Commerce Trust Company
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Midyear Outlook – June 24, 2020
Colbert

Chris Schildz:

Welcome to Conversations with Commerce Trust Company. We have for this segment Scott Colbert, our Chief Economist at Commerce Trust Company. Scott, welcome.

Scott Colbert:

Hi. How are you?

Chris Schildz:

Just fine, thank you. We're ready to go. The first question I think we have from a lot of our clients is the reopening of the economy is underway and it's in various stages across the country. You've described this recovery as V-shaped. What will the bounce-back look like in terms of growth?

Scott Colbert:

Well, I've certainly said that the recovery off the bottom is going to be V-shaped because the drop was so severe. We're looking at an economy that's probably collapsed in the neighborhood of almost 40%, (from) the trough at its very bottom, and is now quickly coming back. It'll be the worst quarter of growth we've ever had, so off the bottom, we are certainly seeing a V from the highs in unemployment and the lows in retail sales. That's already started to show up with retail sales jumping the most they've ever jumped in a month. They were up 17% in May from April. Of course, they were down 24% in April from March. This is the V that I'm talking about, so it's an initial V.

But then once we get the bounce, I'm worried about the lingering and ongoing effects of probably what an economy that's been downsized to adjust to the coronavirus (environment), higher unemployment levels, a stimulus that begins to wear out, what that recovery will look at….I think that will be a bouncier, tougher, longer, slower recovery after that initial V off the bottom that we are still right in the middle of as we speak today.

Chris Schildz:

Scott, you've said we've had a head start on the recovery compared to the Great Recession of 2008. How long will it take for us to get back to where we were in February?

Scott Colbert:

Yeah. By "head start," what I really mean is that it took us 18 months to get through our last recession and we lost 4% of GDP, so the last recession was the longest recession we've ever had since the Great Depression (1929-1939), lasting from January 1, 2008 to June 30th, 2009, and it was the most severe recession, we lost 4% of GDP. If you can think of a 100-story building, a big building like the Empire State Building or something, we lopped four stories off, and then we had to begin to rebuild it. That rebuilding took a total of three years from start to finish, from the beginning of the recession to the end of the recession, to adding those four floors back on during the Great Recession, that took three years.

Your question really is: Why could this one be rebuilt any faster since it's a deeper contraction? The answer to that is because we're getting through the recession so much quicker. This is no 18-month recession. The deepest recession will be the shortest recession. Technically, it's possible the recession ended right now. It began in February, according to the National Bureau of Economic Research. Clearly, we had a recession in March, probably had a recession, of course, in April, but we're beginning to recover in May.

Let's call the dating June, February to June, that is a five-month recession. That'd be the shortest recession we've ever had, and by head start, since it didn't take 18 months to complete the recession, this only took five, it's quite possible that we get the economy back to where it was in February or January of this year. So sooner than three years, but the Federal Reserve thinks it'll take at least two years. At the outset, it'll take three. I'll call it maybe two-and-a-half years. It's going to take two-and-a-quarter, two-and-a-half years to get the economy back dollar-for-dollar just where it was before we started taking those floors off to find the bottom before we begin to rebuild that 100-story building that we started with

Chris Schildz:

Scott, a daunting task. Part of this recovery is the fact that 30 million Americans are either unemployed or have been temporarily furloughed along the way during the pandemic. What are the prospects for bringing people back to work quickly?

Scott Colbert:

Well, that's the key driver. If you asked anyone for one statistic to correlate any problems with the economy, say for instance, delinquent loans on a car, or a credit card, or a home loan or business sales, retail sales…it's unemployment. We probably had 152 to 153 million jobs before the recession started, we've certainly lost at least 20 million and certainly, part-time work, another 10-ish million, as you suggested. Think about it: We've taken 30 million people and dislocated them. How long will it take to put them back? I think the initial bounce-back will be rather strong because, of course, we came to a dead stop in essentially 20% of GDP. What was that 20%? That was hotels, airlines, cruises, car rentals, retail sales at a mall, restaurants, and bars. By the time you add all that up, that's about 20% of GDP. It also happens to be exactly 20% of employment.

We are recovering quickly in that space, but of course, a full recovery is a long ways off, so you can see how we could quickly put half that 20 million back to work, say 10 million. But after that, then it becomes, the typical, slow slog as businesses try and right-size themselves for whatever the future brings each of these businesses. So, the initial bounce and employment will be strong, too, but then we're likely to get down to an unemployment rate, say, of 10% instead of 15%. Then we have to make that slow, steady economic recovery. It took us 10 years in the last recovery to create 20-plus-million jobs. We just lost 20 million jobs. Does that mean it's going to take us 10 years again to put all those people back to work? I sure hope not, but it's certainly possible.

Chris Schildz:

Scott, now the government has created both fiscal and monetary stimulus. Is more needed?

Scott Colbert:

Oh, that's a great question. Thank you for bringing it up. We would be in so much worse shape if it hadn't been for, essentially, the cannons being brought to bear on this deep and severe recession that we're currently in. The cannons are coming from two directions. I'll mix up my military metaphors here and I'll call it a pincer movement now. We've got monetary policy on one side, which is the Federal Reserve lowering rates to zero, pulling out all the old playbook during the last Great Recession, having had authority from Congress to buy up risky assets, quantitatively easing, they doubled almost the size of their balance sheet in several months compared to taking years to add to their balance sheet in the last Great Recession. Then you've got the fiscal stimulus, direct aid from the government going directly to businesses, right, via the PPP (Paycheck Protection Program), directly to families versus the checks cuts to individuals and dependents, plus a litany of other fiscal initiatives totaling almost two-and-a-half trillion dollars.

The combination of that is really helping us build a bridge to the other side of this chasm that is that V-shaped recession that we're in. The V on the other side, of course, isn't going to get back all the way, so it's a bridge that's going to be moving downhill. We just hope that it's going to be long enough to get us to the other side. Some people would suggest we're papering over the problem by literally creating paper, by literally quantitatively easing, raising the money supply, sending checks to people, and borrowing our way forward. That part is all true, but don't discount the substantiality of it relative to any other prior recession. It's two to three times more stimulus in two to three times less time. It's very impactful and it's helped eliminate what could have been just an absolute disaster.

Chris Schildz:

Now, as you've suggested, stimulus does have a flip side and one of those might involve increasing inflation, but we've seen relatively little jump in prices. Is that going to play out that way?

Scott Colbert:

Well, inflation is a rich person's problem, much like, I suppose, having too big a stock portfolio. During the last recovery, of course, despite the stimulus, despite the fact that it was almost 11 years in making, despite the fact that we had near record-low unemployment, which generally results in rising wages and inflation, the Fed never got its inflation back to its inflation target, which they target at basically 2% based upon the personal consumption expenditure indicator, which is a mouthful. But you can think CPI (Consumer Price Index), so let's just pretend that it's the CPI that they're targeting. The CPI in April fell eight-tenths of a percent, meaning that inflation fell nearly 1% of the cost of goods and services, fell nearly 1%. It fell another 10th of a percent in May, so call it 1% in two months. That's the deepest fall in prices this country has ever witnessed.

Now, the Fed does have that target. They'd like to get inflation spooled up. They're trying to do it, of course, by printing a lot of money, but it takes a while for that money essentially to catch fire because right now, it's largely lying in deposits in banks, in checking accounts. It's not being spent because, of course, people are a little worried that they're not going to have much money in the future, especially if they lost their job, so it's been very slow in terms of being pushed back out to society.

The Fed does have the ability to control inflation by raising rates quickly if, in fact, inflation catches fire, but in the longest of runs, inflation has been coming down our whole lifetime. People ask me why, so I'm going to ask myself, 'Why is inflation so dormant?' The answer to that, probably when you take a step back is primarily demographic. As a society ages, we tend not to spend as much on consumption and we start to save more and you buy less suits and less fancy cars and you look towards retirement. We've seen that in Japan, right? No inflation in Japan for decades now. We've seen it over in Europe and it's coming our direction here.

Secondly, it's primarily technology, the use of technology to lower costs to be competitive. I call this the Walmart-ization or the Amazon-ization of the world, the ability to quickly shop, and then using and lever that technology to get access to unlimited amounts of overseas labor that's willing to work for cheaper prices than, say, the developed markets. We can wheel the need for software development to India to find engineers that will work for $6,000 a year instead of $100,000 dollars a year. That's largely technology affording us that.

Then we've got one last kind of miracle on water and that's the supercargo container ship, which is also technologically advanced, all those little freight containers that we're able to get around the world, which turns out for very little energy costs, too, because technology in the energy space developed (oil) fracking, which gave us at the margin a little more oil and gas than we really even needed and drove the prices, of course, down even in the energy space. So inflation is a rich person's problem, one we're not likely to confront anytime soon, despite the fact that they (the government) have ginned up a lot of stimulus and borrowed our way forward.

Chris Schildz:

Scott, it's probably difficult to do the what-ifs for a pandemic, we've never reopened an economy before, but let's wrap up with this: Does the government have any more policy bullets left if there's a second wave of infections or things deteriorate?

Scott Colbert:

Well, first off, there does seem to be at least an ongoing continuation of the first wave. Whether you really want to call it a second wave, we certainly had a pause in coronavirus cases globally, here, too. There has been a recent (surge), in the last two weeks, global coronavirus cases are up 29%, so they've grown from 7 million to 9 million. Our cases here in this country in the last two weeks are up 19%. They've gone from 1.9 million to 2.3 million, and so it does seem to be we're going to have this virus as a perpetual problem until we have much better therapeutics and/or a vaccine.

Given that, is there the potential for another round of stimulus? Well, because we can borrow money in this country at so many basis points (at sub-inflationary rates) and the world will support that, there is always the ability, at least for a while here, to continue to borrow money, so I don't think that's the problem. I do think that there will be a second round of stimulus targeted in two areas.

One area that really does need it are the states and local governments that have been hit the hardest: Think sales taxes from retail sales that were down more than 25%, consumption taxes, energy, you name it, taxes are down. State and local governments have been picking up the tab for the virus and yet their revenues have plummeted, so I think you'll see some help there.

Then secondly, I hope, that we can have an infrastructure built of some type. I'm looking out a window (in St. Louis) and there's a huge building being built and it's very productive use of resources. They've got concrete trucks and dump trucks and 50 people running around the site, but it's an orchestrated use of technology to bring this building up. I'd like to see an infrastructure built, particularly if we can borrow the money at what amounts to basically sub-inflationary rates, because infrastructure creates the productivity to drive future growth and, everybody knows that our roads and our bridges and our tunnels are crumbling. Water, we've really stretched the use of (water) resources, stretched and stretched and stretched. This would be an ideal time to put money back into the infrastructure, which becomes very productive for the country in the longest of runs. With the elections coming, who knows if they can get it done? I'm actually optimistic and hopeful that because both Democrats and Republicans like the idea of infrastructure in some way or another, something is likely to happen.

Chris Schildz:

Scott, thank you. Thanks for walking us through this summary. That was Conversations with Commerce Trust Company, Chief Economist, Scott Colbert. Thank you.

Scott Colbert:

Thanks, Chris.

Chris Schildz:

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