THINK STRATEGICALLY:

The Threat of Inflationomics

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What is the threat of Inflationomics?

In the midst of the accelerating U.S. economic recovery, combined with the most extensive fiscal stimulus funding absent a world war, we begin to see the effect of the Inflationomics Threat.

Adding to the Inflationomics Threat is the fact that the Federal Reserve has pledged to maintain interest rates low until the country reaches full employment. This fact is creating concerns among inflation hawks.

There is an argument that if U.S. inflation is not curbed in time, the economy may overheat. This issue has created high volatility.

How considerable is the threat of Inflationomics?

The reopening recovery, stimulus support, rising personal savings and low interest rates have provided the U.S. the right environment for Growth Domestic Product (GDP) to continue rising even above the current rate of 6.4 percent.

We also expect that the continued rise in economic fortunes will bring the unemployment rate to the 3.5 percent to 4 percent range. However, there are significant risks on the horizon that could impact the overall economy.

The critical question then is what role will Inflationomics play?

We project that personal consumer expenditures will rise near 2 percent to 2.3 percent by 2022-2024, more significantly than in the last economic cycle, but near the Federal Reserve goals. Our expectations for economic growth follow:

– Gross Domestic Product: may rise in the range of 7 percent to 7.4 percent for 2021 and in the range of 4.8 percent to 5.25 percent for 2022.

– Unemployment Rate: our model suggests a range of 4.75 percent to as low as 4.25 percent for 2021.

Latest economic figures:

– U.S. Real GDP rose to 6.4 percent, compared with 4.3 percent last quarter, a 32.8 percent increase.

– U.S. Initial Claims for Unemployment Insurance fell to 406,000, down from 444,000 last week, or 8.56 percent.

– U.S. Personal Savings Rate rose to 21.4 percent, compared with 13.6 percent.

– U.S. Durable Goods New Orders fell 1.29 percent, compared with 2.18 percent last month.

– U.S. Durable Goods New Orders Year-over-Year rose to 45.60 percent, compared to 20.97 percent last month.

The U.S. GDP growth of 6.4 percent remains on target, and the initial jobless claims surpassed projections for the second consecutive week by reaching 404,000 versus 425,000, which was the expectation.

The temporary stimulus funding, including the enhanced unemployment benefits, has kept many people receiving a paycheck during the pandemic. The program has also created a situation in which people do not respond to job ads, given that they continue to receive the enhanced unemployment.

This situation in the United States has become a dramatic shift, and in Puerto Rico is creating significant problems in the most labor-intensive sectors that cannot find enough workers. Overall, employment is 6 percent below the pre-pandemic level. In a familiar economic environment, this would indicate an output gap of significantly more than 6 percent because swings in output typically exceed swings in employment by a factor of about two, a relationship known as Okun's law.

What is Okun's Law?

Okun's law is based on research findings in the 1960s by the economist and Yale professor Arthur Okun. In its simplest form, Okun's law deals with the statistical relationship between a nation's unemployment rate and its economy's growth rate. Total employment equals the labor force minus the unemployed, so there is a negative relationship between output and unemployment.

However, Okun's law doesn't mix well with current circumstances because the labor weakness concentrates on the economy's most labor-intensive sectors.

Because the pandemic was an exogenous economic shock, the market dynamics are behaving quite differently. Take, for example, the fact that manufacturers prepared for a long-term recession that never happened. In turn, they face superlative increases in demand for all kinds of products; the absence of enough supply is driving prices upward. Should this situation prove to be temporary, the threat of Inflationomics could prove just another scare. We shall see soon enough.

Week in Markets: A month for the record books; President Biden's $6 trillion budget:

The U.S. and European stock markets ended the week slightly higher, while the month closed with solid gains for the Dow Jones, which rose 654.60 points. The S&P 500 also ended the month in the black, rising 22.94 points. Although the Nasdaq Composite ended the week up, it closed the month with a 213.94-point loss.

The U.S. GDP growth of 6.4 percent remains on target, and the initial jobless claims surpassed projections for the second consecutive week by reaching 404,000, versus the 425,000 expected.

In our view, the markets remained on their path, absorbing the GDP and jobs data and the generally positive economic tone.

The month-end's main headline was President Biden's $6 trillion budget for 2022. Additionally, Republicans presented their $928 billion counterproposal to the White House's $1.7 trillion infrastructure bill. There may be a glimmer of hope that some form of a bipartisan deal may be reached. This bill contains significant tax increases that may impact the U.S. investment climate across the board.

For investors, the infrastructure bill is the one of most interest, given the significant threat the potential tax hikes pose for the economic recovery.

Two key benchmarks reported:

– U.S. Personal Income fell 13.14 percent, versus 20.88 percent last month. The decrease reflects the lack of stimulus checks that went out in March.

– U.S. Personal Consumption Expenditures rose to $15.07 trillion, up from $14.54 trillion last quarter, an increase of 3.66 percent from the previous quarter.

Weekly Market Close Comparison	5/28/2021	4/30/2021	Return	YTD
Dow Jones Industrial Average	34,529.45	33,874.85	1.93%	12.82%
Standard & Poor's 500	4,204.11	4,181.17	0.55%	11.93%
Nasdaq Composite	13,748.74	13,962.68	-1.53%	6.68%
Birling Puerto Rico Stock Index	2,645.85	2,496.15	6.00%	29.38%
U.S. Treasury 10-Year Note	1.65%	1.65%	0.00%	0.70%
U.S. Treasury 2-Year Note	0.16%	0.16%	0.00%	0.70%

The Final Word: Memorial Day — Comparing the Class of 2021 to 1966's

Like many others before, this Memorial Day, we honor and mourn those brave soldiers who paid the ultimate price for defending our freedom. The holiday, held on the last Monday of May, usually coincides with the graduation of many seniors. This year, more than any other, I have heard many parents and seniors lamenting and calling the pandemic limitations a calamity. They claim their children deserve better than having to graduate with face masks, having to social-distance and no senior trip or as many parties as they hoped for.

As much as we can all relate to their situation, we must remember the class of 1966.

The graduating class of 1966 faced a calamity like no other, the draft and the Vietnam War. Out of a total of nearly 2.7 million students in the United States, 14.33 percent, or 382,010, were sent to the Vietnam war.

That year alone, 6,000 would die, and another 30,000 would be wounded.

In that sense, the graduating classes from 1964 to 1974 that faced the Vietnam War totaled 1,857,304 students. More than 58,200 Americans died.

So, when you consider your current situation that calls for facing graduation wearing a face mask or social distancing, please remember those very much like you who were sent to the Vietnam War following their graduations and paid the ultimate price for our freedom.

Semper Fidelis.

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