STIFEL Economic Commentary

Economic Insight

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Forecast Update: Improved Growth Outlook amid Health and Spending Initiatives

At the end of last year, many questions persisted about the health and political environment of the country. The vaccine rollout was still in the early stages, and the balance of power in Congress had not yet been decided with two Senate seats awaiting run-offs. While many risks remain today, the directional lean of politics and the pandemic containment effort, however, appear to be more certain. At this point, the U.S. economy still has considerable ground yet to recapture before returning to pre-pandemic levels or reaching a strong enough point in the cycle to warrant a removal of policy accommodation, yet discernable progress has been made. The continued reversal of state and local pandemic-related restrictions, along with a rising inoculation rate and declining COVID caseloads and deaths, is a welcome step towards returning to some semblance of normal. Additionally, massive government stimulus will work to boost near-term activity as well as expectations for stronger growth in 2021 and beyond.

A faster growth profile in the coming 12-18 months, however, is likely to prove inorganic amid unprecedented fiscal and monetary intervention, offering near-term benefits with longer-term costs. With trillions of dollars in federal stimulus already allocated – not to mention trillions in monetary lending and liquidity programs – a seemingly insatiable appetite for government spending has and will continue to act as a sizable artificial support to growth. The president's $1.9T stimulus bill figures to be the first of potentially more sizable spending initiatives that could compound the eventual consequences to debt and prices. The continuation of massive funding will almost certainly lead to rising inflationary implications in the longer-run as the economy – eventually – attempts to grow organic legs.

In the nearer-term, however, while *reflation* will expectedly boost prices temporarily through the summer months as the lows of 2020 fall out of the annual calculation, *inflation* is likely to remain modest, reinforcing the Fed's nonchalant approach to rising inflation expectations or a backup in rates. Following short-lived, albeit upside volatility, the majority of which is anticipated to occur in Q2, price pressures are likely to remain marginally restrained through the second half of 2021 and into 2022 as the consumer remains fragile – and increasingly dependent on government support. With labor market conditions still tepid, millions of jobs yet to be recaptured or recreated, an inevitable end to direct payments and enhanced subsidy programs, and a backlog of debt obligations, the U.S. consumer will expectedly continue to face at least some lingering hurdles.

Most in Washington, including those at the Fed, appear to be taking a more narrow view with a focus on spurring economic activity now, regardless of the longer-term repercussions. Furthermore, from a fiscal policy standpoint, even after an appropriate end to pandemic assistance, the Biden administration's social agenda will continue to elevate and promote the importance of robust government outlays. Meanwhile, Fed officials, under a new policy framework that includes a flexible average inflation target, or FAIT, and a *"broad-based and inclusive"* approach to full employment, have ample leeway to allow the economy to run "*hot*," at least temporarily, without pressure to remove accommodation. The market, on the other hand, while elated by the aggressive fiscal and monetary support, is beginning to focus on the potential pitfalls of trillions in rescue funds resulting in an arguably premature backup in rates that could continue through summer as reflation levels peak.

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Economic Forecast Grid
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	End of Quarter Figures												Annual Average			
	Q1 2020	*Q2 2020*	*Q3 2020*	*Q4 2020*	Q1 2021	Q2 2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	Q4 2022	*2019*	*2020*	2021	2022
Growth indicators																
GDP, QoQ %	*-5.0%*	*-31.4%*	*33.4%*	*4.1%*	7.0%	8.2%	5.0%	4.5%	3.7%	3.1%	3.5%	2.8%	*2.2%*	*-3.5%*	6.3%	4.2%
Consumer Spending, %	*-6.9%*	*-33.2%*	*41.0%*	*2.4%*	7.8%	9.0%	6.5%	5.0%	3.5%	2.0%	2.2%	2.0%	*2.4%*	*-3.9%*	7.1%	2.4%
Fixed Investment, %	*-1.4%*	*-29.2%*	*31.3%*	*19.1%*	11.3%	14.2%	9.3%	8.1%	8.5%	8.8%	7.0%	6.7%	*1.9%*	*-1.8%*	12.2%	7.8%
Housing Starts, k	*1,269*	*1,265*	*1,437*	*1,680*	1,620	1,645	1,665	1,680	1,695	1,710	1,720	1,735	*1,325*	*1,413*	1,653	1,715
Unemployment Rate, %	*3.8%*	*13.0%*	*8.8%*	*6.7%*	6.2%	5.9%	5.7%	5.4%	5.3%	5.2%	5.0%	4.9%	*3.9%*	*8.1%*	5.8%	5.1%
Nonfarm Payrolls, k	*-1,373*	*4,781*	*711*	*-140*	250	400	300	250	175	175	175	150	*180*	*995*	300	169
Inflation indicators, YoY%																
PCE	*1.3%*	*0.9%*	*1.4%*	*1.3%*	1.8%	2.2%	2.0%	1.7%	1.3%	1.4%	1.4%	1.3%	*1.5%*	*1.2%*	1.9%	1.4%
Core PCE	*1.7%*	*1.1%*	*1.5%*	*1.5%*	1.6%	1.9%	1.5%	1.5%	1.3%	1.5%	1.4%	1.5%	*1.7%*	*1.5%*	1.6%	1.4%
PPI	*0.3%*	*-0.7%*	*0.4%*	*0.8%*	2.6%	3.3%	3.0%	3.0%	2.5%	1.8%	1.7%	1.6%	*1.6%*	*0.2%*	3.0%	1.9%
Interest rate, %																
FF	*0.25*	*0.25*	*0.25*	*0.25*	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	*2.19*	*0.25*	0.25	0.25
3month UST bills	*0.09*	*0.14*	*0.10*	*0.07*	0.07	0.10	0.15	0.15	0.18	0.20	0.20	0.22	*1.96*	*0.10*	0.12	0.20
2yr UST notes	*0.25*	*0.15*	*0.13*	*0.12*	0.15	0.21	0.24	0.28	0.33	0.35	0.45	0.50	*1.80*	*0.16*	0.22	0.41
5yr UST notes	*0.38*	*0.29*	*0.28*	*0.36*	0.80	0.85	0.75	0.78	0.80	0.85	0.90	0.95	*1.81*	*0.33*	0.80	0.88
10yr UST notes	*0.67*	*0.66*	*0.69*	*0.92*	1.50	1.75	1.65	1.48	1.50	1.45	1.40	1.30	*2.00*	*0.73*	1.60	1.41
30yr UST bonds	*1.32*	*1.41*	*1.46*	*1.65*	2.30	2.60	2.50	2.25	2.30	2.25	2.05	1.98	*2.46*	*1.46*	2.41	2.15
2s to 10s Spread bps	*42*	*51*	*56*	*80*	135	154	141	120	117	110	95	80	*20*	*57*	138	101

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Source: Bloomberg, Stifel
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*Red indicates actual figures
**GPD figures shown as annual change