

Arizona Economy: A Shock to the System



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The Arizona economy suffered a major shock to the system in March 2020, with government- and self-imposed social distancing and the outright shutdown of important sectors. This sent the national and state economies into a tailspin the likes of which few people have experienced. The impact on Arizona employment, unemployment, retail sales, and income will be devastating. If we can get control of the outbreak by the summer months, the economy has a chance to vigorously rebound. The interim forecast summarized here assumes that this happens, but it is by no means guaranteed.

There is still a huge amount of uncertainty about the future of the outbreak and the economic impacts associated with it. Regarding the outbreak, the question at this point seems to be: will it be very bad or very, very bad. The economic uncertainties are similar. We are on track for a major downturn, the question is how bad and for how long. This interim forecast update is our first step in assessing the damage and the recovery. As events unfold in coming weeks and months, we will know more about the economic impacts and the prospects for recovery. Stay tuned to the Forecasting Project website for updated information.

Finally, in this rapidly evolving environment, it is impossible to keep up with current events. As you read through

the forecast tables, keep in mind that they were produced before the statewide “stay-at-home” decree was issued. They were also completed before the \$2 trillion federal fiscal stabilization package (CARES act) was enacted. Most of that additional federal spending was not included in the forecast.

Arizona Outlook

To generate the forecasts for Arizona, Phoenix, and Tucson, the national forecast (summarized below) is combined with my assumptions about the impact of travel-and-tourism industry shutdowns on employment and retail sales. I assume massive reductions in employment in leisure and hospitality during the second quarter of 2020, driven by the government- and self-imposed social distancing measures. Conditions improve little in the third quarter. To give you a sense of the impact, employment in leisure and hospitality is assumed to drop from 336,000 in the fourth quarter of 2019 to 162,000 in the second quarter of 2020. Taxable sales at retail establishments and restaurants and bars also experience a huge decline in the second quarter.

The current projections put the magnitude of the coming downturn at something similar to the Great Recession (2008-2009) but shorter in duration. Under current assumptions, it is a short, sharp shock. Total nonfarm employment in Arizona declines by 300,000 from the first quarter to the third quarter of 2020. That translates into a decline of 10.0%. For comparison, Arizona lost 305,000 jobs from peak to trough (quarterly) during the Great Recession. That was an 11.4% drop.

The state unemployment rate surges to 11.0% by the fourth quarter of 2020, but then drops rapidly.

Taxable retail sales decline this year, as job, income, and wealth declines take a toll on consumers. Sales at restaurants and bars gets hit harder, given the additional headwind from

social distancing.

Population growth slows, with reduced net migration, and that generates lower levels of housing permit activity. Keep in mind that the population estimates are measured on July 1 of the year, which is near the worst of the downturn.

Once we get past the shock, the recovery should be strong. Arizona was in very good shape before the outbreak and once the outbreak is under control, growth will accelerate significantly.

National Outlook

The March 20 interim U.S. forecast from IHS Markit calls for a severe economic downturn. It begins with a modest -0.8% annualized real GDP decline in the first quarter of 2020, followed by a giant -12.6% drop in the second quarter. The recession concludes in the third quarter with a drop of -1.1%. The unemployment rate rises to a peak of 8.8% by the end of 2020. The shape of the recovery is expected to look like the Nike-swoosh: a large drop followed by a gradual recovery.

The monetary policy response is assumed to be very accommodative, with the federal funds rate near zero for the foreseeable future.

The federal fiscal policy response recently enacted (CARES Act) is not included in the forecast. However, the forecast does include cash disbursements to individuals in the amount of \$500 billion in the second quarter. IHS Markit assumes that much of the cash disbursement is saved, and thus the boost to real GDP growth in the second quarter is a modest. It increases the real GDP growth rate by less than 0.5%.

The peak-to-trough decline in real GDP is -3.8%. For perspective, the peak-to-trough decline during the six quarter long Great Recession was -4.0%.

The drop in real GDP in the second quarter would be the largest on record (going back to the official start of the time series in 1947). The next biggest single quarter drop was in the first quarter of 1958 (-10.0%). The largest drop during the Great Recession (2008Q1-2009Q2) was -8.4%.

Risks to the Outlook

At this point it is easier to envision downside risks than upside risks, so do not be surprised if subsequent forecasts are downgraded. However, there are upsides to the outlook. We may find effective treatment for the disease sooner rather than later. The federal fiscal stability package (and subsequent packages) may turn out to be effective in buffering some of the worst impacts of the downturn.

To learn more go to <https://www.azeconomy.org/>

In this interview taped on **Friday March 27, 2020**, EBRC Director George Hammond discusses the COVID-19 recession and factors that will impact the speed of economic recovery once the virus is controlled in this Arizona 360 interview with Lorraine Rivera.