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A Reduced Rate of Recovery

The latest growth report showed the domestic economy accelerated in the second quarter at a faster pace than previously reported. But as the recovery through the first six months of the year proved to be more rapid and robust than most people anticipated, market players now appear increasingly concerned about the sustainability of a relatively solid growth profile in the back half of 2021 and into 2022. Growing fears of the Delta variant, concerns over further robust government spending and rising debt levels, anticipation of less accommodative monetary policy, and lingering supply chain disruptions are all adding to the uncertain outlook and reduced expectations for activity.

Robust Growth

Second-quarter GDP was revised up one-tenth of a percentage point to 6.7% in the third-round revision, a three-quarter high. Following a 6.3% increase at the start of the year, the U.S. is poised to grow at the fastest annual rate in more than four decades.

In the details of the third-round release, personal consumption was also revised up a tenth of a percentage point to 12.0%, a three-quarter high and following an 11.4% gain in Q1. The performance of U.S consumers has been nothing short of stellar, reflecting both a previous year of pent-up demand as well as unprecedented fiscal stimulus.

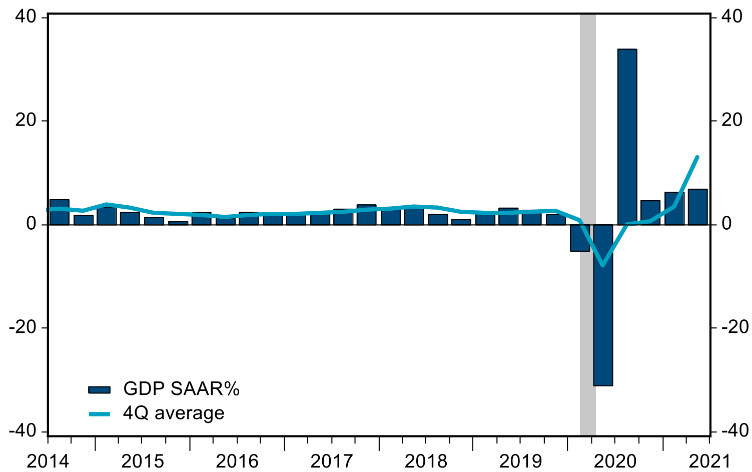
Gross private investment, meanwhile, was similarly revised up one-tenth of a percentage point but for a lesser decline of 3.9% in Q2, and marking the second consecutive quarter of loss. While businesses have widely been permitted to resume activity, many continue to struggle to reconnect with customers and employees within this new environment of safety protocols and vaccine mandates, as well as supply chains still facing massive bottlenecks and interruptions.

Despite an unprecedented challenge of a global pandemic and a nation-wide shutdown, the U.S. economy, however, appears to be rebounding at a faster pace than previously expected with the vaccine initiative well underway and millions of jobs coming back online as businesses are allowed to once again reopen and welcome back customers. Of course, going forward, as the economy continues to recalibrate, supply limiations linger and pandemic stimulus tapers off, even with smaller fiscal initiatives, growth will likely slow from an average 6.5% pace in the first half.

A Slower Pace of Recovery

As the data remain uneven and lingering risks to the recovery persist, many in Washington have seen the current environment as an opportunity to ramp up spending initiatives in the name of economic growth and job creation. Despite the best of intentions and a great effort, however, the Biden administration appears increasingly unlikely to pass everything it has hoped for – meaning the full $4.7T[1] – as moderates and the far Left fail to reach a consensus.

Presuming a quarter or even half the amount of the proposed bill is passed, the government is likely to take a significantly reduced role, at least relative to an unprecedented $6T in stimulus spent since the onset of the pandemic. Thus, with a sizable reduction in fiscal initiatives going forward, as well as ongoing and potentially intensifying supply chain issues disrupting domestic production, growth will expectedly remain positive, but closer to a 3-4% range in the back half of the year with GDP potentially slowing nearer to 2% by 2022. While arguably returning to a more organic composition of growth with a reduced presence of government and a still ongoing solid performance on the part of the consumer with a continued return towards *"normal"* market activity, growth is nevertheless poised to slow towards the end of the year from the more robust performance in Q1/Q2.



Source: Bureau of Economic Analysis/Haver Analytics

Of course, further government spending or a larger than expected package or stimulus could offer an additional boost to GDP beyond current expectations in the second half of the year and as the calendar turns to 2022. Additional government spending in the near term, however, will come at a longer-term cost of higher taxes and increased debt, which will ultimately result in inflationary consequences, not to mention presumably negative implications for investment and hiring.

Reduced Expectations

According to the *Wall Street Journal*, a number of Wall Street economists have revised their third-quarter GDP forecasts sharply lower, joining our previously lonely camp. Although, the report also notes lingering optimism for the longer-term trajectory of the economy with many of the same forecasters elevating their outlooks for 2022 and beyond. While aligning with our assessment of reduced domestic output as a result of the Delta variant and supply chain bottlenecks as well as a somewhat smaller government footprint, some remain hopeful pent-up demand will reaccelerate quickly after the second wave of the crisis. Such a conclusion, however, dismisses the notion of sustained global supply chain disruptions, not to mention what some reports have described as *"critical shortages"* of key goods, including energy.

It's important to note that the U.S. economy was already losing momentum prior to the crisis amid very accommodative monetary policy, with growth slowing from 3% in 2018 down to 2% in 2019 on an annual basis. Thus, going forward, even as the economy continues to recalibrate back to *"normal"* activity, barring the scenario of continued and unlimited government spending and debt creation, there is little expectation that growth will return to a sustainable growth rate much beyond the pre-pandemic level of activity, or the suspected longer-term run rate of the domestic economy at 1.8%.

-Lindsey Piegza, Ph.D., Chief Economist

[1] The $4.7T represents the $1.2T Bipartisan Infrastructure Framework and $3.5T American Families Plan.

Glossary
GDP – Gross Domestic Product
SAAR – Seasonally Adjusted Average Rate