Weekly Economic Update—June 29th, 2020

Mounting health concerns derailed the bulls on Wall Street, raising doubts about the durability of the nascent economic recovery and sending stock prices sharply lower this week. Governors that are seeing record numbers of new infections are having second thoughts about the pace of reopenings, particularly in states that were early to ease lockdown restrictions. In Texas, one of the earliest to ease restrictions, the move to the next phase of reopening was put on hold and other states are either tightening social distancing rules or urging residents to voluntarily abide by them. Echoing this trend, many businesses are also taking a step back; Disneyland is postponing its planned reopening, joining other high-profile names that are retrenching operations, such as Apple, in deference to the rise in outbreaks.

These worrisome signs are overshadowing the onslaught of data that continues to portray a vigorous rebound in economic activity last month. The unleashing of pent-up demand revealed in last week's retail sales report was confirmed by a corresponding jump in the broader personal consumption data this week, which includes services. Durable goods bookings also snapped back as did new home sales. With all key indicators for the month now on the books, the momentum for a sizeable bounce back in growth during the third quarter is firmly in place – unless it is short-circuited by a virus-related sudden stop in June.

No doubt, massive fiscal and monetary stimulus contributed importantly to last month's revival in economic activity. But the growth boost from the fiscal side is fading and all eyes will be on how well the economy continues to hold up. In this regard, next week's jobs report will be particularly informative. To some extent, the unexpected surge in payrolls in May benefited from the Payroll Protection Program, in which banks provided forgivable loans to small businesses if most of the funds were used to retain or rehire workers. Interestingly, the peak demand for these loans appears to have occurred in the week ending May 13, which includes the survey week for the employment data, at least according to the weekly trend in bank business loans. Although there still remains more than $100 billion left to disburse in the program, banks are not receiving takers; indeed, more loans have been repaid than extended over the past month.

The data also reveal some interesting patterns in how the loan funds were disbursed. During the first month of the program, large banks accounted for virtually all of the lending. But since mid-April, the roles flipped 180 degrees as smaller regional banks pumped out funds at an accelerated pace. In fact, over the past two months more loans have been repaid at large banks than extended, confirming anecdotal reports that larger firms returned funds they didn't need in the first place. Meanwhile, smaller banks have taken the lion's share of new loans over the past two months. By early June, they actually accumulated more C&I loans on the books than the big banks.

It's unclear why small businesses have stopped drawing on the funds still available under the program, leaving more than $100 billion on the table despite the easing of terms that extended the loan maturity from eight weeks to six months. Importantly, to the extent that the PPP program boosted job growth in May, it will be interesting to see if the decline in these loans since mid-May had any restraining effect on job growth in June. No doubt, any effect was more than offset by the wide-scale reopening of businesses during the month, which enabled millions of workers to return to their jobs. But like other data, it remains to be seen if the momentum is sustained into the summer months, given the backsliding from rising coronavirus cases now underway.

Indeed, there is growing evidence that the revival in activity is losing some momentum. The sharply falling trend in new claims for unemployment benefits has hit a wall; after plunging from nearly 7 million in late March to 1.56 million in the first week in June, initial claims for benefits have only grudgingly declined over

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the past two weeks, still totaling 1.48 million in the June 20 week. That's far above normal levels, and more than double the 655 thousand peak in first-time filings seen during the Great Recession. That slowing trend is echoed in other measures as well, particularly among households and small businesses, the backbone of the economy.

Following a steep three-month plunge, the University of Michigan household sentiment index staged a healthy rebound in June, reflecting the phased reopening of business across the nation and rebound in job growth. However, as health concerns grew along with the rise in infection rates, the improvement in household spirits faded over the last half of the month. While the index did rise by a healthy 5.8 points from May to 78.1, the preliminary survey that tested the pulse of households earlier in the month had the Index at 78.9, so there was a considerable drop-off late in the month. We suspect that the mind-set of households is only now absorbing the negative influence from rising Covid-19 cases, and sentiment is poised to deteriorate further in July.

A similar story can be seen among small businesses, which have suffered the most during the pandemic. The Census Bureau conducts a small business pulse survey that tracks the changes in business conditions during the pandemic. Among the questions asked of small business owners is how severely they are being impacted by the spread of the virus – whether it is having a large negative effect, moderate negative effect, little or no effect, moderate positive effect or large positive effect. As would be expected, the share of firms experiencing a large negative effect has declined since the first week in May, the start of the survey period. But like the trend in household sentiment, the improvement started to fade in June. After slipping by a weekly average of 2.7 percent over the first six weeks of the survey, the share of firms suffering a large negative effect barely moved in the week ending June 20, edging down from 38.4 percent to 38.2 percent.

Given the growing evidence of the negative impact the spread of Covid-19 cases is having on household and business sentiment, it comes as no surprise that the blockbuster gains in this week's economic reports failed to stem the plunge in stock prices this week. The markets are always forward-looking and investors are increasingly viewing the figures for May as irrelevant. Even the strong reports raise some red flags that suggest all is not as rosy as it seems. Take Friday's personal income and spending report, which produced some eye-opening headlines, most notably a record 8.2 percent surge in personal consumption expenditures in May.

Forget for the moment that the surge merely erased a bit more than one-third of the plunge over the previous two months, and that real outlays are still nearly 10 percent lower compared to a year ago. More important is the source of strength behind the spending rebound. Yes, some of it came from wages and salaries, which rose 2.7 percent, thanks to the surge in payrolls during the month. But given that worker paychecks are still 8.6 percent below pre-pandemic levels, its doubtful that they provided much oomph to the spending surge. Households still had to draw on savings to finance purchases, driving the savings rate down from a record 32.2 percent in April to a still-astronomical 23.2 percent in May.

The reason households had to raid their savings accounts is because they lacked the massive support provided by the government's $1200 stimulus checks received in the previous month. Instead, a major source of income came from unemployment insurance, which surged by a record $825 million during the month and amounted to almost 15 percent of wages and salaries. Normally, these benefits account for a miniscule share of household budgets, averaging less than 3 percent of wages and salaries. But even the help from jobless benefits was not enough to compensate for the loss of stimulus checks, and personal income actually fell by 4.2 percent during the month.

Importantly, the bulk of the jobless benefits consisted of expanded payments under the government's Pandemic Unemployment Compensation program, which reflects the $600 weekly checks that unemployed workers receive in addition to their regular state jobless benefits. This program is set to expire at the end of July and it is unclear how much bipartisan support there is in Congress to extend it. From our lens, the downside risk of relying entirely on the private sector to provide the jobs and income needed to sustain the recovery is rising exponentially, as new cases of the virus continue to grow.

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FINANCIAL INDICATORS

INTEREST RATES	June 26	Week Ago	Month Ago	Year Ago
3-month Treasury bill	0.15	0.15	0.15	2.13
6-month Treasury bill	0.18	0.17	0.17	2.11
3-month LIBOR	0.31	0.31	0.35	2.32
2-year Treasury note	0.17	0.20	0.16	1.75
5-year Treasury note	0.30	0.32	0.31	1.77
10-year Treasury note	0.65	0.70	0.66	2.01
30-year Treasury bond	1.37	1.46	1.41	2.53
30-year fixed mortgage rate	3.13	3.13	3.15	3.73
15-year fixed mortgage rate	2.59	2.58	2.62	3.16
5/1-year adjustable rate	3.08	3.09	3.13	3.39

STOCK MARKET				
Dow Jones Industrial Index	25,015.55	25,871.46	25,383.11	26,599.96
S&P 500	3,009.05	3,097.74	3,044.31	2,941.76
NASDAQ	9,757.22	9,946.12	9,489.87	8,006.24

COMMODITIES				
Gold ($ per troy ounce)	1,784.80	1,754.10	1,743.00	1,413.10
Oil ($ per barrel) - Crude Futures (WTI)	38.19	39.50	35.32	57.17

ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/ Quarter	Two-Months/ Qtrs Ago	Average-Past Six Months or Quarters
New Home Sales (May) - 000s	676	580	612	682
Existing Home Sales (May) - 000s	3,910	4,330	5,270	5,037
Durable Goods Orders (May) - % change	15.8	-18.1	-16.7	-2.4
Personal Income (May) - % change	-4.2	10.8	-2.2	0.9
Personal Consumption (May) - % change	8.2	-12.6	-6.6	-1.2
Personal Savings Rate (May) - Percent	23.2	32.2	12.6	15.3