

There was little in the way of market-moving data out this week, with the lagging consumer credit report highlighting the weekly calendar. That said, credit is the lifeblood of the economy and, crucially, is receiving increasing attention, mostly negative. The three major borrowers – governments, businesses and consumers – all made their presence felt this week, albeit only one – the government – had a meaningful market impact. Despite the good vibes coming out of the Treasury's announcement that it would be issuing fewer longer-term securities to fund operations than expected, the auctions of 3, 10 and 30-year issues this week were met with a tepid response from investors, and bond yields retraced some of the steep declines over the past three weeks, which saw the bellwether 10-year year yield fall from 5 percent to 4.5 percent. Still, at around 4.62 percent to end the week, it retained most of the recent decline, preventing an abrupt rebound in private yields, most notably mortgage rates, which also followed Treasury yields down in recent weeks.

No doubt, Treasury borrowing will be garnering more headlines in the coming week as a partial government shutdown looms on November 17 when the continuing resolution approved by Congress two months ago expires. Deficit hawks in the House are alarmed by the ballooning government debt and are demanding deep spending cuts in return for a new funding bill. Regardless of how or when the issue is resolved, the government will always be able to raise funds in the capital markets and pay whatever interest rate investors demand. That's not the case with private borrowers, whose ability to service debt is coming under increasing pressure. And unlike the market for Treasury securities, lenders can readily deny loans to households and businesses, particularly less creditworthy ones. Both debt servicing and credit availability stresses were on full display this week; how they evolve going forward will have a strong bearing on the economy's performance in 2024.

The most ominous pattern is being seen among households, the economy's main growth engine. Consumer spending has been outpacing income growth for most of the post-Covid recovery, but households filled the income shortfall by drawing down their enormous pool of pandemic-era savings and stepping by borrowing. However, both funding sources are either drying up, becoming more expensive or difficult to obtain. Estimates vary regarding how much excess savings is left out of the more than \$2 trillion accumulated through generous government support payments and from unspent funds during the health crisis. We believe that less than \$500 million remains, and most of that resides in the hands of upper-income households who tend to treat these funds as wealth rather than for spending purposes. While reflective more of flows than levels, the precipitous drop in the savings rate over the past 2 1/2 years, from a peak of 26 percent in April 2021 to the current 3.4 percent, echoes the depletion of the savings cushion that has helped buoy spending in recent years.

Meanwhile, a NY Fed report out this week reveals that households have stepped up their borrowing in the third quarter, with credit card balances staging the largest year-over-year increase since the collection of such data started in 1989. Along with the drawdown in savings to finance purchases, the robust borrowing binge by consumers also contributed to the sturdy increase in consumer spending this year, including most notably the eye-opening 4 percent growth rate in the third quarter. But the borrowing binge is taking a toll on household budgets, pointing to a downshift in spending this quarter and extending into next year. True, not all household debt is a constraint on spending. Most mortgages – which account for the lion's share of outstanding household debt – were taken out at interest rates that are well below the current 7.6 percent and locked in for years to come. Not only are they well below current rate levels, but repayments are also becoming less of a burden as incomes have grown since those mortgage contracts were signed.

Not so for credit card balances, where rates are surging to record levels. Not only does this discourage new borrowing – and, hence, spending – households are falling behind in their repayments on existing balances. That's strikingly revealed in the NY Fed report, which reveals a sharp increase in delinquencies on credit card debt. In the third quarter, the delinquency rate on credit cards rose to just over 8 percent from 7.2 percent in the second quarter. The rate has not been that high since the third quarter of 2011, when households were struggling to emerge from the mountain of debt left over from the Great Financial Crisis. Importantly, the biggest increase is occurring in low-income areas, which aligns with the notion that poorer households have used up most of their savings' cushion. Earlier in the recovery, many lower-income recipients of government stimulus payments used a big chunk of those funds to pay down debt. With that pool of savings depleted and debt levels higher, the ability to stay current on repayments has weakened considerably.

To be sure, while the growing debt burden will restrain spending, particularly among lower-income households, it will not completely stifle consumption, which would send the economy into a recession. With the job market still chugging along, incomes will continue to grow and support spending. What's more, slower price gains are boosting the purchasing power of paychecks, even as workers continue to achieve solid wage increases. True, the monthly jobs reports reveal a slowing of average hourly earnings. But that measure, which tracked a slowdown in October to 4.1 percent over the past year from 4.3 percent in September, is distorted by changes in the mix of jobs from month to month. Other measures that adjust for the changing composition of the workforce portray a heftier gain. The Atlanta Federal Reserve wage tracker, released this week, puts workers' annual pay increases at 5.2 percent in October, the same as September.

No doubt, with income gains catching up to spending, the gap between the two is narrowing and allowing consumers to rely less on savings to support spending. But the impediments to borrowing will still constrain spending. Not only are the high borrowing costs and debt-servicing struggles deterring the demand for credit, households are also facing stricter lending standards that will reduce their access to credit. Aside from the periods involving the Great Recession in 2008 and Pandemic shock in 2000, there has never been a time when the net percentage of banks willing to extend installment loans to consumers was as low as it is this year, according to the latest Federal Reserve Senior Loan Officer Survey, which includes data back to 1982. Nor is it just households facing more restrictive lending conditions. The Fed's survey also shows that banks are closing the credit spigot for small businesses as well.

The notable aspect of the rise in delinquency rates and the growing aversion of lenders to extend credit is that it is occurring amidst a robust job market and a favorable earnings backdrop for businesses. From our lens, these conditions are likely to keep the economy from falling into a recession next year. But labor conditions are gradually turning softer, and we expect job growth to continue to slow in 2024, exacerbating the debt-servicing struggles of households. That, in turn, could narrow the credit spigot even further, reinforcing the drag on spending. These hurdles are expected to cause the economy's growth engine to downshift markedly next year, but not bring on a recession unless the Federal Reserve adds another weight by raising interest rates again. The risk of that occurring would increase if inflation flares up again, a warning that Fed chair Powell noted in a speech at the International Monetary Fund on Friday. But the very conditions underpinning the worsening financial plight of households and small businesses should also keep the disinflationary trend underway from reversing – and the Fed from responding.

## FINANCIAL INDICATORS

INTEREST RATES	Nov 10	Week Ago	Month Ago	Year Ago
3-month Treasury bill	5.37	5.43	5.50	4.17
6-month Treasury bill	5.46	5.49	5.56	4.54
2-year Treasury note	5.05	4.87	5.01	4.32
5-year Treasury note	4.67	4.48	4.65	3.95
10-year Treasury note	4.62	4.52	4.63	3.82
30-year Treasury bond	4.74	4.70	4.77	4.06
30-year fixed mortgage rate	7.50	7.76	7.57	7.08
15-year fixed mortgage rate	6.81	7.03	6.89	6.38

STOCK MARKET					
Dow Jones Industrial Index	34,332.00	34,061.32	33,620.29	33,747.86	
S&P 500	4,431.50	4,358.34	4,327.78	3,992.93	
NASDAQ	15,608.75	13,478.28	13,407.23	11,323.33	

COMMODITIES					
Gold (\$ per troy ounce)	1,941.80	2,000.00	1,945.80	1,774.20	
Oil (\$ per barrel) - Crude Futures (WTI)	77.38	80.84	87.69	88.86	

ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Qtrs Ago	Average-Past Six Months or Quarters
Consumer Credit (Sept) - blns of \$	9.1	-15.8	11.2	5.1

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