WEEKLY
Economic Commentary

January 22, 2021

Millennium
CORPORATE CREDIT UNION

As the curtain rises on the Biden administration, the opening scene contains few surprises. As telegraphed, the President issued a raft of executive orders that rescinds a bevy of actions put in place by his predecessor, encompassing a wide range of priorities, including immigration, the climate, civil rights, foreign policy and the economy. This is the first stage of a determined effort to put his stamp on an ambitious agenda. First and foremost, all efforts will be focused on pulling the nation out of the deadly grip of a pandemic that has wrecked the lives of millions of Americans and wreaked havoc on the U.S. economy.

As has been the case for months, progress on the health front is a mixed bag. On the positive side, cases of the virus are falling in 46 out of 50 states and the seven-day average for all states is down 20 percent from a week ago. The latest falloff may be nothing more than noise, but the newly appointed chief medical advisor, Dr. Fauci, indicated that the virus 'might actually be plateauing'. Furthermore, a third vaccine by Johnson and Johnson is going through the advanced trial stage, putting it on track to hit the market within the next month. The administration is also putting together a national plan aimed at ramping up vaccine production and facilitating a more effective distribution process that to this point has been handled by a patchwork of state-run systems with varying degrees of success.

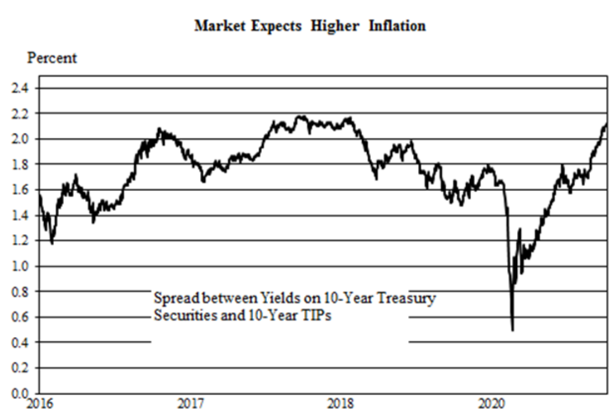
On the negative side, while new cases may be plateauing, the administration is projecting that deaths from Covid-19 will increase dramatically over the next month, lifting the current 400 thousand total that succumbed to the virus to over 500 thousand. And, as noted above, the vaccine rollout has been a huge disappointment, with headlines dominated by incidents of seniors and others eligible for a vaccine unable to wade through the labyrinth of web sites to get an appointment for a first dose. In some cities, officials are warning residents that the supply of vaccines has already been exhausted, prompting appointments to be canceled and rescheduled. Making matters worse, a new mutation of the virus has hit the U.S. shores, and reports that it is more contagious than the current variant could scare the public into doubling down on cautious behavior. That, in turn, would reinforce the consumption decline that marked the final months of last year.

Similarly, the economy is also navigating conflicting forces as it enters the new year. The slump in consumer spending at the tail end of 2020 reflected the weakening job market and falloff in government transfer payments, as unemployment insurance ran out for tens of thousands of workers under special Federal programs. Uncertainty over the fate of these programs added to household anxiety, and the resurgence of virus cases prompted many states to tighten business restrictions, particularly on service providers. With the virus still rampaging in January these restrictions remain mostly in place, which will constrain spending on services this month.

But the passage of the $900 billion fiscal aid package in December threw a lifeline to these workers, extending the emergency Federal Unemployment programs through March and providing most households with direct checks of $600. Anecdotal reports suggest that those checks have already lifted spending at low-end retail establishments, offsetting some of the growth-dampening restraints from pandemic-induced restrictions. Meanwhile, Biden issued executive orders on Friday that would extend immediate relief to low-income families, most notably directing the Agriculture Department to expand access to food stamps and other forms of food assistance. On balance, this too should provide some ballast to personal consumption over the near term.

To be sure, until herd immunity is realized sometime over the second half of the year the health crisis will continue to weigh heavily on the economy. That said, investors have already written off the first quarter and are turning their attention to what comes afterwards. The consensus forecast is that by late spring a confluence of positive forces will drive activity sharply higher, including diminishing virus fears as inoculations ramp up, warmer weather sets in and, importantly, the initial effects of the administration's American Rescue Act jump-starts the economy's growth engine. The fate of the $1.9 trillion proposal is up in the air and is likely to be watered down closer to $1 trillion after tense negotiations in Congress. But there appears to be bipartisan agreement to send additional checks to households and to bolster unemployment benefits, which, together with a recovering job market, portends a mini-boom in consumer spending over the spring and summer months.

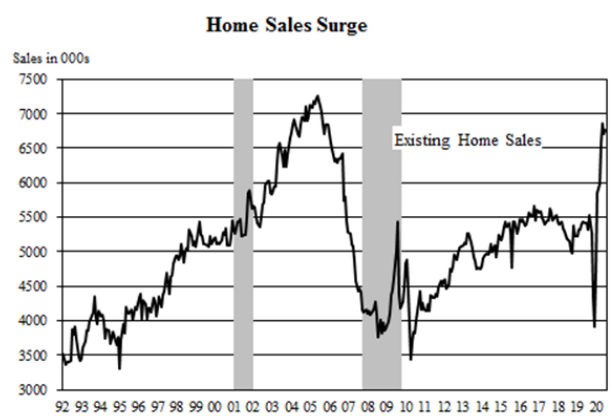
The stock market has been pricing in stronger second half growth for months, staging a robust rally in the final quarter of last year and continuing to forge higher so far in January. More recently, the bond market has joined the party. In the first week of January the yield on the bellwether 10-year note broke above 1.0 percent for the first time since last March, rising to a peak of 1.13 percent before settling back to 1.09 percent at the end of this week. The increase reflects expectations of higher inflation driven by a combination of stronger growth and the belief the Fed will keep short-term rates at rock-bottom levels even as inflation rises above its 2 percent target for a period of time. The gauge that tracks market inflation expectations - the so-called breakeven rate that tracks the spread between nominal Treasury yields and the yield on Treasury Inflation-indexed issues (TIPS) - has spiked to the highest level in almost seven years this week.



While we do not expect inflation to rise above 2 percent for a sustained period of time, it should exceed that threshold for several months this spring when prices will be measured against depressed pandemic-related levels of a year earlier. The Fed is cognizant of this statistical anomaly and is prepared to stay the course throughout that period, although the market could well test its commitment as the expected mini-boom in spending fuels stronger growth in the second and third quarters. Although the growth acceleration and inflation should recede late in the year, there are upside risks to both if fiscal policy imparts more oomph to the economy than expected, leading to a faster healing in the job market amid a lagged response from the Federal Reserve.

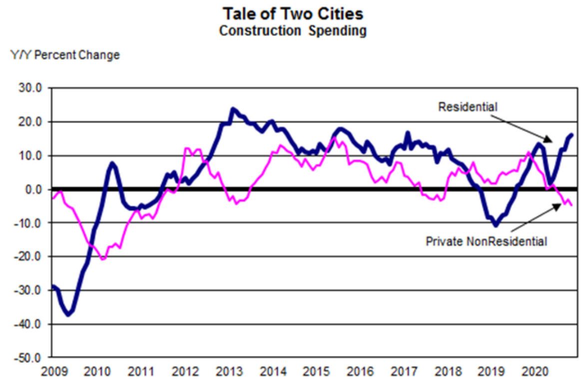
The increase in long-term rates has not yet filtered through to the mortgage market. Indeed, even as the 10-year Treasury yield increased by 40 basis points since early October, the rate on 30-year mortgages actually declined, from 2.90 percent to 2.7 percent in the latest week. The two typically track each other more tightly than observed over this time span, and we suspect that mortgage rates will come under upward pressure unless the Treasury yield suddenly reverses. Given the upside risks to growth and inflation notes above, that is not likely to happen. The question is, how much of a threat would this pose to the housing market, which has been a singular bright spot in the economy throughout the pandemic?

Indeed, to say the housing sector has been outshining the rest of the economy would be an understatement. Home sales and residential construction roared ahead last year, overcoming the temporary plunge during the height of the pandemic. The highlight



of this week's slim batch of economic data amply demonstrates the strength in this sector. Existing home sales in December hit an annual rate of 6.76 million units, punctuating a year in which total sales surged to the highest level since 2006 - the tail-end of the biggest housing boom in modern history. Fueled by low mortgage rates and heightened demand from buyers fleeing densely populated areas during the pandemic and seeking larger spaces to accommodate home offices for remote working, which is likely to become a more permanent work arrangement going forward, the blockbuster sales pace took place despite an historically low inventory of homes for sale.

That combination of slim inventories and strong demand had the predictable effect of driving up home prices, which rose above $300 thousand for a median home last July and remained there for the remainder of the year. A similar run-up in prices occurred in the new-home market, which is spurring homebuilders to ramp up production. As was the case for sales, housing starts surged to the highest level since 2006 by the end of the year and building permits, a leading indicator of future construction, also ended the year on a robust footing, pointing to continued near-term strength in construction activity. Residential outlays have made a disproportionate contribution to the economy's rebound over the second half of last year, in sharp contrast to nonresidential spending, which has been a significant drag on growth.



Looking ahead, the red-hot housing market is likely to cool off in the coming year, as surging home prices push many homebuyers out of the market and higher mortgage rates cuts into housing affordability. That said, housing activity should retain upward momentum, supported by favorable demographics, an expanding supply of homes for sale and continued strength in demand for larger spaces related to shifting working arrangements. While mortgage rates will likely rise above the rock bottom levels of last year, they should remain historically low, as the Fed is expected to keep a lid on short-term rates and lean against an undesirable increase in long-term rates. Housing may not impart as much of a boost to growth later this year, but consumers, nourished by a receding health crisis and fiscal stimulus, should take up the slack.

KEY FINANCIAL & ECONOMIC INDICATORS

FINANCIAL INDICATORS

INTEREST RATES	**January 22**	**Week Ago**	**Month Ago**	**Year Ago**
3-month Treasury bill	0.08%	0.09%	0.09%	1.53%
6-month Treasury bill	0.09	0.10	0.09	1.54
3-month LIBOR	0.22	0.23	0.25	1.79
2-year Treasury note	0.12	0.12	0.12	1.49
5-year Treasury note	0.43	0.45	0.36	1.50
10-year Treasury note	1.09	1.09	0.94	1.68
30-year Treasury bond	1.85	1.84	1.66	2.13
30-year fixed mortgage rate	2.77	2.79	2.66	3.60
15-year fixed mortgage rate	2.21	2.23	2.17	3.40
5/1-year adjustable rate	2.80	3.12	2.79	3.28
STOCK MARKET				
Dow Jones Industrial Index	30996.98	30814.26	30199.87	28989.73
S&P 500	3841.47	3768.25	3703.06	3295.47
NASDAQ	13543.06	12998.50	12804.73	9314.91
Commodities				
Gold ($ per troy ounce)	1853.20	1826.10	1883.90	1570.50
Oil ($ per barrel) - Crude Futures (WTI)	52.05	52.12	48.24	54.38

ECONOMIC INDICATORS

	Latest Month/Quarter	**Previous Month/Quarter**	**Two-Months/ Quarters Ago**	**Average-Past 6 Months or Quarters**
Housing Starts (December) - 000s	1669	1578	1530	1512
Building Permits (December) - 000s	1709	1635	1544	1565
Existing Home Sales (December) - 000s	6760	6710	6860	6457

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