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# U.S. Economic Outlook Report **August 3, 2021: Inflation, Labor Market, and Consumer Behavior... What Now?**

## *Prevedere Chief Economist, Andrew Duguay, provides a personal view on topical economic issues*

Economic media headlines are all over the map as we continue to navigate the repercussions of COVID. While it's challenging to plan for the future, understanding current signals from economic data can help businesses navigate uncertainty. This report highlights three key themes to understand moving forward: inflation, the labor market, and changing consumer behavior.

### **Understanding Inflation Signals**

For the past few decades, the U.S. has been in a very mild inflationary and deflationary environment. However, there have been some supply-side issues in the past few months that caused prices to rise. Combined with strong demand, three rounds of government stimulus, and loose monetary policy, there have been some pockets of inflation.

When talking about inflation, it's critical to think about two separate forms of inflation – transitory inflation and sustained inflation. Transitory inflation is the type of temporary inflation from supply chain shocks. Generally, transitory inflation goes down as supply ramps up to meet demand. Conversely, the more dangerous kind of inflation is sustained inflation.

At Prevedere, we believe that a large portion of the inflation right now is transitory and will correct itself after various supply chain disruptions, like the semi-conductor shortage or constrained lumber mill output, adjust to the high demand. There are also concerning elements of sustained inflation that we are keeping our eye on. One area of potentially long-term inflation is coming from rising labor costs, as wages tend to be sticky once they start rising (they don't go down as easily as they go up). Another area of long-term inflationary concern is the housing market, where most markets have seen double-digit price increases, and outside of large recessions, home prices tend to not give back price gains once they happen.

### **Challenging Labor Market**

In addition to inflation, one of the most uncertain aspects of the economy right now is the labor market, specifically unemployment and wage growth. Even though there are many jobs available, the number of unemployed is not matching with these jobs. Several factors could be affecting this, including the extended and enhanced unemployment benefits. However, these benefits have ended or are ending in September, resulting in the effects declining over the coming months.

Perhaps more importantly, the economy has shifted so drastically over the last 12-18 months that the type of jobs in demand is different. This is creating a traditional skills gap where unemployed workers may not have the skill set required for available job openings. Moreover, as new jobs open up in different geographic areas than before the pandemic, people may not want to relocate and might not be willing to fill these open positions.

Overall, about a third of all people who lost their job during the pandemic do not want to return to their old job and instead are looking for something entirely new. As they look for employment, people consider how accommodating employers are to remote work environments and the new lifestyle routines they have adopted during the pandemic. As a result, employers will need to prioritize flexibility and keep wages elevated to attract workers throughout this recovery.

### **Shifting Consumer Behavior**

In the era of COVID, there is a lot to learn about shifts in consumer behavior. Every month, new data reveals more information about the new consumer. For example, based on consumer sentiment surveys published by Prosper Analytics, it's clear that people are enjoying the reopening of the economy by spending more all around, but especially on clothes, physical goods, and meals out, compared to a year ago.

By comparing the results of their July survey to pre-pandemic data, it's clear that there's a blend of areas consumers are increasing spending and areas where they are pulling away from long-term habits, thus creating a "new normal" trend for many consumer retail categories. Consumer sentiment and spending will continue to change fairly quickly, and businesses will need to maintain a data-driven approach to planning to keep a pulse on where consumer spending is heading.

### **Conclusion**

At Prevedere, our baseline expectation is still for strong economic growth throughout the year. Month-to-month and quarter-to-quarter, the current recovery is already strong by historic U.S. standards. Based on the New York Federal Reserve's Weekly Economic Index, the U.S. is currently recovering at an 8.5% year-over-year growth rate. Prevedere's prediction for the entire 2021 year is for about 6% year-over-year growth. Of course, there will always be some uncertainty around COVID-19 and different variants, but right now it looks like consumers are spending the money they saved during the pandemic.

During the height of the pandemic, traditional business planning was basically thrown out the window because no one could plan during a global crisis of that nature. But, on the flip side, it also helped reshape how businesses plan and the type of information they include in their forecasting process. Overall, this evolution in planning and forecasting will allow companies to navigate uncertainty and find areas of opportunity moving forward. Our forecast suggests there are plenty of opportunities for businesses to take advantage of in this current economic climate, for those who are ready and able to adapt to the changing market conditions.