US spending breakdown fuels recession fears

US consumer spending has been revised sharply lower through the first four months of the year, and with May now reporting an outright contraction it is clear that the trajectory of the US economy is not looking good. Further interest rate rises and an ongoing squeeze on spending power mean that growth forecasts are likely to be cut with recession risks rising

Services data is disappointing given the figures on people movement from Google which suggests people have been on the move and spending money

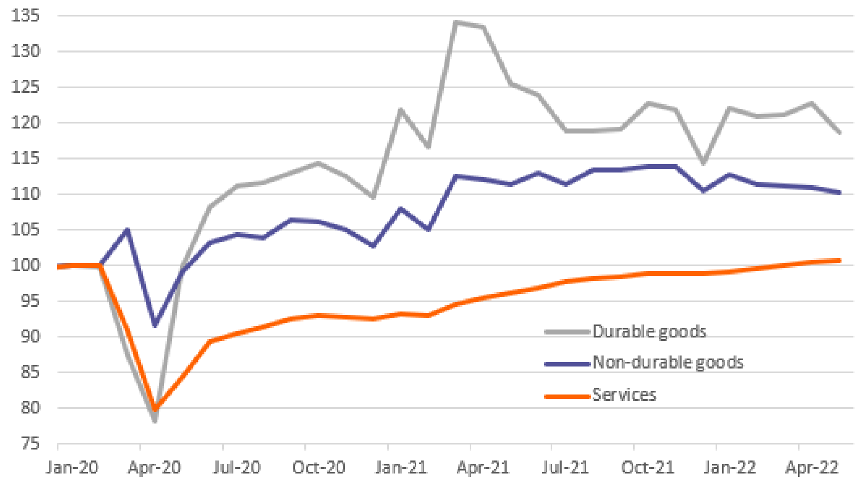
Inflation slows, but spending downturn warrants the headlines

The May personal income and spending report offers some good news in that the Federal Reserve's favoured measure of inflation – the core PCE deflator – slowed from 4.9% to 4.7% year-on-year versus the consensus forecast of 4.8%, but the activity front is not pleasant viewing.

Real consumer spending fell -0.4% month-on-month rather than -0.3% as the consensus predicted, while April's reading was revised down sharply from 0.7%MoM growth to 0.3%MoM. Following the large downward revisions to first-quarter consumer spending data yesterday, it is clear that the consumer sector is not as resilient as we had hoped.

The details show the bulk of the weakness was in durable goods – products that last more than three years, such as cars. This component fell 3.5%, while non-durable goods, such as food and clothing, fell 0.6%. Services spending grew 0.3%, but it wasn't enough to offset the damage elsewhere.

US real spending breakdown (Jan 2020=100)



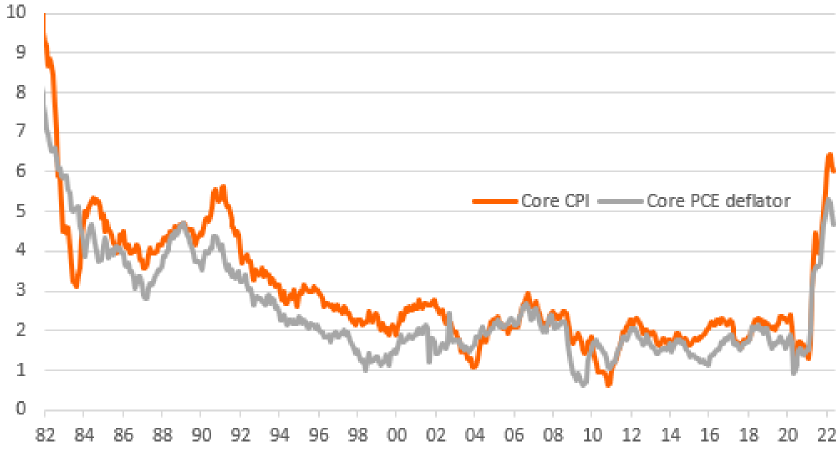
Source: Macrobond, ING

Second-quarter GDP forecasts set to be slashed

The chart above shows that goods spending is well above pre-pandemic levels while services spending is fractionally above. We knew that the goods number was going to be poor given the vehicle and retail sales numbers already published, but we are a little disappointed that services didn't put in a better performance given the data on people movement from Google and air passenger data that had suggested people where on the move and spending money.

Given the weaker consumer spending trajectory seen in the first-quarter GDP revisions, and today's update and revisions to the monthly numbers, it is clear we are going to have to revise down our second-quarter GDP growth forecast. Last month we had been hoping for something close to 3% annualised, but we now think we will be lucky to get something close to 1%. Indeed, even if we see real spending growth of 0.1%MoM in June, this will mean that consumer spending will only have grown 1.1% annualised in the second quarter, which would be the weakest performance since the plunge seen in the immediate aftermath of the pandemic in the second quarter of 2020.

Core inflation measures (ex food and energy YoY%)



Source: Macrobond, ING

Recession risks are on the rise

The dip in core inflation is encouraging, but at 4.7% it is still more than double the 2% target. The Fed has made it clear it is willing to sacrifice activity to get a grip on inflation so the prospect of aggressive rate hikes is undimmed. Consumer confidence is already fragile while the housing market is making creaking sounds, and with more interest rate hikes to come and the squeeze on spending power from gasoline prices unlikely to be eased anytime soon, the prospects for second-half consumer spending are deteriorating. There is a very clear threat that the prospect of recession is a late 2022 scenario rather than early 2023.

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