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Niladri 'Neel' Mukherjee
Chief Investment Officer, TIAA Wealth Management

Gone shopping: why the consumer keeps the U.S. economy humming

Stock-market skeptics have been waiting two-plus years for the U.S. consumer to crack. Back in January 2023, for instance, a Wall Street Journal economists survey put the odds of recession that year at 61%. The reason for all their doom and gloom? "The engine of the U.S. economy—consumer spending—is starting to sputter," the Journal claimed.[i]

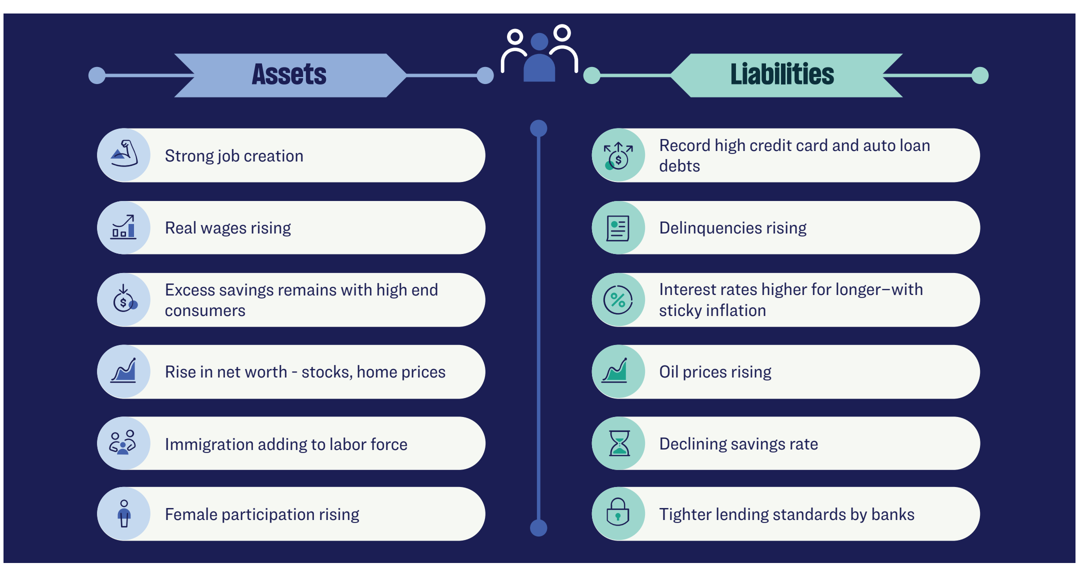
Well, consumer spending never did sputter, and the recession never did happen. Last year, consumer spending rose 6%,[ii] and it climbed another 0.9% during the first two months of 2024.[iii] We predict more of the same through the remainder of 2024—though we continue to keep tabs on consumer debt levels and other risk factors that may eventually force Americans to become thriftier. But let's start with the big picture.

The U.S. consumer remains critical to the health of the U.S. economy, accounting for 70%[iv] of gross domestic product (GDP). Since the onset of the pandemic, the consumer spending boom has been supported by massive fiscal stimulus, a V-shaped recovery in economic activity and a surge in corporate profits that spawned a red-hot job market. Labor demand soon outstripped supply, which led to substantial wage increases, which allowed consumers to splurge on all the purchases they'd put off during lockdowns—cars, travel, electronics, etc. Yes, the rise in spending sparked inflation, but aggressive rate hikes by the Federal Reserve had the proper effect. Indeed, the decline in inflation since late 2022 has only added to the discretionary spending capacity of the American consumer.

In this note, we examine the overall health of the U.S. consumer, concluding that fundamentals can sustain the current U.S. economic momentum. The pace of spending growth, however, may slow as equilibrium returns to the labor market (Figure 1).

Figure 1

Snapshot: The U.S. consumer balance sheet



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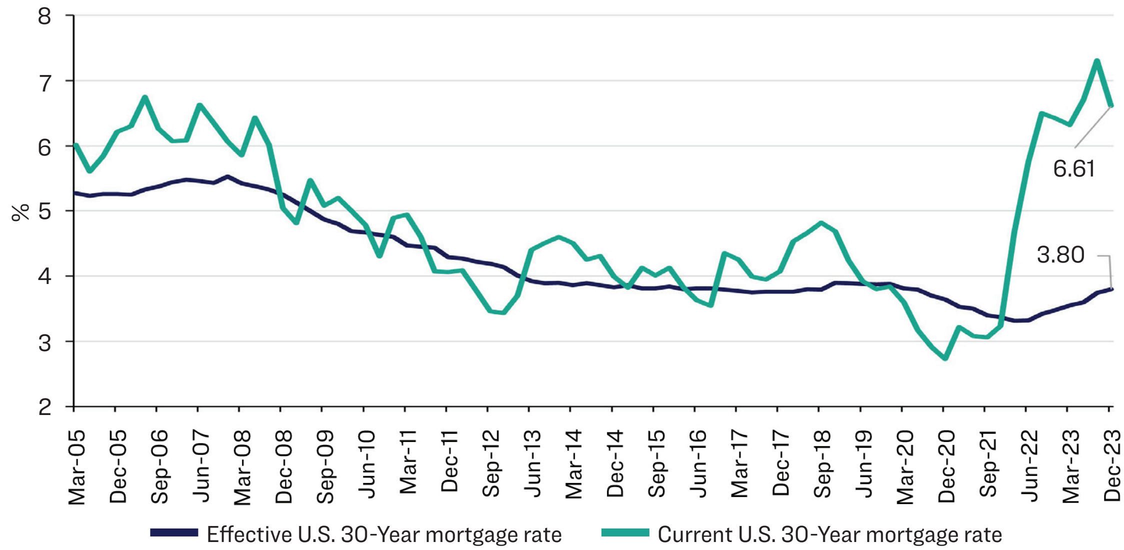
U.S. consumer health – a widening gap

As of Q2 2024, consumer balance sheets remain strong. Household net worth (assets minus liabilities) has increased by more than $45 trillion since the start of the pandemic, and the U.S. consumer has shown great resilience despite the fastest Fed tightening cycle in U.S. history.[v] A big reason for this: low floating mortgage rate risk. Roughly 90% of mortgage loans in the U.S. are in fixed-rate products.[vi] Despite Fed tightening, most homeowners are not yet paying higher interest rates on their home loans, which represent around 70% of total consumer debt on aggregate.[vii] The current effective mortgage rate of 3.8% remains below pre-pandemic levels (Figure 2).

Figure 2

Effective U.S. 30-Year Mortgage Rate and Current U.S. 30-Year Mortgage Rate

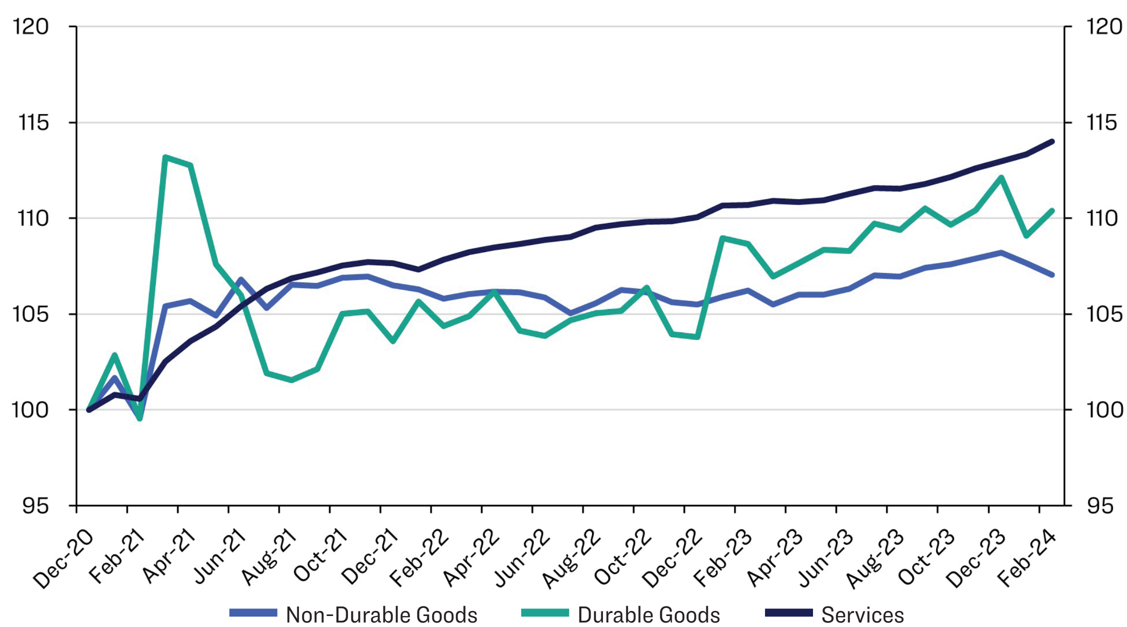


Source: Bureau of Economic Analysis, Freddie Mac

Consumer spending has been resilient because consumers themselves have not felt the full effect of higher rates. The University of Michigan consumer sentiment report recently ticked up to a 3-year high (though Conference Board consumer confidence index has remained near the middle of its post-COVID range).[viii] Taken together, all these data points—consumer spending, consumer confidence and household net worth—suggest the U.S. consumer remains on stable footing (Figure 3).

Figure 3

U.S. consumer spending (indexed to Dec-20)



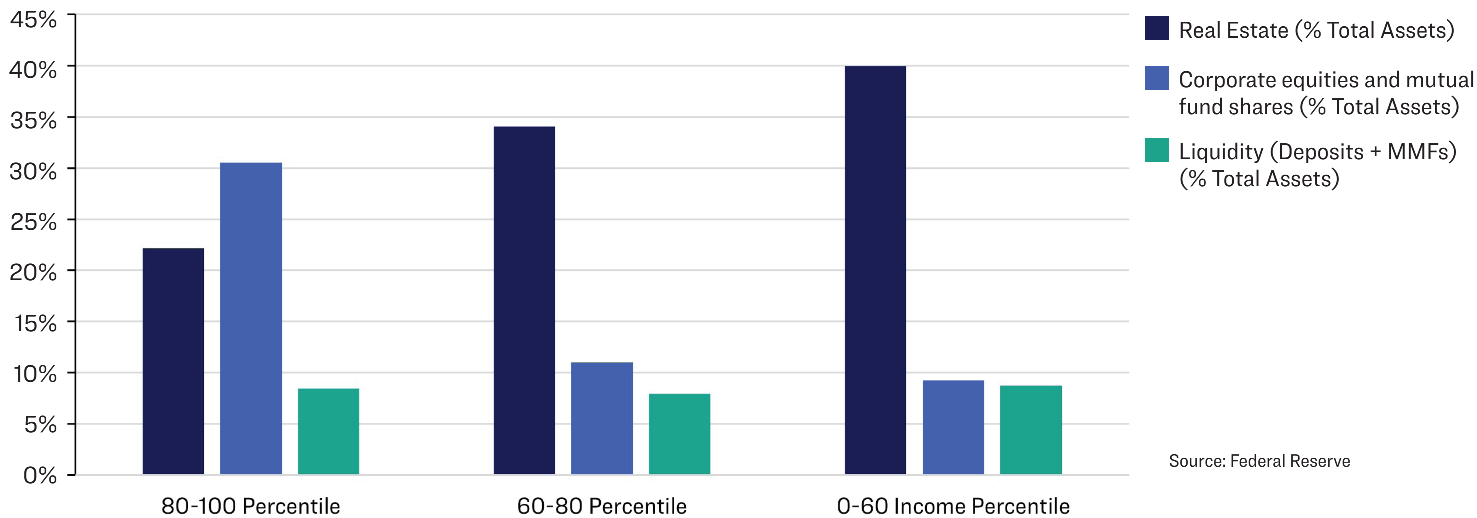
Source: Bureau of Economic Analysis

Context is important though. The increase in household net worth has been largely driven by rising home prices and swelling stock portfolios. While such increases do raise consumer confidence, they are not good indicators of short-term spending power since homes and investments, unless sold, cannot be used to buy goods and services. Since 1989, the average 5-year inflation-adjusted growth in net worth has been around 23%. As of Q4 2023, it was 25%.[ix] While a good coincident indicator, net worth doesn't seem to hold a strong predictive power and, given the purchasing power erosion due to high inflation, looks average in a historical context.

Households in the bottom 60% of income distribution also maintain roughly half of their wealth in real estate, where inherent illiquidity is exacerbated by higher financing costs (Figure 4). When homeowners choose to move and repay their existing mortgages, they implicitly give up the fixed rate advantage and would need to refinance a new residence at the marginal rate, which would likely offset some of the equity appreciation that would be extracted from the initial home sale. Other options, like home equity loans, are costly (around 9% today). The liquidity that lower-income consumers do have (bank deposits and money market fund assets) has nearly reverted to Q4 2019 levels when adjusted for inflation.

Figure 4

U.S. consumer net worth by income percentile

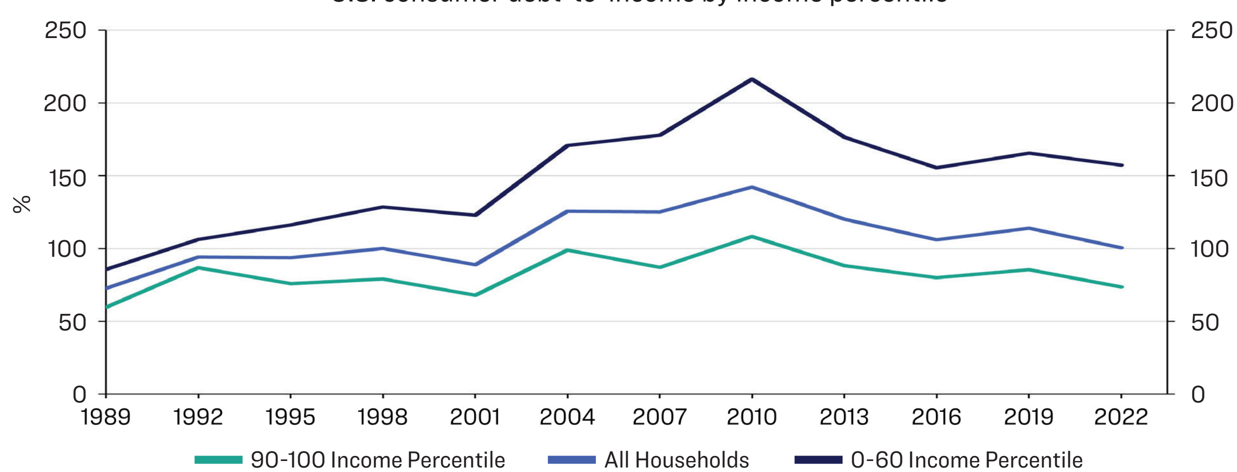


Source: Federal Reserve

Debt levels are another red flag for the lower-income consumer. Nationally, the aggregate debt-to-income ratio stands at around 100%, well below where it was in 2010. The debt-to-income ratio for those in the bottom 60% of household income distribution, however, is above 150% (Figure 5). Lower-income households generally have limited resources invested in income-producing assets, and they tend to carry much more floating, high-interest debt (credit cards, auto loans, etc.). As of April, the median interest rate on credit card debt was 23%.[x] The cascading pressures on lower-income households are evident in the rising number of credit card and auto loan delinquencies since last summer (Figure 6). Fitch's data suggests that subprime auto loan delinquencies are higher than at any point over the past three decades. The delinquencies show inflation has had a much more pronounced impact on households living paycheck-to-paycheck, as the increased cost of living exceeds the nominal increase in available cash.

Figure 5

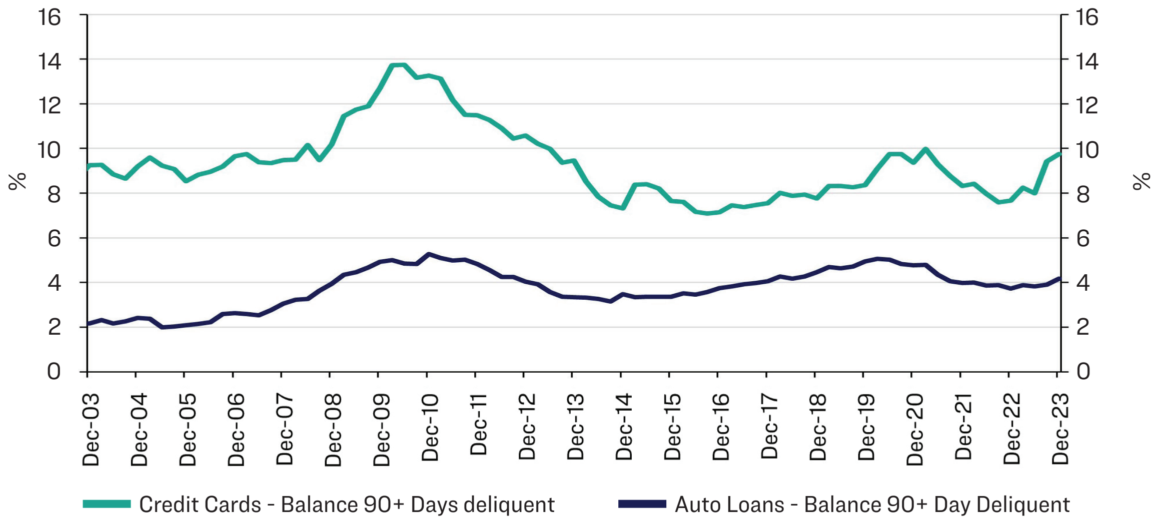
U.S. consumer debt-to-income by income percentile



Source: Bureau of Labor Statistics (Survey of Consumer Finances)

Figure 6

U.S. auto loan and credit card delinquencies



Source: Federal Reserve

Companies are also reporting a mixed picture for the U.S. consumer in the current earnings season. Some restaurant operators (and their suppliers) are citing slower traffic and some bifurcation by income cohort, with higher-income consumers spending more and lower-income consumers spending less. The same trend has been observed in the packaged food segment, with reports of increased value-seeking behavior among consumers. At the same time, several brands in the consumer apparel segment are reporting better-than-expected results, though they remain cautious about future expectations. In other words, the rising tide of consumer spending has lifted many boats, but not all of them.

Despite unique pressures facing lower-income consumers, a healthy and resilient labor market continues to boost disposable income across the board. Wage growth has outstripped inflation. Strong liquidity buffers remain intact, with households' total checkable deposits now standing approximately $3 trillion higher than in 2019.[xi] Payroll growth accelerated in March, exceeding expectations. Unemployment ticked down while labor force participation ticked up. Initial jobless claims have remained in a relatively tight range, near multi-year lows, though continuing claims are up from the lows of 2022. Average hourly earnings growth has cooled, but still remains above pre-COVID levels. Job openings have declined from elevated levels in 2021-2022, but the pace of declines has slowed, with openings remaining well above pre-COVID levels.[xii]

The unstoppable rise of women as an economic force

One unambiguous positive for the economy has been the female consumer—what some are now calling the rise of the "she-conomy."

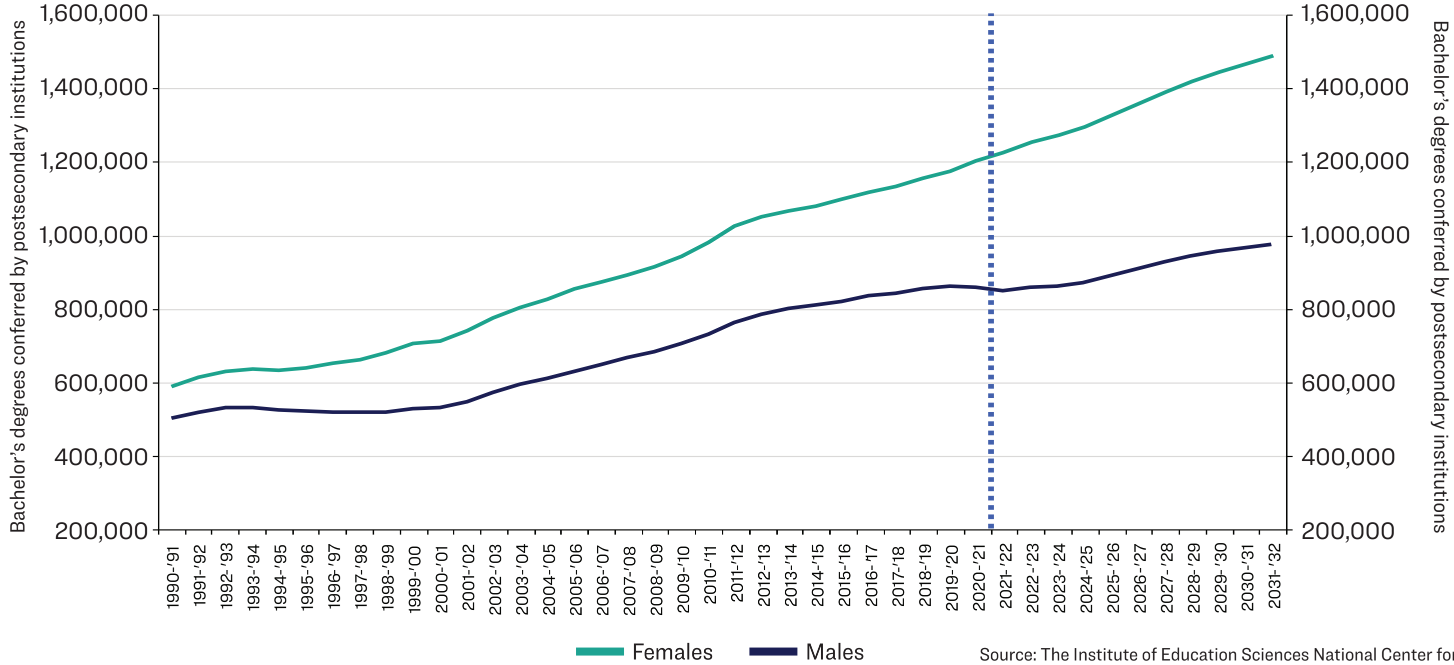
A study from the Bank of America institute reports that older generations are expected to pass on $30 trillion to young women in 10 years.[xiii] Bank of America also reports that 33% of the world's wealth was controlled by women in 2022, and that number is expected to grow rapidly as women become more active in financial decision-making.[xiv]

Additionally, women's wages are growing faster than men's (despite the persistence of the gender wage gap). Same story for consumer spending, as women aged 25 to 44 are now outspending male peers.[xv] As we first pointed out last October, the remarkable improvement in U.S. labor force participation post-pandemic has been driven largely by women.[xvi] Women's labor force participation rate climbed 1.5 percentage points between July 2020 and March 2024, which was more than double the improvement for men.[xvii]

The largest labor-force gains are coming from women aged 25 to 44, and it's clear why: Younger women are better-educated than similar-aged men. Every year since 2000, there have been at least 33% more U.S. bachelor's degrees awarded to women than men (statistics are similar in other Western countries), and this college gender gap keeps getting wider (Figure 7). According to projections from the National Center for Education Statistics, the college class of 2028 should become the first undergraduate class in American history to have 50% more female graduates than male ones.[xvii]

Figure 7

Bachelor's degrees conferred by U.S. postsecondary institutions by sex of student: selected academic years, 1990 through 2031-'32



Source: The Institute of Education Sciences National Center for Education Statistics; data through 2022 (projections right of the dotted line)

Needless to say, personal income is highly correlated with educational attainment. According to the U.S. Bureau of Labor Statistics, the weekly wages of college grads are 68% higher than those of workers with only a high school diploma. Their unemployment rate is also 48% lower.[xix] As a result, it now seems possible that Gen Z women will become the first generation of American women to outearn their male peers. It's already happening in big cities like New York and Washington, D.C., where under-30 women are earning 2% more than male counterparts, according to Pew Research.[xx]

What does this mean for the U.S. economy and markets? Overall, it should be a net positive, as a growing, well-educated work force supports economic growth and productivity. That said, women spend differently than men, which means the rise of the she-conomy will have winners and losers. Single women buy more homes than single men, for instance.[xxi] Women also spend more on apparel, healthcare and furniture, and less on electric vehicles, entertainment and alcohol.

Conclusion

Will consumers continue to maintain confidence in the economy and continue spending? Or will higher interest rates finally take their toll, putting an end to the post-pandemic shopping spree? We lean towards the former. Despite the very real stresses now facing lower-income consumers, the current job market remains strong and supportive of overall consumer spending. That could change, of course. But for now, we believe that reports of the U.S. consumer's demise are exaggerated.

Contributing Authors

John J. Canally, Jr., CFA©
Chief Portfolio Strategist

Alberto Favalli-Ragusini
Director
Investment Strategist

Jon Birger
Director, Editorial Strategy,
Content and Communications

Quinn Martin
Senior Equity Analyst

John Greene
Manager
Investment Content

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IMPORTANT DISCLOSURES

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