

Arizona's Economy: The Recovery Begins?

 azeconomy.org/2020/07/outlook/arizonas-economy-the-recovery-begins/

July 8, 2020



July, 2020 – Second Quarter 2020 June Forecast Update

By George W. Hammond, Ph.D., Director and Research Professor, EBRC

There is still a huge amount of uncertainty about the future of the outbreak and the economic impacts associated with it. The baseline forecast assumes that the current surge in the spread of the coronavirus is contained quickly and that there is no major resurgence in the fall. As a result, the Arizona economy continues to ascend from the low point reached in April.

Based on the May employment release for the state, I have significantly revised the estimated impacts. For leisure and hospitality and retail trade, the impact is less severe than expected in May. The drop in the second quarter is still huge, just not quite as bad as expected in the May projections.

The forecast calls for the current downturn to be a short, sharp shock that is restricted to the second quarter. Growth rates are rapid initially before gains begin to slow in 2021. The state is forecast to regain pre-outbreak employment levels by early 2022.

Keep in mind that the projections may be subject to large revisions in the future as new information impacts the outlook.

Arizona Recent Developments

State and national labor market performance improved in May, according to the preliminary data. This reflected the partial relaxation of stay-at-home orders nationwide and in Arizona at the time. Even with the May increase, we still have a long way to go.

Arizona jobs (establishment survey) were down by 230,000 from February to May 2020. That translated into a 7.7% decline. Employment, as measured by the household survey, was down by 222,000 jobs from February to May, for a drop of 6.4%. Keep in mind that the

household survey includes the self-employed, who are not included in the establishment survey.

The largest job losses from February to April were in leisure and hospitality; education and health services; professional and business services; trade, transportation, and utilities; and other services (hair and nail salons).

The industries most negatively impacted by physical distancing and stay-at-home orders rebounded the most in May. Leisure and hospitality added the most jobs, followed by trade, transportation, and utilities; other services; and education and health services.

Arizona's seasonally-adjusted official (U3) unemployment rate declined in May, to 8.9%, from 13.4% in April. Arizona's rate remained below the national rate, at 14.7% in April and 13.3% in May.

Arizona Outlook

This forecast incorporates updated national forecasts from IHS Markit released in early June. The June forecast for the U.S. was marked down by IHS Markit, compared to their May projections.

For the June U.S. and Arizona forecasts, the baseline projections are assigned a 50% probability. The pessimistic scenario has a 25% probability and the optimistic scenario has a 25% probability.

This forecast reflects the new Executive Order by the Governor. It ordered the temporary closure of bars, indoor gyms, indoor movie theaters, and water parks and tubing operators, among other activities. Operations for these establishments are paused through July 27, 2020. The new order is expected to have a small negative impact on the forecast.

Based on the May employment release for the state, I have significantly revised the estimated impacts. For leisure and hospitality and retail trade, the impact is less severe than expected in May. The drop is still huge, just not quite as bad as expected in the May projections.

Taxable sales at restaurants and bars are forecast to experience a huge decline in the second quarter. Retail sales also decline in the second quarter, but the drop is much smaller than projected in May. This upward revision reflects better than expected performance in April.

The current data put the magnitude of the downturn at about the same size as the 2008-2009 recession but much shorter in duration. The decline in state jobs from February to April was 295,000, for -9.9%. In comparison, Arizona lost 305,000 jobs from peak to trough (quarterly) during the Great Recession. That was an 11.4% drop.

Under current assumptions, it is a short, sharp shock that happens in the second quarter. Total nonfarm employment in Arizona declines by 231,000 from the first quarter to the second quarter of 2020. That translates into a peak-to-trough decline of 7.8%.

The state unemployment rate surges to 10.4% in the second quarter of 2020, but then begins a gradual decline.

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.

Once the outbreak is under control, the recovery should be steady. Arizona was in very good shape before the outbreak. However, it will take time to get back to pre-outbreak levels of economic activity.

Growth rates may look very good initially, particularly if the outbreak is contained, because we are bouncing back from low levels. The forecast calls for the level of employment to return to its first quarter 2020 level by the first quarter of 2022.

The pessimistic scenario assumes somewhat deeper, more prolonged downturn. Arizona jobs decline by 259,000 from the first quarter of 2020 to the third quarter of 2020. That translates into an 8.7% drop.

The state unemployment rate peaks at 11.8% in the first quarter of 2021, then gradually declines.

Under the pessimistic scenario, it takes longer for the state to return to pre-outbreak levels. Jobs return to their first quarter of 2020 level in the third quarter of 2023.

The optimistic scenario calls for state nonfarm payroll jobs to decline by 204,000 from the first to the second quarter of 2020. That is a 6.9% decline. The unemployment rate rises to a peak of 9.7% in the second quarter.

Employment recovers faster under this scenario, with jobs reaching their prior peak by the second quarter of 2021.

National Outlook

The June 2020 projections from IHS Markit assume that the number of COVID-19 cases and deaths fall to levels low enough to permit fairly wide relaxation of social distancing by June.

U.S. real GDP is now expected to drop by 41.9% in the second quarter, at a seasonally adjusted annual rate. That was revised down from the May forecast, which predicted a 36.5% drop. Keep in mind that an annual rate is the rate at which real GDP would decline if the quarterly rate were sustained for an entire year. The decline in real GDP is primarily propelled by the drop in personal consumption expenditures driven by the outbreak.

On a year-over-year basis, real GDP is forecast to decline by 8.1% in 2020, which has been revised down by 1.5 percentage points from the May forecast. Real GDP is expected to bounce back with 5.2% growth in 2021 and a 4.7% gain in 2022.

It takes until the third quarter of 2022 for real GDP to return to the level last seen in the final quarter of 2019.

Total nonfarm payroll jobs are forecast to decline by 6.7% in 2020. The unemployment rate (U3) is projected to hit 13.4% in the second quarter of 2020, then trend down to 4.3% by the end of 2023.

With elevated unemployment, core PCE inflation remains modest at 0.9% in 2020 and 0.4% in 2021.

The federal funds rate remains near zero during the forecast. The Federal Reserve stays focused on maintaining the stability of the financial system.

Fiscal policy includes the fiscal rescue packages passed to date (\$2.5 trillion), but no new action.

The most recent economic forecast data for Arizona, Phoenix metro and Tucson metro.

If your business or organization requires more in-depth forecast data and analysis, find out about the benefits of joining EBRC's Forecasting Project.

Copyright 2020 Economic and Business Research Center, The University of Arizona, all rights reserved.