First Trust
Monday Morning OUTLOOK

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Consumer Spending Set for Slower Growth

Now that we're about to enter the Christmas shopping season, expect even more focus than usual on the consumer over the next several weeks.

We are supply-siders and so usually cringe when we hear analysts and investors dwell on consumption as if it were the ultimate arbiter of economic growth. Ultimately the economy depends on production, which, in turn, hinges on entrepreneurship and innovation, the labor supply, as well as the health of cultural institutions like property rights and freedom of contract.

The government can affect these factors by raising or reducing tax rates, increasing or lowering spending, and adding or cutting regulations. Meanwhile, monetary policy can lead to temporary deviations from these long-run factors, with a policy that raises or reduces inflation.

On top of all this, the wild policy response to COVID – with enormous government checks sent directly to bank accounts – left consumers with more purchasing power than they'd normally have, given output. In turn, that has meant following the consumer is one way to gauge the extra inflationary impulse still remaining in the US economy, as well as the timing of the onset of the tighter monetary policy – the M2 measure of the money supply has dropped 4.4% – that the Federal Reserve began implementing last year.

In the year ending in September, "real" (inflation-adjusted) consumer spending is up 2.4%, no different than the growth rate in the ten years immediately prior to the onset of COVID. However, there are multiple reasons to believe that growth rate should soon decline.

First, much of the increase in spending in the past year has been driven by increases in jobs. Total payrolls are up 243,000 per month in the last year, which is unusually fast given an unemployment rate below 4.0%. A slowdown in job growth should limit the growth in consumer purchasing power.

Meanwhile, consumers have been eating into the excess saving they were able to accumulate during COVID, back when the government was passing out checks with reckless abandon. Immediately prior to COVID, in February 2020, US consumers, in the aggregate, were accumulating savings at a $1.28 trillion annual rate. That's personal income, minus taxes, minus consumer spending. By contrast, in September 2023, consumers were saving at a $690 billion annual rate.

For the time being, accumulating savings at a slower rate makes sense; the government showered consumers with checks during COVID and so they got used to not having to save for themselves. But eventually we expect that old pace of saving to reassert itself. Even if it takes two years to do so, an increase in the pace of saving back to $1.28 trillion per year should trim consumer spending by about 1.5 percentage points per year. That alone could take a pace of real consumer spending growth of 2.4% per year down to less than 1.0% per year. Ouch!

Then there are student loan payments that have finally re-started. By itself, that's unlikely to be a major issue; we estimate the effect at about 0.2% of consumer spending. But it should be a small headwind.

None of this means that consumer spending has to plummet anytime soon. But we don't need consumer spending to drop in order to have a recession. That's what happened in 2001, for example, when real consumer spending rose a respectable 2.0%, while the unemployment rate rose almost two percentage points, as well.

Some economists are already taking a victory lap because they didn't forecast a recession and a recession hasn't started yet. But we think they're declaring victory too early. Some of them say that we never should have been worried about a recession while inflation fell because the surge in inflation was due to supply-chain issues, and then the reduction in inflation has been due to fixing those issues.

The problem with their theory is that they ignore the link between the surge in the money supply in 2020-21 and the inflation that followed, as well as the drop in money and the reduction in inflation this year. They think it's a coincidence, but we think they're going to get a rude awakening in the year ahead.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
11-21 / 9:00 am	Existing Home Sales – Oct	3.900 Mil	**3.910 Mil**		3.960 Mil
11-22 / 7:30 am	Initial Claims – Nov 18	227K	**226K**		231K
7:30 am	Durable Goods – Oct	-3.2%	**-4.2%**		+4.6%
7:30 am	Durable Goods (Ex-Trans) – Oct	+0.1%	**+0.1%**		+0.4%
9:00 am	U. Mich Consumer Sentiment- Nov	60.8	**61.5**		60.4