Beneath the Surface

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SIGNET

On a War Footing

- On the surface, the US economy looks to be in relatively good shape. Lagging or coincident indicators, such as employment and GDP, are holding up well and the inflation surge looks to be rolling over. The US Q3 GDP (advance estimate) came in at a rock-solid 4.9%. The growth observed in the US may be lacking elsewhere, but should we have a more optimistic outlook, given the US data? That US growth has cost a lot of money. The response to the Covid pandemic was swift and significant. Between 2020 and 2021, the government launched a multitude of stimulus packages that injected about $5 trillion directly into the US economy via fiscal policy. A further $5 trillion was added to the public debt load via monetary policy, mostly via the Fed's QE programmes. Therefore, since 2020, US public debt has increased by $10 trillion and now stands at $33.6 trillion, or 120% of GDP. For reference, US public debt-to-GDP previously peaked at 106% in 1945, at the end of WW2. Indeed, the recent trend in US debt-to-GDP looks very similar to the trends experienced around wartime; you might be forgiven for thinking that the US has been on a 'war footing' recently. The chart, below left, highlights the dramatic accumulation of US public debt.

- Household saving, measured as the difference between disposable income and consumer spending, soared during the Covid pandemic. The accumulated difference between actual savings and the pre-pandemic trend can be interpreted as the stock of 'excess savings' in the overall economy. By August 2021, the estimate of accumulated excess savings, in nominal terms and according the Federal Reserve Bank of San Francisco (FRBSF), had reached about $2.1 trillion. The US household sector has been drawing down on these exceptional excess savings ever since, contributing to the 'upside' surprises in corporate and economic releases – and extending the business cycle – where more conservative results might have been expected. The FRBSB assesses that excess savings are due to 'run out' by the end Q4 2023, especially for those in the lower income demographics. The chart, below right, helps quantify the contribution to GDP growth from the drawdown in US excess savings. The green line shows real consumer spending and the blue line shows real disposable income. The red, dotted line shows their average trend over the five years prior to the pandemic. Real consumption plummeted during the early stages of the pandemic but returned to trend by about the middle of 2021. Real disposable income, by contrast, spiked during the early stages of the pandemic, before plunging below trend. The gap between real consumption and real disposable income has been financed by drawing down excess savings. Real consumption would be c. 3% lower without the excess saving drawdown. All other things being equal, this would have left real GDP about 2% lower.

- The drawdown in excess savings in the US can explain recent growth in the face of lagging real income and tighter financial conditions. Unfortunately, studies of highly indebted modern economies suggest that while an economy's fiscal multiplier may be 'event' positive for a year or two, it normally turns negative after three years, as the government sector crowds out private sector productivity. Coincidentally, the US Conference Board Leading Indicator Index (LEI) has tumbled for the 18th straight month, to levels not experienced outside recession (-7.8% YoY). Lastly, let's not forget that US Q3 GDP of 2007 also came in at a rock-solid 4.9%.