Don't Buy the Hype: Four Signs the Recovery Is Less Than It Seems

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Recent positive economic headlines are easily misinterpreted. The record growth we've enjoyed follows even greater downturns and leaves us well short of prior levels on most key measures. With the recovery slowing across the board, a full rebound is not yet in sight.

The latest government reports have brought a spate of upbeat U.S. economic headlines. Last month, the Bureau of Economic Analysis (BEA) said that real GDP grew 7.4% in the third quarter, doubling the prior quarterly record growth and reversing most of the pandemic's initial plunge in output. Then the Census Bureau reported that retailers posted their fourth straight month of record sales in October, and sales now exceed their prior peak logged in January.

More recently, the BEA said that consumer spending (which includes retail sales as well as other items like housing and health care) rose again in October for the sixth consecutive month. Meanwhile, And then just this past week, the Bureau of Labor Statistics (BLS) noted that employers recorded their seventh straight month of strong job gains.

So, plenty of welcome economic data, and certainly better news than this spring. But while technically accurate, the headlines provide a misleading narrative about the economy's strength and near-term outlook.

Sign #1: We've Already Recovered the Easy Jobs—But We Need A Lot More

U.S. employers added 245,000 jobs last month. In normal times, that would be considered an excellent tally. For comparison, job growth averaged just 178,000 per month in 2019.

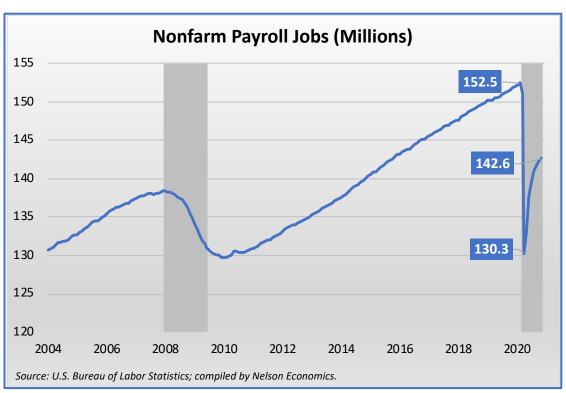

Figure 1

But of course, these are not normal times. The economy lost 22.1 million jobs in March and April, far exceeding any prior two-month total in our history (*Figure 1*). However, the vast majority of these job losses were initially classified as temporary furloughs, rather than permanent layoffs, and thus more easily reversed once the economy reopened. And, indeed, the record job losses were quickly followed by record job gains. By the end of October, we had regained over half of the lost jobs.

This pace of revival is spectacular by historical standards. Still, there is growing evidence that this remarkable "V-shaped" recovery is petering out well before all the lost jobs have been recouped. By now, we can assume that businesses that could reopen already have, and that firms have already rehired the workers they need. In other words, we already recovered the easy jobs; regaining the rest will be more challenging, especially given the current wave of lockdowns and other restrictions meant to fight the latest surge in COVID-19 cases. Moreover, the longer firms remain shuttered or operating with limitations, the greater the likelihood that they will not survive the downturn, slowing further recovery. Restarting an existing business is relatively quick compared with creating whole new enterprises to replace bankrupt firms.

Thus, job gains have been decelerating. After the initial waves of rehires in May and June as the economy first reopened, the number of jobs added to payrolls has declined every month (*Figure 2*). Though we've regained twelve million jobs, we're still nearly ten million jobs down from pre-pandemic levels. At this diminishing rate, we won't get back to prior peak levels until at least 2022.

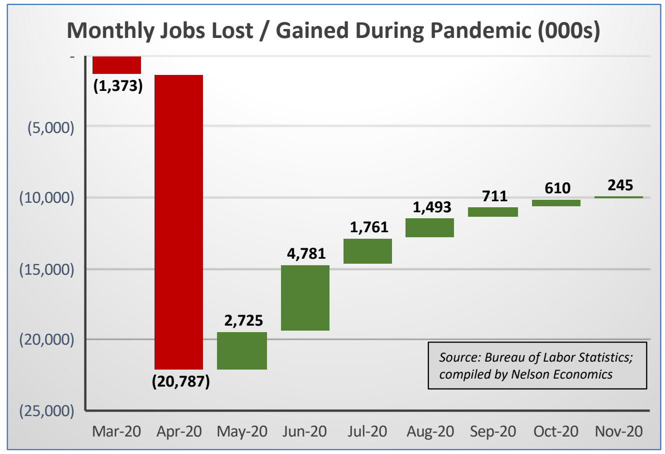

Figure 2

Sign #2: Over One Million Workers are Still Filing New Jobless Benefit Claims Every Week

New claims for unemployment benefits have declined significantly from their astronomical volumes this spring, as have "continuing claims" for unemployment—workers who can't find new work and are still collecting unemployment benefits. Gratifying declines, to be sure, but both metrics remain at extremely elevated levels.

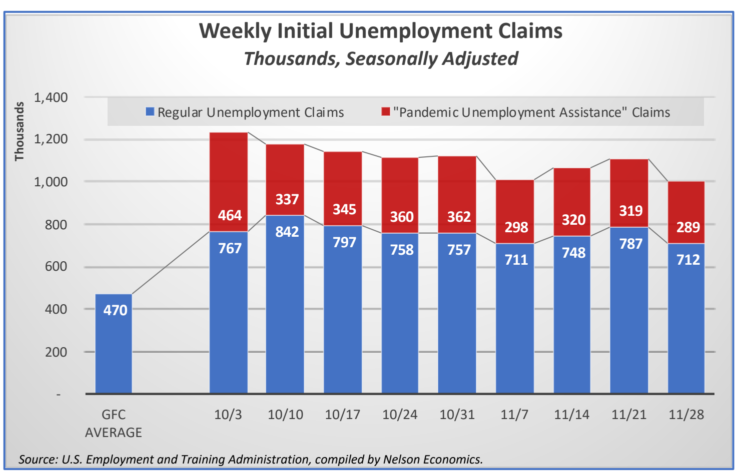

Figure 3

Despite the record pace of job gains, over a million workers are still filing new unemployment insurance (UI) claims **EVERY WEEK**. Last week over 700,000 people filed "regular" state UI claims (which covers payroll employment) and almost 300,000 workers filed claims for "Pandemic Unemployment Assistance" (for gig and contract work), provided under the "Coronavirus Aid, Relief, and Economic Security" (CARES) Act. That's a million new claims in all (*Figure 3*). In fact, the number of new UI claims has topped one million for 37 straight weeks since the beginning of the pandemic.

These figures evince a very troubled labor market. For comparison, weekly unemployment claims during the Great Financial Crisis (GFC) averaged less than 500,000 and never exceeded last week's 712,000 regular claims (seasonally adjusted) in any week during the entire 18 months of that recession.

What's going on here? First, millions of supposedly temporary furloughs are turning into permanent job losses with the expiration of the Payroll Protection Program (PPP), which had kept countless small businesses afloat and enabled them to retain their workers. The special bailout program for airlines also expired, and already leading carriers have commenced significant layoffs. For the first time during the pandemic, the BLS is reporting that permanent layoffs exceed temporary layoffs.

Secondly, with COVID cases shooting past 150,000 a day nationally and rising pretty much everywhere, states are rapidly reversing reopening plans. The longer social mobility is restricted—whether due to either citizen fears or government mandates—the more businesses that will fail, adding to the number of Americans out of work. Washington's failure to agree on another round of stimulus measures means the layoffs are likely to not only continue but escalate.

Sign #3: The Economy Has Required Massive Government Support to Start Recovering

The economy has been propped up during the pandemic by a huge infusion of government support. Personal Income has actually increased during the pandemic (*the blue line in Figure 4*), which is most atypical during downturns. Even with the help of automatic stabilizers (like unemployment insurance and food stamps) and discretionary stimulus programs (like tax cuts and direct cash payments to households), income invariably declines during recessions.

But not in the COVID-19 recession. Thanks to the CARES funding, as well as state unemployment programs, incomes rose 10% above their pre-pandemic level in April and have remained elevated since. Excluding this extraordinary countercyclical funding, income would have dropped more than 10% during the second quarter—more than during any downturn since the Great Depression (t*he red line in Figure 4*).

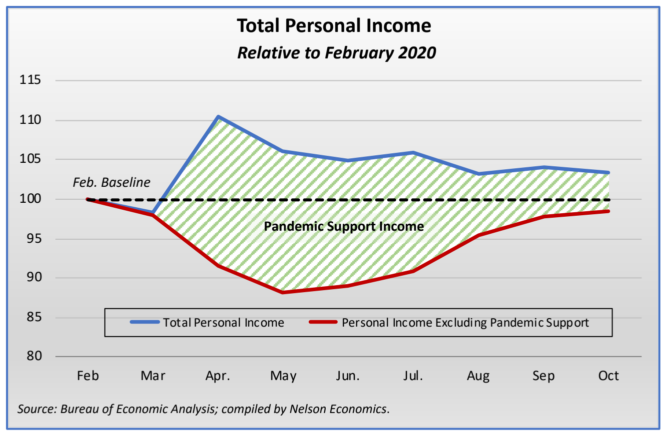

Figure 4

These programs accounted for 16.5% percent of all income in the U.S. during the second quarter. This share fell to 9.3% of all income in the third quarter as various CARES programs either expired or expended their funds, but still accounted for almost 5% of Personal Income in October. Households ended up saving much of their supplemental income or using it to reduce their debt loads, but GDP—as well as job growth--would have been far lower without these programs.

Sign #4: People Can't Keep Buying TVs and Autos Instead of Paying Rent and Tuition

Retailers sold a record volume of goods and services in October for the fourth month in a row, and sales are now 4.5% above their prior peak in January. This recovery is astonishing given the historic plunge in sales during the early weeks of the pandemic—overall spending on retail goods and services plunged 22% in just two months as the country went into lockdown (*Figure 5 on next page*). The recovery is all the more remarkable in the middle of a recession, with unemployment still twice the rate where we began the year.

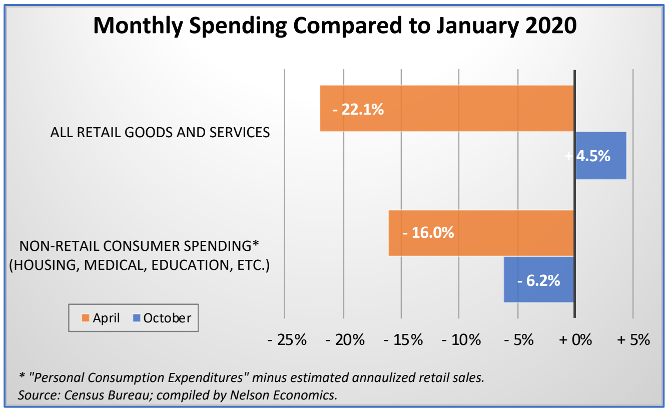

Figure 5

But a closer look at the trends reveals that retail conditions are not as encouraging as they appear. First, overall consumer spending has been supported by the massive stimulus spending by the federal government. As with GDP, consumer spending would have been much lower absent this support and likely will fall without another round of income support programs.

Equally importantly, consumers could splurge on retail goods and services only by cutting back on spending elsewhere. In normal times, spending on retail goods and services together account for less than half of the consumer budget. Households also buy a lot of stuff not generally sold through retailers: housing, education, most health care expenses, travel, and most forms of entertainment.

People have been reducing all sorts of non-retail expenses for various reasons. Ironically, spending on health care is down—despite the pandemic—because medical providers have cut discretionary appointments and patients are afraid to visit medical offices. Many students have suspended their education and cut tuition bills. Everyone is spending a lot less on travel. Finally, many households have paused making housing payments as allowed by the CARES Act. However, these reduced housing payments generally are not reflected in the government's official consumer spending accounts for technical reasons.*

Altogether, non-retail consumer spending initially fell 16% in April—quite significant, though less than the 22% plunge in retail sales over the same period. But as consumers have reallocated their spending away from non-retail services, retailers have gained. Last month non-retail spending was still down 6% relative to the beginning of the year, while retail sales rose 4.5%.

This disparity will endure so long as the pandemic interrupts our old everyday lifestyles. But households can't defer their non-retail spending indefinitely. Notably, the various housing protection programs that enabled families to suspend their housing payments only deferred—but did not forgive—rent and mortgage payments. Households eventually must repay the missed payments. Soon people will need to return for regular visits to their physicians and incur more medical expenses. And people will again travel and return to school. In all of these ways, spending will revert to the sectors that were disfavored during the pandemic, to the detriment of retailers.

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* Technical note for the data-obsessed: The decline in consumer spending is even greater than reported in the BEA tables, which generally does not reflect the reduction in housing payments during the pandemic. Many households have paused paying rent or mortgages this year, as the CARES Act provided a temporary eviction moratorium for millions of qualifying renters and homeowners. However, these reduced payments are not reflected in the consumer spending figures because the government statistics impute a housing cost for all occupied units, whether or not a payment is actually made. Thus, housing costs in the government accounts are reduced only to the extent that households vacate units, which so far has been minimal. In this way, fully accounting for the nonpayment of rents and mortgages would lower non-retail consumer spending further and thereby show additional household resources available for retail goods and services.

Current Conditions in Context

By just about any measure, the U.S. economy is in better shape now than it was during the initial weeks of the pandemic. Much better. And though many parts of the country are again adopting new restrictions, few places will impose limitations as strict as those during the initial lockdowns. Thus, even if we undergo another downturn this winter, it's most unlikely to be as severe as the spring's economic freeze.

At the same time, the recent positive economic headlines can be misleading. The record growth we've enjoyed follows even greater downturns and leaves us short of prior levels on most key measures. And even where we have reached new record levels, as with retail sales, those levels are unlikely to be sustained once government support is removed and people resume their former activities.

The recovery is well underway, but we still have much further to go to recoup what was lost. And that will take a long time to achieve.

