Americans With Best Credit in Decades Renew Economy in Borrowing

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By Shobhana Chandra and Steve Matthews

Aug. 6 (Bloomberg) -- Americans have made progress putting their finances in order and are ready to borrow again -- giving the world's largest economy another driver of spending and growth.

Household net worth soared to a record high in the first quarter, Federal Reserve data show, and the financial-obligations ratio relating consumer debt to income matched the lowest in 33 years. Consumer loans are rising, and the American Bankers Association reports the share of delinquencies on bank cards is the smallest since 1990.

"Household finances are in the best shape in decades," said Joseph Carson, director of global economic research at AllianceBernstein LP in New York, with $435 billion in assets under management. "We now have a creditworthy borrower. It's a powerful ingredient" for the U.S. expansion and "definitely a step up from where we have been."

Credit is thawing gradually for residential mortgages, one reason new-home purchases in June reached the highest since 2008. Lenders also are easing standards for auto loans to expand the pool of buyers and drum up more business. That has put car sales on track for the best pace since 2007, helping companies including General Motors Co., Ford Motor Co. and parts maker Lear Corp. to report better-than-estimated earnings.

Gabriela Magallanes, 23, a Raleigh, North Carolina, hospital research assistant, bought a black 2013 Hyundai Elantra in May after her 24-year-old car broke down. She tapped the auto manufacturer's finance subsidiary for a 60-month loan at 2.9 percent, with monthly payments of $337.

Making Payments

"It was the best thing for the buck," said Magallanes, whose $19,000 purchase has Sirius XM Radio, Bluetooth-enabled hands-free calls and seat warmers among its features. "I definitely could not have gotten a better rate," and "felt very secure I could make my payments."

Total consumer borrowing climbed by $19.6 billion in May, the biggest gain in a year, as Americans charged more purchases on credit cards and increased school and automobile loans, Fed figures showed.

Households may become even more open to taking on debt as property values appreciate, stock prices hover near a record high and improving job prospects boost confidence. Payrolls rose

by 162,000 in July, and the unemployment rate fell to a more than four-year low of 7.4 percent.
The U.S. is entering a new, “stronger growth phase” as healthier finances revive borrowing, Carson said. Credit will spur consumer spending, the biggest part of the economy, generating business investment and jobs to extend the expansion well beyond a fifth year since the recession ended in June 2009, he said.

Investors Benefit

The credit-driven cycle also is good for investors, said James Paulsen, chief investment strategist in Minneapolis for Wells Capital Management, which oversees more than $340 billion. The improving outlook could help give the Standard & Poor’s 500 Index “another nice run of double-digit gains” in 2014 after an advance of as much as 20 percent in 2013, he said.
Shares of financial companies such as banks “will continue to outperform as they’re right at the heart of the credit-creation process, which is becoming noticeable,” he said. The S&P 500 Financial Index of 81 institutions is up 26 percent this year, compared with a 20 percent increase for the S&P 500.
Industrial, materials and technology stocks also are good bets in this environment, according to Paulsen. While consumer cyclicals have less room to build on their already outsized increase, if unemployment falls close to 6 percent, “all of a sudden you’d see a lot more demand for credit” and spending.

‘Unusual’ Confluence

An “unusual” confluence of three metrics is sparking the rebound in finances, laying the foundation for the credit upswing Carson said he anticipates in the next year.
Household wealth measured by net worth soared to $70.3 trillion in the first quarter and may have set a new record in the second, he estimates. It has rebounded almost $20 trillion from its recession low point. As of March, the two-quarter average for the financial-obligations ratio was 15.2 percent, matching the lowest since at least 1980, according to Carson’s calculations based on revised income data issued last week.
Americans also have more readily available funds to cover what they owe. Household liquid assets -- financial assets excluding pension and insurance reserves -- rose by $10 trillion in the past four years, and the ratio of coverage for liabilities is 2.43, the highest since 2000, Carson said.

Take Risks

“We’re starting to see consumers willing to take more risk and spend” because these indicators “are all very, very strong,” he said. “This will be a more-sustainable recovery because we have these pillars in place.”

Bank of America Corp., the second-largest U.S. lender, reported a 63 percent jump in second-quarter profit and said its credit-card issuance is the highest since 2008, while average retail spending on active card accounts rose 9 percent from a year ago.

“You’ve seen growth in our lending across the board, and that indicates that people are willing to take risk,” Brian T. Moynihan, chief executive officer of the Charlotte, North Carolina-based bank, said on a July 17 teleconference. “A year ago, people were not using lines and weren’t asking for a lot of lines, and that’s changed in the last couple quarters.”

Visa Inc., the biggest bank-card network, reported a fiscal third-quarter profit that beat analysts’ estimates, helped by growth in U.S. debit- and credit-card purchases.

Affluent Consumers

Affluent customers have “been the driver of the credit spend that we have been reporting over the past year,” Byron Pollitt, the Foster City, California, company’s chief financial officer, said on a July 24 earnings call. “In the last quarter or two, we are starting to see some participation from the next income cohort down.”

American Express Co., the largest credit-card issuer by purchases, Discover Financial Services, and MasterCard Inc. also reported better-than-estimated quarterly profit.

Bank-card delinquencies dropped to 2.41 percent of accounts in the first quarter, the lowest since June 1990, and payments 30 or more days overdue fell in 11 of 13 categories, according to the American Bankers Association.

“We’re on the cusp of this trend” toward more risk-taking, said Keith Leggett, the Washington-based association’s senior economist. “We’re starting to see an improvement on both the demand and supply side of credit. The consumer will become a bigger contributor to economic growth,” and “credit will play a supportive role in that.”

Loan Requests

Lenders also are responding to the U.S. outlook, according to Daryl Moore, chief credit officer at Evansville, Indiana-based Old National Bancorp. “Now that we’ve moved into a period where there is probably less uncertainty with respect to the economy, you can take on a little more inherent credit risk”

compared with a year or two ago, Moore said on a July 29 conference call with analysts.
Domestic banks generally reported easing their lending standards and experiencing stronger demand in most loan categories during the past three months, the Fed said in its quarterly survey of senior loan officers released in Washington yesterday.
Credit demand and supply have been slow to recover because the housing rebound was delayed, unlike after most recessions, Carson said. Now home sales are rising, foreclosures have waned and banks are more willing to lend against an asset that's gaining value, he said.

Rising Prices

Property prices may jump 11.8 percent this year after climbing 7.3 percent in 2012, and mortgage debt as a share of disposable income -- 76 percent as of the first quarter and the lowest since 2003 -- will continue to fall, said Michelle Meyer, a senior U.S. economist at Bank of America in New York. House-price gains have translated into a $1.8 trillion boost to household wealth, recovering almost one-third of the cumulative loss since the peak of the real-estate boom, she said.
"Consumers feel wealthier and more comfortable spending today in the anticipation of wealth in the future," Meyer said.
This effect, which is "fairly modest now," will provide a bigger lift to consumption over time as the housing recovery helps to "heal households' balance sheets, which ultimately will allow for greater credit creation down the line."
Carson said the rebound in housing and employment needs to be sustained for credit to pick up. Consumers have learned it isn't good to take on too much debt, so "there probably won't be a rush to spend; it'll be gradual."

Emergency Fund

Daniel Hurst, 22, a website designer who graduated in December from Georgia State University in Atlanta, wants to replace his 10-year-old Toyota Camry in the next year, build up an emergency fund and maybe buy a new home down the road. So he's setting aside about 10 percent of his income for savings.
"It is still going pretty good, but the car is on its last legs," Hurst said, adding that the vehicle has 170,000 miles.
"When I need to get a car, I will have the money and it won't break the bank."
The improvement in borrowing and lending is "not strong enough to get front-page coverage yet," Wells Capital's Paulsen said. "Credit was a bad thing for so long, it is just now

starting to become OK again." While that view may change over time to "it's great, job-creating credit is back," he doesn't anticipate "another bubble economy or another Gordon Gekko" environment, referring to the fictional character who came to personify unrestrained greed in the film "Wall Street."

Near Zero

Mortgage rates have climbed from historic lows recently in anticipation of the Fed's plan to pare asset purchases. Even so, Americans may see "almost no effect" on the costs of credit cards and auto loans because those are linked to the target federal funds rate, which the central bank may keep near zero until 2015, according to Barry Bosworth, an economist at the Brookings Institution in Washington.

Meanwhile, "the Fed has to be pretty pleased with the dramatic improvement in household finances" that will help keep this expansion going, Carson said. It indicates that over time, policy makers "can provide less accommodation."

The pickup in credit is noteworthy, he said, because "you can put in all the easy monetary conditions you want but at the end of the day, if the consumer doesn't take advantage of those and banks aren't willing to lend, nothing will work."

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