U.S. Economic Outlook

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Walking a tight rope

After coming in below expectations for two months in a row, nonfarm payrolls rose a robust 855,000 in June while the unemployment rate edged higher. It would not surprise us if June's payroll gain is revised lower in next month's report. The Bureau of Labor statistics noted that seasonally adjusting the jobs numbers has become more difficult, because returning to in-person learning and other school activities have distorted the typical seasonal patterns. Beyond the quirky seasonal patterns, building wage pressure is emerging as a clear trend. Average hourly earnings rose 3.6 percent year-over-year (YoY) in June. Even after accounting for last year's low readings, wage growth is on a higher growth path than before the pandemic. The increasingly tight labor market is fueling wage gains. The share of employees who quit their jobs as a share of total employment—the so-called quits rate—rose to a record high since the series began in 2000. The Fed has been in wait-and-see mode as the labor market continues to recover, and this month's employment report will likely support its case. With inflation hitting above the Fed's two percent target, we expect the Fed to start tapering its monthly asset purchases as it walks a tight rope between supporting the economy and letting it overheat.

In this update we downwardly revised our outlook for GDP growth to 5.7 percent for this year as incoming data suggests business investment will be a bit softer than expected. We are assuming the bulk of supply chain disruptions will subside by Q4 of this year and thus have upwardly revised our 2022 GDP growth forecast to 3.6 percent.

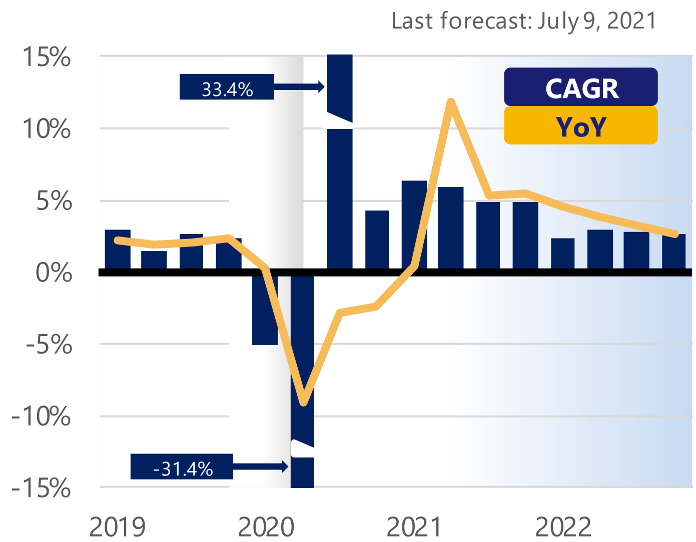
Highlights

Employment growth accelerates as wages rise

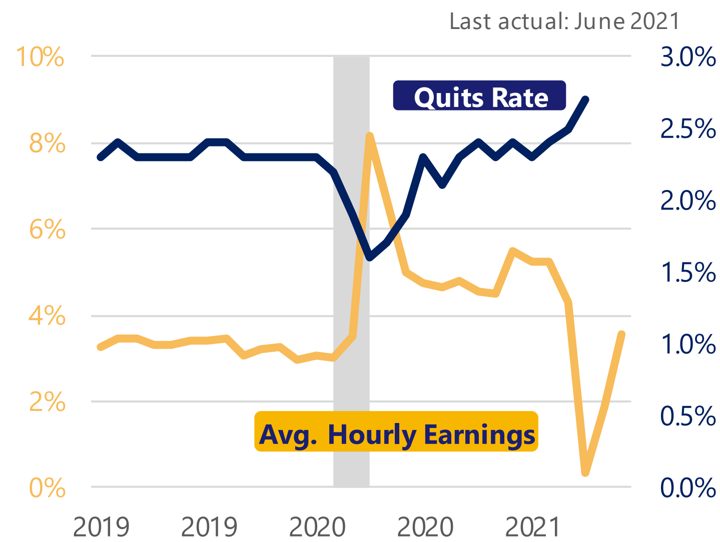
Fiscal stimulus expected to wane soon

COVID variant and inflation pose risk

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



Average hourly earnings (SA, YoY percent change) vs. quits as a share of total employment (SA, percent)



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

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Walking a tight rope (cont.)

Faster wage growth, stronger spending

While higher wage pressure may not be good news for employers, personal income is expected to benefit in the coming quarters. We expect inflation-adjusted after-tax income to rise 3.9 percent YoY in the fourth quarter, before turning negative in Q1 of next year due to the lapping of stimulus checks sent out in 2021. Wage gains should also help offset some of the pressure on households created as fiscal benefits expire. For example, federal student loan payments start up again in October, and the advance Child Tax Credit checks that begin this month will cease at the end of the year. Wage gains have also helped lift consumer confidence. As of June, the share of consumers expecting higher incomes reached its highest level since the onset of the pandemic.

The key drivers of wage growth and higher consumer confidence should translate into higher consumer spending. We expect nominal consumption growth to rise 11.2 percent this year and another 5.8 percent in 2022. One potential counterbalancing factor to the robust spending growth could be the rise in consumer prices. The Consumer Price Index rose 0.6 percent month-over-month in May, pushing the index up 5 percent from a year ago, and marking the twelfth straight month of gains. Supply chain disruptions and a tightening labor market are likely to translate into higher prices through the first quarter of next year.

What's behind the recent move in interest rates?

The yield curve (the difference between the U.S. 10-year and three-month Treasury rate) has flattened quite a bit over the last month. A couple of factors are driving current trends in interest rates. First, the unfortunate global news regarding the COVID-19 Delta variant is raising concerns about economic growth prospects outside the U.S. This, in turn, leads investors outside the U.S. to buy safer assets, such as U.S. 10-year Treasuries. Second, with inflation readings above the Fed's two percent target and increasing evidence of a tighter labor market, it's more likely that the Fed will raise short-term interest rates a bit earlier than expected. This change in the perceived Fed rate hike timing is pushing up the three-month Treasury rates. Our team expects this interest rate spread to widen later this year, as the Fed announces a tapering of its asset purchases. However, stronger U.S. economic activity relative to the rest of the world could keep this yield spread close to current levels.

Risks to the outlook

While growing concern over rapid spread of the Delta COVID-19 variant in less vaccinated areas of the U.S., health concerns may keep some consumers at home even if restrictions aren't imposed. We will continue to monitor global supply chain disruptions, which are starting to hold back spending. Conversely, some upside risk may appear as Congress works through the FY 2022 federal budget.

	Actual					Forecast			Actual		Forecast	
	2020				2021				2019	2020	2021	2022
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
Gross Domestic Product (CAGR)	-5.0	-31.4	33.4	4.3	6.4	6.0	4.9	4.9	2.2	-3.5	5.7	3.6
Personal Consumption	-6.9	-33.2	41.0	2.3	11.4	10.7	3.8	3.8	2.4	-3.9	7.7	3.3
Business Fixed Investment	-6.7	-27.2	22.9	13.1	11.7	6.5	3.3	3.7	2.9	-4.0	7.7	4.1
Equipment	-15.2	-35.9	68.2	25.4	15.0	3.1	2.9	3.5	2.1	-5.0	13.2	3.9
Intellectual Property Products	2.4	-11.4	8.4	10.5	15.3	5.9	5.2	5.0	6.4	1.7	8.0	4.6
Structures	-3.7	-33.6	-17.4	-6.2	-2.0	-0.6	0.3	1.1	-0.6	-11.0	-6.6	2.4
Residential Construction	19.0	-35.6	63.0	36.6	13.1	-6.5	4.0	3.5	-1.7	6.1	12.2	3.2
Government Purchases	1.3	2.5	-4.8	-0.8	5.7	5.3	3.3	3.6	2.3	1.1	2.4	3.3
Net Exports Contribution to Growth (%)	1.1	0.6	-3.2	-1.5	-1.5	-0.6	-0.5	-0.7	-0.2	-0.1	-1.8	-0.6
Inventory Change Contribution to Growth (%)	-1.3	-3.5	6.6	1.4	-2.7	-0.7	1.5	1.5	0.0	-0.6	0.1	0.6
Nominal Personal Consumption (YoY % Chg.)	1.9	-9.7	-1.7	-1.5	3.6	19.8	10.9	11.2	3.9	-2.7	11.2	5.8
Nominal Personal Income	3.2	10.7	6.8	4.7	16.6	2.6	6.3	7.9	3.9	6.3	8.2	-0.1
Retail Sales Ex-Autos	2.6	-7.6	3.3	2.8	11.6	27.7	12.4	11.9	3.4	0.3	15.6	1.5
Consumer Price Index	2.1	0.4	1.2	1.2	1.9	4.7	4.6	4.8	1.8	1.2	4.0	2.7
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	1.45	1.53	1.57	2.14	0.89	1.57	1.74

Forecast as of: July 9, 2021

Interest rates presented are end of quarter rates

Note: Annual numbers represent year-over-year percent changes and annual averages

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

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