NORTHERN TRUST

APRIL 3, 2020

WEEKLY ECONOMIC COMMENTARY

IN THIS ISSUE:

- **Contagion and Consumers**
- **India's Battle to Maintain Economic Health**

Global Economic Research
50 South La Salle Street
Chicago, Illinois 60603
northerntrust.com

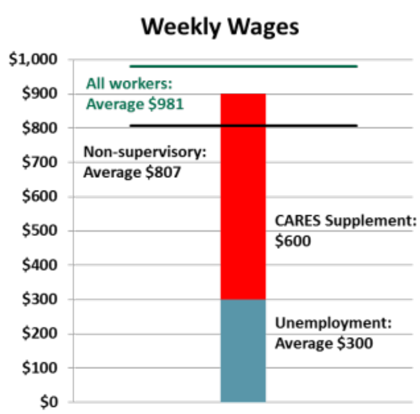
Carl R. Tannenbaum
Chief Economist
312-557-8820
ct92@ntrs.com

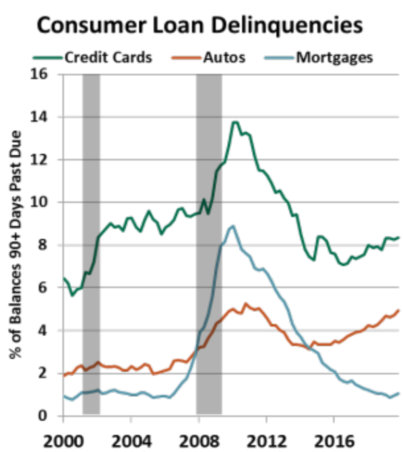
Ryan James Boyle
Senior Economist
312-444-3843
rjb13@ntrs.com

Vaibhav Tandon
Economist
630-276-2498
vt141@ntrs.com

Comedian George Carlin once quipped that "Consumption is the new national pastime." Well, if he was right, no one is having much fun these days. Mandated closures and social distancing have had an immediate and dramatic effect on American spending, which is critical to global economic growth. Substantial fiscal and monetary policy support should help many consumers survive this difficult interval without lasting financial damage. But for some consumers, any income disruption may be too much to bear.

Consumers have been the focus of several stimulus bills passed by Congress this year. The Families First Coronavirus Response Act, ratified March 18, includes job protections and paid leave for certain workers battling COVID-19 or tending to family members, including parents looking after children whose schools have closed. The Act also increases funding for unemployment programs and lowered the eligibility requirements for food assistance. These measures provide only basic relief for people in greatest need.





Sources: Department of Labor, Federal Reserve, Equifax, Haver Analytics

The larger Coronavirus Aid, Relief, and Economic Security (CARES) Act, signed into law March 27, went much further. Under the Act, all taxpayers with earnings up to $75,000 (doubled for a household filing jointly) on their most recently filed tax returns will receive a payment of $1,200. Each child in the household earns an additional $500. Higher earners receive a means-tested partial payment, with the incentive scaling down to zero for individuals earning over $99,000.

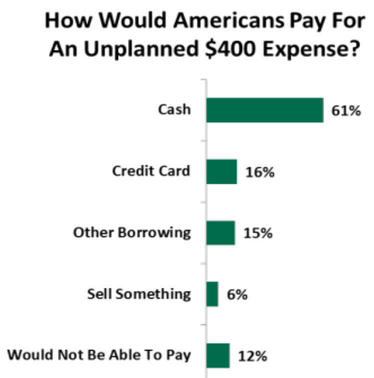
The prospect of receiving cash is enticing, but the payments will only go so far. The one-time checks will only cover one month of rent or mortgage payments for households in most parts of the U.S. The payments are meant only to help households carry on through a temporary suspension of economic activity, not something more permanent. And it may take several months for all of the payments to be distributed.

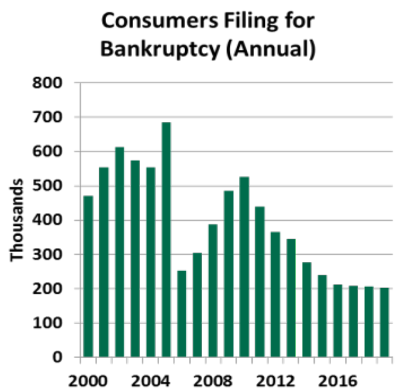
Sidelined workers will also benefit from CARES' enhancement to unemployment insurance (UI) benefits. UI is not a generous system, by design: Small payouts keep employers' insurance premiums lower and encourage unemployed workers to seek work aggressively. Benefits vary depending on the worker's income and state of residence, but average around $300 per week. The CARES supplement of $600 per month brings UI payments up to a more typical level of income.

Larger unemployment benefits will be a big help to a growing number of workers.

CARES also extends UI to populations that never had the benefit before, including self-employed and gig workers. The Bureau of Labor Statistics estimates there were 1.6 million contingent workers in the U.S. as of 2017, comprising about 1% of the workforce. Any of them who cannot work due to COVID-19's effects now qualify for benefits and the CARES supplement. The Act also supplements wages for workers whose hours have been reduced due to the COVID-19 slowdown.

The CARES Act also provides money for small business loans, which will be forgiven if the loan is used to sustain payrolls. This benefit may have been too little, too late; astonishing levels of initial unemployment claims show that layoffs have taken hold. Employers may choose to terminate workers in order to let them collect more generous UI, rather than continue paying them and then applying for debt forgiveness.





Sources: Federal Reserve, Haver Analytics

Whether paid through wages or UI, many households need every dollar that comes in. Too many Americans live on the margin: an estimated 39% of them would be unable to pay for an unplanned $400 expense, even during good times. An abrupt loss of income will hurt these workers badly.

U.S. consumers are entering the coming recession with high debt burdens. In good times, employed consumers have both the confidence to borrow and the income to handle it. Mortgage balances on one-to-four family homes are nearly equal to their 2007 peak. Auto loans and leases, credit card balances, student loans and unsecured personal loans grew for years. With unemployment rising rapidly, however, indebtedness may become much more difficult to handle. And the credit models that lenders rely on may struggle to appreciate increasing risk.

Strain on consumer credit quality will challenge the banks that underwrite the credit. At this time, there is no national policy of debt forbearance: The U.S. Federal Reserve issued guidance that "financial institutions should work constructively with borrowers and other customers in affected communities." Some banks are offering piecemeal accommodations for borrowers affected by COVID-19. But these policies are temporary and will grant no reprieves for routine expenses like rent and insurance.

The rapid downturn we are experiencing today will do minimal damage if it is short-lived. Until recently, the consensus had been that the U.S. will experience a recession that is sharp, but brief. Based on COVID-19's patterns of contagion in other countries that have dealt with an outbreak, it is reasonable to assume the spread of new cases will decline, allowing commerce to recover relatively quickly.

But recent readings from the U.S. job market have been sobering, and raise the possibility of a deeper downturn and a slower recovery. Cessation of local lockdown policies could take some time, and consumers will then need time to overcome their own safety concerns and resume normal patterns of activity. Many households' budgets will be stretched, limiting how quickly consumption and employment will rebound. Impaired American consumption is a global problem: it hurts both domestic producers and those in every country that exports to the U.S.

Unemployment rates rise quickly and fall gradually.

The stimulus measures implemented to date are largely aligned with expectations for a temporary setback. (For example, the UI supplement in the CARES Act is funded only through July 31.) Steps taken so far are not designed to be a lasting survival mechanism for businesses or individuals. Conversations in Washington have consequently shifted to "Phase 4" of fiscal stimulus, which would provide more enduring support. But new legislation will take time.

Though the recent global financial crisis ended in 2009, employment was slow to recover and bankruptcies were elevated for years afterward. If we want to avoid a similar outcome, we will need more support for American consumption. And that is no laughing matter.

A Lot at Stake

Vaibhav reports on the effects of the coronavirus on the world's largest democracy.

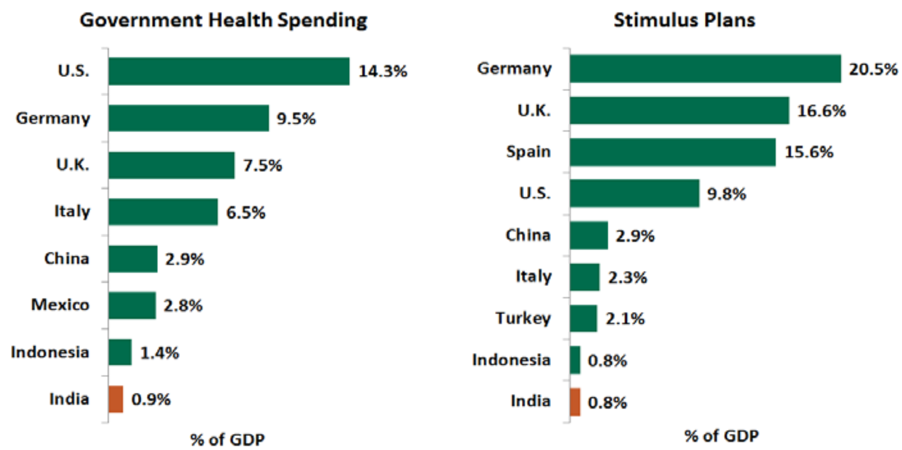
Dozens of countries around the world are under lockdown to contain the COVID-19 outbreak. On March 25, India's 1.4 billion residents joined the group. With more than 2,500 confirmed cases, India still remains quite low in the COVID-19 table, but its rising pace of spread has prompted the Indian government to announce a 21-day nationwide lockdown.

While several high-income nations are hurting severely, the situation is unquestionably more challenging for a country like India. India is not only the world's second-most-populous country, but also has a high population density. (India's 455 people per square kilometer of land area is more than three times higher than China's.) Living conditions in much of the country are tough, with high poverty, severe congestion and a large number of daily wage earners. Ensuring complete lockdown or social distancing without causing serious economic hardships is immensely problematic.

As of this writing, India had tested only 48,000 people for the coronavirus, which compares to over 550,000 in the U.S. and 320,000 in South Korea. This perhaps is masking the extent of the outbreak in India. The low COVID-19-related death count offered fleeting hope that the outbreak was still contained, but now that figure has started to increase.

Should the virus spread swiftly, there are ample reasons to believe the country's health infrastructure will be overwhelmed. According to the World Health Organization, India has just seven hospital beds and eight doctors per 10,000 people. This is in sharp contrast to Italy, a recent viral epicenter, which has five times as many doctors (41 per 10,000 persons).

Much like its broader infrastructure, India's healthcare system has been ignored for far too long. The country lags far behind both advanced economies and comparable emerging markets (EMs) in spending on healthcare. India spends only 0.9% of its gross domestic product (GDP) on public health. By contrast, the U.S. spends about 14.3% of GDP on healthcare, Germany 9.5% and the U.K. 7.5%. Most other major EMs spend far more than India does.



Sources: OECD, Quartz, Statista

India needs to make sure that fiscal stimulus reaches the last mile.

Anticipating the inevitable hardships, the government quickly announced an economic response worth 0.8% of GDP in the form of direct cash transfers and food security measures targeted to the poorest of society. But the package simply won't be enough to absorb the looming economic shock. A large number of people do not have a social safety net. Considering that over 80% of India's 470 million-member workforce is employed in informal sectors, benefits may not reach the last mile. Developed markets encounter this challenge, too, but at a much smaller scale.

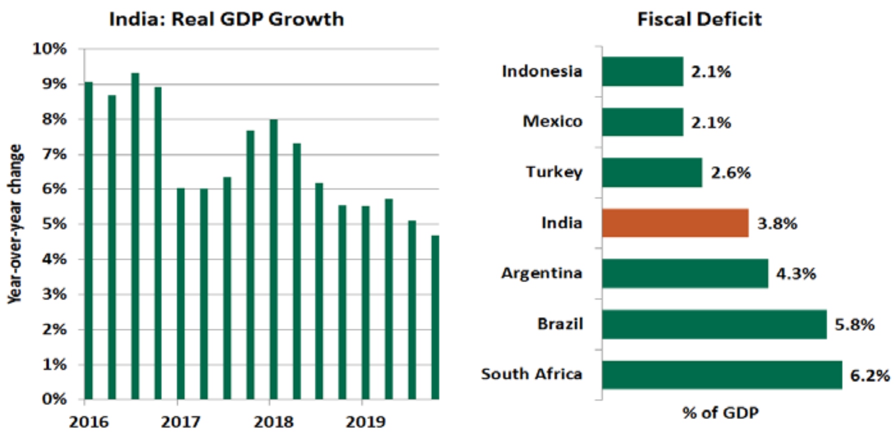
The national relief measures failed to provide aid for businesses and states reeling from shutdown, even though states are expected to roll out measures to ease the pain. The support announced is thus far in line with measures taken in some EMs like Indonesia and South Africa, but miniscule compared to those announced in developed markets. Though late, the Reserve Bank of India joined other central banks and announced measures to deal with the pandemic.

Indian equity markets have plunged as investors flee riskier EM assets, and the rupee has slumped to new lows against the dollar. The timing of the outbreak couldn't have been worse. Growth was slowing even before the viral outbreak. Persistent financial sector woes, including weak bank balance sheets and trust deficits, have been weighing on credit growth. Impaired domestic demand will offset any potential benefits of lower oil prices. Key sectors like power, real estate and airlines were already stressed. Oxford Economics estimates the cost of India's lockdown to be 5.4% of GDP in the first half of the year, which will drag full-year growth substantially under 3% for 2020.

On the external front, the situation looks manageable. India's smaller presence in global supply chains and limited dependency on commodity exports will help it avoid a major trade-related shock. The current account deficit has been narrowing, with over $450 billion in foreign exchange reserves. External debt remains low compared to some EMs, and the U.S. Federal Reserve's new repo facility will ensure an adequate supply of dollars.

Given the sharp and broad-based slowdown, Indian policymakers will have to rely on multiple levers to underpin the economy while laying the foundation for the post-outbreak recovery.

Unfortunately, as with several other EMs, there is hardly any room for additional spending. While the Indian economy is no stranger to running with large deficits, India cannot afford to go all out on the fiscal front, as a few advanced economies have done. The targeted narrowing of the deficit relied heavily on an ambitious government asset sale. Even without asset sales, revenues will collapse as economic activity suffers a body blow.



Sources: Haver Analytics, Oxford Economics

There is little room for a big fiscal action without compromising future prospects.

Creating large imbalances comes with significant costs, especially during stress periods. EMs like Argentina and Turkey are examples of countries that have faced the fury of markets for economic mismanagement. Large deficits and excessive borrowing drive up already high long-term interest rates and erode confidence in currencies. In a nutshell, while massive fiscal easing in India might help mitigate current losses, it could jeopardize medium- to longer-term economic prospects.

India's economic performance matters to the world. The country is the third-largest contributor to global growth and a major recipient of foreign investments. Several global manufacturing businesses have been attracted by its large and growing consumer class, establishing a broad range of stakeholders to India's success.

The nation's first priority must be to stop COVID-19's spread. Social distancing is an important step, as weak medical systems and the lack of social safety nets will wreak havoc when the virus spreads. And while there really is no alternative to stepping up the emergency response to mitigate humanitarian and economic costs, these actions could have serious socio-economic implications. The question for India, and others, is whether policy can stay out in front of the pandemic.