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Global Markets Research

Research Alert

What's Behind Resilient Consumer Spending in the US?

US stock markets have rallied significantly since pandemic era

Wealth effect has boosted the US consumer; similar to the housing boom in 2003 - 2008

Fall in equity markets and wealth effect could presage a downturn in consumer spending

The US consumer continues to surprise

Economic data in the US has continued to surprise on the upside. The latest retail sales report for March came in significantly higher than expectations, confounding expectations that the sharp rise in the Fed Funds Rate and mortgage rates over the last few years would put the brakes on the US consumer.

So how exactly has the US consumer spending continued to remain robust, despite the tightening financial conditions seen over the last few years? ***The strength of the labour market***, and the accompanying solid wage growth, has lent plenty of support to the consumer. Wage growth has been slowing down of late though (Figure 1), but despite this, consumer spending continues to power forward. We believe ***recovery in real wages*** as inflation tapers off has also helped US consumers stay buoyant (Figure 2).

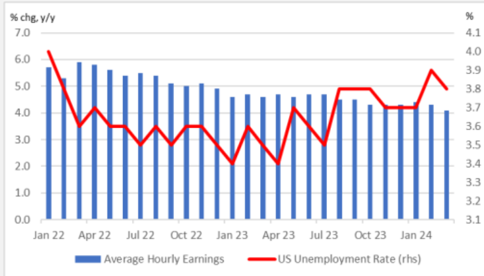
Credit growth has also played a part in supporting consumption. Figures from the US Federal Reserve indicate that consumer credit outstanding has increased by 22% from the recent trough in May 2020. Breaking that down further, revolving consumer credit has increased proportionately more, surging by 34% during the same period (Figure 3).

On top of that, we opine that the ***feel-good factor and wealth effect*** from soaring stock markets over the last few years (Figure 4) are also one of the major reasons that the US consumer continues to defy expectations. This is not dissimilar to the impact from the booming housing market in the US from 2003 to 2008. We seek to dwell a little more into the feel good and wealth effect in this article as below.

Stock markets have soared significantly

- US equities have essentially been on a major uptrend ever since the US housing crisis bottomed out in 2009. We examine how the S&P 500 Index has done below, but a similar story emerges with any of the other major US stock indices:
    - Since the March 2009 trough of 667 points, the S&P 500 Index has risen nearly 8-fold in 15 years, to stand at 5254 points at the end of March 2024.
    - Since the Covid-19 trough in March 2020 of 2192 points, the S&P 500 Index has risen by 128% (Figure 4) in the space of 4 years.
- This massive move has put quite a bit of money in consumer's pockets, be it through realized capital gains or paper gains. Either way, the feel-good factor has definitely played a large part in keeping the US consumer in healthy shape, just as the boost from deployment of excess savings accumulated during the Covid period tapers off.

Figure 1: Wage growth has been coming off gradually as the labour market cools

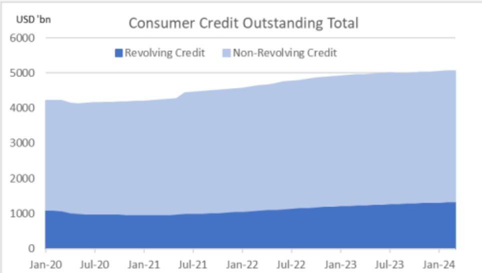


Source: Bloomberg; HLBB Global Markets Research

Figure 2: Recovery in real wages as CPI eases off has supported consumption

Source: Bloomberg; HLBB Global Markets Research

Figure 3: Consumer credit has risen 22% since the recent Covid trough, with revolving credit up 34%



Source: Bloomberg; HLBB Global Markets Research

- This wealth effect has allowed consumer spending growth to continue to outstrip income growth, resulting in a falling savings rate (Figure 5).

The Wealth Effect from equities – how big is it?

- There has been various research on the wealth impact from equities with differing conclusions on how big the impact is on consumption. We look at some of the widely cited research on it.

- A Federal Reserve Board of New York paper in July 1999 by Ludvigson and Steindel found that a wealth effect does exist and is pretty immediate, and that it tends to effect today's consumption more than it does tomorrows. However, measurement of the wealth effect was concluded to be difficult.

- In 2001, economists Karl Case, Robert Shiller and John Quigley wrote a paper "Comparing Wealth Effects: The Stock Market versus the Housing Market" where they concluded from their research from the period from 1982 to 1999, that they found strong evidence that variations in housing market wealth have important effects on consumption, but "at best weak evidence" of a stock market wealth effect.

- A more recent study on the wealth effect by Visa in June 2023, concluded that there is a relationship between wealth and consumption, that it differs between what asset the change in wealth comes from, and that the effect has grown over time. They conclude that for stocks and bonds, consumers tended to spend 9 cents from every 1 dollar of new wealth using data through 2017, but looking at more recent data though 2022, they concluded that this marginal propensity to consumer has increased to 24 cents from every 1 dollar of new wealth from stocks and bonds.

Conclusion

- While the impact on consumption from the result of change in wealth from the stock market is difficult to ascertain with any degree of accuracy, that there is an impact seems to be the conclusion.

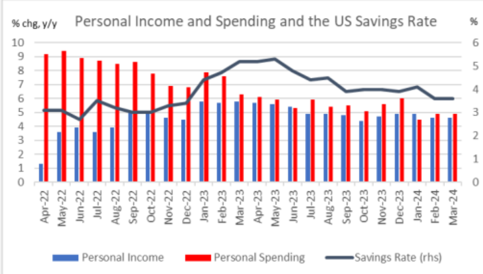
- This helps to explain why consumer confidence (Figure 6), and consumption, has held up so well despite the many headwinds facing the US consumer like the elevated inflation and tightening financial conditions.

- Hence, we conclude that in the absence of a faster pace of labour market cooling, any sharp slowdown in US consumer spending is only likely to come about from a reversal of fortunes in the equity markets given how well they have performed in recent history; hence this is something to pay extra attention to going forward.

Figure 4: The S&P 500 Index has soared by 128% since the Covid-19 trough in March 2020

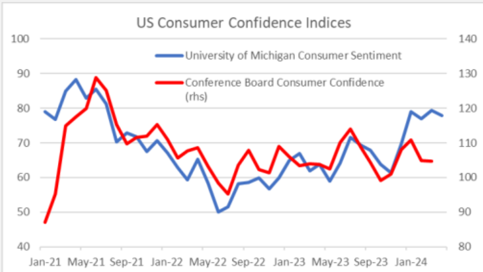
Source: Bloomberg; HLBB Global Markets Research

Figure 5: Spending has grown faster than incomes, resulting in a lower savings rate



Source: Bloomberg; HLBB Global Markets Research

Figure 6: US Consumer Confidence has been holding up very well despite the reduced expectations of interest rate cuts and the rise in bond yields



Source: Bloomberg; HLBB Global Markets Research

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