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Ending $600 weekly unemployment bonus could set back fragile US recovery

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By Evan Fallor
Market Intelligence

The $600 weekly bonus in unemployment checks enacted earlier in the pandemic is due to expire at the end of July, and as Washington debates extending the payments at a time of ballooning deficits, economists warn of the potential harm to the U.S. recovery if the money stops flowing.

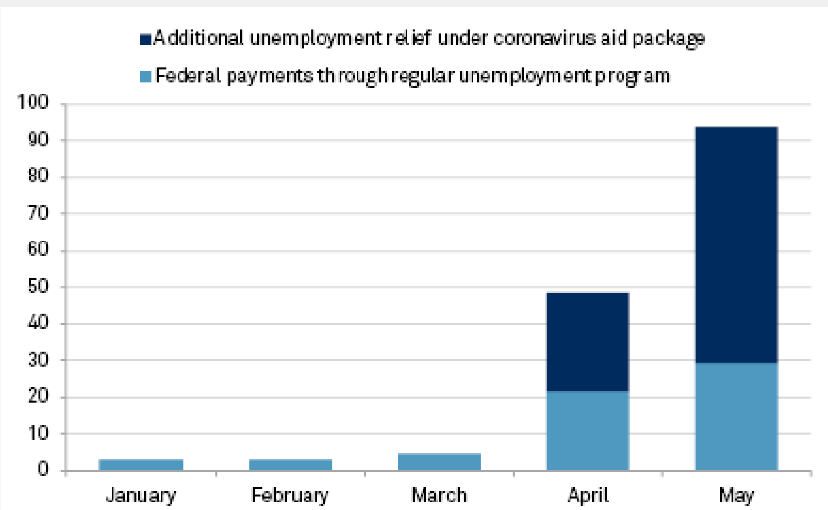
Government outlays for unemployment insurance were $93 billion in May after reaching $49 billion in April, with more than half of that total attributable to the extra $600 payments, according to the Congressional Budget Office. The expansion of unemployment insurance under the CARES Act will add half a percentage point to real GDP growth this year, Moody's Analytics projected.

Since the payments go to people who are likely to spend most or all immediately, losing the benefits when they are due to expire at the end of July without a replacement from Congress and the White House could cause another drop in consumer spending, which is the largest contributor to U.S. GDP.

Role of the consumer

"The end of the $600 benefit will cause a pretty sharp fall in consumer spending, especially in those places with the largest COVID-related economic distress," Michael Hicks, an economics professor at Ball State University, said in an interview. "Even with the good news last month that temporary job losses may have turned a corner, it is clear that permanent job losses continue to expand. It will slow recovery, especially in the hardest-hit places."

Unemployment payouts spike, aided by federal relief programs ($B)



Data compiled June 25, 2020.
Source: U.S. Treasury Department

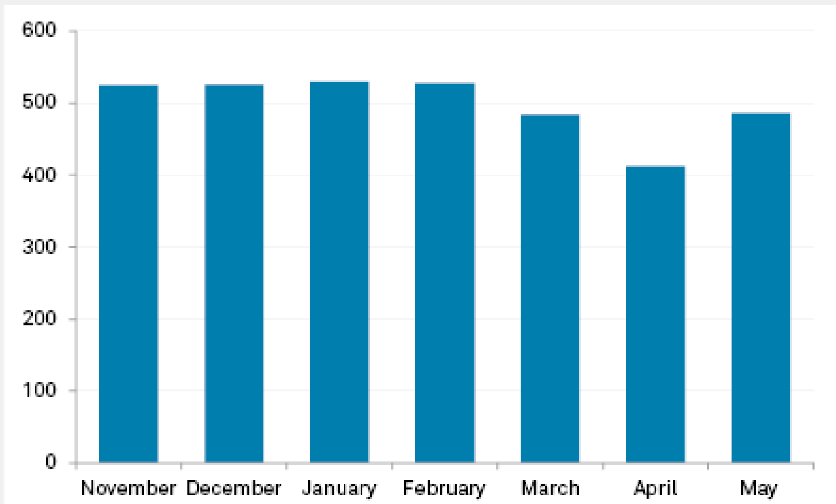
The U.S. economy, after staring down the barrel of its worst downturn in the country's history at the height of the pandemic, has begun to show signs of life. Stocks have bounced back — the S&P 500 is up 36.5% since its March 23 low — after suffering their steepest drops since the Great Depression, and May retail sales exploded past consensus estimates. After peaking at 14.7% in April, the unemployment rate fell to 13.3% in gains.

Still, the hole that was dug in March, April and May is deep, with S&P Global Ratings forecasting a 33.6% annualized drop in GDP in the second quarter. The rating agency does not expect a V-shaped recovery, either: "We don't expect GDP to reach its pre-crisis level until fourth-quarter 2021. The unemployment rate will not get back to pre-crisis levels until at least the end of 2023."

Economists cite the additional unemployment checks, implemented as part of the CARES Act in late March, as a key component of the recovery, along with the Paycheck Protection Program for small businesses that was implemented at the height of the pandemic.

Without that weekly $600, that would mean less spending at retailers and other discretionary sellers such as car dealers and restaurants, Rajeev Dhawan, director of the Economic Forecasting Center at Georgia State University, said in an interview. This would kill the momentum from a 17.7% increase in U.S. retail sales in May, the highest monthly increase on record, and limit future hiring.

US retail sales fall then spike amid coronavirus ($B)

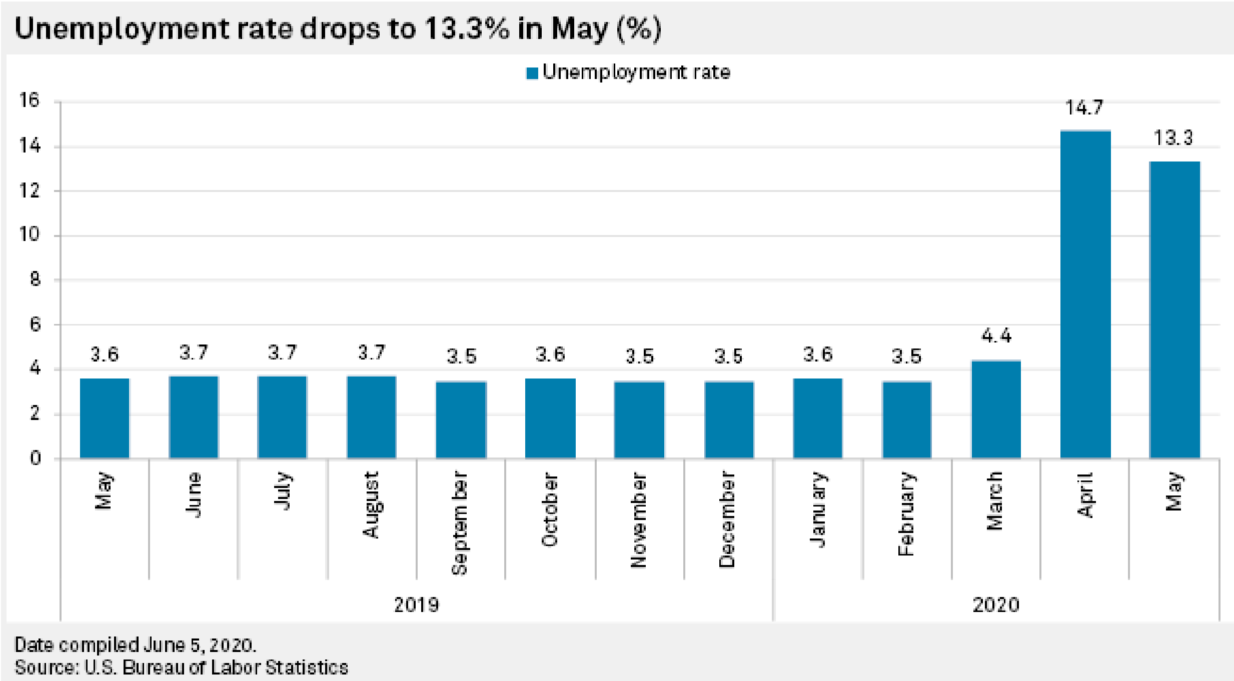


Data compiled June 26, 2020.
Source: U.S. Census Bureau

"Those surplus workers will have to be absorbed in other parts of the economy for it to be a true recovery," Dhawan said. "The issue is how much support do you want to give? There will be some support for long term employment assistance but I doubt it will be as high as $600."

A model developed by Moody's to study stimulus response to the 2008 financial crisis found that $1 in spending on unemployment benefits results in a $1.64 short-term boost to GDP. Applying this to the $260 billion Congress allocated for enhanced benefits would yield a $424.6 billion boost to the economy.

"The support from Uncle Sam and the Fed has gone a long way in terms of propping up market sentiment and most likely prices, and the worry that the federal government might turn off the faucet might spook them," Beth Ann Bovino, U.S. Chief Economist for S&P Global Ratings, said in an interview. "Markets have been pretty excited about it, and it might be a concern that after the $600, the government might move to end other stimulus measures."



Bovino said the weekly $600 initially was used for helping consumers pay down debt, albeit rent or other household debts. Now that some of those have been paid off, they have more of an ability to spend it and give the economy a needed shot in the arm.

Downsides of the payments

House Democrats in May proposed the HEROES Act, which would extend the additional $600 benefits though January 2021, though Republicans declared that bill dead on arrival.

Critics of continuing the expanded payments point to two issues: the strain on the U.S. budget at a time when deficits are already exploding, and the disincentive for unemployed people to go back to work if the enhanced payments are higher than their potential paychecks.

"There's a certain point where all this debt that we're creating ... that has its own price that we're going to pay," Sen. Pat Toomey, R-Pa., told CNBC on June 23. "We don't know exactly when, we don't know exactly how, but this isn't just an endless well that we can just keep dipping into and think there's no adverse consequences."

Noting that the $600 per week brought the U.S. worker incomes above the $933 median as of the fourth quarter of 2019, Tim Quinlan, senior economist and managing director at Wells Fargo Securities, said it is no longer the federal government's place to keep workers "whole" as long as the coronavirus infection curve can be flattened.

"It's a tightening of fiscal policy, but it will remove a disincentive to work and be a contributing factor in the unemployment rate coming down," Quinlan said.

If the extra payments are extended, the benefit to consumer spending, jobs and economic putput would be likely to last through 2020 before flipping to a negative effect in 2021, according to a Congressional Budget Office assessment written for Sen. Charles Grassley, R-Iowa.

Hicks sees the second half of 2020 as a particularly important period to keep up government support of weekly wages and consumer spending. "It is frankly difficult to come up with intellectually honest reasons to end the payments this early," Hicks said. "They are a modest contributor to debt, which is already approaching $24 trillion, and the August-December time frame is sizing up to be a difficult period for our economy."

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