The Student Loan Bubble: Gambling with America's Future

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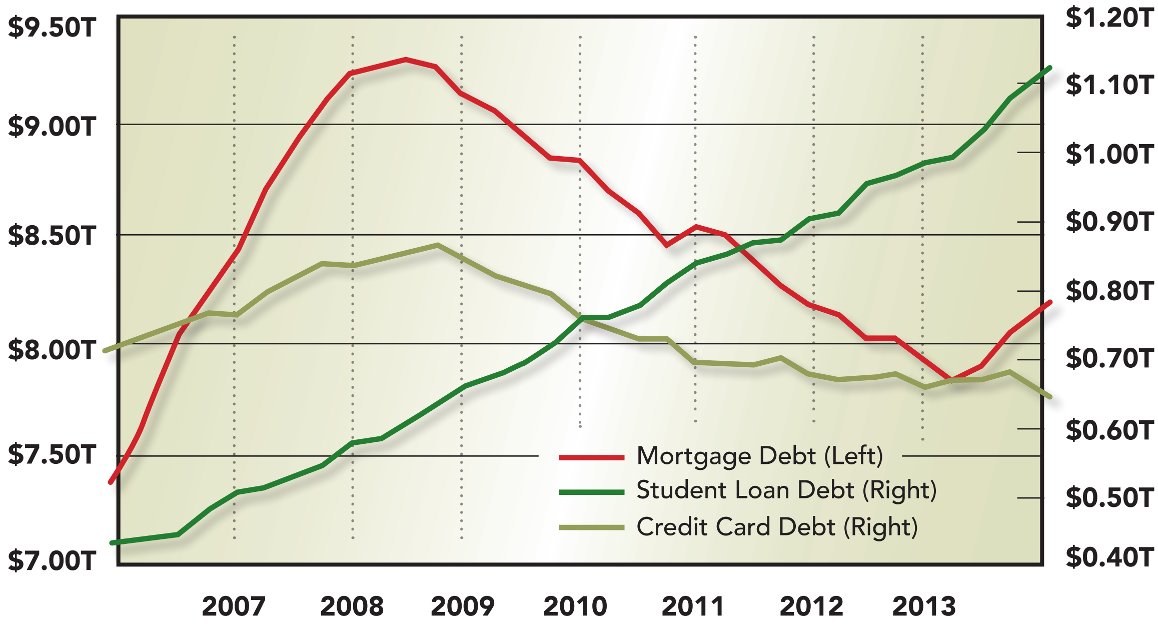
The federal government can't seem to help itself.

After overseeing the inflation and burst of the dot-com bubble in the 1990s, and the subprime mortgage bubble in the 2000s, the United States federal government is at it again – this time in the area of student loans.

Student loan debt now stands at a record $1.2 trillion, which represents the second largest category of consumer debt after home mortgages. It has grown by leaps and bounds since the financial crisis of 2008 and now surpasses even car loans and credit card debt.

Debt Comparison (2006-2014)



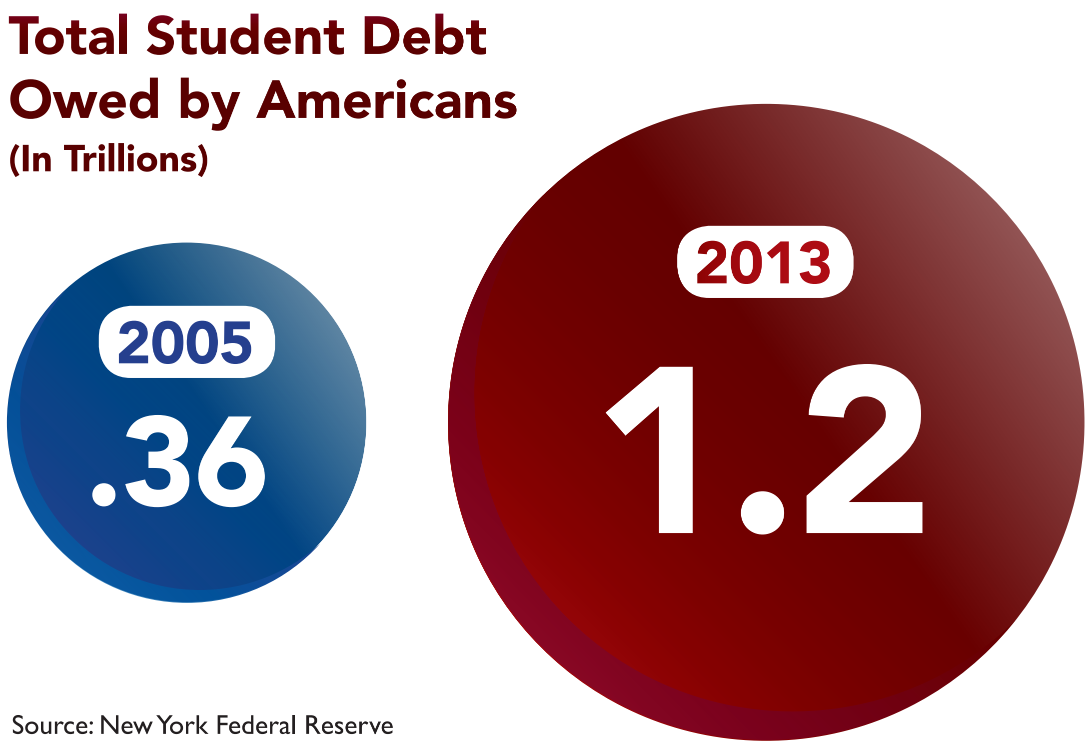
Source: Federal Reserve, Bloomberg

As many are aware, politicians encouraged the subprime mortgage bubble was encouraged by politicians' desires to guarantee the American Dream of a home to all Americans – regardless of their credit rating. Generous home loans were offered to people with little wealth or income, and therefore no realistic ability to actually pay them back. But with artificially depressed interest rates and the assumption that home prices would never cease to rise, it didn't seem like such a bad idea. And with Uncle Sam implicitly guaranteeing to buy these risky mortgages from banks no matter what, subprime mortgage lending exploded.

Of course, we now know the assumption that home prices would go up forever was wrong. Once home prices got overextended and began to crash back to earth, the party was over. Uncle Sam (a.k.a. the American taxpayer) was left footing the bill – to the tune of over $400 billion with the Troubled Asset Relief Program (TARP).

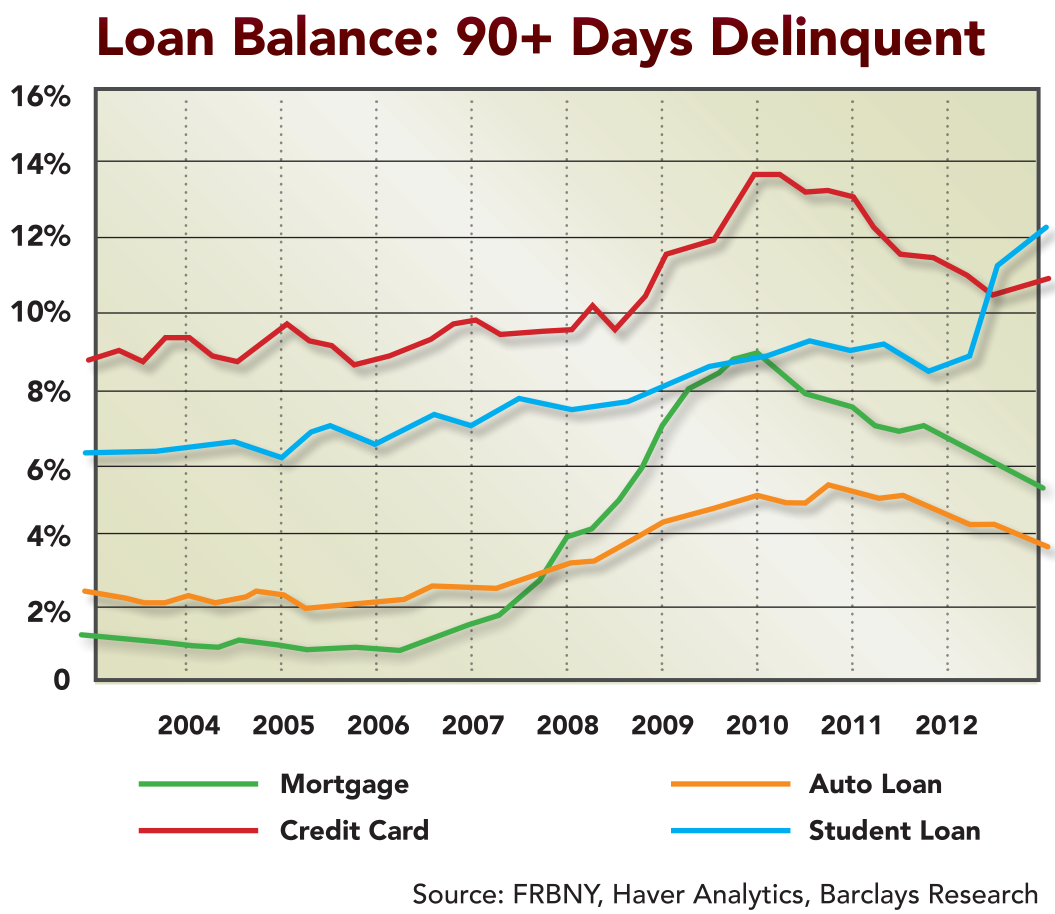
It seems to now be happening all over again. This time politicians claim that every American has the right to a college education, regardless of their credit rating or their SAT scores. Spurred on by even lower interest rates and the implicit promise that John Q. Taxpayer will once again come to the rescue if anybody happens to default, we now have a growing student loan bubble on our hands.

Since 2003, student loan debt has more than quadrupled – rising from $250 billion to well over $1 trillion. It has increased over $500 billion (a 75% increase) since the beginning of President Obama's first term. Furthermore, at the end of 2008, the default rate was 7.9%, but now stands at 11.3% – a huge increase that some consider an underestimation.



Perhaps the saddest part is that many students receiving these loans aren't even academically prepared for the rigors of college. As a result, almost half of them won't even graduate and reap the rewards of their student-loan-fueled college experience. Instead, they'll be saddled with debt for years to come, because not even personal bankruptcy can dismiss student loan debt.

Now at least 11.3% of all outstanding student loans are in default. When added to those in deference or forbearance, which are essentially delinquent loans as well, a more accurate figure of at least a 23% default rate emerges. In other words, we are looking at a total default level of over $250 billion, which most likely will end up being covered by the federal government – otherwise known as the American taxpayer.



While this figure is smaller than the $400 billion shortfall caused by the subprime mortgage crisis, you have to remember that there is no collateral required for a student loan. Banks can foreclose and repossess the house when a borrower defaults on a home loan. However, what can a bank repossess in the case of a student loan? A diploma? Knowledge? The bottom line is that each dollar of a defaulted student loan will pack much more of an economic punch.

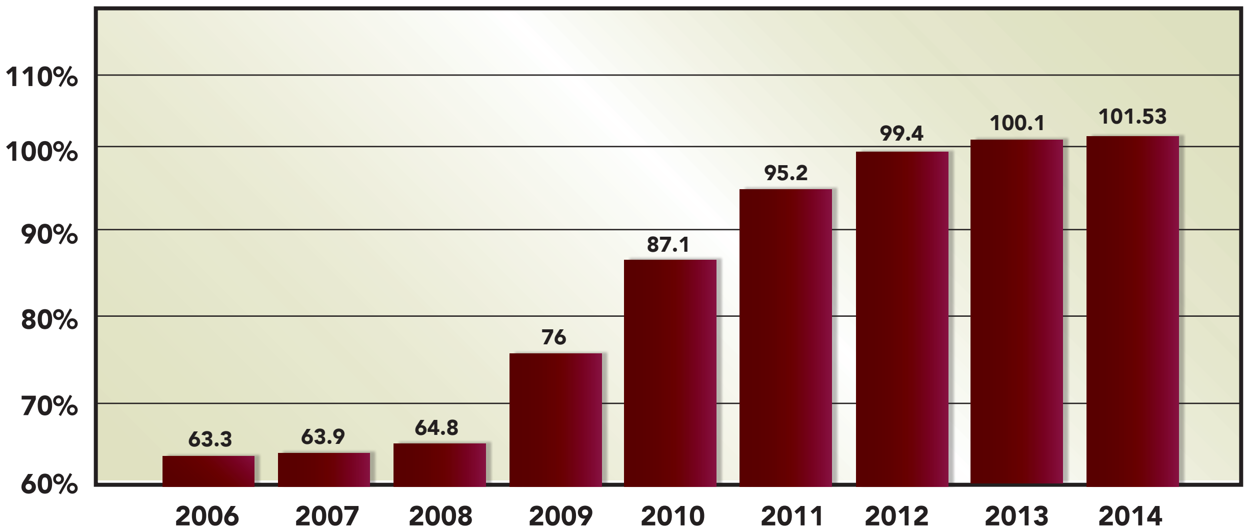
If that seems bleak, consider the fact that $250 billion is just the beginning. It is now projected that the total amount of student loans may balloon to over $3.3 trillion within the next ten years. A 23% default rate on that astounding figure gets you into the neighborhood of over $750 billion. Moreover, with the economy continuing to struggle and more and more college graduates waiting tables instead of landing lucrative jobs, one can only expect this default rate to worsen.

But wait, there's more! With the recent decision to forgive the student loans of all those who were deceived by the false promises of privately run Corinthian Colleges (a total of over $3.5 billion), a slippery slope situation may now be at work. Many hint that the move opened the door to debt "forgiveness" for students attending other private colleges. It may not be long before there is a blanket call for all student loans that are in any sort of trouble to be forgiven. The total numbers here would be absolutely staggering. Again, it would hang the American taxpayer on the hook.

Some might say, "What's the big deal? America is already dealing with massive amounts of debt. Is this really going to make that much of a difference?"

The big deal is that the student loan bubble does add significantly to the nation's enormous debt burden. More importantly, it is emblematic of an American financial system beholden to a federal government continuing to amass skyrocketing amounts of debt, with neither a demonstrated plan nor any ability to ever pay it off. It's yet another chunk of debt added on to an ever-increasing pile, now standing at 102% of an $18 trillion GDP and rising. This doesn't even take into account the federal government's unfunded liabilities (i.e., all future Medicare and Social Security commitments), which can be conservatively projected to be well over $127 trillion. Simply put, United States debt is unsustainable.

US Government Debt to GDP



Source: TradingEconomics.com/U.S. Bureau of Public Debt

Yet this is how we "roll" in a fiat-currency-based monetary system – especially one that happens to control the world's reserve currency. The dollar sits in the catbird seat. It is the most owned, most trusted, and most utilized currency in the world. As such, it can burn through enormous political and social capital before it witnesses any serious consequences.

How long can we expect things to just "roll along" smoothly? The federal government has made way too many promises it simply cannot break without unleashing utter chaos. Can you imagine what will happen if Congress actually takes a stand and says it must tighten its belt and cut spending? Which programs and entitlements will be slashed? The public housing and food stamps millions of poor Americans depend on? Public schools serving millions of families? Medicare and Medicaid? Obamacare? Social security?

To avoid a massive political uprising, the elite will probably just keep borrowing money and printing currency to continue funding these commitments. The endgame seems to be that the federal government will ultimately have no choice but to monetize its debt. If this is the case, the dollar will lose much of its clout and credibility. Hyperinflation may be the final result.

Of course, alternatives to hyperinflation exist. The government could institute one of those notorious "bail-ins," as Cyprus experienced in 2013. Basically, the government could simply seize the savings accounts of rich and middle class Americans in order to cover its enormous budgetary shortfall.

This seems untenable in today's political climate, but the citizens of Cyprus probably never conceived of such a move either. Desperation can quickly change political dynamics.

The fact is, while our financial system seems to be humming along pretty well today, a serious reckoning is inevitable. This current path of consistently spending far more than we consume, lending irresponsibly to those who cannot repay, then just borrowing more and more in order to cover it all up will, indeed, hit a wall.

History has proven time and again that all fiat currencies eventually implode due to their abuse by central bankers. The inevitable bursting of the student loan bubble will add to the already massive debt burden and is just one more example of abuse that points to the eventual collapse of the US dollar. Lest we forget, the collapse of a major fiat currency would not be just an inconvenience for society, but a crippling blow to Western civilization.

WHAT CAN YOU DO?

"Well," you might say, "This is certainly a very depressing future you've painted for us." Yes, it's not pretty. But knowing the truth now allows you to prepare for the worst. There is at least one thing you can do to prepare yourself for a financial crisis triggered by the popping of the student debt bubble – own physical gold and silver. In turn, this will prepare you for the ultimate crisis – a collapse of the US dollar.

US Dollar Purchasing Power (1913-2013)

Source: US Bureau of Labor Statistics

The US dollar is a fundamentally broken promise, and its trustworthiness will not improve. The dollar's purchasing power has fallen by over 97% since the Federal Reserve was first established in 1913. Since it is just a piece of paper or a digit on a screen, the dollar holds no true market value, like a commodity. Its monetary value is completely dependent upon the Federal Reserve's monetary policy. Unfortunately, the Fed is more than willing to abuse its power and print more dollars with the push of a button.

Adding to this inherent risk, if you hold dollars in a US bank, they are vulnerable to seizure should the government execute a bail-in.

However, gold and silver are different. Across countless centuries and through trillions of voluntary economic transactions, gold and silver have emerged over and over again as the best money ever to exist on the planet. This is not just a coincidence. Gold and silver possess true commodity value as precious metals. Gold and silver are always in demand. Gold and silver are physical in nature, not just a promise to pay. Most importantly, nobody can create gold and silver out of thin air. Miners must dig precious metals from the earth at significant cost.

In other words, gold and silver are trustworthy as money. Unlike the dollar, there are no corrupt politicians or arrogant central bankers propping up the precious metals. The dollar is on track to lose its trustworthiness. When it finally does, the world will begin to demand a new, alternative medium of exchange – one that is truly trustworthy. That money will be physical gold and silver.