Utah FOUNDATION Executive Summary

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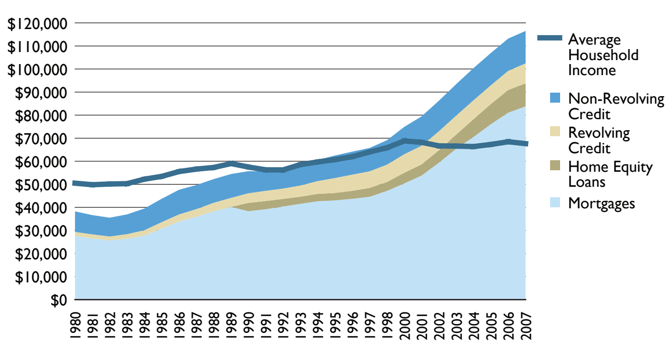
GROWTH IN HOUSEHOLD DEBT:
AN ANALYSIS OF SAVING AND SPENDING IN UTAH AND THE U.S.

As the economic recession deepens, many households are taking a closer look at their current financial situation. Saving rates, consumption habits, and debt levels are being reevaluated and changed. National statistics show the saving rate is up and consumption expenditures are down.

While growth in debt accumulation has slowed, the amount of debt incurred by U.S. households over the last 20 years will become increasingly difficult to payoff as the economy tightens. This creates financial instability for households and can result in increased personal bankruptcies and widespread economic difficulty.

The purpose of this report is to examine how Utah compares to the nation in terms of its consumption expenditures and growth in debt levels. This analysis will in turn provide insight into the financial stability of Utah households and how financially prepared they are for the economic recession. Results from the analysis show that Utah does not appear to be worse than the rest of the nation in terms of household debt loads; however, Utah did follow the same trend of accumulating significant debts during the recent economic expansion and housing bubble, which will make Utah households vulnerable to the economic recession.

Figure 1: Average U.S. Debt per Household, 1980-2007 (2007 Inflation-Adjusted Dollars)



1999 data was not produced by the U.S. Census Bureau.
Sources: Federal Reserve, U.S. Census Bureau. Calculations by Utah Foundation.

NATIONAL SAVINGS, CONSUMPTION, AND DEBT

High levels of consumption promote economic growth, but can also lead to personal financial instability. This is especially true when consumption is fueled by asset appreciation and low levels of personal saving, a scenario which occurred in the United States starting in the early 1980s. Although high consumption levels were considered the principal strength of the U.S. economy during the 2001 recession, many now believe these levels were achieved through structural and behavioral instabilities which allowed, and even encouraged, households to finance consumption by accumulating unsustainable levels of consumer debt.[1]

The National Income and Product Accounts (NIPA) measure of the U.S. personal saving rate has been steadily falling since the early 1980s. This decrease in personal savings is largely due to significant increases in personal consumption expenditures. Measured as a percent of GDP, consumption expenditures steadily increased more than eight percentage points from 62% in 1981 to 70.4% in 2008. This level of consumption had not been seen since 1940 (Figure 2).

There are several reasons as to why consumption increased so dramatically between 1980 and 2008. One reason is that decreased volatility in aggregate economic activity smoothed the effects of the business cycle, which stabilized employment and reduced economic uncertainty.[2] This created positive expectations about secure future earnings, which led households to increase consumption and reduce savings. Another reason is the "wealth effect," in which increases in the real value of assets stimulate consumption.[3] With equity portfolios and homes appreciating in value, many consumers felt comfortable increasing consumption and lowering their saving rates, believing their asset appreciation would cover the difference. A third reason is that financial innovation and decreased financial regulation increased households' access to credit markets. This relaxed household liquidity constraints, reducing their need for current savings.[4]

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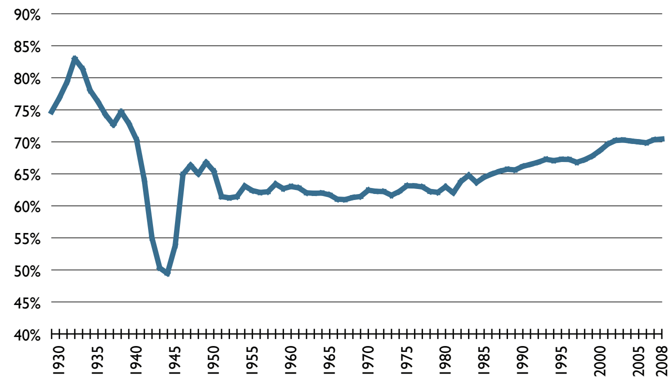
Figure 2: U.S. Personal Consumption Expenditures as a Percent of GDP, 1929-2008



Source: BEA. Calculations by Utah Foundation.

All of these factors contributed to the dramatic increase in household debt accumulated over the last two decades. Figure 1 shows 2007 inflation-adjusted levels of household debt from 1980 to 2007. Between 1980 and 2007, the average debt level per household increased from $38,300 to $116,500. Also shown in Figure 1 is average U.S. household income. Since the early 1980s, household debt has grown at a faster pace than income, with a strong surge in debt accumulation after the late 1990s. By 2007, the average debt per household was more than two-thirds higher than average income.

Non-revolving credit—loans with a fixed number of payments, such as car and student loans—has remained relatively constant since 1980, only growing at an average rate of 1.7% each year. Much of the growth in revolving credit, which primarily consists of credit cards, occurred after a liberalization of usury laws and deregulation of credit card interest rates in the 1980s. Since 2002, just before the recent housing bubble, revolving credit has only grown by an average rate of 0.9% per year.

Mortgage debt, which includes mortgages on 1-to-4 family homes and farm houses, has also increased significantly since 1980. Most of the increase results from the latest boom in home price appreciation which caused average mortgage debt per household to increase from $59,400 in 2002 to $83,700 in 2007, an average growth rate of 7.1% per year. Home equity loan debt, however, has increased at the fastest average annual rate of all four debt categories. It has grown at an average rate of 13.3% per year since 2002 and amounted to an average of $10,000 of additional debt for each household in 2007. These loans have become an extremely popular source of money for homeowners, and it is estimated that nearly one quarter of American households with first mortgages have home equity loans.[5]

A SNAPSHOT OF UTAH'S FINANCIAL SECURITY

Debt levels have a direct effect on people's ability to both consume and save. As the current economic recession continues to deepen, households are becoming more aware of the importance of increasing personal savings and decreasing debt levels. Unfortunately, high levels of debt may prevent households from saving the amount needed to get through the recession, especially considering the recent number of job losses and increases in the unemployment rate. As the effects of the national recession begin to impact Utah, the question remains as to how prepared Utah's households are for the economic downturn.

Utah's Consumption and Bankruptcy Rates

There are no broad measures of consumption spending by households recorded at the state level; however, using retail sales as proxy for consumption expenditures can provide a consistent and objective measurement of changes in spending over time. Changes in Utah's retail sales closely mirror changes in home price appreciation. This trend may indicate homeowners were using home equity loans, made possible by appreciation in home values, to fuel their consumption expenditures. This correlation is probably also influenced by a surge in purchases of building supplies, home furnishings, and equipment related to the increase in home construction and new home sales during those years.

Historically, Utah has had one of the highest bankruptcy rates in the nation. Between 2000 and 2004, Utah's bankruptcy rates ranked between first and third in the nation and between 1983 and 2005, Utah consistently ranked in the top ten states with the highest bankruptcy rates. Notably, there is an almost direct inverse correlation between the growth in home price appreciation and the rise in personal bankruptcies.

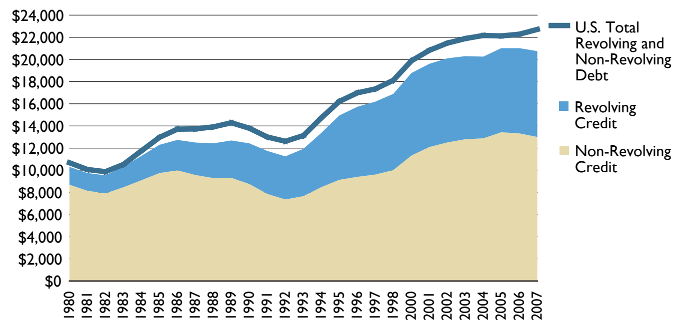
Utah's Revolving and Non-Revolving Debt

If Utah homeowners were using credit to increase consumption expenditures during the 1990s and mid 2000s, then this would have an effect on their overall debt levels. Figure 3 shows the growth in the average amount of revolving and non-revolving debt per household in Utah. While average non-revolving debt only increased from $8,700 to $13,000 between 1980 and 2007, average revolving debt increased from $1,600 to $7,700—more than quadrupling its initial amount. A large part of this growth occurred between 1993 and 1996, the same time Utah experienced a boom in home price appreciation. As in other states, Utah's accumulation of revolving and non-revolving debt slowed in the 2000s. However, national data show that mortgage and home equity debt surged during that same period, and there is some evidence that Utahns followed that surge into deeper housing-related debt.

Utah's Mortgage Debt

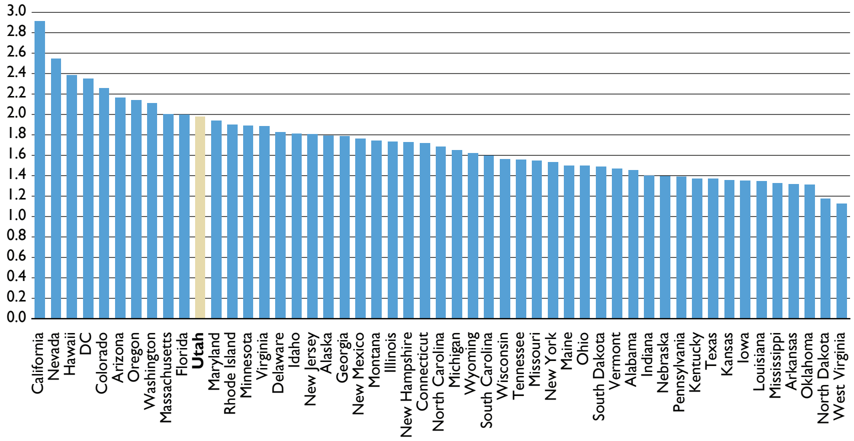
Utah has the 19th highest median mortgage debt per borrower in the nation. When this statistic is compared to median household income, however, Utah's ranking increases even further. In 2006, Utah's ratio of median mortgage debt to median household income (for households with a mortgage) was 1.98, ranking Utah 11th highest. This ranking

Figure 3: Average Utah Revolving and Non-Revolving Debt per Household, 1980-2007 (2007 Inflation-Adjusted Dollars)



1999 data was not produced by the U.S. Census Bureau.
Sources: Moody's Economy.com, Census. Calculations by Utah Foundation.

Figure 4: Ratio of Median Mortgage Debt to Median Household Income, 2006



Median Mortgage Debt is mortgage debt per mortgage borrower. Median Household Income is for households with a mortgage.
Sources: Census, TransUnion. Calculations by Utah Foundation.

suggests homeowners in Utah are taking on more mortgage debt relative to their income than residents in 40 other states.

Because the above statistic is influenced by the state's average ranking of median income for homeowners with a mortgage, it is necessary to examine other aspects of Utah's housing market.[6] One aspect is how Utah compares to the rest of the nation in terms of median home value. Home value is the estimated amount of how much the property would sell for in the current market. In terms of properties with a mortgage, the 2007 median home value in Utah was $224,300 which ranked 21st highest and above the national average of $216,400. It is important to note, however, that the inclusion of older homes may lower these statistics. In terms of new homes, the 2007 median home price in Utah was $335,300 which ranked 11th highest in the nation.[7] The purchase of these expensive new homes could be one of the main factors influencing Utah's above-average ranking in median mortgage debt.

Another aspect of Utah's housing market that can be useful to examine when determining whether Utah homeowners have an unusually high amount of mortgage debt is the state's average loan-to-value ratio. A loan-to-value ratio represents the amount of total mortgage debt outstanding to total property value of all homes with a mortgage. Utah's average loan-to-value ratio is just below the national average and slightly lower than the western states average. However, because this data include mortgage debt outstanding on all mortgages and not just new loans, this ratio may be quite different for homes bought during this decade.

Figure 5: Average Loan-to-Value Ratio for U.S., Utah, and Western States,* Third Quarter 2008

State	Loan-to-Value Ratio
U.S.	66%
Nevada	89%
Arizona	76%
Colorado	72%
California	69%
Utah	**65%**
Idaho	65%
New Mexico	61%
Oregon	61%
Washington	59%
Montana	56%

*Insufficient data were available from Wyoming to produce a ratio.
Source: First American CoreLogic.

Beginning in 2000, the U.S. Census Bureau began tracking monthly owner costs as a percent of household income.[8] According to the Census Bureau, excessive owner costs are those that exceed 30% of household income. In 2007, Utah's median homeowner costs were equal to 24.4% of median household income, ranking Utah 23rd highest in the nation. However, the percent of mortgaged Utah homeowners with monthly owner costs that exceed 30% has grown as well, increasing from 30.5% in 2000 to 33.5% in 2007.

Increasing mortgage debt and owner costs increase the risk of homes having negative equity and going into foreclosure. Negative equity occurs is when the value of a home is below the value of the debt owed on the home. In third quarter 2008, Utah had the 32nd-highest percent of negative equity and near negative equity homes in the nation.[9] The state's low percentage is influenced by its moderate homeowner costs and home values, but also may be influenced by Utah's lag in home price depreciation compared to many states.

At the national level, growth in home prices began to rapidly increase in third quarter 2003 and peaked mid 2005. Growth in Utah's home prices began quickly rising in fourth quarter 2003, but didn't peak until the end of 2006. Because of this lag, Utah's foreclosure rate didn't start increasing until 2008, even though most states experienced an increase in foreclosures beginning in 2005. Therefore, it is expected the rate of foreclosures in Utah will continue to increase, perhaps even after other states' housing markets begin to recover.

Figure 6: Levels and Growth Rates of Debt for U.S. and Utah

	Utah		U.S.	
	Level 2007	Growth Rate 2002-2007	Level 2007	Growth Rate 2002-2007
Average Credit Card Debt per Household	$7,738.54	0.4%	$8,628.00	0.9%
Average Installment Debt per Household	$13,010.40	0.8%	$14,080.14	1.3%
Median Monthly Owner Costs for Housing Units with a Mortgage	$1,358.00	3.3%	$1,464.00	4.6%
Median Monthly Owner Costs as a Percentage of Household Income	24.4%	1.0%	25.1%	2.1%

Growth Rate is average annual growth rate.
Sources: Moody's Economy.com, Census. Calculations by Utah Foundation.

CONCLUSION

Based on this analysis, Utah households appear to have moderate financial stability, with some areas of personal finance being more vulnerable to the economic recession than others. Compared to the rest of the nation, Utah ranks high in terms of median outstanding mortgage debt relative to income, but below average in terms of median credit card debt and installment debt per borrower. Utah also ranks near the national average in terms of monthly homeowner costs and home values. Utah's high ranking of median mortgage debt relative to income is cause for concern because it could lead to greater financial distress and foreclosure rates as job losses mount in this recession.

Another cause for concern is Utah's consumption trends. The purchasing peaks experienced in the 1980s and 1990s eventually led to increases in personal bankruptcies, which indicate these consumption expenditures may have been financed by overextended home equity loans. This increases Utah's total debt levels and creates financial instability, especially during periods of economic downturn. Based on this pattern, it could be expected that Utah will experience another wave of bankruptcies in response to the increased consumption that occurred during the 2005-2007 housing price bubble.

ENDNOTES

1 Milt Marquis, "What's Behind the Low U.S. Personal Saving Rate?" FRBSF Economic Letter Number 2002-09 (San Francisco: Federal Reserve Bank of San Francisco, 2002).

2 Ben S. Bernanke, "The Great Moderation," Remarks given at the meetings of the Eastern Economic Association, 20 February 2004, http://www.federalreserve.gov/BOARDDOCS/SPEECHES/2004/20040220/default.htm (accessed 8 January 2009).

3 Marquis.

4 Ibid.

5 Louise Story, "Home Equity Frenzy Was a Bank Ad Come True," The New York Times, 14 August 2008,

http://www.nytimes.com/2008/08/15/business/15sell.html?_r=2&hp=&oref=slogin&pagewanted=all (accessed 5 February 2009).

6 In 2006, Utah's median income for homeowners with a mortgage was $66,567 which ranked 25th.

7 Moody's Economy.com.

8 Monthly owner costs include mortgage payments, real estate taxes, various insurances, utilities, fuels, and any other homeowner costs or fees.

9 Near negative equity homes are those that are within 5% of being in a negative equity position, but not currently in a negative equity position.

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