THE NORTH CAROLINA ECONOMIC OUTLOOK, 3rd QUARTER 2020

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RECOVERY FROM THE "MANDATED RECESSION"

Key Points

1. **Measured by job losses as a percent of the labor force, North Carolina did slightly better than the nation for the February-April period. Job losses were one percentage point less compared to the country. However, the job recovery during May was less robust in the state than in the nation.**

2. **Leisure/hospitality and other (mainly personal) services were the hardest-hit sectors for job losses in both North Carolina and the nation. The same sectors had a strong performance in the May recovery. The information sector lost jobs in both the February-April and May periods.**

3. **Asheville, Burlington, Hickory, and Wilmington had the largest relative job losses during February-April. Rural North Carolina had the smallest relative job losses.**

4. **North Carolina is expected to experience an economic recovery path similar to the nation, with the strongest growth period being in the third and fourth quarters of 2020.**

5. **However, North Carolina's aggregate production (GDP) will not reach pre-virus levels until 2023. Further, the state's jobless rate will still be more than 1 percentage point higher in 2023 than in late 2019.**

6. **The state should be prepared for significant training and re-training of workers as a result of significant virus-related business bankruptcies and a re-mixing of occupations in the post-virus economy.**

7. **Rural and small-town regions of North Carolina could benefit from new work/living standards based on remote working, cyber delivery of products and services, and an increased desire for lower-density living. However, high-speed and reliable internet service in rural areas will be essential for this lifestyle.**

FROM SMILES TO FROWNS

How quickly the economy changed. Economic forecasts at the beginning of 2020 were upbeat. In 2019 the U.S. economy had set a record for the longest period of time since a recession (over a decade), and that record was expected to be lengthened in 2020. Unemployment rates in both the nation and in North Carolina had fallen below 4% and were expected to go lower. Wage rates – after inflation – were rising for all income groups, and broad economic growth was proceeding at the "goldilocks" – that is, not too hot but not too cold – rate of 2%. Both inflation rates and interest rates were near historic low levels. This package of economic good news was predicted to continue, as evidenced by the soaring stock market.

Then the coronavirus – specifically Covid-19 – hit the country. While there are still debates about whether the virus could have been anticipated, medical experts did quickly agree the virus aggressively spread, and if not contained, virus-infected people could overwhelm the health care system.

Therefore, states eventually imposed orders curtailing human interactions. Most restaurants, retail stores, and entertainment venues were closed. People were told to "stay at home" except for necessary trips such as food shopping and medical visits. Schools were closed and large gatherings – in some cases meaning any group of more than five people – were banned.

These restrictions were devastating for the economy, and as a result the nation fell into a recession by late February. A recession means the economy moves in reverse. Rather than normal times of adding jobs, creating businesses, and boosting incomes, a recession does the opposite. During a recession jobs are cut, businesses shrink, and incomes fall.

While the 2020 recession fits this definition, today's recession has been like no other the country has experienced. Typical recessions are caused by financial dislocations, such as overuse of debt, the collapse of financial institutions, or a correction of excessive investor optimism. The current recession has been created by the need to restrict person-to-person contact in order to hold Covid-19 at bay. I therefore dub the 2020 economic downturn the "mandated recession."

DEPTH AND LENGTH OF THE MANDATED RECESSION

Most economists think the mandated recession of 2020 will be deep but short. Deep means large reductions in economic activity such as production, sales, and employment. However, short means the negative growth will last only a few months.

There are three reasons for this prediction. First, it's expected individuals and businesses will learn to live with the virus and take appropriate measures to limit infections and hospitalizations. Second, eventually – perhaps as soon as late 2020 – first a treatment and then a vaccine for Covid-19 will be developed. And third, while it is possible to absorb the losses associated with keeping a large part of the economy closed for several months, at some point this closure becomes financially as well as socially impossible. With states broadening their re-

openings in June – the fourth month of the shutdown – it may be that the maximum point of tolerance may already have been reached.

Using the data currently available, how has the mandated recession impacted North Carolina, and how does our state's experience compare to the nation's? Table 1 shows a major part of the impact by documenting employment trends in North Carolina and the nation for February to May.

Table 1 is divided into two parts. The first, showing changes for February to April, occurred during the initial economic shock of the closure restrictions. The second, giving changes for May, happened as economic restrictions in most states began to be eased.

Total nonfarm employment in the country declined by 14.5%, and at a slightly lower rate of 13.4% in North Carolina, during the February to April period. The difference was likely due to the earlier shutdown mandates in other parts of the country, particularly the northeast. In both regions, the largest declines were in the leisure/hospitality and other (mostly personal) services sectors. These are industries involving significant person-to-person interactions and were specifically included in most shutdown orders.

But there were also significant differences between the nation and state in sector employment changes between February and April. Employment declined relatively less in North Carolina compared to the nation in construction, transportation and trade, information, professional and business services, and government. Conversely, employment dropped relatively more in North Carolina manufacturing compared to national manufacturing.

There was a noticeable turnaround in the job market in May. Total nonfarm job growth was just under 2% for the nation and slightly less for North Carolina. Compared to the nation, North Carolina gained more in transportation and trade, professional and business services, education and health, leisure and hospitality, and other services. The state continued to lose jobs in construction while the nation gained jobs in that sector. On a percentage basis, North Carolina lost almost twice as many jobs in information and government in May compared to the nation, in contrast to losing relatively less in those sectors during the February – April period. Manufacturing job gains were also smaller in North Carolina than in the nation.

Table 2 gives the job changes during the two time periods for regions of North Carolina. Looking first at the employment changes from February to April, Asheville, Burlington, Hickory, and Wilmington led the declines with just short of a 20% drop in jobs. The Asheville and Wilmington economies are heavily dependent on the leisure/hospitality sector, and – as mentioned above – this was the hardest-hit sector of the mandated recession. Burlington and Hickory have important manufacturing sectors, and Table 1 shows manufacturing suffered a double-digit decline in jobs between February and April. Burlington and Hickory are also important locations on the busy I-40 interstate. Commercial transportation experienced large declines when the economy contracted.

Table 1. Employment Trends by Sector from February to May, 2020, US and NC.

	% Change, February-April		% Change, May	
Sector	US	NC	US	NC
Total Nonfarm	-14.5	-13.4	1.9	1.7
Construction	-13.9	-5.7	7.1	-0.2
Manufacturing	-10.7	-11.2	2.0	1.2
Transp. & Trade	-12.0	-9.1	1.5	2.2
Information	-9.6	-7.3	-1.5	-2.9
Financial Services	-3.2	-3.2	0.4	0.4
Prof. & Business Services	-10.6	-8.6	0.7	1.6
Education & Health	-11.3	-11.3	1.9	3.0
Leisure & Hospitality	-49.1	-50.2	14.4	16.8
Other Services	-22.9	-22.1	5.9	8.5
Government	- 4.3	-3.5	-2.7	-5.0

Source: U.S. Bureau of Labor Statistics, Payroll Survey.

Table 2. Employment Trends for North Carolina Regions from February to May, 2020.

	% Change, February-April	% Change, May
Asheville	-19.4	2.3
Burlington	-18.3	4.4
Charlotte	-14.3	2.0
Durham-Chapel Hill	-11.9	-1.9
Fayetteville	-13.5	1.1
Goldsboro	-14.6	1.4
Greensboro	-16.9	2.8
Greenville	-13.6	6.3
Hickory	-19.0	3.3
Jacksonville	-12.2	2.2
New Bern	-11.0	0.0
Raleigh	-14.9	0.6
Rocky Mount	-11.2	2.8
Wilmington	-18.1	1.7
Winston-Salem	-14.0	0.8
Rural	-5.6	2.2

Source: U.S. Bureau of Labor Statistics, Payroll Survey.

The state's booming metropolitan areas of Charlotte and the Triangle (Raleigh, Durham-Chapel Hill) did not escape the mandated recession. Both experienced double-digit declines in jobs with the Durham-Chapel Hill component of the Triangle having the smallest drop.

Interestingly, the rural (non-metropolitan) region of the state had the smallest reduction in employment during the February-April period, with a 5.6% reduction. Several factors account for this. Rural areas are more dependent on farming and agribusiness, and both of these industries were deemed "essential" – meaning they continued to operate – during the shutdown. Second, leisure and hospitality firms – which suffered the largest reduction in employment – are relatively less important in rural regions. Last, since the virus typically spreads at a slower rate in less dense areas, local government shutdown orders were less strict in rural regions compared to denser metropolitan areas.

The third column of Table 2 shows all regions except one – Durham-Chapel Hill – had job growth in May. The Durham-Chapel-Hill metro has a large concentration of technology (information) jobs in the Research Triangle Park. The continued decline in that sector in May (see Table 1) apparently dominated any job gains in other sectors. Greenville, Burlington, and Hickory, were the top three regions in growth in May. Interestingly, two of those regions – Burlington and Hickory – were among those with the large employment drops during the earlier February-April period.

The federal government's household survey showed the unemployment rate in the nation rose from 3.5% in February to 14.7% in April, an 11.2 percentage point increase.[1] North Carolina's rate jumped from 3.6% to 12.9%, a 9.3 percentage point jump over the same period. Then, in May, the national jobless rate dropped by 1.4 percentage points – to 13.3% - while North Carolina's rate held steady at 12.9%. From these numbers, it could be concluded North Carolina's job picture was better than the nation's during the height of the shutdown from February to April, but better progress was made by the nation than North Carolina in May.

There are two reasons to be cautious about such a conclusion. First, the US Bureau of Labor Statistics has faced an unusual challenge during the pandemic of classifying jobless individuals as unemployed. The issue came from the Payroll Protection Plan, which provided government funds to closed businesses to continue paying employees. Hence, the Bureau confronted the question of how to classify surveyed individuals saying they had no job but continued to be paid.

Also, individuals without jobs typically are classified as unemployed as long as they indicate they are actively looking for work. If they say they are not looking for work, they are considered outside the labor force, meaning they are neither employed or unemployed.

[1] The federal government's Bureau of Labor Statistics conducts two separate job surveys each month. One, the Payroll Survey, uses a sample of businesses to estimate nonfarm job totals and breakdowns by economic sector for the nation, states, and localities. The second, the Household Survey, implements a separate survey of households to construct employment, unemployment, and unemployment rate data for the nation and states. The surveys are of different sizes. The Payroll Survey has a much larger coverage rate of firms than the Household Survey does of households. As a result, the measures of the two surveys are not always consistent.

From this discussion, it is clear one additional piece of labor market data should be tracked. This is the change in the labor force, which is the sum of those counted as employed and those meeting the standard of being unemployed. For the February to April comparison, the US labor force contracted 4.9%, but North Carolina's shrunk almost twice as much, by 8.3%. This indicates a relatively larger number of people "dropped out" of the labor force in North Carolina than in the nation, thereby taking away some of the luster of the state's smaller rise in the unemployment rate than in the nation. But conversely, in May, North Carolina's labor force rose 2.9% compared to a 1.1% rise in the US. With more jobless people actively looking for work – rather than not looking – in North Carolina compared to the nation, the lack of a drop in the state's jobless rate in May can at least partially be explained.

Unfortunately, aggregate production levels (Gross Domestic Product) and personal income data for the months covered in this report are not yet available. However, one important economic measure, building permits, has been released. Comparing February - April, monthly building permits in the nation fell 4.3%, but plunged 14.1% in North Carolina. However, in May, national building permits rose 8.8% compared to a 9.3% gain in North Carolina.

HOW FAST WILL THE ECONOMY RETURN?

The turnaround in numerous economic numbers in May has sparked optimism over an economic recovery. Additional evidence comes from both initial and continuing jobless claims, both of which have trended downward in recent weeks. A quick return to economic growth would also be in line with forecasts of a "deep but short" recession.

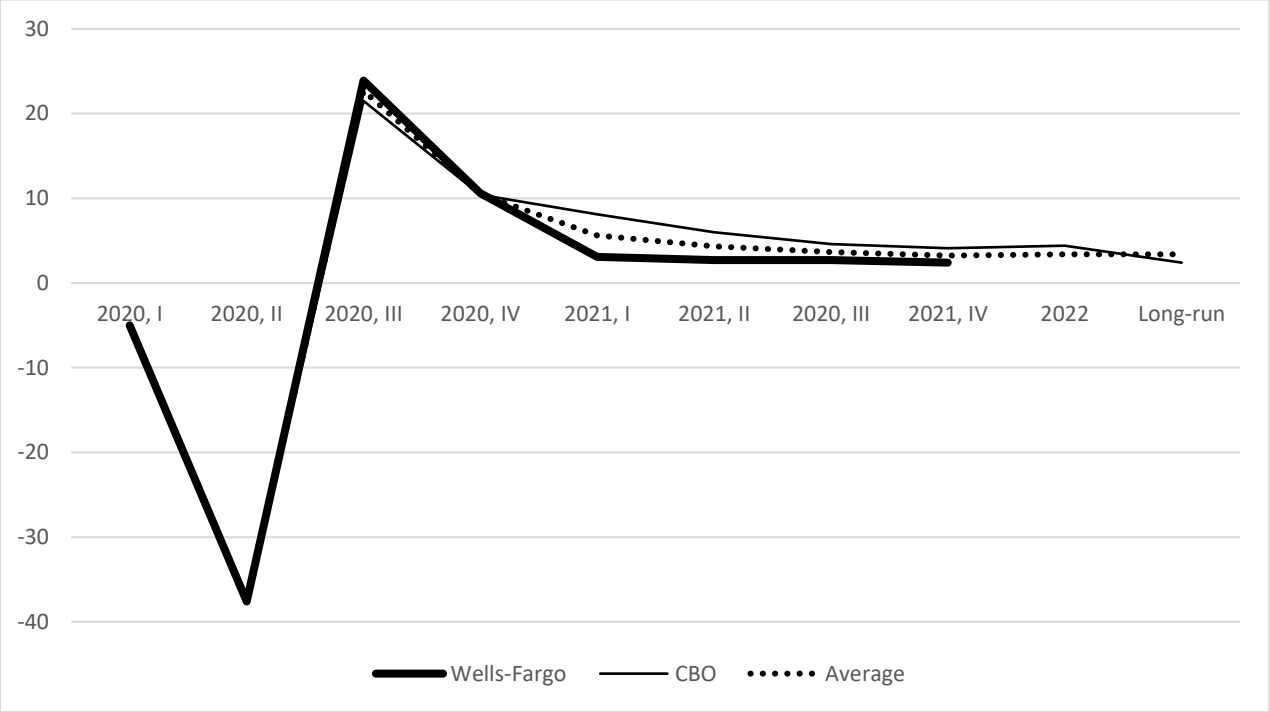
But even a return to economic growth doesn't mean "all is well". The strength and consistency of economic growth will determine how long it will take to return business, labor market, and household conditions to pre-virus levels.

The path of the future economy in North Carolina depends on two factors: how fast and far the national economy will recover, and how North Carolina's economic recovery could differ from the national recovery.

Figure 1 presents forecasts for growth in aggregate real GDP (Gross Domestic Product) – a measure of total national production – from the Congressional Budget Office (CBO), Wells-Fargo, and an average of the two. Figure 2 does the same for national unemployment rate forecasts. The CBO and Wells-Fargo projections are especially useful because they present quarterly forecasts for 2020 and 2021. CBO also gives annual GDP and unemployment rate forecasts for 2022 and a long-run annual average for 2023-2030. In order to form the averages for these periods with the Wells-Fargo information, Wells-Fargo forecasts for 2022 and 2023-2030 were implied based on trends from their 2020 and 2021forecasts.

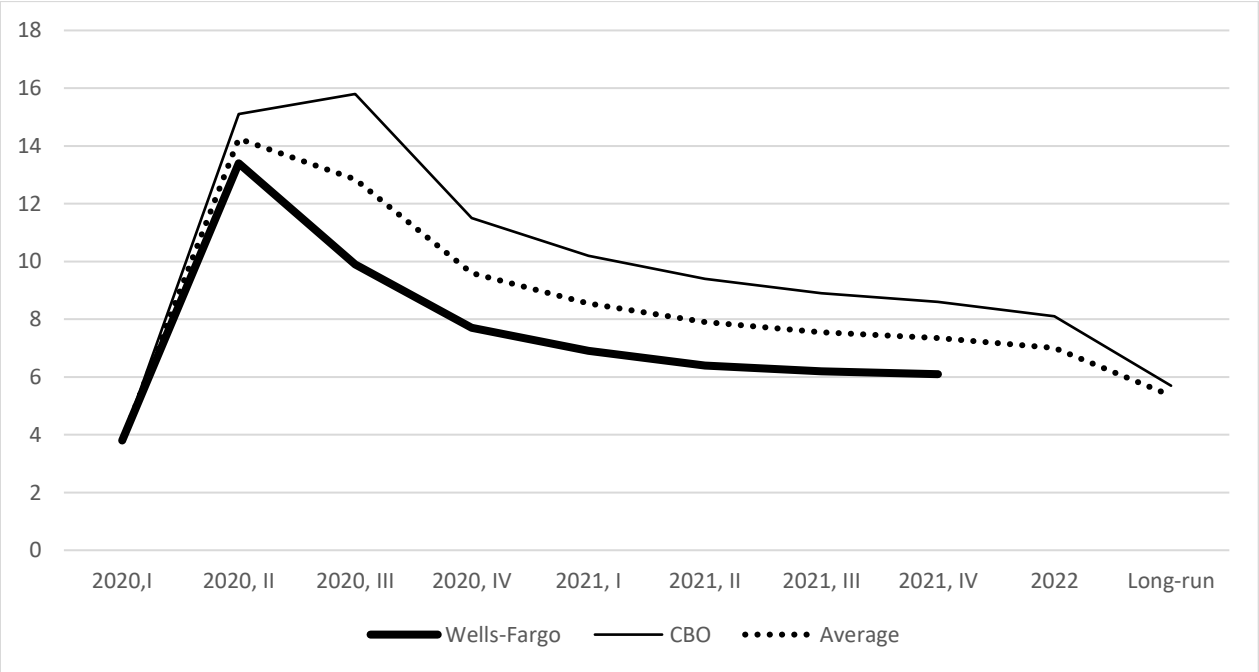
The forecasts show general consistency. Real GDP experiences a sharp contraction in the second quarter of 2020 (2020, II), then followed by strong rebounds in 2020, III and 2020 IV, and with growth continuing, but at much lower rates, afterwards. Similarly, unemployment takes a strong jump in 2020 II and possibly 2020 III, with then a significant reduction in late

Figure 1. Real GDP Forecasts for the US Economy (Annualized % Change).



Sources: Wells-Fargo *Monthly Outlook*, June 2020; Congressional Budget Office, *Economic Projections*, June 2020.

Figure 2. Unemployment Rate Forecasts for the US Economy (% of Labor Force).



Sources: Wells-Fargo *Monthly Outlook*, June 2020; Congressional Budget Office, *Economic Projections*, June 2020.

2020 and more gradual reductions in 2021, 2022, and thereafter. However, the national unemployment rate never reaches pre-Covid-19 levels.

The averages of the Wells-Fargo and CBO forecasts will be taken as the national forecasts for real GDP growth and the unemployment rate. However, these forecasts do not necessarily apply to North Carolina because the state's economic recovery may be different than the nation's recovery.

Traditionally North Carolina recovered faster from recessions than the nation. However, this has not been the case for the last two recessions (2001, 2008-09). For these two recessions, North Carolina averaged a 56% lower annual growth rate in the initial two years after the recession. This was then followed by a 44% higher annual growth rate in the subsequent years until the next recession.

However, there are special reasons for these comparisons. Prior to the 2001 recession – the "dot.com" recession – North Carolina had developed a large technology sector. This was the sector hardest hit by the 2001 downturn. Also, the state's economy was in the midst of adjusting to the NAFTA and China trade agreements, both of which adversely affected North Carolina's traditional manufacturing sectors of textiles and furniture.

The 2008-09 recession – termed the "Great Recession" – began in the financial sector and was associated with over-investment in real estate. In the previous decade, Charlotte had expanded its already significant financial industry, centered around a large concentration of both national and regional bank headquarters. Hence, the financial sector in Charlotte suffered major monetary and employment losses during and after the Great Recession. As North Carolina's largest metropolitan region, these losses significantly impacted the entire state.

The mandated recession of 2020 is different than any recession experienced by the country. It is not clear how North Carolina will fare from the recession. Working against the state is its higher share of workers with lower educational attainment, many of whom work in hospitality, personal services, and retailing. If the percentage of occupations requiring person-to-person interactions contracts in the post-Covid-19 economy, then the state's economy may suffer relatively more than the national economy.

Yet there are factors that could accelerate North Carolina's economic recovery relative to the nation. One is the continued in-migration of households from other states to North Carolina. North Carolina has continually ranked among the leaders in attracting households and businesses from other states. This movement could expand in the post-virus world, especially from the highly dense northeast metropolitan areas – like New York City and Philadelphia – that suffered enormously from the virus.

Also, in the near term, North Carolina's economy could improve from a strong rebound in the state's tourism sector if vacationers prefer shorter trips accessible with personal vehicles rather than commercial airlines.

As a result of these considerations, the national average forecasts from Figures 1 and 2 are directly used to project North Carolina's economic recovery. Figure 3 shows the forecasts for the state's real GDP quarterly from 2019, IV through 2021, IV, followed by the yearly values for 2022 and 2023. All values are annualized and displayed in 2020 dollars. The largest drop in real GDP is expected for the second quarter of 2020, with gains thereafter. Importantly, the level of real GDP is not expected to exceed the pre-virus level (2019, IV) until 2023.

Similarly, the forecasts for the North Carolina unemployment rate (Figure 4) show a large jump in 2020, II, with a reduction to near 10% in 2020, IV, and further reductions in 2021, 2022, and 2023. However, the 2023 rate of 5.4% will still be significantly higher than the pre-virus rate of 3.8%.

CONCLUSION

The remainder of 2020 will be challenging for the North Carolina economy. After a huge reduction in the state's aggregate economic production in the second quarter of the year, a rapid snapback is forecasted for the third quarter, followed by strong – but slower – growth in the fourth quarter. Still, the state economy is expected to be 20% smaller at the end of 2020 compared to the end of 2019. Economic growth will continue in 2021, but at even slower rates. It will not be until 2023 that the state's aggregate production will exceed pre-virus levels.

A similar pattern is expected for the North Carolina unemployment rate. After peaking at over 14% in 2020 II, the rate will decline to 9.6% in 2020 IV, 7.4% in 2021 IV, 7% in 2022, and 5.4% in 2023. Two challenges in the state labor market are the elimination of jobs from firms not coming back from the virus, and the necessary re-training of workers for the new kinds of jobs expected in the post-virus economy.

All regions of North Carolina were hurt by the virus and the associated mandated recession. However, the least harmed were rural regions, where the reduction in employment during the height of the virus was 60% lower than for the state. Indeed, the post-virus economic world may create new opportunities for rural North Carolina. Increased opportunities for remote working, expanded use of cyber-generated delivery of both products and services, and an awareness that highly contagious viruses can be most problematic for denser environments may create a renewed interest in living and working in small towns and rural areas. But key to this shift is the development of high-speed, reliable internet service in those regions.

Although there is substantial uncertainty related to the economy after Covid-19, North Carolina seems to be as well positioned as any state to deal with whatever is ahead. The state has a good mix of urban and rural, big and small, modern and traditional, plus a lower cost-of-living and both air and road access to major national markets. Although the future may be hazy, North Carolina can be a bright light of opportunity.

Figure 3. Forecasted Path of North Carolina's Real Gross Domestic Product (Annualized Billions of 2020 $).

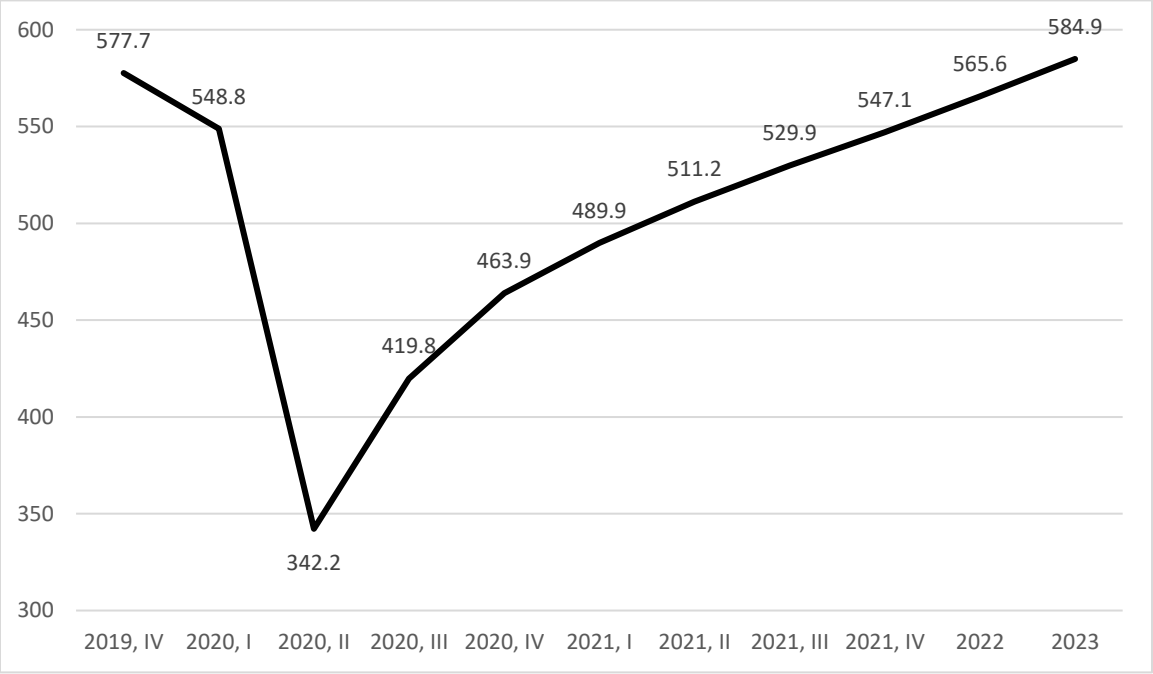


Figure 4. Forecasted North Carolina Unemployment Rates (% of Labor Force).