Rob Rubin, and David Morris

The Banking & Payments Show: Credit cards in the era of uncertainty

Audio

On today's podcast episode, we discuss the challenges the credit card industry is looking at over the next year.

• In our "Headlines" segment, we focus on an Insider Intelligence article published at the end of August about Macy's private label credit card sales and consider if it's a harbinger of problems in the credit card industry overall.

- In “Story by Numbers,” we center the conversation on what will happen to consumer credit card spending if—or when—there’s a recession.
- And in “For Argument’s Sake,” we take up sides to discuss whether there will or will not be a recession, which is a critical issue for the credit card industry. Tune in to the discussion with host Rob Rubin and our analyst David Morris.

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Episode Transcript:

Rob Rubin:

Optimize your credit marketing strategy and drive ROI with solutions that improve targeting, addressability and engagement in any channel. Visit transunion.com/credit informed marketing to learn more today.

David Morris:

There could be a switch to debit and cash and those that are using credit cards and doing so in an increasingly unhealthy manner. You're going to increase risk. You're probably going to be policed and micromanaged more than ever by credit card companies if there's a recession this time around.

Rob Rubin:

Hello everyone and welcome to the Banking and Payment Show a Behind the Numbers podcast from e-marketer, sponsored by TransUnion, true audience credit informed marketing solutions. Today is September 5th, is the summer over? I'm Rob Rubin, GM of Financial Services and your host today. If you enjoy this podcast, please give us a five star rating and subscribe. The title of today's episode is Credit Cards In the Era of Uncertainty. I invited principal analyst David Morris to provide his perspective on the challenges the credit card industry is looking at over the next year. Hey, David, how are you?

David Morris:

Hey, Rob. I'm great.

Rob Rubin:

Before we get into it, are you ready for some quickfire questions?

David Morris:

I am indeed.

Rob Rubin:

They're really about Labor Day weekend. What is your go-to thing on the grill?

David Morris:

Steak.

Rob Rubin:

Oh yeah, what kind of steak?

David Morris:

I like to spend more than I need to on steak. I look around and get prime dry-aged steak, and lately I've been getting it from this company in New York City, DeBragga. It's fantastic. 45 day, dry-aged prime, New York strip.

Rob Rubin:

New York strips. There you go. I love that. I really wanted to ask you what kind of condiments you used on hot dogs?

David Morris:

Ketchup and mustard.

Rob Rubin:

Both together?

David Morris:

Yes.

Rob Rubin:

All right.

David Morris:

Yeah, but moderate application of both.

Rob Rubin:

Okay. Well, this was a lot of fun. We have a lot to cover, so let's get right to the headlines. In the headlines we chat about a top story as it relates to our episode. For today's episode, I want to focus on an article we published at the end of August about Macy's private label credit card sales. Not good. There's a link to the article in the show notes, and it's really to the tune of a 36% decline in credit card related revenue. I mean, on the face of it, obviously any kind of decline is bad, but why is it particularly bad for Macy's other than it happened?

David Morris:

Well, I would back up and I'd provide some additional data points actually, to put the importance of these credit card programs for retailers in focus. So how about this? I have a question for you, Rob.

Rob Rubin:

All right.

David Morris:

How many millions of dollars net revenue did Macy's generate from its credit card programs in 2022? Is it 350 to 500 million? 500 million to 750 million? Or 750 to a billion?

Rob Rubin:

C.

David Morris:

Yes. $863 million net revenue last year for Macy's.

Rob Rubin:

Yikes.

David Morris:

And another little stat to throw out, guess the percentage of consumers who use their credit card to purchase at Macy's.

Rob Rubin:

Any credit card or store card?

David Morris:

Their store card, how many? Out of every a hundred people that go in and buy something at Macy's, how many people do so with a Macy's card?

Rob Rubin:

30 out of a hundred.

David Morris:

Well, that's not bad. 43. 43%. That's a tender share. Yeah, so less revenue is bad. There's the simple answer when you look at it like that, and when you look at the precarious positions retailers have been in, I would extend that argument to airlines. They'd all go bankrupt without their loyalty programs. In this case, it's definitely a bad thing for Macy's in the sense that it's to my understanding, needing to make allowances for increased bad debt, higher delinquencies for its customer base.

Rob Rubin:

All right, so they're preparing for their customers to not pay their bills at a higher rate?

David Morris:

Well, they're preparing, and I think, again, this is per Macy's and the transcript that I read, I think the degree of increase in these delinquencies caught them by surprise. So that may also be why there's more of a decline in revenue because they're having to catch up on setting funds aside or being able to accommodate that.

Rob Rubin:

So Macy's aside, how is it a harbinger then of problems like in the credit card industry overall?

David Morris:

Well, it's potentially a bad omen for who I would call, I'd say spending among mainstream Americans. We think about private label cards. They don't skew as affluent necessarily as co-brand general purpose and some other kinds of cards. These folks are a little riskier. They may have a little lower incomes, and so this could point to a trend in private label that's definitely not good for retail, but I think it also suggests some weakness in the mainstream consumer.

Rob Rubin:

So is there a big picture then if we extrapolate what happens when the mainstream consumer can't spend anymore or stop spending?

David Morris:

I mean, it's a question that I hope we can actually come back to because I think there's just such a disconnect between lower and middle income consumers right now and more affluent consumers. Whether or not this actually ends up saying something about more affluent consumers, I'm not sure, but it does say that there's potential pressure here could accrue to the private label programs in retail, and that's not good for issuers like Citi or Synchrony, Bread. Those are the three that come to mind. Capital One has some private label calls where their portfolios could see some pressure.

Rob Rubin:

But is it a problem that's isolated into an income segment? Clearly the problem that private label cards are having is going to be because the consumers that use those cards are under greater economic pressure. Is that fair to say? So if they are under even greater economic pressure, is it just that it's terrible for them and it doesn't impact anyone else? Or is it something that spreads?

David Morris:

I think it could be related to the pandemic savings drawdown. When you think of the pandemic surplus, all of that money that got pumped out into the ether for businesses and consumers, we had a trove of funds to sit on. Those funds are increasingly being depleted, and it's something that I talk about in a recent report, but I bring that up because the folks who are depleting that the earliest are the ones with the least amount of money. So you could actually see a little bit of post pandemic savings drawdown pressure here, where the first consumers that are going to show cracks are those with less income. What's going to happen over the course of the next six to nine months when those pandemic savings runs out for more affluent folks?

Rob Rubin:

The only thing that I pause about is when I think about purely anecdotally, when consumers were getting the pandemic money from the government, the lower income consumers that I sort of at least were engaged with, I don't think that they were saving the money. They just weren't working at the time. In other words, they were just living off it. I was talking about construction workers that were working who just didn't work while the government was paying them. And that was a problem that I had. And I'm just wondering how many consumers who were sort of day-to-day did use the pandemic money and save it and are now drawing it down versus they just are in a different situation now? They were using the money then.

David Morris:

Yeah, I see your point. I mean, the way I might look at it a little differently, but somewhat similarly, is someone who has less income and then receives these funds, do they have the same capacity to invest? No. Compared to someone who may already have more savings because of the income and so forth.

Rob Rubin:

But maybe they needed things that they couldn't have otherwise gotten. Like we've been washing dishes every night because the dishwasher's broken and we can't buy a new one and now we can. Those were the kinds of things that people were able to do with some of the money as well, which is good, and then good for the economy as well at the time.

David Morris:

Definitely. Yeah, and I mean, I think that that's a really great rationale for why spending has been so strong for the past what? Two and a half years. It's that very reason more money in people's pockets goes right out the door into Best Buy, Macy's than elsewhere, but when that dries up, there's less of a tendency for that same person to go back and replace the washing machine. Maybe there's a few more years on that particular one because they don't have that windfall anymore.

Rob Rubin:

And I think that this is a good spot for us to do a transition to the next segment because this is a topic that we're going to be covering as we go through today's episode. When we look at something that's happening for Macy's, how is it a harbinger? Are we headed for things like a recession, which has been talked about for the last few years and doesn't ever seem to be happening even as interest rates continue to rise? So what I want to get to is first story by numbers.

And in story by numbers we pick a number or two that helps us dig into an episode's topic. And today for story by numbers, I do want to focus on a report that you published over the summer titled Credit Card Risks in a Darkening Economy. And you laid out what would happen to consumer credit card spending if and when there's a recession. So to tell this story, let's begin with the number zero, and that number represents in Q1 2024. Insider intelligence is projecting based on data from the Federal Reserve Board that consumers accumulated savings from the pandemic will be spent down to zero in Q1 2024. Now, that's in aggregate, not individually. So in aggregate, and my question is, isn't that good for the credit card industry? If consumers don't have savings, then they charge stuff. I mean, that seems like that would be good. No?

David Morris:

Well, I mean it is good if you're talking about people getting out there and using their cards to spend. I mean, the question is whether or not they're setting themselves up to be in a higher risk position to pay the loan back. So I would say that could certainly be helpful in terms of being able to drive credit card loan balances up. That's good for issuers, assuming a stable base of consumers because they're going to make more money on the interest and on the swipe fees that they get from the spending in the first place. But that presupposes that the consumer is in a good healthy position.

Rob Rubin:

Right. And I think as consumers get into tighter positions and their credit becomes tighter, they're more likely to be using debit and cash.

David Morris:

That there could be a switch to debit and cash and those that are using credit cards and doing so in an increasingly and healthy manner, you're going to increase risk. You're probably going to be policed and micromanaged more than ever by credit card companies if there's a recession this time around compared to the Great Recession, which is now thankfully what? 12, 13 years ago. There's been just tremendous advances in the ability for issuers and related parties to respond almost in real time to bad behavior. So they'll have that in their back pocket.

Rob Rubin:

We'll have some AI tools to help them figure that out real fast, a second that happens.

David Morris:

That I think is certainly the going theory. I don't know that they're quite there yet, but they certainly are using big data and artificial intelligence to be able to assist.

Rob Rubin:

Well, it would be really helpful for a lot of people if they could tell them a second before it happens.

David Morris:

Well then you have minority report, but then maybe we're in a world we don't want to be in anymore, Rob.

Rob Rubin:

I know.

David Morris:

But that brings to mind what we were just talking about in terms of what Macy's has released is a harbinger for mainstream consumers. Because if you go to this point in time hypothetically, first quarter of 2024, my theory would be that the consumers that would be most stressed at that point would be the lower income to middle income consumers because those savings have dried up. A lot of these folks are also going to have to be paying back their student loans. Those just started this month or last month and the small business loan. So the question is to what degree that ends up pressuring the higher income consumer and how that behavior may ripple into the economy and increase unemployment. And then that happens, then you're talking about something that has macro effects for everyone.

Rob Rubin:

Right. Well, they keep trying to slow the economy down by raising interest rates, but unemployment doesn't seem to be impacted dramatically, even though we're at a fairly historic high.

David Morris:

It's because we're still in a demand driven environment. The money is still there, people are still spending. I'm a bit of a returning wheel on this, but the amount of money, and we've talked about this before I think Rob, trillions of dollars, was it 2.3? In my own report it's 2.2 or $2.3 trillion that consumers got in the pandemic savings. Think about that. $2.3 trillion and it'll be gone, and some people won't know what to do.

Rob Rubin:

And then some people will use their credit cards.

David Morris:

Some people will use their credit cards and for a certain period of time, maybe they'll pay them back and all will be well, assuming things don't go further down some kind of cliff, then maybe things could turn out all right. I don't happen to believe that. I don't think there's bias in this report that would be antithetical to what we do, but I think there's an argument here about this chain reaction, the causality between these added savings and debt burdens, how that could trigger unemployment, what therefore happens to credit card interest income and so forth. That I think is really worth reading. I'm not sure that the credit card issuers out there are as proactive as they might be. Maybe this Macy's piece is a wake-up call.

Rob Rubin:

So what should a credit card issuer do right now to protect themselves in Q1 2024?

David Morris:

Well, fundamentally is putting reserves aside for that moment in time that could blow up on you, but I think it's also a matter of who's risky and how to be able to watch that behavior. One of the other things that came out with the Macy's call was that what Macy's said was that these delinquencies, the increase in delinquencies among their consumer base, that it happened across the board no matter how long that customer had been a Macy's customer. Now that's actually a very, very interesting...

Rob Rubin:

Yeah, that's trouble.

David Morris:

Little thing to say. Because the general theory here, and this is actually a theory that American Express has postulated on its recent earnings calls, is that we're really watching our long-term customers, the older vintages. That's what they will call them.

Rob Rubin:

Thanks.

David Morris:

Because there's less risk there because for one, we have a real good window into their historical behavior. We want to make sure that if we're doing some lending here, we're going to do it to these folks, not to the new people we don't know as much about. And Macy's is saying, hey, there's issues here with delinquencies with new and old, and that could cause credit card issuer to change tack in terms of how to proceed.

Rob Rubin:

Oh, how to issue new cards, you mean?

David Morris:

Well, how to proceed in terms of being able to manage risk.

Rob Rubin:

All right, what their portfolio looks like in terms of mix?

David Morris:

The portfolio mix and ultimately who they're putting their bets on in terms of good loan candidates.

Rob Rubin:

I think this is a good time for us to transition to for argument's sake. In our final segment today, David, we are going to argue nicely about why there will or won't be a recession. You already given us some points, but we can go over them. It's a critical issue obviously for the credit card industry and our report lays out what will happen to the credit card industry. So let's argue about whether there'll be a recession. First David, you believe that we're heading for a recession and I'm going to take the position that we're having a soft landing and we're not going to see our economy recede.

David Morris:

This will be fun.

Rob Rubin:

Right. So first, David, what are the biggest factors that make you think we're headed for a recession?

David Morris:

I would repeat what I've said. So I would only say that very briefly.

Rob Rubin:

Yeah, that's why I asked.

David Morris:

The fact that there's the savings and debt overhang. I won't go there again, but that's the crux of the argument there that I think is underestimated. I would point to an unemployment rate that is and demand that continues to chug forth despite the Fed putting the brakes on it. You still have too much liquidity out there. I think people should be concerned that the Fed is trying to put the brakes on an economy that in my mind really hasn't slowed down sufficiently. You still have strong wage growth. You have a housing bubble that actually is showing few signs of cracking. There's the bubble aspect of the economy. It's something that invariably what comes up must go down. So there's starting points there.

Rob Rubin:

It's super interesting that you use some of those points because those are some of my points about why we're headed for a soft landing. So I think that the reason housing prices haven't declined is because it's just has really low inventory. So it's sort of masked the fact that there's probably fewer buyers. So you haven't seen the housing market crash.

David Morris:

I think that's a great point. So you're really looking at demand is being propped up by lack of supply, not oversupply because there's a lot of people who are hesitant to put their homes on the market. Nobody wants to give up the 3% mortgage rate that they had locked in for the last 10 years.

Rob Rubin:

So the few people that are buying are in the market and there's supply and demand keeps the price sort of where it is versus everybody bidding on every house. I mean, maybe it feels that way in some markets, but I'm sure there are other markets where it's hard to sell a house and that would be regional. But I point to the fact that overall, the fact that housing prices haven't declined because housing represents such a large part of our economy that that have minimized any kind of recessionary trend. The other one is that we've seen that during the pandemic and after six and 7% wage growth and wages represent a huge chunk of our economy, and what we've seen is that unemployment hasn't declined, yet wage growth has started to decelerate back to these pre-pandemic levels. So I think that those factors, you point to the effect that the economy hasn't cooled off, even though interest rates are going up, sectors probably have cooled off, but other sectors have remained strong, sort of have kept the economy resilient.

David Morris:

That's a good point. I think we'll have to have Mr. Schiller on here, right? You make a good point too about the inventory issue. So my way of just responding to that would be, okay, fine. Then we need to be under the assumption that interest rates are actually going to fall again pretty soon. One of the things that I've been reading anyway and that I wouldn't have any means to disagree with is that these elevated interest rates are going to continue longer than people think, and so let's hypothesize that and somebody's sitting around going, well, I'm going to wait, I'm going to wait, I'm going to wait. And then they can't wait. Then the reset occurs. Finally, it's a kicking to the can in my opinion, as to when that reset would actually happen. People can't sit there and not sell their homes indefinitely.

Rob Rubin:

So maybe it is if you look at over decades versus over a decade that the period of time where we had such incredibly low interest rates was actually the blip, and maybe right now what we're seeing is a correction where we're starting to see interest rates to sort of get to higher levels. You're not going to get a 3% mortgage or a two and a half percent mortgage anytime soon.

David Morris:

Yeah, I think there's probably a lot of credence in that, and the way I look at that is you just think about the global economy. There's a shift, I'm not going to get this right in terms of exactly what year, but let's go back 20 years or so and what's changed in 20, 25 years? The supply chain environment where the consumer has been drowned in less expensive goods that actually goods and the prices of goods go down, and I wonder if there's correlation there with things like inflation and other metrics that have forced interest rates to remain so low to one cent demand. That's a little above my economics pay rate, but I mean, I thought a lot about that, and you're actually seeing that shift. The supply chain is shifting where you might actually have computer chips manufactured here in the United States. That'll cut some costs from the standpoint of the length of the supply chain. You're going to have to pay an American a little bit more money than you are going to pay someone in Vietnam.

Rob Rubin:

Well, I think we've done it, Dave. This was so much fun to talk about. I think we had a really good conversation about credit cards and the impact of sort of what would happen if there's a recession and whether we have a soft landing or not. I'm still going with soft landing, but I take on some of your points.

David Morris:

I was just going to ask you. Yeah, soft landing. I hope you're right.

Rob Rubin:

Yeah, I hope I'm right too. I'm the optimist I think. I want to thank you, Dave, for joining me today. It was a lot of fun. I also want thank everyone for listening to the Banking and Payment Show, an e-marketer podcast sponsored by TransUnion, true audience credit informed marketing solutions. Also, thank you to our editor, Todd. In today's episode, we discuss a report and article that we recently published and the links are in the show notes. Our next episode is on September 19th, and you'll not want to miss it. See you then. Thanks Dave, again I really appreciate it.

David Morris:

You bet. Thanks for having me.

Rob Rubin:

Yeah, I enjoyed it.