GOVERNMENT PORTFOLIO ADVISORS

Weekly Economic Update—April 27th, 2020

Despite a spike in optimism in the financial markets, the drumbeat of bad news continues to reverberate throughout the economic landscape. That stark conflict was in full display this week. Investor spirits were buoyed by signs of stability in the oil market after a debilitating plunge in crude quotes briefly sent the price of oil for May delivery below zero. Just as the historic fall in oil prices sent stock prices plummeting, a rebound in crude quotes sparked a modest stock rally later in the week. But few believe that the roller-coaster ride in oil prices is about to end, as a massive glut of oil still overhangs the market. The deal by Russia, Saudi Arabia and other countries to cut production by 12 million barrels a day would do little to ease that overhang. According to the International Energy Agency, the global demand for oil is poised to fall by 26 million barrels in May.

Likewise, the markets sounded a note of cheer as Congress continues to roll out new plans to cushion the economy against Covid-19, including a $484 billion package this week aimed primarily to aid small businesses. The new bill, which the president is expected to sign as soon as it reaches his desk, replenishes the $349 billion fund designed for the same purpose that quickly ran out of cash within a month of its launch. The survival of small businesses has become a focal point of government efforts to staunch the economic bleeding from the pandemic. Another 4.4 million workers filed claims for unemployment benefits in the latest week, bringing the five-week total to over 26 million.

Clearly, the majority of the layoffs are coming from small businesses, those restaurants, bars, construction sites, travel agencies and other small retail establishments that have been forced to shut their doors. These mom-and-pop operations, which have little cash to tide them over more than a month or two of collapsing sales, are the most vulnerable victims of the crisis, just as they are during most recessions. During the depths of the 2008-2009 downturn, small businesses shed a net 170 thousand jobs a month even as real consumer spending on services – which contain the majority of small businesses – only fell by 1.4 percent in its worst quarter. That pullback will be exceeded by about 50-fold in the current quarter.

Importantly, just as small firms are the first to go under when economic conditions turn south, they are also powerful engines of job growth. That's particularly the case for startups. According to Census Bureau data, small firms – those with less than 5 workers on payroll – account for only 4.7 percent of total private employment. But in 2016, those firms accounted for more than 30 percent of job growth during the year. That outsized contribution makes sense; just as children grow faster than adults, young firms grow faster than more mature establishments – and add employees at a faster rate. To be sure, the immediate objective of government support plans is to bolster the chances of survival for small firms that currently exist.

But the profound toll Covid-19 is taking on the economy has longer-run implications for job growth. If the challenge to jump start the job-creating engine is to succeed, it will be necessary not only to backstop the fortunes of existing small businesses, but also to encourage startups. Unfortunately, that prospect is looking dimmer by the week. The Census Bureau also tracks new business formations on a weekly basis, and the latest figures are falling off the chart. New business applications are plunging at the steepest rate on record, with the latest four-week slide more than 50 percent greater than anytime during the Great Recession. The latest tally for the week ending April 18, showing a near-30 percent decline in applications, is sure to deteriorate further in coming weeks.

That said, some glimmer of hope on the health front has come to light over the past week, adding another element of cheer to the stock market. Infection rates have started to decline in some of the worst-hit regions of the nation, including New York, suggesting that painful social-distancing efforts are finally "bending the

curve" that health experts insist is mandatory before the economy can start reopening. With economic hardships deepening each day lockdown restrictions remain in effect, a predictable debate is taking center stage. Some, including government officials, are arguing that the cure is worse than the disease. By this logic, the sheer magnitude and dire consequences of the economic carnage caused by lockdowns pose a greater risk to society than the virus itself.

Accordingly, some states have already relaxed restrictions, opening nonessential businesses before meeting guidelines set by health experts, such as waiting for at least 14-days of declining infection rates. Georgia is the first state to jump the gun, allowing an array of businesses to open their doors, including barbers, gyms and tattoo parlors, to the dismay of many health officials. Several others plan to phase in easier restrictions starting in May. As more states follow this path over the summer, a gradual revival in activity should get underway, suggesting that the second quarter will be the trough of the recession. We concur with that assessment but warn that the trough will be deeper than anything seen since World War II.

The New York Fed provides a hint of how deep a hole the U.S. economy is falling into. Like the Census Bureau, it too recently started tracking weekly data on key aspects of the economy, providing a real-time monitor of its performance. The Fed has compiled an index consisting of 10 key activity measures that are reported on a daily and weekly basis. Specifically, it notes "These include a measure of same-store retail sales, an index of consumer sentiment, initial unemployment insurance (UI) claims, an index of temporary and contract employment, a measure of steel production, a measure of fuel sales, and a measure of electricity consumption. We transform all series to represent 52-week percentage changes, which also eliminates most seasonality in the data."

The latest report, for the week ending April 18, is off the charts, much like the running tally on new business formations. If the –11.5 reading for the week were to be sustained for the entire quarter, it implies that real GDP would fall by 11.5 percent in the second quarter from a year ago. This would translate into an annual rate of decline of more than 50 percent from the first quarter. That's considerably worse than most forecasters expect and is not likely to materialize if the economy gradually reopens over the next two months. We suspect that April will be the worst month of the quarter, as it will be the only one in which nearly full lockdown restrictions were in place.

That said, it's an open question as to how rapidly the economy can regain its footing as the doors to economic commerce gradually reopens. With a nod to "Field of Dreams", if you build it, will they come? Aside from the uncertain prospect of how many of the shuttered firms, particularly smaller ones, will be able to reopen, there is the question of how willing will customers be to return. Households remain highly fearful of infection and a large proportion claim they would abide by shelter-in-place behavior even after restrictions are lifted. This fear will remain in place until people are confident that an effective treatment or a vaccine has been found.

Then there is the economic hardship that households have endured during the crisis and the profound impact it is having on confidence. The personal savings rate tends to rise sharply during recessions and for some time early in recoveries, as it takes a while for households to shake off the anxiety and financial insecurity associated with the recession. This time will be no different; indeed, anxiety levels are being amplified by the virus as well as the economic downturn. According to a recent Pew Research poll, 43 percent say that someone in their household has either lost a job or taken a pay cut. More ominously, 71 percent believe that the negative impact on the economy from Covid-19 will last at least six more months.

Simply put, it will take more than official pronouncements enabling businesses to resume operations to jump-start the economy's engine. The gears will need to be lubricated by a willing population, motivated by confidence that returning to the malls, theaters and stadiums and other well populated venues is safe from contagion. Small firms will need the financial resources to resume operations and rehire staff, and workers need to feel safe about returning to their jobs. These growth catalysts should slowly emerge and underpin a gradual rebound in activity. But a headlong rush to open the economy before the health skies clear runs

the risk of a second wave of infections and another setback for the economy. Instead of a gradual U-shaped recovery, this misguided approach would invite a W-shaped upturn, with a second leg down before a revival finally gains traction.

FINANCIAL INDICATORS

INTEREST RATES	Apr 24	Week Ago	Month Ago	Year Ago
3-month Treasury bill	0.12	0.14	0.00	2.42
6-month Treasury bill	0.14	0.19	0.01	2.45
3-month LIBOR	0.99	1.13	1.37	2.58
2-year Treasury note	0.22	0.20	0.25	2.29
5-year Treasury note	0.37	0.36	0.40	2.29
10-year Treasury note	0.60	0.64	0.68	2.50
30-year Treasury bond	1.18	1.26	1.27	2.93
30-year fixed mortgage rate	3.33	3.31	3.50	4.20
15-year fixed mortgage rate	2.86	2.80	2.92	3.64
5/1-year adjustable rate	3.28	3.34	3.34	3.77
STOCK MARKET				
Dow Jones Industrial Index	23,775.27	24,242.49	21,636.78	26,543.33
S&P 500	2,836.74	2,874.56	2,541.47	2,939.88
NASDAQ	8,634.52	8,650.14	7,502.38	8,146.40
COMMODITIES				
Gold ($ per troy ounce)	1,741.64	1,692.10	1,630.60	1,288.20
Oil ($ per barrel) - Crude Futures (WTI)	17.11	18.34	21.84	63.20

ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/ Quarter	Two-Months/ Qtrs Ago	Average-Past Six Months or Quarters
New Home Sales (March) - 000s	627	741	777	713
Existing Home Sales (March) - 000s	5,270	5,760	5,420	5,452
Durable Goods Orders (March)	-14.4	1.1	0.1	-2.2

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