MACRO STRATEGY

Economic Monthly

# Are Consumers Weakening?

March 19, 2024

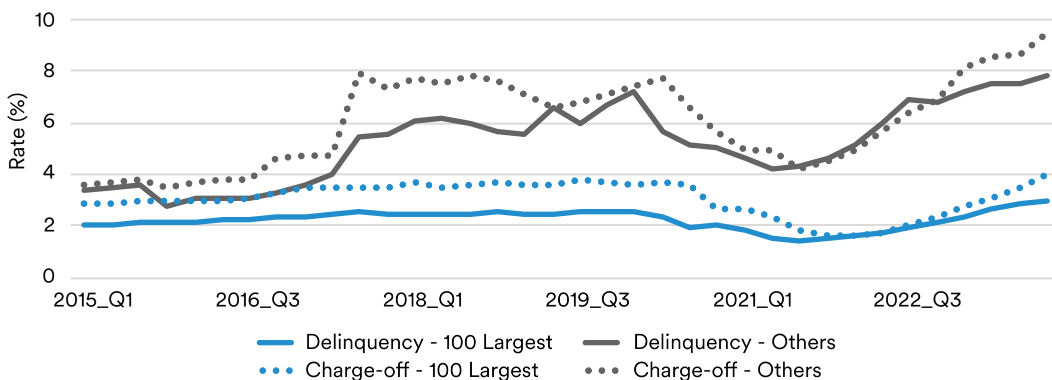
Our baseline forecast continues to incorporate a recession as we remain cautious about the economy. Although aggregate economic and labor market indicators continue to be strong, we are concerned about high consumer loan delinquencies, creeping unemployment, and affordability, all of which are potential headwinds to growth.

## Charge-off Rates Increasing Rapidly on Consumer Loans

Consumers are having more and more trouble paying off debt.

Recent data from the Federal Reserve Board of Governors shows that charge-off rates on consumer credit card loans has reached 4.2% in 2024 Q4, the highest since 2012. Smaller banks face a significantly higher impact, as the credit card delinquency rate for banks other than the largest 100 has reached 7.8% and their charge-off rate reached 9.5%, both surpassing even the peaks seen in the 2008 financial crisis. For the largest 100 banks, credit card delinquencies rose to 3.0% and charge-offs ended the year at 4.0%. While these are not as high as they were during the 2008 crisis, they are at levels not seen since the early part of last decade.

**Credit Card Delinquencies Have Increased for Small Banks**




*Source: Federal Reserve Board, Haver, MIM,. As of Q4 2023.*

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Even as consumers continue to spend, this indicator shows that finances for some consumers, particularly those that are younger and/or lower income who rely more on credit, are stressed by higher prices, higher rates, and the highest credit card interest margins in history.[1]

Credit card delinquency rates are one metric of consumer stress, but other measures also show a worsening picture, with default rates on auto loans rising and more consumers using alternative forms of credit such as Buy Now Pay Later.[2] While the effects of these stresses have not spilled over to the wider economy just yet, we could see more widespread impacts including downward pressure to consumer spending if consumers lose their jobs or are further unable to afford their growing debt usage. Regardless, the narrative around consumers' financial health and spending patterns has shifted materially since the excess savings story of 2022 and early 2023.

## Demographic Segments and Sahm Rule Triggers

We see unemployment rates increasingly flashing warning signs.

In February, we discussed triggers to the Sahm rule at the state level. Various demographic segments are now also triggering the Sahm rule.[3]

The overall unemployment rate remains healthy. Substantial parts of the population are still experiencing a strong labor market.

At the same time, some demographic groupings, including some of those that historically have been the first to see unemployment rise, are seeing an increase in unemployment rates. Those with high school or less are seeing an increase in unemployment, as are Hispanic and foreign-born workers. Older workers (60+), veterans, and persons with disability have also seen an increase in their unemployment rates.

Although several labor market statistics still seem remarkably healthy—job openings are still strong, unemployment rates are still historically low—we believe there are in fact growing areas of concern.

**Sahm Rule Is Being Triggered by an Increasing Number of Demographic Segments.**

| Unemployment Rate (3 mo MA) | Feb-2023 | Aug-2023 | Feb-2024 |
|---|---|---|---|
| Overall (16+) | 3.5 | 3.6 | 3.8 |
| Men, 20+ | 3.2 | 3.5 | 3.5 |
| Women, 20+ | 3.2 | 3.1 | 3.3 |
| Teens | 10.7 | 11.6 | 11.7 |
| White | 3.1 | 3.2 | 3.4 |
| Black | 5.6 | 5.7 | 5.4 |
| Asian | 2.9 | 2.9 | 3.1 |
| Hispanic | 4.8 | 4.5 | 5.0 |
| Less than high school | 5.1 | 5.6 | 6.0 |
| High school diploma, no college | 3.7 | 3.7 | 4.2 |
| Some college | 3.1 | 3.1 | 3.2 |
| College degree(s) | 2.0 | 2.1 | 2.1 |
| Veterans* | 2.8 | 3.1 | 3.0 |
| Persons with disability* | 6.5 | 6.6 | 7.1 |
| Foreign born workers* | 3.6 | 3.4 | 4.1 |
| Cusp of retirement (60-64)* | 2.8 | 2.4 | 2.8 |
| Older workers (65+)* | 2.8 | 3.2 | 3.3 |
| By state - number of states*** | 4 | 5 | 21 |
| By state - % of U.S. GDP*** | 22 | 21 | 46 |

* Seasonally adjusted by Haver; ** Not seasonally adjusted
*** State level unemployment is for January 2024; February data are not yet available.

Sahm rule triggered | Sahm rule close to triggering | Sahm rule not close to triggering

High inflation was thought to be the reason behind the discrepancy between weak consumer confidence and a strong labor market. As inflation has decelerated with only a slight improvement in consumer confidence, observers have tried to construct a new narrative: consumers are finding price *levels* uncomfortable, not just the rate of price increases. That is, consumers remember that eggs used to cost $1.50 a dozen before the pandemic and feel uncomfortable about prices remaining at $2.50—with the implication that consumers just need to get used to the new price levels.

## When keeping up is not enough: wages and consumer spending

After a lot of mid-pandemic back and forth, wages and inflation have settled back into a more stable relationship since the beginning of 2023. However, we observe at least one key way in which that relationship remains substantially off the "old normal" path.

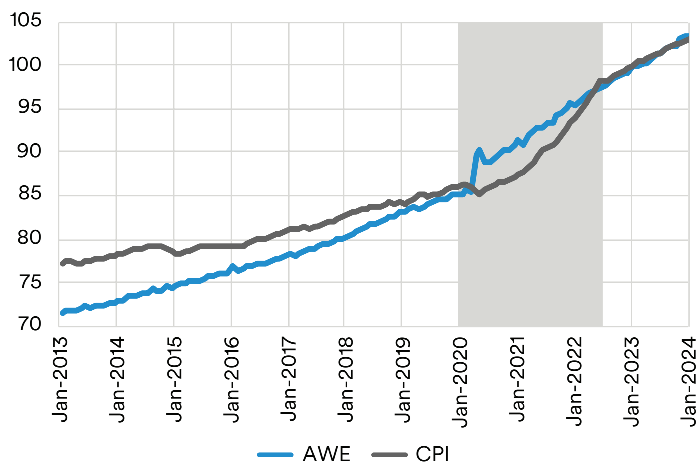
We think there's something else going on. By looking at the recent behavior of average weekly earnings and comparing it with the CPI, we see that there has been a change in the relationship of wages to inflation. From 2013 through 2019, average weekly earnings rose by 2.6% versus CPI of 1.6%. That is, earnings rose a full percentage point faster than inflation on average every

year—the average consumer's earning power was continuously rising.

Over the past year, since the beginning of January 2023, average weekly earnings barely outpaced inflation—rising only 0.1 percentage points faster. This is a far cry from what workers are used to. From this perspective it's no wonder that people remain unhappy about inflation, and no wonder that they feel cautious about consumption.

This dynamic—effectively the flattening out of real wages—may be favorable for the Fed's fight against inflation, but it may equally be a warning about the capacity for consumers to keep spending.

**Consumers May Not Be Imagining It (Jan 2023 = 100)**




Note: Shading denotes pandemic (not recession) from March 2020 through June 2022. *Source: MIM.*
*Source: BLS, Haver, MIM. Data as of Feb. 2024.*

| Annualized avg growth rates | Pre-Pandemic (2013-2019) | Since Jan 2023 |
|---|---|---|
| **AWE (nominal)** | 2.6 | 3.3 |
| **CPI** | 1.6 | 3.3 |
| **Difference** | 1.0 | 0.1 |

## U.S. Outlook Summary

We continue to expect a recession in 2024. A few concerns factor into this view. First, credit conditions remain tight despite recent stabilization. Second, delinquency rates are rising—with consumer loan delinquencies at their highest level in over 10 years and the second-sharpest increase in commercial real estate delinquencies since 2010. Finally, unemployment rates are rising in certain states and demographic segments, which could be a warning signal for broader weakening.

We believe the Fed has finished hiking rates this cycle, given that the core personal consumption expenditure (PCE) deflator moderated to 2.9 percent by year-end. We expect 150bps worth of Fed Funds rate cuts beginning around midyear 2024. Whether or not there is a recession, the Fed is likely to cut as it eases from the current tight conditions.

We expect a particularly mild increase in unemployment relative to prior recessions—these have seen unemployment increase by at least two percentage points—due to this cycle's unusually tight labor market conditions.

Yields have historically peaked ahead of cuts to the Fed Funds rate. We expect the 10-year yield to migrate to 4% by year end; this does not preclude swings through the year, driven by uncertainty about the timing and extent of Fed rate cuts.

## Risks to the Outlook

**MIM Forecast**

| U.S. | 2023* | 2024 | 2025 |
|---|---|---|---|
| **GDP** | 2.5 | 1.0 | 1.4 |
| **CPI** | 3.2 | 2.8 | 2.8 |
| **10 Year** | 3.88 | 4.00 | 3.50 |
| **Policy rates (upper bound)** | 5.50 | 4.00 | 2.00 |
| **Unemployment** | 3.7 | 4.4 | 4.3 |

Note: GDP is annual average growth rate, CPI is Q4 year/year, 10 year is year-end, policy rate is the upper bound year-end rate. Our core PCE forecast for 2004 is 2.5%.
*Denotes actual data; the rest are forecasts.
*Source: BEA, BLS, U.S. Treasury, Federal Reserve, Bloomberg, Metlife Investment Management. As of March 2024.*

We continue to recognize mitigating factors that work against our call for a recession in the first part of 2024. First, labor market robustness could continue to support consumer spending. Second, corporate profits remain robust for many companies, increasing the possibility of a more robust investment program in 2024. Finally, home completions picked up in 2023, while rents have started to fall, raising the probability.

### Endnotes

[1] Martinez, Dan and Margaret Seikel, "Credit card interest rate margins at all-time highs," Consumer Financial Protection Bureau, February 22, 2024.

[2] Federal Reserve Bank of New York, "Credit card and auto loan delinquencies continue rising; notably among younger borrowers," February 6, 2024; Aidala, Felix, Daniel Mangrum, and Wilbert van der Klaauw, "How and why do consumers use 'Buy Now, Pay Later'?" Liberty Street Economics, Federal Reserve Bank of New York, February 14, 2024.

[3] The Sahm rule is triggered when the three-month moving average unemployment rate rises by more than 0.5 percentage points than the lowest point in the last 12 months. Every time – so far – that this has been triggered at the national level, the U.S. has fallen into a recession. Subnational triggers of the Sahm rule provide a warning for a potential national level trigger.

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