CUSTOMER TREASURY SERVICES

Economist's Weekly Market View

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US Economy Heats Up

The data released in the past week show that the recovery in the US economy is gaining momentum in early 2021, even before President Biden's proposed, super-sized $1.9trn fiscal stimulus package is passed into law. The most eye-watering release was the 5.3% jump in retail sales in January, which far exceeded the forecast rise of 1%. Meanwhile, manufacturing output rose by 1% in the month and is now just 1% below its pre-Covid level.

Meantime, the NAHB index of homebuilder sentiment and activity remained close to all-time highs in February, while house building permits surged to a 15-year high in January. Flash PMI data for both the manufacturing and services sectors remained at very high levels in February also, despite much of the US being hit by severe weather.

It requires further growth of 2.5% from its level in the final quarter of 2020 for the US economy to return to its pre-Covid output peak. This probably won't be achieved in this quarter, but looks certain to be reached and surpassed in next quarter. The US labour market, though, continues to lag in its recovery. The rebound in employment largely ground to a halt over the winter, leaving non-farm payrolls still almost 10 million, or 6.5%, below their pre-Covid level. Meanwhile, weekly jobless claims continue to run at historically high levels.

The official unemployment rate may have fallen sharply to 6.3%, but this has been helped by an enormous decline of 4.3 million in the labour force over the past year. The broader U6 unemployment rate stands at over 11%. This weakness in the labour market is a clear focus for policymakers, with both the Federal Reserve and Biden administration determined about achieving a return to full employment.

The scale of the proposed Biden fiscal stimulus is enormous, at some 9% of GDP and almost three times the size of the estimated output gap, in an economy that is close to fully rebounding from the Covid-19 recession. Monetary policy is already very stimulatory, while household savings remain very high. The personal savings rate stood at 13.7% at end 2020, pointing to considerable consumer spending firepower.

Meantime, a lot of progress is being made in the US in terms of the vaccine rollout, with talk the country may be on the way to achieving herd immunity and thus an end to Covid related restrictions on activity. All the ingredients are in place, then, for a period of robust US growth ahead.

There are major constraints on supply, though, with inventories of inputs and raw materials at low levels in many industries, including construction and carmakers, and delays also at ports. Not surprisingly, then, January saw the producer price index leap by 1.3% in the month, far above expectations. Meanwhile, oil prices are surging as producers keep a lid on supply. In the services sector, we can expect to see margins widen after a difficult year in many industries.

Inflation, then, looks set to accelerate over the course of this year, with a real risk of too much money chasing too few goods. The Fed may not be worried as it focuses on the slack in the labour market. The bond markets clearly are, though, as evidenced by the marked rise in long term yields. There is likely to be little comfort for bond investors in the months ahead, as the recovery gathers momentum and inflationary pressures build.

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