Weekly Relative Value

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WEEK OF JUNE 30, 2025

The Consumer Recession Cometh?

"Welcome to the Grand Illusion,
Come on in and see what's happening,
Pay the price, get your ticket for the show."
— Styx, The Grand Illusion

There was a lot to chew on last week. Federal Reserve Chair Jerome Powell testified on the Hill on Tuesday and Wednesday as he delivered the semi-annual monetary policy report to Congress.

If I could have questioned the Fed Chairman, I would have asked how this could possibly show up in the opening sentence of the post-meeting press release:

"… Economic activity has continued to expand at a solid pace."

Come again? The U.S. economy is on a knife's edge, having contracted already (modestly) on a three-month and six-month basis — and yet, few seem to be aware of this fact.

And in May, all we see is weakness as the hard data has now followed the soft data with a lag. To wit: Housing starts (-9.8% month over month), building permits -2.0%, retail sales -0.9%, and industrial production -0.2% were all down this month. Doesn't look so "solid" to me.

Most importantly, in a consumer income-driven expansion, household spending is critical to keeping the flywheel of spending —> income —> spending going that has driven growth in recent years.

Last Friday's Personal Consumption Expenditure (PCE) report for May provided an updated lens into the challenges facing the income-driven expansion. Indeed, the personal income and expenditures report was gut-wrenching. In May, personal income dropped by 0.4%, the first month-over-month decline in almost four years.

THIS WEEK

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- WAGES TO BE GARNISHED
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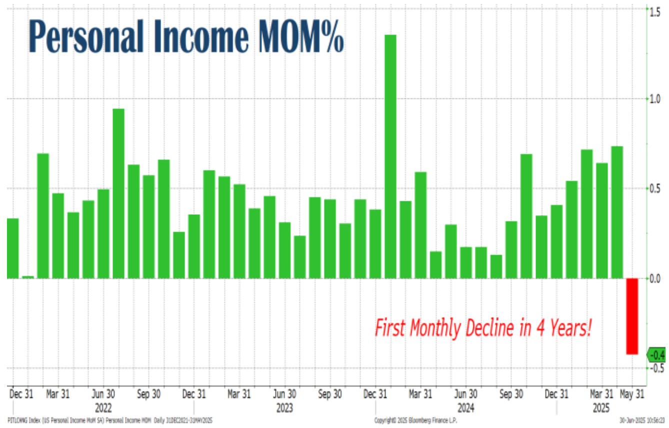
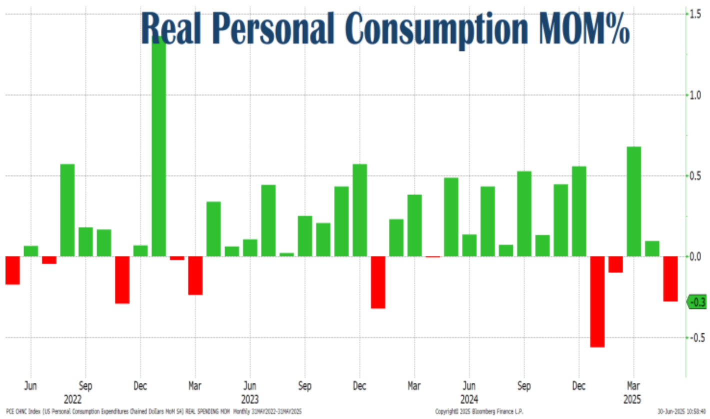
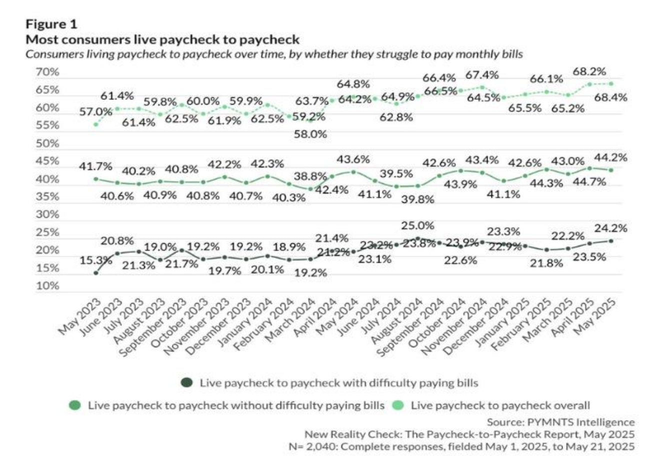
- SLIP SLIDING AWAY
- MARKET OUTLOOK AND PORTFOLIO STRATEGY



Consumer spending dropped 0.3% in May and more than reversed the gains of April. This came as a huge surprise to a consensus that was looking for +0.3% month-over-month increase. It is quite rare for consumer spending to fall in inflation-adjusted terms. It happened during the pandemic and during the fiscal crisis, and it is happening now. Not good. Our entire economy is based on spending. If my spending drops, your income drops. And then your spending drops. And then my income falls even more.



According to PYMTS Intelligence, 68% of Americans now live paycheck to paycheck. Read that again. 68%, y'all! The latest report shows 684 out of every 1,000 U.S. adults are barely keeping up. One in four can't even pay their monthly bills without falling behind.

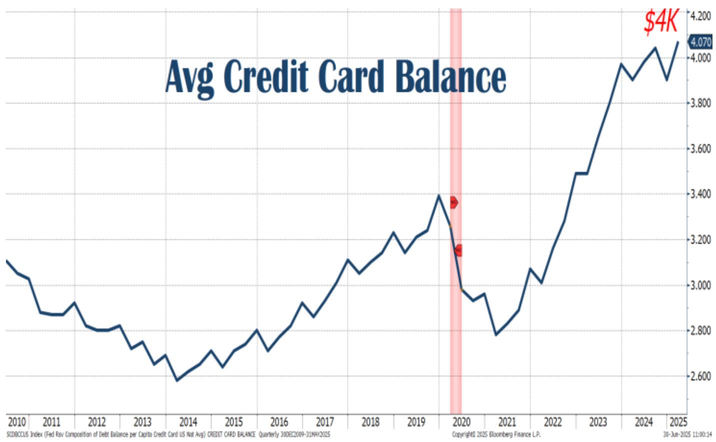


Bottom line: Many consumers are stressed, and real consumer spending has shown no change since last November. That is all anyone needs to know about the state of the U.S. economy.

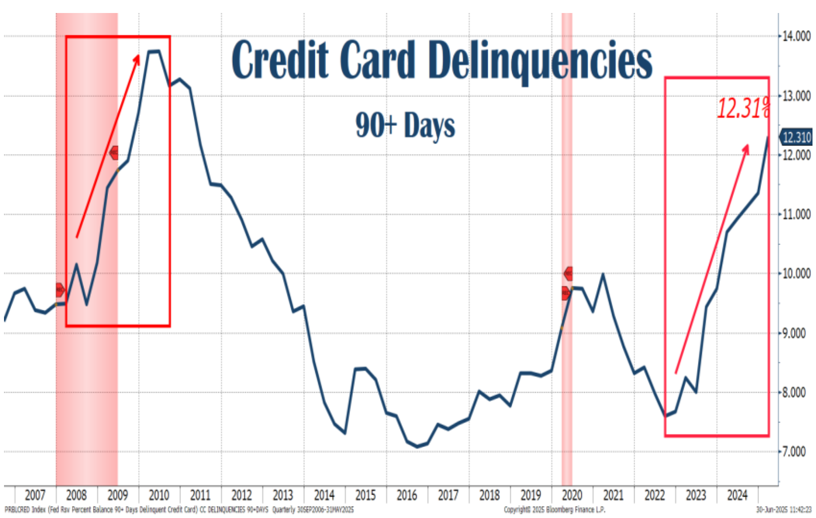
As discussed last week in this space, the “soft” data did end up leading the “hard” data, and Jay Powell should save himself further embarrassment rather than referring to the economy as being “solid.” That is a stale description, to put it politely.

NOT GIVING CREDIT WHEN CREDIT IS DUE

A key source of spending for the U.S. consumer is rapidly losing momentum. Outstanding credit card balances, after ballooning to $1.3 trillion from over $970 billion in the aftermath of the pandemic have declined by an epic near -$50 billion ~7% annual rate) between October and April, which is something ONLY experienced during the pandemic and the 2008-2009 Great Recession. As with every boom, a bust follows in its wake.



We have reached a stage in this debt-driven cycle where there are over 630 million credit card holders — around four per household, and the per capita unpaid balance, topping $4,000 is the highest on record. But the strains are clearly building especially in this punishing interest rate environment. Indeed, the serious delinquency rate in the credit card space has exceeded 12% for the first time since the economy was gingerly coming out of the Global Financial Crisis.



And according to the latest New York Fed's Survey of Consumer Expectations, one in eight Americans do not believe they will be able to make a minimum debt payment over the next three months — not far off the number we saw in the dark days of the 2020 pandemic. Meanwhile, banks have responded by tightening their credit guidelines on plastic for each quarter since the fourth quarter of 2022.

With the banks now responding prudently to the sharp increase in late payment rates, consumers are shifting to "Buy Now, Pay Later" strategies. In fact, the boom in "Buy Now, Pay Later" programs is expected to rise a further +15% to $108 billion, which would represent about one-tenth of the entire market for traditional credit cards.

Shocking stat: 41% of Gen Z borrowed money for groceries or rent in the last year.

What does this tell you about the shape of the consumer? And what does it mean when the grocery chains are offering this type of credit to its customers? Have a look at "Choosing 'Buy Now, Pay Later' at Checkout Will Now Factor Into Credit Score" (*The Wall Street Journal*). The immense volume of unregulated and unsupervised credit in several corners of the economy (including private debt) gets much less attention than it deserves — talk about an accident waiting to happen.

WAGES TO BE GARNISHED

The Wall Street Journal reports "Nearly Two Million Student-Loan Borrowers Are at Risk of Docked Pay This Summer."

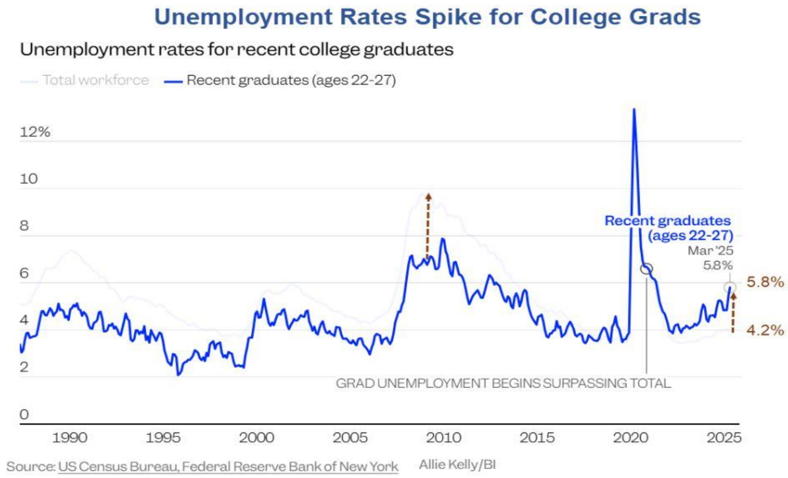
According to TransUnion, six million federal student-loan borrowers are 90 days or more past due after the pandemic-era reprieve ended. The company estimates that about a third of them, or nearly two million borrowers, could move into default in July and start having their pay docked by the government. An additional one million borrowers are on track to default by August, followed by another two million in September. Borrowers fall into default when they are 270 days past due.

Wage garnishment is set to restart this summer. Until past due payments are paid in full or the default status is resolved, borrowers could see up to 15% of their wages automatically deducted from their paychecks.

In addition, borrowers who have been newly reported as delinquent since then on their student loans have seen an average 60-point drop in their credit scores, according to TransUnion. According to the New York Fed, 43 million borrowers owe more than $1.6 trillion in student-loan debt. **More than nine million of them are expected to see their credit scores drop this year.**

Making matters worse, Zoomers (Gen Z) are staring down a tough hiring market. The unemployment rate for recent college graduates ages 22 to 27 has soared compared to unemployment for all workers ages 16 to 65 in recent years. In fact, the job market for 20-somethings with degrees is among the worst it has seen in at least four decades. This is a new trend: Young people with degrees have historically always been more likely to be employed than the rest of the labor force.

Adding salt to the wound, the pool of jobs available for Gen Z — and the workforce as a whole — has shrunk. Job openings have cooled from 12 million in March 2022 to seven million this past April. In what's been dubbed the "Big Stay," current employees are holding on to their seats as well.



Bottom line: This is no small deal. Millions of Zoomers and millennials are spending every penny right now and struggling. Now comes wage garnishment up to 15%. This will be another strong headwind to the consumer-driven economy.

LABOR MARKETS ARE LABORING

There is a view that the U.S. labor market is tight and still vibrant, but that is a real stretch. As I have written repeatedly, the non-farm payroll number or the headline unemployment rate tells you nothing about the quality of jobs being created.

Indeed, full-time jobs are on the decline, being replaced by part-time employment, and we see the trend towards multiple-job holders continues unabated — have a look at "Americans Are Side Hustling Like We're in a Recession" (*The Wall Street Journal*).

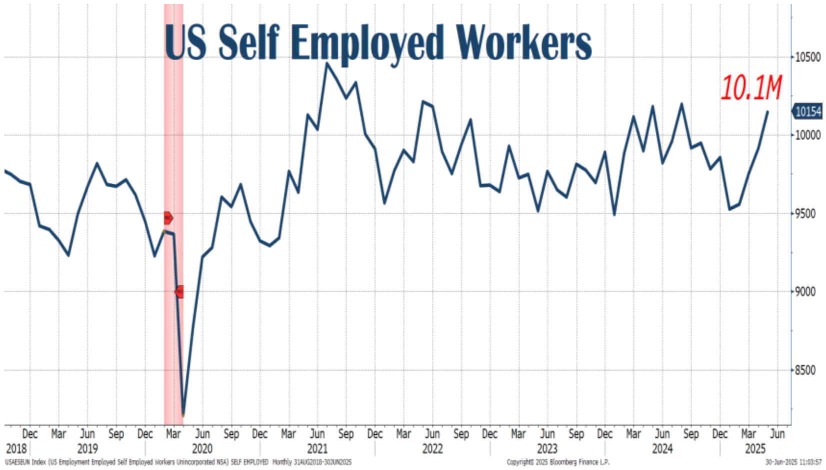
It isn't just part-time job growth that in the past year has almost doubled the pace of full-time employment, but also the fact that the robot workforce is gaining market share. This is a key feature behind the loss in worker confidence, as seen by the diving voluntary "quit rate" this past year. (See "The Holy Grail of Automation: Now a Robot Can Unload a Truck" (*The Wall Street Journal*).)

Then think about this. Of the 1.7 million jobs that were reported to have been "created" over this past year from the payroll report, ~two thirds of the jobs (1.1 million) came from the birth-death model that attempts to estimate ("guess" is a better word) new business creation net of failures. This "guess" alone has added +93,000 per month to the headline payroll number over the past year.

But don't take my word for it. The information from the broad Quarterly Census of Employment and Wages database shows that the headline payroll growth in 2024 that traders had traded off each month has been overstated by around a +70,000 monthly differential.

When you strip out the separate birth-death model, what we see is that payrolls averaged +19,000 per month from January to May, and that is down from an average of +96,000 monthly in the prior five-month period from August to December 2024. Mr. Powell — how is this a "solid" labor market?

What the data also does not tell you is the quality of the jobs that are being created. For example, self-employed workers have risen for three months in a row. The number of multiple-job holders has risen and is close to doubling the overall trend in employment. These are both stress indicators — losing your job at your firm and then setting up your consultant shop in the former and taking on a second job as an Uber driver in the latter.



Meanwhile, the number of permanent job losses in the past year has surged by over +9% over the year to May, and the ranks of the unemployed who have been in a job search for more than 27 weeks with no successful positive results are over +8% above year-ago levels as well. The number of unemployed people who are desperately looking for full-time work but to no avail is also up nearly +9% on a year-over-year basis.

Then tack on the fact that over the past four months, the share of Americans (per the UMichigan Survey of Consumers) who fear job loss over the next five years has averaged out to be nearly 22%. Only coming out of the tech-wreck recession of the early 2000s and the Great Recession back in 2009 have we seen a number this high. If it walks like a duck…

Finally, you can either buy into the massaged Bureau of Labor Statistics payroll data or believe what the business sector was telling the Beige Book staff last month:

"Employment has been little changed since the previous report. Most Districts described employment as flat, three Districts reported slight-to modest increases, and two Districts reported slight declines."

Therefore, job growth has flattened for nearly half of the country. Meanwhile, the Fed continues to fight the last war.

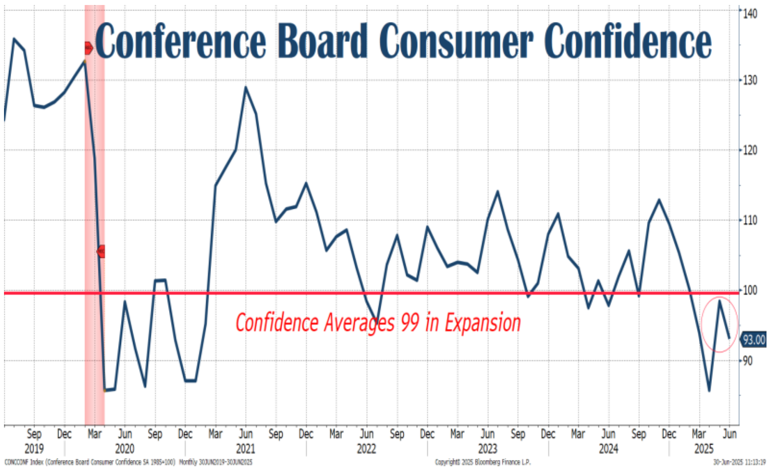
Bottom line: I continue to be amazed at how investors and Fed officials get consumed by the headline data, seemingly incapable or unwilling to dig beneath the surface. Likewise, the markets are fixated on the headline.

Here's the deal. The longer the Fed waits, the more it will have to do next year… and this is a key reason I have remained constructive on bonds. And while the market is rightly concerned about monetary and fiscal policy, there has never been a recession, ever, not even the three in the stagflation period in the 1970s, that did not see the longer end of the Treasury market deliver solid positive returns.

CONFIDENCE PLUNGES

In sharp contrast to the spike in the University of Michigan Consumer Sentiment Index for June, the Conference Board's Confidence Survey went the other way — diving from 98.4 in May to 93.0 in June and sharply undercutting the consensus estimate of 99.8.

Since the survey began in 1967, the average reading in economic expansion is 99.0. We are -6 points below that — in fact, the index has been south of 99.0 in each of the past four months. So, let's get this straight. If this metric is below where it typically is in an expansion, what does it therefore imply for the economy? If we are not in an expansion, then where exactly are we?



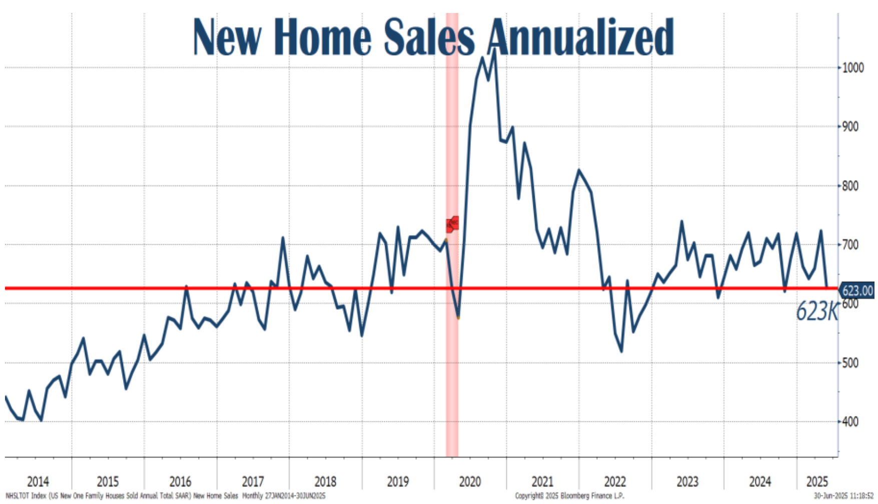
Moreover, the key "expectations" subindex faltered to 69.0 from 73.6. The current consumer confidence level ranks as the second weakest result since January 2021 and is below the worst level recorded (95.3) during the 2022-2023 recession scare.

Why so glum? This was all about the labor market because the share saying that "jobs are plentiful" dropped for the third time in as many months, to 29.2% — the lowest since March 2021.

Fully 52.7% of respondents lament that "jobs are not plentiful," up from 50.5% in May, and again the highest since March 2021.

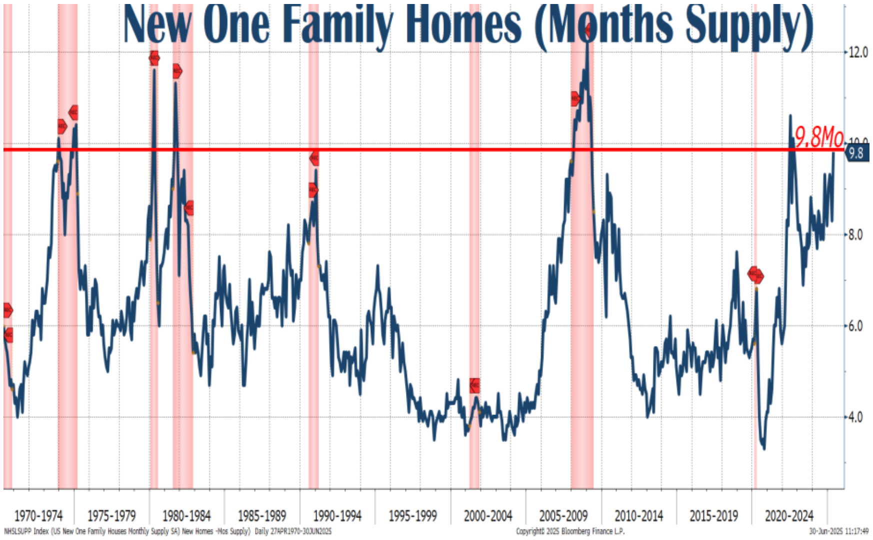
BEGGING FOR RATE CUTS

The cracks in the housing market widened in May, with new home sales sagging by -13.7% month over month to 623,000 annualized units (and April was revised sharply lower to 722,000 from the first 743,000 tally). The consensus was already bracing for a very weak number, at 693,000, but instead, what we got was -10% below that figure. The level of sales is down to a seven-month low and is down -6.3% on a year-over-year basis. Regionally, sales were, by far, the softest in the once-hot South — collapsing by -21% month over month to a near three-year low.



Meanwhile, the new housing inventory rose by +1.4% month over month, and over the past year, the growth in demand has lagged that of supply by more than 14%. In each of the past three months, the backlog of unsold new homes has been 500,000 units or higher, and that deflationary dynamic has not happened since September-November 2007. The recession that nobody saw coming came the very next month. And the rest, of course, is history.

This brings me to the next data point, which is the fact that the unsold inventory backlog expanded sharply to 9.8 months' supply, from 8.3 months in April, to stand at the highest level since September 2022. It is against this backdrop that median prices are down by more than -7% from the cycle high.

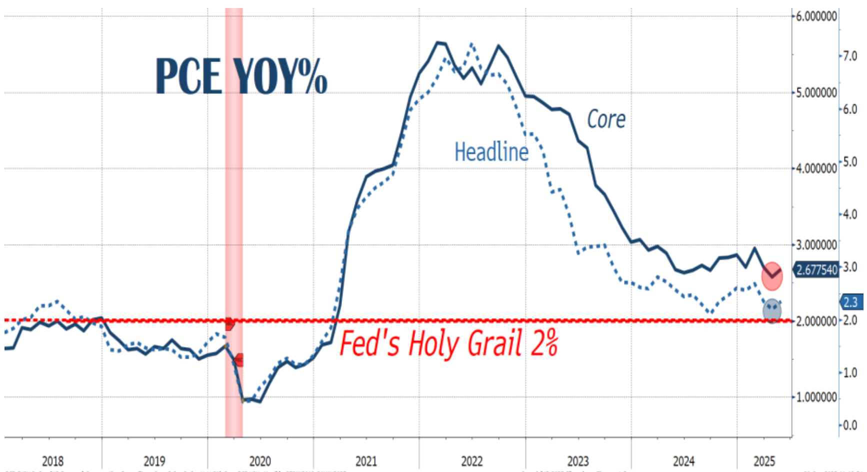


Bottom line: Let us just say that the housing market is begging the Fed to restart rate cuts and is in desperate need of intense mortgage rate relief. Since that will require lower Treasury yields, bullish bond call remains one of very high conviction.

THE TARIFF EFFECT?

The Fed's preferred inflation metric (core PCE deflator) surprised to the high side — coming in at +0.2% month over month in May instead of the +0.1% consensus view. That took the year-over-year core inflation rate up a tick to +2.7% from +2.6% in April. The headline deflator was as expected at +0.1% month over month, but weak year-ago base effects took the year-over-year pace up to +2.3% from +2.2%.

Then again, a +0.2% month-over-month reading on the core deflator is hardly a big inflationary statistic. (It was +0.18% to the second decimal.) Not to mention that the Powell "super-core" index, which measures non-housing service inflation, came in light at +0.1% after a flat April.



Bottom line: PCE inflation ticked upwards in May, perhaps the first glimpse of tariff-related price increases. The consumer recession is starting… but the core deflator keeps the Fed on the sidelines and prevents bonds from rallying.

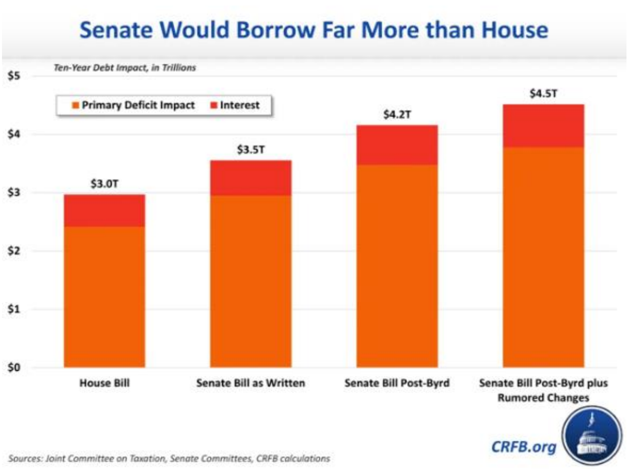
THE ONE BIG BEAUTIFUL BOONDOGGLE ACT

"The latest Senate draft bill will destroy millions of jobs in America and cause immense strategic harm to our country! Utterly insane and destructive. It gives handouts to industries of the past while severely damaging industries of the future." — Elon Musk, Businessman and Former Head of the Department of Government Efficiency

The alleged Senate fiscal hawks threw up the white flag of surrender and voted "yea" to approve the One Big Beautiful Bill Act (OBBA). GOP leaders in the Senate are trying to quickly pass the legislation and send it to the House for final approval in time to meet the July 4 deadline that President Trump has set.

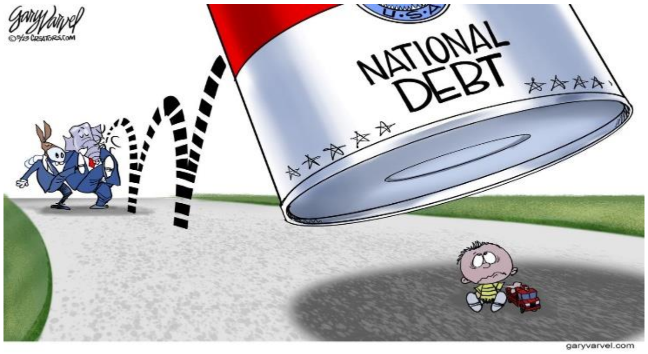
Republicans used an accounting move to exclude the $3.8 trillion tax extension when calculating budget deficits despite the fact that what truly hangs in the balance is the unstable future of unsustainable deficits and debts, and the question of where the money will come from to finance unprecedented government borrowing required.

As it currently stands, the Senate bill is likely to add **$3.5 to $4.2 trillion** to the debt through Fiscal Year (FY) 2034, based on the non-partisan Committee for a Responsible Federal Budget estimates. The debt impact could rise as high as **$4.5 trillion** if various rumored adjustments are made. **That's $500 billion to $1.5 trillion more** in borrowing than under the House-passed bill.



So, as bad as the House version of the One Big Beautiful Bill is, the Senate version is worse. Most likely, the final version signed into law will be even worse than the Senate version. In a word: pathetic.

Frankly, it's a disgusting lot of politicians (on both sides) whose sole purpose is to enrich the current generation on the backs of future generations where massive amounts of money are now needed to have gross domestic product (GDP) growth rates move north and ever decreasing rates relative to money spent. The House will quickly vote for this after it has filled it up with more compromises, and it will be much, much worse.



It is actually a miracle that the 10-year Treasury yield could be sitting south of 4.3% when you consider that the size of the Treasury market has mushroomed to $29 trillion from $5 trillion in 2008, as multiple rounds of tax cuts were bundled with uncontrollable growth in program spending. This attests to the other forms of deflationary pressure at play, especially the aging demographic file and that the fiscal largesse is not being transmitted into improved economic growth.

Bottom line: At 67 years old, I've watched 40 years of tax cuts for corporate and wealthy citizens allegedly going to pay for themselves. Not once does history show that happening.

The sad reality is that there are no fiscal hawks. Everyone is an imposter. Democrats spend and tax. Republicans spend less and cut taxes. Neither care about the financial viability of their country past their personal reelection dates. It's time we face that. We're pushing the envelope ever closer to the edge. We just don't know when it's coming.

SLIP SLIDING AWAY

"We should be at 1% interest rates." — President Donald Trump

The DXY dollar index is off to its worst start since 1973 and is now at its weakest level since March 2022.

It could well be that the dollar is responding to the news that President Trump intends to announce the Fed Chairman's successor by September-October (more than six months before Powell's tenure expires), and the fact that Kevin Hassett and Scott Bessent are in the running is problematic — two "yes men" if there were any.

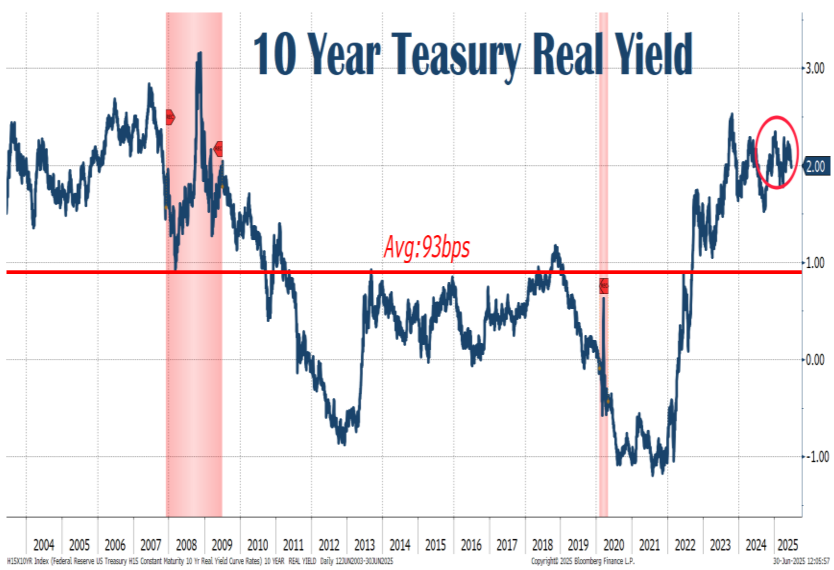
The issue for any future Fed Chairperson is going to be the extent to which he or she will be willing to defend the central bank's independence because, quite frankly, the number of insults the president is hurling at Jay Powell has spun out of control with the sort of comments that one would expect from a child — I mean, "a low IQ for what he does" and "I think he's a very stupid person, actually." I am no Jay Powell fan, but the next chairperson is either going to have to develop a very thick skin or fall into line.

Bottom line: The U.S. dollar has slumped an epic -11% from its recent high. Perhaps both the FX and bond markets are sniffing out a more dovish tilt in Fed policy even though Jay Powell fell short of creating those expectations in this past week's Congressional testimonies. (The swaps market now sees a 20% chance of a July cut and is putting nearly 50% odds on a third move (two are fully priced in) by year-end.)

MARKET OUTLOOK AND PORTFOLIO STRATEGY

The run rate on real GDP growth right now is +1.3%, so the U.S. economy is tilting toward a recession — the one missed in 2022-23 will not likely be averted this time around, especially with monetary policy inordinately restrictive with the fed funds rate 150 basis points above the so called "neutral" rate.

Meanwhile the real 10-year Treasury yield is nearly 2%, which is twice the long-term average of 93 basis points.



What is lost on the non-recession crowd is that back in the 2022-2023 period of Fed tightening, 1) almost no existing mortgage borrowers carried a rate above 4% (whereas one-in-five now have rates above that level), 2) there are no more excess pandemic-era savings to draw down, and 3) real interest rates had averaged barely more than +1.0% (but are now more than double that level).

As noted above, real expenditures have dipped in three of the past five months and are practically flat over the entire January-May period. But the real kicker was service sector spending, which rarely declines outside of recessions. This is very unusual because housing, utilities and health care are huge components, and rarely, if ever, contract.

It is no exaggeration to say that a consumer recession is forming, and data this soft was not occurring during that growth scare of 2022 and 2023. The thing is, back then, investors were scared off by the recession fear — today, even with evidence mounting, there is absolutely no fear out there in market-land.

I say buy bonds on weakness!

The next few weeks will be filled with event risk. What happens on July 9 when the 90-day reprieve on reciprocal tariffs expires? Outside of the U.K., I see no trade deals, and Japan is already balking over the auto sector backdrop, while China is more interested in extending its trade ties in other parts of the world (after having penetrated the EV market in Europe).

MORE INFORMATION

For more information about credit union investment strategy, portfolio allocation and security selection, please contact the author at **tom.slefinger@alloyacorp.org** or (630) 276-2753.

As Alloya's Market Strategist, **Tom Slefinger** leverages nearly 40 years of investment strategy expertise to deliver insightful commentary on the economy and market events to optimize balance sheet performance at the credit union level. With thousands of subscribers, Tom's daily and weekly publications are widely read amongst credit union executives.

Prior to becoming the corporate's Market Strategist, Tom served as the Senior Vice President of Institutional Fixed Income Sales at Alloya Investment Services, a division of Alloya Solutions, LLC. In this role, Tom developed and managed operations associated with institutional fixed income sales in addition to developing investment portfolio strategies, identifying appropriate sectors and securities, and optimizing portfolio performance at the credit union level.

Tom holds a B.S. in business administration from the University of Maine. In addition, he holds a Series 7 and 63 through ISI.