Western New York ECONOMIC NEWS
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https://www.canisius.edu/academics/programs/economics/economics-wny-economic-news

Volume 24, Number 3 September 2021

Extraordinarily accommodative monetary and fiscal policy supported a relatively quick recovery from the Covid-19-induced recession. The inflationary consequences of these aggressive policies, interacting with increased input costs related to global supply chain interruptions, resulted in a 4.85% increase in CPI inflation in the second quarter of 2021. Post-recession income and employment growth failed to keep up with the nearly complete recovery of GDP. Regionally, the Buffalo MSA did not lead the nation into this pandemic related recession, and currently has recovered employment ahead of the rest of New York State, an aberration in the pattern that held over the last 40 years. While unemployment rates have fallen substantially since July 2020, the labor force had 10,000 fewer individuals in July 2021.

The National Economic Outlook

Quarterly inflation rates since 2015 based on the Consumer Price Index and the Personal Consumption Expenditures deflator are shown in Figure 1. The extraordinarily accommodative nature of both monetary and fiscal policy supported the relatively quick recovery from the Covid-19-induced recession, but the inflationary consequences of these aggressive policies are presently being felt. Second quarter 2021 CPI inflation surged to 4.85%. Over the past 4 months, CPI inflation measured on an annual basis has been 5.0%, 5.4%, 5.4% and 5.3% respectively. Inflation based on the PCE deflator, the Fed's preferred measure of economy-wide inflation, increased from 1.82% to 3.86% from 2021Q1 to 2021Q2. As long as inflation expectations are anchored, the Federal Reserve has stated that they would allow inflation to run above their 2% target since PCE inflation has been running at or below this target for many years.

Expectations of future inflation are important in determining the actual inflation level that will occur. If the supply chain problems and shortages of goods that have led to the acceleration in the rate of inflation continue to occur, consumers and firms may begin to behave in such a manner that even higher inflation will result. In September 2021, consumer inflation expectations (based on the CPI) based on the University of Michigan survey showed expectations of 4.7% inflation over the coming year. In June 2021, the Livingston survey of professional economists showed expectations of CPI inflation at 3.3% for the period 2020-2021 but only 2.5% inflation for the 2021-2022 period.

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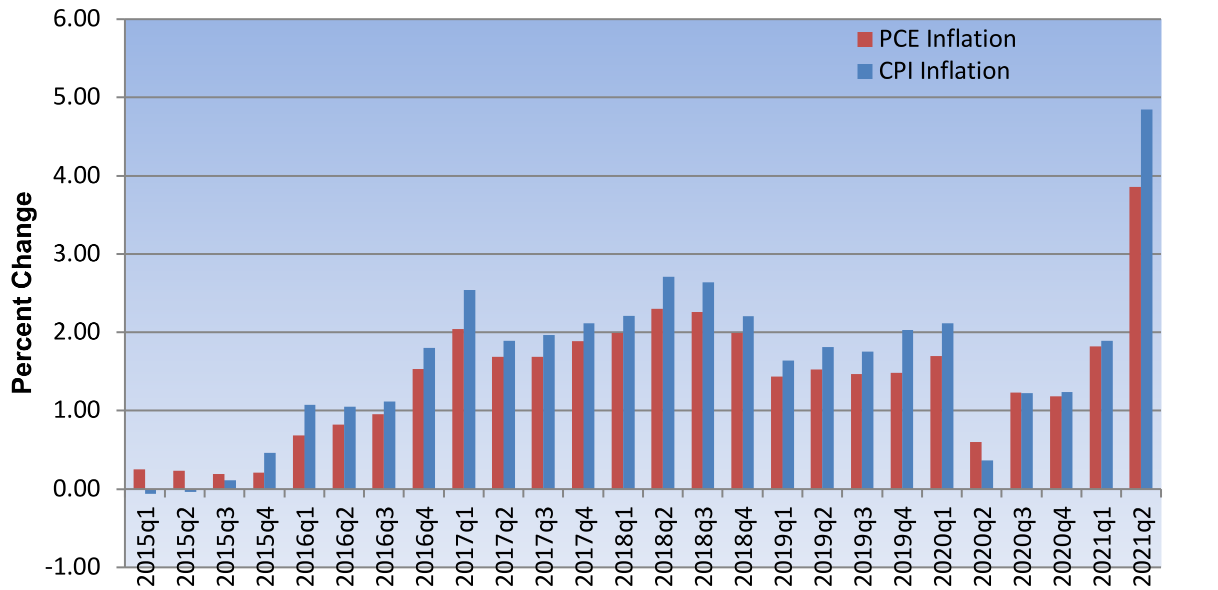
It will be interesting to see whether these survey-based forecasts of future inflation change significantly over the next few months.

Figure 1. CPI & Personal Consumption Expenditure Inflation Rates (Quarterly Data): 2015-2021

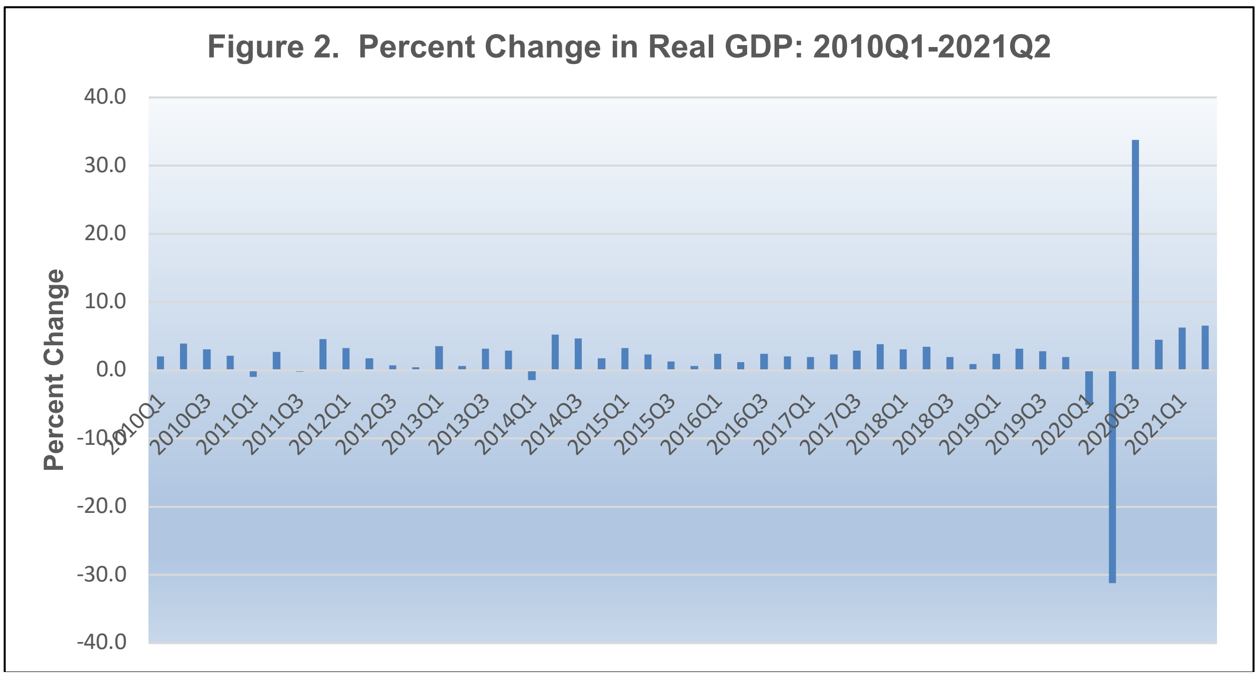


The Federal Reserve has been purchasing $120 billion of U.S Treasury bonds and mortgage-backed securities each month for several months in response to the Covid-19-induced recession. After the September 22 meeting of the FOMC, Fed chairman Powell indicated that tapering of these asset purchases will occur soon. It seems likely that the federal funds target rate will also increase in the near future above its near zero level.

The huge federal budget deficits that have been produced by the massive and unprecedented fiscal expenditures that have already been made, as well as those presently being discussed, combined with the expansionary monetary policy that has been implemented by the Fed could lead to inflation that could be difficult to control. We believe it is important to remember the lessons of the late 1970's and early 1980's when Fed chairman Paul Volker engineered dramatically higher interest rates to slow the economy to reduce inflation. This policy resulted in the twin recessions that occurred in 1980 and 1981-82. This policy was successful at bringing inflation under control, but at the expense of significant levels of economic pain.

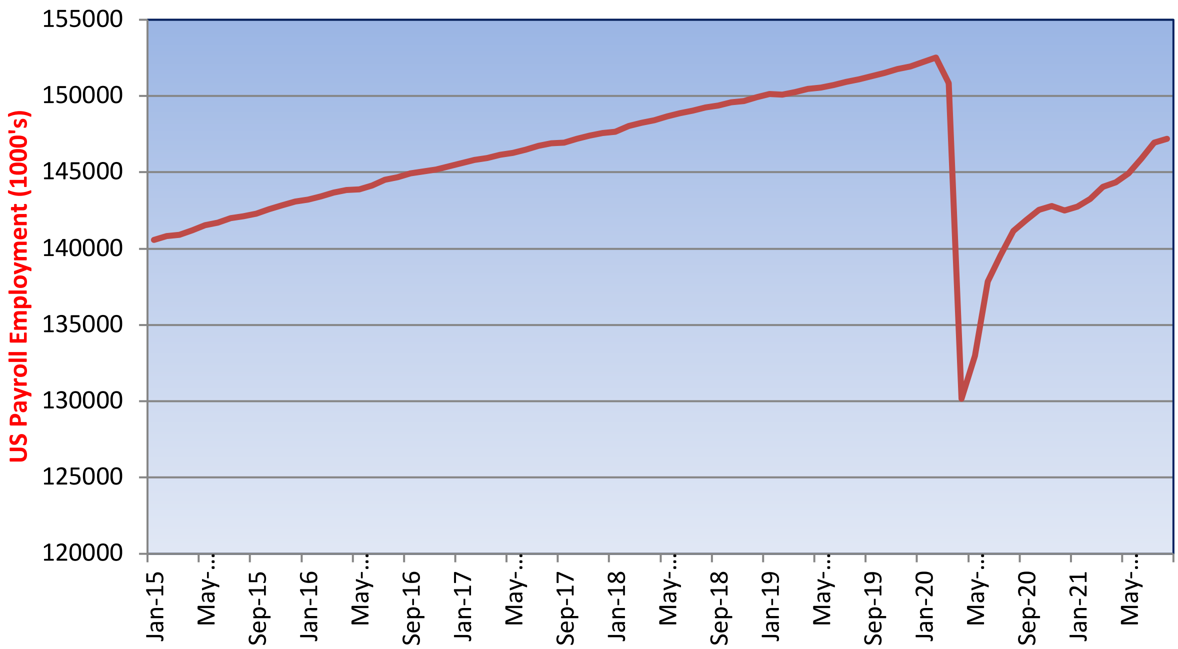
An additional lesson from that dark period of our economic history is the profound impact that rising input prices can have on output, employment and income. The combination of double-digit inflation and unemployment rates, left policy makers with the unenviable choice of reducing one while making the other worse. Economic reality has not changed and that choice still exists. The 1980 to 1982 economic dislocations, in large part, resulted from extraordinary increases in energy prices associated with OPEC crude oil output restrictions. Though current input constraints are most likely Covid-19 related, widespread and long-term disruptions in production could lead to a cost-push inflation with similar effects to those experienced 40 years ago. While there is more flexibility in the financial system today than there was in 1980, the 39% increase in prices reduced the purchasing power of people's savings by nearly 40 percent over the period 1980-1982. An additional fiscal spending package, like the $3.5 trillion expenditure proposal recently discussed in Congress, can only exacerbate the inflation concerns outlined above.

Up to this point, though, the accommodative fiscal and monetary policies have contributed to significant economic growth at the national level. Quarterly real GDP grew strongly over the period 2020:Q3 – 2021:Q2, increasing by 33.8%, 4.5%, 6.3% and 6.6%, respectively over the previous quarter. Figure 2 shows real GDP growth rates since the first quarter of 2010 (www.bea.gov). Although the 2020 Covid-19-induced recession was only two quarters in duration, the magnitude of the decline was severe. From peak to trough, there was more than $1.9 trillion in lost output measured in chained 2012 dollars. Real GDP surpassed its pre-recession peak during the second quarter of 2021. The V-shaped recovery discussed in previous issues of this newsletter has occurred.



While production has largely recovered, employment gains have been slower. Complete labor market recovery after recession usually occurs with a significant lag. Figure 3 shows the level of U.S. non-agricultural payroll employment since January 2015. Nationally, the August 2021 employment level remains 5.3 million below its February 2020 pre-recession peak. The nation has, however, recovered more than 22 million jobs since the employment trough in April 2020.

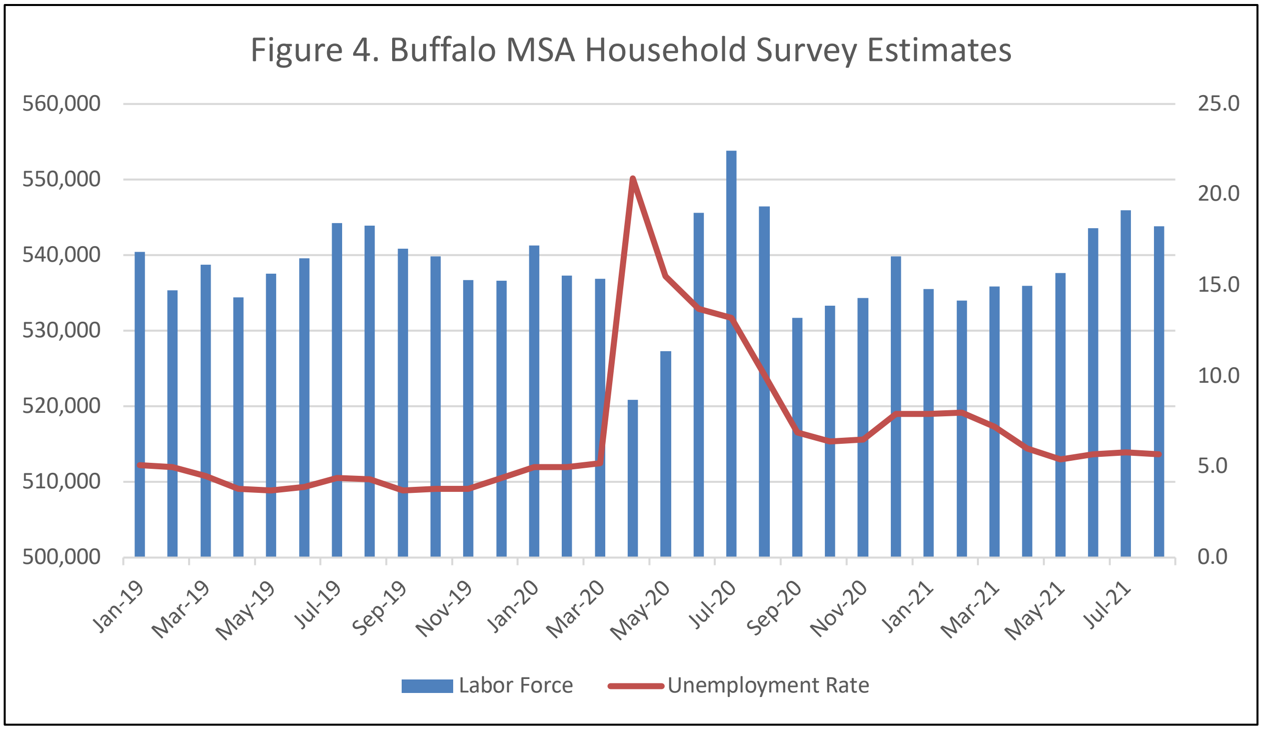
Figure 3. U.S Payroll Employment (2015-2021)



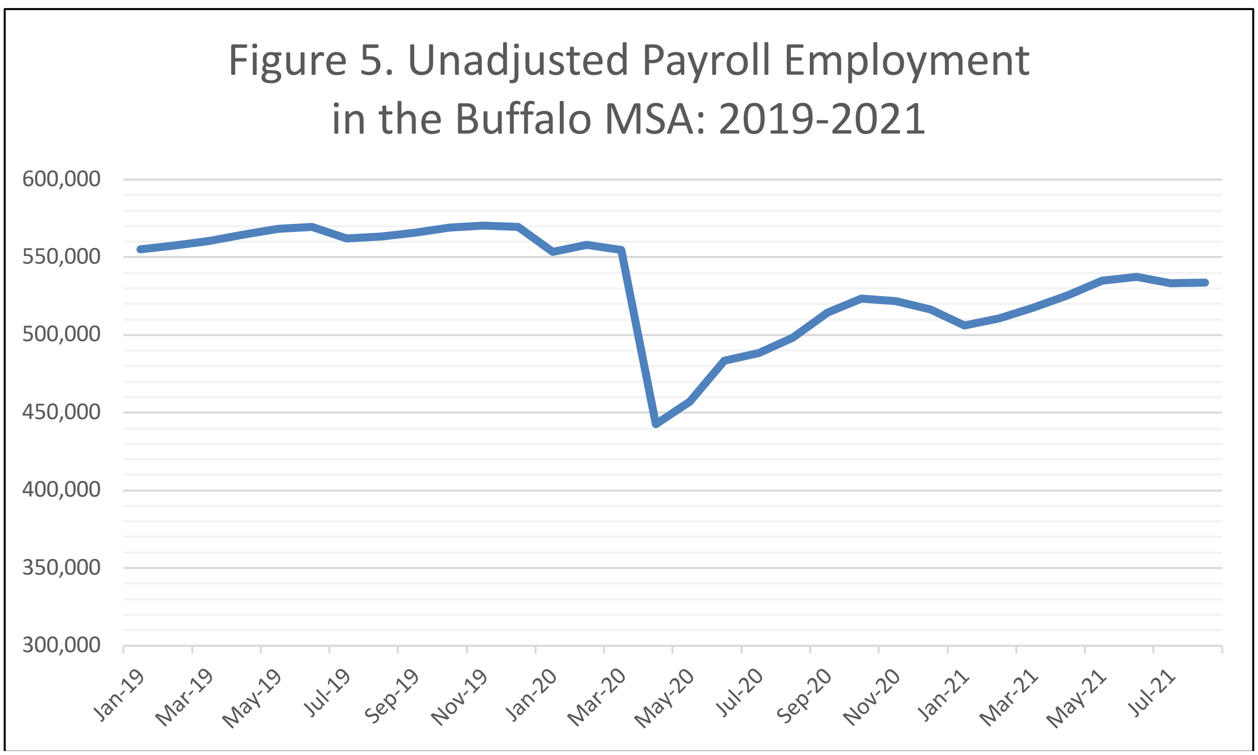
The Economic Outlook for the Buffalo Region

As with the national unemployment rate, the unemployment rate in the Buffalo MSA has shown substantial improvement in 2021, falling from 7.9% in January to 5.7% in August. This occurred while the local labor force increased from 535,500 to 543,800 over the same period. A falling unemployment rate accompanying a rising labor force indicates increases in the level of employment. These trends are reflected in Figure 4 and are based on data from the *Current Population Survey* (CPS).

To control for seasonality at the local level, we compare the same months year over year. Both the unemployment rate and the size of the labor force was much higher in August 2020 than it was in August 2021. While we expect to see the increase in labor force over summer months – full-time students age 16 and over are only included in the labor force during the summer – the jump in 2020 was uncharacteristically large. We suspect that unemployed young people moved back to Buffalo to live with their families during the lockdown and temporarily furloughed workers transitioned to unemployed status during the summer of 2020. This year, the increase in the labor force during the summer months was more typical historically. Though, in 2021, a greater fraction of the entrants during the summer months were employed, which likely means that full-time students alleviated some of the labor shortage that has persisted over the last few months. To the extent that they filled in the gap, labor shortages may get worse in the fall and winter months as students return to school.



https://statistics.labor.ny.gov/laus.asp



https://statistics.labor.ny.gov/lscesmaj.shtm

While these employment trends are consistent with those shown by the payroll statistics (Figure 5), a comparison of the figures makes some of our anecdotal labor shortage issues more obvious. While there were fewer than 8,000 additional unemployed individuals in August 2021, as compared with August 2019, the Buffalo MSA still had 29,000 fewer jobs. Explanations include the presence of fewer multiple jobholders in the local economy, local residents who are working remotely at firms outside the region, and the closed Canadian border. Table 1 shows the status of the payroll employment recovery with trimonthly data from the beginning of the recession, comparing the payroll employment data to the same month in 2019, as we attempt to control for seasonal variation.

Table 1. Loss of Payroll Jobs in the Buffalo MSA by Industry: Monthly CES Survey Data 2019-2021, Not Seasonally Adjusted

	Apr 2019-Apr 2020	Jul 2019-Jul 2020	Oct 2019-Oct 2020	Jan 2019-Jan 2021	Apr 2019-Apr 2021	Jul 2019-Jul 2021
Total	121.9	73.4	45.9	48.9	39.0	28.6
Construction	8.1	1.8	0.3	0.0	-0.2	-0.1
Manufacturing	8.8	3.9	0.7	3.0	1.0	1.2
Wholesale Trade	2.1	1.4	1.4	1.2	1.2	1.3
Retail Trade	15.6	5.5	3.9	3.4	2.4	2.4
Trans and Util	4.2	1.9	1.5	0.0	-0.4	-1.5
Information	0.9	1.0	0.9	1.3	1.0	0.9
Financial Activities	1.8	1.5	1.1	0.7	0.7	1.4
Professional & Business Serv.	12.9	9.0	5.3	5.6	4.7	4.8
Education	2.9	2.1	3.0	2.2	3.0	0.8
Health and Social Assistance	12.6	6.9	5.5	7.9	6.4	5.8
Entertainment and Rec.	5.3	4.9	3.5	1.9	0.6	0.2
Accom. And Food	30.4	16.0	11.9	14.8	10.6	1.8
Other Services	10.0	5.8	3.9	3.4	3.0	1.8
State Govt	0.0	0.4	0.9	0.6	2.1	2.4
Local Govt	6.6	11.6	2.7	3.2	3.2	5.7

* These are counts of jobs lost from the same month in 2019 – negative numbers indicate job gains in an industry

There were some notable changes between April and July of 2021. First, the hardest hit industry has nearly recovered – there were only 1,800 fewer jobs in hotels and restaurants than there were in July 2019. Though, job growth in the other industries that were severely impacted by the pandemic has nearly ground to a halt. The retail trade, health care and social assistance, and professional and business services industries now explain nearly half of the jobs still missing from the local economy. We do not expect all of the jobs in retail trade and in administrative and support services, a business services subindustry, to return. A greater reliance on capital during the pandemic and subsequent lockdown has diminished our needs for labor in those areas. We also expect that the hiring challenges in the social assistance sub-industry will persist as the pre-pandemic wages in that area were nearly the same as in food service, and there is less price flexibility to cover wage rate increases in that sector.

Seasonally-adjusted *Current Employment Statistics* (CES) presented in Figure 5a and Table 2a show the recovery from the 2020 employment disaster in New York State through July 2021. Month over month comparisons between 2020 and 2021 indicate growth rates declined from 13% to 7% from April to July. Inspection of the percentage changes from 2019 to 2021 reveals a different story for New York State. The change in monthly state employment over the two-year period ranged were consistently negative and the smallest decline was in July at -8.7%.

Figure 5a. NYS Non-Agricultural Employment: Seasonally Adjusted (2000-2021)

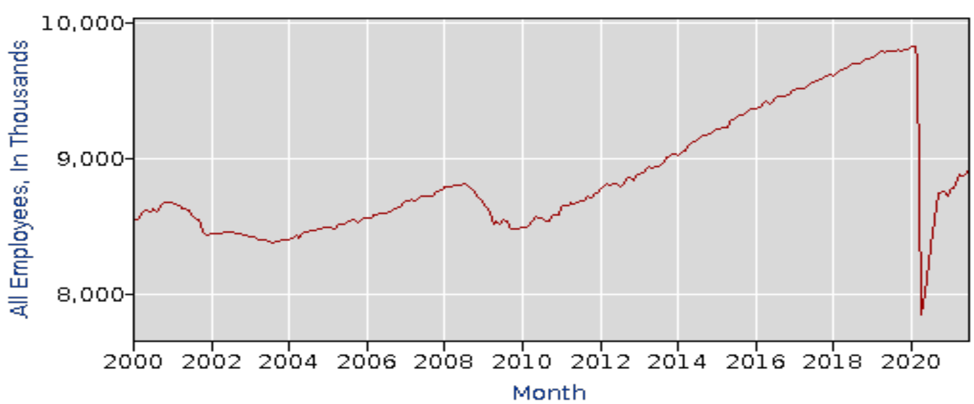


Table 2a. Month over Month % Change in Employment New York State

Year	Jan	Feb	Mar	Apr	May	Jun	Jul
2020-21	-10.8%	-10.7%	-9.0%	13.1%	10.8%	8.1%	7.0%
2019-21	-10.1%	-10.0%	-9.5%	-9.3%	-9.3%	-9.2%	-8.7%

In Figure 5b and Table 2b, the Buffalo MSA reveals similar job destruction and recovery to that which occurred for New York State. Unlike previous economic recessions, during the pandemic-induced recession, Buffalo's job loss was lower in percentage terms than New York State's, and our recovery in the one and two-year periods is somewhat better. However, the CES data indicates that there are fewer jobs in Western New York now, than existed in 2019.

Figure 5b. WNY Non-Agricultural Employment: Seasonally Adjusted (2000-2021)

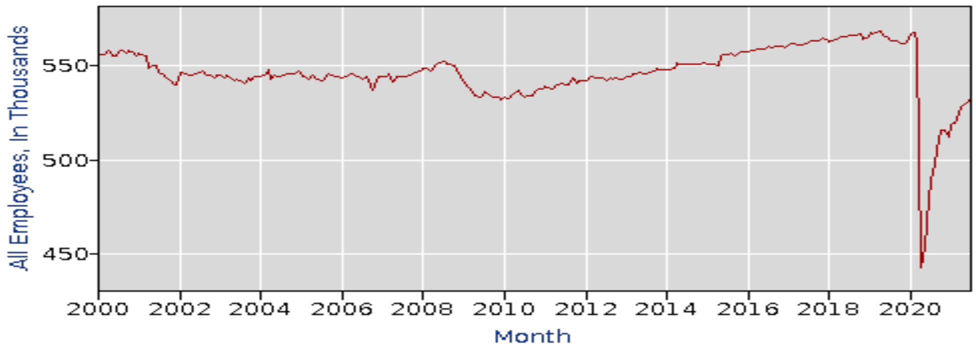


Table 2b. Month over Month % Change in Employment Buffalo MSA

Year	Jan	Feb	Mar	Apr	May	Jun	Jul
2020-21	-8.6%	-8.5%	-6.6%	19.1%	16.7%	10.9%	9.1%
2019-21	-8.6%	-8.3%	-7.6%	-7.1%	-6.5%	-6.0%	-5.3%

https://data.bls.gov/pdq/SurveyOutputServlet

The QCEW-based annual employment and annual pay data for the Buffalo MSA, and for the U.S. in 2019 and 2020 presented in Table 3, identify the changes in earnings per worker by industry. Private sector employment fell by approximately 49,500 jobs, or 92% of the total employment decline. The service-providing sector lost about 44,500 jobs, or 83% of the total number of jobs lost.

Those workers in the lowest paying industries suffered the greatest employment losses. Leisure and hospitality workers, with earnings about one-half of the regional average, accounted for one-third of the total MSA employment lost from 2019 to 2020. The ability to implement work-from-home models in other sectors helped maintain higher annual wages and employment for workers in those industries. In all sectors, save the Federal government, employment declined in the Buffalo MSA. Interestingly, in certain industrial sectors, mainly in government and service-related industries, the gap between average annual wages per worker in 2020 locally and in the nation fell. State and local government employees continued as the only sectors with higher earnings per worker than the national sector average.

A concluding note seems appropriate at this time. All trends and patterns discussed above are at risk if the Congress allows any type of default of U.S. Treasury securities. These securities viewed domestically and internationally as nearly risk-free have sustained low-cost capital inflows to the United States for decades. As such, any default could upend the financial markets that fund Wall Street, as well as Main Street activities. It would be reckless, even by current American political standards, to allow this to occur.

Table 3. Buffalo MSA Employment and Earnings by Industry: 2019-20

Industry	Average Annual Employment 2019	Average Annual Pay ($) 2019	Average Annual Employment 2020	Average Annual Pay ($) 2020	% of MSA Average Annual Pay 2019	% of Change in Total Employment 2019 - 2020
Total, all industries	544,123	$50,912	490,500	$55,756	100%	100%
Total, Federal Government	9,391	$79,265	9,843	$80,305	156%	-1%
Total, State Government	20,285	$74,375	19,970	$75,573	146%	1%
Total, Local Government	55,877	$56,165	51,574	$60,596	110%	8%
Total Private all industries	458,570	$48,653	409,113	$53,587	96%	92%
Goods-producing	74,259	$64,985	69,284	$67,375	128%	9%
Natural resources & mining	1,745	$40,622	1,723	$42,578	80%	0%
Construction	20,489	$59,800	18,795	$64,446	117%	3%
Manufacturing	52,025	$67,844	48,767	$69,380	133%	6%
Service-providing	384,312	$45,497	339,829	$50,776	89%	83%
Trade, transportation & utilities	96,943	$40,331	89,768	$45,122	79%	13%
Information	6,651	$67,014	5,768	$73,858	132%	2%
Financial activities	35,555	$67,313	34,371	$72,467	132%	2%
Professional & business services	68,357	$61,021	62,060	$64,760	120%	12%
Education & health services	95,273	$45,918	88,165	$50,038	90%	13%
Leisure & hospitality	59,967	$25,882	42,065	$30,325	51%	33%
Other services	20,952	$29,367	17,077	$32,574	58%	7%
Unclassified	614	$37,331	555	$45,816	73%	0%

NATIONAL, STATE & LOCAL BUSINESS INDICATORS

NATIONAL INDICATORS	2020:II	2020:IV	2021:I	2021:II	% change 2020:II - 2021:II
Real GDP (billions of chained 2012$) (1)(a)	17,258.2	18,767.8	19,055.7	19,360.6	12.2
US Personal Income (billions of $) (1)(a)	20,348.7	19,542.0	21,867.3	20,564.9	1.1

	Aug-20	Jun-21	Jul-21	Aug-21	% change Aug-20 - Aug-21
Annual CPI Inflation Rate (%) (2)	1.31	5.39	5.37	5.25	
Exchange Rate Canadian cents/US $ (3)(b)	130.49	123.97	124.78	126.15	-4.38
10 Year Treasury Note Yield (%)(3)(b)	0.706	1.469	1.228	1.308	0.52
3 Month Treasury Bill Yield (%)(3)(b)	0.099	0.050	0.052	0.043	-0.05
S&P 500 Stock Index (3)(b)	3,500.31	4,297.50	4,395.26	4,522.68	29.21
Dow-Jones Industrial Average (3)(b)	28,430.05	34,502.51	34,935.47	35,360.73	24.38
LABOR MARKET TRENDS (2)					
Nonag Civilian Employment					
US (1000's)(a)	141,149	145,902	146,955	147,190	4.28
Change from previous month	1,583	962	1,053	235	
NY State (1000's)(a)*	8,548.5	8,891.8	8,936.1	8,959.6	4.81
WNY (1000's)(a)*	498.4	531.1	531.9	533.1	6.96
Unemployment Rate (%)					
US (a)	8.4	5.9	5.4	5.2	-3.2
NY State(a)	11.7	7.7	7.6	7.4	-4.3
WNY	10.7	5.7	5.8	5.7	-5.0
Ave. Weekly Hours in Mfg. US (a)	41.1	41.4	41.5	41.5	0.4
Ave. Weekly. Earnings in Mfg. US ($)(a)	939.96	983.66	991.02	996.42	6.01
US Private Employment (1000's)(a)	119,076	124,104	124,902	125,145	5.10
WNY EMPLOYMENT BY SECTOR					
Mining, Logging & Construction	22.2	23.3	23.4	24.0	8.11
Manufacturing	49.0	51.4	51.6	51.5	5.10
Trade, Transportation & Utilities	91.4	97.4	96.0	95.6	4.60
Durable Goods	29.4	30.6	30.5	30.3	3.06
Finance Activities	35.6	35.8	35.4	35.6	0.00
Government	76.6	86.9	79.1	78.3	2.22

(1) US Dept. of Commerce	(a) Seasonally Adjusted
(2) US Dept. of Labor	(b) End of month data
(3) Wall Street Journal	