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provides a personal view on topical economic issues

May 2023 Economic Outlook: 3 Pillars of Consumer Spending and the Recession

Key takeaways:

- **Employment is trending more negatively, with initial jobless claims edging higher and job openings declining, but the labor market remains relatively tight.**
- **Consumer confidence remains historically low and declined again in May, traditionally a leading indicator of a pullback in spending.**
- **Consumer income has been supported by COVID relief programs (SNAP benefits and Federal Student Loans Deferment). Still, the conclusion of these programs, combined with declining consumer savings, will mark a turning point in consumers' financial strength.**

This May Economic Outlook report dives into the future trajectory of the U.S. economy and the impact of consumer spending.

Consumer spending provides a window into the overall economic environment. The consumer drives two-thirds of overall economic activity. The three pillars of consumer spending are employment, income, and confidence. In this report, Prevedere's Economist team dives into the influence of these three pillars on the economy.

Consumer employment refers to consumers having a job and a source of income. Secondly, consumer confidence lies in the expectation that they will continue to have that job and source of income in the future. Finally, the third pillar is consumer income, the consumer's spending ability. Consumer income is measured in real spending power, meaning that consumers' pay needs to be increased at least at the same pace as inflation to maintain real spending power.

Consumer Employment

The labor market in the United States has been tight for a while now, but we are seeing some signs of cooling. The labor market is finally normalizing after whipsawing during the pandemic. The unemployment rate will rise as the labor market normalizes further through the second half of this year and into 2024.

New hire rates are slowing. When comparing the total number of new hires monthly and a three-month moving average, the number of new hires is trending lower. It is declining on a month-over-month basis, and it is below the pre-pandemic levels.

Yet, the labor market is still tight. Organizations are continuing to hire, although it is at a declining rate, and April brought positive job reports. The bottom is not falling out from the labor market, but early signals are trending in a more negative direction.

On a four-week moving average, initial jobless claims are increasing, but still, they are historically low. This suggests the economy has overcome the extremely tight labor market of 2022 and is displaying trends in a more rebalanced direction.

The last point is that the unemployment rate is ultimately a lagging indicator. Typically the unemployment rate starts to rise significantly months after a recession officially starts, not as a leading indicator of recession. Moreover, the economy is just beginning to see the early signs of softening. Overall, the labor market is trending more negatively. In the post-pandemic recovery period, the economy's strongest pillars were consumer employment and spending. We are starting to see very early signs of that softening in May this year.

Consumer Confidence

Through May, consumer confidence remains historically low. Despite mildly increasing in April, the decline returned in May across all income levels, and confidence levels remain well below historical periods of economic growth. Consumer confidence is mirroring what is typical when the economy and consumer spending start to stagnate.

Macroeconomic events influence consumer confidence. For example, the uncertainty about the debt ceiling, the banking crisis, and the past two years marked by inflation all contribute to decreased consumer confidence.

Lackluster consumer confidence is a leading indicator of a pullback in consumer spending. This spending pullback will likely emerge as consumer employment and spending power drop. The employment pillar has remained strong, while savings and government programs have temporarily propped up the income pillar. This resulted in consumers continuing to spend despite lower confidence levels. Especially as employment and consumer spending power start to crack, the relatively low consumer confidence will begin to transpire into a more significant headwind.

Consumers are already demonstrating signs of spending hesitancy. Consumers across all income brackets are trading down to reduce their expenses. Over the past few quarters, consumers looking to decrease overall spending is significantly higher for nearly all income brackets except the lowest income quartile.

In addition to trading down, consumers are looking to curb expenses in other ways. For example, across all income brackets, consumers want to use coupons more often than during the previous economic growth period. Ultimately, consumers seek to curb monthly costs and expenses by seeking sales and lower price points. These metrics are leading indicators of spending and how consumers do not make these changes suddenly but over time.

Consumer Income

Consumer income and finances are under increased pressure. Real Disposable Personal Income (RDPI), or after-tax, inflation-adjusted income, has been contracting year-over-year since early 2021, but excess savings have supported consumer spending and social programs. However, as savings continue to dwindle, there will be increased headwinds for consumer spending later this year.

Excess savings from pandemic relief programs have

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insulated consumer spending by boosting savings in 2020 and curbing monthly expenses. As a result, during 2021 and most of 2022, RDPI was not keeping pace with inflation, but consumers have continued spending by drawing down their excess savings built up post-pandemic.

We are now seeing some of the additional COVID relief programs end in 2023, such as increased SNAP benefits, student loan repayment, and interest deferment. These programs have also supported consumer spending and the income pillar for the last few years alongside the buildup of excess savings. The fallout of these programs will add to the headwind of this dwindling savings and lackluster real income growth. This conclusion of the programs will contribute to a significant turning point in consumers' financial strength.

SNAP Benefits

The expiration of the emergency allotments to SNAP benefits will contribute to rippling effects in the economy. SNAP benefits are governmental support for food purchases for low-income consumers struggling monthly. The conclusion of the COVID emergency allotments will reduce SNAP benefits to all qualifying consumers.

Before the pandemic, SNAP benefits were approximately $130 per person on average. During the pandemic, Americans saw roughly a 15% increase in some emergency allotments. As a result, SNAP benefits increased to $218 monthly per person in FY21. A permanent Thrifty Food Plan reevaluation again altered the SNAP benefits in FY22, increasing monthly benefits to approximately $232 per person. Then the cost of living, or inflation adjustment to benefits, starting in October 2023, boosted average benefits to roughly $256 per person. However, the COVID emergency allotments expired in the first quarter of this year. As a result, average benefits in the second quarter of 2023 will likely return to around $218 per person from the high of $256 in Q1.

Student Loan Repayment

Student loan repayments will resume later this year after being paused during the pandemic, and interest will begin to accrue again. As part of the government's pandemic relief program, loan interest has not been accruing, and the government has postponed many federal student payments loans since March 2020. In addition, President Biden pushed through a debt forgiveness program that would forgive a small portion of loans. However, this is currently under Supreme Court review and may not come to fruition.

Currently, student loan payments are scheduled to restart at the end of August this year at the latest. However, the payments could resume earlier based on the Supreme Court's decision on the loan forgiveness and would start 60 days after any ruling.

Resuming loan payments would cause a significant amount of money to shift from personal consumption to debt repayment, even if a small portion of loans are forgiven. It is estimated that the total reduction in monthly debt obligations from not having to pay government student loans currently equates to $6.1 billion, approximately 0.41% of total personal consumption expenditures (annualized). There are 26 million Americans affected by federal student loans. At least a portion of the 26 million will have to go back to paying that student debt, an additional $210 a month that they no longer have to spend on discretionary spending. Putting that in perspective, that is 0.41% of total personal consumption expenditures, which is the largest portion of GDP.

Personal Consumption Expenditures

Real personal consumption expenditures are on a downward trend. There has already been a significant slowdown in consumer spending. In the past five months, consumer spending has contracted month-over-month in four of them. January 2023 alone is where all of the Q1 growth came from and the only month with robust consumption expenditures growth.

February and March 2023 saw decline in real personal spending. The U.S. economy has not seen this many concentrated months of month-over-month contraction in real personal consumption expenditures since the early beginnings of the 2008 recessionary period. The slowdown has already started in consumer spending.

A tight labor market, excess savings, increased SNAP benefits, and the delayed repayments of student loans supported consumers over the past year. But the foundation is threatened when the consumer's financial position weakens and the employment pillar of consumer spending begins to turnover.

With the consumer spending power pillar moving in a negative direction, and early signs of a softening labor market, later this year, all three elements of consumer spending (employment, confidence, and income) will not be moving in a favorable direction. That will likely result in a decline in aggregate demand in the U.S. economy, which then will likely ripple into an overall economic contraction as measured by GDP.

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Conclusion

When the three pillars of consumer spending coincide in a positive direction, it results in robust economic growth. But when these pillars move in different directions, consumer spending and the overall economy tend to move sideways, as we see now. Overall, the three pillars are somewhat sluggish, indicating economic challenges as we head into midyear. A risk in consumer spending is when all three pillars move in the negative direction and point toward an economic contraction. The negative movement of all three pillars is the perfect storm and recipe for recession.

Consumer spending impacts B2B and B2C companies significantly. If the consumer starts to pull back, B2C companies begin to see a reduction in their sales, revenue, and profits and start to see headwinds. But that then ripples through to B2B companies over time with reduced capital expenditures and spending by B2C companies. Consumer spending can be a significant leading indicator for B2B and B2C organizations and the overall economy.

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