

Special Commentary — April 8, 2022

# Everything Is Bigger in Taxes: Tax Refunds & Consumer Spending

## Summary

- The U.S. consumer faces a wave of challenges in 2022. Persistent inflation combined with a less supportive policy environment will take much of the wind out of the sails for consumer spending this year.
- But, it's not all doom and gloom for the consumer. Job growth remains strong and household balance sheets are in relatively good shape.
- An underappreciated near-term tailwind for the consumer, in our view, is robust federal tax refunds. The average tax refund is up more than 12% compared to last year and is about 13% higher than the average refund over the past five years.
- Refunds are higher on average due to some federal fiscal policy stimulus that is still flowing. In short, tax season affords households an opportunity to take advantage of any COVID relief benefits they may not have received in 2021.
- The tax filing season is far from over, and as we get closer to the April 18 filing deadline, these data could change. That said, filers who are owed a refund tend to file earlier than individuals who owe the government money. The average refund size might drift lower in the coming weeks, but we doubt it will be a major decline.
- Real personal spending data has been noisy over the past few months, but through February the level of real consumer spending is 0.3% ahead of where it was in November—an impressive feat amid raging inflation, the Omicron COVID wave and less generous fiscal support.
- Higher refunds may have provided a bit of a buffer to spending in February, and this boost could continue through March and April. We forecast real personal consumption grew at about a 3% annualized pace in the first quarter. If realized, this would mark the fastest pace of consumer spending growth since Q2-2021.
- But while refunds are a near-term tailwind for consumption, the effects will only be temporary. The one-time inflow from an outsized refund is no match for persistent price pressures. Higher inflation has pushed real disposable personal income significantly below its pre-pandemic trend, and this presents a growing concern for future spending growth.
- Maintaining the current pace of real spending growth will be more challenging in the second half of the year, and households likely will need to lean on their balance sheets to sustain spending growth.

Economist(s)

### Michael Pugliese

Economist | Wells Fargo Economics  
Michael.D.Pugliese@wellsfargo.com | 212-214-5058

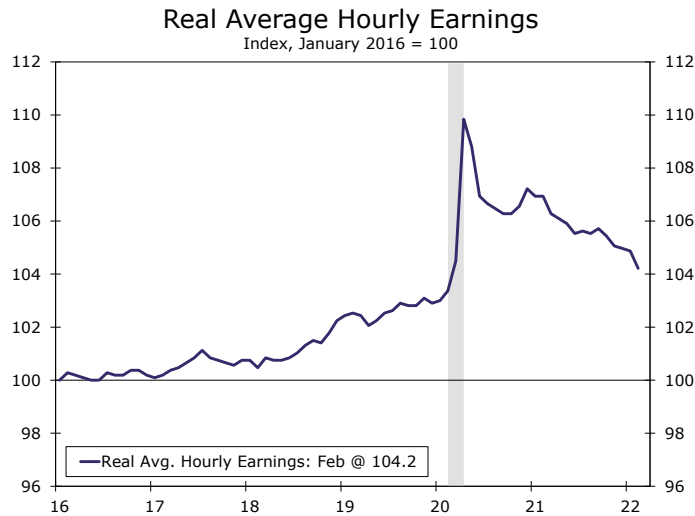
### Shannon Seery

Economist | Wells Fargo Economics  
Shannon.Seery@wellsfargo.com | 332-204-0693

### Average Tax Refunds A Near-Term Bright Spot for the Consumer

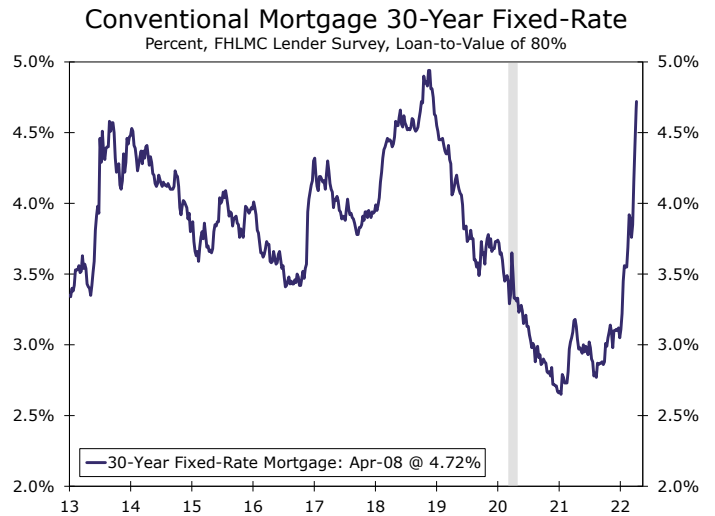
The U.S. consumer is facing a wave of challenges in 2022. Inflation has proven more severe and long-lasting than previously anticipated, and the economic fallout from the Russia-Ukraine conflict has further exacerbated these inflationary pressures. Despite robust nominal wage growth, inflation-adjusted average hourly earnings have stagnated in recent months (Figure 1). Interest rates are on the rise as markets price in an aggressive tightening cycle from the Federal Reserve. The most recent Freddie Mac survey of mortgage lenders shows that the average 30-year fixed-rate mortgage is 4.7%, up from 3.0% in early October (Figure 2). Financial markets have been volatile, and news headlines about recession have reared their ugly heads.

Figure 1



Source: U.S. Department of Labor and Wells Fargo Economics

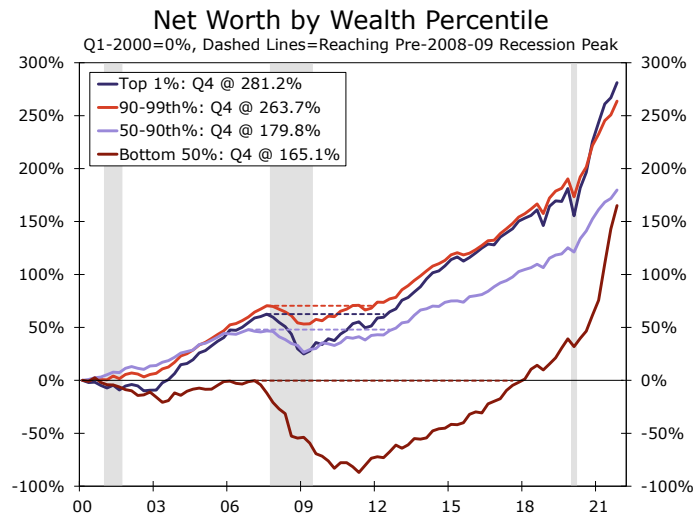
Figure 2



Source: Freddie Mac and Wells Fargo Economics

It is not all doom and gloom for the consumer. Job growth remains strong and averaged 562K per month in Q1, more than triple the average pace of the 2010s. Households' have accumulated a significant amount of "excess savings" as a result of lower spending and robust fiscal support earlier in the pandemic. More broadly, household net worth has soared over the past two years, and not just for those at the top of the distribution (Figure 3). These strong balance sheet positions are not only driven by excess cash savings and elevated asset prices. The liability side of households' balance sheets looks reasonably healthy. The aggregate household debt-to-income ratio is relatively low compared to the past 20 years (Figure 4).

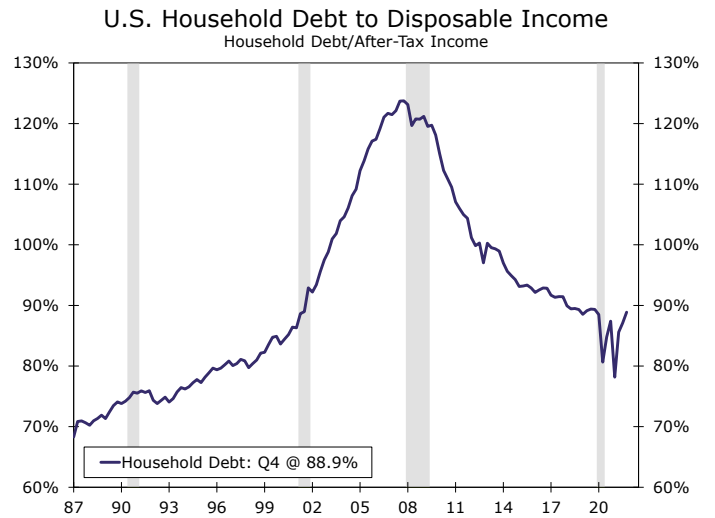
Figure 3



Source: Federal Reserve Board and Wells Fargo Economics

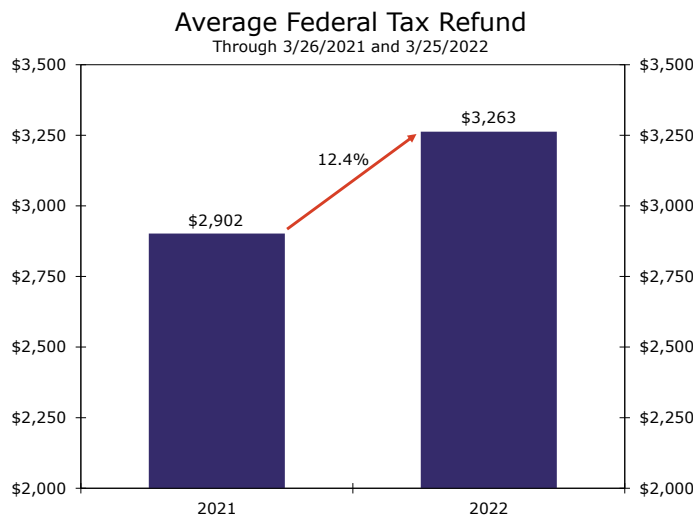
Most of these tailwinds have been discussed at length by us and other analysts. However, we believe robust federal tax refunds are an underappreciated near-term tailwind. As of March 25, the Internal Revenue Service (IRS) has processed 78.9 million individual income tax returns, a 3.8% increase from the same period last year.<sup>1</sup> Of those returns that have been processed, 57.8 million have included a tax refund, with the average refund coming to \$3,263. This is an increase of 12.4% from 2021 and is about 13% higher than the average refund over the past five years (Figures 5 & 6). In total, \$189 billion of tax refunds have been disbursed, a 15.1% increase from the \$164 billion sent out by this point in the 2021 filing season.

Figure 4



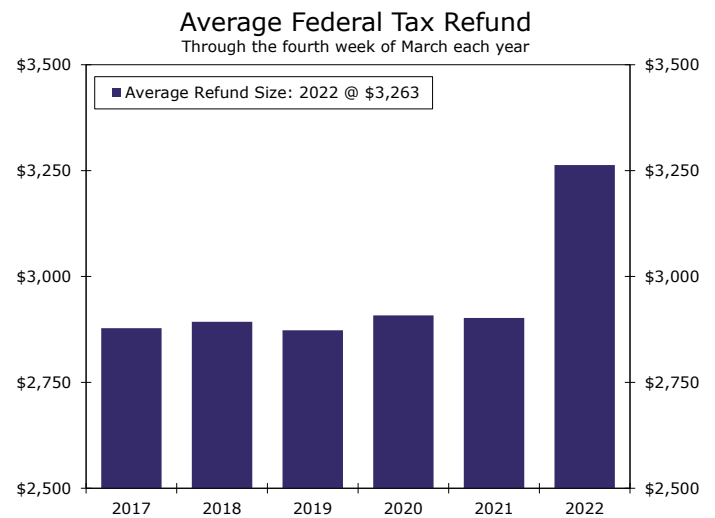
Source: Federal Reserve Board and Wells Fargo Economics

Figure 5



Source: Internal Revenue Service and Wells Fargo Economics

Figure 6



Source: Internal Revenue Service and Wells Fargo Economics

Average tax refunds are up primarily because there is still some federal fiscal policy stimulus flowing. The bulk of federal COVID relief funding went out to households in 2020 and 2021 and has since stopped flowing. The expanded federal unemployment insurance benefits have ended, the final direct checks to households were sent last spring, etc. However, tax season affords households an opportunity to take advantage of any COVID relief benefits they may not have received in 2021. For example, the American Rescue Plan (ARP) enacted in March 2021 temporarily expanded the Child Tax Credit (CTC) from \$2,000 to \$3,000 per child ages 6-17 and to \$3,600 per child under six, subject to income limitations. Parents had the option of either receiving half of these expanded benefits in

monthly installments and the other half when they filed their taxes or receiving the entire amount come tax season.

Now that households are filing their taxes for 2021, some households who opted out of the monthly payments are receiving their full benefit, while others that missed the payments because of outdated income information or a newborn child are receiving what they are owed. We estimate that only 80%-90% of the \$110 billion CTC expansion was sent out in monthly installments in 2021, leaving the rest to be claimed during tax filing season. Similarly, some households may not have received their full economic impact payments (the direct household checks) because of a change in family circumstance or financial situation relative to what the government knew when the checks were first sent out. In addition, some tax credits other than the CTC were expanded as part of the ARP. Congress made the Earned Income Tax Credit Child and the Child and Dependent Care Tax Credit more generous for 2021 in the ARP.<sup>2</sup> These credits are much smaller than the CTC, but add it all together, and it becomes more clear why average refunds are up compared to previous years.

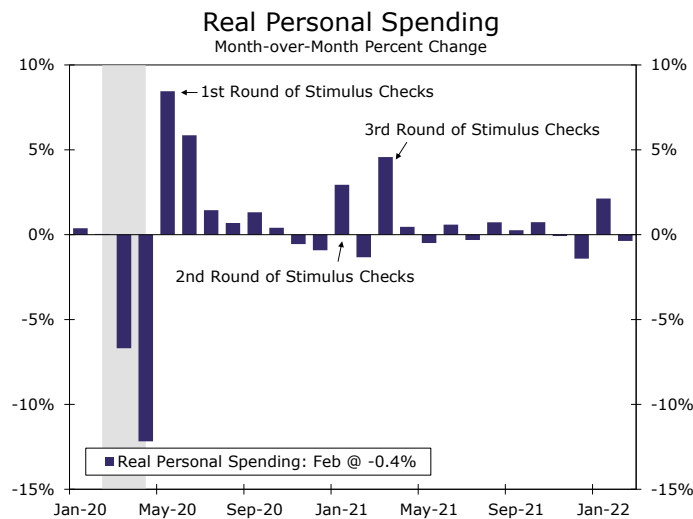
The tax filing season is far from over, and as we get closer to the April 15 filing deadline these data could change. Last year, the IRS processed about 168 million individual income tax returns by the end of the year. That said, filers who are owed a refund tend to file earlier than individuals who owe the government money. This is the major reason that the federal budget deficit tends to be large in February and March, but come April the federal government often runs a budget surplus. The average refund size might drift lower in the coming weeks, but we doubt it will be a major decline.

### Refunds a Tailwind, but Only a Fleeting One

We might expect higher refunds to lift personal income in the near-term. However, there may be a disconnect between what is happening in the real world and what is being reported in the economic data. The monthly personal income and spending data are compiled by the Bureau of Economic Analysis. In that data, tax refunds generally do not show up as a lump sum when distributed but instead are allocated *evenly* over the 12 months of the calendar year.<sup>3</sup> In other words, the personal income data do not fully reflect when the cash changes hands.

So what does this mean for consumption? While it is difficult to know precisely *when* households will spend their refunds, if they're treated like other forms of household stimulus over the past two years, the spend-down rate should be fairly immediate. As seen in [Figure 7](#), a surge in spending occurred each month of the pandemic a lump sum of cash was distributed in the form of stimulus. The seasonal adjustment process should capture the "typical" spending bump from tax refunds, but bigger-than-usual refunds suggest some upside risk in excess of the normal adjustment.

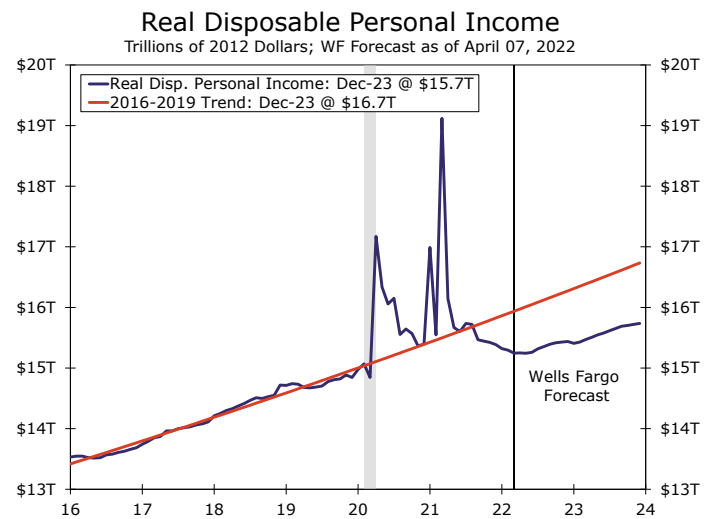
Figure 7



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

Real personal spending slipped 0.4% in February, but that decline came after one of the best months on record for real spending (+2.1% in January). Through the noise, real spending in February was 0.3% above November's level—an impressive feat amid raging inflation, the Omicron COVID wave and less

Figure 8



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

generous fiscal support. It's thus possible higher refunds provided a bit of a buffer in February, and this boost could continue through March and April. The number of refunds processed by the IRS through the fourth week of March is 3.8% above 2021's level but 12% below the five-year average prior to the pandemic. This slower process rate suggests refunds may provide some additional upside to spending in April as well. We forecast real personal consumption grew at about a 3% annualized pace in the first quarter, which if realized would mark the fastest pace of consumer spending growth since Q2-2021.

But, while higher refunds are a near-term tailwind for consumption, the effects will only be temporary. The biggest headwind weighing on the consumer is inflation, and the one-time inflow from a tax refund is outweighed by these persistent price pressures. Inflation is already eating into consumers' purchasing power as seen in the trend decline in real disposable income ([Figure 8](#)). Higher inflation has pushed real disposable income significantly below its pre-pandemic trend, which presents a growing concern for future spending. Maintaining the current pace of real spending growth will be more challenging in the second half of the year, and households will need to lean on their balance sheets to sustain spending growth.

## Endnotes

<sup>1</sup> For the source data, please see "[Filing Statistics for the Week Ending March 25 2022](#)". ([Return](#))

<sup>2</sup> For additional information on these tax changes, see "[Looking Ahead: How the American Rescue Plan Affects Taxes](#)". ([Return](#))

<sup>3</sup> For example, see this [FAQ](#) from the BEA which discusses how the CTC is treated in the NIPAs. ([Return](#))

**Subscription Information**

To subscribe please visit: [www.wellsfargo.com/economicsemail](http://www.wellsfargo.com/economicsemail)

Via The Bloomberg Professional Services at WFRE

**Economics Group**

Jay H. Bryson, Ph.D.	Chief Economist	704-410-3274	Jay.Bryson@wellsfargo.com
Mark Vitner	Senior Economist	704-410-3277	Mark.Vitner@wellsfargo.com
Sam Bullard	Senior Economist	704-410-3280	Sam.Bullard@wellsfargo.com
Nick Bennenbroek	International Economist	212-214-5636	Nicholas.Bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	704-410-3283	Tim.Quinlan@wellsfargo.com
Sarah House	Senior Economist	704-410-3282	Sarah.House@wellsfargo.com
Azhar Iqbal	Econometrician	212-214-2029	Azhar.Iqbal@wellsfargo.com
Charlie Dougherty	Economist	212-214-8984	Charles.Dougherty@wellsfargo.com
Michael Pugliese	Economist	212-214-5058	Michael.D.Pugliese@wellsfargo.com
Brendan McKenna	International Economist	212-214-5637	Brendan.Mckenna@wellsfargo.com
Shannon Seery	Economist	332-204-0693	Shannon.Seery@wellsfargo.com
Nicole Cervi	Economic Analyst	704-410-3059	Nicole.Cervi@wellsfargo.com
Sara Cotsakis	Economic Analyst	704-410-1437	Sara.Cotsakis@wellsfargo.com
Jessica Guo	Economic Analyst	704-410-4405	Jessica.Guo@wellsfargo.com
Karl Vesely	Economic Analyst	704-410-2911	Karl.Vesely@wellsfargo.com
Patrick Barley	Economic Analyst	704-410-1232	Patrick.Barley@wellsfargo.com
Coren Burton	Administrative Assistant	704-410-6010	Coren.Burton@wellsfargo.com

## Required Disclosures

This report is produced by the Economics Group of Wells Fargo Bank, N.A. (“WFBNA”). This report is not a product of Wells Fargo Global Research and the information contained in this report is not financial research. This report should not be copied, distributed, published or reproduced, in whole or in part. WFBNA distributes this report directly and through affiliates including, but not limited to, Wells Fargo Securities, LLC, Wells Fargo & Company, Wells Fargo Clearing Services, LLC, Wells Fargo Securities International Limited, Wells Fargo Securities Europe S.A., Wells Fargo Securities Canada, Ltd., Wells Fargo Securities Asia Limited and Wells Fargo Securities (Japan) Co. Limited. Wells Fargo Securities, LLC is registered with the Commodity Futures Trading Commission as a futures commission merchant and is a member in good standing of the National Futures Association. WFBNA is registered with the Commodity Futures Trading Commission as a swap dealer and is a member in good standing of the National Futures Association. Wells Fargo Securities, LLC and WFBNA are generally engaged in the trading of futures and derivative products, any of which may be discussed within this report.

This publication has been prepared for informational purposes only and is not intended as a recommendation offer or solicitation with respect to the purchase or sale of any security or other financial product nor does it constitute professional advice. The information in this report has been obtained or derived from sources believed by WFBNA to be reliable, but has not been independently verified by WFBNA, may not be current, and WFBNA has no obligation to provide any updates or changes. All price references and market forecasts are as of the date of the report. The views and opinions expressed in this report are not necessarily those of WFBNA and may differ from the views and opinions of other departments or divisions of WFBNA and its affiliates. WFBNA is not providing any financial, economic, legal, accounting, or tax advice or recommendations in this report, neither WFBNA nor any of its affiliates makes any representation or warranty, express or implied, as to the accuracy or completeness of the statements or any information contained in this report and any liability therefore (including in respect of direct, indirect or consequential loss or damage) is expressly disclaimed. WFBNA is a separate legal entity and distinct from affiliated banks and is a wholly owned subsidiary of Wells Fargo & Company. © 2022 Wells Fargo Bank, N.A.

### Important Information for Non-U.S. Recipients

For recipients in the United Kingdom, this report is distributed by Wells Fargo Securities International Limited (“WFSIL”). WFSIL is a U.K. incorporated investment firm authorized and regulated by the Financial Conduct Authority (“FCA”). For the purposes of Section 21 of the UK Financial Services and Markets Act 2000 (“the Act”), the content of this report has been approved by WFSIL, an authorized person under the Act. WFSIL does not deal with retail clients as defined in the Directive 2014/65/EU (“MiFID2”). The FCA rules made under the Financial Services and Markets Act 2000 for the protection of retail clients will therefore not apply, nor will the Financial Services Compensation Scheme be available. For recipients in the EFTA, this report is distributed by WFSIL. For recipients in the EU, it is distributed by Wells Fargo Securities Europe S.A. (“WFSE”). WFSE is a French incorporated investment firm authorized and regulated by the Autorité de contrôle prudentiel et de résolution and the Autorité des marchés financiers. WFSE does not deal with retail clients as defined in the Directive 2014/65/EU (“MiFID2”). This report is not intended for, and should not be relied upon by, retail clients.

SECURITIES: NOT FDIC-INSURED - MAY LOSE VALUE - NO BANK GUARANTEE