DNB

US Update
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US economy set to be hit hard

The first effects of the coronavirus measures have begun to emerge in US macro data. Despite the swift action from the Fed and additional substantial measures today, and a promised huge fiscal package, the US economy looks set to slow markedly.

The coronavirus is now spreading fast in the US

The daily growth in the number of confirmed cases of coronavirus in the US has recently begun to accelerate rapidly. As the number of tests has been very low so far, the real number of infected people is likely much higher. Yesterday the number of confirmed cases rose by almost 13,000 (according to Bloomberg), while the number of deaths surged from 33 on average in the past week to 139 yesterday. As the authorities have been slow to implement nationwide measures to contain the virus, many states have still not implemented strict measures. Hence, the risk is that there could be a rapid surge in new cases and deaths in the coming weeks, much as we have seen in Italy recently.

Tougher measures will slow the economy

At the beginning, the Trump Administration played down the virus. This obviously has led to a delayed response to prevent it from spreading domestically. However, recently the tone has changed markedly. Having seen the dramatic effects in Italy, the message now is that the only solution is to close down most of the service-oriented parts of the economy in order to obtain the vital degree of social distancing. Such measures will hit the economy markedly, and the short-term outlook seems set to deteriorate further. The stronger the measures, the harder the hit to economic activity.

Several reasons why the US economy will likely be hit hard

We see several reasons why the US economy will likely be harder hit than many other economies. First, the US economy has many people working in service sectors that will be affected negatively, and relatively few people in more sheltered industries and the government sector. Consequently, more employees will likely be laid off in the US than in other economies. Second, many individuals are low-paid, with limited financial buffers, lack of sickness benefits, and some even lack health insurance. Even if the household sector on average seems strong, there will likely be many who will have to slow their consumer demand significantly. Third, the shale oil industry has been affected negatively by the sharp drop in the oil price, whereas many other countries benefit from lower oil prices. Fourth, the corporate sector was highly debt-ridden before the crisis, which will exacerbate financial strains, and make it harder for many companies to survive.

The economy will soon enter a recession

Economic effects will mainly take effect from March onwards. Hence, we have not seen much of an impact yet. Some regional PMIs for March (i.e. the NY Fed Empire Stats survey and the Philly Fed survey) have fallen markedly. The national PMIs due to be published tomorrow are expected to drop markedly. Furthermore, the number of initial claims applicants rose by 70k last week. However, regional reports suggest that the claims data will surge to very high levels this week. According to Bloomberg, the estimate is 1500k (up from 281k). All sorts of activity is likely to slow markedly, consumer and business confidence will dive and unemployment will leap. Hence, the economy will soon enter a recession, but it is still uncertain how severe the downturn will be. We have therefore not yet changed our specific GDP-forecasts.

The Fed’s rapid response will be helpful, but cannot prevent a setback

Financial conditions have deteriorated rapidly in recent weeks. This is mainly due the marked equity market sell-off and the rapid rise in credit spreads. The Fed responded very quickly by slashing the Federal funds rate down to the lower bound (0–0.25%), and has provided a series of measures in order to make sure that the rate cuts are transmitted to the money markets. Today the Fed has launched a new package, which implies unlimited QE, and a row of facilities to support credit to employers, consumers and businesses. The new extended package will likely be successful in combatting the strains that have been evident in the markets recently. Even if the total set of measures eventually turns out to be successful in supporting both financial markets and the economy, they cannot prevent a severe setback, as activity is mainly halted by restrictions.

A huge fiscal package could slow the negative impact

Congress has so far failed to agree on a giant stimulus package, likely to amount to USD2trn, or some 12% of US GDP. Such a package will likely dampen the negative economic effects, in particular for households and businesses that are affected directly by the crisis. Even if the package is approved soon, there are reasons to believe the effectiveness would be lower than from similar measures in Europe. In order to reach all in need of financial support, there will likely be lump sum transfers to all inhabitants fairly soon. While such a scheme would also reach those who are not working, and hence not would gain from tax cuts, it would also reach many who are not in need of financial support. A support scheme directed only at all those in real need would hence be more efficient and targeted. Support for the business sector will likely be given as loans and/or loan guarantees. While this may secure short-term liquidity, it may not be enough for companies with a high debt level and/or low credit rating, if the crisis were to continue for a longer period.

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