

Weekly Economic Update—August 17th, 2020

The congressional clock stopped ticking on Thursday, as the Senate adjourned and both chambers are not scheduled to return until after Labor Day. Hence, any hopes for a pandemic relief bill anytime soon fell by the wayside, even as the economy appears to be losing momentum and virus cases are rising in many parts of the nation. This confluence of events does not bode well for activity in coming months, notwithstanding a recent spate of positive economic reports. To be sure, Senate Majority leader, Mitch McConnell, indicated that the Senate could swiftly be brought back into session if a breakthrough in negotiations takes place. But the acrimony and wide gap in proposals between the parties make that a remote prospect.

With the enhanced \$600 weekly unemployment benefit and the Payroll Protection Program having expired at the end of July, a major source of support to the economy has vanished. So too, according to some observers, has the disincentive to look for a job by workers who may have received more in jobless benefits than they had previously been earning at work. The jury on that debate is still out for deliberation; but the case for reducing or even eliminating the bonus payment for unemployment might have received a boost from the back-to-back declines in new claims for unemployment benefits since the expiration of the Federal program two weeks ago. Legislators that favor eliminating the supplemental aid are pointing to the shrinking jobless claims as proof that generous benefits give workers an incentive to stay home.

Whether or not there is a cause and effect, new claims for unemployment benefits have moved decidedly lower over the past two weeks. Indeed, they slipped below one million for the first time since late March in the week ended August 8, slipping by 228 thousand to 968 thousand following a 244 thousand drop the previous week. While the near half-million decline over the past two weeks is a positive sign that pandemic-related layoffs are ebbing, keep in mind that in early March initial claims were running at just over 200 thousand a week, less than a quarter of the current pace. What's more, when the economy shut down in late March and threw a weekly record of 6.9 million workers into the ranks of the unemployed, most laid-off workers thought they would soon regain their jobs. That's not the case now, as the duration of unemployment is lengthening and stoking widespread concerns that the job losses will become permanent.

From our lens, most workers would rather have the security of a sustained paycheck with benefits than the temporary sugar high of enhanced unemployment benefits. The fact that 9.3 million workers gave up those benefits and returned to the workplace over the past three months confirms that impression. Perhaps if finding a job were easy that might not be the case; workers could then afford to be more discerning in their job search while receiving generous government checks. But despite the rebound in job growth, there are still nearly 13 million more unemployed workers than was the case prior to the pandemic, when there were more job openings than people looking for a job. Now there are nearly four unemployed workers for every job opening. Simply put, the competition among job searchers is fiercer and the risk of holding back is greater.

With the cutting off of the \$600 supplemental benefit, the near-term outlook for consumer spending has turned bleaker. True, President Trump has issued an executive order providing an extra \$400 in weekly benefits (including \$100 from states) aimed at providing some short-term relief. But states would have to recalibrate their unemployment systems to accommodate the new program and most say that new systems would not be up and running for at least several weeks. Worse, most states will not pony up their \$100 contribution, as they are already starved for revenue due to the pandemic recession. At the very least, therefore, the dog days of August will see a marked contraction of funds entering the spending stream.

As it is, the fading impact of fiscal stimulus is already being felt. Retail sales in July rose by 1.2 percent, well below the consensus forecast and considerably weaker than the torrid 18.3 percent and 8.4 percent gains seen in May and June when lockdown restrictions were eased and consumers had more outlets to spend their government checks, both from unemployment benefits and direct stimulus payments of up to \$1200 received in April. A similar slowing trend is seen in the control group of sales, which feeds into the GDP accounts. Thanks to the boost provided by generous government transfer payments and pent-up demand, retail sales have recovered all of the losses suffered in March and April and then some.

With retail sales in July standing above the average for the second quarter, consumer spending is on track to post a sizeable gain in the current quarter. And since personal consumption accounts for about 70 percent of total output, that gain should translate into a corresponding hefty growth rate in GDP. But it's important not to read too much into the retail sales figures, as the July increase was likely a last gasp manifestation of the expired jobless supplement. Not only did households have the purchasing power to fuel the spending increase, they also had limited options to spend on services, which were subjected to more lockdown restrictions than retailers selling goods. Hence, retail sales last month probably received some boost from purchases that would otherwise have gone into services.

More important, the withdrawal of supplemental benefits together with a tightening of restrictions in states where virus cases are rising points to slowing momentum in consumer spending. Indeed, a spate of real-time data as well as anecdotal evidence suggests that consumers are already pulling back. Not only are the reclosing of some businesses restricting purchasing options, but the rise in infection cases is heightening safety concerns among households, restraining their willingness to resume more normal shopping habits. In addition to safety fears, households are also more anxious about job and income prospects amid policy gridlock in Congress and diminished confidence in the government's handling of the health crisis. According to the University of Michigan's latest survey, this backdrop is prompting households to boost precautionary savings, an effort that siphons funds from the spending stream.

Indeed, in its latest survey for August, the University of Michigan found that households are boosting precautionary savings not just to cushion the near-term blow from the lapsed government stimulus. Their concern extends beyond the next month or two, reflecting the lingering effects of the coronavirus on the economy. Hence, the survey noted "the majority of consumers expect no return to a period of uninterrupted growth over the next five years." This perception squares with our forecast that after the initial third-quarter bounce in activity, the economy will glide into a slower growth trajectory over the coming years. What's more, if another fiscal relief package is not forthcoming before a vaccine or effective treatment for Covid-19 is found, the odds that the economy will contract again later this year would rise exponentially.

We suspect that congressional leaders will cobble together a package in the \$1 trillion to \$2 trillion range when they return from recess, enough of a fiscal boost to sustain the recovery but not enough to quickly recover all recession losses. Nor would it be a catalyst for the Fed to reverse its turbo-charged easy policy or drive market interest rates to significantly higher levels. The market did have trouble digesting the latest round of massive deficit-financing issuance, which led to a modest uptick in the 10-year Treasury yield this week. But at around .70 percent, the yield is still only about 20 basis points above its historic low reached earlier this month, and well below the 1.75 percent of a year ago.

It is hard to see where sustained upward pressure on yields would come. In the absence of an immediate fiscal booster shot the economy is poised to fall into an air pocket in August, as consumers pull back and hiring slows. The inflation embers shone a bit brighter last month, as both the headline and core consumer price indexes spiked 0.6 percent in July; the increase in the core CPI was the sharpest for a month in nearly 20 years. But like other economic data that reflect more noise than substance amid the chaotic swirl of events associated with the pandemic, this too is not a meaningful reading. Even after the 0.6 bounce, the core CPI is up only 1.6 percent over the past year, still a far cry from the Federal Reserve's 2 percent target.

The Federal Reserve is not about to take its foot off the monetary accelerator in response to a one-month spike in prices, given the powerful deflationary forces that still prevail. The economy has ample excess capacity in both the product and labor markets, domestic demand is deriving most of its strength from fading government stimulus that may or may not be replenished, and the global economy is fraught with the same downside influences that are depressing activity in the U.S. including, most notably, the intractable health crisis. The Fed, in fact, welcomes an uptick in inflation and signaled that it would allow it to run above its 2 percent target for some time before pulling the rate-hiking trigger. We do not expect that to happen for at least several more years.

FINANCIAL INDICATORS

INTEREST RATES	August 14	Week Ago	Month Ago	Year Ago
3-month Treasury bill	0.10	0.09	0.13	1.87
6-month Treasury bill	0.12	0.13	0.15	1.86
3-month LIBOR	0.28	0.24	0.27	2.12
2-year Treasury note	0.15	0.13	0.17	1.48
5-year Treasury note	0.30	0.22	0.31	1.43
10-year Treasury note	0.71	0.56	0.65	1.57
30-year Treasury bond	1.44	1.23	1.34	2.05
30-year fixed mortgage rate	2.96	2.88	3.03	3.60
15-year fixed mortgage rate	2.46	2.44	2.51	3.07
5/1-year adjustable rate	2.90	2.90	3.02	3.35

STOCK MARKET				
Dow Jones Industrial Index	27,931.02	27,433.48	26,075.30	25,886.01
S&P 500	3,372.85	3,351.28	3,185.04	2,888.68
NASDAQ	11,019.30	11,010.10	10,617.44	7,895.99

COMMODITIES				
Gold (\$ per troy ounce)	1,954.00	2,041.40	1,802.20	1,522.60
Oil (\$ per barrel) - Crude Futures (WTI)	42.18	41.54	40.49	54.86

ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Qtrs Ago	Average-Past Six Months or Quarters
Consumer Price Index (July) - % change	0.6	0.6	-0.1	0.0
Core CPI (July) - % change	0.3	0.2	-0.1	0.1
Producer Price Index (July) - % change	0.6	-0.2	0.4	-0.2
Retail Sales (July) - % change	1.2	8.4	18.3	0.8
Industrial Production (July) - % change	3.0	5.7	0.9	-1.2

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