

THE REAL ECONOMY

VOLUME 67



EMPLOYMENT IN BLACK AND WHITE: RACIAL DISPARITIES IN AMERICA

NEGATIVE REAL GROWTH CONTINUES
INTO THE SECOND QUARTER

**WILL YIELDS RISE DUE TO INCREASED ISSUANCE
OF TREASURY BONDS? LET'S GET THE ELEPHANT
OUT OF THE ROOM!**

**INDUSTRY SPOTLIGHT: SUCCESS IN FOOD AND
BEVERAGE** COMES FROM RESILIENCE, INNOVATION
AND TRANSPARENCY

MIDDLE MARKET TREND WATCH: WHO LEADS
DIGITAL TRANSFORMATION?



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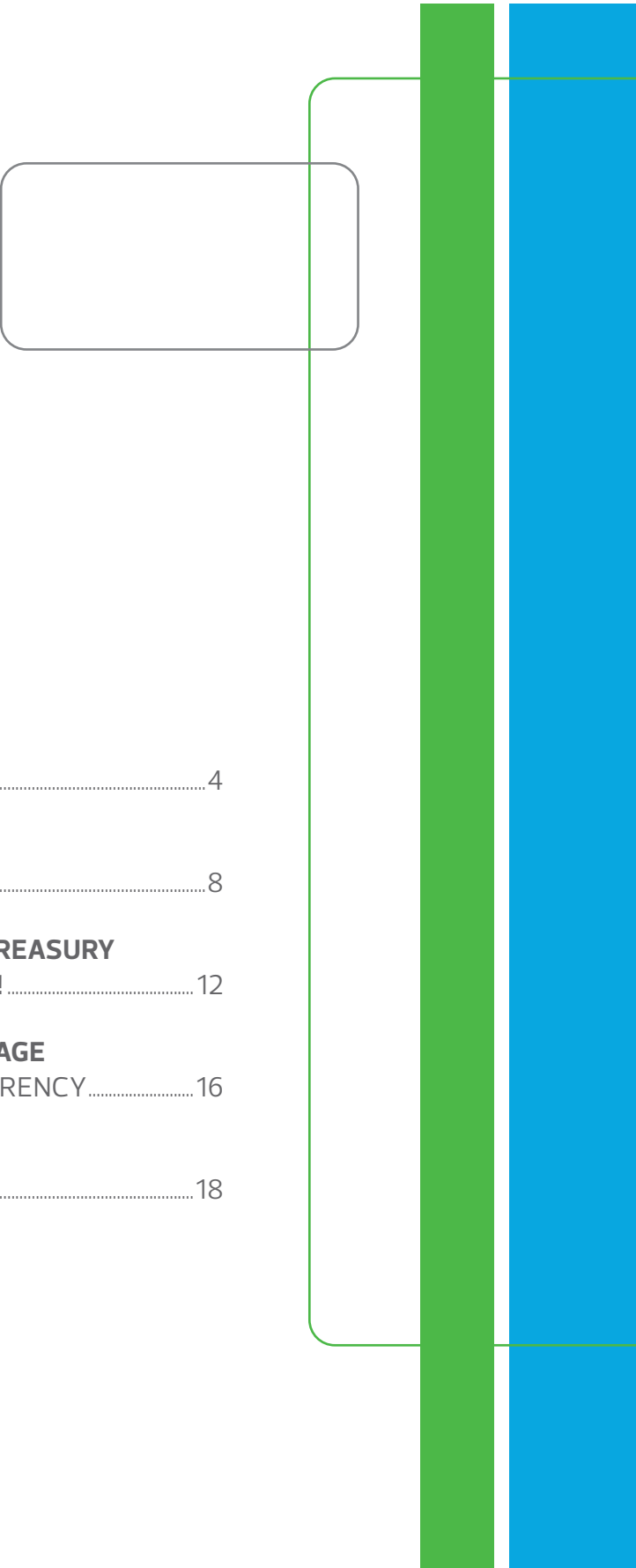


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EMPLOYMENT IN BLACK AND WHITE: RACIAL DISPARITIES IN AMERICA

BY JOSEPH BRUSUELAS

ECONOMIC FALLOUT from the novel coronavirus pandemic and the civil unrest in the weeks following the tragic death of George Floyd have placed an uneasy spotlight on the disparity in employment opportunities among U.S. ethnic groups—in particular, the wide income gap between white and Black Americans.

The overall U.S. unemployment rate eased slightly to 13.3% in May, but it is still up sharply from 3.5% in February, prior to COVID-19's impact; Black Americans during that period saw unemployment increase to an above-average 16.8% from 5.8%. For Black men ages 20 and over, the rate is 15.5%; for Black women, 16.5%.

African Americans, whose ancestors were forced to help build the country's infrastructure—laying the foundations for free enterprise and the wealth that followed—suffer from systemic racism and the degradation of basic human rights.

Some may point to standouts in the Black community such as Barack Obama and Colin Powell, arguing that everyone has equal opportunity. But this flawed logic is akin to saying everyone has a chance to win Mega Millions. One must look instead at timeworn systemic patterns to get a handle on the inherent disparities of race.



in society and the labor market cannot be missed. Until there is equal opportunity to obtain gainful employment for all Americans, the true promise of America will not be realized.

Using the statistics that follow, you can decide for yourself if the legacy of racism in the United States has been resolved; you will likely see an opportunity to commit to ensuring that equal education, opportunity and well-being become available for all.

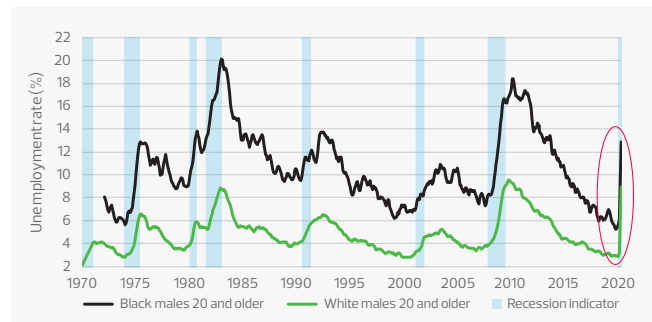
Unemployment rates for Black and white men

Unemployment for white men ages 20 and older has averaged 4.8% since 1972, the earliest year for which data is available. For Black men, it is 10.6% over the same period. Though great reductions in joblessness have been made during the economic recovery since 2010, a gap still exists.

The gap between Black and white unemployment increases during recessions and then endures for months after, before narrowing again during the ensuing recovery. At best, the pattern speaks to white privilege, but more likely it is evidence of a longstanding bias in hiring and firing.

U.S. unemployment rates for Black and white men

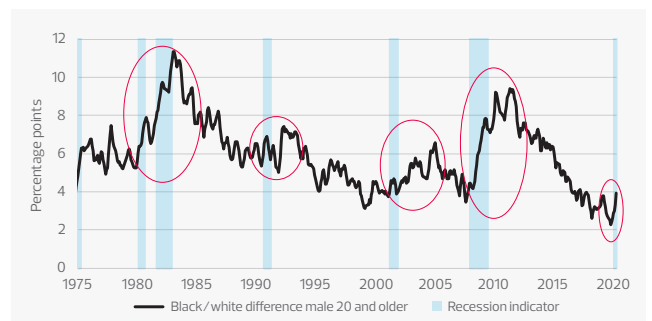
3-MONTH MOVING AVERAGES



Source: BLS; Bloomberg; RSM US LLP

Difference in U.S. unemployment rates of Black and white men

3-MONTH MOVING AVERAGE UNEMPLOYMENT RATES



Source: BLS; Bloomberg; RSM US LLP

Why are Americans of African descent victimized by the coronavirus more than those of European ancestry? Why are schools in predominantly Black communities struggling for books and air conditioning, while suburban children in predominantly white neighborhoods attend modern campuses?

Throughout our history, Black people in the United States have faced a clearly identifiable employment inequality that persists to this day. With the worst of the economic free fall now behind the United States, the opportunity to address long-term inequities embedded

THE UNEMPLOYMENT DISPARITY BETWEEN BLACK AND WHITE AMERICANS IS EXACERBATED BY THE WAGE STAGNATION OF THE PAST FOUR DECADES.

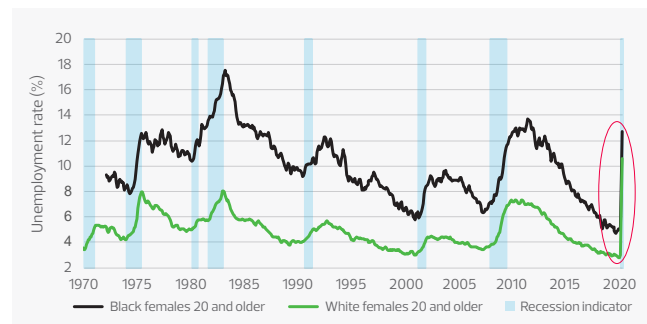
Unemployment rates for Black and white women

Though the employment profile for Black women is slightly better than Black men, a clear Black-white gap persists. Unemployment for white women ages 20 and older has averaged 4.9% since 1972; for Black women it is more than double at 10%.

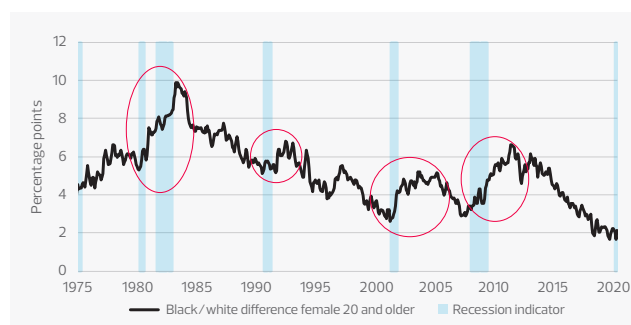
The following chart shows that, similar to the trend with adult men, the unemployment gap between white and Black women also increases during recession, remaining for months before narrowing again in recovery. The gap's tightening during the current health crisis most likely attests to the indiscriminate nature of the shutdown of normal activity.

Meanwhile, the unemployment rate for white teenagers in the labor force (16 to 19 years old) has averaged 15.4% since 1972, while that of Black teens has been a staggering 34.5%. The high rates for both cohorts entering the workforce present a disturbing reminder of the need for programs to accept first-time employees to get them on a path toward successful careers.

U.S. unemployment rates for Black and white women 3-MONTH MOVING AVERAGES



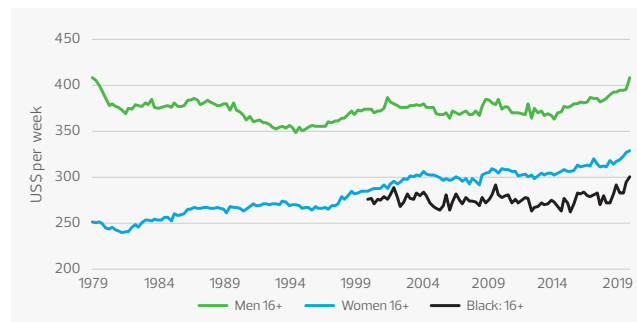
Difference in U.S. unemployment rates of Black and white women 3-MONTH MOVING AVERAGE UNEMPLOYMENT RATES



Wage stagnation

The unemployment disparity between Black and white Americans is exacerbated by the wage stagnation of the past four decades. Looking at inflation-adjusted weekly earnings of salaried employees since 1979 in the figure and table below, earnings in real (inflation-adjusted) terms have been flat, with average annual increases of just 0.4% since 2000.

Real earnings by gender and ethnic origin, 1979–2020 MEDIAN WEEKLY EARNINGS IN CPI-ADJUSTED 1982–84 CONSTANT-DOLLAR TERMS FOR WAGE AND SALARY WORKERS 16 YEARS AND OLDER



CIVIL UNREST IN 350 OF THE 390 MAJOR METROPOLITAN AREAS OF THE UNITED STATES IS NOT ONLY A FUNCTION OF DEMANDS FOR SOCIAL JUSTICE, BUT OF THE ECONOMIC FRUSTRATION DRIVEN BY LONGSTANDING DIFFERENCES IN INCOME AND WAGES.

Average annual growth rates of real earnings of wage and salary workers since 1979 and 2000

Weekly earnings of employees 16 years and older in inflation-adjusted, constant 1982–84 dollar terms				
	Black	Men	Women	College educated
Jan. 1979	N/A	408	251	N/A
Jan. 2000	276	374	285	825
Jan. 2020	300	408	329	1,236
Average annual growth rate since 1979	N/A	0.0%	0.7%	N/A
Average annual growth rate since 2000	0.4%	0.4%	0.7%	2.1%

Source: RSM US LLP

Since the decline of trade unions in the 1980s, many of the manufacturing jobs that men lacking higher education could do have been lost due to the integration of advanced technology into the production of goods or provision of services now occurring in lower-wage areas of the global economy or in states where unions have little power.

Weekly wages of women have been rising at a steady clip of 0.7% per year and now stand at 80% of their male counterparts. The wage inequality of African Americans, however, even compared to blue-collar American workers overall, is more pronounced. Black men are paid just three-quarters of the earnings of male employees overall. Data collected on wages since 2000 implies that Black workers' real earnings have increased by 0.4% per year, keeping pace with white males, but still largely stagnant.

Long-term impact of unemployment

Gains made by the labor force during the 2010–20 economic recovery—and the expansion of opportunity that went with them—are at risk of being reversed by the coronavirus shock. If the economic shutdown drags on, with short-term layoffs leading to further automation, or businesses simply doing more with less, we expect the labor force to shrink as the ranks of the unemployed become more and more discouraged.

Labor force participation grew from the 1960s through the end of the 1990s as the U.S. manufacturing and service sectors expanded, and women entered the workforce in significant numbers. The participation rate peaked at the end of 1999, as manufacturing was pushed offshore, but began to recover in 2014 as the economic recovery from the Great Recession took hold and the service sector gained the dominant role in the U.S. economy.

That upswing in labor force participation lasted until the coronavirus forced the shutdown of the economy after February 2020. A 3 percentage-point drop to 60.2% in the labor force participation rate in April and a slight uptick to 60.8% in May imply the depth of discouragement among workers, which poses a threat to consumption and economic growth.

In short, the American condition, no matter how one measures it, inevitably hinges on jobs and wages. Employment inequality between Black and white Americans is a real concern. Civil unrest in 350 of the 390 major metropolitan areas of the United States is not only a function of demands for social justice, but of the economic frustration driven by longstanding differences in income and wages. ■

NEGATIVE REAL GROWTH CONTINUES INTO THE SECOND QUARTER

BY JOSEPH BRUSUELAS

THE RSM MONTHLY INDEX of real GDP growth that turned negative in March has now dropped below levels recorded during the financial crisis and Great Recession of 2007–09.

We anticipate that the decline in second-quarter gross domestic product will be the largest single decline in the modern economic era.

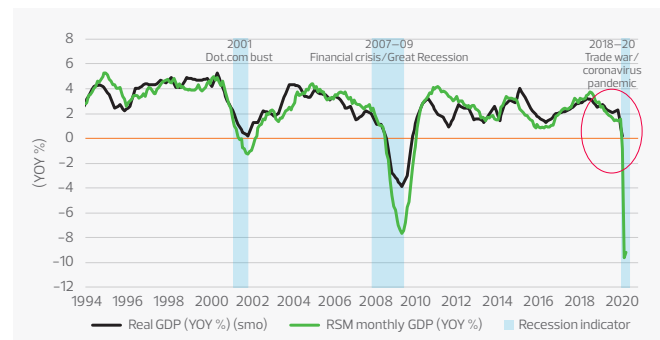
Based solely on domestic consumption and manufacturing activity, our monthly index indicates that the U.S. economy hit bottom in April and stayed there in May.

With all indicators reported for April, the RSM index points to real GDP dropping by 9% relative to last year at the same time. Releases of industrial production and labor market data for May—combined with forecasted values for other indicators—suggest that 9% loss carried over into May.

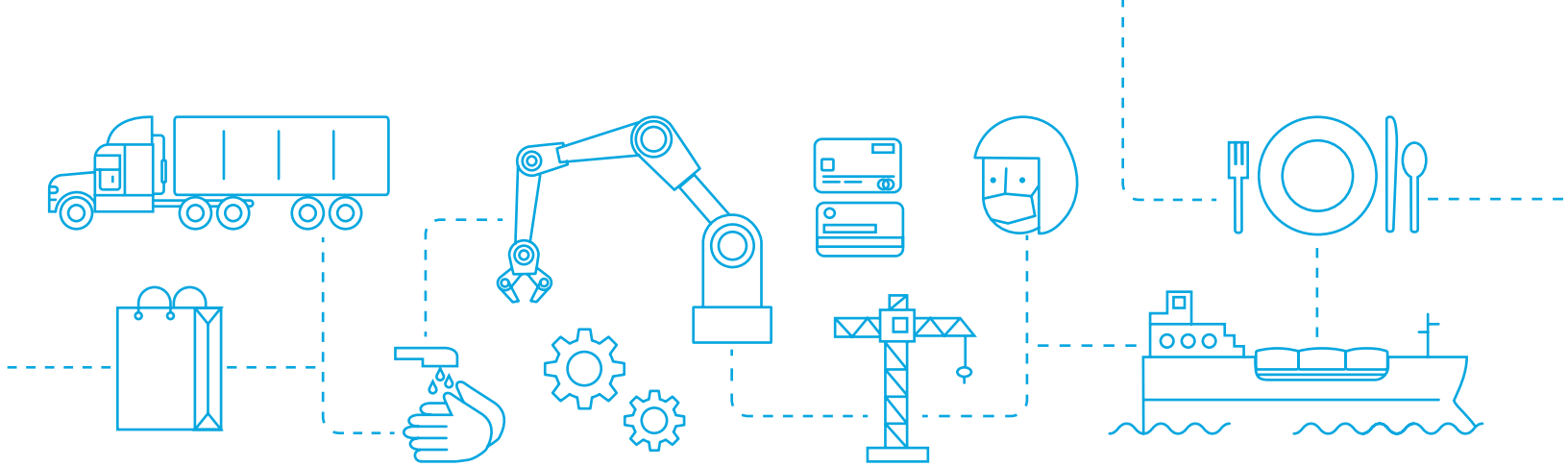
This is the foundation of our estimate of a decline of 38.5% in U.S. second-quarter GDP on a seasonally adjusted annualized pace.

By comparison, the Atlanta Fed's [GDPNow](#) forecast for the second quarter is a 45% decline. The New York Fed's [Nowcast](#) is calling for a 19% decline in the second quarter and a 1.9% decline in the third quarter. These forecasts are based on the release of economic data throughout the quarter.

U.S. real GDP and RSM monthly index of U.S. economic activity



Source: BEA; NBER; Bloomberg; RSM US LLP

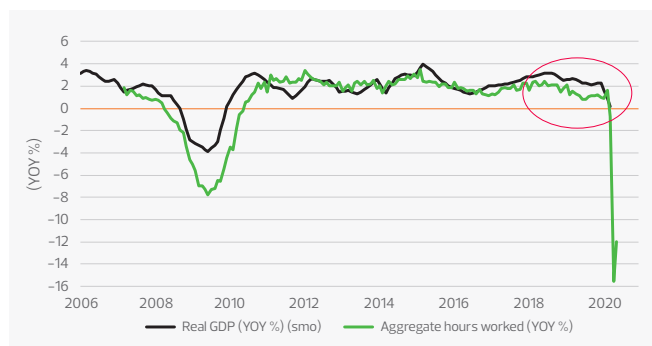


The labor sector

The labor sector has undergone a significant shock, with 45 million members of the labor force being thrown out of work in the last 13 weeks alone. The figure below shows the result of shutting down all nonessential industry and services—a dramatic, overnight drop in hours worked that will have a short- and medium-term negative effect on consumer spending habits.

U.S. real GDP and aggregate hours worked

YEARLY GROWTH RATES



Source: BEA; BLS; Bloomberg; RSM US LLP

The consumer sector

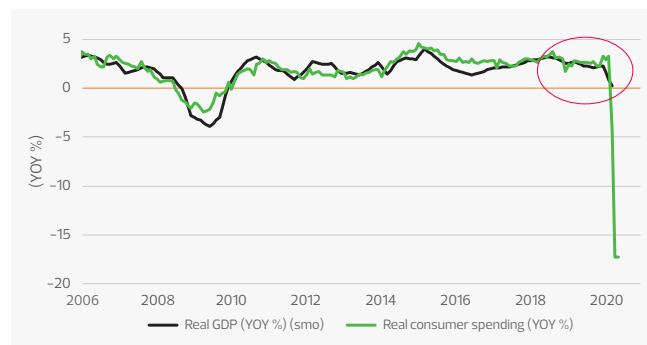
With so many workers out of a paycheck, and with layoffs creeping into white-collar occupations, household spending on nonessential goods and travel and hospitality has plunged during the pandemic. In inflation-adjusted terms, there was a 4% drop in real consumer spending in March, followed by a 17% decline in April.

MIDDLE MARKET INSIGHT

Although states have loosened restrictions on retail shops and restaurants, the reluctance of consumers to relax social distancing practices will have an enduring impact on the way we shop and entertain ourselves.

U.S. real GDP and real consumer spending

YEARLY GROWTH RATES



Source: BEA; Bloomberg; RSM US LLP

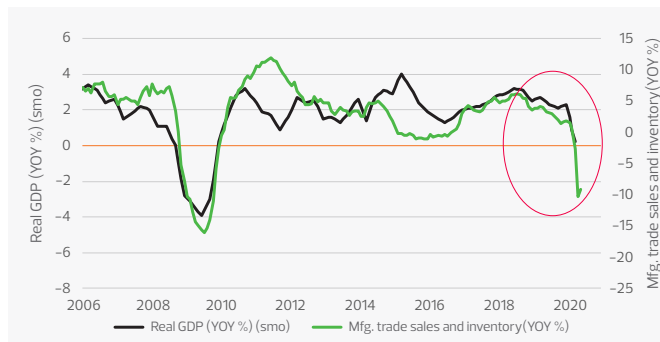
The commercial sector

As with all other sectors, manufacturing and trade sales have been in decline since the third quarter of 2018—a testament to the end of the decade-long recovery from the Great Recession and to the assault on our rules-based system of international trade.

Inventory accumulation has been in decline for more than a year and was flat in the first quarter before losing 2% in April. Manufacturing and trade sales were also in decline, but had a slight increase in January that didn't hold up. Manufacturing and trade sales lost nearly 5% in March followed by an 18% loss in April.

U.S. real GDP and manufacturing trade sales and inventory

YEARLY GROWTH RATES



Source: BEA; Census; Bloomberg; RSM US LLP

LIVING IN A GLOBAL ECONOMY MEANS THAT WHEN DEMAND DROPS (OR RISES) IN THE UNITED STATES, IT IS MOST LIKELY THE CASE THAT DEMAND IN OUR TRADING PARTNER COUNTRIES WILL FOLLOW SUIT.

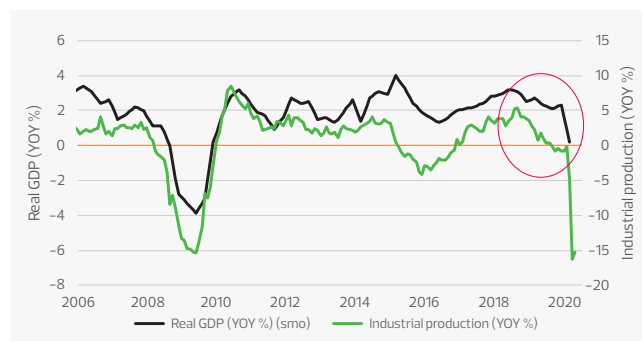
The industrial sector

As the figure below shows, the business cycle closely follows trends in industrial production. This is because of the virtuous circle of industrial growth feeding into the labor market and wages and, in turn, the growth of household spending.

Industrial production has been in decline since peaking in September 2018 and turning negative a year later in September 2019. Industrial production in March 2020 was down by 5% from the previous year, followed by a 15% drop in April and a 14% decline in May.

U.S. real GDP and industrial production

YEARLY GROWTH RATES



Source: BEA; Federal Reserve; Bloomberg; RSM US LLP

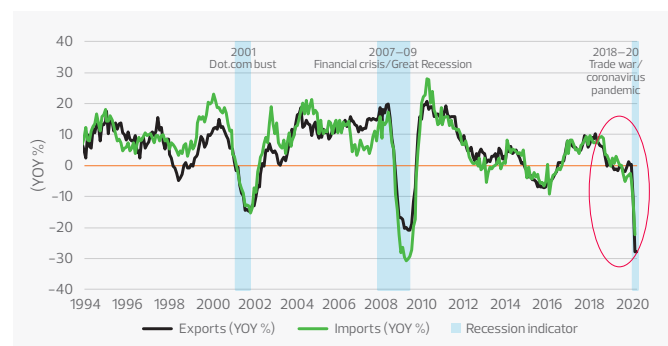
The external sector

Note that our monthly GDP index excludes the impact that the external sector can have on the national accounts. As shown in the first figure below, living in a global economy means that when demand drops (or rises) in the United States, it is most likely the case that demand in our trading partner countries will follow suit. So U.S. exports and imports will tend to have similar patterns of decline during economic downturns and increases during the subsequent recovery.

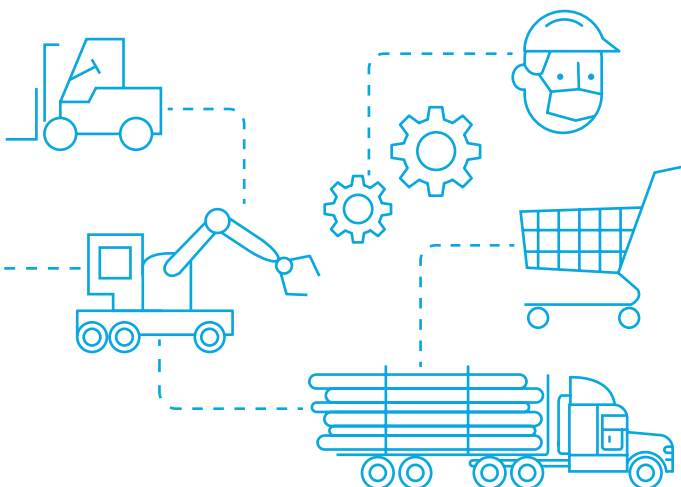
From time to time, however, there will be episodes when U.S. demand for foreign goods outstrips foreign demand for our exports. Though it results in a drop in net exports and is a drag on the national accounts, this is often a positive sign that the U.S. economy is growing faster than the rest of the world and will perhaps lead the global economy out of a recession.

With our trading partners suffering the same consequences of the trade war and the pandemic, there are too many uncertainties to confidently predict divergence in those trends. For instance, how will the spread of the virus to South America and Africa affect international commerce? Will the emergence of a possible second wave of the virus in China carry over to the rest of the world? ■

U.S. export and import growth during recessions



Source: U.S. Census; NBER; Bloomberg; RSM US LLP



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WILL YIELDS RISE DUE TO INCREASED ISSUANCE OF TREASURY BONDS? LET'S GET THE ELEPHANT OUT OF THE ROOM!

BY JOSEPH BRUSUELAS

APPREHENSION EXPRESSED by economic and financial pundits about potential runaway inflation and higher interest rates in the wake of the U.S. Treasury's recent issuance of bonds is high. The concern follows the government's plan to issue \$3 trillion in fresh debt to help fund pandemic-era fiscal stimulus as well as the post-pandemic economy. Our assessment of both the economic and policy paths leads us to believe that pundits' worries will not become actualized in the near term.

Both the fiscal and monetary authorities have ample room to provide support during the current crisis and to bolster growth in the post-pandemic economy. Inflation, interest rate shock and a crowding out of investment do not appear to provide outside risks to the economic outlook.

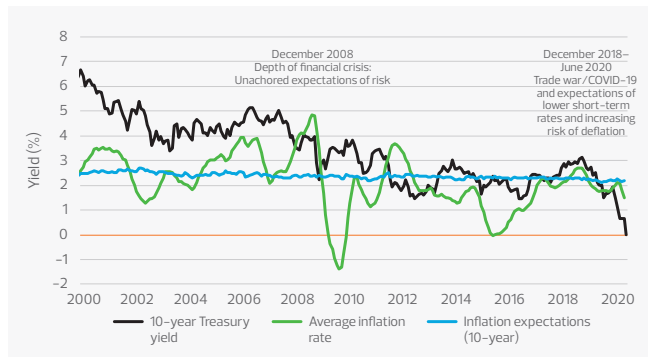
The yield on 10-year Treasury bonds has been in a secular decline since former Federal Reserve Chairman Paul Volcker demonstrated to the world how to squeeze the

IF YIELDS ALONG THE YIELD CURVE HAVE BECOME COMPRESSED, WHY THEN HAVE 10-YEAR YIELDS CONTINUED TO FALL BELOW THE EXPECTATIONS FOR SHORT-TERM RATES?

life out of inflation in the late 1970s. In the four decades since, central bankers learned to target inflation, while a confluence of events in the real economy have limited consumer price increases to the exception, rather than the rule. Since the housing bubble burst in 2008, inflation has risen above 3% only once. That was in 2012, when we expected inflation to rise as more people were working and able to make nonessential purchases. Since 2008, the core personal consumption expenditure index (the Fed's inflation policy variable) has averaged 1.57%, well below its 2% inflation target.

Inflation targeting by the central banks has resulted in diminished expectations for inflation, shown in the figure below, and the worldwide compression of interest rates. Yields on 10-year Treasury bonds have been dropping since late 2018, when the global cost of the U.S. trade war became apparent. Ten-year yields have dipped to less than 1% since the March 2020 onset of the novel coronavirus pandemic.

10-year yields, the CPI and inflation expectations



Source: Philly Fed; Bloomberg; RSM US LLP

As we've discussed before, 10-year yields can be broken down into two components: (1) expectations of short-term interest rates over the life of the bond, and (2) compensation for the risk that short-term interest rates might not follow those expectations. The path of short-term interest rates is determined by Federal Reserve guidance and the central bank's setting of the federal funds rate. Nevertheless, an investor will require compensation for what we call "event risk," such as the risk of a trade war or a pandemic, which causes a divergence in that path. Faced with the choice of holding a bond until term or buying a series of risk-free, short-

term money-market securities, the investor will require compensation in the form of a risk premium—a "term premium."

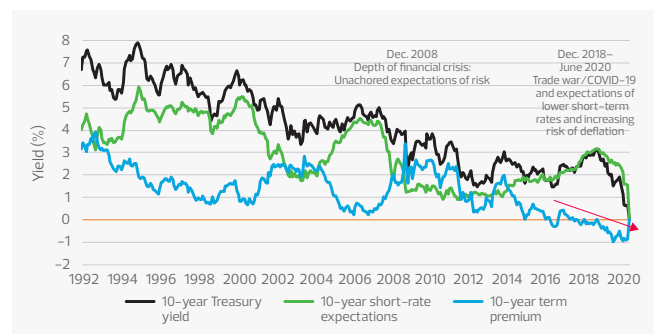
As shown by the green line in the figure below, expectations for short-term rates have been in decline since late 2018, when it became apparent that the Fed would have to stop its interest-rate normalization program and cut the federal funds rate once again in response to a slowing domestic and global economy.

If yields along the yield curve have become compressed, why then have 10-year yields continued to fall below the expectations for short-term rates?

The drop in the term premium into negative rates—shown in the red line in the figure below—reflects investors assigning greater probability over time of a recession and the risk of a severe drop in demand, along with deferred spending by households, and therefore an increased risk of deflation and a decrease in the real return on the investment, which is paramount.

Expectations and risk components of 10-year yields

EXPECTATIONS OF SHORT-TERM RATES AND THE TERM PREMIUM BUILT INTO 10-YEAR TREASURY YIELDS



Source: FRBNY; Adrian Crump & Moench; Bloomberg; RSM US LLP

If issuance continues to increase, will there be enough demand to keep interest rates low?

The following figure shows the bid-to-cover ratio of Treasury bond auctions since 2000. The bid-to-cover ratio can be a measure of the demand for bonds, with a ratio of 2.0 indicating twice as many offers to buy the bonds relative to the amount auctioned. As the figure below shows, the ratio has rarely dipped below 2.0 since 2004.

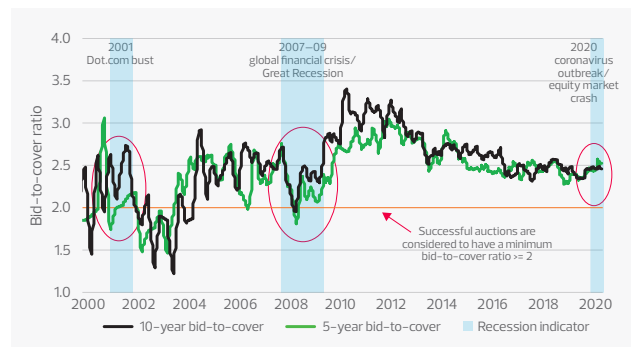
DESPITE THE LOW RETURN, THE TREASURY MARKET REMAINS THE SAFEST GAME IN TOWN.

There are supply considerations in addition to the demand side. We could attribute the dips in the bid-to-cover ratio at the outset of the 2001 dot-com bust and the 2008–09 Great Recession—as well as the latest episode—as the result of an increase in issuance at the outset of a recession. But those dips might also be due to the increased need of investors to hold cash in order to meet short-term obligations. Regardless, the Fed is likely to continue mopping up the supply of Treasury issuance via its quantitative easing operations and the expansion of its balance sheet.

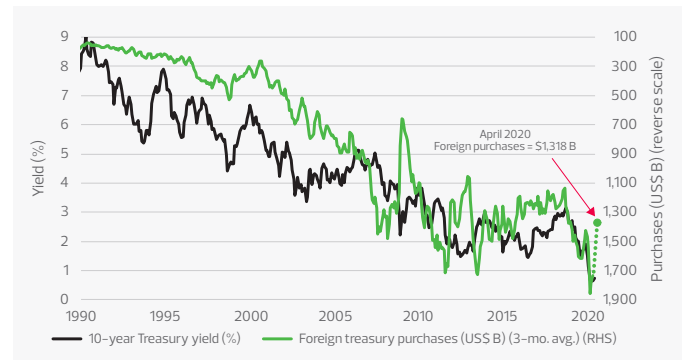
The demand for U.S. Treasury securities by foreign investors over time seems undiminished, despite the secular decline in U.S. interest rates, shown in the figure below. Foreign purchases are the result of the safe-haven demand for the guaranteed returns of U.S. securities, the potential for increases in return due to the strength of the dollar and transactional demand as profits from our trading partners are parked in Treasury securities.

Bid-to-cover ratio of 5- and 10-year U.S. Treasury bonds

13-WEEK AVERAGE (AND LATEST) RATIO OF AMOUNT OF BIDS RECEIVED TO BONDS SOLD AT AUCTION

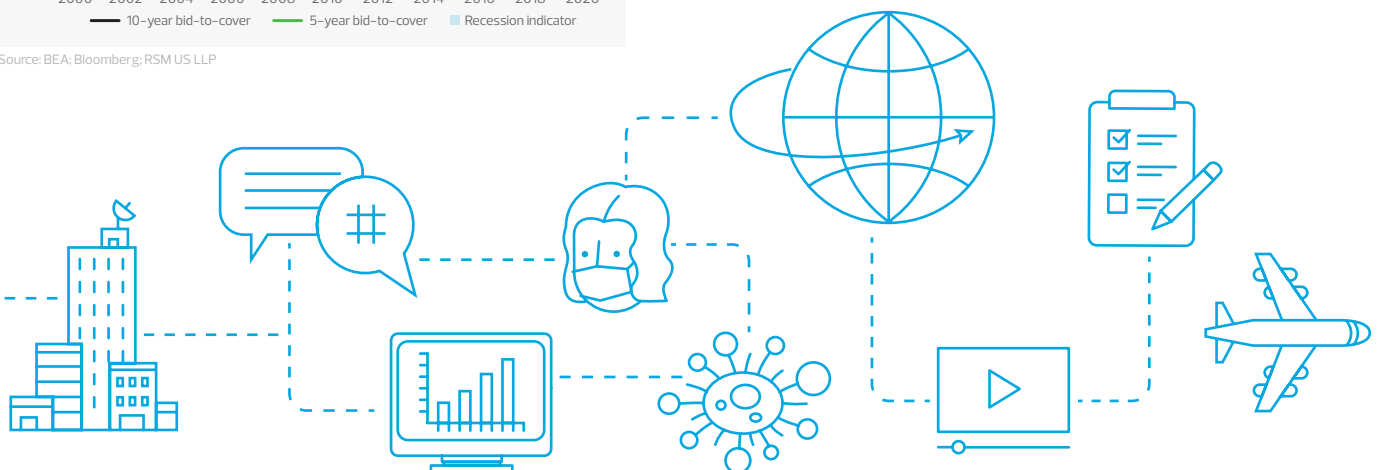


10-year yields and foreign purchases of U.S. treasuries



It is unlikely that these conditions will be overturned, though there are uncertainties regarding the spread of the novel coronavirus and the depth of the commitment by the administration and Congress to minimize damage to the economy. Along with the virus's spread, we must also consider the depth of the economic slowdown in the economies of our trading partners.

Despite the low return, the Treasury market remains the safest game in town. It would take a deflationary spiral to change that reality. Moreover, it is more likely that the Fed will increase its purchases of Treasuries if pandemic-era economics require a more aggressive stance to support growth and bolster employment conditions. What lies beyond that are the economics surrounding yield curve control. ■





THE REAL ECONOMY BLOG

REAL INSIGHTS FOR THE REAL ECONOMY

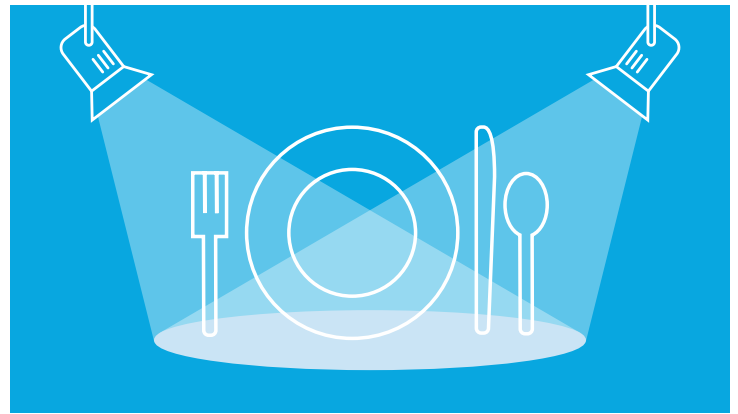
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FOOD AND BEVERAGE



INDUSTRY SPOTLIGHT

SUCCESS IN FOOD AND BEVERAGE COMES FROM RESILIENCE, INNOVATION AND TRANSPARENCY

BY KAREN GALIVAN

AS WE BEGIN a global economic recession, the food and beverage industry is projected to be the only consumer products sector to have growth in 2020, according to Euromonitor. This unprecedented time of record unemployment and pandemic conditions will shape consumer spending and put pressure on food manufacturers and distributors already operating on thin margins. Supply and demand disruption, along with rising operating and transportation costs, will translate into higher prices. As companies continue to manage through the crisis and plan for the road ahead, it will take resilience, innovation and transparency to succeed.

Heading back to center

The pandemic caused consumers to head to the center of the grocery store to stock up on shelf staples like canned and frozen foods. As shelter-in-place rules were announced, there was great uncertainty and shoppers were concerned about everything from contagion to food shortages. Stocking up was something they could control

during an uncontrollable situation. And shopping the center of the store could last for a few reasons.

When shoppers turned to e-commerce for their groceries, many websites featured recipes using canned and frozen foods. Consumers are discovering healthy recipes using items such as rice, beans and tuna. They also opted for frozen fruits and vegetables when fresh alternatives were not available. According to a survey from the American Frozen Food Institute, frozen food purchases increased 70% during the first few months of the pandemic beginning in mid-March. The center aisles also offer healthy, quick-cooking ingredients that meet consumer preferences for both healthy and convenient meals. Finally, the center of the store often offers value with store branded items for the cost-conscious consumer. Center-of-store brands should focus on retaining this new connection with the consumer and developing digital strategies to stay top of mind whether the consumer shops brick-and-mortar or online.

Food and immunity

"Let food be thy medicine and medicine be thy food." – Hippocrates

During the pandemic we have seen the healthy food trend evolve. Consumers eat healthy foods to lose weight, increase energy and sleep better. Now they are looking for ingredients that boost immunity and prevent illness. Shelter-in-place guidance and reduced discretionary income caused more people to cook at home; it is generally easier to eat healthily at home than in restaurants. As unemployment grows, so does the loss of medical benefits—consumers are even more motivated to stay healthy and avoid expensive trips to the doctor.

Consumers continue to consider plant-based products as healthy; however, it may be difficult for some manufacturers to pivot. Many smaller plant-based manufacturers focused primarily on restaurants and may not have a distribution channel to retail in place. Many consumers may choose to eat plant-based proteins considering potential future meat shortages and higher prices. To be successful, manufacturers will need to get control of their supply chains and distribution channels and use predictive analytics to be prepared for potential future disruptions.

Meat concerns

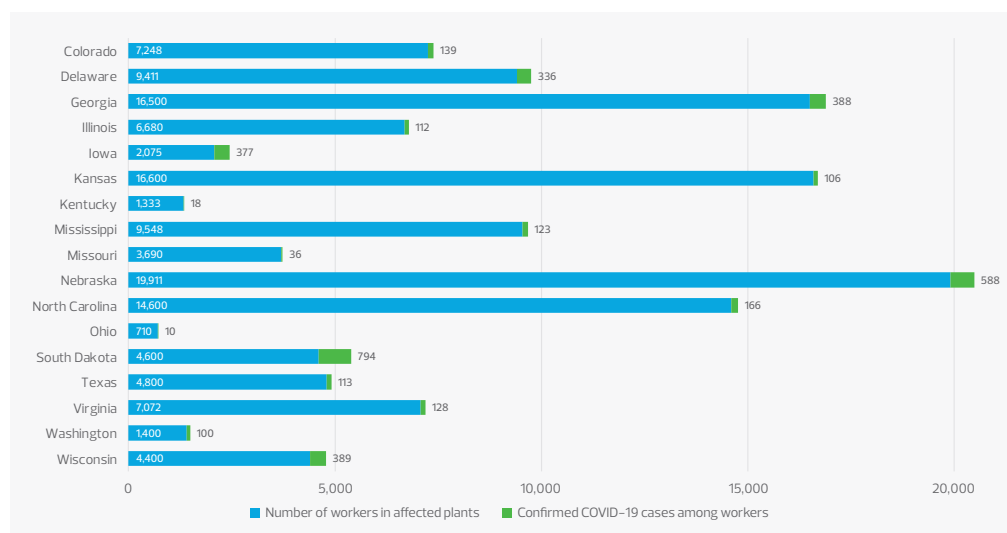
As consumers were stockpiling groceries, food manufacturers of all types were running multiple shifts to keep up with demand. Food processors have strict guidelines to keep food safe; however, the pandemic shone an unfavorable light on the meat and poultry processing industry. In early April 2020, the U.S. Centers for Disease Control and Prevention

was alerted to several cases of plant workers testing positive for COVID-19. After a month-long investigation, the CDC found 4,913 cases of COVID-19 and 20 deaths reported from 115 plants in 19 states.

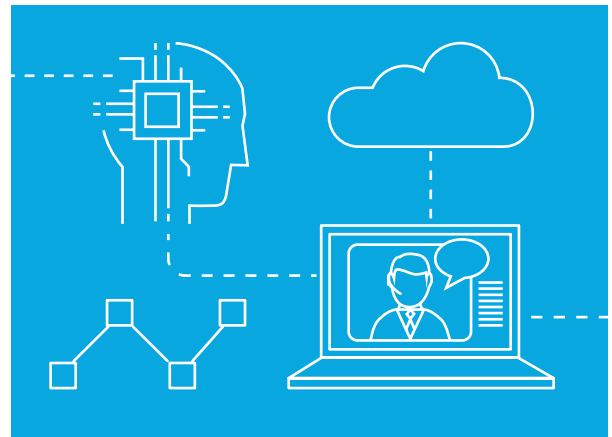
There were several factors that contributed to the quick spread of the virus, ranging from structural and operational constraints to social and economic challenges. The CDC recommended changes such as increased sanitation in high-touch areas, physical distance barriers and face coverings, as well as employee education and improved medical leave benefits. While many plants temporarily closed to address the problem, an executive order was issued to keep the plants open. This encouraged another round of panic-buying causing consumers to see higher prices and limited selection. Regardless, in a survey performed by Datassential in early May, 69% of U.S. consumers identified themselves as meat eaters. These consumers were also asked if the virus spread among the meat processing facilities would prevent them from future meat purchases. Of the 1,000 people surveyed, 39% were concerned but would still buy meat; another 37% were not concerned at all. While these are positive signs for the meat and poultry industry, meat and poultry processors still need to be aware of price. The pandemic has made consumers more resourceful and flexible due to the economic downturn and rise in unemployment. While they may not stop eating meat, they most likely will limit their consumption to save money. ■

Want more industry outlook commentary in a variety of sectors? Check out our second quarter *The Real Economy: Industry Outlook*. Look for it later this month.

Number of workers in affected plants and confirmed cases of COVID-19



Source: Dyal JW, Grant MP, Broadwater K, et al. "COVID-19 Among Workers in Meat and Poultry Processing Facilities—19 States," April 2020



WHO LEADS DIGITAL TRANSFORMATION?

CHIEF TECHNOLOGY officers and other IT leaders frequently drive the majority of digital decision-making in middle market companies; however, RSM's [Digital Transformation Survey](#) shows a significant amount of collaboration throughout many organizations related to technology strategy. Key findings from the survey include:

The CEO and the chief financial officer are also in the top five for digital project responsibility:

- **52%** CEO
- **43%** CFO

Technology specialists are the top three most responsible parties for leading digital projects:

- **76%** CTO
- **70%** Chief information officer/IT director
- **58%** Chief digital officer

In addition, **80%** of middle market survey respondents expect their role in digital decision-making to expand. How?

- **43%** see broadened financial analysis responsibilities
- **40%** see more participation in IT transformation projects
- **37%** see greater data analysis responsibilities
- **36%** see more active involvement in the human resources function for digital talent

THE TAKEAWAY

Responsibilities for digital strategies are quickly changing. Teamwork and input from multiple layers throughout the organization will be even more important and essential for digital transformation moving forward. Synergies mean success.



Business insights to bolster your response to COVID-19

As middle market businesses like yours respond to the impact the coronavirus pandemic has had within organizations, it's important for you to stay on top of the evolving issues related to this crisis in order to mitigate risks and plan accordingly.

RSM can help you stay informed with the latest insights, ideas and countermeasures to minimize the outbreak's negative effects, as well as prepare you for future emergency events.

Visit our [Coronavirus Resource Center](#) to learn more and subscribe to our COVID-19 update newsletter. Or contact us today to speak with an RSM professional about your business recovery options.

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