Economic Outlook Deteriorates due to COVID-19: Short and Long Run Implications for North American Supply Chains

Pia M. Orrenius, Vice President
Federal Reserve Bank of Dallas
Baker Institute and US-Mexico Foundation
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DISCLAIMER: The views expressed are my own and do not necessarily reflect the views of the Federal Reserve Bank of Dallas or Federal Reserve System.
US, Texas & Mexico COVID-19 cases still growing

Despite lower growth rates, U.S. cases have multiplied about 3-fold in past month; Mexico cases 9-fold:

As of April 10:
- U.S. confirmed cases: 496,535
- Texas confirmed cases: 12,105
- Mexico confirmed cases: 3,844

As of May 10:
- U.S. confirmed cases: 1,329,260
- Texas confirmed cases: 39,258
- Mexico confirmed cases: 35,022

- New cases in U.S. May 9: 19,710

Sources: John Hopkins, World Bank
Notes: Cases are the cumulative reported number of cases as of 10pm on May 10, 2020.
Economic decline has followed public and private health measures

- Remote work implemented where possible
- Shelter in place and social distancing orders
- Closures of businesses, amenities; canceled events
  - Essential vs non essential businesses
  - Parks and other common areas
  - Sports events, concerts, other arts & recreation events
- Use mandated of personal protective equipment (PPE)
- COVID-19 testing & contact tracing ramped up
- Addition of medical supplies, hospital beds
Is economic activity bottoming out?

Social distancing in US, Texas has peaked and is declining

NOTE: Data through April 30, 2020.
Economic Conditions
After 20+ million jobs lost in April, US unemployment rate skyrockets; Texas expected to follow.

NOTE: Data through March 2020 for Texas and April 2020 for the U.S.. Dashed line shows estimation of April rate for Texas.

U.S. forecasts suggest recovery begins in 3rd quarter

<table>
<thead>
<tr>
<th>2020 GDP growth Q/Q annualized</th>
<th>GDP Growth Q4/Q4</th>
<th>UR (Q4)</th>
<th>Peak Quarterly UR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q1</td>
<td>Q2</td>
<td>Q3</td>
<td>Q4</td>
</tr>
<tr>
<td>Average</td>
<td>-4.8</td>
<td>-35.7</td>
<td>18.1</td>
</tr>
<tr>
<td>Low</td>
<td>-4.8</td>
<td>-31.8</td>
<td>2.0</td>
</tr>
<tr>
<td>High</td>
<td>-4.8</td>
<td>-27.4</td>
<td>22.2</td>
</tr>
</tbody>
</table>

Source: Forecasts from 7 large financial institutions; low (high) refers to most pessimistic (optimistic) year/year GDP growth forecast.
Mexico outlook also dire, economy was shrinking before COVID-19 and policy response limited

- GDP fell 6.2 percent in first quarter after stagnating in 2019
  - Steeper decline is predicted for second quarter
  - Forecast is for a >7 percent decline for the year (2020)
- Employment in formal sector fell 8.5 percent in March
- Peso down 30 percent from February
- Moody’s downgraded Mexico’s credit rating, and Pemex debt cut to junk
Oil woes in the region don’t help: Prices collapse, Texas rig count follows

NOTE: Data are weekly, through the week ending May 8, 2020.
SOURCES: EIA; Baker Hughes.
Policy responses
Monetary and fiscal policy response expansive in US, more limited in Mexico

Monetary policy
  • Reduced the policy rate
  • Boosted liquidity
  • Support lending programs to businesses

Fiscal policy
  ▪ US & Mexico: tax payment deferrals for businesses
  ▪ US: large monetary transfers implemented to workers, families; grants and loans to businesses, state and local governments and to hospitals, health care providers
Implications for trade
U.S. and Mexico business cycle synchronicity reveals deeply integrated cross-border manufacturing

Percent, Y/Y

NOTE: Monthly changes in manufacturing component of industrial production.

SOURCES: INEGI; Federal Reserve Board.
US manufacturers rely on NAFTA supply chains: U.S. content highest in imports from Mexico, Canada

NOTE: Data is from 2004.
Summary

- COVID-19, fear of infection and private and public health measures have led to a historically large and rapid economic decline across North America.
- Sharp oil price declines are making matters worse in energy-producing regions, including Texas and Mexico.
- Policy response will boost recovery in US, limit it in Mexico.
- Trade is slowing; successful recovery depends on coordination of reopening across the supply chain.
- USMCA implementation can complicate matters; introduces additional challenges, especially in motor vehicle manufacturing.
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