Current Economic Conditions

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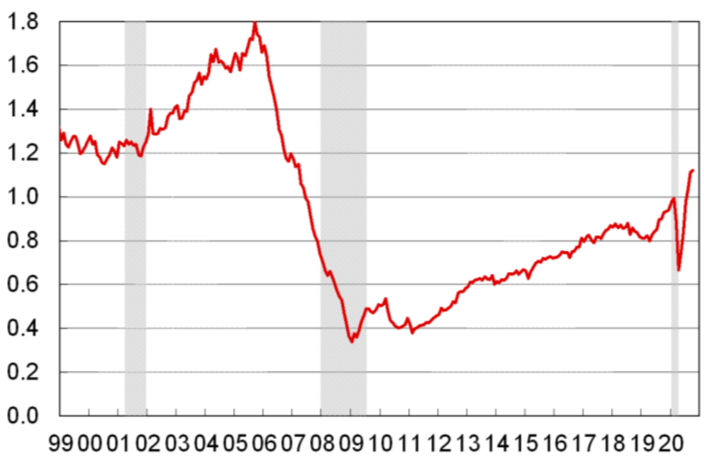
GAME OF THRONES NOW, *BEING THERE* LATER

Most measures of economic activity continue to show the U.S. economy recovering from the worst recession since the Great Depression, but a spike in COVID-19 cases and hospitalizations and the response of governments and consumers will cause economic growth to slow sharply as winter approaches. But the bad news about the spread of the virus has been tempered by trial results that show that vaccines developed by Pfizer and Moderna are much more effective than expected. It will take several months to vaccinate enough individuals to allow people to resume their normal (economic) activities, but by spring we will start to see a positive impact on economic growth.

Single-Family Building Permits

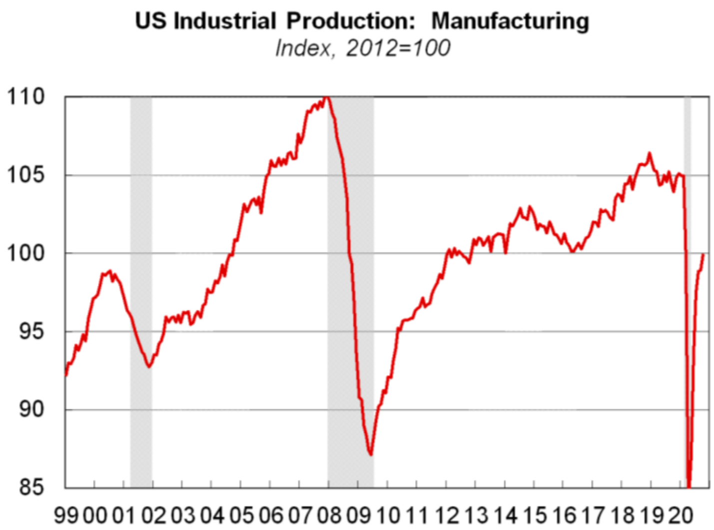
Millions, Seasonally Adjusted Annual Rate



Nonfarm payrolls grew by 638,000 in October, but this understates the strength of the report. Private payrolls grew by 906,000. Total employment was held down the by layoff of temporary government workers hired for the 2020 Census. The civilian unemployment rate fell a full percentage point, from 7.9% in September to 6.9% in October. Retail sales rose 0.3% in October, leaving them up 5.7% year-over-year. Industrial production in U.S. manufacturing rose a strong 1.0% in October, and September's 0.3% decline was revised up to a 0.1% increase. Building permits for single-family homes rose in October to their highest level since March 2007. Single-family housing starts also rose to their highest level since 2007. The National Association of Home Builders/Wells Fargo Housing Market Index set a record high for a third straight month in November.

But high-frequency (weekly and daily) data suggest that the recovery has slowed recently. Initial claims for unemployment insurance have declined little since early October. Mobility data from Apple and Google show **declining** activity in recent weeks. The recovery in credit card transactions has stalled. The slowdown apparent in high-frequency data will likely show up in monthly data for November. And while retail sales rose for a sixth straight month in October, and sales in August and September were revised up significantly, the October increase was the smallest increase since the recovery began.

The third wave of the pandemic, which was expected when colder weather drove people indoors, is kicking the businesses and workers that were already down. Bars and restaurants that were allowed to reopen in some states and stay open in other states are being forced to curtail services or even shut down. Retail sales at food services & drinking places, which had risen for five straight months, fell slightly in October. They are likely to fall much further in November and December. Airline bookings, which had been rising, have turned down again. The renewed shutdowns, combined with the expiration of unemployment insurance benefits, will severely limit the purchasing power and living standards of service-sector workers. Another stimulus package would mitigate the damage. It doesn't need to be as big as the prior stimulus, which sustained spending long after benefits expired, but it needs to come soon.



The third wave will have much less impact on businesses that have done relatively well during the pandemic, people who can work from home, and those with large stock portfolios. Manufacturing activities that can be done safely should continue to recover due to a need to rebuild depleted inventories. Weather permitting, home construction will also remain strong, also due to the need to rebuild depleted inventories. The stock market is looking beyond the COVID winter to the vaccine spring, and stock prices are near record highs. Historically, there has been a strong correlation between holiday sales and stock prices. That suggests strong holiday spending this year, but that spending is likely to be done predominately by high-income households.

The rise in COVID-19 cases and the resulting slowdown in economic activity is not just a U.S. phenomenon. Case counts have surged in most of the northern hemisphere, especially in Europe and North America. Much of Europe may have fallen back into recession. Only China and a few other countries in the Asia/Pacific region have managed to keep the virus under control. In most cases, that has limited the economic damage. However, Japan's economy has performed poorly despite a relatively low incidence of COVID-19. Voluntary actions taken to avoid the virus, reflecting extreme risk aversion, plus reliance on exports to countries hit hard by the pandemic, caused industrial production in Japanese manufacturing to fall 21.1% from February to May. It was still down 10.5% year-over-year in September.

The COVID-19 case count (and the number of hospitalizations, a better gauge of the severity of the pandemic) is likely to get worse as the weather gets colder, students return home from college, and families gather for the holidays. As people react, voluntarily or in response to government mandates, the economy will weaken, but the case count will decline. The case count will decline further as vaccines are distributed and warm weather returns in the spring. Then economic growth will pick up. The economy has likely carried enough momentum into the fourth quarter to avoid a fourth-quarter decline in real Gross Domestic Product, and activity could pick up soon enough to avoid a decline in the first quarter, but we could see declines in monthly data during the November-February period, especially if we don't get further fiscal stimulus before Christmas. Apparently, disagreement over how much stimulus we need has caused Congress to lose sight of how much we need stimulus. As with gift giving, a relatively small package during the holiday shopping season would do far more good than a large package after January 20, 2021.

During my 25 years of writing a newsletter on the economy and giving speeches on the economic outlook, I've frequently quoted Chance the gardener (aka Chauncey Gardiner), played by Peter Sellers in the movie *Being There*, who said, "There will be growth in the spring." The impressive success of Pfizer and Moderna in developing vaccines in record time, plus the natural slowing in the spread of the virus as the weather gets warmer and people head outside, gives us hope that growth will reaccelerate in the spring and that the U.S. economy will return to **some semblance of normal** over the last three quarters of 2021. (John Silvia, former Chief Economist at Wells-Fargo recently told the Philadelphia Council for Business Economics, "We have never returned to normal" after previous shocks to the economy.) But before we get to spring, we face the specter of a very tough winter, with rising case counts, hospitalizations, and deaths, and a sharp slowdown in economic growth. A well-timed stimulus package could ease some of the economic pain being felt by low-income service-sector workers and might help some businesses stave off bankruptcy, but it won't keep businesses open if governments or customers deem them unsafe to patronize. It would be great if we could just skip the next few months and get immediately to the faster growth that will come in the spring, but unfortunately, as the promos for the HBO television series *Game of Thrones* told us for seven years, "Winter is coming."