# US ECONOMIC UPDATE JANUARY 2021

## RECOVERY LOST MOMENTUM AT END OF 2020; HOPE FOR A BETTER 2021

NAB Group Economics

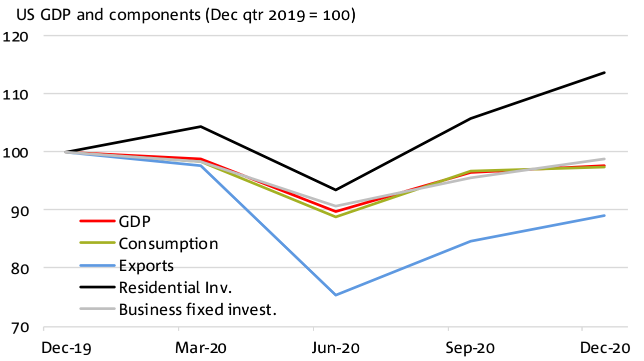
**GDP grew by 1.0% q/q in Q4 2020, but this headline figure masks a weakening in the economy as high rates of COVID-19 transmission and restrictions on mobility and activity took its toll over November/December. The substantial fiscal support passed at the end of 2020, with more expected, as well as the roll-out of vaccines, offers the hope of rapid growth emerging over 2021. As a result, we have revised up our 2021 GDP growth forecast to 4.5% (from 3.3%) and our 2022 forecast to 3.9% (from 2.4%). Fed funds rate to remain unchanged for the next two years at least.**

### Q4 GDP – positive news hides weakness

GDP increased by 1.0% q/q (4.0% annualised) in Q4, reflecting the continued recovery from the recession in the first half of 2020. GDP was still well down (-2.5%) from a year ago, indicating that the recovery has a considerable way to go.

As expected, the rebound was broad based with household consumption, business and residential investment rising, along with exports. The decline in Inventories also came to an end but government spending declined for the second consecutive quarter.

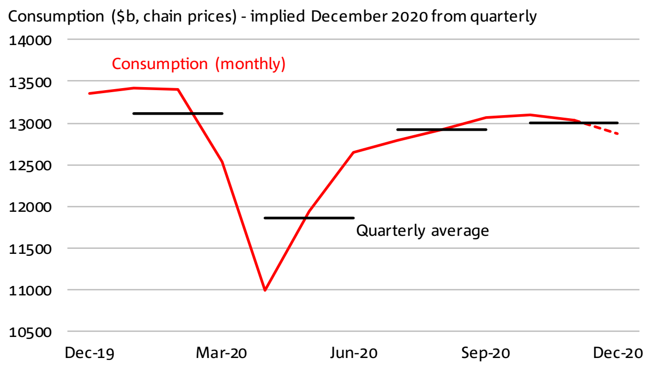
**GDP growth broad based but moderated in Q4**




Moreover, while growth in Q4 was positive, indicators suggest that growth either slowed through the quarter or even turned negative, although weakness was concentrated in a few categories rather than broad based.

This can be seen in monthly consumption data. While consumption rose in Q4, October was the peak month, with spending falling in November and the Q4 outcome suggesting consumption declined again in December by over 1.0%. Monthly non-residential construction expenditure has also continued to fall.

**Q4 consumption growth hides recent weakness**

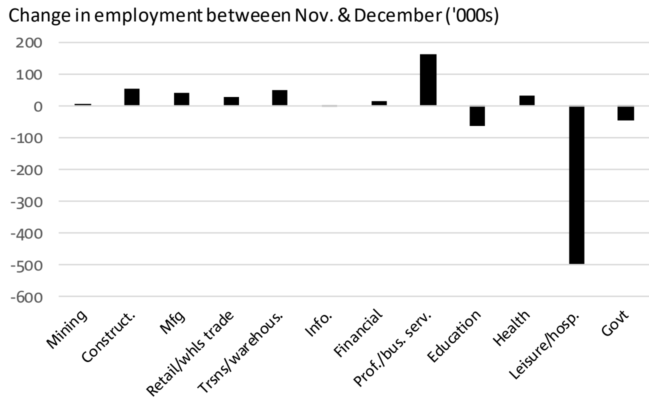



Source: Refinitiv (BEA), NAB. Dec'20 implied from Q4 2020, assumes no revisions to prior data.

High frequency data, such as Google mobility, seated diners at restaurants, and airline traveller numbers also point to activity either plateauing or easing.

Non-farm employment also fell in December for the first time since April when the first round of lockdowns took an enormous toll.

**Employment fell in December...but not broad based**



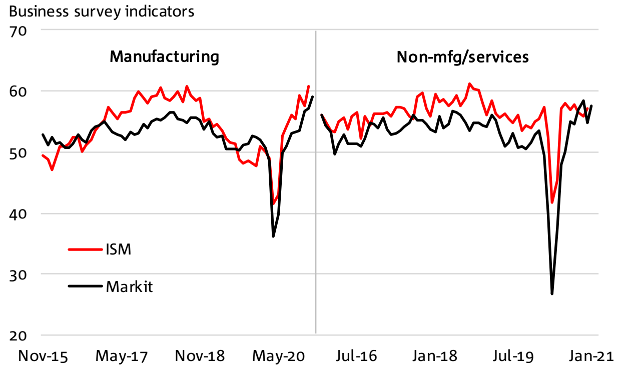

Date 29 **January 2020** | Author Tony Kelly – Senior Economist

The silver lining in the December jobs report was that, unlike earlier in the year where job losses were broad based, losses occurred in a narrower range of industries. The bulk of losses were in leisure and hospitality – the area most affected by the recent round of COVID-19 restrictions. While there was also a fall in education and government jobs, other sectors such as mining, manufacturing, retail trade and health saw gains.

Similarly, unlike earlier in the year, where there were broad based falls across all economic indicators, this time around some measures have continued to improve. This is particularly true in housing (sales and construction), but also capital goods orders (an indicator of equipment investment), industrial production and exports. Mining investment also turned the corner in Q4.

National business surveys also point to on-going recovery in the economy. This is particularly so for the manufacturing sector, where readings are at high levels. The Markit services PMI and non-manufacturing ISM have, in contrast, softened a little but they remain at a solid level.

**National business surveys more positive**




Source: Refinitiv.

Despite these more positive signs, the apparent decline in consumption – the largest expenditure component of GDP – over November and December, pointed to the possibility of an economy going into reverse at the end of the year. It also raised the risk that there would be a decline in Q1 2021 GDP as fiscal support continued to unwind and as COVID-19 transmission remained at high levels.

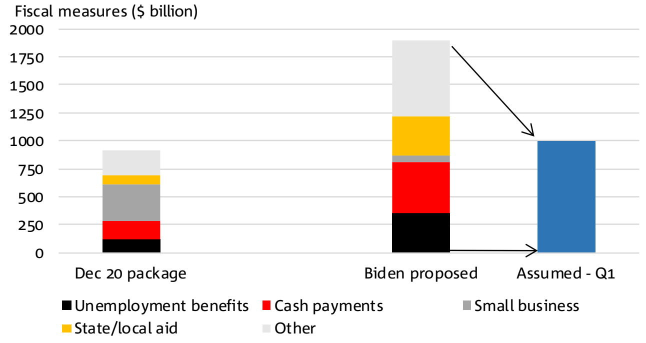
## Fiscal policy and vaccines to the rescue

While COVID-19 transmission remains high, two developments have significantly improved the outlook.

Firstly, significant additional fiscal support was passed late in December, with the prospect of more to come.

The late December 2020 Coronavirus Response and Relief Act amounted to around $0.9 trillion (4.3% of GDP) of extra spending and income transfers to households and businesses. In January, President Biden proposed a further $1.9 trillion package.

**Large scale fiscal support with more to come?**

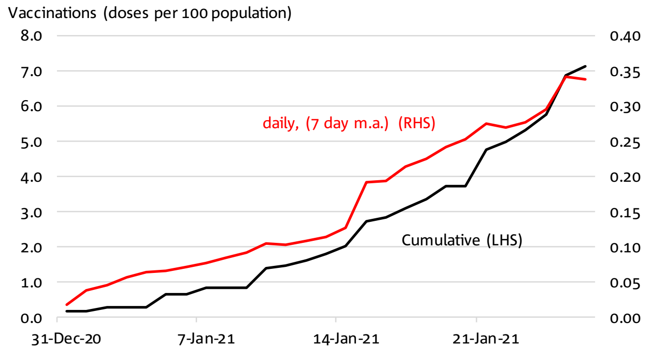



Source: Committee for a Responsible Federal Budget, Financial Times, NAB

With Congress responsible for spending bills, there is no guarantee the President's proposal will make it into law. However, we expect it likely that at least part of the proposal will be enacted. Even if the Democrats cannot get enough Republican support to prevent a filibuster in the Senate, the use of budget reconciliation (which requires a simple majority) provides an avenue going forward. However, not all Democrat senators will necessarily support all elements of the President's plan. We have tentatively assumed that a package of around $1 trillion will be passed. This will probably be by March as the expiration of some unemployment benefits during this month will bring negotiations to a head.

At the same time the roll-out of the vaccine for COVID-19 raises the prospect that the virus will be brought under control. While by 26 January only around 7 doses had been given per 100 head of population (with 2 doses per person required for a full treatment), the daily rate of vaccinations has been steadily increasing. How much further the vaccination program can be accelerated, and what proportion of the population are willing to be vaccinated, is an open question, although it is unlikely that a substantial proportion of the country will have been vaccinated until the second half of the year.

**Vaccination deployment ramping up**




Source: Refinitiv (Our World in Data), NAB

Nevetheless, we assume that the combination of a move to warmer weather in coming months as well as the ongoing vaccination program will reduce COVID-19 transmission and allow for an unwinding of COVID-19 restrictions and less cautious individual behaviour. In recent days some states have announced an easing in restrictions.

The combination of substantial fiscal stimulus, combined with an unwinding of restrictions, offers up the prospect of very rapid growth. We expect that this will be reflected in GDP particularly from Q2 onwards (with Q1 likely to be soft).

As a result we have substantially revised up our GDP forecasts for the US. We now expect growth of 4.5% (previously 3.3%) in 2021 while for 2022 we are projecting 3.9% (previously 2.4%).

There are is a wide range of uncertainty around any point estimate of GDP with both upside and downside risks evident. These include: how the COVID-19 transmission evolves in coming months (and its implications for restrictions), the final amount of fiscal stimulus may be smaller or greater than we assume, our assumed fiscal 'multiplier' may be unduely conservative, and the speed of the vaccine roll-out is uncertain. Moreover, how effective the vaccines are (outside clinical trials) in reducing transmission and mortality, will be crucial, particularly given recent concerns over new strains of the virus.

### Monetary policy on hold for now

The Fed left policy settings unchanged in its January meeting and that is likely to be a recurring theme over the rest of the year.

The Fed's immediate target is to achieve inflation moderately above 2% for some time so that inflation averages 2% over time (and inflation expectations are consistent with 2% inflation). To achieve that it plans:

- To keep the Fed funds rate target at 0-to 0.25% until there is 'full employment' and inflation is above 2% and likely to exceed it for some time.
- Even at this point it will keep policy 'accomodative' until it has achieved its average inflation target.
- It will continue to increase its holdings of Treasury securities by at least $80 billion per month and of mortgage-backed securities by at least $40 billion per month (QE) until substantial further progress has been made towards its goals.

Even with our upwardly revised forecasts, we still don't have inflation consistently hitting 2% by the end of 2022. Measured inflation might temporarily move close to or above 2% in Q2 2021 as last year's price falls early in the pandemic drop out of the annual calculation, but this will be transitory and will be ignored by the Fed.

While we expect the unemployment rate to fall considerably by end 2022 and be close to Fed members view of its longer term level, in the absence of inflation being sustainably above 2%, the fed funds rate would be expected to remain unchanged over this period (and into 2023).

In terms of QE, what the Fed's criterion of 'substantial further progress' means in practice is unclear and gives the Fed considerable wriggle room. However, if our forecasts are realised, by end 2022 (if not before) the economy would be in a state that could be considered consistent with this requirement having been met.

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# U.S. ECONOMIC & FINANCIAL FORECASTS

| | Year Average Chng % | | | | | Quarterly Chng % | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | 2020 | | | | 2021 | | | | 2022 | | | |
| | 2018 | 2019 | 2020 | 2021 | 2022 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 |
| **US GDP and Components** | | | | | | | | | | | | | | | | | |
| Household consumption | 2.7 | 2.4 | -3.9 | 4.8 | 4.7 | -1.8 | -9.6 | 9.0 | 0.6 | **0.0** | **1.5** | **1.9** | **1.6** | **1.1** | **0.8** | **0.7** | **0.6** |
| Private fixed investment | 5.2 | 1.9 | -1.8 | 9.3 | 5.6 | -0.3 | -8.3 | 7.1 | 4.3 | **2.0** | **1.7** | **1.9** | **1.6** | **1.3** | **1.1** | **1.0** | **1.0** |
| Government spending | 1.8 | 2.3 | 1.1 | 0.1 | 1.9 | 0.3 | 0.6 | -1.2 | -0.3 | **0.1** | **0.3** | **0.6** | **0.6** | **0.5** | **0.4** | **0.4** | **0.4** |
| Inventories* | 0.2 | 0.0 | -0.7 | 0.9 | -0.1 | -0.4 | -1.1 | 1.6 | 0.3 | **0.1** | **0.1** | **0.2** | **-0.1** | **-0.1** | **-0.1** | **0.0** | **0.0** |
| Net exports* | -0.3 | -0.2 | 0.0 | -1.3 | -0.4 | 0.4 | 0.1 | -1.4 | -0.5 | **0.0** | **-0.2** | **-0.2** | **-0.2** | **-0.1** | **0.0** | **0.0** | **0.0** |
| **Real GDP** | **3.0** | **2.2** | **-3.5** | **4.5** | **3.9** | **-1.3** | **-9.0** | **7.5** | **1.0** | **0.4** | **1.2** | **1.7** | **1.2** | **0.8** | **0.7** | **0.6** | **0.6** |
| *Note: GDP (annualised rate)* | | | | | | *-5.0* | *-31.4* | *33.4* | *4.0* | *1.8* | *5.1* | *6.8* | *4.8* | *3.3* | *2.9* | *2.5* | *2.3* |
| **US Other Key Indicators (end of period)** | | | | | | | | | | | | | | | | | |
| PCE deflator-headline | | | | | | | | | | | | | | | | | |
| Headline | 2.0 | 1.5 | 1.2 | 1.9 | 1.9 | 0.3 | -0.4 | 0.9 | 0.4 | **0.5** | **0.5** | **0.4** | **0.5** | **0.5** | **0.4** | **0.5** | **0.5** |
| Core | 2.0 | 1.6 | 1.4 | 1.7 | 1.9 | 0.4 | -0.2 | 0.9 | 0.3 | **0.4** | **0.4** | **0.3** | **0.5** | **0.5** | **0.5** | **0.5** | **0.4** |
| **Unemployment rate - qtly average (%)** | **3.8** | **3.6** | **6.7** | **5.8** | **4.2** | **3.8** | **13.0** | **8.8** | **6.7** | **6.8** | **6.3** | **6.1** | **5.8** | **5.1** | **4.6** | **4.3** | **4.2** |
| **US Key Interest Rates (end of period)** | | | | | | | | | | | | | | | | | |
| Fed funds rate (top of target range) | **2.50** | **1.75** | **0.25** | **0.25** | **0.25** | **0.25** | **0.25** | **0.25** | **0.25** | **0.25** | **0.25** | **0.25** | **0.25** | **0.25** | **0.25** | **0.25** | **0.25** |

**Source: NAB Group Economics**

*Contribution to real GDP growth

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