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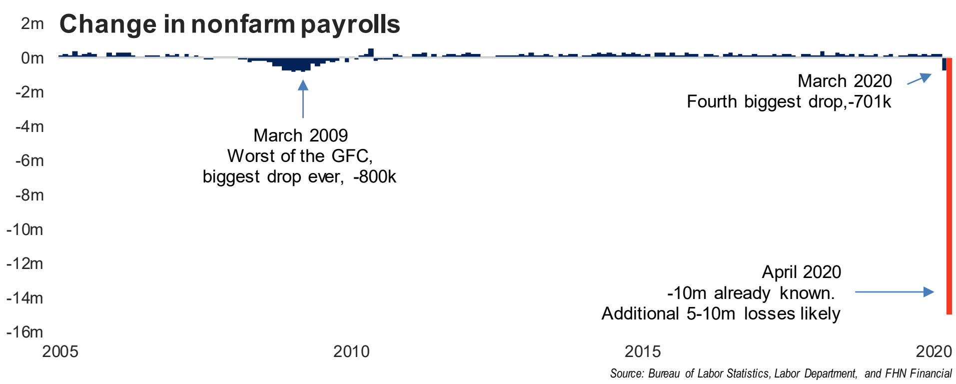
ECONOMIC WEEKLY

Data Point to Size of Economic Challenge

Economic damage from the Covid-19 pandemic came into sharper focus this week. The employment report offered a snapshot of the first half of March, when the economy was tipping into recession. Jobless claims and the ISMs offered a more complete sense of the magnitude of the fall. Unfortunately, our back-of-the-envelope estimate in last week's *Economic Weekly* still looks likely. The worst case — that the economy enters the second quarter at its current rate of growth and remains there through the quarter — would result in a 46% annualized GDP decline (-14% not annualized). The CARES Act will offset part of that, but the best case relies on an actual economic recovery. The best case requires shelter in place restrictions to be relaxed and people returning to work before the quarter ends.



Employment outlook is grim

Seven-hundred-and-one thousand people lost their jobs before March 8. Ten million people filed for unemployment insurance in the two weeks after that, offering early clues to the economic cost of a hard stop in the economy. Employment has fallen at least 15 million, because more will file in the next two weeks, and the number of people out of work is almost certainly bigger than the number eligible for benefits. The BLS calls part one of the employment report the payroll survey because the data are culled from employee payroll records. As a result, the data reflect a pay period, but pay periods differ between companies. When considering the 701k workers let go in the March report, bear in mind, **a person is an employee if paid for even part of one day even if they did not do any work**. That's how we know all these job losses predated March 8. According to the BLS:

- Roughly 33% of companies pay their employees weekly.
- Slightly over 40% are bi-weekly.
- About 20% are semi monthly.
- The rest are monthly.

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The second part of the employment report is the household survey. A quick review of Bureau of Labor Statistics household-survey methodology suggests most of those out of work due to the Covid-19 outbreak are likely to count toward the labor force and therefore should count as unemployed. The BLS actually changed its methodology to ensure this even in March, though the change was too late to fully capture everyone.

The unemployment rate is the percent of the labor force unemployed. A person is unemployed if out of work and actively looking for work or laid off and expecting to be rehired within six months. Here's how the BLS describes a person they would classify actively looking for work:

- Contacting:
  - An employer directly or having a job interview
  - A public or private employment agency
  - Friends or relatives
  - A school or university employment center
- Submitting resumes or filling out applications
- Placing or answering job advertisements
- Checking union or professional registers
- Some other means of active job search

There won't be a lot of job interviews as long as people are socially distancing, but people can submit resumes and answer job advertisements. More importantly in the current situation, "Workers expecting to be recalled from temporary layoff are counted as unemployed whether or not they have engaged in a specific job seeking activity."

Shortly before the March survey, the BLS added a new classification for those out of work due to Covid-19 to prevent misclassification. **All employed persons absent from work due to coronavirus-related business closures will be classified as unemployed on temporary layoff.** In other words, they are in the labor force, they are not employed, and they count toward the U3 unemployment rate.

In March, the BLS estimates 1.5 million people were misclassified as employed but absent from work due to "other reasons." Had they been correctly classified, the unemployment rate would have been 5.4%, not 4.4%. "However, according to usual practice, the data from the household survey are accepted as recorded," the BLS explained in a technical note. "To maintain data integrity, no ad hoc actions are taken to reclassify survey responses."

Next month, the April unemployment rate will reflect all the people who lost jobs in the last three weeks of March and the first week of April. Hence, the rate will reflect the 10 million who filed for unemployment in the last two jobless claims reports, those who file in the next two, as well as people who do not qualify for unemployment insurance. **An increase of 15 million (10 million of which we already know about) will lift the unemployment rate to 13%.**

Cleveland Fed President Loretta Mester says she expects the unemployment rate to reach 15%, implying 17 million out of work. That seems like a reasonable estimate for the peak. It is also consistent with the worst case Q2 GDP estimates floating around, because a 10-12% increase in unemployment from current levels is consistent with a GDP drop of more than 10-12% (some people are still on payrolls, but idle).

PMIs reflect global slowdown began in February, will worsen into May

The global manufacturing PMI rose from 47.1 in February to 47.6 in March, but the economists who compile the index warned it likely overstates activity. Judging from the breakdown of PMIs from around the world, as compiled by Markit and JPMorgan, that seems right to us.

- The February drop from 50.4 to 47.1 mostly reflected China's manufacturing sector operating at about half of capacity as it struggled with the worst of its Covid caseload.
- The March bounce reflects the 50+ March reading in China, which counts for a lot given China's weight in the index
- March was also bolstered by big increases in supplier delivery times in Europe and the US caused by supply chain disruptions

The index will weaken in April. Still, it seems right the index should reflect a W-shaped pattern. After all, we now know the pandemic started in China in late November. It established a toehold in December but the economy remained strong. The disease got worse through January but the economy soldiered on. The virus raged in February, when a significant part of the country was locked down, internal travel was severely restricted, and economic output plunged by about half. These measures caused reported cases to crest and allowed businesses to reopen in March.

Much of Asia was on the same pandemic track as China, seeing the worst economic damage in February and able to regain some lost GDP in March. The rest, including Japan and India, appear to be on a later track than the US.

Europe and the US saw their first cases in late January. The virus got a toehold in February, but the economy held up well until the second half of March, when GDP in most of Europe and in the US likely fell by a third to a half. The worst weeks for Europe will be late March and early April, while the worst for the US will be in April and possibly early May.

Besides, the worst economic damage from the response to the scourge is not to manufacturing. It's to service, shown in the nearby table. We expect the global composite PMI will fall to an all-time low in the low 40s or high 30s in April.

Service PMIs

Country	March	February
China official	52.3	29.6
China Caixin	43.0	26.5
Eurozone	26.4	28.4
Italy	*17.4*	*52.1*
US ISM Non-manufacturing	52.5	57.3
US Markit services	39.8	49.4
Global services	37.0	47.1

Source: Bloomberg, Markit, JPMorgan, Chinese National Statistics Office, Institute for Supply Management

Aside from China's official services PMI, which surveys only the biggest, state-owned companies, and the US non-manufacturing ISM, all service indices are below 50. The US index was boosted in a surge in supplier delivery times. The US business activity index fell to 48.0.

Trying to hit a nonexistent pause button

The US is — well, was — a $22 trillion economy. At its peak, it employed 152 million people. Covid-related work stoppages, mandated and otherwise, cost about 16 million jobs in two months. GDP is likely running at a $15 trillion rate now. Policy makers are doing everything in their power to ensure these work stoppages are a pause and not a full stop.

This week, in addition to evidence of rising infection rates and economic carnage, there was evidence that at least some of the programs implemented to cushion the damage will need work before they function as planned. That's pretty standard in a crisis, when the response is hurried. See *The Weekly Report* pandemic update.

- The Small Business loan program in the CARES Act has already been tweaked. The interest rate was increased from 0.5% to 1.0% because the old rate did not cover costs. Underwriting requirements were clarified and limited. Loan forgiveness now hinges on submitted documentation; lenders no longer have to verify these claims.

- The Fed modified its supplementary leverage rule. The change excludes Treasury securities and deposits at Federal Reserve Banks from the calculation of the rule for holding companies, and will be in effect until March 31, 2021. The Fed estimates the change will temporarily decrease tier-1 capital requirements of holding companies by approximately 2% in aggregate.

Further changes and modifications are likely. For instance, there are already programs in place to help municipalities, but they will need more help. And then there are those who were intentionally cut off from aid. Companies owned by politicians won't get any help for instance. Members of Congress did not want to see Trump getting aid, and Trump clearly insisted that was fine as long as they all agreed to the same treatment. Most Americans, ourselves included, likely agree with this logic. Politicians should not profit from legislation. But what about their employees? Should people lose their livelihoods because they work for Trump's hotel chain? What about the people working Pelosi's vineyard and other ventures she has significant stakes in, like the Sacramento Mountain Lions football team, the Russell Ranch homebuilding venture and, Auberge du Soliel resort in Napa Valley? Should they all lose their jobs?

Congress excluded companies in the oil sector for political reasons. Many of them will need help or will default in coming weeks.

Others excluded from rescue efforts so far include private equity and — to a limited extent — community banks. The former are entirely ruled out, the latter can get loans from the Fed, but have been excluded from CARES Act SBA loans.

The Fed exclude junk-rated companies from its two corporate bond-buying programs. The Fed will buy bonds directly from companies in its Primary Market Corporate Credit Facility (PMCCF) and from the secondary market in its SMCCF. But both facilities cut off borrowers with less-than investment grade ratings. There is no similar lifeline yet for high-yield bonds. It's not clear yet whether bond holders of companies cut from investment grade because of Covid-19 can sue the rating agencies, but it's likely some will try. After all, the downgrades will lead to defaults that would not have happened if the bonds were still triple-B.

Mortgage servicers are another so-far unprotected class. Borrowers get to defer mortgage payments for months, but servicers still must make payments on mortgage-backed securities. The FSOC chose not to address this issue yet because it wanted to see if other support mechanisms kick in first. Jim Vogel estimates the mortgage-servicing infrastructure can support about 1% of the mortgages likely to defer payment.

The House started work on another round of rescue spending, but the Senate is opposed. Mnuchin will have to negotiate the deal if there is to be one. Until then, the biggest challenge to the idea that a $22 trillion economy can be put on pause is the wave of defaults likely to sweep the country in the next several months. If defaults are limited, a robust recovery is possible. If defaults are widespread, robust recovery becomes increasingly unlikely.

– Chris Low, Chief Economist

The Week Ahead

This Week's Numbers

		CONSENSUS				
		PRIOR	HIGH	LOW	MEDIAN	FHN
Tuesday, April 7	Consumer Credit - Feb	$12.021b	$16.200b	$3.000b	$15.000b	**$15.000b**
Thursday, April 9	PPI Final Demand MoM - Mar	-0.6%	0.0%	-0.9%	-0.3%	**-0.5%**
	PPI Ex Food and Energy MoM - Mar	-0.3%	0.3%	-0.7%	0.0%	**0.0%**
	PPI Ex Food, Energy, Trade MoM - Mar	-0.1%	0.1%	-0.1%	0.0%	**0.0%**
	PPI Final Demand YoY - Mar	1.3%	0.6%	-0.1%	0.5%	**0.5%**
	PPI Ex Food and Energy YoY - Mar	1.4%	1.2%	0.2%	1.2%	**1.0%**
	Initial Jobless Claims - 43925	6648k	6500k	2500k	5000k	**6,500k**
	U. of Mich. Sentiment - Apr P	89.1	89.0	60.0	77.5	**60.0**
Friday, April 10	CPI MoM - Mar	0.1%	0.0%	-0.7%	-0.3%	**-0.4%**
	CPI Ex Food and Energy MoM - Mar	0.2%	0.2%	-0.4%	0.1%	**0.1%**
	CPI YoY - Mar	2.3%	1.8%	1.3%	1.6%	**1.5%**
	CPI Ex Food and Energy YoY - Mar	2.4%	2.4%	1.8%	2.3%	**2.3%**

Review

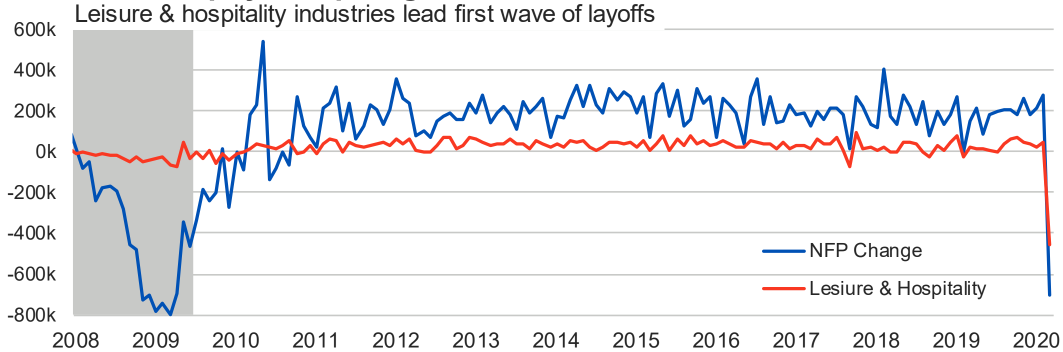
Initial unemployment claims, the employment report, service PMIs, and February's trade data were this week's biggest economic releases.

- **Initial jobless claims for the week ending March 28 were 6.648m on a seasonally adjusted basis.** Over the last two-weeks, 9.995m people filed for unemployment insurance, which lifts the national unemployment rate to at least 10%. California and Pennsylvania led this week's surge, with 878,727 and 405,880 claims reported, respectively. New York, the state hardest hit by the coronavirus, only reported claims of 366,403. The number of people trying to claim benefits are much higher but are delayed by capacity constraints. In addition, millions of unemployed do not qualify for unemployment insurance.

- **Nonfarm payrolls plummeted 701k, led by a drop in leisure & hospitality.** This was the first wave of workers on the firing line after airlines cut international flights. Service-providing jobs fell 659k and goods-producing jobs fell 54k, while on net January and February were revised lower by 57k. The separate household survey, conducted by the Census Bureau, revealed unemployment rose by 1.353m, which pushed the unemployment rate up the fastest in 45 years to 4.4%. Average hourly earnings rose 0.4% m/m, taking the year-over-year pace to 3.4%.

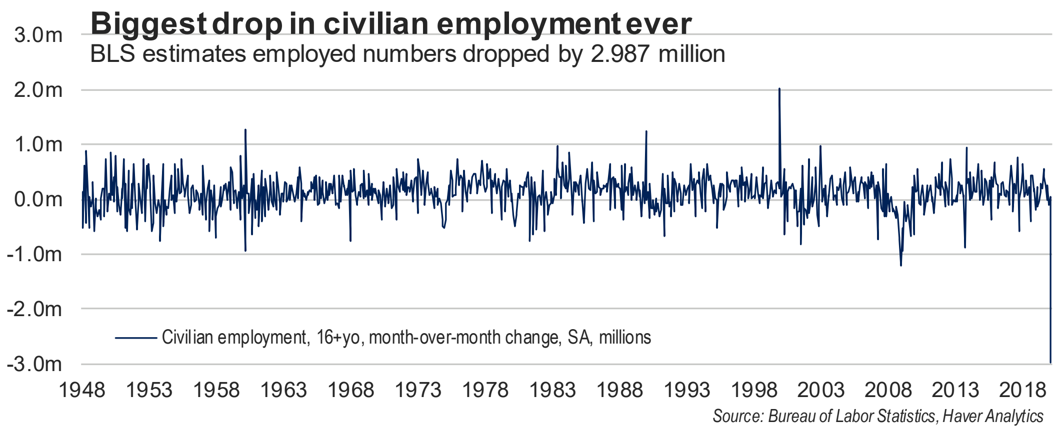
Nonfarm payrolls plunge 701k

Leisure & hospitality industries lead first wave of layoffs

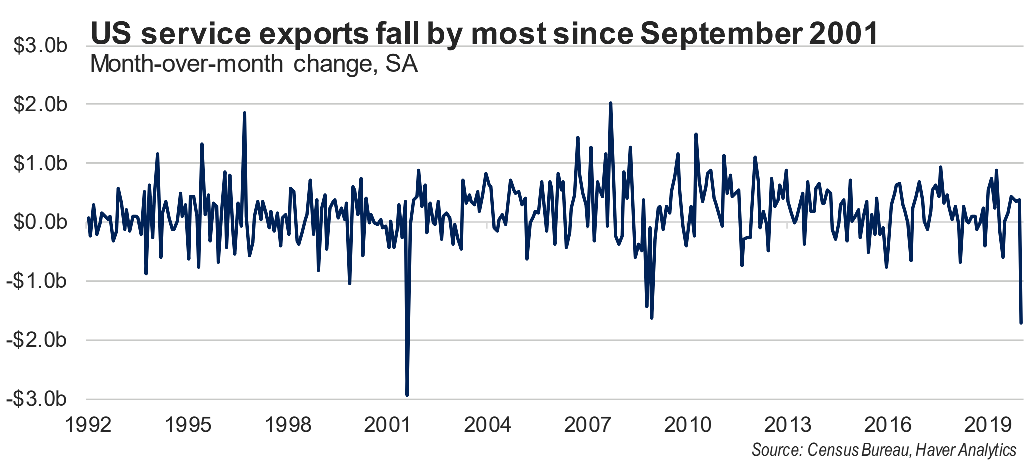


Source: Bureau of Labor Statistics, NBER

The BLS noted an estimated 1.5m people were misclassified as "employed but out of work for 'another reason'" when they should have been classified as "unemployed due to a temporary work stoppage due to coronavirus." BLS estimates the unemployment rate would have been a percentage point higher if they were accurately classified.



- February's international trade data showed the deficit narrowed from -$45.5b to -$39.9b after the coronavirus forced China's economy to shut down. On the face of it, it sounds like one of the few virus-related benefits. But, the reduction in trade was led by a $5b drop in goods imports to $198.4b (see store shelves for details). On the other side of the ledger was the sharpest drop in US services exports since September 2001. On the services side, US transports, travel, and financial services led the drop, while telecommunications, IT, and intellectual property rose marginally. The narrowing of the goods deficit (by $5.9b to $62.1b) and reduction of services surplus (by $0.4b to $21.3b) causes a great deal of short-term pain, and represents a significant setback to globalization.



The Atlanta Fed dropped its Q1 GDPNow forecast from 3.1% last week to 1.3%, while the NY Fed revised its Nowcast from 1.68% last week to 1.56%. Bear in mind, these estimates are not particularly useful. At least, not yet, because most of the March data going into GDP have not yet been released. Even when they are, they will mostly reflect what happened early in the month. Very few government data series capture the full month.

Next week, the FOMC releases minutes from its March 15 meeting. Normally, it would be a big market mover, but given the extra-extraordinary measures central banks have taken over the last month, it should come as no surprise that there was discussion about scaling-up repo operations beyond whatever-it-takes levels and using QE to purchase Treasuries, equities, and just about anything to maintain liquidity and smooth market functions.

Initial jobless claims remain the economic indicator to watch. The reports will be released Thursday morning and will be followed by the University of Michigan's April preliminary consumer sentiment report. Economists' forecasts range from 67 to 89 with a consensus of 82. We expect the drop to be below 60 given that the survey captured consumers strongly reacting to stock market highs reached in February. The market volatility in March will likely have caught many by surprise.

Friday is Good Friday, and most markets will be closed in the US and Europe. The BLS will release CPI report on Friday anyway.

China's PBOC is expected to release aggregate financing, new yuan loans, money supply, and foreign direct investment data within the coming two weeks (TBD). China is also expected to open up Wuhan's borders on Tuesday in a show of confidence that the worst of Covid-19 has passed. Note that last week, when Hubei started to lift its borders after weeks of quarantines, cross-border police from neighboring states erected barriers to prevent residents in Hubei from traveling freely about. In one case, residents' frustration boiled over into a riot, as residents overturned police cars and swatted cross-border police with their own shields, while the Hubei police passively watched. Hubei's residents complained that the cross-border police broke the law by illegally moving Hubei's local traffic police out to impose their own border check.

Next week, Japan and Europe release February trade and industrial production reports, which begins to shed light on the impact China's shutdown had on trade and output. Germany's factory orders report will be one of the most watched indicators. It comes out Monday.

Preview

Note: ★ = High Impact Event
All times Eastern

Sunday, April 5

- 9:10pm – Japan: BOJ Outright JGB Purchases – 5Y-10Y

Monday, April 6

★ China: Public Holiday

- US: Deadline for Wall Street banks with more than $100b in assets to submit capital plans and stress test data to the Fed. The tests were devised in 2009 to reassure investors that banks could withstand a hypothetical doomsday scenario. Banks are opposing suggestions the tests be postponed as a real global crisis unfolds. The Fed will release the results in June.

- ★ US: The Fed opens a temporary repurchase agreement facility for foreign central banks to support the smooth functioning of financial markets. The program is a new weapon in the Fed's arsenal to stabilize dollar funding markets. Note that the rate between 3M T-bills and 3M LIBOR has widened nearly 150bp, indicating credit, liquidity, and market risks inherent in the international banking system.
- ★ 2:00am – Germany:
  - Factory Orders – Feb (Last: 5.5% m/m)
  - Factory Orders – Feb (Last: -1.4% y/y)
- 4:00am – UK: New Car Registrations – Mar (Last: -2.9% y/y)
- 5:45am – Sweden: Riksbank Weekly Extraordinary Market Operation
- 10:00am – Canada: BOC Business Outlook Future – Q1 (Last: 11)
- ★ 7:50pm – Japan:
  - Official Reserve Assets – Mar (Last: $1,359.0b)
  - BoP Current Account Balance – Feb (Last: ¥612.3b)
  - BoP Current Account Adjusted – Feb (Last: ¥1,626.8b)
  - Trade Balance – BoP Basis – Feb (Last: -¥985.1b)
  - Core Machine Orders – Feb (Last: 2.9% m/m)
  - Core Machine Orders – Feb (Last: -0.3% y/y)
  - Foreign Buying Japan Stocks – Apr 3

Tuesday, April 7

- ★ China: China plans to ease mass quarantines in Wuhan to show that the virus threat has been neutralized.
  - Foreign Reserves – Mar ($3,106.72b)
- ★ Australia: RBA sets policy
- EU: EU finance ministers meet on a video call to discuss how to fight the coronavirus and provide help where most needed.
- Hong Kong: Foreign Reserves – Mar (Last: $446.1b)
- 2:00am – Germany:
  - Industrial Production – Feb (Last: 3.0% m/m)
  - Industrial Production – Feb (Last: -1.3% y/y)
- 2:45am – France:
  - Trade Balance – Feb (Last: -€5.887b)
  - Current Account Balance – Feb (Last: -€2.8b)
- 4:00am – Italy:
  - Retail Sales – Feb (Last: 0.0% m/m)
  - Retail Sales – Feb (Last: 1.4% y/y)
- 5:00am – Singapore: Foreign Reserves – Mar (Last: $283.0b)
- 10:00am – US: JOLTS Job Openings – Feb (Last: 6963)
- 3:00pm – US: Consumer Credit – Feb (Last: $12.021b; Con: $13.500b)
- 9:10pm – Japan: BOJ Outright JGB Purchases – 1-3Y and 5-10Y

Wednesday, April 8

- 12:30am – Japan: Bankruptcies – Mar (Last: 10.71% y/y)

- 2:30am – France: Bank of France Industry Sentiment – Mar (Last: 96)
- ★ 7:00am – US: MBA Mortgage Applications – Apr 3 (Last: 15.3%)
- 8:15am – Canada: Housing Starts – Mar (Last: 21.1k)
- 8:30am – Canada: Building Permits – Feb (Last: 4.0% m/m)
- ★ 2:00pm – US: The FOMC releases the minutes from its special March 15 meeting, at which it cut rates to 0.0-0.25% in a surprise move to address Covid-19. It was the biggest one-day rate reduction since the Volcker era.
- 7:50pm – Japan:
    - Japan Buying Foreign Bonds/Stocks – Apr 3
    - Foreign Buying Japan Bonds – Apr 3

Thursday, April 9

- ★ 2:00am – Germany:
    - Trade Balance – Feb (Last: €13.9b)
    - Current Account Balance – Feb (Last: €16.6b)
    - Exports – Feb (Last: 0.0% m/m)
    - Imports – Feb (Last: 0.5% m/m)
- 2:00am – UK:
    - Industrial Production – Feb (Last: -0.1% m/m)
    - Industrial Production – Feb (Last: -2.9% y/y)
    - Manufacturing Production – Feb (Last: 0.2% m/m)
    - Manufacturing Production – Feb (Last: -3.6% y/y)
    - Visible Trade Balance – Feb (Last: -£3.72b)
    - Trade Balance Non EU – Feb (Last: £2.232b)
    - Trade Balance – Feb (Last: £4.212b)
- 2:00am – Japan: Machine Tool Orders – Mar P (Last: -29.6% y/y)
- 4:00am – Italy:
    - Industrial Production – Feb (Last: 3.7% m/m)
    - Industrial Production – Feb (Last: -3.2% y/y)
- ★ 8:30am – US:
- Initial Jobless Claims – Apr 4 (Last: 6.65m; Con: 5.0m)
    - As economists begin to get the hang of Covid's impact on unemployment numbers and just how high initial claims can go, estimates now range from highs of 6.5m to lows of 2.5m for the week ending April 4. Note that unemployment offices around the country are operating at full capacity and therefore are unable to process the backlog of claims started online and awaiting completion by unemployment representatives before they can go into effect. States are adding workers, but it takes time.
    - Continuing Claims – Mar 28 (Last: 3.029m)
    - PPI Final Demand – Mar (Last: -0.6% m/m; Con: -0.3% m/m)
    - PPI Final Demand – Mar (Last: 1.3% y/y)
    - PPI Ex Food and Energy – Mar (Last: -0.3% m/m; Con: 0.0% m/m)
    - PPI Ex Food and Energy – Mar (Last: 1.4% y/y)
    - PPI Ex Food, Energy, Trade – Mar (Last: -0.1% m/m)
    - PPI Ex Food, Energy, Trade – Mar (Last: 1.4% y/y)

- 8:30am – Canada: Employment Reports – Mar
- ★ 10:00am – US:
  - UMichigan Consumer Sentiment – Apr P (Last: 89.1; Con: 82.0)
  - The University of Michigan's preliminary consumer sentiment index is forecast to fall to 82 in April, nearly a six-year low, after plummeting in March by the most since 2008. The report will show how Americans are feeling about the economy as efforts to contain the coronavirus lead to millions of layoffs and a sudden stop to much economic activity.
  - Wholesale Inventories – Feb F (Feb P: -0.5% m/m)
  - Wholesale Trade Sales – Feb (Last: 1.6% m/m)
- 7:50pm – Japan:
  - PPI – Mar (Last: -0.4% m/m)
  - PPI – Mar (Last: 0.8% y/y)
- ★ 9:30pm – China:
  - PPI – Mar (Last: -0.4% y/y; Con: -1.1% y/y)
  - CPI – Mar (Last: 5.2% y/y; Con: 4.9% y/y)

Friday, April 10

- ★ US: The Good Friday holiday starts Easter weekend in countries, including the U.K., France, and Germany. SIFMA recommends a full market close in the US for the trading of US dollar-denominated fixed income securities; stock markets will be closed. The BLS will release data regardless.
- 2:45am – France:
  - Industrial Production – Feb (Last: 1.2% m/m)
  - Industrial Production – Feb (Last: -2.8% y/y)
  - Manufacturing Production – Feb (Last: 1.2% m/m)
  - Manufacturing Production – Feb (Last: -2.2% y/y)
- ★ 8:30am – US:
  - CPI – Mar (Last: 0.1% m/m; Con: -0.3% m/m)
  - CPI – Mar (Last: 2.3% y/y)
  - Core CPI – Mar (Last: 0.2% m/m; Con: 0.1% m/m)
  - Core CPI – Mar (Last: 2.4% y/y)
  - Real Avg Hourly Earnings – Mar (Last: 0.6% y/y)
- ★ 12:30pm – US: Cleveland Fed President and FOMC voter speaks in a virtual forum on the economic impact of Covid-19. (Mester was the lone dissenter at the March 15 emergency meeting, preferring to cut rates by 50bp instead of 100bp, but agreed with using QE as a tool to provide liquidity to financial markets. She said low interest rates don't transmit into the economy if financial markets are not functioning well and preferred to preserve the limited policy space available for a later date.)

– Rebecca Kooshak, Economic Analyst