WEEKLY

Economic Commentary

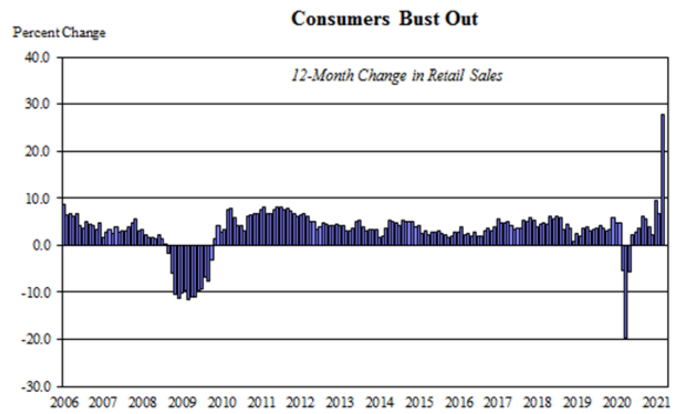
April 16, 2021

Millennium
CORPORATE CREDIT UNION

The first quarter ended with a bang, and the drumbeat of positive economic news should continue to reverberate throughout the spring and summer months. Last week it was the employment report, which featured an astonishing gain of nearly 1 million jobs in March. This week's highlight was the retail sales report that showed consumers went on a much stronger spending binge than anyone expected during the month. In the wake of these blockbuster outcomes, as well as a robust report on housing activity, further improvement on the labor front and a rebound in factory output, the opening chapter of 2021 is looking far more vigorous than thought a month or two ago.

Indeed, the Federal Reserve Bank of Atlanta's GDP tracker now pegs the first-quarter growth rate at 8.3 percent, up from 6 percent a week earlier. Our tracker is pointing to an even stronger 9 percent pace, setting the stage for the strongest full year increase in GDP since 1950. The catalysts propelling these and other upgraded forecasts are readily identified. First and foremost is the government's unprecedented fiscal stimulus, including the latest round of direct checks that most households received in the latter part of the month. These payments, totaling around $400 billion, together with warmer weather and the ongoing reopening of businesses throughout the nation constitutes a perfect storm that drove consumers into a shopping frenzy, unleashing a torrent of pent-up demand and a surge in retail sales last month. But a powerful assist was also provided by the rapid pace of vaccinations, which gave households more confidence to leave their bunkers and engage in social activities, such as travel, sports and dining out.

Since the stimulus payments were sent out on March 17 there was probably a sizeable balance still unspent at the end of the month, which should boost sales in April as well. That said, it would be hard to rival the astonishing 9.8 surge in retail sales that took place last month. The March gain was the second largest on record, exceeded only by the 18.3 percent spike last May; but that jump followed a record 14.8 percent plunge in April when the economy was still in full lockdown mode. While the increase

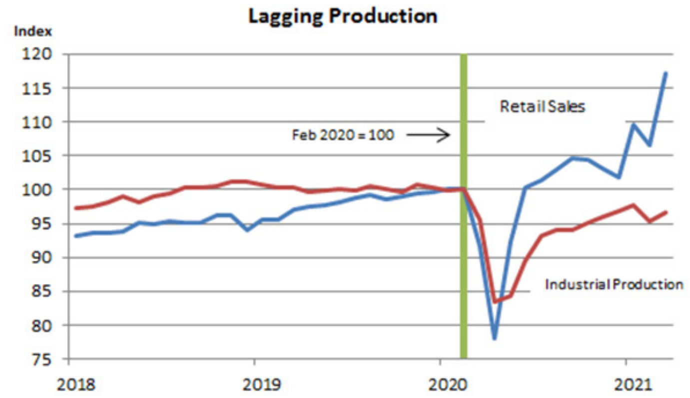


last month also rebounded from a setback in February, the slump in sales that month was a much smaller 2.7 percent, reflecting harsh weather conditions as well as the temporary lapse of government support.

Importantly, the eye-opening surge in March retail sales was spread across the board, with all spending categories posting sizeable gains. Armed with stimulus checks and the doors of leisure activity reopening amidst warmer weather, consumers binged on services and recreational spending long postponed during the pandemic. Hence, households splurged on discretionary goods and services such as sports and hobbies (+23.5%), apparel (+18.3%) and electronics (+10.5%). They also pulled old Betsy out of the garage and drove more, paying higher prices at the pump, which boosted sales at gasoline stations. Indeed, sales at service stations accounted for almost 7.5 percent of total sales, the highest share in more than a year. With the peak driving season approaching, that trend should continue.

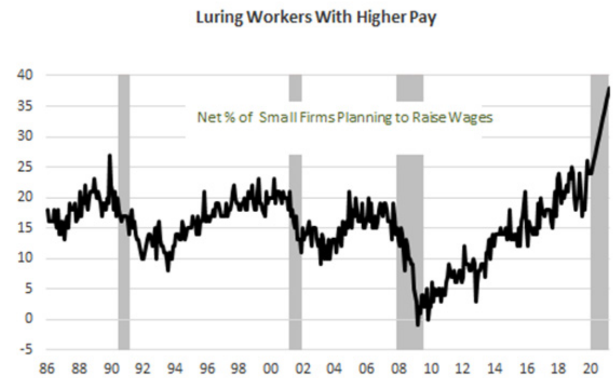
With consumers expected to spend freely in coming months, some are questioning whether demand will outstrip supply and drive up prices, stoking inflation fears. This concern is more pressing in the goods-producing sector, where supply-chain disruptions are holding back production. A severe shortage of semiconductors, for example, is hobbling output in the auto industry, even as sales of motor vehicles surged to the highest level in more than three years in March. To be sure, supply constraints are not stifling production entirely. Industrial production did increase by 1.4 percent in March, which in normal times would be considered a decent outcome. But output plunged by 2.6 percent in February, due primarily to harsh weather, so the March rebound only recouped part of the loss.

Simply put, production is not keeping up with the stimulus-fueled acceleration in demand. That disparity has only grown wider throughout the pandemic. Retail sales in March stood 17 percent above their pre-pandemic level while industrial production has still not recovered its pandemic losses, remaining 3.4 percent below its February 2020 level. With supply chain restraints still very much in effect (a severe drought in Taiwan, a major producer of semi-conductors, is further depressing chip production and crimping global supplies) production costs are coming under increasing pressure. And if recent surveys are any indication, manufacturers as well as a broad swath of producers are planning to pass on these higher costs into selling prices.



The emerging demand/supply imbalance will intensify over the second quarter as households continue to spend freely while producers struggle to keep up. However, the pressure on prices should gradually ease as consumption patterns shift from goods to services, where most of the pent-up demand will be channeled. The reopening of Disneyland, concert venues, movies and theaters as well as restaurants and bars will draw hoards of customers as the weather warms up and business restrictions are eased. But while these service providers still have a ways to go before they recoup the sales lost during the pandemic, they too are experiencing supply constraints as many are reporting a shortage of workers.

This is particularly an issue among small businesses, whose sales are benefiting greatly from the lifting of business restrictions and the accelerated pace of vaccinations. But the struggle to find workers is palpable, as the share of small businesses with at least one unfilled job opening has surged to the highest level on record, according to the latest small business survey by the National Federation of Independent Businesses (NFIB). In order to attract workers, business owners are forced to offer fatter pay packages. Accordingly, the NFIB survey reveals that the share of small businesses planning to lift wages over the next three months has also surged to the highest level on record. And, like manufacturers, these owners believe they can cover rising labor costs by raising prices. The share planning to hike prices rose to the highest level since the late 1980s.



Not surprisingly, the combination of surging demand, supply constraints, warmer weather and improving health conditions is feeding the narrative of a temporary spike in inflation. That narrative received support this week with the Labor Department's consumer price report for March. The headline CPI rose by an out-sized 0.6 percent during the month, the fastest clip since August 2012, lifting the annual inflation rate to 2.6 percent from 1.7 percent in February. However, sharply rising gasoline prices accounted for about half the overall CPI increase from February and the heavily discounted prices during the height of the pandemic last March amplified the annual inflation rate. The less volatile core CPI, which excludes food and energy items, rose by a more modest 0.3 percent over February and 1.6 percent from a year ago. Both readings were up from the previous month, but not alarmingly so, and the so-called base effects also impacted the core CPI.

But the base effects will age out of the calculations over the second half of the year and the current influences putting upward pressure on prices should ease. Some of the global supply constraints stems from production shutdowns during the early stages of the pandemic when suppliers overseas faced a plunge in demand. It takes time for those facilities to fully reopen and catch up with the abrupt rebound in demand now underway. Likewise, the congestion at ports that kept shipping containers from unloading their wares is starting to ease, which will open the supply spigot wider in coming months. Meanwhile, the stimulus-fueled surge in demand is not open ended. Those $1400 checks will soon be expended, either on goods and services, to pay down debt or stashed into savings accounts. After pent-up demand is exhausted over the spring and summer months, consumer spending should downshift even as supply constraints fade, reducing bottlenecks and upward pressure on prices.

Against that prospective backdrop, neither the financial markets nor the Fed believes the spike in inflation will be sustained. One of the more perplexing developments this week was the benign response of the bond market to the muscular economic and inflation data released during the period. The bell-wether 10-year Treasury yield actually fell for the second consecutive week, slipping to a five-week low of 1.58 percent on Friday. No doubt, a number of external factors contributed to the decline, including reports of strong demand from Japan, a better than expected auction of Treasury issues and a short-squeeze by investors caught unprepared by the sudden fall in yields. To the extent these were the primary influences, some payback should be expected in coming weeks as they unwind.

But we suspect that bond investors are also becoming convinced the Fed means what it says regarding its commitment to keep short-term rates anchored at near zero over the foreseeable future, notwithstanding the inflation spike that it considers to be transitory. Until recently, that message was not firmly accepted by investors who believed that the stimulus-fueled surge in activity would prompt the Fed to act sooner than later, which contributed to the 75 basis point climb in the 10-year yield since the beginning of the year. However, the continued barrage of dovish statements by Fed officials, including chair Powell again this week may finally be driving the message home. While inflation is likely to move gently higher after the current spike subsides, it remains to be seen how much of the increase is already priced into the market. We expect the 10-year yield to move up close to 2 percent by the end of the year. That's quite a step-up from the pandemic-induced record low hit last year, but still historically low and hardly a growth-stifling level that would prevent the expansion from extending into 2022.

KEY FINANCIAL & ECONOMIC INDICATORS

FINANCIAL INDICATORS

INTEREST RATES	April 16	Week Ago	Month Ago	Year Ago
3-month Treasury bill	0.02%	0.02%	0.01%	0.12%
6-month Treasury bill	0.04	0.04	0.03	0.16
3-month LIBOR	0.19	0.19	0.19	1.22
2-year Treasury note	0.16	0.15	0.16	0.20
5-year Treasury note	0.83	0.87	0.90	0.36
10-year Treasury note	1.88	1.66	1.74	0.65
30-year Treasury bond	2.28	2.33	2.45	1.27
30-year fixed mortgage rate	3.04	3.13	3.09	3.31
15-year fixed mortgage rate	2.35	2.42	2.40	2.80
5/1-year adjustable rate	2.80	2.92	2.79	3.34
STOCK MARKET				
Dow Jones Industrial Index	34200.67	33800.60	32627.97	24242.49
S&P 500	4185.47	4128.80	3913.10	2874.56
NASDAQ	14052.34	13900.80	13215.24	8650.14
Commodities				
Gold ($ per troy ounce)	1777.30	1743.70	1735.20	1692.55
Oil ($ per barrel) - Crude Futures (WTI)	63.07	59.37	63.22	20.12

ECONOMIC INDICATORS

	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Quarters Ago	Average-Past 6 Months or Quarters
Retail Sales (March) - % change	9.8	-2.7	7.7	2.0
Consumer Price Index (March) - % change	0.6	0.4	0.3	0.3
Core CPI (March) - % change	0.3	0.1	0.0	0.1
Industrial Production (March) - % change	1.4	-2.6	0.9	0.5
Capacity Utilization (March) - % change	74.4	73.4	75.3	74.2
Housing Starts (March) - 000s	1739	1457	1642	1599
Building Permits (March) - 000s	1766	1720	1886	1709

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