GOVERNMENT PORTFOLIO ADVISORS

# Weekly Economic Update—November 30th, 2020

As President-elect Joe Biden fills out his cabinet positions, the one appointment that garnered particular attention in the financial markets was the choice of Janet Yellen for Treasury secretary. The positive buzz following Biden's pick contributed to a robust rally, sending the Dow Jones Industrial average soaring briefly past the 30,000 milestone for the first time. Let's hope that the markets' optimism is justified, and Yellen's career arc turns out better than the last time a former Fed chair became Treasury Secretary.

That was William Miller who, after 18 months of mismanaging monetary policy as Fed chief during the late 1970s, was unceremoniously dumped by president Jimmy Carter and replaced by Paul Volcker. Rather than fade into the background, Miller was instead selected to become Treasury Secretary, where he also served an undistinguished 18 months until Carter's defeat by Ronald Regan in the 1980 election, a defeat that was widely attributed to Carter's mishandling of the economy, which featured the most virulent inflation in the postwar period, lackluster growth and a plunging dollar.

To be sure, Yellen is already ahead of the game, as her career as Fed chair is widely considered to have been distinguished. And her philosophical kinship with the current Fed chair Jay Powell should be far more aligned than it was between Miller and Volker, who spent the first three years at the helm committed to unwinding the inflation surge that transpired under the Miller-led Fed. Indeed, unlike the transition in the late 1970s when Volcker's tough anti-inflation policies sent interest rates sky high and brought the economy to its knees, Powell is fighting just the opposite threat – a low inflation economy that is severely weakened by a pandemic.

Hence, while Yellen is walking into a challenging environment, she will be receiving the full support of a Fed that is committed to keeping interest rates at rock-bottom levels and retaining an aggressive pro-growth policy for as long as it takes. But Yellen will also be fighting the growth-damaging effects of a health crisis that is intensifying, even as progress towards the development of effective vaccines is further along than most expected a few months ago. What's more, while Yellen will not have to worry about a conflicting policy backdrop from the Fed, her persuasive skills will be put to the test in a highly polarized Senate. It remains to be seen if a modest stimulus bill can emerge from the lame duck session before Yellen assumes office. Beyond possibly extending two pandemic relief programs for the unemployed scheduled to expire at the end of this year, the betting is that nothing will be done.

That said, we suspect that Congress will soon come under pressure to provide more fiscal support than it currently finds palatable. The pressure will come from constituents reeling under deteriorating economic conditions. Despite the remarkably swift progress towards developing a vaccine, it is not expected to be broadly available until the second half of next year. Even then, the expected boost to economic activity will partly depend on how much of the population would voluntarily agree to get vaccinated. Health professionals indicate that at least 70 percent would need to have antibodies before herd immunity is reached. Recent surveys indicate that a far smaller proportion would currently agree to get vaccinated shortly after it becomes available.

Regardless of the prospective second-half bounce from a vaccine, the immediate concern is whether the economy can survive the escalating Covid-19 headwinds over the next six months. The drag on growth is already palpable and we caution that some of the broad measures imply more strength to the economy than actually exists. For example, we expect GDP to stage a growth rate of roundly 4 percent in the current quarter. That would be a steep fall-off from the 33.1 percent pace posted in the third quarter, but still a decent above-trend rate by historical yardsticks. However, that gauge is riding the coat tails of the third-quarter's sizzling growth, which elevates the starting point for the fourth quarter. That, in turn, would translate into a strong average growth rate for the period even if the monthly gains were negligible.

Importantly, just as the calendar page turned from the third to the fourth quarter, the health crisis took a turn for the worse, stiffening the headwinds and slowing the economy's momentum. Daily cases of infection increased steadily throughout the month before accelerating dramatically in November. The seven-day average of new cases surged to nearly 180 thousand in the Thanksgiving week and hospitalization rates reached new records in excess of 85 thousand. The deteriorating health crisis spurred new restrictions in a growing number of states, a predictable response that began to take a toll in October. Making matters worse, the fiscal support that fueled the third-quarter's revival in activity continued to fade, following the expiration of enhanced unemployment benefits at the end of July.

This ominous combination – a deteriorating health crisis, restrictions by state and local governments and waning fiscal support –is destined to put an ever-deepening crimp on the economy as the fourth quarter unfolds. The process began in a modest way during October, as confirmed in this holiday-shortened week's active calendar of economic reports. Following last week's tepid retail sales for October, the Commerce Department released more comprehensive data on household income and spending for the month. The broader measure of spending is as downbeat as was the narrower retail sales report. Consumer outlays, both in current dollars and adjusted for inflation, increased by the slimmest margin since the recovery from the pandemic recession began in May.

The current dollar increase of 0.5 percent was entirely for services, as spending on goods was unchanged in October. That validates the weak gain in retail sales, which is mostly for goods, and suggests that the 0.3 percent increase reported last week might be revised down. But it is the inflation-adjusted change in personal outlays that has the biggest influence on real GDP – accounting for 70 percent of total activity – and the news here is nothing to write home about. Real personal consumption advanced by 0.5 percent, less than half the increase in September and much further behind the 3.5 percent average increase over the previous five months.

Importantly, even the scaled-back increase in October is not likely to be sustained in coming months. That's because the income needed to support spending is withering on the vine. Personal incomes fell 0.7 percent during the month, as the modest increase in wages and salaries was more than offset by the collapse in government transfer payments, reflecting the expiration of federal programs that provided income support to unemployed workers. These programs together with the earlier stimulus checks sent to households provided the fuel for spending during the recovery. But outlays have outpaced real disposable incomes for six consecutive months, eating into the savings cushion built up with the government transfer payments. That's not a sustainable trend.

To be sure, even as households have dipped into their stimulus savings to finance purchases, the personal savings rate in October stood at a historically high 13.6 percent, more than double the long-term average. On the surface, that suggests there is still fuel in the pipeline to sustain spending. However, the savings rate, like other aggregate measures, is deceptive in that it masks wide discrepancies among income groups. Keep in mind that the rate stood even higher when the government checks were sent out, peaking at 33.7 percent in April. We suspect that the drawdown since then reflects spending by lower-income recipients of the stimulus payments, who tend to spend every penny of their income and then some, particularly on goods and essential services to survive.

Conversely, households on the mid to upper end of the income ladder spend a higher fraction of income on services, particularly recreational services such as travel, restaurants, hotels and theaters, among others. These spending outlets have been constrained by pandemic-related shutdowns, providing this group of households with idle funds that they parked into savings accounts. The partial lifting of lockdown restrictions in recent months has unleashed some of these funds, underscoring the increased spending on services. But the resurgence in virus cases in November is renewing government pressure on service providers to close heir doors, which is prompting households to once again zip up their wallets.

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While that will be an inconvenience to many consumers, the biggest blow will fall on workers who provide the services that are now being shuttered. First time claims for unemployment benefits are perking up again, having risen for two consecutive weeks for the first time in four months. As the health crisis tightens its grip on the economy, the end-of-year prognosis is darkening. Hence, while the fourth quarter got a big lift from a high launching pad granted by the third-quarter's torrid rebound, the start of 2021 will not be as fortunate. If the virus's grip on the economy continues to tighten in December and the government stays on the sidelines until the new administration takes over, the prospect of a double-dip recession in the first quarter looms larger. Hence, Yellen's powers of persuasion will be quickly put to the test, aimed directly at Congress to provide a meaningful fiscal relief package as soon as possible.

## FINANCIAL INDICATORS

| INTEREST RATES | November 27 | Week Ago | Month Ago | Year Ago |
|---|---|---|---|---|
| 3-month Treasury bill | 0.09 | 0.07 | 0.10 | 1.59 |
| 6-month Treasury bill | 0.09 | 0.10 | 0.12 | 1.62 |
| 3-month LIBOR | 0.22 | 0.21 | 0.21 | 1.91 |
| 2-year Treasury note | 0.16 | 0.16 | 0.18 | 1.61 |
| 5-year Treasury note | 0.37 | 0.37 | 0.38 | 1.63 |
| 10-year Treasury note | 0.85 | 0.83 | 0.88 | 1.78 |
| 30-year Treasury bond | 1.58 | 1.52 | 1.66 | 2.20 |
| | | | | |
| 30-year fixed mortgage rate | 2.72 | 2.72 | 2.81 | 3.68 |
| 15-year fixed mortgage rate | 2.28 | 2.28 | 2.32 | 3.15 |
| 5/1-year adjustable rate | 3.16 | 2.85 | 2.88 | 3.43 |
| | | | | |
| **STOCK MARKET** | | | | |
| Dow Jones Industrial Index | 29,910.37 | 29,263.48 | 26,501.60 | 28,051.41 |
| S&P 500 | 3,638.35 | 3,557.54 | 3,269.96 | 3,140.98 |
| NASDAQ | 12,205.85 | 11,854.77 | 10,911.59 | 8,665.47 |
| | | | | |
| **COMMODITIES** | | | | |
| Gold ($ per troy ounce) | 1,790.70 | 1,869.70 | 1,878.80 | 1,470.40 |
| Oil ($ per barrel) - Crude Futures (WTI) | 45.52 | 42.17 | 35.72 | 55.42 |

| ECONOMIC INDICATOR | Latest Month/Quarter | Previous Month/ Quarter | Two-Months/ Qtrs Ago | Average-Past Six Months or Quarters |
|---|---|---|---|---|
| Durable Goods Orders (October) - % chg. | 1.3 | 2.1 | 0.5 | 6.4 |
| New Home Sales (October) - 000s | 999 | 1,002 | 1,001 | 920 |
| Personal Income (October) - % change | -0.7 | 0.9 | -2.5 | -1.1 |
| Personal Outlays (October) - % change | 0.5 | 1.2 | 1.2 | 3.3 |
| Personal Savings Rate (October) - Percent | 13.6 | 14.6 | 15.1 | 17.6 |