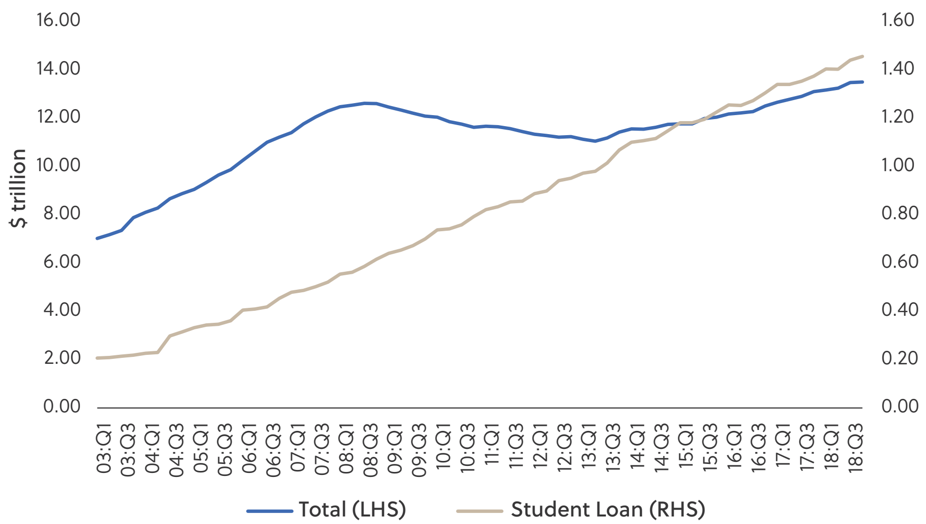
Healthcare Finance

Newsletter | July 2019

Will Rising Student Debt Trigger the Next Economic Crisis?

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 for future economic growth as a more educated population is more productive.

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1 Source: New York Federal Reserve.

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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

- Bond returns for the first half of the year were strong. Equity returns were even stronger. Investors continued to search for an equilibrium between domestic and international growth, bond prices and equity valuations, and policy clarity. Something will eventually have to give. But what?
- The Federal Reserve (Fed) held short-term rates unchanged in June at the current target range of 2.25% to 2.50%. Fed Chair Jerome Powell acknowledged risks to the Fed's sanguine outlook that included: ongoing trade disputes, global growth concerns, a messy Brexit, recent declines in business sentiment and investment, and increased risk of falling inflation. In light of these rising uncertainties, the Fed will "act as appropriate to sustain the expansion." The market now widely expects two to three Fed rate cuts in the second half of 2019 with the first cut expected at the end of July.
- The final release of U.S. GDP showed growth unchanged at a 3.1% annual rate and continues to underscore a seemingly resilient U.S. economy. While growth concerns are focused abroad, most notably in the Eurozone and China, they have yet to spill over to our domestic shores just yet.
- All eyes, including the Fed, are on lackluster inflation. The Consumer Price Index (CPI) indicates inflation near 2%, but the Fed's preferred inflation gauge – the Personal Consumption Expenditure (PCE) Price Index – has risen only 1.6% over the past year. Soft inflation readings will give the Fed room to ease monetary conditions without the worry of an inflation spike.
- The June jobs report reinforced strength in the labor market. The economy added 224,000 new jobs in June, outpacing expectations and bouncing back from disappointing growth of only 75,000 jobs in May. The unemployment rate ticked slightly higher to 3.7% as the labor force participation rate also increased 10 basis points (bps) to 62.9%.

Bond Markets

- U.S. Treasury yields declined across the entire curve in June, with maturities under a year falling more (down 20 to 25 bps) than those between one and ten years (down 10 to 15 bps). Short-term yields are closely tied to the expected near-term cut in the fed funds rate.
- As a result, the spread between 10-year and 3-month Treasury securities shifted modestly, but the yield curve remains inverted out to 10 years.
- Most U.S. Treasury maturities ended the quarter near 18-month lows, driving strong monthly, quarterly and year-to-date bond market returns. Longer-duration strategies benefit most. For example, the 1-year and 2-year Constant Maturity U.S. Treasury Indices returned 0.40% and 0.51%, respectively, for the month. Meanwhile, the 5-year and 10-year indices generated returns of 1.00% and 1.44%, respectively.
- Credit spreads narrowed in June after a temporary widening in May. This led corporate sector returns to outpace Treasury returns by a solid margin.

Municipal Bond Market

- Municipal new issuance increased in June by 4.8% to $34.99 billion from $33.4 billion the same month last year. Year-to-date municipal new issuance is up 1.9% to $168.8 billion for 2019 from $165.7 billion during the same period last year, according to Municipal Market Monitor (TM3) data.
- June experienced positive bond flows throughout the month and ended with net inflows totaling $6.85 billion, following May's net inflows of $8.54 billion, according to Investment Company Institute (ICI) data.
- The Municipal Market Data (MMD) Index saw declining rates across the yield curve in June. The one-year and three-year rate fell 14 bps to 1.24% and 1.26%, respectively. The five-year rate declined 11 bps to 1.31%, while the 10-year rate decreased 2 bps to 1.63%. On the long end, the 30-year rate dropped 1 bp to 2.31%, according to TM3 data.
- The 10-year MMD Single-A General Obligation (GO) Index credit spread and the Double-A GO Index credit spread remained unchanged at 33 bps and 12 bps, respectively, according to TM3 data.
- In June, Municipal-to-Treasury ratios experienced rising rates across the yield curve. The two-year ratio increased to 71.8% from 71.4% in May, and the five-year ratio rose to 74.4% from 73.5%. The intermediate-term ratio rose to 75.9% from 72.6% and the 10-year ratio increased to 81.5% from 77.0%. The 30-year ratio rose to 91.3% from 90.3%, according to TM3 data.
- The Municipal curve steepened in June with the AAA MMD 2-year/10-year slope rising to 38 bps from 26 bps in May, and the AAA MMD 2-year/30-year slope increasing to 106 bps from May's 93 bps.

FIXED-RATE MARKET

Maturity	AAA MMD	US Treasury	Muni Swap Rate
5-Year	1.206%	1.88%	1.21%
10-year	1.36%	2.00%	1.31%
20-year	1.58%	2.13%	1.45%
30-year	2.29%	2.63%	1.81%

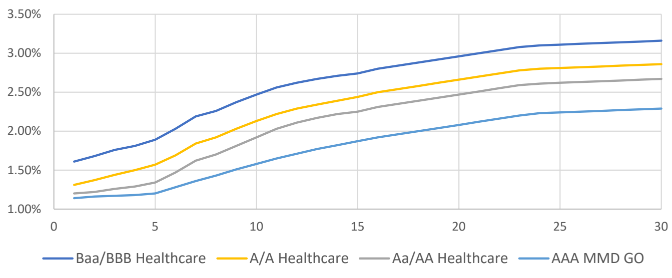
VARIABLE RATE MARKET

Maturity	Current	1-Month Change
SIFMA Index	1.18%	-53 bps
1-Month LIBOR	2.13%	-26 bps
3-Month LIBOR	2.30%	-11 bps
SOFR	2.46%	11 bps

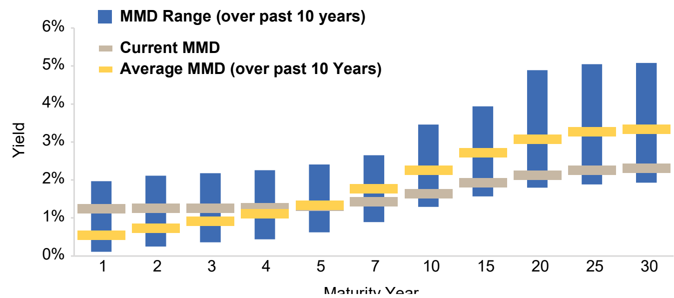
HEALTHCARE 30Y SPREADS

Category	Spread to MMD
AAA Level	20 bps
AA Level	38 bps
A Level	57 bps
BBB Level	87 bps

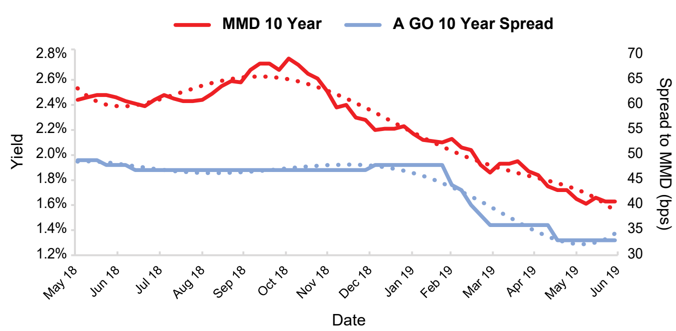
Healthcare Yield Curve



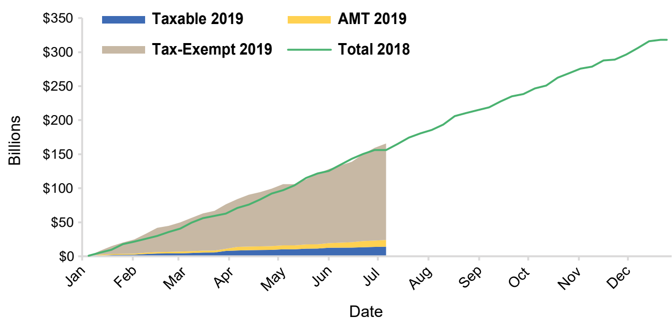
MMD Rates Over Time



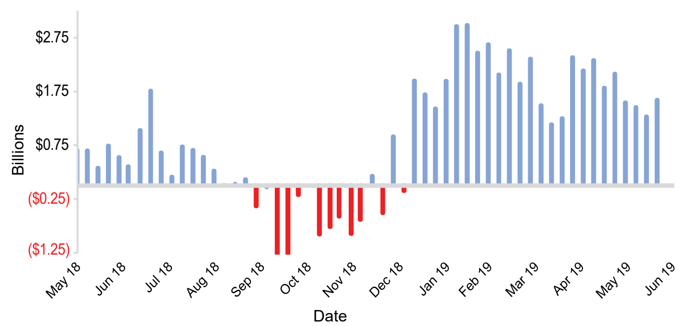
Rate and Spread Movement



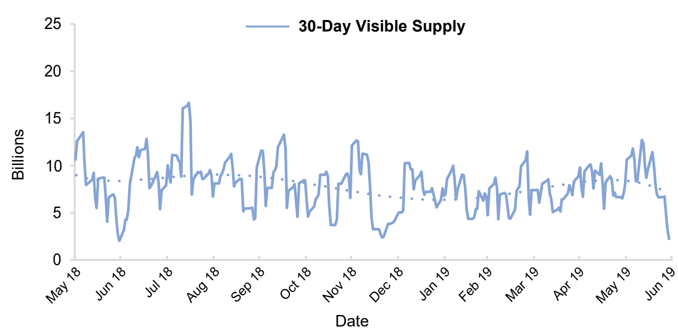
2019 Cumulative Issuance



Weekly Mutual Fund Inflows (Outflows)



30-Day Visible Municipal Supply



Mergers and Acquisitions

- Care New England Health System announced on July 16 that its board voted to withdraw from merger talks with Lifespan and Brown University (***Boston Globe***, 7/16/2019).
- Mayo Clinic has added Saudi German Hospital Cairo in Egypt to the Mayo Clinic Care Network (News Talk 1340 KROC-AM, 7/15/2019).
- Aspirus (WI), a rural health system, signed a letter of intent with Divine Savior Healthcare (WI) (***WiscNews***, 7/11/2019).
- Beaumont Health (MI) has signed a letter of intent to acquire Summa Health (OH) (***Detroit Free Press***, 7/10/2019).
- AHMC Healthcare (CA) acquired Parkview Community Hospital Medical Center (CA) (***Business Wire***, 7/10/2019).

SELECTED HEALTHCARE ISSUANCES								
Borrower	**Tax Status**	**Par Amount**	**Ratings**	**Dated Date**	**Final Maturity**	**Coupon**	**Spread**	**Senior Manager**
Texas Children's Hospital	Tax-Exempt	$600,000	A1/NR/AA-	6/25/2019	2050	4.00%	100 bps	JP Morgan
Novant Health	Tax-Exempt	$306,985	Aa3/AA-/AA-	7/11/2019	2052	4.00%	316 bps	JP Morgan
Texas Children's Hospital	Tax-Exempt	$157,255	Aa2/AA/AA	7/10/2019	2039	3.00%	n/a	Goldman Sachs
Indiana University Health	Tax-Exempt	$133,610	Aa2/AA/AA	7/2/2019	2049	4.00%	74 bps	Citi Group
Chesapeake Regional Medical Center	Tax-Exempt	$113,355	NR/A/NR	6/27/2019	2043	4.00%	77 bps	PNC Capital-PNC
Banner Health	Tax-Exempt	$94,050	NR/AA-/AA-	6/20/2019	2044	4.00%	67 bps	Morgan Stanley
Children Hospital of Orange County	Tax-Exempt	$88,390	NR/AA-/AA-	8/6/2019	2038	4.00%	43 bps	Morgan Stanley
Adena Health System	Tax-Exempt	$83,270	A3/A-/NR	6/19/2019	2049	5.00%	66 bps	Cain Brothers & Co, Inc.

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