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Q&A-Fresh U.S. virus relief bill to be about $1.5 trln; Aimed at sustaining activity: Steven Blitz, TS Lombard

The U.S. coronavirus relief bill currently under debate is likely to come in at about $1.5 trillion and will be aimed at sustaining current levels of economic activity rather than boosting them, **Steven Blitz, Chief U.S. economist at TS Lombard**, told the Reuters Global Markets Forum on Wednesday, August 5.

Blitz said added that better U.S. wage and employment data in recent weeks mean the bill could be less than earlier stimulus, and U.S. lawmakers will bridge their differences to come reach a compromise.

Following are edited excerpts from the conversation:

Q: Both monetary and fiscal stimulus seem to remain firmly in place - What do you expect from the stimulus package and that translating into consumer spending? Somewhere in between the $3 trillion the Democrats are pushing for and the $1 trillion that the Republicans want?

A: The package will come in at around $1.5 trillion and will not be a boost to spending, but more of an attempt to sustain current levels of activity.
Compared to April, employment and wage income is higher so it makes sense that the package could be smaller, but there are still around 30 million collecting some form of unemployment insurance, so ending the $600/week top up would be a problem.

Q: Given the ADP and ISM data this morning, what is your view on the recovery trajectory, and how do you see markets reacting if it doesn't go as promised?

A: Well, I do not see any real chance of the package failing, and expect it to be signed next week with the various programs probably expiring early next year, probably Jan 31. The economic data is split between indicating the return of activity as various states reopen, or shut down (ADP data), which is all to the positive, but the data does not indicate how far the reopening goes -- that is, what's the cap on activity.
My sense is that it will fall well short of pre-March levels and leave the economy in a severe recessionary environment. [A key number on Friday will be the number of unemployed citing permanent job losses.

Q: What more tools do you see the Fed using from its ammunition from here? Do you see the Fed going into negative territory? What could trigger such a move?

A: The Fed is not going to go to negative nominal yields, and for good reason. Negative is not a smaller positive number, there is a big difference between paying less and taking your money away. What they have left is an unlimited balance sheet against a lot of investment capital that needs to find a home, and this, in broad brush strokes, will push marginal money at first into risk assets.
The Fed is, however, concerned that at these low levels of interest rates, their ability to put a floor on equities is perhaps less effective. One reason why they want this stimulus package -- they have no desire to be tested anytime soon.

Q: With the decline in U.S. Treasury yields over recent weeks, do you see the entire U.S. yield curve possibly sinking below 1%? If so, by when?

A: It is certainly possible and could happen later this year. I do not take much from such a move and would consider it a "normal" cyclical event.

Q: How do you think a Democratic sweep including winning the Senate will affect the policy outlook? If you feel markets have priced in higher tax rates under Democratic presidential candidate Joe Biden – how high do you see them going?

A: This high tax rate story is a bit of a canard. If unemployment is high and growth weak, taxes are not going to be raised.
If the Democrats do take the Senate, at best will be 50/50, and this leaves them far short of a filibuster-proof vote. In other words, just as the Republicans need Democratic votes in the Senate today to pass this stimulus, the Democrats will need Republican votes next year.
Lastly, please show me where in U.S. history a drop-in effective tax rates since Reagan took office - that they have paid for themselves or delivered the promised return to growth. True enough, there are confiscatory tax rates that would stifle the economy, but no one is [talking] about that. Clinton raised taxes and the 1990s were a great decade for capital deepening and real growth. Point is a lot goes into growth and these marginal tax changes have more political meaning than economic ones.

Q: What are your thoughts on Biden's economic plan that was announced last week?

A: I think all these plans are more about politics than policy. Of course a Democrat will be more disposed to a green agenda, higher taxes on higher income, etc., but the political message is to get young progressive members of the party enthused to vote and, at the same time, reel in the middle-skill middle-income worker that gave Trump his majority in Pennsylvania, Michigan, and Wisconsin.

Q: So, you don't see much concrete change to economic policy under a potential Biden administration?

A: There will be concrete changes, especially in terms of tone and a redirection of government investment towards the green agenda. It is terrific to have a great fair economy, but it is important to have a good economy first. And good will be the first priority of a Biden Presidency.

Q: This in all probability was the shortest bear market in history. Why do you think stocks rallied so fast, so forcefully?

A: Well the bear market is not necessarily over. We had a created shock to the system, a government mandated shut down, followed by an equally unprecedented fiscal policy to hold in incomes, and an expansion of the Fed's powers into corporates in order to keep these markets functioning and spreads tight with rates low - a positive for equities, always.
None of this precludes a reassessment of the earnings trajectory and subsequent repricing of risk. Given my more bearish outlook on growth in the coming 12 months, I would argue such a reassessment is somewhere on the horizon.

Q: Considering your research, "the probability of knowing the winner on election night is small. Equity markets prefer resolution," and given the Robinhood-inspired rally we've already seen, what is your view on U.S. stocks from here until the election and through the year's end? Where do you think benchmarks will be if the reassessment you refer to occurs before either the election or 2020's end?

A: Anytime markets are priced to perfection, they are ripe for disappointment. As such, I would say flat-to-lower is the likely trajectory for the market as a whole, individual stocks are always a different story. There is also a high likelihood for increased market volatility after Election Day and until the winner is announced and accepted by all parties. There will be an answer, but in between it will not necessarily be a pretty time.
As for how far the markets go down? Well I do not think a crash like last March is in the offing, more of a sustained period of ups and downs that, in the end, lower real equity values as much as 10% perhaps as much as 20% but relative to, say, GDP. Which can be accomplished [in] a number of ways, not all of it a downswing in equity prices.

Q: Do you think the next crash will come in stocks or bonds?

A: Not sure about "crash", but I think the bond market is priced more in line with my sense of the outlook than equities, so I would say the bigger adjustment comes to the equity market.

Q: Hotels, airlines, office real estate - which one of these sectors do you feel will take the longest to recover and why would it take longer than the other two?

A: Hotels and airlines are fairly intertwined, and I suspect both will take a long time to fully recover. When you travel, you are giving over your health security to the hope that others are doing as advertised, and in the current environment this is a big act of faith. Also, with business itself working remotely, business travel is very much likely to lag as well.

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