CenterState
CORRESPONDENT DIVISION

Market Update

Economic News

July 15, 2020

While stock investors once again looked at the world through rose-colored glasses yesterday, second quarter bank earnings certainly don't point to V-shaped recovery. The big three of JPMorgan Chase, Citigroup, and Wells Fargo set aside almost $28 billion in loan loss reserves which is second only to the set asides in the last quarter of 2008 at the depths of that financial crisis. The reserves were higher than expectations and were a reflection of the resurgent virus that darkened most of the outlook for the rest of 2020. Jamie Dimon mentioned that because of all the fiscal stimulus, "the recessionary part of this you're going to see down the road." Treasuries seem to be taking to heart Dimon's comments. While stocks rebounded after a rough Monday, Treasuries remained unimpressed and were mostly unchanged on the day. The range trade (0.54%-0.84% for the 10yr) remains in full effect with little on the horizon to change that. The 10yr is currently yielding 0.65%.

The Fed is obviously full of thoughtful thinkers but we've always been impressed with Fed Governor Lael Brainard as one of the most thoughtful of the group. She gave a speech yesterday where she hit on many thoughts regarding future Fed policy in what she called "Navigating Monetary Policy through the fog of COVID-19." She touched on many areas of policy but here are some of the highlights that we suspect could easily become official Fed policy in the near future.

- It is time for the Fed to abandon the policy of preemptively raising policy rates to head off inflationary pressures and to codify this in guidance, "Instead, policy should seek to achieve employment outcomes with the kind of breadth and depth that were only achieved recently in the last recovery."
- She expressed concern about the risks of a second wave, which "could weigh on the pace of the recovery and could even presage a second dip in activity. A broad second wave could re-ignite financial market volatility and market disruptions at a time of greater vulnerability. Nonbank financial institutions could again come under pressure, as they did in March, and some banks might pull back on lending if they face rising losses or weaker capital positions."
- "Some high-frequency indicators tracked by Federal Reserve Board staff (including mobility data and employment in small businesses) suggest that the strong pace of improvement in May and the first half of June may not be sustained."
- "With some of the fiscal support measures either provided as one-off payments or slated to come to an end in July, the strength of the recovery will depend importantly on the timing, magnitude, and distribution of additional fiscal support.
- "With the policy rate constrained by the effective lower bound, forward guidance constitutes a vital way to provide the necessary accommodation. For instance, research suggests that refraining from liftoff until inflation reaches 2 percent could lead to some modest temporary overshooting, which would help offset the previous underperformance. Balance sheet policies can help extend accommodation by more directly influencing the interest rates that are relevant for household and business borrowing and investment."

That last bullet point is perhaps the most important and echoes a point she has made even prior to the pandemic and that is the Fed shouldn't hike rates until we are at least above the 2% inflation target and at full employment as well. She adds to that here the possibility of using yield curve caps to "influence the interest rate that are relevant for households and business borrowings." Seems like zero lower bound, QE and possibly yield curve caps for as far as the eye can see.

Supplementary Unemployment Benefits—The Latest Political Football

One of the points made by Fed Governor Lael Brainard that we highlighted in the last section was the stimulus measures that were deployed delayed the worst impact of the recession. But with some of the benefits set to expire at the end of this month, namely supplementary unemployment benefits, a renewed economic slowing could occur, especially with the virus surging in vast areas and school and cooler fall temperatures looming around the corner. As Brainard said, "the strength of the recovery will depend importantly **on the timing, magnitude, and distribution of additional fiscal support."**

In that regard, senior administration officials have begun signaling their willingness to approve a narrow extension of the enhanced unemployment benefits that provide a $600/week increase to unemployment benefits but expire in two weeks. When you consider most state unemployment payments are $250-$400/week, loss of that supplementary payment could stall the economic rebound given 30 million people are currently collecting the benefit.

The benefit has become the subject of a wrestling match as Republicans want to, at least, reduce the benefit going forward with some calling for its elimination prior to the spiking of virus cases and the resulting slowing in economic reopenings. With that new reality, more talk has centered on reducing the amount of the benefit with Treasury Secretary Mnuchin wanting to limit it to no more than 100% of the workers pay when employed. How that would be administered is problematic so most revised plans call for a benefit reduction to $200-$400/week. Democrats are largely looking for the $600/week benefit to be extended. Both sides are likely to agree to another round of stimulus checks to all Americans which would smooth the way politically for getting a bill passed.

Lawmakers will have little time to resolve the competing positions. Republicans have discussed the issue internally but have not reached a unified position on the matter and there are no serious bipartisan discussions underway to resolve the impasse. The Senate comes back in session on July 20, five days before the enhanced unemployment benefit expires in 49 states. They expire in New York state on July 26.

Given month-end is approaching and the lack of substantive compromise discussions the most likely path seems a short-term extension of the existing $600/week benefit giving legislators more time to craft a more comprehensive measure. With the virus spiking in many areas, and slowing if not stopping reopening plans, letting the benefit expire seems the least likely outcome. But many recipients have been bracing for just such an outcome as the savings rate in the April and May Personal Income and Spending reports were 32% and 23%, respectively. Both record-breaking rates and due largely to the UI benefit and one-time stimulus checks.

Agency Indications— FNMA/FHLMC Callable

Maturity (yrs)	2 Year	3 Year	4 Year	5 Year	10 Year	15 Year
0.25	0.28	0.42	0.57	0.73	1.43	1.84
0.50	0.27	0.41	0.55	0.70	1.33	1.74
1.00	0.25	0.38	0.50	0.65	1.26	1.66,
2.00	-	0.30	0.44	0.57	1.13	NA
3.00	-	-	-	-	1.05	NA
4.00	-	-	-	-	0.98	NA
5.00	-	-	-	-	0.92	NA
10.00	-	-	-	-	-	NA