CIO | VIEW
U.S. Economic Outlook

August 17, 2020

Marketing Material

AFTER THE DROP COMES THE REBOUND, COMES THE RECOVERY.

Christian Scherrmann
U.S. Economist

IN A NUTSHELL

_ After an unprecedented drop in economic activity early in the second quarter, May and June might have been the best part of the recovery.
_ Fiscal support boosted the bounce back of consumption but the pandemic has changed the way people spend their money – this might have consequences.
_ Thanks to CARES, most households still enjoy a financial buffer, but this buffer is going to run out sooner or later.
_ Early arrival of a vaccine might be a silver bullet for financial markets but less so for the real economy.

Economically speaking, the main direct impact from the pandemic might be well behind us, as evidenced by both the sharp decline in April, and the strong bounce of May and June. Thanks to a combination of generous fiscal support and a rather quick re-opening, the immediate impact was less than some had feared. Still, the second quarter real gross domestic product (GDP) dropped historically by an unprecedented 33% quarter-over-quarter annualized. After April has been hit hardest, the rebound in May and June resulted in record-setting gains in most economic indicators. July's data, however, suggests that we may already have converged toward a flatter path of recovery.

Economists, such as myself, are used to dutifully updating our charts on almost every statistical release. Still, the pandemic even left its footprint in our daily routines. Besides the obvious part of working from home, we were overwhelmed by the sudden flood of new and alternative data that suddenly gained market attention. For instance, weekly data on credit- and debit-card spending for different income levels can provide striking insights (see Chart 1).[1]

CHART 1: WEEKLY DATA ON DEBIT- AND CREDIT-CARD SPENDING INDICATES CONSUMPTION TO REMAIN SUBDUED

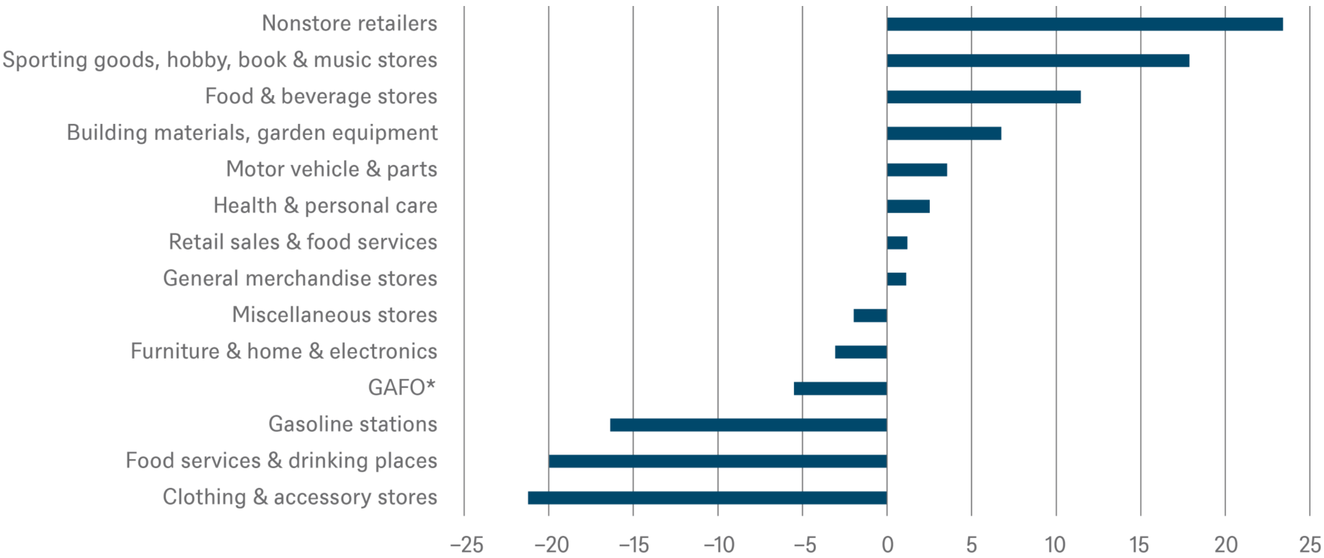
Sources: tracktherecovery.org and Opportunity Insights 8/13/20

1 https://tracktherecovery.org/ and https://opportunityinsights.org/wp-content/uploads/2020/05/tracker_paper.pdf; Raw data is on "…county-by-ZIP code income quartile-by industry-by-day level starting from January 1, 2019…" and is the aggregated on median household income by ZIP. See details at https://opportunityinsights.org/wp-content/uploads/2020/05/tracker_paper.pdf

Right after the start of the stimulus payments around April 15, U.S. households in general, but especially low-income earners, increased their spending quite rapidly, close to levels seen just before the pandemic. This is most likely because spending of low-income earners mainly covers staple goods and services. A better proxy for the overall activity of consumption therefore could be the spending of middle-income earners if the goal is to track the average person's spending patterns. Despite a steady recovery, somewhat slower than that seen among low-income earners, it remains at around 8% below pre-crisis levels – a trend that solidified through July 2020. Meanwhile, high-income earners seem to have been in no rush to open their wallets – "excess spending" recovered more slowly and still remains around 10% below pre-crisis levels.

It is quite revealing to cross-reference alternative data alongside classical economic indicators. Retail sales for instance usually have been a sound gauge of overall consumption. This time around, however, personal consumption reveals the underlying story. Retail sales dropped 7.5% in the second quarter while personal consumption as a whole dropped by 10.5%. The main difference between both measures are services. Personal consumption as measured by national accounts includes more of them than the retail-sales report. Alternative data proved to be quite accurate – debit- and credit-card spending declined by 11% by the end of June – close to what we observed in personal consumption. This by no means should imply that traditional measures are no longer useful. We believe that statistics on retail sales can still give us a quite useful understanding of how the structure of spending has changed as Chart 2 shows. The longer time lag of traditional data is compensated for by a higher degree of detail.

CHART 2: RETAIL SALES SINCE JANUARY 2020 FOR DIFFERENT SECTORS IN PERCENTAGE CHANGE



Sources: Census Bureau and Haver Analytics as of 8/13/20, * General merchandise, apparel and accessories, furniture and other sales; June 2020 data as GAFO lags one month

Chart 2 reveals two trends. On the upper half we observe the pent-up demand and deferred-spending area. One-time payments certainly boosted shopping for hobbies, home and garden as well as groceries - preferred distractions for many from the virus madness. Non-store retailing (i.e. internet shopping) was especially a friend during the lockdown. The lower half of the chart shows what we call the missed opportunity space. Missed spending on most services is likely to be gone forever. Taken together, traditional and alternative data sources suggest that fiscal stimulus brought back consumption, but in ways that reveal a massive change in consumer spending patterns.

The rapid change of where consumers choose to shop might have far reaching consequences. Since March, over 170 companies have filed for bankruptcy, citing Covid-19 as one of the main factors behind their decision.[2] And the real number of closings could be even higher. As a very prominent news outlet puts it: "Small firms die quietly, leaving thousands of failures uncounted." Simply closing down does not show up in bankruptcy statistics.[3] Data from another private vendor indicates that 55% of all businesses that closed in the aftermath of March 1 were out of business permanently by mid-July.[4] An inconvenient truth surrounding these findings is that small businesses account for roughly 44% of economic activity and represent approxi-

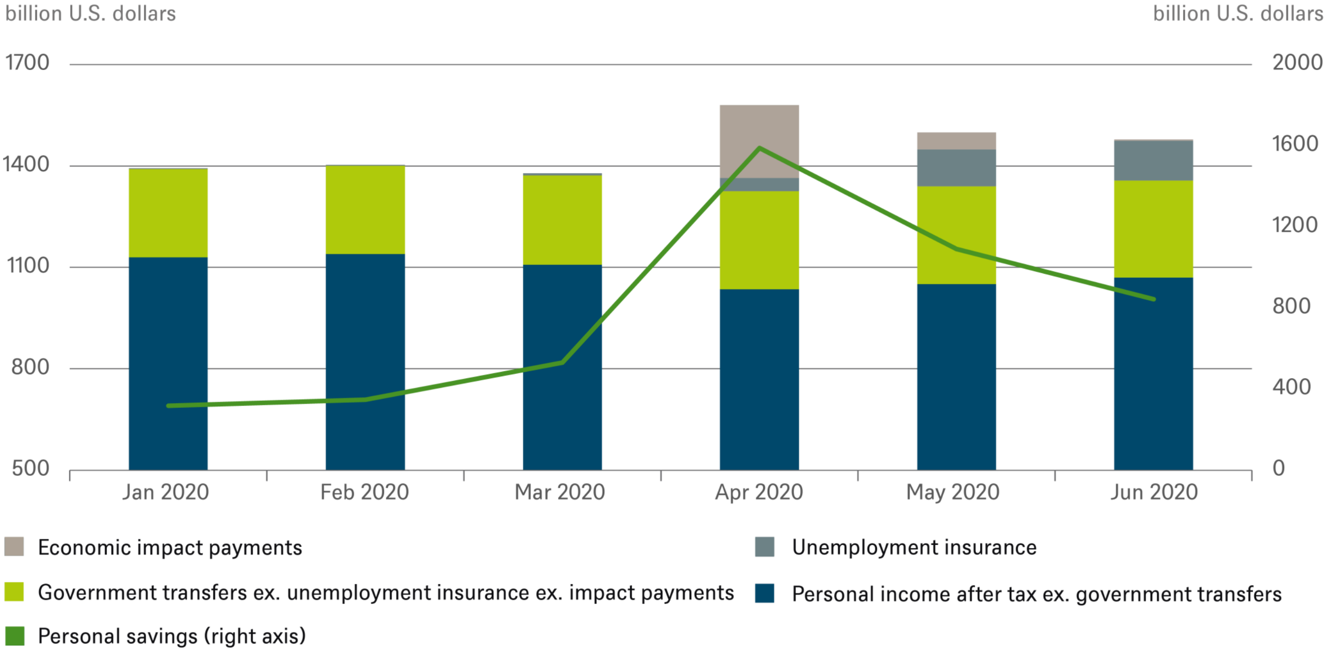
[2] https://www.bloomberg.com/graphics/2020-us-bankruptcies-coronavirus/?sref=azxX96EA
[3] https://www.bloomberg.com/news/articles/2020-08-11/small-firms-die-quietly-leaving-thousands-of-failures-uncounted?sref=azxX96EA
[4] https://www.yelpeconomicaverage.com/yea-q2-2020.html

mately 50% of all people employed.[5] Or in other words, the U.S. economic power house is silently shutting down.

And this loss of momentum already starts to become visible in traditional employment statistics. While there was better-than- expected, job creation in July it was materially lower than during the bounce-back months of May and June. The bulk of job creation was concentrated in the vulnerable service sector: about 1.42 million jobs out of the 1.46 million of total private non-farm payroll gains were created there. In the intervening weeks since the cut-off date, some of those jobs may have already been lost again, as a result of the re-introduction of measures to fight the pandemic. Taken at face value, the report implies that roughly 16 million people are still unemployed, compared to 5.78 million in February. This impressively illustrates that we well have a long road toward a full recovery ahead of us.

With the labor-market recovery losing momentum and extended fiscal benefits fading out, the consumer could face some hard decisions ahead. The good news might be that it seems like he or she can still keep up for at least some time. Personal-income data shows that households still enjoy significantly higher than pre-crisis savings as well as a comfortable income cushion from unemployment transfers by the end of June (see Chart 3). We expect consumers can well make it through August, maybe September if we account for recent executive orders before getting into trouble. We caution, however, that these household aggregates hide that a certain proportion of the population might already face troubles.

CHART 3: PERSONAL INCOME AND SAVINGS SUGGEST HOUSEHOLDS STILL CAN KEEP UP FOR SOME TIME



Sources: Bureau of Economic Analysis and Haver Analytics as of 8/13/20

The ultimate relief of the situation would be another round of fiscal support for households. But it is not just monetary support for the consumer we are looking for. Extended financial support for small and medium-sized businesses as well as for state and municipals is needed as well. While the latter still have some room to navigate by adjusting their investments and their spending, small and medium-sized businesses are already pulled into the abyss.

However, up to now we do not have any real progress on a fiscal package in Congress. While it seems that the majority of politicians and officials welcome another round of support, negotiations stalled, election considerations dominate, and no solution appears in sight. Whatever the reason for the stalling of stimulus talks in Washington might be – political maneuvering or hopes of an early arrival of a vaccine – we caution that a political failure could prove costly. A swift arrival of a vaccine might well be a silver bullet for financial markets but by no means a silver bullet for the economy. A recent poll shows that approximately 35% of all Americans would not get vaccinated.[6] Besides the high uncertainty of how widely available or effective a vaccine might be at the end, the current preferences still foreshadow a less favorable course of the pandemic.

[5] https://advocacy.sba.gov/2019/01/30/small-businesses-generate-44-percent-of-u-s-economic-activity/ and https://www.bls.gov/web/cewbd/table_f.txt
[6] https://news.gallup.com/poll/317018/one-three-americans-not-covid-vaccine.aspx

OVERVIEW: KEY ECONOMIC INDICATORS

	2019	2020				2021				2022
	Q4	Q1	Q2	Q3F**	Q4F	Q1F	Q2F	Q3F	Q4F	Q1F
GDP (% qoq, annualized)	2.1	-4.8	-32.3	29.8	16.9	5.3	3.4	2.4	1.9	2.0
Core inflation (% yoy)*	1.6	1.3	1.0	0.3	0.1	0.4	2.2	2.8	2.6	2.5
Headline inflation (% yoy)*	1.6	1.7	0.6	1.4	1.2	1.2	1.6	1.9	2.1	2.0
Unemployment rate (%) (EOP)***	3.5	4.4	11.1	11.5	8.6	7.1	6.4	6.1	5.8	5.5
Fiscal balance (% of GDP) (EOP)***	-5	/	/	/	-18.2	/	/	/	-8.3	/
Federal funds rate (%)	1.5-1.75	0.0-0.25	0.0-0.25	0.0-0.25	0.0-0.25	0.0-0.25	0.0-0.25	0.0-0.25	0.0-0.25	0.0-0.25

* PCE Price Index
** Forecast
*** End of period

GLOSSARY

Fiscal policy describes government spending policies that influence macroeconomic conditions. Through fiscal policy, the government attempts to improve unemployment rates, control inflation, stabilize business cycles and influence interest rates in an effort to control the economy.

The gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period.

In economics, a real value is adjusted for inflation.

The United States Congress is the legislature of the federal government. It is comprised of the Senate and the House of Representatives, consisting of 435 Representatives and 100 Senators.

IMPORTANT INFORMATION

This marketing communication is intended for retail clients only.

DWS is the brand name of DWS Group GmbH & Co. KGaA and its subsidiaries under which they operate their business activities. The respective legal entities offering products or services under the DWS brand are specified in the respective contracts, sales materials and other product information documents. DWS, through DWS Group GmbH & Co. KGaA, its affiliated companies and its officers and employees (collectively "DWS") are communicating this document in good faith and on the following basis.

This document has been prepared without consideration of the investment needs, objectives or financial circumstances of any investor. Before making an investment decision, investors need to consider, with or without the assistance of an investment adviser, whether the investments and strategies described or provided by DWS Group, are appropriate, in light of their particular investment needs, objectives and financial circumstances. Furthermore, this document is for information/discussion purposes only and does not constitute an offer, recommendation or solicitation to conclude a transaction and should not be treated as giving investment advice.

The document was not produced, reviewed or edited by any research department within DWS and is not investment research. Therefore, laws and regulations relating to investment research do not apply to it. Any opinions expressed herein may differ from the opinions expressed by other legal entities of DWS or their departments including research departments.

The information contained in this document does not constitute a financial analysis but qualifies as marketing communication. This marketing communication is neither subject to all legal provisions ensuring the impartiality of financial analysis nor to any prohibition on trading prior to the publication of financial analyses.

This document contains forward looking statements. Forward looking statements include, but are not limited to assumptions, estimates, projections, opinions, models and hypothetical performance analysis. The forward looking statements expressed constitute the author's judgment as of the date of this document. Forward looking statements involve significant elements of subjective judgments and analyses and changes thereto and/ or consideration of different or additional factors could have a material impact on the results indicated. Therefore, actual results may vary, perhaps materially, from the results contained herein. No representation or warranty is made by DWS as to the reasonableness or completeness of such forward looking statements or to any other financial information contained in this document. Past performance is not guarantee of future results.

We have gathered the information contained in this document from sources we believe to be reliable; but we do not guarantee the accuracy, completeness or fairness of such information. All third party data are copyrighted by and proprietary to the provider. DWS has no obligation to update, modify or amend this document or to otherwise notify the recipient in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate.

Investments are subject to various risks, including market fluctuations, regulatory change, possible delays in repayment and loss of income and principal invested. The value of investments can fall as well as rise and you might not get back the amount originally invested at any point in time. Furthermore, substantial fluctuations of the value of any investment are possible even over short periods of time. The terms of any investment will be exclusively subject to the detailed provisions, including risk considerations, contained in the offering documents. When making an investment decision, you should rely on the final documentation relating to any transaction.

No liability for any error or omission is accepted by DWS. Opinions and estimates may be changed without notice and involve a number of assumptions which may not prove valid. DWS or persons associated with it may (i) maintain a long or short position in securities referred to herein, or in related futures or options, and (ii) purchase or sell, make a market in, or engage in any other transaction involving such securities, and earn brokerage or other compensation.

DWS does not give taxation or legal advice. Prospective investors should seek advice from their own taxation agents and lawyers regarding the tax consequences on the purchase, ownership, disposal, redemption or transfer of the investments and strategies suggested by DWS. The relevant tax laws or regulations of the tax authorities may change at any time. DWS is not responsible for and has no obligation with respect to any tax implications on the investment suggested.

This document may not be reproduced or circulated without DWS written authority. The manner of circulation and distribution of this document may be restricted by law or regulation in certain countries, including the United States.

This document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, including the United States, where such distribution, publication, availability or use would be contrary to law or regulation or which would subject DWS to any registration or licensing requirement within such jurisdiction not currently met within such jurisdiction. Persons into whose possession this document may come are required to inform themselves of, and to observe, such restrictions.

DWS Investment GmbH. As of August 2020

Issued in the UK by DWS Investments UK Limited which is authorised and regulated by the Financial Conduct Authority (Reference number 429806).

In Hong Kong, this document is issued by DWS Investments Hong Kong Limited and the content of this document has not been reviewed by the Securities and Futures Commission.

In Singapore, this document is issued by DWS Investments Singapore Limited and the content of this document has not been reviewed by the Monetary Authority of Singapore.

In Australia, this document is issued by DWS Investments Australia Limited (ABN: 52 074 599 401) (AFSL 499640) and the content of this document has not been reviewed by the Australian Securities Investment Commission.