U.S. outlook: the road to recovery depends on the vaccine

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By Constance L. Hunter, Principal and Chief Economist, KPMG in the U.S.
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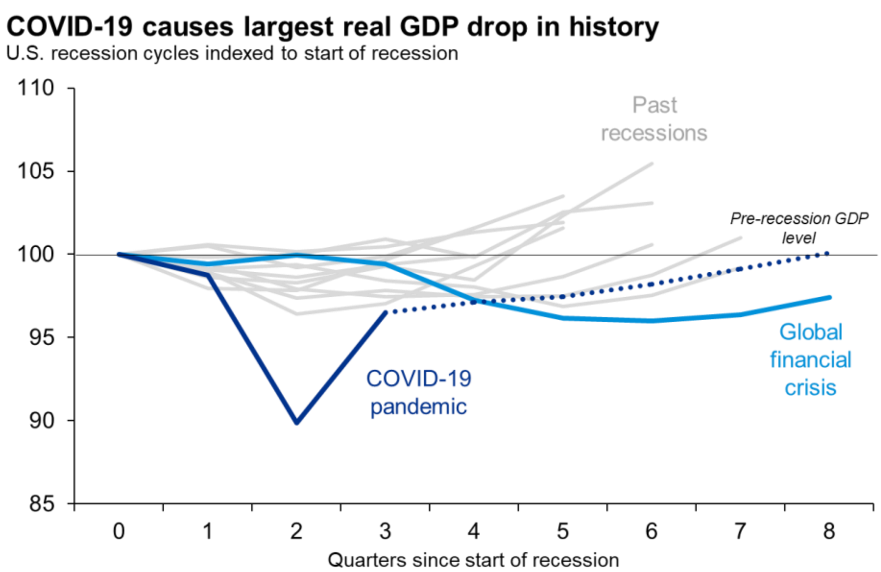
In the United States, three juxtaposing factors will greatly influence the near-term trajectory. The pandemic, its current path and its impact on the economy is the dominant factor. A related, but more medium-term factor is the prospect of multiple vaccines being distributed, perhaps to a substantial number of the U.S. population before the end of the third quarter 2021. And finally, President Elect Joe Biden's economic agenda and the need to shore up the firewall built around the COVID-19 impacted parts of the economy.

Concomitant with the surge in COVID-19 cases is the end of unemployment benefits for millions of impacted workers. The U.S. runs the risk of seeing the advancement in job gains being reversed in December and possibly January as COVID-19 cases continue to rise. The important firewall that the CARES Act provided to the COVID-impacted parts of the economy, particularly preventing incomes from declining on an aggregate basis, is at risk of being eroded as fiscal provisions for enhanced unemployment benefits continue to run out. If the firewall can be fortified either in the so-called lame-duck session of Congress or early in January after the new Congress is seated, it is possible to limit the economic backsliding. However, the rise of COVID-19 cases suggests it will not be possible to fully avoid the adverse impact the virus has on the economy. The growing number of school closures and increased stringency where the outbreaks are the strongest suggest economic progress will be eroded in coming months.

Long path to pre-pandemic levels of GDP

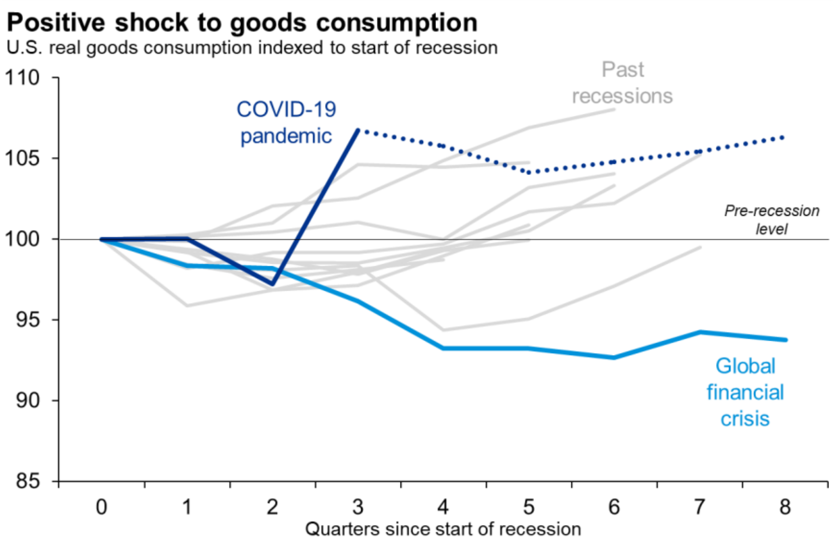


Source: KPMG Economics, Bureau of Economic Analysis (Q3 2020), Haver Analytics

- The economic firewall created by the CARES Act assumed COVID-19 would be under control by Q3 2020.
- With COVID-19 cases rising in the U.S. and globally, a firewall to prevent larger economic fallout from the parts of the services economy still impacted is needed to prevent spillovers to services where workers can work from home as well as the goods economy.
- Based on current data, the swoosh shape recovery is the best case scenario.

However, looking past the pandemic to a time when the vaccine can be widely distributed, it is abundantly clear that low interest rates will be maintained until the recovery is broad-based. The Fed has stated their intention to maintain loose monetary policy until inflation is sustained above 2 per cent, something that will likely not occur until the output gap is closed and we are back above trend GDP levels. This is likely to keep equity markets elevated while maintaining bond spreads at relatively low levels which in turn will help the financing of investment projects. In addition to support from monetary policy, the post-vaccine recovery holds high promise due to a number of unique factors. So long as income levels can be broadly maintained via fiscal assistance until the vaccine is distributed, the large stock of savings, over USD2.5 trillion dollars and nearly 15 per cent of GDP, will be an important catalyst for growth once full economic activity can resume. Additionally, firms are accelerating their digitization plans. We see a step change in the adoption of technology. For example, on-line sales (excluding gasoline store sales) jumped from 12.6 per cent of retail sales to 19 per cent in April during maximum lockdown. The pandemic and lockdowns forced higher adoption rates and higher utilization rates of on-line sales activity. While on-line sales have subsequently dropped to 15 per cent of sales, this step change from 12.6 per cent to 15 per cent is an important feature of the retail landscape and is indicative of broader digital adoption throughout the economy. This greater digital literacy from consumers will help fuel additional digital investment from firms and could help drive lasting productivity gains in the post-pandemic economy.

COVID-19 shock caused dramatic shift to goods consumption

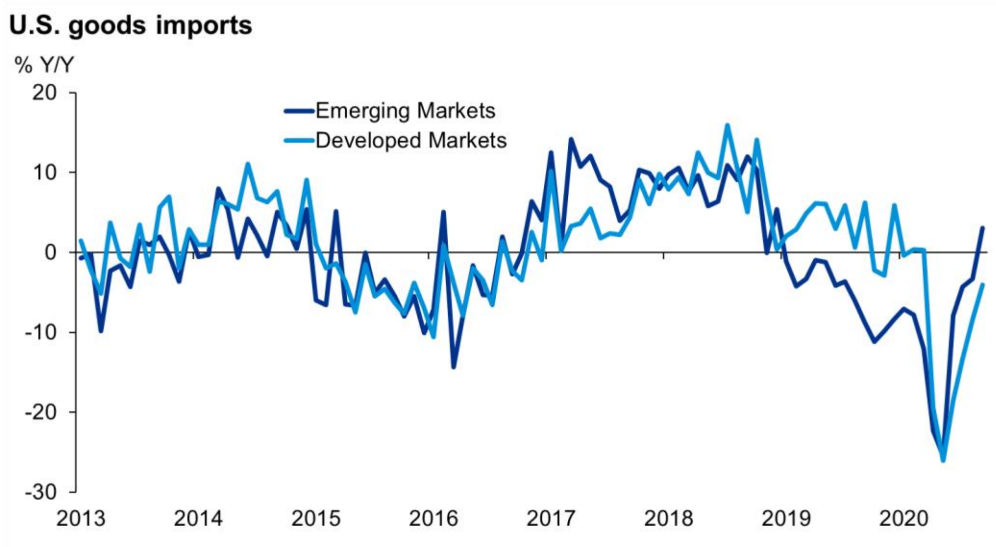


Source: KPMG Economics, Census Bureau (Q3 2020), Haver Analytics

- Multiple factors contributed to the increase in consumption of goods.
  - Pandemic assistance boosted spending power and contributed to the rebound in autos.
  - More time at home, FOGO, boosted demand for goods that improved the quality of home life.
  - Increased churn in the housing market boosted demand for furniture and other home goods.
- Demand is not expected to be sustained at this pace.

While the fate of the Senate remains unknown at the time of publishing, dependent on the outcome of run-off elections on January 5, a simple Democratic majority in the Senate would help the Biden agenda, although compromise will still be needed for major legislation. If the two Georgia Senate seats are won by the Republican candidates, Biden will be challenged to implement the majority of his fiscal policy agenda. Nevertheless, there are other avenues for the Biden administration to press its agenda outside of Congress. For example, a fully staffed Federal government will be helpful in combating the pandemic. The distribution of the vaccine will require coordination and data collection that will be labor and technology intensive. A fully staffed Federal government will be central to other Biden administration initiatives such as environmental and regulatory enforcement. Over the past forty years, Presidents have used an average of 42 executive orders per year. We expect Biden to use this important tool for everything from routine administrative matters to mitigating roadblocks expected on Capitol Hill.

U.S. demand for goods from emerging markets recovers faster



Source: KPMG Economics, Census Bureau (September 2020), Haver Analytics

We believe further fiscal stimulus under a Biden administration, combined with the promise of an effective vaccine that could be widely available to the general public in the first half of 2021, will lead to a risk-on environment in capital markets. This will be particularly helpful for asset flows into emerging markets. In addition, the U.S. monetary stimulus, growing money supply at a rate of 24 per cent year over-year, will provide a significant impetus for the U.S. to continue being the consumption engine for the world. The September reading of U.S. trade data showed that imports of goods from emerging markets have rebounded on a year-over-year basis are now up 3.1 per cent compared to imports from developed economies which are down 4.0 per cent year-over-year.

In conclusion, we expect some stalling of the recovery in coming months in the face of rising COVID-19 cases and a waning stimulus. However, renewed stimulus is likely to come in early January if it does not arrive during the Lame Duck session of Congress. Once the U.S. is able to widely distribute the vaccine, sometime in the second half of 2021, we expect the economy to expand at a faster pace that will allow GDP to grow at just over 3.0 per cent in 2021 after contracting by an estimated 2.9 per cent in 2020.