US ECONOMIC UPDATE DECEMBER 2020
SIGNS OF SLOWING, BUT VACCINE A POSITIVE

National Australia Bank

NAB Group Economics

The surge in COVID-19 cases and the ongoing ramping up of containment measures in response is causing a slowdown in growth, with the risk of a contraction in quarterly GDP. At the same time, regulatory approval for vaccinations to commence has improved the medium-term outlook. The Fed will likely move to 'qualitative outcome-based guidance' for its asset purchases at this month's meeting, with a chance that it also focusses its purchases more on longer dated Treasury securities.

Economic overview and outlook

The latest surge of COVID-19 continues to disrupt the US economy, even as regulatory approval to start vaccinations raises hopes that the virus will be finally be brought under control next year, which would translate into a better economic outcome.

However, for now daily new COVID-19 case numbers continue to rise (although they appear to have peaked in some of the states that kicked off the latest surge).

In response, there has been an ongoing ramping up of government containment measures ("restrictions") aiming to curb the virus. The extent of restrictions is highly varied across US states (and within states, as many restrictions occur at the local level). This makes assessing their overall severity, and economic impact, difficult and highly uncertain. Whether restrictions will be further lifted from here, and how long they will remain in place, also is another source of uncertainty.

COVID-19 related restrictions have tightened but are very mixed across US states

COVID-19 State Reopening Guide: How Open for Business is Each State?

Open — Closed

Source: MultiState. Data as of December 9, 2020. Note: Ratings are calculated based on eleven factors run through a weighted formula. See methodology for details.

Source: MulitState

High frequency indicators are one way of assessing the impact. Unsurprisingly, restaurants have been hard hit, as has travel, as they have been one of the more commonly discouraged or targeted activities in the latest round of restrictions. For other indicators, it is less clear, but the overall picture is one of activity levelling out.

High frequency data indicate some weakening…

High frequency indicators since 1 March 2020 (y/y%)

Petroleum product supplied (EIA)
1010data consumer spend (7 day m.a.)
Google mobility-average workplace & rec/retail (devn from baseline, 7 day m.a.)
TSA traveller number (7 day m.a)
OpenTable seated diners (7 day m.a.)

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

…but surveys lost little momentum in November

Business survey indicators

Manufacturing | Non-mfg/services

ISM
Markit

Source: Refinitiv.

Business surveys also provide a reasonably timely measure of the economy. For November, they provided a more positive signal than the high frequency data. While there some slippage in the ISM

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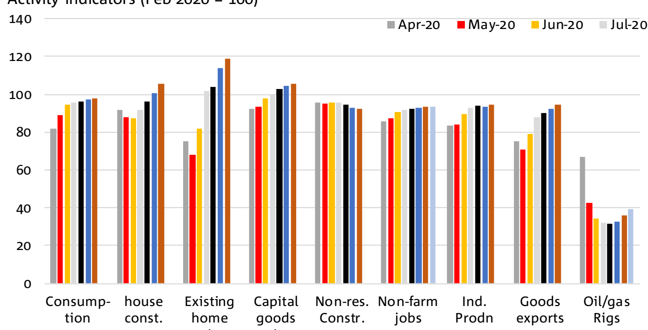
indicators, they remained at a solid level, pointing to ongoing growth.

We would expect that the manufacturing sector will come through this latest round of restrictions in better shape than services (even though the Markit services PMI increased in November). Manufacturers have not been told to shut down, they are better prepared to run their workplaces in a way that mitigates COVID risks, and unlike March/April, there hasn't been the same synchronised raft of restrictions overseas. This means that there will be fewer supply disruptions and external demand will hold up better. Indeed, the manufacturing ISM's export orders index rose to its highest level this year in November.

A sector that has recovered quickly (in common with overseas experience) is housing. House sales and new home construction expenditure in October were above their pre-pandemic levels.

More broadly, monthly activity data generally continued to improve in October and (where available) November. However, the pace of the recovery has slowed, including for private consumption (the largest component of GDP).

Recovery continued into Q4, but at slower pace



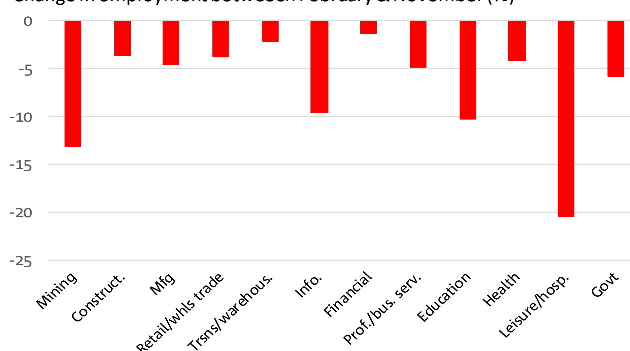
Source: Refinitiv. Capital goods orders are ex transport & defence ('core')

Our forecasts allow for a roughly 1% fall in consumption over November/December, in part due to the impact of the latest round of COVID-19 related restrictions and the winding down of some of the Government's fiscal support measures put in place earlier in the year. This would still leave consumption around 1% higher in Q4 than in Q3, but points to a weak quarterly growth (with the risk of it being negative) at the start of 2021.

The slowdown – and risk of renewed contraction – is evident in the labour market. Non-farm employment increased by 245k in November, well below the 600-700k seen in the previous two months. Allowing for a reduction in Census workers (93k) explains only part of the weakness. In normal times the November result would be solid but with employment still below its February level by close to 10 million jobs it is disappointing. Moreover, weekly jobless claims have moved up again (although nowhere to the same extent as occurred earlier in the year).

The labour market also highlights the fact that the downturn in the economy, and the subsequent recovery, has been highly uneven across different sectors. Mining was hit hard by the downturn in demand (e.g. for fuel) and commodity prices, while sectors such as leisure/hospitality were particularly affected by social distancing and COVID-19 related restrictions (including mandated closures at times).

Labour market highlights uneven recovery



The most recent round of restrictions have been largely targeted at services such as leisure activity, indoor dining (and in some cases outdoor as well) but also gyms and hairdressers to name a few. These sectors are relatively labour intensive, suggesting that the labour market will be highly impacted by the recent surge in COVID-19 and associated policy response. As already noted, manufacturing and construction (relatively capital-intensive industries) are holding up better and even mining will benefit from the improvement in commodity prices that has occurred.

As already noted, we are allowing for some further impact in the mid/latter part of Q4 from the surge in COVID-19. With the economy growing through Q3 and into October (at least), Q4 may still see solid growth but it sets up Q1 2021 growth to be weak with a risk that it is negative. Possibly adding to Q1 weakness is the currently legislated end to some COVID-19 unemployment benefit programs at the end of this year. The short-term outlook will be heavily influenced by how long COVID-19 cases rise, whether restrictions are further tightened and, when new daily cases start to fall, how quickly restrictions are eased.

However, the recent regulatory approval to start vaccinations means that medium term prospects have brightened. While this opens up some upside risk to our forecasts, it will depend on how rapidly the vaccine is taken up (reflecting production constraints and community willingness to take the vaccine) as well as how governments adjust COVID-19 activity restrictions as a result.

Fiscal policy is another uncertainty. There continue to be discussions around another fiscal package, with talks appearing to settle around a package of around $0.9 trillion (4% of GDP). While all parties agree on

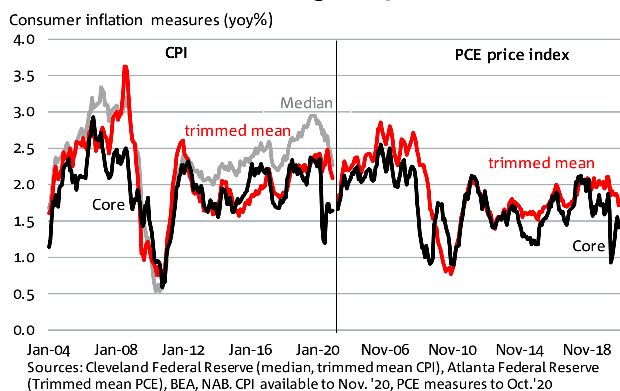
the need for a further package, there continues to be disagreement over what it should contain, so if, and when, a deal will be reached is unclear.

Overall, we expect GDP to contract by 3.6% in 2020, but to rise by 3.3% in 2021 and 2.4% in 2022, with some downside risk in the short-term but upside risk from the second half of 2021.

Monetary policy

With a full recovery expected to take time, the resulting slack in the economy will continue to weigh on inflation. While different measures of underlying inflation differ on the degree, they all point to some slowdown in inflation this year.

Inflation has eased during the pandemic



Sources: Cleveland Federal Reserve (median, trimmed mean CPI), Atlanta Federal Reserve (Trimmed mean PCE), BEA, NAB. CPI available to Nov. '20, PCE measures to Oct.'20

The Fed earlier this year moved to flexible average inflation targeting. This means that following a period of below target inflation – as is currently the case – the Fed will aim for a period of above target inflation. Specifically, the Fed has indicated that there will not be an increase in the Fed funds rate until inflation has reached 2% (and looks like being 'moderately' above that level for a while) and the labour market is very strong. Even when the Fed does start to raise rates, it is promising to keep rates below their neutral level (so that they are supportive of above trend growth) until inflation has been above 2% for 'some time'.

Not surprisingly then, most Fed members, in their September meeting forecasts, did not see any change to the Fed funds rate at least through to the end of 2023.

With COVID-19 continuing to disrupt the economy and with the (long hoped for) additional fiscal package yet to arrive, the question is whether the Fed will take additional steps to support the economy.

The next policy move, if further monetary policy easing is considered necessary, is likely to be asset purchases. The Fed has been purchasing $80 billion per month of Treasury securities and $40 billion per month of agency MBS (mortgage backed securities). The October meeting continued previous 'guidance' around asset purchases – namely that they would continue 'over coming months' at their current pace.

The minutes to the November Fed meeting indicated that most Fed members thought this guidance should move to 'qualitative outcome based' guidance that links the length of time over which asset purchases will be conducted to economic conditions and many thought that this should be done 'fairly soon'.

In relation to options for expanding monetary support through asset purchases, the Fed discussed:

- Shifting its Treasury purchases to those with a longer maturity (with the total amount unchanged).
- Increasing the monthly amount of purchases.
- Leaving the pace and composition of purchase unchanged but doing so for longer.
- Lengthening the maturity of the Treasury purchases while reducing the pace (amount) of purchases somewhat.

The time horizon over which asset purchases will occur should fall out from the qualitative forward guidance so this is not an independent policy option. The latter option is the least likely – it would be difficult to calibrate, appears to have the least Fed member support and would be the most difficult to communicate to the public.

This leaves increasing the pace of purchases and/or extending the maturity of what is purchased; the latter brings with the fewest problems (particularly with financial market functioning not an immediate concern) and so is the likely first step.

Since the September meeting downside pressures – at least to the short-term outlook – have risen (COVID-19 and lack of follow up fiscal support). Therefore, it would not be a surprise for the Fed, at its meeting this week, to move to qualitative forward guidance for the asset purchase program with a chance that it will extend the maturity of its Treasury purchases. An increase in the monthly amount of asset purchases cannot be ruled out either.

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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	-3.8	3.8	2.3	-1.8	-9.6	8.9	**1.0**	**0.2**	**1.0**	**0.6**	**0.5**	**0.5**	**0.5**	**0.5**	**0.5**
Private fixed investment	5.2	1.9	-2.5	5.0	4.3	-0.3	-8.3	6.9	**2.0**	**0.6**	**1.1**	**1.2**	**1.1**	**1.1**	**1.0**	**0.9**	**0.9**
Government spending	1.8	2.3	1.0	-0.5	1.3	0.3	0.6	-1.2	**-0.6**	**0.0**	**0.2**	**0.3**	**0.4**	**0.4**	**0.4**	**0.4**	**0.4**
Inventories*	0.2	0.0	-0.7	0.7	0.0	-0.4	-1.1	1.6	**0.2**	**0.1**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Net exports*	-0.3	-0.2	0.1	-0.8	-0.1	0.4	0.1	-1.4	**-0.2**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Real GDP	**3.0**	**2.2**	**-3.6**	**3.3**	**2.4**	**-1.3**	**-9.0**	**7.4**	**0.9**	**0.2**	**0.9**	**0.6**	**0.6**	**0.6**	**0.6**	**0.6**	**0.5**
Note: GDP (annualised rate)						*-5.0*	*-31.4*	*33.1*	*3.8*	*0.9*	*3.8*	*2.6*	*2.3*	*2.3*	*2.3*	*2.2*	*2.1*
US Other Key Indicators (end of period)																	
PCE deflator-headline																	
Headline	2.0	1.5	1.2	1.8	1.8	0.3	-0.4	0.9	**0.4**	**0.5**	**0.5**	**0.4**	**0.5**	**0.4**	**0.4**	**0.5**	**0.5**
Core	2.0	1.6	1.4	1.6	1.8	0.4	-0.2	0.9	**0.3**	**0.4**	**0.4**	**0.3**	**0.5**	**0.4**	**0.5**	**0.5**	**0.5**
Unemployment rate - qtly average (%)	**3.8**	**3.5**	**6.9**	**6.4**	**6.0**	**3.8**	**13.0**	**8.8**	**6.9**	**7.1**	**6.7**	**6.5**	**6.4**	**6.3**	**6.3**	**6.1**	**6.0**
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

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