The last major Corona stimulus program in the US ends in September

hpo economic commentary, 3rd quarter 2021

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The change in consumer behavior due to Corona has not yet returned to normal.

Consumption in the US remains of great importance for the global economy with crucial months ahead. Until 6 September 2021, the American unemployed will continue to receive $ 300 a week on top of their regular unemployment benefits. Simultaneously, many other measures of the "American Rescue Plan" adopted by the Biden Administration in March will expire.

The expiration of this program will likely have the following consequences:

- **Disposable income:** Disposable income of Americans, which paradoxically rose during the crisis due to sizeable federal transfer payments, is expected to drop again.
- **Unemployment rate:** The rate will continue to fall for the foreseeable future as the unemployed once again have a greater financial incentive to return to work. Although the unemployment rate is still 50 % higher than before the crisis (5.4 % in July 2021 vs. 3.5 % in February 2020), many US companies struggle to fill their vacancies. There is currently upward pressure on wages in the US.

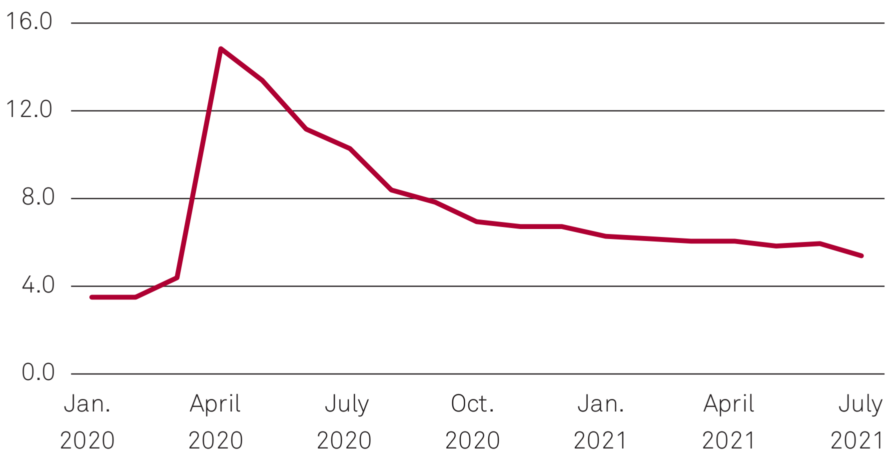

Fig. 1: US unemployment rate from January 2020 to July 2021
Source: Federal Reserve Bank of St. Louis, Illustration hpo forecasting

These two effects – reduced transfer payments vs. further declining unemployment rates with rising wages – will partially offset each other in their effect on consumption. The question is which effect will dominate. The decline in US unemployment seems to be accelerating again. This could indicate that the unemployed are once again increasingly looking for a job given the imminent expiration of supplementary payments.

Despite the falling unemployment rate, the **disposable income** of private households dropped significantly in the second quarter, after the majority of citizens still benefited from direct government payments of $ 1400 in the first quarter. However, it is still above pre-crisis levels, as it was throughout the Corona crisis.

Although disposable income has fallen, **all major consumer spending categories continue to rise** (see fig. 2 on the next page). This additional spending is being financed with the liquidation of savings. As a result, the savings rate nearly halved in the second quarter from 20.8 % to 10.9 % compared with the first quarter of 2021. The significant shifts in consumption since the outbreak of the pandemic, with a sharp rise in spending on consumer goods at the expense of services, have not yet been corrected. However, this is to be expected in the coming quarters.

Interestingly, the US industrial sector benefited only to a limited extent from strong consumption. While **industrial production** in Europe and especially in China returned to or exceeded pre-crisis levels no later than the beginning of the year, the same figure in America is still clearly below the 2019 level. Despite all the measures taken, the industrial sector in the USA continues to lose weight.

The crucial question now is how the "doped-up" American economy will cope with the withdrawal starting in the fall. The current stimulus program will soon expire, but it is still completely unclear whether and in what size the Democrats' planned **infrastructure and social program** will get through Congress.

Given the **persistently high inflation rate** (5.4 % in June and July) and falling unemployment, there is increasing pressure on the Fed to cautiously reduce the purchase programs of US government bonds ($ 80 billion/month) and securitized mortgage securities ($ 40 billion/month), which are still running at full speed. Such so-called tapering entails risks for the highly valued US financial markets.

Thanks to **ultra-expansive fiscal and monetary policies,** the US economy has pulled through the existential crisis of the past 18 months remarkably well, and its stabilizing effect on the global economy should not be underestimated. However, the spirited intervention also led to major misaligned incentives and bubble formations in numerous markets. Getting this situation back to normal will be far from easy and still involves significant risks.

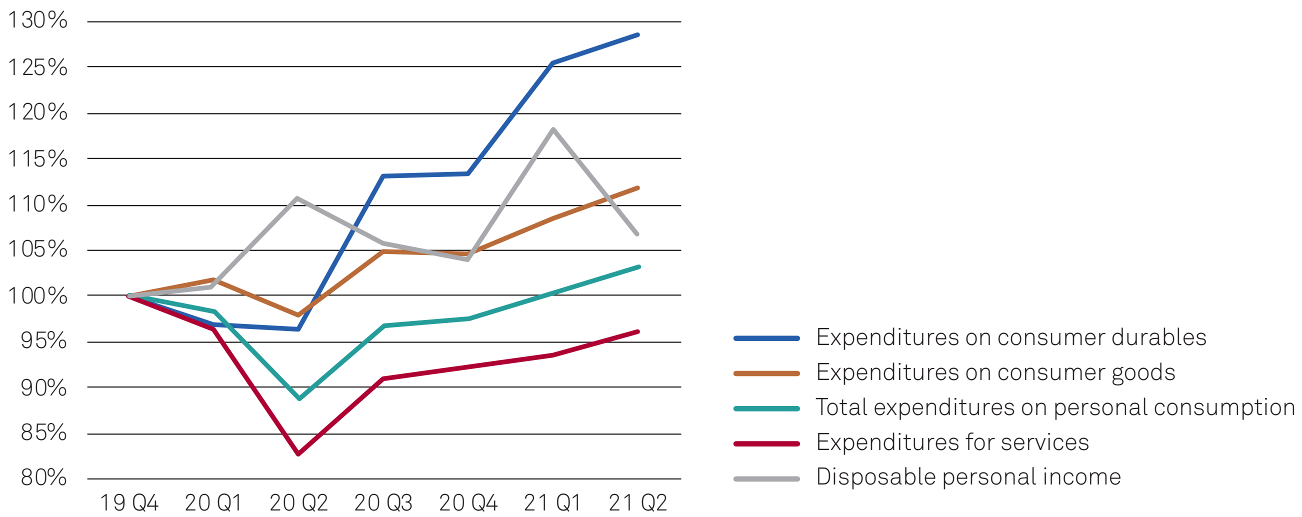

Fig. 2: Change in private spending and disposable income in the US
Source: Bureau of Economic Analysis (BEA), Illustration hpo forecasting

US market participants also seem to be aware of this in the OECD's **Business Confidence Index (BCI)** survey (see fig. 3).

After a 12-month exceedingly sharp rise of this sentiment indicator up to March 2021, it has since fallen again almost just as steeply but is still clearly in an expansionary range. Meanwhile, the BCI continues to rise in Europe and Japan. The value for Major Five Asia

(China, India, Indonesia, Japan, South Korea) has been moving sideways at a neutral level (value 100) for several quarters.

In **China,** economic and monetary policy is much more restrictive than in the US and Europe, as the government seeks to reduce the high level of private-sector debt in a controlled manner. However, the industry benefits from strong demand, particularly from overseas, and Chinese consumption is also continuing to grow. Also, due to the still very low vaccination rate, the damage potential of the highly contagious delta variant of the coronavirus appears to be disproportionately greater in Asia than in the West. There are also reports of weaker efficacy of the Chinese vaccines against the new virus variants. This is weighing on sentiment in Asia.

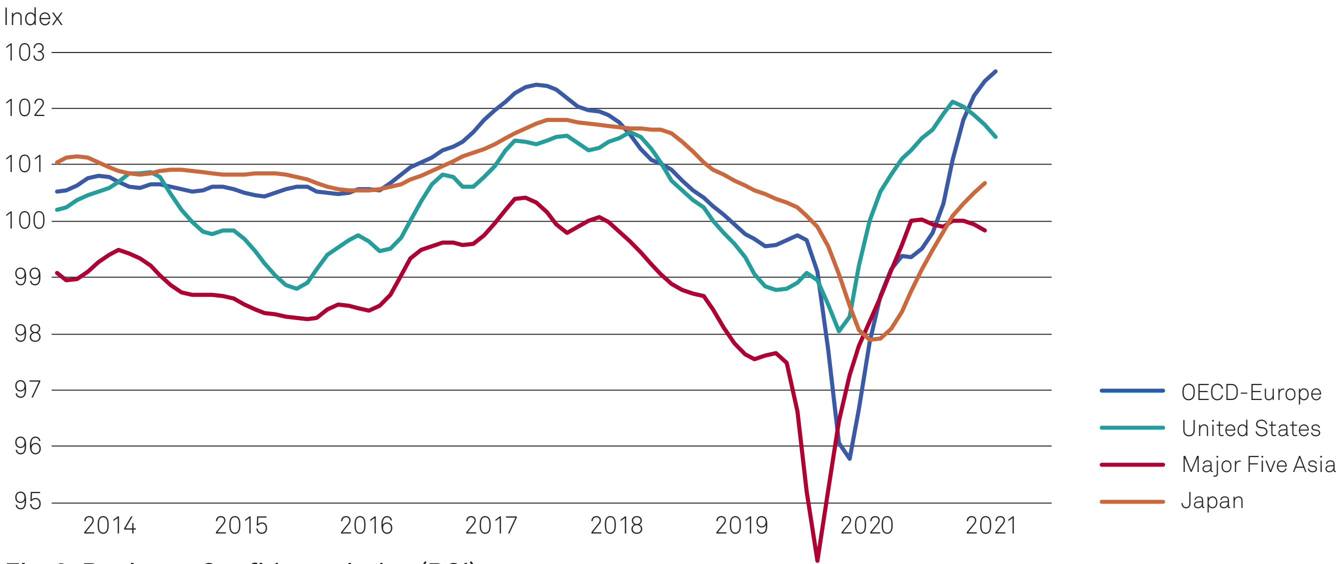

Fig. 3: Business Confidence Index (BCI)
Source: OECD, Illustration hpo forecasting; Status: July 2021

Opening measures are having an impact in **Europe.** The BCI rose to a very high level of 102.6 points in July and is clearly in expansionary territory. After the brilliant catch-up in the past 3 to 4 quarters, the growth momentum both in industrial production and specifically in the German machinery sector has recently flattened out substantially at a high level.

According to our model calculations, the current level of order intake will provisionally correspond roughly to the peak of momentum. Late-cycle sectors can still expect rising order data until around the end of the year. However, we are already seeing the first slight downward trends in individual sectors, which are likely to become more pronounced in the coming months.

Although the economic situation looks quite positive based on the fundamental data, hpo forecasting still considers the risks to be high, and we stand by our assessment that a slowdown is to be expected again in most industries once the current compensation effects have worn off.

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They enjoy working in a team and are committed to the concerns of their clients.

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