Latest U.S. Data Mean Good News for the Inland Empire Economy

by

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The latest data on the national economy reflect the much anticipated recovery from the sharp contraction caused last year by the pandemic. Gross Domestic Product (GDP) was up substantially in the first quarter of this year and personal income rose sharply in March. We should celebrate that the unemployment rate has been cut by more than half from its pandemic peak, despite the fact that it has hardly moved since January 2021 when it was 6.2%. Finally the Dow Jones set a new record. Yet, even as so many indicators point to robust growth this year, some have sounded the inflation alarm and expressed concerns over recent increases in interest rates. What does the U.S. macroeconomic picture tell us about the outlook for the Inland Empire economy in the coming months?

GDP, basically a measure of U.S. output and the most general measure of economic activity, grew at an annualized rate of 6.4% during the first quarter of 2021. This number is quite high by historical standards: Quarterly GDP growth has averaged 2.4% over the last 25 years and has not exceeded 6.0% % since early 2000. Our current forecast calls for the economy to accelerate over the next several months and for annual GDP growth in excess of 7%, making it the highest growth rate since 1984. Most of the gains will come from private sector spending by households and businesses as they resume activities that were stifled by health orders put into place to combat the pandemic. The succession of federal stimulus packages will also contribute to growth this year.

Arguably, these packages along with success in containing the virus here in the U.S. have enabled us to avoid a double-dip recession, which is afflicting Europe at this time. In fact, the U.S. will fully recover the output it lost during the pandemic by June, and shift from recovery to expansion in the second half of the year. However, if we take into account that the U.S. economy was growing at a rate of 2.5% prior to the recent downturn, and assuming the economy hypothetically expanded at that rate during the last year, then we are still below full employment output by roughly $800 billion or almost 4%. Even with high growth rates forecasted for the remainder of 2021, we will not reach the full employment level until a year from now.

The labor market also continues to heal. Despite steady increases in the labor force over the last three months, the unemployment rate has fallen to just over 6%. While not denying that nonfarm employment is still 8.2 million jobs below the February 2020 pre-pandemic level, full recovery in the labor market is expected to occur much faster compared to the Great Recession when it took a full six years to regain lost jobs. Still, progress has been far from even, with high and medium income earners having largely recovered their losses while low income workers continue to suffer disproportionately.
As the economy shifts gears with higher levels of spending, inflation concerns have emerged as have worries about higher interest rates. Higher inflation is all but guaranteed as demand expands while supply chains work through temporary shortages and bottlenecks. But runaway inflation is not in the picture, much less stagflation. Rather, inflation in the low single digits is more likely, somewhat above the new Federal Reserve Bank target of 2% to 2.5%. We forecast it to remain there over the next few months before receding to 2% some time in 2022. The most recent data as measured by the personal consumption expenditure (PCE) price index show a relatively high month-over-month increase, but the inflation rate was just 2.3% year-over-year in March. When the volatile food and energy components are excluded, inflation came in at just 1.8% year-over-year. Inflation may exceed these numbers in the coming months, but not by much.

Interest rates have also responded to economic conditions since the start of the year. Indeed, the yield on the benchmark 10-year U.S. Treasury Bond, which fell below one percent last year, has moved above 1.6% and is expected to approach 2.0% by year end. Rising interest rates are to be expected as the economy improves, both because of higher expected inflation and faster anticipated growth in the economy. Nevertheless, interest rates throughout the year will remain low by historical standards.

What are the implications for the Inland Empire economy of the upbeat U.S. picture? Overall, increased economic activity and job gains are expected throughout the year. The region’s logistics sector will continue to do well, as port activity in Los Angeles and Long Beach is expected to break records this year. However, other sectors will also see sharp gains, notably in the leisure and hospitality sector and in personal services, both of which experienced health order restrictions over the past year but will benefit when the California economy reopens more fully during the summer. In addition, Inland Empire destinations will be attractive for California residents who are ready to travel but will stick to road trips for the time being. Of course, reopening of schools will further contribute to the recovery as individuals who left the labor force for childcare reasons return to the labor force in the coming months.