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Economics Group

Special Commentary

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Unwrapping the Holiday Stimulus Package

Executive Summary

As 2020 comes to an end, the U.S. Congress has passed an eleventh-hour fiscal relief package during the closing moments of its lame-duck session. Until COVID vaccines are widely distributed, this relief package offers a different kind of injection: the package extends an income bridge for cash-strapped consumers and businesses heading into an otherwise bleak winter. We doubt this package will be enough to fully offset the economic damage that has already been done and is still to come, but it should go a long way toward smoothing over what could be a challenging next few months for the U.S. economy. Although the timing of income support has been volatile in 2020, through the noise aggregate household income has held up remarkably well throughout the pandemic, and the bill passed this week should help many households keep piling up the excess savings. Incredibly, the average level of real disposable personal income over 2020-2021 is about 4% higher in our latest projection than in our pre-pandemic forecast from February 2020.

But, as income growth has petered out in recent months amid slowing job growth and fading fiscal support, we have seen consumer confidence wane and retail sales decline in back-to-back months during October and November (Figure 1). In no small part, the initial bounce-back in consumer spending during the spring and summer was supported by fiscal support passed earlier this year. We will fully incorporate the recent COVID relief deal into our baseline forecast in our next monthly forecast update scheduled for January 13. In the interim, we walk through the provisions for the bill, estimate their size and offer some preliminary analysis for what this relief means for the recovery. In short, an even bigger jump in U.S. economic growth seems likely in H2-2021, led by pent-up demand for consumer services, while we are modestly more constructive on the state and local sector. We have revised our forecast for the FY 2021 federal budget deficit to -\$2.5 trillion from -\$1.8 trillion, down from -\$3.1 trillion in FY 2020 but still up sizably from -\$1 trillion in FY 2019 (Figure 2). The bill also limits the scope of the Federal Reserve's emergency lending powers without tying its hands too tightly.

We have revised our forecast for the FY 2021 federal budget deficit to -$2.5 trillion from -$1.8 trillion.

Figure 1

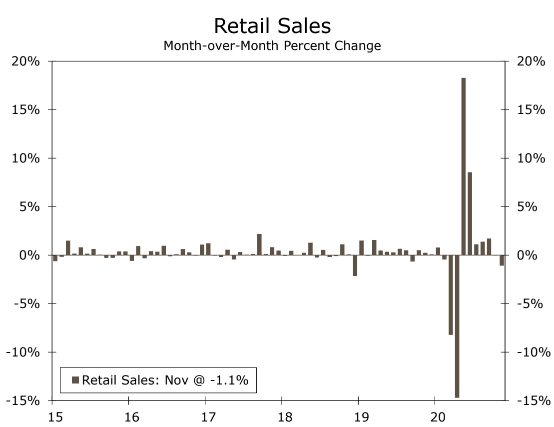
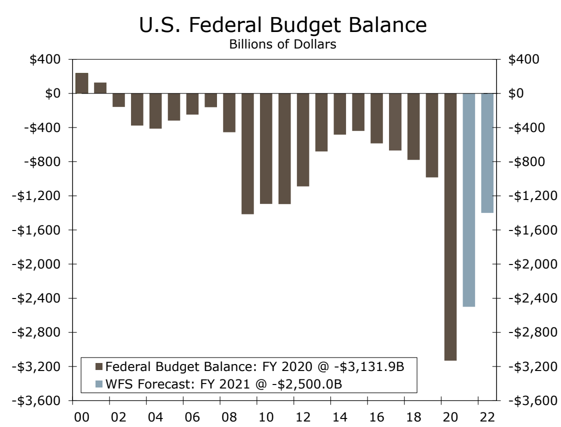


Figure 2



Source: U.S. Department of Commerce, U.S. Department of the Treasury and Wells Fargo Securities

Distilling a 5,593 Page Bill into Its Most Critical Components

Last night, Congress passed a 5,593 page bill, sending it to the president to be signed into law.

Last night, the House of Representatives and Senate passed a 5,593 page bill, sending it to President Trump to be signed into law. What was in such an expansive bill? In a sense, this was really two bills combined into one. First, there was an omnibus appropriations bill that funds normal government operations through fiscal year 2021, which ends on September 30. This package, which the Congressional Budget Office (CBO) estimates will result in $1.4 trillion in discretionary outlays in FY 2021, is generally unrelated to COVID and falls largely in line with our baseline forecast for federal government consumption and investment.

However, the second half of the bill dealt with COVID financial relief for households, businesses and state and local governments. Our last forecast update, published on December 10, did not assume any additional fiscal relief for COVID. As a result, we will fully incorporate the recent COVID relief deal into our baseline forecast in our next monthly forecast update scheduled for January 13. In the interim, we walk through the provisions for the bill, estimate their size and offer some preliminary analysis for what this relief means for the recovery.

At a high level, we think of the COVID relief legislation passed this week as a CARES Act "lite."

While gauging the impact of these measures on the economy is not a perfectly straightforward exercise, helpfully we do have a precedent upon which to base our analysis: the Coronavirus Aid, Relief & Economic Security (CARES) Act, which became law on March 27, included a similar cocktail of direct checks, jobless benefits and loans to businesses in impacted industries. At a high level, we think of the COVID relief legislation passed this week as a CARES Act "lite" in that the structure of this legislation is similar, just roughly half the size of the CARES Act passed in the spring. The CARES Act was about $2.2 trillion, roughly $400 billion of which were funds that provided the equity backstop for several Federal Reserve 13(3) emergency lending programs.[1] The COVID relief portion of the bill passed last night appears to be about $900 billion in size. Outlays on expanded unemployment benefits, direct checks to households and aid to small businesses account for about two-thirds of this new spending.

Compared to when the CARES Act was enacted, the U.S. labor market is still under pressure, but it is certainly on better footing than it was in April when the bottom fell out from the jobs market and more than 20 million people found themselves suddenly out of work (Figure 3). But thanks to the CARES Act, April also saw personal income increase by the largest amount on record (a 12.4% increase) even though wages & salaries fell 7.4% that month (Figure 4). Government transfer payments tied to the CARES Act more than offset those losses in private sector income.

Figure 3

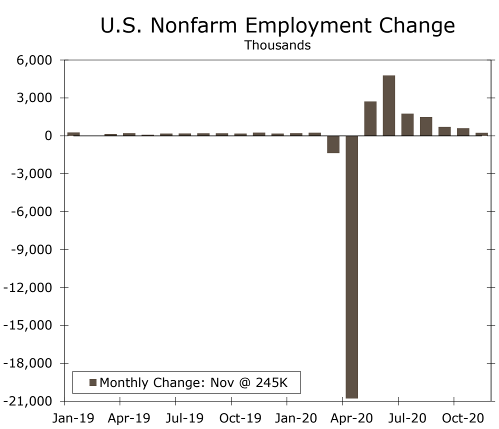
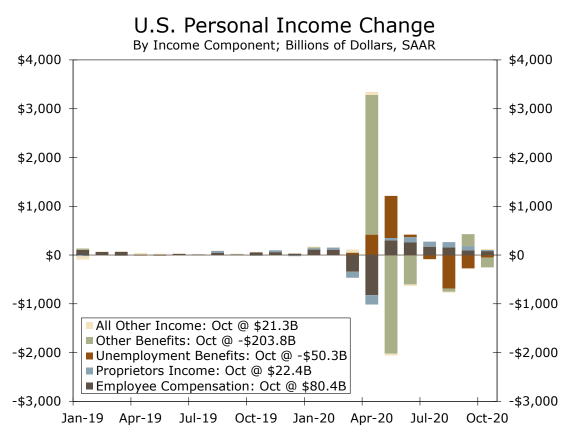


Figure 4



Source: U.S. Department of Labor, U.S. Department of Commerce and Wells Fargo Securities

The bulk of the initial increase in personal income was attributable to the "economic impact payments" or direct checks distributed to households by the federal government. The size of these direct payments to households will be smaller this time: $600 for single filers making up to

[1] **For further reading on these funds and the 13(3) programs, see our recent FOMC flashlight report.**

$75,000 per year and $1,200 for joint filers earning up to $150,000, plus another $600 per child, with gradual phase-outs past those income thresholds. This segment of the bill should total roughly $160 billion. Our new personal income forecast assumes the timing of these checks going out is similar to what occurred in the spring, with most payments made in December and January.

But the stimulus checks are just one part of the recent legislation. Changes to unemployment benefits are another major income lifeline for U.S. households. Here we get into an alphabet soup of acronyms for the various federal programs. In the spring, the CARES Act made three major changes to unemployment benefits. First, it provided federal funding through the Pandemic Emergency Unemployment Compensation (PEUC) program that allows the unemployed to collect an additional 13 weeks of state provided jobless benefits beyond what is usually permitted (most states, though not all, provide a baseline benefit for 26 weeks). Second, it created the Pandemic Unemployment Assistance (PUA) program, which provides unemployment benefits to workers who are not normally eligible for state benefits (e.g. gig workers and independent contractors). Both the PUA and PEUC were slated to expire at the end of 2020 under the CARES Act. Third, the federal government provided an extra $600 per week in unemployment benefits that was added on top of regular state level benefits/PUA/PEUC, pushing the average total unemployment benefit to almost $1,000 per week. This extra $600 lapsed on July 31.

Changes to unemployment benefits are another major income lifeline for U.S. households.

The bill passed this week extends the PUA and PEUC programs until March 14, and lengthens maximum eligibility from 39 weeks to 50 weeks. After March 14, new applicants will no longer be accepted, but individuals collecting benefits who have not yet exhausted their 50 weeks of eligibility can continue collecting until April 3. In addition, the bill adds an extra $300 per week for all unemployment benefits programs, which also expires on March 14.

On the small business side, the CARES Act and a follow-up bill passed about a month later appropriated $670 billion for the Paycheck Protection Program (PPP). The PPP offered loans to small businesses that, if used to cover certain expenses such as labor costs or rents, would be forgiven. The most recent round of COVID relief includes $285 billion for more PPP loans, as well as $40 billion for Economic Injury Disaster Loan advances, emergency grants to entertainment venues and other assorted small business relief. Note that when forecasting personal income these loans show up in the GDP accounts not only in proprietor's income but also in corporate profits, depending on the size of the business receiving the loan.

The final third of the bill's total spending is spread across numerous areas. Although state and local governments did not receive any direct, unconditional grants from the federal government, there is conditional funding for a variety of services provided by state and local governments. This includes $54 billion for K-12 education, $23 billion for higher education, $14 billion for transit agencies and $10 billion for highway transportation. The CARES Act also provided state and local governments with $150 billion in funding for COVID related expenses; the authority to spend this money was originally set to expire at the end of 2020, but now the authority to spend this money has been extended through the end of 2021. Finally, there is also $11 billion in farm aid, $15 billion in payroll support for airlines, $10 billion to forgive a loan to the United States Postal Service and another $60 billion or so for health care related measures that cover everything from COVID testing to vaccine procurement/distribution.

Near-Term Income Boost and Increasing Savings Bode Well for 2021

So what does this all mean for the 2021 economic outlook? Most critically, there will be billions of more dollars in personal income than we had assumed in our last forecast. Given that personal consumption accounts for roughly two-thirds of the U.S. economy, significantly higher personal income should mean a major increase in economic growth at some point. Incredibly, this added income leaves real disposable personal income, a proxy for consumer purchasing power, not far off of what we had been forecasting prior to the pandemic in February at the end of next year (Figure 5). The trend in real disposable income this year has been volatile given the timing of direct checks, on again/off again enhanced unemployment benefits and the quirks of PPP, but through the noise aggregate household income has held up throughout the pandemic. The average level of

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real disposable income over 2020-2021 is about 4% higher in our latest projection than in our pre-pandemic forecast from February 2020.

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Although in the near-term there will be an added boost to personal income, we do not expect this income to flow through to consumption quite as quickly. The resurgence of the virus and increased restrictions will likely constrain consumption for the next few months, as we have seen with the latest retail sales data posting back-to-back monthly declines (see chart on front page). But, what this flood of income likely will do is add to the pile of already elevated savings (Figure 6). Through October, we estimate households are sitting on a whopping $1.4 trillion in excess personal savings.[2] As consumption remains constrained and incomes once again see a boost, we anticipate that excess personal saving will continue to grow in the near term.

Figure 5

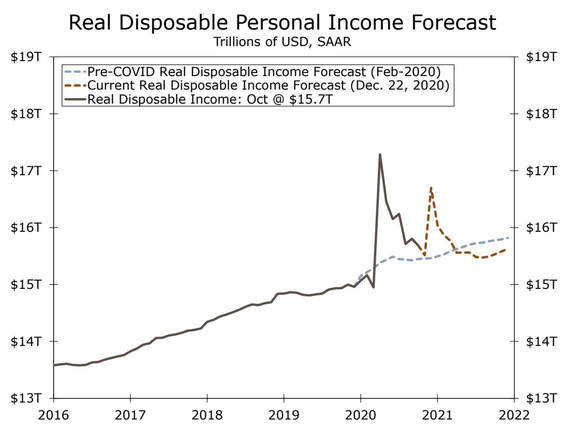
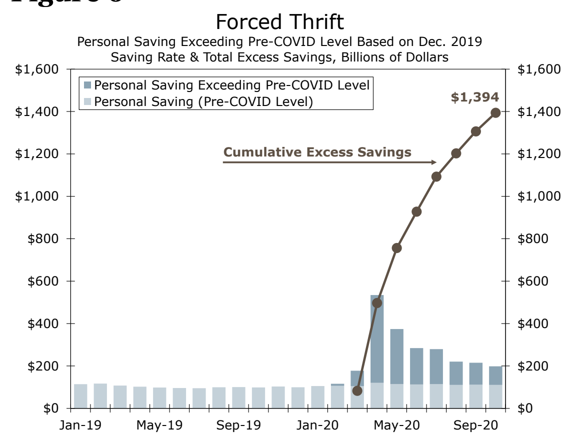


Figure 6



Source: U.S. Department of Commerce and Wells Fargo Securities

Still-high income coupled with the added cushion stemming from record amounts of savings squirreled away suggests a bullish backdrop for consumption once COVID-19 subsides. When a vaccine is widely available, the virus is under control and life returns to some semblance of normal hopefully by the second of 2021, we expect that many consumers will have the means to spend. In that environment, we expect pent-up demand, particularly for services, will be unleashed. Increased income not only underscores the potential for a 2021 rebound in consumption but also suggests that over the next few months financial markets may have good reason to look through weak economic data that could be reported due to the resurgence of the virus.

What about the prospects for the federal budget deficit? Since our previous forecast did not include any additional fiscal stimulus, we have revised our FY 2021 federal budget deficit forecast from -$1.8 trillion to -$2.5 trillion (see chart on front page). This would be about $600 billion smaller than the deficit incurred in FY 2020 but still about $1.5 trillion bigger than the budget deficit run in FY 2019. Measured as a share of GDP, our projected FY 2021 deficit would be about 11%, down from roughly 15% in FY 2020 but still up significantly from 4.5% in FY 2019.

When it comes to state and local governments, many will still face fiscal challenges due to the economic fallout from COVID-19. But, the additional aid for public services like K-12 education and public transit will help to some extent. And as we have noted in previous reports, the initial projections from the spring for state and local finances appear to have been too dire. Numerous factors have helped drive a relatively more optimistic budget outlook for state and local governments. A shift in personal consumption towards goods and away from services has boosted sales tax collections, and a resilient housing market has helped keep property tax collections fairly stable. The robust rebound in equity markets should boost income tax collections in the spring, and the uneven distribution of layoffs towards lower-earning workers has had the side effect of creating

[2] Excess personal saving is calculated by aggregating the addition to personal saving over the prior eight months that is in excess of the amount of saving based off of the December 2019 personal saving rate.

a more limited drag on state income tax collections, which are often progressive in nature. Finally, although the direct checks to households are not taxable, unemployment benefits typically are, and this should also boost state and local income tax collections. Thus, while state and local governments likely will remain a moderate drag on real GDP growth in the quarters ahead, this week's COVID relief deal leads us to be modestly more constructive on the sector than we were previously.

In a bill of this length, there are countless other provisions we have not addressed in this report, but we would be remiss to not discuss the changes made to the Fed's emergency lending powers. In our last FOMC flashlight piece (link can be found in footnote one on page two), we explained how recent actions taken by Secretary Mnuchin would end several Federal Reserve (13)3 emergency lending programs, most notably the Main Street Lending Program (MSLP), the Municipal Liquidity Facility (MLF) and the Corporate Credit Facilities (CCF). However, we argued at the time that the Fed could restart these programs in 2021 using funds from the Exchange Stabilization Fund (ESF) if the central bank felt it was necessary and the incoming Treasury Secretary signed off. The bill passed last night would nix this possibility. The legislation contained language stating that the ESF cannot be used to fund any program that is the "same" as one that received funds in the CARES Act, except for the Term Asset-Backed Securities Loan Facility. The legislation was careful not to tie the Federal Reserve's hands too tightly; it also contained language stating that "nothing in this Act shall be construed to modify or limit the authority of the Board of Governors of the Federal Reserve System under section 13(3) of the Federal Reserve Act as of the day before the date of enactment of the CARES Act."

It would be exceptionally difficult for the Federal Reserve to restart the facilities it runs with CARES Act funding in 2021.

Thus, if our reading of this section of the bill is correct, it would be exceptionally difficult for the Federal Reserve to restart the aforementioned facilities in 2021, but it can continue to operate the numerous other programs it runs without CARES Act funding, including asset purchases of Treasury securities and mortgage-backed securities, central bank FX swaps, the Primary Dealer Credit Facility, the Commercial Paper Funding Facility and the Money Market Mutual Fund Liquidity Facility. At a high level, this should not have a major impact on our forecasts for real GDP growth, nonfarm payrolls, etc. Take up of the CARES Act supported facilities such as the MSLP and MLF has been low, so the near term impact of their termination should be relatively muted. But, should the economy take a major turn for the worse, these facilities would no longer serve as a credit backstop for businesses and state and local governments. For the corporate credit facilities, the Fed has bought a very small share of the corporate bond market, although some have argued that just the existence of the corporate bond buying facilities have kept spreads tight. Thus, the end of corporate bond buying authority may reveal just how much of the spread tightening that has occurred since the spring was driven by the Fed's looming presence in the market.

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