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US Economics Analyst

Consumer Spending: A Harder Path Ahead (Walker)

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- We recently downgraded our Q3 consumption growth forecast to -0.5% annualized to reflect a larger effect of the Delta variant on services spending. Although we expect the Delta setback to be brief, two longer-standing concerns pose challenges for consumption growth over the next few quarters.
- First, we have long highlighted that the fiscal impulse will fade sharply from its Q2 peak through end-2022. Fiscal support boosted disposable income to 9% above the pre-pandemic trend on average in 2021H1, but has already dropped off substantially. This decline will weigh on spending, though the impact should be offset by strong gains in labor income—which should keep disposable income modestly above its pre-pandemic trend—and by spending of excess savings built up during the pandemic, which amount to 18% of a year's consumption.
- Second, consumers will need to rotate from a very elevated level of spending on goods back to a normal level of spending on services. Spending on goods is likely to continue falling, though delayed purchases due to shortages of items such as new cars should slow the decline. But the rest of the service sector recovery will be much slower than the easy phase that followed vaccination, and with Covid fears likely to persist through the winter virus season, it might take a while for spending to recover in still-depressed categories such as very high-contact and office-adjacent services.
- Based on our new analysis, we have lowered our forecast for 2021Q4 consumption growth by 2.5pp to 3.5% but offset most of this downgrade by boosting each quarter of 2022 by 0.5pp. Our forecast of 2.6% (annualized) consumption growth from 2021Q2 to 2022Q4 consists of a 3.7pp boost from services spending offset in part by a 1.1pp drag from goods spending.
- One offset to this slower consumption growth is that the need for inventory restocking has grown larger as supply chain disruptions have hit production again in Q3. We now expect GDP growth of 3.5% in Q3, 5.5% in Q4 (previously 6.5%), and 3.7% in 2022 Q4/Q4 (previously 3.0%). On an annual average basis, our GDP growth forecast is now 5.7% (vs. 6.2% consensus) in 2021 and 4.6% (vs. 4.3% consensus) in 2022, but the annual average masks a sharp deceleration to below trend by end-2022.

Consumer Spending: A Harder Path Ahead

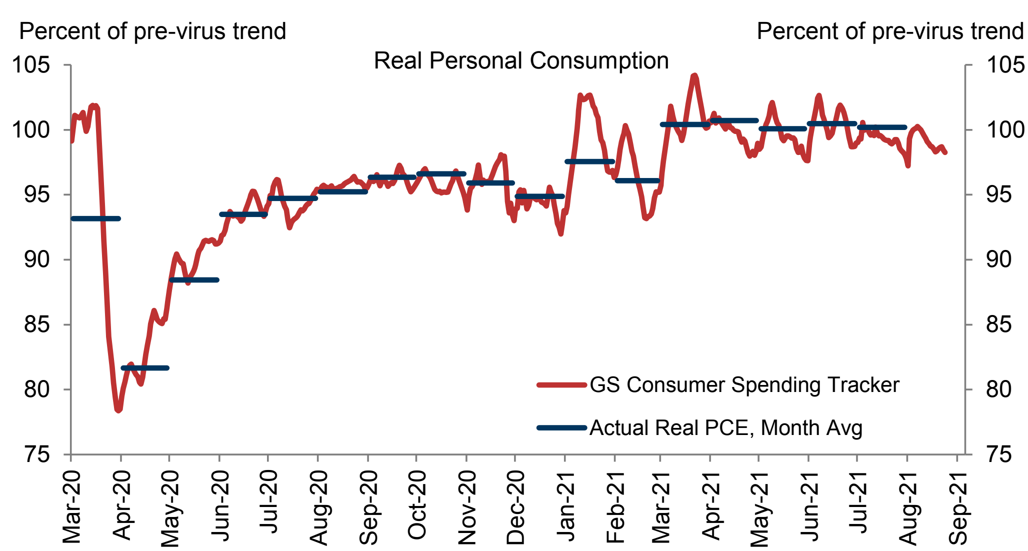
Consumption has jumped by 16% since the pandemic trough—the fastest one-year rate on record—and reached its pre-pandemic trend in 2021Q2. But the hurdle for strong consumption growth going forward appears much higher: the Delta variant is already weighing on Q3 growth, and fading fiscal stimulus and a slower service sector recovery will both be headwinds in the medium term. In this week's *Analyst*, we discuss each of those challenges and assess their bearing for the outlook.

The Consumption Setback from the Delta Wave

The coronavirus situation has deteriorated over the last couple months: daily new cases increased from 20k to 163k (7dma), daily fatalities have increased six-fold, and hospitalizations now exceed the winter peak in the South.

Last month, we lowered our 2021Q3 consumption forecast, reflecting declines in forward-looking indicators that pointed to a pullback in services spending. Since then, our consumer spending tracker has declined moderately (currently at 98% of the pre-virus trend vs. 99% in July; Exhibit 1), and activity in virus-sensitive services has slowed. OpenTable data show a 3% decline in restaurant reservations, subway ridership has edged down from already low levels, and airport throughput has declined roughly 5% since the start of August.

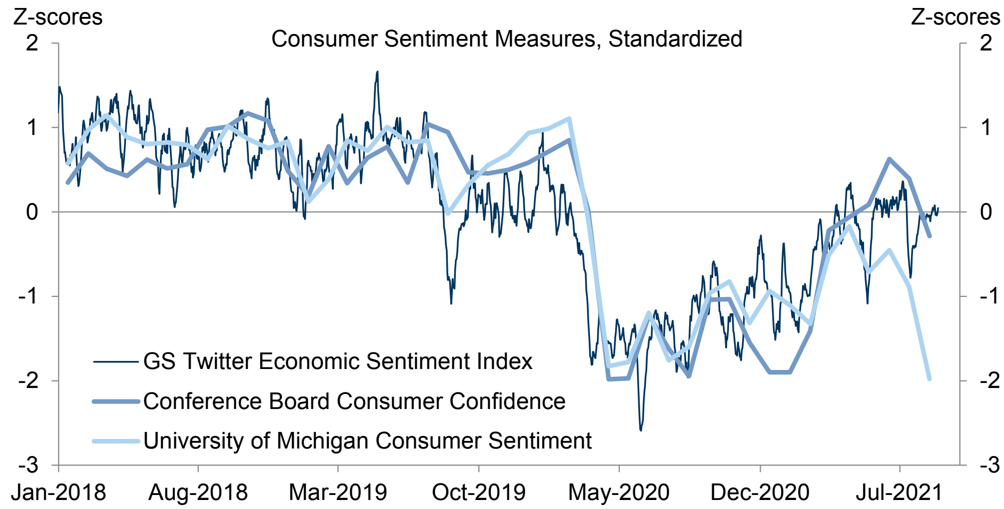
Exhibit 1: After Briefly Returning to Trend, Our Consumer Spending Tracker Has Declined to 98% of the Pre-Virus Trend



Source: Department of Commerce, Goldman Sachs Global Investment Research

While our spending tracker has only declined moderately, sharper declines across consumer confidence measures have led some to worry about an even steeper pullback in consumer spending (Exhibit 2).

Exhibit 2: Consumer Sentiment Has Fallen as Virus Fears Have Increased



Source: The Conference Board, University of Michigan, Goldman Sachs Global Investment Research

However, we do not expect the current pullback to last long or get much worse, for two reasons. First, our best guess—based on the experiences of some European countries and the recent decline in domestic positivity rates—is that US virus cases will start falling later this month. And second, economic activity has become less sensitive to the virus in recent waves, in part because people have adapted their spending habits, widespread vaccination has reduced the likelihood of government restrictions, and vaccinated individuals are less likely to voluntarily disengage from the economy.

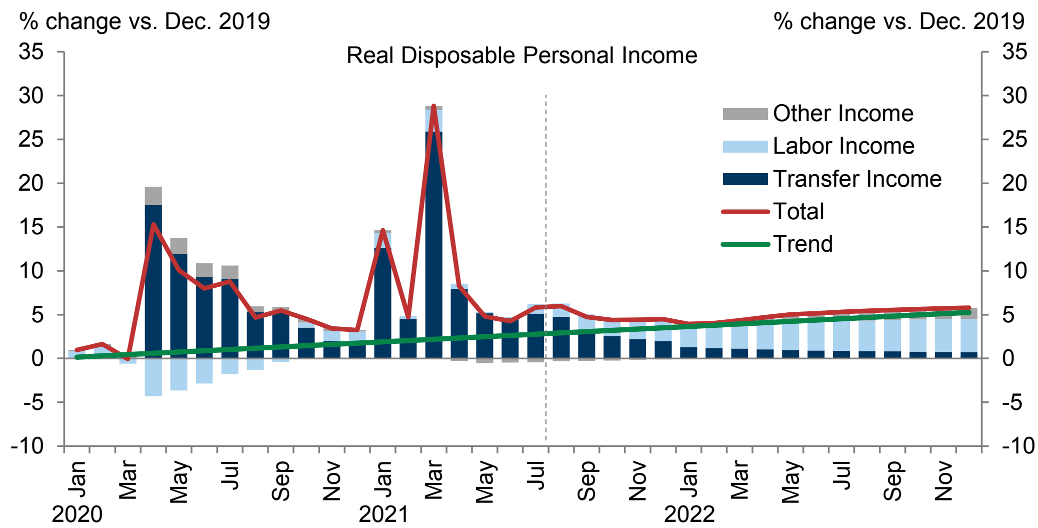
In light of these developments, we expect real consumer spending to drop 0.5% in August before bouncing back in September, leaving real consumption growth at -0.5% for Q3 (qoq ar).

Fiscal Fuel Running Out

After the Delta drag, we see two key medium-term challenges for consumption growth. First, we have long expected that the fiscal impulse will turn sharply negative through end-2022. As we wrote last week, pandemic-related transfers to households peaked at just under $5.0tn (annual rate) in March 2021 and boosted disposable income to 9% above the pre-pandemic trend on average in the first half of this year (Exhibit 3). However, by July disposable income had dropped to just 3% above trend, and we estimate that the continued pullback in transfers will drive a further 1.1% reduction in income by end-2021.

Despite our forecast for a moderate short-term decline, we maintain a reasonably positive outlook for household income because strong gains in labor income from a rapidly recovering labor market and firm wage growth should keep income above its pre-pandemic trend through end-2022.

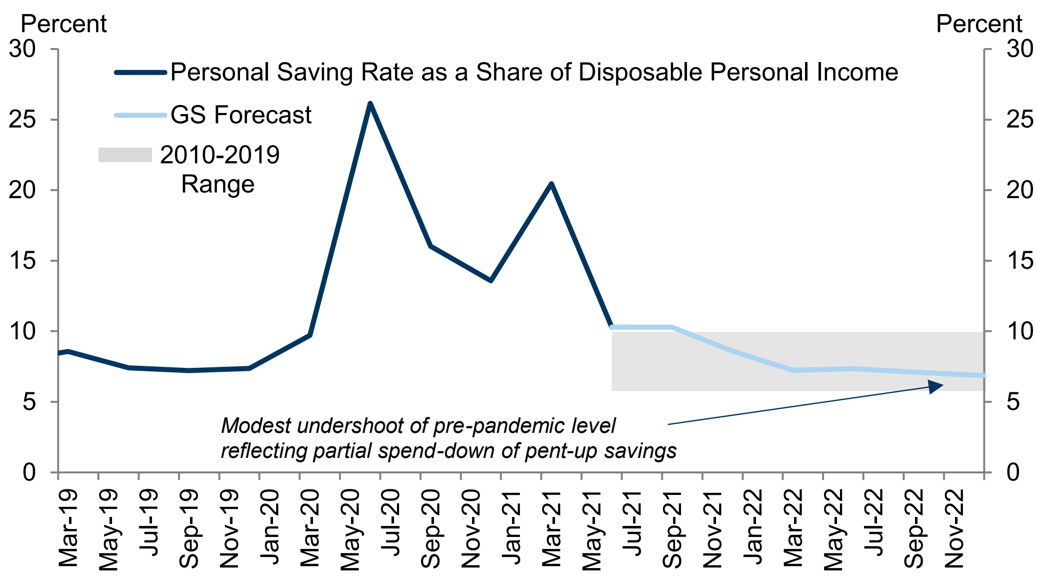
Exhibit 3: We Expect Household Income to Soften Through End-2021 as the Fiscal Boost Fades, but an Improving Labor Market Should Keep Disposable Income Above the Pre-Pandemic Trend



Source: Department of Commerce, Goldman Sachs Global Investment Research

In addition, households have accumulated $2½tn excess savings since the start of the pandemic—equivalent to roughly 15% of a year's worth of disposable income, or 18% of 2021 consumption—that should dampen the drag from income normalization. It is hard to know what share of these savings will be spent, as the era of modern economic statistics provides little useful precedent. We previously decomposed where the excess savings sit by income quintile and asset class, and found that a high share remains in highly-liquid forms like bank deposits (65%)—which argues for a larger spending effect—but that households in the top two income quintiles hold about two-thirds of the total excess savings—which argues for a smaller spending effect. On net, we estimate that a bit less than 20% of the excess savings will be spent in the first full year after reopening, which would cause the saving rate to dip modestly below the pre-pandemic level (Exhibit 4).

Exhibit 4: We Expect the Personal Saving Rate to Modestly Undershoot the Pre-Pandemic Level Reflecting Partial Spend-Down of Pent-Up Savings

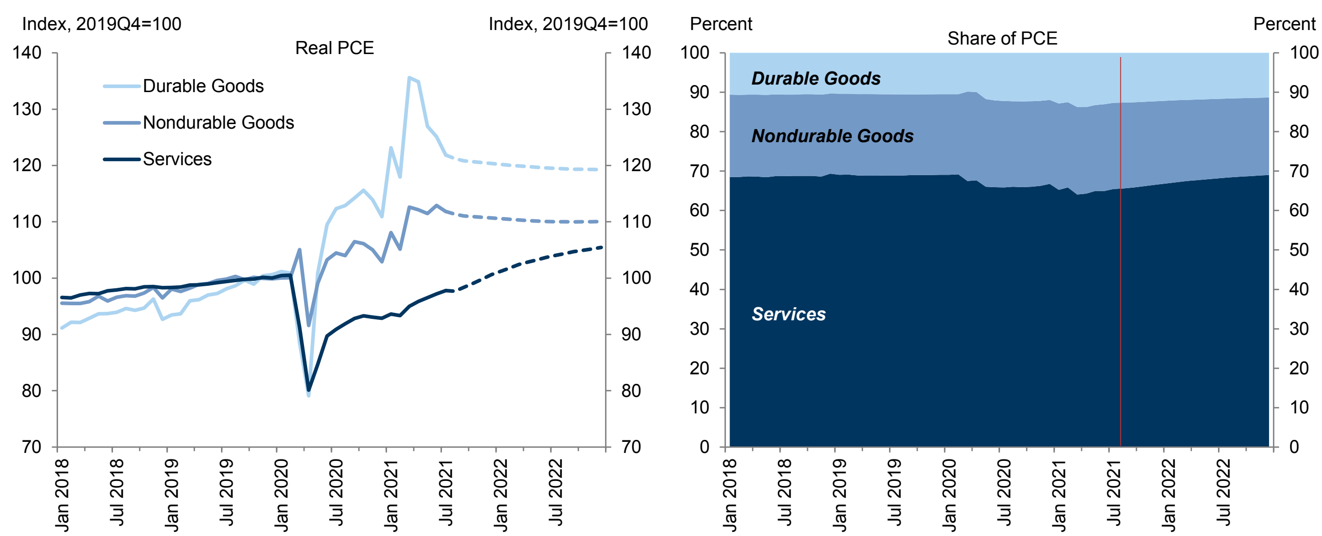


Source: Department of Commerce, Goldman Sachs Global Investment Research

The Goods-to-Services Rotation

The second challenge is related to the current composition of consumer spending. Exhibit 5 shows that goods purchases now make up a disproportionate share of total consumption relative to the pre-pandemic split (35% today vs. 31% pre-pandemic), as durable (122% of the pre-pandemic level in real terms) and nondurable (112%) goods consumption seem to be unsustainably high, while services consumption remains soft (98%).

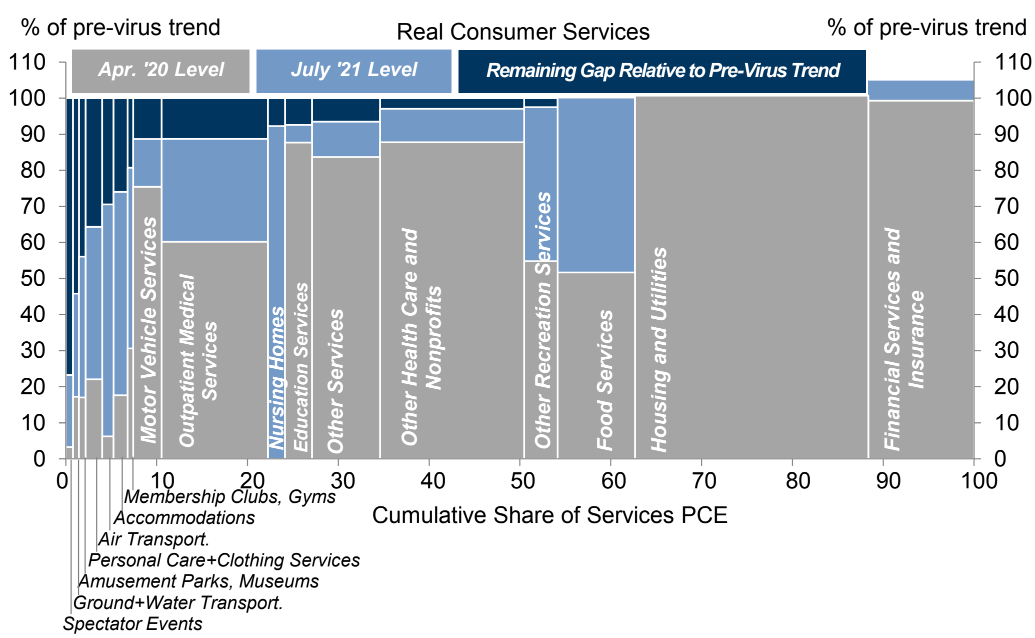
Exhibit 5: Durable (122%) and Nondurable (112%) Goods Consumption Are Well Above Their Pre-Pandemic Levels, While Services Consumption Remains Soft (98%)



Source: Department of Commerce, Goldman Sachs Global Investment Research

The majority of services categories are well on the way to recovery. Even some high-contact activities such as food services that fell sharply at the start of the pandemic are at or near their pre-pandemic trend (Exhibit 6). But a number of services categories remain quite depressed. Most of these categories are either associated with large crowds and high virus risk, such as spectator events (-77% vs. trend) and amusement parks (-44%), or connected to office-based work, such as personal care and clothing services (-36%). Although the eight leftmost service categories in Exhibit 6 only account for a moderate share of total consumption (7% of total PCE), cumulatively they have lowered total spending by 2% relative to trend.

Exhibit 6: Spending Remains Significantly Depressed in Services Categories That Have Very High Virus Risk or Are Connected to Office-Based Work



Source: Department of Commerce, Goldman Sachs Global Investment Research

Leaning on commentary from our sector analysts and our previous research, we have taken a bottom-up approach to estimating the path of consumption through the end of next year (Exhibit 7).

We expect goods demand to decline back to just above trend by the end of next year, as the boost from stimulus checks and pandemic preferences fade and durable goods demand becomes further satiated. However, this process may be more gradual than we previously expected, as shortages of items may have delayed some purchases.

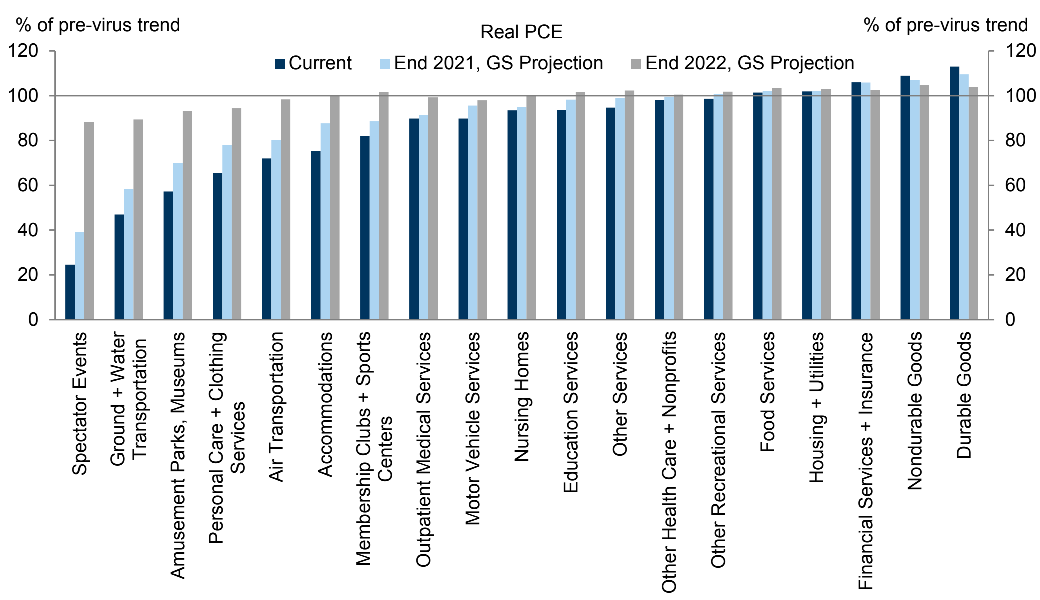
As demand for goods fades, the burden to carry the recovery forward is shifting to the service sector, and we expect the services categories that are already near trend and represent large shares of consumption, such as housing and food services, to continue growing roughly in line with their pre-pandemic trend.

However, the problem is that recovery in the rest of the service sector looks likely to be much slower than the easy phase that followed vaccination, as there does not appear any imminent catalyst to restore spending in those categories.

For categories where spending is only moderately below the pre-pandemic trend, such as outpatient medical services which includes elective medical procedures, we expect demand to eventually return to trend, but the tepid pace of recovery and likely winter virus resurgence mean that full recovery won't be achieved before later next year.

For the most depressed categories discussed above, we think that lasting cautiousness around the virus and a permanently greater share of remote work will likely leave spending short of full recovery by the end of next year. The vaccination of young children who are not currently eligible could incrementally boost demand for some of these services. For example, parents might be more willing to take children to movies, boosting high-contact entertainment services. Additionally, fewer childcare constraints might encourage some parents to return to office, aiding office-adjacent services. But even with these drags gone, we still expect demand will remain depressed.

Exhibit 7: We Expect Most Consumption Categories to Revert to Near-Trend by End-2022, but Do Not See Imminent Catalysts to Substantially Boost Virus-Sensitive Services in the Near-Term; Goods Spending Should Normalize but Could Benefit from Pent-Up Savings

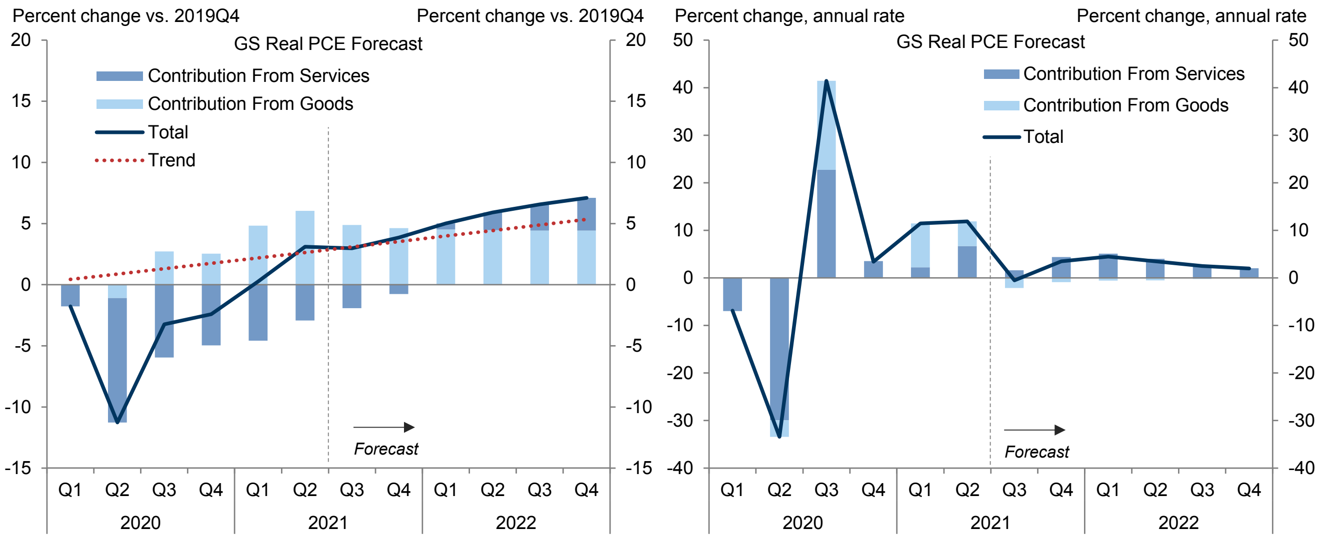


Source: Department of Commerce, Goldman Sachs Global Investment Research

A Steeper Climb for the Consumer Recovery

Our analysis suggests that the continued recovery in demand for services will more than offset a partial normalization of demand for goods from current elevated levels (Exhibit 8), keeping total consumption on an upward trajectory after Q3. But the goods-to-services rotation looks likely to take longer than we had previously assumed. As a result, we now expect more gradual and backloaded consumption growth following a decline in Q3, and have lowered our forecast for 2021Q4 consumption growth by 2.5pp (annualized) to 3.5% but offset most of this downgrade by boosting each quarter of 2022 by 0.5pp. Of the +2.6% (annualized) consumption growth we expect between 2021Q2 to 2022Q4, 3.7pp reflects a boost from services spending and 1.1pp reflects a drag from goods spending.

Exhibit 8: We Expect Rising Demand for Services to More Than Offset Normalization of Demand for Goods



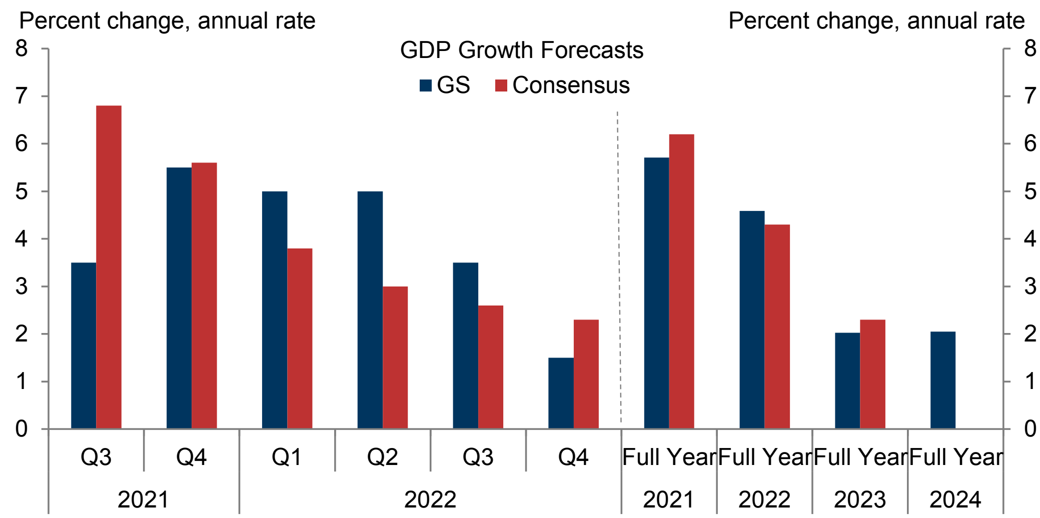
Source: Department of Commerce, Goldman Sachs Global Investment Research

At the same time, the need for inventory restocking has grown even more massive as supply chain disruptions have hit production again in Q3 and appear unlikely to abate by Q4, and we have therefore upgraded our inventory accumulation assumptions for 2022 to offset a downgrade to our 2021 assumptions.

Our revised consumption and inventory accumulation forecasts imply 3.5% growth in Q3 (vs. +6.8% consensus), as we noted in a forecast revision last week, and a 1pp downgrade to 5.5% in Q4 (vs. +5.6% consensus). This lowers our 2021 growth forecast to +5.7% (vs. +6.2% consensus), or +5.5% on a Q4/Q4 basis.

Lower growth in 2021 implies stronger growth in 2022, and we have raised our forecast to +4.6% (vs. +4.3% consensus), or +3.7% on a Q4/Q4 basis. However, the annual number masks a slowdown below trend by end-2022, a sharper deceleration than consensus expects, which reflects the last of the large and prolonged fiscal drag (Exhibit 9).

Exhibit 9: A Delayed Service Sector Recovery and Inventory Restocking Will Support Solid GDP Growth into Mid-2022; Thereafter We Expect a Sharper Deceleration Than Consensus to 1.5% Growth in 2022Q4



Source: Bloomberg, Goldman Sachs Global Investment Research

Consistent with the downgrade to our 2021 growth forecast and reflecting the disappointing job gains in Friday's employment report, we have also bumped up our unemployment rate forecast slightly from 4.1% to 4.2% at end-2021.

Ronnie Walker

The US Economic and Financial Outlook

Forecast Changes

THE US ECONOMIC AND FINANCIAL OUTLOOK

(% change on previous period, annualized, except where noted)

	2019	2020	2021 (f)	2022 (f)	2023 (f)	2024 (f)	2021 Q1	2021 Q2	2021 Q3	2021 Q4	2022 Q1	2022 Q2	2022 Q3	2022 Q4
OUTPUT AND SPENDING														
Real GDP	**2.3**	**-3.4**	*5.7*	*4.6*	*2.0*	*2.0*	**6.3**	**6.6**	*3.5*	*5.5*	*5.0*	*5.0*	*3.5*	*1.5*
Real GDP (annual=Q4/Q4, quarterly=yoy)	**2.6**	**-2.3**	*5.5*	*3.7*	*1.7*	*2.1*	**0.5**	**12.2**	*5.2*	*5.5*	*5.1*	*4.7*	*4.7*	*3.7*
Consumer Expenditures	**2.2**	**-3.8**	*7.6*	*3.5*	*2.0*	*2.1*	**11.4**	**11.9**	*-0.5*	*3.5*	*4.5*	*3.5*	*2.5*	*2.0*
Residential Fixed Investment	**-0.9**	**6.8**	*11.0*	*3.0*	*2.6*	*2.0*	**13.3**	**-11.5**	*3.1*	*6.0*	*4.0*	*4.0*	*3.0*	*3.0*
Business Fixed Investment	**4.3**	**-5.3**	*8.1*	*5.9*	*4.1*	*3.9*	**12.9**	**9.3**	*5.4*	*6.4*	*6.1*	*5.6*	*5.1*	*4.2*
Structures	**2.1**	**-12.5**	*-7.3*	*2.7*	*4.9*	*3.4*	**5.4**	**-5.4**	*0.5*	*2.0*	*2.0*	*4.0*	*8.0*	*6.0*
Equipment	**3.3**	**-8.3**	*14.1*	*6.4*	*3.0*	*2.8*	**14.1**	**11.6**	*3.4*	*7.0*	*8.0*	*7.0*	*4.0*	*2.5*
Intellectual Property Products	**7.2**	**2.8**	*10.5*	*7.0*	*5.0*	*5.2*	**15.6**	**14.6**	*10.0*	*8.0*	*6.0*	*5.0*	*5.0*	*5.0*
Federal Government	**3.8**	**5.0**	*0.9*	*-1.2*	*0.0*	*0.0*	**11.3**	**-5.2**	*-4.0*	*-2.0*	*0.0*	*0.0*	*0.0*	*0.0*
State & Local Government	**1.3**	**0.9**	*0.9*	*3.3*	*0.6*	*0.5*	**-0.1**	**0.3**	*5.2*	*5.0*	*5.0*	*2.0*	*0.5*	*0.5*
Net Exports ($bn, '12)	**-905**	**-943**	*-1,240*	*-1,277*	*-1,259*	*-1,233*	**-1226**	**-1247**	*-1236*	*-1251*	*-1269*	*-1276*	*-1281*	*-1283*
Inventory Investment ($bn, '12)	**75**	**-42**	*-63*	*150*	*96*	*60*	**-88**	**-169**	*-44*	*50*	*75*	*150*	*200*	*175*
Industrial Production, Mfg.	**-2.0**	**-6.6**	*6.1*	*4.8*	*1.9*	*1.7*	**2.7**	**5.0**	*3.0*	*4.9*	*5.4*	*6.0*	*4.5*	*1.9*
HOUSING MARKET														
Housing Starts (units, thous)	**1,292**	**1,397**	*1,623*	*1,676*	--	--	**1,599**	**1,586**	*1,662*	*1,645*	*1,653*	*1,682*	*1,686*	*1,685*
New Home Sales (units, thous)	**683**	**828**	*860*	*918*	*977*	*978*	**896**	**739**	*876*	*928*	*913*	*901*	*908*	*951*
Existing Home Sales (units, thous)	**5,327**	**5,658**	*5,972*	*5,964*	*6,086*	*6,210*	**6,303**	**5,833**	*5,862*	*5,891*	*5,920*	*5,949*	*5,979*	*6,009*
Case-Shiller Home Prices (%yoy)*	**3.4**	**9.9**	*9.4*	*7.6*	*6.2*	--	**11.7**	**15.2**	*11.7*	*9.4*	8.1	6.1	7.8	7.6
INFLATION (% ch, yr/yr)														
Consumer Price Index (CPI)**	**2.3**	**1.3**	*5.0*	*2.2*	*2.4*	*2.4*	**1.9**	**4.8**	*5.2*	*5.0*	*4.6*	*3.2*	*2.2*	*2.2*
Core CPI **	**2.2**	**1.6**	*4.4*	*2.5*	*2.5*	*2.5*	**1.4**	**3.7**	*4.1*	*4.2*	*4.5*	*3.1*	*2.4*	*2.5*
Core PCE** †	**1.6**	**1.5**	*3.80*	*2.00*	*2.15*	*2.20*	**1.7**	**3.4**	*3.5*	*3.8*	*3.6*	*2.6*	*2.1*	*2.0*
LABOR MARKET														
Unemployment Rate (%)^	**3.6**	**6.7**	*4.2*	*3.5*	*3.3*	*3.2*	**6.0**	**5.9**	*5.0*	*4.2*	*3.8*	*3.7*	*3.6*	*3.5*
U6 Underemployment Rate (%)^	**6.8**	**11.7**	*7.6*	*6.8*	*6.4*	*6.2*	**10.7**	**9.7**	*8.7*	*7.6*	*7.2*	*7.0*	*6.8*	*6.8*
Payrolls (thous, monthly rate)	**168**	**-785**	*620*	*215*	*123*	*100*	**518**	**615**	*679*	*667*	*317*	*213*	*179*	*150*
Employment-Population Ratio (%)^	**61.0**	**57.4**	*59.6*	*60.2*	*60.2*	*60.2*	**57.8**	**58.1**	*59.0*	*59.8*	*59.8*	*60.0*	*60.1*	*60.2*
Labor Force Participation Rate (%)^	**63.3**	**61.5**	*62.2*	*62.4*	*62.3*	*62.2*	**61.5**	**61.6**	*61.9*	*62.2*	*62.2*	*62.3*	*62.4*	*62.4*
GOVERNMENT FINANCE														
Federal Budget (FY, $bn)	**-984**	**-3,132**	*-3,000*	*-1,300*	*-1,100*	*-1,200*	--	--	--	--	--	--	--	--
FINANCIAL INDICATORS														
FF Target Range (Bottom-Top, %)^	**1.5-1.75**	**0-0.25**	*0-0.25*	*0-0.25*	*0.25-0.5*	*0.75-1*	**0-0.25**	**0-0.25**	*0-0.25*	*0-0.25*	*0-0.25*	*0-0.25*	*0-0.25*	*0-0.25*
10-Year Treasury Note^	**1.92**	**0.93**	*1.60*	*1.80*	*2.30*	*2.45*	**1.74**	**1.45**	*1.40*	*1.60*	*1.60*	*1.60*	*1.60*	*1.80*
Euro (€/$)^	**1.12**	**1.22**	*1.21*	*1.25*	*1.30*	*1.30*	**1.17**	**1.18**	*1.18*	*1.21*	*1.23*	*1.24*	*1.25*	*1.25*
Yen ($/¥)^	**109**	**103**	*109*	*105*	*102*	*100*	**111**	**111**	*110*	*109*	108	107	106	105

* Weighted average of metro-level HPIs for 381 metro cities where the weights are dollar values of housing stock reported in the American Community Survey. Annual numbers are Q4/Q4.

** Annual inflation numbers are December year-on-year values. Quarterly values are Q4/Q4.

† PCE = Personal consumption expenditures. ^ Denotes end of period.

Note: Published figures in bold.

Source: Goldman Sachs Global Investment Research

Economic Releases

Date		Time (ET)	Indicator	Estimate GS	Consensus	Last Report
Wed	**Sep 08**	10:00	JOLTS Job Openings (July)	n.a.	+10,000k	+10,073k
Thu	**Sep 09**	**8:30**	**Initial Jobless Claims**	**+325k**	**+343k**	**+340k**
			Continuing Claims	n.a.	n.a.	2,748k
Fri	**Sep 10**	**8:30**	**Producer Price Index, Final Demand (August)**	**+0.6%**	**+0.6%**	**+1.0%**
			Ex Food and Energy	**+0.6%**	**+0.5%**	**+1.0%**
			Ex Food, Energy, & Trade	**+0.6%**	**+0.6%**	**+0.9%**
		10:00	Wholesale Inventories (July Final)	n.a.	+0.6%	+0.6%

Source: Goldman Sachs Global Investment Research

Disclosure Appendix

Reg AC

We, Jan Hatzius, Alec Phillips, David Mericle, Spencer Hill, CFA, Joseph Briggs and Ronnie Walker, hereby certify that all of the views expressed in this report accurately reflect our personal views, which have not been influenced by considerations of the firm's business or client relationships.

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