

## DECLINE AHEAD?



Christian Scherrmann  
U.S. Economist

### IN A NUTSHELL

- The recovery over the summer was still boosted by fiscal stimulus.
- The labor market is still far from pre-pandemic levels.
- As the pandemic is back and the fiscal impulse is fading, consumers might again get more cautious in terms of spending.

This will be our last U.S. economic outlook before the most controversial topic of 2020 finally reaches its conclusion. And we are not talking about the emergence of a silver bullet for the pandemic, but the U.S. presidential election. Conventional wisdom might overstate the tendency of economic performance to predict the election outcome. Experts in the field, like 538.com's Nate Silver, however, conclude that this "... doesn't mean the [economic] fundamentals are of no use at all ..." despite also acknowledging their predictive limitations.<sup>1</sup> But the state of the economy might be a factor in the election.

Economists love to judge how an economy is faring by the amount and quality of jobs it produces. Employment serves as the ultimate test of how the broad mass of the population is doing and therefore may best reflect citizens' mood. And labor-market statistics impressively illustrate what a big hit the economy took as measures to fight coronavirus were implemented. Between February and April 2020, almost 22 million jobs were lost.<sup>2</sup> Most of them were in the vulnerable service sector: almost 18 million jobs wiped out by lockdowns and social distancing. Quickly after the economy reopened the trend reversed sharply and people got back to work. Almost 11 million jobs have been "created", or better "recovered" since the low in April – again, most of them, about 10 million, in the service industry. Though these re-

covery numbers might seem impressive, total non-farm employment remains about 7% lower than before the pandemic – taking it back to its April 2015 level. To provide a historic reference: measured from peak to trough, "only" about 5% of all jobs were lost during the Great Financial Crisis and it took almost four years for the labor market to fully recover.

Right now it seems we might be on a similar track. Labor-market healing is slowing. Weekly initial unemployment claims stabilized somewhere around 800,000 per week in September before slightly increasing again by mid-October. This data has come under close scrutiny in recent weeks. Not only has the methodology changed, in that seasonal factors are now attributed differently, but there have also been disruptions in the delivery of data, for example in California.<sup>3</sup> And the chances are high that even more people might need support looking ahead. Anecdotal evidence suggests that more and more small businesses are beginning to feel the pressure to let staff go permanently or even close their doors forever. There are also an increasing number of reports of bigger companies adjusting their workforce.<sup>4</sup> These factors are likely to limit progress in labor-market healing and could weigh on consumption.

<sup>1</sup> <https://fivethirtyeight.com/features/how-fivethirtyeights-2020-presidential-forecast-works-and-whats-different-because-of-covid-19/> and <http://fivethirtyeight.blogs.nytimes.com/2011/11/18/which-economic-indicators-best-predict-presidential-elections/>

<sup>2</sup> As measured by total nonfarm payrolls

<sup>3</sup> <https://www.reuters.com/article/us-usa-economy/us-weekly-jobless-claims-inch-lower-but-remain-stubbornly-high-idUSKBN26T29M> and <https://www.reuters.com/article/us-usa-economy-employment-idUSKBN25N2R2>

<sup>4</sup> E.g. here <https://www.bloomberg.com/news/articles/2020-09-29/u-s-bankruptcy-tracker-small-business-busts-lift-filings-pace?sref=azxX96EA>

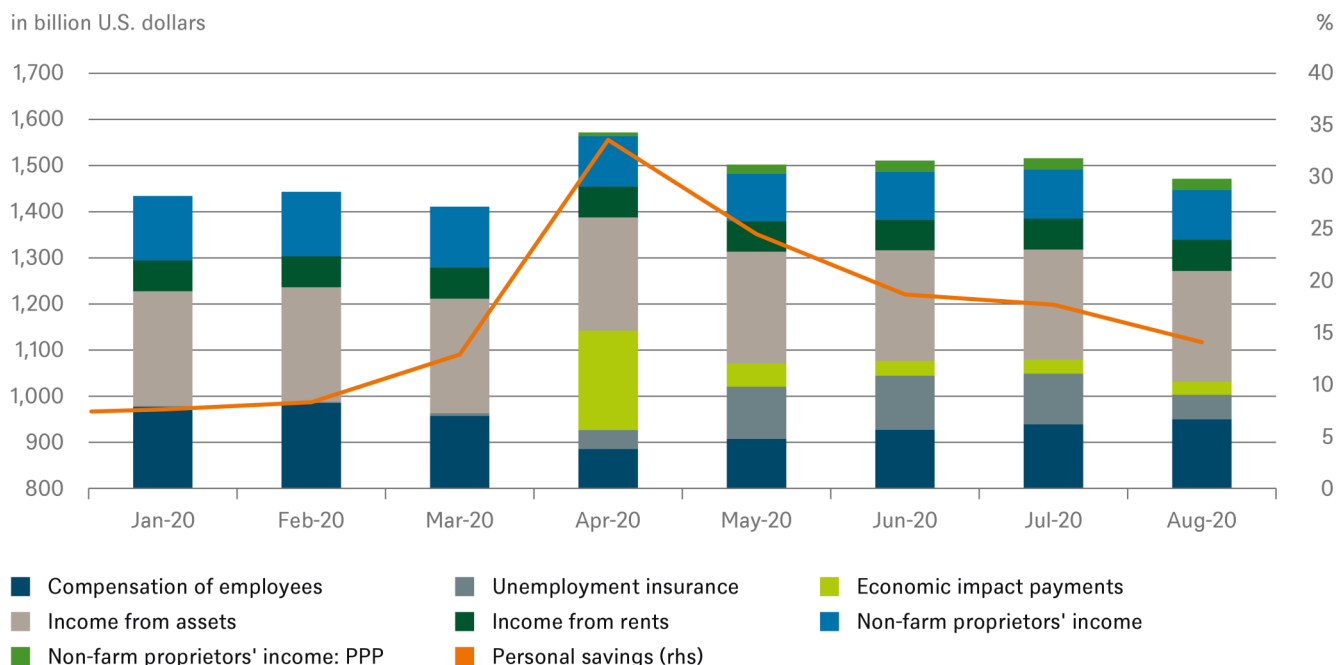
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Our regular readers will already know Chart 1, which deconstructs aggregate income – still one of the most important statistics these days, we think. For this issue we have modified the chart slightly in order to dig deeper into the sources of income. The good news is that Americans still generate a significant proportion of their aggregate income from assets and rents. Owners of real estate have done quite well: while income from dividends and interest remains about 5.5% and 1.9% below February 2020 levels, income from rents is actually 1.1% higher. Growth rates for rental income are, however, lower than before the crisis, but this still illustrates how important alternative assets are in the mix. However, we are also sure that the recent stock-market rally produced some winners (we eagerly await the 2020 census report to learn more about the current level and distribution of personal wealth).

The bad news is that work-related income is still lagging behind: employees' aggregate income remains 3.9% lower than its February 2020 level and income from proprietary activity is down an extraordinary 25%. Most of the latter is compensated by the Paycheck Protection Program (PPP) and to a lesser extent by the Food Assistance Program. However, the non-farm sector currently receives almost 19% of its aggregate income from the PPP. Therefore many Americans who have lost their jobs are not the only ones who are dependent on fiscal transfers; so, too, to some extent are the fortunate ones who are still employed. And fading subsidies might already have impacted the recovery. The savings rate has dropped markedly from its all-time high in April. Should this trend continue it could dive below pre-pandemic levels – we are eager to see these numbers, too. There are likely to be consequences for spending.

## CHART 1: THE MAIN ELEMENTS OF INCOME

in billion U.S. dollars



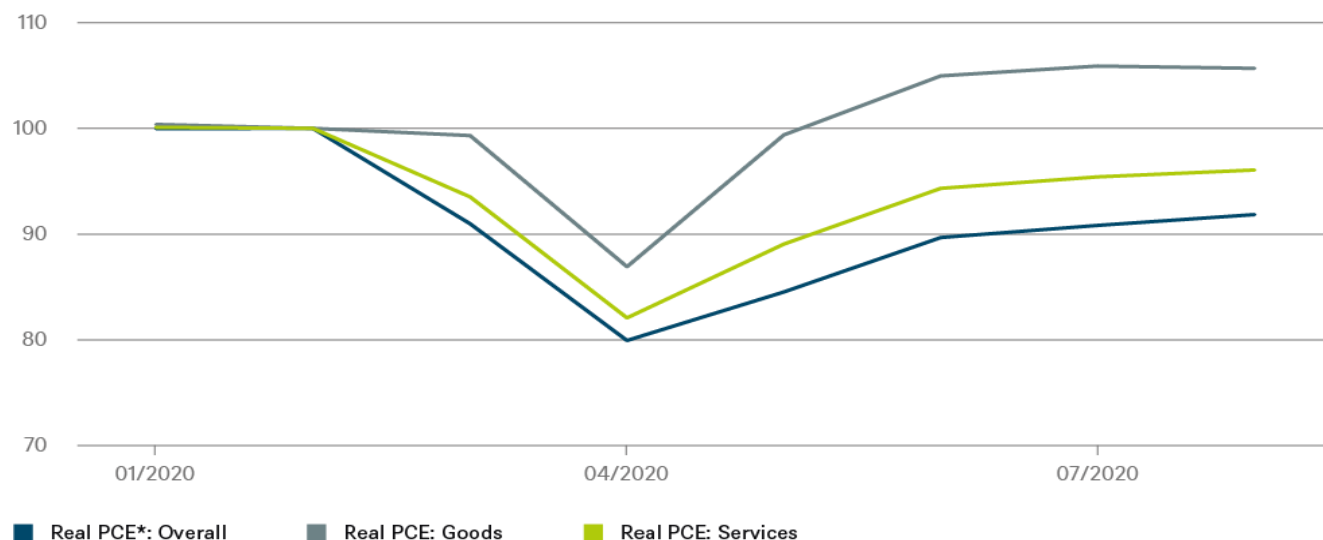
Sources: Bureau of Economic Analysis, DWS Investment GmbH as of October 2020

It is quite obvious that lockdown measures suppressed consumption in April, and to some extent, afterward in the case of services. The bounce back in goods consumption during the summer is still quite remarkable, however. Boosted by one-time payments, Americans took the chance to treat themselves. Goods consumption even surpassed pre-pandemic levels.

In addition, the consumption mix within goods changed (Chart 2). As the demand for services declined, durable goods in particular became more popular: motor vehicles, household equipment and recreational goods moved to the top of the shopping list. Preparing for a life with Covid-19

might have been the motivation. Meanwhile, low mortgage rates and the desire to escape crowded environments generated a booming housing market. Of course, the new home must be well equipped, too. And there were also property-owners who opted for a new pool and barbecue grill rather than the canceled costly overseas vacation. With cars it might be different. The demand above all for used cars increased once the economy reopened. When people try to avoid using public transport, used cars are an obvious substitute. And, having lost their job, leasing a new car might not be an option.

## CHART 2: ROTATION OF CONSUMPTION PREFERENCE



Sources: Bureau of Economic Analysis, Haver Analytics as of October 2020

\* Personal consumption expenditures

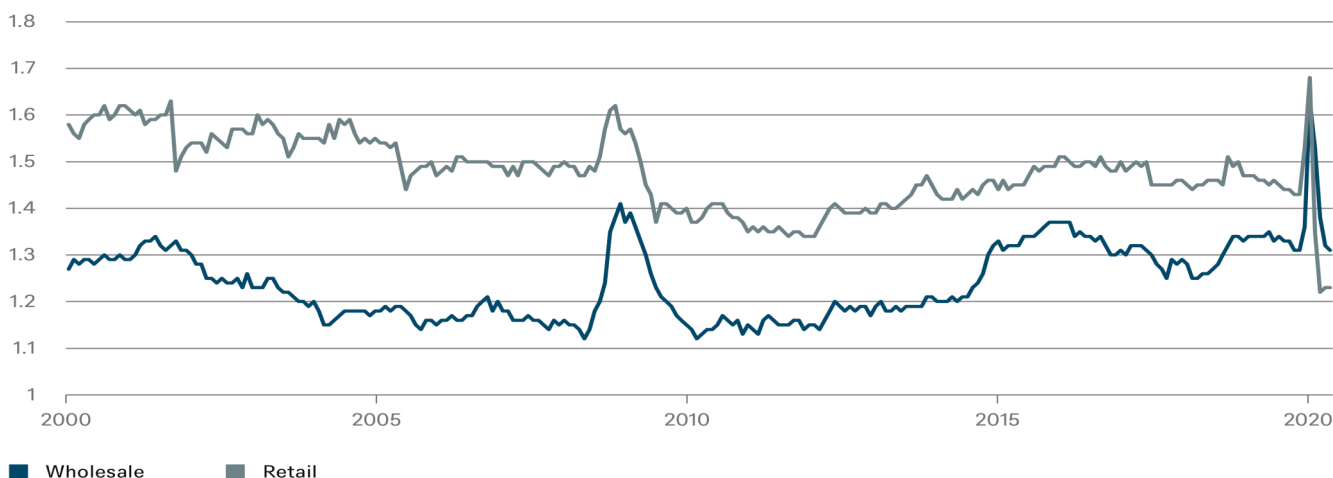
Again, fading fiscal stimulus might have consequences. Demand for new cars recovered somewhat as the recovery progressed. Again, the motivation could be partly connected to government spending. Having been muted in August, when most extended unemployment benefits ran out, retail spending picked up again in September – shortly after President Trump released an executive order for an additionally 300 dollars unemployment benefit per week.<sup>5</sup> While an extra 300 dollars per week might not solely explain the surge in retail sales (the labor market improved as well), hopes for another big round of fiscal stimulus might also have incentivized spending: based on the hope of fresh help, people

may have tapped again their still abundant savings. Hopes for further stimulus, however, are clearly fading as we get closer to the elections; political meddling stands in the way of a real result.

Optimists argued that the recent increase in spending will help to kick-start industrial production, as inventories declined during the summer. Compared to consumption, U.S. industry has had a hard time and is still about 7% below February 2020 levels.<sup>6</sup>

## CHART 3: INVENTORY-TO-SALES RATIO

inventory-to-sales ratio



Sources: Census Bureau, Haver Analytics as of October 2020

<sup>5</sup> <https://www.cnbc.com/2020/08/12/trumps-executive-order-guarantees-300-dollars-per-week-enhanced-ui-payment.html>

<sup>6</sup> Sources: Federal Reserve Board, Haver Analytics as of September 2020

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But while it is true that retail inventories, compared to retail sales, are at historical lows, wholesale inventories are at levels seen just before the pandemic (see Chart 3). On the other hand, wholesale inventories for consumers' new favorites (durable goods such as cars, home furnishing and computer & software) did actually decline somewhat as well. Anecdotal evidence, however, suggests that retailers have become more cautious about building up inventory and that wholesalers are facing capacity constraints in terms of sea freight (especially for home furniture).<sup>7</sup> And the consequences of lower capacity are well known. We already saw mounting price pressures in durable goods in the August PCE report and they are also evident in the September release of the Consumer Price Index. Our judgement, for now, remains the same. As we have written previously, the recent increase in durable-consumer prices might well prove transi-

tory but serves as an example of how quickly inflation can react to fast-changing circumstances.<sup>8</sup>

Overall, it would seem that many of the moving parts in this recovery still depend on fiscal stimulus. And the lack of stimulus could be a big influence on how the final quarter unfolds. Funds for the temporary increase in unemployment benefits are about to run out quickly: the Committee for a Responsible Budget reports that almost 29 billion dollars of the allocated 44 billion dollars had been spent by mid-October.<sup>9</sup> And with virus cases surging across the country and hopes of another fiscal package shrinking, we could well imagine that at least some people will be rethinking their current political preference.

## OVERVIEW: KEY ECONOMIC INDICATORS

	2020				2021				2020	
	Q1	Q2	Q3F**	Q4F	Q1F	Q2F	Q3F	Q4F	Q1F	Q2F
GDP (% qoq, annualized)	-4.9	-32.3	15.8	8.3	6.8	5.3	2.4	1.1	3.2	3.2
Core inflation (% yoy)*	1.3	1.0	1.1	1.2	1.4	1.5	1.5	1.7	1.8	1.9
Headline inflation (% yoy)*	1.7	0.6	0.6	0.9	1.4	1.6	1.7	1.8	1.9	2.0
Unemployment rate (%) (EOP)***	4.4	11.1	7.9	7.1	6.7	6.3	6.0	5.7	5.5	5.6
Fiscal balance (% of GDP) (EOP)***	/	/	/	-21	/	/	/	-7	/	/
Federal funds rate (%)	0.0-0.25	0.0-0.25	0.0-0.25	0.0-0.25	0.0-0.25	0.0-0.25	0.0-0.25	0.0-0.25	0.0-0.25	0.0-0.25

\* PCE Price Index

\*\* Forecast

\*\*\* End of period

## GLOSSARY

The **consumer price index (CPI)** measures the price inflation as a percentage, year over year, of a basket of products and services that is based on the typical consumption of a private household.

A **dividend** is a distribution of a portion of a company's earnings to its shareholders.

The **financial crisis** refers to the period of market turmoil that started in 2007 and worsened sharply in 2008 with the collapse of Lehman Brothers.

The **U.S. dollar (USD)** is the official currency of the United States and its overseas territories.

<sup>7</sup> <https://www.ismworld.org/supply-management-news-and-reports/reports/ism-report-on-business/services/september/>

<sup>8</sup> <https://www.bls.gov/news.release/cpi.nr0.htm> and our chart of the week on PCE prices: <https://www.dws.com/en-us/insights/cio-view/charts-of-the-week/cotw-2020/chart-of-the-week-20201009/>

<sup>9</sup> <https://www.covidmoneytracker.org/>

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