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U.S. Economy Booming

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CENTRAL TO
AMERICA'S ECONOMY®

Any opinions expressed here are my own and do not necessarily reflect those of the Federal Open Market Committee.

Introduction

Key themes

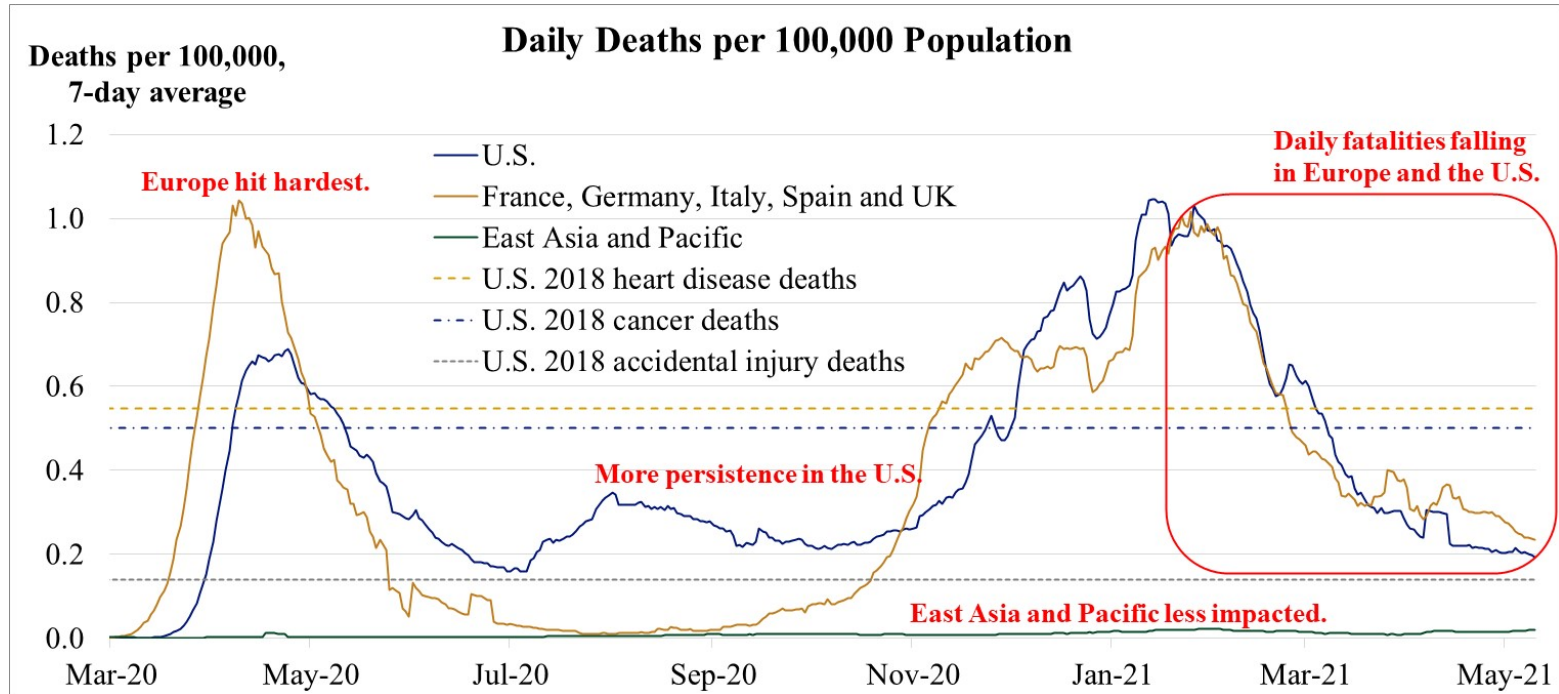
- Pandemic intensity continues to moderate in the U.S. and Europe, suggesting the health crisis will continue to wane in the months ahead.
- In the current quarter, the U.S. economy is poised to surpass the previous peak in real gross domestic product (GDP) reached in the fourth quarter of 2019. The “keep households whole” fiscal strategy has been successful well beyond initial hopes.
- The number of unemployed workers per job opening is approaching an all-time low, suggesting an exceptionally strong labor market.
- Inflation is likely to be meaningfully above 2% over the forecast horizon.
- Downside risk remains but is becoming less pronounced.

Health Crisis Waning in the U.S. and Europe

Fatality rates and economic activity

- Daily fatalities per 100,000 population have continued to decline in both Europe and the U.S.
- East Asia and Pacific countries continue to report daily fatalities per 100,000 population that are an order of magnitude lower than those of the U.S. and Europe.
- Some emerging market countries remain vulnerable to the pandemic and will take longer to vaccinate.
- Overall, regions where much of global output is produced appear poised to bring the pandemic under control.

Pandemic intensity falling in the U.S. and Europe

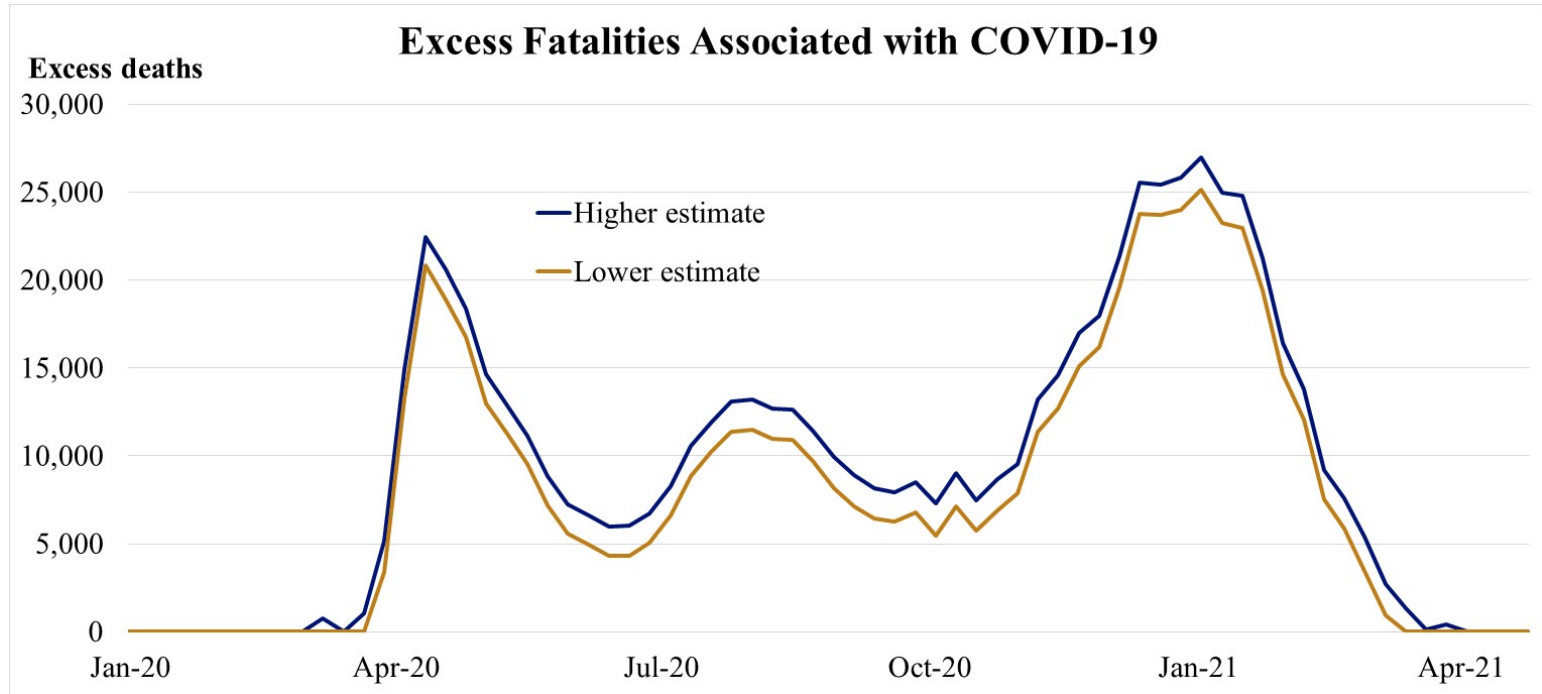


Sources: Center for Systems Science and Engineering at Johns Hopkins University, Centers for Disease Control and Prevention and author's calculations. Last observation: May 10, 2021. For this chart, the East Asia and Pacific region consists of Australia, China, Indonesia, Japan, Malaysia, Myanmar, New Zealand, Philippines, Singapore, South Korea, Taiwan and Thailand.

Excess fatalities falling in the U.S.

- Because of measurement issues, another metric of pandemic intensity is deaths in excess of those that would be expected to occur in a normal year.
- For the U.S., excess fatalities are approaching zero, suggesting that the vaccination strategy is bringing the pandemic under control.

Excess fatalities in the U.S. are back to zero



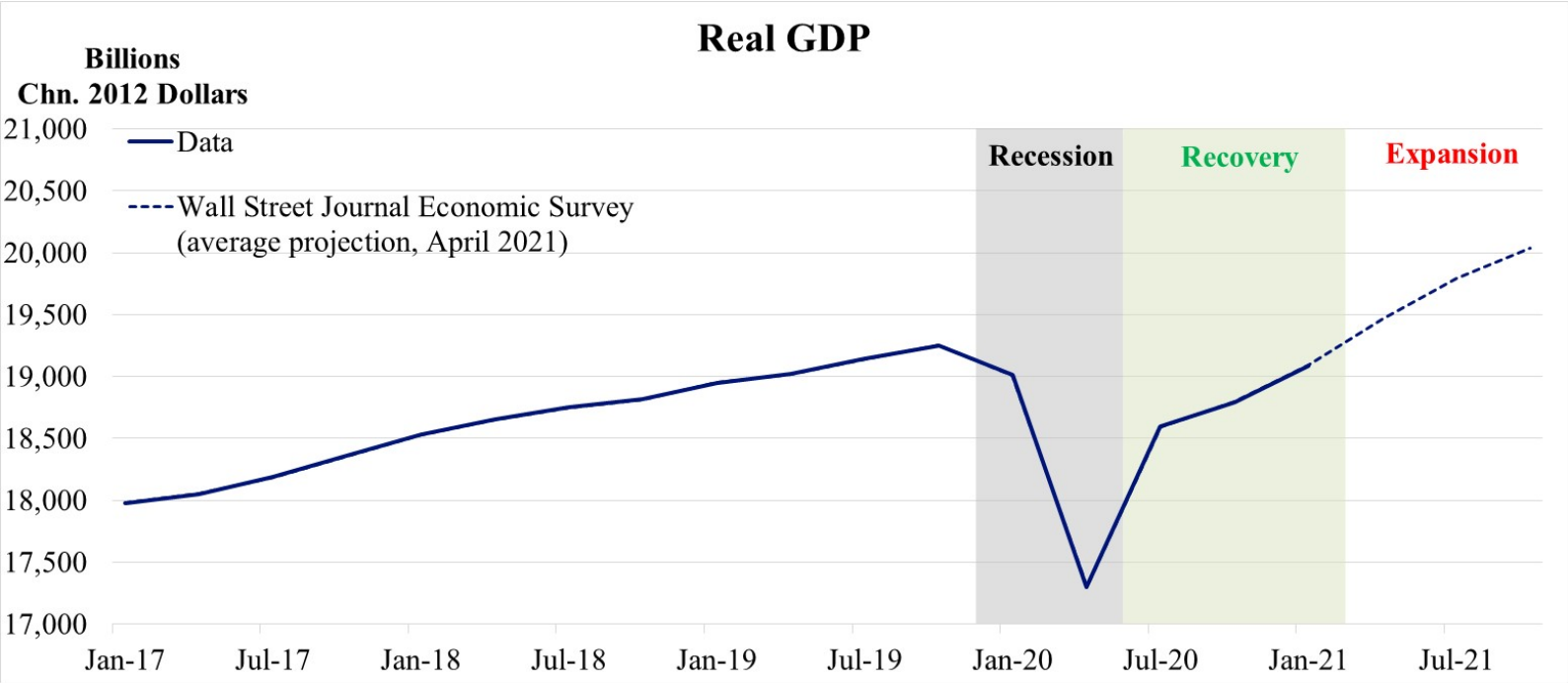
Source: Centers for Disease Control and Prevention. Last observation: Week of April 24, 2021.

U.S. Moving to Expansion Phase of the Business Cycle

U.S. moving into economic expansion

- Business cycles have a clear traditional definition. Periods of declining output are called “recessions.”
- Periods of increasing output following a recession are called “recoveries” until the previous peak is attained.
- Periods beyond the previous peak are called “expansions.”
- During the current quarter, the U.S. is moving into the expansion phase of the business cycle.
- National income is as high as it ever was and is poised to grow at an above-trend rate, due in part to the “keep households whole” fiscal strategy.

Moving into the expansion phase



Sources: Bureau of Economic Analysis, Wall Street Journal and author's calculations. The gray shaded area indicates U.S. recession, assuming the 2020 recession ended in Q2. Last observation: 2021-Q1.

The size of the fiscal policy response

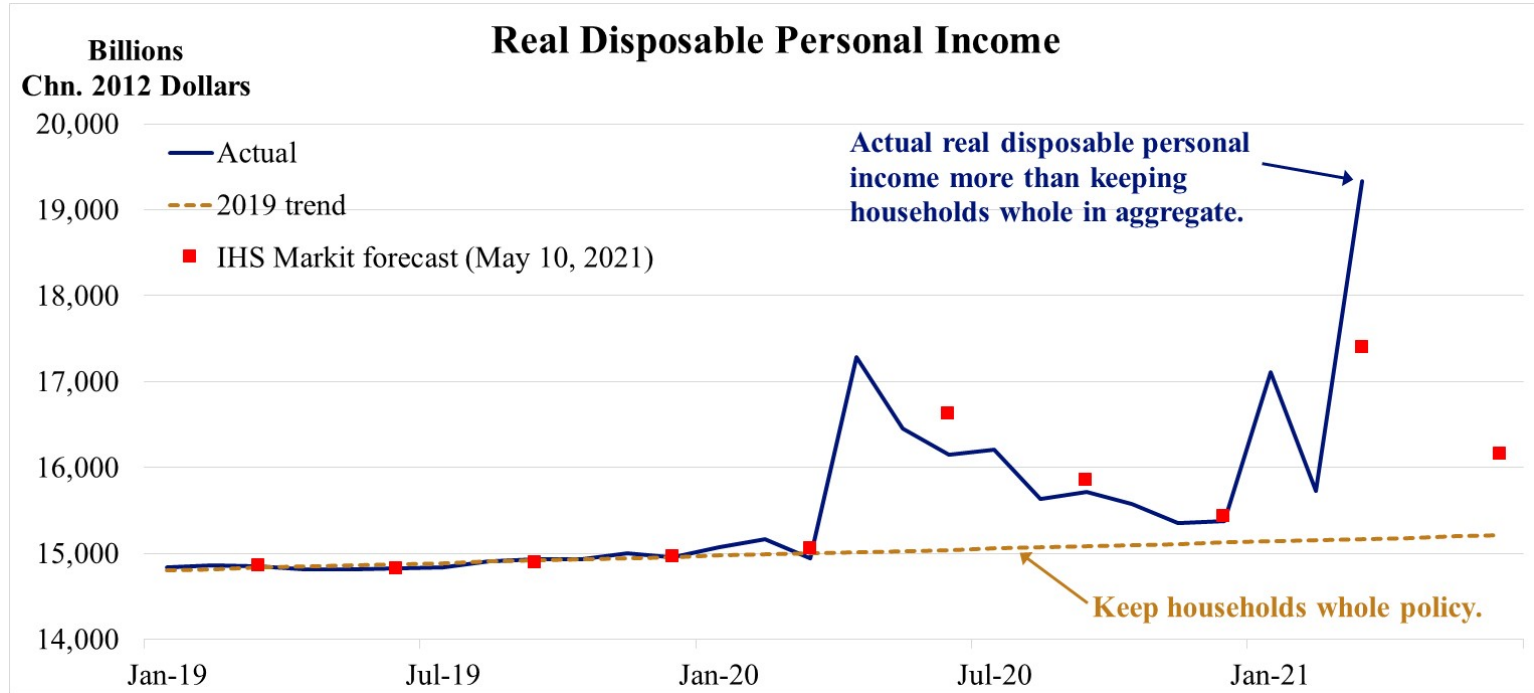
- In the first 11 months of 2020, U.S. fiscal policy included the CARES Act along with additional legislation. In total, this fiscal policy response was valued at about \$3.148 trillion.*
- The Consolidated Appropriations Act of 2021 signed into law on Dec. 27, 2020, includes an additional \$900 billion in pandemic relief.
- The American Rescue Plan Act of 2021 signed into law on March 11, 2021, adds \$1.9 trillion to the fiscal policy response to the pandemic.

** See the International Monetary Fund's [Policy Responses to COVID-19](#) and the Committee for a Responsible Federal Budget's [estimates of the cost of President Trump's executive orders](#).*

The “keep households whole” fiscal policy

- The nature of the response to the pandemic shock has been to ask some workers in “high physical contact” jobs to stay home to invest in national health.
- The goal of fiscal policy has been to insure these disrupted households by borrowing funds on international markets and using the funds to replace disrupted household incomes.
- I have called this the “keep households whole” policy.
- This policy has been so successful that personal income in 2020 was actually higher than it would have been if the economy had simply remained on the 2019 trend line.

Personal income above 2019 trend



Sources: Bureau of Economic Analysis, IHS Markit and author's calculations. Last observation: March 2021.

The private sector's saving response

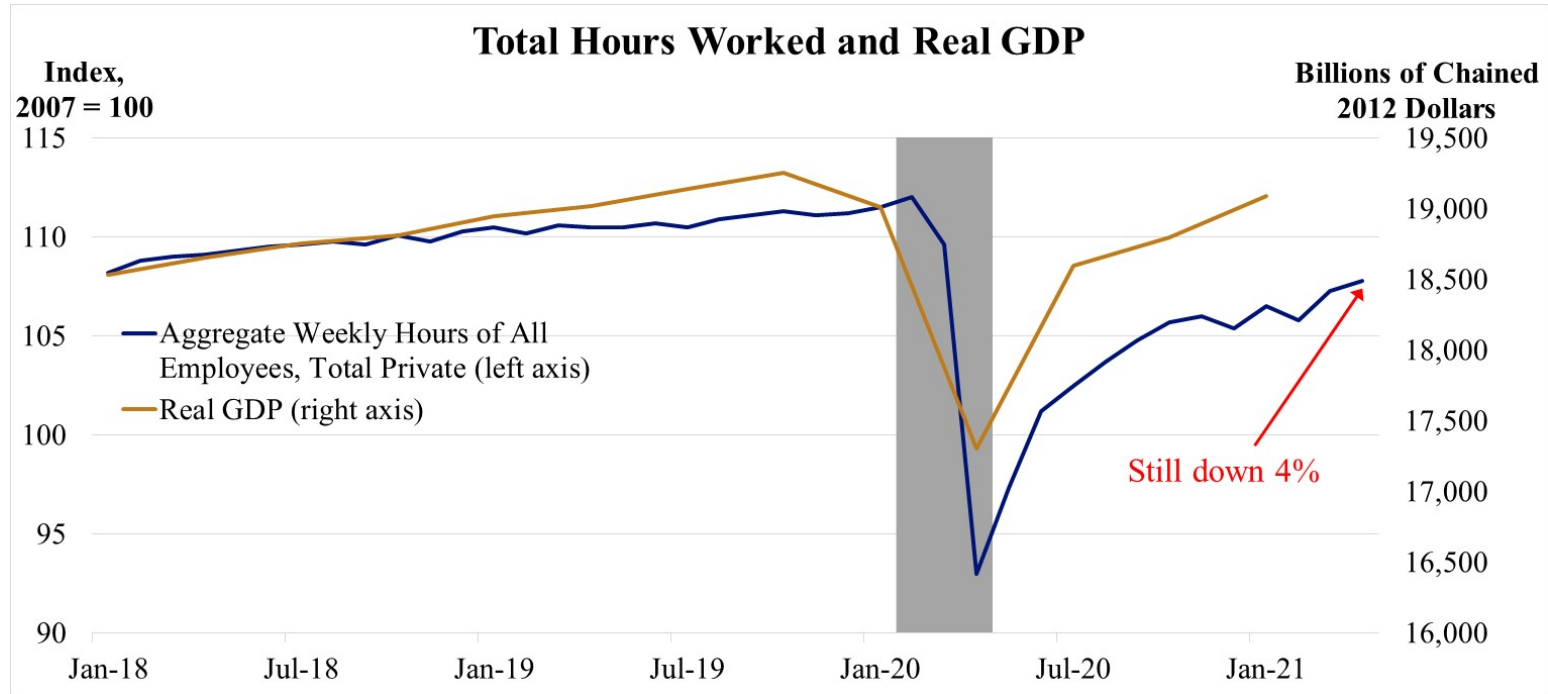
- The households receiving federal transfers often saved much of it.
- This was a rational and prudent response, as households were naturally unsure how long the health crisis would last and whether Congress would appropriate more funds.
- The arrival of vaccines has meant that the probability of the health crisis ending in coming months is rising dramatically.
- This suggests households will be less inclined to save going forward and more inclined instead to spend any federal transfers, leading many forecasters to predict very rapid U.S. real GDP growth in 2021.

U.S. Labor Market

Labor markets and output

- While real GDP is poised to return to and surpass the previous peak level, the labor input remains below the previous peak by many measures.
- The total hours worked index, for instance, remains at about 96% of the pre-pandemic level.
- How can output be recovered with the labor input still down 4%?
- The likely answer is composition effects: The most disrupted workers have been in “high physical contact” jobs, which also tend to be lower wage jobs.
- The “keep households whole” policy insures many of these workers.

Hours have not yet fully recovered

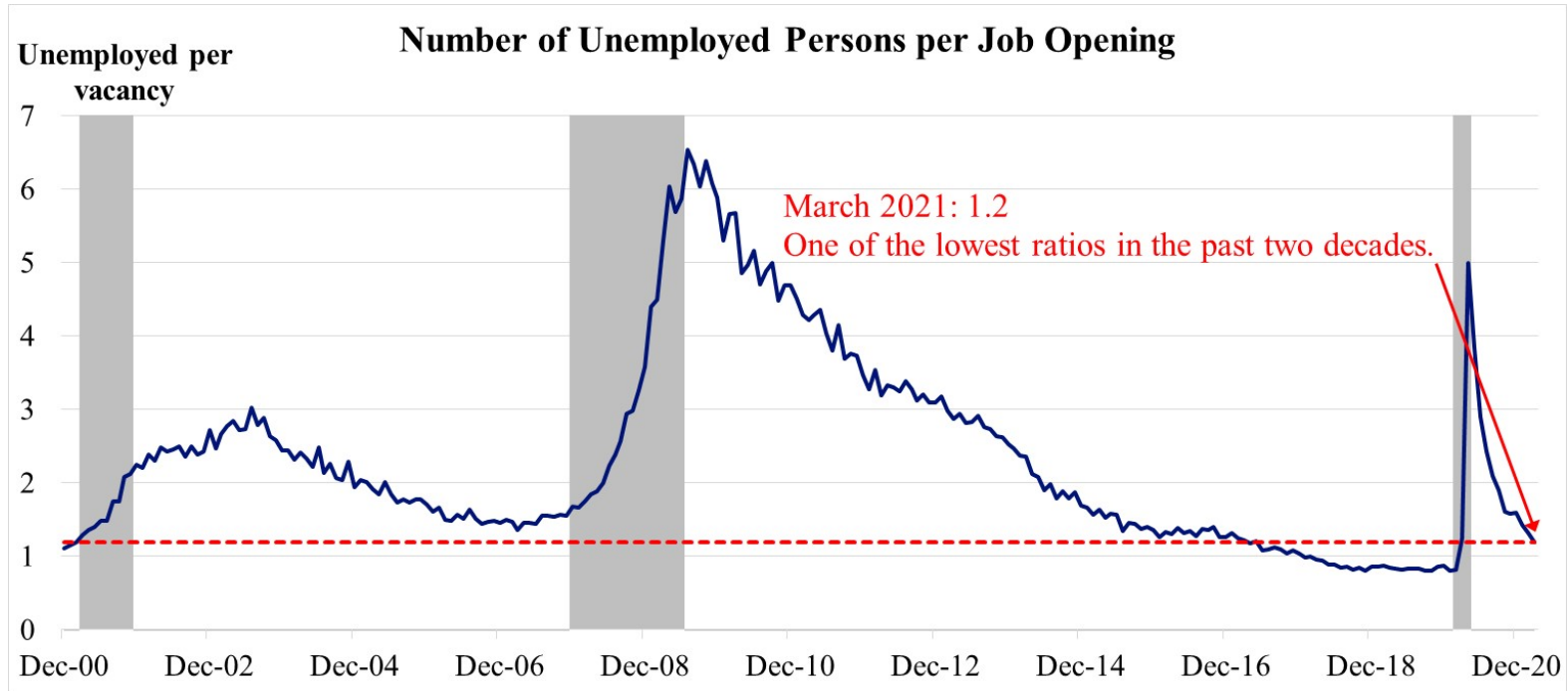


Source: Bureau of Economic Analysis and Bureau of Labor Statistics. The shaded area indicates U.S. recession, assuming the 2020 recession ended in April last year. Last observations: 2021-Q1 and April 2021.

Labor markets tighter than you might think

- Anecdotal reports from businesses strongly suggest that attracting workers to available jobs is difficult in the current environment.
- Alternative measures of labor market performance may give a more accurate reading of the state of the labor market than the number of jobs on payrolls or the number of hours worked.
- One alternative measure is the ratio of officially unemployed workers to job openings.
- This measure is approaching an all-time low, suggesting a very strong labor market.

A tightening labor market

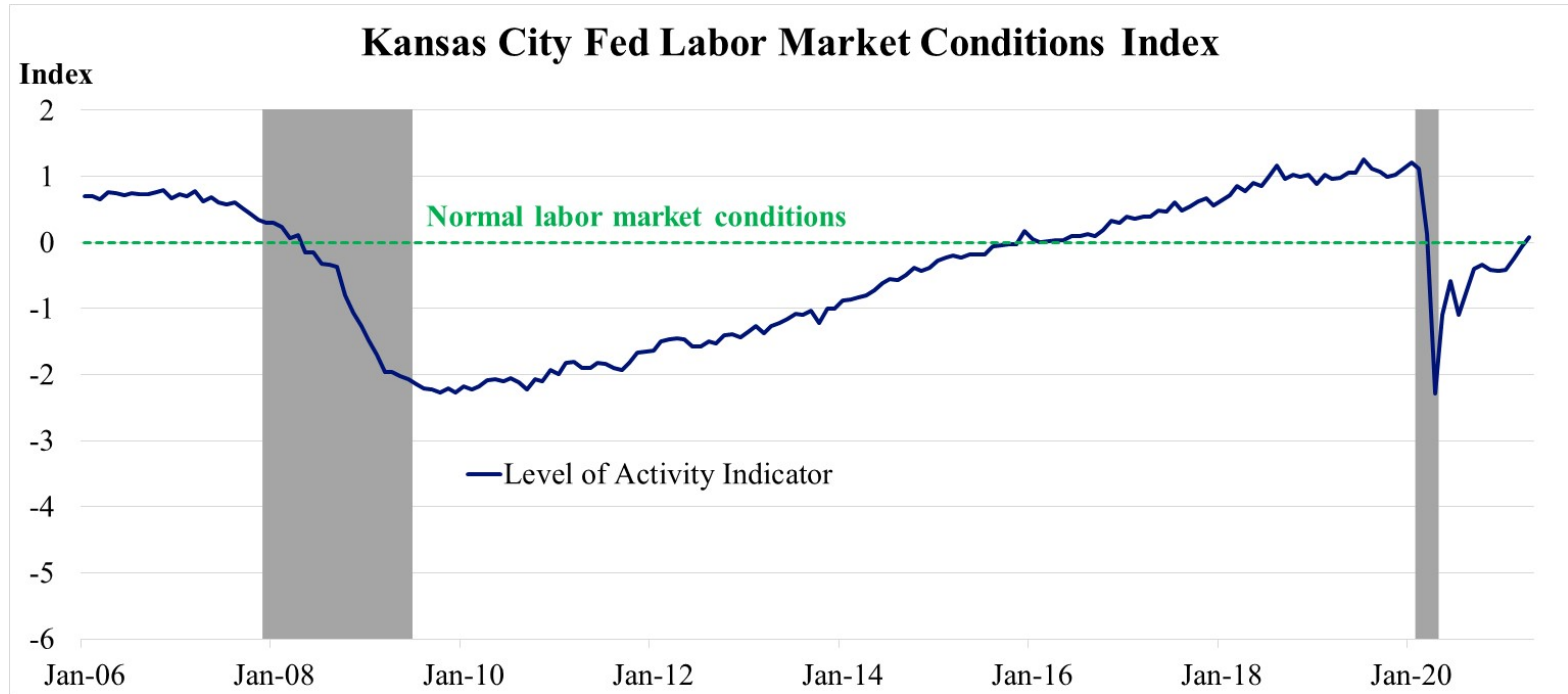


Sources: Bureau of Labor Statistics and author's calculations. Shaded areas indicate U.S. recessions, assuming the 2020 recession ended in April last year. Last observation: March 2021.

Broader measures of labor market performance

- There are many additional measures of labor market performance other than the official unemployment rate or unemployed workers per job opening.
- These measures can be organized into an indicator of labor market performance that takes multiple aspects into account.
- The Kansas City Fed's level of activity index provides one attempt to organize these data.
- This indicator suggests today's labor market conditions are markedly better than those following the 2007-09 recession.

Better labor market conditions than after the previous recession



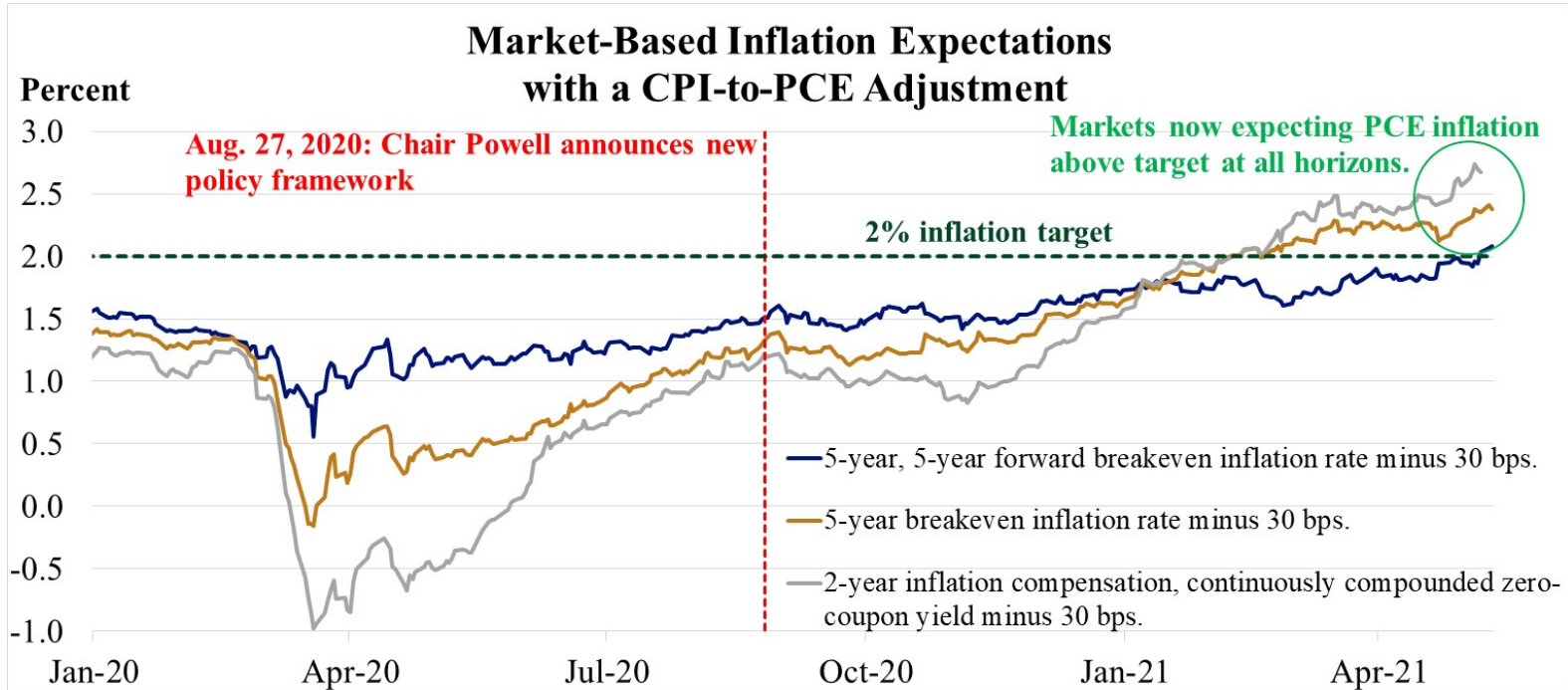
Source: Federal Reserve Bank of Kansas City. Shaded areas indicate U.S. recessions, assuming the 2020 recession ended in April last year. Last observation: April 2021.

Inflation Expectations Rising

Inflation expectations moving higher

- Market-based inflation expectations have recovered from lows reached during March 2020.
- The FOMC's new policy framework, announced in Chair Powell's Jackson Hole speech in August 2020, has likely encouraged some of this movement.
- TIPS-based breakeven inflation, based on CPI inflation measures, could move higher and still be consistent with a PCE inflation outcome modestly above the 2% target.
- This would be a welcome development for the FOMC, as inflation has generally been below target for many years.

Inflation expectations improving



Sources: Federal Reserve Board and author's calculations. Last observations: May 7, 2021, and May 11, 2021.

Conclusion

A booming U.S. economy

- Pandemic intensity continues to moderate in the U.S. and Europe, suggesting the health crisis will continue to wane in the months ahead.
- In the current quarter, the U.S. economy is poised to surpass the previous peak in real GDP. The “keep households whole” fiscal strategy has been successful well beyond initial hopes.
- The number of unemployed workers per job opening is approaching an all-time low, suggesting an exceptionally strong labor market.
- Inflation is likely to be meaningfully above 2% over the forecast horizon.
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