

US EXECUTIVE BRIEFING

Global Coronavirus Recession will leave a scar on the economy

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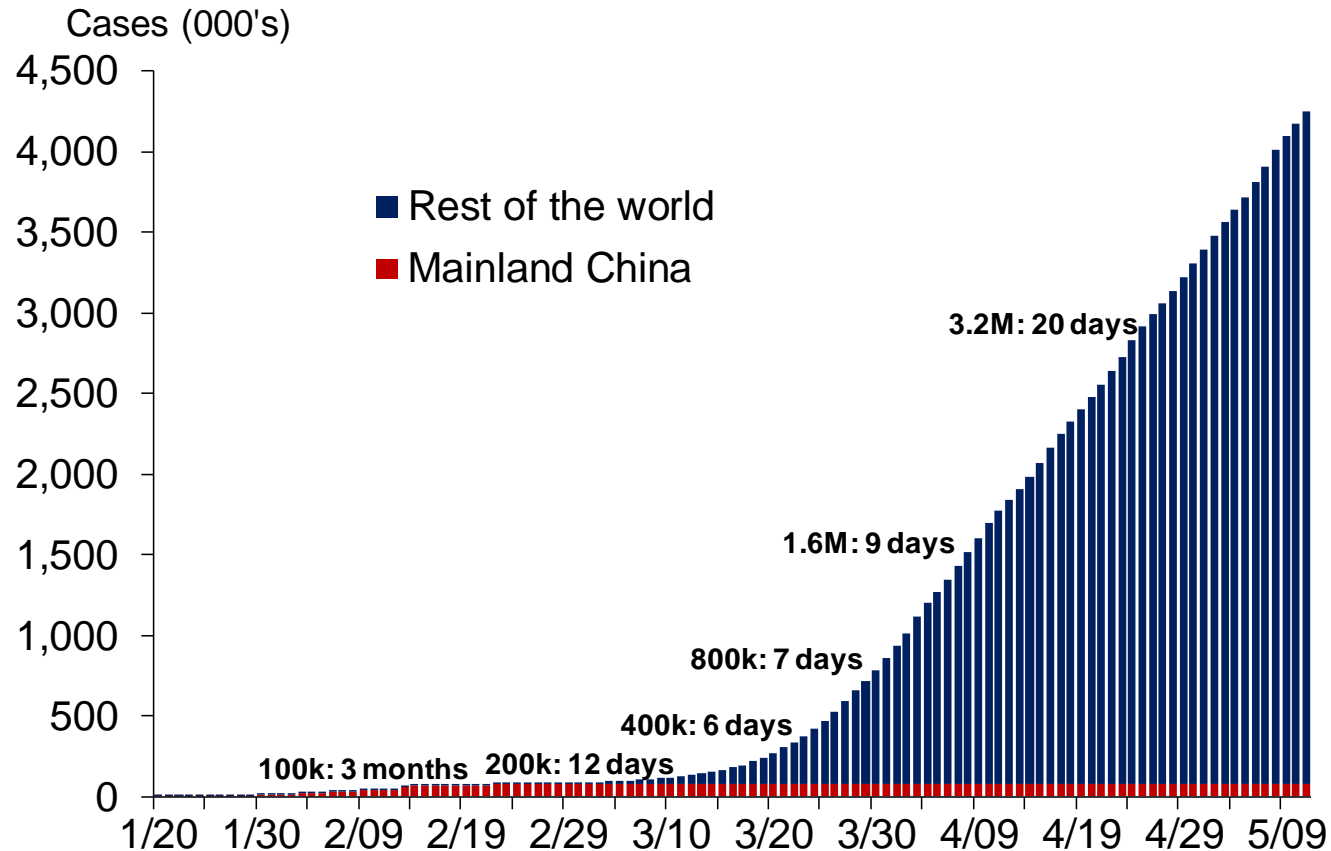
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Coronavirus: Reaching 5 million global cases

Spread of coronavirus across the globe

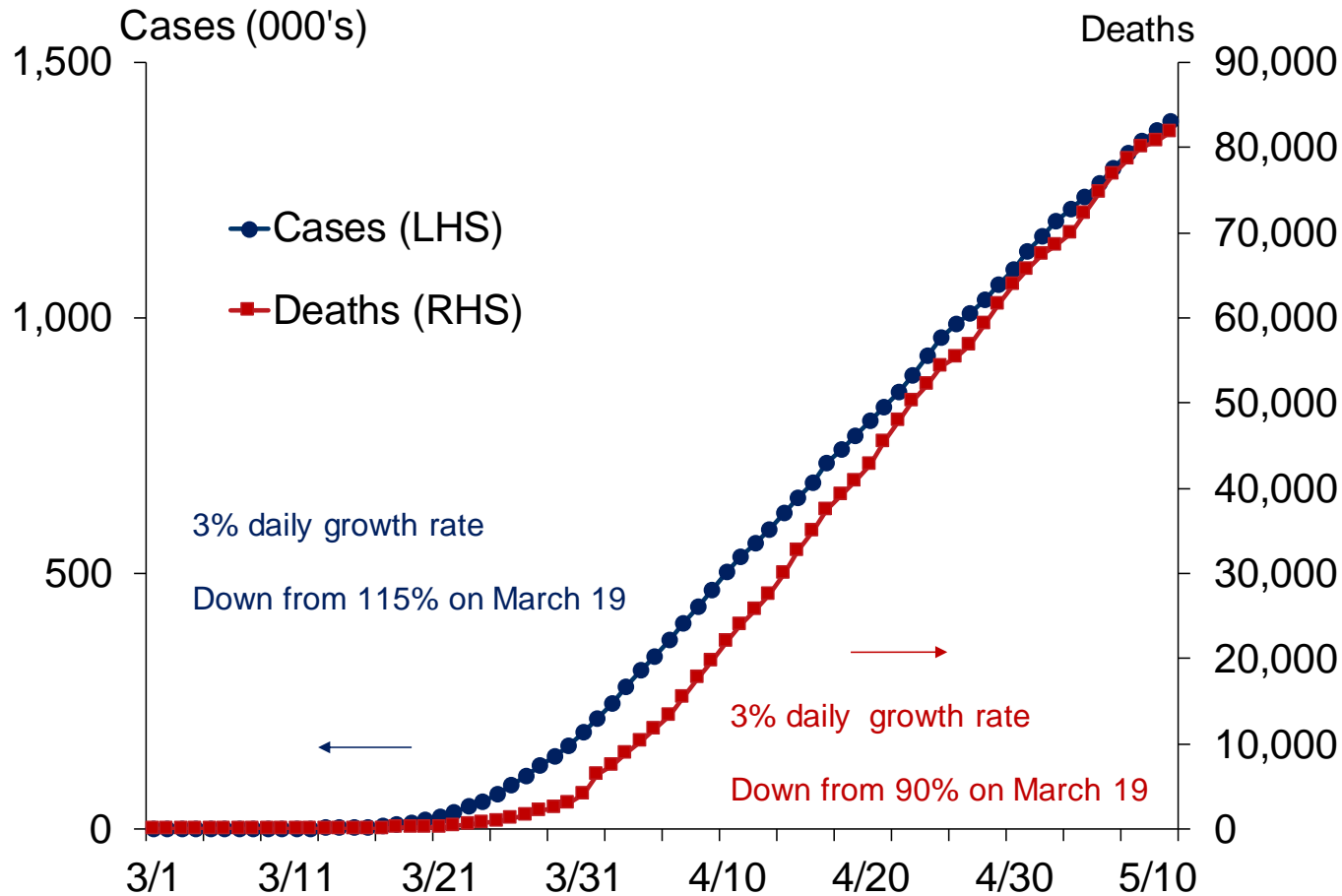


Source : Oxford Economics/WHO

*As of May 12th, 2020

“Flattening the curve” is extremely difficult in the US

US: The coronavirus outbreak at national level

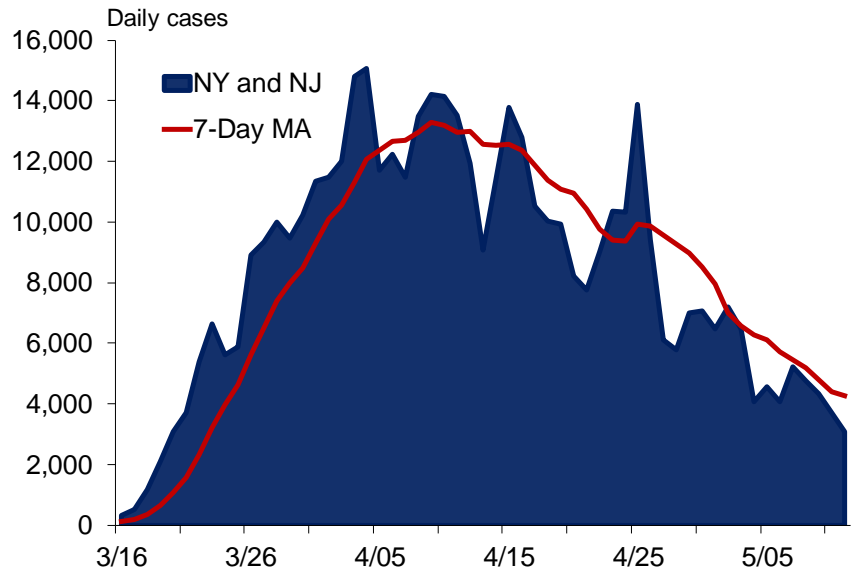


Source : Oxford Economics/COVID Tracking Project

As of May 12th, 2020

Encouraging news from NY/NJ but rest of country is lagging

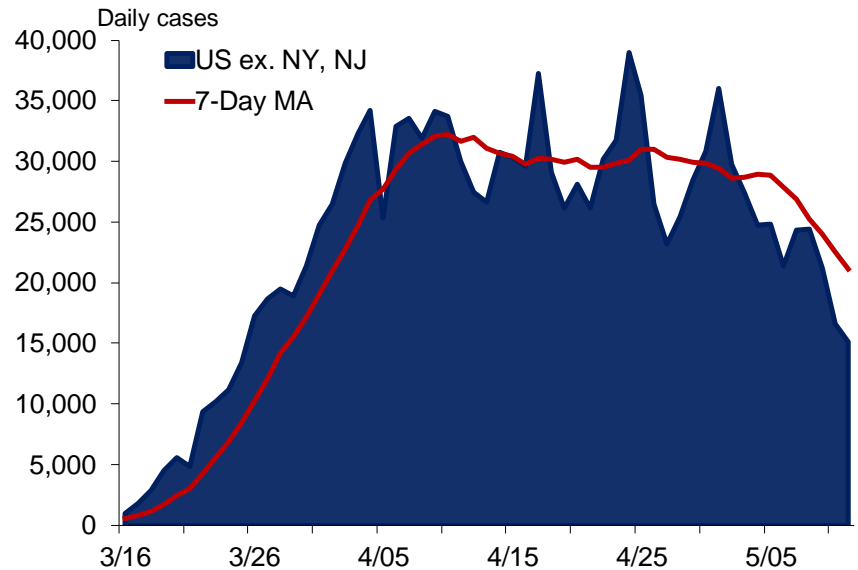
US: New COVID cases in New York, New Jersey



Source : Oxford Economics/NY.gov/NJ.gov

*As of May 12th, 2020

US: New COVID cases ex. New York, New Jersey

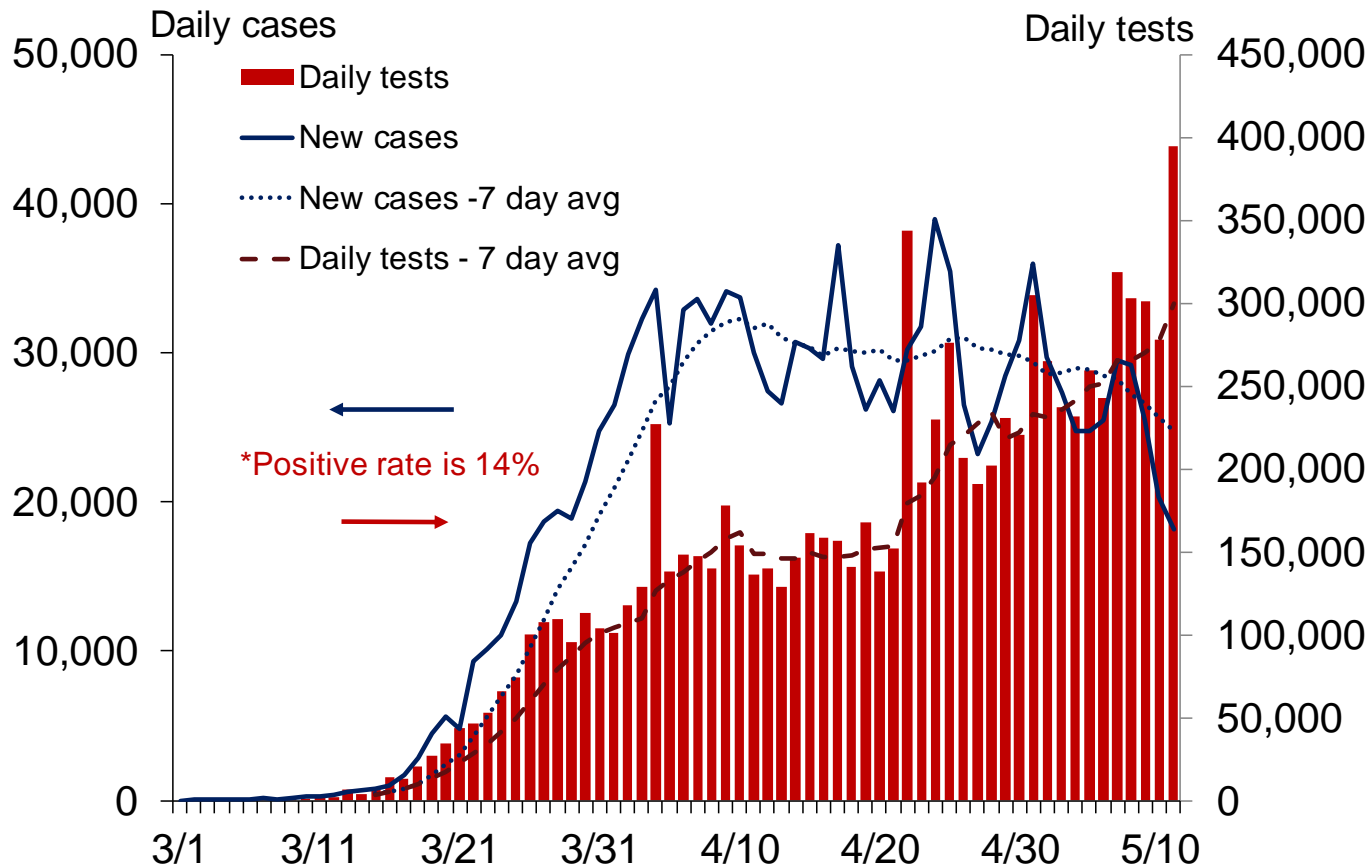


Source : Oxford Economics/State websites

*As of May 12th, 2020

Increased testing trend is also encouraging

New US coronavirus cases & testing*



Source : Oxford Economics/COVIDTRACKING

*As of May 12th, 2020

Economics of 'fear' + Economics of 'sudden stops'

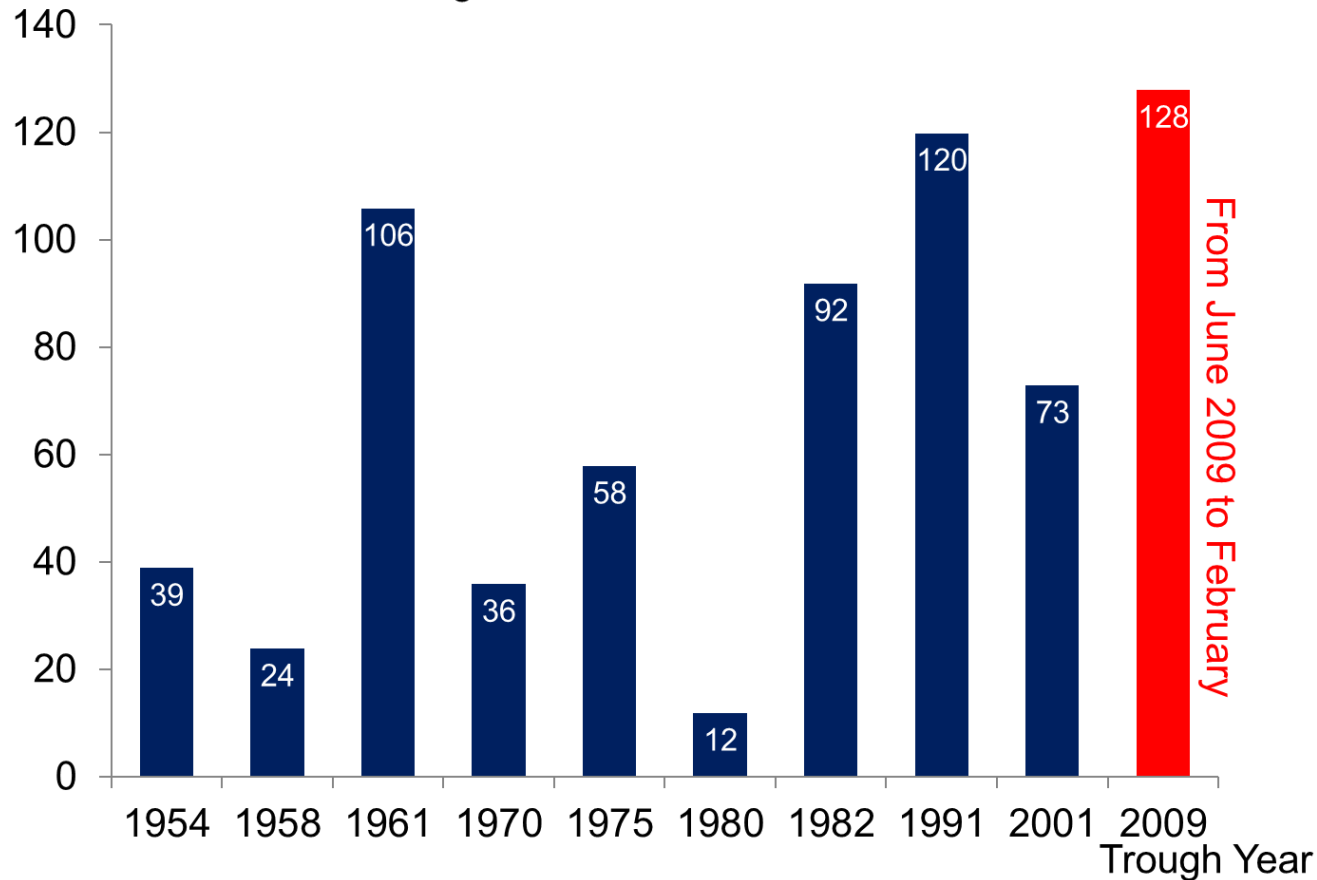


GCR hit the US with tremendous force

Longest expansion on record is over

US: The longest economic expansion on record

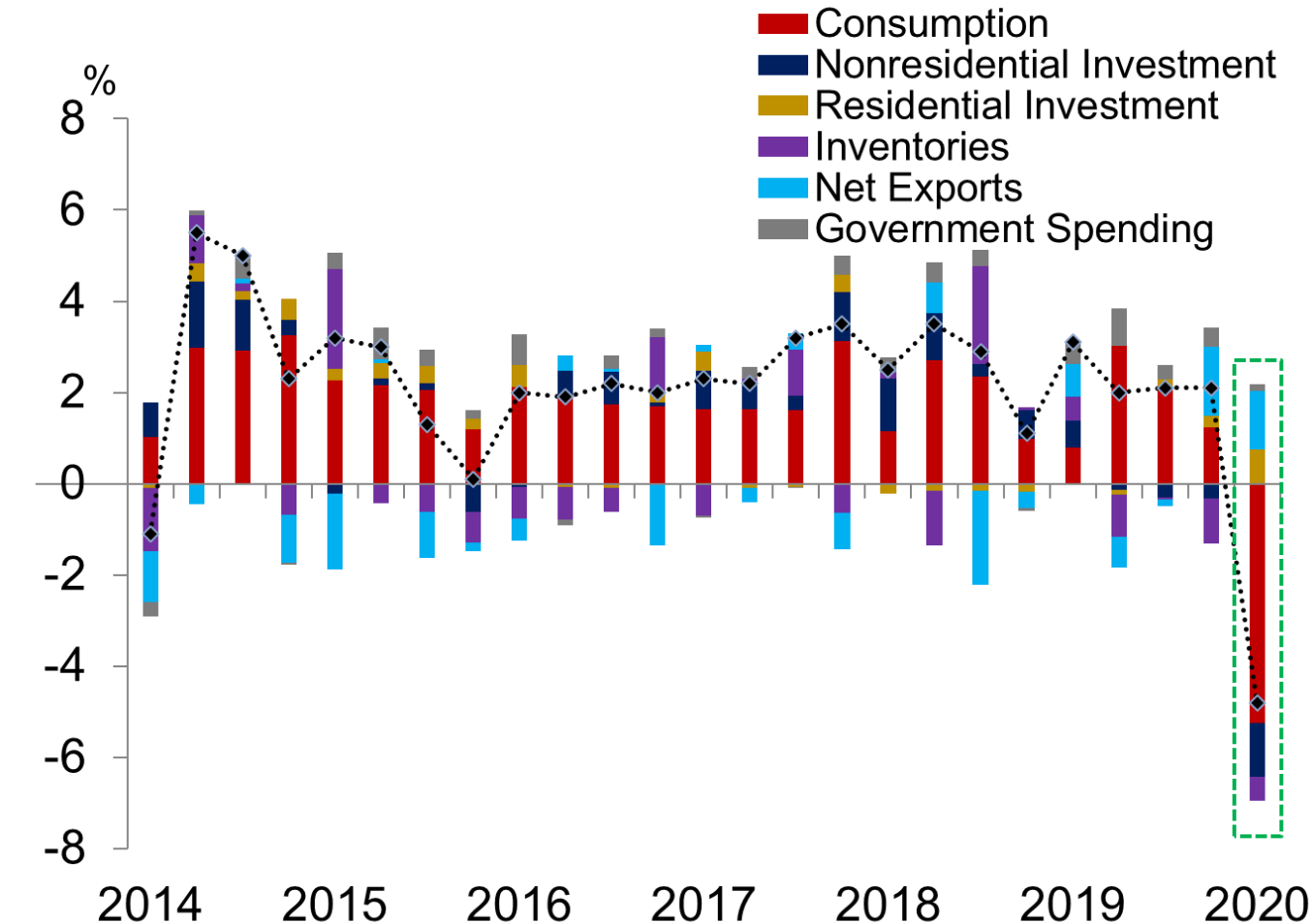
Number of months, Trough to Peak



Source : Oxford Economics, NBER

With consumer spending suffering its worst hit since 1980

Real GDP Growth Contribution

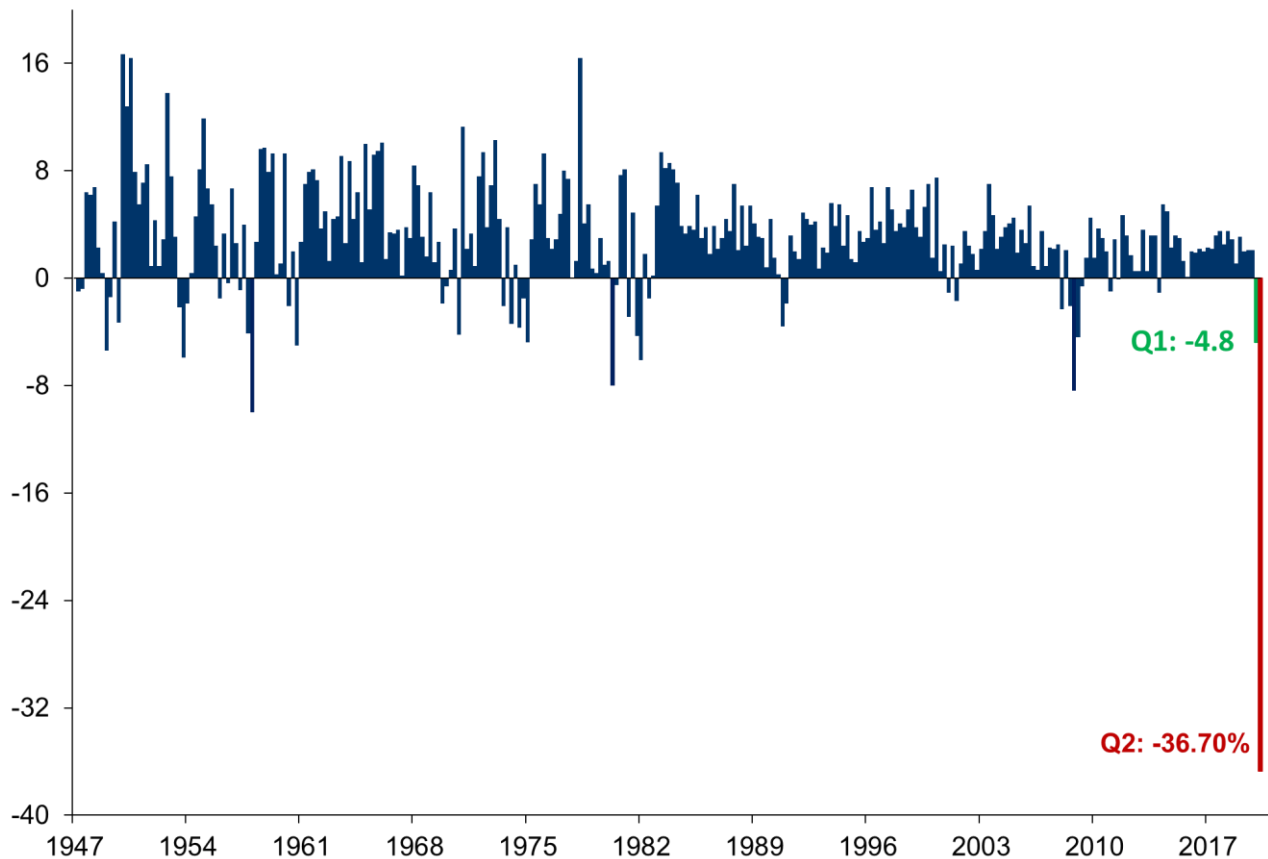


Source : Oxford Economics/Haver Analytics

GCR has it the US with tremendous force

US: Real GDP growth

Percent change, q/q annualized

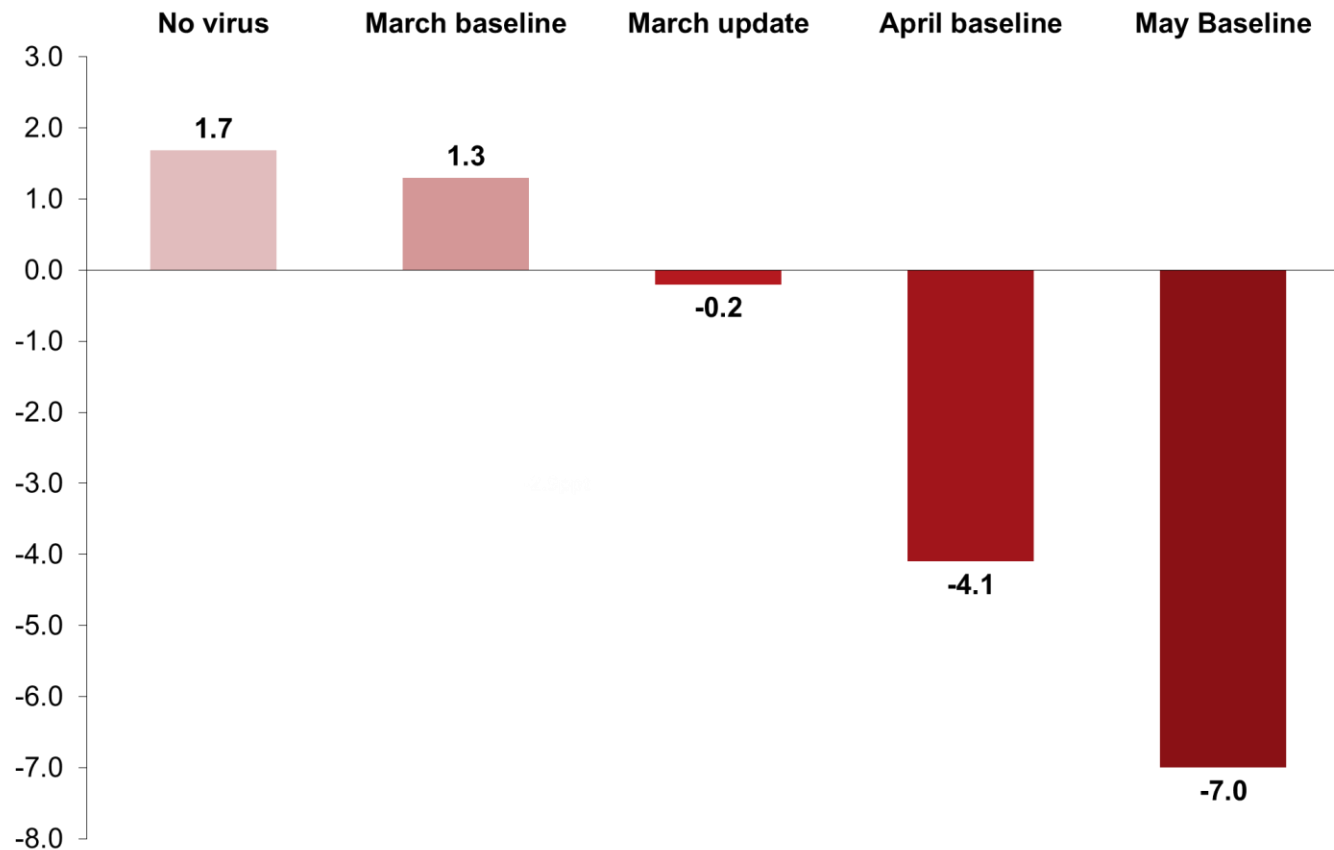


Source : Oxford Economics/Haver Analytics

A severe output contraction in 2020

US GDP growth in 2020

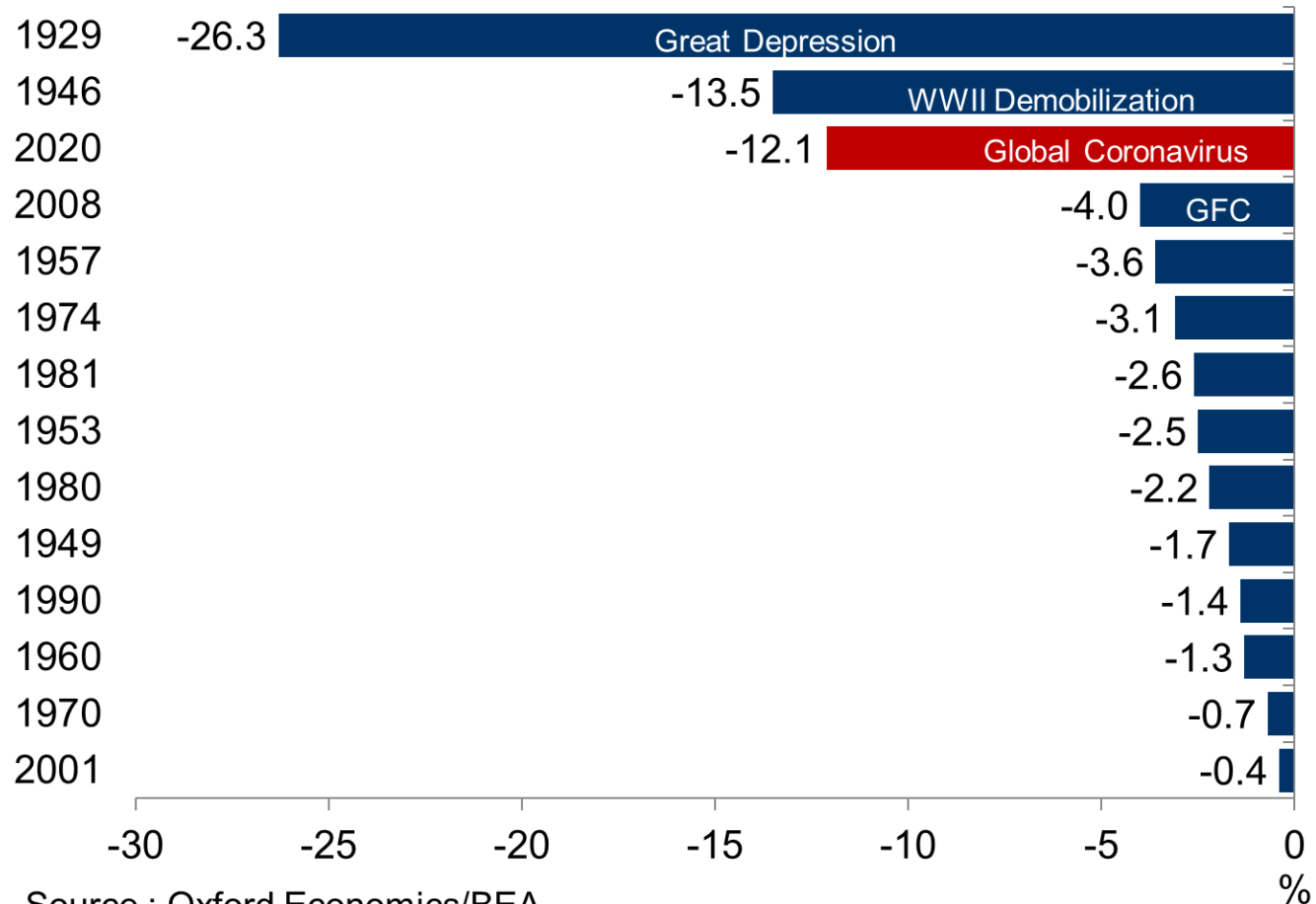
% change



Source : Oxford Economics

Sharpest drop in activity since WWII

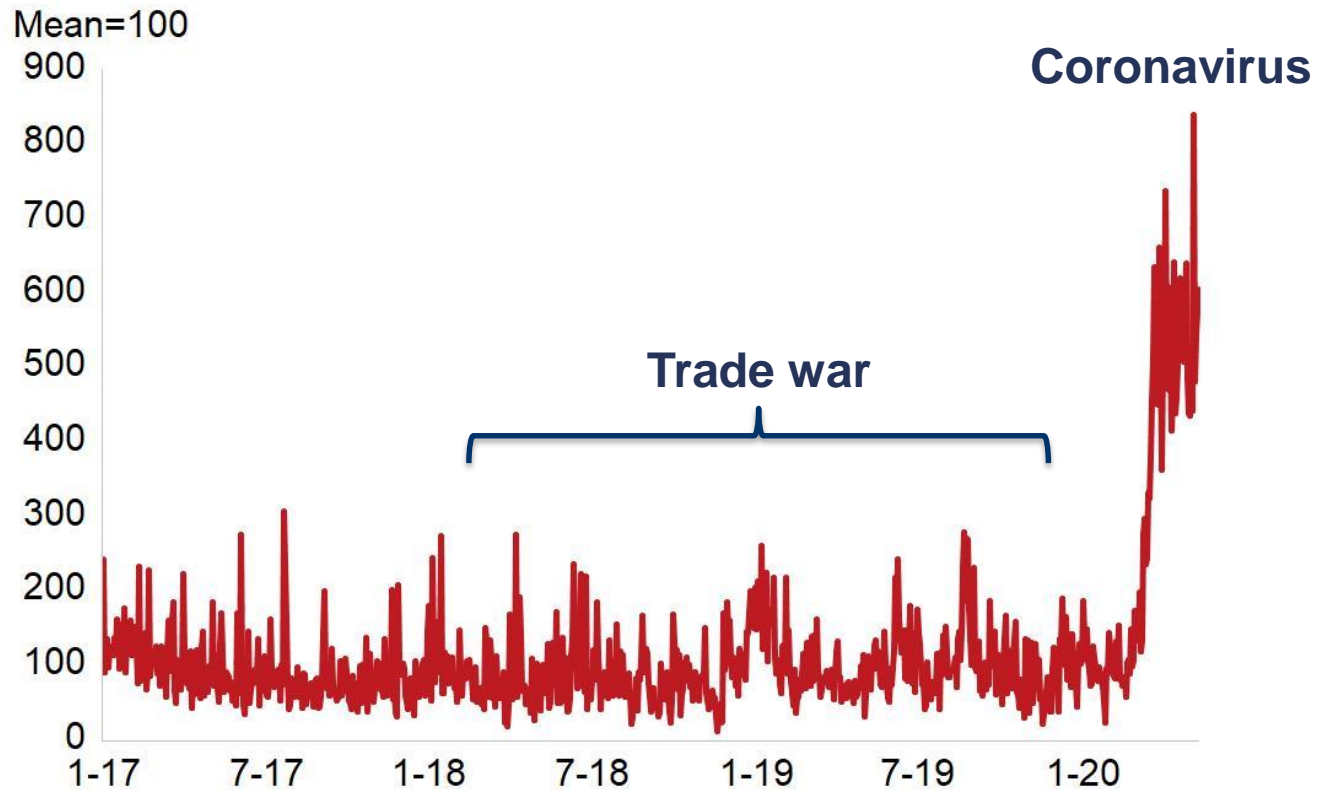
US: Cumulative GDP decline during recessions



Severe disruptions across sectors

Policy uncertainty has surged

US: Economic Policy Uncertainty

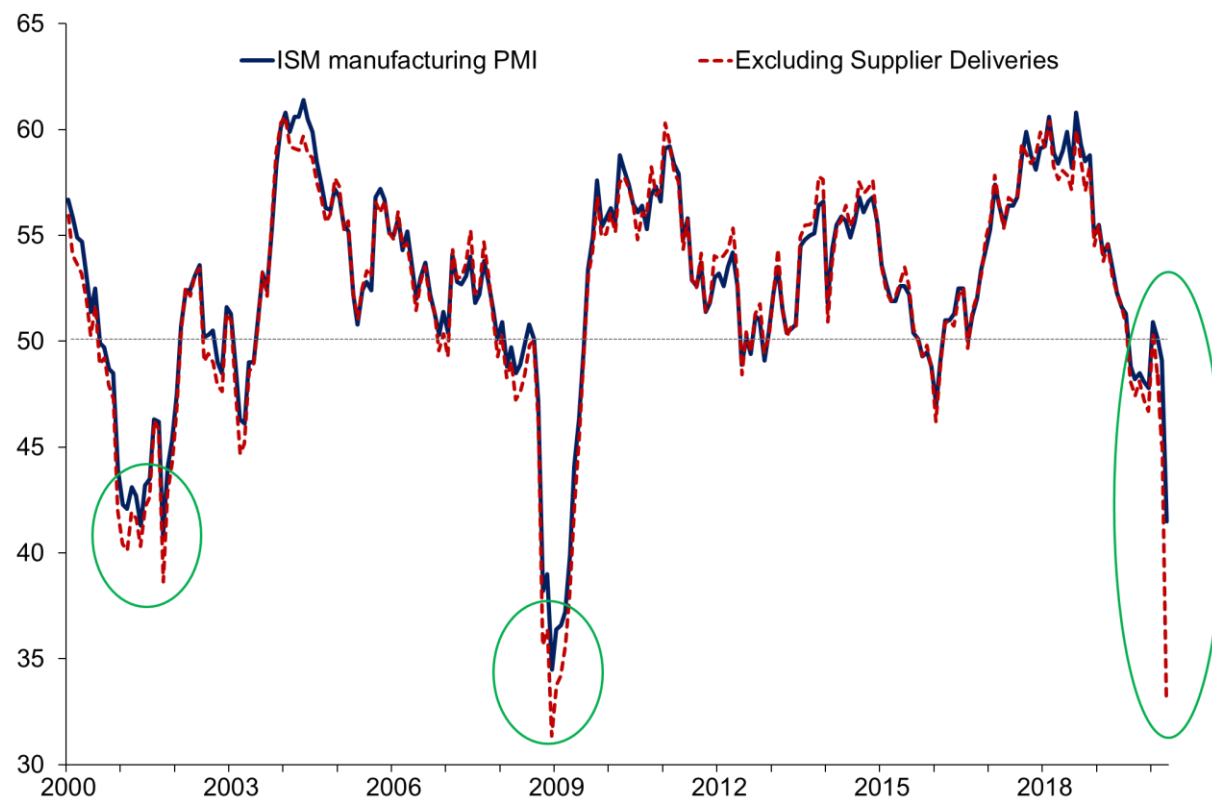


Source: Oxford Economics/Haver Analytics

Industrial activity is severely constrained

US: ISM manufacturing PMI

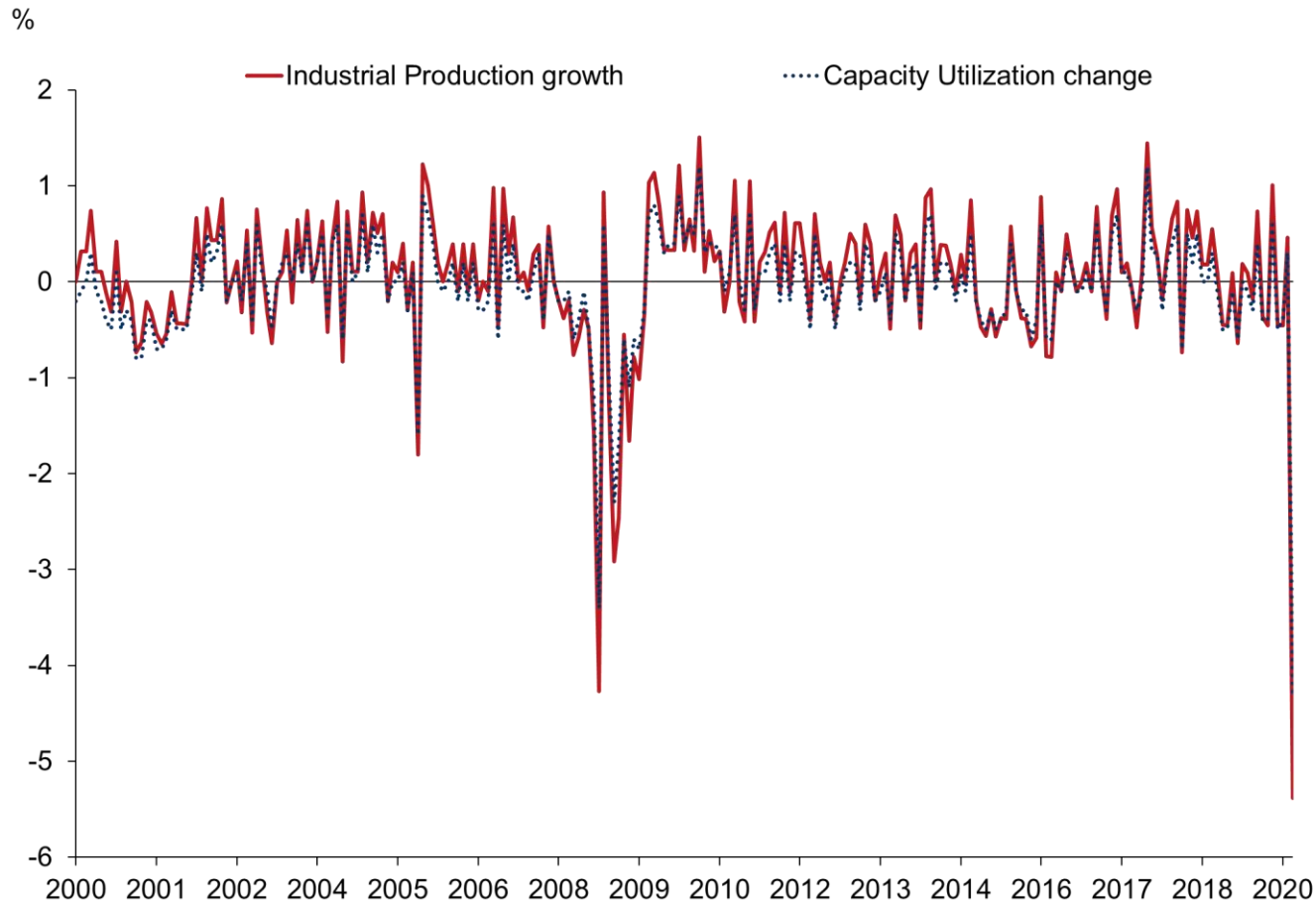
Index; above 50=expansion



Source: Institute for Supply Management/Oxford Economics

Factories suffer their worst blow since WWII

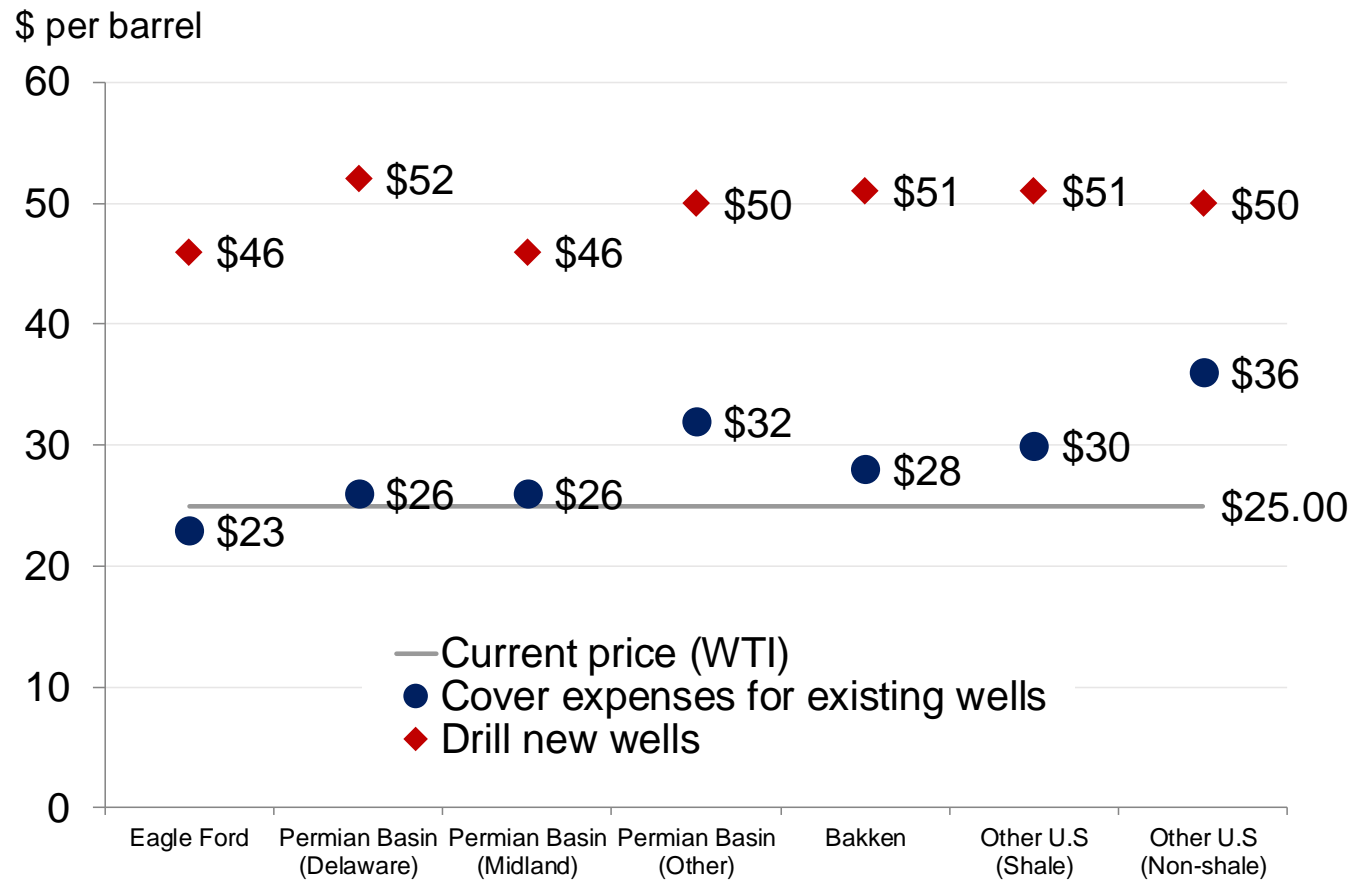
US: Industrial production & capacity utilization



Source : Oxford Economics/Haver Analytics

Low oil prices will leave a scar on oil sector

US: Average breakeven WTI oil price required to:

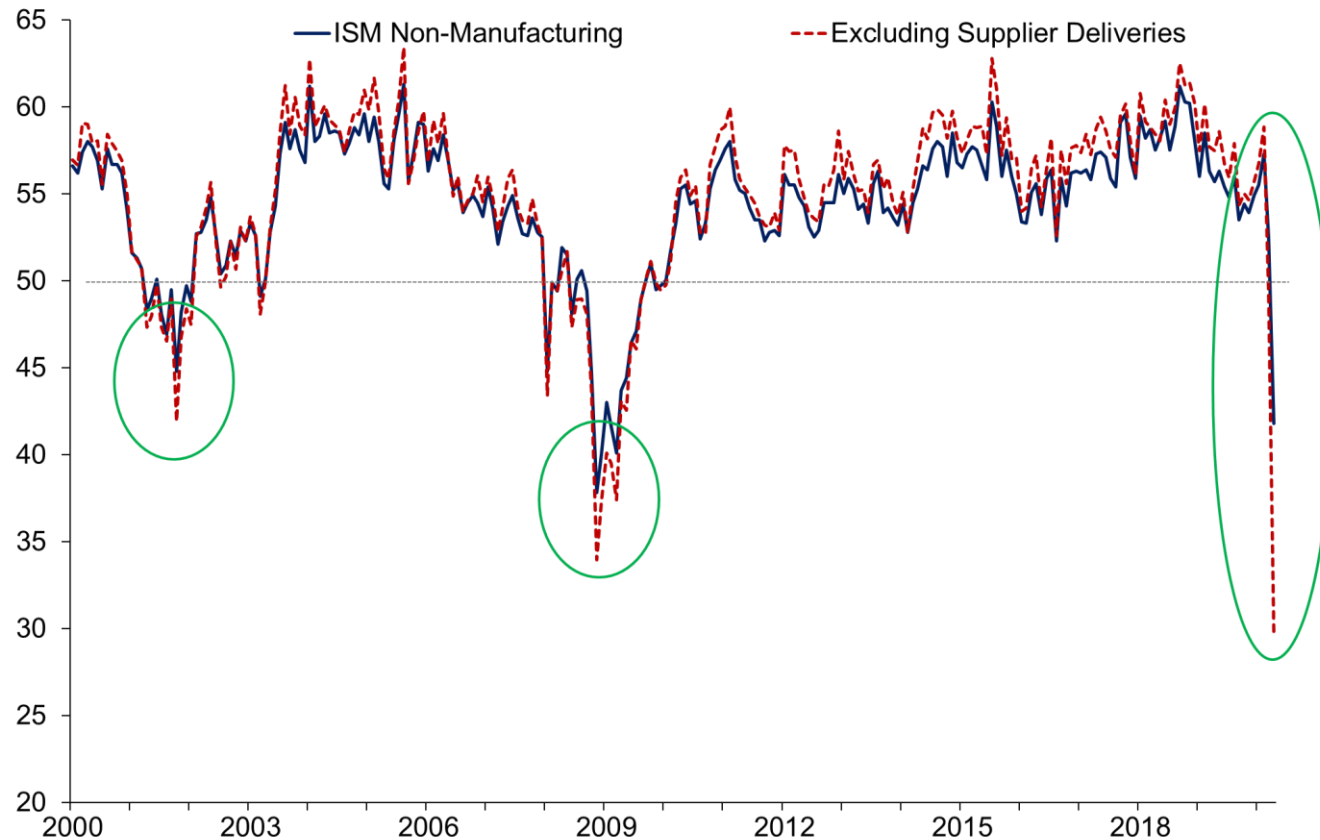


Source : Oxford Economics/Dallas Fed/Bloomberg

Service sector is even more restrained

US: ISM Non-Manufacturing

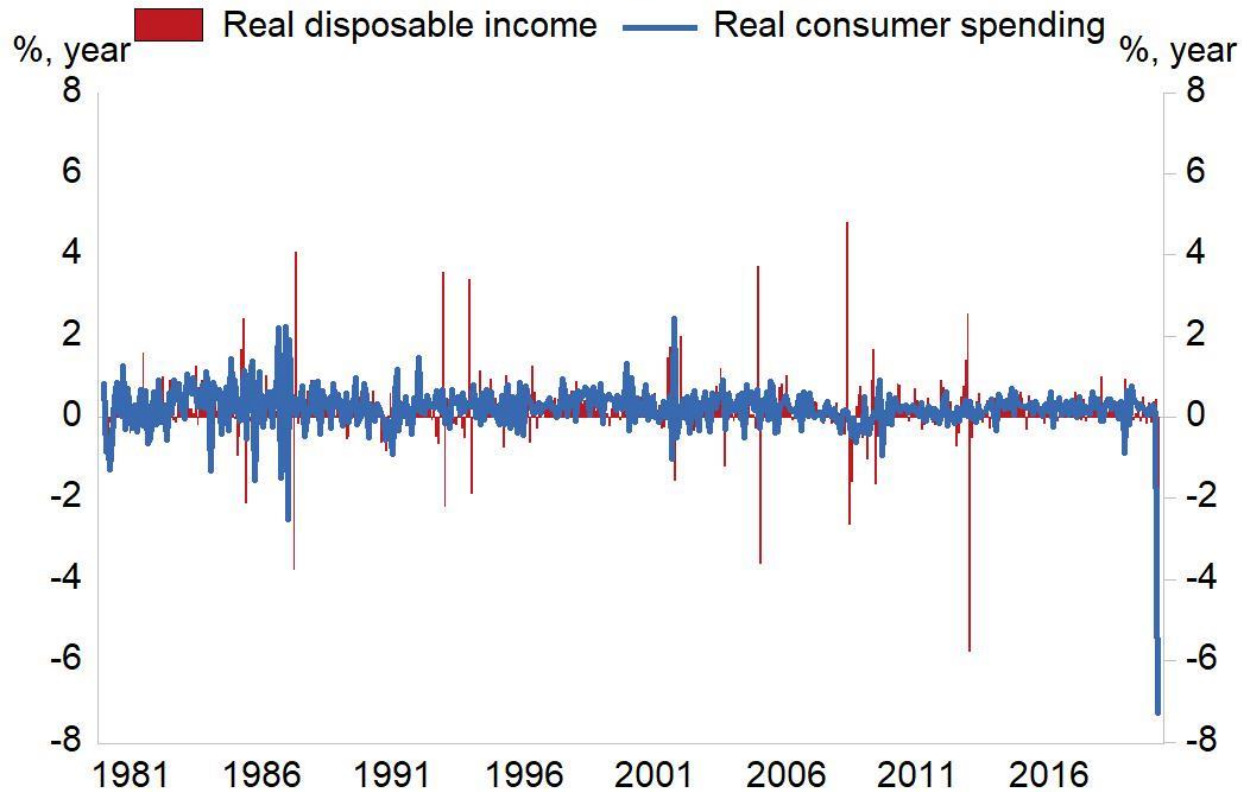
Index; above 50=expansion



Source: Institute for Supply Management/Oxford Economics

Income plunge & severe consumer spending retreat in March

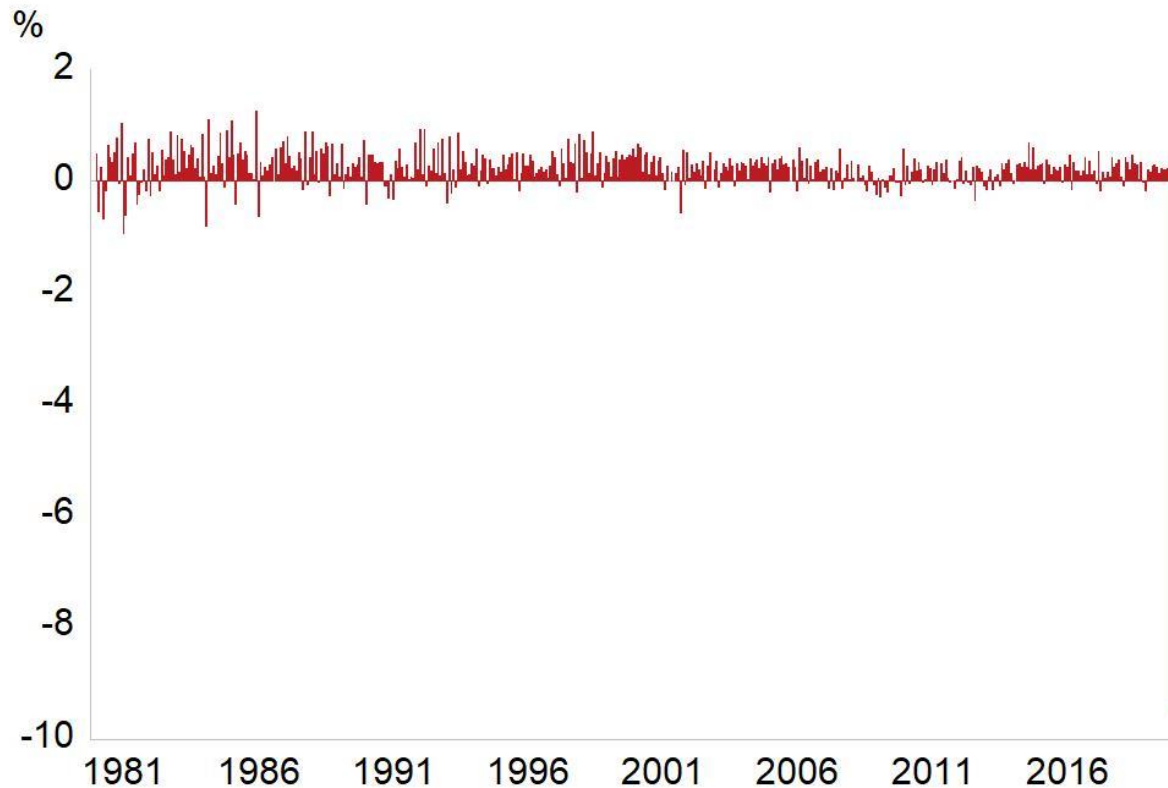
US: Personal income and spending



Source: Oxford Economics/Haver Analytics

With spending on services plunging by the most ever

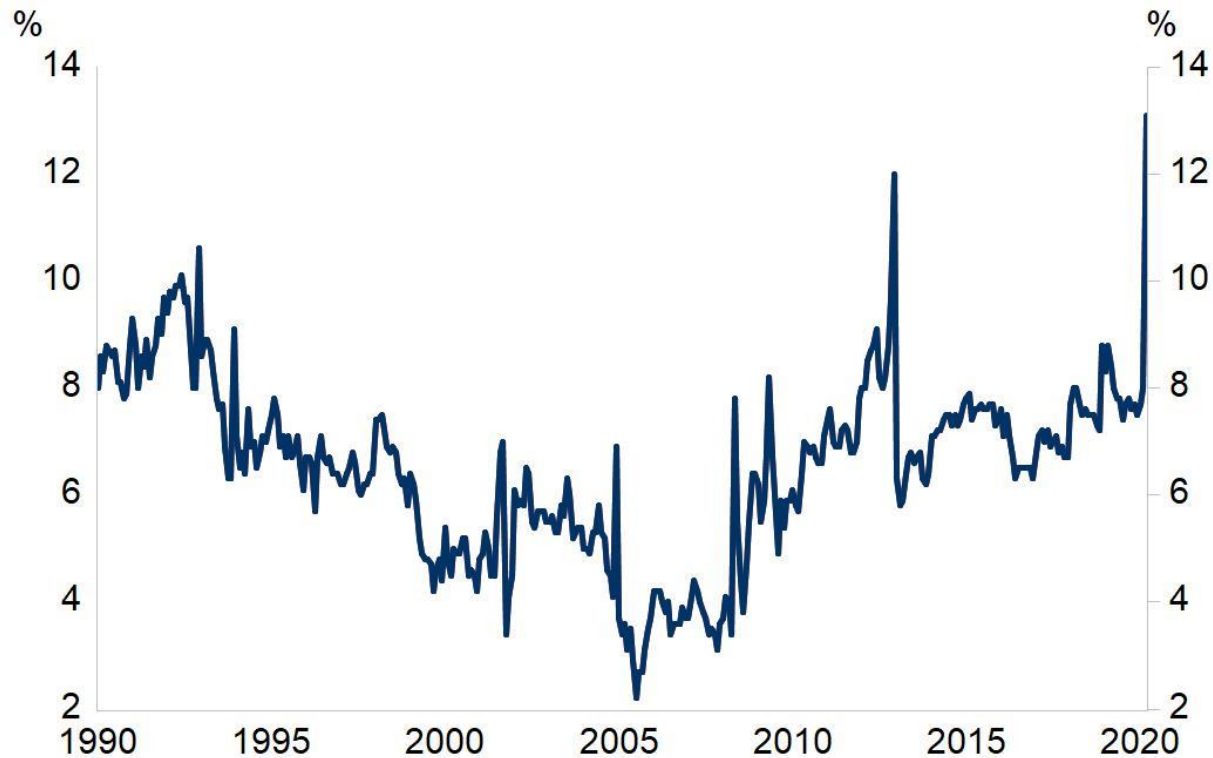
US: Personal Consumption Expenditures on Services



Source: Oxford Economics/Haver Analytics

Surge in precautionary savings points to weak demand

US: Personal savings rate

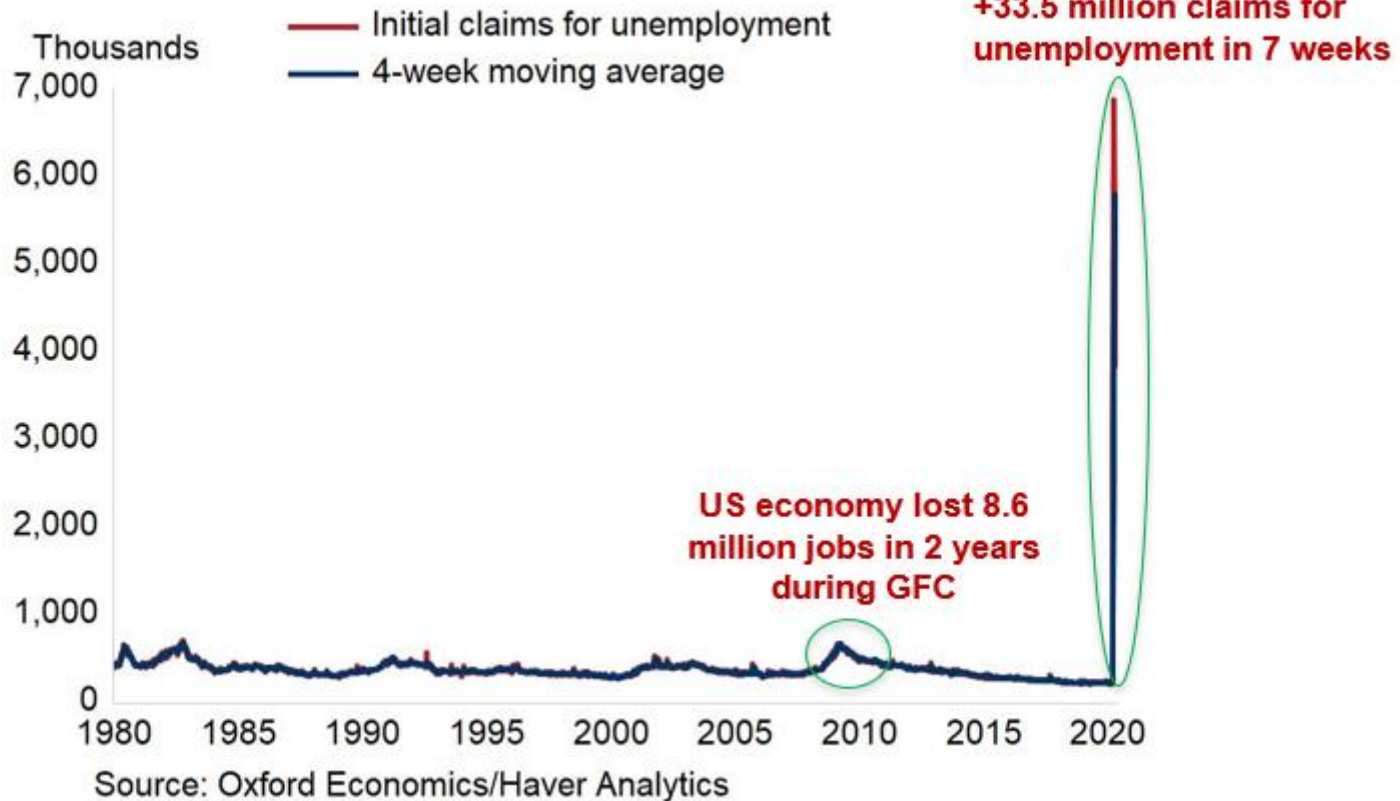


Source: Oxford Economics/Haver Analytics

An unprecedented labor market shock

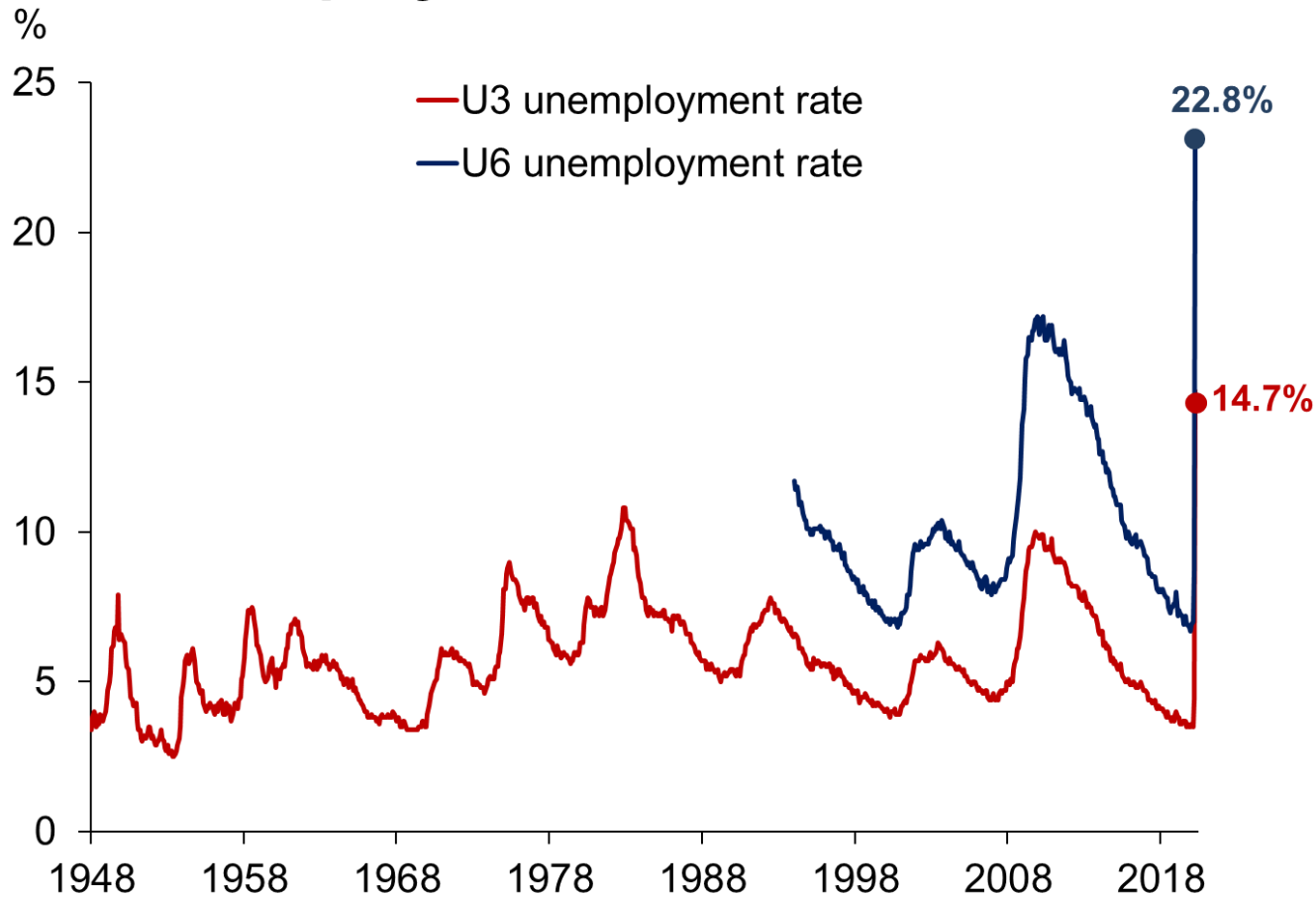
Unemployment claims still excessively high

US: Unemployment claims



Unemployment rate triples in one month

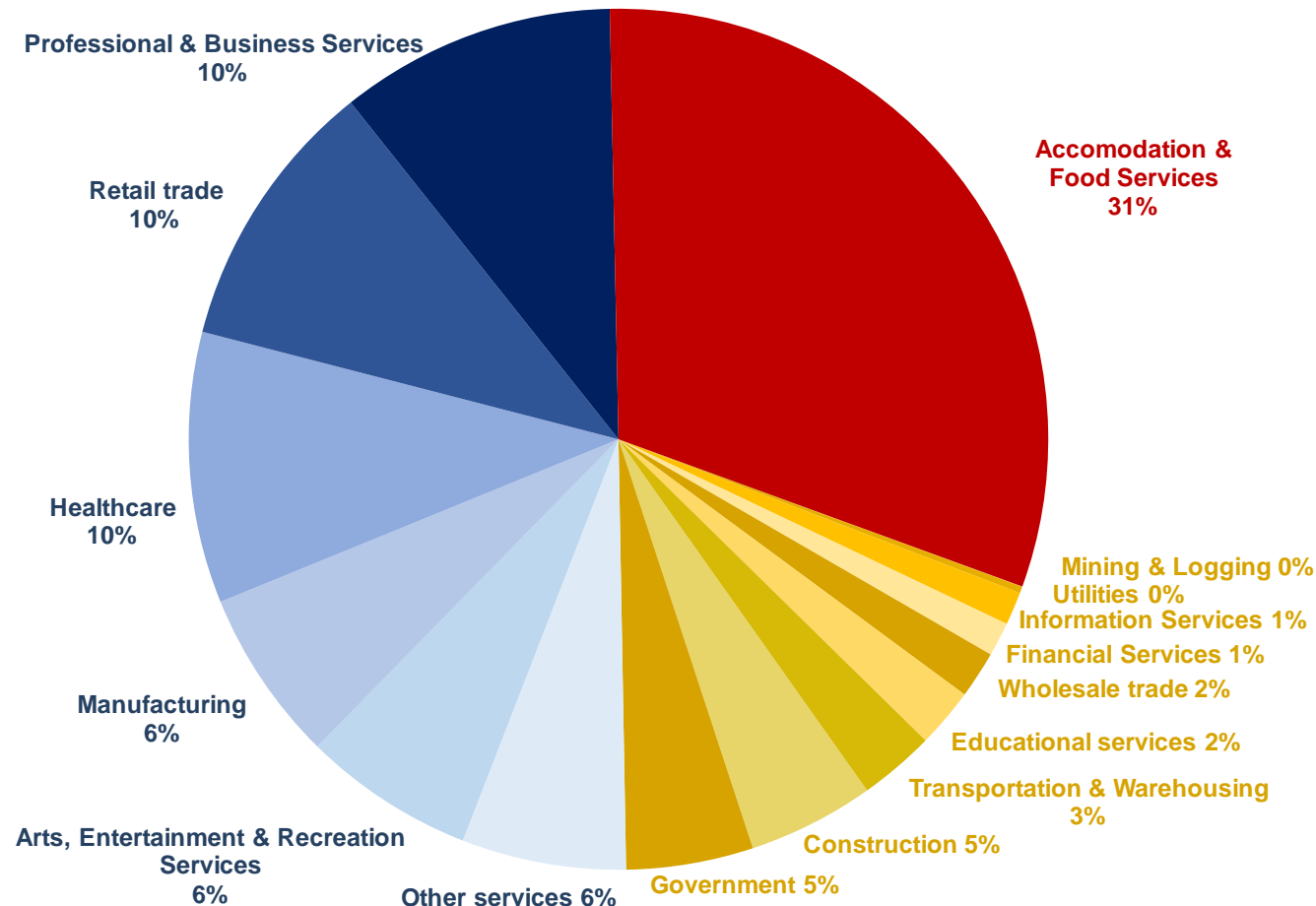
US: Unemployment rates



Source : Oxford Economics/Haver Analytics

Where we are: job losses across all sectors

US: Industry breakdown of April job losses

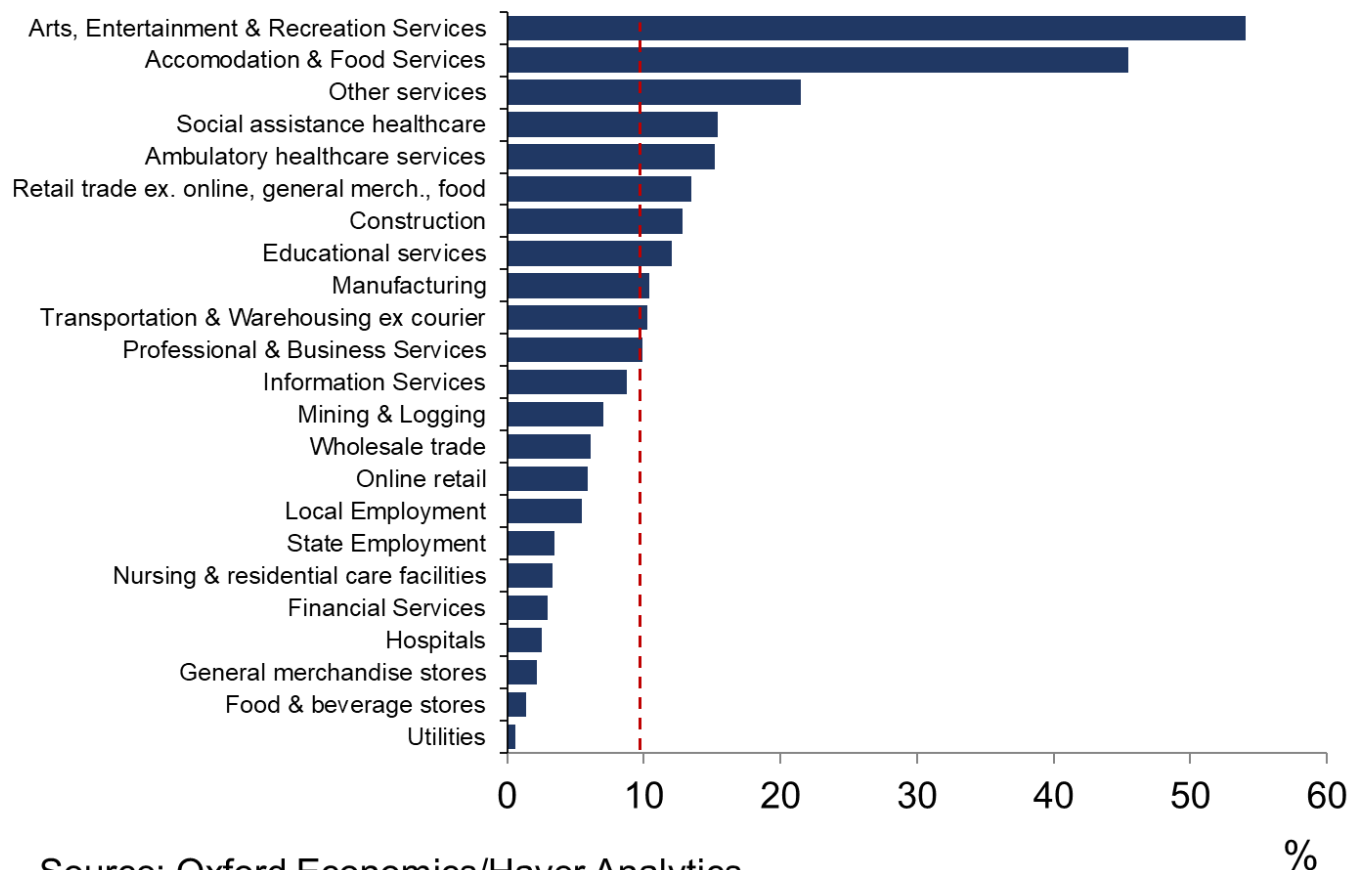


Source: Oxford Economics/Haver Analytics

Where we are: Tremendous sector disruption

US: April job losses by industry

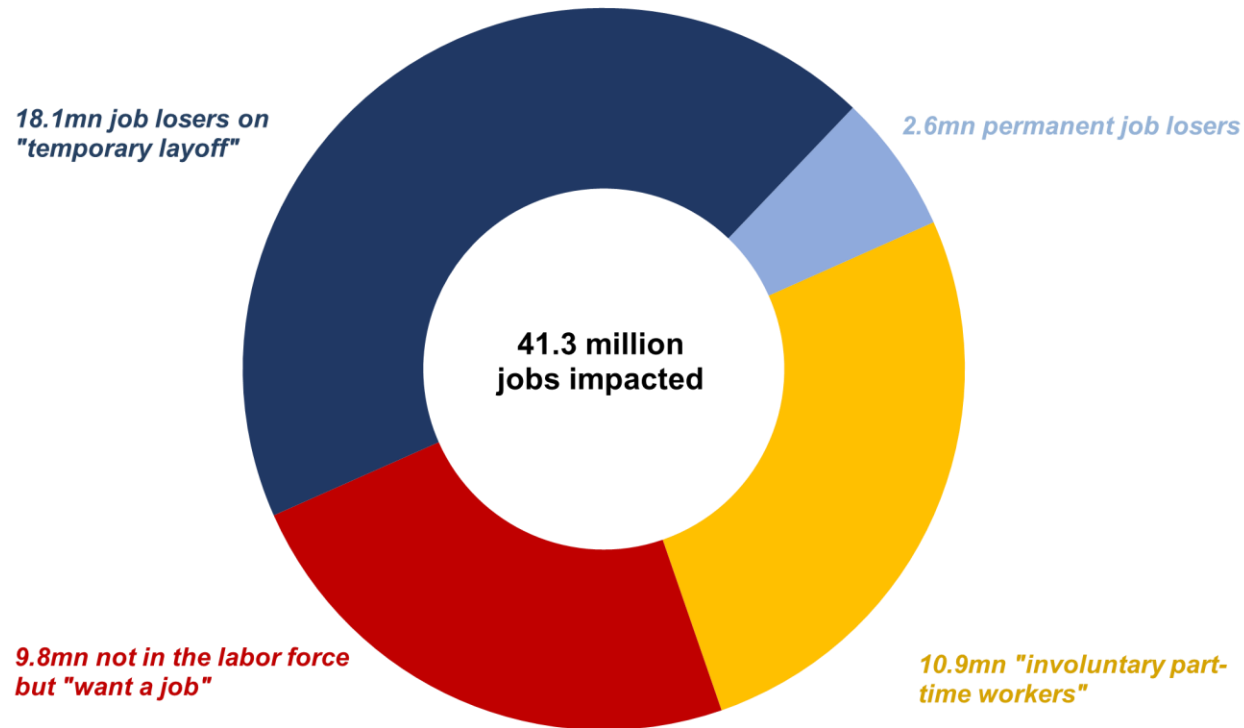
Job losses as a share of March industry employment



Source: Oxford Economics/Haver Analytics

Where we are: Underestimated unemployment

US: April COVID-19 impact on the labor market

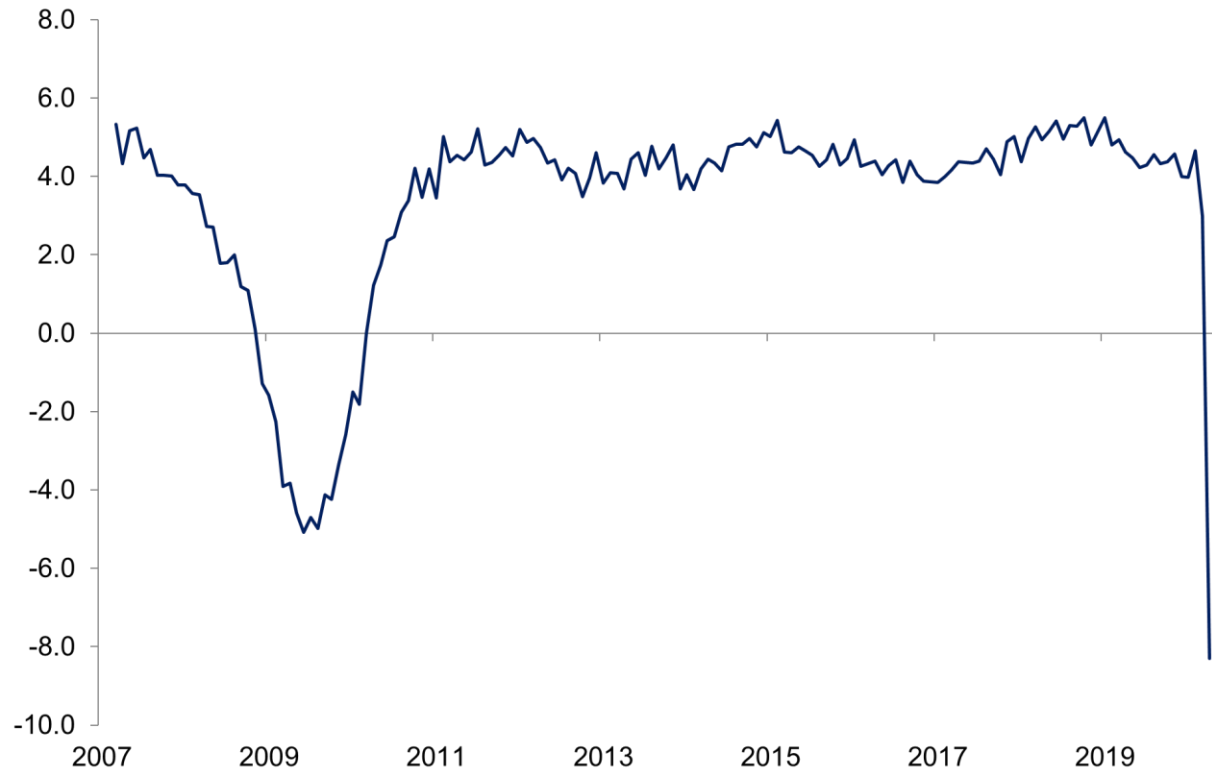


Source : Oxford Economics/Haver Analytics

Where we are: Massive income loss

US: Aggregate weekly payrolls

% year

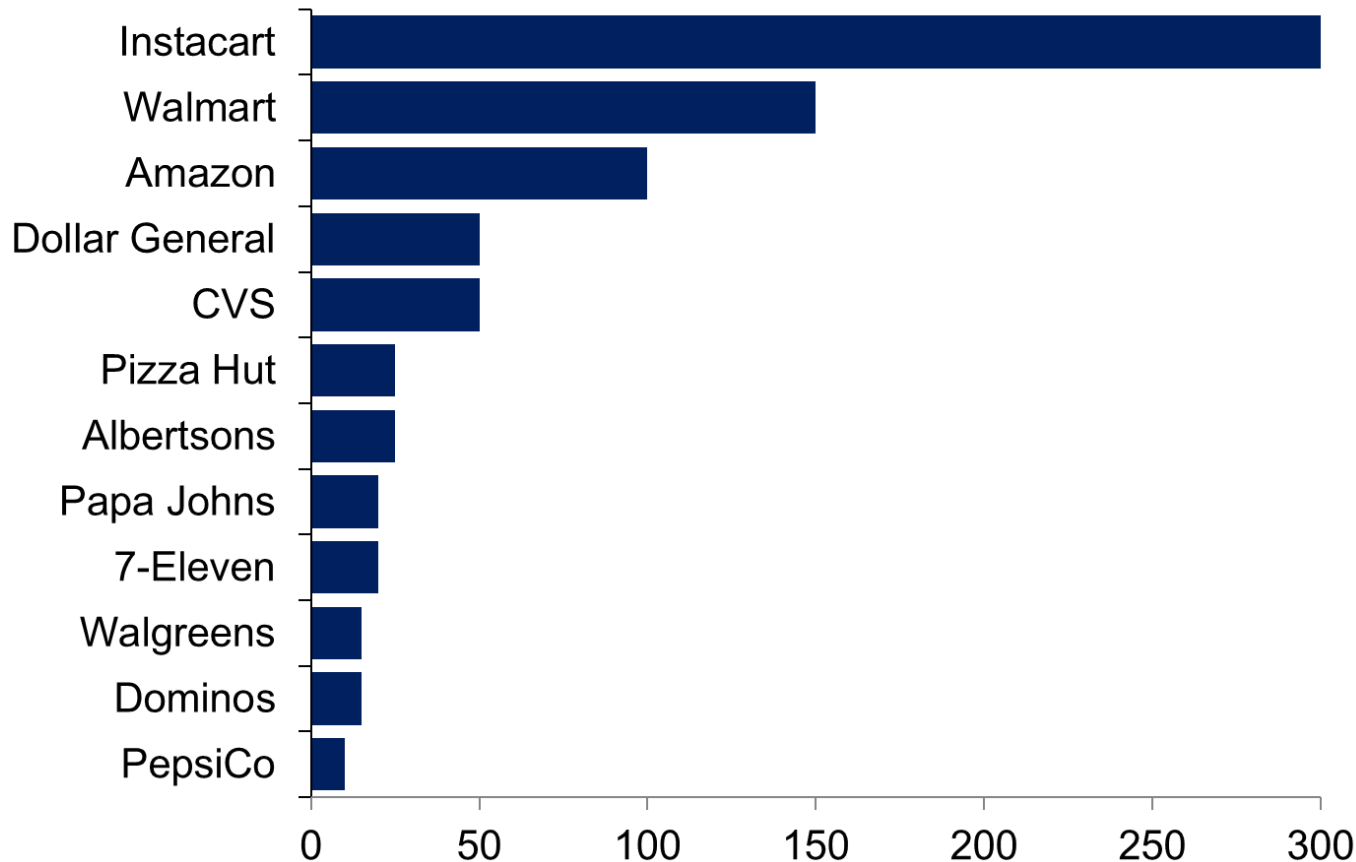


Source : Oxford Economics/Haver Analytics

Some large firms are hiring but not enough to offset shock

US: Firms hiring amid growing lockdowns

Announced hiring plans (000's)

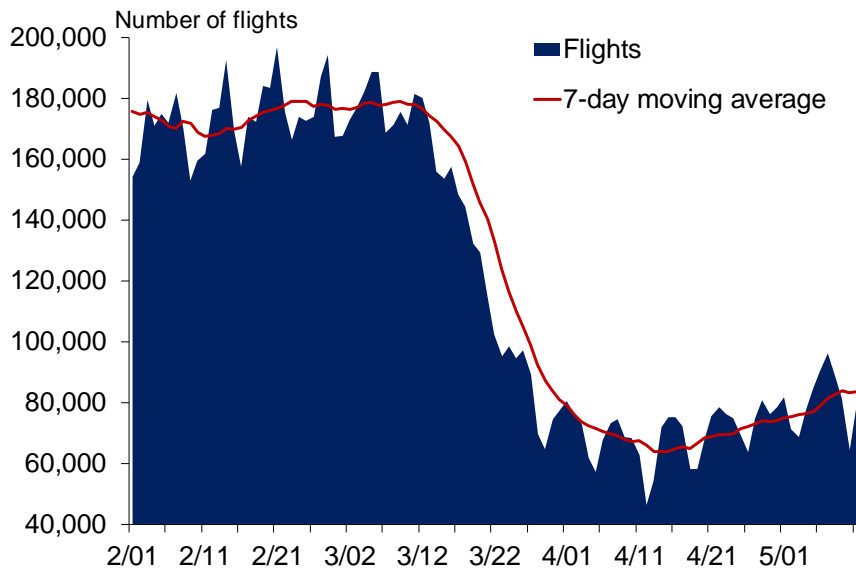


Source : Renaissance Macro Research

High frequency data point to a plateau?

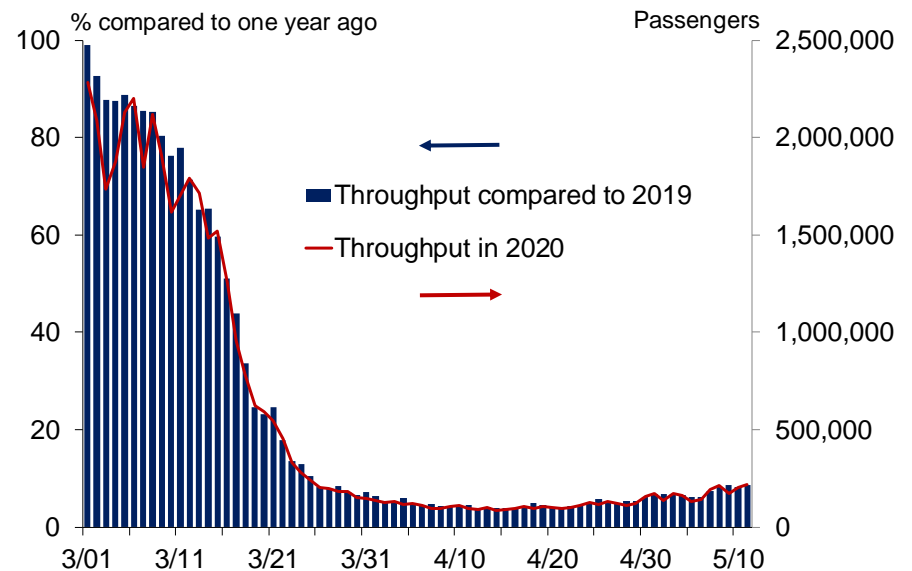
Air traffic & TSA throughput appear to have troughed

US: Global air traffic starts to recover



Source: Oxford Economics/FlightRadar24

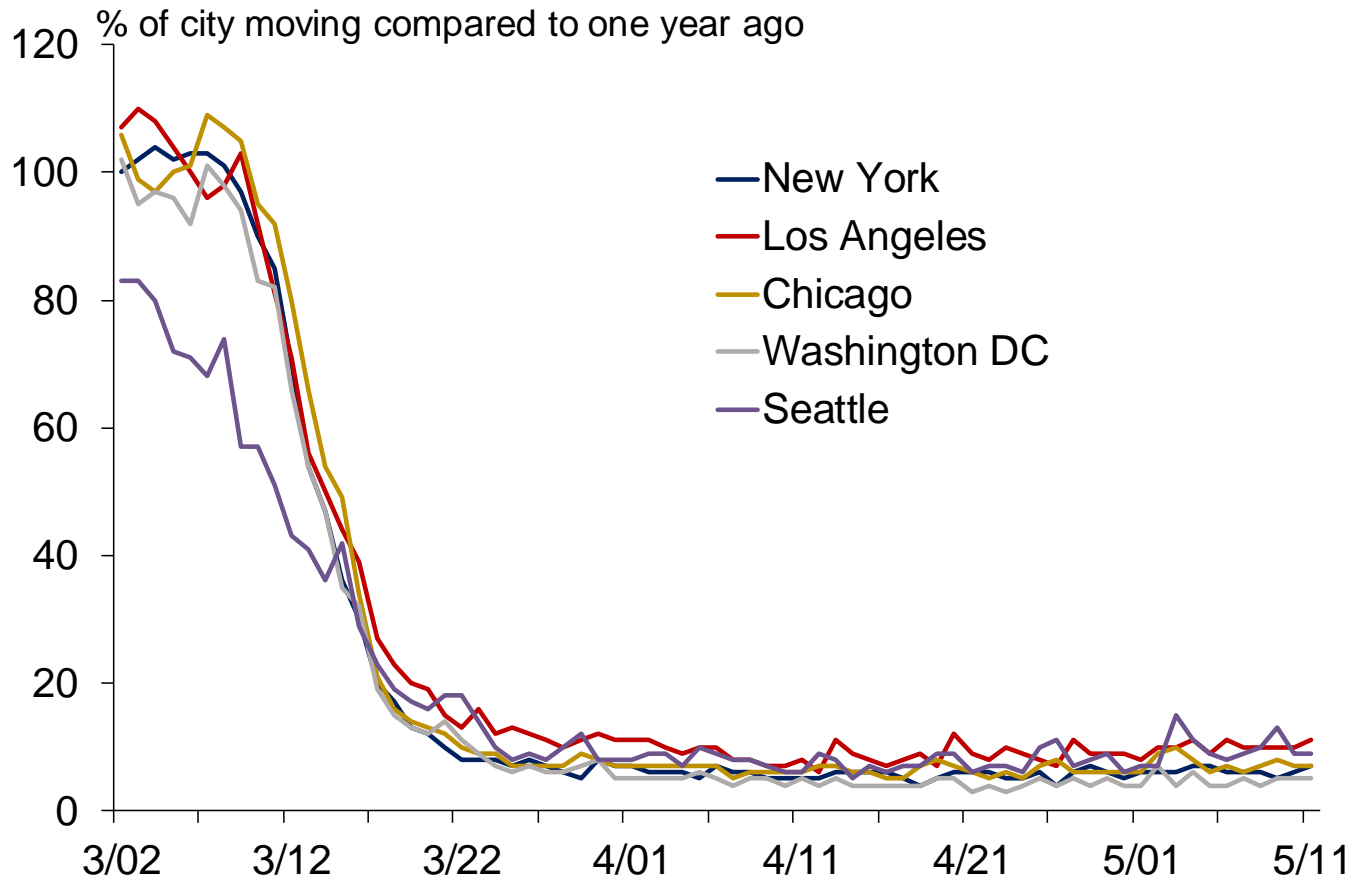
US: TSA throughput during COVID-19



Source: Oxford Economics/TSA

Mobility has also found a (low) floor

US: Mobility in major metros has been flat

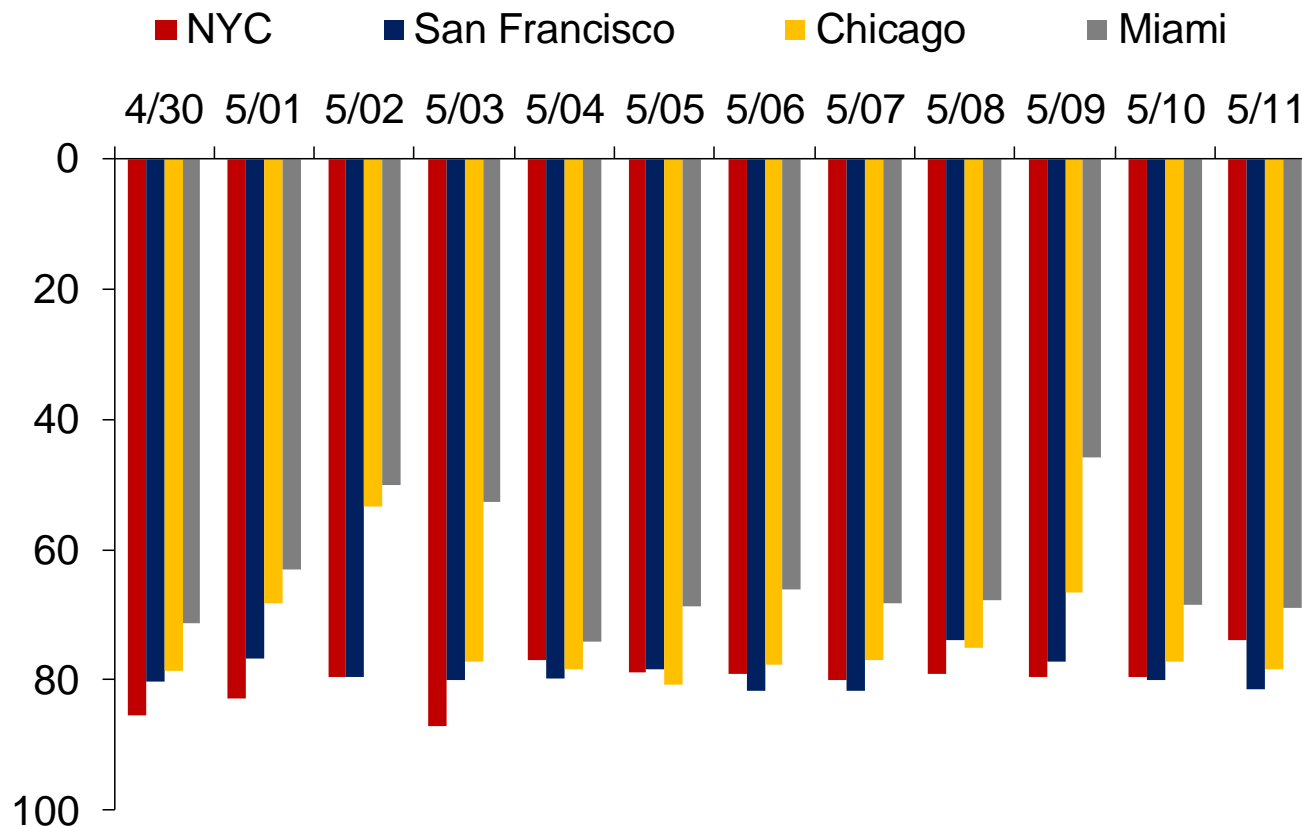


Source: Citymapper/Oxford Economics

Road congestion isn't worsening anymore

US: Traffic congestion at 5pm local time

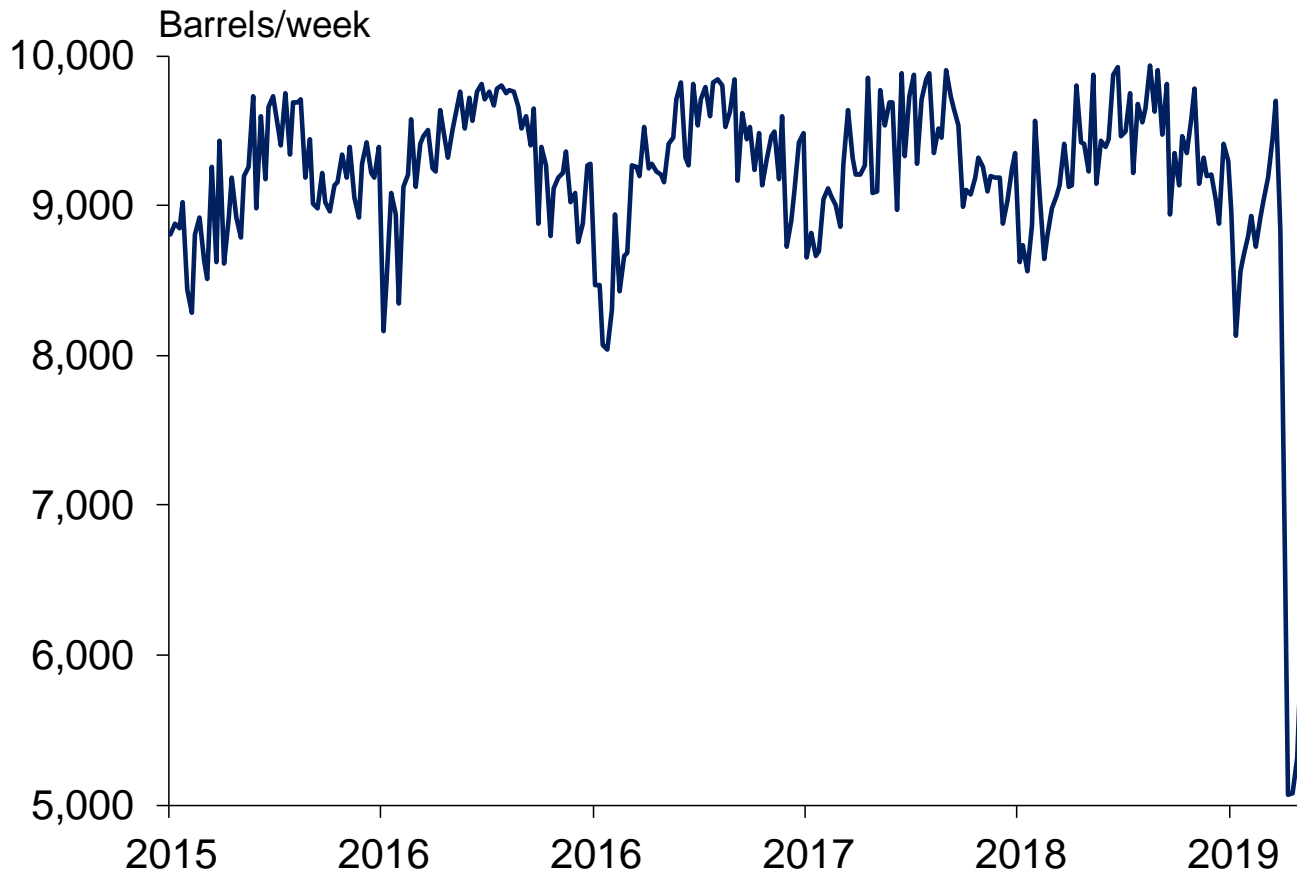
%, congestion level, 2020 relative to 2019; y-axis inverted



Source: TomTom/Oxford Economics

Gasoline demand has bottomed

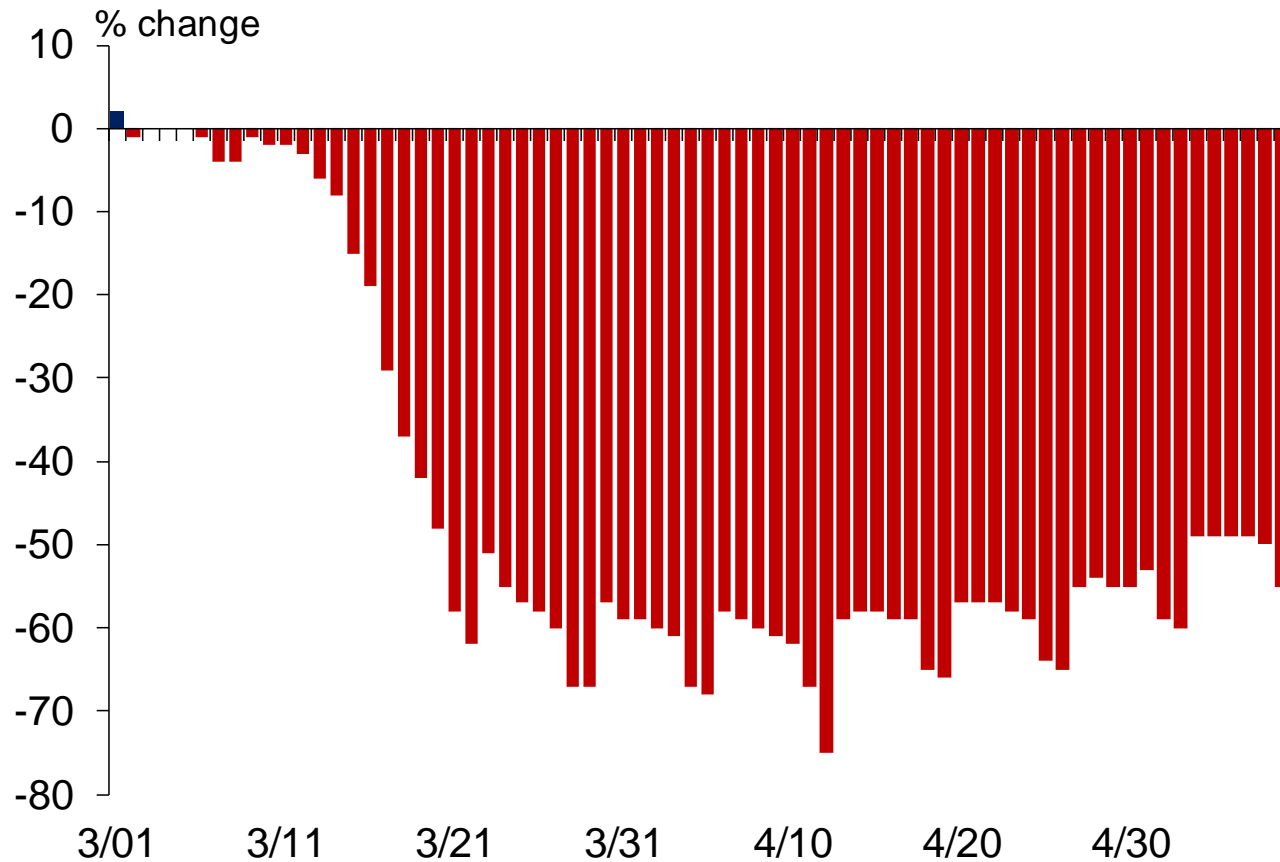
US: Implied gasoline demand



Source: Oxford Economics/EIA

Hours worked at small biz is rebounding modestly

US: Hours worked by hourly employees

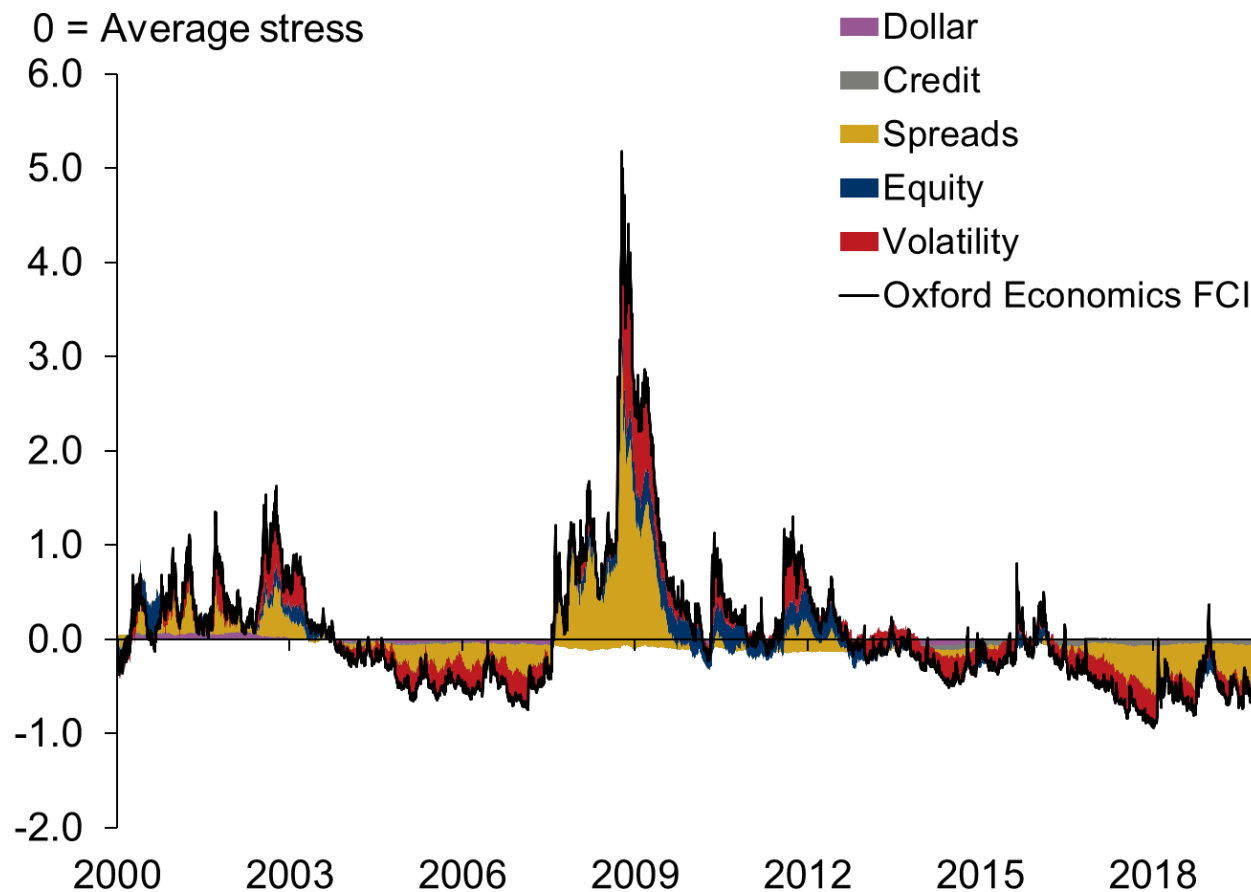


Source: Homebase/Oxford Economics

Corporate sector stress

Financial conditions tightening has been partially reversed

US: Financial conditions

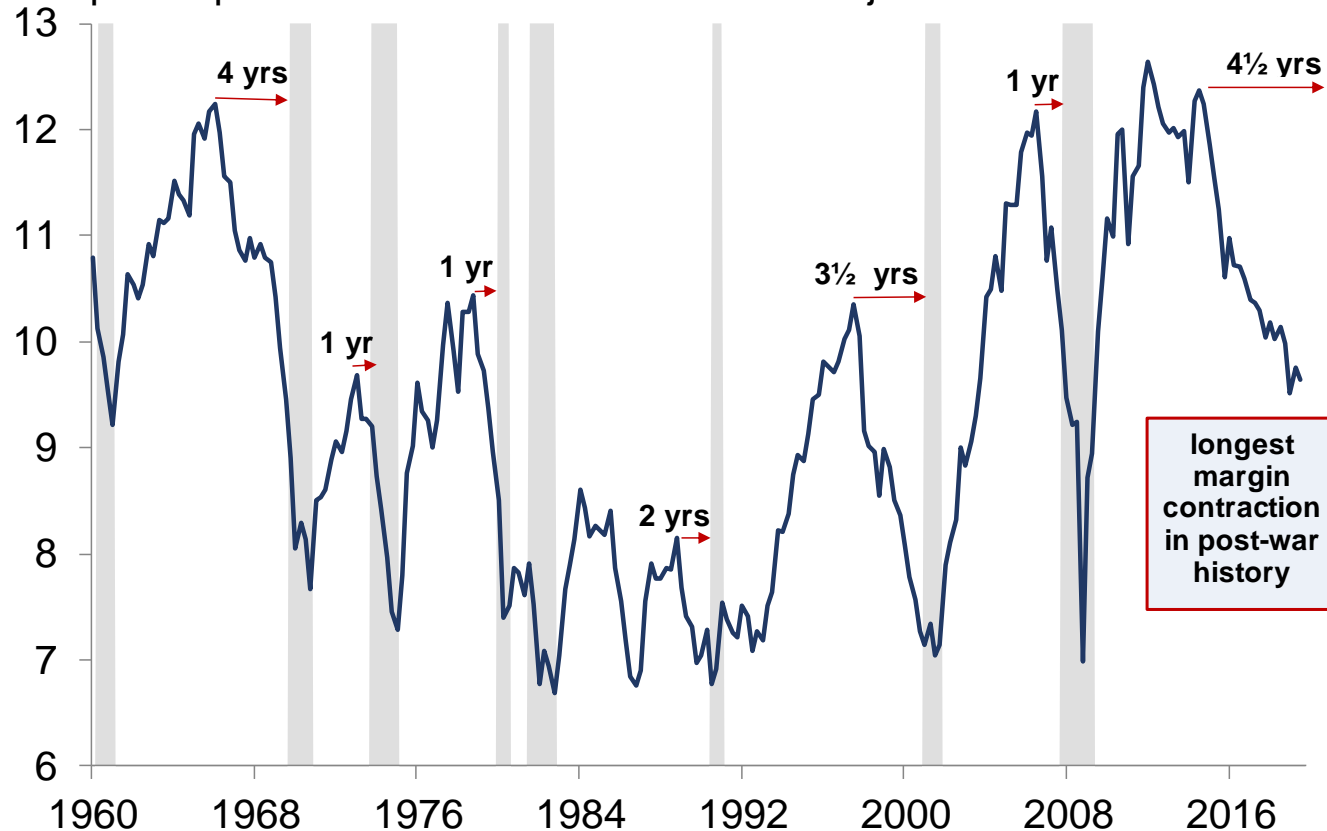


Source: Oxford Economics/Haver Analytics

But the corporate sector remains exposed

US: NIPA profit margins and recessions

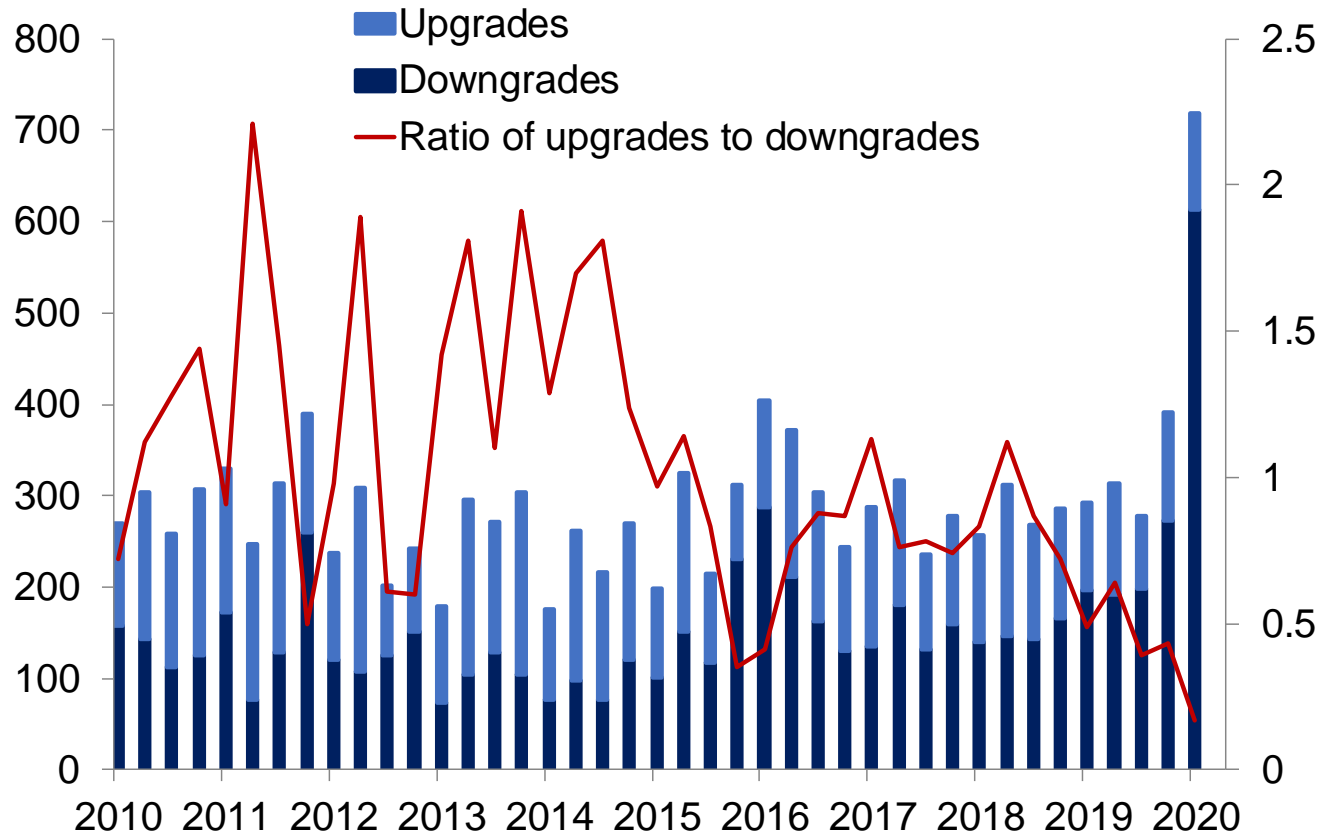
Corporate profits before tax with IVA and CCadj % GDP



Source : Oxford Economics/Haver Analytics

Corporate debt downgrades have spiked

US: S&P credit ratings

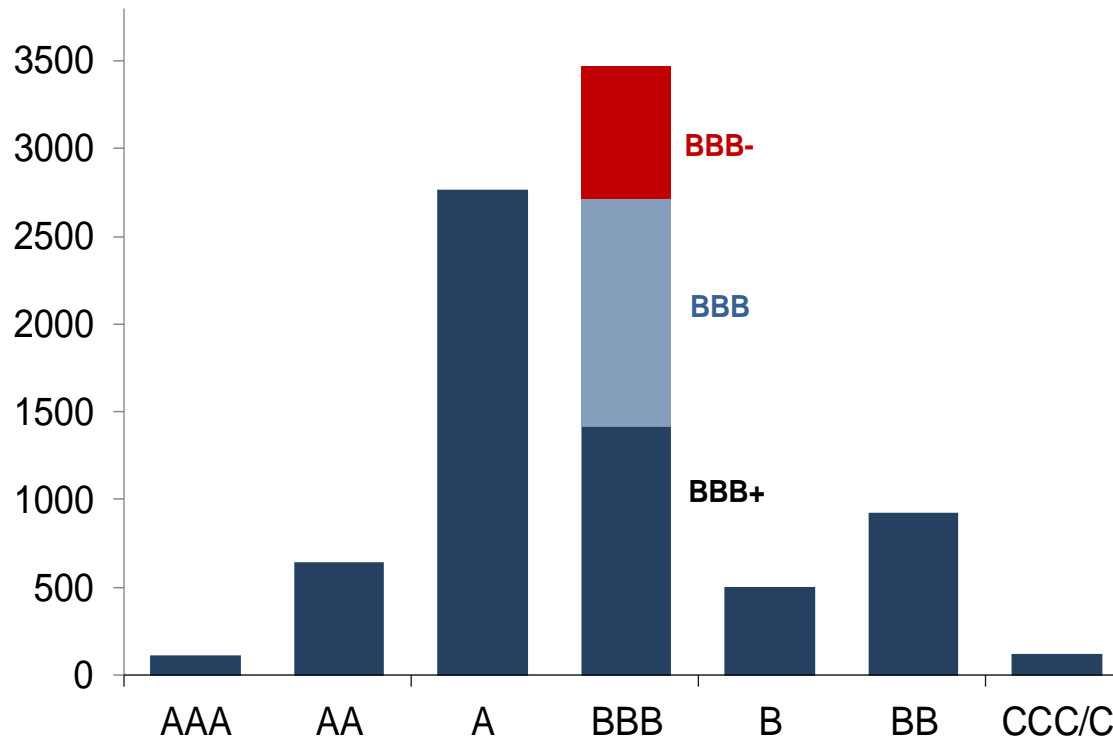


Source : Oxford Economics/Bloomberg

The risk from 'fallen angels'

US: Corporate bonds outstanding by S&P ratings*

\$ billion



Source : Oxford Economics/Bloomberg

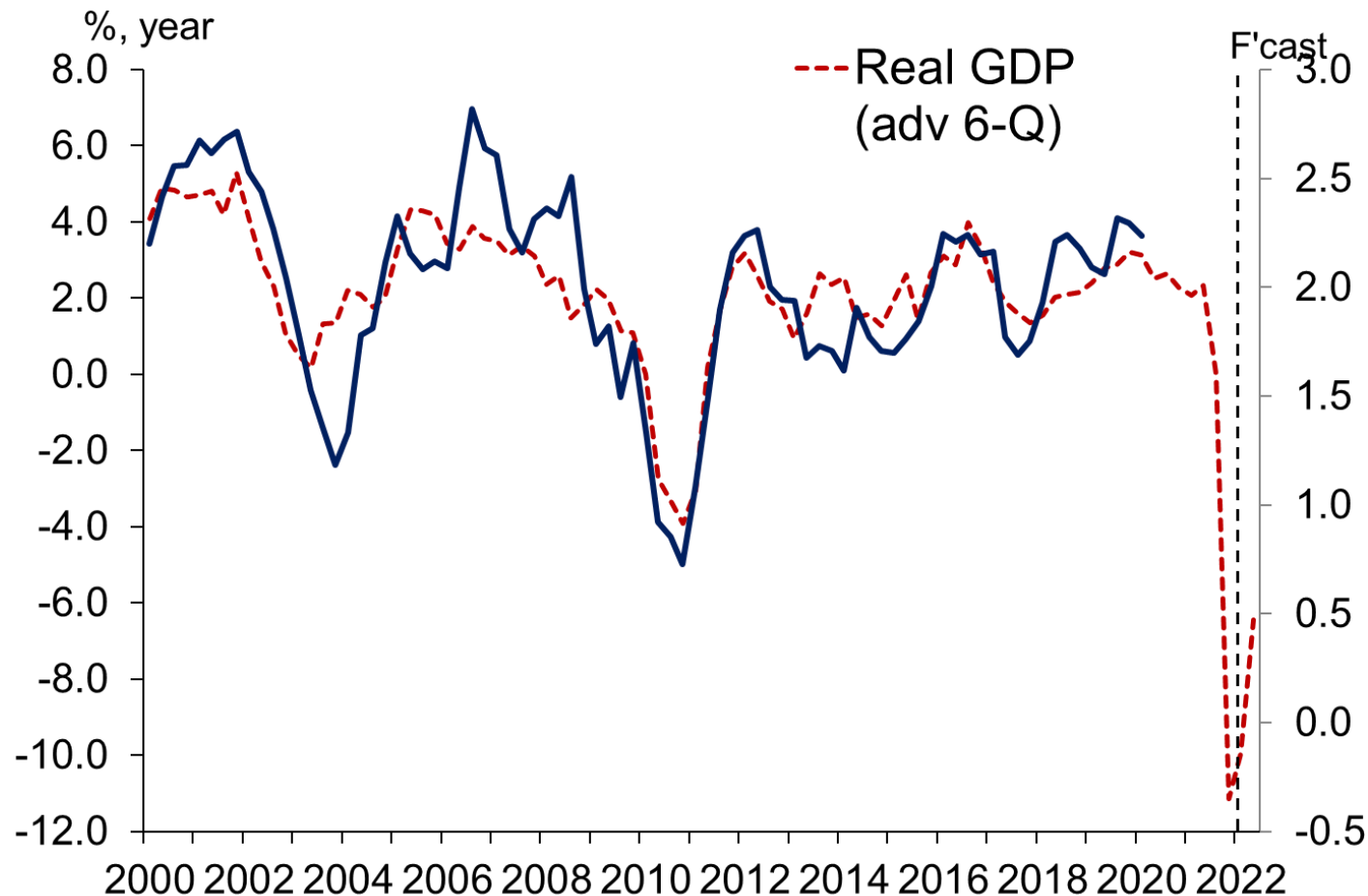
*Data as of April 6, 2020

A stylized blue globe with a grid of white lines, representing latitude and longitude, serves as the background for the top half of the slide.

Inflation should be the least of our worries

A large demand shock driven by lockdowns & fear

US: Core inflation & real GDP

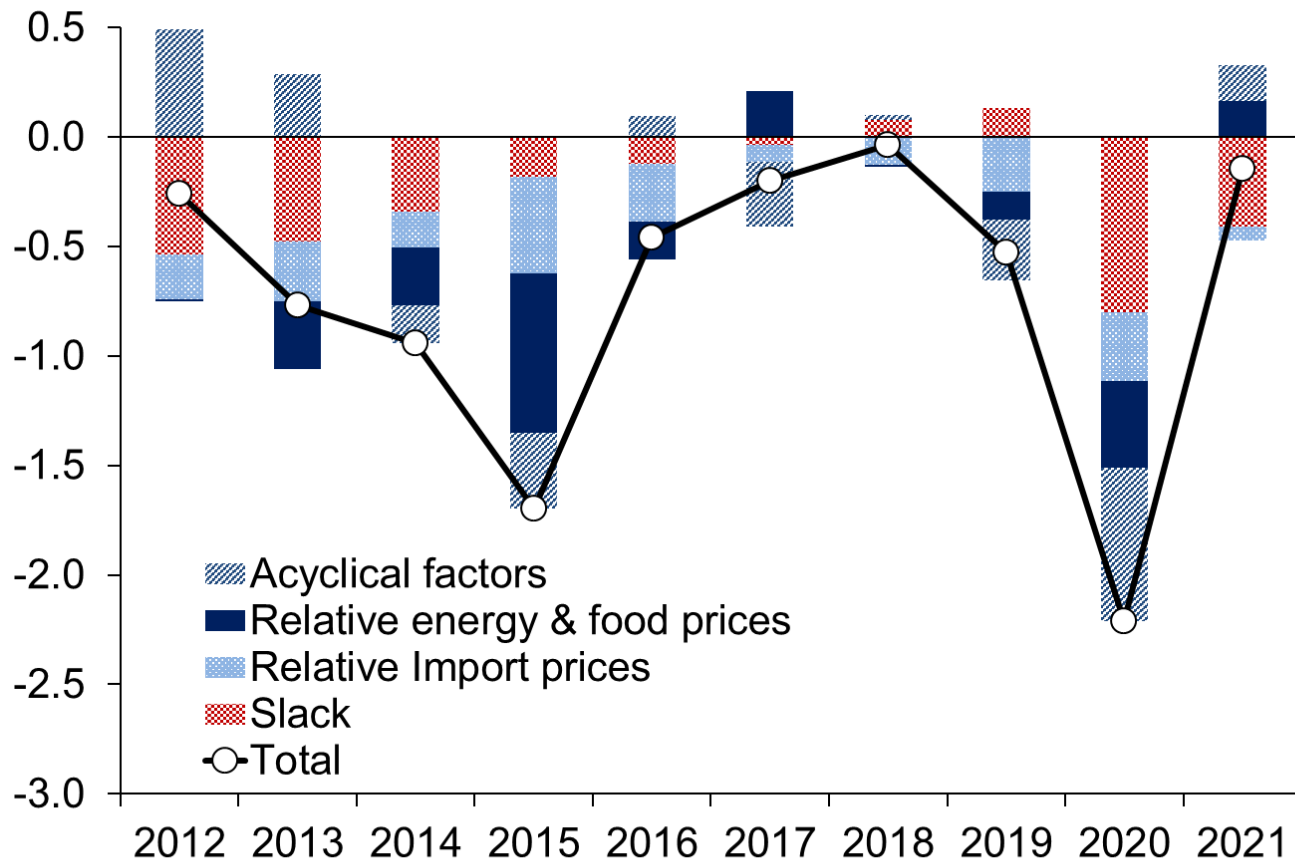


Source: Oxford Economics

Slack, dollar, oil and acyclical factors constrain inflation

US: Inflation unlikely to surpass Fed's 2% target

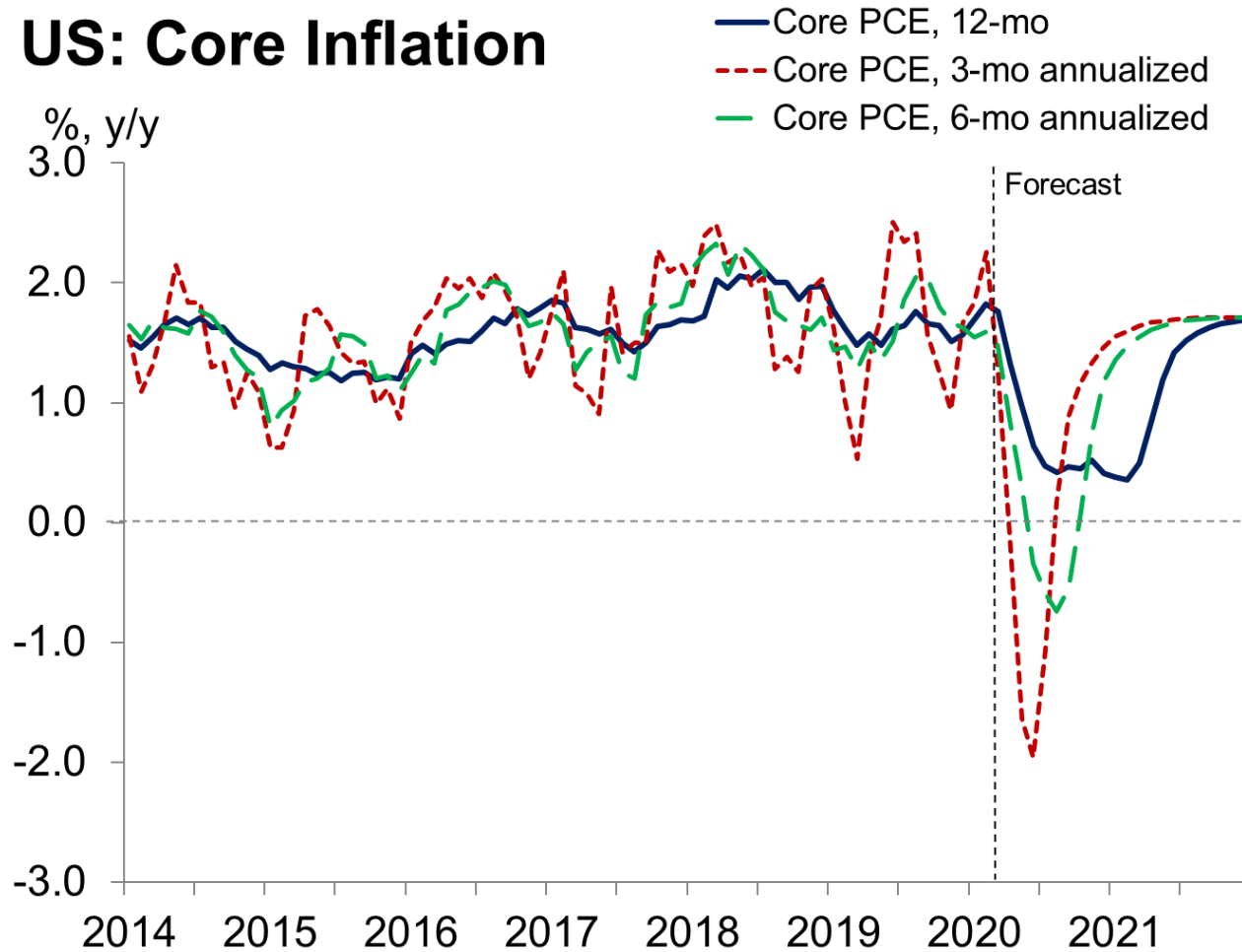
Deviation of PCE inflation from 2% & contribution of each factor, %



Source: Oxford Economics

Pushing core inflation to its lowest level on record

US: Core Inflation

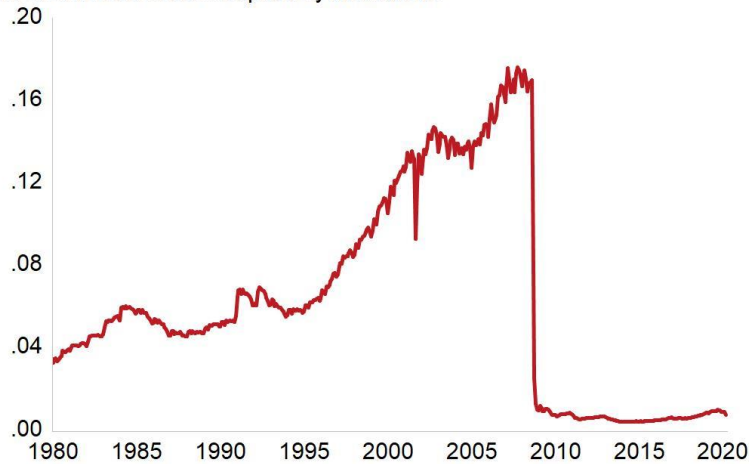


Source: Oxford Economics

Fed policies unlikely to lead to surging inflation

US: A plunging reserve multiplier

M2 to total reserves of depository institutions



Source: Oxford Economics/Haver Analytics

US: Declining money velocity

GDP divided by M2



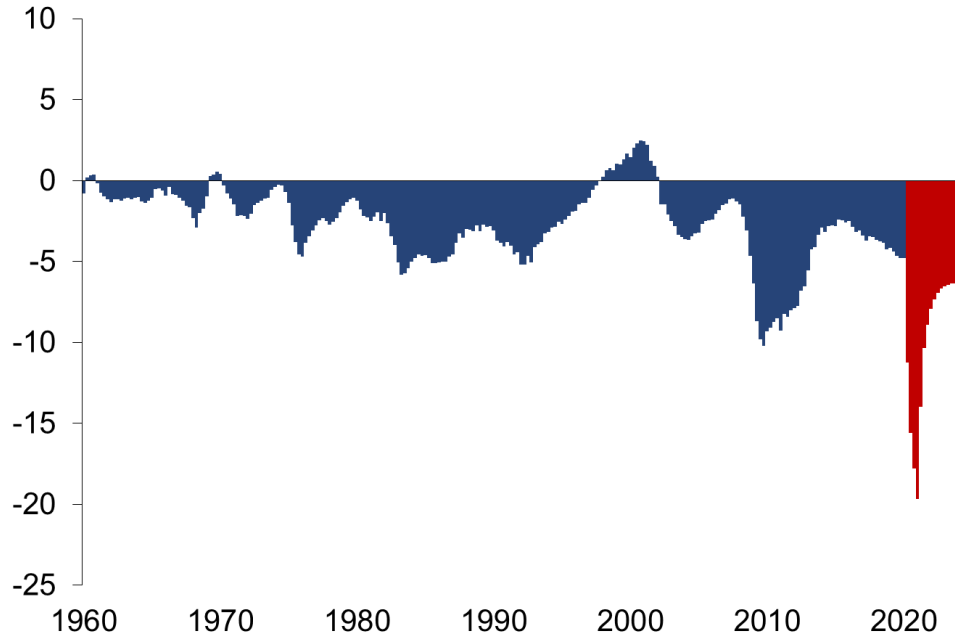
Source: Oxford Economics/Haver Analytics

The Fed's ultra-loose monetary policy and rapidly expanding QE purchases are unlikely to lead to surging inflation because the pass-through to the real economy will be curtailed by a low reserve multiplier, reduced demand for credit, and using funds for cash flow preservation rather than new investment.

Fiscal stimulus won't lead to inflation spiral unless...

US: Federal budget balance

4 quarter rolling average as % of GDP



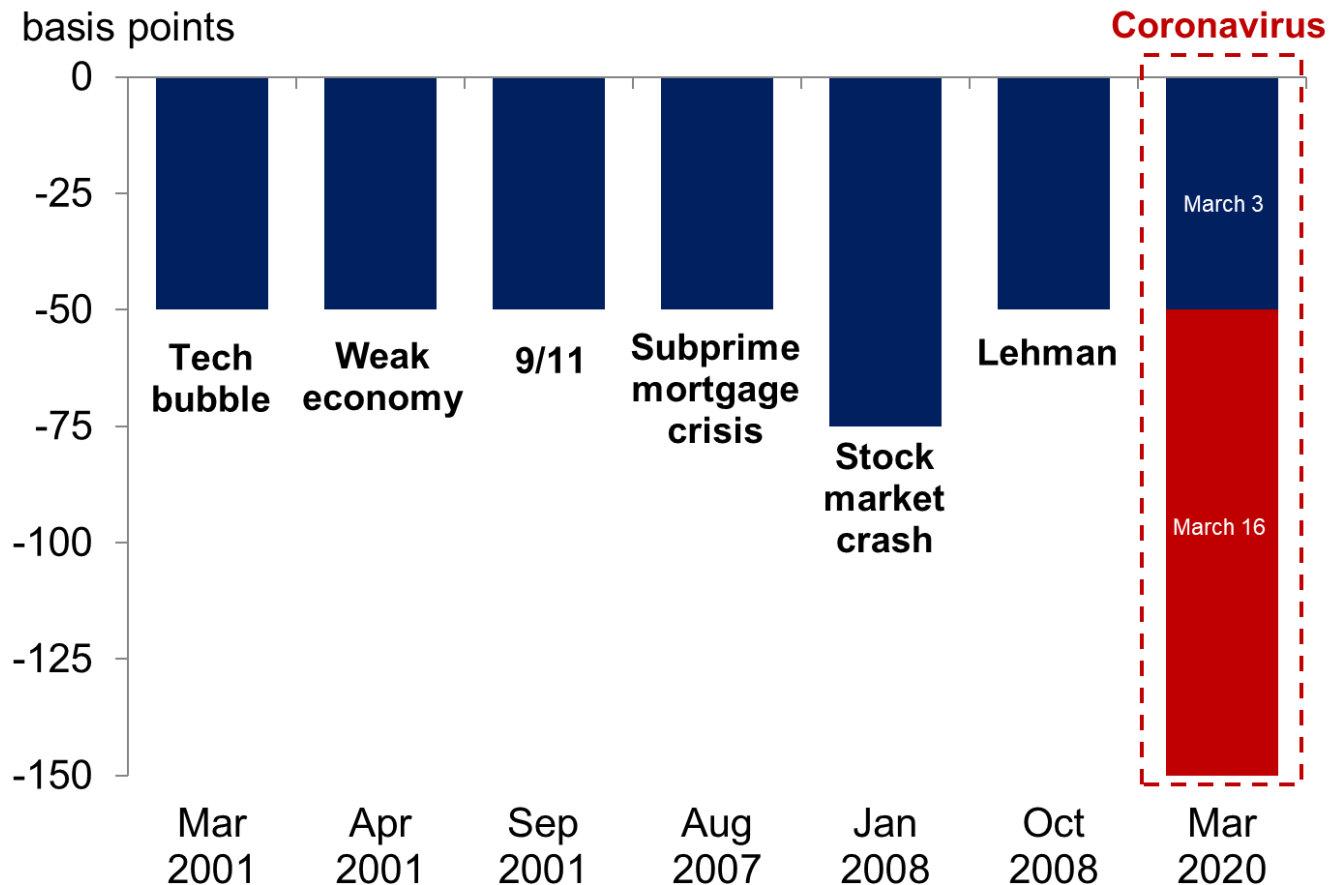
Source : Oxford Economics/Haver Analytics

- While fiscal stimulus measures will lift the debt-to-GDP ratio to above 100% for the first time since WWII, we should recall that the stimulus is temporary and aimed at preventing a sharper economic drag rather than relaunching activity.
- One important risk for inflation is the “fiscal dominance” of the Fed whereby debt monetization becomes a permanent feature of monetary policy.

Policymakers to the rescue?

Fed reacted early with emergency rate cuts

US: Emergency Fed rate cuts



Source : Oxford Economics/Haver Analytics

“Whatever it takes” policy actions

Fed's emergency policy actions	
Traditional policy tools and QE	
1. Fed slashed the fed funds target rate to the effective lower bound via two intermeeting cuts	
2. Relunched open-ended QE - start buying \$500 billion in Treasury securities and \$200 billion in MBS	
3. QE becomes unlimited and add CMBS to asset purchases	
4. Massively pumped up repo offerings	
5. Provided forward guidance - rates remain low until closer to Fed's dual mandate	
6. Cut the reserve requirement ratio	
Lender of last resort - providing liquidity to financial institutions	
7. Discount window borrowing rate lowered and term increased to up to 90 days	
8. Lower pricing and extend terms on standing US dollar liquidity swap lines	
9. Increase the frequency of swap line operations with original five central banks to daily from weekly	
10. Establish temporary US dollar liquidity swap lines with wider group of central banks	
11. Temporary FIMA Repo Facility	
12. Intraday credit extended by the Reserve Banks	
13. Revived the Primary Dealer Credit Facility (PDCF)	
14. Temporary change to the supplementary leverage ratio rule - Treasuries and deposits exempt	
Liquidity provider of last resort to credit markets	
15. Revived the Commercial Paper Funding Facility (CPFF)	
16. Established the Money Market Mutual Fund Liquidity Facility (MMLF)	
17. Established the Primary Market Corporate Credit Facility (PMCCF) - support new corp. bond issuance	
18. Established the Secondary Market Corporate Credit Facility (SMCCF) to buy corporate bonds	
19. Increase the size and scope of PMCCF, SMCCF, and TALF - include BB- rated high yield debt	
20. Revived the Term Asset-Backed Securities Loan Facility (TALF).	
21. Municipal Liquidity Facility - buy short-term debt of state and local governments	
Lender of last resort to main street	
22. Paycheck Protection Program Liquidity Facility (PPPLF) - provide term financing backed by the SBA PPP loans	
23. Main Street Lending Program - provide loans to small and medium-sized firms	

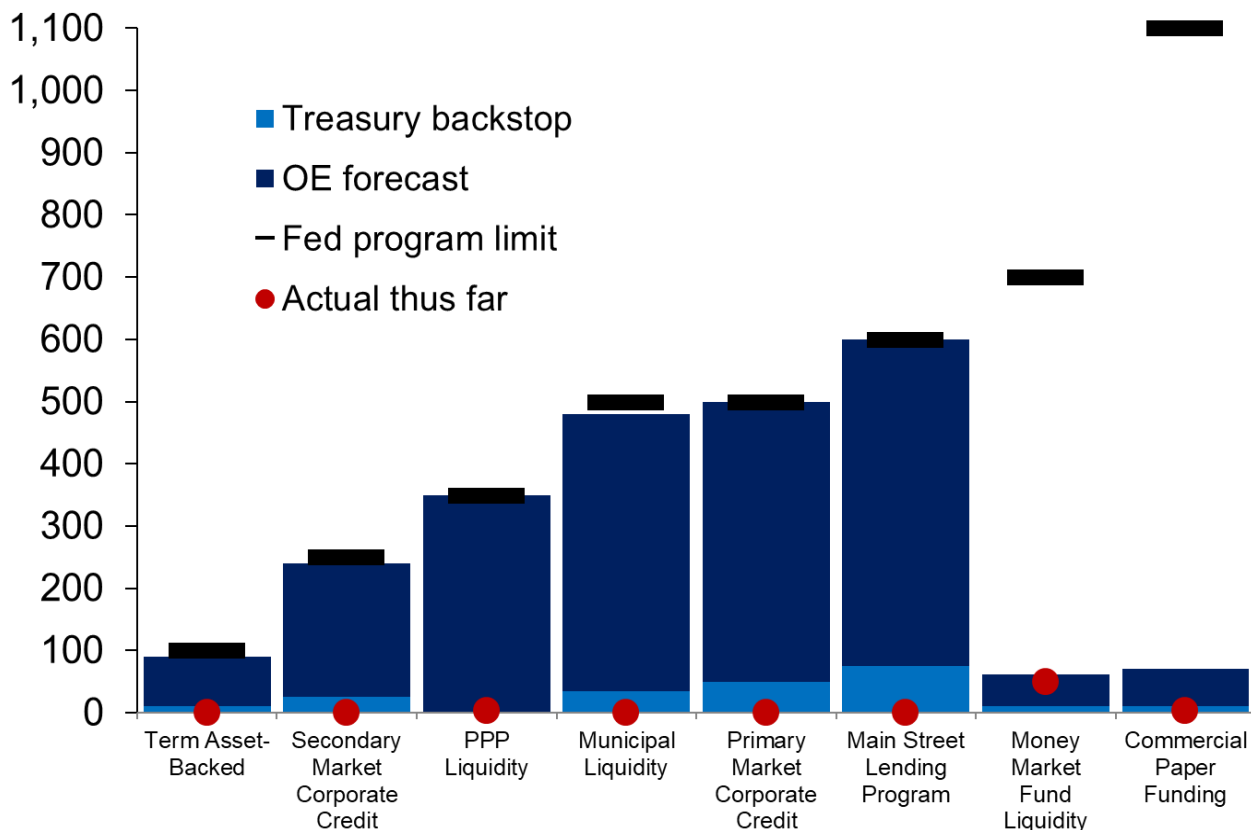
FOMC – April Meeting

- Fed reaffirmed its **dovish forward guidance: do “whatever it takes”**
- **Shifting towards next phase of providing economic stimulus to support the recovery and underpin inflation expectations.**
- Powell cautioned that beyond the near-term economic, employment and inflation shock, the **virus “poses considerable risks to the economic outlook in the medium term.”**
- Policy rate remain pegged near **zero until the recovery is firmly in place, open-ended and flexible QE continues, and Fed stands ready to lend via its emergency facilities.**
- Focus on **launching five of the nine facilities** that have yet to come online while operating the others.
- Eventually we look for all **credit facilities to lend a total of \$2.5tn and the balance sheet to widen to over \$10tn**

Vast amount of firepower remaining

US: Fed's credit lending facilities

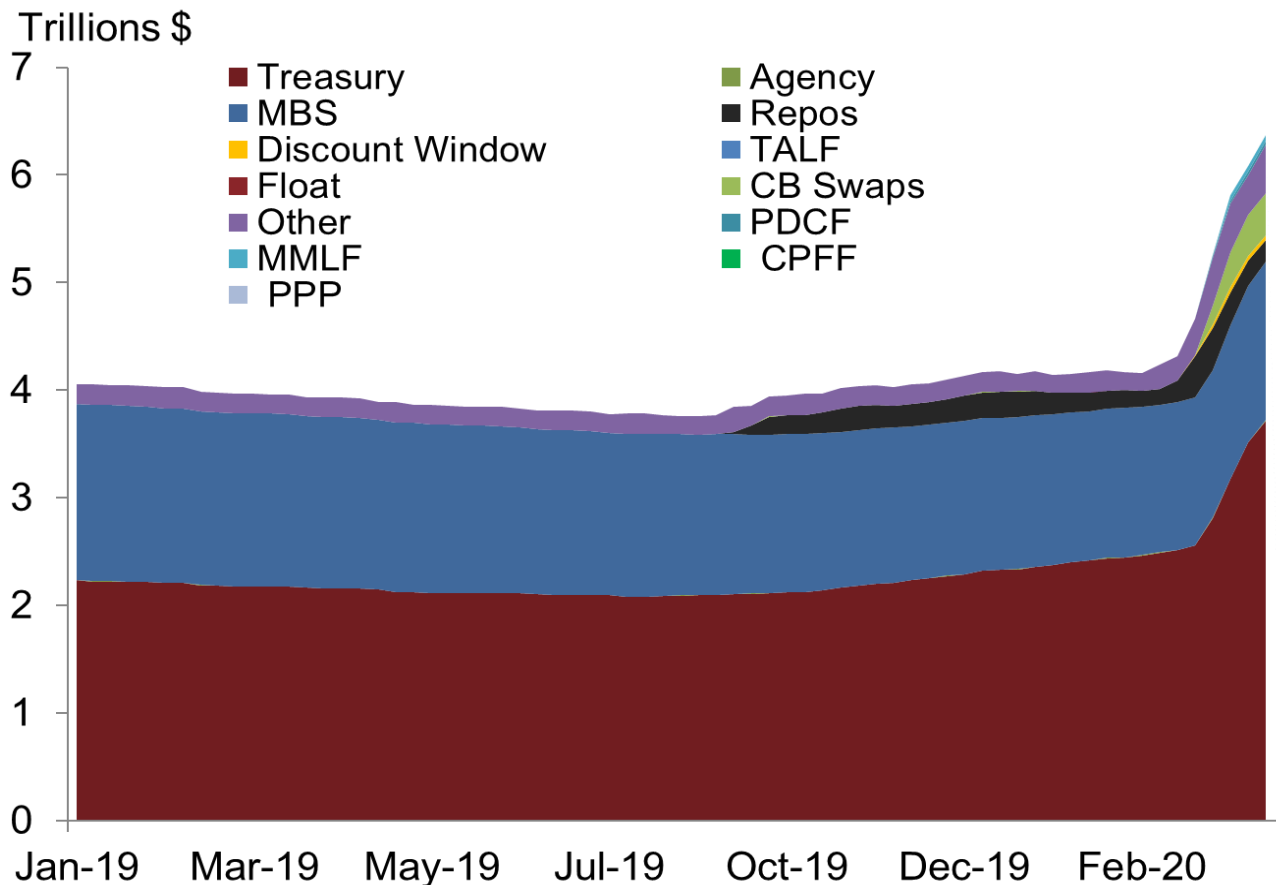
\$, billions



Source : Oxford Economics//Federal Reserve/ Haver Analytics

Bulk of balance sheet expansion led by QE and \$ swaps

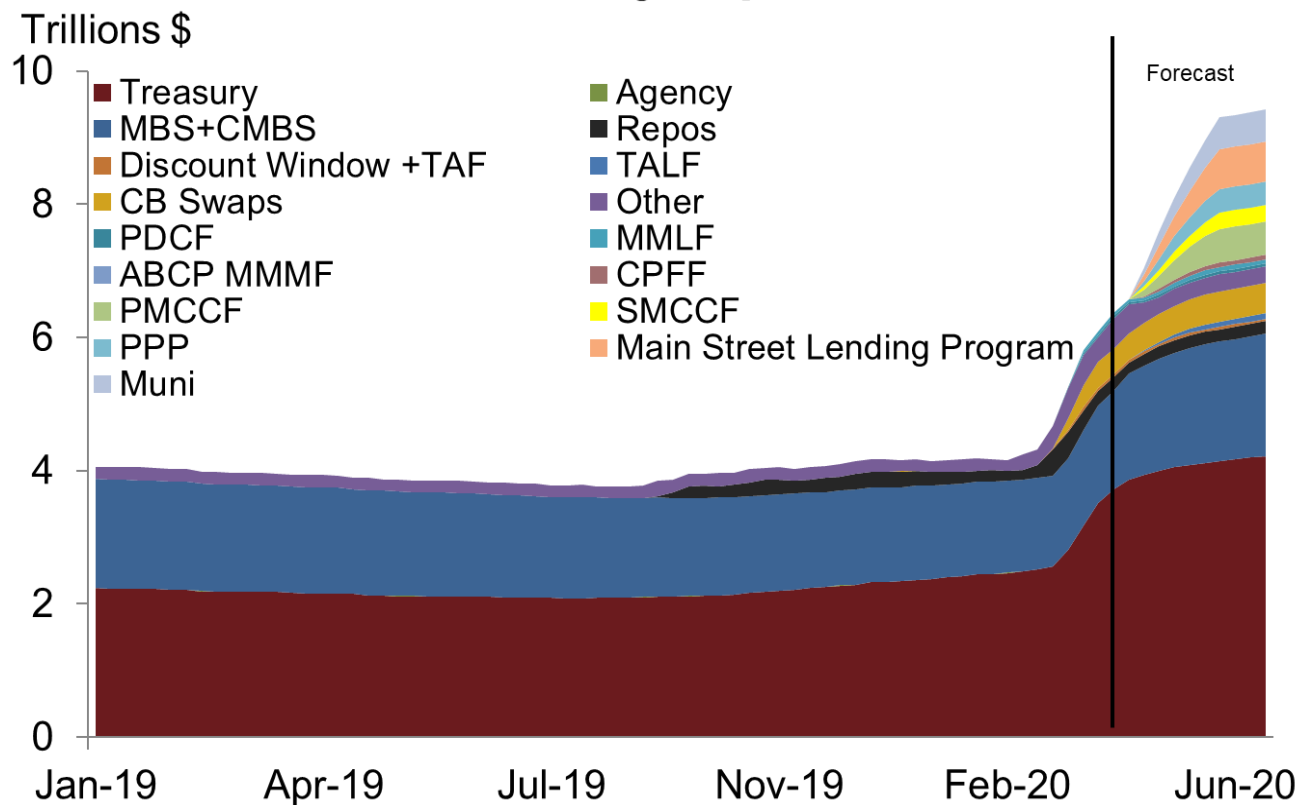
US: Fed balance sheet



Source : Oxford Economics/Haver Analytics

Balance sheet to double in size as facilities come on line

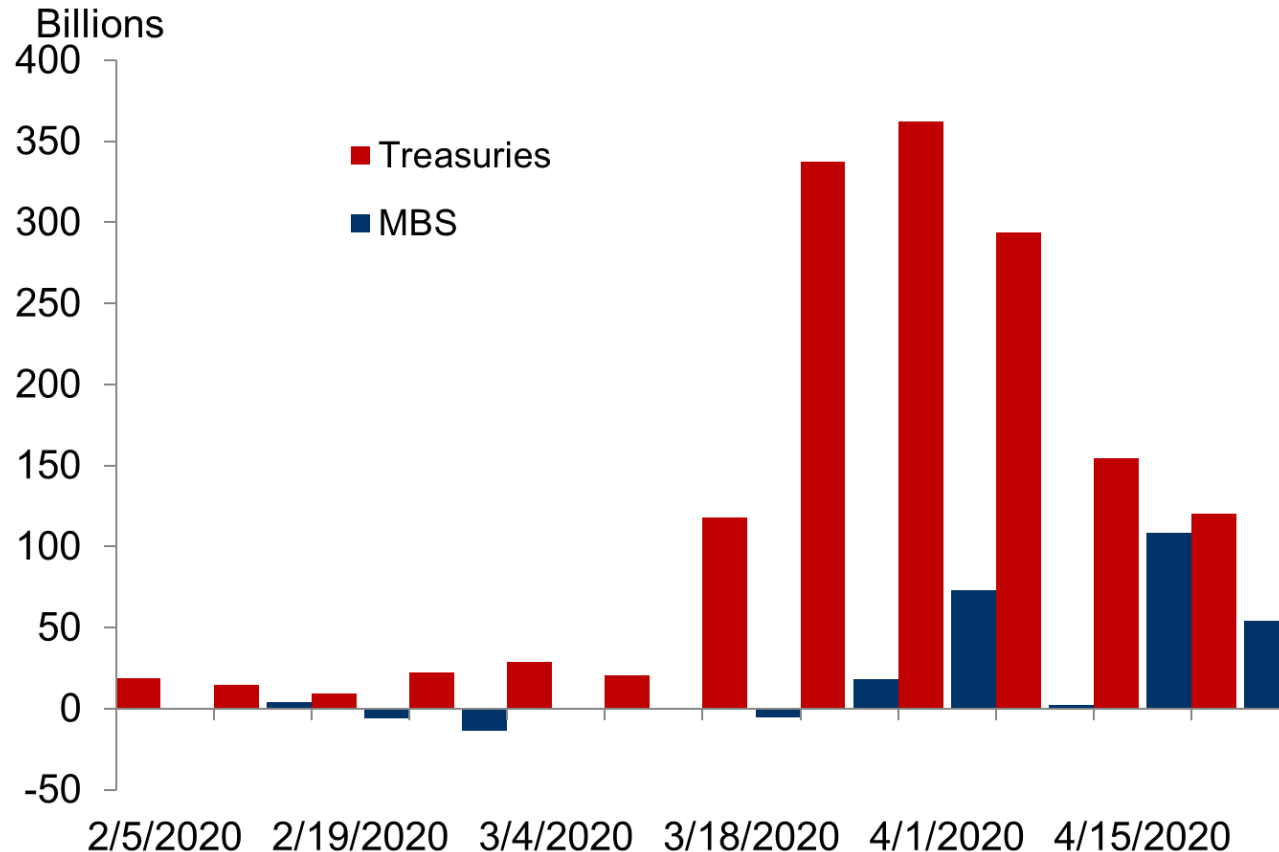
US: Fed balance sheet jumps to new record



Source : Oxford Economics/Haver Analytics

QE is open-ended and flexible – slower pace

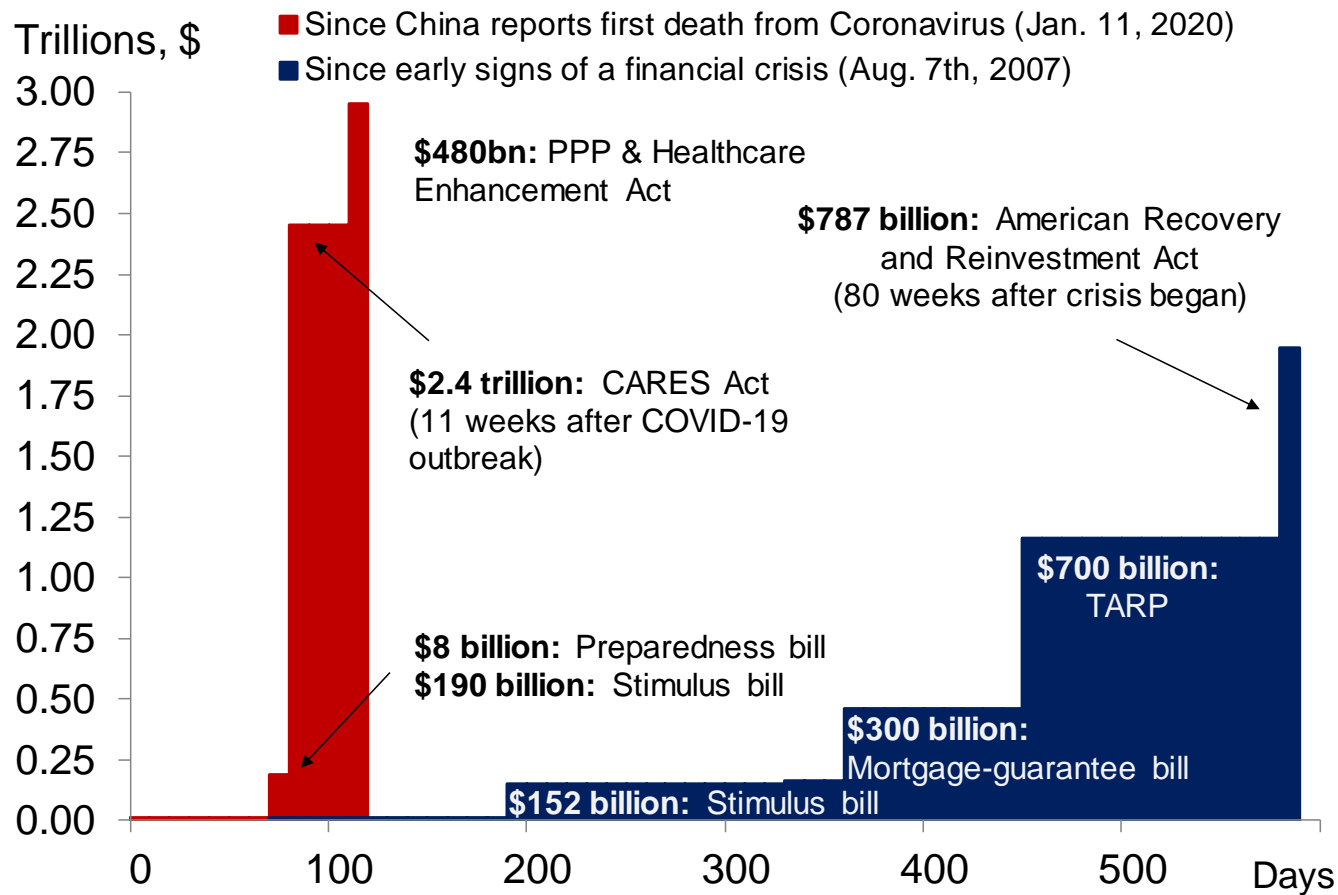
US: Fed QE asset purchases



Source : Oxford Economics/Haver Analytics

COVID stimulus in comparison to the GFC

US: Funds authorized by Congress



Source : Oxford Economics/CBO

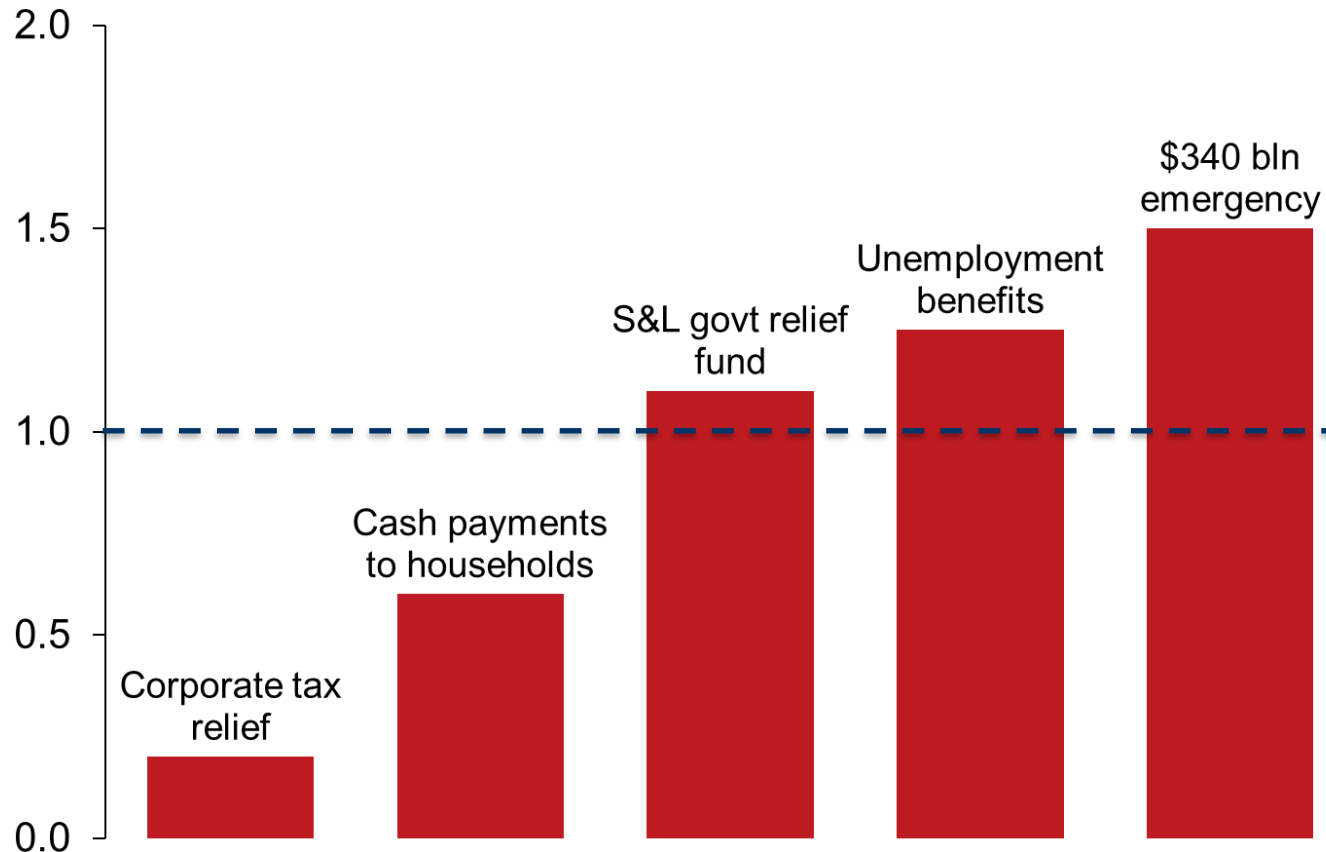
Congress does “whatever it can”

Key Provisions of the Coronavirus Aid, Relief and Economic Security (CARES) Act		
Provision	How much	For what
Cash payments to individuals	\$290 billion	\$1,200 per adult, \$500 per child. Payments start to phase-out for incomes above \$75,000
Increased unemployment benefits	\$250 billion	Expanded eligibility, increased benefits, additional emergency benefits after state benefits exhausted
Assistance for small businesses	\$350 billion	Loans forgiven if used to maintain payrolls, benefits; pay rent, utilities
Aid to hard-hit industries	\$500 billion	\$75 billion for airlines, industries related to national security; balance used to leverage up to \$4 trillion in Fed lending
FY 2020 Supplemental	\$340 billion	About \$150 bln of the total will go to hospitals; 80% of funds funneled through state and local governments. Most agencies get extra funding.
Corporate tax relief	\$232 billion	2020 payroll taxes deferred until end of 2021; fixes errors in the TCJA.

Source: Oxford Economics

Multipliers are capped by lockdown

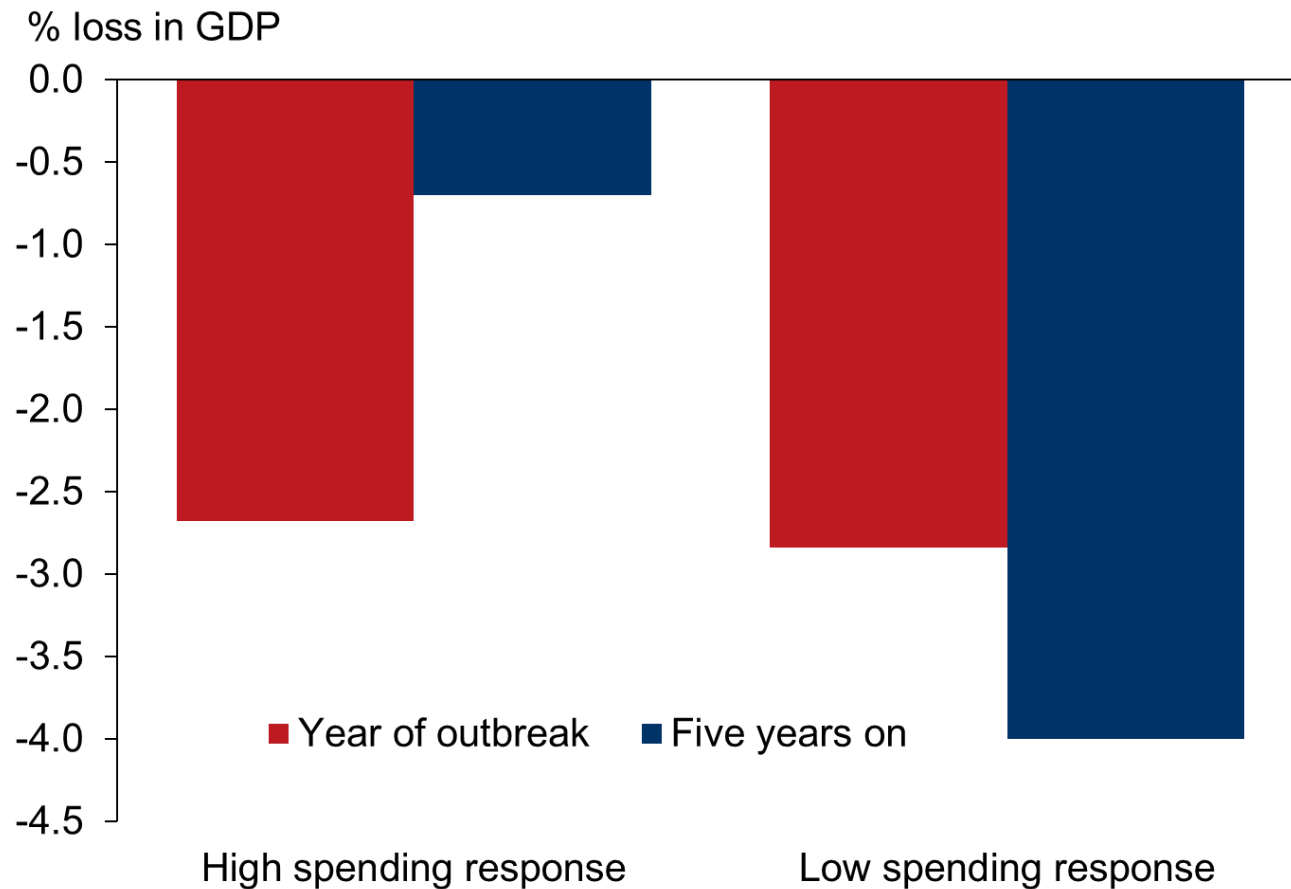
US: Fiscal multipliers for major CARES provisions



Source : Oxford Economics

But fiscal stimulus is essential to preserve economy

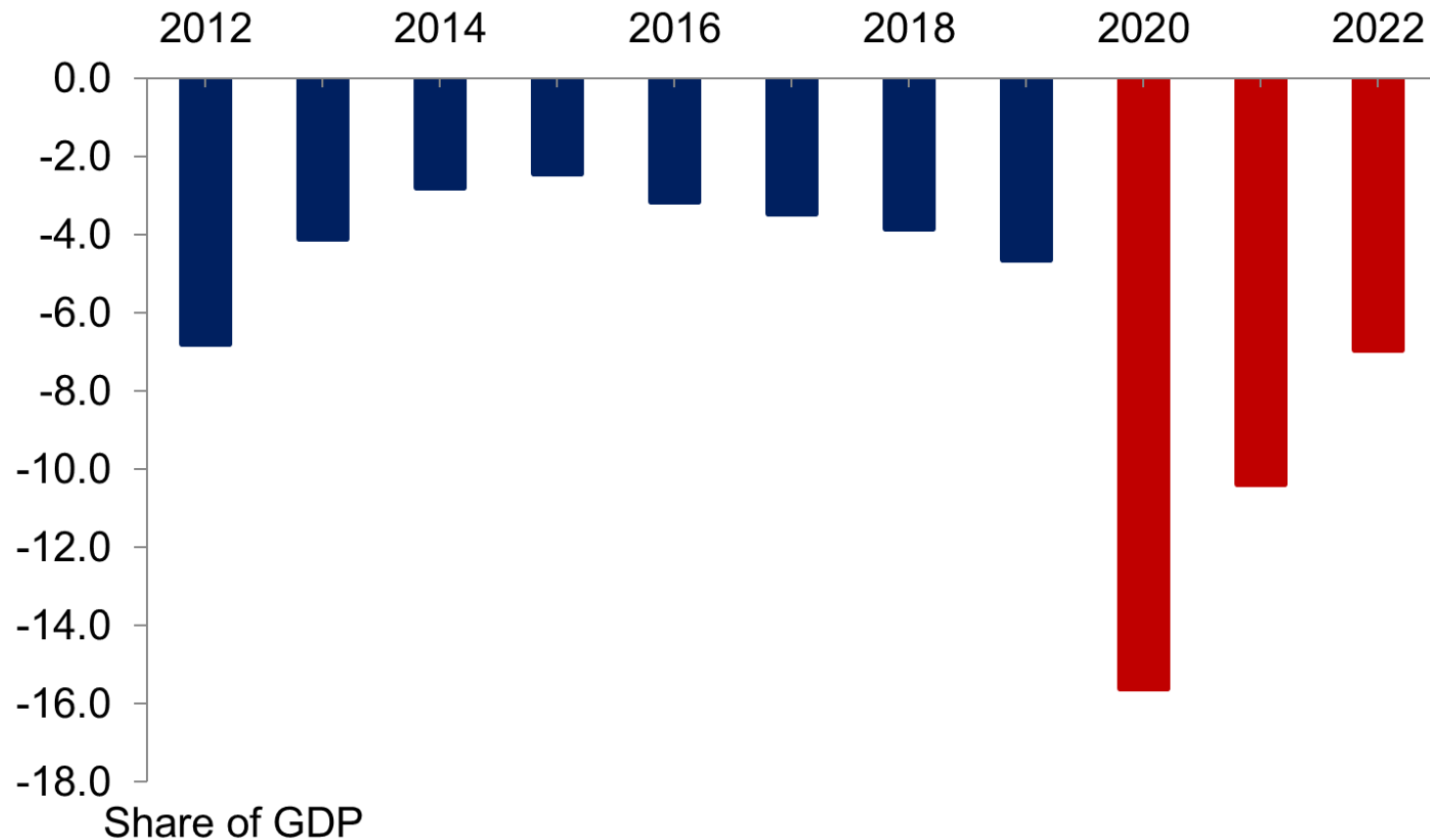
US: Effect of policy responses to pandemics



Source : Ma et al. (2020)

A widening federal budget deficit to fight the GCR

US: Federal budget deficit will surge in FY 2020



Source: Oxford Economics

Public debt rising to highest since WWII

US: Debt held by the public

Share of GDP



Source : Oxford Economics/Haver Analytics

Conclusions

Figuring out where we're going

- The Global Coronavirus Recession (GCR) hit the US economy with tremendous force. We anticipate a peak-to-trough decline in GDP of around 12% in H1 – 3 times larger than the output loss during the GFC, and the biggest economic contraction since 1946.
- We anticipate a gradual rebound with the economy not regaining its Q4 2019 size before mid-2021.
- The 7.3% decline in consumer spending in March was the largest monthly drop on record. With the economics of fear in full swing, consumers bolstered their precautionary savings to 13.1% – the highest since 1975.
- Disinflation strengthened in April. We expect the strong disinflationary impulse from the Global Coronavirus Recession will lead to deflation for headline PCE, and the weakest core PCE inflation on record.
- At the April FOMC meeting, the Fed stressed the tremendous near-term damage from the GCR and highlighted significant medium-term downside risks to the outlook. Chair Powell pledged to act “forcefully, proactively, and aggressively” to ensure a robust economic recovery but stressed the Fed only had “lending powers, not spending powers [like Congress]”.
- Sudden stop in private sector activity will be partially offset by massive public sector spending, worth over \$3tn, and unprecedented Fed stimulus with firepower of around \$4tn, but even so, the employment losses will be huge and traumatic, and the rebound post-virus will be very gradual and fraught with pitfalls.



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