

## Economic highlights from the week ending on December 31, 2021

Shelly Henbest, CFA  
*Senior Credit Analyst*

Inflation remains top of mind for financial market participants heading into the new year. The Personal Consumption Expenditures (PCE) index was up 5.7% year-over-year in November, according to data released last week. The Core PCE index, the Fed's preferred inflation measure, was up 4.7% year-over-year last month. The year-over-year increase in both the headline and core PCE indices were higher in November than in October, suggesting that upward pricing pressure has yet to abate. Given the current surge in US virus cases, along with strict lockdown measures in China (one of our largest trading partners), we expect supply chains will continue to face disruptions over the near term. The upcoming Chinese New Year holiday may also exacerbate supply chain disruptions at Chinese ports. Meanwhile, the supply and demand for labor in the US is likely to remain imbalanced, in our view, as reported covid infections in the US are currently at a record high. As such, we expect pricing pressures will remain elevated over the near-term.



It has been a little over one year since the first person in the US (outside of clinical trials) was vaccinated against COVID-19 on December 14, 2020. The rollout accelerated in the first quarter of this year and vaccine administration rates peaked in April 2021. According to the Centers for Disease Control and Prevention (CDC), 73.3% of the US population have now received at least one dose of a vaccine, and 62% are considered fully vaccinated. However, only 33.4% of the population have received a booster dose. Virus infection rates have increased rapidly this month, with daily case averages in the US now more than 30% higher than the previous January 2021 peak. Though the impact on economic activity from each resurgence of the virus seems to lessen with each wave, we believe the momentum in economic activity has recently softened amid the current surge.

Though the US and global economy continued to face headwinds from the pandemic in 2021, US Gross Domestic Product (GDP) surpassed its pre-pandemic level during the second quarter of this year, fueled by vaccinations, easing restrictions, and tailwinds from government fiscal support and easy monetary policy. The U-3 unemployment rate (as of November) has declined from 6.7% to 4.2% this year and weekly jobless claims have declined toward pre-pandemic levels. US equity market performance was strong this year with the S&P 500 up roughly 27% year-to-date, following a 16% year-over-year gain last year. Meanwhile, Treasury yields have also increased this year, with the 2-year and 10-year Treasury yield both up about 60 basis points year-over-year to 0.72% and 1.51%, respectively (as of last night's market close).

We project economic growth is likely to moderate but remain modestly above-trend in 2022, as US fiscal support begins to wane, and the Federal Reserve becomes less accommodative. Though we believe the path of growth may remain somewhat uneven due to the virus, the Bloomberg consensus estimate for full year 2022 GDP growth is 3.9%, well above the past 20-year average growth rate of about 1.8%. Supply chains are likely to face ongoing challenges over the near-term, but we project inventory rebuilding

will likely be a significant driver of US GDP growth in the second half of the year. Continued improvement in the labor market, particularly an increase in the participation rate, should also help drive economic growth. Our outlook assumes an improving global health backdrop, though risks to the downside from variants or waning vaccine efficacy remain. Consumer spending, the largest component of US GDP, should remain solid, supported by healthy consumer balance sheets, an improving health situation, and an improving labor market. Notably, US retail sales were up 8.5% between November 1st and Christmas Eve this year, compared with the same period last year, according to Mastercard SpendingPulse. That is the strongest growth in 17 years, and sales were up 10.7% versus 2019 levels, which bodes well for consumer spending trends heading into 2022. Though the Fed has recently pivoted toward a more hawkish stance, we believe policymakers will take a gradual approach to normalizing monetary policy. We see potential upside to economic growth estimates from continued fiscal support and the potential passage of a social infrastructure spending package next year. Inflation is likely to remain elevated over the near-term but may be at or near a peak as we enter 2022. We expect inflationary pressures will stabilize as global vaccination rates increase, antiviral drugs enter the market, and supply chain bottlenecks ease. Overall, we believe economic and market dynamics will remain supportive of risk assets in 2022.



## Next Week

*Next week: Construction Spending, ISM Manufacturing, FOMC Minutes, Factory Orders, ISM Services, International Trade, Consumer Credit, Employment*

Chandler Asset Management | [info@chandlerasset.com](mailto:info@chandlerasset.com) | 800.317.4747 | [chandlerasset.com](http://chandlerasset.com)



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