August 12, 2020

Economics Group

Even as Pandemic Drags On, Consumer Poised for Strong Q3

The bottom fell out under spending in March, but after back-to-back surges in subsequent months, consumer spending is on track for record Q3 growth. Goods spending has fully recovered; services still has a way to go.

Two Out of Three in the Black, but PCE Is All About Services

The consumer shapes the economic outlook more than any other factor. In the midst of a pandemic that has completely transformed the way people live, work and consume, the consumer outlook is more consequential than ever.

In a typical recession services spending holds up, while big ticket purchases on durable goods typically are put off until better times. It has been the opposite in this cycle, as we anticipated.

The forced-thrift of quarantine and stay-at-home orders may have emptied out restaurants and hair salons leaving services outlays still in a deep hole relative to the pre-recession peak, but services spending has risen more than $350 billion at an annualized rate in each of the past two months.

Goods spending is on the rise as well. In fact, despite all of the hand-wringing over the shape of the recovery, some parts of the consumer economy have already fully recovered. Durable goods outlays are already more than 9% above their pre-pandemic level, with some categories like recreational goods and vehicles up even more than that.

Nondurable goods—like food and gas which are consumed more quickly, really only had one down month in this pandemic—which was in April after the panic buying at grocery stores the prior month set the category up for a payback month. Since then, nondurable spending has been on the rise.

See You in September

The upshot of all of this is consumer spending is coming into the third quarter running at an all-out sprint. Even with an interruption in unemployment benefits, case counts that are still rising in parts of the country and slowing momentum in the labor market recovery, consumer spending is on track to post a record increase in the third quarter.

Our analysis finds that even if all three categories of spending were to come to a complete stop in July and remain stuck in neutral in August and September, personal consumption expenditures (PCE) would still come in with a growth rate of about 27%. This is because Q2 ended on such better footing than where it was after the bottom fell out under spending in March.

When we updated our forecast this month, we did so cognizant of the fact that a re-emergence of the virus, particularly in some hard-hit states in the South and West, likely means a slow-walked re-opening in those states. Our concern is that this never-before-seen climate for consumers could force some services spending back into negative territory in the months ahead so we actually have some monthly declines baked into our forecast in the much larger services category. Even with those declines continued growth in goods outlays suggests that Q3 consumer spending will come in at an annualized growth rate of nearly 30%. If service spending proves more resilient than we presently expect, PCE could be even stronger.

Source: U.S Department of Commerce and Wells Fargo Securities