

Unsustainable

The US economy is recovering rapidly from the COVID-19 disaster. The rollout of vaccines, the lifting of restrictions, loose monetary policy, and a massive increase in government spending are all playing their parts.

The problem is that the massive government “stimulus” checks have put the economy in a strange position, where retail sales are far above where they would be if COVID had never happened, even as the production side of the economy remains relatively weak.

Friday’s report on the retail sector showed that retail sales were unchanged in April, remaining at essentially the same lofty level they were in March. However, the lack of an increase in April shouldn’t have been much of a surprise. Even with no increase in April, retail sales were 17.9% higher than they were in February 2020, pre-COVID. To put this in perspective, that’s the fastest gain for any 14-month period since 1978-79. A key difference? That period in 1978-79 had double-digit inflation, versus the 3.1% increase in consumer prices since February 2020.

Another way to think about how high retail sales have been lately is that if COVID had never happened and sales since February 2020 had increased at a more normal 4.5% per year pace, it would have taken until November 2023 for retail sales to reach where they were in March and April this year. In other words, sales have arrived at the recent level about two and half years ahead of schedule.

This means that growth in retail sales will face a headwind over the next few years as the extraordinary recent bouts of “stimulus” peter out, roughly offsetting the benefits of more jobs and higher wages.

Meanwhile, even though retail sales have surged to abnormal highs, the production side of the economy is still operating below pre-COVID levels and even further below where production would be today if COVID had never happened. Manufacturing production is down 2.7% versus February 2020. Part of this is damaged supply chains. The demand for new cars and trucks has rarely been higher.

Retail spending at auto and motor vehicle dealerships was 33.1% higher in April than in February 2020.

And yet motor vehicle production (excluding parts) is down 18.1% versus February 2020, largely due to a shortage of semiconductor chips. But it’s not only autos. Manufacturing excluding autos is down 0.9% versus February 2020.

In spite of the hopes of some policymakers, the economy doesn’t work like a light switch. It’s not just sitting there waiting for some public officials to turn it on, returning it to pre-COVID normal operation. Many businesses have disappeared, never to return, and many of them had a huge store of operational and knowledge capital built into them, know-how about the best way to get certain things done, that capital having been developed over decades.

The divergence between consumer spending and actual production is a manifestation of inflationary economic policies, which also showed up in last week’s reports. Consumer prices are up 4.2% from a year ago while producer prices are up 6.2%. That’s what you get when people are spending more dollars provided by short-term oriented government policies, not the return for the production of actual goods and services.

But, ultimately, there is no free lunch. All extra government spending today must be paid for by reduced spending by others, today or in the future. Yes, in theory, there are some “good” infrastructure projects out there that could help the overall economy. But the monies for those projects could easily come out of other government spending commitments; they shouldn’t add to the deficit or require higher taxes, which themselves will tend to dampen future economic growth further.

For now, there are plenty of reasons to remain bullish. Opening up is the best stimulus and the economy still has long way to go to get fully open. Look for further gains in production in the year ahead, even as policymakers in Washington adopt some policies that hurt us in the long run.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
5-17 / 7:30 am	Empire State Mfg Survey – May	23.8	20.0		26.3
5-18 / 7:30 am	Housing Starts – Apr	1.703 Mil	1.705 Mil		1.739 Mil
5-20 / 7:30 am	Initial Claims May 15	460K	493K		473K
7:30 am	Philly Fed Survey – May	41.9	47.1		50.2
5-21 / 9:00 am	Existing Home Sales – Apr	6.090 Mil	5.910 Mil		6.010 Mil