Key Questions

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SCOTUS Squashed Biden's Student Loan Forgiveness Program. Will It Squash the US Economy?

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Consumer spending is a major driver of the US economy, accounting for nearly 70% of our nation's total Gross Domestic Product (GDP). Measured as a share of the world's GDP, US expenditures represent roughly 17%, on par with the total economic output from Japan, Germany, the United Kingdom, and Italy, combined! In other words, as goes the US Consumer, so goes the global economy.

Over the past few years and on the whole, the US Consumer has been in a spending mood, especially when it comes to spending on services. Services encompasses things such as vacations, food, healthcare-related expenses, and even things like haircuts, dry cleaning, and tax preparation. Money spent on services outpaces goods by a margin of 2.5:1, and with an increasing emphasis being placed on experiences over things, this gap seems destined to widen even further.

In the immediate aftermath of COVID-19 in April 2020, services-related spending cratered by more than 16%, the biggest decline ever recorded. The following year, however, consumer spending exploded by an astronomical and unprecedented rate of nearly 24%. Since then, spending on services has returned to a more modest rate of 8%. But this is still roughly twice that of the average rate over the past 30 years of 4.6%.

These statistics frame an important narrative – US consumer spending is critical to the ongoing growth of the US and the global economy. But they don't reveal the whole picture.

The statistics cited above are expressed in nominal terms. That is, they are not adjusted for inflation. After such an adjustment is made, consumer spending on services is still growing, but at a far more muted pace of 2.6%. To be true, this rate of spending is strong relative to the average rate of the past 20 years of 1.8%, but the rate of growth is slowing and bears monitoring[1].

Recently, the Supreme Court of the United States (SCOTUS) struck down the Biden administration's student loan forgiveness program. We will refrain from discussing the Court's rationale and leave it to others to opine on the political consequences. Instead, we'll focus on economic consequences that may arise as a result.

Under their original proposal the Biden Administration relied on the Higher Education Relief Opportunities for Students Act (HEROES Act), first introduced after the September 11, 2001, terrorist attacks. The law permitted the waiver of education-related debt obligations during the time of war or national emergency and the Administration argued that COVID-19 was such a national emergency that put borrowers "in a worse position financially." The proposal provided debt cancellation of up to $20,000 for borrowers with individual income less than $125,000 ($250,000 for married couples).

With the SCOTUS decision, student loan repayments are currently scheduled to resume on October 1, 2023, after more than three years of forbearance. Based on various media reports[2], there is over $1 trillion in student loan obligations currently in forbearance linked to nearly 27 million borrowers. These debts will now likely come due which could cause some consumers to reprioritize their finances, alter their spending patterns, and trigger a slowdown for the broader economy.

Companies dependent on consumer spending have signaled their concerns. A major US retailer, for instance, recently informed their investors that they are "*closely watching emerging challenges to consumer spending due to the end of the fiscal stimulus and the resumption of student loan payments*."

Similarly, economic forecasters have attempted to put pen to paper and estimate the aggregate fallout. When doing so, however, the impact is thought to be relatively modest, potentially shaving 0.1-0.2% of total US GDP. Meanwhile, other proposals being drafted to lessen the burden include offering extended grace periods for certain borrowers along with implementing a new repayment plan known as SAVE (Saving on a Valuable Education). Under this program the typical borrower could save more than $1,000 per year on payments, allow many borrowers to make $0 monthly payments, and ensure borrowers do not see their balances grow from unpaid interest.

That said, the uncertainty surrounding future obligations could cause some consumers to pause. Statistics vary considerably as to the average monthly student loan repayment amount, ranging from $150 to $300 per month. So it seems plausible that spending will moderate at a time that the labor market is beginning to cool and other forms of tightening are emerging, and while higher student loan indebtedness may not necessarily be a catalyst for the next recession, it could be a contributor to it.

1. Figures derived from The Federal Reserve Bank of St. Louis FRED Economic Database
2. Source: Bloomberg

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