June 3, 2022

MARKET SIGHT LINES

The Consumer Remains Strong... For Now...

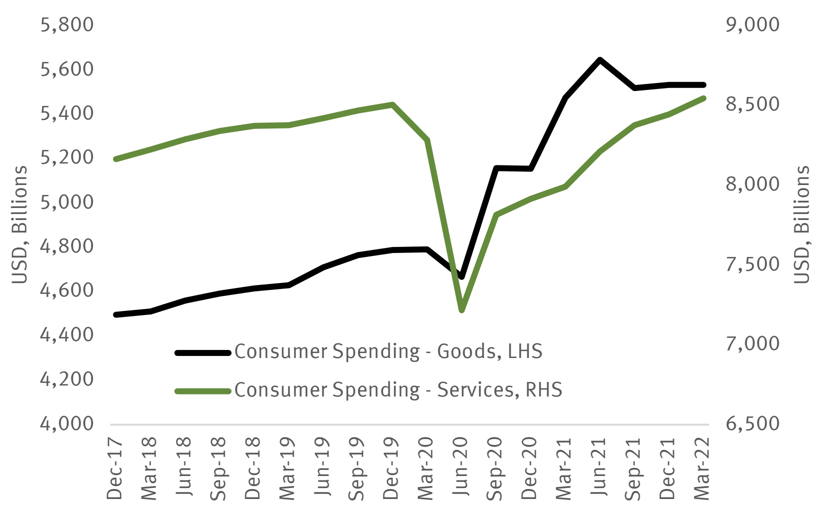
By Michael O'Keeffe, *Chief Investment Officer*

I've been in several client meetings over the past week, and the one question that's come up at every meeting is whether or not the U.S. is headed for a recession. While it's inevitable that we'll have a recession at some point, our base case remains that the U.S. economy will grow above trend this year. One of the main inputs into our outlook is the consumer, as consumer spending represents about two-thirds of total U.S. GDP. In this week's Sight|Lines, we review the state of the consumer in this unusually volatile 2022.

HOW HAVE CONSUMERS BEEN SPENDING?

Despite an overall decline of 1.5% in U.S. GDP in the first quarter, households continue to spend, with consumer spending within GDP up 3.1% (annualized) during that period.

Figure 1. Consumer Spending



Source: Stifel's CIO Office via Bloomberg, as of June 2, 2022

Consumer spending can be broken into spend on goods and services. Goods are defined as tangible objects, separated into durable goods, such as furniture and autos, and non-durable goods, like clothing, fuel, and food. Services are intangible, like restaurants, travel, media, financial services, and healthcare. Figure 1 presents the breakdown between goods and services over time. Notably, during the pandemic consumers shifted spending to goods, partly the result of increased demand for goods related to working remotely and staying home, and partly from a decline in demand for services like restaurants and travel.

Of course, retail sales are an important part of consumer spending. Figure 2 presents retail sales over time, along with the corresponding annual growth rates. After a decline at the start of the pandemic, retail sales climbed at a faster rate, supported by the stimulus checks paid to consumers to help with recovery. Now, even as the positive growth rate has declined, the rate overall remains well above pre-pandemic levels.

Main takeaway: Inflation hasn't stopped the consumer from spending, for now.

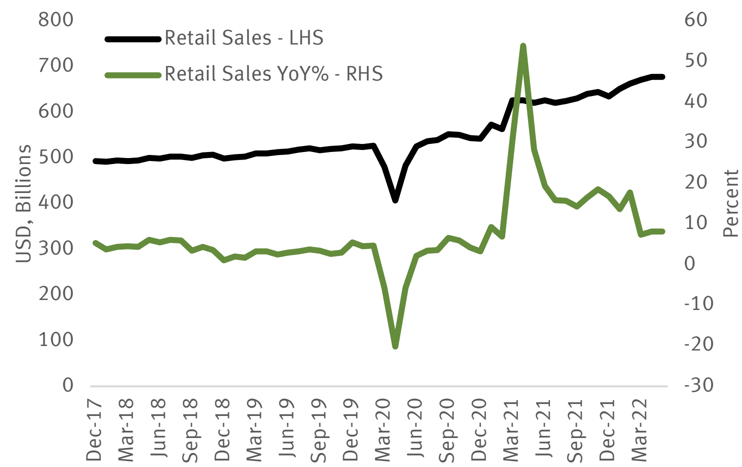
CONSUMER FINANCIAL HEALTH

We look at household wealth, personal savings, excess savings, and the financial obligation ratio, among other things, to get an overall picture of consumer financial health.

Let's first review household wealth. The increase in real estate values and the stock market led to household net worth surpassing $150 trillion for the first time at the end of 2021, a 34% increase from the Q1 2020. Although it has likely fallen this year as a result of the market's decline, net worth is expected to still be above pre-pandemic levels. This contributes to the "wealth effect," the theory that consumers spend more as their wealth increases.

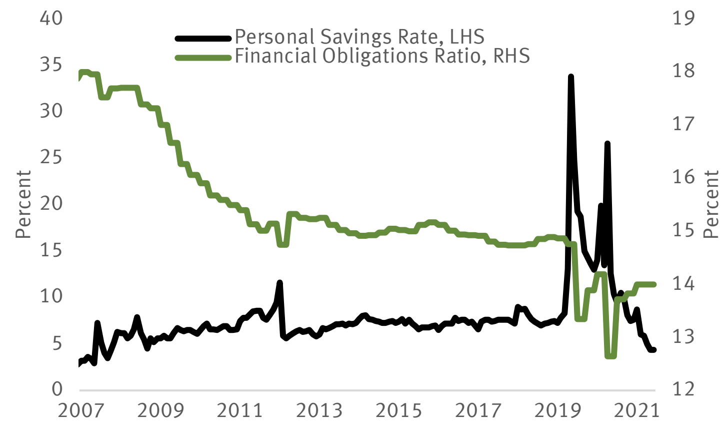
The personal savings rate hit a record 33.8% in 2020 as stimulus checks bolstered bank accounts and the COVID-19 lockdowns forced many businesses to temporarily close. But now, amid higher levels of inflation, the level of savings is under pressure. In April, the personal savings rate fell to 4.4%, the lowest since 2008. However, consumers still have more than $2 trillion in excess savings. This is the extra money that consumers have put away since the beginning of the pandemic above and beyond what they would have saved, assuming the pre-pandemic trend of saving.

Figure 2. Retail Sales



Source: Stifel's CIO Office via Bloomberg, as of June 2, 2022

Figure 3. Consumer Financial Health



Source: Stifel's CIO Office via Bloomberg, as of June 2, 2022

The financial obligation ratio is a broad-based measure of the ratio of household debt payments (revolving and installment debt, mortgage and rent payments, auto lease payments, and property tax) to total disposable income. This ratio has declined to the lowest levels (14%) since the metric began being tracked in 1980.

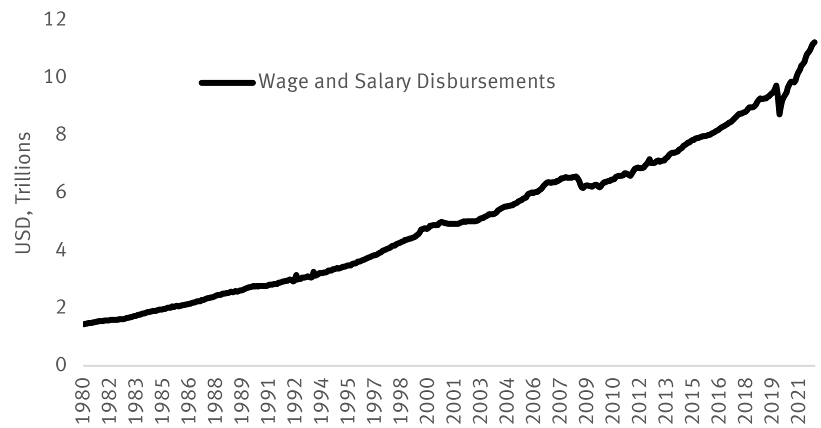
Main takeaway: Overall consumer financial health remains strong.

HEADWINDS

Inflation is a headwind for the consumer. The consumer price index (CPI) is up 8.3% over the year ended April, with core CPI, which excludes food and energy, up 6.2% over the same period. The consumer is worried about inflation, as evidenced by the decline in consumer sentiment. A lower consumer sentiment means consumer spending is likely going to be lower than it would otherwise be. We've seen credit card debt start to rise and consumers switching to different brands and retailers as they adjust for higher prices.

Through Figure 4 we see that wages have risen dramatically, with wage growth accelerating into 2022. Strong wage growth is helpful to the consumer, but it also adds pressure to inflation as companies may raise prices to cover rising labor costs. In fact, 85% of S&P 500 companies mentioned inflation on their first-quarter earnings calls.

Figure 4. Wage and Salary Growth



Source: Stifel's CIO Office via Bloomberg, as of June 2, 2022

Main takeaway: Higher costs present challenges for consumers, but a rise in wages and excess savings should provide a cushion until the Federal Reserve's monetary tightening begins to tame inflation.

CONCLUSION

While inflation, declining sentiment, and weaker markets may impact consumer spending, the consumer overall remains in a solid financial position and should remain an important pillar to positive economic growth this year.

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