FISCAL STIMULUS IS UNLIKELY TO CAUSE PERSISTENTLY HIGHER INFLATION

May, 2021

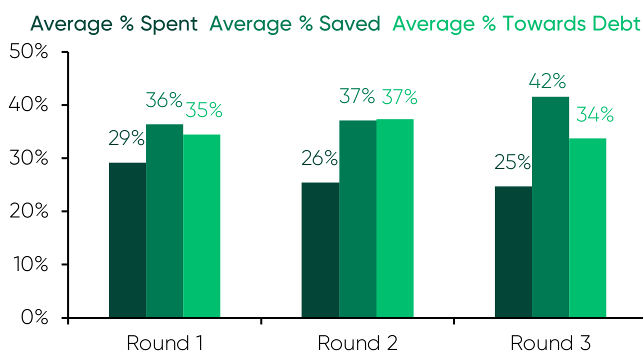
KEY POINTS

- Majority of stimulus checks allocated to debt repayment and savings rather than consumer spending.
- Real GDP growth increases modestly following stimulus, losing momentum in proceeding years.
- Despite recent data points showing price increases, we expect inflation will remain benign longer term and growth leadership to resume.

Several prominent economists have argued the recently passed $1.9 trillion American Rescue Plan portends high inflation, stirring some investors' fears. Unlike prior COVID-19 relief packages, they argue, this package is too frivolous in handing out cash, which will inevitably trickle down to the real economy and push prices higher. We disagree with this for a number of reasons, not least because there is not much evidence money is changing hands quickly. Some recent survey and data results illustrate this, showing why investors needn't fear runaway inflation hurting stocks.

Exhibit 1 shows results from a recent New York Fed survey, which asked stimulus check recipients how they allocated proceeds among spending, saving and paying down debt. Perhaps surprising many, recipients reported spending only 26% of funds (on average across the three rounds of stimulus checks), saving or paying down debt with the balance.

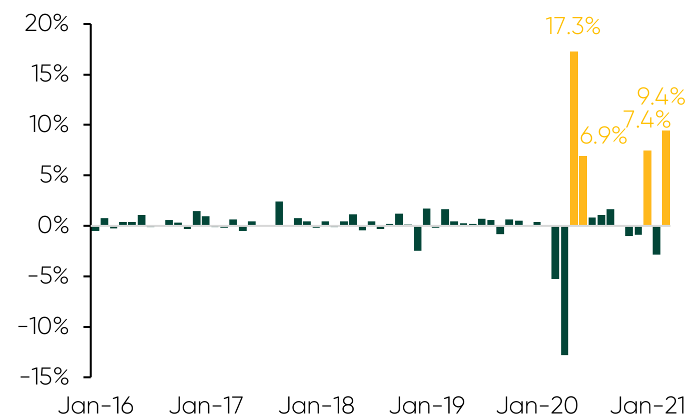
Exhibit 1: Distribution of Stimulus Check Usage



Source: Federal Reserve Bank of New York, as of 19/04/2021.

While the percentage spent was surprisingly small, the checks were still big enough to impact retail sales data. As Exhibit 2 shows, each of the four largest monthly gains in recent years (May 2020, June 2020, January 2021 and March 2021) occurred in the aftermath of COVID relief checks being distributed. However, the post-check bounces were short-lived, which suggests the impact from the latest round is mostly in the rearview already. Absent additional waves of checks, retail sales growth is likely to decelerate.

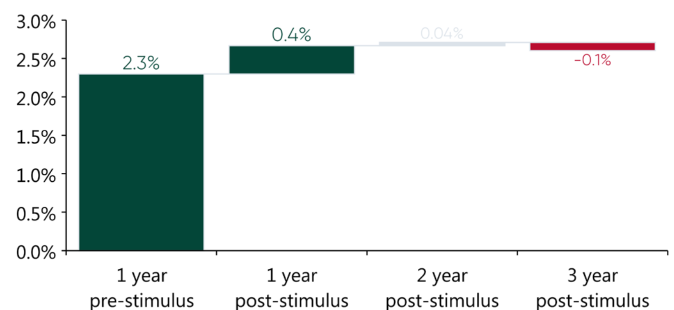
Exhibit 2: US Retail Sales Growth (M/M % Change)



Source: US Census Bureau, as of 19/04/2021.

Similarly fiscal stimulus may provide a near-term boost to consumer spending and GDP growth, but historical data shows that stimulus have only a modest effect and that this effect quickly fades. As seen in Exhibit 3, historically the median real GDP growth rate modestly increases +40 bps in the year following stimulus, but loses momentum in the following years, with growth decelerating by year 3 post stimulus.

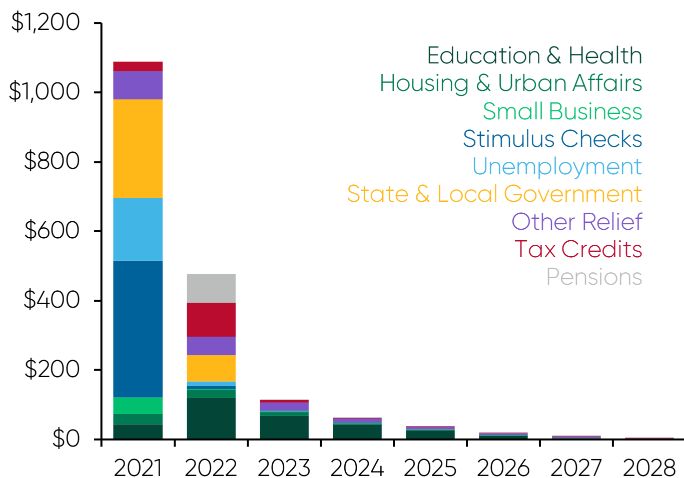
Exhibit 3: Median GDP Growth Post Stimulus



Source: St. Louis FED, Fisher Investments Research Stimulus Dates; Real GDP in 2012 chained prices, SAAR.

Of course, the stimulus checks are only one aspect of the American Rescue Plan. However, according to analysis done by the Congressional Budget Office, the checks are the largest component of the plan, accounting for 36% of fiscal year 2021 outlays. Additionally, the next two largest components, state and local government relief and unemployment compensation are, to a large degree, replacing pre-pandemic income rather than adding to it. Substitution isn't stimulus. So while we acknowledge the package may impact some prices by boosting demand of some goods relative to supply, that doesn't equate to broad and lasting inflation, which entails prices rising across the entire economy for a significant length of time.

Exhibit 4: American Rescue Plan Spending Details



Source: Congressional Budget Office, US House of Representatives archives. Estimated budgetary effects as passed by the Senate on 6 March, 2021. Estimates are relative to CBO's February 2021 baseline. Components may not sum to totals because of rounding.

That doesn't mean inflation is permanently absent. The April headline US CPI came in at 4.2% Y/Y, exceeding consensus forecasts of 3.6%. This was the largest increase since 2008, further spurring inflation fears among investors. While much of the increase can be attributed to base effects, which are likely to spill over into May, base effects were widely anticipated and don't account for the upside surprise. Fed officials have remained dovish and reiterated that they believe this is likely to be a temporary jump in inflation. In this case we would be inclined to agree. Key contributors to the rise, beyond used cars, whose prices soared were more typical reopening categories like airfares, shelter and recreation, signaling a strong demand recovery as things start returning to normalcy. In our view, this is likely temporary as the initial pent-up demand fades and companies start catching up and running at full capacity following recessionary cutbacks during the pandemic.

For inflation to be lasting it probably requires a lasting pickup in the velocity of money, which we haven't seen. To the extent any official money supply measures accurately capture what society uses as money, last year's large increases in money supply didn't stoke inflation. If that changes, velocity won't just appear out of nowhere. There will be tells, most likely from a significantly steeper yield curve and rising lending. Even then, rising inflation has accompanied some excellent years for equities.

A short-term jump in consumer prices aren't reason to be bearish today. Although the April CPI and PPI numbers were higher than expected, a significant jump in prices was widely anticipated due to base effects and is likely transitory in our view.

DISCLOSURES

Fisher Investments Europe Limited (FIE) is authorised and regulated by the Financial Conduct Authority. It is registered in England, Company Number 3850593. Fisher Investments (FI) is an investment adviser registered with the United States Securities and Exchange Commission. FIE is wholly-owned by Fisher Asset Management, LLC, trading as Fisher Investments (FI), which is wholly-owned by Fisher Investments, Inc.

Fisher Investments (FI) is an investment adviser registered with the Securities and Exchange Commission. As of 31 March 2021, FI managed $168 billion, including assets sub-managed for its wholly-owned subsidiaries. FI and its subsidiaries maintain four principal business units – Fisher Investments Institutional Group (FIIG), Fisher Investments Private Client Group (FIPCG), Fisher Investments International (FII), and Fisher Investments 401(k) Solutions Group (401(k) Solutions). These groups serve a global client base of diverse investors including corporations, public and multi-employer pension funds, foundations and endowments, insurance companies, healthcare organisations, governments and high-net-worth individuals. FI's Investment Policy Committee (IPC) is responsible for investment decisions for all investment strategies.

For purposes of defining "years with Fisher Investments," FI was established as a sole proprietorship in 1979, incorporated in 1986, registered with the US SEC in 1987, replacing the prior registration of the sole proprietorship, and succeeded its investment adviser registration to a limited liability company in 2005. "Years with Fisher Investments" is calculated using the date on which FI was established as a sole proprietorship through 31 March 2021.

FI is wholly owned by Fisher Investments, Inc. Since Inception, Fisher Investments, Inc. has been 100% Fisher-family and employee owned, currently Fisher Investments Inc. beneficially owns 100% of Fisher investments (FI), as listed in Schedule A to FI's form ADV Part 1. Ken and Sherrilyn Fisher, as co-trustees of their family trust, beneficially own more than 75% of Fisher Investments, Inc., as noted in Schedule B to FI's Form ADV Part 1.

FIE outsources portfolio management to FI. FI's Investment Policy Committee is responsible for all strategic investment decisions. FIE's Investment Oversight Committee (IOC) is responsible for overseeing FI's management of portfolios that have been outsourced to FI. Matters arising pursuant to FI's portfolio management policies are elevated to the IOC.

This document has been approved and is being communicated by Fisher Investments Europe Limited.

The foregoing information constitutes the general views of Fisher Investments and should not be regarded as personalised investment advice or a reflection of the performance of Fisher Investments or its clients. Investing in financial markets involves the risk of loss and there is no guarantee that all or any capital invested will be repaid. Past performance is never a guarantee nor reliable indicator of future results. Other methods may produce different results, and the results for individual portfolios or different periods may vary depending on market conditions and the composition of a portfolio or index. The value of investments and the income from them will fluctuate with world financial markets and international currency exchange rates. If you have asked us to comment on a particular security then the information should not be considered a recommendation to purchase or sell the security for you or anyone else. We provide our general comments to you based on information we believe to be reliable. There can be no assurances that we will continue to hold this view; and we may change our views at any time based on new information, analysis or reconsideration. Some of the information we have produced for you may have been obtained from a third party source that is not affiliated with Fisher Investments. Fisher Investments requests that this information be used for your confidential and personal use.

This document may be considered advertising within the meaning of article 68(1) of the Swiss Financial Services Act dated June 15, 2018 (status as of January 1, 2020).