WEEKLY

Economic Commentary

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Millennium

CORPORATE CREDIT UNION

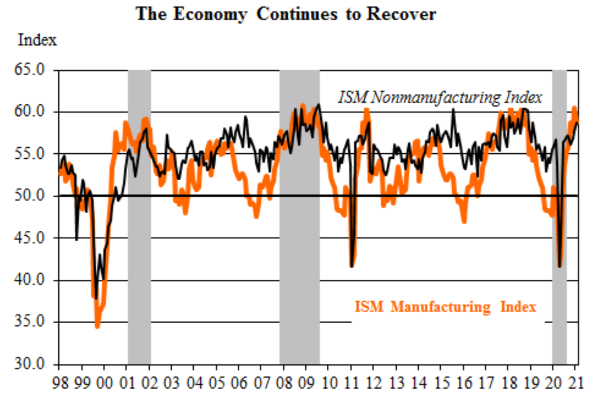
It's not a gangbusters start to the year, but the economic ship has steadied and promising signs on the fiscal and health fronts point to a pick-up in momentum in coming quarters. The January jobs report was mildly disappointing, with only 6 thousand new jobs created in the private sector and 49 thousand overall including the government sector. The weak reading should bolster the administration's case to "go big" on fiscal stimulus.

This week's report from the Congressional Budget Office showing a much slower recovery in jobs than in economic output has garnered considerable attention. A look at the record, however, shows that this is not unusual at all. Indeed, the lag in the jobs recovery projected by the CBO is actually shorter than in the previous two upturns. Given the unique nature of this cycle, with the service sector experiencing most of the output and job losses, this is not surprising.

The sample size is small, but so far the economy, financial conditions and the health situation are all getting off to a decent start in 2021 - at least relative to expectations that prevailed late last year. Recall that the consensus view was anything but positive as the curtain descended on 2020, a year to forget for most Americans. Covid-19 was infecting the population at an accelerating pace, driving up death and hospitalization rates and prompting governments to re-impose business restrictions, which stifled consumer spending and vaporized more than a half-million jobs in the leisure and hospitality sector in December.

Add to the mix, the initial phase of the vaccine rollout was a disappointment, heightening fears that the goal of reaching herd immunity would be pushed back. Unsurprisingly, economic activity slumped towards the end of the year, delivering a major blow to consumer spending and arresting seven months of job gains in December. But while momentum faded late last year, the growth engine received some critical fuel from the $900 billion fiscal package passed in December that helped steady the ship at the start of 2021. Importantly, the health crisis took a turn for the better in January, as cases of the virus fell dramatically and the vaccine campaign started to improve, although it is still months away from achieving herd immunity.

Hence, rather than falling off a cliff, early indications are that the economy remained on a positive growth trajectory in January. The Institute for Supply Management reported that its indexes of manufacturing and service-sector activity surpassed their pre-pandemic peak at the start of the year, and most business respondents were optimistic about future conditions. No doubt, their more upbeat attitude reflects the improving health situation, as business restrictions eased in several regions, as well as expectations of more fiscal stimulus linked to President Biden's $1.9 trillion proposal. The prevailing mood is that once the pandemic is brought under control the stage will be set for a growth surge over the spring and summer, as a torrent of pent-up demand will ignite consumer spending and job creation.

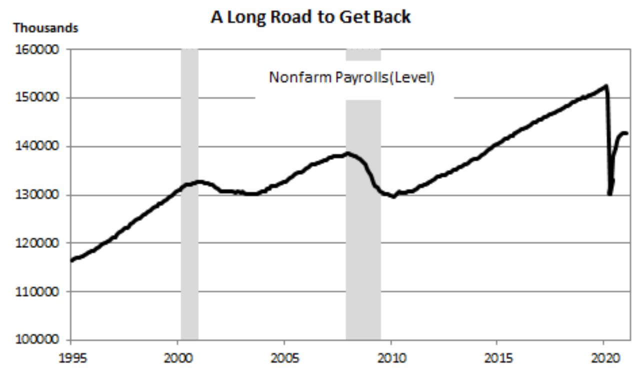


It's important to remember, however, that the ISM surveys say nothing about the strength of economic activity, but only the proportion of businesses that are expanding or contracting. With both indexes - for manufacturing and service providers - comfortably above the 50 threshold that separates expansion from contraction, the majority of industries in the index are growing, i.e., generating more output, increasing payrolls and receiving increased bookings among other activities. But it is the magnitude as well as the breadth of the increases that determine how fast the economy is growing, and here the news is not so good. What's more, the survey results do not entirely square with hard facts.

For example, the ISM indexes depict a much stronger job market in January than revealed in that month's job report, released on Friday. The employment component for both manufacturing and services climbed above 50, with services reaching 55.2, the highest in nearly a year. But according to the Labor Department's report, only 48.1 percent of private industries expanded payrolls in January. Not only was that a precipitous drop from over 60 percent in last year's final quarter, it was the lowest fraction of industries adding staff since February 2010. Put simply, most industries were shrinking their workforce last month, although in the aggregate the private sector added 6 thousand jobs. When adding in the government's 43 thousand new jobs, total nonfarm payrolls increased by 49 thousand in January.

On the surface, that headline increase looks encouraging, as it partially reverses the 227 thousand plunge in payrolls that took place in December. But the January gain is nothing to write home about. Not only did the private sector add fewer jobs than expected on Wall Street, the slim 6 thousand increase was greatly helped by favorable seasonal adjustment factors. Ordinarily, the economy sheds close to 3 million jobs in January, as companies lay off workers taken on during the holiday shopping season in December. But thanks to business closures and other restrictions in place during that month, there was effectively no shopping season to speak of and, hence, fewer workers to lay off in January. If companies remove less than 3 million workers from payrolls during the month that actually translates into a seasonally adjusted gain in jobs, which is what happened in January.

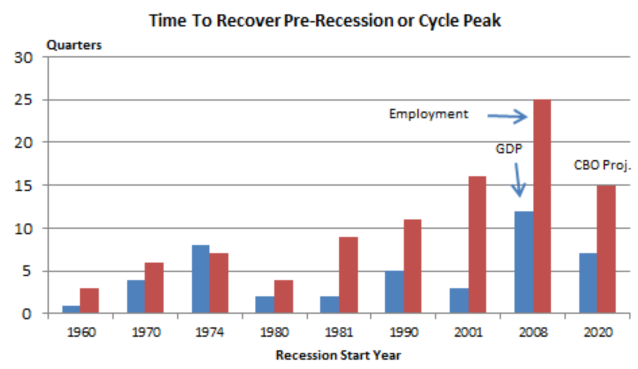
Nor is the initial tally of payrolls in January cast in stone, as future revisions can alter the picture significantly. If the previous two months are any indication, things could look much weaker in January after revisions are made. In its latest report, the BLS chopped 159 thousand from its previous estimates for payrolls in November and December. As a result, job growth over the last three months averaged a tepid 27 thousand, a dramatic downshift from the 2.1 million average increases over the previous six months. In other words, since the initial burst in job creation coming out of the pandemic recession, there's hardly been any further progress in recovering the 22 million jobs lost during the downturn. Following January's report, there are still around 20 million fewer workers collecting paychecks than there were prior to the pandemic.



Interestingly, this week's report from the Congressional Budget Office showing a much slower recovery in jobs than in economic output has garnered considerable attention. The CBO expects the economy to recoup all of its lost output by the middle of this year whereas employment is not expected to return to pre-pandemic levels for another three years. The report does not include the potential effects of the administration's proposed $1.9 trillion fiscal package, which would no doubt accelerate the timetable for job growth. Indeed, the disappointing jobs report on Friday may well be used to drum up support for the proposal, something that clearly added a spark to the stock market on Friday - another case of investors seeing bad economic news as good news for the market.

That said, a closer look at the historical record indicates that the divergent recoveries between output and jobs are not that unusual, and the latest CBO projection is hardly an outlier relative to previous cycles. Indeed, the record covering the last eight cycles back to 1960 reveals some interesting trends. First, the time it takes for the labor market to recover all of its job losses during the recession has increased in each of the last four cycles. The projected 15 quarter lag by the CBO would reverse that trend, falling behind the 25 quarter delay after the 2008

Great Recession and the 16 quarter lag following the 2000 recession. Hence, the job market would recover its recession losses faster than was the case in the previous two expansions even without further fiscal stimulus.



Second, the fact that the economy is projected to recover its output losses much sooner than the labor market recovers its job losses is a time-honored cyclical development. Indeed, that pattern has occurred in seven of the last eight expansions, with the exception being a slim one-quarter faster pace of jobs recovery following the 1974 recession. The eight-quarter lag in the jobs recovery projected by the CBO is actually shorter than the 13-month lag that followed each of the previous two recessions. Given the nature of this cycle, this shorter lag is not surprising. The loss of jobs and output in the service sector accounted for a much larger fraction of total losses than in previous recessions. Since the output gap is larger in the services than in the goods sector and productivity is lower in the service sector, it requires more workers to close that gap than would be the case in a more typical upturn.

We suspect that the economy will stay on a positive growth path this quarter and pick up momentum as fiscal stimulus kicks in and the vaccine campaign moves into a higher gear, ushering in herd immunity by the summer. Consumers have plenty of firepower to satisfy pent-up demand when business restrictions ease. Savings from foregone spending have swelled bank accounts, particularly among mid-and upper-income individuals who have retained jobs throughout the pandemic. The robust rally in the stock market since last spring has further fattened the financial position of this segment of the population.

With the Fed committed to keeping rates at rock-bottom levels until the economy returns to full employment, the policy levers are being pushed to the limits to light a fire under growth. Both the administration and the Fed are determined not to let a good crisis go to waste.

KEY FINANCIAL & ECONOMIC INDICATORS

FINANCIAL INDICATORS

INTEREST RATES	February 5	Week Ago	Month Ago	Year Ago
3-month Treasury bill	0.03%	0.06%	0.09%	1.57%
6-month Treasury bill	0.05	0.08	0.09	1.57
3-month LIBOR	0.19	0.21	0.22	1.73
2-year Treasury note	0.11	0.11	0.14	1.40
5-year Treasury note	0.47	0.42	0.48	1.41
10-year Treasury note	1.17	1.07	1.12	1.58
30-year Treasury bond	1.97	1.83	1.88	2.05
30-year fixed mortgage rate	2.73	2.73	2.65	3.45
15-year fixed mortgage rate	2.21	2.20	2.16	2.97
5/1-year adjustable rate	2.81	2.80	2.75	3.32
STOCK MARKET				
Dow Jones Industrial Index	31148.24	29982.62	31097.97	29102.51
S&P 500	3886.83	3764.24	3824.68	3327.71
NASDAQ	13856.30	13070.69	13201.98	9520.51
Commodities				
Gold ($ per troy ounce)	1815.20	1848.60	1849.70	1573.90
Oil ($ per barrel) - Crude Futures (WTI)	57.07	52.18	52.73	50.34

ECONOMIC INDICATORS

	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Quarters Ago	Average-Past 6 Months or Quarters
ISM Manufacturing Index (January)	58.7	57.7	56.8	57.3
ISM Non-manufacturing Index (January)	58.7	60.5	57.7	57.8
Nonfarm Payrolls (January) - 000s	49	-227	264	511
Unemployment Rate (January) - Percent	6.3	6.7	6.7	7.1

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