WEEKLY

Economic Commentary

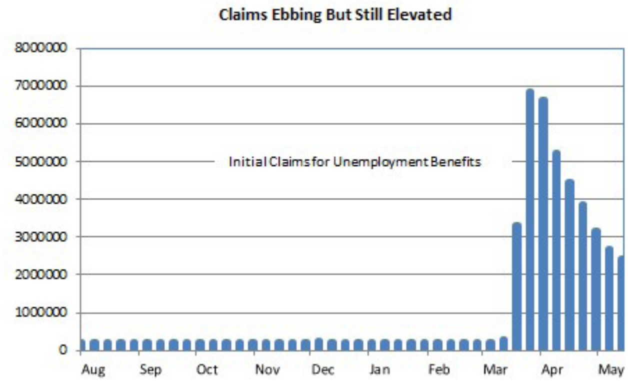
May 22, 2020

Millennium
CORPORATE CREDIT UNION

Now that all 50 states have at least partially re-opened for business, optimists will be searching for "green shoots" confirming that the economy is poised for a recovery that President Trump believes will be the "transition to greatness." The search will not be entirely in vain as the U.S. economy is slowly coming back to life. Restaurants are reopening, the weather is turning balmier, luring people out of their homes and engaging in recreational activities, sales of bicycles are surging, consumers are snapping up outdoor gear and accessories, and traffic on highways is increasing. With department stores reopening shoppers are unleashing pent-up demand; TJ Maxx reports that sales of reopened stores in the first week of May were greater than a year ago.

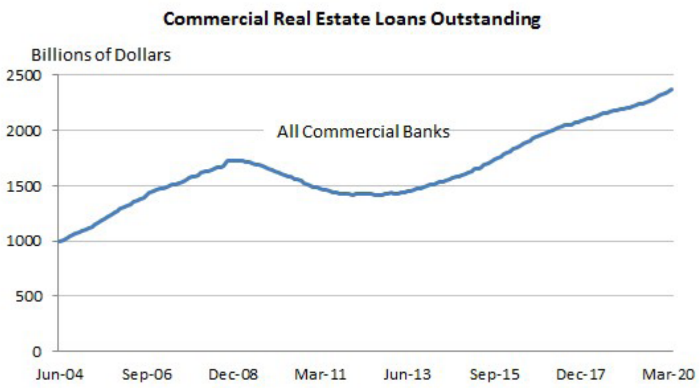
A good case can be made that the worst of the Covid-19 recession occurred in April. But the road to greatness has many potholes to overcome, and the upward climb will be bumpy at best. Indeed, the green shoots are still far outnumbered by the weeds restraining growth, of which there will be none this quarter. Overshadowing the silver linings is the litany of downbeat forecasts that describe a race to the bottom for the economy over the near term. The negative readings for GDP for the quarter are off the charts: the New York Fed's model is tracking a 31 percent annual rate of decline, the Atlanta Fed is at 41.9 percent, the St. Louis Fed at 48.1 percent and the Congressional Budget Office at 38 percent. We think the New York Fed is being overly optimistic.

From our lens, the process is akin to when you stop banging your head against the wall. The pain eases, but it still hurts. Nowhere is the lingering headache more evident than in the job market. The number of workers filing for unemployment benefits continues to ebb from the peak 6.9 million reached in the March 28 week. But the 2.4 million first time applicants in the May 16 week is ten times the normal filings that prevailed in the pre-Covid-19 days. What's more, the latest figures understate the plight of the newly unemployed as they do not include the 6.1 million self-employed and gig workers who are receiving benefits under the emergency Pandemic Unemployment Assistance (PUA) program. These figures are not seasonally adjusted and, hence, are not included with the seasonally adjusted filings reported weekly.



Even the signs of life among retailers come with caveats. The reported surge in sales at TJ Maxx, for example, reflected deep pricing discounting by the firm in a desperate effort to reduce inventories that ballooned during the pandemic. This may be more of a deflation story than an optimistic sales report. Like most chain stores that rely on foot traffic earnings are dropping, even as some high-profile retailers like Neiman Marcus and J. Crew are filing for bankruptcy. Industry analysts note that 3300 stores have already closed their doors this year and a record 12000 are projected to be shuttered by year's end.

This is bad news for the commercial real estate sector that is saddled with vacant spaces with little or no rent payments coming into service burdensome debt. Senator Tim Scott of South Carolina gave a striking reminder of that disturbing development at this week's Senate hearings on the coronavirus relief bill. The Senator noted that 80 percent of commercial retail space renters in his state were unable to pay rent this month. Nor is it just the closing of retailers that is bedeviling this sector. With employees working remotely from home, companies are finding that they need less office space to function. Importantly, this is occurring with little or no loss of productivity, which is prompting corporations to consider down-sizing the amount of space they will need going forward. Not surprisingly, commercial landlords are reporting that office-leasing activity is drying up. It remains to be seen how much strain the inevitable increase in mortgage delinquencies puts on the banks, which holds $2.4 trillion of commercial real estate loans.



Fewer workers going to offices means there will be fewer customers at neighborhood restaurants, street vendors and other retail establishments that cater to these workers. This is just one of the many upheavals in the new "normal" economy that will emerge on the other side of the pandemic. And as property tax revenues fall, state and local budgets will be further squeezed, prompting governments to lay off public workers in the education, health, and social services sectors. Simply put, the negative feedback loop from the pandemic is still unfolding, and the endgame is far from clear. What is clear is that the downside risks to the outlook continue to outweigh the upside prospects.

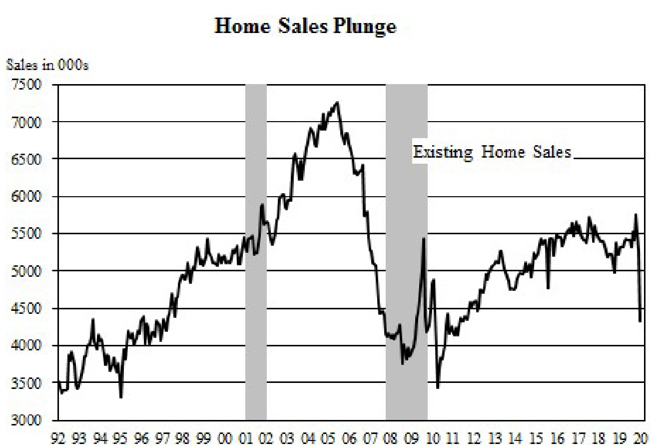
To be sure, not all policymakers share that assessment. Indeed, the disparate opinions over how the post-pandemic economy will look were highlighted at the aforementioned hearing on the CARES Act this week. Treasury Secretary Mnuchin is optimistic about the future, stating in his prepared remarks before the Senate Banking Committee that "our country will emerge from the pandemic stronger than ever." Fed Chair Powell, who also testified at the hearing, was not as upbeat, noting, "This precipitous drop in economic activity has caused a level of pain that is hard to capture in words, as lives are upended amid great uncertainty about the future. In addition to the economic disruptions, the virus has created tremendous strains in some essential financial markets and impaired the flow of credit in the economy."

Both Powell and Mnuchin agree that more support from Washington will be needed to jump-start the economy's growth engine. Even Senate majority leader Mitch McConnell appears to be abandoning his earlier reluctance to more Federal aid, acknowledging that another stimulus bill will be forthcoming in the near future. But there is a big partisan divide over the urgency and magnitude of support that will be needed. The Democrats are arguing for a more muscular bill that would include copious aid to cash-strapped state and local governments as well as expanded unemployment benefits to laid-off workers. Republicans are urging more restraint, with some preferring to wait and assess the impact that the previous rounds of stimulus, totaling about $3 trillion, are having on the economy.

Powell is siding with the more aggressive approach and is backing his preference with the promise of additional monetary stimulus, pledging to do whatever it takes to prevent the economy from descending into another Great Depression. He is more concerned about the permanent scars that the pandemic recession might leave on the economy. High among his worries is that the longer the downturn continues and/or the weaker the upturn is, millions of temporary layoffs will morph into permanent job losses. The longer workers remain unemployed, the greater the chance their skills will erode and become unemployable in the future. This would not only be a dispiriting permanent scar on the economy, it would also undue all the progress made during the record-long expansion in bringing long sidelined workers back to the labor force.

Fiscal stimulus, particularly if it is skewed towards spending rather than tax cuts, is a more powerful tool than monetary policy to get the economy moving. That said, the Fed is doing its part, notwithstanding the glitches in getting some of the emergency lending facilities off the ground. It revitalized the corporate bond market by promising to purchase these securities, leading to a record volume of new issues over the past two months. By keeping rates at rock-bottom levels, it is putting a floor under credit-sensitive sectors, most notably the housing market. That may not be obvious in light of the stomach-turning plunge in housing starts and existing home sales last month.

At first glance, the data suggests that home purchases and construction activity are suffering a more severe downturn than was the case during the housing collapse of 2007 that ushered in the financial crisis and Great Recession. Housing starts staged a record 30 percent decline last month, wiping out five years of increases. Likewise, existing home sales tumbled by 11 percent during the month, pushing transactions down to the lowest levels since 2011. But the abrupt contraction in residential activity was not the result of overbuilding or speculative borrowing that catapulted the industry into a meltdown a little over a decade ago. This time, external forces - i.e. the coronavirus that strangled the entire economy - knocked the sector off the rails.



When the pandemic runs its course, the housing sector should be in good shape to lead the economy out of the recession. To be sure, a robust housing rebound is not in the cards given the elevated level of unemployment that is expected to persist through the end of the year. But mortgage applications are already rising, indicating that home sales could begin to increase over the summer. The recovery would receive a major assist if more growth-boosting fiscal stimulus were to roll out in coming weeks. The $3 trillion HEROES Act passed by the House of Representatives would clearly inject much-needed fuel into the economy's growth engine, but that expansive bill has little chance of getting though the Senate. A watered down bill will likely be enacted, providing some upside support but not much thrust. As noted earlier, the pain is easing, but the headache will linger for the foreseeable future.

KEY FINANCIAL & ECONOMIC INDICATORS

FINANCIAL INDICATORS

INTEREST RATES	May 22	Week Ago	Month Ago	Year Ago
3-month Treasury bill	0.12%	0.12%	0.12%	2.35%
6-month Treasury bill	0.15	0.15	0.14	2.39
3-month LIBOR	0.40	0.39	0.99	2.12
2-year Treasury note	0.17	0.15	0.22	2.16
5-year Treasury note	0.34	0.31	0.37	2.52
10-year Treasury note	0.66	0.65	0.60	2.39
30-year Treasury bond	1.37	1.33	1.18	2.82
30-year fixed mortgage rate	3.24	3.28	3.33	4.06
15-year fixed mortgage rate	2.70	2.72	2.86	3.51
5/1-year adjustable rate	3.17	3.18	3.28	3.68
STOCK MARKET				
Dow Jones Industrial Average	24465.16	23685.42	23775.27	25601.32
S&P 500	2955.45	2863.70	2836.74	2829.02
NASDAQ	9324.59	9014.56	8634.52	7637.01
Commodities				
Gold ($ per troy ounce)	1736.20	1754.10	1741.64	1284.20
Oil ($ per barrel) - Crude Futures (WTI)	33.55	29.76	17.11	59.06

ECONOMIC INDICATORS

	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Quarters Ago	Average-Past 6 Months or Quarters
Housing Starts (April) - 000s	891	1276	1567	1385
Building Permits (April) - 000s	1074	1356	1438	1395
Existing Home Sales (April) - 000s	4330	5270	5760	5272

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