

WEEKLY

Economic Commentary

January 8, 2021

As the curtain rises on 2021, a brighter script for the U.S. economy is about to be written. The final chapter could not come soon enough, as the gruesome health and political drama that wreaked havoc on the nation last year continues to unfold. Fears of a post-holiday surge of the pandemic are coming to fruition. Cases of the virus are accelerating, spurring record levels of hospitalizations and deaths, and a new variant is complicating the remedial process. Health officials expect conditions to worsen in coming weeks, confirming predictions that January would be the darkest month of the pandemic. Meanwhile, this week's riots in Washington punctuated a highly polarized and turbulent campaign that unfortunately did not end with the November 6 elections.

Despite this distressing backdrop, the financial markets are drawing encouragement from the litany of tailwinds poised to right the ship once the immediate turbulence ends. For starters, the rollout of the vaccine distribution is underway and, despite a distressingly slow start, inoculations are about to accelerate and cover the majority of the population by mid-year. The onset of herd immunity will enable governments to ease pandemic restrictions and bring the public out of a bunker mindset that has crippled broad swaths of the economy, particularly in the service sectors. The ebbing of the health crisis beginning in the spring sets the stage for a vigorous rebound in activity over the summer months.

For another, the government is stepping up its efforts to help the economy navigate the near-term headwinds. The \$908 billion fiscal relief bill passed in December is already entering the system. The Treasury reported that \$112 billion of the \$164 billion stimulus checks have already been sent out, providing most adults and children with a \$600 payment. Many states have also started to give unemployed workers the extra \$300 per week in benefits included in the fiscal package that will last for an additional 11 weeks. What's more, elections have consequences; the Georgia runoff election that is sending two Democrats to the Senate, giving the party control over all three branches of government, greatly enhances the prospect of additional stimulus sooner rather than later.

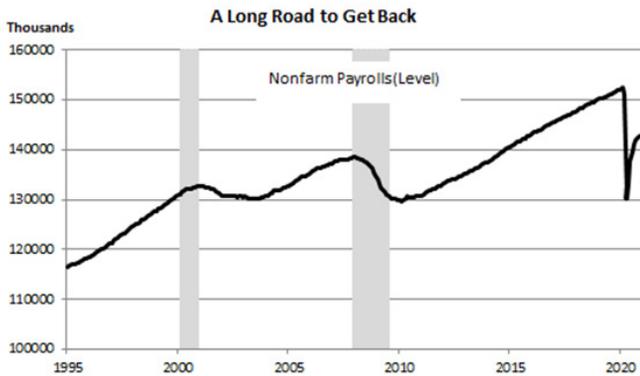
The most likely components of a future package would include a bump-up of additional stimulus checks, from the current \$600 to \$2000, more aid to state and local governments and expanded unemployment benefits. There will be a push for a large infrastructure spending bill as well as more generous fiscal support in a number of other areas from the more liberal wing of the Democratic party. This has raised some concerns that Washington could unleash a torrent of stimulus, which would raise the ire of inflation and deficit hawks. But those fears have not gained traction at this juncture, largely because the Democrats have a razor thin majority in the House and Senate; additionally, more than a handful of them are fiscally conservative and would likely resist voting for an aggressive budget-busting stimulus unless the economy were in dire straits.

Indeed, with the economy struggling under the tightening grip of the pandemic, the incoming president is not likely to have the support to push through some of his campaign promises regarding tightening regulations and hiking taxes. The absence of these restraining influences, at least in the immediate future, is another reason growth expectations have increased in recent weeks. Those expectations have been amply reflected in the financial markets since the elections. Stock prices have raced to new record highs and bond yields have registered meaningful increases. The 10-year Treasury yield finally pierced 1.0 percent this week reaching 1.12% on Friday, the highest level since last March.

Clearly the fiscal thrust together with ongoing dovish monetary policy portend a stronger economy over the near term than thought a few weeks ago. That said, the divergence between the behavior of the financial markets and current economic conditions continues to widen. As noted, both the stock and bond markets are discounting the economy's immediate struggles and pricing in stronger growth down the road, thanks to the muscular boost from fiscal and monetary policies. But the struggles are not only difficult to ignore they are becoming more intense. Nowhere is that more apparent than in the job market. For the first time in the recovery, the economy lost more jobs than it gained in December, a develop-

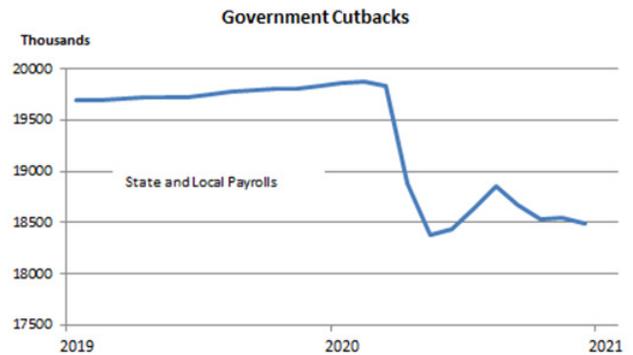
ment that validates both the need and timing of the enhanced aid for jobless workers contained in the latest Covid relief bill.

In December, nonfarm payrolls plunged by 140 thousand, arresting seven consecutive months of job growth. The reversal cuts short a recovery that still has a steep hill to climb to reach pre-pandemic levels. With December's setback, the job market has recovered 12.3 million of the 22.2 million jobs lost in February and March, leaving just under 10 million still on the sidelines. With stiffer lockdown restrictions put in place this month, thanks to the spread of virus cases, the recovery process will be stretched out. Companies relying on in-person sales, particularly those in the hospitality and leisure sector, are feeling the harshest blow. Last month, an astonishing 498 thousand workers were purged from payrolls in this sector, reducing its workforce by nearly 25 percent, or 3.9 million workers, below its pre-pandemic level.



The good news is that while workers at restaurants, bars and elsewhere in the hospitality industry took it on the chin, most other sectors retained or even added to payrolls. In fact, 61 percent of industries in the private sector expanded their workforce, primarily among goods-producing firms. Manufacturing and construction firms continue to be standout performers in this regard, adding 38 thousand and 51 thousand workers to payrolls last month. With homebuilding activity still on a tear and the demand for such big-ticket goods like autos benefiting from pent-up demand, that pattern should continue and buffer the cutbacks among service-providing firms. But pressure on the latter will not ease up any time

soon. In addition to leisure and hospitality, state and local governments are reeling from declining tax revenues and increased Covid-related health costs, prompting them to purge 1.4 thousand jobs over the last 10 months, including 51 thousand in December.



On the surface, the unemployment side of the ledger appears to have stabilized. The official jobless rate held steady at 6.7 percent and the 61.5 percent share of adults in the labor force was the same as November. But neither reading is anything to write home about. The jobless rate understates the actual weakness in the labor market, as it fails to account for the more than 4 million workers who dropped out of the labor force since the pandemic struck. Nor does it account for those working part time but would prefer full time positions. The broader unemployment rate, which includes marginally attached workers to the labor force, stands at a much higher 11.7 percent. Meanwhile, the 61.5 percent labor force participation rate remains at the lowest level since the 1970s, excluding the brief pandemic-induced plunge in the spring.



The same distorted view can be seen in the pattern of earnings. Average hourly earnings jumped by a formidable 0.8 percent last month, lifting the annual gain to 5.1 percent from 4.4 percent in November. But it would be a mistake to think that most workers are suddenly getting huge pay raises in the midst of a weakening job market. Instead, the composition of the workforce is shifting radically, with fewer low-paid workers on payrolls. Think of the waiters and bartenders among the 498 thousand leisure and hospitality workers that got laid off last month. As the composition of the workforce shift towards higher-paid workers, average hourly earnings are correspondingly increased. We expect this aberrational trend to continue until lockdown restrictions are lifted and lower-paid service workers regain their jobs, weighing down average earnings.

Clearly, investors are looking beyond the grim readings in the job markets, seeing the proverbial light at the end of the tunnel. They do have reasons for optimism as the endgame in the health crisis is in sight. Meanwhile, the financial system is awash in liquidity, household savings are at historically high levels and about to be reinforced with additional stimulus checks, more fiscal support is likely on the way, and the Federal Reserve is committed to keeping rates at rock-bottom levels for the foreseeable future. All this is building up firepower that could be unleashed once the health crisis ends and the economy reopens for business.

But any optimism has to be tempered by the scarring effects from the pandemic. With hundreds of thousands of small businesses shuttered, many of which will never reopen, the demand for labor may not match supply. Then there is the question of how long will it take for households to restore normal behavior. Will they retain a social distancing mindset and avoid crowd-gathering events until fears of infection are fully vanquished? Businesses too have become much more cautious in their hiring strategy, opting for temporary over permanent workers. Nearly 700 thousand temporary workers have been added to payrolls since May, reflecting a strong desire among firms to remain as flexible as possible in this uncertain environment. How long will they retain this cautious mindset as the health crisis winds down?

KEY FINANCIAL & ECONOMIC INDICATORS

FINANCIAL INDICATORS

	December 31	Week Ago	Month Ago	Year Ago
INTEREST RATES				
3-month Treasury bill	0.09%	0.08%	0.08%	1.54%
6-month Treasury bill	0.09	0.09	0.08	1.54
3-month LIBOR	0.22	0.24	0.22	1.85
2-year Treasury note	0.14	0.12	0.13	1.58
5-year Treasury note	0.48	0.36	0.37	1.64
10-year Treasury note	1.12	0.92	0.90	1.82
30-year Treasury bond	1.88	1.65	1.63	2.28
30-year fixed mortgage rate	2.65	2.67	2.71	3.64
15-year fixed mortgage rate	2.16	2.17	2.26	3.07
5/1-year adjustable rate	2.75	2.71	2.79	3.30
STOCK MARKET				
Dow Jones Industrial Index	31097.97	30606.48	30046.37	28823.27
S&P 500	3824.68	3756.07	3663.46	3265.35
NASDAQ	13201.98	12888.28	12377.87	9178.86
Commodities				
Gold (\$ per troy ounce)	1849.70	1895.10	1843.50	1562.80
Oil (\$ per barrel) - Crude Futures (WTI)	52.73	48.52	46.56	59.20

ECONOMIC INDICATORS

	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Quarters Ago	Average-Past 6 Months or Quarters
ISM Manufacturing Index (December)	60.7	57.5	59.3	57.2
ISM Services Index (December)	57.2	55.9	56.6	57.1
Nonfarm Payrolls (December) - 000s	-140	336	654	803
Unemployment Rate (December) - Percent	6.7	6.7	6.9	7.8

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