Economic highlights from the week ending on August 13, 2021

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While the US economic reopening theme continues, the path toward a full reopening of the economy and return to normalcy has been more uneven than many economists and CEOs were forecasting just a few months ago. The resurgence of the virus in the US is causing a modest disruption in economic activity and having a negative impact on consumer sentiment, with the University of Michigan sentiment index plunging more than 10 points this month to 70.2 (the lowest level since 2011). Multiple airlines have recently reported an increase in cancellations and a drop in demand as virus cases continue to rise. Supply chain and labor market disruptions are also likely to continue while global infection rates remain uncontained, putting ongoing upward pressure on transportation, input, and labor costs. Many automakers previously expected a meaningful improvement in their supply chains in the second half of this year, but the ongoing global semiconductor shortage is now expected to spill into next year. Overall, we believe the US economy continues to grow at a strong, above-trend, pace but we believe economic data will remain somewhat choppy over the near-term.

The Consumer Price Index (CPI) was up 5.4% year-over-year in July, unchanged on a year-over-year basis from June. Core CPI (CPI less food and energy) was up 4.3% year-over-year in July (in line with expectations), versus up 4.5% in June. Current inflation readings are running well above the Fed's longer-run target of around 2.0%. While the Fed believes many of the factors fueling higher inflation will be temporary, the upward pressure on inflation from supply chain bottlenecks and pandemic-related disruptions is likely to remain elevated over the near-term. Nevertheless, we believe core year-over-year inflation rates may have peaked in June, as base effects from the pandemic-related decline in prices last year continue to phase out of the calculation.

Accommodative monetary and fiscal policy, along with further progress on US and global vaccination rates, continue to support the economy. Although inflation remains elevated, we believe the Federal Reserve will remain patient in adjusting policy. However, the growing divergence in opinion among Federal Reserve policymakers about the appropriate path of monetary policy is fueling uncertainty for the financial markets. Multiple Federal Reserve Bank Presidents made public comments this week advocating for a change in the pace of Fed asset purchases beginning this fall. We believe the probability of an official announcement on the tapering of asset purchases later in the year is elevated (with the taper starting early next year), but we think the majority group bias of the Fed will remain dovish in the near-term due to ongoing uncertainty over the virus, the phasing out of some pandemic-related fiscal and policy support (including the end of the federal eviction and foreclosure moratoriums), and still high levels of unemployment. As market participants gain more visibility on the outlook, we anticipate the steepening bias in the US Treasury curve will reassert itself and look for the longer maturity interest rates to move higher as the year progresses.

Next Week

Next week: Empire State Manufacturing, Retail Sales, Industrial Production, Housing Market Index, Housing Starts & Permits, FOMC Minutes, Philly Fed, Leading Indicators

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