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# Macro Insight

# US election puts recovery in spotlight

The US economy has rebounded sharply following the Covid-19 shock

But the path to full recovery relies on further fiscal policy support

**Our views**

We expect a new fiscal support package by early 2021. This supports our overweight view on US equities, where cyclical sectors look attractive

Meanwhile, we stay underweight US Treasuries although they can act as a portfolio diversifier

HSBC Global Asset Management

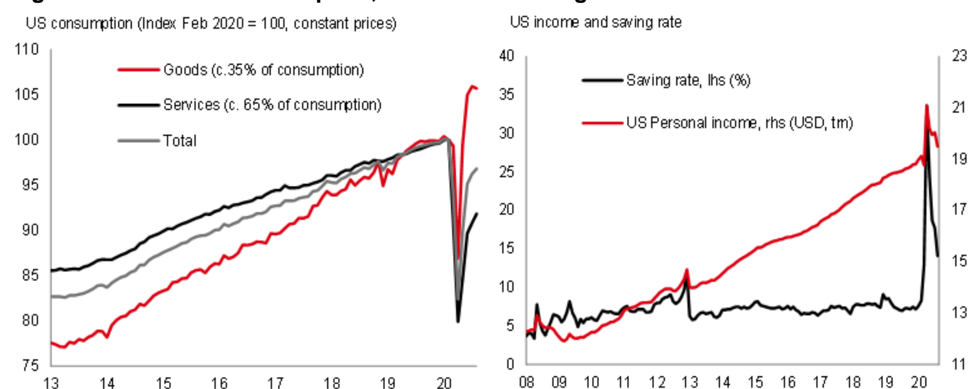
After a deep slump following the outbreak of Covid-19 in early 2020, the US economy has staged an impressive rebound amid income support measures and the unwinding of lockdown rules over the summer. US equity indices have recently hit fresh all-time highs.

However, the path to full economic recovery is likely to be long and dependent on factors such as Covid-19 dynamics through the winter and the degree of policy support. In particular, the timing and magnitude of a second substantial fiscal package are important. This means the outcome of the 3 November US presidential election is a major determinant of the outlook.

**Initial rebound has been strong but unbalanced**

Since June, economic data releases have surprised to the upside. Retail sales and home purchases in August were above their pre-pandemic levels. The unemployment rate has fallen rapidly and is already below the peak reached after the global financial crisis of 2007-08. These developments have led economists to revise upwards their forecasts for US GDP over the whole of 2020, from roughly -6% in June to -4.5% in October.

**Figures 1 and 2: US consumption, income and savings rate**




Past performance is not a reliable indicator of future results.

Source: Macrobond, HSBC Global Asset Management, as at 14 October 2020.

We can see the path of the US recovery by focusing on personal consumption, which accounts for over two-thirds of US GDP (Figure 1). After falling by nearly 20% in April, total consumption has staged an impressive recovery and is now only 3-4% below February levels. However, similar to other countries, the rebound has been disproportionately driven by the goods sector. The recovery of the larger services sector has been impeded by Covid-19 restrictions, which are likely to persist in some form until the mass rollout of a vaccine.

Therefore, the path to full recovery from here is likely to be flatter; the economy cannot rely on continued outsized growth in the goods sector given its smaller share in total consumption. Furthermore, the recovery could stall if a new, uncontrolled Covid-19 outbreak leads to re-imposed restrictions. This makes continuing fiscal support an important part of the recovery.

**Income support has been essential**

In March, US policymakers agreed a USD2.2 trillion fiscal stimulus package in the form of the CARES Act, which provided substantial income support to households and businesses, and has been a major tailwind behind the rebound in consumer spending in recent months (Figure 2).

Republican and Democratic lawmakers have since struggled to agree on a new fiscal package. However, while a pre-election deal would give a further boost to the recovery, it is currently neither likely nor urgently required; three factors can sustain the recovery in the near-term:

**1. Momentum in the economy**: Private incomes have been boosted as temporarily laid-off workers return to work. The unemployment rate has fallen from 15% in April to 8% in September.

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There are factors sustaining the recovery in the near-term, reducing the urgency for a new fiscal package

**2. Elevated household savings**: Large cash transfers in the CARES Act boosted household savings. In August, the savings rate was 14%, about twice its average over the past decade. There is now room for consumers to reduce their rate of saving and maintain spending.

**3. Strong household balance sheets**: Asset purchases and rate cuts by the Federal Reserve in March helped household wealth fully recover after a USD7 trillion drop during Q1 2020.

Bold measures taken earlier in the year have bought US lawmakers time. To compare with other developed countries, direct fiscal stimulus measures in the US have amounted to 11.5% of 2019 GDP, compared to 8.9% in Germany and 7.3% in the UK.

This means that **the possible absence of new stimulus between now and the end of the year, while unhelpful, is not a game changer for the US economic outlook, provided a package arrives in early 2021**. However, it does mean that the outcome of the US election itself is now a key factor in how the next phase of the recovery will play out.

**Risks to the recovery from the US election**

The outcome most likely to result in a new fiscal deal is a Democratic "clean-sweep", whereby the party wins the presidency and takes full control of Congress, aiding implementation of new legislation. Polls and prediction markets currently indicate this as the most likely outcome.

A democratic "clean sweep" would make a new and significant stimulus package more likely

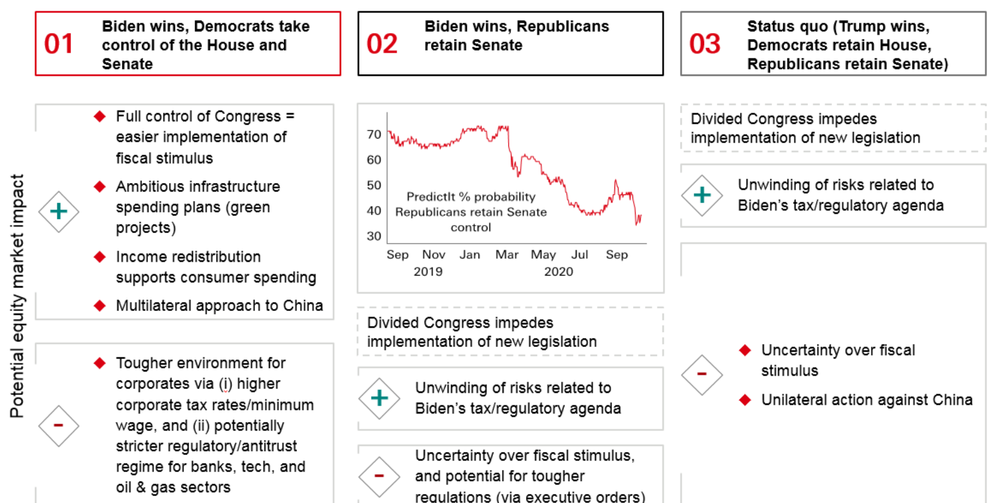
All else being equal, this scenario is likely to be most positive for the near-term US economic outlook given the Democrats' ambitious spending plans. A result, which maintains a split Congress, could see further tortuous negotiations that ultimately result in a package that is still substantial but notably smaller than Democrat proposals.

One important downside risk is that of a contested outcome, where the result is close and neither party concedes. An extended period of legal wrangling between the parties over a period of months could further delay a deal in Congress over a new fiscal package, leading to policy under-delivery that stalls the recovery. At this stage, however, we think the risk of this is low.

The election also poses other, longer-term risks to the US economy, but we see these being fairly balanced between the parties (Figure 3). For example, while Democrats have talked about raising business taxes and toughening regulations, specific proposals so far have been modest and in some cases are similar to those mooted by the Republicans.

The overall environment remains constructive for US risk assets

**Figure 3: Potential equity market impact from the US election**




Source: HSBC Global Asset Management, as at 14 October 2020

**Investment implications**

The US economic recovery has been underpinned by strong policy support and the unwinding of Covid-19 restrictions. While uncertainty over virus developments remains elevated, the probability of a Democratic "clean sweep" result that brings about more significant support has risen. We expect a new fiscal deal by early 2021 which supports the economic recovery and US risk assets.

We therefore remain overweight on US equities. Additionally, we believe cyclical parts of the market could benefit from fresh government stimulus measures and look relatively attractive.

Meanwhile, we stay strategically underweight US Treasuries given low prospective returns and bond yields. However, valuations are relatively attractive versus other global government bond markets, implying that they can still act as a portfolio diversifier.

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