State of & Outlook

US GDP 2020-2022 Outlook Report

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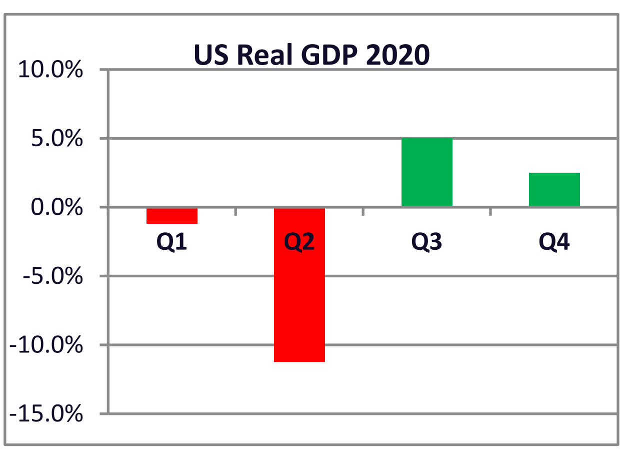
Table of Contents

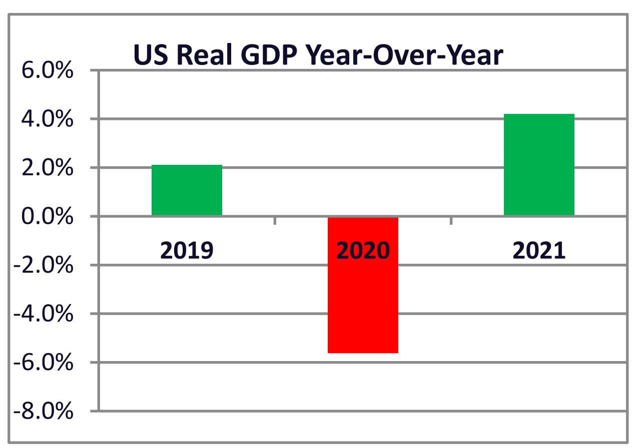
I. Introduction

I sincerely hope that the reader and his/her families are well and that the economic impact of the current situation has not been too severe. We will not elaborate on the pandemic itself, but rather focus on what we think is a most likely economic future based on the forecasts of the most reputable economists, financial institutions and business leaders we follow and will offer a cautious opinion. Despite the fact, that what we are living through has never happened in our lifetimes, events like these have happened many times in the more distant history. Since the 2nd quarter will be very dismal in regards to construction activity, due to the nationwide shut-down, we will revisit actual construction activity in the late fall issue as in the previous reports when we have 3rd quarter numbers to compare side by side.

II. Outlook into 2020/2022

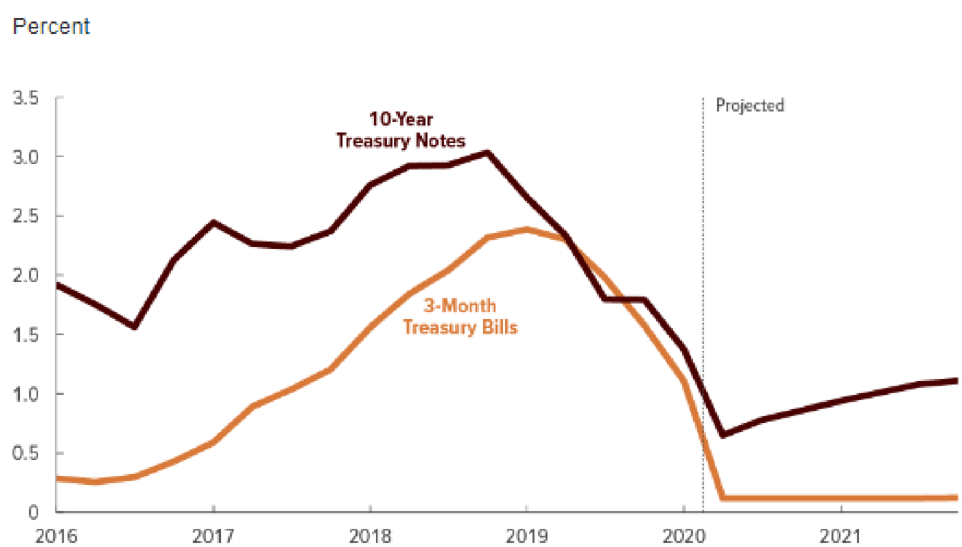
On June 1st the director of the Congressional Budget Office (CBO) published their forecast to assess the economic damage that Covid-19 has caused and what a most likely scenario to a full recovery back to GDP levels at the end of 2019 might look like. The CBO estimates that the negative impact of Covid-19 to the GDP for the first half of 2020 will be at minus 14% and by the end of 2020 will stand at minus 5.6%. GDP is estimated to be at 1.4% below 2019 levels by the end of 2021 and very likely a full recovery by 2022. It is interesting to note that the CBO has calculated the net economic GDP loss due to Covid-19 to take 10 years to fully amortize.





The 2020 numbers include the massive stimulus package over USD 3 Trillion passed by the US government and asset purchase programs of the Federal Reserve which surely cushion the blow of the unprecedented economic shut-down (Bond King Jeffery Gundlach made the comment that this amount equates to more than 90% of total US tax revenue collected in 2019 which was at USD 3.5 Trillion). In reality the GDP loss is going to be close to minus 16% and hyperinflation resulting from these additional debt loads for the US is a real concern to many, but the current Federal Chair, Jerome Powell has been handling the crisis incredibly well. For the time being the Federal Reserve refinances this new debt with 90 day bills and it works similar to a credit forbearance plan pushing the higher inflation risk with each expiration and reissuing of bills almost indefinitely out into the future until the economy is very robust and tax revenue is back to normal before to start shrinking the balance sheet of the Fed. Hence the CBO does not foresee inflation to rise above 1.5% beyond 2022/23.

Interest Rates



We are expecting to some degree a V shaped recovery in line with major economists and financial institutions. As large parts of the economy were mostly shut down for the second half of March, April and May, the expected contraction in the 2nd quarter is in the high 30% range and as all states will be back open before the end of June 2020, there will naturally be a substantial increase in the 3rd quarter from where it was before at estimated at around 20% and another 10% in the 4th quarter, leaving the US GDP below its 2019 levels until at least through early 2022.

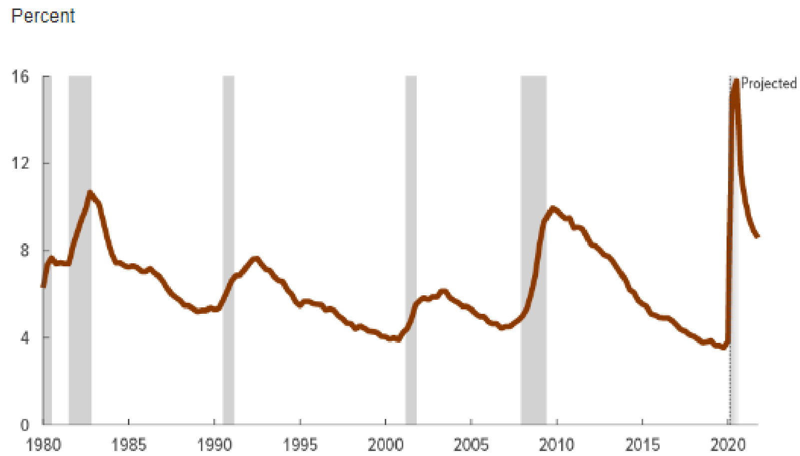
III. Assessing Cause and Effect

There are plenty unknowns about how the economy recovery will develop. Will the pandemic cause other outbreaks at times and if yes, how severe? If any, will it trigger government intervention and to what extent? How will medical treatments have progressed for prevention and for the critically ill, so society can resume its activities normally? When will society be able to go back in modern times as severe epidemics and pandemics in the past took several years to die down?

From today's perspective the biggest challenges to assess cause and effect for the economy are: How many total jobs will be lost long term because of the pandemic, taking into account actual losses during shut down period? What rehiring will do under the stimulus package and what will the net effect be after the stimulus payroll subsidies will wear off (in May 2020 2.5 Million jobs were added back to the work force which in part was due to the stimulus cushion provided by the government)? How many jobs will be actually coming back after all states and economies around the world are opening back up? What impact will social distancing have for society to be able to resume normal (or new normal) lifestyles? What effect will technology have from shopping online to not meeting in person but through video conference calls? What impact will some of these near permanent changes have to actual real estate square footages needed and ultimately how will it affect construction volume for office and retail space? Many real estate projects were under contract and financed before the pandemic started and are still due to be completed. What will new project financing look like when these come to completion? As these events have yet have to unfold it is very difficult to make any reasonable assumption with certainty. As things progress over the next several months we will have a better idea what the actual net loss in employment will look like, what effect it will have on consumer behavior and how the various real estate segments will be impacted.

We expect that construction activity compared to 2019 will be negatively impacted through 2022 due to higher unemployment than in 2019, expected by the COB to be at 11.5% (2020) and 9.3% (2021). What impact will the additional remaining expected 8% unemployment have on existing home sales, new residential construction and multifamily?

Unemployment Rate



As 4 million households are already skipping payments under the CARES Act and have 180 days to defer payments, what slow down effect to residential markets will it have? What will have reduced spending power per household do to the overall health of the economy? Banks have built record reserves preparing for credit defaults for both consumer and business loans, so they have a rather cautious outlook.

As we will go in the fall through the 3rd quarter, we will get a better grasp if a stronger residential housing contraction will be underway (except for Multifamily which will benefit from these developments, since people have to live somewhere) and how commercial real estate will adjust to the actual demand.

Unfortunately, these are difficult questions to answer and making a reliable forecast is nearly impossible. To illustrate this, the Congressional Budget Office is expecting a fairly strong V shaped economy in the 2nd half of the year while it's counterparts in Europe who have a very similar economy as the US, expect another contraction by the end of the 3rd quarter. As we adjust in our industry to the current business environment, we will have to see how some of these things will develop and elaborate on them as more definite trends emerge.