Current Economic Conditions

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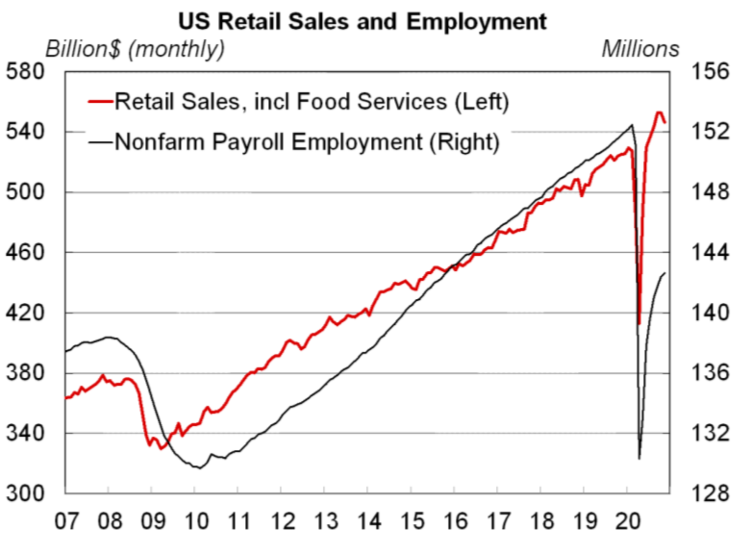
RETAIL SALES FADING AFTER STRONG REBOUND

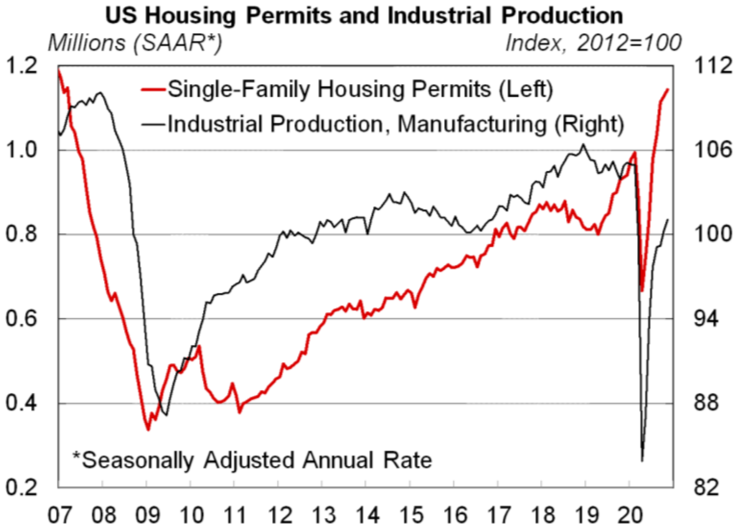
U.S. retail sales fell 1.1% in November, much worse than expected, and October sales were revised from up 0.3% to down 0.1%. Sales were up at food and beverage stores, building material and garden supply and equipment dealers, and "nonstore" (e.g., online) retailers but were down everywhere else. Sales fell 4% at food services and drinking places, 6.8% at clothing stores, and 7.7% at department stores. Light vehicle sales declined for a second straight month. The declines reflect the worsening pandemic and its impact on the willingness of consumers to shop and eat out and Congressional failure to pass another relief bill. The very generous fiscal packages passed in the spring managed to sustain consumer spending long after the checks were cashed, but their impact faded in October and November.



Nonfarm payroll employment (based on a survey of employers) rose by just 245,000 in November, the smallest gain since recovery began in May, and civilian employment (based on a survey of households) showed a 74,000 decline. The unemployment rate declined from 6.9% to 6.7%, but this occurred because the labor force shrank more than civilian employment did. A shrinking labor force often means potential workers have grown discouraged and have stopped looking for jobs, but in this case, it probably reflects the need for parents to stay home with their children when schools are closed in response to rising COVID-19 case counts. A big jump in initial claims for unemployment insurance over the last two weeks suggests that employment could decline in December. Employment growth has slowed despite record job openings in manufacturing. Although I recognize that unemployed service-sector workers might not reside near the unfilled manufacturing jobs, employment would be significantly higher if those unemployed service-sector workers took jobs in manufacturing. (And anyone who has tried to hire a contractor lately knows that labor shortages persist in home construction and improvement despite the high national unemployment rate.)

Spending and employment will probably get worse before they get better. Even if Congress passes a relief package in the next week, the money probably won't get to people in time to boost holiday shopping and prevent a decline in (seasonally adjusted) retail sales in December, and because the employment surveys for December were done last week, it will do nothing to boost December employment data. But while consumer spending is likely to weaken until consumers receive their relief checks and unemployment insurance benefits are bolstered and extended, I don't expect a severe collapse. High-income individuals who can work from home and those with big stock-market gains this year will continue to spend. This spending will be largely online and will do little to benefit the small brick-and-mortar retailers, bars, and restaurants that have felt the brunt of the pandemic but it will help sustain economic growth. And even if retail sales fall further in December, the rapid (and more-than-complete) recovery in retail sales from April to October virtually guarantees that retail sales in December will be up strongly on a year-over-year basis.

While retail sales and vehicle sales fell and employment growth slowed, industrial production in U.S. manufacturing grew a solid 0.8% in November, and production over the prior six months was revised up. Manufacturers continue to replenish depleted inventories and are obviously looking forward to spring, when widespread distribution of COVID-19 vaccines reinvigorates the recovery. Furthermore, because workers can usually distance themselves and are already accustomed to wearing personal protective equipment (PPE), most manufacturers are able to operate safely and are much less likely to be affected by mandatory or voluntary shutdowns than are bars, restaurants, and providers of personal services. The need to replenish inventories has also caused imports to surge to record levels.



Housing starts and building permits also remained strong in November. Building permits for single-family houses rose to their highest level since March 2007 and were up 71.6% from their April low. This bodes well for the rest of the economy, particularly the manufacturing sector. Starts, permits, and home sales are reliable leading indicators for industrial production. Construction of a new home, even the sale of an existing home, sets in motion a stream of spending on lumber, nonmetallic mineral products, furniture and furnishings, appliances, paint, and floor coverings. Production in those industries is likely to grow strongly next year in response to the strong rebound in housing.

While the COVID-19 pandemic has caused recessions in most of the world, its impact has differed significantly across countries, in both timing and magnitude. Most East Asian countries have done far better in dealing with the virus than their Western counterparts, and their economies haven't been hit as hard. Most European countries suffered bigger economic declines than the United States did, both in the spring and during the second wave in the fall, but that second wave hit Europe earlier than it hit the United States, and economic activity has started to turn back up in Europe, at least for now.

The lead economic story of 2020 has clearly been the deep recession caused by the COVID-19 pandemic. But we should not overlook the resilience of the U.S. economy in the face of this unprecedented shock. Employers have figured out how to operate safely. Employees have figured out how to do their jobs from homes, sometimes while caring for, even teaching, their children. With the aid of package-delivery companies, shoppers have shifted purchases from brick-and-mortar stores to online ordering and delivery, with the result that total consumer spending has been much stronger than anyone could have expected. And while I obviously would like to see more of it, some workers have moved from industries that can't operate safely in a pandemic to those that can. Because of the economy's ability to adapt and adjust, the recession ended earlier than most people expected, and the recovery has been stronger.

The lead story for 2021 is likely to be the strong rebound in economic activity unleashed by vaccines that are now being rolled out. It will be a few months until enough people have been vaccinated to have much impact on the economy, but growth is likely to reaccelerate in the spring as vaccinated Americans (and their younger family members who have been making big sacrifices to protect their elderly relatives) begin to return to restaurants, shows, sporting events, theme parks, airlines, and cruise ships. Spending on goods has already exceeded its pre-recession peak and is unlikely to play a big role in the reacceleration of growth in the spring, but manufacturers will have to boost production further to catch up with this year's surprising increase in goods spending. Growth is likely to remain strong through the remainder of the year, so that by the end of 2021, Gross Domestic Product and industrial production will have returned to their pre-recession peaks. (It will take longer for employment to fully recover.) The next few months will be tough, but I think it's a safe bet that 2021 will end better than it begins.