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The U.S. Economy and COVID-19: An Update

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Webinar

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Any opinions expressed here are my own and do not necessarily reflect those of the Federal Open Market Committee.

Introduction

Key themes

- There has been progress in managing the global health crisis, but substantial risks remain.
- U.S. macroeconomic news from May through October surprised dramatically to the upside, suggesting that business sector adjustment to the pandemic has been rapid.
- U.S. monetary and fiscal policies have been exceptionally effective and were designed for a larger shock than the one that has occurred.
- Downside risk remains substantial, and continued execution of a granular, risk-based health policy will be critical to maintain economic momentum.

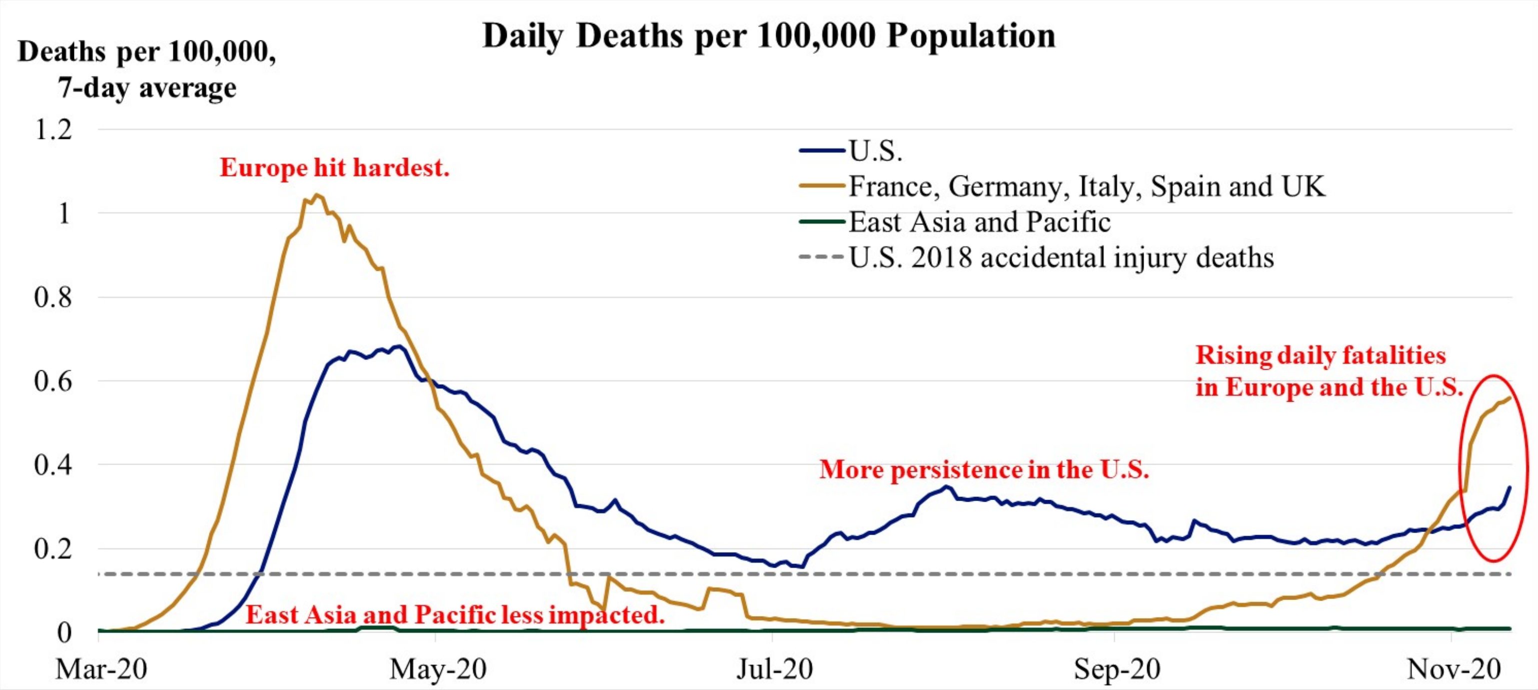
Managing Health Outcomes Remains Critical

Fatality rates and economic activity

- The global health crisis requires continued daily management.
- Daily fatalities per 100,000 population have declined substantially from peak levels in March and April in both Europe and the U.S., but recently began to rise again.
- East Asia and Pacific countries continue to report daily fatalities per 100,000 population that are an order of magnitude lower than those of the U.S. and Europe.
- Key areas of global production are well past the initial phase of the crisis but must maintain safety protocols.*

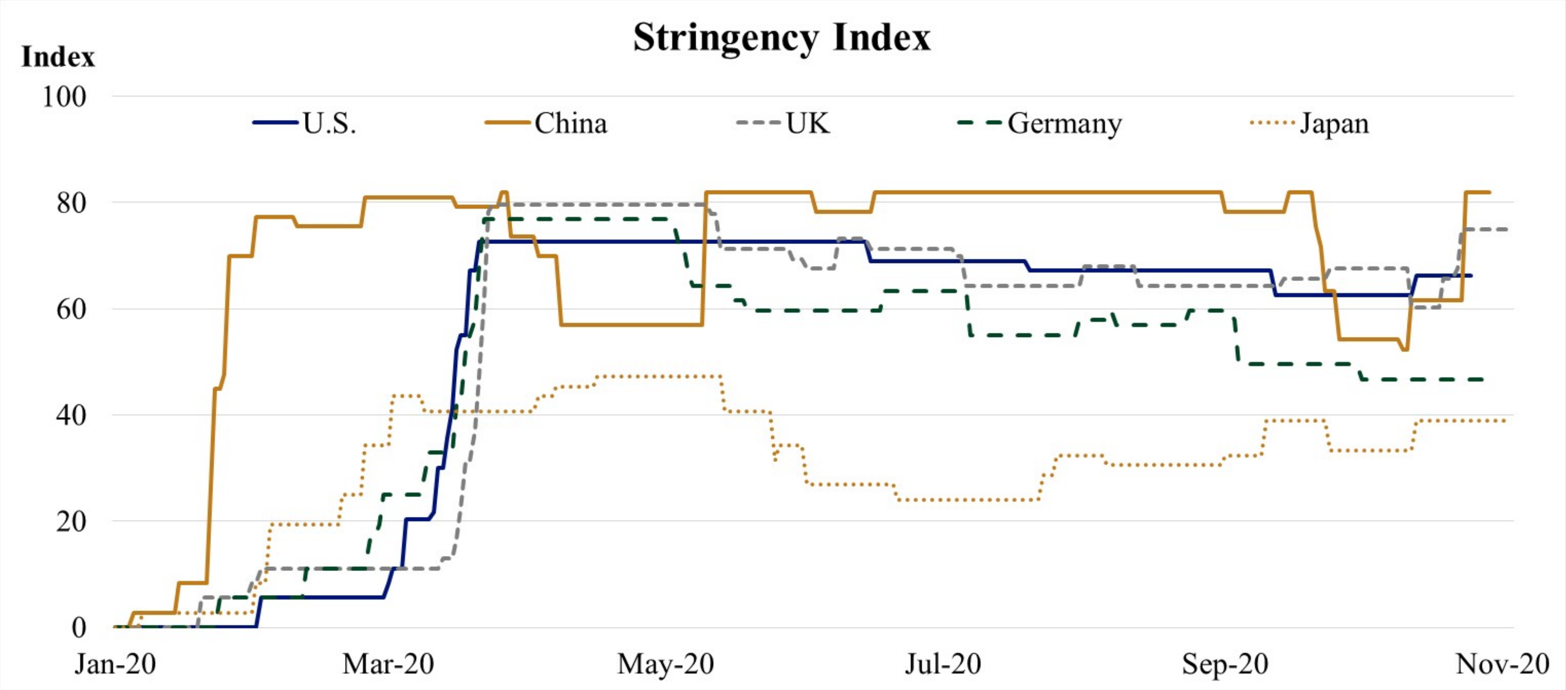
* *For an analysis of fatality rate data worldwide, see A. Atkeson, K. Kopecky and T. Zha, 2020, "Four Stylized Facts about COVID-19," National Bureau of Economic Research, Working Paper No. 27719.*

Progress in health outcomes



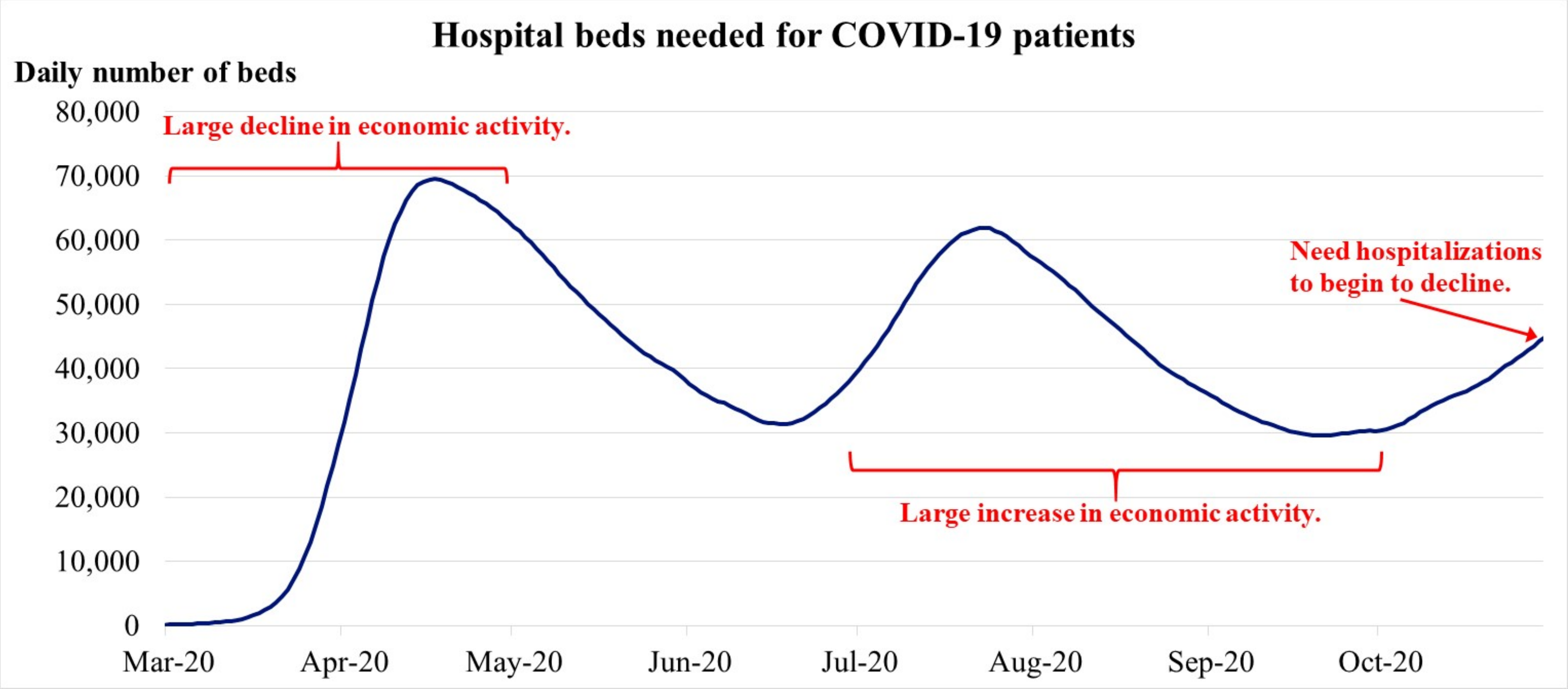
Sources: Center for Systems Science and Engineering at Johns Hopkins University, Centers for Disease Control and Prevention and author's calculations. Last observation: Nov. 11, 2020. For this chart, the East Asia and Pacific region consists of Australia, China, Indonesia, Japan, Malaysia, Myanmar, New Zealand, Philippines, South Korea, Singapore, Thailand and Taiwan.

U.S. public health limits remain stringent



Source: University of Oxford's Blavatnik School of Government COVID-19 Government Response Tracker. Last observations: Nov. 8, Oct. 29, Nov. 5, Nov. 9 and Nov. 6, 2020.

U.S. hospitalizations rising



Source: Institute for Health Metrics and Evaluation, University of Washington. Last observation: Oct. 29, 2020.

Responding to renewed pandemic intensity

- The Oxford stringency index suggests business restrictions today are not too different from what they have been in recent months on a national basis in the U.S.
- Businesses, generally speaking, have strong incentives to try to keep their customers and workers safe; otherwise, a major outbreak could occur, which would severely impact the business.
- It may be that renewed increases in infections are coming more from personal interactions at the household level.
- If so, a renewed public education initiative asking households to take actions to reduce disease transmission may be helpful.

Upside Surprise in U.S. Macroeconomic Data

Substantial expansion in Q3

- Current macroeconomic data suggest that April 2020 will prove to be the lowest point of the crisis, provided the remainder of the crisis can be managed effectively.
- The Citi Economic Surprise Index indicates substantial upside surprise in macroeconomic data releases in recent months.
- Third-quarter real GDP growth, at an annualized rate of 33.1%, was the fastest on record.

Data releases surprise to the upside

Source: Citigroup. Last observation: Nov. 11, 2020.

Above-trend growth forecasts for Q4

Source	Date	2020:Q4 Forecast
Blue Chip	Nov. 10	3.8%
IHS Markit	Nov. 9	3.7%
Atlanta Fed GDPNow	Nov. 6	3.5%
New York Fed Nowcast	Nov. 6	2.9%

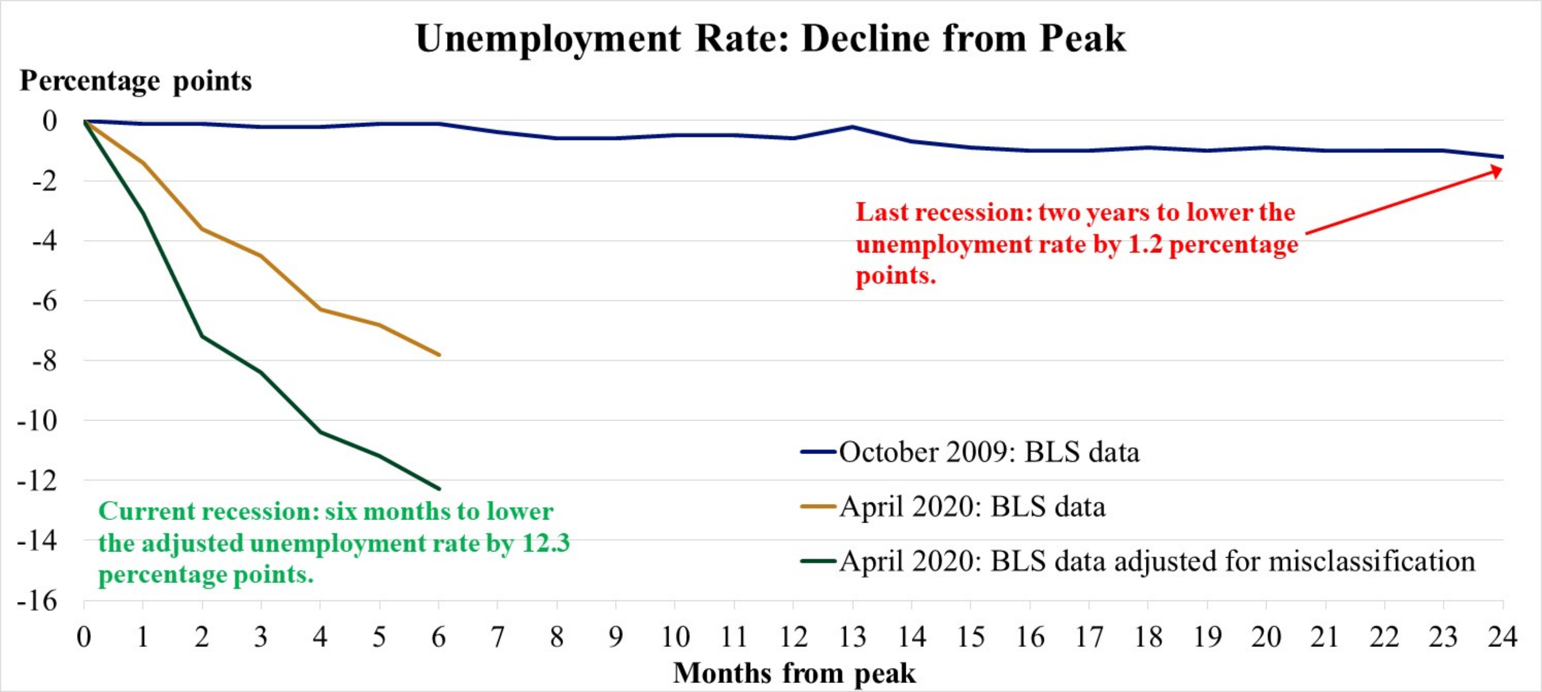
Growth rates are quarter-over-quarter at annual rates.

Labor markets continue to improve

- Employment has rebounded more rapidly than expected, supporting the idea that many layoffs were temporary as firms adjusted to the pandemic.
- Hall and Kudlyak (2020), in particular, have emphasized that the temporary layoff category of unemployment has been dramatically more important in this recession as compared with previous recessions.*
- As a result, the U.S. labor market recovery is 48 to 50 months ahead of where it was following the 2007-09 recession.

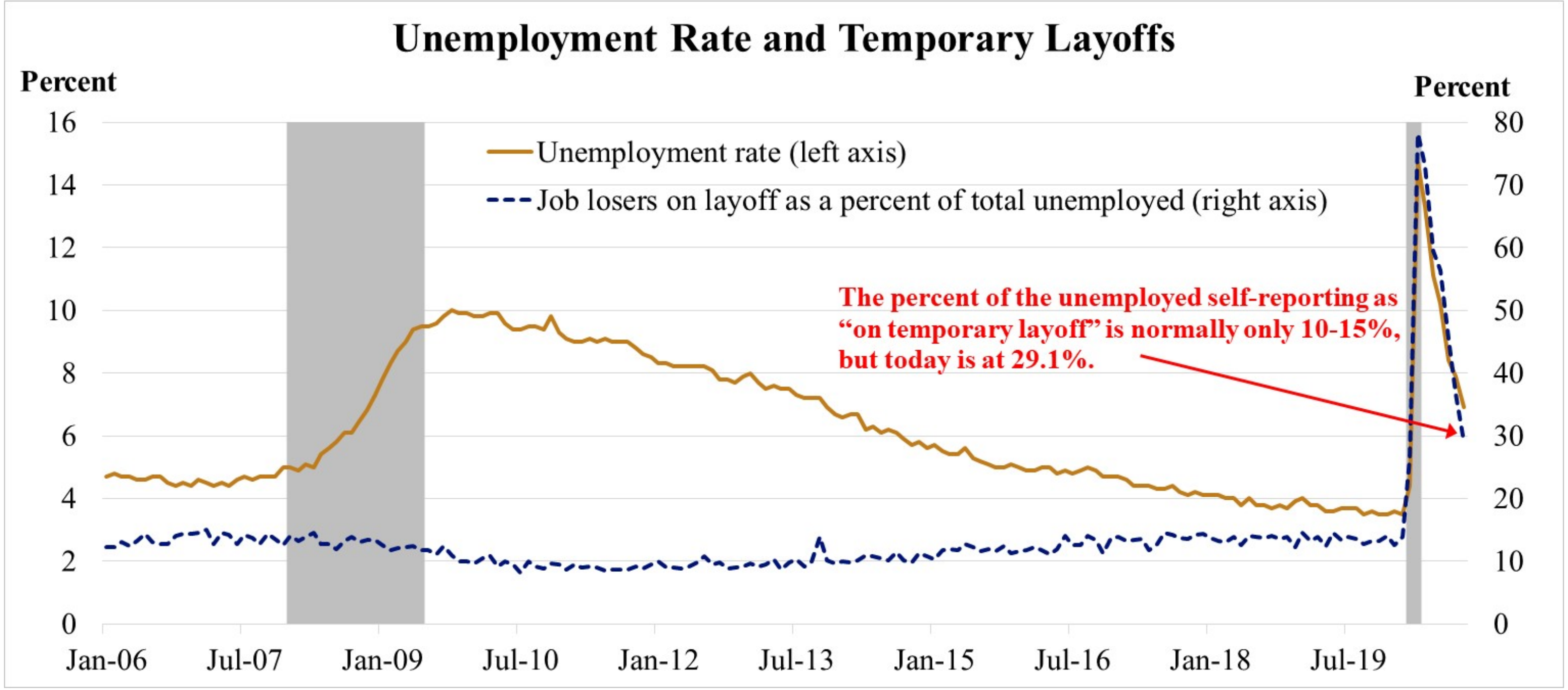
** See R.E. Hall and M. Kudlyak, 2020, "Unemployed With Jobs and Without Jobs," National Bureau of Economic Research, Working Paper No. 27886.*

Unemployment declining more rapidly than after the previous peak



Sources: Bureau of Labor Statistics and author's calculations. Last observation: October 2020.

Unemployment driven by temporary layoffs



Source: Bureau of Labor Statistics. Shaded areas indicate U.S. recessions, assuming the 2020 recession ended in April. Last observation: October 2020.

Potential unemployment declines

- A back-of-the-envelope calculation suggests that there is room for a substantial decline in the official unemployment rate in the months ahead.
- If all those unemployed identifying as “on temporary layoff” are simply recalled and nothing else changes, the official unemployment rate would decline to 4.9%.
- If the “on temporary layoff” category returns to a normal value (e.g., 1 million workers) and nothing else changes, the official unemployment rate would still decline to 5.5%.

How far ahead of schedule is the U.S. labor market?

	February peak	April trough	October	Percentage recovered	Months ahead of previous recovery
Aggregate weekly hours (index)	112.0	93.2	105.6	66%	48
Civilian employment (millions)	158.8	133.4	149.8	65%	50
Nonfarm payrolls (millions)	152.5	130.3	142.4	55%	49

Sources: Bureau of Labor Statistics and author's calculations. Last observation: October 2020.

COVID-19: Mortality Risk Management

Learning to run a business in a pandemic

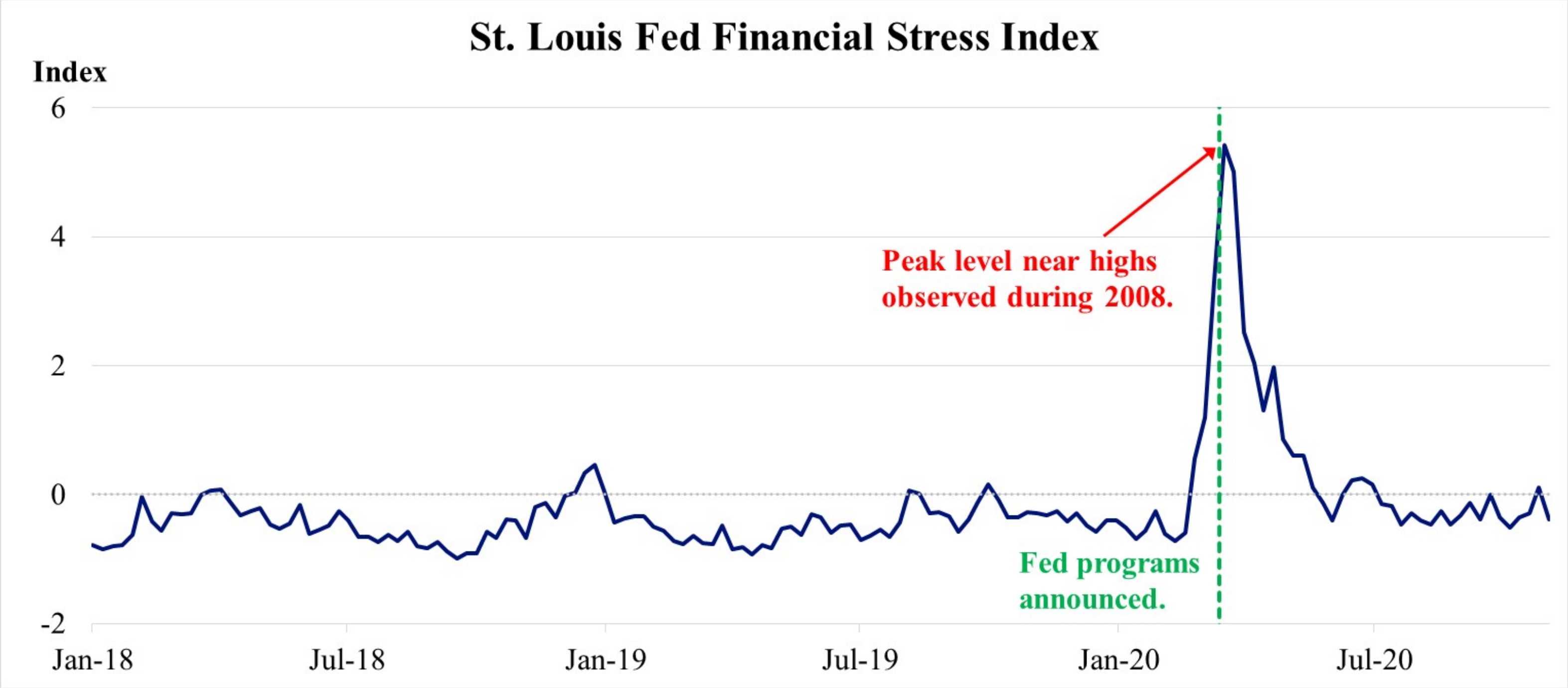
- U.S. citizens face many types of mortality risk.
- Households and businesses have developed strategies for mortality risk mitigation, such as wearing seat belts and adhering to fire codes.
- The second-quarter results showed that essential retail services can be provided with low risk, so long as simple precautions are taken.
- Since then many firms have adopted proven, simple risk mitigation strategies pioneered by the essential services industries in the second quarter.
- This has allowed many, but not all, firms to get back in business safely.

Effective Monetary and Fiscal Policies

A policy rate cut and increased liquidity

- U.S. monetary and fiscal policies have been exceptionally effective during the initial phase of the crisis.
- Monetary policy included lowering the policy rate to the effective lower bound and providing liquidity to financial markets through a variety of programs supported by the U.S. Treasury.
- The backstop programs stemmed an incipient financial crisis during the March-April time frame, to the point where current levels of financial stress are near pre-pandemic levels.

Financial stress has abated



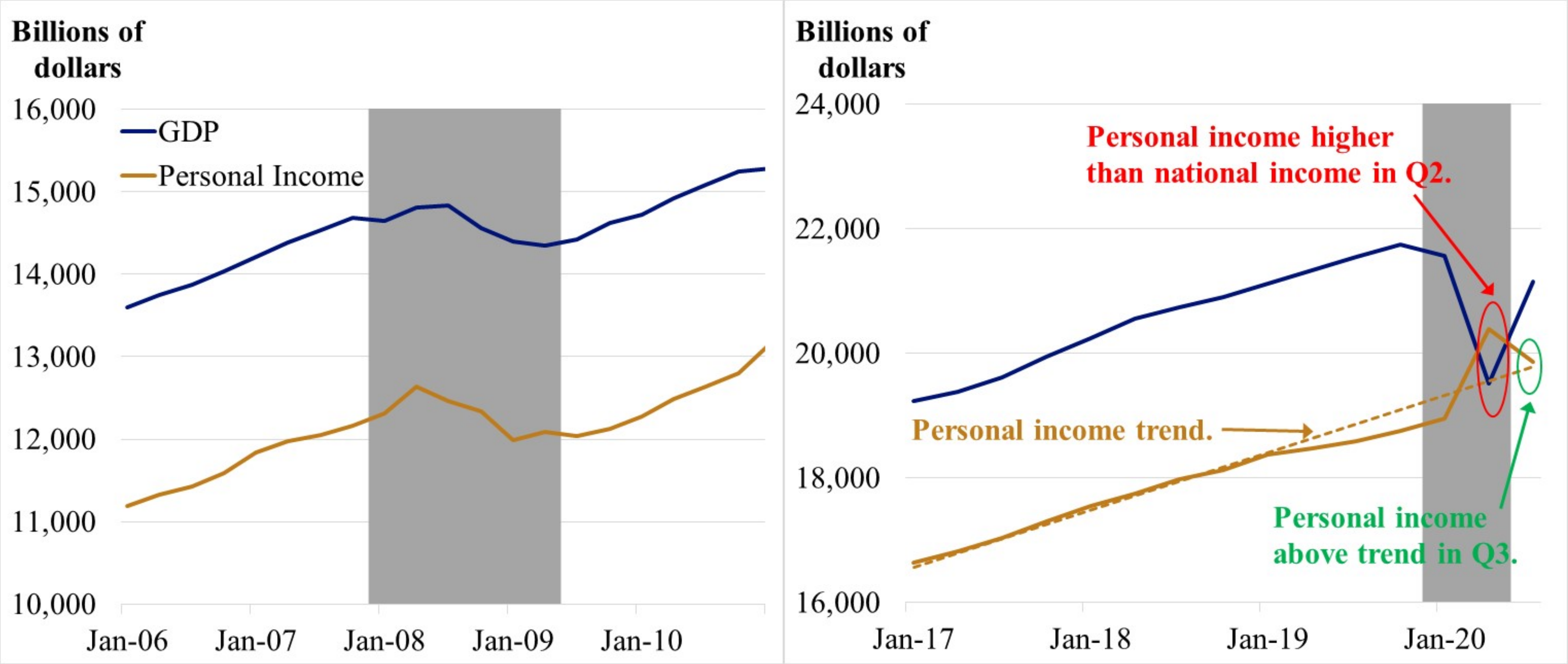
Source: Federal Reserve Bank of St. Louis. Last observation: Week of Nov. 6, 2020.

Fiscal policy

- U.S. fiscal policy included the CARES Act along with additional legislation. In total, the fiscal policy response has been valued at about $3.148 trillion.*
- The total value would be about 14.5% of U.S. nominal GDP in the fourth quarter of 2019.
- The actual shortfall in U.S. real GDP in 2020, according to forecasters, will likely be closer to 2.5% of GDP, or about $500 billion.
- In an aggregate sense, there are considerable resources pledged to combat the crisis, which should continue to be helpful in 2021.
- The fiscal response drove personal income up to an all-time high in the second quarter, the opposite of normal recession dynamics.

** See the International Monetary Fund's* Policy Responses to COVID-19 *and the Committee for a Responsible Federal Budget's* *estimates of the cost of President Trump's executive orders*.

GDP and personal income, then and now



Source: Bureau of Economic Analysis. Shaded areas indicate U.S. recessions, assuming the 2020 recession ended in the second quarter. Last observation: 2020-Q3.

Conclusion

Adapting to the pandemic

- The second half of 2020 continues to be a period of learning and adaptation to the new mortality risk in the global economy.
- The adaptation has been much faster than initially expected so far, and accordingly macroeconomic outcomes have been considerably better than originally expected.
- This outcome has been supported by exceptionally effective monetary and fiscal policies.
- Despite this success, downside risk remains substantial, and continued execution of a granular, risk-based health policy will be critical in the months ahead.

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