



“Late Credit Card Payments Hit 15-Year Low”

-Associated Press, May 24, 2011

Yes, you read the headline above correctly. Late credit card payments are at their lowest levels since the late 1990s—the last time our economy was in a full-blown boom!

The rate of payments 90 days or more delinquent dropped to 0.74 percent in the first quarter—a reduction of almost half from the highs seen in the first quarter of 2009, during the peak of the meltdown and credit crisis.

Given that unemployment remains near multi-decade highs and that millions of Americans are in debt trouble or underwater on their mortgages, it is fair to ask: how is this possible? Is the crisis over?

Not exactly. When something sounds too good to be true, it generally is.

As is always the case with economic data, you have to read between the lines. Yes, credit card delinquency is at its lowest levels since 1996. But a major reason for this is that the banks have written off \$74.5 billion in bad credit card debts over the past few years, according to Moody's. It's not that delinquent borrowers got religion and started making payments. No, the banks simply gave up and wrote off the debt as a loss. Debt that gets written off is no longer “delinquent.” It just disappears, along with a corresponding amount of shareholder equity.

Continued consumer deleveraging has also played a large part. Americans—and particularly the Baby Boomers who see retirement looming in front of them—underwent a major psychological shift over the last few years. With their home equity and stock market investments decimated by the crisis, they have reacted prudently by cutting back on their spending, paying down their debts, and building up their savings. As a result, the average credit card balance has dropped from \$5,165 to \$4,679 over the past year—a drop of 9 percent.

Consumers aren't the only ones with a newfound sense of responsibility. The banks too have significantly raised credit standards. Most mortgage lenders require substantial down payments now, and credit card lenders have become far more cautious about who gets a card and how large a credit line they get.

So, while a reduction in credit card delinquency should be viewed as a positive, it's important to understand the underlying parts and what they mean for the economy. Writing off bad loans reduces banks' capital and their ability to extend new credit. Every dollar that a consumer opts to save is a dollar that does not get spent growing the economy.

Consumers and banks are being more prudent, and that is good for the long-term health of the economy. But in the short-term, it means that we have a long period of slow growth in front of us.

Meanwhile, conditions in the housing market—where this entire mess began—continue to deteriorate. New data show that the Case-Shiller Home Price Index fell for its eighth consecutive month, and 18 of the 20 cities that comprise

the index saw declines. Record numbers of foreclosures are flooding the market with inventory, and many Americans are unwilling or unable to buy—due in part to the tighter credit conditions mentioned above.

Things will eventually get better, dear investor. In fact, by many measures they already are. But deflationary credit contractions are never fun to live through, and we have a couple more years to go.

Sincerely,

Jeremy E. Portnoff

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Sources:

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