3Q20 Economic Summary

Unfortunately, the coronavirus pandemic remained the key focus and driver of economic activity during the third quarter of 2020. The quarter started with COVID cases surging around the world, and by quarter end global infections topped 33 million and deaths exceeded 1 million. In the US, businesses and restaurants continued to reopen as nationwide lockdowns eased; however, new outbreaks prompted many states to pause or even reverse their reopening plans. US markets fluctuated during the quarter as investor sentiment vacillated between optimism and despair based on the latest updates about the virus, possible vaccines and the potential for additional fiscal stimulus. By quarter-end, equity markets were higher and the yield curve had steepened slightly as the Fed's commitment to keeping rates lower for longer caused front-end Treasury yields to fall while the back-end of the curve rose in anticipation of further fiscal stimulus and the potential for higher inflation.

Although the pandemic continued to rage on, global economies began to recover in the third quarter. As restrictions eased and fiscal stimulus kicked in, countries benefited from increased consumer demand and a resumption in trade activity. With most advanced economies recovering faster than expected, the International Monetary Fund (IMF) recently updated its forecast to reflect a less severe contraction in the world economy for 2020. Although improved, the forecast is far from rosy. The IMF estimates that the global economy will shrink 4.4% this year, resulting in the worst annual plunge in growth since the Great Depression. A rebound in global growth of 5.2% is forecasted for next year; however, the institution warned that the coronavirus crisis is far from over. The IMF's chief economist, Gita Gopinath, prefaced the forecast by saying "While the global economy is coming back, the ascent will be long, uneven and uncertain."

The US was one of the economies cited by the IMF as having experienced a stronger-than-expected bounce in its recovery. After suffering a dismal 31.4% contraction in the second quarter, US GDP growth is expected to be north of 30% for the third quarter. Both manufacturing and service sectors returned to expansion territory as the economy opened more broadly. Retail sales accelerated as Americans, sick of being stuck inside, ventured out to stores and restaurants. Although people are getting out more, many still prefer to cook and shop at home, resulting in elevated sales at grocery stores and online retailers. Labor markets also continued to improve as the US added 3.9 million jobs during the quarter and the unemployment rate declined to 7.9% in September. In addition, the housing sector has proven to be one of the strongest parts of the recovery. Historically low mortgage rates and increased demand for single-family homes in the suburbs resulted in brisk homes sales throughout the quarter. As inventories shrank, housing starts and building permits rose, driving homebuilder optimism to an all-time high. While the sharp rebound in growth is a positive sign for the US recovery, there is concern that economic momentum may be slowing as the country battles new outbreaks of the virus and government aid fades.

The Fed noted the US's accelerated recovery at the September FOMC meeting and revised its GDP and employment forecasts to reflect the improvements. While the Committee was pleased with the way the economy was progressing, it admitted that we have a long way to go before getting back to pre-pandemic levels. In addition, there was concern that another coronavirus wave could lead to further lockdowns and undermine the return to growth. As a result, the Fed reiterated its pledge to use all the tools at its disposal to shore up the recovery and limit lasting damage. Based on the September dot plot forecast, the Fed is predicting no rate hikes for at least the next three years. In addition, the Fed adopted explicit forward guidance at the meeting, stating that rates will be on hold until inflation reaches 2% and is on track to exceed 2% for some time. The shift to average inflation targeting means that the Fed will allow inflation to run "moderately" above its 2% goal to offset periods when inflation has run below target. The Fed is also focusing on maximum employment, believing that a robust job market can be sustained without causing an outbreak of inflation.

With the Fed pulling out all the stops, Chair Powell and his colleagues continue to call on the government to do more, stating that the recovery would move along faster "if there is support coming from both Congress and the Fed." Federal Reserve Governor Lael Brainard was more direct, saying that a failure by Congress to reach an agreement on additional stimulus is the biggest risk to the outlook aside from the coronavirus itself. She warned that "Premature withdrawal of fiscal support would risk allowing recessionary dynamics to become entrenched, holding back employment and spending." Despite the pleas and warnings, the Congressional stalemate continues. While both parties agree that more aid is needed, there are disagreements as to the size and scope of the deal. With the political brinkmanship showing no signs of abating, hopes are fading that a bipartisan agreement can be reached ahead of the November election, adding more uncertainty as to how the economy will fare through the end of the year.