DALLASFED

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Financial Insights

FIRM • FINANCIAL INSTITUTION RELATIONSHIP MANAGEMENT

CALENDAR OF EVENTS

Oct. 7
Economic Roundtable
Amarillo, Texas

Oct. 8
Economic Roundtable
Lubbock, Texas

Oct. 14
Corporate Payments Council Meeting
Dallas, Texas

Oct. 15
Regional Bank Council Meeting
San Antonio, Texas

Oct. 22
Community Depository Institutions Advisory Council Meeting
Dallas, Texas

Nov. 4
Economic Roundtable
McAllen, Texas

For more information about these events, email FIRM at Dallas_Fed_Firm@dal.frb.org.

Student Debt: Trends and Possible Consequences

by Ericka Davis

Student debt in the United States totals more than $1.1 trillion, having expanded by $855 billion in the past 10 years. The rate of serious delinquency on student loans has averaged more than 11.25 percent over the past two years. Student loans are receiving increased attention from borrowers, lenders and policymakers as concerns mount over students' heavier debt loads and their potential inability to repay.

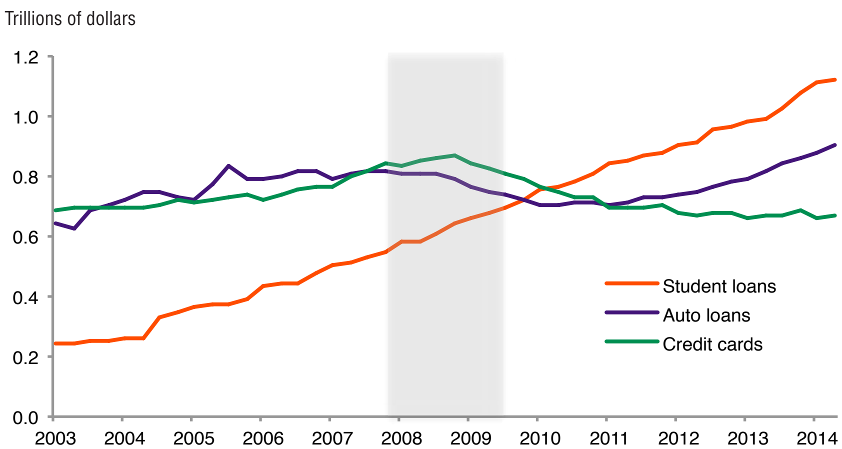
So how do current student debt levels and delinquency rates, as well as trends over the past decade, compare to other major consumer lending categories? Should borrowers, lenders and policymakers be alarmed? And what are some possible consequences to younger borrowers?

Changing Trends of Consumer Debt

Chart 1 shows the rapid growth in student debt since 2003, surpassing the overall size of the credit card lending market and the auto lending market. Near the beginning of 2003, there was $688 billion in credit card debt, $641 billion in auto loans and just $241 billion in student loans. Since then, student loans have increased at a compound annual growth rate of nearly 15 percent—more than three times faster than for auto loans. Credit card lending—which increased prior to the Great Recession and then receded—is currently lower than its balance in 2003. As of June 2014, credit card debt stood at $669 billion, auto lending at $905 billion and student debt at $1.1 trillion.

Unlike auto loans and credit card lending, student debt continued to grow during and after the Great Recession. Of course, rising student debt levels might be expected as college enrollment expands and tuition rates and fees increase. And during the recession, the growth of student

Chart 1 The Expanding Student Loan Market



NOTE: Shaded area represents Great Recession.
SOURCES: Federal Reserve Bank of New York; Equifax; Haver Analytics.

DALLAS FED RESOURCES

Economic Updates

Regional—"Regional Growth: Full Steam Ahead"

National—"Economic Growth Accelerates; Job Openings Outpace Hires"

International—"Advanced Economies Slow; Global Outlook Cloudy"

Publications

Community Banking Connections

Dallas Beige Book
September 2014 Summary

Economic Letter
"Despite Cautionary Guidance, Leveraged Loans Reach New Highs"

Southwest Economy
"Mexico's New Banking Measures Aim to Increase Credit, Transparency"

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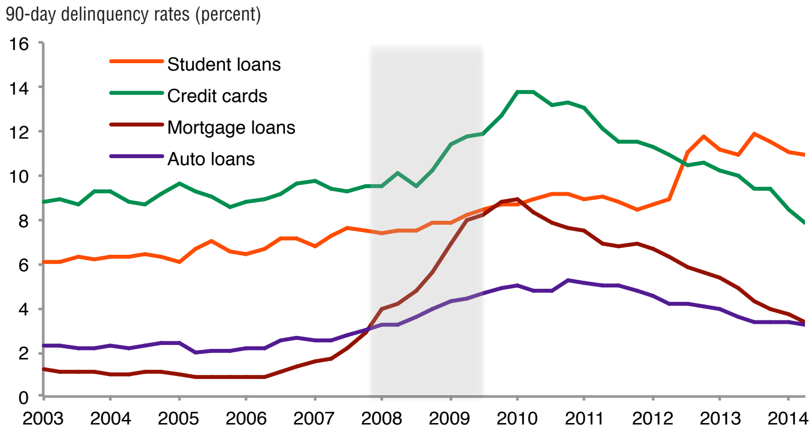
loans might have been the result of many workers returning to school to gain additional skills until more-promising job opportunities return. Even given recent trends of rising college costs and lower earnings upon graduation, research shows that the benefits of college still tend to outweigh the costs.[1] Regardless, as costs for higher education continue to rise, college students seem likely to take on more student debt.

Impact of Borrowers

The unique circumstances of student loan borrowers coupled with the distinctive characteristics of student loans may lead to excessive borrowing, more delinquent payments and lower credit scores. Student loans are often originated when borrowers earn little income. Many borrowers have only a vague idea of their future earnings potential and ability to repay. Borrowers can defer payment of unsubsidized loans while enrolled in college, which results in an even larger debt burden. And many borrowers do not understand the structure and repayment options associated with student loans. Moreover, with the exception of certain programs or an undue hardship petition or death, student loans are rarely forgiven.

Since the end of the Great Recession, serious delinquencies (loans past due 90 or more days) have declined across all lending categories except student loans (*Chart 2*). At 10.9 percent, the second quarter 2014 delinquency rate on student loans was more than three times that of mortgages and auto loans, and more than 3 percentage points higher than the rate of serious delinquencies on credit cards. Although the causes of increasing student loan delinquencies require further research, the long-run implications for seriously delinquent borrowers likely include higher interest rates on other consumer lending products; greater difficulty in securing loans, housing and utilities; and lower credit scores. However, it is important to remember that these challenges can be mitigated if borrowers commit to diligent and timely payments.

Chart 2 Student Loan Delinquencies Buck Trend

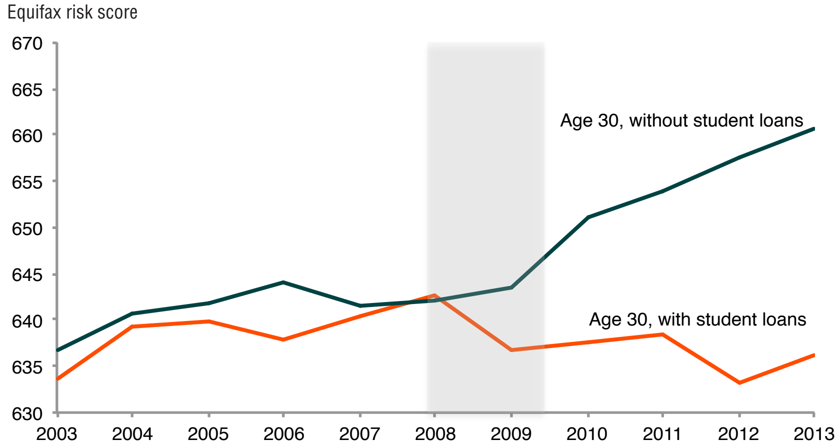


NOTE: Shaded area represents Great Recession.
SOURCES: Federal Reserve Bank of New York; Equifax; Haver Analytics.

Younger Borrowers Face a Bigger Battle

For younger borrowers, the consequences of high student debt combined with greater difficulties in making required payments can be even more devastating. Younger borrowers with student debt problems may have greater difficulty starting their own business or securing employment since some jobs require applicants to have a good credit history. According to Federal Reserve Bank of New York research, credit scores of student borrowers and nonborrowers have recently diverged (*Chart 3*).[2] From 2003 to 2008, Equifax risk scores for 30-year-olds with student debt are nearly the same as those for 30-year-olds with no student debt. But after 2008, the risk scores for these two groups deviate: Average credit scores for 30-year-olds with student debt begin to stagnate or gradually slide, whereas average scores for

Chart 3 Student Borrowers Deemed More Risky



NOTE: Shaded area represents Great Recession.
SOURCES: Adapted from "Young Student Loan Borrowers Retreat from Housing and Auto Markets," by Meta Brown and Sydnee Caldwell, *Liberty Street Economics* (blog), Federal Reserve Bank of New York, April 17, 2013.

those without student debt improve. By 2013, there is a 24-point differential in average scores between the two groups, which could result in broader implications for many sectors of the U.S. economy.

Indeed, the New York Fed study concludes that younger workers with student debt may have more limited access to housing and auto debt, which could also limit their options in these markets. Lower homeownership rates among younger workers suggest that the burden of student loans may have kept these potential homeowners from making major investments. According to the U.S. Census Bureau, homeownership rates for householders under 35 years of age fell to 35.9 percent in second quarter 2014, the lowest proportion of any young adult generation since 1982.[3]

More Research Needed

Over the past decade, student debt has skyrocketed and delinquency rates have nearly doubled to levels much higher than for other consumer lending products. These trends are generally viewed as troubling. Recent research suggests that consumers with student debt are at a disadvantage in other lending markets and in their influence on economic activity. But other research continues to indicate that investing in a college education is a wise economic decision, despite recent trends in higher tuition costs and lower wages. While the choice to become more educated has numerous positive benefits, mortgaging future opportunities with more student debt may present considerable long-run, negative consequences. It is important that further research be conducted on the expanding student loan market to monitor and assess changing trends and to better understand potential implications to borrowers, lenders and the broader economy.[4]

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NOTES

[1] See "Do the Benefits of College Still Outweigh the Costs?" by Jaison R. Abel and Richard Deitz, *Current Issues in Economics and Finance*, Federal Reserve Bank of New York, vol. 20, no. 3, 2014.

[2] See "Young Student Loan Borrowers Retreat from Housing and Auto Markets," by Meta Brown and Sydnee Caldwell, *Liberty Street Economics* (blog), Federal Reserve Bank of New York, April 17, 2013.

[3] See "Residential Vacancies and Homeownership in the Second Quarter 2014," by Robert R. Callis and Melissa Kresin, *U.S. Census Bureau News*, U.S. Department of Commerce, July 29, 2014.

[4] For more information on consumer credit conditions, see the Dallas Fed's Consumer Credit Resource Center, http://www.dallasfed.org/cd/ccc/index.cfm.

ABOUT *FINANCIAL INSIGHTS* AND FIRM

Financial Insights is published periodically by FIRM – Financial Institution Relationship Management – to share timely economic topics of interest to financial institutions.

FIRM was organized in 2007 by the Federal Reserve Bank of Dallas as an outreach function to maintain mutually beneficial relationships with all financial institutions throughout the Eleventh Federal Reserve District. FIRM's primary purpose is to improve information sharing with district financial institutions so that the Dallas Fed is better able to accomplish its mission. FIRM also maintains the Dallas Fed's institutional knowledge of payments, engaging with the industry to understand market dynamics and advances in payment processing.

FIRM outreach includes hosting economic roundtable briefings, moderating CEO forums hosted by Dallas Fed senior management, leading the Dallas Fed's Community Depository Institutions Advisory Council (CDIAC) and Corporate Payments Council (CPC), as well as creating relevant webcast presentations and this publication. In addition, the group supports its constituents by remaining active with financial trade associations and through individual meetings with financial institutions.

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Noteworthy Items

Federal Reserve Governor Jerome Powell provides remarks at the Federal Reserve and Conference of State Bank Supervisors community banking conference (Sept. 23, 2014)
Powell discusses community banks' important role within the economy. Powell also elaborates on the Federal Reserve's commitment to understanding the challenges faced by the community banks. READ MORE

President Richard Fisher provides remarks upon receiving the Woodrow Wilson Award for Public Service (Sept. 19, 2014)
The Woodrow Wilson International Center for Scholars recognized Richard Fisher and Myron E. Ullman III, current chairman of the Dallas Fed Board, for their commitment to public service. READ MORE

Community Banking Connections releases FedLinks bulletin on "Introducing a New Product or Service" (Sept. 19, 2014)
This bulletin, while not intended to set forth supervisory guidance, discusses five factors that examiners have found are associated with successful new product development: the repeatable process; strategic fit for the institution and its customers; risks and mitigants; regulatory compliance; and financial costs and benefits. READ MORE

Dallas Fed Community Development releases updated edition of Building Wealth (September 2014)
Building Wealth is a personal finance education resource that presents an overview of wealth-building strategies for consumers, community leaders, teachers and students. READ MORE

Federal Reserve Vice Chairman Stanley Fischer speaks in Sweden about the challenges the U.S. faced during the Great Recession (Aug. 11, 2014)
Fischer discusses how policymakers learn from the challenges that arise from economic crises. Specifically, he refers to the difficulties of assessing the relative importance of cyclical versus structural factors affecting the global economy and the difficulties associated with returning to higher output and productivity growth. READ MORE

Federal Reserve System releases the 2013 Federal Reserve Payments Study (July 24, 2014)
The study is the fifth of a series of triennial studies conducted to estimate and study aggregate trends in noncash payments in the United States. READ MORE

President Richard Fisher speaks at the University of Southern California on the current risks associated with monetary policy (July 16, 2014)
Fisher asserts that the Federal Reserve is overstaying its welcome by staying too loose for far too long. He refers to "macroprudential supervision" as a Maginot Line: It can be circumvented because relying upon it to prevent financial instability creates an artificial sense of confidence that is not healthy for our economy. READ MORE

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