

# ECONOMY

## The \$15 Billion Economic Experiment

THINK STRATEGICALLY:

# Puerto Rico Amid a Great Economic Experiment

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**P**uerto Rico's great economic experiment began taking shape last year, marked by three extraordinary events:

A series of earthquakes in the southern part of the island, which continue.

The COVID-19 pandemic that began in March 2020.

The change of administrations from Trump to Biden appears to be benefiting Puerto Rico greatly.

The widespread impact of the early 2020 earthquakes was followed by the COVID-19 pandemic lockdown, which led to the suspension of most commercial activity and forced 43 percent of Puerto Rico's businesses to close 100 or more days. Meanwhile, the island's recovery under the Trump administration was slow, with the disbursement of congressionally approved federal disaster funding even blocked in many instances.

Puerto Rico's Economic progress continued to lag amid chaos and uncertainty spurred by the novel coronavirus' spread across the island. In the end, most of the federal funding received began to be put to use in early 2021 and will continue through 2022.

Besides the 2017 hurricanes and the 2020 earthquakes, the COVID-19 pandemic has been one of the most significant crises for which a substantial amount of federal funds has been allocated and received by

individuals, businesses, and state and local governments.

As reported by the Central Office for Recovery, Reconstruction & Resiliency (COR3) in December 2020, the federal funds for post-Hurricane Maria reconstruction amounted to \$60.5 billion, of which \$17.7 billion has been disbursed.

However, for the Coronavirus pandemic, the federal funds granted to Puerto Rico amount to \$16.2 billion, of which as of March 1, \$15 billion has been disbursed. That \$15 billion capital infusion to the Puerto Rico economy is the largest funding allocation in history. Its impact on the local economy has become a great economic experiment in its own right.

As we revise the \$15 billion already in our economy, we note the main categories:

**Income Support (Pandemic Unemployment Assistance, etc.):** \$5.8 billion, or 38.7 percent

**Loan Programs (Paycheck Protection Program):** \$3.2 billion, or 21.3 percent

**State and Local Funding:** \$4.1 billion, or 27.3 percent

**Other Uses:** \$1.9 billion, or 12.7 percent

In addition, Puerto Rico will receive additional funding shortly from the \$1.9 trillion stimulus package and the proposed \$2 trillion infrastructure bill proposed by President Biden. When added, Puerto Rico is facing the most significant economic experiment in its history.

Lastly, have you noticed a more significant number of job ads? Most business owners have a difficult time hiring employees due to the enhanced employee benefits. Take, for example, a store worker making \$8.50 an hour. Assuming a work schedule of 40 hours per week, his or her gross take-home pay would be \$340 a week, \$1,473.33 a month or \$17,680 a year. The pandemic hit, that person lost their job and began receiving the enhanced unemployment of \$840 a week, \$3,640 a month or \$43,680 a year.

The number represents a 147 percent pay increase or equivalent to getting paid \$21 an hour. These numbers evidence the problem we now have in Puerto Rico, that there are not enough people to fill the jobs due to the enhanced unemployment issue; even the now-reduced PUA still represents an hourly raise of 59 percent. It is hard not to blame them. Due to the above-mentioned reasons, the Puerto Rico Economic Experiment is now more daunting.

What remains to be seen is how Puerto Rico will use this \$15 billion infusion to jumpstart an economic transformation that will propel the island toward sustainable growth for years to come.

### Week in Markets: The S&P 500 breaks record; claims for unemployment rise; producer price index increases to 4.23 percent, a strong week for Wall Street

U.S. and global stock markets ended with solid gains. The S&P 500 broke its record every day, to end with a record-breaking 4,128.80, an increase of 2.71 percent during the week. European

markets closed near their all-time highs. In contrast, Asian markets were mainly mixed, with China stock prices falling hard after the Chinese producer price index reportedly reached 4.4 percent, its most significant increase since 2018.

Notably, the CSI 300 index of large Shanghai and Shenzhen-listed stocks closed down more than 1.5 percent.

The week ended without headlines that create market turmoil; instead, it provided the perfect growth path. When the stock market is trading near all-time highs, the market volatility index is subdued. This occasion has not been the exception, given that in the last seven trading days, volatility has been lower than historical averages for the first time in more than a year.

Several U.S. economic benchmarks reported during the week, with mixed results:

**U.S. Initial Claims for Unemployment Insurance:** rose last week to 744,000, versus 728,000 the previous week, a 2.2 percent rise and above the estimate of 694,000.

U.S. Producer Price Index rose to 0.98 percent, versus 0.49 percent last month, much higher than estimated.

U.S. Producer Price Index rose 4.23 percent, versus 2.79 percent last month, or 0.34 percent higher than last year.

As we analyze these results, we note the following: The U.S. unemployment rate on April 1, 2020, rose to 14.8 percent and has fallen 8.8 percent in the past 12 months to reach 6 percent. There are two ways to analyze this; first, this is a hugely positive outcome as it is the most significant decline in unemployment since the 1940s. The other way to see it is just how damaged the U.S. labor market is from the pandemic's exogenous shock, unemployment at a historically high rate of 6 percent.

As we read the tea leaves, we note that the United States will not reach full employment levels until the vaccination effort helps the country to achieve herd immunity and the pandemic is under control, allowing states and territories to eliminate most restrictions. The current COVID-19 case surge scenario in several parts of the country will impact the economic recovery.

The producer price index increases for the United States of 4.23 percent, and China's, of 4.4 percent, are the former's fastest pace since 2011 and the latter's since 2018. The contributing factors are rising shipping costs, massive supply chain disruptions, rising commodity prices, all linchpins of higher inflation, which show up when the consumer price index is reported.

### The Final Word: What should investors expect from the markets?

As we see the economy slowly progressing, we view fiscal and monetary policies as potentially impacting the growth and longevity of the stock markets. As the market absorbs Biden's \$2 trillion infrastructure proposal, this newest plan pushed stimulus above 30 percent of GDP, which is the highest since WWII. Additionally, the [proposed] corporate tax rate increase from 21 percent to 28 percent may impact the growth of the stock markets, even as it produces much-needed revenue to address the federal deficit. We think the proposed hike in the corporate tax rate from 21 percent to 28 percent will spark some indigestion in the equity markets.

### Facts to consider:

The corporate tax increase is not a done deal, it is a proposal; we would not be surprised if congressional horse-trading lowers the rate to 25 percent.

With the economy delivering robust growth, corporate earnings should rise dramatically. This development will help the bull market to continue; however, tax rate increases tend to create volatility.

As we saw in the producer price index of 4.2 percent, higher inflation will continue to negatively affect investor sentiment and will surely oblige the Federal Reserve to pivot toward tightening. We think the Fed policy will remain in its easing stance for some time, with rate increases unlikely to happen in the coming year.

*Francisco Rodríguez-Castro is president and CEO of Birling Capital LLC. Think Strategically© is a publication by Birling Capital LLC that summarizes recent geopolitical, economic, market and other developments. This report is intended for general information purposes only and does not represent investment, legal, regulatory, or tax advice. Recipients are cautioned to seek appropriate professional counsel regarding any of the matters discussed.*

Weekly Market Close Comparison	4/9/21	4/1/21	Return	YTD
Dow Jones Industrial Average	33,800.60	33,153.21	1.95%	10.44%
Standard & Poor's 500	4,128.80	4,019.87	2.71%	9.92%
Nasdaq Composite	13,900.19	13,480.11	3.12%	7.85%
Birling Puerto Rico Stock Index	2,468.21	2,439.14	1.19%	20.69%
U.S. Treasury 10-Year Note	1.67%	1.69%	-1.18%	0.80%
U.S. Treasury 2-Year Note	0.16%	0.17%	-5.88%	0.75%