

Market Sense – The K-Shaped Economy Is Hidden Under the Headlines in Credit

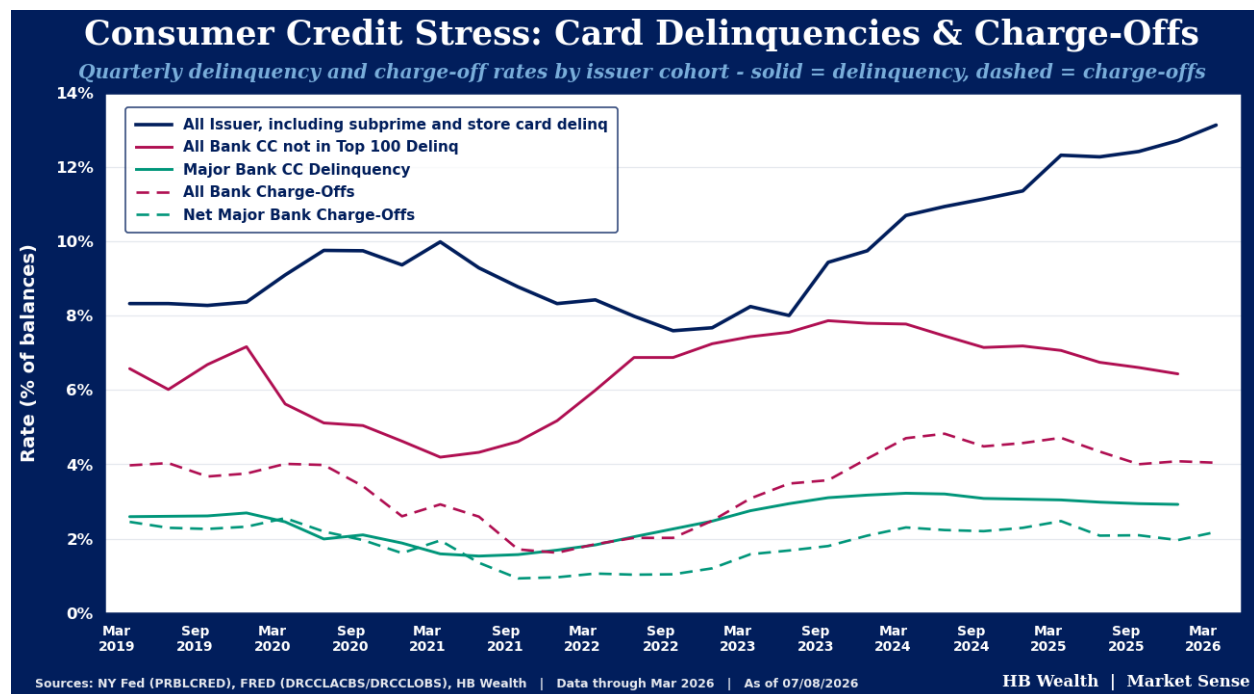
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Abstract:

- *A look under the hood of the ABS market shows two different realities for US consumer loans as the k-shaped economy flows through to fixed income markets.*
- *The tail is already at crisis-era levels. Small bank card delinquency has surpassed its '08-'09 peak, and subprime auto delinquency is just off a 32-year high. Meanwhile, large-bank card delinquency and prime auto remain historically healthy.*
- *ABS markets are one of the few areas of fixed income not trading at multi-decade tight spreads. The sector sits close to its historical average, partly because the market is pricing the borrower divergence that gets lost in the headline statistics.*
- *Technical factors also contribute to keeping ABS spreads wide. Record issuance is meeting a buyer base that is more selective than the passive bids that corporate bonds and mortgages receive, which adds extra spread for those that can parse the data.*
- *The dynamic should be monitored for broader implications, but the current takeaway is the opportunity for active management. ABS offers genuine relative value, and senior tranches provide strong structural protection. With the risk concentrated on the weakest underlying borrowers, issuer selection and tranche level diligence may matter more than ever.*

Much has been written about the wealth and income gap that has developed among US households over the last several years, and the impacts of this gap on household spending patterns. However, the financial consequences of the k-shaped economy are now showing up as well. The consequences of a k-shaped economy, where the upper tier has accumulated financial assets and the lower tier has accumulated financial liabilities, are starting to show up in consumer credit markets.

Credit card delinquencies broadly are near a level last reached during the 2008 financial crisis, but closer to longer term average as far as commercial bank books are concerned. Autos confirm the story from credit cards that subprime borrowers are under strain. If the trend persists, we may see delinquencies spread through medical bills, utility payments, and eventually mortgages. This fundamental dynamic impacting underlying collateral is amplified by a structural supply/demand mismatch in ABS broadly, which adds to the relative yield found in the ABS market vs more traditional areas of fixed income markets. As these delinquencies make their way into charge-offs, the ABS market may increasingly become a center of strain in fixed income. Due to the highly idiosyncratic nature of the market, however, such a strain should also present opportunities for active managers.



One Economy, Two Consumer Experiences

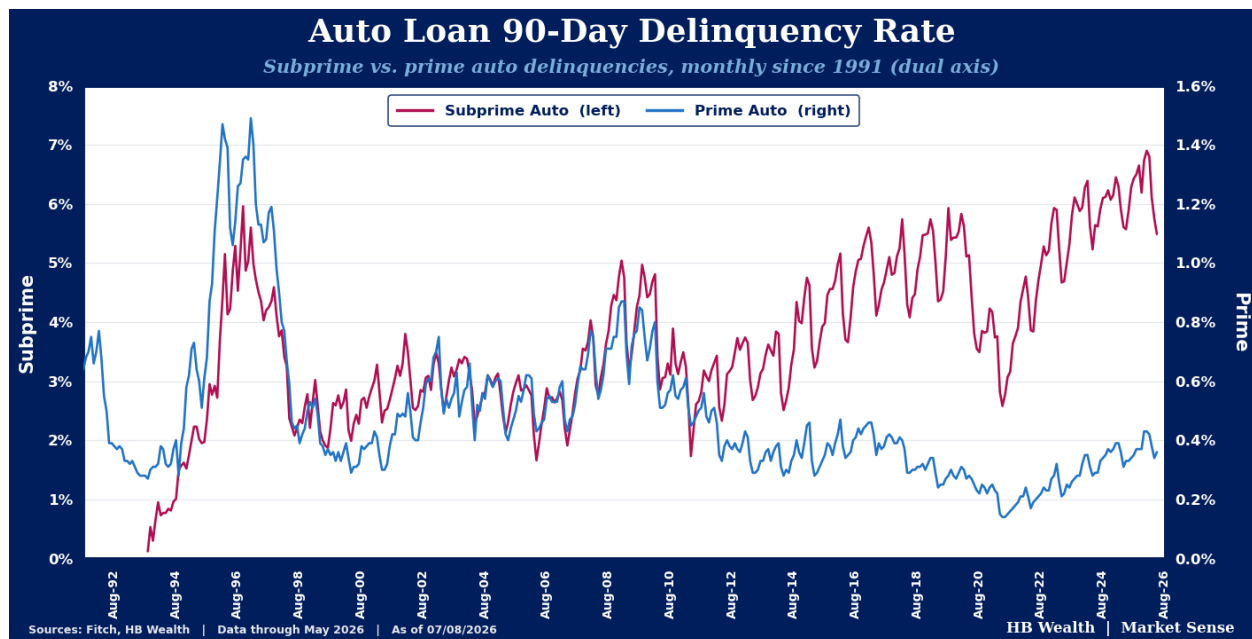
Credit card 90-day delinquencies have climbed to 13.12% of outstanding balances as of Q1 2026, according to the Federal Reserve Bank of New York's Household Debt and Credit Report. This is the highest reading since 2011, when the country was still digging out of the financial crisis, and within striking distance of the 13.74% peak reached in mid-2010. According to the Fed's Survey of Household Economics and Decision-making, 37% of Americans cannot cover a \$400 unexpected expense. Bank of

America Institute data likewise shows 24% of households are spending 95% or more of their income on essentials. Such tight budgets often lead to cards not being used for discretionary spending but to cover groceries, utilities, and rent when income and monthly obligations do not match. Card balances built on essential spending at an average 21% APR typically compound rather than being resolved through budgeting.

However, the Federal Reserve's FRED database says credit card loan delinquencies at all commercial banks are sitting at a mere 2.92%, down from a 3.22% cycle peak in 2024, and less than half its GFC-era high of 6.77%. The gap between 13.12% and 2.92% reflects a structural divide in the credit card market that was deepened by the regulatory response to the last crisis. The FRED aggregate is dominated by the major prime issuers: JPMorgan, Bank of America, Citigroup, and peers who spent the years after 2008 tightening underwriting standards and pushing lower-quality borrowers down-market to smaller institutions and specialty issuers.

The NY Fed's measure captures balances across all issuers, large banks, regional banks, credit unions, finance companies, and importantly, the store-card and subprime card originators that are not part of the FRED commercial bank series. Delinquency rates at banks outside the top 100 by asset size, the "small bank" cohort that starts to capture more of the subprime exposure, are already above their GFC peak at 6.43%. The headline institutional commentary mostly ignores this number because benchmark-constrained credit portfolios do not hold much small-bank card ABS.

The consumer pattern visible in card delinquency data is not isolated to credit cards alone. Auto loans tell the same story. NY Fed data shows 90-day auto loan delinquency reached 5.6% of outstanding balances in Q1 2026, already above the prior GFC peak of 5.27% from Q4 2010. At the ABS level, Fitch's subprime auto loan 60+ day delinquency index hit 6.90% in January 2026, the highest reading in their 32-year history of tracking that metric, while their prime auto measure sits at just 0.36%. The prime/subprime delinquency gap in auto is a mirror of the k-shaped underlying consumer market that card data shows.



What the Delinquency vs Charge-Off Relationship is Saying

One of the most important features of the current cycle is the gap between delinquency and loss that has resulted from the two-tier consumer economy.

At the GFC peak, both measures of stress were running at similar extremes, 13.74% of balances at smaller banks and store cards were 90+ days delinquent, while charge-off across all banks reached 13.21%. The two figures come from different data sets; one includes the more subprime heavy end of the market and the other looks at the “all banks not in the top 100” set that includes smaller regional traditional banks with limited subprime exposure, not strongly focused on subprime or store cards. While that does make them less directly comparable, together they paint a picture of a system where stressed borrowers were flowing quickly from delinquency to recognized loss with little accumulation in between. Today the same two measures tell a different story with all issuer delinquencies at 13.12%, yet smaller bank charge-offs sit at just 4.04%. A growing pool of borrowers has crossed the serious delinquency threshold but has not yet generated a proportionate level of recognized bank losses.

Several explanations are plausible and not mutually exclusive. Average balances at impaired issuers are smaller than at prime banks, so the dollar loss per delinquent account is lower. Banks and issuers may be extending hardship programs and deferments to keep borrowers in delinquency and buy time, in hopes of being repaid, rather than charging them off. And the distribution of stress is more concentrated as a smaller number of borrowers carrying larger balances have become stuck in a cycle. At an average credit card APR of 21%, there is no easy path back to current for a borrower who has fallen significantly behind. Whether the current delinquency-to-charge-off gap represents a temporary lag or an extended period of unresolved stress could have significant consequences for consumer ABS credit quality going forward.

What This Means for ABS Investing

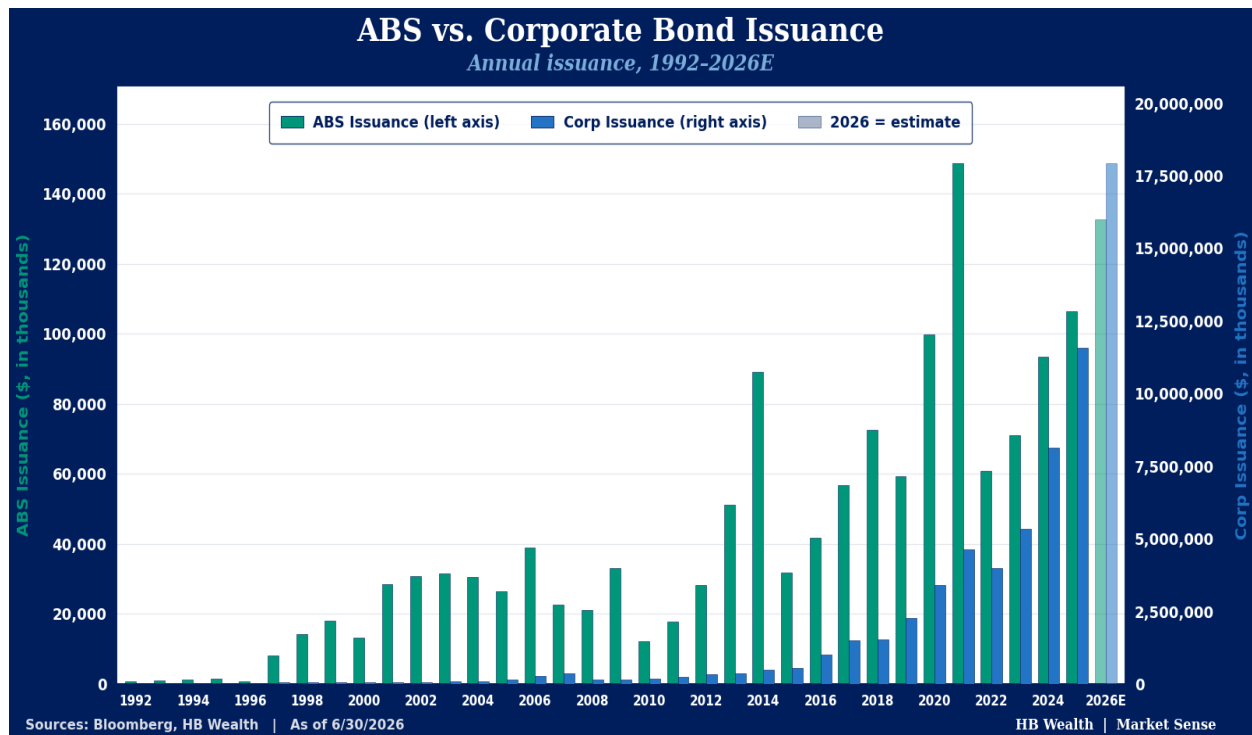
The k-shaped economy is not just a macro narrative, it shows up tangibly in consumer ABS. Part of the reason ABS spreads haven't compressed to the same degree as other segments of the fixed income markets is that the ABS market is starting to price in the underlying stress that headline statistics miss.

However, none of this is a reason to avoid investing in the sector. Quite the contrary, ABS offers genuine relative value versus other areas of credit on a risk-adjusted basis, and senior-tranche structures provide meaningful protection against stressed loss scenarios. But the data argues strongly for differentiation within the sector and validates the need for active management. The gap between large-bank and small-bank card delinquency is not a statistical quirk; it is a map of where the credit risk lives and makes the case for active management rather than buying the sector wholesale.

In addition to the fundamental tea leaves to be read in the divergence of underlying credit, there are technical factors contributing to spread widening. ABS issuance has grown notably as issuers find different ways to raise cash with rates elevated, with 2026 volume on pace for 20% growth vs 2025, and nearly double 2023. Corporates can absorb that kind of supply growth easily since there is a built-in buyer base for corporate bonds through passive ETFs, insurers, and pensions that buy the market broadly. ABS doesn't get the same automatic bid since it is not a homogenous curve trade. Each corner

of the ABS market (auto, credit card, equipment, etc.) requires its own due diligence, so the marginal buyer is more discerning. More supply meeting a selective buyer means extra spread.

Heightened base rates are a major factor in both the technical and fundamental aspects to the spread gap, as it simultaneously strains lower income borrowers and gives corporations reason to find ways to raise cash other than traditional bonds. As such, lower rates would alleviate some of the stress, but until the larger institutional players start participating more meaningfully in these markets, we are likely to see ABS continue to provide relative value for opportunistic managers to exploit.



The bottom line: ABS offers reasonable compensation relative to history, but not all collateral within the headline spread is created equally. In an environment where the aggregate consumer credit picture looks manageable and the tail is already at crisis-era stress levels, issuer selection and tranche-level diligence may matter more than ever.

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