MORNING BRIEFING
September 13, 2022

Keeping Up With The Joneses

Check out the accompanying chart collection.

Executive Summary: Q2 GDP revisions may well show that the US economy was not in a recession during H1 after all. If so, we have the consumer to thank. Consumer spending has held up well this year despite depressed sentiment and inflation-eroded purchasing power. But purchasing power soon should get a shot in the arm as wage inflation starts outpacing price inflation. … Also: A look at how much the average US household spends and on what. … News flash: "The Joneses" have been spending as though they've never been better off—because they haven't! Inflation-adjusted consumption per household has been running at a record high.

US Consumers I: How Are They Doing? There has been a huge debate in the US about whether the economy is in a recession or will soon be in one. Everyone seems to agree that there was a "technical" recession during the first half of this year because real GDP fell 1.6% (saar) during Q1 and 0.6% during Q2. Since those are minor declines, the presumed recession could easily vanish once the data are revised. Indeed, the preliminary estimate for Q2 was revised from -0.9% to -0.6%. As we noted in the August 29 *Morning Briefing*, the gap between gross domestic income and gross domestic product has widened over the past seven quarters through Q2-2022 by more than ever before, also raising the possibility that the latter will be revised upward.

Now let's focus on the outlook for consumer spending, since it is the main driver of GDP in America:

(1) *Consumer spending holding up.* Consumer spending accounted for 68.0% of nominal GDP in the US during Q2 (*Fig. 1*). That's up from 58.5% during Q1-1967. It's hard to have a recession in the US unless consumers retrench. In the past, that's happened whenever they were losing jobs. During the first eight months of this year, payroll employment rose 3.5 million to a record 152.7 million (*Fig. 2*). As a result, consumer spending held up quite well during the first half of this year, rising 1.8% and 1.5% during the first two quarters (both q/q, saar).

(2) *Consumers are depressed.* Nevertheless, rising inflation has been depressing the Consumer Sentiment Index (CSI), while solid employment gains have been boosting the

Consumer Confidence Index (CCI). Over the years, Debbie and I observed that the CSI is more sensitive to inflation, while the CCI is more sensitive to employment. That's why we like to average the two to derive our Consumer Optimism Index (COI) (*Fig. 3*).

The COI rebounded smartly last year through June to 107.2, but then it declined as bad news on inflation had a negative impact on all consumers, while the good news on jobs impacted mostly the newly employed. It fell to this year's low of 73.4 during July. It edged back up to 80.7 during August.

(3) *Inflation has been depressing purchasing power.* Rising inflation depresses consumers because it reduces the purchasing power of their incomes. Core personal income (excluding government social benefits to persons) rose 7.6% y/y through July but only 1.2% when adjusted for inflation (*Fig. 4*). Disposable income (DPI)—which is personal income including benefits and less taxes—was up 2.3% y/y through July but down 3.7% after adjusting for inflation (*Fig. 5*).

Average hourly earnings (AHE), a measure of hourly wages, is up 6.0% y/y through July but flat on an inflation-adjusted basis (*Fig. 6*).

It's no wonder that the CSI, CCI, and COI all show that consumers are very depressed. So how did consumers manage to increase their real outlays on goods and services during the first half of this year and by 2.2% y/y through July (*Fig. 7*)?

(4) *Excess saving and saving less.* Consumers saved a lot during the pandemic. That has allowed them to dip into those savings and to reduce their current rate of saving to boost their purchasing power. Over the past 24 months through July, they saved $1.9 trillion, or roughly twice as much as they saved on a comparable basis before the pandemic (*Fig. 8*). During July, they lowered their pace of saving to $0.9 trillion (saar), the lowest since December 2016. That's not likely to be sustainable.

(5) *The future of purchasing power.* So what will keep consumers spending? Job gains are likely to remain strong given that job openings well exceed the number of unemployed workers. The labor force participation rate might continue to rebound. It was 62.4% in August, still below the 63.4% reading during January and February 2020, just before the pandemic. Most importantly, we think is that wage inflation may be starting to outpace price inflation, boosting the purchasing power of households. Admittedly, that forecast is supported by just two data points, both during July: AHE rose 0.5% m/m, while the PCED edged down 0.1%.

US Consumers II: How Do They Allocate Their Budgets? We've previously observed that American consumers are born to shop. They do so when they are happy, and many do so even more when they are depressed, for the dopamine that shopping releases in their brains. It makes them feel good. When faced with rapidly rising prices, consumers seem to reason that they'd better buy before prices go even higher. However, they must have enough purchasing power to do so. So far, so good, as suggested by our analysis above.

What do they buy? It must be much more than groceries and gasoline, which aren't likely to release much if any dopamine. Let's examine the budget of the average household in America ("the Joneses") with two different but related sets of data. The first set is average spending per household (in current dollars and at an annual rate), available through July. The second set is the shares of various spending categories as percentages of DPI. Let's take a look:

(1) *Income, taxes, and saving.* During June, there were a record 128.1 million households in America. The Joneses had personal income of $169,770 during June and disposable income of $145,240, after paying $24,530 in taxes (*Fig. 9* and *Fig. 10*).

The 12-month average of annualized personal saving per household spiked to a record-high $27,600 during March 2021 as a result of the lockdown recession and three rounds of government pandemic support checks (*Fig. 11*). It was down to $10,000 during June, the lowest since February 2020, just before the lockdowns. For all households, personal saving accounted for 7.8% of DPI. So personal consumption accounted for 92.2% of DPI. (The savings rate is 100 minus the consumption rate.)

(2) *Major consumption categories.* Total consumption per household rose to a record-high $134,000 during June (*Fig. 12*). Here are the amounts and DPI budget shares of the three major categories of consumption: durable goods ($16,700 in June, 11.6% in July), nondurable goods ($30,000, 20.4%), and services ($87,300, 60.2%).

(3) *Durable goods.* From the Great Financial Crisis in late 2008 through just before the start of the Great Virus Crisis, the share of DPI spent on durable goods was remarkably flat around 9.5% (*Fig. 13*). Once the lockdowns were gradually lifted, the demand for consumer durable goods soared along with their prices, especially relative to services, which took longer to reopen. As a result, the share of DPI spent on durable goods shot up to 11.6% over the past year through July.

Here's what the Joneses spent on various durable goods during June (on average and at a

seasonally adjusted annual rate): used cars & light trucks ($1,900), new cars & light trucks ($3,000), furniture & furnishings ($2,500), household appliances ($600), and recreational goods and vehicles ($4,750).

(4) *Nondurable goods.* There was a significant downtrend in the share of DPI spent on nondurables from 35.6% at the start of the data in 1959 to 18.3% at the end of 2019, just before the pandemic. The same can be said for the share of outlays on food and energy, which fell from 28.7% in 1959 to 14.9% at the end of 2019 (*Fig. 14*). It jumped to 16.8% for these essentials as their prices rose faster than most other prices during July of this year.

During June, the Joneses spent a record $18,100 on food, with $10,200 in groceries "purchased for off-premises" consumption (i.e., at home) and $7,900 for purchased meals and beverages (at restaurants and included as services in the government's accounts). They spent $4,300 on gasoline and other energy goods. The Joneses purchased a record $3,900 in clothing and footwear and $5,000 in pharmaceutical and other medical products.

(5) *Services.* During July, Americans spent more on health care services than they did on rent. That might not surprise anyone, but notably rent includes both tenant rent and imputed owners' equivalent rent (OER). That last category is a figment of the imagination of the government's bean counters, who need to assign a charge to homeowners for housing services they receive from themselves. According to them, a homeowner is both a renter and a landlord.

So here are the DPI shares of some of the major categories in services as of July: OER (10.4%), tenant rent (3.3), household utilities (2.3), health care services (14.4), transportation services (2.9), recreation services (3.1), food services and accommodations (6.5), financial services and insurance (6.8), other services (7.4).

Here is what the Joneses spent on these categories during June: OER ($15,000), tenant rent ($4,800), household utilities ($3,350), health care services ($20,900), transportation services ($4,225), recreation services ($4,500), food services and accommodations ($9,400), financial services and insurance ($10,000), other services ($10,650).

US Consumers III: Are They Better Off Or Worse Off? The analysis above was based on consumer income and spending data in current dollars. The shares of DPI does adjust for inflation, since the numerator reflects the prices of the spending categories while the denominator reflects the overall consumer price level (i.e., the PCED).
To get a better idea of whether the standard of living of the Joneses has been increasing or

decreasing over time, we divide inflation-adjusted total personal income, disposable income, and consumption by the number of households (*Fig. 15*). All three series have been on solid upward trends since 1968. The first two have been declining over the past year as inflation reduced the purchasing power of consumer incomes. Nevertheless, average real consumption per household was little changed during June from April's record high of $109,025.

We conclude that the Joneses have never been better off based on inflation-adjusted consumption per household. We recognize that this flies in the face of conventional wisdom, especially on the left side of the political spectrum. Progressives will quickly note that the rich are skewing the income data since they are based on means rather than medians. Maybe so, but average real consumption per household surely isn't biased by the rich. That's because there aren't enough of them to make much of a difference to this average and because they don't consume much more of the categories reviewed above than the rest of us do.

Calendars

US: Tues: Headline & Core CPI -0.1%m/m/8.1%y/y/0.3%m/m/6.1%y/y; NFIB Small Business Optimism Index 90.1; Federal Budget Balance -$230.0b; OPEC Monthly Report. **Wed:** Headline & Core PPI -0.1%m/m/8.9%y/y & 0.3%m/m/7.1%y/y; MBA Mortgage Applications; Crude Oil Inventories; EIA Monthly Report. (Bloomberg estimates)

Global: Tues: Eurozone ZEW Economic Sentiment -58.3; Germany ZEW Economic Sentiment -60.0; Germany CPI 0.3%m/m/7.9%y/y; Spain CPI -0.2%m/m/10.8%y/y; Italy Quarterly Unemployment Rate 8.1%; UK Average Earnings Including & Excluding Bonus 5.2%/5.0%; UK Employment Change 3M/3M 256k; UK Claimant Count Change -13.2k; UK Unemployment Rate 3.8%; Japan Reuters Tankan Index; Japan Core Machinery Orders -0.8%m/m/6.6%y/y; Bailey; McCaul. **Wed:** Eurozone Industrial Production -0.8%m/m/0.6%y/y; UK Headline & Core CPI 0.6%m/m/10.2%y/y & 0.8%m/m/6.3%y/y; UK PPI Input & Output 0.2%m/m/23.9%y/y & 1.0%m/m/16.2%y/y; Japan Industrial Production 1.0%; Japan Trade Balance; Australia Employment Change 35k; Australia Unemployment & Participation Rates 3.4%/66.6%; RBA Bulletin; EC President Ursula von der Leyen; Enria; Lane; McCaul. (Bloomberg estimates)

Strategy Indicators

S&P 500/400/600 Forward Earnings (*link*): Last week, forward earnings rose w/w for LargeCap and SmallCap for a second straight week, but MidCap's fell for a second week. For an 11th straight week, none of these three indexes had forward earnings at a record high. LargeCap's forward earnings is now 0.8% below its record high at the end of June. MidCap's is 0.3% below its record high in early June, and SmallCap's latest gain puts it 2.5% below its record high in mid-June. In the latest week, the yearly rate of change in LargeCap's forward remained steady at 11.0% y/y, up from a 17-month low of 10.9% at the end of August; that's down from a record-high 42.2% at the end of July 2021 and up from -19.3% in May 2020, which was the lowest since October 2009. The yearly rate of change in MidCap's forward earnings dropped w/w to a 17-month low of 21.4% y/y from 21.6%. That's down from a record high of 78.8% at the end of May and compares to a record low of -32.7% in May 2020. SmallCap's rate fell to 16.2% y/y from 16.4%. That's up from a 17-month low of 16.1% at the end of August and down from a record high of 124.2% in June 2021. It had been at a record low of -41.5% in June 2020. Companies have been beating consensus estimates quite handily since the Q2-2020 earnings season, causing analysts' consensus earnings forecasts for 2021 to 2023 to improve instead of decline as is typical, but their forecasts are likely to stall or head lower now. Here are the latest consensus earnings growth rates for 2022 and 2023: LargeCap (8.3%, 8.1%), MidCap (16.3, 2.4), and SmallCap (10.9, 8.6).

S&P 500/400/600 Valuation (*link*): Valuations rose for the first time in four weeks for all three of these indexes and from seven-week lows. LargeCap's forward P/E rose 0.6pt to 17.1 from 16.5, which compares to a 16-week high of 18.1 in early August, a 26-month low of 15.3 in mid-June, and an 11-year low of 11.1 during March 2020. MidCap's forward P/E was up 0.5pt w/w to 12.5 from 12.0, which compares to a 16-week high of 13.2 in early August, a 27-month low of 11.1 in mid-June, a record high of 22.9 in June 2020, and an 11-year low of 10.7 in March 2020. SmallCap's forward P/E rose 0.3pt w/w last week to 11.9 from 11.6. That's down from a 16-week high of 12.8 in early August and up from its mid-June reading of 10.7, which was the lowest since it bottomed at a record low of 10.2 in November 2009 during the Great Financial Crisis. That compares to its record high of 26.7 in early June 2020 when forward earnings was depressed. LargeCap's forward P/E in February 2020—before Covid-19 decimated forward earnings—was 18.9, the highest level since June 2002. Of course, that high was still well below the tech-bubble record high of 25.7 in July 1999. Last week's level compares to the post-Lehman-meltdown P/E of 9.3 in October 2008. MidCap's P/E was below LargeCap's P/E yet again last week, as it has been

for most of the time since August 2018. In contrast, it was last solidly above LargeCap's from April 2009 to August 2017; MidCap's current 27% discount to LargeCap is near its biggest since September 2000. SmallCap's P/E was below LargeCap's for an 108th straight week. That's the longest stretch at a discount since 1999-2002; SmallCap's current 30% reading is near its biggest discount since February 2001. SmallCap's P/E had been mostly above LargeCap's since 2003. Looking at SmallCap's P/E relative to MidCap's, it was at a discount for a 65th straight week; the current 5% discount is up from a 9% discount in December but remains near its lows during 2000-01.

S&P 500 Sectors Quarterly Earnings Outlook (*link*): Since the Q3-2020 earnings season, analysts as a whole have been raising their consensus forecasts for future quarters instead of lowering them as is the norm through the earnings warnings seasons. That six-quarter streak of positive revisions throughout the quarter officially ended with Q1-2022, and the declines have accelerated for Q3-2022. In the latest week, the Q3-2022 S&P 500 earnings-per-share forecast fell 4 cents w/w to $56.23, and is now 5.5% below its $59.49 forecast at the start of the quarter. Analysts expect S&P 500 earnings growth to weaken to 4.3% y/y on a frozen actual basis and 5.1% on a pro forma basis. That's down from Q2-2022's blended actual/estimate of a 9.9% y/y gain on a frozen actual basis and 8.5% y/y on a pro forma basis. Double-digit percentage growth is expected for just four sectors in Q3-2022, and y/y declines are expected for six. That compares to Q2-2022's count of four sectors with triple- and double-digit growth, three with a single-digit gain, and four with a y/y decline. Here are the S&P 500 sectors' latest earnings growth rates for Q3-2022 versus their blended Q2-2022 growth rates: Energy (120.3% in Q3-2022 versus 296.7% in Q2-2022), Industrials (28.0, 31.5), Consumer Discretionary (17.7, -12.3), Real Estate (10.6, 13.0), Materials (6.6, 17.4), S&P 500 (5.1, 8.5), Information Technology (-3.3, 1.5), Consumer Staples (-2.9, 2.0), Health Care (-4.0, 8.7), Utilities (-7.0, -3.7), Financials (-8.9, -19.1), and Communication Services (-15.8, -20.3).

Global Economic Indicators

UK GDP (*link*): Real GDP in July rose only 0.2%, less than half the expected gain of 0.5%, though it was a rebound from June's 0.6% drop (which was impacted by two fewer working days). July's increase was driven by a 0.4% expansion in services output, following June's 0.5% drop, while agriculture, up 0.1%, was a minor contributor. Meanwhile, both industrial production and construction contracted for the second month, with the former down 0.3% m/m and 1.2% over the period, while the latter fell 0.8% and 2.2% over the comparable

periods. Production was a mixed bag, with two of the production sectors in the black and two in the red. Output of mining & quarrying rebounded 3.5% from June's 1.8% shortfall, while manufacturing production eked out a 0.1% uptick, with seven of its 13 subsectors in the plus column. As for the main industrial sectors, capital goods production increased for the third month, by a total of 4.7%, moving back to the top of its volatile flat trend, while consumer durable goods output held steady in July after rebounding 4.5% during the two months through June, erasing April's 4.3% drop. Meanwhile, consumer nondurable goods production fell for the second month by 1.9% and is down 5.2% year to date, while intermediate goods output ticked up only 0.2% in July after sinking 4.1% in June. Meanwhile, output of both electricity, gas, steam & air conditioning (-3.4%) and water supply, sewage & waste management (-2.1) headed lower.

Contact us by *email* or call 480-664-1333.

Ed Yardeni, President & Chief Investment Strategist, 516-972-7683
Debbie Johnson, Chief Economist, 480-664-1333
Joe Abbott, Chief Quantitative Strategist, 732-497-5306
Melissa Tagg, Director of Research Projects & Operations, 516-782-9967
Mali Quintana, Senior Economist, 480-664-1333
Jackie Doherty, Contributing Editor, 917-328-6848
Valerie de la Rue, Director of Institutional Sales, 516-277-2432
Mary Fanslau, Manager of Client Services, 480-664-1333
Sandy Cohan, Senior Editor, 570-228-9102

Copyright (c) Yardeni Research, Inc. Please read complete copyright and hedge clause.