First Trust
Monday Morning OUTLOOK

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July 26, 2021

Inflation, Shutdowns, Spending

Someone once said, "technology has never moved this fast, and at the same time, will never move this slow again." So true! A partial list of recent technological advances includes: messenger RNA (mRNA) gene therapies, 5G wireless, blockchain, the cloud, low orbit communication satellites (Starlink), vertical indoor farming, and much more.

At the same time, the government in the United States has never been larger or more intrusive. This makes economic forecasting and investing a balancing act between the "supply side" of new technology and the "demand side" of government intervention.

Case in point is the Federal Reserve, which meets this week. The Fed is far less concerned than it should be about falling behind the curve on inflation. As a result, we don't expect any significant changes to monetary policy.

Obviously, the Fed is still a long way off from raising short-term interest rates. But, as we explained as far back as mid-June when the 10-year Treasury Note yielded roughly 1.5%, financial markets are much better prepared for an announcement about tapering and the eventual end of quantitative easing than they were back in 2013 under Fed Chair Ben Bernanke, when we witnessed the "taper tantrum." In other words, we think the Fed will continue to kick the can down the road, though it shouldn't.

The consumer price index is up 5.4% versus a year ago and up at a 3.5% annualized rate since February 2020, pre-COVID. The Fed's preferred measure of inflation is the PCE deflator. We think this was up about 0.7% in June (to be reported Friday). If so, this inflation measure is up 4.1% from a year ago and up at a 2.9% annualized rate versus February 2020. Yes, some of this inflation represents temporary supply-chain issues. But it also reflects overly loose monetary policy. The M2 measure of the money supply has soared 32% since COVID hit, something that didn't happen during or after the Financial Crisis in 2008-09. Those assuming inflation gets back to a roughly 2.0% trend in 2022 are in for a rude awakening.

But inflation shouldn't be our only government worry. Even though hospitalizations and deaths remain way down versus previous spikes, the media has been amplifying any negative news it can find on the "Delta" variant and we can't casually dismiss the possibility that some places around the country are going to re-tighten limits on economic activity and schools later this year.

Our best guess, though, is that the hurdle to re-imposing strict limits is going to be very high. Republican states have generally supported looser restrictions, while Democratic states more often supported tighter restrictions. With elections right around the corner, there are reasons to expect a less restrictive response on average.

Meanwhile, policymakers are fighting about two measures to increase federal spending over the next several years. The first measure is a bipartisan infrastructure deal to raise spending by about $1 trillion, although some of the spending may be repurposed from other programs. No guarantees, but our best guess is that this measure eventually dies.

The other measure would be a purely partisan Democrat effort to boost spending by up to $3.5 trillion over the next several years. The momentum behind this effort is waning because the US has already pushed through nearly $5 trillion in spending bills during the pandemic and it only takes one "no" vote from a Democratic senator to kill it. However, Democrats have a great deal of political capital invested in the idea of "human infrastructure" and tax hikes, and this legislation is far from dead.

The economy is healing rapidly, the bull market remains intact and technology is raising potential future growth. But, government actions could undermine these positive trends. For now, we remain bullish.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
7-26 / 9:00 am	New Home Sales – Jun	0.796 Mil	**0.802 Mil**	0.676 Mil	0.769 Mil
7-27 / 7:30 am	Durable Goods – Jun	+2.0%	**+2.6%**		+2.3%
7:30 am	Durable Goods – Jun	+0.8%	**+0.4%**		+0.3%
7-29 / 7:30 am	Initial Claims - Jul 20	382K	**380K**		419K
7:30 am	Q2 GDP Advance Report	8.5%	**8.3%**		6.4%
7:30 am	Q2 GDP Chain Price Index	5.4%	**4.9%**		4.3%
7-30 / 7:30 am	Personal Income – Jun	-0.4%	**-1.0%**		-2.0%
7:30 am	Personal Spending – Jun	+0.7%	**+0.5%**		0.0%
8:45 am	Chicago PMI	64.0	**69.0**		66.1
9:00 am	U. Mich Consumer Sentiment- Jul	80.8	**81.0**		80.8