WEEKLY

Economic Commentary

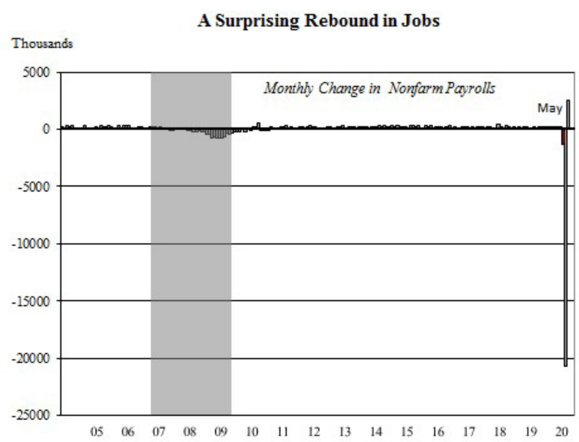
June 5, 2020

Millennium
CORPORATE CREDIT UNION

The financial markets were jolted by another unexpected development this week, although this time the surprise was a welcome one. To be sure, equity investors had effortlessly climbed a wall of worry over the past month, driving stock prices up by more than 40 percent from their lows in late March, recovering all but about 5 percent of the debilitating plunge over the previous month. It was the sharpest rally over a 50-day period ever recorded and it continued into this week, overcoming additional challenges posed by roiling protests throughout the nation and in increase in tensions with China over its dealing with Hong Kong. These latest growth deterrents would only complicate the economy's ability to recover from the deep slide in activity caused by the coronavirus pandemic.

But the wall of worry took an unexpected turn on Friday when the Labor Department issued a surprisingly upbeat jobs report, defying consensus expectations that the economy lost several million more jobs in May. After all, most high frequency data and anecdotal reports pointed in that direction, most notably the 12.3 million new filings for unemployment benefits during the month. Keep in mind that the markets were already looking beyond another bleak report, rallying on expectations that the muscular stimulus pumped into the economy would fuel a turnaround in activity, although the timing and strength of the expected recovery remained an open question. What's more, most felt that additional fiscal and monetary stimulus would be forthcoming if needed to turn things around.

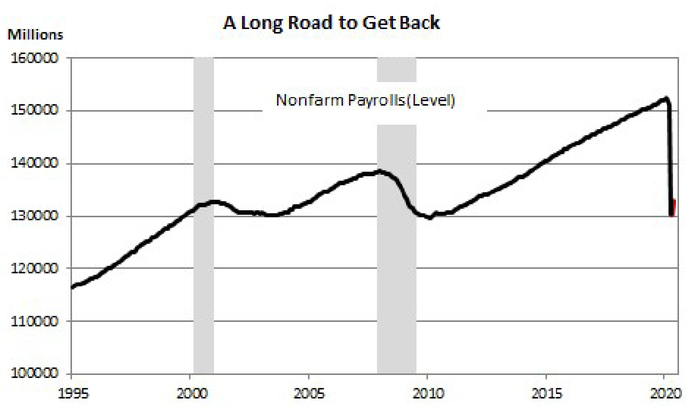
With Friday's jobs report, the markets optimistic take on prospects didn't seem as far-fetched as many skeptics believed. Indeed, stock prices surged by another 3.0 percent or so during the day, bolstered by expectations that the economy is poised to recover sooner rather than later. Instead of losing 6 to 8 million more jobs in May as widely expected, the Labor Department stunned the markets, reporting that nonfarm payrolls actually rose by 2.5 million during the month. And instead of rising to 20 percent or higher as the consensus had projected, the unemployment rate actually fell 1.4 percent to 13.3 percent. The gain in employment was widely spread, with 64 percent of all industries expanding payrolls, the sharpest jump in the diffusion index ever and up from less than 4 percent in April.



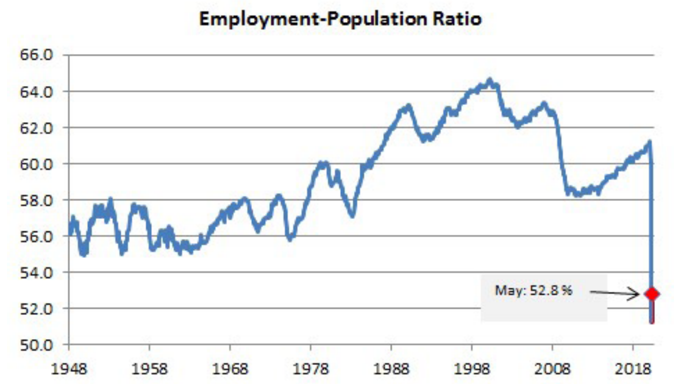
Needless to say, the astonishing turn of events pleased the administration as well as the stock market. But as promising as the headline numbers appear, we believe it is far too early to uncork the champagne. For sure, the jobs report is unequivocally positive news for an economy that has been reeling since the pandemic struck. At the very least, it confirms that the worst of the downturn is behind us and the trough of the recession likely occurred in April. But while an inflection point may well have been reached, it is important to remember that a one-month report, as positive as it is, does not make a trend. It would be a mistake to extrapolate a 23 million swing in jobs - from a 20.6 million loss in April to a 2.5 million gain in May - into upcoming monthly gains.

From our lens, the remarkable turnaround last month reflected the easy-lifting part of the healing process. In a note accompanying the report, the Labor Department notes that the number of workers on temporary layoffs decreased by 2.7 million in May, virtually spot-on with the increase in payrolls. This suggest that the job gains last month consisted entirely of companies recalling furloughed workers, a natural response as lockdown restrictions gradually eased. There are still 15.3 million workers on temporary layoff, about 73 percent of all unemployed workers. Hence, the good news is that most unemployed workers retain a link to their jobs, making recalls easier as the economy continues to take fitful steps towards reopening. No doubt, the Payroll Protection Program is giving this process a big lift.

The bad news is that the longer it takes to recall these workers, the greater the chance that many of these temporary layoffs will become permanent. Keep in mind that at the May pace of gains, it would take seven months to drain the pool of temporary layoffs and another five months to recover the 22 million job losses that occurred in March and April. That timeline gives a sense of how deep a hole the labor force has fallen into, and how steep a climb lies ahead just to get back to where we were before the pandemic. It would be a stretch to believe the pace of job recovery would be as brisk as was the pace of job destruction. The health crisis is far from over, social distancing mandates remain in effect and lingering fears of infection will restrain the willingness of workers to return to their jobs and consumers to resume normal purchasing habits.



We suspect that the unemployment rate will remain elevated for at least a year. At 13.3 percent it still stands firmly in recessionary territory, well above the postwar peak of 10.8 percent. What's more, it still understates the level of unemployment. Nearly 6 1/2 million workers were classified as "employed but absent from work". If they were counted as unemployed, the jobless rate would be about 3 percentage points higher, putting it at over 16 percent. The broader measure of underemployment, which includes workers in part-time positions who would prefer full-time jobs as well as discouraged workers, still stands above 20 percent, falling 1.6 percent to 21.2 percent in May. Instead of looking at the various unemployment rates, many prefer to use the employment/population ratio as a barometer of job performance because it removes the distortion of who should or shouldn't be classified as unemployed or part of the labor force. In May, that ratio remained at a low 52.8 percent, well below the pre-pandemic peak of 61.2 percent.



That said, there is little question that the job market has started to recover much more quickly than anyone expected. This probably should come as little surprise as economists are notoriously bad at predicting turning points in economic activity. As much as anything, the above-mentioned surge in the diffusion index from under 4 percent to 64 percent last month depicts how rapidly industries and businesses reopened their doors. But the index measures the percent of industries adding jobs and says little about the number of jobs being added. Hence, a high percentage of firms may be coming back to life, but if they are recalling only a portion of their workforce it will be a long while before the massive job losses are recovered.

Importantly, the welcome earlier-than-expected recovery in job growth should not spur widespread upward revisions in GDP forecasts for the current quarter. A more telling indicator is aggregate hours worked, which remains deeply depressed even with a modest uptick in May. The average for April and

May is still running an annualized 56 percent below the first quarter. Even allowing for a modest increase in productivity, the second quarter's growth rate continues to wallow deep in negative territory, tracking a negative growth rate of more than 40 percent. We expect that hours worked will edge higher again in June, which should make another dent in that shortfall; but the headline performance for the period will still be worse than anything seen in the postwar period.

As already noted, the latest jobs report is very encouraging news for the administration, which is already championing the notion that the economy will rebound like a "rocket ship" from the pandemic-induced recession. We concur that the rebound is starting sooner than expected and the economy should experience a robust growth pickup in the third quarter. But again, the early stage of the recovery will be like picking low-hanging fruit; once the easy lifting of rehiring furloughed workers is finished, the uphill climb will become more difficult. Indeed, it's fair to wonder how much of a temporary boost to employment is coming from the PPP program, as companies rush to obtain forgivable loans for hiring workers before the funds run out.

Which raises the question of whether the upside surprise in the latest jobs report diminishes the urgency for more fiscal and monetary stimulus. This poses a conundrum for the administration. On the one hand, it would like to revel and take credit for the rapid comeback in activity it believes is underway, something that would support the argument that no further stimulus is needed. On the other hand, the administration would clearly like to see the economy as strong as possible heading into the election, something that would argue for more stimulus to jump start growth. To the extent that the president pushes for the latter option, he would run head-on with his own party in the Senate that is urging fiscal restraint.

From our lens, the economy would need more help just to keep the nascent recovery on track, much less provide impetus for accelerated growth. To be sure, there is a considerable pent-up demand that is fueling the earlier-than-expected snapback in activity. But once these demands are satisfied the heavier lifting will start, as consumers struggle to decide how quickly to resume normal shopping behavior amid ongoing fears of infection. Our sense is that they will remain cautious and restrain spending activity until an effective treatment or a vaccine is found. Indeed, as encouraging as the latest jobs report is, it also bolsters the case for more assistance to state and local governments. While the vast majority of industries were expanding payrolls, these cash-starved local governments continued to cut back, shedding 487 thousand, mostly educational, workers in the face of slumping tax revenues.

KEY FINANCIAL & ECONOMIC INDICATORS

FINANCIAL INDICATORS

INTEREST RATES	June 5	Week Ago	Month Ago	Year Ago
3-month Treasury bill	0.16%	0.15%	0.12%	2.28%
6-month Treasury bill	0.19	0.17	0.15	2.16
3-month LIBOR	0.32	0.35	0.43	2.45
2-year Treasury note	0.21	0.16	0.16	1.86
5-year Treasury note	0.48	0.31	0.33	1.85
10-year Treasury note	0.90	0.66	0.69	2.08
30-year Treasury bond	1.67	1.41	1.38	2.57
30-year fixed mortgage rate	3.18	3.15	3.26	3.82
15-year fixed mortgage rate	2.62	2.62	2.73	3.28
5/1-year adjustable rate	3.10	3.13	3.17	3.52
STOCK MARKET				
Dow Jones Industrial Average	27110.98	25383.11	24331.32	25983.94
S&P 500	3193.93	3044.31	2929.80	2877.34
NASDAQ	9814.08	9489.87	9121.32	7742.10
Commodities				
Gold ($ per troy ounce)	1688.40	1743.00	1704.80	1345.20
Oil ($ per barrel) - Crude Futures (WTI)	38.94	35.32	24.63	54.10

ECONOMIC INDICATORS

	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Quarters Ago	Average-Past 6 Months or Quarters
ISM Manufacturing Index (May)	43.1	41.5	49.1	47.1
ISM Non-manufacturing Index (May)	45.4	41.8	52.5	51.2
Nonfarm Payrolls (May) - 000s	2509	-20687	-1373	-3150
Unemployment Rate (May) - Percent	13.3	14.7	4.4	7.2

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