Rising Debt Levels and Rates Weigh On Consumer Spending
Retail Sales Weaken in Recent Months

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While inflation has been moderating in recent months, its toll on consumers widened as the year progressed.

As reported last week, retail sales for December came in weaker than analysts expected and November sales estimates were revised lower. And that's before factoring in inflation, which would show real retail sales in December just 1.4% higher than a year before.

In aggregate, household balance sheets were boosted by the generous relief payments accumulated early during the pandemic, as savings in excess of pre-pandemic levels skyrocketed to an estimated $2.5 trillion, assuming a pre-pandemic savings rate. However, these balances have been eroding, with some analysts suggesting that any remaining portions of these savings are being held by wealthier households who are less likely to spend, leaving lower-income families with fewer safety nets and needing to lean on credit cards and other debt to finance current spending.

Total outstanding debt held by commercial banks rose by 13.5% from the end of 2019 to November 2022, about 1 percentage point less than during a similar period prior to the pandemic, or from the end of 2016 to November 2019.

Growth in nonrevolving debt, much of which is in auto loans and student loans, has been growing at a typical pace.

Many households were able to pay down credit card balances and reduce their revolving debt in 2020 and 2021. But by November 2022, revolving debt accounted for 2.3 percentage points of the growth in outstanding debt since the end of 2019 — less than during the similar period prior to the pandemic but rising speedily.

On a year-over-year basis, outstanding revolving debt grew by 7.9% in November — growth rates not seen since late 1997.

Just as concerning as the pace of growth in debt is rising interest rates. Following the Federal Reserve's interest rate hiking program, commercial banks raised credit card interest rates on average from 14.5% in April 2022 to 19.1% in November 2022.

Higher interest rates make the revolving nature of credit card debt lose its appeal, as cardholders see more of their monthly payments go towards interest rather than to paying off the balance.

At the same time, rates on personal loans with a 24-month term on average increased from 9.4% to 11.2% over the same period, and rates on new auto loans with 60-month terms increased from 4.5% to 6.6%.

The rapid increase in credit card interest rates and in the cost of other loans are likely to put a damper on spending on travel, dining out, and other entertainment activities, while costlier personal and auto loans could discourage consumers from purchasing big-ticket items — which isn't good news for the overall economy, as we're depending on continued consumer spending to avoid a recession.

According to the New York Federal Reserve's Survey of Consumer Expectations, households are indeed expecting to curb spending over the next 12 months. The median expectation for household spending growth one-year ahead has fallen from 9% in May 2022 to 5.9% in December 2022.

Ever optimistic, though, consumers' expectations for what inflation will be a year ahead have fallen from a peak of 6.8% in June 2022 to 5% in December 2022, suggesting they trust the Federal Reserve to steer the economy into a "softish" landing.

As we've noted several times, this is an important indicator that the Fed watches to determine if inflation is becoming entrenched. So far, this isn't the case. Consumer expectations for inflation three years ahead is 3% and for 5 years ahead is 2.9%, close to the Fed's target policy rate. We'll see how resilient that optimism is as the economy rebalances.