

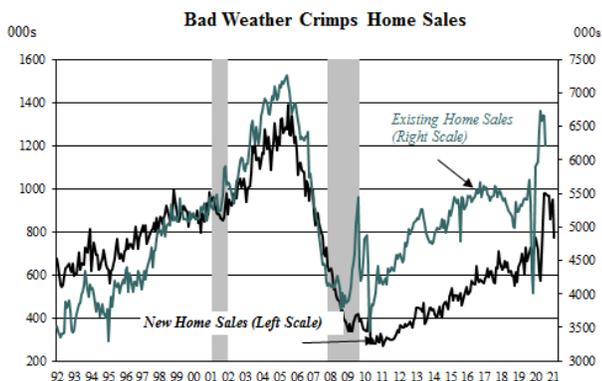
WEEKLY

Economic Commentary

March 26, 2021

Separating signal from noise is always a difficult challenge for economists and policymakers, and that task becomes ever more complicated when unusual weather intrudes. That was clearly the case in February. According to the National Weather Service, the month was the coldest in the U.S. since 1989, with temperatures averaging 5-10 degrees below normal. A polar vortex, record snowstorms in the Northeast as well as the South, and a deadly tornado in North Carolina were among other notable weather extremes that buffeted the nation in February. Needless to say, when climactic conditions turn as unruly as was the case last month, the economy is invariably affected.

True to form, there was hardly an economic report for the month that wasn't skewed by adverse weather. Even the otherwise stellar jobs report was impacted. According to the BLS official report... "Data from the survey of households showed that the number of employed people who missed work due to bad weather for all or part of the calendar week including the 12th was elevated compared to a typical February." Clearly, the dismal results for home sales and construction - activities conducted mostly outdoors - as well as for retail sales reflected this influence. Nor did Mother Nature's dark side take a breather this month as storms ravaged Texas and tornadoes are once again ripping through the south as this is written.



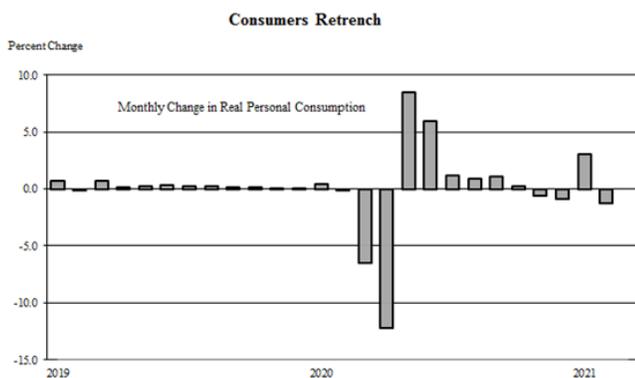
Not only is harsh weather keeping people indoors, stifling sales, and restraining output as electricity shuts down and workers can't get to their jobs, but

it is also contributing to supply disruption that may ultimately push up prices for consumers. The Texas storms removed about 3 million barrels of daily oil production in that state, lifting crude prices that is pushing prices at the pump closer to \$3 a gallon for motorists; they also put a severe crimp on plastic production. What's more, globalization amplifies weather-related effects on the supply chain. The latest calamity in the Suez Canal, where a gigantic container ship is stuck because of winds of up to 40 knots, is a stunning example of that development. The mishap is clogging a key shipping artery, forcing other ships to reroute to get to their destination, something that will lead to longer delivery delays, higher freight charges and shortages that will exacerbate production shutdowns and result in increased input costs.

Importantly, the setbacks are not changing the minds of investors or policy makers who see the signal trumping the noise and propelling the economy into a spring/summer burst of activity. While the weather no doubt also had a negative impact on activity in March, it was no match for the powerful tailwinds that came on stream during the month. Leading the list, of course, is the massive fiscal stimulus provided by the \$1400 checks sent to 90 million households and the rapid progress on vaccine distribution. The improving health environment is spurring an increasing number of states to lift business restrictions and encouraging households to venture outdoors, returning to restaurants and bars and engaging in more leisure activities. The long-beleaguered service sector of the economy is coming back to life and will be the driving force propelling growth in the months ahead.

As much as the weather distorted economic data in February, the personal income and spending report released on Friday highlights the outsized role fiscal policy is playing in the economy's performance. In January, person income surged 10.1 percent, thanks to the boost provided by the government's \$600 checks sent to households. With the absence of those payments in February, households suffered a fiscal mini-cliff, as government transfer payments plunged by \$1.6 trillion. That haircut, in turn, vaporized

personal incomes, which crashed by 7.1 percent in February, the largest single-month decline ever recorded. Needless to say, an income destruction of that magnitude together with the aforementioned weather effects was bound to have an effect on spending. The impact was palpable, as real personal consumption tumbled by 1.2 percent, the worst reading since last April.



The good news is that the February setback followed an upwardly revised gain of 3.0 percent in January, so households are still on track to post a decent gain in consumption in the first quarter. And, as noted, the final month of the period is benefiting from some formidable tailwinds, underpinned by those \$1400 checks, enhanced unemployment benefits and a rehiring binge that is already boosting consumer confidence. All told, those positive influences should more than offset last month's shrinkage in personal incomes and once again fatten household bank accounts. We expect the personal savings rate, which collapsed from nearly 20 percent to 13.6 percent in February due to the plunge in income will shoot up to about 30 percent in March as the massive government transfer payments will far exceed the speed with which households could spend the funds.

The pile-up of savings adds to the already huge pool of unspent funds accumulated during the pandemic, estimated at nearly \$2 trillion. On the surface, this represents a considerable amount of firepower that could be unleashed into the spending stream, fueling concerns that the economy will be propelled into overdrive and ignite an inflation outbreak. For

sure, consumers will go on a spending spree in coming months, spurring a double-digit growth rate in GDP during the second quarter. The confluence of pent-up demand, particularly for services, the broader reopening of the economy as the health crisis continues to ebb, warmer weather, heightened spirits of households, stronger job creation and the purchasing power generated by the fiscally-induced bulge in savings is bound to have an explosive impact on spending over the near term.

Of all those influences, however, it is the \$2 trillion of accumulated savings that some believe will have the most enduring impact on spending. It is also the one that has stoked the ire of fiscal critics because it is directly linked to the three rounds of stimulus that they believe is overkill relative to the economy's needs. However, this criticism is based in large part on the assumption that this vast pool of savings will be drawn down as the economy reopens, producing the sustained explosion in consumer spending that sends activity into overdrive. That is not likely to be the case. For one, most of the savings have accrued to high-income households who have a low propensity to spend. Some portion of these savings is being earmarked to pay higher expected taxes down the road, as the administration has already indicated that more tax revenues from the rich will be needed to help finance its ambitious spending agenda and huge deficits projected in coming years.

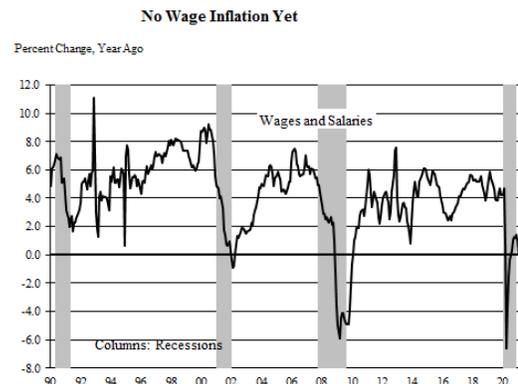
For another, the evidence provided by last year's Cares Act, when the first round of direct payments to households was made, reveals the scaled down impact on spending that the savings bulge produced. According to the New York Federal Reserve, about one-third of the stimulus went into savings, one-third to pay down debt and one-third into spending. This observation is mirrored by the behavior of the savings rate. After spiking to a record high of 33.7 percent last April, the personal savings rate gradually declined in each of the next seven months, but only to a trough of 12.5 percent in November, well above the 6.5 percent average of the previous 30 years. We suspect that the behavior of savers this time will be no different. Indeed, it is estimated that homeowners are facing about \$500 million in unpaid principal

from mortgage forbearance provided under last year's Cares Act. To the extent savings are being earmarked to pay down that principal, they will not be available for spending.

It is also important to recognize that households may be in a less profligate mindset than in earlier years. Following two major shocks over the past decade - a financial crisis and a pandemic - they are likely to prefer having a larger balance of precautionary savings than otherwise. That's particularly the case since the pandemic, while vastly less threatening than last year, is far from the minds of the public. With variants pushing up cases of the virus overseas and accounting for a larger fraction of cases in the U.S., the threat continues to lurk in the wings. Until it is extinguished, many people simply will not resume normal behavior, nor assume that their financial situation is secure. That's a recipe to maintain a larger cushion of savings to guard against adversity.

That said, the upside risk to the economy from the unprecedented fiscal stimulus has increased, underscoring the growing inflation fears being expressed in the financial markets as well as among some prominent economists. Those fears will probably escalate in coming months when inflation is poised to accelerate for a period of time. From our lens, however, a sustained inflation cycle cannot take root unless supported by a corresponding pick-up in inflation expectations and, importantly, in labor cost pressures. Neither is in the cards for the foreseeable future. Consumer long-run inflation expectations remain firmly anchored, weighed down by decades of slowly rising prices. Meanwhile, with wages rising at a 1 percent annual rate, as confirmed in the February income and spending report, pressures from the labor front continue to be relatively dormant.

To be sure, some upward wage pressure can be expected as businesses strive to fill rapid job openings as growth picks up over the spring and summer. But productivity has also picked up over the past year, providing businesses with the revenues to cover higher labor costs. What's more, there's a long way to go before the job market reaches the point of tightness that would give workers greater bargaining power. There are still 9.4 million fewer



workers earning paychecks than there were prior to the pandemic, and it will take years before they will be reabsorbed back into the workforce even under the strengthened pace of job creation that the fiscal stimulus is expected to generate. Indeed, finding jobs for these marginalized workers is the primary reason the Federal Reserve is willing to let the economy run hot for a while, giving this a greater priority than staving off an inflation threat that may never become a reality.

KEY FINANCIAL & ECONOMIC INDICATORS

FINANCIAL INDICATORS

	March 26	Week Ago	Month Ago	Year Ago
INTEREST RATES				
3-month Treasury bill	0.02%	0.02%	0.04%	0.04%
6-month Treasury bill	0.04	0.02	0.06	0.18
3-month LIBOR	0.19	0.19	0.19	1.20
2-year Treasury note	0.14	0.16	0.12	0.32
5-year Treasury note	0.87	0.89	0.73	0.46
10-year Treasury note	1.69	1.73	1.44	0.86
30-year Treasury bond	2.39	2.44	2.14	1.45
30-year fixed mortgage rate	3.17	3.09	2.97	3.65
15-year fixed mortgage rate	2.45	2.40	2.34	3.06
5/1-year adjustable rate	2.84	2.79	2.99	3.11
STOCK MARKET				
Dow Jones Industrial Index	33072.88	32627.97	30932.37	19173.98
S&P 500	3974.54	3913.10	3811.15	2304.92
NASDAQ	13138.72	13215.24	13192.35	6879.52
Commodities				
Gold (\$ per troy ounce)	1731.40	1744.90	1733.20	1497.20
Oil (\$ per barrel) - Crude Futures (WTI)	60.74	61.46	61.63	19.84

ECONOMIC INDICATORS

	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Quarters Ago	Average-Past 6 Months or Quarters
New Home Sales (February) - 000s	775	948	919	905
Existing Home Sales (February) - 000s	6220	6660	6650	6548
Durable Goods Orders (February) - % change	-0.8	0.6	1.5	1.0

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