ODDO BHF
CORPORATES & MARKETS

Economy

Focus US
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US: towards a federal budget deficit of 20% of GDP?

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In just a few months, the federal budget deficit widened by around 10 points of GDP, flirting with the 14% of GDP threshold. For the time being, this exceptional fiscal support has helped preserve household income and corporate access to credit. But it is running out of steam as the pandemic continues to spread. It is widely acknowledged that fresh support for households and local governments is needed to ensure that the recovery is confirmed (one of Trump's last cards to play). The amount and details are yet to be confirmed by Congress but a conservative estimate would see the deficit head towards 20% of GDP.

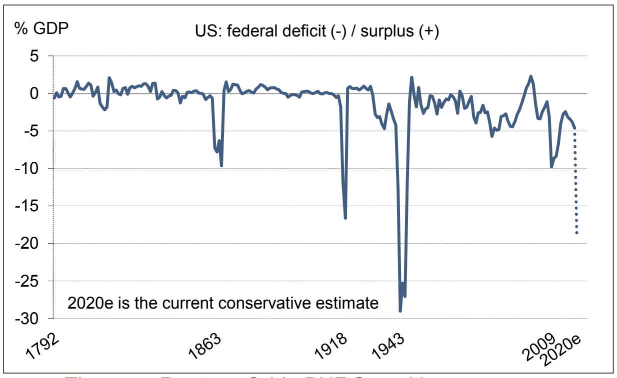
The week's focus

Over the first nine months of the fiscal year, the federal budget deficit is already flirting with the $ 3,000bn level, i.e. 14% of GDP. The current budget situation can only be compared with the civil war or the two world wars (chart lhs). The widening of the deficit reflects the rise in transfer spending aimed at cushioning the shock of the pandemic, and, to a lesser extent, the loss of tax receipts (chart rhs). The CARES Act and other legislation passed since the spring have so far provided a fiscal stimulus of $ 2.4bn[1]. In addition to providing for businesses, this plan is intended to protect households. As a result, despite the rise in unemployment, their available income has increased. The flagship measure, which is an exceptional payment of $ 600 per week to jobless claimants, is nonetheless due to expire at the end of the month.

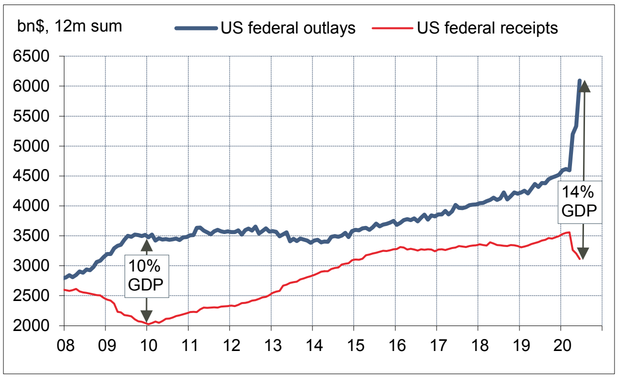
Despite the electoral contest, the two parties know that they must reach an agreement to extend the support, without which, the economic and social cost would soar, and no one wants to be blamed for such a failure. The surge in the pandemic, which has been resolutely confirmed since mid-June, underpins the need to act. However, opinions diverge concerning the form and amounts this help will take. The Democrats project (HEROES Act) would apparently cost $ 3tn. It plans to extend the bonus payment to jobless claimants by six months (before gradually reducing the payment in 2021), to send a new, more generous stimulus check, and to provide aid for local government finances. The details of the Republicans' plan have not yet been published. Press leaks put the bill at 1.3tn[2], with support measures for households and local governments albeit less generous than in the Democrats' plan. Initially, Republicans were reluctant to accommodate some of their opponents' demands, but the recent trend in political polls no longer permits a wait-and-see stance. Given Biden's current lead over Trump, if the elections were held today, the Democrats would not only win the White House but also the House of Representatives and the Senate.

1 CBO, *The Budgetary Effects of Laws Enacted in Response to the 2020 Coronavirus Pandemic, March and April 2020* 2 CNN, *Prospects slim for new recovery package as Dems scoff at emerging Senate GOP proposal*

US: 228 years of budget balance



US: federal outlays and receipts



Sources: Thomson Reuters, Oddo BHF Securities

Economy

- **Supply** – After a modest rebound in May (+1.4% m-o-m), industrial activity picked up more strongly in **June** (+5.4% m-o-m), aided in good part by automotive production. Taking February as base 100, the manufacturing production index now stands at 89. Despite these two months of recovery, the industrial sector will nonetheless record the strongest ever contraction in **Q2**, with a fall of 43% q-o-q on an annualised basis. According to the Atlanta Fed's nowcast, real GDP growth is estimated at -35% q-o-q on an annualised basis in Q2.
- **Demand** – In **June**, retail sales grew at a strong pace (+7.5% m-o-m), though this was below the rate in May (+18%). Spending that had been put on hold during the lockdown has now been almost fully made up, though there are big differences between sectors (table). With the resurgence of the epidemic since mid-June, the increase in consumer mobility has stalled, which could curb consumer spending in the short term.

	pre-shock level (bn$)	% of total	February (index)	March	April	May	June
Retail sales	**527**	**100**	**100**	**92**	**78**	**92**	**99**
_Auto	105	20	100	74	65	97	105
_Gasoline	41	8	100	83	63	71	81
_Building materials	33	6	100	101	99	111	110
_Restaurants	65	12	100	70	46	60	73
_Online stores	69	13	100	105	115	123	120
_Food stores	64	12	100	127	111	113	112
_General stores	60	11	100	108	94	99	102
_Health stores	30	6	100	105	90	91	94
_Clothing stores	22	4	100	51	14	38	77
_Furniture stores	10	2	100	78	40	71	94
_Other stores	27	5	100	84	56	77	96

- **Survey** – According to the Beige Book, which covers the period up to **6 July**, activity picked up everywhere except in the San Francisco Fed district (the entire West Coast). The recovery is very unequal from one region to the next. Overall, the level of activity is well below what it was before the pandemic. The return of employees to work is hampered by health concerns, childcare problems (hence the importance of the current debate on reopening schools after the summer) and the generosity of unemployment benefit payments. Demand for credit is flat except for mortgages (renegotiations to take advantage of low rates) and lending to businesses under the Paycheck Protection Program.

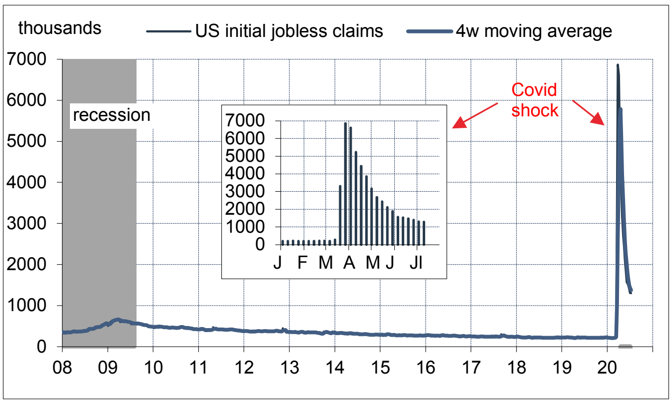
Monetary and fiscal policy

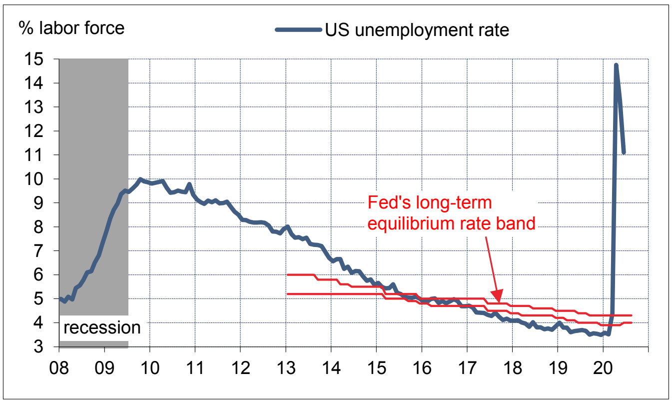
- In a speech on **14 July**, Lael Brainard, an influential member of the Fed Board, asserted that the priority was to keep monetary policy very accommodative for as long as employment conditions remain deteriorated, which could mean for years. Lael Brainard has a penchant for average inflation targeting, which is the simplest way of saying that inflation that exceeds the target of 2% may be tolerated (and even desired) if it comes after a period in which inflation was too low. Given the downside risks to the recovery (virus, loss of potential), Lael Brainard is in favour of the Fed setting targets for certain points on the yield curve. In her view, this would be the best way to strengthen the credibility of the forward guidance on low rates and avoid misunderstandings with the markets (as happened in 2013 with the taper tantrum).
- China-US tensions continue in the form of visa restrictions between the two countries. President Trump officially ended Hong Kong's special status after China asserted more direct control of the territory. The prospect of a "phase 2" in the trade agreement is suspended indefinitely.

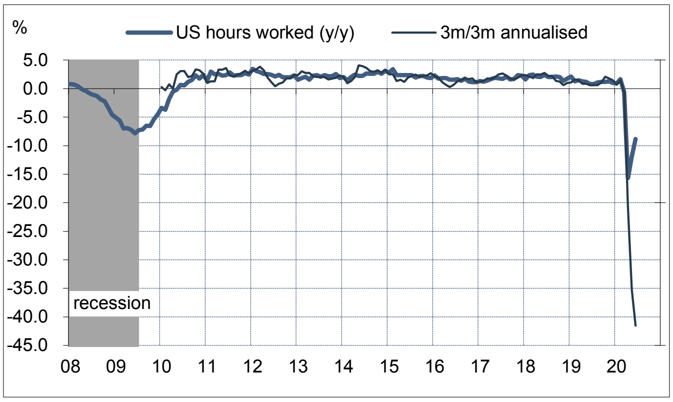
The week ahead

- PMI indices (**24 July**) will be the main information on the economy in the coming days. They will reflect the business climate in the first two weeks of July, a period impacted by a new rise in the pandemic. The high-frequency data currently available suggest a slower pace of recovery rather than a decline in activity. The composite PMI index rebounded 20 points from April to June, at 48.2 points – still a shade below the pre-pandemic level. Note that July's first manufacturing surveys have continued to improve in the Fed districts of New York and Philadelphia.

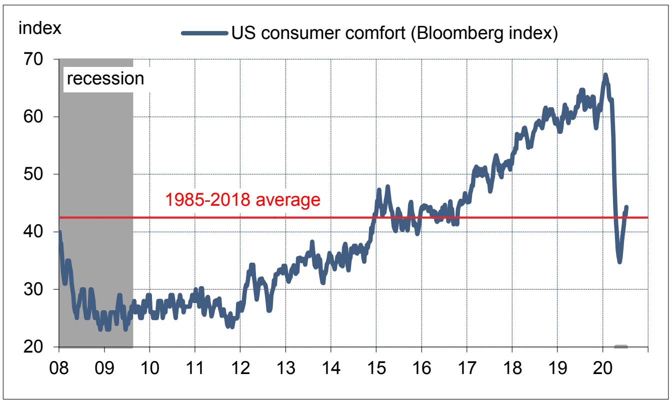
Appendix 1 - Labour market

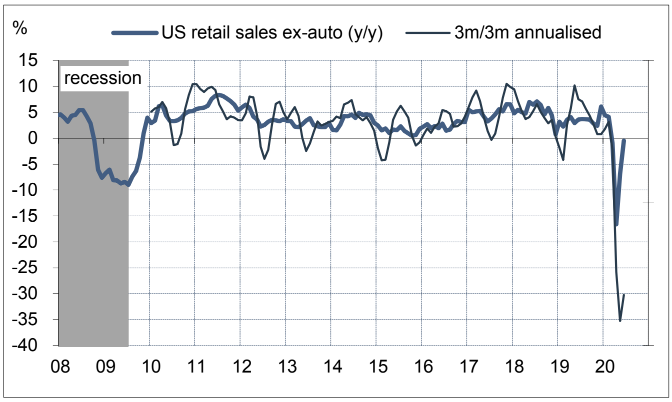


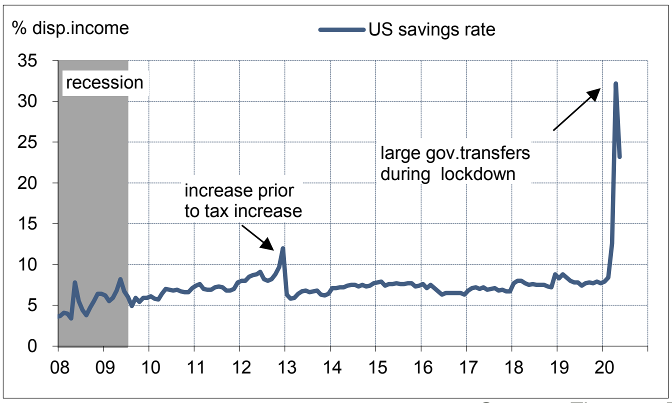


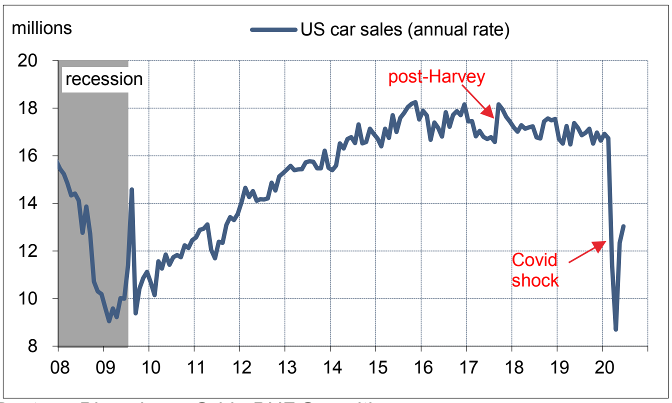


Appendix 2 - Consumer



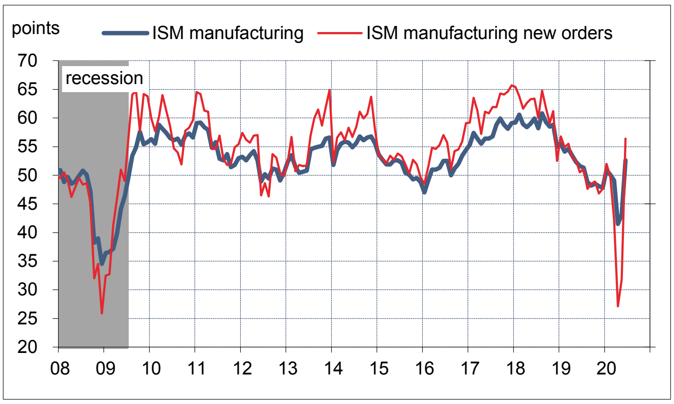


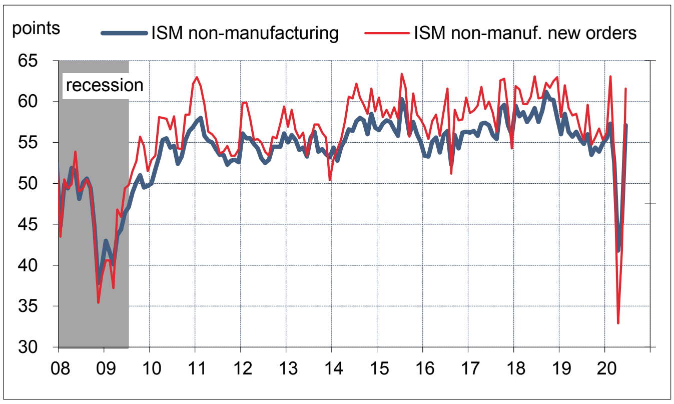


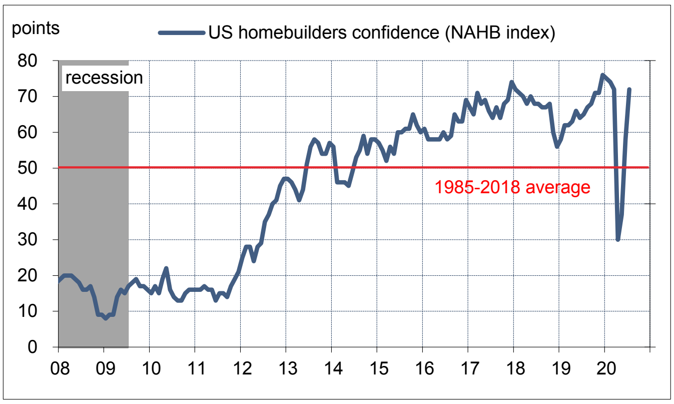


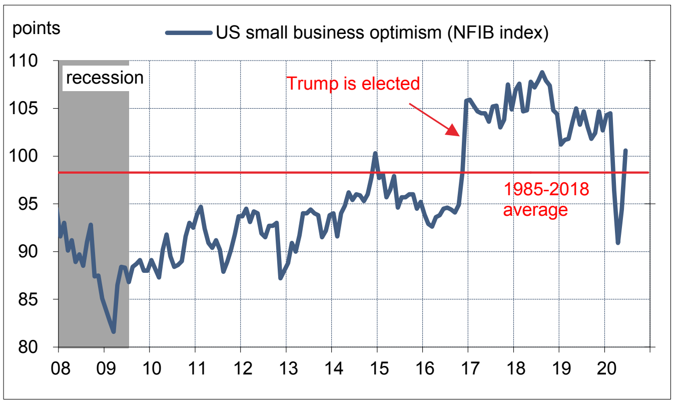
Sources: Thomson Reuters, Bloomberg, Oddo BHF Securities

Appendix 3 - Business climate

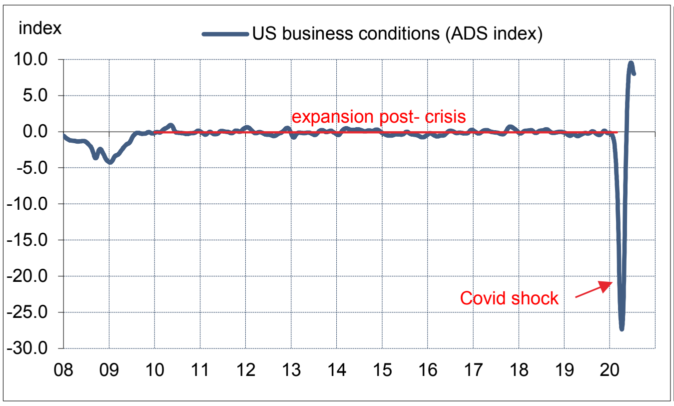


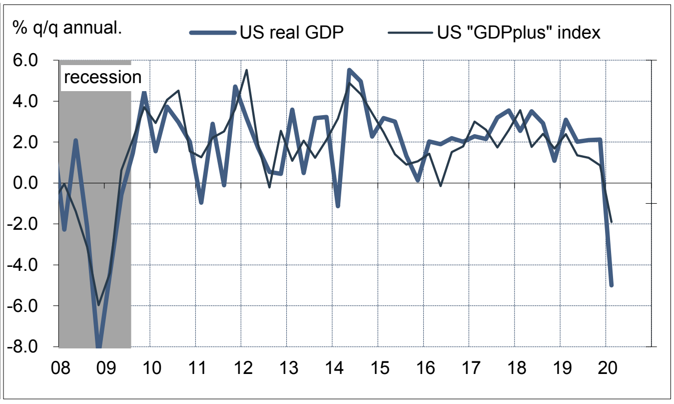


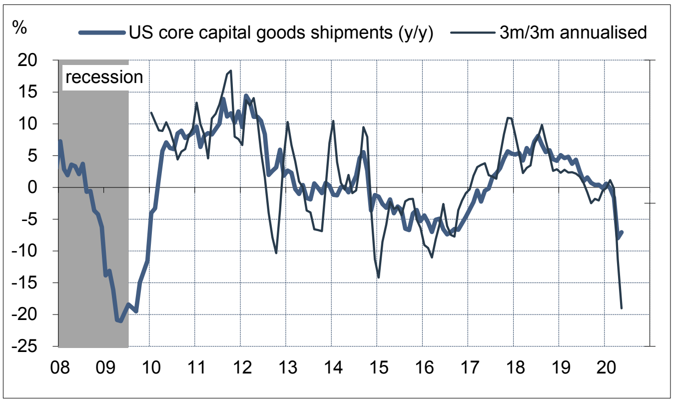


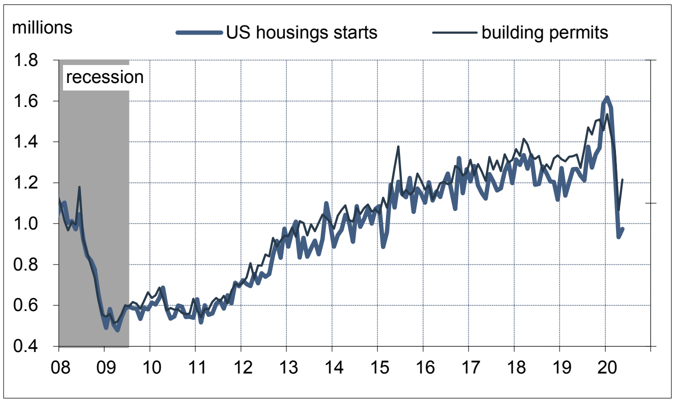


Appendix 4 - Conditions of economic activity



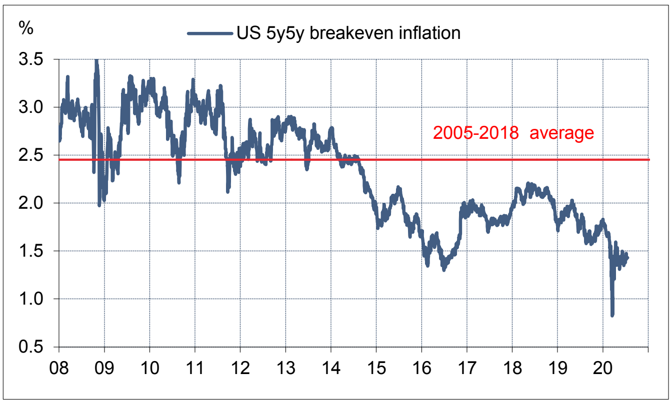


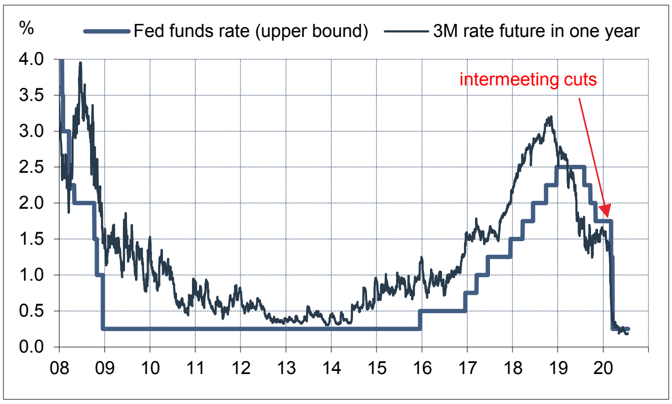


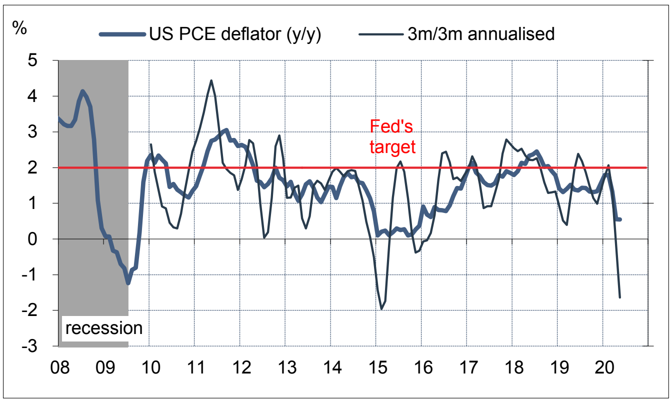


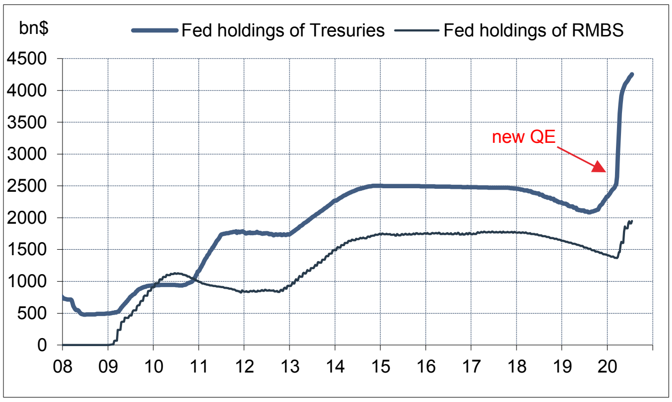
Sources: Thomson Reuters, Bloomberg, Oddo BHF Securities

Appendix 5 - Inflation and monetary policy

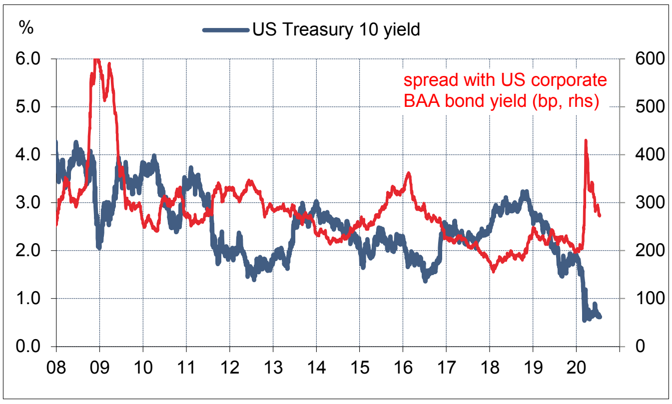


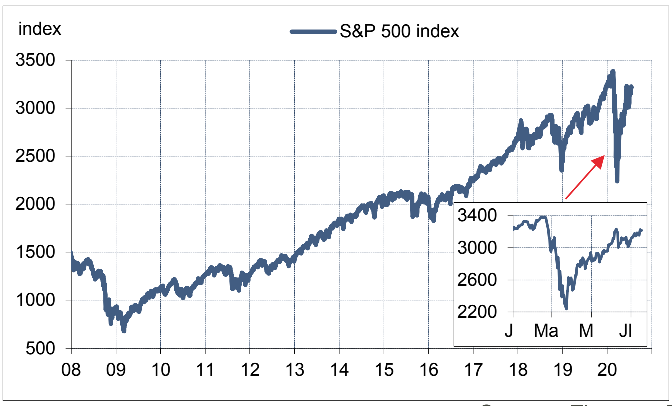


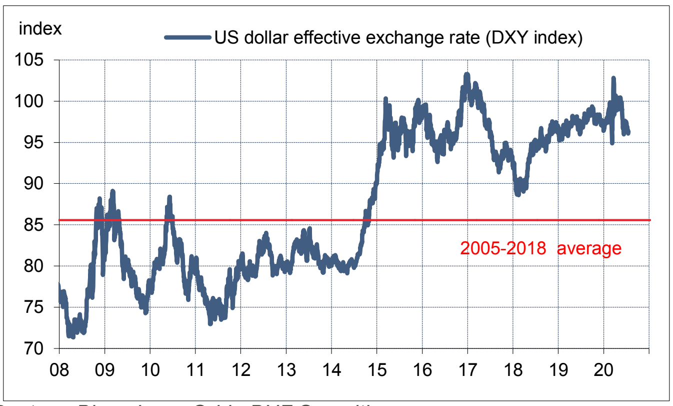




Appendix 6 - Financial markets







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