Financial Market Weekly

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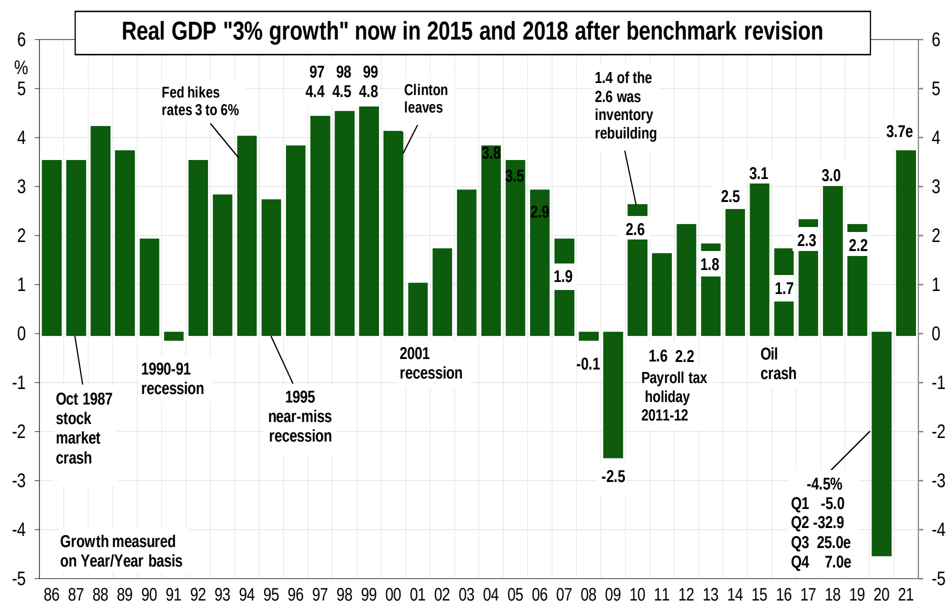
CORONAVIRUS LOCKDOWN OF ECONOMY SENDS GDP TUMBLING 32.9% IN SECOND QUARTER



It's bad. But this recession is looking like it will be just two quarters long over the first half of this year, one the shortest downturns in history technically. It is the after-shocks that could be a gigantic drag on economic growth over the next year or two with close to 30 million out of work and receiving unemployment benefits right now. Every July the Bureau of Economic Analysis does a benchmark revision back at least five years. Both Obama and Trump will be happy to know growth was revised higher to 3.1% in 2015 and to 3.0% in 2018: both years had been short of the 3 percent "gold standard" at just 2.9% each. Real GDP fell 32.9% in the second quarter of 2020 which is the new news, the 5.0% decline in Q1 2020 was unrevised, while the benchmark revision back to 2015 also said the economy was stronger heading into the recession with growth of 2.6% in Q3 2019 and 2.4% in Q4 2019, where growth had been just 2.1% in both of the final two quarters of last year. How bad is it historically? The -32.9% Q2 figure is annualized,

	Q1 19	Q2 19	Q3 19	Q4 19	Q1 20	Q2 20p
REAL GDP	2.9	1.5	2.6	2.4	-5.0	-32.9
REAL CONSUMPTION	1.8	3.7	2.7	1.6	-6.9	-34.6
CONSUMPTION	1.3	2.5	1.8	1.1	-4.8	-25.1
Durables	0.1	0.9	0.4	0.2	-0.9	0.0
Nondurables	0.5	0.7	0.4	-0.1	1.0	-2.2
Services	0.7	0.9	1.0	1.0	-4.8	-22.9
INVESTMENT	0.7	-1.0	0.3	-0.6	-1.6	-9.4
Business Plant	0.2	0.1	0.1	-0.2	-0.1	-1.2
& Equipment and	0.1	-0.2	-0.1	-0.1	-0.9	-2.1
Intellectual Property	0.2	0.2	0.2	0.2	0.1	-0.3
Homes	-0.1	-0.1	0.2	0.2	0.7	-1.8
Inventories	0.2	-1.0	-0.1	-0.8	-1.3	-4.0
EXPORTS	0.2	-0.5	0.1	0.4	-1.1	-9.4
IMPORTS	0.3	-0.3	-0.1	1.1	2.3	10.1
GOVERNMENT	0.4	0.9	0.4	0.4	0.2	0.8
Federal defense	0.2	0.2	0.2	0.3	0.0	0.2
Fed nondefense	-0.1	0.4	0.1	0.0	0.1	1.0
State and local	0.3	0.3	0.1	0.2	0.1	-0.4

Below line: Percentage point contributions to Q2 2020 -32.9% real GDP
Second estimate for Q2 is Thursday, Aug 27

the quarter-to-quarter change in the SAAR level was -9.5%, so the economy would have to fall at this rate another few quarters for this to be an unparallelled disaster for the year as a whole. There were no quarterly estimates, but annual GDP data show the economy fell 8.5% in 1930, 6.4% in 1931, 12.9% in 1932, and 1.2% in 1933 so we aren't seeing the Great Depression II in the 2020 GDP data at least. Historically, the only other big drop was 11.6% in 1946 after World War II.

Consumer spending fell 34.6% in the second quarter, but it is easy to see a rebound of at least 25% in the third quarter even if there is some temporary slowing of spending after the second wave of the coronavirus outbreak. Consumer spending was about 25 percentage points of the 32.9% GDP decline. But most of the consumer expenditures drop was in three services categories: Health care services fell and were a huge 9.5 percentage point drag on GDP, Recreation services (theme parks) a 4.69 percentage point drag, and Food services and accommodations a 5.55 percentage point drag. We are guessing there will be a consumer rebound in these categories, along with a reversal of the negative 3.98 percentage point drag from falling inventory levels, and this is why we are forecasting a 25% jump in GDP in Q3, to be released Thursday, October 29, just days before the presidential election on Tuesday, November 3. Business investment tumbled. The recovery there is less certain with questions about demand for companies' goods and services and many businesses are saddled with massive financial losses from reduced sales and may not have the cash. Business investment on structures fell 34.9%, purchases of equipment fell 37.7%, and intellectual property products like software fell 7.2%. The Federal government nondefense expenditures added 1.0 percentage point to "growth" which was the result of unemployment claims and those $1,200 Economic Impact Payments.

Real Business Investment (% change SAAR)

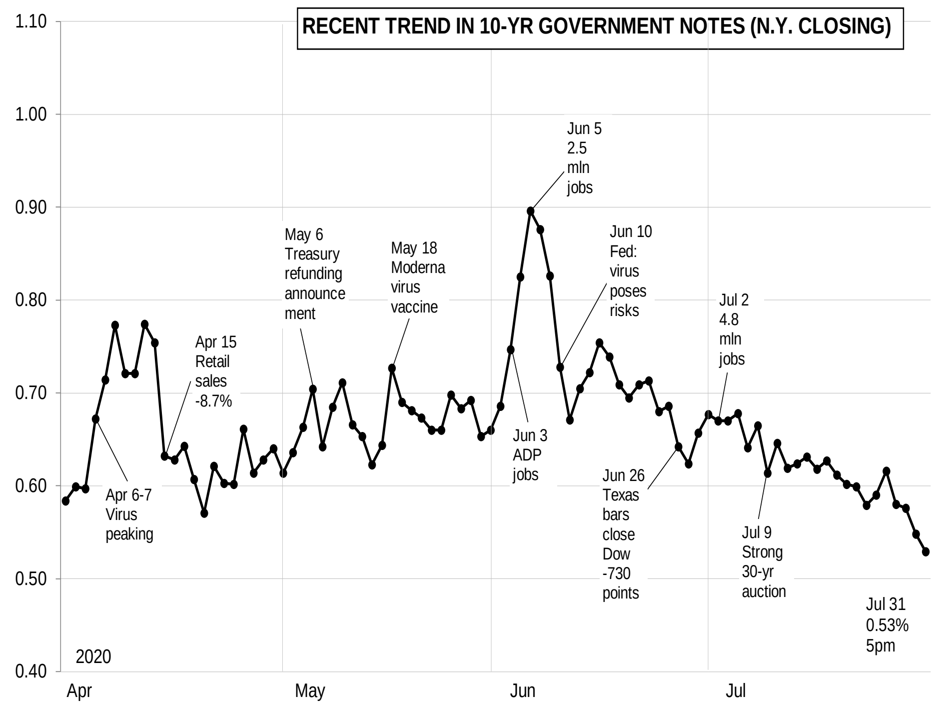
$bln 2019		2017	2018	2019	Q3 19	Q4 19	Q1 20	Q2 20
547.7	STRUCTURES	4.2	3.7	-0.6	3.6	-5.3	-3.7	-34.9
162.2	Commercial and health care	3.2	1.3	-2.3	5.0	1.8	-0.7	-18.0
62.6	Manufacturing	-13.4	-1.8	4.6	-0.4	-6.4	-16.8	-25.3
110.7	Power and communication	-4.6	-5.7	3.5	25.3	22.2	2.6	-19.4
118.0	Mining exploration, shafts, wells	38.8	25.2	-2.1	-6.5	-36.6	8.7	-77.8
99.2	Other structures 1	3.8	1.3	-3.4	-5.2	-6.6	-16.5	-27.6
1,267.7	EQUIPMENT	3.2	8.0	2.1	-1.7	-1.7	-15.2	-37.7
493.9	Information processing equipment	7.4	8.6	3.0	-0.5	-1.1	-13.2	22.3
130.7	Computers	7.7	12.2	5.5	-9.2	16.1	-18.1	67.7
363.8	Other processing equipment 2	7.3	7.2	2.0	3.7	-7.9	-10.9	5.5
249.1	Industrial equipment	5.5	8.2	2.1	1.9	-9.3	-5.5	-22.5
285.7	Transportation equipment	-1.6	5.8	-0.4	-8.9	8.7	-31.1	-85.7
250.1	Other equipment 3	0.6	9.6	3.5	1.6	-5.8	-7.2	-34.5
968.2	INTELLECTUAL PROPERTY	4.2	7.8	6.4	5.3	4.6	2.4	-7.2
449.3	Software	8.3	11.2	7.9	8.7	8.1	9.6	-1.4
440.5	Research & Development (R&D)	1.4	6.0	5.9	3.0	2.4	-1.5	-8.9
83.7	Entertainment, literary, artistic	2.2	3.2	2.3	2.9	1.7	-6.9	-23.0

1 Religious, educational, vocational, lodging, railroads, farm, amusement/recreational, other
2 Communication, medical, photocopy, office and accounting equipment; nonmedical instruments
3 Furniture; agriculture, construction, mining/oilfield, and service industry machinery; electrical equipment

In conclusion, the economy fell hard in the second quarter as the pandemic virus locked Americans down at home, but even though the collapse was the greatest in U.S. history, the damage to growth is limited as pent-up demand pushed spending right back up as the quarter came to a finish in June, especially for retail sales. Fed Chair Powell said Wednesday that high-frequency data such as credit card spending has shown the economy is slowing again after mid-June with the spreading second wave of the pandemic to new areas of the economy down South and out West. But we doubt the virus' second wind will drop the economy as low as it was in last quarter's sharpest downturn in economic history. This recession is over. Bet on it.

MARKETS OUTLOOK

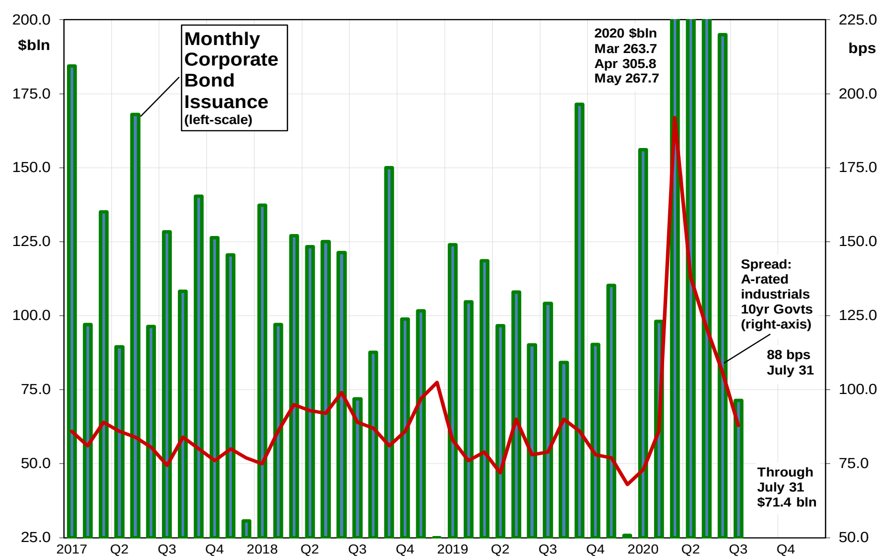
	28-Jun 2019	30-Sep 2019	31-Dec 2019	31-Mar 2020	30-Jun 2020	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021
30-Yr Treasury	2.53	2.11	2.39	1.32	1.41	1.40	1.40	1.50	1.60	1.70
10-Yr Note	2.01	1.67	1.92	0.67	0.66	0.70	0.70	0.80	0.90	1.00
5-Yr Note	1.77	1.55	1.69	0.38	0.29	0.30	0.30	0.40	0.50	0.60
2-Yr Note	1.76	1.62	1.57	0.25	0.15	0.20	0.20	0.20	0.30	0.30
3-month Libor	2.32	2.09	1.90	1.45	0.30	0.30	0.30	0.20	0.20	0.20
Fed Funds Rate	2.50	2.00	1.75	0.25	0.25	0.25	0.25	0.25	0.25	0.25
2s/10s spread	25	5	35	42	51	50	50	60	60	70



10-yr year yields closed at 0.53% this week versus 0.59% last week. Bonds are rallying in this hard to understand era with Friday's close at a record low. Not too much of a record as the old low close was 0.54% on March 9 which was the day of the Saudi Russia oil price war news. Bond yields at this low of a level are helping stocks to rally with the S&P 500 closing this week up 1.2% year-to-date. We cannot recall another recession where stocks got so far out in front of more positive economic data. The economy looks grim with 30 million collecting unemployment benefits and out of work, where the jobless numbers behind the 10.0% peak unemployment rate in the last recession were 15.352 million. The only thing that is true is that the economic outlook would be worse if stocks were still down big on the year.

CORPORATES: ENTERPRISE PRODUCTS, CENOVUS ENERGY, SOUTHWEST AIR

Corporate bond offerings were $25.7 billion in the July 31 week versus $7.0 billion in the July 24 week. On Monday, AT&T sold $11.0 billion 7.5s/11.5s/22.5s/31.5s/40.5s. It priced a $2.5 billion 2.25% 31.5-yr (m-w +25bp) at 165 bps (Baa2/BBB). The communications company will use the proceeds to buy back debt. Corporate bond yields (10-yr Industrials rated A2) were 88 bps above 10-yr Treasuries Friday versus 85 bps last week.



FEDERAL RESERVE POLICY

The Fed met July 28-29, 2020 to consider its monetary policy. The press statement inserted a new sentence saying: "The path of the economy will depend significantly on the course of the virus." Fair enough, even if there isn't much policy can do to change the economy's path at this stage with rates at zero. Powell differed with our view in the press conference listing three things (tools) they could still do if required. (1) The credit and liquidity facilities which are "unlimited." (2) They can adjust their forward guidance. (3) They can adjust their asset purchases. Powell was also asked when would he hike rates again. He reiterated they were not even thinking of raising rates again. He thinks the economy will need highly accommodative policy for an extended period. He said, "I wouldn't look for us to be sending signals about cutting back on facilities or anything like that for a very long time." There is going to be a "long tail" after the reopening of the country following the lockdown, where the "14 million" out of work since February are going to struggle to find a new job. Powell then answered a long question about the disincentives inherent in giving out $600 weekly checks and blended this into what does this mean for the widening of the wealth gap in the country. The answer was interesting, too long to print here, but it's his belief that it will take a fairly long time to put workers back to work in the parts of the economy that involve people getting together in close proximity. There won't be enough jobs for those employed in restaurants, bars, public entertainment, travel and accommodation. Interesting comment from a non-economist. Someone should track those employed in "Leisure and Hospitality."

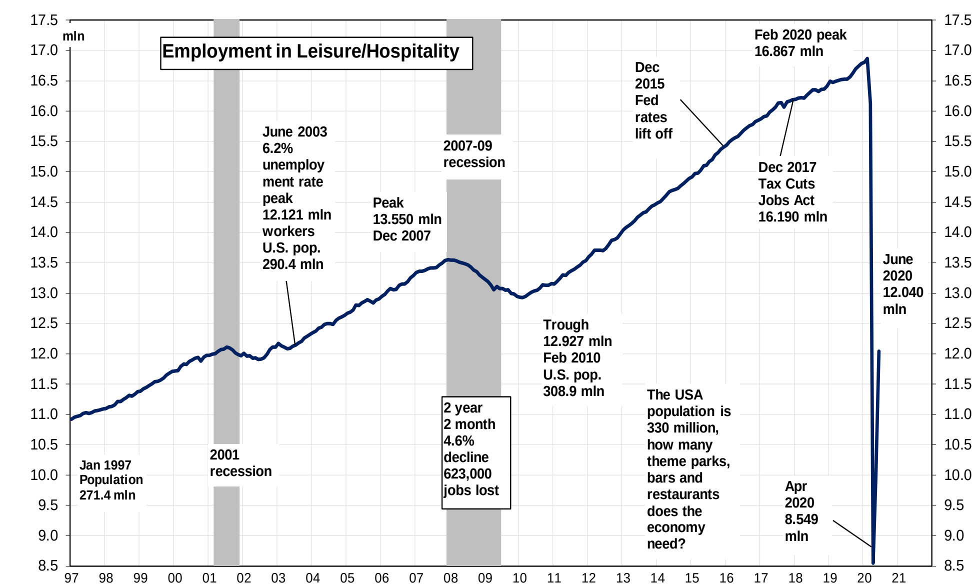
Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	29-Jul	22-Jul	15-Jul	8-Jul	pre-LEH
Factors adding reserves					
U.S. Treasury securities	4293.563	4265.878	4253.229	4231.355	479.782
Federal agency debt securities	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	1933.380	1970.600	1948.388	1911.401	0.000
Repurchase agreements	0.000	0.000	0.000	0.000	126.750
Primary credit (Discount Window)	3.611	4.578	5.058	4.846	23.455
MMLF	14.273	17.541	18.635	18.927	
PDCF	1.788	1.899	1.699	1.874	
Commerical Paper Funding Facility	8.900	10.105	10.659	12.802	
Paycheck Protection Facility	70.816	68.503	67.989	67.685	
Corporate Credit Facility (CCF)	44.210	44.046	43.423	42.644	
Municipal Liquidity Facility	16.086	16.085	16.084	16.082	
Main Street Lending Program	37.588	37.518	37.515	37.503	
Term Asset-Backed Facility (TALF II)	9.439	9.439	9.439	8.753	
Central bank liquidity swaps	117.473	121.992	154.850	179.095	62.000
Federal Reserve Assets	6997.0	7013.4	7007.2	6969.4	961.7
3-month Libor %	0.26	0.26	0.27	0.27	2.82
Factors draining reserves					
Currency in circulation	1992.869	1985.894	1981.644	1977.346	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Treasury credit facilities contribution	114.000	114.000	114.000	114.000	
Reverse repurchases w/others	0.001	0.000	0.001	0.001	0.000
Reserve Balances (Net Liquidity)	2685.376	2659.658	2732.649	2813.296	24.964
Treasuries within 15 days	75.015	74.899	58.895	66.114	14.955
Treasuries 16 to 90 days	256.470	259.225	279.380	270.043	31.549
Treasuries 91 days to 1 year	644.020	637.534	633.384	618.085	69.272
Treasuries over 1-yr to 5 years	1627.218	1607.135	1604.839	1607.239	170.807
Treasuries over 5-yrs to 10 years	746.156	745.867	738.129	735.426	91.863
Treasuries over 10-years	944.684	941.219	938.604	934.448	101.337

**September 10, 2008 is pre-Lehman bankruptcy of 9-15-08

MMLF: Money Market Mutual Fund Liquidity Facility: loans secured by assets bought by banks from money market funds

PDCF: Primary Dealer Credit Facility: o/n and term funding with maturities to 90 days

CCF: Corporate credit facility: Primary market (PMCCF) and Secondary Market (SMCCF)



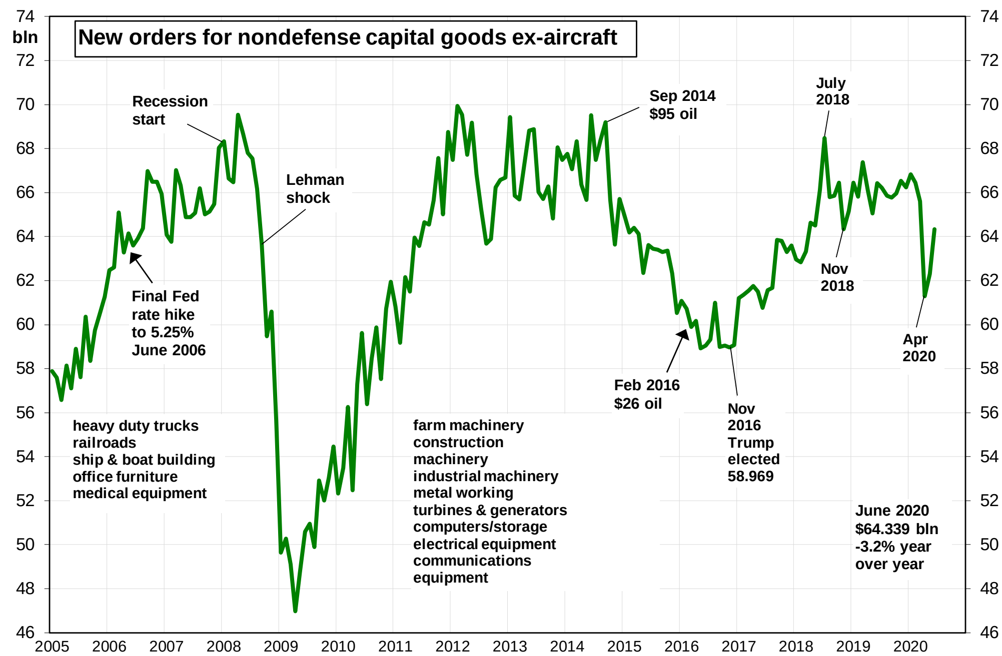
	U.S. Treasury New Cash Needs and Fed Treasury Purchases (QE)										
	Monthly Changes ($ billions)										
	Fiscal Year (FY) Ending September 2020										Total
	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	FY 2020
Fed QE	67.808	73.007	80.364	80.246	64.952	504.312	993.047	138.093	87.892	96.159	2,185.9
New Cash	166.8	112.5	50.9	38.5	199.8	238.7	1368.6	699.2	685.2	102.2	3,662.4
Bills	79.1	59.0	-98.2	-12.5	160.3	92.8	1344.3	628.2	449.7	-0.7	2,702.0
Coupons	87.6	53.4	149.2	51.1	39.5	145.8	24.2	71.0	235.5	102.9	960.2
Federal Reserve's 11 Lending Facilities (month-end outstanding)					0	58.352	94.641	136.343	204.607	203.100	
Central bank liquidity swaps (month-end outstanding)					0.044	206.051	438.953	448.946	274.963	117.473	

OTHER ECONOMIC NEWS THIS WEEK

Light at end of tunnel is durable goods (Monday)

Breaking economy news. Nondefense capital goods orders ex-aircraft surged in June by 3.3 percent after rising 1.6 percent in May from April's precipitous 6.6 percent drop. These orders were $64.339 billion in June which is just modestly lower than the $66.453 billion level in February before the pandemic locked down the economy. You can't have a recession without plunging durable goods orders and we don't have either. No plunge and no more recession apparently.

Net, net, business capital spending is up big in June which means those gloomy, deep recession forecasts have to be reconsidered. Either that or this is going to be the longest developing recession in history because the recessionary headwinds are receding not intensifying. Corporate balance sheets may be in tatters from the collapse in sales, but it is not limiting the recovery in business orders for new equipment.



Companies don't buy equipment if they think the economy is headed over the cliff. It is one thing if retail sales has a V-shaped recovery, returning back near the start of the year before the coronavirus virus shutdown of the economy, but it is much more important if businesses are back and confident enough to make the expensive outlays for long-lived capital goods because it means the recessionary winds are abating.

In every recession, it is the tremendous downward swing in business investment that digs the economy's grave and makes the recession a recession and right now it is looking like business investment and consumer spending is coming back stronger than we would have ever imagined.

It isn't a Great Depression anymore despite the millions out of work if the downturn in growth grows shallower and briefer by the day. Maybe the stock market had it right all along. Recession what recession. This one may be over before it started.

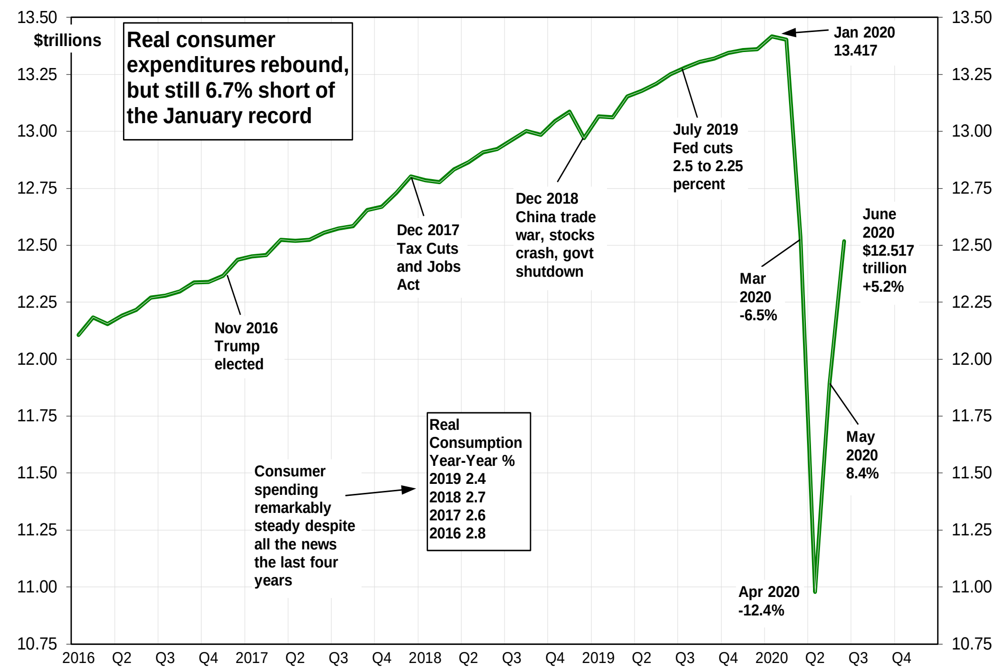
It's fashionable in forecasting circles to think the pandemic second wave and the delay in additional fiscal stimulus, where those extra $600 weekly unemployment checks from the Federal government go away, could bring the economy to its knees again. But we aren't so sure because the economy might have greater underlying strength than we thought. Stay tuned. This is one of the strangest recessions that America has ever met. Hard to believe with almost 32 million out of work, but there is light at the end of the tunnel and the outlook may be just as positive as the stock market thinks.

Consumer spending jumps despite coronavirus second wave (Friday)

Breaking economy news. The June personal income report detailing spending and savings and the Fed's preferred inflation measure which can never seem to find much inflation. We were shocked to see that consumer spending jumped in June despite the coronavirus second wave in much of the country.

Real consumer spending jumped 5.2% in June after rising 8.4% in May from the recession lows made in April during the second month of the country's lockdown. Real consumer spending is now 6.7% short of the record made in January before the pandemic. Consumer purchases of goods are actually 4.4% higher than January and set a new record this month. Services spending as we found out yesterday in the second quarter GDP report is lagging with consumer real expenditures of services down 11.6 percent from the peak in January before the Covid-19 storm hit. Health care, and bars, restaurants, hotels, and theme parks and other recreation activities are all a big drag on the economy right now and if they don't open, then the economic recovery will not be complete.

There's the inflation data, but there wasn't much inflation in the best economy in 50 years at the start of the year, so there won't be any now during the worst economic downturn since the Great Depression. Headline personal consumption expenditures (PCE) inflation is up 0.8% from last year and core PCE inflation is up 0.9% over the last 12 months. (yawn)



Net, net, consumers have still got it and they were spending it in June despite the second wave of the virus spreading to states in the South and in the West. And the consumer has plenty of powder left to fire with personal saving as a percentage of disposable personal income at 19.0% versus just 7.6% in January before the pandemic lockdown began. One cliff down, with the virus second wave fears diminishing, and one to go if Congress and the White House can't get those $600 weekly unemployment checks reinstated. Those checks are worth about $75 billion per month to the economy for consumers to spend. The economy wouldn't mind another round of $1,200 Economic Impact Payments either as these totaled roughly $275 billion. No wonder retail spending at shops and malls is holding in there despite almost 30 million unemployed in the country as consumers have a lot of savings, they aren't taking expensive vacations, and the Federal government pandemic assistance payments have been considerable up through the end of the second quarter. Stay tuned. Story developing. It isn't as bad as you think out there as this recession is over. Bet on it.

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