

## US: ECONOMIC RESILIENCE DESPITE HIGHER RATES. THE ROLE OF HOUSEHOLD FINANCES

In the US, household deleveraging, fixed rate mortgages, rising financial income on the back of higher interest rates and dividends, in combination with an increase in net worth have contributed to the resilience of households in an environment of aggressive monetary tightening. Nevertheless, some caution is warranted. Aggregate data, by construction, do not shed light on the heterogeneity of households. The financially fragile categories will need to be monitored closely in an environment of high rates for longer, in view of possible spillover effects to the broader economy should their situation worsen significantly.

Faced with a swift and huge policy tightening by the Federal Reserve, the US economy has been surprisingly resilient. Household spending has played an important role in this respect, underpinned by the run-down of excess savings accumulated during the pandemic, the pace of job creations and strong wage growth. The financial situation of households has also helped. Despite a jump in interest rates on mortgages and credit card balances, the debt service -which includes principal repayments- in percent of disposable income has been stable in recent years (chart 1), reflecting the beneficial impact of household deleveraging in previous years. Indeed, after peaking at 100% in the first quarter of 2009, household debt as a percent of GDP has been on a downward trend -only briefly interrupted by the drop in GDP during the pandemic- to reach 73.5% in the third quarter of 2023, the latest available data (chart 2). This stands in sharp contrast with the experience in the run-up to the recessions starting in March 2001 and December 2007, when the debt service ratio recorded a significant increase. Household resilience has also benefitted from the fact that the bulk of mortgage debt outstanding has been contracted at fixed rates. Based on data from the 2019 survey of consumer finances, "about 40% of U.S. households have mortgages, of which 92% have fixed rates and the remaining 8% have adjustable rates."<sup>1</sup> This protects households from an increase in mortgage rates and the latter essentially influence the economy through the demand for new mortgages<sup>2</sup>.

When analysing monetary transmission, the focus tends to be on the negative impact of higher interest rates. However, the latter also generate an increase in financial income and, as shown in chart 3, this has largely shielded households from the impact of higher interest payments on non-mortgage debt<sup>3</sup>. In addition, household net worth, after a dip in 2022, has increased strongly since and is now at a record high. In real terms, the jump in inflation caused a large drop in 2022 before increasing again (chart 4). Testimony to a resilient economy, personal dividend income has continued to increase in recent years after rising very strongly in the aftermath of the pandemic (chart 5).

To conclude, household deleveraging, fixed rate mortgages, rising financial income on the back of higher interest rates and dividends, in combination with an increase in net worth have contributed to the resilience of households in an environment of aggressive monetary tightening. Nevertheless, some caution is warranted. Aggregate data, by construction, do not shed light on the heterogeneity of households. Some benefit from high interest rates whereas others suffer, and the Federal Reserve is of course aware of this issue. Quoting from its latest Financial Stability Report, "some borrowers continued to be financially stretched, and auto loan and credit card delinquencies for nonprime borrowers increased"<sup>4</sup>, although it should be added that delinquency rates are still low compared to history (chart 6).

1 Source: Yu-Ting Chiang, Mick Dueholm, Which Households Prefer ARMs vs. Fixed-Rate Mortgages?, Federal Reserve Bank of St. Louis, On the economy blog, 6 February 2024. The authors quote an article of The Wall Street Journal, which reported that ARM applications were just over 7% of all mortgage applications in 2023.

2 To the extent that house prices decline, higher mortgage rates could have an indirect impact on the net worth of households that may have contracted a fixed rate mortgage years ago.

3 In the national accounts, the item 'personal interest payments' only consists of nonmortgage interest paid by households. Mortgage interest paid by households is an expense item in the calculation of rental income of persons. Source: US Bureau of Economic Analysis.

4 Source: Board of Governors of the Federal Reserve System, Financial Stability Report, April 2024 (federalreserve.gov).

5 See in this respect Federal Reserve: high for longer, the sequel (bnpparibas.com), EcoWeek, 7 May 2024, BNP Paribas.

### HOUSEHOLD DEBT SERVICE RATIO AND INTEREST RATES

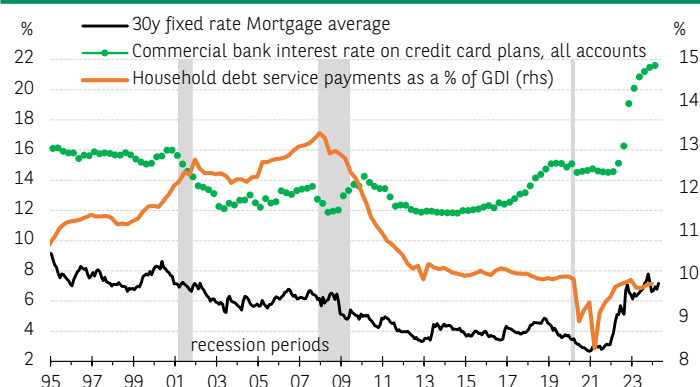


CHART 1

SOURCE: FEDERAL RESERVE, BNP PARIBAS

### HOUSEHOLD DEBT AS A PERCENT OF GDP

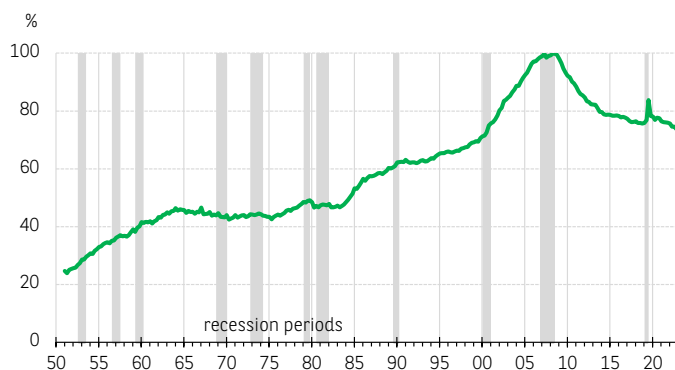


CHART 2

SOURCE: FEDERAL RESERVE, BNP PARIBAS

The financially fragile categories will need to be monitored closely in an environment of high interest rates for longer<sup>5</sup> in view of possible spillover effects to the broader economy should their situation worsen significantly.

William De Vijlder



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### HOUSEHOLDS' INTEREST INCOME AND INTEREST PAYMENTS

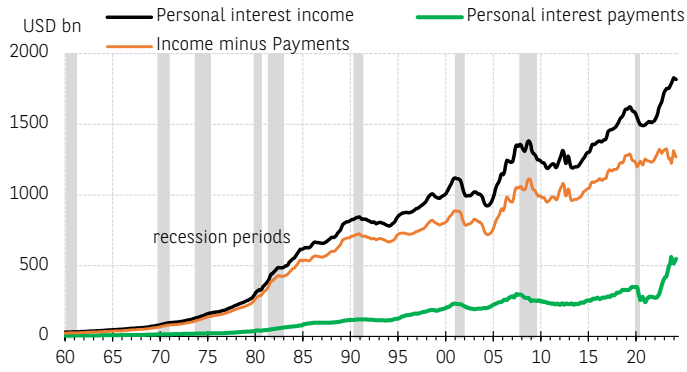


CHART 3 SOURCE: BEA, BNP PARIBAS

### HOUSEHOLDS' NET WORTH (NOMINAL AND REAL)

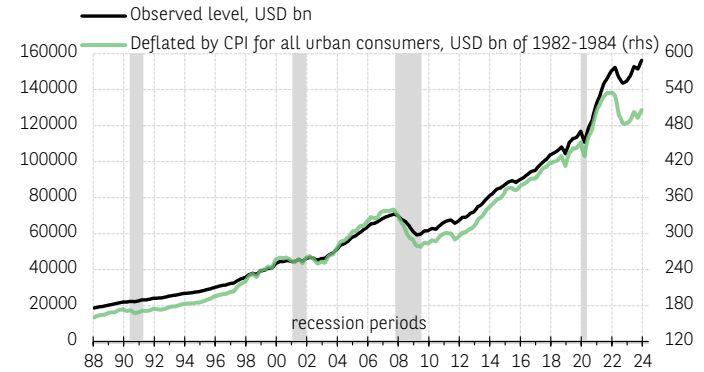


CHART 4 SOURCE: BOARD OF GOVERNORS, BLS, BNP PARIBAS

### HOUSEHOLDS' DIVIDEND INCOME

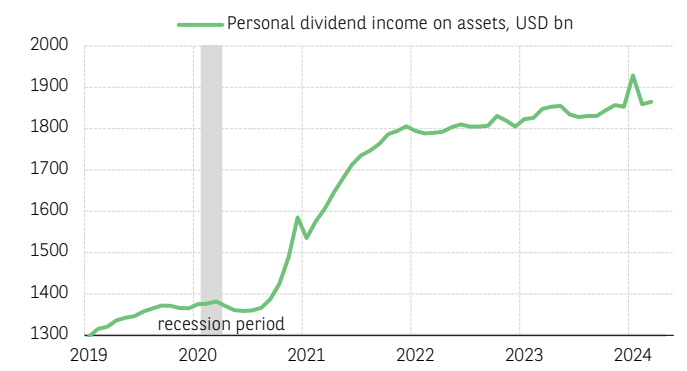


CHART 5 SOURCE: BEA, BNP PARIBAS

### DELIQUENCY RATES ON CONSUMER AND CREDIT CARD LOANS

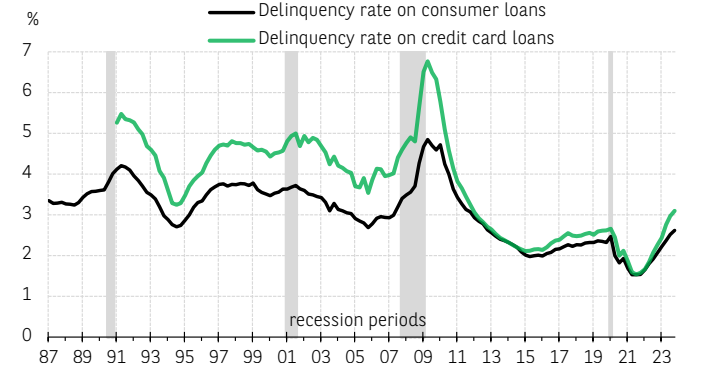


CHART 6 SOURCE: FEDERAL RESERVE, BNP PARIBAS