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Can households withstand the high levels of inflation?

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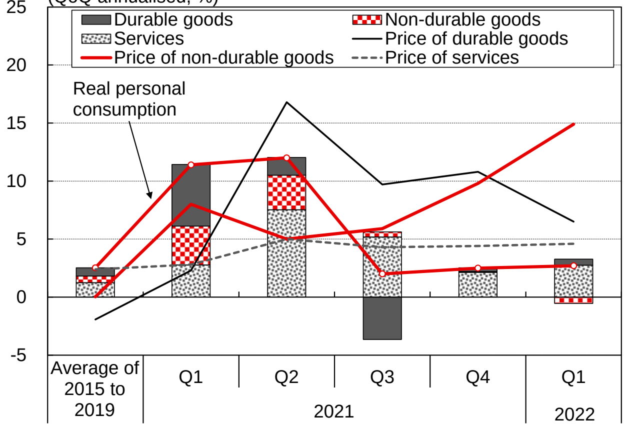
In the US, real GDP growth rate (preliminary estimate) for the January-March quarter was -1.4% QoQ annualised, which is the first negative growth since the April-June quarter in 2020 when the first wave of the pandemic hit. Large dampeners on growth came from the negative contributions from net exports and inventory investment. On the other hand, personal consumption (2.7% QoQ annualised) and capital expenditure (9.2% QoQ annualised) were robust, which implies growth of the US economy was firm.

That being said, we cannot be blindly optimistic when looking at the breakdown for personal consumption expenditures – a major component of GDP. The contribution by durable goods, non-durable goods and services to the growth of real personal consumption (QoQ annualised) shows the majority of growth is due to services, which experienced a carry-over effect from “the recovery from COVID-19 restrictions”. On the other hand, with the exception of 2020, when there were huge fluctuations due to the pandemic, the negative contribution from non-durable goods in the January-March quarter this year (-0.55% points) was the largest since the October-December 2008 quarter (-0.85% points) during the global financial crisis (Chart 1). The price of non-durable goods has risen dramatically, especially energy and food, and it appears inflation is eating into purchasing power. Durable goods maintained robust growth, even compared with past periods of economic expansion; however, there is an undeniable possibility they will be impacted by future rate hikes by the Fed as well as supply constraints in the global manufacturing sector caused by the conflict in Ukraine and city lockdowns in China.

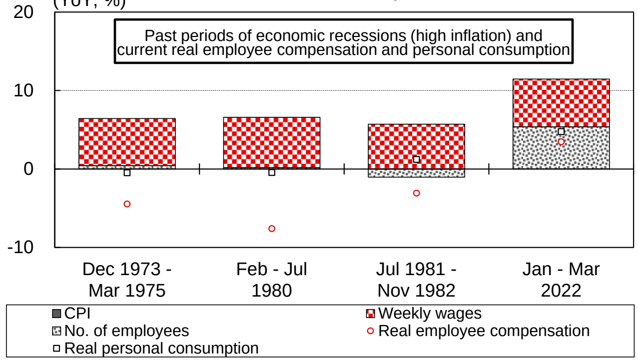
In addition to the recovery of appetite for spending on services following a decrease in concern about the spread of infection, there are specific sources of support for personal consumption resulting from the pandemic. They are: a build-up of savings due to suppressed consumption as well as benefits as a part of economic policies; the continued positive growth of real employee compensation as employment continues to recover (Chart 2); and an improvement in households’ expectations for employment owing to a tight labour market as a large number of people left the labour market (including retirement) due to COVID-19 (Chart 3). Of these factors, the second and third in particular are definitely different to the “stagflation” of the 1970s and 1980s when inflation coincided with a deterioration of the labour market. However, ascertaining whether the momentum of the recovery from the pandemic will continue and whether inflationary pressure from the pandemic and other geopolitical factors will put larger-than-expected downward pressure on the economy will probably be difficult for some time.

Chart 1: Real Personal Consumption and Price Indicators



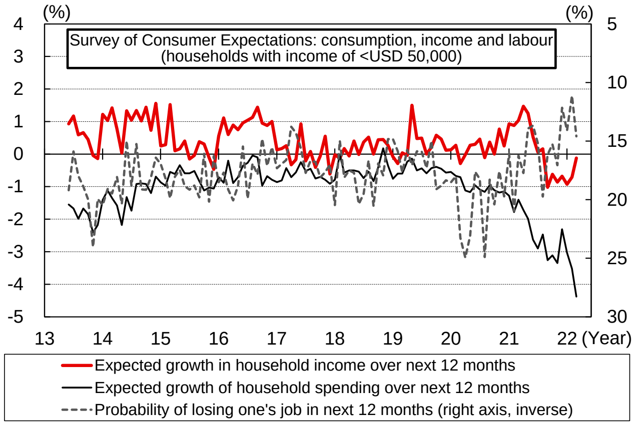
Source: Department of Commerce, MUFG Bank Economic Research Office

Chart 2: Employee Compensation and Personal Consumption



Note: Real total compensation = (weekly wages + no. of employees both production and non-managerial)/CPI.
Source: Department of Labor, Department of Commerce, Federal Reserve Bank of New York, MUFG Bank Economic Research Office

Chart 3: Household Sentiment



Note: Change or rise = nominal value - expected rate of inflation
Source: Department of Labor, Department of Commerce, Federal Reserve Bank of New York, MUFG Bank Economic Research Office

Translation by Elizabeth Foster

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