

On the minds of investors

August 22, 2019

Is the consumer starting to crack?

One defining feature of this economic expansion has been the propensity of consumers to support growth in the face of growing economic headwinds. Even with the ebb and flow of trade tensions, consumer sentiment has been resilient, particularly in the U.S. Given that consumption accounts for the bulk of the economy in many developed markets, elevated levels of consumer sentiment have gone some way to mitigating the concerns about a near-term recession. However, cracks in consumer optimism may be starting to appear.

The fallout from rising protectionist policies from the U.S. has placed a heavy weight on the corporate confidence and sentiment surveys for the manufacturing sector have fallen sharply in recent months. However, that uncertain and unpredictable nature of the trade rhetoric has yet to spread from the manufacturing sector into services industries or the labor market.

Furthermore, as the tariffs applied on Chinese imports to the U.S. have been focused on intermediate and capital goods the consumer has been insulated from the direct effects of rising tariffs. That changed, however, with the announcement of additional tariffs on remaining circa USD 300 billion of goods which would largely apply to consumer goods.

Even as tariffs on approximately half of the goods to be implemented on 1 September were deferred, consumer confidence displayed weakness. The Bloomberg Consumer Comfort index has declined for the past two weeks, while the University of Michigan Index of consumer confidence fell sharply in August.

The dip in confidence in U.S. consumers is something to monitor. Accounting for approximately 70% of the economy by expenditure a shock to consumption would greatly increase the chance of a recession occurring in the near term.

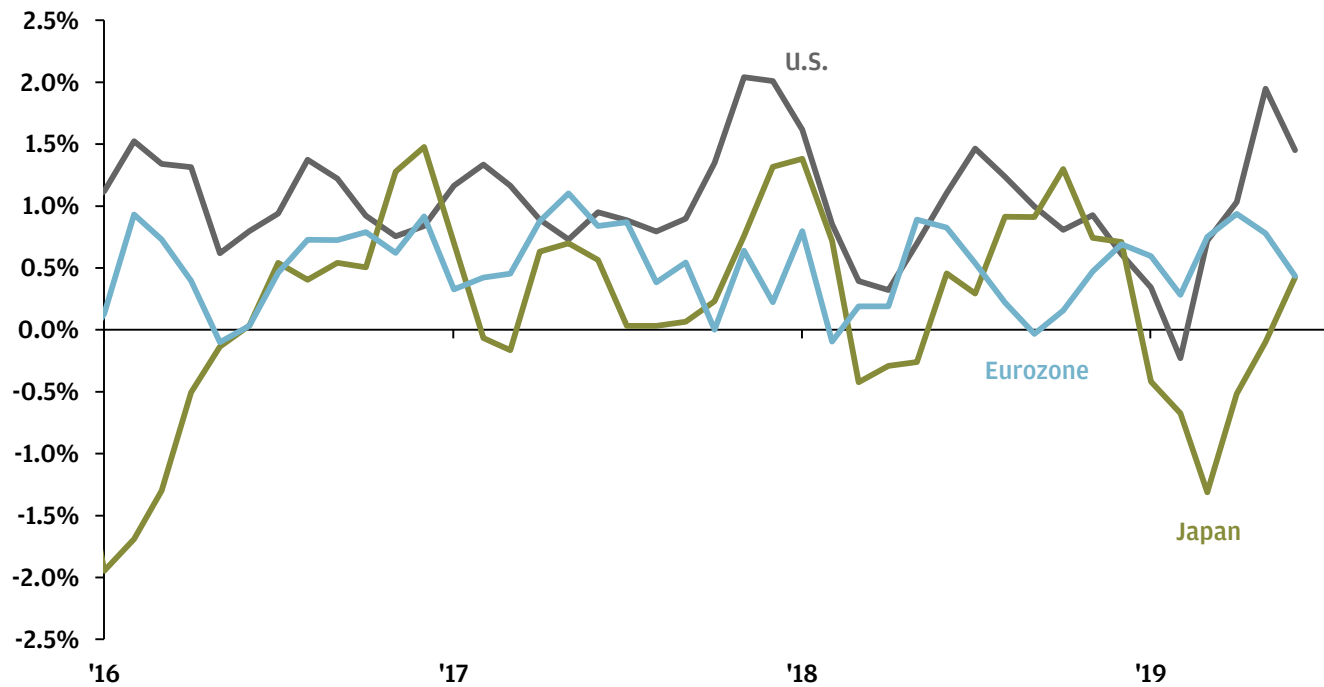
However, the dip in consumer sentiment indicators should be viewed in the broader context of consumer health. The U.S. labor market remains very tight and the unemployment rate of 3.7% is near the lowest in near 50 years. In fact, data from the Job Openings and Labor Turnover Survey (JOLTS) showed that there were 7.3 million vacancies in the U.S. labor market at the end of July, more than the current 6.1 million unemployed people. The tight labor market has underpinned low but steady wage growth helping to stabilize the consumption outlook.

It's also worth noting that U.S. household balance sheets remain fairly robust. A prolonged period of deleveraging after the global financial crisis reduced household debt levels, and what debt remains is relatively low cost. The debt service ratio, debt payments as a percent of disposable income, was below 10% in the second quarter of the year.



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EXHIBIT 1: CONSUMPTION REBOUNDED SINCE THE START OF THE YEAR
 RETAIL SALES VOLUMES 3MMA, 3 MONTH ON 3 MONTH CHANGE



Source: FactSet, U.S. Census Bureau, Japan Ministry of Economy, Trade and Industry, Eurostat, J.P. Morgan Asset Management. Data reflect most recently available as of 21/8/19.

Investment implications

The resilience of consumers globally and in the U.S. will be tested while the economic outlook remains in a stage of flux. However, the more favorable position of household balance sheets in the U.S. and average levels of the savings rate suggest that consumers could withstand a short-term shock. The recent dip in sentiment levels may be temporary as news about a delay to new tariffs takes time to appear in the economic data.

A slowing in consumption given the heightened level of uncertainty on the economic outlook and length of this expansion is to be expected. However, a moderation in spending patterns is very different to weaker spending or a contraction in consumption. Recent data on spending is broadly positive, reinforcing our view of slowing rather than stalling economic growth. As such, we reiterate our cautious approach to risk assets, but are not yet advocating an all out risk-off stance to positioning.

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Material ID: 0903c02a8269574e