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Economics Group

Interest Rate Weekly

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Student Loans and the Household Lending Landscape

Aggregate household debt balances grew a modest 0.5 percent in the third quarter. As has been the case for much of this expansion, student and auto loans drove most of the increase.

Auto, Student Loans Continue Steady Growth

Total household debt rose 0.5 percent in Q3 and 2.4 percent over the past year according to the most recent *Household Debt and Credit Report* from the New York Fed. Auto and student loans drove 83 percent of the quarterly increase despite accounting for only 20 percent of total household debt outstanding.

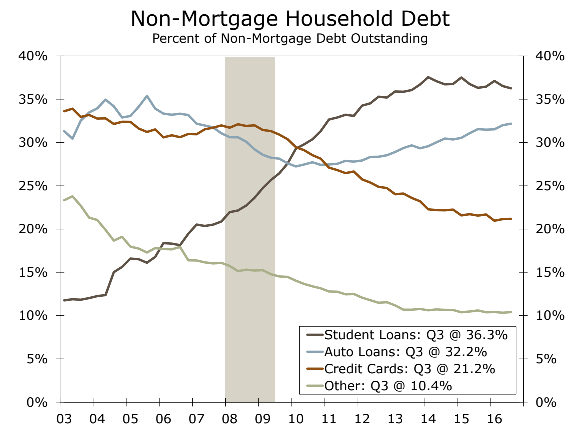
Student loans in particular have come to play an increasingly large role in household lending. Student loans have grown a striking 186.3 percent over the past ten years according to the New York Fed's data compared to just 3.8 percent for all other forms of debt. As a share of non-mortgage debt outstanding, student loans have tripled since 2003 (top chart).

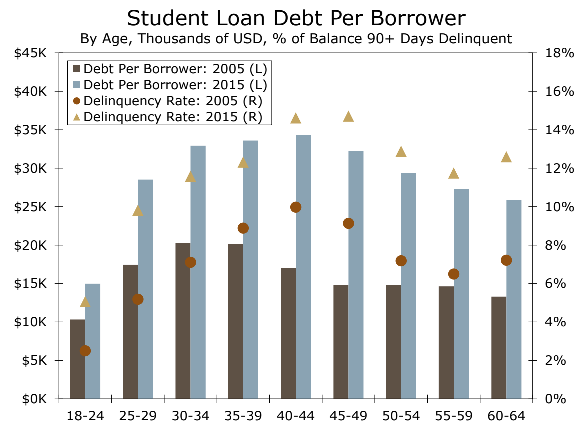
In addition to the quarterly data, the New York Fed also breaks down student loan debt by age on an annual basis. Interestingly, debt per borrower has risen across the age spectrum, with debt doubling for individuals age 55 and older (middle chart). Delinquency rates have risen in-kind and have climbed the most for older borrowers.

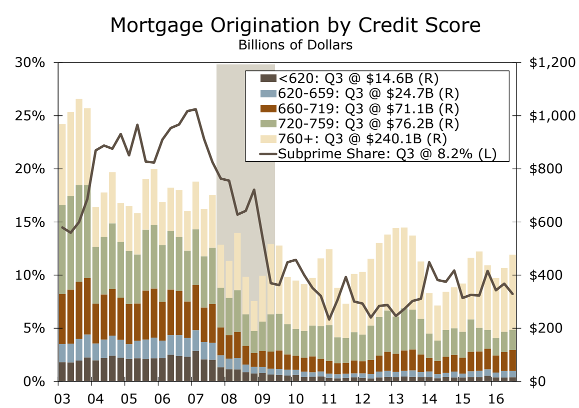
On the positive side, there are signs that the student loan pressures have begun to ease. On a year-ago basis, the consumer price index for college tuition & fees is at the lowest point in series history (January 1979). This has likely contributed, in part, to the deceleration in student borrowing from the pace seen earlier in the expansion. In addition, for those who have already borrowed, a tighter labor market should make it easier for younger and older workers alike to find work and see their wages accelerate. Finally, we must recall that student loans, unlike many other types of borrowing, finance an investment in human capital. Student loans should result in not only a liability but also a valuable asset that does not numerically show up on a household balance sheet. That said, the rising delinquency rates bear close monitoring for potential risks in an aging business cycle.

Mortgage Lending Standards Still Tight Relative to Past Cycle

The housing market has faced a slew of challenges in this recovery, the growing burden of student debt among them. Tight lending standards have also weighed on mortgage lending. In the third quarter, mortgage originations to borrowers with a credit score below 720 accounted for just 24.7 percent of new mortgages compared to 47.2 percent ten years ago (bottom chart). Banks reported some modest easing of standards in the recent Senior Loan Officer Opinion Survey and it is possible the incoming administration may alter some regulations to encourage more lending. That said, even with some easing in standards, it would take a sizable jump in subprime mortgage originations to reach the levels seen in the run up to the housing bust. For now, the credit quality of mortgage lending is not an area of concern in this aging expansion.







Source: Federal Reserve Bank of New York and Wells Fargo Securities

Wells Fargo U.S. Interest Rate Forecast

	Actual			Forecast								
	2016				2017				2018			
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
Quarter End Interest Rates												
Federal Funds Target Rate	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.50	1.75
3 Month LIBOR	0.63	0.65	0.85	1.05	1.05	1.25	1.25	1.50	1.50	1.75	1.75	2.00
Prime Rate	3.50	3.50	3.50	3.75	3.75	4.00	4.00	4.25	4.25	4.50	4.50	4.75
Conventional Mortgage Rate	3.69	3.57	3.46	4.12	4.13	4.15	4.17	4.19	4.22	4.26	4.30	4.35
3 Month Bill	0.21	0.26	0.29	0.49	0.57	0.78	0.84	1.02	1.10	1.25	1.30	1.55
6 Month Bill	0.39	0.36	0.45	0.62	0.69	0.88	0.94	1.12	1.20	1.35	1.40	1.65
1 Year Bill	0.59	0.45	0.59	0.82	0.86	1.02	1.08	1.38	1.46	1.58	1.65	1.79
2 Year Note	0.73	0.58	0.77	1.14	1.17	1.33	1.40	1.66	1.73	1.86	1.91	2.03
5 Year Note	1.21	1.01	1.14	1.86	1.91	1.99	2.06	2.21	2.27	2.37	2.41	2.51
10 Year Note	1.78	1.49	1.60	2.42	2.45	2.48	2.51	2.54	2.58	2.63	2.68	2.74
30 Year Bond	2.61	2.30	2.32	3.09	3.16	3.22	3.28	3.34	3.41	3.49	3.57	3.66

Forecast as of: December 8, 2016

Wells Fargo U.S. Economic Forecast and FOMC Central Tendency Projections

	2016	2017	2018
Change in Real Gross Domestic Product			
Wells Fargo	1.8	2.2	2.2
FOMC	1.8 to 1.9	1.9 to 2.3	1.8 to 2.2
Unemployment Rate			
Wells Fargo	4.8	4.6	4.5
FOMC	4.7 to 4.8	4.5 to 4.6	4.3 to 4.7
PCE Inflation			
Wells Fargo	1.5	2.2	2.3
FOMC	1.5	1.7 to 2.0	1.9 to 2.0
"Core" PCE Deflator			
Wells Fargo	1.8	2.0	2.1
FOMC	1.7 to 1.8	1.8 to 1.9	1.9 to 2.0

Forecast as of: December 8, 2016

NOTE: Projections of change in real gross domestic product (GDP) and in inflation are from the fourth quarter of the previous year to the fourth quarter of the year indicated. PCE inflation is the percentage rate of change in the price index for personal consumption expenditures (PCE). Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated.

Fed Data as of: December 14, 2016

Source: IHS Global Insight, Bloomberg LP, Federal Reserve Board and Wells Fargo Securities

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