

U.S. Economic Outlook

May 13, 2021

A pothole on the road to recovery

Regular readers will note that we have been pointing out the risk of higher inflation for several months now. Not only do we expect high year-over-year (YoY) readings for inflation due to last year's low readings, but also greater price pressures as a result of the stimulus-fueled demand combined with global supply constraints. These supply shortages have created a bit of a pothole on the road to recovery, which will likely limit aggregate consumption growth for the next two quarters. April's ISM Manufacturing data underscored the severity of the shortages, with the Consumer's Inventory Index reaching its lowest reading on record while the Prices Paid (for Inputs) Index reached its highest level since July 2008. Outside of the supply chain issues, we now know the economy expanded at a robust 6.4 percent annualized pace in Q1 and GDP is quickly on its way to fully recovering to pre-pandemic levels by the end of Q2. Job growth in April was disappointing, with 266,000 jobs added for the month. Evidence points to supply chain issues, while chip shortages for auto manufacturers resulted in a decline in jobs in the automobile sector.

In light of the higher price pressures and severity of the supply constraints, we have downwardly revised our outlook for GDP growth this year to 5.6 percent (YoY). The supply and demand imbalance is now expected to limit growth, which is still expected to be above its long-run average in 2022 at 3.1 percent. Key drivers of growth this year will continue to be the robust pace of consumer spending as health-related restrictions are lifted and consumer confidence fully recovers to its pre-pandemic levels.

Highlights

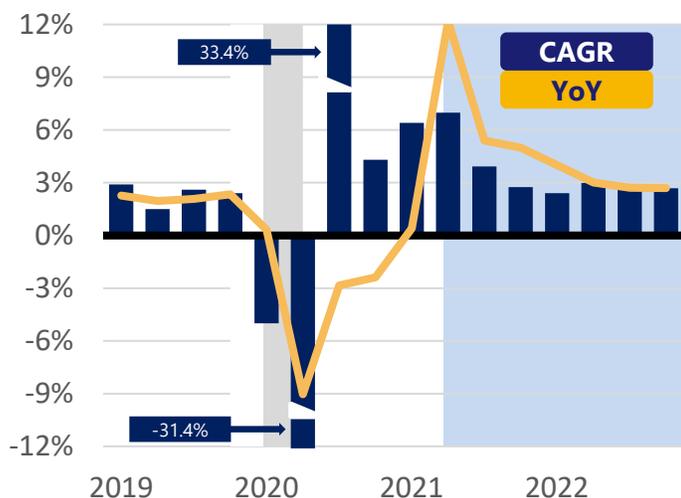
Robust GDP growth in Q1

Inflation headwinds emerging, but are expected to be temporary

Fed timeline may accelerate

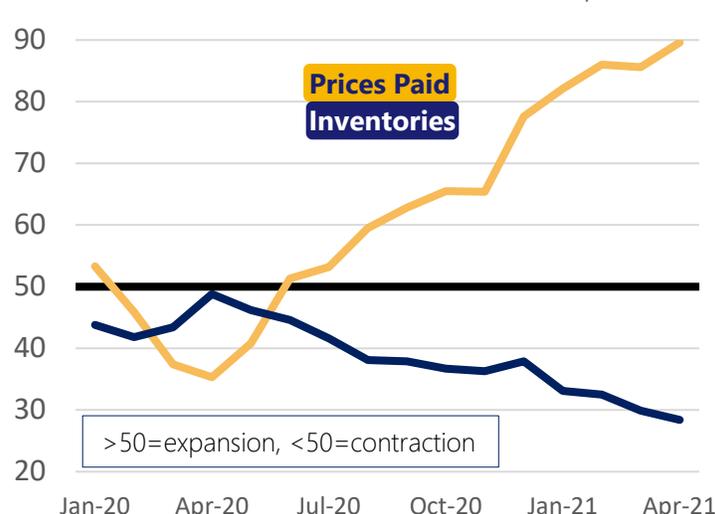
Real gross domestic product (GDP) (SA, CAGR and YoY* percent change)

Last forecast: May 13, 2021



ISM Manufacturing Prices Paid and Consumer's Inventory Indices (NSA index)

Last actual: April 2021



*Seasonally adjusted (SA), compound annualized growth rate (CAGR), year-over-year (YoY). Sources: Visa Business and Economic Insights, U.S. Department of Commerce and Institute for Supply Management.

A pothole on the road to recovery (cont.)

A pack of chicken was how much?

Data on the consumer side of the economy reflected the multiple rounds of fiscal stimulus as nominal disposable income rose 17.5 percent in Q1 and job gains averaged 513,000 for the quarter. While data is sparse on Q2, we still expect the robust consumer-led recovery to continue. Nominal consumer spending is expected to rise 19.1 percent in Q2 as last year's contraction is lapped and higher prices boost the numbers.

In the business world, nominal spending most closely aligns with revenues, but when it comes to the health of consumer spending, real consumer spending provides a much clearer picture. Our outlook calls for real spending to grow 14.9 percent (YoY) in Q2 before downshifting to 6.2 percent (YoY) in both the third and fourth quarters of the year. The more modest pace of real spending reflects higher prices eating into the purchasing power of consumers. The Fed's preferred measure of inflation, the PCE Deflator, is expected to top out at 3.6 percent (YoY) this quarter and remain firmly above the Fed's 2 percent target through Q1 of next year. As of March, the Consumer Price Index had reached 2.6 percent (YoY), with food prices rising 3.5 percent. In the short-term consumers should get ready to pay more for the goods and services they need until the COVID recovery broadens out globally.

The inflation debate

While the recent rise in consumer prices is largely due to base effects from when the economy was shuttered last April, the higher prices are also stemming from global supply chain disruptions. Economists debate how long-lasting the inflationary pressures will be. As the economy reopens, consumer spending on both goods and services will spur inflation to near-term highs, but the rise in prices should be temporary. Some sectors—such as lumber and used cars—may experience exceptionally large spikes. Even with that, we expect prices to moderate by the end of the year as companies work through supply constraints in the global economy.

Risks to the forecast

As noted in our 2021 Annual Economic Outlook published last year, inflation has profound effects on both disposable income and corporate profits, and could become a bigger drag to growth this year. If supply constraints fail to dissipate this fall, the economy will likely experience persistent inflation. That would likely create headwinds to consumer purchasing power and business profit margins, which would result in a further downgrade to our outlook. In addition, we would need to reconsider our outlook for Federal Reserve rate hikes should inflationary pressures begin to materially alter the trajectory of real GDP growth.

Visa's U.S. Economic Forecast

	Actual				Forecast				Actual		Forecast	
	2020 Q1	2020 Q2	2020 Q3	2020 Q4	2021 Q1	2021 Q2	2021 Q3	2021 Q4	2019	2020	2021	2022
Gross Domestic Product (CAGR)	-5.0	-31.4	33.4	4.3	6.4	7.0	3.9	2.7	2.2	-3.5	5.6	3.1
Personal Consumption	-6.9	-33.2	41.0	2.3	10.7	9.1	3.1	2.1	2.4	-3.9	7.1	2.7
Business Fixed Investment	-6.7	-27.2	22.9	13.1	9.9	7.3	4.3	4.1	2.9	-4.0	7.6	4.3
Equipment	-15.2	-35.9	68.2	25.4	16.7	5.4	6.2	5.4	2.1	-5.0	14.7	5.0
Intellectual Property Products	2.4	-11.4	8.4	10.5	10.1	4.9	3.8	4.0	6.4	1.7	6.3	4.2
Structures	-3.7	-33.6	-17.4	-6.2	-4.8	-1.2	-0.4	0.3	-0.6	-11.0	-7.6	1.1
Residential Construction	19.0	-35.6	63.0	36.6	10.8	14.6	10.1	9.8	-1.7	6.1	17.2	9.5
Government Purchases	1.3	2.5	-4.8	-0.8	6.3	5.7	4.0	4.1	2.3	1.1	2.7	3.7
Net Exports Contribution to Growth (%)	1.1	0.6	-3.2	-1.5	-0.9	-1.6	-0.8	-0.7	-0.2	-0.1	-1.8	-0.7
Inventory Change Contribution to Growth (%)	-1.3	-3.5	6.6	1.4	-2.6	1.2	0.8	0.3	0.0	-0.6	0.3	0.4
Nominal Personal Consumption (YoY % Chg.)	1.9	-9.7	-1.7	-1.5	3.4	19.1	10.0	9.7	3.9	-2.7	10.3	5.0
Nominal Personal Income	3.2	10.7	6.8	4.0	15.6	7.5	11.1	13.7	3.9	6.1	11.9	2.3
Retail Sales Ex-Autos	2.7	-7.5	3.3	2.8	11.0	27.6	12.9	12.8	3.4	0.3	15.8	2.2
Consumer Price Index	2.1	0.4	1.2	1.2	1.9	4.1	3.6	3.7	1.8	1.2	3.3	2.4
Federal Funds Rate (Upper Bound)	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	2.19	0.25	0.25	0.25
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	5.28	3.54	3.25	3.25
10-Year Treasury Yield	0.70	0.66	0.69	0.93	1.74	1.78	1.88	1.92	2.14	0.89	1.83	1.99

Forecast as of: May 13, 2021

Sources: Visa Business and Economic Insights analysis of data from the U.S. Department of Commerce, U.S. Department of Labor and Federal Reserve.

Forward Looking Statements

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