for lenders, 2012 is the year for them to return to pre-recession strategies if they are to grow significantly. They should concentrate on specific markets and portfolios. They must mitigate vanilla offerings of credit with market share gains.

Why? Because this economic rebound is real, and savvy lenders — just like those marathon runners and bicycle racers — understand that it’s in the uphill stage of the race that they can gain competitive advantages.