First Trust
Monday Morning OUTLOOK

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Overstimulation on the Way

Things are looking up for the US economy.

Later this week we'll get an update on real GDP growth for the 4th quarter of 2020. We estimate that'll be revised up to a 4.3% annual rate of growth from a prior estimate of 4.0%.

Meanwhile, 2021 got off to a roaring start. Retail sales soared 5.3% in January and are now up 7.4% from a year ago (pre-COVID). All major categories of sales rose in January, reflecting stimulus spending approved in late December and less onerous lockdowns of business.

But it wasn't just the demand side of the economy picking up in January. Industrial production increased 0.9% and was revised up for prior months. More importantly, the gain in industrial production was led by manufacturing excluding the auto sector, which is what we think of as "core" industrial production – it increased 1.1% in January. That measure of production has now increased nine months in a row.

Other positive news on the manufacturing front was an increase in the Empire State index to 12.1 from 3.5, and the Philadelphia Fed index coming in at a very robust 23.1. it's good to see the northeastern US continue its revival.

It's true that housing starts declined in January and fell short of consensus expectations. But those figures are volatile from month to month, and a better measure of how much residential construction is happening every month is the total number of homes under construction, which increased 0.6%.

Putting this all together, we're now estimating that real GDP will rise at about a 6.0% annual rate in the first quarter, and grow about 5.0% (Q4/Q4) in 2021. Yes, we know that the Atlanta Fed's GDP Now model projects a 9.5% growth rate for Q1, but that model has been overestimating growth since the recovery started and doesn't factor-in the polar vortex that has wreaked havoc throughout much of the mid-section of the country in February.

Either way, it's now clear that there is virtually zero risk of a double-dip recession. In fact, a new $1.9 trillion stimulus bill is winding its way through the legislative process. It's like using a credit card to push spending above your current income level. This massive package includes a further extension of unemployment benefits, direct help for households and businesses, more money for vaccinations, $350 billion for state and local governments, and $170 billion for education.

Much of this spending is for 2022 and beyond (which we would argue has nothing to do with the pandemic). In fact, our estimates suggest the US will reach herd immunity by April, allowing organic growth to accelerate.

Budget scorekeepers on Capitol Hill estimate the current proposal, which has the blessing of the White House, will increase the budget deficit by $1.2 trillion this fiscal year (which ends in September), and an additional $700 billion in future years, mostly 2022. This bill would drive the annual budget deficit to roughly $3.5 trillion for Fiscal Year 2021, a new record high. And roughly a third of this will be financed by Federal Reserve bond purchases.

All the money printing and extra spending will boost demand, which is a recipe for higher inflation. Consumer prices are up 1.4% from a year ago, but that should rise to 2.5% by year end. It'd go even higher than that, but the moratorium on evictions has the government's measure of housing prices – which focuses on rents, not actual prices - artificially low right now.

We have argued that stimulus spending that offsets damage from shutdowns can be viewed as "just compensation" for a "taking." But we are beyond that now. The pandemic is winding down, and economic activity is being boosted by both re-opening and stimulus. What is really happening today is that we are over-stimulating the economy. And while this is great for earnings and equity markets in the near-term, it has long-term risks.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
2-24 / 9:00 am	New Home Sales – Jan	0.855 Mil	**0.905 Mil**		0.842 Mil
2-25 / 7:30 am	Initial Claims – Feb 20	840K	**900K**		861K
7:30 am	Q4 GDP Second Report	4.2%	**4.3%**		4.0%
7:30 am	Q4 GDP Chain Price Index	2.0%	**2.0%**		2.0%
7:30 am	Durable Goods – Dec	+1.0%	**+2.6%**		+0.5%
7:30 am	Durable Goods (Ex-Trans) – Dec	+0.7%	**+0.3%**		+1.1%
2-26 / 7:30 am	Personal Income – Jan	+9.5%	**+9.9%**		+0.6%
7:30 am	Personal Spending – Jan	+2.5%	**+2.4%**		-0.2%
8:45 am	Chicago PMI – Feb	61.0	**61.2**		63.8
9:00 am	U. Mich Consumer Sentiment- Feb	76.5	**78.0**		76.2