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The Consumer Economy Is About to Come Down from Its Sugar High

Large retailers mostly reported blowout sales and earnings in 1Q21, and commentators were quick to laud these results and the resilience of consumer spending as a recovery scenario unfolds. Some of these headlines read, *"Target Stores 'Stars of the Show' in Blowout Quarter," "Walmart Blows Past Q1 Expectations," "Amazon Smashes Earnings Expectations Amid 44% Sales Increase,"* and *"Home Depot in Blockbuster 1Q."* You get the idea.

The U.S. retail sector (excluding Amazon) has widely outperformed the broader stock market so far in 2021 (**Exhibit 1**). Conveniently underreported in most of these stories was the outsized impact of huge federal stimulus payments on consumer spending. Payments to individuals in March, under the $1.9 trillion American Rescue Plan (ARP), were an astounding $391 billion, with checks going out to some 167 million Americans.[1] This comes on the heels of the Consolidated Appropriations Act, which paid Americans another $135 billion in January.[2] These latest two rounds of stimulus payments were intended to be a single round of reduced financial relief in late 2020 before a Congressional stalemate on the issue held up legislation until Democrats effectively won control of the Senate in early January and passed the ARP bill by a one-vote margin via a budget resolution procedure. Though presented as financial relief to struggling Americans, payments to individuals under the ARP was a huge stimulus package paid indiscriminately to most households. Payments to individuals in March under the ARP far exceeded amounts paid under The CARES Act in 2Q20 amid the worst economic impact of the pandemic.[3] Large retailers have primarily reaped the benefits of this generous stimulus, which boosted retail sales in March by 10.7% (MoM) and 29% (YoY). Total U.S. retail sales in 1Q21 increased by 14.3% over the prior year's quarter, an aberrant growth rate under normal circumstances. Were it not for the ARP stimulus and other continuing federal payments to individuals, the prevailing narrative around retailing and consumer spending would be far less impressive.

An honest discussion of the recent recession and the federal response to it must acknowledge an uncomfortable truth, mainly that government payments to individuals have far exceeded the economic hit endured by Americans in the aggregate. The pandemic-induced recession produced one brutal quarter of economic contraction—the worst since the Great Depression—that saw GDP contract by nearly one-third as much of the nation's outdoor economy shut down, followed by three quarters of a grinding rebound from that abyss. In a workforce of 160 million, some 40 million Americans lost a job or were furloughed at some point in 2020, while continuing claims for unemployment peaked at just over 30 million in July and currently stand at 16 million.[4] Most of these job losses were lower-paying positions in the retail, leisure and hospitality industries. As painful as these numbers were for those impacted by unemployment, total wage income (which, by definition, excludes any stimulus relief or unemployment insurance paid to individuals) still increased marginally in 2020. Incredibly, private sector wage income grew last year compared to 2019, albeit negligibly. Contributing to this better-than-expected outcome, millions of furloughed workers were recalled in the second half of 2020, while wage growth was robust for many of those fortunate enough to be untouched by unemployment. Few realize that wage income took a much bigger and longer hit during the Great Recession of 2009 than it did in 2020, even though far fewer workers experienced unemployment (**Exhibit 2**).

The federal government responded to the pandemic in two distinct ways with respect to individuals, mainly with three rounds of stimulus payments paid directly to qualifying households and enhanced unemployment benefits paid via the Pandemic Unemployment Assistance Program (PUA) and Pandemic Emergency Unemployment Compensation (PEUC). The sums paid under these programs since the start of the pandemic have been enormous. The three rounds of stimulus payments to individuals have totaled more than $800 billion to date[5], according to the Congressional Budget Office, while federal pandemic unemployment benefits totaled nearly $500 billion through 1Q21.[6] State unemployment benefits have provided another $190 billion of relief to individuals[7] — bringing total financial payments from government to individuals since the start of the pandemic to approximately $1.5 trillion. To give this some perspective, that works out to nearly $12,000 per household on average.

The intention to financially protect those hit by unemployment during the 2020 recession is certainly commendable and desirable as a policy goal, and some straightforward math can demonstrate that federal pandemic unemployment payments combined with state unemployment benefits almost certainly achieved that goal in the aggregate. That is, any reasonable assumptions of displaced workers and average wages lost during the pandemic produces an estimation of total lost wages that were covered by federal and state unemployment programs. The relatively lower wages of most of the jobs lost during the pandemic helped make this manageable.

This implies that most of the $800 billion paid to Americans as stimulus payments was a financial windfall for many tens of millions of households untouched by the economic fallout of the pandemic. Much of this "stimmy" money was spent on stuff, and lots of it also found its way into the stock market. (The "stimmy" meme began on Reddit stock trading boards.) The unprecedented plunge in personal bankruptcies since the start of the pandemic is at least partially attributable to stimmy payments that have allowed struggling households to pay some overdue bills and perhaps forestall a filing. Some economists certainly will argue that stimulus payments were needed to avoid a potential economic collapse at the height of the pandemic and shutdown, but this argument is disputable. The 2020 recession was never about inadequate aggregate demand; it was that consumers were unable to transact with large swathes of the economy, such travel & leisure, and no amount of stimulus money could have changed that. Consumers redirected much of their spending from services to stuff, and large omnichannel retailers were the primary beneficiaries. Topline retail sales growth was strong in 2020, all things considered — including two months of panic in March and April when most Americans retreated to their basements. It's also puzzling that the largest round of stimulus payments to Americans came in March under the ARP, at a time when the recovery was already well underway, and a reopening of outdoor commerce had begun in sections of the country.

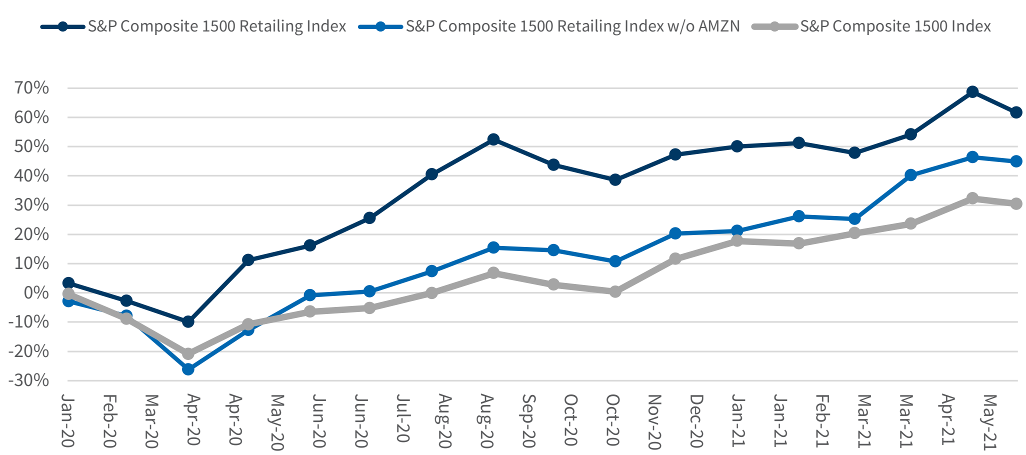
Sending hundreds of billions of dollars to individuals so they could buy consumer goods made overseas hardly sounds like effective stimulus policy in any case. Large retailers certainly recognize that stimulus payments were a big factor in their outperformance, and it is doubtful they are making plans to hire or expand aggressively based on stimulus-impacted operating results. Hence, the multiplier effect of such stimulus payments was likely muted.

Regardless of one's views of the need, adequacy, or effectiveness of the federal response to the pandemic, the relevant consideration of the moment is that government relief for most Americans will be going away soon. Federal pandemic unemployment programs are scheduled to end on Labor Day, but more than 20 states have already begun the process of opting out of these programs in June or July in the belief that they are keeping jobless people on the sidelines. Furthermore, millions of people receiving extended unemployment payments will exhaust those benefits prior to Labor Day. Federally mandated moratoriums on evictions and forbearance on federal student loan payments are scheduled to expire at the end of June and September, respectively. A substantial increase in the child tax credit that was part of the ARP will expire at the end of the year.

Stimulus payments made in 2021 have mostly been spent, though excess savings of the past year can support above-average spending for a few more months. Republicans strongly disapproved of the ARP, and the bill passed in the House and Senate without a single Republican vote. With the economy in recovery mode, it seems safe to say that there will be no more payment stimulus packages coming from Congress. Moreover, the prospect of a huge bipartisan infrastructure bill grows increasingly unlikely given the riven state of Congress, and any Democratic proposed infrastructure bill would be subject to a filibuster.

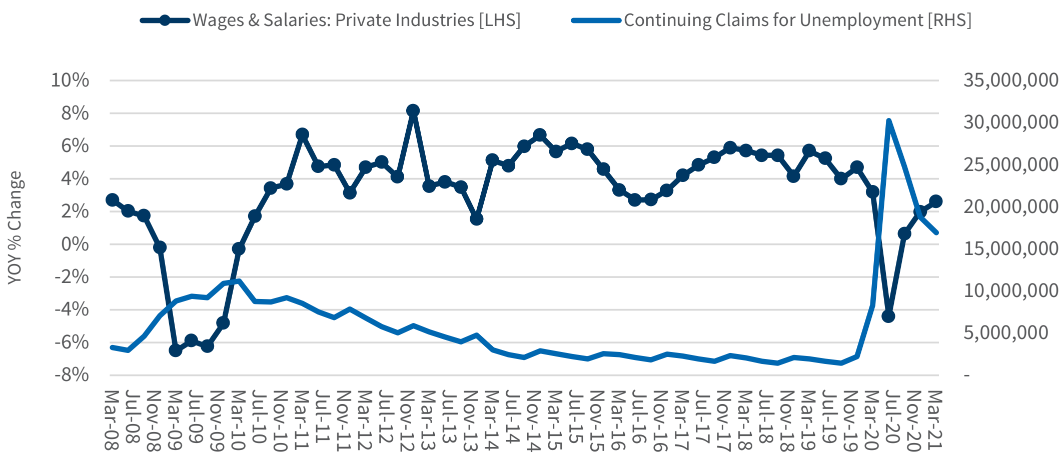
Replacing the flow of government money and other financial reprieves to individuals is the assumed comeback of jobs, many of them low-paying, as the economy reopens. This reopening scenario and the job creation associated with it certainly will proceed in the months ahead, but whether these jobs gains are sufficient to offset the withdrawal of a vast safety net remains to be seen. Call us skeptical. Furthermore, a reopening of the economy should also see a redirection of consumer spending back towards services and experiences and away from stuff, to the detriment of retailers. Financial markets seem to have an entirely different take on the matter, as if a return to a pre-pandemic consumer and retail environment was such a great place. It wasn't.

Exhibit 1 - S&P 1500 Composite Index Returns Since 1/1/20



Source: S&P Capital IQ

Exhibit 2 - Wage Income vs. Continuing Unemployment Claims



Source: U.S. Bureau of Economic Analysis, U.S. Department of Labor

Endnotes

1. CNBC, May 26, 2021, https://www.cnbc.com/2021/05/26/new-round-of-1400-stimulus-checks-brings-total-sent-to-391-billion.html?&qsearchterm=stimulus
2. Peter G. Peterson Foundation, https://www.pgpf.org/blog/2021/03/what-to-know-about-all-three-rounds-of-coronavirus-stimulus-checks
3. Ibid
4. United States Department of Labor, Unemployment Insurance Data
5. Peter G. Peterson Foundation, https://www.pgpf.org/blog/2021/03/what-to-know-about-all-three-rounds-of-coronavirus-stimulus-checks
6. U.S. Bureau of Economic Analysis, Effects of Selected Federal Pandemic Response Programs on Personal Income, April 29, 2021
7. Ibid

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