Visa Business and Economic Insights

U.S. Economic Outlook

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Inflation: The price of recovery?

Incoming economic data over the last month has been mixed. U.S. job growth in February was robust, with 379,000 jobs added, and the unemployment rate edged lower to 6.2 percent, according to the U.S. Department of Labor. Income growth and consumer spending were solid in January, the vaccine rollout gained momentum and Congress was on the cusp of enacting another round of fiscal stimulus. There are, however, a few headwinds to growth that emerged as well. Severe winter weather across the South and New England regions appears to have weighed on consumer spending in February, while supply chain issues have slowed the pace of inventory rebuilding. Strong domestic demand is boosting import growth but slower vaccine rollouts globally are weighing on export growth. Combined, these factors resulted in a downward revision to our Q1 real GDP growth estimate to 2.2 percent. While we downgraded a number of sectors, we now expect net exports and inventories to subtract as much as 2.2 percentage points from GDP growth this quarter.

Looking ahead to the rest of this year, Q2 will likely shape up to be the strongest quarter of the year (bottom left chart) fueled by the passage of the $1.9 trillion stimulus package. The short-term boost from stimulus should begin to fade in the second half of the year as inflation pressures build. The likely result is that real, inflation-adjusted, economic activity will begin to decelerate as the purchasing power of consumers and businesses is eroded. The anticipation of higher inflation pressures later this year is driving interest rates higher and thus will likely reduce housing affordability later this year and into 2022.

Key Takeaways

A downward revision to Q1 growth

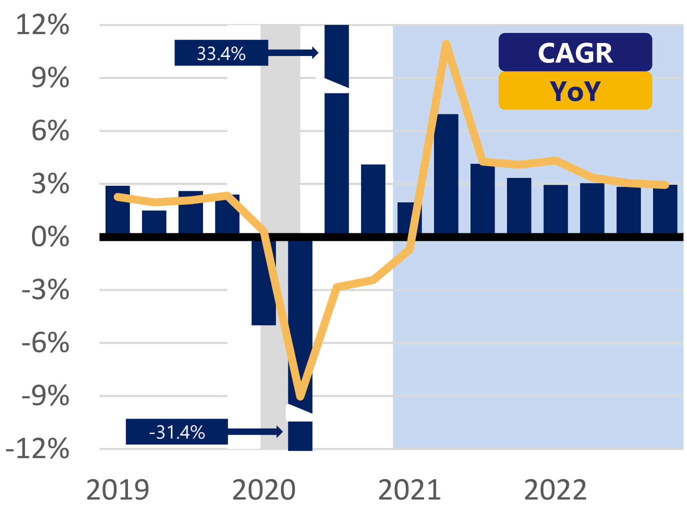
Signs of inflation emerging

Interest rates climbing higher

New risks to the outlook are emerging

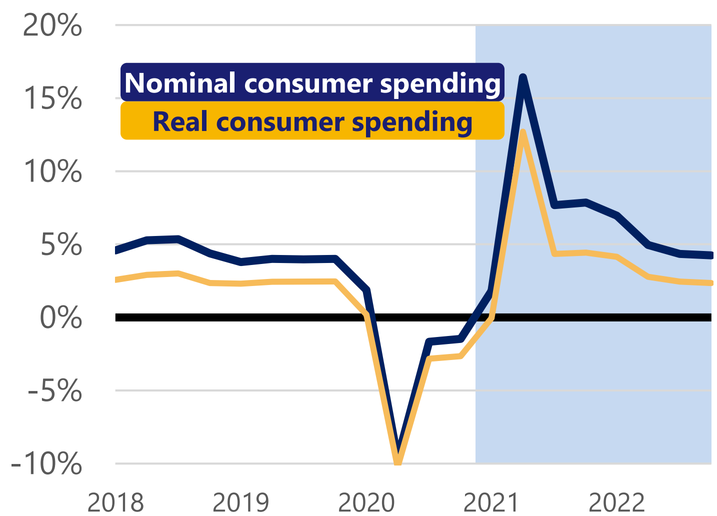
Real gross domestic product (GDP) (SA, CAGR and YoY* percent change)

Last forecast: March 11, 2021



Nominal versus real consumer spending (SA, YoY* percent change)

Last forecast: March 11, 2021



*Seasonally adjusted (SA), compound annualized growth rate (CAGR), year-over-year (YoY). Sources: Visa Business and Economic Insights and U.S. Department of Commerce.

Inflation: The price of recovery? (cont.)

Inflation's impact on consumer spending

Our outlook has reflected the expectation of higher inflation for some time, but recent data suggests price pressures are finally beginning to materialize. The February ISM survey data for both the manufacturing and service sectors rose dramatically, with the manufacturing sector's prices paid component reaching its highest level since 2008. The reading was the first to suggest that pandemic-related global supply chain disruptions are beginning to lead to higher prices as constrained supplies globally in light of accelerating demand domestically lift prices.

We expect the headline PCE Deflator, the Fed's preferred measure of inflation, to rise above 3 percent on a YoY basis and stay there until the first quarter of next year. The combination of supply constraints and another round of fiscal stimulus will be the key drivers. The higher inflation rates will ripple through the economy in two key ways. First, revenues will be higher for some industries as they are measured in nominal terms. Real spending however, is likely to be constrained as the inflation pressures erode some of the real purchasing power of consumers. The result is a gap between our outlook for real and nominal consumer spending this year (right graph on pg. 1).

Inflation, growth and interest rates

Beyond the inflation effects on the consumer sector, the expectation of higher inflation is also putting upward pressure on interest rates. The 10-year U.S. Treasury reached 1.60 percent last week, up from just 91 basis points at the start of this year. While the expectation of more federal debt issuance and stronger economic growth are helping to lift interest rates, the dominant factor in our view is the expectation that inflation will be allowed to exceed the Fed's 2 percent target as the Fed awaits a more robust labor market recovery before beginning to hike interest rates or reduce its asset purchases.

Risks to the outlook

The risk to economic growth remains skewed to the upside in our view. The stimulus package along with a faster pace of vaccine rollouts could lift GDP growth higher than we currently expect. On the downside, we remain concerned about supply chain disruptions and the resulting inflation pressures, which have the potential to hold back real growth. We are currently assuming that the inflation pressures will be transitory, but should they persist, such rates of inflation would put downward pressure on real GDP growth and squeeze corporate profits.

Visa's U.S. Economic Forecast

	Actual				Forecast				Actual		Forecast	
	2020				2021				2019	2020	2021	2022
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
Gross Domestic Product (CAGR)	-5.0	-31.4	33.4	4.1	2.0	7.0	4.1	3.3	2.2	-3.5	4.5	3.4
Personal Consumption	-6.9	-33.2	41.0	2.4	3.5	8.0	3.6	2.7	2.4	-3.9	5.2	2.9
Business Fixed Investment	-6.7	-27.2	22.9	14.0	12.6	5.5	5.3	5.4	2.9	-4.0	8.3	5.3
Equipment	-15.2	-35.9	68.2	25.7	14.9	7.7	6.7	6.4	2.1	-5.0	14.9	6.0
Intellectual Property Products	2.4	-11.4	8.4	8.4	7.6	4.9	5.8	6.3	6.4	1.6	5.7	6.3
Structures	-3.7	-33.6	-17.4	1.1	2.4	0.7	0.4	0.3	-0.6	-10.6	-4.1	1.0
Residential Construction	19.0	-35.6	63.0	35.8	18.3	16.6	14.0	12.1	-1.7	6.0	20.1	11.1
Government Purchases	1.3	2.5	-4.8	-1.1	2.5	3.5	2.5	2.8	2.3	1.1	1.1	2.9
Net Exports Contribution to Growth (%)	1.1	0.6	-3.2	-1.6	-1.3	-1.0	-0.6	-0.7	-0.2	-0.1	-1.7	-0.6
Inventory Change Contribution to Growth (%)	-1.3	-3.5	6.6	1.1	-0.9	0.3	0.4	0.4	0.0	-0.6	0.6	0.2
Nominal Personal Consumption (YoY % Chg.)	1.9	-9.7	-1.7	-1.5	1.8	16.4	7.7	7.9	3.9	-2.7	8.2	5.1
Nominal Personal Income	3.2	10.7	6.8	4.0	12.6	14.1	17.8	20.6	3.9	6.1	16.3	4.3
Retail Sales Ex-Autos	2.5	-7.5	3.2	2.7	7.5	18.6	6.2	7.5	3.5	0.3	9.7	3.4
Consumer Price Index	2.1	0.4	1.2	1.2	1.7	3.4	3.2	3.7	1.8	1.2	3.0	2.5
Federal Funds Rate (Upper Bound)	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	2.19	0.25	0.25	0.25
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	5.28	3.54	3.25	3.25
10-Year Treasury Yield	0.70	0.66	0.69	0.93	1.59	1.75	1.80	1.85	2.14	0.89	1.75	1.93

Forecast as of: March 11, 2021

Sources: Visa Business and Economic Insights analysis of data from the U.S. Department of Commerce, U.S. Department of Labor and Federal Reserve.

Forward Looking Statements

This report contains forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Act of 1995. These statements are generally identified by words such as "outlook," "forecast," "projected," "could," "expects," "will" and other similar expressions. Examples of such forward-looking statements include, but are not limited to, statements we make about Visa's business, economic outlooks, population expansion and analyses. All statements other than statements of historical fact could be forward-looking statements, which speak only as of the date they are made, are not guarantees of future performance and are subject to certain risks, uncertainties and other factors, many of which are beyond our control and are difficult to predict. We describe risks and uncertainties that could cause actual results to differ materially from those expressed in, or implied by, any of these forward-looking statements in our filings with the SEC. Except as required by law, we do not intend to update or revise any forward-looking statements as a result of new information, future events or otherwise. Our forecast assumes the bulk of the negative effects of the COVID-19 outbreak will occur in the second quarter of this year with a gradual relaxing of social distancing guidelines over the second half of 2020.

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