

# Research Commentary | US

## Macro Musings

### Economist

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- **An explosive second-quarter growth rate is set to occur, although the floodgates barely opened in April. Many economic reports for the month were soft, beginning with the jobs report and ending the month with a lackluster income and spending report. The setback should be only temporary, as all the ingredients for a snapback are in place.**
- **Supply shortages and bottlenecks continue to be the biggest restraint on growth, not demand. Until recently, the goods sector felt the brunt of the shortages, as demand far outpaced supply. With the economy reopening and the service sector coming back to life, the shortages are shifting from the goods to the service sector, with labor replacing raw materials and supplies as the main culprit.**
- **While generous unemployment benefits may be holding back the supply of labor, a more compelling argument could be made that the high cost of childcare is a more serious impediment. It is hard to justify that jobless benefits are encouraging workers to stay out of the labor force when new claims for unemployment benefits are falling like a stone.**

The U.S. economy closed out the month of May riding a host of mixed feelings. Companies are upbeat, households are cautiously optimistic, and investors are grateful for past gains but anxious over the future policy decisions. As the weather heats up over the summer months so too will activity, which should generate warmer feelings all around. The emotional relief derived from the fading of the pandemic is imparting a jolt of energy into the economy. People are eager to resume dining out, go to museums, book travel plans and attend sporting events. Flush with cash from generous government transfer payments, the itch to reconnect with friends, family and society in general should underpin the economy's stellar performance in coming months.

While we expect the current quarter to stage the second strongest growth rate in more than 40 years, the floodgates didn't exactly open wide in its initial month. Indeed, many indicators for April, highlighted by the jobs report, came in weaker than expected. Consumers, the economy's main growth driver, turned out to be less of a sparkplug than hoped, and housing activity morphed from sizzling to ice-cold. Yet, no one is concerned the recovery is on the ropes. For the most part, blame for the April setbacks is placed squarely on supply restraints, which are limiting the gains that the tidal wave of pent-up demand would otherwise have produced.

Over the past year, the primary burden of these restraints fell on goods producers.

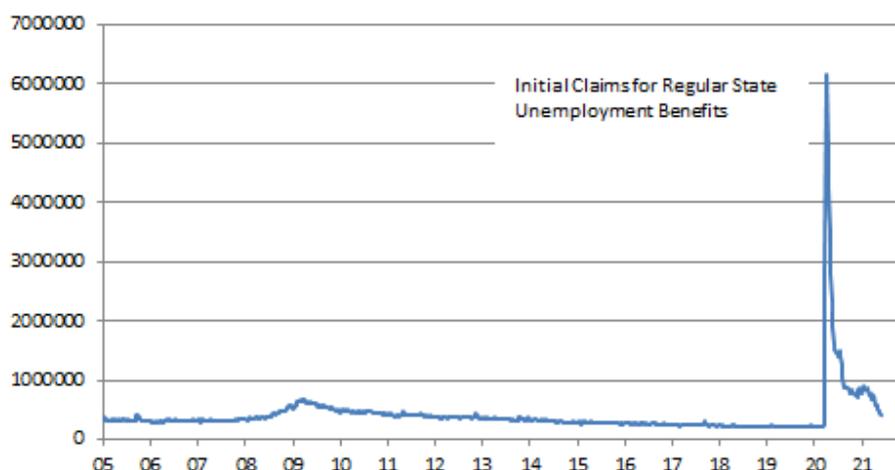
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Manufacturers struggled to meet production schedules, fueled by outsized demands for appliances, furnishings, computers, electronics and an array of other goods from consumers looking to stock up on items that would embellish their shelter-in-place living arrangement during the pandemic. Under normal circumstances, the unexpected surge in demand for goods would have overwhelmed producers. But supply-chain disruptions and other external forces that prevented manufacturers from obtaining needed components to complete production also aggravated the bottlenecks and shortages that ensued. To this day, auto companies are warehousing vehicles on lots until they can obtain scarce semiconductor chips that are needed to make cars roadworthy.

But with the economy reopening and virus fears waning, consumers are shifting their purchases from goods to services. Over time, that should relieve shortages in the goods sector, allowing supply to catch up with demand. Lumber, copper, steel and other raw material and industrial prices have already declined meaningfully over the past two weeks, a sign that pressures are beginning to ease. Service providers, however, are much more labor intensive than goods producers, and the supply restraints have likewise shifted from a shortage of goods components to a shortage of labor. Just as the stimulus-fueled increase in demand has been blamed for the supply shortage in goods, many argue it is now responsible for the labor shortages being reported.

Central to their argument is that generous unemployment benefits are discouraging lower paid workers from taking a job, which pays less than they are receiving by not working. No doubt that argument has some merit, as it is backed up by the experience of many restaurants and small businesses that can't fill open positions. That said, it is getting harder to justify the argument that unemployment benefits are holding back the labor supply when the number of applicants filing claims for benefits are steadily falling. In the latest week, first-time claims fell to a pandemic low of 406 thousand. That's still double the pre-pandemic levels but a far cry from the 6.1 million filing claims last April.

**Jobless Claims Hit Pandemic Low**

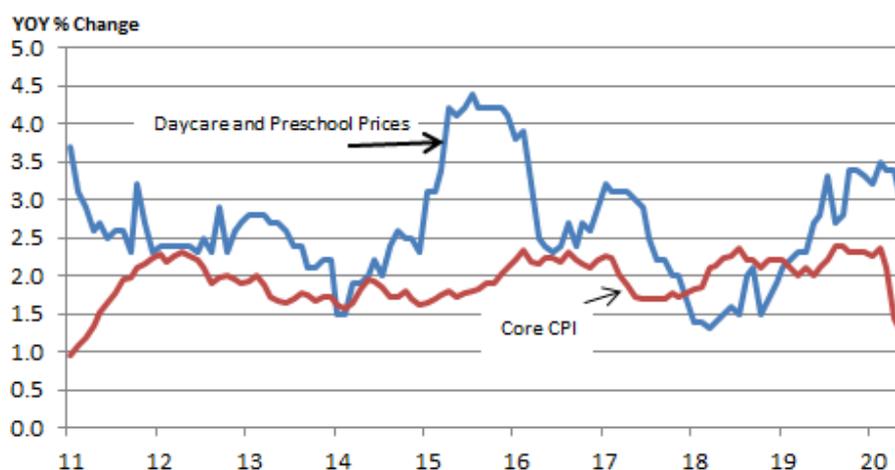


We suspect that the downward trend in filings will continue as more attractive starting pay lures more workers off the sidelines. Amazon, Walmart, Costco, Bank of America and many other high-profile firms have recently upped their minimum wages to levels that are more lucrative than unemployment benefits. What’s more, nearly half the states are opting out of the Federal program that provides an additional \$300 weekly benefit —and that supplement is scheduled to expire in September. Of course, many smaller firms can’t compete with the higher wages offered by larger companies with deeper pockets. With the waning of the health crisis increasing the mobility of workers, the shortage of labor will likely persist or even worsen for large swaths of these businesses.

However, a strong argument can be made that the cost of childcare is just as important, if not more so, in restraining the labor supply. Women, particularly minorities in low-paid industries, have dropped out of the labor force in greater numbers than others. Early in the pandemic, the drop-outs were more widespread, as the shutdown of the service sector impacted women more severely than men. School closings intensified the disparity, prompting mothers to stay home with their offspring. With the service sector now reopening and rehiring picking up, women are returning to the labor force as quickly as men. However, those in low paying jobs are likely holding back due to the high cost of sending children to pre-school or child care services.

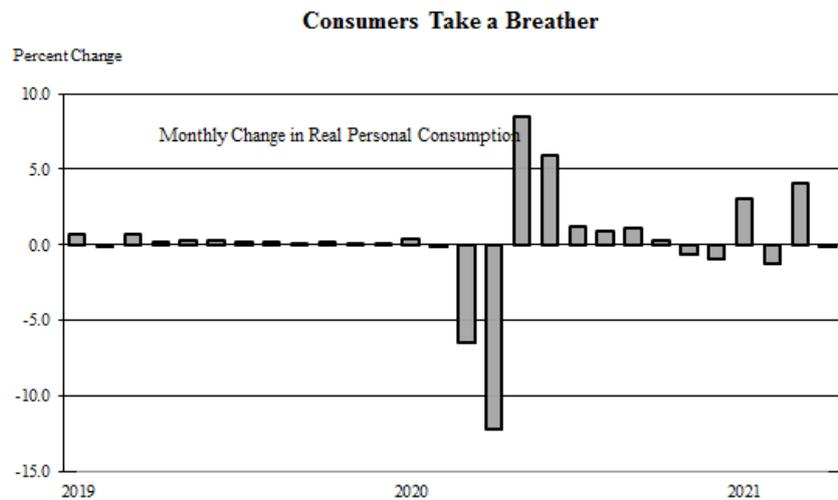
In the year leading up to the pandemic, price increases for daycare and preschool were running more than 30 percent above the core inflation rate. The gap closed during the shutdown as the demand for childcare services vanished, sending prices plummeting. But like other services that are experiencing resurgence in demand, prices will also rebound as women return to the workforce. Except for a few brief periods, the cost of childcare has historically increased faster than prices of most goods and services. There is no reason to believe this won’t recur and restrain lower-paid women from returning to the labor force this time. One positive omen is that the administration’s proposed budget provides more generous support for childcare than is currently the case, albeit how much of it passes muster with Congress remains to be seen.

**High Cost of Childcare**



That said, there should be little question about how much heft the government’s income support has provided to the economy. The latest consumer spending and income report released Friday starkly illustrates its importance. In March, consumers feasted on the

\$1400 stimulus checks sent to most households, sending personal consumption up by a robust 4.7 percent, the strongest since last June. In the wake of that one-month income spike, government transfer payments plunged in April, driving personal income down by a record 13.1 percent. Not surprisingly, spending also faltered. Personal consumption rose a mere 0.5 percent last month, virtually all of it due to higher prices. Real consumption slipped 0.1 percent.



To be sure, the flat reading in consumer spending last month was telegraphed well in advance by the soft retail sales report released two weeks ago. Hence, it came as little surprise to the financial markets. Also telegraphed is that the entire weakness was for goods; purchases of services rose 0.6 percent, reflecting an increase in dining out and other recreational services. The rotation in consumer outlays is just beginning. Spending on services is still 4.7 percent below pre-Covid levels whereas spending on goods stands a whopping 17.2 percent higher. The shortfall in services will narrow in coming months although the speed at which it recovers depend on how well service providers can lure workers off the sidelines.

It's important not to read too much into the soft reading on consumer spending last month. Some may view it as a sign that households are poised to pull in the reins. Indeed, recent surveys of household spending intentions provide support for this notion. In the May Conference Board's survey of consumer confidence, household buying intentions over the next six months for autos, refrigerators, washing machines and appliances all fell dramatically, with appliances plunging to a 10-year low. We suspect that this has less to do with deteriorating expectations for the economy and more with the fact that purchases of these big-ticket items have been pulled forward during the pandemic, leaving little pent-up demand. What's more, the sharply reduced buying intentions of big-ticket durable goods belies the notion that inflation expectations are picking up considerably, as some indicators suggest. If people believe prices are going up, they would plan on making purchases in advance, not reducing them.

We believe that consumers took a breather last month, not going into a hiatus. Indeed, rather than view the latest spending report as weak, the more impressive development is that none of the eye-opening consumption increase in March, which was revised up to 4.7 percent from 4.2 percent, was given back. One reason is that households drew down

some of their formidable cushion of savings to finance purchases. With the savings rate still at an elevated 14.9 percent, there is plenty of firepower in the pipeline. Along with the fading health crisis, rebounding employment and ongoing support from an easy monetary policy, we expect consumers to stage the strongest full-year increase in consumption since 1946.