United States of America: Staff Concluding Statement of the 2020 Article IV Mission

July 17, 2020

A Concluding Statement describes the preliminary findings of IMF staff at the end of an official staff visit (or 'mission'), in most cases to a member country. Missions are undertaken as part of regular (usually annual) consultations under Article IV of the IMF's Articles of Agreement, in the context of a request to use IMF resources (borrow from the IMF), as part of discussions of staff monitored programs, or as part of other staff monitoring of economic developments.

The authorities have consented to the publication of this statement. The views expressed in this statement are those of the IMF staff and do not necessarily represent the views of the IMF's Executive Board. Based on the preliminary findings of this mission, staff will prepare a report that, subject to management approval, will be presented to the IMF Executive Board for discussion and decision.

The Impact of the Pandemic

1. **The longest expansion in U.S. history has been derailed by the unanticipated advent of COVID-19.** To preserve lives and support public health, it was necessary to put in place a broad-based shutdown of the U.S. economy in March. Despite the gradual easing of state lockdown restrictions and lifting of stay-at-home orders starting in late April, the collateral economic damage has been enormous. First, and foremost, more than 130,000 Americans have tragically lost their lives and many more have become seriously ill. Almost fifteen million Americans have lost their jobs, many small and large businesses are under financial stress, and future prospects are highly uncertain. Reopening decisions will have to be handled carefully to mitigate the economic costs while containing the ongoing rise in COVID- 19 infection rates. It will likely take a prolonged period to repair the economy and to return activity to pre- pandemic levels. All in all, globally there will be difficult months and years ahead and it is of particular concern that the number of COVID-19 cases is still rising.

2. **The poorest households face particularly precarious prospects** . The economic costs of the crisis are being borne disproportionately by the poor and vulnerable, bringing into stark relief deep inequities that have long afflicted the U.S. The pandemic has also underscored some of the structural shortcomings of the U.S. health system whereby the provision of healthcare is fragmented, decentralized, predominantly employer-based, at high cost, and with a significant share of low-income households lacking coverage. The nature of the pandemic has created particularly large strains for labor intensive, face-to-face services (which tend to employ a large share of lower-income workers) and the unemployment rate among lower income households, that have few financial buffers, is expected to remain high for a protracted period. Poverty rates and other social strains are expected to exceed those that were experienced in the wake of the global financial crisis.

3. **In the face of this unprecedented shock, U.S. policymakers acted quickly and assertively to protect livelihoods and businesses and to mitigate the lasting economic costs of the pandemic.** The Federal Reserve took unprecedented steps to provide monetary stimulus, to underpin the smooth functioning of domestic and international financial markets, to support the flow of credit, and to strengthen the

transmission of monetary policy. At the same time, a range of fiscal measures were put in place to assist small businesses and specific sectors (such as airlines), increase resources to healthcare providers, expand unemployment insurance, create incentives for firms to retain workers, transfer cash directly to households, and provide resources to state and local governments.

4. **Even with the unprecedented policy support being provided to the economy, output is expected to contract by an annualized rate of 37 percent in the second quarter and by 6.6 percent for 2020 as a whole.** Personal consumption spending fell by 18 percent between February and April with particularly acute contractions in labor-intensive services like restaurants, hotels, and retail. There was, though, an important bounce-back in May with consumption growing by 8 percent, as businesses reopened and began to rehire workers. Nonetheless, there are tremendous uncertainties surrounding the economic propagation of the COVID-19 shock. The dramatic rise in unemployment has broken employee- employer relations and reduced labor force participation. The sudden drop in demand will result in an uncertain amount of corporate bankruptcies. Changing preferences and work practices will call for a significant reallocation of capital and labor. The scope and duration of these shifts are inevitably going to take a toll on the pace of recovery.

Outlook and Risks

5. **There are important risks surrounding the outlook:**

- The principal risk, and one that is the most difficult to quantify, is that a resurgence in the number of COVID-19 cases in the U.S. could lead to renewed, partial shutdowns in order to preserve lives, particularly of vulnerable populations. While a cautious public health approach (by both local governments and the population at large) will mitigate this risk, the recent increase in infection rates in some states is already leading to a slowdown or partial reversal of reopening decisions.

- There are already urgent warning signs that the depth of the economic contraction and the sectoral distribution of economic losses will lead to a systemic increase in poverty, adding to macro risks. Poverty rates were high (e.g. relative to other advanced economies) even prior to the pandemic. There is also an important racial dimension to poverty in the U.S. (with African Americans and Hispanics more likely than White households to be in poverty, unemployed, and without health insurance). The loss of income in the second quarter has been particularly incident on lower income workers although, over the near-term, the supplemental unemployment insurance and economic impact payments can help mitigate the effects of the pandemic on lower income households. However, the risk ahead is that a large share of the U.S. population will have to contend with an important deterioration of living standards and significant economic hardship for several years to come. This, in turn, can further weaken demand and exacerbate longer-term headwinds to growth (e.g. by preventing the accumulation of human capital, eroding labor force participation, or contributing to social unrest).

- The significant increase in debt levels gives rise to important vulnerabilities. General government debt is expected to rise to 160 percent of GDP by 2030 even without further rounds of fiscal stimulus. Job losses and income declines will lead to increased household indebtedness. Corporate debt has already increased above the already-high pre-pandemic levels (as firms have drawn on credit lines and issued new debt) which, when combined with a slow return of corporate earnings to pre-pandemic levels, may trigger an upswing in corporate failures.

- The very large amount of slack in the economy increases the risk of an extended period of low, or even negative, inflation. This could mute the impact of monetary policy (given the effective lower bound) and cause businesses and consumers to delay demand. A disinflationary path would be particularly problematic in the face of the expected increase in public and corporate indebtedness.

- It is worth noting the specific risks facing state and local governments. The bulk of public health care, education, social assistance, and unemployment insurance spending rests on state and local government budgets. State and local governments are also reliant on sales tax revenues (which have plummeted) and, for the most part, constrained by balanced budget requirements. As such, there is a risk that a premature, procyclical fiscal tightening by subnational governments in 2020-21 could create an important headwind to growth and be particularly disruptive for low income households and the unemployed, at a time when they need more support (not less).

- Finally, on the upside, staff's outlook does not incorporate any future monetary or fiscal policy stimulus beyond that which has been already put in place (while it seems likely that another fiscal package will be legislated, it is difficult at this stage to predict the size or composition of that stimulus). The forecast also does not assume that a vaccine discovery is imminent. Additional policy efforts to stimulate demand or rapid progress on vaccines or therapeutics would have important effects in accelerating the pace of recovery. Beyond those policy efforts, it is worth emphasizing that the U.S. economy has proven time and again that it has the flexibility to adapt to shifts in the economic environment as well as the talent and human capital to innovate in new and unexpected ways.

Fiscal, Monetary and Financial Sector Policies

6. **Further policy efforts will be needed to counter the pandemic and also address a range of deep-rooted social and economic challenges that continue to afflict the U.S.** Prior to the pandemic, even after a decade-long expansion, the U.S. faced troubling social and economic outcomes related to poverty; inequalities of opportunity and declining socioeconomic mobility; an increasingly polarized income distribution; rising barriers to trade and foreign investment; and an unsustainable upward path for public debt. It will be important, therefore, to ensure that policy solutions put in place to tackle the consequences of the pandemic are simultaneously geared toward reshaping the existing systems for social assistance, education and healthcare (to expand opportunities and lessen inequities); investing in infrastructure; helping create a more open, stable, and transparent trade policies, underpinned by a strengthened international system; and, over the medium-term, putting the public debt- GDP ratio on a downward path.

7. **Pursuing these multiple objectives will require a further round of fiscal measures in the coming months that boost demand, increase health preparedness, and support the most vulnerable** . The U.S. has fiscal space and it should be deployed quickly to hasten the recovery from the second quarter contraction, permanently improve the social safety net, and facilitate a broader remaking of the U.S. economy. Policymakers will need to respond proactively to the evolution of the economy and the trajectory of the pandemic, quickly adjusting the size and composition of the fiscal response as both

economic and public health conditions change. Fiscal measures that should be considered include:

- ***Investing in public health*** by further funding both domestic and international public health efforts to increase readiness and provide protection against future pandemics (including by establishing a "standing army" for public health with capacity in testing and medical supplies as well as a rapid-response unit that could be deployed for testing, tracking and treatment of viruses).

- ***Supporting poor families*** through greater funding for the Supplemental Nutrition Assistance Program, increasing direct cash aid to poor families, and temporarily expanding the Section 8 housing voucher program. Eligibility for Medicaid and the Child Health Insurance Program could be expanded and the federal and state social safety net system could be simplified with "cliffs" eliminated in the phase out of social benefits.

- ***Boosting household income*** by increasing personal income tax credits and targeting them toward the most vulnerable (e.g. by expanding the Earned Income Tax Credit and raising the child tax credit).

- ***Labor market policies*** including making permanent the recent changes that provide unemployment insurance to the self-employed, those seeking part-time employment, and independent contractors. Resources could be increased for retraining workers (including by facilitating geographical mobility) and all employers should be required to provide paid family leave along the lines of that now provided to federal workers.

- ***Incentivizing investment*** by moving the business tax to a cash flow tax with all new capital investments immediately expensed and interest deductibility gradually phased out.

- ***Boosting consumption.*** Once restrictions are fully lifted and localities can safely reopen, temporary vouchers can be offered to incentivize consumption and/or incentives could be provided to states to temporarily reduce their sales tax.

- ***Supporting state governments*** through a large increase in transfers to states as a means to preserve essential health, education, and social assistance programs and avoid a procyclical tightening of fiscal policy at the subnational level.

- ***Improving education opportunities*** by increasing spending on early childhood education, universal pre-K, and science, technology, engineering and mathematics programs. In addition, the funding model for public schools could be redesigned to provide more resources to schools with a higher concentration of poor students. There could also be increased federal funding of apprenticeship and vocational programs to expand opportunities for building human capital.

- ***Infrastructure investments*** that upgrade the scope and quality of U.S. infrastructure, including for "green" investments and digital infrastructure of the federal and subnational governments.

8. **The historic size of the fiscal packages, coupled with a lower level of nominal GDP, will cause a sizable jump in the U.S. debt-to-GDP ratio** . Low interest rates will provide some breathing space but, once the economy is on a much firmer footing, the structural primary balance will need to be brought to a modest surplus in order to stabilize the debt path. This will require difficult political decisions to raise revenues and reduce spending potentially including the introduction of a federal value-added tax and a carbon

tax, higher fuel taxes, increasing corporate tax rates, containing healthcare costs, raising the earnings cap for social security contributions, indexing social security to chained CPI, and aligning the age for Medicare eligibility with that for social security.

9. **There is potential to bolster the monetary support that has already been put in place** . In the coming months, asset purchases could be scaled up to increase policy stimulus and the Federal Reserve could adapt its forward guidance to more firmly anchor market expectations about the future path for policy (e.g. by committing to maintain policy rates at the lower bound at least until inflation rises above 2 percent for a sustained period of time). Now would be an opportune time to begin shaping Fed communications around an internally-consistent economic projection that is endorsed by the FOMC with alternative, quantified scenarios that show the range of risks around this baseline. These actions could potentially be supported by the introduction of yield curve control. The current credit and liquidity facilities should be regarded as unusual and exigent tools and should be phased-out (as planned). The risk-reward trade-off does not appear to favor the introduction of negative policy rates in the U.S. context.

10. **Treating undervalued currencies as a countervailable subsidy represents a significant risk to the multilateral trade and international monetary systems** . While there have been longstanding concerns over the conduct of currency policy in some countries, the imposition of countervailing duties on imports from countries that are assessed to have an undervalued currency would hinder, rather than facilitate, efforts to address such concerns. The adoption of currency-based countervailing duties could lead to retaliation, to other countries replicating such policies with their own approach and methodologies, and to increased trade tensions. Finally, such an approach could stand in the way of a more effective dialogue over the underlying macro-structural distortions that are affecting external positions. Instead, the U.S. should work constructively with its trading partners to better address these underlying distortions.

11. **The real-time economic and financial stress test experienced over the past few months has shown the U.S. financial system to be both resilient and flexible** . While the crisis has been devastating on many dimensions, the financial system has responded flexibly to the unprecedented macro-financial shock. The system experienced important liquidity problems in the early days of the crisis but these were quickly resolved by prompt action by the Federal Reserve. Banks entered the current crisis with sizable capital and liquidity buffers and nonbanks and capital markets have largely absorbed unprecedented shifts in portfolios. Stress tests contained in the IMF's Financial Sector Assessment Program show, even under a downside scenario—relative to the already-stressed baseline forecast—banks would need a relatively small amount of incremental capital to meet Tier-1 common equity regulatory requirements and banks remain liquid even under severe assumptions. Nonetheless, the crisis is at an early stage and deteriorating credit quality of both household and corporate lending is likely to be increasingly visible in the coming months. This argues for continued restraint on banks' capital distribution plans.

12. **The Financial Sector Assessment Program findings do, however, reveal a number of areas where the U.S. system of financial oversight could be adapted to further mitigate systemic risks** . The priorities should include introducing an explicit financial stability mandate for the principal regulators, increasing the budgetary independence of the Commodity Futures Trading Commission, Securities and Exchange Commission and state-level insurance regulators, developing macroprudential policies to mitigate the growing vulnerabilities outside of the core banking system, and intensifying the crisis preparedness function of the Financial Stability Oversight Council. There is

scope to improve risk management and the stress testing of central counterparties as well as to transition to principles-based reserving and develop consolidated group capital requirements for insurers in parallel with the aggregation approaches of the Federal Reserve and National Association of Insurance Commissioners. The Federal Reserve should be permitted to provide bilateral emergency liquidity assistance to systemically important nonbanks. Prudential requirements for non- internationally active banks should be reviewed to ensure they are, and continue to be, broadly consistent with the Basel capital framework and appropriate liquidity and concentration limits. In determining liquidity metrics for banks, it would be appropriate to allow banks to assume full access to the discount window as part of the liquidity planning process (allowing Treasuries and bank reserves to be fully fungible). Finally, important data gaps continue to obscure regulators' visibility on the nature of systemic interconnections and vulnerabilities; this will require sustained efforts to address.

13. **Efforts should be made to reverse existing trade restrictions and tariff increases while working with partner countries to address policies that distort trade flows and investment decisions.** There is a clear need to address trade and investment distortions that are partly rooted in the global trading system's inability to adapt to long-term changes in the international environment. However, the imposition of import tariffs (and other steps taken by the administration) is undermining the openness and stability of global trade by increasing restrictions on trade in goods and services and catalyzing a cycle of retaliatory trade responses.

United States: Selected Economic Indicators

					Projections			
	2018	2019	2020	2021	2022	2023	2024	2025
Real GDP (% change from previous period)	2.9	2.3	-6.6	3.9	3.3	2.3	1.9	1.8
Real GDP (q4/q4)	2.5	2.3	-6.9	5.1	2.8	2.0	1.9	1.8
Output gap (% of potential GDP)	0.2	0.9	-4.9	-1.8	-0.6	-0.4	-0.4	-0.5
Unemployment rate (q4 avg.)	3.8	3.5	9.7	7.4	5.7	4.6	4.3	4.2
Current account balance (% of	-2.2	-2.2	-2.2	-2.1	-2.1	-2.1	-2.0	-2.0

GDP)								
Fed funds rate (end of period)	2.2	1.7	0.1	0.1	0.1	0.1	0.1	0.1
Ten-year government bond rate (q4 avg.)	3.0	1.8	0.8	1.0	1.5	1.7	1.8	1.8
PCE Inflation (q4/q4)	1.9	1.4	0.7	2.1	2.0	2.0	2.0	2.0
Core PCE Inflation (q4/q4)	1.9	1.6	0.8	1.8	1.9	1.9	1.9	1.9
Federal fiscal balance (% of GDP)	-3.8	-4.6	-18.0	-10.4	-5.4	-4.5	-4.7	-4.9
Federal debt held by the public (% of GDP)	77.4	79.2	99.6	107.4	106.8	106.8	107.4	108.3

Sources: BEA; BLS; Haver Analytics; and IMF staff estimates.