**Profile of the Economy**

(Office of Macroeconomic Analysis)

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**Introduction**

The U.S. economy has now expanded for four consecutive quarters, following the sharp contraction in the first half of 2020 that accompanied the beginning of the pandemic. Although the recent recession—officially dated as starting in March 2020 and ending in April 2020—was the shortest on record, it was also unprecedentedly severe, requiring multiple rounds of government fiscal support. Given the success of stimulus programs and vaccination efforts, the economy rose briskly in the first and second quarters of 2021 and, as of the second quarter, has now recovered all of the activity lost during the first half of 2020. Moreover, the economic outlook for the remainder of 2021 as well as 2022 remains strong. A consensus of private forecasters expects real GDP to rise by 7.1 percent at an annual rate in the third quarter, 5.4 percent in the fourth quarter, and 3.1 percent over the four quarters of 2022. These projections suggest that the U.S. economy will return close to or above trend in 2022, though the delta variant and potential future variants add uncertainty to the outlook.

**Economic Growth**

According to the most recent estimate of economic activity, real GDP rose 6.5 percent at an annual rate in the second quarter of 2021, picking up from the already-strong 6.3 percent pace in the first quarter.

Real private domestic final purchases (PDFP)—the sum of personal consumption, business fixed investment, and residential investment—grew 9.9 percent at an annual rate, nearly a double-digit pace despite a pull-back in residential investment in the second quarter. The advance followed an increase of 11.8 percent in the first quarter. Combined, both quarters produced the strongest growth of PDFP for any half-year since 1950—excluding the unprecedented rebound in the second half of 2020 after the initial lockdowns.

For the second consecutive quarter, personal consumption grew at a double-digit pace, despite a sharp drop in stimulus payments to households, which were mostly distributed by the end of March. Growth in real personal consumption expenditures (PCE), which accounts for about two-thirds of overall GDP, accelerated to 11.8 percent at an annual rate in the second quarter, up from 11.4 percent in the first quarter. Purchases of durable goods—a category that includes motor vehicles, household equipment and furnishings, among other items—grew by 9.9 percent. Significantly, this nearly double-digit advance followed a surge of 50.0 percent in the first quarter, which was fueled by two rounds of federal Economic Impact Payments. The continued growth of durables purchases in the second quarter reflected strong consumer balance sheets, pent-up demand, and an improving labor market picture. Spending on nondurable goods—such as food and beverages purchased for off-premises consumption, gasoline and other energy goods, clothing, footwear, and other goods—remained very strong in the second quarter, increasing 12.6 percent, after a 15.9 percent jump the previous quarter. Household expenditures on services—roughly two-thirds of PCE and the component most severely affected by the pandemic—rose 12.0 percent in the second quarter, a marked acceleration from the 3.9 percent pace in the first quarter. Even so, household spending on services in the second quarter was 3.3 percent below the level at the end of 2019. In contrast, total PCE in the second quarter stood 3.1 percent above its pre-pandemic level. Overall, real PCE growth added 7.8 percentage points to GDP growth in the second quarter.

Following three consecutive quarters of double-digit gains, growth of business fixed investment (BFI) slowed to 8.0 percent at an annual rate in the second quarter. Strong investment in equipment and intellectual property products was partly countered by an outright decline in structures investment. For four consecutive quarters, equipment investment has grown at double-digit paces—including a 13.0 percent gain in the most recent quarter—driven by strong investment spending on transportation and industrial equipment. Investment in intellectual property products rose at a double-digit pace for the third consecutive quarter, increasing 10.7 percent at an annual rate and following a 15.6 percent increase in the first quarter. In contrast, investment in structures resumed its longer-term decline, falling 7.0 percent in the second quarter, after a short-lived rebound of 5.4 percent in the first quarter. Aside from the first quarter of 2021, business structures investment has been trending lower since the fourth quarter of 2019, due to a variety of influences. Initially, structures investment was constrained by low oil prices—which shuttered many unprofitable rigs and reduced oil and gas well drilling. More recently, recovering oil prices have boosted mining structures investment, but investment in commercial structures has declined, reflecting uncertainty regarding telework, firms’ need for office space, and the ongoing shift toward online, rather than on-site, retailing. Overall, the contribution of total BFI to growth declined to 1.1 percentage points, after adding 1.7 percentage points to first quarter GDP growth.

After returning to a more normal pace of accumulation in last year’s final quarter, the private inventory component of real GDP registered a considerable drawdown in the first and second quarters of this year. Movements in this component of GDP tend to be volatile, and a large drawdown in one quarter can precede a large rebuild in the following quarter. However, the consecutive large drawdowns reflect recent supply-chain disruptions—like the global semiconductor shortage that has hindered motor vehicle production—as well as persistent high demand for consumer goods. In the second quarter, the change in private inventories subtracted 1.1 percentage points from economic growth, after reducing growth by 2.6 percentage points in the first quarter.

Residential investment declined 9.8 percent at an annual rate in the second quarter, subtracting 0.5 percentage points from GDP growth and only the second reduction in residential investment since the first quarter of 2019. The pull-back followed three consecutive quarters of double-digit growth. Consistent with the decline in residential investment in the second quarter, housing market indicators have softened. Single-family housing starts have decreased in four of the last seven months and, year-to-date, are down 15.5 percent since the end of 2020. Similarly, single-family permits, which signal future starts, have declined in five of the last seven months and are down 15.0 percent since December 2020. Still despite the recent retracement, starts were 5.3 percent higher and permits were up 3.9 percent relative to pre-pandemic levels. The National Association of Home Builder’s confidence index has been trending lower since reaching a record high of 90 in November 2020 but, at 81 in June 2021, remains at an historically high level, relative to the average levels of 66 in 2019 and 70 in 2020.

Demand for homes surged during the pandemic, and supply has not been able to keep pace. In June, existing home sales, which account for 90 percent of all home sales, rose by 1.4 percent and were 2.8 percent above pre-pandemic levels. After reaching a 14-year high in January 2021, new single-family home sales declined in each of the past 3 months, including a 6.6 percent drop in June. Lower home sales have largely reflected very lean inventories. At the end of June, existing home inventories were equivalent to 2.6 months of sales, down by 1.3 months from a year earlier and well below the roughly 7-month supply realtors considered a balanced market. By contrast, the inventory of new single-family home sales available for sale has moved closer to a balanced market, rising from 3.6 months’ supply in January to a 6.3-month supply as of June.

The supply-demand mismatch for housing has led to brisk rates of house price appreciation, mirroring the housing boom in the 2000s and significantly impacting affordability. The Case-Shiller national house price index—which only includes existing home sales—was up 16.6 percent over the year ending in May 2021, a sharp acceleration from the 4.4 percent and 3.4 percent rates seen in May 2020 and 2019, respectively. The Federal Housing Finance Agency’s purchase-only house price index, which includes new homes, jumped 18.0 percent over the year ending in May 2021, well above the 5.2 percent pace a year earlier. Despite relatively low mortgage rates—the average 30-year rate dropped to 2.80 percent at the end of July, just 15 basis points above the record low—housing affordability remains a concern.

Total government spending declined 1.5 percent at an annual rate in the second quarter, after rising by 4.2 percent in the first quarter. The overall decline occurred as a sharp pullback in federal spending offset an increase at the state and local government level. Federal spending declined 5.0 percent at an annual rate in the second quarter, after surging 11.3 percent in the first quarter, largely reflecting fewer payments of lender fees for a new round of Paycheck Protection Program loans. State and local government expenditures, in contrast, increased 0.8 percent in the second quarter as fiscal conditions continued to improve. State and local government consumption remains well below pre-pandemic levels, but fiscal relief should ensure accelerating growth in coming quarters.

The net export deficit widened moderately in the second quarter, increasing $39.2 billion at an annual rate to $1.26 trillion. Export growth picked up markedly from the first quarter while import growth moderated. Total exports of goods and services advanced 6.0 percent at an annual rate, more-than-reversing a 2.9 percent decline in the first quarter, reflecting stronger international demand for U.S. nonautomotive capital goods and consumer goods, as well as increased travel services that has followed the relaxation of travel restrictions. Meanwhile imports advanced 7.8 percent at an annual rate in the second quarter, slowing from the previous quarter’s 9.3 percent increase. The slowdown in imports was led by fewer imports of computers and peripheral equipment, automotive vehicles and parts, and nondurable consumer goods. Imports of services, however, rebounded as more Americans traveled abroad. In the second quarter, the widening of the trade deficit pared 0.4 percentage points from GDP growth, significantly less drag than the 1.6 percentage point subtraction in the first quarter.

**Growth of Real GDP**

(Quarterly percent change at annual rate)

**Labor Markets and Wages**

As a result of the pandemic and measures taken to contain it, the economy lost almost 22.2 million jobs last year over March and April, including 21.4 million jobs in the private sector. Payroll job growth resumed in May 2020, and by July 2021, labor markets had reclaimed 16.7 million jobs, or nearly 75 percent of the total lost. Nonetheless, total employment was still 5.7 million persons lower than the level in February 2020. Weekly initial unemployment claims have continued to trend lower over the past several months but, as of mid-August, were still running nearly 2 times the average levels seen in January and February 2020, prior to the pandemic’s onset.

The unemployment rate rose from a 50-year low of 3.5 percent in February 2020 to a post-World War II high of 14.8 percent in April 2020. Yet by July 2021, the unemployment rate had fallen 9.4 percentage points to 5.4 percent. The broadest measure of labor market slack, the U-6 unemployment rate, has also declined noticeably over the past several months yet remains above pre-pandemic levels. By July 2021, the U-6 had been cut to 9.2 percent, less than half its level in April 2020. But it remained 2.4 percentage points above the pre-pandemic low of 6.8 percent observed in December 2019. Moreover, long-term unemployment remains elevated: the share of the labor force who were unemployed 27 weeks or more stood at 2.1 percent in July 2021, or more than three times the 0.6 percent rate seen in April 2020.

The headline labor force participation rate (LFPR)—as well as prime-age (ages 25-54) LFPR—reached multi-year highs earlier in 2020, before declining to multi-year lows in April of that year. These measures have trended higher since then. As of July 2021, the headline LFPR stood at 61.7 percent, or 1.5 percentage points above April 2020’s 4½ decade low, and the prime-age LFPR was 81.8 percent, or 2.0 percentage points above April 2020’s multi-decade low.

Nominal average hourly earnings for production and nonsupervisory workers grew at or above the 3 percent mark for 30 consecutive months between October 2018 and April 2021, a consistency not seen since the mid-2000s. After the onset of the pandemic, job losses were predominantly among lower-wage workers, which pushed up average wages of those still employed to a much higher range—between 4 and 8 percent. Even as the economy resumed hiring, wage gains remained elevated, in part due to continued composition effects as low-wage workers were slower to return to their jobs. Twelve-month wage growth rates averaged 5.4 percent through March 2021. Over the year through July 2021, however, nominal average hourly earnings for production and nonsupervisory workers grew 4.7 percent. An acceleration in inflation and the increasing return of lower-wage workers to jobs continued to erode real average hourly earnings, which declined 1.1 percent over the year through July 2021, a sizeable reversal from the year-earlier gain of 3.7 percent. Meanwhile, growth in wages and salaries for private industry workers, as measured by the Employment Cost Index (ECI), slowed modestly over the past year. This measure of labor cost has fewer issues adjusting for compositional changes of the labor force than do other measures. The ECI for wages and salaries advanced 3.5 percent over the four quarters ending in June 2021, accelerating from the 2.9 percent gain over the four quarters through June 2020. Aside from some volatility associated with the pandemic in 2020, year-over-year growth in the Employment Cost index held around 3 percent since mid-2018.

**Payroll Employment**

Monthly average for year shown and monthly amounts)

**Unemployment Rate**

(Percent)

**Nonfarm Productivity of Labor**

For the 19 quarters through 2021 Q2, four-quarter nonfarm labor productivity growth rates have remained at or above 1 percent, a streak not seen since 2001. However, with the sudden shutdown of the economy in March 2020 and attendant labor market dislocations, quarterly productivity growth rates have reflected the unusually sharp fluctuations in output and hours worked. For example, productivity growth surged by 11.2 percent at an annual rate in the second quarter and by 4.6 percent in the third quarter. Taken together, these were the largest quarterly increases in productivity since the fourth quarter of 2009.

Although quarterly productivity declined by 3.4 percent at an annual rate in the fourth quarter of 2020, it rebounded by 4.3 percent in the first quarter of 2021, and grew 2.3 percent in the second quarter. The most recent gain in productivity reflected a 7.9 percent advance in output which more than offset a 5.5 percent increase in hours worked. Over the four quarters through 2021 Q2, productivity growth slowed to 1.9 percent from a 2.6 percent pace over the four quarters through 2020 Q2.

Nominal hourly compensation costs in the nonfarm business sector rose 3.3 percent at an annual rate in the second quarter of 2021, after increasing 1.4 percent in the previous quarter. Over the most recent four quarters, hourly compensation costs rose 2.0 percent, decelerating from the 8.8 percent, year-earlier pace. Unit labor costs, defined as the average cost of labor per unit of output, rose 1.0 percent at an annual rate in the second quarter, reversing from the 2.8 percent decline in the first quarter. These costs were up 0.1 percent over the most recent four quarters, slowing from the 6.0 percent pace over the four quarters ending in 2020’s second quarter.

**Industrial Production, Manufacturing, and Services**

Due to the pandemic, measures of industrial production, manufacturing, and services output began declining last year in March and fell further last April. A quick recovery began in May 2020 as social distancing measures and stay-at-home orders were relaxed, although over the ensuing months, growth of output in these categories fluctuated markedly. In July 2021, industrial output at factories, mines, and utilities was up 0.9 percent. Over the 12 months ending in July, output was up 6.6 percent, in contrast with the 7.0 percent decline over the previous twelve months. Industrial output was within 0.2 percent of pre-pandemic levels.

Manufacturing production, which accounts for about 75 percent of all industrial output, increased 1.4 percent in July and was 7.4 percent higher over the past year, after a 6.4 percent decline over the previous twelve months. Relative to its pre-pandemic level, manufacturing output is 0.8 percent higher. Production of motor vehicles and parts has also fluctuated from month to month since the unprecedented monthly gains seen during the summer of 2020 as previously-shuttered factories reopened. This year, auto production has been constrained by a global shortage of semiconductors, such that output of motor vehicles and parts declined in the three consecutive months through June 2021. There are signs presently that the shortage is beginning to ease, and in July, production of motor vehicles and parts jumped 11.2 percent. However, production was 6.9 percent lower over the year through July 2021, due in part to base effects from the surge in production a year ago. Relative to pre-pandemic levels in February 2020, production of motor vehicles and parts is still 3.7 percent lower. Meanwhile, manufacturing output at select high-technology factories was flat in July but rose 12.1 percent over the past year and was 14.3 percent above pre-pandemic levels. Excluding motor vehicles and parts and high-technology industries, manufacturing output rose 0.7 percent in July. This measure was 8.5 percent higher over the past year and was 0.8 percent above the level in February 2020, before the onset of the pandemic.

Output at mines, which includes crude oil and natural gas extraction and accounts for 15 percent of industrial output, rose 1.2 percent in July. At the start of the pandemic, energy prices plunged, weighing on mining output; however, energy prices have been rising strongly as the economy has reopened. Over the year through July 2021, mining output was up 12.1 percent, although it is still 8.4 percent below its pre-pandemic level.

Utilities output, the remaining 10 percent of total industrial output, declined 2.1 percent in July. Weather is usually a factor contributing to swings in this sector; unseasonable weather in months often causes sharp swings in output from one month to the next. Over the 12 months through July, utilities production was down 3.8 percent.

Measures of manufacturing and services business activity in the economy have recovered since summer 2020 and have signaled expansion for over a year. In March 2020 due to the pandemic, the Institute for Supply Management (ISM) manufacturing index began to signal the first multi-month contraction for the sector since early 2016. By April 2020, the index had dropped to an 11-year low. In July 2021, however, the manufacturing index stood at 59.5, indicating expansion in this sector for the fourteenth consecutive month. Similarly, the ISM’s services index in April 2020 fell to its lowest level since March 2009. By July 2021, however, the index had risen to 64.1, an all-time high (series dates from July 1997), and signaling expansion for the fourteenth consecutive month.

**Prices**

Last year, the onset of the pandemic triggered deflationary pressures as domestic demand declined, but these pressures dissipated quickly at the headline and the core levels. Inflation readings were subdued for several months thereafter, despite rising oil prices, with 12-month readings remaining well below year-ago rates. Earlier this year, however, inflation rates rose markedly, elevated by a sharp increase in prices for used motor vehicles—due in part to supply-chain constraints—high demand for durable goods in general, and the reopening of sectors that had languished during the pandemic, such as travel, leisure, and hospitality. As some of these factors began to fade, inflation slowed in July: headline inflation was 0.5 percent, while core inflation was 0.3 percent. The slowdown in the latest month reflected flat prices for used autos and some moderation in prices for pandemic-affected sectors—though inflation for new cars, food services, and lodging remained elevated. Over the 12 months through July, CPI inflation rose by 5.4 percent, matching June’s pace as the fastest 12-month pace since August 2008. Both energy and food prices have risen in recent months. The energy price index was up 23.8 percent over the year, while food price inflation was 3.4 percent over the past twelve months. Over the past 12 months, core inflation was 4.3 percent.

The headline Personal Consumption Expenditures (PCE) Price Index (the preferred measure for the Federal Open Market Committee (FOMC)’s 2 percent inflation target) showed a relatively restrained pace of inflation earlier in the pandemic, but in the past few months, it also has accelerated as the economy reopens and energy prices continue to rise. The 12-month headline PCE inflation rate was 4.0 percent through June 2021 and core PCE inflation was 3.5 percent over the year through June 2021. Prior to the 12-month reading for March 2021, inflation as measured by the PCE price index had held below the FOMC’s target since November 2018, and these consistently low PCE inflation readings prompted the FOMC to adopt a more explicit inflation target strategy last year, in which the 2 percent target would be an average over time.

**Consumer Prices**

(Percent change from a year earlier)

**Consumer and Business Sentiment**

After improving strongly through most of the first quarter in 2020, measures of consumer and business sentiment pulled back in March 2020 as social distancing and business closures took effect. The Reuters/Michigan consumer sentiment index rose to 101.0 in February 2020, just shy of the 14-year high reached in 2018, the subsequently fell by more than 29 points. This index trended higher for several months, reaching 88.3 in April 2021. Since then, however, this index has trended lower, and dropped sharply in early August to 70.2, or 1.6 points *below* the pandemic low reached in April 2020. The 11-point drop in early August, one of the sharpest in the survey’s history, reflected renewed concerns among consumers about the impact of the delta variant on the economy. From a pre-pandemic level of 132.6 in February 2020, the Conference Board’s consumer confidence index plunged by 46.9 points to 85.7 in April 2020, reaching its lowest level since mid-2014. This index fluctuated over the next several months, then began a noticeable uptrend in March 2021, and by July 2021, had risen to 129.1, only 3.5 points below its pre-pandemic level. On the business side, the National Federation of Independent Business’s (NFIB) small business optimism index was, as of February 2020, only 4.3 points belowits all-time high reached in August 2018. But this index fell nearly 14 points over March and April of last year to its lowest level since March 2013. Small business optimism then recovered noticeably, with the index rising to 104.0 last October (only 0.5 points below its level in February), but has since fluctuated, and stood at 99.7 as of July 2021.

**Federal Budget Deficit and Debt**

Before the pandemic, the Federal Government’s deficit and debt were trending higher, and the fiscal response to the pandemic elevated borrowing more. At the end of FY 2020, the Federal Government posted a deficit of $3.13 trillion (15.0 percent of GDP), up $2.15 trillion from the $984 billion deficit (4.6 percent of GDP) posted in FY 2019. The primary deficit (which excludes net interest payments) was 13.3 percent of GDP in FY 2020, up from 2.9 percent in FY 2019. Federal receipts totaled $3.42 trillion in FY 2020, down $44 billion (1.3 percent) from FY 2019. Net outlays for FY 2020 were $6.55 trillion, up $2.1 trillion (47.3 percent) from FY 2019. As of July 2021, the federal deficit was $254.0 billion, bringing the 12-month total deficit to $2.86 trillion.

Before the pandemic in 2019, the Treasury’s borrowing limit was suspended until July 31, 2021. After the suspension ended, Treasury began implementing cash conservation measures to avoid exceeding the federal borrowing limit. These measures will allow the Department to meet the government’s expenditures without issuing new debt—though the length of that these measures may last is subject to heightened uncertainty related to the economic impact of the pandemic. At the end of FY 2020, gross federal debt was $26,945.4 billion. Federal debt held by the public, or federal debt less the debt held in government accounts, rose from $16.80 trillion at the end of FY 2019 (79.2 percent of GDP) to $21.0 trillion by the end of FY 2020, or 100.3 percent of GDP. As of July 2021, gross federal debt was $28,427.7 billion, while federal debt held by the public totaled $22,284.6 billion.

**Economic Policy**

The U.S. government has responded to the effects of the COVID-19 pandemic with a range of significant countercyclical fiscal and monetary policies, including an unprecedented level of fiscal assistance and a reduction in the key policy interest rate to near-zero.

On the fiscal side, Congress authorized a record-setting economic aid package of roughly $2.7 trillion in March 2020, and a second, smaller package was passed in December 2020. The aid included two rounds of direct Economic Impact Payments to low- and middle-income Americans, a temporary weekly federal addition to normal state unemployment compensation, and broadened eligibility for unemployment benefits to the self-employed and gig workers. Tax payments were postponed in 2020, loan payments were delayed for borrowers of federally backed student loans, and a moratorium on evictions was instated. This slew of policies boosted disposable incomes and has help American households to weather the pandemic.

In addition, Treasury and the Small Business Administration (SBA) launched the Paycheck Protection Program (PPP)—a forgivable loan for small businesses—less than a week after its authorization at the end of March 2020. The federal government worked directly with private lenders and used their infrastructure to hasten how quickly businesses could receive funds. In less than two weeks, the PPP had exhausted its initial funding: it had processed nearly 1.7 million loans worth $342 billion. After a second appropriation, the PPP provided 5.2 million loans by the time of the program stopped accepting applications in August 2020, worth over $525 billion. A third appropriation was passed in December 2020, which allowed a second draw PPP loan. As of August 15, 2021, the PPP had processed a total of 11.5 million loans to small businesses and forgiven $471.1 billion of borrowing.

In 2021, President Biden signed the American Rescue Plan (ARP) into law. The ARP provides an additional $1.9 trillion in economic aid, primarily through Economic Impact Payments and direct aid to low- to middle-income families and to the economically vulnerable. It also assists state and local governments, provides additional funding for addressing COVID-19 infections and vaccinating the population, creates new loans and grants for small businesses, and extended the deadline for PPP applications.

On the monetary policy side, the Federal Reserve’s Federal Open Market Committee (FOMC) resumed monetary easing in early March 2020. At the January 2020 meeting, the Federal funds rate target was at a range of 1½ to 2 percent, and in the accompanying statement, the Committee observed that at the time, “the current stance of monetary policy is appropriate to support sustained expansion of economic activity, strong labor market conditions, and inflation near the [Fed’s 2 percent target].”

However, the pandemic led to an inter-meeting move. On March 3, 2020 the FOMC announced a 50-basis point cut in the target range to 1 to 1¼ percent, and on March 15, 2020 at another unscheduled meeting, the FOMC cut the target range by 100 basis points to 0 to ¼ percent. (The scheduled, March 17-18, 2020 FOMC meeting was cancelled.)

At its scheduled meetings from April 2020 through July 2021, the FOMC left the target range for the federal funds rate unchanged. In each of the accompanying statements for those meetings, the Committee noted that it expects to maintain this FFR target range until labor market conditions and the level of inflation are consistent with its maximum employment and price stability goals.

The Federal Reserve has also implemented large-scale purchases of Treasury securities and agency mortgage-backed securities. Importantly, the Federal Reserve assuaged market worries by using its Section 13(3) authority to establish numerous emergency lending facilities, leveraging capital provided by Treasury. The existence of these facilities ensured that financial markets operated smoothly and mitigated the risk of the public health crisis from becoming a financial crisis, but they were only authorized on an emergency basis through December 31, 2020. Treasury extended capital for some of these lending facilities through March 31, 2021, and these have now expired.