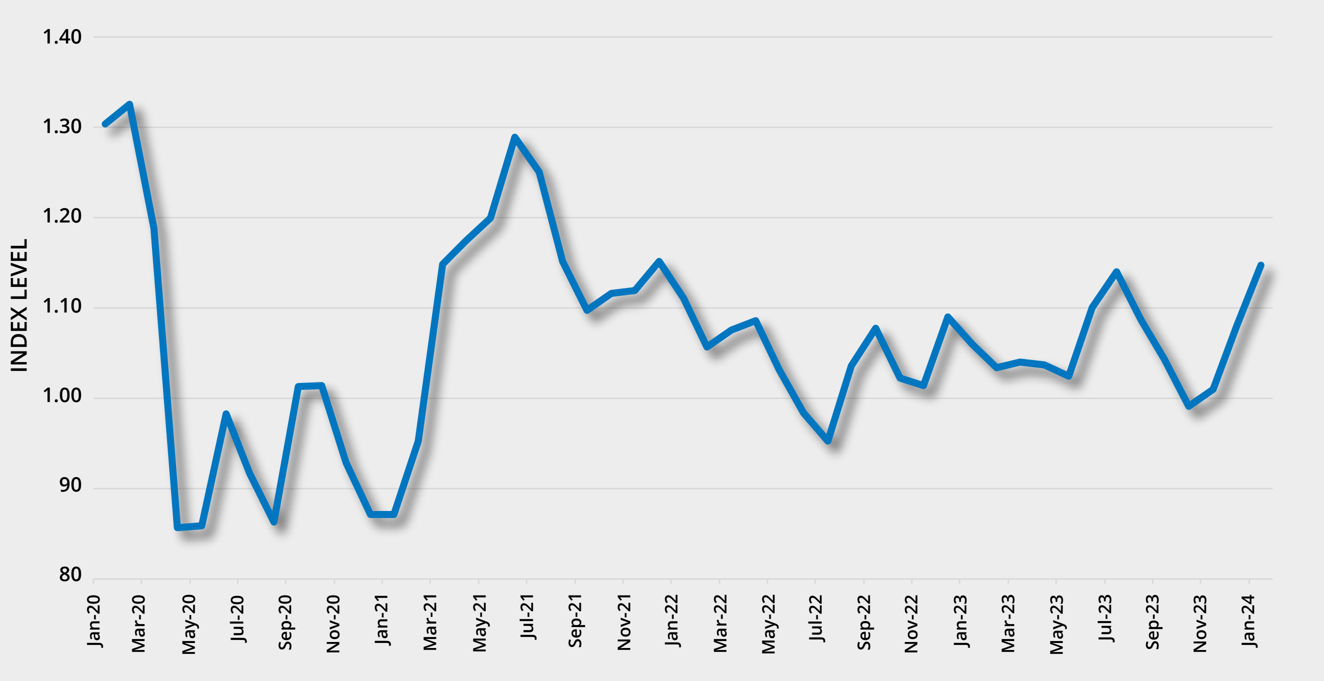
# Are Consumers Running on Fumes?

Amid the intricate web of economic dynamics, one entity stands out as the powerhouse propelling the engine of domestic economic growth: the American consumer. The significance of the consumer cannot be overstated; our spending habits heavily influence the rhythm of economic cycles. Surveying the current economic landscape, it becomes increasingly evident that consumer demand has remained robust, persevering despite higher prices and borrowing costs. However, lurking beneath the surface are potential signs of exhaustion, raising critical questions about the future trajectory of the economy and financial markets.

The American consumer has long been the linchpin of the US economy, contributing meaningfully to its ebbs and flows. Consumer spending accounts for approximately 70% of the nation's Gross Domestic Product (GDP), making it the single largest driver of economic output. Such dependence on consumer demand underscores its pivotal role in sustaining growth and fueling prosperity across various sectors.

Examining recent economic data, the persistent strength of the American consumer is clear. Despite proclamations of a looming recession from titans of industry like Jamie Dimon and Jeff Bezos in 2022, consumer confidence remains buoyant. According to the January report from the Conference Board, consumer confidence reached its highest level since the end of 2021, signaling optimism regarding economic prospects and personal finances. This positive sentiment is mirrored in record retail sales figures over the holidays, with consumer spending showing resilience even in the face of inflationary pressures and increased borrowing costs.

**Consumer Confidence Index**




Source: Bloomberg, The Conference Board, 2/23/24

Meanwhile, the labor market portrays a picture of resilience, with unemployment rates hovering near historic lows. As of January, the unemployment rate stands at just 3.7%, reflecting a tight labor market characterized by robust job creation and limited layoffs. Most economists will argue that labor market conditions are a lagging economic variable, but undoubtably the lack of concern about job security reinforces willingness to spend. Weekly initial jobless claims, a statistic that tends to foreshadow inflection points in monthly unemployment figures, steadily remain at pre-pandemic levels.

Another buttress to consumer confidence has been rising asset prices. The housing and stock markets have experienced notable appreciation, bolstering household wealth and, consequently, consumer spending – a dynamic economists refer to as the "wealth effect."

Yet, amidst these signs of strength, there is an increasing risk that momentum could be poised to stall with evolving circumstances that call into question the sustainability of the current pace of consumer spending. We believe mounting pressure could potentially dampen consumer sentiment and ultimately slow demand.

Inflation tops the list of headwinds consumers face today. Elevated inflation erodes purchasing power, effectively reducing consumers' real incomes and constraining their ability to spend. In other words, spending becomes 'crowded out' by paying more for essentials like food and shelter, leaving less to spend on discretionary items like travel and entertainment.

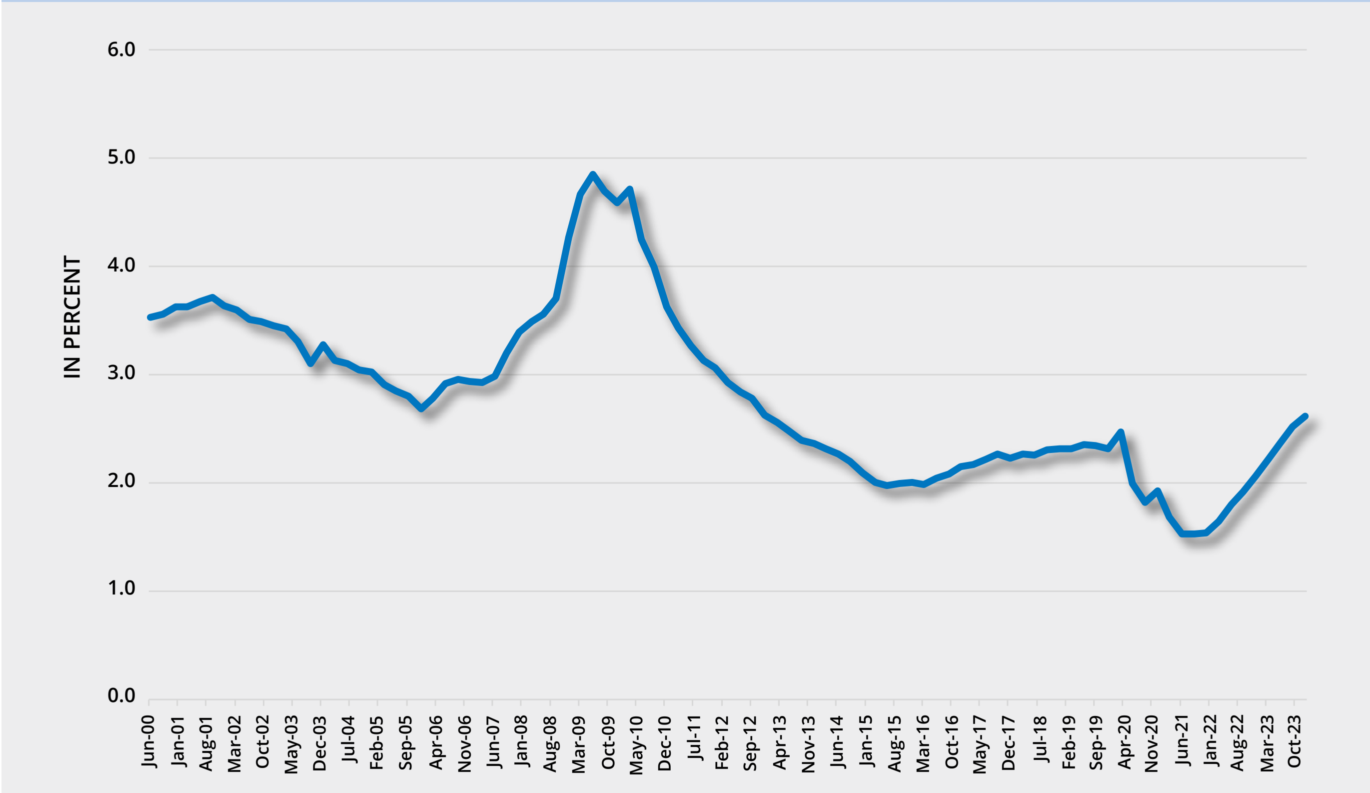
Surprisingly, American consumer's ability to spend has so far endured through inflationary pressures not seen in more than 40 years. The pinch of inflation has been more tolerable than past episodes largely because excess personal savings from pandemic era stimulus programs have been tapped to absorb higher prices.

But the key question is how long can this last? There is some evidence the stockpile of household savings is dwindling. While assessing precisely how much was saved and what remains is nearly impossible, one estimate by the Federal Reserve Bank of Boston suggests that just $321 billion of the nearly $2 trillion accumulated cushion remains. Once depleted consumers could start to pull back.

Anecdotes from consumer goods companies are beginning to suggest this is already happening. On the fourth quarter earnings call for The Kraft Heinz Company, CEO Carlos Abrams-Rivera remarked "What we see is low-income consumers are actually shopping more at places like Dollar Stores, higher-income consumers, more club stores. But mostly, we are seeing them looking for overall, smaller trips to stretch their dollar further."

Data on delinquencies for consumer loans corroborates the thesis consumers are beginning to feel stretched. Since an all-time low in the fourth quarter of 2021, delinquency rates have steadily climbed to levels that now exceed the pandemic peak. While current levels are still low by historical standards, and the optimist might dismiss them as simple normalization, the trend should raise eyebrows.

**Bank Consumer Loan Delinquency Rate**




Source: Bloomberg, Federal Reserve, 2/23/23

The implications of a slowdown in consumer spending reverberate throughout the economy, impacting businesses, employment, and overall growth prospects. Reduced consumer demand could lead to tepid business investment, as firms scale back production and expansion plans in response to weaker sales. This, in turn, could dampen job creation and wage growth, exacerbating the challenges faced by households.

Moreover, a slowdown in consumer spending could have ripple effects across global markets, particularly in economies reliant on exports to the United States. As the largest consumer market in the world, any deceleration in US consumer spending would reverberate across supply chains and trade networks, impacting businesses and economies worldwide.

The American consumer remains the cornerstone of the US economy, wielding immense influence over its trajectory. Despite facing various headwinds, including inflationary pressures and geopolitical uncertainties, the consumer has thus far demonstrated unexpected resilience buoyed by robust confidence, a tight labor market, and supportive asset prices. However, the potential for a slowdown in consumer spending looms large, posing significant challenges to future economic growth potential and financial market sentiment.

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