US ECONOMIC UPDATE FEBRUARY 2021

2021 SET TO BE A YEAR OF VERY STRONG GROWTH

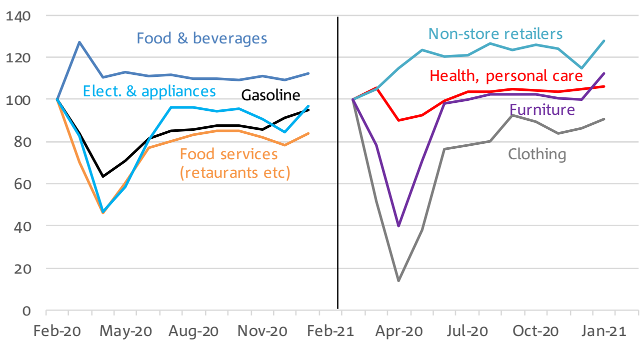
NAB Group Economics

A spike in January retail sales point to an immediate boost from end-2020 fiscal stimulus. The combination of the end 2020 stimulus (still largely unspent) with another (potentially much larger) fiscal stimulus package on the way, an elevated level of household savings, declining COVID-19 case numbers and the vaccine roll-out, point to very strong growth over the rest of 2021. We have revised up our forecast for 2021 GDP growth to 5.0% (previously 4.5%) and expect growth of 3.9% in 2022.

Fiscal stimulus gives an immediate boost

The decline in household consumption that occurred in November and December appears to have been abruptly reversed in January. Retail sales (in nominal terms) increased by 5.3% mom, completely reversing the weakness in prior months. While retail sales are only a subset of total consumption, the almost 7% m/m increase in food services sales – one of the sectors most affected by COVID-19 related restrictions – provides a positive signal.

Broad based bounce in January retail sales



Sources: Refinitiv, NAB

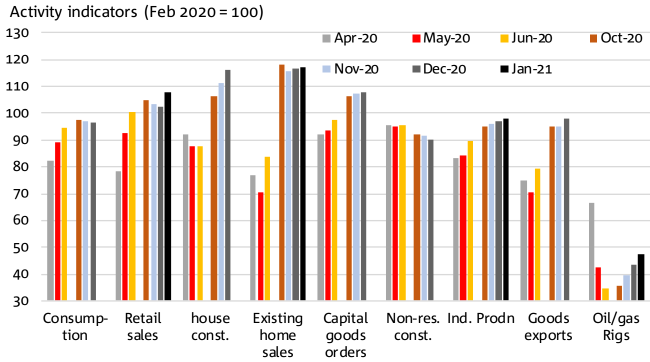
While non-store retailers (i.e. online sales) were one of the big beneficiaries, the increase in sales was broad based across the major categories. Some of the larger increases occurred in big ticket items such as electrical & appliances and furniture and discretionary items such as sporting goods and hobbies, musical items & books.

The size of the January increase, in the absence of any major relaxation of COVID-19 restrictions, as well as its composition, points to the $900 billion December 2020 fiscal stimulus package as the main cause. This included $600/$1200 Economic Impact Payments to many individuals/joint filers (families) which were largely sent out in January. Moreover, additional unemployment benefits would have also started flowing immediately.

The total value of the increase in retail sales in January represents around 20% of the Economic Impact Payments and unemployment benefit payments (additional to what was available in December). As a result, a large rise in household savings is likely when the personal income report is released at the end of this week.

Outside of household consumption, the latest data point to an economy continuing to recover. Housing construction has been increasing strongly and home sales are at a high level, even if growth has flattened in recent months. Capital goods orders (an equipment investment indicator) have been rising, as have industrial production, mining investment and goods exports. Non-residential construction (ex mining) continues to be an area of weakness.

Other activity indicators also generally rising

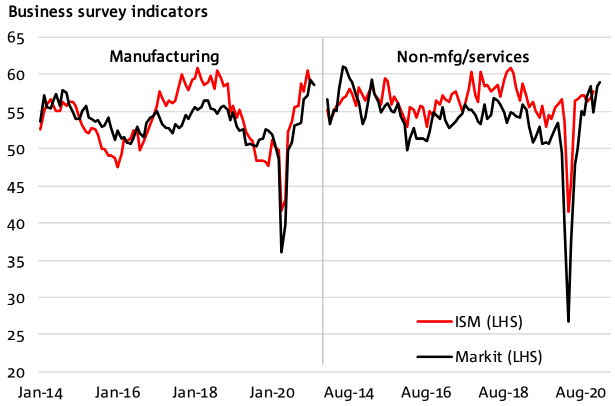


Source: Refinitiv. Capital goods orders are ex transport & defence ('core')

National business surveys bucked the slowdown evident in activity data in late 2020, and they remained strong into January and, based on preliminary Markit data, February.

Date **24 February 2021** | Author Tony Kelly – Senior Economist

Business surveys robust

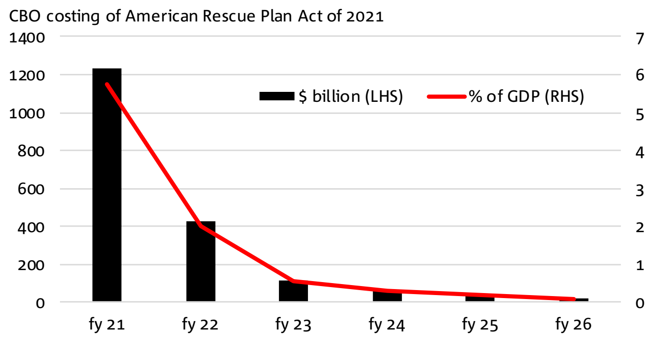


Stars aligning for rapid growth over 2021

The combination of a sizable stimulus package at the end of 2020 (still largely unspent) with another one on the way, an elevated level of household savings, declining COVID-19 case numbers and the roll-out of COVID-19 vaccines, point to very strong growth over the rest of 2021.

President Biden has proposed a $1.9 trillion stimulus package – the American Rescue Plan. Estimates by the Congressional Budget Office (CBO) indicate that spending under the Act will be heavily front loaded into fy 21 even though there are only seven months left of the financial year. Congressional leaders are aiming to obtain final passage by mid-March (ahead of scheduled expiry of some unemployment benefits).

More stimulus on the way



Source: Congressional Budget Office, NAB

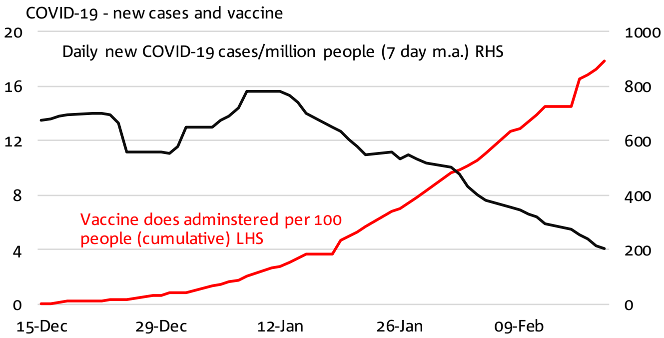
Our expectation had been that the amount of stimulus that would be passed by Congress would likely be in the order of $1 trillion. However, with the Democrats eschewing a bipartisan approach and looking to use the budget reconciliation process to gain passage, the odds of something closer to the President's proposal have increased. For now, our forecasts still assume a further $1 trillion package, which is still very large in its own right, but the distinct possibility of it being substantially larger represents an upside risk to our forecast.

An issue with the December stimulus package was how much would be spent in an environment of continued mobility restrictions. The answer provided by January retail sales is that even in the current environment, fiscal stimulus can meaningfully affect activity. Nevertheless, an easing of restrictions would clearly boost activity particularly when combined with large scale stimulus.

The rollout of COVID-19 vaccines underway opens the prospect of a sustained easing, and eventually removal, of activity restrictions. At the current pace of vaccination 'herd immunity' may not be reached until well into the second of the year (although the large number people of have contracted the virus and may have developed a level of immunity, and the different estimates of what is need for 'herd immunity', makes it hard to be definitive).

That said, there has been a large fall in the number of new COVID-19 cases. From their January peak, new cases have declined by around 75%. This is likely to lead to at least some easing in restrictions or less cautious behaviour by households. While the experience of the past year, and the different 'waves' of the virus, as well as risks from different strains of the virus, suggest caution in extrapolating out this trend, while it persists it will help provide some boost ahead of a full vaccine roll-out.

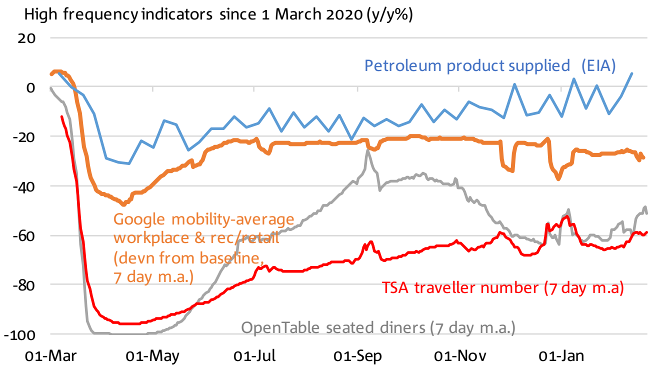
COVID-19 cases declining; but full vaccine roll-out has a way to go



Sources: Refinitiv, NAB

There is already some evidence this is playing out. Airport traveller numbers have started to move up (a bit) after their post-Christmas/New Year lull and restaurant numbers are also up, consistent with several states easing dining restrictions.

Some high frequency indicators moving higher; artic freeze weighing on mobility



Sources: Google, US EIA, TSA, OpenTable

In contrast Google Mobility indicators have not improved. However, they were relatively flat even during a period of growth in Q3 last year.

The most recent dip in the mobility data appears to reflect a large fall in Texas (and some other states) due to exceptionally cold weather which caused widespread disruptions, including power outages, effectively closing much of the state. While these disruptions will be transitory (the daily mobility indicators have already largely recovered), they will likely have a small negative impact of Q1 GDP growth (but a positive impact on Q2).

There are a few other headwinds which will also act as break on growth in Q1 but should fade as the year unfolds. Supply shortages are disrupting some sectors; this is particularly evident in a shortage of semi-conductors which is impacting auto production as the closure of some plants has been announced. A tightening of COVID-19 related restrictions in Europe and Japan are likely to lead to a fall in GDP in Q1 which may affect demand for US exports (although the slowdown is likely to be concentrated in service sectors, limiting the impact).

Nevertheless, given the strong rise in retail sales in January and the fall in COVID-19 numbers, we have raised our expectation for Q1 growth, and now expect it to be similar to Q4. For the rest of the year we continue to expect very strong growth as another round of stimulus hits the economy and as the continuing vaccine roll-out enables a roll-back of restrictions (mainly in the second half of the year).

For 2021 we now expect GDP growth of 5.0% (previously 4.5%) and we still expect growth of 3.9% in 2022. While the path of the virus and the ultimate effectiveness of the vaccines, particularly given new strains, remains a risk, the distinct possibility that the next round of fiscal stimulus will be larger than assumed in our forecasts suggests there is upside risk to our forecasts.

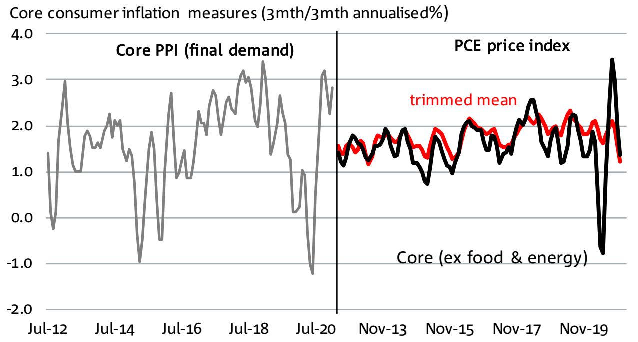
Inflation

The annual Personal consumption expenditure (PCE) inflation rate remained relatively low in December at 1.3% y/y although the core measures (which excludes food and energy) was slightly higher at 1.5% y/y.

Annual Inflation is set to move higher – likely above 2% - in Q2 as the initial large price falls during last year's recession drop out of the calculations (but the subsequent partial rebound remain). However, on a monthly frequency, PCE inflation is not obviously moving higher, although the high degree of volatility makes discerning the underlying trend difficult.

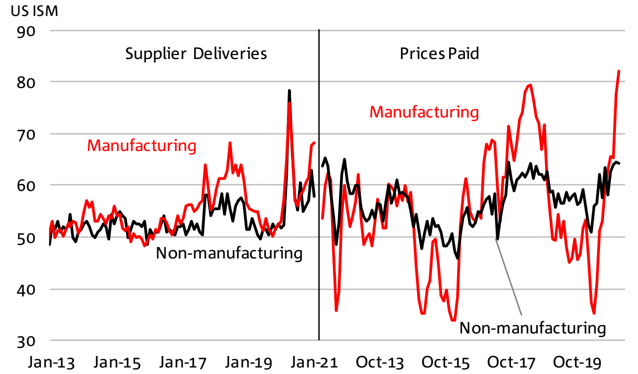
However, producer price (PPI) inflation has moved higher and business surveys point to supply issues (illustrated by the elevated 'supplier deliveries' indices) and prices paid. price swings so are not a reliable indicator of underlying inflationary pressures.

Consumer inflation volatile; PPI inflation up

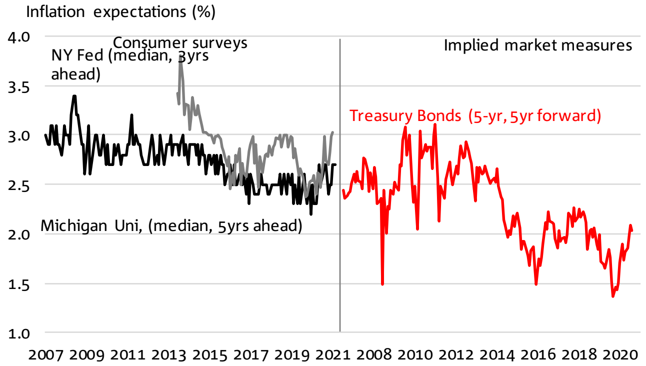


Sources: Cleveland Federal Reserve (trimmed mean CPI), Atlanta Federal Reserve (Trimmed mean PCE), BEA, NAB.

Business surveys – supply disruptions & prices up



Inflation expectations higher…but not high



Sources: Bloomberg, Philadelphia & New York Fed. reserves, Thomson Reuters/Michigan Uni.

Inflation expectations have also risen in recent months – based on both consumer surveys as well market implied inflation rates. However, in both cases the level of expectations is not high by historical standards.

The experience since the GFC has been that inflation is relatively insensitive to swings in the economy. Accordingly, despite the expected rapid growth over the rest of 2021, we expect (annual) inflation, outside of a temporary spike in Q2 2021, to remain at or below the Fed's 2% inflation target over our forecast horizon (to end 2022).

With the Fed wanting to see a period of sustained above target inflation, the fed funds rate is set to remain unchanged over the next couple of years at least. Less certain is what happens to the amount of monthly asset purchases (QE). The benchmark set by the Fed for any scaling back of QE is that it needs to see 'substantial progress' towards its goals. What consitutes substantial progress is unclear but, on the face of it, our forecasts indicate that this requirement could easily be satisfied during 2022 as inflation gets close to target and the unemployment rate moves back to a low level.

There is considerable debate about the size of fiscal stimulus being proposed by the President, and its potential implications for inflation. While the apparent low inflation sensitivity to moves in aggregate demand suggests fears are overblown, we would have to acknowledge there is upside risk. If you had to guess what set of circumstances might generate a sustained upwards lift to inflation then a (arguably) larger than needed fiscal stimulus, with no offset from monetary authorities who won't act until inflation has breached their target (in contrast to the rate hikes after the Trump tax cuts), combined with structural dislocation post-COVID-19 as well as on-going supply disruptions, would be one possibility.

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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	5.7	4.7	-1.8	-9.6	9.0	0.6	**0.9**	**1.5**	**1.9**	**1.7**	**1.1**	**0.7**	**0.7**	**0.6**
Private fixed investment	5.2	1.9	-1.8	8.9	5.4	-0.3	-8.3	7.1	4.3	**1.9**	**1.6**	**1.6**	**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	**0.0**	**0.2**	**0.1**	**0.0**	**-0.1**	**-0.1**	**0.0**	**0.0**
Net exports*	-0.3	-0.2	0.0	-1.4	-0.4	0.4	0.1	-1.4	-0.5	**-0.1**	**-0.2**	**-0.2**	**-0.2**	**-0.1**	**0.0**	**0.0**	**0.0**
Real GDP	**3.0**	**2.2**	**-3.5**	**5.0**	**3.9**	**-1.3**	**-9.0**	**7.5**	**1.0**	**0.9**	**1.4**	**1.5**	**1.2**	**0.8**	**0.7**	**0.6**	**0.6**
Note: GDP (annualised rate)						*-5.0*	*-31.4*	*33.4*	*4.0*	*3.5*	*5.6*	*6.3*	*5.0*	*3.4*	*2.9*	*2.4*	*2.3*
US Other Key Indicators (end of period)																	
PCE deflator-headline																	
Headline	2.0	1.5	1.2	2.1	1.9	0.3	-0.4	0.9	0.4	**0.7**	**0.4**	**0.4**	**0.5**	**0.5**	**0.4**	**0.5**	**0.5**
Core	2.0	1.6	1.4	1.8	1.9	0.4	-0.2	0.9	0.3	**0.5**	**0.4**	**0.4**	**0.5**	**0.5**	**0.5**	**0.5**	**0.4**
Unemployment rate - qtly average (%)	**3.8**	**3.6**	**6.7**	**5.4**	**4.0**	**3.8**	**13.0**	**8.8**	**6.7**	**6.3**	**6.0**	**5.7**	**5.4**	**5.0**	**4.5**	**4.2**	**4.0**
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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