



DAVID PAUL MORRIS/ BLOOMBERG NEWS

High Rates Are Hurdle for Card Borrowers

The lower interest fees a Fed reduction would bring would stand to unleash a wave of consumer spending

What is holding back Americans from borrowing more to fuel spending probably isn't their level of debt. It's the cost of it.

As debate rages about whether the Federal Reserve should slash borrowing costs, and how soon, the state of the consumer will be a key question. Some of the latest data points suggest that many consumers, particularly lower-income households, are slowing their spending—but could in theory borrow more on their credit cards to keep it going.

An uptick in late payments and loan losses for card debts that began a couple of years ago seems to have crested.

Among several large card-lending banks reporting second-quarter earnings, the median rate of net charge-offs on card loans fell year over year for the first time in three years, according to figures tracked by analysts at Truist Securities.

The percentage of large banks' card balances with delinquent payments also fell from a year earlier, according to Truist analysts' figures. Likewise, at two of the country's largest auto lenders, **Ally Financial** and **Capital One Financial**, second-quarter delinquency rates on consumers' vehicle loans declined year over year as well.

"The U.S. consumer is in a great place here," Capital One Chief Executive Richard Fairbank recently told analysts.

And while credit is often talked about as a tale of two cities—consumers with strong balance sheets versus those with more marginal profiles—in the second quarter there was apparent improvement across the spectrum.

*NOTE

A group of large card lenders with broader exposures to both higher-score and lower-score borrowers logged a sharper median drop in their rate of late card payments in the latest quarter, according to Truist analysts' figures.

Not only are people evidently managing the debts they have, they also aren't borrowing that much by historical standards.

U.S. households' debt-servicing payments were at about 11% of their disposable personal income as of the first quarter, according to the most recent Fed data. That is running below what was typical before the start of 2020—and a far cry from the 15%-plus peaks seen leading up to the 2008 financial crisis.

Overall, the average U.S. household's inflation-adjusted card balance as of the first quarter was almost \$1,500 below the record level hit in 2008, according to figures calculated by WalletHub.

Yet despite this placid picture, card loan growth has been slowing. It is now at around 3% year over year across all commercial banks, according to Fed data.

So what is holding people back from borrowing more? One impediment may be lenders' tightening of their credit standards over recent quarters, following a big loosening during the postpandemic stimulus period. That is part of what explains banks' improvement in loan performance.

The share of large banks' new card accounts going to subprime borrowers was around 16% as of the first quarter, a sharp drop from about 23% in the last quarter of 2022, according to Philadelphia Fed data.

But even for those who still have access to card credit, a big barrier could be the cost of using it. Average credit-card interest rates have fallen from their peak last year, though they are still quite elevated compared with any time since at least the 1990s. The average rate on card accounts being assessed interest stood at over 22% as of May, according to Fed data. It was around 16% just before the Fed started raising rates in 2022.

Notably, it has been people more likely to feel the squeeze of higher borrowing costs who have been more cautious with their spending of late.

Overall, a three-month rolling average of seasonally adjusted credit- and debit-card spending was up year over year in June for middle- and higher-income consumers, according to Bank of America Institute tracking. But it fell for lower-income consumers.

In theory, though, even lower-income households have the capacity to put more on their credit cards. Consumers in the lowest-income tier were using about 40% of their available credit-card borrowing as of May, according to VantageScore's CreditGauge tracker. That is 3 percentage points below where the figure was at the start of 2020.

So, with part of credit cards' interest rates determined by the prime rate, which is in turn linked to the Fed's rate target, substantial cuts would likely lower the cost of borrowing on cards. Combine that with the loosening of some capital requirements for banks plus their improving credit performance, and there could be a swift drop in the rates charged on cards—potentially unlocking more card usage and spending.

But on the whole, American consumers don't seem to need the help.

—Telis Demos

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