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Four months in, still lots of questions about the coronavirus' impact on the economy

By

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From the beginning much uncertainty surrounded the coronavirus pandemic. But almost four months after stay-at-home orders started, economists agree on little about the shape of the recovery, the timing, and where things stand right now.

While the worst of the predictions failed to materialize — unemployment never hit the high levels expected and most numbers started improving after a month or two — a second wave of the virus could take another bite out of the economy.

"The recovery is happening much sooner and much faster than anyone expected," according to Jeffrey Cleveland, chief economist at Payden & Rygel. He pointed to the purchasing manager indices, which suggest a V-shaped recovery. This is "important, because PMIs are close to real-time, while a lot of hard data lags."

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But, headwinds remain, he noted. “It’s entirely plausible that the virus is with us indefinitely and that a vaccine will remain elusive,” he said, but that doesn’t necessarily mean another global shutdown. And, as long as the economy stays open, recovery continues.

Another key employment issue is the $600 federal assistance for the unemployed. While some say the payments make being unemployed “more lucrative” than working, Cleveland noted, others say when the payments end this month, it “will halt the nascent economic recovery.”

The stimulus will probably be extended, he said, but at a lower amount. “A combination of workers hired back and continued benefits for those still unemployed means the recovery will continue, fiscal cliff fears are overdone.”

Also, expect the Federal Reserve to have a say. “We suspect the next policy tool to be unsheathed will be outcome-based forward guidance not yield curve control or negative rates,” Cleveland said. “The Fed is more familiar with outcome-based guidance, having used it to good effect in the early 2010s and far too many questions in the minds of policymakers remain on yield curve control and negative rates. That being said, outcome-based forward guidance could keep monetary policy easy for years to come. For investors, the yield famine will continue.”

Eric Leve, CIO of Bailard, also stated concern about the $600 benefit. “As supplemental unemployment benefits roll off at the end of July, the economy is at risk of going from one where net disposable income was actually higher than it was at the end of 2019 to a much weaker position,” he said. “A weak consumer means a weak economy, and if we expect to get many of those service sector jobs back, spending is critical.”

And while the economy has improved as closures eased, Leve said, the economy won’t return to the levels from the fourth quarter of 2019 “until late 2021 or even early 2022,” although the recession will be over well before then.

Learning how to manage the spread from the first wave, he said, “We will probably be able to experience a second wave of COVID without the same extreme economic shutdown if people wear masks whenever they are in public places. This is probably the much more critical element than social distancing and can pave the way to manage a COVID wave without similar economic impact to what we experienced in the second quarter.”

There is no clear answer, said Hank Smith, chief investment officer at Haverford Trust Co. “In some regards we are better off because of the massive fiscal stimulus (and monetary stimulus) has buffered the impact of COVID-19 by putting extra cash above unemployment benefits in consumer's wallets," he said. "In other ways we are not better off as Main Street (small business), restaurants, hotels, hospitality/events and airlines continue to suffer."

"We should never again shut our economy down as we did for a couple of months," said Hank Smith, chief investment officer at Haverford Trust Company.

Experts originally thought the summer weather would slow COVID-19, as is the case with other viruses. "Clearly the virus isn't fading and the impact of the forced shutdown of non-essential business is greater than first anticipated," he said. "We will not fully recover until social distancing goes away and that won't happen until either there is an effective vaccine or the virus fades on its own."

His key takeaway: "We should never again shut our economy down as we did for a couple of months. The harm done to small businesses is hard to justify. The U.S. consumer is smart enough to behave rationally during a pandemic without government ordering capricious rules and regulations."

Allen Sukholitsky, founder and chief macro strategist at Xallarap Advisory, called thoughts of a V-shaped recovery "a head scratcher." He added recovery expectations were overly optimistic. "Coronavirus concerns kept consumers —

the driving force behind GDP growth — from consuming, which is why it should have been clear that economic growth would contract considerably.”

“Supply chains do not turn on overnight and the labor market is currently facing businesses that have been forced to operate with fewer resources,” he said. “We expect contraction to end in the second half of 2021.”

“The recent spike in cases portends a difficult path for economic progress,” said Robert R. Johnson, Professor of Finance, Heider College of Business, Creighton University. “The economy will turn when the virus is under control and there is no reason to believe that is imminent.”

Stock market gains do not suggest “the prospects for the underlying economy are strong. The stock market is strong because of the support for asset prices provided by the Fed’s unprecedented infusion of liquidity.”

He fears a slow recovery.

“We’re ahead of where we thought we would be at this point in the cycle,” said Gary Schlossberg, Global Strategist at Wells Fargo Investment Institute. “However, worries about second-wave infections and the strength of the economic reopening leave us with a more guarded outlook than anticipated.” This means a W-shaped recovery is more likely than a V- or U-shaped one.

And while the number of cases has increased in states that have reopened, “the impact, thus far, has been far milder than it was earlier in the spring, partly because lockdowns have been more limited geographically and by breadth. Moreover, higher infections haven’t been followed as quickly by increased deaths, at least not yet, tempering the hit to confidence (at least so far). The big test will be in coming weeks, to see if infections skewed more toward younger, more resilient cohorts spread to older, more vulnerable age groups.”

“Until we have a durable method to contain the coronavirus outbreak, risks to the economic outlook remain biased to the downside,” said Peter Donisanu, chief financial strategist at Franklin Madison Advisors.

Data showing improvement in the second quarter “may have led to a false sense of comfort regarding current and future economic conditions,” he said. While the June nonfarm payrolls report appeared better than expected, “a closer look at the report, however, shows that the number of permanent job losses continues to accelerate.”

He agreed, “economic pain will continue until we have a reliable method to contain the coronavirus outbreak.” Further, “rising coronavirus infection rates reintroduce a host of risks, particularly related to economic growth.”

Should cases continue to rise, it “could pave the way for a prolonged hiring slowdown, weaker consumer spending, and a more severe economic contraction in 2020,” Donisanu said. Measures to stem the spread of the disease “have become politicized,” he said. “Unless we can separate the political issues from the genuine healthcare crisis, a second wave might be more disruptive to the economy than the first.”

Michael White, portfolio manager, multi asset strategy at Picton Mahoney Asset Management, also said the jobs report was deceptive. “There is a stealthy rise in the incidence of permanent layoffs,” he said.

While stimulus programs have kept bankruptcies in check, “when these programs wane, we could see lingering pain in some structurally inefficient business models which the pandemic exposed and exacerbated. It’s likely the full extent of economic impact is not yet known. That said, there is massive pent up demand, consumers have been net savers on average through the pandemic, and when economies re-open, we should expect a fairly swift acceleration.”

It’s not certain that all jobs lost will come back. “Lasting damage has been done to certain industries and they may not fully recover to the way they were before COVID-19,” White said. “New business models will evolve from this disruption, but it will be difficult to assess how soon everything will return to prior levels of economic output.”

The increase in cases suggests some regions “were hasty in their re-opening plans.”

Uncertainty remains. KC Mathews, executive vice president & chief investment officer at UMB Bank, pointed to the difficulty of predictions. “A perfect example is the variance in the Federal Reserve’s forecasts, the Atlanta Fed’s GDPNow model estimates a 35.2% contraction in the second quarter, yet the New York Fed’s forecast is only down 15.1%.”

Aggressive moves by Congress and the Federal Reserve prevented a worse outcome, he said. “However without additional stimulus, consumers may face a household fiscal cliff.”

Mathews said, “There is a material risk that consumption slows if layoffs continue and stimulus is reduced.”

While a second wave would delay the recovery, “many state officials have declared they will not shut down the economy again, nevertheless, if consumers self-isolate, the economic recovery may be in jeopardy. In addition, companies want to protect their workers. If they can’t reopen safely, expect more delays.”

A full recovery may be a misleading term, said Kevin Philip, managing director at Bel Air Investment Advisors. “The economy can recover to pre-COVID GDP levels perhaps by 2022, but there will be permanent damage offset with large winners and new segments of growth.”

The increase in cases “will test our political will to keep the economy trending toward opening, it will stress our healthcare professionals and infrastructure, and most importantly, it will increase deaths and health ramifications for those infected,” he said.

Staying closed for at least a year while a vaccine is developed, “would dramatically change our open market system as we know it; we would, in essence, become a state-backed zombie economy. We are trying to find the balance of who we are, who we want to be, and what we need to be in the meantime — and there are very many valid opinions about different approaches.”

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