Recession Recovery: An Economic Primer

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A terrible recession is again upon us, but in all probability, we have already hit the bottom and are slowly beginning to dig ourselves out of the abyss. However, it seems obvious that the recovery from this recession, or any other economic crisis, is definitional. The current widely-accepted definition of a recession is “two consecutive quarters of negative economic growth as measured by GDP.” Now, the formal definition of GDP or Gross Domestic Product, is the “…monetary value of all finished goods and services made within a country or other economic unit during a specific period, usually per calendar quarter.” Unfortunately, in today’s world, these kinds of definitions may be oversimplifications. This notion of a recession was devised back in the 1930s when the domestic and world economies were much simpler.

To the proverbial man (or woman) on the street, the rate of unemployment is often considered to be a better indicator of economic health. However, unemployment (or new employment) has historically been an economic laggard. Even as factory orders fall, firms are justifiably reluctant to lay off workers until they are sure that there is little or no chance they will soon be needed. On the upside, firms are equally reluctant to hire new workers until the recovery is fairly certain. However, given that it has been sparked by government decree rather than an economic collapse, the 2020 Recession is somewhat unique in that unemployment is more of an economic leader than laggard.

Some economists today favor reporting economic health using a broader economic measure called Gross Output, or more simply, GO. The advantage of GO is that it measures “total economic activity in the production of new goods and services in a given accounting period.” Granted, it is more comprehensive, but it also bounces around, i.e., fluctuates up and down, a lot more than GDP. A glance at the economic record for GO over the past few years tells us that this measure may be more accurate, but it is highly volatile and may drive the general public crazy if it were to replace GDP.

One of our well-known local financial planners, Bruce Pienton, points out that a highly regarded non-profit organization called the National Bureau of Economic Research (NBER) favors looking at several factors in determining a recession. Their recession definition:

> “A significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales.”

A similar “market basket” of economic indicators is also now favored by numerous European economists, especially those associated with the current French government. The problem, of course, is that this definition STILL (at least partially) relies on GDP and STILL does not immediately yield a nice, clean single index number that the general public can easily grab.

Economic Statistics: A Brief History

A complete census of the population of the United States, to be conducted every ten years, was a significant provision built into the 1787 U.S. Constitution. Even today, we know that representation in the House of Representatives is determined by this prescribed census. The first nine censuses (1790–

1870) were conducted by U.S. Marshals, and contained nothing more than a basic head count of all the men in a given county and state. Women were not initially counted because they had no right to vote, and even the Constitution regarded male slaves as 3/5 of a person. By 1890, The newly formed Bureau of Census began collecting much more demographic information, including sex, age, color, and basic national origin. Beyond this population census conducted every ten years, few significant government economic statistics were published at that time.

In the pit of the Great Depression, the Roosevelt Administration recognized that it was necessary of the government to get a better handle on all forms of economic activity. In 1933, the Secretary of Commerce pulled together as many of the top economists in the country (many of them Republicans) to put together some new economic measurement tools. Among other things, the Census Bureau was expanded to include a monthly survey of households, which evolved to be what we now call the Current Population Survey (CPS).

About the CPS

To repeat, the Census Bureau conducts surveys like the Current Population Survey every month, not just every ten years. At present, the CPS is a joint project between the Bureau of Labor Statistics and the Census Bureau. Although several attempts were made to collect accurate data during the Great Depression, the current CPS format dates to about 1948. Obviously, the Census Bureau could not survey the entire population every month, so the attempt was made to statistically "sample" the entire population of the entire nation. We should note that prior to 1948, we knew little about the accuracy of the data collection technique called "sampling." Dr. George Gallop, a college professor and founder of the Gallop Organization, was credited with developing systems for accurately selecting samples.

Over the past 70 years, our sampling methodology and accuracy have improved, but this methodology has become increasingly complex and technical. Initially, the CPS sample was about 30,000 people, but this sample size has now been expanded to about 66,000—still not large for a county of 330 million people. Hence, most of the general public is unaware that this survey is conducted every month. The most noteworthy report that BLS generates from this survey is a monthly unemployment report, although the survey collects other information as well. The data from this same survey is distributed to each state for further analysis, and becomes the basis for our state and local estimates of employment and unemployment. The survey is of households, NOT places of work. As a result, Michigan's Wayne County has exhibited a flurry of new economic activity in recent years, but the workers often reside in Oakland County to the north. Hence, the unemployment rates reported in Oakland County have fallen significantly since the end of the Great Recession, while Wayne County rates remain very high.

The CPS collects unemployment data in six different categories, but the most publicized is called U-3, or what we call "headline" unemployment, which basically includes all members of the household above 16 years old who are actively looking for work as a percentage of the total workforce. "Full Employment" is generally reached when the unemployment rate falls below 4 percent. Another measure, U-6, adds discouraged job seekers and workers who are underemployed (i.e., engineers bagging groceries or delivery pizzas), involuntary part-time workers, and a few other minor categories. Some people justifiably claim that U-6 is the "real" unemployment rate, but most everyone has grown accustomed over the years to the U-3 numbers that are widely reported monthly.

West Michigan Recovery

Looking back at the history of "Current Business Trends," (my first report was dated February 15, 1979), the all-time low was recorded in December 2008, the pit of the Great Recession. NEW ORDERS, our index of business improvement, hit an all-time low of -57. We then began to dig our way out of a very deep hole, which INITIALLY occurred rather quickly. This is what some economists refer to as the "V" recovery. After hitting -57, NEW ORDERS for our January 2009 survey came in at -28, followed by February's -20, and -5 in March. In April, the index flipped back to positive at +3, and NEW ORDERS have generally remained positive ever since. In fact, by April 2010, only a year later, the NEW ORDERS index rose to +51, just four points shy of our all-time record of +55 set back in 1994. To some pundits, this bounce signaled that prosperity had returned. Unfortunately, it was only a reflection of pent-up demand. And it's worth repeating; we were just beginning to dig out of a very deep hole. It would take us another <u>seven years</u> (2009-2016) before we returned to full employment.

Once this initial bounce is over, it becomes time to assess the permanent damage this recession has caused. Obviously, the damage for the Great Recession was considerable. New office construction had been decimated, which resulted in a challenging time for the office furniture industry. Auto sales fell to a SAAR rate of about 14 million units, and had it not been for the "Cash for Clunkers" program, the rate may have fallen further. Many of the marginal auto parts suppliers went out of business, resulting in <u>permanent</u> damage to the Michigan economy. Of course, the housing market collapsed, and a few houses in Kalamazoo that had sold for as much as $60,000 were sold a few years later for as little as $8,000.

Going forward in 2020, we will begin to dig our way out of another very deep hole. Yes, many of this month's numbers show some definite improvement over last month. However, I do not expect to see a quick bounce like the one we saw ten years ago. With as many firms still shut down or operating on reduced schedules, this is going to take several months. Also, we still have the latent threat of a resurgence of the virus in the fall. It is worth repeating that we will not begin to FULLY recover from this recession until we have a vaccine and/or viable anti-virus medication available and widely disseminated. And then we will need to assess the structural damage that this recession has caused.

<u>Structural Damage Assessment</u>

In the recovery phase of any recession, most businesses begin to reopen and resume normal growth. Great. But part of the economy has been permanently lost. For economists, the term "structural damage" refers to the businesses or other employers that have closed or bankrupted. For full recovery from any recession, these lost jobs have to be recovered by new firms opening or existing firms expanding. THIS IS NOT FAST OR EASY. As we saw in the Great Recession, many firms boarded their doors. The housing and construction industries were especially hard hit. A plethora of sub-prime mortgages fell into default, and the value of at least 90% of all homes in the U.S. declined in value, some by a factor of 5 to 1. For West Michigan, our key cyclical industries, namely automotive, office furniture, aerospace, and capital equipment, all declined substantially. When these key industries decline, there is a domino effect. The Tier I and Tier II suppliers to these industries are impacted, but so are most of the other business in the community from hardware stores to restaurants. The ponderous task of moving large numbers of unemployed people from old jobs to new jobs took from 2009 until 2016. This is why we called it the Great Recession.

For the recovery from the 2020 Pandemic Recession, some of the businesses that are permanently lost are already obvious. Here is my projected assessment of major West Michigan economic segments to watch:

1. **Automotive Parts and Components**

Of course, we do not assemble automobiles in West Michigan, but a significant amount of our employment growth in recent years has been among our numerous auto parts suppliers. Although internet sales have helped some auto dealers stay in business, most of the traditional showrooms are still operating at limited occupancy. Sales for the industry have been hurt significantly, and the consumer migration away from sedans and toward trucks and SUVs has intensified. As the auto assembly lines reopen, so will orders for the parts and components we build in West Michigan. However, with industry sales down by 30 percent, so will be the parts and component orders for our local firms. Some of the firms supporting the truck platforms will probably fare better, but the demand for the entire industry will be problematic. The potential good news for our local firms is that the entire auto industry may reevaluate their convoluted supply chains, and at least some work may be brought back to the U.S. Keep in mind that quite a few of our local parts fabricators can go toe-to-toe with the world markets. But even “reshoring” will not be enough to bring the numbers completely back to the level of 2019. **Recovery watch**: (1) Monthly auto sales reports, and (2) Reshoring announcements.

2. **Office Furniture**

Indeed, the concept of the traditional “office” may be dramatically changing. Numerous news reports have noted that many office workers have been very successful working from home, and some would prefer to continue to do so even after the crisis has passed. Modern technology like Zoom and Skype provide video conferencing, and MS Word and PDF files can be easily passed around on the web. Even though this trend may only last a year or two, it seems obvious that many firms will be redefining their office configuration needs. Unfortunately, many of our local firms are not well configured to meet the needs of the rapidly growing home office market segment. Although some local firms have been successfully developing new offerings for the growing medical market segment (which is not doing well with all the hospital staff reductions), the current crisis will have a lasting impact on this industry. **Recovery watch**: (1) Announcements by office furniture manufacturers of new segments/offerings. (2) New office expansion, since new offices usually want new furniture. (3) Mike Dunlop’s quarterly report on the office furniture industry.

3. **Aerospace**

Just like automobiles, we do not assemble aircraft in West Michigan, but we have numerous aerospace Tier I and Tier II suppliers. Because of the 737 Max disaster, this industry was already having difficulties. The volume of air travel has now been reduced to a fraction of what it was just a few months ago, and no one expects it to come roaring back. Even Warren Buffett has dumped all of B-H’s airline stock. **Recovery watch:** Volume of air passenger traffic. The current planes that have already been built will need to get back in the air before new ones will be ordered and delivered. Some sources have predicted that it may take as long as four years for air traffic to return to the 2019 level.

4. <u>Capital Equipment</u>

Economics 101 makes it obvious that capital equipment firms do poorly in an economic downturn. To compound the problem, the recovery phase is often characterized by at least some of the firm's equipment remaining idle. **<u>Recovery watch:</u>** Firms getting back to full capacity. This is going to take time, but this market will recover.

5. <u>Restaurants and Bars</u>

Even though this economic decline has been very severe to the food service sector of our economy, there is still no evidence that the American public is about to go on a diet and consume, say, 5% less food. What WILL change is the nature of the food supply chain. A news report in mid-2019 declared that, for the first time in history, more than 50% of the American food dollar was now being spent on eating out or home-delivery vs. buying groceries from the usual grocery supply chains for home consumption. The 2020 Pandemic Recession has already put a large number of restaurants out of business, and the road to recovery for this segment of the economy looks slow. We are probably overbuilt on restaurants, so more restaurants will close, and most of the major chains will close their marginal stores. Hence, it appears obvious that the family food budget will now tend to shift back to eating at home, although the Grubhub concept is here to stay and will probably expand. Another note for the grocery business: In any of our past recessions, there has been a shift in buying behavior away from prepared foods (pizza, TV dinners) and more toward lower cost grocery staples. **<u>Recovery watch:</u>** Short term, parts of the current food supply chains will be redirected back to grocery outlets and away from restaurants. Full restaurant recovery will begin when we have a viable vaccine. However, in time, this segment <u>WILL</u> recover.

6. <u>Other Hospitality Industry Segments</u>

For the next few months, most of us will travel less, which will leave most hotels fairly empty for some time to come. The hospitality industry is also highly dependent on meetings, weddings, and other gatherings, that will again be thwarted as we continue to keep a six-foot distance from non-family members. **<u>Recovery watch:</u>** (1) Expansion of travel, and (2) a viable vaccine. Given enough time, this segment WILL recover.

7. <u>Movie Theaters</u>

Another segment of the economy that is permanently damaged is the basic movie theater. Even after Showtime, HBO, and taped VCR movies became available eons ago, many people still patronized theaters for the experience of seeing the movie on the 'big screen." But home television screens have continued to get larger and larger as well as cheaper and cheaper. In addition, the cost for a family to attend a first-run movie at a local theater has risen dramatically. One of my friends with three kids recently noted that the cost of two adult tickets and three children's tickets, along with popcorn and sodas, was now over $70. As a budgetary move, he purchased a new hi-res 75-inch tv, and his wife now pops the corn while he downloads a movie for the family. Over the objection of the theater owners, several of the studios have recently skipped the theaters altogether and released several big-budget movies <u>directly</u> to the downloaders. Just like drive-in movies, the traditional movie theater market will probably be much smaller when the current pandemic is finally over. **Recovery watch:** A viable vaccine will help, but part of this segment may be permanently lost. However, because of built-in social distancing, there may be a small revival for the drive-in theaters.

8. **Other Mass Gatherings**

We have all been told that the virus is MOST easily spread by breathing the exhaled air of an infected carrier, and that we should keep a distance of six feet when interacting with practically everyone outside of the home. However, we have been given additional information that the virus can live on other surfaces for an extended period of time. Worst case: The virus clinging to a container placed in a freezer can live for up to TWO YEARS. Ouch. Until there is a viable vaccine, most of us older folks will especially want to avoid gatherings that press us together, even if we are wearing N-95 masks. This includes most sporting events, rock concerts, bus/airplane rides, and regrettably, typical church gatherings. Any activity where people are screaming, yelling, or even singing can spread the virus to nearby people. For example, take football. For Michiganders, there is a psychological "charge" to experiencing a Big Ten football game in the "Big House" in Ann Arbor that is hard to describe. However, ever since the first U of M football game was televised in 1954, TV camera technology has relentlessly improved. Even die-hard fans will reluctantly admit that today's best view of the game is at home with a big-screen TV, a beer, and a bowel of popcorn. From a financial standpoint, the revenue from the television broadcast rights have risen to millions of dollars per game. Hence, the larger athletic events may begin with nearly empty stadiums and still make money. But non-televised games with teams from CMU or WMU will not be so lucky. **Recovery watch:** Again, full recovery will begin when we have a viable vaccine. Given time, much of this segment WILL recover, but MSU and U of M football tickets may go for less than the current price of $150 or so per ticket until the Pandemic fades.

Recovery Statistics: Road to Recovery

To monitor the recovery, we will obviously watch a variety of statistic. There are dozens of indicators published weekly, and if you ask seven different economists, you will get seven different lists of things to watch. That said, here are the things that I plan to watch more closely. I've already mentioned the monthly report on automobile sales from the publication, "Automotive News," as being one of THE most important statistics to scrutinize. In addition, we need to pay close attention to Mike Dunlop's quarterly survey of the Office Furniture Industry. Here are the other things I will be watching fairly closely as well:

1. **NEW ORDERS.** This is the most important statistic in our own survey, and I often refer to it as West Michigan's index of business improvement. When these NEW ORDERS come in, businesses begin to order materials, ramp up production schedules, and call people back to work. As the firms approach capacity, and ONLY after they approach capacity, they begin to hire more people and purchase new equipment. Just like the domino effect, it will take time for the NEW ORDERS to activate their respective supply chains so that the economy can begin returning to normal.
2. **PRODUCTION.** It is somewhat obvious that an improvement in new orders soon leads to an increase in production, or as some modern economists are calling it, OUTPUT. This component eventually becomes part of the statistic that BLS collects called call Gross Output (or GO), which some economists feel is a better measure of economic activity.
3. **ISM/IHS Market.com Purchasing Manager's Indexes (PMIs).** These surveys provide the best information about the health of the U.S. industrial economy. According to the way that the government assess GDP, the industrial economy is only 30 percent of the entire economy. Fine.

But the industrial economy accounts for about 70-80 percent of the economic variation we experience in any recession.

4. **PMIs for the Eurozone and China.** Every month, IHS Market publishes the purchasing manager's indices for the Chinese economy as well as the overall Europe economy. Collectively, the European economy is about the size of the U.S. economy, and the Chinese economy is the second largest in the world. Despite all the wrangling, China is still our third largest customer.
5. **Local Business Confidence**. In our local business survey, we began measuring long and short-term business confidence about seven years ago. It seems somewhat obvious that local business expansion will be driven in part by positive sentiment.
6. **Small Business Confidence.** In the U.S., about 60 percent of all employment is with small businesses. The National Federation of Independent Business (NFIB) conducts a monthly survey of the confidence lever of the membership, which of course has taken a HUGE hit just like many other statistics. An improvement in small business confidence is therefore essential to 60 percent of the economy.
7. **Consumer Confidence.** Our economy is ultimately driven by consumer spending, which is partially predicated on consumer confidence. The two widely-reported surveys to watch are "Consumer Confidence," surveyed by the Conference Board, and "Consumer Sentiment," surveyed by the University of Michigan.

This is not everything to watch, but this list constitutes the main statistics and concepts that I will personally be watching in the coming weeks. As I've noted many times, this recovery has just begun, and there may be a few additional twists and turns around the corner. And it is worth repeating that a full and complete recovery cannot begin until most people feel medically confident being within breathing distance of numerous other people. This requires a viable vaccine, as well as some form of an effective anti-virus medication. With literally thousands of scientists working toward these goals, both of these medical miracles may be available as early as December. That is when the real recovery will begin.