Weekly Economic Update—September 14th, 2020

The abrupt reversal this week of the stunning 37.5 percent surge in the S&P 500 may or may not mark the beginning of the end of the torrid market rally that began on March 23. Before Friday's modest comeback, the benchmark index had contracted by 7.0 percent, just short of the 10 percent that would place it in correction territory. It's unclear if the setback reflects a widely anticipated adjustment from an overbought condition, as many analysts believe, or something more fundamental that will play out in coming weeks. Many pundits have lost their shirts, not to mention their reputation, by making firm, but misguided, assertions that they know which way the market is heading.

That said, it is safe to say that the later stages of the market rally were fueled, at least in part, by expectations the government would help sustain the nascent economic recovery with another much-needed pandemic relief bill. Despite the wide divide between Republicans and Democrats over details of a prospective bill heading into the Labor Day weekend, most believed that cooler heads would prevail and some compromise would be reached when Congress reconvened after the holiday. After all, the election was drawing closer even as signs proliferated that the recovery was losing momentum. No candidate wants to be blamed for pulling the rug out from under a recovery that promised to bring back millions of jobs lost during the height of the pandemic.

But that hopeful prospect suffered a severe and possibly permanent setback this week, as the slimmed-down Republican proposal died on the vine amid vitriolic accusations of bad faith negotiations from both parties. At this juncture, leaders on neither side look ready to mend fences and meet somewhere in the middle. To the extent that hopes for a bill gave impetus to the market's rise, that source of strength is falling by the wayside. No doubt, compelling arguments can be made for and against elements of both the generous $3.4 trillion House bill, passed in May, and the just-defeated skinny $650 billion Senate bill, which included only $350 billion of new spending funds. Wall Street had bet that legislators would agree on something in the $1-$2 trillion range that would include another round of direct stimulus payments to households, a revival of the expired enhanced unemployment benefits, aid to small businesses, as well as some relief to struggling state and local governments.

From our lens, some support for households and small businesses is critically needed to sustain the recovery and will likely garner the most attention in any future negotiation. However, the total absence of funds to help states and municipalities in the derailed Senate bill comes as a particular disappointment, as local governments – beset by plunging tax revenues and increased pandemic-related costs – have laid off an army of workers and are poised to further shrink payrolls if the flow of red ink is not staunched. The failure to plug a widening hole in local government budgets would put a severe crimp in the economic recovery, reminiscent of the drag from the public sector following the end of the Great Recession in mid 2009.

Recall that despite unprecedented relief provided to states and municipalities in the American Recovery and Reinvestment Act of 2009, it took a painfully long time for local governments to regain their footing. One reason is that the Federal Government took its foot off the pedal too quickly, as grants-in-aid to state and local governments under ARRA – which totaled over $100 billion in 2010 – were cut in half in 2011 and virtually disappeared in 2012. Yet the financial plight of states and municipalities persisted and layoffs continued until July 2013. It was not until 2019, that the 800 thousand jobs purged by local governments during the downturn were recovered. Indeed, the drag from lost wages and weak state and local spending put a severe crimp in the subsequent recovery.

But the struggle during the last recession pales in comparison to what's happening this time around. In March and April, state and local governments purged 1.5 million workers from payrolls, nearly double the haircut seen during the Great Recession. And while 371 thousand of those jobs were recovered over the last three months, most of gain – 224 thousand – occurred in July; the increase slowed to 94 thousand in August. What's more, nearly 95 percent of the July increase in jobs was in education, which reflected a statistical quirk related to early school closings induced by the pandemic. Without additional federal aid, the prospect of further massive layoffs by local governments looms large. Several large cities have already announced they are poised to lay off large numbers of jobs in public transit, social services and education due to the plunge in tax collections and increased health costs.

To be sure, factors other than reduced tax revenues are contributing to the prospective reduction in public-service jobs. People are fleeing the cities in droves, reducing demand for public transportation and hence jobs in that sector. Clearly, the newfound acceptance of remote working is facilitating that trend, which is likely to persist even after the health crisis ends. But we are also mindful of another trend that is at least indirectly linked to the flight from urban areas, namely the wave of young adults that are returning home to live with parents. According to recent Census data, the majority of people aged 18-29 are living with at least one parent for the first time since the Great Recession. In July, the share of young adults living at home increased to 52 percent from 47 percent a year earlier.

No doubt, that trend can be traced to the pandemic-induced recession, which has taken a bigger toll on millennials than on other groups. As young adults saw their paychecks vanish, it became harder for them to sustain paying high rents in big-city apartments. That burden became virtually impossible for many with the expiration of the $600 supplement to weekly unemployment benefits at the end of July. And while the enhanced payments have disappeared, the demand for benefits has not. Indeed, the number of new applicants for state unemployment insurance continues to run at a prepandemic record rate, plateauing at 884 thousand in the week of September 5. That stubbornly high level of claims is consistent with other data indicating that the jobs recovery is running out of steam.

The return flight of youngsters to family homes also complicates retirement plans for aging boomers who for the most part are taking on the additional expense of a returning child (offset hopefully, by the increased psychic income of assuming that burden). Nonetheless, this adds another demographic nuance to the broad array of changes that are upending the economy until the health crisis ends. Odds are, when activity returns to normal and jobs become more plentiful, young adults will move out of the basement-- but to where? As noted, one of the more pervasive changes in the job market that is likely to remain is the widespread acceptance of remote working, as companies find that productivity has not been impaired while many costs have been lowered.

Indeed, with fewer workers needed in the office, so too is there less of a need for office space, thus pointing to reduced rental expenses and ancillary costs of maintaining a larger work space than otherwise. Of course, this changes the budgeting and working arrangement for remote workers as well. More than likely, when the young adults who moved in with their parents return to their jobs or find new ones, they won't be coming back to the big cities – at least for a while – but will look instead for larger spaces at cheaper rents in suburban areas. This, of course, has implications for the rental market – both commercial and residential – for the foreseeable future.

To some extent, the changes are already showing up in the inflation data. For example, the move to suburbs has increased demand for used cars and trucks, spurring the steepest price increases for these purchases since August of 1969. That alone contributed mightily to the pick-up in the consumer price index, which rose by a greater-than-expected 0.4 percent during the month. Meanwhile, a slim 0.1 percent increase in rental prices, the slowest in nearly 10 years, had just the opposite effect, keeping the CPI increase in check. The annual increase in rental prices is slowing drastically, falling to a year-over-year increase of 2.9 percent from 3.8 percent prior to Covid-19.

Importantly, the acceleration in used car and truck prices should dissipate fairly soon as demand is satisfied and new car prices, which rose only 0.1 percent in August, become more attractive. We suspect that the weakening trend in rental prices will continue longer, albeit prices for a home purchase should remain under upward pressure as demand for homes continues to be strong. That said, overall inflation should remain in check and allow the Federal Reserve to retain an accommodative monetary policy for years to come. The question is, will the fiscal side join the Fed in providing the much-needed stimulus to keep the recovery going?

FINANCIAL INDICATORS

INTEREST RATES	September 11	Week Ago	Month Ago	Year Ago
3-month Treasury bill	0.12	0.11	0.10	1.96
6-month Treasury bill	0.13	0.13	0.12	1.92
3-month LIBOR	0.25	0.25	0.28	2.12
2-year Treasury note	0.13	0.15	0.15	1.80
5-year Treasury note	0.25	0.30	0.30	1.76
10-year Treasury note	0.67	0.72	0.71	1.90
30-year Treasury bond	1.42	.1.47	1.44	2.38
30-year fixed mortgage rate	2.86	2.93	2.96	3.56
15-year fixed mortgage rate	2.37	2.42	2.46	3.09
5/1-year adjustable rate	3.11	2.93	2.90	3.36
STOCK MARKET				
Dow Jones Industrial Index	27,665.64	28,133.31	27,931.02	27,219.52
S&P 500	3,340.97	3,426.96	3,372.85	3,007.39
NASDAQ	10,853.55	11,313.13	11,019.30	8,176.71
COMMODITIES				
Gold ($ per troy ounce)	1,948.60	1,940.90	1,954.00	1,496.20
Oil ($ per barrel) - Crude Futures (WTI)	37.30	39.51	42.18	54.90

ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/ Quarter	Two-Months/ Qtrs Ago	Average-Past Six Months or Quarters
Consumer Price Index (August) - % change	0.4	0.6	0.6	0.0
Core CPI (August)- % change	0.4	0.6	0.2	0.1
Producer Price Index (August) - % change	0.3	0.6	-0.2	0.0
Small Business Optimism Index	100.2	98.8	100.6	96.9

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