GOVERNMENT PORTFOLIO ADVISORS

Weekly Economic Update—December 24th, 2020

Our next Weekly Commentary will be published on January 11. We would like to wish all of our readers a happy holidays and prosperous New Year.

As 2020 draws to a close, we reflect on a difficult year that couldn't end soon enough. Covid-19 infected more than 18 million individuals and led to 325,000 lost lives in the US. The economy suffered its most severe contraction since the WWII demobilization, 22 million people lost their jobs, and thousands of small businesses were shuttered. The initial recovery phase was extremely rapid with unprecedented fiscal and Fed stimulus helping the economy recoup roughly 80% of its output loss and 55% of its job losses in just eight months. But while some sectors like tech, retail and housing were outperformers, hard-hit households and businesses remain extremely vulnerable to the virus resurgence.

On the positive side, vaccine distribution should ensure we reach the critical herd immunity threshold around mid-summer. However, there will be hiccups along the way with virus mutations, logistical issues, and reduced public vigilance making the vaccine rollout phase a delicate one to navigate. With that in mind, dovish Fed policy and additional fiscal stimulus should provide much needed support to households and businesses. We expect the Covid relief bill will eventually be signed in time to prevent significant hardship for millions of vulnerable Americans, but President Trump's last-minute objection to the bill represents a significant risk.

The long-awaited $900 billion Covid relief bill is months late and will likely fall short of what is needed to prevent a rough winter, but it should help buffer the current economic slowdown and provide increased dynamism to the economy during the initial vaccine rollout phase. The deal extends emergency unemployment benefits for 14 million Americans until mid-March while extending eviction protections for millions of renters through January 31. The package also includes $600 checks for most adults and children, a $300 weekly top-up to unemployment benefits for 11 weeks, $280 billion in aid to small businesses, along with funding for vaccines, education and transportation.

Last minute political drama with President Trump seemingly opposing the bill unless it includes $2,000 checks instead of $600 is symptomatic of 2020. While a larger check would no doubt support stronger consumer spending growth in the coming months there are two important considerations. First, direct stimulus checks are generally less potent in supporting spending than unemployment benefits. This was amply demonstrated with the more generous direct stimulus payments sent to households under the CARES Act passed in March. While lower-income families undoubtedly spent the funds almost immediately on essential goods and services, the more financially secure households stashed a significant portion into savings. Indeed, the personal savings rate surged to a record high of 33.7 percent in April, and still remains well above historical levels.

Conversely, unemployed workers – particularly those lower on the income ladder that have borne the brunt of the pandemic-related layoffs – spend every penny of their unemployment benefits as soon as they are received. These households have little savings cushion to begin with and are not in a position to put aside a portion of their unemployment checks for a future day. Simply put, jobless benefits provide a bigger bang for the buck than do direct payments to households earning up to $150 thousand a year (for a couple), as many would save a portion of their checks or pay down debt instead of spending it. But while the Covid relief bill is not ideal, any further delay in passing it poses serious consequences. With renter eviction protections and unemployment benefits at risk of expiring after Christmas and a government shutdown looming, the urgency of passing a deal should override its imperfection.

As of this writing, several scenarios are possible: Trump could sign the bill, Trump could veto the bill, or Trump could do nothing. Under the latter scenario, the legislation would have to be taken up by the new Congress, delaying for weeks the stimulus needed to keep the economy from possibly slipping into a double dip recession. Also, the coronavirus relief bill is paired with a fiscal 2021 funding measure, so unless Trump signs the bill, or another continuing resolution is passed and signed, the government would shut down on December 28. To be sure, Congress could also amend the bill to include $2,000 payments that the president wants, but that seems less likely given the Republican's opposition to a price tag for the bill above $1 trillion.

Meanwhile, time is growing short for the economy, as this week's data confirms. Importantly, its main growth driver, consumer spending, is running out of fuel. A rapidly worsening health situation, weakening income, depleted savings for lower income families and cooler weather led consumers to slam their wallets shut in November. Personal spending fell for the first time in this recovery cycle, and real time data points to ongoing weakness in December. Not surprisingly, the major weakness was in spending categories most exposed to the resurgence of the virus.

Consumers shied away from malls and department stores, with spending on clothing plunging 4.8 percent. Spending on restaurants and hotels fell 4.1 percent, and with mobility reduced around the Thanksgiving holiday, spending on gas fell 2.2 percent. Hence, despite the fiscally-driven surge in consumer spending over the summer months, the recovery from the pandemic remains incomplete. That shortfall is particularly evident in the services sector of the economy, which were the most affected by lockdown restrictions. Hence, real spending on services remains depressed, down 7.1 percent relative to its pre-Covid level, with restaurants and hotels down 21 percent and recreation down 30 percent.

It is not hard to see why households reined in spending and why fiscal aid is vitally needed to sustain the recovery. Personal incomes fell for the second consecutive month, slipping 1.1 percent in November. The main drag came from the fall-off in government transfer payments, reflecting lower unemployment benefits from the expiration of the FEMA Lost Wages Supplemental Payments program. Small businesses also took it on the chin. Proprietor's income fell a whopping 8.5 percent owing to reduced Paycheck Protection loans to businesses and reduced Covid aid to farmers. To be sure, with payrolls still rising through November, labor compensation also increased. Wages and salaries rose 0.4 percent and are 2.0 percent above year-earlier levels.

But the 0.4 percent increase was the slimmest in seven months and half the average increases over the previous two months. The weakening wage gains align with the slowing pace of job growth and points to a continued softening trend in coming months. Indeed, we may well have seen the end of the jobs recovery, as layoffs keep mounting and job openings are sliding. There is a good chance that the December jobs report, due out on January 8, will show a decline in payrolls. Ironically, that might add an upward bias to the wage data, as the loss of jobs would be concentrated among lower-wage workers in the services sector, which again is being hobbled by renewed restrictions due to the resurgence of the virus. As low-wage workers drop out of the calculations, the heavier concentration of higher-wage workers on payrolls gives a boost to the average for all wage earners.

This is just another reflection of the K-shaped recovery that has defined this recovery. White-collar workers who retained jobs that can be carried out remotely are doing just fine. They represent the upper right arm in the K not only because of the paychecks that keep coming in. They also are in the group that holds the majority of stocks, and hence, are benefiting from the robust market rally this year, which has not been stifled by the pandemic. But the pandemic has taken the biggest toll on workers that occupy the lower right leg of the K – the ones that have borne the brunt of the layoffs and have little in the way of stock holdings. This inequality also underpins the argument against expanding the direct stimulus payments from $600 to $2000, as the president proposes. As recent history has shown, many of the families that would receive the more generous checks already hold well-paying jobs and would simply stash the funds into savings accounts – or stocks.

We still believe that a Covid-relief bill will eventually see the light of day, if not early next week during the last few days Congress is in session this year, then shortly after the start of 2021. But the delay of even a week puts an extra financial burden on those who can least afford it. On December 28, two emergency Federal programs established with the CARES Act that provide extended unemployment insurance will expire, removing a critical source of support for 14 million jobless workers who are collecting benefits under the programs. Even if an extension is granted early next year, some state governments that administer the programs would not be able to swiftly re-start the process of sending out checks.

Hence, even as the economy is limping out of 2020, it is poised to enter the new year on crutches. We suspect that activity will hit an air pocket in January, setting the stage for an anemic first quarter. The good news on the health front, with the rollout of the vaccine hitting full speed in coming months, does provide a powerful antidote to the economy's dismal start. But a policy bridge that would carry the economy over to the post-Covid world would clearly brighten the skies as the calendar turns to 2021.

FINANCIAL INDICATORS

INTEREST RATES	December 24	Week Ago	Month Ago	Year Ago
3-month Treasury bill	0.09	0.08	0.09	1.56
6-month Treasury bill	0.09	0.11	0.09	1.59
3-month LIBOR	0.25	0.24	0.22	1.96
2-year Treasury note	0.12	0.12	0.16	1.58
5-year Treasury note	0.36	0.38	0.37	1.68
10-year Treasury note	0.94	0.95	0.85	1.88
30-year Treasury bond	1.66	1.69	1.58	2.32
30-year fixed mortgage rate	2.66	2.67	2.72	3.74
15-year fixed mortgage rate	2.17	2.21	2.28	3.19
5/1-year adjustable rate	2.79	2.79	3.16	3.45
STOCK MARKET				
Dow Jones Industrial Index	30,199.87	30,179.05	29,910.37	28,645.26
S&P 500	3,703.06	3,709.41	3,638.35	3,240.02
NASDAQ	12,804.73	12,755.64	12,205.85	9,006.62
COMMODITIES				
Gold ($ per troy ounce)	1,883.90	1,886.40	1,790.70	1,515.60
Oil ($ per barrel) - Crude Futures (WTI)	48.24	49.06	45.52	61.72

ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/ Quarter	Two-Months/ Qtrs Ago	Average-Past Six Months or Quarters
New Home Sales (November) - 000s	841	945	965	925
Durable Goods Orders (November) - % chg.	0.9	1.8	2.1	4.1
Personal Income (November) - % change	-1.1	-0.6	0.8	-0.6
Personal Consumption (November) - % chg	-0.4	0.3	1.3	1.7

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