U.S. and Global Economies Slammed by COVID-19
U.S. and World Outlooks
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Key findings

• The combination of social distancing and stay-at-home measures will lead to a drop in U.S. real GDP of 22.0 per cent in the second quarter of this year.

• For 2020 as a whole, U.S. real GDP is set to contract by 3.5 per cent, compared with a gain of 2.3 per cent in 2019.

• The service sector has borne the brunt of the damage.

• The shutting down of numerous retail outlets and factories will cause the U.S. unemployment rate to jump above 10.0 per cent in the second quarter.

• Aggressive monetary and fiscal stimulus has averted what would have been a far worse outcome for the U.S. economy as it deals with the COVID-19 pandemic.

• The economy is expected to begin to recover in the second half of this year. That scenario is based on our assumption that the pandemic will start to fade as the strict measures implemented by the U.S. federal government and numerous states ultimately prove to be successful in curbing the spread of COVID-19.

• If the pandemic continues to rage on through the summer months, another drop in real GDP in the third quarter of this year can’t be ruled out.

• The severe disruptions in the global economy are likely to cause many multinational corporations to re-examine their supply chain linkages with China.
U.S. outlook

The U.S. economy expanded by close to 2.0 per cent last year, and solid gains in the fourth quarter suggested that another year of modest growth close to the economy’s long-term potential was in store for 2020 as well. The U.S. consumer was in good shape thanks to ongoing strength in labour markets, and wages continued to rise due to growing labour shortages.

The strength in consumer spending offset weakness in investment spending and trade. But even the outlook for trade grew more promising late last year as China and the United States reached agreement on phase one of a broader trade deal, which led to a truce in the war of escalating tariffs between the two countries.

These projections changed dramatically once the COVID-19 pandemic hit the U.S. and world economies with a vengeance. As the virus spread from China to other countries, fears of a full-fledged recession—or even a depression—ratcheted higher, and global equity markets tumbled. U.S. household spending plunged as federal and many state governments tried to control the spread of the virus by urging people to practise social distancing and refrain from leaving their homes except to visit grocery stores, pharmacies, or for medical appointments. As part of their efforts to limit large gatherings of people, many states ordered the closure of restaurants (except for takeout) and shops (except for those offering essential services).

Production at many factories, including auto plants, ground to a halt. Several states have implemented even more drastic measures by barring visitors from states such as New York that have been hit especially hard by the virus. Many have also put in place strict stay-at-home directives, including fines for violators. We expect the U.S. economy to decline by a staggering 22.0 per cent in the second quarter of this year. It will then begin to recover, based on our assumption (see Appendix A) that the impact of the virus will start to fade in the summer months. Overall real GDP growth is forecast to drop by 3.5 per cent (see Chart 1) in 2020, down from 2.3 per cent growth in 2019. A sharp recovery in growth is anticipated in 2021.

What has saved the U.S. economy from a far worse fate—perhaps even a return to a 1930s-style Great Depression—has been the widespread and dramatic steps taken by the federal government and the U.S. Federal Reserve to support the economy through this crisis and ensure that it doesn’t spiral out of control.
The Fed slashed interest rates (see Chart 2) to near zero in March and resumed its bond-buying program, including purchases of $700 billion worth of government bonds and mortgage-backed securities. The central bank also took steps to support corporate and municipal bond markets. In the middle of March, Fed governor Jerome Powell emphatically stated that the central bank will do whatever it takes and use all of its tools to ensure that credit continues to flow through U.S. and global financial markets. The Fed’s actions included a decision to bring back several programs initiated during the 2008–09 recession—among them, initiatives to unclog the short-term lending markets.

The U.S. Congress and the White House, while generally pleased with the Fed’s efforts, quickly realized that monetary policy on its own wouldn’t be enough to stabilize the economy, as millions of workers were losing their jobs due to widespread shutdowns. In March, the Trump administration and Congress unveiled three pieces of legislation. Phase I included $83 billion for funding the development of vaccines and diagnostics, while Phase II enhanced sick leave pay and protection for workers whose jobs have been disrupted by the virus. Then Phase III—a package worth a mind-boggling total of more than $2 trillion to support workers and businesses—was introduced.
Among the programs’ highlights:

- Around $700 billion in loans and grants to distressed companies, including $50 billion for the airline industry. Companies receiving the funds won’t be able to buy back shares, and executive compensation will be limited.

- Some $500 billion in loans for small businesses. These loans are guaranteed by the federal government and won’t have to be paid back if companies limit layoffs or pay cuts for their employees.

- $200 billion for state and local governments.

- A boost in unemployment insurance benefits.

- Direct payments to low- and middle-income families of $1,700, as well as $710 for each child.

- Help for hospitals—around $166 billion.

- No assistance for Trump properties.

Consumption

We expect that the plunge in financial markets, the closure of numerous retail outlets, and the social distancing measures will lead to a decline in real household spending of close to 30 per cent in the second quarter of this year, with the service sector bearing the brunt of the collapse. Spending will recover in the third and fourth quarters as life slowly starts to return to normal, in line with a drop in the incidence rate of the coronavirus. One of the most immediate negative impacts on spending comes from the crash in equity markets. U.S. equity markets dropped by around 30 per cent in a matter of a few weeks and, especially in mid-March, have been extremely volatile, registering large daily swings up and down. Stock markets erased all of the gains that occurred since the beginning of 2019 and have fallen back to where they were when Donald Trump first took over as president at the start of 2017.

Economists refer to the link between spending and equity markets as the “wealth effect.” When equities are rising, consumers feel better about their prospects and spend more. Conversely, when equities are plunging, people hunker down and cut back on spending. Most stocks in the United States are held by baby boomers, and for many of them, their stock holdings account for the bulk of their retirement savings. When stock markets tumble, as has been the case over the past few weeks, these boomers naturally become anxious and immediately cut back on spending to protect their savings that they will need soon or (if they are already retired) immediately. It took four or five years for equity markets to return to levels they were at just before the 2008–09 recession struck, and this is likely to be the case coming out of the current downturn.
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Gasoline prices have dropped sharply in line with world oil prices that have tumbled well below the $30 per barrel mark. The plunge in oil prices is the result of both a drop in demand and the fierce fight between Saudi Arabia and Russia over market share. By the first week of April, gasoline prices in the U.S. were averaging less than $2.00 per gallon, down from $2.60–$2.70 earlier in the year. The drop in gasoline prices comes at a good time for consumers—as summer driving season approaches, prices generally rise due to the use of more costly fuel blends to meet environmental standards. However, there are some factors that could blunt the positive impact of lower gasoline prices on consumer budgets. People are staying home as many outlets are closed. Also, companies have told workers to work from home, which means that they aren’t using their cars as much. Either way, households are saving money thanks to lower gasoline prices and reduced travel demands.

**Investment**

The investment outlook is grim, as business confidence in the United States and elsewhere has dropped sharply. The plunge of 30 per cent or more in equity markets is also weighing on confidence, and with earnings set to take a huge hit, many firms are in survival mode and will naturally cut back on their capital spending. We expect expenditures on both non-residential construction and equipment (see Chart 3) to decline in 2020, although a rebound is anticipated in the second half of this year as the impacts of the virus fade and business confidence rebounds.

Investment in the energy sector could dry up entirely, as oil prices plunged from more than $55 per barrel in late 2019 to between $20 and $25 in March—an unprecedented drop.

**Chart 3**

**U.S. real spending on equipment**

(percentage change)

The industry was already in trouble when the spread of the coronavirus started to hit the world economy with a vengeance in February and demand for oil dropped in line with much weaker economic growth. Then, in early March, OPEC and Russia failed to reach an agreement on production cuts. This was followed by Russia and Saudi Arabia deciding to wage a full-scale price war that has seen both countries ramp up production and flood the market with oil. Rising supply during a time of recession in the global economy is something we have never seen before, creating a nightmarish situation for many industry players.
Housing

The rapid spread of the coronavirus across the United States and the tough measures implemented to slow it down have abruptly halted economic activity and sharply reduced income gains, implying that big-ticket purchases, such as homes, will be put on the backburner until things settle down. The Fed’s decision to reduce interest rates to near zero and its promise to purchase $200 billion in mortgage-backed securities could help housing markets, but it is doubtful that the lower financing costs will generate enough demand among homebuyers to offset the impact of the virus on household incomes, employment, and confidence. The decline in mortgage rates benefits homeowners with adjustable-rate mortgages, as their monthly expenditures drop. But this type of mortgage accounts for only a small share of total mortgages in the United States.

Home affordability has been a problem in U.S. housing markets for the past few years, as the supply of homes hasn’t kept up with demand. Lower financing costs and the anticipated negative impact of the virus on home prices won’t change the situation significantly. Tighter labour markets and higher regulatory costs have restrained home construction, especially in the entry-level segment of the market. Also, many builders can’t find the skilled workers they need to complete their projects. The ongoing mismatch between supply and demand will keep housing prices high in most parts of the country even as the economy slips into recession.

International trade

The coronavirus has exposed a major problem for the global economy – China’s rapidly expanding presence in global supply chains over the past few decades. Even some multinational corporations that have shifted production from China to other Asian countries haven’t managed to escape China’s long tentacles. China became the world’s largest exporter in 2009 and accounted for about one-third of global trade in 2018 – up from just 1.2 per cent as recently as 2000. Currently, China manufactures about 25 per cent of the goods the U.S. imports, and this is one of the factors behind the large U.S. trade deficit. Manufacturing activity in almost every corner of the world depends on China’s factories for intermediate inputs, ranging from electrical wiring for cars manufactured in Europe to electronic components for mobile phones produced in Brazil. Chrysler announced in February that it was halting production at a car factory in Serbia because of shortages of crucial parts from China. General Motors’ factories, as well as those of other auto manufacturers in the United States, have shut down due in part to the stay-at-home orders from state governments, but also because of low supplies of Chinese-made parts. We expect that the combination of bottlenecks in global supply chains and plunging global demand will cause U.S. exports to fall this year, but that will be followed by a modest recovery in 2021.
World outlook

In the space of just two months, world economic activity plunged as the world’s largest economies closed factories, schools, airports, non-essential shops, and other businesses and activities. Workers are concerned about their jobs. Unemployment insurance claims in the United States and elsewhere have surged, while many companies could go under, brought down by their quickly rising debt and dwindling revenues. These shocking developments will lead to one of the largest contractions in global economic activity in modern times. At the beginning of this year, we expected global GDP to expand by 2.6 per cent in 2020. But the adverse developments over the past two months will likely reduce that to no growth at all this year. (See Chart 4.) And if the virus is not contained, we could even see a global economic contraction. China, where the virus originated, likely experienced a decline of between 10 and 20 per cent in economic activity in January and February, compared with year-ago levels. Real GDP in China is expected to increase by less than 4.0 per cent this year, down from the gain of 5.8 per cent that we were forecasting in January before the coronavirus crushed the global economy.

The economies of some countries in Asia—notably, China, Singapore, and Taiwan—have started to emerge from the worst effects of the virus. But there is still room for considerable disruption, as many of their major trading partners, such as the United States and Europe, are currently feeling the full effects of the coronavirus pandemic. Asia should manage a small gain (by the region’s standards) in real GDP in the 3.0 per cent range this year and a return to more normal growth in the 5–6 per cent range in 2021.

China’s economy is experiencing a comeback of sorts after collapsing in the first quarter. Many factories have reopened and some of the strict quarantine measures enforced in some parts of the country have been relaxed.

However, Japan and South Korea won’t manage to escape slipping into recession. That is because their economies were doing poorly prior to the outbreak of the virus and remain closely tied to China’s supply chains, which have been disrupted and won’t return to normal levels for a few more months.
India is attempting the unenviable task of enforcing social distancing in a country where the majority of its 1.4 billion people reside in rural areas where health care services are weak or non-existent. Real GDP in India is expected to expand by around 3.5 per cent, down from a gain of 5.0 per cent last year. The collapse in world oil prices will help somewhat, as India is a major importer of oil.

Europe is being hit hard by the virus. Italy, which by early April had recorded five times as many deaths from the virus as China, will slip into a steep recession. Most countries in Europe have closed borders and schools and have quarantined large segments of their populations. To fight the recession, the Bank of England recently reduced interest rates to close to zero, while the European Central Bank has maintained negative interest rates since the crisis began. Germany, France, and the United Kingdom have implemented large fiscal stimulus packages similar to the actions taken in the United States. But, the problem in other European countries, including Italy, is that their economies were in a delicate state even before the virus took hold and had only managed to return to full employment toward the end of last year following a decade-long slump. After years of running large deficits, Italy simply doesn’t have the fiscal room to implement fiscal stimulus. Real GDP in the European Union is forecast to decline (see Chart 5) by about 3.0 per cent this year.

Emerging countries will fare little better than Europe as the crisis unfolds. The dramatic decline in commodity prices, particularly oil prices, has hammered several Latin American, Middle Eastern, and African countries that count on oil to drive their revenues. Oil is currently trading at well below $30 per barrel due to a combination of the global recession and the fight for market share between Saudi Arabia and Russia. There is also widespread speculation that one of Russia’s goals in flooding the market with oil is to damage U.S. shale producers.
The other difficulty for some emerging economies is the downward pressure on their currencies due to the flight to the safety of the U.S. dollar during times of severe global uncertainty. This drains foreign exchange reserves and increases import prices. Conversely, countries such as Hong Kong and Saudi Arabia that peg their currencies to the greenback face a different challenge. As the U.S. dollar appreciates, their currencies also move higher, hurting the competitiveness of their exports.

Latin America will barely eke out positive growth in 2020 as the region deals with weaker demand for its exports and rock-bottom prices for oil and other resources. Like the rest of the world, many Latin American countries have implemented social-distancing measures in response to the virus (although the governments of Mexico and Brazil haven’t, as yet, taken the virus threat as seriously as they should). Mexico and countries in Central America that have close links to the U.S. economy will likely slip into recession or record sluggish gains in real GDP this year. Also, many countries in South America, including Brazil, have close trade linkages with China and have been hit hard by the collapse in the Chinese economy.
Appendix A

Forecast assumptions

Our revised forecast is based on key assumptions concerning the spread of the coronavirus and its impacts on the world economies. Currently, most of the largest economies in the world are practicing varying degrees of social distancing, with many countries telling residents to stay at home and refrain from all but essential trips to obtain groceries or prescription drugs or to see their doctors. Italy has had to take more drastic steps, including fines for violators, due to the rapid spread of the virus there. But China and South Korea have started to relax some of their strictest measures, as the number of cases in both countries appears to have peaked.

This outlook assumes that the strict social distancing and stay-at-home guidelines in the United States will remain in place until the end of April, with most non-essential stores remaining closed. International borders will stay closed as well, while restaurants can only offer takeout services and most non-essential industries remain shut down. But, by May, it is assumed that the tough rules covering social interactions are successful in controlling the spread of the virus. Life for many Americans will begin to return to something like normal as restaurants and shops start to reopen and some industries restart production. However, bans on personal travel to other countries will continue, and most gyms, theatres, and sporting venues will remain closed. Some professional sports leagues could, however, resume action, but without fans in the stands. By September, most economies could be operating normally, but restrictions on international travel to some countries would remain in effect. Social and recreation activities will slowly begin to resume.
Acknowledgements
The spread of the novel coronavirus disease (COVID-19) has created uncertainty in all global markets. We're doing our best to provide timely updates, but information can fall out of date quickly. All products related to our COVID-19 coverage will be available for free on our website. To access them, go to conferenceboard.ca. The Conference Board of Canada reserves the right to adjust content as necessary.
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