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MarketWatch

Outside the Box

Opinion: Coronavirus has ushered in an economic ice age. When can we expect activity to heat up again?

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U.S. recession or depression isn’t yet clear, but severe pain is unavoidable

In the end, it took a microscopic protein molecule to knock out a $22 trillion U.S. economy and abruptly end the longest expansion in American history. The COVID-19 virus, which is not even a living organism, has now infiltrated the world’s economic body and the convulsions have only just begun.

The latest evidence of that in the U.S. came with the March employment report where private payrolls plummeted by 713,000, bringing a sudden end to an historic streak that saw 113 consecutive months of job growth. Most forecasters have predicted a range of -100,000 to -500,000, which are stunning numbers by themselves. But March's jobless figures turned out to be substantially higher and it suggests forecasters (and we're among them) still have no real sense of how much damage this virus is doing to the economy.

Indeed the violence of the sudden economic downturn can be seen when viewed in contrast with the strong job gains in January and February, up a hefty 220,000 and 224,000, respectively, before the earth opened up and caused nearly three-quarters of a million payrolls to disappear.

In the separate household survey, the size of the U.S. labor force shrank by 1.63 million last month as nearly 3 million American workers suddenly found themselves jobless. That kicked up the unemployment rate from 3.5% in February to 4.4% in March.

But here's the truly alarming news. Since mid-March when the BLS conducted its employment survey for the month, the economic deterioration has greatly accelerated. For that reason, the March report is by definition old news. There is no more vivid illustration of its irrelevance than the number of first time filings for unemployment insurance. In the month of March it went from about 200,000 new applications in the week ending March 7, to 3.3 million by March 21, to 6.65 million by March 28. In short, the U.S. economy in just the last two weeks was in a free fall with no end in sight. We have never seen business conditions disintegrate with such speed.

So what now? The time line for when this economy regains its footing has less to with the massive emergency fiscal and monetary policies introduced and much more to do with when we can contain the spread of this dangerous pathogen. Simply put, the virus is calling the shots here. The problem is you can't defeat the virus without doing damage to the economy in the interim. The admonition to maintain social distancing and keep away from public places means that 60% of American consumers are now hibernating at home and contributing little to growth.

And while the government is working feverishly to dole out $1,200 to individuals and larger unemployment checks, do not expect these funds to revitalize the economy anytime soon. The funds being spend (i.e., borrowed) by federal, state and local governments are absolutely staggering. But as recent consumer confidence surveys show, Americans are very fearful about their health and safety and the security of their jobs and income. These are not prerequisites for consumer spending; they are preconditions for building up savings because the outlook is both frightening and uncertain.

There is also the temptation to proclaim the U.S. economy has now entered a recession or possibly the start of a depression. But both terms seem inadequate in portraying what the economy is going through.

The intensity and warp speed of the economic deterioration seems more serious than even the Great Recession that followed the financial crisis. We have overnight entered what feels like an economic ice age. It's a deep freeze for farmers, airlines, most manufacturers, retailers, restaurants, hotels, and both the hospitality and energy industries. When pressed, this has all the earmarks of a highly compressed depression. The Great Depression unfolded in numerous waves over a four-year period (1929 – 1933). The current downturn looks more like a destructive depression, but one that is compressed into just one or two quarters.

This is a compressed depression, one triggered by a deadly virus that has effectively sidelined economic forecasting. Frankly, we are flying blind here, unable to fully wrap our heads around this culprit. Without reasonable, well thought-out assumptions, economic projections have no real value. Talk of a V-, U-, L- or W-shape recovery at this moment is an exercise in word salad.

About the best that can be said with some confidence is that there is an inverse correlation between changes in the increase of COVID-19 and when economic activity picks up again. Once people see the corner has been turned and the virus is no longer a major threat, consumer spending and business activity will resume.

For now, all we can do is look at three possible scenarios:

Scenario A: The infection and mortality rates of COVID-19 peak by later spring or summer of 2020 and markedly turn down. Pharma produces an anti-viral vaccine or other effective immune response that greatly reduces the danger of a COVID-19 relapse next season. In this case, the $10 trillion plus fiscal and monetary packages will bring about a healthy rebound of 4% to 6% growth in the final quarter of 2020. For the year as a whole, however, GDP growth will be minus 2%.

Scenario B: The infection and mortality rates peak at the end of the year. The pharmaceutical industry produces an anti-COVID-19 vaccine but not enough in time to prevent another upsurge in casualties in the fall. The fiscal and monetary package will have only a modest impact on the U.S. economy in 2020. GDP output will fall by a 24% rate in the second quarter, followed by a relatively modest 3% growth in the third quarter, and a 5% increase in the final three months of the year. Overall GDP output for 2020 will be minus 3.5%. This represents our baseline forecast.

Scenario C: The infection and mortality rates peak in mid-2021. The pharmaceutical industry distributes an anti-viral vaccine or other effective immune response that ends the threat posed by COVID-19 in the summer of 2021. In addition, the fiscal and monetary package has no discernable impact on the economy in 2020 for two reasons:

(1) Americans continue to hunker down until receiving the vaccine because this particular virus has spread faster and shows nearly the same mortality rate as the Spanish Flu pandemic of 1918.

(2) An economic downturn that lasts more than a year will result in many business casualties with multiple bankruptcies and significant industry consolidations. The resulting dislocation will mute any recovery in 2021. Given the permanent changes expected in the economic and business landscape, we do not see a quick rebound in economic activity in 2021. In this scenario GDP output will remain negative for the next three quarters of 2020, with overall output dropping to negative 7%, and a weak rebound no greater than 2.5% in 2021.

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