

James Knightley: Why I am getting nervous

There's a threefold threat to America's economic recovery, says ING's James Knightley in New York. And that's why he's getting increasingly worried



Re-opening triggered a rapid recovery

'We will come back strong!'. So said Donald Trump in a recent tweet. I'm not so sure. After last week's GDP number, we know that US economic output plunged 10.6% through the first half of the year – the worst downturn since the end of the Second World War.

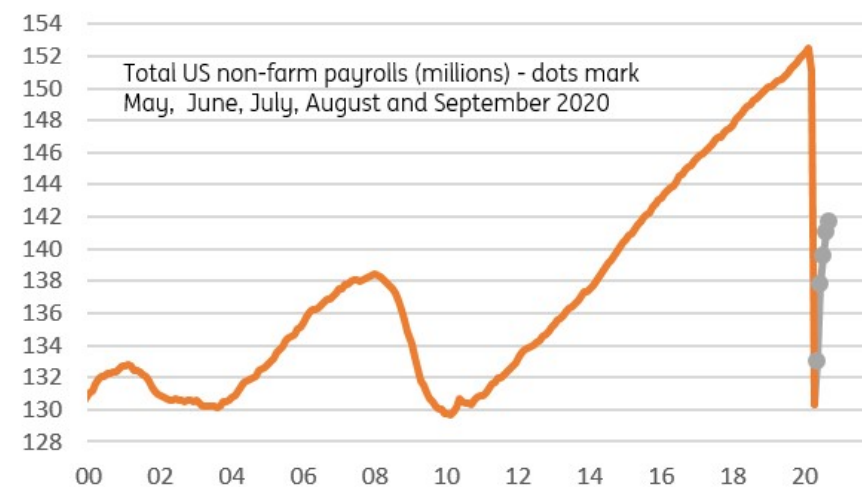
It's true: as containment measures were eased throughout May and June the economy has bounced back strongly, led by the US consumer. There was certainly plenty of pent-up demand as we escaped the confines of our homes, but substantial stimulus from both the Federal Reserve and the Federal government undoubtedly fueled the recovery story. On the monetary policy front, early and aggressive interest rate cuts, credit easing measures, liquidity injections and quantitative easing lowered borrowing costs, kept credit flowing and supported confidence and asset prices.

And on the fiscal side, we saw a \$2+ trillion support package for both households and businesses including \$1200 cheques and financial incentives for keeping staff on payrolls. Another key plank was the Federal government's decision to expand the number of people eligible to receive

unemployment benefits and then additionally boost weekly payments by \$600.

Given the scale of the economic hit, unemployment was surging and this was a key way to protect incomes and support consumer activity, which makes up nearly 70% of total economic output. In fact, it was such a generous scheme a [University of Chicago paper](#) estimated that 69% of benefit recipients were now earning more money than when they were working with the median uplift in incomes put at around a third. With upwards of 30 million people having received these additional payments we believe this has been critical to the recovery. Daily data from www.tracktherecovery.org based on daily debit and credit card transactions suggests it has been lower-income households that have led the recovery in consumer spending.

Spending breakdown by income



Source: www.tracktherecovery.org

It is higher-income households that are holding back, largely because they spend proportionately more on “experiences” such as eating out, going to the cinema or travelling, which people have been much less able or willing to do over the past few months.

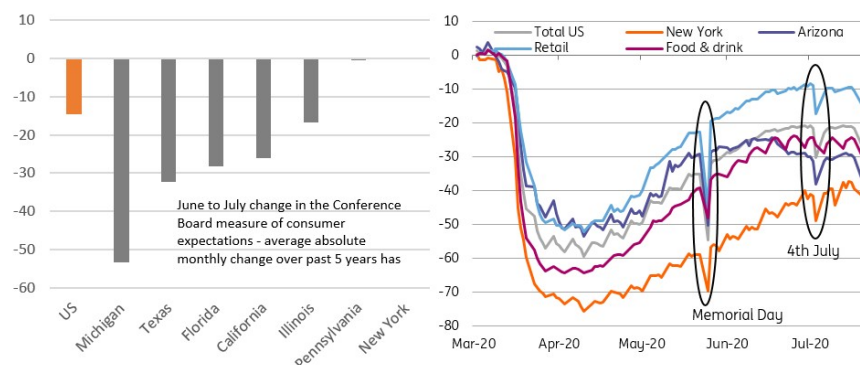
1 Covid 19: A halt to re-openings

However, there is now a threefold threat to this recovery. Firstly, Covid-19 is far from beaten with the recent spike in cases disrupting the economy once again. Fear of catching the virus is on the rise which is hurting confidence and leading many State Governors to reverse course on their re-opening plans as they worry about the potential strains on their healthcare systems if rising infection rates are left unchecked.

Given this experience we suggest governors will tread more carefully on a second wave of re-openings in coming months, particularly given the experiences of southern hemisphere nations, which are finding containing the virus is even more challenging once colder weather returns.

Renewed shutdowns take their toll on confidence and jobs

Homebase data for over 60,000 businesses and 1 million hourly employees active in the US in January 2020. All the rates compare employment that day vs. the median for that day of the week for the period Jan 4, 2020 – Jan 31, 2020.



Source: Bloomberg, Macrobond, ING

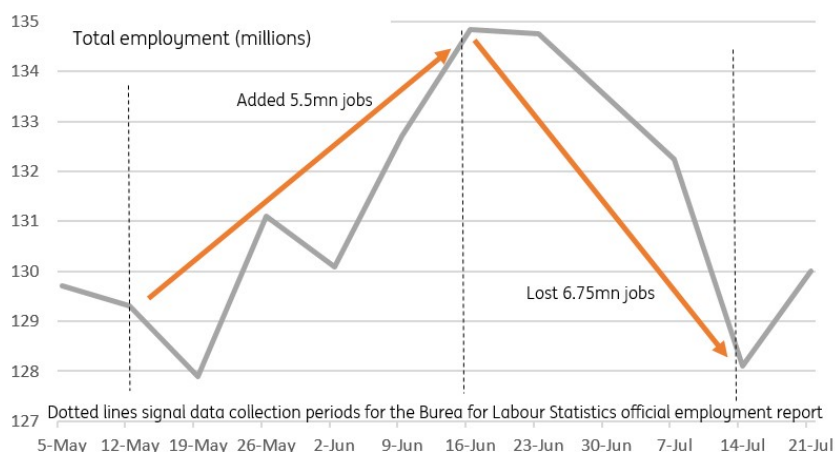
2 Jobs: the second big concern

The result is that businesses that had re-opened are being forced to close again with workers losing their jobs – the second major worry for the economic outlook. Data from Homebase, a payroll scheduling and tracking company, suggests employment in the small business sector has been falling through July. Meanwhile the Census Bureau has recently been publishing data from its new Household Pulse survey, which suggests that after 5.5 million job gains from mid-May to mid-June there were 6.75mn jobs lost between mid-June and mid-July.

Admittedly, both data series are new and we don't have enough history to comment on their long-run predictive accuracy, but even the ISM manufacturing and non-manufacturing employment component, which have decades of history, are indicating companies are shedding workers right now. At a minimum, it suggests there is downside risk to expectations for [Friday's non-farm payrolls](#) which has a consensus forecast of a 1.5 million gain in employment. We increasingly expect to see an outright fall in employment in August.

Employment has plunged lower again

Derived from experimental data produced by the Census Bureau. *"The new experimental Household Pulse Survey is designed to quickly and efficiently deploy data collected on how people's lives have been impacted by the COVID-19 pandemic"*. <https://www.census.gov/programs-surveys/household-pulse-survey/data.html>



Source: Census Bureau, ING

3 Stimulus: Talks are dragging on

Then, thirdly, the US\$600 a week unemployment benefit-boost given to 30 million or so claimants ended last week. Talks on another fiscal stimulus are dragging given the broad differences between the Republicans' proposed \$1 trillion stimulus and the Democrats' \$3.5 trillion plan. In all likelihood the \$600/week will be replaced with something much smaller in size – Republicans are talking of a transition period where it is cut to just \$200/week until systems are put in place when the benefit can be adjusted to maybe 60% or 70% of pre-Covid employment income.

Moreover, with only slow progress being made, we recognise the prospect that tens of millions of workers receive only the basic state benefits for a few weeks at a time when job opportunities have been severely restricted by the return of Covid containment measures.

So, with virus fears on the rise, jobs being lost and incomes squeezed, we feel the second phase of the recovery will be much more challenging. We should be braced for weaker employment and spending numbers in the absence of a new broad and substantial fiscal package. This suggests financial market optimism on a “V”-shaped rebound could be severely tested over the next couple of months.

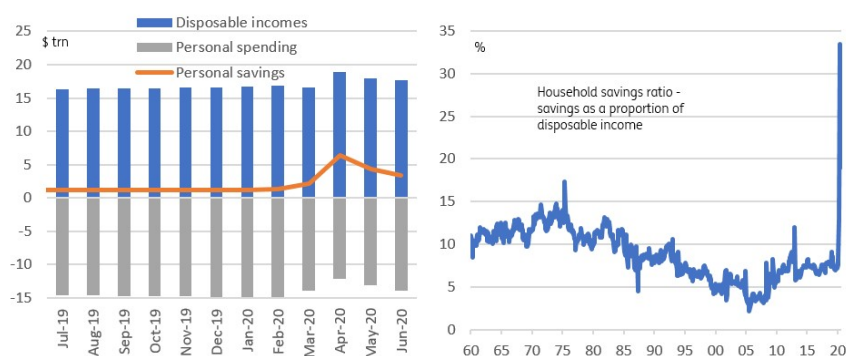
The potential upside

We acknowledge that there is optimism about a vaccine and that could be a game-changer, but its timing and efficacy are unknown. Moreover, implementing a plan to get the world inoculated could take many months meaning restrictions of movement and behaviour remain in place well into 2021 even if a vaccine is found this year.

Nonetheless, an announcement on a vaccine would undoubtedly boost consumer and business sentiment and be a trigger for new highs in stock prices. It would also likely

incentivise the restart of corporate investment plans that had been put on hold and could prompt preparatory hiring, particularly in travel and hospitality, as businesses see the light at the end of the tunnel.

Savings boosted by unemployment benefit income and lower spending



Source: Macrobond, ING

✓ A consumer spending buffer

Many analysts have also noted that the household savings ratio has surged and this creates a buffer that can be drawn on to keep consumer spending robust until we get to the point of a vaccination program. However, our caution regarding this assessment centres on where the savings are located. In the absence of such specific data, we surmise it is concentrated in middle and higher-income households that are involuntarily saving given they are effectively prevented from spending to the degree that they normally would on entertainment, travel and hospitality services.

Unemployed and lower-income households, which appear to have led the recovery in consumer spending, may have saved a few hundred dollars from the extra \$600/week, but financial fears for the future mean they will be more cautious as unemployment benefits are scaled back. Further protection against foreclosure and eviction in addition to an extension of a generously sized unemployment benefit extension would be a must within the new financial package to reassure us that this demographic is not going to cut back their spending significantly.

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