

## COMMENTARY

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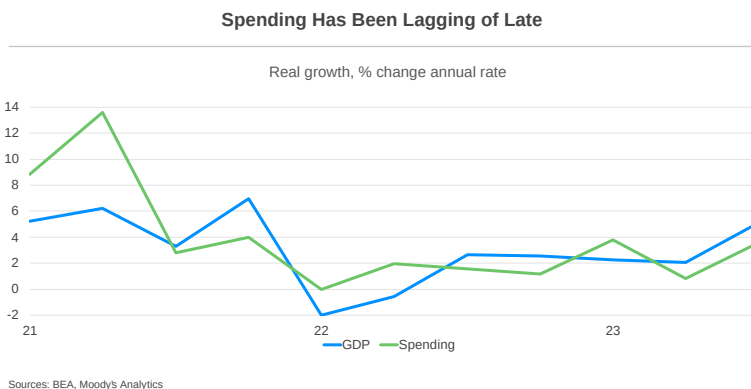
# How Aggressively Are U.S. Consumers Spending?

To the extent there are excess savings, they will be a buffer for consumers against an economic downturn.

- Real spending growth has lagged growth in real GDP in four of the last five quarters, and with saving low, prospects for an acceleration are low.
- Real incomes are currently below their pre-pandemic trend, also dampening the outlook.
- Saving is low, but how low and how much excess savings remain depend on the accuracy of the saving data, which is of low quality.
- It also depends on estimates of equilibrium saving and consumers' willingness to spend savings, which vary widely.

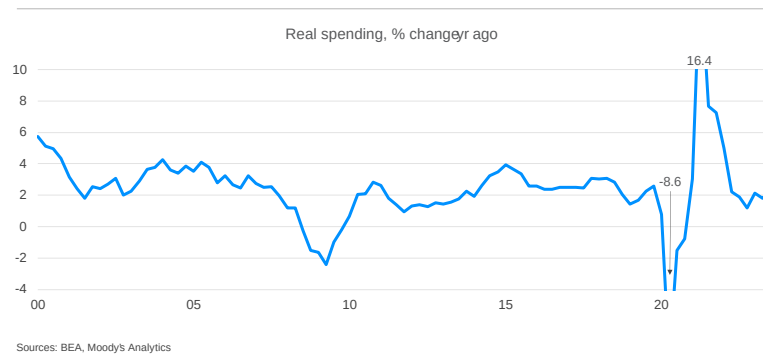
U.S. consumer spending is vital to the strength of the economy. As conventionally measured, spending accounts for over two-thirds of GDP, so it is difficult for the economy to withstand a decline in spending without falling into recession. Fears of a falloff in spending are one of the concerns frequently voiced by those worried about a recession. With real after-tax income barely growing in recent months after surging at the start of the year and the continuing debate about the amount of excess savings that remains and the willingness of consumers to spend it, these fears remain.

There is evidence that spending growth has been weak. Real spending growth has lagged growth in real GDP in four of the last five quarters. The exception came at the start of this year, when cost-of-living adjustments, particularly to government support and tax payments, generated a surge in after-tax income.



From a longer perspective, growth also looks pedestrian. Since the turn of the century, real spending growth has averaged 2.4% on a year-ago basis, whether or not the period since the onset of the pandemic is included. For the last year and a half, growth has rarely reached that level.

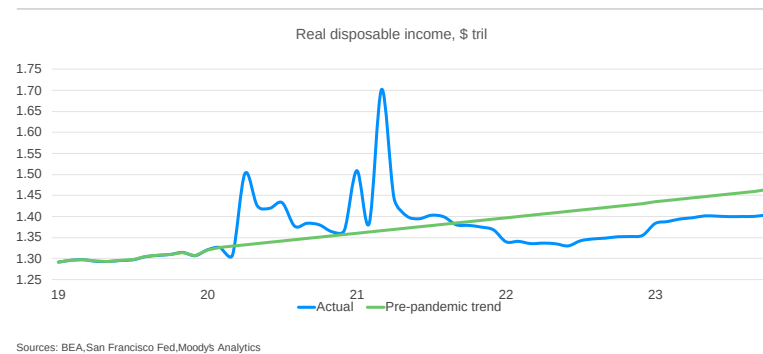
### Spending Growth Looks Modest



Another question is the extent to which the level of spending is low. This is not clear. Real spending growth from the start of 2020 to today has been nearly exactly the same as its pre-pandemic trend. This, of course, does not take into account that spending during the pandemic was well below trend. By our calculation, total real consumption since the start of 2020 is about 1.1% below what it would have been had the prior trend been maintained.

There are reasons to question whether this omitted spending will ever be made up. First, most of the lost spending is for services for which it is much more difficult to shift the timing. To a larger degree, such spending is either done on schedule or skipped entirely. Second, there is the question of income. Income surged as government stimulus flowed rapidly during the pandemic, but it subsequently retreated, undermined by high inflation. Real income has been below what was implied by its pre-pandemic trend since the fall of last year. Further, total real after-tax income received since the start of 2020 dropped below what was implied by the prior trend in July and was 0.3% below in October.

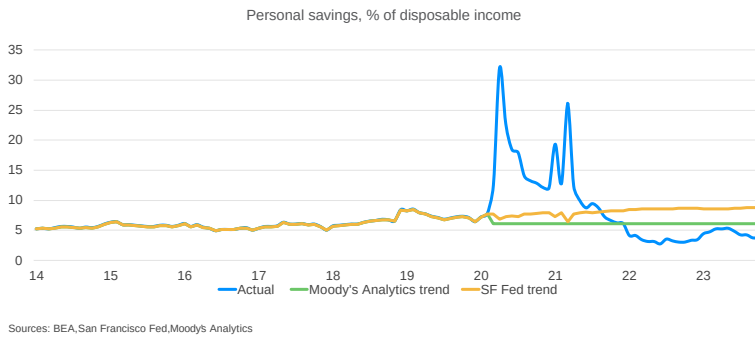
### Inflation Has Undermined Real Income Growth



Third, even if there are excess savings, it is not clear if consumers intend to spend it. Excess savings may have transitioned to wealth, set aside for long-term goals like retirement, education, or a large purchase such as a house. This also highlights questions about the outlook. Since spending is consistent with its prior trend and income is not, this could suggest spending is too high relative to income. This implication is confirmed by the low saving rate. In recent months, the saving rate has fallen back under 4%, clearly below its equilibrium level.

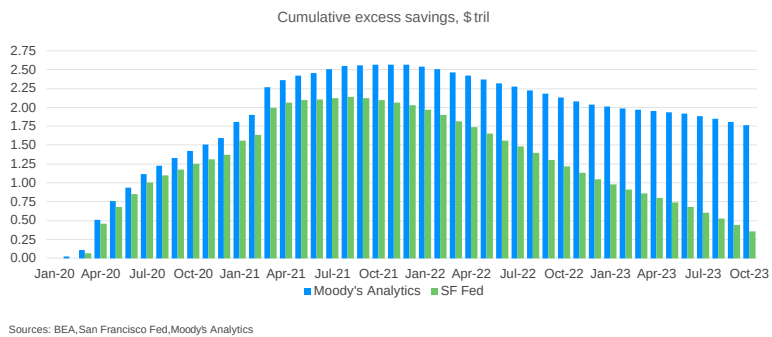
However, the level of that equilibrium has important implications for the outlook. For purposes of computing excess saving, Moody's Analytics assumes the equilibrium saving rate is its average over the five years prior to the pandemic, 6.2%, although we expect it will be many years before saving returns to that level. By contrast, the economists at the Federal Reserve Bank of San Francisco assume the pre-pandemic trend in the level of saving will be maintained. Based on this work, they assume the equilibrium saving rate is currently more than 8.5%. These compares with 3.8% in October and a 4.35% average rate over the last 12 months.

### Assumptions About Trend Saving Rate Differ



A higher equilibrium saving rate is a clear negative for the outlook. It requires a larger and longer period when income growth materially exceeds spending growth to return the saving rate to close to its equilibrium level. Further, it implies that most of the excess savings accumulated during the pandemic, when incomes were above trend and spending was below trend, have been exhausted. Our estimate of equilibrium saving leaves about 70% of the excess savings still on consumers' balance sheets, available to support an extended period of low saving or to buffer consumers in the event of a downturn.

### Two Views of Excess Saving



The differences in these estimates highlight how difficult it is to determine equilibrium saving and anticipate consumer saving behavior. The frequent large revisions to saving, while unavoidable given the methodology for estimating it, only compound the difficulties. Saving is measured as the difference between income and outlays and seemingly inconsequential revisions or changes in the forecast of either can shift the path of saving dramatically.

Assuming excess savings remain, even if consumers intend it for long-run objectives like retirement or education, it will serve as a buffer against an economic downturn. However, recent behavior and low saving suggest consumers are unlikely to be able to drive economic growth at the pace seen recently.

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