What We Don't Know about What's Next

Every American is aware by now of the sudden, unparalleled economic changes created by the coronavirus and the public health measures taken to contain it. These changes have created major economic uncertainty for households and businesses. And uncertainty has, as it often does, made a bad situation worse: Confidence in the future, or the lack of it, is a key driver of consumer and business spending and investment decisions. For economic policymakers, then, the atmosphere of uncertainty creates new challenges in understanding the environment and anticipating the economy's path.

At the Richmond Fed, we've therefore greatly stepped up our engagement with our business and community contacts to gauge how uncertainty is playing out. We've been combining this work with our economic research to understand more precisely where our economy is going. (You can read about these efforts on p. 7.) At this early stage in what may well be a difficult process of recovery, I would like to share with you not what policymakers know, but what we don't know about several major areas of uncertainty.

The most important area of uncertainty, as I see it, is medical rather than economic: What will be the path of the virus in reaction to our public health responses? What infection and recovery rates will we see?

The biggest *economic* uncertainty is consumer confidence. Consumer spending is two-thirds the size of GDP — and no one knows at this point how consumers are going to behave after they receive the "all clear" or "mostly clear" to resume their full range of day-to-day activities. Will we see a lot of pent-up demand for going out, for retail shopping at brick-and-mortar stores, for taking vacations? Or will the habits developed during the lockdowns, plus lingering caution, keep these areas of the economy highly depressed? Right now, the sinking consumer confidence that we have seen in the data concerns me. Although we will see early indications of the future of consumer behavior as some states relax their restrictions, those short-term reactions, whichever way they fall, might not be reliable guideposts for the longer term or for the country as a whole.

Second, just as we don't know how quickly consumers will come back, we don't know when the lost jobs will come back — or in what form. Will dislocated service workers, for example, struggle for a long time to enter new occupations? As work arrangements shift, will parents have a harder time finding ways to balance work and home needs?

Another significant area of uncertainty is the future shape of credit markets. The Fed has put numerous programs in place during the crisis to support the ability of banks, and the financial system in general, to lend. (These programs are listed on p. 6.) Congress has done so as well. Moreover, the banking system remains healthy at this point, unlike in 2008. But many assets of financial institutions are likely to remain under stress for some time, including both consumer debt and the debt of highly levered businesses. Banks in the United States hold more than $2.3 trillion in commercial real estate loans, making this sector worth watching closely; in addition to the uncertainty of the retail component, we have new uncertainty as to the future demand for office space. After the immediate crisis has passed, it's unclear whether the banks will be in a weaker position — and what implications this will have for access to credit.

A fourth major area of uncertainty is what economists call "wealth effects." Research at the Richmond Fed and elsewhere tells us that sudden, unexpected changes in wealth can have major effects on individuals' behavior on a variety of fronts, such as postponing retirement decisions and reducing consumption, charitable giving, and entrepreneurship. As I write these words, stock market values have rebounded to a large extent after a period of sharp decline — but of course, this could change. Moreover, other forms of household wealth, such as housing, could see meaningful declines. And the massive job losses that have occurred will result in drawdowns of household savings and increases in debt. All in all, the crisis is likely to translate into negative wealth shocks — and into wealth effects.

These are some of the longer-term economic issues that have been on my mind. I am confident that we will eventually regain our prosperity, but we have much to learn about how our economy will change along the way. **EF**

TOM BARKIN
PRESIDENT
FEDERAL RESERVE BANK OF RICHMOND

Share this article: https://bit.ly/after-crisis