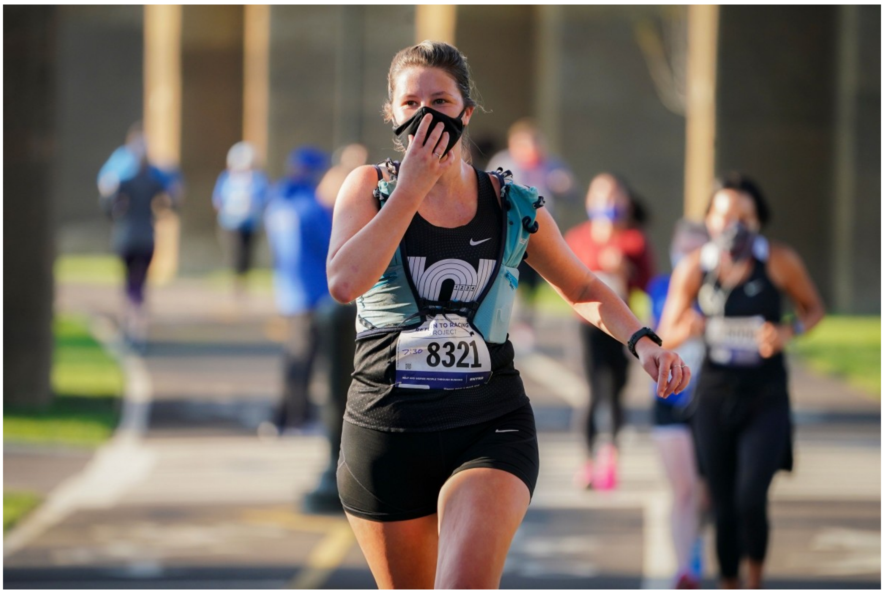
The US economy races ahead but for how much longer?

A record US annualised growth rate of 33.1% in 3Q20 as pent-up demand post lockdowns and surging government transfer payments to households fuelled spending. However, rising Covid cases, consumer anxiety, squeezed incomes and election worries create massive uncertainty for 4Q activity. We tentatively suggest 2% growth, but we can't rule out a drop



Like this masked runner in New York, the US economy roared ahead in 3Q but for how much longer?

33.1%

GDP growth in 3Q 2020

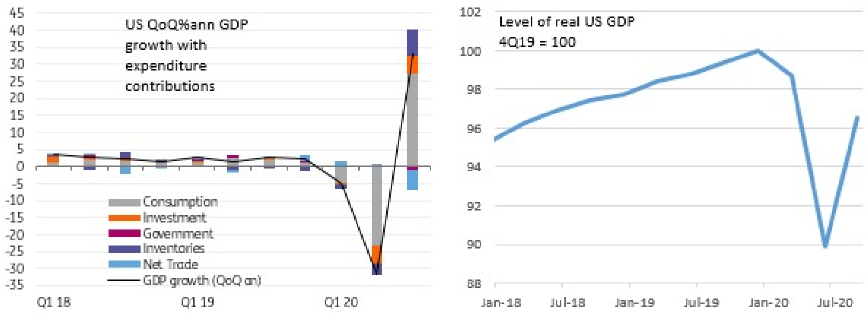
Better than expected

A record rebound

The US economy expanded at a record 33.1% annualised rate in the third quarter, slightly better than the 32% consensus forecast. The post-lockdown rebound was led by a 40.7% gain in consumer spending where durable good consumption jumped 82%. It is important to remember that this wasn't purely a post-lockdown spending splurge, but massive government transfers (the $1200 cheque, expanded unemployment benefits and the $600/week additional Federal payment) supported sentiment and boosted spending.

There was a 59% gain in residential investment as record-low mortgage rates helped trigger a wave of housing transactions and a big 6.6 percentage point contribution to headline growth from inventories being rebuilt following factory shutdowns in 2Q. Net exports subtracted 3.1% from headline growth as consumer demand sucked in imports while government spending subtracted 0.7pp as the CARES stimulus faded.

US GDP growth and output levels



Source: Macrobond, ING

Covid fears, election uncertainty and squeezed incomes

Even after today's record growth figure, we need to remember that output is still 3.5% below that of the end of the fourth quarter 2019 and there are 10 million fewer Americans in work than in February. There is a long way to go until the economy has fully healed and there could be more economic pain ahead.

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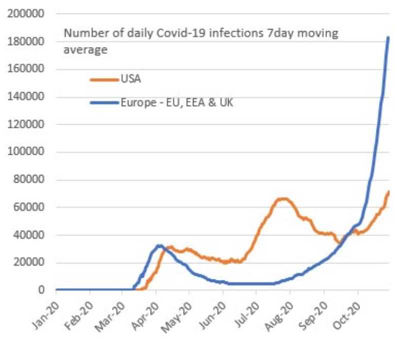
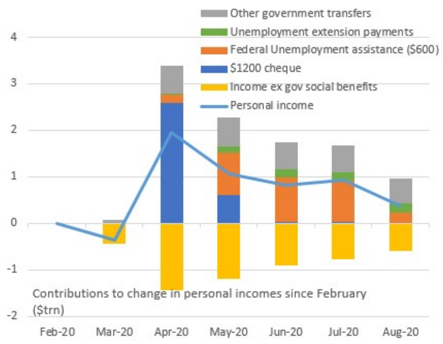
The number of new Covid-19 cases is rising sharply with the potential for social gatherings around Halloween and Thanksgiving accelerating this process. Should hospitalisation rates continue to rise and healthcare systems start to struggle this may necessitate the return of containment measures, such as we are seeing in Europe. This would inevitably be economically damaging and result in more job losses.

Even if we don't see such action, health fears could mean consumers disengage with the economy – not go to shops, restaurants and gyms - and activity weaken in any case.

If next week's election fails to deliver a clear result and we instead get acrimony, legal battles and protests, anxiety levels could rise amongst households and businesses, compounding the problems for financial markets and the real economy. Political animosity would also weaken the prospect of a near-term fiscal stimulus that could prevent the very real chances that household income growth moves into negative territory in November and/or December.

Covid and falling unemployment benefits





Source: Macrobond, ING

Income from employment and assets remains below the levels of February while the support from incomes from the $1,200 government cheque has passed and the $600/week Federal payment has been tapered to $400 (and to $300 in many instances). We also need to remember that millions more have now exhausted their 26 weeks of state unemployment benefits.

With politicians so far failing to agree on a new stimulus plan, there is the risk that uprated benefits soon no longer fully offset to the decline in employment incomes, especially if rising Covid cases lead to a weaker economy and mounting job losses.

A double dip?

We continue to hear encouraging words on the prospect of an approved Covid-19 vaccine in coming months, but the timeframe to roll out a vaccination program means a return to pre-Covid consumer behaviour norms is a long way off. Given the potential health and economic impact of a European style spike in Covid and the prospect of weaker income growth, the risks are increasingly skewed to a sub 2% GDP growth reading for 4Q 2020. If aggressive containment measures are introduced in December it will likely be negative.

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