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

Index, 2019:Q4=100

- Goods
- Services

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

Millions of Jobs, Change from Year Earlier

-6 -5 -4 -3 -2 -1 0 1

Jan-2007 Jan-2011 Jan-2015 Jan-2019
Recession

Source: BLS, NBER, Haver Analytics
Figure 7: Defaults in the Consumer Discretionary Sector in 2020

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

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
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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

<table>
<thead>
<tr>
<th>Demographic Group</th>
<th>Industry Share Relative to All Industries Share (Ratio)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Services</td>
</tr>
<tr>
<td>Women</td>
<td>1.12</td>
</tr>
<tr>
<td>Black or African American</td>
<td>1.07</td>
</tr>
<tr>
<td>Hispanic or Latino</td>
<td>0.94</td>
</tr>
<tr>
<td>Workers Age 16 - 24 Years</td>
<td>1.06</td>
</tr>
</tbody>
</table>

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
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