SMITH AFFILIATED CAPITAL

WEEKLY ECONOMIC COMMENTARY

Last week, the employment report featured an astonishing gain of nearly 1 million jobs in March. This week's highlight was the retail sales report that showed consumers went on a much stronger spending binge than anyone expected during the month. In the wake of these blockbuster outcomes, as well as a robust report on housing activity, further improvement on the labor front, and a rebound in factory output, the opening chapter of 2021 is looking more vigorous than thought a month or two ago.

Indeed, the Federal Reserve Bank of Atlanta's GDP tracker now pegs the first-quarter growth rate at 8.3 percent, up from 6 percent a week earlier. The catalysts propelling these and other upgraded forecasts are readily identified. First and foremost is the government's unprecedented fiscal stimulus, including the latest round of direct checks that most households received in the latter part of the month. But a powerful assist was also provided by the rapid pace of vaccinations, which gave households more confidence to leave their bunkers and engage in social activities, such as travel, sports, and dining out.

With the stimulus payments sent out on March 17, there was probably a sizeable balance still unspent at the end of the month, which should boost sales in April. That said, it would be hard to rival the astonishing 9.8 surge in retail sales that took place last month. The March gain was the second largest on record, exceeded only by the 18.3 percent spike last May, but that jump followed a record 14.8 percent plunge in April when the economy was still in full lockdown mode. While the increase last month also rebounded from a setback in February, the slump in sales that month was a much smaller 2.7 percent, reflecting harsh weather conditions as well as the temporary lapse of government support.

With consumers expected to spend freely in the coming months, some question whether demand will outstrip supply and drive up prices, stoking inflation fears. This concern is more pressing in the goods-producing sector, where supply-chain disruptions are holding back production. A severe shortage of semiconductors, for example, is hobbling output in the auto industry, even as sales of motor vehicles surged to the highest level in more than three years in March. To be sure, supply constraints are not stifling production entirely. Industrial production increased by 1.4 percent in March, which would be considered a decent outcome in "normal" times.

With supply chain restraints still very much in effect (a severe drought in Taiwan, a major producer of semiconductors, is further depressing chip production and crimping global supplies), production costs are coming under increasing pressure. And if recent surveys are any indication, manufacturers and a broad swath of producers are planning to pass on these higher costs into selling prices. However, the pressure on prices should gradually ease as consumption patterns shift from goods to services, where most of the pent-up demand has been.

Not surprisingly, the combination of surging demand, supply constraints, warmer weather, and improving health conditions feed the narrative of a temporary spike in inflation. That narrative received support this week with the Labor Department's consumer price report for March. The headline CPI rose by an outsized 0.6 percent during the month, the fastest clip since August 2012, lifting the annual inflation rate to 2.6 percent from 1.7 percent in February. However, sharply rising gasoline prices accounted for about half the overall CPI increase from February. And the heavily discounted prices during the height of the pandemic last March amplified the annual inflation rate. The less volatile core CPI, which excludes food and energy items, rose by a more modest 0.3 percent over February and 1.6 percent from a year ago. Both readings were up from the previous month, but not alarmingly so, and the so-called base effects also impacted the core CPI.

These base effects will age out of the calculations over the second half of the year, and the current influences putting upward pressure on prices should ease. After pent-up demand is exhausted over the spring and summer months, consumer spending should downshift even as supply constraints fade, reducing bottlenecks and upward pressure on prices. Against that backdrop, neither the financial markets nor the Fed believes the spike in inflation will be sustained.

One of the more perplexing developments this week was the benign response of the bond market to the muscular economic and inflation data released during the period. The bellwether 10-year Treasury yield fell for the second consecutive week, slipping to a five-week low of 1.58 percent on Friday. Several external factors contributed to the decline; however, Fed officials' continued barrage of dovish statements, including Chair Powell again this week, may finally be driving the message home. We expect the 10-year yield to move up close to 2 percent by the end of the year. That's quite a step-up from the pandemic-induced record low hit last year, but still historically low and hardly a growth-stifling level that would prevent the expansion from extending into 2022.

FINANCIAL INDICATORS				
INTEREST RATES	April 16	Week Ago	Month Ago	Year Ago
3-month Treasury bill	0.02%	0.02%	0.01%	0.12%
6-month Treasury bill	0.04	0.04	0.03	0.16
3-month LIBOR	0.19	0.19	0.19	1.22
2-year Treasury note	0.16	0.15	0.16	0.2
5-year Treasury note	0.83	0.87	0.90	0.36
10-year Treasury note	1.88	1.66	1.74	0.65
30-year Treasury bond	2.28	2.33	2.45	1.27
30-year fixed mortgage rate	3.04	3.13	3.09	3.31
15-year fixed mortgage rate	2.35	2.42	2.40	2.8
5/1-year adjustable rate	2.80	2.92	2.79	3.34
STOCK MARKET				
Dow Jones Industrial Index	34200.67	33800.60	32627.97	24242.49
S&P 500	4185.47	4128.80	3913.10	2874.56
NASDAQ	14052.34	13900.80	13215.24	8650.141
Commodities				
Gold ($ per troy ounce)	1777.30	1743.70	1735.20	1692.55
Oil ($ per barrel) - Crude Futures (WTI)	63.07	59.37	63.22	20.12
ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/ Quarter	Two-Months/ Qtrs Ago	Average-Past Six Months or Quarters
Retail Sales (March) - % change	9.8	-2.7	7.7	2.0
Consumer Price Index (March) - % change	0.6	0.4	0.3	0.3
Core CPI (March) - % change	0.3	0.1	0.0	0.1
Industrial Production (March) - % change	1.4	-2.6	0.9	0.5
Capacity Utilization (March) - % change	74.4	73.4	75.3	74.2
Housing Starts (March) - 000s	1739	1457	1642	1599
Building Permits (March) - 000s	1766	1720	1886	1709