UNITED STATES

MONETARY EASING, POLITICAL UNEASE

Social distancing and lockdown measures implemented to combat the Covid-19 pandemic severely damaged the US economy in Q2 2020, resulting in a record 9.1% decline in GDP. The ensuing recovery is still incomplete and inequitable, as many of Americans still unemployed because of the pandemic are from low-income categories. The health toll is getting worse, and the United States is the country with the highest number of deaths (nearly 200,000 victims to date). President Donald Trump long played down the disease but must now deal with consequences during the run up to the presidential election on 3 November. Although the incumbent president is lagging in the polls, the election's outcome is still highly uncertain.

The US economy, like nearly every other economy, was partially paralysed in spring 2020 due to lockdown measures introduced to contain the Covid-19 pandemic. US GDP plummeted by an unprecedented 9.1% in Q2 2020 (an annualised rate of 31.7%). Business nonetheless managed to recover thanks to the brief respite offered by the disease and massive support from the Federal government, with transfers of roughly USD 2,200 billion over the past six months, nearly the equivalent of France's GDP[1]. As fall approaches, household and corporate economic surveys have returned to quasi-normal levels. According to estimates by the Atlanta and New York Federal Reserve Banks, GDP rebounded between 6% and 7% in the third quarter.

AN INCOMPLETE AND INEQUITABLE RECOVERY

That leaves a shortfall of 4-5 percentage points of GDP relative to 2019 levels, which is less than in Europe but still a considerable gap to close. Whereas unemployment figures need to be approached with caution (see box), job statistics probably paint the most realistic picture of the severity of the shock. Available through August, it shows that only half of the 22 million jobs destroyed between March and April have been restored. Although it cannot be compared with the 2008 financial crisis, the Covid-19 pandemic has had similarly profound and inequitable repercussions on the labour market.

Two thirds of the job losses reported since February have hit unskilled and low-income populations. This is also where we find the highest concentration of people experiencing difficulties enrolling in the unemployment insurance system[2]. As a result, numerous low-income Americans have been excluded from the labour force. Data from the Bureau of Labor Statistics (BLS) shows an historic decline in the participation rate for adults without a diploma[3], and this decline cannot be seen in the rest of the population, at least not to the same extent. Since February, nearly 4 million people have already left the labour market (see chart), and this exodus from the radar screen can have unexpected effects on certain macroeconomic variables. This is the case for hourly wages, for example, where the buoyant rise recently (+6.6% year-on-year in Q2) is due less to the enrichment of American workers than to a reduction in working hours and to the underrepresentation of the poorest categories[4]. There are no inflationary pressures, to the contrary: increasingly fierce competition and the need to slash inventory have tended to pull down consumer prices in recent months[5].

The recovery is also unequal not only by population but also by sector. Unsurprisingly, the sectors that have preserved or returned to quasi-normal levels of business and employment are those with a large

GROWTH AND INFLATION (%)

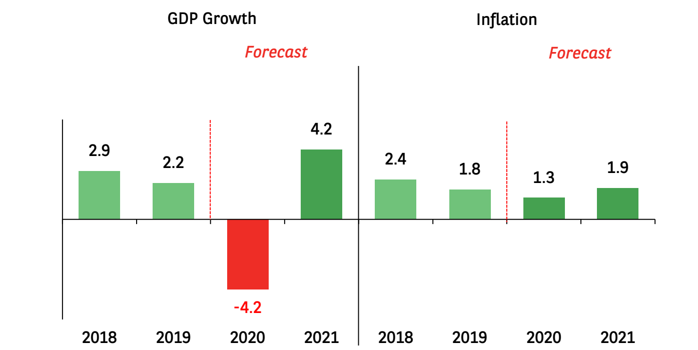

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

ACTIVE POPULATION WITHOUT A COLLEGE DIPLOMA

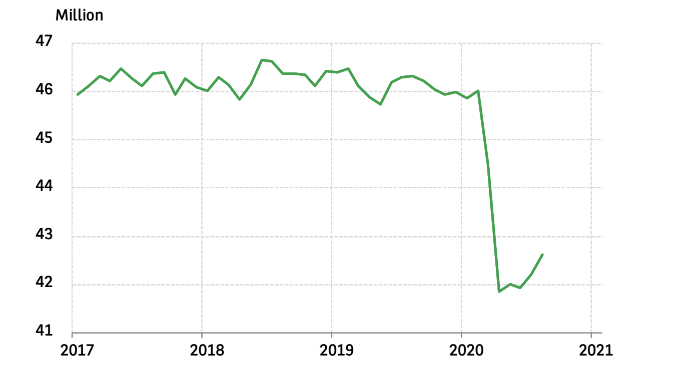

CHART 2 SOURCE: BUREAU OF LABOR STATISTICS

domestic footprint (residential construction, utilities, food retailing etc.), or specifically requested during the crisis (computer equipment, financial services, telecommunications, etc.). In contrast, the situation is still very difficult in sectors that depend on international trade and/or imply large crowds or physical contact. Hotel and food services,

1 Committee for a Responsible Federal Budget (2020), USD2.2 of USD4 Trillion in Fiscal Relief is Out of the Door, September.
2 According to estimates by One Fair Wage, a large percentage (44%) of hotel and food service employees who lost their jobs during the pandemic did not have unemployment insurance in May 2020. See CNBC, 2020, "Study finds 44% of US unemployment applicants have been denied or are still waiting", May 15.
3 Adults in the 25 and over age group, without a college degree or only a high school diploma.
4 The Washington Post, 2020, "The awful reason wages appeared to soar in the middle of a pandemic", May 15.
5 Food, energy and used car prices are notoriously volatile in the United States. To better understand inflationary trends, the BLS proposes a "core" price index for goods that excludes these three components. Although core inflation rebounded a little in August, it is still on a downward trend: -1.3% at an annualised rate over the six months prior to the latest reckoning.

leisure and the performing arts, transport industries and services, and clothing together account for 15% of total US employment, but about half of the job losses since February.

MONETARY EASING, POLITICAL UNEASE

A full recovery should not be expected soon. Most countries are experiencing resurgence in Covid-19 cases and international trade is far from showing a return to normal. Aware of difficulties, the Fed has embarked on a policy shift. At the Jackson Hole Symposium in late August, Fed chairman Jerome Powell unveiled new longer-term monetary policy targets and strategy that seem to herald in a system of unlimited monetary easing. The inflation target is still set at 2%, but will now be assessed *"over time"*, a manner of indicating greater tolerance of overshoots. The job mandate will become asymmetric. It aims explicitly to eliminate any shortfalls, but will no longer attenuate any labour market tensions, a decision that de facto disqualifies the Taylor Rule.

Presented as the end of a long process of disinflation and the lowering of the neutral rate, this new strategy is also shaped by exceptional circumstances which require the Fed to monetise considerable quantities of public debt. In counterpart, the Fed is creating an unprecedented amount of central bank liquidity, which risks feeding asset bubbles (see chart). Another inconvenience is a loss of precision in forward guidance. In the end, assuming the situation will return to better fortunes, it is hard to see what might trigger a change of course. Monetary policy committee members have just updated their macroeconomic projections, and they do not foresee any rate increases before 2024.

That year will also mark the end of the 4-year term of the next US president. Who the winner will be is still an open question, and one that risks dominating the headlines well beyond Election Day on 3 November. The most likely winner, at least theoretically, is the Democrat Joe Biden, who has a significant and stable lead in the national polls (50% of voting intentions, compared to 43% for the incumbent Republican, Donald Trump). Yet the results will hinge on a few swing states (which could swing to one candidate or the other). Under the "winner takes all" principle, the candidate that receives the most votes in a state will receive all of that state's electoral college votes, which are the only votes that count when electing the president. A candidate who receives the most popular votes can still lose the election, as was the case with Hillary Clinton, who had nearly 3 million more popular votes than her rival Donald Trump.

If the results are tight, they are bound to be contested by one of the two parties, a scenario that Donald Trump has already espoused. Mail-in ballots lie at the heart of the upcoming battle: though welcomed in the midst of a health crisis, they risk slowing down the vote counting process. Donald Trump also sees them as a source of fraud, without which his victory is basically assured[6]. If he fails to win the presidential election on 3 November, the current occupant of the White House may well be reluctant to concede.

Jean-Luc Proutat
jeanluc.proutat@bnpparibas.com

THE DIFFICULTY OF MEASURING UNEMPLOYMENT

Like in almost all business sectors, the production of macroeconomic data was disrupted during the Covid-19 pandemic. Establishing price indices or unemployment figures, to cite but two, implies field surveys that could not be carried out normally. Concerning the collection of unemployment data, which is collected directly through individuals, the BLS said it had proceeded by using telephone interviews almost exclusively, resulting in a much lower response rate than normal (70% in August, compared to 83% normally). Not only is the margin of error higher, the results could underestimate the unemployment rate (8.5% in August, but in reality, more than 9%), since many respondents said they were employed even though that had not worked during the reference period. A priori, employment data collected directly from companies should be more reliable, if for no other reason than the response rate is higher (77%, close to the pre-crisis average).

SOURCE: BUREAU OF LABOR STATISTICS

MAGIC MONEY

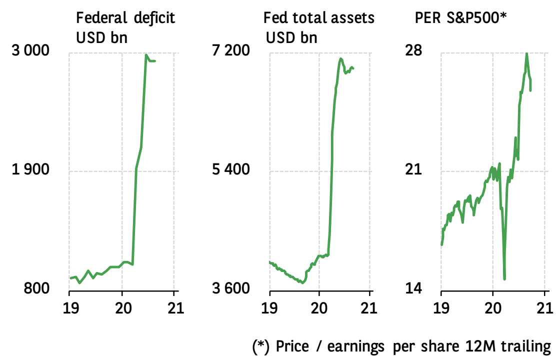

CHART 3 SOURCE: FED, STANDARD & POOR'S

6 "The only way we are going to lose this election is if it is rigged [...] That is the only way we can lose this election, so we have to be very vigilant." D. J. Trump, Wisconsin speech, 18 August 2020.