

The Unexpected Tailwinds Of Higher Rates

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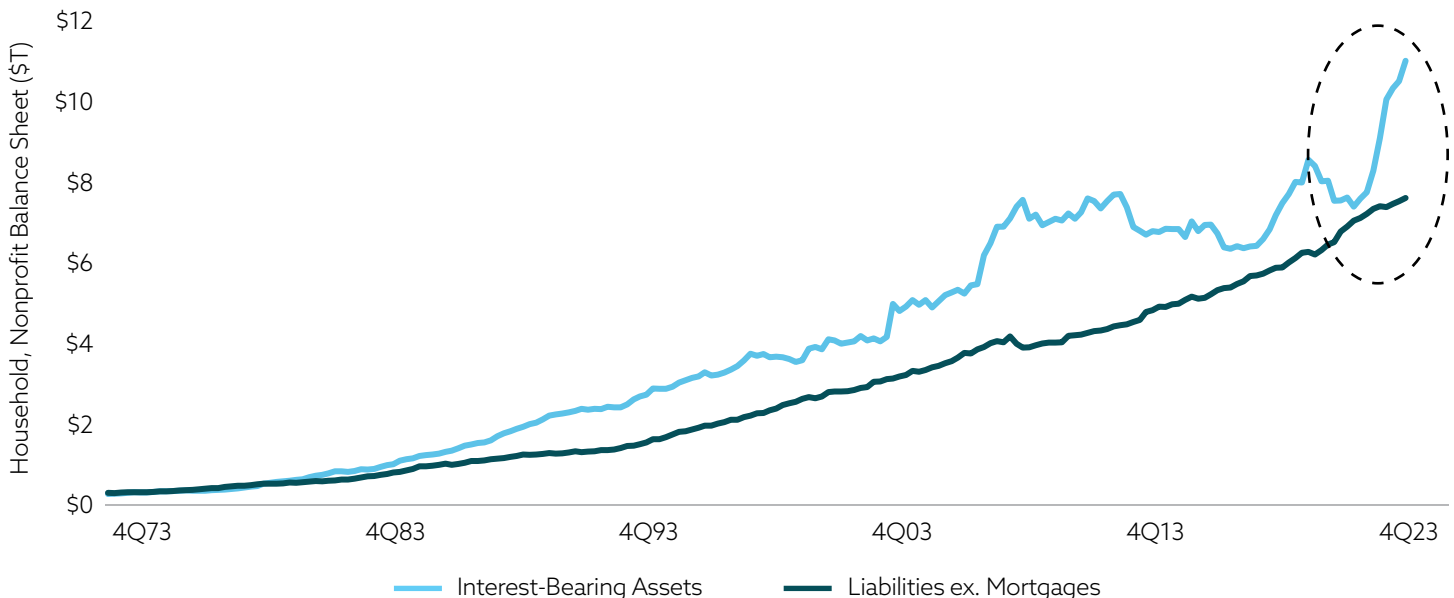
Despite the Federal Reserve (Fed) raising its benchmark interest rate by over 5%, the US economy has grown for seven straight quarters.^{1,2} This resilience has been led by the US consumer. Despite idiosyncratic headlines about layoffs, the overall unemployment rate has remained historically low and initial jobless claims have not spiked, providing confidence to consumers and driving spending. On the other end, businesses have, in general, been able to [absorb higher interest rates](#) and maintain employment levels.

But there is another aspect to the US consumer that is receiving more and more attention from economists and markets.

SIGNIFICANT INCOME

The Fed significantly raised interest rates in 2022 and 2023. At the same time, the amount of interest-bearing assets (debt, loans, MMFs) on household balance sheets spiked from around \$7T to nearly \$11T. When compared to non-mortgage liabilities, the current gap of over \$3T is nearing the record from early 2009. This gap is providing US consumers with a significant stream of income. Further, this analysis excludes the more than \$30T households own in retirement assets such as pension funds that can also benefit from today's elevated interest rate environment.

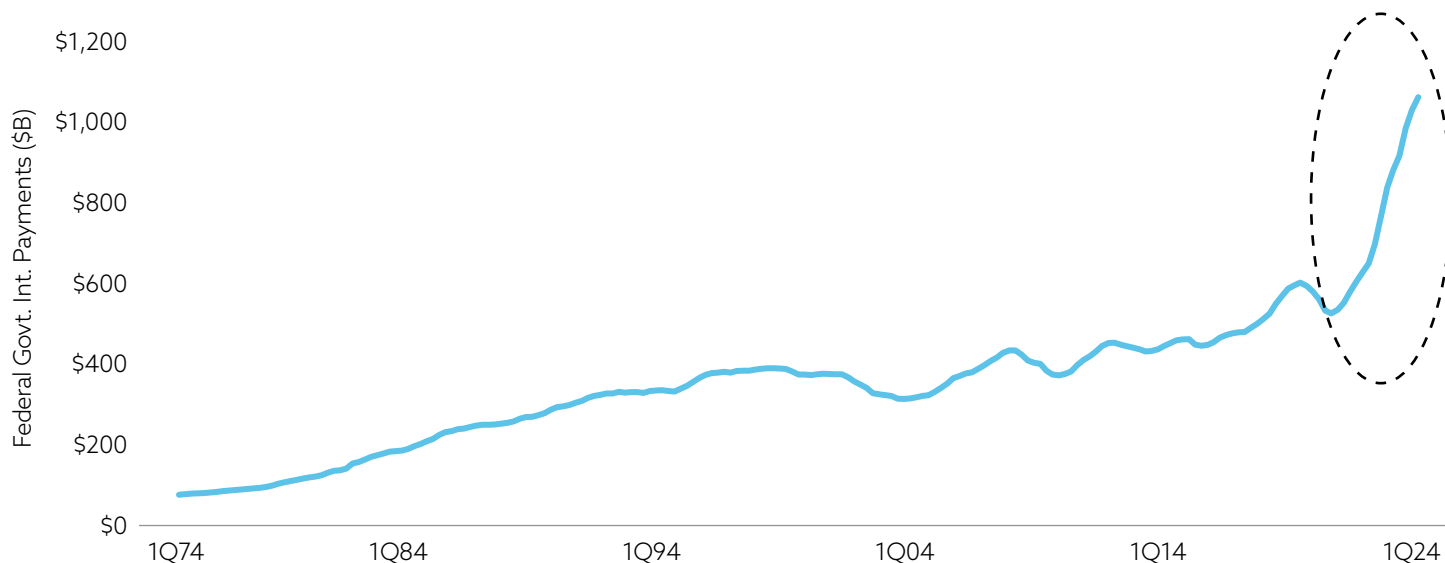
INTEREST RATES HELPING MORE THAN HURTING US HOUSEHOLDS?³



(1) As of 22 May 2024. Unless otherwise stated, the information presented has been prepared from market observations and other sources believed in good faith to be reliable. Information and opinions expressed by PPM are current as of the date indicated and are subject to change without notice. Past performance is no guarantee of future results. Forward-looking statements are subject to uncertainties that could cause actual developments and results to differ materially from the expectations expressed. (2) Bureau of Economic Analysis. 25 April 2024. (3) FRED, Federal Reserve Bank of St. Louis. Quarterly data for households and nonprofit organizations through Q4 2023, the latest available. Interest-bearing assets are an aggregate of debt, loans and money market funds.

Investing is a zero-sum game, so who is providing this income to US households? The US Treasury is one example. The significant increase in interest rates has led to a spike in Treasury interest payments. The seasonally-adjusted annual rate has surpassed \$1T, or approximately \$88B per month in the pockets of US households and other investors.

THE FEDERAL GOVERNMENT HAS BEEN PAYING A LOT MORE INTEREST⁴

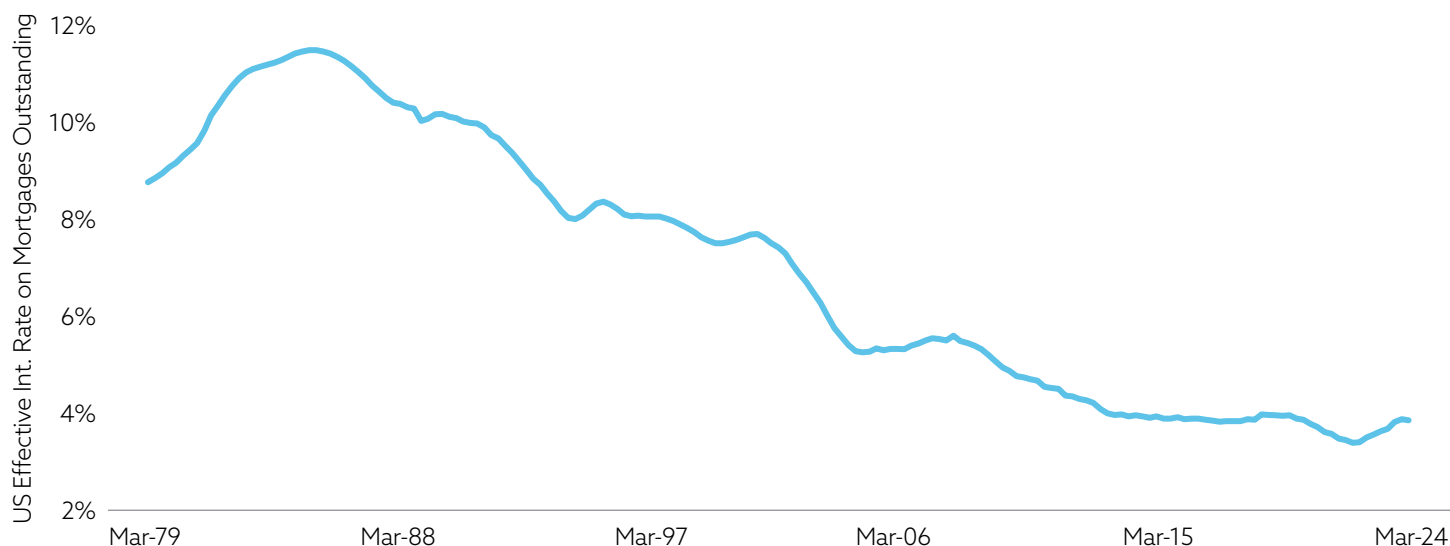


COROLLARY: DON'T FORGET FIXED RATE MORTGAGES, BABY BOOMERS

The idea that rising interest rates can stimulate the economy is a fringe economic theory that appears to be getting more attention. Our view is that higher rates are simply doing less economic damage than in the past. The preceding data help show how, but there are two secular shifts unique to this cycle that explain why.

The first is a direct result of the previous cycle, specifically the Fed's zero interest rate policy that lasted over a decade. Many US households locked in mortgage rates at historically low levels. Despite current mortgage rates more than doubling since 2022, the effective rate paid has barely budged. This is why our analysis above of household balance sheets excluded mortgages when discussing liabilities – at a national level, mortgage rates have hardly moved relative to the magnitude of interest rate increases. Arguably, without this phenomenon, higher interest rates would be a much larger headwind to consumers.

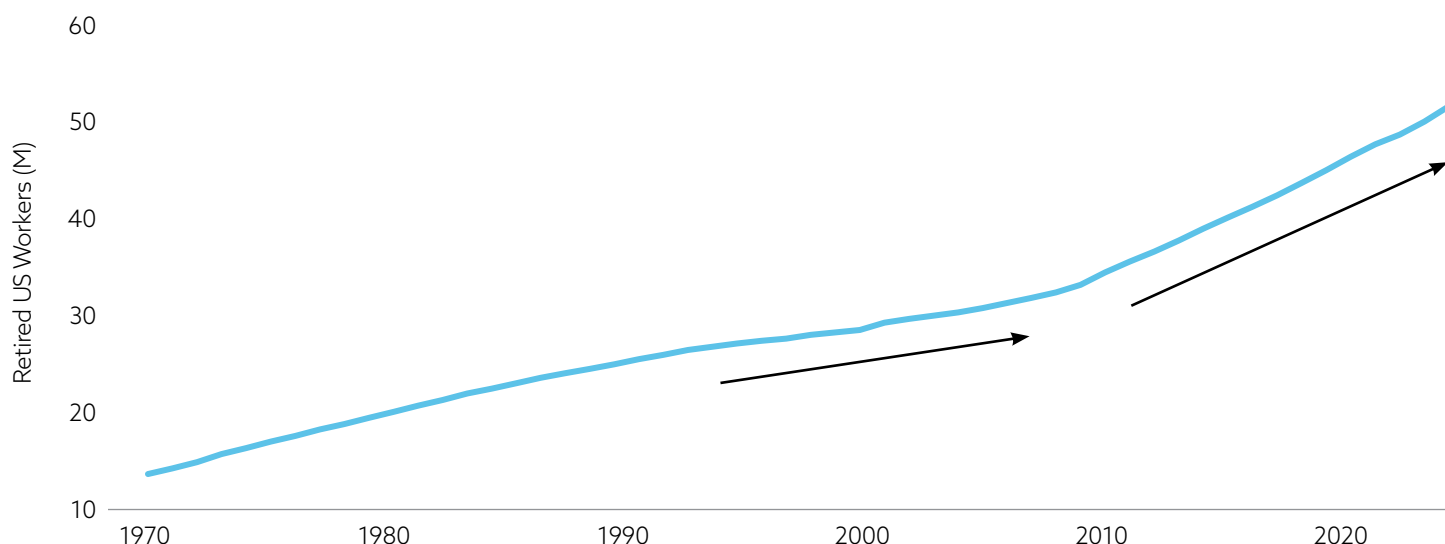
HOUSEHOLDS BROADLY NOT IMPACTED BY ELEVATED MORTGAGE RATES⁵



(4) FRED, Federal Reserve Bank of St. Louis. Quarterly seasonally-adjusted annual rate through Q1 2024. (5) Bloomberg. Quarterly data through Q1 2024.

The second secular shift has been the aging of the Baby Boomer generation, which has led to a sharper increase in the number of retired workers since 2009. These workers are receiving social security benefits, but also hold trillions in retirement savings. Broadly, more retirees with more savings are allowing them to invest and earn larger incomes, boosting their potential spending. However, if we were not at a point in time with a record number of retirees, consumers would not have as many assets to invest at today's higher interest rates.

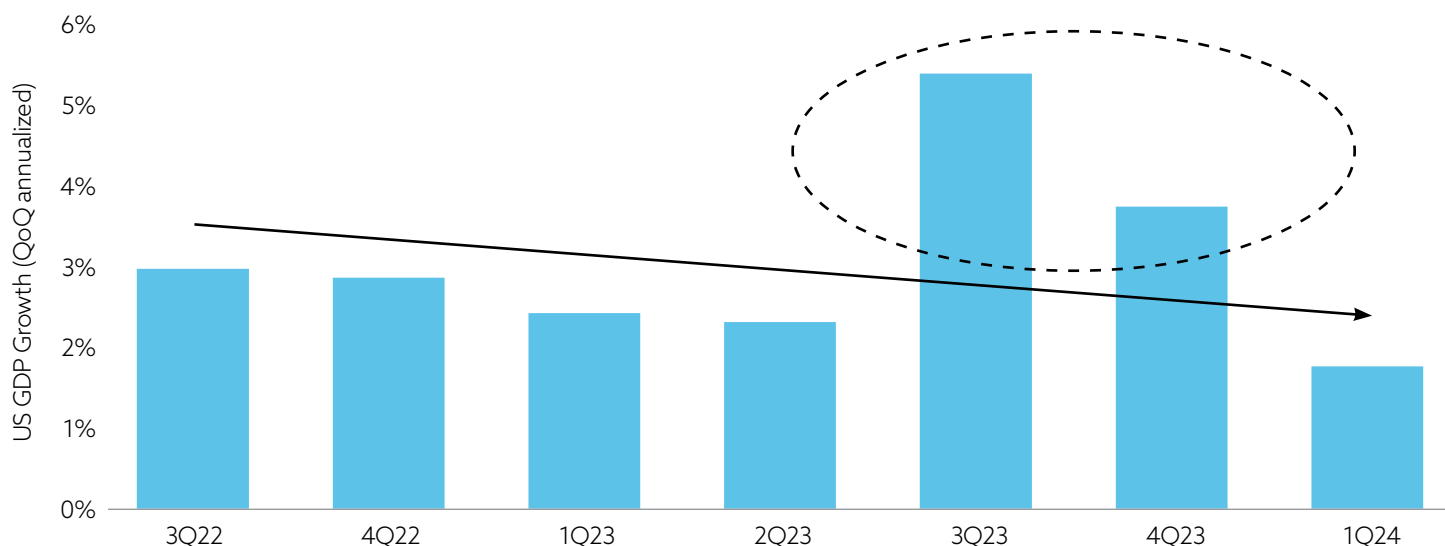
MORE RETIREES WITH MORE SAVINGS⁶



CONTINUED LAGGED EFFECTS OF HIGHER RATES?

Even as the US economy surged in the second half of 2023 (personal consumption expenditures alone contributed 2%+ to growth in those quarters), we worried long and variable lags were still at work.⁷ While more painful for lower-income workers, higher interest rates must be endured by all borrowers. Indeed, outside of H2 2023, quarterly GDP growth has been on a downward trend since the middle of 2022. Current expectations for the second quarter of 2024 call for a modest increase, but higher-for-longer could take its toll. Investment income is up, but so are rates on auto loans, credit cards, business loans and, yes, even mortgages for many seeking to purchase a home.

OUTSIDE OF H2 2023 OUTLIERS, GDP GROWTH HAS DECELERATED⁸



Market participants have been hoping for decelerated growth if it leads to Fed rate cuts. But, considering the analysis we just presented, could lower rates be less positive for the economy?

(6) Social Security Administration. Annual data through 2023. (7) Bureau of Economic Analysis. 25 April 2024. (8) FactSet. 7 May 2024.

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(9) AUM includes committed but unfunded capital for PPM's private equity and commercial real estate businesses.

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