The US economic outlook: bounce, fade, slog

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After the bounce: fade and slog

- After reaching a trough in April, GDP rose sharply over May and June, reversing 60% of the spring decline—but the recovery slowed sharply after that. As of August, about 26% of the decline had yet to reverse.
- As of our 5 October forecast, we estimate that real GDP in the third quarter grew at an annualized rate of 33.2%. We expect the decline in 2020 to come in at 3.5%, 0.5 percentage point above last month.
- We expect GDP growth to fade for three main reasons:

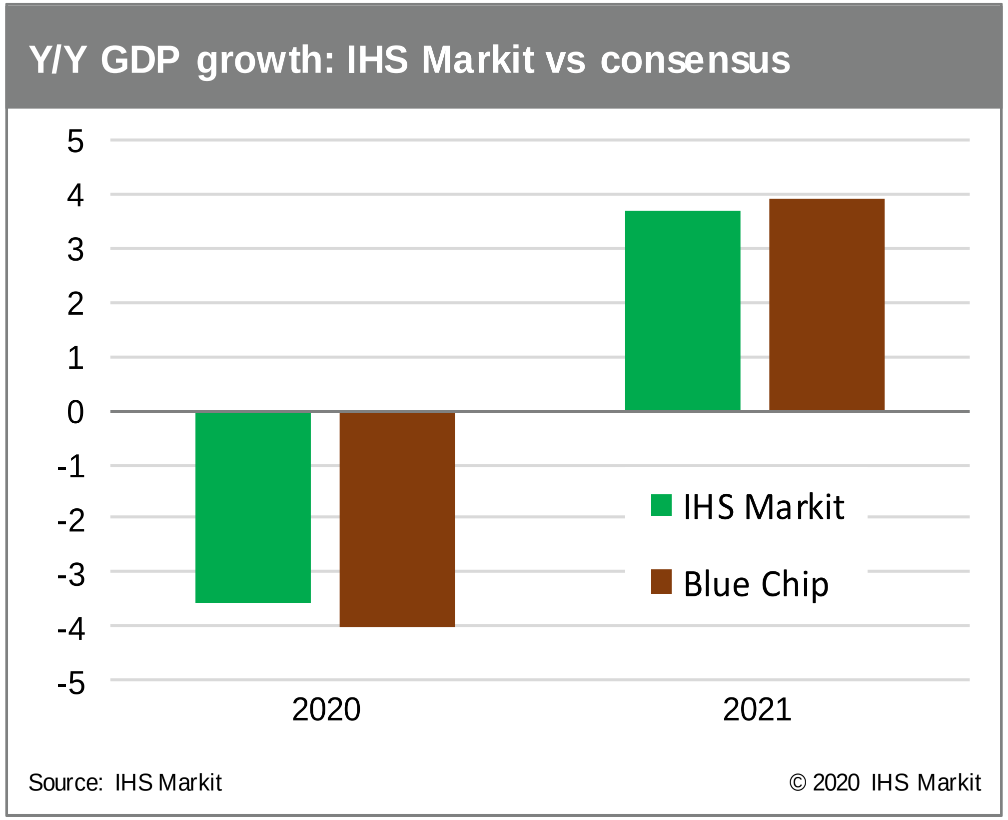
1. Consumer spending on durable goods are above the pre-pandemic trend.
2. Fiscal support will dwindle.
3. COVID-19 infection rates remain high and have risen as the fall progresses.

- We project growth of 3.7% in 2021 and 3.2% in 2022. GDP surpasses its previous peak late in 2021, and the economy regains full employment in mid-2023—slightly earlier than in last month’s forecast.

Policy assumptions in the October forecast

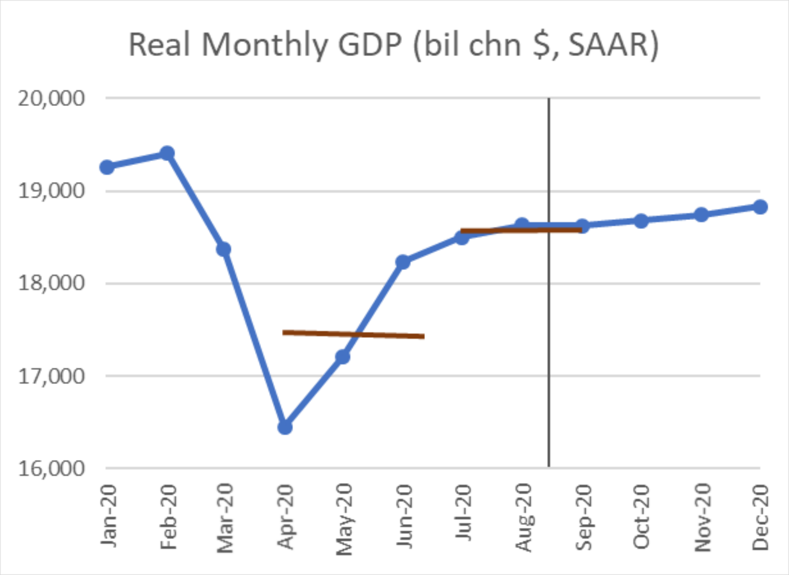
- A short-term spending bill currently funds federal agencies through mid-December. We assume it is extended as necessary to prevent a government shutdown.
- Negotiations over another stimulus bill continue in a chaotic fashion. Without further legislation, recent massive federal support of personal and business incomes will dissipate quickly by the end of the year.
- This forecast assumes emergency unemployment benefits of $300/week from October through December and a second round of stimulus checks is distributed in the fourth quarter. We estimate these payments boost annualized GDP growth by approximately 2.5 percentage points in fourth-quarter 2020 and first-quarter 2021.
- The Fed maintains the federal funds rate near 0% until late 2026 when the economy is again beyond full employment. The Fed encourages inflation temporarily above 2%, starting in the forecast in 2026.

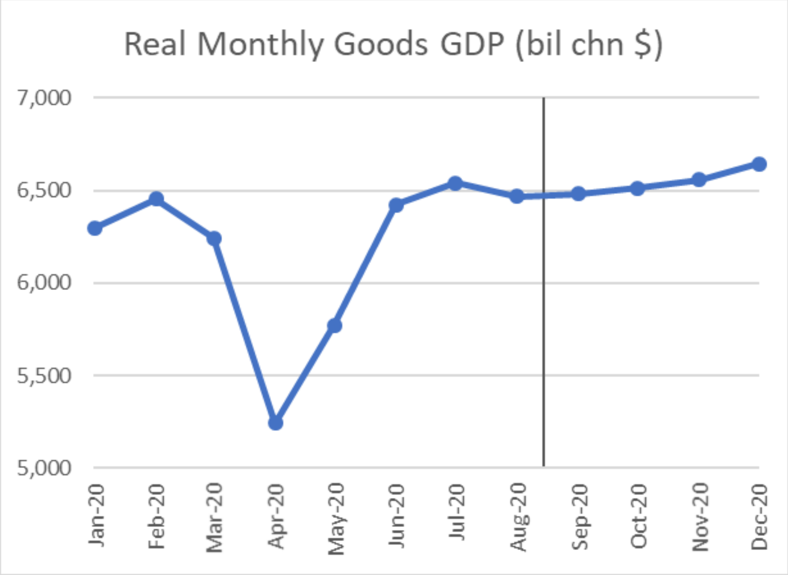
Forecast in summary: IHS Markit vs 10 October Blue Chip consensus

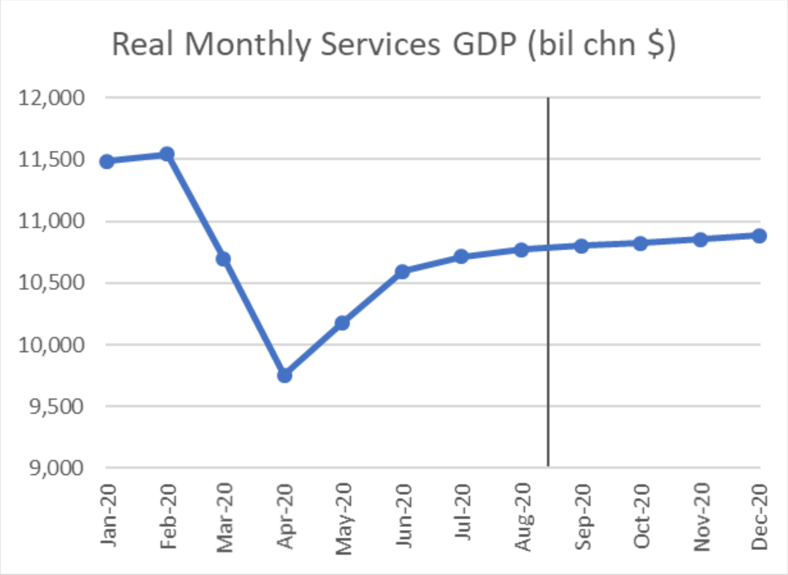


- The IHS Markit forecast for Y/Y real GDP growth is slightly above consensus in 2020, below consensus in 2021
- For 2020, the difference is entirely in Q3. IHS Markit is showing 33% (annualized) growth for the quarter, Blue Chip showing 29%
- Y/Y growth can be misleading. For 2021, measured Q4/Q4, the IHS Markit forecast (2.8%) is a percentage point below the consensus forecast (3.8%). We see a harder slog after a quick bounce.
- But, both IHS Markit and the consensus see GDP regaining its previous peak in 2021:Q4.
- Post-pandemic, IHS Markit expects a persistent loss of (potential) output, with risks to the downside
- Inflation and interest rates seem almost an afterthought
- Forecast depends crucially on fiscal assumptions…
- … and assumptions about the course of the pandemic

High frequency data: Q3 bounce, Q4 (and beyond) fade







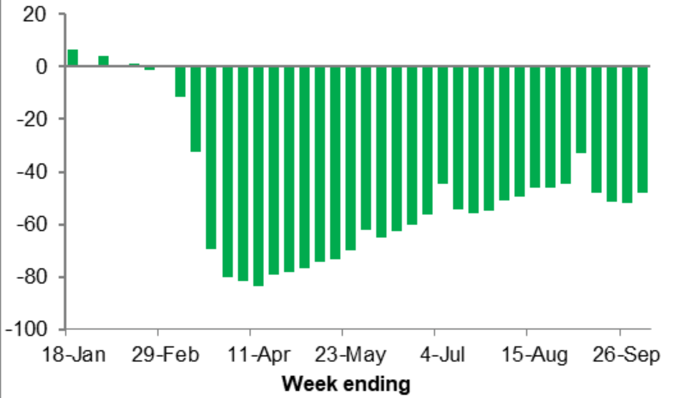
With 2 months of Q3 in the books, GDP is set to grow > 30%, but incremental slowing is setting up a much weaker Q4.

Monthly GDP-goods has already regained the pre-pandemic peak.

Monthly GDP-services has flattened out well below the pre-pandemic peak.

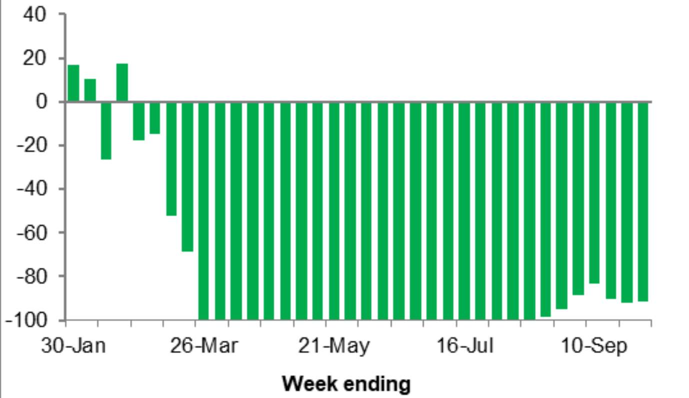
Fading growth in activity sensitive to social distancing

STR hotel data: revenue per available room
Percent change from comparable week, 2019



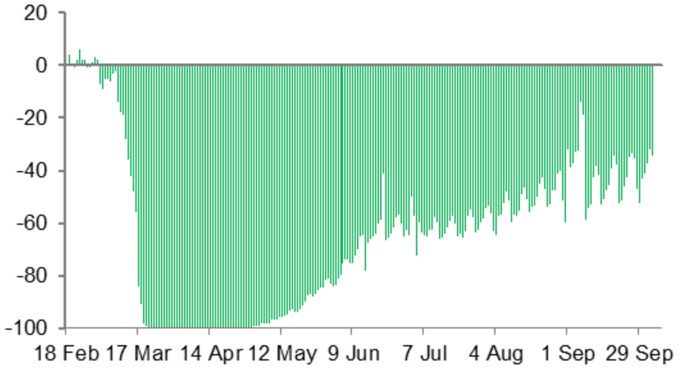
Source: STR © 2020 IHS Markit

Gross movie receipts
Percent change from comparable week, 2019



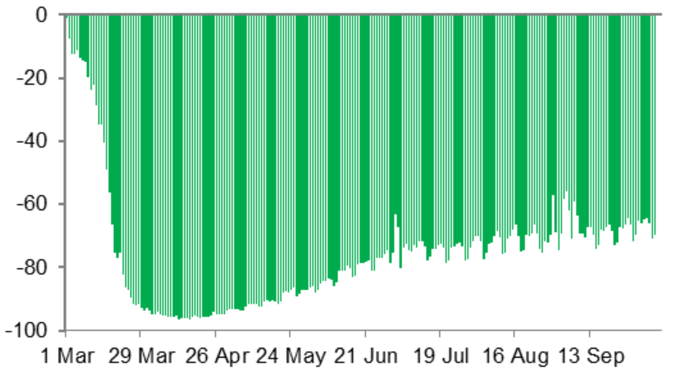
Source: Box Office Mojo © 2020 IHS Markit

Seated diners at US restaurants
Percent change from comparable day, 2019, daily data



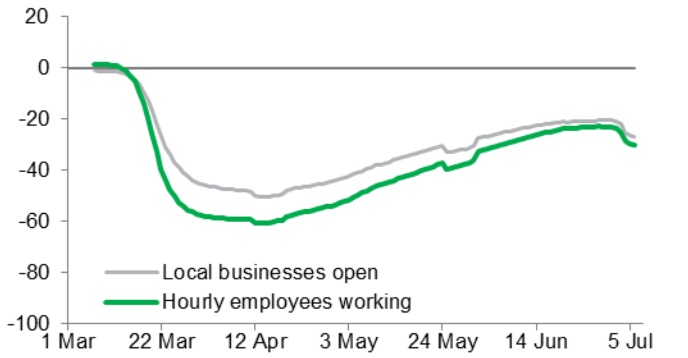
Notes: Seated diners at restaurants on the OpenTable network.
Source: OpenTable © 2020 IHS Markit

TSA checkpoint travel numbers
Percent change from one year ago, daily data



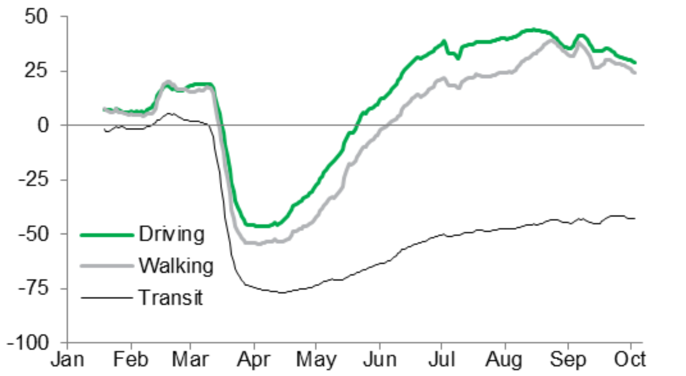
Notes: Total traveler throughput.
Source: Transportation Security Administration © 2020 IHS Markit

US local businesses & hourly employment
% difference from Jan 2020, 7-day average



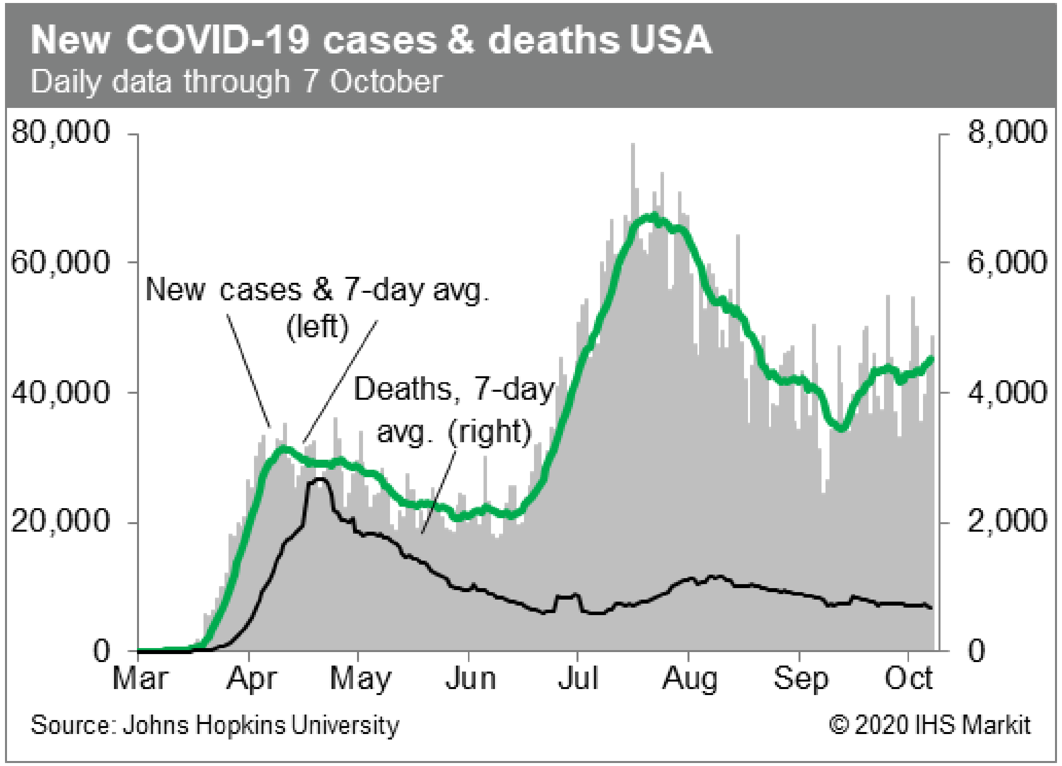
Notes: % difference is from median of comparable Jan weekday
Source: Homebase © 2020 IHS Markit

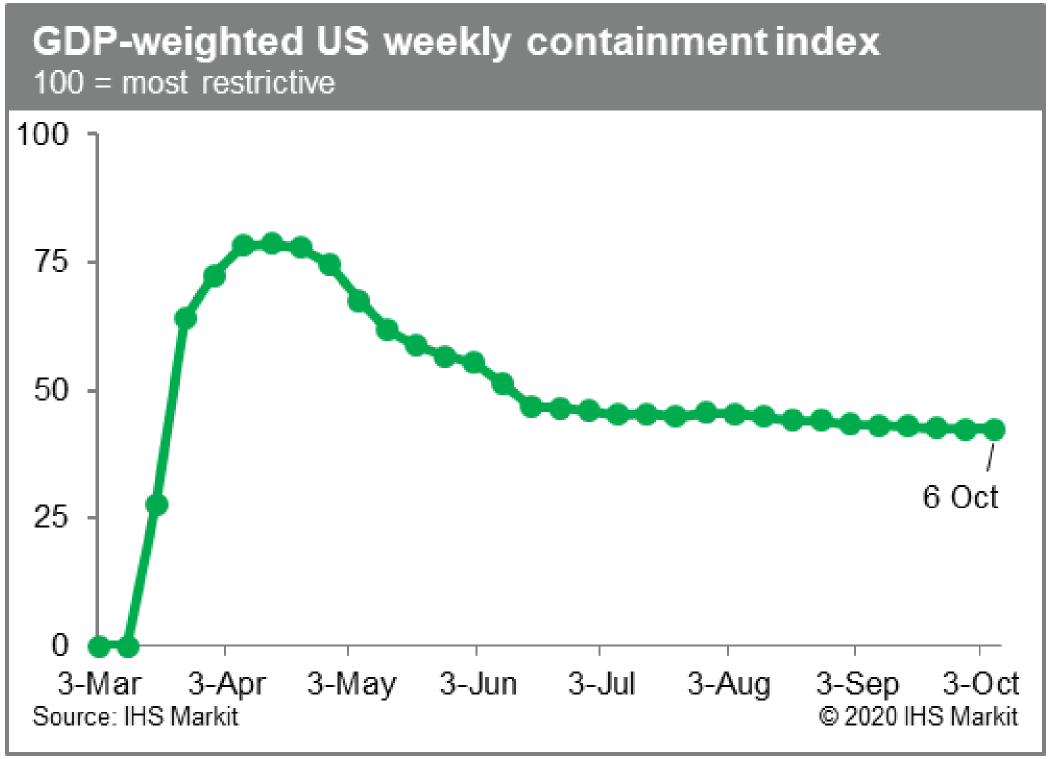
US volume of directions requests on Apple Maps
% difference from 13 Jan 2020, 7-day moving average



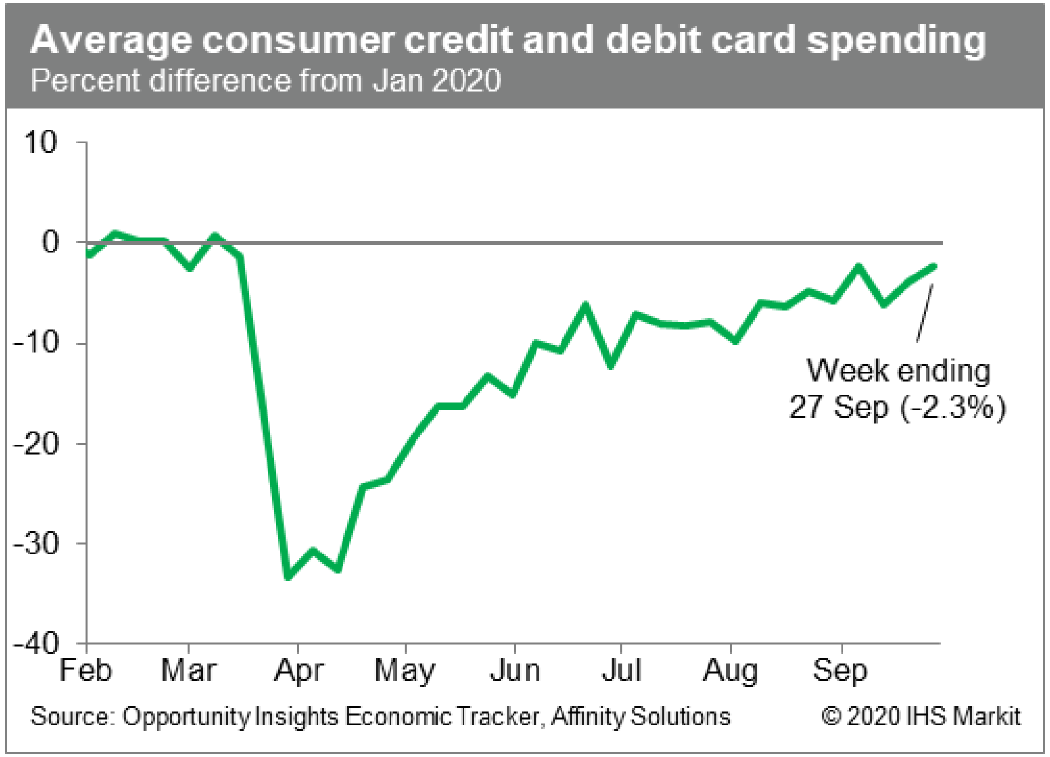
Source: Apple © 2020 IHS Markit

Behind the fade: the two "Cs": cases and containment…





Our empirical analysis suggest both cases and containment matter near term



Dependent Variable: D(AFFINITY)
Method: Panel Least Squares
Date: 10/12/20 Time: 08:52
Sample (adjusted): 2/16/2020 9/20/2020
Periods included: 32
Cross-sections included: 51
Total panel (balanced) observations: 1632

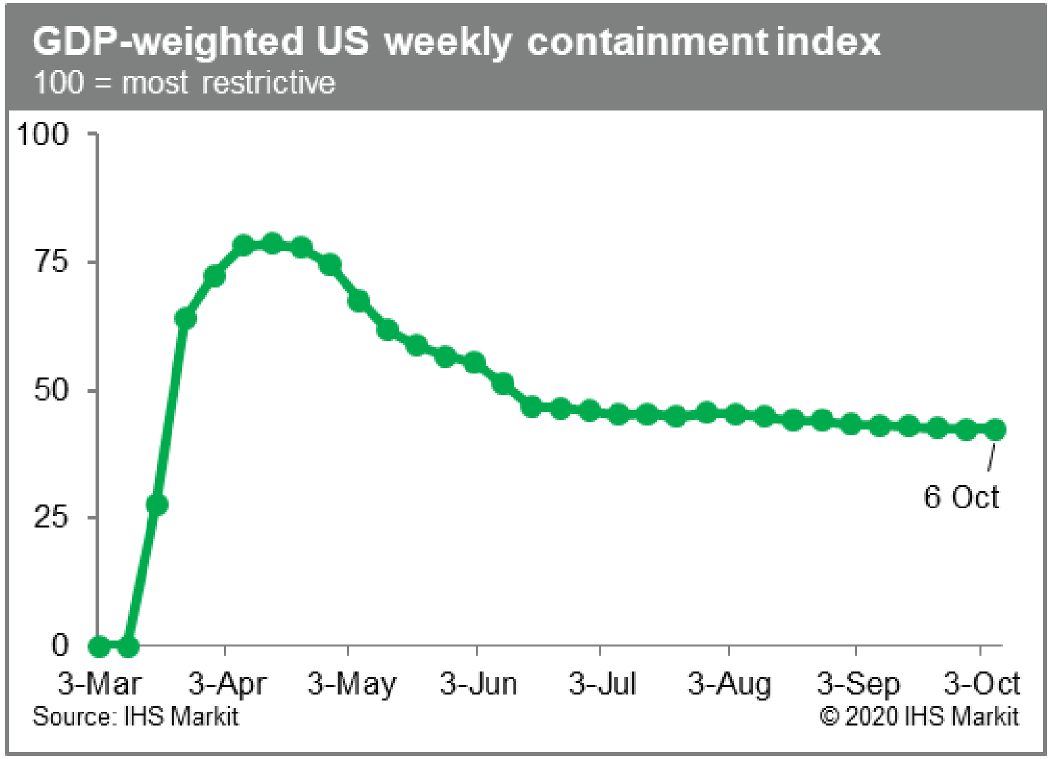
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.001343	0.000727	-1.848844	0.0647
D(CONTAINMENT)	-0.000179	9.74E-05	-1.832239	0.0671
D(CASES)	-0.000673	0.000244	-2.762679	0.0058
D(AFFINITY(-1))	-0.387225	0.022983	-16.84805	0.0000

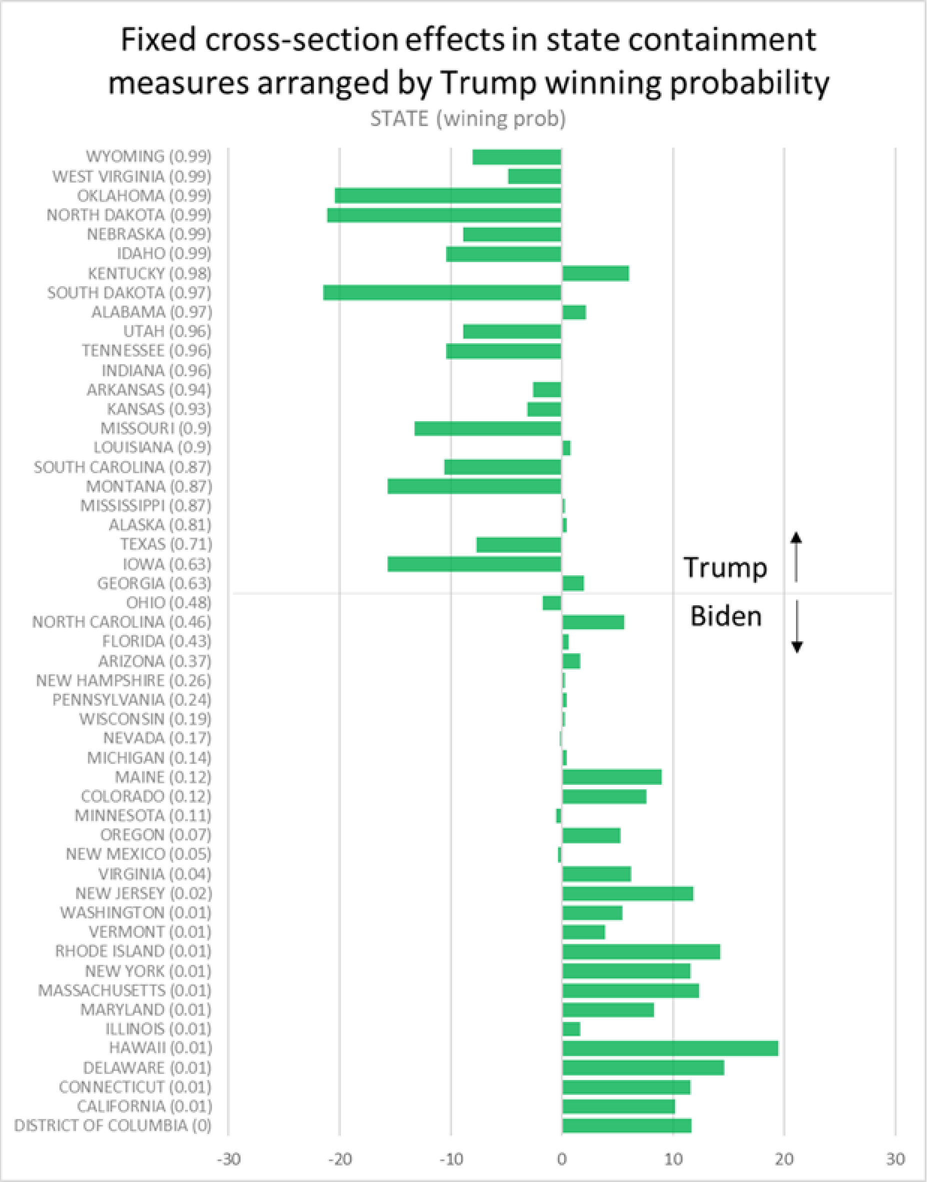
Effects Specification

Period fixed (dummy variables)

R-squared	0.775134	Mean dependent var	-0.001189
Adjusted R-squared	0.770347	S.D. dependent var	0.059689
S.E. of regression	0.028604	Akaike info criterio	-4.249326
Sum squared resid	1.306650	Schwarz criterion	-4.133569
Log likelihood	3502.450	Hannan-Quinn criter.	-4.206384
F-statistic	161.9124	Durbin-Watson stat	2.110896
Prob(F-statistic)	0.000000		

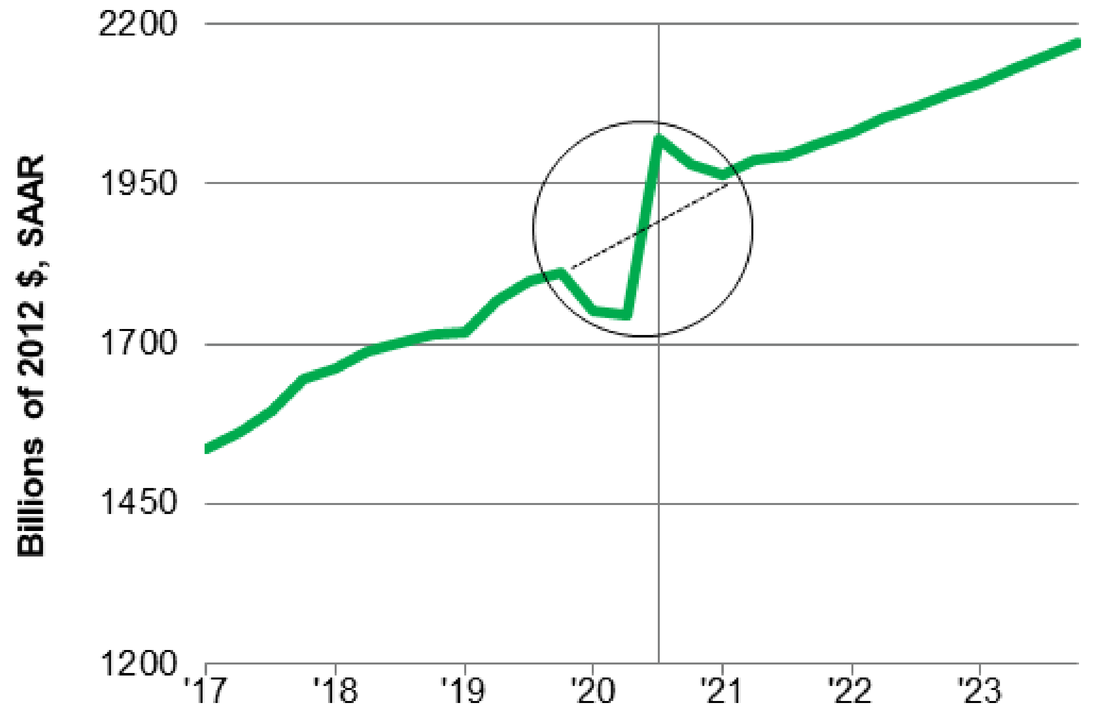
Containment has a clear political profile…





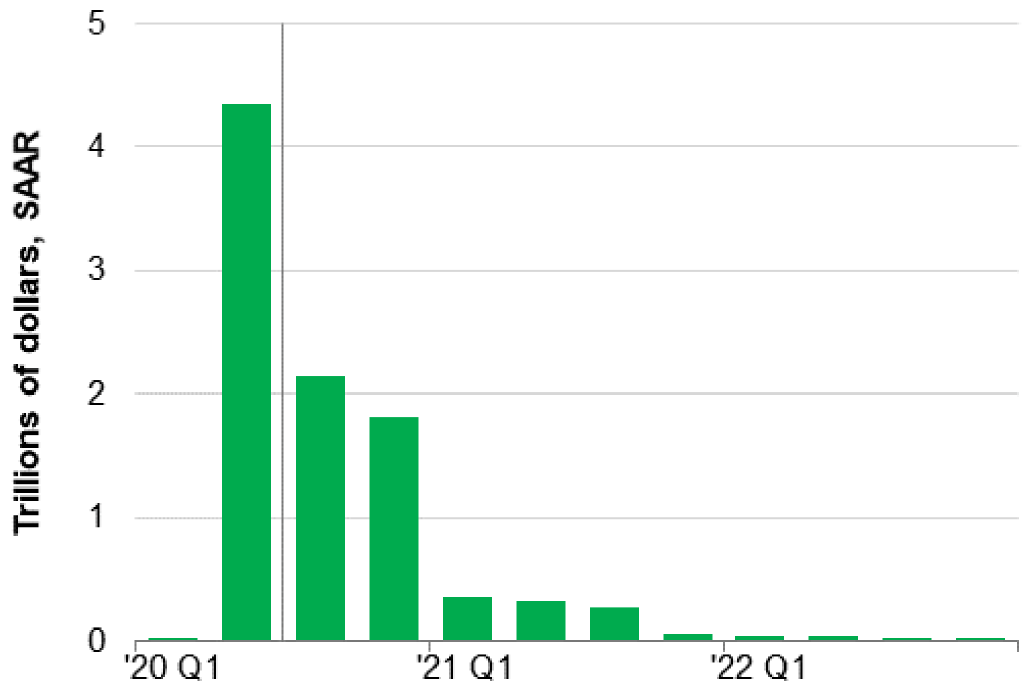
Behind the fade: overshoots and waning fiscal policy support

Overshoot in PCE-durable goods to reverse in Q4



Source: IHS Markit

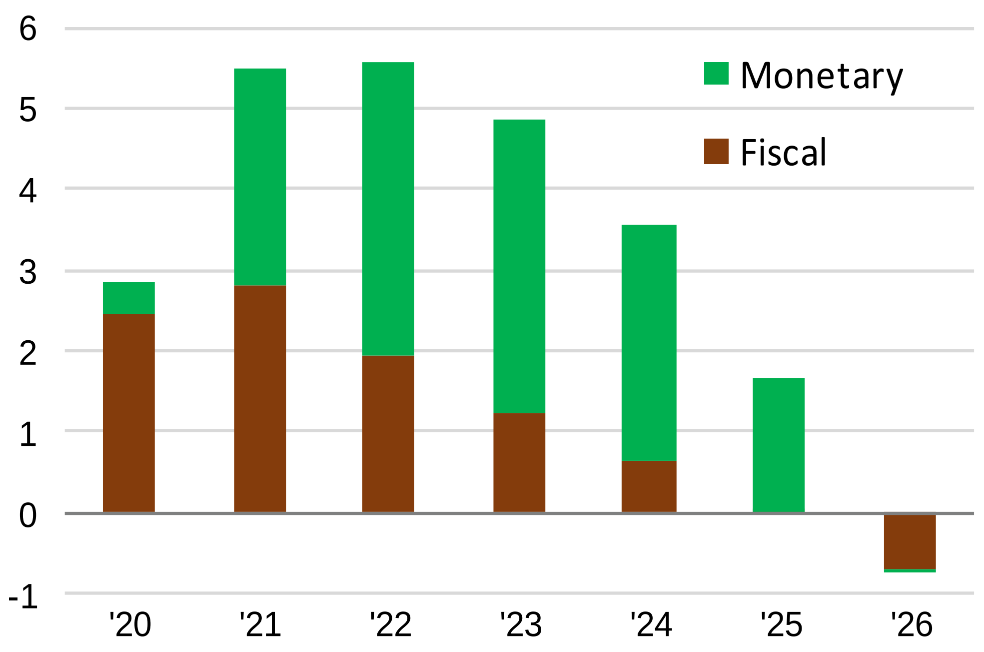
Income support from pandemic relief measures



Source: IHS Markit

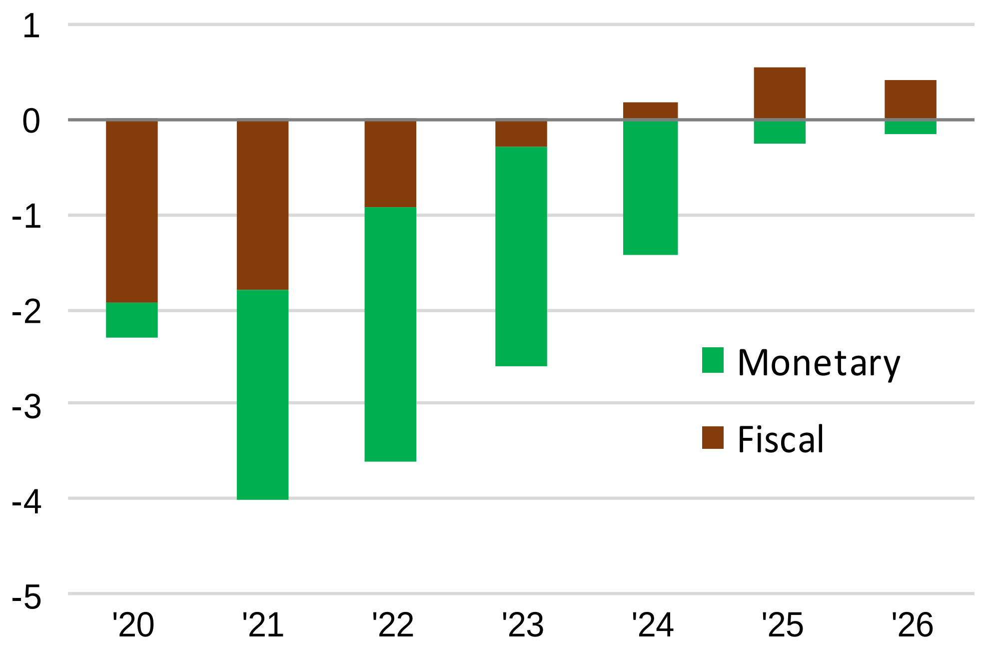
Unprecedented fiscal support of incomes to wane by next year

Effect of pandemic stimulus on real GDP
percent of base forecast level



Source: IHS Markit

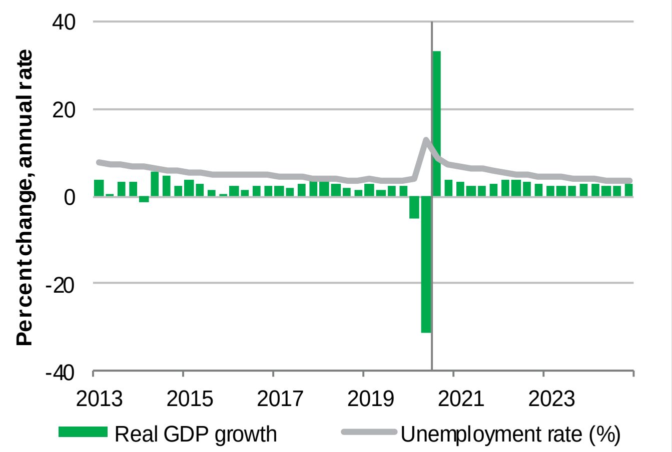
Effect of pandemic stimulus on unemployment
percentage points



Source: IHS Markit

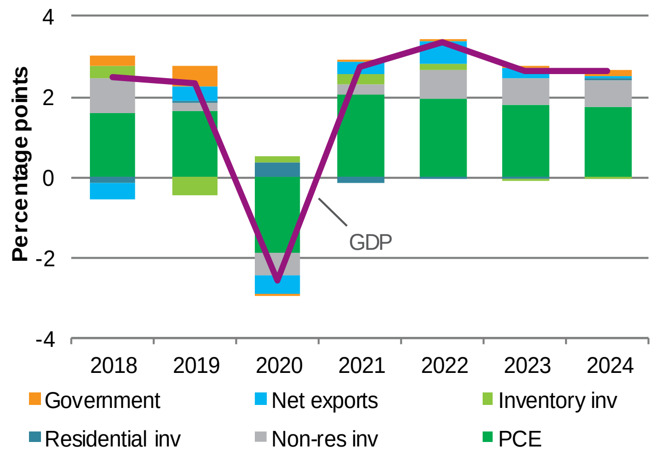
Forecast at a glance

Historic contraction in 2020 Q2



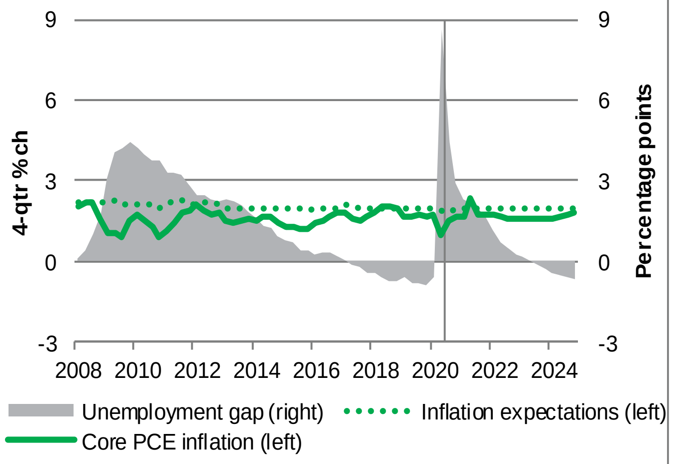
Source: IHS Markit, BEA, BLS © 2020 IHS Markit

Contributions to GDP growth (Q4/Q4)



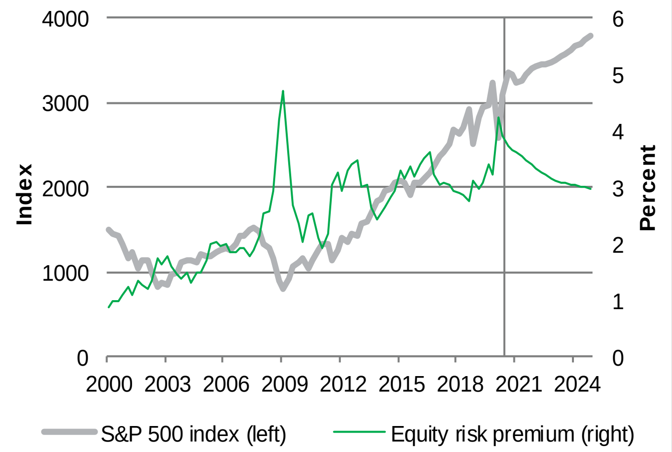
Source: IHS Markit, BEA © 2020 IHS Markit

Core inflation to remain below 2% through 2024



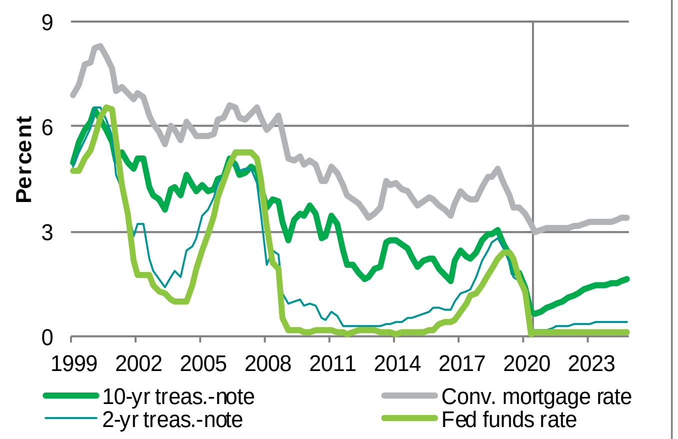
Source: IHS Markit, Philly Fed, BEA, BLS © 2020 IHS Markit

Equities to continue to rebound gradually



Source: IHS Markit, S&P © 2020 IHS Markit

Fed keeps funds rate pinned at 0 through 2026, term yields rise gradually



Source: IHS Markit, FRB © 2020 IHS Markit

Forecast overview

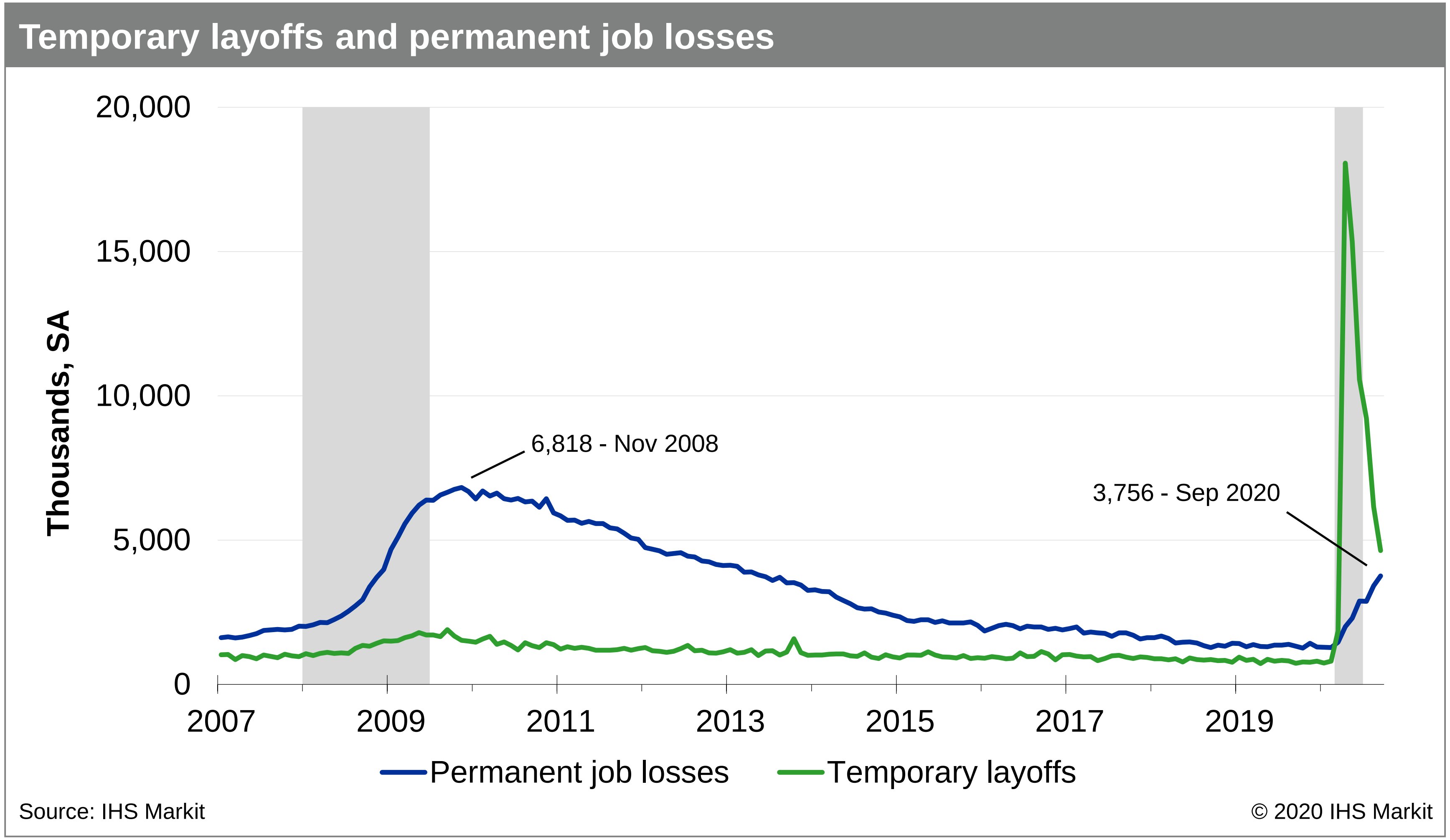
	2019	2020	2021	2022	2023	2024
Real GDP*	2.3	-2.6	2.8	3.4	2.6	2.6
		-3.6	3.5	3.5	2.6	2.5
Pvt Final Dom Dem*	2.3	-2.5	2.6	3.1	2.9	2.9
		-3.6	3.1	3.2	2.8	2.6
Unemployment Rate**	3.5	7.3	6.0	4.6	4.1	3.6
		7.7	6.0	4.6	4.0	3.6
Core PCE Inflation*	1.6	1.7	1.7	1.6	1.6	1.8
		1.2	1.8	1.6	1.7	1.8

* Q4 to Q4 percent change, ** Q4 average

Note: Prior base forecast values (published 3 March) shown below each line.

Source: IHS Markit © 2020 IHS Markit

Permanent job losses are accumulating



Late October update: Stimulus probability down, but not out

- We still maintain the baseline assumption that there will be a deal for additional fiscal stimulus, it just might happen after the November election.
  - > Checks to households and supplemental UI benefits would arrive in time for holiday shopping
  - > Trump win likely result in stimulus
  - > Democratic win ironically lowers chances of stimulus in Q4 (Trump veto)

- What if politics prevent a deal?
  - > GDP growth would be 2-3% lower in Q4, mostly because of income and wealth effects on PCE
  - > Over the year, this would pull forward spending that otherwise would have occurred later, dampening out the overall impact
  - > IHS Markit will produce a “no stimulus” forecast by early November

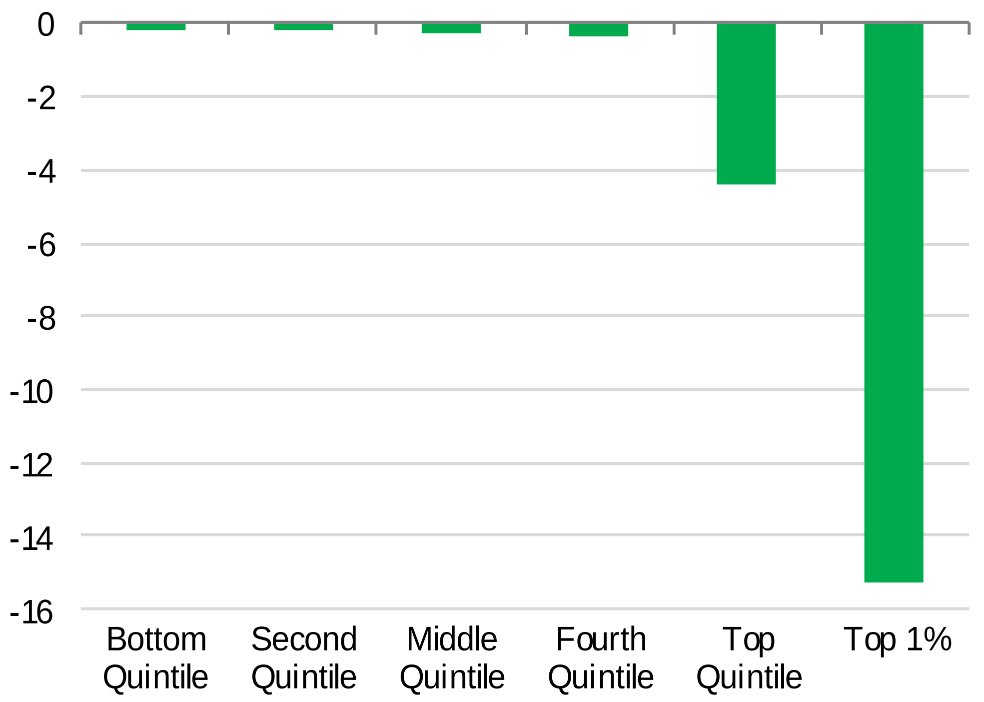
Biden tax proposals: 10-yr / $3.5 trillion progressive tax increases

Biden tax proposals: 10-yr / $3.5 trillion
Billions of dollars, fiscal years 2021-30

Provision	Amount
Raise corporate tax rate to 28%	$1,248
Increase Social Security earnings cap	$901
Gains taxed as ordinary income for incomes > $1 mil; no step-up in basis	$428
Cap itemized deductions (28% limit, Pease limitation)	$327
Double (to 21%) minimum tax on foreign subsidiaries	$311
15% minimum tax on book income with foreign tax credit	$218
Phase out small business income deduction > $400,000	$209
Restore top individual rate to 39.6%	$137
Financial risk fee on large banks	$100
All other	$38
Increase child and dependent care tax credits	$100
First-time homebuyers & renters' tax credits	$300
Total	**$3,517**

Source: IHS Markit, CRFB

Biden tax proprosal: change in after-tax inome (%)



Source: IHS Markit
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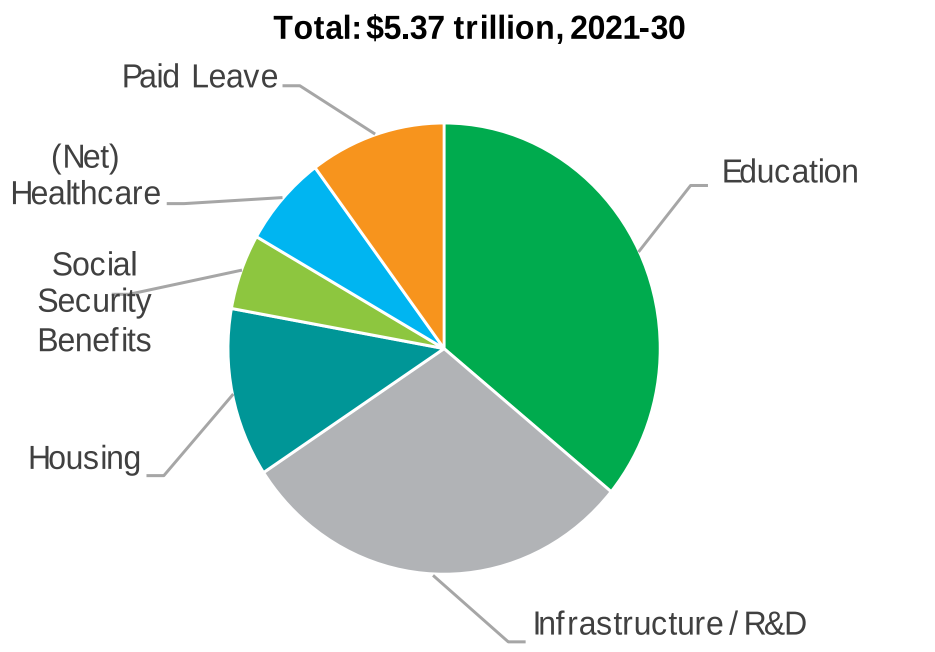
Biden spending proposals: 10-yr / $5.4 trillion of investments

Biden spending proposals: 10-yr / $5.4 trillion
Billions of dollars, fiscal years 2021-30

Category	Amount
Education	$1,930
Infrastrucutre and R&D	$1,601
Housing	$650
Social Security benefits	$291
Net healthcare	$352
Prescription Drugs	$1,253
Other new spending	$1,605
Paid leave	$547
Total	**$5,370**

Source: IHS Markit, PWBM

Biden spending proposals



Source: IHS Markit, BEA
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Initial thoughts on macro impact of Biden fiscal agenda

- Keynesian stimulus to aggregate demand: could be pretty big!
  - > $5.4 tril spending, $3.5 tril taxes ➔ $190 bil/yr higher primary deficit over 2021-30 = ¾% of GDP
  - > "Balanced budget multiplier" of 1 on first $3.5 tril of tax-financed spending, plus multiplier of 1.5 on extra $1.9 tril of debt-financed spending = $635 bil/yr on aggregate demand = 2.5% of GDP!
  - > Staggered implementation: spending first, taxes later ➔ front-loaded stimulus
- Disincentives of higher marginal rates: ~ -0.6% long-run impact on level of GDP
- Long-run impacts on potential GDP
  - > Negatives: tax disincentives; higher deficits
  - > Positives: public investments; demand creates supply ➔ more private investment
- Other considerations
  - > "Sustainable" GDP
  - > Income distribution