Weekly Economic Commentary

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Highlights

In our view, the outlook for the student loan situation is much more balanced than recent headlines suggest.

Student debt is soaring, but the devil is in the details behind the headlines.

The federal government guarantees 85% of student loan debt.

An improving economy and labor market will likely head off the worst-case scenario of widespread defaults on student loans in the coming years.

Please see the LPL Financial Research Weekly Calendar on page 4

Check out our full page cheat sheet graphic on page 4 for a breakdown on student loan debt.

Crash Course on Student Loans

Hysterical Headlines

In recent months, student loans have been all over the news. Some recent headlines include:

- "Student loan crisis"
- "Student loan rates to double"
- "Student loan delinquency skyrocketing"
- "Are student loans becoming a macroeconomic issue?"
- "Lighting the student loan dynamite"
- "Yes, there is a student loan bubble"
- "College debt bubble mimics housing bubble"

These headlines, and similar ones, can be found by just typing "student loans" into an internet search engine, or by simply picking up your local newspaper. As with any headlines, there is some truth to this very serious issue, but as always, the devil is in the detail, and the student loan situation is no different. Yes, student loan debt outstanding (nearly $1 trillion) is soaring, student loan rates did double (from 3.4% to 6.8%) on July 1, 2013, thanks to inaction from Congress, and student loan debt is larger than auto financing debt ($800 billion), credit card debt ($660 billion), and home equity debt ($550 billion). In addition, delinquency rates for student loan debt (11%) are nearly double the rate for all consumer credit (6%), and nearly $22 billion in student loan debt is "seriously delinquent" (more than 90 days).

However, 85% of student loan debt is guaranteed by the federal government, likely limiting the impact of rising student loan defaults and delinquencies on private credit markets. Congress agreed last week (July 8–12, 2013) to tie student loan rates to the yield on 10-year Treasury notes, which, if adopted into law, would push rates back under 4.0% (from 6.8%) for most student loans. Although $1 trillion of student loan debt is a huge number in absolute terms, it pales in comparison to overall (private and public) U.S. debt outstanding ($55 trillion), the mortgage market ($13 trillion), the Treasury market ($12 trillion) and the corporate bond market ($9 trillion). As the economy and especially the labor market continue to improve, the overall delinquency rate on all consumer debt has moved lower from 9% in 2010 to 6% in early 2013. Student loan delinquency rates

Close to Home

As with the housing market, the issues around student loans are often, no pun intended, close to home. Almost everyone has student loan debt, just finished paying off their student loans, or knows someone (a relative, a roommate, a co-worker, a neighbor) in those two categories. While the data we present in this week's commentary may differ from your experience with student loans, please keep in mind that it is intended to represent the student loan issue from a national perspective.

One of the main culprits in the hyperbole surrounding the student loan market is that there is not one universally accepted data source on student loans.

The risk, however, is that the economy does not improve quickly enough before the onset of the next recession to avert a larger crisis in the next decade or so.

followed the same pattern in 2010 (around 9%) and 2011 (under 8.5%) before surging to nearly 12% in 2012. They ticked down a bit in the first quarter of 2013.

Know Your Source

One of the main culprits in the hyperbole surrounding the student loan market is that there is not one universally accepted data source on student loans. For example, if you want to know about the state of the U.S. labor market, the universally accepted data source is the Bureau of Labor Statistics of the U.S. Department of Labor. Similarly, if you want information on gross domestic product (GDP), the Bureau of Economic Analysis of the Department of Commerce is the place to go. On the other hand, there are numerous sources, both public and private sector (and often confusing and conflicting), for student loan data, including, but not limited to:

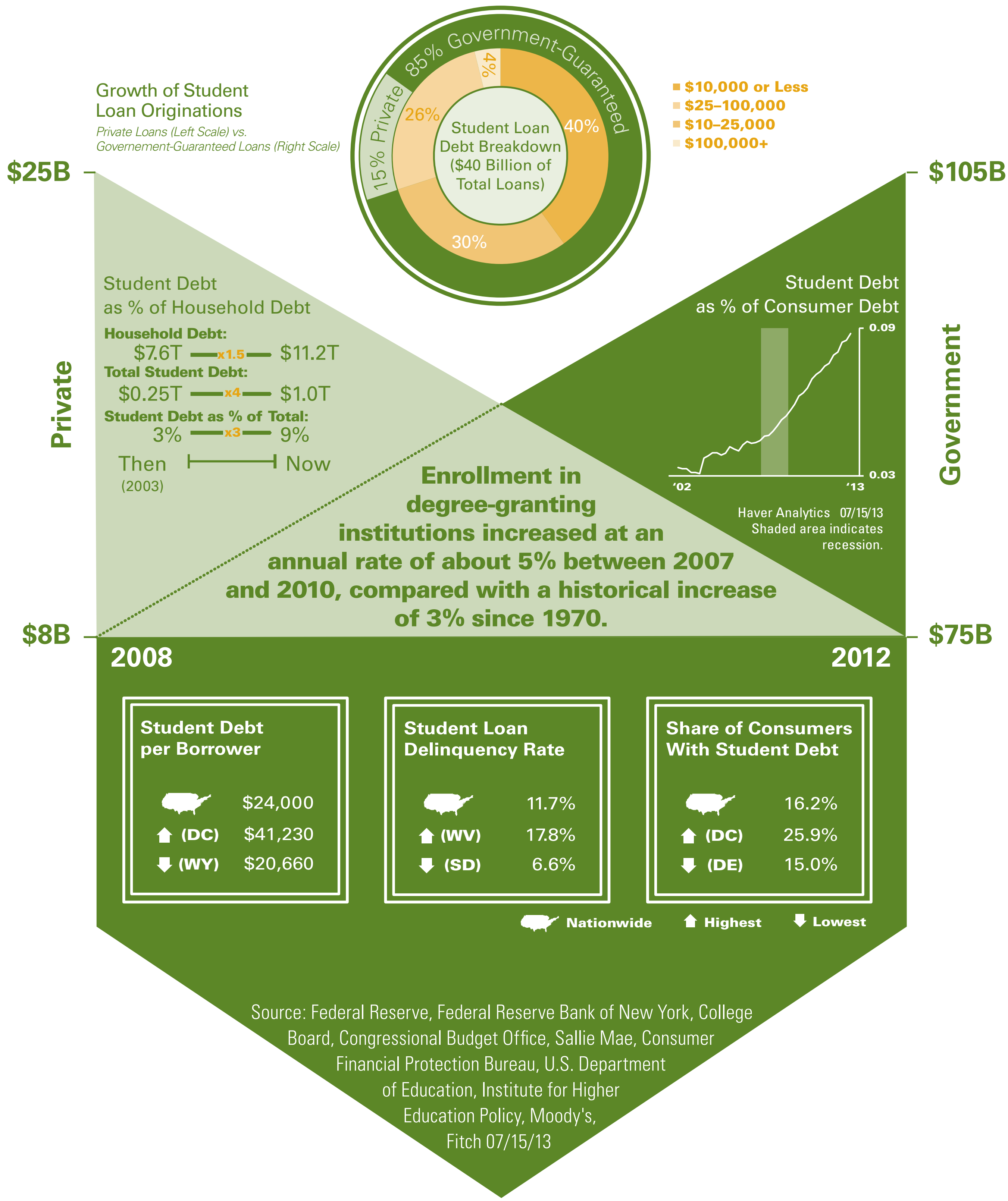
- The Federal Reserve Board of Governors
- The Federal Reserve Bank of New York
- The College Board
- The Congressional Budget Office
- Sallie Mae
- The Consumer Financial Protection Bureau
- The U.S. Department of Education
- The Institute for Higher Education Policy
- Moody's
- Fitch

Although there are a wide variety of sources for the data, the basic message from all of them is pretty clear (see infographic on page 4). On the surface, the student loan issue is daunting:

- Student loans outstanding are closing in on $1 trillion, and they have increased by more than 10% per year on average since 2006.
- At 11.2%, the delinquency rates on student loans are rising, and rising rapidly.
- The rates on government-backed student loans, while not likely to double, are likely headed higher, making it more difficult for borrowers to repay, and to qualify for other forms of consumer debt (auto and credit card) and for mortgages. This may crimp consumer spending and overall economic growth.

But in our view, the outlook for the student loan issue on the financial system and economy is much more balanced than the rash of recent headlines suggests. An improving economy and labor market—especially for those with a college degree where the unemployment rate is 3.9%, well below the overall unemployment rate of 7.6%—is likely to head off the worst-case scenario of widespread defaults on student loans in the coming years. The risk, however, is that the economy does not improve quickly enough before the onset of the next recession to avert a larger crisis in the next decade or so. ■

Student Loan Debt



LPL Financial Research Weekly Calendar

2013	U.S. Data	Fed	Global Notables
15 Jul	▪ **Empire State Manufacturing (Jul)** ▪ **Retail Sales (Jun)** ▪ Business Inventories (May)		
16 Jul	▪ CPI (Jun) ▪ Industrial Production (Jun) ▪ Capacity Utilization (Jun) ▪ **Homebuilder Sentiment (Jul)**	**George***	▪ **Germany: ZEW (Jul)** ▪ Eurozone: Trade Balance (May)
17 Jul	▪ **Housing Starts (Jun)**	▪ **Beige Book** ▪ **Bernanke's Humphrey-Hawkins Testimony**	▪ Japan: Machine Tool Orders (Jun) ▪ Canada: Central Bank Meeting ▪ **China: Property Prices (Jun)**
18 Jul	▪ Philadelphia Fed (Jul) ▪ Leading Indicators (Jun)		▪ **G20: Finance Ministers Meeting** ▪ France: Bond Auction ▪ Spain: Bond Auction
19 Jul			▪ **G20: Central Bankers Meeting**

Hawks: Fed officials who favor the low inflation side of the Fed's dual mandate of low inflation and full employment

Doves: Fed officials who favor the full employment side of the Fed's dual mandate

* Voting members of the Federal Open Market Committee (FOMC)

Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.

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