

WEEKLY

Economic Commentary

January 29, 2021

On the heels of a tumultuous week in the financial markets, the list of uncertainties that portend more instability ahead continues to expand. On the health front, the drive to ramp up vaccinations is being dogged by supply constraints as well as distribution problems; importantly, there's growing fears about new variants of the virus that appear to be more contagious and deadly than the current strain. It's also unclear if the new mutations, originating in the U.K., Brazil, and South Africa, are resistant to the vaccines currently being distributed.

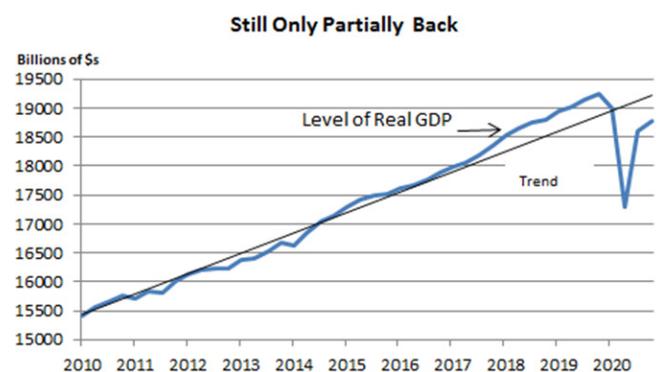
On the policy front, battle lines are being drawn around the \$1.9 trillion American Rescue Plan, with Republicans objecting to its size as well as certain components and the administration objecting to efforts to break the plan up into pieces. It is uncertain how much of the plan the White House can ram through into legislation via the budget reconciliation process. That would require just a majority vote in the Senate, which is evenly split and where Vice President Harris would cast the deciding ballot. However, it would also amplify the partisan divide that President Biden is hoping to avoid.

Partisan bickering is also poised to intensify as the impeachment trial of former president Trump gets underway on February 8. That said, if Ted Cruz and Alexandria Ocasio-Cortez can agree on an issue (investigating the Robinhood marketplace for imposing trading restrictions on the high-flying GameStock shares) there is some hope that a bi-partisan deal on the American Rescue Plan can be struck. We still expect that a slimmed-down version of about \$1.2 trillion will come to pass when all is said and done. But even as fiscal policy is shrouded in uncertainty, the near-term outlook for monetary policy is set in stone. Federal Reserve officials held their regular policy meeting this week and, as expected, made no changes in its ongoing strategy of maintaining short-term rates at near zero or in purchasing \$120 billion a month in government-backed securities.

Fed chair Powell made it clear at his post-meeting press conference that the current turbocharged easy policy will remain in effect until the central bank's twin objectives of achieving maximum employment and a stable inflation rate of 2 percent

are met. The economy is far from meeting either of those goals. While Powell is mildly more optimistic over the economic outlook than last year, thanks to the massive fiscal stimulus in train and the enhanced prospects of widespread inoculation later this year, he still recognizes the downside risks associated with the uncertain path of the virus. Simply put, he reiterated the Fed's preference to err on the side of ease, indicating that policy would not react in a knee-jerk fashion to an abrupt flare-up in inflation that is not driven by sustained fundamental influences.

From our lens, the economy has a ways to go before those influences rise to the surface, a slim prospect that was amply revealed in this week's raft of economic data. The good news is that the recovery from the pandemic recession that began last spring is still alive and well. The bad news is that the recovery lost considerable steam at the end of last year, reflecting the negative drag from resurging cases of Covid-19 and renewed business restrictions imposed by state and local governments. The broadest measure of the economy's performance, GDP, downshifted to an annual growth rate of 4.0 percent in the fourth quarter from the torrid 33.4 percent pace in the third. The slowdown left the economy well short of recovering the output losses incurred last spring, when the initial shock from the pandemic sent the nation into a full lockdown mode.

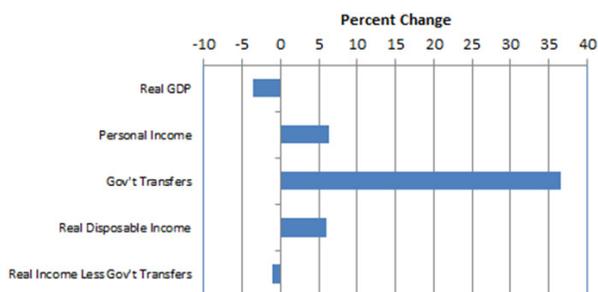


For sure, a 4 percent growth rate would, under normal circumstances, be considered a decent outcome, well above the economy's long-term trend pace. But the gain in the fourth quarter was front-loaded, as most of the heavy lifting took place

in October, before the pandemic's grip on the economy tightened again; activity in both November and December slumped considerably, not only because of the resurging virus, but also due to the temporary lapse in Federal income support. Although fiscal aid kicked in again in December, giving household income a boost, that did not prevent a second consecutive drop in personal consumption that month. The Commerce Department does not compile monthly data for GDP, but the quarterly growth rate undoubtedly masked a contraction in the final two months of the year.

For the year as a whole, real GDP fell by 3.5 percent, the largest setback for the overall economy since demobilization following World War II. As bad as that was, it could have been much worse if not for the massive support from Federal programs that sent direct checks to households and expanded unemployment benefits to the 22 million workers laid off in the spring. Indeed, if not for government transfer payments to households last year, real disposable income would have fallen by 1.0 percent instead of posting a 6.0 percent increase, which clearly limited the negative fallout from the pandemic. The 6.0 percent DPI increase, in fact, was the strongest annual gain since 1984. Even the Fed's Powell acknowledged that the 3.5 percent contraction in GDP last year was considerably better than what Fed officials had expected to occur last spring.

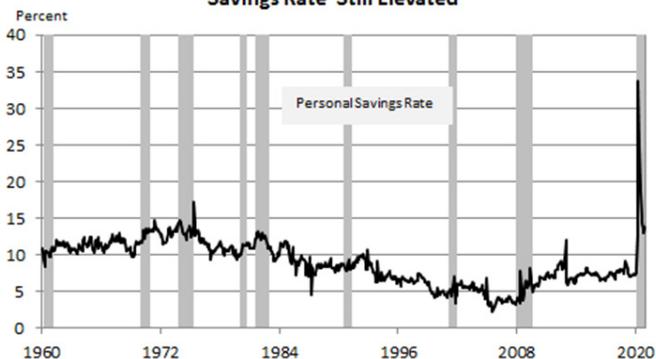
Fiscal Aid Saved 2020



Importantly, while the resurgence of Covid-19 late last year sapped all momentum from the economy heading into 2021, the firepower provided by the massive income support from Washington should

ignite a torrid rebound as the health crisis ebbs, hopefully by mid-year. The engine should come from households who, in the aggregate, stashed away about \$1.5 trillion of additional savings from foregone spending last year as business restrictions limited purchasing options. At one point when full lockdown restrictions were in effect last April, the personal savings rate surged to a record 33.7 percent. Following eight months of sporadic reopenings of businesses, the rate declined, but still stood at an elevated 13.7 percent in December. That's higher than any month before last year since the summer of 1975.

Savings Rate Still Elevated



As people feel confident about socializing and attending in-person gatherings, they will resume going to concerts, movies, stadiums, restaurants and other events, and take up traveling once again. This change in behavior will not happen overnight; but as households' fear of infection fades they will increasingly unlock the funds put away last year, sending consumer spending sharply higher and powering big gains in GDP. We expect that mini-boom in activity to occur in the second and third quarters, and spearhead an impressive annual rebound in GDP in 2021. The one caveat, of course, is that the health crisis does not receive a second life from new mutations of the virus that overwhelm the vaccine rollout now underway. On this score, health experts believe that pharmaceutical companies can develop a booster shot to counteract new strains more quickly than the time needed to develop existing vaccines.

If all goes according to plan, the economy should

recover all of its output losses by the middle of this year, but the jobs shortfall will take longer to recoup. We don't expect payrolls to return to pre-pandemic levels until sometime in 2023. However, a rebounding economy, steady progress on the labor front and shrinking spare capacity should finally spur a sustainable pickup in inflation to the Fed's 2 percent target by next year. If so, the central bank could finally start to consider unwinding its ultra-easy monetary policy. Again, the process would not begin this year, as the Fed is still sensitive to the risk of moving too soon, as was the case following the 2008 financial crisis. While there is no explicit timetable for how long Fed officials would allow inflation to surpass 2 percent, they are more tolerant of an overshoot because inflation has been running below that target for so long.

We suspect that the Fed would begin by slowing its purchases of government-backed bonds, most likely next year, and giving ample warning to the markets beforehand to avoid the "taper tantrum" it triggered in 2013. Should inflation remain above 2 percent throughout the period, as we expect, the Fed could then start nudging up short-term rates sometime in 2023, when the goal of achieving maximum employment would be within reach. It's important to remember that Fed chair Powell is more keenly attuned to the issue of inequality than most of his predecessors. His repeated public comments regarding the importance of bringing jobs to less educated and unskilled workers long sidelined when there is slack in the labor force highlight that concern.

The extended period low rates are expected to remain in effect should sustain the vigor in one of the few improving sectors throughout the pandemic, the housing market. While the torrid increase in home sales and residential construction seen last year will probably not be replicated this year, the prognosis is favorable for another decent performance. For one, the demographics are poised to help demand for homes, as the millennials are moving into the home-buying stage and an improving job market should encourage them to move out of their parents' basements. As the health crisis eases, job mobility should also improve, facilitating turnover of existing

homes and shoring up slim inventories. Finally, surging home prices and scarce homes for sale are powerful incentives for homebuilders to rev up construction. Indeed, as Covid-19, a hobbled consumer and struggling labor market weigh on activity early in the first quarter, the housing market will be a key pillar keeping the economy afloat.

KEY FINANCIAL & ECONOMIC INDICATORS

FINANCIAL INDICATORS

	January 29	Week Ago	Month Ago	Year Ago
INTEREST RATES				
3-month Treasury bill	0.06%	0.08%	0.08%	1.56%
6-month Treasury bill	0.08	0.09	0.09	1.54
3-month LIBOR	0.21	0.22	0.24	1.76
2-year Treasury note	0.11	0.12	0.12	1.32
5-year Treasury note	0.42	0.43	0.36	1.31
10-year Treasury note	1.07	1.09	0.92	1.50
30-year Treasury bond	1.83	1.85	1.65	2.00
30-year fixed mortgage rate	2.73	2.77	2.67	3.51
15-year fixed mortgage rate	2.20	2.21	2.17	3.00
5/1-year adjustable rate	2.80	2.80	2.71	3.24
STOCK MARKET				
Dow Jones Industrial Index	29982.62	30996.98	30606.48	28256.03
S&P 500	3764.24	3841.47	3756.07	3225.52
NASDAQ	13070.69	13543.06	12888.28	9150.94
Commodities				
Gold (\$ per troy ounce)	1848.60	1853.20	1895.10	1594.00
Oil (\$ per barrel) - Crude Futures (WTI)	52.18	52.05	48.52	51.58

ECONOMIC INDICATORS

	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Quarters Ago	Average-Past 6 Months or Quarters
Durable Goods Orders (Dec.) - % change	0.2	1.2	1.8	2.9
Real GDP (Q4) - % change.SAAR	4.0	33.4	-31.4	1.0
New Home Sales (December) - 000s	842	829	949	924
Personal Income (December) - % change	0.6	-1.3	-0.7	-0.4
Personal Consumption (December) - % change	-0.2	-0.7	0.3	0.6

Millennium Corporate Credit Union
8615 West Frazier Street
Wichita, Kansas 67212