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
## 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>
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<tr>
<td>Bluestem Brands, Inc.</td>
<td>Retailing</td>
<td>Bankruptcy, Chapter 11</td>
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<td>2,100</td>
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<tr>
<td>Shiloh Industries, Inc.</td>
<td>Automobiles and Components</td>
<td>Bankruptcy, Chapter 11</td>
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<td>3,600</td>
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<td>Tupperware Brands Corporation</td>
<td>Consumer Durables and Apparel</td>
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<td>Libbey Inc.</td>
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<td>5,872</td>
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<td>Ascena Retail Group, Inc.</td>
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<tr>
<td>GNC Holdings, Inc.</td>
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<td>8,400</td>
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<tr>
<td>J. C. Penney Company, Inc.</td>
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<td>Tailored Brands, Inc.</td>
<td>Retailing</td>
<td>Bankruptcy, Chapter 11</td>
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<td>16,500</td>
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<tr>
<td>CEC Entertainment, Inc.</td>
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<td>16,400</td>
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<tr>
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<td>Consumer Durables and Apparel</td>
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<td>4,000</td>
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<tr>
<td>Party City Holdings Inc.</td>
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<td>Default</td>
<td>11</td>
<td>14,350</td>
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<tr>
<td>Neiman Marcus</td>
<td>Retailing</td>
<td>Bankruptcy, Chapter 11</td>
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<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>
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<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>Default</td>
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<td>3,000</td>
</tr>
<tr>
<td>Cool Holdings, Inc.</td>
<td>Retailing</td>
<td>Default</td>
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<td>528</td>
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<td>Pier 1 Imports, Inc.</td>
<td>Retailing</td>
<td>Bankruptcy, Chapter 11</td>
<td>NA</td>
<td>18,000</td>
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<td>Horizon Global Corporation</td>
<td>Automobiles and Components</td>
<td>Default</td>
<td>NA</td>
<td>3,600</td>
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<td>RTW Retailwinds, Inc.</td>
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</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
Figure 8: Median Debt to EBITDA 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. EBITDA is earnings before interest, taxes, depreciation, and amortization. Total debt includes operating and capital leases. Firms with negative EBITDA, which have no debt service capacity, on balance, are excluded from computations.

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

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. EBITDA is earnings before interest, taxes, depreciation, and amortization. Total debt includes operating and capital leases.

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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
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