Covid Casting a Long Economic Shadow

The US employment report for August was much weaker than anticipated, but it is just the latest economic release to come in below expectations recently. We have had weaker than anticipated retail sales figures in a number of countries, as well as softer than forecast sentiment and activity surveys, and a very disappointing UK GDP reading for July.

Data over the past year have generally been stronger than expected, triggering significant upward revisions to GDP growth forecasts for 2021 and, indeed, next year also. However, data released in the past month or so have been below forecast, most notably in the US and UK. There are clear signs that the highly transmissible Delta variant of Covid-19 has slowed the pace of recovery recently, amid a spike in new case numbers.

This does not mean that the recovery is being derailed, but it has lost momentum. It shows the Covid-19 pandemic continues to have a major impact on activity, despite the roll-out of highly effective vaccines. Another factor holding back the pace of recovery has been supply bottlenecks in terms of shortages of raw materials and key inputs, as well as capacity constraints in transport, most notably shipping. This has been impacting on manufacturing and construction activity in particular.

Labour shortages are also being widely reported, especially in the services sector, which is affecting the ability of businesses to meet the surge in demand as economies re-open. It may be that income support measures put in place to assist those who lost employment as a result of the pandemic are slowing the return of workers to jobs, although these programmes are now starting to be wound down.

Emphasising the ongoing impact of the pandemic, it would also appear that some employees are still reluctant to return to the workforce due to continuing Covid-19 related concerns. This may be particularly true where Covid case numbers are high and vaccination rates are relatively low. Covid may have also seen some workers move away from their previous place of employment, making it harder to match labour supply to jobs.

Certainly, where hard data are available, they make for startling reading. The JOLTs report for July in the US showed the number of job openings increased to yet another new record high of 10.9 million, up from 10.2 million. This is well above the level of unemployment, which currently stands at 8.4 million. Meanwhile, total employment remains some 5.5 million below its pre-pandemic level.

Meantime, in the UK where unemployment has been edging steadily lower, it will be interesting to see whether the ending of the furlough scheme this month leads to a spike in the unemployment rate. In the Eurozone, the jobless rate had declined to 7.6% by July, down from a Covid peak of 8.7% last summer and not far above its pre-pandemic level of 7.1%. However, the full impact of Covid-19 will only become apparent when government supports are withdrawn.

It could well be that the most significant impact is on labour force participation rates and labour supply, rather than unemployment. This would increase the risk of a sustained pick up in wage inflation. In such circumstances, another impact of Covid, a marked pick-up in inflation globally this year, could prove stickier than central banks and the markets expect. Covid-19 is proving a difficult bug to shake, and seems likely to continue dominating the economic landscape for quite some time yet.

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