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Why the Largest Stimulus in History Still Is Not Enough

COMMENTARY By Roman Frydman and Lawrence Hatheway March 29, 2020 8:30 am ET

An ambulance sits outside the US Capitol in Washington, DC. Saul Loeb/AFP/Getty

Global equity markets rallied over 20% last week on expectations that the $2 trillion U.S. fiscal stimulus package would be adequate to combat the economic consequences of the pandemic, thereby stabilizing the U.S. and world economies. It did not take the market long to see that the size and design is nowhere near sufficient.

On Friday morning, the three-day rally began to falter. Remarkably, prices continued to decline even after congressional approval of the bill at midday. As unreliable a guide to economic performance as many consider the stock market to be, this time the market has it right.It is obvious to investors that the problems we face stem from the public-health crisis—and cannot be cured by the "stimulus" package.

Most European countries, as well as the United States, remain unprepared to combat the pandemic. Even if Covid-19 turns out to be seasonal and subsides with the arrival of warm weather, many experts believe that effect wouldn't be sufficient to end the pandemic. Unless we direct our expenditures with laser-like focus at the root of the crisis, the growth-depressing lockdowns and social distancing that will be required will severely undermine investors' assessments of share values until a vaccine is developed. And that is not expected for 12-18 months.

A few simple figures highlight the stark situation investors are likely to face. U.S. equity valuations are marginally above long-term norms, and index levels imply about zero growth in earnings per share in 2020. That's absurd. If, as many forecasters anticipate, the economy contracts at a rate of 20% or more over the coming few months, and then experiences additional shocks when public health measures falter or seasonal effects appear, not only will earnings fall by as much as 25%, but uncertainty will force a large contraction of valuations. From here, it is easy to imagine another 25-30% drop in the stock market.

But why should matters unfold that way with the largest fiscal stimulus in history now in place?

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multipliers as personal and corporate savings rates rise) will not suffice to prevent what Nouriel Roubini recently called “a greater depression” in economic activity (and an even more precipitous earnings decline).

Second, the overall spending is not only too small, it is also poorly designed. Of the $2 trillion, $1.5 trillion is rightly earmarked for expanded unemployment benefits and one-off cash grants to eligible taxpayers, and for loans and grants to small businesses. In contrast, some $500 billion takes the form of unconditional loan guarantees, while only $100 billion is allocated to health care.

That is not a winning strategy against a pandemic. The U.S. currently has about 924,000 hospital beds, with roughly two-thirds occupied at any given time by patients with other ailments than Covid-19. Yet the most reliable data on infection rates—from Germany, thanks to its superior testing ability—suggests that infection rates and hence overall hospitalization requirements will far exceed capacity. In scenarios that are increasingly spoken of as the norm, over one-third of the U.S. population—some 100 million people—will at some point be infected by the virus. If 3-5% require hospitalization (as seems to be the case, based on available data), some five million hospital beds will be required over the life of the pandemic. Of course, the aim is to prevent demand spikes—hence the need to flatten the contagion curves—but reasonable estimates would put the current supply of hospital beds at only one-third of what is required. Add to this the associated equipment and staffing that will be needed, and the $100 billion allocated to health-care spending appears paltry.

The stimulus package also falls short in terms of incentivizing shifts in production and logistics to address the problem. As one of us has argued elsewhere, corporate debt guarantees should be conditional on recipients’ contribution to the effort to stem the pandemic and contain its economic consequences. For example, airlines that receive government aid should be required to transport vital medical supplies to where they are most needed. Similarly, hotel chains should receive support only if they agree to repurpose their hotels to serve as temporary hospitals. In the manufacturing sectors, companies that receive assistance should be mandated to produce medical equipment or provide logistical support to combat the pandemic.

Another large sum of government spending will also be required to ensure the safety and health of those most at risk. The most urgent need is to address reported severe shortages of personal protective equipment, so that medical personnel can stay healthy and deliver care to those who need it. Moreover, at some point, as working-age people return to their occupations and, inevitably, infection rates pick up, it will be necessary to quarantine, provision, and care for the elderly, the indigent, and those with compromised health conditions. That will probably cost trillions more.

Finally, more government spending will be required to test and then continuously monitor citizens. Early evidence from China, South Korea, Singapore, and Germany suggests that frequent testing, and rapidly isolation of suspected cases of infection, is the most effective approach to contain the virus while allowing some restoration of economic activity. In the U.S., but also elsewhere, shortages of test kits are acute, and the technological infrastructure to identify and contact-trace infected individuals is utterly lacking. In a country as vast as the U.S., or as densely populated as much of

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Western Europe, the costs of putting those resources in place run well into the hundreds of billions of dollars.

Until we move well beyond the $2 trillion package, both in size and scope, the crisis is likely to deepen considerably. The “recovery” of stock prices earlier this week might have appeared to signal the beginning of the end of the crisis. But investors are beginning to realize that current U.S. economic policy is woefully inadequate to combat the public-health crisis and its economic consequences. This dangerous disconnect between policy and reality bodes ill for the health of many of our countrymen, for U.S. and global economic prospects, and for future returns on equity investments.

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