FHLB Chicago
Federal Home Loan Bank of Chicago

FHLBC Solutions

Consumer Lending: Auto Lending Solutions

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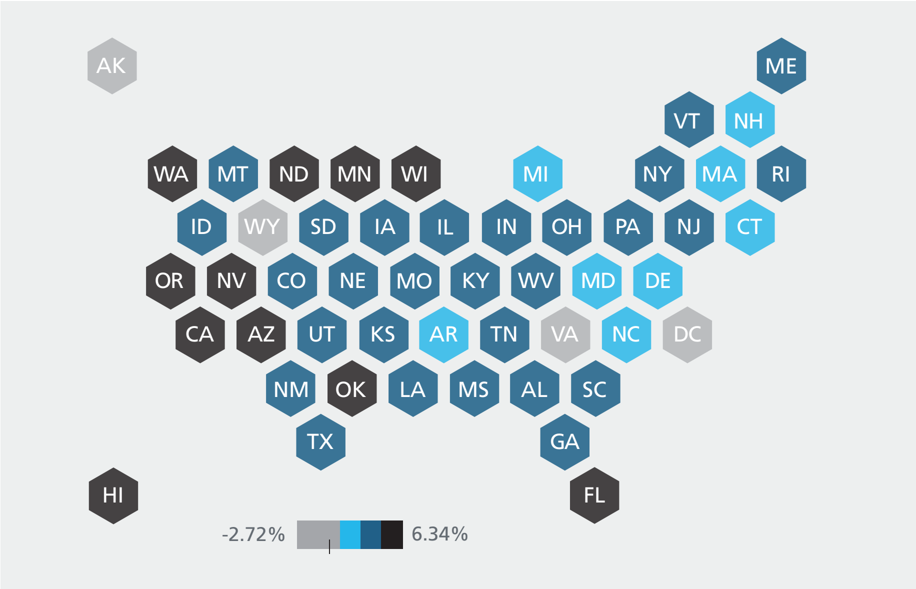
Overview

May through October is considered the new-auto buying and lending season, and as a result you may have seen an increase in auto loan balances at your institution during this time. Year-over-year growth in auto debt balances continues to rise throughout the United States, as shown in Figure 1. Based on Q2 2019 data from the New York Fed's Consumer Credit Panel, auto loans make up 9.4% of total debt in the United States—recently growing to $1.3 trillion as of Q2 2019 versus $0.91 trillion in Q2 2014. Is your institution prepared to handle auto loan portfolio fluctuations? The strategy described in this paper is a common approach given today's low long-term interest rates and the uncertainty whether short-term rates will decrease.

Figure 1: Year-over-Year Growth in Auto Debt Balance Per Capita

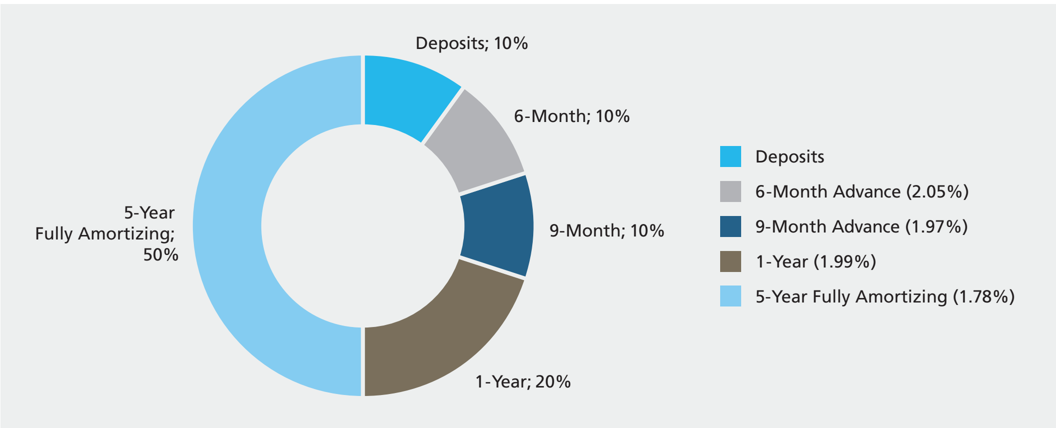


Source: New York Fed Consumer Credit Panel/Equifax; data as of Q4 2018

Using a Blended Strategy to Hedge an Auto Loan Portfolio

In the current inverted yield curve environment, your institution can hedge its auto loan portfolio by taking advantage of low, long-term advance rates in order to increase net interest margin (NIM). By funding your portfolio with a combination of deposits and a ladder of longer-term advances, you can prepare for the uncertainty of future interest rates by locking in rates today. If the Federal Reserve lowers interest rates over the next several months, auto interest rates will likely fall as well. Your institution can take advantage of these low advance rates to hedge your auto loan portfolio by using a mixture of deposits and short-term advances. However, by adding a longer-term amortizing advance to the mix, you can lock in longer-term funding. When the amortizing advances pay down on schedule, you can meet your funding needs with short-term advances or deposits. For example (see Figure 2), a $5 million auto loan portfolio can be hedged with a combination of deposits, a 6-month fixed-rate advance at 2.05%, a 9-month fixed-rate advance at 1.97%, a 1-year fixed-rate advance at 1.99%, and a 5-year fully amortizing advance at 1.78% to mitigate interest-rate risk and maintain a starting NIM of 3.51%, assuming an auto loan rate of 5.36% (Federal Reserve's Q2 2019 Consumer Credit report).* [*Rates as of August 23, 2019]

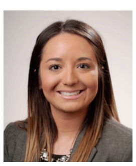
Figure 2: Example – Hedging a $5 Million Auto Loan Portfolio



To Learn More

Contact your Sales Director at membership@fhlbc.com to find out more about the products, strategies, and tools you can use to develop competitive lending solutions for your consumer loan customers.

Contributors



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