BNY MELLON

# Aerial View

Morning Briefing

**Nov 23, 2020**

## Monday Morning Macro - Policy Tightening

- **The COVID-19 surge is affecting the short term outlook – but policy is tightening**
- **Two unemployment insurance programs affecting 12-13 million people to expire in a month**
- **Emergency lending facilities withdrawn from Fed; pressure to loosen policy further**

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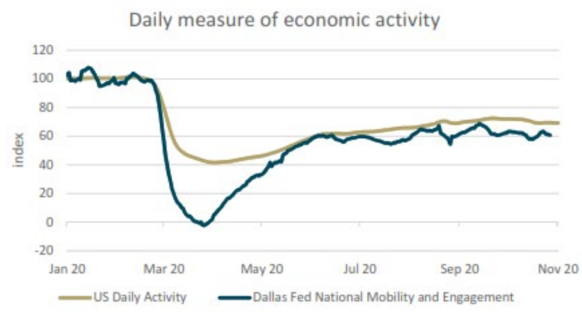
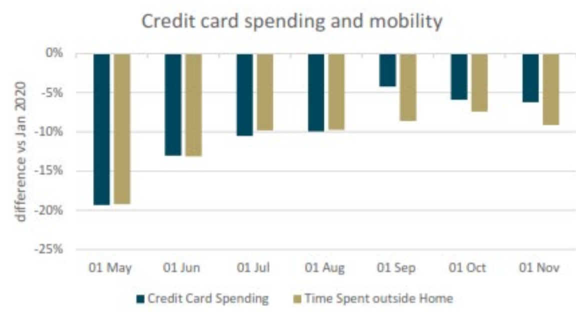
**Vaccine Optimism Versus COVID-19 Pessimism**

Median consensus forecasts still have the US economy growing by 4% in the 4th quarter and around the same pace (3.8%) for 2021, maintaining a roughly steady trajectory. We are not as optimistic.

The spread of COVID-19 infections is dampening our outlook for the near term. As the accompanying charts show, daily measures of mobility and engagement are starting to decline. Credit card spending and time spent away from home are also turning lower over the last month.

***Inflection Point***



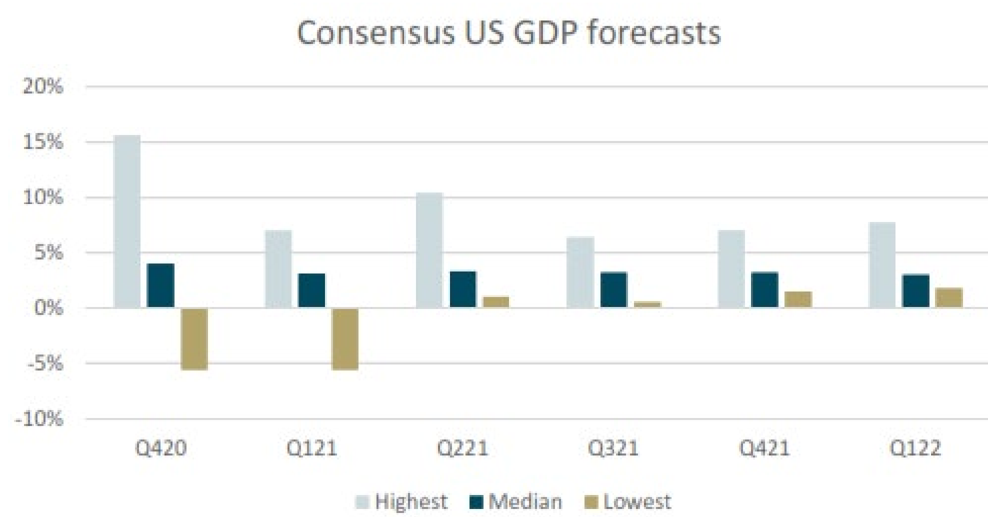

*Source: BNY Mellon Markets, Federal Reserve Bank of Dallas, Opportunity Insights; data as of November 18, 2020 or earlier*

Obviously the vaccine is a game-changer, but we think that markets and forecasters were pricing in the probability of a vaccine that would become available and effective at some point in 2021 even before the news actually broke.

There has been some reflation excitement in the equity market and some narrowing of premia, but we note that the 5s30s curve is actually flattenow by just under 20 basis points than it was on the day after the election. The ten-year UST yield is currently lower than it was on the day before the election.

The interim period between now and when the vaccine becomes effective is beginning to concern the bond market. We think it is only a matter of time before the consensus median sees some downward revision. Instead of the steadily growing trajectory implied by the blue bars in the chart below, we expect much lower, likely slightly negative growth in Q4. This could last into early Q1 with COVID-19 stress running into vaccine optimism.

***Consensus Sees Steady Growth***




*Source: BNY Mellon Markets, Bloomberg; data as of November 20, 2020*

At the same time the outlook – as we see it – is deteriorating. We see policy tightening, at least in a *de facto* sense. The expected termination of two pandemic unemployment insurance programs is looming at the end of the year, affecting over 12 million persons. The US Treasury's removal of some of the Federal Reserve's 13(3) lending programs, while not directly affecting financial conditions at the moment, represents a constraint on monetary policy and one less tool in the Fed's toolbox.

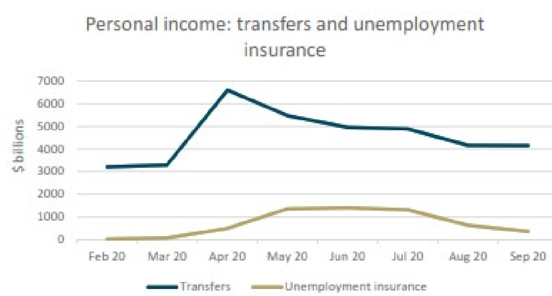
## *Two major pandemic unemployment insurance programs to expire in December*

**<u>End of Pandemic Unemployment Programs is a Form of Fiscal Tightening</u>**
As of the end of October, the latest date for which we have data, 13 million people were covered by supplemental unemployment insurance associated with the CARES Act. The Pandemic Unemployment Assistance (PUA) program covered employees who were not covered by regular state unemployment insurance programs (such as gig economy workers, sole proprietors, etc.) and covers over 8.5 million people. The Pandemic Unemployment Emergency Assistance (PEUA) grants an additional 13 weeks of coverage on top of regular state benefits once the latter run out, and currently covers 4.4 million people.

Both of these programs are scheduled to cease on December 31, 2020, with final payments scheduled for December 26th. This will represent a material drag on aggregate income as we head into 2021.

As the accompanying charts show, personal income less government transfers is still below pre-pandemic levels; incomes are still being propped up by government spending – which of course, include the PUA and PEUA. The chart at right shows the initial rise and subsequent decline in total government transfers as well as unemployment insurance payments from the federal government, which also included the supplemental $600 per week associated with the Extended Benefits program which expired at the end of July.

***Without Transfers, Personal Income Still Lagging***


*Source: BNY Mellon Markets, Bloomberg; data through September 30, 2020*

With stimulus negotiations still stalled, we view the chances that these programs will be extended as minimal for the time being. Although we remain hopeful that the post-election political landscape will eventually settle down and enable some serious negotiations to resume for the time being, we cannot assume that this *de facto* fiscal tightening will be avoided.

## *Pressure on the Fed to loosen policy, even as backstops are wound down*

**<u>Closing of Special Lending Facilities</u>**

Opinions are still mixed regarding the US Treasury's decision to wind up the Federal Reserve's special lending facilities, implemented during the darkest days of the pandemic. In wrapping up and requesting the return of $455 billion in untapped capital provided to the Fed by Treasury, Secretary Mnuchin argued that these facilities were meant to provide emergency support and aid in the smooth functioning of credit markets, which had come under pressure in the spring and were no longer needed.

The Fed clearly wanted the Municipal Liquidity Facility, the Term Asset-Back Securities Loan Facility, the Main Street Lending Facilities, and the Corporate Credit Facilities to remain funded into 2021, providing a backstop to these markets. In fact just two days before the Treasury announced its intention to wrap up the program, Chair Powell was vocally arguing for their extension, in a speech that was viewed as rather pessimistic about the short term economic outlook and has darkened with the resurgence of COVID-19 around the country and globally.

It is true that spread markets are behaving well now, and the take-up of these special lending facilities remains quite small, so terminating them would be inconsequential. As the accompanying chart shows, total commitments on the Fed's balance sheet for these four programs sums to just $117 billion and have been barely growing since this summer, only $25 billion of which are backed by Treasury funding.

Secretary Mnuchin has suggested that the unused funds, once transferred back to the Treasury, could be used to provide more conventional stimulus as part of a new negotiated relief package – although it is unclear these monies could be so easily repurposed as a matter of law.

***Small Take-up of Liquidity Facilities***


*Source: BNY Mellon Markets, Federal Reserve, Bloomberg; data as of November 18, 2020*

We nevertheless view the removal of these facilities as a *de facto* tightening of monetary policy, although extremely small and at the margins. It is true that these facilities are miniscule in comparison to the size and nature of the accommodation provided by the Fed's asset purchases programs and near-zero policy rates (which are expected to stay that way for several years). Furthermore, the Fed will keep $25 billion in monies already loaned against to recapitalize some additional lending, and could tap the Exchange

Stabilization Fund, which currently has a capacity of around $95 billion.

We think, as we said at the outset of this piece, the economy is in a delicate spot. There is pressure on the Fed to provide additional accommodation, and the central bank – along with the IMF – is outwardly voicing its concern over the near term outlook. The expectation of some form of intervention at the long end of the curve is growing, and the termination of the lending facilities is adding to the pressure.

Please direct questions or comments to:

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