Economic Snapshot: Analyzing the Impact of Stimulus Checks and Other Aid, Part 1

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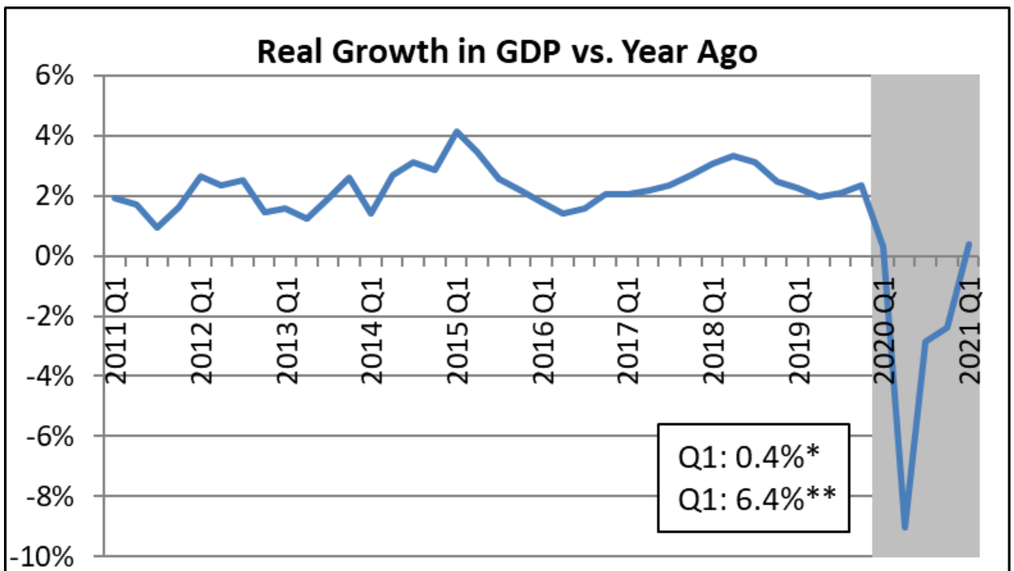
As an economist I admit I relish in-depth, econometric reports with formulas, detailed tables, and graphs. But I do have a strong reality streak and know that most people would rather forget their economics classes. For this reason, and because I think sound information is foundational to good decision making, I set out to quickly develop an economic dashboard when I first came to Colorado to serve as a local economist. I wanted to help disseminate data that our community could easily understand and tangibly use. I firmly believe that from an economic development standpoint, what gets measured gets done.

I found our community wonderfully receptive and now have sixty UCCS Economic Forum partners who receive the monthly, two-page dashboard. I like to periodically share this with the broader community and now seems like a good time given the disruption of the past year. Below you have part one of the highlights with the second half publishing next Sunday.

<u>GDP for 2021 Q1</u> was recently released, and the economy grew 0.4% in Q1 of this year when comparing to Q1 of last year. If we stay at the current pace of increase and annualize the growth in Q1, the economy will grow 6.4% in all of 2021. This is a bit lower than the consensus estimates amongst economists, which was a projected, annualized growth rate of 6.7%.



Source: U.S. Bureau of Economic Analysis. *Change from Q1 last year. **Annualized change

There is a lot to unpackage here. Let's start with the nuts and bolts. With stimulus checks, augmented unemployment benefits, and easing of social distancing requirements, personal consumption expenditures (PCE) increased significantly. Specifically, PCE increases were most notable in durable goods (led by cars and auto parts), nondurable goods (led by food, adult, and lame beverages), and services (led by food services and accommodations). There was also an increase in nonresidential fixed investment, which was mostly for IT-related equipment (+16.7% over the quarter) and intellectual property products (software, +10.1%). This boon in computer-related spending makes me wonder if individuals and companies are buying for partial, but indefinite work from home or for upgrades to return to the office or both. Recent tech earnings confirm that many stimulus checks are being used to upgrade phones and other techie purchases. Residential investment also continues to buoy GDP growth. There was an increase in government spending mostly comprised of the payments the government made to banks to process PPP loans and to purchase COVID-19 vaccines. There was a decrease in inventories mostly due to a decline in retail trade inventories.

Let's first dissect personal consumption, which increased because personal income increased. Most of that is due to the increase in social benefits (e.g., stimulus checks and augmented unemployment benefits). In fact, personal income increased $2.4 trillion, or a whopping 59.0%, from Q4 of last year to Q1 of this year. The personal savings rate is now way up again to 27.6%. This is all very positive especially for the households that have been disproportionately hit by the pandemic. Not surprisingly, a large national survey recently found that 70% of U.S. residents plan to spend more in the next 12 months (28% plan to spend more on restaurants).[i]

Now, I hate to be the sober voice at the bar, but what happens to growth once all the government-driven increase in income and expenditures goes away? As I've mentioned in the last couple of articles I've written, this is much of the reason I think we have to be so very strategic in the way the stimulus dollars are spent. I am indeed concerned about seemingly endless stimulus bills and the long-term impact on national debt, but something along the lines of the American Jobs Plan (AJP) does attempt to give more than a short-term boost. The AJP would take eight years to fully implement and the plan targets some of the structural barriers we have had to long-term economic growth. These include investments in transportation infrastructure including electric vehicles ($621B); reducing nursing home care through expanded access to home/community-based care for older and disabled populations ($400B); manufacturing and small business development including building a national medical equipment stockpile ($300B); research and development for the 21st century across disciplines ($213B); building, preserving, and retrofitting federally-owned structures ($208B); education and child care ($137B); water infrastructure ($111B); high-speed broadband ($100B); upgrading our power infrastructure ($100B); and workforce development ($100B). This comes to $2.25 trillion in public investment. In a nutshell, go big or go home. The downside would be for the top earners (roughly the top 1%) since the payment plan includes hefty increases in the corporate income tax rate alongside other tax changes. In theory, these tax changes would raise about $2 trillion over the next 15 years. If the tax changes stuck, this means that the added tax revenue would pay for the American Jobs Plan in about 10 years and would switchover after that to a tax revenue gain as opposed to being deficit-increasing. This is all theoretical, of course, and the likelihood is close to zero that the AJP passes in full (the Democrats hope to pass it in July) or that the tax increases pass in full. There is another plan out there now too: the American Families Plan including $1 trillion in investments and $800 billion in tax credits for lower-income groups over a decade also funded by taxing the highest-income Americans. This plan is targeted more to family assistance and I think it also is unlikely to pass in full, but the web version of this article on the Forum website has specifics. [ii]

Another important detail in the newly released GDP data is the PCE price index, which increased 3.5% over the past quarter. The PCE price index is an alternative measure for inflation. This is a big jump in just one quarter and similarly, the **Consumer Price Index** has increased 2.6% from March 2020 to March 2021 (up from 1.7% in the February 2020 to February 2021 measure). I've been talking for a while about why I think inflation is going to be a bigger issue in coming months and that is another whole article. I will say that another confounding issue on top of short or medium-term inflation is the increasingly high probability that unemployment will fall faster than expected. Although this would be a good thing, remember that the Federal Reserve has two mandates that dictate interest rate policy: inflation and unemployment. I discuss this further below in part two of this article in the unemployment discussion.

Net exports were down more than usual and that significantly moderated GDP growth. The U.S. traditionally imports more than they export, but the high infection rates around the world alongside the supply bottlenecks dragged our exports down further. Simultaneously, the improving infection rates across most of the U.S. alongside rapid ramp up of vaccination kept Americans buying foreign goods (or American goods with foreign parts – which is just about everything). Given how slowly the rest of the world appears to be vaccinating, it's likely that net exports will continue to be a drag on GDP growth. Similarly, the supply-chain and labor constraints within the U.S. will not only impact prices, they will also impact our ability to increase our own production of manufactured goods, which will also be a drag on GDP growth albeit not indefinitely.

I would like to highlight how this bounce back in GDP is so very different than other recessions. In previous recessions, there has almost always been a structural issue that has caused the economy to contract for at least two consecutive quarters ("recession"). The most recent example is the Great Recession, which exposed loose lending standards alongside a surge in homebuying. It took 34 quarters, or 8 ½ years, for real GDP to reach "potential GDP," as economists call it. It took 30 quarters, or 7½ years, for the unemployment rate to drop below the natural unemployment rate (~4.0%). To be fair, the Great Recession was particularly severe, but looking at the two previous downturns shows a range of 3 to 5½ years, for GDP to reach potential GDP and a range of 3½ to 5¼ years, for unemployment to dip below the 4.0% threshold.

And now is so very different. Experts are saying that real GDP will reach potential GDP post-COVID in 4 quarters, or ONE YEAR, and unemployment to return to the roughly 4.0% "natural" range in 9 quarters, or 2¼ years.

If this is indeed true, do we need additional stimulus? That's a policy decision and I prefer spreadsheets, but what I see is an administration that is on the heels of the greatest economic and health disruption of our lifetimes, and it is capitalizing on that to do some restructuring.

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[i] https://www.nytimes.com/2021/04/02/business/economy/jobs-report-march.html

[ii] The American Families Plan unveiled on April 28th, 2021 includes: $225 billion toward high-quality child care and ensuring families pay only a portion of their income toward child-care services, based on a sliding scale; $225 billion to create a national comprehensive paid family and medical leave program; $200 billion for free universal preschool for all 3- and 4-year-olds; $109 billion toward ensuring two years of free community college for all students; $85 billion toward Pell Grants, and increasing the maximum award by about $1,400 for low-income students; $62 billion grant program to increase college retention and completion rates; $39 billion program that gives two years of subsidized tuition for students from families earning less than $125,000 enrolled in a four-year historically Black college or university, tribal college or university, or minority-serving institution; $45 billion toward meeting child nutritional needs, including by expanding access to the summer EBT program, which helps some low-income families with children buy food outside the school year; $200 billion to make permanent the $1.9 trillion Covid stimulus plan's provision lowering health insurance premiums for those who buy coverage on their own; extending through 2025, and making permanently fully refundable, the child tax credit expansion that was included in the COVID relief bill; making permanent the recent expansion of the child and dependent care tax credit; making permanent the earned income tax credit for childless workers.