# Financial Stability Factors and the Severity of the Current Recession

Eric S. Rosengren
President & CEO
Federal Reserve Bank of Boston

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Mossavar-Rahmani Center for Business & Government, Harvard University's Kennedy School of Government

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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

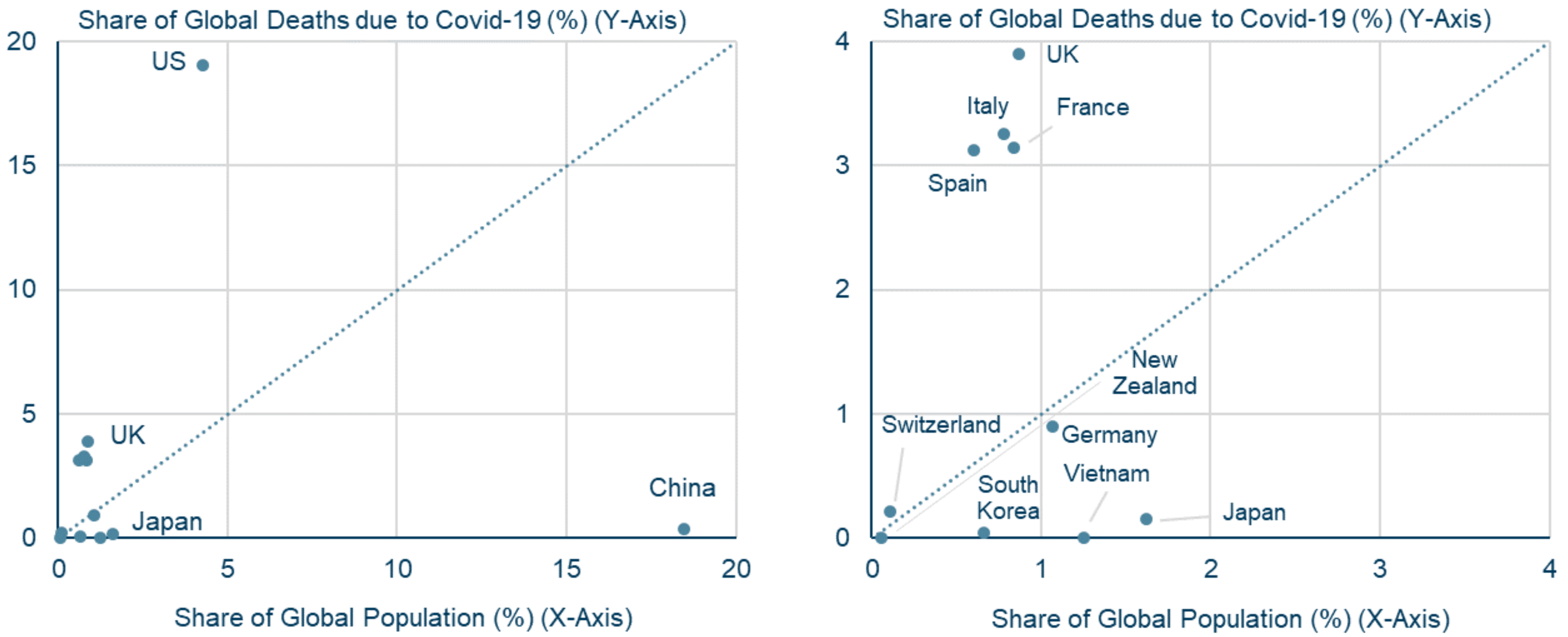
- FOMC intention: Maintain current low level of interest rates until 2 percent inflation
- Implies being slower to raise rates than in previous recoveries
  - Reflects concerns about below-target inflation over previous decade
  - Risk of households and firms taking on more leverage and risk

# 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

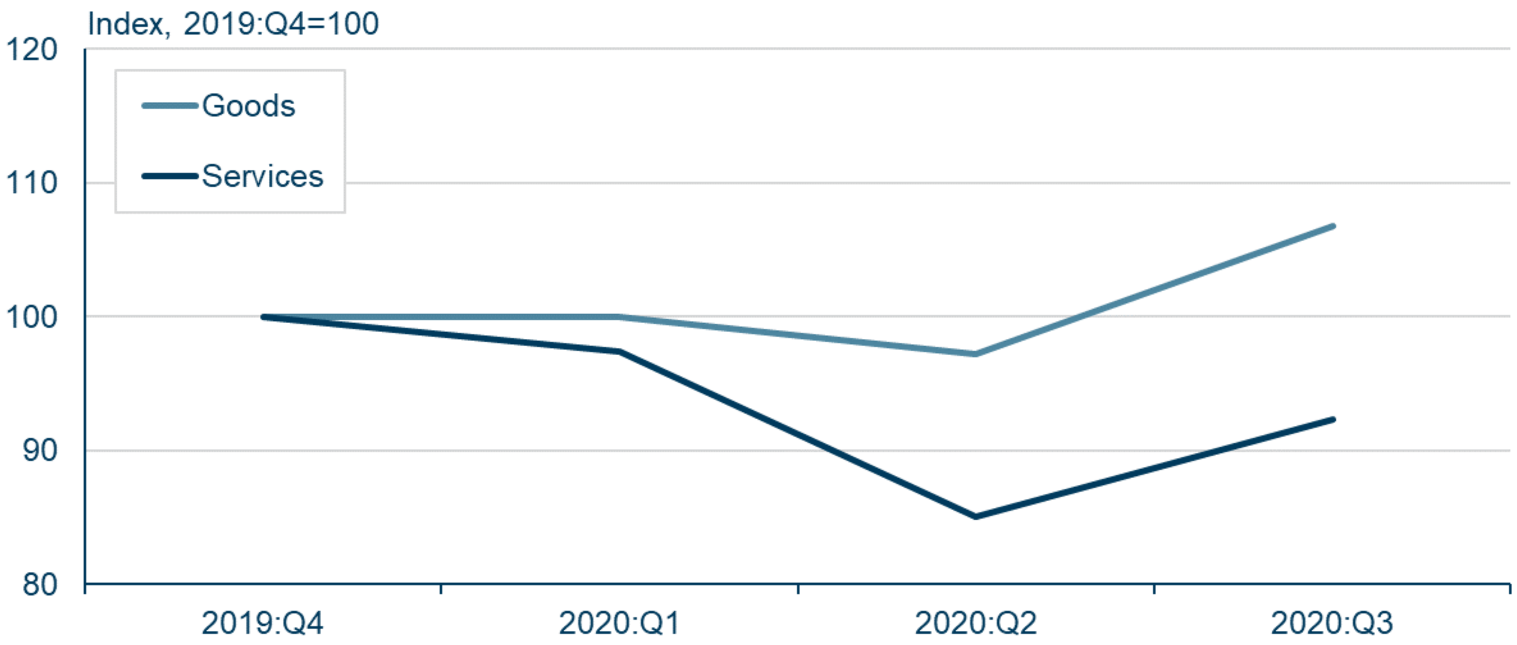



*Note: Countries above the dotted line are, given their population, overrepresented in deaths caused by the virus and those below the dotted line are underrepresented in deaths, given their population.*

*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.*

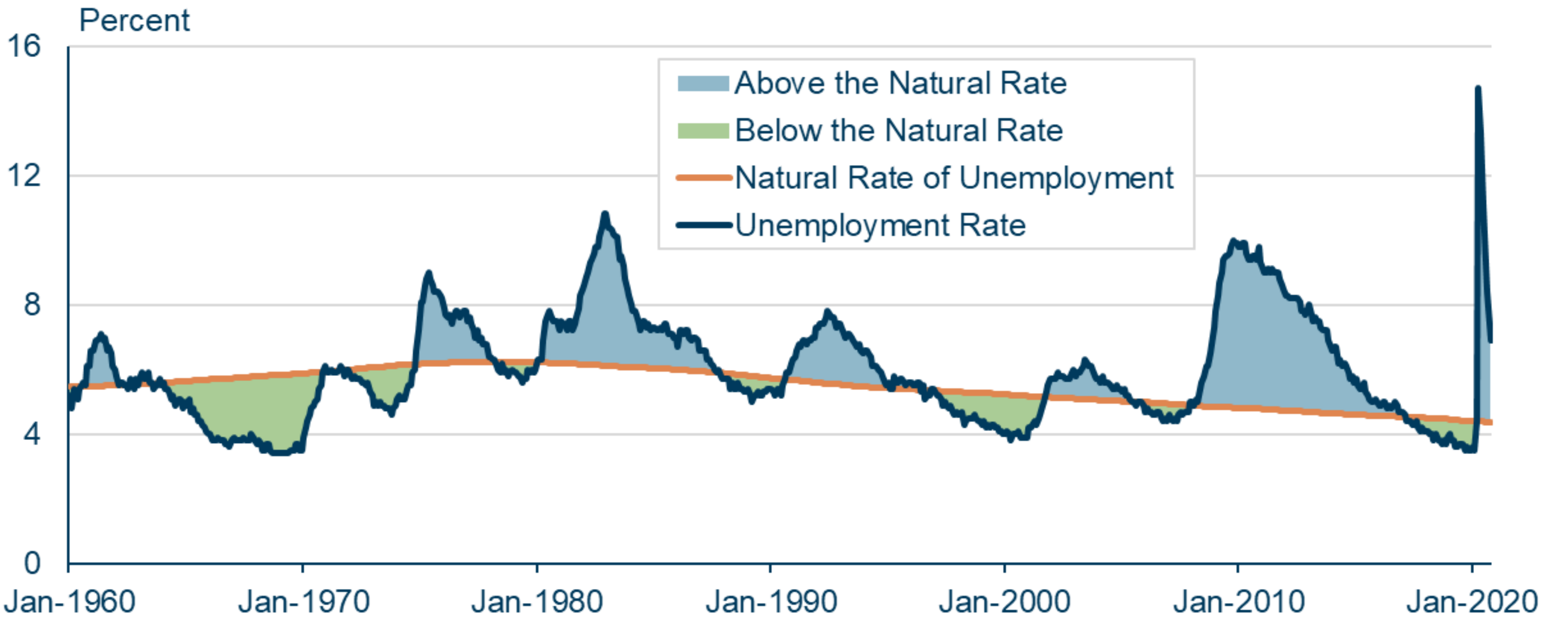
*Source: BEA, Haver Analytics*

# 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

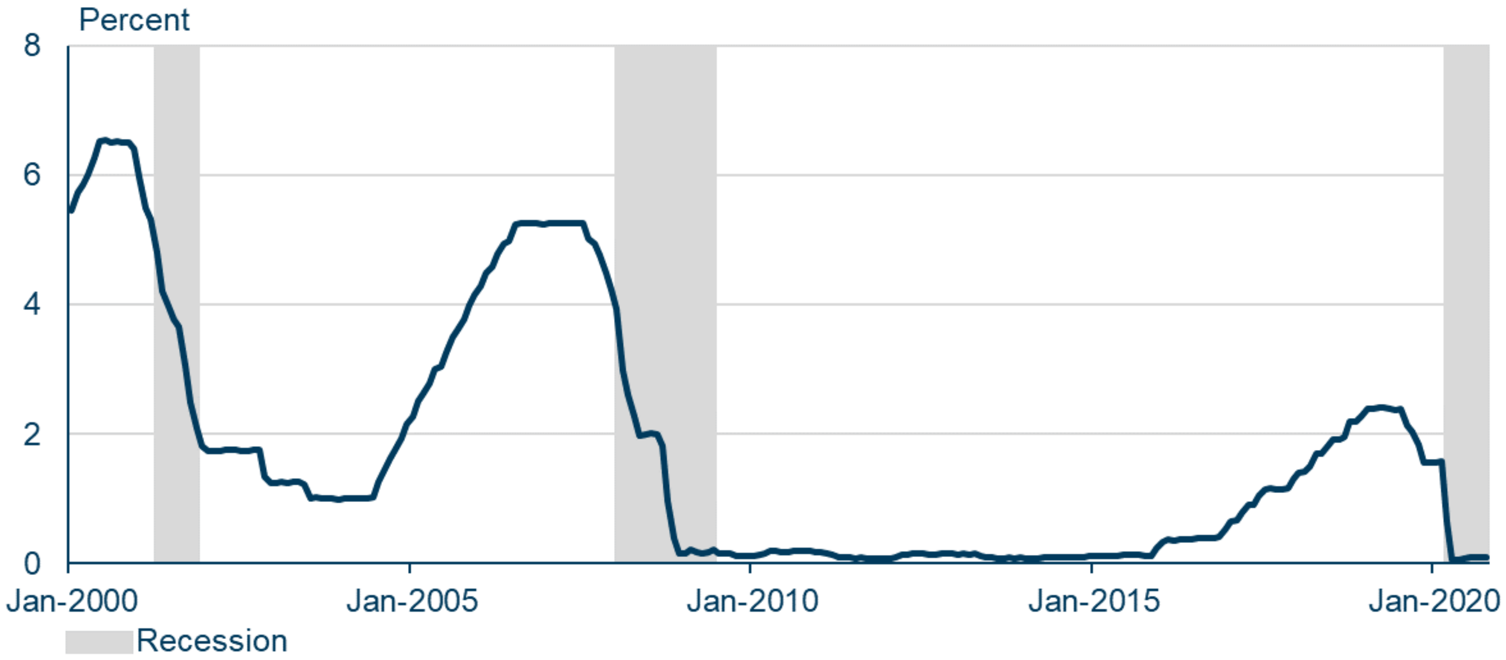
# Figure 3: The Unemployment Rate and the Natural Rate of Unemployment

## January 1960 - October 2020




*Source: BLS, CBO, Haver Analytics*

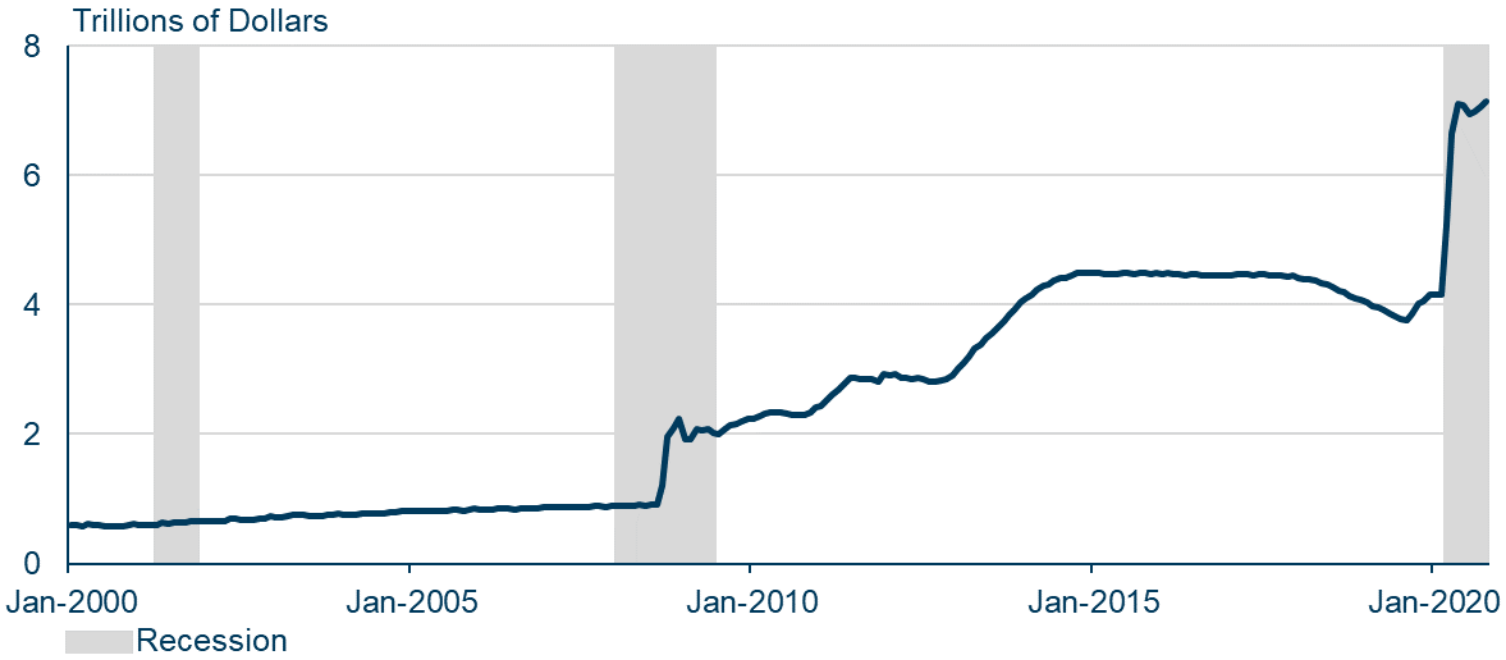
# Figure 4: The Federal Funds Rate
## January 2000 - October 2020




*Source: Federal Reserve Board, NBER, Haver Analytics*

# Figure 5: Federal Reserve System Assets

## January 2000 - October 2020



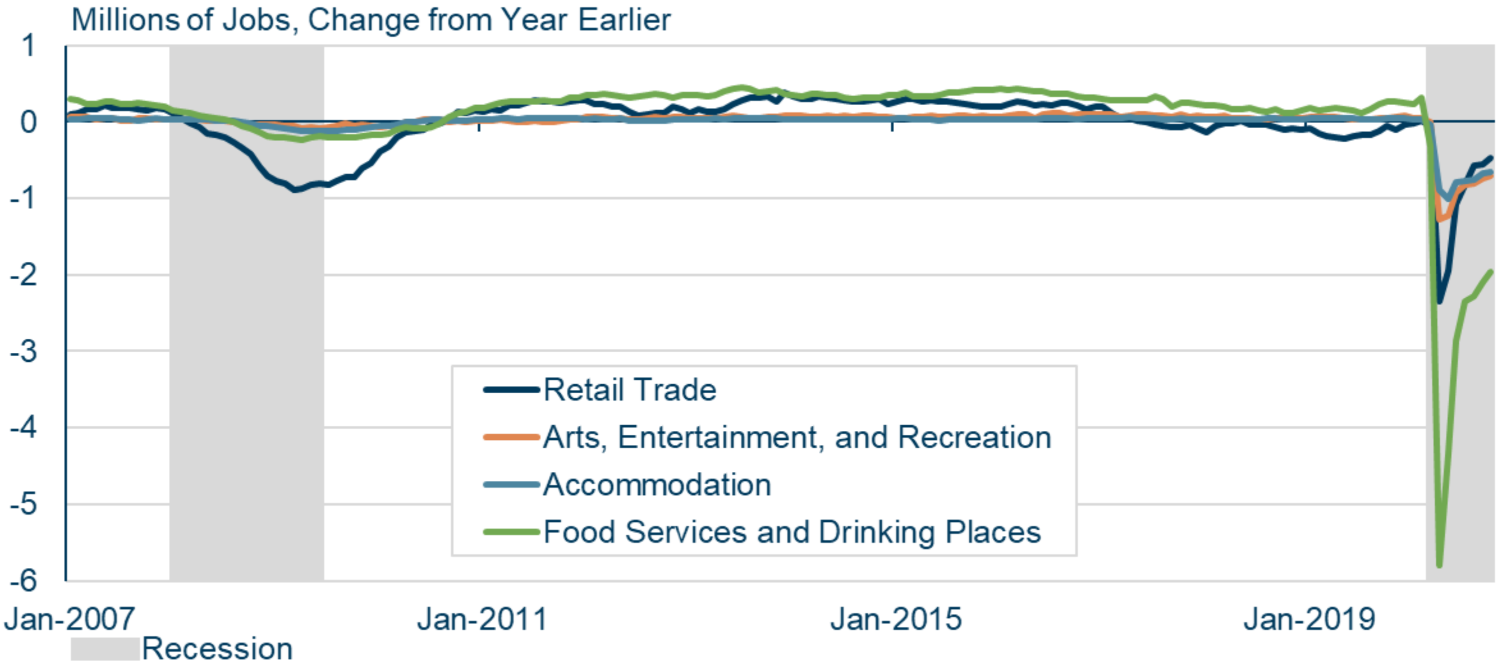

*Source: Federal Reserve Board, NBER, Haver Analytics*

# 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

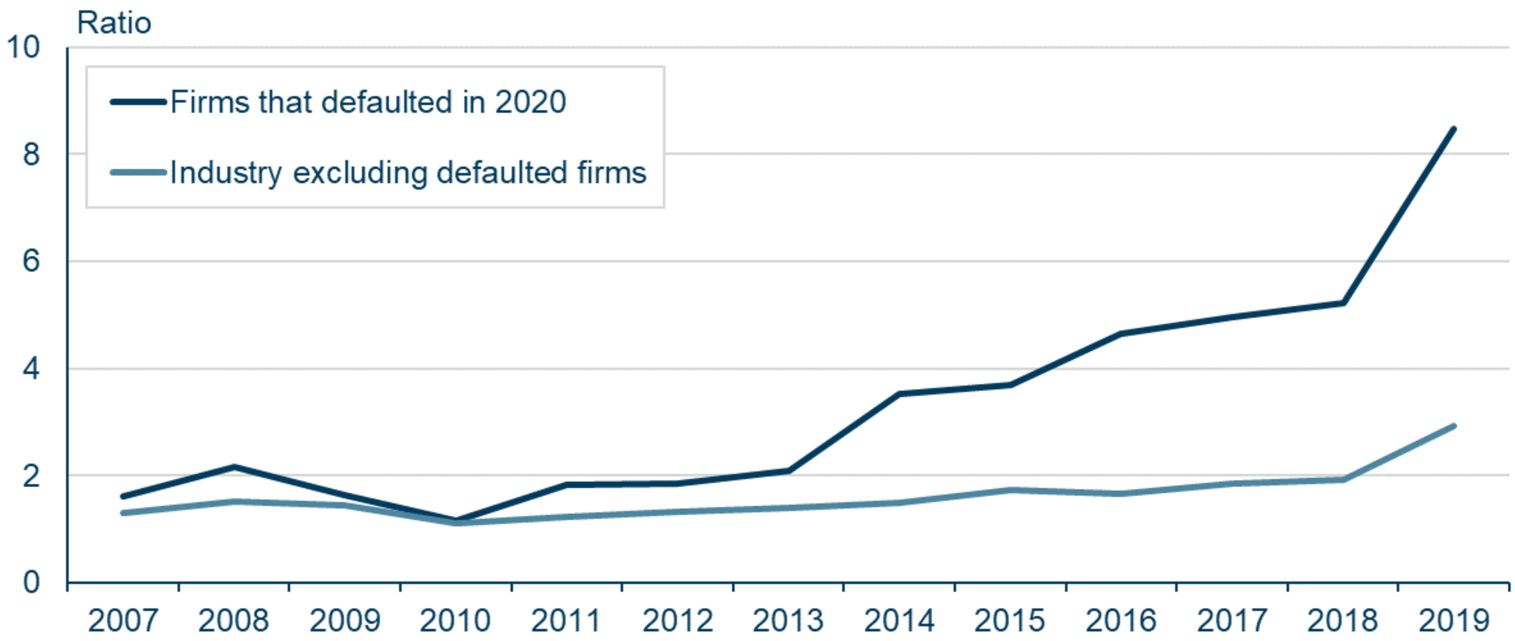
| Publicly traded firms that defaulted in 2020 | Industry Group | Event Type | Debt / Ebitda | Number of Employees |
|---|---|---|---|---|
| Tuesday Morning Corporation | Retailing | Bankruptcy, Chapter 11 | 2 | 5,749 |
| Bluestem Brands, Inc. | Retailing | Bankruptcy, Chapter 11 | 2 | 2,100 |
| Shiloh 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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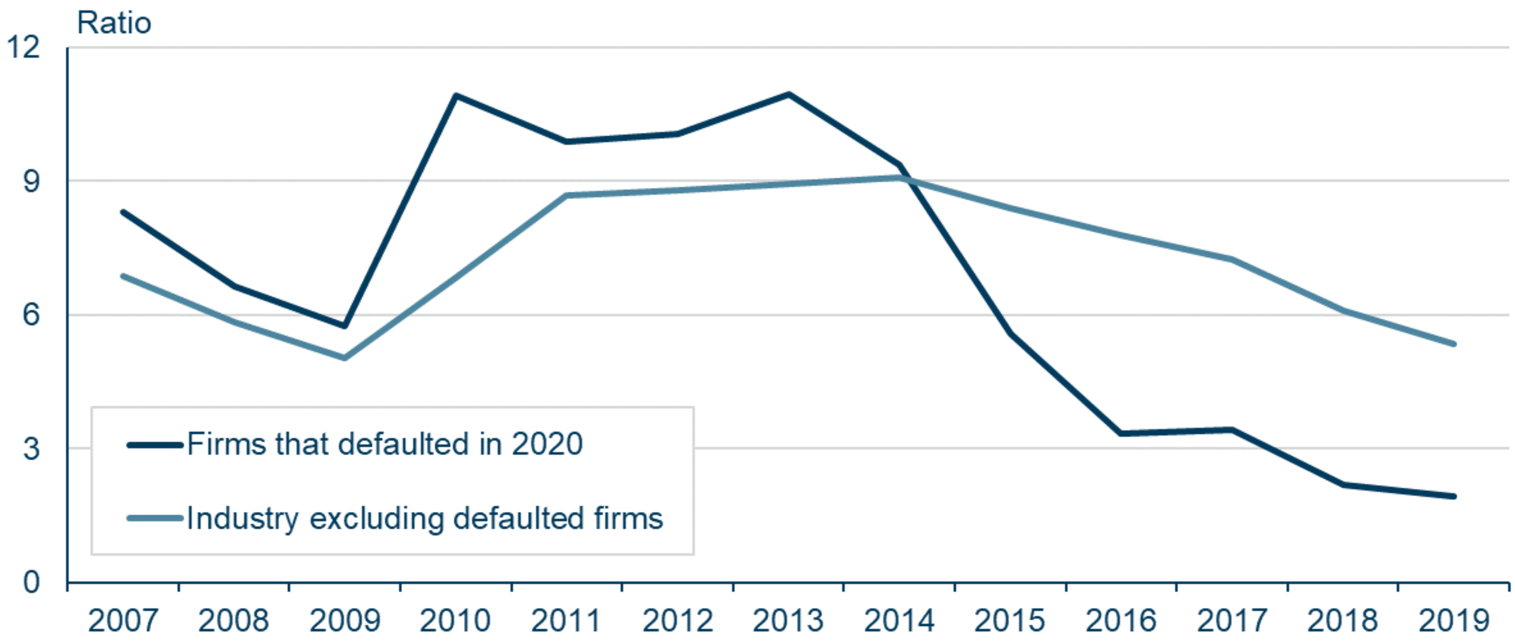
*Source: Bloomberg Finance L.P.; S&P Global Market Intelligence's Capital IQ and Compustat, Moody's*

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

## 2007 - 2019

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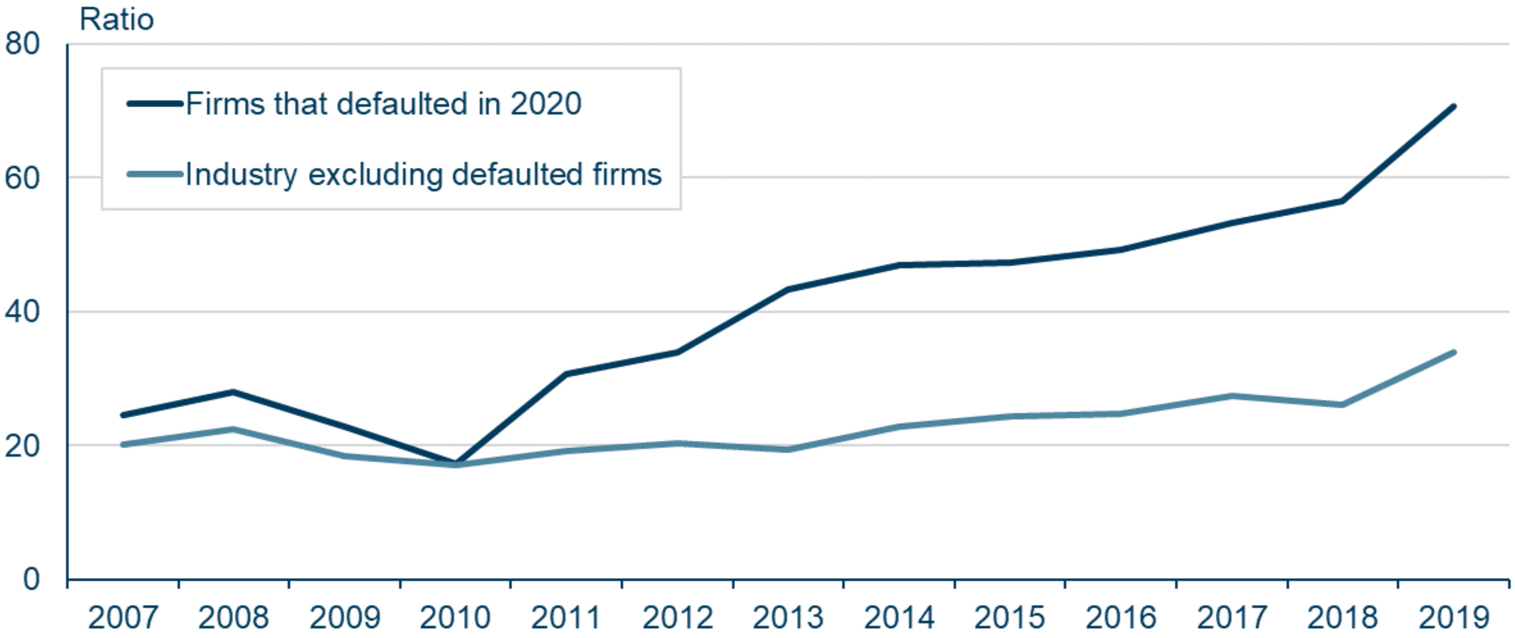
*Source: Bloomberg Finance L.P.; S&P Global Market Intelligence's Capital IQ and Compustat, Moody's*

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

2007 - 2019

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*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

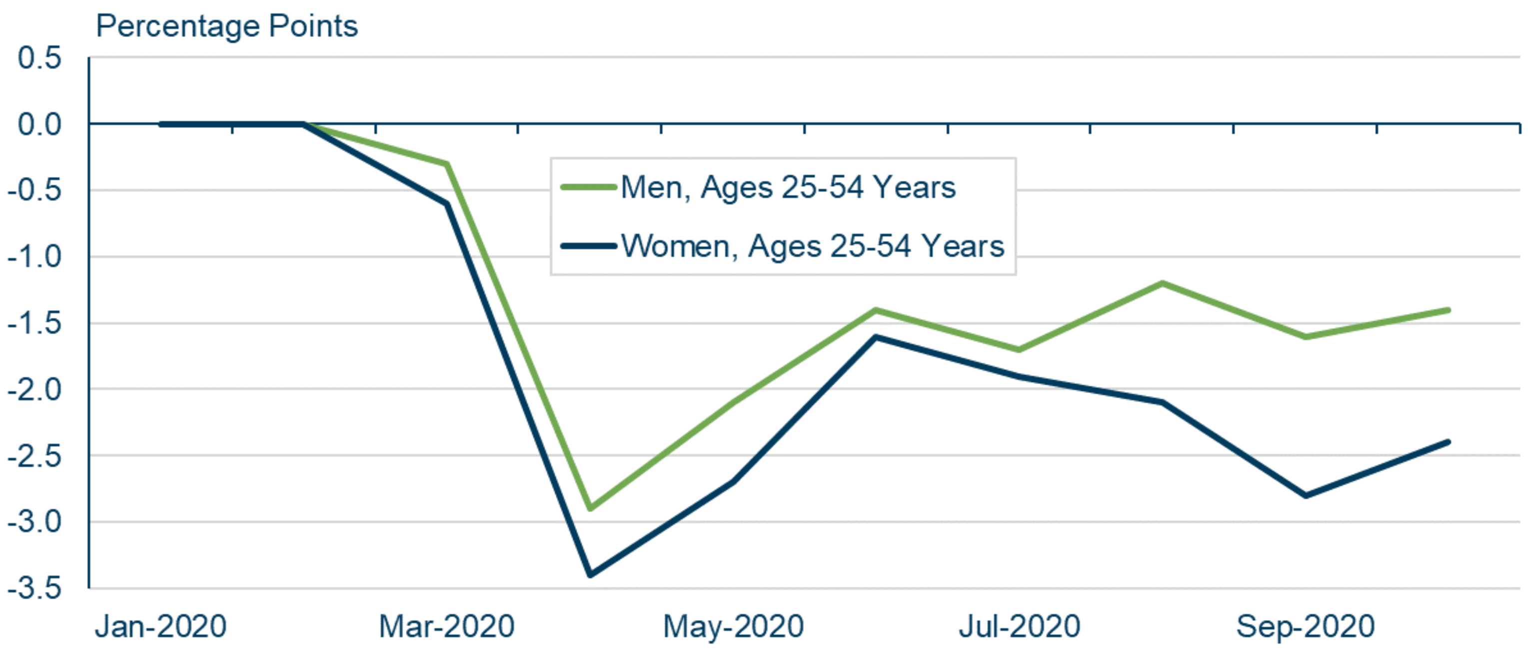
| Demographic Group | Industry Share Relative to All Industries Share (Ratio) | | |
|---|---|---|---|
| | Services | Retail Trade | Leisure and Hospitality |
| Women | 1.12 | 1.01 | 1.08 |
| Black or African American | 1.07 | 0.99 | 1.05 |
| Hispanic or Latino | 0.94 | 1.05 | 1.37 |
| Workers Age 16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

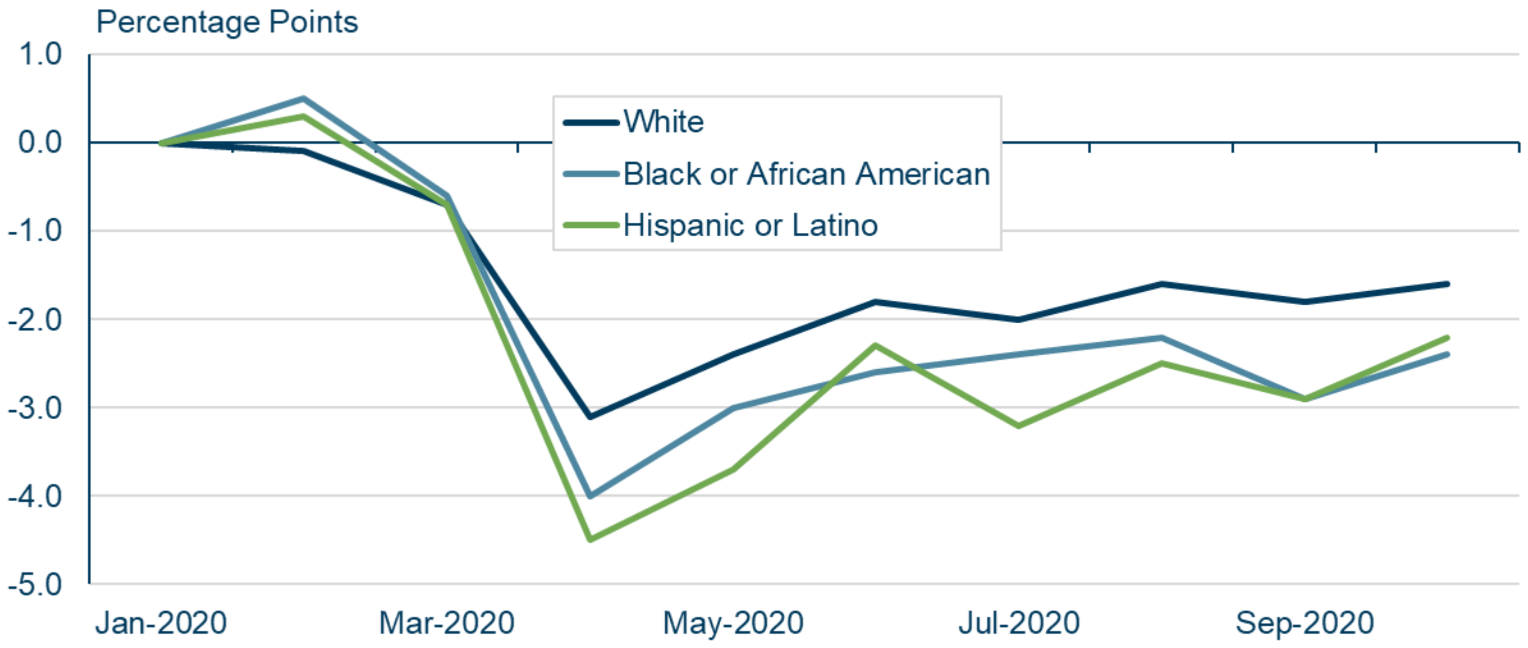
## January 2020 - October 2020




*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