GOVERNMENT PORTFOLIO ADVISORS

Weekly Economic Update—December 7th, 2020

The mid-20th century German politician Ludwig Erhard is famously quoted as saying “a compromise is the art of dividing a cake in such a way that everyone believes he has the biggest piece”. While that principle may apply in many cases, a cynic would likely view a compromise in a more distressing light, one that leaves all parties involved in negotiations equally unhappy. We suspect that the $908 billion Covid relief bill cobbled together by a bipartisan group of lawmakers this week fits that more cynical description. For sure, the Democrats, as well as president-elect Biden would like to see a more muscular relief effort, something closer to the $2.2 trillion Heroes Act passed in the House last spring. Conversely, most Republicans would no doubt be happier with a skinnier bill, something closer to the $500 billion package put forward by Senate majority leader McConnell a few months ago.

The bipartisan effort is still on the drawing board and the proposal is likely to undergo significant alterations before being put to a full vote. But after months of deadlock on Capitol Hill that suggested nothing would be done, the enhanced prospect of a meaningful bill getting through Congress before the end of this year is clearly a welcome development. The signals from the White House that President Trump would sign whatever crosses his desk is just icing on the “cake”. President-elect Biden also signaled that he would welcome the proposal with open arms, viewing it as a down payment on a bigger package his administration hopes to advance soon after assuming office. From our lens, a relief package would come none too soon.

While the proposal contains some key elements vitally necessary to cushion the blow from the pandemic – some additional relief to unemployed workers, small businesses and state and local governments – it does not include direct stimulus payments to households that played such a vital role in kick-starting the economy out of the pandemic recession earlier in the year. That said, there is arguably less urgency for such payments now than it was then, when the job market was spiraling out of control and sending the unemployment rate up to a peak 14.7 percent. The loss of 22 million paychecks in March and April together with harsh lockdown restrictions vaporized consumer spending and drove the economy into its worst quarterly contraction on record. Since then, the job market has been on the mend, confidence has rebounded, consumers reopened their wallets and the economy has clawed back much of its output loss.

But the tailwinds that have been driving the economy’s growth engine are waning and the spurt of activity is morphing into a simmer. Importantly, the health crisis that temporarily eased early in the summer and allowed the economy to reopen for business is once again deteriorating rapidly. New cases of the virus, hospitalization and death rates are hitting record highs, prompting renewed restrictions in a growing number of states. The resurgence of the Covid-19 headwind has steadily picked up steam and eroded the economy’s strength in recent months, although its full impact will become more apparent as we transition to the new year. But the drag is already palpable and taking a toll on the economy’s main growth driver, the job market.

Indeed, the pace of job growth decelerated sharply in November. Nonfarm payrolls increased by 245 thousand during the month, less than half October’s 610 thousand increase and the weakest of the recovery so far. Job gains in manufacturing and construction, health and social services and, notably, transportation and warehousing paced the latest increase. The latter category highlights the growing influence of e-commerce in economic activity at the expense of brick and mortar establishments. Payrolls in the retail sector fell by another 35 thousand last month and are down by 550 thousand since February, a 3-½ percent shrinkage in the retail workforce. Over the seven-month span since the overall massive jobs destruction in March and April, the economy has recovered 12.3 million jobs. But that still leaves the number of jobholders

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9.8 million below the pre-pandemic level in February. Simply put, there is a long ways to go before the labor market is fully healed.

Likewise, the unemployment rate continues to recede, but progress on this front is slowing as well. The rate slipped 0.2 percentage points to 6.7 percent last month, cutting it to less than half the peak rate in April. But the latest dip is the slimmest of the recovery, following a hefty 1.0 percentage point drop in October. What's more, the official jobless rate overstates the health of the job market. For one, it declined for the wrong reason last month, as workers are dropping out of the labor force in droves. The labor force participation rate fell to 61.5 percent in November, near the lowest share since the 1970s. In numerical terms, the labor force shrank by 400 thousand in November, extending a seven-month trend that leaves fully 4 million fewer workers in the labor force than was the case in February.

For another, the Labor Department continues to misclassify a chunk of workers as being "employed but absent from work" instead of properly designating them as being unemployed. If they were properly classified, the unemployment rate would be 0.4 percent higher. But the distortion in the figures doesn't stop there. If the labor force participation rate had not shrunk so dramatically and those 4 million workers that dropped out remained in the workforce seeking jobs, the unemployment rate would be well above 8 percent. As it is, the Labor Department's broader underemployment rate (U6), which includes workers in part-time positions that would prefer full time jobs and those too discouraged to search for a job, remains at an elevated 12.0 percent.

It is also important to note that most of the job gains over the past seven months were workers who were rehired after being temporarily laid off during the height of the pandemic in March and April. But the ones not rehired and those who were permanently laid off are spending more time on the unemployment lines. The number of workers unemployed for at least six months shot up to almost 3.9 million in November from 929 thousand in April. They now comprise 36.9 percent of all jobless workers, up from 4.1 percent in April. This fraction hit a record high of 45.5 percent in April 2010, having climbed over a two-year period from a low of 16.9 percent. The current uptrend began a short six months ago and the climb has been much steeper. Clearly, the previous high is within reach over the next several months.

Indeed, with the health crisis worsening so rapidly in recent weeks, prompting more business restrictions and closures, there is a good chance that the next jobs report for December could see an outright decline in payrolls. If so, the plight of the unemployed would only intensify. Not only would the pool of jobless workers expand, but so too would job opportunities, making it even harder for people on extended layoffs to land a position. As workers are forced to remain longer on the sidelines, their link to the workforce becomes ever more weaker, highlighting the longer-term scarring effects that the pandemic could have on the labor market.

The good news is that vaccine development is proceeding at a surprisingly fast pace, with at least three major pharmaceutical companies racing to bring a product to the market later this month, albeit on a limited scale. If all goes well, the distribution to the public would broaden exponentially late in the first and into the second quarter, with enough vaccine to cover the entire population sometime in the second half of next year. That prospect together with improving odds of a stimulus bill has emboldened the stock market, as it points to a second-half rebound in growth and profits. Stock prices staged the biggest rally in decades last month and the upward trend continued this week, with the S&P 500 setting a new high.

That said, the next six months promises to be a rough patch for the economy, particularly if the escalating trend in virus cases continues. That would not only prompt more state-mandated restrictions, but also stoke fear among households and prod them to batten down the hatches. There is little policy makers can do to thwart that response, which would clearly raise the odds of a double-dip recession early next year. Barring the worst-case health scenario, however, the economy should survive the current wave of Covid-19 cases if cushioned by more fiscal support. With key Federal programs for unemployed workers expiring in three weeks and the plight of jobless workers growing worse, the need for fiscal relief sooner rather than later is becoming ever more apparent.

FINANCIAL INDICATORS

INTEREST RATES	December 4	Week Ago	Month Ago	Year Ago
3-month Treasury bill	0.08	0.09	0.10	1.52
6-month Treasury bill	0.09	0.09	0.11	1.55
3-month LIBOR	0.23	0.22	0.21	1.89
2-year Treasury note	0.15	0.16	0.17	1.63
5-year Treasury note	0.42	0.37	0.37	1.67
10-year Treasury note	0.97	0.85	0.82	1.84
30-year Treasury bond	1.74	1.58	1.61	2.28
30-year fixed mortgage rate	2.71	2.72	2.78	3.68
15-year fixed mortgage rate	2.26	2.28	2.32	3.14
5/1-year adjustable rate	2.86	3.16	2.89	3.39

STOCK MARKET				
Dow Jones Industrial Index	30,218.26	29,910.37	28,323.40	28,015.06
S&P 500	3,699.12	3,638.35	3,509.44	3,145.91
NASDAQ	12,464.23	12,205.85	11,895.23	8,656.53

COMMODITIES				
Gold ($ per troy ounce)	1,842.00	1,790.70	1,952.70	1,464.60
Oil ($ per barrel) - Crude Futures (WTI)	46.09	45.52	37.43	59.13

ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/ Quarter	Two-Months/ Qtrs Ago	Average-Past Six Months or Quarters
ISM Manufacturing Index (November)	57.5	59.3	55.4	55.8
ISM Services Index (November)	55.9	56.6	57.8	57.1
Nonfarm Payrolls (November) - 000s	245	610	711	1,600
Unemployment Rate (November) - 000s	6.7	6.9	7.9	8.5

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