NAFCU CORONAVIRUS OUTLOOK

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In a stunningly short amount of time, the coronavirus has gripped the global news cycle. Just three months ago whispers trickled out of China about a unique form of pneumonia. Now the virus has effectively brought society to a halt in several nations, has been deemed a global pandemic by the World Health Organization (WHO), and has officially brought the longest U.S. bull market in history to an end.

The potential for coronavirus to develop into a full-blown health crisis is, of course, the most important consideration for the public and policymakers alike. But credit unions must weigh the possible economic and financial impacts, as well. What will that impact be, and will it lead to a recession? Why have financial markets turned so suddenly? And as credit unions, how will this impact your members and how can you best serve them? While we have no crystal balls, we will attempt to shed some light on these broad questions and on how the credit union industry will be impacted.

What is the state of the U.S. economy and what will be the impact of coronavirus?

1. **The U.S. economy was in a great place prior to the virus.** While real GDP growth remained modest right up until the virus hit, there were legitimate reasons to feel as confident in the economy as at any time in the recovery. The labor market continued to add jobs at a robust pace through February, reducing unemployment among minority groups, and even pulling substantial numbers of individuals on disability leave back into the workforce. After an ill-advised rate hike (arguably, series of rate hikes) in 2018, the Federal Reserve adopted a more accommodative stance. In a bit of irony, after having consistently failed to lift inflation to its stated target throughout the expansion, the Fed received the strongest reading for consumer price growth since the Great Recession in February. Finally, the housing market was just kicking into high gear, with a long-awaited uptick in construction and sales growth.

   As the last bits of economic data roll in from prior to the downturn in the stock market, it is with the recognition that tougher times ahead are likely. Yet, the strength of yesterday's economy is not all for naught. The fact that we will face the coming challenges with substantial forward momentum should help the U.S. economy weather the storms better than it would otherwise.

2. **Actions taken thus far already represent a hit to the economy.** Even at this relatively early stage of addressing the coronavirus threat, airlines have culled flights, conferences and festivals have been cancelled, and hotel vacancies are surging. Businesses in the travel and tourism industry are clearly going to suffer, as will any connected to oil extraction. The drop in global production is likely to do more damage to the manufacturing sector.

   Day by day, more institutions, businesses, and locales enact social distancing measures, whether as a general precaution or because of a confirmed case. The impact at the household level will be severe. One of the largest sources of hiring in the blowout February employment report was restaurants, but hourly employees are going to be the most vulnerable to layoffs. As compared to the Chinese economy, the U.S. is far more highly dependent on services. This is a key reason why U.S. income and GDP per capita is much higher than China. But it is the services sector which looks especially vulnerable to prolonged damage from changes in social interaction.

3. **The high degree of uncertainty of the economic impact is itself a headwind.** Regardless of the number of people who contract the virus, the uncertainty it brings will have a major impact on the economy. One of the weak spots for the economy recently has been business investment. Despite a strong labor market, tax breaks, and robust profits, businesses simply have not engaged in long-term capital investing. Whatever uncertainties were weighing on corporate America are surely higher now.

We can expect a similar effect on consumers. Particularly problematic is that low-income households – those most vulnerable to income and job loss – traditionally spend more as a share of their income. Even a mild rise in household-level anxieties could dent retail spending. These fears are of course impacted by how swiftly and effectively authorities manage the coronavirus threat, but they may last beyond the point where case growth begins to slow.

In the near term, NAFCU expects a sharp slowdown to the economy in the second and third quarters, at a minimum. Recession is a distinct possibility. It remains an open question whether we should expect a rapid recovery once the worst is over (i.e., a v-shaped recovery). While that would be typical of a natural disaster, those events do not typically hang in the psyche of the consumer.

The U.S. does have some distinct advantages over other countries. First, our financial institutions are as strong as any and more highly capitalized than at any point in recent history. Second, the U.S. remains the safest haven in the world, and any expansion in the fiscal deficit will be serviced at exceedingly low rates. Finally, the U.S. and others will be watching and taking notes as countries like China and South Korea, who were on the leading edge of the spread of the virus, transition from containment and mitigation back into regular economic life.

Why has the market reaction been so extreme?

1. **So far, successfully combatting the virus has come only through extreme measures.** Early on there were concerns that the virus would spread exponentially through every developed country in the world. More recent evidence has calmed some of those concerns and shown that mitigation techniques do work. Some nations have been relatively successful confronting the virus and "flattening the curve." This has provided adequate space for their health systems to treat active cases without being overwhelmed, as has occurred in Wuhan, Italy, and Iran.

   While the epicenter of the disease is still under quarantine, the rest of China is beginning to stir to life. Early on, economic concerns largely focused on the impact that the Chinese quarantines would have on global supply chains. As an auto supply chain strategist noted, "It takes 2,500 parts to build a car, but only one not to." Getting even a share of China's manufacturing sector back online will be key to the global economic recovery.

   South Korea is being hailed as an example of a relatively open society which was able to stem the tide of a rapidly spreading contagion. While that news provides both hope and lessons from the leading edge, their successes have involved radical societal adoption of stringent hygiene, social distancing, broadly available testing, and vigilant monitoring.

   On the positive side, some of the more pessimistic early beliefs about the virus are being called into question. For example, we heard reports of asymptomatic patients—those who had the COVID-19 disease, did not go on to develop any identifiable symptoms, but still were able to pass the disease along to others. But the findings of a WHO mission to China to study the disease concluded that asymptomatic infection "appears to be relatively rare and does not appear to be a major driver of transmission." And while initial opinion was that warm weather would be powerless to stem the spread of the coronavirus as it does the seasonal flu, a recent study finds that coronavirus may in fact weaken under warmer conditions. If true, the summer months may see a reduction in its spread, allowing more time for researchers to study it.

2. **Growing concerns about the response to the virus, both in the U.S. and abroad.** Delays in testing for the virus have increased concerns as to the readiness of the U.S. system. While official data on number of confirmed cases remains low, that is likely to scale up as testing capacity increases. The relatively measured steps the U.S. had been taking toward mitigation and containment seemed out of step with the experiences of other countries that have successfully mitigated the impact of the virus thus far. However, more recently there has been broader acceptance that a more aggressive approach is needed.

   Markets appear eager for a robust fiscal response to support the health efforts and to address the inevitable economic fallout. A comprehensive spending package, possibly coordinated across developed nations, could help to steady markets. However, that has proven elusive thus far as Congress and the administration formulate which policies are likely to achieve the greatest impact at the least cost. The prospects for international coordination look remote, with Germany reluctant to take on more debt and Russia and Saudi Arabia preparing to unleash a flood of oil into a tottering global economy.

Furthermore, there seems to be little room for the Federal Reserve to enact monetary policy or confidence that doing so will offer lasting support to markets and the economy. With market interest rates already near zero for even the longest-dated Treasuries, some Fed officials are even contemplating opening up the Federal Reserve Act in order to provide more ammunition to the central bank.

3. **Ability of impacted nations to restart their economies is still unknown.** While it is encouraging that China and South Korea have been able to avoid the worst-case scenarios of exponentially-expanding contagion, measures taken thus far have already sapped economic growth. As they try to get back to life as normal, headwinds remain. There is the potential for another outbreak of the virus. Consumers may still be reluctant to gather in crowds, much less spend as before. And even if domestic production returns to scale, their industries face waning global demand from the rest of the world. As with their mitigation and containment efforts, the rest of the world will be eyeing their efforts to prime the economic pump.

What does all this mean for my credit union?

1. **Experiences will vary…** Certain credit unions are likely to be hit harder by the economic and financial impact of the coronavirus than others. Those located in areas heavily dependent on oil production or those in vacation or conference destinations (Las Vegas, Orlando) may struggle for a time. Depending on how the virus responds to warmer weather, your region's climate may play a role. Credit unions located in denser urban areas should probably plan on seeing a bigger impact from the virus than those in rural areas where members and staff can more easily limit close contact with others. Finally, given that social distancing may be part of the response to the coronavirus threat, those credit unions that have invested in technology in recent years and have robust digital offerings are better placed to continue to serve their members in the coming months.

   NAFCU's Research Division analyzed data from the Bureau of Labor Statistics, which break out local employment by industry. Those areas that have relatively high job concentrations in oil and gas extraction, retail, hotels, and restaurants are more vulnerable to job losses related to the impact of the virus. NAFCU members may download that data here.

2. **… but all will be impacted.** For years, credit unions have been urged to prepare for the potential return of rates to levels that were more typical of prior decades. Now we find ourselves yet again in a zero-rate world. While the Federal Reserve has not taken its target rate to that point yet, markets are betting heavily on that happening at some point this year, while longer-dated Treasuries are already there. This low-rate environment is likely to persist for at least the remainder of 2020. While this may spur some refinance activity, it makes for a difficult environment to generate earnings.

   Fortunately, the industry is well-capitalized overall and there is an ample equity cushion in the Share Insurance Fund (SIF). Although there will not be a distribution from the SIF this year, the NCUA is unlikely to charge a premium assessment in the near future.

3. **Operational considerations are paramount.** Credit unions are in the people business, and there is nothing more important than their members and the hard-working staff members who serve them. Many credit unions have unfortunately had to deal with the effects of natural disasters in recent times, but the threat of the coronavirus may introduce some unique problems. The FFIEC released some operational guidance for financial institutions to consider. NAFCU also has a dedicated webpage with coronavirus-related resources.

   While there will undoubtedly be challenges ahead, credit unions have faced down greater ones in the past and will surely do so again in this instance. A couple of qualities that set credit unions apart from profit-motivated institutions are their focus on member service and their united spirit with fellow credit unions. There will be unique opportunities to provide for the needs of your members and, as you do so, to share those experiences with other credit unions who are in the same situation. NAFCU has a growing list of networks to help connect you with other credit union professionals. And as always, NAFCU is here to assist in any way that we can.