Dear Client:

After one of the deepest recessions ever... albeit one that lasted only a few months this spring...
The economy is rebounding sharply.  
The question: How long can it continue?

First, the good news on this odd economy:  
Third-quarter GDP growth will be stellar... on the order of 19% or higher. Of course, that follows an absolutely brutal second-quarter drop of 31.7%.  
The fourth quarter: Also strong at 6%.  
Next year: A solid expansion of 3.8%.  
GDP will be back to 2019 levels by 2022.  
Unemployment: Below 5% by early 2023.  
If that sounds like a long time to recover from the hit from COVID-19, remember that it took far more time to recover from the Great Recession. Unemployment didn’t get back to a healthy level for seven long years.

The factors in the economy’s favor now:  
A housing market that is red-hot.  
A surprising rebound in manufacturing.  
The recovery in businesses’ capital spending.  
Strong consumer spending on goods.  
And rock-bottom interest rates from the Federal Reserve, which has signaled that it won’t be raising rates for years...not until 2023 at the earliest. That’s good news for borrowers, both consumers and businesses. But a heavy blow for savers, of course.  
The rate on the 10-year Treasury will rise a tad from today’s 0.7% but stay under 1.5%.

Now, the bad news: The economy is still down 11.5 million jobs vs. pre-COVID.  
Many businesses are still in severe distress, especially in travel and tourism: Airlines, restaurants, hotels, etc. It’ll be a long time before those industries recover.  
Nearly 1 million workers are still losing their jobs every week...a toll that would have been unthinkable even during the worst of the Great Recession.  
Many low-income households can’t pay the rent. Unpaid rent is as high as $30 billion.  
Bankruptcies of big companies are running high. And smalls are struggling; Activity among small firms is only 80% of normal. Few have the cash reserves needed to hang on until whenever the virus threat is truly over and life gets back to normal. Many that do survive won’t be able to bring back all the workers they had to lay off.

Here’s what the economy needs to go right in the next six months or so:  
Wide availability of fast COVID tests, to limit any new viral outbreaks.  
A commercialized vaccine next spring to truly put the crisis behind us.  
That seems doable, given all the candidates in trials, but can’t be assumed for now.  
If and when one comes, look for a surge in spending on travel, tourism, etc.  
Finally, more fiscal help from Washington this fall. Congress is deadlocked for now, but we think that legislators will feel tremendous pressure to pass something.
The Aug. jobs report shows further economic reopening. 1.4 million jobs were added, with the biggest gains in retail, food service, temporary help and Census workers. The unemployment rate dropped to 8.4% or 13.6 million, but this does not account for the extra 5 million who dropped out of the labor force because of the pandemic, or the extra 3.3 million who are having to work part-time.

Gains in nongovernment jobs are slowing. Though more big job gains will continue, it will take two years to return to pre-COVID levels of employment.

President Trump’s effort to assist unemployed folks is off to a slow start as state agencies reconfigure their computer systems to handle payments. Trump’s Aug. 8 executive order allowed the Federal Emergency Management Agency to use $44 billion of Disaster Relief Fund money to provide an extra $300 per week on top of regular state unemployment benefits. 45 states have been approved so far. Only four states have managed to get money doled out...Ariz., Texas, Mo. and La.

What’s more, the program is likely to run out of funds in a matter of weeks. FEMA will not be able to contribute any more than $44 billion because it needs funds to handle recent and future natural disasters. To make sure laggard states aren’t totally shut out, FEMA will initially provide states only three weeks of benefits.

Small-business optimism is improving in spite of renewed uncertainty, per a key index of small-business sentiment. One of the reasons for the optimism: Most small firms have partially or fully reopened, a big relief after forced closures. But companies’ expectations of sales remain subdued and earnings trends are still negative. Nearly half of smalls have seen a big impact on their revenues because of COVID-19. Almost half say it will take six months to return to normal.

Many small firms are interested in hiring, but staffing levels are still smaller than before the virus. Hiring plans rose a bit in July, but the recovery in hours worked has slowed. The biggest pullback in hours is in businesses that rely on close contact.

The resurgence of COVID-19 in Europe will likely slow down its recovery. The recovery continued in July and Aug., but activity is losing momentum in some countries, according to recent consumer and business sentiment surveys. Regional containment measures are more likely than widespread lockdowns. The eurozone will see sluggish growth in the third quarter. As for the virus...

The feds are making it easier for more people to invest in start-ups. The Securities and Exchange Comm. has eased rules barring retail investors from participating in private markets unless they are wealthy. Under previous rules, only individuals who earn over $200,000 per year or have net worth over $1 million could be accredited. The SEC will now base participation on “financial sophistication,” not just salary or net worth. Among the changes: The agency will let people qualify as accredited investors based on certain professional accreditations and designations, such as an entry-level stockbroker license or an investment adviser license. Limited liability companies with over $5 million in assets may also get accredited.

The upshot: Private firms seeking funding will have a bigger pool of capital.

One industry that is beefing up online ad spending: Financial services. There’s a fresh focus on landing new online customers, as more folks look into digital options for ways to spend and save. Total digital ad spending will dip in the U.S. this year, but digital ad spending by financial services firms will rise 10%, to nearly $20 billion, as folks look online for credit cards, mortgages, brokerages, etc.
Lawmakers face two huge tasks when they return from recess on Sept. 8:

Pass another giant COVID-19 relief package and keep the government open with funding for federal agencies for the 2021 fiscal year, which begins Oct. 1.

While all sides involved are nowhere close to a deal on either matter...

The issues will likely be resolved after a slow, painful and ugly battle.
Both parties are fearful of a voter backlash in Nov. if they fail on either.

The biggest sticking point on a pandemic relief bill is the cost. Democrats are willing to bring down their initial proposal of $3 trillion to $2 trillion, but the GOP so far has said no. Republicans are wary of spending more than $1 trillion on additional aid.

As for the government funding bill, look for a temporary continuing resolution that will mostly keep 2021 funding at this year’s level. It’s unclear how long it will last.

Employers and private insurers can exclude drug copayment assistance from counting toward enrollees’ deductibles or out-of-pocket maximums in 2021, per a recent rule change by the Centers for Medicare and Medicaid Services. This involves drugmakers helping consumers afford high-priced pharmaceuticals.

Only payments by patients themselves need to apply toward these targets, a victory for employers, who maintain drug copayment assistance raises their costs.

The goal is to discourage patients from taking high-priced pharmaceuticals, especially in cases where a lower-cost generic version is already available. One issue: About half of drugs that come with copayment assistance have no generic equivalent, meaning some patients could find it more difficult to afford essential medicines.

A surge in unemployment-related calls pushed states into using chatbots. Now state agencies are looking to use more of the automated messaging tools.

As millions of people were suddenly out of work at the onset of the pandemic, state workers couldn't keep up with the unprecedented surge in online questions and transactions related to unemployment benefits and other virus-related topics. The answer? Chatbots, which use artificial intelligence to answer written questions.

Around three-quarters of states now use chatbots for virus-related matters, such as health or unemployment questions. Some systems were set up in just days. Chatbots will help states boost customer service and expand online services.

K-12 school administrators are about to get better data on the pandemic and how it’s affecting classrooms around the country. A new database being created by education associations representing principals and superintendents, plus Brown University and Qualtrics, a customer data firm, launches this month. Data collected will include infections, how they spread and different virus responses.

The district-level data will help schools track national virus-related trends to make better decisions about opening, closing, safety measures and much more.

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The Trump administration will green-light oil and gas leasing in ANWR... The Arctic National Wildlife Refuge in northern Alaska. The first round of leasing for ANWR’s 1.5-million-acre coastal plain could start before the end of 2020. Proponents of the move say it will revive Alaskan petroleum output, which has fallen from a peak of over 2 million barrels per day in the late 1980s to less than 500,000 barrels per day last year, ranking sixth among the U.S. states. The region is considered one of the largest undeveloped U.S. oil prospects, containing anywhere from 4.3 billion to 11.8 billion barrels in recoverable reserves. The problem: Getting the industry on board. Besides the unique challenges of drilling in the area, oil and gas firms worry about investing in ANWR operations when the new policy could soon be scrapped if President Trump loses this fall.

Also: Overcoming legal challenges. Already, two lawsuits have been filed challenging the administration’s decision to open up ANWR to oil and gas drilling.

The COVID-19 pandemic will weigh on U.S. solar installations this year... But not by much. Industry watchers expect the U.S. to add 18 gigawatts of new solar capacity this year, a 33% increase from 2019. This despite the fact that the virus has delayed many project timelines, especially for installations of rooftop and other small-scale solar, which are set to plunge 31% this year. Expect the U.S. to add 113 GW of new solar generating capacity by 2025, an amount roughly equal to America’s total solar generating capacity in 2011.

The uptick in solar capacity will also boost demand for energy storage. Despite pandemic-related setbacks, U.S. energy storage deployment will reach 1.2 GW this year and rise to 7 GW by 2025, mostly driven by large-scale utility procurements. With renewable energy on the rise, energy storage will grow in importance, helping to reduce the variability of wind and solar power and improve grid stability. By 2025, at least one-third of new residential solar systems and a quarter of nonresidential ones will be paired with batteries or other types of energy storage.

Case in point: Calif. The state recently experienced its first rolling blackouts since 2001, which many experts say were a side effect of the state’s increasing shift from natural gas to solar, which works only when the sun is shining. The solution: More energy storage. Calif. leads the country in energy storage, with 500 megawatts, and recently installed the world’s largest grid battery. But that’s well below the 12 GW of storage capacity the state needs in order to transition to 100% clean energy by 2045.

Yet another wrinkle in the ongoing U.S.-China standoff over TikTok: Beijing will use export controls to block the transfer of the app’s algorithms, which help keep users engaged with fresh content, if TikTok is sold to a U.S. buyer. Experts say TikTok without the algorithms is like a fancy car without an engine. Don’t be surprised if the TikTok sale is delayed or ultimately derailed. President Trump has threatened to ban the app unless ByteDance, TikTok’s parent company, sells its U.S. operations to an American company. Also expect the Trump administration to soon clarify its ban on WeChat. Officials have been privately reassuring U.S. companies they can still do business with the messaging app in China, even if it is ultimately prohibited in America.

Yours very truly,

Sept. 4, 2020

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