U.S. Economic Outlook

Fed up with inflation

Wayne Best
Chief Economist
wbest@visa.com

Michael Brown
Principal U.S. Economist
michael.brown@visa.com

Over the course of the last month, we learned that the economy expanded at an impressive 6.9 percent annualized pace in Q4 of last year, mostly due to massive inventory rebuilding efforts. But core economic growth—excluding the effects of trade and inventories—rose just 1.9 percent in Q4. We expect this core measure of growth to rebound in Q1 even though we forecast a 1.7 percent contraction in GDP. We expect this measure to bounce back slightly in Q1 to 4.2 percent (annualized) even with the projected contraction. The result is GDP for this year rising 2.8 percent YoY and another 2.8 percent in 2023.

Consumer spending in Q1 looks to be much softer as a combination of virus impacts and severe winter weather slow the recovery in services spending. We have also been talking for some time about the erosion of real purchasing power due to elevated inflation. In addition to the virus and weather impacts to consumer spending over the last month, we also see inflation beginning to dent spending in Q1. That said, we do see some light at the end of the tunnel on the inflation front. If inflation rates do not change on a month-over-month basis, then year-over-year "base effects" alone would cause inflation to ease (see Fig. 2). We are not assuming that MoM inflation rates will be zero, but suspect that the preponderance of this year's inflation change will be dominated by these base effects and thus put downward pressure on overall inflation. Even with inflation rates coming down, expect the Fed to be aggressive about the path of interest rates.

Key Points:

- Q1 GDP set to contract
- We now expect four rate hikes from the Fed this year
- Persistent inflation remains a risk

Fig. 1 Real gross domestic product (GDP)
(SA, CAGR and YoY* percent change)

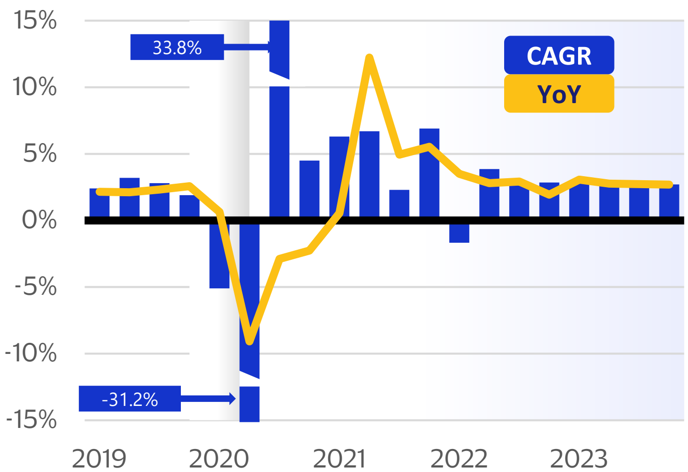
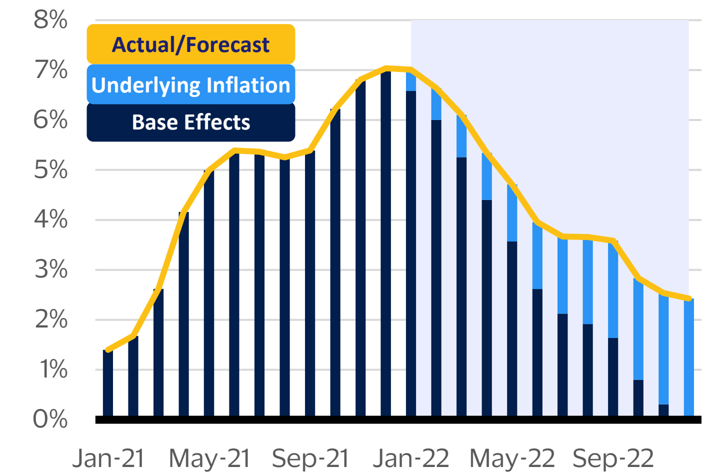


Fig. 2 Headline Consumer Price Index
(SA, YoY percent change)



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

Fed up with inflation (*cont.*)

The real economy begins to feel the pressure

While the January jobs report showed robust hiring (467,000 jobs added) our Visa Spending Momentum Index told the story of less broad-based consumer momentum in January.

This could translate into the third straight month of a decline in real consumer spending in January. While we expect a modest bounce back in spending in the second quarter, beyond the H1 distortions, longer-run trends suggest a continued moderation in the pace of real consumer spending this year. As the fiscal support of the last two years fades away, the longer-term fundamentals of a large retiree population, a smaller labor force and more modest income growth may moderate both the pace of real consumer spending and overall real GDP growth over the longer-run.

Income growth will likely fade in the near term due to the expiration of the Child Tax Credit payments and smaller than expected tax refunds. In addition, borrowing costs are set to rise as interest rate hikes from the Fed begin to increase the cost of consumer credit. Yet another marginal hit to some consumers' income could occur again in May with the expiration of the federal student loan deferral program. We expect nominal consumer spending to grow 7.1 percent this year with real growth of 3.0 percent. Nominal spending is expected to rise 3.9 percent in 2023 with real spending growth of 2.3 percent.

Rate hikes on the horizon

Following the most recent FOMC meeting, Fed Chairman Jay Powell held a press conference where he signaled that rate hikes were on the horizon. Many, including financial markets, were taken off guard by Powell's tone, which suggested that the Fed members were getting fed up with high inflation readings and set to act quickly to begin increasing interest rates. We now expect the Fed to hike interest rates by 25 basis points during the March meeting and continue each quarter. We see the upper bound of the federal funds rate ending this year at 1.25 percent and 2.25 percent next year. The Fed has also signaled that it will move up the timeline for reducing its balance sheet, which will also impact rates. In response to these policy changes, the yield curve is expected to flatten with the spread between the 3-month T-bill and the 10-year U.S. Treasury falling to 1.43 basis points by the end of this year and 1.11 basis points by the end of 2023.

Risks to the outlook

Risks to the outlook continue to be virus related. Even as case counts begin to subside, we remain concerned about the possibility of near-term inflation pressures continuing as production may have been disrupted due to employee illness, exacerbating ongoing supply chain issues. In addition, uncertainty remains about how consumers will respond to the expiration of the Child Tax Credit and other fiscal programs that ended in December. The other emerging risk is that the Federal Reserve could act too aggressively to combat inflation and thus slow the economy (and hiring) too much.

	Actual				Forecast				Actual		Forecast	
	2021				2022				2020	2021	2022	2023
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
Gross Domestic Product (CAGR)	6.3	6.7	2.3	6.9	-1.7	3.9	2.8	2.8	-3.4	5.7	2.8	2.8
Personal Consumption	11.4	12.0	2.0	3.3	1.2	3.7	2.3	2.2	-3.8	7.9	3.0	2.3
Business Fixed Investment	12.9	9.2	1.7	2.0	12.9	10.1	9.2	8.7	-5.3	7.3	7.9	8.1
Equipment	14.1	12.1	-2.3	0.8	11.5	11.7	10.3	9.6	-8.3	12.9	7.5	8.8
Intellectual Property Products	15.6	12.5	9.1	10.6	11.9	11.7	10.5	9.7	2.8	10.2	11.0	8.9
Structures	5.4	-3.0	-4.1	-11.4	1.1	1.3	2.0	3.3	-12.5	-8.2	-2.0	3.5
Residential Construction	13.3	-11.7	-7.7	-0.8	0.6	-0.3	0.8	0.9	6.8	9.0	-1.7	1.0
Government Purchases	4.2	-2.0	0.9	-2.9	0.2	1.1	1.2	1.5	2.5	0.5	-0.1	1.6
Net Exports Contribution to Growth (%)	-1.6	-0.2	-1.3	0.0	-0.2	-0.5	-0.4	-0.4	-0.3	-1.4	-0.5	-0.4
Inventory Change Contribution to Growth (%)	-2.6	-1.3	2.2	4.9	-2.0	0.0	0.0	0.0	-0.5	0.3	0.6	0.0
Nominal Personal Consumption (YoY % Chg.)	3.9	20.7	11.7	13.0	10.4	7.2	6.3	4.8	-2.6	12.1	7.1	3.9
Nominal Personal Income	16.1	1.6	5.2	7.0	-4.5	1.8	1.8	2.0	6.5	7.3	0.2	4.0
Retail Sales Ex-Autos	11.6	28.5	15.8	18.5	8.6	3.4	2.2	0.4	0.2	18.4	3.5	2.5
Consumer Price Index	1.9	4.8	5.3	6.7	6.6	4.7	3.6	2.6	1.2	4.7	4.3	1.9
Federal Funds Rate (Upper Bound)	0.25	0.25	0.25	0.25	0.50	0.75	1.00	1.25	0.25	0.25	0.88	1.88
Prime Rate	3.25	3.25	3.25	3.25	3.50	3.75	4.00	4.25	3.54	3.25	3.88	4.88
10-Year Treasury Yield	1.74	1.45	1.52	1.52	1.80	2.32	2.50	2.55	0.89	1.45	2.29	2.71

Forecast as of: February 10, 2022

Interest rates presented are end of quarter rates

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

Forward-looking statements

This report may contain forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Art 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, statement 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. Expect 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

Disclaimer

Case studies, comparisons, statistics, research and recommendations are provided "AS IS" and intended for informational purposes only and should not be relied upon for operational, marketing, legal, technical, tax, financial or other advice. Visa Inc. neither makes any warranty or representation as to the completeness or accuracy of the information within this document, nor assumes any liability or responsibility that may result from reliance on such information. The Information contained herein is not intended as investment or legal advice, and readers are encouraged to seek the advice of a competent professional where such advice is required.

Visa Business and Economic Insights Staff

Wayne Best, Chief Economist	wbest@visa.com
Bruce Cundiff, Vice President, Consumer Insights	bcundiff@visa.com
Michael Brown, Principal U.S. Economist	michael.brown@visa.com
Adolfo Laurenti, Principal European Economist	laurenta@visa.com
Richard Lung, Principal Global Economist	rlung@visa.com
Glenn Maguire, Principal Asia Pacific Economist	gmaguire@visa.com
Mohamed Bardastani, Senior CEMEA Economist	mbardast@visa.com
Jennifer Doettling, Director, Content and Editorial	jdoettli@visa.com
Michael Nevski, Director, Consumer Insights	mnevski@visa.com
Dulguun Batbold, Global Economist	dbatbold@visa.com
Travis Clark, U.S. Economist	wiclark@visa.com
Angelina Pascual, European Economist	anpascua@visa.com
Mariamawit Tadesse, Global Economist	mtadesse@visa.com
Woon Chian Ng, Associate Asia Pacific Economist	woonng@visa.com
Juliana Tang, Executive Assistant	jultang@visa.com

For more information, please visit us at Visa.com/Economicinsights or VisaEconomicInsights@visa.com.

Accessibility notes

Fig. 1

GDP CAGR ranges from 2.4% in Mar-2019, to a low of -31.2% in Jun-2020, a high of 33.8% in Sep-2020, and the latest reading of 6.9% in Dec-2021, with the GDP CAGR forecast to finish 2022 at 2.8% and 2023 at 2.7%. YoY GDP growth ranges from 2.2% in Mar-2019 to a low of -9.1% in Jun-2020, a high of 12.2% in Jun-2021, and the latest reading of 5.5% in Dec-2021, with YoY GDP growth forecast to finish 2022 at 1.9%, and 2023 at 2.7%.

Fig. 2

A chart beginning in Jan-2021 showing a stacked bar graph breaking down the overall year-over-year rate of the Consumer Price Index (inflation) into base effects and underlying inflation. The base effects bar begins in Jan-2021 at 1.4% and continues to gradually climb to a peak of 7% in December 2021. A forecast then shows the base effects coming down from the Dec-21 high to zero by Dec-2022. The stacked bar of underlying inflation begins in the forecast period Jan-2022 at 0.4% and then steadily rises as a share of overall inflation effects through Dec.-2022 at 2.4%. A yellow line traces the sum of the two components from Jan-2021 at 1.4% to a peak of 7 percent in December 2021 and finally coming down slowly through Dec-2022 to 2.4%.