First Trust
Monday Morning OUTLOOK
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# Don't Fret Student Debt

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For the past six years, investors have faced one fear after another. One of those fears has been the more than $1 trillion of student loan debt outstanding. This debt is up 160% since the start of 2006 (and growing) while the share of student loans with payments 90 days late, or longer, has risen from 6.4% to 11.3%.

Look, we're not thrilled with this debt. Just like with low-income housing loans, the government is pushing hard, providing subsidies and creating avenues to avoid paying it back. The worst problem is that much of it is financing education with little chance of increasing future earnings. But the lack of quality, or productive, education would be a problem even if it was fully paid for with cash up front, with no borrowing at all.

The lack of a quality, earning-enhancing education is a legitimate long-term structural issue that can stifle productivity growth and therefore the growth potential of the US economy for decades into the future. Also, the easy availability of student loans tends to depress labor force participation among young people. Students are less likely to work than their friends who aren't going to school. And because student aid has become more generous, students are less likely to work than students from a generation ago.

However, the effects of student loans on long-term productivity growth and labor force participation are not a short- or medium- term cyclical issue for the economy. They won't derail the current expansion. Moreover, defaults on student debt, while rising, are still a small burden relative to the size of the economy.

It's important to remember that, like other forms of debt, student loans *re-arrange* purchasing power. They don't *create or destroy* purchasing power. Yes, students who graduate (as well as those who drop out) with larger debt loads will have more trouble buying a home as long as the debt burden exists.

However, the stakeholders in the college or university they attended – the professors, administrators, and other employees – view that student loan money as income. They buy homes, too.

Second, the financing burden of all consumer obligations combined – mortgages, rent, car loans and leases, student loans and other consumer loan obligations – was 15.3% of after-tax income in 2014, the lowest on record going back to 1980. So, yes, the burden of student debt is higher, but the burden of <u>all</u> consumer debt combined is much lower than usual.

Third, many student borrowers are starting to take advantage of loopholes designed to ease their burden, like income-based repayment plans and taking public sector jobs that can result in some "loan forgiveness." This doesn't mean we like these loopholes – trust us, we don't. But, in effect, it means a portion of student loan debt won't get repaid, which means the government has to absorb the cost, adding to government debt.

As usual, bad government policy is a key driver behind the big increase in student loan debt. Government subsidies encourage over-borrowing and lead to schools charging more for tuition and fees. As costs rise faster than inflation, and subsidies encourage the use of debt, students pursue loans more aggressively.

One idea we've heard would be to make schools guarantee some portion (we think 25% would be perfect), of all student loans used to pay tuition at their school. That kind of shift would be a game changer. Schools would have an incentive to teach real skills that can help students lift their future earnings.

A change like that will probably take several years. In the meantime, the huge increase in student loans is likely to remain a headwind for students who didn't get value for their money, not for the economy as a whole.

| Date/Time (CST) | U.S. Economic Data | Consensus | First Trust | Actual | Previous |
|---|---|---|---|---|---|
| 3-23 / 9:00 am | Existing Home Sales – Feb | 4.900 Mil | **4.900 Mil** | 4.880 Mil | 4.820 Mil |
| 3-24 / 7:30 am | CPI – Feb | +0.2% | **+0.1%** | | -0.7% |
| 7:30 am | "Core" CPI – Feb | +0.1% | **+0.1%** | | +0.2% |
| 9:00 am | New Home Sales – Feb | 0.465 Mil | **0.449 Mil** | | 0.481 Mil |
| 3-25 / 7:30 am | Durable Goods – Feb | +0.2% | **-0.7%** | | +2.8% |
| 7:30 am | Durable Goods (Ex-Trans) – Feb | +0.2% | **0.0%** | | 0.0% |
| 3-26 / 7:30 am | Initial Claims Mar 21 | 290K | **298K** | | 291K |
| 3-27 / 7:30 am | Q4 GDP Final Report | 2.4% | **2.5%** | | 2.2% |
| 7:30 am | Q4 GDP Chain Price Index | 0.1% | **0.1%** | | 0.1% |
| 9:00 am | U. Mich Consumer Sentiment- Mar | 92.0 | **91.7** | | 91.2 |