US ECONOMIC UPDATE AUGUST 2020
Q3 REBOUND FIRMING UP

NAB Group Economics

Growth is set to bounce back in Q3, but the recovery lost momentum through July/August following a surge in COVID-19 cases and reimposition of some restrictions. More positively, case numbers have declined since late July. We still expect that a full recovery will take a long time. The Fed has moved to flexible average inflation targeting, reinforcing our expectation that the fed funds rate will remain unchanged at least through to end-2022. Fiscal policy and the future path of the virus remain key risks.

After an exceptionally large fall in GDP in Q2 – now estimated to be -9.1% q/q (first estimate was -9.5%), incoming data point to strong growth in Q3.

Retail sales and home sales in July were above their pre-COVID-19 (February) level but most other activity indicators still have not fully recovered. Consumption is still 4.7% below its February level due to weakness in services consumption.

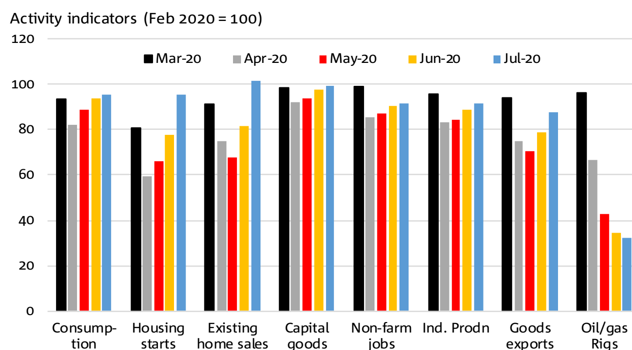
Nevertheless, most indicators in July were well above their Q2 average – consumption was 8% higher, while existing home sales and housing starts were up 30%, manufacturing industrial production up 7%, core capital goods orders 5% and non-farm employment 4%. Mining was an exception; the Baker Hughes rig count (oil and gas) which as 70% lower in July than its Q2 average and still falling (although the partial recovery in oil prices the has occurred means that they are likely nearing their trough). The rise in capital goods orders is a positive sign as a concern has been that businesses would significantly defer or cancel investment given the current uncertainty.

High frequency indicators such as Google Mobility and consumer spending data (based on card transactions) are also well above their Q2 levels. However, some of these indicators flattened out starting late June, pointing to a slowdown in the pace of the recovery, if not an outright pause.

This likely reflected the resurgence in COVID-19 cases over June & July. In response, many states either paused 'reopening' or reintroduced some of the restrictions that had been in place previously. The rise in cases also likely induced more caution by individuals and businesses. However, at the same time other states continued to 'reopen'.

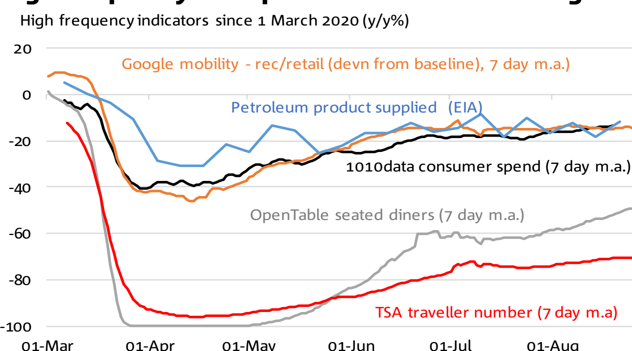
The high frequency indicators for the US are biased towards domestic activity (demand), particularly that

Recovery continued through to July



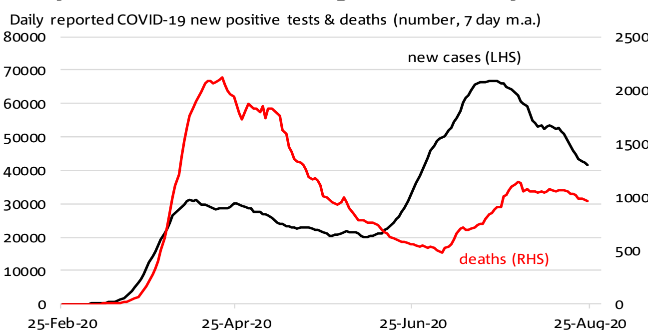
Source: Refinitiv. Capital goods orders are ex transport & defence ('core')

High frequency data points to some flattening out



Sources: Google, US EIA, TSA, 1010data, OpenTable

Likely due to COVID-19 Surge in June/July



Source: Covidtracking.com, NAB

Date **August 2020** | Author Tony Kelly – Senior Economist
© National Australia Bank Limited ABN 12 004 044 937 AFSL and Australian Credit Licence 230686

of households. However, the global economic recovery underway, the gradual easing in supply disruptions and the need to rebuild inventories are likely providing a boost to activity.

In a positive development, the number of COVID-19 cases has been falling since late July and deaths of people with COVID have also started to fall. So far, there are mixed signals from the high frequency indicators as to whether this is boosting activity and it may be a while before restrictions are eased. It is also possible that the surge of cases in June/July, and the re-introduction of restrictions, by highlighting the uncertain path of the virus and policy, will lead to longer-lasting caution.

Certainly, consumer confidence is showing no signs of picking up, and has remained stuck at very low levels. In contrast, business surveys such as the ISM (up to July) and the Markit PMI (to August) have returned to positive territory and have been trending higher, both for manufacturing and services.

A concern has been the lack of fiscal follow up since April. While both major parties have put forward proposals for significant further stimulus, they have not been able to reach agreement on the details.

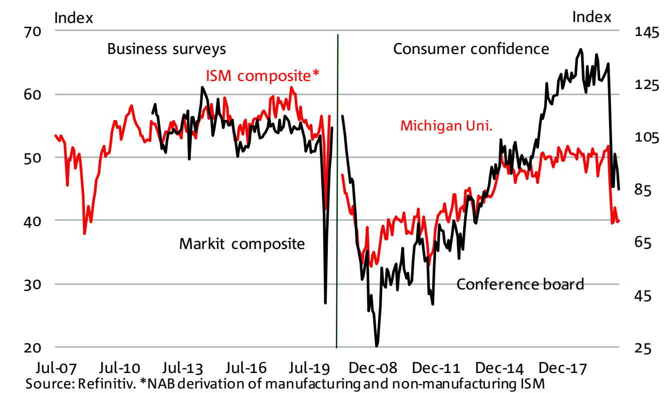
Some fiscal measures to support the economy through the pandemic were one-off (such as cash grants to households, the bulk of which were made over April/May) while others have ended more recently. This includes an extra $600 per week for unemployment benefit recipients (Pandemic Unemployment Compensation or PUC).

While the President has taken executive action to extend PUC at $400/week ($100 to be funded by states), this utilises disaster relief funding which is limited in size and it will not last long if states participate.

The Phase 3 and 4 fiscal packages passed in March and April had a large impact on household budgets. Despite large scale job losses – and the associated loss of wages and other benefits – there was a significant rise in overall household incomes in April. While household disposable income subsequently eased through to June, there was a small rise in July, and since April it has been well above its pre-COVID-19 level (by 6% or more).

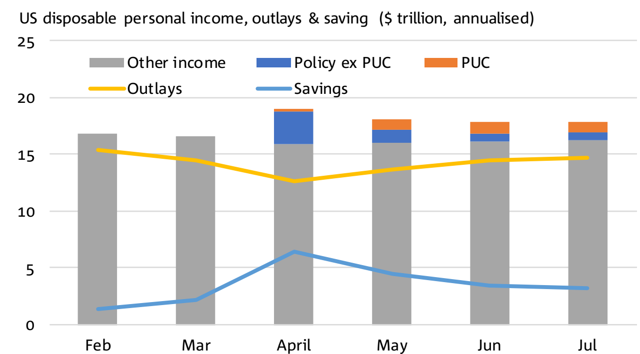
In July, PUC payments made up around 5% of household disposable income. Even excluding these payments, income would have been a little above its February level in July. That said, other policy measures – such as Paycheck Protection Program (PPP) payments – are likely to start running down soon (if they haven't already) and an abrupt withdrawal of all policy support would leave household income well down. Continued growth in employment, and hence wage income, will be

Business surveys rising; consumer confidence low



Source: Refinitiv. *NAB derivation of manufacturing and non-manufacturing ISM

Due to policy response h'hold income higher and savings have been built up



Source: BEA; income from Policy is limited to COVID-19 response. PUC = Pandemic Unemployment Compensation program. Coumns are income components

necessary to offset any fiscal wind-down, although job gains will likely slow given the slowdown in the recovery evident over July/August.

Nevertheless, the large increase in household savings over April to July suggests that households have built up their savings, which we they can draw down in coming months – although there will be a big variation across individual households.

Consistent with this, the high frequency data we highlighted earlier have not been obviously impacted by the loss of PUC. The pause in some indicators occurred before the expiration of the PUC and is better explained by virus spread and re-introduction of some restrictions.

Complicating the overall impact of the PUC program, the benefits were so high that it meant many people earnt more being unemployed than in a job. A survey by the Philadelphia Federal Reserve indicates unemployment benefits were a substantial impediment to 30% of businesses attempting to-recall workers in July.

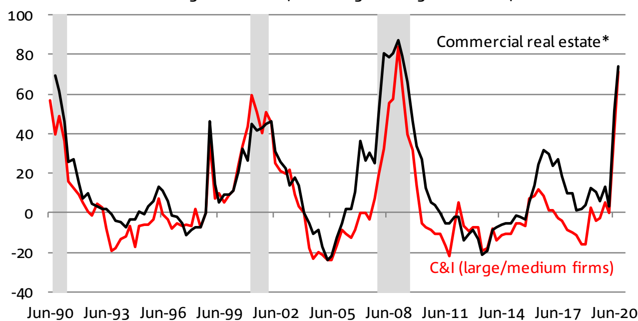
All of this suggests that while Q3 growth will be very strong (by historical standards), within the quarter growth has likely slowed. We expect the recovery to continue into Q4, but at a slower pace. Fiscal developments and the path of the virus will remain major factors influencing how strongly the economy recovers.

We continue to expect that a full recovery will take a long time. This reflects several factors including the only gradual removal of COVID-19 related activity restrictions, ongoing consumer and business caution, as well as the possibility of further flare ups of the virus continuing to slow the process.

Parts of the economy will also need to adjust to significant structural change, such as less travel, more on-line activity and work from home. While general financial conditions have recovered over recent months, there has been a notable tightening in lending standards by banks. That said, credit has flowed freely (unlike the GFC), and various Government and Fed lending policy programmes may reduce the headwinds to obtaining credit.

Tightening in lending standards for businesses

Business loans - lending standards (net % tightening standards)



Source: Federal Reserve. * From Dec 13 qtr simple average of three CRE components. Shaded

Nevertheless, in this environment business investment is likely to be constrained.

Damage to government finances is another factor likely to slow the recovery, as the loss of revenue (and exhaustion of 'rainy day' funds) will necessitate cut backs, as many state governments have balanced budget requirements.

Overall, we expect GDP to decline by 4.1% in 2020 (revised up from -5.1%) and 3.4% in 2021 (revised down from 3.7%). The stronger estimate for 2020 revision reflects the upwards revision to the Q2 outcome by the BEA and stronger than expected data up to July which lifts our Q3 estimate. However, with the recovery in activity occurring more quickly than expected, a slowdown in the speed of the recovery in recent months and still widespread restrictions on activity, we have made downward revisions to subsequent quarters which lowers our 2021 forecast.

Monetary Policy

Last week the Fed revised its Statement on Longer-Run Goals and Monetary Policy Strategy.

As expected, the key change is that the Fed has adopted an average inflation target. The target is still 2% inflation (personal consumption expenditure price index measure) but the Fed will now seek to achieve this over time. As the statement notes, this means that "...when inflation has been running persistently below 2 percent, appropriate monetary policy will likely aim to achieve inflation moderately above 2 percent for some time."

Interestingly, the Fed did not explicitly state the reverse would be true (persistent above 2% inflation means targeting below 2% inflation for a while), but this may just be a nod to the reality that they have undershot the target for a while now.

The Fed Chair made clear in his Jackson Hole speech, which announced the changes to the goals and strategy statement, that they are not tying themselves to a set time period over which the average inflation rate is calculated. He described their approach as a "flexible form of average inflation targeting."

The Fed's dual mandate includes a goal of maximum employment. While, as before, the Fed has declined to quantify what this means, it will focus on 'shortfalls in employment from its maximum level'.

The obvious follow up question is what this means for actual Fed actions. We have been expecting the Fed to strengthen their forward guidance, either through either time based or, more likely, outcome based forward guidance.

The July FOMC minutes cast some doubt on when and if they might do this, although it is still possible that they will act as early as their September meeting.

There has also been discussion of yield curve targets, but the minutes reveal little enthusiasm for this right now.

In any event, over our forecast horizon to end-2022, we still expect to see an unchanged fed funds rate target range (0 to 0.25%). This reflects our expectation that inflation will remain below target over this period (and unemployment relatively high even if falling). The changes to the Fed's strategy statement simply reinforces this view.

CONTACT THE AUTHOR

Tony Kelly
Senior Economist
Antony.Kelly@nab.com.au

U.S. ECONOMIC & FINANCIAL FORECASTS

	Year Average Chng %					Quarterly Chng %											
						2020				2021				2022			
	2018	2019	2020	2021	2022	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
US GDP and Components																	
Household consumption	2.7	2.4	-4.5	3.5	2.5	-1.8	-9.9	8.2	0.4	0.9	0.7	0.7	0.6	0.6	0.6	0.6	0.6
Private fixed investment	5.2	1.9	-5.5	2.6	4.8	-0.3	-8.2	0.8	0.7	1.5	1.7	1.5	1.3	1.1	1.0	0.9	0.9
Government spending	1.8	2.3	2.0	1.5	1.9	0.3	0.7	0.0	0.4	0.4	0.4	0.4	0.5	0.5	0.5	0.5	0.5
Inventories*	0.2	0.0	-0.8	0.7	0.0	-0.4	-1.1	1.4	0.4	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net exports*	-0.3	-0.2	0.6	-0.2	-0.1	0.4	0.1	-0.4	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real GDP	**3.0**	**2.2**	**-4.1**	**3.4**	**2.7**	**-1.3**	**-9.1**	**6.5**	**0.8**	**0.9**	**0.8**	**0.7**	**0.7**	**0.7**	**0.6**	**0.6**	**0.6**
Note: GDP (annualised rate)						*-5.0*	*-31.7*	*28.4*	*3.3*	*3.8*	*3.2*	*3.0*	*2.8*	*2.7*	*2.5*	*2.4*	*2.4*
US Other Key Indicators (end of period)																	
PCE deflator-headline																	
Headline	2.0	1.5	1.1	1.5	1.6	0.3	-0.4	0.8	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Core	2.0	1.6	1.3	1.5	1.6	0.4	-0.2	0.8	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Unemployment rate - qtly average (%)	3.8	3.5	8.7	7.4	7.0	3.8	13.0	9.9	8.7	8.3	7.6	7.5	7.4	7.3	7.2	7.1	7.0
US Key Interest Rates (end of period)																	
Fed funds rate (top of target range)	2.50	1.75	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25

Source: NAB Group Economics

*Contribution to real GDP growth

Group Economics

Alan Oster
Group Chief Economist
+(61 0) 414 444 652

Dean Pearson
Head of Behavioural & Industry Economics
+(61 3) 8634 2331

John Sharma
Economist
+(61 3) 8634 4514

Jacqui Brand
Personal Assistant
+61 3 8634 2181

Australian Economics and Commodities

Gareth Spence
Senior Economist
+(61 0)436 606 175

Phin Ziebell
Economist – Australia
+61 (0) 475 940 662

Behavioural & Industry Economics

Robert De Iure
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 4611

Brien McDonald
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 3837

Steven Wu
Economist – Behavioural & Industry Economics
+(613) 9208 2929

International Economics

Tony Kelly
Senior Economist
+61 (0)477 746 237

Gerard Burg
Senior Economist – International
+(61 3) 8634 2788

Global Markets Research

Ivan Colhoun
Global Head of Research
+61 2 9293 7168

Important Notice

This document has been prepared by National Australia Bank Limited ABN 12 004 044 937 AFSL 230686 ("NAB"). Any advice contained in this document has been prepared without taking into account your objectives, financial situation or needs. Before acting on any advice in this document, NAB recommends that you consider whether the advice is appropriate for your circumstances.
NAB recommends that you obtain and consider the relevant Product Disclosure Statement or other disclosure document, before making any decision about a product including whether to acquire or to continue to hold it.

Please click here to view our disclaimer and terms of use.