

TEACHING TIPS

from the Federal Reserve Bank of Kansas City

FALL 2016:
TRACKING CONSUMER
CREDIT TRENDS

Economists Troy Davig and William Xu tracked consumer credit trends from 2008-2016 and found that consumer debt has increased steadily since 2013, but sharp differences underlie this trend. Who is borrowing and what they are borrowing mark some of those differences. Borrowers with lower credit scores have borrowed at higher rates than those with higher credit scores, whose borrowing has only increased by a small amount. While mortgage debt tumbled during the recession, it has slowly increased but remains four percentage points below pre-crisis levels. Auto loans, however, are on the rise led by borrowers with lower credit scores. Davig argues that adding to consumer debt can benefit consumers and the broader economy. Their findings also suggest that consumers are handling debt levels well.

Reading the Article with Students

Suggested use: Read and discuss the TEN article in class, using the discussion questions below. Students interested in further research on this topic could work on the extension activities included in this Teaching Tips. The article can be found at: https://www.kansascityfed.org/~media/files/publicat/ten/pdf/fall2016/ten_fall_2016_issue.pdf

- According to graphic 1, consumer debt plunged when the Great Recession took hold in 2008. Why do you think that is?
- According to graphic 2, when and why did people start borrowing again?
- According to graphic 2, why might people with lower credit scores be adding more consumer debt over those with higher credit scores?
- How does the increase in consumer debt among those with lower credit scores effect:
 - o Individuals,
 - o families,
 - o overall economy?
- What kind of debt do you think people are taking on?
- What does an increase in consumer debt tell us about the economy?
- How could an increase in consumer debt impact consumers and the economy?
- According to graphic 3, how has the type of debt trended differently in the post-crisis economy? What do you think accounted for the change?

Direct Discussion Questions

KEY PERSONAL FINANCE & ECONOMIC CONCEPTS

Review the meanings of some of the personal finance and economic concepts contained in this article.

CONSUMER DEBT: a debt to fund consumption rather than investment

CREDIT SCORES: numerical expression based on analysis of a person's credit files, to represent the creditworthiness of a person.

CREDITWORTHINESS: a creditor's judgment on a person's inclination to honor debt obligations.

GREAT RECESSION: period of general economic decline during the late 2000s-early 2010s.

CREDIT: the ability a consumer has to obtain goods or services before payment, based on trust of future payment.

Continued on next page

Extension Activities

- Look at the MyFICO website: <http://www.myfico.com/credit-education/credit-scores/>. This link describes what a credit score is and the factors that influence it. Give students time to read through this first page, then ask:
 - What is a credit score? What is the purpose of it?
 - Why are credit scores important?
 - What factors do you think help determine credit scores?
- Direct students to <http://www.myfico.com/credit-education/whats-in-your-credit-score/>. After students have read through this page, ask them:
 - What factors help determine credit scores?
 - What is the range of credit scores?
 - What is an excellent credit score?
- Explain to students that when lenders try to decide whether or not to loan someone money, they have to consider the likelihood that the borrower will repay the loan. This is called creditworthiness. Lenders use credit scores to help them determine if someone is credit worthy.
- Direct students to the chart below. Read the situation and details of each borrower. Have students write their justification for whether or not they will loan the money to the borrower.
- After students have filled out the entire chart, have them share their answers with the class.
- Ask students how they can build creditworthiness for themselves, especially in light of no credit history.
- Debrief the major concepts discussed today.

Determining Creditworthiness

Situation: You are a lender with \$50,000 to loan for car loans. You have four people who have applied for a car loan and it is your job to determine who you will loan to and why. All loans will be calculated for 5 years.

- You do not have to disperse all of the money you have.
- Remember, debt is different than monthly expenditures. Items not included in "other debt" that people still pay for includes but is not limited to: utilities, food, clothing, shelter (renting), gas, insurance, etc.

	Amount requested	Car value	Monthly income	Current job	Length of time at job	Other debt	Credit Score	Would you loan the money? Why or why not?
A	\$3,500	\$5,000	\$400	Student/Cashier	2 years	none	none	
B	\$20,000	\$20,000	\$2,000	Secretary	2 months	\$1,000/month	675	
C	\$7,500	\$6,700	\$4,000	Construction worker	3 years	\$1700/month	750	
D	\$35,000	\$38,000	\$7,500	Principal	10 years	\$4,000/month	580	

Federal Reserve Bank of Kansas City:
TEN Magazine - Fall 2016

Consumers taking on more debt: What does the trend say?
https://www.kansascityfed.org/~media/files/publicat/ten/pdf/fall2016/ten_fall_2016_issue.pdf

The Macro Bulletin:

Tracking Consumer Credit Trends
<https://www.kansascityfed.org/~media/files/publicat/research/macrobulletins/mb16davigxu0715.pdf>

Federal Reserve Bank of St. Louis:

Credit Cred Online Course for Teachers and Students
<https://www.stlouisfed.org/education/credit-cred-online-course-for-teachers-and-students>

Federal Reserve Bank:
Credit Reports and Credit Scores
<http://www.federalreserve.gov/creditreports>

MyFico

What's in my FICO Scores
<http://www.myfico.com/credit-education/whats-in-your-credit-score/> and <http://www.myfico.com/credit-education/credit-scores/>

Free Credit Report

www.freecreditreport.com

Links and Standards

Teaching Tips is a FREE resource from the Federal Reserve Bank of Kansas City. It is available on our web site at www.kansascityfed.org. For more educational resources from the Federal Reserve Bank, contact Tina Ellsworth tina.ellsworth@kc.frb.org