An Auto Loan Debt Crisis Looks Imminent

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With auto loan rates at historic highs, rising payments, and mounting consumer debt, the auto lending industry is facing an inflection point. With lenders continuing to tighten restrictions and some even deciding to leave the consumer auto loans market, the stage is set for what could become a full-blown auto loan debt crisis. But how impactful such a crisis would be and how the industry can navigate its way out remains to be seen.

The Auto Loans Industry Is Showing Serious Signs of Trouble

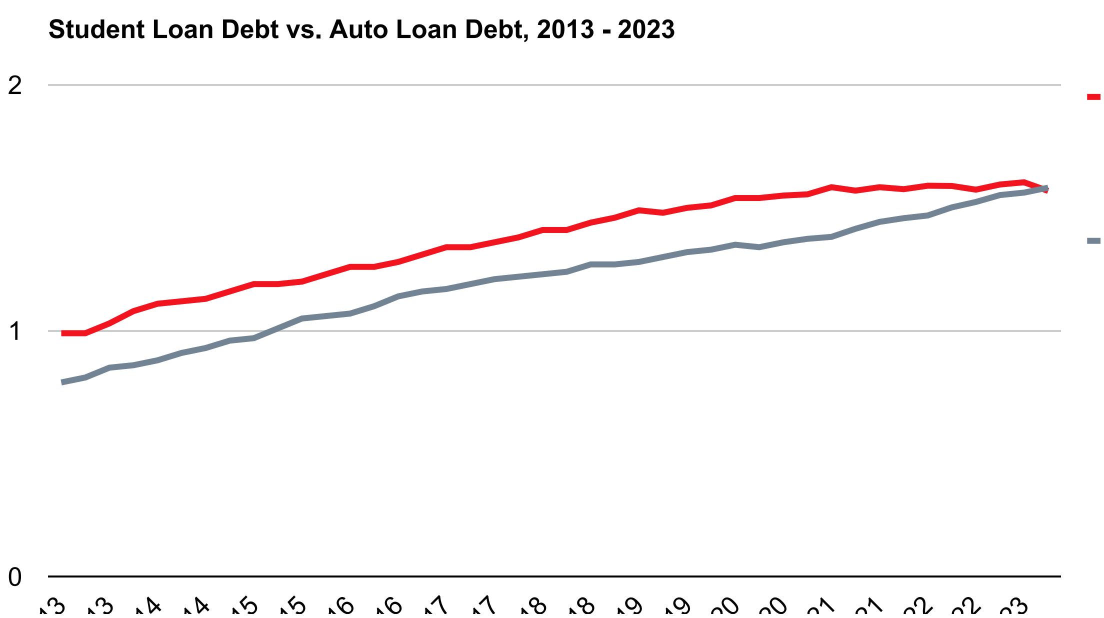
Automotive finance loans are one of the most popular loan products in the country and a staple of most major lending institutions' portfolios. In a stable market, they are a fairly safe bet for lenders, as they are backed by the vehicle being purchased as collateral, and a relatively small amount compared to mortgages and some other types of loans.

However, the auto loans market has been anything but stable recently. Following a series of increases to the federal funds rate from the Federal Reserve, auto finance interest rates have skyrocketed. Higher rates don't necessarily spell trouble for the industry on their own, but along with several other significant red flags, the combination of factors currently present in the market paints a worrisome picture.

Auto Loan Debt Has Surpassed Student Loan Debt

In the first quarter of 2023, more than 43 million people in the U.S. were holding federal and private student loan debt, totaling more than $1.77 trillion overall. The staggering statistics around student loan debt have made the topic a fixture of news headlines and a recurring point of discussion in the halls of government.

However, in September, the Wall Street Journal reported that auto loan debt had surpassed student loan debt in total amount. At the end of Q2 2023, auto loan debt reached $1.58 trillion compared to $1.57 trillion in student loan debt.



Date	Student Loan Debt (In Trillions of Dollars)	Auto Loan Debt (In Trillions of Dollars)
January 2013	$0.99	$0.79
April 2013	$0.99	$0.81
July 2013	$1.03	$0.85
October 2013	$1.08	$0.86
January 2014	$1.11	$0.88

Date	Student Loan Debt (In Trillions of Dollars)	Auto Loan Debt (In Trillions of Dollars)
April 2014	$1.12	$0.91
July 2014	$1.13	$0.93
October 2014	$1.16	$0.96
January 2015	$1.19	$0.97
April 2015	$1.19	$1.01
July 2015	$1.2	$1.05
October 2015	$1.23	$1.06
January 2016	$1.26	$1.07
April 2016	$1.26	$1.1
July 2016	$1.28	$1.14
October 2016	$1.31	$1.16
January 2017	$1.34	$1.17
April 2017	$1.34	$1.19
July 2017	$1.36	$1.21
October 2017	$1.38	$1.22
January 2018	$1.41	$1.23
April 2018	$1.41	$1.24
July 2018	$1.44	$1.27
October 2018	$1.46	$1.27
January 2019	$1.49	$1.28

Date	Student Loan Debt (In Trillions of Dollars)	Auto Loan Debt (In Trillions of Dollars)
April 2019	$1.48	$1.3
July 2019	$1.5	$1.32
October 2019	$1.51	$1.33
January 2020	$1.54	$1.35
April 2020	$1.54	$1.34
July 2020	$1.55	$1.36
October 2020	$1.56	$1.37
January 2021	$1.58	$1.38
April 2021	$1.57	$1.42
July 2021	$1.58	$1.44
October 2021	$1.58	$1.46
January 2022	$1.59	$1.47
April 2022	$1.59	$1.5
July 2022	$1.57	$1.52
October 2022	$1.6	$1.55
January 2023	$1.6	$1.56
April 2023	$1.57	$1.58

The issue of student loan debt has been recognized in the national conversation and among lawmakers as one that poses an existential threat to borrowers and the economy at large. With the auto loan debt now exceeding student loan debt, will authorities and the general public recognize this development as a major warning sign for the future of the automotive finance industry?

Auto Finance Delinquencies Are Still on the Rise

At the same time that total auto loan debt is increasing, so is the number of Americans who are failing to meet their auto loan payments. According to the Federal Reserve, auto loans delinquent for 60 days or more increased again in September for the fifth month in a row, and up 13.3% on the year. Delinquencies among subprime borrowers reached a nearly-30-year high in September of 6.1% – the highest rate since 1994.

But while delinquencies increased between August and September, auto loan defaults – in which a lender formally terminates a loan agreement after failure to pay – actually decreased. However, even with the slight decrease, the default rate in September was still 31.7% higher than one year earlier.

High delinquency and default rates mean that lenders could face significant losses as they have a harder time recouping funds they lent out. But while these numbers may look alarming, Experian Head of Automotive Financial Insights Melinda Zabritski told Automoblog that the increase in people failing to meet loan obligations doesn't come as a surprise.

"While delinquencies are slightly above pre-pandemic levels, we must keep in mind the increase was expected, particularly over the past few years," said Zabritski. "2020 to 2022 was a bit of an anomaly. Keeping a close eye on these trends over the coming quarters will be paramount."

People Are Paying More Each Month Towards Auto Loans

Another notable trend is the rise in average car payments. According to an industry report from Edmunds, the average new car payment in Q3 2023 reached $736 per month – a 4.6% increase over a year earlier.

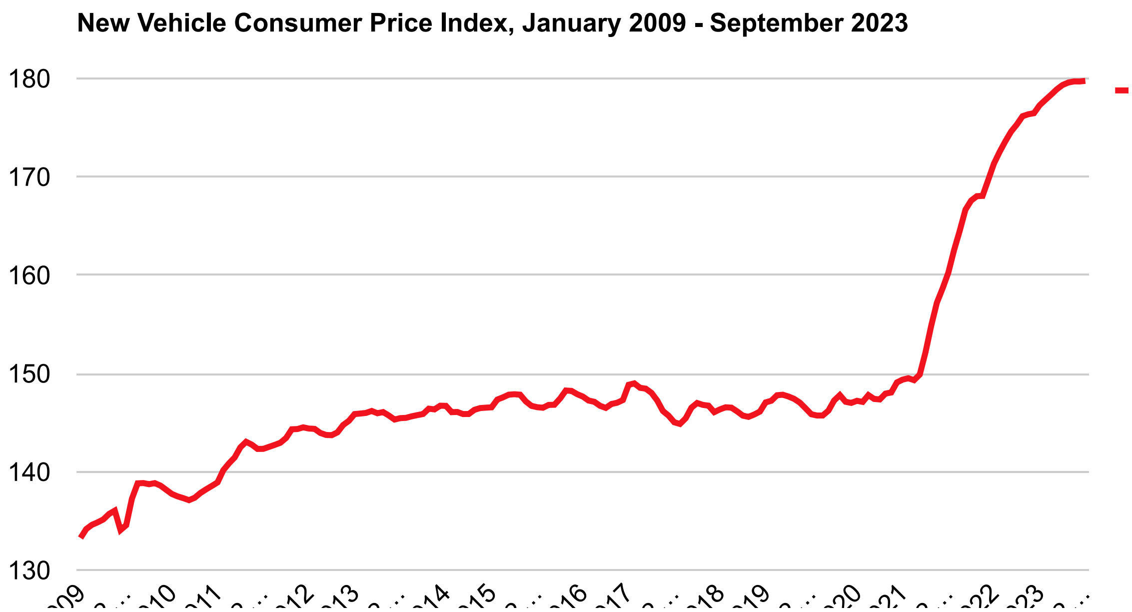
In addition to the rise in the average payment, there has also been a significant increase in car payments that far exceed that average. In July, Experian reported that three times as many people were paying more than $1,000 per month towards an auto loan in April 2023 than were doing so in 2019.

The dramatic surge in annual percentage rates (APRs) since 2022 has played a substantial role in increasing car payments. However, Zabritski explained that another factor influencing this trend is a similar rise in the price of new cars since 2020.

"Perhaps the biggest factor contributing to auto loan debt is vehicle prices," she said. "Inventory shortages led to an uptick in vehicle pricing, resulting in car shoppers having to take out larger loans."

After remaining relatively flat throughout the 2010s, new car prices increased sharply beginning in 2020. According to data from the U.S. Bureau of Labor Statistics (BLS), the new car consumer price index (CPI) rose only 6.1% from 2010 to 2020. Then, between January

2020 and September 2023, the new car CPI increased by 22%. Much of this increase happened at the same time as interest rates began to climb, leaving car buyers paying higher interest rates on top of higher prices.



Date	New Vehicle CPI
January 2009	133.273
February 2009	134.186
March 2009	134.611
April 2009	134.863
May 2009	135.162
June 2009	135.719
July 2009	136.055
August 2009	134.08
September 2009	134.576
October 2009	137.268
November 2009	138.831
December 2009	138.857
January 2010	138.743

Date	New Vehicle CPI
February 2010	138.851
March 2010	138.6
April 2010	138.174
May 2010	137.75
June 2010	137.503
July 2010	137.323
August 2010	137.119
September 2010	137.365
October 2010	137.849
November 2010	138.222
December 2010	138.567
January 2011	138.925
February 2011	140.158
March 2011	140.86
April 2011	141.462
May 2011	142.494
June 2011	143.054
July 2011	142.763
August 2011	142.327
September 2011	142.334
October 2011	142.535
November 2011	142.736
December 2011	142.953
January 2012	143.438
February 2012	144.326

Date	New Vehicle CPI
March 2012	144.35
April 2012	144.522
May 2012	144.401
June 2012	144.367
July 2012	143.953
August 2012	143.749
September 2012	143.725
October 2012	144.011
November 2012	144.762
December 2012	145.181
January 2013	145.871
February 2013	145.925
March 2013	145.989
April 2013	146.188
May 2013	145.955
June 2013	146.076
July 2013	145.726
August 2013	145.316
September 2013	145.457
October 2013	145.488
November 2013	145.643
December 2013	145.766
January 2014	145.88
February 2014	146.421
March 2014	146.348

Date	New Vehicle CPI
April 2014	146.724
May 2014	146.708
June 2014	146.067
July 2014	146.086
August 2014	145.873
September 2014	145.88
October 2014	146.306
November 2014	146.481
December 2014	146.524
January 2015	146.558
February 2015	147.345
March 2015	147.574
April 2015	147.844
May 2015	147.889
June 2015	147.845
July 2015	147.154
August 2015	146.704
September 2015	146.57
October 2015	146.516
November 2015	146.804
December 2015	146.817
January 2016	147.456
February 2016	148.268
March 2016	148.227
April 2016	147.895

Date	New Vehicle CPI
May 2016	147.646
June 2016	147.245
July 2016	147.119
August 2016	146.713
September 2016	146.499
October 2016	146.896
November 2016	147.027
December 2016	147.299
January 2017	148.848
February 2017	148.993
March 2017	148.543
April 2017	148.457
May 2017	148.033
June 2017	147.262
July 2017	146.19
August 2017	145.712
September 2017	145.037
October 2017	144.868
November 2017	145.442
December 2017	146.522
January 2018	146.996
February 2018	146.807
March 2018	146.727
April 2018	146.069
May 2018	146.349

Date	New Vehicle CPI
June 2018	146.562
July 2018	146.526
August 2018	146.149
September 2018	145.715
October 2018	145.588
November 2018	145.826
December 2018	146.126
January 2019	147.059
February 2019	147.226
March 2019	147.788
April 2019	147.84
May 2019	147.659
June 2019	147.417
July 2019	147.035
August 2019	146.456
September 2019	145.854
October 2019	145.726
November 2019	145.728
December 2019	146.22
January 2020	147.253
February 2020	147.803
March 2020	147.124
April 2020	147.007
May 2020	147.222
June 2020	147.108

Date	New Vehicle CPI
July 2020	147.803
August 2020	147.412
September 2020	147.361
October 2020	147.956
November 2020	148.063
December 2020	149.091
January 2021	149.377
February 2021	149.515
March 2021	149.321
April 2021	149.892
May 2021	152.143
June 2021	154.847
July 2021	157.203
August 2021	158.652
September 2021	160.244
October 2021	162.527
November 2021	164.511
December 2021	166.653
January 2022	167.582
February 2022	168.027
March 2022	168.056
April 2022	169.699
May 2022	171.35
June 2022	172.546
July 2022	173.618

Date	New Vehicle CPI
August 2022	174.598
September 2022	175.312
October 2022	176.157
November 2022	176.354
December 2022	176.463
January 2023	177.276
February 2023	177.817
March 2023	178.342
April 2023	178.892
May 2023	179.329
June 2023	179.577
July 2023	179.696
August 2023	179.691
September 2023	179.75

Zabritski said that in addition to external factors causing an increase in the average price of new cars, buyers have also been opting for pricier vehicles – which also factors into the rise in auto loan payments.

“While we’ve seen that trend level out a bit, consumers are also financing more expensive vehicles,” she said. “For instance, SUVs made up more than 60% of new vehicles financed in Q2 2023.”

Lenders Are Making Major Changes to Their Auto Finance Programs

While the trends that have contributed to the current situation have developed quickly, they have not gone unnoticed by lending institutions. Since interest rates began to climb in March 2022, many lenders have made significant changes to their automotive finance businesses.

Lenders Have Tightened Restrictions on Auto Financing

Auto loans have gotten more expensive over the last several years due to rising new and used car prices. However, they have also gotten harder to come by.

In April 2023, the Federal Reserve conducted a survey of senior loan officers at U.S. banks to gauge their institutions' lending behaviors. One question focused on how respondents' credit standards or approval processes have changed in the past three months. While a majority of respondents said there have been no significant changes, 30% said that their lending standards have either "tightened significantly" or "tightened somewhat."

These heightened restrictions don't appear to be easing up anytime soon, either. The same survey asked respondents whether they expected their banks' lending practices to change by the end of 2023. A majority – 61% – said that they did not expect any changes to their practices by the end of the year, and 39% said they expected standards to tighten somewhat or significantly. None of the respondents said that they expected their standards to loosen before the end of the year.

Some Lenders Have Left the Auto Finance Market

One of the most troubling developments this year is lenders drastically reducing their automotive finance options or leaving the market entirely. In September 2022, Capital One CEO Richard Fairbanks announced that the bank would significantly reduce the auto loans portion of their business. The announcement came after Capital One saw a 12% drop in earnings from the first quarter of 2022 to the second.

Another major lender, Citizens Financial Group, announced in June of 2023 that it would be exiting the auto loans market. The company had served as an indirect lender, meaning that it did not offer loans to car buyers directly, but instead through dealerships. Through a spokesperson, the company implied that this change to their business model would be permanent.

Lenders outside the U.S. are also leaving the troubled auto finance market. Canadian firm Bank of Montreal (BMO) announced in September that it, too, would shutter its indirect auto loans division. In a statement to Reuters, the company said that it would shift its focus to other sectors of the financial services industry.

The Current Situation Spells Trouble for Both Car Buyers and Dealerships

As 2023 draws to a close, the auto finance industry is in a precarious position, but not yet in a state of emergency. However, if the trends that have developed in recent years continue, a true crisis could easily develop, which may have a grave impact on the auto industry and the economy at large.

More lenders leaving the indirect auto loans market would significantly reduce the financing options available to dealerships, and therefore, to their customers. As credit becomes less available, lower-income and lower-credit borrowers would likely have to accept even higher

APRs for car loans, substantially reducing their purchasing power or even taking them out of the market entirely.

Continued increases to the cost of auto loans and restrictions on lending standards would make vehicles less affordable and more difficult to buy. With fewer buyers in the market and reduced budgets for those who remain, the auto industry as a whole could see weakened demand and a softened market.

Significantly lower demand could be a complete disaster for an industry already embattled by years of supply chain issues and other hurdles. And for people in need of a new vehicle, the lack of available or affordable credit could result in some difficult situations.

With No Immediate Relief In Sight, Borrowers Must Protect Themselves

There is no guarantee that the current situation will develop into a full-blown auto loan crisis. However, it is unlikely that car buyers, dealerships, or manufacturers will see the situation improve any time soon.

The Federal Reserve has already indicated that the federal funds rate will not go down before the end of the year. Some of the most optimistic forecasters predict that the country may see the funds rate drop in the middle of 2024, but Federal Reserve Chairman Jerome Powell has been steadfast in his assertion that they will not lower the rate until several benchmarks are reached.

While the supply chain looks to be recovering, even a full recovery won't translate into an immediate return to full inventory. And there is no guarantee that full inventories will result in the price of new and used cars coming down. Due to the substantial increase in car prices since 2020, even a significant decrease would still result in historically-high sticker prices.

Auto lenders have very few levers that they can pull to improve the current lending environment. Some are turning to new practices, such as the use of AI, to identify new opportunities and mitigate risk. Car dealerships and the brands they represent are at the mercy of several external factors over which they have very little control, if any.

Individual car buyers have even less influence over the situation. That means that the safest bet for car owners is to prepare for the possibility that it could be a long time before the auto finance market becomes more favorable, and for the very real possibility that things could get worse before they get better.