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The Fed's Consumer Credit Report: Devastating Household Debt Crisis in Main Street America

No light in the tunnel

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On Monday, the Federal Reserve released its Consumer Credit Report which showed that consumer credit increased at an annual rate of 2.5% in January. That might sound good, but there's more here than meets the eye. Non-revolving credit increased at a rate of 7% per anum, while revolving credit decreased at an annual rate of 6.5%. So, people are taking out more loans, but using their credit cards less.

What's disturbing about the report is that the two main areas of improvement are auto loans and student loans. Both sectors are built on foundations of sand. After all, the reason that auto sales are booming this year is because the big car dealers are giving away the farm to people with poor credit. As Autonation's President Michael Maroone said last week on the Nightly Business Report:

"The big driver of the recovery in 2010 was the restoration of credit. The change in 2011 is we`re now seeing an improving environment for sub-prime. So last year prime and near prime were more normal and this year we`re starting to see the sub- prime segment come along and that`s very important for our industry." (The Nightly Business Report)

So, we're back to "Square 1", right? GM is offering "72 months zero percent financing" to people with dodgy credit. And then the dodgy loans are being chopped up, glued together, and sold to as bonds to "yield seeking" institutional investors around the world. That's the way the new financial system works, and that's why the system broke down when investors tried to ditch these crappy bonds in the autumn of '08. It triggered a run on the shadow banking system that led to worst financial crisis in 70 years. Now car dealers are back for a double-dip reviving subprime loans to inflate another bubble.

Mike Whitney's Chapter in *The Global Economic Crisis*

The uptick in auto sales has nothing to do with "organic demand" for autos. That's baloney. It's about getting anyone who can fog a mirror to sign on the dotted line so the contract can be sold to gullible investors looking for higher yield.

Even so, sales did increase on the month, so, technically speaking, there was a boost in credit. The question is whether subprime auto lending is a sign of recovery or not? The answer is "No".

The other area of nonrevolving credit that improved was student loans, which basically represented all of the increase in non-revolving credit aside from auto sales. Think about that for a minute. In other words, the commercial banks, finance companies, credit unions, savings institutions, nonfinancial business and pools of securitized debts all barely squeaked-by or lost ground in January. That's amazing. Virtually every area of non-revolving credit is still flat on its back a full 30 months after Lehman Bros collapsed except for student loans. And the media tries to spin this as good news?

The credit issued via student loans soared from $317 billion to $342 billion from December to January, a $25 billion windfall in just one month. But, as we pointed out in an interview with Professor Alan Nasser, the student loan business is the biggest swindle of all. Bigger than subprime by many orders of magnitude. Here's an excerpt from the interview:

MW–Is it fair to say that the student loan industry is a scam that targets borrowers who will never be able to repay their debts?

Professor Alan Nasser—"It's as fair as fair can be….How many of these students are subprime borrowers? That is, how closely do student loans resemble junk mortgages? The answer hinges on three factors: how these loans are rated, how likely the borrower is to repay, and the default rate on student loans.

The ratings of student loans are supposed to reflect the "health" of those loans, defined as the likelihood that the borrowers will default…..In September 2008, then-Secretary of Education Margaret Spellings announced in a news release that default rates on federal loans were "historically low": only 5.2 percent of recent grads were in trouble. Spellings used the cohort-default rate to arrive at this figure. But the Department's Inspector General Office employed a more realistic method in its 2003 audit, which calculated lifetime risk. It estimated that over their lifetime between 19 and 31 percent of college freshmen and sophomores would default on their loans (depending on the type of loan and when it was taken on). For community college students, the prospects were grimmer still: between 30 and 42 percent were expected to default. And the future was most discouraging for students at for-profits: between 38 and 51 percent were anticipated to default."

You can see that the default rate among student borrowers is expected to be higher than that for subprime home mortgages."

Repeat: A default rate of 51%. This is predatory lending writ large.

So, when we talk about student loans, we're not talking about something that strengthens economic recovery. We're talking about a scam that targets vulnerable young people who want to play by the rules so they can make a positive contribution to society. These kids are getting fleeced by banksters and loan sharks whose only interest is lining their own pockets. Most of these students will be in debt until the day they die. (Students are not afforded any of the consumer protections of other borrowers. They cannot shed their debts through bankruptcy.)

So, apart from these dubious "improvements" in non-revolving credit, the Fed's credit report is really pretty grim, much as one would expect when households are still deleveraging from a gigantic financial meltdown that cost them $11.4 trillion in personal wealth and home equity.

So, why does it matter? What difference does it make if people are borrowing or not?

It matters a lot. Economists watch credit expansion very closely to see how the economy is doing. You see, when wages stagnate–as they have for the last 30 years—the only way that working people can increase their spending is by borrowing. And since consumer spending is roughly 70% of GDP, if consumers don't borrow, then the economy doesn't grow.

So, the credit report is bad news on many levels. First, it shows that the only thing that has kept the economy on life-support has been the government deficits which have made up for the loss in private spending. Second, it shows that consumers are only slightly better off than they were in 2008. (and less inclined to take on more debt) And, finally, it shows that the Fed's QE2 (bond buying program) has had no measurable effect of consumer spending/credit at all. While it's been a god-send for the equities markets, it's been a total bust for consumers.

Don't believe the "Happy Day's Are Here Again" blabber. Two and a half years into the so-called recovery and the country is still in the throes of a severe multi-year depression. The Fed's Credit Report proves it.