The Long and Short of It: The Economic Impact of the Coronavirus

Thomas Prusa
Professor of Economics
Rutgers University

What this talk is NOT

• Not about politics, who is to blame, etc.
  • Tune into your favorite TV channel if you want talking heads filling time with political speculation

• Not a public health talk
  • I’m definitely not qualified to discuss medical treatment, infection rates, etc.

• No forecasts of stock market, when vaccine will be ready, etc.
  • Speculation, speculation, speculation
Goal of this talk

• To give you a framework for understanding the historical economic event that is happening
  • Discuss facts of what we know
  • Discuss short-run vs. longer-run effects
  • Review Federal gov’t response (fiscal & monetary policies)

Biggest economic shock ever?

“Perfect Storm”

• Supply side

• Demand side

• Financial

Most downturns involve just one motivating factor
“Perfect Storm”

• Supply side \(\leftarrow\) ability for firms to produce efficiently 
  \(\text{(regulation, certain tax policies, investment)}\)

• Demand side \(\leftarrow\) can economic agents make purchases 
  \(\text{(Keynesian approach; still popular)}\)

• Financial \(\leftarrow\) impetus for the 2007-09 recession

Early Take (e.g., through mid-Feb)

• Might be mostly limited to China
  • Trade with China is Significant, but Small

[Graph showing U.S. trade with China]
Early Take (e.g., through mid-Feb)

- Might be mostly limited to China
  - Trade with China is Significant, but Small
- Complicated by Supply-Chain Issues
Early Predictions Far Too Optimistic

- Geographic Spread
- Number of Seriously Ill Patients
- Death (and over-run healthcare facilities)
- Social Distancing Becomes the Norm

Coronavirus: Demand Side

- Stock market
  - Wealth Effect → Postpone major purchases
- Event cancellations
  - More broadly, tourism industry devastated
- Universal pseudo-quarantine
  - Work from home
    - Eat at home (lots of snacking!)
    - Watch movies at home
  - Teach from home!
Coronavirus: Supply Side

- What does “work at home” mean if
  - Manufacturing industry

- Service sector:
  - Restaurants
  - Sports
  - Gambling
  - Hotels
  - Airline
  - Cruise industry
  - Movie theaters
  - Shipping (ports closed) → chain reaction due to complicated supply chain

Can you operate your factory if your workforce is sick?

Impact on GDP of COVID-19 – No Social Distancing

- Many, many deaths (millions?)
- Psychological Trauma
- GDP hit deep (6%) but fairly quick recovery
Flattening the Curve & Lengthening the Recession

Confirmed Cases

Several countries have turned the corner, with numbers of new cases now in decline.
Deaths

Italy and Spain’s daily death tolls are falling; in the UK and US daily deaths still trend upward

Impact on GDP of COVID-19 – W/Social Distancing

The response of GDP is likely to be a U-shaped recovery with social-distancing

1) The depth will depend on
   1) The extent of social distancing, and
   2) The length of time spent social distancing.

With social distancing, then we can expect a reduction in GDP because:

1) Some services are most effective when delivered face-to-face.
2) Working remotely is likely to reduce the productivity of most workers.
3) Disrupted supply chains.
Impact of Social Distancing on Economy

- **U.S. GDP (2019)** -- $21.4 trillion (about $5.4 trillion per quarter)

- One estimate of impact of reduced activity (UChicago)
  - Q1-2020: $700 billion
  - Q2-2020: $1300 billion

- 22 million newly unemployed Americans
  - (3.5% → at least 15% unemployment rate within one month)

- Largest drop in retail sales post-WWII era

(Additional staggering economic news likely forthcoming)

Priorities for Policy

- Policies to protect public health.
  - Long run benefits for the economy.
  - Though there may well be short run pain.

- Policies to protect the economically vulnerable.

- Policies to maintain resiliency of the economy.
  - Help firms stay in business, maintain ties with workers.
  - Allow banking system to operate

- Policies to stimulate aggregate demand.
  - Long run – once the economic switch is turned back on.
### Monetary Policy Timeline

<table>
<thead>
<tr>
<th>Date</th>
<th>Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>March 3</td>
<td>Fed Funds Rate Lowered 1.75-1.5 to 1.25-1</td>
</tr>
<tr>
<td>March 15</td>
<td>Fed Funds Rate Lowered to 0.25-0 Announced QE of $700 billion</td>
</tr>
<tr>
<td>March 17</td>
<td>Commercial Paper Funding Facility</td>
</tr>
<tr>
<td>March 18</td>
<td>Primary Dealer Credit Facility</td>
</tr>
<tr>
<td>March 18</td>
<td>Money Market Mutual Fund Liquidity Facility</td>
</tr>
<tr>
<td>March 23</td>
<td>Primary Market Corporate Credit Facility</td>
</tr>
<tr>
<td></td>
<td>Secondary Market Corporate Credit Facility</td>
</tr>
<tr>
<td></td>
<td>Term Asset-Backed Securities Loan Facility</td>
</tr>
<tr>
<td></td>
<td>Unlimited QE</td>
</tr>
<tr>
<td>TBA</td>
<td>Main Street Business Lending Program</td>
</tr>
</tbody>
</table>

- Informed by 2007-09 financial crisis
- Bigger than monetary response in 2007-09

### Fiscal Policy Timeline

<table>
<thead>
<tr>
<th>Phase</th>
<th>Amount ($)</th>
<th>Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>Phase 1</td>
<td>$8</td>
<td>Emergency response, health care, vaccine development, prevention</td>
</tr>
<tr>
<td>Phase 2</td>
<td>$100</td>
<td>Paid sick leave, unemployment insurance, free virus testing</td>
</tr>
<tr>
<td>Phase 3</td>
<td>$250</td>
<td>Direct cash payments to families with income cap; $1,200 per adult, $500 per child</td>
</tr>
<tr>
<td></td>
<td>$250</td>
<td>Enhanced unemployment benefits</td>
</tr>
<tr>
<td></td>
<td>$350</td>
<td>Small business loans up to 250% of monthly payroll</td>
</tr>
<tr>
<td></td>
<td>$100</td>
<td>Corporate tax changes</td>
</tr>
<tr>
<td></td>
<td>$17</td>
<td>Community lending</td>
</tr>
<tr>
<td></td>
<td>$500</td>
<td>Loans &amp; loan guarantees for businesses, incl. airlines</td>
</tr>
<tr>
<td></td>
<td>$180</td>
<td>State and local governments &amp; Education</td>
</tr>
<tr>
<td></td>
<td>$100</td>
<td>Hospitals</td>
</tr>
<tr>
<td>TOTAL</td>
<td>$1.5-2.5 Trillion</td>
<td>7-12% of GDP</td>
</tr>
</tbody>
</table>

- At least 4x larger than 2007-09
Comments on Fiscal Policy

• Direct cash payments
  • Are they really getting into the hands of those most in need?

• Payments to large corporations:
  • Airlines and car and airplane manuf.
  • How effective are these at maintaining the structure of the economy?

• Enough to maintain employee-employer ties?

• Enough for medical care?
  • The amount spent fighting the virus is relatively small.
  • Offer to pay for all coronavirus related health care expenses?

What Should be in Phase 4 ??

• Stimulate the economy or more economic support?
  • Duration of “shelter in place” will determine the answer.

• Stimulate: Plenty of options:
  • Spending for government programs:
    • Infrastructure, worker training, social programs
  • Expanded unemployment benefits.
  • Cash payments to individuals and businesses.

• What form should it take?
  • Depends on why the economy is slow to recover.
    • Supply side: businesses having trouble flipping the on switch?
    • Demand side: consumers reluctant to spend?
State Finances

- Looming state budget crises
- “Balance budget” required by most states
  - Many states already have large debt
- The impact of dramatic reductions in state spending will cause serious economic harm
- Fed bailout?

A Few Final Thoughts

- COVID-19 is a health crisis that has extreme economic implications.
  - Negative GDP growth likely for at least several quarters (longer?)
  - Hard to see robust growth until health issue resolved
- Unprecedented Fiscal and monetary response:
  - First: targeted at health crisis.
  - Second: income and employment maintenance.
  - Third: stimulate the economy when health crisis is over.
- Economy will recover, maybe even stronger on the other side.
  - How long? Might take some time to get there.