U.S. Economic Outlook April 2020

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Economic Outlook: Recession
Balance of Risk:

A Profound Economic Event

The coronavirus pandemic has rapidly evolved into a profound economic event. We expect second quarter real GDP in the U.S. to contract at the fastest rate recorded since World War II. Likewise, we expect the U.S. unemployment rate to peak late this year at a post-WWII record of near 15 percent.

As usual, we have included our forecast tables in this publication. The one thing we can say with certainty about our forecast is that actual events and metrics will follow their own path, and not our forecast. There are simply too many unknowns at this time to speak with a high degree of confidence about any particular forecast data point. In addition to the layers of uncertainty about economic and financial markets linkages, and the massive U.S. and global policy response to the coronavirus pandemic to date, there remain fundamental biological uncertainties too. What we can do at this time is to posit a path out of the current downturn, and discuss our assumptions in order to provide a reference point for the unprecedented intensity of business planning that is now taking place.

With this forecast, we assume that the coronavirus outbreak in the U.S. fades with warmer temperatures this summer. We assume that it does not disappear completely, but many regions and many industries are able to return to work more or less normally this summer. Not all establishments and not all industries will return. The return to work will be less efficient than we would like. Work processes will have to be altered. Supply chains will take time to realign. Credit markets will adjust to another new normal. Further, we assume that the disease does not re-emerge next fall with the same consequences as it had this winter and spring. If we remain under wide-spread and long-lasting shelter-in-place directives next fall and winter that will certainly impede the economic recovery. We assume that there will be an effective and available immunization for COVID-19 within a year.

We could be incorrect in our biological assumptions in either direction. A quick fade of the disease this spring and minimal return next fall would allow nearly all regions and all industries to get back to work relatively soon. However, a tenacious disease could impede the economic recovery in the U.S. and globally.

The policy response to the coronavirus pandemic has been massive. We assume that more will follow. The Federal Reserve has already done four very important things. First, they lowered the fed funds rate to near-zero. This is certainly not enough to pull the U.S. economy out of deep recession by itself, but it does prime the credit market pump, which is essential to getting and keeping businesses running. Second, the Fed has announced that they are buying large volumes of Treasury bonds and mortgage-backed securities. The Fed has backstopped the U.S. Treasury market by announcing that they will buy Treasury bonds with no preset limit. This will allow financial markets to function as the Treasury Department increases debt sales in order to finance a huge volume of fiscal stimulus. Third, the Fed has announced a number of new programs designed to keep the financial system running despite very high stress. They are providing enormous amounts of liquidity to various parts of the U.S. financial system through repurchase agreements. Fourth, the Fed has announced a new facility for meeting the demand for U.S. dollars from other central banks and international entities, thus shielding the U.S. from dollar demand stress coming from overseas.

The fiscal response to the crisis has so far come in three phases. Phase 1, approved on March 3, was $8.3 billion for health agencies, testing and small business loan guarantees. Phase 2, approved on March 18, was $100 billion for tax credits for employers, increased unemployment insurance benefits and food assistance. Phase 3, approved on March 27, was the CARES Act. The more-than-$2 trillion CARES Act includes significant near-term relief for large and small businesses, state and local governments, households, the unemployed, healthcare and victims of disasters. There are two central features of the CARES Act that were designed to provide quick relief. One is the new mechanism for business

U.S. Economic Outlook, Summary

a = actual f = forecast	3Q'19a	4Q'19a	1Q'20f	2Q'20f	3Q'20f	4Q'20f	1Q'21f	2Q'21f	2019a	2020f	2021f
Real GDP (*Percent Change Annualized*)	2.1	2.1	-4.3	-29.1	6.3	12.4	9.0	4.5	2.3	-5.1	4.5
CPI (*Percent Change Year-over-Year)*	1.8	2.0	2.2	1.2	0.9	0.2	0.2	1.0	1.8	1.1	1.3
Payroll Jobs *(Average Monthly Diff., Ths.)*	183.7	209.3	124.4	-1938.6	-681.7	451.7	217.5	137.2	162.4	-511.1	-487.8
Unemployment Rate *(Percent)*	3.6	3.5	3.8	10.8	14.3	14.7	14.5	14.3	3.7	11.0	14.2
Federal Funds Rate *(Effective)*	2.19	1.64	1.26	0.13	0.13	0.13	0.13	0.13	2.16	0.41	0.13
10-Yr. Treasury Rate	1.80	1.79	1.38	0.66	0.80	0.81	0.81	0.81	2.14	0.91	0.82

Risk of Recession Outlook

Probability of Recession (in the next)	6 months	12 months	24 months	36 months
April 2020	100%	100%	100%	100%

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loans, many of which will revert to grants if business payrolls are maintained. The other key feature is the direct payments to individuals of up to $1200, scaled down by income caps. Both features were designed to bridge about an 8-week disruption in business and household finances due to shelter-in-place guidelines. The key dimensions of the CARES Act are amplitude, speed and duration. Given the early guidance on shelter-in-place, the size (amplitude) of the package was appropriate. The package was also designed to get funds dispersed quickly. However, the speed of dispersal has already been frustrating for many potential recipients. Also, the duration of the funding may have to be revisited if shelter-in-place guidance is extended. Some areas have already extended shelter-in-place guidance well into May.

The Trump Administration has floated the idea of a Phase 4 stimulus bill which could include significant funding for infrastructure projects. If adopted, a major Phase 4 plan could provide a longer lasting positive impulse for the economy than the Phase 3 bill.

There has been a great deal of speculation about various paths to economic recovery from here. Discussion has focused on “V-shaped”, “U-shaped” or “L-shaped” paths. The contours of a V-shaped recovery would be hard down, as we expect to happen in the second quarter, followed by a rapid bounce back in the third quarter. We believe that the odds of a V-shaped recovery are low. It is the most optimistic path, assuming that by the end of the summer we are back to business as usual. However, the V-shaped recovery does not take into account the likely second-order effects of the current downdraft. We expect that the current downdraft in the second quarter will create further negative impulses in the economy which will result in a slower-than-V-shaped recovery.

Even though the CARES Act was designed to reduce the volume of layoffs due to coronavirus social mitigation techniques, we have already seen a large volume of layoffs. Unemployment insurance claims in the second half of March were significant. Our concern is that businesses were running “labor rich” after years of rapidly expanding their payrolls heading into the downdraft. Now that many companies have reduced their workforces, other companies could feel pressure to do the same in order to realign their efficiency ratios to a new industry standard. Thus layoffs tend to lead to more layoffs at the end of a long business cycle.

Another second-order effect will be a reassessment of risk by credit markets. This could eventually be punishing for over-leveraged firms with weak revenue streams. Related to that would be a reassessment of debt ratings by the ratings agencies. This could put pressure on parts of the financial system as investment portfolios are realigned.

We expect the second-order effects of the Q2 downdraft to be mitigating factors against a V-shaped bounce back in the U.S. economy. A U-shaped is more likely. The U describes an economy that experiences a hard downdraft, takes a quarter or two to stabilize and then experiences a recovery. In our April forecast, we show a very hard GDP downdraft in the second quarter at a negative 29 percent annualized rate for real GDP. This is followed by stabilization and some improvement in the third quarter, and then stronger recovery in late 2020 and early 2021. With this U-shaped path of GDP growth rates, it is important to keep track of the levels of GDP also. We show the pre-crisis high point of real GDP in 2019Q4 at $19.2 trillion ($2012). We do not recover this level of real GDP until 2022Q1. Also, and importantly, we show a lingering high unemployment rate. We assume that unemployment benefits are extended, while job creation quickly settles following a relatively short-lived bounce back in hiring. Three factors will determine how quickly the unemployment rate falls. One is the rate of post-crisis job creation. The second is the duration of extended unemployment benefits. The third is the retirement patterns of older workers.

An L-shaped recovery is less vigorous, described by an L laying on its side, showing a hard downdraft followed by a long period of weak growth. The level of GDP could potentially take much longer to regain under this scenario.

The V, U or L discussion ignores what will likely be differences in the economic recoveries of regions and industries. Looking at the 5 key Comerica states of Michigan, Texas, California, Florida and Arizona we see obvious differences. Michigan will be disproportionately impacted by its large durable goods manufacturing sector. We expect U.S. auto sales to pull back meaningfully in the second quarter. Auto companies have announced and already extended production cuts this spring. They will delay the development and rollout of new vehicles this year. Also, the stall in airplane production is weighing on an important cluster of aviation-related manufacturers in Western Michigan. In Texas, the combination of demand destruction and over-production of oil has wreaked havoc on the energy sector. We are hopeful that a Saudi-Russia agreement will eventually stabilize crude oil production, but a global glut of oil will not soon evaporate in this weak economy. Also, North Texas is home to two major airlines that are seeing a huge amount of demand destruction and curtailment. California is heavily dependent on tourism and trade which are both suppressed now. The economies of Florida and Arizona both depend on tourism and home building. Also, states and municipalities are not uniform in their exposure to COVID-19 and in their mitigation protocols and medical services capacities.

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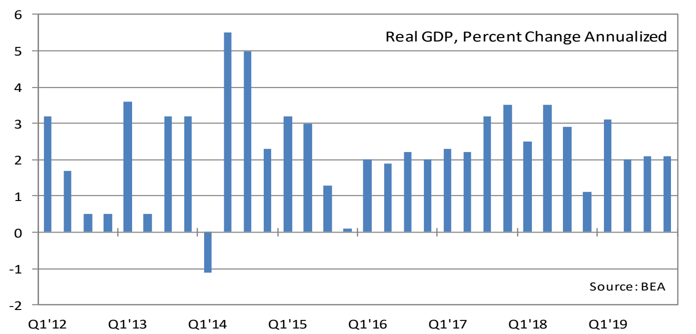
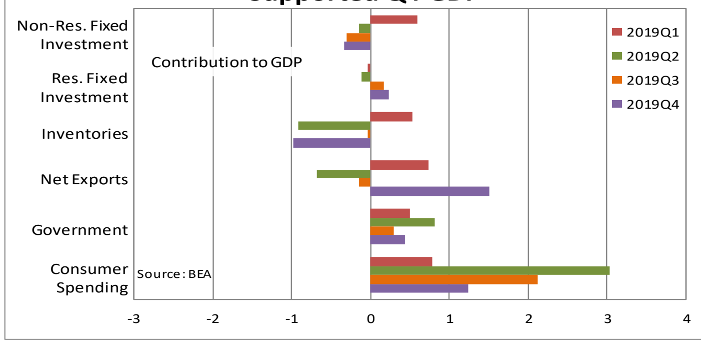
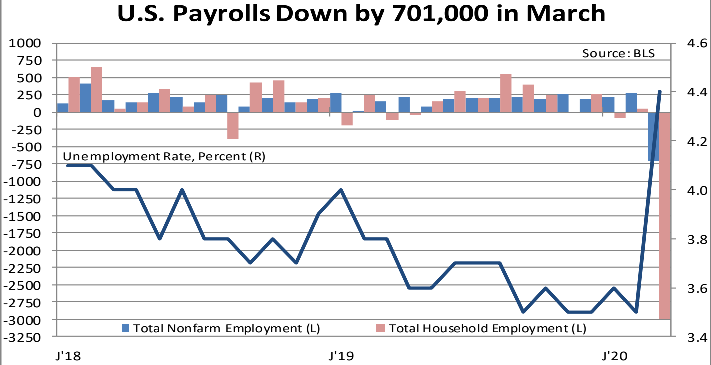
Q4 Real GDP Grew at 2.1%



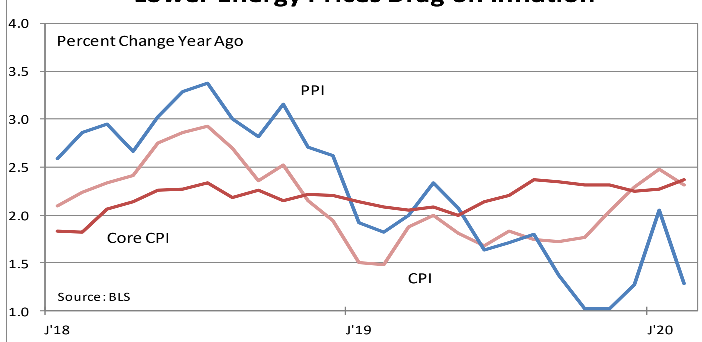
Consumer Spending and Net Trade Supported Q4 GDP



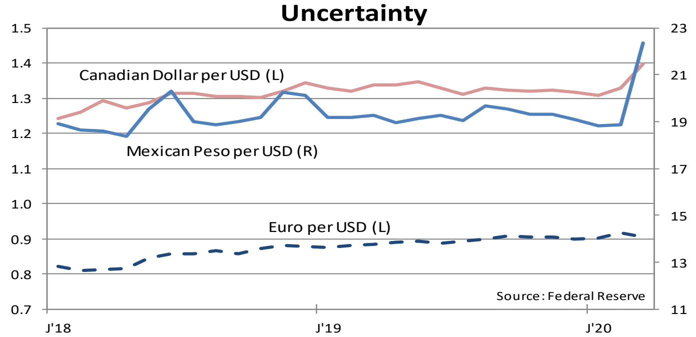
U.S. Payrolls Down by 701,000 in March



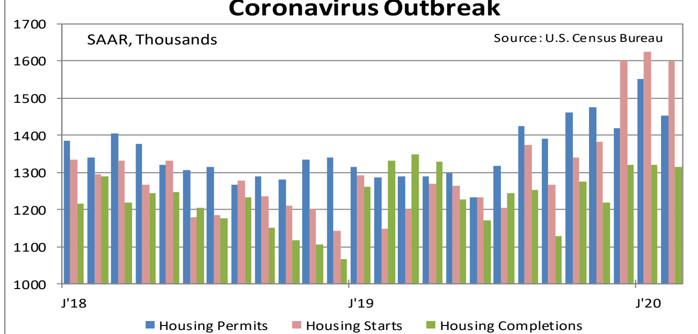
Lower Energy Prices Drag on Inflation



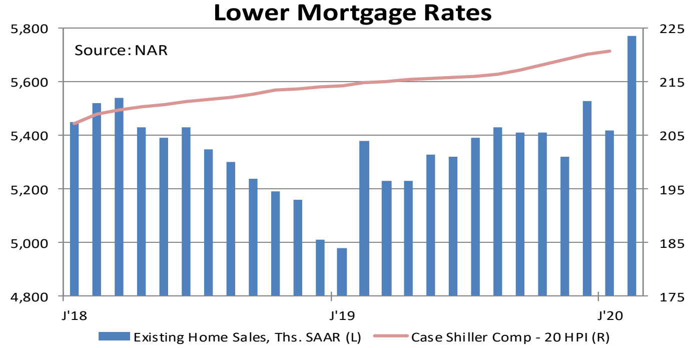
The Dollar Rallies on Global Economic Uncertainty



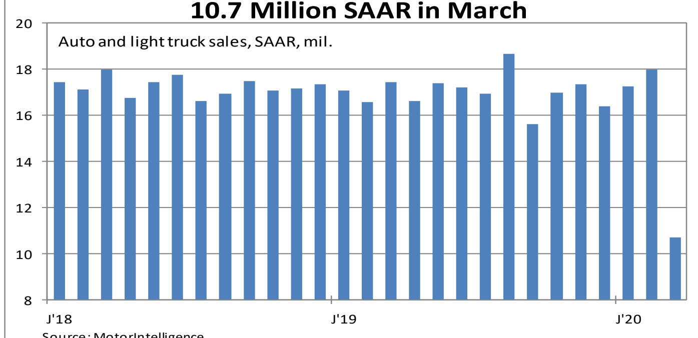
Housing Activity Strengthened Ahead of U.S. Coronavirus Outbreak



Existing Home Sales Surged in February with Lower Mortgage Rates



Auto Sales Plummeted to a 10.7 Million SAAR in March



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Comerica Bank

	3Q'19a	4Q'19a	1Q'20f	2Q'20f	3Q'20f	4Q'20f	1Q'21f	2Q'21f	2019a	2020f	2021f
Output											
Nominal GDP *(Billions $)*	21543	21729	21563	19781	20117	20764	21282	21611	21428	20556	21776
Percent Change Annualized	***3.8***	***3.5***	***-3.0***	***-29.2***	***7.0***	***13.5***	***10.4***	***6.3***	***4.1***	***-4.1***	***5.9***
Real GDP *(Chained 2012 Billions $)*	19121	19222	19011	17442	17709	18233	18629	18836	19073	18099	18919
Percent Change Annualized	***2.1***	***2.1***	***-4.3***	***-29.1***	***6.3***	***12.4***	***9.0***	***4.5***	***2.3***	***-5.1***	***4.5***
Pers. Consumption Expenditures	13353	13414	13167	11783	12091	12458	12864	12983	13280	12375	13039
Percent Change Annualized	***3.1***	***1.8***	***-7.1***	***-35.9***	***10.9***	***12.7***	***13.7***	***3.8***	***2.6***	***-6.8***	***5.4***
Nonresidential Fixed Investment	2743	2726	2689	2255	2337	2398	2461	2512	2748	2420	2538
Percent Change Annualized	***-2.3***	***-2.4***	***-5.3***	***-50.5***	***15.4***	***10.9***	***10.8***	***8.7***	***2.1***	***-12.0***	***4.9***
Residential Investment	594	603	612	447	473	530	560	581	594	516	588
Percent Change Annualized	***4.6***	***6.5***	***6.1***	***-71.5***	***24.9***	***58.1***	***24.4***	***16.2***	***-1.5***	***-13.2***	***14.1***
Change in Private Inventories	69	13	-19	-258	-217	2	16	41	67	-123	42
Net Exports	-990	-901	-818	-171	-369	-540	-630	-632	-954	-475	-649
Government Expenditures	3310	3331	3345	3357	3365	3352	3325	3316	3299	3355	3326
Percent Change Annualized	***1.7***	***2.5***	***1.6***	***1.5***	***0.9***	***-1.5***	***-3.2***	***-1.1***	***2.3***	***1.7***	***-0.9***
Industrial Prod. Index *(2007=100)*	109.5	109.5	108.6	94.7	95.7	100.3	103.4	104.8	109.5	99.8	105.5
Percent Change Annualized	***1.1***	***0.2***	***-3.5***	***-42.2***	***4.5***	***20.6***	***12.8***	***5.6***	***0.9***	***-8.8***	***5.7***
Capacity Utilization (Percent)	77.6	77.2	76.6	68.5	67.4	69.6	71.7	72.9	77.8	70.5	73.3
Prices											
CPI *(1982-84=100)*	256.3	257.8	258.7	258.2	258.6	258.4	259.2	260.6	255.7	258.5	261.9
Percent Change Annualized	***1.8***	***2.4***	***1.4***	***-0.9***	***0.7***	***-0.3***	***1.2***	***2.2***	***1.8***	***1.1***	***1.3***
PCE Price Index *(2012=100)*	109.9	110.3	110.5	109.9	110.4	110.8	111.1	111.7	109.7	110.4	112.2
Percent Change Annualized	***1.5***	***1.4***	***0.8***	***-2.2***	***1.7***	***1.4***	***1.3***	***2.2***	***1.4***	***0.7***	***1.7***
GDP Price Index *(2012=100)*	112.7	113.0	113.4	113.4	113.6	113.9	114.3	114.8	112.3	113.6	115.2
Percent Change Annualized	***1.8***	***1.3***	***1.3***	***0.0***	***0.7***	***1.1***	***1.4***	***1.8***	***1.8***	***1.1***	***1.4***
PPI, Final Demand *(Nov. 2009=100)*	118.5	118.7	118.4	116.3	115.7	115.9	116.3	117.0	118.2	116.6	117.5
Percent Change Annualized	***0.7***	***0.8***	***-1.2***	***-6.7***	***-1.9***	***0.6***	***1.5***	***2.3***	***2.2***	***-0.8***	***-0.3***
Crude Oil, WTI *($/barrel)*	56.4	56.7	45.1	30.0	40.0	50.0	50.0	50.0	56.9	41.3	52.5
Labor Markets											
Payroll Jobs *(Average Monthly Diff., Ths.)*	183.7	209.3	124.4	-1938.6	-681.7	451.7	217.5	137.2	162.4	-511.1	-487.8
Unemployment Rate *(Percent)*	3.6	3.5	3.8	10.8	14.3	14.7	14.5	14.3	3.7	11.0	14.2
Average Weekly Hours	34.4	34.3	34.3	33.4	32.9	33.5	33.9	33.9	34.4	33.5	33.9
Population *(Millions)*	328.8	329.4	330.0	330.6	331.2	331.8	332.4	332.9	328.5	330.9	333.2
Percent Change Annualized	***0.6***	***0.7***	***0.8***	***0.8***	***0.7***	***0.7***	***0.7***	***0.7***	***0.5***	***0.7***	***0.7***
Personal Income											
Average Hourly Earnings *($)*	28.12	28.32	28.52	28.73	28.95	29.15	29.35	29.54	28.00	28.84	29.64
Percent Change Annualized	***3.5***	***2.8***	***2.9***	***3.0***	***3.0***	***2.8***	***2.9***	***2.5***	***3.3***	***3.0***	***2.8***
Real Disp. Income *(2012 Billions $)*	15012	15073	15142	14977	15072	15327	15490	15588	14974	15130	15622
Percent Change Annualized	***2.1***	***1.6***	***1.8***	***-4.3***	***2.6***	***7.0***	***4.3***	***2.6***	***2.9***	***1.0***	***3.3***
Personal Saving Rate *(Percent)*	7.6	7.6	8.2	7.5	5.0	5.5	6.0	6.5	7.9	6.6	6.8
Housing											
Housing Starts *(Ths., Ann. Rate)*	1282	1441	1494	595	764	873	970	1049	1298	932	1047
Exst. SF Home Sales *(Ths., Ann Rate)*	4823	4833	5449	4035	4198	4388	4463	4520	4754	4518	4545
New SF Home Sales *(Ths., Ann Rate)*	698	710	746	562	581	596	634	654	684	621	661
Case/Shiller HPI *(Jan. 2000=100)*	210.2	212.7	215.2	217.3	217.9	219.0	220.4	222.1	209.7	217.3	223.1
Year/Year Percent Change	***3.2***	***3.4***	***3.9***	***4.1***	***3.7***	***3.0***	***2.4***	***2.2***	***3.5***	***3.7***	***2.7***
Consumer											
Household Economic Stress Index	2.2	2.1	2.1	7.8	11.6	11.9	12.3	13.1	2.0	8.3	12.9
Auto Sales *(Millions)*	17.1	16.9	15.3	7.3	11.1	13.9	14.2	14.8	17.0	11.9	15.1
Interest Rates (Percent)											
Federal Funds Rate *(Effective)*	2.19	1.64	1.26	0.13	0.13	0.13	0.13	0.13	2.16	0.41	0.13
Prime Rate	5.30	4.83	4.44	3.23	3.23	3.23	3.23	3.23	5.28	3.53	3.23
1-Month LIBOR	2.17	1.79	1.41	0.93	0.46	0.27	0.25	0.25	2.23	0.77	0.25
3-Month LIBOR	2.19	1.93	1.53	1.37	0.86	0.53	0.46	0.43	2.33	1.07	0.43
1-Yr. Treasury Rate	1.84	1.58	1.09	0.18	0.23	0.25	0.25	0.25	2.05	0.44	0.26
5-Yr. Treasury Rate	1.63	1.62	1.16	0.40	0.54	0.55	0.56	0.57	1.96	0.66	0.58
10-Yr. Treasury Rate	1.80	1.79	1.38	0.66	0.80	0.81	0.81	0.81	2.14	0.91	0.82
30-Yr. Fixed Rate Mortgage	3.66	3.70	3.51	3.83	3.56	3.21	3.14	3.07	3.93	3.53	3.02

a = actual f = forecast ***April 6, 2020***

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