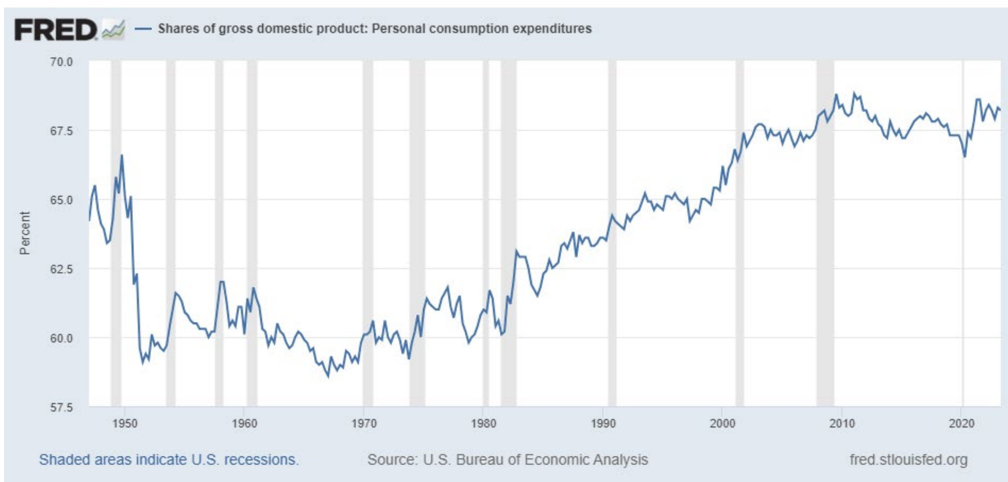
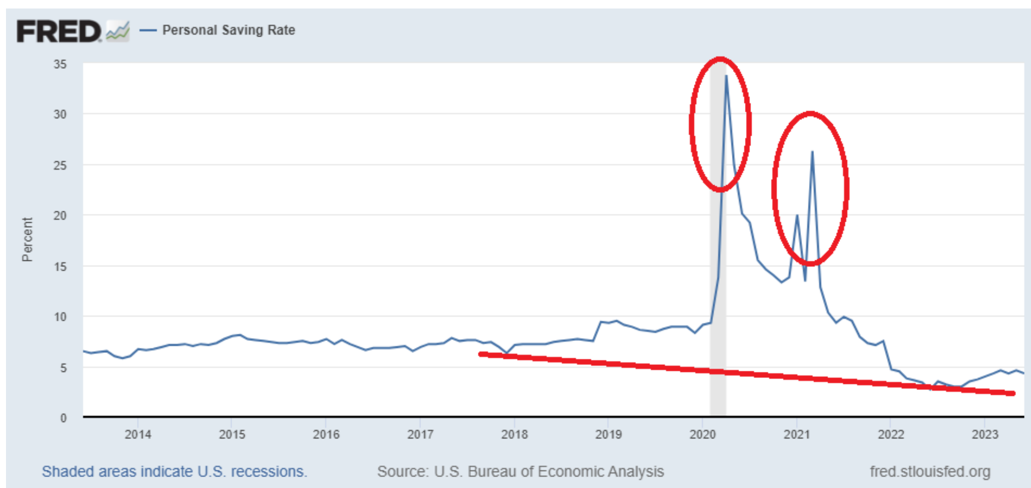
Market Commentary: How Is the Consumer Doing and Implications for the Economy

July 2023

As the consumer goes, so goes the economy. A lot of attention has been justifiably spent on inflation, corporate health, and earnings. At the same time, the consumer is the real driver of the US economy, contributing roughly 2/3 to GDP. So, how are we doing?



The quick answer is that we are doing just fine, on average. Given the rather unique path of the markets over the past few years It is worth connecting the dots on where we have been and where we may be going. We have generally spoken about ripples emanating from the once-in-a-century event of Covid. Due to that event the government provided historical support to the economy, flushing the system with cash while the world seemed to adjust to a new, potentially more efficient way of living. Consumers saved by working from home—a reality that seems to be permanent—and through the temporary freeze of most service-oriented spending (e.g., travel / vacation). The chart below highlights the direct effect of those historical government support programs on personal savings rates, which have now reverted to a normal (if not slightly lower) rate.



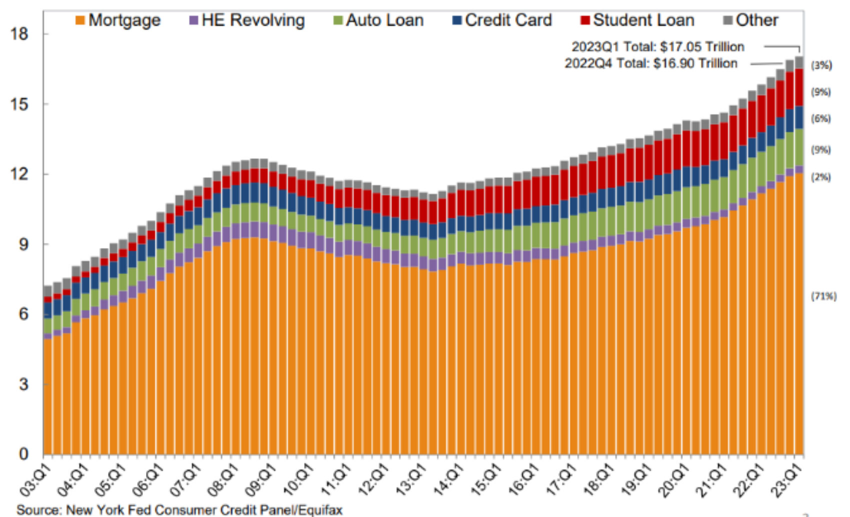
Covid threw the world askew with massive monetary easing and a global lock down. While we had (and still have) an incredibly impressive global supply chain, that supply chain was built for efficiency, not risk. For example, there was a lack of redundancies and meaningful inventory, which caused the supply chain to grind to a halt. The combination of spectacular monetary easing (through billions of dollars produced by the government) and the lack of readily available products (due to stress on the global supply chain) resulted in a dramatic supply / demand mismatch. This resulted in inflation readings not seen in close to half a century. Inflation was then compounded by Putin's seemingly bad bet in aspiring for a greater Russia, which further exacerbated geopolitical tensions.

It is good to be an American…for many reasons, but for the purposes of this discussion, because we are geographically far away from other countries, have a large breadbasket, many natural resources, the largest economy in the world and, in my opinion, the better of the political systems (representative democracy with mature checks and balances) combined with a capitalist / entrepreneurial ethos. These facts partially protect us from global inflation and geopolitical tensions (though at the same time we may be responsible, or at least a contributor to, those tensions).

Inflation was supposed to be temporary. Supply chains were supposed to sort themselves out and government bail outs were supposed to momentarily support the population while they sheltered at home. But this has not been the case. There are many really important reasons to attempt to maintain inflation within a very tight range (LINKS), so the Fed used the blunt tool of raising interest rates.[1] They were very transparent, maybe even hawkish, with their view that they would raise rates until they broke the back of inflation – and they still maintain this narrative despite the recent CPI print of 3% down from multi-year highs of 9.1%[2] in June 2022. Along the way, the quick increase in Fed rates broke some banks, but the economy continues to hum, and pundits continue to adjust their views positively about what's to come.

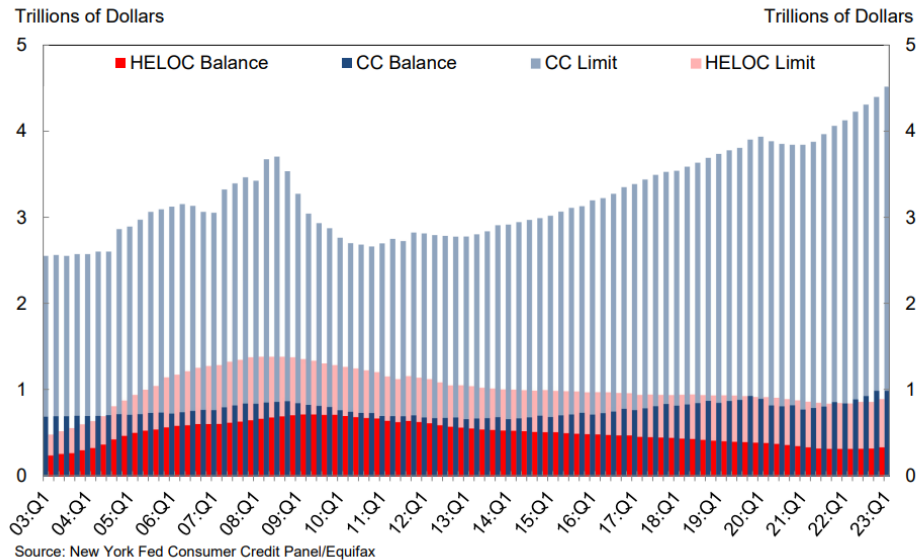
How resilient is the consumer and what is to come? Where is inflation going? Let's review some metrics:

Consumer debt is overwhelmed by mortgages which are primarily long-term fixed rate credit. Higher mortgage rates should result in lower house values longer term but if one does not swap out an existing lower-rate mortgage for a higher one, the monthly costs of the borrower (the consumer) are not affected by the increase in rates.

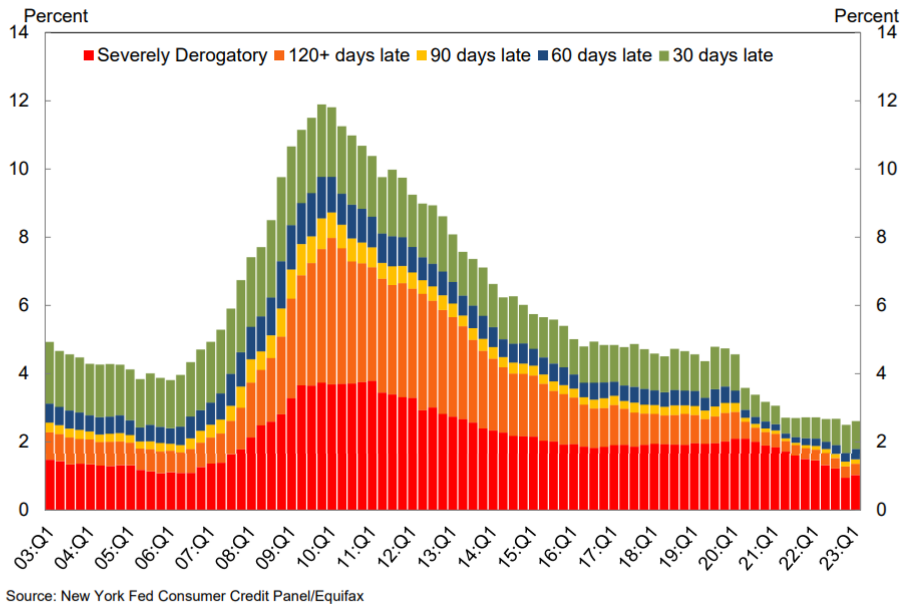


[1] It is blunt as it does not directly address sources of inflation, but rather seeks to pull US dollars out of the system (tightening policy) which should result in fewer purchases (due to fewer dollars available). But if inflation is due to systemic issues like a rupture in the supply chain, how much does this actually help? Nevertheless, the Fed has to work with the tools it has.

[2] The Fed is aiming for 2%. Additionally, the year over year comparison was particularly easy this month given the spike in CPI during the summer of 2022 due the Ukraine invasion and subsequent material increase in food and energy costs.



Meanwhile, variable rate borrowing, such as HELOC (home equity loans) and CC (credit card balances) have had limits increase, but not balances. CC has remained surprisingly constant and HELOC balances have been declining since '08.



And delinquency rates remain low compared to the last 20 years. The consumer is on solid footing with low unemployment, continued positive corporate reporting, and inflation trending in the right direction.

An additional item to watch out for is the end of a moratorium of student debt payments. Student debt represents 9% of outstanding consumer debt, resulting in a meaningful additional cost to households. And while inflation seems to be tracking in the right direction,

we have seen inflation revert back up internationally. And the recent end to the Russia-Ukraine grain deal, coupled with significant weather issues which can affect food, signal some further upward pressure on inflation going forward despite some expected tailwinds from the real estate component of CPI. These are all factors that can further pressure the dwindling savings rate as presented in our second graph.

In summary, the consumer is doing just fine, which is a positive for the economy. Yes, a number of negatives can play out such as inflation reverting back up or continued Fed tightening policy placing too much pressure on the economy but there are always risk (and reward) characteristics present in the markets.

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