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Signs of an emerging debt crisis are everywhere, from credit cards and mortgages to government budgets.



LIFE SCIENCE

America's 'Buy Now, Pay Later' Economy

Serious credit-card and auto-loan delinquencies have climbed to 2008-09 recession levels. The housing market shows cracks while the labor market is weakening. You wouldn't know it from the buoyant stock market and consumer spending.

Credit America's "buy now, pay later" economy, increasingly fueled by leverage. Consumers, investors, businesses and the government are taking on more debt, which we may all pay for later.

As Americans max out their credit cards after years of inflation, buy-now-pay-later offers are popping up everywhere, from concert vendors and travel-booking sites to supermarkets. Consumers can tap an app to split the cost of their purchases into installment payments over weeks or months, sometimes without interest. Unlike credit cards, many of these services don't report loans to credit bureaus. So users don't have to worry about their credit scores getting dinged if they make late payments or borrow excessively.

About half of consumers have used a buy-now-pay-later service, according to a recent LendingTree survey. A Federal Reserve paper last December found such users are more likely to have low credit scores, carry a balance on credit cards, have incurred checking-account overdraft fees, and have more delinquent credit accounts.

Financially vulnerable consumers "may be overextending themselves," the Fed paper warned. Research has also found that consumers spend more when they're given the option to buy now, pay later in stores. No doubt that's why more retailers offer the option despite hefty transaction fees.

Sweden's Klarna, a popular buy-now-pay-later service, last week announced the launch of an initial public offering, which is expected to be one of the biggest this year. Such services make money by capitalizing on financially stretched consumers, especially young people, who don't want to tighten their belts.

A recent New York Times story, "For Gen Z, 'Little Treats' Are Worth Going Over Budget," described a trend, popularized on social media,

of 20-somethings who cope with "uncertain times" by splurging on personal indulges. Tough day at work? Treat yourself—to a \$5 dessert, a \$30 key-ring doll, a \$500 guitar. If your bank account is low, you can always pay later.

Such services are less expensive than payday loans. But they also enable borrowers to overextend themselves. Then again, the government has done the same by allowing overleveraged home buyers to take out bigger mortgages. Taxpayers may pay for it later.

About 69% of borrowers who took out a mortgage insured by the Federal Housing Administration last year had debt-to-income ratios that are considered risky, compared with 28% in 2012. For Fannie Mae and Freddie Mac, the share was 38%, up from 16% in 2012.

More borrowers are struggling to pay mortgages, yet it isn't apparent by official delinquency rates. The reason? The government and Fannie Mae and Freddie Mac are effectively buying down the mortgages of distressed borrowers to

prevent foreclosures.

The FHA has waived or reduced monthly payments on nearly 1.2 million mortgages over the past two years—about 15% of its portfolio. Without such forgiveness, delinquencies would be near the levels of the 2008-09 meltdown. Fannie and Freddie have also been slashing and deferring payments on hundreds of thousands of mortgages.

If the labor market takes a turn for the worse, watch out. The Biden administration instituted these supposedly temporary payment-reduction programs on the expectation that mortgage rates would drop in a few years. Borrowers might then reduce their payments by refinancing. Don't bet your house on it.

Mortgage rates rise and fall with yields on long-term U.S. debt. The more government borrows and spends—buys now and pays later—the more it must pay investors in interest. This is why a rate cut by the Federal Reserve won't necessarily help homeowners or buyers. What it will do is fuel more leverage and risk in the financial system.

Margin borrowing—when investors borrow to buy stocks—has surged this year amid market exuberance and anticipation of more easing by the Fed. Retail traders can borrow at rates as low as 5.75% on Robinhood to buy and flip stocks for a double-digit return. If the market goes south, some will lose their shirts.

Meanwhile, companies are raising capital by piling on debt. Issuance of junk-rated debt hit a record this summer as investors demand less of a premium to buy risky debt. Spreads between high-yield bonds and Treasuries have shrunk to levels seen during the dot-com and housing bubbles.

Some companies are borrowing to cope with tariff costs, others to pay dividends or buy back shares to juice their stock prices. Buy now, pay later. And why not? The government and Fed bailed out overleveraged investors and borrowers in 2008-09. Wall Street may be betting they'll do it again, which we will all pay for one way or another later.

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