U.S.News & WORLD REPORT

Fed Ups 2021 Economic Forecast Significantly, Leaves Interest Rates Unchanged

The central bank is walking a fine line between helping the recovery from the pandemic and dealing with a strengthening economy.

By Tim Smart - March 17, 2021

THE FEDERAL RESERVE ON Wednesday raised its forecast for 2021 gross domestic product by more than 50% from its December estimate while holding interest rates steady.

GDP is now expected to increase 6.5% in 2021 before cooling off in later years, according to the Federal Open Market Committee, the central bank's monetary policy making group. That is sharply higher than the 4.2% forecast made in December.

"Following a moderation in the pace of the recovery, indicators of economic activity and employment have turned up recently, although the sectors most adversely affected by the pandemic remain weak," the Fed said in a statement following its two-day meeting. "Inflation continues to run below 2 percent."

The Fed cut interest rates to essentially zero a year ago as the pandemic shut down much of the economy and has been buying $120 billion in bonds and other securities per month, maintaining easy and cheap credit that has buoyed the economy and prevented more damage. Its actions, which have been unprecedented, along with relief from Washington in the form of direct payments to working families, extended unemployment benefits and support for business and governments, have been widely hailed as a success.

Markets rallied on the news, which had been expected, with the Dow Jones Industrial Average gaining more than 150 points in initial trading after the statement.

The statement comes as many readings on the economy show progress one year removed from the dramatic decline in GDP in the second quarter of 2020 as the nation locked down to battle the coronavirus. With the winter surge in coronavirus cases having ended, rollouts of vaccines accelerating and additional stimulus from Congress, the economy has significantly improved from the beginning of the year.

The job market is improving, manufacturing is strong and consumer spending, while taking a breather in February amid a record cold spell, should improve as the year goes on. Many forecasters, both in the private and public sector, have raised their estimates of GDP for 2021 to as high as 8%.

"We have revised up our forecast for full-year GDP growth for 2021 to 6.4%," Wells Fargo wrote in a note to clients last week. "That rate is not only above the consensus expectation, but if realized it would make the fastest pace of growth for the U.S. economy since 1984."

And while there are still 9 million unemployed, that is way below the 22 million who lost their jobs in March and April of last year – a drop of a magnitude never seen before. But, the economy also has never before "managed the feat of adding more than 11 million jobs in a five-month period, as it did between May and September," Goldman Sachs noted last month.

The Fed has consistently said that until labor market conditions improve, it will allow inflation to trend above its 2% goal. While some economists and politicians have raised the spectre of inflation – especially with an additional $1.9 trillion in stimulus about to flow into the economy with passage of President Joe Biden's American Rescue Plan, others have noted there is still considerable slack in the global economy.

Bernard Baumohl, chief global economist at The Economic Outlook Group, acknowledges the growing concern about an upward spiral of inflation this year as annual GDP reaches a possible range of 6%.

"The worry has been that this would push yields on 10-year Treasury notes to 2%, if not exceed it, this year," **Baumohl** says. "But what is often missed in the equation is the desire of foreign investors (both private and central bankers) to buy U.S. debt since their real returns now look much more attractive relative to the sovereign debt of all other industrial countries."

Indeed, at the most recent offering of 10-year Treasury debt, demand was solid.

"Total foreign ownership of U.S. Treasuries in January increased to $7.12 trillion, a 12-month high," **Baumohl** notes "If we're to spin this forward and assume the U.S. rollout of the vaccine continues to improve and the economy does pick up more speed, foreign demand for Treasuries will continue to increase, and that should keep yields from climbing to a point where it can snuff out U.S. growth."

And, he points out, "No one should be more quietly grateful of this foreign appetite than Jerome Powell," since it lessens the pressure on the Fed to raise interest rates anytime soon.

While much of the current optimism about 2021 reflects the performance of giant global companies that have adapted their business models during the pandemic, even small businesses are seeing hopeful developments.

Kabbage, an American Express company, recently surveyed 550 companies with workforces ranging in size from fewer than 20 to 500 employees. It found 57% of them are fully open as states and localities ease restrictions and vaccinations become more available. And the survey found many had increased their online sales, as large companies like Walmart and Lowe's have done.

"The shift to online has reset revenue expectations across small businesses," the Kabbage Small Business Recovery Report found. "Prior to the pandemic, respondents said their average monthly online sales represented 37% of total revenue. "As of February 2021, these numbers jumped to 57%, a 54% increase in less than one year."

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