



Passing the Baton

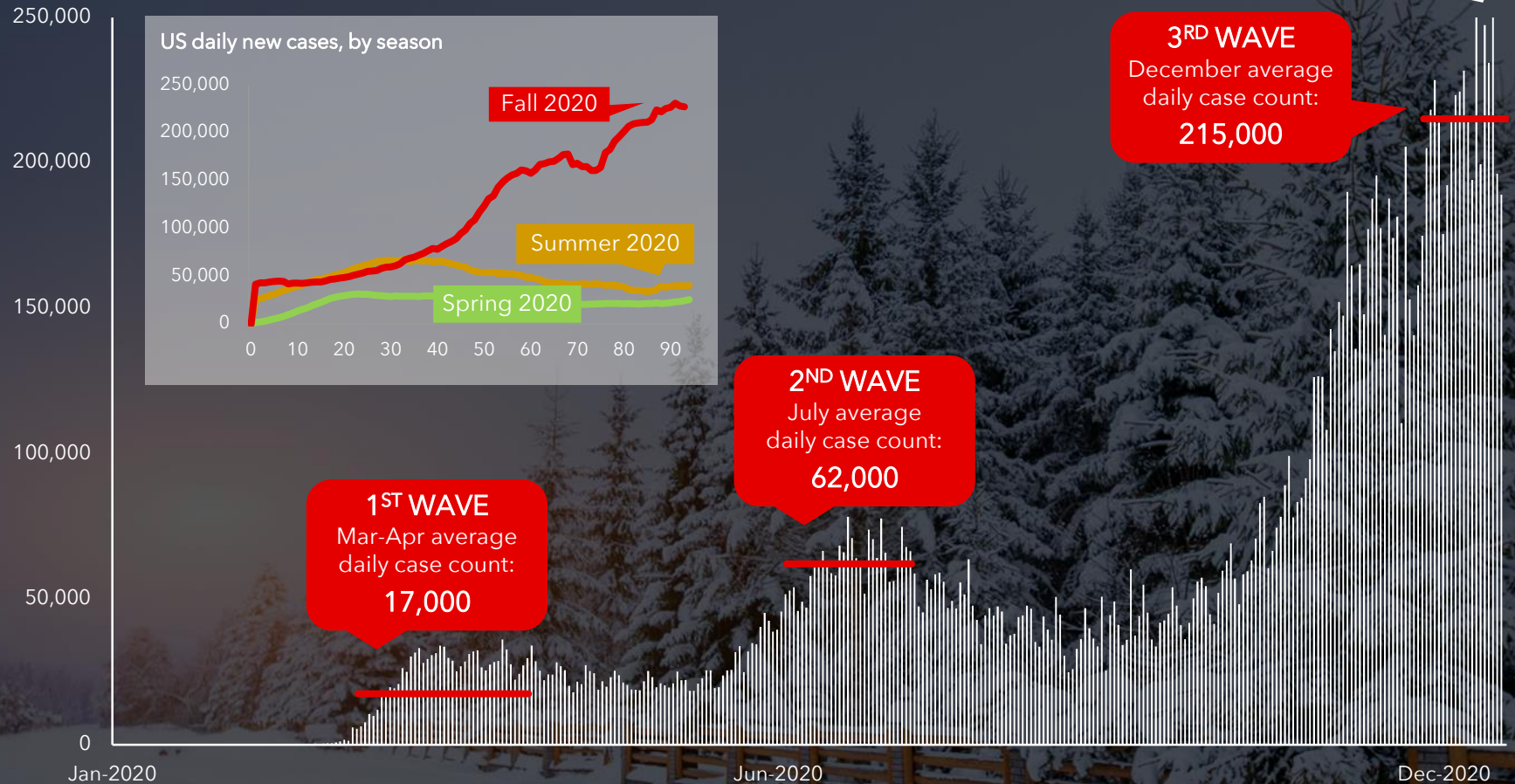
The Transition from Monetary to
Fiscal Policy During COVID-19

DEC 2020



COVID-19's Winter Resurgence

US daily new cases



Source: (1) Bloomberg. Data as of December 21, 2020. (2) Bloomberg. Data as of December 21, 2020. Spring 2020 is March 19, 2020 - June 20, 2020. Summer is June 20, 2020 - September 22, 2020. Fall starts September 22, 2020. Longview Economics. John Authers.

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“ Good policy is enough to offset bad economics. ”

Krishna Memani, CIO of Lafayette College &
Former CIO of Oppenheimer Funds



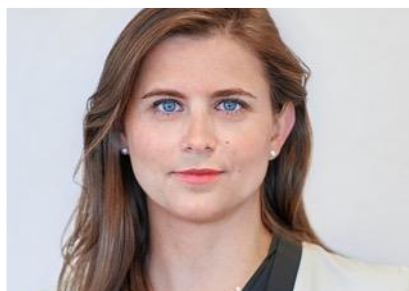
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1 Notable Observations

Notable Observations

- 1 While continued Fed and central bank accommodation remains critically important for markets, the “passing of the baton” from monetary to fiscal policy has become the more pervasive marginal driver of the economy and markets during the COVID-19 crisis.
- 2 The US Congress and Treasury Department have facilitated \$4.3 trillion of fiscal stimulus in 2020, the largest such stimulus in US history (nearly 20% of GDP).
- 3 The actual incremental impact of the \$900 bn December stimulus is likely much lower, as it remains unclear how much originates from new funds, as opposed to reallocations of unused stimulus earlier in the year (including \$429 bn and \$134 bn from unused Fed emergency lending and PPP, respectively).
- 4 The composition of the bill also suggests that the economic multiplier will be low, as the single largest sub-component is the forgivable PPP loans for small business, which the CBO estimated previously as having the lowest multiplier of all provisions in the CARES Act.
- 5 The \$900 bn stimulus includes nearly 80 tax saving provisions for individuals and small business. Notably, the current bill includes nearly \$100 bn of potential tax write-offs for small business by effectively allowing them to “double dip” on tax breaks by deducting expenses paid for by PPP loans.

Notable Observations

- 6 While fiscal and monetary policy are important for bridging the gap to normalcy for households, small business and markets, “virus policy” ultimately matters more for the real economy. To this end, the inability of Western countries to suppress virus transmission (as compared to Asia-Pacific) will have adverse economic implications over the next 2-3 months.
- 7 Despite shortcomings in US virus and fiscal policy, the \$900 bn of stimulus nonetheless provides another reason (in addition to vaccine implementation) to be optimistic that US growth rebounds well above normal trend growth from Q2 2021 onward.
- 8 The \$900 billion of December stimulus is roughly allocated 1/3 to US households (\$300bn), 1/3 to US businesses, and 1/3 to other (including a large \$70 bn allocation to vaccine implementation and health services). While likely insufficient in size and focus, it may be enough to prevent a double-dip recession in the months ahead.
- 9 With the infrastructure from the CARES Act earlier this year in place, money should reach households and businesses more quickly this time. Families of four, for example, earning less than \$150,000 per year, can expect to receive direct payments of \$2,400 (\$600 for each adult and child) via direct deposit as early as next week.
- 10 In addition to expanding the size and duration of the PPP program by \$284 bn to \$807 bn through March 31, the Congress has increased flexibility on both use of proceeds and qualifying terms for loan forgiveness. However, new eligibility restrictions were added to only include businesses with < 300 employees (vs. 500 previously), and a required 25% decline in 2020 gross revenue (in at least one quarter, Y/Y).

Notable Observations

- 11 Unable to reach agreement, the preponderance of state and local aid (Democratic priority), and COVID-19 liability protections for corporations (Republican priority), were left out of the legislation. Modest state and local aid was included in some areas including transportation, healthcare and education services.
- 12 After much disagreement between Republicans and Democrats, four important Fed crisis lending facilities (the PMCCF, SMCCF, Main Street and Muni lending programs) will be shut down, and their \$429 bn of unused funds reallocated accordingly. More importantly, however, the Fed will preserve its Federal Reserve Act Section 13(3) lending authority, as it existed prior to 2020, for future crises.
- 13 Markets had already priced in a very high likelihood of an additional \$900 bn in US fiscal stimulus and are currently trading more on vaccine implementation and virus resurgence-mutation risk, as well as the knock-on effect to the economy of additional lockdowns and activity restrictions.
- 14 Given the current trajectory of US COVID-19 case counts, hospitalizations and deaths, additional fiscal relief will likely be needed in Q1, 2021. The size and form of this stimulus, however, will be determined by the outcome of the two US Senate races in Georgia on January 5th, and related control of the US Congress.
- 15 The passage of record-sized fiscal stimulus with overwhelming bipartisan support earlier this year, and again this December (Senate passed 92-6, House passed 359-53), offers very little predictive value for bipartisan cooperation during President-elect Biden's first term. If Republicans hold the Senate, Biden will need to rely on the "soft power" of the US Presidency and executive orders to implement his agenda given the likely absence of legislative accomplishments.

2 Extraordinary Fed Accommodation Continues

Extraordinary Monetary Policy Support

The US Federal Reserve took decisive and comprehensive action in early 2020, utilizing a broad range of tools to ease financial conditions, address market dislocations and restore funding markets

The Fed's 2020 crisis playbook

■ Easing financial conditions

■ Addressing market dislocations

■ Restoring Funding Markets

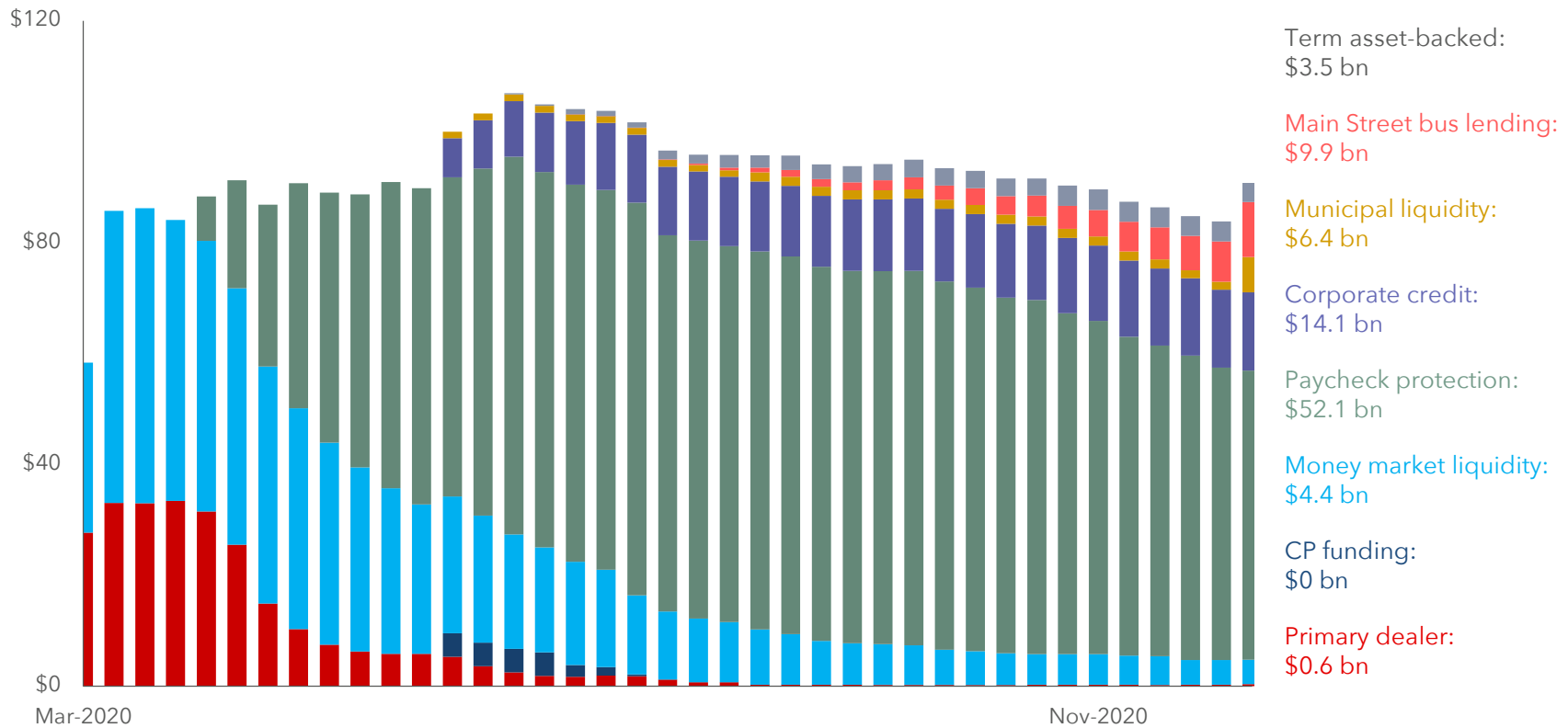
Emergency interest rate cut	Commercial Paper Funding Facility
Bank repo facilities	
Lower bank reserve requirements	Main Street Business Lending Program
Revised discount window terms	
Primary Dealer Credit Facility	Primary Market Corporate Credit Facility
Paycheck Protection Program Liquidity Facility	Secondary Market Corporate Credit Facility
Unlimited quantitative easing	
Central Bank swap lines	Term Asset-Backed Securities Loan Facility
US Dollar repo facility	
Money Market Mutual Fund Liquidity Facility	Municipal Liquidity Facility

Source: (1) Federal Reserve.

Section 13(3) Fed Emergency Lending

On November 19th, Treasury Secretary Steve Mnuchin announced the expiration of five COVID emergency lending programs at year-end 2020. The Fed's emergency lending powers became a significant point of debate in the final hours of negotiating the \$900 bn COVID fiscal relief bill. An agreement was eventually reached that winds down programs established under the CARES Act while maintaining the Fed's emergency authority and ability to respond to future economic crises.

Fed emergency programs, USD bn outstanding

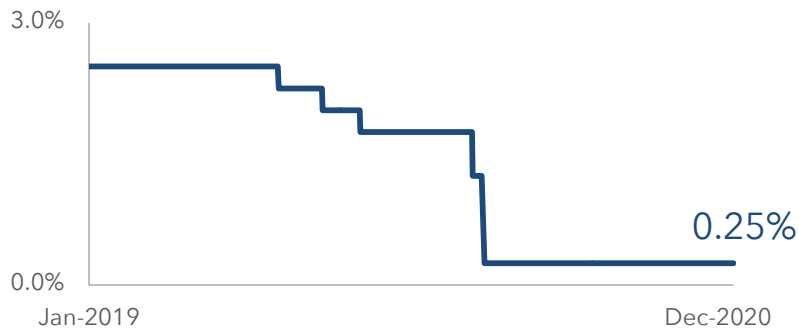


Source: (1) Federal Reserve. Data as of December 18, 2020.

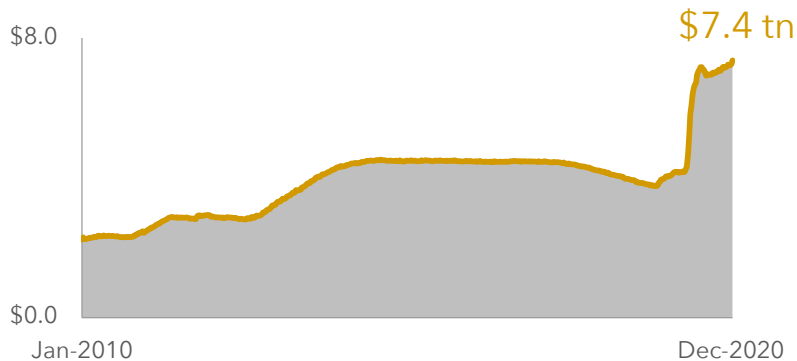
The December 2020 FOMC Meeting

The December 2020 FOMC meeting was unambiguously “dovish” while simultaneously emphasizing the importance of additional fiscal stimulus to complement continued Fed accommodation

Fed funds, upper bound



Fed balance sheet assets, USD tn



Takeaways from December FOMC meeting

- Rate hike unlikely before mid-2024
- QE tapering unlikely before 2023
- No material changes to size (\$120 bn) or tenor of monthly QE purchases
- Optimistic US GDP forecasts of 4.2% in Q4 2021 (Q4/Q4)
- 2% inflation target not expected until 2023
- “Qualitative” forward based guidance (“until substantial progress has been made”) contrasts with ECB’s time based, and the BOJ’s yield targeting, approach

Source: (1-2) Bloomberg. Data as of December 18, 2020.

Passing the Baton

“ The fiscal policy actions that have been taken thus far have made a critical difference to families, businesses and communities across the country. Even so, the current economic downturn is the most severe of our lifetimes. It will take a while to get back to the levels of economic activity and employment that prevailed at the beginning of this year, and it may take continued support from both monetary and fiscal policy to achieve that. ”

Jerome Powell, Federal Reserve Chair,
FOMC Meeting - Dec 17, 2020

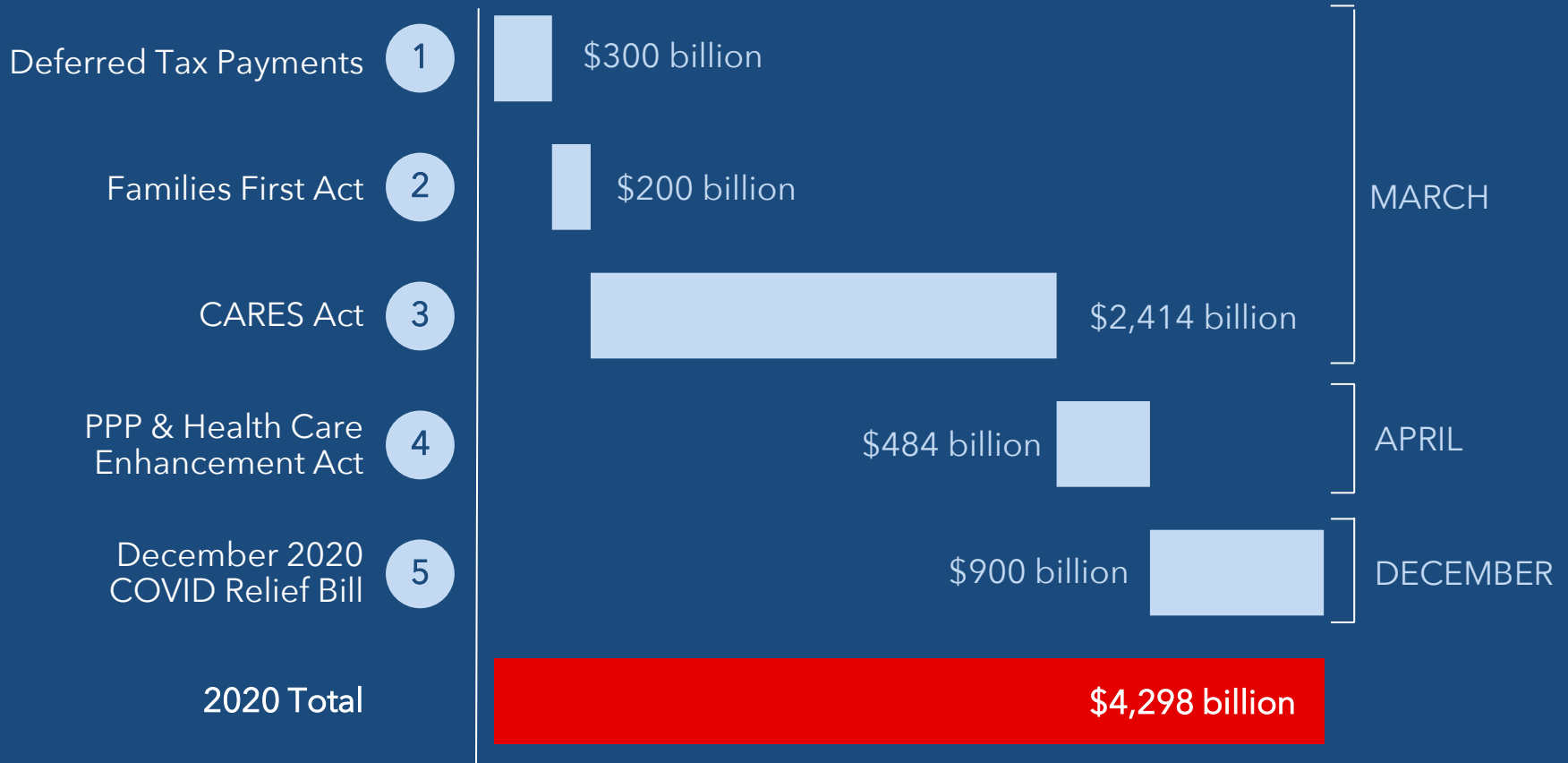


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Passing the Baton to Fiscal Stimulus

Historic 2020 US Fiscal Stimulus

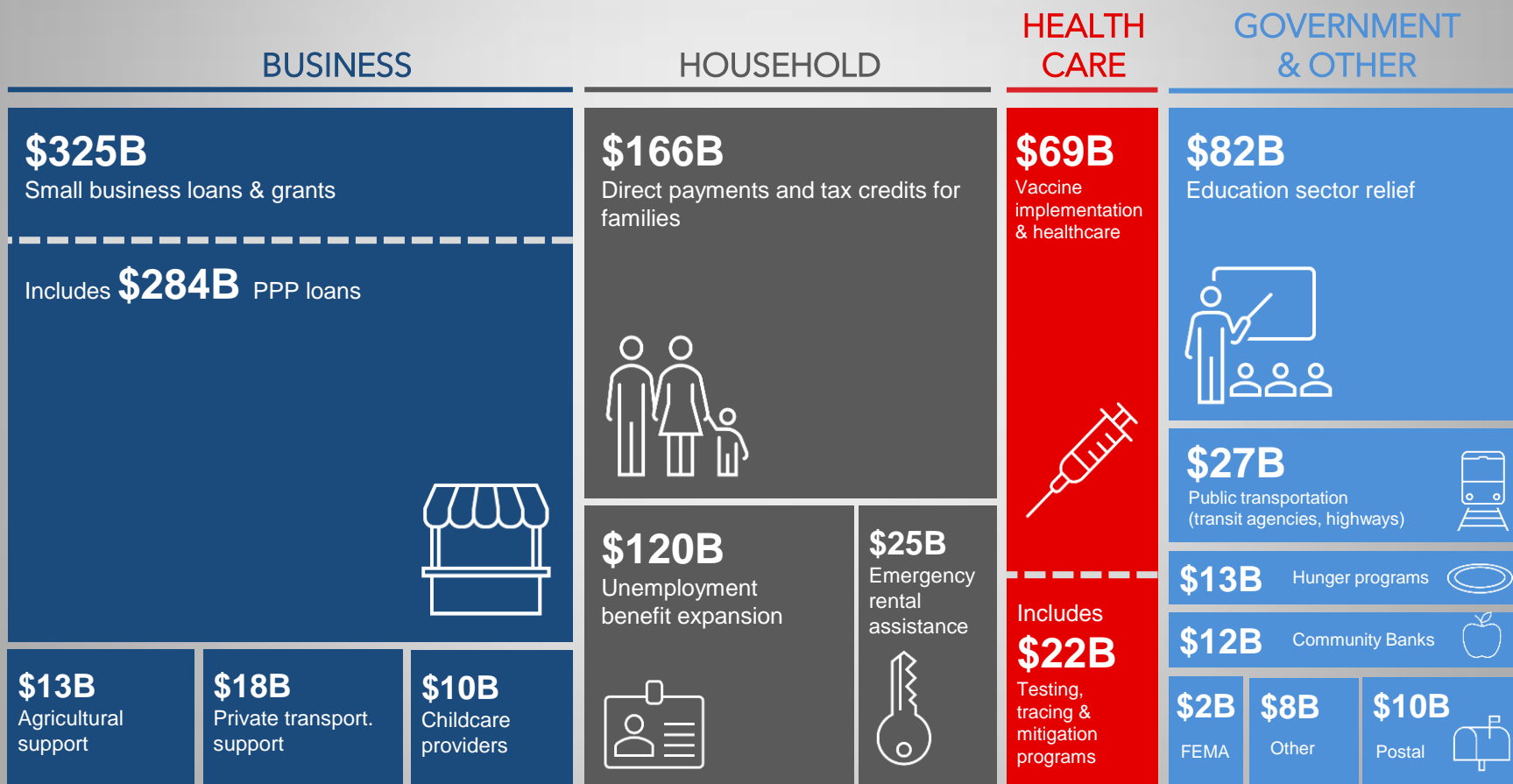
The US Congress and Treasury Department have facilitated \$4.3 trillion of fiscal stimulus in 2020, which, at close to 20% of GDP, is the largest fiscal stimulus in US history



Source: Peck Madigan Jones "COVID Legislation Tracker". Committee for a Responsible Federal Budget. CBO. Note - bill size includes mandatory and discretionary outlays, loss of revenue and loan guarantees that are not expected to have a net effect on the budget. Families First Act includes \$8 bn from the Coronavirus Preparedness and Response Supplemental Appropriates Act. Deferred tax payments originated by Treasury Department not US Congress.

December 2020 Fiscal Stimulus: \$900 Billion

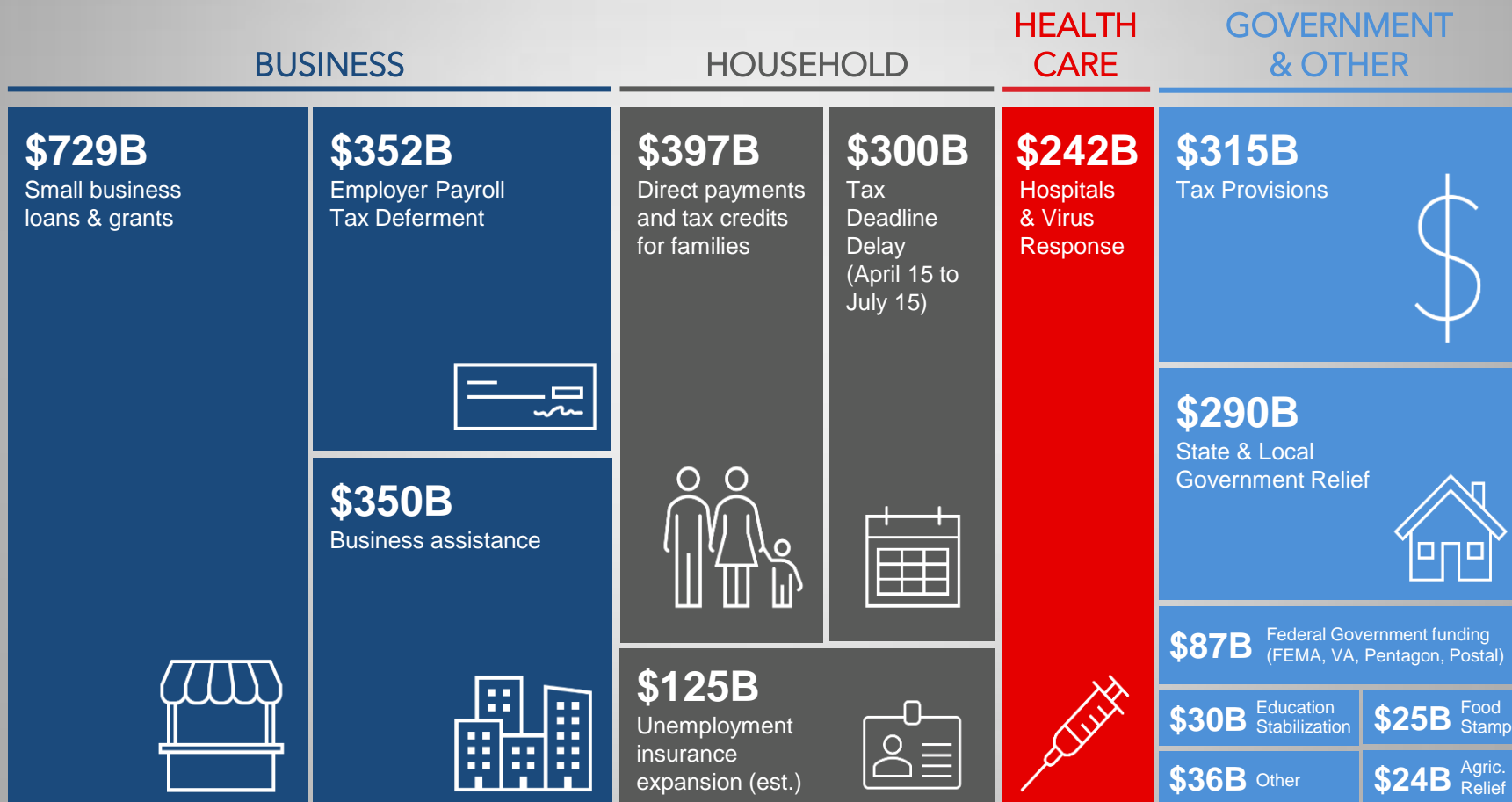
On December 21, 2020, the US Congress passed the \$900 bn (4.3% of GDP) COVID-19 Emergency Relief Package. Notably absent from the bill are additional aid for state & local governments and liability protections for businesses, key issues for Democrats and Republicans, respectively.



Source: US Senate, Committee for a Responsible Federal Budget, Bloomberg Research

Early 2020 Fiscal Stimulus: \$3.3 Trillion

At roughly 15% of GDP, the \$3.3 trillion US fiscal response to COVID-19 in the first half of 2020 was the largest in history. With virus resurgence outpacing expectations, the US Congress passed an additional \$900 bn of stimulus in December 2020.

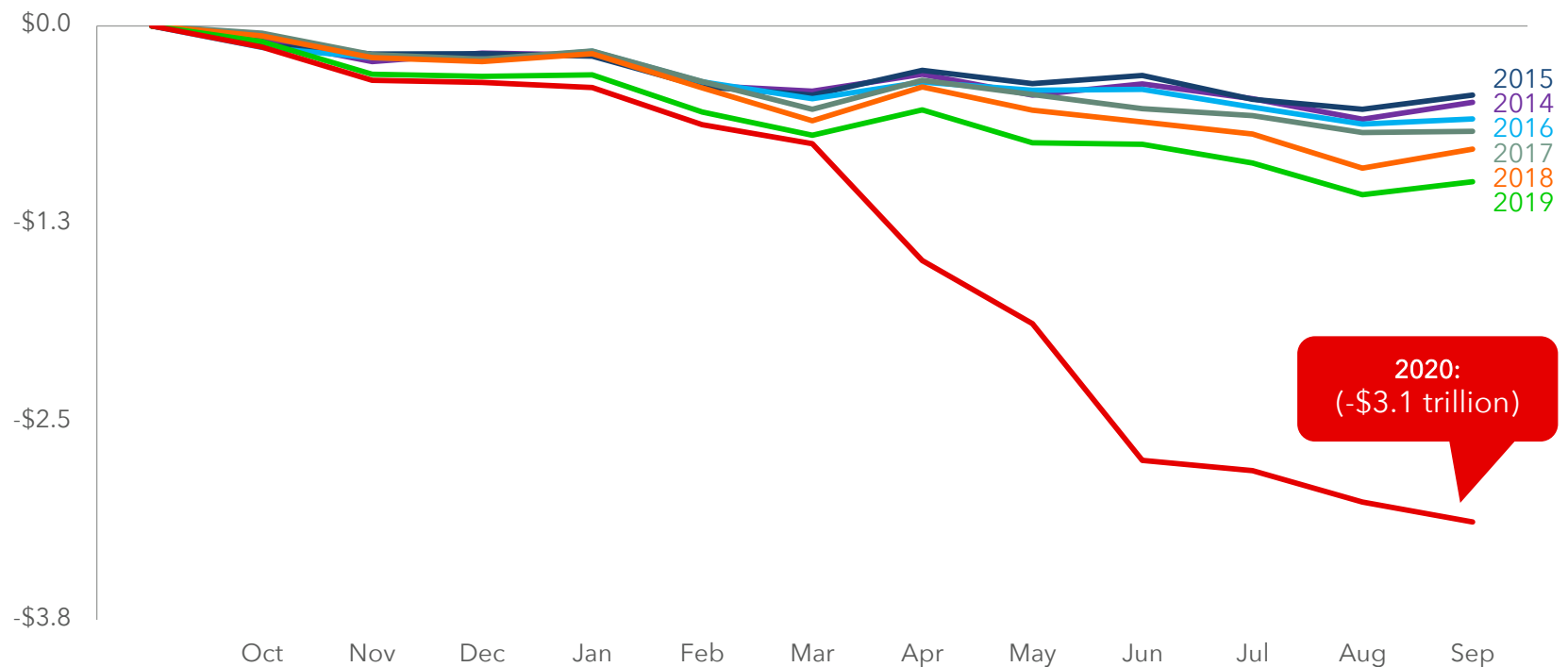


Source: US Senate, Committee for a Responsible Federal Budget, Bloomberg Research

Expanding US Fiscal Deficit

The US budget deficit increased to \$3.1 trillion for fiscal year 2020 (ended September 30th 2020), more than double the prior record of \$1.4 trillion in 2009 and more than three times fiscal year 2019's deficit. Congress's December 2020 \$900 billion COVID relief bill will keep fiscal year 2021 deficits elevated as well.

US Treasury federal deficit, cumulative fiscal YTD, USD tn



Source: (1) Bloomberg. Data as of December 21, 2020.

\$166 bn of Direct Payments to Households

While direct payments of \$600 per adult are less than the \$1,200 payments earlier this year, the \$600 allocation per child is larger than the \$500 amount paid for each child in March

- **One time direct payment of \$600** for individuals making up to \$75,000 (with phase-out for those earning up to \$87,000)
- **One time direct payment of \$1,200** for couples making up to \$150,000
- **One time direct payment of \$600** per eligible child dependent
- Translates to a **one time direct payment of \$2,400** for families of four
- Includes retroactive provision for “mixed-status” households, providing additional support for immigrant families



Source: Consolidated Appropriations Act, 2021 (Including Coronavirus Stimulus & Relief)

\$120 bn Emergency Unemployment Benefits

More than \$100 bn of enhanced unemployment benefits were extended through March 14, 2021 for the 14 million Americans receiving emergency benefits that were scheduled to expire on Christmas Day

- **Additional \$300 top-up** in weekly unemployment benefits from Dec 26 to March 14
- **Extends unemployment benefits** for self-employed and freelance workers; also expands number of weeks an individual may claim from 39 to 50 weeks
- **Additional federally funded unemployment benefits** for workers who have exhausted state-level benefits; also expands number of weeks an individual may claim from 13 to 24 weeks
- **Additional federal funding for state-level “shared work programs”**, whereby employees relying on multiple jobs may be eligible for \$100 weekly for reduced income

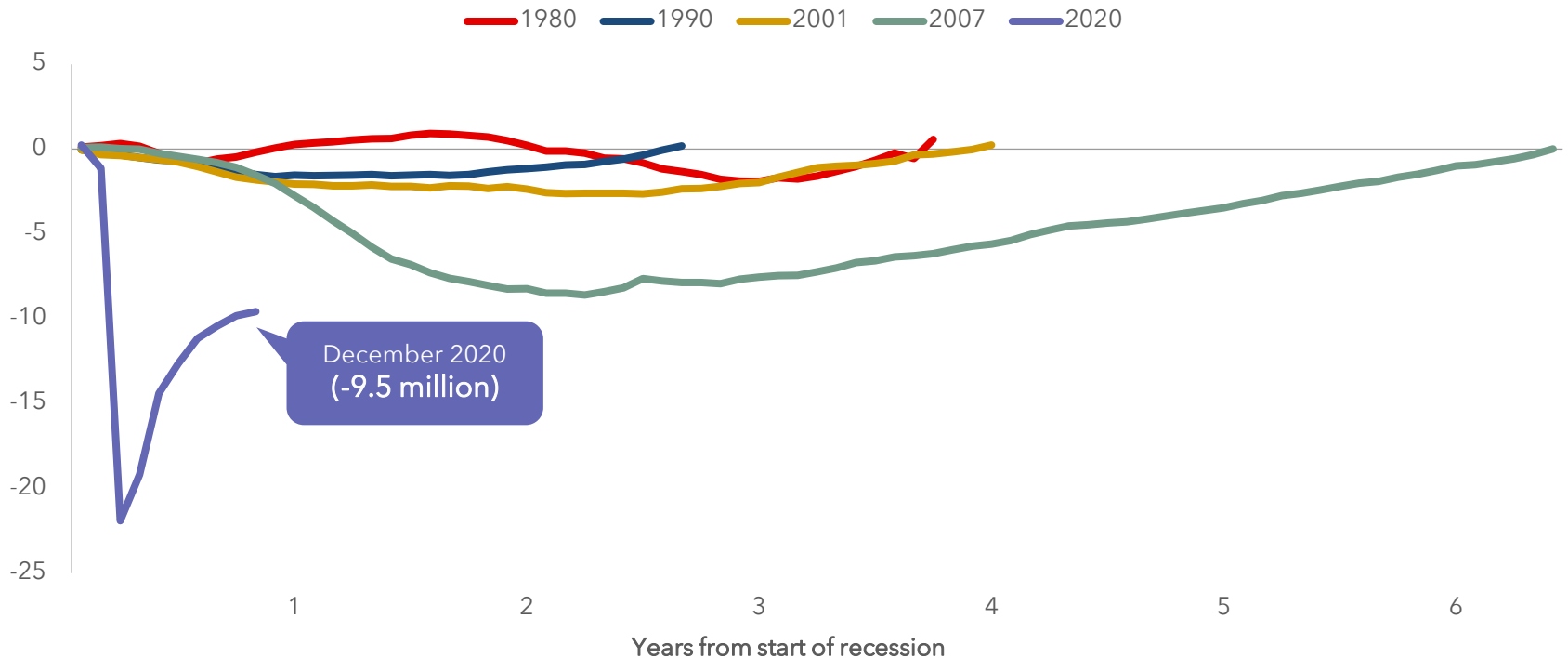


Source: Consolidated Appropriations Act, 2021 (Including Coronavirus Stimulus & Relief)

Elevated US Unemployment

Between March and August 2020, the US economy suffered 22 weeks with initial jobless claims topping 1 million. While the labor market has tightened since then, 14 million Americans are still receiving emergency unemployment benefits and both headline unemployment and U6 underemployment rates remain elevated at 6.7% and 12.0%, respectively.

Change in nonfarm payrolls from the beginning of each recession (millions)



Source: (1) Bloomberg. Data as of December 21, 2020. Combines January to July 1980 and July 1981 to November 1982 recessions. Seasonally adjusted. Labor Department, Bureau of Economic Research (recessions).

Additional Support for Households

Tens of billions in other programs have been funded to assist individuals and families with rent payments, student debt, childcare, food, water, technology access and dozens of other household expenses

\$25 bn Rental Assistance:

- \$25 billion of rental assistance to states and localities prioritized for renters most in-need due to COVID-19
- Extension of the CDC rental eviction moratorium through Jan 31, 2021

\$26 bn Nutrition and Agriculture:

- \$13 bn of direct payments to farmers suffering COVID losses
- \$13 bn to combat “food insecurity”

\$10 bn Childcare

- \$10 bn of immediate relief for impacted child care providers

\$7 bn in Broadband Access Funds:

- Includes \$3.2 bn for low income families and \$1 bn for tribal areas
- \$1.9 bn to assist small service providers replacing equipment made by certain Chinese firms
- \$265 million for tele-health

\$2 bn in Funeral Assistance Funds:

- Funding for FEMA’s Disaster Funeral Assistance fund for those with COVID-related family deaths covering caskets, mortuary services and burial plots

\$638 mm Water Utility Assistance:

- Drinking water and waste water utility support for low income families



Source: Consolidated Appropriations Act, 2021 (Including Coronavirus Stimulus & Relief)

Notable Tax Provisions in the COVID-19 Emergency Relief Package

The COVID-19 Emergency Relief Package includes a number of extensions, expansions and clarifications of tax provisions from prior COVID relief bills

Business tax provisions:

- CARES Act Employee Retention Tax Credit extended through July 1, 2021 with expanded eligibility and rates
- PPP loan program clarifications:
 - Forgiven PPP loans will not be included in taxable income
 - Expenses paid with forgiven PPP loan funds qualify for tax deductions; effective date retroactive to the CARES Act original PPP

Individual tax provisions:

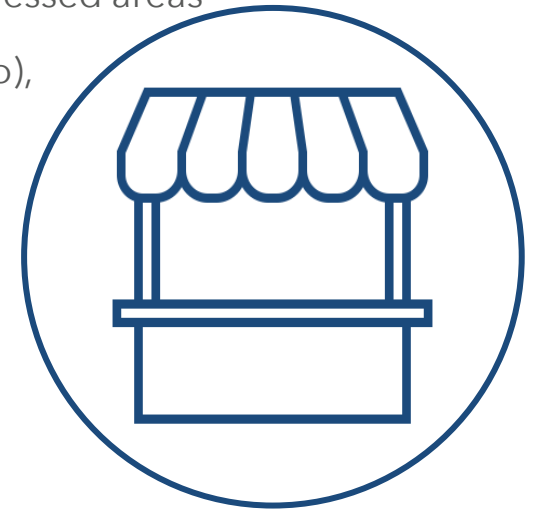
- Special “lookback” for EITC and CTC allowing lower-income individuals to use 2019 income to determine Earned Income Tax Credit and Child Tax Credit
- Paid Leave Credits established in the Families First Coronavirus Response Act extended to March 31, 2021
- One year extension for CARES Act Charitable Giving Incentives that were set to expire at year-end 2020
- Permitted carryover of any unused health and dependent care FSA benefits from 2020 into 2021 for individuals
- Payroll tax deferral extended to Dec 31, 2021 vs. original deferral to Apr 30, 2021

Source: Consolidated Appropriations Act, 2021 (Including Coronavirus Stimulus & Relief)

\$325 bn of Small Business Support

About one third of the \$900 bn relief bill provides direct support for small business, including an additional \$284 billion of additional funding for the Paycheck Protection Program (PPP), which has been extended through March 31, 2021. While this round of PPP loans has more flexibility on use of proceeds and qualifying conditions for forgiveness, additional restrictions have been placed on qualifying participants.

- **\$284 bn of forgivable PPP loans** for small businesses with < 300 employees and a 25% decline in gross revenue (measured for any 2020 Q, compared to 2019)
- Additional **\$15 bn for lending** through community financial institutions (including for minority-owned and underserved small businesses and non-profits)
- **Additional funding for small businesses** with < 10 employees or in distressed areas
- **PPP eligibility expanded** for hospitals, local news outlets (print, tv, radio), housing cooperatives and 501(c)(6) non-profits
- **Larger forgivable loans** of 3.5x average monthly payroll (vs. 2.5x) for restaurant and hospitality industries
- **Expands forgivable expenses** to include PPE, outdoor dining expenses, and supplier costs
- **Streamlined forgiveness process** for loans < \$150,000

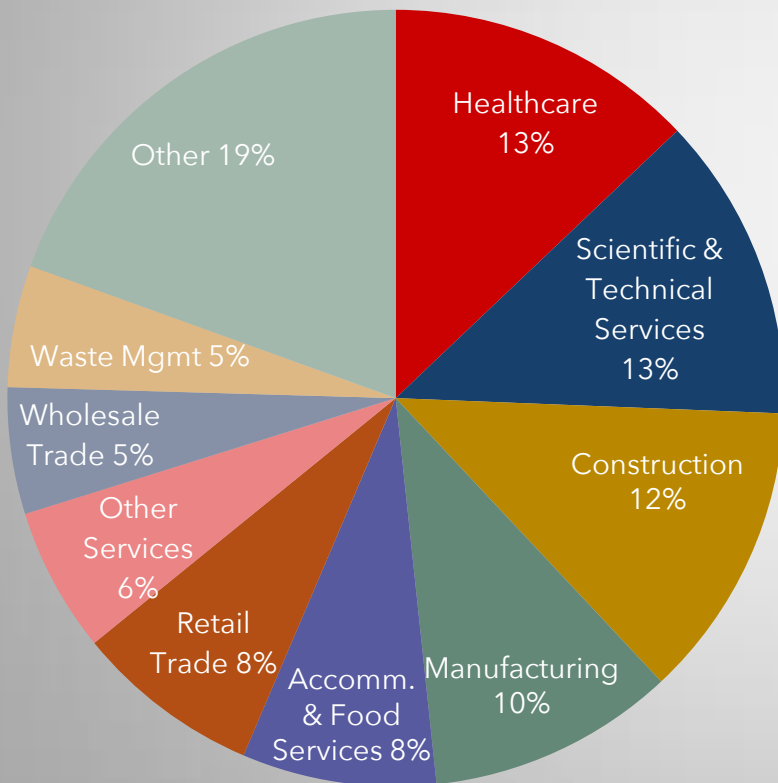


Source: Consolidated Appropriations Act, 2021 (Including Coronavirus Stimulus & Relief)

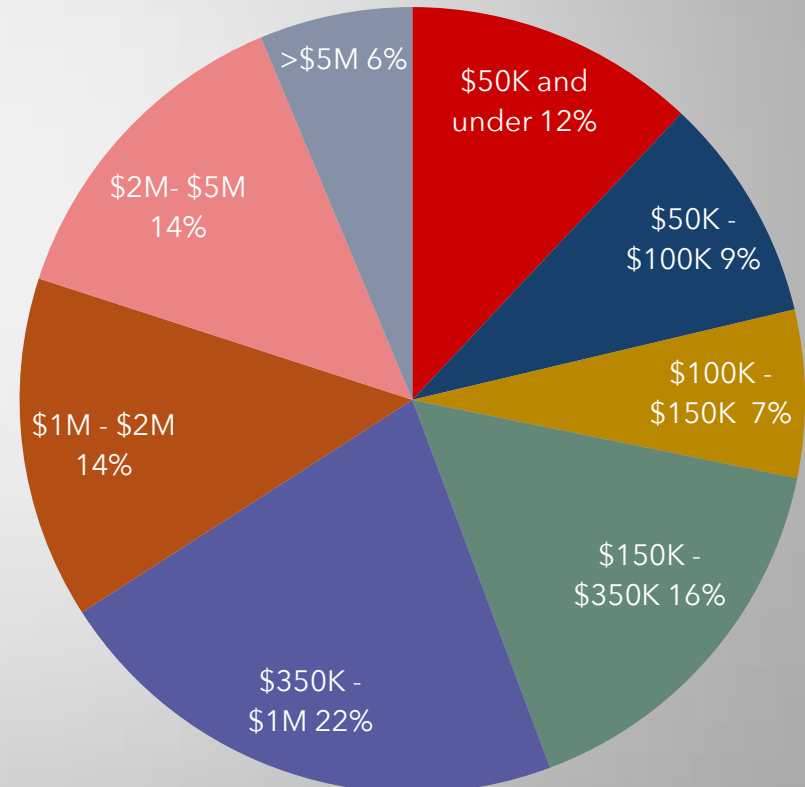
Breaking Down the Original PPP: \$525 Billion

Over \$525bn of loans were made to small businesses through the Paycheck Protection Program in 2020 with almost 40% of loans concentrated in the healthcare, professional, scientific & technical services, and construction sectors

PPP loan breakdown, by sector



PPP loan breakdown, by loan size



Source: (1-2) US SBA. Paycheck Protection Program (PPP) Report. Approvals through August 8, 2020. \$525 bn of loans made of the Congressionally allotted \$659 bn.

\$82 bn of Education Sector Relief

The bill provides \$82 bn of education funding split into three funds for state education services, K-12 institutions, and higher education institutions impacted by COVID

- **\$54 bn** of elementary and secondary school emergency relief for K-12 schools
- **\$23 bn** of emergency relief for public and private higher education schools
- **\$4 bn** of Governor emergency education relief set aside for services to K-12 schools administered by public agencies
- **Over \$2 bn** of funding for HBCUs, tribal colleges and minority servicing institutions
- **Significant flexibility** on use of proceeds and services



Source: Consolidated Appropriations Act, 2021 (Including Coronavirus Stimulus & Relief)

\$69 bn of Funding for Vaccines & Healthcare

Over \$60 bn in funding will be directed toward vaccine procurement and distribution, testing and tracing programs and additional healthcare relief services. Additionally, the bill prohibits “surprise medical billing” for COVID testing and treatment.

- **Over \$30 bn** in funding to BARDA, the CDC and strategic national stockpile for vaccine procurement and distribution
- **Over \$20 bn** sent directly to states for testing, tracing and COVID mitigation programs
- **\$9 bn** of support for health care providers
- **\$4.5 bn** in mental health services funding
- **\$4 bn** of funding for GAVI for international vaccine distribution
- **\$3 bn** in budget neutrality adjustments for Medicare Physician fee schedules
- **\$1 bn** of NIH funding for COVID-19 research
- **Targeted funds** separated in numerous funds for minority, under-served and Indian communities



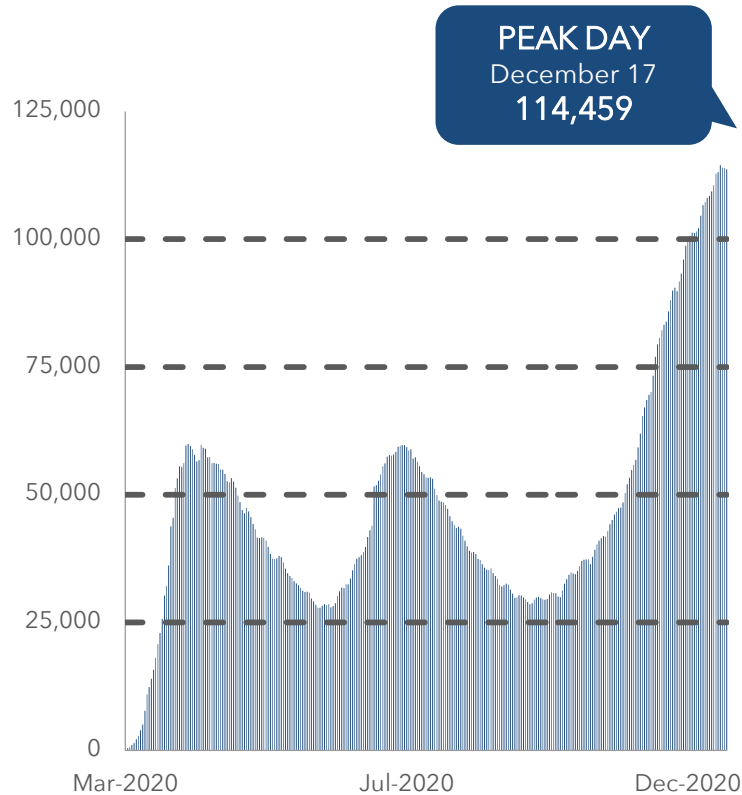
Source: Consolidated Appropriations Act, 2021 (Including Coronavirus Stimulus & Relief)



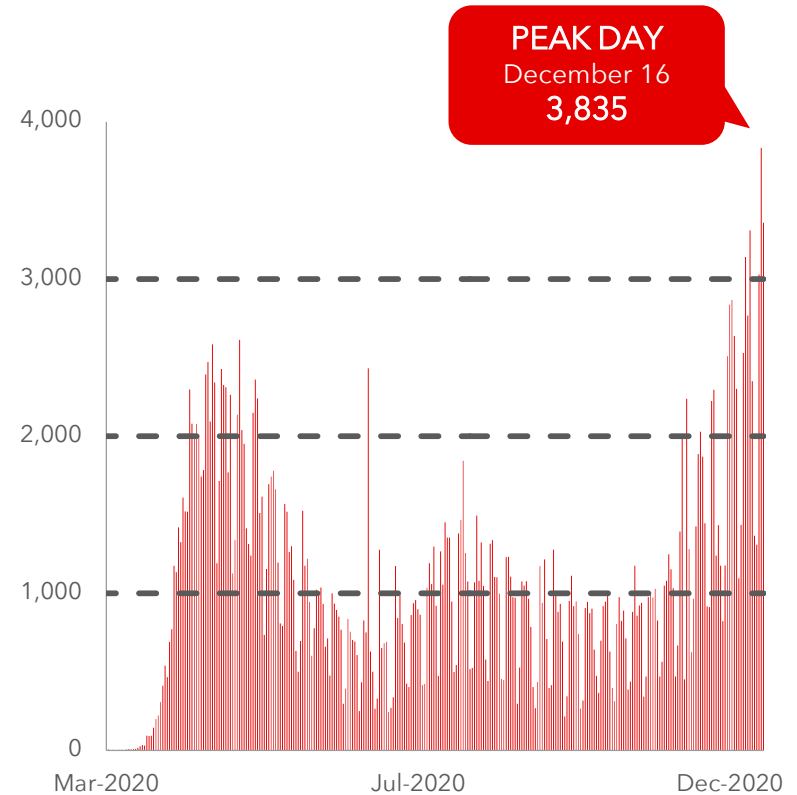
Daily US COVID Hospitalizations & Deaths

US daily COVID-19 hospitalization and deaths continue to reach new record highs. Further, both are lagging indicators of the severity of the pandemic. With the US unable to “bend the transmission curve” heading into the holiday travel season, hospitalizations and deaths are likely to continue their recent upward trajectory. While fiscal and monetary policy are most important for the market, ultimately, the key to economic recovery is in suppressing virus transmission.

Daily COVID hospitalizations



Daily COVID deaths



Source: (1) The COVID Tracking Project. Data as of December 21, 2020. Bloomberg. Data as of December 121 2020. New infections are 7 day moving average.

\$45 bn of Transportation Sector Relief

The bill also includes \$45 bn of additional relief for the transportation sector, including airlines, airline contractors, airports, bus, railway and ferry services

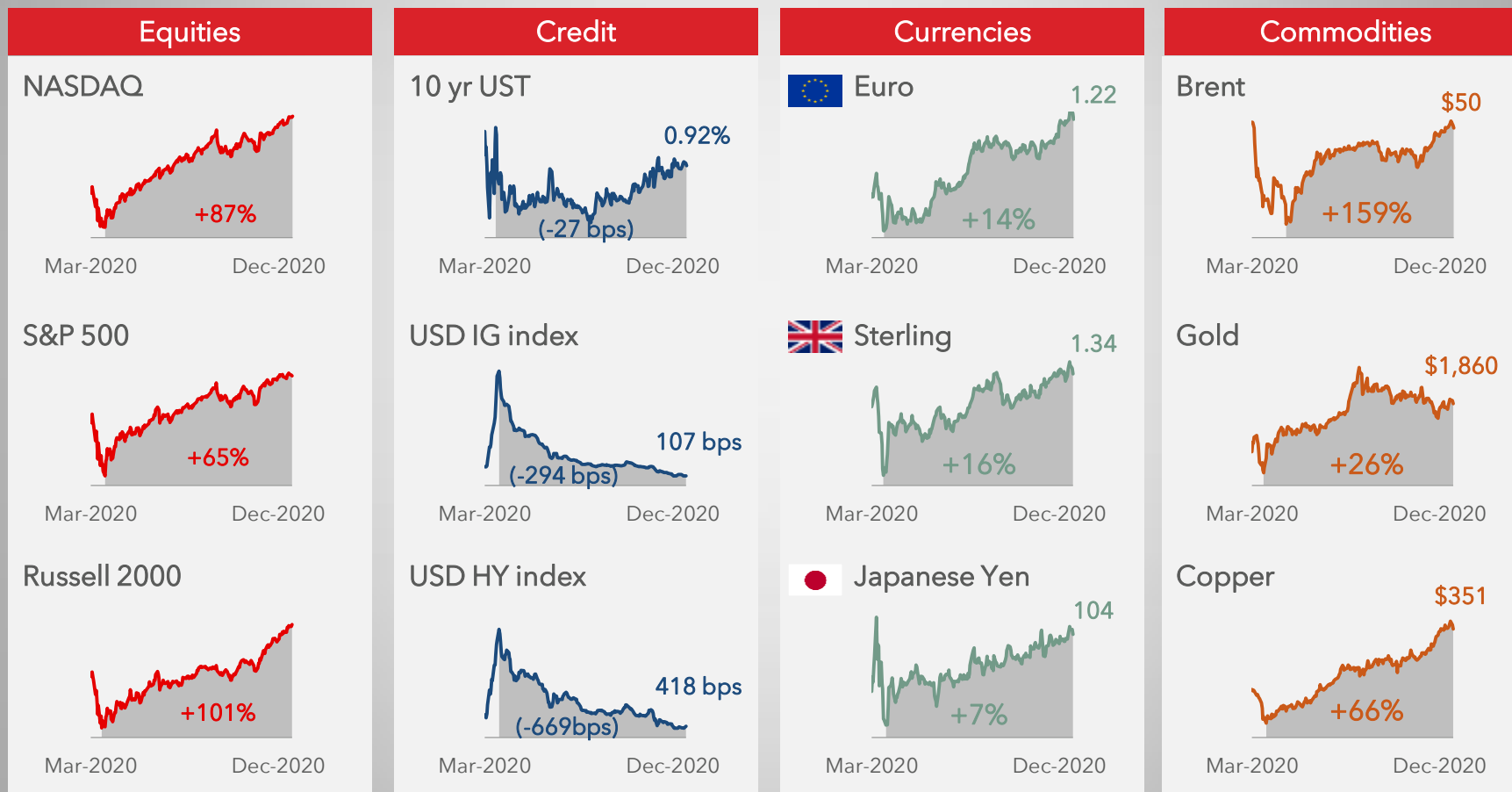
- **\$15 bn** of airline payroll support through March 31, 2021, with requirements to rehire certain employees laid off after Sept 30, 2020 and restrictions on future pay rate reductions or furloughs
- **Restrictions on stock buybacks**, executive compensation and use of proceeds (worker payroll only) for those receiving funds
- **\$1 bn** of additional funding for airline contractor payroll support
- **\$2 bn** of relief for private motor coaches, school buses, and US-flagged small passenger vessels
- **\$27 bn** for transit agencies, airports, highways and trains
- **Additional \$10 bn** of relief funding for the US Postal Service



Source: Consolidated Appropriations Act, 2021 (Including Coronavirus Stimulus & Relief)

Markets During the COVID-19 Crisis

While extraordinary Fed accommodation remains a key pillar underpinning the performance of markets, the more pervasive driver into year-end has been a combination of vaccine optimism and expectations of additional fiscal stimulus



Source: (1-12) Bloomberg. Data as of December 22 2020. USD IG & HY credit indices are ICE BofA OAS. FRED. All currencies vs. USD. JPY axis inverted to show appreciation. Performance Data is from 2020 low through December 22, 2020.



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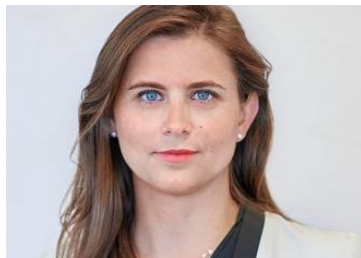
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Hailey graduated with honors from the University of Michigan's Ross School of Business with a BBA and a minor in International Studies.

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