

April 30, 2020

The Shape of the Economy

On yesterday evening's social distancing walk, your blogger's partner asked what he thought was going to happen with the economy for the rest of the year. While he is basically a micro-economist, he studied macro-economics at Yale (the star student was a woman from Brooklyn named Janet Yellen), and learned a few things. Most of them have to do with aggregate supply and aggregate demand.

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.

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.

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.

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.

Allen C. Goodman
Professor of Economics