Grant Thornton

ECONOMIC CURRENTS

OCTOBER 22, 2020

All or Nothing: Fiscal Stimulus Edition

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The back and forth between the White House, the House of Representatives and the Senate on the current round of stimulus talks is dizzying. It has made me nauseous, given what is at stake: hunger, evictions and the risk of yet another retrenchment in the overall economy.

Much of what was left of the aid provided by the CARES Act, whether for businesses or households, has been liquidated. Millions of people remain unemployed, despite what will easily be a record pace of growth in the third quarter. Permanent business closures and bankruptcies are accelerating.

A resurgence in COVID-19 cases threatens yet another pullback in spending. Epidemiologists, including doctors at the Centers for Disease Control and Prevention (CDC), have been warning for months that the surge this fall could be the worst of the crisis. Barring a major shift in behavior to mask and distance, those scenarios will be realized.

Most states are expected to limit lockdowns relative to the first round but that won't prevent economic losses. Baby boomers, who account for about one third of consumer spending, have proven to be among the most skittish when it comes to spending amidst a surge in the pace of infections. They avoid restaurants and bars, cancel travel plans and, sadly, preventive doctor appointments, which has led to a jump in deaths that are not directly tied to COVID. The toll on holiday celebrations will be palpable.

Europe is ahead of us, with the second wave already taking a toll on economic activity. This will deal another blow to U.S. exports and crimp manufacturing activity at a time most factories are still operating well below the level they hit prior to the crisis. (See Chart 1.)

This special edition of ***Economic Currents*** compares the outlook for the economy, with and without another stimulus package. Chart 2 shows the differences between the two extremes; they are stark. With additional aid from Washington, the economy gets back to its previous peak in mid-2021, a year and a half sooner than if we do nothing. That forecast may be too optimistic. The losses that we will suffer during the third wave of infections will be nonlinear; they will compound over time. What was a recession triggered by a health crisis could morph into a financial crisis, from which it would take even longer to recover. The losses in commercial real estate are already large and mounting at home and abroad.

Scenario 1: $1.9 Trillion in Stimulus

Treasury Secretary Steven Mnuchin and House Speaker Nancy Pelosi are currently closing in on a $1.9 trillion stimulus plan - $1.5 trillion in new funding added to about $400 billion in previously appropriated funds. It includes more generous checks for families, smaller supplements to unemployment insurance ($400 instead of $600 per week), funds for a national testing and tracking program, aid for schools and hospitals, transfers to the states and some targeted aid for small businesses.

Speaker Pelosi has said the negotiations may take until after the election to finalize. That would further complicate its chances, depending upon who wins the election. Our own in-house policy expert, Robert Shea, is optimistic that a deal in some form can be done prior to the election. The prospects thereafter are nil.

The aid is expected to blunt but not stop the slowdown in the fourth and first quarters, while it sets the stage for a more robust rebound once the crisis abates - after a vaccine and therapeutics become more widely available. The level of economic activity will return to its previous peak in 2021 and then accelerate as the pent-up demand is unleashed.

Those who have money will continue to purchase big-ticket items such as homes - there are bidding wars on houses, sight unseen - vehicles, appliances, furniture, repairs and upgrades to homes. Some of the strength we saw in spending in September and early October reflects the push to prepare for a hard winter.

Those who don't have a lot of extra cash will be able to once again pay for groceries and cover their rent. Stimulus checks will be used to pay for outstanding bills and keep millions of households from starvation and homelessness.

The funding for testing, tracking and therapeutics will not come soon enough to dramatically mitigate the pending surge this fall. But it could help us to manage the spread of the virus along with the availability of a vaccine.

The economy will not be able to fully reopen until a vaccine becomes available and concerns about its safety are alleviated. Both Democrats and Republicans worry that politics will trump safety when it comes to getting a vaccine to market. Only time and a proven track record on the vaccine will get more people to take it.

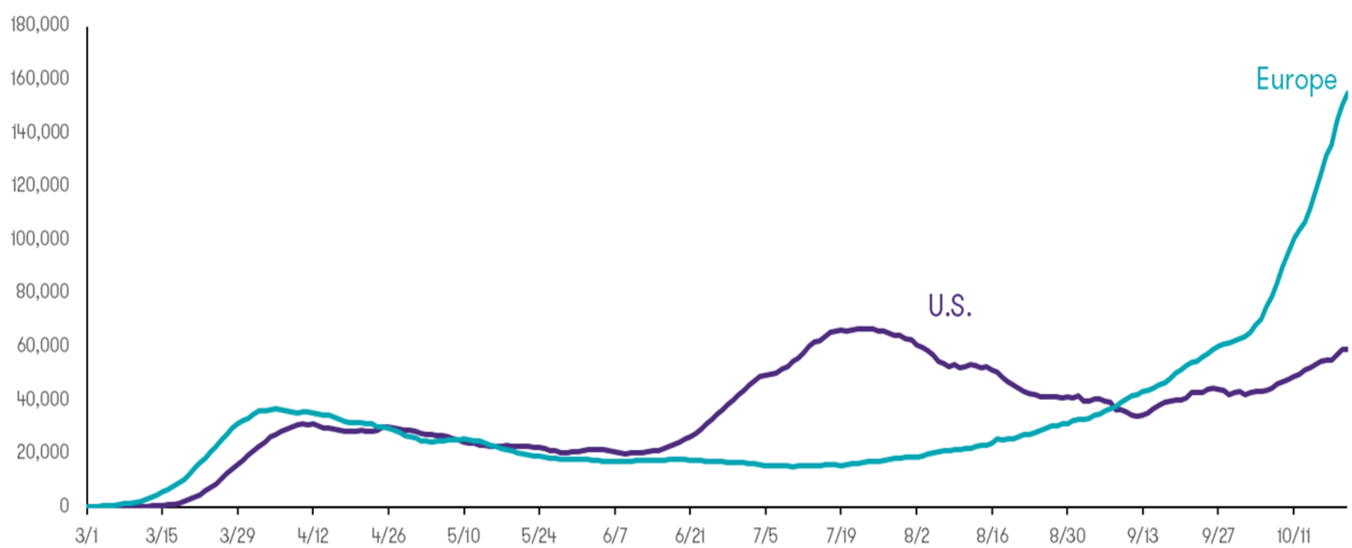
Concerns about how long we remain immune to the disease once we are vaccinated suggest that a full-scale reopening could be more labored than many would like. That is why efforts to stay ahead of testing, tracking and treating the disease are likely to become a part of any new normal.

Employment will take longer to reach its precrisis peak. With stimulus, we could get there by 2023, or a little more than three years after the economy cratered. That is a much faster rebound in employment than we saw in the wake of the 2008-09 recession when austerity overshadowed the need for more stimulus. We should be able to learn from past mistakes.

Chart 1

Second Surge Likely to be Worst Yet

Number of New Daily Cases, 7-Day Moving Average



Source: Johns Hopkins University, European Centre for Disease Prevention and Control (ECDC) 2020

Longer term, we will need to address the shadow that COVID casts. Children who lost schooling will need summer programs to make up for lost time. Community colleges will have to be leveraged to retrain low-wage workers. Gaps in our health care system will need to be filled to deal with the emerging, long-term consequences of COVID. We will need to invest much more aggressively in childcare and programs for young adults; the payoffs have proven to be greater than the costs.

Debt and deficits will need to be dealt with to ensure a more sustainable fiscal path. Growth alone will not cure those problems but can alleviate them over time. Best-case scenarios use COVID as a catalyst for reforms that make growth more equitable, which would unleash more rapid overall growth. I hope we learn something from the inequalities revealed and exacerbated by COVID.

Scenario 2: Nothing

The second scenario assumes that our elected officials fail to pass much-needed aid in the Senate, where the hurdles to enactment prior to the election are greater. It is unclear we will get anything until the next president is sworn in. Under such a scenario, that would be late January or early February, an eternity for households that are already running on fumes.

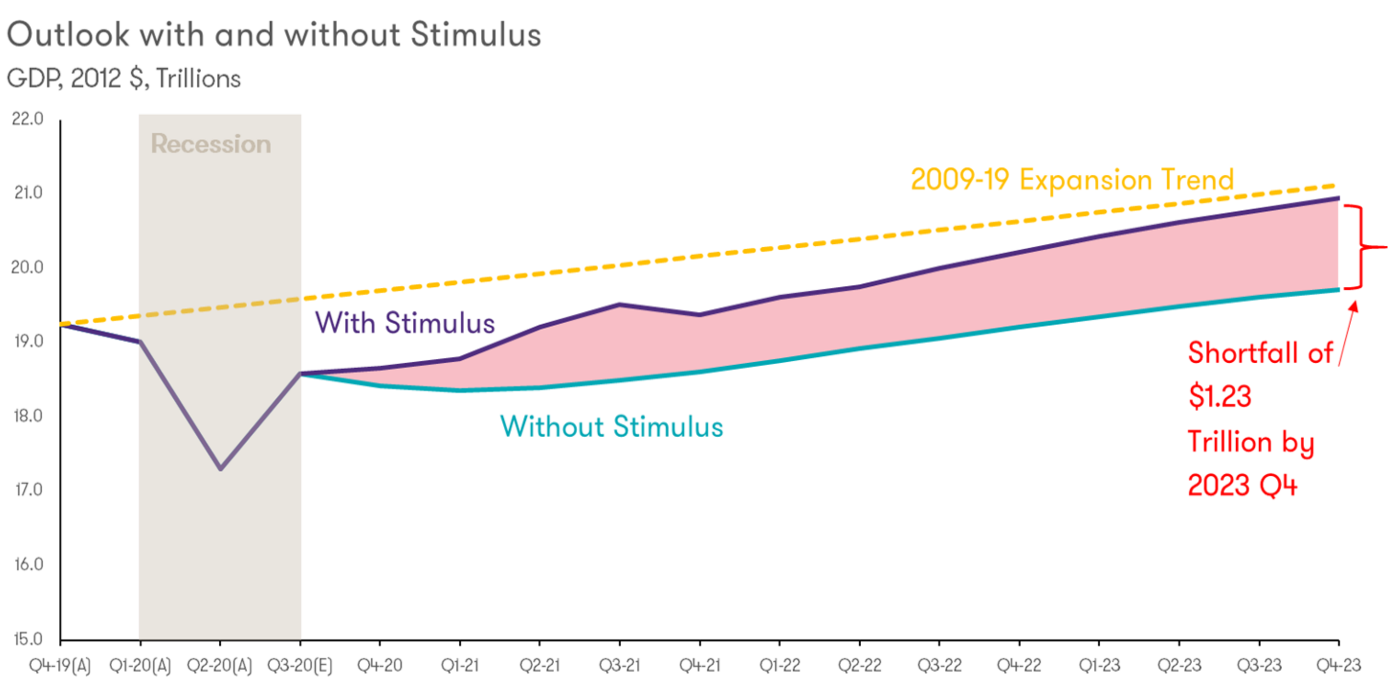
Much depends on the outcome of the election and whether a lame-duck Senate will do anything. My colleague Robert Shea says that the probability of a post-election deal is low.

Even then, the composition of the Senate will matter. Many who resisted additional stimulus today are likely to remain reluctant to do more in 2021, although risks to the outlook with no stimulus are to the downside. Hunger and homelessness will rise if we do nothing, which hurts us all and increases the threat that the recession could metastasize into a more traditional recession or worse, a full-blown financial crisis. That would diminish our financial architecture and leave much deeper cracks in the foundation.

Our analysis shows the repercussions of a third wave or "second surge" as many epidemiologists are calling it. Europe is already moving into it. We are not far behind. As of the writing of this report, cases and hospitalizations were rising in all but two states in the country.

We have consumers and firms pulling back without stringent lockdowns. Most states and localities would like to avoid the draconian measures that failed to keep infections in the U.S. under control last spring.

Chart 2



Source: BEA, Grant Thornton LLP

“Hunger and homelessness will rise if we do nothing”

That said, we can’t rule out measures that limit mobility, given the threat that the next surge poses to our health system. Some cities are again setting up makeshift hospitals in stadiums and convention halls to deal with the jump in cases. Staffing is also a problem, as many medical personnel are burned out and are having a hard time caring for children still at home.

Europeans hoped to avoid lockdowns as well but some have since acquiesced, given the sheer volume of illness they are now seeing. Shutdowns are being implemented with record cases across the continent. Ireland has imposed the most aggressive measures, shutting down for six weeks to contain the spread of the virus. More limited curfews and lockdowns are unfolding in France, Spain and the UK.

This is going to exacerbate the toll that a surge in the virus takes on the U.S. economy. Exports are expected to slow or worse after rebounding over the summer and in October. Supply chain disruptions could exacerbate those problems, although so far Asia - where supply chains are the most vulnerable - has used masks and testing to more effectively manage outbreaks and keep factories running. The manufacturing exodus that many predicted from China has not occurred, despite its role in the spread at the start of the pandemic.

The overall U.S. economy doesn’t reach its previous peak until early 2023. The level of economic activity remains more than $1.2 trillion short of the pace we would see with stimulus by the end of 2023. Employment won’t fully recover until well into 2024.

Worse yet, risks are to the downside with much deeper scarring of the labor market and the financial system. Long-term unemployment, which is already rising, takes a toll on physical and mental health and erodes skills. Those losses, combined with increased bankruptcies, business closures and widespread consolidation, could reduce growth potential for years to come.

Frankly, I have a hard time thinking about how bad things could get if the federal government does nothing. The reality of losses will intensify the political pressure on our elected officials to act. The only question is when, and that matters. The prospect of waiting until January or February looks like an eternity if you can’t feed your family for a week now.

The Fed Intervenes

The Federal Reserve will not stand idly by. It could work with the Treasury to further ease conditions in the Main Street lending program. This would unleash hundreds of billions in loans for small and mid-sized firms and help for nonprofits to stay afloat during the worst of the crisis. It could also buy longer-term municipal bonds to provide state and local governments a longer runway before they have to cut budgets more aggressively.

The Fed has discussed yield curve controls, which would help finance the costs of more spending by the government. That is where the largest bang for the buck can be found. The multipliers on government spending rise when monetary and fiscal policy are in sync.

Why not just let the Fed fix it? Because the Fed is still limited to lending, not spending; members are not elected officials. Pushing more of the burden onto central bankers blurs the line with fiscal policy and undermines the Fed’s ability to act independently in the future. There will come a day when the Fed needs to take the punch bowl away from the party. That is an economy we can only hope for.

Bottom Line

The consensus among economists for additional stimulus is extremely high. That is not surprising. We are all looking at a similar set of scenarios, some markedly worse given the downside risks of the recession morphing into a financial crisis as well as the health crisis. The debt we would take on to cure the problem is less than the human misery and the shortfall in growth would be if we do nothing. Congress: Get the details ironed out and act. It shouldn’t be this hard.