
# Credit Risk Ready Podcast

## Host Linda Keith CPA With Bill Conerly

# *The Square Root Recession*

Hi, this is Linda Keith, CPA, with Credit Risk Ready, a podcast where we interview senior credit and lending professionals from community financial institutions across the United States, their regulators and banking advisors to better understand and mitigate credit risk.

In this episode, Dr. Bill Conerly will share his current economic forecast and what bankers should be watching for to anticipate how long the recession will last, how bad it will be, and what to do now to serve their customers and to protect their bank. Bill Conerly is a forbes.com writer. He has a PhD in economics and he is a business-focused economist. You can read more about Bill in the show notes. Of everyone I know, Bill has the economics and the business chops to connect the dots for us.

Welcome Bill.

**Bill Conerly:**

Great to chat with you, Linda.

**Linda Keith:**

So Bill, you have said that successful business leaders are humble about their ability to predict the future, but aggressive in developing the flexibility to thrive, whatever the future brings. Well, the future is as uncertain now as I have ever seen it. Would you give us a quick thumbnail sketch of where we are as we record this interview in June 2020, as to the pandemic, the civil unrest, and the descent into recession.

**Bill Conerly:**

Yeah, we are in, I guess, a mess.

**Linda Keith:**

Yeah.

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**Bill Conerly:**

I think we've all been humbled and I had forgot that quote that you just read, but yeah, anybody who feels strongly that they know where the economy is going is not thinking too carefully. And I hate to be the economist who says, "On the one hand, on the other hand," but the range of uncertainty is really, really strong. Let me tell you what my forecast is, but I'd like to come back in a moment to the uncertainty, if that's all right, Linda.

**Linda Keith:**

Sure, yeah, what do you think is going to happen? And I must admit, I think you're very brave going on record at all right now as to any kind of forecast because, well, you'll come back to the uncertainty, but go ahead, be brave.

**Bill Conerly:**

Well, the old joke is, if they ask for a number, do not give them a date. And if they asked for a date, don't give them a number.

**Linda Keith:**

Okay.

**Bill Conerly:**

What we had when we did the lock downs was an alphabet soup. Is this going to be a V-shape recovery where it goes sharply down, sharply back up? Or L-shape, down and then levels off? A U-shape is down and then stays low before it comes back up. And some people use the swoosh image, but I don't use it because I don't want to violate anybody's trademark.

**Linda Keith:**

Well, and I've heard of the W also.

**Bill Conerly:**

Right. The W, if in the fall, we learn that COVID is seasonal and we get another round of cases and hospitalizations go up, we might get another shutdown. I'm a square root kind of guy.

**Linda Keith:**

Oh, okay.

**Bill Conerly:**

I have a math aptitude, though I don't really love math, but I've envisioned the economy going sharply down. That part is correct. And then coming sharply up, but not getting as high as it had been, and then leveling off. And leveling off at a subpar level, not as high up as we had been in January and that's because of continued social distancing. So restaurants will have people at tables, but maybe every other table. The travel industry is going to be way down. Hotel industry will be way down. So the overall economy, sharp down, partial, sharp recovery, and then a level. So it kind of looks like a square root sign.

**Linda Keith:**

And what's going to make the sharp up part? Because it feels like this whole reopening thing is happening so sporadic throughout the country. So maybe there's a sharp up in Thurston County, Washington, where I am, but do you expect that to be for the economy as a whole? And then of course, potentially global? Or is that going to be geographically different?

**Bill Conerly:**

Yeah, definitely geographically different. If you're in New York City today, you're in a different situation than if you're in Clackamas County, Oregon, where we have reopened at phase one reopening. So for businesses with a geographic concentration, keeping track of your local case loads and stage of reopening is important. But there's been so much doom and gloom and it's human nature to focus on risks and dangers, but incomes are actually high. In the most recent data we got, it was stunning, that we had an all time record high increase in personal income in the country.

**Linda Keith:**

I had no idea.

**Bill Conerly:**

Right. Well, personal income is not only wages and salaries, but also government transfer payments. And we had a record high level of unemployment insurance, plus the bonus, the extra $600 a week that people on unemployment were getting. Plus those $1,200 stimulus checks. Some of the listeners may be in the high income level, in that case, you didn't get a check, but many other people did. So incomes were high, but consumer spending was also a record decline.

**Linda Keith:**

Yeah. Because we couldn't get our massages, our pedicures, our going out to restaurants. There's a lot of things we didn't get to spend money on.

**Bill Conerly:**

I looked at my credit card statement and I had spent a lot less and I was not trying to cut back, I just didn't have the opportunity.

**Bill Conerly:**

So we have had forced savings and a lot of consumers are ending up with extra money in their bank account and paying down a credit card bills and thinking about draperies and blinds, garden tools.

**Linda Keith:**

Fences. Home Depot is doing great. Home Depot has got to be doing well.

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**Bill Conerly:**

Yeah. And I do a little bit of puttering around woodworking and some of the new equipment I wanted is on back order. So there's a lot of parts of the economy where people are trying to spend money and some businesses are seeing opportunities. You've seen those plexiglass screens at checkout counters. Well, there's some business that's selling those.

**Linda Keith:**

That's right.

**Bill Conerly:**

So there are some folks spending money and that's why I think we're going to get back up, but we're not going to get all the way up to where it had been.

**Linda Keith:**

Well, let me ask you, because the focus of the news often is the increase in unemployment claims and the people who are in trouble, and certainly there are many of them, so I don't discount that at all. But what I'm hearing you say is that when they look at the big picture, actually, personal income is up across, if you look at the aggregate rather than individuals. So it's an example of how, if we are just listening to the news, we might get a real different impression of what the economic impact will be on our business borrowers in our local communities.

**Bill Conerly:**

That's right. And the newsworthy story is about the person who lost a job. It is not newsworthy to say that Joe who lives next door to me, continued to work.

**Linda Keith:**

Right. Or the people who actually made a little bit more money on unemployment than they did when they were working.

**Bill Conerly:**

That's right, because of the bonus. So that square root shape is my forecast. But one of the things I've written is that I did not advise companies to bet the business on any one guru's economic forecast.

**Linda Keith:**

Even yours?

**Bill Conerly:**

Even mine. And I started forecasting professionally as a young man with dark hair and because this is not video, your listeners don't know, but I've got a lot of gray hair and I've been doing this a long time and this has been the biggest challenge to me as an economic forecaster.

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**Bill Conerly:**

One of the things I look at, that your listeners can look at, is the Wall Street Journal every month does a survey of economists. And if you have a forecast, you can go online and get all the details of the survey. And it turns out that if you get a group of economists and track their forecasts month by month by month, that the average forecast is more accurate than the most accurate individual forecaster over long period of time. But what I'm seeing now when I look at the forecast is huge range. Estimates for the second quarter, the quarter that we're in through June 30th of 2020, from minus 57% GDP to minus 8%. If you don't know whether it's minus 57 or minus 8, you don't know anything.

**Linda Keith:**

You know, that makes probably me and other non-economists feel a little bit better that we don't know what's going on, because apparently the experts don't either.

**Bill Conerly:**

Exactly. And this is unprecedented. I've gone through plenty of recessions and for this pandemic, I pulled out my notes on the Spanish flu that I had taken, when we had the avian flu worries a decade ago, and we can learn a little bit from those things, but we have not had the lockdown like we had. So this is totally new ground and our sophisticated statistical econometric models, as wonderful as they are, they're based on historic averages. And when things are not average, those models don't work very well.

**Linda Keith:**

Well, this is very much like what our loan originators face when they are looking to either lend or restructure and we say, "Oh, good, look at the last three years and make sure you're able to do a good cashflow forecast and then project forward." Well, right now, however the business did in the last three years, it is helpful to know, but it certainly isn't predictive of what's happening next.

**Bill Conerly:**

Right. And the business underlying a particular credit analysis, a business owner, or executive walks into a bank office, that's an old story, gets on a Zoom call with the bank-

**Linda Keith:**

Yeah, there you go.

**Bill Conerly:**

On a Zoom call with the banker, well, some small portion of the businesses that talk to bankers are destined to fail. And the question is, is it going to be 2020 or 2021 or 2022? And if you follow restaurants, you see failures all the time. But even major names, we used to have a company called Toys"R"Us, where you might have shopped for that new grandchild, but it's gone the way. But there are other companies that could have survived in the absence of a pandemic, but are not going to survive. They just didn't have the resources to get through. And then probably the largest class of companies are businesses that will get through, it's going to take a hit, it's going to be tough, but they'll get through. And the poor banker has to figure out which category is the particular company in.

**Linda Keith:**

Absolutely. And I think another variation here, you've got the ones that would have failed anyway, you've got the ones that are strong enough to make it through, and then there's this other category where maybe it is strong enough to make it through, but the owner just doesn't have the heart. Maybe they were 10 years from retirement and they look at this and go, "You know what? I can hit the stop button now, or I can spend the next five years trying to recover this position and not get any further than I would if I just found something else to do." I'm not sure how the bankers find that one out either.

**Bill Conerly:**

Yeah. And that's a good point and it's a much broader point than just the business owner, because in a time of great disruption, of great change, people are re-evaluating a lot of things. How much time should I spend at work compared with spending time with my family? How do I want to spend my free time? How important is the business to me? Do I want to keep working for this jerk of a boss? I'm sure that nobody listening here has a boss who's a jerk.

**Linda Keith:**

No, or is a boss that's a jerk.

**Bill Conerly:**

I've heard rumors.

**Linda Keith:**

Yeah, exactly.

**Bill Conerly:**

This is a time where there's a lot of reevaluation and some of it is nuts and bolts of supply chains and work from home issues. But some of it is life choices. And I would expect a lot of surprises. And the way that the lender deals with that in terms of a customer is the same way that a senior executive deals with a line employee, and that is conversation, "Tell me how you're feeling, tell me what's going on. What's your sense of it? What are you afraid of? What are you optimistic about?" Just open-ended conversation is really, really valuable at helping the banker understand the business owner and helping the executive understand the employee.

**Linda Keith:**

And in so much uncertainty, because, as evidenced by your range of a negative 50% to a negative 8%, everybody is in uncertainty, those conversations are going to also help solidify the thinking of the person asking the questions.

**Bill Conerly:**

That's right. And I have been in on some of the conversations, although I was never a loan officer, the goals are twofold. The first goal is always present, evaluate the credit risk of the business. But the second goal is to build the relationship and to be a value-added partner for the customer and asking good questions is really, really helpful. And the banker does not need to know the answer to the question, but asking questions like, "Well, gee, inventory levels, let's talk about inventory levels. Do you need more because of supply chain disruptions or do you want to trim inventories because of the recession?" I would recommend that the banker not pretend to know the answer, but to ask the question.

**Linda Keith:**

Well, and truly, one of the reasons the banker needs to ask those kinds of questions is because if they do need to build more inventory, there may be a loan component to that that the banker needs to decide, could we step in and help make that happen? So, very dynamic circumstances. We're going to do another episode, Bill, where we dive into a case study, if you will, of what the different areas of the business those business owners should be looking at. So let me just wrap up this piece on the economic forecast. I understand you're going for a square root, which really, I don't think I'd heard anybody else say that, so very, very different. But also what that does mean if it turns out that you've described it correctly, is that the bankers need to be looking at their borrowers to help them understand a, can they withstand the big drop? Do they have enough liquidity, capital, personal resources to do it? And, can they make whatever changes are necessary to be viable during that flattened out period that's not where they were, but hopefully at some point they'll be able to grow back to where they were, it's just not going to be fast? Is that a fair synopsis of your thinking?

**Bill Conerly:**

You've got it, Linda. And just throw in that this is my economic forecast, but let's not bet the business on it.

**Linda Keith:**

Don't bet the business on anybody's forecast. Well, Bill, thank you so much for being with us today and helping us figure out, not only what you think it looks like, but some of the things to watch for as we move forward helping our borrowers and our bank through what's coming.

**Bill Conerly:**

Great chatting with you, Linda.

**Linda Keith:**

Thanks for joining us on the Credit Risk Ready podcast. Subscribe, comment, or share on social media to stay connected and spread the word. Join me next time as we bring our bank, our customers, and our communities through the recession safe and sound. Take care.

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### *About Bill Conerly*

Bill has a Ph.D. in economics and over 30 years applying economics to business challenges. He worked for First Interstate Bank rising to the level of Senior Vice President and has held positions in economics and corporate planning at two Fortune 500 corporations. And for the past 10 years he has consulted for companies large and small, helping them to make better decisions through a better understanding of the economy.

He writes for Forbes Magazine and is the author of two books.
The first is 'Businomics: From the Headlines to your Bottom Line -- How to Profit in Any Economic Cycle."

His most recent book is 'The Flexible Stance: Thriving in a Boom/Bust Economy." He is also a member of the Oregon Governor's Council of Economic Advisors.

Links to books:
Businomics, https://www.conerlyconsulting.com/writing/businomics/, also available on Amazon.

The Flexible Stance, https://www.conerlyconsulting.com/writing/the-flexible-stance/

Newsletter (free): latest issue, plus option to sign up:
https://www.conerlyconsulting.com/writing/newsletter/

### *About Linda Keith*

Linda Keith CPA draws on her 30+ years of experience consulting with and training lending institutions, background in public accounting, 15+ years as CFO of the family residential construction company, experience as an Examiner with the Washington State Auditor's office and as adjunct faculty in Accounting Principles and Managerial Accounting to help lending and credit professionals say “Yes” to good loans.

Of course, you know those are not consecutive years or she'd be over 100 by now!

Linda is known by her clients to be both practical and funny. In fact, there is a move afoot to change the 'P' in CPA to stand for 'Playful'. The fact is people absorb ideas and learn better when they are having a little bit of fun. So, Linda brings the fun along with her practical knowledge and depth of understanding to provide credit analysis training and presentations that make a difference.

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She is the founder of Lenders Online Training, a virtual classroom approach to improving tax return and financial statement analysis capabilities; the host of the Credit Risk Ready Podcast; and a consultant/trainer on credit risk to banks and credit unions across the country.

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