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The Consumer Remains Resilient, For Now

Americans are still spending. Despite a significant increase in rates and a growing threat of recession, consumers have proven surprisingly resilient at the start of the year. At the same time, consumers are more indebted than ever, drawing down savings and ramping up credit card usage. Without an offset in income growth, a continued reliance on such temporary factors suggests spending power is likely to wane

– further – sooner than later. This raises a red flag for the balance sheet of financial institutions as well as the broader economy.



RETAIL SPENDING PICKS UP IN APRIL

At the start of the second quarter, retail sales jumped 0.4%. While falling short of expectations for a larger 0.8% increase, April's gain marks the first month of positive expenditures since January.

Year-over-year, retail spending rose 1.6% in the latest report, down from a 2.4% pace reported at the end of the first quarter and even further below a recent peak of 10.3% in July of last year. Nevertheless, the modest pace of spending marks nearly three years of positive retail activity.

The weakness in April spending spilled over into several categories including sporting goods, department store sales, furniture, and electronics. Gasoline station sales alone dipped 0.8% in April, the sixth consecutive month of decline. Looking at control group spending, which excludes gas stations along with food service, auto dealers, and building materials, sales rose 0.7%, a three-month high and 4.2% over the past 12 months. While markedly stronger than the headline read suggests, this remains a three-year low.

SPENDING BUT HOW?

While consumer spending has undeniably lost steam from earlier more robust levels, equally irrefutable is the consumer's resilience in the face of increasingly difficult conditions. With the Federal Reserve raising rates 500 basis points in the last 14 months, the fastest pace of acceleration in 40 years, coupled with a rising risk of recession by year end and a longer trend of negative real income growth, it would be understandable, if not expected, that the consumer was already significantly tightening purse strings. Thus, it begs the question, exactly how are consumers continuing to maintain this reduced, but still positive, level of activity? The answer appears to be both inorganic and unsustainable.

Economic
INSIGHT



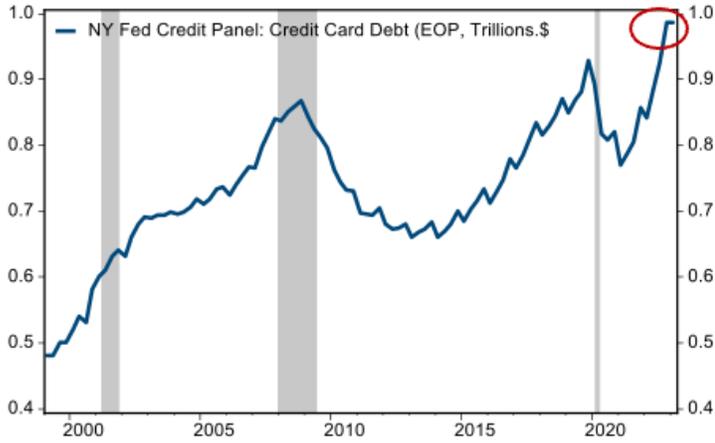
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The U.S. labor market remains tight with a lingering imbalance between demand and the pool of available labor. The limitation, however, stems from the supply side with over 9.5 million job vacancies, leaving businesses desperate for workers and willing to pay up to keep existing employees as well as entice new employees to join the ranks. As a result, wage pressures have surged on a relative basis over the past two and half years. Inflation, however, continues to outpace wage growth, leaving a real trend pace of earnings relatively flat – and disappointing – since 2021.

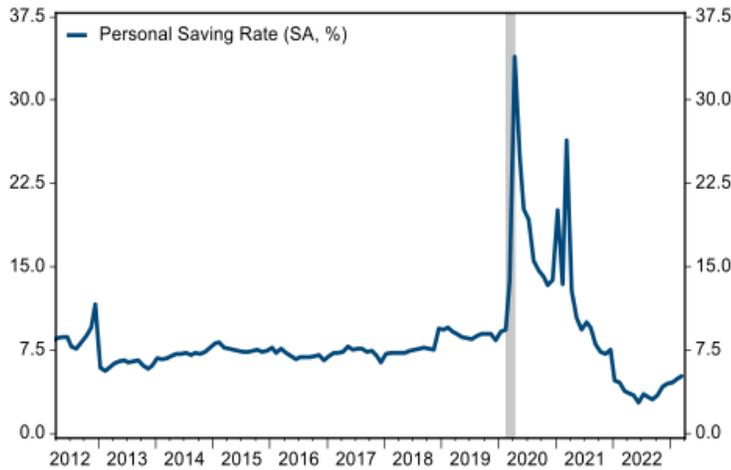


Source: FRBNY Consumer Credit Panel/Equifax/Haver Analytic

With income undermined by elevated price pressures, consumers are increasingly turning to a drawdown in savings, a last sputtering of state and local stimulus, and a ramp-up in credit card debt to finance monthly purchases. According to the Federal Reserve

(Fed)’s latest Household Debt and Credit Report, consumer debt has reached the highest level since the data were first published in 1999. The report showed consumer debt rose 0.9%, or by \$148 billion, to \$17.05 trillion in the first quarter of 2023.

Housing debt, which comprises of mortgages and home equity lines of credit (HELOC), rose 1% to \$12.4 trillion, significantly less than the 2.2% increase in Q4 and reflecting a near decade low in mortgage originations including refinances at the start of 2023. Non-housing debt, which is comprised of auto loans, student loans, personal loans, and credit cards, rose 0.5% to \$4.7 trillion.



Source: Bureau of Economic Analysis/Haver Analytic

Isolating auto, student, and personal loans in the Fed’s Consumer Credit – G.19 report, non-revolving credit rose 3.0% at the end of the first quarter to \$3.6 trillion. Revolving credit, meanwhile, which largely reflects consumers’ use of credit cards, rose 17.3% to \$1.2 trillion. Typically, consumers ramp up credit card debt at year end due to holiday

GLOSSARY

EOP– End of Period

GDP– Gross Domestic Product

SA– Seasonally Adjusted

¹ Non-revolving credit includes secured and unsecured credit for automobiles, mobile homes, trailers, durable goods, vacations, and other purposes). Consumer credit excludes loans secured by real estate (such as mortgage loans, home equity loans, and home equity lines of credit). Revolving credit includes credit card credit and balances outstanding on unsecured revolving lines of credit.

purchases but pay down balances at the start of the year. This marks the first time credit card debt has failed to decline between the fourth and first quarter in more than two decades.

At the same time consumers are loading up on debt, the savings rate has fallen markedly, indicating a growing willingness – and need – to draw down household wealth to supplement spending needs. The savings rate averaged 8.9% leading up to the pandemic, and then skyrocketed to a high of 33.8% in April during the lockdown. Since then, the savings rate has fallen well below the pre-pandemic trend, rising just 5.1% as of March 2023. Additionally, while federal stimulus largely concluded in 2021, at least some unspent funds continue to make their way to individuals and households reporting a position of hardship, including the unemployed and unhoused. States such as California, Georgia, Maine, and New Mexico have issued additional rounds of stimulus in the form of rebates, subsidies, or refunds to residents meeting certain criteria.

TAKEAWAY...



While higher rates may have curtailed overall outlays somewhat with a second derivative decline in topline expenditures, the latest Fed policy action has not deterred the consumer's appetite for borrowing, at least not yet. After all, the starting point was one of relative

health with household debt payments relative to disposable personal income dropping to a multi-decade low in the aftermath of the pandemic. Which is to say consumers weren't just buying electronics or Pelotons during the lockdown but also paying down debt. Now, going forward, while few would outright advocate for consumers to take on new amounts of credit card debt, the household balance sheet clearly has additional runway to support further debt accumulation before it becomes a sizable red flag or an impediment to spending activity. In other words, the consumer may remain "resilient" for at least some time longer.

That being said, credit card rates are on the rise, making it increasingly costly to carry debt. According to Bankrate data, the average credit card interest rate is currently at an all-time high since tracking began in 1985 at 20.4%. Late payments and defaults have also risen as of late, albeit minimally, up 0.6% and 0.2% for credit cards and auto loans, respectively, according to the New York Fed's Household Debt and Credit Report. Nevertheless, a hearty reliance on credit cards could eventually prove problematic, choking off consumers' ability to spend, leading to a significantly lower level of GDP and higher rates of joblessness.

Additionally, in the aftermath of recent bank failures, relative calm has seemingly returned to financial markets. However, volatility and uncertainty remain. With

increased scrutiny of bank balance sheets, a rising level of non-performing loans relative to loan loss reserves could be another point of concern for an already fragile sector.

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