THE WALL STREET JOURNAL.
WSJ.com

SEPTEMBER 9, 2009

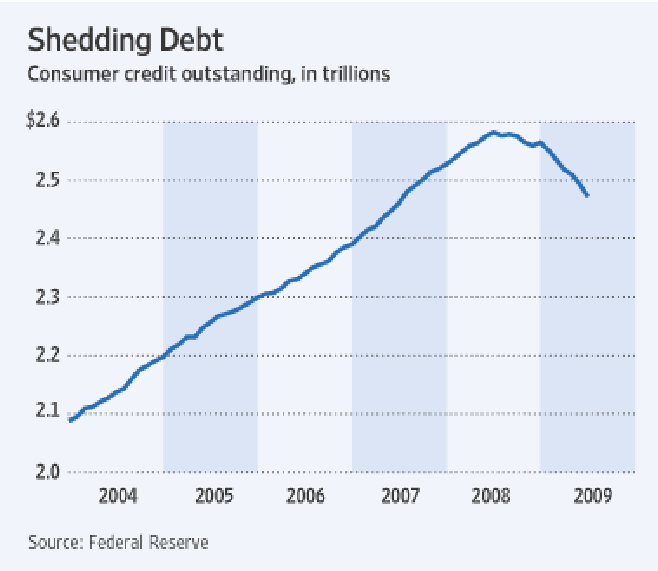
Record Drop Hits Borrowing

Consumers Cut Debt by Choice and by Force, Draining Fuel for Economic Rebound

By SARA MURRAY

Americans borrowed less for the sixth consecutive month in July, fueling concerns that strained consumers will stall an economic recovery.

People shed debt by choice and by force, reflecting a combination of the thrifty attitudes and tighter lending conditions that have defined the recession. Total borrowing, which includes most consumer loans except real estate, decreased at a 10.4% seasonally adjusted annual rate in July to $2.47 trillion, the Federal Reserve said Tuesday. July's $21.6 billion drop from June was a record; total credit had declined at a 7.4% annual rate in June.



The credit conditions bode ill for a quick rebound in consumer spending, which accounts for 70% of gross domestic product, even as glimmers of an economic recovery emerge elsewhere.

"There is no real way to put a positive spin on these data," Charmaine Buskas, a TD Securities economist, wrote in a note to clients. "Credit is still shrinking and that is going to have an impact on consumption."

The manufacturing sector finally began to grow in August and retailers showed signs of improvement, reports last week showed. But many economists predict the savings rate will continue to rise as consumers cut back on borrowing.

"There's general frugality," said Brian Riley, a research director for bank cards at TowerGroup, a financial-research company. "People are more concerned about buying milk and eggs right now than they are about buying a plasma TV."

Tuesday's report showed Americans are ditching their plastic. Revolving credit, which is primarily credit-card borrowing, declined at an 8% annual rate. The Fed's July senior loan officer survey showed 35% of banks tightened credit-card approval standards; no banks reported easing them. Nearly half the banks surveyed also said they had decreased the size of credit lines for existing customers, whereas just 3% increased them.

That affects the bottom line of businesses relying on customers who could more easily get credit in better times. For example, retailer Target Corp., where about one-third of overall sales are made on credit cards, said tightening credit standards on its proprietary cards may have contributed as much as half a percentage point to its sales declines in the second quarter at stores open more than a year.

Nonrevolving credit, such as loans for autos, vacations and education, declined at an 11.7% annual rate. Economists expected a far smaller decline, given the increase in auto sales from the federal "cash for clunkers" program. The program, which ramped up in late July, gave consumers a government rebate if they traded in certain vehicles for more fuel-efficient models.

Tighter credit played a part in this realm, too, as 33% of banks in the Fed's loan officer survey reported tighter terms and conditions for approving consumer loans other than credit cards. None of the banks said they loosened credit standards.

Macroeconomic Advisers, a St. Louis forecasting firm that has been among the more optimistic forecasters, predicted Tuesday that even with little immediate pickup in consumer spending, the economy will gain steam this year -- with growth at an annual rate of 3.5% in the current quarter, 2.7% in the fourth quarter and 3.6% in the first half of 2010. But the firm anticipates much stronger growth in consumer spending early next year.

Write to Sara Murray at sara.murray@wsj.com

Printed in The Wall Street Journal, page A2