Looking out over a new horizon

Visa Business & Economic Insights

As we look ahead to 2022, there are several changes on the horizon that will define the economic landscape over the next year. Many of the stimulus measures enacted in early 2021 will sunset, interest rates are likely to rise to begin reigning in inflation pressures that emerged with global supply chain bottlenecks, and new uncertainties are emerging with pending legislation in Congress and the rise of the COVID-19 Omicron variant.

Despite the uncertainties, **our 2022 economic outlook calls for considerably less volatility in quarterly gross domestic product (GDP) growth than the last several quarters.** GDP growth should expand 3.6 percent in 2022, with broad-based contributions to economic growth stemming from consumer spending and business investment. Inventory rebuilding as manufacturers and suppliers better match supply with robust demand should add 0.7 percentage points to GDP growth for the year. Continued softness in commercial real estate and rising mortgage rates will put a damper on both nonresidential and residential investment next year. Finally, robust domestic demand coupled with modest export growth will result in net exports subtracting from economic activity.

In constructing our outlook for 2022, we see five key themes defining economic growth in 2022:

- **Jobs:** The labor market is expected to recover further with more individuals entering the workforce as job growth remains robust.
- **Inflation pressures** are likely to persist for consumers throughout much of next year as goods inflation gives way to greater service sector inflation pressures.
- **Fed rate hikes:** In response to both labor market improvement and high inflation, the Federal Reserve is set to start hiking rates next year.
- **Business investment:** Many industries will likely continue to face challenges related to tight labor markets given long-run demographic trends, which should result in greater business investment in the coming year.
- **Consumer spending growth** is set to moderate closer to its prior expansion average as marginal increases to income growth diminish as pandemic-era fiscal policy support expires.

Our annual economic outlook this year reflects a step down from the above average rates of GDP growth this year to the more modest pace of growth expected of an economy with an aging population and slowing population growth. The key themes of our 2022 outlook represent our perspective on the core drivers of economic activity in the year ahead. As usual, we will continue to monitor the incoming economic data, revise our outlook, and provide business intelligence in service of our clients.

Labor market outlook: Searching for the recovery

In 2021, the economy recovered to pre-pandemic levels of both GDP and consumer spending, but one key metric has yet to fully recover: employment. As of November, nonfarm employment remained 2.6 percent or 3.9 million jobs below the pre-pandemic level.

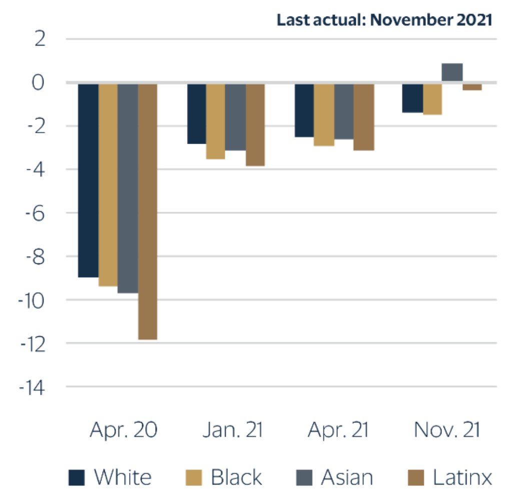
We anticipate that further easing of virus fears, less fiscal support and rising nominal wages will all incentivize more people to re-enter the labor force. Based upon these assumptions and recent employment growth, our forecasts indicate that **the U.S. should reach a full labor market recovery in September of 2022**, with the unemployment rate ending next year at 3.9 percent.

The employment recovery is important to the economic outlook for many reasons. It not only serves as a core driver of sustainable economic growth but is also key to understanding when the Fed may begin to lift interest rates. Following its revised long-run monetary policy framework, the Fed changed its view of full employment to include broad-based and inclusive measures of employment. One such measure is the employment-to-population ratio, sometimes called the "employment rate," across demographic groups.

When looking at the labor market recovery through the lens of the employment rate, the recovery is not evenly distributed. Latinx and Asian American employment rates declined the most at the onset of the pandemic. As of November, Asian Americans led the way in the employment recovery, while the employment rate for Black/African Americans was the furthest below the pre-pandemic peak.

The employment recovery is uneven

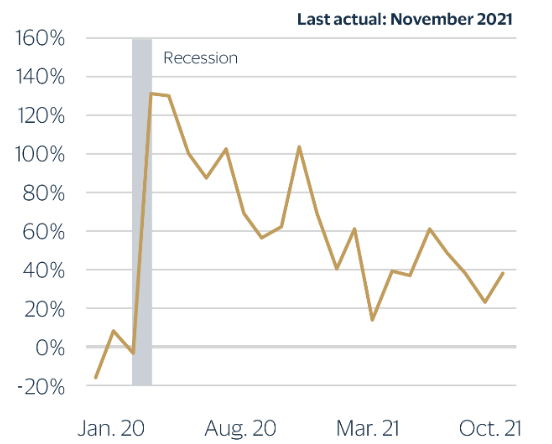
(*SA, Emp-to-population ratio, percentage points from 2017-2019 average)



*SA = Seasonally adjusted year-over-year and compound annualized growth rate
Sources: Visa Business and Economic Insights, U.S. Department of Commerce and U.S. Department of Labor

Childcare duties lead women to drop out of labor force

(**NSA, Not in labor force – other, Percentage points above 2019 average)



**NSA = Non-seasonally adjusted year-over-year
Sources: Visa Business and Economic Insights, and U.S. Department of Labor

Beyond race, there are also stark differences in the employment recovery for men and women. When measured by the gap from their pre-recession levels, men's and women's employment rates are similar; however, women currently have a labor force participation rate 11.6 percentage points lower than men's, according to U.S. Department of Labor data. This is due, in large part, to the fact that childcare disproportionately fell on women during the pandemic, when schools and daycares closed. Women cite childcare and transportation among other reasons for not being in the labor force (percent change relative to 2019 average of women reporting being out of labor force due to childcare concerns. In the pre-pandemic labor market, women made up the majority of employees in the leisure and hospitality sector, which was the most negatively impacted by the pandemic. Unlike other sectors, the jobs in this sector are often high contact, were not deemed essential and cannot be done remotely. We expect that as virus fears subside and wage gains continue, more workers will come back into the workforce. As the labor force expands, the labor market will loosen up, which will eventually slow the growth rate in nominal wages that has persisted since June 2021.

A driving factor behind the tight labor market is the lower number of individuals in the workforce overall, but the ageing population and increased retirements are also contributing factors. While that is a concern, the 65+ labor force participation rate is just 1.4 percent off of its pre-pandemic level. Additionally, higher wages will likely motivate some of the retired to come back to work. There are already signs of this. According to the Department of Labor, the rate of retirees rejoining the labor force (the unretirement rate) rose to 2.6 percent in October from a pandemic low of 2.1 percent. We suspect this upward trend will continue through 2022.

While a broad-based and inclusive labor market recovery may still be a way off, we anticipate that many of the challenges holding back the size of the labor force and creating upward pressure on wages will begin to course-correct in the year ahead.

Inflation outlook: Any relief in sight?

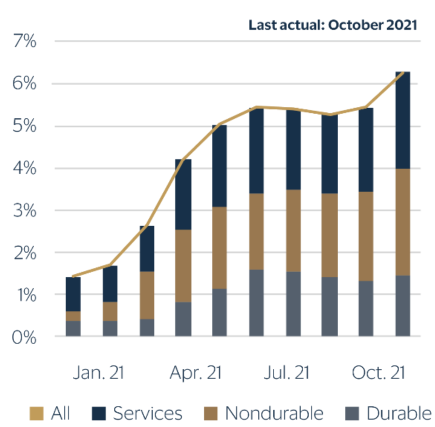
As domestic demand snapped back in the first half of this year much faster than many firms anticipated, supply shortages began to emerge as a potential headwind to economic growth.

By October, the headline Personal Consumption Expenditures (PCE) deflator, the Fed's preferred measure of inflation, was up 5.0 percent year-over-year (YoY), the highest reading since 1990. The elevated inflation readings combined with a late summer surge in COVID cases pushed consumer confidence lower. Consumers, for the most part, have looked past the elevated inflation readings, but many are wondering how long they will remain elevated. We see consumer prices likely to remain above the Fed's two percent target through the end of 2022. The PCE deflator should begin to come down beginning in the first quarter and reach 2.1 percent YoY growth by the fourth quarter of next year. While the elevated inflation pressures are far from "transitory," we still expect the rate of inflation to come back down below the Fed's two percent target in early 2023. **It is important to note that we are not expecting a reversal in the higher price levels of the past year, but rather the rate of growth in prices to subside over the next year.**

To understand why inflation rates will come down, we need to understand the current dynamics driving inflation higher. Breaking down the Consumer Price Index—an alternative measure of inflation—into three main components of durable goods, nondurable goods, and services, a disproportionate share of the upward inflation pressures stems from the goods side of the economy. This can be attributed to the ongoing supply chain disruptions in both durable goods (e.g., automobiles) and nondurable goods (e.g., oil). There is reason to believe that the goods inflation pressures may be easing. November data from the Institute for Supply Management showed that order backlogs fell, and supplier delivery times improved for the third month in a row. Additionally, Brent crude prices as of December 1 are back down to below $70 per barrel after surging to over $86 per barrel in October.

Goods inflation is the main driver of overall inflation

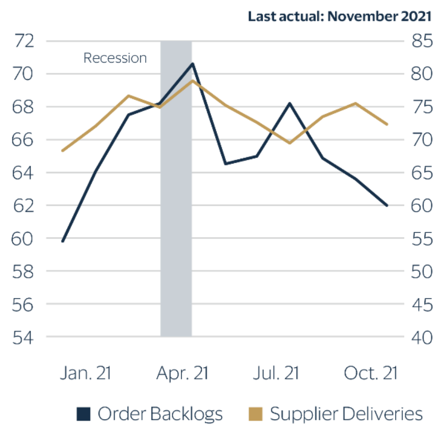
(*NSA, Consumer Price Index, YoY percent change)



*NSA = Non-seasonally adjusted year-over-year
Sources: Visa Business and Economic Insights, and U.S. Department of Labor

Supply chain issues are beginning to ease

(**NSA, Index and ***SA Index)

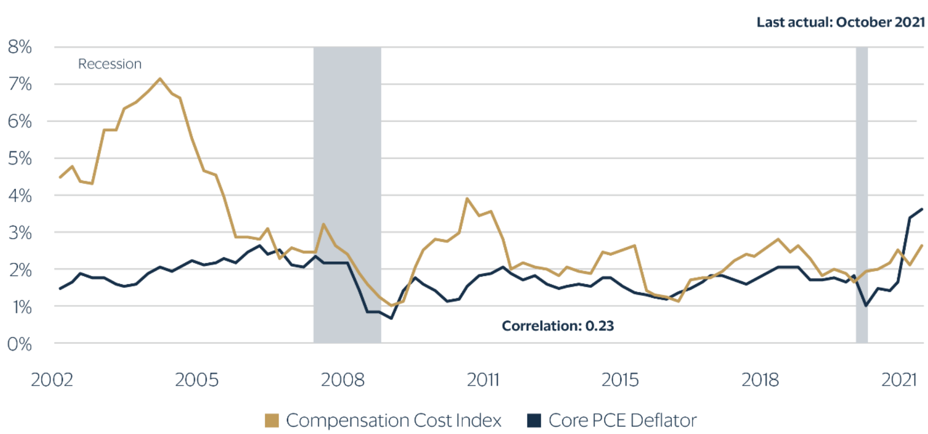


**NSA = Seasonally adjusted, ***Seasonally adjusted rate
Sources: Visa Business and Economic Insights, ISM Manufacturing Index, U.S. Department of Labor and U.S. Department of Commerce.

Even as upward price pressures alleviated on the goods side of the economy, inflation pressures are now starting to build on the services side. Housing costs will likely put upward pressure on core inflation in the coming months as last year's home price appreciation works its way into the CPI calculations. Recent increased stability in home prices should help to ease that upward pressure in the latter half of 2022. Despite arguments that inflation will continue to grow rapidly over the coming year as elevated wage pressures push services inflation higher, the correlation between higher wages and higher consumer prices is quite weak. In addition, we suspect that as COVID fears begin to ease, the elevated earnings will attract more workers back into the workforce and put some marginal downward pressure on wage gains. While inflation readings are likely to be softer next year, we still expect the PCE deflator to lead the Fed to reconsider the current path of monetary policy.

There is little evidence that higher wages lead to higher consumer prices

(**SAAR, YoY percent change and *SA Index)



*Seasonally adjusted rate **Seasonally adjusted annualized rate year-over-year
Sources: Visa Business and Economic Insights, ISM Manufacturing Index, U.S. Department of Labor and U.S. Department of Commerce.

Monetary policy outlook: The times they are a changin'

We expect a series of Federal Reserve policy moves in the year ahead, but the changing composition of the Federal Open Market Committee (FOMC) clouds the policy outlook a bit.

With the renomination of Fed chair Jerome Powell for a second term and Lael Brainard as vice chair for monetary policy to fill the vacancy left by Richard Clarida, whose term expires at the end of January, the President is expected to nominate a replacement for one open seat on the FOMC and a replacement for Randal Quarles, the vice chair of supervision who is leaving at the end of the year. With all the personnel changes on the FOMC, we expect the Fed to stay relatively dovish as the newer members likely favor lower interest rates for longer.

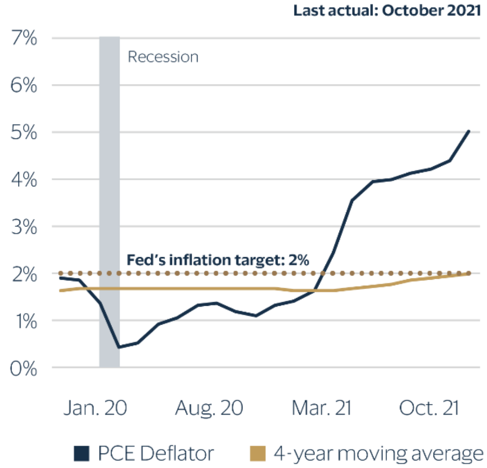
The Fed had already announced the tapering of its asset purchases back in early November, which started the process of removing accommodative monetary policy. Heading into 2022, we expect the Fed to announce plans to slow asset purchases more dramatically in the first quarter of the year in direct response to the elevated levels of inflation over the last few months and continued robust job gains. We suspect the Fed will conclude its asset purchases by the end of the first quarter of 2022 and keep its balance sheet unchanged by re-investing the proceeds from any maturing assets. Only after the end of the asset tapering process will the Fed turn its attention to interest rate hikes. While financial markets seem to think that high levels of inflation will be the catalyst for the Fed to hike rates, the Fed's new monetary policy framework rolled out back in August 2020 suggests that reaching a broad-based and inclusive employment recovery will also be key to determining when it hikes interest rates or tightens monetary policy.

So how far until liftoff? From an inflation pressure standpoint, the longer-run inflation rate as measured by the four-year moving average of the PCE deflator suggests that the inflation box is checked for the first hike.

Long-run inflation suggests the Fed's inflation target is met

(*SA, Personal Consumption Expenditure Index, YoY percent change)

Last actual: October 2021



The Fed will be looking closely at the labor market recovery among different demographics

(*SA, Percentage points from 2017-2019 average)

Last actual: November 2021

Demographic	Unemployment Rate	Participation Rate	Employment Rate
Total (25-54)	+0.4	-0.3	-1.0%
Men (25-54)	+0.5	-0.7	-1.8%
Women (25-54)	+0.2	+0.1	-1.4%
White	+0.2	-1.3	-1.4%
Black/ African American	+0.0	-1.6	-1.5%
Hispanic/Latinx	+0.5	-0.1	-0.4%
Asian	+0.8	+1.4	+0.9%

*SA = Seasonally adjusted year-over-year

Sources: Visa Business and Economic Insights, U.S. Department of Commerce and U.S. Department of Labor.

As for the broad-based and inclusive employment recovery, the employment rate remains below pre-recession levels across nearly all demographic groups (Table 1), which suggests rate hikes are still a bit further on the horizon. Given our employment forecast through the first half of 2022, we suspect that many of the demographic groups in the table will be significantly closer to their full or maximum employment levels by mid-2022. As a result, we expect the Fed's rate hikes to roll out as follows:

Expected Fed rate hike schedule

Treasury rates will likely respond to the probability of rate hikes in two ways. First, short-term interest rates (inside of two years) are likely to edge higher faster as markets price-in the Fed's rate hikes. Second, longer-term interest rates are likely to rise as well, but at a slower pace than short-term interest rates. Global investors will help drive this second dynamic by parking more funds into U.S. long-term Treasury securities as expectations for higher returns (higher rates) attracts greater foreign capital inflows. Such inflows put upward pressure on bond prices and downward pressure on the corresponding long-term interest rates. In short, the changes in the stance of monetary policy will be rather significant in the coming months and will have knock-on effects in financial markets.

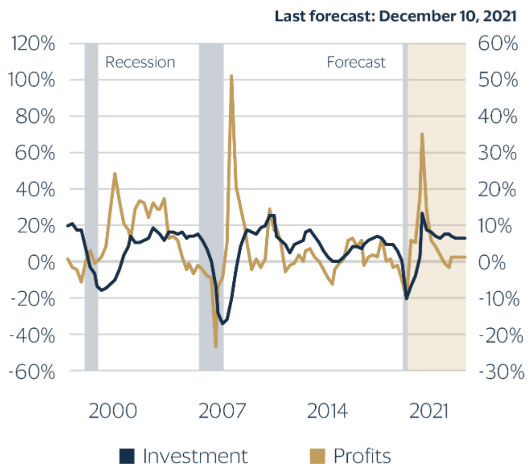
Business fixed investment outlook: Strong incentives to automate

The recent supply chain disruptions have put a temporary dent in what was a fairly robust recovery in business fixed investment for most of this year. As supply chain issues begin to fade in 2022, we expect a continued robust pace of business fixed investment, rising 7 percent in 2022.

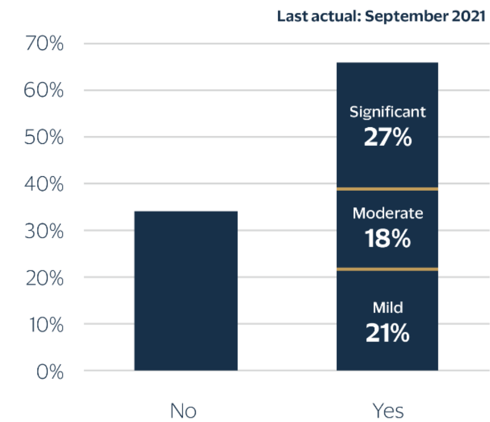
The main supports to investment growth are the sharp increase in corporate profits this year, more workers returning to the office in the coming months, higher labor costs and expectations of higher interest rates. All these factors suggest that some business fixed investment will be pulled forward into 2022 from 2023.

The robust economic recovery in 2021 helped to significantly boost corporate profits for the year. Historically, an increase in corporate profits usually leads to higher growth in business fixed investment in subsequent quarters. The supply chain disruptions and shortages of materials in the latter half of the year in some cases weighed on the ability of many corporations to put their increased profits to work in the form of equipment investment. **With supply chain issues expected to subside by the end of Q1, we expect that businesses will ramp up purchases of equipment by the middle of 2022**. Equipment investment will rise 4.4 percent next year after rising an estimated 13 percent this year.

The rise in corporate profits should lead to more business investment
(*SA, YoY percent change)



Most small businesses are facing a labor shortage
(Percent of respondents)



SA = Seasonally adjusted year-over-year
Sources: Visa Business and Economic Insights, U.S. Department of Commerce and National Federation of Independent Businesses Covid-19 Small Business Survey, September 2021.

Another important factor that should incentivize further business investment in 2022 is the impending return to office for some firms. As workers re-enter an office setting, companies will likely need to invest in new equipment and, in some cases, facilities. We suspect the bulk of the investment, however, will be in the form of software and other equipment. Intellectual property products, which include software investment, are expected to rise 11.6 percent in 2022. The tight labor market continuing to drive up labor costs will also be an incentive for firms to look for alternative ways to maintain or increase output. Such trends are especially likely in the small business sector, which is feeling the current labor shortage particularly acutely.

Finally, with Fed interest rate hikes on the horizon, many firms may opt to pull forward some of their business investment into 2022 rather than waiting a year or two. Larger investments with higher capital costs are prime candidates for such pull-forward activity. There is already some emerging evidence of such a trend as new orders for core capital goods (non-defense capital goods excluding aircraft) have increased every month since March 2021, suggesting a robust pipeline of equipment spending ahead. Additionally, the Architectural Billings Commercial Index has been in expansion territory since February of 2021, which typically leads an increase in structures investment by 9-12 months. We expect nonresidential investment to be backloaded in 2022. Taken together, this makes a strong case for another year of robust business investment growth.

Consumer spending outlook: Coming back down to Earth

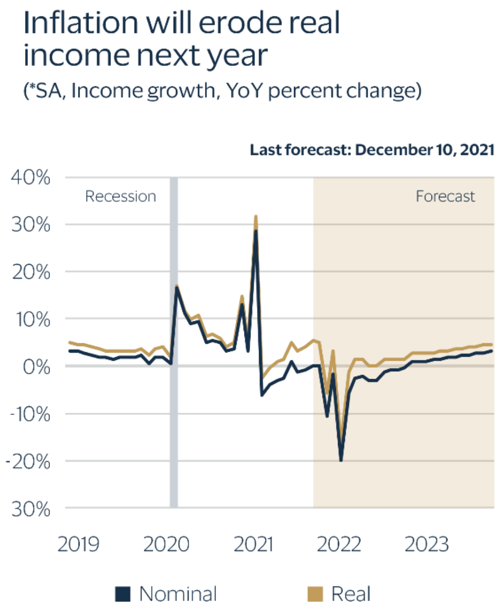
Thanks to large scale fiscal stimulus and record high savings rates in the wake of lockdowns in 2020, consumer spending continued to rebound rapidly in 2021. The outlook for 2022 is very different as much of this support from the federal government is set to wane under current law and savings rates normalize.

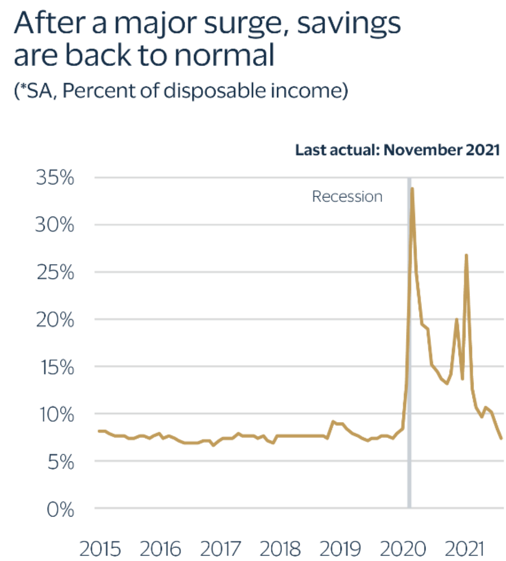
Additionally, consumers' purchasing power continues to be eroded by inflation rates last seen over 30 years ago. While our forecasts do not indicate a contraction in consumer spending, **we do anticipate real (inflation-adjusted) consumption growth to moderate substantially in 2022 compared to 2021 levels**. We expect 3.5 percent YoY real personal consumption growth in 2022, which is much more in line with the pre-pandemic average during the last expansion. Given the inflation pressures in 2022, nominal consumer spending is set to rise 7.1 percent YoY in 2022 after an estimated 12.2 percent increase in 2021.

Among the stimulus programs enacted over the last year and a half, the monthly Child Tax Credit payments and deferred federal student loan payments remain. Unless Congress and the White House can agree on a final deal for the Build Back Better bill, the Child Tax Credit is set to expire at the end of December. Additionally, the student loan deferral program is set to end in January if the Biden Administration elects not to extend it. Taken together, the negative marginal impact of these changes to consumers' disposable income will weigh on consumer confidence and likely lead to more modest spending growth in the year ahead.

The stimulus programs over the last two years combined with virus fears led many consumers to save a large portion of their incomes. The saving rate climbed to as high as 26.6 percent of disposable income in the wake of the American Rescue Plan passed in March of 2021. As of October, the saving rate has come back down to 7.3 percent, in line with 2019 levels. While some of the decline in the saving rate can be attributed to the reopening of the economy and additional spending, there is also strong evidence that consumers paid down debt. As a result, consumers are likely to seek more credit to finance any additional spending in the year ahead rather than relying on additional sources of income outside of wages and salaries.

Accommodative monetary policy from the Fed was another major boon to consumption via the wealth effect over the last year as low interest rates and the Fed's asset purchases boosted stock market and housing market prices to new heights. As consumers' wealth rose, it fed into higher levels of consumer confidence. With the first rate hike from the Fed on the horizon in 2022, we expect the borrowing costs to rise for consumers, which may give some consumers pause about borrowing. These changes in monetary policy will likely lead to more modest home price appreciation and may moderate the appreciation in financial markets. This would likely limit growth from wealth effect-induced spending.





*SA = Seasonally adjusted year-over-year
Sources: Visa Business and Economic Insights, and U.S. Department of Commerce.

Finally, inflation represents another, and arguably more significant, headwind for real personal consumption growth next year. **While we expect the rate of inflation to subside somewhat in 2022, we still expect historically elevated levels of inflation for the next several quarters**. Such high rates of inflation erode the real purchasing power of consumers as they buy fewer goods at higher prices. Looking ahead to 2022, we see the effects of higher inflation eroding real disposable income growth for consumers in all four quarters of next year. Between the absence of stimulus and higher inflation, we see real disposable income growth contracting 4.6 percent YoY in 2022 before normalizing at 2.1 percent in 2023. The combination of these factors is expected to bring real consumer spending growth more in line with average growth in the prior expansion.

Risks to the outlook: Variants, vacancies, and very high prices

After nearly two years of volatile economic activity, we suspect there will be more normalization in growth rates for a broad array of economic measures in the year ahead. While our outlook appears more stable than in years past, there are still sizable risks to the outlook that could materially change the path of economic growth and, by extension, fiscal, and monetary policy. The new COVID-19 Omicron variant has been identified in the U.S and was flagged by the World Health Organization as a variant of concern, which resulted in a significant sell-off in equity markets. It is unclear at this point how disruptive the new variant may be to economic activity. It is unlikely there will be a quarter in 2022 like the Delta downshift in economic activity in Q3 2021 but admit this assumption could be undermined as more is learned about Omicron. Beyond the ongoing virus concerns, we remain focused on both the labor market recovery and elevated inflation rates. Should retirements continue to surge over the next year and fewer workers return to the workforce than expected, the tight labor market and wage pressures could persist longer, hampering the labor market recovery and denting corporate profits. Such an environment may also lead to greater inflation pressures than we expect as firms pass along higher costs to consumers. If inflation rates do not begin to come back down in the first few months of 2022, we suspect the Fed will begin hiking rates earlier and more aggressively than we are currently forecasting. Such actions would likely lead to a more modest pace of GDP growth than our baseline forecast.

Visa's U.S. Economic Forecast

(Forecast as of: December 9, 2021)

	Actual			Forecast					Actual	Forecast		
	2021				2022							
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2020	2021	2022	2023
Gross Domestic Product (CAGR)	6.3	6.7	2.1	6.6	2.8	2.6	2.5	2.6	-3.4	5.6	3.6	2.5
Personal Consumption	11.4	12.0	1.7	6.4	2.0	2.3	2.2	2.2	-3.8	8.1	3.5	2.2
Business Fixed Investment	12.9	9.2	1.5	8.1	7.9	7.6	7.0	6.7	-5.3	7.7	7.0	6.6
Equipment	14.1	12.1	-2.4	2.5	6.0	5.8	5.1	4.9	-8.3	13.0	4.4	5.3
Intellectual Property Products	15.6	12.5	9.3	12.5	13.0	11.9	10.2	9.7	2.8	10.3	11.6	8.8
Structures	5.4	-3.0	-5.0	-1.9	0.8	1.9	3.7	4.1	-12.5	-7.7	0.1	4.0
Residential Construction	13.3	-11.7	-8.3	2.0	0.8	-0.5	1.3	1.1	6.8	9.1	-1.2	1.4
Government Purchases	4.2	-2.0	0.9	1.3	1.4	1.4	1.5	1.5	2.5	0.7	1.1	1.6
Net Exports Contribution to Growth (%)	-1.6	-0.2	-1.2	0.7	-0.6	-0.6	-0.4	-0.4	-0.3	-1.8	-0.4	-0.4
Inventory Change Contribution to Growth (%)	-2.6	-1.3	2.1	2.0	0.6	0.2	0.1	0.1	-0.5	-0.2	0.7	0.1
Nominal Personal Consumption (YoY % Chg.)	3.9	20.7	11.6	13.5	10.8	7.3	6.4	4.3	-2.6	12.2	7.1	3.8
Nominal Personal Income	16.1	1.6	5.2	6.6	-4.9	1.3	1.3	1.8	6.5	7.2	-0.2	4.0
Retail Sales Ex-Autos	11.6	28.5	15.9	20.0	11.9	6.6	5.9	3.2	0.3	18.8	6.8	3.4
Consumer Price Index	1.9	4.8	5.3	6.8	6.7	4.8	3.7	2.6	1.2	4.7	4.4	1.9
Federal Funds Rate (Upper Bound)	0.25	0.25	0.25	0.25	0.25	0.5	0.75	0.75	0.25	0.25	0.56	1.38
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.5	3.75	3.75	3.54	3.25	3.56	4.38
10-Year Treasury Yield	1.74	1.45	1.52	1.55	1.68	2.2	2.38	2.4	0.89	1.57	2.17	2.52

Interest rates presented are end of quarter rates
Note: Annual numbers represent year-over-year percent changes and annual averages