Weekly Economic Update—April 13th, 2020

GOVERNMENT PORTFOLIO ADVISORS

With the stock market having its best week since 1974, the disconnect between Wall Street and Main Street has become ever more striking. Clearly, equity investors are seeing "green shoots" that are eluding households and businesses. In this holiday-shortened week, all of the major indexes posted double-digit gains, moving them further away from the lows hit on March 23. At the end of trading on Thursday, the Dow Jones industrial average stood 30.0 percent higher and the S&P 500 was up by 27.3 percent from its low. Simply put, roughly 50 percent of the huge losses suffered between mid-February and March 23 have been recovered, although the market is still down by around 18 percent from its February peak.

To be sure, the stock market is forward looking; the recent gains reflect growing optimism that the massive fiscal and monetary aid set to course through the economy in coming months will help cushion it against the shock of Covid-19 and plant the seeds for a recovery sooner rather than later. The package of policy measures expanded meaningfully this week, as the Federal Reserve bulked up its arsenal of tools to include aid for less than pristine companies and for state and local government. All told, the sum total of policy moves established since the Fed slashed its policy rate to the zero lower bound in mid-March will balloon its balance sheet to $10 trillion, almost half the size of the U.S. economy. The Fed is backing up its stated commitment to "do whatever it takes" to rescue the economy with its formidable portfolio.

Likewise, Capitol Hill is ramping up efforts to short-circuit the virus's impact. Following the massive $2.2 trillion relief bill signed two weeks ago, Congress is working on an additional proposal that would be at least equal in size to the earlier one. While the Fed's efforts are designed mainly to shore up the financial markets and keep credit flowing to households and businesses, the fiscal relief bill aims to get money directly into the hands of households and small businesses as quickly as possible through expanded unemployment benefits and direct payments. In addition to this unprecedented infusion of funds by policymakers, the markets may also be encouraged by nascent signs the pandemic is ebbing in parts of the world. China's Wuhan city, where the initial outbreak occurred, is slowly coming back to life as the government ended a 76-day lockdown period for its residents.

But the harsh reality is that conditions on the ground are still getting worse for the U.S. economy. Another 6.6 million workers lost their jobs in the week ending April 4, punctuating a three-week period that saw 16.8 million individuals filing claims for unemployment benefits, nearly 10 percent of the entire workforce. With consumer spending accounting for about 70 percent of gross domestic product, the massive loss of paychecks together with widespread social- distancing government mandates is bringing the economy to its knees. We expect personal consumption to plunge by a 40 percent annual rate in the second quarter, contributing to a 32 percent annualized drop in GDP.

Except for a drop in global pollution, there are few silver linings in the news related to the pandemic, which has claimed nearly 100 thousand lives worldwide. True, the abrupt shutdown in activity has prompted widespread price reductions, underpinning a strong disinflationary trend in the U.S. The consumer price index fell 0.4 percent in March, the steepest monthly decline in more than five years, paced by a 5.8 percent plunge in energy prices. On its surface this is good news for consumers, as lower prices translate into more purchasing power. Indeed, average hourly earnings adjusted for inflation actually increased by 0.8 percent for all private-sector workers last month. That increase was exceeded only once before going back to 2008.

But that dose of good news comes with important caveats. For one, the increase in average hourly earnings was skewed higher by the removal of low-paid workers from payrolls in March, as they accounted for a major share of the 701 thousand drop in nonfarm payrolls during the month. What's more, those who

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remained on the job had their hours cut, as the workweek was drastically shortened. Hence, real weekly earnings of nonmanagement workers were actually unchanged in March. For another, it is unlikely that lower-income individuals benefited from the fall in inflation last month as much as those higher up the income ladder.

Keep in mind that lower income households devote a larger share of their budgets to essential purchases. Nothing is more essential than food, shelter and medical care; none of those three categories fell in price and two of them increased. While shelter costs were unchanged, rents for primary residents increased 0.3 percent. Importantly, during this lockdown period, which is tethering about 70 percent of the population to their homes, food at home prices are rising sharply, up 0.5 percent in March. While this may not be much of a burden to people working remotely from home and still getting paid, those on furlough, laid-off or drawing meager paychecks are being squeezed.

Indeed, a review of food price changes last month provides a sense of how various income groups that are homebound might be faring. Eggs, for example, are a cheap source of protein for low-income households. But with more families forced to stay home, demand for egg products have skyrocketed. According to the market-research firm Neilson, egg sales surged 48 percent in the week ended March 28 from a year ago. Accordingly, egg prices are rising sharply, up 2.8 percent in the March CPI report. But that upward climb has accelerated exponentially in recent weeks. As of April 8, the price of a dozen eggs had tripled compared to three weeks earlier.

As times get tough, families tend to substitute cheaper for more expensive foods. That shift in preferences, however, is coming at a cost. Chicken is usually a lower-cost alternative to beef, fish or pork. But according to the CPI report, chicken prices increased 1.3 percent in March, while prices of beef, fish and pork all declined. We suspect, however, that these too will experience upward price pressure as supply becomes scarcer. Workers at meat-processing plants are either getting sick from the virus or staying away out of fear of getting it. Hence, plants will be forced to shut down, or owners will have to give workers a pay bonus to sustain production, as many reportedly are. Both options lead to higher prices.

That said, a spike in selected prices related to the pandemic does not weaken the powerful disinflationary trend that is spurred by sagging demand. Importantly, there is little chance that this will change anytime soon. Household spirits are sinking as the daily mortality rate from Covid-19 continues to escalate. The University of Michigan index of consumer sentiment posted its biggest one-month decline on record in April, according to the preliminary reading released this week. Not surprisingly, the biggest drag on the overall index came from households' assessment of current conditions, which is heavily influenced by the persistent deterioration in the labor market. The overall drop would have been even steeper if not for a milder slippage in expectations for the economy a few months down the road.

But those expectations are poised to come down as it becomes apparent that the post-pandemic recovery will not begin as soon or be as robust as households believe. Notwithstanding the massive fiscal and monetary stimulus forthcoming, consumers are unlikely to resume normal activities until they feel confident that a reliable treatment or vaccine for the virus has been found. No such medical breakthrough is on the near-term horizon. What's more, with not enough testing kits to go around, the scope of the pandemic gripping the nation is still unclear.

Just as households will be slow to resume normal activities, it is hard to see small businesses quickly reopening their doors and rehiring the massive number of workers that have been laid off. Like consumers, the optimism index of small businesses compiled by the National Federation of Independent Businesses (NFIB) recorded the biggest one-month drop on record in March. Of the tens of thousands that have shut down, many will not survive the sudden stop in cash flow that is vital to paying bills. Likewise, many of their laid-off workers will probably not return to the labor force, reinforcing the secular downward trend in the labor force participation rate.

Finally, the myriad programs aimed at helping businesses and households are getting off to a sputtering start. State unemployment offices and web sites are being overwhelmed, which is delaying and in many cases preventing jobless benefits from reaching unemployed workers. Business applicants seeking low-cost or forgivable loans under the government's recently-enacted fiscal plans are meeting with bottlenecks and other issues, as lenders struggle with paperwork and technical details involving how the plans should work. In time, the funds will flow to the intended parties and set the stage for an eventual recovery; but things will get worse before they get better.

FINANCIAL INDICATORS

INTEREST RATES	Apr 10	Week Ago	Month Ago	Year Ago
3-month Treasury bill	0.22	0.01	0.28	2.44
6-month Treasury bill	0.24	0.16	0.38	2.46
3-month LIBOR	1.22	1.37	0.74	2.60
2-year Treasury note	0.22	0.22	0.51	2.40
5-year Treasury note	0.42	0.39	0.72	2.38
10-year Treasury note	0.73	0.60	0.98	2.56
30-year Treasury bond	1.35	1.22	1.55	2.98
30-year fixed mortgage rate	3.33	3.33	3.36	4.12
15-year fixed mortgage rate	2.77	2.82	2.77	3.60
5/1-year adjustable rate	3.40	3.40	3.01	3.80

STOCK MARKET				
Dow Jones Industrial Index	23,719.37	21,052.53	23,185.62	26,412.30
S&P 500	2,789.82	2,488.65	2,711.02	2,907.41
NASDAQ	8,153.58	7,373.08	7,874.88	7,984.16

COMMODITIES				
Gold ($ per troy ounce)	1,752.80	1,640.70	1,576.40	1,294.10
Oil ($ per barrel) - Crude Futures (WTI)	22.73	28.83	32.97	63.78

ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/ Quarter	Two-Months/ Qtrs Ago	Average-Past Six Months or Quarters
Consumer Price Index (March) - % change	-0.4	0.1	0.1	0.1
Core CPI (March) - % change	-0.1	0.2	0.2	0.1
Producer Price Index (March) - % change	-0.2	-0.6	0.5	0.0
Consumer Sentiment Index (April)	71.0	89.1	101.0	92.8