2021 Economic Outlook

The forecasts, estimates below are a summary of 2021 outlooks from Barron's, Wall Street Journal (WSJ), Fortune, BusinessWeek, Charles Schwab, Merrill Lynch, podcasts from several prominent investment firms, analysts, and my analysis of economic, business, and investment trends. Some of the forecasts below are from WSJ surveys of over 60 economists from Wall Street, academia, and corporate America. Predicting the future is extremely difficult if not impossible. It is helpful to follow these forecasts to determine are they improving, stabilizing, or contracting. The ongoing forecasts, trends are what is important to follow and is why I do Quarterly Economic Updates and monthly market outlooks.

Many economists and analysts agree that for the U.S. and global economy to have a full recovery, we must solve the pandemic, health crisis. We start this outlook with a focus on the pandemic, especially in the U.S.

COVID 19 & Vaccines

The good news, we have several vaccines and therapies that have been approved and more to come, thanks to Operation Warp Speed. The rollout of getting people vaccinated has been challenging with many issues rising, but it seems like many of these issues are being resolved.

Here are some recent data regarding covid:

The Latest Numbers

42,417,617 vaccine doses given so far in the U.S.

89,727 new U.S. cases recorded yesterday

1,596 deaths in the U.S. recorded yesterday

80,055 people currently hospitalized in the U.S.

465,083 total U.S. deaths

27,097,346 total confirmed cases in the U.S.

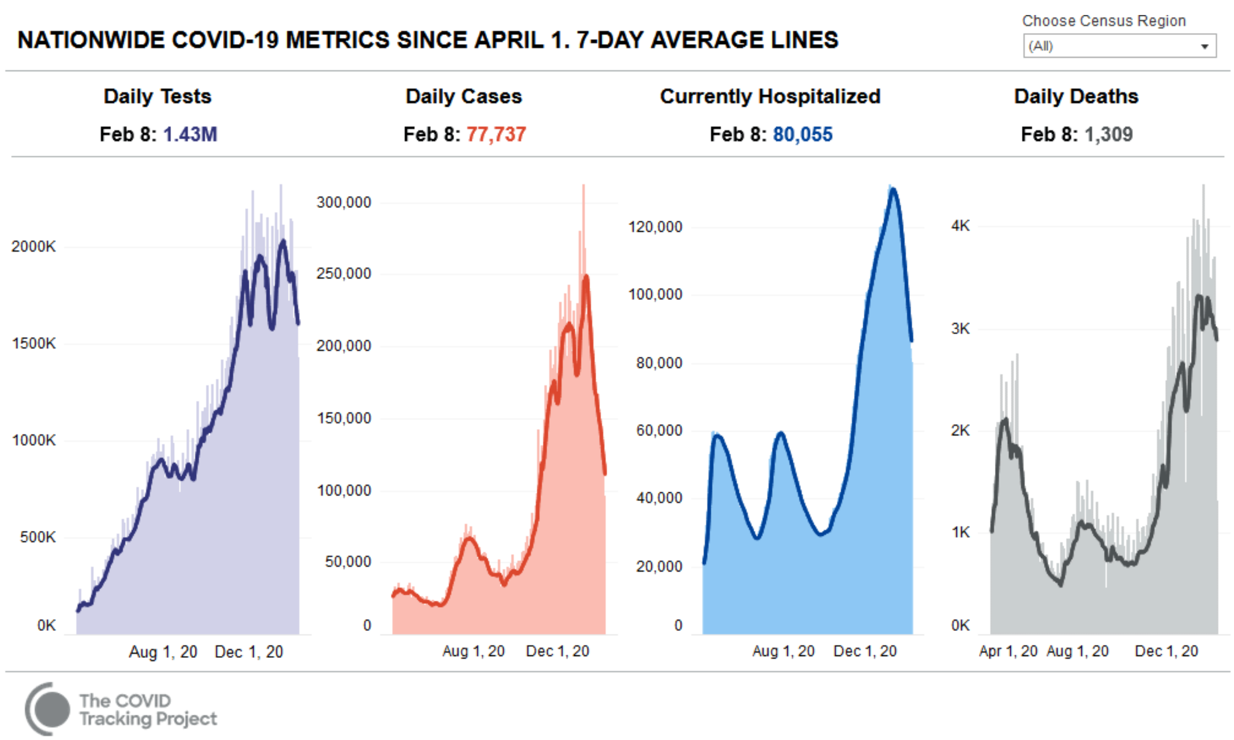
106,533,071 confirmed cases world-wide, and 2,327,231 deaths

Sources: Johns Hopkins University as of 6:30 a.m. ET; Hospitalization figures from the Covid Tracking Project as of yesterday; Vaccination figures from the Centers for Disease Control and Prevention.

It's awful that almost 500,000 people have died due to covid. According to health experts, we need about 70% of the population to have antibodies, proteins against the virus to achieve herd immunity.

With a population of about 330 million that would be about 231 million people who need to get vaccinated/ get the virus and recover (it's not certain if and how long a person will be immune from being infected). According to the information above, about 27 million citizens have gotten the virus and so far 42 million people have been vaccinated for a total of about 70 million, about 30% of what is needed to achieve herd immunity. Health experts are forecasting that we may achieve herd immunity by the summer at the earliest.

We are seeing significant progress in turning around the surge that occurred late last year and part of January as the charts below evinces:



Most of the trends above have reversed dramatically. Unfortunately, deaths have not reversed as much as other trends, but deaths normally lag and then follow the overall trends. We can see a light at the end of the tunnel.

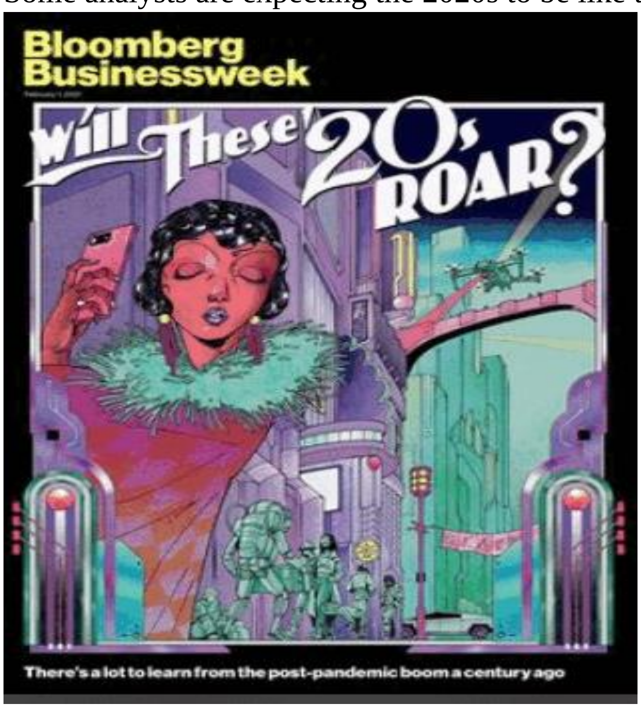
Experts are concerned about: 1. Variants of the virus have shown up in South Africa, Britain, and Brazil. These variants are causing the virus to spread faster. It is not known at this time if the variants are more deadly. So far studies show that the current vaccines are effective against these new variants.

2. Health experts believe that herd immunity for the world would probably not occur until 2022, especially in poorer countries that can't afford the vaccines and the infrastructure to vaccinate. This could cause delays in U.S. herd immunity because the world is mobile (air, boat, and land travel). Variants are showing up in certain cities in the U.S.

It's expected that science will continue to help us out of the global health crisis. For example, U.K. scientists are using artificial intelligence to try to predict what future mutations may look like.

GDP

Some analysts are expecting the 2020s to be like the Roaring 20s 100 years ago.

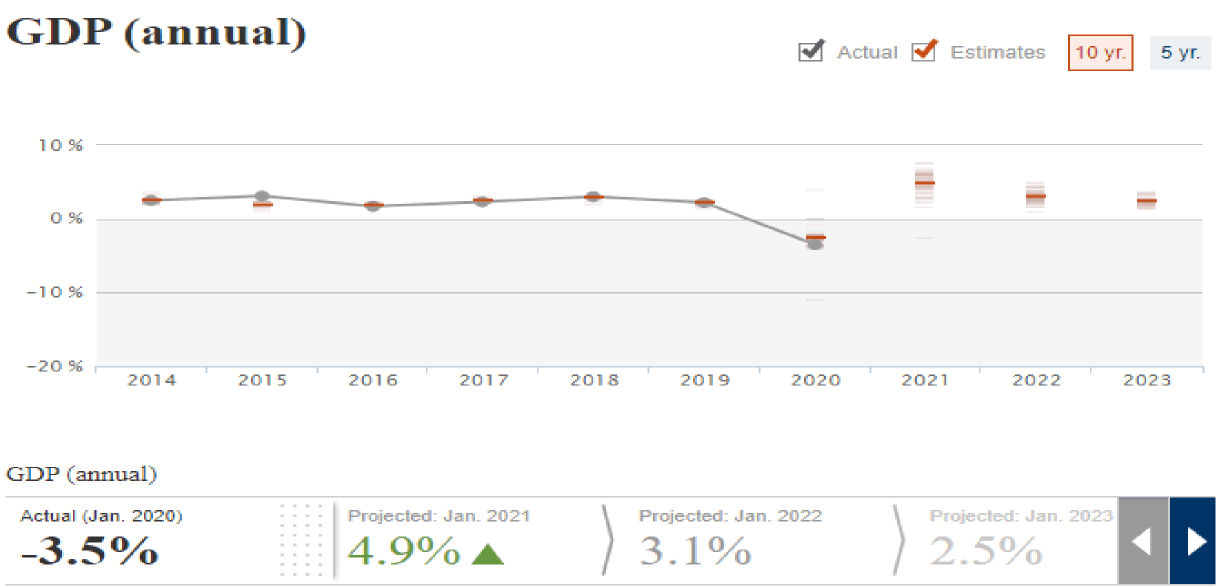


According to the above article, that economy benefited from electrification and the internal combustion engine creating much higher productivity and prosperity for the country in the 1920s.

The first digital revolution of the late 1990s, early 2000s included faster cheaper software and hardware and the development and acceptance of the internet and web browsers. These innovations changed the world and how we worked, entertained, learned, shopped, and even invested and created more prosperity and higher productivity. Some analysts claim were going through a second technology revolution with the cloud, smartphones, and social media, but they won't have the same effect on productivity as the Roaring 20s and the first technology revolution. Both Businessweek and I agree that this decade will probably not be a Roaring 20s.2.

Besides not having major innovations to increase productivity our economy is much larger. Real GDP, adjusted to inflation was about $900 billion in 1925. Today our economy is close to $20 trillion. It is much harder to move the economy of a $20 trillion economy versus one that is about $1 trillion, the law of large numbers.

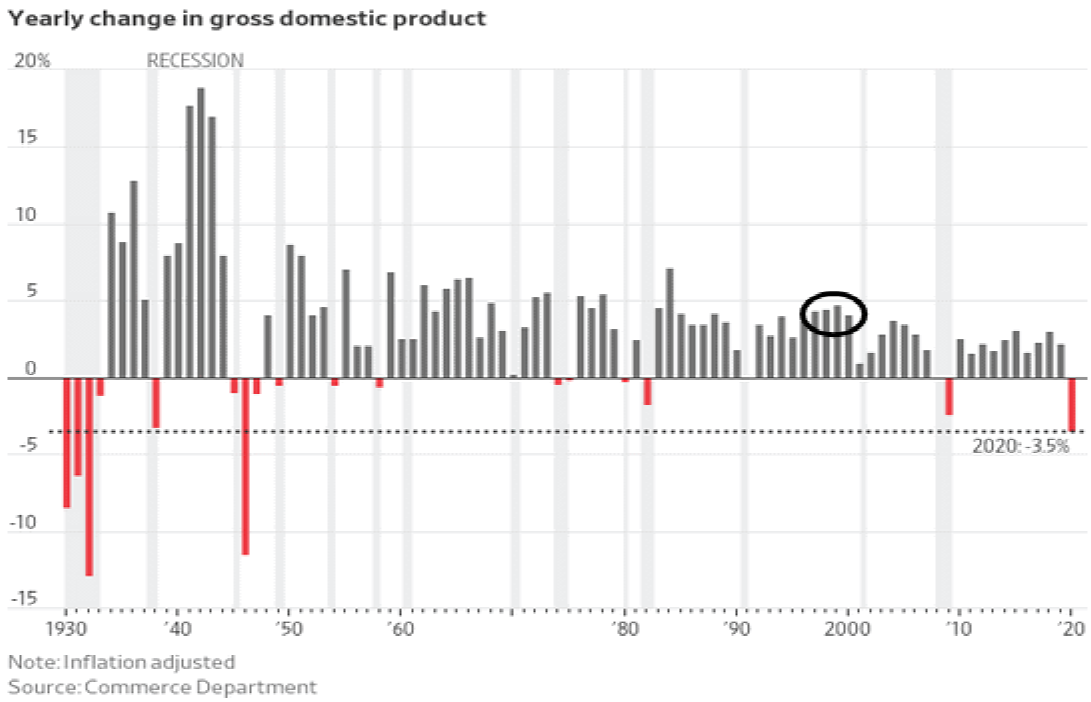
Below is the trend for our GDP:



Source: WSJ

The historical average for U.S. GDP growth is about 3%. This has slowed to about 2% for about the last 15 years, the 'new normal'. I've written about the new normal, [click here](#) to read about it. The economy contracted 3.5% in 2020. The WSJ survey of economists forecasts GDP growth for 2021 to be about 4.9%. Because last year was so bad, it will be easy to beat last year's economic and earnings performance, and economists, analysts are forecasting a much better 2021, especially if covid is defeated. In the following years, as the chart shows the economy slows as comparisons won't be so easy.

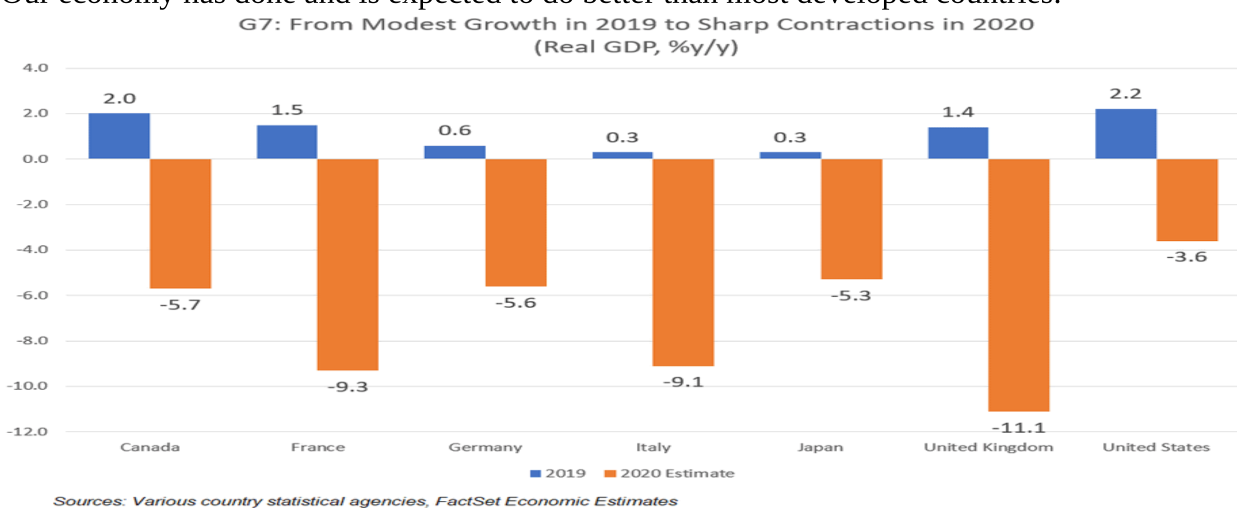
This could be the strongest growth since the late 1990s as the chart below shows:



Let's review this graph:

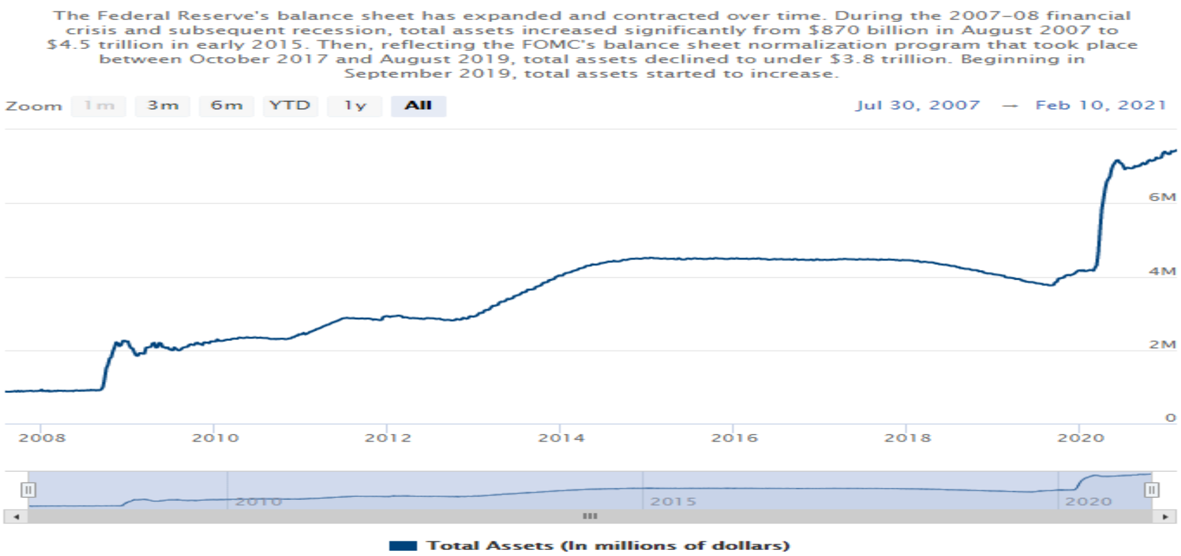
- The shaded areas are recessions
- GDP growth contracted in 2020 to -3.5%
- Growth is expected to climb to about 4.9%. The last time growth was this strong was the late 1990s, circled years, growth.
- One of the reasons why growth slows over time is the law of large numbers. As the economy grows larger, growth comparisons slow.

Our economy has done and is expected to do better than most developed countries:



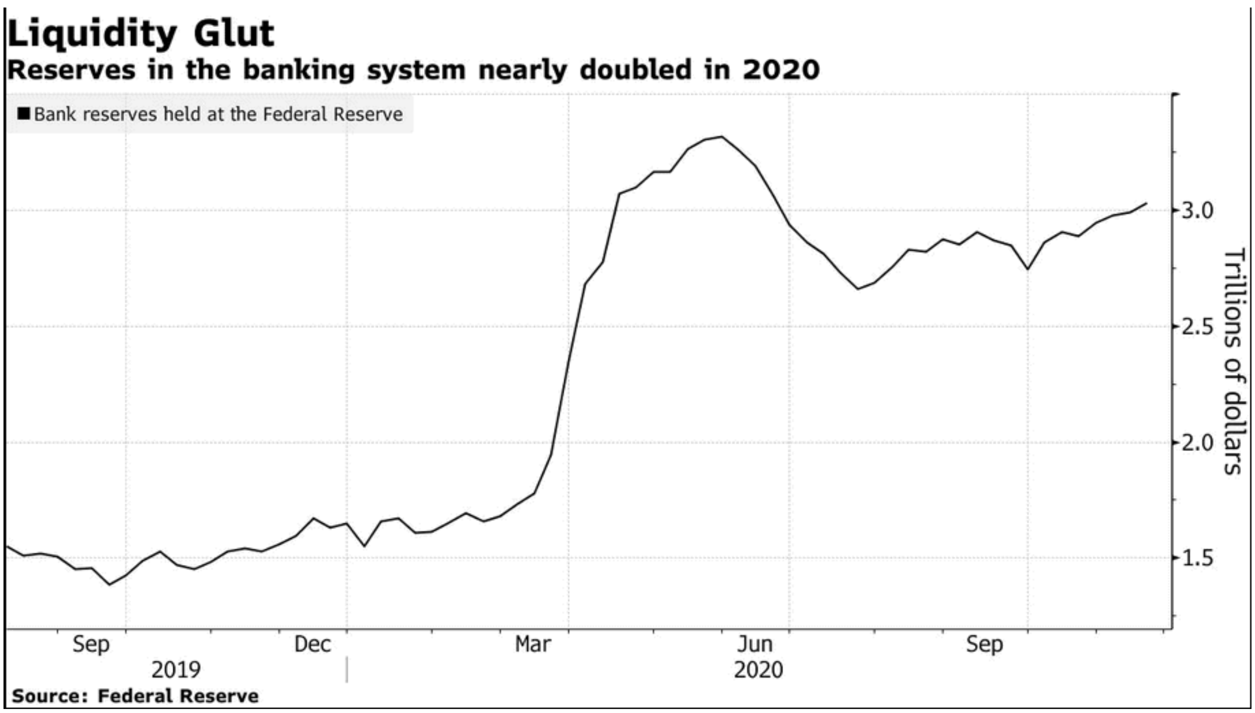
When the economy was growing in 2019, the U.S. had the highest growth. Last year, 2020, we were in a global recession. The U.S. had the lowest contraction.

There are two main reasons why our economy performed better than other developed nations:
1. Massive liquidity provided by the Fed. The Fed's balance sheet has grown from about $4 trillion to about $7.4 trillion



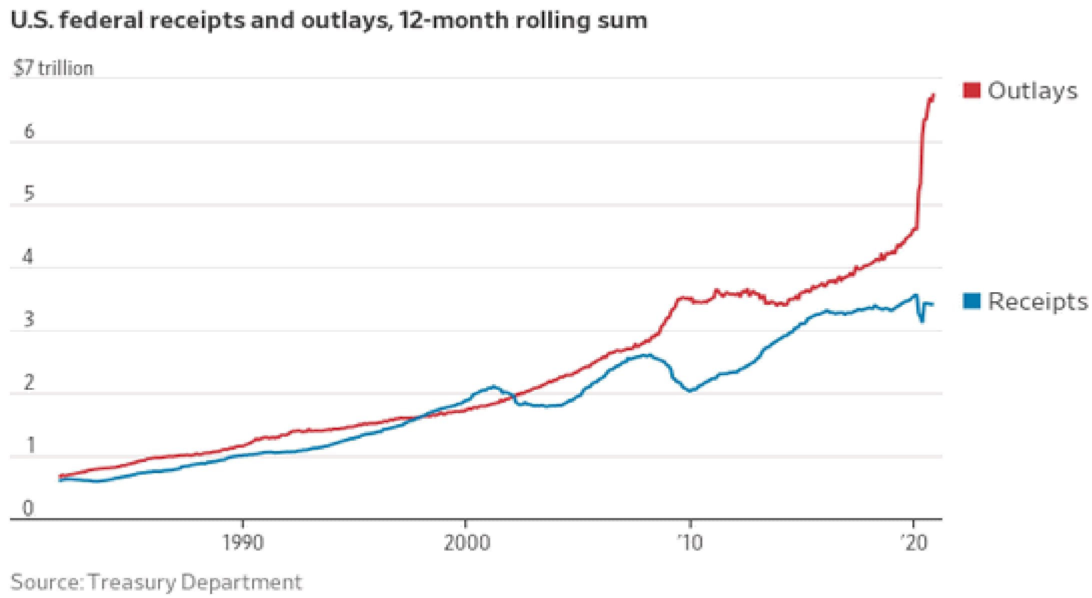
Source: U.S. Federal Reserve

2. Lawmakers have passed massive aid and support to workers and businesses. There is still high liquidity in our banking system. If you need a loan you can probably get it.



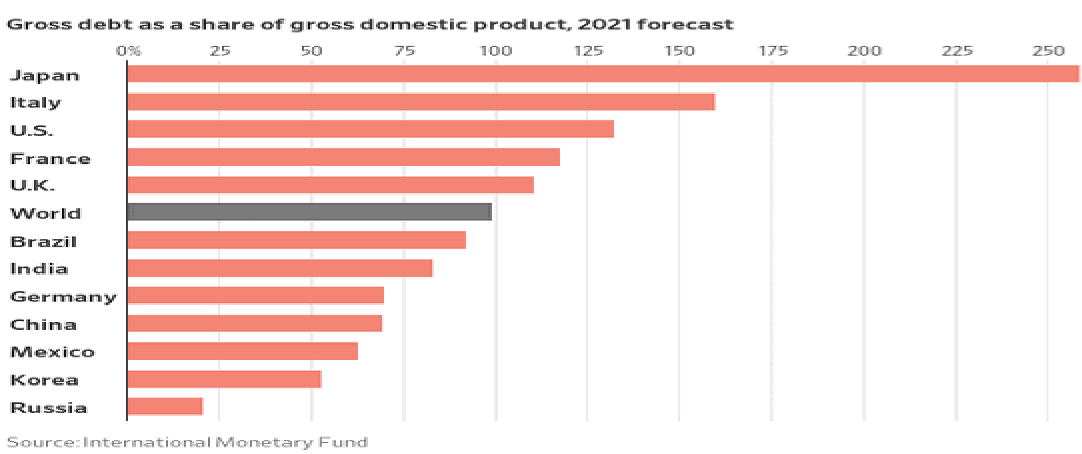
Most recessions have a liquidity and credit crunch, making getting a loan difficult. The banking system has plenty of cash, liquidity to make loans. We remain in a recession but avoiding the normal credit crunch has been greatly reduced.

A headwind going forward is the dramatic increase in our national deficit, close to $4tillion. Notice in the chart below, for decades, outlays (spending) and receipts (taxes) were not far apart. They increased in the Great Recession and now in the global health crisis. Also notice that there was a surplus in the late 1990s, early 2000s.



U.S. Government spending has exploded to almost $7 trillion, but taxes, receipts have essentially stalled at about $3.5 trillion because of the tax cuts that took effect in 2018. This means a huge deficit of over $3 trillion.

These deficits have to be financed by debt, the same as a household that spends more than it makes. The difference is, the Federal Reserve can create money out of thin air that can create liquidity to make sure we don't have a liquidity and credit crunch. We are now one of the worst debtor nations as the chart below shows.

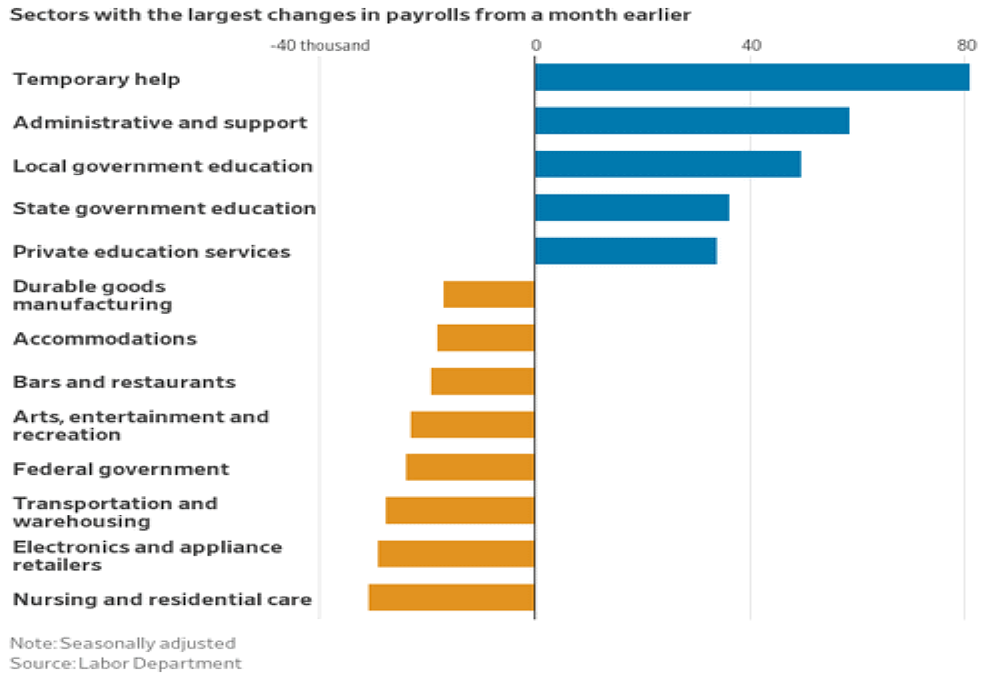


Japan and Italy are the only developed nations that have more debt. We are above the global average.

Servicing debt and interest payments takes away from investing in other areas of the economy like cyber-security, badly needed infrastructure and repairs, education, and training (an investment that could lead to better family incomes and tax receipts).

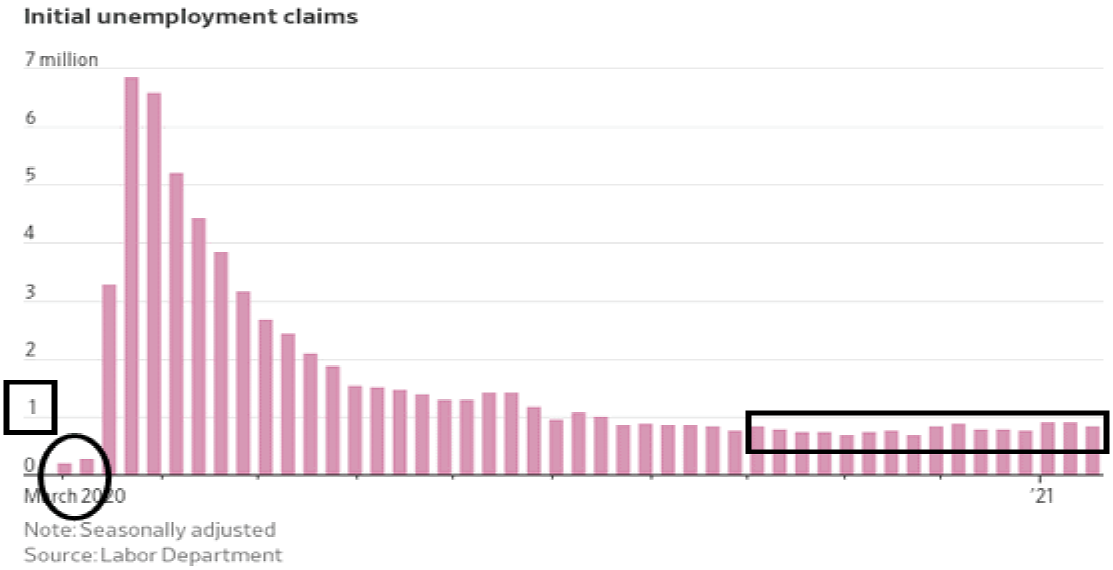
Employment

The employment picture is an example of how our economy looks like a K (certain parts of the economy are doing fine, others are struggling) as the chart below corroborates:



Unfortunately, many of the new jobs being created are temporary. This probably means employers are not confident yet in the economy to hire full-time employees and is not a good sign. As expected, bars, restaurants, hotels, arts and entertainment, brick and mortar retailers continue to suffer job losses. Nursing and residential care are losing lots of jobs. The industry is finding it hard to fill positions and parents, relatives are pulling their older parents/relatives out of nursing homes because of the high death rates. Many of these homes do not allow visitors as a precaution and relatives, friends don’t like this and is another reason why the nursing home industry is losing jobs.

In a normal economy, unemployment claims are rarely above 500,000 as the first two data points in the chart below show. Since the pandemic unemployment claims have exploded.



Again, when the economy is growing, claims rarely are above 500,00. Claims climbed to close to 7 million a year ago. Once claims peaked they began declining, but were still high. Unemployment claims rose again with the surge of infections during the summer and this winter.

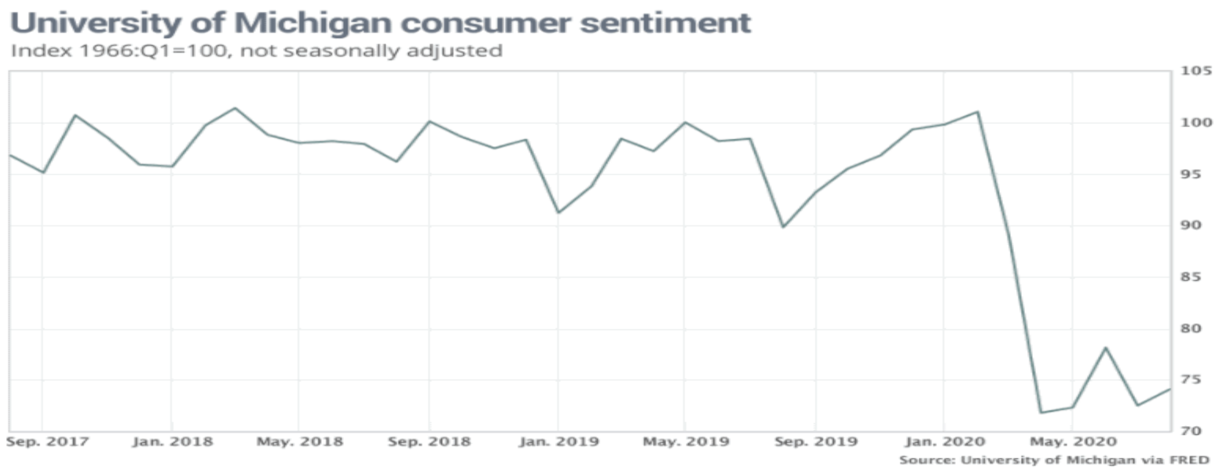
High unemployment will continue to be a challenge for this economy, especially for the parts of the economy mentioned above that are struggling. Small businesses are major employers and the closing of many of these businesses, especially restaurants and retail, are the main challenges.

The unemployment picture does highlight a major problem not only for the U.S. but the rest of the world, the difference between the haves and have nots. For the U.S. the solution can be better education and training for our workers including helping workers move to areas of the country that are hiring and doing better. The other problem we have is the high cost of housing, autos, childcare, education… The high cost of living is a much tougher challenge. I write more about this in the Inflation & Interest Rates section below.

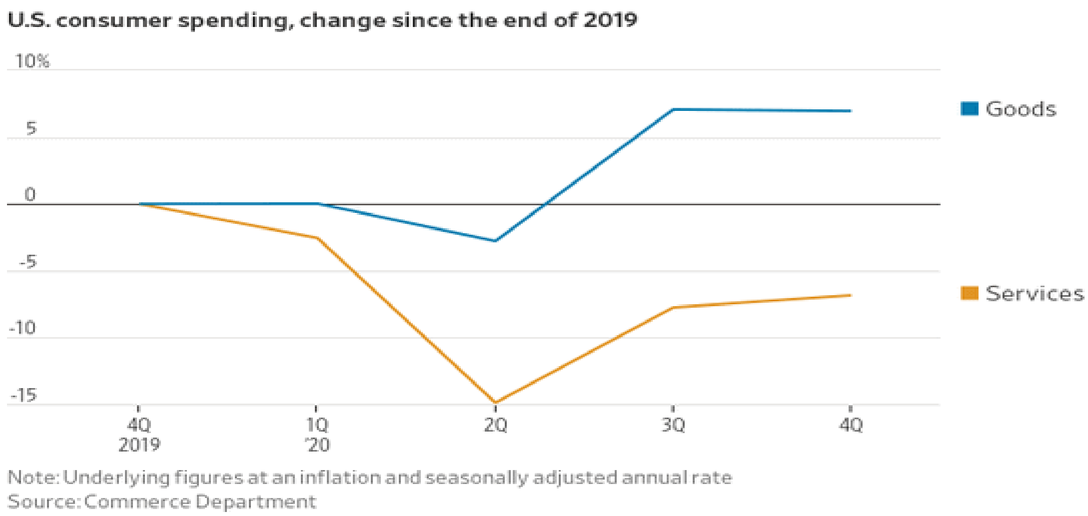
Recently Treasury Secretary Janet Yellen said if the U.S. Congress passes Biden's proposed aid/support package we could get to full employment, below 4% by next year. She also said that without a relief package, it could take until 2025 for unemployment to achieve full employment.

The Consumer

Consumer sentiment has taken a hit due to the pandemic. We will monitor to see if, when, and how much it will improve. The consumer is about 70% of our economy.

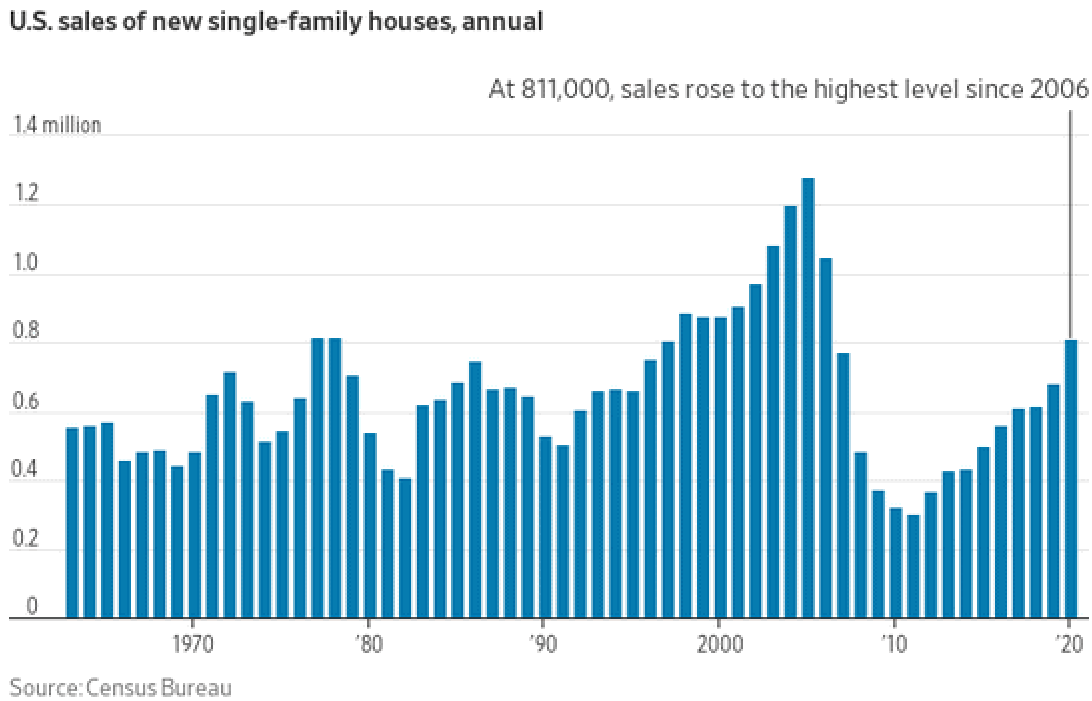


Certain workers, citizens are doing fine and are buying goods, homes, and autos/trucks.

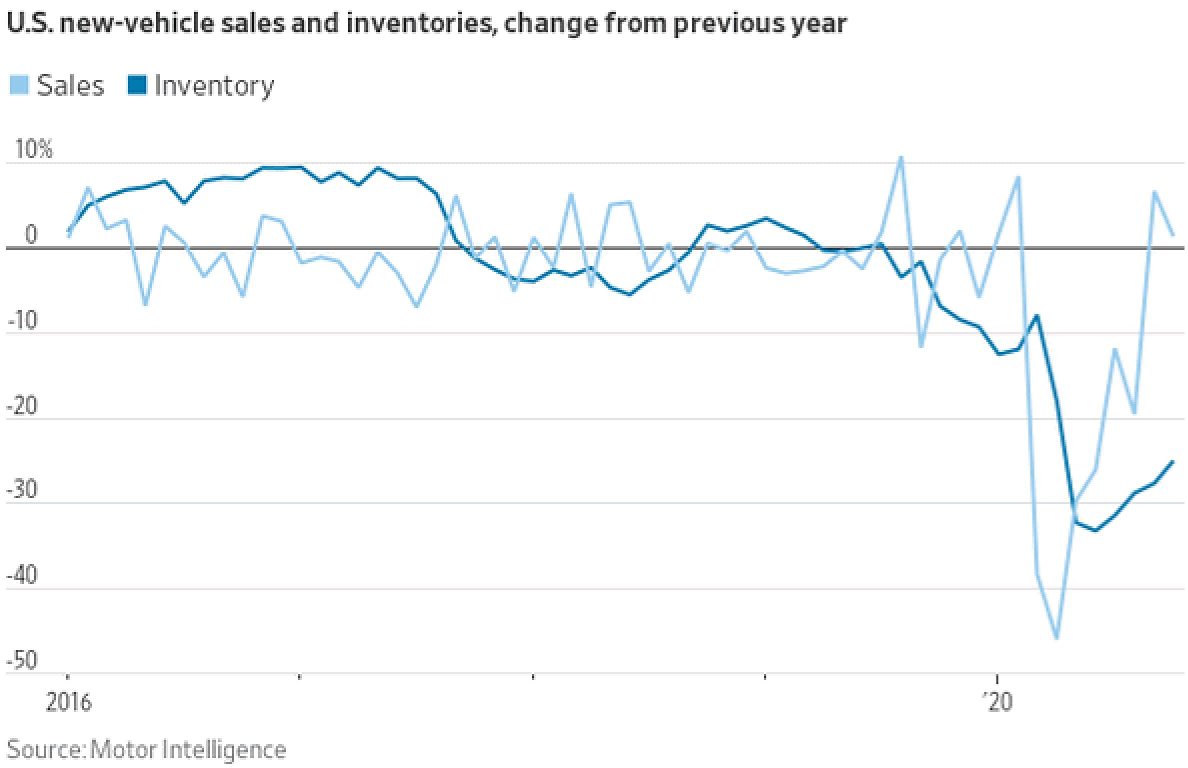


Goods have recovered and are above pre-pandemic. The service sector has improved but remains under pre-pandemic levels. Again, homes and auto sales are doing well and are large and important sectors of the economy.

New home sales have recovered and are above normal levels.



Auto sales are also above pre-pandemic levels, but inventories are lagging due to plant closings and chain supply problems.

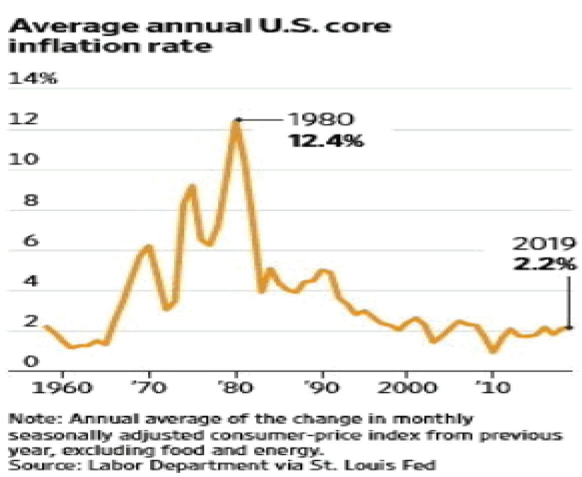


The above chart shows auto sales collapsing at the start of the pandemic, but once the bottom was made there has been a remarkable recovery. Again, auto sales are an important component of the U.S. economy.

The second chart below in the Inflation and Interest Rates section also shows where spending and inflation are in the economy.

Inflation & Interest Rates

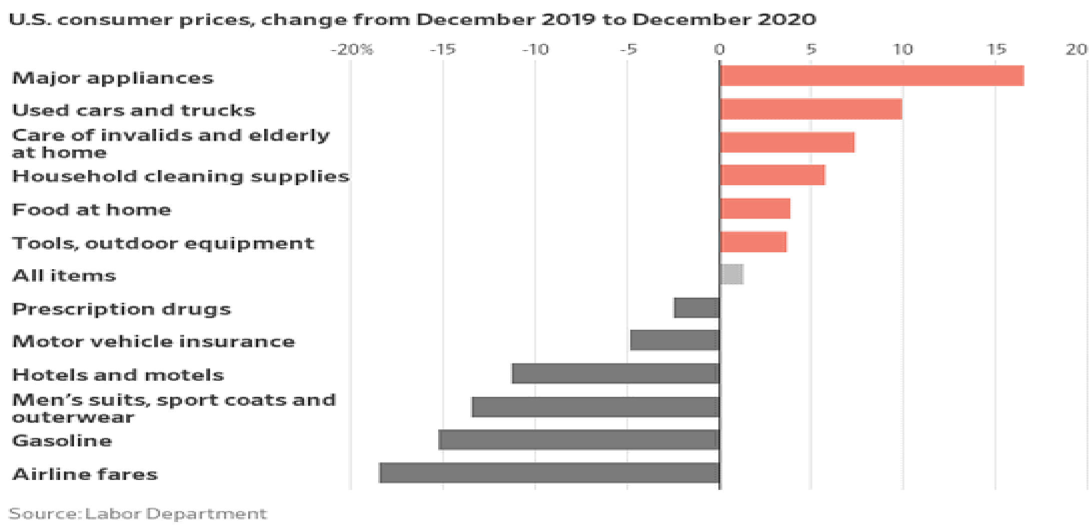
Below is a chart that shows the trend of inflation going back to about 1950:



The inflation of the 1970s and 1980s had to do with oil embargos from Arab nations and bad monetary policies. Better monetary policies and investing in finding and producing more energy helped bring down inflation. Fortunately, inflation is at the lower end of inflation now.

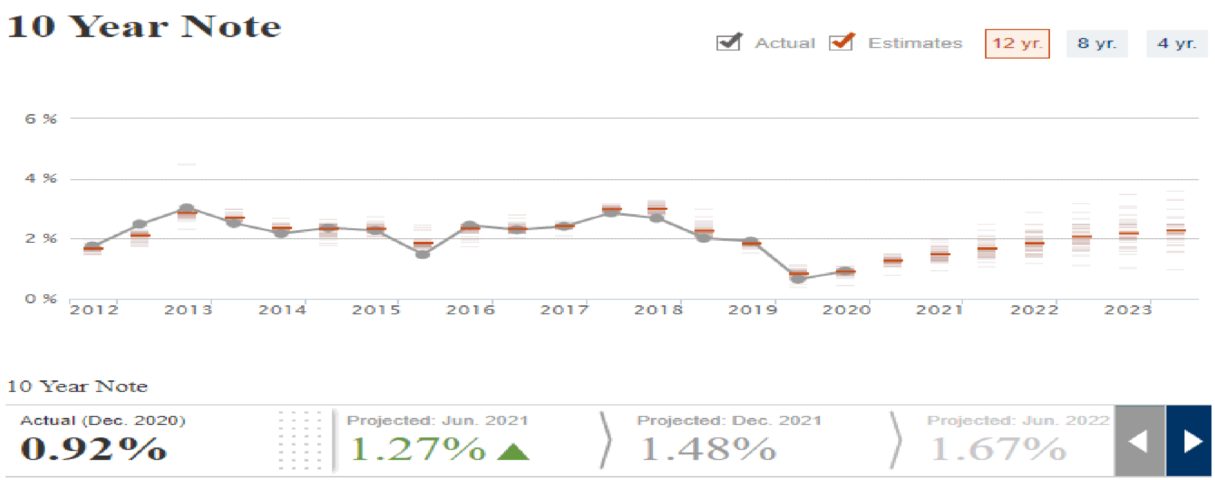
Most of the 2021 economic forecasts that I studied were concerned about inflation. If inflation rises then interest rates normally also rise as interest rates normally reflect expected inflation. Normally when interest rates rise, it slows the economy. Many asset valuations models have interest rate variables. Future cash flows and earnings mean less if it's expected there will be higher inflation and interest rates. Also, money could move to interest-paying investments versus risk assets.

Below is a chart of the areas of the economy where inflation is rising. These areas of inflation also suggest this is where consumer spending is.



From the above chart, we can see inflation occurring in major appliances, autos, food, and the care for the elderly. Of course, the areas of the economy that are closed or partially closed are seeing prices drop like airfares, staying at hotels or motels, clothing. As the economy fully recovers, we can expect some of these prices to rise. We are already seeing energy prices rise.

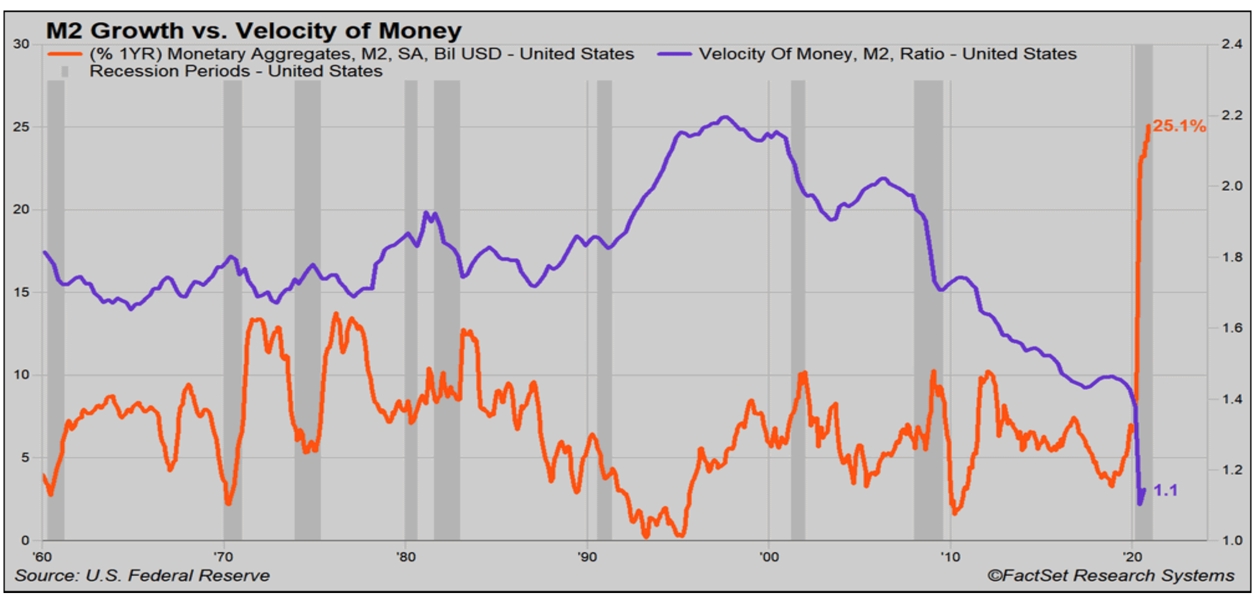
The WSJ survey, consensus of economists is forecasting interest rates rising to the 2% level. The 10-year Treasury Note has averaged about 5% over the last 50 years, so 2% is still low.



Over the last 10 years, interest rates have not reflected inflation (lenders want at least inflation to protect the purchasing power of their investment dollar).

The Fed has been buying treasuries, agencies at all maturities and all the buying does keep interest rates artificially low.

Some economists are concerned that if we get another aid/stimulus package, especially if it's about $2 trillion, all this money could create higher inflation and interest rates. The Fed and lawmakers have been creating lots of liquidity for over ten years and we have not seen much inflation. Part of the reason has to do with the low velocity of money as the chart below shows:

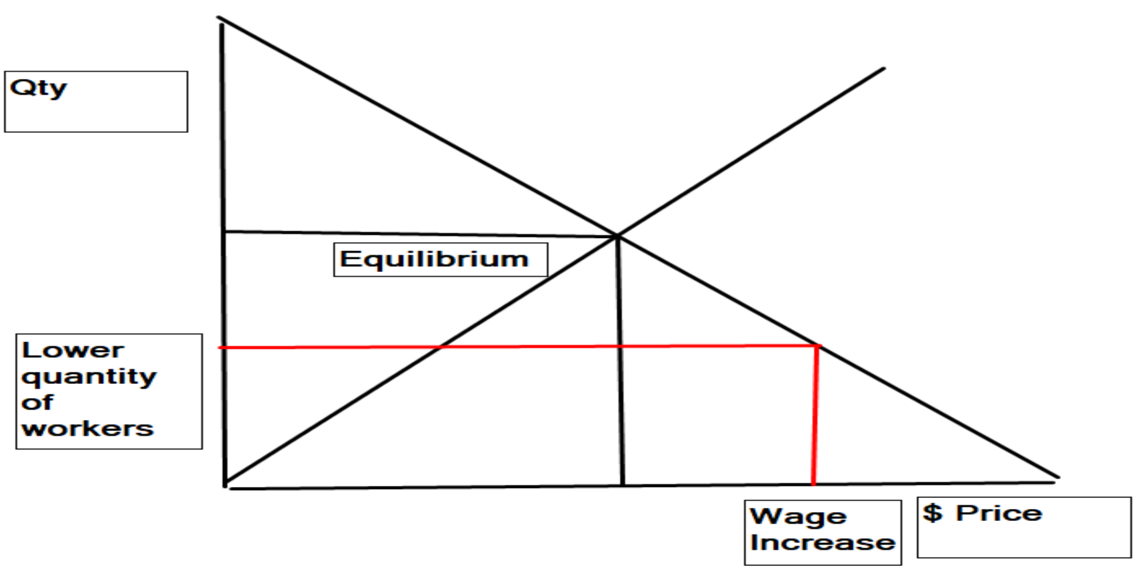


The orange trendline shows the money supply growing, especially during recessions. Notice how high money supply growth grew after 2010 and is exploding now, but the velocity of money, blue trendline, has crashed meaning businesses, consumers don’t want money, even when it’s cheap and abundant. In other words, all the liquidity from the Fed is barely being spent. Low economic activity from all the liquidity is not creating inflation.

Another inflation concern is the potential for a higher minimum wage. Economists believe higher labor costs could lead to higher prices, inflation. Below is the history of the minimum wage.

Currently, the national minimum wage is $7.50. The minimum wage is higher in high-cost states. Also, notice the gray trendline (2020 inflation-adjusted dollars) has essentially gone sideways. This means even though the minimum wage has gone up from less than a dollar to $7.50, adjusted to inflation wages haven't gone up.

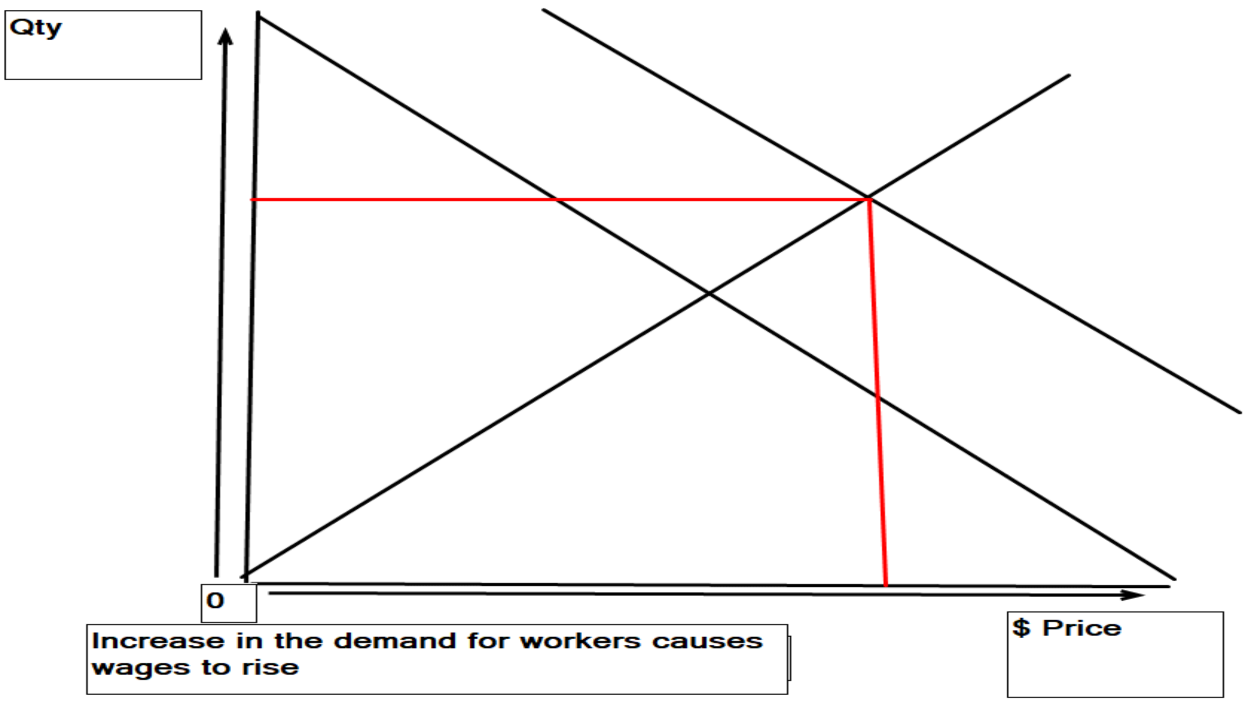
Many times laws to raise the minimum wage are defeated because of the belief that higher wages will lead to lower demand for workers. Below is a chart that explains this belief:



The chart shows that the price of labor and the quantity of labor is in equilibrium when prices equal demand. The red lines show what happens when you raise wages, the demand for workers drops. This is basic economics.

BUT

Microeconomics and some basic economic courses explain what happens when labor demand increases, then wages have to rise to attract workers.



2009 was the last time the national minimum wage was increased when the economy was about $15 trillion. Now the economy is close to $20 trillion so the economy is bigger, demand for workers has increased. From an academic economic point of view, the demand curve has shifted upward meaning wages should increase as we have a new equilibrium between wages and the demand for workers.

If you're a single mother with two children and are making minimum wage it is still at the poverty level for a family, even if the minimum wage increases to $15. A single person could probably live on $15 an hour, barely.

Also, I remember when was I was a child in the 1960s a burger and fries was about 25 cents. Today a McDonald's burger and fries are about $6, a 2400% increase. This is a major problem that most U.S. citizens face, the cost of living has grown much faster than wages. Also, even though prices of food have increased dramatically, especially at Mcdonald's, they sell much more burgers than they did in the 1960s. According to economic theory higher prices lead to lower demand. Economic theory does not always explain the economy or economic behavior, as the economy and behavior are much more complex than a graph or equation can represent.

We have to monitor inflation and interest rates. Rising inflation and interest rates are the enemies of a healthy economy and markets.

New President and Agenda

The previous President was focused on: domestic issues/America first, tax cuts for corporations and high-income earners, the border, building the military, taking on China, Iran, and North Korea.

The new President's focus is dramatically different and includes: unions and workers, immigration reform, income and wealth inequality, gun reform, mending relations with international allies.

Climate change will also be a major focus. Currently, much of the nation is facing a 'polar vortex'. Briefly, the major weather pattern of the jet stream is not holding the frigid air from the artic allowing it to travel south. This has happened a few winters over the past few years, and it probably won't be the last.

The economy and markets have not adjusted to these policy/agenda changes.

Conclusion and Summary

- The key to the economy is solving the health crisis. Approved vaccines and treatments are leading to vaccinations and are reversing the surge in infections that occurred late last year and January. We can probably achieve herd immunity later this year.

- There are concerns about new variants of covid. Also, the global health crisis, especially among poorer nations, will take more time.

- Because 2020 was so bad, economic and earnings comparisons will be easy to beat. We should have a recovery and better economy and earnings in 2021.

- Economists call this a K economy with certain industries doing well, and others are struggling. If we can get to herd immunity, the struggling parts of the economy could have a strong recovery especially because of the pent-up demand for travel, restaurant sitting, concerts, and other forms of entertainment, and some retail outlets.

The millions of workers that have jobs in restaurants, retail, and many service jobs will struggle to find new jobs and get back on their feet. Despite this, the economy could have a recovery even though millions of workers will be left behind. The new President wants to work on income and wealth inequality.

- All the fiscal (lawmaker's spending on relief and covid) and monetary (the Fed using its balance sheet to create liquidity in our economy and capital markets) support/relief has helped our economy compared to countries that did not open their money spigots.

- The new President has a very different agenda than the previous President and it could be a big adjustment for the economy and markets.

- What makes this year better is the easy comparisons. After this year it won’t be so easy. This has implications for investors that I will write about in future Market Outlooks.