Getting some answers from the US consumer puzzle

The US growth story remains driven by consumer resilience. High income households are in a great financial position, but those on lower incomes are feeling intensifying stress. How these competing stories play out will be key to the growth outlook for the rest of the year and the prospect of Federal Reserve interest rate cuts

How long can the spending strength of the top 20% of Americans offset everyone else?

It's all about the high-earning consumer

The remarkable resilience of the US economy to high interest rates and tight credit conditions has to be admired. But now we're starting to see signs of softening. Business surveys have weakened notably, consumer confidence is moderating, and first-quarter GDP growth was weaker than expected, although that was mainly due to a negative contribution from inventories and net trade.

Nonetheless, inflation continues to run too hot. With three consecutive 0.4% month-on-month core CPI prints from the start of the year, the Fed is in no mood to cut interest rates imminently. The reason for the strength of the US economy remains the consumer, who accounts for 70% of GDP. The top 20% of households by income spend roughly the same dollar amount as the bottom 60%. By definition, those at the top have good incomes and probably own their own home, either outright or with a low fixed-rate mortgage. They have exposure to rising property and stock prices and have their savings in money market funds making 4-5%, so high interest rates actually benefit these households.

The question hanging in the air is how long the spending strength of the top 20% can continue to offset intensifying stresses for everyone else.

Savings are being sharply depleted

There are four ways to finance consumer spending: through income, savings (either saving less each month or running down the stock of savings), borrowing or selling assets. Real household disposable income is flat-lining and hasn't been the prime driver of consumer strength for well over a year; wage growth has slowed and inflation is eating into spending power. Instead, it is households in aggregate which have fully run down the excess savings built up during the pandemic which are keeping the momentum going.

The San Francisco Fed estimates that during Covid, excess savings maxed out at $2.1tn in August 2021. They now stand at a negative $72bn. We know wealthier households have continued to build savings, so this suggests that lower-income households have not only exhausted those pandemic-era savings but are likely eating into pre-existing savings, too.

Credit card spending isn't particularly sustainable

That leaves credit as the primary source for many households to be able to increase spending. But with credit card borrowing costs at all time highs and car loans at 20+ year highs, this is hardly sustainable. Indeed, delinquency rates on consumer loans are rising sharply, and Philly Fed data suggests more than 10% of households are only making the minimum payment on their credit cards as of the last quarter of last year.

If business surveys, such as the ISM employment series and the NFIB hiring intentions survey, are correct and job losses become a reality, it is difficult to see consumers as the driving force of economic growth in the second half of 2024 as they have been over the past few years. Intensifying weakness in lower-income household spending power runs the risk of offsetting what we see in those higher-income brackets.

Such an outcome will help dampen inflation pressures and, if we see the unemployment rate start to rise, both the Fed's and the market appetite for interest rate cuts will intensify. We continue to look for three interest rate cuts this year, starting at the September FOMC meeting.

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