



WEEKLY

Economic Commentary

June 19, 2020

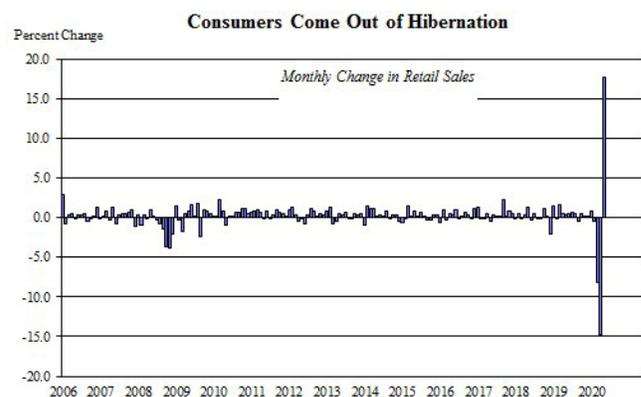
The financial markets continue to grapple with conflicting forces. On the positive side, the economy is steadily mending as the easing of lockdown restrictions allows shuttered businesses to reopen and enables households to unlock a torrent of pent-up demand. Factories are coming back to life, millions of workers are being rehired and cash registers are ringing again. Record low mortgage rates, the onset of spring and improving sentiment are spurring a burst of activity in the housing market. For the most part, economic indicators are showing more strength than expected, confirming that the worst of the Covid-19 recession is behind us.

But the health crisis continues to cast a dark shadow over the economic landscape. Along with the phased reopening of the economy, the number of infections is once again rising, particularly in states that were among the earliest and most aggressive to lift restrictions. While the increase has not yet prompted an economic backlash, concerns over a second wave are rising, even as most health officials insist that the first wave has not yet been tamed. The lingering presence of the coronavirus poses two main threats. First, if the increase in cases accelerates, states may well re-impose lockdown restrictions, short-circuiting the recovery before it gains traction. Second, as long as the prospect of getting infected remains a genuine risk, consumers will be reluctant to resume normal activities, including traveling, going to restaurants or participating in any event where more than a handful of people congregate. Social-distancing mandates may be relaxed, but households striving to stay safe will still follow them.

This conflict of opposing forces will not be resolved anytime soon, preventing investors from getting a clear sense of market direction. Last week, for example, heightened fears of a second wave sent stock prices lower, but generally positive economic news brought a reversal this week, notwithstanding a setback on Friday. For the most part, however, the positive vibes that stoked a record-setting rally beginning in late March remain very much in place thanks largely to an aggressive Federal Reserve, which continues to expand its arsenal of policy tools to keep the recovery going. This week the Fed

announced that it would add more support to the corporate bond market, even as Chair Powell in his congressional testimony reaffirmed the Fed's commitment to retain a highly accommodative monetary policy for the foreseeable future. Meanwhile, a movement is afoot on Capitol Hill to pump-prime the economy with an infrastructure-spending bill that could amount to trillions of dollars of added stimulus.

The combination of policy stimulus, the easing of lockdown restrictions and stronger-than-expected economic data in recent weeks has led many to believe that a V-shaped recovery is getting underway. To some extent, that perception may also be fueling a heightened sense of optimism on Wall Street, keeping upward momentum under stock prices. No doubt, recent upside surprises in key economic indicators do argue for a less dire near-term outlook than thought a few weeks ago. The biggest surprise was this week's report on retail sales, which revealed a record surge in consumer spending last month. The consensus on Wall Street was that sales would increase by about 8.5 percent in May. But the outcome more than doubled the consensus forecast, surging by 17.7 percent. Put in context, the previous record increase for a month was 6.7 percent in October 2001.



Not surprisingly, the rebound was paced by spending categories that suffered the most during the lockdown, including apparel, furniture, recreational goods, autos and electronics and appliances. The unleashing of spending on these discretionary items reflects pent-

up demand that had built up while consumers were confined to their homes. As lockdown restrictions were gradually relaxed, impatient households wasted no time unleashing this demand to the delight of long-suffering retailers, many of which were on the cusp of bankruptcy. What's more, consumers had plenty of firepower to support the torrent of spending. Flush with \$1200 stimulus checks, expanded unemployment benefits and record savings that ballooned to 33 percent of disposable incomes in April, the wherewithal to flood the spending stream was clearly in place.

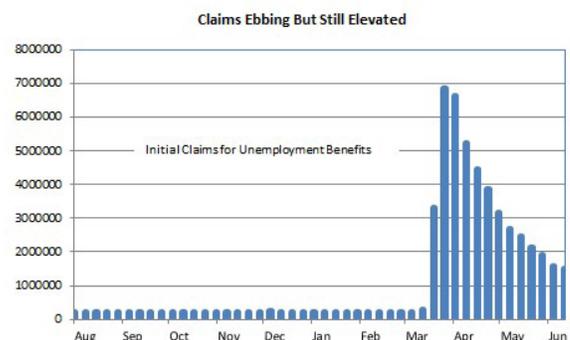
The stronger-than-expected retail sales report together with other recent upside surprises, particularly the eye-opening jobs report for May, shines a brighter spotlight on the economic landscape. From our lens, the second quarter still looks terrible, but the contraction in overall activity now appears somewhat less severe than earlier thought; we shaved our GDP forecast to a negative 35 percent from just over 40 percent. That's still a huge hole to climb out of, and hopes for a V-shaped recovery that would make up lost ground quickly is just that - a hope rather than a realistic prospect. There are too many hurdles to overcome for us to subscribe to that prospect.

For one, much of the fuel that propelled consumer spending last month is set to dissipate. The expanded unemployment benefits that give laid-off workers an extra \$600 a week is set to expire at the end of July; at this juncture, there is not enough support in Congress to extend it. Likewise, the \$1200 stimulus checks sent out earlier this spring only goes so far; odds are, they were probably used up by the vast majority of recipients. No doubt, lawmakers would come back to the table with more stimulus if the economy falters in the summer. But by then it might be too little, too late to swiftly offset the headwinds threatening to derail the recovery. Then there is the still-uncertain path of the virus, which could be the hammer that nails the recovery door shut.

Indeed, an indication of how sensitive the financial markets, much less the economy, is to the ebb and flow of the virus's path surfaced on Friday, when Apple announced a slew of store closings due to a rise in infections at their locations. Within minutes of

the announcement, the stock market turned south, sending prices sharply lower. The response by Apple could well be replicated in coming weeks if the rise in Covid-19 cases continues and reaches alarming proportions. As it is, many high-profile companies that are labor intensive are reopening with fewer workers than they had before the health crisis, both to comply with social-distancing policies for employees and to retain a smaller staff in case the sales recovery is weaker than expected. A growing trend may also restrict the pace of rehiring; retailers are implementing measures that enable them to operate with fewer workers. Walmart, for example, is testing a new payment system that allows it to eliminate all cashiers at one of its stores.

Assuming that the move towards reopenings by states is not interrupted, there is a better than even chance the recovery will gain traction, marking the end of one of the shortest, albeit the steepest, recessions on record. Most high-frequency data indicate that the burst of activity in May has extended into June, although with somewhat less vigor. On the jobs front, for example, initial claims for unemployment benefits are steadily receding, slipping by another 58 thousand to 1.51 million in the June 13 week. That's the 11th consecutive week of declining claims and leaves the latest tally far under the peak 6.87 million first time claimants in late March. The number of recipients receiving benefits is also declining.



That's the good news. The bad news is that the pace of declines has slowed considerably in recent weeks,

suggesting that the rehiring binge accompanying the first phase of easier lockdown restrictions may be petering out. Worse, if more firms follow the path of Apple and close down due to the virus, the ranks of the unemployed will once again swell. Even so, the current level of first-time applicants for jobless benefits, at 1.5 million, is considerably above anything seen in the postwar period, except for the spike at the start of the current recession. In the four years prior to the crisis, a normal pace of jobless claims would hover around 200 thousand a week.

That said, with more states reopening in June than in May, there is likely to be more hiring than layoffs, pointing to another net gain in payrolls during the month. Other high-frequency data are also sounding a positive note, particularly in the housing market, where mortgage applications for home purchases are surging. In the week ending June 12, the index measuring the volume of purchase applications jumped to its highest level since January 2009, according to the Mortgage Bankers Association. Homebuilder sentiment is also high and the supply of homes for sale is low. That's a combination that augurs for a pickup in residential construction in coming months.

the picking of low-lying fruit. The heavy lifting lies ahead and we note that every postwar recession contained at least one-quarter of growth. Even the Great Recession and financial crisis from 2007-2009 included a 2.1 percent increase in GDP in the second quarter of 2008 before relapsing into four more quarterly contractions. The sizeable increase in GDP for the third quarter, which we expect, may not be another head-fake; but neither will it be the launching pad for a V-style rocket.



But we caution against thinking that the vigorous rebound in recent economic reports points to a V-shaped recovery. While we believe the upturn will be sustained, barring a serious relapse in the health crisis, the initial burst of activity is coming off an exceptionally low base and, hence, is akin to

KEY FINANCIAL & ECONOMIC INDICATORS

FINANCIAL INDICATORS

INTEREST RATES	June 19	Week Ago	Month Ago	Year Ago
3-month Treasury bill	0.15%	0.18%	0.12%	2.13%
6-month Treasury bill	0.17	0.20	0.15	2.06
3-month LIBOR	0.31	0.31	0.40	2.34
2-year Treasury note	0.20	0.21	0.17	1.75
5-year Treasury note	0.32	0.34	0.34	1.78
10-year Treasury note	0.70	0.71	0.66	2.06
30-year Treasury bond	1.46	1.36	1.37	2.56
30-year fixed mortgage rate	3.13	3.21	3.24	3.84
15-year fixed mortgage rate	2.58	2.62	2.70	3.25
5/1-year adjustable rate	3.09	3.10	3.17	3.48
STOCK MARKET				
Dow Jones Industrial Average	25871.46	25605.54	24465.16	26719.13
S&P 500	3097.74	3041.31	2955.45	2950.46
NASDAQ	9946.12	9588.81	9324.59	8031.71
Commodities				
Gold (\$ per troy ounce)	1754.10	1738.70	1736.20	1402.70
Oil (\$ per barrel) - Crude Futures (WTI)	39.50	36.52	33.55	57.60

ECONOMIC INDICATORS

	Latest	Previous	Two-Months/ Quarters Ago	Average-Past 6 Months or Quarters
	Month/Quarter	Month/Quarter		
Retail Sales (May) - % change	17.7	-14.7	-8.2	-0.8
Industrial Production (May) - % change	1.4	-12.5	-4.6	-2.7
Capacity Utilization (May) - Percent	64.8	64.0	73.2	72.1
Housing Starts (May) - 000s	974	934	1269	1325
Building Permis (May) - 000s	1220	1066	1356	1346

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