22 July 2020

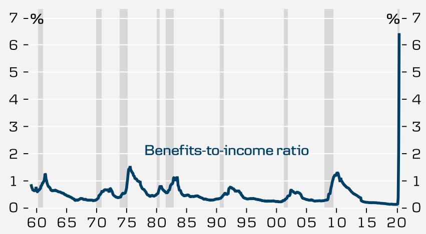
Research US

Not extending higher unemployment benefits would lead to a significant negative income shock

Key takeaways

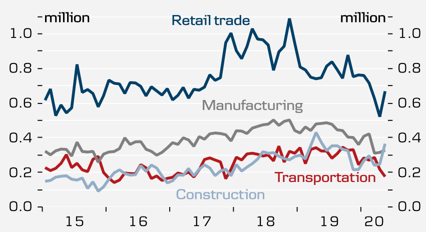
- **Temporarily higher unemployment benefits (an additional USD600 a week) are set to expire by the end of month. Negotiations on a new stimulus package have begun this week.**
- **In our view, the lack of demand for labour is stronger than people's incentive not to work despite some anecdotal evidence that it is hard to get people back to work.**
- **Assuming total claims are 20,000,000 at the end of the month, a decision not to extend the support would remove USD48bn a month from the economy if these people cannot find a job.**
- **The fiscal multiplier for unemployment benefits is assumed to be high and hence the total economic impact is even larger (cumulative 3.3% decline in GDP all else being equal).**
- **We expect the next stimulus package to include an extension of the higher benefits but, unfortunately, as of today, it does not look as though the negotiations will conclude before 31 July. However, we expect a reduction in the level of benefit, which could potentially slow the recovery. We cannot rule out the possibility of no extension and if this materialises, we expect a more significant setback in the recovery.**

Benefits-to-income ratio rose to 6.4% in May



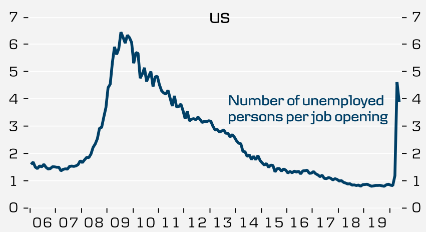
Sources: BEA, Macrobond Financial

Job openings still subdued



Sources: BLS, Macrobond Financial

4 unemployed persons per job opening



Sources: BLS, JOLTS, Macrobond Financial

Lack of labour demand

One of the main elements in the US emergency support for American employees was temporary higher unemployment benefit (an additional USD600 a week on top of regular benefits), which is set to expire at the end of this month. **The negotiations on the next stimulus package have begun now that Congress has returned from its two-week 4 July recess.** In this document, we take a closer look at the temporary higher unemployment benefit and what it would mean from an economic perspective if Congress did not extend it.

In May, unemployment benefits accounted for 6.4% of total income and without the higher unemployment benefits, the current crisis would have led to a significant negative income shock for many people.

One uncertainty is whether the attractive higher unemployment benefit of USD600 a week makes Americans unwilling to find a job or whether many people are receiving unemployment benefits because of a lack of labour demand. **Looking at recent data, there were four unemployed people per job opening in May, which, although not as high as at the peak of the financial crisis, suggests to us that lack of demand is the dominant effect here.** Job openings in retail, leisure and hospitality, transportation and manufacturing remain subdued. Construction has recovered due to the V-shaped recovery in the housing market but construction accounts for a smaller share of total employment.

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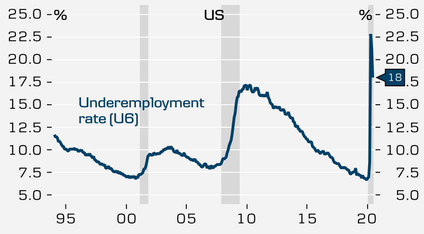
Important disclosures and certifications are contained from page 4 of this report.

High-frequency data for job postings from *Track The Recovery* show that job postings have started to decline again after the initial rebound and are currently 16% below the level in January 2020. It is likely this is driven by a combination of new local lockdowns and people staying at home to avoid getting sick. The broad unemployment rate (U6), which includes marginally attached workers and people working part-time for economic reasons, is still very high at 18%. **That said, there is anecdotal evidence that some businesses are having difficulties getting people back, although people risk losing their benefits if they decline to return** (see, for example, *NPR*). A**s not all are able to receive claims, we believe the lack of demand outweighs the incentive not to work.**

Broad unemployment rate (U6) remains extremely high at 18%



Sources: BLS, Macrobond Financial

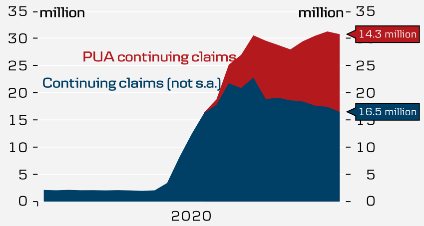
No extension would lead to a large negative income shock hurting the recovery

Approximately 30 million Americans (not seasonally adjusted) are currently claiming benefits (regular claims and Pandemic Unemployment Assistance combined) including the additional USD600 a week. **Assuming the claims remains at the current level, it would remove 4 × 600 × 30,000,000 = USD72bn a month from the US economy by expiration, assuming these people are unable to find a job.** This is equivalent to 4% of monthly GDP. **Assuming claims have declined to 20,000,000 in total, the economy would lose USD48bn a month by expiration (2.7% of monthly GDP).**

If we are right that the lack of demand effect is strongest, the expiry would force many people to reduce their spending. This would start a negative spiral, as it would lead to even lower employment followed by even lower spending and so on. According to *CBO (2015)*, the estimated fiscal multipliers for transfer payments to individual are in the range 0.4-2.1 (low to high) over eight quarters, which is among the highest multipliers found for different types of economic policies. Usually the multiplier is higher when the Federal Reserve is constrained by the zero lower bound, which is the case right now. It is quite clear from daily private consumption data that spending started to recover after the direct payments to Americans (and, in particular, to low income families) (see *Track The Recovery*).

Assuming a fiscal multiplier of 1.25 (midpoint) and total claims at 20,000,000, this would lower GDP by 3.3% over a few quarters all else being equal (with the biggest decline taking place in the early quarters).

Still a lot of people are receiving unemployment benefits despite the gradual recovery and reopening

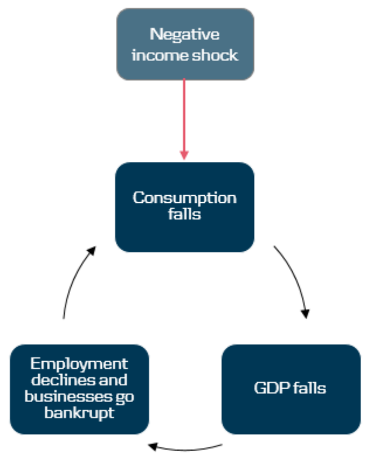


Sources: Department of Labor

We expect an extension eventually

Negotiations on the next stimulus package have begun but things are not looking bright so far, as the Republican Party and the Democratic Party remain far apart. Not only do the two parties disagree with each other but there are also divisions within the parties, especially within the Republican Party, as **the White House and Senate Republicans disagree on priorities**. Republicans disagree on a payroll tax cut, money for testing and linking school money to reopening. **Given the internal division, an agreement must be bipartisan to pass the Senate.** According to POLITICO, one source involved in the talks put 0% chance on a bill passing by the end of July and 40% chance on it passing by mid-August. **According to *Forbes*, the Republicans are likely to support another round of stimulus checks for low-income households and an extension of the higher unemployment benefit but probably at a lower level** than the current USD600 a week in order to increase the incentive to work (although McConnell did not mention an extension during his speech on Tuesday). Another possibility is to include sunset provisions such that the programmes expire when the unemployment rate has reached a certain level or something along those lines. **Our base case is an extension but at a reduced level of USD400 per week, which could potentially slow the recovery. If there is no extension, we expect a setback in the recovery, as the unemployed would be likely to reduce their spending**.

Multiplier effect



Source: Danske Bank illustration

COVID-19 benefits programmes

Programme	Description	Expiration
Federal Pandemic Unemployment Compensation (FPUC)	Provides an additional 600 dollars per week on top of regular claims to individuals who are claiming unemployment benefits	31-Jul
Pandemic Unemployment Assistance (PUA)	Provides up to 39 weeks of unemployment benefits to people not eligible for regular unemployment benefits (e.g. self-employed and independent contractors)	31-Dec
Pandemic Emergency Unemployment Compensation (PEUC)	Provides up to 13 additional weeks of payments to individuals who have exhausted their regular state benefits.	31-Dec
Short-Time Compensation (STC)	Allows employers to reduce wages and hours for employees while allowing the employees to receive partial unemployment benefits (federal government will cover 100% of the compensation)	31-Dec

Sources: Department of Labor, lawandtheworkplace.com, NELP

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None.

Date of first publication

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