Debt Rising, Consumption Falling?

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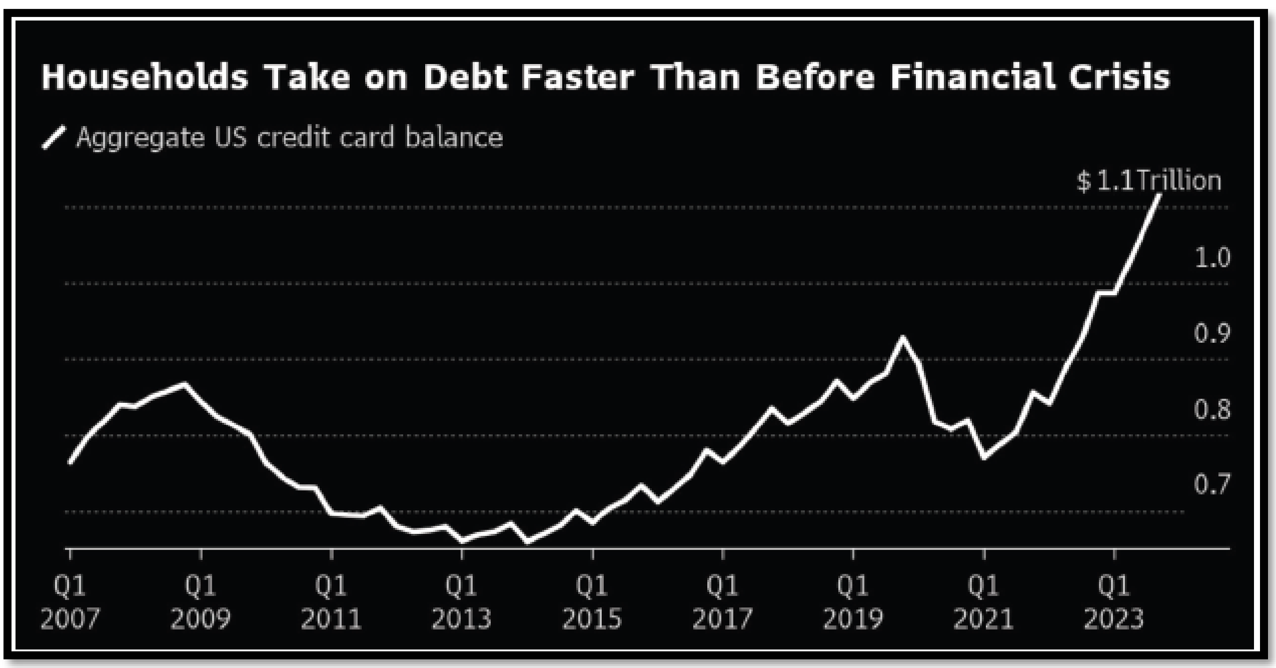
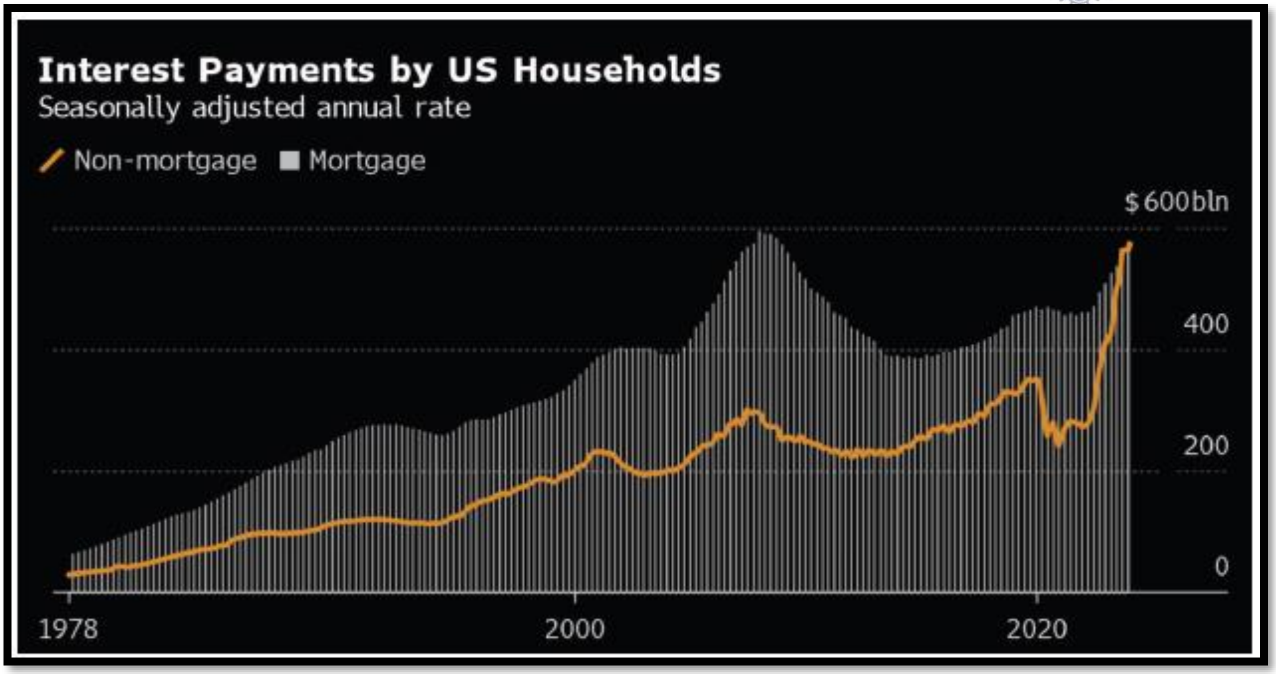
By all accounts, the U.S. economy is humming along on all cylinders. Inflation is down (but not out), unemployment is still low by historical standards and GDP growth is healthy. Worker wages continue to rise. What's there to be concerned about?

If you feel the need to worry, then consider consumer debt. Since the pandemic, U.S. families have gone on somewhat of a spending spree beyond what they can afford out of pocket. The result is a rapid growth in their aggregate credit card balance, far more rapid than we've experienced historically. According to the Federal Reserve Bank of New York, American consumers are now carrying $1.1 trillion in revolving credit on their credit cards, and the growth curve is steep.



This might not have been concerning when interest rates were low, but today's higher rates mean that it has become increasingly expensive to pay the monthly charges that are accruing so rapidly. The typical charge on a credit card is now a record 22% of the money owed.



If you add in mortgage debt—whose interest rates have recently ballooned as well—American consumers are now looking at an estimated $600 billion in annual interest payments. Most of us know that consumer spending is a big part of the economy's health and growth; some economists are worried that so much money sucked out of the pockets of American consumers will depress their ability to keep buying products and services at recent rates.

One might argue that rising wages will address this issue but remember that this explosion of debt has been happening during this period of rising wages, meaning that many consumer balance sheets are falling behind even as their income goes up. In fact, real compensation—wage growth minus inflation—has amounted to less than half a percent a year since the pandemic. Workers are basically coming out even between employers putting more in their pockets and inflation making the things they buy increasingly expensive.

Should we be worrying about this? It probably depends on whether you believe that American consumers will continue borrowing and spending (economic growth!) or they'll start cutting back and paying down debt (healthier consumer balance sheets but stalled GDP growth and a possible recession). Neither option would be fatal to the stock market; after all, we've survived multiple recessions before, and the markets have bounced back. But it's worth noting that the current debt binge is ultimately unsustainable. Something will have to change.

Sources:

https://www.advisorperspectives.com/articles/2024/03/15/american-debt-stings-like-never-before-new-era-for-households

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