

US: Optimism and apprehension

I'm looking forward to 2021 optimistically amid a sense that “normality” is within touching distance. For now, the story is one of near-term pain, but medium to long-term things look good. However, we know the pandemic is far from over and when it is, it'll leave a financial legacy of huge bills and massive structural change



United States Capitol building silhouette and US flags at sunrise

Source: Shutterstock

Look forward, not back

2020 has been an incredibly tough year, exerting both a huge human and economic toll. But the outlook for 2021 has undoubtedly brightened with vaccine optimism.

But the US economy isn't out of the woods yet. While a vaccination program is underway it'll take time before it is distributed to enough people to allow a full return to “normality”.

In the meantime, Covid-19 cases are rising sharply and containment measures are being re-introduced at a heavy economic cost. This window of vulnerability could last more than two, three or even four months during which restrictions on movement could push up unemployment and weaken activity.

The agreed fiscal relief package amounting to \$900bn will undoubtedly help mitigate some of the

negatives but unfortunately, it won't be able to fully offset the effects of people staying at home as many businesses face tighter restrictions or are even forced to close.

However, by preventing a substantial rise in unemployment - by funding a new round of the paycheck protection program (PPP) is critical here - and extending unemployment benefits, it provides a stronger platform for recovery when the re-opening gets underway.

Boom! It's 2021

When we do get the all-clear, hopefully at some point in the Spring, pent up demand can fuel a rapid recovery in consumer spending as we "make up for lost time". Credit card balances are at three-year lows and savings levels are at record highs so there is plenty of cash ammunition.

Business investment plans, which have been put on hold for 12 months, will also become more pressing and help fuel the recovery.

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I suspect incoming President Joe Biden will be primarily focused on creating work for the 10 million people who lost their jobs due to the pandemic and are yet to find employment. That means we are likely to see another substantial fiscal stimulus focused on infrastructure and energy. The outcome of the two Georgia Senate seat run-off elections on 5 January will determine the scale. Current polling points to Democrat victories, which would give Biden the greenlight to go big given his party would control Congress.

Next year is all about growth so I think concerns about near-term tax hikes or tougher regulations are misplaced. That will more likely be a 2023 story. Likewise, the Federal Reserve has emphasised that it will be doing all it can to ensure the recovery gains real traction, implying little prospect of higher interest rates anytime soon.

Reflation, reflation, reflation

In terms of what this means for markets - the focus will remain on so-called reflation trades. As global investment opportunities improve, our FX team believe the "safe haven" dollar will come under sustained downward pressure.

Inflation may also start to make an appearance in the second half of 2021 with vibrant demand coming up against pandemic induced supply constraints in many sectors. Nonetheless, weak wages and a substantial output gap means medium-term price pressures should be contained.

That said, we suspect the yield curve will steepen further with 10-year benchmark government borrowing costs likely to test 1.5% in 2021 while the Federal Reserve keeps short-term borrowing costs pinned down close to zero.

Equities will be interesting - a global cyclical rebound may see more traditional stocks back in

favour with the tech sector perhaps being asked to show some justification of the dramatic repricing seen through 2020.

But big questions are coming...

So the story we have been telling clients for a while now is one of near-term pain, but medium to long-term things look very good indeed. But with that said, the pandemic will have a lasting legacy that we are still trying to comprehend.

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Greater confidence in technology means structural change over how and where we work and live will be major issues for both government and the private sector to address – are vast swathes of office space now redundant? Are schools and hospitals located in the right place to meet future demand? What is the future for retail and public transport? These are just a handful of questions that pose massive challenges, but also huge opportunities.

On top of those, a lot of us are asking the question as to who ultimately pays the bill for the massive accumulated debts and how do we tax appropriately? These are going to be huge issues not only for Joe Biden, but also, I suspect, for the president that follows.

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