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## US Public Policy & US Economics Brief | North America

# CARE for the Economy

Congress's $2 trillion aid package is a patch, not a panacea for the economy. Yet it does meet our two-pronged test to help the US avoid a prolonged slowdown: 1) Targets liquidity to people and companies specifically harmed by health measures; 2) Big enough to build faith in an economic rebound.

***Note: We encourage clients to reach out directly for more detailed discussion on the content and function of the Coronavirus Aid, Relief, and Economic Security (CARES) Act. We've prepared this brief note in the interest of communicating our thoughts in a timely fashion. Our colleagues will also be publishing market and sector-specific notes regarding their thoughts on the content of this bill.***

**Other key takeaways:**

- **Support now...** At a substantial ~10% of GDP, the package provides critical lifelines to keep businesses and households afloat while economic activity is intentionally suppressed to deal with COVID-19. Hence, there shouldn't be much multiplier effect in the near term.

- **...stimulus later:** Issuing rebate checks and boosting unemployment payments (which for now will beat median wages in some industries) helps to replace lost income at a time when spending should still decline. Alongside debt payment relief, we expect these near-term savings to build capacity for spending, and a greater multiplier to this money later.

- **Conclusion: A patch, not a panacea:** The package will not help the US avoid lost output that we estimate will be around $920 billion this year, but we estimate it will close that gap by mid-2021 and ensure a faster recovery. An additional fiscal stimulus package as social distancing measures recede could act with more traditional multipliers to deliver a greater impulse.

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# What Does $2 Trillion Buy the Economy? Time and Confidence

*Michael Zezas, Ariana Salvatore*

As we've previously discussed, the uniqueness of the economic challenge now facing the US means that fiscal and monetary aid tools that were used historically would be insufficient. The wealth effect does little to encourage people to participate in the economy when a public health crisis specifically precludes them from doing so. The ineffectiveness of traditional tools is likely one reason, in our view, that negative risk market reactions were so swift and severe.

**Hence the primary purpose of any aid package is to give people and businesses short-term financial support as well as the confidence that they will have capital to deploy when normal activity resumes.** This, in our view, is important to ensuring that a sharp, short-term recession doesn't extend into a longer downturn or even a depression. As a reminder, we recently outlined a two-pronged test for this in US Public Policy & Macroeconomics Brief: What's a Sufficient Stimulus? (11 Mar 2020). A comprehensive fiscal response is one that adheres to the following two guidelines:

1. **Targeted measures that limit the risk that anyone "goes out of business" because of necessary health and safety measures.** When there are unforeseen circumstances that are beyond the norm for an economy and carry no moral hazard to fix, it makes sense to address them. Social distancing conceivably keeps many home from work without pay, and keeps many consumers home and not spending. Temporary expansion of paid sick leave, subsidized loans to businesses and affected industries (potentially including energy after the OPEC issue), and other measures aimed at sustaining the physical and financial logistics of coping with social distancing seem prudent.

2. **Be big enough to build some faith in a V-shaped recovery.** When social distancing and a potential increase in unemployment are in play, putting money in people's pockets might not cause an immediate rebound. But we think when paired with our first point, a large-enough stimulus could build a dynamic in which individuals and small businesses can subsist in the near term, and then have fresh capital to put into the economy after the virus passes and the energy industry resets. This would cut against the argument that recovery is far off or must be slow in nature.

**While not perfect, the content of the CARES Act appears to satisfy both of these guidelines.** Nearing $2 trillion (which roughly equates to 10% of US GDP), the revised deal targets four major areas for aid in the American economy: (1) distressed companies, which along with states and municipalities are eligible for ~$500bn in loans and loan guarantees, (2) small businesses, with more than ~$350bn in aid administered through the SBA, (3) individuals, through a ~$250bn direct payment system and another $250bn enhancement of unemployment insurance, and (4) hospitals and health care providers, which are set to receive a ~$150bn boost in funding. See Exhibit 1 for more details and conditions on the major provisions in the "Phase Three" stimulus package.

**Exhibit 1:** Revised CARES Act Fiscal Stimulus

| Approximate Cost | Provision | Details |
|---|---|---|
| **$377bn** | **Loans to small businesses (under 500 people) to maintain payroll and cover other expenses.** | • These loans would be made by banks/financial institutions to qualifying small businesses and would be guaranteed by the Small Business Administration. No one loan over $10 million to an eligible business with less than 500 employees. Businesses need to certify employee retention, and allowable uses of the loan include payroll support, such as employee salaries, paid sick or medical leave, insurance premiums, mortgage payments, and any other debt obligations. Overnight, additional language was included that would give the SBA $17 billion to wipe out six months' worth of principal and interest payments for the 320,000 U.S. businesses that have already have outstanding SBA-backed loans. These new loans would be made through the existing SBA small business lending program. |
| **~$290bn** | **"Recovery Rebate" for individual taxpayers.** | • Individuals making less than $75,000 would receive $1200 and a married couple making less than $150,000 would receive $2400 from the US Treasury in approximately 2-3 weeks (reduced payments to persons making less than $99K and couples under $198K). Each child would receive $500. |
| **~$75bn** | **Industry-specific loans through the US Treasury** | • $58bn in loan guarantees to US passenger and cargo airlines. Same dynamic with banks acting as agents of the US Treasury to issue loans. A portion of the airline money could also convert to a grant if the airlines make no layoffs through a date certain.<br>• $17bn for businesses important to maintaining national security.<br>• Airline companies and national security related businesses receiving loans would have buyback, executive compensation and loan forgiveness restrictions placed upon them – as well as having to maintain employment levels as of March 15, 2020 while loan remains outstanding.<br>• There would be a new Inspector General and bipartisan oversight board created to review all loans made and establish a layer of government oversight and accountability |
| **$450bn** | **Treasury capacity for loans and federal reserve support** | • Loan/loan guarantee program to eligible American businesses, states, and municipalities. Banks and financial services companies will become agents of the US Treasury to assist in making the loans to qualified businesses and the federal government will guarantee the loans made. Companies receiving loans would be restricted in their ability to engage in buybacks and loans could not be forgiven.<br>• There would be a new Inspector General and bipartisan oversight board created to review all loans made and establish a layer of government oversight and accountability |
| **~$180bn** | **Health care provisions** | • Additional hospitals and health care services funding (hospitals and public health funding ~$100bn) – includes hospitals, emergency care facilities, the Center for Disease Control, health care products, and other services broadly. This includes preparedness funding, increased Medicare payments, expanded telehealth and home services, and repealing the Medicare sequester, as well as increased funding toward veterans and defense health. |
| **$260bn** | **Unemployment insurance expansion** | • Additional $600 per unemployment insurance applicant and the extension of unemployment insurance payments out 120 days. (Independent contractors and gig-economy employees qualify). |
| **~$290bn** | **Business and individual tax provisions** | • A variety of individual tax provisions including measures on charitable donation deductibility and retirement accounts<br>• Business tax measures including loosening caps imposed under TCJA, payroll tax credits for businesses who retain employers, and deferment of employer payroll tax payments |
| **$175bn** | **State, tribal, and local government coronavirus relief fund** | $150bn dedicated to a state and local stimulus fund. Unclear if this includes disaster relief fund to provide financial assistance to state, local tribal, and territorial governments, as well as private nonprofits providing critical and essential services (valued at $30bn). Additional $25bn for infrastructure grants to transit providers around the country, including state and local governments. |
| **$75bn** | **Transportation and increased disaster assistance** | • $10bn in aid to US airports and $20bn to other transportation infrastructure (rail/bus/car).<br>• Expand FEMA disaster assistance fund |
| **~$70bn** | **Increase in education spending and safety net provisions** | • Establish education stabilization fund for states, school districts, and higher education institutions, enact supplemental appropriations for Department of Education programs to respond to the crisis, and preserve student aid for those affected by the crisis.<br>• $25bn increase to SNAP and child nutrition funding, as well as housing support and increase in child and family services funding |

Source: CRFB, Tax Foundation, Morgan Stanley Research

**First, does it substantially limit the risk that people and businesses will run out of cash because of the virus? Yes.** From a corporate perspective, we see benefits in the package's provision for small business loans, which are sizable and forgivable if businesses don't lay off employees. We still have questions about how quickly this money can be dispersed, and whether some small businesses might not have the wherewithal to wait before laying off employees to preserve cash. However, the expansion of unemployment benefits should blunt the impact of this risk factor as well. This further expansion in unemployment, as well as a direct check mechanism known as the "recovery rebate," are both aimed at alleviating the economic burden on individuals. Under the recovery rebate, individuals making less than $75,000 would receive a $1,200 check, and couples making less than $150,000 would receive $2,400. The payments are reduced proportionally before phasing out at $99,000 for individuals and $198,000 for couples.

Larger corporations should similarly benefit from the availability of funds through a ~$500bn loan program intended to aid eligible businesses, states, and municipalities, with limitations on executive compensation and stock buybacks.

**Importantly, about $450 billion of the money allocated to this loan program can also be used to support credit market liquidity.** The money can be used to invest in Federal Reserve facilities, which can level the initial investment multiple times, to buy primary and/or secondary market loans and securities of corporations and municipalities. Easing credit markets is another important way that the bill mitigates the risk of a liquidity crisis in markets turning into a credit crisis for the economy.

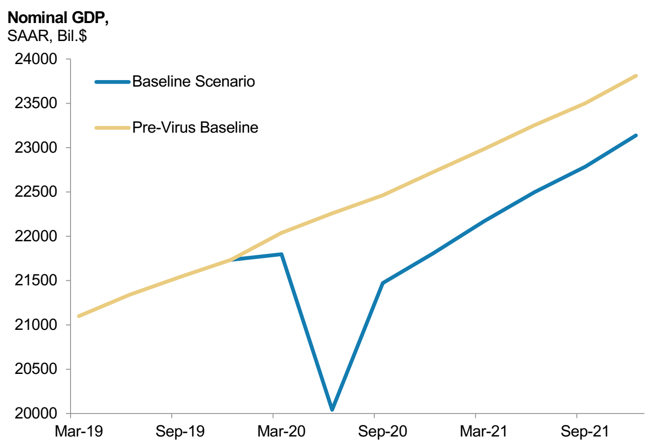
**Second, does it provide enough hope for a quicker economic recovery? We think so.** At nearly $2 trillion, the measure represents the largest economic stimulus measure in modern history. The stimulus reflects a record-breaking number, with most measures addressing more immediate than longer-term needs. Although our economists revised down their GDP forecasts significantly as coronavirus disruptions became more pervasive (see US Economics: A Deeper US Recession (22 Mar 2020)), the heavy front-loading in the stimulus package suggests that lawmakers are focused on getting cash flowing into businesses and to the consumer in the short term, which can then be deployed into the economy as we pass a reset point (for more details, see Support Now, Stimulus Later).

# Closing the Gap

*Ellen Zentner, Robert Rosener, Jan Kozak, and Sarah Wolfe*

In our March 22 US Economic Outlook, we projected a steep drop-off in economic activity followed by a slow ramp back in normalization. Comparing that forecast to our pre-COVID-19 forecast implies that nominal GDP ends 2020 roughly $920 billion below that previous baseline (Exhibit 2). With this perspective, **a ~$2 trillion aid package appears to be of a sufficient size to help to mitigate lost output, as well as provide support once economic activity begins to normalize** (see US Economics: A Deeper US Recession (22 Mar 2020)). Without the CARES Act, the rebound from a sharp downturn might be weaker and more gradual than our current forecast predicts.

**Exhibit 2:** Nominal GDP to Fall Roughly $920 Billion Below the Prior Baseline




Source: Bureau of Economic Analysis, Morgan Stanley Research forecasts

This fiscal package, along with the policy rate at zero and the spate of Federal Reserve programs to support market functioning, underpins our growth estimates beyond the peak in COVID-19 cases that see economic growth moderately normalizing, then quickening as we move into the final quarter of this year and throughout 2021. To be sure, **following a 2.3% 4Q/4Q drop in real GDP this year, the deepest since 2008, we forecast above-potential growth in 2021 of 3.3%, the strongest since 2004.**

The sharp drop into recession and relatively quick start to the climb out is conditioned on our biotechnology team's COVID-19 outbreak dynamic model, which estimates the outbreak peak around late April/early May. On the evidence of sequential declines in the number of new cases, we expect that state governors would slowly begin to ease social distancing measures and forecast a gradual normalization in economic activity in 2H20.

## Support for small business and households is key

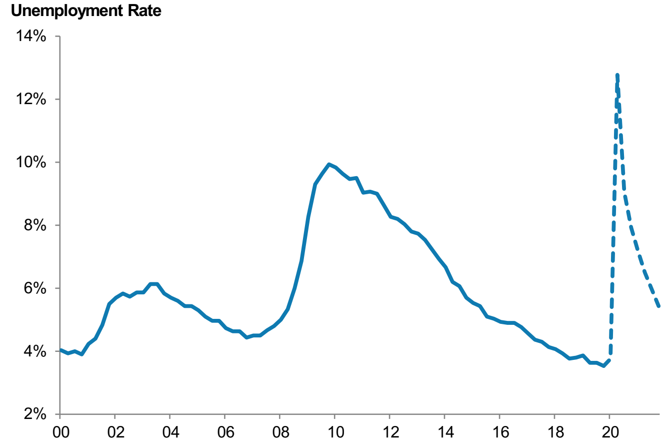
Providing a critical lifeline to small businesses and households is **the best way to ensure a swift return to growth, and therefore critical to avoiding a prolonged economic downturn**. The targeted provisions in the CARES Act are aimed to keep as many small businesses from closing (or ensuring those that temporarily close can reopen) and as many households above water by making loans available and shoring up income such that an extraordinarily difficult circumstance does not turn into something that is catastrophic.

This outcome is critical because the more small businesses are able to reopen after social distancing and coronavirus-related disruptions have passed, the faster **the unemployment rate will begin to normalize as employees are able to return to work.** Not only do small businesses account for a large share of the job losses we forecast in our baseline outlook, they account in large part for the rise in the unemployment rate we envisage as a result.

A substantial amount of jobs have already been lost – 3.3 million initial jobless claims were filed in the week ending March 21 alone – and **we think it is unrealistic to assume that every small business will make it to the other side, which is one reason why – after spiking to a record-high 12.8% in 2Q20 – we expect that the unemployment rate will not return all the way back to its pre-COVID-19 level of 3.5% as the economy recovers.** But to the extent the CARES Act is able to keep small businesses alive, the unemployment rate should gradually drift lower as we depict in Exhibit 3.

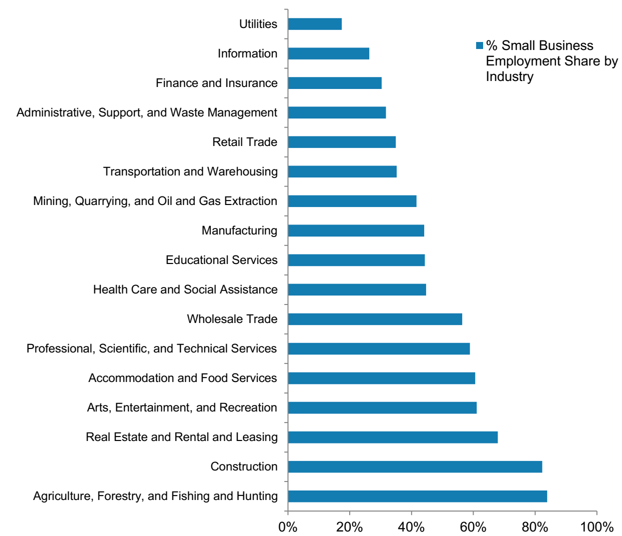
According to the Small Business Administration (SBA), in 2019 there were 30.7 million small businesses, accounting for 99.9% of all businesses in the US. Nearly half of all private sector employees (about 60 million workers) held a job at a small business, and firms with fewer than 100 employees accounted for the largest share of small business employment. Small businesses make up even larger shares of employment in specific sectors (Exhibit 4).

**Exhibit 3:** Unemployment Rate Forecast




Source: Bureau of Labor Statistics, Morgan Stanley Research forecasts

**Exhibit 4:** Share of Small Business Employment Out of Total Employment by Industry




Source: Small Business Administration, Morgan Stanley Research

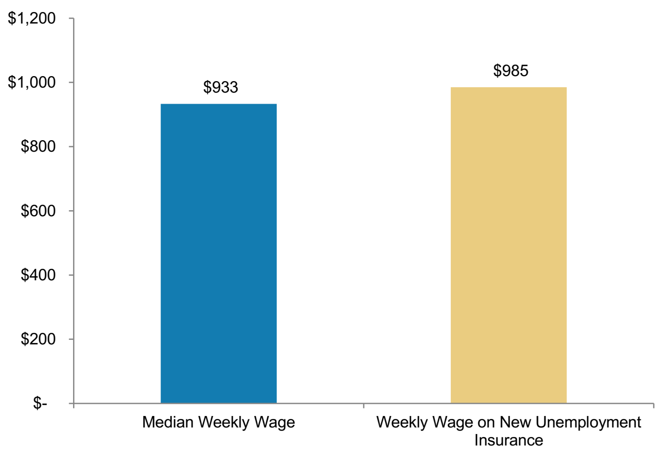
**To provide additional relief to small businesses, the CARES Act will give a refundable payroll tax credit for 50% of wages paid by employers to employees during the COVID-19 crisis.** The credit is available to employers whose (1) operations were fully or partially suspended due to a shut-down order, or (2) gross receipts declined by more than 50% when compared to the same quarter a year prior. The tax credit is available for wages paid up to $10,000 during the crises and for all employees who work at firms with 100 or fewer employees. The credit can also be applied for employees who are retained but not currently working due to the crisis for firms with over 100 employees. This would provide temporary relief to small businesses, whose payroll tax rate is nearly 8%.

## How does it shore up income for households?

**The average unemployment insurance benefit size in the US as of January 2020 was $385/week.**[1] Traditionally, this money is sent to beneficiaries through direct deposit or in the form a debit card by mail. Certain states have a seven-day waiting period before workers can claim unemployment insurance, which is being waved on a state-by-state basis. In the CARES Act, **an additional $600 weekly payment** will be added for each recipient for up to four months, bringing the total weekly unemployment insurance amount to ~$985.

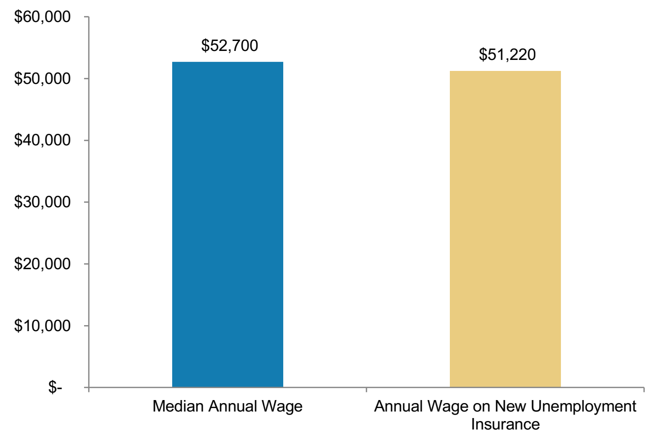
**In 4Q19, the median weekly earnings for full-time wage and salary workers was $933, below the amount the median-paid worker would be able to receive in unemployment benefits** (Exhibit 5). Exhibit 6 provides a comparison on an annual salary basis. For part-time workers, the amount of support is less clear. The median weekly earnings for part-time workers was $284 in 4Q19. Unemployment insurance will now be available to support these workers through a "short-time compensation" program, where employees at businesses that have reduced their hours instead of laying them off can receive pro-rated benefits. In turn, the CARES Act compensates those employers for that cost.

**Exhibit 5:** Median Weekly Earnings, 4Q19




Source: Bureau of Labor Statistics, Morgan Stanley Research

**Exhibit 6:** Annual Wage Comparison

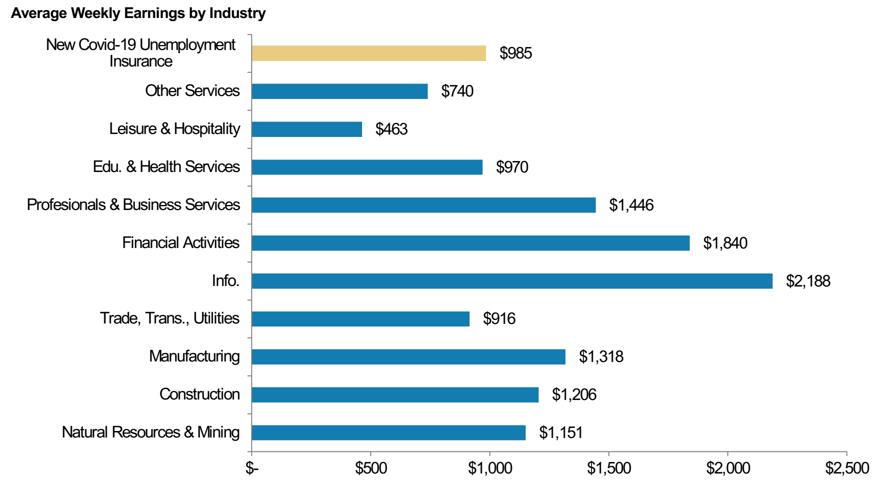



Source: Bureau of Labor Statistics, Morgan Stanley Research

**Unemployment insurance has also been expanded for self/employed, contracted workers, and nonprofit/government employees who are not typically eligible.** If any of these people have found their ability to work impaired by shutdowns, being sick, or having sick family, or had to quit their job because of COVID-19, then they can receive benefits. Their base benefits will be determined state-by-state, as state programs will have extended coverage, and they will also receive the $600/week additional bump.

Looking at average weekly wages by industry, the average $985 that would be provided by the CARES Act is greater than average earnings for four industries, which include some of the hardest hit areas of consumer discretionary spending: Leisure & Hospitality, Education & Health Services, Trade, Transportation, & Utilities, and Other Services. In contrast, it is about $350 below the average weekly earnings for Natural Resources & Mining, Construction, and Manufacturing (Exhibit 7).

Exhibit 7: Average Weekly Earnings by Industry




Source: Bureau of Labor Statistics, Morgan Stanley Research

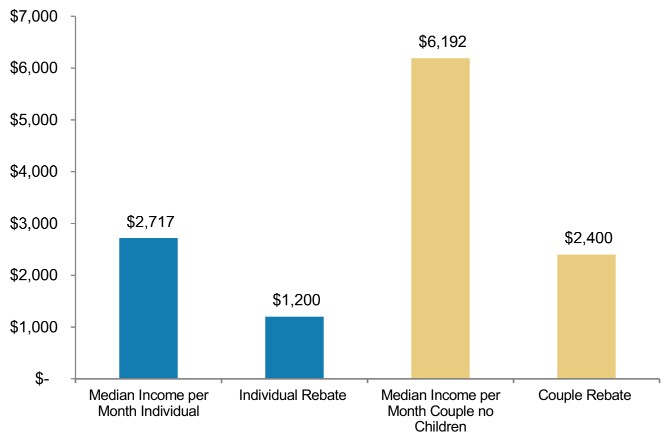
The fiscal package also provides an additional 13 weeks of unemployment benefits through the end of 2020. The length of time a recipient can receive unemployment benefits varies by state and the amount of hours worked in the last 52 weeks or since the last unemployment insurance claim (whichever is shorter), but it is on average 26 weeks. Overall, **it could take up to three weeks from now for recipients to receive their benefits.** In the meantime, the additional $600/week in unemployment insurance benefits does a solid job in compensating for the loss in income millions will face in the coming months.

**The legislation also provides rebate eligibility (direct payments) for US residents with a gross income up to $75,000 ($150,000 married), with a work-eligible social security number.** The rebate is $1,200 for individuals and $2,400 for married couples. There is also eligibility for an additional $500 per child. The Tax Policy Center estimates that, under this legislation, "low and middle-income households would receive about 68% of the payments. Because of the income-based phase-outs, the top 20% of households (those with incomes of $163,000 or more) would get only about 11% of the benefits, and the top 1% would get none."

The legislation does not state how often singles or families will receive a rebate, but the current median income for an individual is $32,000 (or $2,717/month), and the median income for couples with no children is $74,300 (or $6,192/month). While this appears to be a one-off payment for now, it is an additional income source on top of individuals' wage or salary income (Exhibit 8).

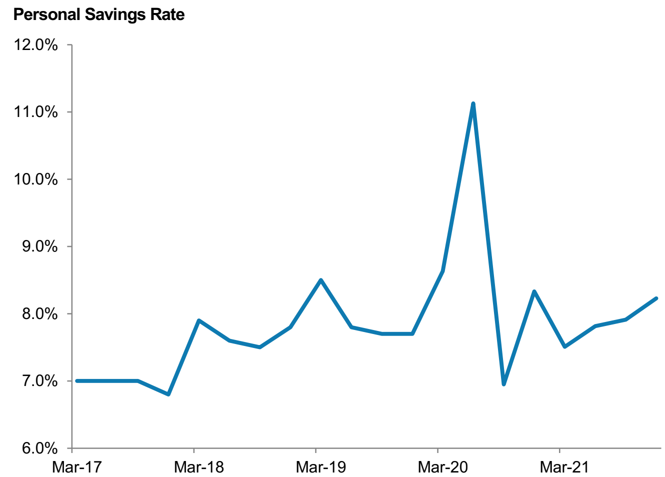
The mixed incentives for small businesses to keep employees on payrolls versus laying them off will no doubt create noise in near-term employment figures. Jobless claims in the week ending March 21 jumped by 3.3 million, but this was one week prior to the passage of the CARES Act. Our **preliminary estimate for March payrolls sees job losses of around 700,000.** This estimate is more a function of fewer hirings as opposed to increased layoffs. **In April, job counts may fall by an even greater amount** as it picks up the increase in layoffs and continued drop in hirings. As the year progresses, we think the CARES Act will have a net positive impact on employment, keeping small businesses intact and putting downward pressure on the unemployment rate after 2Q20, though we do not have a historical comparison to the current environment.

**Exhibit 8:** Median Income for Individuals and Couples Compared to Rebate




Note: Median Income data is latest available from 2016.
Source: Federal Reserve Board's Survey of Consumer Finances, Morgan Stanley Research

**Exhibit 9:** A Rise in Household Savings Should Support Consumption over the Medium Term




Source: Bureau of Economic Analysis, Morgan Stanley Research

Finally, **further support will be provided to households through forbearance on mortgage loan payments.** A borrower of a federally backed mortgage loan experiencing a financial hardship due, directly or indirectly, to the COVID-19 emergency may request forbearance on their loan regardless of delinquency status. Forbearance can be granted for up to 180 days and can be extended for an additional period of up to 180 days. During the forbearance period, mortgage servicers are not to levy any fees, penalties, or interest that would not normally accrue if borrowers paid their monthly obligations. Additionally, servicers of federally backed mortgages cannot initiate any foreclosure/eviction process within 60 days beginning March 18, 2020 on properties with federally backed loans. Owners of multifamily properties who were current on their loan payments as of February 1 may also seek forbearance for 30 days, with the possibility of two additional 30-day extensions. **This should help to alleviate a largest portion of household debt payments and further boost savings over the next few months.**

## Patchwork now, laying the foundation for later

With social distancing measures in place during the COVID-19 crisis, **support funneled to US households should result in higher-than-usual household savings.** To be sure, there are many households that will need these funds for basics like food and housing, but for some, the funds may also be saved now that aggregate spending outside of essentials has dropped dramatically. A higher savings rate today represents the cushion households will have later that can be drawn upon to fund purchases as social and economic activity begins to resume. We project the savings rate to jump to 11% by June 2020 from 7.9% in January, alongside a record rise in unemployment as households receive a large boost to income from government transfers. We then expect the savings rate to drift lower as households find their way toward a new normal post-COVID-19 (Exhibit 9).

# Endnotes

1 This is estimated by the Center on Budget and Priorities, and the range nationwide for unemployment insurance benefits is between $213 in Mississippi and $546 in Massachusetts.

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(as of February 29, 2020)

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| | COVERAGE UNIVERSE | | INVESTMENT BANKING CLIENTS (IBC) | | | OTHER MATERIAL INVESTMENT SERVICES CLIENTS (MISC) | |
|---|---|---|---|---|---|---|---|
| STOCK RATING CATEGORY | COUNT | % OF TOTAL | COUNT | % OF TOTAL IBC | % OF RATING CATEGORY | COUNT | % OF TOTAL OTHER MISC |
| **Overweight/Buy** | **1194** | **37%** | **311** | **43%** | **26%** | **534** | **37%** |
| **Equal-weight/Hold** | **1457** | **45%** | **332** | **46%** | **23%** | **697** | **48%** |
| **Not-Rated/Hold** | **2** | **0%** | **1** | **0%** | **50%** | **2** | **0%** |
| **Underweight/Sell** | **572** | **18%** | **77** | **11%** | **13%** | **224** | **15%** |
| **TOTAL** | **3,225** | | **721** | | | **1457** | |

Data include common stock and ADRs currently assigned ratings. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months. Due to rounding off of decimals, the percentages provided in the "% of total" column may not add up to exactly 100 percent.

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