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LOWER JOB LOSSES SUPPORTING IMPROVING CONSUMER CREDIT

Even though the unemployment rate is still close to “double digits”, consumer credit delinquency trends are showing improvement. DBRS sees this improvement as reflecting the slower pace at which people are becoming unemployed. One indicator is the initial claims for unemployment insurance, which was running at 469,000 in the week ended February 27, still elevated but well down from its peak of 658,000 in March 2009.

A major driver of delinquencies is the loss of jobs. With fewer people becoming unemployed, fewer households are facing a sudden loss of income. Over 2010, DBRS expects lower new delinquencies to translate into lower losses for banks, as the pace of job losses continues to fall. Credit trends will improve more rapidly, however, if the recovery results in greater job creation than the current slow pace.

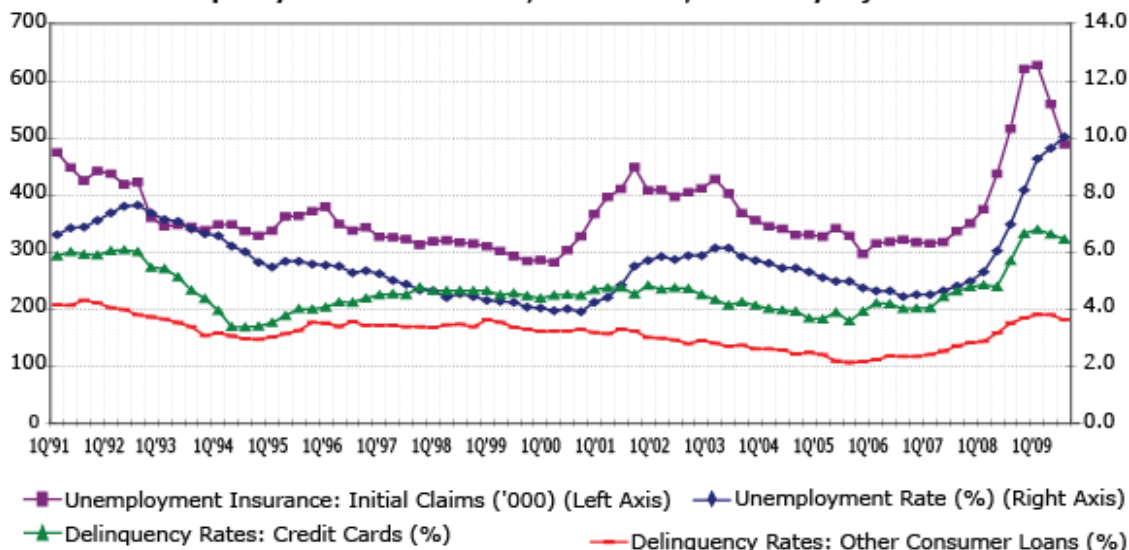
The picture is relatively simple. In an economic downturn, consumer credit quality starts to improve after initial claims for unemployment start to decline, but before there is any significant improvement in the overall unemployment rate. From a slightly elevated level of 350,000 in 1Q08, the average weekly initial claims for unemployment accelerated upwards as the recession deepened (see Chart 1). It reached 621,000 in 1Q09 and peaked at 627,000 in 2Q09, before declining to 488,000 in 4Q09 as the recovery began. So far in 2010, this improving trend has moderated, with only modest and uneven reduction in the level of claims.

Consumer credit delinquency trends for banks mirror those for initial unemployment claims. For credit cards at the top 100 U.S. banks, the delinquency rate reported rose from a slightly elevated 4.77% in 1Q08 to 6.64% in 1Q09. It peaked at 6.78% in 2Q09, up about 200 basis points, before declining to 6.44% in 4Q09. For other consumer credit, the pattern is similar, but less elevated. The delinquency rate rose from 2.81% in 1Q08 to 3.68% in 1Q09. It then peaked at 3.80%, up about 100 basis points, before declining to 3.62% in 4Q09.

Showing little improvement the unemployment rate is less indicative of the turn in consumer credit. The unemployment rate continued to climb through 2009, breaching the double digit level with 10% in 4Q09. In February 2010, the rate was down only slightly to 9.7% versus the 30% decline in the level of initial claims from its peak.

Although less pronounced, these patterns are evident in earlier cycles. The decline in the level of initial claims comes earlier than the turn in the unemployment rate. The timing of a turn in consumer credit delinquency trends is more associated with the turn in initial claims than with the turn in the unemployment rate. (See Chart 1)

Chart 1: Unemployment-Initial Claims, Unemployment Rate, Consumer Delinquency Rates - Credit Cards, Other Credit; Seasonally Adjusted



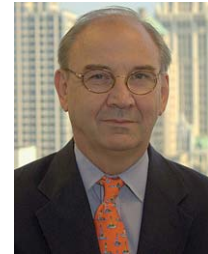
In our view, more job creation is needed for banks to benefit more substantially from the recovery. Reduction in the currently high level of nonperforming assets requires not only fewer households becoming delinquent, but also more households working their way out of their debt problems. That requires more unemployed people finding new jobs. With more cash flowing in, these households may be able to recover and get current on their payments.

So far, however, the pace of job creation has not recovered. For those who are already unemployed, the outlook remains rather bleak. The slow creation of new jobs is reflected in the monthly net loss of jobs that continues. It is also reflected in the still growing length of time that people are unemployed.

In considering how banks may be challenged in 2010, DBRS looks at various job market indicators to understand the impact of the recovery. With many banks facing very elevated levels of losses, economic developments that suggest credit trends are likely to improve are an important consideration in evaluating a bank's ability to weather the current level of stress. Improvement in the housing market overhang is another important consideration in evaluating the pace of improving credit trends for households.

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