BANK OF AMERICA INSTITUTE

BANK OF AMERICA

Consumer Morsel

The power of forgiveness

31 August 2022

Key talking points

- The US government's recent announcement extending the moratorium on student loan repayments alongside a policy of debt forgiveness stands to benefit a significant number of households. We use Bank of America internal data to help gauge the impact.
- The moratorium represents a median saving of more than $150 per monthly student loan repayment for impacted households, providing a few months cash flow boost.
- The debt forgiveness is likely to mean a more significant reduction for many, with a particular benefit for younger and lower paid borrowers.

In moratorium

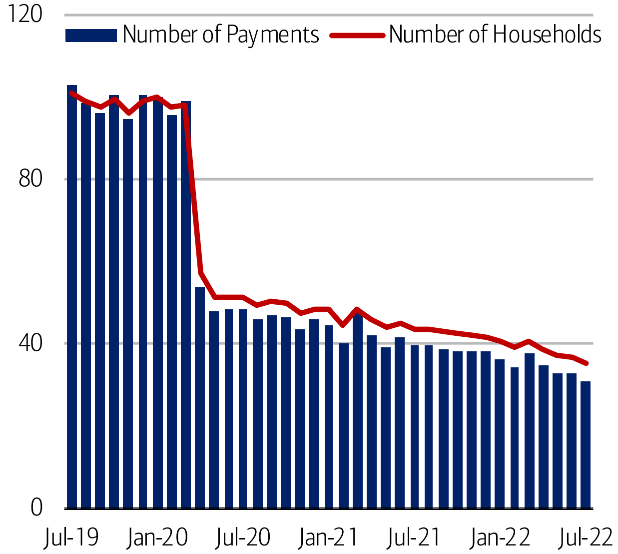
The Biden administration has announced an extension of the moratorium on federal student loan repayments. The maximum loan forgiveness for most beneficiaries will amount to $10K for individuals that make $125K or less and for households that earn $250K or less. In addition, Pell Grant student loan recipients, who are generally from households that have annual incomes of <$50K, are eligible for debt forgiveness of $20K. The plan has other components as well, including a proposal to implement a cap on undergraduate loan repayments at 5% of monthly income.

A federal student loan payment pause was first enacted by the Trump administration in March 2020 as part of a package of measures rolled out to support households during the pandemic. Following the first announcement, the moratorium on repayments has been extended a total of seven times. Over the course of the moratorium, loan repayments have been suspended, interest has stopped accruing on the debt and collections have stopped on defaulted loans. The New York Fed reports that the share of student loan debt accounts for approximately 10% of total household debt as of Q2 2022, compared to 11% in Q1 2020.

What has been the impact of the moratorium and how much of a boost could the new extension be? To evaluate this, we look at Bank of America household consumer deposit data. This is derived by anonymizing and aggregating data from Bank of America consumer deposit accounts in the US, identifying student loan payments through ACH and online bill pay and analyzing that data at a highly aggregated level. We identify customers making student loan repayments to see who has benefitted from this years-long freeze.

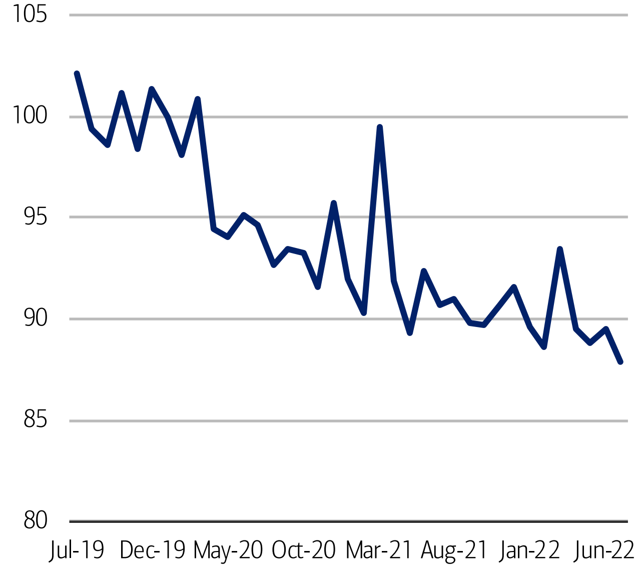
What do we find? Following the first moratorium announcement, the number of households making student loan repayments dropped sharply in April 2020 and has remained low, down 63% in July vs pre-pandemic (Exhibit 1).

Exhibit 1: Number of households making student loan repayments and number of those payments (indexed Jan 2020 = 100)
After the first moratorium the number of households making student loan repayments fell sharply



Source: Bank of America internal data

Exhibit 2: Average number of student loan repayments per month per household (indexed Jan 2020 = 100)
The average number of student loan repayments per household also fell following the moratorium

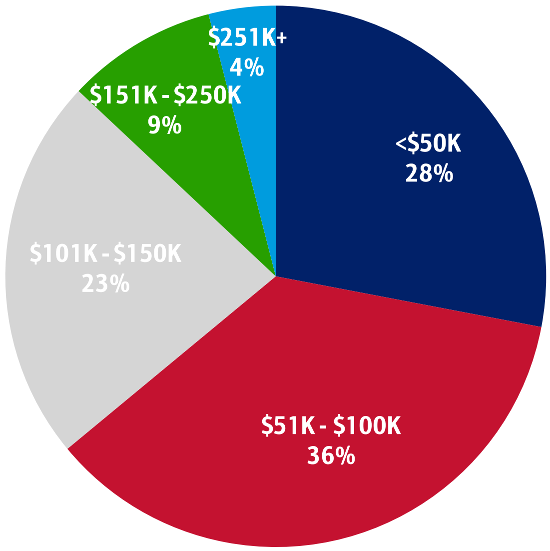


Source: Bank of America internal data

The average number of student loan repayments per month per household also dropped by slightly over 5% in April 2020, following the initial implementation of the moratorium (Exhibit 2). The spikes in the average number of student loan repayments may be related to stimulus checks – potentially with stimulus being used to make one-off payments.

Exhibit 3 shows the composition of those making student loan repayments by income in the second half 2019. We take this as a "normal" period prior to the freeze. It suggests that approximately two-thirds of households making student loan repayments before the freeze were from low (<$50K) and middle income ($51-100K) households. It is reasonable to assume that these households have benefitted the most from the moratorium and presumably been able to allocate funds elsewhere, either by saving, paying down other debt or increased spending.

Exhibit 3: Share of student loan payments, breakdown by income category (7/31/2019-12/31/2019)
Approximately two-thirds of payments came from low and middle income households



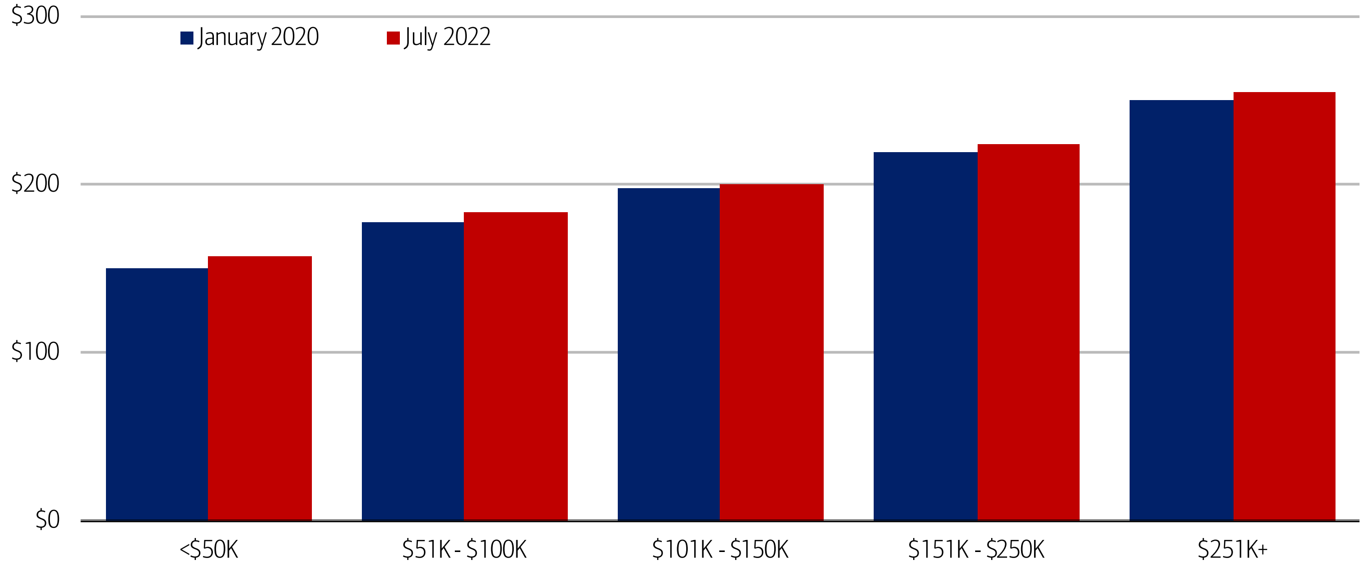
Source: Bank of America internal data

BANK OF AMERICA INSTITUTE

While the absolute numbers of households making student loan repayments have fallen sharply, for those making repayments, little has changed in how much they pay. As Exhibit 4 demonstrates, student loan repayment size increases with income, but it appears to do less so than proportionately. This means that as a percentage of income, households earning <$100K benefited more from the moratorium and will likely do so again from the latest extension.

Exhibit 4: Median monthly student loan payment for households making payments ($)

The median student loan repayment rises with income, but has remained little changed from just before the pandemic



Source: Bank of America internal data

Overall, the extension of the moratorium would represent a fairly significant boost to short-term cash flow. Most text-book economic theories of consumer behavior assume a degree of smoothing of consumer spending, so any short-term gain in saved repayments is unlikely to make a dramatic difference to household consumption decisions over the rest of this year, in our view. But with higher inflation having already stretched consumers' spending power, it will likely provide some offset, particularly for lower-income households.

Please forgive me

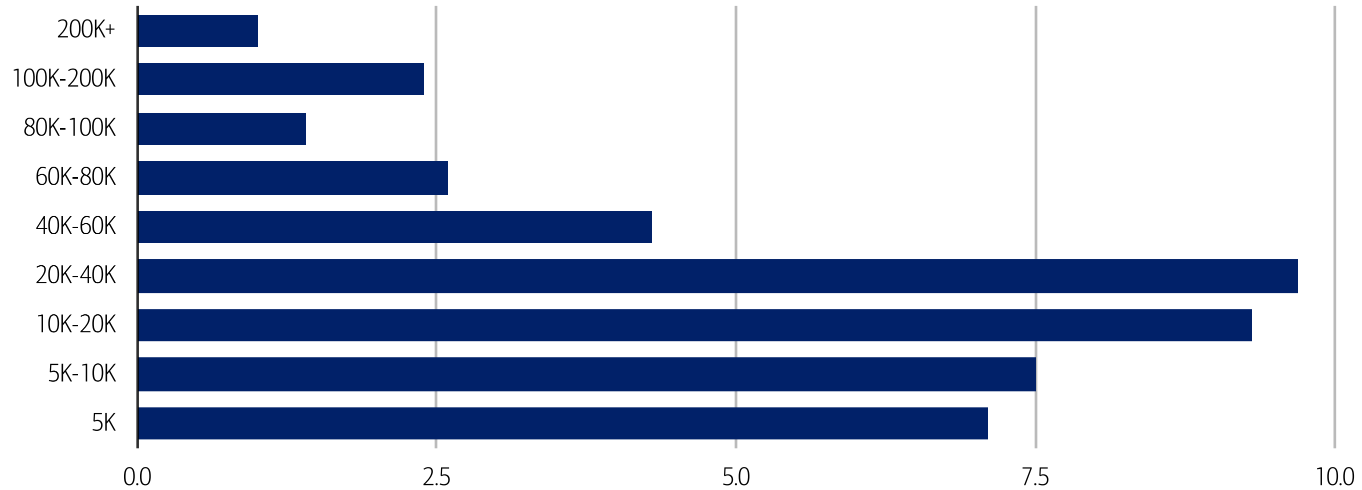
The other element of the Biden administration announcement concentrates on federal student loan forgiveness. Single filers who make less than $125K and joint filers who make less than $250K can amass up to $10K in relief. Pell Grant recipients are eligible for twice that amount.

So, the 10,000-dollar question is: who could benefit here?

Bank of America internal data indicates that 75% of households who have made a student loan repayment have an annual income of <$125K and may therefore see some benefit from debt cancellation of up to $10-20K.

Around one-third of borrowers have a student loan of $10K or less, with just over 50% having a loan of $20K or less, according to Department of Education data (Exhibit 5), Therefore, given the large number of households potentially eligible via income and the size of their debt, it appears many borrowers could see a large chunk of their total student debt forgiven. The Department of Education estimates that nearly 90% of debt cancellation benefits will go to borrowers earning less than $75,000.

Exhibit 5: Distribution of Federal Student Loan Debt by size of loan and numbers of borrowers (millions)
Around a third of borrowers have a federal student loan of $10,000 or less

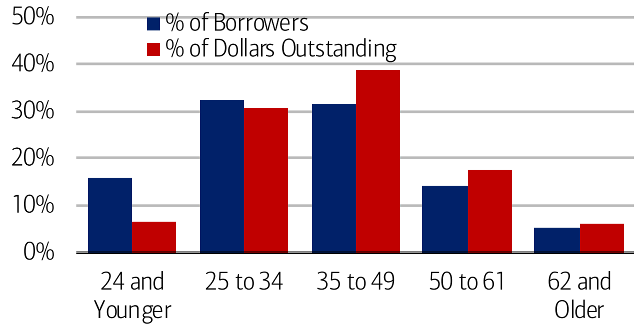


Source: Department of Education

According to the Department of Education data, as of Q2 2022, those aged 25-34 accounted for the largest percentage of federal student loan borrowers, while those aged 35-49 had the largest percentage of loan amount outstanding (Exhibit 6). Together, these two age groups accounted for both the largest percentage of borrowers and loan amount outstanding.

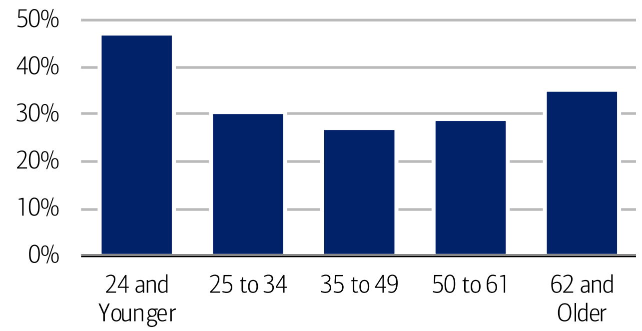
How much then are these age groups potentially going to benefit? Data suggest that the majority of borrowers who have less than $10K in federal student loans falls primarily within the 24 and below age group (Exhibit 7). This is likely due to the length of time in which debt has been accrued, especially given the freeze over the past two years. Borrowers aged 35-49 make up the smallest percentage with $10K or less in debt.

Exhibit 6: Federal Student Loan Portfolio by Borrower Age (%)
People ages 25 to 34 and 35 to 49 accounted for the largest shares of both borrowers and dollars outstanding



Source: Department of Education

Exhibit 7: % of total borrowers by age with federal student debt below $10,000
The majority of loans less than $10K are held by the youngest age groups



Source: Department of Education

Arguably, what matters more from an economic perspective is the forgiveness relative to total debt, or indeed net wealth. Given debt tends to rise with age as people accumulate housing debt and other liabilities, the proportionate debt reduction is likely to be highest among the young.

Macro Matters

What about the macroeconomic impacts of the forgiveness and forbearance policies? Given the forbearance extension is for a limited time, it is likely to have only a fairly limited impact at the macro-level. In the short-run, it boosts consumer's disposable income and provides some support for the economy, but in 2023 this support will fall away.

The forgiveness policy will potentially have a much larger impact, as it wipes out a large stock of accumulated debt. The Penn Wharton Budget Model team estimates the total cost of forgiveness at around $500bn. But to put that in perspective, the latest estimate for 2022 Q2 from the Federal Reserve Bank of New York puts total household debt at $16.2 trillion. So the impact on aggregate total household debt is relatively modest. Ultimately, the impact on the economy is also dependent on how the forgiveness of student debt affects the total envelope of government debt and deficits over time.

Contributors

David Tinsley

Senior Economist, Bank of America Institute

Taylor Bowley

Economist, Bank of America Institute

Sources

Ana Maxim

Senior Vice President, Consumer and Small Business

Jonathan Kaplan

Senior Vice President, Digital and Marketing

Ashley Clark

Senior Vice President, Consumer and Small Business

Methodology

Selected Bank of America transaction data is used to inform the macroeconomic views expressed in this report and should be considered in the context of other economic indicators and publicly available information. In certain instances, the data may provide directional and/or predictive value. The data used is not comprehensive; it is based on aggregated and anonymized selections of Bank of America data and may reflect a degree of selection bias and limitations on the data available.

The household consumer deposit data based on Bank of America internal data is derived by anonymizing and aggregating data from Bank of America consumer deposit accounts in the US and analyzing that data at a highly aggregated level. Bank of America student loan repayment data include payments identified through ACH and online bill pay on a per household basis. Data is not adjusted for seasonality, processing days or portfolio changes, and may be subject to periodic revisions. Student loan repayments data will include both federal and private payments.

Additional information about the methodology used to aggregate the data is available upon request.

Disclosures

These materials have been prepared by the Bank of America Institute and are provided to you for general information purposes only. Such materials are not intended to be reflective or indicative of, and should not be relied upon as, the results of operations, financial conditions or performance of Bank of America. The Bank of America Institute is a think tank dedicated to uncovering powerful insights that move business and society forward. Drawing on data and resources from across the bank and the world, the Institute delivers important, original perspectives on the economy, Environmental, Social and Governance (ESG) and global transformation. Unless otherwise specifically stated, any views or opinions expressed herein are solely those of the Bank of America Institute and any individual authors listed, and are not the product of the BofA Global Research department or any other department of Bank of America Corporation or its affiliates and/or subsidiaries (collectively Bank of America). The views in these materials may differ from the views and opinions expressed by the BofA Global Research department or other departments or divisions of Bank of America. Information has been obtained from sources believed to be reliable, but Bank of America does not warrant its completeness or accuracy. Views and estimates constitute our judgment as of the date of these materials and are subject to change without notice. The views expressed herein should not be construed as individual investment advice for any particular client and are not intended as recommendations of particular securities, financial instruments, strategies or banking services for a particular client. This material does not constitute an offer or an invitation by or on behalf of Bank of America to any person to buy or sell any security or financial instrument or engage in any banking service. Nothing in these materials constitutes investment, legal, accounting or tax advice.