The Kiplinger Letter

FORECASTS FOR EXECUTIVES AND INVESTORS

1100 13th Street NW, Washington, DC 20005 • kiplinger.com • **Vol. 99, No. 11**

Dear Client:

Washington, March 17, 2022

Time for a fresh appraisal of the economy. The war in Ukraine and Western sanctions on Russia have roiled commodities markets and supply chains. Inflation, already bad, has gotten worse. Can the U.S. weather these storms and stay out of recession?

U.S. ECONOMY

Let's start with the bad news: Inflation. It's going to get worse and last longer, chiefly due to higher prices of energy, grains, metals and other commodities Russia specializes in.

We see CPI inflation peaking at 8.5% in March...the highest reading since 1981. Then, declining only slowly later in the year, ending 2022 at a still painful 6.5%. All the inflation ingredients... easy money, deficit spending, high consumer demand and supply chain problems...have come together to produce the worst bout of inflation in 40 years.

The Federal Reserve is pivoting to inflation, finally, after months of insisting it was temporary. This month brings the first in a series of rate hikes, likely each a quarter of a percentage point...a step toward getting prices under control, but not enough to really quell inflation quickly. Tightening faster would help with inflation, but at some point, that risks choking off GDP growth. Look for the Fed to proceed cautiously, preferring inflation over a recession.

Other threats loom overseas. The war, of course...as always with war, the outcome is highly uncertain. The U.S. is bent on keeping it contained to Ukraine, but there's no certainty it won't escalate. Direct conflict between the U.S. and Russia, the stuff of Cold War nightmares for 45 years, would surely weigh on the economy. Even without that scenario, the present war figures to sap European GDP growth.

Then there's COVID-19 in China. While the pandemic wanes in the U.S., it is intensifying in China, prompting Chinese officials to order strict lockdowns in some big cities. That "zero COVID" approach could hamper commercial activity in the world's second-largest economy (one reason for oil prices' sudden drop).

Economic Forecasts

GDP growth NEW
3.0% in '22,
down from 5.7% in '21

Interest rates NEW
10-year T-note rates 2.5% by end '22;
30-year fixed mortgage, 4.5%

Inflation NEW
6.5% at end '22,
down from 8.5% currently

Unemployment
3.2% at end '22,
down from 3.9% at end '21

Crude oil NEW
Trading from $90 to $100 in coming weeks, highly volatile

Manufacturing production
Rising 4.3% in '22,
down from 6.5% in '21

Complete economic outlook at
kiplinger.com/outlooks

Set against these threats are some underlying U.S. economic strengths:

The reopening of the economy after COVID, which spells a big increase in demand for all sorts of services, which make up the bulk of U.S. GDP. People want to get back to normal life, which means healthy spending on dining, travel, etc.

A sizable savings cushion. Americans have $2.3 trillion more in savings than they likely would have if the pandemic hadn't curbed much of their spending or prompted Congress to dole out stimulus checks. That cash adds to buying power, even as prices of virtually everything keep rising. Plenty of it will get spent this year.

Perhaps most important, strong job growth, which is badly needed now.

Add it all up and you get about 3% growth for the year...*if* no new crisis like a widening of the Ukraine war intervenes. After the past two years, that's a big if.

The Kiplinger Letter (ISSN 1528-7130) is published weekly for $199 per year, including first-class postage, by The Kiplinger Washington Editors, Inc., part of Future Publishing Limited (company number 2008885), registered in England and Wales. Registered office: Quay House, The Ambury, Bath BA1 1UA. Postmaster: Send address changes to The Kiplinger Letter, P.O. Box 37234, Boone, IA 50037-0234.

Subscription inquiries and customer service: Call 800-544-0155; e-mail KLservice@kiplinger.com; or visit service.kiplinger.com. Editorial information: Tel., 202-887-6462; e-mail, letters@kiplinger.com Mailing address: 1100 13th St. NW, Suite 1000, Washington, DC 20005

GLOBAL ECONOMY

Russia's invasion of Ukraine is straining the global air freight industry. Up until recently, demand for goods shipped by air was robust, while the sluggish recovery in commercial air travel kept jet fuel prices low. Now...

Jet fuel costs have leaped along with crude oil and other petroleum products. Average prices spiked from about $2.30 per gallon before the invasion to $4.00.

Plus, the conflict has complicated some key air freight routes, as Russia and its adversaries close their respective airspaces to each other's planes. Now, the skies over Europe and much of North America are closed to Russian flights, while most European and American planes can no longer fly over Russia, forcing carriers to seek alternative routes. Some routes, such as Helsinki to Tokyo, simply can't be flown now. Per one estimate, 20%-25% of the air freight capacity between Europe and Asia has been taken off the market, further raising costs.

That spells higher prices for everything from smartphones to video games, and any other product shipped by air...yet another source of inflationary pressure.

Central banks appear likely to move forward with monetary tightening.

But they may take a less aggressive approach in response to the conflict in Ukraine. The dilemma officials face: How to manage rapidly rising inflation without derailing the post-pandemic economic recovery. This task is more difficult now that geopolitical unrest has resulted in a huge run-up in global commodity prices, particularly energy prices, which may put large swaths of economic activity at risk.

Inflation is now the main concern of central banks in advanced economies, including the U.S., but officials can't avoid risks stemming from the Ukraine situation.

FINANCE

The U.S. has taken its first steps toward delisting Chinese companies from American stock exchanges. The Securities and Exchange Comm. recently named the first five companies that will be delisted, unless they comply with a 2020 law requiring them to hand over audit documents to U.S. regulators. The law also requires companies to disclose whether they are owned completely or controlled by any foreign government. Delisting won't happen until 2024, unless Congress approves legislation to move up the compliance deadline to 2023.

Washington and Beijing are working on a compromise. Heretofore, Beijing has blocked Chinese companies and their auditors from complying with requests from foreign regulators. But officials say negotiations have made significant progress.

The heightened uncertainty may deter new listings of Chinese companies, which have benefited from access to U.S. capital markets. Since the early 1990s, over 400 Chinese companies have raised money via American depositary receipts, which work like shares of foreign companies traded on American stock exchanges. Moreover, Chinese firms have raised over $70 billion from U.S. initial public offerings in the past decade alone. Note that many of the companies at risk of being delisted aren't qualified to list in Hong Kong and would struggle to get listed in China.

CRYPTO

The White House wants more clear and consistent cryptocurrency rules.

A recent executive order directs federal agencies to research the issue, with the goal of making the U.S. a global leader in crypto development and adoption. Agencies will have anywhere from 90 days to one year to release their findings.

It's a case of the U.S. zigging while many other countries zag. China, for one, has banned cryptocurrency production, also known as mining, as well as transactions involving such digital assets. The EU is also mulling tighter cryptocurrency rules.

The cryptocurrency industry is pleased with the government's recent actions and hopes they will pave the way for greater use of digital assets and blockchain tech in the U.S. and global financial systems. But the long-term impact is still unclear.

One idea that may prove more divisive: A digital central bank currency, which the Biden administration is also studying. Crypto and finance experts are split on the issue, though any decision on a so-called digital dollar is still many years away.

CONGRESS

Expect Congress to stay united on aiding Ukraine and punishing Russia. Lawmakers recently agreed on a $13.6 billion Ukraine assistance package.

Next up: Legislation to suspend normal trading relations with Russia, which is expected to pass easily in the coming days with broad bipartisan support.

Congress has helped push the White House to assume a tougher posture on Ukraine. This includes pressuring the Biden administration to enact a ban on Russian oil imports. Lawmakers have also urged officials to take up an offer by Poland to provide Kyiv with older military aircraft…if Washington, in turn, supplies Poland with newer ones. President Biden has so far resisted this step.

But the administration isn't sitting still. In the last week alone, Biden has green-lit over $1 billion in military aid to Ukraine, including armed drones.

The executive and legislative branches share the same long-term goal of helping Ukraine resist Russian aggression and rebuild after the conflict, however long it lasts. Such plans, modeled after the post-WWII Marshall Plan, are already in the works…assuming Kyiv can eventually prevail over Moscow.

HEALTH CARE

Businesses should keep an eye on the White House's updated COVID plan. It has tactics that will help them handle future pandemic challenges related to COVID-19, such as new variants or an uptick in cases later this year. The plan will give businesses up-to-date guidance, tests and supplies to stay open. The Occupational Safety and Health Admin. will provide new workplace guidance on everything from vaccinating and boosting employees to enhancing ventilation.

Officials are looking at refundable tax credits for small and midsize firms to fully reimburse for paid leave for employees who miss work because of COVID-19. Also expect new tools to help child care providers avoid closures, and more timely info for keeping track of COVID-19 outbreaks, including wastewater surveillance data.

The new plan holds promises for K-12 schools, too, with a strong focus on keeping public schools open full-time and in person, via access to testing, updated guidance, etc. Schools will be prodded to spend the federal funding that has already been sent out…totaling $122 billion…swiftly and efficiently.

Parts of the sweeping plan require a lot more congressional funding.

There's certainly no guarantee of that at this point, as COVID caseloads ease.

But businesses will see useful ideas implemented even without new money. It's worth paying attention and heeding the best advice to avoid future disruptions.

The Dept. of Health and Human Services wants to shore up supply chains for various medical equipment and diagnostics in preparation for future pandemics. Officials are hoping to avoid another scenario like the first stages of COVID-19, which brought widespread shortages of personal protective equipment and test kits.

The agency's priorities include more domestic production of raw materials, such as nitrile butadiene rubber and other key chemicals used in the manufacture of gloves, gowns and surgical masks. While there have been efforts to boost output of these items domestically, the U.S. still depends heavily on imports from countries in Asia, particularly China (gowns, surgical masks) and Malaysia (gloves).

Also, investments in cutting-edge manufacturing technologies. These include extruders for increasing production of man-made fibers, special robots for sewing and finishing gowns, and head models to aid in respirator development.

For diagnostics, HHS wants to lower test-kit costs by developing reagents with longer shelf lives and increasing the interchangeability of certain components.

A major challenge: Finding ways to stimulate and sustain demand. Ideas include increasing federal stockpiles of crucial medical equipment and diagnostics, and establishing a revolving fund for the stockpile with Buy American requirements.

Expect more coverage of Uncle Sam's supply chain initiatives next week.

TELECOM

Expect strong growth of wireless 5G home broadband this year. T-Mobile netted 224,000 cellular home internet customers in 2021's fourth quarter, while Verizon ended 2021 with 223,000 customers...signs of building momentum. With 5G internet, customers plug in a cell antenna for high-speed home service, creating a powerful mobile hotspot that beams internet around the entire location.

The key advantage is not having to install wires all the way to the premises, giving carriers the ability to directly compete with traditional wired internet providers. So-called fixed-access 5G is expanding fast and will eventually be available nationwide.

Businesses should check out deals, since carriers are increasingly eager to sign up new users. Verizon is offering a 10-year price guarantee for 5G broadband for new business customers. Plans start at $69 per month and come with fast speeds, unlimited data and often little technical setup. AT&T and T-Mobile also have plans.

Some companies figure to buy the cellular service for emergency backup in case their main internet service has an outage and they can't afford downtime.

SPORTS

Move over, tennis and golf. Pickleball is becoming the hottest new amenity at luxury real estate developments. Developers in the U.S., Mexico and the Caribbean can't build courts fast enough. Home buyers and vacationers are increasingly attracted to the paddle sport...a combination of tennis, pingpong and badminton...even over golf. Courts, roughly one-third the size of tennis courts, are also gaining traction with homeowners' associations and local municipalities.

The sport, with its simple rules, has seen incredible growth in recent years. It has 5 million participants in the U.S. of all ages, playing competitively and for fun.

GAMBLING

America's record spending on gambling shows no signs of slowing down. 2021 was the top-grossing year ever for the commercial gaming industry, reaching $53 billion in revenue, a 21% increase over the previous high-water mark in 2019. The record total includes casinos, sports betting and online gambling. 33 states and Washington, D.C., ran operational gaming markets in 2021, and 23 set revenue records last year. Nev. is still top dog, raking in $13.4 billion in 2021.

In-person casino gaming alone is above prepandemic levels, at $45 billion in revenue for slots and table gaming last year, which is about 7% above 2019.

And, of course, sports betting is flying high, with scorching growth in 2021 of 177% over 2020, the old record. Seven new states launched markets last year.

TAXES

Though major tax legislation has stalled in Congress as Nov. elections near... Many states have plans to lower individuals' tax burden this year or next, according to this week's edition of *The Kiplinger Tax Letter.* The trend comes as states boast huge budget surpluses from higher tax revenues and federal pandemic aid. Tax cuts are being mulled in both red and blue states, often with bipartisan support.

Some states have already passed big tax cuts, such as Idaho, Iowa, N.M. and Utah, ranging from lowering personal income tax rates to reducing sales taxes.

Among the most likely proposals: Slashing or eliminating income taxes. Tax breaks for seniors. One-time rebates. Cutting sales and property taxes. And, with gas prices surging, many states are eyeing short-term fuel tax relief.

Yours very truly,

Knight Kiplinger

March 17, 2022

THE KIPLINGER WASHINGTON EDITORS

P.S. Tax filing season is upon us. But it's not too early to prepare for next year. Visit *kiplinger.com/go/taxletter* to access a free issue of *The Kiplinger Tax Letter*.