Will Policy Support be Enough?

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Our baseline case remains: Growth to resume in 3Q20, accelerate in 2021

We continue to believe that the economic fallout from the COVID-19 global pandemic is a temporary shock that will not fundamentally impair productive capacity. We expect a recovery will start in the third quarter of this year, setting the stage for a more meaningful acceleration of economic growth in 2021. Our outlook assumes that progress on COVID-19 treatment will continue, and that a vaccine will be widely available in the first half of 2021. In addition, our outlook implies ongoing policy support that continues to bolster consumers, who were relatively strong heading into this crisis. As May and June numbers are proving out, this policy support is the lifeline the economy needs, serving as a bridge to help consumers emerge on the other side of the pandemic intact.

What happens when the policy lifeline runs out?

What does the consumer look like when policy support runs out? In May we caught a glimpse of the answer—it wasn't pretty. Personal income fell 4% month over month as a modest 2-3% bounce back in wage-related income and proprietor's income was not enough to offset fading fiscal transfers (which include unemployment benefits).

Figure 1. Personal income takes a hit as government support starts to fade

Personal Income Component	Weight	May-20	Apr-20	Mar-20
Total Personal Income	100%	−4.2%	10.8%	−2.2%
+ Compensation of Employees	54%	2.5%	−7.4%	−3.4%
Wages and Salaries	44%	2.7%	−7.6%	−3.7%
Supplements to Wages	10%	1.2%	−6.4%	−2.0%
+ Proprietors Income	7%	2.8%	−12.7%	−8.0%
+ Rental Income	4%	0.2%	0.1%	0.3%
+ Personal Income Receipts on Assets	15%	−1.4%	−1.5%	−0.3%
Interest Income	8%	−1.3%	−1.7%	−0.7%
Dividend Income	6%	−1.5%	−1.3%	0.3%
+ Transfer Receipts	27%	−17.2%	90.1%	2.3%
− Contributions to Social Insurance	7%	2.5%	−5.8%	−3.1%
− Taxes	10%	1.8%	−6.9%	−3.1%
= Disposable Income	84%	0.0%	0.0%	0.5%
− Personal Outlays	69%	7.8%	−12.3%	−6.5%
Interest Payments	2%	−1.5%	−5.8%	−6.7%
= Savings	21%	−31.6%	189.9%	46.5%
Personal Income Ex-Transfers	73%	1.6%	−6.6%	−3.2%
Taxes % of Income	10%	6.3%	−16.0%	−0.9%
Taxes & Contributions % of Income	17%	6.6%	−15.6%	−0.9%
Non-Wage, Non-Transfer Income	26%	0.0%	−4.6%	−2.6%

As of May 2020. Source: U.S. Bureau of Economic Analysis and Voya Investment Management

A look at the longer-term trend in personal income provides a more comprehensive view regarding the impact of government support. On a year-over-year basis, personal income growth remains steadfastly positive, increasing by 12% in April. However, when government support is backed out, wage-related income growth was down 8% year-over-year in April.

Figure 2. Year-Over-Year Personal Income Data Shows the Full Impact of Government Support

Personal Income Component	Weight	May-20	Apr-20	Mar-20
Total Personal Income	100%	7.0%	11.9%	1.4%
+ Compensation of Employees	54%	−5.4%	−7.8%	−0.5%
Wages and Salaries	44%	−5.7%	−8.3%	−0.9%
Supplements to Wages	10%	−4.3%	−5.3%	1.3%
+ Proprietors Income	7%	−10.9%	−12.7%	0.6%
+ Rental Income	4%	2.8%	3.2%	3.5%
+ Personal Income Receipts on Assets	15%	−3.7%	−1.6%	1.4%
Interest Income	8%	−6.6%	−4.3%	−0.6%
Dividend Income	6%	0.5%	2.1%	4.1%
+ Transfer Receipts	27%	67.5%	103.2%	7.5%
− Contributions to Social Insurance	7%	−3.0%	−5.5%	0.2%
− Taxes	10%	−6.7%	−8.0%	−0.4%
= Disposable Income	84%	3.3%	3.3%	3.3%
− Personal Outlays	69%	−9.4%	−15.6%	−3.1%
Interest Payments	2%	−15.5%	−13.8%	−8.1%
= Savings	21%	224.9%	361.9%	52.6%
Personal Income Ex-Transfers	73%	−5.5%	−6.7%	0.1%
Taxes % of Income	10%	−12.8%	−17.8%	−1.7%
Taxes & Contributions % of Income	17%	−11.4%	−16.9%	−1.5%
Non-Wage, Non-Transfer Income	26%	−4.9%	−4.2%	1.5%

As of May 2020. Source: U.S. Bureau of Economic Analysis and Voya Investment Management

The trend in figures 1 and 2 reinforces the importance of government support and highlights the potential consequences when it starts to fade. The good news for the economy is that more stimulus is on the way. But will it be enough?

Stimulus has supported lower-income earners—will that trend continue?

The United States has mounted a colossal effort to combat the economic fallout from the COVID-19 pandemic. Prior to the most recent stimulus package, government spending already amounted to more than 12% of GDP. As we highlighted last quarter, government stimulus has also been focused on small businesses and consumers, the latter of which were in relatively good shape heading into this crisis. However, as we also noted, consumers on the lower end of the income bracket were in good shape primarily because of low unemployment (which provided cash flow liquidity), not necessarily because of asset growth or declining leverage.

Populism remains a growing force of uncertainty for the global economy and the primary risk of a "two-speed recovery" between higher and lower income brackets is its potential to reinforce the foundation that has helped populism take root. From this perspective, the good news is that stimulus spending to date has provided adequate support for lower income earners. In fact, a recent analysis from the National Bureau of Economic Research[1] shows that with existing stimulus benefits (scheduled to end July 31), 68% of eligible unemployed workers will have received benefits that exceed lost earnings. This was especially true for those on the lower end of the income spectrum, as workers in the bottom 20% of the income distribution had replacement rates above 200%, which means the amount of government support was significantly more than the wages received when these workers were employed.

With stimulus benefits scheduled to expire on July 31, the government is evaluating additional measures to provide continued support for the economy. Due to the congressional calendar, this latest stimulus package will likely be the last piece of fiscal stimulus before the presidential election in November. As the details of the latest spending package emerge and additional stimulus begins to flow through to the economy, we will be paying close attention to see if the trend of support for lower-income earners continues.

Of course, as we start to think about the post COVID-19 world, the short- and long-term implications of the stimulus seem to be at odds with each other. In the short-term, the primary risk is that the stimulus is not enough. Longer term the risk is that its tremendous size and scope set a dangerous precedent for how we are forced to respond to future crises. With the latest package, the fiscal deficit will approach levels only reached during the United States' response to World War II. In the short-term, however, we believe policymakers will continue to do what it takes to sustain the economy. From a near-term standpoint, this backdrop should favor industries and sectors that are positioned to capitalize on a cyclical upswing.

[1]May 2020. National Bureau of Economic Research. US UNEMPLOYMENT INSURANCE REPLACEMENT RATES DURING THE PANDEMIC.

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