WEEKLY

Economic Commentary

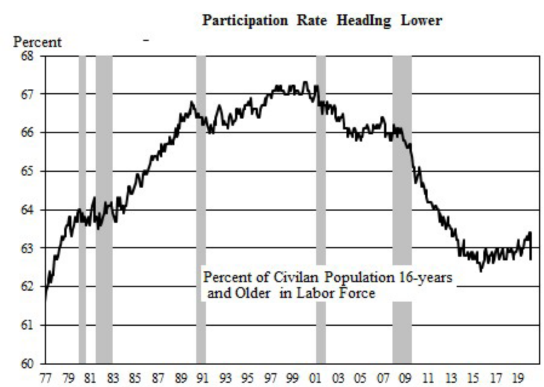
April 17, 2020

Millennium
CORPORATE CREDIT UNION

In like a lion, out like a slaughtered lamb. That's the path traveled by the U.S. economy in the first quarter. With virtually all important economic indicators for March now in the books, the opening chapter of 2020, which started off so promising, ended with a decided thud as Covid-19 sucked all the air out of the economy. The deflating experience, which is replicated throughout the world, has thrown both the U.S. and the global economy into the steepest recession since the 1930s. That ominous depiction won't be confirmed by the NBER for at least several months, but official validation is not needed for the more than 20 million U.S. workers thrown out of their jobs since mid-March, fully 13 percent of the American workforce.

The drumbeat of economic reports over the last two weeks throws a harsh spotlight on the economy's performance in March, with no sector escaping the pain. But with a nod to Al Jolson, we caution that "you ain't seen anything yet." As bad as economic conditions looked last month, they will look even worse in April. That's particularly true for the job market; as grim as the employment report for March was, with 701 thousand workers cut from payrolls, it only covered the period through the second week of the month. The social distancing and shelter-in-place mandates that shut down the economy didn't take hold until the second half of March, when claims for unemployment benefits skyrocketed. Those layoffs and furloughed workers will be captured in the April jobs report, which will see the unemployment rate soar well into double digits.

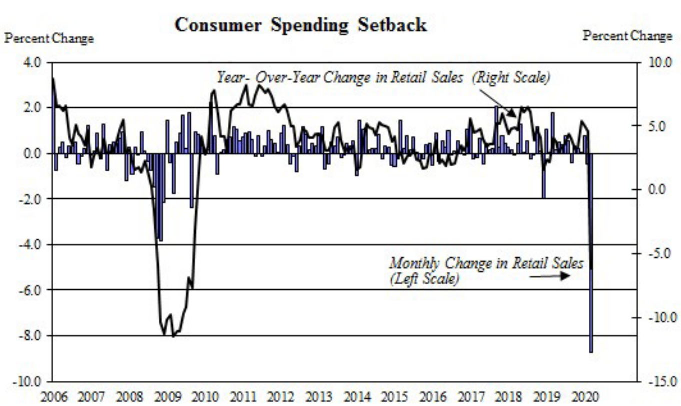
What's more, the official jobless rate will understate the actual carnage that Covid-19 is inflicting on the labor market. For one, state employment offices are overwhelmed by the huge volume of applications for jobless benefits, leaving many laid-off workers still waiting to have their claims processed. For another, a sizeable fraction of claims are being rejected for a variety of reasons. According to some estimates, only about 65 percent of jobless claims are being accepted. Many of the rejected workers will simply drop out of the labor force and not be reflected in the official unemployment rate. It took ten years of steady job growth to finally start pulling workers off the sidelines and arrest the long downturn in the labor force participation rate. That progress has been reversed in less than a month. Indeed, the participation rate slipped by 0.7 percentage points in March, erasing fully 70 percent of the increase accomplished since 2015. We suspect that next month will see the rate fall back to the lowest level since the early 1970s.



Unlike the jobs report, the batch of economic reports released this week does capture activity for all of March. But they also reflect conditions that prevailed earlier in the month when the economy's gears were still mostly turning. To some extent, the pre-lockdown period enjoyed a bump in activity as households loaded up on essential goods amid rising fears of Covid-19. As those fears materialized and lockdown restrictions became a reality, the urgency to possess food, toilet paper and other essential items intensified, resulting in surging sales at grocery stores and panic buying over the Internet from households unwilling to leave their homes. Indeed, the 26.9 percent increase in grocery sales last month was the largest on record. Not surprisingly, that increase was mirrored by a 26.5 percent drop in revenues at restaurants and bars, as shoppers opted to eat and drink in the confines of their homes.

While sales at grocery stores and food and drinking places are roughly the same ($188 million versus $174 million) there are four times as many workers at restaurants and bars than at groceries (12 million versus less than 3 million). Hence, the shutdown of millions of small businesses in the leisure and hospitality sector is causing far more job losses than are gained from the temporary boost in grocery sales. With households hoarding so much food amid the uncertainty of how long lockdown restrictions would stay in place, it's reasonable to wonder when they will return to restaurants after the restrictions are lifted. Until there is widespread confidence that a vaccine or treatment for the virus has been developed, households could well decide to work off their bloated food inventory at home rather than risk getting infected in populated venues, such as restaurants.

That said, the panic-driven increase in a select group of sales does not alter the larger picture of how abruptly consumers have gone into hibernation. Total retail sales plunged 8.7 percent in March, the steepest freefall on record. The decline cut across most retail sectors and included a laundry list of record-setting pullbacks. Among them, sales of autos fell 25.6 percent, home furnishings (-26.8 percent), clothing (-50.5 percent), sporting goods (-23.3 percent) and merchandise at department stores (-19.7 percent). Understandably, most of the setbacks were for discretionary purchases, as consumers least able to afford such items are among the hardest-hit by the wave of layoffs.



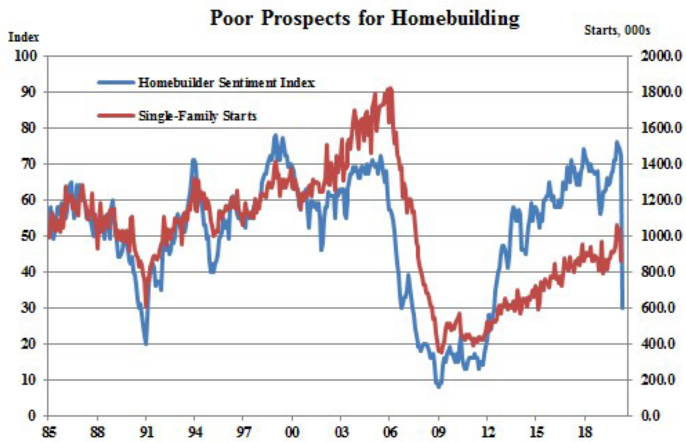
With lockdown restrictions applying to a broader swath of the nation this month and unemployment rolls swelling exponentially, consumers will zipper up their wallets and purses to an even greater extent. We expect the floor under retail sales to open wide in April, putting the economy in a deep hole at the start of the second quarter. Even under the best of circumstances that sees an easing of lockdown restrictions by next month, the economy is not likely to climb up very far. We expect GDP to contract by an eye-opening 40 percent annual rate in the second quarter, paced by a record drop in consumer spending, the economy's main driver.

Needless to say, the destruction of demand is taking a major toll on producers of goods. Factories, bereft of orders and beset by massive cancellations, are slashing operations or shutting down plants completely. Industrial production fell 5.4 percent in March, the sharpest decline since 1946 when the U.S. was demobilizing following the war, prompting a clampdown of military-related production. And like consumer spending, the downturn in production accelerated over the second half of the month as the pandemic gained traction and prompted ever-more factories to shutter operations. The near-term outlook looks even bleaker. Regional surveys of manufacturing are pointing to a deeper slide in production this month. The New York Fed's Empire State manufacturing index plunged to a record low in April, and the Philadelphia Fed's manufacturing index slumped to a multi-decade low during the month.

Ordinarily, the housing sector benefits from the decline in interest rates and easing financial conditions that typically occur when the economy falls on hard times. Not so this time. Indeed, the fall in interest rates could not be more dramatic, driving mortgage rates to all-time lows this week. But while the precipitous slide in mortgage rates is spurring a wave of refinancings, it is doing little for the overall housing market. Simply put, the tightening of economic conditions is more than offsetting the loosening of home financing conditions. With jobs drying up and income prospects falling by the wayside, prospective homebuyers are retreating to the woodworks.

That, in turn, is putting the kibosh on housing construction. Housing starts fell 22.3 percent in March, reversing a promising trend that low interest rates helped facilitate earlier in the year. Indeed, even with the March setback, housing starts in the first quarter rose from the previous quarter, indicating that residential outlays made a modest contribution to economic growth during the period. But the second quarter will be a different story. In addition to the fall in starts last month, building permits - a barometer of future construction activity - also fell by almost 7 percent.

Importantly, single-family permits, which account for the lion's share of residential spending, plunged by 12 percent to the lowest level since last August. This falloff together with a steep decline in home-buying traffic is sending homebuilders into a deep depression. The Homebuilders Sentiment Index staged the sharpest one-month decline in its history, tumbling by an eye-opening 40 points in April. With this sinking feeling, homebuilders are likely to close down construction of single family homes for the foreseeable future. Hence, following the modest first-quarter gain, we expect housing starts to slide by a 25 percent annual rate in the second quarter.



Ironically, building permits for multi-family homes actually rose in March as did the volume under construction, most of which are apartments. In fact, multi-family starts picked up considerably last year, reflecting the strength of the job market and demographic trends that spurred higher demand for rental units. Hence, a growing supply of apartments will be hitting the market just as the economy is sliding into a deeper recession and destroying the very jobs that underpinned the demand for rental units. With a growing number of these occupants falling behind in their rents and supply poised to expand later this year, the stage is set for a severe imbalance in this sector of the housing market later this year.

The kick-off to the earnings season also offered a grim picture of the initial impact of the coronavirus crisis on corporate profits. Amid collapsing sales, the near-term outlook for corporate earnings is dire: according to the latest Factset estimates, Q1 earnings of S&P 500 companies are expected to contract 14.5% from a year ago, which would mark the largest annual decline since Q3 2009. Despite historically weak fundamentals, equity markets continued to rally this week as forward-looking investors focused on plans to reopen the economy. That said, given the extreme uncertainty surrounding the evolution of the contagion post-lockdowns - with elevated risk of a new wave of infections - we believe optimism should be tempered. Without medical advances in the form of broad-based testing, therapeutics, and an eventual vaccine, relaxing the current lockdown will happen only very gradually, and in the absence of public trust, the resumption of activity will be slow and economic confidence likely still depressed.

KEY FINANCIAL & ECONOMIC INDICATORS

FINANCIAL INDICATORS

INTEREST RATES	April 17	Week Ago	Month Ago	Year Ago
3-month Treasury bill	0.14%	0.22%	0.04%	2.42%
6-month Treasury bill	0.19	0.24	0.18	2.47
3-month LIBOR	1.13	1.22	1.20	2.58
2-year Treasury note	0.20	0.22	0.32	2.39
5-year Treasury note	0.36	0.42	0.46	2.37
10-year Treasury note	0.64	0.73	0.86	2.56
30-year Treasury bond	1.26	1.35	1.45	2.96
30-year fixed mortgage rate	3.31	3.33	3.65	4.17
15-year fixed mortgage rate	2.80	2.77	3.06	3.62
5/1-year adjustable rate	3.34	3.40	3.11	3.78
STOCK MARKET				
Dow Jones Industrial Average	24242.29	23719.37	19173.98	26559.54
S&P 500	2874.56	2789.82	2304.92	2905.03
NASDAQ	8650.14	8153.58	6879.52	7998.06
Commodities				
Gold ($ per troy ounce)	1692.10	1752.80	1497.20	1277.90
Oil ($ per barrel) - Crude Futures (WTI)	18.34	22.73	19.84	64.00

ECONOMIC INDICATORS

	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Quarters Ago	Average-Past 6 Months or Quarters
Retail Sales (March) - % change	-8.7	-0.4	0.8	-1.3
Industrial Production (March) - % change	-5.4	0.5	-0.5	-0.9
Capacity Utilization (March) - Percent	72.7	77.0	76.7	76.3
Housing Starts (March) - 000s	1216	1564	1619	1454
Building Permits (March) - 000s	1353	1452	1550	1452

Millennium Corporate Credit Union
8615 West Frazier Street
Wichita, Kansas 67212