US growth re-accelerating after 3Q Covid speed bump

Personal income and spending numbers confirm the economy experienced a slowdown in 3Q, but with Covid cases dropping sharply, incomes rising and household balance sheets in fantastic shape, we think the consumer sector will lead a 4Q rebound with the economy set to grow by close to 5% next year

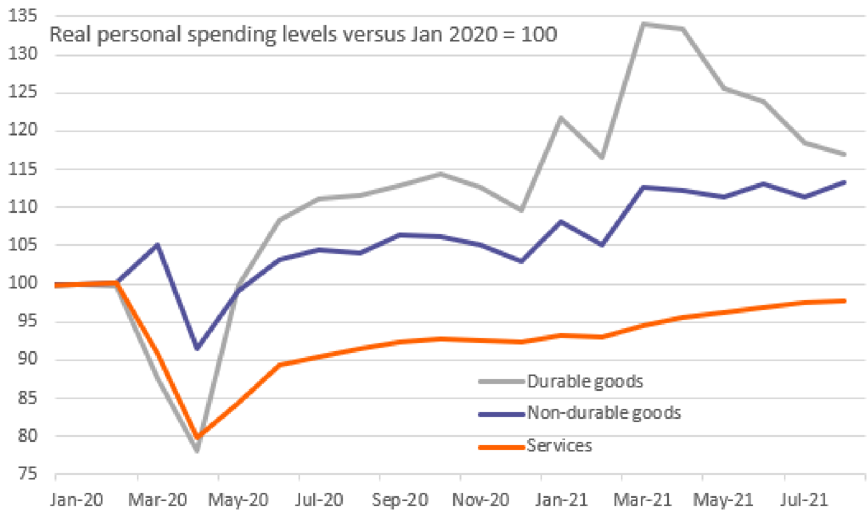
Shoppers at a technology store in Houston

Slower spending a temporary story

The US personal income and spending report is a little disappointing in that while the consumer spending numbers came in broadly in line with expectations for August (0.8% month-on-month nominal, 0.4% real) there was a sizeable 0.4 percentage point downward revision to the July figures. This means that 3Q GDP growth will end up coming in closer to 4% annualized rather than the 5% rate that is the current consensus.

It is quite clear that the resurgence of Covid over the past few months has slowed the economy with consumers behaving more cautiously. However, this looks set to be more of a speed bump rather than a true slowdown in economic activity. With Covid cases now falling sharply the high frequency numbers for September are looking good, be it air travel, restaurant visits or hotel stays. Given these are a good proxy for broader spending on consumer services we expect to see GDP growth to re-accelerate back to something around the 6.5% rate for 4Q.

Real consumer spending levels



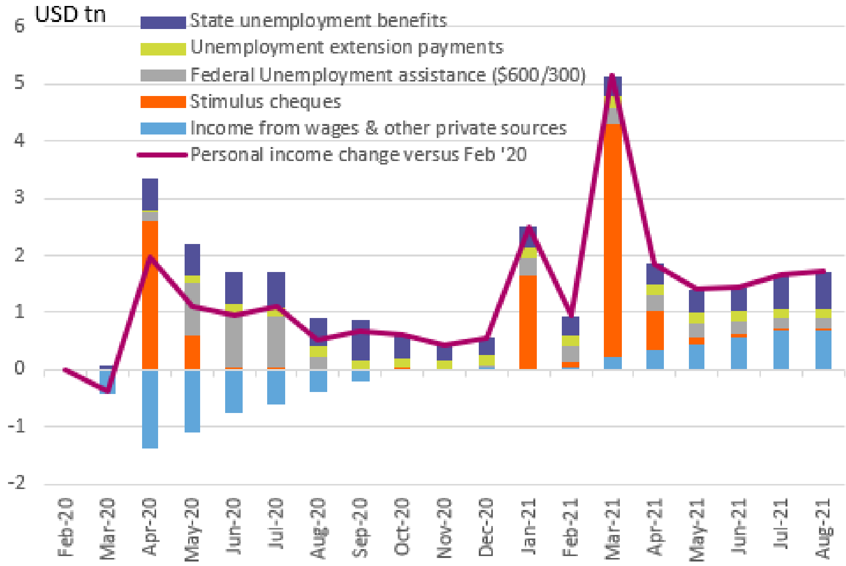
Source: Macrobond, ING

Incomes continue to rise despite waning government support

The chart above shows that spending on services remains 2.2 percentage points below pre-pandemic levels and this is where we expect the bulk of the growth in consumer spending to come from. Spending on durables is moderating now that we have more options on where to spend our money, but it is important to remember that higher service sector spending does not mean spending needs to fall significantly in other areas.

The chart below shows that incomes continue to grow (up 0.2% MoM in August) with the composition showing that while the ending of support from the government's pandemic programs is a headwind, rising income from wages and other private sources is more than offsetting that decline.

Household income changes versus the February 2020 level

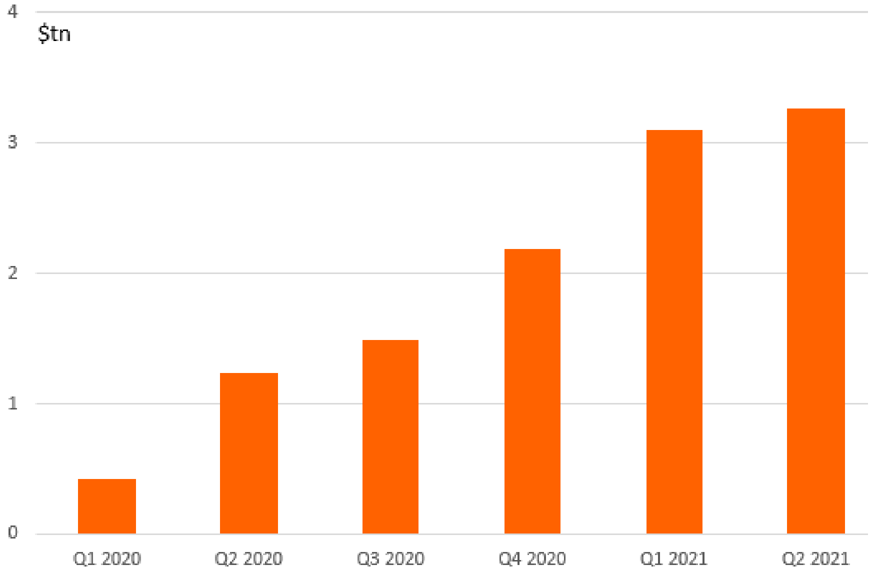


Source: Macrobond, ING

Household balance sheet improvements provide a strong base for 2022

The economy is creating jobs despite the lack of labour supply right now with rising wage growth further boosting household incomes. We also need to remember that household balance sheets are in great shape too. That $3tn accumulated in cash, checking and time savings deposits during the pandemic is a huge support for ongoing strong consumer demand. Given consumer spending accounts for nearly 70% of total economic activity we remain confident that the US will continue to post robust growth rates over coming quarters with full year growth forecast at 4.7% for 2022.

Cumulative increase in household cash, checking and time savings deposits since end-2019

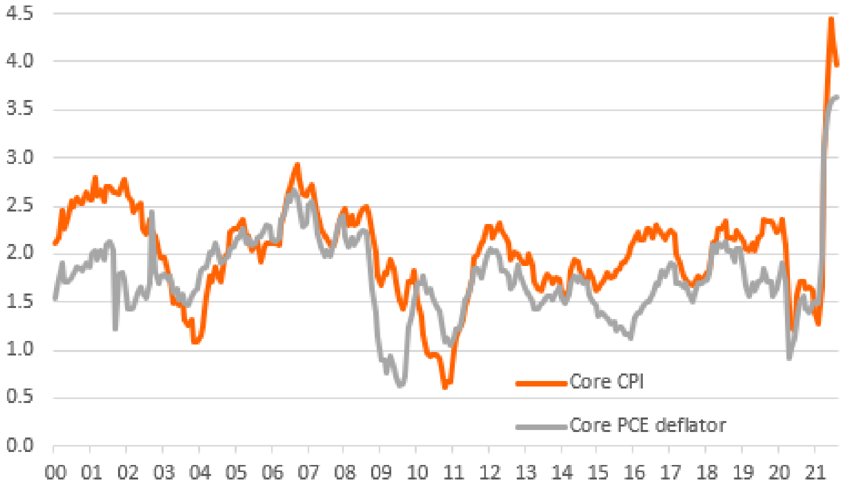


Source: Macrobond, ING

Inflation at its highest since 1991

Separately, the Federal Reserve's favoured measure of inflation – the core Personal Consumer Expenditure Deflator – held at 3.6% year-on-year rather than dropping back to 3.5%. If you go to the effort of measuring to two decimal places, we see this measure of inflation is actually at a 30-year high. Coupled with a likely rebound in next week's September payrolls report this should be enough to confirm a November QE taper announcement from the Fed.

US core (ex food & energy) measures of inflation YoY%



Source: Macrobond, ING

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