Rodney's Take

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Government Shutdown and UAW Strikes are Side Shows

We started the fourth quarter with a lot of news, but as the old adage goes, most of it provided a lot of heat but very little light. The government shutdown, if it's still a thing by the time you read this, won't affect most Americans much unless they are in a federal government job or waiting on a document like a passport to be processed. The UAW strikes are an argument over who can capture more of our money as taxpayers and consumers that the Big Three automakers will pull in through subsidies and forced sales. None of that is news. The big stories without known endings are student loans and leveraged loans.

I've discussed student loans many times, including the myriad ways taxpayers subsidize the program by moving value from the many (through national borrowing, in which all taxpayers share) to the few (through individual student borrowers). It starts with underpriced loans to unqualified borrowers and ends with dreaming up new ways to give them a pass on repayment. We can talk about the finer points all we want, but that's the crux of the issue.

One of the biggest gifts student borrowers have received historically is the moratorium on repayment they've had for the last three and a half years. During that time, interest did not accrue on the loans, and if you were delinquent before the pandemic, your account was reset. But the moratorium is ending, and around 30 million borrowers will have to start making their student loan payments this month. They will send cash to the government instead of spending it or saving it, which will depress consumer

spending. The big question is, "By how much?" No one knows. We know it should be roughly the number of borrowers multiplied by the average loan payment ($200), so about $6 billion per month, but how many borrowers simply will not pay or will not be able to figure out how to pay due to changes in their servicers? Also, will the borrowers plow ahead, spending down more of their savings and using credit to remain at their current standard of living? We will find out over the next three months.

The other unknown is how leveraged loans will fare as the Fed holds rates higher for longer. Leveraged loans, typically money lent to highly indebted companies or those with poor credit histories, usually have floating rates based on the secured overnight financing rate (SOFR, the new LIBOR) plus a margin. The SOFR is based on Fed rates, so as the Fed rate climbs higher and stays there, leveraged loans charge higher rates to their clients. That's awesome… as long as clients can pay. According to Fitch Ratings, companies with about $270 billion in loans outstanding have weak credit profiles and are at risk of default. This is why many companies that issue leveraged loans and pay 10% have lost stock value. No one knows if their clients will repay.

If the first variable, student loan repayments, ends up taking a chunk out of consumer spending, it likely will cause financial troubles for the second variable, leveraged loans, which could see a pop in defaults. A double whammy of falling spending and business defaults likely would give the Fed what it's looking for, rising unemployment. This doesn't mean that inflation will fall, given that oil is closing in on $100 per barrel, but it would make for a very unmerry holiday season.

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