Newsweek

Why The U.S. Economy May Never Be The Same Again After Coronavirus

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It's been a crazy couple of weeks in the pandemic economic prediction business.

So crazy that even the White House can't get its stories straight. In one corner President Trump's advisor/son-in-law Jared Kushner and U.S. Treasury Secretary Steven Mnuchin told us that happy days will be here again—and the country "rocking" by July. In the other, former White House Council of Economic Advisors chair Kevin Hassett and now White House consultant called the economic situation "grave." (Granted, he was quickly told to knock off the "gloom and doom" by his colleague, Peter Navarro.)

But be wary of those rosy forecasts put out by market analysts and the White House. It's going to take a while. Exactly how long depends on science, not politics, as Warren Buffett said April 2 at Berkshire Hathaway's annual meeting.

Now, nobody likes that answer. But Hassett, before his time out, was simply saying what most economists are saying. His mistake was being honest and saying it in words we can all understand— instead of talking about V, L, W-shaped recoveries and SAAR's (seasonally adjusted annual rates.) As Bart van Ark, global chief economist at The Conference Board, says, "Growth rates are confusing. Of course we'll get a recovery. If one store opens that will be a recovery. That doesn't mean we'll be anywhere close to where we were."

Recovery starts when the economy bottoms out and shifts from negative growth to positive. But what the person-on-the-street means by recovery is when we will get back to where we would have been without COVID. That's not going to happen for a while. Oxford Economics is predicting the US economy will contract by -12 percent in the first half of the year and then grow slowly. (Arithmetic alert: Even recovering at the same rate doesn't get us back to level. If the economy contracts by 12 percent over six months and then expands by 12 percent over the next six, it will end the year smaller.)

Here's what the experts told us will happen—in English:

Good news first. Don't panic. We aren't headed for a Great Depression. During the Great Depression the economy went backward for four years in a row. David Wessel, director of the Hutchins Center on Fiscal & Monetary Policy at the Brookings Institution and winner of two Pulitzers says, "We aren't going to repeat the 1930s: Monetary and fiscal policy have responded aggressively and quickly. Congress hasn't done all that it should...but both Congress and the Fed saw the economic threat and acted. They learned both from the mistakes of the 1930s and from those made just a decade ago in the Great Recession."

However, the economy won't be back to the pre-pandemic baseline until mid-2021 or later. This year will be one of fits and starts. The economy will improve as pandemic numbers fall and as the government pumps trillions into election-year stimuli. Then it will fall back if pandemic numbers rise as restrictions are loosened or a second wave hits in the fall. Growth will only become less saw-toothed once there's a vaccine or treatment. Very best case, a vaccine will become widely available late in 2020.

But even if the virus were to vanish overnight, restarting an economy isn't like turning on the tap. Think about reopening a restaurant. It's not just flipping the light switch and unlocking the front door. The premises will need to be cleaned and restocked. Staff will have to be rehired, and in an industry with high turnover that may be challenging. Customers will have to be convinced it's safe to return. More complex enterprises will face more complex restarts. It's weeks and months, not days.

Scott Minerd of Guggenheim Investments predicts it will be four years before the entire economy gets back to where it was. Even that may be optimistic. It took 51 months for the economy to come back after the Great Recession, and the economy is in a much bigger hole today. After any downturn, there's a lot that has to be flushed from the financial system—CLO's (bundles of low grade debt), weak business models, bad real estate projects, and industries that can only exist in a booming economy, like shale oil.

Don't be fooled by the stock market. The stock market will catch up long before the economy does. Gregory Daco, Chief US Economist at Oxford Economics US, estimates the economy contracted by -5 to -7 percent in March. The S&P 500 rose by almost 13 percent the following month as unemployment claims boomed. In other words the market moved in the opposite direction of the economy.

Call it economic PTSD. Van Ark says consumer confidence before COVID was at near-record levels, but fell by a record 19 percent in April. For many, the economic hardships haven't even hit yet, as they will when savings are exhausted. Jerry Nickelsburg, director of the UCLA Anderson Forecast says, "After the Great Recession, we saw people responding in two ways. People who'd been unemployed had to rebuild savings. People also had a greater sense of insecurity. Both led to more savings and less consumption, and a slower recovery, not the rapid snap-back some people are calling for." Which is why...

Some sectors will come back slowly. Van Ark says The Conference Board forecasts seventy different sectors. He believes many will adjust easily, but many will not. Service industries whose business model is based on making money by running a lot of people through, like airlines, sports venues, and cruise lines, will struggle to adapt to what he calls "the six foot economy."

If there's no vaccine or treatment, airlines might need to leave every other seat empty in order to convince customers (and maybe crew) to return. But airlines must fill around 80 percent just to break even. It's no surprise that Buffett has dumped his airline holdings. Until there's a vaccine, it's hard to envisage the sector rebounding. Other industries with high levels of face-to-face interaction, like ride-sharing, will also come back slowly.

Some sectors may never recover. Nickelsburg says brick and mortar "Retail was in decline before in an expanding economy. There will be fewer people re-employed there after this is over." The decrease in consumer demand and the interruption of operations may also be a death knell for many small businesses. Van Ark says, "We will see a lot of bankruptcies. The problem with small businesses is 'Do they have the time to recover?' Every week they're closed means they're closer to insolvent." According to the National Restaurant Association, 3 percent of restaurants that have closed so far will never reopen. There could also be a shake-out for businesses based on the gig economy, i.e., part-time employees, as many shift to full time jobs that pay less but are more certain.

But what about people?

Some families will never recover economically. Patricia McIlreavy, CEO of the Center for Disaster Philanthropy, says, "The arc of a disaster is very long. We have to be careful not to be overly simplistic in our definition of recovery." Those just entering the workforce and those down the economic pyramid will fall behind and may not catch up. Income inequality will get worse. That's what happened in the Great Recession. According to Pew Research Center, those at the bottom of the income ladder had less in 2016 than they did in 2007, $10,800 vs. $18,500 before the recession. Middle-income families saw their net worth drop from $163,300 (2007) to $110,100 (2016.) After almost a decade, the only ones to have caught up and gained ground were upper-income families.

The economy will be more volatile going forward. We're unlikely to see any more 10-year expansions. Our modern, hyper-specialized economy is very efficient, but it's surprisingly fragile. There's not a lot of spare capacity or inventory lying about, as we found with ventilators. Despite talk of building resilience in, it's unlikely we will because it comes at a cost. It's hard for companies that live quarter to quarter to take the long view. Instead, we will deal with shocks as they come. The last decade has been a great ride, but it's taken a lot to pull it off. We've used every tool in the economic toolkit—tax cuts, monetary policy, and fiscal stimulus. The Fed Funds Rate is at 0.25 percent, almost zero. The deficit is at record levels. With the COVID crisis, the Fed has used its emergency 13(3) powers to lend to business for only the second time since the Great Depression. At some point we'll run out of tricks.

We all want to get back to "normal" right now (although the levels of sustained growth and low unemployment we've experienced over the last 126 months weren't truly "normal.") That's not going to happen. Wessel says, "We don't know how quickly science can come up with treatments and a vaccine. And we don't know how consumer and business behavior will change. The rapid V-shaped recovery seems unlikely. The question is how long it takes for us to recover. Quarters? Years? A decade? And whether we'll ever get back to the pre-COVID baseline." And things will be different after COVID.

That's what Kevin Hassett wanted to say—before Pete Navarro pulled the plug on his microphone.