Special Commentary — October 2, 2023

Don’t Make a Mountain Out of Loan Bill

Summary

Student loan payments are due again this month after a more than three-year pause on payments and interest accrual. For the roughly 43 million borrowers who hold student loan debt, this means increased obligations and less ability to spend on discretionary purchases. But for the broader household sector, this is a drop in the bucket. Student loan repayment should be a relatively contained headwind.

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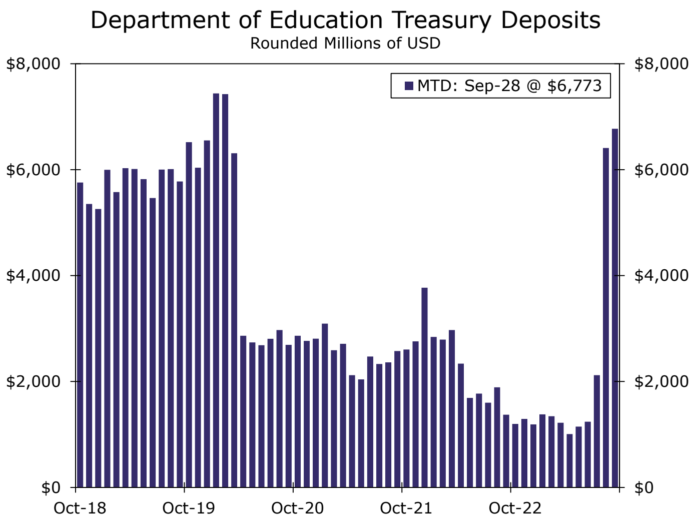
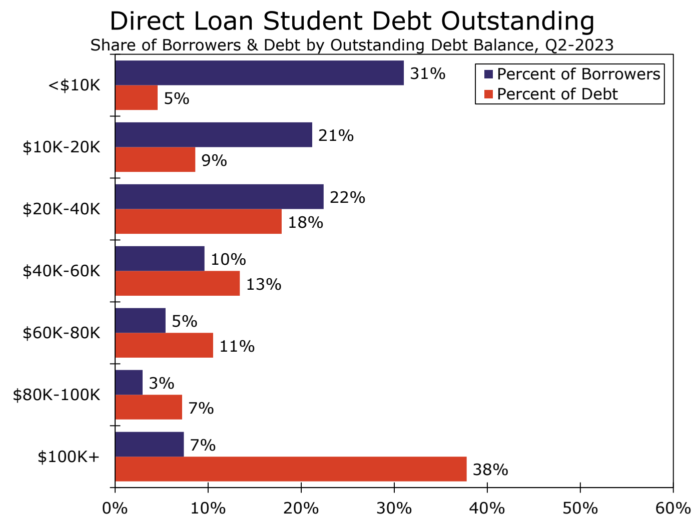
The Basics of Repayment

Interest accrual re-started at the beginning of September and payments are due in October. Yet, we have already seen borrowers resuming payments ahead of the due date. The U.S. Department of Education sent $6.4 billion to the Treasury in August, nearly five-times the monthly average from January through July. For September, payments came in even faster. Through September 28, $6.8 billion has been sent to the Treasury (Figure 1). Monthly payments vary widely by household depending on income and debt outstanding, but we estimate the average payment to fall somewhere in the ballpark of $200-300 per month, which equates to around 5% of the U.S. median annual salary.



Source: U.S. Department of the Treasury and Wells Fargo Economics

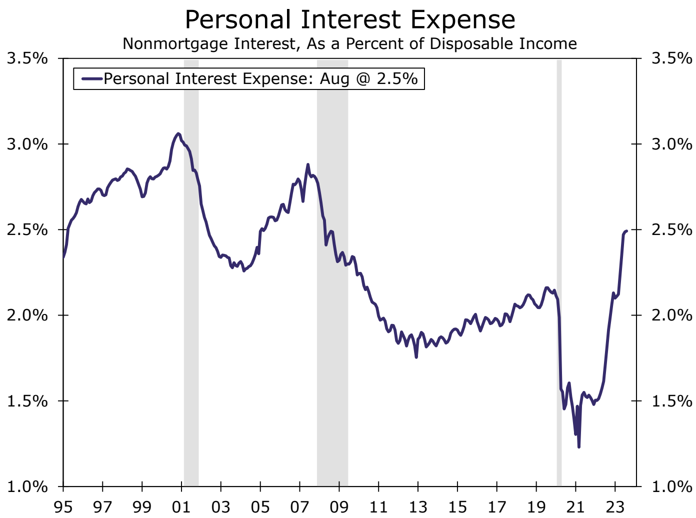


Source: U.S. Department of Education and Wells Fargo Economics

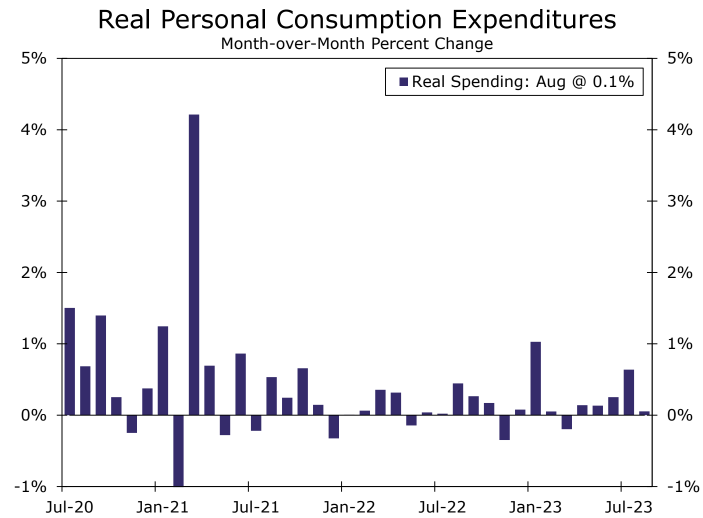
A Relatively Contained Macro Impact

Even as monthly obligations resume, the distribution of debt helps soften the impact on the broad household sector. Relatively large outstanding student loan balances are concentrated in a small number of households. More than half of all borrowers—as of the second quarter—had comparatively manageable loans totaling $20K or less (Figure 2). The enormous student loan debts, in which borrowers owe $100K or more in debt, comprise only a 7% of student loan borrowers. That is equivalent to fewer than 3 million people or less than 1% of the total U.S. population.

With large balances relatively concentrated, we do not expect payment resumption to be detrimental to the broad household sector, though it is obviously a constraint on individual households and an added headwind as consumers become more financially vulnerable late this year amid rising borrowing costs and dwindling excess liquidity. Households personal interest expense, which covers all non-mortgage interest, is rapidly rising and likely set to move higher as more borrowers resume student loans and broader interest rates remain elevated (Figure 3).



Source: U.S. Department of Commerce and Wells Fargo Economics



Source: U.S. Department of Commerce and Wells Fargo Economics

Still An Added Headwind

Real personal spending slowed in August, rising just 0.1%, the smallest gain in five months (Figure 4). While the August slowdown likely somewhat reflects base effects after a strong July, we expect to see some weakness in spending materialize as more borrowers resume payments in the remaining months of the year. The total impact, however, should be fairly minimal. We estimate student loan debt repayment to subtract just about 0.4-0.6% from total *annual* consumption.

There is a notion that the impact of student loan payments will be felt immediately in October, but there is scope for the impact to be spread across an even longer period. It depends on the extent to which borrowers rely on a number of measures taken by the Biden administration to soothe the sting of loan payment resumption. First, there is somewhat of a grace period where collection efforts won't occur and borrowers won't be penalized for nonpayment in the first 12 months of resumption, though interest will accure during the period. The creation of the Saving on Valuable Education (SAVE) program by the Biden Administration can also lower monthly obligations, as it allows borrowers to make payments based on a small percentage of discretionary income.

Even with a relatively contained direct macro impact, repayment is coming at a time when households' staying power is dwindling, and will likely contribute to a slowdown in spending later this year and into early 2024.

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