As of this writing, the number of confirmed COVID-19 cases in the US is 607. To put that into perspective, the Centers for Disease Control and Prevention estimates that there have been between 34 and 49 million illnesses this flu season, with 20,000–52,000 deaths. Despite the small number of COVID-19 cases, the negative economic impact may be very large in the near term. Up until now, the main problem caused by the virus has been supply chain disruptions and the falloff in tourists visiting the US from countries affected by the virus, especially China. It appears that this is about to change.

We expect the number of confirmed cases to rise sharply in the days ahead as testing ramps up. This is likely to trigger more aggressive action by state and local governments to help protect public health, such as closing schools and other places where large numbers of people gather.

Fear of the virus will also cause businesses and individuals to change behavior on their own. For example, people have already started to avoid air travel even though it isn’t banned by the government.

It may seem like panic buying of toilet paper is boosting spending, but this type of behavior isn’t a good sign for the economy. In the days ahead, in addition to data on COVID-19 itself, it’s important to keep a close watch on business and consumer sentiment.

Fed to the rescue?
On 3 March, the Federal Reserve cut interest rates by 50 basis points, setting the fed funds target range at 1–1.25%. With the virus spreading rapidly around the world, the Fed appears ready to cut again at its next meeting on 18 March, if not sooner. Given that inflation remains below the Fed’s 2% target, and all of the risk for the economy is on the downside, it is possible that the Fed will end up cutting rates all the way to zero in the near future. They could also take additional actions to help provide liquidity, but in our view they are unlikely to resort to negative rates.

Cutting rates will not cause people to go out and spend as though the virus doesn’t exist. Further, monetary policy acts with a lag. By the time the Fed rate cuts start to be felt, the shock may already be over.
Congress to the rescue?
In our view, this is clearly a case that is better handled with fiscal measures. Legislation passed by Congress and signed by President Trump last week focused mainly on funding directly related to the virus. It also included funds that will allow the Small Business Administration to provide around USD 7bn in loans. A variety of additional measures are being considered.

For example, around 25% of workers get no sick leave, giving them an incentive to continue working even if there is a risk to coworkers. Congress could pass legislation that temporarily provides paid leave to anyone who is required to go into quarantine, whether or not they actually have the virus. Another possibility is a temporary payroll tax cut or a one-time tax rebate designed to keep consumers spending.

In our view, even though the budget deficit is already large, all sides will likely be willing to increase the deficit further to help mitigate damage to the economy. With Treasury yields hitting new record lows, it is hard to argue that this is the time to give priority to public finances.

A sustained downturn may be avoided
In our view, the near-term outlook is bleak. It appears that economic disruptions caused by the virus are about to get much worse, and growth is likely to turn negative in 2Q20. However, the underlying strength of economic conditions could make it possible for a quick rebound once it appears that the virus is under control. With support from both monetary and fiscal policy, our base case is that a sustained downturn will be avoided.

See full report US Economy: COVID-19 threatens recovery
09 March 2020.

Main contributor: Brian Rose

Produced by the Chief Investment Office.