US ECONOMIC UPDATE APRIL 2021

GDP GROWTH OFF TO A GOOD START IN EARLY 2021 AND SET TO ACCELERATE

NAB Group Economics

GDP grew by a robust 1.6% q/q in Q1. With the ongoing vaccination effort supporting a re-opening of the economy, and with the full effects of recent fiscal stimulus still to flow through, growth is set to accelerate further. The Fed may be able to announce its intention to taper asset purchases towards the end of 2021, with tapering to commence in Q1 2022, but the fed funds rate will likely be on hold for much longer.

A strong start to 2021

Q1 GDP increased by a robust 1.6% q/q (6.4% annualised) in Q1 2021, leaving the economy just 0.9% below its Pre-COVID-19 (Q4 2019) level.

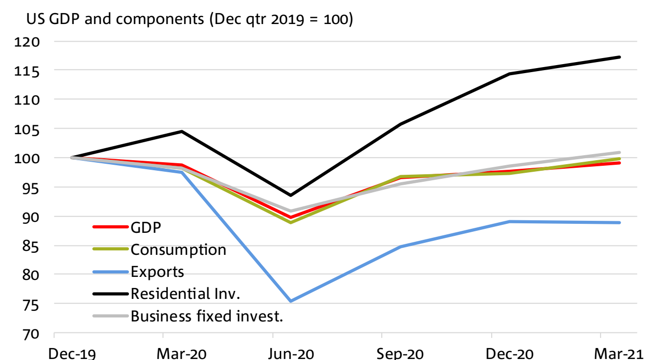
Growth was driven by strong increases in household consumption (up 2.6% q/q), business fixed investment (up 2.4% q/q) and residential investment (up 2.6% q./q). Government demand bounced back, after falling the previous two quarters, growing by 1.5% q/q. The lift was due to Federal government COVID-19 related spending (including vaccine purchases).

Domestic final demand ('final sales to domestic purchasers') grew more strongly than GDP, up 2.4% q/q. The gap between US demand and production was filled by imports (1.4% q/q) and a run-down in inventories (which detracted 0.8ppts from growth). The inventory run down reflects the supply issues (capacity constraints and shortages of parts) in some sectors.

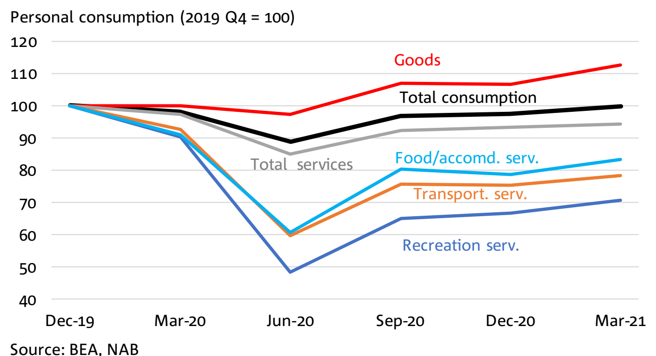
Relative to pre-COVID-19 levels, residential investment is the stand-out (up over 15% since Q4 2019), but business fixed investment (despite a continuing fall in structures investment) and government spending are now also above their pre-virus level. Consumption is now only slightly below, while exporters are still struggling, reflecting travel limitations and an incomplete global recovery.

Consumption data also highlights the still very uneven nature of the recovery. Spending on goods consumption moved above its end-2019 level in the second half of 2020 and continued to grow faster than services spending in Q1. Spending on some services that were heavily impacted by COVID-19 related restrictions – such as accommodation, restaurants, travel and recreation – remains very low.

GDP close to pre-virus level, led by investment



Consumption split highlights uneven recovery



Source: BEA, NAB

The strong growth in household consumption in Q1 reflects several factors. Fiscal stimulus packages in late December 2020 and March boosted both January and March activity, while extreme weather held back February and pushed some spending into March. Consumption rose 3% m/m in January, declined in February, resulting in an implied March growth rate (assuming no revisions to prior months) of 3.7% m/m. March would also have been boosted by the easing in COVID-19 related restrictions that occurred.

Households are in a strong position to keep spending at high levels in coming months. Mainly due to government stimulus payments, disposable personal

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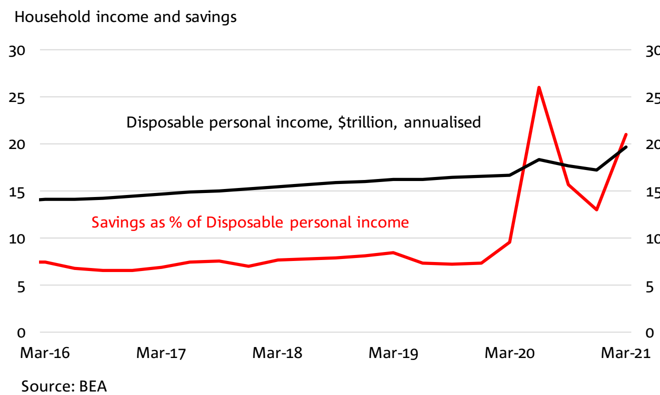
income jumped higher in Q1 – up 14% q/q; the fastest quarterly growth rate recorded (the data begin in 1947). As a result, despite the strong growth in spending, the savings rate bounced to a very high level.

Massive bump higher in h'hold savings and income



Source: BEA

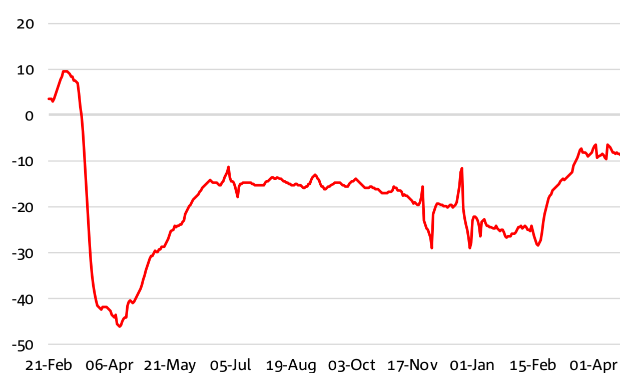
Consumer inflation (as measured by the personal consumption expenditure price index) increased by a robust 0.9% q/q in Q1. This was partly due to the rise in oil prices, but core (ex energy and food) inflation also rose by a solid 0.6% q/q (2.3% annualised).

Compared to the same quarter last year, core prices were up 1.5% y/y. Inflation has been very volatile over the last year, but the rise in commodity prices, business survey indicators, a likely recovery (or 'normalisation') in prices in the sectors most affected by COVID-19, as well as the expected strength in growth this year, all point to inflation settling at a higher level going forward.

Outlook – very strong growth expected

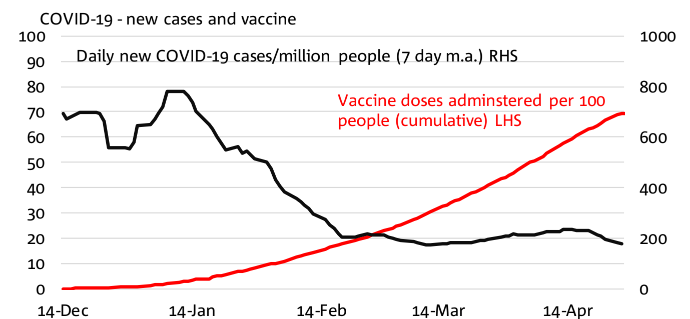
Mobility data highlights the re-opening of the economy that has occurred. The sharp drop in case numbers between mid-January to mid-March was accompanied by a winding back or removal of many COVID-19 related restrictions, with some states removing all restrictions on businesses.

Re-opening reflected in mobility data



While there were worrying signs of a renewed pick-up in COVID-19 case numbers between mid-March to mid-April, the number of new cases has eased back more recently. With over 40% of the population (and rising) having received at least one vaccine dose, the risk of another major round of restrictions appears to be receding (although it may not have fully dissipated).

Cases have eased as vaccine roll-out continues

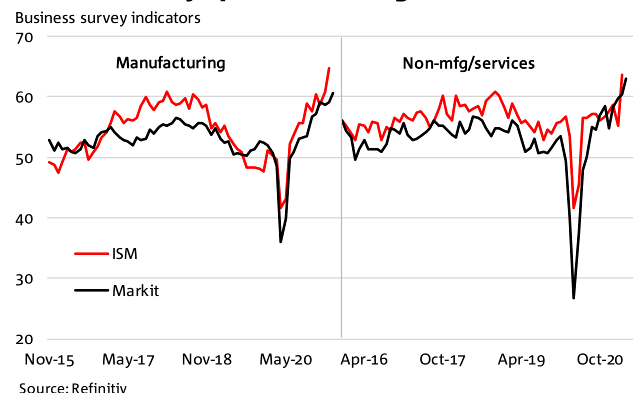


Sources: Refinitiv, NAB. Note: some vaccines require more than 1 does per person.

The combination of easing COVID-19 restrictions, healthy household and corporate balance sheets (in aggregate), increasing mobility, very easy monetary policy and the full effect of the March 2021 fiscal stimulus should result in strong growth over the rest of the year - particularly in Q2.

Business surveys highlight the strength of the momentum currently in the economy. The preliminary Markit US composite (manufacturing and services) PMI in April was a record high, as was the non-manufacturing ISM in March. The US manufacturing ISM – which has a longer history – reached its highest level since the early 1980s.

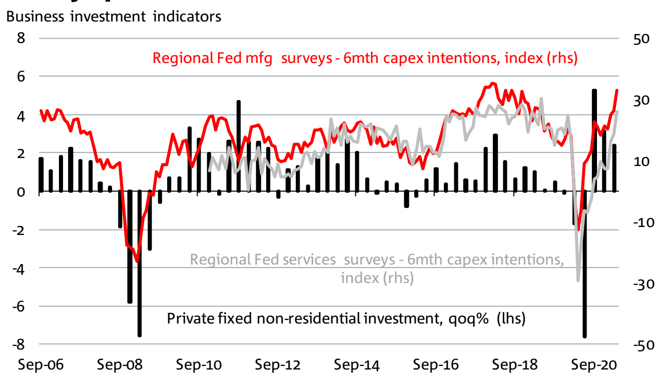
Business surveys point to strong momentum in Q2



Source: Refinitiv

The strength of the ISM surveys was in part due to high readings for the supplier deliveries indices. This likely reflects supply shortages or capacity constraints which are weighing on production in some sectors such as autos. However, while this will constrain growth somewhat in the short-term, the combination of strong demand and high capacity utilisation would be expected to drive business investment. Consistent with this, regional Fed survey capex expectations indicators are pointing to the growth in business investment being sustained.

Surveys point to robust business investment ahead



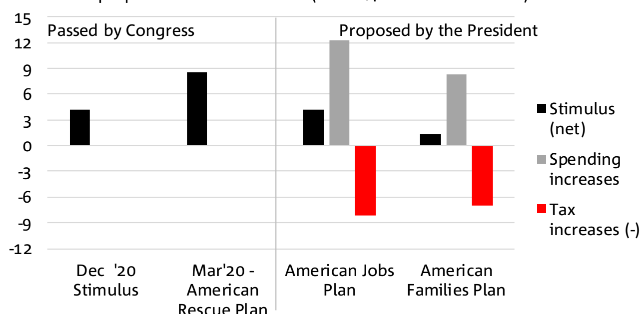
Source: BEA, Kansas City, New York, Richmond, Dallas, Philadelphia Fed. Reserves, NAB

We have revised up our 2021 GDP growth forecast from 6.0% to 6.7%. This is partly due to Q1 growth being higher than expected, but also reflects the strength of recent indicators and the surprisingly rapid winding back in COVID-19 related restrictions. In 2022, we expect growth to slow to 4.1% (previously 3.9%) but this is still well above its long-term trend.

An upside risk to our forecasts remains fiscal policy. Following stimulus passed by Congress in December 2020 and March 2021, the President's American Jobs Plan (AJP) and, this week, the American Families Plan (AFP), propose further spending increases and tax credits worth over $4 trillion spread over many years. Tax increases have also been proposed, although in the case of the AJP, over a ten-year window, if enacted it would still represent a net stimulus.

At this stage, it is unclear what will ultimately be passed by Congress. Moreover, the timing of the planned expenditure (and higher tax revenue) will also be crucial in assessing any impact on the economy over the next few years. While the American Rescue Act was heavily front loaded, the AJP has a focus on infrastructure which would take a while to roll-out even if Congress were to act quickly.

President has proposed further stimulus



Sources: CBO, CFRFB, NAB. 10 yr costing used where available

Monetary policy

Based on our central forecast we see no change in the federal funds rate target range (0 to 0.25%) right though our projection period to end-2023. However, our inflation forecasts are not far off the level that may justify rate hikes. As we also expect the labour market to quickly recover, there is therefore a risk of rate hikes from the second half of2022 onwards.

The criteria set by the Fed before it will increase the fed funds rate are:

- The labour market needs to be at 'maximum employment'
- inflation needs to have risen to 2% percent and
- inflation needs to be on track to moderately exceed 2% for some time.

While the Fed will consider a range of labour market indicators in assessing 'maximum employment' an unemployment rate moving close to its (very low) pre-pandemic level in the second half of 2022 and around 3% by end-2023 (as we project) would probably be consistent with satisfying this requirement. Similarly, our forecasts, if realised, would mean the second criterion is met.

The third criterion may prove to be the stumbling block. Annual core inflation is set to move above 2% in Q2 2021 as the decline in core inflation in Q2 2020 drops out of, but the subsequent Q3 rebound in prices remains in, the annual growth calculation. However, the Fed has indicated that it will look through this. It has also indicated that it will discount any inflation generated by a 'normalisation' in prices (back to pre-COVID-19 levels) or from supply bottlenecks which it considers will be transitory.

The Fed has not specifically set out what constitutes 'moderately' above 2% although we suspect our forecast of inflation between 2.1 to 2.2% over much of 2022 and 2023 would not meet this requirement. More likely, 'moderately above' means annual inflation of at least 2¼%. Nevertheless, this suggests it would not take much of a forecast miss (to the upside) to our inflation forecast for the Fed to consider rate hikes, particularly if our labour market projections are realised.

The more immediate decision faced by the Fed is for how long to continue its current level of Treasury and mortgage-backed securities purchases ($120b per month).

The Fed's criterion for scaling back asset purchases (tapering) is for substantial further progress to have been made toward its maximum employment and inflation goals. The Fed has not explained what would constitute 'substantial progress'. We would note that the Fed's intention to discount any short-term inflationary strength as being due to transitory factors may also push back the date at which it could declare substantial progress towards its inflation goal.

Following the April FOMC meeting the Fed Chair said it is not yet time to talk to about tapering. He also indicated that it will likely be 'some time' before

substantial progress will be achieved and that they will communicate well in advance of any decision to taper.

We still expect that if our forecast for rapid growth over the rest of the year is realised, that the Fed may announce late in 2021 that it is considering tapering. This would be subject to the caveat that the economy continues to evolve as expected. Assuming this happens, actual commencement of tapering would then occur in 2022 (we are pencilling in Q1 2022).

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U.S. ECONOMIC & FINANCIAL FORECASTS

						Quarterly Chng %									
						2020		2021				2022			
	2019	2020	2021	2022	2023	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
US GDP and Components	Year Average Chng %														
Household consumption	2.4	-3.9	8.5	4.5	2.1	9.0	0.6	**2.6**	**2.9**	**2.0**	**1.2**	**0.8**	**0.7**	**0.7**	**0.6**
Private fixed investment	1.9	-1.8	10.0	5.7	4.0	7.1	4.3	**2.4**	**2.0**	**1.8**	**1.6**	**1.4**	**1.1**	**1.1**	**1.0**
Government spending	2.3	1.1	1.2	1.9	1.8	-1.2	-0.2	**1.5**	**0.0**	**0.3**	**0.5**	**0.6**	**0.6**	**0.5**	**0.5**
Inventories*	0.0	-0.7	0.5	0.3	-0.1	1.6	0.4	**-0.8**	**0.6**	**0.2**	**0.0**	**0.1**	**0.0**	**-0.1**	**0.0**
Net exports*	-0.2	0.0	-1.8	-0.5	-0.1	-1.4	-0.6	**-0.3**	**-0.4**	**-0.2**	**-0.2**	**-0.1**	**0.0**	**0.0**	**0.0**
Real GDP	**2.2**	**-3.5**	**6.7**	**4.1**	**2.1**	**7.5**	**1.1**	**1.6**	**2.5**	**1.7**	**0.9**	**0.9**	**0.7**	**0.6**	**0.6**
Note: GDP (annualised rate)						*33.4*	*4.3*	*6.4*	*10.4*	*6.9*	*3.8*	*3.5*	*2.9*	*2.4*	*2.2*
US Other Key Indicators															
PCE deflator-headline	Dec/Dec % change														
Headline	1.5	1.2	2.8	2.1	2.0	0.9	0.4	**0.9**	**0.7**	**0.6**	**0.6**	**0.6**	**0.5**	**0.5**	**0.5**
Core	1.6	1.4	2.2	2.1	2.1	0.9	0.3	**0.6**	**0.5**	**0.5**	**0.5**	**0.5**	**0.5**	**0.5**	**0.5**
	End of period														
Unemployment rate - qtly average (%)	**3.6**	**6.7**	**4.2**	**3.4**	**2.9**	**8.8**	**6.7**	**6.2**	**5.4**	**4.8**	**4.2**	**4.0**	**3.8**	**3.6**	**3.4**
US Key Interest Rates	End of period														
Fed funds rate (top of target range)	**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**

Source: NAB Group Economics

*Contribution to real GDP growth

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