Predictions of Strong Economic Rebound Are Too Optimistic

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The far better than expected jobs report for May released earlier this month – showing a whopping 2.5 million new jobs created last month and an unemployment rate which dipped to 13.3% – set off a wave of optimism regarding US economic growth prospects in the second half of this year.

However, as I explained on *June 9* in these pages, the May jobs report looked as good as it did because the Labor Department decided *not* to count millions of workers who were furloughed or had their hours cut to zero as unemployed – on the thinking they would be going back to work soon. Unfortunately for many, that is not likely to happen.

Yet despite that major *"miscalculation"* the Labor Department admitted, most economists are now issuing very favorable forecasts for growth in the second half of this year. It's clear most forecasters have bought into the idea that we're going to see a strong "V" shaped recovery in the 3Q and 4Q. I simply do not believe that is what will happen.

I still believe we are going to see millions of small and medium-sized businesses go bankrupt in the second half of this year. For example, a new report from the Independent Restaurant Coalition predicts that as many as 85% of independent restaurants may be gone by the end of this year. That's stunning! But the fact is, most restaurants simply can't survive operating at only 25%-50% of capacity.

Even if retail businesses were able to reopen at full capacity, that is no guarantee consumers will return in numbers anywhere close to what they were before the coronavirus outbreak. It could easily be the second half of 2021 before we see that happen, if at all.

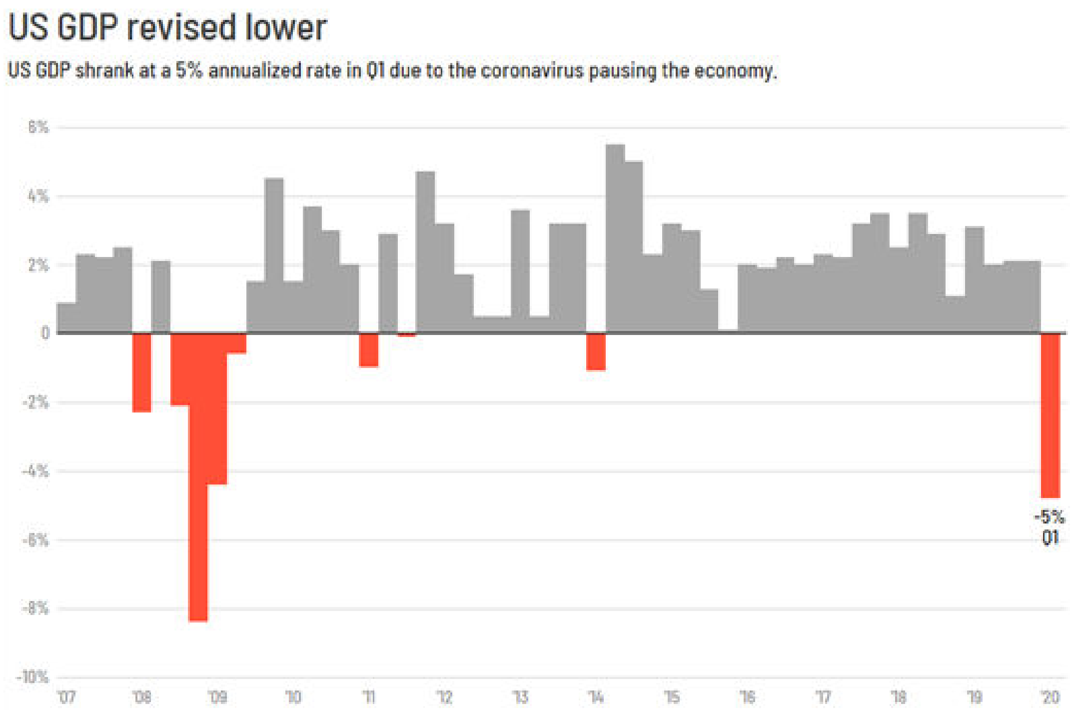
Today, we'll take a look at some of the rosy forecasts for second half US economic growth and why I think they could prove to be far too optimistic. Let's get into the numbers.

The Illusion of a Rapid US Economic Recovery Just Ahead

Ironically, a growing number of economists are warning Democrats that the US economy will come roaring back later this year, just in time to insure President Trump is re-elected in November. Even Paul Krugman, the high-profile *New York Times* ultra-liberal columnist, is predicting this scenario.

Forecasters widely agree the 2Q has been an economic disaster, and most predictions have GDP plunging by 30%-40% (annual rate) in the current quarter, the worst since the Great Depression. However, forecasts for the second half of this year suggest a huge rebound.

The Congressional Budget Office (CBO), for example, predicts a surge in GDP of 23.5% in the 3Q and over 20% in the 4Q. That would be the strongest economic growth in decades. Yet the flaw in this line of thinking is the assumption that US consumers will soon return to their normal spending habits, making up roughly 70% of GDP, over the next couple of months.



Yet as I have predicted consistently since the coronavirus pandemic arrived, there is no evidence consumers are about to return to spending virtually everything they make and taking on ever-increasing amounts of debt. The personal savings rate skyrocketed to a record 33% of disposable income in April. That trend is not going to change overnight as many forecasters would have us believe.

Faced with ongoing uncertainty over the coronavirus and the economy, US consumers will continue to save more and spend less in the months just ahead. Even if the government replaces their lost incomes for a time, people know that stimulus is short term. What they do not know is when the next job offer – or layoff – will come along.

Moreover, people now clearly distinguish between needs and wants. For example, Americans need to eat, but they mostly don’t need to eat out. Many don’t need to travel by air. Restaurant owners and airlines, therefore, have two big problems: they can’t cover costs while their capacity is limited for public-health reasons, and demand would be down even if the coronavirus disappeared.

This explains why many businesses are not reopening even though they legally can. Others are reopening but fear they cannot hold out for long. And the many millions of workers in America’s vast services sector are realizing that their jobs are simply not essential. This is yet another reason why the economy is not going to come roaring back just ahead.

Let me be clear: I’m not saying there will not be an economic rebound just ahead. There will be, of course, following the worst contraction (-30%-40% in 2Q GDP), but the rebound is almost certain to disappoint. Think of it this way: If GDP plunges 30%-40% in the 2Q, and then rebounds 23.5% in the 3Q as the CBO predicts, we are nowhere back to where we were.

Amount of Loss Incurred	Return Needed to Break Even
20%	25.0%
30%	42.9%
40%	66.7%
50%	100%
60%	150%

For example, let’s say the economy contracts by 35% in the 2Q. To recover from a 35% drawdown, the economy has to surge by 53.8% going forward to get back to breakeven. Some forecasters believe that is possible in the second half of this year, but I highly doubt it.

That would require the fastest economic recovery in modern history, and I don’t see any way consumer spending can ramp up that dramatically in the second half of this year. I will be very happy if I am proven wrong, but I just don’t see it.

85% of Independent Restaurants May Be Gone This Year

A new report by the Independent Restaurant Coalition (IRC) warns that as many as 85% of non-chain restaurants may permanently close by the end of this year due to the COVID-19 pandemic. Independent restaurants, which comprise over 70% of all restaurants, rely more heavily on dine-in revenue than chains and don’t have a corporate safety net or cash reserve to fall back on.

Restaurant owners say that while the Paycheck Protection Program (PPP) loans have provided a temporary lifeline, they won’t prevent independent restaurants from incurring serious losses that will force them out of business later this year when the loans are no longer available.

Owners also say it will be a long time before dine-in revenues return to pre-pandemic levels, meaning that most independent restaurants will be forced to operate at a loss. The IRC is pushing for a $120 billion federal grant from Congress as soon as possible.

Although the restaurant industry as a whole has suffered major losses during the pandemic, independent restaurants like mom-and-pop diners, neighborhood eateries and fine dining establishments are much more at risk than fast-food chains like McDonald's and Starbucks. Independents, which comprise over two-thirds of all restaurants, rely much more heavily on dine-in revenue and don't have the corporate resources that make some chain franchises so resilient in the face of disaster.

Restaurants have long operated on razor-thin margins. For sit-down restaurants, those margins are decimated by capacity limits, which will likely be in place until a coronavirus vaccine is found. Many restaurants that have pivoted to takeout and delivery have found that it simply isn't profitable. A recent survey of San Francisco restaurant owners found that 87% said they would not be able to survive on just delivery and takeout, and 60% said they're losing money by staying open.

It's likely that restaurants won't be able to return to pre-pandemic business levels until they're able to open dining rooms at full capacity without social distancing restrictions. Although May saw the return of nearly 1.4 million restaurant jobs, that recovery trajectory is unlikely to persist through the coming months as most restaurants continue to operate at a loss.

Especially in dense urban areas, social distancing protocols are a death sentence for non-chain restaurants that pay high rent and rely on densely-packed dining rooms. Some cities and states have been letting restaurants spill out onto sidewalks, parking spaces and even closed streets as part of a partial easing of their lockdown orders.

But even that is not a lasting solution as it does not get them back to near full capacity. A May survey of restaurants in New York City found that most owners say they must get back to at least 70% of capacity to simply break even.

The bottom line is that news regarding the independent restaurant industry is going to get a lot worse in the months to come. It remains to be seen if 85% of non-chain restaurants will close their doors just ahead but, no doubt, many will go out of business. This is due to capacity and social distancing requirements, but also because consumers have cut back on eating out.

And finally, the restaurant industry is but one example of the realities facing many sectors of the economy.

As I and others have maintained since the pandemic unfolded, we are likely to see several million small and medium-sized businesses shutter as this year goes on.

Best regards,
Gary D. Halbert