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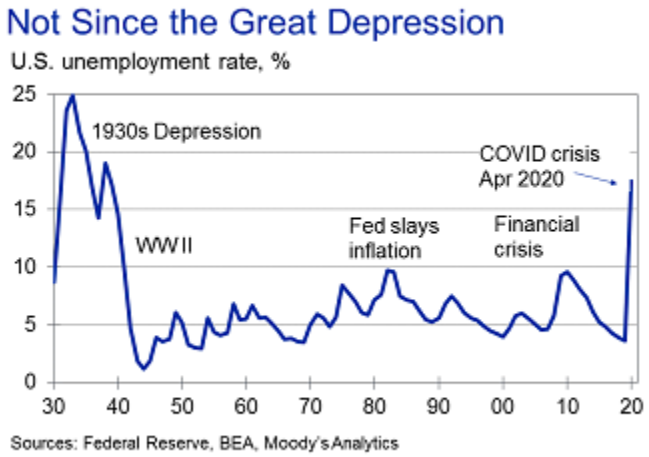
This Week in the COVID Crisis

Introduction

The apex of the economic blow from the coronavirus in the U.S. is occurring now. Moody's Chief Economist Mark Zandi offers his thoughts on the economy in a look ahead at the pandemic and its fallout. This article was originally published on Economic View.

The apex of the economic blow from the COVID-19 crisis in the U.S. is occurring now. The employment loss will peak in April, with between 20 million and 25 million lost jobs. This will entirely wipe out the 22.8 million increase in jobs during the previous record long expansion. The jobs lost are about half the nearly 50 million jobs that existed in businesses considered nonessential in the crisis and cannot be done while working at home.

Unemployment will surge in April to between 15% and 20%. This will be far-and-away the highest unemployment rate since the 1930s Great Depression. Nevertheless, this unemployment rate significantly understates the stress in the job market, since many of the unemployed will not be actively looking for work (because they can't), and thus according to the Bureau of Labor Statistics are not in the labor force and therefore not officially counted as unemployed. A broader measure of underemployment—the U-6 rate, which includes these workers—will approach 25%, the peak unemployment rate in 1933.



Some businesses across the country appear likely to reopen in coming weeks. Governors of many states are under intensifying pressure to ease the lockdowns, regardless of whether this makes the most sense in combating the virus. Construction will open up first, if it isn't already considered an essential activity as it is in some states, as will manufacturing. These are high-value-added industries, and their reopening will lift GDP, and to a lesser degree, jobs. Just over one-fourth of GDP is estimated to be off line, and only about half of that is expected to be off line a month from now. Despite this restart, real GDP is expected to decline by more than 30% annualized in the second quarter.

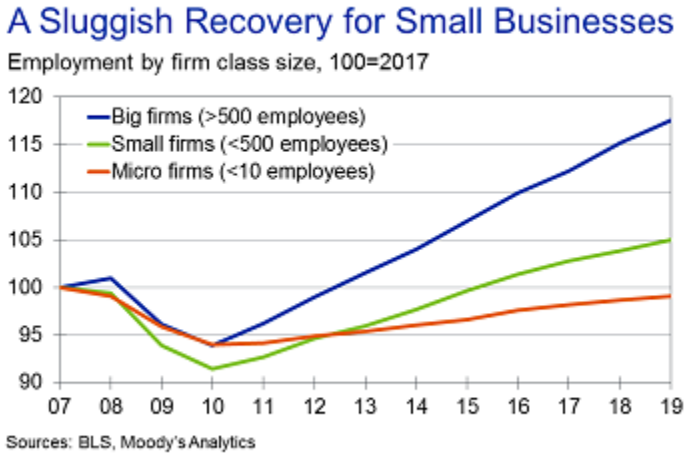
The job losses should also turn to job gains by late May, in part because of the easing of the business shutdowns, but also because of the federal government programs implemented as part of the CARES Act fiscal rescue legislation. The Paycheck Protection Program, for businesses with fewer than 500 employees, provides loans that become grants if the bulk of the money is used to pay worker wages. Businesses receiving the $350 billion appropriated for the PPP will bring back some of their furloughed workers. The construction, manufacturing, healthcare and professional services industries are the principal beneficiaries of the PPP, at least so far. The Main Street Lending Program, which provides financial support to businesses with up to 10,000 employees, should also help restore payrolls, although this will take even more time to roll out.

Lawmakers are close to agreement on a much-needed fourth fiscal rescue package totaling close to $500 billion in additional aid. This will include more funds for the PPP and additional help for hard-pressed hospitals battling the virus. Much-needed support to state and local governments will need to wait for the next fiscal package. By our estimate, states will have a combined budget shortfall of $200 billion between now and the end of their 2021 fiscal year, and at least an additional $100 billion in fiscal 2022. Without help from the federal government, state and local governments will have no choice but to cut jobs and spending on services particularly critical to lower-income and underserved communities. When all is said and done, some $4.5 trillion in federal monies—another $2 trillion on top of the $2.5 trillion already appropriated—is expected to be spent to support the economy now and to stimulate it later. This is more than 20% of precrisis GDP, and about double the federal support provided during and after the financial crisis a decade ago.

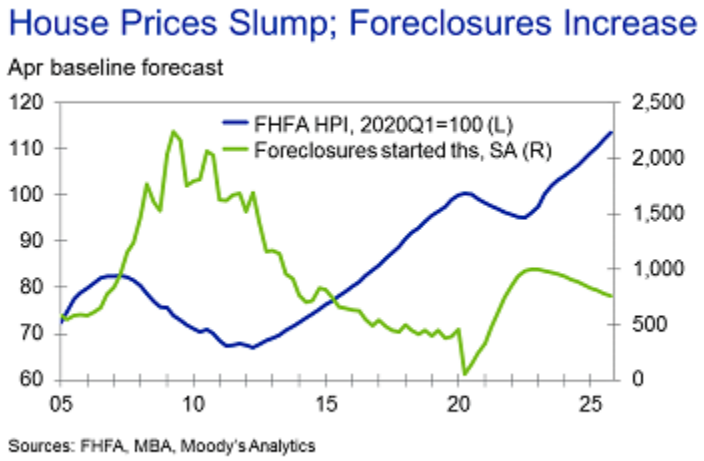
With businesses restarting and the federal government and Federal Reserve providing massive fiscal and monetary support, the recession will end this summer and the economy will enjoy a bounce in the third quarter. Real GDP and jobs will increase, and unemployment will decline. By the fall, unemployment should be back in the high single digits. Of course, this presupposes that the business restart and the scaling back of social distancing rules will not reignite more infections, hospitalizations and deaths. This is a big if, particularly since it is unlikely to be the kind of widespread testing for the illness and its antibodies necessary to quickly track down and quarantine the sources of new infections. A serious second wave of the virus would be the fodder for a cataclysmic double-dip recession and what would likely be considered an economic depression.

The restart of the Asian economy, which began almost two months ago, is a cautionary tale. Many Asian countries were aggressive in responding to the virus, imposing severe lockdowns and social distancing rules and engaging in widespread testing. Infections and deaths were limited, at least compared with the experience in Europe and the U.S. But the virus isn't going away, and Asian nations are still grappling with how to contain it. Singapore, for example, recently re-implemented lockdowns, and its border with Malaysia has been closed. Japan also appears set to suffer a nasty second bout of infections.

Even if the U.S. business restart goes reasonably well, and the virus remains largely contained, the economy is unlikely to get fully back on the rails until there is a vaccine, or barring that, an effective treatment that forestalls hospitalizations and deaths. A surge in business failures and bankruptcies will impede any economic recovery. Smaller businesses—those with fewer than 50 employees—are the most vulnerable to failure, because they have fewer financial resources and are less likely to receive government support. Before the virus hit, these businesses accounted for almost one-fifth of all jobs. New businesses will ultimately form and fill the void, but that will take time. After the financial crisis ended, it took six years for employment in smaller businesses to return to its pre-crisis levels. There are proposals in Congress that would provide cash directly to these businesses, and forgo the complicated PPP process, but the odds of getting these proposals into law in time to help much are not particularly good.



Households will also struggle to pay on their debts, including residential mortgage loans, although the most severe credit problems may not show up until this time next year. Homeowners with government-backed mortgage loans, including those from the FHA, Fannie Mae and Freddie Mac—which together account for about 70% of outstanding loans—can receive forbearance on their mortgage payments for up to a year. Private financial institutions, mostly banks, that hold the other 30% of the loans are not nearly as forgiving but are also providing some forbearance. An estimated 1.4 million loans have already received forbearance, and close to 15 million loans are ultimately expected to receive help (based on the expectation that nearly 40% of government-backed borrowers will have some disruption to their income due to the virus and will request forbearance). House prices will weaken, adding to the foreclosure problems, but it is important to note the problems will be nothing compared with those of the financial crisis. With affordable housing in extraordinarily short supply, the house price declines will be limited, and given the tight mortgage underwriting and plain vanilla fixed-rate mortgage loans originated since the crisis, so too will the foreclosures.



Nonetheless, as loan losses mount, the financial system and markets will come under renewed pressure. The Federal Reserve has done an admirable job standing up a firewall between the severe economic downturn and the financial system. By quickly pushing short-term rates to the zero lower bound, reducing bank reserve, capital and liquidity requirements, engaging in massive bond purchases, and standing up a potpourri of credit facilities, the stock market has rebounded, and credit markets are functioning reasonably well. Ensuring that the financial system is not infected by the COVID-19 crisis is critical to limiting the economic damage done by the virus. But the Fed's firewall will almost surely be tested again once investors actually see the extent of the losses from the failures, bankruptcies and defaults. A necessary condition for a fulsome recovery is for the firewall to hold.

A necessary and sufficient condition is a vaccine. That seems on track for mid-2021, at least according to most health officials and the pharmaceutical and bio-technology community. Until then, any economic recovery will remain something of a slog, characterized by halting growth and high single-digit unemployment. And even then, the economy won't be in full swing and fully-recovered until mid-decade.