GEN Z AND MILLENNIAL AUTO LOAN DEFAULT RATES ARE SOARING

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(08Dec2022) … Young adults are starting to default on auto loans at an alarming rate. According to a recent analysis by TransUnion, pre-pandemic and current default rates for Generation Z (Gen Z) and millennial car owners shows some startling differences and yet, we have returned to traditional trends - that preventing loan default in the current financial landscape can be challenging – especially for individuals early in their careers and learning to balance new expenses with financial freedom.

RISING DELINQUENCY ON YOUNGER GENERATION AUTO LOANS … In 2019, before the pandemic began, Gen Z had a past-due rate of 1.75%. Today, past-due rates have reached as high as 2.21% among Gen Z car owners. Similarly, millennials now show increased past-due rates of 2.14%, compared with 1.66% before the pandemic. In today's financial environment – which has been impacted by a worldwide pandemic, inflation, geopolitical conflict, and more – it is increasingly difficult for many people to keep up with financial obligations. Inflation has especially affected Gen Z and millennials.

According to a study by Wells Fargo, younger generations are also being impacted far greater by inflation in 2021-22 when compared to older generations. One aspect of that differential is the rise in average vehicle costs of a new car that reached $47,148 as of May 2022. This is a 13.5% increase from the average cost only one year ago and now requires 40.6 weeks of income on average – close to one year's worth of pay.

This financial challenge alone may contribute to the increased auto loan default rates of Gen Z and millennial car owners in particular. According to TransUnion, 4.35% of car owners ages 18 to 40 were at least 60 days late on their auto loans this year. As mentioned above, the data also shows that current default rates for Gen Z borrowers are 0.46% higher than they were pre-pandemic, while rates for millennial borrowers show an even larger increase, of 0.48%.

FALLING CREDIT SCORES … In addition to Gen Z and millennials experiencing higher rates of inflation, they are dealing with negative financial effects due to lower average credit scores. The average US credit score (FICO) required to purchase a new car is 726. Gen Z has an average credit score of 660.5, while the average score for millennials is 667.4. With lower-than-average credit scores, it can be much more challenging to purchase a new car – or even get an auto loan. With the average credit score needed to secure an auto loan sitting at 726 for new cars and 675 for used cars, there are many among Gen Z and millennials who will likely have difficulty getting a loan. Additionally, lower credit scores result in higher auto loan interest rates, ultimately making it more challenging for Gen Z and millennial car owners with lower credit scores to pay off what they owe.

LONGER LOAN TERMS … Another challenge that likely contributes to higher default rates is the increasing amount of time it takes to pay off an auto loan. Approximately 27.2% of auto loan borrowers were taking 73 to 84 months to pay off their loan, an almost 7% rise from the previous year. With a longer loan term, borrowers will likely pay a higher interest rate and ultimately end up paying more over time. Stacked with higher interest rates from having lower credit scores on average, this can increase the likelihood of loan default for Gen Z and millennials.