WEEKLY

Economic Commentary

July 17, 2020

Millennium
CORPORATE CREDIT UNION

The streak of upside surprises provided by incoming economic reports continued unabated this week, highlighted by robust increases in retail sales, industrial production and even consumer prices, all for the month of June. Like the jobs report released two weeks ago, these stronger-than-expected reports confirm that the economy's performance in the second quarter will not be as abysmal as thought a month or so ago. From our lens, we see real GDP declining by an annual rate of 28 percent, a slight haircut from the 30 percent tumble expected prior to the latest retail sales report, and a meaningful improvement from the near-40 percent plunge thought likely earlier in the quarter.

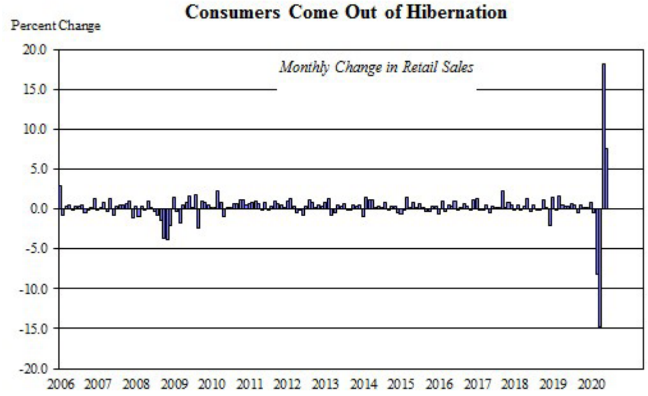
But while the consensus of economists has also tempered its grim estimate for the period, the prognosis for the rest of the year has not brightened. If anything, the resurgence of Covid-19 cases in recent weeks has cast an ever-darker shadow over the economic landscape, notwithstanding some promising developments on the vaccine front. To be sure, the latter has lifted spirits on Wall Street, where stocks posted another gain this week. But sentiment on Main Street is becoming less upbeat. The reason: many states are walking back their reopening plans, delaying the lifting of lockdown restrictions, forcing many businesses to shut down again or, at best, enforcing social distancing mandates by imposing penalties on companies that fail to comply. Some restaurants in New York have been forced to close for not abiding by state mandates that prohibit large gatherings of patrons.

All this is creating heightened uncertainty among firms and households. The former eagerly responded to the lifting of lockdown restrictions in May and June, as a tidal wave of returning customers with huge pent-up demands from weeks of self-quarantine prompted them to recall many furloughed workers. Most firms expected to rehire the remainder of their work force as the economy continued to reopen. But those plans are now being upended by the resurgence of the virus, which has prompted renewed government-mandated closings as well as growing health anxiety among customers that is derailing the return of normal shopping habits.

With sales prospects looking less promising than a few weeks ago, a growing swath of firms is putting the planned rehiring of furloughed workers on hold, and many are poised to reduce staff once again. Indeed, the steep decline in layoffs from April's peak has stalled; new claims for regular jobless benefits remained virtually unchanged in the latest week at 1.3 million, which is still about six times higher than the running tally just prior to the onset of the pandemic. A month ago, most furloughed workers expected to be rehired as businesses reopened. Now according to recent surveys more than half do not expect to get their jobs back, either soon or the foreseeable future. Worse, legislation that temporarily provides them with an extra $600 in weekly unemployment benefits expires in less than two weeks, with no assurance that it will be extended.

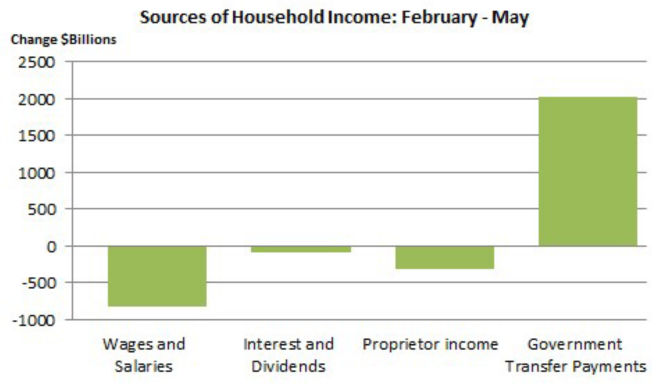
All this puts the recent rebound in key economic reports in a less flattering light. Among this week's releases, retail sales are the most vulnerable to an abrupt setback. For one, much of the pent-up demand during the lockdown has been satisfied. The outsized 7.5 percent increase in retail sales in June following the eye-opening 18.2 percent surge in May has recovered virtually all of the pandemic-related losses in March and April. Total retail sales are now just a tad below the pre-Covid level and are actually 1.1 percent higher than a year ago. Core retail sales, which feed directly into personal consumption in the GDP accounts, have moved above their pre-pandemic level by nearly 2 percent and stand more than 6 percent higher than June of last year. That underscores our latest upward revision of GDP for the second quarter.

Consumers Come Out of Hibernation



While the increases among retail sectors were uneven, most posted gains, as ten of the thirteen major categories saw sales increases. Not surprisingly, discretionary purchases led the way, reflecting pent-up demand for such items. Hence, the sectors that suffered the steepest declines during the pandemic recorded the sharpest bounce-backs in May and June. Most notably, revenues at bars and restaurants jumped 20 percent in June following an even-steamier 31.5 percent surge in May. Despite those torrid increases, however, this sector is still feeling the effects of pandemic restrictions, which put limits on indoor dining and allowed only the partial reopening of other recreational establishments. Hence, sales at bars and restaurants are still more than 25 percent below the February level, just before Covid-19 gained traction in the U.S. However, consumers satisfied pent-up demands for other discretionary goods, including motor vehicles where sales exceeded pre-pandemic levels in June.

With unfilled demands mostly met, future sales gains would be more incremental in line with store reopenings and the availability of goods to purchase. However, the upswing in cases of the virus and renewed restrictions on business reopenings put the prospective broadening of supply in jeopardy. Just as important, the sources of strength that have underpinned the rebound in consumer demand may not be sustained in coming

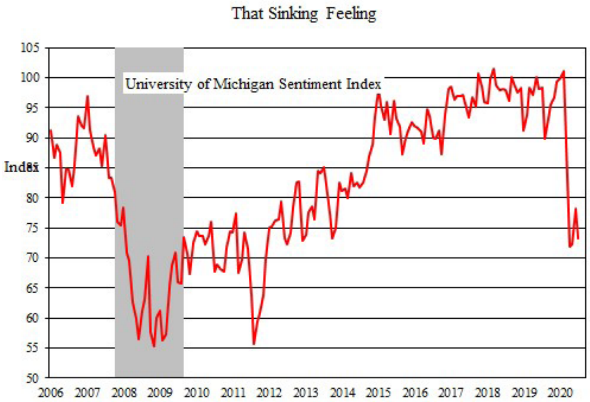


months. Keep in mind that while consumer outlays, and particularly retail sales, are up strongly over the past two months, the traditional income supports for spending are not. Wages and salaries are down, as are proprietors' income and receipts from financial assets. The only source of income support has come from the government, as transfer payments surged by more than $2 trillion between February and May.

While the increase in government transfer payments, mostly in the form of unemployment benefits and direct stimulus payouts, are considered part of income in the government's calculation, they are not as powerful a source of sustained spending as is earned income. With nearly 15 million fewer jobs than existed in February, there is a steep hill to climb before workers can regain the $822 million in wages and salaries that have been wiped out by pandemic-related layoffs. Nor are small businesses in a good position to recoup their losses incurred since February, as the reopenings that spurred a rebound in proprietors' income in May - and probably in June - are now in the process of reversal. Meanwhile, the drop in interest and dividend receipts should continue, as the Fed is holding down rates and corporate profits are shrinking.

That leaves fiscal stimulus as the main engine of consumer spending and the extent, much less the prospect, for continued support from this source is far from assured. As noted, the $600 supplement to weekly unemployment benefits is set to expire before the end of the month and Congress has a narrow window before the August recess to reach a compromise on further aid. The odds favor some form of help, but they must overcome pockets of resistance among lawmakers. Some believe that the muscular rebound in jobs and spending in recent months justifies a pullback in fiscal stimulus, at least until there is evidence that the economy falters again. Others feel that generous government handouts, such as the enhanced unemployment benefits, discourage beneficiaries from searching for work. Most believe that some continued stimulus is needed, but there remains wide disagreement over its scope and how the funds should be distributed.

The uncertainty over job prospects and whether the government will continue to offset the loss of paychecks with additional payouts is infiltrating the mind-set of households. Household sentiment tumbled in early July, according to the preliminary University of Michigan survey released on Friday, erasing virtually all of the rebound in the previous month. Importantly, household expectations sank more than assessments of current conditions, indicating that consumers have a grimmer outlook for employment and incomes. In fact, there was a jump in negative expectations for both. Unless Congress acts quickly to pass legislation that provides income relief to households, a further deterioration in household sentiment seems inevitable.



That, of course, bodes poorly for consumer spending, which is the economy's main engine of growth. Again, we expect some form of government relief to be forthcoming, although the longer it takes for policy makers to get their act together, the greater will the economy suffer over the near term. As it is, we suspect that the upside surprises in the economic data are about to ebb and may be replaced by downside surprises in coming months, as consumers pull back and firms, both small and large, are forced to close down or reduce operations. Auto manufacturers revved up assembly runs in recent months to restock dealer inventory and accommodate a spike in sales. That catch-up phase is over and production may stumble in the face of a dimming sales outlook and tougher credit conditions. The solid rebound in economic activity in May and June set the stage for a robust increase in GDP during the third quarter. But momentum heading into the period is fading and, depending on fiscal action and how much progress on the health front is made, speculation about a double-dip recession may well gain traction in the fall.

KEY FINANCIAL & ECONOMIC INDICATORS

FINANCIAL INDICATORS

INTEREST RATES	July 17	Week Ago	Month Ago	Year Ago
3-month Treasury bill	0.12%	0.13%	0.15%	2.07%
6-month Treasury bill	0.14	0.15	0.17	2.04
3-month LIBOR	0.27	0.27	0.31	2.28
2-year Treasury note	0.15	0.17	0.20	1.81
5-year Treasury note	0.27	0.31	0.32	1.81
10-year Treasury note	0.63	0.65	0.70	2.05
30-year Treasury bond	1.33	1.34	1.46	2.58
30-year fixed mortgage rate	2.98	3.03	3.13	3.81
15-year fixed mortgage rate	2.48	2.51	2.58	3.23
5/1-year adjustable rate	3.06	3.02	3.09	3.48
STOCK MARKET				
Dow Jones Industrial Average	26671.95	26075.30	25871.46	27154.20
S&P 500	3224.73	3185.04	3097.74	2976.61
NASDAQ	10503.19	10617.44	9946.12	8146.44
Commodities				
Gold ($ per troy ounce)	1812.00	1802.20	1754.10	1425.70
Oil ($ per barrel) - Crude Futures (WTI)	40.57	40.49	39.50	56.13

ECONOMIC INDICATORS

	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Quarters Ago	Average-Past 6 Months or Quarters
Retail Sales (June) - % change	7.5	18.2	-14.7	0.5
Industrial Production (June) - % change	5.4	1.4	-12.7	-1.8
Capacity Utilization (June) - % change	68.6	65.1	64.2	70.9
Consumer Price Index (June) - % change	0.6	-0.1	-0.8	-0.1
Core CPI Index (June) - % change	0.2	-0.1	-0.4	0.0

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