

US HOUSEHOLD FINANCES IN DECENT SHAPE

The Federal Reserve released its quarterly report on the Financial Accounts (Flow of Funds) of the US today. The finances of households and nonprofit organizations for Q3 were much improved, with household net worth increasing \$1.5 trillion to \$90 trillion.

After decelerating (year-on-year) for several quarters, growth in the total value of financial assets held by households accelerated in both Q2 and Q3 (see Chart 1). Expect further increases in the value of household assets in Q4 from the strong rally in equity prices (as of yesterday's close, the S&P 500 index was up 3.4% from the end of Q3). The drop in the price of US Treasury securities may weigh on the value of household portfolios, but debt securities make up only 5% of household financial assets while equities (corporate and noncorporate) account for 35%. The acceleration in home prices put the value of real estate up 7.2% yr/yr in Q3.

Unlike household assets, total household liabilities only surpassed its pre-recession peak in Q2 of this year. The sluggish recovery in liabilities is primarily due to the slow growth in mortgage loans which account for roughly 65% of total liabilities. Excluding mortgages, household liabilities are 38% higher than they were in Q4 2007 (see Chart 2).

It is unreasonable to expect housing activity to mimic the robust growth observed before the financial crisis, but the slow recovery in mortgage loans highlights issues with housing affordability and household access to credit. On the affordability front, despite historically low mortgage rates, wage growth has only really started to pick up over the last year and home prices are accelerating at a relatively fast pace due to the limited supply of for-sale homes. (Although mortgage rates remain low, the recent surge in rates may slow the pace of activity for some time see [note](#)). Mortgage credit remains tight with the median credit score for newly originated mortgages up about 40points from the pre-crisis era (see Chart 3).

The boost to household activity from higher household wealth has been modest, with the saving rate notably higher than one would expect during periods of rising wealth as households have become much more cautious with their spending patterns since the financial crisis (see Chart 4). More cautious households imply that a major acceleration in household spending from cuts in marginal income tax rates is unlikely (see "[US: stronger growth, higher rates, more uncertainty](#)" for a discussion of our revised economic forecasts).

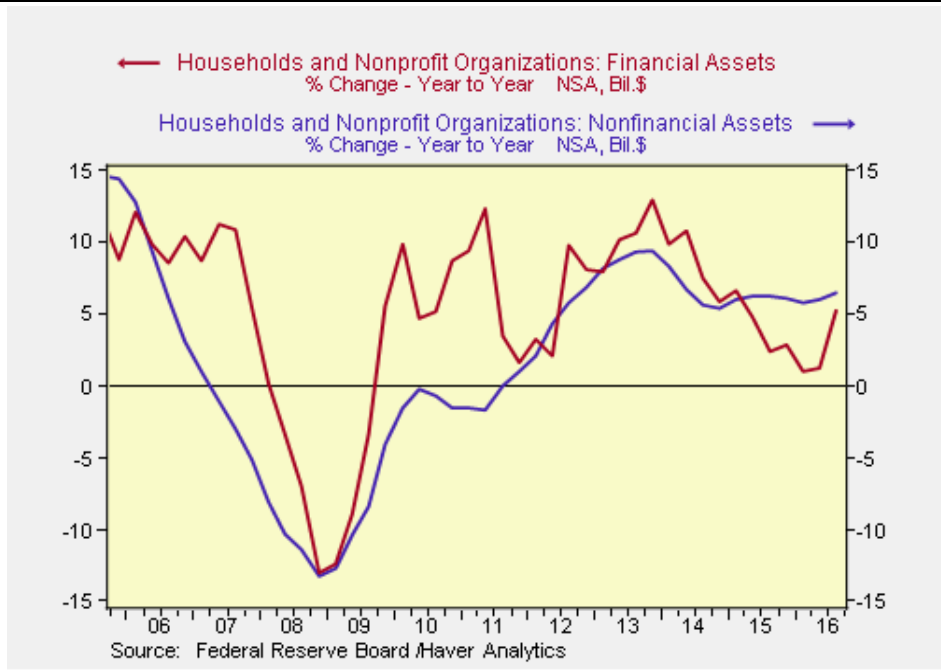
Private consumption on discretionary goods and services has been relatively subdued in this recovery compared to prior periods and reflects more cautious household attitudes. In addition, higher consumption on health care, partly due to the Affordable Care Act, is eating into disposable incomes and reducing spending on discretionary items (see Chart 5). Moreover with depressed home ownership, less persons have access to home equity lines of credit to help finance purchases.

That said, there are signs that consumers are becoming more confident in their finances. 1) Revolving consumer credit outstanding (includes credit card) has accelerated since last year (see Chart 6). 2) Consumers have become more optimistic about the economy and labor markets. 3) Spending on big ticket items such as motor vehicles has boomed in recent years.

08 December 2016

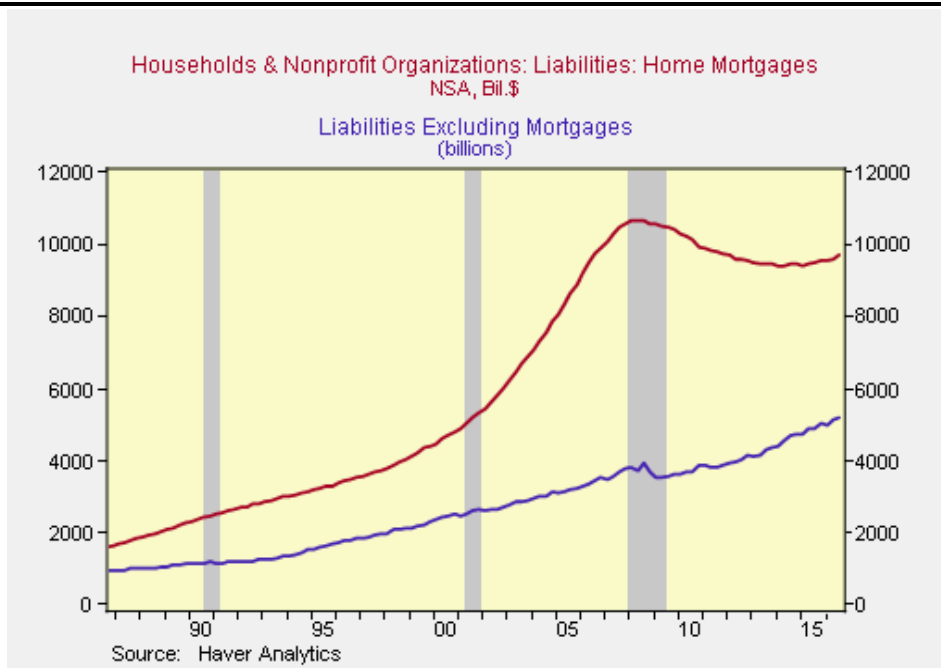
With the wealth effect more diminished in this recovery, any major acceleration in consumer spending growth in the medium term is unlikely. However, with consumer finances in decent shape and a relatively elevated personal saving rate, the risk of a sharp downturn in consumer activity is unlikely as consumers are better prepared to handle adverse shocks. Expect consumption to continue to expand at a solid pace.

Chart 1: Year-Over-Year Growth in Households and Nonprofit Organizations' Financial and Nonfinancial Assets



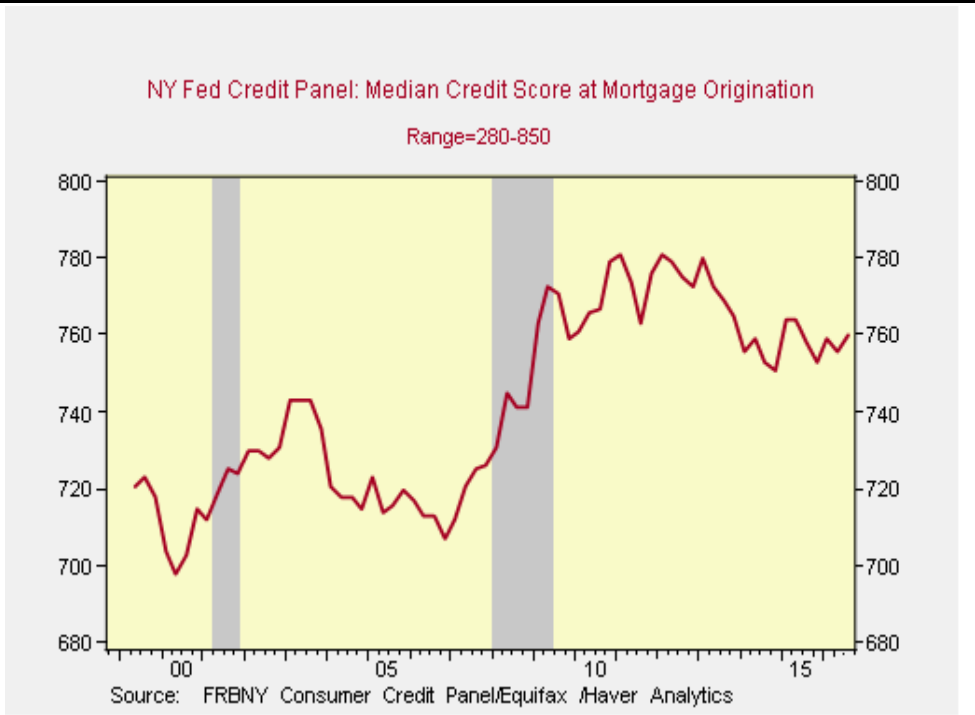
Source: Quarterly data. Source: Federal Reserve Board and Haver Analytics

Chart 2: Households and Nonprofit Organizations' Mortgages and Liabilities Excluding Mortgages



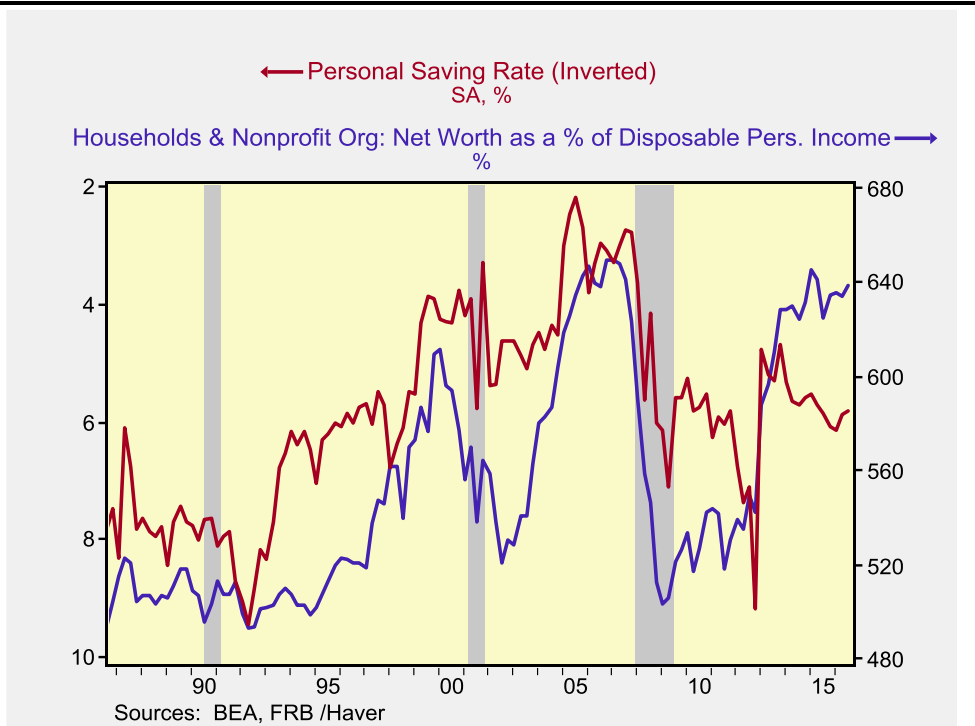
Source: Quarterly data. Source: Federal Reserve Board and Haver Analytics

Chart 3: Median Credit Score at Mortgage Origination



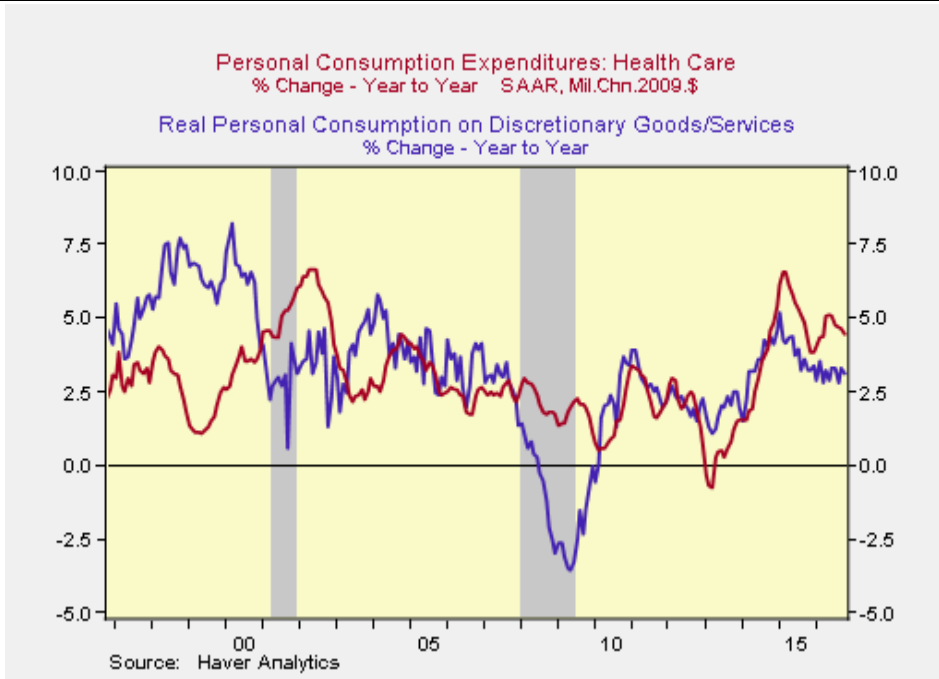
Source: Quarterly data. Source: Federal Reserve Bank of New York Consumer Credit Panel, Equifax and Haver Analytics

Chart 4: Personal Saving Rate (Inverted) and Household and Nonprofit Organizations' Net Worth as a % of Disposable Personal Income



Source: Quarterly data. Source: Bureau of Economic Analysis, Federal Reserve Board and Haver Analytics

Chart 5: Real Private Consumption of Health Care vs Consumption of Discretionary Goods/Services



Note: Discretionary Spending Equals Total Personal Consumption Expenditure - (PCE Food + PCE Clothing & Shoes + PCE Gasoline & Energy Goods + PCE Housing Services). Source: Monthly data. Source: Bureau of Economic Analysis and Haver Analytics

Chart 6: Year-Over-Year Growth in Revolving Consumer Credit



Source: Monthly data. Source: Federal Reserve Board and Haver Analytics

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