Macro

COVID-19 and the impact on the U.S. economy

Efforts to contain the spread of COVID-19 in the U.S. are resulting in shuttered businesses and an unprecedented dislocation of economic activity. It has become painfully clear that growth will be significantly impacted. We attempt to measure the immediate impact of specific industry shutdowns, although it's clear that second- and third-order effects will leave few areas of our economy unharmed. The breadth and depth of the impact may ultimately be determined largely by the length of time it takes to get the pandemic under control.

KEY TAKEAWAYS

- COVID-19 will have a material, negative impact on the economy.
- Given the nature of the crisis, certain areas of the economy are likely to be hit hardest.
- While we can quantify the most at-risk sectors, uncertainties persist around knock-on effects on consumer spending, business investment and efficacy of government stimulus.

A rapid realization

The realization that the COVID-19 outbreak would wreak havoc on the U.S. and global economies has come at an alarmingly quick pace.

Over the past month, the S&P 500 has declined 32% from its peak, the quickest fall into a bear market in history.[1] Markets, governments, businesses and workers have come to realize that the virus will grind economic activity to a halt for a period of time. The disruptions are growing rapidly by the day, especially affecting particular industries and some of the largest metro areas in the U.S.

California, the largest state in the country, with 40 million citizens comprising 15% of U.S. GDP, has ordered residents to shelter in place,[2] and many more states are beginning to do the same. Epidemiology has crashed into economics, as these measures are necessary to prevent further spread of the virus but will have a severe impact on jobs, income, businesses and consumers.

The impact at ground zero

It is clear that shelter-in-place orders and other "flatten the curve" initiatives will have a disproportionate impact on certain sectors of the U.S. economy, both from a consumer spending and employment standpoint. We attempt to identify those sectors and quantify their significance in the context of the broader economy.

1 Bloomberg Finance, L.P., as of March 20, 2020.

2 U.S. Bureau of Economic Analysis, as of December 31, 2019.

Areas of consumer spending in the eye of the storm include sectors such as transportation, food and drink service, hotels and certain retail stores. The table below shows the relative size of these sectors as a percentage of GDP.

Consumer spending category	**$B**	**% GDP**
Nonessential retail[3]	$1,008.5	5.3%
Food services	$738.9	3.8%
Accommodations	$137.4	0.7%
Air transportation	$104.8	0.5%
Casino gambling	$103.3	0.5%
Spectator amusements	$67.4	0.4%
Amusement parks & campgrounds	$60.4	0.3%
Membership clubs & sports centers	$59.1	0.3%
Other public transit	$52.9	0.3%
Childcare	$38.3	0.2%
Moving, storage & freight services	$14.9	0.1%
Museums & libraries	$9.0	0.0%
Total	**$2,395.0**	**12.5%**

Source: U.S. Bureau of Economic Analysis, as of February 29, 2020.

This is hardly an exhaustive list. Lack of human movement and a general sense of uncertainty will likely hit many more areas of the consumer economy. However, these sectors are likely to be the first and most seriously impacted. Indeed, we are already seeing instances of significant disruption. For example, one report has shown that global flights have already declined by 30% from December levels.[4] The spending impact is likely to be larger than that, as we've all heard stories about empty flights.

Some areas of the economy have seen a temporary uptick in economic activity. For example, personal hygiene and sanitation products, pharmacies and grocery stores are likely to see greater spending. Amazon is already being inundated with online orders and has vowed to hire 100,000 workers to deal with increased demand.[4] However, these increases will likely pale in comparison to the negative impacts mentioned above.

Labor market impact

Another way to look at how the COVID-19 outbreak is affecting the economy is through the lens of employment. A large number of people (e.g., food service and hotel workers, retail store employees, airline crew and support staff) are employed by the areas of the economy mentioned above. The table below lays out employment for the most-affected sectors—but again, this is not an exhaustive list.

Employment sector	**Workers** (000s)	**% total**
Food services & drinking places	11,987	7.9%
Nonessential retail trade[5]	5,860	5.9%
Entertainment & recreation	2,269	1.5%
Accommodation	2,003	1.3%
Transportation support activities	761	0.5%
Rail transportation	508	0.3%
Arts & spectator sports	474	0.3%
Travel arrangement services	218	0.1%
Air transportation	158	0.1%
Scenic & sightseeing transportation	28	0.0%
TOTAL	**33,803**	**17.9%**

Source: U.S. Bureau of Labor Statistics, as of February 29, 2020.

While the retail trade employs more than 15 million people, impacts will vary and depend on the type of store in which they work. Some restaurants are retooling for takeout orders, and retailers are trying to keep demand moving via e-commerce. But the percentage of the U.S. workforce facing an immediate work stoppage, especially in the retail space, looks to be devastating.

While official employment data is released with a lag, initial reports show an unprecedented surge of job losses. In a survey done by NPR/PBS and Marist University, 18% of respondents reported either losing their jobs or having their hours cut. The impact was even worse for lower-income workers, with 25% of earners with incomes below $50,000 reporting job disruption.[6]

Finally, these employment numbers don't even take into account the estimated 15 million American workers who rely on the gig economy. This includes drivers for rideshare and food-delivery apps as well as those who rent out their properties via services like Airbnb. It will be difficult to quantify the impact on

3 Includes household appliances, clothing & footwear, jewelry & watches, sport & recreational vehicles, furniture and motor vehicles.

4 Wall Street Journal, March 17, 2020.

5 Includes auto dealers as well as clothing, book & music, department, furniture, and building material & gardening stores.

6 NPR/PBS NewsHour/Marist poll of 835 U.S. adults. Poll conducted March 13-14, 2020.

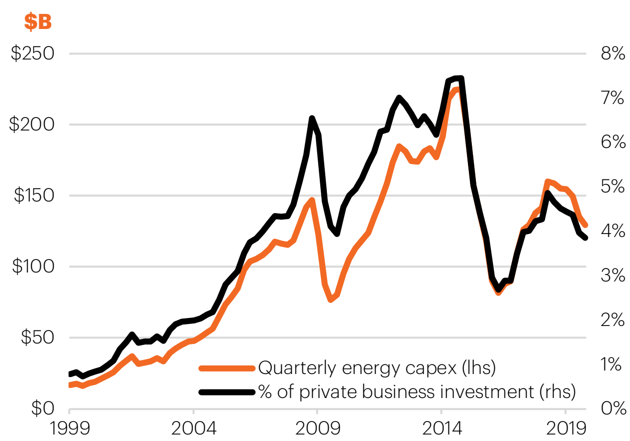
these jobs; while Uber and Lyft have seen a drop in demand, spending on food delivery services may rise.

Crude plunge adds insult to injury

The energy industry adds yet another sector to the list of at-risk areas of the economy. Crude oil prices, which began the year at $61/bbl, have plummeted more than 50% to the mid-$20/bbl range currently.[1] Prices have been hit by a combination of demand and supply factors. The COVID-19 outbreak has stunted demand for fuel as flights are cancelled and major cities shut down. Now a price war figures to flood the market with oil as Saudi Arabia and Russia jockey for market share. (Read more in our recent report, "Impact of oil market dynamics.")

Prior to the shale revolution, lower crude prices were mostly a positive for the U.S. economy, as consumers could spend their savings at the pump elsewhere. Now, however, the U.S. is the largest oil producer in the world, somewhat reversing the relationship of oil prices to our economy. At the start of the 2014–16 oil price decline, energy capital expenditures (capex) represented 7.5% of total private business investment. The subsequent downturn caused a 64% decline in energy capex, resulting in a roughly 1% drag on GDP over a 6-quarter period. Today, energy represents only 3.9% of gross business investment, leaving the economy less exposed in another downturn.[2]

ENERGY CAPITAL EXPENDITURES



Source: Bureau of Economic Analysis, FS Investments.

The employment side paints a similar picture. Energy employment has been on a downtrend as more efficient extraction technologies have allowed firms to utilize less labor. In 2014, employment in the oil & gas industry peaked at close to 650,000 workers and fell by more than a third by mid-2016. Today, just 470,000 people are employed by the industry.[7] A prolonged period with sub-$40/bbl oil prices would no doubt have a material impact on the U.S. energy industry. The U.S. economy may be less exposed to the sector than it was in 2014, but from both an investment and employment perspective, oil prices at these historic lows will add further pain through lower investment and higher unemployment.

Uncertainties persist

This is an initial attempt to quantify the impact of widespread shutdowns across the economy due to the COVID-19 outbreak—but no area of the economy will be unaffected.

Significant uncertainties still exist around the economic impact of COVID-19. Aggregate consumer spending will certainly be hit hard by shutdowns and store closures, as well as lost income, in the immediate term. In the longer term, we do not expect spending to snap back to pre-crisis levels right away. Not only will it take time for businesses to start rehiring and workers to feel secure in their income again, but shocks to household wealth will likely tax consumer confidence, making consumers more hesitant to spend as households repair their balance sheets.

A true wild card remains business investment, which came into 2020 having contracted for three straight quarters.[2] The ability of businesses to retain workers during this downturn will be a central factor in determining the depth of the economic downturn. Additionally, businesses' willingness to continue to invest will likely impact the speed and magnitude of any post-crisis recovery.

Finally, the federal government is clearly prepared to enact a level of economic stimulus that could surpass even that seen in the wake of the financial crisis. Having already passed bills dealing with virus-related healthcare costs and extended leave and unemployment benefits, plans for a massive package in excess of $1 trillion have been put forth. All told, these measures would represent around 5% of U.S. GDP.[2,8] The efficacy of these measures will, like everything else, likely rest on the ability to get the outbreak under control in a relatively expeditious manner.

7 U.S. Bureau of Labor Statistics, as of December 31, 2019.

8 Axios, as of March 20, 2020.

Lara Rhame
Chief U.S. Economist, Managing Director

Lara is Chief U.S. Economist and Managing Director on the Investment Research team at FS Investments, where she analyzes developments in the global and U.S. economies and financial markets. Her fresh take on macroeconomic issues helps to inform and develop the firm's long-term views on the economy, investment trends and issues facing investors. Lara is committed to the Philadelphia community and serves on the boards of the Economy League of Greater Philadelphia, Hyperion Bank and Starr Garden Park.

INVESTMENT RESEARCH

Robert Hoffman, CFA
Managing Director

Lara Rhame
Chief U.S. Economist
Managing Director

Andrew Korz
Associate

Kara O'Halloran, CFA
Associate

Contact
research@fsinvestments.com

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