HIGHLY UNUSUAL FEATURES OF THE 2020 U.S. RECESSION

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Abstract: *On June 8, 2020, a group of economists declared that the U.S. economy entered a recession as the Covid 19 struck the nation, thereby ending the longest economic expansion on record. They concluded that employment, income, and spending peaked in February 2020 and then fell sharply afterward as the coronavirus shut down businesses across the country, marking the start of the downturn after nearly 11 full years of economic growth. The National Bureau of Economic Research (NBER) has become the official arbiter of recessions. It broadly defines a recession as "a decline in economic activity that lasts more than a few months." For that reason, the NBER typically waits longer before making a determination that the economy is in a downturn. In the Covid 19 recession, the NBER did not declare that the economy was in recession until July 19, 2021, a year after it had actually begun. The major objective of this article is designed to discuss four unusual features of the latest recession: 1) the major cause of the recession, 2) the K-shape recovery, and 3) the government rescue effort, and 4) inflation spike.*

Keywords: *Covid 19, Recession, Inflation Spike, K-Shaped Recover, Federal Fund Rate*
JEL Classification: *E31. E44. E 62*

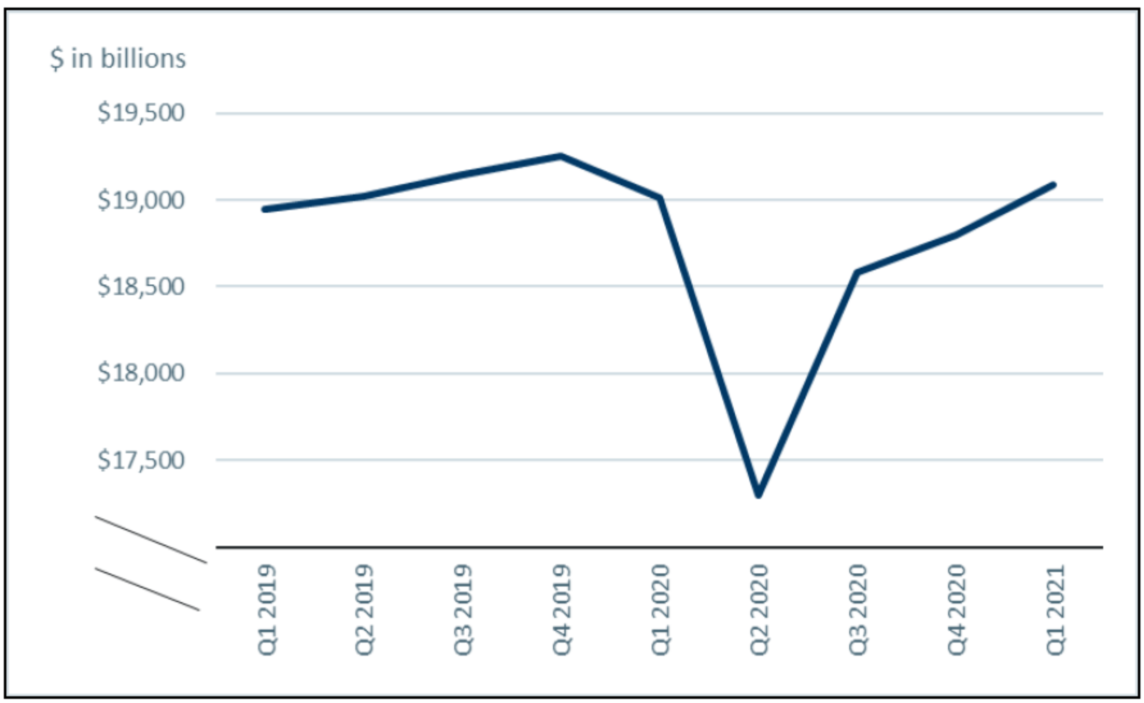
Introduction

Covid 19, also known as the coronavirus pandemic, has been an ongoing global pandemic of coronavirus disease since 2019 caused by severe acute respiratory syndrome coronavirus 2 (SARS-CoV-2). The virus was first identified in December 2019 in Wuhan, China. The World Health Organization (WHO) declared Covid 19 as a Public Health Emergency of International Concern on January 30, 2020, and later declared a pandemic on March 11, 2020. As of January 2, 2022, the Google News confirmed a total of 289 million Covid 19 cases and a total of 5.4 million Covid 19 death worldwide, making it one of the deadliest pandemics in history. This same news confirmed a total of about 55 million coronavirus cases and a total death of 822 hundred thousand in the United Sates. Almost all countries around the world restricted free movement and set up border controls. National reactions have included containment measures such as quarantines and curfews (known as stay-at-home orders, shelter-in-place orders). Such restrictions have had a negative economic and social impact on the US and just about every other country in the world (US Government Response to Covid 19, August 27, 2021).

The real gross domestic product (GDP) of the US—economic output adjusted for inflation—fell at an annual rate of 5.0% in the first quarter of 2020 and fell at an annual rate of 31.4% in the second quarter of 2020, the largest quarterly decline on record. GDP partially recovered in the 2nd half, but the U.S. economy shrank by 3.5 percent in 2020 as the coronavirus pandemic ravaged factories, businesses and households, pushing U.S. economic growth to a low not seen since the United States wound down wartime spending in 1946 (Siegel, Dam and Werner, 2021). The Bureau of Economic Analysis estimated that as of the first quarter of 2021, it was still 0.9% lower than in the fourth quarter of 2019, before the pandemic began (see Figure 1) (Congressional Research Report, R46606).

The major objective of this article is designed to discuss a number of highly unusual features for the latest recession that past US recessions have rarely faced: 1) The major cause of the recession, 2) the K-shape recovery, and 3) the government rescue effort, and 4) inflation spike.

Figure 1. Real Growth Domestic Product (GDP)



Source: Bureau of Economic Analysis (BEA).

Note: Data using billions of chained 2012 dollars seasonally adjusted at annual rates.

*We obtained Figure 1 from Congressional Research Service (R46606), Covid-19 and the US Economy, May 11, 2021, p. 4.

The major cause of the recession

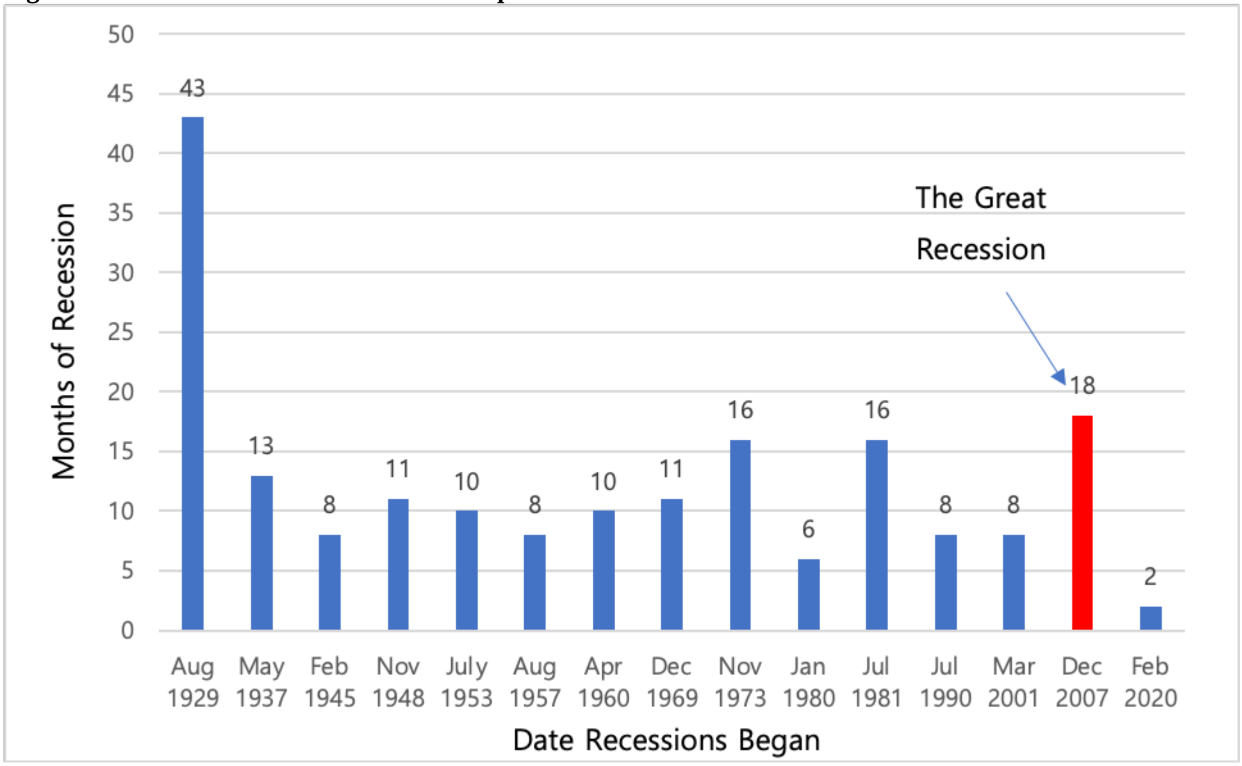
Almost all past US recessions had happened mainly due to the economic reasons. Causes of some specific recessions are the boom bust—easy money (the Great Depression), the Arab oil embargo against the US and other Western countries (1973 recession), tight monetary policy in an effort to fight mounting inflation (1980-81 recession), and the subprime mortgage crisis (the 2008 great recession). Between 1980 and 1982 the U.S. economy experienced a deep recession (usually known as a double dip), the primary cause of which was the disinflationary monetary policy adopted by the Federal Reserve System. One noteworthy recession in Figure 2 is the 1981-82 recession that received a lot of attention. This is because just everybody called "inflation was a public enemy number one" at the time and the government adopted a tight monetary policy to make the recession even worse on purpose (Wikipedia, "Early 1980s recession").

Unlike past US recessions caused by economic reasons, the United States entered into a recession in February 2020, a result of the Coronavirus Disease 2019 (Covid 19) pandemic. To prevent the spread of Covid 19, lockdown orders were issued in many parts of the country and travel restrictions were put in place. These measures, along with general fears of the coronavirus, caused swift and large aggregate demand and supply shocks that resulted in the deepest economic downturn the US has seen since the Great Depression (Congressional Research Service, R46606).

The fall and rise of the US economy caused by Covid 19 have been sharpest. For example, "employment in the United States experienced the sharpest decline on record in April 2020 as the negative economic effect of the Covid 19 pandemic and social distancing measures caused employers to cut almost 21 million jobs as unemployment rate jumped to 14.7 percent" (Cox, 2020). The next largest single month decline was almost three quarters of a century earlier, in September1945, when almost 2 million jobs were lost (Nutting, 2009). On the other hand, the Covid 19 recession turned out to be the shortest on record. As shown in Figure 2, the Covid 19 recession lasted for only two months from February to April 2020, while all other recessions for the last 90 years lasted more than 6 months. In fact, this latest recession is the only recession that failed to meet the textbook definition of recession, thereby implying that the Covid 19 recession is one of the worst recessions on record.

As mentioned earlier, the pandemic, along with the resultant stock market crash and other impacts, led a recession in the United States following the economic cycle peak in February 2020. The economy contracted 4.8 percent from January through March 2020, and the unemployment rate rose to 14.7 percent in April. During the second quarter of 2020, the U.S. economy suffered its largest drop on record, with GDP falling at an annualized rate of 32.9 percent. As of June 2020, the U.S. economy was over 10 percent smaller than it was in December 2019 (Long 2020, Abelson 2020, and Tapee 2020). Most economic statistics of the United States deteriorated dramatically from February 2020 until June 2020, but most economic sectors began to improve in July 2020.

Figure 2. US Recessions since the Great Depression of the 1930s

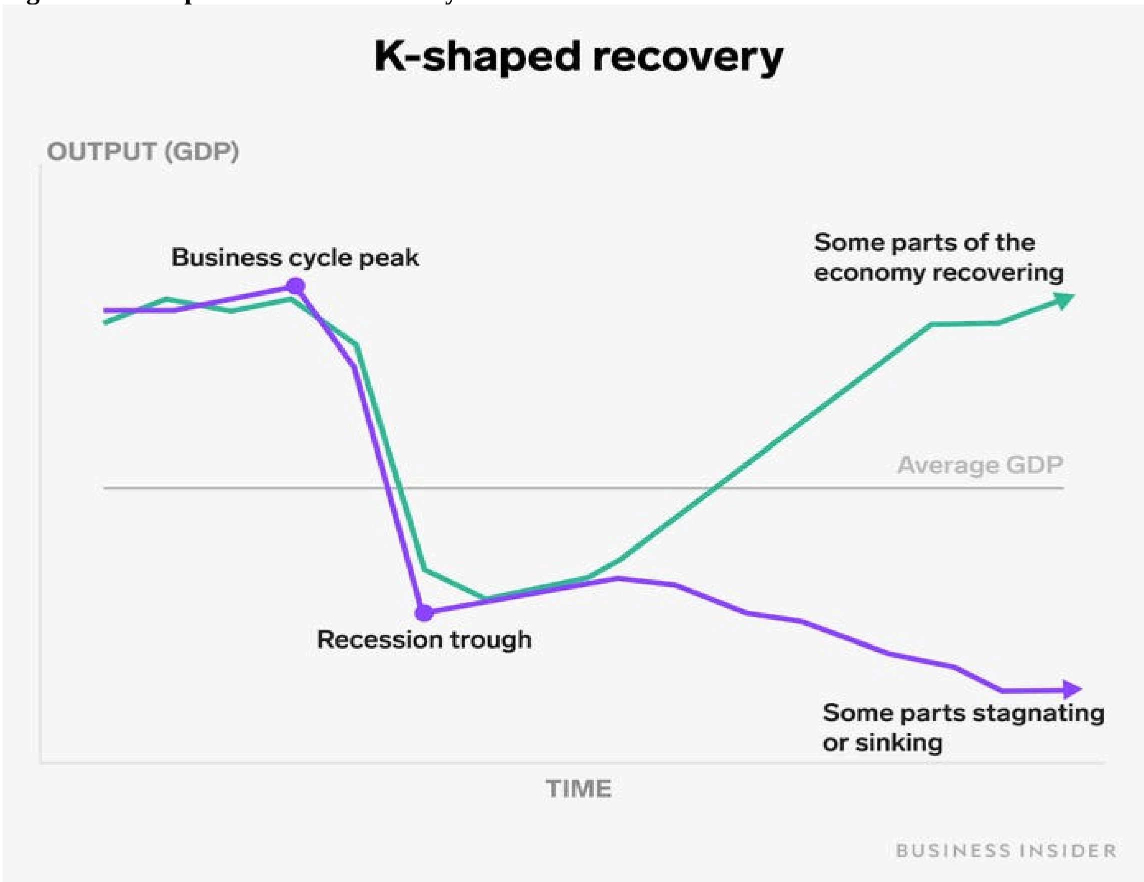


The K-shaped recovery

Economies can get out of recessions in a variety of different letter shapes, such as V, U, W, L, and K. A recession is a significant economic downturn generally identified by a fall in GDP in two successive quarters. Figure 2 will help understand these most common letters used to characterize all these various recovery paths. After a recession hits its lowest point, the economy begins to grow again. But it can recover in several different shapes (Aldrich, 2021). The economy can bounce back immediately to its pre-recession level (V-shaped recovery, such as the 1980 recession). It declines and then spends a significant period of time at the trough before recovery (the U-shaped recovery, such as the 2007-2009 recession). It can bounce back and then dip again (the W-shape recovery, such as the early 1980s). It can remain near the low point and take years to fully recover its former levels of output (L-shape recovery, such as the great depression of the 1930s).

The K-shaped recovery is a relatively new term created to describe what economists see happening with the Covid 19 pandemic. In this situation, one segment of the economy trends upward — experiencing more of a V-shaped or U-shaped recovery — while another segment either sinks further or recovers much more slowly, like the L-shaped recovery. As shown in Figure 3, this divergence between two different economic groups is depicted by the two diagonal lines in the letter K. The affected groups consist of both industries and individuals.

Figure 3. K-Shaped Economic Recovery



Source: Erin Gabler, "What is a K-Shaped Recovery?" The Balance, April 5, 2021, https://www.thebalance.com/k-shaped-recovery-5120738

The economy rebounded in the second half of the 2020 as it reopened, with sharp gains in employment and consumer spending over the summer that were helped by trillions of dollars in government aid. However, some industries such as health care, recreation, transportation, and business investment, and private inventories have suffered a major slowdown or been virtually unable to function, while others such as durable goods, food and beverage, government spending, residential investment industries, and e-commerce, have been able to continue operating or have even thrived during the pandemic. Similarly, individuals have been affected along class, generational, and racial lines. Low-income or paycheck-to-paycheck families, young adults, and Black and Hispanic Americans have largely struggled to recover. In contrast, many white and upper-class families have bounced right back, especially if their wealth is concentrated in the stock market (which is also on the rebound). The recession didn't necessarily cause these disparities. But the K-shaped recovery has certainly uncovered, and in some cases, greatly exacerbated, the already existing inequalities (Torry, 2020).

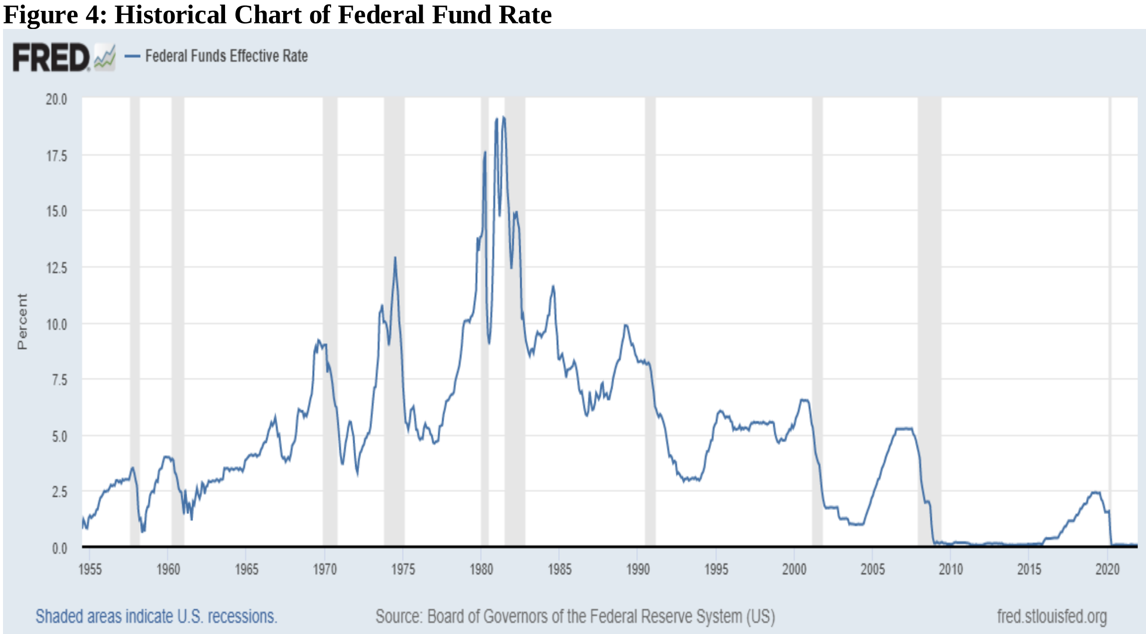
Government rescue efforts

Between 2008 and 2012, the federal government spent roughly $1.8 trillion of fiscal stimulus and other economic support to combat the Great Recession (The Committee for a

Responsible Federal Budget, 2020). By companion, the US government had spent and/or committed a total of $4 trillion in response to the coronavirus as of October 20, 2020. At $4 trillion, the assortment of grants, loans and tax breaks has already been the costliest economic relief effort in modern history. The Great Recession funds were mostly distributed over five years, but the current relief would be distributed more quickly. Furthermore, the Congress and the federal government expected to spend more money in some other forms such as infrastructure and social spending not directly related to the Covid 19, but to stimulate the economy (Whoroski et al., 2020). On November 8, 2021, Congressional Budget Office reported that “In fiscal year 2021, the federal deficit totaled nearly $2.8 trillion—about $360 billion less than in 2020, but nearly triple the shortfall in 2019. That deficit was equal to 12.4% of GDP, down from 15.0% in 2020, but up from 4.7% in 2019.” At 12.4 percent of gross domestic product (GDP), the deficit in 2021 was the second largest since 1945, exceeded only by the 15 percent shortfall recorded last year (Congressional Budget Office, 2021).

In addition to this easy fiscal policy adopted by the executive branch, the Federal Reserve System adopted an easy monetary policy to increase the money supply through open market operations, the federal fund rate, and other instruments. For example, the Federal Reserve System purchased Treasury and agency securities in the amount needed and lowered the existing low federal fund rate even lower in March 2020 (International Monetary Fund, 2021) (see Figure 4). The federal funds rate is the target interest rate set by the Federal Open Market Committee. This is the rate at which commercial banks borrow and lend their excess reserves to each other overnight. The Covid 19 recession lasted only for two months, but the government has spent a lot more money than the Great Recession which lasted for 18 months. Some experts warn that such unprecedented easy fiscal and monetary policies would eventually create inflation spike such as the early 1980s which will be bad for the US economy in the long run.

Figure 4: Historical Chart of Federal Fund Rate



Note: Light shaded bars in the figure indicates recessions and the width of each bar indicates the length of the recession.

Source: Board of Governors of the Federal Reserve System (US), Federal Funds Effective Rate retrieved from FRED, Federal Reserve Bank of St. Louis, https://fred.stlouisfed.org/series/FEDFUNDS, January 7, 2022

Inflation spike

Inflation is a double-edged sword: Higher interest rates may follow which will help savers to earn money, but higher prices for goods and services could erase those gains (Iacurci, 2021). However, inflation spike is bad for any national economy in the long run because it erodes purchasing power and disrupt the sustainable economic goals of the country's macroeconomic policy. There are a variety of causes for potential inflation spike, all of which have one common denominator—man-made. On June 10, 2021, for example, The Wall Street Journal explained the man-made potential inflation spike as follows: "Nobody should be surprised that prices are increasing everywhere from the grocery store to the car dealership. Demand is soaring as the pandemic recedes while supply constraints linger, especially in labor and transportation. As always, this is a price shock largely made by government. Congress has shoveled out trillions of dollars in transfer payments over the past year (2020), and the Federal Reserve System has rates at zero while the economy may be growing at a 10% annual rate (Land, 2021)." It is important to understand that the federal fund interest rate in the early 1980s had been extremely high so the Federal Reserve System created the two recessions by adopting the tight monetary policy on purpose (see Figure 4). Experts warn that this unpleasant history might repeat itself unless the government continues to use an easy economic policy for short-term gains.

Many people welcomed such a massive economic stimulus package because it would definitely create short-term economic boom. At the same time, some other people expressed serious consequences from such a quick-massive spending. The Covid 19 aid could cause problems by fueling inflation, increasing the budget deficit, allowing politicians to use surplus money for their political purposes, and giving people receiving unemployment benefits in an incentive not to work. For example, many states turned down unemployment aid because workers do not want to look for jobs. In fact, many employers, especially the service industry, began to face a labor shortage as early as May 2021. On May 10, 2021, California projected a staggering $75.7 billion surplus despite a year of pandemic closures — an amount that surpasses most states' annual spending and prompted Gov. Gavin Newsom to propose sending cash back to residents as he faces a recall election. On May 19, 2021, Michigan announced that it could enjoy 4.7 billion in budget surplus (Yamamura, 2021).

One concrete sign for a potential inflation spike has to do with the change in social security benefit payments. In 2020, Social Security benefits increased by just 1.3 percent, raising the average benefit by only about $20. However, Social Security recipients can look forward to one of the largest cost-of-living adjustments (about 5.9 percent) in nearly 40 years in 2022 since 1983, when it was 7.4 percent (Social Security, Latest Cost of Living Adjustment). Evidence indicates that the US inflation rate would continue to rise beyond 5.9 percent. On December 10, 2021, for example, the Bureau of Labor Statics reported that the US inflation rate rose to 6.8% in 2021 to its highest point since 1982 (The Guardian, 2021). The cost-of-living adjustment (COLA) is based on the average of the July, August, and September CPI data. Social Security benefits are one of the few types of income in retirement that are adjusted for inflation. In 2020, 61 million people, one of every five Americans, received benefits from programs administered by the Social Security Administration (SSA) (SSA, 2020 and Goforth, 2021). However, soaring inflation still can knock a hole in the household finances of retired and disabled Social Security recipients.

Conclusion

The government's generous coronavirus relief package and more money in some other forms such as infrastructure not directly related to the Covid 19 have economists worried it will drive up both prices and federal budget deficits, thereby wreaking havoc on the economy. If inflation were to rise quickly, the Federal Reserve System could act to contain it by raising interest rates from their current low levels, which would make borrowing more expensive and slow economic activity. However, raising interest rates to control inflation has sometimes led to economic contractions and even recessions. In addition, if interest rates were to increase in conjunction with higher inflation, there would be significant implications for our national debt (Peterson, 2021). More broadly, inflation spike caused by the easy fiscal policy and the tight monetary policy to contain it are likely to disrupt the major goals of the macroeconomic policy--full employment, price stability, the sustainable rate of economic growth and the sustainable balance of payments in equilibrium (Goforth, 2021). In summary, we can say that there is no guarantee that the US will not face the terrible economic dilemma again, just like the one of the early 1980s if the government ignores its long-term problems by focusing on only short-term gains.

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