

What's next for the US after the summer spending splurge

The US economy has performed strongly with the Federal Reserve and financial markets both re-evaluating the likely path for interest rates. But the Beyoncé and Taylor Swift stimulus has ended and households are facing more challenges. Sharply higher borrowing costs will increase financial stresses in the economy and mean recession fears will linger



Recent tours by Taylor Swift, pictured, and Beyoncé have given the US economy a helping hand as Americans spent big

Robust consumer spending means 4% GDP growth is possible

The US economy has had a stellar summer, with third-quarter GDP growth set to come in close to 4% annualised. Robust consumer spending has been the main driver, with households keen to maintain their lifestyles by tapping savings and borrowing on credit cards while inflation continues to eat into spending power. Leisure, tourism and travel have performed particularly strongly, with air passenger numbers hitting record highs, cinema attendance climbing and record-breaking concert tours by Taylor Swift and Beyoncé benefiting hotels, restaurants and bars wherever they performed.

Residential construction has done better than expected, too, with a lack of existing homes for sale boosting prices and making home building more profitable. Non-residential construction also continues to benefit from government initiatives, including the Inflation Reduction Act and the CHIPS Act that promote investment in energy infrastructure and semi-conductor production facilities.

Higher for longer Fed messaging drives borrowing costs up sharply

This means the US jobs market has remained hot with the Federal Reserve wary that unless the economy cools sufficiently, inflation may not slow sustainably to the 2% target, despite recent favourable data. At the September FOMC meeting, the Federal Reserve left the door open to a further rate rise while signalling it saw less chance of interest rate cuts next year. The market has also been reconsidering the prospect of policy easing and, in combination with lingering concerns over the scale of US government borrowing needs over coming years, we have seen Treasury yields climb. Longer-dated yields are at their highest level since 2007; we expect the 10-year to soon hit 5%.

This is pushing borrowing costs higher throughout the economy, with the pace of increase reigniting talk of potential financial stress emerging at some point. We already know that credit card and auto loan delinquencies are rising quickly while mortgage rates, which are fast approaching 8%, are prompting a downturn in prospective home buyer traffic. Car loan rates are climbing and even good quality corporate names are not immune from the rise in borrowing costs, leading to some market concern about the impact on investment plans and long-term corporate profit growth. Commercial real estate remains the big worry though given weak valuations, subdued office usage and the prospect of significant refinancing needs over the next 18 months.

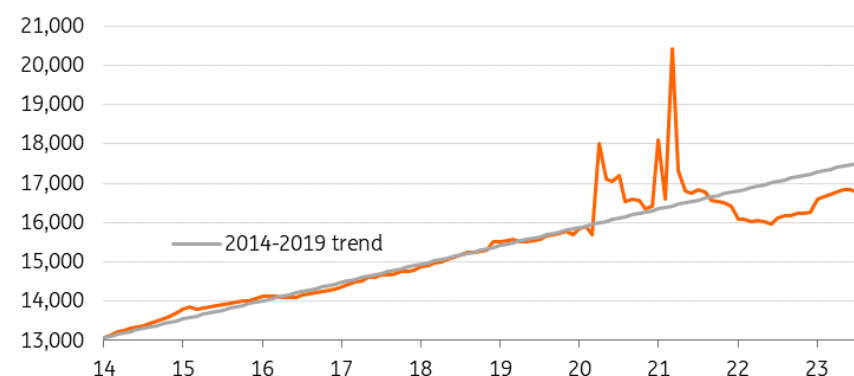
Household headwinds set to blow much harder as Taylor Swift moves on

The challenges facing the economy and the household sector, in particular, will intensify in the current quarter now that Beyoncé's tour has concluded and Taylor Swift has moved on to stimulating Latin America's economies. The Federal Reserve's own Beige Book warned that the summer spending splurge was mostly considered "the last stage of pent-up demand... from the pandemic era". It also noted that there were reports that "consumers may have exhausted their savings and are relying more on borrowing to support spending". There have been significant revisions to personal income and spending numbers and our calculations suggest that there is a larger savings war chest left than we had previously thought. Nonetheless, we would certainly agree that for many lower-income households, the cash savings accrued during the pandemic via reduced spending and higher incomes have been run down to zero.

These data revisions also showed a concerning trend for real household disposable income (RHDI). While incomes spiked during the pandemic, they have dropped back and have effectively flatlined over the past two years. Furthermore, they are over \$800bn below where the pre-pandemic trend of growth suggests that we should be. In fact, RHDI has fallen for the past three months, which raises real concerns about how long consumer spending can remain so strong. If we don't have meaningful income growth, savings are depleted and credit is much harder to come by, the economy more broadly will struggle given consumer spending accounts for nearly 70% of

economic activity. And this is before we consider the additional financial pressures from the restart of student loan repayments.

US Real Household Disposable Income (\$bn) relative to the 2014-19 trend



Source: Macrobond, ING

Inflation will offer the Fed the flexibility to respond with rate cuts

Auto strikes will also provide a headwind for the economy, hitting suppliers and logistic companies, with some temporary lay-offs already announced while a government shutdown may only have been temporarily delayed by the recent stop-gap deal.

There has at least been good news on inflation with three consecutive 0.1% or 0.2% month-on-month prints for the Fed's favoured measure – the core personal consumer expenditure deflator. Slowing housing costs will increasingly depress this core inflation measure although recent rises in food and energy costs will mean headline inflation rates will be slower to fall.

Given the backdrop of inflation looking less threatening and the economic outlook looking increasingly challenging, we continue to doubt that the Fed will carry through with another interest rate increase. The spike in Treasury yields is doing the heavy lifting, but if they continue to move higher at the current pace it risks triggering economic pain that could quickly snowball. As a result, we continue to see the risks skewed towards more aggressive policy easing than the market is pricing for next year with rate cuts potentially starting in the spring.

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