

Trickle Down Economics to the Rescue?

July 16, 2024

Monetary policy appears to be working—finally. Inflation appears to be moderating and the labor market has softened considerably over the last year. In recent months there has been increasing concern that those with lower—or even moderate—incomes are beginning to struggle. Does this mean the next stop for the economy is recession as consumers stop spending money?

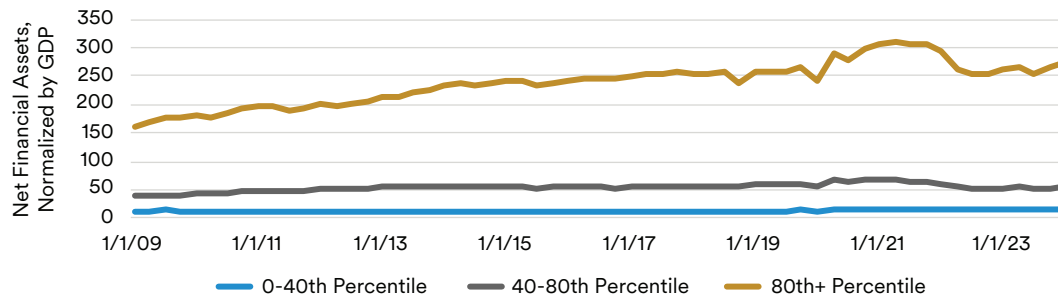
Looking at recent data, we suggest that high-earning households may have enough strength left to carry the economy for some time. There are a substantial number of relatively high-earners, and they are exhibiting continued strength. Of course, this depends on continued strong asset market performance and continued employment, but for now we see no notable areas of concern among the high-earning group of U.S. consumers.

It Takes Money To Make Money

There is an increasing concentration of net financial assets among the top 20% of income-earners, supported both by strong stock market performance and higher interest earnings on savings.

The bottom 80% of income earners have also seen unusually high growth of their financial assets.

Chart 1 | Net Financial Assets Support Continued Spending From the Top 20% by Income



Source: Federal Reserve, U.S. BEA. Data as of July 2024.

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Those high earners in the 40-80th percentile most recently saw a 2.1% year-on-year growth in their net financial assets, compared with a long run growth rate of 0.4% annualized since 1990. The lowest income bracket, from the 0-40th percentiles, which historically saw a decline in net financial assets of 0.1% annualized, has in the most recent year seen an increase of 0.2%.¹

Although strong by historical standards, these growth rates pale in comparison to those in the 80th+ percentiles, who have seen their asset growth rate more than double from 2.0% to 4.5%.

Wealth concentration has been a long-running trend since at least the 2008 financial crisis. However, high earners saw asset balances decline as the Fed began raising rates. The recent re-accumulation by high earners, likely caused by them adjusting their portfolios to a higher rate environment, is likely to improve their spending confidence.

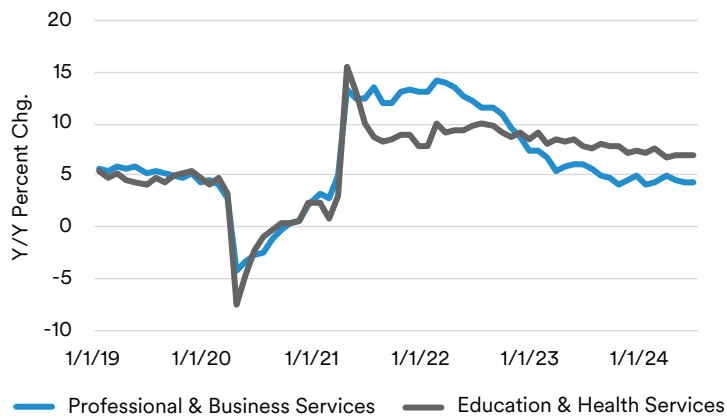
This improvement in net assets could continue to provide a tailwind for spending, particularly for the middle- and high-income populations. The wealth effect driver of spending is obviously somewhat precarious as it depends on continued strength in asset markets. Consumer confidence is also dependent on continued strength in earning power (see next section).

Wage Bill Growth Is Still Strong

Sectors with large wage bills remain supportive of continued spending.

Continuing job and wage growth in business services and private education and healthcare, relatively higher-earning, high-impact services sectors, could bolster consumer spending and smooth bumps in the economy

Chart 2 | Highest Impact Sectors Have Strong Wage Bill Growth



Source: BLS, Macrobond, MIM; July 2024

even if consumers employed in other sectors are impacted by an uncertain macroeconomic environment and tighter monetary policy.

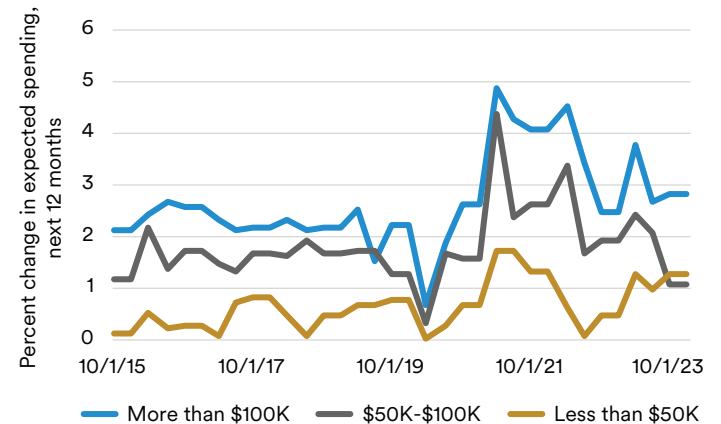
BLS data shows that by the end of June, total private non-farm payrolls in the U.S. were 135 million. Of those employees, 49.2 million, or 36%, work at jobs related to business services, healthcare, and private education. The wage bill (i.e., average weekly earnings multiplied by the number of people employed) paid into these two largest sectors make them more impactful on consumer spending. Some sectors have strong wages, but do not employ nearly as many workers. The information sector, for example, has average weekly earnings even higher than the financial sector but employs only three million people. Conversely, the leisure/hospitality sector employs many workers but pay is relatively lower, making it less likely to move the needle on consumer spending.

The wage bill for the biggest two sectors continues to grow at a healthy pace matching or exceeding its pre-pandemic growth rate, meaning consumers employed in higher paying services jobs still have spending capacity. The wage bill for professional and business services has normalized to 4.3% year-over-year, while that of the education/health services sector remains elevated at 6.8% year-over-year.

Relying on the Rich?

Looking ahead, high-income consumers expect to keep spending at elevated levels. Figure 3 shows the median expected spending by income level on non-essentials. Middle-income households are expecting a sharp decline in discretionary spending relative to the last few years. By contrast, those earning at least \$100k are expecting

Chart 3 | Non-Essential Spending To Remain Elevated Among High-Earners



Source: Federal Reserve Bank of NY SCE Household Spending

to keep spending at recent rates, or even at rates slightly elevated relative to the pre-pandemic trend.

This effect appears to be a result of greater expected spending power rather than higher prices. Looking at expectations of spending on essentials (not shown) does show inflation effects: lower income earners expect the greatest increase in spending relative to pre-pandemic times, while the highest earners expect the weakest increase in spending.

U.S. Outlook Summary

We continue to expect growth in 2024 to be softer than 2023 but remain healthy. First quarter GDP, although lower than expectations, showed strong residential investment and weaker but still healthy consumption, especially in services. Corporate investment has disappointed so far this year in light of strong profit margins. Election uncertainty may keep investment on the sidelines until year-end or 2025.

Residential investment has improved since the beginning of the year, increasing in Q1 2024 after contributing negatively to GDP in 2023.

The government sector, while pulling back vis-à-vis 2023, is still expected to contribute quite a bit to growth as industrial policies at the Federal level and continued tax revenue growth at the local level induce spending.

We expect the Fed to cut rates by a total of 75 bps by year end, although there is an increasing likelihood that this may be as few as 50 bps this year. Some Fed officials have in recent weeks indicated that they are more pleased with recent progress in inflation and further softening in the labor market, although it looks unlikely that they could become comfortable enough by the July 30-31 FOMC meeting to vote in favor of a cut.

Risks to the Outlook

Although we remain optimistic, we acknowledge several factors that keep us cautious. Credit card delinquency rates have risen quite sharply over the last few months, lending standards remain relatively tight, and the labor market has softened. Risks of a re-emergence of inflation remain a possible concern,

If high earners are correct that their earnings streams are secure, we can expect to see continued strength in spending from them. And this may even be enough: some 37% of U.S. households fit into this income bucket, and if they continue to spend on discretionary items, this could sustain consumer spending.²

MIM Forecast

U.S.	2023*	2024	2025
GDP	2.5	2.0	2.0
CPI	3.2	3.1	2.8
10 Year	3.88	4.50	4.20
Policy rates (upper bound)	5.50	4.75	4.00
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 2024 is 2.5%.

*Denotes actual data; the rest are forecasts.

Source: BEA, BLS, U.S. Treasury, Federal Reserve, Bloomberg, MetLife Investment Management. As of July 2024.

although these risks are coming into greater balance with downside risks to economic growth.

Both geopolitical and political uncertainty remains elevated even though many of the elections set for this year have already taken place—e.g. in Taiwan, India, U.K. and France. The longer run fallout of these, particularly of uncertainty around the French election outcomes, as well as of the ongoing conflict between Hamas and Israel, are still very unclear.

Perhaps most consequentially, uncertainty around the U.S. elections has increased with President Biden's much-discussed debate performance on June 27th, and with the failed assassination attempt on President Trump on July 13. Prediction markets show an enormous drop in President Biden's likelihood of being the Democratic nominee, from 86% on June 26 to 45% on July 10.³ With a change in the Democratic nominee, the range of policy outcomes are likely to expand as both parties maneuver to maximize Electoral votes as well as the number of Senate and House seats.

Endnotes

¹ Calculated by MIM from U.S. BEA and Federal Reserve data. Data as of July 2024.

² U.S. Census Bureau as of July 2024.

³ Source: Predictit.org, Macrobond. Data as of July 11, 2024.

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