Weekly Market Flash

No Landing, Or Delayed Landing?

February 17, 2023

One of the phrases making the rounds among the financial media chatterboxes this week has been "no landing." This is the too-cute-by-half riposte to the usual dual-choice framework of "hard landing" or "soft landing" when issuing an opinion on where the economy finds itself as the Fed finishes off its monetary tightening cycle. Last week's barnstorming jobs report gave some octane to the no-landing narrative. So did this week's retail sales print, showing that consumers spent at a rate roughly double that of economists' forecasts in January. Over in Europe, the freakishly balmy weather this winter has served up seems to have taken all fears of a severe crunch off the table – natural gas prices there are at an 18-month low and down roughly 85 percent from their nosebleed highs last August.

So all good and its back to the brandy, eh? Perhaps not. The macro news has indeed given some cause for cheer relative to some of the more dour scenarios we've been looking at in the past few months. We'll take the best unemployment rate since before the 1969 moon landing, for sure. But "no landing" is a misleading sentiment. The economy is starting to slow down – that is evident from the vast majority of corporate management calls we've been tracking this earnings season. It's a question of when, not if.

Debt and Delinquency

Household debt rose to a record level of $16.9 trillion at the end of last year, according to a report released yesterday by the Federal Reserve Bank of New York. As a percentage of household income that is still not at the levels we saw in 2007, just before the onset of the Great Recession. Back then the debt-to-household income level reached a peak of 123 percent; at present it is 91.5 percent. But the trend has been steadily increasing. Credit card balances rose to $986 billion in the fourth quarter according to the New York Fed report, easily surpassing the pre-pandemic high of $927 billion. Delinquencies are increasing too; while still not at red flag levels by historical standards they are substantially higher across most categories, including home mortgages, credit cards and auto loans, than they were a year ago. And households have lost that savings cushion they got during the pandemic; household savings as a percentage of household income is at its lowest level since the beginning of this century.

Prices and Rates

Whether the economic slowdown turns into a recession or not, and if so for how long, depends mainly on consumer spending as that single metric accounts for nearly 70 percent of total GDP. When we look at where companies have been showing sales growth for the past twelve months, much of it has come from pricing power. Sales is a function of volume and price; how many units of something you sell, and at what price. For many companies especially in the consumers goods space, that function has largely gone as follows: we sold fewer units but we sold them at higher prices, so the net effect was that our sales grew. Customers happily (or maybe grudgingly but still willingly) paid whatever price was on tap.

That dynamic will change as a result of (a) increasingly constrained household budgets from the combination of more debt and wages that are not keeping up with inflation; (b) consumer price inflation that is still running well above recent norms; and (c) higher interest rates that make the cost of credit more expensive (and those outstanding credit card balances more onerous). Companies are guiding towards lower profit margins as they need to mark down prices in order to clear inventory. Layoffs are spreading beyond the tech and financial sectors where they have been going on for half a year. At some point – and sometime in the second half of this year is our best guess as to when – we think these factors will come together and (as we set out in some detail in our annual outlook last month) produce a cyclical recession. Not a deep, grinding recession of the type experienced in 1980 or 2008, but perhaps of a piece with the 1990 downturn.

Those other macro factors that have been giving folks cheer as of late – they are real and they will likely help cushion the impact of the downturn. But to return to the air traffic control language so dear to the economic conversation, we don't see the plane as avoiding a landing altogether. It may circle the runway a couple times, but the pressures on consumers will, we believe, bring that plane down in the not too distant future.

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