18 March 2020

The US economy catches COVID-19

What effect will the coronavirus have on the US economy and how can the impact be minimized?

- **There is no manual for the economic situation facing the US**
- **The challenges start with transport and hospitality but extend to other sectors**
- **The technology sector can play a key role in helping the economy in the both the short and long term**

The US could see COVID-19 coming but its true impact is yet to be revealed. As of this report's publication, the full effects on society are unknown, as are the economic ramifications. Governments, private industry and consumers will all have to work together to mitigate this global crisis and help the economy and society get back on track, but it may be a long road.

The economy needs a rapid kickstart to ensure a brief stall, not a lengthy stop

Before focusing on the potential downsides, there should be comfort in knowing that the economic period leading up to COVID-19 was strong in the US. Furthermore, China and other Asian countries that were affected early on are now showing signs of recovery, though China may face a second round of economic pressures as exports to Western countries stall. Getting the US economy back to a pre-COVID-19 state will require collaboration at all levels.

- **The government will face tough choices as it explores stimulus packages**. During the 2009 recession, efforts were made to protect the largest financial institutions, including mortgage companies and other industry titans that were deemed "too big to fail". Certain airlines may fall into that category now. But greater efforts should also be made to protect the lower-income and hourly workers that will feel the biggest brunt of the economic shutdown. The US Treasury Secretary has stated that they are 'looking to send checks to Americans immediately." This is the right sentiment, but the Federal administration may soon discover that it is not equipped to make this happen quickly enough.
- **Businesses must react both fiscally and socially when considering their role and responsibilities** In an interconnected economy, all businesses suffer when a global crisis hits. Leaders need to focus on those stakeholders beyond investors, primarily employees, partners and customers. Companies with cash reserves should be injecting capital to keep staff employed where possible. Temporary payroll cuts should begin at senior-level positions (note, the CEOs of Delta and United are forgoing salaries). Larger companies should continue to commit to smaller suppliers, signing contracts and purchase orders where possible to ensure the effects in their own sectors are minimized. Financially stable companies should extend payment terms to both customers and partners (note, Apple is allowing Apple Card customers to skip their March payments without incurring interest).
- **Aside from healthcare, the US needs to lean on its technology, communications and financial sectors** Financial institutions (and cash-rich technology companies) should provide the necessary liquidity to keep

parts of the economy moving. Furthermore, no crisis has highlighted the need for a robust digital infrastructure to the same degree as COVID-19. Notebooks, VPNs, video conferencing, chat applications, cloud-based applications, rigid cybersecurity and, above all, a robust online infrastructure are all vital components to enable remote working and the provision of digital services, entertainment and connectivity. These will be staples in the post-COVID-19 world and show plenty of long-term opportunities for tech spending.

- **Consumers (with the means to do so) need to support their local businesses**. Social distancing must be matched with social support, as this is the best way to ensure local communities stay strong. The businesses and people that will be most affected are likely around the corner, not in countries far away. Restaurants that have been forced to close may still be offering pick-up, drive-through and delivery services. These establishments may also sell gift cards, a small way to help ensure they can still collect cash in the short term.

Some economic impact is already being felt

What is the US facing? Every downturn has its own underlying unique characteristics, and this case is no exception. While the 1918 influenza outbreak was a similar pandemic, there is no manual for what is currently happening. Some of the economic ramifications are obvious:

- **The airline industry is badly affected**. Travel had already begun to decline at the start of the outbreak, but the impact was mostly felt on certain routes to specific countries. Now, every major US airline has significantly reduced its routes for the next 30 to 90 days, affecting staff throughout the entire industry. Delta announced that it would cut flights by about 40% during the next few months, the largest cuts in its history. American Airlines and United Airlines have both announced even larger cuts.
- **Hospitality, restaurants, retail and entertainment services are shutting down**. Social distancing was not a familiar concept in 2019 but is now the status quo for many in 2020. While promoted vigorously by the health sector as the best way to combat the spread of the virus, social distancing also shuts down large portions of the economy. Restaurants across the country are suffering mandatory shutdowns. Disney theme parks will be closed for the longest time on record. Major sporting events are being cancelled and, in some cases, unlikely to resume. Hotels are being hit by record cancellations and some of the biggest properties in Las Vegas, including those owned by Wynn Resorts and MGM Resorts, are shutting their doors completely. Shops are closing and, though the impact on this sector will be softened by ecommerce to a degree, it will by no means be immune to COVID-19.
- **Non-essential healthcare services will suffer**. Appointments are being postponed and administrative staff are likely to be put on limited hours. Internal projects will be delayed unless they directly support the fight against COVID-19.
- **Trade conferences are being cancelled**. While not an industry itself, they are important drivers of sales and marketing initiatives for all sectors, and drive spending in travel, hospitality and entertainment.

The ripples of COVID-19 extend further

The challenges mentioned so far represent the early impacts; the picture becomes bleaker as the further ramifications are assessed:

- **Service workers will struggle.** All the industries mentioned so far employ a large number of services workers, many of whom will enter financial hardship. 107 million people work in the US private services sector , and nearly half of them (44.5 million) work in trade, transportation, leisure and hospitality. Many of these employees will suffer to some degree. Unions will protect some (though only about 11% of US workers are

covered by a union contract). Many business leaders have also vowed to do what they can to support their employees, but smaller businesses may not have that luxury, and there will be an inevitable slowdown in jobs and an increase in unemployment. The US Treasury Secretary cautioned senators that unemployment could hit 20% without immediate action. Social security and unemployment benefits will be strained.

- **Consumer spending will fall**. Consumer confidence will wane as people see their own incomes decline, or simply get concerned with a worsening global crisis. People will notice a rise in sales promotions as businesses look to keep consumer activity going, but retail stores are closing. Ecommerce will help offset this, but still only counts for about 10% to 11% of retail sales in the US. Meanwhile, global supply chains are in disarray. Many companies will experience a strong calendar Q1 as people (and businesses) look to buy necessary supplies, from food and sanitizer to PC notebooks. But production challenges in China (due to factory closures in January and February) coupled with current logistics challenges are creating a tremendous amount of uncertainty in supply chains across all industries. Priority will be given to essential goods and equipment that are needed to combat COVID-19.
- **Suppliers to all the industries mentioned so far will have orders delayed or cut** These include wholesalers of restaurant and hotel supplies, airline catering companies and trade show exhibitor construction companies to name a few. The aviation sector was already reeling from challenges associated with the Boeing Max, and it is now unlikely any airline will make new aircraft commitments over the next few months. This will be the first wave of business-to-business companies that see project delays but it will not be the last.
- **The US stock market decline has cut the wealth and spending power of pensioners, businesses and the upper middle class**. The ramifications of the stock market declines alone are wide-reaching, yet this is just one of many issues the economy is facing. Businesses that have been leaning on their valuations to raise capital and compensate employees (especially high-growth technology companies) will have to closely manage their cash reserves. Individuals that were leaning on their shares in order to buy homes in expensive housing markets (such as San Francisco and Seattle) will no longer be able to do so.

There are two other major economic concerns that were not created by COVID-19 but will be exacerbated by it, and are worth adding to the list of potential problems that lie ahead:

- **Corporate debt in the US was already reaching record levels, and a recession will trigger bankruptcy for many companies**. For many economists, this was one of the next major worries before COVID-19 came along. Low interest rates and a growing economy in the period following the 2009 financial crash has led to significant corporate borrowing to fund growth. Approximately one third of this US corporate debt that is maturing in 2020 is considered below investment-grade, and a surge of defaults could be catastrophic. The Federal Reserve's decision to cut interest rates to near zero, despite not hitting the right tone in combating COVID-19, will be important in mitigating some corporate debt-related issues.
- **The US shale industry will collapse**. In addition to the impact of COVID-19, Russia and Saudi Arabia are engaged in an oil war. Saudi Arabia is flooding the market with oil to gain global share, driving prices down and making US shale unviable. COVID-19 is compounding this by reducing demand for oil.

There is every reason to feel optimistic that the virus can be defeated (as Asia is starting to show) and the US economy can bounce back swiftly, but there must first be an acknowledgement that this is a serious issue and that everyone has a part to play in these uncertain times.

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