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How Does the Consumer Impact the Economy?

By: Aaron Dunn, CFA | & Bradley Galko, CFA | April 28, 2023

KEY POINTS

1. We believe consumer spending will remain solid over the next quarter.

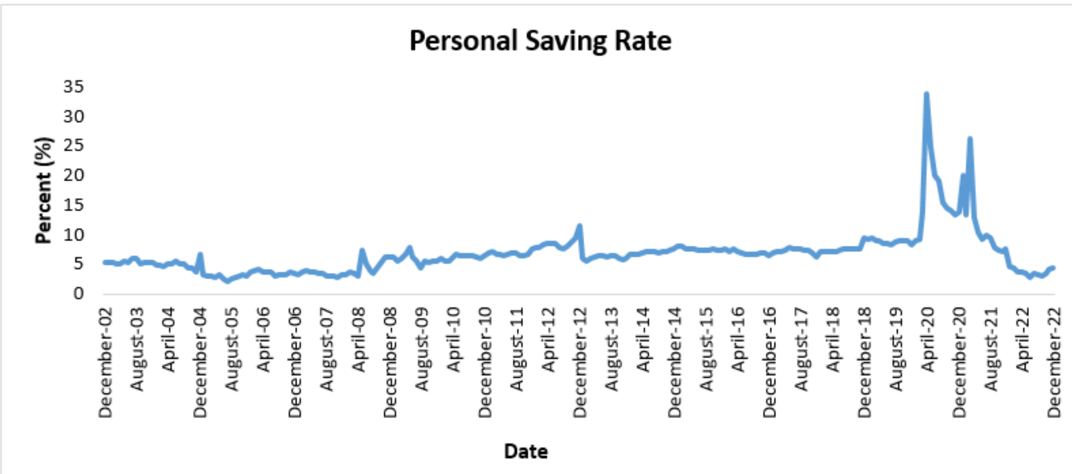
2. The current savings rate is at the lowest recorded level since 2005.[1]

3. Continued declines in wage and employment growth through 2023 will hurt the consumer.

4. We favor brands and companies that are already anticipating a tougher consumer environment.

Boston - With nearly 70% of U.S. gross domestic product (GDP) driven by consumption, the state of the consumer is important, not only for the sector, but for the overall economy and potential stock market performance, based on CEIC Data. The U.S. consumer stands at an important crossroads today, which may have significant implications for future equity returns.

To fully appreciate the U.S. consumer's role in the markets, let's rewind to the early days of the pandemic. In 2020 and 2021, 10% and 11% of domestic GDP, respectively, was dispersed in various forms of government stimulus to the U.S. consumer, according to the Congressional Budget Office. Much of this stimulus was initially saved by individuals, which led to a large spike in the personal saving rate compared to prior years.



Source: Federal Reserve

Economic Data (FRED) data on Personal Saving Rate, as of December 31, 2022.

In 2020, consumer revolving credit (credit card balances) fell 11%, or $120 billion, year over year — the largest decline ever, according to the Federal Reserve Board.

Feeling flush, consumers spent

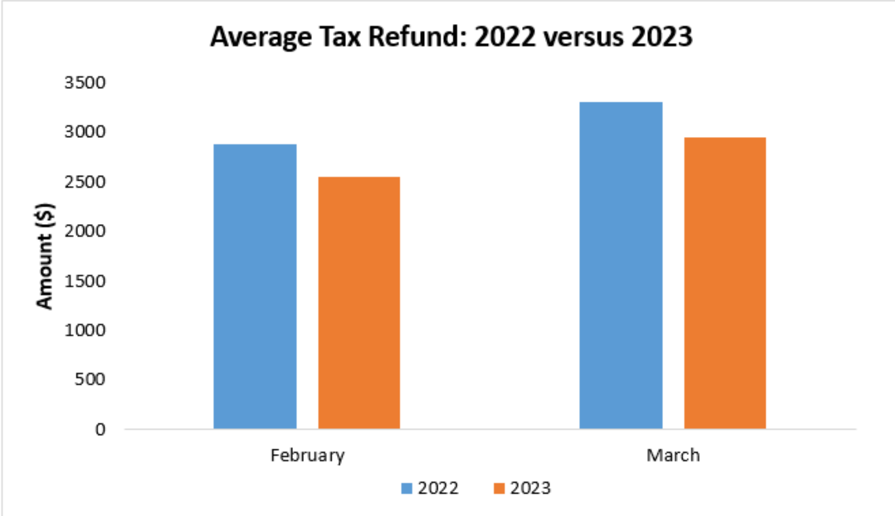
The average annual growth in personal consumption expenditures (PCE) from 1999 to 2019 was 4%. In 2020, PCE growth halved to 2%. Once stimulus payments arrived, however, consumption increased to an average of 6% to 9% in 2021 and 2022, based on Federal Reserve Economic Data (FRED) through November 30, 2022. This increase was predominantly for goods rather than services. Ironically, consumer discretionary was the worst-performing sector of the Russell 1000 Index in 2021 and 2022, as inflation ignited by spending forced the Fed to begin raising interest rate, according to Bloomberg.

Consumers may be living on borrowed time, however

The current saving rate is at the lowest recorded level since 2005, according to J.P. Morgan. As of September 2022, though, consumers still had around $1.1 trillion in excess savings, leaving approximately 12 months of savings cushion. Anticipated ongoing declines in wage and employment growth through 2023 also magnify worries for consumers.

Additional data further informs our current view on the consumer. According to Strategas, a $256 billion drop in tax payments should generate additional spendable income. Looking deeper under the hood of that metric, though, we believe the U.S. consumer has less wealth, which is ultimately why they are paying less in taxes.

There also has been an increase in earlier tax refunds from the government, which should result in more money in the consumer's pocket. However, the average amount of a refund is down by over 10% during the peak months of February and March, according to Strategas data.



Source: Strategas, as of March 31, 2023.

While a significant boost in Social Security payments, due to the cost of living adjustment, is theoretically a bright spot for the consumer, other transfer payments have the potential to create headwinds for many consumers. Fewer child tax credit payments are anticipated to be made this year, the student loan deferral is likely to end in August, supplemental nutrition assistance program (SNAP) spending is expected to decline and Medicaid eligibility is being re-determined after the pandemic.

Although unemployment remains low, the overall combination of factors does not bode well for U.S. consumer confidence. In our view, consumer spending over the next quarter will remain solid, given lower gasoline prices and some stockpile of excess savings still accounted for. The second half of this year, though, could become more difficult for the U.S. consumer. The credit cushion from 2020 has deflated.

Bottom line: The red warning light is not yet flashing, but if employment breaks, the consumer could potentially suffer. We are actively evaluating the potential impact of consumer health on companies in our portfolio. Having an active approach and thoroughly evaluating companies and all the impacts different inputs have on their valuation is essential during these volatile times. In the current environment, we favor brands and companies that are already anticipating a tougher consumer environment, as well as those that could benefit as the consumer looks to trade down.

[1] Source: J.P. Morgan, as of December 31, 2022.

Risk Considerations: *The value of investments may increase or decrease in response to economic, and financial events (whether real, expected or perceived) in the U.S. and global markets. The value of equity securities is sensitive to stock market volatility. Diversification does not eliminate the risk of loss. Active management attempts to outperform a passive benchmark through proactive security selection and assumes considerable risk should managers incorrectly anticipate changing conditions.*

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