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SFA Research Corner

U.S. Credit Card ABS Tacking Into Headwinds Stays the Course for Now

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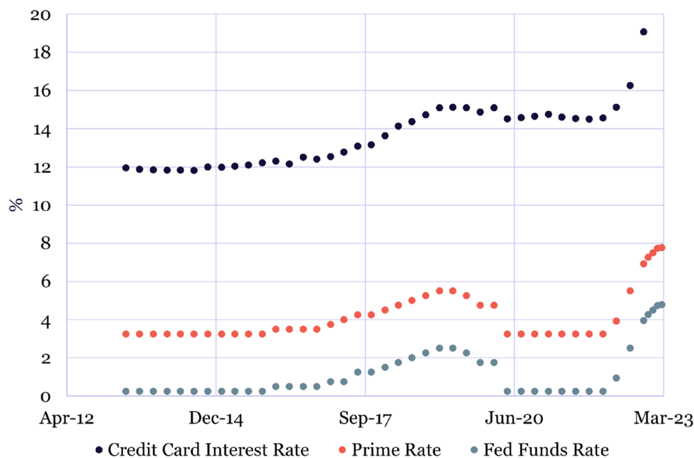
On March 22, the Federal Reserve raised the benchmark rate for the ninth time in the past 12 months by 25 bp, leaving open the possibility of tighter monetary policy going forward. Below, we look at the impact of rising rates on credit card debt and securitization trends in this sector.

In his comments, Chair Powell prioritized inflation, reiterating that the Fed is "strongly committed" to bringing inflation down to 2%, noting that "inflation remains too high, and the labor market continues to be very tight." He acknowledged that "events in the banking system over the past two weeks are likely to result in tighter credit conditions for households and businesses, which would in turn affect economic outcomes." While it is too soon to understand the extent of those outcomes, Chair Powell anticipates that "some additional policy firming may be appropriate."

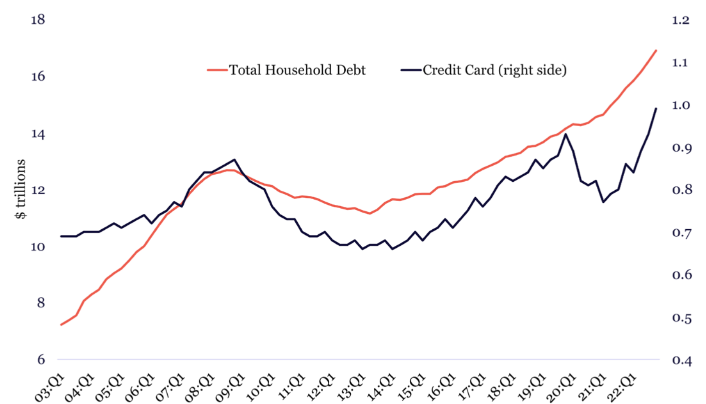
Unlike auto loans, which track the yield on the 5-year Treasury bond, and mortgages, which track the 10-year Treasury bond, credit card rates are tied to the prime rate, the rate at which commercial banks lend to their most creditworthy customers. Since the prime rate moves in tandem with the Federal Funds rate, credit card rates are particularly sensitive to increases in interest rate, typically increasing within one or two months after a Fed rate hike.

Credit Card Interest Rate Sensitive to Changes in Fed Funds Rate Through Prime Rate



Source: Board of Governors of the Federal Reserve System, G.19 Consumer Credit

Credit Card Debt Nears Record $1 trillion; Up 15% Year Over Year



Source: New York Fed Consumer Credit Panel/Equifax

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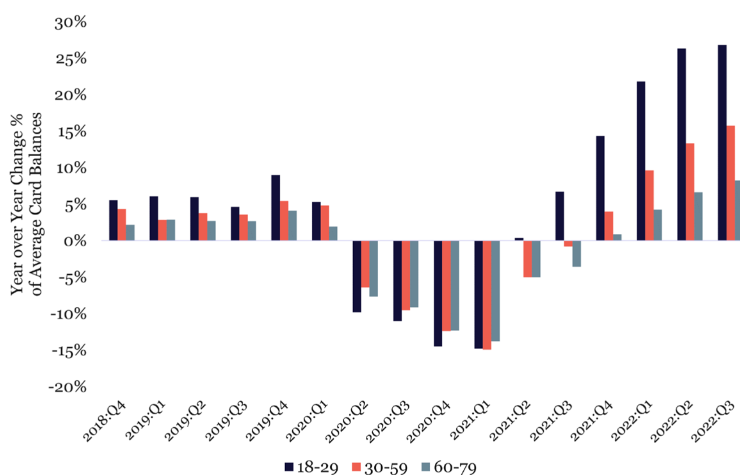
Credit card debt neared a record $1 trillion in 2022. Credit card debt rose 15% on the year, nearly double the inflation-driven 8% rise in total household debt (excluding credit cards) for the same period. The increase in card balances has been attributed to robust demand, higher prices, and rising interest rates. Although card debt makes up less than 6% of the $17 trillion total household debt, its rapid increase over the past year is a trend regulators and market participants have been watching.

According the [New York Fed's Consumer Credit Panel], 30- to 59-year-olds, who hold 63% of all card debt, saw their average credit card balance rise 16% for the year, while 18 to 29-year-olds, who hold 7% of all card debt, saw their average card balances rise 27% for the same period.

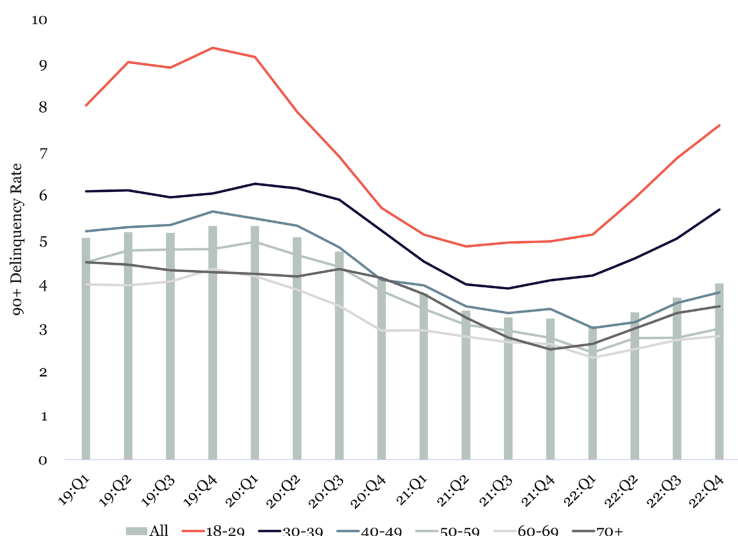
Average Credit Card Balances Rose Fastest for 18- to 29-Year-Olds



Source: New York Fed Consumer Credit Panel/Equifax

Faced with higher balances and higher interest rates, card holders who don't pay off their balances in full every month are subject to higher minimum monthly payments. This is particularly challenging for 18- to 29-year-olds, as this group has been missing payments more than any other age group even as they continue to benefit from extended student loan forbearance. The share of 18- to 29-year-olds that became 90+ days past due in 4Q 2022 rose 11% from the 3rd quarter and 53% from one year prior. This is meaningfully above the 9% and 25% increases recorded for all the age groups for the same time periods, respectively.

90+ delinquency rate for 18- to 29-Year-Olds Rose 53% YOY compared to 25% For All Age Groups



Note: 90+ delinquency data includes charged-off balances, which are not reported in bank delinquency rates. The New York Fed Consumer Credit Panel includes this data to present a fuller picture of the overall debt obligations of the consumer.
Source: New York Fed Consumer Credit Panel/Equifax, Liberty Street

Despite these broader credit trends, U.S. credit card ABS continue to perform well as ABS pools overwhelmingly reflect accounts with strong credit characteristics. Moody's Credit Card ABS Sector Update for Q1 2023 shows that the charge-off rate for the Big Six bank card issuers (Bank of America, Citibank, Capital One, Chase, Discover, and American Express) increased faster for its broader portfolio than from their ABS trusts. According to the rating agency, "the Big Six trusts held well-seasoned, geographically diversified pools of mostly prime quality borrowers." All the accounts in the Big Six trusts were older than five years and for all but one trust, the share of accounts tied to cardholders with FICO scores less than 660 was limited to 6%. These metrics will help insulate the performance of these accounts as headwinds from high interest rates, sticky inflation, and an expected softer labor market will continue to challenge the consumer moving forward.

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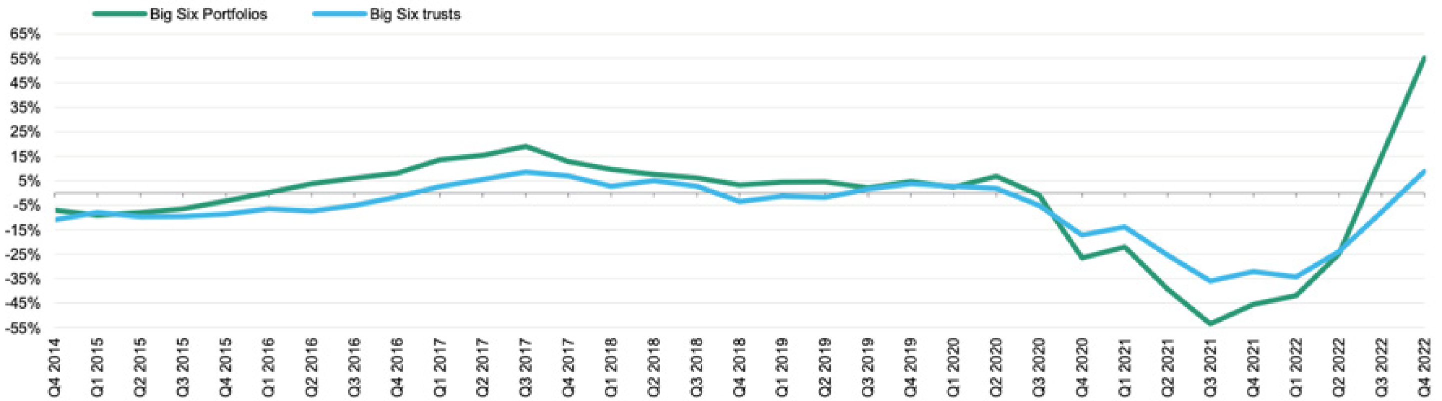
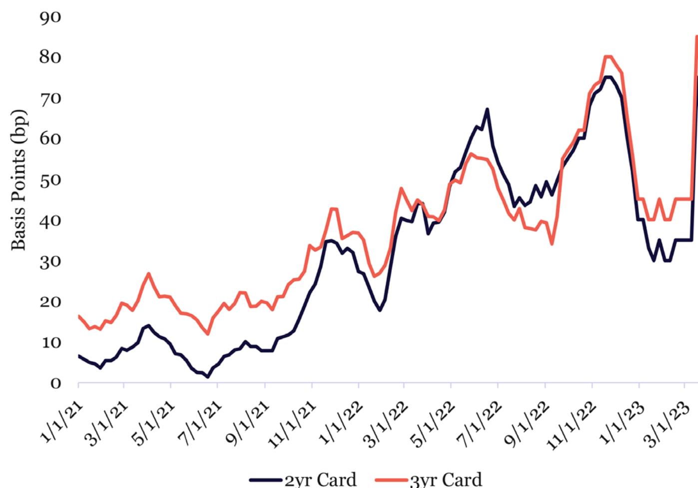
Charge-off Rates of Big Six Managed Portfolios Increased Year-Over-Year in Q4 2022
(Year-over-year charge-off rates on a quarterly basis)



Note: Portfolio data represent net charge-offs, while trust data represent gross charge-offs. Trust figures are an average of charge-offs from American Express Credit Account Master Trust, BA Credit Card Trust, Chase Issuance Trust, Capital One Multi-asset Execution Trust, Citibank Credit Card Issuance Trust and Discover Card Execution Note Trust. Portfolio figures are averages of information listed by card issuers in their respective corporate financial reports. Source: Moody's using data compiled from Company filings.

Strong credit performance notwithstanding, the credit risk spreads on triple-A Credit Card ABS widened, and prices moved lower, as investors paused to reassess broader credit risks in the wake of SVB's demise. Despite subsequent news of liquidity challenges in the banking sector, risk spreads on highly rated credit card ABS have recovered modestly as investors see the asset class's strong credit performance and high-quality loans as a safe harbor from intensifying credit headwinds.

AAA Card ABS Credit Risk Spreads to Benchmarks Widened with Broader Market in the Wake of SVB's Demise



Source: Deutsche Bank Research