WEEKLY

Economic Commentary

July 24, 2020

Millennium

CORPORATE CREDIT UNION

The economy is awash in available credit and the only ones borrowing and spending it are the U.S. government and, to a lesser extent, homebuyers. The latter may soon be scaling back their appetite for new loans as heightened anxiety over job security, a resurgence in cases of Covid-19, deteriorating affordability and scarce supply of homes for sale are all conspiring to restrain housing activity. Yet, the funds keep on coming, with the Fed keeping its foot on the monetary accelerator, hoping that bringing the economic horse to the trough will encourage it to drink. So far, that's been a fruitless exercise.

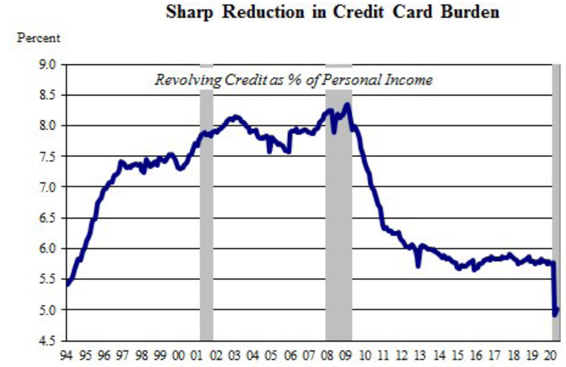
For sure, the government is stepping up to the plate, incurring a deficit that is poised to hit $3 trillion and on track to head higher depending on the size of the upcoming stimulus package currently being deliberated in Congress. The $2.2 trillion stimulus from the CARES Act passed in March has clearly played a huge role in putting a floor under the economy's knife-plunge in activity during the second quarter, filling an income gap that would have become a chasm for households as the pandemic vaporized more than 20 million paychecks in March and April. But the funds from that program are running out, and the prospect that laid-off workers would soon find their unemployment checks slashed because of inaction or delayed action is sending tremors through both Wall Street and Main Street.

Odds are, Congress will get its act together and forge a compromise that would extend enhanced jobless benefits for workers. Timing may be critical, as the additional $600 a week currently received by unemployed workers is set to expire this week. That extra benefit will likely be cut, given the stiff resistance from many members of the Senate to maintain a benefit of that size. But there is broad agreement on other parts of a prospective deal, such as providing aid to facilitate school reopenings, boosting funds to deal with the health crisis, renewed help for small businesses and doling out stimulus checks directly to households. The Democrat-led House has already approved a $3.2 trillion bill and the Republican-led Senate is countering with a smaller figure, starting with about $1 trillion. Something in between should emerge from negotiations over the next week or so.

The question is, what impact will another round of fiscal relief, whatever its size, together with the ongoing flood of credit generated by the central bank will have on the economy. As noted, putting funds in the hands of households and businesses does not guarantee that they will spend it. True, the $1200 stimulus payments made in March plus the enhanced jobless benefits for the past three months have put some hefty muscle into consumer spending in May and June. But it's not as if households went on a spending binge and neglected to shore up their finances in the face of adversity. In fact, one of the striking features of household behavior during this pandemic recession is their determination to reduce debt burdens and remain solvent.

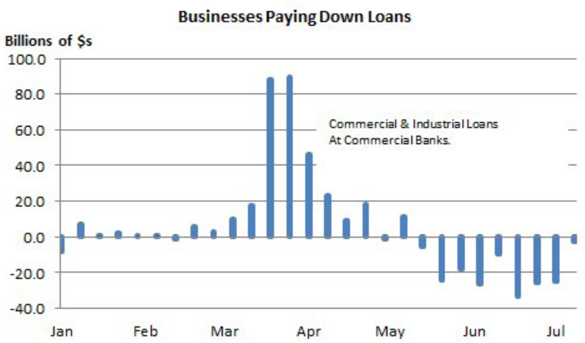
For example, consumers paid down a record $104 billion of their credit-card debt in the three months from March through May. While some of the decline may have been write-offs related to the recession, that influence was far less prevalent than was the case during the Great Recession, when households were clearly overburdened with debt and had little recourse but to declare bankruptcy to rid themselves of their obligations. The success in rebalancing debt burdens in recent months is nothing short of remarkable, as credit-card debt has not been lower as a share of personal incomes in more than 25 years. To be sure, the plunge is partly an artifact of an income numerator bloated by government transfer payments. But there is no doubt, that some portion of those payments was used to pay down debt and some to prop up

Sharp Reduction in Credit Card Burden



savings, which remained elevated at 23.2 percent of personal income in May.

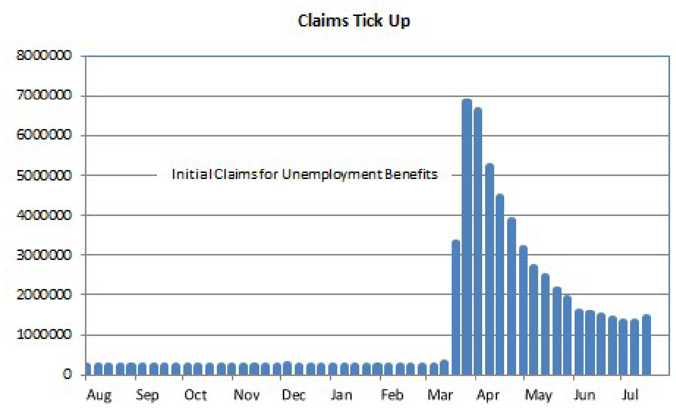
Likewise for businesses, which have hardly availed themselves of all the credit available to them. True, most of the funds from the Payroll Protection Program (PPP) have been tapped and another round is likely to come out of Congress. But after the initial spurt in borrowing, businesses have been paying down debt incurred at commercial banks, erasing more than half of the increase taken in March and April, the most intense period of the recession. No doubt, the paydowns have not come out of revenues, which have been squeezed by the collapse in economic activity during the second quarter. Instead, large corporations with access to the capital markets refinanced short-term debt with the proceeds from a frenzied pace of bond issuance.



According to Federal Reserve data, nonfinancial corporations raised a record $655 billion through bond offerings in the three months from March through May, more than three times the gross proceeds raised in the previous three months and exceeding the entire amount raised in 2018. The upsurge reflected a number of factors, including rock-bottom interest rates and the Federal Reserve's commitment to backstop the corporate bond market through direct purchases. That, in turn, bolstered market confidence and stoked a buying spree among investors willing to snap up lower-credit issues offering higher yields. Importantly, however, while the funds raised may shore up corporate balance sheets, they have not translated into increased investment spending.

To be sure, healthier balance sheets will enable businesses to ramp up operations and rehire workers when the health crisis ebbs and the economy embarks on a sustainable recovery path. But it's far from certain when that inflection point will be reached. The stimulus-fueled rebound in activity in May and June is already falling victim to the resurgence in virus cases. Baseball has returned but stadiums are devoid of fans, mirroring the patchwork reopening of businesses throughout the economy. Rather than gaining traction and putting the economy on a fast track towards recovery, the gears of the reopening process are starting to sputter in the face of the escalating health crisis.

With many states hitting the pause button and some reimposing lockdown restrictions that were only recently eased, the recovery is losing momentum early in the third quarter. Both consumer and small business confidence is starting to buckle, underscoring a raft of anecdotal evidence pointing to weaker sales and hiring trends. The most dramatic manifestation of this among the week's slim calendar of reports came from the Labor Department, which revealed an increase in new claims for unemployment benefits for the first time since March. After falling steadily from a peak of 6.87 million in late March to 1.31 million in the July 11 week, initial claims rose in the latest week to 1.40 million. One week does not make a trend of course, but the downtrend in filings had slowed considerably in recent weeks and the latest uptick suggests that the July employment



report may well show a net loss of jobs for the month following the record gains in April and May.

It's too early to conclude that the revival in hiring has stalled. But it does heighten the imperative of more fiscal support, lest the absence of compensation growth undercut consumer spending, the economy's main growth driver. Even if an agreement on a stimulus bill that extends enhanced unemployment payments is accomplished next week, there is a strong possibility that the program will not be recalibrated in time to prevent some interruption of payments. Keep in mind that the House and Senate would need some time to reconcile differences in their respective bills, and a scaling back of the $600 weekly bonus payment will likely be part of the compromise.

The one bright spot coming from the copious flow of cheap credit is the housing market, as record-low mortgage rates is stoking a home-buying surge. New home sales spiked by almost 14 percent in May to the highest level in nearly 14 years. The robust pace of sales reduced the inventory of homes on the market to a slim 4.7-month supply, far below a normal six-month supply. The scarcity of homes on the market is boosting prices, which is a potential headwind for future sales. On the flip side, however, low inventories and higher prices are time-honored catalysts for homebuilders to rev up construction. That said, residential activity has less of an influence on the broader economy than in earlier cycles and the housing market faces the same headwinds as other sectors, most notably the resurgence of Covid-19 that threatens to stifle jobs and income growth and restrain demand for homes.

The markets will be closely monitoring the progress of negotiations in Congress on a stimulus package as well as news on the health front over the coming week. The latter is going in the wrong direction as cases of the virus are rising while the former may well run into avoidable delays if some headstrong legislators resist making compromises on key issues. We do expect a package to be delivered that will not satisfy everyone but serve as a stabilizing force in the markets. One wild card that has once again resurfaced is the rise in China-U.S. tensions, which is always a catalyst for heightened volatility. The latest flare-up threatens to inject another unwelcome dose of uncertainty in a market that is already coping with a good deal of unsettling events.

KEY FINANCIAL & ECONOMIC INDICATORS

FINANCIAL INDICATORS

INTEREST RATES	July 24	Week Ago	Month Ago	Year Ago
3-month Treasury bill	0.11%	0.13%	0.15%	2.07%
6-month Treasury bill	0.13	0.15	0.17	2.04
3-month LIBOR	0.25	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	0.59	0.65	0.70	2.05
30-year Treasury bond	1.23	1.34	1.46	2.58
30-year fixed mortgage rate	3.01	3.03	3.13	3.81
15-year fixed mortgage rate	2.54	2.51	2.58	3.23
5/1-year adjustable rate	3.09	3.02	3.09	3.48
STOCK MARKET				
Dow Jones Industrial Average	26469.89	26075.30	25871.46	27154.20
S&P 500	3215.63	3185.04	3097.74	2976.61
NASDAQ	10363.18	10617.44	9946.12	8146.44
Commodities				
Gold ($ per troy ounce)	1899.80	1802.20	1754.10	1425.70
Oil ($ per barrel) - Crude Futures (WTI)	41.27	40.49	39.50	56.13

ECONOMIC INDICATORS

	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Quarters Ago	Average-Past 6 Months or Quarters
Existing Home Sales (June) - 000s	4720	3910	4660	4902
New Home Sales (June) - 000s	776	682	571	689
Leading Economic Indicators (June)	2.0	3.2	-6.3	-1.4

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