US Consumer: Confidence-Driven Spending

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Important disclaimer located on slide 36
Confidence boosts consumer spending

Consumer spending growth outpaces disposable income, driven by confidence.

The significant gains in household net worth – rally in equity prices and home prices – have boosted confidence and spending.

Robust credit card debt growth

Consumers are supplementing incomes with credit. But total consumer credit debt outstanding remains below the crisis peak.

Personal saving rate near all-time lows

Personal saving rate recedes near 2005-07 lows – signals improving confidence but small buffer for adverse shocks.

General Trends in Consumption, Incomes and Consumer Confidence
Real consumption has picked up in recent years, growing 3% on average since 2014, due to robust job growth, rapidly rising net worth and confidence.

- Real consumption is expected to grow 2.5% and 2.2% in 2018 and 2019, respectively.
- We expect elevated confidence to support spending further.
- Individual income tax cuts will lift real disposable incomes and provide near-term boost.

Source: Bureau of Economic Analysis and Berenberg Capital Markets
Pick up in wage growth remains elusive

Real disposable income and consumption growth

- Real disposable income gains have been suppressed by slow gains in wages and aggregate hours worked.
- But consumers remain confident in labor markets and the economy.

Longer-run: disposable incomes are key to consumption – people tend to spend most of their take home pay.

The pace of consumption growth may be unsustainable, if the disappointing income gains continue.

Source: Bureau of Economic Analysis and Berenberg Capital Markets
High net worth and consumer credit driving consumption

- Total consumer credit debt outstanding has accelerated over 8%.
- This reflects confidence in labor markets.

- All-time highs in household net worth increases propensity to spend.

Source: Bureau of Economic Analysis, Federal Reserve Board, Federal Reserve Bank of New York Consumer Credit Panel/Equifax and Berenberg Capital Markets
Consumers benefitting from modest inflation

- Low inflation -- both headline and core inflation are running below 2% -- lifts consumer purchasing power.

- Falling durable goods prices increases demand for those goods.

- Consumer inflation expectations are low but well anchored.

Source: Bureau of Economic Analysis, Federal Reserve Bank of New York, University of Michigan, Bloomberg and Berenberg Capital Markets
Consumers confident as finances improve

Key measures of consumer confidence

- Continued improvement in labor markets, low inflation, and the equity market rally support confidence.

- The very optimistic confidence has boosted spending in the absence of strong income growth.

Change in confidence by income, Nov. 16 to Nov. 17 (Conf. Board)

- Confidence has improved the most among middle-income households, where the propensity to spend is high.

Source: Conference Board, University of Michigan, Bloomberg and Berenberg Capital Markets
Consumers positive on labor markets and buying plans

- Consumers hold the most favorable view of the labor market since the early 2000s, with 20% more viewing jobs as plentiful than hard to get.
- Attribute this to the unemployment rate that is hovering near early-2000 lows.
- Household buying plans for large household durables remain high due to cheap financing costs and prices.
- Households are not as excited about buying homes due to high prices and short supply. Vehicle demand has peaked.

Source: Conference Board, University of Michigan, Bloomberg and Berenberg Capital Markets
Interest Rates and Debt
With the persistently low interest rates, individuals have been forced to rely less on interest income.

This has been particularly challenging for retirees.

Credit card plan rates have picked up.

Low interest rates boosted auto sales earlier on. The recovery in housing activity has underperformed despite low mortgage rates.

The low rates have held down household debt service ratios.

Source: Federal Home Loan Mortgage Corporation, Federal Reserve Board, Bureau of Economic Analysis and Berenberg Capital Markets
Auto and student loans dominate lending

Credit, auto, student loan debt, and home equity lines of credit

- Auto and student debt outstanding have surged. Student debt burdens have held back spending on other goods and services and have squeezed mortgage credit availability for some.

- Credit card usage only started to re-accelerate a few years ago and is now growing over 8% yr/yr.

- In aggregate, the consumer debt service ratio is increasing but remains near mid-90s low.

*Note: Ratio of consumer debt service payments to disposable personal income. Source: Federal Reserve Bank of New York Consumer Credit Panel/Equifax, Federal Reserve Board and Berenberg Capital Markets
Mortgage debt, which accounts for 67% of household debt, has yet to return to pre-crisis levels.

The slow growth in mortgage debt outstanding reflects a slower pace of new originations and amortization of principal.

The ratio of mortgage debt service to disposable income is near historical lows.

*Note: Ratio of mortgage debt service payments to disposable personal income. Source: Federal Reserve Bank of New York Consumer Credit Panel/Equifax, Federal Reserve Board and Berenberg Capital Markets
What do Consumers Spend On?
Consumers spend mostly on services (68%) and less on goods (32%).

Many necessities tend to be services. Also, inflation for services is higher than durable and nondurable goods.

As the population ages, consumption of services increases.

Real durable goods consumption has far outpaced spending on services and nondurable goods.

Declining durable goods prices have helped fuel this outperformance.

Source: Bureau of Economic Analysis and Berenberg Capital Markets
Durable goods prices continue downward trend

U.S. govt. agencies measure inflation on a quality-adjusted basis.

Quality-adjusted prices of durables have fallen consistently for the last 20 years due to technological innovations and product improvements.

Recreational goods prices have fallen the most (video, audio and photo equipment, computers, software and accessories account for 58% of total).

New vehicle prices are now declining, and used vehicle prices are falling markedly; due to high inventories and dealers seeking to lure potential buyers off the new vehicle market.

Source: Bureau of Economic Analysis and Berenberg Capital Markets
• Real spending on durable goods has been growing 6%, far outpacing total consumption.

• This reflects elevated confidence and willingness to borrow.

• The improved confidence is particularly evident in the strong spending on recreational goods and vehicles, including consumer electronics.
Motor vehicle sales get temporary boost

- Motor vehicle sales are being boosted by the replacement of storm-damaged vehicles in Houston and Florida.
- The elevated level of sales will be short-lived – expect a return to the prior trend soon.
- Excesses in the subprime auto market and increases in delinquencies are clearly apparent.
- Lenders have tightened standards, as the median credit score for new auto loans has jumped.

Source: Bureau of Economic Analysis, Federal Reserve Bank of New York Consumer Credit Panel/Equifax and Berenberg Capital Markets
Health and housing dominate services consumption

Components of services spending, as share of total

- Health care and housing account for half of services spending.
- Amid soft growth in disposable income, big spending on housing and health care crowd out spending on other discretionary services.

Real services spending growth

- Real services spending has grown at a modest pace in this recovery, reflecting broader economic trends.

Source: Bureau of Economic Analysis and Berenberg Capital Markets
Health care spending has moderated from its earlier fast pace.

- The expanded insurance coverage under the Affordable Care Act has raised health care obligations of households and firms.

- The CPI for health care, which measures out-of-pocket prices for consumers, reflects higher health insurance premiums.

- The PCE deflator for health care, which measures prices of total health care costs including by employers and government, has grown more slowly than the CPI for health care.

Source: Bureau of Economic Analysis and Berenberg Capital Markets
Home prices have risen rapidly, in large part due to the short supply of housing.

Rental prices have increased more slowly, constrained by disposable incomes.

Renting is more attractive for many individuals facing affordability constraints and tight mortgage credit.

The home ownership rate has only recently bottomed out and remains very depressed.

Source: Bureau of Economic Analysis, Standard & Poor’s, Case-Shiller, Census Bureau and Berenberg Capital Markets
Spending Growth: Weaker for Essential Items, Rapid for Discretionary Goods and Services
Purchases of sports and recreational vehicles accelerate, reflecting elevated confidence especially among higher income households.

- Spending on sporting equipment and guns has picked up.

Source: Bureau of Economic Analysis and Berenberg Capital Markets
Spending on games, hobbies and books robust

- Spending on games, hobbies, flowers, and other discretionary activities have jumped.

- People are also spending significantly more on books, driven in part by lower prices and increased electronic access.

Source: Bureau of Economic Analysis and Berenberg Capital Markets
Discretionary services spending accelerates

• Consumers are spending more on experiences and activities.

• They are also taking care of themselves, spending more at hairdressing salons and grooming places.

Source: Bureau of Economic Analysis and Berenberg Capital Markets
Evidence of more leisure travel

- Growth in hotels and motels spending moderated last year but has rebounded so far in 2017.
- The strong gains in Q3 despite storm-disruptions in tourism-dominant Florida is impressive.
- Vehicle rentals remain elevated reflecting lower rental prices and increased willingness to spend on travel and experiences.

Source: Bureau of Economic Analysis and Berenberg Capital Markets
Apparel spending gains sluggish

The pace of apparel spending growth has moderated, despite sharp discounting.

Spending on household supplies has continued to grow rapidly.

Hurricane preparation and repair efforts have boosted spending on household supplies.

Source: Bureau of Economic Analysis and Berenberg Capital Markets
Spending on energy and pharmaceutical goods slow

Real consumption on gasoline and energy goods

- The volatility in energy prices has influenced real energy consumption. The initial drop in energy prices led to increased consumption on gasoline and other (ex-energy) categories, but that is reversing.

Real consumption on pharmaceutical products

- The increased coverage provided by the ACA may have boosted purchases of pharmaceutical products, but purchases slowed towards the end of 2016.

Source: Bureau of Economic Analysis and Berenberg Capital Markets
Personal care products, child care spending strong

- Gains in purchases of essential personal care products have slowed, but they are still growing solidly.

- Parents have been spending significantly more on child care.

Source: Bureau of Economic Analysis and Berenberg Capital Markets
• Since the US presidential election season in mid-2016 people have contributed significantly more to social and civic organizations.

• Note that such contributions are tax deductible.

• Other types of contributions have also accelerated sharply.

Source: Bureau of Economic Analysis and Berenberg Capital Markets
Shifting in Spending Patterns
Online platforms are increasing penetration of various consumer and business services.

This shift has little impact on the total amount of sales.

But retail physical locations are being shut down.

And the demand for traditional retail jobs has declined.

But this has been offset somewhat by a strong pick up in non-store retail employment, including at fulfillment centers.

Result in near-term is net loss of jobs in retail sector.

Source: Census Bureau, Bureau of Labor Statistics and Berenberg Capital Markets
Cord cutting is a very real phenomenon as cheaper options for watching television shows and movies are attractive.

Spending on cable services and radio has fallen dramatically since H2-14.

Though the declines appear to be moderating.

Video media rentals include streaming services, they make up a small but rapidly growing share of total sales that is eating into revenues of traditional media companies.

Expect traditional media companies to continue announcing new strategies.
Food consumption patterns shifting

- Low grocery prices – in part due to high competition among grocers and more efficient distribution – and higher prices at restaurants – seem to be enticing people to prepare their own meals.

- Sales increases at restaurants and drinking places have simmered.

- Home food delivery and meal-kit options – oftentimes healthier, quick to prepare and convenient – are facilitating this shift.

Source: Bureau of Economic Analysis and Berenberg Capital Markets
Issues to Ponder

- How long can consumer confidence remain high, and what will end it? The end of the equity market rally, policy/political disappointment, geopolitical scares?

- How sustainable is this rally in equity prices that is driving net worth? Will real disposable income gains recover in time?

- Although credit card debt remains below crisis levels, is its growth something to be concerned about?

- Will monetary policy normalization finally translate to higher long-run interest rates? If so, could the boom in durable goods spending fade?
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