US spending outlook boosted by income gains

The July personal income and spending report shows household finances are in very good shape and this will keep consumer spending supported. Inflation, meanwhile, continues to rise and will intensify the pressure on the Fed to move earlier on QE tapering and eventual rate hikes

Shoppers at a technology store in Houston

Inflation at a 30-year high

May's core Personal Consumer Expenditure deflator (the Federal Reserve's favoured inflation measure) has come in as expected at 3.6% year-on-year. This is the highest reading since summer 1991 and there are plenty of inflation risks still out there given ongoing supply frictions, surging freight costs and the fact businesses are struggling to find workers.

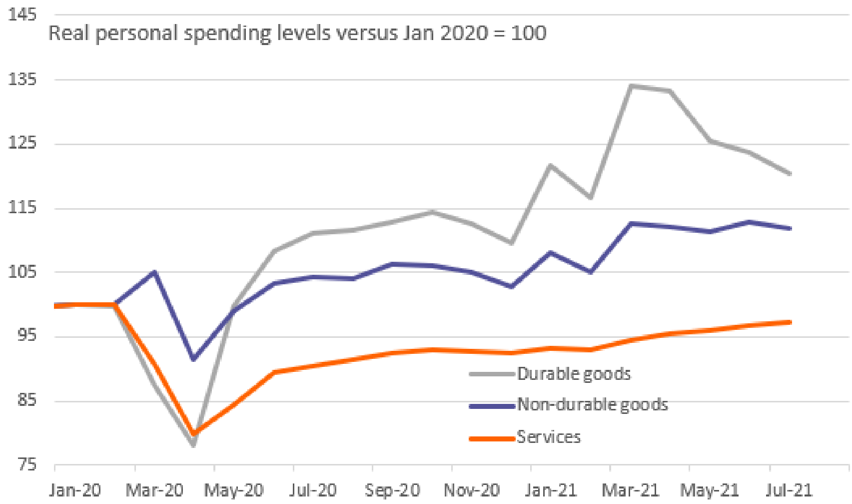
This is putting up costs and in an environment for strong consumer demand there is growing evidence that companies are increasingly aware of their own pricing power. It is an increasing challenge for the Fed to say with a straight face that inflation is “transitory” and supports an earlier Fed QE tapering strategy while we continue to look for at least one interest rate hike next year.

Private income growth is bouncing back

Household incomes rose 1.1% MoM, well above the 0.4% consensus. Wages and salaries rose 1% MoM and have now been rising consistently since March while proprietors' income fell 0.2% and transfer payments increased 2.9%.

This is an excellent story that can drive spending in the months. With jobs coming back and wages ticking higher it can more than offset the ending of extended Federal unemployment benefits and should provide a strong underpinning for consumer demand.

Spending is switching towards services



Source: Macrobond, ING

Spending is rebalancing towards services

Rounding out the details of the report we see that personal spending rose 0.3% on the month and fell 0.1% in real terms after the recent stimulus fueled surge earlier in the year. We are seeing a rebalancing away from the purchase of physical goods, particularly durable goods, towards services with the former seeing a 2.3% MoM decline and the latter posting a 1% increase.

The resurgence of Covid may mean this story loses a little momentum in the short-term as consumer caution leads to less leisure and travel spending. Nonetheless, the success of vaccines means that over the medium term we would still expect to see more and more spending being focused on services.

Importantly, higher service sector spending does not mean spending needs to fall significantly in other areas. With private sector income growing robustly on job creation and higher wages households will continue to have the cash to spend. We have to remember that household balance sheets are in great shape too. That $3tn accumulated in cash, checking and time savings deposits during the paandemic is a huge support for ongoing strong consumer demand while credit card borrowing is $100bn below pre-Covid levels.

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