October 28, 2020

MACRO STRATEGY

The Consumer in Crisis? Differences Between Downturns

The consumer is the cornerstone of the macroeconomy with personal consumption expenditures making up approximately 70% of domestic GDP. A view into the health of the consumer should help our understanding of how economic activity could develop over the coming quarters. Analyzing the state of the household is perhaps most valuable during a recession, when economic uncertainty is highest. Although downturns have similar aggregate consumer characteristics, their causes and the impact on different groups can vary widely. How these various groups are affected ultimately plays a large role in a recession's progression and what actions authorities may need to take in order to mitigate both the depth and length of a downturn. By parsing through detailed macro- and microeconomic data, we may be better able to infer the impact these differing effects may have on consumer groups following the COVID-19 pandemic.

MetLife Investment Management

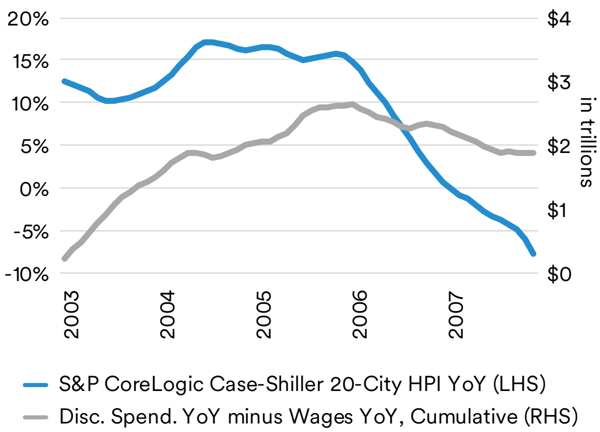
Key Takeaways

- The Great Financial Crisis (GFC) and the coronavirus pandemic created two unique crises that impacted consumers in dissimilar ways. While the bursting of the housing bubble hit asset holders and workers who were closest to the residential real estate market, the coronavirus economically struck those at the lowest end of the income spectrum.
- The services industry, specifically leisure and hospitality, remains the most battered of all sectors. A substantial decline in services spending, moving money away from a traditionally low-wage and tight-savings labor demographic, is a major factor of the current economic fallout.
- Low-wage earners are likely to experience little immediate or direct benefit from extraordinary monetary policy measures. This income group had the least exposure to housing during the GFC and currently has the lowest incidence, either directly or indirectly, of stock ownership. A boost for this demographic will mainly come from an improvement in the jobs market, not rising asset prices.
- Although the job openings rate has improved noticeably for the leisure and hospitality sector, there is still a substantial number of individuals collecting unemployment benefits. This is evident in the still-outsized level of accommodation & food services' share of continuing unemployment claims.
- A strong fiscal and monetary policy response from Capitol Hill has temporarily backstopped low-income consumers, buying time for the labor market to improve. The absence of further fiscal stimulus may deteriorate their financial standing.

A Tale of Two Crises

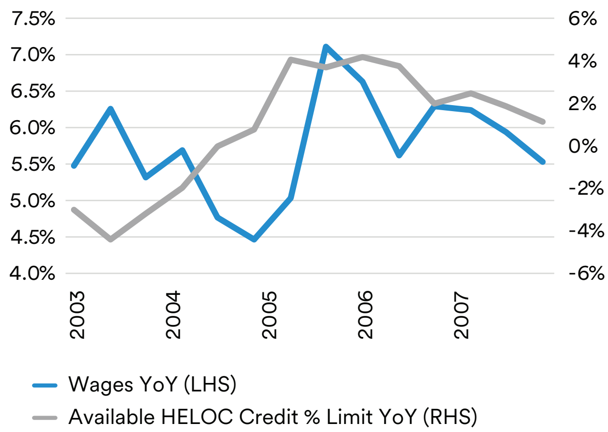
The lead-up to the GFC saw the emergence, and subsequent end, to the largest housing bubble in the history of the United States. Housing values grew at a rapid rate through the early-to-mid 2000s. As shown in Figure 1, home prices rose in lockstep with elevated levels of excess discretionary spending, both peaking at approximately the same time. This relationship held because rising housing prices, and the financial securitization that supported it, facilitated higher spending on the part of those positively impacted by increasing asset values via the phenomenon commonly known as the "wealth effect." This frothy economic environment, propelled by rising housing prices, is evidenced through the rapid growth in available HELOC credit as a percentage of the credit limit, which, like discretionary spending ex-wage growth, also peaked near the beginning of 2006 (see Figure 2). This growth in available credit was solely due to rising limits and was not a consequence of falling usage. In fact, outstanding HELOC balances grew alongside limits through much of the 2000s. In other words, the post-millennium economy saw ballooning housing prices bleed into the labor market, pushing up wages but also incentivizing excessive discretionary spending, arguably a sign of irrational exuberance. It was only when housing price growth began to slow that wages stagnated. With wage stagnation and lower home values, excessive discretionary spending declined and growth in both HELOC usage and limits began to turn.

Figure 1 | Housing Helped Boost Discretionary Spending



Source: Haver, MetLife Investment Management (MIM)

Figure 2 | Declining Available Credit and Wage Growth

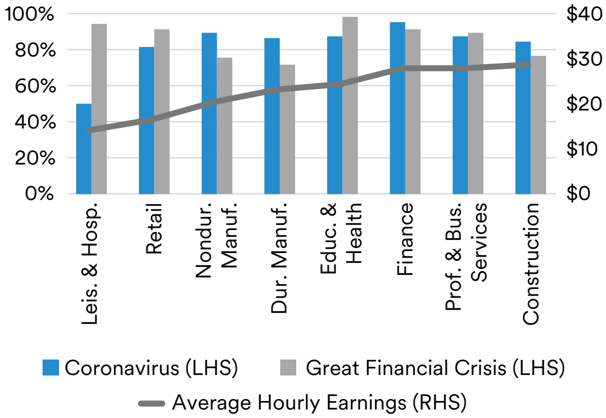


Source: Haver, MIM

However, economic dependence on rising housing values was not entirely uniform pre-GFC. Certain labor segments felt a larger impact from the fallout of the housing bubble than did others. Naturally, the ones most devastated were laborers who depended on ever-rising property values to support ongoing construction and residential real estate owners who had levered themselves to unsustainable levels. As shown in Figure 3, the fallout of the housing bubble had a significant effect on manufacturing (both durable and nondurable) and construction. In contrast, the devastation from the coronavirus landed squarely at the feet of leisure and hospitality workers. Laborers in other industries were hit much less harshly and were generally affected more evenly.

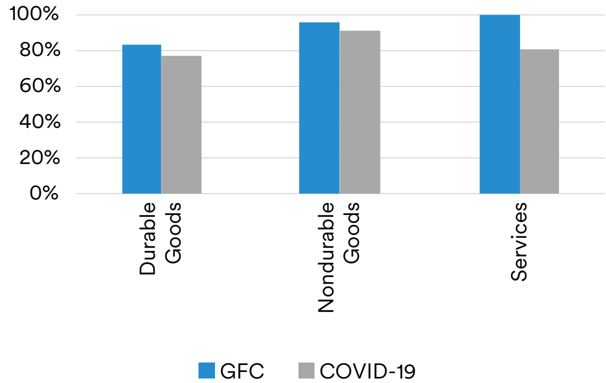
In the GFC, the economic ramifications of the housing bubble's demise touched individuals across the wage curve. This is not as much the case with the coronavirus pandemic, which has impacted those at the very bottom wage bracket the hardest (at least for now). The relationship between those affected during the GFC and the coronavirus is also illustrated in Figure 4, which shows the percentage of real personal spending at the trough of the crisis from the pre-recessionary peak for broad categories. As seen, goods were hit modestly during both downturns but services experienced an outsized decline during the COVID crisis relative to the GFC. This last observation is a key issue, for it is precisely in services where low-wage hospitality workers are found and it was this spending category that received an unusually large blow.

Figure 3 | Employment at Trough from Peak



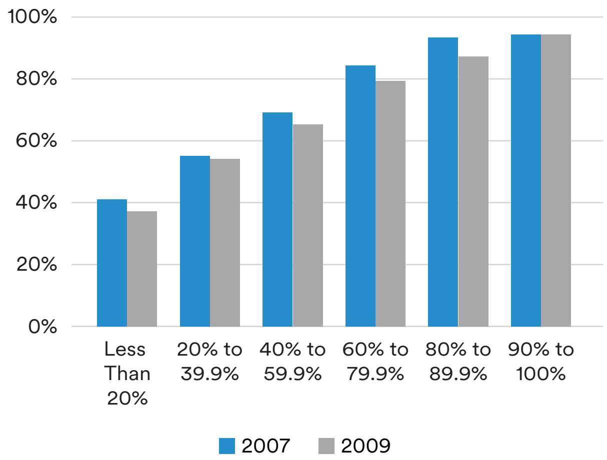
Source: Haver, MIM

Figure 4 | Real Expenditures at Trough from Peak



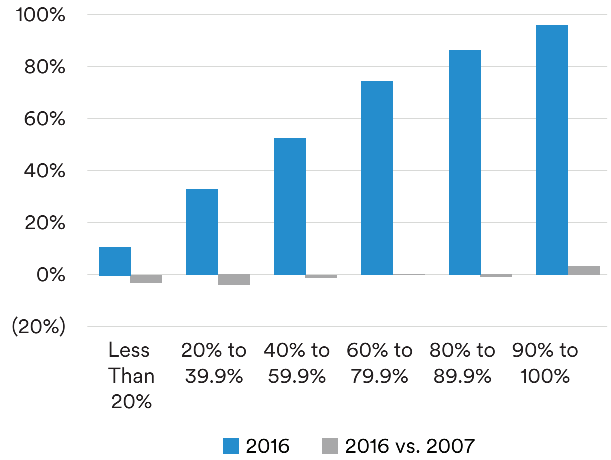
Source: Haver, MIM

Figure 5 | Primary Home Ownership by Income Percentile



Source: Haver, MIM

Figure 6 | Stock Ownership by Income Percentile



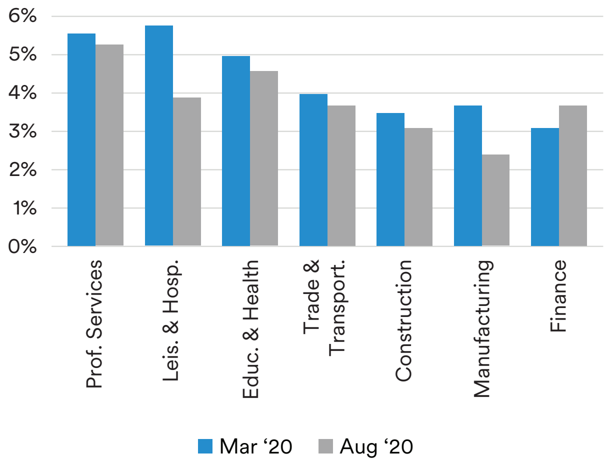
Source: Haver, MIM

Stimulus for Thee

During the housing bubble, lower income brackets had notably less exposure to falling housing prices with only an average of approximately 50% of consumers in the bottom two income brackets owning their primary residence (see Figure 5). This reality contrasts with the elevated exposure lower income brackets had in industries that were most affected by COVID-19, as shown previously. And, although financial markets have rallied strongly after a vicious sell-off in March of this year, those “wealth effect” gains are unlikely to be reaped by the bottom income rungs very soon. As shown in Figure 6, the bottom 40% of income earners own substantially less stock, either directly or indirectly, than other income groupings and have been reducing their exposure since 2007. That is to say, although recent support from both the U.S. Treasury and the Federal Reserve are likely to ease the anxieties of financial assets owners, those most impacted by the coronavirus pandemic from an economic standpoint are least likely to benefit in the short-run from extremely supportive monetary measures.

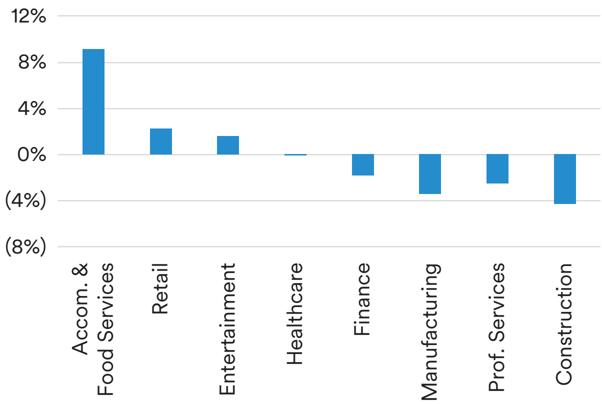
Despite these difficulties, some improvement is starting show in the services sector as a result of the loosening of economic lockdowns across the country. As shown in Figure 7, the leisure & hospitality industry is seeing solid levels in its job openings rate, according to the latest Bureau of Labor Statistics (BLS) Job Openings and Labor Turnover Survey (JOLTS). At least for the time being, it seems that there is appetite to bring back some percentage of laid-off workers. However, large disruptive events create lasting dislocations even after a recovery has begun. Significant issues remain, many of which have already been discussed and can be further brought to light by dissecting continuing unemployment insurance claims. Figure 8 shows the year-over-year change in the composition of continuing claims as of August 2020. As illustrated, accommodation & food services’ share of the pool of continuing claimants remains highly elevated and has only showed minor improvement. Higher job openings coupled with extreme levels of continuing claims could partially be due to a short-term, intertemporal issue of supply failing to meet demand. However, the sheer volume of unemployed workers is likely to require an extended period of solid job openings and time to allow unemployment claimants to connect with willing employers. A close watch on these metrics is of tantamount importance over the coming months.

Figure 7 | Rising Job Openings Rate



Source: Haver, MIM

Figure 8 | Elevated Shares of Continuing Claims



Source: Haver, MIM

The Policy Buoy

For those hardest hit, the speed and magnitude of the fiscal stimulus response at the onset of the coronavirus crisis likely backstopped their financial standing. Swift initiatives aimed at flooding the economy with liquidity served to reinforce the household. Passed in late March, the CARES Act provided a variety of tools for the federal government to use in supporting both workers and businesses. Sizeable direct stimulus payments, labeled economic impact payments (EIPs), were made to households to spur spending and provide much-needed funding for families across the country. Many of these were households who had suffered severe financial hardship as a result of pandemic-induced economic lockdowns. In contrast, swift and decisive fiscal policy measures were not the de facto responses during the collapse of the housing bubble. It took Congress months to pass a substantive economic relief bill during the GFC, only for it to have limited effect due to the delay and the relatively narrow scope of the legislation.

Many of the elements of the CARES Act had meaningfully positive impacts on the consumer beyond just the EIPs. The Paycheck Protection Program (PPP) allowed businesses with fewer than 500 employees to borrow funds from the federal government in order to meet certain costs associated with maintaining their workforce. Over $650b was disbursed to businesses under the PPP, much of which was eligible for partial or even full forgiveness if the firm met certain conditions. Importantly for laborers, one of the main conditions for loan forgiveness was the general maintenance of both the level and pay of the workforce. The Small Business Administration (SBA) estimated in a July press release that 51mm jobs were likely saved as a result of the PPP. Many of these job losses would have likely occurred in the income groups most unable to weather the economic downturn.

Another noteworthy provision of the CARES Act was the inclusion of additional unemployment benefits of $600 per week. These were to be provided to unemployed workers above and beyond traditional state programs. For many Americans, the inclusion of the additional payment meant that pre-unemployment incomes were often replaced entirely or, in some cases, exceeded. This benefit further stabilized the finances of unemployed Americans, the majority of which belong to lower income households, as noted earlier. This provided a means for these families to meet their soon-to-be due financial obligations.

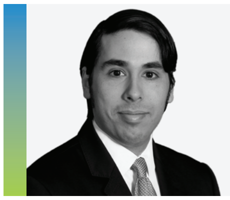
Lastly, the CARES Act, along with parallel initiatives, allocated funds toward research and development for coronavirus therapies and vaccines. Although this is unlikely to have direct or immediate benefits to those most negatively impacted by the pandemic, the eventual discovery of a medical solution will allow for an environment capable of supporting a functioning economy. Without such funding, a vaccine or viral therapy may take longer and, as a result, authorities may be forced to adhere to rolling waves of localized lockdowns, which will have the effect of continuously removing these pools of workers from their jobs. This kind of regular displacement could have had long-term damaging effects on the labor force, possibly reducing the participation rate for years to come.

Uncertainty Remains

For the time being, it seems that the COVID-19 pandemic is having an outsized impact on those at the bottom of the income range. As shown, individuals who work in service-intensive industries, specifically leisure and hospitality laborers, are coming under the greatest pressure. They continue to endure high levels of unemployment claims, have the lowest incidents of financial and nonfinancial asset ownership, and have already spent through much of their EIPs in order to make good on required payments, according to the financial services app SaverLife. Although the recent job openings rate for service sector jobs seems promising, it is certainly a consequence of the wave of economic reopenings across a variety of large states. Continued fears of a second wave of the coronavirus going into the winter may cut into state government resolve and could be the catalyst for another series of localized lockdowns, making it much more difficult for service sector employees to either retain their existing positions or find new ones.

Ultimately, the future for low wage earners depends on the course of the labor market and continued fiscal stimulus initiatives, with a strong albeit temporary emphasis on the latter. Since it will take some time for the virus to fully abate, and because economic recovery in such an atmosphere is likely to be stunted for some time, a strong level of government financial support will likely be needed to make sure these households stay afloat. Also, strong fiscal and monetary policy responses on the eve of the coronavirus pandemic provided much-needed liquidity for families across the country, including those most negatively impacted. As such, the consumer is likely in a meaningfully better position than they were during the GFC, potentially improving their financial standing in comparison and positively impacting the relative outlook for the household.

Global Economic & Market Strategy



ALEXANDER VILLACAMPA

Associate, Market Strategy and Research

Alexander Villacampa is an Associate with the Global Economic & Market Strategy team, helping the asset allocation process by furthering the firm's views on the global macroeconomic landscape and achieving this through a combination of rigorous data analysis and narrative construction. Previously, he worked as a wealth manager at Bank of America Merrill Lynch and as an investment specialist at Euro Pacific Capital. He earned his MBA in Economics from The University of Chicago Booth School of Business in 2018 and received his BA in Economics from The University of Florida in 2009. Alexander has passed the CFA Level II exam and is now studying for Level III.

JUN JIANG

Associate Director, Market Strategy and Research

Jun Jiang is a Market Strategist in Global Economic & Market Strategy team, where he helps to develop and communicate the firm's global macro-economic outlook and market views as well as assisting in the overall asset allocation and portfolio management process. Previously, Mr. Jiang was in the Global Portfolio Strategy unit, where he worked on portfolio strategy and portfolio analytics. Mr. Jiang joined MetLife in 2011. Prior to joining MetLife Investment Management, Mr. Jiang was a Credit & Portfolio Risk Management Analyst at Citigroup.

Mr. Jiang earned a Ph.D. degree in Polymer Physics from SUNY-Stony Brook in 2007 and an MBA degree from Cornell University in 2009. Mr. Jiang is a Chartered Market Technician (CMT) and Chartered Financial Analyst (CFA) charterholder.

About MetLife Investment Management

MetLife Investment Management (MIM),[1] MetLife, Inc.'s (MetLife's) institutional investment management business, serves institutional investors by combining a client-centric approach with deep and long-established asset class expertise. Focused on managing Public Fixed Income, Private Capital and Real Estate assets, we aim to deliver strong, risk-adjusted returns by building tailored portfolio solutions. We listen first, strategize second, and collaborate constantly as we strive to meet clients' long-term investment objectives. Leveraging the broader resources and 150-year history of the MetLife enterprise helps provide us with deep expertise in navigating ever changing markets. We are institutional, but far from typical.

For more information, visit: **investments.metlife.com**

[1] MetLife Investment Management ("MIM") is MetLife, Inc.'s institutional management business and the marketing name for the following affiliates that provide investment management services to MetLife's general account, separate accounts and/or unaffiliated/third party investors: Metropolitan Life Insurance Company, MetLife Investment Management, LLC, MetLife Investment Management Limited, MetLife Investments Limited, MetLife Investments Asia Limited, MetLife Latin America Asesorias e Inversiones Limitada, MetLife Asset Management Corp. (Japan), and MIM I LLC.

L1020009019[exp0521][All States], L1020009013[exp1022][All States], L1020009018[exp1022][All States], L1020009017[exp1022][All States]

MetLife Investment Management

One MetLife Way | Whippany, New Jersey 07981