

US: Feeling the squeeze

Evidence is mounting that while demand is booming, the pandemic has led to damaging scarring of the economy. Supply bottlenecks will be slow to ease, which will negatively impact economic activity and prompt more inflation. The result is we now expect the Federal Reserve to raise interest rates in 2022



Industrial worker people inside warehouse, USA

Source: Shutterstock

Demand is outpacing supply

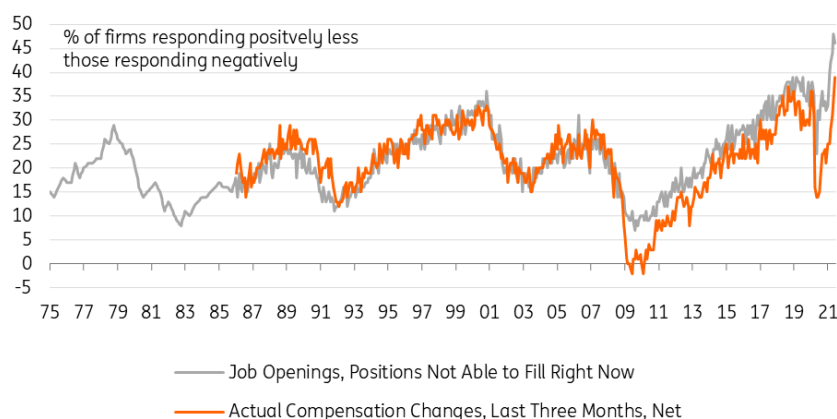
Our long-held views of strong growth, elevated inflation and early Federal Reserve interest rate increases in the US are all still valid, but we have decided to add a few tweaks this month. We are revising down growth a touch, revising inflation upwards and bringing the Fed rate hike call into 2022, as evidence mounts that the supply capacity of the economy is struggling to keep pace with demand.

It is clear from a majority of business surveys that corporate America is facing bottlenecks in supply chains while also suffering from a lack of suitable workers. These capacity constraints mean that output is unlikely to be quite as strong as we had thought likely with 2Q GDP coming in closer to 10% annualised and full-year 2021 growth revised down to 6.7%.

It is important to emphasise this is not a demand issue. Companies are seeing rising order backlogs

at a time when their customers are becoming increasingly desperate with record low inventory levels. The implication is that corporates have got more pricing power than they have had for years, meaning that companies facing higher costs have the ability to pass some (or all) onto customers.

NFIB survey 1974-2021: Businesses can't find workers and are raising compensation at a record pace



Source: Macrobond, ING

Persistent inflation to force the Fed's hand

The rhetoric from Fed officials surrounding the “transitory” nature of inflation has shown clear signs of cracking with the “dot plot” from their June FOMC forecast update now indicating a majority of officials expect interest rates to be increased at least twice in 2023.

Rising worker compensation is set to be a key story for 2H21, to both recruit and retain staff and coupled with surging housing costs, this means inflation looks set to linger in a 3.5-4.5% range well into next year.

We are even less confident that inflation will fade quickly. The narrative that workers would flood back into the jobs market once childcare issues fade and updated unemployment benefits cease is being challenged by evidence that retirement rates have surged through the pandemic, fuelled by booming stock valuations in 401k plans.

Rising worker compensation is set to be a key story for 2H21, to both recruit and retain staff and coupled with surging housing costs, this means inflation looks set to linger in a 3.5-4.5% range well into next year. We suspect the Fed will start tapering its QE asset purchases before the end of this year, with the potential for two 25bp interest rate rises next year.

Author

James Knightley

Chief International Economist, US

james.knightley@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user’s investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.