

THE ECONOMIC OUTLOOK GROUP



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ECONOMIC TALKING POINTS

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What Worries the Fed Is Not Inflation, But Whether The New Covid Strains Draws Fresh Blood From The Economy

These are tough days for Jerome Powell. Pressure has been building on him to shut down the Federal Reserve's emergency measures that were put in place at the onset of the pandemic. Members of Congress, Wall Street analysts and even several notable economists say now is the time to begin removing some liquidity.

Yet Powell keeps resisting such appeals, arguing that the economy "is still a ways off" from achieving "further substantial progress." But what exactly, or even roughly, does "further substantial progress" mean? What, they wonder, is Powell waiting for?

After all, there has been a cascade of bullish economic reports. We saw upward surprises in retail sales, consumer prices and producer prices. More Americans see inflation accelerating the next couple of years. Isn't this an appropriate time for the Fed to scale back the \$120 billion a month it spends on mortgage-backed securities and treasuries? And if not now, how about at least setting some timetable to do so?

But Powell and most members of the Federal Open Market Committee show no inclination to do so. And, frankly, they have a very good reason for holding off.

When Powell says he wants to see "further substantial progress," it suggests there is something else on his mind right now. He is clearly aware of the

economy's muscular recovery! And yes, households are still flush with cash and consumers continue to show a ravenous appetite to spend. It's also true that inflation has leaped to levels beyond the Fed's target. Powell is not denying any of this.

What's troubling him is another emerging threat to growth. The Fed has over 400 PhD economists and they are constantly surveying the universe of variables that shape the business cycle. Lately, some of these experts have been spending more time with scientists at the Centers for Disease Control to assess whether the new, more virulent set of Covid-19 variants (Delta, Delta Plus and Lambda) could spread enough this fall and winter to stall the US recovery and reverse the progress made in the job market.

The very last thing Powell wants to do is announce plans to tighten monetary policy just as the economy is in danger of suffering another major wave of infections and selected shutdowns. But, unfortunately, those talks between the CDC and Fed economists have taken a disquieting turn. You can sense that in the minutes to the June 15- 16 FOMC meeting, which were released earlier this month: *"The staff continued to see the uncertainty surrounding the economic outlook as elevated..."* Behind this worry was the fear of *"adverse alternative courses of the pandemic --- including the possibility of the spread of more contagious, more vaccine-resistant Covid-19 variants."*

In the more recent Beige Book, the Federal Reserve Bank of Boston found it necessary to note the *"uncertain outlook given the possibility of a resurgence in Covid-19 cases later in 2021."*

And the news continues to alarm. According to the CDC, less than half of the US population has been fully vaccinated. Nearly 100 million American ages 12 and older --- we're talking here about students, consumers, employees, business owners and investors --- have not even received a single shot! In fact vaccination rates are falling. They are less than a quarter the pace of two months ago. Hospitals across the country are already seeing an upsurge in Covid-19 patients. Just this past week, several large counties in California moved to reinstate indoor mask requirements. With Covid cases rising in every state, there is the prospect of more communities putting new restrictions in place.

Simply put, the proliferation of the more deadly Covid-19 strains has made monetary policy hellishly more complicated, a point the Federal Open Market Committee will likely acknowledge when it meets next week.

So, yes, we have seen a spate of upbeat "economic news" lately. But that only tells us how the economy performed in the past. Before any decision is made on when to rein in quantitative easing, policymakers must first have a better understanding of what direction the economy, employment and inflation will take in the months and years ahead. Let's face it; no driver puts their foot on the brake based on what they see in the rear view mirror.

Is there a lot of educated guesswork about the future? Absolutely. But what is undeniable now is that the morphing of the Covid-19 virus *could* set back the economy's recovery later this year and next.

For that reason Powell and the monetary policy committee are right to resist any pressure to tighten monetary policy. The risk at the moment is not the Fed falling behind the inflation curve. The greater peril is to proceed and remove liquidity just when Covid-19 rears its ugly head again and threatens to draw fresh blood from the economy.

United States																
	I 2020	II 2020	III 2020	IV 2020	I 2021	II 2021	III 2021	IV 2021	I 2022	II 2022	III 2022	IV 2022	I 2023	II 2023	III 2023	IV 2023
Real Gross Domestic Product (GDP):																
%	-5.0	-31.4	33.4	4.3	6.4	8.8	6.4	5.7	3.8	4.9	5.5	4.2	2.8	3.5	3.1	2.9
Personal Consumption Expenditures:																
PCE %	-6.9	-33.2	41.0	2.3	11.4	13.9	6.5	6.0	3.4	5.2	4.2	3.6	3.1	4.1	2.8	3.5
Inflation, end of period, year-over-year:																
CPI %	1.5	0.6	1.4	1.4	2.6	5.4	3.4	2.8	2.4	2.4	2.3	2.2	2.5	2.6	2.6	2.7
Unemployment Rate (end of period):																
%	4.4	11.1	7.8	6.7	6.0	5.9	5.7	5.6	5.4	5.5	5.6	5.4	5.4	4.9	4.4	4.1
Non-farm Payrolls, monthly avg. thousand:																
	-303	-4,427	1,322	213	513	567	650	875	524	425	265	240	185	225	235	250
Treasury 10-yr Note Yield % (end of period):																
	0.63	0.65	0.68	0.91	1.75	1.44	1.55	1.60	1.73	1.82	2.00	2.10	2.18	2.22	2.36	2.40
Federal funds rate % (end of period):																
	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.38	0.88	1.13

GDP Growth - Global Economy															
Country	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	
US	2.6	1.6	2.2	1.8	2.5	3.1	1.7	2.3	3.0	2.2	-3.5	7.2	4.6	3.1	
Eurozone	1.7	1.4	-0.9	-0.2	1.4	2.1	1.9	2.5	1.9	1.2	-6.7	3.8	3.1	2.0	
United Kingdom	1.7	0.7	0.3	1.8	2.9	2.2	1.9	1.9	1.3	1.5	-9.8	5.5	4.6	3.1	
Japan	4.6	-0.4	1.6	1.5	-0.1	1.1	0.5	2.2	0.3	0.7	-4.8	2.4	2.8	2.2	
Canada	3.1	3.1	1.8	2.3	2.9	0.7	1.0	3.2	2.0	1.6	-5.4	6.0	5.1	2.9	
India	8.4	8.6	6.7	4.9	7.4	8.0	8.1	7.2	6.8	4.8	-8.2	6.5	7.1	6.7	
China	10.5	9.5	7.8	7.7	7.3	6.9	6.7	6.8	6.6	6.1	2.3	7.7	5.7	5.6	
Brazil	7.5	2.7	0.9	2.3	0.1	-3.5	-3.5	1.2	1.2	1.1	-4.4	2.9	3.1	2.4	
Mexico	5.2	4.0	3.9	1.4	2.3	2.7	2.7	2.4	2.1	-0.1	-8.4	4.1	2.9	2.7	
Australia	2.8	2.6	3.6	2.4	2.6	2.5	2.4	2.4	2.7	1.8	-1.1	4.8	3.1	2.3	
Russia	4.0	4.3	3.4	1.3	0.6	-2.8	-0.2	1.6	2.5	1.2	-2.9	2.4	2.8	2.4	
World	4.2	3.1	2.5	2.6	2.8	2.8	2.6	3.4	3.2	2.9	-3.8	5.6	4.2	3.9	

Key Economic & Geopolitical Projections for 2021 & 2022

• Updated: July 19, 2021

PROBABILITY	U.S.
HIGH	Congress to pass \$900 billion - \$1.2 trillion physical infrastructure bill late 2021.
Moderate	Senate reconciliation passage of \$3.5 trillion American Families Plan is unlikely. May require multiple legislative parts.
HIGH	Inflation surge will prove to be temporary as supply chain bottlenecks ease and with fiscal and monetary restraint.
Moderate	Treasury 10-yr. yields to hover between 1.3% to 1.6% in 2021 even as the Fed hints of scaling back asset purchases.
HIGH	Covid-19 to become an endemic as virus continues to mutate. Another wave of infections likely this fall and winter.
HIGH	Competition for workers spurs higher wages. Companies to offset these costs with greater productivity & thinner margins.
FOREIGN	
HIGH	Beijing fortifies naval presence in SCS; further erodes autonomy in Hong Kong and increases threats against Taiwan.
HIGH	Biden orders greater US naval presence in SCS to defend International Law of the Sea and support regional allies.
HIGH	US - Russian tensions approach cold war levels over Moscow's cyberattacks, extrajudicial killings and Ukraine.
Moderate	A cyber World War is underway; may result in periodic disruptions to global financial networks and power grids.
HIGH	Iran's new hard-line president secretly backs policy to produce enough fissile material for a nuclear weapon.
Moderate	Europe & Asia's 2022 economic outlook improves. Africa & South America to be laggards given low vaccination rates.
HIGH	US resets trade relations with Europe. No such reset in the works with China as trade tensions and sanctions remain.

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