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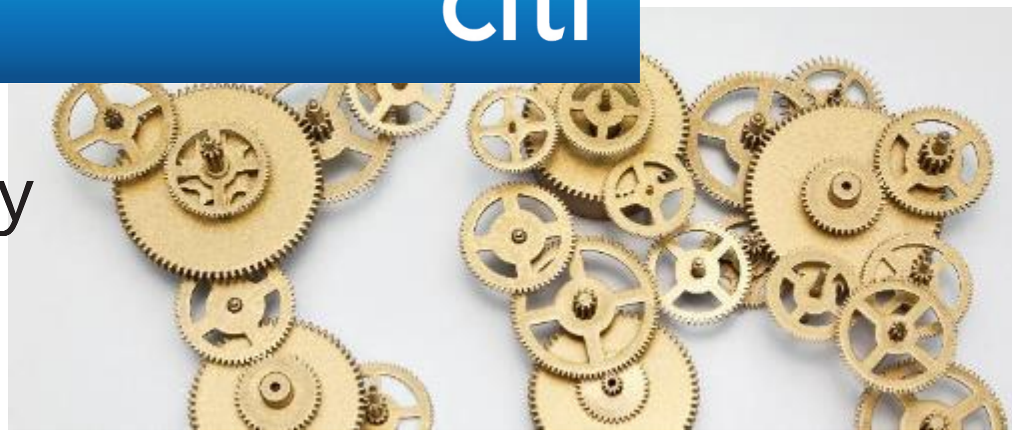

Wave 1 Virus Acceleration Requires Wave 2 Stimulus

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Summary

- More government spending is required now. The failure of the US to contain the virus early - and the lasting impacts this is having on all "socially close" economic activities – means that the rate of re-employment in the US will slow. We reaffirm our March $4.5 trillion fiscal response estimate and note that $2 trillion of that amount is required to bridge the economy to January 1st.
- We expect Congress will agree to an extension of emergency benefits as they have 36 times previously. Additional income supports are likely and greater attention is needed to avoid the government creating disincentives to work. Federal unemployment benefits to date are just 18% of all COVID-related supplemental Federal outlays. While the failure to pass additional benefits would be quite worrisome, the idea that a massive "spending cliff" is upon us is an exaggeration.
- An effective vaccine would represent the greatest fiscal savings instrument in world history. Keep an eye on its progress.
- This week will start the period of drama and suspense over how the two US political parties come to eventual agreement.

$2 or $3 Trillion Is Not Enough

With COVID spreading rapidly across major portions of the US (see figure 1 and appendix 1), the speed of the economic recovery in the US has slowed. A rapid economic rebound off the bottom that exceeded expectations and supported the US stock market is now in jeopardy. A poor federal health policy response and lack of central coordination to the pandemic have the public and investors reassessing the sustained economic and social impacts of the virus.

We have previously praised the US Congress and Fed Chairman Powell for their rapid action to provide a bridge across the chasm of COVID (ESSAY 2: CIO Strategy Bulletin | Jerome Powell 1, Warren Buffet 0 and CIO Strategy Bulletin | The Inevitable Rise). The US government provided $1.6 trillion in direct and indirect aid to businesses, governments and individuals in record time and in advance of the full brunt of the pandemic itself. The Federal Reserve has financed this with newly created money and went further in providing credit to impacted businesses in several unprecedented ways.

In our publication "Catching the COVID-19 Knife: What It Will Take" we previously estimated that total fiscal spending required to get the US through the crisis period was $4.5 trillion (see Figure 7 below). We affirm that $4.5 trillion estimate of which $2 trillion more is needed now.

One-time "stimulus" checks to most households arrived in April. Federal emergency unemployment insurance supplements worth $600 per week for the unemployed will be exhausted at the end of the July. In our view, this is precisely the time when the government must act to enable the US economy to reach "escape velocity" and ensure a lasting economic recovery in 2021 and 2022. And yet, the Democrat-led House and Republican-led Senate are not coming together quickly to provide more necessary aid.

Will Congress have the will to act? And what will it take for them to be successful?

Where is the Economy Now?

The labor market took a severe blow from the chaotic and self-imposed economic shutdown in April. Unemployment rose to a post-1930s high in the space of just 6 weeks. And now, an extension of “Wave 1 COVID” across the US threatens the economic recovery. The states initially hit hardest by the pandemic continue to move into “remission,” while the majority are seeing COVID gather strength (see figure 1). The rise in disease levels across the US coincides, not surprisingly, with a softening of consumer and business sentiment in July as well as other modest signs of downward economic momentum. Yet, consumer confidence and consumer expectations for the future have not collapsed severely (see figure 2). Their fragile confidence is due to the exogenous and temporary of the pandemic and the government’s bold initial steps to assist the public.

Figure 1: GDP-Weighted Share of US Metropolitan Areas With New COVID Cases Rising

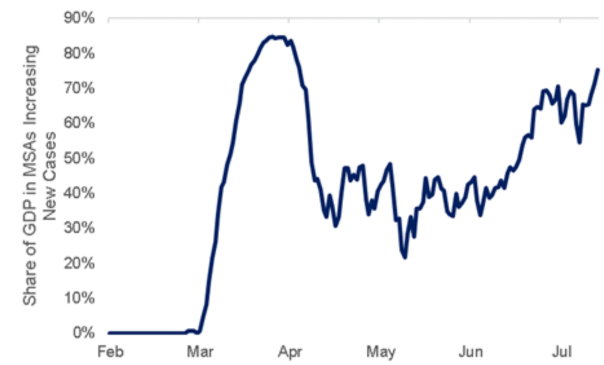
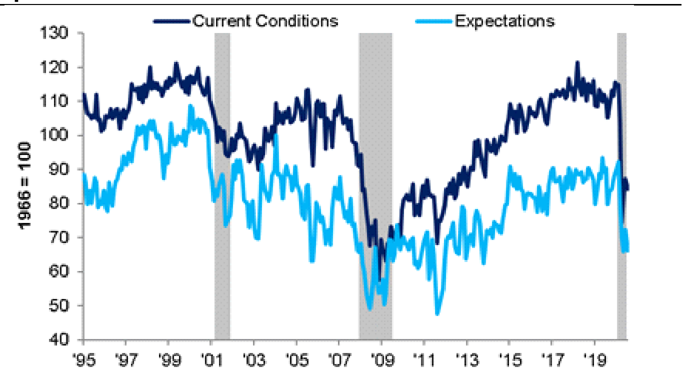


Figure 2: Consumer Sentiment: Current Conditions and Expectations



Sources: Haver Analytics as of July 17, 2020.

Low long-term US Interest rates (and the shape of the yield curve) do not suggest policymakers have used overwhelming financial “firepower” to address the immediate crisis. Despite large gains in consumer spending in the past two months, labor markets are deeply depressed. The “recall effect” from furloughs allowed 7.5 million US jobs to be recovered in May and June, but this still left US employment 14.6 million lower than the pre-COVID period. With COVID in the US on its present course, we would expect one more sizeable monthly gain in hiring in July before a leveling off in employment beyond.

As we look at the data, keep in mind how much a well-tested, mask-wearing public would have slowed the spread of the virus. If the US government had acted in a coordinated fashion to mitigate the disease such that recoveries exceeded new cases, there would be no slowdown in the reopening of the economy (see figures 3 and 4). Because this is NOT the case for much of the US, it will hamper the ability of many to work or seek new work, thus increasing the risk of an economic relapse without further government action.

In short, the economic and fiscal costs of the virus have moved materially higher. While we see no need for worried local and state governments to collectively repeat the broad, indiscriminate shutdown of the US economy that occurred in March-April, we do see the need for them to take bold steps to mitigate the spread of disease.

Figure 3: Mobility gains are slowing in areas where new COVID cases are ramping up

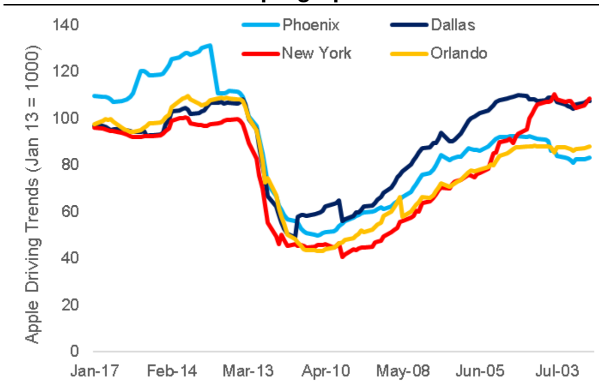
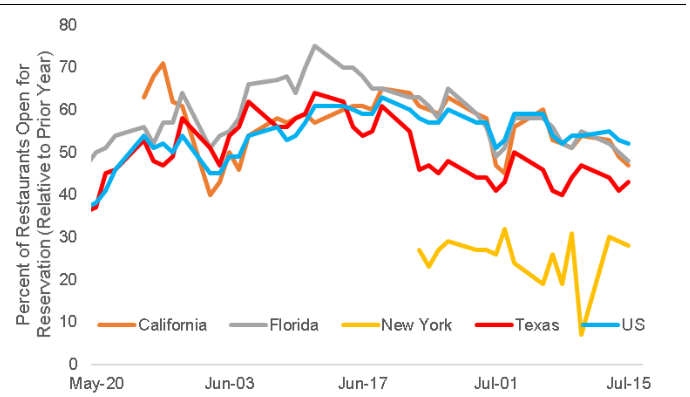


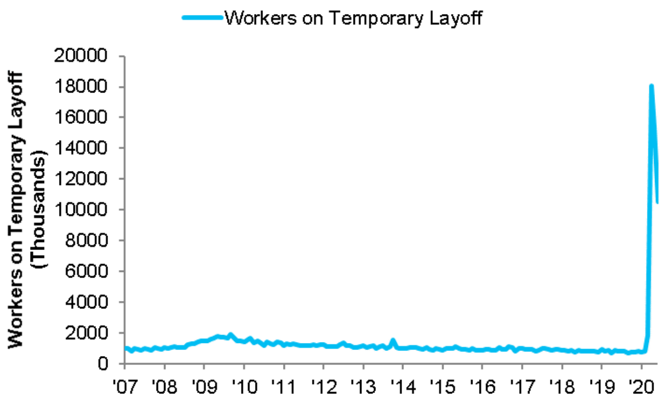
Figure 4: Restaurants are shutting down again in some areas



Sources: Haver Analytics as of July 17, 2020. Seasonally adjusted by CPB OCIS

Right now, there are 10.5 million workers on temporary furlough waiting to return to work (figure 5). The spread of the disease is so severe that it threatens the safety of reopening schools in roughly six weeks. This, in turn, could further limit the ability of laid-off workers to return to jobs and others to seek employment away from the home. In the face of this wall of worry, the US Congress has its early August holiday break coming up.

Figure 5: Workers on Temporary Layoff (Seasonally Adjusted)



Sources: Haver Analytics as of July 17, 2020

Reasons to Believe In a Rescue

The history of emergency government actions is actually surprisingly comforting. In 36 prior instances, Congress has acted in times of need to further extend emergency income supports (see figure 6). And, as the data shows, the length of additional unemployment benefits they provided -- between 13 and 26 weeks initially -- suggests that a decision to bridge benefits to the end of December 2020 is well within the realm of possibility.

Figure 6: Past Extensions of Previous Federal Unemployment Insurance Payments

Year	Number of extended unemployment compensation bills passed	Combined maximum duration of extended unemployment compensations (weeks)
1958	1	13
1961	1	13
1971	2	13
1974	4	26
1982	6	16
1991	6	33
2002	3	26
2008	12	73
2020	1	13

Sources: Citi Private Bank – Office of the Chief Investment Strategist, July 2020

What Congress Has Done So Far…

As we discussed in our March 22 report "Catching the COVID-19 Knife: What It Will Take" we calculated that $4.5 trillion in added 2020 spending, backed by Federal Reserve fiat financing, would effectively bridge the COVID chasm (see figure 7). We knew, even then, that the path of the virus, including a likely reacceleration of infections in the winter months, would require more than a short period of support.

Figure 7: CPB March Estimate of Required Spending and Contingencies

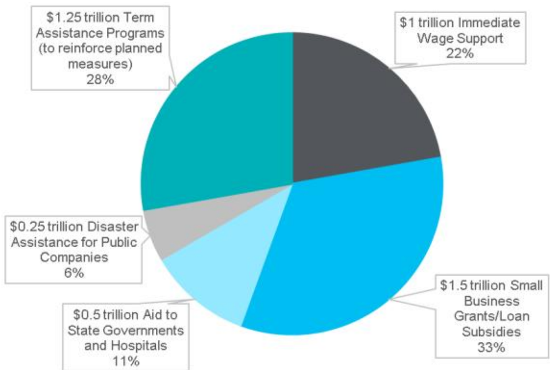
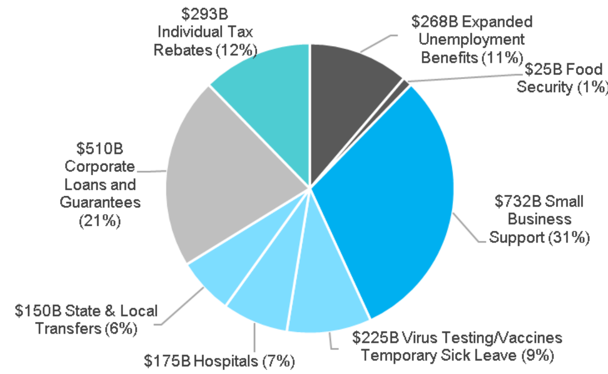


Figure 8: US Domestic Fiscal Support to Date



Sources: Citi Private Bank – Office of the Chief Investment Strategist, July 2020

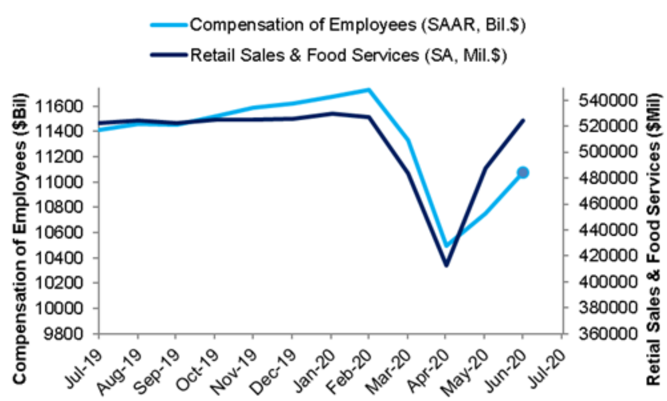
The unemployment insurance payments of the past quarter were about $250 billion, 18% of the total increase in Federal spending during the virus impact period (See figure 8). One time "stimulus checks," to most households were nearly as large in value as the payments to the newly unemployed over the full quarter. Together, the amounts provided were so generous that it literally paid for workers to stay home, and many earned more by doing so.

Total spending to support the economy in 2Q 2020 was three times larger than direct income support for households. The Paycheck Protection Program (PPP) provided $525 billion in grants to business to keep workers employed when COVID kept them idle. The program remains funded for now, with signs that businesses are utilizing it more slowly.

Thus, in total for the second quarter, the US Congress "over-funded" the income losses of the unemployed to push personal income higher (see figure 9). And this explains, in large measure, the return of US retail spending to pre-COVID levels in June (see figure 10).

Figure 9: US Personal Income Incl. Government Transfer Payments

Figure 10: US Retail Sales and Employee Compensation



Sources: Citi Private Bank – Office of the Chief Investment Strategist, July 2020

…And What Congress Must Do Now

As COVID has not been defeated, "social-close" industries remain deeply depressed and short-term shutdowns may become permanently lost economic capacity without government action. The US should help support workers and businesses stay viable until COVID is in deep remission. If not, the investment tax payers have already made will have been lost.

While political brinksmanship is common ahead of US fiscal deadlines, so is finding a solution at the last minute.

In the coming week, we expect to see initial action by Senate Republicans for a Phase 2 plan to support the US economic recovery. Figure 11 shows the "competing proposal", the House "HEROES" act. At a $3.5 trillion price tag, it includes many provisions that will likely see Senate passage only if Democrats win control in November. We believe the incentives to come to a compromise deal are strong. Yet, we also think it likely that the two sides will keep investors in suspense until the last moment, likely acting after unemployment insurance payments have been discontinued in early August.

Figure 11: House Passed Second Stimulus Package

Second Stimulus Package – the "HEROES" Act

- $900 Billion Additional Funds For States and Cities
- Expanded Second Round of Stimulus Checks
- Extend Expanded Unemployment Insurance through January 2021
- Additional Money for Testing and Tracing
- Additional $10B for Small Business grants and loans
- Increase funding for SNAP food aid
- $3.6B to assist states in voting by mail
- $25B for the Postal Service
- Reinstate the State and Local Tax deduction

Sources: Citi Private Bank – Office of the Chief Investment Strategist, July 2020

Here are the plan elements that we think are essential for the US economy to maintain sufficient momentum into 2021:

- Enhanced unemployment insurance payments through end 2021. These can be limited to a wage level no greater than previous salaries. Workers should not immediately lose these benefits if they take a job providing essential work.
- Fiscal support for schools – which represent the majority of local government employment – would be a reasonable new spending priority. The ability of parents to return to work will often hinge on the ability of schools to safely reopen. It's rather late timing to roll out a national support measure, but COVID-safe schools could prevent disruptive shutdowns in the fall and winter.
- Fiscal support for states and local governments – The COVID shock has had a dramatic drain on their coffers. State and local government job losses were a drag on economic recovery from 2009-2011. The demand for services from state and local governments can become a federal liability. Thus, even though this is a highly partisan matter, some level of "COVID coverage" can achieve bi-partisan support in an election year.
- Overall outlays should rise by $1 trillion on average in each of the next two quarters.

The public shouldn't be given disincentives to adapt and innovate, but deliberate fiscal and monetary support should remain policy until a COVID-19 vaccine is ready for mass distribution, or a substantial number of those who have lost jobs can find work. This is possible in an economy that reorganizes around living with COVID risk. But it is not possible in a reasonable timeframe without the assist of a Federal fiscal and monetary boost.

The speed of recovery of course depends on the path of the virus. Not having perfect estimates of the future, fiscal policymakers have historically used deliberate triggers on unemployment to withdraw emergency funding when it is no longer required (again see figure 6). The Congressional Budget Office's estimate of "full employment" is just below 4.5%. A drop to such a level from a present (understated) 11% is simply not possible. But US policymakers should act with a plan that can credibly get us there over time, with immediate actions to bridge the COVID chasm to year-end.

Appendix 1: Nearly a Quarter of US GDP is produced in areas in our CPB COVID-19 Watch List

MSA	Cases	GDP Share	Current Growth Rate	Prior Week Growth	New Cases to ICU Beds	New Cases Per 1000 Residents	Retail & Restaurant Traffic (% of Baseline)
LAREDO, TX	3,373	0.1%	7%	4%	27	6.4	-36
PENSACOLA, FL	6,717	0.1%	6%	6%	29	7.6	-6
BROWNSVILLE-HARLINGEN-SAN BENITO, TX	4,905	0.1%	6%	4%	23	5.7	-32
SAN ANTONIO, TX	29,563	0.6%	6%	5%	2	6.6	-26
HUNTSVILLE, AL	3,721	0.1%	6%	7%	19	4.6	-29
BOISE CITY, ID	7,862	0.2%	6%	7%	33	6.4	-8
CORPUS CHRISTI, TX	8,225	0.1%	6%	8%	41	11.7	-13
SAVANNAH, GA	3,679	0.1%	5%	5%	2	4.8	-10
SARASOTA-BRADENTON, FL	9,638	0.2%	5%	5%	2	5.7	-27
AUGUSTA-AIKEN, GA-SC	4,260	0.1%	5%	4%	5	3.6	-15
FORT LAUDERDALE, FL	35,566	0.5%	5%	6%	35	9.4	-32
FORT MYERS-CAPE CORAL, FL	11,721	0.1%	5%	4%	36	7.1	-33
DAYTONA BEACH, FL	5,147	0.1%	5%	4%	11	3.6	-11
Rural FLORIDA	15,955		5%	0%	7		
NORFOLK-VIRGINIA BEACH-NEWPORT NEWS, \	9,739	0.4%	5%	3%	10	2.3	
LAKE CHARLES, LA	3,864	0.1%	5%	6%	22	9.9	-15
ORLANDO, FL	34,420	0.7%	5%	5%	28	6.2	-37
LAKELAND-WINTER HAVEN, FL	8,498	0.1%	5%	5%	29	5.8	-21
JACKSONVILLE, FL	19,587	0.4%	5%	6%	20	6.7	-16
OKLAHOMA CITY, OK	8,518	0.4%	4%	4%	6	2.7	-9
TALLAHASSEE, FL	3,430	0.1%	4%	5%	25	4.9	-26
LAFAYETTE, LA	8,551	0.1%	4%	4%	17	8.4	-10
MIAMI, FL	75,425	0.8%	4%	5%	41	12.9	-35
BRAZORIA, TX	4,190	0.1%	4%	4%	92	4.7	-15
MODESTO, CA	5,777	0.1%	4%	9%	28	6.1	-22
CHARLESTON-NORTH CHARLESTON, SC	13,065	0.2%	4%	6%	19	7.9	-17
WACO, TX	3,005	0.1%	4%	11%	46	7.5	-19
LAS VEGAS, NV-AZ	29,246	0.6%	4%	4%	16	4.6	-23
HOUMA, LA	3,696	0.1%	4%	3%	24	6.7	-7
MOBILE, AL	7,093	0.1%	4%	3%	9	4.0	-5
HOUSTON, TX	63,250	2.2%	4%	3%	11	3.5	-24
Rural TEXAS	31,788		4%	0%	7		
WEST PALM BEACH-BOCA RATON, FL	23,711	0.4%	3%	3%	21	5.9	-34
Rural WASHINGTON	4,591		3%	0%	7		
NAPLES, FL	7,076	0.1%	3%	3%	31	6.6	-41
Rural IDAHO	5,096		3%	0%	7		
Rural SOUTH CAROLINA	15,707		3%	0%			
Rural OREGON	4,002		3%	0%			
FORT PIERCE-PORT ST. LUCIE, FL	6,286	0.1%	3%	3%		4.6	-25
GREENVILLE-SPARTANBURG-ANDERSON, SC	13,506	0.3%	3%	3%		3.8	-14
Rural TENNESSEE	14,907		3%	0%			
SAN JOSE, CA	7,046	1.6%	3%	3%		1.2	-46
Rural LOUISIANA	18,321		3%	0%			
COLUMBIA, SC	8,802	0.2%	3%	3%		3.9	-18
Rural WISCONSIN	5,622		3%	0%			
ATLANTA, GA	60,067	1.9%	3%	3%		3.4	-22
BATON ROUGE, LA	11,745	0.2%	3%	3%		5.0	-15
JACKSON, MS	6,223	0.1%	3%	2%		3.8	-9
Rural MISSOURI	6,050		3%	0%			
Rural ARKANSAS	12,385		3%	0%			
CHATTANOOGA, TN-GA	4,802	0.1%	3%	2%		2.6	-17
CHARLOTTE-GASTONIA-ROCK HILL, NC-SC	27,135	0.8%	3%	3%		3.6	-21
ALBUQUERQUE, NM	4,564	0.2%	3%	3%		1.6	-18
Rural GEORGIA	39,898		3%	0%			
Rural OKLAHOMA	7,049		3%	0%			
SANTA BARBARA-SANTA MARIA-LOMPOC, CA	4,635	0.1%	3%	2%		3.1	-25
SAN FRANCISCO, CA	13,271	1.6%	3%	2%		2.0	-47
MONROE, LA	3,388	0.0%	3%	2%		5.6	-6
Rural KENTUCKY	9,604		2%	0%			
LOS ANGELES-LONG BEACH, CA	147,678	3.8%	2%	2%		2.0	-34
Rural ALABAMA	20,131		2%	0%			
RALEIGH-DURHAM-CHAPEL HILL, NC	17,933	0.7%	2%	2%		2.6	-27
COLORADO SPRINGS, CO	3,306	0.2%	2%	2%		1.2	-9
MILWAUKEE-WAUKESHA, WI	17,871	0.5%	2%	2%		2.8	-9
Rural ILLINOIS	5,210		2%	0%			
Rural MISSISSIPPI	27,244		2%	0%			
ST. LOUIS, MO-IL	18,799	0.8%	2%	2%		1.6	-12
TACOMA, WA	3,486	0.2%	2%	2%		0.9	-10
Rural NORTH CAROLINA	23,996		2%	0%			

Note: MSA are Metropolitan Seasonal Areas.

Source: Citi Private Bank Office of the Chief Investment Strategist, Google, Haver and Johns Hopkins as of July 17, 2020.