Weekly Economic Update—June 1st, 2020

As lockdown restrictions and shelter-in-place mandates gradually ease across the U.S., the economy is slowly regaining its footing. Hotel bookings are up; restaurants are serving customers again, albeit mostly outdoors; some beaches are reopening and the roads are filling up with drivers heading for vacation spots; states are allowing some nonessential businesses to open their doors, and are poised to phase in more reopenings in coming weeks. Even factory floors are beginning to hum again. By all accounts, the worst stage of the Great Coronavirus Recession is behind us.

But if April was the cruelest month of the cycle, the magnitude of the carnage wrought by the pandemic continues to exceed all historical yardsticks. We already knew that the job market was decimated, as record numbers of workers saw their paychecks vanish and the unemployment rate surge to the highest level since the 1930s. Including the 2.1 million new filings in the latest week, over 40 million laid-off workers have applied for jobless benefits since the start of the pandemic, more than one-fourth of the entire workforce. The bleeding is ebbing but continuing; the unemployment rate is set to rise above 20 percent in May, rivaling the worst years of the Great Depression. Unless Congress decides to strengthen the safety net, millions of workers will soon exhaust their unemployment benefits and be cast adrift unless they are quickly rehired.

That said, the impact that the government's rescue efforts have had in sustaining the livelihood of Americans should not be underestimated. Nor could they have prevented the historic free-fall in household spending last month. As reported by the Commerce Department on Friday, personal consumption expenditures recorded the steepest decline on record, plunging by 13.6 percent in April. Adjusted for inflation, real spending tumbled by 13.2 percent and by a record 17.2 percent from a year ago. Following a downwardly revised 6.7 percent decline in March, the slump in personal consumption will hit a record for the second quarter and cause the economy to contract by an unprecedented annual rate of about 40 percent.

However, it would be a mistake to attribute the slump in spending entirely to voluntary decisions by households. Much, if not most of it, was self-imposed, as consumers were forced to shelter-in-place even as lockdown restrictions compelled stores to close. This produced an interesting dynamic that differs from most past recessions. Historically, households tend to shut down spending following sustained declines in incomes and deteriorating expectations regarding job and income prospects. Initially, consumers resist spending cuts, striving to retain living standard as long as possible. However, once the recession sets in and expectations sink, consumers respond by slashing spending in order to stay within budgets and preserve financial resources against continued adversity.

This time, however, the first shoe to drop is spending, as personal incomes actually posted a remarkable gain last month, surging by a record 10.5 percent. Needless to say, the largest component of incomes, wages and salaries, did not drive the increase as the slump in the job market vaporized more than 20 million payrolls during the month. Nor did most other sources of income provide any help. Interest and dividend income both fell considerably as did proprietors income. Simply put, the government replaced the entire drop in incomes from earnings and financial assets and then some.

Virtually all of the eye-popping $3.1 trillion increase in government subsidies consisted of increased unemployment benefits and the $1200 stimulus checks sent out during the month. The $430 billion in jobless benefits was three times greater than the largest monthly payment during the Great Recession. And that payment occurred two months after the recession ended in June 2009. This time, the payout flowed into bank accounts during the initial stage of the downturn. But with limited places to spend those funds,

most of it went into savings. The personal savings rate soared to a record 33 percent, up from 8.2 percent just two months earlier.

With such a huge buildup in savings and government support, some are understandably making the case that households have an enormous amount of firepower to unleash pent-up demand once the economy fully reopens and goods and services become widely available to purchase. That, in turn, underpins the notion that a V-shaped recovery is poised to unfold, as bottled-up consumers uncoil from their long-confined shelters and fuels an upsurge in consumption. What's more, unlike past recessions when rising unemployment resulted in declining wages that was only partially offset by the government safety net, this time the government has replaced all of the lost incomes and then some. However, despite these seemingly favorable conditions, a V-shaped scenario is unlikely to play out.

No doubt, the drastic spending cutbacks over the past two months were at least partially imposed by forces outside the control of households. As these enforced spending restraints are eased, including shelter-in-place restrictions as well as business lockdowns, pent-up demand will spur a pickup in consumption. That, in turn, points to a robust increase in GDP in the third quarter. But that initial spurt is not likely to be sustained into next year for a number of reasons. For one, the savings buildup over the past two months can hardly be considered firepower for future consumption. A big part of it consisted of the $1200 stimulus checks as well as the expanded unemployment payments that were not immediately spent.

The stimulus checks were a one-time payment that has already run its course. True, unemployed workers continue to receive jobless benefits. Indeed, many are receiving more than they earned on their jobs, thanks to the additional $600 a week from the Federal CARES Act that augments regular state unemployment benefits. But the spending decisions of households, particularly for big-ticket items, are influenced by their permanent incomes and it's doubtful that workers consider these payments to be part of a permanent income stream. In fact, these expanded payments are scheduled to expire at the end of July, and prospects for an extension are less than favorable.

For another, households had turned cautious before they knew how severe the pandemic would turn out to be, much less the harsh impact it would have on the economy. That suggests precautionary instincts have also been driving the increase in the personal savings rate, particularly in March when spending had already weakened before turning into a rout in April. Just how quickly consumers turn less cautious and spend more of their incomes depends primarily on how quickly the job market recovers. As workers are rehired and permanent incomes are restored via wages and salaries, so too will their willingness to spend.

Of course, that's where the rubber meets the road. We expect that only about 60 percent of jobs vaporized by the virus will come back over the foreseeable future. Most likely construction workers will be among the first to be rehired, as the housing market has been the sole ray of light amid the ever-darkening economic landscape this quarter. Thanks to record low mortgage rates, new home sales steadied in April after a steep decline in March, and mortgage applications for home purchases are rising strongly. To be sure, sales of existing homes are plunging, partly because of scarce inventory as homeowners are staying put during the pandemic. But this may push buyers into the new home market and stoke an increase in building activity.

Aside from a modest blip for construction workers, however, the hiring outlook is not favorable. Even with stern lockdown restrictions starting to lift, social-distancing mandates remain in effect in most states. This means businesses won't be catering to a full slate of customers at any given time, and the workplace would not be able to accommodate as many workers as usual. And while social distancing mandates will also ease over time, many households fearing infection will be reluctant to return to recreational spaces where people congregate, including dining establishments, sporting events, and entertainment venues. Hence, while muscular government benefits are keeping millions of households afloat and limiting the economic carnage, it will not be enough to fuel a robust V-shaped recovery. The path of the upturn will depend primarily on the path Covid-19 takes, when it succumbs to effective treatments and a vaccine or whether it morphs into a second wave of infections later in the year.

FINANCIAL INDICATORS

INTEREST RATES	May 29	Week Ago	Month Ago	Year Ago
3-month Treasury bill	0.15	0.12	0.11	2.35
6-month Treasury bill	0.17	0.15	0.13	2.39
3-month LIBOR	0.35	0.40	0.56	2.12
2-year Treasury note	0.16	0.17	0.20	2.16
5-year Treasury note	0.31	0.34	0.35	2.52
10-year Treasury note	0.66	0.66	0.62	2.39
30-year Treasury bond	1.41	1.37	1.25	2.82
30-year fixed mortgage rate	3.15	3.24	3.23	4.06
15-year fixed mortgage rate	2.62	2.70	2.77	3.51
5/1-year adjustable rate	3.13	3.17	3.14	3.68
STOCK MARKET				
Dow Jones Industrial Index	25,383.11	24,465.16	23,723.69	25,601.32
S&P 500	3,044.31	2,955.45	2,830.71	2,829.02
NASDAQ	9,489.87	9,324.59	8,604.95	7,637.01
COMMODITIES				
Gold ($ per troy ounce)	1,743.00	1,736.20	1,710.20	1,284.20
Oil ($ per barrel) - Crude Futures (WTI)	35.32	33.55	19.69	59.06

ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/ Quarter	Two-Months/ Qtrs Ago	Average-Past Six Months or Quarters
New Home Sales (April) - 000s)	623	619	717	693
Durable Goods Orders (April) - % change	-17.2	-16.6	2.0	-5.3
Personal Income (April) - % change	-10.5	-2.2	0.5	-1.7
Personal Consumption Exp. (April) - % chg.	-13.6	-6.9	0.2	-3.2
Personal Savings Rate (April) - %	33.0	12.7	8.2	12.9

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