Key Takeaways

- A rapid shutdown is likely to create lasting negative effects on the economy
- Normal is not a likely outcome in the near-term
- Unemployment is likely to remain higher for an extended period of time
- Demobilization post World War Two may offer a template for comparison
- Supply chains are likely to shift again with a focus on returning to domestic production

The United States has just entered a recession without a true precedent. As a consequence, models of past behavior are unlikely to offer a roadmap to what the recession will look like, either in terms of the magnitude of the recession, its duration, or the recovery.
MetLife Investment Management believes the United States entered a recession in late March, downshifting abruptly from positive growth in the first half of the month, to negative growth in the second half. The key driver was virus-driven “stay at home” orders that began in mid-March and quickly spread throughout the United States. As of March 31st a majority of states had orders in place.¹

We expect the recession will be both sharp and short, but not quite as short as the consensus, which appears to be suggesting growth decline followed by an immediate growth rebound. Instead, we look for a significant drop in the second quarter followed by a smaller, though still significant, decline in the third quarter. We anticipate that, by the fourth quarter, activity should begin to grow again. 2021 is expected to be a recovery year, with larger gains at the start of the year tapering off towards a more sustainable rate of growth in the second half. The unemployment rate is expected to remain elevated for some time although the distribution of unemployment is likely to be skewed towards sectors with relatively lower pay and fewer benefits that rely on direct human interactions.

A return to normal post this crisis will be unlike other post-crisis periods.

Spring Break
The drop off in activity beginning this recession was unusually sudden and widespread, created as it was by government-mandated shutdowns. Unemployment claims jumped by almost 10 million during the first two weeks of the shutdown, representing close to 7% of the labor force.² The U.S. economy, at least as represented by the labor market, appeared to simply break this March.

This surge in unemployment claims and the sudden stop in the economy has been met with significant policy responses, both monetary and fiscal. However, these responses are not designed to prevent a recession which, despite the speed at which these policies were put into place and the magnitude of these responses, was not possible. Rather, they are designed to keep markets functioning and to allow the economy to restart—consumers may not spend and companies may not be active, but the policies put in place are likely to maintain functionality until the economy and society are able to return to normal.

What is Normal?
A return to normal after the virus is not likely to be the same as the return to normal post-September 11 or post-2008. After the former, fear of a low probability event abated and, with rare exception, most people could return to their lives with only the inconvenience of a more onerous journey through an airport or to a concert, etc. Similarly, after 2008, once the labor market began to improve and home prices stabilized, the lasting impact of 2008 was concentrated within large firms who faced a more constraining regulatory environment that absorbed resources, which were still ample.

We do not believe the economy can move to a post-virus world until there is a cure. In the meantime, a high level of rapid testing coupled with effective treatment regimens seems likely to offer an opportunity to get the economy restarted to some degree even if it does not result in a return to normal (i.e. everyone able to leave their house when they feel like it with minimal regard to risk). Because of this, sectors like travel, hospitality and entertainment may take longer to recover, limiting the rebound in employment in those heavily impacted sectors. Other sectors could see intermittent shutdowns which disrupt supply chains and result in reduced efficiency across the remaining sectors of the economy. Perversely, in these sectors, limiting employment growth would reduce the risk to the operations of the organization, thereby creating another factor limiting the ability of the unemployed to join the workforce.

System Stress
Before the virus, a key concern for many economists was the ongoing existence of so-called “zombie firms”, those able to keep current on their low interest payments but unlikely ever to be able to repay their debts. The prevalence of these firms post-2008 was thought to be the result of the Federal Reserve’s aggressive easing policies and was sustained by still-low rates within a modestly growing economy. The existence of these zombie firms diverted resources from productive firms and likely lowered overall productivity in the economy, lowered wage growth...
and exacerbated income inequality. As a result, the loss of some of these firms each year was a net positive. The employees could easily find new work in a growing economy and the individual company’s loss was the economy’s gain.

The virus has raised the specter of a sharp increase in zombie firm failures and, with them, a further decline in employment at a time when the unemployment rate is surging to extraordinarily high levels. In the long run, the absence of these firms is still likely to be a net positive, but in 2020, the loss of a high number of firms at the same time will put additional stresses on the labor market at a time when additional stress cannot be easily handled. As a consequence, we believe an elevated unemployment rate could persist for some time.

**War may not be the Worst Analogy**

1945 saw the end of World War II and the beginning of demobilization. Inside the United States, GDP dropped by 11.6% over the year as a surge in private consumption and investment as well as a 300% increase in housing activity were not enough to offset a 65% drop in government spending. Employment plunged over the year but the decline in September 1945 was almost two million workers representing more than 6.5% of the labor force. Despite healthy activity in non-government sectors, 1946 also saw a decline in economic activity, likely concentrated in the early part of the year. Despite a surge in activity across other sectors of the economy, it took almost seven months to recover the jobs lost in that one month and almost 10 months for the economy to return to peak employment.

Although not a true precedent, given the scale of the post-World War II labor market realignment and the resulting employment dislocation, it seems the best proxy we have for what we can expect. Although there are numerous differences—the decline in 1945 was concentrated in durable goods manufacturing, the labor markets was seeing both significant inflows and outflows and demand away from durable goods related to defense production was high—that experience suggests that even a short-term collapse in activity can have longer-lived effects. The most likely scenario that we can envision ends with a long-term of potential disruption casting a shadow over every effort to normalize. As a consequence of the ongoing uncertainty, firms remain hesitant to fully re-staff after the lockdown ends, a development that could leave those workers who do not immediately avail themselves of the opportunity to restart work in favor of more generous unemployment benefits out in the cold and leave the unemployment rate higher on a sustained basis.

**Structural shifts**

After the crisis fades and the economy begins to return to something approaching normal, we would anticipate a rethinking of global supply chains as well as a broader rethinking of the benefits of efficiency versus resiliency. For some industries the supply chain adjustments are likely to be mandated by the government either via legislation where needed or by Executive fiat if not. Or it could be managed by exerting the purchasing power of the U.S. government. For others, simplifying complex just-in-time supply chains may be expedient as ongoing supply disruptions may be the new normal. Finally, for others, consumers may be the primary catalyst with domestic consumers favoring firms with supply chains that are more domestically oriented or oriented through traditional allies.

**Endnotes**

1 CNN.com  
2 U.S. Department of Labor  
3 U.S. Bureau of Economic Analysis  
4 U.S. Bureau of Labor Statistics  
5 U.S. Bureau of Economic Analysis  
6 U.S. Bureau of Labor Statistics

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