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LIA Monthly Economic Report

A Research Report for Directors and Members of the Long Island Association, Inc.

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Prepared by Dr. John A. Rizzo, LIA Chief Economist

This issue of the LIA newsletter examines the economic impact of the coronavirus pandemic. After achieving record highs in the stock market, historically low unemployment rates and strong business activity, economic activity froze as non-essential workers were required to work from home and stay-at-home orders were implemented in New York and many other areas across the nation.

March jobless claims jumped ten-fold from the previous month, almost five times as high as the previous record which occurred during the financial crisis of 2008.

Enormous fiscal and monetary stimulus was implemented in order to stabilize credit markets, aid small business and help consumers to weather the storm of the coronavirus crisis.

Given the ominous adverse economic impacts of an extended shutdown, researchers and policymakers are beginning to weigh these costs against the benefits.

Despite the damage that has and will continue to affect the economy, there is reason to expect a robust recovery once the crisis has past. Evidence from China, Taiwan, South Korea and Singapore indicates that those economies are already recovering. And strong fiscal and monetary stimulus should continue to promote growth.

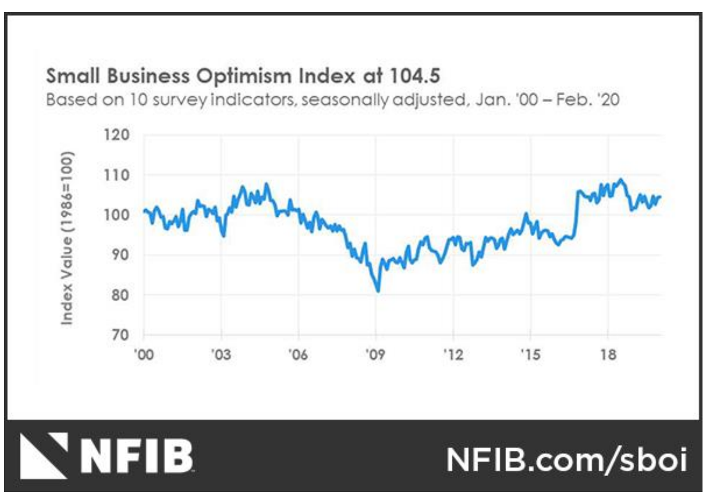
THE CALM BEFORE THE STORM

How well the Long island economy will be able to weather the storm of the coronavirus pandemic depends importantly on the strength of the economy prior to the advent of the virus. Accordingly, this section briefly reviews the evidence on the status of economic conditions as of February, just before the impact of the coronavirus was felt.

The labor market continued to perform very well in February, with unemployment rates remaining at historically low levels. Consumer confidence and spending were strong and the real estate sector showed clear signs of improvement. The stock market soared to record highs as well.

And while small business optimism was at historically high levels, experts saw storm clouds on the horizon. As National Federation of Independent Business Chief Economist William Dunkelberg noted:

February was another historically strong month for the small business economy, but it's worth noting that nearly all of the survey's responses were collected prior to the recent escalation of the coronavirus outbreak and the Federal Reserve rate cut. Business is good, but the coronavirus outbreak remains the big unknown.



As the chart below indicates, there was a large increase in the percent of survey respondents who expected the economy to improve. Some 22 percent of respondents expected to see such improvement, up 8 percentage points for the previous month.

Small Business Optimism

Small Business Optimism Starts New Year as Solid as Ever

Index Component	Net %	Change From Jan.
Plans to Increase Employment	21%	▲ 2
Plans to Make Capital Outlays	26%	▼ -2
Plans to Increase Inventories	2%	▼ -2
Expect Economy to Improve	22%	▲ 8
Expect Real Sales Higher	19%	▼ -4
Current Inventory	-4%	▼ -1
Current Job Openings	38%	▲ 1
Expected Credit Conditions	-1%	▲ 3
Now a Good Time to Expand	26%	▼ -2
Earnings Trends	-4%	▼ -1

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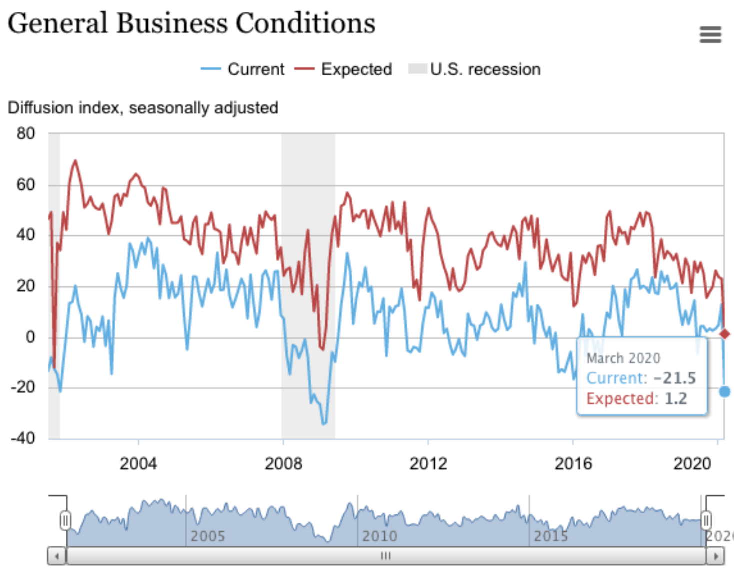
And business activity in both the manufacturing and service sectors increased in February. The Empire State Manufacturing Index reached its highest level in nine months. The Business Leaders Survey also indicated that expansion in the service sector hit its highest level in several months.

ECONOMIC EFFECTS OF THE PANDEMIC

How things have changed so quickly. Business activity declined sharply in March, as illustrated by the March Empire State Manufacturing Survey. The headline general business conditions index fell thirty-four points to -21.5, its lowest level since 2009. The new orders index dropped to -9.3 and the shipments index fell to -1.7. Optimism about the six-month outlook fell sharply, with firms less optimistic than they have been since 2009.

EMPIRE STATE MANUFACTURING SURVEY



Source: Federal Reserve Bank of New York

Business activity in the region's service sector also declined substantially in March, according to firms responding to the Federal Reserve Bank of New York's March 2020 Business Leaders Survey. The survey's headline business activity index fell twenty-three points to -13.1, its lowest level in more than three years. The business climate index fell twenty seven points to -29.0, indicating that firms regarded the business climate as substantially worse than normal.

In response to rising cases in the coronavirus, non-essential workers have been ordered closed in a number of states, including New York. This led to an almost immediate loss in jobs and output. Jobless claims spiked to 3.28 million during the week ending March 21, almost five times higher than ever before. Some observers have noted that this implies a nation-wide unemployment rate of 5.5 percent, a number which will almost surely increase substantially as the pandemic continues.

Jobless claims increased in all 50 states and the District of Columbia. States that have implemented stay-at-home orders and closure of non-essential businesses have experienced the most jobless claims:

- Pennsylvania reported the biggest number of claims, with an estimated 378,900.
- California claims rose to 186,800.
- Ohio claims rose to an estimated 187,800.
- Illinois claims rose to 114,700.
- Michigan claims jumped to 129,300.

In New York State, where approximately half of all known coronavirus cases in the U.S. are located, claims rose by 66,000 to 80,300. This figure, while very concerning, is still relatively low, given New York's large population. The precise reasons for this are uncertain, but may reflect New York's relatively strong economy and perhaps a jobs mix that allows a relatively higher share of employees to work remotely.

The governor has decreed that all non-essential workers must work from home. Comparing the list of essential work with employment patterns on Long Island, this could mean about one-third of all private sector workers must work at home, if possible. But many of these workers, such as employees in manufacturing, retail and leisure and hospitality are unable to work remotely.

The implications for employment and business activity are ominous. The Economic Policy Institute estimates that the US could lose 14 million jobs by the summer, and that New York State's private sector jobs could decline by 10.4 percent by the summer, implying a loss of some 856,000 jobs in New York State and 117,000 jobs on Long Island.

Experts estimate that the potential for corporate bankruptcies have already doubled. According to data tracked by NYU Stern School of Business professor emeritus Ed Altman, bankruptcy and default potential for high-yield companies doubled from 5 percent to 10 percent in just a few weeks:

Today, our numbers are showing a likely default [rate] over the next 12 months of just under 10% that is a huge, unprecedented increase in such a short period of time," he told Yahoo Finance. "It does signal a crisis in the credit market whenever you get to that 10% level.

And for small businesses, which are typically much less well-capitalized than larger corporations, the risk of bankruptcy would seem to be substantially greater than this.

The stock market reflected the economic upheaval. The Dow Jones Industrial Average fell to levels not seen since 2016, and many companies experienced declines in their stock market values of 60 percent more almost overnight. The energy sector was especially hard hit, as an oil price war developed between Saudi Arabia and Russia concurrently with the pandemic, causing oil prices to plummet.

ASSISTANCE FOR BUSINESS AND CONSUMERS

In response to the severe economic consequences of the coronavirus pandemic, the Federal Government has passed the CARES ACT which in part provides $350 billion in loans to small businesses (<=500 employees) that have trouble covering payroll and operating expenses because of the COVID-19 pandemic.[1] The loans will be administered through a network of more than 800 banks. The new law creates a small business loan program, called the "Paycheck Protection Program." The key features of this program:

- expands benefits and eligibility for Small Business Administration (SBA) disaster loans
- covers payments on existing SBA loans
- creates new tax credits to help cover the cost of paid leave and payroll

The low-interest loans are meant to cover payroll costs, paid sick leave, supply-chain disruptions, employee salaries, health-insurance premiums and mortgage payments. The maximum loan amount is $10 million while the interest rate on the loans can't surpass 4%. If the employers maintain their payrolls until June, the portion of the loans used for payroll costs, interest on mortgage obligations, rent, and utilities would be forgiven.

[1] Self-employed individuals, or those part of the "gig economy," can access Paycheck loans, as can certain nonprofits, including 501(c)(3) organizations and 501(c)(19) veteran organizations.

The legislation also aids consumers by providing payments of $1,200 for single individuals earning up to $75,000 and $2,400 for couples earning up to $150,000. These payments gradually decrease for individuals making up to $99,000 and $198,000 for couples. Moreover, unemployment benefits will be increased by $600 per week for a four-month period.

Another $500 billion in loans is to be provided for distressed companies. These are larger companies who have been particularly hard hit by the pandemic. These will likely include companies in the leisure and hospitality, airline, manufacturing and energy sectors.

Small business assistance is also available from state and local governments. The LIA website provides detailed information and links to these sources of assistance.

ASSESSING THE TRADEOFFS

As the economic shutdown continues and losses mount, observers have argued that more attention needs to be paid to a distressing tradeoff that economists have long considered; namely, how can a society assess the trade-off between economic well-being and health?

Walter Scheidel, an economic historian at Stanford University argues that economists need to be conducting cost-benefit analyses to assess the costs and benefits of an extended shutdown:

Economists should be doing this cost-benefit analysis. Why is nobody putting some numbers on the economic costs of a month long or a yearlong shutdown against the lives saved? The whole discipline is well equipped for it. But there is some reluctance for people to stick their neck out.

And Casey Mulligan, a University of Chicago Economist has noted that:

We put a lot of weight on saving lives…. But it's not the only consideration. That's why we don't shut down the economy every flu season. They're ignoring the costs of what they're doing. They also have very little clue how many lives they're saving.

But there is a widespread consensus among economists and public health experts that lifting the restrictions too soon would impose huge economic costs in addition to lives lost to the virus.

To be sure, weighing economic costs against human lives is quite challenging, both on technical and ethical grounds. At the same time, societies also value things like jobs, food and money to pay the bills — as well as the ability to deal with other needs and prevent unrelated misfortunes. Government agencies calculate these trade-offs regularly. The Environmental Protection Agency, for example, has established a cost of about $9.5 million per life saved as a benchmark for determining whether to clean up a toxic waste site.[2]

[2] Other agencies use similar values to assess whether to invest in reducing accidents at an intersection or to tighten safety standards in a workplace. The Department of Agriculture has a calculator to estimate the economic costs — medical care, premature deaths, productivity loss from nonfatal cases — of food-borne disease.

Perhaps adding to our reputation as practitioners of the dismal science, some economists have decided to stick their necks out and apply this thinking to the coronavirus pandemic. A recent paper by economists from Northwestern University and the Free University of Berlin examines how policymakers should optimally respond to the virus, taking both human lives and economic activity into account. Their findings suggest that partial shutdowns are useful but that beyond a certain point the economic costs of shutdowns will indeed exceed the benefits in terms of lives saved. These are preliminary estimates. But the bottom line is that the economic costs need to be brought to the policy table for greater consideration, especially as the shutdown persists.

THE OUTLOOK

The coronavirus pandemic presents unique and pressing challenges to policymakers and public health officials. Despite the uncertainty and large economic costs, there is reason to expect a robust recovery once the crisis has passed. Evidence from China, Taiwan, South Korea and Singapore indicates that those economies are already recovering. The United States has not imposed as restrictive policies in addressing the virus as in these countries. However, efforts have ramped up considerably and in the greater New York area, the pandemic will peak before almost any other area in the country. That means that, as bad as the pandemic has been for the greater New York area, it will subside sooner than in other areas.

A recent study by Federal Reserve Bank researchers concludes that shutting down schools and workplaces when a pandemic strikes lessens economic harm as well as reducing mortality. Moreover, the researchers conclude that such a strategy could get things back to normal faster when the threat tapers off. This is certainly the strategy being taken in New York State, so perhaps this strong medicine will ultimately result in a stronger recovery for the economy on Long Island and the rest of the state.