Covid resurgence weighs heavily on US households

The seventh biggest fall ever in University of Michigan sentiment must be acknowledged as a clear sign that the latest Covid spike is causing huge anxiety amongst households. Rising inflation is adding to their worries. Sentiment has given misleading signals on spending before and we think it will do again this time, but caution is warranted

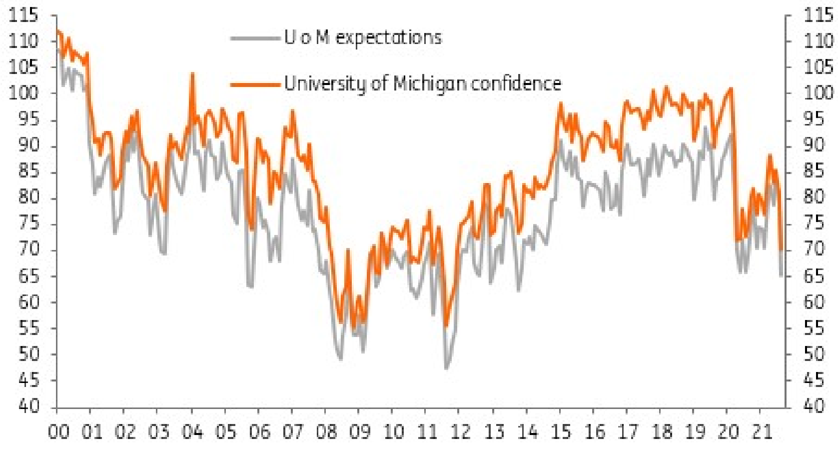
Movement of people wearing a protective mask and maintaining social distance, Domino Park, Brooklyn

Source: Shutterstock

Huge hit to sentiment

The University of Michigan consumer sentiment report has thrown up a very negative surprise with confidence plunging to its lowest level since 2011. It is an 11 point drop to 70.2. A huge fall has only been previously seen around major events, such as the pandemic start (March 2020 with an 11.9 point drop followed by a 17.3 point drop in April 2020), the Global Financial Crisis (12.7 point drop in October 2008) and Hurricane Katrina (12.2 point drop in September 2005).

University of Michigan sentiment index



Source: Macrobond, ING

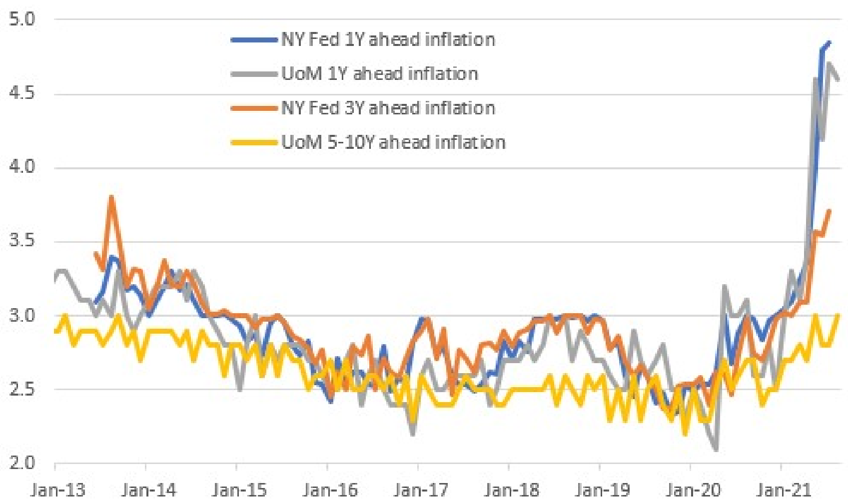
Covid worries return

It is difficult to rationalise given the strong macro performance and equity markets at all-time highs. Weakness seems driven by concerns over personal finances, which may at the margin be related to the ending of unemployment benefits, but we have to attribute the majority of the weakness to the latest spike in Covid cases. After all, there was a huge (37 point) drop in the "country will have continuous good times over next 12 months", while the survey also thinks there will be more unemployment over the next 12 months.

Inflation anxiety played its part

It could also be tied to inflation anxiety – 47% of households think inflation will exceed income growth over the next 1-2 years with just 19% thinking incomes will outpace inflation. The "good time to buy major household item" fell 11 points, which could also be tied to this. So too the readings for home purchases and vehicles.

Inflation expectations series

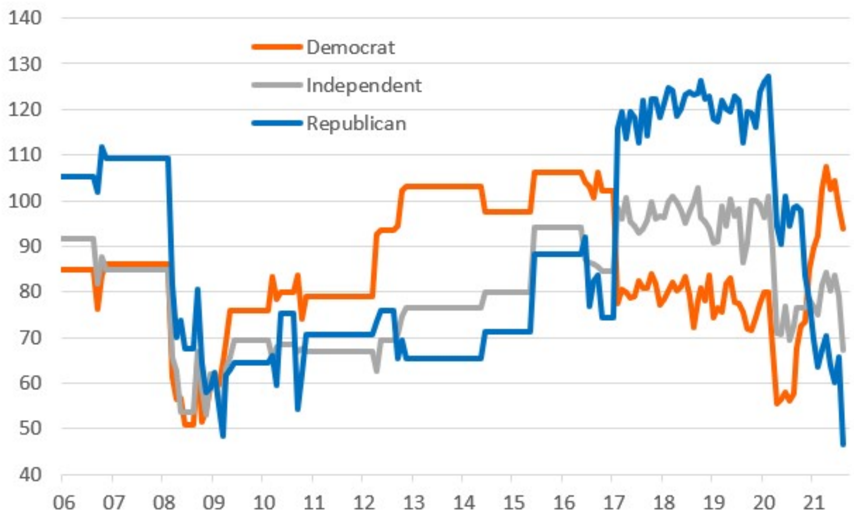


Source: Macrobond, ING

The political divide grows

There does seem to be a political angle as well. Confidence amongst Republican Party supporters plummeted from 65.7 to 46.7. That is an all-time low for a series that goes back to 1984! Sentiment amongst Democrat supporters did fall, but by less than 5 points. Independents were obviously in between – showing a drop of 11.6. The Republican Party themselves have been pushing the line that Government spending plans will only add to inflation risks while eye-balling a map shows that several of the Republican controlled states are seeing some of the biggest increases in Covid cases.

University of Michigan sentiment split by political support



Source: Macrobond, ING

Beware misleading signals...

That said, plunging confidence has given misleading signals in the past – such as Hurricane Katrina and we are hopeful that this will be repeated after this month's release. After all, incomes are growing, jobs are being added in significant number, equities are at all-time highs so fundamentals in general are healthy and point to robust spending. We are also highly doubtful that we will see new lockdowns happen in the US given high vaccination numbers, that continue to rise.

Assuming we are correct then the Fed will likely "dial back" on its stimulus this year. The inflation expectations series shows 5-10Y ahead inflation expectations rising to 3% from 2.8%. This follows from the NY Fed survey of consumer inflation expectations that jumped to 3.7%. Given these events it looks increasingly difficult for the Fed to justify its assertion that "longer-term inflation expectations remain well anchored at 2 percent" as they still do within the FOMC statement.

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