Economy in Focus
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Huntington PRIVATE BANK

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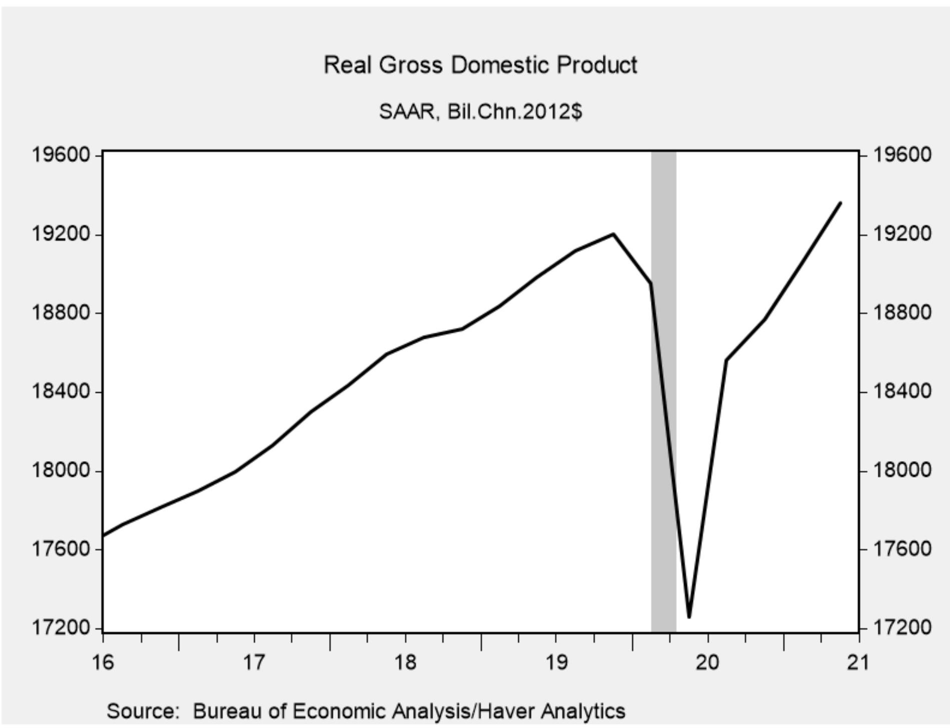
# The Economic Outlook

## The Economy Continues to Recover from COVID-19

The economic forecast encompasses the continuation of strong recovery from the COVID-19 downturn with broadening growth in GDP and labor markets. Inflation will likely remain high in 2021 before moderating in 2022 as supply constraints gradually ease, although long-term inflation risks have likely increased. The Federal Reserve is forecasted to begin to taper (reduce) its government bond purchases (QE) in the fourth quarter 2021 and begin to raise the policy Fed Funds rate target gradually in the second half of 2022. **The U.S. dollar should perform well relative to foreign currencies in 2021 as the United States is generally recovering faster than the world economy.** However, the dollar is expected to weaken relative to its trading partners next year as the economic recovery abroad takes firm hold.

**As has generally been the case during the COVID-19 pandemic period, forecast risks are unusually high, especially with regards to uncertainty in monetary and fiscal policies**. For the full forecast, please see the Summary Forecast Table at the end of this report.

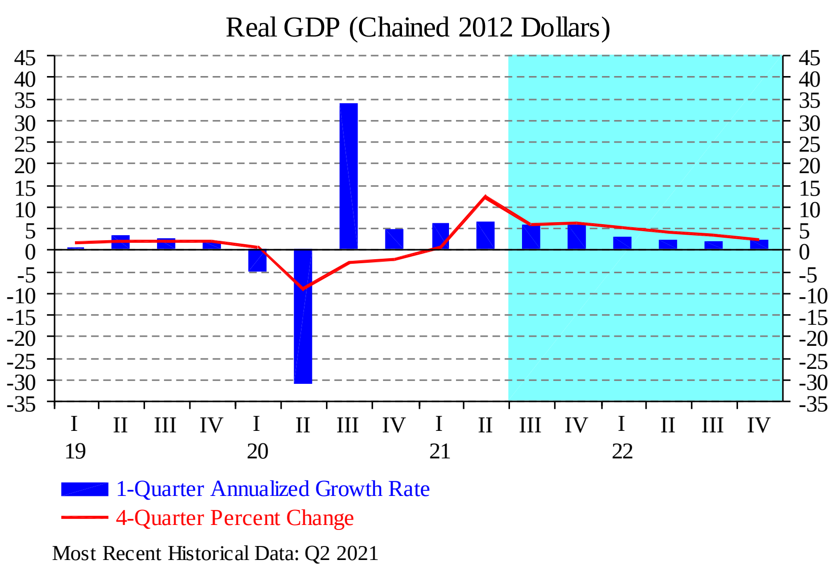
### United States Real GDP Recovers to its Pre-COVID-19 Level in the Second Quarter



We highlight recent economic performance and our forecasts for 2021 and 2022:

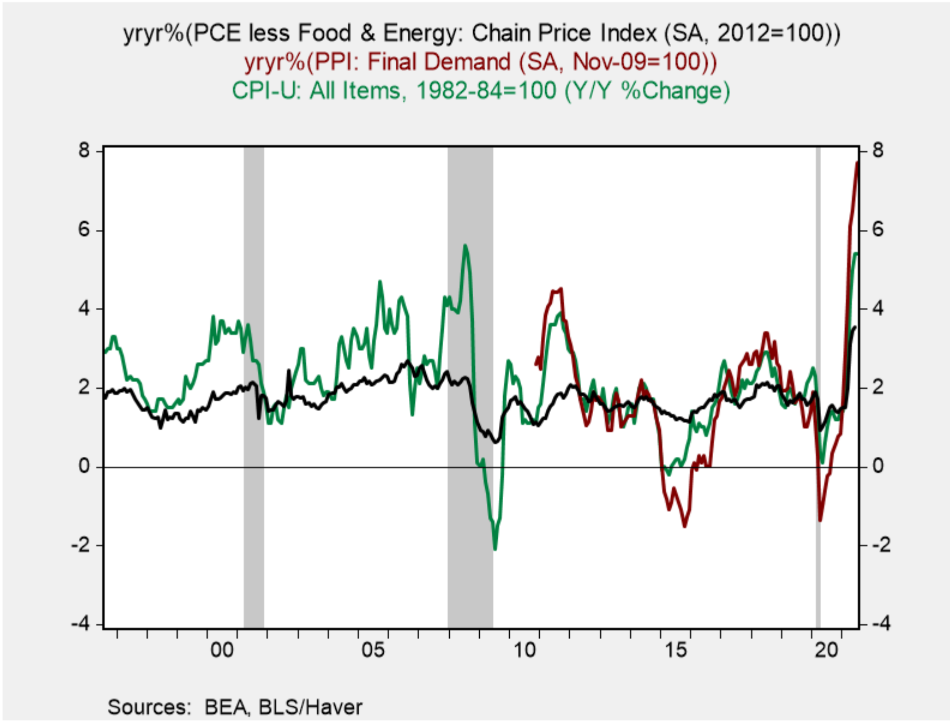
- Growing at a 6.5% annualized rated in the second quarter, real GDP surpassed pre-COVID-19 levels and reached a new high. Excluding a sharp decline in private inventories from GDP during the quarter, final sales of domestic product rose at a 7.7% annualized rate. Solid growth is expected to continue in the second half of the year, with inventory replenishment adding further to growth. Average annual real GDP is forecasted to grow 6.0% overall in 2021 and 3.7% in 2022. **As the economy approaches full employment in early 2022, GDP growth rates are forecasted to slow significantly.** Quarterly GDP growth rates are projected to approach long-term potential growth rates of 2.0% in the second half of 2022. (Please see the chart below.)
- Total non-farm payrolls grew 943,000 in July for the strongest employment growth since August 2020. The unemployment rate declined from 5.9% in June to 5.4% in July. Employment recoveries from COVID-19 were large in the Leisure and Hospitality sector, Local Government Education, and Professional & Business Services. Solid employment growth is expected to continue for the remainder of 2021, bringing the unemployment rate down to 4.5% at year-end. **The unemployment rate is forecasted to stabilize around 4.5% in 2022 as labor force participation rises and economic growth slows.**
- Real Consumption grew at a blistering 11.8% pace in the second quarter after 11.4% annualized growth in the first quarter. Total Consumption achieved a record high during the second quarter, rising 3.1% from the fourth quarter of 2019, the last full quarter before the COVID-19 downturn began. A 17.6% increase in the Consumption of Goods more than offset a -3.3% decline in the Consumption of Services during the period. However**, for the first time during the COVID-19 pandemic, the growth rate in Services Consumption at 12.1% exceeded the growth rate in Goods Consumption at 11.6%.** In the second half of 2021, Consumption of Services is expected to continue to grow faster than Goods Consumption and recover fully to pre-COVID-19 levels by the end of the year. The overall real Consumption forecast is 8.3% in 2021 and 3.8% in 2022.

## GDP Growth is Forecasted to Slow in 2021 as the Economy Attains Full Employment

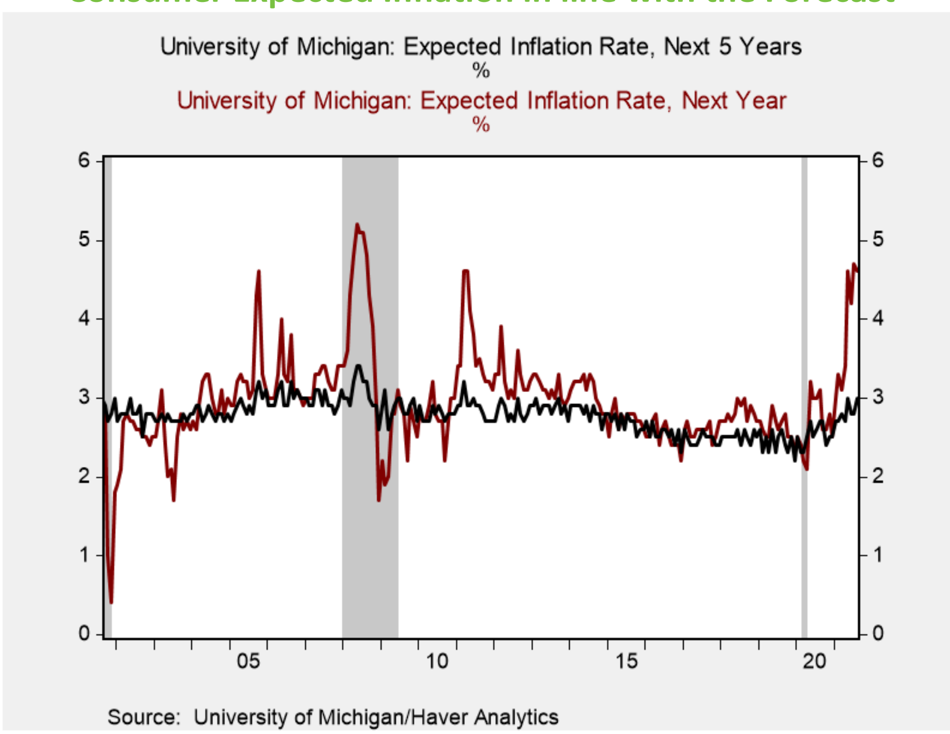


- **GDP in the areas most impacted by the COVID-19 related shutdowns of 2020 performed the best during the second quarter.** Food Services and Accommodations rose at a 67.7% annualized rate in the second quarter, following 32.9% in the first quarter. Recreation rose at an annualized rate of 42.8%, following 27.8% in the first quarter. Transportation rose at an annualized rate of 37.6%, following 5.4% in the first quarter. The high social contact industries will add thousands of jobs in the months ahead.
- Non-residential Fixed Investment rose at an 8.0% annualized rate in the second quarter, following 12.9% annualized growth in the first quarter. Led by industrial and transportation related equipment, Equipment investment exhibited the fourth consecutive quarter of double-digit annualized growth, rising 13.0% in the second quarter following 14.1% annualized growth in the first quarter. Intellectual Property investment rose at a 10.7% annualized rate, following 15.6% in the first quarter. The only weak area of Fixed Non-residential Investment was Structures, down at a -6.9% annualized rate following 5.4% annualized growth in the first quarter**. Business capital investment is expected to remain on a solid upward growth path as businesses counter supply constraints with productivity-enhancing capital spending.** The Non-residential Fixed investment forecast is 5.2% growth in 2022 with the potential for upside surprises. This follows 8.1% expected growth in 2021.
- **Impacted by supply constraints and inflation, residential investment rose at a 3.3% annualized rate in the second quarter**, slowing from 27.3% annualized growth in the first quarter. Residential investment in new structures is expected to continue a moderating trend, rising 3.7% in 2022 after increasing 11.4% in 2021. Jobs and income growth in the economy are expected to strengthen in the coming year, offsetting the negative impacts on demand from higher expected mortgage rates and higher housing prices.
- **Exports and Imports have been highly impacted by rising inflation.** Nominal exports rose at a 26.7% annualized rate in the second quarter, following 17.5% in the first quarter. After adjusting for inflation, exports rose at a 6.0% annualized rate in the second quarter, following a -2.9% annualized rate of decline in the first quarter. Imports similarly rose at 7.8% annualized rate in the second quarter following 9.3% in the first quarter, well below respective nominal growth rates of 22.3% and 23.8%. Although the world is still struggling with the COVID-19 pandemic, international trade is expected to continue a synchronized recovery from the widespread shutdowns of the last year. **Exports are forecasted to accelerate from 5.0% in 2021 to 6.5% in 2022, but upside potential resulting from a strong global economic recovery is significant in 2022.**
- Given the massive stimulus programs in the first half of 2021, it may be surprising that government purchases from the private sector rose by only a 4.2% annualized rate in the second quarter, following -1.5% in the first quarter. **Trillions in stimulus payments to individuals were recorded as Current Personal Transfer Receipts, and therefore did not enter directly into GDP accounting. Notwithstanding recent statistics, government spending on infrastructure and other programs is expected to rise in 2022 over 2021.**
- **Economic growth was high during the second quarter, but so was inflation**. The GDP price index rose at a 6.0% annualized rate in the second quarter reflecting broad-based inflation in the economy. The Consumer Price Index for urban consumers rose at an 8.4% annualized rate during the second quarter. The Producer Price Index rose at a 9.4% annualized rate. Inflation is expected to gradually slow from second quarter highs but remain high compared to recent decades. **Annual inflation as measured by the CPI is forecasted to ease from 4.0% in 2021 to 3.5% in 2022, but inflation forecast risks to the upside.**

## Highest Inflation in Decades



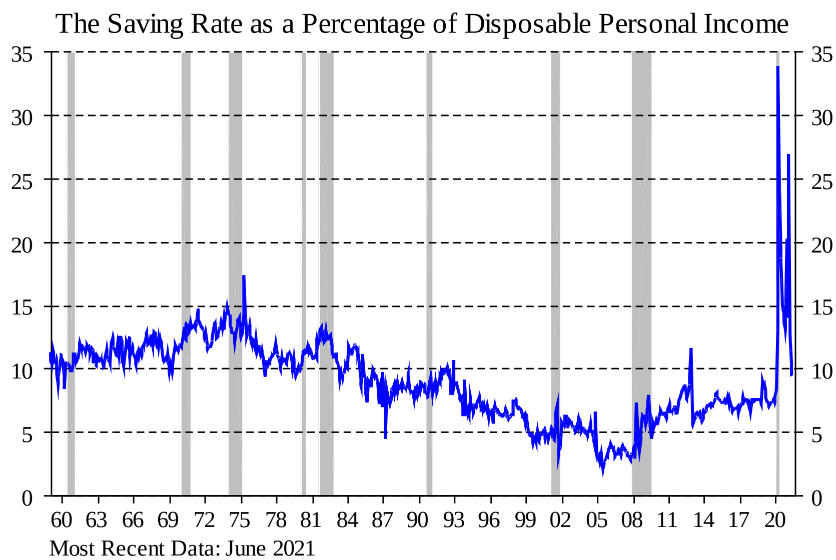

## Consumer Expected Inflation in line with the Forecast



## Consumer Financial Fundamentals Remain Strong

The Delta variant of COVID-19 and the highest inflation in decades are creating new headwinds to the economic recovery that began in the second quarter of 2020. These headwinds may slow the pace of economic recovery but are not expected to forestall it. **The state of the consumer remains the most important determinant of economic growth in the United States, a reality that has not changed throughout numerous business cycles in our nation during modern times. In this regard, the average consumer in the United States today is the strongest financially in decades, as indicated in the following review of average household balance sheets in the United States.** The financial conditions of any given consumer may differ significantly from the aggregate trends in the following. Dispersion in financial conditions among consumers has generally increased in recent decades. However, strong overall financial conditions indicate solid consumer spending in the year to come, even as consumers, and businesses that depend on consumers, continue to grapple with COVID-19 and elevated inflation.

### Personal Savings has been boosted strongly by Stimulus Payments and COVID-19 related reductions in spending

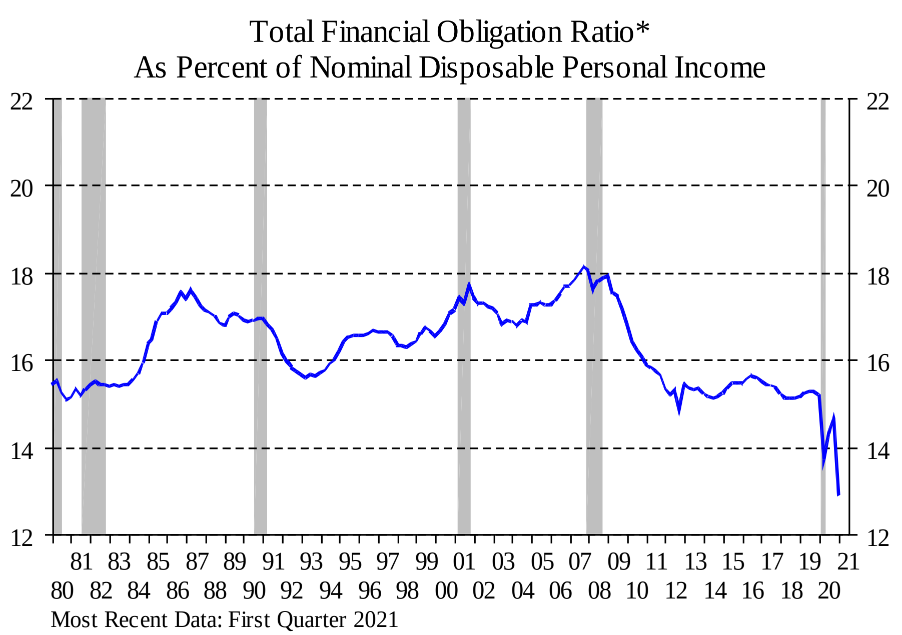



Benefitting from the longest economic expansion in United States history and the lowest unemployment rate since the fourth quarter of 1969 at 3.5%, consumers entered the COVID-19 downturn in generally strong financial condition. Employment losses were severe during a relatively short period in March and April of 2020. However, a V-like recovery commencing in the subsequent months, supported by historically high levels of policy support from the initial CARES Act, the supplementary CARES Act II and most recently the ARP, have strongly increased disposable personal incomes. These increases in disposable incomes have served to bolster not only consumer spending growth, but also personal savings growth and debt repayment. In addition to direct stimulus payments from the Federal government, consumers generally reduced consumption of services during the COVID-19 closures, thereby providing another source of funds for personal savings growth and debt repayment. Although increased savings and debt repayment do not immediately increase spending in the economy, **higher personal savings and lower debt ultimately improve the state of consumer finances, thereby creating a lasting source of consumer spending power.**

An important measure of consumer financial health is the Household Financial Obligations Ratio, provided by the Federal Reserve. The Household Financial Obligations Ratio encompasses not only quarterly mortgage and consumer debt services, but also automobile lease payments, rents on residential property, homeowner property insurance and tax payments. Hence, it represents a highly comprehensive measure of ongoing household obligations.

Reflecting the improvement in consumer finances, **the Household Financial Obligations ratio fell to 12.88% of nominal disposable personal income in the first quarter 2021 - the lowest on record.** In comparison, the ratio stood at 15.28% in the fourth quarter of 2019, the last complete quarter before the COVID-19 recession. Consumers reduced debt service sharply during the COVID-19 period spanning Q1 2020 to Q1 2021, as Consumer debt service payments declined to their lowest relative to disposable personal income since the early 1990s. Mortgage debt service payments relative to disposable personal income declined to a record low. The lowest financial obligations on record reflects plentiful capacity for increased spending by the average household in the nation.

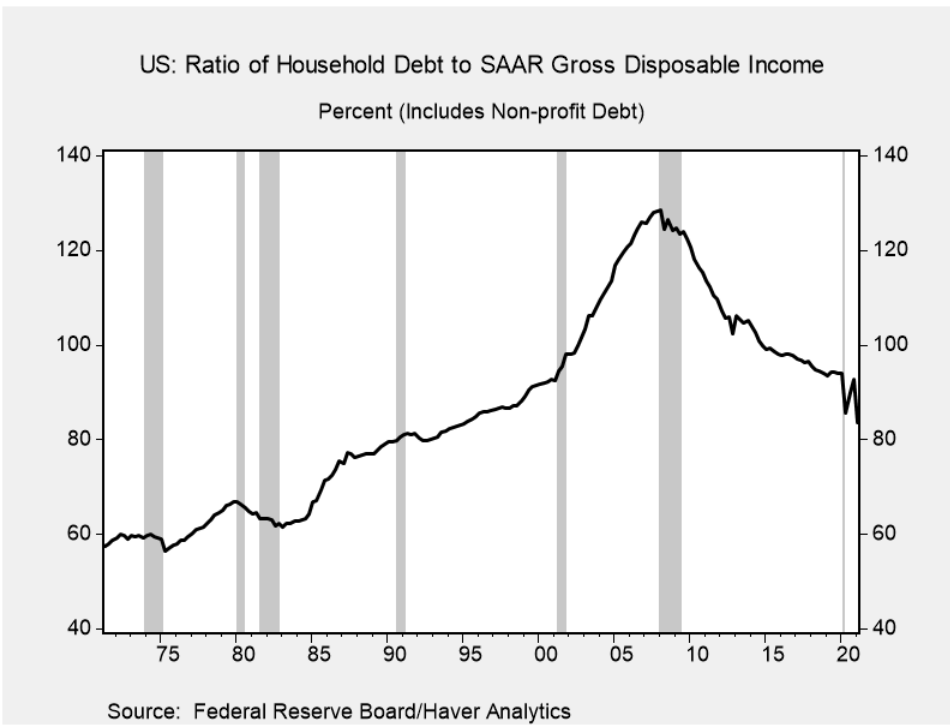
## Household Financial Obligations Ratio was at Record Low in Q1 2021




**Financial Obligations Ratio (FOR) is an estimate of the ratio of financial obligations payments to disposable personal income. It's a broader measure than the debt service ratio and includes automobile lease payments, rental payments on tenant-occupied property, homeowners' insurance and property tax payments.*

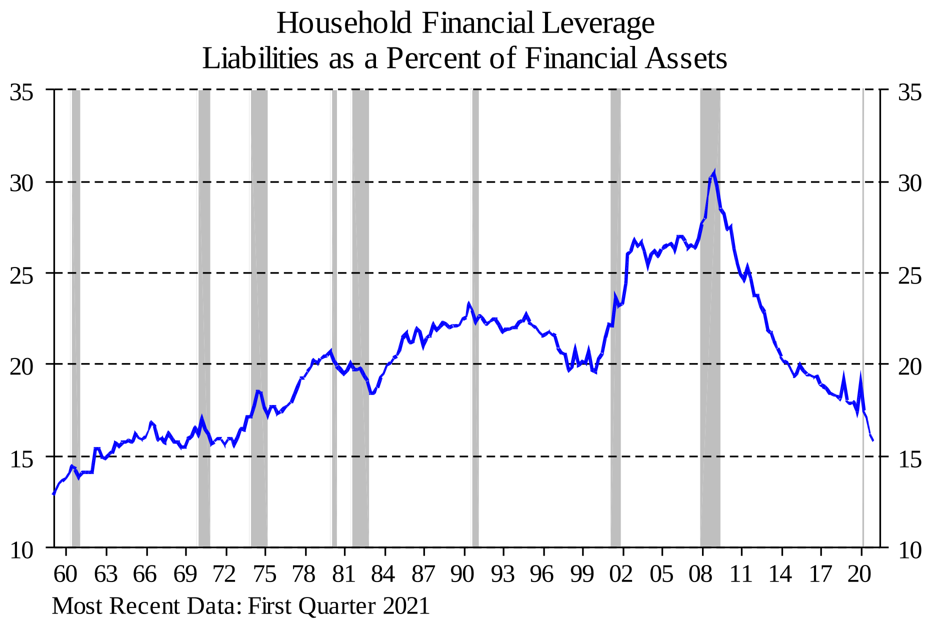
The Household Financial Obligations ratio will likely rise somewhat in the coming quarters as Federal stimulus payments decline. Record low interest rates will also begin to rise as the economic recovery gains traction. Despite these factors, debt levels have been significantly paid down in the last year, resulting in a lasting reduction in overall household financial obligations. Total Household Debt relative to Gross Disposable Income during the first quarter of 2021 was at its lowest level since the first quarter of 1995. (Please see the chart below). Anticipated increases in earnings and employment in the second half of 2021 and in 2022 are also expected to replace the temporary federal stimulus payments as they expire.

## Total Household Debt at Lowest Level relative to Gross Disposable Income since Q1 1995




While disposable personal income is a useful measure of consumer debt carrying capacity, it is not the only measure. The Household Financial Leverage ratio is the ratio of total financial obligations to total financial assets. It measures total debt relative to total financial asset wealth from stocks, bonds and other financial assets. (The Household Financial Leverage ratio does not include real estate.) **This ratio of debt-carrying capacity is at 15.7% in the first quarter of 2021, its lowest since the fourth quarter of 1972**. (Please see the chart below). The ratio has generally remained on a strong declining trend since the Great Recession of December 2007 – June 2009. **The average consumer has plentiful capacity to increase spending in the coming year, and potentially in the coming years, depending on the sustained strength of financial markets.**

## Household Financial Leverage Ratio: Lowest since Q4 1972



Forecast Summary Table

Key Economic Indicators

August 24, 2021

| | 2019 | 2020 | 2021* | 2022* |
|---|---|---|---|---|
| Total Real GDP Annual Growth Rates<br>2012 Chained Dollars | 2.3% | -3.4% | 6.0% | 3.7% |
| | | | | |
| Consumption | 2.2% | -3.8% | 8.3% | 3.8% |
| Non-Residential Fixed Investment | 4.4% | -5.4% | 8.1% | 5.2% |
| Residential Fixed Investment | -0.9% | 6.8% | 11.4% | 3.7% |
| Exports | -0.1% | -13.6% | 5.0% | 6.5% |
| Imports | 1.2% | -8.9% | 13.7% | 7.0% |
| Government Purchases | 2.2% | 2.5% | 1.8% | 4.1% |
| Change in Private Inventories<br>(Billions 2012 Chained Dollars) | $75.2 | $-42.3 | -$33.6 | $27.5 |
| | | | | |
| Nominal GDP<br>Current dollars | 4.1% | -2.2% | 9.8% | 7.1% |
| | | | | |
| Consumer Price Index for Urban Consumers<br>(CPI-U) – Average Annual Rate | 1.8% | 1.2% | 4.0% | 3.5% |
| | | | | |
| Federal Funds Rate Target<br>Year-end range | 1.50% to 1.75% | 0.00% to 0.25% | 0.00% to 0.25% | 0.50% to 0.75% |
| | | | | |
| 10-year Treasury Note<br>Year-end interest rate yield | 1.92% | 0.93% | 1.8% | 2.7% |
| | | | | |
| National Income Pre-tax Corporate Profits<br>Average annual growth rate | 2.7% | -5.2% | 16.1% | 4.5% |
| | | | | |
| Net New Average Monthly Non-Farm Payrolls<br>(Thousands of Workers) | 178K | -785K | +600K | +150K |
| Unemployment Rate – Year End | 3.6% | 6.7% | 4.5% | 4.4% |
| | | | | |
| Trade-Weighted Dollar Index (Jan. 2006 = 100)<br>Year-End Source: Federal Reserve | 114.67 | 111.56 | 111.0 | 107.0 |

- Historical Data Sources: Haver Analytics, Federal Reserve, Factset Inc., and other sources noted in text.

* Forecasts: Huntington Investment Management of the Private Bank, Division of Huntington National Bank

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