The United States was in an historically strong economic position before the SARS-CoV-2 pandemic. Real GDP rose 2.3 percent in 2019 on a Q4/Q4 basis and was poised to maintain a solid pace of growth until the pandemic. In January and February, nonfarm payroll employment rose an average of 232,500 per month, the unemployment rate hovered near the five-decade low of 3.5 percent, and the labor force participation rate reached a six-year high of 63.4 percent.

In March, however, the spread of SARS-CoV-2 resulted in state and local governments implementing various restrictions to mitigate its impact on health resources. These measures contributed to an historically sharp contraction: 22 million jobs were lost in March and April, and the unemployment rate peaked at 14.7 percent – a post-WWII high. Moreover, real GDP decreased 5.0 percent at an annual rate in the first quarter of 2020, sharpening to 31.4 percent in the second quarter. Altogether, the U.S. economy contracted by nearly $2.0 trillion at an annual rate in the first half of the year.

The U.S. government responded quickly to the economic shock with unprecedentedly bold policy to support American households and small businesses during the pandemic. Just two weeks after the first stay-at-home orders were issued, Congress authorized three record-setting economic aid packages totaling roughly $2.7 trillion. The Administration rapidly implemented the various measures, including Economic Impact Payments, expanded eligibility for unemployment insurance benefits, and the Paycheck Protection Program, which provided forgivable loans to small businesses to encourage employee retention. These policies temporarily boosted household savings, reduced unemployment, and allowed small businesses to resume operations when their local economies re-opened.

Due to the government’s robust response and the relaxation of stay-at-home orders, the economy started to recover in May after just two months of contraction. By the end of Q3,
11.4 million jobs had been recovered and the unemployment rate had fallen by 6.8 percentage points to 7.9 percent. In addition, real GDP surged by 33.1 percent at an annual rate in 2020 Q3, or almost double the previous record pace set in 1950. Given this record-setting growth in Q3, the U.S. economy recovered in one quarter roughly 66 percent of the cumulative loss in the first half of 2020.

**GDP GROWTH**

The economy’s rebound in the third quarter was substantial as well as historic: real GDP growth of 33.1 percent at an annual rate was the fastest quarterly pace in seventy years. This followed declines of 5.0 percent and 31.4 percent in the first and second quarters, respectively – declines that were directly related to the effects of the global pandemic as well as the social-distancing measures and mandated business closures implemented in mid-March. Two major components of GDP – private consumption and private fixed investment – grew at double-digit paces, and the change in private inventories also made a strong positive contribution to growth in the third quarter. Two other components – government expenditures and net exports – subtracted from GDP growth in Q3, but in the case of net exports, the silver lining was that surging imports reflected much stronger domestic demand. Private domestic final purchases – the sum of personal consumption, business fixed investment, and residential investment – advanced 38.1 percent in the third quarter, after declining by 32.4 percent in the second quarter.

Real personal consumer expenditures (PCE), which accounts for about two-thirds of overall GDP, grew 40.7 percent at an annual rate in the third quarter. The surge recovered 71 percent of the consumption lost in the first and second quarters combined. Purchases of durable goods – a category that includes motor vehicles, household equipment and furnishings, among other items – spiked 82.2 percent in the third quarter, after slipping 1.7 percent in the second quarter. Purchases of nondurable goods – such as food and beverages purchased for off-premises consumption, gasoline and other energy goods, clothing, footwear, and other goods – increased 28.8 percent in the third quarter, following a 15.0 percent decline in the second quarter. Meanwhile, household expenditures on services – the component of PCE most severely affected by the pandemic and related measures – rebounded by 38.4 percent in the third quarter. Even with the rebound in household expenditures for services, spending in Q3 was down $660 billion at an annual rate from its level at the end of 2019. The loss partly reflected households shifting spending that they could not spend on services toward goods: purchases of durable and nondurable goods were $325 billion (annualized) above
their level at the end of 2019. Overall, real personal consumption expenditures added 25.3 percentage points to the rise in total GDP in Q3.

Business fixed investment (BFI) rose 20.3 percent at an annual rate in the third quarter, in sharp contrast with the 27.2 percent drop in the second quarter. Driving the overall gain in third quarter BFI, equipment investment soared by 70.1 percent (particularly reflecting spending on transportation equipment), as it recovered handsomely from a 35.9 percent plunge in the second quarter. In contrast, investment in structures fell for the fourth consecutive quarter. In the most recent two quarters, this has partly reflected lower oil prices and a pull-back in petroleum exploration and development of wells; according to private sources, the average rig count declined 36 percent in Q3. But the pandemic, through the continued use of telework, and other factors, such as the shift from brick-and-mortar retail stores to online retail, have also played a role in dampening appetite for new structures, especially for commercial investment.

After contributing to growth in every quarter from early 2015 to early 2020, expenditures on intellectual property products (IPP) were down for the second consecutive quarter. Even so, the third quarter’s 1.0 percent decline was modest after the 11.4 percent decrease in the second quarter. Looking at the components, investment in software recovered in the third quarter, growing 2.6 percent after a 5.9 percent decline in the previous quarter. But research and development spending and investment in entertainment, literary, and artistic originals each declined for the third consecutive quarter, though more modestly in the third quarter than in the second. Despite the rescission of stay-at-home orders in most locales, many movie theaters and other entertainment venues remained closed in Q3; thus, the declines in that category partly reflect lower corporate expenditures on artistic IPP. Overall, total business fixed investment added 2.9 percentage points to real GDP growth in the third quarter, after subtracting 3.7 percentage points from growth in the second quarter.

The change in private inventories, a volatile component, added 6.6 percentage points to economic growth in the third quarter of 2020, after the partial economic shutdown forced firms to draw down inventories in the second quarter.

Apart from a sharp and temporary decline in the second quarter, residential investment has grown in four of the past five quarters, including a 59.3 percent rebound in the third quarter, its largest advance since 1983. Residential investment added 2.1 percentage points to growth in the third quarter, after the sharp and temporary decline in this component posed a drag on growth in the second quarter of 1.6 percentage points. Despite the sharp decline in the
second quarter, the housing sector has been recovering since May and continues to perform very well, supported in part by record-low mortgage rates and new record-highs in builder confidence. Housing starts and permits have grown strongly since May. As of September, single-family housing starts were more than 7 percent above their February level, and single-family building permits – a leading indicator for starts – were 12 percent above pre-pandemic levels. Buoyed by record-low mortgage rates, demand for homes has far exceeded supply. Existing home sales, which account for 90 percent of all home sales, rose to their highest level in fourteen years and were up nearly 21 percent over the past year. New single-family home sales reached a thirteen-year high in August before pulling back slightly in September; nonetheless, sales were still nearly 34 percent above pre-pandemic levels. In October, the National Association of Home Builder’s home builder confidence index rose to a fresh record high, conveying a strongly positive view about housing market conditions. Average rates for 30-year mortgages have recently set new record lows and are now more than 2 percentage points below levels in mid-November 2018. Low rates have helped boost affordability despite recent, rapid gains in home prices, the latter reflecting a growing imbalance between supply and demand.

Government spending declined 4.5 percent at an annual rate in the third quarter, as Federal spending was down 6.2 percent at an annual rate, and state and local government expenditures fell 3.3 percent. Nonetheless, the decline in Federal spending followed a 16.4 percent jump in the second quarter, which reflected the implementation of the Coronavirus Aid, Relief, and Economic Security (CARES) Act after its passage at the end of last March. Meanwhile, state and local governments reduced their spending by 3.3 percent in the third quarter, following a 5.4 percent reduction in the second quarter. Even so, total government spending pared only 0.7 percentage point from real GDP growth in the third quarter, after contributing 0.8 percentage point in the second quarter.

The net export deficit increased $235.7 billion at an annual rate during the third quarter to $1.01 trillion, as a surge in imports more than offset a very strong increase in exports. Total exports of goods and services grew by 59.7 percent, while imports advanced 91.1 percent. The widening of the trade deficit subtracted 3.1 percentage points from third quarter GDP growth; in the second quarter, net exports contributed 0.6 percentage point to economic growth.

LABOR MARKETS AND WAGES
Due to the pandemic, the economy lost almost 22.2 million jobs in March and April. However, payroll job growth resumed in May, and labor markets reclaimed 11.4 million jobs between May and September, or 52 percent of the total lost. This is a sharper labor recovery than previously seen. For example, the economy did not start materially adding payroll jobs until nine months after the Great Recession ended, and it took another 2½ years from that point to recover 52 percent of the jobs lost.

Likewise, the unemployment rate rose from a 50-year low of 3.5 percent to a post-World War II high of 14.7 percent in April. Yet by September, the unemployment rate had fallen by 6.8 percentage points to 7.9 percent, the sharpest five-month decrease on record. After the unemployment rate peaked at 10 percent in October 2009, well after the Great Recession ended, it took over four years to bring about the same proportionate reduction. Moreover, most of those currently unemployed continue to identify themselves as “temporarily laid off,” contrasting sharply with the persistently high levels of long-term unemployment during and after the Great Recession.

The headline labor force participation rate (LFPR) – as well as prime-age (ages 25-54) LFPR – are have risen sharply from lows in April. Progress has slowed recently, however, despite steady improvements in other labor market indicators. As of September, the headline LFPR stood at 61.4 percent, or 2 percentage points below the six-year high seen in February, and the prime-age LFPR was 80.9 percent, roughly 2 percentage points below January’s eleven-year high. The employment report for October 2020 will be released this Friday, November 6.

Nominal average hourly earnings for production and nonsupervisory workers rose 4.6 percent over the year ending in September 2020, faster than the 3.7 percent pace over the 12 months through September 2019. September marked the 26th month that this measure of wage growth has remained above 3 percent, a consistency not seen since the mid-2000s. Outsized gains over the past seven months reflected higher job losses among lower wage workers, but even with rehiring of many of these workers, wage gains remain elevated, and more subdued inflation has boosted gains in real terms. Real average hourly earnings rose 3.0 percent over the year through September 2020, accelerating from the year-earlier pace of 2.2 percent. Wages and salaries for private industry workers, as measured by the Employment Cost Index, advanced 2.7 percent over the four quarters ending in September 2020, slowing from the 3.0 percent gain over the four quarters through September 2019.

PRICES

The deflationary pressures that emerged in March at the headline as well as core levels dissipated quickly. In recent months, inflation readings have been consistently positive. Even though 12-month inflation rates remain below year-ago levels, the gaps are narrowing. The Consumer Price Index (CPI) for all items advanced 0.2 percent in September, reflecting more stable movements in energy prices and a taper in food price inflation during the month. Over the 12 months through September, CPI inflation rose by 1.4 percent, or 0.3 percentage point below the year-earlier pace. Energy prices have stabilized in recent weeks, but over the year through September, were still 7.7 percent lower, extending the 4.8 percent decline over the year through September 2019. After accelerating sharply earlier this year, monthly food price inflation has tapered considerably in recent months. Even so, the CPI for food was up 3.9 percent over the year through September, reflecting increased demand for food at home due to the pandemic. The year-over-year pace in September was more than double the 1.8 percent pace over the 12 months through September 2019. Meanwhile, core CPI inflation was 0.2 percent in September. Over the past 12 months, core inflation was 1.7 percent, quite a bit slower than the 2.4 percent pace over the year through September 2019.

The headline Personal Consumption Expenditures (PCE) Price Index (the preferred measure for the FOMC’s 2 percent inflation target) also shows a restrained pace of inflation. The 12-month headline PCE inflation rate was 1.4 percent through September 2020, matching its year-earlier rate. Core PCE inflation was 1.5 percent over the year through September 2020, slowing modestly from the 1.7 percent, year-earlier rate. Inflation as measured by the PCE price index has held below the FOMC’s target since November 2018, and these consistently low PCE inflation readings recently prompted the FOMC to adopt a more explicit inflation target strategy in which the 2 percent target would be an average over time.

CONCLUSION

The U.S. government responded quickly with unprecedentedly bold fiscal and monetary actions to support American households and small businesses during the pandemic. This degree of coordination has been significantly greater in scale, and faster in implementation, than what was deployed following the 2008 financial crisis. In part due to this timely and integrated response, real GDP rebounded a record-setting 33.1 percent in Q3 and the economy has already reclaimed 52 percent of the jobs lost over March and April.

Notwithstanding the stellar rebound from the shutdown, real GDP has only recovered about 66 percent of the economic activity lost due to the pandemic, and much of the support
provided in the CARES Act has now been exhausted. Moreover, some sectors – such as restaurants and bars, hotels and accommodations, music venues, theaters, etcetera – have been more severely affected by the pandemic than other sectors, and their full recovery may remain elusive without additional action.

Another round of fiscal assistance can bolster the economy by reinforcing household balance sheets, mitigating the impact of pandemic-related unemployment, and providing small businesses the necessary liquidity to weather this challenging time.

Yet for the response to be most effective and fiscally responsible, it must be timely, targeted, and temporary. It should be targeted toward individuals and industries still greatly impacted by ongoing effects of the pandemic. Moreover, it should not be a permanent increase in the size of government. The overall objective should be to provide assistance in a way that maximizes the economic effect while protecting all taxpayers.