



An intentional pause

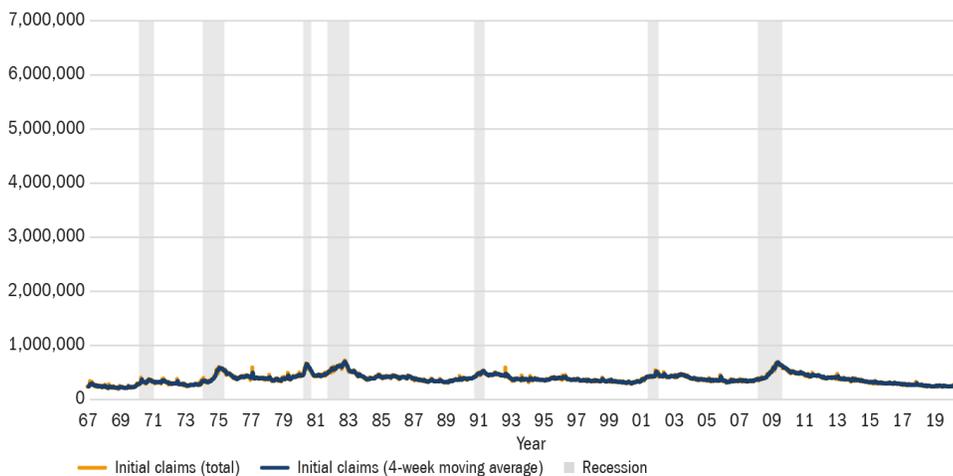
April 3, 2020

What we are experiencing now is a calculated economic shutdown, unlike other post-war recessions. But a swift policy response is helping to soften the blow.

It's now all but inevitable that we will see a deep contraction in U.S. economic activity as a result of the shutdown to contain the coronavirus. As of April 2, initial jobless claims (as reported by the Department of Labor) spiked to 6.6 million — a new record. Future DOL reports are likely to show further increases in the coming weeks, and it's very likely that we'll see the unemployment rate, recently at historic lows, rise to 6% in April. It may even reach 9%-10% in the upcoming months.

▶ Unemployment claim spikes are reliable indicators of recessions

Unemployment claims



Source: Columbia Threadneedle Investments



Anwiti Bahuguna, Ph.D.
Senior Portfolio Manager, head of Multi-Asset Strategy

Labor market data is the most reliable indicator that a U.S. recession is underway, and it's one of the more certain statistics we can observe in the current environment. The present situation is so novel (like the virus itself) that applying historical models to

forecast what may unfold is a significant challenge. Unlike most post-WWII recessions (i.e., a result of the business-cycle overheating, financial bubbles, etc.), what we're experiencing now is a calculated shutdown to dramatically slow the spread of the coronavirus. Given that we don't know how long the shutdown may last, it's now almost impossible to predict U.S. growth in the near term (i.e., the second quarter).

From an investment perspective, we frequently present scenarios in terms of base, bull and bear cases. Presently, our base case assumes that the U.S. is in a nearly complete lockdown for six weeks or more. As a result, airlines, restaurants, travel and leisure and many other sectors will struggle to survive, and there will be second-order effects.

The multiplier effects and the likelihood that consumers will not return to "normal" activity immediately implies that a recovery in economic activity may not occur until the fourth quarter of 2020. In our view, a quarterly sequence of GDP growth consisting of a very sharp decline for the second quarter, weakness in the third quarter, and perhaps a decent bounce in the fourth quarter will translate into -2% to -4% negative year-over-year GDP growth. It's also almost certain that we will see a sharp decline in year-over-year earnings. A more protracted period of economic shutdown, one that lasts longer than the next couple of months, could translate into a longer global recession — well into 2021. But if widespread testing allows people to come back to work faster than anticipated, or if some therapeutics designed to relieve the impact of virus are discovered, the outlook may be more optimistic.

It's easy to feel overwhelmed by these numbers, and while a recession now appears certain, central banks and elected officials have mounted a swift and substantial response. The Fed and global central bankers quickly announced measures to keep markets liquid and credit flowing. Monetary policy is fully accommodative and focused on liquidity and solvency issues. Many new programs have been introduced, aimed at making credit available to banks and other institutions. The Fed can now purchase almost any security (except high yield) and has established itself as the lender of last resort. Fiscal stimulus in the U.S., focused on reducing funding stress and stimulating growth, is on track to exceed \$2 trillion. In addition, measures to reduce regulatory oversight are being considered.

While these are encouraging actions to support the economy, economic data in the upcoming months will likely paint a bleak picture. Many of these measures are lagging indicators and may already be priced into markets, but the aggregate drumbeat of grim news could weigh on investor sentiment.

Bottom line

Ultimately, the duration and the intensity of this unprecedented economic contraction depends on the duration of the shutdown. We take some encouragement in the swift and substantial ongoing policy response from monetary and fiscal authorities to help consumers and businesses cushion the blow. As the virus-induced shutdown ends and activity begins to normalize, we expect the unemployment rate and jobless claims to edge down and the long road to recovery to begin. After a rude shock, U.S. activity will slowly return to normal levels.



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