GOVERNMENT PORTFOLIO ADVISORS

Weekly Economic Update—November 23rd, 2020

There are still two months to go before inauguration day but, barring a miracle, Joe Biden will be inheriting a damaged economy when he assumes office on January 20, much like his former boss, Barack Obama. Unlike his predecessor, however, Biden will likely have to coax members of a split legislature to carry out his agenda. For the first two years of Obama's regime, his party had total control of Congress, which greased the way for the aggressive bills passed in the early stage of his presidency. To be sure, if the Democrats eke out victories in both runoff elections for the Senate in Georgia on January 5, Biden would have a more hospitable political backdrop, as Vice-President Harris would have the deciding vote in the event of a 50-50 tie.

Assuming that's not the case, Biden's ability to get a muscular fiscal stimulus bill passed would be severely compromised, if not completely stifled by a recalcitrant Senate. How much of an impediment that implies for the recovery depends on how much momentum the economy has as the calendar turns to 2021. The good news is that until recently, activity has been stronger than expected – in some cases, much stronger. The housing market, for example, has been on fire, lifting the fortunes of corollary industries, and producers of big-ticket goods, such as autos, have been relatively unscathed by the pandemic. The unified efforts of policy makers, both at the Fed and on Capitol Hill, at the height of the health crisis earlier this year contributed mightily to the outperformance of these sectors. The CARES Act provided households with vital income support to spur spending while the Fed's swift move to slash interest rates stoked demand for homes and autos.

But the cohesiveness displayed by policy makers last spring is breaking down, as the fiscal thrust provided under the CARES Act is waning and the mindset in Congress to extend it is fractured. A similar turn of events occurred during the Obama administration, but the unwinding began two years after the inauguration when mid-term elections stripped Democratic control in the House of Representatives, resulting in a shift towards fiscal austerity. While there is no corresponding call to rein in the budget deficit now, the prospect of inaction on expiring income support programs at the end of this year could undercut a key source of strength that, until recently, has propelled the robust recovery from the pandemic recession.

Most notably, the scheduled expiration of two pandemic-related programs would remove a vital lifeline for about 13 million unemployed workers starting next year. That prospect would not be too ominous if the job market were absorbing the unemployed and replacing benefits with paychecks. Such has been the case over the past six months, as hiring exceeded layoffs, thus reducing new claims for unemployment benefits. But that trend is reaching an inflection point. Net job growth has slowed in each of the last four months and the decline in initial unemployment claims has stalled. Indeed, the number of new applicants filing a claim increased in the November 14 week for the first time since the second week of October; what's more, those already out of a job are remaining longer on the unemployment lines. In October, half of unemployed workers were out of work for 19.9 weeks, the longest stretch of unemployment since May 2012.

Importantly, the waning momentum in the job market is the mirror image of the escalating number of virus cases throughout the nation. Infection rates are hitting record highs on a daily basis – reaching almost 188 thousand on Thursday – and hospitals are being overrun, with more than 80 thousand Covid patients admitted for the first time. The resurgence is prompting tougher restriction in most states, which is having a chilling effect on the job market. Job listings are starting to shrink and the tightening up of social distancing mandates as well as restrictions on bars, restaurants and other service providers point to softer hiring and increasing layoffs in coming weeks. Health professionals expect Covid-19 to worsen over the winter months, underscoring the headwinds buffeting the economy as Biden takes office in January.

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Not surprisingly, there are signs that the softening job market and worsening health crisis are putting a damper on consumer spending. One month does not make a trend, but the surprisingly weak retail sales report for October suggest that households are turning more cautious after their spending spree over the summer months. Total sales increased by a timid 0.3 percent during the month, the weakest increase since the recovery from the pandemic began five months ago. The slowdown was more steep than gradual as it follows a 1.6 percent gain in September, which itself was revised down from 1.9 percent. Importantly, the control group of sales, which excludes food, autos, building materials and gasoline that feeds directly in the GDP calculations rose by an even slimmer 0.1 percent.

The tepid increase in retail sales last month highlights the loss of momentum behind the economy's main driver, personal consumption, heading into the fourth quarter. Again, it's important not to put too much emphasis on one month, but it is noteworthy that the reading for October would have been even softer had it not included Prime Day sales, which Amazon pushed back from July due to Covid-19. Other competitors followed suit, lifting online sales up by a torrid 29.1 percent from the same month a year ago. E-commerce now accounts for almost 16 percent of total retail sales, up three percentage points from the start of the year. That share is destined to rise further as the virus keeps shoppers away from brick and mortar establishments to avoid crowds and social gatherings.

Indeed, that shift in behavior was palpable last month as department store sales plunged by 4.6 percent and sales at eating and drinking places fell for the first time since February when the pandemic initially struck and forced total lockdowns at these establishments. Keep in mind that heightened virus fears among shoppers have become more intense since the end of October. That, along with the government restrictions now rolling out, should put an even deeper crimp on spending behavior. With the holiday shopping season just ahead, the seasonal factors are looking for a big bump up in sales over the final two months of the year, something that is not likely to happen.

Hence, the fourth quarter could look particularly sickly, generating seasonally adjusted data that could pale in comparison to the third quarter. We are expecting personal consumption expenditures, which account for 70 percent of GDP, to grow by less than a 4 percent annual rate during the period compared to 40 percent in the third quarter. A drop-off of that magnitude, which will drag down growth in GDP, may garner enough support in Congress to break the deadlock over a stimulus bill. If so, that would give Biden the much-needed policy thrust that Obama received early in his administration. At this juncture, however, that is more a hope than a reality, and the extent of stimulus support may well depend on the runoff election results in Georgia.

In the interim, the Federal Reserve continues to do much of the heavy lifting, particularly for interest-rate sensitive sectors of the economy. As noted earlier, the housing market is on fire, thanks to record-low mortgage rates and increased demand for larger and second homes fueled by the pandemic. Sales of existing homes soared to the highest level since 2006, the tail-end of the most vibrant housing boom in modern history, as buyers snapped up virtually anything on the market. Indeed, inventories of homes for sale fell to a record low of 2.5 months at the current sales pace, a scarcity that is also driving home prices up to nosebleed levels. At $313 thousand, the median price of a existing home sale last month hit a record high, and may be on the verge of exceeding the affordability of large swaths of the population.

Odds are, home sales should cool down, not only because of high prices but also due to the broader drag on the job market and incomes from Covid-19 and fading fiscal support. That said, president-elect Biden ought to benefit from a more supportive monetary policy than his predecessor. True, the Fed did not abandon its zero-rate policy set in December 2008 until December 2015. But it started to communicate a desire to "normalize" policy fairly early on, which had the effect of tightening conditions in the financial markets. By early 2010, the 10-year Treasury yield had risen back to its pre-recession level, up by more than 1 ½ percentage point from its recession low.

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In addition, recall the "taper tantrum" in 2013 when Fed chair Bernanke hinted that the central bank was poised to taper its bond-buying program, which sent bond yields soaring for a while. That's a shift in message the current Fed is not likely to make. Indeed, the current chair Powell has been unequivocal in stating that interest rates would remain at rock-bottom levels for the foreseeable future, at least until inflation rises about its 2 percent target for a meaningful period of time. What's more, unlike previous Fed chiefs, Powell has been urging Congress to help the Fed inoculate the economy from the virus by providing more fiscal stimulus. Without that help, the race to develop a vaccine, which has picked up speed in recent weeks, may not reach the finish line in time to prevent a recession.

FINANCIAL INDICATORS

INTEREST RATES	November 20	Week Ago	Month Ago	Year Ago
3-month Treasury bill	0.07	0.10	0.10	1.58
6-month Treasury bill	0.10	0.10	0.12	1.59
3-month LIBOR	0.21	0.22	0.21	1.91
2-year Treasury note	0.16	0.18	0.17	1.63
5-year Treasury note	0.37	0.41	0.38	1.63
10-year Treasury note	0.83	0.90	0.84	1.77
30-year Treasury bond	1.52	1.65	1.64	2.22
30-year fixed mortgage rate	2.72	2.84	2.80	3.66
15-year fixed mortgage rate	2.28	2.34	2.33	3.15
5/1-year adjustable rate	2.85	3.11	2.87	3.39
STOCK MARKET				
Dow Jones Industrial Index	29,263.48	29,479.81	28,335.57	27,875.62
S&P 500	3,557.54	3,585.15	3,465.39	3,110.29
NASDAQ	11,854.77	11,829.29	11,548.28	8,519.88
COMMODITIES				
Gold ($ per troy ounce)	1,869.70	1,888.20	1,904.40	1,462.40
Oil ($ per barrel) - Crude Futures (WTI)	42.17	40.12	39.77	57.95

ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/ Quarter	Two-Months/ Qtrs Ago	Average-Past Six Months or Quarters
Retail Sales (October) - % change	0.3	1.6	1.4	1.1
Industrial Production (October) - % change	1.1	-0.4	0.7	2.1
Housing Starts (October) - 000s	1,530	1,459	1,373	1,359
Building Permits (October) - 000s	1,545	1,545	1,476	1,421
Existing Home Sales (October) - millions	6.85	6.57	5.98	5.65

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