NORTHERN TRUST

NOVEMBER 13, 2020

WEEKLY ECONOMIC COMMENTARY

IN THIS ISSUE:

- **Vaccinomics**
- **Locking Down Europe**
- **Permanent Job Losses Growing**

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

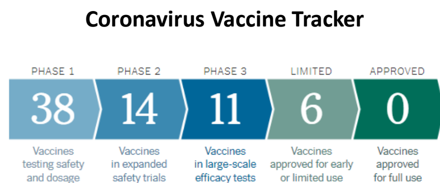
Equity markets were already in a buoyant mood in the days following the U.S. election, which delivered a divided government. The outcome may not be ideal for legislative progress, but gridlock is good for corporate profits. It is unlikely corporate taxes will be raised, and unlikely that Congress will tighten regulations on key industries.

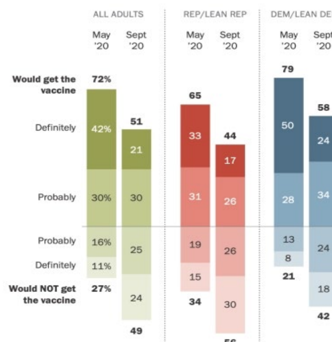
But the rally got a shot in the arm (pun intended) from Monday's news that a COVID-19 vaccine had performed well in clinical trials. The news proved a potent antidote (pun intended) to the concern raised by escalating infections. Stock prices surged on the prospect of an accelerated return to economic health.

We normally don't comment on biological sciences in this space, as it is not our area of coverage or expertise. But anything that hastens the end of the pandemic would provide a significant boost to economic prospects. Assembling an economic outlook must make some assumption about how long it will take to bring the virus under control.

This week's developments are exciting, and a testament to the speed with which science has tackled COVID-19. But there are a number of laps to run before we cross the finish line. Consider:

- The results released by Pfizer have not been fully reviewed by the Food and Drug Administration (FDA), whose approval will be required before vaccination can begin.





Sources: New York Times, Pew Research Center

- Production has already begun, in the hope that FDA approval will soon be secured. But making enough doses (two per person are required) could take considerable time.
- Distributing the product for administration is not an easy task, as it must be kept at extremely low temperatures.

- At the moment, surveys show that a large fraction of Americans are hesitant to receive the vaccine. Even if promising early results overcome resistance, getting sufficient numbers inoculated could take a number of months.

It will be many months before widespread vaccination is achieved.

In the short term, the vaccine announcement could cause some of the public to drop their guards. Any retreat of preventative measures could accelerate the spread of the virus and raise the odds of renewed restrictions.

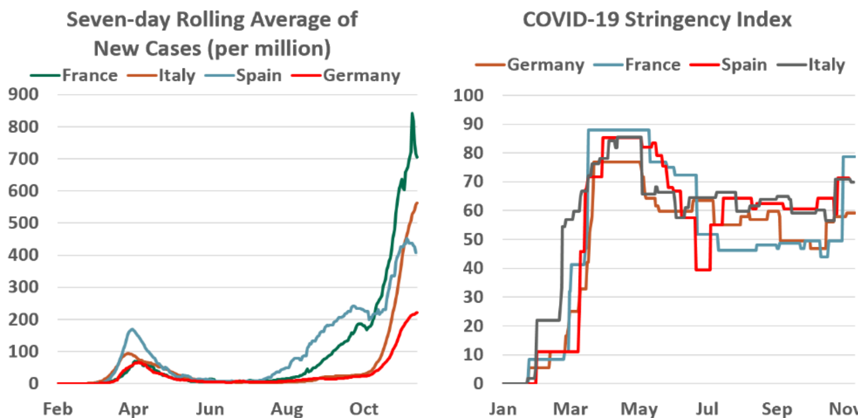
There is certainly light at the end of the tunnel. But until vaccines have been broadly administered, economic recovery will be constrained by the restrictions required to secure public health. Learning to live with the virus will be a central theme for 2021.

Europe Chills

Early last March, I began a trip through Europe to visit our clients. COVID-19 had made the headlines, but still seemed very remote. Yet each day of the trip revealed signs that brought it closer. More travelers were masked, and a central banker I was scheduled to meet was taken ill with the virus. Out of an abundance of caution, clients we were scheduled to see began to cancel. At the end of the first week, I was ordered home, and I have not been on an airplane since.

Europe was hit particularly hard during the early months of the pandemic. Caseloads tested medical capacity, and lockdowns brought economic activity to a near standstill. As scary as the experience was, spirits were high: populations dealing with COVID-19 showed immense resolve and resourcefulness, dedicating themselves to beating the virus back. Scenes of Italians playing music for one another through their windows were a testament to the human spirit.

Today, Europe is going back into lockdown as the pandemic enters a dangerous second wave. This will almost certainly interrupt the economic recovery in the euro area, and may pave the way to a double-dip recession. Policy makers will find it difficult to respond to the renewed challenges. And spirits, so high last spring, are flagging as winter approaches.



Sources: Our World in Data, University of Oxford

The lockdowns that were implemented in Europe last spring were extensive. Italy's measures lasted more than two months, and included shuttering non-essential businesses as well as enforcing bans on public events, school closures, and limits on movement. The extent and duration of the restrictions were expected to contain the spread of the virus, which is contagious in hosts for only about 14 days.

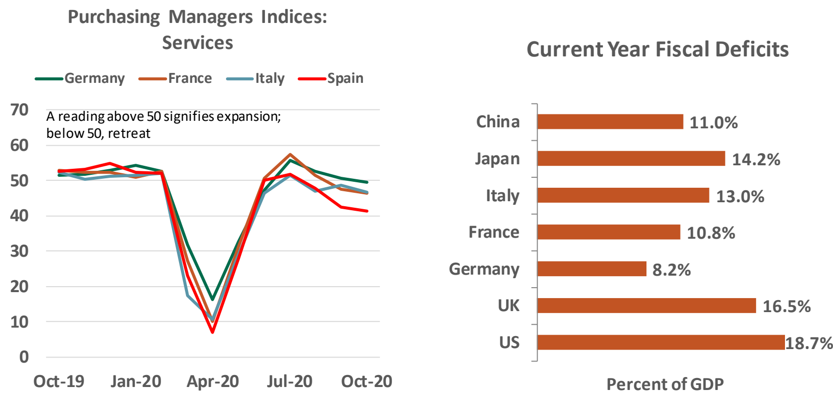
The effort appeared to have worked. The number of new cases in Europe fell rapidly during the

spring, allowing countries to relax their restrictions. Cafés were full again, and economic activity rebounded. But the presence of asymptomatic carriers within the population and (in some cases) a failure to reinforce ongoing preventative measures like masking allowed the virus to remain at large. As summer ended and cooler weather drove people inside, contagion surged.

This experience raises questions over whether lockdowns are an effective way of combatting the pandemic. To be sure, many probably avoided contracting COVID-19 because of government actions. But those governments have been understandably reluctant to reimpose lockdowns, given their failure to stamp out the virus and the immense economic costs of shutting down.

Hospital capacity has forced another round of lockdowns in Europe.

What forced Europe's hand last spring was medical capacity. In the Lombardy region, which was the center of the Italian outbreak, the surge in COVID-19 cases overwhelmed intensive care units. Today, several European countries are once again facing extreme stress on their hospital systems. This situation forced the hands of leaders and led to the return of restrictions on movement and business operations. The impact on Europe's service sector has been significant.



Sources: Markit, Bloomberg, IMF

Europe's governments have allowed substantial amounts of deficit spending to combat the pandemic. The European Commission suspended its national caps on budget deficits in the spring, and may extend them for another year. But more will be needed to make it through the winter without re-entering recession. Germany and Italy have moved forcefully in this direction; France and Spain have lagged.

Automatic stabilizers in many European countries have stepped in to support those whose jobs are threatened, but no comparable system is in place for small businesses like bars and restaurants. These enterprises are damaged the most by lockdowns, and are finding it difficult to sustain themselves.

Last July, European leaders agreed on a €750 billion recovery fund, which would be financed with a common bond issue. It is pathbreaking in its structure, as the euro area has typically shied away from mutualizing its debt. But the money has not yet been raised or spent. The program was set up to become part of the 2021 budget outline, which European officials are only now finalizing. Haggling over the administration of the recovery fund has been intense, echoing the controversy that surrounded its passage. Administrative frictions could delay disbursement of some of the funds until next summer, a full year after the plan was conceived.

These actions are not good enough. The economic challenges presented by the pandemic demand a sizeable and speedy fiscal response. Further, the recovery fund is only about 5% of

eurozone gross domestic product (GDP), a small sum relative to the loss of demand caused by COVID-19. Concern over the expansion of government debt seems misplaced; interest rates for most sovereign debt are currently negative. Europe's economies are likely to underperform in the quarters ahead. And the outlook is complicated greatly by the uncertain status of Brexit.

Structural factors in the euro area have always made it more difficult to use fiscal policy to stimulate activity. Framers of the common currency wanted to ensure its stability, and therefore limited the ability of members to go into deficit. If there is a silver lining in Europe's plight, it may be that today's difficult circumstances lead to some reform of the current system.

Europe's fiscal response to the pandemic hasn't been good enough.

The lessons of Europe's experience extend beyond its borders. The United States is also dealing with a rapid rise in COVID-19 cases, and is facing strains on hospital capacity. Additional restrictions on a population weary of them seem almost inevitable, despite their economic cost. Fiscal authorities here have been at a standstill for months, and the split election results won't help.

Vaccine development is progressing, but, even at best, broad inoculation is many months into the future. Until then, countries must learn to live with the virus without doing too much damage to public and economic health. That will be no easy task.

Permanent Record

As COVID-19 took hold, workers optimistically braced for a temporary disruption. Business closures and work furloughs seemed destined to be fleeting. But while most businesses have reopened, some job losses have become more permanent.

Last week's Employment Situation Summary from the Bureau of Labor Statistics revealed a labor market that is continuing to improve. The decline of a full percentage point in the unemployment rate was better than expected. But deeper down, the report included several indicators of stress.

Household survey respondents are polled on whether they believe their job loss is temporary or permanent. At the crisis peak, more than 18 million people were estimated to be on temporary layoff. And indeed, most of them have gotten back to work. Permanent layoffs were slower to materialize as most respondents believed they had jobs to return to.

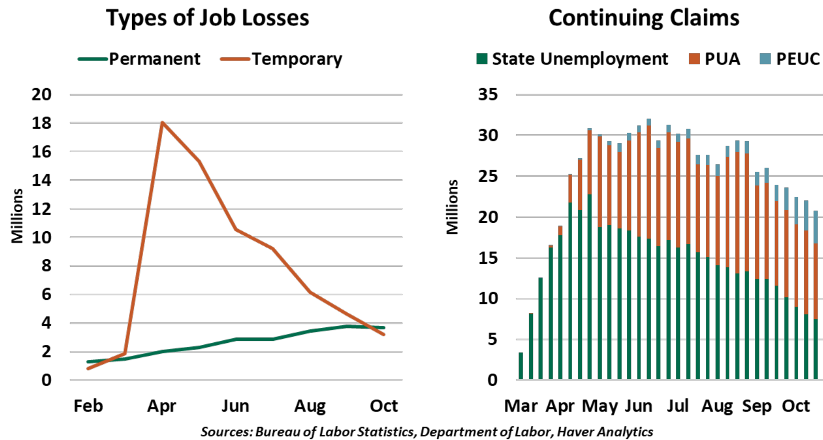
As of October, however, the number of unemployed people suffering permanent job loss is greater than those on temporary layoffs. And this far into the pandemic, our skepticism of whether a layoff is still "temporary" is growing.

Similarly, in October, the share of those unemployed without work for 27 weeks or longer increased to 32.5%; prior to the pandemic, this portion usually hovered around 20%. Twenty-seven weeks is a crucial inflection point, as most states end unemployment insurance (UI) eligibility after 26 weeks.

Lengthening durations of unemployment are only part of the story. The total labor force has contracted, and the labor force participation rate of 61.7% is deeply depressed. (No other recession on record has seen this sort of fall in the workforce.) Quitting the labor force is an action taken by workers who are discouraged about their prospects.

Our hopes for a fulsome labor market recovery are dented every Thursday, as initial UI claims continue to run at elevated levels. The most recent reading of 709,000 claims is a new low for this cycle but still higher than anything seen in any past downturn. It would appear that the labor market recovery is taking place in fits and starts, with workers on the margin returning to unemployment.

The CARES Act envisioned that the employment recovery could be uneven. It included two new programs that have quietly helped millions of displaced workers. The Pandemic Unemployment Assistance (PUA) program offers UI to the self-employed, gig workers and those with limited work histories. PUA peaked at 13.8 million recipients in June and remains with over nine million today.



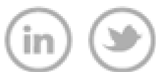
The Pandemic Emergency Unemployment Compensation (PEUC) plan is a federal extension of unemployment payments available to workers who have exhausted their state unemployment benefits. The distributions replace state UI and are entirely funded by the federal government. PEUC enrollment has recently leapt as recipients exhaust their conventional state benefits. Over four million people are claiming PEUC today, a figure that more than doubled in just six weeks.

Unemployment eligibility expanded by the CARES Act will soon expire.

Both PUA and PEUC will expire December 31, 2020. Without an extension, more than 13 million people will lose this vital income support. An extension would have precedent: The American Recovery and Reinvestment Act of 2009 extended UI eligibility as job losses proved intractable. However, current negotiations over whether and how to provide more stimulus have been fraught. A 13-week extension of PUA and PEUC was included in the House's $3 trillion HEROES Act, but it could be sacrificed in a difficult negotiation. And the hurried rollout of these programs opened the window to rampant fraudulent claims, adding resistance to their renewal.

The decline in the unemployment rate reduced the urgency to pass more stimulus, and further funding for PUA and PEUC looks unlikely at this time. The CARES Act's decisive response helped to prevent the worst outcomes in 2020, as the crisis proved not to be temporary. We are left to hope that an end of temporary support does not cause permanent hardship.

northerntrust.com

 @NT_CTannenbaum

Information is not intended to be and should not be construed as an offer, solicitation or recommendation with respect to any transaction and should not be treated as legal advice, investment advice or tax advice. Under no circumstances should you rely upon this information as a substitute for obtaining specific legal or tax advice from your own professional legal or tax advisors. Information is subject to change based on market or other conditions and is not intended to influence your investment decisions.

© 2020 Northern Trust Corporation. Head Office: 50 South La Salle Street, Chicago, Illinois 60603 U.S.A. Incorporated with limited liability in the U.S. Products and services provided by subsidiaries of Northern Trust Corporation may vary in different markets and are offered in accordance with local regulation. For legal and regulatory information about individual market offices, visit northerntrust.com/disclosures.