

Structured Finance Newsletter

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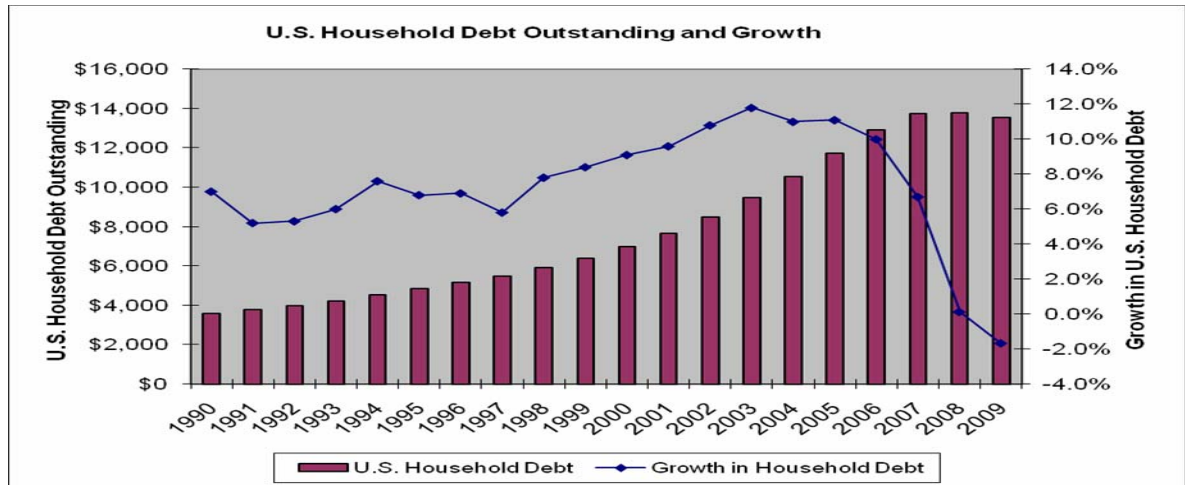
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HOW LEVERAGED IS THE U.S. CONSUMER?

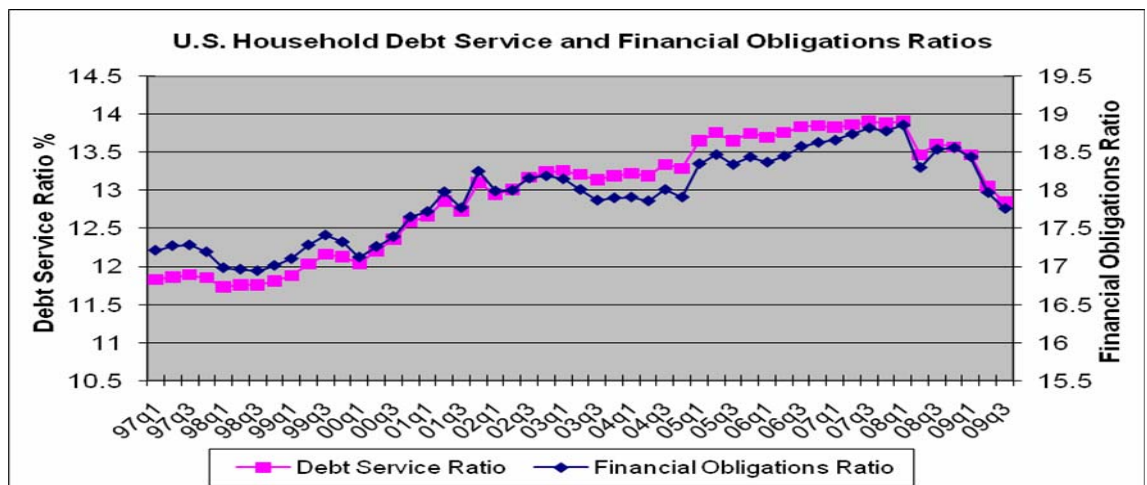
Before the start of the recession in 2007, U.S. households increased their debt outstanding at 8.3%, on average, since 1990. The trajectory of this growth in household debt averaged 10.7% from 2001-2006 before slowing considerably in 2007 and 2008. Recent data from the Federal Reserve shows that overall U.S. household debt levels declined for the full year 2009 by 1.7%. This was the first decline in debt levels since 1990, as depicted in the graph below.



Source: Federal Reserve Flow of Funds

DBRS attributes the primary reason for the decline in debt levels to an increase in defaults on outstanding debt, as consumers have been unable or unwilling to fully service their debt obligations. U.S. households have endured considerable financial challenges since the start of the recession as a result of a confluence of the following additional factors: sustained high unemployment rates relative to historical levels; lower equity values in real estate holdings and a volatile stock market. The impact of these additional factors has been that consumers have seen a decline in income levels and have been unable to tap the equity in their homes or take money out of the stock market to pay their debts.

The following graph depicts the U.S. household debt service and financial obligations ratios, on a quarterly basis, since 1997. The household debt service ratio is an estimate of the ratio of debt service payments to disposable income. Debt service payments consist of the estimated required payments on outstanding mortgage debt. The financial obligations ratio adds automobile lease payments, rental payments on tenant-occupied property, homeowners' insurance and property tax payments to the debt service payment portion of the ratio.



Source: Federal Reserve Board.

These ratios demonstrate that U.S. households had to allocate an increasing portion of their disposable income to cover their debt service and other financial obligations through 2007. Both ratios increased from 2000 to a peak in the first quarter of 2008, before declining. However, these ratios are still high when compared to historical levels.

As a result of the credit crisis and resulting decline in liquidity in the debt markets, many lenders have tightened underwriting standards thereby making credit more difficult for consumers to obtain, particularly if they have a less than stellar credit history. These consumers are expected to continue to reduce debt leverage since they are unable to obtain the same levels of credit they were availed historically.

DBRS expects the performance of 2010 vintages to be better relative to prior vintages as debt levels continue to decline and the overall credit quality of the consumer improves. The ultimate performance of the consumer loan asset-backed securities sectors will continue to depend upon the interaction of many factors herein mentioned. In addition, the ultimate level of new financial regulation will also impact the availability of credit to consumers in the future.

For questions or comments, please contact Rosemary Kelley at rkelley@dbrs.com.

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