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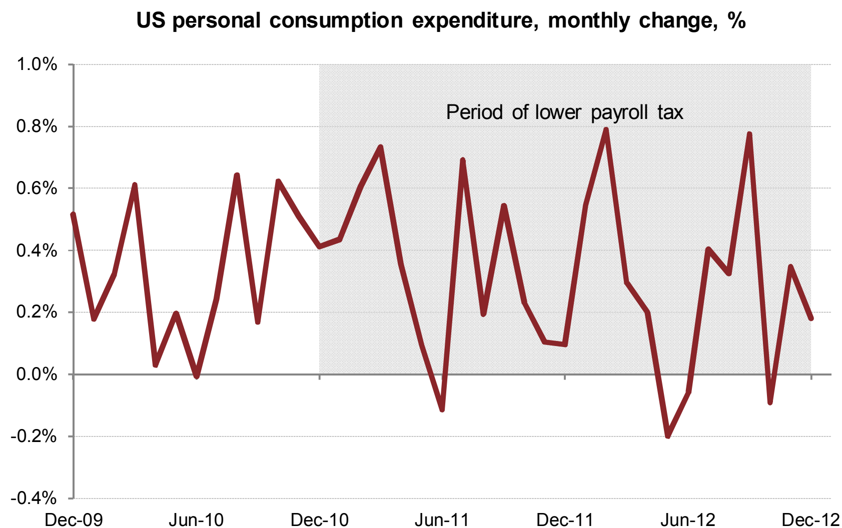
Impact of US payroll tax hike likely negligible

Cut in 2011 made little difference, nor will hike in 2013

Last week saw a slew of US data pointing in all directions. GDP fell by 0.1% in Q4 and car sales edged down for a second month in January (but remaining higher than at any time between February 2008 and November 2012). On the other hand, consumer sentiment and business confidence both picked up; and personal income shot up in December as bonuses and dividends were paid out early in order to avoid the increase in employee payroll taxes in January 2013. Less well reported but still important was the continued strong growth in US bank deposits, the main component of broad money. Although bank deposits are down slightly from the two weeks around the New Year, their thirteen-week (ie, three-month) annualised growth rate remained in the double digits, rising by 11.3% in the week of 23rd January. I will return to this later in February when I do an update on US broad money developments. But it seems to me that in order to estimate where the US economy is headed in 2013, another key set of data is the personal income and spending numbers. This is obviously true because household spending makes up 70% of US GDP; but also because this is the one field where the much-hyped fiscal cliff is supposed to have an immediate effect. As noted above, the temporary reduction in employee payroll taxes from 6.2% to 4.2% introduced in 2011 was reversed at the beginning of 2013. The general view is that, as this will cut disposable income, it will lead to a slowdown or even fall in household spending, potentially pushing the US economy into recession (if GDP falls in Q1 2013, since it possibly fell in Q4 – possibly, since this is still subject to at least two revisions).

However, this view at least partly depends on the reverse – ie, an increase in household spending – having occurred when payroll taxes were cut two years earlier.



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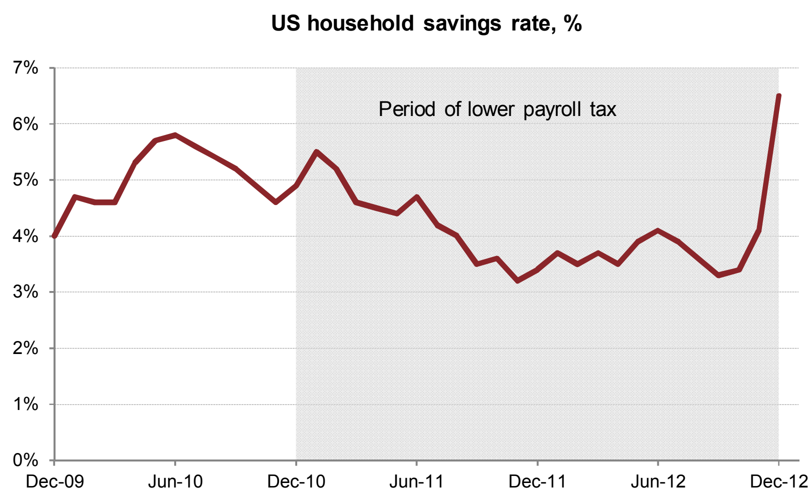
Personal consumption data is very volatile from month to month. But it is nevertheless clear from the chart that there was no surge in spending following and clearly attributable to the cut in payroll taxes. If anything, spending growth initially weakened in 2011. Looking at a somewhat longer period, personal consumption expenditure rose by an average monthly rate of 0.3% in 2011, the same rate as in 2010, and continued to rise at this pace in 2012. If you go to the second decimal (and bear in mind that economists use numbers after the decimal point to show that we have a sense of humour), the average monthly change in personal consumption expenditure in 2011 was 0.33%; identical to that in 2010. In 2012, there was a minimal fall to 0.29%.

If there was any effect at all from the original payroll tax cut, it seems to have been in increased household savings; but, if so, this impact was also transient (ignore the distorted value for December 2012 in the chart). The savings rate edged down throughout most of 2011 and edged up very, very slightly throughout most of 2012. On this basis, it seems that the impact of the 2011-2012 payroll tax cuts was almost negligible.



That is confirmed by GDP data, which show the contribution of personal consumption to growth weaker in Q1 2011 than in Q4 2010 (and much weaker in Q2 2011) before picking up in the second half of 2011 and changing very little through 2012.

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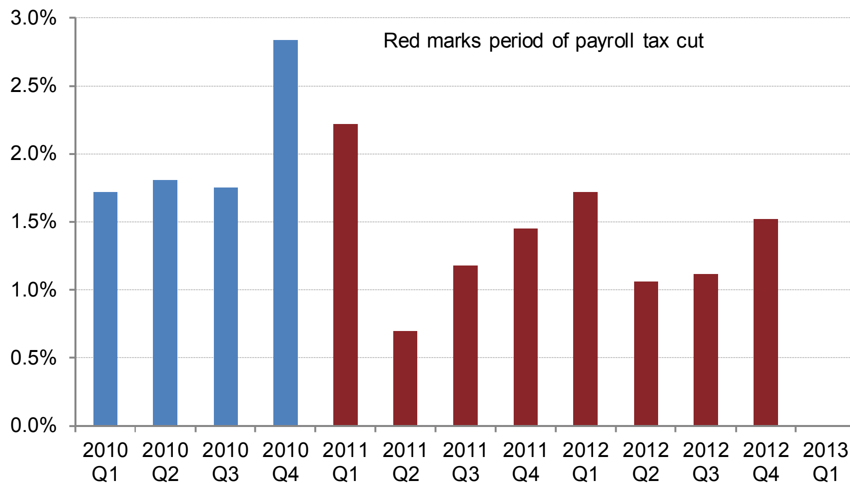
Contribution of personal consumption expenditure ot overall GDP growth, percentage points at saar



Add to this another factor: in 2011, US households still badly needed to deleverage. At the end of 2010, the household debt/personal disposable income ratio was 116%. By the end of Q3 last year it was 108% and probably lower one quarter later. The difference may not seem very large; but it is the difference between a debt ratio that is historically unsustainable versus one that is sustainable, the latter estimated by me as between 100 and 110% of PDI. US households still need to bring down their debt burden; but the imperative to do so is not as great as it was two years ago.

We will know soon enough whether there was any significant impact of the payroll tax reverting to 6.2%. However, judging by the experience of the cut, this impact is likely to turn out to be negligible. This is clearly a further argument in favour of US economic strength in 2013.

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