

Coronavirus and the Economic Outlook
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The economic outlook is obviously a rapidly evolving and rapidly changing situation. We want to make sure to share the best information that we have with you, whenever we have the opportunity to do so. The first thing to acknowledge when we talk about the economy today is that it is in a recession. The economy is shrinking. It is going to shrink for a period of months. And there is nothing at this stage that is going to prevent that from happening.

The questions we're asking are about how deep that contraction is going to be, how long it's going to last and what the recovery will look like once we get to the other side. In thinking about those things, there are three policy channels that we're monitoring very closely. The first is the public health channel. The second is monetary and liquidity policy. And the third is fiscal policy.

And I want to start with the public health channel, even though it is the one that we know the least about. Public health policy is not really our expertise. Not really my expertise as an economist, but it is also obviously the most critical one in this situation, from a social perspective, no doubt, but also from an economic perspective. And that's because if the public health crisis isn't addressed, the monetary, liquidity and fiscal policy programs we expect simply won't matter. If people are not able to resume their normal lives to one degree or another; if we're not able to get the economy rebooted and restarted, then none of the rest of it is going to make a difference. So, it really is the public health channel that is the most important.

And it may sound a little bit counterintuitive to say this, given the recent headlines, but we actually are a little bit more confident today about this channel than we were a week ago. And it isn't because the situation itself has improved. If you're following the headlines, it's clear that that's not the case. What has changed, though, is that the public health policy response has become much more dramatic. We're seeing much wider spread shutdowns. We're seeing social isolation, social distancing. All of these measures are being taken increasingly seriously. And the more seriously those are taken now, the better the chances that they are effective and that in time the economy will be able to reboot.

Now, of course, all of those measures do have serious economic consequences. And remember that the primary economic damage that is being done here is from those very same public health measures. They are inevitable and necessary, but the consequence is that the economy is struggling. It's a simple fact that when you shut down major cities and tell people not to perform their normal daily tasks, the economy has to suffer. So, the second and third channels are the ones that we are monitoring to see how policymakers are addressing those challenges. I'll start with channel number two, which is monetary and liquidity policy.

This is primarily driven by the Federal Reserve. And here again, I think there's reason for some optimism. The Fed has, from a pure monetary policy perspective, already done almost everything it can do. It has cut interest rates to zero. It has resumed quantitative easing. It has given forward guidance that it won't raise rates for a very long time indeed. All of that is what you would expect when the economy's in distress. Unfortunately, we don't think there is very much more they can do on that front. However, as they have demonstrated this week, there is a lot that they can do in terms of providing liquidity and in

terms of keeping financial markets and the financial sector functioning. And that is absolutely critical.

One way that this recession becomes much longer lived, is if it impacts the banking sector and the financial sector in a way that prevents them from dealing out credit, from providing liquidity, from keeping businesses afloat in the longer term. That would be a much more severe or much more protracted recession. We should all take some comfort from the fact that the Fed has been as proactive as it has been. Over the course of this week it has restarted several crisis programs designed to provide liquidity to the commercial paper market, to the municipal market, to the primary dealer community, all designed to make sure that the plumbing works in the financial system and that the banking sector can continue to perform its function.

I have no doubt that the Fed will continue to bring policies to bear as quickly as is necessary. It does feel a little bit this week like they're playing a game of whack-a-mole. A different source of stress pops up in financial markets on a daily basis, and every day the Fed institutes a new policy to whack it back down. And we think that over time, their willingness to do that will be critical. And we do think that there's reason to think that it will work. Not only that, the financial sector comes into this crisis in better shape on the heels of 10 years' worth of enhanced regulatory and supervisory oversight. So, from a monetary and liquidity provision perspective, the situation, again, looks a little bit better today than it did a week ago.

In terms of fiscal policy, it is encouraging, I think, to see that the sense of urgency in Washington has increased. We have seen proposals going back and forth between the administration and the different houses of Congress, with very large numbers attached to most of them. The measures currently under consideration represent about a trillion dollars' worth of fiscal stimulus or about 5% of GDP. And that's a meaningful number. It is the kind of thing that is going to be necessary. I suspect that in time more than that will be necessary to put the economy back on a reasonable footing. Again, subject to the condition that the public health crisis is addressed.

Regarding the nature of the fiscal response, I think it is important to think about what channels the government is targeting with its different policies. Some of the things that it has discussed are very sensible. The idea of using the Small Business Administration to increase credit availability to small businesses, subject to the condition that they continue to pay their employees, is a very good idea. It doesn't take very much imagination to envision a lot of restaurants and a lot of small businesses that simply can't survive the loss of cash flow during this period. And so channeling credit to those entities is a very good thing, particularly to the extent that we can guarantee they continued to pay their workforce.

There are people who are going to suffer economically, even if they are fortunate enough not to suffer from a health perspective. And a great many households cannot afford to go without income for a significant period of time. We need to make sure that they have the ability to get through this period and to come out the other side, still with the resources to make an economic contribution, to pay for childcare, to rejoin the workforce when the opportunity presents itself. So not only encouraging businesses to pay their employees, but also seeing proposals that involve direct payments to households, are things that are very good and things that are happening relatively quickly, all things considered, given the normal timetable for things in Washington.

It's also likely to be necessary for a variety of different industries that are specifically impacted here, to be bailed out, airlines being a prime example. Airlines have systemic importance in our economy and we cannot resume normal economic life without functioning airlines. So, I do expect to see a bailout there. I think it's likely that we'll see additional funds devoted to state and municipalities to prevent them from falling into distress as tax revenues decline as well. So, all of these things are encouraging. I think we need to see more of it, but it is good news that things are moving quickly right now. So, when we put all of this together, what does it look like for the outlook? And I want to give the caveat here that, as I said at the outset, this is a very dynamic, very fluid situation.

There's no number that we can give in which we will have great confidence at this stage. We've only seen the very earliest bits of hard data demonstrating that the economic impact is large. We don't have the ability to look into the distant future and see how things will shake out. But in broad brush-stroke terms, the way we're thinking about things today is that there will be a period of significant economic destruction, a loss of somewhere between 5 and 10% of GDP at least, in the very short term. That is a very sharp, very severe recession. But if we presume that the public health response is acceptable and that things do start to improve, by the second half of the year we expect the economy to begin growing once again.

We think that over time the economy will regain the prior rate of growth. So if we were growing around 2% coming into the crisis, we think that over the course of the next 18 to 24 months, the economy should once again be growing at around that rate.

We also think, however, that there will be some loss of activity, that the level of the economy will be lower. We may regain the previous rate of growth, but there is simply going to be some activity that will not be made up for. Think here about trips not taken, restaurant meals not eaten, services not consumed. You know, businesses may have pent up demand and when the economy restarts, they may produce faster for a time. But it's not very likely that people will double down on restaurant meals or vacations, having not been able to do those things for a period of time.

So, there is going to be deep lasting damage to the economy. But subject to the condition that the public health crisis eases. We think that over time we'll get back onto a more normal trajectory. It is going to take some time, however, and we all need to prepare ourselves for a long period of increased financial market volatility, for a long period of increased economic volatility and some difficult days still ahead. This crisis is not past. And while we are hopeful that over time it will and while we are optimistic that over time it will, it's going to be a long few weeks before we can have a great deal of comfort, or a great deal of confidence in that expectation.

One of the consequences of the outlook that we've just described is that we expect interest rates to remain low for a very long time. Certainly, policy interest rates, but also interest rates further out the curve, as the economy only gradually recovers from the economic damage.

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