

THE REAL ECONOMY

VOLUME 66



THE POST-CORONAVIRUS ECONOMY: WHAT TO EXPECT, AND WHAT IS NEEDED

**ECONOMIC FREE FALL HAS ENDED, NONTRADITIONAL
DATA SHOWS**

INDUSTRY SPOTLIGHT:

THE FUTURE OF WORK: 5 PREDICTIONS FOR
PRIVATE EQUITY FIRMS

IS BRICK AND MORTAR DEAD? THIS TIME, WE'RE
TALKING ABOUT OFFICE BUILDINGS

MIDDLE MARKET TREND WATCH: WORKFORCE
DYNAMICS

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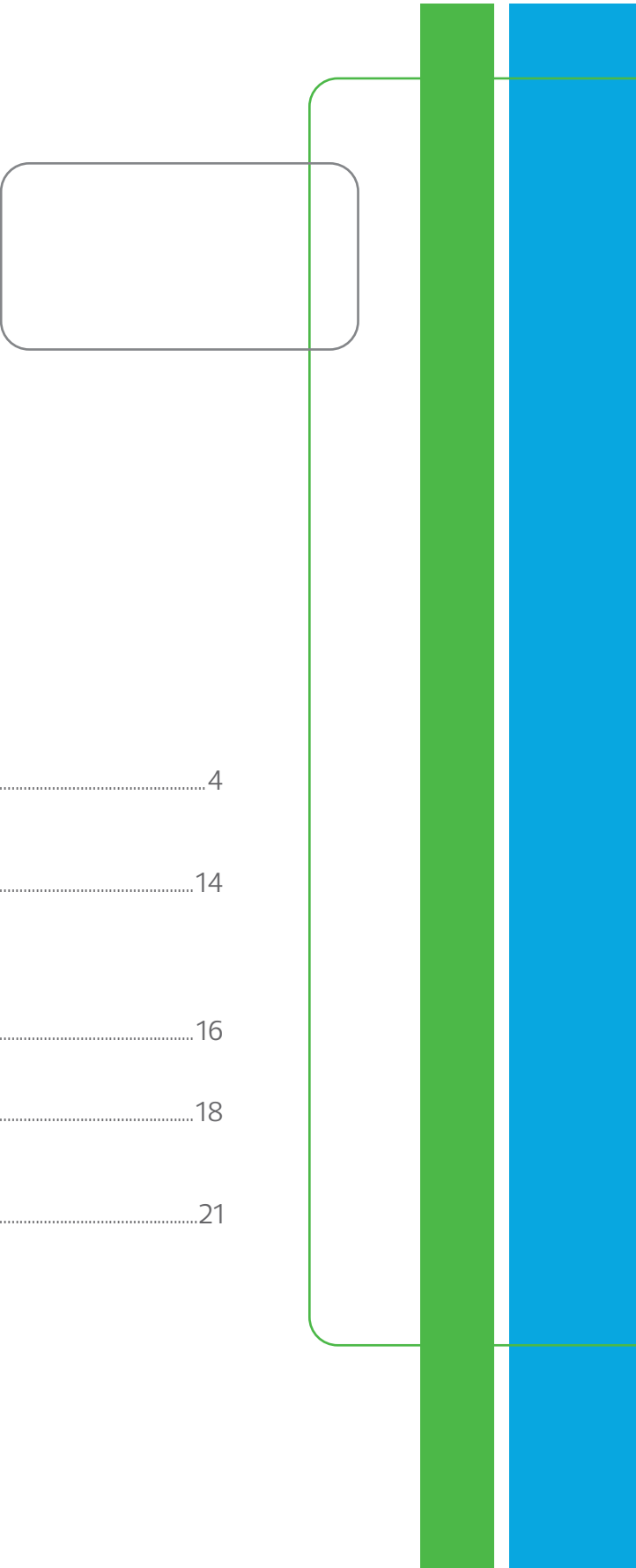


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THE POST-CORONAVIRUS ECONOMY: WHAT TO EXPECT, AND WHAT IS NEEDED

BY JOSEPH BRUSUELAS

WE THINK that the U.S. economy has ended its pandemic-induced free fall. Tentative signs of the recession's nadir are evident in near real-time data across the economy. It is now time to begin considering the shape of the post-pandemic economy: What it will look like, whose interests are given preference, and how fiscal and monetary policy will drive the American economy.

In our estimation, the depression-like shock of the pandemic will result in a wholesale destruction of what the scholar Mancur Olson called distributional coalitions—groups such as, for example, lobbyists who play a significant role in the allocation of wealth and income that often negates economic reform. These groups have blocked the modernization of the American economy for some time.

The status quo is not going to return. The pandemic is shattering what is left of the old social contract that survived the financial crisis. The special interests, cartels and policy coalitions, which shaped the political economy before the pandemic, will likely not survive the magnitude of the shocks working their way through the economy and society. What lies ahead will include a major shift in the balance of power between state and society, labor and capital, and the individual and government.

These changes will require a set of policies including government spending and monetary accommodations to support the multiyear recovery ahead that are quite different from the policies that prevailed before the pandemic. Large budget deficits, real negative interest rates and government-sponsored initiatives such as

WE COULD EXPECT LABOR COSTS TO BE MODERATE ONCE THE ECONOMY IS BACK TO WORK AGAIN. THE FEAR OF INFLATION-DRIVEN WAGE INCREASES SEEMS OVERBLOWN.

the Federal Reserve's Main Street Lending Program and worker retraining are all going to be necessary.

The days of rage in the United States following the tragic death of George Floyd in Minneapolis are indicative of the likely social, economic and political change ahead. The unwillingness of the emerging demographic majority to sustain the injustices and inequities of the past will almost certainly usher in a quicker collapse of the old social and economic order. The commitment to social justice of that cohort will not leave the economy unchanged.

The following is a brief synopsis of what we expect the economy to look like during the early phase of recovery in employment, inflation, wages, fiscal policy and monetary policy.

The shock

Our baseline forecast has been predicated on the notion of "depression-like shock, no depression." The bottoming of economic activity and rebound in equity prices underscore that call, and we are sticking with it until economic data or policy implies otherwise.

But it is important that the idea of a depression-like shock without a depression is predicated on a sustained policy response from the U.S. fiscal and monetary authorities. Large fiscal support and real negative interest rates should prevent negative feedback loops of budget cuts at the state and local levels. Those cuts would result in wholesale layoffs of public-sector employees such as teachers, firefighters, medical personnel and police officials.

If that policy of fiscal and monetary support gives way to premature austerity policies, there is a significant risk that the recession will rival the Great Recession of 2007–09; the double-dip recession of the early 1980s; or worst of all, the Great Depression of the 1930s. At this point, the difference between a deep recession and a depression is a policy choice and not fate. We are still early enough in the policy response process that the U.S. political authority has the capacity to prevent a depression.

The Great Depression was solvency-induced (and precipitated by the 1929 stock market crash). The 2020 recession, by contrast, is a byproduct of an ill-advised trade war and the global shutdown of economic activity due to an overwhelming health crisis. It will almost certainly be followed by a solvency crisis, particularly among small firms in the retail, leisure and the hospitality sectors. All of this will take place amid elevated unemployment.

Given the record of the past decade, if the policy responses are misdirected, insufficient and short-lived—all of which are likely to prolong the misery of those not fortunate enough to adapt to changes in workplace requirements—then the risks of an outright depression will rise.

Shape of the recovery

We expect an elongated and frustratingly slow recovery that will look like a Nike swoosh rather than a W or a V in the near- to medium-term. Our base case anticipates a solid economic rebound in the final quarter of 2020, followed by a more modest multiyear period of recovery. We do not expect expansion beyond January 2020 levels until the middle of the decade.

Our alternative to the baseline is a W-based recovery that is defined by a second wave of the virus and another dip in economic activity in early 2021, followed by another round of layoffs and rising unemployment.

The difference between our baseline and the alternative forecast will be the combination of macroeconomic policy and individual behavior that mitigates the disease later this year. Should policymakers pull back on support for the economy or should the recent reopening of the economy prove premature and a second wave of infections occurs, then we will begin talking about depression-level economic growth and policy responses.

Finally, our alternative to the W would be a V-shaped recovery along the lines implied by the improvement in financial conditions and equity markets. Under this scenario, the virus ends and a massive return to work and a boost to the economy by fiscal and monetary measures result in a strong recovery starting in the third quarter of 2020.

But none of these scenarios are pre-ordained. How the government responds is a choice, one that can be informed by the experience of past recessions. If policymakers choose to reaffirm the status quo, it runs the risk of a far larger economic catastrophe.

In the analysis that follows, we look at the reaction of the labor market, consumer prices, wages and the federal budget deficit in the 14 economic downturns since 1929. Though the current episode is unlike any other recession, and despite the many uncertainties, it will certainly share characteristics with the worst of the lot.

THE LARGE GOVERNMENT OPERATING DEFICITS ARE GOING TO BE A DEFINING NARRATIVE OF THE POST-PANDEMIC ECONOMY, AND THE FED WILL KEEP INTEREST RATES AT ZERO FOR THE FORESEEABLE FUTURE.

Employment: American labor dynamics

This recession is uniquely distressing. Instead of a gradual drop in demand and production causing a gradual drop in demand for labor, the rug was pulled out from under 40 million employees virtually overnight, leaving them unemployed or furloughed and pushing the economy into recession.

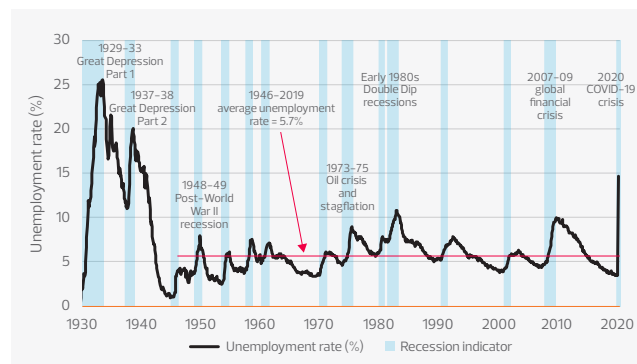
We expect roughly 25% of those 40 million to permanently lose their jobs. That implies an optimistic outcome of greater than 10% unemployment over the next few years. This will be the baseline of what one should anticipate is a much larger government role in how the labor force is managed, trained and retrained. Greater government regulation of the labor force and expenditures on training are going to be the equilibrium going forward.

As the following figure illustrates, the unemployment rate has reached its lowest point at the end of each business cycle since the Great Depression. The unemployment rate then begins to climb as each recession takes hold. It will typically increase for months past the official end date of the recession as businesses delay furloughing employees due to contractual reasons or out of loyalty.

In the following table, we show that the high point in the unemployment rate has occurred anywhere from 11 to

U.S. unemployment rate before and after recessions

AND EPISODES OF SIGNIFICANTLY GREATER THAN NORMAL LEVELS OF POST-WAR UNEMPLOYMENT



Source: BLS; NBER; RSM US LLP

27 months after the start of the recession (excluding the first dip of the 1980–81 double-dip recession). On average, the peak rate of unemployment occurs 15 months after the start of the recession. If this holds true, then that implies double-digit unemployment rates well into 2022 or further.

What's most important for policymakers to consider is that not only does it take one to two years for the unemployment rate to reach its peak once a recession has begun, but it also takes an even longer time for the unemployment rate to move back below the 5% equilibrium level.

Length of time for unemployment to recover after recessions

	Unemployment at the outset of the recession		Highest unemployment rate after the recession			Getting back to normal	
	Start of recession	Unemployment rate in month before recession	Date of highest unemployment rate in cycle	Highest unemployment rate in cycle	Number of months after start of recession	Date of reaching NAIRU	Number of months to reach NAIRU
Post-war recessions	Jan. 1945	1.1%	March 1946	4.2%	14	Oct. 1947	19
	Nov. 1948	3.8%	Oct. 1949	7.9%	11	July 1950	9
1950s monetary tightening	July 1953	2.6%	Aug. 1954	6.0%	13	Dec. 1954	4
	Aug. 1957	4.1%	July 1958	7.5%	11	June 1959	11
1960s monetary and fiscal tightening	April 1960	5.2%	May 1961	7.1%	13	July 1964	38
	Dec. 1969	3.5%	Aug. 1971	6.1%	20	Jan. 1973	17
Oil crisis induced recessions	Nov. 1973	4.8%	May 1975	9.0%	18	July 1979	50*
	Jan. 1980	6.3%	July 1980	7.8%	6	July 1981	12*
	July 1981	7.2%	Dec. 1982	10.8%	17	March 1989	75
Austerity and energy crises	July 1990	5.5%	June 1992	7.8%	23	May 1997	59
	March 2001	4.3%	June 2003	6.3%	27	June 2005	24
Financial and health crises	Dec. 2007	5.0%	Oct. 2009	10.0%	22	Sept. 2015	71
	Feb. 2020	3.5%	April 2020	14.7%	2	—	—
Average number of months					15		32

Source: NBER; BLS; Bloomberg; RSM US LLP * Did not reach NAIRU before next recession

IF THE PAST IS ANY INDICATION, WE SHOULD ANTICIPATE AN INCREASE IN THE NATIONAL MINIMUM WAGE IN 2021. THAT WILL MOVE TOWARD WHAT IS QUICKLY BECOMING A CONSENSUS LIVING WAGE OF \$15 PER HOUR.

In the table, we show that the average length of time for the unemployment rate to reach 5% or lower has been 32 months after the peak month of unemployment. This underscores our forecast of the economy not reaching January 2020 levels until mid-decade.

That suggests that a quick end to income assistance for the unemployed is unreasonable and counterproductive. Given the high multiplier effect of low-income spending, a dollar of assistance for those who have no other source of income creates more than a dollar of spending throughout the economy and is beneficial to all.

The equilibrium rate is referred to as the natural rate of unemployment—which refers to the normal level of joblessness as workers transition to new jobs or locations, or life-changing situations. This 5% natural rate lines up with the postwar average unemployment rate of 5.7% shown in the figure, particularly if the 10% rates of unemployment during the 1980s and 2007–09 recessions are treated as outliers.

In recent years, the natural rate concept has given way to an idea called the non-accelerating inflation rate of unemployment, or NAIRU. As the demand for labor increases during business cycle upswings and as unemployment dips toward the assumed NAIRU level of 5%, wages were thought to increase, pressuring inflation higher.

NAIRU is thought to evolve over time with changes in the business cycle. So in recent periods of high growth, NAIRU was thought to dip to 4.5% or lower, perhaps as a way of explaining a low level of wage increases. In our discussion of inflation and wages that follows, recall that the unemployment rate before the coronavirus crisis was at a post-World War II low of 3.5%, with inflation in decline and below the Federal Reserve's targeted 2% rate.

We argue that as labor unions lost their sway and as sophisticated technology was integrated into the production of goods and provision of services, the supply of labor became no longer fixed. Businesses can now offshore production to low-wage centers, outsource low-skill tasks to firms that draw on unprotected workers, or substitute technology for labor, driving down costs and increasing profits.

Businesses took the opportunity of the 2007–09 Great Recession to substitute technology for labor and offshore manufacturing. There is little reason to think that this

trend might not continue after this recession. In fact, this recession will pull forward trends in technology like artificial intelligence and machine learning that will hurt many blue- and white-collar workers.

This gives even more impetus for a government-initiated infrastructure policy that includes rebuilding transportation networks and electrical grids, expanding and increasing broadband coverage, developing on-shore manufacturing capacity of medical supplies, and creating a well-paid corps of educators, researchers and health care providers to help the elderly and disabled, and to trace and treat victims of pandemics.

Inflation

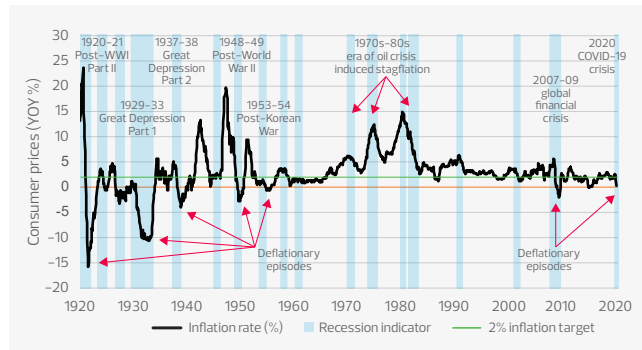
The mantra for anti-government forces has always been “more government spending equals runaway inflation.” Even after deflation had crippled the economy during the Great Depression of 1929–33, the government decided that the public needed a dose of austerity in the midst of a recovery, sending the economy back into another deflationary spiral from 1937 to 1938.

The economy has gone into deflation in seven of the 18 recessions beginning with the post-World War I recession of 1920–21 and including the 2007–09 Great Recession and today's coronavirus-induced recession.

As shown in the following figure, runaway inflation occurred in only two periods. The first occurred after World War II, when the economy was transitioning from wartime shortages and price controls, and was reducing the value of real government debt. The second took place during the oil embargoes of the 1970s, which drove up costs of production and consumer prices and drove down demand (the era of stagflation). But the Federal Reserve under Paul Volcker proved that monetary policy could control inflation and that the Fed knew how to do it.

And so it has been four decades of inflation targeting by the world's central bankers, aided and abetted by the now infinite size of the global labor market. Inflation has been squashed out of the global economy like stepping on an overripe cantaloupe. Interest rates have been compressed across the board and wages of the working classes have stagnated, all while corporate profits have taken off due to the consumer-driven, worldwide demands of an ever-expanding middle class.

U.S. inflation rate in post-recession periods and episodes of deflation



Source: BLS; NBER; RSM US LLP

That last part about the ever-expanding middle-class spending is showing signs of faltering, however, as we enter what looks to be another disinflationary or outright deflationary period. As the figure and table indicate, inflation declines and usually reaches its lowest point in the cycle, an average of 22 months after the start of the recession. And then it has taken another 27 weeks for inflation to recover to its 2% target. This is important because the cost of a recession will need to be financed by the government through the sale of Treasury bonds. Rather than tax the public to pay the dividends, it would be less costly if those costs were inflated away—that is, paid off with inflated dollars.

There have been arguments organized around the return of inflation. Most of these are predicated on outdated dogma and are not linked to the significant structural changes that have occurred in the U.S. economy.

The argument that inflation is always and everywhere a monetary phenomenon is true only under certain conditions. The example is banks taking extra reserves and pushing them into a closed economy, creating a situation in which too much money is chasing not enough goods. Those conditions prevailed quite nicely in the U.S. between 1965 and 1985. They are not here now, nor were they present during the great financial crisis of 2007–09.

For the U.S. to experience an inflation problem would require two major things:

- **A significant supply shock.** An example would be cutting off China and closing the economy to what we would consider a reasonably open global trading system. Most times when one speaks of inflationary risks, it is an argument that is based on nationalism, anti-globalism and repatriation of supply chains.
- **A major upside surprise in the economic rebound** over the next number of years that results in the release of assets held on reserve as the central bank meets major demand. That would require the Fed and Treasury Department to acquiesce and create inflationary conditions. And if they did, it would be directed at reducing the real value of public and private debt obligations.

Length of time for inflation to reach 2% target after recessions

	Inflation at the outset of the recession		Highest inflation rate after the recession			Getting back to normal	
	Start of recession	Inflation rate in month before recession	Date of lowest inflation rate in cycle	Lowest unemployment rate in cycle	Number of months after start of recession	Date of reaching inflation target	Number of months to reach target
Post-war recessions	Jan. 1945 Nov. 1948	2.30 4.80	Feb. 1946 July 1949	1.70 -2.90	13 8	na Aug. 1950	na 13
1950s monetary tightening	July 1953 Aug. 1957	0.40 3.70	Oct. 1954 March 1959	-0.70 0.30	15 19	July 1956 Feb. 1960	21 na**
1960s monetary and fiscal tightening	April 1960 Dec. 1969	1.70 6.20	June 1961 June 1972	0.70 2.70	14 30	Feb. 1966 June 1972	56 na**
Oil crisis induced recessions	Nov. 1973 Jan. 1980 July 1981	8.30 13.90 10.80	Nov. 1976 June 1981 Dec. 1986	4.90 9.60 1.10	36 17 65	Dec. 1976 June 1981 Feb. 1987	na** na** 2
Austerity and energy crises	July 1990 March 2001	4.80 2.90	Jan. 1992 Jan. 2002	2.60 1.10	18 10	Nov. 1997 Oct. 2002	70 9
Financial and health crises	Dec. 2007 Feb. 2020	4.10 2.30	July 2009 April 2020	-2.10 0.30	19 2	Feb. 2011 na	19*** na****
Average number of months					22		27

Source: NBER; BLS; Bloomberg; RSM US LLP * Inconsistent data due to lifting of price controls ** Inflation did not reach target before next recession *** Includes shock from 2011 European debt crisis **** Assumes recession starts in March 2020

Under current economic conditions, an inflation problem would be one of choice either through trade policy or an explicit decision by the government to reduce the real value of public and privately held debt. It will not occur automatically due to an increase in the money supply or government spending.

Wages

We've divided our analysis of wages into three groups to capture the separate effects of de-unionization, the global supply chain and outsourcing of essential labor. As such, we look at the impact of recessions on manufacturing wages, average hourly wages and the minimum wage.

Our findings support the notions of wage rigidity, pent-up deflation and a rational labor force since 1985, with employees in the production sector facing competition from an infinite supply of labor (willing to undercut domestic manufacturing wages) and employees moving to a growing and more educated service sector.

Manufacturing wages: The modern manufacturing sector grew out of wartime mobilization and formed the backbone of the U.S. economy from the late 1940s into the early 1980s. The figure below shows wild swings in manufacturing wages as the price and wage controls were lifted after the war and as the economy went through two low unemployment recessions in 1945 and 1948–49. After the post-Korean War recession, manufacturing wages began an upward trend that lasted until the early 1980s.

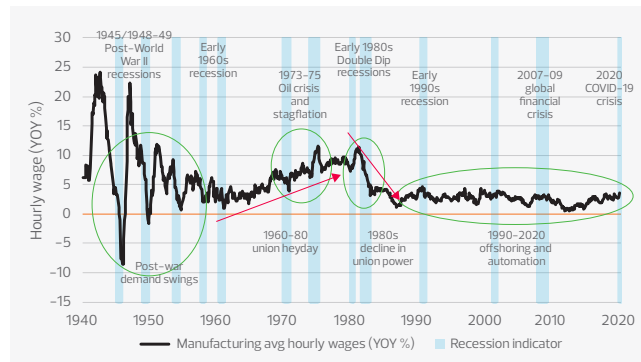
The decline of union bargaining power during the Reagan years coincided with an expansion of the supply of labor. The end of traditional manufacturing began with factories being lured away from regions with high costs of labor to the lower-wage areas of the South, which had state-enforced guarantees of a nonunionized labor force. That shift was then superseded by the development of the global supply chain and its cheap foreign labor.

The lack of union representation left a shrinking workforce subject to wage rigidity that we attribute to several factors. These include the decline in the demand for labor resulting from the general decline in domestic manufacturing—due to offshoring and changing consumer tastes—and to the substitution of labor with automation. Though wages were not going up, they were not declining either, as employment opportunities in the growing service sector put a floor on manufacturing wages.

Finally, manufacturing wages often increased at the outset of recessions before falling again as the recession matured. This is attributed to the last-in, first-out dismissal of lower-paid employees at the

outset of the downturn, leaving higher-paid employees operating the facility. As the recession deepens, the higher-paid employees are finally laid off and average wages deteriorate.

U.S. manufacturing wages during and after recessions

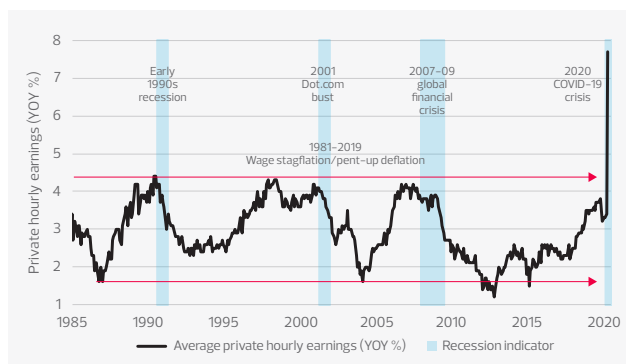


Source: NBER; RSM US LLP

Average private hourly earnings: As we mentioned at the outset, this recession is unique; 40 million employees were put out of work virtually overnight. The result has been a huge jump in the average pay of those who remain in the workforce and fortunate enough to work at home.

Though manufacturing remains a driving force of local economies, with production wages supporting downstream spending, the service sector has overtaken the production of goods as the dominant employer nationwide. As the following figure shows, private-sector wages (which include both production and service sectors) tend to drop during recessions and then increase during economic recoveries as employers compete for a shrinking pool of available labor.

U.S. average private hourly earnings during and after recessions



Source: FRED; NBER; Bloomberg; RSM US LLP

	Earnings growth at the outset of the recession		Lowest earnings growth after the recession			Getting back to normal	
	Start of recession	Earnings growth in month before recession	Date of lowest earnings growth in cycle	Lowest earnings growth in cycle	Number of months after start of recession	Date of reaching average earnings growth	Months to reach average earnings growth
Austerity and energy crises	July 1990 March 2001	4.1% 4.1%	Sept. 1992 Feb. 2004	2.3% 1.6%	26 35	Sept. 1995 Oct. 2005	36 20
Financial and health crises	Dec. 2007 Feb. 2020	3.8% 3.3%	Oct. 2012 na	1.2% na	58 na	Aug. 2018 na	70 na
Average number of months					40		42

The increase in wages in April has to be treated as an outlier—a data event in a unique set of circumstances. As the table indicates, in the three recessions during the period of ascension of the service sector, the average number of months for wage growth to bottom out was 40 months after the start of the recession. It then took another 42 months for earnings growth to recover to 3%, which is the average growth of earnings from 1985 to February 2020, and which we'll consider to be the normal level of growth.

Minimum wage: One thing that is almost certainly to be done after witnessing the horror of the pandemic is to increase the wages for those workers who keep our hospitals clean, and who feed and care for our elderly and infirmed. If the past is any indication, we should anticipate an increase in the national minimum wage in 2021. That will move toward what is quickly becoming a consensus living wage of \$15 per hour. Minimum wage increases have occurred in seven of the 12 recessions in the post-World War II era as shown in the following figure.

The graph displays the minimum wage in the U.S. (black line) and recession periods (blue shaded areas) from 1930 to 2020. The y-axis represents the minimum wage in U.S. dollars per hour, ranging from 0 to 8. The x-axis represents the year, ranging from 1930 to 2020. Key historical events and recessions are labeled: 1929-33 Great Depression Part 1, 1937-38 Great Depression Part 2, 1945/1948-49 Post-World War II recessions, Early 1960s recession, 1973-75 Oil crisis and stagflation, Early 80s Double Dip recessions, Early 1990s recession, 2007-09 global financial crisis, and 2020 COVID-19 crisis. The minimum wage shows a general upward trend, with significant jumps during the Great Depression and the 1970s, followed by a period of relative stability and then a sharp increase in the early 2000s.

Year	Minimum wage (U.S. \$/hour)	Recession indicator
1930	0.25	No
1933	0.25	Yes
1938	0.40	Yes
1945	0.75	No
1948	0.75	Yes
1950	0.75	No
1960	1.00	No
1962	1.00	Yes
1973	1.60	No
1975	1.60	Yes
1980	3.40	No
1982	3.40	Yes
1990	3.80	No
1992	3.80	Yes
2000	5.15	No
2007	5.15	No
2009	5.15	Yes
2010	7.25	No
2020	7.25	Yes

Minimum wage	Hours per week	Weekly earnings	Yearly income	Poverty level family of four	Percent of poverty level
\$7.25	40	\$290	\$15,080	\$26,200	58%
\$10.00	40	\$400	\$20,800	\$26,200	79%
\$12.50	40	\$500	\$26,000	\$26,200	99%
\$15.75	40	\$630	\$32,760	\$26,200	125%

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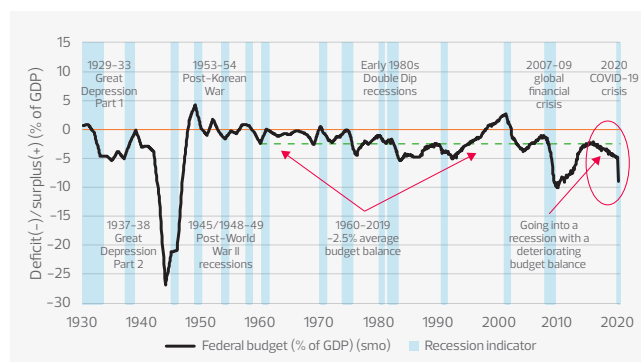
THE COSTS OF A RECESSION AND REALITIES OF RECOVERY ARE NOT JUST ABOUT MONEY. IT IS ABOUT THE DEGRADATION OF SKILLS, THE LOSS OF INCENTIVE FOR THOSE JUST ENTERING THE LABOR FORCE AND THE LOST HOURS OF OUTPUT THAT CAN NEVER BE RECOUPED.

After shrinking to 2.2% of gross domestic product in January 2016, the federal budget deficit had deteriorated to 4.9% by February 2020, the month before the coronavirus health crisis shut down the economy. The current output gap is the result of corporate tax cuts—which have reduced revenues but failed to generate investment—and a military buildup that has increased spending.

We have divided our budget analysis into two periods: The pre-Keynesian world of the 1930s to the 1950s, and the modern Keynesian world of monetary and fiscal policies working to maximize output within a system of stabilized inflation and unemployment.

In plain English, the modern economic system accepts modest deficit spending—borrowing against ourselves—to finance economic growth and to promote the well-being and opportunity for all. As the figure illustrates, we have rarely had a budget surplus since 1960, the latest occurring during the late-1990s economic boom that ended with the 2001 dot.com bust and recession.

U.S. federal budget balance before and after recessions



Source: BLS; NBER; RSM US LLP

On average, budget deterioration has continued for 21 months after the start of a recession, and then for another 38 months for the deficit to rebound to normal levels. (We have defined a normal budget deficit to be 2.5% of gross domestic product, which is the average of deficits recorded from January 1960 to February 2020.)

Length of time for budget to recover after recessions

	Budget balance at the outset of the recession		Lowest deficit after the recession			Getting back to normal	
	Start of recession	Budget balance in month before recession	Date of largest deficit in cycle	Largest deficit in cycle	Number of months after start of recession	Date of reaching equilibrium deficit	Number of months to equilibrium deficit
The Great Depression	Dec. 1929	0.7	Dec. 1934	-5.4	60	na	na*
	April 1937	-4.2	April 1937	-4.2	na	na	na**
Post-war recessions	Jan. 1945	-21.2	Jan. 1945	-21.2	na	na	na
	Nov. 1948	4.1	Dec. 1950	-1.0	25	na	na***
1950s monetary tightening	July 1953	-1.1	Dec. 1953	-1.7	5	na	na****
	Aug. 1957	0.8	Dec. 1959	-2.5	28	na	na
1960s monetary and fiscal tightening	April 1960	1.6	April 1960	-1.6	na	na	na****
	Dec. 1969	0.5	Feb. 1972	-2.2	na	na	na****
Oil crisis induced recessions	Nov. 1973	-0.7	March 1976	-4.4	28	April 1977	13
	Jan. 1980	-1.1	Feb. 1981	-2.5	13	Feb. 1981	na****
	July 1981	-1.9	June 1983	-5.4	23	April 1989	70
Austerity and energy crises	July 1990	-3.6	April 1992	-5.1	21	Dec. 1994	32
	March 2001	2.4	July 2004	-3.7	40	July 2005	12
Financial and health crises	Dec. 2007	-1.3	Dec. 2009	-10.1	24	May 2015	65
	Feb. 2020	-4.9	April 2020	-9.0	2	na	na
Average number of months					21	38	

Source: FRED; Bloomberg; RSM US LLP * Deficit increased throughout Great Depression Part 1 ** Deficit increased throughout Great Depression Part 2 *** Post-war government spending declined throughout cycle **** Deficit remained above -2.5%

THIS GIVES EVEN MORE IMPETUS FOR A GOVERNMENT-INITIATED INFRASTRUCTURE POLICY THAT INCLUDES REBUILDING TRANSPORTATION NETWORKS AND ELECTRICAL GRIDS, EXPANDING AND INCREASING BROADBAND COVERAGE, DEVELOPING ON-SHORE MANUFACTURING CAPACITY OF MEDICAL SUPPLIES, AND CREATING A WELL-PAID CORPS OF EDUCATORS, RESEARCHERS AND HEALTH CARE PROVIDERS TO HELP THE ELDERLY AND DISABLED, AND TO TRACE AND TREAT VICTIMS OF PANDEMICS.

So with a deficit already twice the size of normal even before the recession began, and with the administration calling for more tax cuts, perhaps policymakers and the public need to rethink the situation.

The 2017 tax cut did not spur investment, but managed only to inflate stock prices through corporate equity buybacks. High-end spending did occur, but how many yachts can one person buy?

Monetary policy

In a short period, it does appear that fiscal and monetary policies have become functionally integrated. The Fed has put forward nine different lending facilities, increased quantitative easing and reduced the nominal interest rate to zero, with real negative interest rates dominating the term spectrum out to 10 years.

The large government operating deficits are going to be a defining narrative of the post-pandemic economy, and the Fed will keep interest rates at zero for the foreseeable future.

If this sounds familiar, it is because it should. The Fed subordinated itself to the Treasury during the period of 1942 to 1951, when the federal government ran enormous annual operating deficits to support wartime production and the postwar transition.

The U.S. central bank possesses an institutional memory and knows how to manage such a condition. In addition, given the proliferation of monetary tools used over the past decade and the evolution of monetary policy, there is no reason to anticipate significant interest rate risk with respect to the Fed's balance sheet. That balance sheet is now more than \$7 trillion and will likely soar well above \$10 trillion in the near-term.

We expect the Fed to impose the policy of yield curve control, which is quite similar to how it operated in World War II and its immediate aftermath. Essentially, the

central bank will pin the 10-year yield at, for example, half a percent and inform the public that it will remain there until the central bank can attain a specific nominal growth target or inflation target over a specified period of time.

Our assessment of the future of monetary policy is that it does not include nominal negative interest rates as long as the economy remains out of depression. Should that happen, then the Fed could quickly choose to employ a widespread policy of nominal negative interest rates—which is distinct from real interest rates that account for inflation. This would entail changes to the financial regulatory framework that would include penalties against cash hoarding by large firms, insurance companies and pension funds, as well as the phasing out of large-scale cash denominations.

The shape of things to come

In this health crisis, the policy focus needs to be on saving small businesses and the employees they support. The Small Business Administration's flawed Paycheck Protection Program and the Main Street Lending Program put forward by the Fed are likely to define the near- to medium-term policy response.

Efforts to support employment will likely also include wage guarantees for employees who cannot work at home. (European governments are subsidizing 80% of wages, which creates a great, real-life experiment for damage control during a recession.)

To shift consumer behavior back toward traditional social and commercial activities will require the creation of a "healthy America" program to fund testing, tracing and treatment programs to fight this pandemic and those to come. And, of course, it would be helpful if the United States funds the development of a vaccine that is then manufactured and distributed to every person in the United States and around the world at no cost.

THE STATUS QUO IS NOT GOING TO RETURN. THE PANDEMIC IS SHATTERING WHAT IS LEFT OF THE OLD SOCIAL CONTRACT THAT SURVIVED THE FINANCIAL CRISIS. THE SPECIAL INTERESTS, CARTELS AND POLICY COALITIONS, WHICH SHAPED THE POLITICAL ECONOMY BEFORE THE PANDEMIC, WILL LIKELY NOT SURVIVE THE MAGNITUDE OF THE SHOCKS WORKING THEIR WAY THROUGH THE ECONOMY AND SOCIETY.

MIDDLE MARKET INSIGHT

The pandemic has accelerated the digital transformation already taking place in the U.S. economy. The uncertainty around designated work facilities means that middle market employers will need to establish ongoing remote work policies and make the necessary technology investments to support them.

The behavioral shift to working at home will result in a demand for expanded broadband throughout the economy, including rural America. Rebuilding of the American energy transmission system and transportation system will be necessary to support an economy that has been fractured by the pandemic.

Economic evidence is unmistakably clear that policy stimulus has to be large and applied quickly, and be sustained for as long as it takes to get employees back to work again. Waiting for a miracle to happen is erroneous and more costly than solving the problem in the first place.

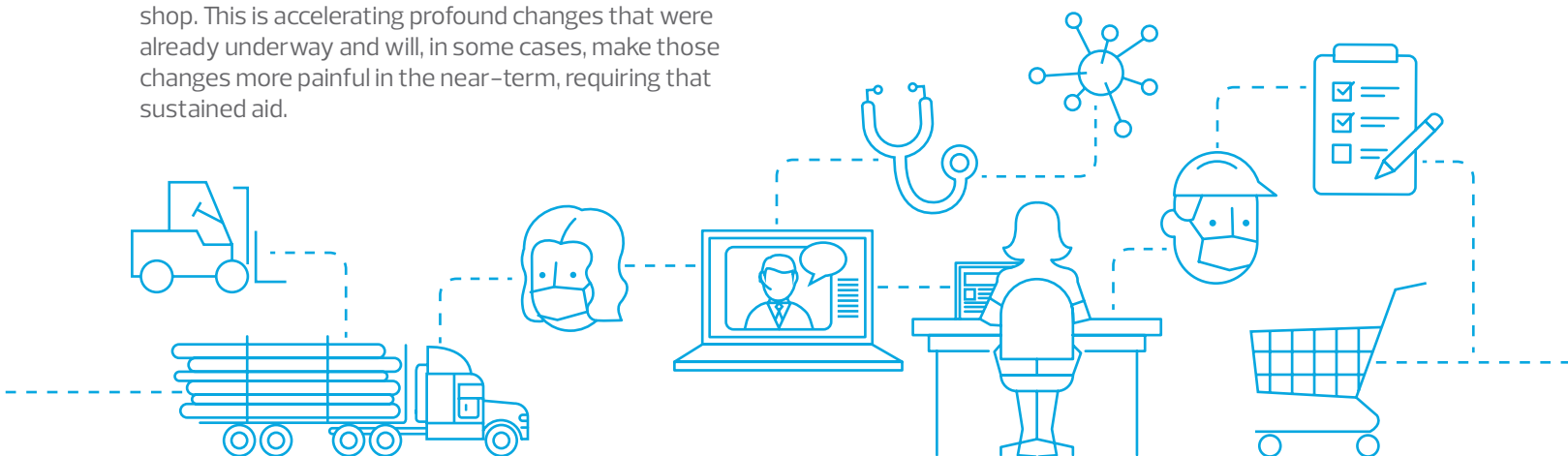
The pandemic is causing a plunge in demand that is resulting in significant changes in the way we work and shop. This is accelerating profound changes that were already underway and will, in some cases, make those changes more painful in the near-term, requiring that sustained aid.

Employing a period of fiscal and monetary austerity in the near- to medium-term would be significantly counterproductive. The second half of the Great Depression and the downturn in 1937–38 didn't have to happen. It was brought on by self-imposed fiscal austerity four years after the worst downturn in history and a budget deficit of only 4.2%.

Similarly, the sluggish recovery from the financial crisis was a choice driven by fears about the debasement of the dollar, interest rate shock, inflation and fiscal solvency that never arrived. The difference between a solid recovery and falling back to barely-there growth following the pandemic is a choice.

The costs of a recession and realities of recovery are not just about money. It is about the degradation of skills, the loss of incentive for those just entering the labor force and the lost hours of output that can never be recouped.

The decomposition of distributional coalitions that have prevented much-needed economic and social reforms over the past two decades presents the chance for recovery, renewal and revitalization of the American social compact and its political economy. ■



ECONOMIC FREE FALL HAS ENDED, NONTRADITIONAL DATA SHOWS

BY JOSEPH BRUSUELAS

OVER THE PAST few weeks, an array of near real-time economic data implies that the economic free fall caused by the coronavirus has come to an end. While there will be some troubling data ahead—including employment, wages and bankruptcies—we expect that the data for May and June will show that the economy is contracting at a slower pace than before. Under current conditions, that will illustrate a turn in the economy and points to a long, slow road out of the recession's nadir.

Six regional manufacturing and consumer confidence surveys point to a recovery in the offing. Most important, a 75% increase in mortgage applications on a year-ago basis and 0.6% increase in new home sales for April both look to be potential economic leaders out of the abyss.

The following data briefly discussed all point to economic stabilization, albeit at low levels and substantially below that observed one year ago.

The gradual reopening of the economy has clearly begun. We expect an elongated and frustratingly slow recovery that will look like a Nike swoosh rather than a W- or V-shaped period of growth in the near- to medium-term.

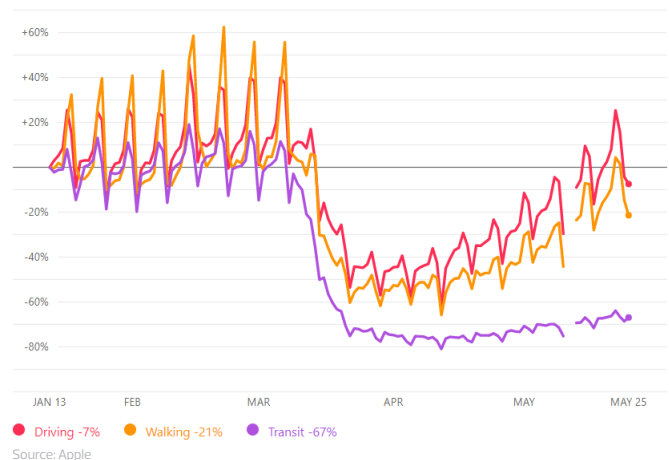
Our base case anticipates a solid economic rebound in the final quarter of the year followed by a more modest multiyear period of recovery. We do not expect expansion beyond January levels until the middle of the decade.

Apple mobility data

Demand for directions using Apple maps all point to the gradual emergence of individuals from social distancing and shelter-in-place orders. This is significant because individuals began social distancing before general government shelter-in-place orders went into effect around March 9, so behavior here is key to understanding the pace and magnitude of any consumer-led recovery.

Mobility trends

CHANGE IN ROUTING REQUESTS SINCE JANUARY 13, 2020

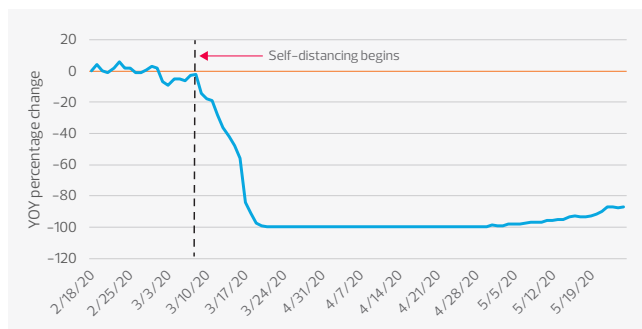




OpenTable reservations' data

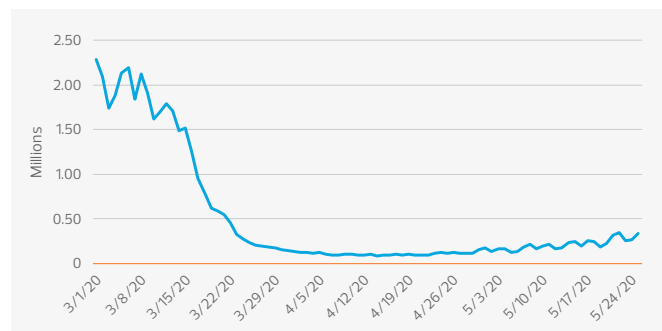
The same dynamic was revealed in restaurant reservations' data, which showed that people were self-distancing before any government orders were imposed. While it would be premature to state that consumer confidence has returned—it definitely has not—one can note that following the May 1 reopening of local economies around the country, there has been a pickup in restaurant reservations. Here we can observe a slowing in the pace of contraction on a year-ago basis.

Restaurant reservations



Source: OpenTable; RSM US LLP

TSA checkpoint



Source: TSA; Bloomberg

TSA checkpoint data

Traffic at Transportation Security Administration checkpoints, like restaurant reservation data, is tentatively demonstrating signs of life. While this data is well off from a year ago, individual and business travel is beginning to improve. From our vantage point, given the health risks around travel, this is going to be one of the economic bellwethers that will be used to estimate the pace and magnitude of the recovery. ■



INDUSTRY SPOTLIGHT

THE FUTURE OF WORK: 5 PREDICTIONS FOR PRIVATE EQUITY FIRMS

BY ANTHONY DECANDIDO

AS BUSINESSES around the world consider how they return to work amid the coronavirus pandemic, private equity professionals are already making plans for widespread changes to their workforce.

Like other businesses, private equity firms have limited nonessential travel, closed offices and imposed strict limits on in-person contact. But it has come at a cost. In an industry that relies on speed and innovation to close deals and drive returns for investors, this absence of face-to-face meetings is one reason that mergers and acquisitions activity in the private equity sector has had the most sudden drop-off since the Great Recession.

Now, private equity firms must transform quickly, a challenge that companies in the broader economy are facing. According to RSM's Q2 [Middle Market Business Index](#) survey, 70% of middle market executives are encouraging employees to reduce or restrict face-to-face meetings, and 52% won't allow travel outside the United States.

The future of private equity work is changing by the day, and innovative practices are needed to drive more lucrative deals. Here are five lasting changes for private equity firms that will follow COVID-19:

People remain your No. 1 asset...

Private equity firms already attract the best and brightest in corporate America, including top performers from Fortune 500 companies and elite banking firms. This won't change. But the methods taken to do so will. Virtual interviews will need to include aptitude tests to measure critical thinking skills, learning ability and problem-solving. And determining emotional intelligence will be equally important to establishing the type of trust that will be needed to work alongside management teams in a remote setting. LinkedIn, for example, is expanding its curriculum to engage more of its users with soft skills that private equity firms will need.

... yet data is becoming increasingly important

Data handling has the chance to revolutionize deal-making. Without having the benefit of physical access to evaluate company performance, analysts will instead look for alternative data sources to determine the areas of greatest earnings impact. Alternative data sets will reveal strategic movements within companies and help track when companies are hiring or firing employees, interacting with customers, moving product and other metrics that



offer insight into a company's performance. Visualizations will be important to affect the conclusions that otherwise were made during in-person meetings. And adult learning has become cheaper and more effective thanks to new technologies such as microlearnings, simulations, virtual coaching and gamifications.

As talent disperses, offices fade

Investment managers will stretch for talent outside of their geographic region as the in-office workforce diminishes. Areas like New York, Chicago and San Francisco have long been the hotbeds for finance talent, but that will change as private equity staffs increasingly work outside of concentrated urban neighborhoods. Firms will find that lavish office spaces, used for events like pop-in investor meetings, are overly costly, and the firms will instead opt for remote work options.

RSM's MMBI survey results show that 66% of employers have asked employees to work remotely. Employers will offer home office stipends to accommodate multiple screens, standing desks, printers and scanners. New employee benefits that encourage wellness will be the score that employees look for to encourage more stay-at-home working.

The fluid workweek and gender diversity

Private equity has a culture for competition that is not easily compatible with family life. Private equity professionals managing parental responsibilities amid the pandemic have learned to schedule around work commitments. This is difficult and trying, especially as parents manage home schooling, but a positive aspect is that men and women are sharing child care duties more regularly.

One likely result of remote working is that more parents may be willing to accept a fluid work schedule while still caring for children. And that may be one additional way for progressive funds to differentiate their strategies.

Outsourcing will grow

Limited partner and regulatory requirements for greater transparency are driving the need for substantial investments in technology, which middle market firms aren't always willing to make. Not all general partners have the ability to make those investments and will instead look to advisers who can.

As the risk of cybersecurity breaches rises, lean private equity firms will focus on the privacy of its front-office deal functions and leave back-office responsibilities to the outside firms. Human resources, fund administration and regulatory compliance will be one less worry for investment managers looking to make deals. ■

MIDDLE MARKET INSIGHT

Stay-at-home orders have sidelined nearly all of the private equity industry in the United States. But private equity is filled with bright and sophisticated people. And although the coronavirus has upended deal flow in the near-term, deal-making will go on; it just may look different.



INDUSTRY SPOTLIGHT

IS BRICK AND MORTAR DEAD? THIS TIME, WE'RE TALKING ABOUT OFFICE BUILDINGS

BY LAURA DIETZEL AND TROY MERKEL

AS THE HUMAN TOLL of the coronavirus pandemic has mounted, companies have limited nonessential business travel and told employees to work from home. The effect on cities has been profound, and unsettling, with a cityscape characterized by empty office buildings, quiet streets and shuttered stores.

Now, as many middle market companies have shown that they can shift from a traditional brick-and-mortar setting to a virtual one, office building tenants and landlords are rethinking the need for offices in the future and the related fixed costs they bring.

The issue

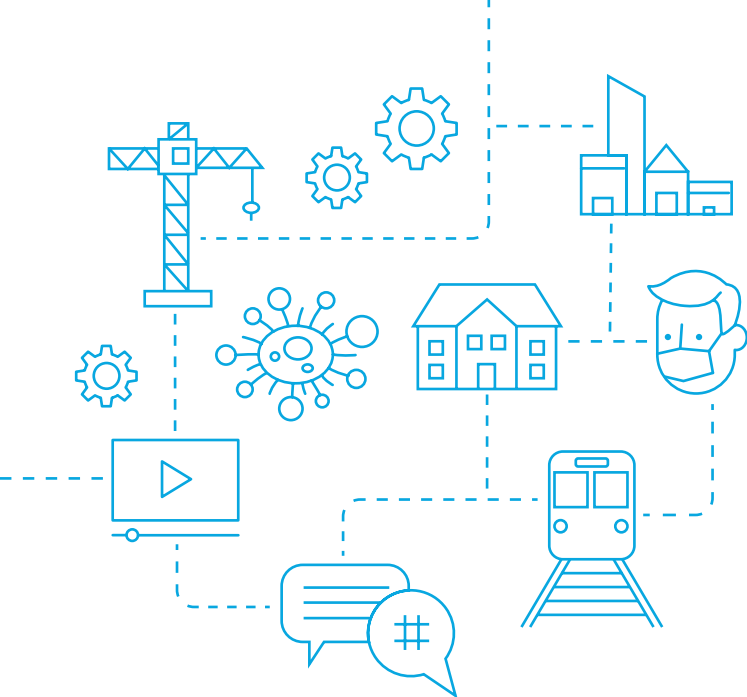
The pandemic has served as a beta, of sorts, to test the capabilities of computing networks in handling a broad-based work-from-home population for companies across the country. A significant increase in employees working remotely in a short period of time has caused an “ah-ha” moment for many workers who have cut their commute time, been just as productive at home and spent more time with their families.

The real question is: Will this be a longer-term shift of preferences for larger-scale mobile workforces? The answer could have a profound impact on the demand for office space and other real estate.

What we know

In a survey of executives for RSM's proprietary [Middle Market Business Index](#) for the second quarter, executives across sectors said that at least some employees who were forced to work remotely will not have a reason to return to the office once the pandemic subsides. Additionally, within each segment, at least 10% were not sure what the future of their office will look like.

While the full impact of the coronavirus on the office sector is yet to be seen, we do know that leasing activity and transaction volume in the sector has fallen off a cliff on the demand side. Decision-makers are putting off major investment decisions like entering into a long-term lease that becomes a fixed cost for a company facing so much uncertainty.



On the supply side, CoStar data shows that across the United States, there are roughly 160 million square feet of office space under construction, with most concentrations in tech hubs such as Austin, San Jose, San Francisco and Seattle. This pipeline represents about 2% of the office stock nationally. Even before the coronavirus, new projects coming online were slowing the rate of office absorption nationally, and rent growth had been decelerating as a result. Now, with COVID-19 spreading, these trends are accelerating.

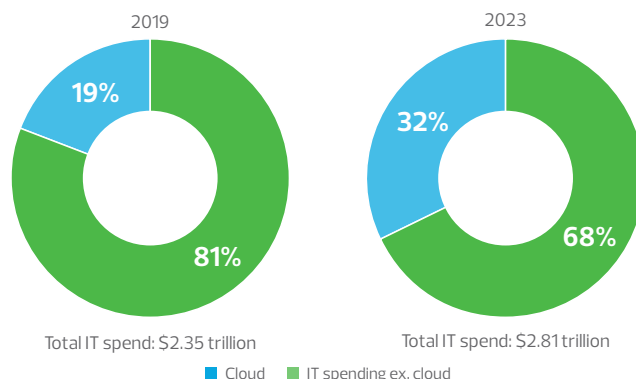
Adding to headwinds facing the office sector is continued densification, a trend that won't likely reverse as more employees are able to work remotely, and shifting demographics as boomers age out of the workforce with the much smaller population of millennials and Generation Z showing up at work. The further potential downshift in the office sector spurred by the coronavirus will drive overall uncertainty in the sector, which may halt companies' significant leasing decisions until certainty replaces panic in the marketplace.

The future

Even in a future with smaller physical office footprints, the computing power necessary for a fully functional mobile workforce will result in increased demand for data centers. These centers will need to support technologies, including teleconferencing and web conferencing, and work-from-home capabilities enabled by cloud computing.

Another play for real estate are infrastructure-focused investments, telecom towers and wireless infrastructure, which stand to benefit from the shift from working in brick-and-mortar office spaces to remote locations. Investors with significant coworking exposure in their portfolios may be affected by a decline in short-term rentals as companies looking for flex space may forgo communal space centered in the middle of an outbreak.

Cloud spending as a percentage of total IT spending



Source: Bloomberg; RSM US LLP

The case for the office

Many things that seem inconceivable during a crisis are softened with time. Our collective memories are pretty short. Take, for example, the 9/11 attacks—there was a time when many recoiled at the thought of taking office space on high floors in skyscrapers. Nearly 20 years later, the most expensive office real estate around the world before the coronavirus continued to be in densely populated cities, in skyscrapers.

At a minimum, landlords and tenants need to evaluate how they manage people flow and tracing within their buildings. This base-level tracking is going to be imperative to reassure tenants that precautions are being taken to limit exposure, and if there is exposure, there is sufficient tracing to be able to notify all those exposed.

The ability to provide a system that is effective and secure, and meets privacy protocols will be a challenge for every company and landlord trying to get back to work. Still, while there will almost certainly be a shift in what the "next normal" looks like in office buildings, people have an innate want to meet and gather as a community. This is how many of the best companies have built their cultures and attracted, and kept, top talent. ■

MIDDLE MARKET INSIGHT

What is certain is that long-term fixed leases may be a thing of the past as companies facing greater uncertainties look for increased flexibility. After all, who can plan for a pandemic? Expect to see shorter leases, and more creative terms.

REAL BUSINESS INSIGHTS FOR MIDDLE MARKET COMPANIES

Check out *The Real Economy: Industry Outlook* and get data-driven, sector-specific insights from RSM's senior industry analysts, a select group of professionals dedicated to studying economic and industry data, market trends and the emerging issues faced by middle market businesses like yours.

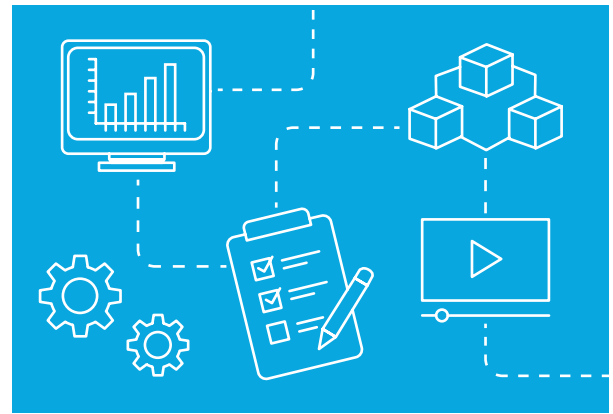
Each outlook provides unique perspectives and planning opportunities affecting businesses in the following industries:

- Consumer products
- Financial services
- Health care
- Industrial products
- Life sciences
- Real estate
- Technology, media and telecom

Watch for our next issue: July 2020.



MIDDLE MARKET TREND WATCH



WORKFORCE DYNAMICS

THE LATEST DATA on employment and compensation strongly implies that expectations of a third quarter rebound should be reset, according to the Q2 [RSM US Middle Market Business Index](#). Report findings included:

Amid the crisis, **90%** said some employees were working off-site, with a disproportionate **96%** of those workers at larger middle market businesses, compared to **83%** at smaller midsize companies.

Roughly **29%** noted a decline in current compensation offered in April and expect that to be the case over the next six months.

Nearly a third of middle market executives said employee compensation decreased in the current period.

Approximately **46%** of middle market executives noted a decline in April hiring and **37%** anticipate a downturn over the next six months.

Before the COVID-19 outbreak, more than two-thirds of middle market businesses had some employees working remotely.

THE TAKEAWAY

The workplace has undergone a fundamental shift and will likely continue to evolve amid reopening and recovery efforts. Middle market businesses must work to understand how to support employees in this new work environment, foster engagement while setting clear expectations, leverage technology to create a productive remote workforce and keep up with changing legislation related to labor needs. For more on workforce dynamics and other insights related to the impact of COVID-19 on middle market businesses, visit our [resource center](#).



THE REAL ECONOMY BLOG

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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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