COVID-19 and the U.S. Economy: Progress on Health and Incomes

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Global Interdependence Center
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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 substantial progress in managing the global health crisis.
• U.S. macroeconomic news has surprised dramatically to the upside, and economic activity will likely show outsized growth in the third quarter.
• I expect this rebound to continue in the U.S. as businesses learn how to produce products and services safely using simple, existing technology.
• 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.
Substantial Progress in Health Outcomes
Falling fatality rates and rising economic activity

• There has been substantial progress in managing the global health crisis.
• Daily fatalities per 100,000 population have declined substantially from peak levels in March and April in both Europe and the U.S.
• 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.
• This suggests that key areas of global production are well past the initial phase of the crisis and are likely to continue to increase economic activity under new safety protocols.*

Substantial progress in health outcomes

Deaths per 100,000, 7-day average

Daily Deaths per 100,000 Population

- U.S.
- France, Germany, Italy, Spain and UK
- East Asia and Pacific

Europe hit hardest
East Asia and Pacific less impacted
More persistence in the U.S.

Sources: Center for Systems Science and Engineering at Johns Hopkins University and author’s calculations. Last observation: Sept. 21, 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

Upside Surprise in U.S. Macroeconomic Data
Substantial expansion expected in Q3

• Current macroeconomic data suggest that April 2020 will prove to be the lowest point of the crisis.
• The Citi economic surprise index indicates substantial upside surprise in macroeconomic data releases in recent months.
• Employment has rebounded more rapidly than expected, supporting the idea that many layoffs were temporary as firms adjusted to the pandemic.
• Third-quarter GDP growth is projected to show substantial expansion.
• There is an outside chance that U.S. GDP could reach the 2019 average level by the end of 2020, a form of “full recovery.”
Data releases surprise to the upside

Citigroup Economic Surprise Index

Unemployment declining more rapidly than after the previous peak

Unemployment driven by temporary layoffs


The percent of the unemployed self-reporting as “on temporary layoff” is normally only 10-15%, but today is at 45.5%.
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 a shocking 4.6%.

- 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 5.2%.
Outsized U.S. GDP growth forecasts for Q3

<table>
<thead>
<tr>
<th>Source</th>
<th>Date</th>
<th>2020:Q3 forecast</th>
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<tbody>
<tr>
<td>Blue Chip</td>
<td>Sept. 10</td>
<td>24.0%</td>
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<tr>
<td>IHS Markit</td>
<td>Sept. 8</td>
<td>29.6%</td>
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<tr>
<td>Atlanta Fed GDPNow</td>
<td>Sept. 17</td>
<td>32.0%</td>
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<tr>
<td>New York Fed Nowcast</td>
<td>Sept. 18</td>
<td>14.3%</td>
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</table>

*Growth rates are quarter-over-quarter at annual rates.*
Potential for recovery in 2020

• Very rapid third-quarter GDP growth may put the U.S. economy within reach of a sort of “full recovery” by the end of 2020.

• The average level of aggregate national income in 2019 was $19.1 trillion in inflation-adjusted 2012 dollars. This is the average level, not the peak level.

• We could reach the average of 2019 by the end of 2020.

• For this to happen, real GDP would have to grow 35% at an annual rate in the third quarter, followed by about 10.3% at an annual rate in the fourth quarter.

• These are big numbers, but not outside the realm of possibility.
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. This crisis is no different.
• For many businesses, work from home has proven to be a viable and powerful strategy.
• The second-quarter results show that essential retail services can be provided with low risk, so long as simple precautions are taken.
• This suggests that during the third quarter many firms have simply adopted proven, simple risk mitigation activities pioneered by the essential services industries in the second quarter.
Effective Monetary and Fiscal Policies
A policy rate cut and increased liquidity

• U.S. monetary and fiscal policies have been 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 lending programs supported by the U.S. Treasury.

• The backstop lending 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

Fiscal policy

- U.S. fiscal policy included the CARES Act along with additional legislation.
- The CARES Act is often valued at $2.3 trillion.*
- Other legislation is valued at $848 billion.*
- 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 3% to 4% of GDP, and so in an aggregate sense there are considerable resources pledged to combat the crisis.
- 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

Conclusion
Adapting to the pandemic

• The global health policy response has managed to contain the pandemic in terms of health outcomes relative to the March-April 2020 period.

• The second half of 2020 is a period of continued learning and adaptation to the new mortality risk in the economy.

• Simple mortality risk mitigation strategies hold the promise of delivering higher household incomes along with lower fatalities from COVID-19, thus improving outcomes along both dimensions.

• The 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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