Global Economics Comment: Spending Headwinds Still to Come on Both Sides of the Pond

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- The interim US-Iran peace deal has diminished upside tail risks to energy prices: our oil strategists now see Brent declining to $80 per barrel in 2026Q4 (vs. $90 previously) and our gas strategists also forecast slightly lower near-term prices (although they leave their year-end forecasts unchanged). Moreover, consumer spending has so far held up reasonably well on both sides of the Atlantic since the start of the conflict. While these are both welcome developments for the growth outlook, we see three reasons why it is too early for complacency on real income and consumer spending in the coming months.
- First, while gasoline prices jumped shortly after the start of the war (and may ease following the recent interim deal), the passthrough from wholesale gas and electricity prices to consumers is more drawn out. Second, seasonal spending patterns should amplify the hit to income this winter when energy demand peaks, especially in Europe. Lastly, while outsized tax refunds dampened the real income hit in the US this spring, this temporary boost is now behind us and we expect real cash flow to stagnate on a year-on-year basis in H2.
- Based on historical statistical relationships, we estimate that each 1% pullback in real cash flow from an energy shock results in a 0.6% decline in consumer spending after two quarters. Our model is able to explain the limited consumption impact of higher energy prices so far but projects more meaningful weakness in H2, even with our new energy price forecasts. These predictions align with consumer surveys that show DM consumers anticipate making fewer large purchases over the next 6-12 months.

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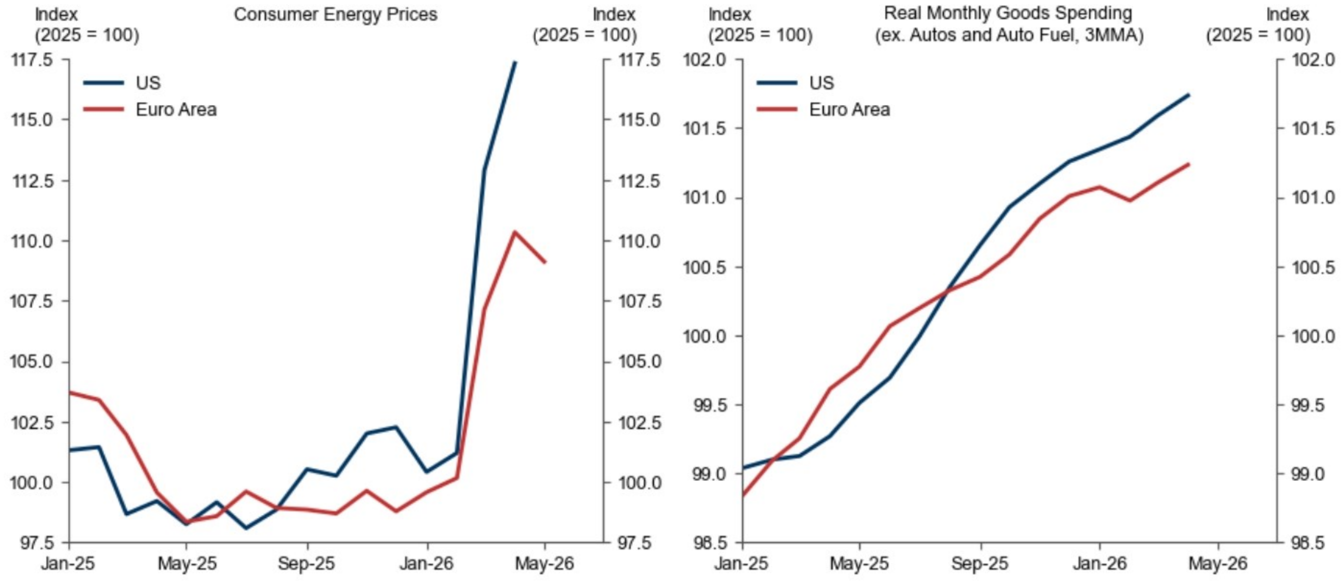
Exhibit 1: Consumer Spending Has Held Up So Far Despite the Surge in Energy Prices



Source: Haver Analytics, Goldman Sachs Global Investment Research

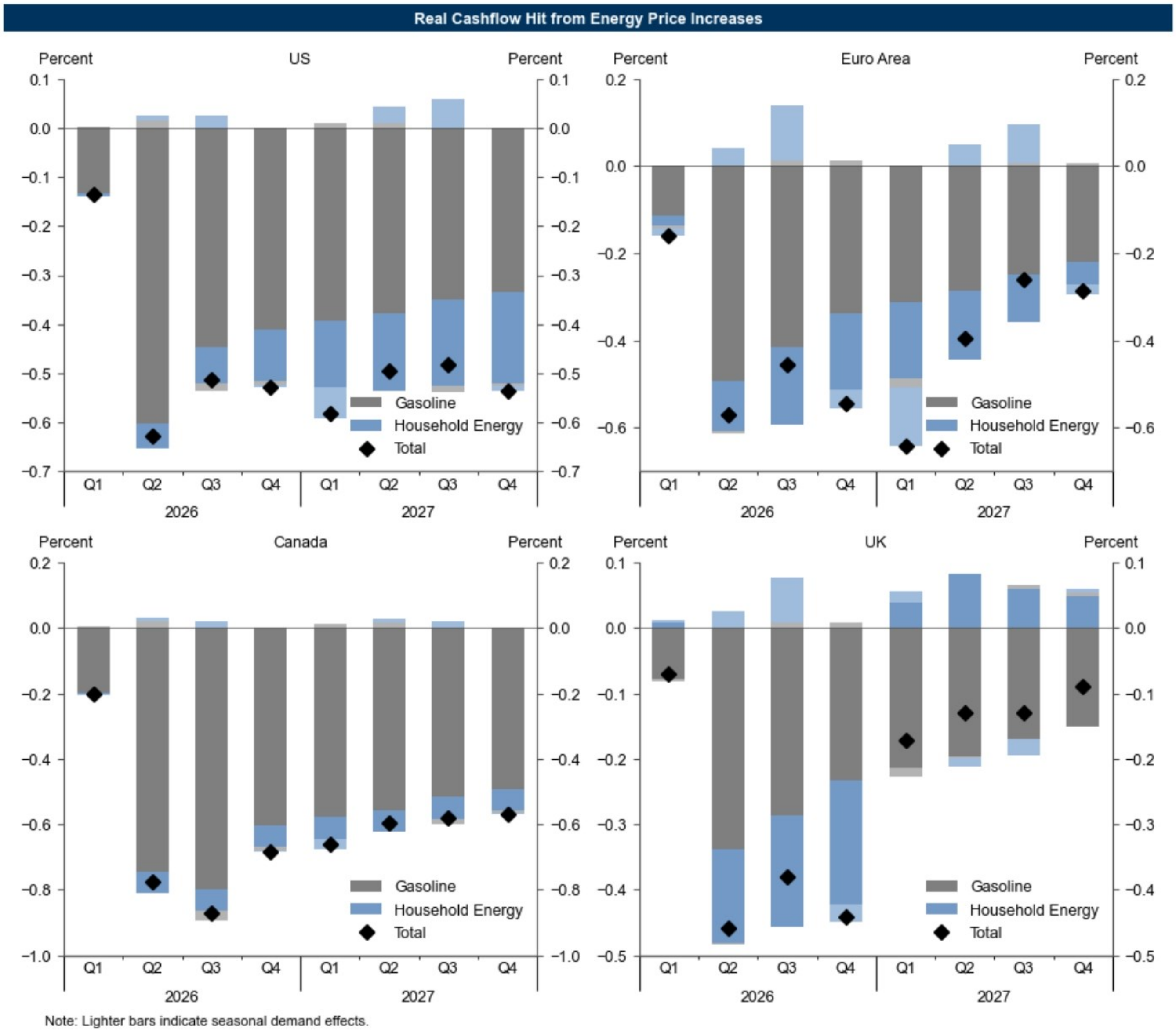
First, while gasoline prices have already risen sharply, the increase in natural gas and electricity prices has been more limited so far. Our commodity strategists expect further price increases as countries build stocks ahead of next winter (especially as China begins rebuilding inventories after destocking this spring) while our European economists highlight that fixed contracts and government regulations have historically led to more gradual price increases relative to wholesale prices. As a result, a large share of the relevant consumer price increases has yet to be realized.

Second, seasonal energy demand will amplify the hits to actual cash flow this winter (particularly in Europe) beyond what official seasonally adjusted income measures will suggest.

In Exhibit 2, we use the changes in our country teams' energy price forecasts since the onset of the conflict—which incorporate our commodities strategists' latest forecast downgrades—to estimate how rising energy prices will affect realized cash flow after correcting for seasonal swings in nominal spending. To separate the price and seasonal demand channels, we first calculate the implied hit under fixed consumption shares (the darker-coloured bars) and then recalculate the impulse allowing for typical seasonal demand fluctuations. The difference between these two estimates captures the seasonal effect (the lighter-coloured bars).

Accounting for higher winter demand implies a more backloaded impulse in Europe, with the trough shifting to early 2027 compared to mid-2026 under fixed consumption shares. While higher prices account for most of the hit to cash flow, seasonal demand poses a meaningful incremental drag in winter: in 2027Q1 it lowers real incomes by a further 14bp in Europe (over 20% of the combined impulse) and by 5bp in the US (around 10% of the total drag).

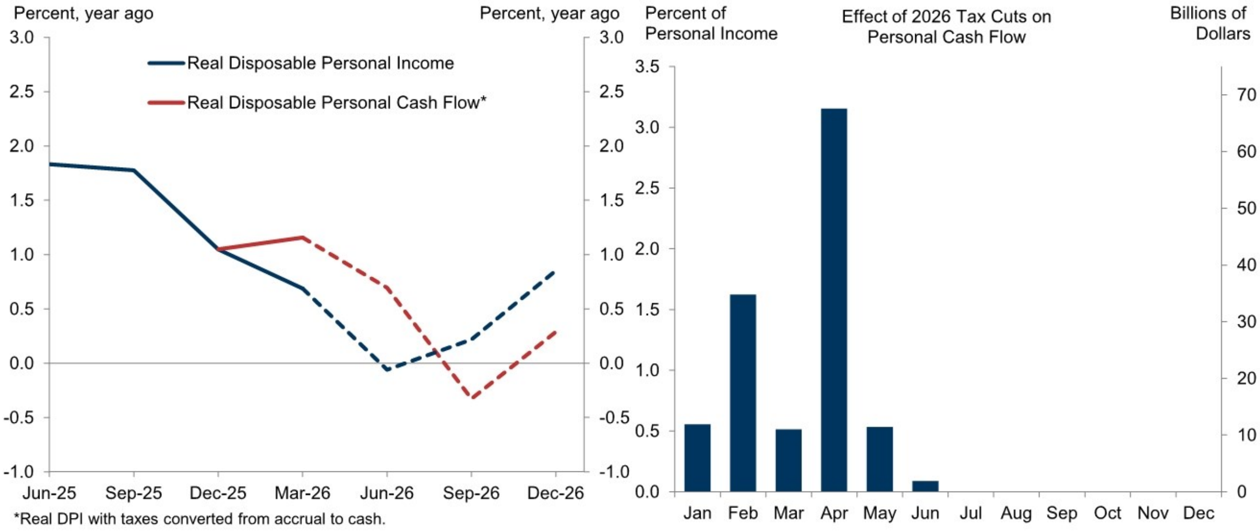
Exhibit 2: We Expect Backloaded Cash Flow Headwinds from Gas Price Increases in Europe



Source: Goldman Sachs Global Investment Research

Third, in the US, larger-than-usual tax refunds in the first half of this year temporarily boosted real cash flow by 0.8% in Q1 and 1.2% in Q2. But this boost should reverse in H2 now that tax refunds have been fully paid out, with year-over-growth growth set to temporarily turn negative in Q3 (Exhibit 3). Combining this impulse with the energy price drag in Exhibit 2 implies a sharp swing from a 0.7% boost to real cash flows in Q2 to a drag of 0.6% in Q3.

Exhibit 3: In the US, Larger Tax Refunds Boosted Real Cash Flow by 0.8% in Q1 and 1.2% in Q2

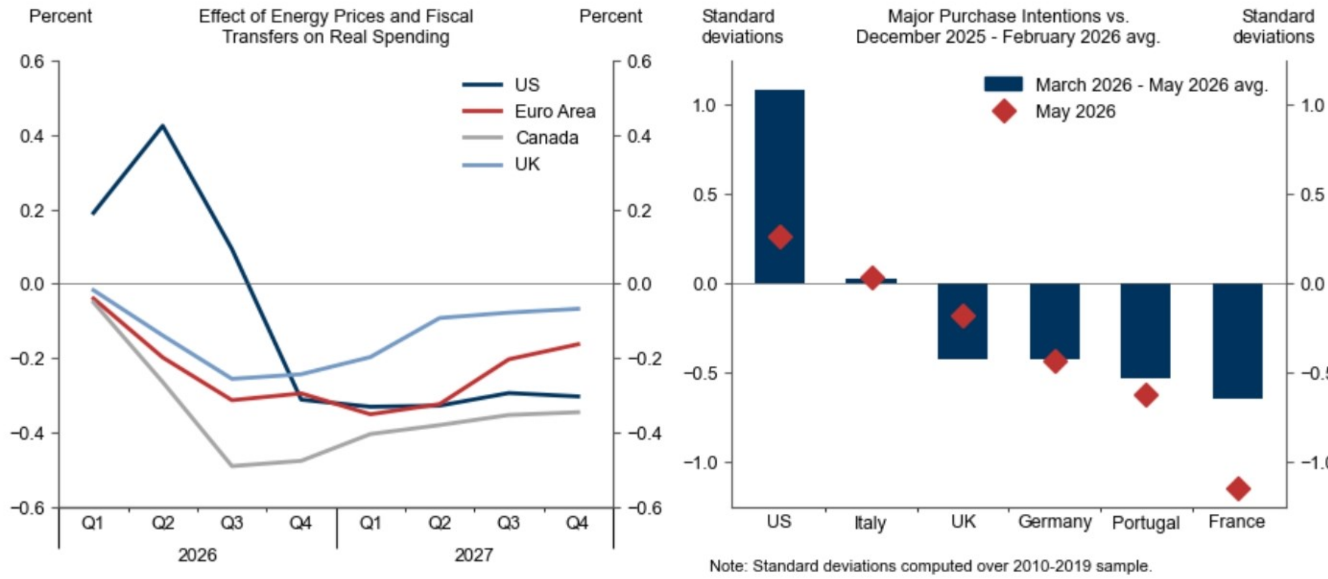


Source: Department of Commerce, Goldman Sachs Global Investment Research

We estimate that each 1% decline in real income due to an energy shock has historically lowered the level of spending by around 0.6% after 2 quarters. Applying this estimate to the cash flow headwinds in Exhibits 2 and 3 implies a peak drag on real spending of 0.5% in Canada, 0.4% in the Euro area, and 0.3% in the US and UK (left chart, Exhibit 4). Our estimated spending impulses imply that spending headwinds are yet to materialize in the US, while only around half of the peak spending hit will be realized in the Euro area, UK and Canada by the end of Q2.

Forward-looking survey evidence also suggests that spending headwinds lie ahead. Most DM consumers anticipate making fewer large purchases over the next 6-12 months than they did before the onset of the war (right chart, Exhibit 4). And while US spending intentions picked up notably this spring on the back of fiscal support, they pulled back in May (consistent with our US economists' estimate that consumers cut back disproportionately on discretionary durable goods in response to an energy shock).

Exhibit 4: We Estimate that the Spending Drag is Yet to Materialize in the US, While Only Half of the Peak Drag Has Been Realized in the Euro Area; Consumer Spending Intentions Also Suggest Further Spending Drags Remain in the Pipeline



Source: Haver Analytics, Goldman Sachs Global Investment Research

Taken together, drawn-out energy passthrough, winter heating fuel demand, and the reversing US fiscal boost suggest spending headwinds remain in the pipeline despite the resilience of spending data so far.

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