Overview

The Federal Reserve Bank of New York reported last week that US household debt reached a new all-time high in the 1Q of this year. The new report also included some troubling internal metrics, not only on the overall household debt levels but also with regard to the level of delinquencies. I’ll give you the details below.

On the same day that the Fed’s debt report was released, US stocks plunged lower in their worst day since last September. The surprise drop last Wednesday came just two days after the S&P 500 and the Nasdaq closed at new record highs. The Dow plunged 373 points, down 1.8% and the S&P 500 lost a similar amount.

Stocks cratered on the revelation (from an unnamed source) that former FBI Director James Comey apparently has a memorandum stating that President Trump asked him to call off the investigation into former National Security Advisor Michael Flynn. That, of course, sparked fears in some circles that the president might be guilty of “obstruction of justice,” and this set off talk of impeachment.

This in-turn led to fears that the president’s agenda – healthcare, tax reform, deregulation and infrastructure spending – could be off the rails. This combination caused the stock markets to tank, the volatility indicator (VIX) to soar by 40% and gold to spike – all in one day.

So there’s no shortage of things to talk about today. Let’s begin with the latest report from the Fed on household debt hitting a new record high in the 1Q.
Household Debt Soars to Record $12.7 Trillion in 1Q

On Wednesday of last week, the New York Fed reported that US household debt and credit hit a new all-time high in the 1Q, despite the fact that the economy continues to recover (albeit slowly), the unemployment rate continues to fall and business investment has increased.

The Fed reported that household debt climbed to a record **$12.73 trillion** at the end of the 1Q, up $149 billion from the 4Q of last year. Gains in mortgage debt, auto debt and student loan debt were all cited as reasons for the large increase to a new record high.

Source: Federal Reserve Bank of New York

Debt balances climbed in several areas. Mortgage debt rose 1.7% (up $147 billion) to $8.63 trillion. Car loans were up 0.9% (up $10 billion), and student loans were up 2.6% (up $34 billion). Interestingly, balances on home equity lines of credit fell slightly in the 1Q, down $19 billion to $456 billion.

The Fed also reported that credit card balances were actually down by **1.9%** ($15 billion) in the 1Q, but there is a seasonal aspect to that component, and there are some troubling signs on the internal credit card metrics. Of the $764 billion in credit card balances as a whole, credit cards with 90 or more day delinquency rates deteriorated and they now stand at **7.5%** of the total.

What is interesting about the latest debt report is that the $12.73 trillion is approx. $50 billion above the previous debt peak reached back in the 3Q of 2008 — right before we hit the depths of the Great Recession.
Delinquency Rates Were Flat in the 1Q But Still Troubling

While the New York Fed showed that aggregate delinquency rates were roughly flat in the 1Q of 2017, some 4.8% of outstanding debt was listed as being in some stage of delinquency. Of that total, $615 billion of household debt was listed as “delinquent,” and some $426 billion was listed as “seriously delinquent” -- at least 90 days late.

The report found that there has been deterioration in auto loan performance and a more recent uptick in early delinquency rates on credit card debt. Delinquencies in the $1.2 trillion auto loan market were down a bit, but they bear watching after a steady rise since 2012.

On student debt, the percentage of student loan balances that transitioned to serious delinquency has remained high, around 10%, and that has been the case over the past five years.

The bottom line is that Americans have now borrowed more money than they had at the height of the credit bubble in 2008, just as the global financial system began to collapse. Some consider this another milestone in the long, but slow, economic recovery; others say we should be worried once again.

While it likely means many Americans have rebuilt their credit since the recession and are feeling optimistic enough to take out loans, the record also comes with risk. The debt held by American households could keep them from buying houses and other large purchases that spur economic growth and possibly trigger another round of defaults, as happened in 2008.

In late 2008, household debt began a decline that would last for 19 consecutive quarters, an unprecedented period of deleveraging during which many Americans shied away from new borrowing. Yet total debt began to rise again in 2013, finally hitting a new high in this year’s 1Q.

Most financial analysts believe that today’s record level of household debt is much healthier and stable than it was in 2008 due to tighter lending standards since the Great Recession. That may be true but it remains to be seen how this ultimately turns out.

Trump Turmoil Caused Stock Markets to Tumble Last Week

As everyone reading this knows, US stocks have been on a bullish tear since Donald Trump was elected president. The S&P 500 Index exploded from near 2,080 at the time of the election to above 2,400 earlier this month.
The strong rally has been largely based on optimism that Trump’s economic plan – **tax reform, deregulation and infrastructure spending** – would spur the economy to a new higher gear at long last.

Yet that optimism has been increasingly called into question in the last couple of weeks due to growing controversy surrounding the Trump administration. Among other things, there is the outstanding issue of whether anyone in the Trump campaign may have colluded with the Russians in supposedly tampering with the outcome of the presidential election.

The FBI has been conducting an investigation into whether any such collusion occurred. Thus far, there is no hard evidence that has been made available to the public to support such a charge. But the FBI investigation is reportedly in its early stages, so we’ll see what happens.

Then, of course, there was President Trump’s firing of the FBI Director, James Comey, on May 9. While Mr. Comey issued a statement saying it is well within the president’s authority to fire the FBI Director for any reason, or no reason, the media and the Democrats launched a vicious attack on President Trump for doing so.

Next there was the revelation (from an unnamed source) last Wednesday that the now-former FBI Director apparently has an internal memorandum stating that President Trump asked him to drop the FBI investigation into former National Security Advisor (NSA) Michael Flynn.
Assuming such a request was actually made by the president to Comey, that would raise questions of “obstruction of justice” by Mr. Trump. And questions of obstruction of justice raised further questions of impeachment.

This is what many believe caused the stock markets to tank last Wednesday. The Dow Jones Industrial Average and the S&P 500 dropped nearly 2% on that day, the worst daily drop since last September. As you can see in the chart above, the S&P (and the Dow) has yet to make it back to its previous highs.

Mr. Comey is scheduled to testify before Congress after Memorial Day, and there is great anxiety over what he may reveal about the FBI’s investigation into possible Trump campaign collusion with the Russians. Ditto for what he might say about Trump allegedly asking him to drop the investigation of former NSA Director Michael Flynn. This could get very interesting and controversial quickly.

Questions abound about what evidence Mr. Comey may reveal in his testimony before Congress. For example, if Comey has evidence that the president may have committed obstruction of justice in his alleged request to Comey to drop the investigation, he had a legal obligation to immediately report such evidence to his superiors at the Justice Department.

The question is, if he had such evidence, why did he not report it to his superiors then? So it will be very interesting to see what Mr. Comey has to say to Congress just ahead.

So What Happens Next? Is Trump’s Agenda Dead? Maybe Not

Following the developments discussed just above, most political analysts concluded that President Trump’s aggressive agenda of tax reform, deregulation, infrastructure, etc. is very likely dead in the water, at least until the Russian investigation is concluded.

With the appointment of former FBI Director Robert Mueller as “Special Counsel” to oversee the Russian investigation -- which potentially could take a year or longer to conclude -- most analysts became even more convinced that Trump will not be able to advance any major parts of his agenda anytime soon.

And of course, the appointment of a Special Counsel fanned the flames of obstruction of justice suspicions and a possible impeachment of the president, however unlikely. All of this news and speculation could weigh on stocks in the months ahead.

Yet there are some political analysts who believe that the appointment of a Special Counsel to investigate the Russian scandal will provide President Trump with a near-perfect window of time to push through his agenda of healthcare and tax reform, deregulation and infrastructure spending. How so?

Kudlow: Don’t Bet Against Tax & Healthcare Reform in 2017

CNBC’s Larry Kudlow, one of my favorite writers, published a thought-provoking article on Saturday
in which he argued that the appointment of a Special Counsel could provide just the opportunity Trump needs to advance his economic agenda. Others are joining this chorus.

Kudlow believes that the Special Counsel will take months (if not longer) to complete his investigation, and this will provide cover for Mr. Trump to press ahead with his legislative agenda. Kudlow and others believe the steady stream of leaks in Washington will dry up in the presence of the Special Counsel. That remains to be seen, of course.

By law, information on the Special Counsel’s probe into Russian interference in our election must be kept secret. So whatever the outcome of the investigation, Trump should have months without the attack headlines in which to push his healthcare and tax reform plans and other priorities.

Kudlow also believes that the GOP Congress will be anxious to go along with Trump’s ideas since the Republicans know they could get whacked in next year’s midterm elections if they fail to pass any significant accomplishments.

Thus, Kulow and others are growing very confident that President Trump will aggressively move forward with his economic agenda as soon as he returns from what has so far been a very successful foreign trip.

As for the talk about obstruction of justice and impeachment, Kudlow believes it is baseless Democratic rhetoric that will not go anywhere, especially after the Special Counsel gets rolling on his investigation. That, too, remains to be seen.

Likewise, Kudlow is not worried about what former FBI Director Comey will reveal in the coming days to Congress. Kudlow points out that if Comey really has evidence of obstruction of justice by President Trump, he would have had to present that evidence to the Justice Department immediately.

The bottom line is that Kudlow and others believe that President Trump has a window of opportunity just ahead to aggressively pursue his economic agenda which includes healthcare and tax reform, deregulation, infrastructure spending, etc. And the Republicans in Congress should be anxious to help Mr. Trump succeed.

It will be very interesting to see how this all plays out, especially with so many in Washington convinced that the president’s agenda is now dead in the water.

The latest column by Larry Kudlow is included as the first link in SPECIAL ARTICLES just below.

All the best,
Gary D. Halbert

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