



THE FAULT IN OUR STARS

“The only function of economic forecasting is to make astrology look respectable.”

These irreverent words of Canadian-American economist John Kenneth Galbraith capture the great challenge facing economists today as they attempt to divine the future in a COVID-19 world. Current conditions are changing so rapidly and so dramatically that we are not sure where we are. On top of the uncertainty regarding current conditions, we are in uncharted territory both in terms of the economic response to all the steps taken to control the spread of the coronavirus and the profile of the recovery once the pandemic is past.

One thing we know for certain is that the consumer is key to both the response and the recovery, and in more ways than one. Underneath the nearly -28% contraction in consensus GDP forecasts for the April/May/June quarter is a -23% reduction in consumer spending. With near record high unemployment, reduced income, less opportunities to spend, and a higher inclination to save, consumer spending will suffer large declines. Though consumers are receiving large scale support from the federal government, it is hard to predict if it will be enough to cushion the adverse effects of the self-imposed shuttering of much of the economy and to ensure businesses and jobs are preserved for the recovery. Congress and the Administration have relied on the political support of consumers to implement the efforts to control the virus and to incur the costs of these efforts. Without the patient, political support of consumers – and young consumers in particular on whom the burden of the higher federal debt will disproportionately fall, government officials may balk at the costs of keeping the economy on life support. Consumer support is key for maintaining that support. Consumers' future spending will also be key to the strength and pace of the post-pandemic recovery.

But there are three major reasons that U.S. consumers — the backbone of the economy at all times, with consumer spending amounting to two-thirds of GDP — are likely to come out of the COVID-19 crisis no longer able, or willing, to bear the same load as before.

First, the rapidly deteriorating job market will hurt consumers badly, and for many the damage will not be temporary. Until last month, unemployment was at historic lows, standing at just 3.5%. Unemployment rose to 14.7% in April, is predicted to reach 25% in the months ahead, and to remain as high as 9% by the end of 2021.

Second, business activity is chunky, rather than smooth, in the wake of unexpected events. Economic activity is the sum of billions of discrete decisions, influenced by available financing, uncertainty, and differing expectations. Such activity is not able to snap back into place suddenly or consistently, as much as we might hope it will. Inevitably, some Americans will remain unemployed longer than others. Those who go back to work quickly are still likely to emerge from their experience of sheltering at home with less ability to resume spending at the same levels. Large numbers of households are falling behind on major debt obligations, such as rent or mortgage payments, auto loans, and credit card bills. Even those who return to pre-crisis jobs will have to cope with the burden of this overhanging debt, which will constrain their discretionary spending for months or even years to come.

Third, the wrenching experience of the COVID-19 pandemic is likely to change many consumers' behavior. As happened in the Great Depression, this crisis has reminded people of the fragility of their financial situations, making them more cautious about borrowing and spending. Social changes, too, are likely to linger. Until people feel sure about an effective vaccine and manageable treatment for the virus, they may be reluctant to travel or even to circulate as widely as they used to, producing lower levels of economic activity overall.

While we share the consensus view of economists that economic growth will resume in the third quarter, we are cautious about the strength of the recovery in the near term. Without the engine of consumer demand producing the same impetus for growth as it did over the past decade, we need to brace for a slow and painful recovery this year, and perhaps even in 2021. In our market economy, the consumer is king. And at least for today uneasy lies the head that wears the crown.

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CHARITABLE GIVING GUIDANCE

Many charitable organizations are facing unprecedented challenges in the face of the COVID-19 crisis. The demand for services has been acute for frontline nonprofits while at the same time the lockdown has limited traditional fundraising efforts. Donors are eager to find a way to help, but identifying the best way to maximize your gift from a tax and planning perspective can be hard to analyze. We are here to help.

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