prevedere

STATE OF THE U.S. ECONOMY

2021 Economic Outlook

By Andrew Duguay
Chief Economist

Table of Contents

State of U.S. Economy

As the nation still wrestles with the COVID-19 pandemic and recession, the U.S. will continue to face economic challenges.

This report pursues the difficult task of shaping an economic outlook for 2021. There are many challenges ahead, and the first challenge will be making an accurate prediction about what exactly those challenges will be. This year was a time of increased disruption, and more disruption means decreased predictability. However, more disruption also means more opportunity. World shaking events can stir up new possibilities, and this report hopes to exploit some of those economic opportunities.

First, it's worth noting some 2020 reflections, and of course, COVID-19 tops the list. The U.S. is far from out of the woods, and there is much to consider going forward as the population begins receiving vaccinations. At a macro level, we often talk about being in "economic recovery", meaning that the U.S. saw the worst of the dip in the March and April timeframe, followed by measurements of how the economy is improving from that point. A lot of the data at a high level will show a sharp dip followed by some general degree of incline over the following months.

However, it is important to caution that the reality for many businesses and individuals is very different. In past recessions, most people, businesses, and industries would go through a downturn followed by an upturn in unison.

State of U.S. Economy

In contrast, this recession has been very polarizing, and it's created a bifurcated economy with micro-recessions and pockets of growth that are very industry and company-specific.

This recession has shown to often oscillate at different frequencies on an individual level than the general macro-U.S. economy. This is important to consider when looking at Prevedere's macroeconomic generalities and outlook. Ultimately, it will be unique, industry by industry, business by business, and we don't want to make broad statements that get misconstrued.

There are areas of opportunity and risk across different industries, but they will present themselves in very different ways throughout 2021. This will likely be a theme of 2021 that, on net, the U.S. is looking at recovery and economic growth. However, there will be elevated risks and uncertainties, and it's not going to be the same across all industries.

Looking forward, forecasts tend to be in ranges and scenarios. Multiple possible outcomes are depending on how the pandemic goes, how fast the vaccine rolls out, and how different stimulus measures play out. The U.S. is an economy that, like it or not, is heavily dependent on government assistance right now. This will continue to be a headline story as a significant impact on the economy in 2021.

OUTLOOK

Right now, Prevedere has a baseline outlook of about 2.7% growth, with our optimistic outlook looking closer to 4% year over year growth. This shows some recovery or movement back up towards 2019 levels, but not quite getting there.

State of U.S. Economy

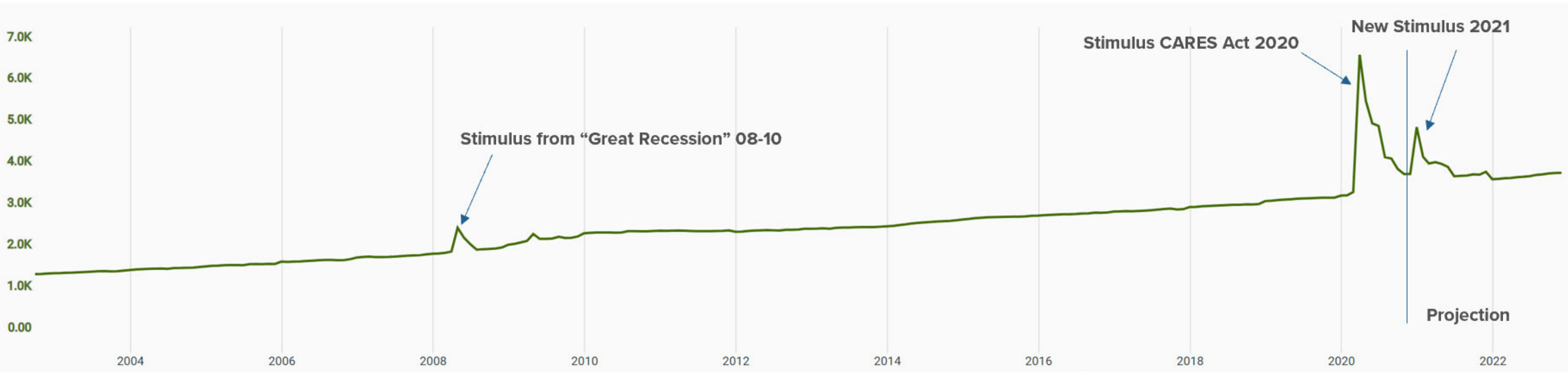
Now, many other economists are even more optimistic. They are optimistic because there's been a lot of money that has pushed into the economy that hasn't been spent yet because people cannot go out to restaurants, concerts, or vacations. Simultaneously, people want to spend, and people want things to get back to normal. Looking at total income and wages measures, there should be many opportunities to spend in 2021. If some return to normalcy is allowed and consumer confidence gets a boost, this could unleash a lot of spending.

There is some upside opportunity to 2021 because there is so much pent-up demand for specific services restricted in 2020 that people could not spend on. Of course, the timing of this depends on the vaccine and the virus. Realistically speaking, it might be the second half of the year before the U.S. gets those things under control enough that consumers can start spending more freely.

In addition to the opportunities, it is just as important to look at the risks and uncertainties that are still very elevated.

Government Boost Like Never Before

Government Social Benefit Transfers to People



The graph above puts the severity of this recession into perspective. The U.S. lost 6% of total jobs, and around 9 million jobs are gone compared to pre-pandemic levels. Consequently, as a society, we have asked the government to step in, and by historical standards, they have really stepped up. In comparison, during the Great Recession, which was the worst since the Great Depression, the Recovery Act pumped in almost a trillion dollars worth of stimulus from 2008 to 2010. Of course, stimulus takes a while to drip out, and it does not all get spent at once. The little blip on the graph in 2008 shows the effect of total government social benefit transfers. This data set demonstrates normal social transfers like unemployment benefits and social security, but will rise in a recession as stimulus checks are issued or unemployment benefits are raised.

Fast forward to today, and the government response has been much more aggressive than in the past. Looking back at 2020, one of the hardest things to predict was how bad the year would be as a whole because no one knew how the government would respond or how much impact the stimulus would have. This is largely because the U.S. has never seen stimulus like this before. Specifically, the CARES Act's $2.2 trillion unprecedented nature and this new round of stimulus approved in late December adding another $900 billion in support, and President Biden's current proposal of another $1.9 trillion in additional stimulus. Combined, these efforts dwarf the stimulus efforts in 2008-10, which totaled closer to $800 billion, and this is part of the reason we should expect consumers and the economy to have a different response to this recession than the last one.

Government Boost Like Never Before

In historic recessions, there tends to be a vicious downward cycle of job losses, which leads to lower wages. This leads to lower incomes, which leads to more job losses, and people spend less, and this cycle takes years to break. The U.S. experienced this cycle from 2008 to 2010, and then a very mild recovery out to 2014 and 2015. Conversely, the recession and recovery cycle now, on a macro level, is more of a V shape. There was a very sharp decline, and then the government loaded the economy full of stimulus to the extent that total personal income has seen record year-over-year gains in April (13.7%) when most of the first-round checks were distributed, and after-tax 2020 wages are estimated to end 6.1% higher than 2019, the highest one year gain in over 35 years .

This is looking at total income as a combined package of wages (which have gone down as jobs have been lost), combined with stimulus checks and extra unemployment benefits. All of this was pushed into the economy, plus the PPP loans for small businesses, and has created large gains to real disposable personal income that have far exceeded the economy's negative impacts on total wages.

All of this means that the U.S. is starting 2021 with many opportunities. The U.S. has a chance to not go through this downward cycle of additional job losses and more conservative spending because people, on net, have the money in their hands to spend. Once the vaccine is implemented and the virus wanes, much of this money can presumably be unleashed into the economy; a positive for 2021.

It is important to note that the new stimulus for 2021 in the previous graph does not include any future stimulus. Congress is now split in the Senate, with the Vice President being the tiebreaker, giving the Democrats a majority essentially in the Senate, the House, and the Presidency. This majority could open up new opportunities for even more stimulus, that would further support the “pent up demand” expectations of many once the economy is safe to reopen.

Government Boost Like Never Before

Now that Democrats are essentially in charge of all areas of lawmaking for the next few years, the expectation is that they would not necessarily stop that support if the economy starts to weaken. If the U.S. begins to face new strains of the virus or different things that cause further shutdowns, there will likely be an aggressive government response.

Of course, this might have consequences for 2022 and beyond, depending on how aggressive the U.S. government is in 2021. However, looking at the near-term outlook, there should be a sharp rise in disposable personal income combined with a government that is not likely to flip flop on their response stimulus, which should make for an economy that is going to see continued economic growth. While this is positive, it does not come without its risk.

2021 Opportunities

The 2021 opportunities are in the fact that Americans have plenty of cash to spend. Savings are up 80% versus last year. This is an extra $1 trillion in savings from last winter. A lot of this has to do with the extra money that has been pushed into the economy by the federal government, combined with the Federal Reserve pushing interest rates to the floor and making very loose accommodative monetary policy. The assumption is that widespread vaccination will draw out new spending. Wage gains are one of the more interesting data points when talking about 2020 as, on net, incomes are higher, largely due to extra stimulus.

One of the most positive numbers and one of the most fascinating numbers about 2020 is actually a negative one, which is the -0.5% decline in total wages in the U.S. last year. That is a surprisingly very modest number compared to the fact that total employment was down 6% and that the U.S. lost over 9 million jobs last year. Where are all these extra wages coming from?

This number means that wages on net only declined by 0.5%, which means many people are getting higher hourly pay, higher salaries, and extra bonuses. All of this money helps compensate for the lack of jobs on net. This pandemic has forced a lot of businesses and industries to shift more of their money towards their employees in terms of pay, seen in particular through hazard pay. Many frontline workers needed to work during this pandemic, even though it was not safe.

2021 Opportunities

As a result, businesses had to compensate them accordingly, and so many were getting wage increases in terms of hazard pay throughout the year.

At the same time, there is a lot of base pay or minimum wage increases. Some of these are coming from state and local governments as a lot of new minimum wages are getting passed. 25 states will see minimum wage increases in 2021. Now, with Democrats in control, this might be a possibility on a national level as well. Minimum wage legislation as well as private company policies of increased base, or starting pay, above what the government mandates are starting to push average hourly and weekly wages higher for those who are working.

It is also important to think about the bifurcation of the economy. Many industries have seen rapid growth, such as technology and grocery, where the consumers have shifted, and they have needed to hire employees and grow their industry like never before. That demand from winning industries will also drive wages up. There has been a suppression on wages for so long, and the U.S. was just starting, in 2018 and 2019, to see wages start to climb up above 2%, where real wage gains were very minimal for the previous ten years before that. Overall, this is a very net positive for the U.S. consumer.

The labor market is finally starting to reap some rewards, and the U.S. is starting to see wages stabilize and increase in more areas. This is ultimately a healthy long-term trend for the economy. The more people get paid, and the less money held up in corporate accounts or invested back in stock buybacks, the more the economy works. Furthermore, the more people spend and circulate that money throughout the economy, the more possibility of creating new jobs. As the U.S. faces recovery, this could be very positive for 2021 and beyond.

Disruptive markets can also present some new opportunities. There is an old economic concept of “creative destruction” that there are established players who get disrupted during downturns and there are businesses who go out that previously might have been blocking a market for your business. 2020-21 is a prime case for this “creative destruction” to open up new opportunities for smaller, more innovative companies.

2021 Opportunities

Going forward, there's still a lot of uncertainty, and building the predictive model with 99% accuracy and fine-tuning those profit margin expectations might still be a challenge in 2021. Forecasts in 2020 had to be thrown out and continuously redone. However, in 2021 there are a lot more knowns than in 2020. For example, we know that a vaccine is coming, and we know that the federal and fiscal response will be aggressive. There are many more knowns that can support business decision-making than in the early parts of last year, where everything was uncertain, and no one knew how long this would last or if a vaccine would come out in a year or ten years.

Looking to the future, the U.S. can bank on some form of recovery. We can also start to monitor what industries will end up winners and losers and try to focus on the winners. However, there are two common shortcuts to forecasting that should be cautioned against in 2021.

The first shortcut to avoid is thinking that 2021 will be a return back to 2019. This shortcut assumes that what went up must come down, and so as the pandemic unwinds, the economy returns to normal. That is not the case. The U.S. did lose 9 million jobs. Consumer sentiment is well below 2019 levels, and historically it takes a long period of time for consumers to build confidence back up after a deep recession. This is particularly interesting now as consumers are full of new habits that they were forced to create over the last year as a result of the pandemic. Not all of these habits are going away when enough of the population is vaccinated. Just because you can do what you did before, does not mean you are going to do it. When thinking about 2021 forecasting, it is crucial to avoid the trap of saying things will go back to pre-pandemic levels.

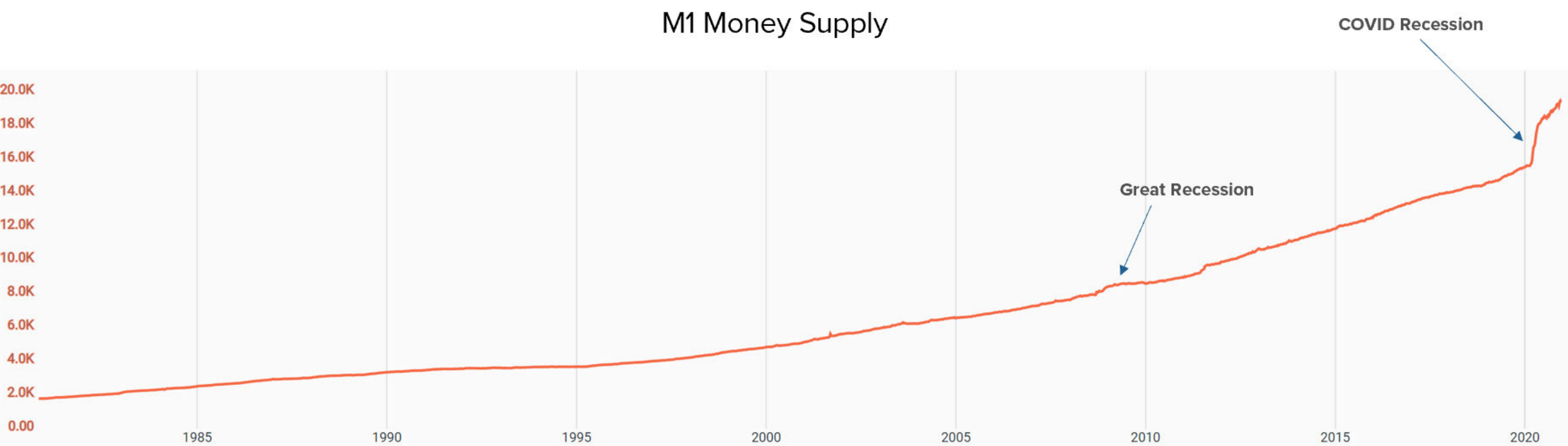
The second trap to avoid is thinking 2021 is just an extrapolation of 2020. Thinking about what the country went through in 2020, psychologically and monetarily, cannot repeat itself in 2021 for many reasons. The U.S. can only pass so many stimulus bills before there are some consequences. It is important not to assume that all the uncertainty of 2020 will repeat itself in 2021, especially given some recent successes on the vaccine, so there is a light at the end of the tunnel.

2021 Opportunities

The forecasting shortcut of taking last year and extrapolating forward will not work. Similarly, assuming that everything will return to pre-crisis levels will not work when the current crisis goes away. Reality is going to fall somewhere in between.

This is where a lot of real-time data monitoring comes into play to see where consumers will land in all of this. How fast are they going to unleash their spending? Where are they going to spend it? Will the millions who lost their jobs gain them back? Businesses will have to learn a lot on the fly still. In 2020, everyone had to learn to pay more attention to real-time data and look at more sentiment metrics. There will be much learning on the go moving forward, given the situation, and a lot of opportunity in 2021 for those who can pick up on the new trends early.

How Much is Too Much?



It is also important to look at the other side of all of this opportunity. Just as the government has boosted stimulus like never before, we are likely to see some economic impacts we have not seen before. Specifically, how do we unleash all this money into the economy without some consequence down the road?

Ultimately, what goes up must come down. If the U.S. prints money, how does it retract that money out of the money supply before it turns into something very drastic and negative like rapid inflation? To answer this question, it is helpful to see what past stimulus looked like compared to the current stimulus.

The graph above takes a look at the money supply. This is interesting because there is barely any noticeable change in the money supply during the last recession. Conversely, there is a lot more money sloshing around in U.S. bank accounts after COVID hit.

This has to do with a very aggressive monetary policy that is unprecedented in many ways, combined with very aggressive stimulus. Overall, there is a lot more money out there, and a lot of it is sitting in savings with almost an extra trillion dollars just sitting in bank accounts. People have been spending their money, and not all of it is spent on consumer goods.

How Much is Too Much?

For example, by historical standards, stock valuations are pretty elevated, and the stock market had a very good year. A lot of this money could be shifting into inflation in asset values in the stock market. Housing is another area this shift could be occurring due to high housing demand and fast rising prices.

Some near term inflation could be temporary COVID related supply chain issues, which can be seen by looking at rising manufacturer and logistics costs. One plant shut down due to COVID can disrupt many supply chains and push costs higher. Evidence is that there is currently some real inflation through the manufacturing supply chains and Producer Price Indices are rising.. This has not hit consumer prices yet, however. The total consumer price index is still around 1%, which is very low and conservative. This all has to do with the fact that the relationship between inflation and the money supply is not a one-to-one relationship, and weak consumer demand will often squash inflationary pressures in the near term.

The graph above shows the fact that the money supply went up 53% year-over-year. The fact that our total M1 money supply jumped 53% on a year-over-year basis is a little frightening. Moreover, the fact that the U.S. has outpaced other developed nations by several percentage points puts the U.S. at some exposure to very loose monetary policy, which could have some ramifications down the road should we see this post-pandemic surge in consumer spending in 2021.

The fundamental economic principle is that the economy has to be moving before it can instigate inflation. Typically for a solid developed nation with a strong currency, inflation does not just organically happen. There has to be some demand-driven element. During the pandemic, people cannot spend the money, either because it's sitting in bank accounts, they are too afraid to spend it, or they can't spend it because they can't go on that vacation or out to eat. As long as people are not spending it, they are not creating inflation. It will be very interesting to see what happens moving forward as 2021 or 2022 could get overheated. The U.S. could see bouts of inflation happen as people unleash all this money sitting on the sidelines at record levels.

How Much is Too Much?

Rising government debt has been an issue long before this pandemic happened. In 2019, the Congressional Budget Office stated that high and increasing debt poses substantial risks to the nation and presents policymakers with significant challenges. Regarding GDP projections, they anticipated that the U.S. would hit a 104% debt to GDP ratio in 2036.

As of their September projections, the U.S. already had hit that 104% debt to GDP ratio, pulling in their projections by 16 years. This was even before the additional trillion-dollar stimulus in December was passed.

The U.S. is quickly accelerating its debt, and the Federal Reserve is expanding its balance sheet at a record pace. Think about how people were worried about quantitative easing back over the last ten years. To put it into perspective, the Federal Reserve expanded its balance sheet over the last ten months by $3.2 trillion. That's compared to 3 rounds of quantitative easing from 2010 to around 2016 that lasted over six years and expanded only $3.6 trillion. The U.S. is well on pace to matching all the quantitative easing that was done over a 6-year period in about a 12-month period. The word “unprecedented” is a little cliché, but it just needs to be said in some cases, and no one wants to be caught off guard by this.

The fact is that the Federal Reserve's response and the government's response is a logical one. Borrowing at virtually 0 or 1% treasury rates in order to save the economy from a depression makes logical sense and they should do that. From the Federal Reserve's standpoint, do they stave off a financial crisis due to this externality? They have agreed that they are going to continue to pursue these loose monetary policies. Everybody seems to be waiting for inflation to happen, and then they will deal with it. If inflation occurs, it will disrupt 2021.

2021 Caution

So far, some of the key indicators to watch out for are things like the 30-year breakeven inflation rate. What is expected inflation? The 30-year breakeven inflation rate is a measure of comparison of normal Treasuries versus inflation-adjusted or TIPS Treasuries. They are around 2% and rising, compared to normal Treasuries that fluctuate anywhere from 0.36% to about 1.7%. This is signalling some inflation expectations starting to build into the market.

Additionally, it will be essential to watch the dollar as it has been declining over the past 9 or 12 months. If that decline accelerates, it will add some inflationary pressure. Finally, the last thing that's going to move up and the last thing policy makers are going to respond to is the CPI, or Consumer Price Index, which is only at about 1%.

There are other industries that are likely to face challenges in 2021. There is expected reciprocal pressure and share of wallet declines that will be putting pressure on areas of the manufacturing, distribution, and retail of consumer durables, which got a boost in 2020. It will not be surprising if people get caught off guard by this. If someone bought a bread maker in 2020, it does not mean they will buy another bread maker in 2021. From groceries, to consumer electronics and appliances, many different goods saw solid gains over the past year but will likely retreat some in 2021 as share of wallet diminishes and more services open back up. Some demand has likely even been pulled forward so you could see retreats to negativity below pre-pandemic levels after a strong gain in 2020. It will be important to watch out for that.

2021 Caution

Another area to keep an eye on will be the automotive industry. Changing consumer habits with travel will be a net negative on the auto industry and those companies will likely see a challenging 2021, both in automotive and in transportation in general.

Non-residential construction is another obvious candidate for a challenging 2021. There will be extra office space, additional retail space, and businesses learning how to continue to live without it. In 2021, there will be much space left that was designed for the old economy and that is just not compatible with the new economy. This will likely cause a lot of challenges due to high vacancy rates and lower rents, which will impact the construction market in particular. It is not easy to get new construction off the ground in an environment like this, regardless of how low-interest rates are.

To help navigate where consumers are likely headed, it will be important to watch many consumer-designed survey metrics that are asking about forward-looking expectations. One example we are watching is Spending Plans on Vacation Travel, which is a consumer sentiment metric published by Prosper Insights & Analytics and that we have in our Prevedere database.

The survey asks, “What do you expect your spending plans to be on vacation travel over the next six months?”. Interestingly, the results of the survey question show that still only 12% say they are actually planning on vacation travel in the next six months. This is lower than even the April to July timeframe last year. People were in denial for a while, thinking this will be a quick thing, and they still were going to plan their vacations. Now, people are just entrenched in a negative outlook, and will likely take some convincing that everything is “ok” again.

Much of the data suggests this cautious optimism to 2021. Yes, stimulus has boosted incomes and consumers, on average, have money to spend. However, consumers are going to be conservative. They have learned many lessons, and they know that the economic environment is volatile. The U.S. still sees job losses every week over 700,000, which is higher than any point during the last recession. We still see a record amount of job losses and new jobless claims. For those people, stimulus checks are a lifeline and full recovery will not happen until new jobs are secured and savings is built back up, which can take years.

Conclusion

Ultimately, on net, Prevedere is expecting economic growth in 2021. We will also remain tuned into the many threats the US economy still faces.

As we head into the new year, we will continue to update our forecast as things develop. Of course, things change rapidly, and we will continue to provide up-to-date information on the latest economic data, the indicators we are watching, and any of the latest economic news.

Andrew Duguay
Chief Economist

About Andrew Duguay

Mr. Duguay is a Chief Economist for Prevedere, a predictive analytics company that helps provides business leaders a real-time insight into their company's future performance. Prior to his role at Prevedere, Andrew was a Senior Economist at ITR Economics. Andrew's commentary and expertise have been featured in NPR, Reuters, and other publications. Andrew has an MBA and a degree in Economics. He has received a Certificate in Professional Forecasting from the Institute for Business Forecasting and Certificates in Economic Measurement, Applied Econometrics, and Time-Series Analysis and Forecasting from the National Association for Business Economics.

Navigate What's Next with Economic Scenario Planning

The COVID-19 crisis has given rise to a world of economic uncertainty, with uneven effects across regions and industries.

Prevedere's Economic Scenario Planning solution helps companies navigate these tumultuous times. The solution projects future business outcomes for three plausible macroeconomic scenarios under COVID-19. Companies can use these insights to sharpen 2021 forecasts and plans, improve shareholder guidance, and stay on top of the pandemic's evolving impact.

Click here to learn more about Economic Scenario Planning. >>

Prevedere is a predictive analytics software company that delivers insights into future business outcomes based on current economic trends. Our predictive economic intelligence offerings help executives see what lies ahead for their business and solve for upcoming risks and opportunities. Prevedere's SaaS solutions apply the power of machine learning and predictive modeling to millions of indicators of global economic and consumer activity. Our customers include Fortune 500 industry leaders in retail, manufacturing, and consumer packaged goods.

To learn more, visit www.prevedere.com
or follow @Prevedere on Twitter.

prevedere

www.prevedere.com