FHN FINANCIAL

MARCH 27, 2020

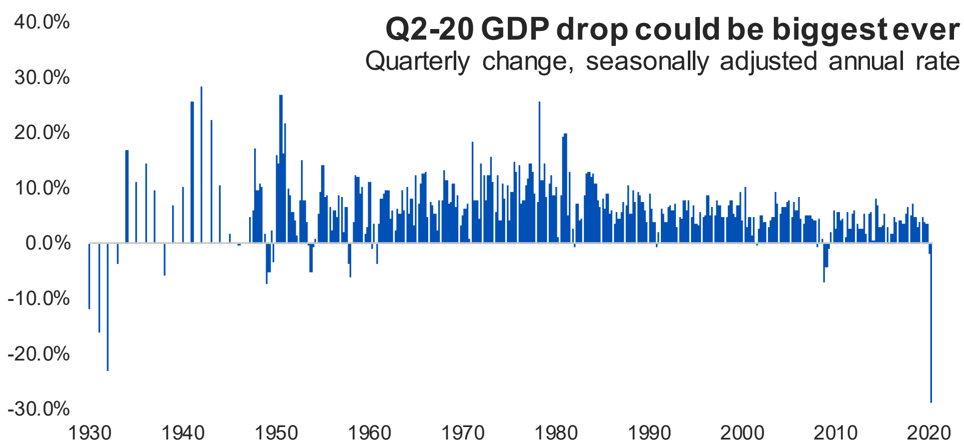
ECONOMIC WEEKLY

Stimulus to the Rescue

The $2 trillion stimulus will not prevent a recession; it should prevent the recession from being catastrophic.

Just before midnight on Wednesday, the Senate unanimously passed $2 trillion in loans, grants, and tax forgiveness to offset some of the economic damage wrought by Covid-19. It is by far the biggest economic stimulus as a percent of GDP at least since the country mobilized for World War II. Nevertheless, it is not likely to prevent a recession. What it will do — along with the Fed's war chest of loan programs, backstops, and bond purchases — is prevent a truly catastrophic decline and set the stage for a more robust recovery.

Nevertheless, if people are unable to return to work in significant numbers in the second quarter, if the lockdown is as severe — or worse — through the quarter as it is now, GDP will fall at almost a 30% annual rate even with the CARES Act. Of course, it goes without saying the damage would be worse without it.



Nominal dollar GDP, annual changes before 1947, annualized quarterly after

Source: Bureau of Economic Analysis

Perspective

States have shut down a significant portion of the US economy. If there was any doubt about the economic impact, the 3.3 million Americans filing for unemployment insurance last week, 2.2% of the 152.3 million people working as of February, put those doubts to rest.

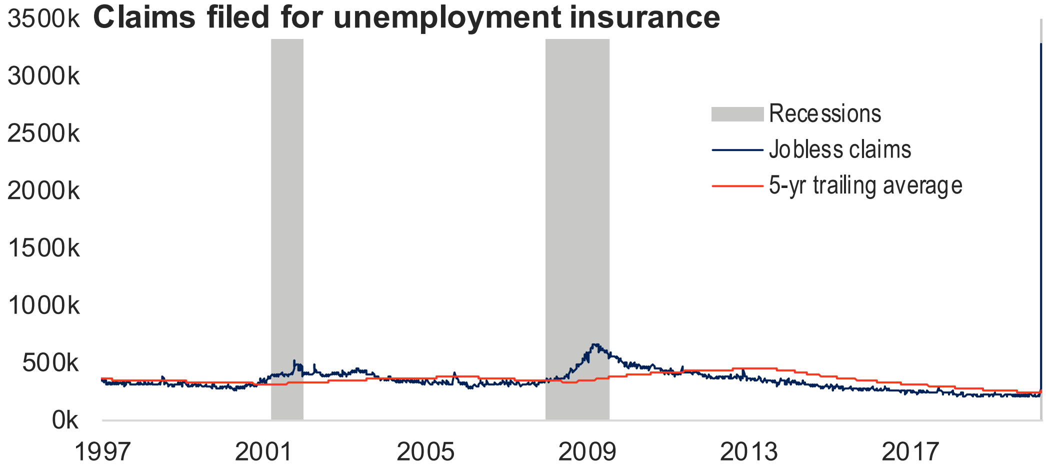
CONTENTS

ECONOMICS

Chris Low
Chief Economist
212.418.7909
chris.low@fhnfinancial.com

Rebecca Kooshak
Economic Analyst
212.418.7966
rebecca.kooshak@fhnfinancial.com

FHNFINANCIAL.COM
800.456.5460



Source: Bloomberg, Bureau of Labor Statistics

Next week's claims will likely be worse. Since the March 21 unemployment-insurance filing deadline last week, the following states issued restrictions: New Jersey on March 21, Florida and Ohio on March 22, Hawaii, Washington, Oregon, New Mexico, Louisiana, large parts of Pennsylvania, New York, and Connecticut on March23, Wisconsin, Massachusetts, Michigan, West Virginia, and Delaware on March 24.

Across the US last week, unemployment insurance systems were overwhelmed and crashed. People struggled to log their information and the staff struggled to process the claims. Those who could not file last week will file this week. Millions more will be out of work and they will have to file, too.

Q2 GDP change without CARES

	Share of GDP	Q2 change
Agriculture	0.8%	-5%
Mining	1.4%	-40%
Manufacturing	11.0%	-21%
Construction	4.1%	-20%
Utilities	1.6%	-15%
Wholesale trade	1.6%	-15%
Retail trade	5.5%	-50%
transportation	3.2%	-28%
Information	5.2%	-5%
Finance & insurance	7.6%	-10%
Real estate	13.4%	-10%
Business services	12.9%	-5%
Educational services	1.2%	-10%
Health care	7.6%	10%
Accommodation	0.8%	-80%
Food services	2.3%	-80%
Arts & entertainment	1.1%	-80%
Other services	2.1%	-30%
Government	12.3%	5%
Change in GDP		-14.2%
Annual rate		-45.8%

Source: Beureau of Economic Analysis

All 50 states have their own unique rules governing who qualifies for unemployment insurance. The Labor Department issued new rules eliminating some restrictions on the unemployment insurance program. Each state will make a judgement on whether to allow claims under the new Covid-19 guidelines. Specifically:

- An employer temporarily ceases operations due to Covid-19, preventing employees from coming to work;
- An individual is quarantined with the expectation of returning to work after the quarantine is over; and
- An individual leaves employment due to a risk of exposure or infection or to care for a family member.
- In addition, federal law does not require an employee to quit in order to receive benefits due to the impact of Covid-19.

The Department of Labor tracks state unemployment regulations here. These changes will allow millions more to file, and the CARES Act removes still more restrictions. Anecdotally, we have reason to believe many companies waited for the CARES Act to pass before letting workers go.

In two to three weeks, the number of unemployed could triple, leading to an increase in the unemployment rate of as much as 10 percentage points. If everyone currently not working is eventually laid off, the unemployment rate will reach 17.5%.[1] Thankfully, part of the stimulus is designed to keep idle workers on payrolls. Indeed, the portion of small business loans used to make payroll, rent, and utilities converts to grants.

The March employment survey was conducted two weeks ago when claims increased 70k. The unemployment rate in March, therefore, is only likely to rise a few tenths, to 3.8%. The rate in April will spike to 10% or higher. It will rise higher still in May and June.

To put that into perspective, a 2.2 percentage-point increase in unemployment in a week is indicative of a bigger drop in GDP because quite a few companies ceased operations but retained workers. With a quarter of the US population locked down, it's likely GDP will fall about 14.2% in the second quarter, or $3.1 trillion, which works out to 46% at an annual rate. That's nominal GDP. Real GDP will fall at a 44% rate assuming 2% inflation.

When will CARES cash hit the economy?

Congress designed part of the CARES Act to get cash into the economy right away, but other parts stagger the support. Unemployment insurance supplements, for instance, arrive over nine months. Medicaid and Medicare supplements will pay out over time as well.

Companies will tap the loan programs, but these programs, too, are designed to pay out as needed, not all at once. Likewise, some states will use their loans right away — New York, for instance — while others are likely to take their time. The table delineates the spending in the bill and our estimate for how much of each portion is likely to be tapped in the second quarter.

Spending under the Cares Act

	Allocated	Likely spent in Q2	Percent
Loans	*$835b*	*$674b*	
Loans to corporations	$454b	$363b	80.0%
Small business loans	$349b	$279b	80.0%
Airlines and cargo	$32b	$32b	100.0%
Grants	*$951b*	*$614b*	
Households	$301b	$301b	100.0%
Tax deferels & extd deadlines	$221b	$147b	66.7%
Unemp insurance	$250b	$83b	33.3%
Airlines and cargo	$29b	$7b	25.0%
Aid to states	$150b	$75b	50.0%
Supplements	*$340b*	*$170b*	
Transit	$25b	$13b	50.0%
Medical	$117b	$58.50	50.0%
Other	$198b	$99b	50.0%
Total	*$2,126b*	*$1,458b*	68.6%

Source: The Wall Street Journal and FHN Financial

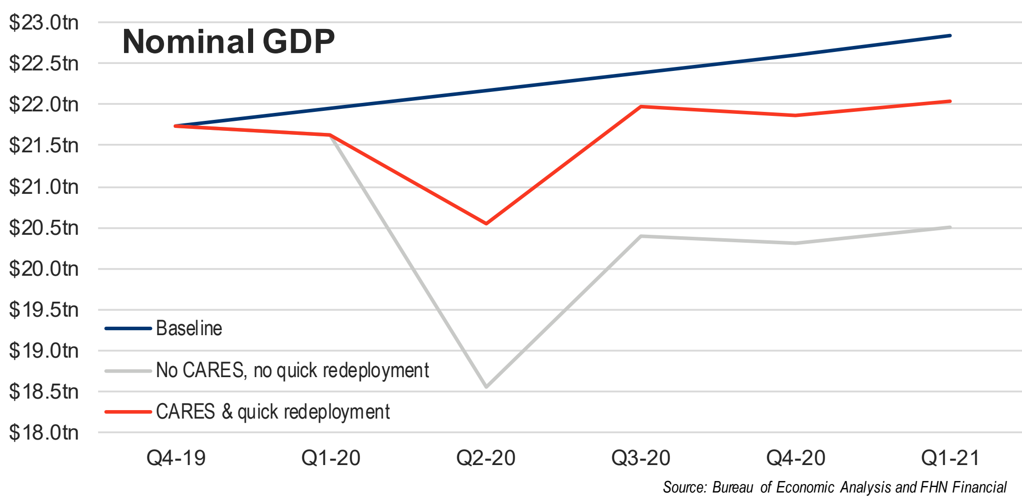
[1] Because people do not count as unemployed unless actively looking, the U6 underemployment rate is more likely to reflect the full damage, while the U3 is likely to rise to 10-12%.

US GDP peaked at $21.7 trillion in the fourth quarter. We estimate companies will tap $674m of the $835m in loans in the second quarter while approximately $614bn of the $951bn in grants will be paid out to households, workers, and companies. Supplements will add another $229bn.

The total offsetting stimulus, therefore, will be a little less than half of the loss in GDP. In other words, the economy is still likely to drop 7.5% or so in the second quarter, half as much as it would have without the stimulus, or 27% at an annual rate. That is still the biggest quarterly decline in GDP ever.

The only way to prevent such a large decline is for people to return to work. The rest of the stimulus will be tapped in the second half. It's entirely possible third quarter GDP will rise rather than fall. Hence, the recovery will be stronger.

Assuming workers redeploy at the same pace as in China, economic output will recover somewhat in May and a little more in June. The second quarter decline could be limited to 5%, or 18.5% annualized. Follow that with a 3% rebound in Q3 and a fade in Q4, when the second wave of Covid-19 is likely, and the path of GDP growth looks something like this:



New lessons from China

Two big stories from China this week shed light on the future in the US. First, the economic recovery is weaker than expected. Local economists expect official Chinese statistics to be downright cheerful, but consumers are wary of spending and businesses are letting workers go. Meanwhile, health experts are reporting good and bad news. The good news is likely a million people not tested and counted have already had Covid-19. The bad news is another wave is inevitable when social distancing is relaxed, a wave likely to crest in October.

A similar pattern is expected in Europe and the US. The size and speed of the second wave depends very much on how many people developed immunity the first time around, how tight travel restrictions are, whether people learned avoidance techniques like hand washing and not touching faces, and the capability of the healthcare system to cope with the resurgence. All of these variables will determine whether the economy has to be shut down again and for how long.

– Chris Low, Chief Economist

The Week Ahead

This Week's Numbers

			CONSENSUS			
		PRIOR	HIGH	LOW	MEDIAN	FHN
Monday, March 30	Pending Home Sales MoM - Feb	5.2%	0.2%	-4.0%	-1.8%	**-2.0%**
Tuesday, March 31	MNI Chicago PMI - Mar	49.0	44.0	40.0	44.0	**40.0**
	Conf. Board Consumer Confidence - Mar	130.7	125.0	87.4	114.0	**88.0**
Wednesday, April 1	ADP Employment Change - Mar	183k	10k	-360k	-125k	**-150k**
	Construction Spending MoM - Feb	1.8%	0.8%	0.5%	0.6%	**0.5%**
	ISM Manufacturing - Mar	50.1	50.0	37.2	46.0	**38.0**
	Wards Total Vehicle Sales - Mar	16.83m	15.70m	10.80m	15.20m	**11.00m**
Thursday, April 2	Trade Balance - Feb	-$45.3b	-$42.6b	-$46.0b	-$43.8b	**-$46.0b**
	Initial Jobless Claims - Mar 28	3,283k	--	--	--	**4,000k**
	Continuing Claims - Mar 11	1803k	--	--	--	**5,000k**
	Factory Orders - Feb	-0.5%	0.5%	-1.4%	-0.8%	**-1.3%**
Friday, April 3	Change in Nonfarm Payrolls - Mar	273k	150k	-350k	-81k	**-140k**
	Change in Private Payrolls - Mar	228k	95k	-360k	-100k	**-150k**
	Unemployment Rate - Mar	3.5%	4.9%	3.5%	3.8%	**3.8%**
	Average Hourly Earnings MoM - Mar	0.3%	0.4%	0.2%	0.2%	**0.3%**
	Average Hourly Earnings YoY - Mar	3.0%	3.1%	2.9%	3.0%	**3.1%**
	Average Weekly Hours All Employees - Mar	34.4	34.4	34.2	34.3	**34.0**
	Labor Force Participation Rate - Mar	63.4%	--	--	--	**63.0%**
	Underemployment Rate - Mar	7.0%	--	--	--	**7.4%**
	ISM Non-Manufacturing Index - Mar	57.3	54.5	42.0	48.0	**42.0**
	PCE Core Deflator YoY - Feb	1.6%	1.9%	1.6%	1.8%	**1.6%**
	U. of Mich. Sentiment - Mar F	95.9	95.0	82.5	93.3	**82.0**

Review

This week, the Senate and House passed the $2 trillion CARES Act, US initial jobless claims rose the most ever, with more pain expected over the coming weeks, and Markit PMIs fell across the globe.

- Initial jobless claims shattered records with 3.3 million people (seasonally adjusted) filing for unemployment the week ending March 21. The prior record was 790k in 1982. Pennsylvania was hardest hit with an estimated 379k (non-seasonally adjusted) claims and that is with its unemployment site unable to process claims without crashing. Nine other states had claims exceeding 100k, including Ohio, California, Texas, Massachusetts, Illinois, and New Jersey. Next week's number could be bigger, as a number of states ordered lockdown after the previous week's filing deadline and the Department of Labor relaxed filing restrictions. Continuing claims will be the next indicator to watch for updated readings on the labor market.

- In Europe and the US, the Markit PMIs showed more damage to the service sector than manufacturing as social distancing takes its toll.
  - The US composite fell from 49.6 to 40.5. Manufacturing edged down to 49.2 and services fell to 39.1.
  - The EU composite fell from 51.6 to 31.4. Manufacturing was 44.8 and services was 28.4.

- In Germany, the composite fell from 50.7 to 34.5. Manufacturing was 44.8 and services 34.5.
- France's composite fell from 52.0 to 30.2. Manufacturing was 42.9 and services was 29.0.
- The UK's composite fell from 53.0 to 37.1. Manufacturing was 48.0 and services was 35.7. Markit PMIs overseas indicated no surprises.

- In Japan, the composite fell from 47.0 to 35.8. Manufacturing fell from 47.8 to 44.8, its sharpest contraction since April 2009 and services fell to 32.7. Japan's economy began the year on weak footing as global demand slowed for auto manufacturing. Japan's consumption tax increase helped further slow domestic demand. While Japan remains one of the few countries appearing to contain an outbreak of Covid-19 without imposing quarantines, if an outbreak does occur, it could devastate the economy, especially after postponing this summer's Tokyo Olympics.

The Atlanta Fed's Q1 GDPNow forecast fell from 3.1% last week to 2.7%, driven solely by advance durable manufacturing, Q4 GDP revisions and income and outlays. It will not reflect the impact of Covid-19 on GDP until March data are available. The NY Fed revised its Nowcast up from 1.49% to 1.68%, driven largely by the increase in wholesale inventories.

Next week's big US economic releases are ISM Manufacturing on Thursday, and the employment report followed by ISM Non-Manufacturing on Friday. Nonfarm payroll forecasts range from a 350k drop at the low end and 150k jobs added at the high end. The consensus calls for -81k. The unemployment rate is expected to rise to 3.8% with forecasts ranging from 4.9% to 3.5%.

Next week's big international releases begin Monday and Tuesday evening, when China releases its state and Caixin PMI reports. Economists seem perplexed about how much of a bump to expect in manufacturing and services activity. Bear in mind that whatever the increase is, it is unlikely to accurately capture industrial output or services activity growth trends, particularly as Covid-19 is making a second wave through China. Anecdotal reports in *The Wall Street Journal* and elsewhere suggest activity popped, then fell back. Final readings of Markit PMIs are due out throughout the week across Europe, Asia, and North America.

Preview

Note: ★ = High Impact Event
All times Eastern

Monday, March 30

- 5:00am – EU:
  - Economic Confidence – Mar (Last: 103.5; Con: 91.9)
  - Consumer Confidence – Mar F (Mar P: -11.6)

- 8:00am – Germany:
  - CPIH – Mar P (Last: 1.7% y/y)
  - CPI – Mar P (Last: 1.7% y/y)
- 10:00am – US:
  - Pending Home Sales – Feb (Last: 5.2% m/m; Con: -1.8% m/m)
  - Pending Home Sales – Feb (Last: 6.7% y/y)
- ★ 10:30am – US: Dallas Fed Manufacturing Activity – Mar (Last: 1.2; Con: -9.5)
- 7:01pm – UK:
  - Gfk Consumer Confidence – Mar (Last: -7; Con: -15)
  - Lloyds Business Barometer – Mar (Last: 23)
- 7:50pm – Japan:
  - Industrial Production – Feb P (Last: 1.0% m/m; Con: 0.0% m/m)
  - Industrial Production – Feb P (Last: -2.3% y/y; Con: -4.9% y/y)
  - Retail Sales – Feb (Last: -0.4% y/y; Con: -1.5% y/y)
- ★ 9:00pm – China:
  - Manufacturing PMI – Mar (Last: 35.7; Con: 45.0)
  - Services PMI – Mar (Last: 29.6; Con: 42.0)
  - Composite PMI – Mar (Last: 28.9)

Tuesday, March 31

- 2:00am – UK:
  - GDP – Q4 F (Last: 0.0% q/q)
  - GDP – Q4 F (Last: 1.1% y/y)
  - Exports – Q4 F (Last: 4.1% q/q)
  - Imports – Q4 F (Last: -0.8% q/q)
- Current Account Balance – Q4 (Last: -£15.9b)
- 2:45am – France:
  - CPI – Mar P (Last: 1.4% y/y)
  - CPIH – Mar P (Last: 1.6% y/y)
  - PPI – Mar P (Last: 0.20% y/y)
- 3:50am – Italy:
  - CPIH – Mar P (Last: 0.2% y/y)
  - PPI – Feb (Last: -3.4% y/y)
  - Bank of Italy releases Q4 '19 Credit Conditions and Risk.
- ★ 3:55am – Germany:
  - Unemployment Change – Mar (Last: -10.0k)
  - Unemployment Rate – Mar (Last: 5.0%)
- 4:30am – Hong Kong:
  - Retail Sales Value – Feb (Last: -21.4% y/y; Con: -41.8% y/y)
  - Retail Sales Volume – Feb (Last: -23.0% y/y)

- 5:00am – EU:
  - CPI – Mar (Last: 1.2% y/y)
  - Core CPI – Mar P (Last: 1.2% y/y)
- 9:00am – US: S&P CoreLogic CS – Jan
- ★ 9:45am – US: MNI Chicago PMI – Mar (Last: 49; Con: 44)
- ★ 10:00am – US: Conference Board Consumer Confidence – Mar (Last: 130.7; Con: 120.0)
- ★ 7:50pm – Japan: Bank of Japan's releases Quarterly Tankan Report – Q1.
- ★ 8:30pm – Japan: Jibun Bank Manufacturing PMI – Mar F (Mar P: 44.8)
- ★ 8:30pm – Vietnam: Markit Manufacturing PMI – Mar (Last: 49.0)
- ★ 9:45pm – China: Caixin Manufacturing PMI – Mar (Last: 40.3; Con: 47.0)

Wednesday, April 1

- ★ The current OPEC+1 deal ends on April 1, leaving all OPEC+ member countries to begin producing output at will.
- US: Wards Total Vehicle Sales – Mar (Last: 16.83m; Con: 15.35m)
  More major auto manufacturers are reporting sales figures on a quarterly, rather than monthly basis, including GM, Ford, and Fiat Chrysler, leaving analysts to estimate results from January and February. The consensus is that January and February were strong months, but will be followed by a sharp decline in March.
- ★ 3:45am – Italy: Markit Manufacturing PMI – Mar (Last: 48.7)
- 3:50am – France: Markit Manufacturing PMI – Mar F (Mar P: 42.9)
- ★ 3:55am – Germany: Markit/BME Manufacturing PMI – Mar F (Mar P: 45.7)
- ★ 4:00am – EU: Markit Manufacturing PMI – Mar F (Mar P: 44.8)
- ★ 4:30am – UK:
  - Markit Manufacturing PMI – Mar F (Mar P: 48.0)
  - Markit/CIPS Services PMI – Mar F (Mar P: 35.7)
  - Markit/CIPS Composite PMI – Mar F (Mar P: 37.1)
- ★ 5:00am – EU: Unemployment Rate – Feb (Last: 7.4%)
- ★ 8:15am – US: ADP Employment Change – Mar (Last: 183k; Con: -90k)
- ★ 9:30am – Canada: Markit Manufacturing PMI – Mar (Last: 51.8)
- ★ 9:45am – US: Markit Manufacturing PMI – Mar F (Mar P: 49.2)
- ★ 10:00am – US:
  - ISM Manufacturing PMI – Mar (Last: 50.1; Con: 46.0)
  - Construction Spending – Mar (Last: 1.8% m/m; Con: 0.6% m/m)
- 7:50pm – Japan:
  - Monetary Base – Mar (Last: 3.6% y/y)
  - Japan Buying Foreign Bonds/Stocks
  - Foreign Buying Japan Bonds/Stocks

Thursday, April 2

- 5:00am – EU: PPI – Feb (Last: -0.5% y/y)
- 7:30am – US: Challenger Jobs Cuts – Mar (Last: -26.3% y/y)

- ★ 8:30am – US:
  - Initial Jobless Claims – Mar 28 (Last: 3283k)
  - Continuing Claims – Mar 21 (Last: 1803k)
  - Trade Balance – Feb (Last: -$45.3b; Con: -$43.8b)
- 10:00am – US:
  - Factory Orders – Feb (Last: -0.5% m/m; Con: -0.8% m/m)
  - Factory Orders Ex Transportation – Feb (Last: -0.1% m/m)
  - Durables Goods Orders – Feb F (Feb P: 1.2% m/m)
  - Durable Goods Orders Ex Transportation – Feb F (Feb P: 4.6% m/m)
  - Capital Goods Orders Nondefense Ex Aircraft – Feb F (Feb P: -0.8% m/m)
  - Capital Goods Shipments Nondefense Ex Aircraft – Feb F (Feb P: -0.7% m/m)
- ★ 8:30pm – Japan:
  - Jibun Bank Services PMI – Mar F (Mar P: 32.7)
  - Jibun Bank Composite PMI – Mar F (Mar P: 35.8)
- ★ 8:30pm – Hong Kong: Markit Hong Kong PMI – Mar (Last: 33.1)
- ★ 9:45pm – China:
  - Caixin Services PMI – Mar (Last: 27.5)
  - Caixin Composite PMI – Mar (Last: 26.5)

Friday, April 3

- ★ 3:45am – Italy:
  - Markit Services PMI – Mar (Last: 52.1)
  - Markit Composite PMI – Mar (Last: 50.7)
- ★ 3:50am – France:
  - Markit Services PMI – Mar F (Mar P: 29.0)
  - Markit Composite PMI – Mar F (Mar P: 30.2)
- ★ 3:55am – Germany:
  - Markit Services PMI – Mar F (Mar P: 34.5)
  - Markit/BME Composite PMI – Mar F (Mar P: 37.2)
- ★ 4:00am – EU:
  - Markit Services PMI – Mar F (Mar P: 28.4)
  - Markit Composite PMI – Mar F (Mar P: 31.4)
- 5:00am – EU:
  - Retail Sales – Feb (Last: 0.6% m/m)
  - Retail Sales – Feb (Last: 1.7% y/y)
- ★ 8:30am – US:
  - Nonfarm Payrolls – Mar (Last: 273k; Con: -81k)
  - Unemployment Rate – Mar (Last: 3.5%; Con: 3.8%)
  - Average Hourly Earnings – Mar (Last: 0.3% m/m; Con: 0.2% m/m)
  - Average Hourly Earnings – Mar (Last: 3.0% y/y; Con: 3.0% y/y)
  - Labor Force Participation Rate – Mar (Last: 63.4%)

- 9:45am – US:
  - Markit Services PMI – Mar F (Mar P: 39.1)
  - Markit Composite PMI – Mar F (Mar P: 40.5)

★ 10:00am – US: ISM Non-Manufacturing Index – Mar (Last: 57.3; Con: 48.0)

– Rebecca Kooshak, Economic Analyst