December 22, 2020

ECONOMIC REPORT

Gus Faucher Chief Economist | **Stuart Hoffman** Senior Economic Advisor | **William Adams** Senior Economist | **Kurt Rankin** Economist | **Abbey Omodunbi** Economist

THE PNC FINANCIAL SERVICES GROUP | The Tower at PNC Plaza | 300 Fifth Avenue | Pittsburgh, PA 15222-2401

STIMULUS WILL SUPPORT US ECONOMY DURING EARLY 2021 WEAK PATCH; FOMC TWEAKS LANGUAGE ON QE

SUMMARY

- Congress passed a $900 billion stimulus bill. Key components include stimulus payments, extra unemployment insurance benefits, and more funding for the Paycheck Protection Program.
- The stimulus bill will provide support to the economy in early 2021, when growth will be very soft because of the pandemic.
- The Biden administration will likely push for additional stimulus next year.
- The FOMC tied its quantitative easing program to economic conditions, suggesting that it will continue to put downward pressure on long-term interest rates well into 2021.

As of the afternoon of December 22, Congress has passed a $900 billion stimulus bill and sent it to President Trump for his expected signature. The bill would provide stimulus checks to many households, although they would be smaller than those paid out earlier this year; extend unemployment insurance benefits set to expire at the end of 2020; allocate an additional $284 billion for the Paycheck Protection Program, for low-interest loans for small and medium-sized businesses; and provide $30 billion for distributing COVID vaccines. The bill also includes rental assistance and extends a foreclosure moratorium; provides aid to hospitals, colleges and universities, and the airline and entertainment industries; and grants additional assistance to low-income households. With 12 million unemployed set to lose benefits at the end of this year unless Congress acts, and two runoff elections in Georgia in early 2021 set to determine control of the Senate, Congress had a very strong incentive to pass a bill.

The bill will be extremely important in supporting the U.S. economy through a very difficult period in late 2020 and early 2021. With an acceleration in coronavirus cases in recent weeks and states and municipalities reimposing restrictions on economic activity, although in a more targeted fashion than earlier this year, economic growth at the end of 2020 has slowed from the torrid pace of the fall. After an initial flurry of hiring in May and June when businesses reopened, job growth has slowed for five straight months, and initial claims for unemployment insurance have been increasing in recent weeks. Some measures of consumer activity have weakened in November and December.

With support from the federal government, consumers should be able to maintain their spending over the next few months. Aid to small and medium-sized businesses will allow more firms to remain open until enough Americans are vaccinated that the pandemic begins to recede. With vaccine distribution and stimulus, economic growth should pick back up by the middle of 2021.

There could be additional stimulus under the incoming Biden administration, especially if Democrats end up in control of the Senate. With federal borrowing costs extremely low right now—the federal government can borrow for 10 years at an interest rate of less than 1 percent—it makes sense to provide near-term support to vulnerable sectors of the economy to ensure a strong economic recovery from the pandemic. In addition to more aid for the unemployed, who are likely to spend most of the funds that they receive, many state and local governments would benefit from federal support, given pressure on their revenue sources from the pandemic. And the federal government should work to prevent unnecessary business failures; permanent closures over the next few months of firms that could be viable post-pandemic would create a significant and avoidable drag on longer-run economic growth.

In its December 16 monetary policy statement, the Federal Open Market Committee said that it will continue to purchase

STIMULUS WILL SUPPORT US ECONOMY DURING EARLY 2021 WEAK PATCH; FOMC TWEAKS LANGUAGE ON QE

long-term securities "until substantial further progress has been made toward the Committee's maximum employment and price stability goals." This language on tying purchases to economic outcomes was new; in its previous statement on November 5 the FOMC said that it would purchase long-term securities (Treasurys and Fannie Mae and Freddie Mac mortgage-backed securities) "to sustain smooth market functioning and help foster accommodative financial conditions, thereby supporting the flow of credit to households and businesses," with no mention of progress toward the FOMC's goals. Similar language on credit flows was included in the December 16 statement, but was secondary to the goals of an improved labor market and higher inflation.

Also in the December 16 statement, the FOMC was more explicit about the size of securities purchases, saying that "the Federal Reserve will continue to increase its holdings of Treasury securities by at least $80 billion per month and of agency mortgage-backed securities by at least $40 billion per month". The previous statement said that it would increase its purchases simply "at least at the current pace."

As expected, the FOMC kept its short-term policy rate, the federal funds rate, in the 0.00 to 0.25 percent range where it has been since March. As it did on November 5, the committee said that it expects to keep the fed funds rate in this range until the economy has returned to full employment and "inflation has risen to 2 percent and is on track to moderately exceed 2 percent for some time." The FOMC changed its policy framework earlier this year, moving to a goal of inflation that averages 2% "over the longer run." Therefore, the central bank would like inflation to move above 2%, to make up for inflation that has been "running persistently below this longer-run goal."

The first three paragraphs of the December 16 statement were unchanged from November 5. The FOMC said that "economic activity and employment have continued to recover but remain well below their levels at the beginning of the year." The FOMC also said that the ongoing pandemic "poses considerable risks to the economic outlook over the medium term."

The statement was unanimous.

The December 16 statement provided more detail on the extent of the Federal Reserve's asset purchases, known as "quantitative easing" or "QE." In QE the central bank puts money on its balance sheet electronically, using the funds to purchase long-term securities. This helps push down long-term interest rates, keeping borrowing costs low for businesses, homebuyers, consumers, and municipalities, encouraging economic growth. The December 16 statement tied these purchases to progress in meeting the central bank's full employment and price stability objectives, although it did not establish any numerical targets. The expectation is that by the Fed pledging to maintain its asset purchases well into the future, monetary policy will put further downward pressure on longer-term interest rates. The explicit discussion of the size of the purchases is designed to send a signal that the FOMC could increase its long-term securities purchases in 2021 to put additional downward pressure on long-term rates if it views that as necessary to support a stronger economic recovery. At some point in 2021 the Fed could increase its purchases, skew its purchases more toward longer-term assets, or undertake some combination of the two if it believed those steps necessary to keep long-term interest rates low to bolster growth. The FOMC is unlikely to reduce its securities purchases in 2021.

In his post-meeting press conference, Fed Chair Powell vowed to maintain aggressive monetary policy to support the recovery, saying no one should doubt the central bank's commitment.

This FOMC meeting also included the Summary of Economic Projects, or "dot plot," which provides FOMC participants' expectations for the economy and the fed funds rate. The updated median projections for GDP growth in 2020 and 2021 were somewhat higher than the comparable projections from the previous dot plot, released on September 16. However, the median projection of long-run GDP growth moved slightly lower, to 1.8%, from 1.9% in September. The median unemployment rate projection for the next few years moved slightly lower from September to December, in large part because of a faster-than-expected decline in the unemployment rate in recent months. The median long-run unemployment rate remained at 4.1%.

Well over one-half of the FOMC participants expect the fed funds rate to remain in its current near-zero range until at least 2024. The median long-run fed funds rate remained unchanged from September at 2.50%. PNC expects the FOMC to keep the funds rate in its current range 0.00% to 0.25% range until 2024.

Visit http://www.pnc.com/economicreports to view the full listing of economic reports published by PNC's economists.

Disclaimer: The material presented is of a general nature and does not constitute the provision of investment or economic advice to any person, or a recommendation to buy or sell any security or adopt any investment strategy. Opinions and forecasts expressed herein are subject to change without notice. Relevant information was obtained from sources deemed reliable. Such information is not guaranteed as to its accuracy. You should seek the advice of an investment professional to tailor a financial plan to your particular needs. © 2020 The PNC Financial Services Group, Inc. All rights reserved.