In Focus

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ECONOMICS

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Our Lives and the Economy—3 Months From Now

by Benjamin Tal and Taylor Rochwerg

We basically know what to expect in the coming few weeks. The infection curve will steepen, the economic damage will be more and more visible, government money will find its way over to households and businesses, but not without delays and confusion.

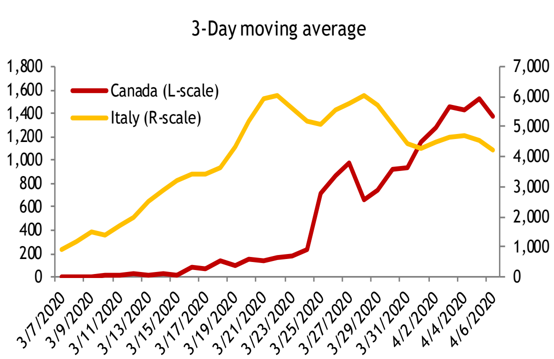
Any wishful thinking about things going back to normal by the summer, have all but vanished. So what will our lives look like come July?

A reasonable working assumption is that, at one point between now and July, the infection curve will flatten. Social distancing will do the trick. We have seen it in China, South Korea, and very recently in Italy (Chart 1).

Furthermore, there is growing optimism that in the coming months progress will be made regarding the availability of an antiviral treatment. Since the outbreak of COVID-19, we've witnessed an unprecedented and unparalleled global coordination in scientific and medical research related to treating the disease. With over fifty companies and universities worldwide testing potential antiviral drugs and vaccines, human trials have now begun and there are over thirty therapies being tested, including those related to treating SARS and MERS. The Canadian government recently funded 49 additional research projects, bringing the number up to 99 grants at a total investment of $54.2 mn. Any progress here will have a significant impact, as for the first time, we will feel that we are not totally defenseless against the virus.

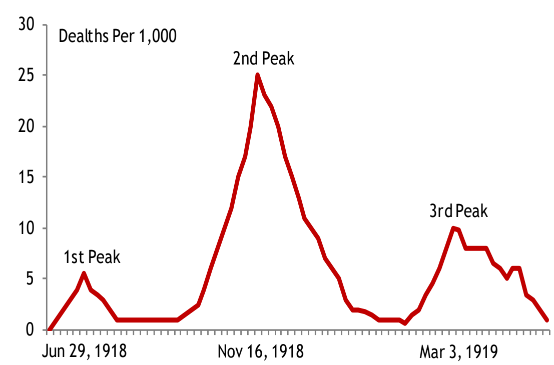
After months of living the way that we all live now, it is natural to expect the desire to go back to normal as soon as possible. As a society, we should resist that temptation. The 1918 pandemic came in three waves, as an

Chart 1
Daily growth in number of COVID-19 infection



Source: WHO, CIBC

Chart 2
UK During Spanish Flu



Source: WHO, CIBC

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early flattening of the curve led to a premature increase in activity (Chart 2). Early signs suggest that China and Singapore are now repeating that mistake (see our latest In Focus titled "*China's Emerging Rebound: Lessons For North America*").

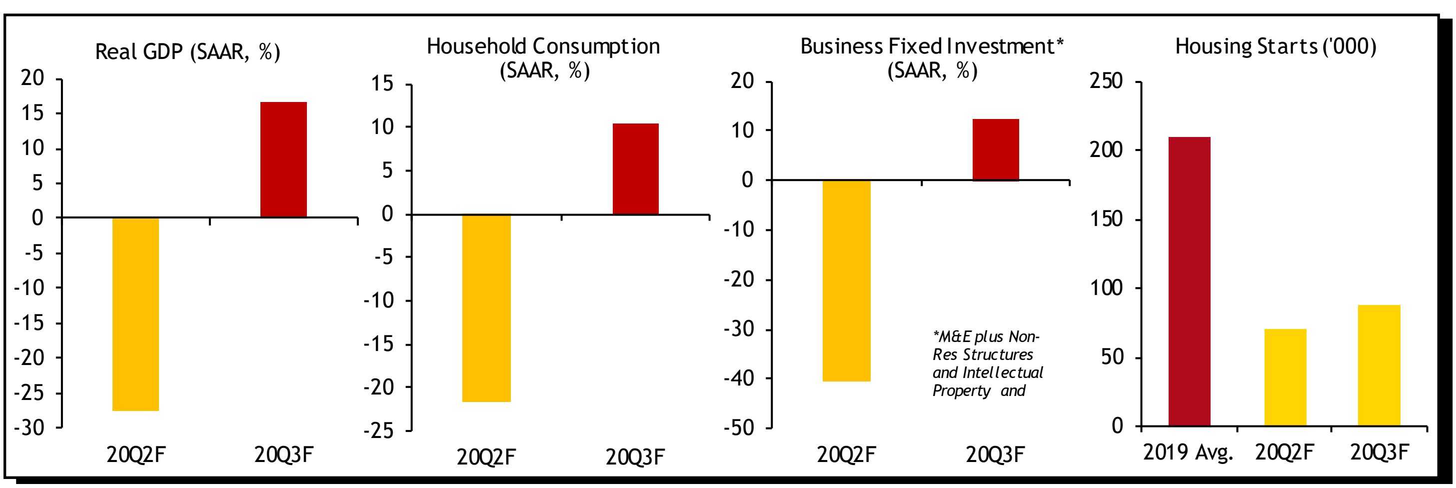
Assuming a gradual resumption of activity, we can imagine the following picture, three months from now:

- Canadians above a certain age and those with medical preconditions will be asked or told to remain at home.
- Essential workers will remain essential. Hiring and wage inflation in that space will rise.
- Businesses will be required to maximize the number of employees working from home. In the pre-virus era, one in five office-related employees worked from home. Look for that number to be notably higher in the early stages of the recovery. For those working from the offices, workstations will be rearranged to maximize distance between workers.
- Many factories will reopen, but at notably reduced levels of activity. Flex hours and shifts will be introduced in order to minimize workers' physical interaction. That will notably reduce productivity, similar to what we saw during the Spanish flu of 1918.
- Construction work will be resumed, at a larger scale than what's allowed today. Again, here we expect very strict regulations pertaining to workers' interactions—a factor we estimate can reduce the speed of completion by no less than 50%.
- Non-food retail stores will reopen, but strict social distancing procedures will be observed, as we see today in most food and grocery stores.
- Large gatherings won't be allowed, suggesting no sporting events, concerts or conferences.
- Museums and other heritage centres will remain closed or will be operating at significantly lower levels of activity.
- As for public transportation, the continued increased reliance on remote work, along with flexible hours in the manufacturing and construction sectors, should reduce passenger volume and ease or eliminate rush hour bottle necks. Service frequency will increase, and limits will be imposed on the number of passengers at any given time.
- The frequency of domestic air transportation will rise, but at significantly reduced capacity per plane. Very clear social distancing rules will be established at airports, and if possible, masks and gloves will be available to passengers.

Given that picture, it's reasonable to assume that after falling by 28% in the second quarter, economic growth will return to positive territory in the third quarter, but a V-shaped recovery is simply not in the cards. Chart 3 summarizes the expected trajectory of the early recovery stage that is consistent with the scenario described. Overall GDP growth is projected to rise by close to 17% during the third quarter, while construction activity will also rebound to a still-historically low level of activity (in

Chart 3

CIBC Forecast (2020Q2-Q3)



Source: CIBC

none of the other recessions in the post-war era, did housing starts in Canada fell below the 100,000 units level). We expect household spending to grow by close to 10% in the third quarter, as many stores reopen, and pent-up demand is released.

The key question is, of course, what that scenario means for the labour market. How temporary are those temporary layoffs that we've seen to date, and no doubt, unfortunately, that we will see in the near future? Based on special tabulations obtained from Statistics Canada, we examined 97 occupations in the Canadian labour market and categorized them based on their level of job security given the scenario described above.

The table below summarizes our findings:

Essential Workers will remain in high demand during the early stages of the recovery. That category consists of workers in the medical field, such as ambulance drivers, physicians, and nurses, as well as workers in utilities, postal and delivery services, and food production-related industries, such as those in agriculture and harvesting, food manufacturing and cashiers at grocery stores. We estimate that category to account for just under 20% of workers in the economy. As we mentioned earlier, that group will be a net job creator during that period, and as we have seen in any past pandemics, their bargaining power will rise notably during that period.

Minimum Impact. That category accounts for close to 9% of the labour market, is largely consistent of public sector employees, such as teachers, monetary authorities (the central bank), and government employees. Given the current environment, with a few exceptions, we do not expect governments, at any level, to reduce employment.

Table 1

	Share of Workforce (%)	Above/Below Avg. Wage (%)
Essential	**18.2**	**-2.0**
Minimum Impact	**9.0**	**10.2**
Some Impact	**46.1**	**30.4**
Notable Impact	**17.4**	**9.9**
Vulnerable	**5.1**	**-2.0**
Highly Vulernable	**4.1**	**-30.3**

Source: Statistics Canada, CIBC

Some Impact: Pay Cut/Job Sharing. This category accounts for 46% of total workers, and is consistent of mostly office-related jobs, such as those at larger corporations, including occupations in finance and insurance, data processing, as well as management and administrative service. While we expect some job loss here, the main impact will be on compensation and reduced hours as job sharing will be implemented in some cases.

Notable Impact: Reduced Capacity & Productivity. That groups largely includes workers in construction and the manufacturing and wholesale distribution in industries that aren't related to the production of basic goods and necessities, such as clothing, textiles and printing. This group also includes real estate, rental and leasing services, and air transportation, and accounts for just over 17% of total workers.

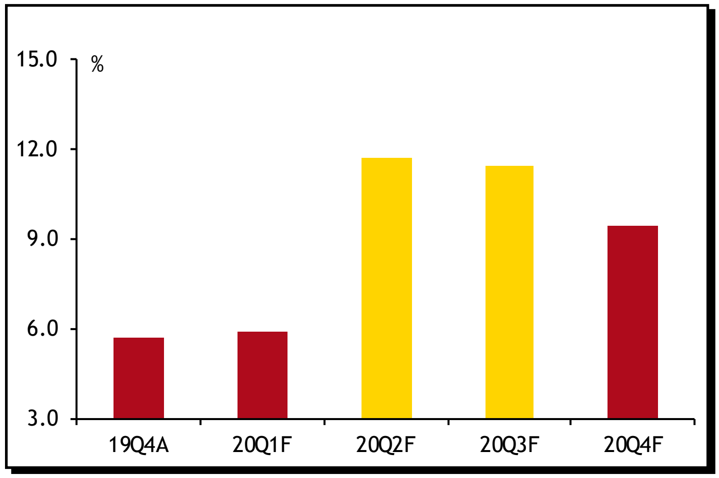
Highly Vulnerable: That category which we estimate to account for just under 9% of workers include those that will be very late to return and, those that will not survive the current recession. That category includes, personal services, such as laundry services and hairdressers, some retails stores that are unrelated to food and basic goods, such as sporting goods, clothing and electronics, publishing and broadcasting services, as well as some segment of the energy sector. Within the Highly Vulnerable group, the workers that are most at risk in not regaining employment are those in travel and accommodation, sports and entertainment, and the restaurant industry. That subgroup accounts for close to 5% of workers.

Of particular interest is the restaurant industry. That industry, which generated $93 bn in sales (approximately 4% of GDP) in 2019, is particularly vulnerable to the COVID-19 crisis. With almost 100,000 restaurants, bars and caterers across Canada, and roughly 1.5 mn Canadians directly or indirectly employed by the industry, 800,000 restaurant workers are now considered unemployed, given that 53% of restaurant operators have at least temporarily closed their restaurants. One in ten have already closed permanently, and one in five are expected to close permanently within the next month. While wage subsides and access to a $40,000 interest free loan might help at the margin, we expect a very slow recovery in that industry.

Accordingly, while we see some rebound in overall economic activity, we might see a slower reaction in the improvement in the unemployment rate (Chart 4), which we expect to remain elevated in the third quarter, reflecting continued difficulties in the vulnerable segment, as well as some job loss in sectors such as construction and manufacturing, due to reduced capacity. That will be exacerbated by difficulties to implement the 75% wage subsidy, as many firms will find it difficult to show 30 percent reduction in revenue.

Chart 4

Unemployment Rate



Source: CIBC