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Can US households continue driving growth?

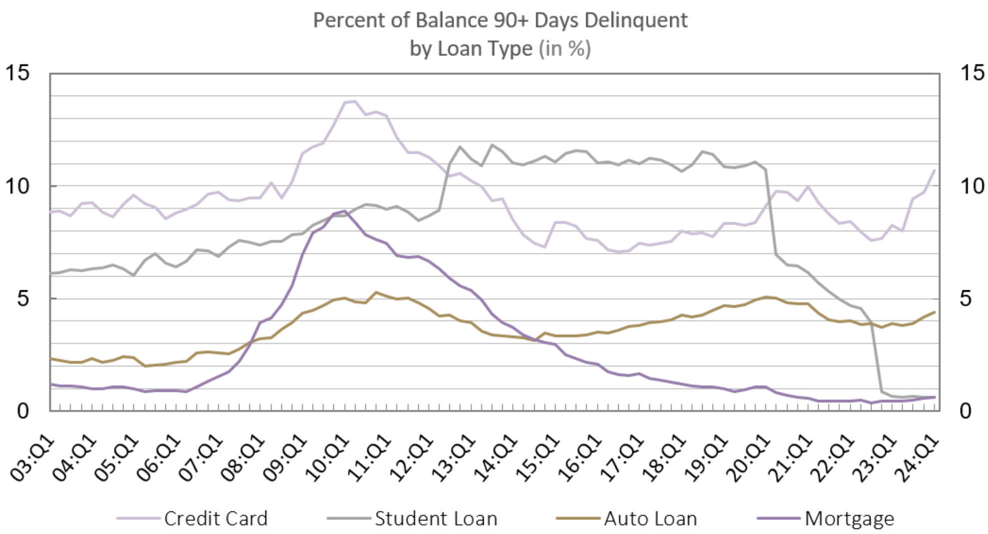
Consumers are the Atlas holding up the American economy. With the US representing around one-quarter of global output, and with personal consumption accounting for an estimated 70% of US GDP, the willingness and ability of US households to spend, matters.

In the period following the pandemic, US consumption appeared infallible. Neither high inflation, nor one of the fastest rate hiking campaigns on record deterred spending. Americans with their shopping carts trampled over the consensus view among economists of late-2022, that monetary tightening would lead to a recession within twelve months. They also compelled most reputable research bodies to revise up their growth forecasts for the US, and to an extent, the global economy.

Fast-forward to today, however, we can see that the factors supporting US consumption are fading…

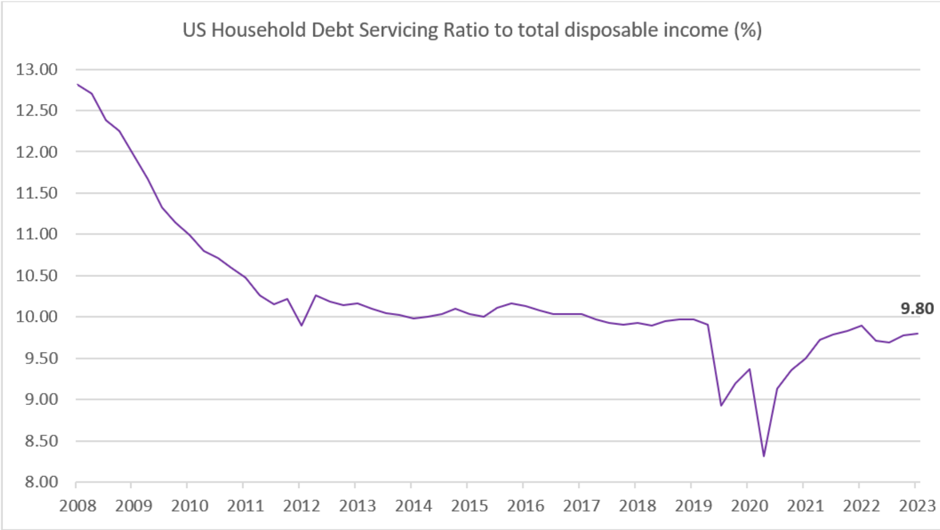
Combined, generous government stimulus and forced savings amassed during lockdowns, were a proverbial protein shake that helped our metaphorical Atlas to hold up the US economy for so long. A host of fiscal programs, including stimulus checks, expanded unemployment benefits, and child tax credits, injected households with liquidity and relieved expenses, resulting in a remarkable increase in disposable income. But it appears that households have reached the bottom of the glass. According to recent research by the San Francisco Fed, USD 2.1 Trillion in excess savings have now been fully depleted. Meanwhile, the savings rate has fallen to just 3.2%, well below the long-term average of over 8%, implying that US households now have a very thin cushion for when the cycle turns.

Debt was another supplement allowing Americans to continue indulging post-lockdown. Prior to the pandemic, US credit card debt sat at USD 927 Billion. The most recent data from the Federal Reserve reveals that it now amounts to a staggering USD 1.12 trillion. That's not to mention the phantom debt in Buy Now Pay Later schemes which official statistics fail to capture. With the average APR on credit card debt currently around 27%, the strain on household balance sheets is increasingly apparent. In Q1 2024, nearly 9% of credit card balances transitioned into delinquency, leaving the total amount in the red above pre-pandemic levels.



Source: New York Fed Consumer Credit Panel/Equifax, *BIL*

The silver lining is that many US households took the opportunity to lock in low mortgage rates before the lift-off in interest rates (US mortgages tend to be fixed for 30 years). Because of this, the overall household debt servicing ratio [1] still looks very manageable at below 10%.



Source: Federal Reserve, Bloomberg, *BIL*

A third, and probably the most crucial factor supporting US spending, is the labour market. As companies scrambled to hire workers after the pandemic and the 'Great Resignation', the US unemployment rate dropped to levels unseen since 1969. Workers enjoyed newfound bargaining power and paychecks ballooned. Now, we see that the once red-hot labour market is cooling – perhaps to a greater extent than official statistics show. The number of job openings is now at the lowest level since February 2021, while after-tax personal income rose just 1.5% in Q1 of this year, the slowest annual advance since 2022. Tellingly, the number of people claiming unemployment benefits has been on a sharp upwards trajectory since late-April. Growth in nonfarm payrolls pushes back against the hypothesis that the labour market is weakening meaningfully, however, we believe that this datapoint will undergo significant downwards revisions in the future due to the way business closures are estimated in the BLS model.

As these supporting factors wane, and with a potentially toxic Presidential election in the pipeline, US consumer sentiment is really starting to turn. The latest Conference Board survey showed that consumer expectations (a good guide to future real consumption growth), have dropped by a sizeable 8.9 points since December, to 73 today. Note that in the past, a reading below 80 has been a recession indicator.

Hard spending data is also decelerating. In Q1, US GDP growth cooled to 1.4%, with a major detractor being a slowdown in spending. Personal consumption grew at an annualised pace of 1.5%, a sharp drop from the 3.3% growth recorded in Q4 2023. Comments on earnings calls from companies acknowledge the slowdown, and the most recent retail sales data has disappointed on the downside. Notably, sales at food services and drinking places has started to drop, hinting that even services consumption – which has been a real lynchpin – is also starting to taper off.

But consumers aren't only cutting back on treats. In the consumer staples sphere, tighter purse strings are increasingly evident. The number of items scanned at supermarkets dropped by billions in the twelve months to June, and where consumers are still buying, grocery chains note they are "trading down", i.e., opting for less expensive alternatives such as store-brand products. While households at the lower end of the income spectrum are switching due to necessity, there is also an element of pushback among all consumers with regard to higher prices. Inflation might have retreated (the latest headline CPI was 3.3% YoY), but the compounding of price increases for a year and a half has left everything expensive, and consumers are becoming fatigued.

In all, after spending with relative abandon, all the signs now point to a consumer sector that is increasingly cautious, discerning, or downright unable to consume as much.

Conclusion

The US consumer, the metaphorical Atlas holding up the US economy, undoubtedly looks a lot less athletic today. As the strength of the collective household balance sheet starts to wane, we expect Americans to begin reining in spending going forward. We do not, however, expect an imminent collapse in consumption.

Why? Firstly, a collective move to lock-in low mortgage rates is shielding households from the full brunt of higher rates. Secondly, the labour market may be cooling, but it is doing so from exceedingly strong levels. History suggests that as long as income comes in, Americans are likely to spend it.

Therefore, much now hinges on how much the labour market weakens from here. The recent pullback in spending should help cool the economy, meaning the Federal Reserve will be able to cut interest rates this year before the labour market weakens substantially. If the Fed is forced to wait too long, cutting only once the labour market is mired in a downward spiral, then it would really spell trouble for consumption and probably take the 'no landing scenario' off of the table.

[1] The ratio of total required household debt payments to total disposable income

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