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THE CONSEQUENCES OF A K-SHAPED RECESSION RECOVERY

The COVID-19 recession is wholly unique. Although United States recessions have always been followed by recovery, this recession has presented a unique — if troubling — divergence from the norm.

CLASSIFICATIONS OF RECESSION RECOVERY

Economists use an alphabetical shorthand to describe the different types of recession recovery based on the shape seen on a line graph. These graphs can follow a multitude of factors, including recession performance by industry, job market, and income.

V-Shaped — The most desirable type of recession recovery. Defined by a sharp decline followed by a sharp, near-immediate recovery.

W-Shaped — A sharp decline followed by a temporary incline, another dip, and finally, a more lasting recovery. These types of recoveries can be mistaken as V-shaped, presenting risk when the other shoe drops.

U-Shaped — Similar to a V-shaped recovery, although it lingers at the lowest point of the recession before slowly climbing out.

L-Shaped — The worst outcome in a recession. This is a recession that is not followed by a clear pattern of recovery.

K-Shaped — Recession recovery in which different demographics or industry recover from the recession at wildly different paces. Where one group bounces back quickly, other groups experience prolonged negative consequences.

THE ECONOMIC IMPLICATIONS OF K-SHAPED RECOVERY

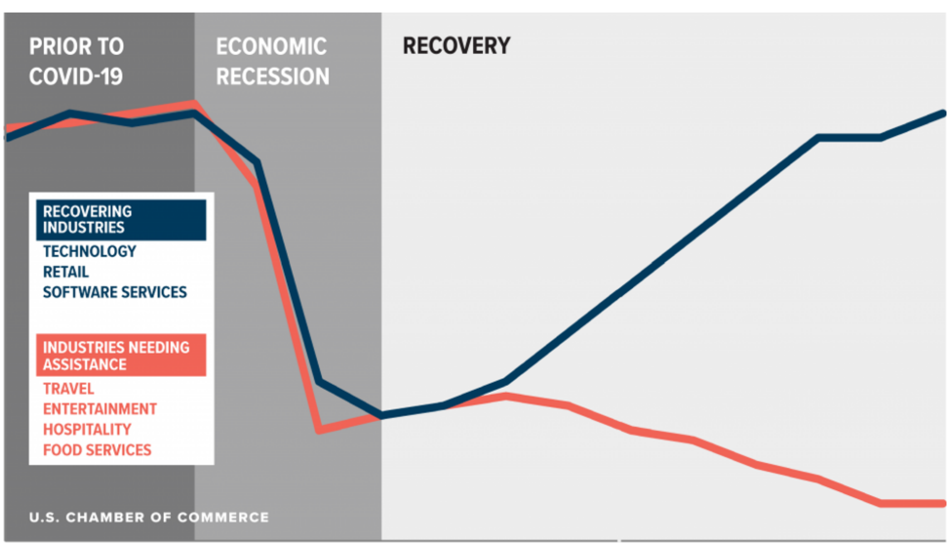
The pandemic recession's unique K-shaped recovery demonstrates divergence on a few significant levels.

AN INDUSTRY SPLIT

On an industry level, the pandemic caused some sectors to flourish and others to falter. Small businesses, restaurants, hospitality, and tourism were hit the hardest. Even in areas where COVID-19 restrictions were fewer, these industries still experienced (and continue to experience) hardship.

On the other hand, digital and low-contact industries thrived. Companies like Amazon, ZOOM, and delivery services fared well. Grocery and liquor stores over-performed, along with gaming companies, tutoring, telehealth, fitness, and streaming services.

Real recovery won't be determined by the return to a pre-pandemic GDP but by the recovery of the small businesses and industries most impacted by pandemic restrictions.



A SOCIOECONOMIC SPLIT

The uneven recovery among American workers is the most pressing issue at hand. The Bureau of Labor Statistics released a pertinent research paper on the issue.

In short, lower-income households are those still feeling the financial impact of the pandemic where higher-income households have remained largely unaffected on an economic level. Higher-earners are more likely to have jobs that allow them to transition to at-home work.

Lower-income households are more likely to work outward-facing jobs, such as those in foodservice and hospitality.

This demographic is more likely to contain young workers, minorities, and those lacking higher education. Not only are they more at risk for job loss but they are at a greater risk for cut hours and going from full to part-time work.

WHAT K-SHAPED RECOVERY MEANS FOR REAL ESTATE

These factors have defined the COVID-era real estate market:

-Intense demand
-Low inventory
-Disrupted supply chains
-Suburban migration
-Skyrocketing property prices

While these are not universal truths for every market, they have largely been the pattern — particularly in larger southern and midwestern metros, like Dallas-Ft. Worth, Texas.

Although real estate has been thriving, K-shaped recession recovery threatens the future stability of real estate. Keep in mind: when the foreclosure moratorium ends, we're likely to see more economic distress in the real estate sector.

Millions of households have struggled to keep up with their mortgage payments. As a result, we're likely going to see a surge in foreclosures.

In some ways, that's a good thing.

Unaffordability is threatening the real estate market both in buying and rental sectors. This crisis only worsens with the disparities in income and recession recovery, especially compared to inflation.

An increase in inventory, even from foreclosures, will help temper the pace of the market and cool prices. Similarly, we expect that many households who bought during the pandemic will experience buyer's remorse.

Having overpaid and overextended on their mortgages, these buyers will likely put their homes back on the market — further increasing existing inventory.

THE BEST CASE SCENARIO

Ideally, there will be a push-comes-to-shove in real estate. Unaffordability will bring more properties on the market, softening demand and prices at the same time. Rather than experiencing a market crash, we'll see a return to more balanced pre-recession levels.