ALPINEMACRO
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# SPECIAL REPORT

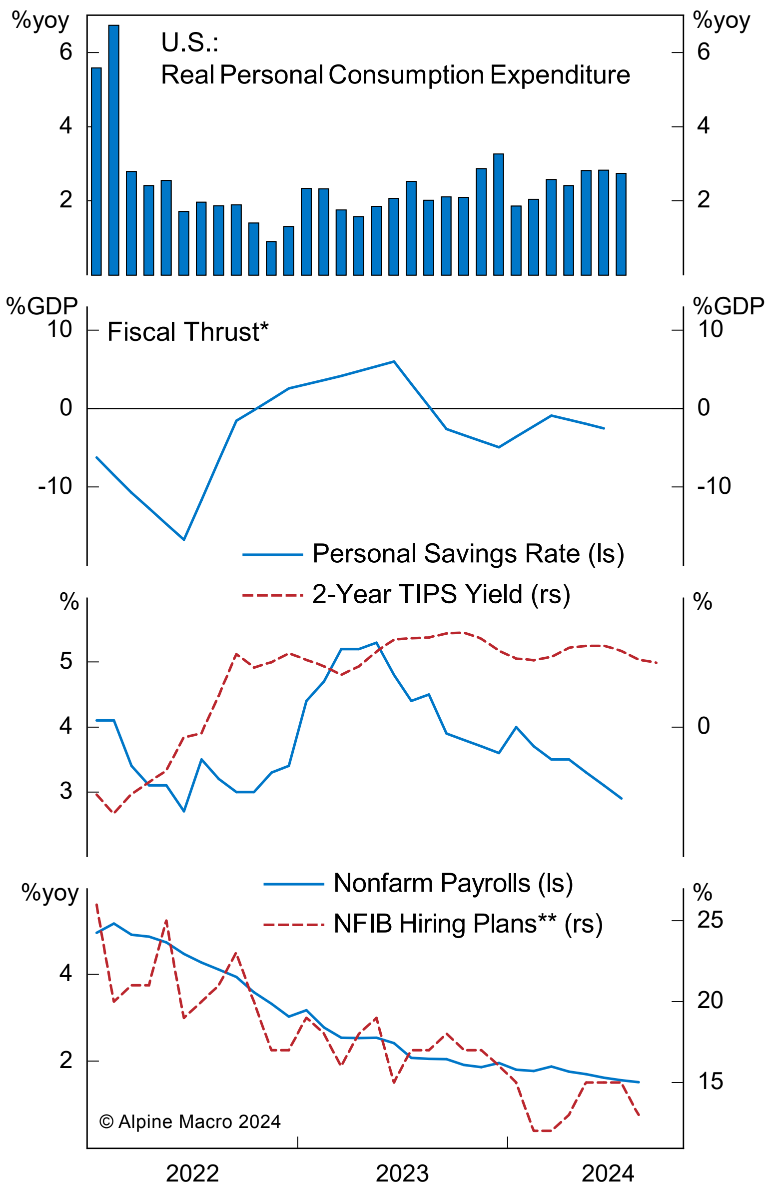
September 13, 2024

# Consumer Slowdown: Signposts To Monitor

- Household spending will slow but the consumer is not "tapped out". This is consistent with a perfect landing. Bullish for both stocks and bonds.
- The main deflation risk is that the rest of the world cannot handle even a moderate slowdown in U.S. spending. Both TIPS and inflation breakevens would benefit from a burst of deflation from abroad. Oil would break down.
- More obvious threats to the consumer include the U.S. jobs and housing markets. So far, so good.

The U.S. consumer will play a critical role in determining whether the Alpine Macro perfect landing scenario plays out. This scenario allows the Fed to ease without much weakness in profit margins as economic growth and inflation downshift but stay positive. Personal spending has been steady, but is set to slow, which in turn will cool overall economic growth given that the consumer accounts for 69% of GDP (**Chart 1**). The household savings rate has dropped near a 16-year low and the Fed has pushed up short-term real interest rates to a 15-year high. Leading employment indicators point to weaker job creation and wage growth. Fiscal thrust has shifted from stimulus to restraint over the past year.

**Chart 1** Consumer Spending Will Slow




*Annual change in quarterly primary deficit as a % of GDP
**In the Next 3 Months

The bigger issue is whether this will push the economy into a recession or merely guide the expansion into a perfect landing. We are in the latter camp. Last year, we published two *Special Reports* arguing that the consumer benefited from five tailwinds.[1] This *Special Report* updates our analysis, concluding that many of these tailwinds have downshifted to neutral, but there are not yet any major headwinds.

This is consistent with a gradual economic slowdown in line with the Alpine Macro baseline scenario. However, it also warns that a "mild recession" on the order of 2015 or 2022 cannot be ruled out.[2] In fact, the underappreciated deflation concern is not domestic. Rather, the rest of the world may not be able to withstand even a gradual retrenchment by the U.S. consumer. This report provides signposts to monitor this risk from abroad, as well as other more obvious domestic threats to the consumer.

## Tailwinds Have Faded

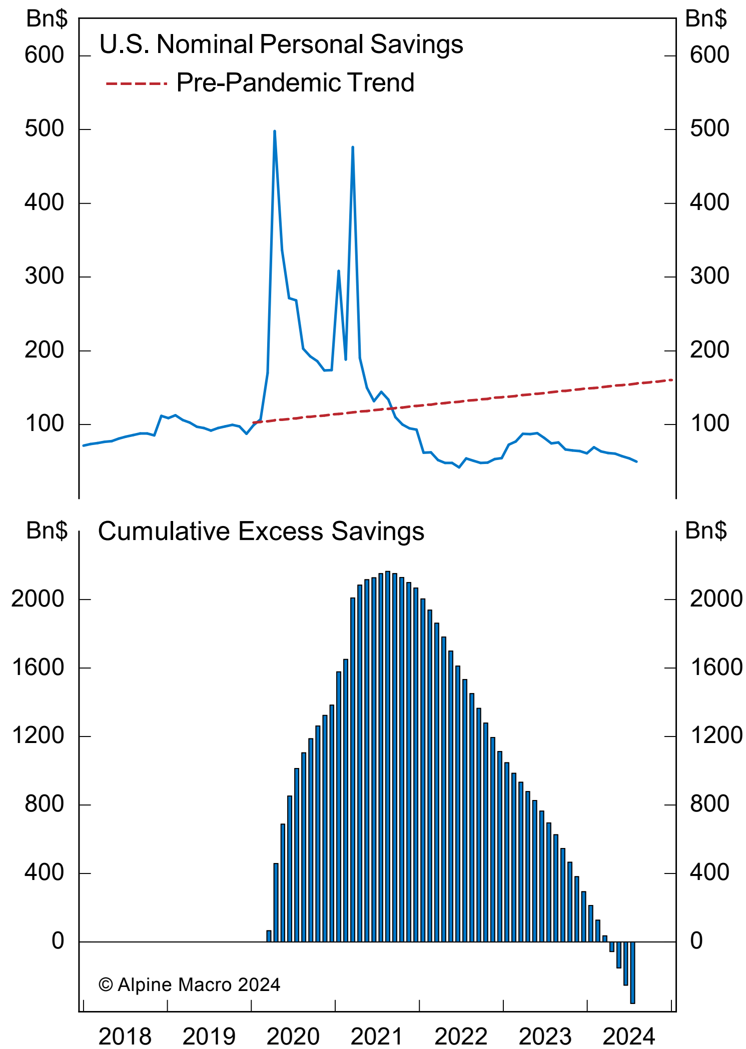
Tailwinds that benefited the consumer in 2023 have since gone into a holding pattern or present mild headwinds. Nevertheless, the risk of a severe recession remains low because there are no major headwinds:

- **Depleted household savings mountain:** Moderate headwind. The savings buildup from pandemic subsidies is gone and the consumer has already boosted spending faster than income growth

1 Alpine Macro *Monthly Special Report* "U.S. Consumer: What Kind Of Mean-Reversion?" (August 18, 2023) and "U.S. Consumer: Easing Tailwinds" (December 21, 2023).

2 Alpine Macro *Monthly Special Report* "Of Technical And Nominal Recessions: Lessons From 2022 And 2015" (July 19, 2024).

**Chart 2** Pandemic Excess Savings Are Gone




by 160bps since the savings rate peaked 16 months ago (Chart 2). Still, household wealth also has risen sharply, with both housing and financial market wealth appreciating over the past year (Chart 3). Moreover, GNI (gross national income) data gives a household savings rate of 5.7% versus the 2.9% rate with the commonly used expenditure measure of GDP. The two versions usually do not diverge significantly, and only differ because of measurement error.

**Chart 3** Positive Wealth Effect

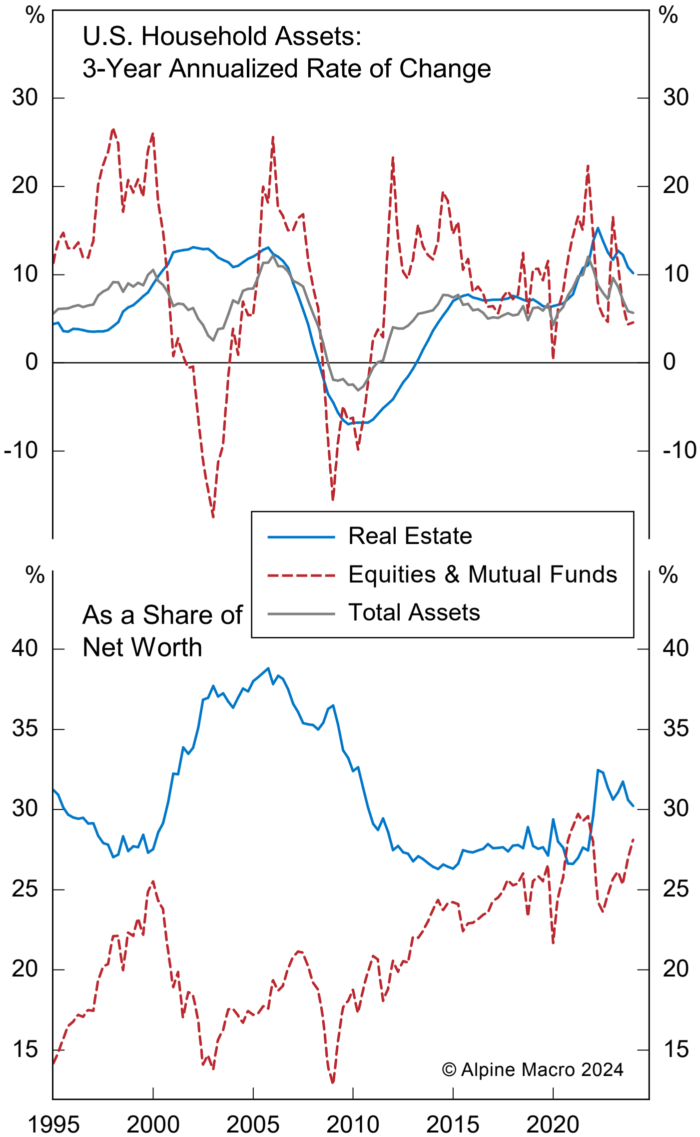
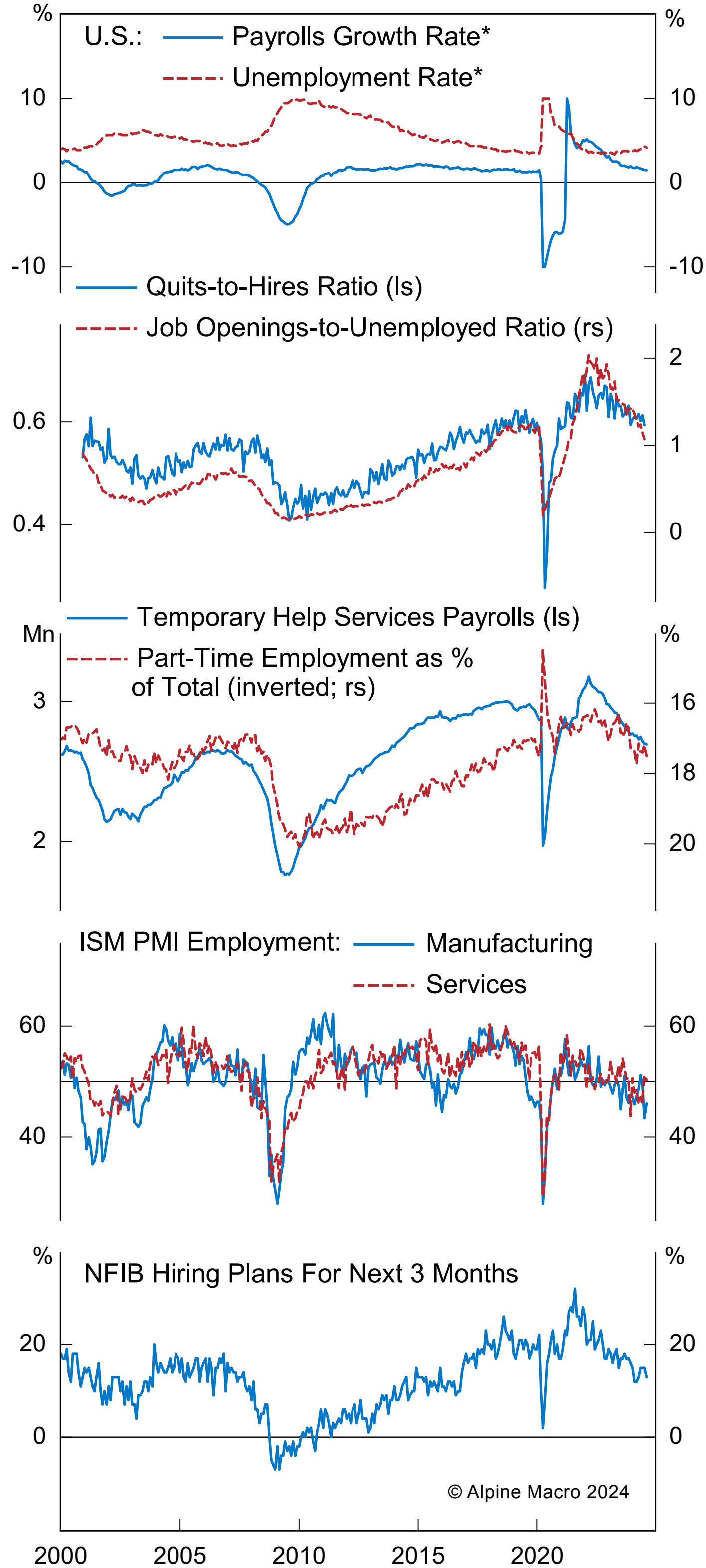



**Chart 4** Employment Will Slow




*Truncated at -/+ 10

- **Job market easing:** Moderate headwind. Most leading employment indicators are well below last year's levels, but many have begun to flatten out (**Chart 4**).

- **Revenge services spending well advanced:** Transition to neutral. The pandemic is further away, though there is no sign of a major falloff. Both the ISM and S&P Global services PMI readings remain above 50 (**Chart 5**).

**Chart 5** Services Activity Holding Up

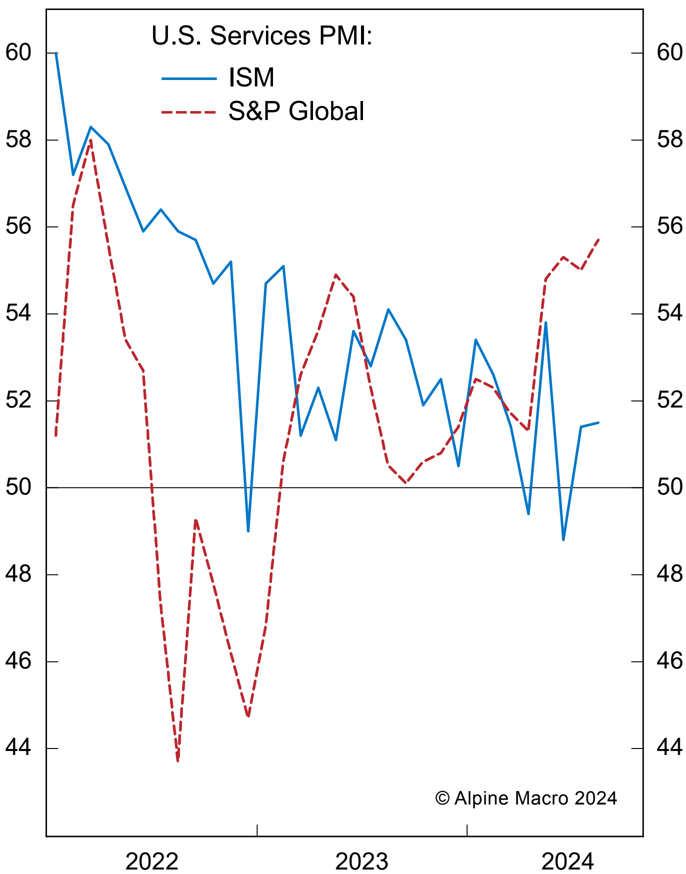
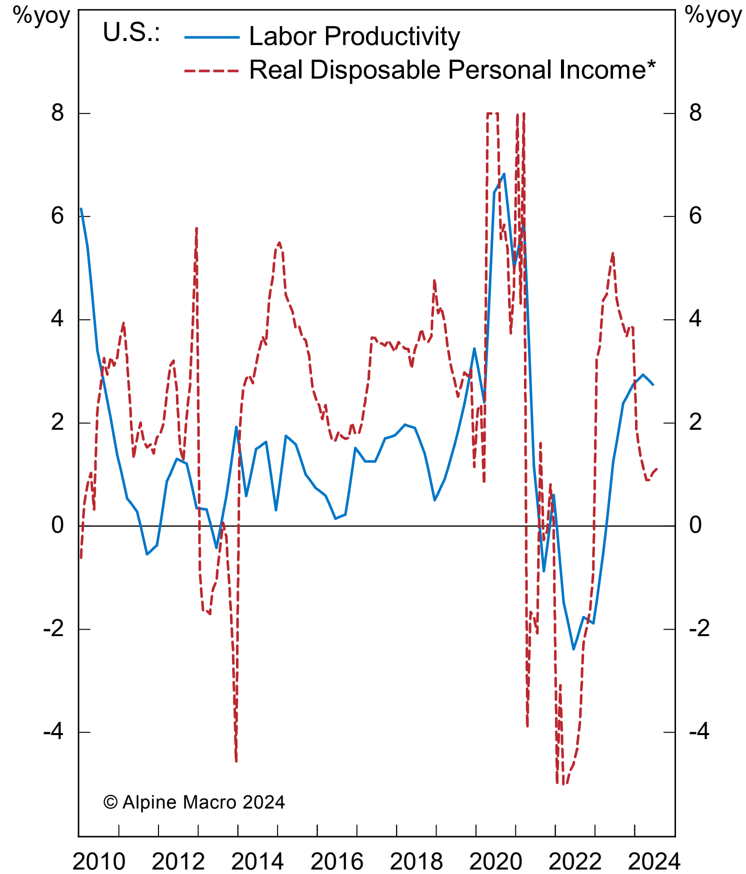



**Chart 6** Productivity Robust, Real Income Growth Softening




*Truncated at -5 and 8

- **Productivity gains:** Moderately positive. Recent benchmark downward revisions in employment imply higher productivity growth. Granted, businesses are getting the bulk of benefit from rising labor productivity, with real personal disposable income up only 1.1% over the past year (Chart 6). Still, businesses will not be under pressure to slash headcounts with unit labor costs barely rising.

The reduced exposure of consumer debt to Fed rate hikes also reduces the odds of a major spending retrenchment. Charts 7 and 8 show that most household loans are at fixed interest rates, and that the share of mortgage loans at fixed rates is very high. Bank mortgage lending standards have stayed extremely conservative since the GFC at a time when house prices are still rising (Chart 9). Household balance sheets are healthy and there has been an extended period of deleveraging. One corollary is that overall consumer credit charge-off rates remain low, even though they are rising for categories such as credit cards (Chart 10).

**Bottom line:** Consumer spending may well slow, but in an orderly manner that is consistent with a perfect landing.

**Chart 7** Mortgages Are 70% of HH Debt

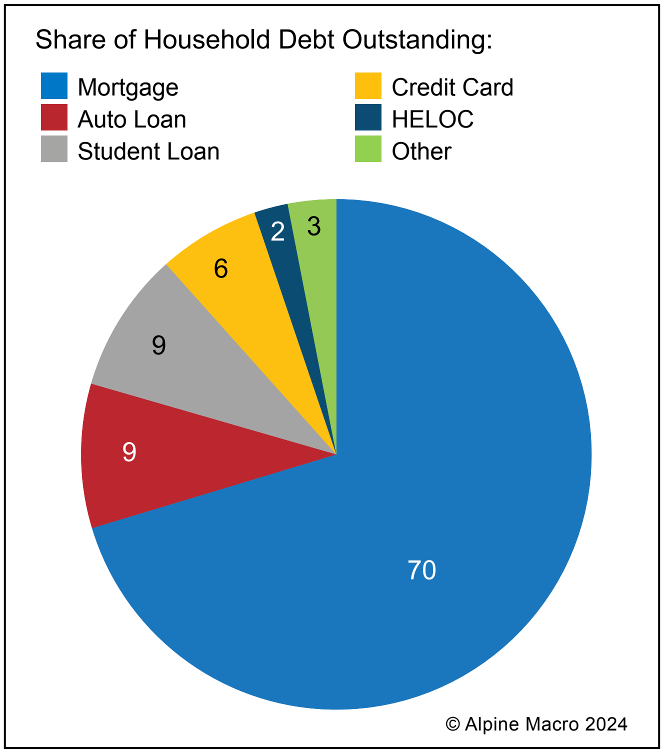



**Chart 8** Most Mortgages Are At Low Fixed Rates

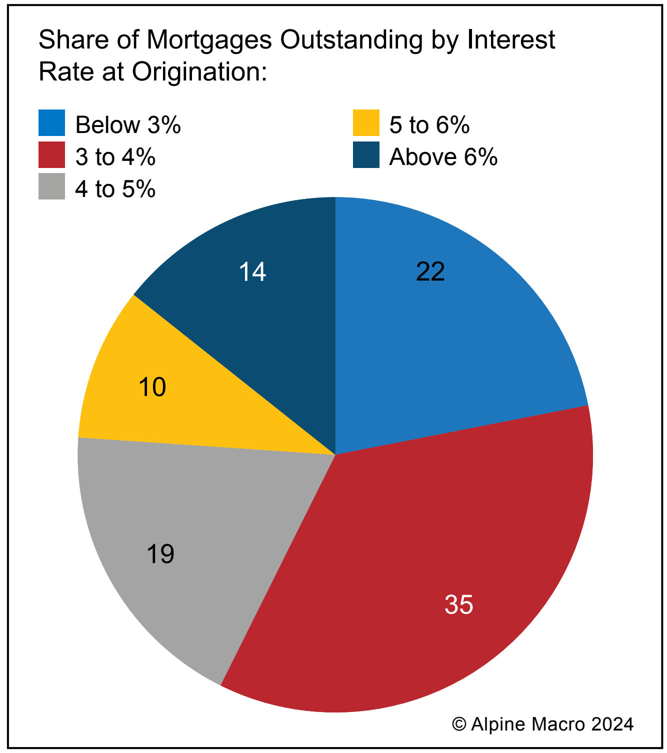
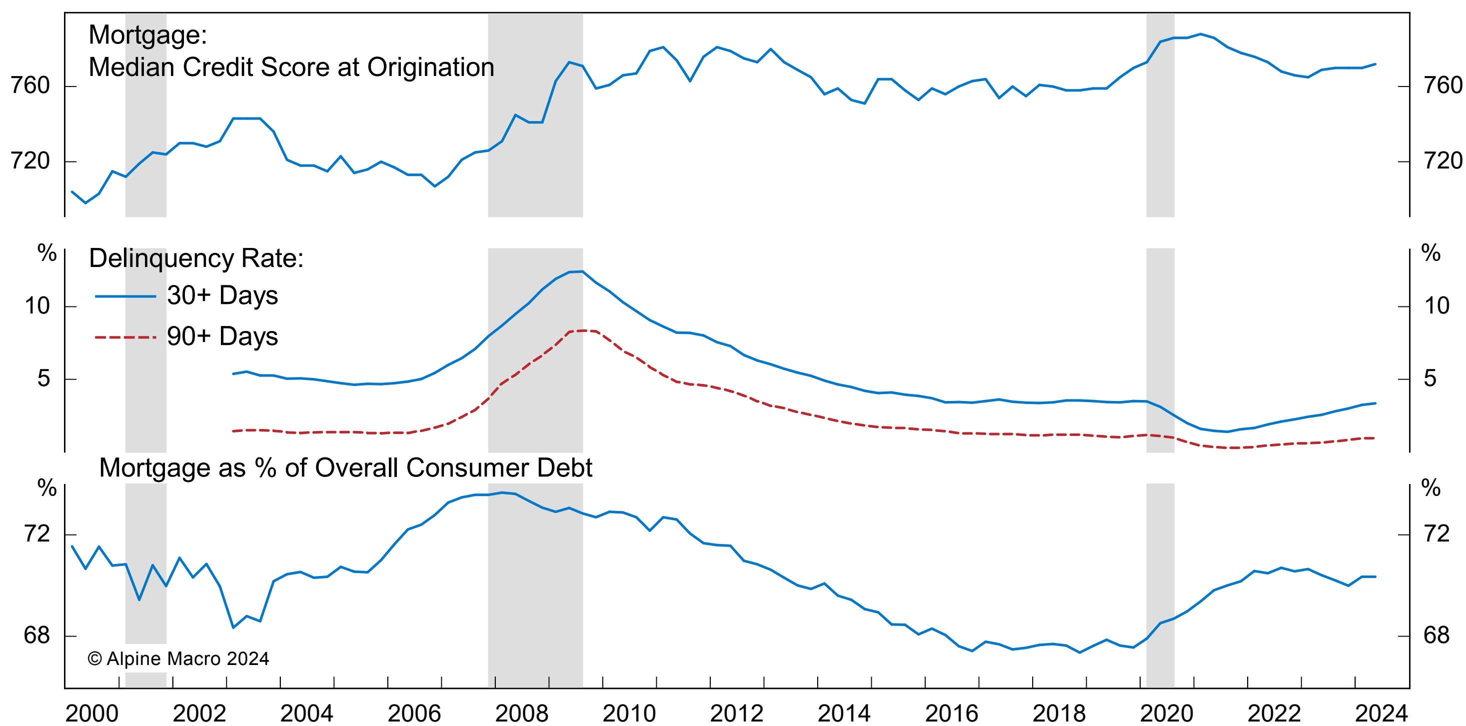
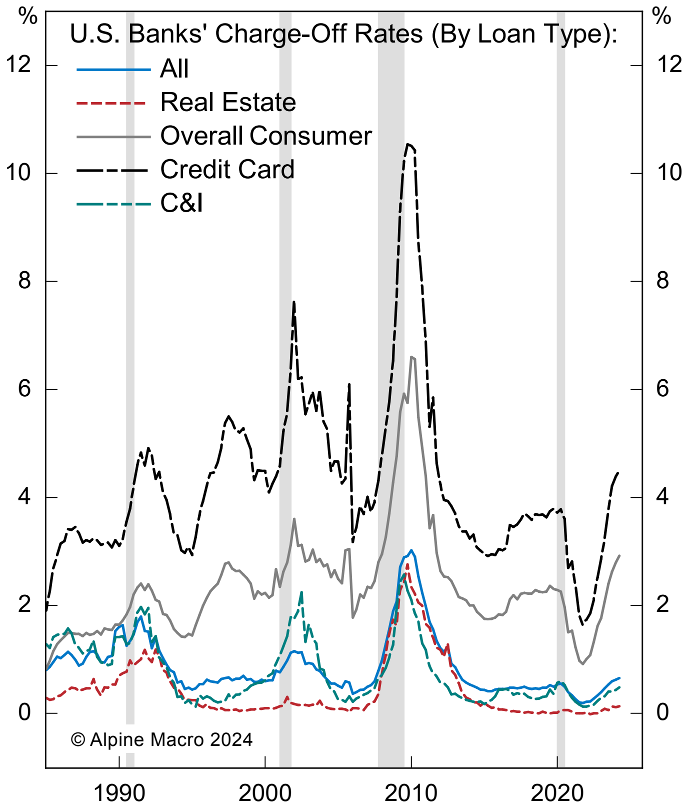



**Chart 9** Banks Have Had Conservative Mortgage Origination Standards




Source: Federal Reserve Bank of New York
Note: Shading denotes U.S. recessions

**Chart 10** Low Consumer Credit Charge-Off Rates




Note: Charge-off rate is proportion of average loans outstanding that is deemed delinquent, removed from the books and charged against loss reserves; shading denotes U.S. recessions; source: Federal Reserve

## Five Signposts To Monitor

The Alpine Macro perfect landing view requires that "this time is different" for the response of the economy and consumer to a Fed tightening cycle. Even though the consumer appears in good shape and shows no signs of entering a new deleveraging cycle, there are plenty of risks on both external and domestic fronts.

One underappreciated risk relates to the dependence of global producers on the U.S. consumer. Even moderate retrenchment could lead to a whiff of deflation in everything from traded goods prices to crude oil to global manufacturing activity.

Chart 11 shows that there is a tight correlation between the U.S. current account deficit and the combined surpluses of the euro area and China. The U.S. deficit is near a record. In theory, this could result from a domestic spending boom or uncompetitive U.S. tradable goods sector. In reality, the deficit reflects the lack of confidence and willingness to spend among consumers abroad.

At the end of the day, excess supply in the rest of the world is bullish for the U.S. consumer. However, the transmission mechanism would be U.S. import price deflation, falling commodity prices, much lower U.S. TIPS yields and a stronger dollar to "convince" a reluctant consumer to buy. One signpost to monitor is the contribution of the consumer to the U.S. expansion (Chart 12), which would rise from already-high levels if globally oriented U.S. businesses and the current account deteriorate.

Four other signposts will provide warning signs that the consumer is more vulnerable than we expect:

- **Recession comparisons:** Various measures of consumer expenditure are holding up. We will become more concerned if they follow the roadmap of the 2015 "nominal recession" or 2022 "technical recession", dragging down overall real private demand growth (previously referenced Chart 12 and Table 1 in Appendix).

- **Labor market worsens:** Layoffs and job openings stand at 7.7 million and 1.7 million, respectively, after coming out of the pandemic. We would become more cautious if layoffs rise above, or job openings fall below, pre-pandemic levels (Chart 13).

**Chart 11** Bullish ROW Trends For TIPS

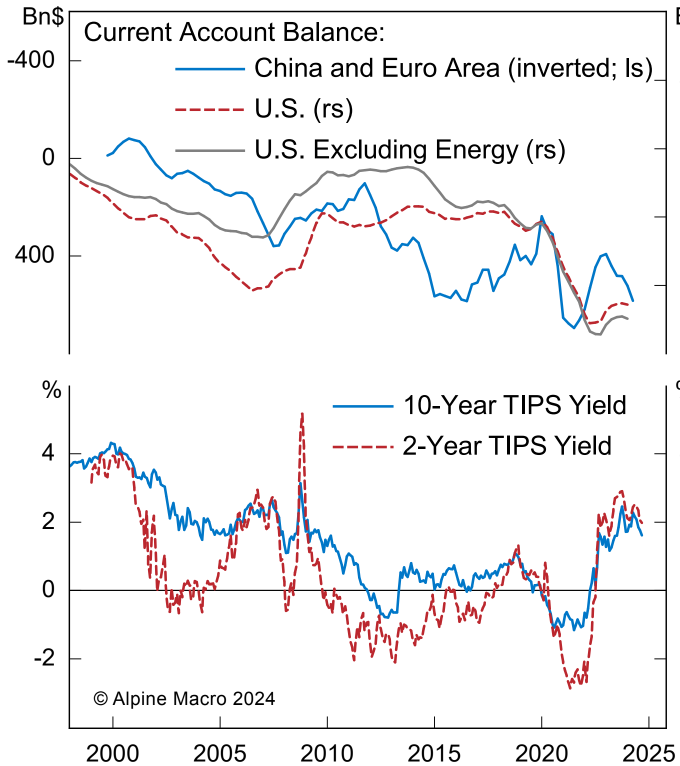
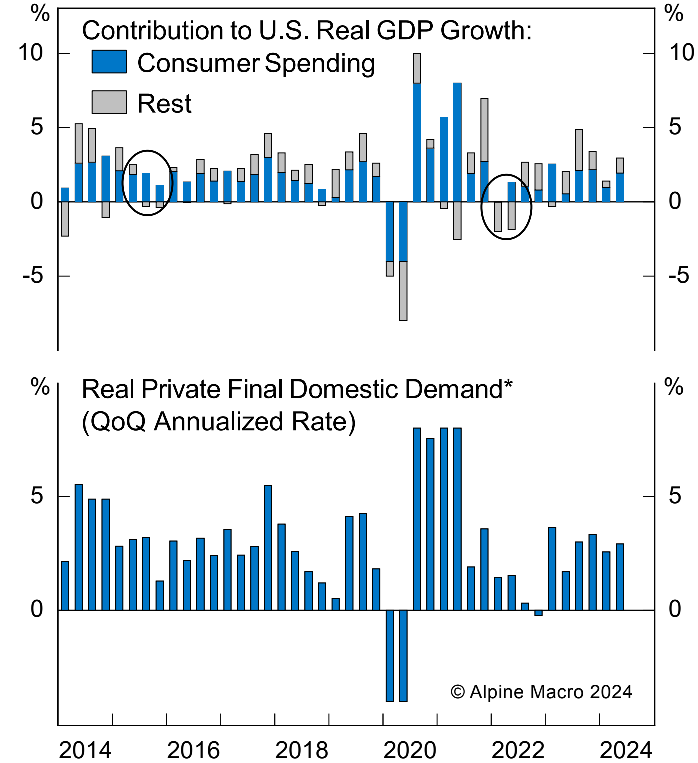
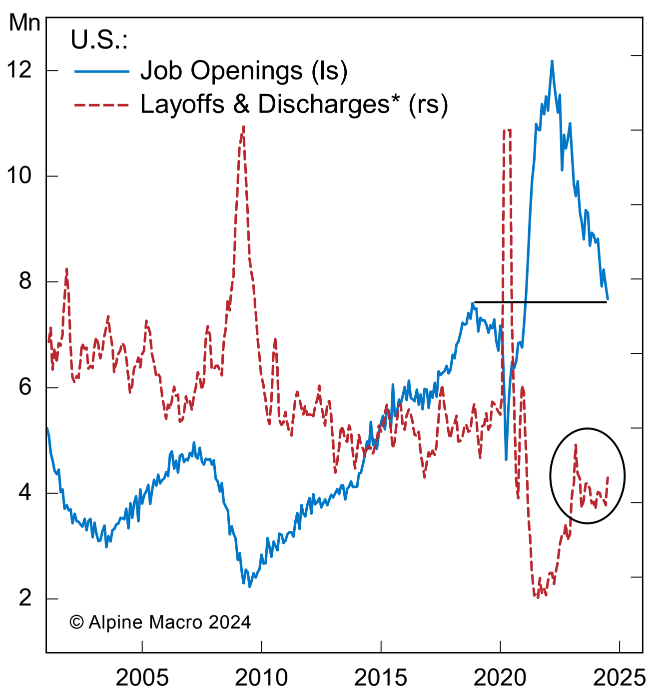



**Chart 12** High Consumer Growth Contribution




*Sum of final consumption, investment and stock building expenditures by the private industry, referred as "core GDP"
Note: Both series are truncated at -4 and 8

**Chart 13** Labor Signposts: Openings And Layoffs

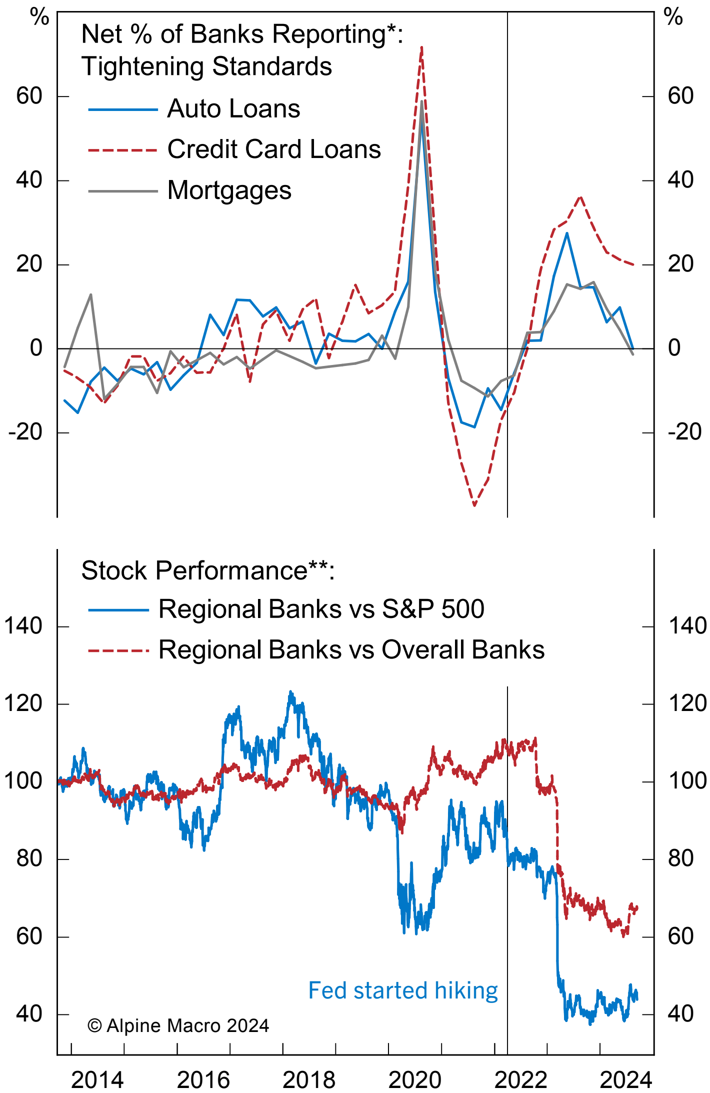



*Truncated at 2.6

- **Supply of bank credit:** Banks have slowed the pace at which they are tightening lending standards on all categories of consumer credit, according to the Fed quarterly SLOOS survey. This fits with the resilience of regional bank stock prices. A renewed phase of tightening standards could cause the savings rate to rise, as usually happens in recessions (**Chart 14**).

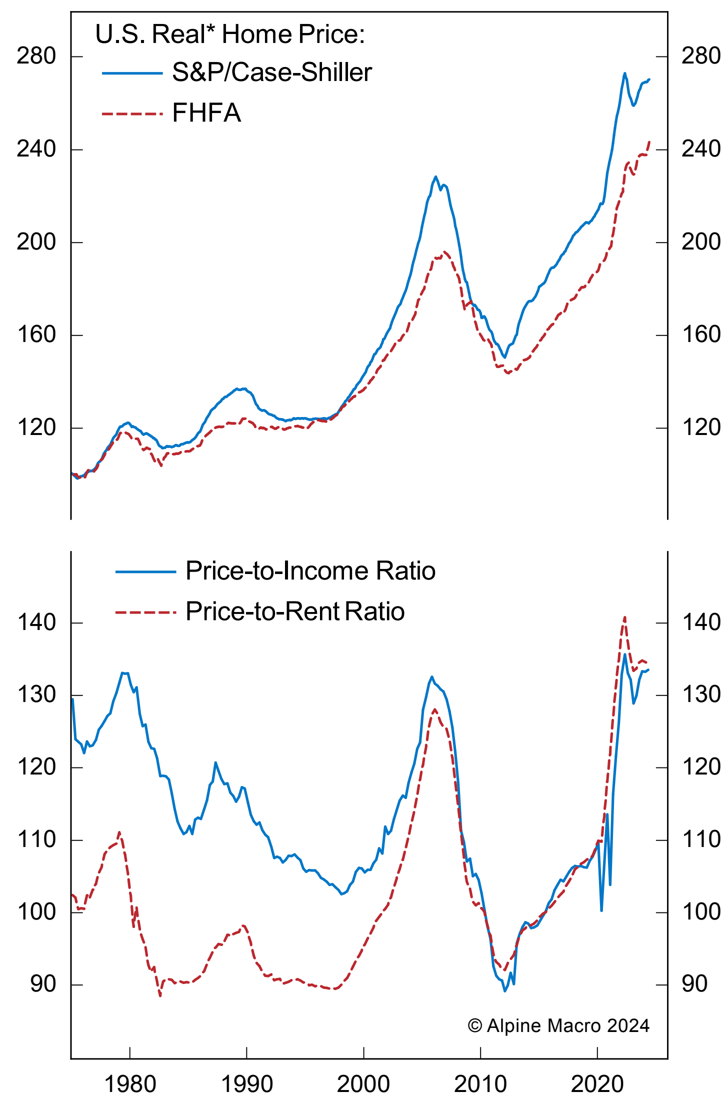
- **Residential real estate:** We would become more concerned if house prices mean-revert after getting to expensive extremes in real terms and *vis-à-vis* for both rents and incomes (**Chart 15**). Housing accounts for 27% of household wealth, so a sharp drop in prices would likely put the savings rate under upward pressure.

**Chart 14** Bank Signposts: Lending Standards And Regional Stocks




*Source: Senior Loan Officer Opinion Survey, Federal Reserve
**Rebased to Oct 2013=100

**Chart 15** Housing Signposts: Valuation Mean-Reversion




*Deflated by PCE inflation; rebased to Mar 1975=100
Source: OECD

**Bottom line:** The consumer likely will avoid an outright contraction. Still, we are monitoring five external and domestic signposts for warning signs. As a result, both TIPS and inflation breakevens offer hedge value. TIPS should outperform in the absence of a waterfall decline in oil prices.

**David Abramson**
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**Table 1** Mild Versus Average Recession Comparisons

| | Peak-to-Trough Change | | |
|---|---|---|---|
| | Nominal Recession 2015 | Technical Recession 2022 | Average During Actual Recessions |
| S&P 500 | -13% | -25% | -38% |
| 10-Year Treasury Yield | -98 Bps | 290 Bps | -266 Bps |
| Real GDP | 0.5% | -0.5% | -3.8% |
| Real Personal Consumption Expenditure | 1.6% | -0.3% | -2.2% |
| S&P 500 Forward EPS | -5.4% | -8% | -19.2% |
| S&P 500 EPS | -3.3% | - | -24.6% |
| WTI Oil Price | -58% | 7%* | -60% |
| High Yield Spread | 650 Bps | 130 Bps | 1082 Bps |
| High Yield Ex. Energy Spread | 400 Bps | 210 Bps | 926 Bps |

*This is the change for 2022, the actual drawdown was -36% from the Russia-Ukraine War peak before recovering.

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