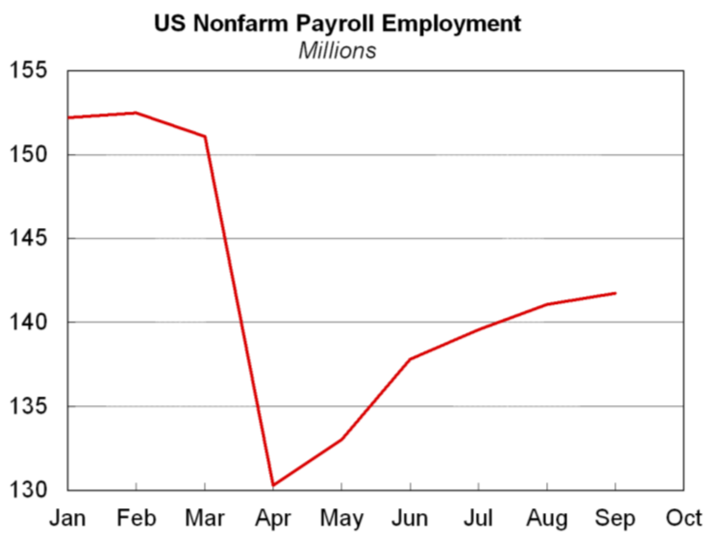
Current Economic Conditions

Robert C. Fry, Jr., Ph.D. October 21, 2020

PAYROLL RECOVERY LOSING STEAM

U.S. nonfarm payroll employment grew by 661,000 in September. Employment growth was down from 1.489 million in August, 1.761 million in July, and a record 4.781 million in June. If employment continues to grow by 661,000 per month, with no further deceleration, it will take until February 2022 for employment to get back to its February 2020 peak. Unfortunately, employment growth is likely to decelerate further before accelerating when a COVID-19 vaccine becomes widely available. Initial claims for unemployment insurance rose last week, indicating that layoffs have turned up after a big decline over the last six months. (Continued claims, which take into account hiring as well as layoffs, but which are reported a week after initial claims, continued to decline through the prior week.)



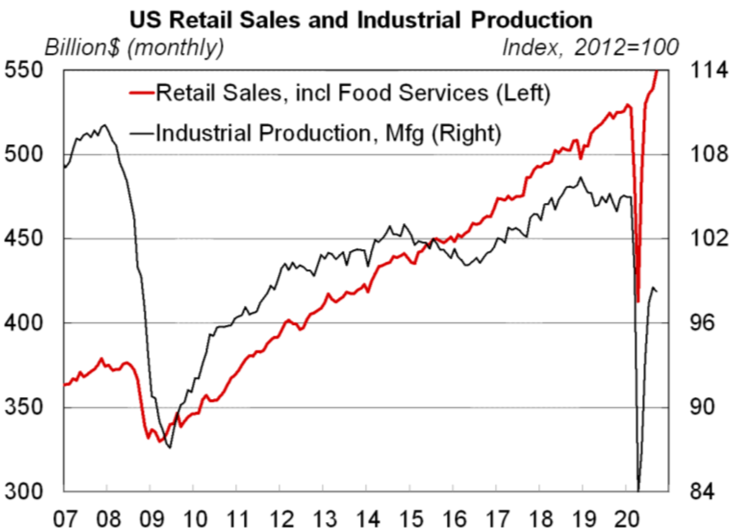
Employment growth has slowed because economic activities that can be done safely have already resumed in most of the country, while the "unsafe" activities that have not resumed won't resume until there's a vaccine or effective treatment. In effect, the low hanging fruit has already been picked. Until a vaccine is available, further growth will have to rely on shifting unemployed workers from services that can't be done safely (e.g., restaurants, bars) to activities that can be done safely (e.g., home construction), but if waiters, waitresses, and bartenders (and pilots and flight attendants) aren't willing and able to pick up a hammer or a spackling knife, that's not going to happen, and total employment will remain well below its pre-recession peak.

The deceleration in employment was not reflected in retail sales in September. Retail sales rose a much-stronger-than-expected 1.9%, the biggest increase since June. Sales were up in all major categories of business except electronics and appliance stores. Despite the pandemic and recession, retail sales were 5.4% **higher** in September than they were a year earlier. Excluding food services and drinking places, retail sales were up **8.2%** year-over-year.

The strength of retail sales vis-à-vis employment largely reflects the impact of fiscal and monetary stimulus, which was rolled out in record time earlier this year. The combination of direct ($1200) payments to most Americans, enhanced Unemployment Insurance benefits, and the Paycheck Protection Program for small businesses has left disposable income **higher** than it was before it was before the recession, something that has never happened in previous recessions. The $600/week federal enhancement to Unemployment Insurance benefits expired in late July – it was replaced by a $300/week enhancement via an executive order from President Trump – but households have saved so much of the fiscal stimulus that the decline in UI benefits and failure to pass another stimulus plan has yet to hit broad measures of consumer spending. The personal savings rate – the percentage of disposable income not devoted to consumer outlays – rose from 7.6% in January to a record 33.6% in April and was still an elevated 14.1%

in August. Retail sales have also been helped by monetary stimulus, which has helped push stock prices and house prices to record highs even though the economic recovery is far from complete.

But aggregate measures of consumer spending don't tell the full story. Unemployed low-income individuals will be hurt by failure to pass another stimulus bill long before this shows up in aggregate measures of retail sales, personal consumption expenditures and Gross Domestic Product. Data on missed rent and mortgage payments suggest that is already happening. Growth in the broad aggregates can be sustained, for a while, by higher-income individuals who are still employed, who can work from home, and who have large stock portfolios, but growth will soon fade or even stall without further stimulus. The policy challenge is in providing stimulus that's enough to prevent human suffering and a big decline in aggregate demand but not so much that it discourages unemployed workers from seeking and accepting job offers from new employers and in new occupations. Like most of economics, it's an optimization problem, and the optimum is rarely a "corner solution", i.e., one extreme or the other.



Unlike retail sales, industrial production in U.S. manufacturing was a disappointment in September, falling 0.3% after big increases in the prior four months. Declines in production of motor vehicles and parts and computers and electronic products accounted for more than 100% of the decline. In these two industries, production had already exceeded pre-recession levels as manufacturers made up for production lost to shutdowns (vehicles) or met a temporary surge in demand as people shifted towards working from home (computers). With retail sales still strong and wholesale and retail inventories still very lean, industrial production in manufacturing is likely to resume its recovery in coming months.

Housing remains the brightest spot in the U.S. economy. Single-family housing permits, the most important number in the monthly residential construction report, rose in September to their highest level since March 2007. The National Association of Home Builders/Wells Fargo Housing Market Index, which fell to an 8-year low in April, rose to a record high in October. With inventories of existing single-family homes below three months of sales, house construction must remain strong to keep up with demand.

The deceleration in payroll employment and industrial production will have little effect on third quarter GDP growth, which will be reported later this month. Growth probably exceeded 30% at an annual rate, close to twice the previous record growth rate. Without annualization, GDP fell 10.1% in the first half and rose about 7% in the third quarter, leaving it almost 4% below its late 2019 peak. That means that despite the strongest quarterly growth rate in history, GDP is still about as far below its pre-recession peak as it got in 2009 at the depths of what was then the worst recession in 75 years.

The deceleration in monthly data on employment and industrial production – and a likely deceleration in consumer spending as the impact of fiscal stimulus fades and the number of COVID-19 cases rises – will show up in quarterly GDP data in the fourth quarter. I expect GDP growth to slow to the low single digits and to remain there is the first quarter of 2021. Growth will reaccelerate when a vaccine is rolled out, but if this fall's resurgence in COVID-19 cases is especially severe, we could have a "double-dip" before the reacceleration. However, in all humility, I should note that I have been too pessimistic about the depth of the recession and the strength of the recovery so far. The U.S. economy is very resilient, and despite media focus on what we've done wrong, large parts of the economy, notably those that produce and distribute goods and build houses, have figured out how to operate safely in a pandemic.