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Financial Stability Factors and the Severity of the Current Recession

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Challenging Times

- United States and Europe in midst of a pandemic second wave
  - Several European countries moved to a “shutdown-light” model
  - In the U.S., divergent responses across states
- Many people limiting activity regardless of government mandates
- Full economic recovery does require getting the virus under control
- Aggressive monetary and fiscal actions mitigated impact, but without effective *public health* policy, virus will remain the major source of *economic* problems

Pandemic is What Economists Call a “Tail Event”

- Unexpected severe outcomes, almost never predictable
- Severity of impact depends on a variety of factors
  - Willingness and ability of monetary and fiscal policymakers to respond
  - Financial positioning of households, financial institutions, and firms
- Economies in more fragile condition likely to have amplified economic problems when shocks occur
- Impact could have been less severe, with more proactive financial stability steps taken in advance

Implications of New Monetary Policy Framework

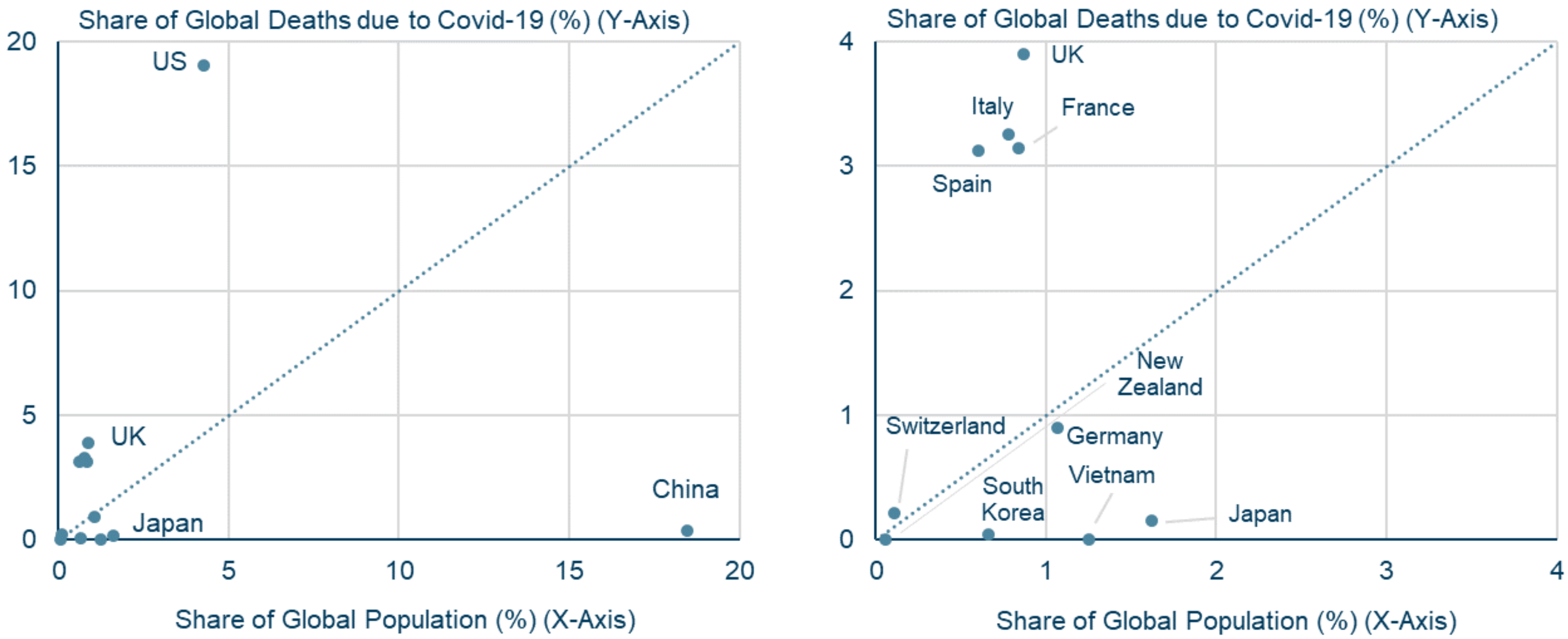
- FOMC intention: Maintain current low level of interest rates until 2 percent inflation
- Implies being slower to raise rates than in previous recoveries
  - Reflects concerns about below-target inflation over previous decade
  - Risk of households and firms taking on more leverage and risk

Implications of New Monetary Policy Framework
(Continued)

- I'm supportive of low rates to ensure monetary policy mandates are achieved
- My view: A more proactive supervisory and financial stability focus is required to prevent the buildup of financial imbalances that make downturns more severe
  - In the U.S., a too-big-to fail focus rather than financial stability focus
  - In the U.S., limited regulatory tools to address financial stability concerns
- Absence of financial stability "guardrails" most impacts vulnerable segments of labor markets

Figure 1: Deaths due to COVID-19 vs Population

as of November 5, 2020

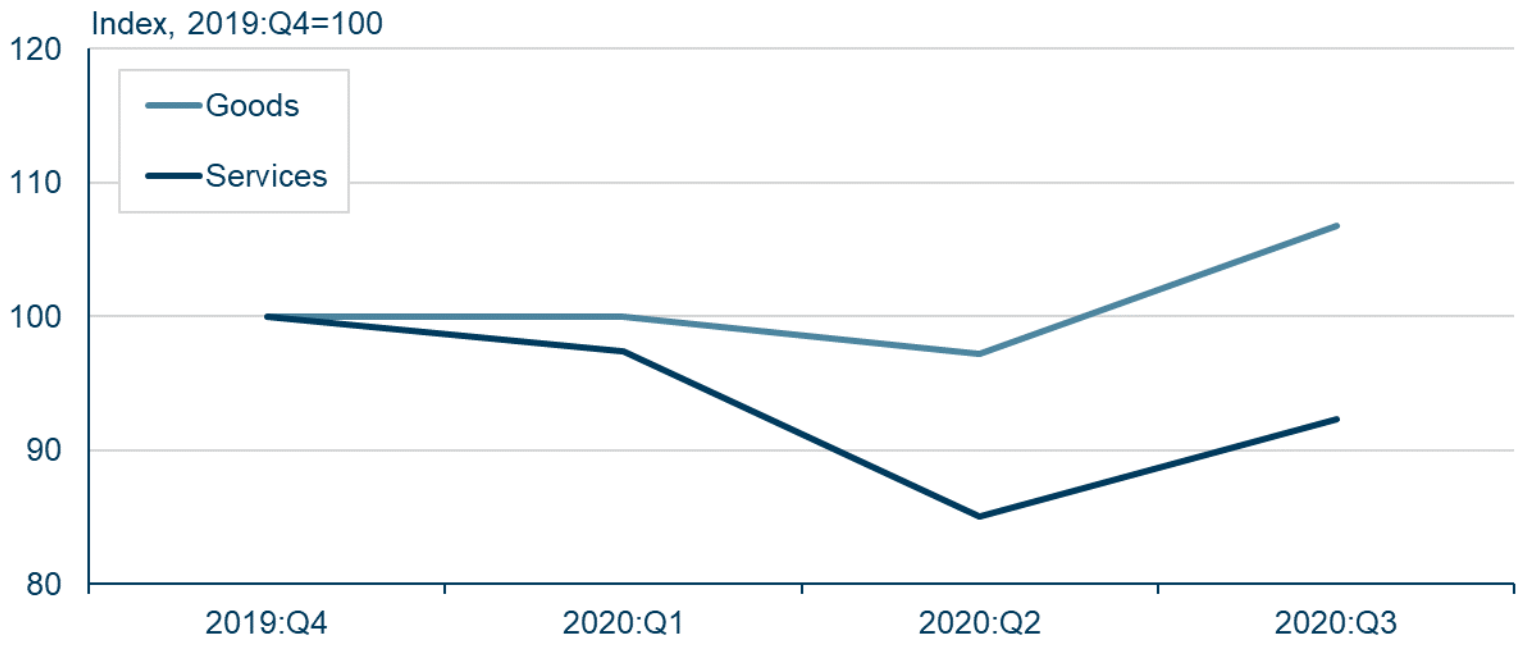


Note: Countries above the dotted line are, given their population, overrepresented in deaths caused by the virus and those below the dotted line are underrepresented in deaths, given their population.

Source: Johns Hopkins University, United Nations Population Estimates for 2020

Figure 2: Real Personal Consumption Expenditures on Goods and Services

2019:Q4 - 2020:Q3



Note: Underlying figures are seasonally adjusted at annual rates.

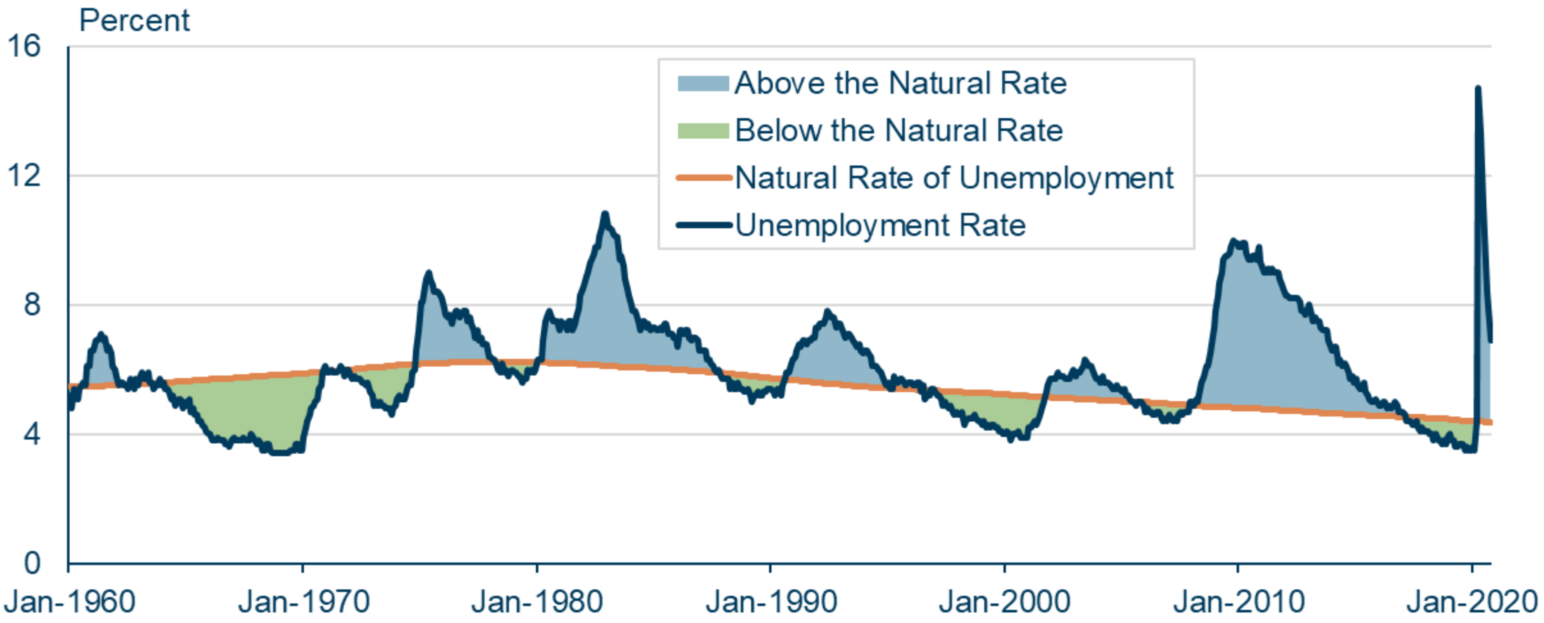
Source: BEA, Haver Analytics

The Current Situation

- U.S. and many European countries have disproportionate pandemic problem
- Countries with pandemic under control are seeing more rapid recoveries
- Developed countries more impacted because economies are more reliant on services than on the production and sale of goods

Figure 3: The Unemployment Rate and the Natural Rate of Unemployment

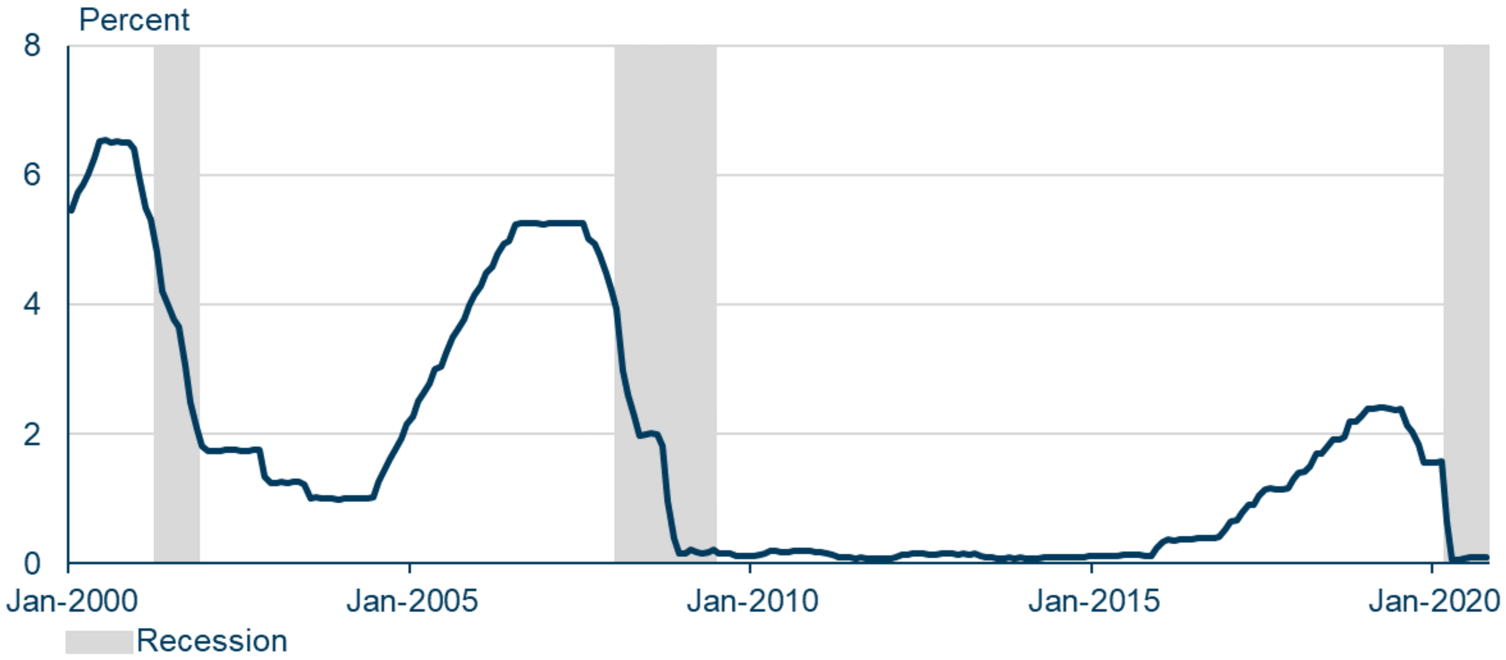
January 1960 - October 2020



Source: BLS, CBO, Haver Analytics

Figure 4: The Federal Funds Rate

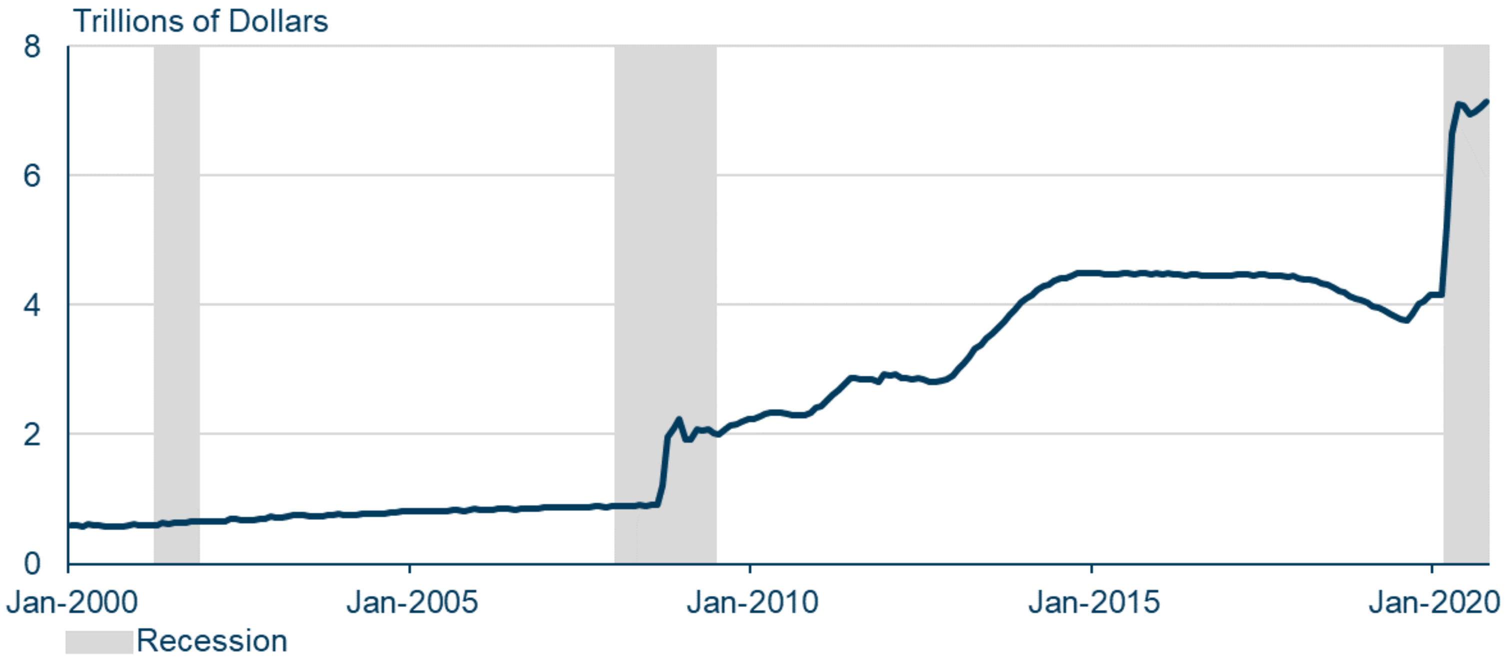
January 2000 - October 2020



Source: Federal Reserve Board, NBER, Haver Analytics

Figure 5: Federal Reserve System Assets

January 2000 - October 2020



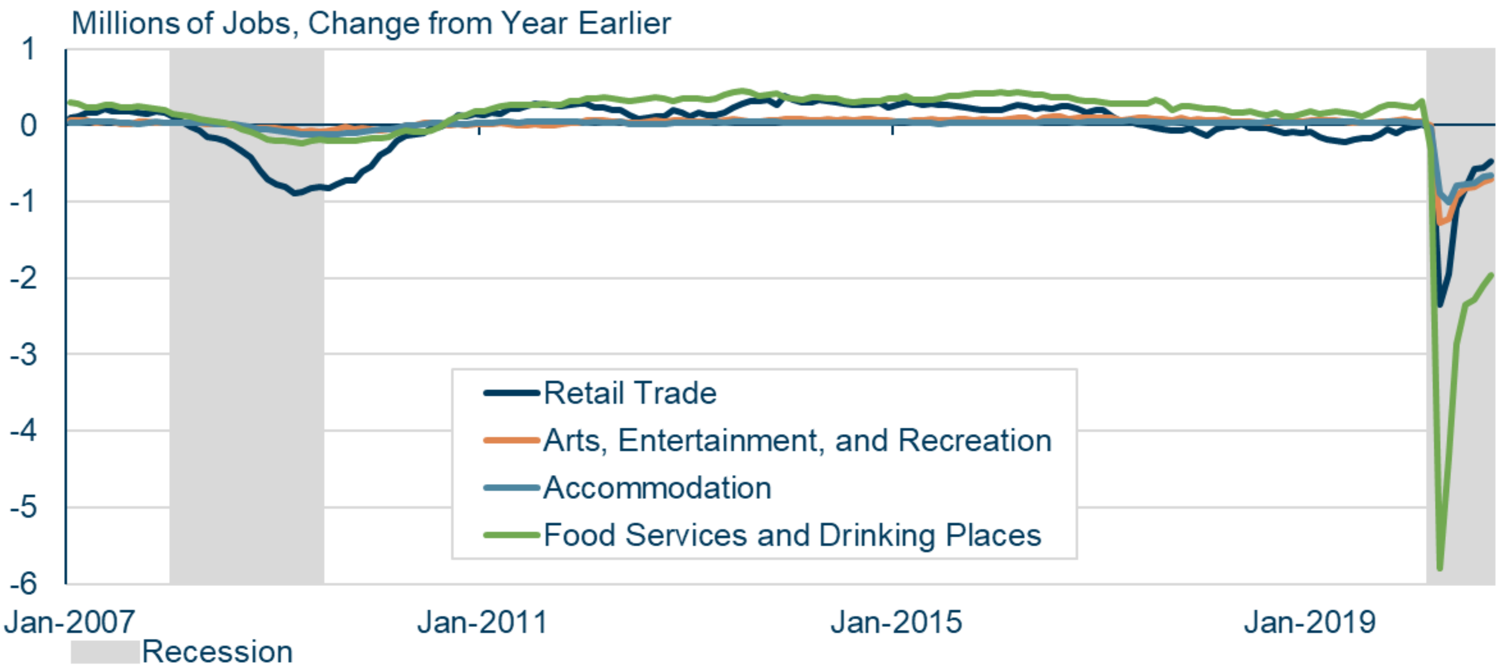
Source: Federal Reserve Board, NBER, Haver Analytics

Monetary and Fiscal Policy Response has been Important Mitigant

- Initial response by fiscal and monetary policymakers was prompt and substantial
- More fiscal and monetary accommodation is appropriate as pandemic worsens
- Imbalances in economy prior to a shock like a pandemic can amplify problems – making the economic recovery more difficult

Figure 6: Payroll Employment Growth in Retail Trade and Leisure and Hospitality Industries

January 2007 - October 2020



Source: BLS, NBER, Haver Analytics

Figure 7: Defaults in the Consumer Discretionary Sector in 2020

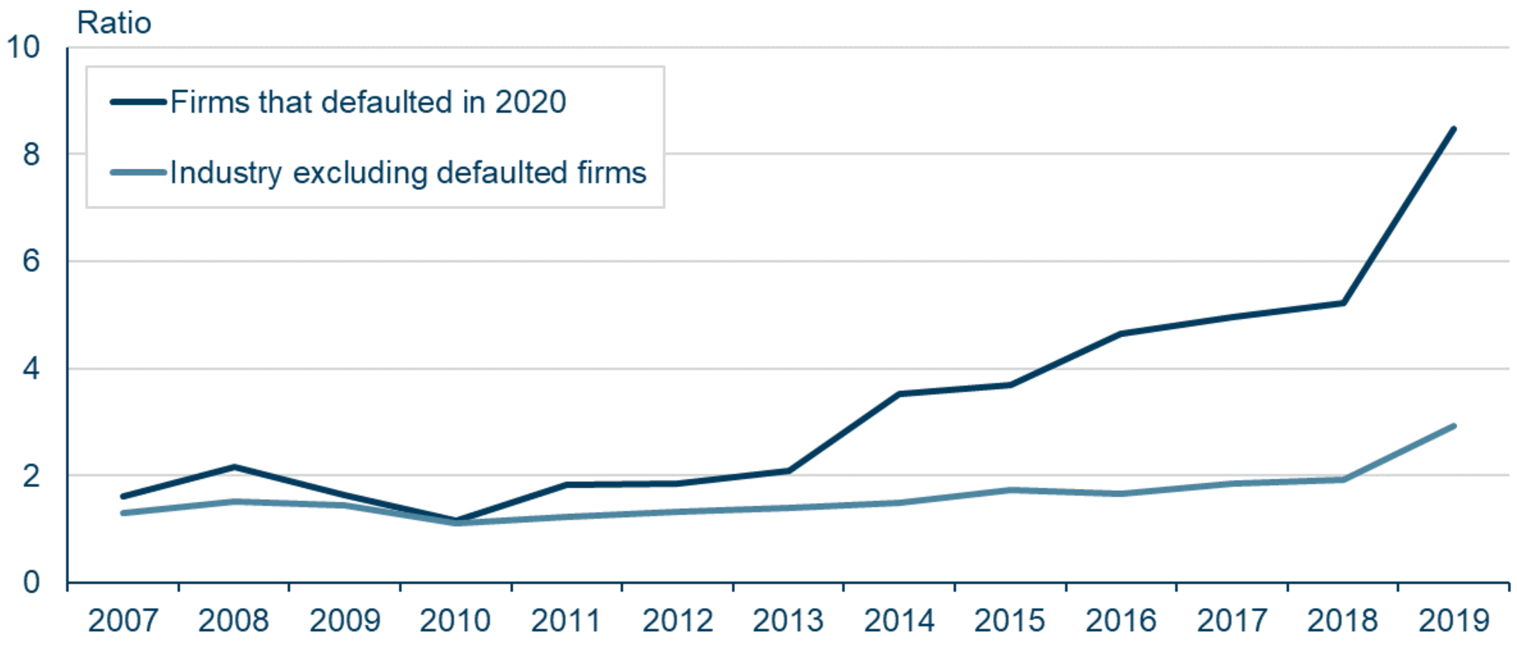
Publicly traded firms that defaulted in 2020	Industry Group	Event Type	Debt / Ebitda	Number of Employees
Tuesday Morning Corporation	Retailing	Bankruptcy, Chapter 11	2	5,749
Bluestem Brands, Inc.	Retailing	Bankruptcy, Chapter 11	2	2,100
Shiloh Industries, Inc.	Automobiles and Components	Bankruptcy, Chapter 11	4	3,600
Tupperware Brands Corporation	Consumer Durables and Apparel	Default	4	11,300
Libbey Inc.	Consumer Durables and Apparel	Bankruptcy, Chapter 11	6	5,872
Ascena Retail Group, Inc.	Retailing	Bankruptcy, Chapter 11	7	33,000
GNC Holdings, Inc.	Retailing	Bankruptcy, Chapter 11	7	8,400
J. C. Penney Company, Inc.	Retailing	Bankruptcy, Chapter 11	8	90,000
Tailored Brands, Inc.	Retailing	Bankruptcy, Chapter 11	9	16,500
CEC Entertainment, Inc.	Consumer Services	Bankruptcy, Chapter 11	10	16,400
Centric Brands Inc.	Consumer Durables and Apparel	Bankruptcy, Chapter 11	10	4,000
Party City Holdings Inc.	Retailing	Default	11	14,350
Neiman Marcus	Retailing	Bankruptcy, Chapter 11	12	13,500
J. Crew Group	Retailing	Bankruptcy, Chapter 11	12	14,500
Stein Mart, Inc.	Retailing	Bankruptcy, Chapter 11	17	5,000
Town Sports International Holdings, Inc.	Consumer Services	Bankruptcy, Chapter 11	20	5,550
Yunhong CTI Ltd.	Consumer Durables and Apparel	Default	69	380
YogaWorks, Inc.	Consumer Services	Bankruptcy, Chapter 11	NA	3,000
Cool Holdings, Inc.	Retailing	Default	NA	528
Pier 1 Imports, Inc.	Retailing	Bankruptcy, Chapter 11	NA	18,000
Horizon Global Corporation	Automobiles and Components	Default	NA	3,600
RTW Retailwinds, Inc.	Retailing	Bankruptcy, Chapter 11	NA	3,192
Stage Stores, Inc.	Retailing	Bankruptcy, Chapter 11	NA	13,600

Note: Data are limited to mostly publicly traded companies and do not include privately held firms, whose financials are not publicly available. Default is defined as a missed or delayed disbursement of interest or principal payment, bankruptcy filing or receivership, or a distressed debt exchange. Total debt includes operating and capital leases. EBITDA is earnings before interest, taxes, depreciation, and amortization. Debt/EBITDA uses the latest available 2019 data. NA depicts firms with negative Debt/EBITDA.

Source: Bloomberg Finance L.P.; S&P Global Market Intelligence's Capital IQ and Compustat, Moody's

Figure 8: Median Debt to EBITDA Ratio for the Consumer Discretionary Sector

2007 - 2019



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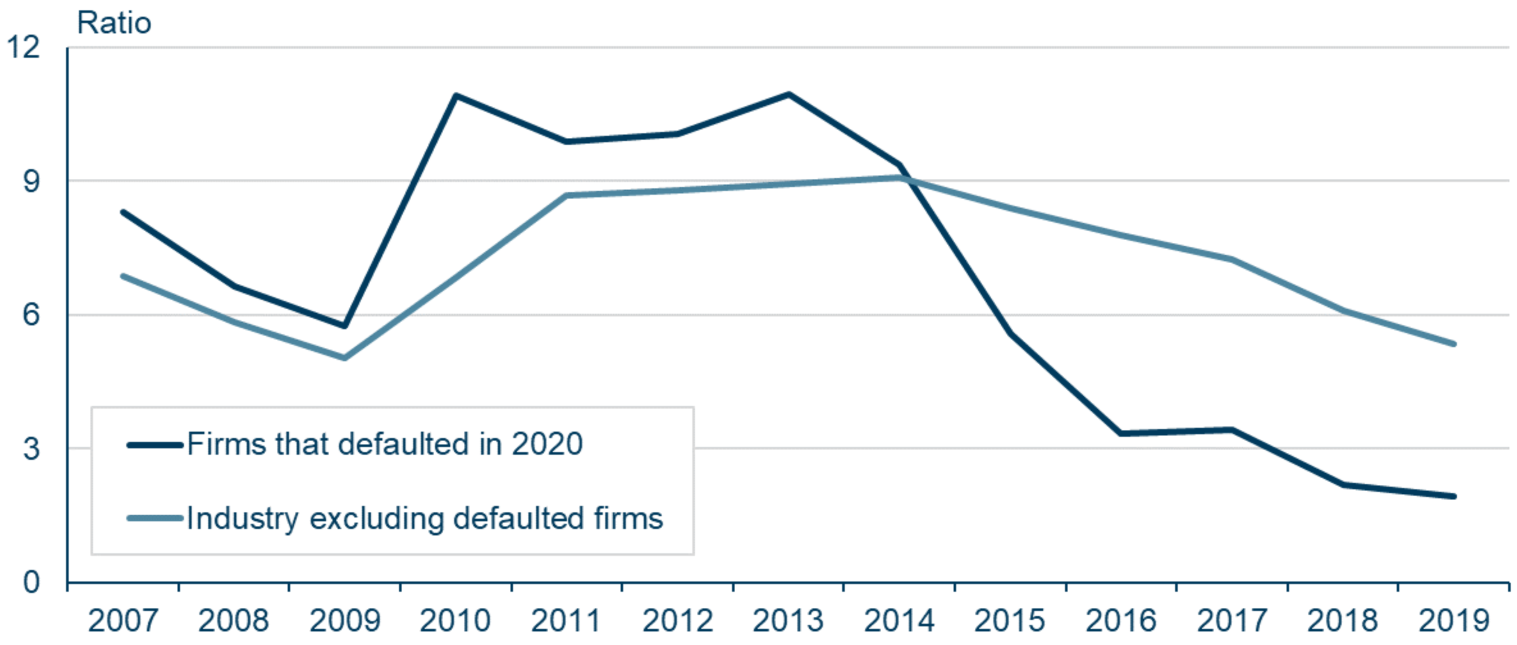
Source: Bloomberg Finance L.P.; S&P Global Market Intelligence's Capital IQ and Compustat, Moody's

Figure 9: Median EBITDA to Interest Expense Ratio for the Consumer Discretionary Sector

2007 - 2019



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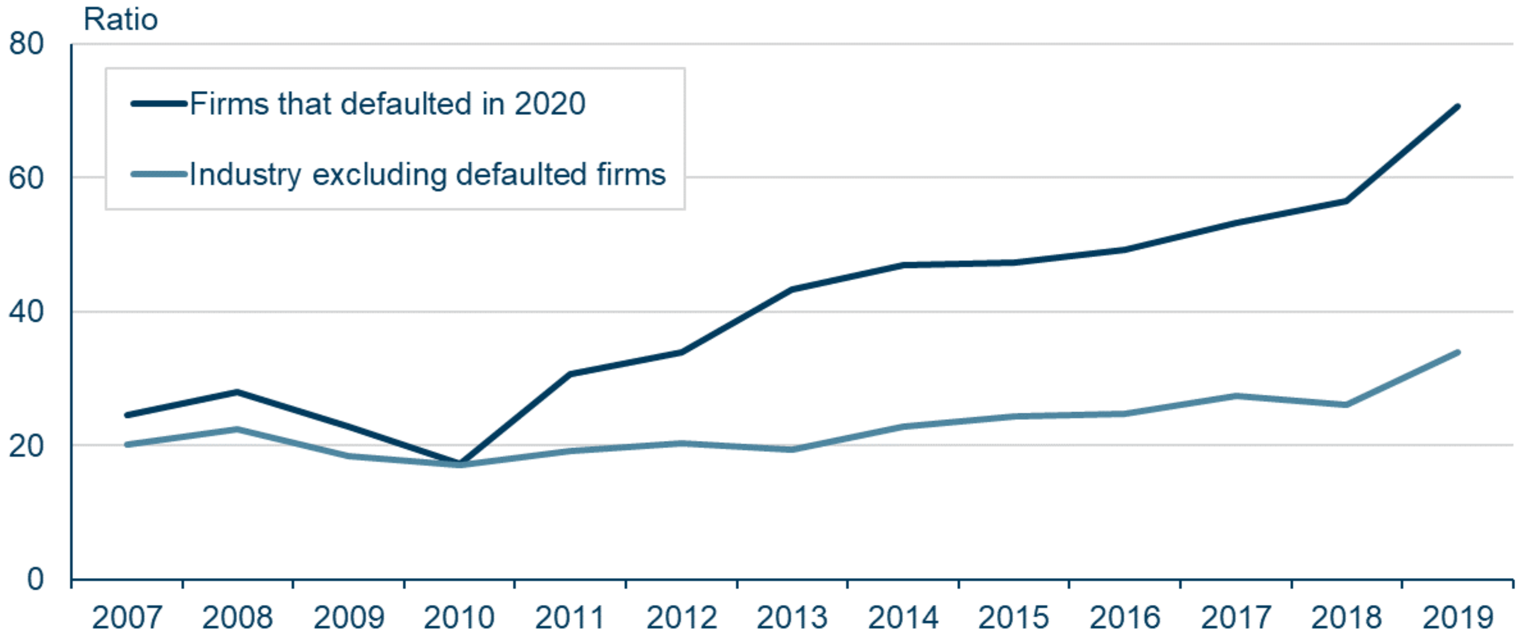
Source: Bloomberg Finance L.P.; S&P Global Market Intelligence's Capital IQ and Compustat, Moody's

Figure 10: Median Debt to Assets Ratio for the Consumer Discretionary Sector

2007 - 2019



Note: Data are limited to mostly publicly traded companies and do not include privately held firms, whose financials are not publicly available. Default is defined as a missed or delayed disbursement of interest or principal payment, bankruptcy filing or receivership, or a distressed debt exchange. Total debt includes operating and capital leases.

Source: Bloomberg Finance L.P.; S&P Global Market Intelligence's Capital IQ and Compustat, Moody's

Severity of Recession related to Pre-pandemic Financial Fragility

- Excessive risk-taking becomes problematic when tail events occur
- Consumer discretionary sector impacted by pandemic
  - Firms with elevated leverage more likely to experience bankruptcy
  - Such risk-taking behavior has implications well beyond shareholders of those firms – customers, suppliers, and employees also hurt

Figure 11: Composition of Service Industries Relative to All Industries

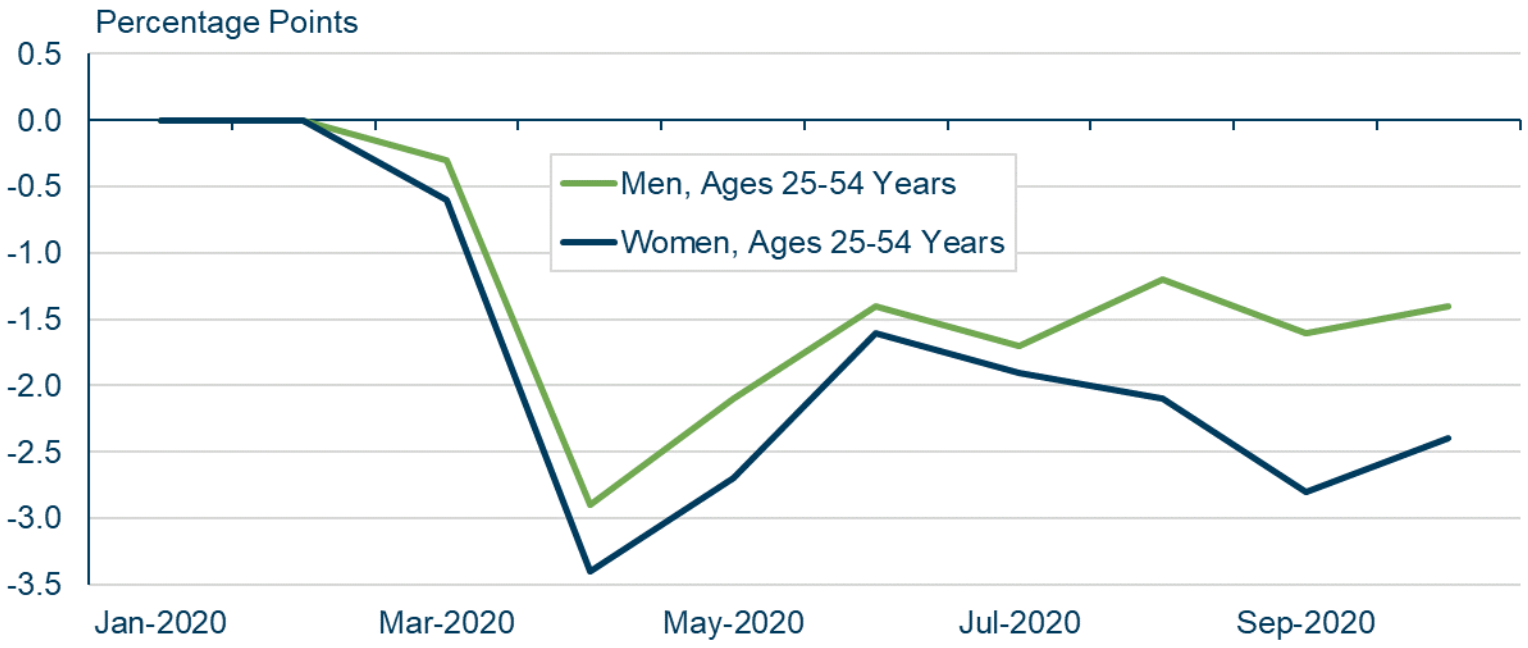
Demographic Group	Industry Share Relative to All Industries Share (Ratio)		
	Services	Retail Trade	Leisure and Hospitality
Women	1.12	1.01	1.08
Black or African American	1.07	0.99	1.05
Hispanic or Latino	0.94	1.05	1.37
Workers Age 16 - 24 Years	1.06	1.79	2.66

Note: Persons whose ethnicity is identified as Hispanic or Latino may be of any race. Based on 2019 annual averages.

Source: BLS, Haver Analytics

Figure 12: Change in the Labor Force Participation Rate Since January for Prime Working-Age Men and Women

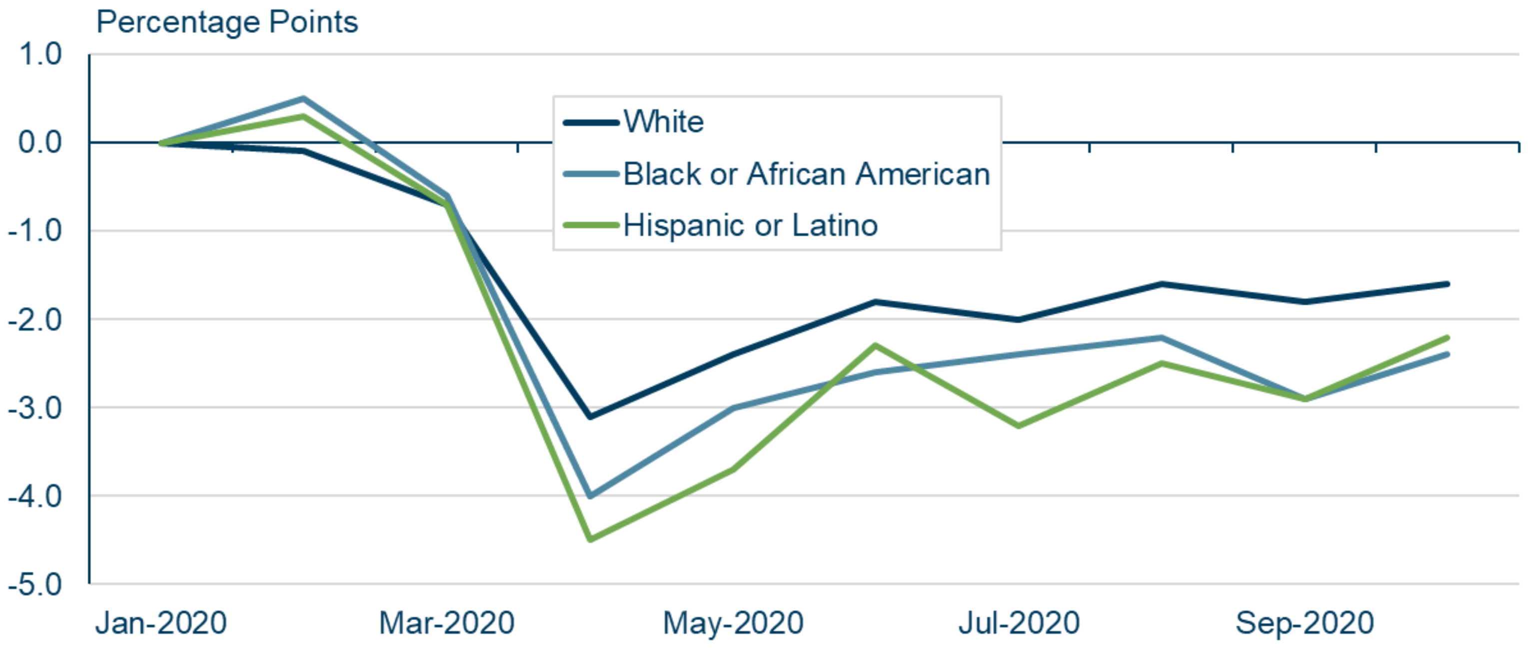
January 2020 - October 2020



Source: BLS, Haver Analytics

Figure 13: Change in the Labor Force Participation Rate Since January by Race and Ethnicity

January 2020 - October 2020



Note: Persons whose ethnicity is identified as Hispanic or Latino may be of any race.

Source: BLS, Haver Analytics

Pandemic's Effect on Vulnerable Populations

- Younger workers, women, and minorities overrepresented in service sector
- Service sector more severely hit by pandemic (challenges of social distancing)
- Troubled firms more likely to lay off workers
- Re-employment difficult when entire sector impacted and risks many workers leaving the workforce

Concluding Observations

- Shocks happen, but many factors impact severity
- Monetary and fiscal response in the U.S. has been important mitigant
- Excessive risk-taking before a shock impacts the severity of the ensuing recession – likely to prolong economic distress for most disproportionately affected and those that can least afford it

Concluding Observations (Continued)

- Policy implications: In the U.S., we're not equipped to limit financial imbalances
  - Lack the governance of many European and Asian countries
  - Lack the tools of many European and Asian countries
- Easy monetary policy requires more guardrails against financial imbalances
- Failure to address likely to result in deeper and longer recessions