US households in fine shape as inflation rises further

While headline readings for income and spending may not look great, the underlying story is one of a household sector that is in a very healthy position. With the economy re-opening consumer demand will continue to drive growth, but the inflation threat is not going to disappear quickly

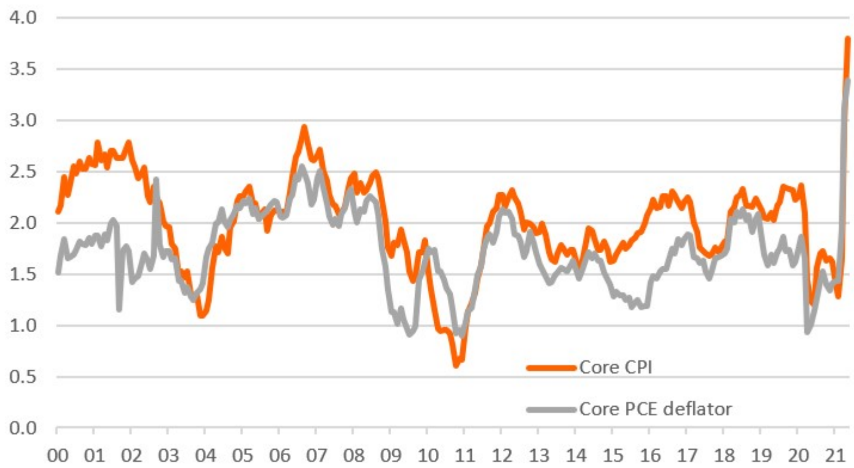
Source: istock

Inflation at a 29-year high

The main market interest in the personal income and spending report is focused on the inflation readings. May's core Personal Consumer Expenditure deflator (the Federal Reserve's favoured inflation measure) has come in as expected at 3.4% year-on-year despite the month-on-month reading being a touch below anticipated at 0.5% MoM versus the 0.6% consensus forecast. The Treasury market appears to have liked that story, as it hints that inflation momentum may be moderating.

Nonetheless, we have to remember that the annual rate of inflation is still the highest since April 1992 and there are plenty of inflation risks still out there given ongoing supply frictions and the fact businesses are struggling to find workers. This is putting up costs and in an environment for strong consumer demand there is growing evidence that companies are increasingly aware of their own pricing power. We continue to suspect that inflation may not be as transitory as the Federal Reserve initially thought.

Core inflation at multi-year highs



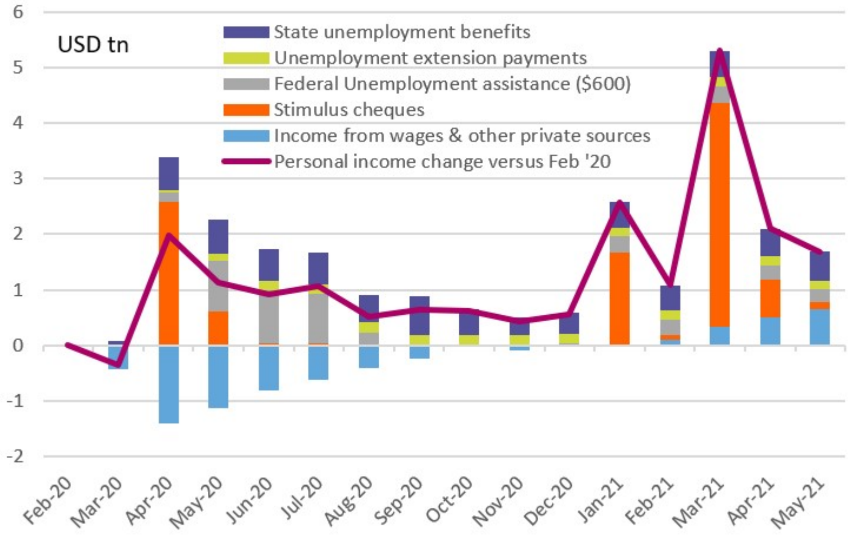
Source: Macrobond, ING

Private income growth is bouncing back

Household incomes fell 2.0% MoM, but this is mainly a legacy hangover from the $1,400 individual Federal stimulus payments that mostly came in March, but some payments continued into April (see the orange bar in the chart below). In any case income levels remain well above pre-pandemic levels. This explains why consumer spending has been able to grow while at the same time households have paid down credit card balances and have increased cash, checking and time savings deposits by $3tn since late 2019.

This is an excellent story that can drive spending in the months and quarters ahead. Note too the big improvements in income from wages and other private sources (the blue bar). With jobs coming back and wages ticking higher this, in addition to improved finances, can continue to provide really strong impetus to booming consumer demand.

Household income levels versus February 2020 (USD tn)



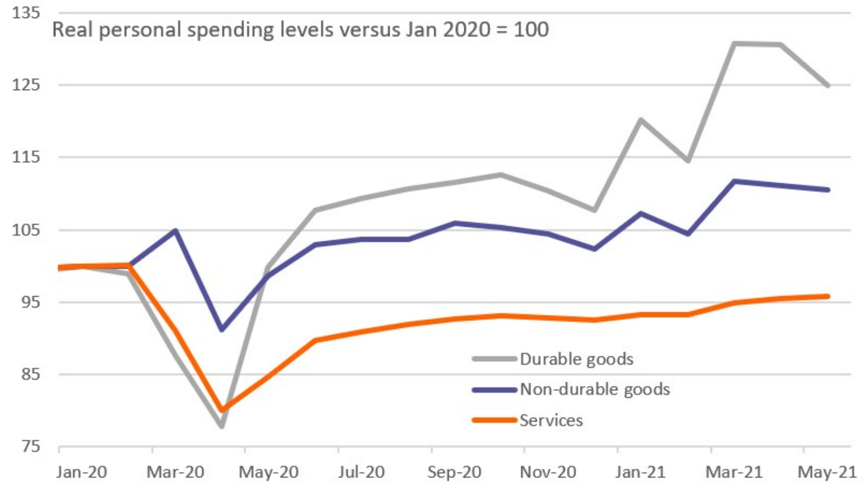
Source: Macrobond, ING

Spending is rebalancing towards services

Rounding out the details of the report we see that personal spending was flat on the month and fell 0.4% in real terms after the recent stimulus fueled surge. This was weaker than the 0.4% nominal and -0.1% inflation adjusted figures expected, but we should note some significant upward revisions to the recent history. April's figures were revised up by 0.4 percentage points for both measures so on balance the report is broadly as expected when looked at in level terms.

As the chart below shows, we are starting to see a rebalancing away from the purchase of physical goods, particularly durable goods, towards services. As the re-opening gathers momentum we expect to see more and more spending being focused on services such as travel and leisure. Importantly, this does not mean spending needs to fall significantly in other areas since private sector income growth looks set to accelerate sharply and we have to remember that consumer finances are in great shape.

Household consumption levels



Source: Macrobond, ING

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