First Trust
Monday Morning OUTLOOK

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

630-517-7756 • www.ftportfolios.com December 7, 2020

2021: Robust Growth, Higher Inflation

The COVID-19 Recession is the weirdest we've ever had. There is no way anyone could have forecast it. It did not happen because the Fed was too tight. It did not happen because of a trade war. It was self-inflicted, caused by COVID shutdowns.

And, in spite of a V-shaped bounce off the bottom – 33.1% annualized real growth in Q3, and likely 5%+ growth in Q4 – the economy is still smaller than it was a year ago.

Most big companies have not suffered financial damage, and clearly big tech has allowed much of the economy to operate virtually, but damage to small service industry businesses has been dramatic. What this means is that, while the economy will continue to heal, it will take years to fully recover.

The pace of recovery will depend heavily on renewed shutdowns and the speed of a vaccine rollout. We watch high frequency data, including TSA checkpoint flow-through, OpenTable reservations, rail traffic, and gasoline usage. These weekly, or daily measures turned up in May, signaling a second half recovery. Now, they have leveled out, and in some cases slightly weakened. "Green Shoots" are temporarily going dormant due to large state closures.

This may mean some data weakness in the first quarter of 2021. But don't let that scare you, we do not see a double dip. In fact, we anticipate solid 3.0% real growth for 2021. Three percent growth might not sound great, but it would be the first time growth has reached 3% for any calendar year since 2005.

Nonetheless, any return to complete normalcy (getting the unemployment rate back down to under 4%) will take years. Because of reopening, the first waves of jobs came back fast. From the April peak of 14.7%, unemployment has fallen to 6.7% in November.

And even with our robust forecast of 6.3 million new jobs in 2021, the unemployment rate will still only fall to about 5% by the end of next year. At that rate, total jobs will still be below where they were in February 2020, before shutdowns began.

Part of this recovery has been artificial. Demand has remained robust because the Federal Reserve is monetizing stimulus the government has provided. That stimulus simply borrowed from the future to hold up spending now. This is already leading to imbalances in demand versus supply and, combined with 25% year-over-year growth in the M2, has pushed consumer and producer price indices higher. Too much money chasing too few goods (and services) is a natural recipe for higher inflation.

In terms of interest rates, the Fed is dead set on leaving short-term rates near zero for all of 2021, and we doubt inflation rising modestly above its 2.0% target will change its mind. After all, the Fed has already said it *wants* to see inflation exceed that target for a prolonged period before it raises rates. Higher inflation might get the Fed to start thinking about ending quantitative easing, but lifting short-term rates is an issue for 2022 and beyond, not 2021.

Long-term interest rates, however, should drift higher as investors get more confident about the economic recovery and see higher inflation. Expect the 10-year yield to finish about 1.40% next year. Yields could move even higher, but the low level of short-term rates, the Fed's commitment to keep short-rates low, and investor skepticism about how long higher inflation will last should keep long-term rates from soaring.

One segment of the economy deserves special attention, and that's home building. The US was building too few homes for the past decade before COVID-19, and now the demand for residential real estate is even higher. Expect the surge in construction - and prices for single-family homes - to continue, as people seek more living space and life in places that provide adequate police protection.

In the next several weeks, news headlines may be filled with dire stories. But there is light at the end of the COVID-19 tunnel, and 2021 is likely to be a much better year than 2020.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
12-7 / 2:00 pm	Consumer Credit– Oct	$16.1 Bil	**$16.0 Bil**		$16.2 Bil
12-8 / 7:30 am	Q3 Non-Farm Productivity	+4.9%	**+5.3%**		+4.9%
7:30 am	Q3 Unit Labor Costs	-8.9%	**-7.8%**		-8.9%
12-10 / 7:30 am	Initial Claims – Dec 5	725K	**693K**		712K
7:30 am	CPI – Nov	+0.1%	**+0.2%**		0.0%
7:30 am	"Core" CPI – Nov	+0.1%	**+0.2%**		0.0%
12-11 / 7:30 am	PPI – Nov	+0.1%	**+0.1%**		+0.3%
7:30 am	"Core" PPI – Nov	+0.2%	**+0.2%**		+0.1%
9:00 am	U. Mich Consumer Sentiment- Dec	76.0	**78.0**		76.9