



First Quarter 2020 Economic Summary and Outlook

A severe recession due to COVID-19 is underway. While the worst of the recession is likely to be felt in the second quarter, there are many uncertainties going forward. The self-imposed lockdown of the economy is easing, but there is no guarantee that the virus will wane or that a vaccine will be forthcoming soon. Added headwinds from potential trade tension with China and domestic unrest may also take a toll on the recovery. With this in mind, there should be caution in interpreting forecasts.

The economy shrank 5% in the first quarter of 2020 due to the early consequences of the virus outbreak. The first quarter is really just an introduction to the recession since March was the only month in the first quarter where the economy was in a lockdown. Consumption fell 4.69% as consumers began losing jobs and became more cautious. The saving rate jumped from 8.2% in February to 12.7% in March and an astounding 33% in April as consumers were largely in quarantine during these later months. Job losses mounted at the end of the first quarter where the unemployment rate was only 4.4% for March but ballooned to 14.7% in April and 13.3% in May. Over 30 million workers have lost their jobs this year to date. Jobs data are now improving more than expected as the economy slowly opens up, but the unemployment rate is expected to be around 10% for the remainder of the year.

Prompt fiscal and monetary policy stimulus has been unprecedented, but these moves offer only temporary relief to consumers and businesses who are facing lost income until a full recovery occurs. An effective vaccine is not likely before the middle of 2021. Even so, a full recovery is not likely until later in 2022, if there are no other major disruptions. Mounting debt will pose longer run headwinds for growth. The Federal government debt burden will exceed 25 trillion dollars this year and will be higher than the U. S. GDP. Another round of fiscal stimulus should occur this summer. Large debt burdens existed prior to the virus in many blue states, often due to poor management of pension liabilities. The added strain on state and local government finances due to the virus has partly been addressed by the Fed through debt purchasing programs. However, this program has been uneven and not all states and local governments have benefitted.

Looking forward, the Fed is committed to keeping the federal funds rate near zero and to continue easy money policies through 2022. Forecasts call for a dismal second quarter with GDP contraction around 33%, but with a recovery starting in the third quarter. A V-shaped recovery is expected with relatively high GDP growth later in the year. All this is optimistic if the virus is not contained. Inflation and interest rates will remain low, although there may be upward pressure on longer term rates as government borrowing increases and the dollar cools. Equity values are hard to understand in this market as stock prices are out of line with sentiment and earnings growth. Applications of discounted cash flow models suggest that it takes an equity risk premium of only about 3% to justify current valuations compared to a more normal 6%.



COVID-19 and the Economy

The 5% decline in GDP for the first quarter of 2020 provides only an early glimpse of the impact that the pandemic will have on the economy. March was the only month in the first quarter where the virus affected economic activity. With full lockdowns in March, April, and May, the second quarter decline in GDP could top 30%. Even as the economy begins to open, it will not be business as usual. Without an effective vaccine, the COVID-19 virus changes how goods and services are produced and consumed worldwide. Production will be more expensive with social distancing and new safety procedures. It is unlikely that businesses will be able to maintain volume by investing in additional physical capacity to accommodate more spacing between customers and/or workers. The more likely scenario is a reduction in business volume from the given physical capacity. For example, fewer customers per restaurant or fewer workers on a given work floor will occur. Many firms will fail with the new higher costs of production along with reductions in business volume. Additional government assistance may prolong this process for some businesses, but without a vaccine the end result will be a significant shrinkage in GDP. These relationships tend to be true world-wide and not just in the U. S.

By the end of 2020, without any other major disruption, it is likely that the U. S. economy will have regained about half of the jobs lost due to the virus. This would correspond with an unemployment rate of about 10%. Inflation and interest rates will remain low while the national debt will exceed 25 trillion. The ratio of the national debt to GDP will exceed 100% without any chance of improving this ratio in the near future, even with much higher tax rates. A full recovery will not begin in earnest until a vaccine is widely available, even so, it is not likely to have a full recovery until 2013, everything else equal.

Lingering COVID-19 Effects

Even as the U. S. economy improves, there are lingering effects from the pandemic. The trend toward globalism and wealth creation through specialization in production and trade may be reversed. The COVID-19 pandemic illustrated the dangers of not having domestic supply lines. The danger of spreading any disruption in one country or region to the rest of the world has been now clearly demonstrated. For the U. S., being a service economy with dependence on key products and inputs from other countries is troubling. The move to bring back more manufacturing to the U. S. with less dependence on other countries may be more likely, especially if the fall election goes Trump's way.

State and local governments, especially in blue states such as New York and New Jersey, are drowning in debt and obligations to pensions that they are not able to cover. This was true before the pandemic but is now much worse. Pleas for federal help to cope with the virus are now being matched with pleas to bail out states from fiscal disaster. Early versions of relief efforts drafted in the House included such state support expenditures. While states that have remained solvent will



continue to balk at taxes earmarked to help out states that did not follow fiscal restraint and prudent pension management, the balance of political parties in the Senate may change to allow such funding. Overall, the massive fiscal stimulus required to ease the pain of the pandemic-driven recession will further complicate the debt drag on the economy. Neither austere budgets nor very rapid growth to build tax revenues are likely solutions. More likely scenarios include higher tax rates, which will further depress economic growth, or living with the consequences of the debt burden by accepting a lower standard of living over time. The option of getting by with less was a predominant theme in the Obama years and may well become the theme of future administrations who put social issues ahead of economic issues.

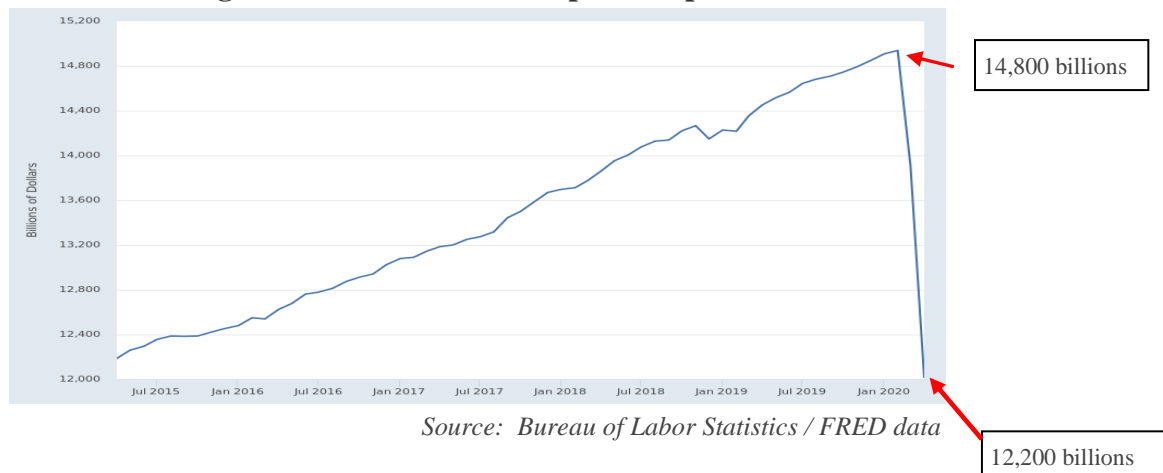
The Virus and Productivity

A major issue covered in prior “Outlooks” is the declining productivity in the U. S. and the necessity of stronger productivity for higher GDP growth. The pandemic will make productivity gains more difficult going forward. Social distancing in the workplace, less efficient protocols to avoid contagion, potential reliance on less efficiently produced goods in the U. S., and the potential for older workers to remain in the workforce due to lost wealth from the pandemic all work against increasing productivity. Lower productivity, lower wage growth, lower consumer income, and lower growth potential all follow from the consequences of the pandemic. Only an effective and comprehensive immunization program for COVID-19 and its potential mutations will prevent the downdraft on U. S. growth.

Can Consumers Drive the Economy?

The loss of jobs and income hurt consumer spending in the first quarter and was only partially eased by the first three fiscal spending programs. Figure 1 shows the pattern of consumer spending through April of 2020.

Figure 1. Personal Consumption Expenditure





Lower consumer spending accounted for nearly all of the decline in economic activity in the first quarter followed by a 13.2% drop in April as lockdowns went into full effect. The baby boom cohort, now in its 50s and 60s, are now more cautious as retirement prospects dimmed in the first quarter. Another fiscal spending program is likely this summer, but the lingering effects of the pandemic will continue to lower consumer spending. If a second wave of the virus hits this summer, mandatory shutdowns and stay-at-home orders may occur again. Stimulus checks, increased unemployment insurance benefits, loan forbearance, and foreclosure restrictions tend to be one-time transfers that will not sustain consumers for long. Even so, these efforts are largely insufficient when compared to the loss of jobs, work hours, and erosion of savings that may continue into the third quarter or longer. While there is pent-up demand, consumers may not likely be able to carry the load required for a robust recovery until 2021.

The Fed – Ample Support will Continue

The Fed continues to offer ample liquidity to support the economy. In the most recent open market committee meeting, the Fed revealed expectations that the fed funds rate will remain near-zero through 2023. The Fed's purchases of Treasury and agency securities peaked in late March. The Fed continues to focus on providing credit to households, non-financial firms and state governments. But, the Treasury is scheduled to issue about \$3 trillion of added debt in the second quarter that would put upward pressure on interest rates unless the Fed absorbs more of that debt issue. While long term yields remain low currently, there is a growing discussion around central banks capping longer term yields as massive government debt from virus-related stimulus hits the market. Figure 2 illustrates the increase in the Fed's balance sheet of Treasury Securities over time. The growing trend in holdings represents a dramatic degree of easing by the Fed.

Figure 2. Federal Reserve Bank holdings of U.S. Treasury Securities



Source: Board of Governors / FRED data

Forecast by the Fed

Fed officials forecast GDP to contract by 6.5% for 2020 and then rebound to growth of 5% in 2021 and 3.4% in 2022. These forecasts would still leave the level of GDP well below the pre-pandemic path by the end of 2022. Fed forecasts call for the unemployment rate to decline to 9.3% in the



fourth quarter of this year. The unemployment rate is expected to fall to 6.5% by the end of 2021 and to 5.5% by the end of 2022. A surprising aspect of the Fed forecast is the implicit assumption that there will be no long lasting effects from the virus. The Fed's forecasts of long-run growth and long-run interest rate were left unchanged. Finally, the Fed forecast for core PCE remains below the 2% target through 2022, suggesting ample room for the Fed to follow an easy money policy.

Survey of Professional Forecasters

The May 15 revision of the February 15, 2020 forecast by the Survey of Professional Forecasters provides a much weaker outlook for near term growth. According to the panel of 42 forecasters surveyed by the Philadelphia Federal Reserve Bank, a recovery will begin in the third quarter after a very rough second quarter. The revised median consensus forecasts more fully reflects the expected impact of the COVID-19 pandemic and its potential impact on the economy. GDP growth was revised from an expansion of 2.1% to a 32.2% decline in the second quarter. Forecasters tend to see the major damage from the virus to be concentrated in the first half of 2020, a view likely based on the assumption that a vaccine will be available later in 2020. Forecasters see GDP falling 5.6% for the overall year (compared to a Fed forecast of a 6.5% decline) based on a second half recovery. This forecast seems to minimize the lingering after-shocks of the virus and assumes high growth rates in the recovery. The forecast assumes a traditional V recovery pattern, unlike the long and slow recovery from the Great Recession.

Table 1 below summarizes the revised consensus forecast of May 15 for GDP, unemployment, and payrolls relative to the prior forecast on February 15 of 2020. After a major second quarter loss of jobs the economy is expected to have a dramatic recovery in job expansion as the economy reopens. Nevertheless, forecasters see the unemployment rate to be in double digits for the remainder of 2020.

Table 1. Survey of Professional Forecasters GDP, Unemployment, and Payroll Forecasts

Quarter	Real GDP (%)		Unemployment Rate (%)		Payrolls (000s per month)	
	Prior	Revised	Prior	Revised	Prior	Revised
II Q 2020	2.1	-32.2	3.5	16.1	168.6	-7,647.8
III Q 2020	2.0	10.6	3.5	12.9	132.8	2,328.9
IV Q 2020	2.1	6.5	3.6	11.0	116.7	900.9
I Q 2021	2.2	6.8	3.6	9.3	114.5	514.9
II Q 2021	NA	4.1	NA	8.8	NA	739.1

Source: Survey of Professional Forecasters, Philadelphia Federal Reserve Bank

As would be expected with the revision of lower growth, forecasters revised inflation estimates lower. Forecasters expect disinflation in the second quarter with inflation rates returning to more normal levels for the remainder of the year. The forecast calls for headline consumer price index (CPI) inflation in 2020 to average 0.5%, which is a full 2% lower than in the prior survey. The headline personal consumption expenditure index (PCE) inflation in 2020 is expected to be 0.8% compared to the 1.9% estimate in the February forecast. Table 2 below shows the inflation forecasts in the prior February survey and in the more recent May survey.

**Table 2. Survey of Professional Forecasters CPI and PCE Inflation Rates**

Quarter	Headline CPI (%)		Core CPI (%)		Headline PCE (%)		Core PCE (%)	
	Prior	Revised	Prior	Revised	Prior	Revised	Prior	Revised
II Q 2020	2.0	-2.6	2.1	0.7	1.8	-1.5	1.9	1.0
III Q 2020	2.2	1.5	2.1	1.5	1.9	1.3	1.9	1.3
IV Q 2020	2.2	1.9	2.2	1.6	2.0	1.6	1.9	1.4
I Q 2021	2.2	2.0	2.2	1.7	2.0	1.6	1.9	1.6
II Q 2021	N.A.	2.0	N.A.	1.8	N.A.	1.6	N.A.	1.7



Summary of Recent Economic Data

Gross Domestic Product – The economy shrank by 5% in the first quarter as the early stage of the pandemic hit consumers and the economy. The full impact of the pandemic will be felt in the second quarter due to quarantines in April and May and a transition in June. Government transfer payments and relief programs provided temporary relief that will extend through the second quarter, making another round of stimulus likely this summer. Social unrest and business interruptions linked to urban riots may pose added threats to the recovery.

- GDP growth declined 5% in the first quarter, based on the revised estimate by the Bureau of Economic Analysis. The drop in GDP is the largest since the first quarter of 2008. The economy was on a near normal pace through February, but the COVID-19 lockdown in March pushed the economy into a downturn. The self-imposed contraction will have the largest impact in the second quarter.
- Overall, declines occurred in consumer spending, nonresidential business investment, and inventories while residential investment, net exports, and government spending provided some expansion. Table 3 summarizes the quarterly changes in GDP.

Table 3. Real GDP and GDP Components (Annualized Percentage Change)

	2020 Q1	2019 Q4	2019 Q3	2019 Q2	2019 Q1	2018 Q4
Real Annualized GDP	-5.05	2.13	2.10	2.01	3.10	1.09
Consumption	-4.69	1.24	2.12	3.03	0.78	0.97
Fixed Investment	-0.41	-0.09	-0.14	-0.025	0.56	0.46
Residential	0.66	0.24	0.17	-0.11	-0.04	-0.18
Non-residential	-1.06	-0.313	-0.31	-0.14	0.60	0.64
Inventories	-1.43	-0.98	-0.03	-0.91	0.53	0.07
Net Exports	1.32	1.51	-0.14	-.68	0.73	-0.35
Government	0.15	0.44	0.30	0.82	0.50	-0.07

Source Bureau of Economic Analysis, Second Estimate

- Corporate profits fell 13.9% in the first quarter after a 2.6% increase in the fourth quarter.
- Year-over-year growth in real GDP slowed to 0.2% compared with the comparable quarter in 2019, down from 2.3% in the prior quarter. Final sales, which exclude the impact on GDP from inventories, fell 3.7% after rising 3.1% in the fourth quarter.
- Gross domestic income, an alternative measure of the size of the economy, fell 4.2% in the quarter after rising a revised 3.1% the prior quarter.



Personal Income and Saving – Consumer income took a dive in March but massive government fiscal stimulus programs boosted income in April. With lower spending linked to the lockdown, the saving rate jumped to 33%. As the economy transitions into phases of reopening and government transfer payments wane, income growth will be slow.

- April data on personal income shows improvement from March due to fiscal stimulus and transfer payments. Nominal personal income fell 2.2% in March but rebounded by 10.5% in April. Even so, the pandemic caused a major drag on earned income. Employee compensation fell 7.7% in April. The April decline in compensation to employees is the largest monthly drop in the history of the series.
- Nominal disposable income fell 2.1% in March but rebounded with a 12.9% increase in April, due to temporary government social transfer payments. The personal savings rate jumped from 12.7% to 33% as consumer spending continued to fall due to the lockdown.
- Economic impact payments, unemployment insurance benefits, SNAP benefits, and related forms of fiscal stimulus from the CARES Act increased 89.6% in April to overcome the drop in all other components of personal income. Table 4 summarizes monthly changes in disposable income and the saving rate.

Table 4. Change in Monthly Disposable Income, Year-ago Changes, and Saving Rates

	April 2020	Mar. 2020	Feb. 2020	Jan. 2020	Dec. 2019	Nov. 2019	Oct. 2019	Sept. 2019	Aug. 2019	July 2019	June 2019	May 2019
Mo. % Change												
Nominal	12.0	-2.1	0.5	0.6	0.2	0.5	0.1	0.3	0.5	0.2	0.4	0.3
Real	13.4	-1.8	0.4	0.5	-0.1	0.4	-0.1	0.3	0.5	-0.1	0.2	0.2
Yr.-Ago % Change												
Nominal	14.4	1.6	4.2	4.2	3.5	4.4	4.1	4.4	4.1	4.0	4.3	4.7
Real	13.8	0.3	2.4	2.4	2.0	3.0	2.7	3.0	2.6	2.5	2.9	3.3
Saving Rate (%)	33.0	12.7	8.2	7.9	7.7	7.9	7.7	7.8	7.7	7.4	7.8	8.0

Source Bureau of Economic Analysis



Employment and Labor Data - Employment data for the first quarter reflect only the early consequences of the COVID-19 virus. The most restrictive aspects of the virus didn't occur until the middle of March. As expected, the virus lockdown starting in March brought about a double-digit unemployment rate. The unemployment rate increased from 4.4% in March to 14.7% in April. A strong rebound in payrolls occurred in May as the economy entered phase I of the reopening. The unemployment rate dipped to 13.3%. Approximately 30 million Americans are unemployed and virus protocols will result in a reduced employment capacity in many sectors.

- The May employment report delivered a surprise as payrolls expanded by 2.5 million jobs. The unemployment rate fell to 13.3% even as the labor participation rate nudged higher. The employment data may be off somewhat since the response rate to the employment survey was 15% lower than normal.
- Table 5 summarizes monthly data on unemployment and payrolls. The May rebound represents a big improvement and bodes well for the economy as the lockdown eases. Nevertheless, there are reasons to be cautious. Some of the workers added to payrolls are paid by the CARES Act's Payroll Protection Program. The program requires employers to use at least 75% of the funds received to pay workers. These workers are listed on payrolls but may not be working. Furthermore, many of these workers may lose their jobs when the program ends at the end of July.

Table 5. Monthly Unemployment and Job Expansion Data

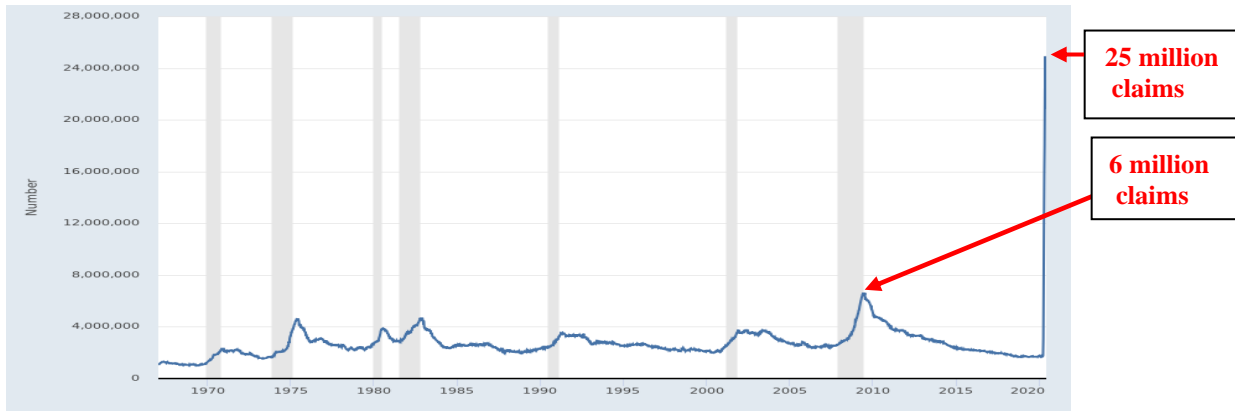
	May 2020	Apr. 2020	Mar. 2020	Feb. 2020	Jan. 2020	Dec. 2019	Nov. 2019	Oct. 2019
Unemployment Rate (%)	13.3	14.7	4.4	3.5	3.6	3.5	3.5	3.6
Change in Non-farm Payroll (000s)	2,509	-20,687	-1,3737	251	214	184	261	185
3-mo. Moving avg. change (000s)	-6,517	-7,270	-303	216	220	210	218	200
Labor Force Participation Rate	60.8	60.2	62.7	63.4	63.4	63.2	63.2	63.2

Source: Bureau of Labor Statistics

- By the end of the first quarter, nearly 12 million workers filed initial claims for unemployment insurance. By the end of May nearly 25 million continuing insured unemployment claims had been filed. The magnitude of the lockdown on unemployment claims compared to the 2008-2009 recession is astounding, as illustrated in Figure 3.



Figure 3. Continuing Insured Unemployment Claims (weekly average)



Source: U. S. Employment and Training Administration, FRED data File

- The workweek increased in March from 34.2 to 34.7 hours. Average hourly earnings dropped by 29 cents as lower-paid workers were brought back.
- Although productivity can be volatile, the longer-run trend remains slow. After revisions, productivity is up only 0.7% on a year-ago basis. In the first quarter productivity fell only 0.9%. Growth in unit labor cost increased to 5.1% at an annualized rate. Overall, the weak trend in productivity, the acceleration in unit labor costs, and the impact of COVID-19 have all compressed corporate profits. Table 6 provides the quarterly percentage changes in productivity, compensation and unit labor costs over the last seven quarters.

Table 6. Quarterly Productivity, Compensation, and Unit Labor Costs

	Q I 2020	Q IV 2019	Q III 2019	Q II 2019	Q I 2019	Q IV 2019	Q III 2019
Non-Farm Business							
Output per Hour	-0.9	1.2	-0.3	2.7	3.9	0.6	1.7
Compensation per Hour	4.2	3.4	-0.1	2.7	9.8	1.2	3.4
Unit Labor Costs	5.1	2.2	0.2	0.1	5.7	0.7	1.6
Manufacturing							
Output per Hour	0.3	-0.8	-0.5	-2.3	1.3	0.9	0.3
Compensation per Hour	7.3	5.5	-1.2	2.7	8.3	3.5	2.3
Unit Labor Costs	6.9	6.3	-0.7	5.2	6.9	2.5	2.0

Source: Bureau of Labor Statistics

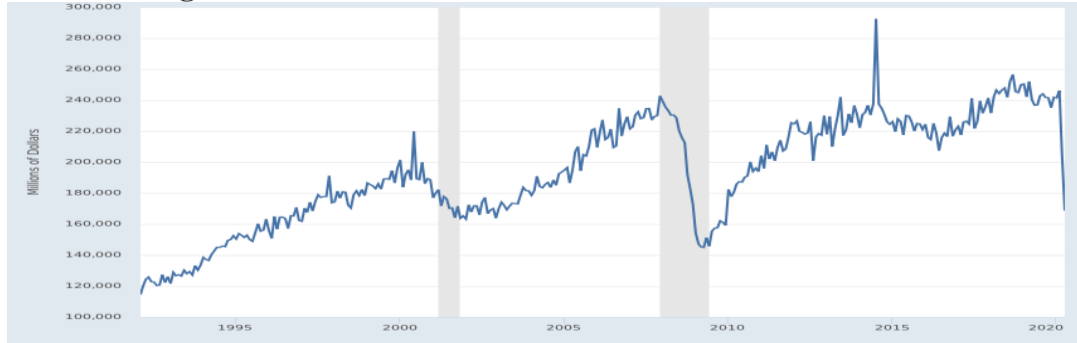
- The employment cost index (ECI) rose 0.8% in the first quarter, continuing a consistent pattern over the past two years. On a year-ago basis, the ECI is 2.8% higher, matching the change relative to the first quarter of 2019. Given the construction of the ECI, the impact of the virus will not show up until at least next quarter. Even without wage increases, the cost of workers will go up due to added costs of virus protection per worker.



Production and Manufacturing – U. S. manufacturing had been slowing before the pandemic, but the lockdown pushed production over the edge. Factory and durable goods orders both posted double digit declines. Capacity utilization rates plummeted and re-tooling for social distancing and greater safety from the virus will require expensive but non-productive changes.

- U.S. durable goods orders fell 17.2% in April following a decline of 16.8% in March. Transportation orders took the largest hit. Motor vehicles and parts orders fell 52.8%. Excluding transportation, new orders declined 7.4%. Figure 4 illustrates the time series of new orders for durable goods. While orders fell dramatically, the data are still ahead of the decline during the 2008-2009 recession.

Figure 4. Manufacturer's New Orders for Durable Goods



Source: U. S. Census Bureau (FRED Data)

- U.S. factory orders fell 13% in April following a revised 11% decline in March. Excluding transportation, orders were down 8.5% in April, the fourth consecutive monthly decline. Unless there is a second virus wave this summer, April may be the worst of the recession as the economy slowly opens up again. Other threats from social unrest and likely increased tension with China may pose additional threats beyond the virus.
- Industrial production fell 11.2% in April while manufacturing output dropped 13.7%. Industrial capacity utilization fell from 76.8% in January to 64.9% in April. Manufacturing capacity utilization fell from 75.1 to 61.1%. With such low utilization rates, business investment in the coming months is most likely to be focused on virus protection rather than expansion. Figure 5 shows the pattern of industrial capacity utilization over time. Utilization is now lower than during the 2008-2009 recession.



Figure 5. Industrial Capacity Utilization



Source; Board of Governors (FRED)

- The manufacturing sector has been weak but generally above the expansion level since the Great Recession of 2008-2009. The trend has been for production to move abroad and the U. S. to become more service-oriented. A confrontation with China is lurking, making it possible for manufacturing to move back to the U. S. and away from China.
- Figure 6 illustrates the movement of the ISM index over the past decade. The May ISM manufacturing index improved to 43.1 in May from 41.5 in April, both well below the threshold of 50 for an expansion.

Figure 6. ISM Purchasing Manager Index (An Index Over 50 Suggests an Expansion)



Source: FRED data

Inflation - The personal consumption expenditure index (PCE) grew 1.3% in the first quarter, following a 1.4% rate in the prior quarter. The pandemic will keep inflation low going forward, although costs of providing goods and services will be higher. The squeeze in profit margins may eventually put upward pressure on prices.

- The PCE increased 1.3% in the first quarter, slightly below the 1.4% for the fourth quarter. Excluding food and energy, inflation was 1.6%, up from 1.3% the prior quarter. Energy prices will rebound slowly as the economy recovers.



- COVID-19 created disinflation pressure. The PCE deflator fell 0.5% in April and 0.2% in March. Excluding food and energy, the PCE deflator declined 0.4%. Food prices increased 2.4% following a 0.6% gain in March. Monthly PCE data appear in Table 7.

Table 7. Monthly PCE Deflator Data

	Apr. 2020	Mar. 2020	Feb. 2020	Jan. 2020	Dec. 2019	Nov. 2019	Oct. 2019	Sept. 2019	Aug. 2019	July 2019	June 2019
Headline PCE	-0.5	-0.2	0.1	0.1	0.3	0.1	0.2	0.0	0.0	0.2	0.1
% change Year-Ago	0.5	1.3	1.8	1.8	1.6	1.3	1.3	1.3	1.4	1.4	1.4
Core PCE	-0.4	0.0	0.1	0.2	0.2	0.1	0.1	0.0	0.1	0.2	0.3
% Change Year-Ago	1.0	1.7	1.8	1.7	1.6	1.5	1.6	1.7	1.8	1.7	1.6

Source: Bureau of Economic Analysis

- The Consumer Price Index (CPI) also shows a disinflation pattern from the COVID-19 virus. The CPI fell 0.8% in April, the largest decline since 2008. Table 8 provides the changes in monthly CPI data. Lower energy prices were a factor in the April deflation.

Table 8. Monthly and Year-Ago Changes in the Consumer Price Index

	Apr. 2020	Mar. 2020	Feb. 2020	Jan. 2020	Dec. 2019	Nov. 2019	Oct. 2019	Sept. 2019	Aug. 2019	Jul. 2019
Headline CPI	-0.8	-0.4	0.1	0.1	0.2	0.2	0.2	0.1	0.1	0.3
Year-Ago % Change	0.4	1.5	2.3	2.5	2.3	2.0	1.8	1.7	1.8	1.8
Core CPI	-0.4	-0.1	0.2	0.2	0.1	0.2	0.1	0.2	0.2	0.3
Year-Ago % Change	1.4	2.1	2.4	2.3	2.3	2.3	2.3	2.4	2.4	2.2

Source: Bureau of Labor Statistics

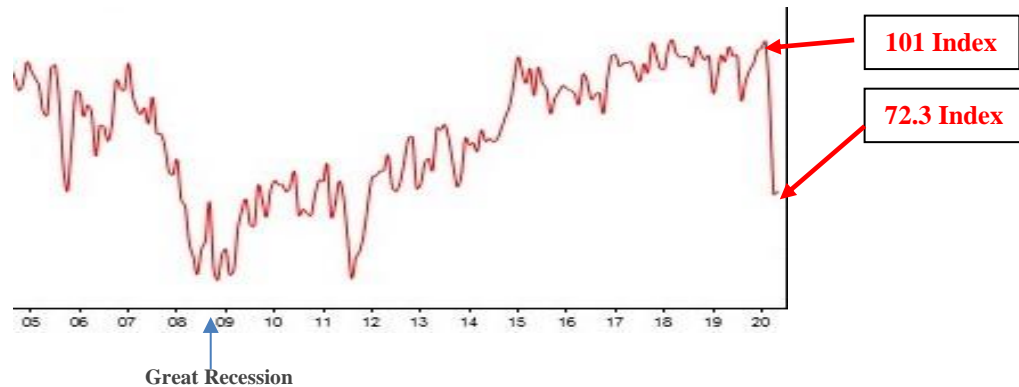
Sentiment and Confidence – While sentiment is well below the levels achieved earlier in the first quarter, sentiment appears to be stabilizing and is higher than levels reached in the Great Recession of 2008-2009. Likely factors that help cushion sentiment relative to prior recessions include a much stronger financial position of households going into the downturn in March, optimism for a bounce back as the economy slowly reopens in May, and the self-imposed nature of this recession compared to the “economic determination” of prior recessions.

- The University of Michigan Consumer Sentiment Index reached 72.3 in May, slightly higher than the 71.8 index in April. While there was an uptick in May, the index is down 28.7 points from February. The sentiment index level is consistent with a recession but the index was close to an historic high in February, illustrating the dramatic effect of the COVID-19 shutdown.



- Figure 7 helps put the current index reading for the Michigan Sentiment Index in perspective. The index has not reached the level seen in the Great Recession when the index fell to the 60s range.

Figure 7. Consumer Sentiment Index (Reuters/university of Michigan)



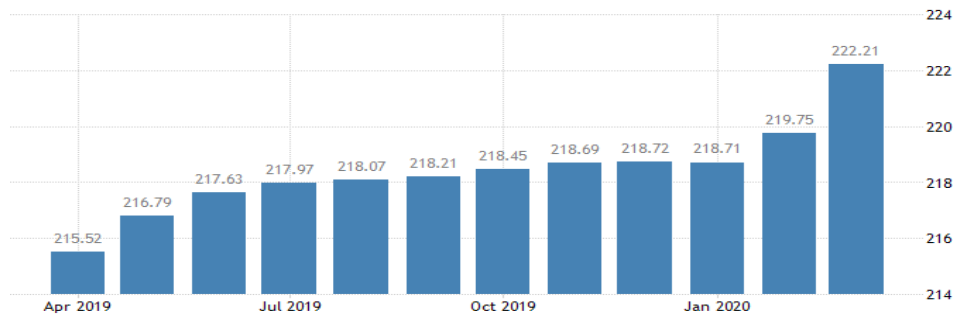
- The Conference Board's Consumer Confidence Index provides a picture much like the one provided by the University of Michigan Sentiment Index. The Conference Board's index inched up from a revised 85.7 in April to 86.6 in May after reaching 132.6 in February of this year.

Housing – After a modest end to 2019, the housing market appeared to be cooling off, but the first quarter of 2020 saw new housing pricing records. Fueled by low interest rates and low unemployment going into 2020, the housing market continued to improve. Housing prices climbed and the housing inventory declined in the first quarter. The impact of the virus on housing is likely to have a lag. The economic slowdown from the virus may hurt housing in subsequent quarters, especially during the key Spring buying season.

- The median price for single-family homes and condominiums rose to a new high of \$265,900 in the first quarter of 2020, up 2.9% for the quarter and 11.3% year-over-year. The annual increase was the largest since the third quarter of 2013. The S&P CoreLogic Case-Shiller 20-City home price index increased 3.9% on a year-over-year basis in March following a 3.5% increase in February. Figure 8 below illustrates the monthly movement of the index.



Figure 8. S&P CoreLogic Case-Shiller 20-City Composite Index



Source: FRED / data

- Distressed home sales in the first quarter of 2020 were only 9.9% of all U.S. single-family home and condo sales compared to 10.8% in the prior quarter and 13.8% one year ago. First quarter distressed home sales were the lowest since the fourth quarter of 2006.
- Housing starts weakened in April but improved in May. Housing starts in April fell from 1.28 million annualized units to only .89 million in April. Housing permits fell 20.8% in April, the fourth decline in the last five months.
- New-home sales performed better than the existing home sales, largely due to the virus. New-home sales increased 0.6% in April to 623,000 at a seasonally adjusted annualized rate. The inventory-to-sales ratio for new homes fell to 6.4 months from 6.3 months in March. On the other hand, existing home sales fell 17.8% in April, most likely due to home owners taking houses off the market due to fear of the virus from prospective buyers.

Summary of Selected Global Issues – *The pandemic will likely affect relationships between China and its trading partners as well as with countries within the euro zone.*

- The U.S. nominal trade deficit widened in March because of global supply chain disruptions and shutdowns of U.S. nonessential businesses in the second half of the month. The nominal trade deficit widened from a revised \$39.8 billion (previously \$39.9 billion) in February to \$44.4 billion in March.
- The International Monetary Fund forecasts a contraction of 12% between the last quarter of 2019 and the second quarter of 2020 in advanced economies and 5% in emerging and developing countries. The IMF forecasts a 3% global contraction in 2020 followed by a 5.8% expansion in 2021. For advanced economies the IMF forecasts a 6.1% contraction in 2020. Overall, these forecasts are based on no additional lockdowns from the virus with no second wave of the contagion. As such, the IMF forecasts may be too optimistic.



- The European commission projected that Europe will contract 7.4% this year. In the prior forecast the growth rate was 1.2%. In comparison, the contraction in Europe during the 2009 recession was 4.5%. Poland is expected to suffer the lowest contraction at 4.5% and Greece is expected to have the worst contraction at 9.7%. The largest economy in Europe, Germany, is expected to shrink 6.5% and France is expected to decline by 8.5%. The United States and Europe are each other's largest trading partners, making any disruption in Europe a problem for the U. S. Europe is China's second largest customer.
- The virus has the potential to deepen the crisis of membership in the European Union. Over a decade ago the European Central Bank (ECB) used monetary policy to prevent Greece, Italy, and Spain from becoming insolvent as a means of holding the union together. With more serious economic damage in the southern tier of the Union, the ECB may be tested again if the union is to survive.
- Low income nations face debt problems that are made much worse by the virus. The IMF has been writing off some of the debt of emerging economies and the G20 group reached a deal for a broader suspension of debt payments from low-income countries. In general, the virus linked to existing debt problems in business, governments, and investment firms may accelerate strains on the financial system going forward.

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