Current Economic Conditions

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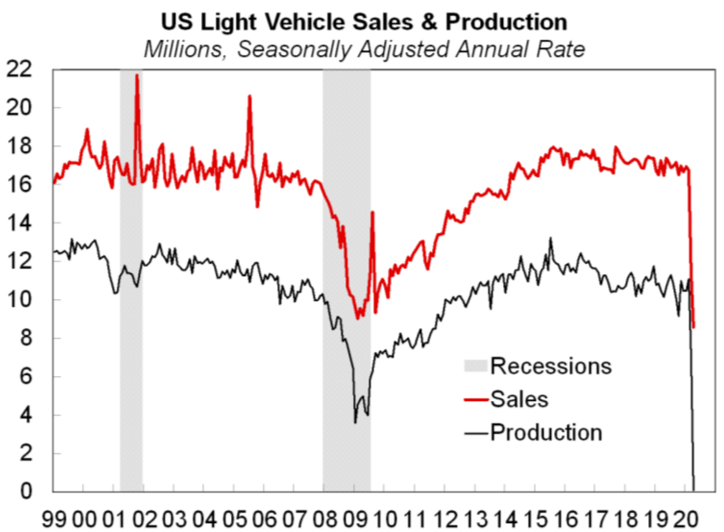
THE RECOVERY BEGINS

April was, in many ways, the worst month ever for the U.S. economy. Nonfarm payroll employment fell by 20.5 million, more than 10 times the previous record decline, which was in September 1945 as the economy demobilized after World War II. The headline unemployment rate, which was at a 51-year low of 3.5% in February, rose to 14.7% in April, the highest since the Great Depression. And because this measure doesn't count people as unemployed if they have not looked for a job within the last month, it greatly understates the percentage of people who are not working. The decline in employment was largely the result of government-mandated closures of "non-essential" businesses, schools, and other institutions. Those same closures also caused a record decline in retail sales. Retail sales including food services fell 16.4% in April, almost doubling March's then-record 8.3% decline. Over the last two months, sales fell by 89.3% at clothing stores, by 67.4% at furniture and home furnishings stores, and by 50.5% at food services and drinking places. Sales rose only at nonstore (e.g., online) retailers and food and beverage stores.

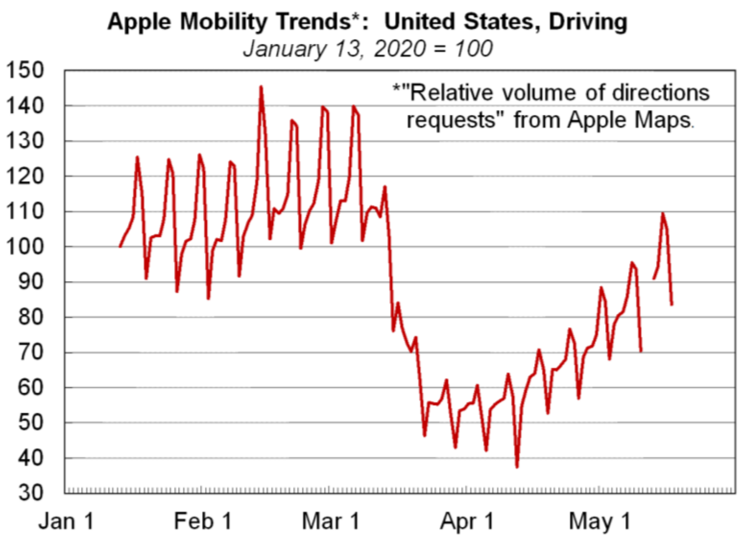


Industrial production in U.S. manufacturing, which suffered its biggest decline since 1946 in March, fell 13.7% in April. This was the largest decline ever in a data series that goes all the way back to 1919. Production was down by more than 25% from April 2019 levels in motor vehicles and parts, aerospace and miscellaneous transportation, primary metals, textiles and products, apparel and leather goods, and printing and related support activities. Auto and light truck assemblies plummeted from a 11.1 million seasonally adjusted annual rate in February to a 71,700 annual rate in April. Single-family housing permits, the most important number in the monthly housing report, fell to 669,000 in April, down from 994,000 in February. Because of a pickup in housing market activity late in the month, the April decline in permits, while still very large, was smaller than expected.

With states lifting shutdown orders, retail sales and consumer spending more broadly are likely to be higher in May than in April and higher in June than in May. The number of people working is likely to rise as well, but this might not show up in May data, for two reasons. First, the payroll employment data measure the number of people who are getting paid, not the number who are working; people who were kept on payrolls in April even though they weren't working might fall off those payrolls in May. Second, the civilian employment survey, used to calculate the unemployment rate, is taken the week that includes the 12th day of the month. If the lifting of shutdown orders boosts employment after that week, it won't show up in the data until the following month. In many cases, manufacturing sites were exempted from shutdown orders. Except in industries that were shut down (by state order or voluntarily) because the production process didn't allow social distancing, most of the April decline reflects a decline in demand. Demand for new production might not come back quickly at materials suppliers – excess inventories down the supply chain must be worked off first – but this week's resumption of motor vehicle production could produce an upturn in total industrial production as early as May and almost certainly by June.

With consumer spending (70% of GDP) bottoming in April and employment and industrial production likely to bottom in either April or May, it appears that the economy has hit bottom, at least for now. If a resurgence in COVID-19 cases prompts states to reinstate their shutdown orders or a wave of job losses and bankruptcies causes the recession to take on a life of its own, independent of the shutdowns, economic activity could fall to new lows, but if it doesn't, the National Bureau of Economic Research is likely to place the business-cycle trough in April or May. That would mean that the recession is either over or ending, at least in the way economists define recessions. (For non-economists, especially those who have lost jobs, the recession will last until economic activity returns to pre-recession levels.)

If the recession is over, the key question becomes, "what will the recovery look like?" That will depend largely on how quickly consumers resume their normal activities after the shutdown orders are lifted. That, in turn, will depend on whether and how much COVID-19 cases and deaths increase after the shutdowns end, how consumers and governments react to those increases, and how soon a vaccine or effective treatment gives the vulnerable and risk-averse enough confidence to return to restaurants, retail stores, movie theaters, airplanes, and cruise ships. High-frequency data (e.g., Apple mobility data, credit card transactions) suggest that business is bouncing back faster than I expected. The second-quarter decline in real Gross Domestic Product will still be the biggest ever, but probably smaller than I had expected.



I expect a quick but incomplete rebound in the next few months. That will produce strong annualized growth rates in the third quarter but will leave the level of economic activity well below its pre-recession peak. I then expect a gradual recovery until roll-out of a vaccine unleashes a period of faster growth that gets the economy back to the pre-recession peak, probably around the middle of 2022. However, because of uncertainty about the course of the virus, about how people react to something they haven't seen before, and especially about the timing of the development and rollout of a vaccine, you should not have a great deal of confidence in this or any other forecast. With so much uncertainty about the recovery, businesses need to consider various scenarios, varying as to when the economy hits bottom and how fast it recovers.

Notice that I have said nothing about government policies. The Federal Reserve is doing everything it can to prevent a collapse in the financial system. The President, Congress, and state and local governments are trying to ease the human cost of the pandemic. They might be able to take a worst-case scenario off the table, but they can do little to reduce the decline in second-quarter GDP or to quickly return GDP to its pre-recession level. When it comes to recovering from the recession and ending the pandemic that caused it, what medical researchers do is far more important than what policy makers do.

When I was in graduate school, I played in a Beatles cover band. (I was the least talented musician and least accomplished economist in a group that included Richard Clarida, the current Vice Chairman of the Federal Reserve.) One of my favorite Beatles songs is "Getting Better." When people complain that the world is going down the tubes, despite evidence to the contrary, I remind them of Paul McCartney's optimistic message, "It's getting better all the time," and urge them to ignore John Lennon's response, "Can't get no worse." But this is a time when both Paul and John are correct. In all likelihood, the economy has hit bottom and is getting better. But it can't get much worse than it was in April.