



## The Hexagon Briefing: A Global Perspective from HSBC

### Episode 4: U.S. Re-opening After Covid – Travel and Leisure

May 19, 2021

Please refer to important disclosure at the end of this document.

**Jose Rasco:** Thank you for joining us today. Before we begin, you should be aware that relevant information relating to this podcast and the products and services we are about to discuss are available at the end of this recording and on our website at [www.us.hsbc.com](http://www.us.hsbc.com).

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I'm your host, Jose Rasco, and thanks for joining us today.

In today's episode, we're going to examine what's going on, the U.S. is set to reopen after covid, and what does this mean for the economy, for consumer spending and for the broader travel industry?

Former White House economic adviser Todd Buchholz is here today to help unpack that. Plus, we'll talk about what is really happening to the travel industry.

This podcast was recorded on Wednesday, May 19, 2021.

Thanks for joining me, and let's get going.

All right. Our weekly topic: commodity prices and inflation. Now we've looked at commodity prices and commodity prices have risen materially. There's no question about it. If you look at the commodity price space, the CRB is up a fair amount. The CRB is up more than 54% in this cycle so far. Commodity prices, it depends on where you go and what you look at, but they are up substantially. Now, why are commodity prices up so much and what does it mean for us? Commodity prices are up a lot because we just reopened the global economy and we are seeing that pent up demand for goods like lumber and steel and tin and copper from almost being zero are rising. And they're trying to make up for that pent up demand.

In addition, we depleted inventories for the better part of nine months. Think of how tough it was to go out there and find toilet paper or paper towels. Well, now consumers are struggling with trying to find a new home and trying to buy a new car. So what have we seen? We've seen the commodity prices have risen. And guess what? The price of new cars have risen because you can't find semiconductors to make the new cars. And as a result, consumers said, I can't buy a new car, I'll buy a used car. But when you have a limited supply of used cars and demand goes up 20-30% from where it was

last year before covid, prices go up there and we saw the price of used cars rise 10% in the month of March. So the important point to remember is commodity prices rise when you begin a business cycle because supply can't keep up with demand that resolves itself over a period of months. So that's important to keep in mind. That type of inflation should wither away and price gains should normalize as supplies go up to meet demand. So that's an important thing to keep in mind.

Now, you will also see commodity prices are up in certain sectors where demand is up because people couldn't get this. So that's pent up demand. The consumer savings rate is at twenty seven point six percent through the month of March. That means consumers have plenty of money to spend. So try to book a vacation and try to book a vacation for less than you spent in 2019. Impossible. Because vacation facilities and hotels and resorts know that we're desperate to get out of the house and they know that they have to make up for the revenue they lost last year. And they know the consumer savings rate is exceedingly high. So prices will be up for the foreseeable future in those sectors too, until things normalize. And that's probably through the end of the summer. So we don't think we're going to see runaway inflation for the next 5 years and that, you know, the price of milk will be up to 10 dollars a gallon in those kinds of things. We don't see that happening and we think that way before that happens, we think the Federal Reserve will take action and the markets will take action by raising interest rates and putting a bit of a slowing effect in terms of some of the interest rate sensitive sectors. So bottom line, keep in mind, we're at the beginning of a business cycle. We're also at the beginning of a multi-year buildout of technology. 5G is coming, 6G coming, new hardware, new software, new security software, all that is going to have a dampening effect on inflation and is going to keep wages under control. And we firmly believe that we're at the beginning of a period of good economic growth with a little higher inflation, but not runaway inflation. That is going to erode your purchasing power or the money you're going to make in the markets.

With the U.S. reopening after covid, what are the plans for the future? Where is the economy going? Where are we going? To help me answer those complicated questions is former White House senior economic adviser, Todd Buchholtz. Todd is also a frequent contributor to The Wall Street Journal. Todd, thanks for coming on the Hexagon Briefing.

**Todd Buchholz:** Good to be with you.

**Jose Rasco:** So listen, a lot of news out there in terms of the virus and vaccines and herd immunity. And and you've been at the upper levels of Washington and economic thinking in terms of what what guidance can you give us in terms of the vaccine, the concept of herd immunity?

**Todd Buchholz:** The first thing I would say is we live in an extraordinary time, as we've seen in a negative way from the pandemic. But how miraculous that pharmaceutical companies could in such a short time develop lifesaving vaccines that will, in fact save, who knows, hundreds of millions of lives. So that is really remarkable. And, you know, for all the acrimony, political acrimony in Washington and throughout the world, we should remember that in 2020, Democrats and Republicans came together to create new economic policies in the midst of a pandemic not seen in about a hundred years, essentially saved the economy, helped foster a V shaped recovery and those people who stay away from the vaccine, I think they are taking

obviously a personal health risk. But I also think they are opting out of what could be a very, very robust economic recovery.

**Jose Rasco:**

Some of the examples from around the world in different countries like New Zealand, you know, we look at Australia, we look what's going on in Israel. You don't necessarily need to get to those upper levels of vaccination rates where you can still see the ebbs and flows in the vaccine affecting the virus, the the number of cases. But essentially, it does allow you to open up the economy or so it seems. So point well taken. Now, if you look at where we are, right? Clearly the economy is reopening. But a lot of people ask, what is the recession going to end? The recession actually ended in the third quarter of last year. It's not official from the NBER, but we had very robust growth in the third quarter of last year and we've had growth ever since. And this year we expect at HSBC, the growth is going to be fairly robust again this year, six and a half percent or more.

So the government has proposed, if you include all the Biden plans together, the infrastructure plan, in addition to all the plans we've already seen with the social plan that he's talking about for another 1.8 trillion, it would be 9.4 trillion dollars in fiscal stimulus in less than a little like 13, 14 months, right? Which is about 45% of GDP, which exceeds what FDR spent, which is about 40% of GDP to get the US economy out of the Great Depression in the 30s. So plenty of support from the fiscal side. If we just focus on that for a moment. Where do you see that going? Do you see there being some sort of effort, bipartisan effort to enact some of these plans? How much of that is actually going to come through? We're about 5.3 actually spent and the rest of it's TBD in terms of the political backdrop and timing. So what are your thoughts on fiscal stimulus?

**Todd Buchholz:**

Jose, the first thing I have to say is that I disagree with using the word recession to describe what we went through in 2020. I call it the Great Cessation, not recession. And there's a difference. A recession is when the economy slows down because there's been excess speculation. Inventories have built up, unsold cars on the lots, unsold homes, the Federal Reserve Board in these cases would have jacked up interest rates to slow down the economy. That's a typical recession as we had in the 1930s, which turned into a depression, 1980s, early 2000s. This was something very different.

This I called the Great Cessation because essentially people were told and made their own correct judgments to stay home and not go out and do not contract the coronavirus. The difference here is that it is easier to recover from a cessation than from a recession because, as you know, from a recession, you have to wait until all those unsold trucks and cars and homes and washing machines are finally sold off. And then you call the factory workers back to build more. In a cessation, all you need is the vaccine and the all clear signal. So we are recovering very strongly.

**Jose Rasco:**

The savings rate on the consumer side is more than 27%. We have in terms of wages are growing 4.5% year over year. And I know you're an economist, so you're going to be really keen on this number, transfer payments are up 4.9 trillion year over year. So I would say the U.S. consumer and keep in mind, we have a 20 trillion dollar, 21 trillion dollar economy. So it's almost 25% of GDP is out there in cash. And I'm asking you, is it a fair statement to say that the consumer has some dry powder and there might be some pent up demand happening as we reopen? What's your view on the consumer?

**Todd Buchholz:** Well, the consumer is in good shape. If you look at FICO scores, if you look at credit ratings of individuals, they are much higher than they've been for years. If you look at credit card delinquencies, those are looking good as well. I would suggest as a guidepost that listeners to the podcast can keep an eye on the share prices of credit card issuing companies or companies that issue credit to automobile buyers. And you see that they're near all time highs.

Now, if they begin shaking and shuddering, that might be a sign that consumers don't have the wherewithal. But the savings rate is very high, the government is still sending out checks, and in fact, one of the biggest problems that we have are the unfilled jobs, the several million jobs for which employers cannot find employees.

Jose, I was at a restaurant last week, one of the first restaurants I've been to in 14 months. I was speaking to the owner. He said he had 5 interviews, 5 people scheduled to come in to be interviewed that day. The first 3 were no shows. The fourth was acceptable and the fifth had not yet arrived. We need to induce people to get off unemployment compensation and get back to work. So I would propose that the government convert payments into signing bonuses so that if you take a new job or go back to work, you get extra money for taking that step.

**Jose Rasco:** And I guess the question everyone wants to know Todd is, what did you eat?

**Todd Buchholz:** Oh, it was an Italian restaurant.

**Jose Rasco:** There you go.

**Todd Buchholz:** And yes, it was a it was a lovely meal. I started with the traditional eggplant parmesan, and then I had the whole branzino.

**Jose Rasco:** So one of the things we've noticed is in the month of May, for the first time since last spring, we're seeing that the number of airline passengers are up year over year. It's up above where it was last March.

So the question I've got for you is clearly certain sectors have been hammered by covid – cruise ships, concerts, sports, hotels, airlines, et cetera. But we are seeing that domestic travel at least is starting to pick up. And we're seeing in some of the high frequency mobility data that consumers are spending money increasingly on services. If you look at retail services versus retail spending on goods versus services, services are starting to pick up.

So as we look toward that, what should we expect in terms of the travel business and domestic travel in particular? Because international travel might still be a bit tough, given restrictions between countries and, you know, in terms of herd immunity rates in other countries and vaccination rates in other countries being lower, it's more probable, we think, that domestic travel will pick up more quickly. What are your thoughts there in terms of travel and some of these down beaten sectors?

**Todd Buchholz:** It's very interesting. Jose if you think about it, many of us have given lectures prior to covid or listen to talks or written or read reports about the, "experienced economy", that everything was going to be about experiences as opposed to goods and shopping malls were converting to be more

experiential, whatever, whatever that meant. You know, maybe it meant shiatsu massages in the atrium.

**Jose Rasco:** Have you ever done an escape room, Todd?

**Todd Buchholz:** No you know, I once watched *The Silence of the Lambs* and I felt –

**Jose Rasco:** – I recommend everyone, everyone try one escape room. But go ahead. Keep going. I'm sorry.

**Todd Buchholz:** Yes. You know, my escape room was called the White House in Washington, D.C. and I got out. So look, I was I'm involved in the experience economy. I was one of the original producers of the Broadway show *Jersey Boys* and I'm still involved in in those sorts of activities, but covid changed everything around. It became goods, not experiences. Well, experiences will be coming back. Travel is coming back. Would you look at travel and as you say it at HSBC, domestic travel comes back first.

Which domestic travel? Well, many people are a little bit reluctant to get on airplanes, though airplane travel is coming back. So driving locations are the first to recover and in many cases, smaller cities, not New York City, not Chicago, but places like St. Petersburg, Florida, Savannah, Georgia, Jacksonville, those sorts of driving locations are attracting lots of visitors.

From the point of view of the hotel sector, I would say that group travel takes longer. Group travel takes longer, because organizing conventions requires more buyin a greater belief that the vaccines are going to be working and widespread enough and non-variant and so on and so forth. I think upscale hotel chains will recover last because those driving locations are more for middle income families. The upscale hotels cater to the group travel and the business traveler.

So there's an order in which the travel industry is recovering and I think it is US first, smaller cities and towns, first group travel second, upscale chains, maybe last, and the cruise ships, of course, are and have been suffering the most because the CDC cracked down on them in in a very firm way. And even the government of Canada essentially destroyed the Alaskan cruise trade this summer by forbidding American cruise ships from stopping in Canada.

**Jose Rasco:** Right. Which leads me to the question for the cruise industry, do you think there will be an effort in Washington and in other capital cities to help revive the industry? Because it is an important part of the Travel and Leisure segment, right? And do you think, given the relaxation in mass rules and other things and the increasing vaccination rates around the world, do you think we should expect to see that from the world of politics any time soon? Because it seems like that's one sector that definitely needs some regulatory relief.

**Todd Buchholz:** The cruise ship sector employs a great number of people. Now it's frequently attacked in Washington because the ships themselves are not made in the USA and they fly under foreign flags. And many of their onboard employees, waiters, busboys and the like, are not Americans. However, when you consider those cruise ships coming into the Port of Miami or Fort Lauderdale or Seattle or Los Angeles or Boston or New York, and you add up all the provisioning that goes on, the food that goes on the ship, the musicians that

enter the ship, the passengers, the tourism dollars that are created by those ports and or in those ports and at those stopovers, the numbers are indeed large. But the cruise industry has the difficult political predicament in explaining that relationship. And I think the Cruise Industry Trade Association needs to do a better job of explaining the jobs that are created by their presence in those port cities.

**Jose Rasco:**

Yeah, no question there's a value added, a second order effect that takes place, right? And I think I agree with you and I think they need they need some definite help. The one thing we've seen with the mobility data, again, we're trying to look at this high frequency data to get a a quick read on what's going on is that we've seen that people so far at least, have been unwilling. And we have seen the transit station numbers, they're up, but they're not up much. People are willing to go to parks, their workplaces, the numbers, again, sort of flattish, going up a little bit, but not much. What people are willing to do is more recreation, more outdoor activities, even restaurant usage is going up in a more meaningful fashion in the U.S.

So do you see that lag continuing? Do you see people still struggling with getting together in large groups like sporting events or concerts as well? Or is it just early days and will turn around quickly?

**Todd Buchholz:**

I think that people will be getting used to it. Look, there are stages. There are stages of recovery. There are apparently stages of recovery from addiction. There are stages of recovery from mourning a friend or a relative. And there are stages of recovery from the great cessation. So the first thing that we do is we go out having been vaccinated with our masks on, then perhaps outside we realize we don't need the masks. And then the CDC tells us perhaps we don't need them inside. We trust that others are vaccinated. And then we finally say, well, wait, if I'm vaccinated, what do I care if the other guy isn't vaccinated himself? He's not going to infect me. So I do think that things will eventually return to normal.

Now, it might depend on some level of distancing. If I think about an outdoor baseball stadium, if I think about Yankee Stadium, sure, the seats are rather tightly packed, but it's outside. If I compare that to a Broadway theater where I'm inside and there's very little leg room and very little shoulder room, well, maybe I'm a little bit more reluctant to go inside that theater. So I think those sort of dimensions will be taken into account. But my best guess is that eventually and eventually, what do I mean? Probably by mid, by Thanksgiving, we shrug off most of this reluctance and assuming that the vaccines continue to work against variants, we return to normal.

**Jose Rasco:**

Right, right, right. And you raise a great point in terms of the number of people going to places and inundating events and all that because people have that pent up demand we want to see other people were social animals as as people. And so I guess the question is, and it's a major issue in the markets today and in our economy is we're seeing that inflation expectations are going up. And in part, it's the base effect where prices were low last year and they just look artificially higher now. Part of it is that traditional cyclical supply demand problem where we need to increase supply. Right? And we will see consumers switch preferences as until prices come down. And then the third part is you talked about and we both talked about the excess liquidity that's in the system.

So one thing we saw at University of Michigan, for example, if you look at the short term inflation expectations, there as high as they've been in the last decade, but short term inflation expectations not as high. So, I mean, long term rather. I should say so short term inflation expectations, very high, long term, not as high. They're still up, but not as high. So this consumer seems to understand that there's a push to raise prices now that everything's reopened.

And I guess two questions for you. Do you agree that you think for the most part, prices will normalize as supply picks up and consumers spend some of that excess money? And the second question is, what's the Fed's reaction function to that? We don't think the Fed's going to raise rates this year. They'll probably do something at some point next year. What about tapering, quantitative easing? And and what effect did that have on real estate? So two or three questions and wrapped up in one. But let's start with the first one, if you don't mind.

**Todd Buchholz:**

Jose, I have to say, I have been a dove on inflation for about fifteen years when many of my friends were condemning Ben Bernanke and Janet Yellen for pumping up the money supply, for keeping interest rates at near zero percent levels. I disagreed with them. They were promised, they said, all with Bernanke and Yellen and Powell, continue this. It'll lead to hyper inflation. Well, that didn't happen. It'll lead to the dollar frittering away to nothing. Well, the dollar was, in fact, a little too strong, not a little too weak.

So I have been a dove for a long time, but for the first time in about 15 years I have put on my hawkish feathers. What are the inflation fighters? What has been keeping inflation down for so long? And I would identify 5 factors.

The first, I'd say the gig economy. I'd written a piece in The Wall Street Journal at one time, about a couple of years ago, about the gig economy slowing inflation. The gig economy is a supply side shock because of companies, and I won't name names that are giggers that compete with hotels. Hotels haven't been able to raise prices because there are gigging companies that provide car services. Taxis have not been able to raise prices. The gig economy takes idle resources, empty apartments, idle cars and shoves them onto the market. And as you know, supply and demand. You push out the supply curve, prices go down. So the gig economy has been one of those forces. When I now see the attack on the gig economy by the Labor Department in the US and similar Labor departments abroad trying to convert giggers into employees, that is taking away one of the inflation fighting forces.

Deregulation is a second inflation fighter because it creates more competition.

The Internet is another inflation fighter. The ability to compare prices as we go to different auction sites.

The strong dollar has been an inflation fighter because it makes foreign goods look cheaper to Americans, makes it more difficult for domestic companies to raise prices.

And finally, a vigilant Fed is an inflation fighter.

When I look at those five factors, I become worried because I think new regulations will make it more difficult for companies or individuals to enter and create more competition.

**Jose Rasco:** Todd, thank you so much for your time. Really appreciate the insight and look forward to speaking again soon.

**Todd Buchholz:** Thank you, Jose.

**Jose Rasco:** So I want to thank Todd Buchholz for coming on, I mean, clearly very interesting and a well informed person and something to keep an eye on, right? Given the size of government spending. Certainly, as I said, we're exceeding what FDR spent on the New Deal. I think that that the Biden administration, in addition to rescuing us from covid and making sure that everybody is covered after covid, is trying to sort of reshape the economy and spend on what they're calling social infrastructure to make sure everybody gets a seat at the table. So it's a little different approach than what we've seen from government in the past couple of years.

On the inflation front, clearly, you know, we're seeing a little higher inflation, inflation at 3%, up from 1.8% where it was a couple of months ago. But keep in mind, there's a couple of different factors at play there. And while Todd's warnings are well heeded, we still think we're at the beginning of a multi-year rollout of technology that, as he mentioned, is going to be exceedingly deflationary. So not that we should not keep an eye on inflation, we should. But we think the overarching story in the markets and in the economy today is one of growth and reopening. And that's where our focus is, is the pent up demand that the consumer has and what are businesses doing that have a ton of cash and want to make acquisitions going forward and would like to figure out how to set up that business model for this business cycle, which hopefully will last for a long period of time.

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