The US economic outlook: bounce, fade, slog

FTA Webinar
13 October 2020

Joel Prakken, Chief US Economist
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 2020: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

**Gross movie receipts**
Percent change from comparable week, 2019

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

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

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

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

Source: STR © 2020 IHS Markit
Source: Box Office Mojo © 2020 IHS Markit
Notes: Seated diners at restaurants on the OpenTable network. Source: OpenTable © 2020 IHS Markit
Source: Transportation Security Administration © 2020 IHS Markit
Notes: % difference is from median of comparable Jan weekday Source: Homebase © 2020 IHS Markit
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

### Average consumer credit and debit card spending

Percent difference from Jan 2020

- **Week ending 27 Sep (-2.3%)**

Source: Opportunity Insights Economic Tracker, Affinity Solutions © 2020 IHS Markit

### Regression Analysis

**Dependent Variable:** D(AFFINITY)

**Method:** Panel Least Squares

**Date:** 10/12/20  **Time:** 09:15

**Sample (adjusted):** 2/16/2020 9/20/2020

**Periods included:** 32

**Cross-sections included:** 51

**Total panel (balanced) observations:** 1,632

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Std. Error</th>
<th>t-Statistic</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>C</td>
<td>-0.001343</td>
<td>0.000727</td>
<td>-1.848844</td>
<td>0.0647</td>
</tr>
<tr>
<td>D(CONTAINMENT)</td>
<td>-0.000179</td>
<td>0.000305</td>
<td>-0.582428</td>
<td>0.5616</td>
</tr>
<tr>
<td>D(CASES)</td>
<td>-0.000613</td>
<td>0.0000244</td>
<td>-2.762679</td>
<td>0.0058</td>
</tr>
<tr>
<td>D(AFFINITY(-1))</td>
<td>-0.307229</td>
<td>0.022983</td>
<td>-13.98085</td>
<td>0.0000</td>
</tr>
</tbody>
</table>

**Effects Specification**

**Period fixed (dummy variables)**

- E-squared: 0.775134
- Adjusted R-squared: 0.770347
- S.E. of regression: 0.028604
- Sum squared resid: 1.306650
- Log likelihood: 3502.450
- F-statistic: 161.9124
- Prob(F-statistic): 0.000000
- Mean dependent var: -0.001189
- S.D. dependent var: 0.059609
- Akaike info criterion: 4.249326
- Schwarz criterion: 4.133509
- Hannan-Quinn criter: 4.206384
- Durbin-Watson stat: 2.110896
Containment has a clear political profile…

GDP-weighted US weekly containment index
100 = most restrictive

Source: IHS Markit
© 2020 IHS Markit

Fixed cross-section effects in state containment measures arranged by Trump winning probability

STATE (winning prob)

Trump
Biden
Behind the fade: overshoots and waning fiscal policy support (under current law)

Overshoot in PCE-durable goods to reverse in Q4

Source: IHS Markit  © 2020 IHS Markit

Income support from pandemic relief measures

Source: IHS Markit  © 2020 IHS Markit
Forecast at a glance

Historic contraction in 2020 Q2

Contributions to GDP growth (Q4/Q4)

Core inflation to remain below 2% through 2024

Equities to continue to rebound gradually

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

Forecast overview

* Q4 to Q4 percent change, ** Q4 average
Note: Prior base forecast values (published 3 March) shown below each line.

Equities
- S&P 500 index (left)
- Equity risk premium (right)

Real GDP**  
2019 2020 2021 2022 2023 2024
-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*  
2019 2020 2021 2022 2023 2024
2.3 -2.5 2.6 3.1 2.9 2.9
-3.6 3.1 3.2 2.8 2.6

Unemployment Rate**  
2019 2020 2021 2022 2023 2024
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*  
2019 2020 2021 2022 2023 2024
1.6 1.7 1.7 1.6 1.6 1.8
1.2 1.8 1.6 1.7 1.8
Unprecedented fiscal support of incomes to wane by next year

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

- '20: Monetary 3%, Fiscal 2%
- '21: Monetary 5%, Fiscal 3%
- '22: Monetary 6%, Fiscal 4%
- '23: Monetary 3%, Fiscal 1%
- '24: Monetary 2%, Fiscal 1%
- '25: Monetary 1%

**Effect of pandemic stimulus on unemployment**
percentage points

- '20: Monetary 0, Fiscal 1
- '21: Monetary 0, Fiscal 1
- '22: Monetary 0, Fiscal 1
- '23: Monetary 0, Fiscal 1
- '24: Monetary 0, Fiscal 1
- '25: Monetary 0, Fiscal 1
- '26: Monetary 0, Fiscal 1

Source: IHS Markit © 2020 IHS Markit
Biden tax proposals: 10-yr / $3.5 trillion progressive tax increases

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

Source: IHS Markit, CRFB

Biden tax proposal: change in after-tax income (%)
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

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Education</td>
<td>$1,930</td>
</tr>
<tr>
<td>Infrastructure and R&amp;D</td>
<td>$1,601</td>
</tr>
<tr>
<td>Housing</td>
<td>$650</td>
</tr>
<tr>
<td>Social Security benefits</td>
<td>$291</td>
</tr>
<tr>
<td>Net healthcare</td>
<td>$352</td>
</tr>
<tr>
<td>Prescription Drugs</td>
<td>$1,253</td>
</tr>
<tr>
<td>Other new spending</td>
<td>$1,605</td>
</tr>
<tr>
<td>Paid leave</td>
<td>$547</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$5,370</strong></td>
</tr>
</tbody>
</table>

Source: IHS Markit, PWBM

### Biden spending proposals

Total: $5.37 trillion, 2021-30

- Education
- Infrastructure / R&D
- Social Security Benefits
- Healthcare
- Paid Leave
- Housing

Source: IHS Markit, BEA © 2020 IHS Markit
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