Economic **INSIGHT**

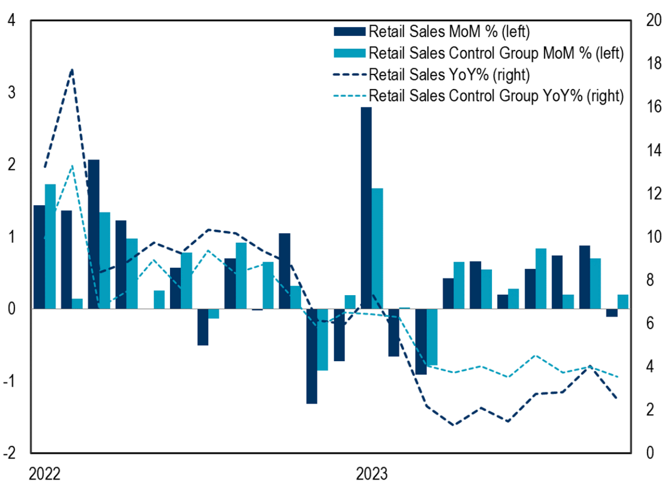
December 4, 2023

Buy Now, Pay Later: Consumers' Willingness to Spend May be Stronger than Ability

The U.S. consumer continues to defy expectations for a material slowdown amid elevated prices. A perceived sense of purchasing power seems to be perpetuating a willingness – justified or not – for consumers to keep spending. However, momentum is fading as short-term supplements, such as a drawdown of savings, a ramp up of credit card spending, and 401(k) emergency withdrawals, are inching closer to exhaustion.

NOMINAL SPENDING

The latest data shows consumer retail activity fell outright at the start of the third quarter with October retail sales dropping 0.1%, significantly less than expected. The decline marks the first monthly drop since March, but also follows an upwardly revised 0.9% gain in September, helping to offset the monthly weakness. Parsing through month-to-month volatility, retail sales rose 2.5% year-over-year, a solid but reduced pace from 4.1% in September and marking the slowest annual increase since June.



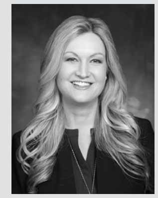
Source: Census Bureau/Haver Analytics

Stripping out the noise of auto sales, gasoline station sales, building material and food sales, control group purchases rose 0.2% for the month and 3.5% over the past 12 months.

Taking into account goods and services consumption, total spending rose 0.2% at the start of the fourth quarter and 5.3% year-over-year, down from a 5.7% pace in September.

While the strength in baseline growth is far from remarkable, there is still a clear lack of downward momentum or outright weakness. Against the backdrop of tighter credit conditions and firming monetary policy, this is a surprising development.

Such resilience is even more startling amid the resumption of student loan payments in October after more than three years of forbearance and the expected cooling of summer spending boosted by *"Barbenheimer and Taylor Swift."*



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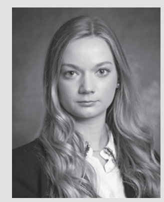

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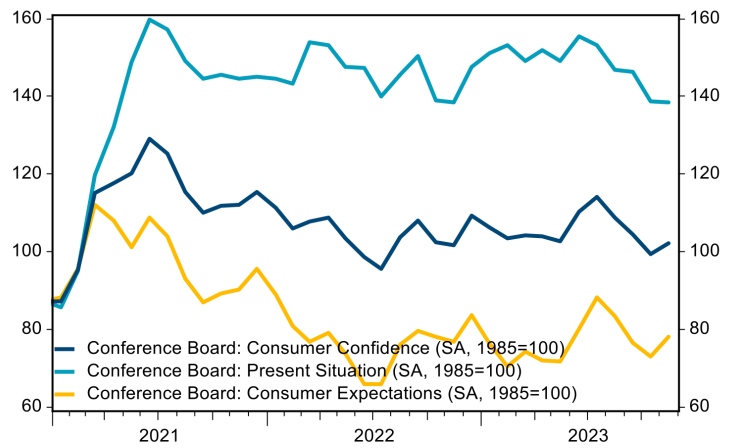
While the consumer's footing is far from steady as price pressures continue to erode the extent of household disposable income, consumer behavior appears surprisingly in line with recent months.

HOLIDAY SPENDING

A steady performance at the start of the fourth quarter is a welcome boost to expectations for the holiday shopping season. In fact, while many retailers sought to draw shoppers in with deep discounts and price cuts over the Thanksgiving holiday, the strategy appears to have paid off with preliminary estimates showing a sizable jump in weekend sales.

Shoppers spent a record $9.8 billion online for black Friday, up 7.5% from last year, according to Adobe Analytics. Shopping at physical stores, furthermore, was up 2%-5%, with a 4.6% increase in in-store traffic, the strongest in recent years, according to RetailNext. The momentum carried into Cyber Monday, which saw sales jump nearly 10% from last year to $12.4 billion, surpassing expectations and marking a record high.

The rising use of *"buy-now, pay-later"* options, however, is partly behind the jump in consumer activity, suggesting the ongoing willingness to consume may be more solid than the consumer's actual ability to spend. For some, household net worth has risen sustainably throughout the first half of the year, boosted by elevated asset valuations from equities to housing. Most, however, find themselves in the middle or lower end of the income spectrum and less likely to have a stake in the equity market or own property. Thus, a sizable portion of the population has largely been precluded from enjoying the benefits of three quarters of rising net worth.



Source: The Conference Board/Haver Analytic

Still, even without a more tangible or realized increase in wealth, many consumers are feeling increasingly confident given a perceived rise in "value," which itself has perpetuated a readiness to finance further spending. The upward performance of the market, coupled with a higher return on savings accounts and CDs, not to mention declining gas prices and a broader theme of employee pricing power for the "little guy" in the wake of several high-profile labor strikes, has many consumers feeling wealthier.

Such a perception of being more valuable has buoyed consumer confidence, rising to a two-month high in the most recent November report, and helping to loosen purse strings. Thus, even without a quantifiable monetary justification, more consumers are willing to psychologically rationalize additional debt accumulation to finance today's spending.

GLOSSARY

CDS – Credit Default Swaps

MoM – Month over Month

SA – Seasonally Adjusted

YoY – Year over Year

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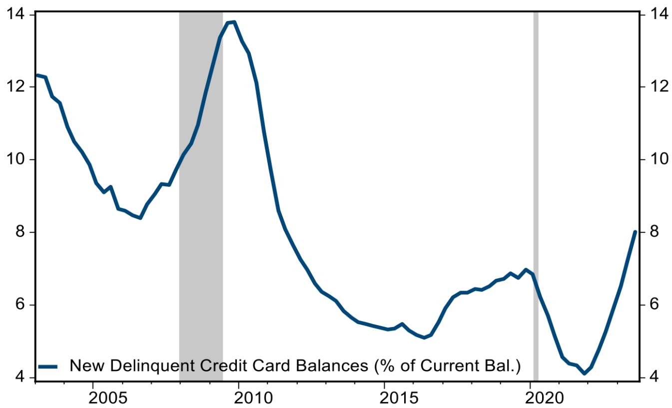
Of course, regardless of emotional standing, higher interest rates compound the real burden of debt with financing costs increasingly more expensive. According to the New York Federal Reserve (Fed)'s Quarterly Report on Household Debt and Credit, total credit card balances stand at $1.08 trillion, rising by $48 billion or roughly 5% in the third quarter and 17% year-over-year. Furthermore, according to Federal Reserve data, financing rates have risen 1.5 fold in the past two years to 21.2%, a record high. Thus, it's unsurprising that by the end of September 8% of credit card balances have transitioned into delinquency, a 0.8% increase from the quarter prior and a more than 5% gain from last year.



Source: FRBNY Consumer Credit Panel/Equifax/Haver Analytic

While delinquency rates are noticeably higher, they remain below pre-pandemic levels and previous spikes following periods of more pronounced consumer weakness. Nevertheless, still relatively benign at this point, the backup is an early warning sign or, at the very least, a reminder that consumers cannot indefinitely finance elevated spending

CONCLUSION

The consumer remains resilient, continuing to spend despite mounting pressure of elevated prices and rising borrowing costs. Lingering access to pandemic savings, 401(k) hardship withdrawals, and credit cards continue to supplement spending patterns, but will eventually dry up in 2024. Organic improvement in the labor market, including positive real earnings, will help soften the loss of temporary supports, but will unlikely offer an equal offset. This will expectedly result in a further loss of momentum in consumption. Of course, as consumers feel more valuable and confident in this ever-changing economy and complicated market environment, the pace of reduction may be slower than previously expected, extending the timeline for the eventual demise of the consumer.

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