The Shape of the Economy – One Year Later

A year ago, today, your blogger’s partner asked what YB thought was going to happen with the economy. Fifty-two weeks later, it is worth taking stock. Last year’s quotes are in red. This year’s observations follow.

Aggregate supply is determined by labor force, capital stock, technology, and know-how. Although we are pushing 60,000 lost lives at this writing due to COVID-19, the labor stock is fundamentally intact. We haven’t lost factories, and the great technology stocks (Alphabet, Apple, Amazon, Microsoft, and Facebook) are leading the stock market recovery. They help people work from home. This is all good.

The statement about labor force, capital stock, technology, and know-how proved about right, although the number of lives lost is approaching 600,000, rather than 60,000. Our technology sector has shined. People are still working from home. If “Zoom” wasn’t the word of the year, it should have been.

However, the factories will not be able to operate the way they did before – public health measures will cost billions of dollars and this will ultimately be reflected in lower output, and higher prices for the goods produced. The medical sector has seen a sea change. A sector that had pushed back on tele-medicine is now embracing it. Moreover, we will have to have planning for the next great pandemic. “Reserve” hospital wings, inventoried n95 masks and ventilators will use up productive capacity without providing much in the way of consumer goods. Think of this as we do the stockpiling of missiles, aircraft, and armaments. Important to have, but costly and hardly leading to increased consumption.

Our current output is lower, and our prices are higher. There are shortages in computer chips, in building materials, and in lots of other items, and these shortages are leading to higher prices. A fascinating news article observed that in popular warm places such as Hawaii, Arizona, Florida, and Puerto Rico vacationers were renting U-Hauls rather than rental cars, because the rental car prices were up by factors of five to ten.

We seem too busy fighting this pandemic to plan for the next one. “Reserves” seem either unnecessary or too expensive. It took one hundred years after 1918 for the “next” pandemic. From a planning standpoint, we might hope that the next one doesn’t occur for another hundred years. If one occurs in 2025, it is unlikely that we will be prepared.

Aggregate demand has been decimated and it will not come back quickly. Almost any sector of the economy related to entertainment will look totally different. People will not want to go into crowded restaurants, and those restaurants which were on the financial edge when 100% full will not make it if
25% or 50% full. Forget crowded lecture halls, concerts and sporting events ... until people can feel safe going there. Cruises, hotels, conventions, European vacations? There are no easy bounce-backs here.

Aggregate demand has soared in the housing sector, with accompanying price increases. The stock market has reached new highs. The leisure/entertainment sector (a year later) is still devastated. People are traveling more than in 2020, but they are not traveling like they did in 2019, and they are not going to downtowns and to shopping malls. Theaters and stadia, to the extent that they are open at all, are under severe capacity constraints. While everyone is waiting for the familiar crowded venues, YB remains pessimistic. Schedule a football game at the Big House in Ann Arbor, open it to capacity, and prepare for thousands of cases of COVID-19. Then what? Sports, concerts, theater, movies will look better than 2020, but they will not look like 2019.

The result, to your blogger, will be a hockey stick with a very long handle. Your blogger is not a forecaster, but the economy will almost certainly be smaller well into the end of 2020, and probably well into 2021.

This morning’s New York Times showed that as of the first quarter of 2021, the Gross Domestic Product was still 0.9 percent less than the fourth quarter of 2019 (https://www.nytimes.com/2021/04/29/business/economy/united-states-gdp.html ). According to the Federal Bureau of Economic Analysis (BEA) “real GDP decreased 3.5 percent in 2020 (from the 2019 annual level to the 2020 annual level), compared with an increase of 2.2 percent in 2019.” (https://www.bea.gov/news/2021/gross-domestic-product-4th-quarter-and-year-2020-advance-estimate ) Roughly speaking, the GDP was at least 5.7 percent lower than would have been expected with the previous (fairly low) growth level.

The result, as surmised last year, has been a hockey stick with a long handle that is now bending slightly upward. The first quarter growth of 1.6% annualizes roughly at an annual growth rate of about 6.4 percent for the calendar year 2021. This is good news for the economy, although it could be well into 2022 or later that we reach the levels that might have been expected pre-COVID-19. Making up for the lost output of 2020 could take longer still.

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