THE ECONOMIC OUTLOOK GROUP

475 Wall Street
PRINCETON, NEW JERSEY 08540 Tel: 609 - 529 - 1300
www.economicoutlookgroup.com

ECONOMIC TALKING POINTS

Bernard Baumohl
Chief Global Economist

April 3, 2020

The Economic Ice Age Has Begun. How Long Will It Last?

In the end, it took a microscopic protein molecule to knock out a $22 trillion US 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 US 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.

Chart 1. Unemployment rate, seasonally adjusted, March 2018 – March 2020

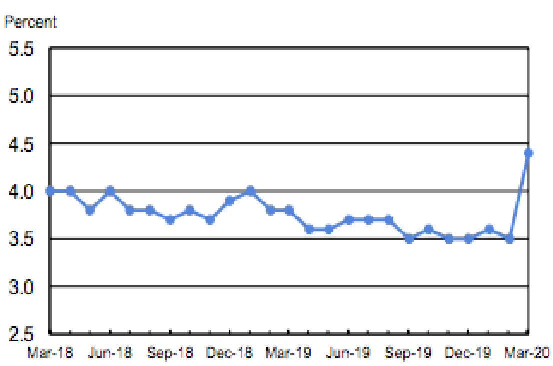
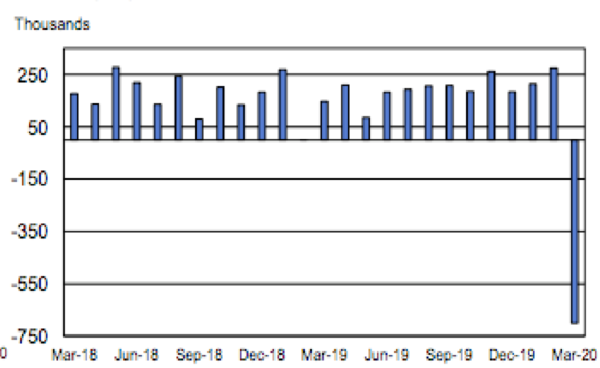
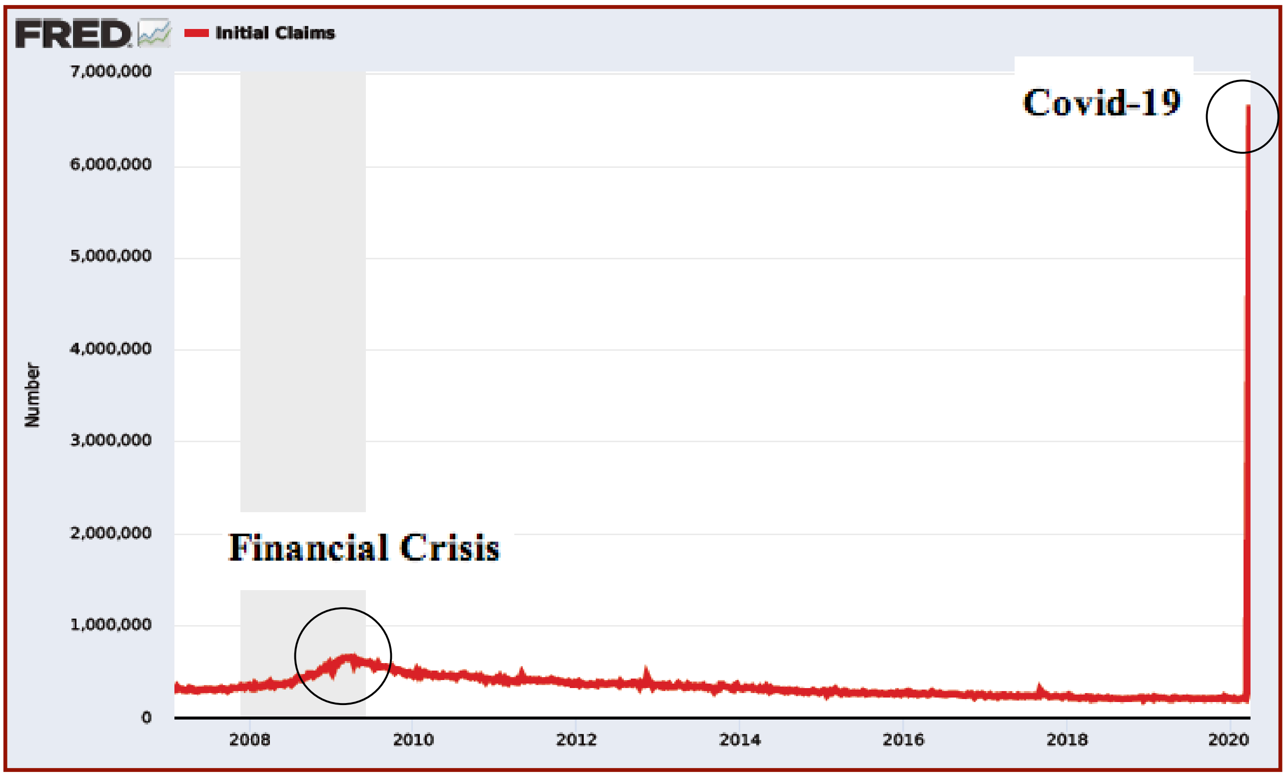


Chart 2. Nonfarm payroll employment over-the-month change, seasonally adjusted, March 2018 – March 2020



In the separate household survey, the size of the 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 28th. In short, the US 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, it's the virus that's 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 65% of the American economy is 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 any time soon. The funds being spend (i.e., borrowed) by federal, state and

local governments are absolutely staggering. But as recent consumer confidence surveys have show, Americans are very fearful about their health and safety and the security of their jobs and income. These are not the 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 US 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 speed of the economic deterioration feels 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 to just one or two quarters.

Not only is this deadly virus in the process of producing a compressed depression, it has also effectively sidelined economic forecasting. Frankly, we economists are flying blind nowadays, unable to fully wrap our heads around this bizarre culprit. In the absence of some 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 we can say with some confidence is that there is an inverse correlation between changes in the increase of Covid-19 victims and when economic activity should pick 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 late spring or summer of 2020, and then markedly turns down. Pharma produces an anti-viral vaccine or other effective immune response that greatly reduces the risk 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. Pharma produces an anti-Covid-19 vaccine but not enough in time to prevent another upsurge in casualties this fall. The fiscal and monetary package will have only a modest impact on the economy in 2020. GDP output will fall by at a 24% rate in 2Q, followed by a relatively modest 3% growth in 3Q, and a 5% increase in the final three months. 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. Pharma distributes an anti-viral vaccine or other effective immune response that ends the threat posed by this virus next summer. The fiscal and monetary package will have no discernable impact on the economy in 2020 and much of 2021 for two reasons.

(1) Since this particular virus appears to spread faster and shows nearly the same mortality rate as the Spanish Flu pandemic of 1918 did in the US, Americans will continue to hunker down until the vaccine becomes widely available.
(2) An economic downturn that lasts more than a year will result in many business casualties. The result will be a surge in bankruptcies and lead to industry consolidations. Under this scenario, the business and economic landscape will undergo permanent changes and the dislocations that follow will delay a meaningful rebound in economic activity 2021. GDP growth under such circumstances is likely to remain negative for the next three quarters of 2020, with overall output dropping to minus 7%, and limit the recovery in 2021 to no greater than 2.5%.

United States

	I 2019	II 2019	III 2019	IV 2019	I 2020	II 2020	III 2020	IV 2020	I 2021	II 2021	III 2021	IV 2021	I 2022	II 2022	III 2022	IV 2022
Real Gross Domestic Product (GDP):																
%	3.1	2.0	2.1	2.1	0.8	-23.7	4.2	4.4	2.6	4.1	2.7	3.1	1.5	2.2	2.0	2.1
Personal Consumption Expenditures:																
PCE %	1.1	4.6	3.2	1.8	1.4	-18.1	5.1	4.5	2.8	4.4	3.2	2.7	1.7	2.9	2.3	2.0
Inflation, end of period, year-over-year:																
CPI %	1.9	1.6	1.7	2.3	2.1	-4.3	0.6	1.8	2.6	3.0	2.5	2.1	2.4	2.5	2.3	2.2
Unemployment Rate (end of period):																
%	3.8	3.7	3.5	3.5	4.4	11.5	7.1	7.5	7.1	6.8	6.4	6.2	6.0	6.0	5.8	5.8
Non-farm Payrolls, monthly avg. thousand:																
	174	152	188	210	-71	-335	-85	38	85	110	135	140	135	120	110	115
Treasury 10-yr Note Yield % (end of period):																
	2.42	2.00	1.65	1.88	0.63	0.70	1.00	1.25	1.80	2.00	2.55	2.80	2.80	2.95	3.00	3.20
Federal funds rate % (end of period):																
	2.38	2.38	1.88	1.63	0.13	0.13	0.13	0.13	0.13	0.63	1.13	1.13	1.63	1.88	1.88	1.88

GDP Growth - Global Economy

Country	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
US	2.6	1.6	2.2	1.8	2.5	2.9	1.6	2.4	2.9	2.3	-3.0	3.0	2.3
Eurozone	1.7	1.4	-0.9	-0.3	1.2	1.6	1.7	2.5	1.9	1.2	-2.0	0.9	1.2
United Kingdom	1.7	0.7	0.3	1.8	2.9	2.2	1.9	1.9	1.3	1.4	-1.0	1.0	1.3
Japan	4.6	-0.4	1.6	1.5	-0.1	1.1	1.0	1.9	0.8	0.4	-0.9	0.9	0.8
Canada	3.1	3.1	1.7	2.2	2.5	0.9	1.4	3.0	1.9	0.9	-1.9	0.9	1.5
India	8.4	8.6	6.7	4.9	7.4	8.0	8.1	7.2	6.8	3.2	4.1	6.1	6.2
China	10.5	9.5	7.8	7.7	7.3	6.9	6.7	6.8	6.6	6.1	3.4	5.8	5.6
Brazil	7.5	2.7	0.9	2.3	0.1	-3.5	-3.5	1.2	1.2	-1.4	0.7	1.8	1.7
Mexico	5.2	4.0	3.9	1.4	2.3	2.7	2.7	2.4	2.1	-0.1	-1.8	1.4	1.2
Australia	2.8	2.6	3.6	2.4	2.6	2.5	2.4	2.4	2.7	0.0	-1.8	2.2	2.3
Russia	4.0	4.3	3.4	1.3	0.6	-2.8	-0.2	1.6	2.5	1.3	-0.5	1.3	0.9
World	4.2	3.1	2.5	2.6	2.8	2.8	2.6	3.4	3.2	2.6	-0.5	2.2	3.0