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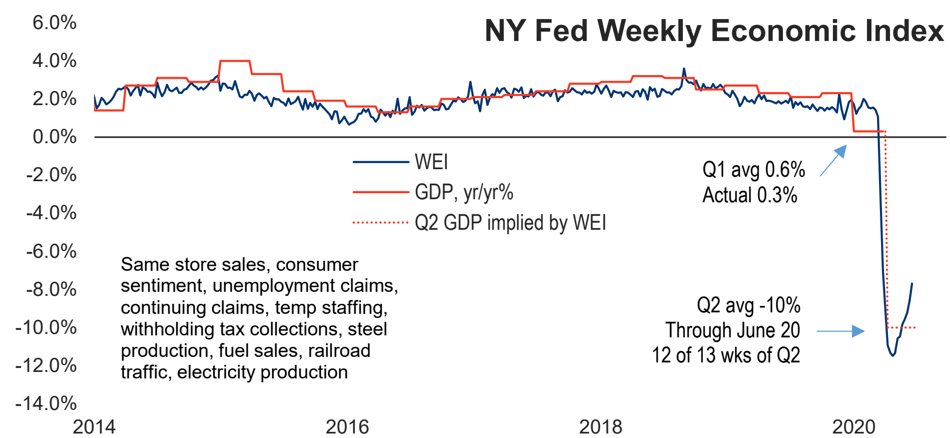
ECONOMIC WEEKLY

The Shape of the Recovery

Judging from the New York Fed's Weekly Economic Index, the economy bottomed in the last week of April, when the model's 11 components were collectively down enough to suggest an 11.5% drop in GDP from a year ago. The recovery was steady through May and big enough to be real. There is no doubting the upward momentum of the past nine weeks.

There are still a handful of economists calling for V-shaped recoveries, and the weekly data have not yet proven them wrong. A little more of the economy has reopened every week through May and June. But, the COVID story changed significantly this week.



Source: New York Federal Reserve Bank

COVID case numbers were rising last week, but other indicators, like hospitalizations and morbidity, were falling. This week, all the numbers are climbing at a rapid pace. Texas and California each reported more than 5,000 new cases Tuesday. Florida reported 3,000-4,000 new cases a day until topping 8,000 on June 26. Texas hospitalizations are up 60% in a week. As Dr. Anthony Fauci explained at Monday's press briefing, warm weather clearly does not help with the coronavirus the way it does with other diseases.

The resurgent case rate has not yet translated into a compelling faster rate of deaths, partly because the fastest recent increases are among younger people, who have proven hardier against COVID. But it is also too early to be complacent. The peak in deaths after the wave that slammed the Northeast was eight days after the peak in reported cases. The rapid increase of cases in the chart below[1] began only eight days ago. Hope for the best — of course — but don't be surprised if the number of deaths climbs next week.

[1] Note, we used 7-day averages because there is weekly seasonality in the data. Testing, and case numbers, peak on Friday's and Saturdays. They drop off midweek. Reported deaths also follow a weekly pattern, lowest on Sunday, highest on Tuesdays, which is harder to explain, but likely follows the work schedule of coroners and medical examiners.

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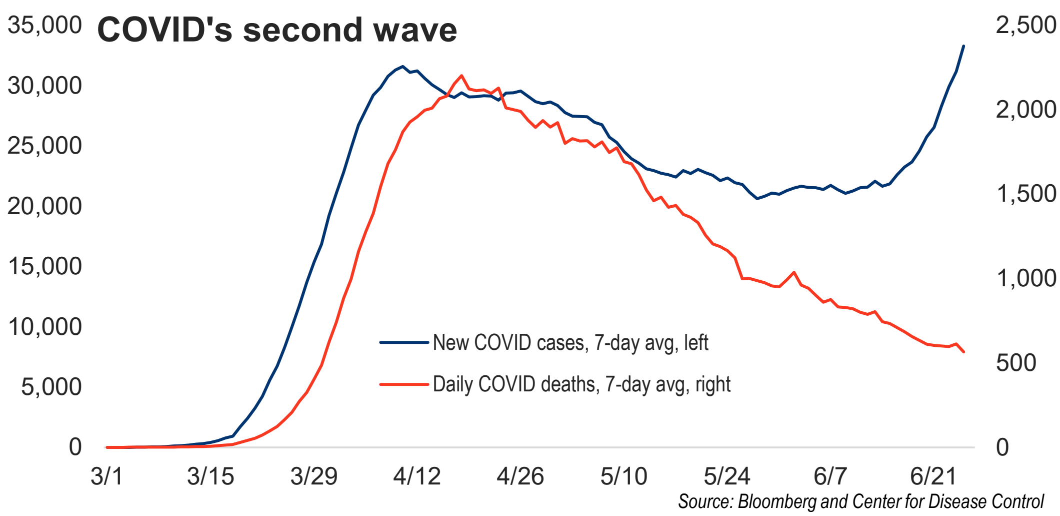
Reopening the economy will not be a linear, week-to-week process. There will be setbacks. Each city and state will have to feel its way back to normal. Some elements of Phase II plans might turn out to be problematic, while parts of a Phase III blueprint might be fine. In some place, however, things got so bad so fast, officials are going all the way back to square one. See Harris County, TX, for example.

Alphabet soup

The recovery will not be a V. It appears to be following a V-track now, but a second wave



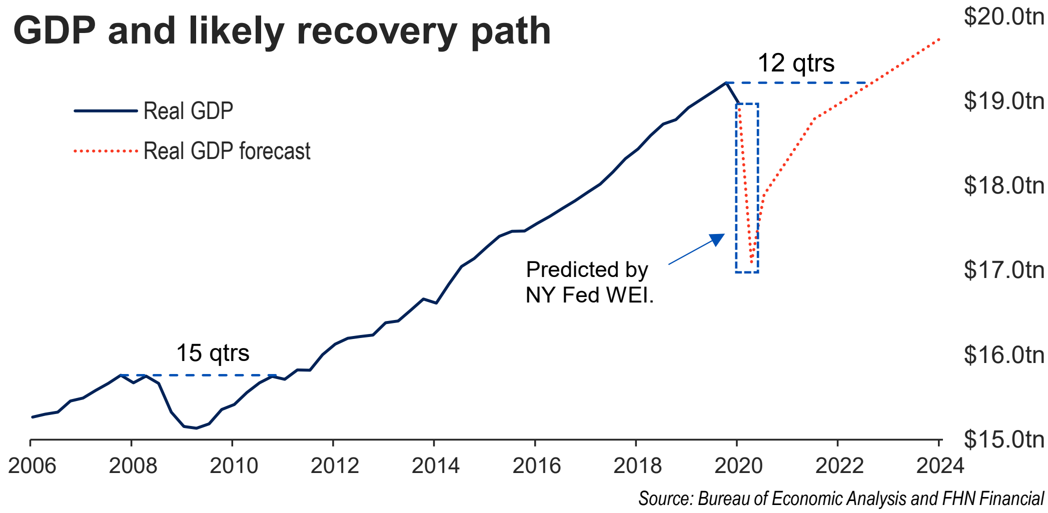
will damage consumer sentiment, and consumers are vital to the recovery. Plus, as a colleague recently noted, if the second wave doesn't sap consumer sentiment, the third wave will. Maybe it's a U, and maybe a W, or a collapsed-right-side-W, but our chart doesn't really look like any of these. It's more like a one-quarter zoom followed by increasingly slower progress.

Maybe it's time to drop the alphabet talk and focus instead on the real issue, which is time. The recovery will make rapid progress at first, but progress will become frustratingly slow by early next year. We're climbing out of a deep hole.

The chart below shows our baseline GDP forecast, with GDP falling 34% annualized in Q2, bouncing at a 20% rate in Q3, rising at a 5% rate in Q4 and through 2021 before settling down to 2% growth thereafter. We are most confident in the area highlighted by the blue box, the Q2 drop and initial Q3 recovery. These two are consistent with the New York Fed's Weekly Economic Index, thus reflecting what has already happened. After that, the only certainty is that even if the recovery roughly follows the predicted path, some quarters will underperform and some will exceed expectations.

The forecast path follows from the optimistic assumption there will be a vaccine available early next year and most Americans will be vaccinated. Oh yes, and the assumption the vaccine works. That's three big things that must go right. Between now and then, assume reality will pose more speed bumps than reflected in the chart. There will be bad months.

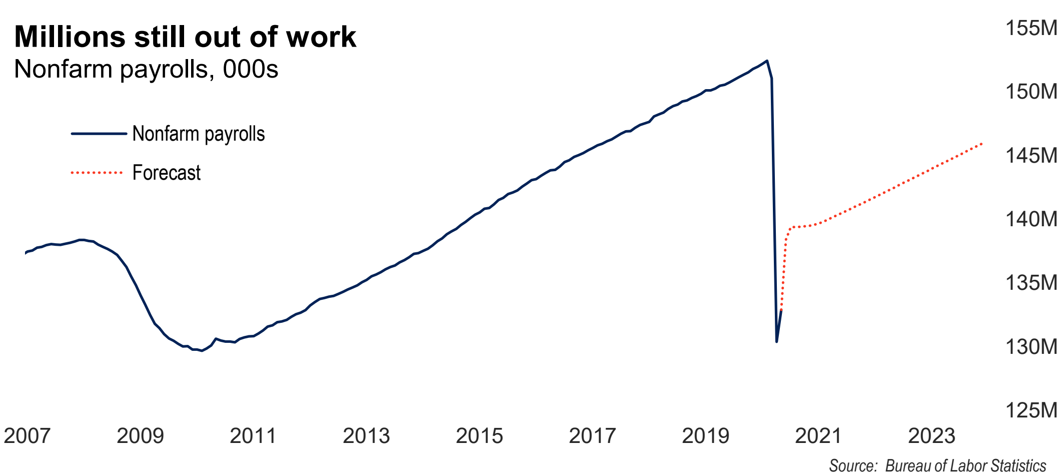
Risks skew to the downside. As explained above, the recent COVID resurgence in a dozen states is uniquely different from state to state. Some may be due to increased testing.



Others are rising faster than the increase in testing, however, meaning the case rate really is increasing. Some appear to follow from recent Black Lives Matter protests. Some are the result of over-exuberant reopenings. In all of these states, however, people are shopping less and eating out less. Reports of rising case numbers are enough to incite caution and impede spending. Some businesses reopened in the past month are closing again, and states that have not yet fully opened are dragging their feet in worry.

A true V-shaped recovery — one with no lost momentum until GDP recovers its prior cycle high — requires not just a steady, sustained reopening, but also that almost all the jobs before COVID are still there after COVID. It's already too late for that. The recovery pace will slow because rapid jobs gains from companies gearing back up will give way to something like the job growth in the decade after the Global Financial Crisis, when the economy has to create new businesses to create new jobs.

The resulting jobs recovery consistent with the GDP forecast, looks like this:
As slow as the employment recovers, it will take even longer for the unemployment rate to fall to full employment because the potential labor force will be growing at the same

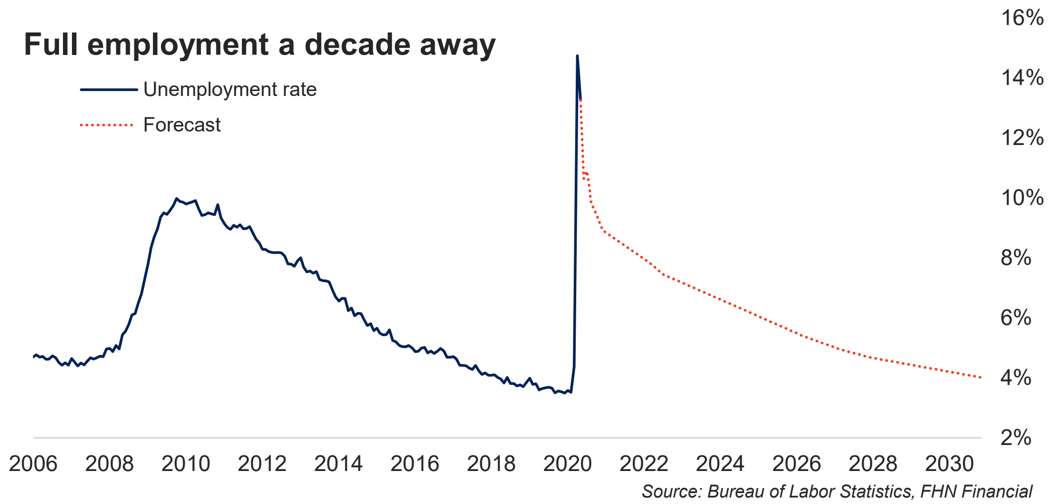


Note that while GDP recovers in three years, it takes years longer for employment to recover thanks to companies' focus on cost control and resulting productivity gains.

time the economy is recovering. Labor force growth is likely to lag for years, as jobs will be scarce, competition fierce, and many lower-skilled people will opt out in frustration. When the unemployment rate falls to a more manageable level, however, labor force growth will accelerate and the pace of the unemployment drop will slow, adding years to the path to full employment.

The Fed is more optimistic

As Jay Powell explained in his last press conference, the last few years of the 2009-



20 expansion were revelatory for the FOMC. Participants kept waiting for inflation to accelerate, but it never did. Real wages grew, income inequality declined, and poorest Americans' living standards improved. The Fed is not quite able to admit it has spent the past four decades inadvertently contributing to income inequality with its anti-inflationary zeal, but it is very close. In his June press conference, Powell was adamant in his praise of economic conditions before the pandemic and expressed the Fed's eagerness to regain those conditions as quickly as possible.

The Fed's GDP forecast looks a lot like ours, but they expect a much faster drop in the unemployment rate. FOMC participants' median forecast is 9.3% at the end of this year, 6.5% at the end of next year, and 5.5% in 2022. At that rate, the economy would be at full employment in 2025. The top of the central tendency range is 10%, 7.5%, and 6.1%. That's closer to our baseline.

There are likely three explanations for the relative optimism in the Fed's median forecast:

1. Labor force participation is very difficult to predict. The slowing rate at which unemployment drops in our forecast reflect faster increases in participation as the labor market tightens. Without increasing participation, the rate would fall much faster.
2. Participants make SEP forecasts themselves, before the staff weighs in with their projections. To a large extent, they reflect educated guesses more than formal forecasts. It's natural to think the job market will be close to fully recovered when GDP reaches the prior cycle high, but it never works that way in practice. Productivity can stick at zero for years, but not forever, and productivity growth means GDP always outpaces employment in the long run.
3. Participants are eager for the unemployment rate to drop. In the absence of certainty, they will lean toward optimism in the hope optimism is contagious, and

thus — to an extent — self-fulfilling.

Bottom line: Return of the rational in the second half

In April and May, an enormous quantity of cash flowed into the financial system. Three factors accounted for it. First, the federal government has never been so generous with aid. Second, the Fed has never been so generous with loans and asset purchases. And, third, corporations have never raised so much cash out of fear of a liquidity squeeze in such a short time. The result is about $3.8 trillion in cash flowing into household and corporate accounts since the beginning of March. In a $19 trillion economy, $3.8 trillion is significant.

More than a little of this cash found its way into the stock market, fueling its near-full recovery from its March lows. Households spent some of the cash in May, too, lifting consumption 8.2% off its April low. Big gains in economic statistics and an optimistic rise in stocks encouraged belief in a V-shaped recovery, lending credibility to the Fed's optimistic jobs forecast.

In the past few weeks, three things changed enough to cast doubt on the recovery.

1. The second wave of COVID is upon us. The statistics are murky, some states look worse than they really are, but the economic impact is real nonetheless. Governor Greg Abbott just ordered every bar in the state of Texas to close and announced new restrictions on restaurants just 24 hours after insisting reversing the reopening would be a last resort. In Harris County, where COVID has overwhelmed Houston's hospitals, the county executive is expected to issue a stay-at-home order today. Florida is ending alcohol consumption at bars. Arizona has stopped its reopening, NY has new restrictions on out-of-state visitors, and California is considering restrictions after a 25% surge in cases in two weeks. Maybe most importantly from an economic perspective, bad COVID news is dominating headlines and consumer behavior is growing cautious even in states where COVID is not spiking.

2. The money stopped flowing. Aid is still coming to households in the form of unemployment insurance, but it's no longer enough to offset lost economic income. Companies are still borrowing, but that's slowing too as almost all of those needing cash now have cash. In fact, companies paid down commercial and industrial loan balances in the past couple of weeks.

3. The political picture has changed. Senate Democrats refused to open the Republican's police reform bill to debate signals a sea change for Washington. Chuck Schumer and his party made this decision because polls show Democrats will win both the White House and Senate in November, at which point they can join with their House majority and pass the bill they want rather than compromising. Needless to say, the same goes for the next round of stimulus. There will be no more stimulus cash this year unless the polls shift back in the other direction enough to allow compromise.

Together, these three factors are likely to bring a new sobriety to the outlook. Those few economists still predicting V-shaped recoveries should soon throw in the towel. May data were terrific, and June could be even better. In the second half, however, the easy part of the recovery will be behind us and the climb back to pre-COVID economic conditions will slow from a gallop to a slog.

– Chris Low, Chief Economist

The Week Ahead

This Week's Numbers

			CONSENSUS			
		PRIOR	HIGH	LOW	MEDIAN	**FHN**
Monday, June 29	Pending Home Sales MoM - May	-21.8%	38.0%	10.0%	18.9%	**15.0%**
	Dallas Fed Manf. Activity - Jun	-49.2	-20.8	-35.0	-29.5	**-22.0**
Tuesday, June 30	MNI Chicago PMI - Jun	32.3	44.0	37.0	42.0	**44.0**
	Conf. Board Consumer Confidence - Jun	86.6	97.1	87.0	90.0	**92.0**
Wednesday, July 1	ADP Employment Change - Jun	-2,760k	5,800k	1,100k	3,000k	**3,000k**
	Construction Spending MoM - May	-2.9%	3.5%	0.5%	1.0%	**1.5%**
	ISM Manufacturing - Jun	43.1	53.5	44.0	49.0	**50.0**
	Wards Total Vehicle Sales - Jun	12.21m	14.00m	12.50m	13.00m	**13.50m**
Thursday, July 2	Trade Balance - May	-$49.4b	-$42.0b	-$54.9b	-$52.0b	**-$55.0b**
	Change in Nonfarm Payrolls - Jun	2,509k	8,000k	1,000k	3,000k	**5,000k**
	Change in Private Payrolls - Jun	3,094k	5,300k	2,000k	2,660k	**5,200k**
	Change in Manufact. Payrolls - Jun	225k	600k	155k	500k	**600k**
	Unemployment Rate - Jun	13.3%	14.5%	11.2%	12.5%	**13.0%**
	Average Weekly Hours All Employees - Jun	34.7	34.8	34.3	34.5	**34.8**
	Average Hourly Earnings MoM - Jun	-1.0%	1.2%	-2.0%	-0.5%	**-1.0%**
	Average Hourly Earnings YoY - Jun	6.7%	6.1%	4.3%	5.5%	**5.5%**
	Initial Jobless Claims - Jun 27	1,480k	1,400k	1,000k	1,350k	**1,400k**
	Continuing Claims - Jun 20	19,522k	--	--	--	**19,400k**
	Factory Orders - May	-13.0%	10.0%	1.0%	8.0%	**8.0%**

Review

This week, another 1.5 million Americans filed for unemployment insurance, which takes total filings to over 47 million since COVID lockdowns. This week's preliminary PMI reports showed more layoffs are likely even as the economy reopens and some furloughed workers are called back. Concerns over a second wave of COVID are actualizing, prompting firms to cancel or postpone new orders.

The third reading of Q1 GDP was unchanged at -5.0% annualized q/q. The IMF downgraded global GDP for 2020 from -3.0% to -4.9%.

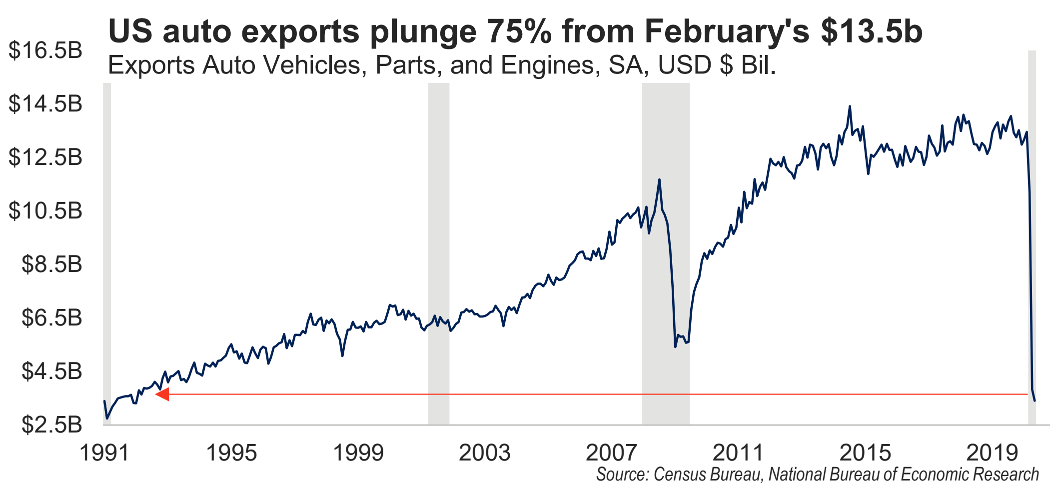
Durable goods orders rose 15.8% in May, beating expectations of 10.5%. Nondefense capital goods orders excluding aircraft were up 2.3% m/m.

- **Last week, another 1.48 million Americans filed for unemployment insurance**. While market participants believe the worst is over, a steady continuation of bad news piling on top of previously announced dismal news is not relieving. Among other things, the number of new COVID cases on Thursday was a record, which startled global markets.

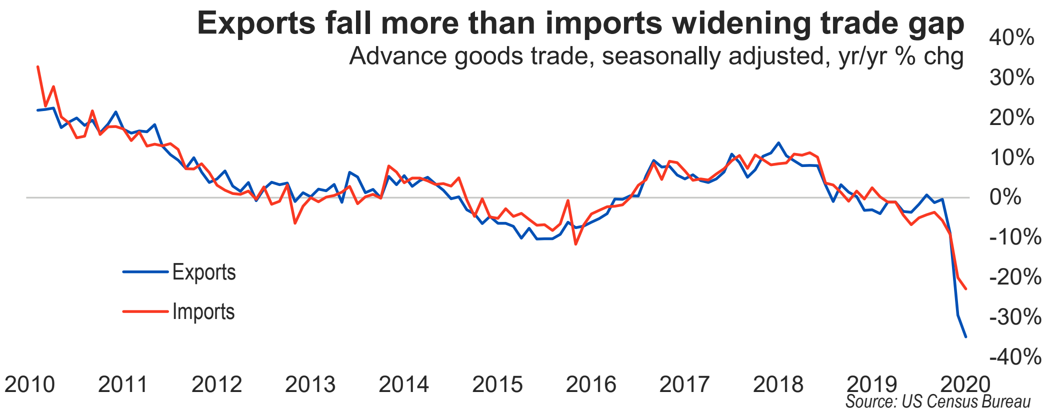
  The number of people regularly receiving unemployment benefits — continuing claims — fell from a revised 20.3m to 19.5m. That's a good sign, indicating furloughed workers are returning to work, and PMI reports have confirmed that. But, there are reports of people who traditionally do not receive unemployment, like waiters and waitresses, independent contractors, and gig workers, being tossed out of state unemployment systems. As thousands of unemployed, particularly in swing states, learned they are not eligible for CARES Act support, it has become a campaign issue. Senator Sherrod Brown (D-OH) instructed Ohio's Department of Jobs and Family Services not to recoup non-fraud unemployment payments. Senate Minority Leader Chuck Schumer (D-NY) and Senator Ron Wyden, the ranking Democrat on the Senate Finance Committee from Oregon, called for a federal investigation into Florida's "uniquely poor" handling of unemployment.

This week's latest uproar is in Hawaii, where Uber and Lyft drivers have been fighting to receive unemployment compensation. Initially, drivers received federal pandemic assistance, but payments abruptly stopped in May. Hawaii's labor department is trying to charge Uber and Lyft for back payments from their unemployment trust fund. In turn, Uber and Lyft are trying to change Hawaii's law to clarify drivers are independent contractors, and therefore, not entitled to unemployment coverage at all.

- **May's advance report on trade showed the US deficit ballooned**, from April's -$70.7b to -$74.4b. Imports fell 1.2% in May (-22.9% y/y) but exports dropped -5.8% (-34.9% y/y). Exports have fallen for three straight months. Autos have plunged 75% from February's $13.5 billion in monthly exports to $3.4b.



Capital goods exports, which includes aircraft, machines, equipment, and semiconductors, are down 31.8% over the year. Adding to trade issues, the US Trade Administration is weighing adding tariffs on $3.1b of EU goods exports to the US. The list includes Greek and Spanish olives, Irish whiskey, French clothing, and Swiss cheeses. This would be in retaliation for illegal subsidies the Union (including the UK) offered Airbus. *Bloomberg* reported the WTO's decision on whether the EU can legally impose tariffs on $11.2b of US exports in retaliation for illegal subsidies to Boeing will be decided in September. European stocks fell on the news.



- **The preliminary US manufacturing PMI rose from 39.8 to 49.6 in June; services rose from 37.5 to 46.7.** Manufacturing's rebound to fractionally below 50 reflects a slower drop in new orders in domestic and key export markets. Survey responses signaled more job cuts and hiring freezes in the next six months, in-line with softening demand. What is more concerning is order backlogs have dropped sharply, which increased already spare capacity. Without a surge in new orders, many furloughed workers are unlikely to be called back. Notably, profit margins are steady as US firms partially passed-on higher input costs to clients and took advantage of government aid to cover some costs. Demand along the supply chain is such that it no longer requires price discounts. The manufacturing PMI survey includes 600 US companies, while the services survey includes 400 US firms.

  The EU manufacturing PMI rose from 39.4 to 46.9 in June led by French manufacturing production; EU services PMI rose from May's 30.5 to 47.3.

  - **The French manufacturing PMI rose from 40.6 to 52.1 in June**; services rose from 31.1 to 50.3. Despite climbing above 50, it is difficult to see what led to manufacturing or service growth as demand slowed and more jobs were cut. But, if you squint you can see how production boosted the headline. The manufacturing index is a composite of five variables with a 25% weighting on whether output was higher, lower, or the same as last month. The services business activity level is solely based on the same question. *Due in part to France's relatively debilitating lockdown recession in recent months compared to Germany's, the rebound appears sharply higher.*

  - **The German manufacturing PMI rose from 36.6 to 44.6**; services rose from 36.6 to 45.8. Manufacturing led job cuts, but both manufacturing and services sectors continue shedding jobs. Margins have narrowed across both sectors as "fierce competition" forced selling prices lower. Note that services margins have been especially impacted due to a combination of input costs rising for the first time in three months (wage pressures are driving it) and discounting selling prices. Manufacturing input prices fell sharply.

  UK manufacturing PMI rose from 40.7 to 50.1 in June; services rose from 29.0 to 47.0. Some workers were called back from furlough, though with new orders contracting for the fourth straight month and with especially weak auto and aviation sectors, more cuts were made to staff levels. "There are deep concerns about how the end of furlough support will affect employment levels in the next few months," Duncan Brock, Group Director at CIPS said. In the services sector, financial intermediation performed best, followed by transport and communication services.

Japan's Jibun Bank manufacturing PMI fell from 38.4 to 37.8; services jumped from 26.5 to 42.3. Employment cuts continued in manufacturing but jobs rose in the services segment. The manufacturing PMI drop reflects Japan's late and comparatively softer response to COVID. It never declared an official lockdown, as other countries had, but PM Shinzo Abe declared a state of emergency on April 7.

The Atlanta Fed's Q2 GDPNow forecast rose from -45.5% last week to -39.5% driven by personal income and expenditures. The NY Fed revised its Weekly Economic Indicator from -8.57% to -7.69%.

Preview

Note: ★ = High Impact Event
All times Eastern

Next week big US events are Tuesday, when Chair Powell and Secretary Mnuchin testify before a House financial panel. Wednesday, the FOMC releases its meeting minutes from June. And Thursday, the BLS releases June's employment report; the Department of Labor releases weekly unemployment filings, and trade and factory orders are also due out.

International releases are Monday and Tuesday, when China releases June PMIs. Final readings of Markit PMIs are released throughout the week.

Saturday, June 27

- 9:30pm – China: Industrial Profits – May (Last: -4.3% y/y)

Sunday, June 28

- 7:50pm – Japan: Retail Sales – May (Last: -9.6% m/m; Con: -3.0% m/m)

Monday, June 29

- 4:30am – Hong Kong:
  - Exports – May (Last: -3.7% y/y; Con: -5.2% y/y)
  - Imports – May (Last: -6.7% y/y; Con: -7.0% y/y)
- 5:00am – EU: Consumer Confidence – Jun F (Jun P: -14.7)
- ★ 10:00am – US:
  - Pending Home Sales – May (Last: -21.8% m/m; Con: 18.9% m/m)
  - Pending Home Sales – May (Last: -34.6% y/y)
- 10:30am – US: Dallas Fed Manufacturing Activity – Jun (Last: -49.2; Con: -29.5)
- ★ 3:00pm – US: New York Fed President John Williams moderates discussion with IMF Managing Director Kristalina Georgieva. (FOMC voter)
- 7:30pm – Japan: Unemployment Rate – May (Last: 2.6%; Con: 2.8%)

- 7:50pm – Japan: Industrial Production – May P (Last:-9.8% m/m; Con: -5.7% m/m)
- ★ 9:00pm – China:
  - Manufacturing PMI – Jun (Last: 50.6; Con: 50.5)
  - Non-Manufacturing PMI – Jun (Last: 53.6; Con: 53.7)
  - Composite PMI – Jun (Last: 53.4)

Tuesday, June 30

- 2:00am – UK:
  - GDP – Q1 F (Q1 P: -2.0% q/q)
  - Current Account – Q1 (Last: -£5.6b; Con: -£15.0b)
- 4:30am – Hong Kong: Retail Sales Value – May (Last: -36.1% y/y; Con: -31.9% y/y)
- 5:00am – EU: CPI – Jun (Last: 0.1% y/y; Con: 0.2% y/y)
- 9:00am – US: S&P CoreLogic CS – Apr
- ★ 9:45am – US: MNI Chicago PMI – Jun (Last: 32.3; Con: 42.0)
- ★ 10:00am – US: Conference Board Consumer Confidence – Jun (Last: 86.6; Con; 90.0)
- ★ 11:00am – US: New York Fed President speaks via webinar on central banking in age of COVID. (FOMC voter)
- ★ 12:30pm – US: Chair Powell and Secretary Mnuchin speak before House financial panel.
- ★ 7:50pm – Japan: Tankan Survey – Q2
- 8:30pm – Japan: Jibun Bank Manufacturing PMI – Jun F (Jun P: 37.8)
- ★ 9:45pm – China:
  - Caixin Manufacturing PMI – Jun (Last: 50.7; Con: 50.7)
  - Caixin Services PMI – Jun (Last: 55.0; Con: 53.3)
  - Caixin Composite PMI – Jun (Last: 54.5)

Wednesday, July 1

- US: Wards Total Vehicle Sales – Jun (Last: 12.21m; Con: 13.00m)
- 2:00am – Germany: Retail Sales – May (Last: -5.3% m/m; Con: 3.6% m/m)
- 3:45am – Italy: Markit Manufacturing PMI – Jun (Last: 45.4; Con: 47.6)
- 3:50am – France: Markit Manufacturing PMI – Jun F (Jun P: 52.1)
- 3:55am – Germany:
  - Markit/BME Manufacturing PMI – Jun F (Jun P: 44.6)
  - Employment Report
- 4:00am – EU: Markit Manufacturing PMI – Jun F (Jun P: 46.9)
- 4:30am – UK: Markit Manufacturing PMI – Jun F (Jun P: 50.1)
- ★ 7:00am – US: MBA Mortgage Applications - Jun 26
- 7:30am – US: Challenger Job Cuts – Jun (Last: 577.8% y/y)
- ★ 8:15am – US: ADP Employment Change – Jun (Last: 2.76m; Con: 3.0m)
- 9:45am – US: Markit Manufacturing PMI – Jun F (Jun P: 49.6)
- ★ 10:00am – US:
  - ISM Manufacturing PMI – Jun (Last: 43.1; Con: 49.0)
  - Construction Spending – May (Last: -2.9% m/m; Con: 1.0% m/m)
- ★ 2:00pm – US: FOMC Minutes from June 10 Meeting

Thursday, July 2

- 4:00am – Italy: Unemployment Rate – May P (Last: 6.3%; Con: 8.1%)
- 5:00am – EU:
  - PPI – May (Last: -4.5% y/y; Con: -4.7% y/y)
  - Unemployment Rate – May (Last: 7.3%; Con: 7.7%)
- ★ 8:30am – US:
  - Change in Nonfarm Payrolls – Jun (Last: 2.509m; Con: 3.000m)
  - Unemployment Rate – Jun (Last: 13.3%; Con: 12.5%)
  - Average Hourly Earnings – Jun (Last: -1.0% m/m; Con: -0.5% m/m)
  - Average Hourly Earnings – Jun (Last: 6.7% y/y; Con: 5.5% y/y)
  - Labor Force Participation Rate – Jun (Last: 60.8%)
  - Initial Jobless Claims – Jun 27 (Last: 1.48m; Con: 1.35m)
  - Continuing Claims – Jun 20 (Last: 19.522m)
  - Trade Balance – May (Last: -$49.4b; Con: -$52.0b)
- 9:30am – Canada: Markit Manufacturing PMI – Jun (Last: 40.6)
- ★ 10:00am – US:
  - Factory Orders – May (Last: -13.0% m/m; Con: 8.0% m/m)
  - Factory Orders Ex Trans – May (Last: -8.5% m/m)
  - Durable Goods Orders – May F (May P: 15.8% m/m)
  - Durable Goods Orders Ex Trans – May F (May P: 4.0% m/m)
  - Capital Goods Orders Nondefense Ex Aircraft – May F (May P: 2.3% m/m)
  - Capital Goods Shipments Nondefense Ex Aircraft – May F (May P: 1.8% m/m)
- 8:30pm – Japan: Jibun Bank Services PMI – Jun F (Jun P: 42.3)

Friday, July 3

- 3:45am – Italy: Markit Services PMI – Jun (Last: 33.9; Con: 25.3)
- 3:50am – France: Markit Services PMI – Jun F (Jun P: 50.3)
- 3:55am – Germany: Markit Services PMI – Jun F (Jun P: 45.8)
- 4:00am – EU: Markit Services PMI – Jun F (Jun P: 47.3)
- 4:30am – UK: Markit Services PMI – Jun F (Jun P: 47.0)

– Rebecca Kooshak, Economic Analyst