GW&K INVESTMENT MANAGEMENT

GLOBAL PERSPECTIVES

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CONSUMER SPENDING FACES CROSSWINDS AFTER STRONG 2024

HIGHLIGHTS

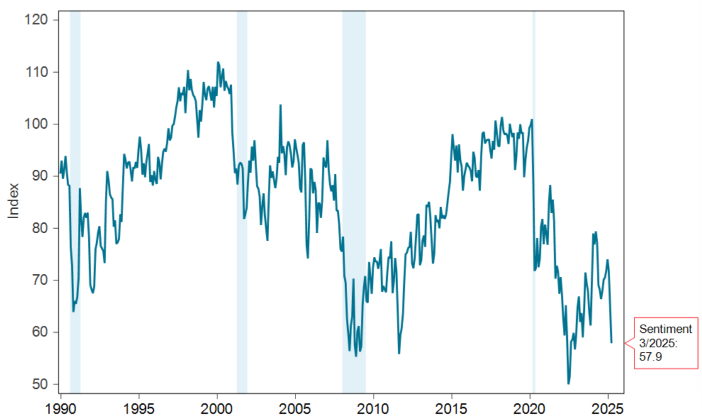
- The strong job market and locked-in low mortgage rates continue supporting consumer spending but rising credit card delinquencies and auto loan defaults signal growing stress among younger and lower-income households.
- Newly proposed tariffs on Canadian, Mexican, and Chinese imports could cost the average American household up to $2,000 annually in purchasing power, potentially accelerating the widening spending gap between income groups.
- While higher-income households still hold significant pandemic-era savings and benefit from rising asset prices, middle-income consumers are increasingly showing price sensitivity and trading down to more affordable brands.

MIXED SIGNALS FOR CONSUMER SPENDING IN 2025

US consumer spending demonstrated resilience through 2024, capped by solid holiday retail sales that rose 3.8% from the previous year. This performance was bolstered by a strong labor market, rising household wealth, and residual pandemic-era savings. However, challenges such as elevated interest rates and emerging financial stresses among lower-income households may temper spending growth in 2025. Additionally, recent policy initiatives on tariffs and immigration introduce uncertainties that could significantly impact consumer behavior. Such uncertainties have recently resulted in a sharp decline in consumer confidence, suggesting the need for a balanced review of fundamental forces driving consumer spending (**Figure 1**).

FIGURE 1

A Sharp Decline in US Consumer Sentiment: University of Michigan Index



Note: Shaded areas denote NBER recession periods.
Sources: GW&K Investment Management, University of Michigan, NBER, and Macrobond

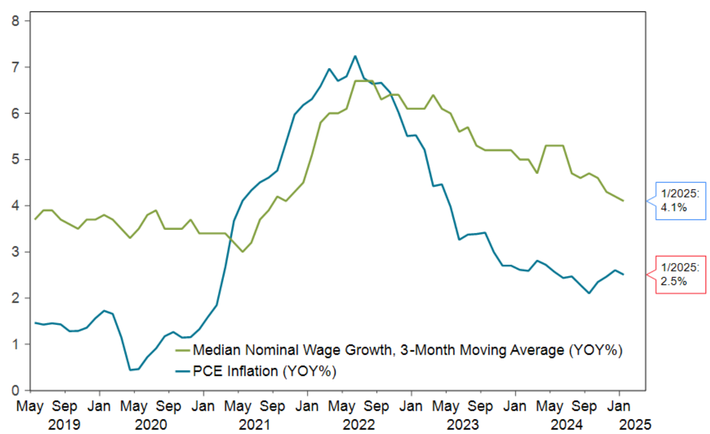
US consumer sentiment has plunged to recession levels in the first few months of 2025 as tariff and inflation worries dampened households' expectations for the future.

SUPPORTIVE FACTORS FOR CONSUMER SPENDING

1. **Labor Market Strength and Wage Growth**
   The US job market remains robust, with unemployment rates near historic lows. Wage growth, particularly in sectors like leisure, hospitality, and health care, continues to outpace inflation, providing a solid foundation for both essential and discretionary spending (**Figure 2**).

FIGURE 2

Rising Real Wages: US Wage Growth Outpaced Inflation in 2023 and 2024



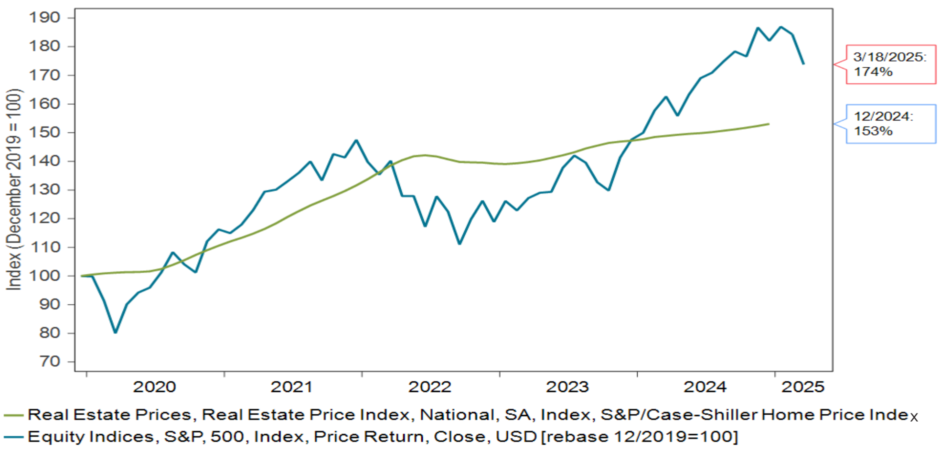
Sources: GW&K Investment Management, Atlanta Fed, BEA, and Macrobond

The solid labor market has recently kept wage growth ahead of inflation, with wages at the end of 2024 rising 4.1% from a year ago versus inflation of 2.5%.

2. **Positive Wealth Effects from Stock and Housing Markets**
   Rising stock prices and home values have increased household wealth, especially among higher-income groups. The S&P 500 has seen substantial gains through 2024, and home prices have continued to post gains despite higher mortgage rates, due to ongoing supply constraints (**Figure 3**).

FIGURE 3

Positive Wealth Effect: Gains in Stock and Home Prices Since 2019



Sources: GW&K Investment Management, S&P Global, and Macrobond

Robust gains in asset prices help support consumer spending among wealthier households, with stock and home prices up 74% and 53% respectively since 2019.

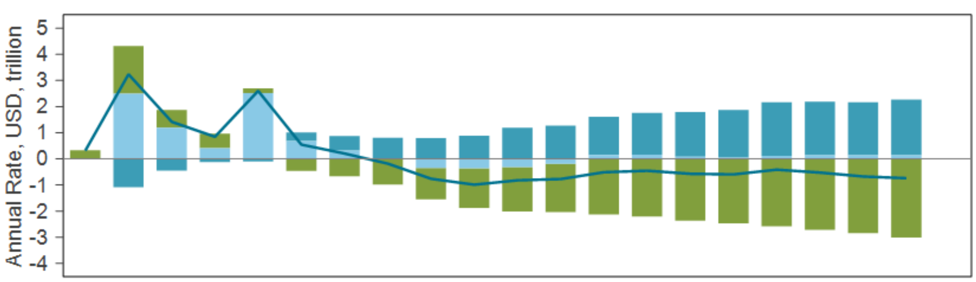
3. **Residual Pandemic-Era Excess Savings**

While much of the excess savings accumulated during the pandemic has been utilized, some households, particularly higher-income ones, still maintain elevated cash reserves (**Figure 4**). This financial cushion continues to support spending, though its impact is diminishing as savings normalize.

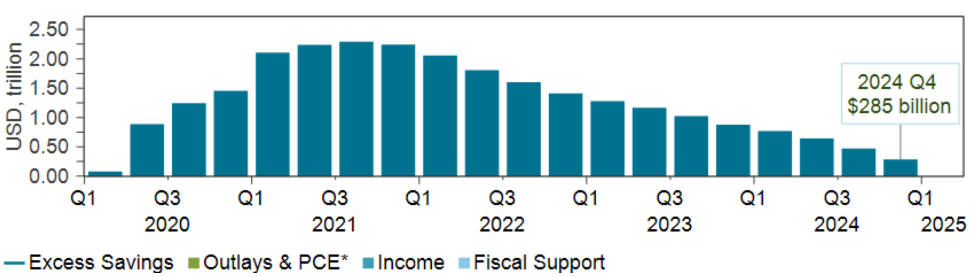
FIGURE 4

US Excess Savings: Declining But Still Ample

Flow of Income versus Outlays and Personal Consumption Expenditures



Aggregate Stock of Excess Savings (USD Trillions)



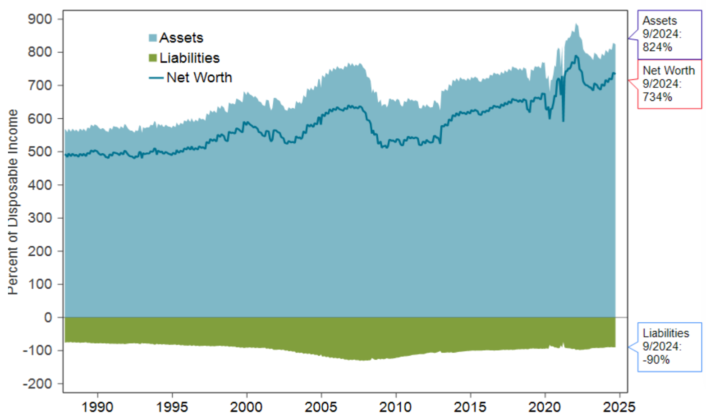
*Note: A positive contribution from outlays & PCE should be interpreted as decreased spending
Sources: GW&K Investment Management, BEA, and Macrobond

Excess saving grew during the pandemic when spending fell and government fiscal support to households soared. Those excess savings have declined but remain ample at an estimated level of $285 billion at the end of 2024.

4. **Household Balance Sheet Strength**
   The ratio of household net worth to disposable income remains high, reflecting strong asset valuations. Debt-to-income ratios are not yet at critical levels, suggesting that many households retain financial flexibility (**Figure 5**).

FIGURE 5

Healthy Household Balance Sheets: Assets, Liabilities, and Net Worth Ratios



Sources: GW&K Investment Management and Macrobond

Despite pockets of distress, household balance sheets overall remain healthy with assets of 824% of disposable income far outweighing liabilities of 90% of disposable income.

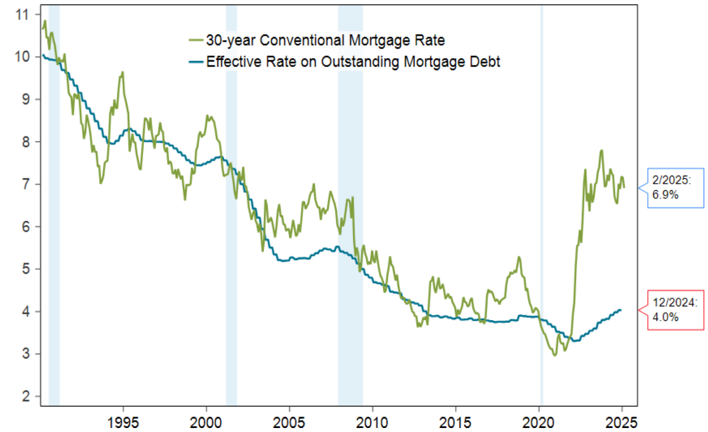
5. **Impact of Locked-In Low Mortgage Rates**
   While current 30-year mortgage rates are near 7%, approximately 54% of existing homeowners are locked into rates below 4% (**Figure 6**). This translates to about $600 – $800 in monthly payment advantages for a median-priced home compared to current market rates, helping sustain discretionary spending power for these households.

HEADWINDS FOR CONSUMER SPENDING

1. **Impacts of High Interest Rates on Consumer Debt**
   The Federal Reserve's prolonged higher-rate environment has increased borrowing costs for mortgages, auto loans, and credit cards (**Figure 7**). Consumer credit growth has slowed, and delinquency rates on credit cards and auto loans have risen, particularly among younger and lower-income borrowers (**Figure 8**).

FIGURE 6

The Legacy of Low Rates: Effective Outstanding Mortgage Rates Is Around 4%

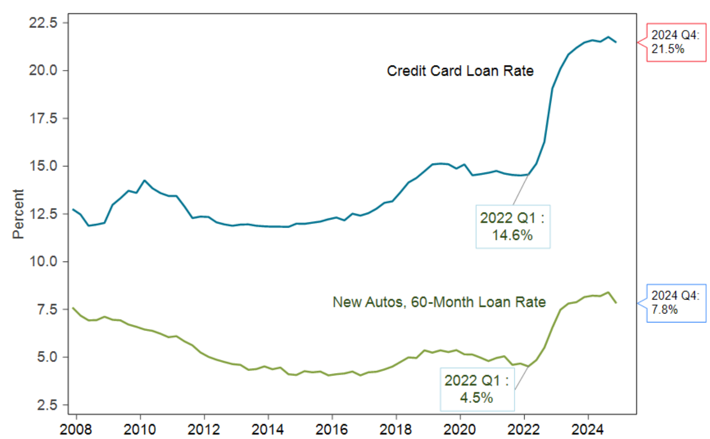


Note: Shaded areas denote NBER recession periods.
Sources: GW&K Investment Management, BEA, Mortgage Bankers Association, and Macrobond

Despite recent rate cuts by the Fed, consumer loan rates remain very elevated relative to where they stood before the Fed started tightening in 2022, providing a headwind to consumer spending.

FIGURE 7

Consumer Loan Rates Have Soared Since the Fed Started Tightening in 2022

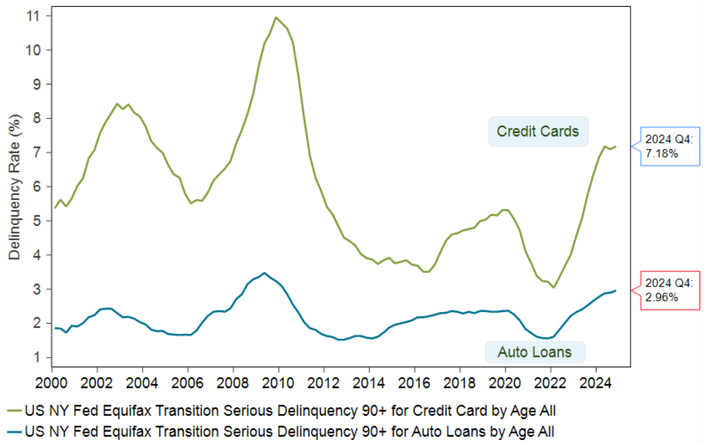


Sources: GW&K Investment Management, Federal Reserve, and Macrobond

Despite recent rate cuts by the Fed, consumer loan rates remain very elevated relative to where they stood before the Fed started tightening in 2022, providing a headwind to consumer spending.

FIGURE 8

Delinquency Rates on Credit Cards and Auto Loans Have Risen

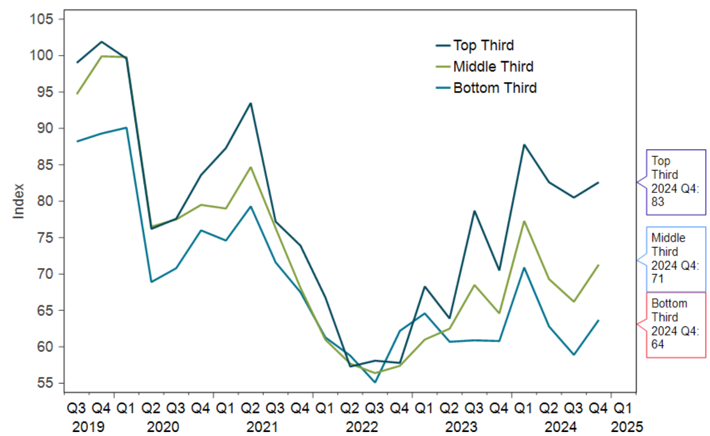


Sources: GW&K Investment Management, Equifax, NY Fed, and Macrobond

Higher consumer loan rates have resulted in a surge in delinquency rates on credit cards and auto loans, with younger and lower-income borrowers most likely to feel the pinch.

FIGURE 9

Depressed Sentiment Among Low-Income Households: Index of a Consumer Sentiment by Income Group



Sources: GW&K Investment Management, University of Michigan, and Macrobond

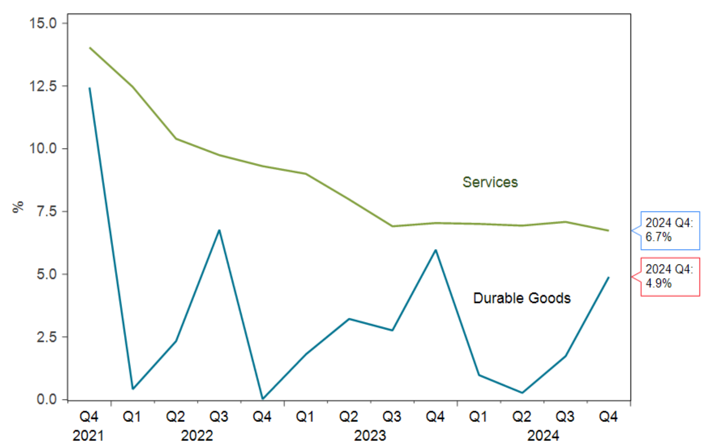
Consumer sentiment surveys reveal an increasingly stratified economy, with sentiment remaining most depressed among lower-income households.

2. **Greater Financial Stress Among Low-Income Households**
   While wealthier households benefit from rising asset prices, lower-income consumers face challenges such as rising rents, persistent inflation in essential goods, and high borrowing costs. The expiration of pandemic-era support programs has further strained these households, limiting their discretionary spending capacity. Consumer sentiment among lower-income households remains depressed relative to that of higher income levels (**Figure 9**).

3. **Softening Demand for Big-Ticket Items**
   Higher financing costs have dampened purchases of durable goods like cars and appliances. While demand for services remains resilient, categories requiring significant financing have experienced slowing sales growth (**Figure 10**).

FIGURE 10

Growth in Spending on Durable Goods Has Been Slower and More Volatile than Spending for Services



Sources: GW&K Investment Management, BEA, and Macrobond

While demand for services has remained resilient, higher financing costs have dampened purchases of durable goods like cars and appliances.

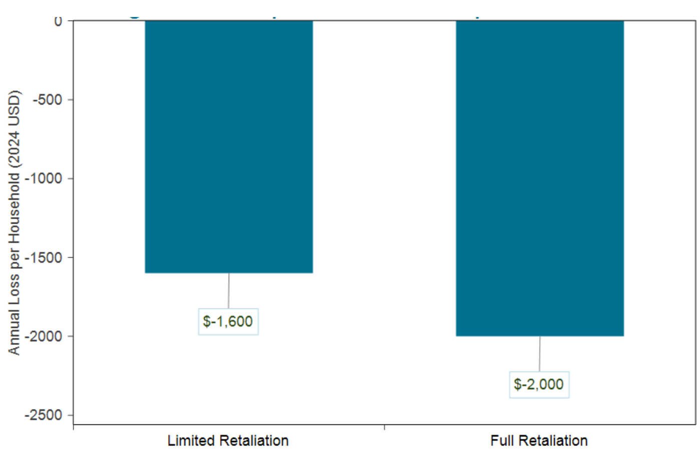
4. **Evolving Consumer Preferences and Cautious Spending Behavior**
   Consumers are increasingly prioritizing experiences and essentials, leading to uneven performance across discretionary retail categories. Middle-income households, in particular, are exhibiting heightened price sensitivity, seeking discounts and opting for more affordable brands.[1]

KEY RISKS AND WILD CARDS

1. **Proposed Tariffs**
   On February 1, 2025, the administration announced new tariffs: a 25% additional tariff on imports from Canada and Mexico, and a 10% additional tariff on imports from China. Canadian energy imports face a lower 10% tariff. Although the new tariffs on Canada and Mexico were put on pause for 30 days and then subject to further exceptions, analyses suggest these tariffs could raise prices on a range of consumer goods, from cars and gas to homes and food, effectively acting as a regressive tax that disproportionately affects lower-income households. Estimates indicate that the average American household could lose between $1,600 to $2,000 in annual purchasing power due to these tariffs (**Figure 11**).[2] The hit to households' purchasing power could be significantly larger depending on what the Administration announces on April 2 regarding potential additional sectoral tariffs and so-called reciprocal tariffs that are under consideration.

FIGURE 11

Impact of 20% China + 25% Mexico & Canada Tariffs on Average Real Disposable Income per Household



Sources: GW&K Investment Management, The Budget Lab at Yale University, and Macrobond

Proposed tariff hikes would cost the typical US household up to $2,000 a year, with the burden of tariff hikes falling disproportionately on lower-income households.

2. **Immigration Policy Changes**
   Proposed immigration policy changes, including potential reductions in legal immigration and increased deportations, could have significant economic implications. Immigrants contribute to labor force growth and consumer spending, and their reduced presence could lead to labor shortages in key sectors, dampening economic growth. Some analysts suggest that restricting immigration could lead to slower GDP growth and increased wage pressures in certain industries.[3]

   These policy uncertainties cloud the outlook for consumer spending, introducing potential risks that could disproportionately impact lower-income households and sectors reliant on immigrant labor.

THE ROAD AHEAD

The American consumer enters 2025 at a crossroads. While Bloomberg's panel of economists project real spending to grow at 2.6% — down from 2.8% in 2024 — these average rates mask a deepening split in consumer behavior. Higher-income households, cushioned by strong balance sheets and favorable mortgage rates, show few signs of pulling back. But middle and lower-income consumers face mounting pressures from high interest rates and potential tariff impacts. This divergence, coupled with proposed immigration restrictions that could drive up service costs, suggests the spending slowdown may be more complex than the headline numbers indicate.

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To hear more about recent consumer behavior and key economic indicators shaping the landscape, read the latest from GW&K's Equity Research Analyst Gaby Greenman, "From the Front Lines: Company Insights on Consumer Spending."

1 Zachary Russell, "Consumers to buy cheaper brands, shop less online in 2025," Chain Store Age, January 15, 2025.
2 Kimberly Clausing and Mary E. Lovely, "Trump's tariffs on Canada, Mexico, and China would cost the typical US household over $1,200 a year," PIIE Charts, Peterson Institute for International Economics, February 3, 2025.
3 Warwick McKibbin, Megan Hogan, and Marcus Noland, "The International Economic Implications of a Second Trump Presidency," Working Paper 24-20, Peterson Institute for International Economics, September 2024.

DISCLOSURES: