

US: Getting back on track

Covid, inflation and political intransigence have weighed on the economy during the third quarter, but things are starting to look a little clearer as we move into the final three months of the year. Inflation remains an issue though with the Federal Reserve set to dial back on the stimulus this quarter and raise interest rates next year



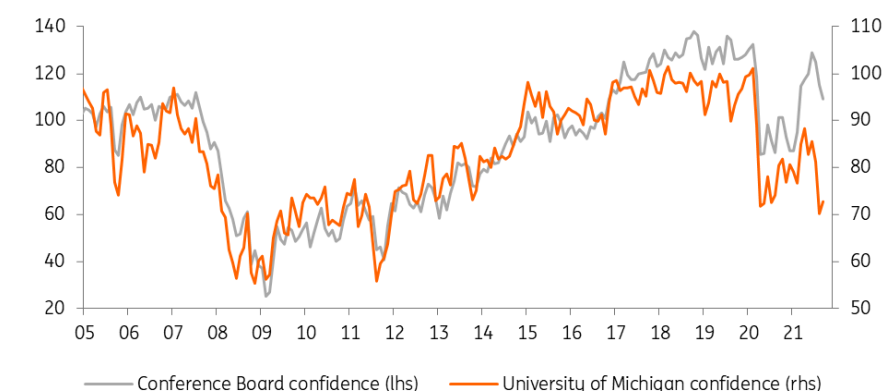
Changing Economy
Downtown Blues,
Nashville, United
States - 10 Sep 2021

Source: Shutterstock

3Q slowdown led by Covid and inflation fears

Growth was always likely to slow following the stimulus cheque driven spending splurge in the second quarter, but the rate of deceleration caught us a little by surprise. The blame lies with the surge in cases of the Delta variant combined with anxiety over rising inflation, which led to consumers spending more cautiously. This was compounded by supply chain strains hurting a number of sectors, most notably vehicle sales, which plummeted from an annualised rate of 18.5m units in April to 12.2m in September.

US consumer confidence fell sharply through the summer



Source: Macrobond, ING

Budget problems add to the uncertainty

With inflation remaining elevated and energy prices rising sharply, we are hearing some commentators raise the specter of stagflation. Nervousness surrounding the US debt ceiling and the lack of progress on President Biden's spending plans is not helping either.

18 October is the date that Treasury officials have suggested as the deadline for when the US exhausts all its options to prevent a potentially calamitous debt default. To prevent this the debt ceiling either needs to be raised or suspended in order to allow the government to continue paying its obligations. For electoral reasons, Republicans want to label the Democrats as the party of higher spending, taxes and debt and have made it clear they will not be making it an easy process. This is despite having accrued a significant proportion of the debt under President Trump.

The Republicans have offered an extension of the debt ceiling until December, but this will merely kick the proverbial can down the road and we will be facing the same dilemma in two months' time. With little chance of getting the 60 Senate votes required to raise the ceiling, we expect the Democrats will have to go it alone and use the more complicated budget reconciliations process to suspend the debt ceiling. This needs a simple majority (the Democrats' 50 Senators plus Vice President Kamala Harris).

The other problem is that the Democrat party is far from unified on President Biden's spending plans. Our central case is that there will be eventual alignment with the infrastructure plan and a stripped down version of the Build Back Better social spending plan approved that comes in close to \$2tn rather than the \$3.5tn proposed.

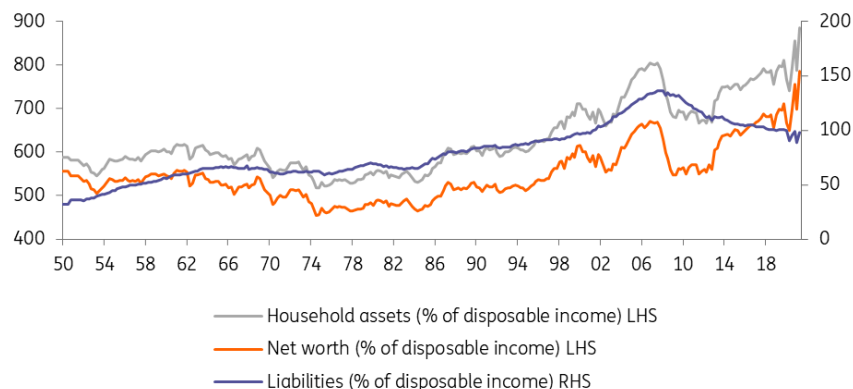
Optimism is returning as Covid wanes

This will lift some of the uncertainty over the economic outlook, but what is really improving sentiment is that Covid cases are falling sharply across the United States. High frequency data suggests consumers are responding positively with a significant turnaround seen in restaurant dining, air travel and hotel stays over the past few weeks.

Household fundamentals are also in great shape. Incomes are being supported by rising employment and with businesses continuing to complain about a lack of suitable workers, we expect wages to push higher. This is complemented by a huge strengthening in household balance

sheets resulting from the unprecedented fiscal and central bank stimulus efforts.

Household balance sheets provide a strong underpinning for spending



Corporate capex is returning and the infrastructure money should start flowing next year. On top of this, we think that the international borders being reopened to vaccinated visitors is going to add an extra \$150-180b of spending in the economy. Exports may also receive a boost from stronger global growth while a rebuild in domestic inventories will add to growth, at the expense of imports.

Persistent inflation puts pressure on the Fed

Unfortunately, we doubt supply chain issues and labour market shortages will be resolved quickly, so inflation will remain elevated through 2022. Remember, too, that housing accounts for a high proportion of the inflation basket and with house prices rising 20%+ year-on-year, this is a story that can offset much of the decline in the components seeing “transitory” inflation.

Given this situation, we continue to expect a Federal Reserve QE tapering announcement in November, which is concluded within six to eight months. We also still expect interest rate rises in September and December next year.

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