Weekly Economic Update—May 11th, 2020

The avalanche of grim news continued to overwhelm the economic landscape this week, headlined by a jobs report that was about as awful as expected. Other indicators this week offered no comfort, as measures of manufacturing and service-sector activity posted historic monthly declines in April. These are just the first of a series of upcoming economic barometers that collectively will depict an economy in freefall this quarter, weighed down by government lockdown restrictions aimed at curtailing the spread of Covid-19 as well as public safety fears that are keeping households locked in their homes and their wallets zippered up.

Yet the financial markets continue to display a dogged sense of optimism, fueling a powerful stock market rally that has recovered more than half of a debilitating collapse that saw the S&P 500 plummet by 34 percent between February 19 and March 23. The rally continued this week, gaining traction even after Friday morning's terrible jobs report for April was released. For the week, the S&P rose 3.5 percent, punctuating a 31 percent gain over the past five weeks. No doubt, investors are looking beyond April's dismal figures and are writing off the downbeat earnings that most companies will be reporting for the year.

It remains to be seen if the market rally is sustainable, but investors appear to be encouraged by several developments. First, the patchwork reopening of the economy that is getting underway, with more than half the states relaxing or about to ease lockdown restrictions on some businesses. Second, the ebbing of infection and death rates in some of the more hard-hit regions as well as encouraging news of progress in developing a vaccine or effective treatments for afflicted patients. Third, the massive stimulus measures put in place not only give households and businesses some cushion to weather adversity, but they also provide considerable ammunition to fuel the recovery. Finally, some constructive high-level trade talks with China are being reported, defusing for the moment the belligerent accusations and threats of tariffs that would clearly hamper recovery efforts.

How long the markets are willing to downplay the disastrous economic news now evolving is anyone's guess. Even the most die-hard optimist has to be taken back by the abrupt disintegration of the job market wrought by Covid-19. To be sure, much of the bad news in the April jobs report reported on Friday was telegraphed by the surge in weekly claims for unemployment benefits over the past six weeks. That, in turn, diluted some of the shock effect from the actual report. Even so, the 20.5 million plunge in payrolls last month on top of the 870 thousand drop in March was eye opening, as nearly a decade of job growth has been wiped out in just two months. The bleeding is set to continue; while the job losses in May should be somewhat less than in April, it will still be daunting relative to the monthly setbacks seen during normal recessions. There is nothing normal about this downturn.

As expected, the biggest toll was taken on sectors most vulnerable to the pandemic. These include nonessential businesses and those providing discretionary goods and services that were ordered shut down. Hence, nearly half of the 20.7 million job losses were concentrated in leisure and hospitality and retail trade, which accounted for 9.8 million of the decline in payrolls. But no sector was unscathed. Manufacturing shed 1.3 million jobs and construction nearly 1 million. Even the stalwart health and public sectors, which are usually immune to cyclical setbacks, laid off an army of workers, reflecting the drop-off in elective surgery and other nonvital medical procedures and the closing of schools, which suspended teachers and support staff. Local governments saw a 469 thousand decline in educational jobs.

The massive drop in payrolls pumped up the ranks of the unemployed as never before. The official unemployment rate spiked to 14.7 percent from 4.4 percent, the sharpest monthly increase on record and the highest level in the postwar period. But the official rate understates the toll on the job market as the number of workers forced to work part time more than doubled over the past two months from 4.3 million in February to nearly 11 million last month. If these and other workers who were too discouraged to look for a job were also counted, the underemployment rate jumps to 22.8 percent from 8.7 percent. Worse, more than 6 million workers dropped out of the labor force and were not even counted among the unemployed.

There are many ways to measure the health or sickness of the job market at any given time, but practically all of them have flaws that can distort interpretation. But one measure provides a snapshot that is the most comprehensive and telling: the percentage of the population that is employed. Prior to last month, the lowest employment rate occurred during demobilization after the Second World War when it fell to 54.9 percent in October 1949. That floor has now been eclipsed by the staggering fall last month, as the rate plunged to 51.3 percent. It would be understandable to think that the shrinking share of employed received a big push from older workers opting to take early retirement rather than subject themselves to the increased safety risk of returning to their jobs. Their ranks did decline, but not as much as those in their prime working years – those in the 25-54 age group.

More disturbingly, the least educated workers are most severely impacted by the massive layoffs. The unemployment rate among workers with less than a high-school diploma shot up to 21.2 percent last month from 6.8 percent, a sharper increase than for the overall workforce, particularly those with a bachelors degree or higher who only saw their jobless rate increase to 8.4 percent from 2.5 percent. This less-educated cohort has had a much more difficult time getting a job throughout the expansion, but were finally reaping the benefits of the ever-tightening labor market just before the pandemic struck. Hopefully, they will be quickly rehired when the economy regains its footing and not shunted back to the sidelines where they long languished until the job market got hot.

Ironically, these are among the lowest paid workers and their massive removal from payrolls gave a big boost to average hourly earnings last month. The 4.7 percent month-to- month increase in average hourly earnings was the largest on record and towered over the more normal increases of 0.2 to 0.3 percent per month. But this is another example of a measure giving a meaningless impression of the strength in the job market. The strong increase in average earnings clearly did not reflect workers getting larger raises; rather it is a sign of extreme weakness with the lowest paid workers dropping out of the calculation and distorting the results. Indeed, the cutback in aggregate hours worked together with the plunge in payrolls indicates that wages and salaries took a major hit last month.

That, of course, does not bode well for consumer spending going forward and casts a shadow over the strength of the recovery. Some still believe that we will be looking at a robust upturn, with the economy quickly returning to normal once the pandemic ends. But that minority view has dwindling support. True, there are promising signs in the jobs report that could point to a speedy recovery in hiring. The most prominent is that 18 million of the 23 million unemployed workers are on temporary layoffs, meaning they are still tied to their jobs and are likely to be rehired once the economy opens up. What's more, the infusion of funds to small businesses through the Payroll Protection Program is helping to keep these firms solvent even as it encourages them to rehire workers when they reopen for business.

But the worker-employer link will fray over time if the hoped for recovery is weak or, worse, short-circuited by a second round of the virus later this year, which most health officials expect. That makes the search for a treatment and a vaccine even more imperative and argues for still more support from the government to struggling businesses and households as well as state and local government to sustain economic activity while the search continues. The optimists believe that as lockdown restrictions are lifted, business will return to normal sooner rather than later. Underpinning this belief is that businesses and households would quickly return to the spending routines they had prior to the pandemic.

That is a misguided perception in our view. Even before the pandemic fully broke out and lockdown restrictions put in place, households became increasingly fearful of infection and turned defensive. Many self-quarantined and avoided public spaces; retail sales turned soft in March and precautionary savings rose sharply. We suspect that fear factor will prevail after lockdown restrictions are lifted and restrain household spending propensities. There will be some unleashing of pent-up demand, but consumers are not likely to resume traveling, go to sporting events, shop at malls or eat at restaurants until they feel safe. We expect to see a gradual recovery setting in over the second half of the year, but the more vigorous stage of the upturn will only happen after fears of the pandemic are fully put to rest.

FINANCIAL INDICATORS

INTEREST RATES	May 8	Week Ago	Month Ago	Year Ago
3-month Treasury bill	0.12	0.11	0.22	2.44
6-month Treasury bill	0.15	0.13	0.24	2.45
3-month LIBOR	0.43	0.56	1.22	2.54
2-year Treasury note	0.16	0.20	0.22	2.27
5-year Treasury note	0.33	0.35	0.42	2.27
10-year Treasury note	0.69	0.62	0.73	2.47
30-year Treasury bond	1.38	1.25	1.35	2.89
30-year fixed mortgage rate	3.26	3.23	3.33	4.10
15-year fixed mortgage rate	2.73	2.77	2.77	3.57
5/1-year adjustable rate	3.17	3.14	3.40	3.63
STOCK MARKET				
Dow Jones Industrial Index	24,331.32	23,723.69	23,719.37	25,942.37
S&P 500	2,929.80	2,830.71	2,789.82	2,881.40
NASDAQ	9,121.32	8,604.95	8,153.58	7,916.94
COMMODITIES				
Gold ($ per troy ounce)	1,704.80	1,710.20	1,752.80	1,286.80
Oil ($ per barrel) - Crude Futures (WTI)	24.63	19.69	22.73	61.74

ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/ Quarter	Two-Months/ Qtrs Ago	Average-Past Six Months or Quarters
ISM Nonmanfacturing Index (April)	41.8	52.5	57.3	52.7
Consumer Credit (March) - Billions of $s	-12.0	19.9	10.3	10.0
Nonfarm Payrolls (April) - 000s	-20,500	-870	230	-3,413
Unemployment Rate (April) - Percent	14.7	4.4	3.5	5.5
Average Hourly Earnings (April) - % chg.	4.7	0.5	0.3	1.0