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ECONOMIC TALKING POINTS

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The Economy Will Face Many Hurdles In 2021---Even With Yellen as Treasury Secretary

There's a lot going for the economy in 2021. With Joe Biden in the Oval Office in January we will have a more predictable and seasoned leader. He has already shown a readiness to pick the best and brightest for key posts in his Administration. Tapping Janet Yellen as the next Treasury Secretary, Avril Haines to be Director of National Intelligence and Michele Flournoy to lead Defense are ideal examples of that. We're also getting exciting news on the pharmaceutical front with the recent breakthrough of new vaccines to combat the coronavirus. It all clearly suggests that the "annus horribilis" of 2020 is coming to an end and that we are about to get a fresh start politically and medically.

Having said that, we must not lose sight that 2021 will also be a difficult transition year for the nation and economy. The two questions I get asked most often from clients are these: With one or more vaccines now in sight, how soon will the pandemic fade into history? And how will the incoming Biden Administration impact business and consumer activity in the coming year?

We have not pulled any punches in our responses. Yes, the economy will be on a better glide path in 2021. But there are still many formidable hurdles ahead and it is far from certain the next White House will be able to navigate through them without a serious stumble or two in the process. As a result,

we have advised clients that the better strategy is to look beyond next year and do what is necessary to tide them over to 2022.

Here's the short list of potential impediments to growth next year:

- President Trump is using his final days in the White House to rush through policy directives designed to make Biden's presidency as problematic as possible.
- If Republicans manage to hold their majority in the Senate, they will likely veto many of Biden's fiscal and social policy initiatives.
- The economic scars left behind by Covid-19 are deep and will require time for business leaders, investors and households to adjust to the new landscape.
- Even if an effective vaccine is available, serious questions remain whether enough Americans will rush to be inoculated.

For now, let me drill down on what I perceive are the four biggest challenges that could constrain economic activity in 2021.

1. How difficult will it be for President Biden to implement his policies?

There should be no doubt by now that we'll have a Democrat in the White House come January 20th. The next question is whether *Trumpism* will continue to hover menacingly over Washington as a disruptive force? That is, will we continue to see GOP leaders in Congress express the same extremist views, vitriol and bombast that so characterized Trump's term? If so, that would likely doom any effort by Biden to revive a spirit of bi-partisanship.

On the other hand, it is entirely plausible that with Trump gone, the vestiges of *Trumpism* will rapidly fade as well. Such an outcome would lessen the hostilities on Capital Hill, defuse tensions and get the institution operating back to the more traditional, if still laborious, practice of give and take when crafting legislation.

Another related element is the Senate race in Georgia, which has evolved into a full-fledged political war. Battalions of Democrats, Republicans and Hollywood celebrities now swarm the state to get the vote out for their candidate. More than \$100 million in TV ads are being spent in the January 5th run-off. The stakes are clearly high. If Senators Kelly Loeffler and David Purdue regain their seats, the Senate remains in Republican hands. Should Democrats Jon Ossoff and Ralph Warnock be victorious, the upper body would be split 50 – 50. In that case, Kamala Harris in her role as Vice-President would break the tie.

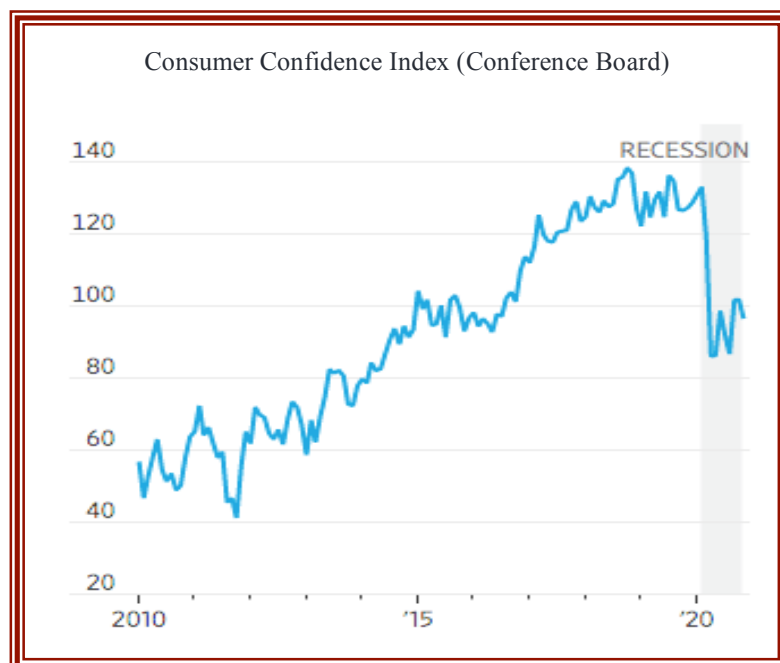
Now for the nightmare scenario: There is the danger the Georgia race, whatever its outcome, may trigger yet another wave of court cases to challenge its legitimacy (i.e., election fraud charges 2.0) and a protracted battle here would further inflame the political environment in Congress.

**OUR BASELINE ASSUMPTION:
LOEFFLER AND PERDUE BOTH WIN.
GOP TO STAY IN CONTROL OF SENATE.**

2. Should the GOP hold the Senate, it would kill any chance of Congress passing the larger \$2.2 trillion emergency stimulus package sought by the House. We then expect a slimmer plan (\$700 billion) to eventually pass the Senate.

The problem is the timing for an anemic stimulus couldn't be any worse. When the initial \$2.2 trillion CARES Act became law on March 27th, there were 17,300 new Covid-19 cases that day. We are now seeing daily infection rates ten times that amount, causing businesses and schools in parts of the country to shut down.

Moreover, the economy has begun to flash warning signs of another downturn. The latest weekly report on applications for unemployment benefits rose by up more than expected, to 742,000, and the total number of Americans collecting some form of jobless benefits also jumped to 20.3 million. Consumer moods are souring as well. The Conference Board today reported that Consumer Confidence in November dropped to its lowest level since August.



Adding to those woes is the prospect that several emergency support programs are to expire at the end of the year. They include the additional 13-weeks to receive jobless benefits (Pandemic emergency Unemployment Compensation) and the program to provide benefits to gig workers and freelancers (Pandemic Unemployment Assistance).

That's not all. Under current law, student debt forbearance and the moratorium on home evictions of financially strapped Americans will also expire December 31st.

Moreover, the Treasury last week announced it would discontinue several of the emergency lending facilities set up with the Federal Reserve last spring. Up for expiration are the Main Street Lending Program, the Municipal Liquidity Facility and two related corporate credit facilities. Now, it may well be that if the next Senate confirms Janet Yellen to be as the new Treasury Secretary, she may work quickly to reinstate these same programs. Yellen and Jerome Powell have worked closely together when they served as the Fed Governors and share similar views on how to support the economy. But for now, we cannot yet incorporate into our forecast the kinds of policies that she and President-elect Biden will pursue.

What is clear is that the only reason US GDP bounced back so strongly in the third quarter was because of the massive financial infusion the economy received last March and April from the Federal Reserve, Congress and Treasury.

Unfortunately, a large part of that safety net is being removed just when coronavirus cases are surging and the economy is showing signs of wobbling.

OUR BASELINE ASSUMPTION:

CONGRESS PASSES A SCALED DOWN \$700 BILLION PLAN IN Q1 2021.

3. Another factor that will affect growth next year are the severe scars left behind by the coronavirus. For many industries, the destruction will be widespread and permanent, especially those in travel, hospitality, entertainment and retail. The damage done will bring about structural changes to the business and economic landscape with repercussions that could last for years.

As the extent of the scars becomes more noticeable, CEOs, investment managers and venture capitalists will confront a whole new marketplace and ponder new questions. For example, given the horrific nightmare of the past

year and the haunting prospect of perhaps a future pandemic, does it make sense to invest one's savings or seek a bank loan to open a new restaurant, a hotel or a retail shop?

Given how woefully unprepared the nation was in dealing with the pandemic and the way it highlighted America's vulnerability to bioterrorism, business leaders will think twice on how to deploy investment capital in the future.

Letting go of the pandemic nightmare will not be easy. Even the recent positive news about vaccines has not slowed the pace of layoffs in aviation, theme parks and hospitality. And while IHS/Markit's flash PMI showed US manufacturing activity expanded in November by the most in six years, these factories are still operating with 620,000 fewer workers than last February. What this tells you is that employers are still nervous about bringing back workers while the virus rages on.

And that leads me to my next point below: It's not at all certain the availability of one or more vaccines will change economic conditions in 2021.

OUR BASELINE ASSUMPTION:
HOUSEHOLDS AND BUSINESSES WILL REMAIN CAUTIOUS ABOUT SPENDING NEXT YEAR AS THEY ASSESS THE ECONOMIC SCARS CAUSED BY THE PANDEMIC.

4. We can certainly cheer the news of several breakthroughs in vaccines against Covid-19, but how many will actually take it?

Three pharma companies --- Moderna, Pfizer/BioNTech and AstraZeneca Oxford --- may soon be able to provide this much-needed treatment to the public. The speed with which they have come up with the vaccines has been remarkable. Normally it takes nearly a decade to research, test and get FDA approval for a new drug. Up to now, the shortest time ever was four years and that was to prevent the mumps.

The fact that Trump's Warp Speed program produced several vaccines in less than a year is truly impressive. And now for the BUT; that speed has also generated concerns about their safety. There has been much speculation in the broadcast and social media platforms on whether the White House pressured the FDA and other agencies to approve a vaccine before it was thoroughly tested.

The Trump Administration has, of course, denied applying such pressure and several top health experts agree that all the necessary protocols are being satisfied. Yet the results of several polls show a large number of Americans

distrust the medicine and say they will not rush to take it next year once it becomes available.

What's odd, if not intriguing, is that even with Trump's repeated assurance that the vaccines are going to be effective and safe, more Republicans than Democrats don't believe him. That leaves us with a peculiar dichotomy on Trump's powers of persuasion.

If the President claims the November elections were fraudulently stolen by Joe Biden, that alone was enough for more than 70% of Republicans to share in the belief the outcome was rigged. However, when the President regularly asserts the vaccine is safe and urges everyone to take it, many Republicans are just not buying Trump's line. In a survey out this month by Economist/YouGov, it showed that once a coronavirus vaccine becomes available, only 39% of Republicans said they would take it. That is even less than the 43% of Democrats who agreed to be vaccinated. Another poll conducted by Gallup showed a similar trend. Less than half of Republicans queried would agree to be vaccinated, while 69% of Democrats were prepared to do so.

These two different surveys actually raise a larger question. If these percentages hold, it may not be enough to get past the pandemic in 2021. The pace of new coronavirus infections should decline next year, but the threat to public health will remain and that could set back the timetable for a full economic recovery.

**OUR BASELINE ASSUMPTION:
MANY AMERICANS WILL BE WARY OF TAKING THE
VACCINE, GIVEN HOW LITTLE IS KNOWN ABOUT ITS
LONGER TERM SIDE EFFECTS.**

As a result of the risks cited above, we have downgraded our US forecast for real GDP growth in 2021 from 3.4% to 2.9%, but raised it from 3.9% to 4.2% for 2022.

United States

	I 2019	II 2019	III 2019	IV 2019	I 2020	II 2020	III 2020	IV 2020	I 2021	II 2021	III 2021	IV 2021	I 2022	II 2022	III 2022	IV 2022
Real Gross Domestic Product (GDP):																
%	2.9	1.5	2.6	2.4	-5.0	-31.4	33.1	2.2	1.5	3.5	3.8	3.0	3.5	5.2	4.9	3.7
Personal Consumption Expenditures:																
PCE %	1.8	3.7	2.7	1.6	-6.9	-33.2	40.7	4.0	2.2	3.8	4.6	3.3	2.4	5.1	4.8	3.7
Inflation, end of period, year-over-year:																
CPI %	1.9	1.6	1.7	2.3	1.5	0.6	1.4	2.1	1.6	2.1	2.3	2.5	2.4	2.5	2.3	2.2
Unemployment Rate (end of period):																
%	3.8	3.7	3.5	3.5	4.4	11.1	7.9	8.1	8.2	7.4	6.8	6.8	6.4	5.8	5.4	5.2
Non-farm Payrolls, monthly avg. thousand:																
	174	152	188	210	-303	-4,427	1,304	690	785	710	375	320	300	320	375	360
Treasury 10-yr Note Yield % (end of period):																
	2.42	2.00	1.65	1.88	0.63	0.65	0.68	1.05	0.90	1.05	1.10	1.20	1.20	1.30	1.55	1.85
Federal funds rate % (end of period):																
	2.38	2.38	1.88	1.63	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13

GDP Growth - Global Economy

Country	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
US	2.6	1.6	2.2	1.8	2.5	3.1	1.7	2.3	3.0	2.2	-2.8	2.9	4.2
Eurozone	1.7	1.4	-0.9	-0.2	1.4	2.1	1.9	2.5	1.9	1.2	-8.8	3.5	2.5
United Kingdom	1.7	0.7	0.3	1.8	2.9	2.2	1.9	1.9	1.3	1.5	-10.3	4.6	3.9
Japan	4.6	-0.4	1.6	1.5	-0.1	1.1	0.5	2.2	0.3	0.7	-5.2	2.4	3.2
Canada	3.1	3.1	1.8	2.3	2.9	0.7	1.0	3.2	2.0	1.6	-5.8	5.4	3.4
India	8.4	8.6	6.7	4.9	7.4	8.0	8.1	7.2	6.8	4.8	-8.8	9.9	6.4
China	10.5	9.5	7.8	7.7	7.3	6.9	6.7	6.8	6.6	6.1	2.1	7.4	6.2
Brazil	7.5	2.7	0.9	2.3	0.1	-3.5	-3.5	1.2	1.2	1.1	-6.0	2.9	2.7
Mexico	5.2	4.0	3.9	1.4	2.3	2.7	2.7	2.4	2.1	-0.1	-9.6	3.3	2.8
Australia	2.8	2.6	3.6	2.4	2.6	2.5	2.4	2.4	2.7	1.8	-3.9	3.5	3.8
Russia	4.0	4.3	3.4	1.3	0.6	-2.8	-0.2	1.6	2.5	1.2	-4.9	2.9	3.3
World	4.2	3.1	2.5	2.6	2.8	2.8	2.6	3.4	3.2	2.9	-3.8	4.7	4.2

