William C Dudley: Household borrowing, student debt trends and homeownership

Opening remarks by Mr William C Dudley, President and Chief Executive Officer of the Federal Reserve Bank of New York, at the Economic Press Briefing on Household Borrowing, Student Debt Trends and Homeownership, Federal Reserve Bank of New York, New York City, 3 April 2017.

* * *

Andrew Haughwout, Joseph Tracy and Wilbert van der Klaauw assisted in preparing these remarks.

Good morning, and welcome to the New York Fed's Economic Press Briefing. Today, we will focus on recent developments in household borrowing, with special attention on student debt. As always, what I have to say reflects my own views and not necessarily those of the Federal Open Market Committee or the Federal Reserve System.

Following a period of steady deleveraging that began during the Great Recession, households have gradually increased their borrowing during the past three years. Later this year, total household debt is expected to reach its previous peak, from the third quarter of 2008. Given past experience, one might wonder whether this level of indebtedness is sustainable or a reason for concern. Answering this question requires a fuller consideration of household balance sheets and a deeper analysis of who is indebted. The increase in liabilities in recent years has been accompanied by significant improvements in the value of assets held by households, due to strong growth in housing and stock prices. Moreover, household incomes have been rising at a moderate pace due to sturdy job gains and modest wage increases. As a result, the household sector's financial condition today is in unusually good shape for this point in the economic cycle. In relative terms, household indebtedness is low, and—thanks in part to low interest rates—debt service burdens relative to household income have fallen to levels not seen since at least the early 1980s.

As we will show in today's presentation, compared to 2008, a greater proportion of overall debt today is now held by older households that have higher and more stable incomes and more experience as borrowers, on average. Consequently, a much larger proportion of debt is currently held by borrowers with higher credit scores. The resulting higher overall debt quality is reflected in historically low overall delinquency rates. Transition rates into new delinquency are below the levels of the early 2000s, and foreclosure and bankruptcy rates in 2016 are the lowest since our data series began in 1999.

Notwithstanding this overall rosy picture, the improvement in aggregate debt quality and performance conceals important underlying changes in debt holdings that could be consequential, with implications for the housing market and for consumer spending over the longer term. While older borrowers hold more debt of all types, there has been a significant shift among younger people toward student debt and away from mortgage and other debt. Student debt has increased more than fivefold over the past 14 years, with more young adults taking out loans and borrowing larger average amounts. And, while debt delinquency rates overall have fallen, those for student debt have remained elevated.

Since 2012, the New York Fed has devoted considerable attention to the rapid growth in student debt levels and delinquencies by publishing a number of reports. The findings in these reports were largely based on data from our Consumer Credit Panel (CCP), a nationally representative dataset sourced from Equifax credit reports. This unique dataset has enabled us to provide new insights into the overall state of the student loan market and into individual student loan borrowing and repayment behavior not available from other data sources.

Today, we will first provide a brief overview of aggregate household debt and its borrowers, followed by a presentation based on new research on student debt, which focuses on delinquency and repayment rates. We find that recent cohorts of college students are defaulting at a lower rate than those who left higher education during the recession. But, at the same time, their repayment rates are also lower. Despite an improving labor market, overall delinquency rates on student debt remain stubbornly high, and repayment progress has slowed further, likely reflecting the recent introduction of more accommodative payment plans. Payment progress is particularly low for those with larger debts and for those from lower-income areas.

Much remains to be learned about the causes of the observed expansion of debt burdens and repayment problems among recent college graduates. Over the past two decades, there has been a significant change in the financing of higher education—with state and local funding covering a smaller share, and students and their families bearing a greater proportion of rising college costs. While the federal student loan program has undoubtedly helped mitigate the impact of higher costs on college enrollment, more students now leave college with higher amounts of debt. At the same time, college dropout rates remain stubbornly high, and empirical evidence indicates that graduates from some colleges have had trouble finding good-paying jobs.

Another important question concerns the consequences of growing student debt for the overall economy. To investigate this question further, we linked our CCP dataset to student enrollment records from the National Student Clearinghouse in order to analyze the relationship between homeownership, educational attainment and student debt. Not surprisingly, our research shows a strong positive association between educational attainment and homeownership, consistent with the fact that higher educational attainment is associated with higher average earnings. Interestingly, this relationship appears to hold irrespective of family background, suggesting that colleges may be successful in "leveling the playing field" across students from different socioeconomic backgrounds.

At the same time, our analysis reveals that those with significant student debt are much less likely to own a home at any given age than those who completed their education with little or no student debt. This finding is consistent with other past and ongoing research here at the New York Fed that points to the potential longer-term negative implications of student debt on homeownership and other types of consumer spending. Of course, homeownership is more than just consumption—it has historically been an important form of wealth accumulation. For a large share of households, housing equity is the principal form of wealth. Thus, changes in the way we finance post-secondary education could also have important implications for the distribution of wealth.

Before turning it over to my colleagues, I would like to comment briefly on the importance of college costs, financing and access to higher education. It is well known that the average earnings premium from having a college education is high and has risen over the past few decades, in part because of a decline in real average earnings for those without a college degree. In addition to higher earnings, a college education is associated with increased homeownership, as I just discussed. The economic and social returns to having a well-educated and skilled labor force are also well documented. However, I would like to highlight another important role of higher education: it is a pathway to and engine of upward income mobility.

I believe that income mobility—the degree to which individuals or families can move up or down in the income distribution over time—is a foundational element for a well-functioning society and indicates the ability of an economy to provide opportunities for all. As I have discussed previously, important research by Stanford economist Raj Chetty and his co-authors has shown that intergenerational income mobility in the United States—a child's chances of moving up in the income distribution relative to his or her parents—has remained stable over the past half century.[1] However, because of the increase in income inequality and stagnant or declining incomes for the least well-off, the consequences of being born to low- versus high-income parents are greater today than in the past. These trends have contributed to a steady decline in "absolute" upward income mobility in the United States, as defined by the share of children who earn more in real terms than their parents. This fraction has fallen from 90 percent to 50 percent over the past half century.

Recent work by Chetty and his co-authors has investigated the importance of higher education in achieving upward mobility. They find that many highly qualified lower-income students do not attend selective colleges, while those low- and middle-income students who do—despite facing greater challenges—fare almost as well as affluent students who attend the same colleges. Their research also indicates that some colleges are better engines of upward income mobility than others, and that colleges that offered the largest number of low-income students pathways to upward mobility have become less accessible to them during the 2000s. As a result, higher-education's contribution to increasing intergenerational mobility has diminished.

It is unclear why access has fallen to colleges with relatively high mobility rates. One possibility is that recent budget cuts may have forced these colleges—which tend to be mid-tier public institutions—to raise tuition and change their admissions policies more than other institutions, such as less budget-constrained elite private institutions. Empirical evidence points to a greater sensitivity to college costs in the higher education decisions of low-income populations. As a result, continued increases in college costs and debt burdens could inhibit higher education's ability to serve as an important engine of upward income mobility. In my view, these developments are important and deserve increased attention.

Thank you for your kind attention. I will now turn it over to Wilbert van der Klaauw, who will give a brief overview of the current state of household debt.

---

[1] See Economic Opportunity and Income Mobility, Remarks at the Association for Neighborhood and Housing Development Annual Community Development Conference, April 11, 2016.