First Trust
Monday Morning OUTLOOK

Brian S. Wesbury – Chief Economist
Robert Stein, CFA – Dep. Chief Economist
Strider Elass – Senior Economist
Andrew Opdyke, CFA – Senior Economist
Bryce Gill – Economist

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2022: Moderate GDP, Persistent Inflation

From 30,000 feet, the COVID lockdown and re-opening played out pretty much like we thought. GDP collapsed in the first half of 2020, then exploded in the third quarter, followed by strong, but erratic, quarterly growth ever since. The fourth quarter data, when it's released in January, will show 2021 had the fastest GDP growth, and highest inflation, since the 1980s.

As a reminder, this is not a normal business cycle and shouldn't be treated like one. We have never locked down businesses, we have never seen such a rapid peacetime expansion of federal spending, and we have rarely seen such a huge increase in the M2 measure of money.

Shutting down the economy destroys supply chains because they work best with a free flow of information. And paying people not to work after the economy is open makes it worse. Small businesses have suffered much more than large companies, so while profits and stock prices are at, or near, all-time highs, real GDP will still end 2021 lower than it would have if COVID had never happened. Meanwhile, inflation under COVID has been much higher than the pre-COVID trend.

Normally, government involvement in an economy does not alter its path so much from quarter to quarter, or year to year. Sure, Fed rate hikes, or tax rate changes must be accounted for, but the massive nature of government interference in the economy since March 2020 has made us all Keynesians now. Factoring in how much spending is borrowed from the future, how much new money the Fed is printing, and whether tax rates will become more punitive is all part of any forecast.

For example, some of our economic peers are now saying 2022 growth will be slower than it otherwise would have been because Joe Manchin has said "no" on the Build Back Better plan. Their forecast argues that fewer government handouts will reduce spending and therefore GDP growth.

We think that is simplistic analysis. Yes, fewer handouts will lead to a reduction in deficit spending. However, with 11 million job openings, it will likely lead to more actual employment. So, any slower growth from less government spending will be offset by more growth from the private sector, which will help supply chains. At the same time, without BBB, tax rates will not rise, which is a positive for longer-term growth.

Putting it all together, **we expect real GDP to rise at about a 3.0% rate in 2022**. Why slower than 2021? Because 2021 was artificially boosted by big deficit spending. Why not slower than 3.0%? Because small businesses will bounce back and the BBB tax hikes and distortionary spending are now less likely.

For inflation, it looks like the Consumer Price Index will be up in the 6.5 - 7.0% range this year. The consensus among economists is that will slow to 2.7% next year, but **we think inflation will run 4.0% or more**. On a granular level, look for the rental price of housing, which makes up more than 30% of the CPI, to be a key driver of inflation for the next few years. In addition, we expect oil prices will move higher again as regulatory ambiguity related to environmental rules curbs exploration.

For the job market, look for solid job growth to continue. Job openings remain plentiful and, slowly but surely, some of the people who have left the labor market should get pulled back in by rising wages. **Look for about 325,000 – 350,000 jobs per month next year.** Don't get too excited, though; at that pace, at the end of 2022, we'll be barely 700,000 jobs above the pre-COVID level. Not impressive for a time period of almost three years. Yes, the unemployment rate should get down to the 3.5% the Federal Reserve expects by the end of 2022, equaling the pre-COVID rate, but it'll be with much lower labor force participation, so 3.5% is not as impressive as it sounds.

Put it all together and we have an inflation problem that is obviously not "transitory" and economic growth that's a glass half full: good growth versus historical measures but not yet enough to get us back to where we would have been if COVID had never happened.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
12-22 / 7:30 am	Q3 GDP Final	2.1%	**2.1%**		2.1%
7:30 am	Q3 GDP Chain Price Index	+5.9%	**+5.9%**		+5.9%
9:00 am	Existing Home Sales – Nov	6.530 Mil	**6.490 Mil**		6.550 Mil
12-23 / 7:30 am	Initial Claims – Dec 18	205K	**197K**		206K
7:30 am	Personal Income – Nov	+0.4%	**+0.5%**		+0.5%
7:30 am	Personal Spending – Nov	+0.6%	**+0.6%**		+1.3%
7:30 am	Durable Goods – Nov	+1.8%	**+1.9%**		-0.4%
7:30 am	Durable Goods (Ex-Trans) – Nov	+0.6%	**+0.6%**		+0.5%
9:00 am	New Home Sales – Nov	770K	**769K**		745K
9:00 am	U. Mich Consumer Sentiment- Dec	70.4	**70.4**		70.4

Consensus forecasts come from Bloomberg. This report was prepared by First Trust Advisors L. P., and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security.