

SUBPRIME RISKS RETURN

There are some worrying trends in delinquency rates on credit-card-loan balances.

Once again, odd things are happening in the subprime part of the U.S. consumer loan markets. For evidence, look no further than at the delinquency rates on credit-card-loan balances of thousands of smaller U.S. commercial banks. Since the fall of 2016, the share of delinquent loans (defined as having payments overdue for thirty days or more and still accruing interest) among these smaller banks has more than doubled, to about 6%. This is above the levels seen during the financial crisis of 2008. By contrast, the picture looks far healthier for credit-card-loan books of the 100 largest banks, as our Chart of the Week shows.

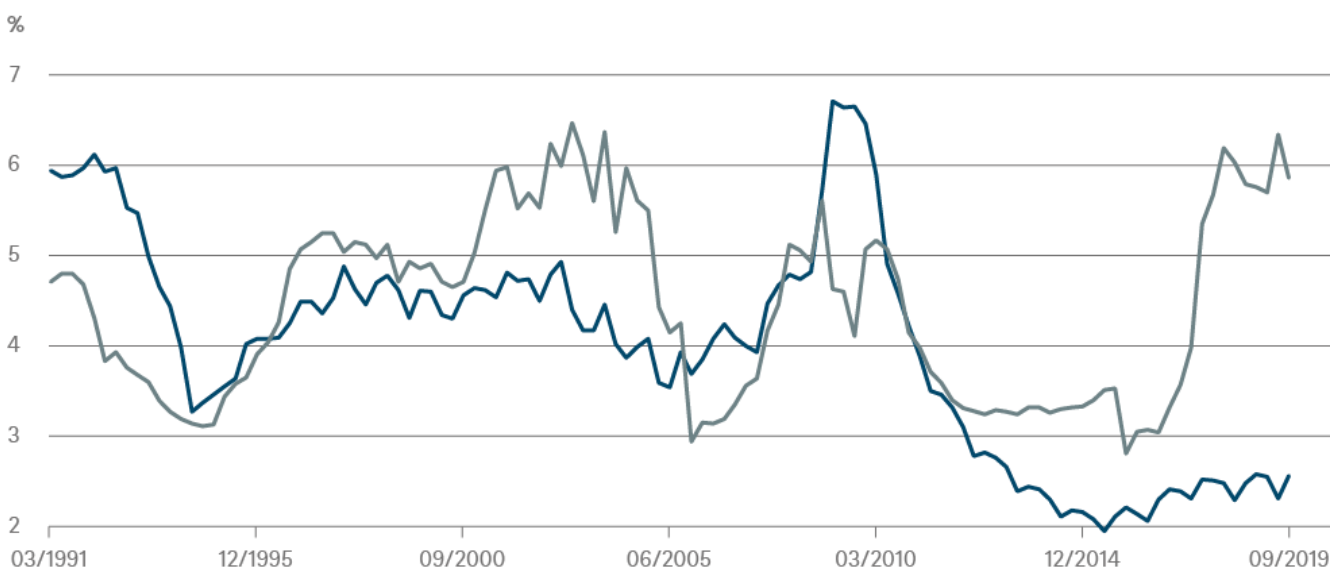
"The main explanation for the divergence appears to be growing customer segmentation in the market for credit cards," explains Christian Scherrmann, U.S. Economist at DWS. Larger U.S. banks can offer some of the most sophisticated incentives and marketing. As a result, they tend to attract customers having some of the best credit ratings allowing them to pick and choose which subprime customers to accept. Overall, larger banks have most of the customers and most of the credit-card balances. But, partly as

a result of regulatory changes, subprime clients now only account for a tiny fraction of their credit-card business.

When times are good, subprime lending can of course be immensely profitable, precisely because borrowers have patchier credit histories. Such borrowers often have to accept whatever deal they can get. Fees and interest charges tend to be high in that segment. However, it also can be very risky, especially for credit-card loans, which are unsecured. So when a loan goes sour, only a small fraction of the debt can typically be recovered. Nor is it just credit cards. Delinquency rates for other types of subprime lending, such as auto loans, have also been rising.

In the current cycle, the rise in delinquencies has been highest among younger borrowers, often in their 20s.¹ They typically have jobs, but are nevertheless struggling to keep up with their minimum payments. Given the role subprime lending played during the buildup of the last crisis, such trends are never the less worrying. "Labor markets might not stay this favorable forever," Scherrmann points out.

¹ <https://www.americanbanker.com/news/whats-behind-the-rise-in-credit-card-delinquencies>



- Delinquency rate of U.S. credit-card-loan balances for 100 largest U.S. commercial banks
- Delinquency rate of U.S. credit-card-loan balances for other U.S. commercial banks

Source: U.S. Federal Reserve Board as of 1/8/20

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Source: DWS Investment GmbH

GLOSSARY

Loans are considered **subprime** when the borrower has a weak credit rating and therefore there is a relatively high probability that the loan might not be repaid (on time).

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