Bill's Comments on The Economy, Financial Markets and the Second-Quarter Senior Loan Officer Opinion Survey

May 8, 2020

- **The economy**
  - **Current state of the economy**
    - New York Fed's Weekly Economic Index suggests real GDP right now is about 12% lower than a year ago; worst year-over-year decline in Great Recession was 4%.
    - Employment report for April was released today.
      - Unemployment rate was reported at about 15%, but the BLS said in its notes to the report that the true number was probably closer to 20%, given confusion about many people's current job status—permanent vs. temporary layoffs; looking for work vs. out of the labor force.
      - Nonfarm payroll employment declined 20.5 million, wiping out all net job gains of the last 20 years.
      - The employment-to-population ratio (16+) is probably the best indicator of slack.
        - E-P ratio dropped from 60% to 51%, the lowest since the Great Depression.
      - Hourly wages increased sharply—but this is mostly a statistical quirk due to lower-wage workers losing their jobs disproportionately.
  - **Two views of the economic outlook**
    - Pres. Jim Bullard says Q2.2020 will be the worst; Q3 will experience a rapid bounce-back; by Q4, the worst of the crisis will be behind us—this is a "V-shaped recovery."
    - My own view is that the recovery will be slower and longer, maybe a U or W.
      - The underlying health risk won't go away until a vaccine is available.
      - Overcoming fear and restarting a complex economy are very difficult.

- **Financial and commodity markets**
  - The stock market is surging higher, reversing nearly 60% of the sell-off in March.
    - This is consistent with a V-shaped economic recovery beginning in 2nd half of 2020.
    - My own view is the rally is premature, given the large uncertainties that remain.
  - VIX (stock-market volatility indicator) has declined to the lowest level since February.
  - The rise in credit spreads that occurred in March have been cut in half.
    - Conclusion from these indicators: Investors on average expect an economic recovery will begin later this year and believe the danger of a severe recession is low.
  - Ag prices have diverged, partly reflecting disruptions in food supply chains
    - Live cattle are down 23% since early Feb., lean hogs up 22%.
    - Corn and cotton prices down 17%, rice up 24%.
  - Oil prices
    - WTI front-month contract has bounced back by $60 per barrel from the bizarre negative price on April 20.
    - Apart from that technically driven fluke, U.S. oil prices are still less than half what they were before the pandemic.

- **Federal Reserve Senior Loan Officer Opinion Survey**

  - Survey responses were collected from 66 banks in April; the report was released May 4.
  - The survey asks:
    - How have your credit policies changed in the last three months, looking at a variety of loan types and borrowers?
    - How has loan demand changed?
    - Loan types include C&I, various CRE, various types of residential mortgages and consumer loans.
    - Loan terms include maximum size of credit lines, maximum maturity, cost, spread, risk adjustments, loan covenants, collateral requirements and use of interest-rate floors.
  - On average, loan demand was reported to be weaker, but not for all loan types or all banks.
    - For example, C&I loan demand was stronger among large borrowers.
  - On the supply side, the survey reported the sharpest tightening of lending standards in the 30-year history of the survey.
    - Terms on all loan types have tightened, on balance.
      - Sharpest tightening on CRE, least on residential mortgages.
      - Significant tightening of lending standards on C&I and consumer loans.
    - Large banks (over $50 bn.) are tightening loan conditions more rapidly than mid-sized and smaller banks.

- **Summary comments**
  - The economy may be close to the bottom of its historic contraction but even that is not certain.
  - Financial markets are more buoyant than the economic data flow might suggest.
  - Pervasive uncertainty remains about the timing and strength of the rebound.