WEEKLY

Economic Commentary

May 15, 2020

Millennium
CORPORATE CREDIT UNION

As the debate swirls over how swiftly the economy can recover from the COVID-19 recession, the uphill climb keeps getting steeper. For sure, the deep dive in payrolls has yet to find a bottom, as another 3 million laid-off workers filed for unemployment benefits in the latest week, bringing the cumulative total of new claims to more than 36 million since March 21. The number of new weekly applications is ebbing, but the ranks of the unemployed are poised to swell further and likely drive the unemployment rate to over 20 percent, rivaling the highs of the 1930s depression.

Optimists are clinging to the notion that most of the increase reflects temporary layoffs, suggesting that workers will be quickly rehired as lockdown restrictions are lifted and the economy reopens for business. But that hopeful outlook depends on whether sales rebound swiftly enough to justify putting workers back on payrolls. For that to happen, several conditions would have to be met. First, the process of lifting restrictions would have to gain traction, steadily spreading throughout the nation. So far, more than half the states have eased restrictions in varying degrees, and more are poised to do so in coming weeks. Second, the flattening of infection, hospital and death rates that guides the reopening decisions of government officials would need to continue. Third, households and workers would need to feel safe enough to resume buying habits and return to their jobs. That, in turn, depends heavily on progress being made on the health front, including finding effective treatments for the virus, having enough testing equipment to diagnose the virus and developing a vaccine that would inoculate the population against a recurrence of the virus.

To believe that all three of these conditions are being met would be a stretch. Pressure on states to reopen continues to build and infection rates have receded in some of the hardest-hit regions. For the most part, however, the reopenings are progressing in a patchwork fashion and health experts are warning that a more aggressive approach invites a resurgence of infection rates. Schools remain mostly closed and sports officials are reopening stadiums for games but keeping fans away. Social-distancing mandates are limiting patrons at restaurants and bars as well as other public venues. Each state has its own metrics to determine how rapidly it can reopen. In New York, for example, the hardest hit state in the nation, the governor has allowed regions to reopen if they meet seven metrics. Even then, the reopenings will not be automatic or complete. As the Governor has said, it is not an "on-off" switch; it is more like a dial, allowing regions to open up in phases. For example:

Phase 1: Includes construction, manufacturing and select retail (with curbside pickup)

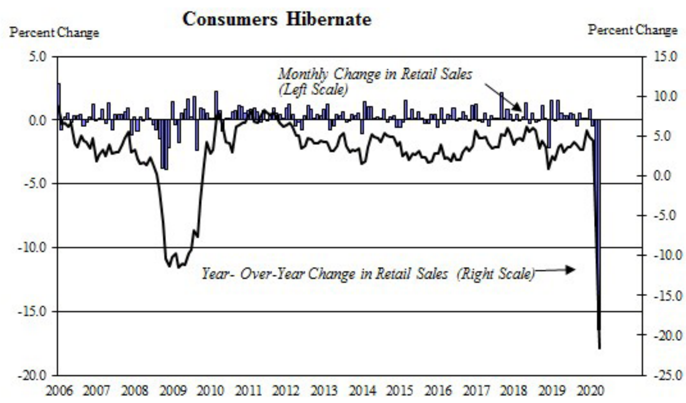
Phase 2: Includes professional services, finance and insurance, retail, administrative support and real estate/rental leasing

Phase 3: Includes restaurants, food services and hotels

Phase 4: Includes arts, entertainment, recreation and education

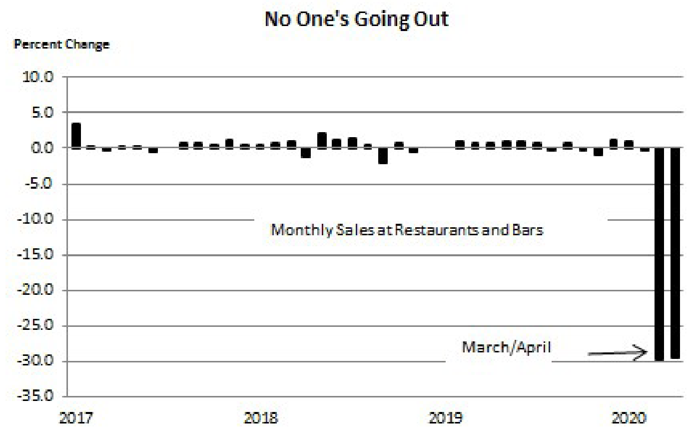
While states are following guidelines to reopen at varying speeds, it's clear that the process will unfold over time and restrain the pace of recovery. But even as businesses reopen their doors, the biggest obstacle to the recovery is, in our view, coming from the demand side. Simply put, most Americans still believe it is too early to reopen the economy, fearing a spike in outbreaks that threatens their safety. It remains to be seen how long this reluctance to resume normal behavior persists. No doubt, spring weather is tempting ever-more households to escape self-quarantine and engage in outdoor activities, going to malls, restaurants, sporting events and even travel. To some extent, that temptation will override fears and spur a pick-up in sales.

But it would take a far more vigorous rebound in spending than expected to make up the staggering losses that businesses have endured over the past two months. Indeed, the falloff in retail sales last month was breathtaking both in its depth and breadth. Total sales plunged by a record 16.4 percent from the previous month, about double the then-record 8.3 percent drop in March. Compared to a year earlier, sales are down by an off-the-charts 21.6 percent. Virtually all businesses took a hit, with sales of discretionary items suffering the biggest declines. That include, most notably, such big-ticket items as autos, where sales fell by 12.4 percent from March and by a whopping 32.9 percent from a year ago. The auto industry is struggling mightily, coping with huge inventories and vanishing sales. Can another "cash for clunkers" program be in the works?



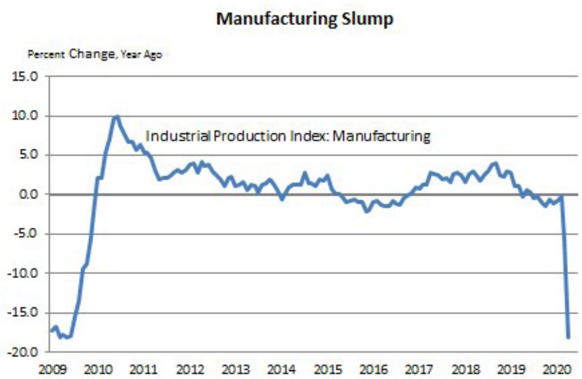
There is an oft-quoted thought experiment that asks, "If a tree falls in the forest and no one is around, does it make a sound?" Following in that vein of thought, "If the price of a product drops and no one is buying it, does it become cheaper?" With the economy falling off a cliff in the second quarter and demand for goods across the board tanking, it comes as no surprise that companies are marking down prices dramatically to retain customers. Hence, prices of apparel fell nearly 5 percent last month, eclipsing the previous record fall of 2.0 percent in March. Yet, no one is buying clothes. Looking over the list of items consumers are shunning, one stand-out category is clothing and clothing accessories, where sales tumbled by 78.8 percent between March and April and by 89.3 percent over the past year. Clearly, people shut in their homes are paying little attention to the latest fashions that can only be admired in their bedroom mirrors.

That said, as lockdown restrictions are lifted, department stores reopen and more people return to work and venture outdoors, clothing sales will pick up. But can the same be said for another discretionary purchase that commands ten times the consumer dollar and employs far more workers than clothing store, namely dining at restaurants and bars? These establishments have arguably taken the biggest blow from the pandemic, suffering a slump in sales even before the virus reached peak intensity in April. More than any other activity, this sector embodies all the anxieties related to the disease, including the reluctance of consumers to venture back to public spaces and the dreadful choice workers must make between returning to their jobs or forgoing a paycheck to remain safe.



If the response of restaurant customers in states that have lifted restrictions on dine-in services is a barometer of household readiness to resume normal behavior, the near-term outlook for the recovery is not promising. In Georgia, for example, one of the earliest states to ease restrictions, restaurant attendance in the week ending May 12 was down 92 percent from a year ago, according to data provided by OpenTable. A similar lackluster response is seen in other early-opening states, including Texas and Missouri, where attendance is down 98 percent. Simply put consumers are putting a high priority on safety and choosing to stay home even after being allowed to venture out. This does not bode well for other forms of recreational spending that involves social interactions, such as travel, going to movies and theaters or sporting events.

If the consumer-spending spigot is slow to reopen, so too will the economy's growth engine be slow to rev up. For one, the temporary layoffs will morph into permanent job losses, as millions of small businesses that are on life support due to lack of customers will close their doors. For another, the lagging recovery in demand will reverberate back to the investment spending decisions of companies. As bookings dry up and growth prospects dwindle, the demand for equipment, machinery and structures, such as oil rigs, to generate output would likewise shrivel. The outsized plunge in industrial production last month is a clear sign of that retrenchment.



Indeed, the preponderance of earnings reports coming out is rife with announcements of investment cutbacks. One sign that companies are dramatically cutting back on investment spending can be seen in the latest industrial production report. While total production fell by a record 11.2 percent in April, business equipment output fell by an even steeper 17.3 percent, also a record by far, leaving the level a full 26 percent lower than a year ago. No doubt, some of the weakness reflects the slump in oil prices that is weighing on energy-related investments. But virtually all industries were cutting back, led by the auto sector where motor vehicle output plummeted by a record 71.7 percent.

With the overall operating rate down to a record low of 64.9 percent in April, it will be a long while before industrial companies are pressured to expand capacity, foreshadowing a sluggish recovery in investment spending as well as in consumer spending. In public comments this week, Fed Chair Powell minced no words in stating that the economy needs more help from the fiscal side to jump-start the growth engine. The latest batch of indicators only confirms that the uphill climb has gotten steeper and more muscular policy efforts will be needed to pull the economy back up.

KEY FINANCIAL & ECONOMIC INDICATORS

FINANCIAL INDICATORS

INTEREST RATES	May 15	Week Ago	Month Ago	Year Ago
3-month Treasury bill	0.12%	0.12%	0.14%	2.39%
6-month Treasury bill	0.15	0.15	0.19	2.42
3-month LIBOR	0.39	0.43	1.13	2.52
2-year Treasury note	0.15	0.16	0.20	2.20
5-year Treasury note	0.31	0.33	0.36	2.18
10-year Treasury note	0.65	0.69	0.64	2.39
30-year Treasury bond	1.33	1.38	1.26	2.82
30-year fixed mortgage rate	3.28	3.26	3.31	4.07
15-year fixed mortgage rate	2.72	2.73	2.80	3.53
5/1-year adjustable rate	3.18	3.17	3.34	3.66
STOCK MARKET				
Dow Jones Industrial Average	23685.42	24331.32	24242.49	25764.00
S&P 500	2863.70	2929.80	2874.56	2859.53
NASDAQ	9014.56	9121.32	8650.14	7816.28
Commodities				
Gold ($ per troy ounce)	1754.10	1704.80	1692.10	1277.60
Oil ($ per barrel) - Crude Futures (WTI)	29.76	24.63	18.34	62.68

ECONOMIC INDICATORS

	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Quarters Ago	Average-Past 6 Months or Quarters
Consumer Price Index (April) - % change	-0.8	-0.4	0.1	-0.1
Core CPI (April) - % change	-0.4	-0.1	0.2	0.0
Producer Price Index (April) - % change	-1.3	-0.2	-0.3	-0.2
Retail Sales (April) - % change	-16.4	-8.3	-0.4	-4.0
Industrial Production (April) - % change	-11.2	-4.5	0.1	-2.6
Capacity Utilization (April) - Percent	64.9	73.2	76.7	73.7

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