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MACRO MORNING BRIEFING

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Household Restraint Selectively Emerging

Signs of household consolidation starting

- Pandemic-era savings have fallen sharply but a buffer remains
- US households still the outlier but credit reliance a risk
- Public-sector demand above household demand in much of G7

Household cashflow deterioration a dovish catalyst for policy

As the April-May round of policy decisions draws to a close, market fears of a Federal Reserve-led hawkish turn globally have proven unfounded; in most cases it's 'as you were'. Most central banks – especially in G10 – have made clear that upcoming meetings will be 'live' and that nothing is ruled out. Yet, the impact of ongoing strength in US data on the global policy environment is clear. Three examples: Latin American central banks are refraining from jumbo interest-rate cuts, Indonesia’s central bank noted that it probably did not need to hike further because the Fed was “less hawkish”, and the Riksbank warned that the strength of the US economy represented an upside risk to its own inflation outlook. That the Riksbank did not mention unanticipated resilience in Eurozone data is somewhat surprising with Sweden’s exports to the Eurozone almost five times its exports to the US.

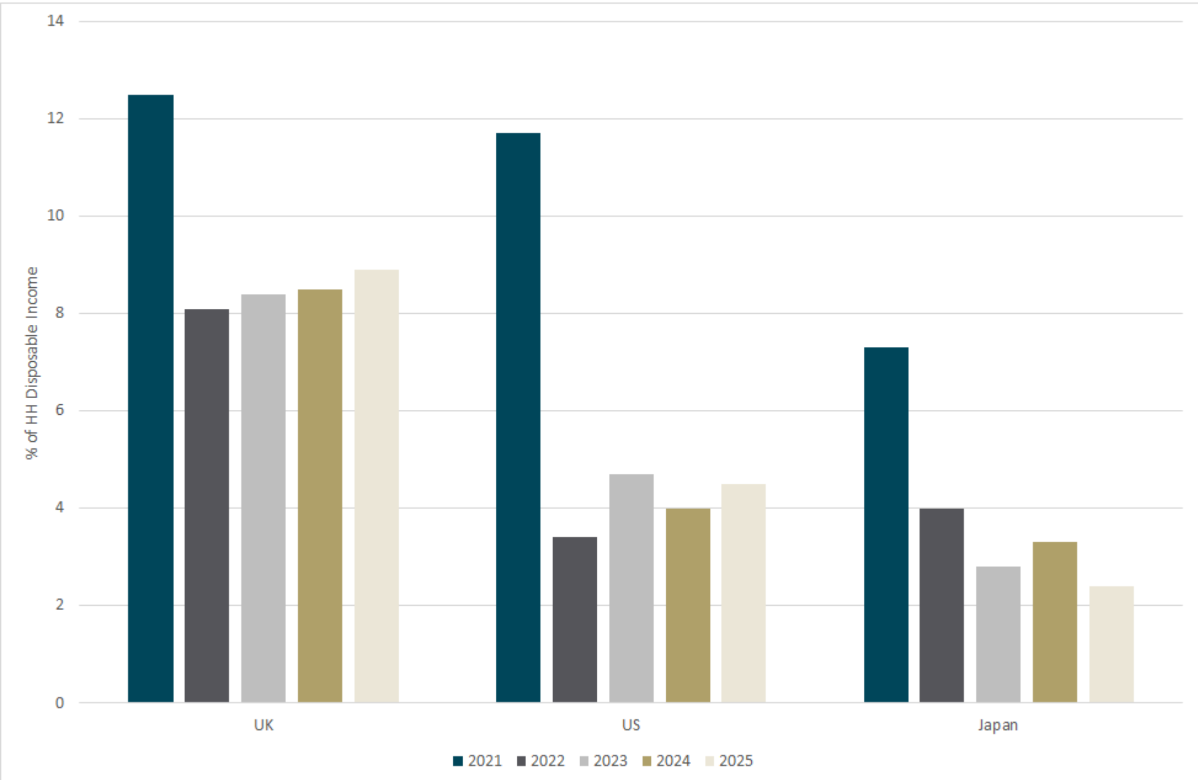
The FOMC decision earlier this month may have provided some relief, but the bottom line globally is that policy space has proven far more restrained this year due to the strength of the US economy, especially its consumer. However, there are now signs that household consolidation is starting, even though the pace remains frustratingly slow for policymakers. In some economies, there is enough evidence of easing in demand to move ahead of the Fed, while the US remains somewhat of an outlier in absolute and relative terms.

For example, we highlighted last week that one of the reasons the Bank of England may seek to bring forward its first rate cut to June, rather than wait for August, is that household spending was starting to face greater constraints. Although wage growth remains stubbornly high, elevated swap rates, which in turn anchor mortgage rates, are now eating into household cashflow on a current and potential basis. Retail sales figures will help determine spending power, but savings rates may need to rise not only to meet deposit requirements, but also to reduce net liabilities as debt-servicing costs are now very high. Similar dynamics are in play in the US, but there manifest via reductions in transactions as households refrain from mortgage-based purchases that would mean getting locked into a higher interest rate.

Based on the OECD's latest economic outlook for members (exhibits #1 and #2), savings for all economies have fallen from pandemic levels; there are differences in subsequent trends and levels, to be sure. In both the US and UK, the sharp declines between 2021 and 2022 represent what's become known as 'revenge spending' and general normalisation.

Strong wage growth also contributed to subsequent improvements in 2023, but divergence followed: UK households have continued to accumulate savings whereas a new decline in the US is expected this year – supports the elevated demand story. In both economies, savings levels are expected to rise again in 2025, most likely on a view for a slowdown in demand as both wage growth and net interest income are expected to slow and adversely affect household cashflow. We note also that the degree of 'demand excess' in 2022 was far stronger in the US than the UK. Even though the savings rate recovery, measured as a share of household income, is expected to be higher in the US than in the U.K. (1.1ppt from 2022 to 2025 vs. 0.8ppt), in absolute terms the US savings buffer is expected to be lower.

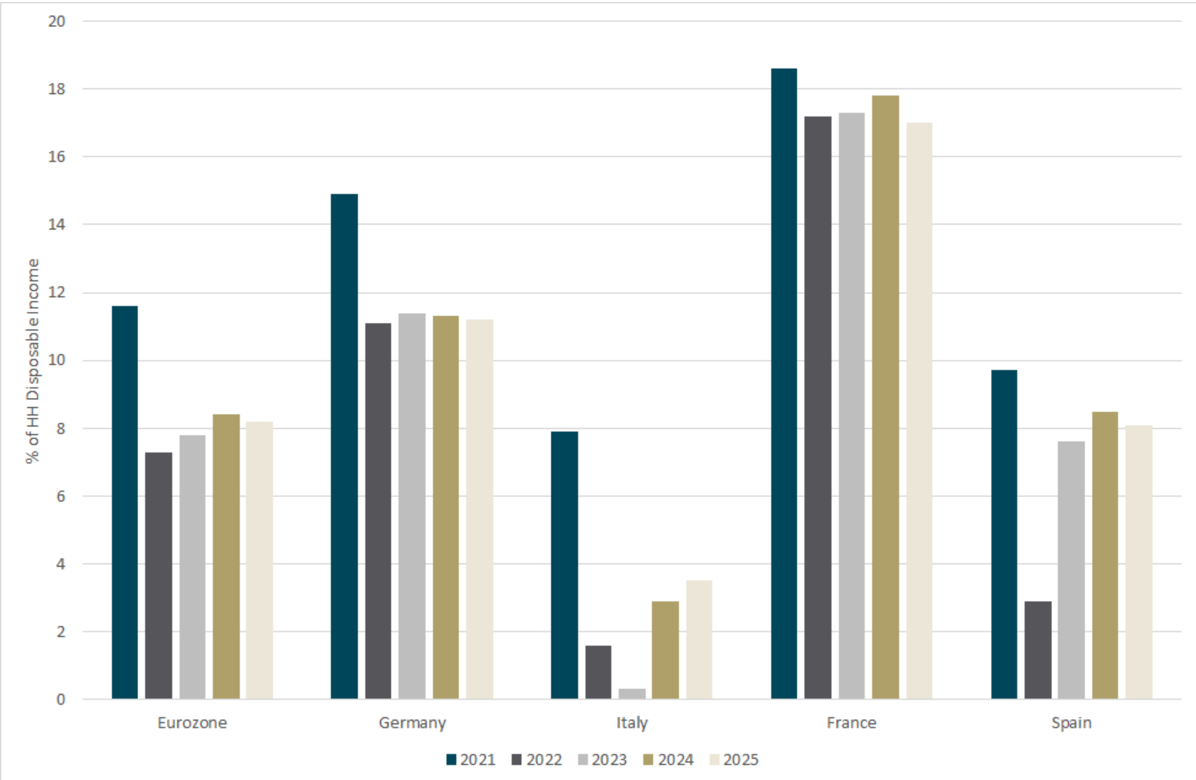
Exhibit #1: Household Savings, UK/US/Japan



Source: OECD, BNY Mellon

Historically, savings preference has been far higher in the Eurozone, anchored by Germany. The opposite side of this coin means that even when demand recovers, it is also weak in the currency area. Measured by the drop in the savings rate, France's spending impulse in 2022 was the weakest, as savings as a share of household disposable income only dropped by 1.4ppt, against 3.8ppt in Germany, 4.4ppt in the UK and a massive 8.3ppt in the US. Even when there is spending power, households in the Eurozone's strongest economies have been averse to deploy it. There are stark regional disparities which support our view that the European Central Bank is potentially overestimating the extent of household demand generated by strong services wage growth, whereas other sectors continue to contract. For example, Italy's savings rates fell to almost zero in 2023; the strong recovery this year points to demand restraint as wage growth is low. And in Spain, where savings rates are hovering around the Eurozone average, there doesn't appear to be major preference changes.

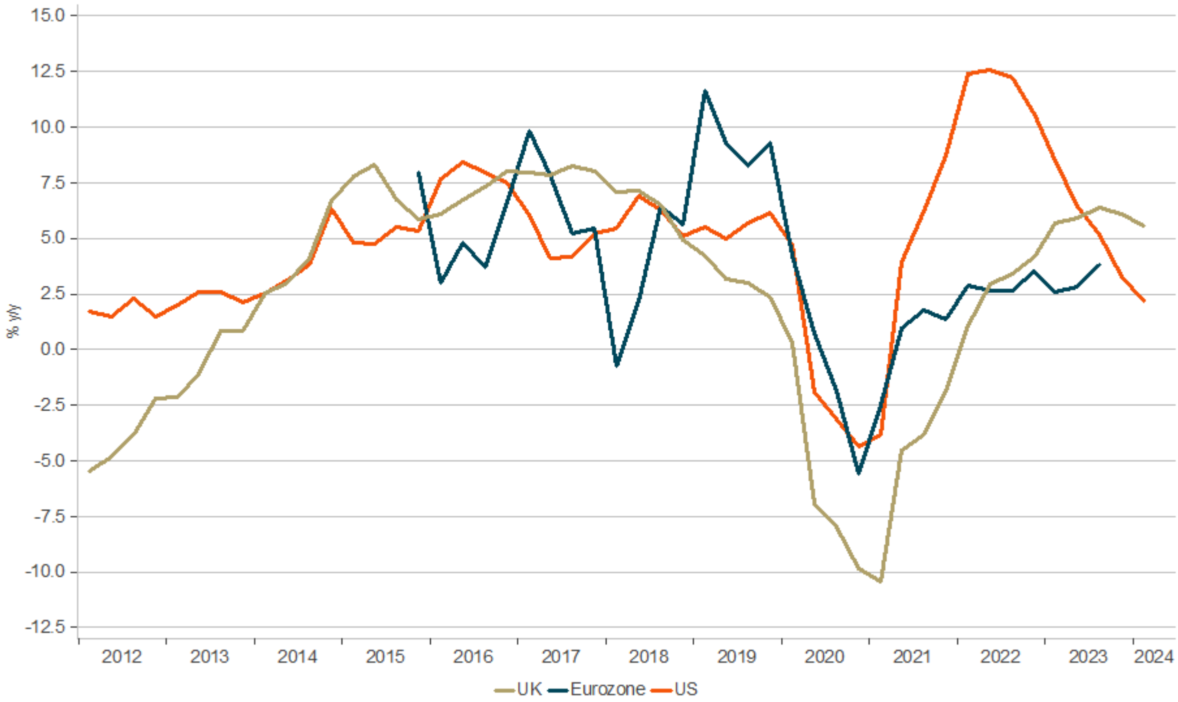
Exhibit #2: Household Savings, Europe



Source: OECD, BNY Mellon

While US savings levels are expected to be lower compared to G7 peers, the country remains an outlier for households – structural demand remains strong and there is ample credit availability to sustain it. The ECB's lending survey, by contrast, has warned that credit is already contracting in the Eurozone. The BoE has noted that "credit volumes have been subdued for both households and business" in the UK (though "there are some signs of a pickup"). Comparing non-mortgage consumer credit, volume growth since 2021 in Europe is incomparable to the strength seen in the US (exhibit #3). US growth rates are finally falling due to base effects, but the Fed would be mindful that there is no guarantee for a general drop in demand. It remains to be seen whether the savings increase is purely precautionary, or because of household cashflow improvement, which in turn can keep credit flowing.

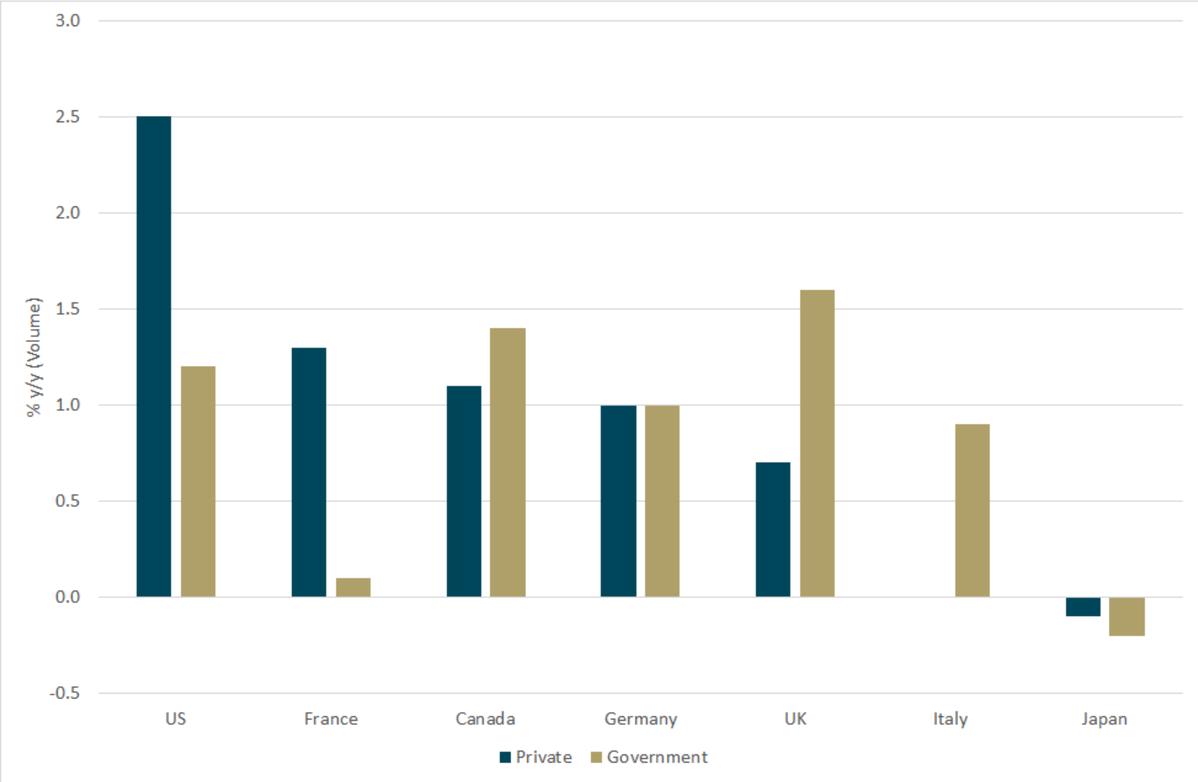
Exhibit #3: Consumer Credit Growth



Source: Macrobond, BNY Mellon

As the focus moves away from central banks, fiscal paths will likely remain under scrutiny. Despite the need for fiscal consolidation, the OECD continues to expect most countries' distribution of growth (exhibit #4) to be skewed in favour of government demand. France and Japan are the exceptions where government consumption volume is expected to remain flat or even contract. In Italy, for example, there is no private consumption improvement – not a surprise considering there is no credit or savings to fall back on. Even in the UK, government consumption is expected to grow at more than twice the pace of the private sector.

Exhibit #4: G7 Public vs. Private Sector Demand



Source: OECD, BNY Mellon

The US, yet again, is the outlier: while private consumption growth is expected to be double government consumption, the level of the latter is still one of the highest in the G7. It is almost a self-fulfilling cycle whereby ongoing fiscal expansion supports household cashflow, which is in turn channelled into consumption growth rather than savings. However, even in this supposed virtuous cycle, the US's fiscal situation continues to deteriorate – that cannot escape bond market scrutiny indefinitely.

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Please direct questions or comments to: iFlow@BNYMellon.com

Geoff Yu

EMEA MACRO STRATEGIST

CONTACT GEOFF