April 24, 2023

Consumer Slowdown Supports Recession Call, at Some Point

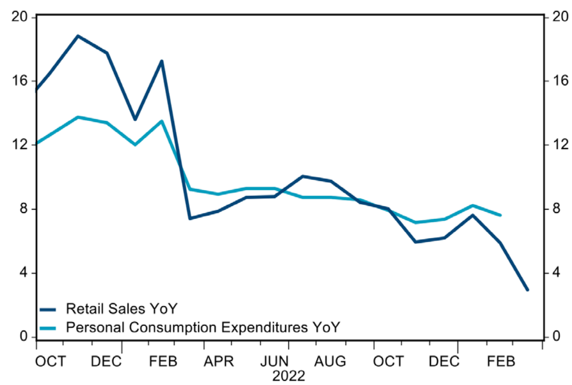
Economic **INSIGHT**

U.S. consumers are continuing to spend on goods and services. Under the weight of rising prices, however, along with lackluster real income growth and dwindling savings, the pace of expenditures has slowed markedly. As the backbone of the U.S. economy, a continued – or intensified – slowdown in consumer activity will likely result in a broad-based downturn of the economy, if not outright recession, a more dire scenario the Federal Reserve (Fed) is already anticipating in the second half of the year.

CONSUMER SPENDING SLOWS

After an unexpected bounce at the start of the year, consumers now appear to be under mounting pressure. U.S. retail spending, for example, dropped a full percentage point in March, marking the second consecutive month of negative activity, following a 0.2% decline in February. Year-over-year, retail spending rose less than 3%, down from a near 6% pace the month prior.

Of course, while pulling back nominally on expenditures as external supports fade, consumers are also shifting away from goods (or stuff) to more experiential or services-oriented purchases, resulting in a more accentuated decline in the latest retail numbers. Total spending – including goods and services – rose 0.2% in the latest February report and 7.6% year-over-year. While falling short of the prior month's increase of 8.2%, the downward trend in overall consumption appears somewhat less dramatic.



Sources: Census Bureau/Haver Analytics, Bureau of Economic Analysi

Of course, elevated prices continue to undermine the relative "strength" or soundness in nominal spending. Adjusting for inflation, real consumer spending fell 0.1% in February with an outright decline in both goods and services consumption.

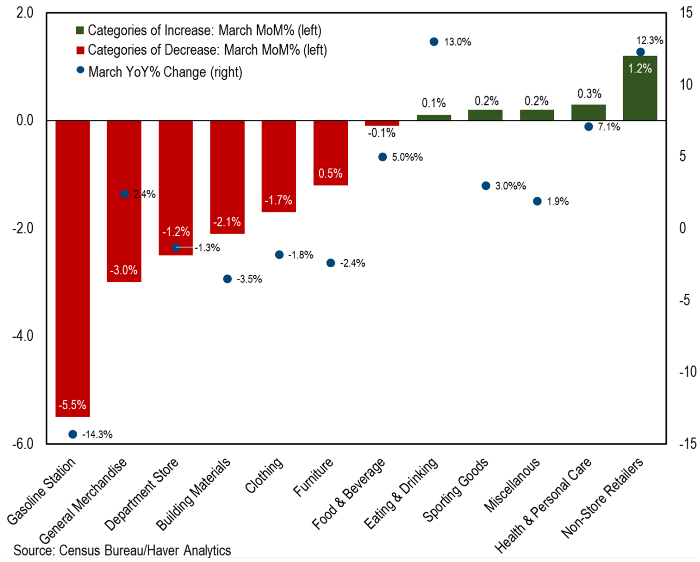
WHERE CONSUMERS ARE (NOT) SPENDING

As wealth erodes, consumers unequally adjust the goods and services in their basket. The brunt of the weakness in March retail spending, for example, centered on general merchandise, off 3.0%, as well as gasoline station sales, down 5.5% in March. The latter marks the largest monthly decline since April 2020, primarily, however, a reflection of

Lindsey M. Piegza, Ph.D.
Chief Economist
piegzal@stifel.com

Lauren G. Henderson
Economist
hendersonla@stifel.com

STIFEL



Source: Census Bureau/Haver Analytics

a reduction in prices at the pump rather than a reduced quantity purchased.

Heading into the end of 2022, gasoline was averaging $3.75 a gallon. Even after steadily rising over the past four months from a December low, the average cost from December through March is still roughly $3.36 a gallon. Furthermore, on a longer-term basis, gasoline prices are down nearly 30% from a peak in June 2022, offering consumers additional spending power.

Beyond the pump, weakness in March retail spending extended to department store sales and building materials sales, which were down 2.5% and 2.1%, respectively. Clothing sales were also down 1.7%. On the other hand, non-store retailers (or internet sales) led the limited strength in March, up 1.9%. Other risers included health and personal care (+0.3%), miscellaneous sales (+0.2), and eating and drinking sales (+0.1%).

BALANCE SHEET SUPPORT OR LACK THEREOF

While still maintaining positive spending levels, consumers are losing momentum. They are also shifting the goods and services in their basket month to month, an indication of concern over one's financial footing. With savings eroding, fiscal support mostly concluded, and elevated inflation eating into real income growth, consumers are understandably curtailing purchases.

Personal savings surged in 2020, a reflection of pandemic-related government stimulus and consumers' limited ability to spend amid shutdowns. This pattern of elevated savings continued for more than a year, but by the start of 2022, this positive trend reversed course.

To counteract rising prices and a loss of government funds, consumers turned to their COVID-era savings to supplement more robust spending patterns. According to the Fed, excess savings (savings beyond traditional levels of accumulation of wealth) topped $3 trillion in 2021. Now, less than two years later, more than half of excess savings has been deployed or spent. Furthermore, according to the Bureau of Economic Analysis, as of February, households are now only saving 4.6% of their income, less than half of the near 10% pre-pandemic rate.

Lackluster earnings growth has further eroded the strength of the household balance sheet. Wage growth remains arguably solid, or at least positive on a nominal basis, up 4.2% as of March. Down from a 4.6% increase the month prior, however, and even further below an earlier peak of 5.9% in March 2022, wage acceleration now marks the weakest annual rise since June 2021. Furthermore, adjusting for inflation, real wage growth rose only 1.1% in February after nearly a year of negative real income growth.

GLOSSARY

BEA – Bureau of Economic Analysis

EOP – End of Period

FOMC – Federal Open Market Committee

GDP – Gross Domestic Product

IRS – Internal Revenue Service

MoM – Month over Month

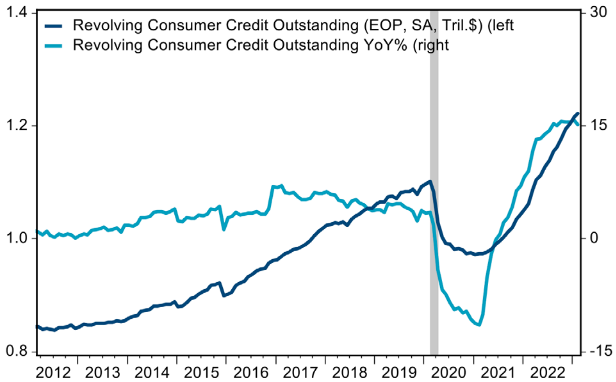
SA – Seasonally Adjusted

YoY – Year over Year

Smaller tax returns also likely played a role in declining spending activity in more recent months with tax returns falling short of expectations, or at least shy of last year's payout. According to IRS data, March tax refunds were $25 billion less than in 2022.

A SPUTTERING OF HOPE

There is little doubt the consumer is facing challenges. That being said, while inflation continues to erode what little income growth remains and much of the stockpile of savings has been spent, consumers still have access to "some" savings. This might not last another year, but according to former Treasury Secretary Larry Summers, it could give the average American a few more months "to run." Additionally, while fiscal stimulus has mostly concluded, a sputtering of state and local assistance remains. And furthermore, in the absence of real wealth, consumers have turned to credit cards to supplement their positive, albeit reduced, spending habits. In other words, the American consumer appears somewhat resilient – or at the very least resourceful – at least for now.



Source: Federal Reserve Board/Haver Analytic

According to Fed data, credit card debt has soared to record levels, rising 16% since the start of 2022. Total revolving debt, which primarily reflects credit card debt, has risen by $5 billion from January to February this year and jumped over 15% year-over-year. In fact, as of February, for the first time since the crisis, the total amount of revolving debt surpassed excess pandemic savings. Typically a red flag, household debt payments relative to disposable personal income, however, are at a multi-decade low, a reflection of crisis-era decisions to pay down existing debt along with the proverbial peloton purchase. In other words, given the relatively "healthy" starting point of debt to income, there is room for additional growth in consumer liabilities before it becomes a concern or an impediment to consumer activity. While far from a lasting solution, debt accumulation will provide at least a temporary support to spending.

Furthermore, while federal support largely ended in 2022, state and local stimulus has continued to provide its own layer of assistance to the consumer well beyond the end of the health crisis. Enhanced pandemic-era benefits provided through the Supplemental Nutrition Assistance Program, for example, were carried through February of this year with other support programs such as the moratorium on student loan payments extended through this fall.

BOTTOM LINE

Despite the Fed making significant headway in reducing price pressures from an earlier peak, inflation remains extremely elevated. As such, real income growth and savings have dwindled rapidly. Additionally, with minimal government initiatives, credit cards have provided temporary support to consumer spending. And even as activity remains positive, the trend pace of expenditures has clearly slowed, raising concerns about the viability of the broader economy as the consumer becomes increasingly fragile.

According to the latest projections from the Fed, with consumer activity largely "modest" for now, topline GDP is expected to slow from 2.1% in 2022 to a minimal 0.4% for 2023. Additionally, the March Federal Open Market Committee (FOMC) meeting minutes specifically noted the Fed staff is now including a "mild recession" in their forecasts. Expected to begin later this year, "the potential economic effects of the recent banking-sector developments," as well as persistently sticky inflation and an ongoing tight labor market may result in the need for more robust policy action and a period of negative growth.

A downturn, or an outright technical recession, is not a foregone conclusion. And given the surprising "resilience" of the consumer, particularly at the start of the year, most economists on the Street, ourselves included, have delayed calls for the initial drop into net negative territory. However, as the Fed presumably continues to tighten policy in – a well-founded – effort to thwart inflation, consumption will slow and topline weakness becomes increasingly likely.

Lindsey Piegza
Ph.D., Chief Economist
piegzal@stifel.com

DISCLAIMER

STIFEL