

## **Will the Coronavirus Take the Economy Back to 2008?**

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Here's some good news: in many countries, the coronavirus pandemic has already been brought under control. And here in the U.S., it's reasonable to expect that we'll reach that point in the next month or so. The bad news? At that point, our problems will not be over. Instead, we will need to reckon with the damage that has been done to the U.S. and global economies—and that damage will extend well beyond the end of the pandemic.

That damage is real—it exists now and is getting worse every day. But much of the current discussion is focused more on the possible downside than the most likely outcome; that is, it has been focused on what *could* happen, rather than what likely *will* happen. So, let's take some time to think through what is likely to happen with the economy. We won't ignore the could happen—it is important to understand the downside risk—but we also will not assume the end of the world.

### **A 9/11 Event: Sudden Shock to the Economy**

The base question here is whether the pandemic is more like a 9/11 event (where a sudden shock derails the economy that then takes time to recover) or a 2008 crisis (where the system itself seems to be falling apart). The could-happen commentary assumes this situation is a 2008. It could be, and we can draw a path to that outcome. But so far at least, it seems this is more like a 9/11 event.

Let's think about what 9/11 really was, from an economic standpoint. There was an exogenous shock, a sudden event that nobody had thought was coming. It shook everybody's behavior, shook everybody's actions, and there was a sudden collapse in demand as people stayed home. Looking back, many people stayed home for at least two weeks after 9/11 because no one knew what else was going to happen. And even after that, they were more cautious. The economy slowed until people recovered their confidence.

### **A Massive Crisis of Confidence**

A sudden, terrifying event. People staying home and not spending. Does this scenario sound familiar? It should, because it is exactly what we're seeing right now. Further, it's going to last until, first, the pandemic is brought under control and, second, until people regain confidence.

Given that, the economic impact is going to be greater and longer lasting than 9/11. But once again, we have a similar situation where most of the economic damage comes from the fact that people are scared, and they're pulling back. Once we know the virus is under control, economic activity and confidence will eventually come back. In 2008, the system itself was threatened with collapse. But right now, we have a massive crisis in confidence, and that's something that can come back over time. As such, right now, it looks more like 9/11.

### **Could This Crisis Become Another 2008?**

Yes, and there are two main ways. First, we are likely to see much greater unemployment than we saw after 9/11. With the lockdowns, large parts of the restaurant and hospitality industry are now shut down. That's a lot of jobs. Add in airlines, retail, and all other public-facing jobs, and you have potentially millions of people who suddenly have no income. You also have millions of businesses that are suddenly out of business. Every day of that is a tragedy for them and real damage for the economy. If it lasts beyond a couple of weeks—as it likely will—that alone could bring down the economy. Second, if that economic damage led to sustained disruptions in the financial system, that would make the crisis directly like 2008. We might be seeing signs of that in the bond market right now.

So yes, the current 9/11 situation could evolve to a 2008, and we should consider that possibility. The question is whether that is the most likely case or whether (like the pandemic itself) there is something that can be done that would avert that worst case. Once again, there is, and signs are that what needs to be done is in fact being done. We could see a 2008 but we're not there yet. In fact, because of the lessons learned 12 years ago, the likelihood is that we won't get there.

### **How Can We Avoid Long-Term Damage**

First, we need the Federal Reserve (Fed) to support the financial system. As of last Sunday, the Fed just went all in to do just that. It cut interest rates to near zero in an unprecedented move, it arranged to push capital into the financial markets to stabilize the system, and it changed the rules to let banks lend more to businesses in need. In other words, the Fed said very explicitly, whatever it takes, we're going to get in and we're going to get in early before a 2008 collapse can even start.

Here is the big difference from what happened in 2008. Back then, nobody knew what was happening with the financial system. Nobody really believed a collapse could happen. When it threatened, both the Fed and Congress balked at doing what was necessary. This time, they know what might happen and are determined to prevent it. On monetary policy, the Fed has done everything it can do—and it is prepared to do more.

But monetary policy can only do so much. For the suddenly unemployed, and for businesses that were just shut down, we need fiscal support from the government. Here again, the news is good. Congress is on board and is in the process of changing policies to help the people and businesses in trouble. While the details are not yet finalized, there is a clear decision from both the House and the White House that what is needed will be done. It looks like the government will mandate money for people who can't work and is talking about sick leave for people who need to take sick leave. These actions won't eliminate the damage, but they will help contain it. Other countries around the world are doing the same thing.

### **A Solvable Problem**

Just as with the pandemic itself, with the economic damage we know what the problem is. We know how to manage the problem, both fiscally and monetarily, and we are working on it. We're not there yet. It depends on politics, but again, this is eminently a solvable problem and we're on track to solve it. There will be economic damage, but right now it looks far more likely to be short term and limited rather than long term and systemically threatening. Just as with the pandemic itself, the situation is far from ideal—but certainly solvable.

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