Healthcare Finance

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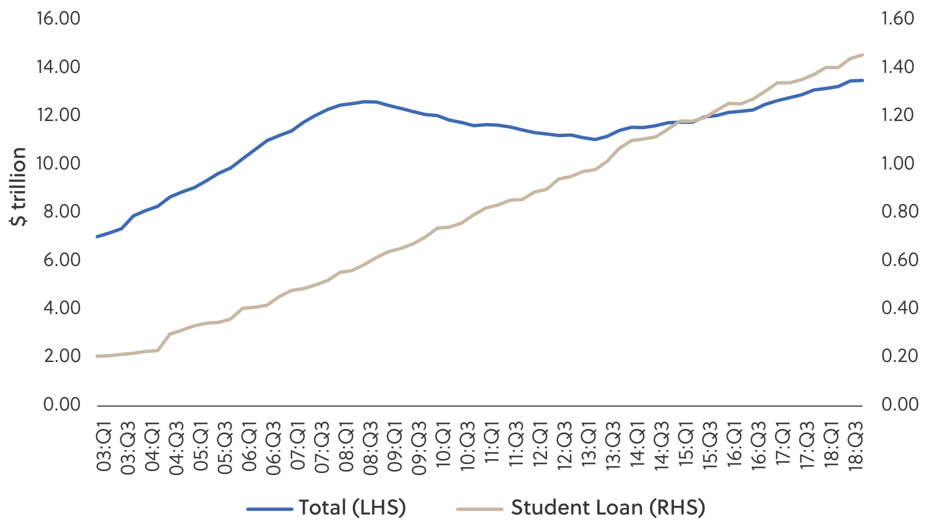
Will Rising Student Debt Trigger the Next Economic Crisis?

Introduction

In an earlier InvestEd, we examined the issue of rising debt among governments, corporations and households (Exhibit 1). One driver of growing debt among households is student loans. Debt taken on by college students and graduates has grown significantly faster than overall household debt and is currently $1.5 trillion.1 Since 2003, student debt has grown at an annual rate of 13% vs. 4% for overall household debt and currently represents 11% of household debt up from 3% in 2003.

Exhibit 1: Growth in Student Debt vs. Total Household Debt



Source: New York Fed Consumer Credit Panel/Equifax.

The significant growth in student debt is drawing attention from economists and investors due to the concern that future economic growth will be negatively impacted. The servicing of student debt may crowd out aggregate consumption, adversely impact the ability to purchase a house, start a new business, etc.The impact of student debt on future economic growth is an important topic for us to consider since it has implications for our investment strategy and our long term capital market assumptions. In this report, we examine the issue and conclude that while rising student debt is something for us to monitor, the negative impact on future economic growth is likely to be modest. The average student debt balance is manageable and as more jobs require a college education, one source of growth in student debt is that more people are going to college, which on balance is positive

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PFM'S HEALTHCARE TEAM

Errol Brick
Group Co-Head
bricke@pfm.com
Miami • 786.671.7480

Chris Doyle
Group Co-Head
doylec@pfm.com
Boston • 617.330.6914

Pierre Bogacz
Director
bogaczp@pfm.com
Orlando • 407.406.5780

Brian Carter
Director
carterb@pfm.com
Philadelphia • 215.814.1962

Alford Evans
Director
evansal@pfm.com
Chicago • 312.523.2435

Duncan Brown
Senior Managing Consultant
brownd@pfm.com
Seattle • 206.858.5367

Stephen Murphy
Senior Managing Consultant
murphys@pfm.com
Boston • 617.330.6914

Brenda DeGoias
Senior Analyst
degoiasb@pfm.com
New York • 646.561.0714

JP Jakes
Analyst
jakesj@pfm.com
Orlando • 407.406.5769

for future economic growth as a more educated population is more productive. College graduates enjoy higher income and lower unemployment and leverage ratios for households headed by a college graduate are lower than those without a college degree. Average student debt, compared to average starting salaries, remains at a manageable level for many graduates and increases in tuition, which is a driver of higher student debt, is moderating and a large proportion of outstanding student debt is held by only a small percentage of borrowers. We then discuss the impact of rising student debt on various measures of economic growth, including homeownership, future labor force demographics and aggregate consumption, and find that overall student debt levels are unlikely to have a large negative economic impact. Our conclusion does not negate the fact that certain segments of those with student debt will struggle to repay their loans and a growing portion of those loans are likely to default.

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Economic Highlights

- Trade talk and tariff disputes ruled the day in May as a new front in the trade war emerged with Mexico on top of unresolved disputes with China. This has begun to take its toll on economic conditions, triggering a slowdown in manufacturing activity and sharp declines in measures of CEO optimism.
- Second quarter U.S. gross domestic product (GDP) growth estimates are now in the 1.5%-2% range, far below the first quarter which was revised in May to 3.1% (vs. initial estimate of 3.2%).
- The World Bank reduced its global growth forecasts for both 2019 and 2020. Global growth in real GDP is now expected to be 2.6% in 2019 and 2.7% for 2020. Downward revisions were especially noteworthy for the Euro area and Emerging Market economies.
- The latest Fed-speak turned more dovish, revealing a shift in the Fed's stance on monetary policy from "patient" to "appropriate." At a recent conference, Fed Chair Jerome Powell acknowledged the consequences of escalating trade tensions and affirmed that the Fed will "act as appropriate to sustain the expansion." The market's expectation is now for two to three rate cuts by year end.
- Inflation pressures remain low. The Consumer Price Index (CPI) indicates inflation at 2%, while the Fed's preferred inflation gauge, the Personal Consumption Expenditure (PCE) Price Index, has weakened over the last several months and is now well below the Fed's target of 2%.
- The U.S. jobs report for May was a huge disappointment as non-farm payrolls grew by only 75,000, well below expectations of 175,000. Monthly job gains have averaged just 164,000 this year, compared with average gains of 223,000 per month in 2018. Wage growth slowed, but the labor market remains tight with the unemployment rate holding at 3.6%.

Bond Markets

- U.S. Treasury yields declined across the curve with the yield on longer maturities falling more than 30 basis points (bps) (0.30%) in May. Long maturity yields are now down more than 100 bps from their highs of last November.
- The yield curve reached its greatest level of inversion since 2007 as the spread between the 10-year and 3-month Treasuries reached -25 bps (-0.25%). The shorter-term Treasury Bill curve is also now inverted, reinforcing the market's expectation for a lower Fed rate policy in the near term.
- As a result of falling yields, bond returns were very strong in May, with Treasury benchmarks generating some of their best monthly performance over the last five years. The increasing inversion also meant that longer duration indexes outperformed shorter ones. For example, the 2-year Treasury Index returned 0.77%, while the 10-year index returned 3.35% for the month.

Municipal Bond Market

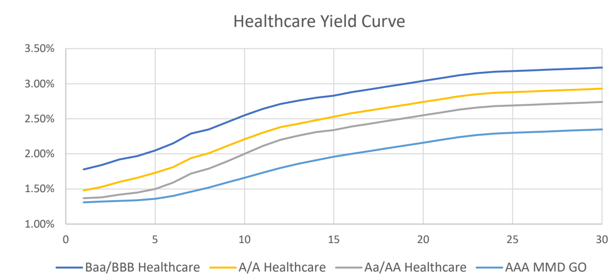
- Municipal new issuance fell in May by 20.6% to $27.93 billion from $35.19 billion the same month last year. Year-to-date municipal new issuance is up 0.2% to $132.5 billion for 2019 from $132.3 billion during the same period last year, according to Municipal Market Monitor (TM3) data.
- May experienced positive bond flows throughout the month and ended with net inflows totaling $8.37 billion, following April's net inflows of $6.26 billion, according to Investment Company Institute (ICI) data.
- The Municipal Market Data (MMD) Index saw declining rates across the yield curve in May. The one-year rate fell 17 bps to 1.38% while the three-year rate dropped 19 bps to 1.40%. The five-year rate also declined 21 bps to 1.42%. The 10-year rate decreased 21 bps to 1.65%. On the long end, the 30-year rate dropped 23 bps to 2.32%, according to TM3 data.
- The 10-year MMD Single-A General Obligation (GO) Index credit spread fell by 3 bps to 33 bps and the Double-A GO Index credit spread remained unchanged at 12 bps, according to TM3 data.
- In May, Municipal-to-Treasury ratios cheapened slightly across the yield curve. The two-year ratio increased to 71.4% from 69.2% in April, and the five-year ratio rose to 73.5% from 71.5%. The intermediate-term ratio rose to 72.6% from 70.7%, while the 10-year ratio increased to 77.0% from 74.3%. The 30-year ratio increased to 90.3% from 86.9%, according to TM3 data.
- The Municipal curve flattened in May with the AAA MMD 2-year/10-year slope falling to 26 bps from 29 bps in March, and the AAA MMD 2-year/30-year slope decreased to 93 bps from April's 98 bps.

FIXED-RATE MARKET			
Maturity	AAA MMD	US Treasury	Muni Swap Rate
5-Year	1.36%	1.85%	1.22%
10-year	1.46%	1.96%	1.31%
20-year	1.66%	2.09%	1.46%
30-year	2.35%	2.59%	1.83%

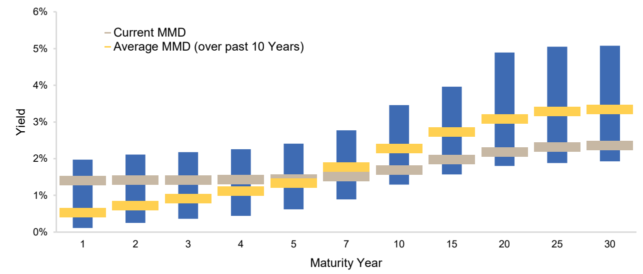
VARIABLE RATE MARKET		
Maturity	Current	1-Month Change
SIFMA Index	1.71%	36 bps
1-Month LIBOR	2.39%	-5 bps
3-Month LIBOR	2.41%	-11 bps
SOFR	2.35%	-7 bps

HEALTHCARE 30Y SPREADS	
Category	Spread to MMD
AAA Level	21 bps
AA Level	39 bps
A Level	58 bps
BBB Level	88 bps

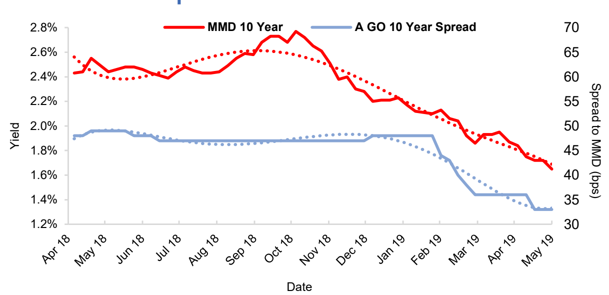
Healthcare Yield Curve



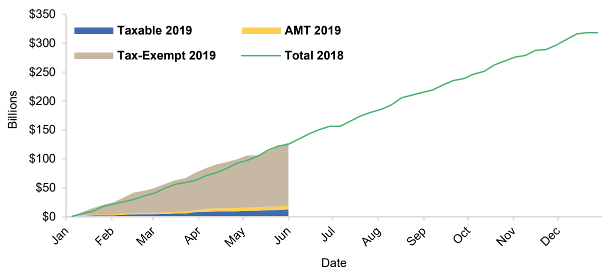
MMD Rates Over Time



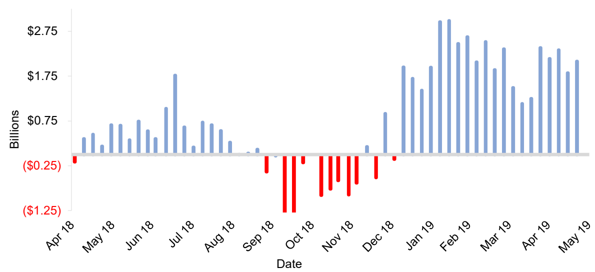
Rate and Spread Movement



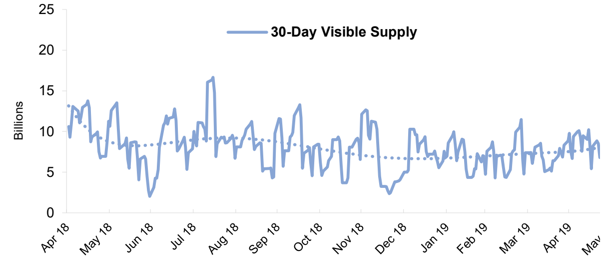
2019 Cumulative Issuance



Weekly Mutual Fund Inflows (Outflows)



30-Day Visible Municipal Supply



Mergers and Acquisitions

- Mayo Regional Hospital (ME) and Northern Light Health (ME) received a key approval to create Maine's second-larget Health system (*Mainebiz*, June 14, 2019).
- University of Louisville ended talks with Catholic Health Initiatives about acquiring KentuckyOne Health's local assets including Jewish Hospital (*Louisville Courier Journal*, June 13, 2019).
- Tampa General Hospital is partnering with Fast Track Urgent Care (*Tampa Bay Business Journal*, June 7, 2019).
- Quorum Health has entered into a definitive agreement to sell Watsonville Community Hospital (*Nashville Post*, June 7, 2019).
- Penn Highlands added J.C. Blair Memorial Hospital as a member of the Healthcare group (*Penn Highlands Healthcare*, June 6, 2019).

SELECTED HEALTHCARE ISSUANCES								
Borrower	Tax Status	Par Amount	Ratings	Dated Date	Final Maturity	Coupon	Spread	Senior Manager
Banner Health	Tax-Exempt	$94,050	NR/AA-/AA-	6/5/2019	2044	4.00%	67 bps	Morgan Stanley
Adena Health System	Tax-Exempt	$83,270	A3/A-/NR	6/5/2019	2049	5.00%	66 bps	Cain Brothers & Co, Inc.
UAB Medicine	Tax-Exempt	$103,385	Aa3/AA-/NR	5/22/2019	2048	4.00%	72 bps	Raymond James & Associates
UAB Medicine	Tax-Exempt	$8,120	Aa3/AA-/NR	5/21/2019	2026	5.00%	24 bps	JP Morgan
University of Pittsburgh Medical Center	Tax-Exempt	$726,650	A1/A+/A+	5/15/2019	2039	4.00%	81 bps	RBC Capital
Mosaic Health System	Tax-Exempt	$228,975	A1/NR/AA-	5/14/2019	2054	4.00%	87 bps	JP Morgan
Charleston Area Medical Center	Tax-Exempt	$87,985	Baa1/NR/NR	5/8/2019	2039	5.00%	76 bps	BAML

Sources: Bloomberg, Refinitiv and ICI. Unless otherwise noted, all data is presented as of April 30, 2019.