

2021 Annual U.S. Economic Outlook

December 10, 2020

Beginning the recovery journey: 5 things to watch for

As we approach the end of 2020, many of us are eager to turn the page and focus on the year ahead, optimistic that the next year will be better than the last. This report represents the collective views of our U.S. economics team and our department's first U.S. Annual Economic Outlook. We take a step back from the quarterly variations in GDP growth or consumer spending and focus on the key themes that will determine economic growth in the year ahead.

Next year will be **a tale of two halves**, with surges in COVID-19 cases marking the first half, eroding consumer confidence and slowing aggregate economic activity. The second half of the year will likely reflect the gradual containment of the virus through more widespread vaccine adoption and increased confidence in hard-hit areas of consumer spending, such as travel and dining out. **Consumers' confidence** in re-engaging more broadly in spending will be critical to the path of the consumer spending recovery over the next 12 months. The re-emergence of **inflation** is one potential headwind to consumption growth; it will help to lift nominal spending, but also reduces inflation-adjusted disposable income. We expect the Federal Reserve to look past the emerging inflation pressures and keep short-term interest rates and their bond-buying program (known as quantitative easing) unchanged throughout next year.

The new Biden administration is likely to face a divided Congress next year, which will make major fiscal policy changes, outside of another round of stimulus, less likely. Both **fiscal and monetary policy** will move to the back burner. The low rate environment and the Fed's bond buying program will help to keep a lid on mortgage rates while the pandemic continues to reshape consumer perceptions of how and where they live. Both trends will help boost residential **construction** next year, providing a bright spot of growth. Conversely, nonresidential construction (commercial real estate) will not benefit much from the stability in economic fundamentals in the second half of next year as firms rethink the mix of in-person and remote work and manage risk for the long-term.



A tale of two halves



The nature of
consumer confidence



The re-emergence of inflation



Fiscal and monetary policy
on the back burner



The boom and bust
of construction

"Consumers' confidence in re-engaging more broadly in spending will be critical to the path of the consumer spending recovery over the next 12 months."

As a result, a sizable downshift in nonresidential investment in the year ahead will likely offset the positive effects of residential investment.

Our December economic forecast (see last page) reflects these key themes and represents our informed point-of-view regarding the future path of economic growth. We remain humbled by the events of 2020 and recognize the larger than normal error bands around our outlook. As we await the events of 2021, we stand ready to continue assessing key developments in the economy as they unfold and keeping our readers and clients informed along the way. We wish you all the best in the year ahead.

A tale of two halves

Looking ahead to 2021, GDP growth for the year is forecast at 3.9 percent. Stronger contributions from consumer spending will drive this growth, along with residential and business investment. The recovery in domestic demand will result in net exports subtracting from GDP growth. Import growth will outpace export activity while a rebuilding of inventories will nearly offset the drag from trade. In addition, watch for the two halves of next year to shape up very differently. The first half will be much like this year, with consumers remaining cautious in their spending, and spending more on durable goods than services. They will also continue their migration to online purchases and home purchase-related spending. In contrast, the second half of 2021 could herald the post-pandemic environment, with more stability in the economy and a broadening of economic activity. For the most part, these expectations will come true only if consumers can access a broadly-distributed vaccine, as we are assuming.

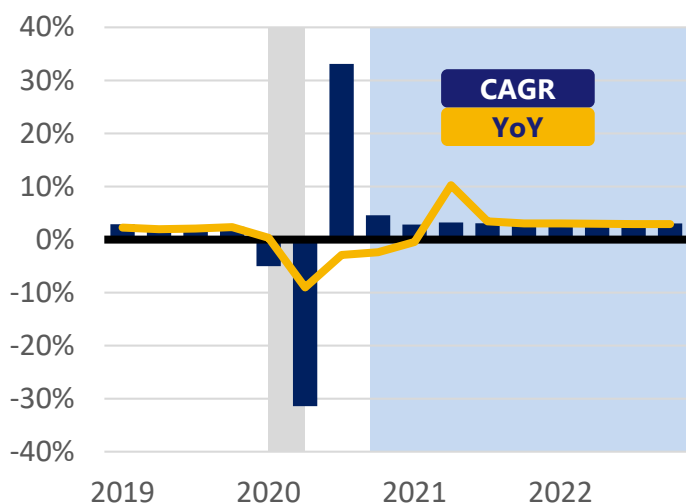
Contact-intensive industries¹ will likely be under pressure as long as social distancing guidelines remain and consumers feel hesitant to engage like they normally would. Within the goods category, durables are clearly the darling for the foreseeable future as consumers spend on recreational equipment, autos and home-related items.

Real consumer spending during the first half of the year will be tepid, with levels still below Q4-2019. However, as consumption broadens to the contact-intensive industries, such as travel, we expect real consumer spending to gradually recover from the pandemic-induced recession.

Spending patterns will likely change when consumers can return to the office and resume normal spending on office attire, commuting and meals. Thus, monthly gains in retail sales will likely improve and average 0.5 percent in the latter months of 2021 after posting weaker monthly growth rates early in the year. Lower-income families led the recovery in 2020 and we expect that to continue; however, in the second half of 2021, we think spending will normalize across spending categories and income ranges. As uncertainty and volatility decline, spending will likely broaden into discretionary spending by all income brackets. Eventually, we expect middle- and higher-income households to resume spending as savings rates return to more historical levels. These dynamics will help to fuel broader economic activity in the second half of the year and GDP growth rates at or above 3 percent on an annualized basis.

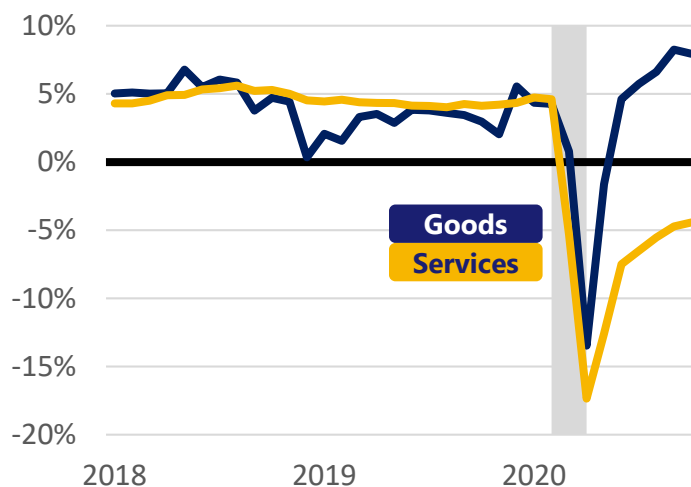
Real gross domestic product (GDP) (SA, CAGR and YoY* percent change)

Last forecast: December 10, 2020



Nominal consumer spending on goods vs. services (YoY* percent change)

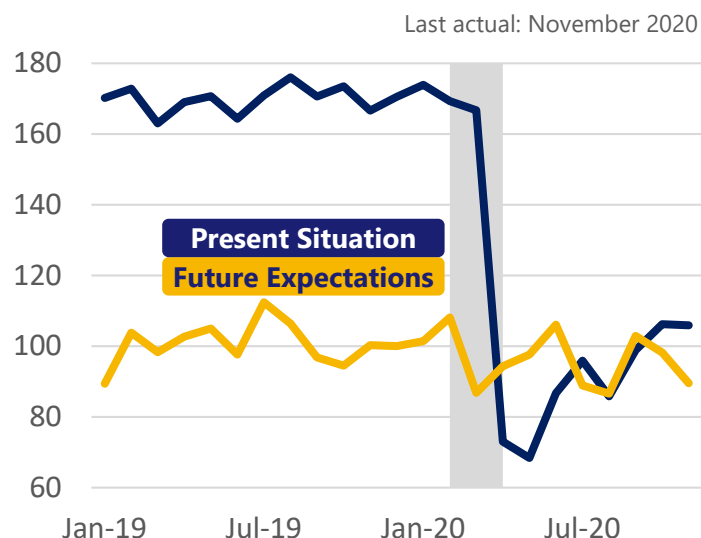
Last actual: November 2020



*Seasonally adjusted (SA), compound annualized growth rate (CAGR), year-over-year (YoY). Sources: Visa Business and Economic Insights, and U.S. Department of Commerce.

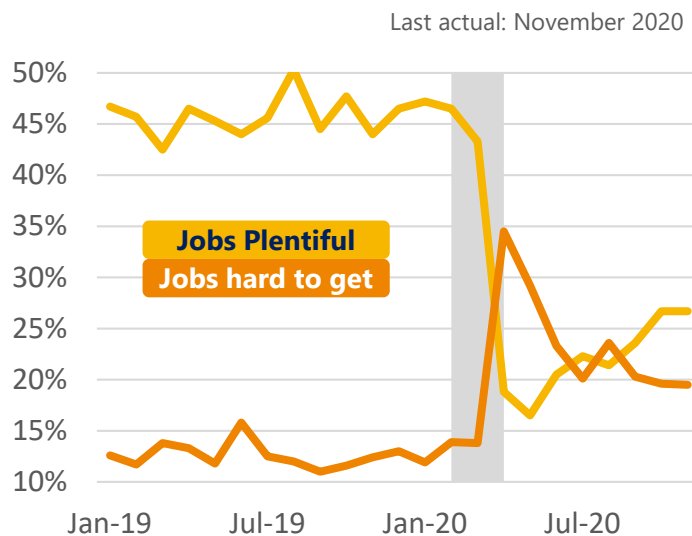
¹ For more on contact-intensive occupations, see the St. Louis Fed's blog post here: <https://www.stlouisfed.org/on-the-economy/2020/march/social-distancing-contact-intensive-occupations>.

Consumer confidence in current and future conditions (SA, index, 1985=100)



*Seasonally adjusted (SA), compound annualized growth rate (CAGR), year-over-year (YoY). Sources: Visa Business and Economic Insights, and Conference Board.

Consumers reporting jobs plentiful vs. jobs hard to get (SA, percent)



The essential nature of consumer confidence

As the economy progresses through the recovery next year, consumer confidence will determine how quickly broad-based consumer spending returns. After a steep drop at the beginning of the pandemic, U.S. consumer confidence has yet to recover, with the November headline reading sitting at 96.1, well below January's 110 reading. There are several factors critical to increased confidence in both current and future expectations of economic conditions, including further economic stimulus, the path of the pandemic, the possibility of more lockdowns and the effective distribution of vaccines. Consumers tend to be more concerned about the economy at present. Recent consumer data from Phoenix Marketing International² show that a higher percentage of consumers are very concerned about "the economic impacts of a shutdown" rather than "the health impacts of NOT shutting down," by a measure of 52 percent to 42 percent.

Additional stimulus measures may help to lift confidence in Q1, but consumers' comfort level with broadly engaging in activities such as air travel and face-to-face transactions again will be key to the recovery next year. E-commerce will continue to provide support for the recovery in the consumer sector.

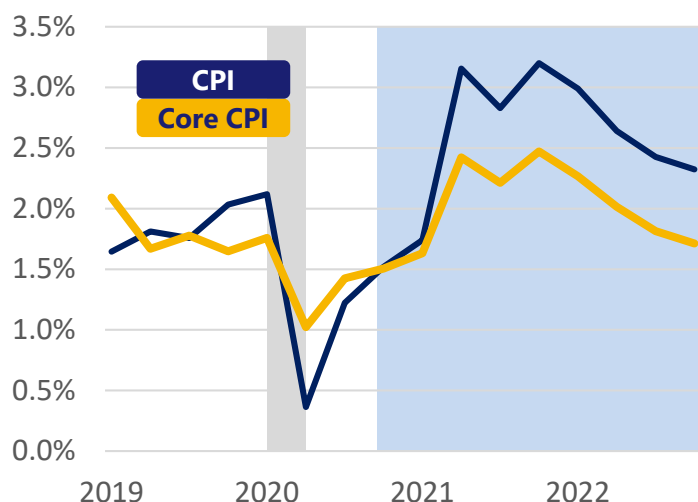
Job creation leading to falling unemployment rates will also help boost consumer confidence going forward. As COVID cases have surged, the likelihood of further economic restrictions has dampened future expectations for the coming six months. This component of the Confidence Index has been less volatile throughout 2020, but it declined sharply in November with the case surge. This brought expectations close to the March low of 77—the lowest expectations reading in more than three years. Widespread availability of the vaccine should boost confidence in Q2-2021, but downside risks remain.

Ongoing layoff announcements among several large companies, with an increasing share that are permanent layoffs, have stalled consumers' optimistic view of the labor market. Nearly 20 percent continue to feel that jobs are "hard to get," while those who think jobs are "plentiful" remained unchanged at 26.7 percent in November. With COVID cases likely to increase throughout the winter, spending could be curtailed and lead to more business failures that would accelerate the negative perceptions of business conditions and the labor market in the coming months. This would increase the risk of a slower recovery.

² Phoenix Marketing International COVID-19 Consumer Sentiment Pulse, November 2020

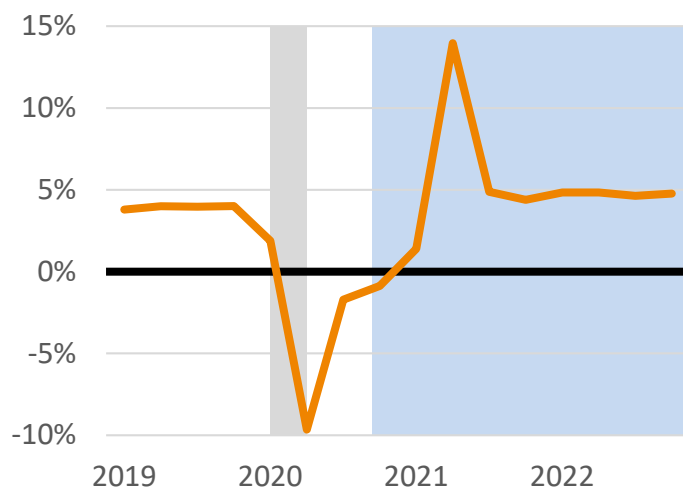
Headline and core Consumer Price Indices (SA, YoY* percent change)

Last forecast: December 10, 2020



Nominal consumer spending (SA, YoY* percent change)

Last forecast: December 10, 2020



*Seasonally adjusted (SA), compound annualized growth rate (CAGR), year-over-year (YoY). Sources: Visa Business and Economic Insights, U.S. Department of Labor, and U.S. Department of Commerce.

Re-emergence of inflation: an unusual driver of nominal spending

Nominal consumer spending, which is what consumer-focused firms recognize as revenues, is a function of two factors: how much customers actually purchase (the so-called real component of spending) and how high the selling prices go (inflation). In the year ahead, we anticipate that real spending will help the economic recovery as inflation lifts nominal spending. Inflation was benign over the last several years, and especially during the pandemic. In Q2-2020, when COVID was surging, the headline Consumer Price Index rose a mere 0.4 percent from a year ago. Removing the volatility from food and energy prices, core prices rose just 1.3 percent over the same time period. Energy prices dropped as global uncertainty increased and aggregate demand weakened. Oil prices in particular hit all-time lows: Brent crude fell to \$17.66 per barrel in April 2020.

The COVID pandemic shifted aggregate demand across a number of spending categories. With many people working from home, demand for clothes dropped and apparel prices fell an unprecedented 8 percent in May from a year earlier. Over the same period, demand for recreational equipment increased, leading to higher prices for recreational goods, such as bikes—rising roughly 2 percent, and ultimately to 6 percent year-over-year (YoY) in July and August.

Next year will be different. Inflation will likely remain subdued at the beginning of the year, but as consumer demand improves, prices will increase and temporarily rise above the Federal Reserve's long run target of 2 percent. The headline Consumer Price Index, suppressed this year by the pandemic, is expected to fall to 1.3 percent, but rise 2.7 percent in 2021. An expected increase in aggregate demand for both goods and services will also bolster inflation next year as consumers enter a post-pandemic environment where a vaccine is expected to be widely available.

Upside risks include persistent supply constraints for some goods, putting upward pressure on inflation. Ripple effects from a strong housing market will likely push up prices next year for furniture, appliances and other large ticket items. So what does this mean for the payments industry? The re-emergence of inflation will likely become a driver of nominal personal spending and, hence, payment volume. Inflation metrics will likely look temporarily bloated in mid-2021 as we lapse the sharp negative readings of Q2-2020 during the depths of the pandemic. In short, expect nominal spending to reflect more balanced growth from an increase in both real spending and higher inflation in the year ahead.

Fiscal and monetary policy will move to the back burner

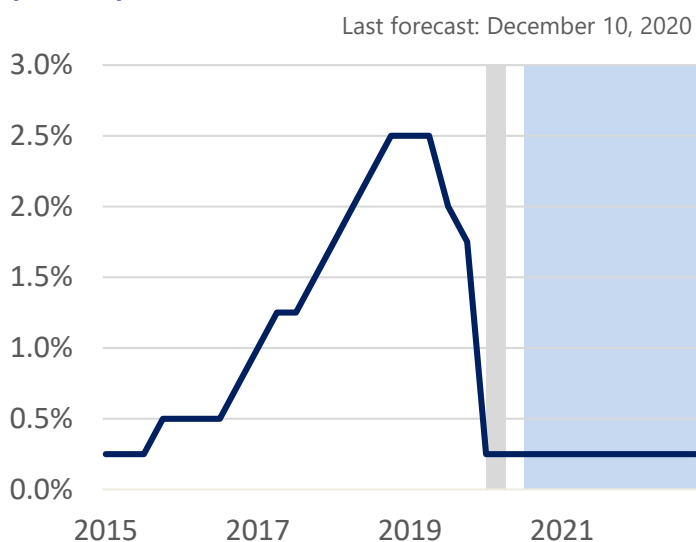
Monetary policy next year is set to bounce back to boring. After slashing interest rates to near zero and resuming their quantitative easing (QE) program, the Federal Reserve has successfully stabilized financial conditions this year, which minimizes the financial overhangs that plagued the economy in the wake of the financial crisis. Members of the Federal Open Market Committee have signaled that they are likely to keep interest rates near zero through the end of 2023. They will also likely continue the QE program through the end of 2021 as the economy continues to recover. These actions will keep both short and longer-term interest rates lower for longer, with only a modest rise in the spread between short and long-term interest rates. Higher inflation next year is not likely to lead the Fed to change course, even with inflation rates above their 2 percent target. Expect Fed officials to continue calling on Congress to enact another round of fiscal stimulus as the Fed sees its own options for further stimulus having a limited impact on economic growth and the labor market.

The start of 2021 will also mark the beginning of the Biden administration. While the exact outcome of the January Georgia Senate races will determine party control of Congress, we continue to assume that President-elect Biden will be facing a divided Congress, with major changes in

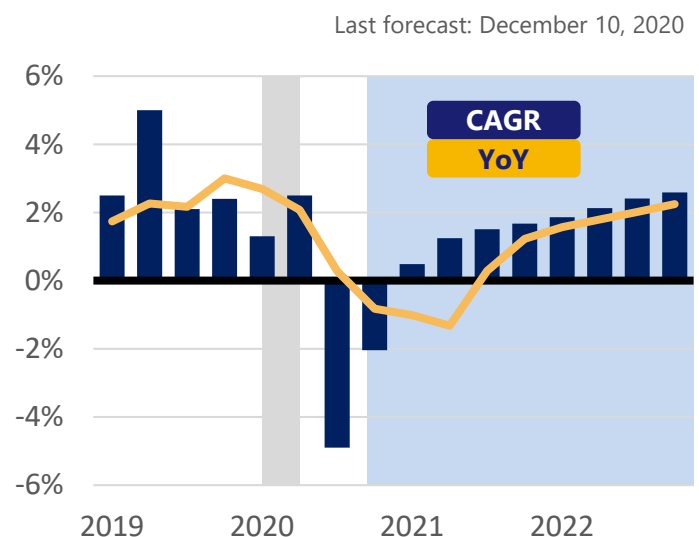
fiscal policy unlikely over the next two years. Our baseline forecast for next year calls for federal government spending and investment to rise 2.9 percent, down from an estimated 4.5 percent this year. The slight increase in spending assumes that Congress will enact another round of stimulus by the end of Q1 next year. Executive orders will likely continue to be used for some policy initiatives due to the divided Congress. Existing trade tariffs enacted by the Trump administration probably won't be removed on day one, but future trade policy will become more clear going forward, which should help boost business investment and the export-focused aspect of the manufacturing sector.

At the state and local levels, there will continue to be pressure on budgets due to pandemic-related spending and unemployment insurance program costs. State and local government spending and investment have a much larger weight in overall government spending, so we expect only marginal improvements in budgets, and by extension spending, in the year ahead. With mildly expansionary federal fiscal policy, and budget-constrained state and local governments, we expect government spending and investment to contract 0.2 percent in 2021, a sizable downshift from the 1 percent spending growth estimated for 2020.

Federal funds rate upper bound (Percent)



Real government spending and investment (SA, CAGR and YoY* percent change)



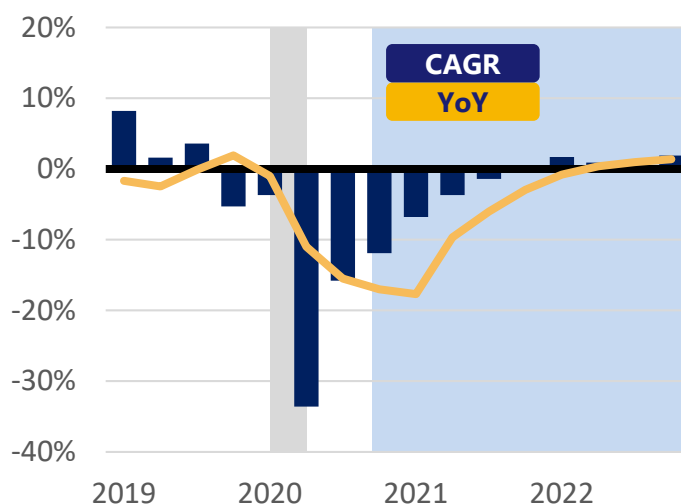
*Seasonally adjusted (SA), compound annualized growth rate (CAGR), year-over-year (YoY). Sources: Visa Business and Economic Insights, Federal Reserve Board and U.S. Department of Commerce.

The boom and bust of construction

The economic fallout from the COVID-19 pandemic has had very disproportional impacts on construction spending between the residential and nonresidential sectors. The nonresidential (commercial real estate) sector has been ravaged by the crisis, as even what were once considered safe assets such as office and hotel properties have come under intense pressure due to the unique nature of the pandemic. The large increase in employees working from home and popularity of e-commerce will likely depress construction investment in office and retail spaces but lift investment in warehouse space. In addition, only modest increases in oil prices expected next year will keep a lid on further investment in the oil and gas sectors. Given the pressures being faced by multiple commercial real estate sectors, we anticipate that nonresidential investment will contract 9.5 percent next year.

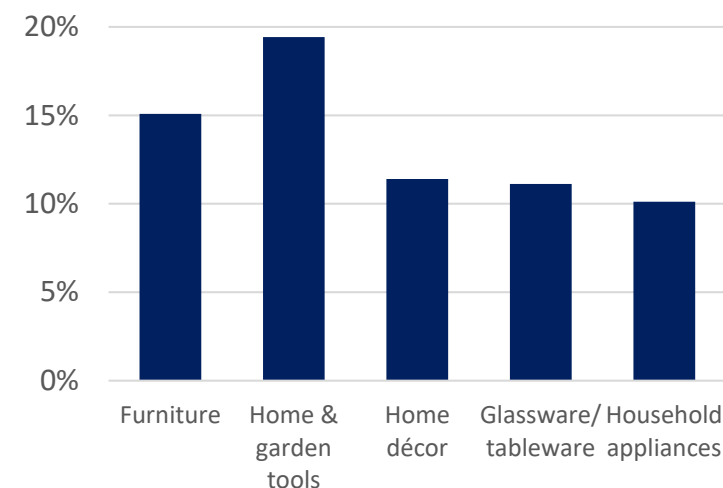
One bright spot in the economy that emerged this year was the housing market. Record low mortgage rates and the increase in millennials reaching typical home-buying age have caused a surge in demand for homes. The move to working from home and higher home prices in cities have pushed housing demand to the suburbs and exurbs where new home sales are growing at rates that rival the housing boom between 2002 and 2006. The increased homeownership rates will serve as a tailwind to consumer spending growth next year as consumers buy new furniture and home furnishings. Other bright spots in consumer spending benefiting from this trend are home improvement goods, tools, gardening supplies, sporting goods, and home maintenance services. Furthermore, the exodus from cities and low interest rates will drive both new and used auto purchasing as most suburbs and exurbs have poor mass transit connections to the city. This switch from mass transit to cars will drive an increase in spending on fuel, auto maintenance services, and tools. Thus far, the home and auto based spending categories (except for gas and auto maintenance) have been bright spots in the recovery, and we expect this trend to continue throughout 2021.

Real nonresidential investment
(SA, CAGR and YoY* percent change)

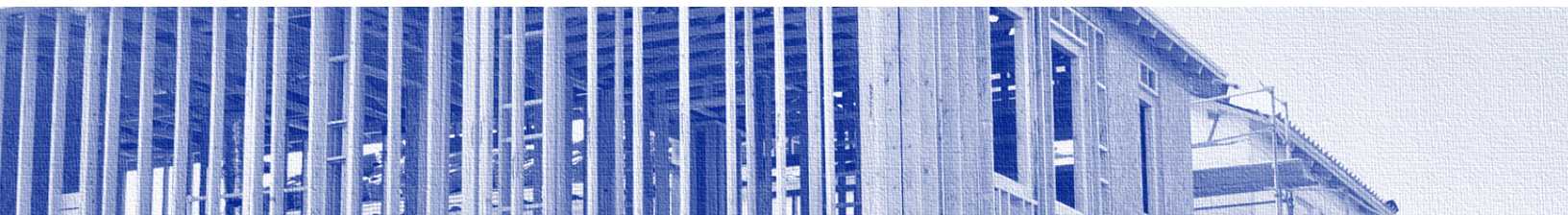


Nominal consumer spending on housing related goods
(YoY percent change)

Last actual: October 2020



*Seasonally adjusted (SA), compound annualized growth rate (CAGR), year-over-year (YoY). Sources: Visa Business and Economic Insights, and U.S. Department of Commerce.



Visa's U.S. Economic Forecast

	Actual				Forecast				Actual		Forecast		
	2020				2021				2019	2020	2021	2022	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4					
Gross Domestic Product (CAGR)	-5.0	-31.4	33.1	4.6	2.8	3.2	3.1	3.0	2.2	-3.5	3.9	3.0	
Personal Consumption	-6.9	-33.2	40.6	4.7	1.0	2.3	2.5	2.7	2.4	-3.8	3.7	2.4	
Business Fixed Investment	-6.7	-27.2	21.8	13.1	5.8	4.2	4.7	4.9	2.9	-4.1	6.0	5.7	
Equipment	-15.2	-35.9	66.6	22.2	10.3	5.7	5.4	4.9	2.1	-5.3	12.3	5.5	
Intellectual Property Products	2.4	-11.4	6.0	9.8	6.1	5.9	6.5	6.8	6.4	1.4	5.6	8.2	
Structures	-3.7	-33.6	-15.8	-11.9	-6.8	-3.7	-1.4	0.3	-0.6	-11.1	-9.5	0.5	
Residential Construction	19.0	-35.6	62.3	30.8	18.3	15.6	14.2	11.8	-1.7	5.7	19.1	11.2	
Government Purchases	1.3	2.5	-4.9	-2.0	0.5	1.2	1.5	1.7	2.3	1.0	-0.2	1.9	
Net Exports Contribution to Growth (%)	1.1	0.6	-3.2	-1.5	0.1	0.0	-0.2	-0.4	-0.2	0.0	-0.9	-0.4	
Inventory Change Contribution to Growth (%)	-1.3	-3.5	6.6	0.8	0.5	0.2	0.0	0.0	0.0	-0.7	0.8	0.1	
Nominal Personal Consumption (YoY % Chg.)	1.9	-9.7	-1.7	-0.9	1.4	14.0	4.9	4.4	3.9	-2.6	6.0	4.8	
Nominal Personal Income	3.2	10.7	7.1	5.4	5.0	-2.1	1.1	2.6	3.9	6.6	1.6	4.2	
Retail Sales Ex-Autos	2.5	-7.5	3.2	4.6	5.4	15.7	3.7	3.3	3.4	0.7	6.8	3.6	
Consumer Price Index	2.1	0.4	1.2	1.5	1.7	3.2	2.8	3.2	1.8	1.3	2.7	2.6	
Federal Funds Rate (Upper Bound)	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	2.19	0.25	0.25	0.25	
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	5.28	3.25	3.25	3.25	
10-Year Treasury Yield	0.70	0.66	0.69	0.90	0.94	0.97	1.02	1.07	2.14	0.74	1.00	1.17	

Forecast as of: December 10, 2020

Interest rates presented are end of quarter rates

Note: Annual numbers represent year-over-year percent changes and annual averages

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Forward Looking Statements

This report contains forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Act of 1995. These statements are generally identified by words such as “outlook,” “forecast,” “projected,” “could,” “expects,” “will” and other similar expressions. Examples of such forward-looking statements include, but are not limited to, statements we make about Visa’s business, economic outlooks, population expansion and analyses. All statements other than statements of historical fact could be forward-looking statements, which speak only as of the date they are made, are not guarantees of future performance and are subject to certain risks, uncertainties and other factors, many of which are beyond our control and are difficult to predict. We describe risks and uncertainties that could cause actual results to differ materially from those expressed in, or implied by, any of these forward-looking statements in our filings with the SEC. Except as required by law, we do not intend to update or revise any forward-looking statements as a result of new information, future events or otherwise. Our forecast assumes the bulk of the negative effects of the COVID-19 outbreak will occur in the second quarter of this year with a gradual relaxing of social distancing guidelines over the second half of 2020.

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