Economics and Country Risk

Indiana Economic Forecast Update

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Tom Jackson, Principal Economist, US Regional Economics
Tom.Jackson@ihsmarkit.com

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Upward revisions to the forecast as COVID-19 inoculation campaign accelerates

- Real GDP rose at a 4.3% annual rate in the fourth quarter, according to BEA's third estimate, 0.2 percentage point above the second estimate. The recovery through the fourth quarter left the level of GDP 2.4% below the peak attained in the fourth quarter of 2019.
- Our forecast of real GDP growth has been revised up from 5.7% to 6.2% in 2021 and from 4.1% to 4.3% in 2022.
- One factor is the strength in credit/debit card spending through mid-March. In addition, most stimulus checks from the American Rescue Plan Act were delivered in March, earlier than we had assumed, boosting our estimate of first-quarter real consumer spending growth to 9.2%.
- More important is the acceleration of the vaccination campaign. Recent projections show widespread inoculation of the US population by July, and many states are relaxing containment measures. This encouraged us to revise up projected growth of real consumer spending on services other than housing, utilities, and healthcare to approximately 15% for the year.
- The conditions for Fed "lift-off" are still met by mid-2024. Hence, we have not changed our Fed call and still expect the target for the federal funds rate to be raised at that time.

Policy assumptions in the April forecast

- This forecast reflects all pandemic relief measures of 2020 and the recently enacted $1.9 trillion American Recovery Plan (ARP). ARP includes:
  - stimulus checks of $1,400
  - extension of emergency unemployment programs through early September including an enhanced unemployment benefit of $300/week
  - $350 billion of unrestricted aid to state and local governments
  - $287 billion of support for education, and
  - a range of additional tax credits and outlays for pandemic-affected industries and COVID-19 mitigation efforts
- The forecast does not (yet) include the President's American Jobs Plan which proposes to spend $2.1 trillion on social investments paid for over 15 years by higher corporate taxes.
- Strong revenues, reinforced by ARP, limit the usual cyclical state and local fiscal contraction. State and local employment rebounds in the fall as schools re-open.

Indiana economy began its rebound from pandemic lows relatively quickly, but full recovery will take more time

- Indiana had a relatively modest initial COVID-19 outbreak, allowing an early reopening.
  - Many office workers were able to switch to full-time remote work
  - “Essential” workers remained on the job as much as feasible amid outbreaks
  - Shutdown of air travel, business travel, most sports and entertainment venues very costly
- Manufacturing has recovered much more quickly than from most downturns.
  - Manufacturers reopened after a two-month break.
  - Stimulus checks, limited income losses for many workers, and drop in leisure spending boosted demand for durable goods, including motor vehicles.
  - Supply chain bottlenecks and shortages of some components are a threat to production gains
- Job recovery has resumed after a slowdown, but lower-wage service jobs will be difficult to restore or replace.
- State payroll employment will return to pre-pandemic peak by late 2022; real GDP returned to peak in early 2021.

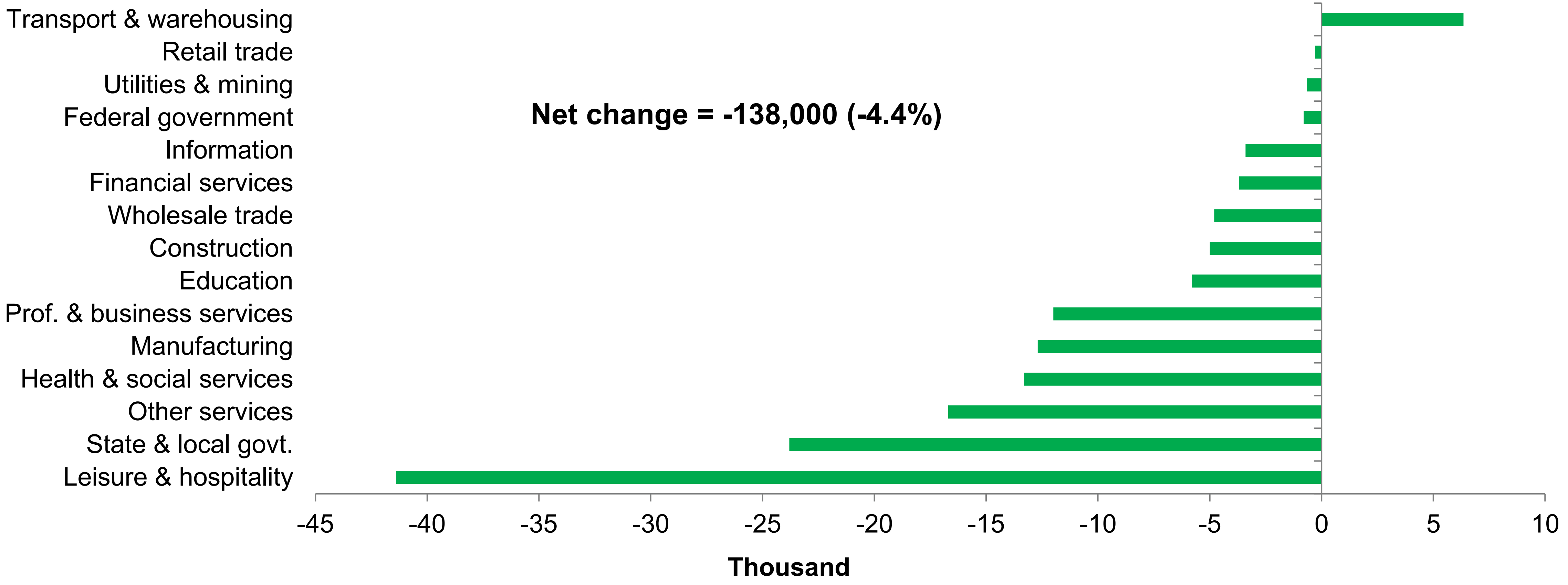
Changes to April forecast from December

- Federal fiscal stimulus much higher than we had assumed in December
- Added fiscal stimulus plus gains in reopening economy boost most major indicators
  - Real GDP, personal income, consumer spending, business fixed investment, all higher in April
- Revisions to 2020CY Indiana data were mostly minor
  - Downward revision to payroll employment (mostly in leisure and hospitality) offset by higher average wages
  - Transfer payments to individuals were much higher in 2020Q4 thanks to addition of $600 stimulus checks

- Indiana wages, personal income, consumer spending now higher along with national forecast
  - Consumer spending boosts demand for manufactured goods, an Indiana strong point
  - Service sector will see faster growth as long as COVID-19 cases remain relatively subdued

Freight transportation jobs rolling along, while leisure and hospitality remains well below year-ago

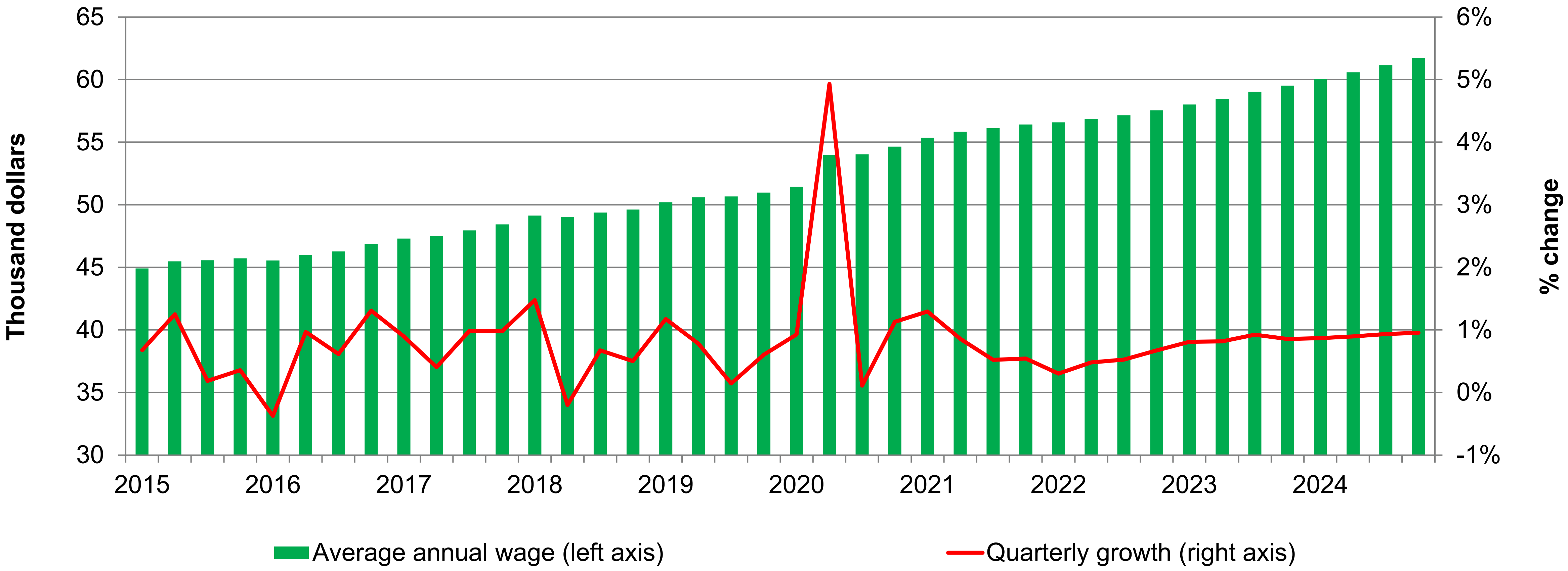
Change in Indiana payroll employment, Feb 2020 - Feb 2021



Source: IHS Markit

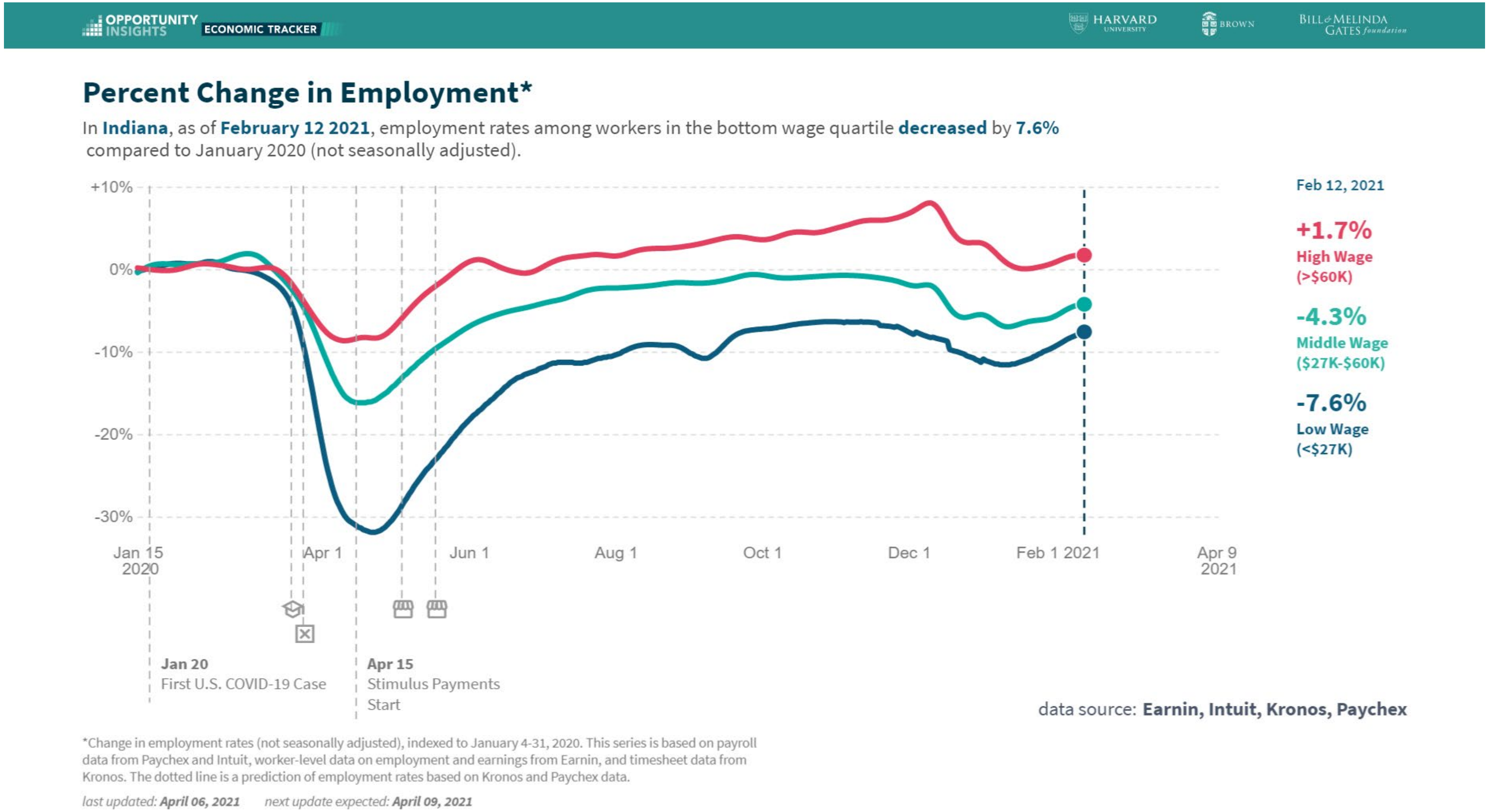
Disproportionate losses of low-wage jobs skewed average wage gains much higher than normal in 2020

Indiana wage growth

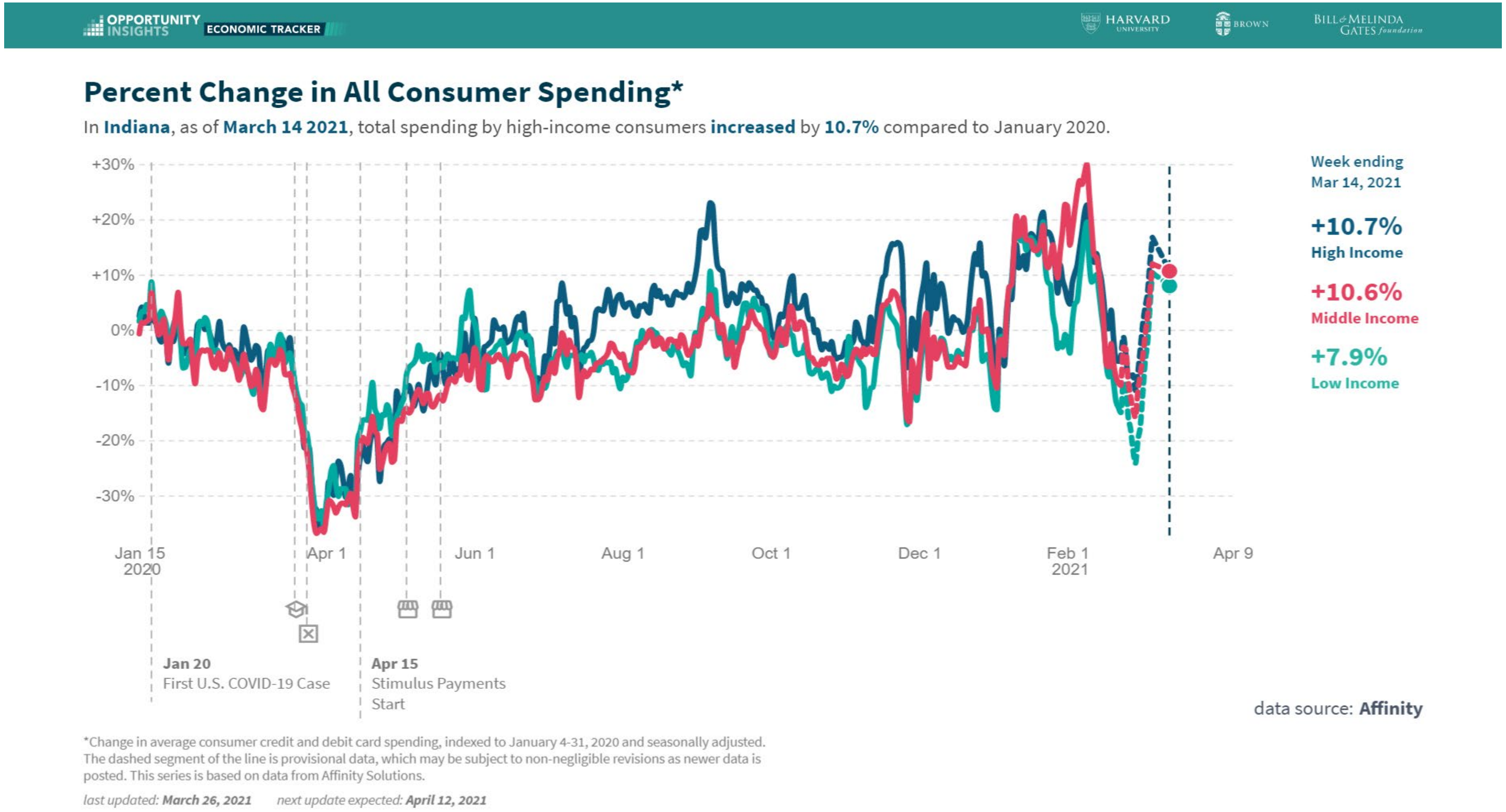


Source: IHS Markit

What the "K-shaped recovery" means in terms of jobs



Fiscal stimulus payments have supported consumer card spending



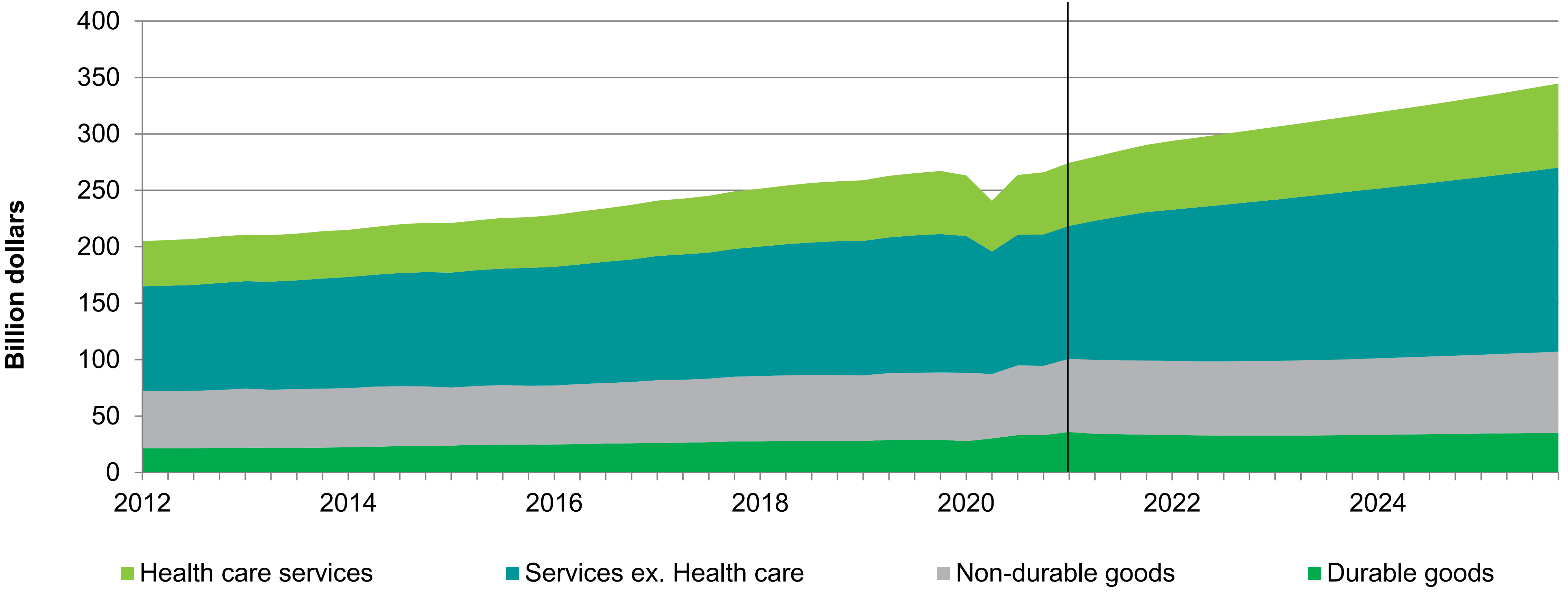
Key economic indicators for Indiana

	2019	2020	2021	2022	2023
Units: Percent change					
Payroll employment	0.7	-5.5	3.6	2.0	0.6
Unemployment rate (%)	3.2	7.2	3.9	3.5	3.2
Wage income	3.3	0.0	8.4	4.0	3.6
Personal income	3.4	5.8	7.4	-0.5	3.5
Real gross state product	1.6	-3.1	7.5	3.0	1.2
Personal consumption exp.	3.3	-2.0	9.3	5.7	4.2

- Personal income boosted by Federal stimulus/extra unemployment payments, rebound in wage disbursements in 2021; absence of stimulus checks shows in 2022
- PCEs boosted by stimulus checks and pent-up demand from 2020

Spending on services, including health care, dropped sharply in last spring, but will regain share as economy gets back to normal

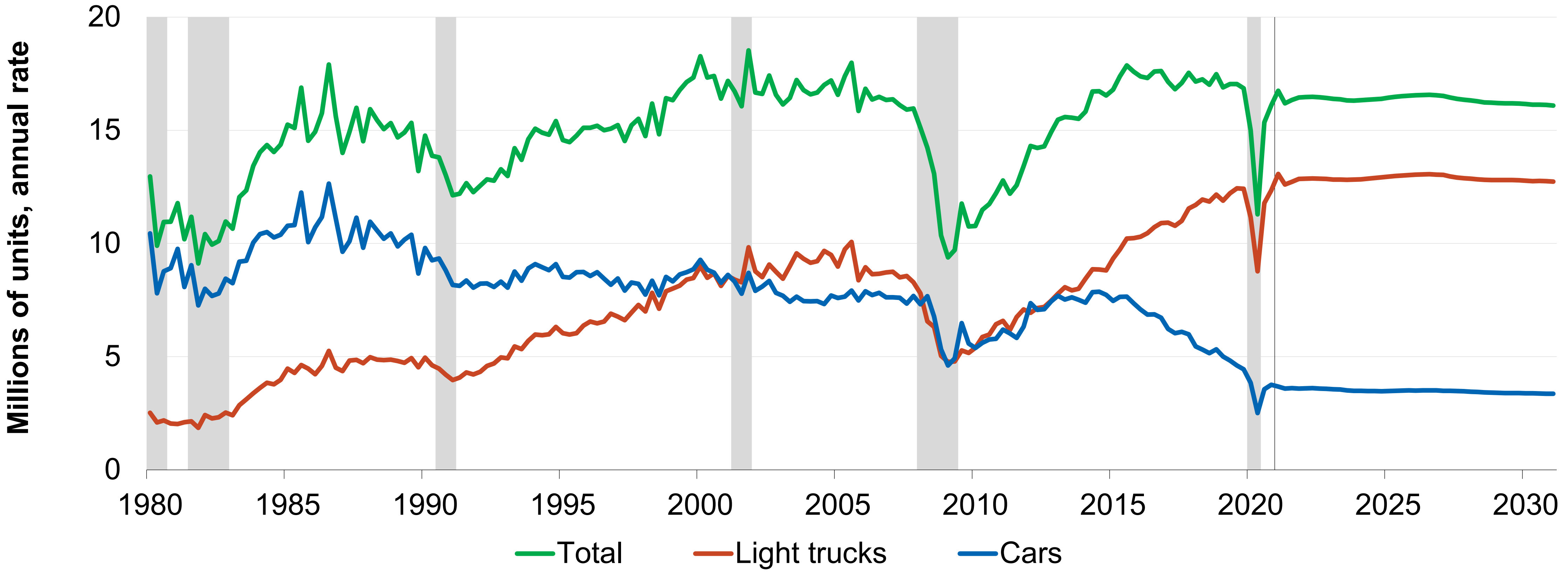
Personal consumption expenditures by category, Indiana



Source: IHS Markit

U.S. auto sales stalled initially but accelerated quickly by summer

Total U.S. light-vehicle sales



Source: IHS Markit

Bottom line for Indiana

- The fate of the recovery depends partly on avoiding another “surge” in virus cases, both within the state and nationally
  - Return to in-person education will help on multiple fronts, including boosting labor supply
  - Portions of leisure and hospitality will return quickly, while business and international travel remain slow
  - A return to offices on at least a part-time basis is very important to businesses in downtowns of all sizes
- Outlook for manufacturing output and employment remains solid
  - Demand for goods supported by robust personal income
  - Supply chain issues causing sporadic problems, while input costs rise rapidly
  - Reconfigured supply chains (re-shoring) could provide opportunity, but too early to tell
- Reckoning with financial fallout from lagging payments for mortgages, rents, credit cards, other debts is another hurdle to avoid lingering economic effects
- Recent burst of homebuilding will moderate by late 2021, but will remain at elevated levels
- Longer-term fundamentals remain the same – labor force must continue to grow in size and skill level to allow existing business to expand and to attract new business

Evolution of short-term Indiana forecast

	U.S. GDP		Indiana employment		Indiana income	
Forecast date	**2020**	**2021**	**2020**	**2021**	**2020**	**2021**
Apr 2019	2.1	1.9	0.4	0.0	4.1	4.0
Dec 2019	2.1	2.0	0.5	0.3	3.4	3.8
Apr 2020	-5.4	6.3	-5.7	-1.4	1.8	2.6
Dec 2020	-3.4	4.3	-4.4	-2.5	6.0	0.6
Apr 2021	-3.5	6.2	-5.5	3.6	5.8	7.4

Units: Percent change

Source: IHS Markit

US macro outlook – supplemental information

US economic growth by sector

Percent change	2020	2021	2022	2023
Real GDP	-3.5	6.2	4.3	2.2
Final sales	-2.9	5.4	3.9	2.5
Consumption	-3.9	7.0	4.7	2.8
Light vehicle sales (Millions)	14.4	16.4	16.5	16.3
Residential fixed investment	6.1	11.7	-5.5	-4.7
Housing starts (Millions)	1.40	1.55	1.39	1.27
Business fixed investment	-4.0	7.3	6.6	4.4
Federal government	4.3	2.7	-2.1	-0.8
Exports	-12.9	6.3	7.6	5.4
Imports	-9.3	14.4	4.9	2.9

Source: IHS Markit

Other key US indicators

Key indicators				
Percent change	**2020**	**2021**	**2022**	**2023**
Industrial production	-6.7	6.5	4.4	2.2
Payroll employment	-5.7	3.1	3.1	1.5
Consumer Price Index	1.2	2.4	1.5	1.8
Core CPI	1.7	1.7	2.0	2.2
Brent crude oil price (USD/barrel)	41.8	65.9	63.5	61.7
Federal funds rate (%)	0.38	0.07	0.08	0.10
10-year Treasury yield (%)	0.89	1.64	1.92	2.02

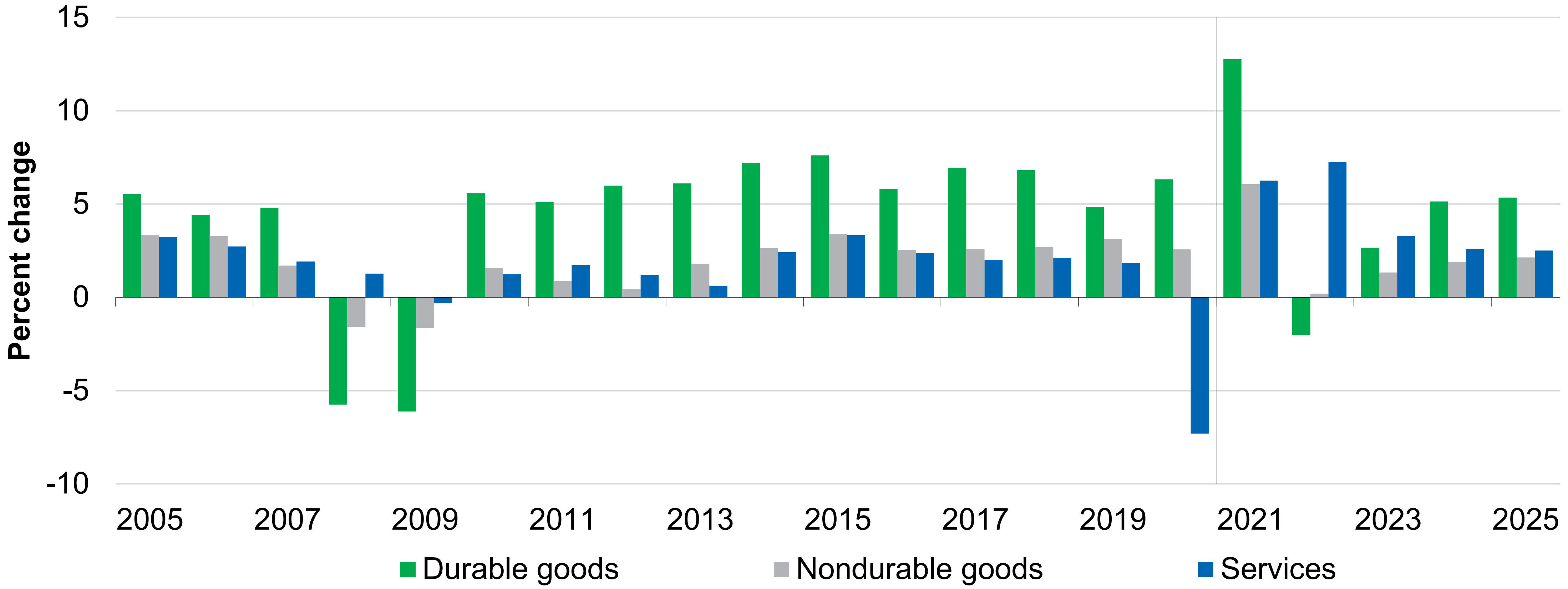
Source: IHS Markit

American Jobs Program

- President Biden's American Jobs Program (AJP) is not reflected in this forecast. However, we offer some preliminary observations:
- The media refers to AJP as an "infrastructure bill", but less than a third of the spending ($621 billion) is for transportation projects conventionally considered infrastructure investments. Even within that $621 billon, $174 billion is in "unconventional" support of electric vehicles.
- Otherwise, AJO allocates $590 billion to domestic manufacturing, R&D, and job training; $400 billion to expanding home care services and supporting care workers; $328 billion to improving housing, schools, childcare facilities and VA hospitals; and $311 to improving broadband access, upgrading the electrical grid, and purifying drinking water.
- Our initial estimates suggest that the ramp up in spending could raise GDP growth by between 0.2 and 0.4 percentage point for several years—enough to lift the level of GDP about 1% above our baseline forecast by 2024 and push the unemployment rate below 3%—before the effects reverse.

Big losses for services, but astonishing goods spending

Real consumer spending



Source: IHS Markit

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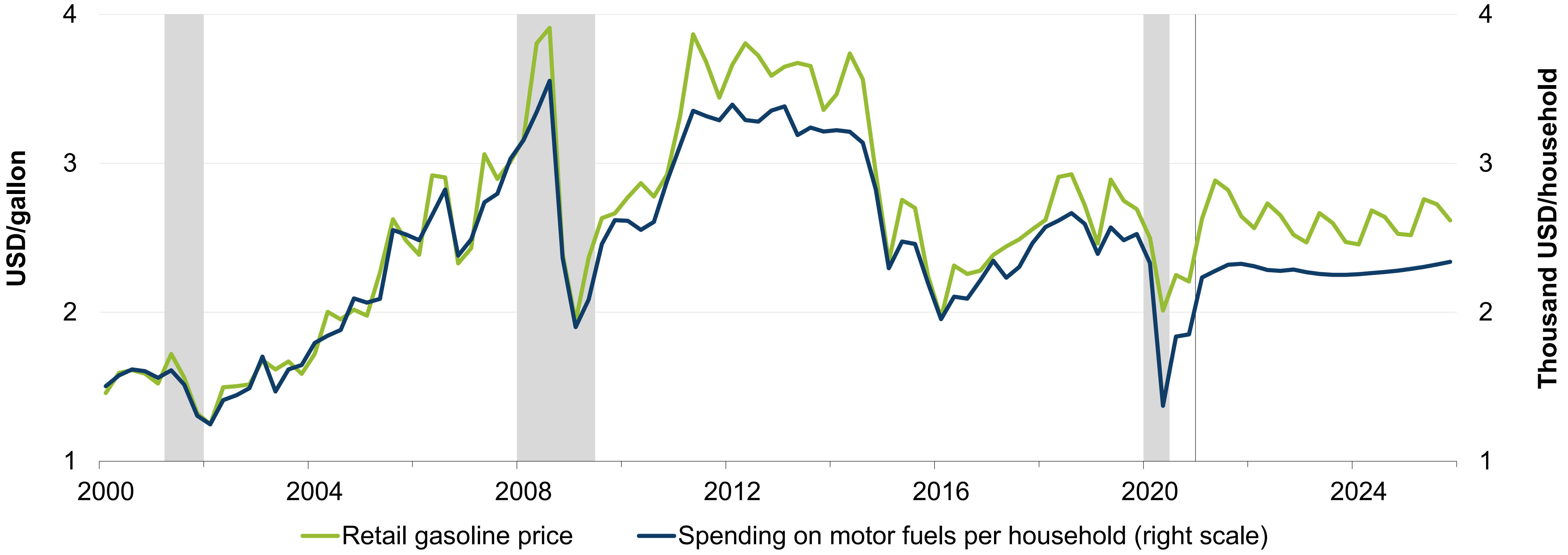
Retail gasoline prices reflect changes in crude oil prices

Retail gasoline price and annualized spending on motor fuels



Source: IHS Markit

The housing market is hot, but headwinds are blowing

- The housing market remains strong but is cooling. New and existing home sales, housing starts, and housing permits all declined in February. Forward-looking indicators—pending home sales, builder sentiment, and mortgage applications to buy homes—are slipping.
- The cooling is in line with expectations. Hence, our forecast for housing starts is essentially unchanged in April.
- Housing starts peak in the first half at a 1.6 million annual rate, and then over a two-year period move down to a level determined by population growth (1.2-1.3 million annually).
- With inventory at an all-time low and shrinking, home prices will sizzle in the first half of this year; home price growth will eventually slow as prospective homeowners are priced out of the market.
- Forbearances remain a risk. On 28 March, 4.96% (or 2.5 million) of mortgage loans were in forbearance plans, up from 0.25% in early March.

Risks to the US forecast

Scenario	Characteristics
Pessimistic: Recovery stumbles as consumers hunker down amid fourth wave (Probability = 25%)	• Amid a fourth wave of COVID-19 infections, including more contagious strains of the virus, consumers turn cautious until the vaccines are more widely available in the summer. Re-introduced containment measures accompany this caution. • The unemployment rate declines at a gradual pace, not falling below 5.0% until mid-2022. The previous peak in GDP is passed in the fourth quarter this year, two quarters later than in the baseline. • Same fiscal assumptions as the baseline, but we assume that consumers are more reluctant to spend their stimulus checks and instead save most of the additional income.
Optimistic: Easing containment measures, accelerating vaccinations and still more stimulus drive faster recovery (Probability = 25%)	• The daily number of new cases dwindles quickly, allowing business restrictions to relax and consumer spending to approach pre-pandemic patterns earlier than assumed in the baseline. • The vaccination timeline continues to accelerate, resulting in the population effectively reaching herd immunity by late spring rather than summer. • The previous peak in GDP is passed in the second quarter of 2021, the same as in the baseline. The unemployment rate falls below 4.0% by the end of this year. • The Fed begins to raise the federal funds rate in mid-2022, two years earlier than in the baseline forecast. • Same fiscal assumptions as the baseline, but we assume the aid is more front-loaded and the consumer response more robust than in the baseline.
Baseline forecast (Probability = 50%)	• COVID-19 cases plateau around their current level, while the vaccination campaign continues apace and results in moderately looser containment measures and a gradual recovery in consumer spending. • Real GDP crosses its previous peak in the second quarter of 2021. The federal funds rate is held near zero until mid-2024 as the Fed encourages a slight inflation overshoot. • Fiscal stimulus totaling $1.9 trillion, including another round of stimulus checks, extensions to unemployment programs, COVID-19 mitigation, and aid to state and local governments.

Bottom line for the US economy

- Our forecasts of year-over-year real GDP growth for 2021-22 have been revised up, from 5.7% and 4.1%, to 6.2% and 4.3%, respectively.
- This forecast incorporates the $1.9 trillion American Rescue Plan (ARP) Act passed in March.
- Given its uncertain political prospects, we have not (yet) included the American Jobs Plan (AJP) in our base projections. The AJP includes spending of $2.1 trillion on social investments, paid for over 15 years with higher corporate taxes. The AJP could boost GDP growth by 0.3–0.4 percentage point from 2022 through 2024.
- In this forecast, quarterly real GDP surpasses its previous peak in the second quarter, while monthly real GDP passes its previous peak in May of 2021; the output gap is eliminated by mid-2022.
- Core PCE inflation reaches 2% in mid-2023.
- We have not changed our Fed call. The conditions for Fed “lift-off” are still met by mid-2024.

IHS Markit Customer Care

CustomerCare@ihsmarkit.com
Americas: +1 800 IHS CARE (+1 800 447 2273)
Europe, Middle East, and Africa: +44 (0) 1344 328 300
Asia and the Pacific Rim: +604 291 3600