First Trust
Monday Morning OUTLOOK

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Distorted

One thing we must remember when looking at economic data, is that everything is distorted. The US (in fact, much of the world) panicked in 2020. COVID caused governments around the world to implement unprecedented policies. The US borrowed, printed, and spent its way through the lockdowns. We believe, and we don't think it's hard to understand, that the economic bill for these policies, is soon coming due.

We don't expect a recession like in 2020, or a repeat of the Great Recession in 2008-09, but the unemployment rate will eventually go up, job growth will go negative, industrial production will fall, and so will corporate profits. At that point we won't have a big debate about whether we're in a recession; everyone will know it.

In the meantime, before a real recession sets in sometime in 2023 or early 2024, many people will believe the recession is already here. Especially, as the shift away from goods and toward services gathers steam.

Right before COVID started, in February 2020, "real" (inflation-adjusted) consumer spending on services was 64% of all real consumer spending. With the economy locked down, services fell to 59% of spending by March 2021. That five percentage point decline represented roughly $700 billion of spending. Consumers have clawed some of that back with services now up to 62% of total spending, with big recoveries in health care, recreation, travel, restaurants, bars, and hotels. And, we expect this trend to continue.

Yes, companies like Peloton and Carvana, where investors apparently projected COVID-related trends to persist, have gotten hammered. Some look at layoffs at these companies, and others in similar straights, as a sign that recession is already here. But these aren't macro-related developments; they are a realignment of economic activity from a distorted world to a more normal one.

Another distortion from COVID policies was a big drop in labor force participation, which is the share of adults who are either working or looking for work. The participation rate was 63.4% in 2020 but now, even though the unemployment rate is back down to the pre-COVID low of 3.5%, participation is only 62.1%.

Part of the problem might be inflation. "Real" hourly earnings are *lower* than they were pre-COVID. So fewer people might be participating, despite low unemployment, because they (correctly) realize the real value of work is less than it used to be. Another problem is that big-box stores and Amazon stayed open, while many small businesses in certain states were closed. Whether this represents a permanent shift in employment and productivity, or a temporary one, remains unclear

Yet another shift is in housing. Home prices soared during COVID, with the national Case-Shiller home price index up a total of 41.4% rate in the past 27 months (through May 2022). That's the fastest increase for any 27-month period on record, even faster than during the "housing bubble" of the 2000s. Meanwhile, with the government preventing landlords from evicting tenants, rent payments grew unusually slowly during the first eighteen months of COVID.

But now rent payments are catching up. Expect a major transition in the next few years, with rents continuing to grow rapidly while home price gains slow to a trickle by late this year and then home prices remain roughly unchanged in the following few years.

What a fiasco. More employment at large firms, less at small firms. More renters, fewer owners. Lower inflation-adjusted incomes. Distorted economic data. The costs of the lockdowns, one of the biggest policy mistakes in US history, are absolutely immense.

Voters will react, and at least one house of Congress is likely to go the opposition party this November, meaning legislative gridlock for the next two years as the nation sorts all of this out.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
8-23 / 7:30 am	New Home Sales – Jul	0.575 Mil	**0.567 Mil**		0.590 Mil
8-24 / 7:30 am	Durable Goods – Jul	+0.9%	**+0.4%**		+2.0%
7:30 am	Durable Goods (Ex-Trans) – Jul	+0.2%	**+0.3%**		+0.4%
8-25 / 7:30 am	Initial Claims – Aug 22	252K	**249K**		250K
7:30 am	Q2 GDP Preliminary Report	-0.7%	**-0.8%**		-0.9%
7:30 am	Q2 GDP Chain Price Index	8.7%	**8.7%**		8.7%
8-26 / 9:00 am	Personal Income – Jul	+0.6%	**+0.6%**		+0.6%
7:30 am	Personal Spending – Jul	+0.5%	**+0.4%**		+1.1%
7:30 am	U. Mich Consumer Sentiment- Aug	55.5	**55.2**		55.1