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*JLL Research Report*

# Economic Insight

# Coronavirus: facts versus fear in the United States

## Quick take

- *Coronavirus cases increasing globally*
- *Domestic equity markets move into correction territory*
- *Fed cuts interest rates by 50 bps*
- *Impact on U.S. economy appears marginal*
- *CRE mostly immune to sudden shocks*

The coronavirus presents the first global crisis since the Great Recession. As the coronavirus, or COVID-19, continues to spread around the world, breaking containment, concern is increasing quickly. Fear gripped the world last week, pulling domestic equity markets down into correction territory (a decline of 10% from peak) and driving long-term Treasury yields to record-low levels. While other factors could have contributed to the massive shift in the markets, the potential impact on the global economy clearly played a role. The Fed has already taken emergency measures by cutting interest rates 50 basis points (bps) to try to bolster the economy. The last time the Fed cut at least 50 bps occurred in December 2008 when it lowered the Fed funds rate to effectively zero during the financial crisis.

### How could the economy get impacted?

While many variables will dictate the impact on the economy, we see three key unknown areas that could have a large impact:

1. How widespread will infection occur and how severe might it be?
2. How will individuals, governments, and companies respond?
3. Will the direct and indirect impacts and responses be more transitory or long lasting?

We will leave the medical questions to the epidemiologists and other health experts, but below we discuss the potential responses and economic and market implications of plausible scenarios.

### What to expect for the United States and global economy?

Much of the direct impact on the economy will depend on the response function from consumers, businesses, and government. A measured response, even in the face of a widespread outbreak or more negative health outcomes, would likely produce limited impact on the economy. But if we get a pronounced response, like measures already observed elsewhere: quarantines, travel restrictions, closure of schools and businesses, increased prevalence of telecommuting, cancellation of public events, etc., we would see a much more pronounced impact. Therefore, the economic impact depends as much on the response as the severity and duration of the outbreak. Our macroeconometric scenario modeling produces slowdowns and recessions depending upon the range of these specifics. At this juncture, it is far too early to make a specific call on this, but the risks clearly line up on the downside.

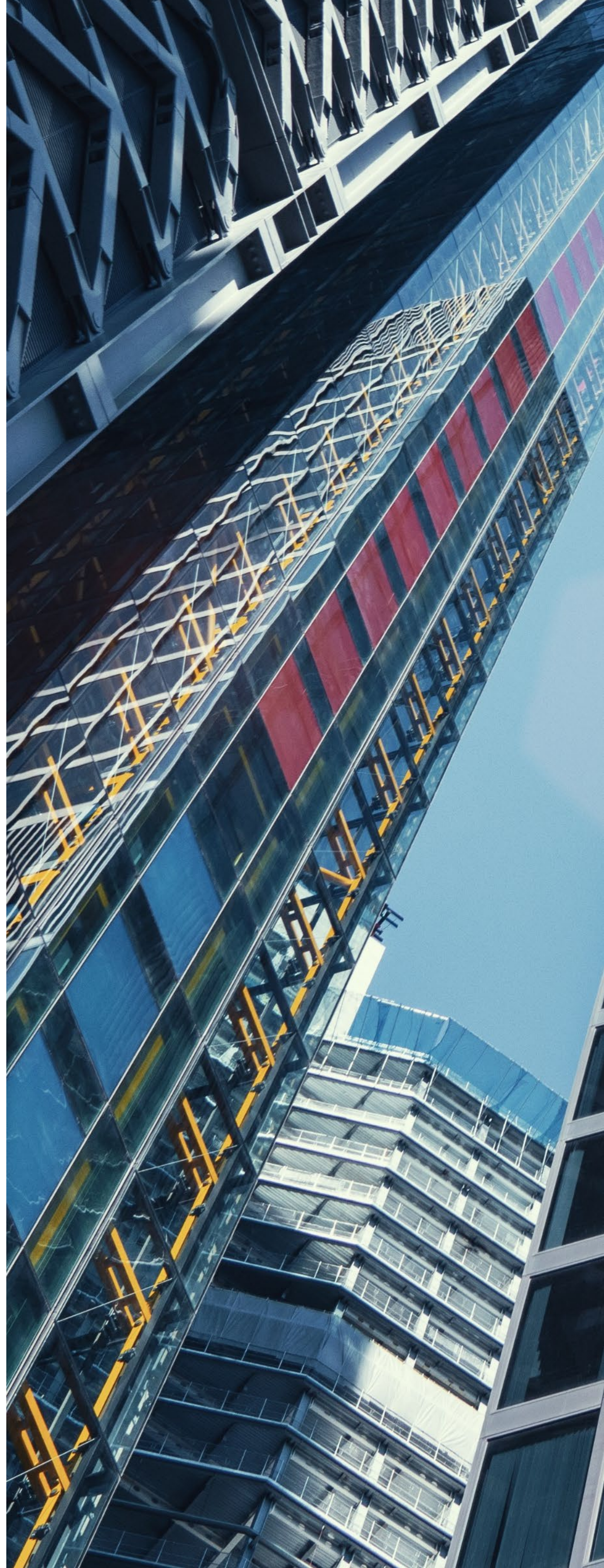
> *"...we are already seeing early actions that will have an impact: precautionary travel restrictions are increasing in the US across industries, business conferences in the U.S. are getting cancelled, and some school districts in impacted areas are closing temporarily."*

From what has transpired thus far, we expect little impact on U.S. GDP growth for 2020. But we are already seeing early actions that will have an impact: precautionary travel restrictions are increasing in the US across industries, business conferences in the U.S. are getting cancelled, and some school districts in impacted areas are closing temporarily. Our original GDP forecast for the U.S. came in at 1.8% for 2020. The best-case scenario, our current base-case scenario with relatively limited impacts from coronavirus, has now changed the baseline GDP forecast for the U.S. to roughly 1.5%, down 30 basis points. But the probability of a downside scenario occurring has increased notably in the past week. And data, even positive data, will likely take on a diminished role until the fear of coronavirus lessens.

> *"If the (coronavirus) situation produces an acute response, causing consumers to cut back on typical activities, avoid going to work, quarantining inside their homes, etc., (there could be) ... a sudden, but temporary decrease in the demand for goods and services."*

How exactly would a downside scenario unfold? If the situation produces an acute response, causing consumers to cut back on typical activities, avoid going to work, quarantining inside their homes, etc., that could produce a significant exogenous aggregate demand shock – a sudden, but temporary decrease in the demand for goods and services. That would come at a time when consumption has risen to 70% of the U.S. economy. Private investment, already weak from trade policy uncertainty, would weaken further as businesses sour on deploying capital in an uncertain health environment. Government spending, already high, could produce a small boost (more on fiscal policy later). And exports, under threat from slowing growth around the world and the trade war, will likely struggle because economies around the world are also weakening, with several key large economies likely headed for recession. Typically, an aggregate demand shock temporarily lowers GDP and reduces prices. When prices decline, short-run aggregate supply increases in response to cheaper prices (inputs), production increases, and the economy expands and returns to equilibrium in a relatively short time period. This typically occurs during an average recession.

But, if workers stay home (voluntarily or involuntarily) and cannot telecommute because their jobs cannot be done remotely, that could also produce an aggregate supply shock – a sudden decrease in the willingness or ability to supply an input to production. We estimate roughly 50% to 60% of all workers could telecommute if necessary. In that case, the typical positive response from short-term aggregate supply would not occur because if workers stay home (and are not telecommuting) that would reduce a very significant input to production, labor, especially in a services-oriented economy. Even if the price for labor adjusted upward (as typically occurs to the price of the limited input during a supply shock) workers still might not want to supply labor if they believe that doing so would jeopardize their health. The simultaneous combination of a demand shock and supply shock could prove troublesome, causing a more severe and potentially prolonged downturn. And, of course, the duration of the response matters too – the longer life deviates from normal, the longer any downturn would persist. All other things equal, the shorter the duration, the better for the economy.



## Can government policy help?

Government policy can always play a role but might only produce limited help. Conventional monetary policy is running out of ammunition now that the Fed reduced the target Fed funds rate to a range of 100-125 bps. Lower rates could prop up confidence in the markets, loosen financial conditions (which recently tightened), and potentially help some companies with funding or liquidity issues. But lower interest rates would not likely spur economic activity on their own because rate cuts do not address the underlying issues. The Fed could also implement other measures such as quantitative easing, forward guidance, etc. but their effectiveness against a health issue seems uncertain.

Fiscal policy, via tax cuts and spending increases could have a larger role to play, but beneficiaries of such policies would still have to spend the funds. Targeted fiscal policy, toward industries tasked with combating the infection, such as healthcare, could produce greater benefit.

## Summary and outlook

For now, the impact on the U.S. economy appears marginal. But the downside risks are building, and we remain vigilant.

Broadly speaking, the commercial real estate market continues to range between stable and performing well depending upon the location and sector. The long-term duration of leases and institutional ownership horizons serve to provide some stability and provide some measure of a safety net in the event of more direct fallout. Previous idiosyncratic shocks, such as 9/11 or other more localized virus outbreaks (such as H1N1), produced more temporary than prolonged impacts on the economy and the CRE market. If the outbreak does not spread widely or becomes contained within a relatively short period of time, we would expect a short (even if acute) impact lasting a couple of quarters at most and relatively quick rebound in growth. If the impact persists, and the response becomes more pronounced, then the probability of our more prolonged, severe downside scenarios will increase.

We will continue to monitor the demand and supply impacts and update our economic forecast as we receive more information.

*Note: A broader piece on implications for commercial real estate is forthcoming.*

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