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

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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.
COVID-19 Update
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
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

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

<table>
<thead>
<tr>
<th></th>
<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>Average</td>
<td>-4.8</td>
<td>-5.7</td>
<td>10.1</td>
</tr>
<tr>
<td>Q2</td>
<td>Low</td>
<td>-35.7</td>
<td>-8.6</td>
<td>14.0</td>
</tr>
<tr>
<td>Q3</td>
<td>High</td>
<td>18.1</td>
<td>2.0</td>
<td>5.6</td>
</tr>
<tr>
<td>Q4</td>
<td></td>
<td>10.1</td>
<td>0.9</td>
<td>9.9</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 more dire, economy was shrinking before COVID-19 and policy response limited

- GDP fell 6.2 percent in first quarter after stagnating in 2019
  - Far 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.

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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

Percent

<p>| | |</p>
<table>
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<tbody>
<tr>
<td>Mexico</td>
<td>40</td>
</tr>
<tr>
<td>Canada</td>
<td>25</td>
</tr>
<tr>
<td>Weighted Average (Mex-Can)</td>
<td>32</td>
</tr>
<tr>
<td>China</td>
<td>4</td>
</tr>
</tbody>
</table>

NOTE: Data is from 2004.
U.S. exports highly correlated with intermediate imports from Mexico

SOURCES: Bureau of Economic Analysis and Haver Analytics.
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
Thank you!
Please visit dallasfed.org for more information
Long term effects of transition to USMCA trim automotive sector output

A. Effect on Light Vehicle Production
Thousands of units

B. Effect on GDP
Percent
Texas Exports to China Plunge after Tariffs Imposed

Index, 2011=100, 3mma, real $, SA

- Europe (15.1%)
- Asia ex. China (22.6%)
- Canada (8.4%)
- Mexico (34.0%)
- Others (15.8%)
- China (3.5%)

NOTE: Numbers in parentheses are share of Mar. 2020 Texas exports.
SOURCES: U.S. Census Bureau; Bureau of Labor Statistics.
Texas Exports Drop in 2020

*Seasonally adjusted, real dollars.
NOTE: Numbers in parentheses refer to share of Mar. 2020 Texas exports.
SOURCE: Census Bureau; Bureau of Labor Statistics.
U.S. loses over 20 million jobs in April

NOTES: Dotted lines are long-run growth from January 1990 to December 2019: U.S. 1.1; Texas 2.1
SOURCES: BLS; Texas Workforce Commission; seasonal and other adjustments by FRB Dallas.