US Economic Outlook

COVID-19 plunges economy into uncharted waters

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Guidance on the COVID-19 virus spread from the IHS Markit Life Sciences team

- The global peak of the virus is expected between May and August 2020.
- The virus will take different paths in different regions and countries.
- The virus will return across 2020–22, in local pockets of different countries.
- Treatments are in development and early data are coming in.
  - By the fourth quarter of 2020, drugs could be made available to the most vulnerable but not the general public until more is known about side effects.
  - Full approval could come in early 2021.
- Early clinical data on a vaccine should be available by August 2020.
  - A vaccine might be available for compassionate use in autumn 2020.
  - However, a general vaccine for a healthy population must be safe, implying a timeline closer to November 2021 at the earliest.

US economy enters a deep recession

- The US economic outlook has deteriorated sharply over the past month as the coronavirus disease 2019 (COVID-19) has spread and most states have mandated closures of nonessential businesses.
- Equity price declines, a widening of risk spreads, and widespread disruptions of activities indicate that consumer and business spending will be considerably weaker than previously forecast.
- The Federal Reserve (Fed) is expected to hold its federal funds rate near zero for several years.
- We assume the pandemic will subside in the third quarter. The biggest hit to US growth will come in the second quarter, when consumer spending plunges.
- The recession will result in a peak-to-trough decline in real GDP of 8.3% over the first three quarters of 2020.
- The forecast includes the new $2.3-trillion Coronavirus Aid, Relief, and Economic Security (CARES) Act, which funds unemployment benefits, “recovery rebates” to individuals, business loans, and aid to state and local governments and hospitals. This will raise the federal deficit near $2 trillion this year and next.

COVID-19: Unprecedented shock to the US economy

- **Consumer service sector is ground zero of economic impact**
  - Transportation, restaurants & bars, amusement parks, museums, sporting events, casinos
  - "At-risk" comprises ~6% of GDP, 10% of PCE, 14% of employment (> 20 mil. jobs)
  - We assume that the peak-to-trough decline in "at-risk" PCE approaching 75-100%
- **Sharp decline in consumer expenditures is not limited to services**
  - Non-essential retail (department, general merchandise, vehicles, other durables)
  - Home sales and construction
  - Oil price decline will hammer oil patch: production declines and investment collapse
  - Cascading effects as businesses pull back and trim variable costs
    - Lay-offs, order cancellations, construction projects on hold, cashflow squeeze, profit hits, delinquencies, defaults, etc
    - Continuing fixed costs require cash reserves or bridge loans … but who is lending?
    - Small and medium sized businesses go under with insufficient equity and limited access to credit
- **Silver lining: There are offsets**
  - Increase in consumption of food (and toilet paper) at home; take-out & delivery
  - Increase in medical care (COVID-19 related) and supplies
  - Home delivery services for other goods…
  - …But supply chains not equipped for rapid response

Knock-on effects make a bad situation worse

- **Multiplier effects**
  - Laid off workers decrease non-essential spending
  - Further reduces business revenues
  - Orders get cancelled, more workers laid off…and around we go
- **Financial market impact**
  - Expected earnings decline; volatility and risk aversion increase; valuations decline
  - Credit spreads widen → ratings downgrades → value of leveraged loans declines → defaults & bankruptcies rise
  - Wealth destruction impacts household and business balance sheets
  - Rush to liquidity drives investor withdrawals; managers sell most liquid assets
- **Uncertainty around the world**
  - Strengthening dollar hurts emerging markets, weakening global growth
  - Collapsing commodity prices (Saudi/Russia deal may help?)
  - Inadequate healthcare systems and social infrastructure in much of developing world
  - Inability to fund adequate fiscal policy responses spells a long road back
  - Could reignite political and economic tensions in the Euro Zone
  - Trade tensions with China, other geopolitical relationships could flare up
  - And of course, it's an election year

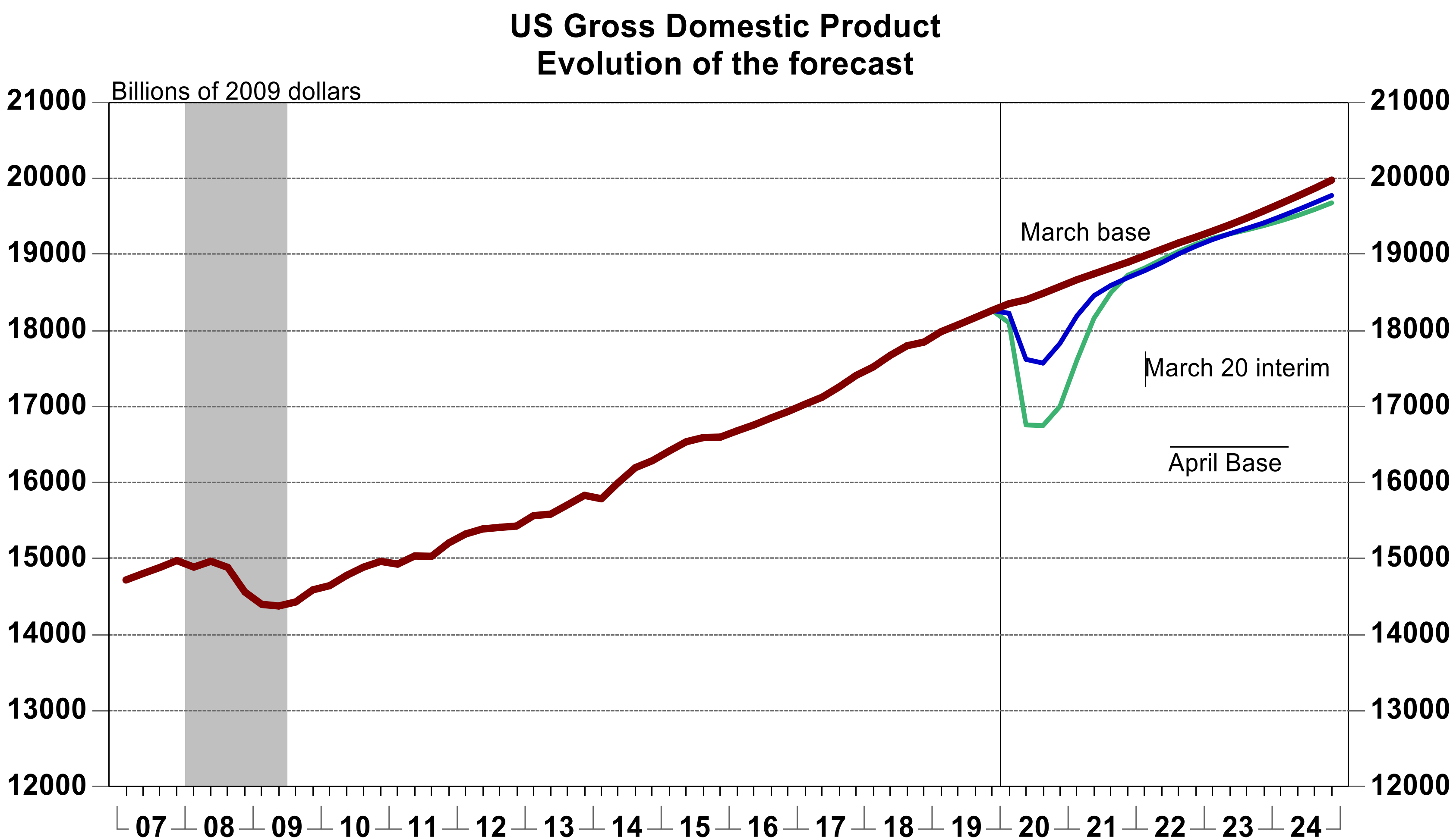
What needs to happen to “reopen” the economy?

- **Everything hinges on the path of the disease**
  - How effective will social distancing policies be at bending the curve?
    - When is the peak in new cases/deaths?
    - When will new cases dwindle to near zero and allow lifting restrictions?
  - How effective will “new” treatments prove to be?
    - Reduce severity of symptoms and load on the hospital system – a “bad flu”
    - Reduce mortality rate
    - Reduce fear
  - What is the true degree of infections in the population?
    - More testing and antibody tests
    - How does herd immunity work?
    - When will vaccines be widely available?
  - How do we “reopen” the economy?
    - Will this happen “en masse” across the country?
    - Will politics get in the way?
    - Does the private sector have the ability to set health guidelines?
    - How cautious will consumers be when the “all clear is sounded?
    - Game theory and Domino effect could define the timeline

When and how will consumers recover?

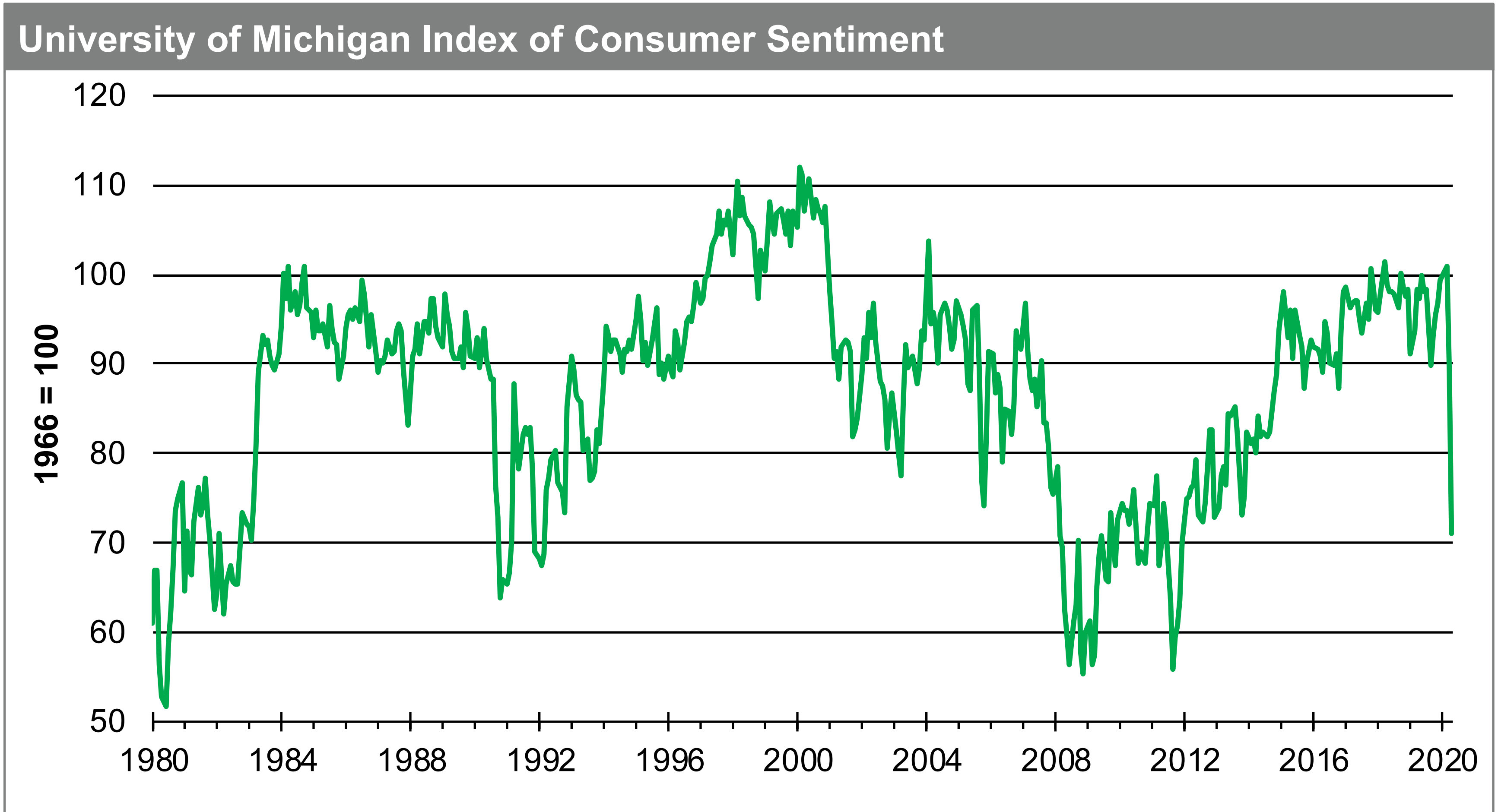
- **How do you "reopen the economy"?**
  - The government can't flip a switch to make businesses open or consumers buy things
  - High unemployment, balance sheet destruction, health concerns, business closures will delay consumer rebound
  - Some reticence on social gatherings for the remainder of this year
- **Some good news**
  - Fiscal and monetary relief – money to households, UI expansion, SBA loan forgiveness, corporate bailouts, financial market stability
  - Low gas prices, but will anyone want to travel?
  - High savings and low debt burdens before this episode
  - Pent-up demand for some segments of retail
- **Will everything be different from now on?**
  - Probably not. The same trends that were already at play will likely accelerate.
  - Increased demand for online experiences, retail store closures, PPE becomes the norm
  - Longer term, urban density may lose its appeal; tailwinds for suburban homeownership?

“V-shaped” recovery is not a likely outcome



Source: IHS Markit

Consumer sentiment collapsed in March and April as job losses mounted



Source: University of Michigan, IHS Markit

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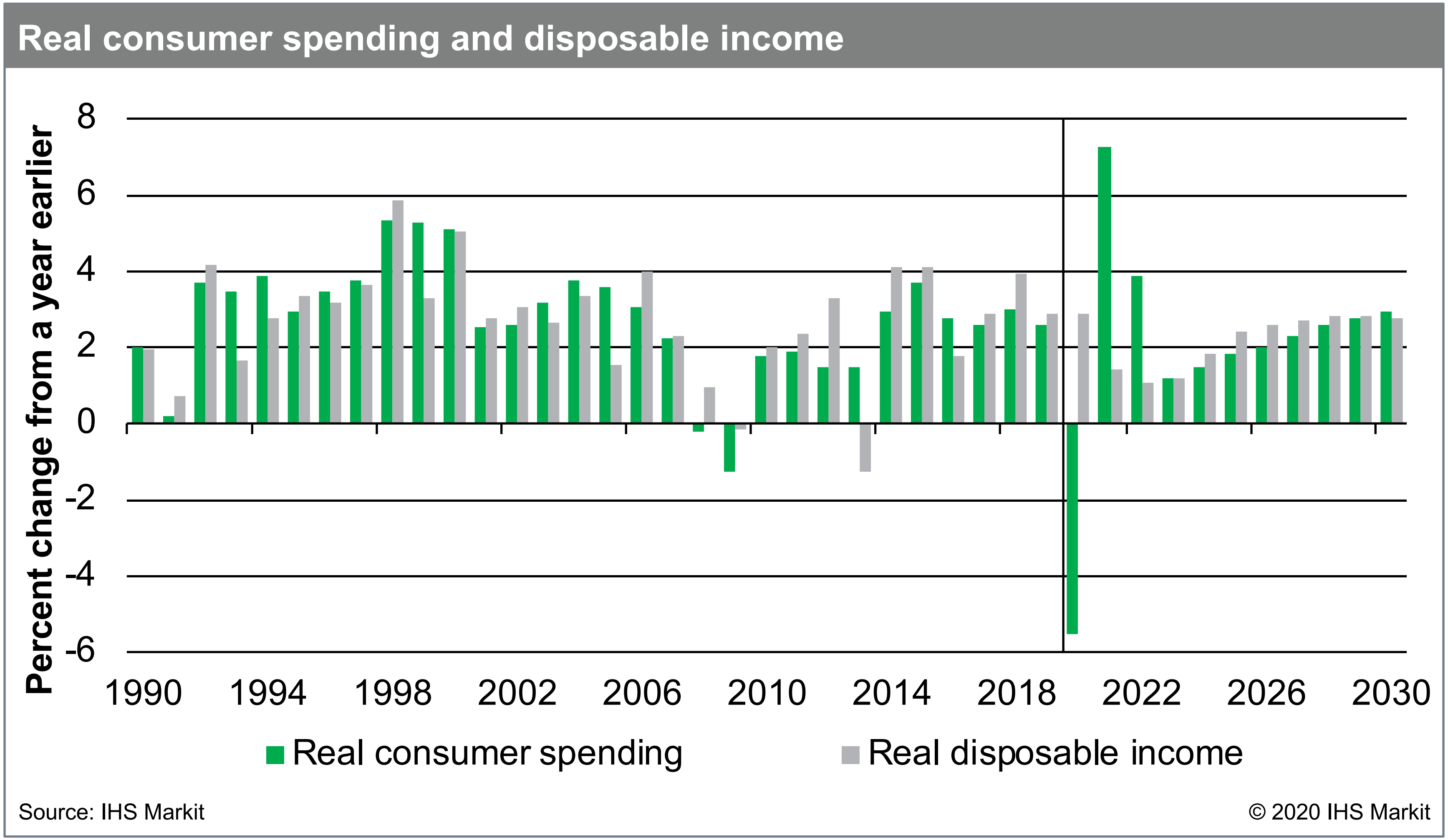
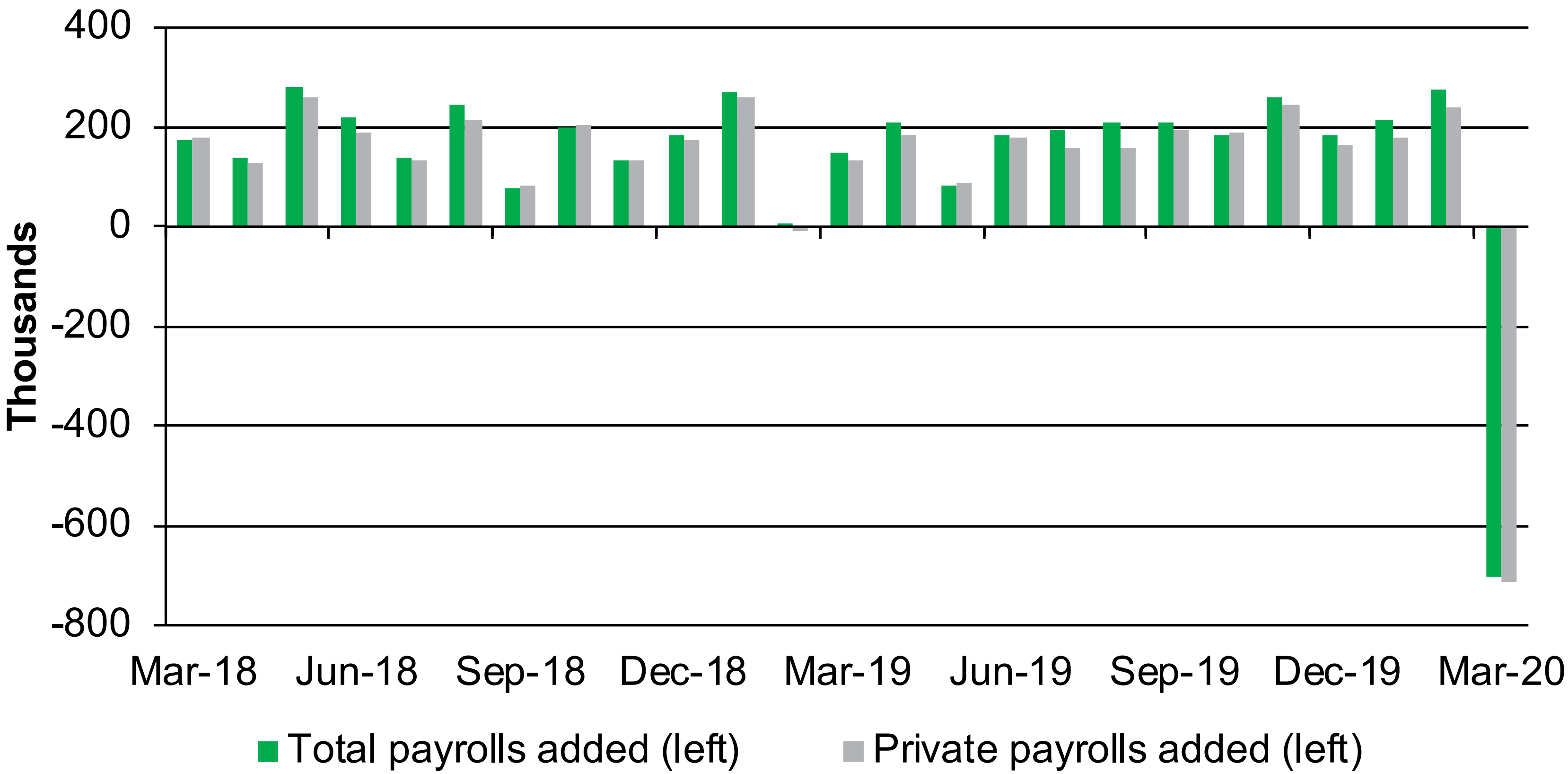
Stimulus will reinforce income but do little for consumer spending



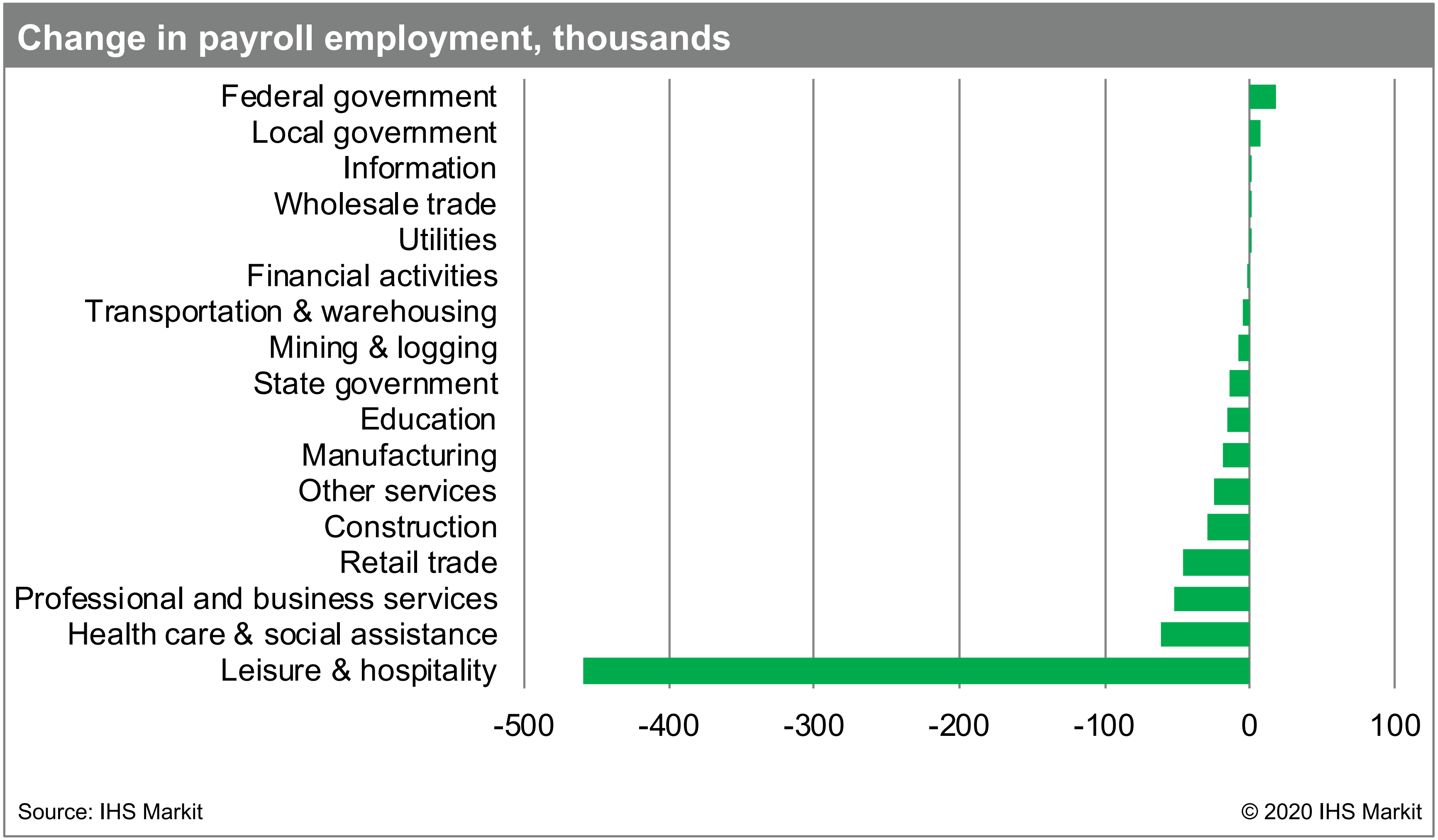
Despite a hair-raising March, the biggest hit to nonfarm payrolls won’t appear in official data until April

Change in nonfarm payrolls



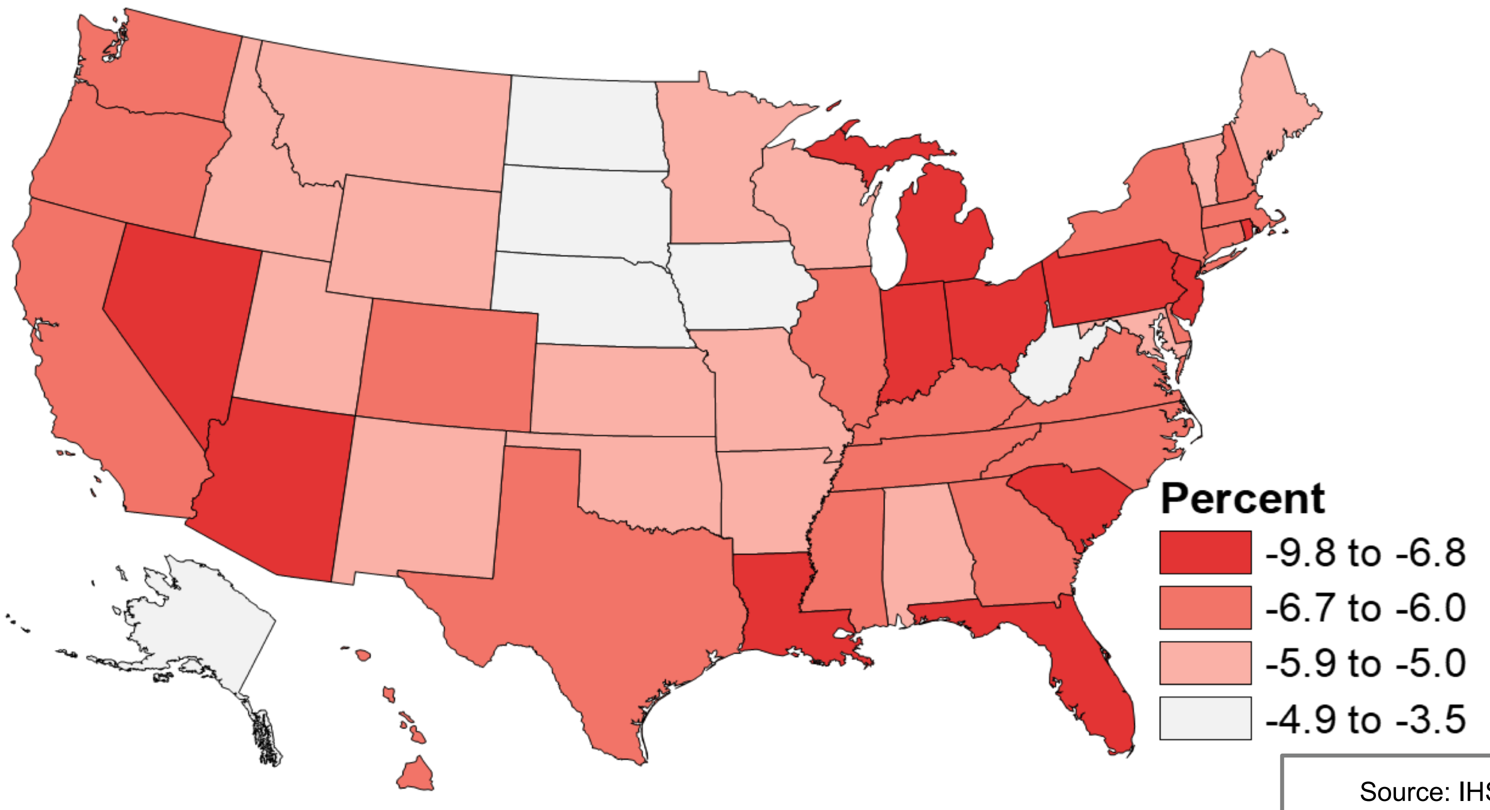
Source: IHS Markit

Most of March job losses were in leisure and hospitality



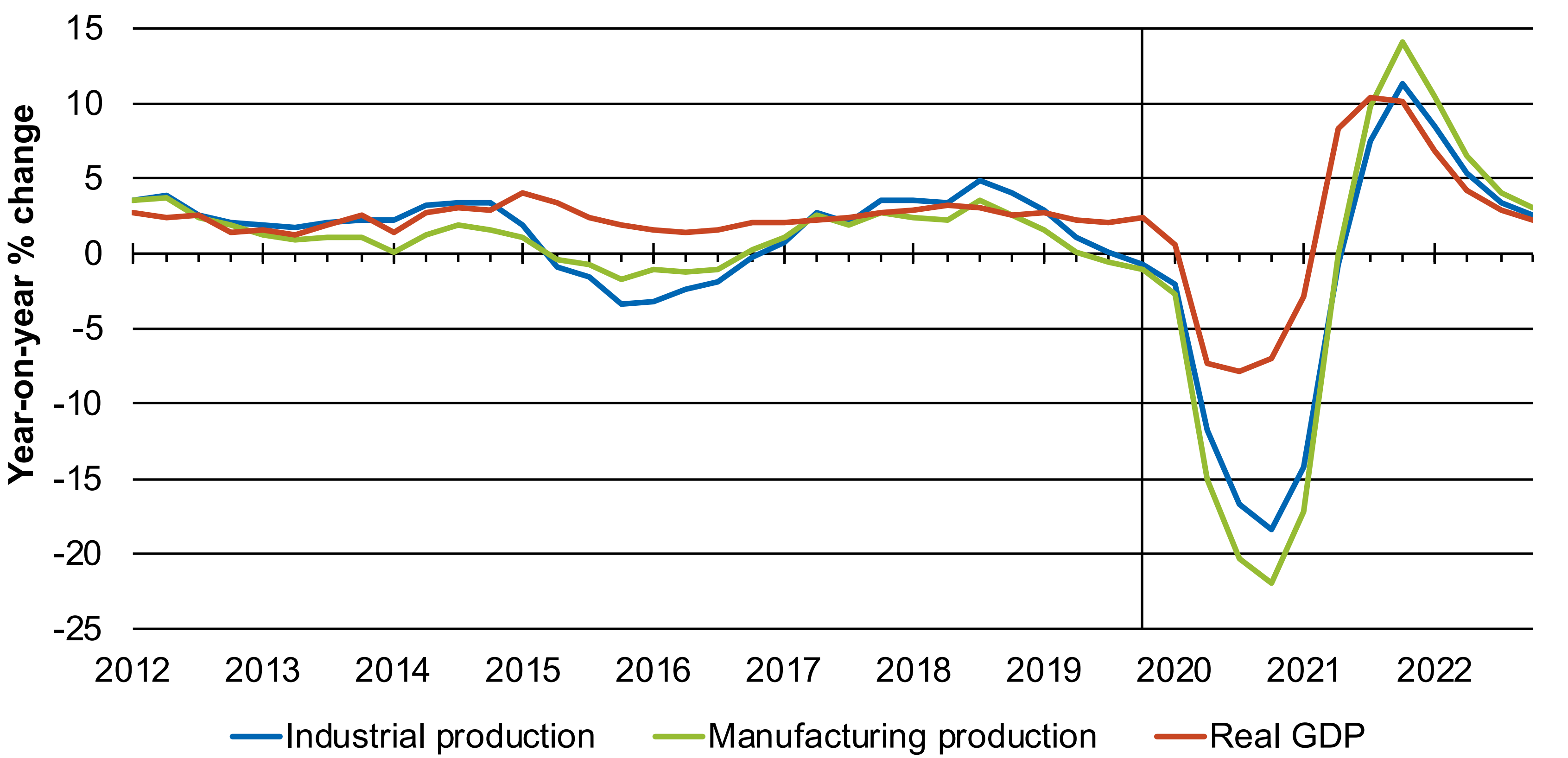
Every state will experience job losses in 2020

Employment growth, 2020 (fourth quarter over fourth quarter)



Industrial production is entering a steep downturn

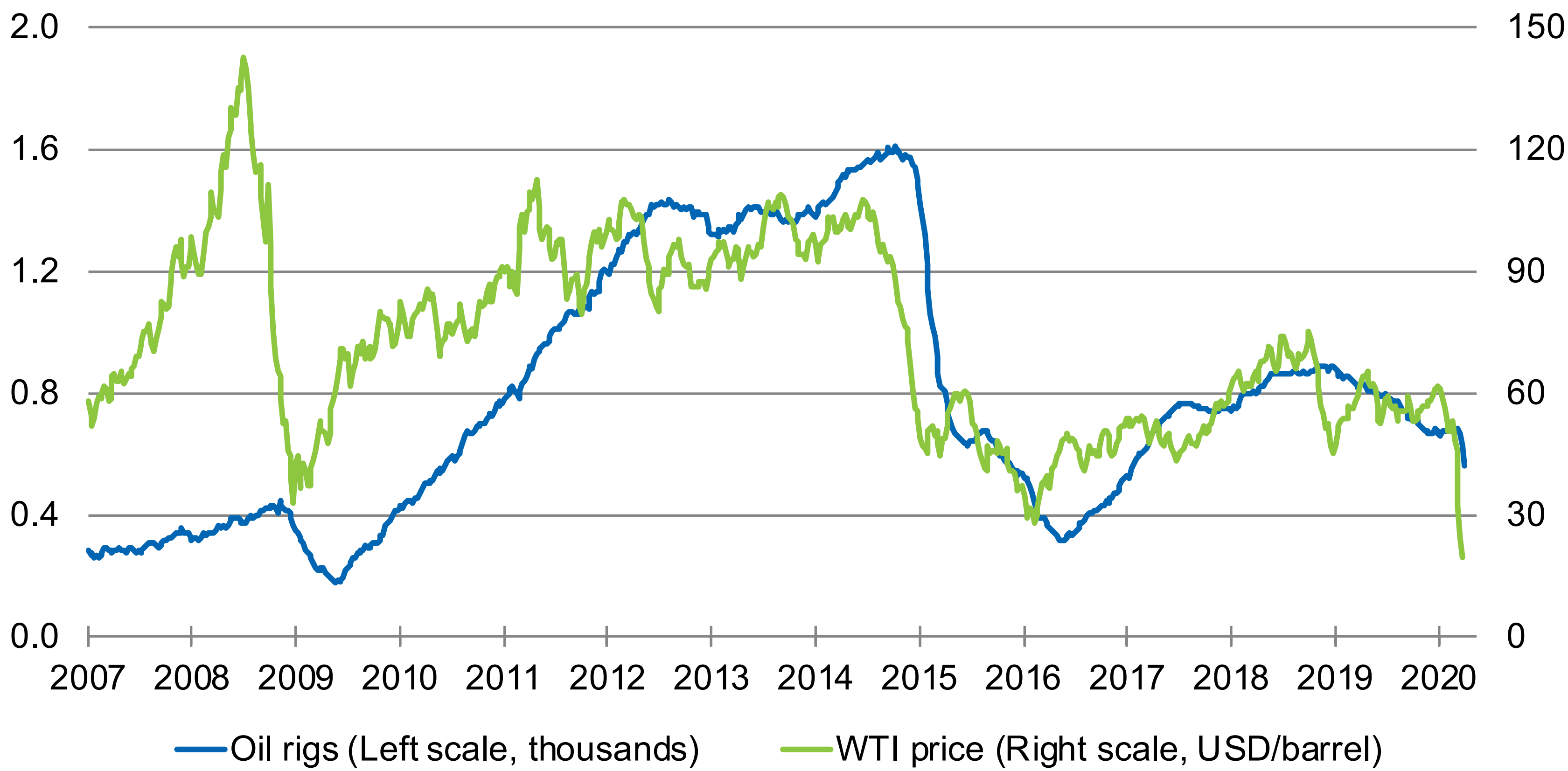
Industrial production and real GDP



Source: IHS Markit

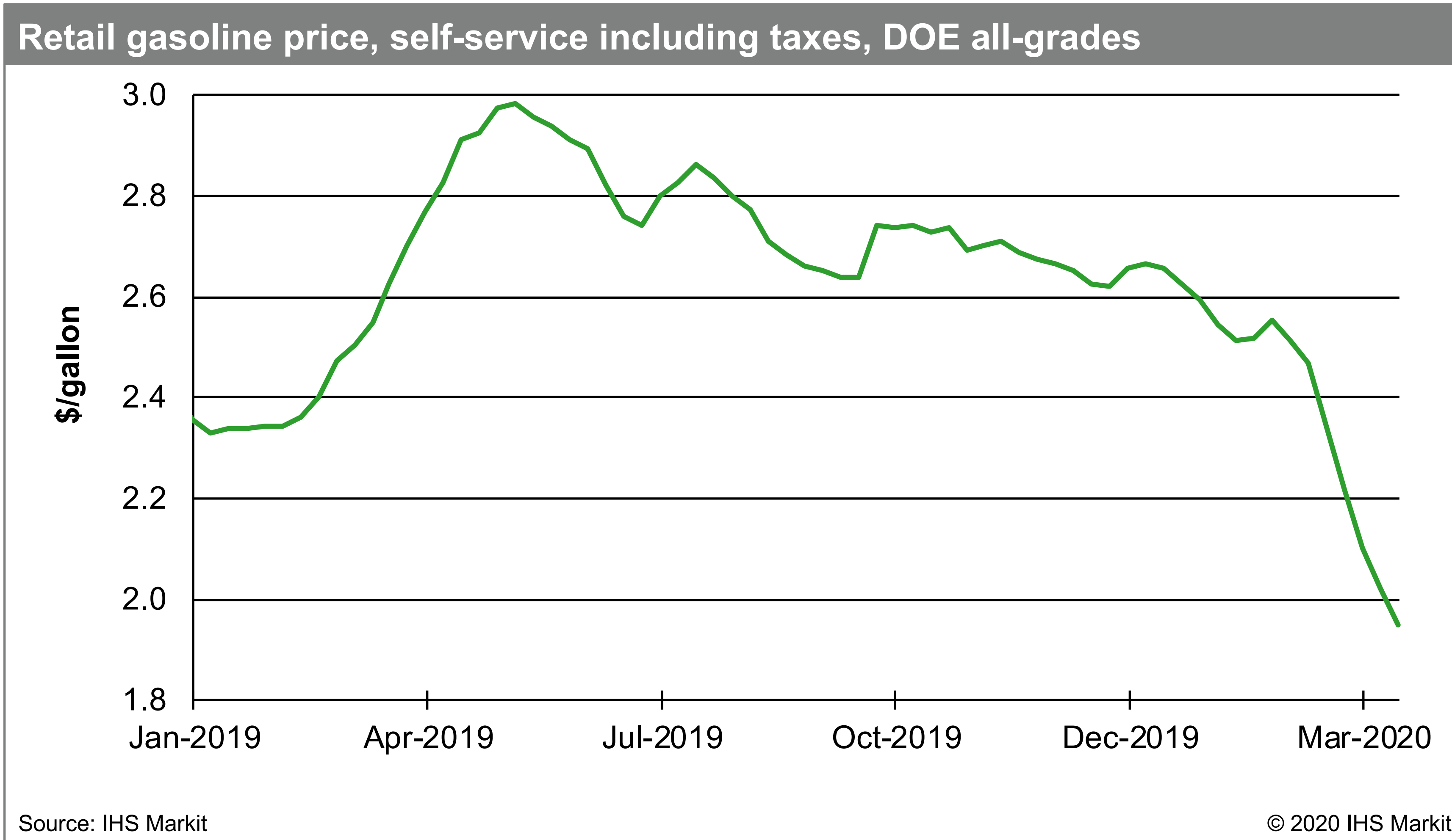
US oil drilling follows crude oil prices

Weekly oil rig count and West Texas Intermediate crude oil price

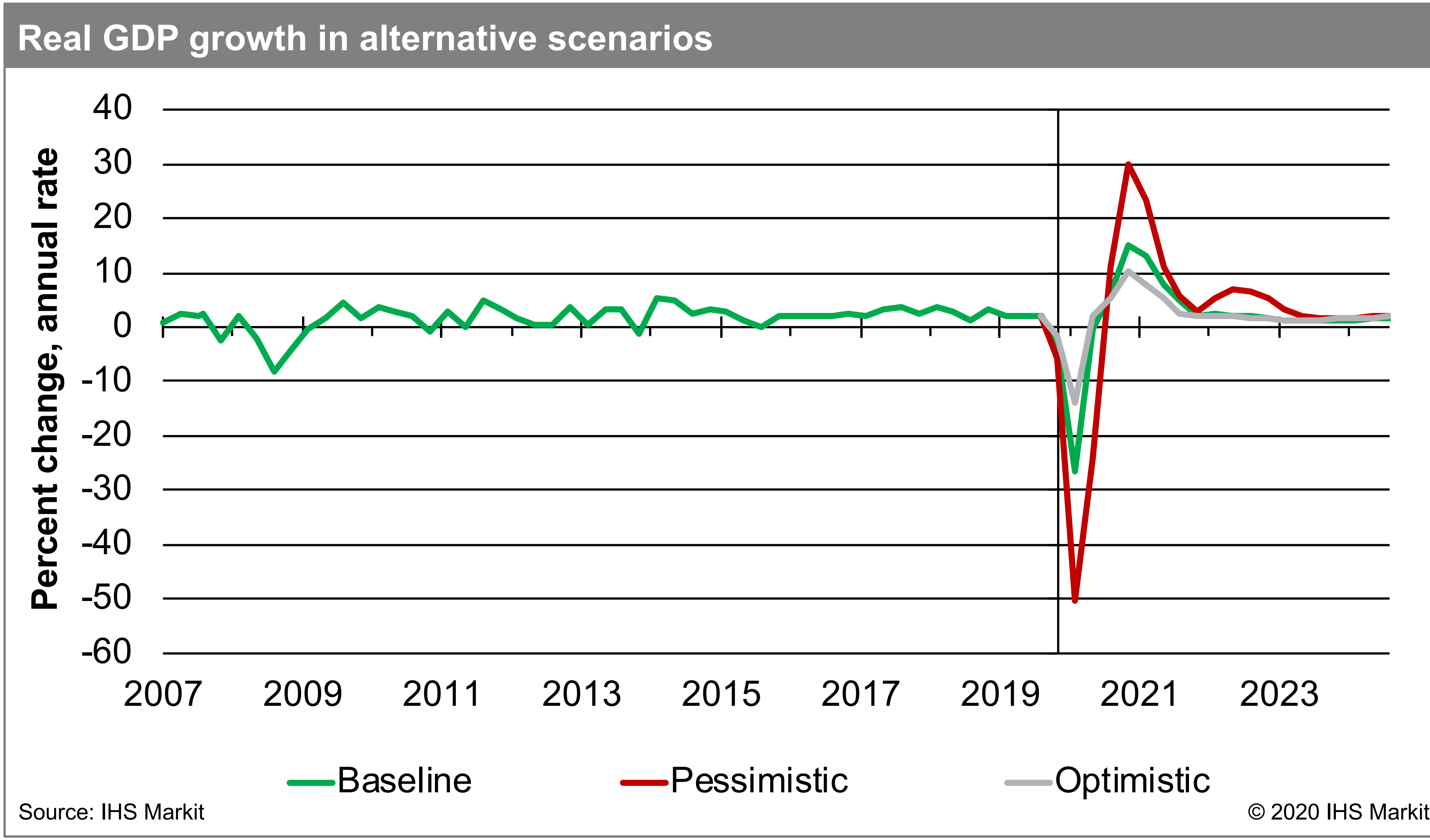


Sources: Baker Hughes and EIA

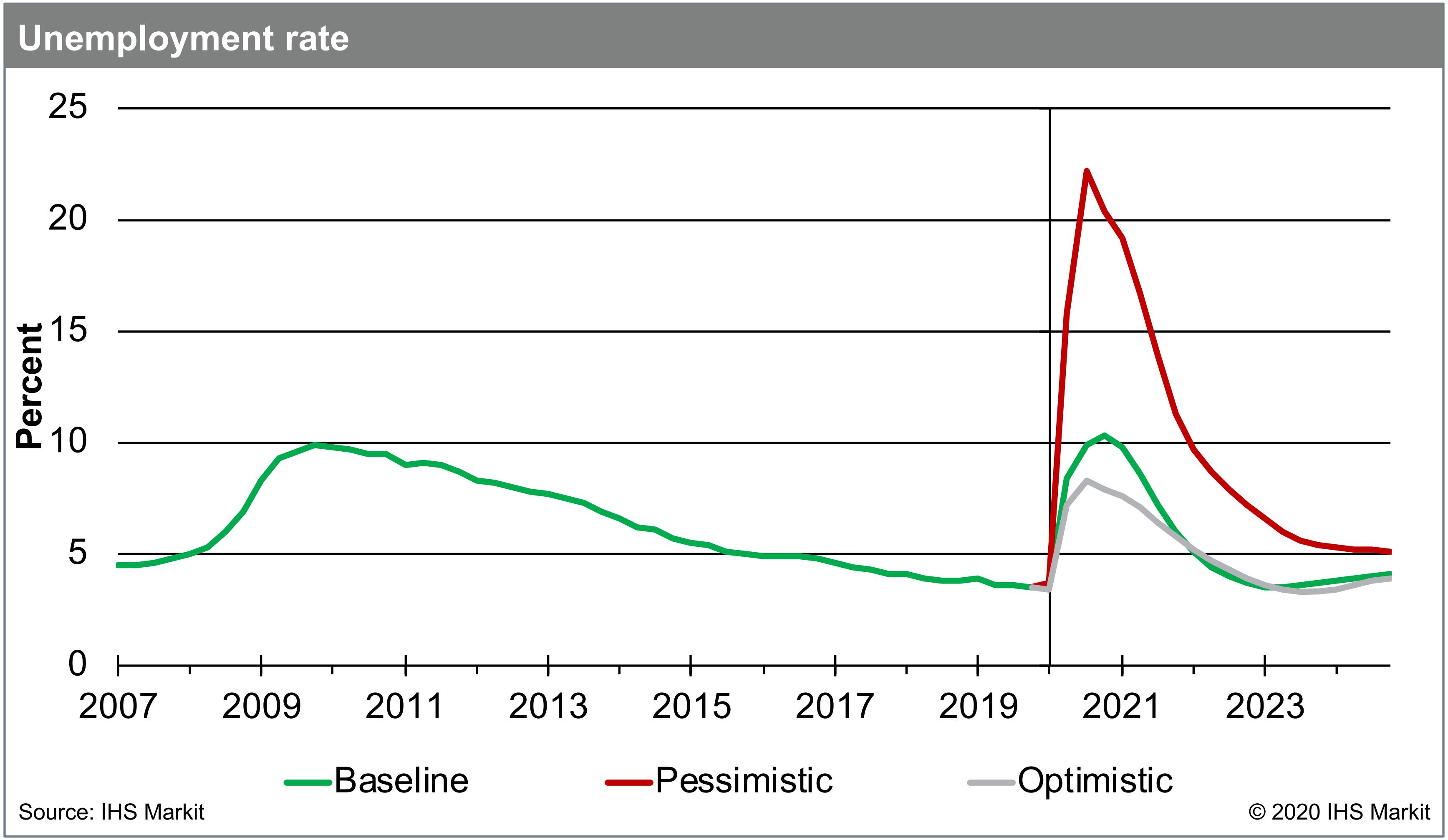
Pump prices heading downward



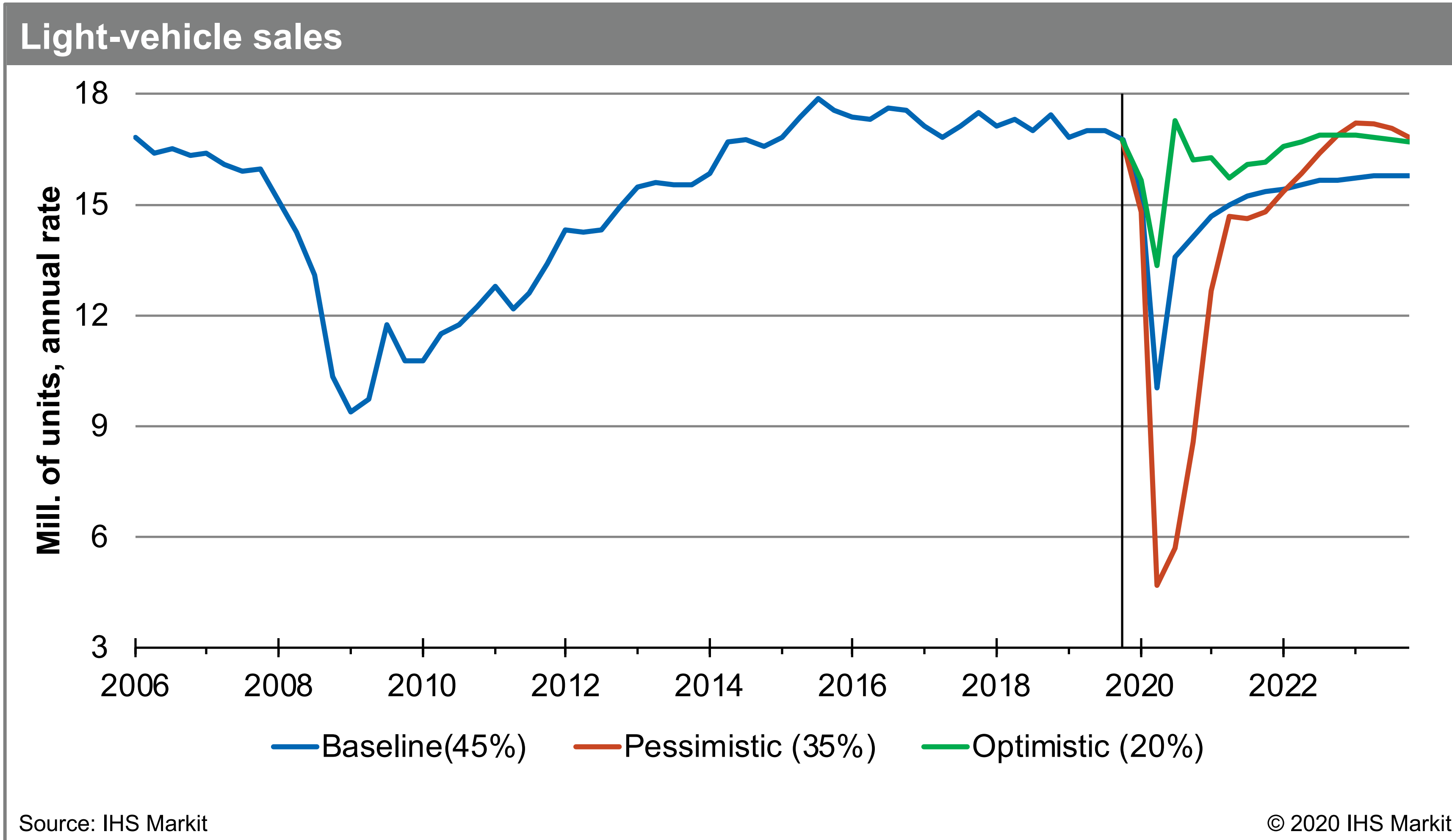
Real GDP growth in alternative scenarios



Unemployment rate alternative scenarios

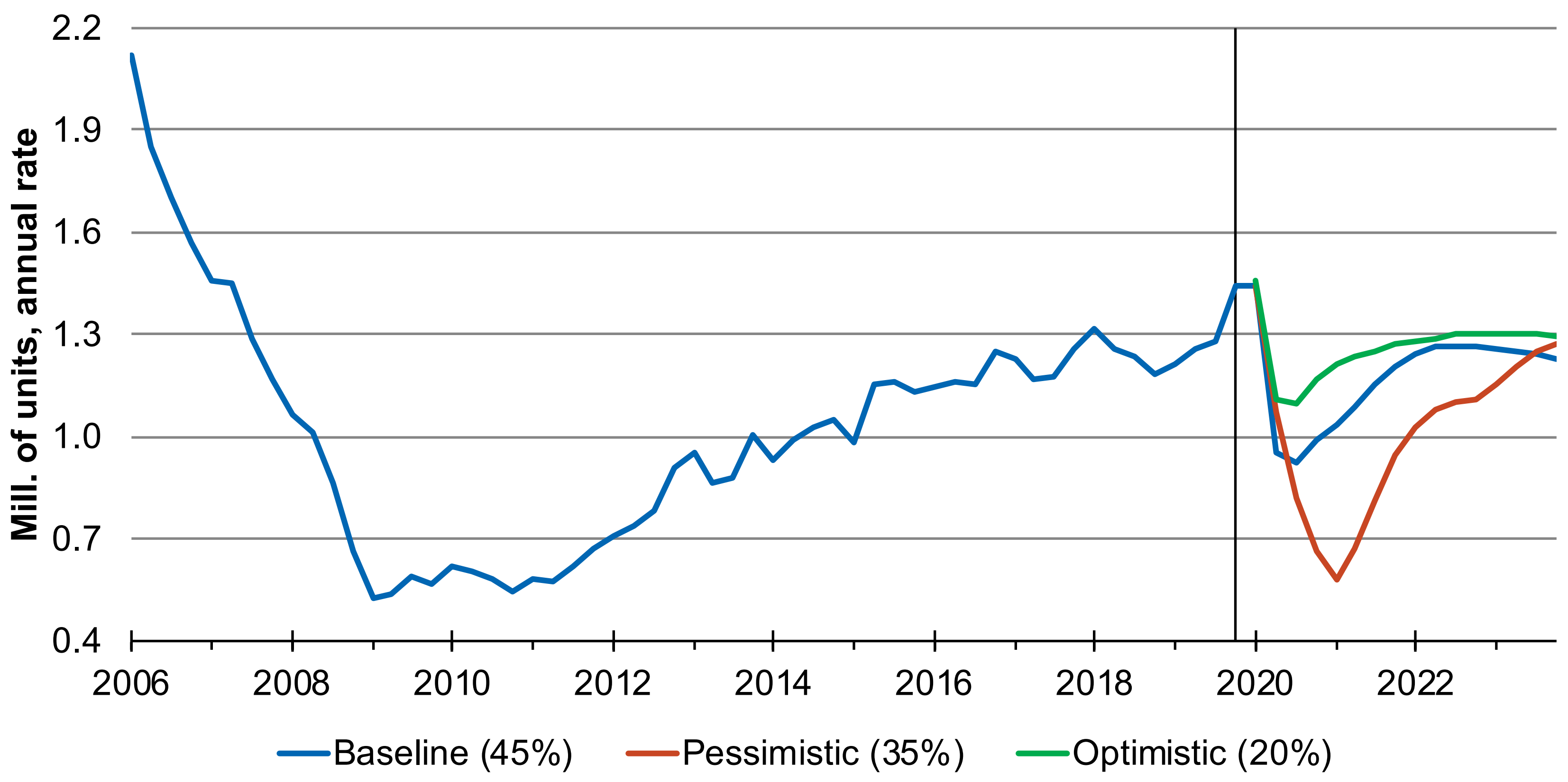


Light-vehicle sales in alternative scenarios



Housing starts in alternative scenarios

Housing starts



Source: IHS Markit

Risks to the US forecast

Scenario	Characteristics
COVID-19 causes an even larger, longer hit to production, employment, and income (Probability = 35%)	• It takes longer to bring the COVID-19 virus under control. • Consumer and business spending decline more sharply in the second and third quarters. • The peak-to-trough decline in real GDP is 22.9% over the first three quarters of 2020, compared with 8.3% in the baseline. • The unemployment rate peaks at 22.2% in the third quarter.
Faster V-shaped recovery from COVID-19 recession (Probability = 20%)	• The number of new COVID-19 cases peaks by mid-April and drops toward zero by June, allowing activity restrictions to ease. • Discovery of an effective treatment leads to better health outcomes. • The US recession is milder than in the baseline, with real GDP declining 4.1% peak to trough in the first two quarters of 2020. • Existing fiscal and monetary measures mitigate the damage to household and corporate balance sheets, expediting recovery.
Baseline forecast (Probability = 45%)	• Real GDP contracts 8.3% over the first three quarters of 2020. • The CARES Act provides fiscal support. • The federal funds rate is held near zero through 2025. The Fed pursues aggressive quantitative easing and liquidity measures. • Core inflation is mild initially, then rises to 2% in 2022.