



# WEEKLY

Economic Commentary

March 13, 2020

The financial markets and vested participants are understandably obsessed with hard data. But when events strike suddenly and move the needle as swiftly as is currently the case, even the most recent economic report becomes moot. For example, the Federal Reserve Bank of Atlanta's GDPNow tracking model pegs growth for the first quarter at 3.1 percent, up from a 2.7 pace in the previous estimate, based primarily on the blockbuster payroll report released last Friday. To be fair, the bank unequivocally states that: "GDPNow is not an official forecast of the Atlanta Fed. Rather, it is best viewed as a running estimate of real GDP growth based on available data for the current measured quarter. There are no subjective adjustments made to GDPNow - the estimate is based solely on the mathematical results of the model."

That, of course, is the problem. Since the shock from the coronavirus struck the global economy like a thunderbolt, market participants, economists and policymakers are essentially flying blind. The hard data coming out now merely highlight how high a perch the economy stood before the news of the virus became a headline-grabbing depressant on the American economy. The only questions now are, how steep will the fall be and how long will it last? Given the fact that the downfall is rooted in a health crisis that still has no remedial endgame, it would be folly to provide definitive answers. Household and businesses are still adjusting their behavior in response to changing fears and developments that are evolving daily. The government is also struggling to come up with answers, but the proposals coming out of Congress as of Friday morning fall far short of the "shock and awe" that is probably needed to restore public confidence.

For sure, investors remain on edge given the uncertainty regarding the ultimate fallout from the virus on earnings, the economy and the financial system. After suffering the steepest daily plunge since 1987 on Thursday, the stock market officially entered bear territory at the end of the day, having exceeded the necessary 20 percent price decline from its nearby peak before rebounding sharply on Friday. What's more, investors are not finding safe havens easy to come by. The bellwether 10-year note, a time-honored landing spot for safety-seeking

funds, has actually lost value over the past week, as its yield rose by more than half-percentage point between Monday's low and Friday's close. Even gold prices fell by more than \$150 from its \$1675/oz. level over the period.

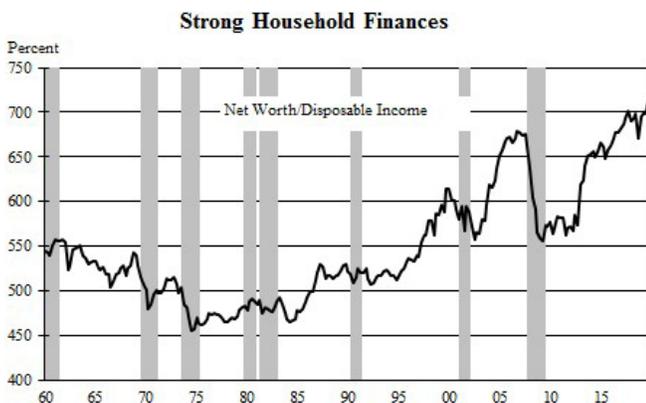
The Federal Reserve, acting as the only adult in the room, is moving swiftly to mitigate disruptions in the financial markets, pumping as much as \$1.5 trillion of liquidity into the banking system and increasing its purchases of long-term Treasury securities, reviving the policy of quantitative easing employed earlier in the expansion to relieve financial stress. At its upcoming policy meeting next week, odds are it will reduce the federal funds rate again on the heels of the emergency half-point cut taken last week. The rate currently stands in a range of 1.00-1.25 percent and at least another half-point cut is widely expected. Some believe that the central bank should slash the rate back to the zero bound like it did during the financial crisis in December 2008. While there is a good chance the move to a zero bound will ultimately be needed to stave off a recession, the sentiment to go there now and get it over with is growing. That would be akin to the "shock and awe" needed to restore public and market confidence that many believe should be coming from the fiscal side.

Clearly, no matter what policy moves lay ahead, the disruption in the financial markets and the economy will only end when the health crisis is brought under control, something that is not yet on the radar screen. The good news, as alluded to earlier, is that the deterioration in economic conditions is coming off of a lofty perch, which provides some cushion before a recession sets in. Most important is that the job-creating engine was running in a high gear, highlighted by the stunning 273 thousand payroll increase for February, capping a robust 243 thousand average gain over the last three months. Not only has the recent pace of job creation far exceeded expectations as well as the growth in the working-age population. It is also an acceleration from the pace of last year, which averaged 178 thousand a month.

No doubt, the job-creating engine is running into

a brick wall and the slowdown will be precipitous. Layoffs already announced in a broad swath of industries, paced by airlines, tourism and leisure and hospitality sectors that are bereft of customers under self-imposed quarantine, are poised to spread throughout the service and goods-producing sectors. Needless to say, the loss of paychecks will impose financial hardship on affected workers and put a severe crimp on spending. To some extent, however, the damage will be offset by the striking improvement in balance sheets that households collectively experienced in recent years. The extent of that progress was confirmed in the latest balance sheet data released by the Federal Reserve, which covers the period through the fourth quarter of last year.

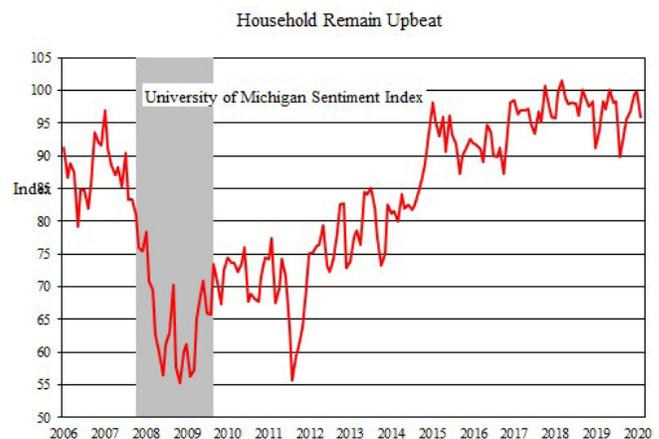
Thanks to rising home values and appreciating stock prices, household net worth grew by another \$3.1 trillion in the fourth quarter and more than \$11 trillion for the year, reaching a new record of \$118.4 trillion. The financial cushion this provides households is also formidable, as net worth is more than seven times higher than disposable incomes, which is also a record high. That said, it is important to remember that wealth is not distributed equally among income groups. The vast majority of stocks are held by upper income households who have benefited the most from the unprecedented 11-year bull market. Conversely, the 20 percent correction that just occurred delivered the biggest blow to this cohort.



Since shifting asset values does not materially alter

the spending behavior of wealthy households, the market correction should not pose a significant drag on their consumption over the near term. But a deep and enduring slide in stock prices does have a psychological impact on most households, as it signals the onset of adversity that could damage job and income prospects. The freefall in the market has happened so suddenly and swiftly that it may not yet be a confidence-shattering event, reminiscent of the 50 percent plunge over a 15-month period that devastated stock portfolios during the Great Recession and financial crisis from late 2007 to March 2009.

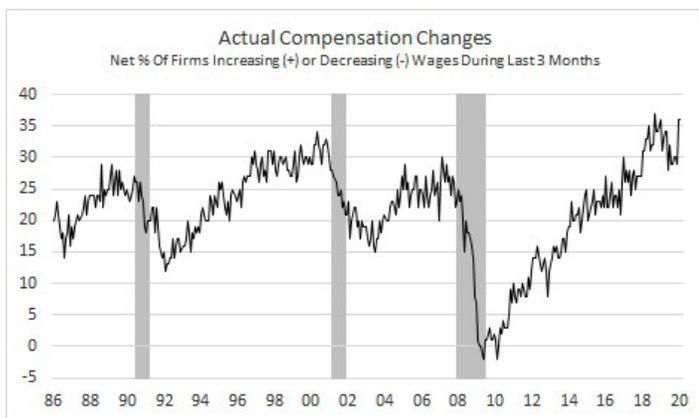
Indeed, according to the latest University of Michigan consumer sentiment survey released on Friday, household spirits were holding up quite well in early March. The overall sentiment index did slip 5.1 points to a five-month low, but at 99.5 it still hovers within 5 points of the high for the expansion. The slippage was entirely due to concerns over the coronavirus, but respondents believed that the episode would be temporary, which seems to be the key support along with the strong job market heading into the crisis for the still-elevated level of confidence. No doubt, that perception will soon crumble as the number of reported infections increases in coming weeks. Ironically, that would be a positive development, as it would signify an expansion in the availability of testing kits, which have - indescribably - been in short supply.



Like households, small businesses had yet to feel the full brunt of the Covid-19 virus or the financial

market turbulence to come when the most recent survey of sentiment was taken. And like households, they too rode a wave of optimism over the first two months of the year, reflecting the economy's strong performance. Hence, the NFIB Small Business Optimism Index rose to a three-month high in February with the biggest concern among owners continuing to be a shortage of labor. Indeed, the share of firms raising wages spiked in recent months, reflecting the strong desire to retain existing workers as well as the difficulty of attracting new ones. But again, the latest survey was taken before the coronavirus and financial market turbulence intensified. Since these firms have a heavy representation in the very service industries - travel, leisure and hospitality, hotels, etc. - most vulnerable to the virus, they obviously suffered a severe blow in early March.

From our lens, the damage may have already been done, and only heroic efforts by the fiscal and monetary authorities would stave off a recession this year. We expect the Fed to step up to the plate at its upcoming meeting next week and slash rates, perhaps by a full percentage point, and indicate that it stands ready to use whatever conventional and unconventional tools available to keep the economy afloat. The odds of success, however, will depend heavily on whether Congress and the administration will also step up to the plate and provide the necessary tax and spending support to boost public morale and stabilize the financial markets. Friday's sharp rebound in stock prices suggests that there is some optimism among investors that this can be accomplished. If not forthcoming over the next few days, however, fasten your seatbelts in preparation of another week of extreme turbulence in the financial markets.



Given the long-standing difficulty of finding workers to fill positions, we suspect that these firms will try to resist handing out pink slips as long as they can. However, announced layoffs have already picked up as shutdowns in sports and entertainment venues, school closings and stiffer travel restrictions are taking place in virtually every state in the nation. We suspect that signs of labor distress will start to show up in rising unemployment claims in coming weeks. While details of the government support that is sure to come are not yet available, they will almost certainly contain aid for workers that have been laid off due to the virus. Some financial support will clearly be needed to sustain consumer spending and keep the economy out of a recession.

# KEY FINANCIAL & ECONOMIC INDICATORS

## FINANCIAL INDICATORS

	<b>March 13</b>	<b>Week Ago</b>	<b>Month Ago</b>	<b>Year Ago</b>
<b>INTEREST RATES</b>				
3-month Treasury bill	<b>0.28%</b>	0.47%	1.58%	2.45%
6-month Treasury bill	<b>0.38</b>	0.41	1.55	2.52
3-month LIBOR	<b>0.74</b>	1.00	1.69	2.60
2-year Treasury note	<b>0.51</b>	0.53	1.42	2.40
5-year Treasury note	<b>0.72</b>	0.61	1.42	2.40
10-year Treasury note	<b>0.98</b>	0.77	1.59	2.59
30-year Treasury bond	<b>1.55</b>	1.29	2.04	3.01
30-year fixed mortgage rate	<b>3.36</b>	3.29	3.47	4.31
15-year fixed mortgage rate	<b>2.77</b>	2.79	2.97	3.76
5/1-year adjustable rate	<b>3.01</b>	3.18	3.28	3.84
<b>STOCK MARKET</b>				
Dow Jones Industrial Average	<b>23185.62</b>	25864.78	29398.08	25848.47
S&P 500	<b>2711.02</b>	2972.37	3380.16	2822.48
NASDAQ	<b>7874.88</b>	8575.62	9731.18	7688.53
<b>Commodities</b>				
Gold (\$ per troy ounce)	<b>1576.40</b>	1674.20	1586.90	1302.30
Oil (\$ per barrel) - Crude Futures (WTI)	<b>32.97</b>	41.57	52.22	58.40

## ECONOMIC INDICATORS

	<b>Latest Month/Quarter</b>	<b>Previous Month/Quarter</b>	<b>Two-Months/ Quarters Ago</b>	<b>Average-Past 6 Months or Quarters</b>
Consumer Price Index (February) - % change	<b>0.1</b>	0.1	0.2	0.2
Core CPI (February) - % change	<b>0.2</b>	0.2	0.1	0.2
Producer Price Index (February) - % change	<b>-0.6</b>	0.5	0.2	0.0
Small Business Optimism Index (February)	<b>104.5</b>	104.3	102.7	103.4

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