

Weekly Economic Update—March 23rd, 2020

In a welcome pause from its Fed-bashing ways, the administration is now lining up with the central bank to apply a full-court press against the rapidly spreading coronavirus. The full extent of this all-out effort has yet to be realized, as policy makers are still rolling out measures to contain the escalating human and economic fallout from the pandemic. The more nimble Fed took the lead, embracing a series of emergency moves akin to those taken during the Great Recession and global financial crisis a decade ago, including slashing its policy rate to near zero and reviving a massive asset-purchase program.

Despite the deep dive into its arsenal of unconventional tools over the past week, the Fed is far from done, as it is likely to ask Congress for authority to use other untapped tools to prop up the economy and financial markets. This may include authority to purchase corporate bonds, which has come under extreme selling pressure from investors fleeing all forms of risky assets. Importantly, like the Fed, Washington is also flexing its fiscal muscles to a far greater extent than it did back in 2008 and 2009. As menacing and damaging as the Great Recession was, it did not involve a daily mortality rate that is injecting a wartime mentality into the mindset of the nation and its leaders.

As noted, the shock absorber being developed on Capitol Hill is still evolving, and the final price tag will easily exceed \$1 trillion. Such a shock-and-awe response to an uncompromising threat to the economy is imperative and, remarkably, is being hammered out without too much partisan bickering, although aspects of the latest Republican plan is coming under attack from Democrats. The key objectives of the government's efforts is to extend a lifeline to the accelerating number of laid-off workers, strengthening the safety net and providing them with the means to sustain spending, and to support struggling businesses that are hemorrhaging revenue through no fault of their own. These include airlines, a broad swath of the hospitality sector and particularly small businesses facing a massive loss of customers that are being forced into self-imposed quarantine. Unlike during the Great Recession and financial crisis, the targeted firms, both large and small, are not suffering setbacks due to bad behavior.

A central feature of the package to help households is the decision to get money swiftly into their hands through direct payments, probably in two monthly installments, of about \$1000 each. The details are still being worked out and the payments will likely vary according to household income and size. Even the size of the monthly payments could change, although it is not likely to deviate much from \$1000. That number is not derived out of thin air, as it is almost spot-on with the monthly cost of food, rent and utilities for the median-income consumer. Those three items added up to \$1084 in 2018 according to the latest Consumer Expenditure Survey compiled by the Bureau of Labor Statistics.

To be sure, both the fiscal and monetary measures are aimed at jump-starting economic growth after the pandemic runs its course as much as limiting the carnage that is already baked in. As we have pointed out in recent commentaries, the economy was holding up quite well before the virus first arrived on American shores in early February. The heady momentum early in the year will give some misleading heft to the first quarter's reading on the economy's performance. But as the virus morphed into a global pandemic in February and March, the momentum vanished and has now transitioned into a meltdown. That fall from grace will be strikingly apparent in the data for March, but signs of the downward shift in consumer spending – the economy's main growth driver – were already visible in February.

Following a solid upwardly revised 0.6 percent increase in January retail sales hit a brick wall in February, as consumers zipped up their wallets and purses. Sales fell 0.5 percent last month, the largest setback since December 2018, paced by weakness in virtually all forms of discretionary spending. Not surprisingly

as restraints on social interactions began to take hold, brick and mortar establishments took the biggest hit. Spending on cars, meals at restaurants, clothing, electronics and furniture all fell. Conversely, consumers filled their shopping needs online, as sales at nonstore retailers rose by 0.7 percent. If not for that increase, overall retail sales would have fallen by a more precipitous 0.7 percent instead of the 0.5 percent last month.

Indeed, the ever-strengthening pace of e-commerce sales is the one bright spot in an otherwise dismal trend in retail activity. Not only is it providing support for consumer spending, it is also facilitating a much-needed offset to the mounting toll of layoffs that is building by the day. The announcement by Amazon that it intends to hire 100 thousand workers to help fill orders is perhaps the most dramatic illustration of this development. Even some brick and mortar establishments are benefiting from online orders. For example, surging demand for take-out meals by sequestered households is boosting demand for delivery workers. On Thursday, Domino's Pizza announced that it expects to hire 10,000 workers in response to the coronavirus.

That said, the welcome increase in hiring related to online activity is but a drop in the bucket compared to the massive layoffs that looms ahead. The latest weekly release of first-time applications for unemployment benefits offers a hint of what's to come. In the week ended March 14 claims spiked by 70 thousand, one of the largest weekly increases on record. The 281 thousand workers filing for initial benefits are still well below the 655 thousand peak in filings seen at the depth of the Great Recession in February 2009. But that mountain will be scaled quickly, and the peak is likely to soar into the millions in coming weeks.

Historically, a half-percent increase in the unemployment rate within a 12-month period has signaled the onset of a recession nearly 100 percent of the time. That upswing should be exceeded in a month and could drive the rate up to 10 percent as soon as April from the current 3.5 percent. As Treasury Secretary Mnuchin opined last week, in a worst-case scenario the jobless rate could reach 20 %, a level not seen since the Great Depression. With both unemployment spiking and consumer spending tanking in the blink of an eye, there is little question that the economy has already fallen into a recession, putting an end the longest U.S. expansion on record. As noted earlier, the first quarter may not look too shabby, thanks to a muscular early start to the period. But after slipping by an expected fraction in the January-March period, the floor under GDP will open wide.

We expect the economy to contract by an eye-opening pace of more than 10 percent in the second quarter. By comparison, the steepest quarterly fall in GDP during the 2007-09 downturn – the worst since the 1930s – was 8.4 percent. No doubt, without the massive stimulus being put in place through monetary and fiscal channels, the fall-off would be considerably worse. But whereas aggressive policy moves were able to arrest the downturn during the Great Recession and financial crisis, they will not have a similar impact this time around. Ultimately, the depth and length of the current recession will depend on the ability of public and private health professionals to arrest the coronavirus.

However, the enormous fiscal and monetary stimulus that is flooding the economy and financial system sets the stage for a robust recovery at the other end of the pandemic. Assuming the coronavirus is contained over the summer, the economy should snap back to life late in the year, with GDP rebounding by 14.5 percent in the fourth quarter. Admittedly, that's an optimistic assessment and assumes the fallout from the carnage now being felt in the economy and financial markets does not leave a lasting scar that impairs consumer and business behavior over the longer term. Some believe that the harsh recession a decade ago is at least partly responsible for the economy's subpar – albeit lengthy—recovery, as memories of the wealth destruction and surge in unemployment prompted consumers to restrain spending more than they otherwise would have.

But the last recession stretched out over a lengthy 18-month period and the maladies that brought the economy to its knees took a long time to heal. The current downturn should be much shorter and its catalyst should not have a lasting effect on economic behavior once a cure is found. Simply put, the fate of the economy rests in the hands of health professionals as much as with policy makers. Importantly, unlike the

experience during the Great Recession both the fiscal and monetary authorities are responding to the crisis with much more urgency, which should spur a faster and stronger initial recovery this time.

FINANCIAL INDICATORS

INTEREST RATES	Mar 20	Week Ago	Month Ago	Year Ago
3-month Treasury bill	0.04	0.28	1.55	2.46
6-month Treasury bill	0.18	0.38	1.52	2.48
3-month LIBOR	1.20	0.74	1.68	2.60
2-year Treasury note	0.32	0.51	1.34	2.31
5-year Treasury note	0.46	0.72	1.32	2.23
10-year Treasury note	0.86	0.98	1.47	2.44
30-year Treasury bond	1.45	1.55	1.92	2.87
30-year fixed mortgage rate	3.65	3.36	3.49	4.28
15-year fixed mortgage rate	3.06	2.77	2.99	3.71
5/1-year adjustable rate	3.11	3.01	3.25	3.84

STOCK MARKET				
Dow Jones Industrial Index	19,173.98	23,185.62	28,932.41	25,502.32
S&P 500	2,304.92	2,711.02	7,337.75	2,800.71
NASDAQ	6,879.52	7,874.88	9,576.59	7,642.67

COMMODITIES				
Gold (\$ per troy ounce)	1,497.20	1,576.40	1,645.90	1,312.90
Oil (\$ per barrel) - Crude Futures (WTI)	19.84	32.97	53.39	58.84

ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Qtrs Ago	Average-Past Six Months or Quarters
Retail Sales (February) - % change	-0.5	0.6	0.0	0.0
Industrial Production (Feb.) - % change	0.6	-0.5	-0.4	0.0
Housing Starts (February) - Thousands	1,599	1,624	1,601	1,469
Building Permits (February) - Thousands	1,464	1,550	1,420	1,460

DISCLAIMER: This communication has been prepared by Government Portfolio Advisors LLC solely for informational purposes for institutional clients. Sources for this commentary include Bloomberg and Stone McCarthy Research Associates. It is not an offer, recommendation or solicitation to buy or sell, nor is it an official confirmation of terms. It is based on information generally available to the public from sources believed to be reliable. No representation is made that it is accurate or complete or that any returns indicated will be achieved. Changes to assumptions may have a material impact on any returns detailed. Past performance is not indicative of future returns. Price and availability are subject to change without notice. Additional information is available upon request.