The Daily Dish

Taking the Pulse of the Economy

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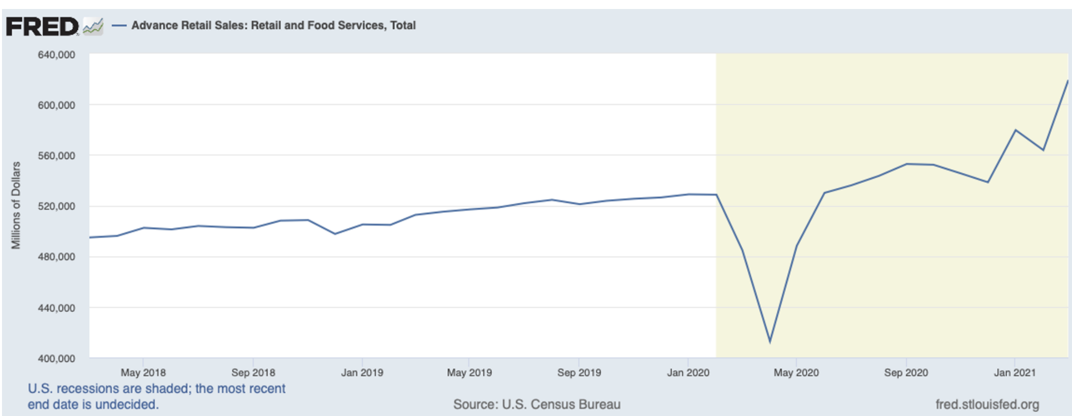
Eakinomics: Taking the Pulse of the Economy

With the news this past week that retail sales ballooned by 9.8 percent in March (see below), and that new claims for unemployment insurance declined by over 200,000 in the previous week, there is much chatter that the economy is out of the woods. Is that right?

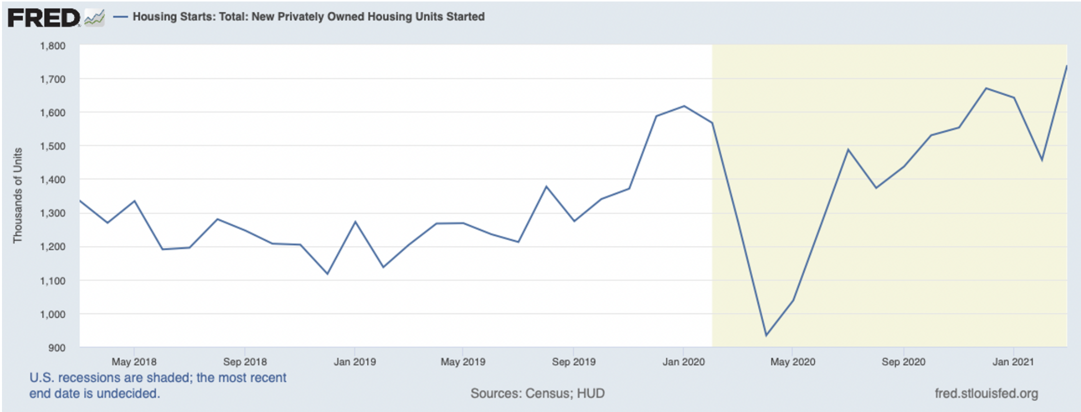
As we shall see, indicators of aggregate demand – spending by households, businesses, and homebuilders – are quite strong. In addition, monetary and fiscal policy are both strongly – perhaps overly strongly – supporting demand. Unfortunately, the same cannot be said for indicators of supply conditions – particularly labor force participation – and policies are exacerbating supply constraints.

Let’s start with U.S. households. As the chart indicates, retail sales are now well above their pre-pandemic trend, a good sign for the macroeconomy.



Turning to businesses, a very good indicator of business fixed investment is new orders for non-defense capital goods (excluding the volatile aircraft sector). In the graph below the data place business investment strongly above the pre-pandemic trend.

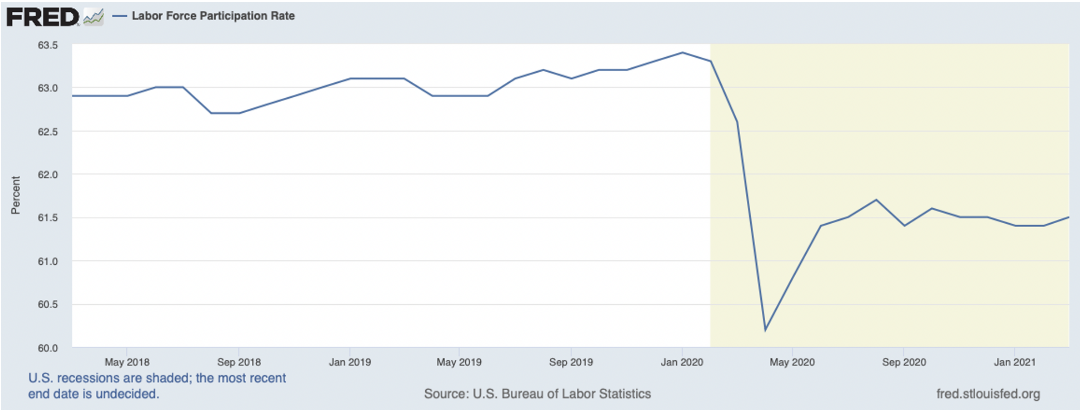
In a similar fashion, housing starts – the best single indicator of the cyclical state of the housing market – are up sharply.



In short, aggregate demand seems to be in good shape, monetary policy is very accommodative (the Fed has essentially promised to be late; just not dangerously late), and fiscal policy is busy distributing the $2.8 trillion doled out in December and March. Overheating is the only real risk.

The supply side shows a different story. As seen below, employment (in either absolute terms or relative to the population) remains well below the pre-pandemic peak.

One of the reasons is that labor force participation remains depressed as well (below).



A big part of the problem remains the coronavirus itself and the resultant inability to conduct normal economic affairs. But in contrast to the demand side, policies are not helping much. Schools remain closed despite the evidence that there is no heightened risk associated with conducting classes. The federal bonus of $300 per week on top of normal unemployment insurance benefits is far too generous and will be an increasing headwind to finding employees. And the Biden Administration has been busily cooking benefits that accrue regardless of work – child tax credit, premium tax credit, child and dependent care tax credit – and will further distort work decisions.

The economy will continue to strengthen as the virus recedes. But it will recover faster if detrimental policy headwinds are removed.