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James V Sadrianna PA - September 2022 Newsletter

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Recessions can be driven by fear as well as by fundamental economic weakness.

Is the U.S. Economy in a Recession?

In an early July poll, 58% of Americans said they thought the U.S. economy was in a recession, up from 53% in June and 48% in May.[1] Yet many economic indicators, notably employment, remain strong. The current situation is unusual, and there is little consensus among economists as to whether a recession has begun or may be coming soon.[2]

Considering the high level of public concern, it may be helpful to look at how a recession is officially determined and some current indicators that suggest strength or weakness in the U.S. economy.

Business Cycle Dating

U.S. recessions and expansions are officially measured and declared by the Business Cycle Dating Committee of the National Bureau of Economic Research (NBER), a private nonpartisan organization that began dating business cycles in 1929. The committee, which was formed in 1978, includes eight economists who specialize in macroeconomic and business cycle research.[3]

The NBER defines a recession as "a significant decline in economic activity that is spread across the economy and lasts more than a few months." The committee looks at the big picture and makes exceptions as appropriate. For example, the economic decline of March and April 2020 was so extreme that it was declared a recession even though it lasted only two months.[4]

To determine peaks and troughs of economic activity, the committee studies a range of monthly economic data, with special emphasis on six indicators: personal income, consumer spending, wholesale-retail sales, industrial production, and two measures of employment. Because official data is typically reported with a delay of a month or two — and patterns may be clear only in hindsight — it generally takes some time before the committee can identify a peak or trough. Some short recessions (including the 2020 downturn) were over by the time they were officially announced.[5]

Strong Employment

Over the last few months, economic data has been mixed. Consumer spending declined in May when adjusted for inflation, but bounced back in June.[6] Retail sales were strong in June, but manufacturing output dropped for a second month.[7] The strongest and most consistent data has been employment. The economy added 372,000 jobs in June, the third consecutive month of gains in that range. Total nonfarm employment is now just 0.3% below the pre-pandemic level, and private-sector employment is actually higher (offset by losses in government employment).[8]

The unemployment rate has been 3.6% for four straight months, essentially the same as before the pandemic (3.5%), which was the lowest rate since 1969.[9] Initial unemployment claims ticked up slightly in mid-July but remained near historic lows.[10] In the 12 recessions since World War II, the unemployment rate has always risen, with a median increase of 3.5 percentage points.[11]

Negative GDP Growth

One common definition of a recession is a decrease in real gross domestic product (GDP) for two consecutive quarters, and the current situation meets that criterion. Real (inflation-adjusted) GDP dropped at an annual rate of 1.6% in the first quarter of 2022 and by 0.9% in the second quarter.[12] Because GDP is reported on a quarterly basis, the NBER committee cannot use it to measure monthly economic activity, but the committee does look at it for defining recessions more broadly.

Since 1948, the U.S. economy has never experienced two consecutive quarters of negative GDP growth without a recession being declared. However, the current situation could be an exception, due to the strong employment market and some anomalies in the GDP data.[13]

Negative first-quarter GDP was largely due to a record U.S. trade deficit, as businesses and consumers bought more imported goods to satisfy demand. This was a sign of economic strength rather than weakness. Consumer spending and business investment — the two most important components of GDP — both increased for the quarter.[14]

Initial second-quarter GDP data showed a strong positive trade balance but slower growth in consumer spending, with an increase in spending on services and a decrease in spending on goods. The biggest negative factors were a slowdown in residential construction and a substantial cutback in growth of business inventories.[15] Although inventory reductions can precede a recession, it's too early to tell whether they signal trouble or are simply a return to more appropriate levels.[16] Economists may not know whether the economy is contracting until there is additional monthly data.

The Inflation Factor

With employment at such high levels, it may be questionable to characterize the current economic situation as a recession. However, the employment market could change, and recessions can be driven by fear as well as by fundamental economic weakness.

The fear factor is inflation, which ran at an annual rate of 9.1% in June, the highest since 1981.[17] Wages have increased, but not enough to make up for the erosion of spending power, making many consumers more cautious despite the strong job market.[18] If consumer spending slows significantly, a recession is certainly possible, even if it is not already under way.

Inflation has forced the Federal Reserve to raise interest rates aggressively, with a 0.50% increase in the benchmark federal funds rate in May, followed by 0.75% increases in June and July.[19] It takes time for the effect of higher rates to filter through the economy, and it remains to be seen whether there will be a "soft landing" or a more jarring stop that throws the economy into a recession.

No one has a crystal ball, and economists' projections range widely, from a remote chance of a recession to an imminent downturn with a moderate recession in 2023.[20] If that turns out to be the case, or if a recession arrives sooner, it's important to remember that recessions are generally short-lived, lasting an average of just 10 months since World War II. By contrast, economic expansions have lasted 64 months.[21] To put it simply: The good times typically last longer than the bad.

Projections are based on current conditions, are subject to change, and may not come to pass.

1) *Investor's Business Daily,* July 12, 2022

2) *The Wall Street Journal,* July 17, 2022

3–5) National Bureau of Economic Research, 2021

6, 12, 15, 21) U.S. Bureau of Economic Analysis, 2022

7) Reuters, July 15, 2022

8–9, 17–18) U.S. Bureau of Labor Statistics, 2022

10) *The Wall Street Journal,* July 14, 2022

11) *The Wall Street Journal,* July 4, 2022

13–14) MarketWatch, July 5, 2022

16) *The Wall Street Journal,* July 28, 2022

19) Federal Reserve, 2022

20) *The New York Times,* July 1, 2022

New Cancellation for Federal Student Loans and Delayed Repayment to 2023

The new plan will cancel $10,000 in federal student loan debt for individual borrowers whose income is below $125,000 ($250,000 for married couples) in 2020 or 2021, plus another $10,000 for Pell Grant recipients.

On August 24, 2022, just a few days before federal student loan repayment was set to resume, President Biden announced a plan for additional student loan debt relief.

Federal student loan repayment was originally halted in March 2020 at the start of the pandemic. The new plan extends the payment moratorium through the end of the year, offers partial debt cancellation, and includes proposed updates to the Public Service Loan Forgiveness program and a new income-based repayment plan.

What's new

Here is the new framework for federal student loans.

Loan cancellation. The plan will cancel $10,000 of federal student loan debt for borrowers with an adjusted gross income less than $125,000 ($250,000 for married couples filing jointly). The loan cancellation increases to $20,000 for borrowers who are Pell Grant recipients.[1] (A Pell Grant is a federal financial aid grant award to students from low-income households.) Eligibility is based on income from 2020 or 2021, but not 2022.[2]

The Department of Education estimates that 21% of the borrowers eligible for relief are 25 years and younger, 44% are ages 26 to 39, and the remaining 35% are ages 40 and up, including 5% who are senior citizens. The Department also estimates that approximately 27 million borrowers (more than 60% of the borrower population) are Pell Grant recipients and will be eligible to receive up to $20,000 in debt relief.[3]

Payment pause extended. The pause on federal student loan repayment is being extended one "final" time through December 31, 2022. President Biden's announcement states that "borrowers should expect to resume payment in January 2023."[4] In practice, borrowers should expect to hear from their loan servicer at least three weeks before their first payment is due.

Changes to the Public Service Loan Forgiveness (PSLF) program. Borrowers who are employed by a nonprofit organization, the military, or the government may be eligible to have their federal student loans forgiven through the PSLF program due to time-sensitive changes. These temporary changes waive certain eligibility criteria for the program and make it easier for borrowers to receive credit for past periods of repayment that would otherwise not qualify for PSLF. These changes expire on October 31, 2022.

Important note: Borrowers who might qualify for loan forgiveness or credit under the PSLF program due to these time-sensitive changes must apply to the program before October 31, 2022. Borrowers can visit the administration's PSLF website for more information.

In addition, the Department has proposed allowing certain kinds of deferments and forbearances, such as those for Peace Corps and AmeriCorps service, National Guard duty, and military service, to count toward PSLF.

A new income-based repayment plan. The Department of Education is proposing a new income-driven repayment plan that does the following:

- For undergraduate loans, caps monthly payments at 5% of a borrower's discretionary income (currently borrowers must pay 10% of their discretionary income)
- For borrowers with original loan balances of $12,000 or less, the loan balance would be forgiven after 10 years of payments (currently borrowers must repay their loans for 20 years)
- Raises the amount of income considered non-discretionary, with the result that a borrower who earns an annual salary based on a $15 minimum wage would not have to make any payments (the monthly payment would be calculated at $0)
- Covers a borrower's unpaid monthly interest, so that a borrower's loan balance won't grow due to interest as long as the borrower is making monthly payments (under current income-driven repayment plans, a borrower's loan balance can grow even if the borrower continues making monthly payments, because the interest keeps accruing)
- Makes income recertification automatic, which will allow the Department of Education to automatically retrieve a borrower's income information every year instead of making borrowers recertify their income annually

Will my loans be cancelled automatically?

For most borrowers, no. The Department of Education will be creating a "simple" application for borrowers to claim relief, which will be available by early October. Borrowers who would like to be notified when the application is open can sign up on the Department's subscription page. Once borrowers complete an application, their loan cancellation should be processed within four to six weeks. The Department recommends that borrowers apply before November 15 in order to receive loan cancellation before the payment pause expires on December 31, 2022. (The Department will still process applications even after the pause expires.)

Some borrowers, however, may be eligible to have their loans cancelled automatically because the Department already has their income data on record.

Are current students eligible for loan cancellation?

Yes, current students are eligible for loan cancellation, provided their loan was obtained before July 1, 2022. However, borrowers who are dependent students need to qualify based on parental income, not their own income.[5]

Are graduate students eligible for loan cancellation?

Yes, provided income limits are met and it is a federal loan, such as a Direct Loan or Grad PLUS Loan. Private loans are not eligible.

Do parent PLUS Loans qualify for cancellation?

Yes, provided the income limits are met. Any private loans taken out by parents to pay their child's college education are not eligible.

Will I be taxed on my cancelled debt?

At the federal level, no. At the state level, maybe. Any student loan relief will not be treated as taxable income at the federal level, thanks to provisions in the American Rescue Plan Act of 2021. However, a handful of states that have not yet aligned their laws with this Act could still tax the amount of student debt forgiven unless they act to amend their laws and affirmatively exclude this debt.

I have more than $10,000 in student loan debt. Will my monthly payment be adjusted after cancellation?

It depends. Borrowers who are already in an income-driven repayment plan generally won't see their monthly payment change because their payment is based on their discretionary income and household size, not their outstanding loan balance. By contrast, borrowers who are in a fixed payment plan should have their monthly payment recalculated by their loan servicer because their outstanding balance will be lower after loan cancellation, which should result in a lower monthly payment.

I made monthly payments during the payment pause. Can I still qualify?

According to the Department of Education, borrowers who continued to make payments on their federal student loans after March 13, 2020 will still qualify for loan cancellation (assuming they meet the income guidelines). Borrowers can request a refund by calling their loan servicer directly. According to Mark Kantrowitz, a financial aid and student loan expert, only 1.2% of borrowers continued to make payments during the payment pause.[6]

1) U.S. Department of Education, 2022

2) *The New York Times,* August 25, 2022

3-5) White House Fact Sheet, August 24, 2022

6) *The Wall Street Journal,* August 25, 2022

Inflation Reduction Act: What You Should Know

The Inflation Reduction Act includes health-care and energy-related provisions, a new corporate alternative minimum tax, and an excise tax on certain corporate repurchases of stock.

The Inflation Reduction Act, signed into law on August 16, 2022, includes health-care and energy-related provisions, a new corporate alternative minimum tax, and an excise tax on certain corporate stock buybacks. Additional funding is also provided to the IRS. Some significant provisions in the Act are discussed below.

Medicare

The legislation authorizes the Department of Health and Human Services to negotiate Medicare prices for certain high-priced, single-source drugs. However, only 10 of the most expensive drugs will be chosen initially, and the negotiated prices will not take effect until 2026. For each of the following years, more negotiated drugs will be added.

Starting in 2025, a $2,000 annual cap (adjusted for inflation) will apply to out-of-pocket costs for Medicare Part D prescription drugs.

Starting in 2023, deductibles will not apply to covered insulin products under Medicare Part D or under Part B for insulin furnished through durable medical equipment. Also, the applicable copayment amount for covered insulin products will be capped at $35 for a one-month supply.

Health Insurance

Starting in 2023, a high-deductible health plan can provide that the deductible does not apply to selected insulin products.

Affordable Care Act subsidies (scheduled to expire at the end of 2022) that improved affordability and reduced health insurance premiums have been extended through 2025. Indexing of percentage contribution rates used in determining a taxpayer's required share of premiums is delayed until after 2025, preventing more significant premium increases. Additionally, those with household incomes higher than 400% of the federal poverty line remain eligible for the premium tax credit through 2025.

Energy-Related Tax Credits

Many current energy-related tax credits have been modified and extended, and a few new credits have been added. Many of the credits are available to businesses, and others are available to individuals. The following two credits are substantial revisions and extensions of an existing tax credit for electric vehicles.

Starting in 2023, a tax credit of up to $7,500 is available for the purchase of new clean electric vehicles meeting certain requirements. The credit is not available for vehicles with a manufacturer's suggested retail price higher than $80,000 for sports utility vehicles and pickups, $55,000 for other vehicles. The credit is not available if the modified adjusted gross income (MAGI) of the purchaser exceeds $150,000 ($300,000 for joint filers and surviving spouses, $225,000 for heads of household). Starting in 2024, an individual can elect to transfer the credit to the dealer as payment for the vehicle.

Similarly, a tax credit of up to $4,000 is available for the purchase of certain previously owned clean electric vehicles from a dealer. The credit is not available for vehicles with a sales price exceeding $25,000. The credit is not available if the purchaser's MAGI exceeds $75,000 ($150,000 for joint filers and surviving spouses, $75,000 for heads of household). An individual can elect to transfer the credit to the dealer as payment for the vehicle.

Corporate Alternative Minimum Tax

For taxable years beginning after December 31, 2022, a new 15% alternative minimum tax (AMT) will apply to corporations (other than an S corporation, regulated investment company, or a real estate investment trust) with an average annual adjusted financial statement income in excess of $1 billion.

Adjusted financial statement income means the net income or loss of the taxpayer set forth in the corporation's financial statement (often referred to as book income), with certain adjustments. If regular tax exceeds the tentative AMT, the excess amount can be carried forward as a credit against the AMT in future years.

Excise Tax on Repurchase of Stock

For corporate stock repurchases after December 31, 2022, a new 1% excise tax will be imposed on the value of a covered corporation's stock repurchases during the taxable year.

A covered corporation means any domestic corporation whose stock is traded on an established securities market. However, the excise tax does not apply: (1) to a repurchase that is part of a nontaxable reorganization, (2) with respect to certain contributions of stock to an employer-sponsored retirement plan or employee stock ownership plan, (3) if the total value of stock repurchased during the year does not exceed $1 million, (4) to a repurchase by a securities dealer in the ordinary course of business, (5) to repurchases by a regulated investment company or a real estate investment trust, or (6) to the extent the repurchase is treated as a dividend for income tax purposes.

Increased Funding for the IRS

Substantial additional funds are provided to the IRS to help fund operations and business systems modernization and to improve enforcement of tax laws.

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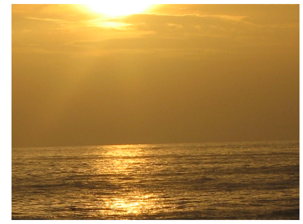

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