Weekly Economic Update—December 14th, 2020

The deadlock in Congress over fiscal aid shows no sign ending before the end of the year. The dysfunction in Washington is stoking anxiety on Wall Street, even as the pandemic is taking a bigger toll on Main Street. Layoffs are once again rising and restrictions on businesses are spreading, threatening to undercut the jobs recovery.

Some aggregate data indicate that households should be able to weather the storm. Net worth surged again in the third quarter, as asset appreciation is more than making up for sagging incomes. But the gains are accruing mostly to the wealthier segment of the population, amplifying the income and wealth disparity in the nation and confirming a K-shaped recovery.

A similar pattern is unfolding in the business sector. Large corporations are flush with funds, thanks to cost cutting and huge sums raised in the capital markets. But mom-and-pop establishments are suffering, bearing the brunt of the pandemic-related drag on the economy. The onset of harsher lockdown restrictions is amplifying the disparity in the business community.

The saga of the coronavirus relief bill continues to rattle the financial markets, as the struggle by lawmakers to reach a compromise on key issues shows no sign of ending. As the struggle wears on, it is testing the patience of investors. Following several weeks in which improved expectations of a bill lifted market sentiment and stock prices – highlighted by a bipartisan proposal by a group of lawmakers last week – the effort took a turn for the worse this week; a new proposal by the administration muddied the waters and Senate Republican leaders rejected the bipartisan bill put forward last week. Not surprisingly, stocks wavered throughout the week and the S&P 500 ended the period with a loss after two weeks of solid gains.

No doubt, the market impact would be harsher if not for the uplifting news on the vaccine front. With the pending FDA approval of the Pfizer vaccine, the first series of inoculations should begin next week and steadily broaden to include most of the population by the middle of 2021. That prospect offers hope that the pandemic's drag on the economy has a shortened shelf life, setting the stage for a rebound in activity over the second half of next year. That said, some fiscal aid would be needed to ease the transition between now and then. We still believe that a relief bill will come to pass, although not as swiftly as hoped a week or two ago. Keep in mind that even if a deal is struck before the new administration is sworn in, it will take several weeks before the funds start flowing through the economy.

Meanwhile, the delay and dysfunction in Washington are not only stoking anxiety on Wall Street. The distressing escalation of virus cases, hospitalizations and deaths is taking an ever-bigger toll on Main Street, heightening the urgency for fiscal support. Government officials in a majority of states are imposing tougher restrictions to stem outbreaks, limiting group activities and forcing nonessential businesses to either close down or reduce operations. The restrictions are not as harsh as they were earlier in the spring when the pandemic first struck the U.S., prompting more severe lockdowns throughout the economy. That led companies to furlough millions of workers, spurring a upsurge in claims for unemployment benefits. At its peak in late March and early April, nearly 7 million workers a week submitted claims for benefits, prompting swift action on Capitol Hill to inject a massive amount of fiscal relief via the $2.2 trillion CARES act.

The stimulus did not prevent the calamitous second-quarter collapse in economic activity but it went a long ways towards limiting the duration of the downturn and easing the financial pain for millions of households. As lockdown restrictions gradually eased over the summer, the economy swiftly recovered in the third quarter, recouping about two-thirds of lost output, assisted by the income support that unleashed a huge volume of pent-up demand. Furloughed workers were rehired as the service sectors that were most

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impacted by the pandemic reopened for business, resulting in a steady decline in unemployment claims. The downtrend, which mirrored the rebound in nonfarm payrolls and slide in the unemployment rate, persisted through the middle of the fourth quarter.

But progress on the employment front hit a wall in the first week of November, when initial claims for regular jobless benefits hit a low of 711 thousand. Over the past month as the health crisis deteriorated, consumers pulled back and the economy's momentum slowed. That together with renewed restraints placed on business operations stifled the hiring process and prompted a new wave of layoffs. Since the first week in November, first time applications for jobless benefits have moved erratically higher. Sadly, the upward trend may be on the verge of kicking into higher gear. In the first week of December, initial claims spiked by 137 thousand, the largest one-week increase since the last week in March. The pace of claims is now back to the level prevailing in late September.

To be sure, the rebound in jobless claims belies the continued growth in nonfarm payrolls and decline in the unemployment rate revealed in the November employment report. But that report was based on surveys of businesses and households taken in the week ending November 14, and does not reflect the erosion of labor market conditions since then. What's more, the decline in the unemployment rate last month was more an artifact of people dropping out of the labor force – and, hence, the job search – than of an improving labor market. In November, the labor force shrank by 400 thousand and the labor force participation rate slipped to close to the lowest level since the 1970s.

Meanwhile even as layoffs are rising more rapidly, about 13 million jobless workers are on the verge of losing unemployment benefits under special Federal programs set to expire in two weeks. These would be the most immediate victims of the government's delay or, worse, failure to extend benefits as part of a fiscal relief bill. Importantly, the biggest job losses are hitting the group least able to survive another wave of layoffs, workers in the service-sector economy that is bearing the brunt of the renewed restrictions. On Friday, the New York Governor announced that indoor dining at restaurants in New York City would be shut down, sending waiters, bartenders, dishwashers and other mostly low-wage employees of eateries and bars back on the unemployment lines.

Ironically, some aggregate data suggest that households are well equipped to weather the incoming Covid-19 storm. The latest Federal Reserve data reveal that household net worth jumped by another $3.8 trillion in the third quarter, following the second quarter's outsize $8.3 trillion gain. Hence, while income growth is slowing, the astonishing appreciation in asset values is more than making up for the shortfall. Indeed, net worth now stands at almost seven times larger than disposable income, exceeding the peak ratio reached during the height of the speculative housing-related bubble at the end of 2006. While rising property values has contributed to the latest gains in net worth, the biggest influence this time has been the roaring stock market, which recovered strongly from the pandemic-induced meltdown in the second quarter and raced to new peaks this quarter. In the third quarter, the value of household stock holdings held directly and indirectly increased by $2.76 trillion.

The problem is that wealthy shareholders hold the preponderance of stocks. Fed figures show that 10 percent of the wealthiest households hold 80 percent of all stocks. And while more than 60 percent of the population own homes and are benefiting from rising home prices, they are also wealthier than renters, who are facing the mounting threat of mass evictions in coming months as a higher share of this segment of the population is hit with layoffs. Simply put, the pandemic is amplifying the inequality in incomes and wealth and staking out the K-shaped recovery underway. The upper right arm of the K represents the wealthy while its right leg consists of the people left behind.

A similar divergent pattern is unfolding in the business sector. Large corporations are surviving the health crisis in generally good shape, at least as far as their balance sheets are concerned. While the pandemic has put a dent in profits, corporations have been able to protect cash flow by cutting costs, not only by keeping labor costs in check but also by holding back investment spending. They have also raised a copious volume of funds in the capital markets thanks to rock-bottom interest rates, high share prices and eager investors. Over the first three quarters of the year, nonfinancial corporations padded their liquid assets by more than $10 trillion, and have more than enough to wipe out 100 percent of all short-term debt – a liquidity threshold not seen in at least 60 years.

Conversely, the brunt of Covid-19 restrictions is being born by small businesses – the mom-and-pop establishments in the hospitality and other parts of the services economy that rely on an in-person customer base. Their plight is highlighted by New York's clampdown on restaurants noted above, but travel agencies, gyms, barbers and other service providers are also at risk of having their doors shut as cases of the virus escalate. The Paycheck Protection Program that helped them weather the first wave of Covid-19 has run dry; resurrecting fiscal aid for small businesses is just as vital to the economy's health as would the extension of unemployment benefits to laid-off workers.

The good news is that the healthy cash position of larger corporations puts them in a good position to expand investment spending and payrolls and jump-start the economy's growth rate when the health crisis ends, hopefully over the second half of next year. The bad news is that if the economy suffers a major setback in the first half of the year because of a lack of fiscal support, there might be no incentive for corporations to open up their spending budgets. We remain cautiously optimistic that a fiscal deal will be struck around the turn of the year, but worry that it might be too watered down to have much of an immediate impact.

FINANCIAL INDICATORS

INTEREST RATES	December 11	Week Ago	Month Ago	Year Ago
3-month Treasury bill	0.08	0.08	0.10	1.57
6-month Treasury bill	0.08	0.09	0.10	1.56
3-month LIBOR	0.22	0.23	0.22	1.89
2-year Treasury note	0.13	0.15	0.18	1.61
5-year Treasury note	0.37	0.42	0.41	1.66
10-year Treasury note	0.90	0.97	0.90	1.82
30-year Treasury bond	1.63	1.74	1.65	2.26
30-year fixed mortgage rate	2.71	2.71	2.84	3.73
15-year fixed mortgage rate	2.26	2.26	2.34	3.19
5/1-year adjustable rate	2.79	2.86	3.11	3.36

STOCK MARKET				
Dow Jones Industrial Index	30,046.37	30,218.26	29,479.81	28,135.28
S&P 500	3,663.46	3,699.12	3,585.15	3,168.80
NASDAQ	12,377.87	12,464.23	11,829.29	8,734.88

COMMODITIES				
Gold ($ per troy ounce)	1,843.50	1,842.00	1,888.20	1,480.00
Oil ($ per barrel) - Crude Futures (WTI)	46.56	46.09	40.12	59.79

ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/ Quarter	Two-Months/ Qtrs Ago	Average-Past Six Months or Quarters
Consumer Price Index (November) - % chg.	0.2	0.0	0.2	0.3
Core CPI (November) - % change	0.2	0.0	0.2	0.3
Producer Price Index (November) - % chg	0.1	0.3	0.4	0.3
Consumer Credit (October) - $billions	7.2	15.0	-8.6	5.4

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