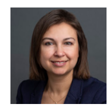
The Resilient Engine of the U.S. Economy Could Stall

Consumer fundamentals seem to be weakening from a strong position.

October 2023



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KEY INSIGHTS

- We believe that consumer balance sheets remain healthy and are supportive of spending fundamentals.
- We see the recent worsening in debt quality as reason for some concern.
- The resumption of student debt payments for millions of borrowers in early fall is likely to present a key headwind to consumer spending.

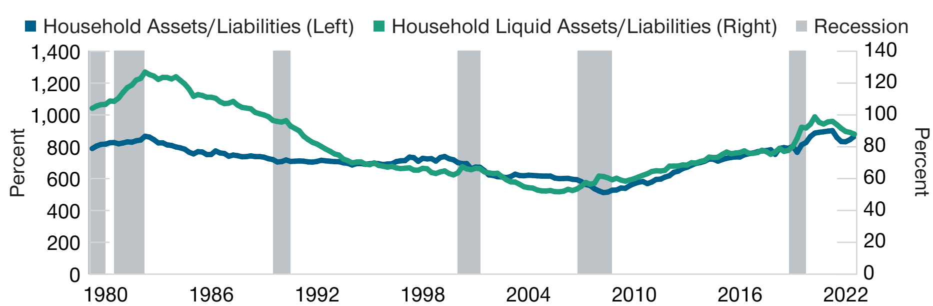
Consumer spending typically has made up over 70% of the U.S. economy and historically has been a significant driver of growth. At this juncture, the consumer balance sheet appears healthy after many years of deleveraging[1] after the global financial crisis. However, we see two key risks to consumer spending heading into year-end: rising consumer credit card debt and delinquencies and the resumption of student loan repayments.

Consumer Debt Level Appears Manageable...

We believe that consumer balance sheets remain healthy and are supportive of spending fundamentals. Despite headlines about high debt levels, total and liquid assets as a share of liabilities

Household Assets Remain High Relative to Liabilities

(Fig. 1) U.S. Household Balance Sheet Ratios



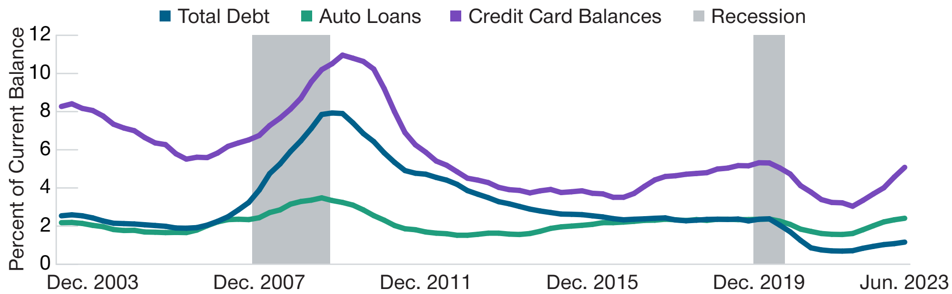
As of June 30, 2023.
Sources: Federal Reserve Board and Haver Analytics.

[1] Leverage refers to the level of debt compared with income or assets.

> ...we see two key risks to consumer spending heading into year end...

New Serious Delinquencies by Debt Category

(Fig. 2) Percentage of Balances Newly Delinquent



As of June 30, 2023.
Sources: Federal Reserve Bank of New York and Haver Analytics.

are both high for U.S. households. Unlike the 2000s, when consumers were over-levered relative to their assets, today's consumers do not need to deleverage. Checking account balances also remain well above pre-pandemic levels.

Additionally, debt servicing costs remain low relative to history, even with rising interest rates, and U.S. consumers' financial obligations remain manageable relative to disposable income. Mortgage debt represents a sizable proportion of total household debts, and many borrowers were able to lock in low mortgage rates in recent years. This has helped insulate a large portion of debt from higher interest rates.

...but Credit Card and Auto Loans Are Showing Signs of Stress

While our baseline expectation is for the U.S. consumer to remain on a steady upward trajectory, we see the recent worsening in debt quality as reason for some concern. For instance, credit card and auto loan delinquencies have risen recently, particularly among younger borrowers. While overall delinquencies are still below pre-pandemic levels, the acceleration could be a sign that consumers are feeling the stress of rising interest rates and the squeeze to disposable incomes from high inflation. The recent rise in consumer bankruptcy filings could be another sign of stress.

Credit conditions for consumer loans have also tightened significantly in the past year, meaning they are less likely to fund large purchases with favorable loans. Banks face higher funding costs and heightened regulation to retain capital following the regional banking crisis in March 2023. According to the Fed's Senior Loan Officer Opinion Survey on Bank Lending Practices, the proportion of banks less willing to lend to consumers has risen to historic highs.

Key Risks to the Consumer Outlook

Following the U.S. Supreme Court's ruling on student loan debt forgiveness, the resumption of student debt payments for millions of borrowers starting in October is likely to present a key headwind to consumer spending in the fourth quarter of 2023 and into 2024. We anticipate that student loan payments will have a larger impact on younger borrowers, who are already displaying pockets of weakness in the form of increased delinquencies on credit cards and auto loans.

Finally, the excess savings accumulated during the height of the pandemic across developed economies has been dwindling. While there is some debate about exactly when the excess savings will be completely depleted, most analyses indicate this buffer will have run out by the end of 2023. Without the savings buffer to smooth over the shocks of rising prices, interest rates, or the resumption of student loan repayments, the U.S. consumer could be under increased pressure.

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