CenterState
CORRESPONDENT DIVISION

Market Update

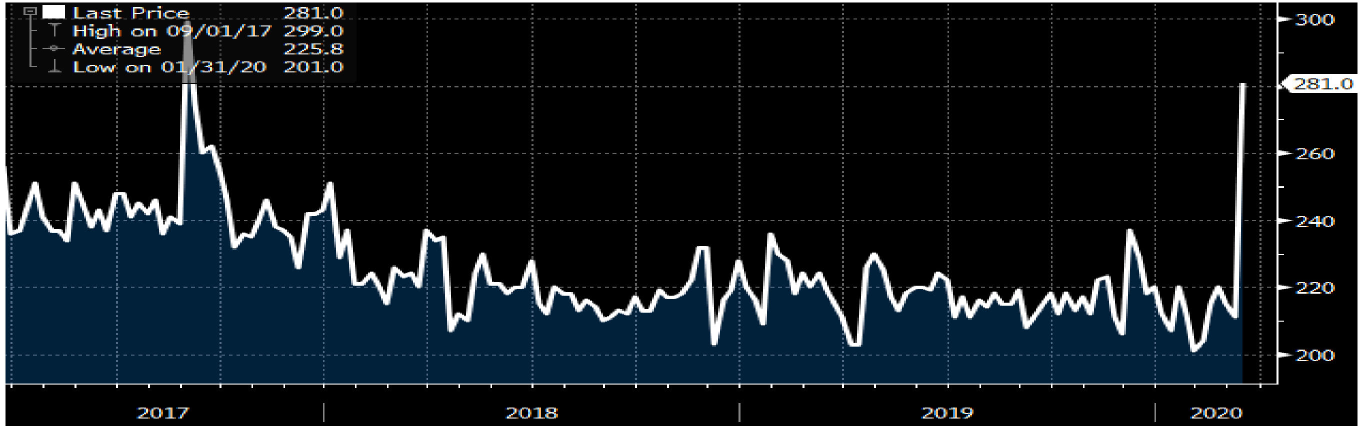
Economic News

March 20, 2020

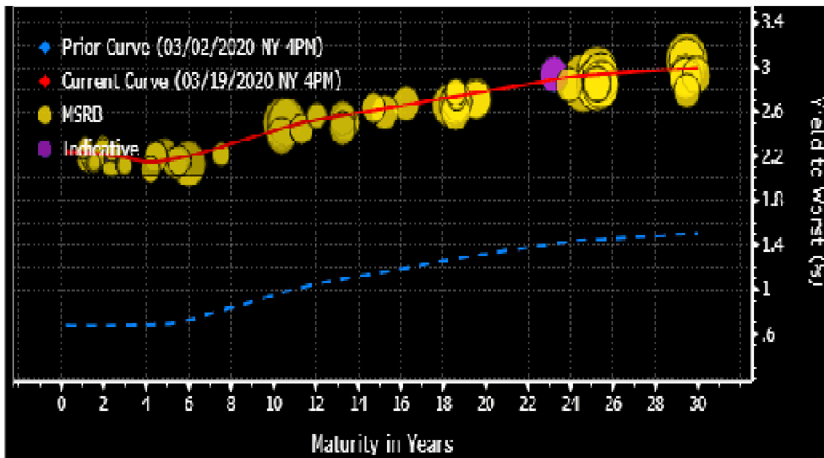
As the virus spreads its way across the U.S., the question turns to how long will this last? You've no doubt seen the charts that compare case numbers by country and across time. Looking at the results from China they started reporting cases in early January and are now taking tentative steps to return to some sense of normalcy, two and half months later. Japan and South Korea seem to be doing better in suppressing new cases and might see a slightly shorter time span. The U.S., however, is following the higher case arc of Italy which indicates the China time-frame might be the best we can achieve. Thus, if we mark last weekend as the effective start of the effort to stem the virus's spread that puts us at the end of May, and more likely June, before we can expect some type of return to normalcy. Let's project then that first quarter GDP will be near 0% and second quarter GDP an ugly –5% to –14%. The question is do we get a bounce in the third quarter as pent-up demand is unleashed? Perhaps, but we suspect there will be longer-lasting damage to many small service businesses that won't survive the two-plus month shutdown, or find it difficult to re-start. Thus, we foresee a positive third quarter but probably not a huge rebound as the economy slowly staggers back to life. The question then becomes if the spread of new cases is stymied by social distancing and warmer spring/summer weather, do outbreaks erupt anew in the cooler months of the fourth quarter along with renewed social gatherings? We think it's possible; thus, we don't see a return to stable GDP growth until a vaccine is made available and that, we're told, may be close to a year.

- If you thought that with the Fed stepping into the MBS market this week with QE purchases totaling more than $60 billion that mortgage spreads would finally tighten against Treasuries, well, you would be wrong. Instead, what we've seen this week is spread widening to levels last seen nine years ago. The chart below tracks the spread of current coupon FNMA 30yr MBS against a blend of 5yr and 10yr Treasuries. Yesterday alone the spread widened by 36bp, the largest single-day increase in seven years as Treasury prices rose while MBS prices fell. The reasons for the widening are varied from fear of a coming supply deluge as refinance applications flood the market, and the fear that durations will extend as increasing numbers of borrowers lose jobs and begin missing payments. With the optics as they are right now, some measure of forbearance on the part of lenders is likely for suddenly struggling homeowners. In any event, for those investors with funds to put to work, the mortgage market offers the widest spreads in years.

- And so it begins. The graph below tracks weekly unemployment claims, and as shown it spiked to 281,000 new claims last week. That's the highest since September 1, 2017 and it's also survey week for the March employment report so the early spike bodes ill for that report, but no doubt a drop in the bucket of what we're about to see over the next 60 to 90 days. The claims number next week will, in all likelihood, spike towards the million mark as the impact of social distancing starts to be felt in a big way. The financial crisis peak was a 665,000 print. Keep in mind too that many of restaurant and bar workers don't qualify for unemployment insurance so the claims numbers, as high as they are bound to be, will still understate the true impact of the economic slowdown. Remember that when you have a chance to patronize spots that are trying to remain open through the coming viral spread.



Muni Market Redemptions Create Value



While market volatility has become common in this era of spreading COVID-19, one sector that has really come under pressure is the muni market. The graph shows the AAA-rated yield scale from March 2 (blue line) to yesterday (red line). As shown, most yields across the curve have risen by around 150bps as individual investors raise cash through mutual fund redemptions attempting to weather the COVID-19 storm. This move reflects the influence retail investors have in muni's as the wealthy sought out one of the few tax breaks after the SALT cap was put in with the 2018 tax cuts. For bank investors, however, these price moves have created the best yields in more than a year.

Market Rates

Treasury Curve	Today	Chg Last wk.	LIBOR Rates	Today	Chg Last wk.	FF/Prime	Rate	Swap Rates	Rate
3 Month	-0.02%	-0.28%	1 Mo LIBOR	0.77%	-0.03%	FF Target Rate	0.00%-0.25%	3 Year	0.566%
6 Month	-0.03%	-0.39%	3 Mo LIBOR	1.12%	+0.35%	Prime Rate	3.25%	5 Year	0.647%
2 Year	0.38%	-0.12%	6 Mo LIBOR	0.95%	+0.21%	IOER	0.10%	10 Year	0.878%
10 Year	0.99%	+0.09%	12 Mo LIBOR	0.89%	+0.14%	SOFR	0.06%		

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