



MORNING BRIEFING

April 1, 2020

After the Pandemic

Check out the accompanying [chart collection](#).

(1) After the Great Virus Crisis, how will the economy be different? (2) A steep global recession with massive fiscal and monetary stimulus. (3) Demand likely to remain in shock longer than supply after GVC. (4) Moving supply chains closer to home is necessary and costly. (5) From just-in-time to just-in-case. (6) Aggregate demand is in shock. (7) Roundtrip for China's M-PMI. (8) As parts supplies increase in China, demand for them falls everywhere else. (9) Massive job losses and plunging consumer confidence ahead. (10) Fiscal and monetary policies to the rescue, again?

US Economy I: Supply & Demand Shocks. The global economy is in a precarious condition. Governments and companies around the world have shut down critical segments of the global economy to slow the spread of COVID-19 and end the Great Virus Crisis (GVC). Fiscal authorities are implementing massive stimulus programs, the largest in history, to lessen the blow to the economy. Instead of dropping money from helicopters, central bankers are doing so from B-52 bombers.

But what will the economy look like after the pandemic has peaked and the restrictions are lifted? Will economic growth rebound strongly back to normal or recover slowly and remain relatively depressed? Will inflation rise or fall? Debbie and I are expecting a strong initial rebound during Q4-2020 and the first half of next year, but relatively slow growth beyond mid-2021. Inflation is likely to trace out a similar pattern.

It all depends on which of the GVC's two economic shocks outweighs the other: the supply or the demand shock. In our view, the short-run supply constraints caused by the pandemic will be overcome over time, but the aftershocks to demand may persist long after the virus dies out. Consider the following:

(1) *Supply shock.* The virus has given more credibility to Peter Navarro's view that trade is not just about business. It is also a matter of national security, including now public health. In other words, it's not just business; it's personal too! Navarro is President Trump's trade adviser. The

President has repeatedly referred to the pandemic as a war against an invisible enemy, “the China virus.” The health crisis has clearly shown that the US is too dependent on critical medical imports, which have been hard to get.

Multinational companies started looking to move their supply chains away from China before the GVC as the US-China trade dispute escalated during 2018 and 2019. Now as a result of the widespread and severe disruptions to global supply chains resulting from the pandemic, they are likely to move even faster. Initially, shifting supply chains to countries other than China will be less efficient and more costly for companies. That could force companies to boost their prices or take a hit to their profit margins. But these most likely are short-term problems as companies readjust to a new post-pandemic normal. Technologies that can help to keep supply chains cost efficient while making them more reliable by bringing them home (or closer to home) are sure to be post-pandemic winners.

In any case, just-in-time inventory management undoubtedly will be replaced by just-in-case inventory management as a result of the GVC.

(2) *Demand shock*. Lots of businesses already have closed their doors, and it’s not just because governments have forced them to do so. It’s also because customers who are either frightened or practicing social distancing (or both) are not showing up. But when consumers are given the all-clear signal to go out, will everyone rush back to the malls, restaurants, and theaters? Any post-pandemic pent-up demand boom may be short-lived.

The longer the shutdown continues, the higher the likelihood that more people will permanently lose their jobs and their savings will be seriously depleted. Consumers will be inclined to spend less and save more, resulting in weaker aggregate demand growth and lower consumer prices. If the shutdown is not long lasting, a quick economic recovery is still possible. For now, the national guidelines for social distancing in the US have been extended to seven weeks—from [March 16](#) to April 30 (if no more time is added). If the restrictions last beyond June, we think aggregate demand could be structurally weakened.

To prop up aggregate demand during the crisis, monetary and fiscal policymakers are flooding the markets with liquidity. Their responses so far suggest that they believe that doing too much may be better than doing too little. However, they can’t make the pandemic go away.

US Economy II: Assessing the Damage to Supply Chains. Dun & Bradstreet has [reported](#) that 938 of the Fortune 1000 companies have at least one tier 1 or tier 2 supplier whose operations have been disrupted by COVID-19. Many of those suppliers are either in China or depend on China for their supplies.

When the virus outbreak occurred in China, mass quarantines forced factories to shut down. China's manufacturing activity collapsed during February, with the M-PMI plunging to 35.7 from 50.0 in January ([Fig. 1](#)). Yesterday, we learned that March's M-PMI rebounded dramatically to 52.0—the highest since September 2017—suggesting that China has succeeded in beating the virus.

Nevertheless, one immediate consequence of the virus disruption is that many multinationals now are assessing their supply-chain resiliency and reliability. Many already had begun to [diversify](#) their supply chains away from China before the pandemic. “Coronavirus Could Be The End Of China As A Global Manufacturing Hub” was the title of a March 1 *Forbes* [article](#). Two-thirds of 160 US-based executives recently [surveyed](#) by Foley & Lardner LLP said that global trade tensions were causing them to move manufacturing operations from another country to Mexico. The July 14 *WSJ* [observed](#) that Asian countries where production costs are low—as in Vietnam, India, Taiwan, and Malaysia—already have experienced significant increases in exports to the US. Some global companies are also building up their supply-chain strength by leveraging [technology](#) like new 3D printing capabilities.

But as China seems to be recovering, the US and other regions have yet to see the peak of the pandemic. So global supply disruptions could worsen until the health crisis abates. At that point, it will take time to restart or reconfigure supply chains, but the supply challenges should be short-lived. Companies now have a big incentive to improve their supply-chain resiliency by physically moving operations and investing in technologies that ensure the reliability of their supply at times of crisis.

Let's review some of the supply disruptions so far:

(1) *Infected industries.* Many companies have been running their inventory systems based on just-in-time models, leaving them vulnerable to the virus's supply shocks for all kinds of goods. Shortages of face masks, hand sanitizers, and toilet paper are salient examples of demand outpacing supply as consumers seek to protect themselves from the virus. On February 27, the US Food and Drug Administration [warned](#) that the outbreak “would likely impact the

medical product supply chain, including potential disruptions to supply or shortages of critical medical products in the U.S.”

On an industry basis, parts for technology and consumer electronics products have been the hardest to come by. Apple was one of the first multinational corporations to warn of global supply shortages of iPhones and AirPods resulting from the closure of its suppliers’ factories in China, [according](#) to the March 8 *WSJ*. The auto and pharmaceutical industries are also exposed to the supply challenges. Companies that have warned about virus-related supply-chain disruptions, according to the *WSJ* article, include Hanesbrands, Ralph Lauren, Fiat Chrysler, General Motors, Hyundai, Nintendo, LG Electronics, and Sanofi.

(2) *Worried manufacturers*. According to a March 11 Institute of Supply Management (ISM) [survey](#) on COVID-19, nearly 75% of companies report supply-chain disruptions due to coronavirus-related transportation restrictions. The ISM produces a monthly survey of manufacturing supply executives in the nation. Its February 2020 [report](#), full of commentary about the pandemic’s supply-chain disruptions, said: “Global supply chains are impacting most, if not all, of the manufacturing industry sectors. ...Suppliers continue to struggle to deliver ... Concerns about current and ongoing reliable Asian supply dominated the comments from panelists.”

(3) *Woeful small businesses*. The National Federation of Independent Businesses polled a random sample of 300 of its 300,000 members that employ up to 120 workers regarding COVID-19 in early March, [reported](#) CNBC. By then, 23% already had been negatively impacted by the virus, and 39% of those negatively impacted were experiencing supply-chain disruptions.

(4) *Slowed supplier deliveries*. Global supply strains are showing up in the US data. The ISM’s Supplier Deliveries Index is an inverse leading [indicator](#) that rises when deliveries slow as suppliers face impediments to speedy service. Directionally, supplier deliveries [slowed](#) over the previous four months. In February, the index reached its highest level since November 2018, meaning that supplier deliveries slowed at an increasingly faster pace ([Fig. 2](#)).

US Economy III: Assessing the Damage to Aggregate Demand. Non-essential businesses have been told to cease operations. Non-essential workers have been told to work from home if possible. But not everyone can work from home. Furloughed and fired workers are uncertain about when they can go back to work and whether their jobs will still be available then. Many

are forced to dip into their savings, if any. Consider these troubling developments that may still weigh on demand after the crisis is over:

(1) *Soaring unemployment*. Before the GVC, record numbers of people were employed in industries that have mostly shut down, including retail trade, hotels & motels, air transportation, restaurants & other eating places, arts, entertainment & recreation, and office of real estate agents & brokers ([Fig. 3](#)). GVC-related job losses could push the unemployment rate higher than the post-depression-era peak near 25.0%, according to a recent Fed paper discussed in a March 30 CNBC [article](#). The coming tsunami of job losses was apparent in the initial unemployment claims, which jumped to 3.28 million during the March 21 week.

(2) *Plunging confidence*. During March, the Consumer Sentiment Index dropped 11.9 index points, the fourth largest one-month decline in nearly a half century ([Fig. 4](#)). The Consumer Confidence Index also dropped during March, to 120.0 from 132.6 the month before ([Fig. 5](#)). Much bigger drops are expected in the months ahead as unemployment surges and household income falls.

US Economy IV: Will Policy Shocks Shock & Awe? If the virus is overcome in a matter of weeks, consumers and businesses may be more apt to return to business as usual. If that happens, aggregate demand could pick up steam and inflation could begin to significantly heat up, buoyed by all the fiscal and monetary stimulus. But if the GVC drags on for months, the less effective may be fiscal and monetary policies in combating a major economic downturn.

The JPMorgan Chase Institute, the bank's in-house think tank, [studied](#) what happened to local economies after natural disasters. It showed that the longer unemployment remained elevated after a disaster, the worse the economic toll was on consumer incomes and spending as consumers lost hope. That's why policymakers have opted to go so big and so fast with the stimulus. Consider the following:

(1) *Unlimited debt*. The massive \$2 trillion stimulus package President Trump signed on March 27 should triple the 12-month forward deficit from \$1 trillion to \$3 trillion, not even accounting for the impact of lower revenues coming in. Fiscal authorities have taken the stance that the debt problem will just have to be dealt with later. But there is a case to be made that it needn't be dealt with at all.

Unwittingly, fiscal policymakers may be embracing the offbeat school of thought called “Modern Monetary Theory” (MMT). Its advocates argue that when sovereign governments borrow in a national currency that they alone issue, that debt has no risk of default, as the governments can always print more money to make good on future promises. MMT suggests that governments can borrow without limits until inflation becomes a problem. Inflation only becomes a problem when resources become so constrained that prices rise.

Given the size and scope of the recent fiscal aid and monetary stimulus, we can safely say that neither the federal government nor the Fed is concerned about inflation!

(2) *Limits to infinity and beyond.* The economic relief funds will bolster the Fed’s new emergency lending facilities, which will inject near \$4 trillion into the economy. In other words, the Fed is providing helicopter money, and the Treasury is providing the capital to leverage the Fed’s lending facility to lend \$4 trillion! The choppers have been replaced with B-52 bombers, dropping trillions of dollars on the economy. Since November 2019, the Fed’s balance sheet has increased \$1.2 trillion through the March 25 week to a record \$5.2 trillion.

Since the GVC hit, the Federal Open Market Committee has cut the federal funds rate and reserve requirement ratios to zero. It has also launched another QE program with no set purchasing schedule, no upper limit, and no end date. And it has created a structure to provide for the Fed to purchase corporate bonds. In short, the Fed has provided a nearly unlimited supply of ultra-easy monetary policy, much as the Bank of Japan (BOJ) has done for years now.

A March 30 [*Economic Letter*](#) from the San Francisco Fed discussing the impact of the health crisis on demand concluded (emphasis ours): “[T]he spikes in uncertainty triggered by the COVID-19 pandemic will contribute to a protracted increase in unemployment and a significant decline in the inflation rate in the United States. The Fed’s decision in March to cut the federal funds rate to a near-zero level can *partly* cushion these demand-like effects resulting from the more uncertain environment.”

CALENDARS

US: Wed: ADP Employment -150k, ISM & IHS Markit M-PMIs 45.0/48.0, ISM Prices Paid Index 41.6, Construction Spending 0.5%, MBA Mortgage Applications, DOE Crude Oil Inventories. **Thurs:** Jobless Claims 3.0m, Trade Balance -\$40.0b, Challenger Job Cuts, EIA

Natural Gas Storage. (DailyFX estimates)

Global: **Wed:** Eurozone, Germany, France, and Italy M-PMIs 44.6/45.5/42.9/41.0, Eurozone Unemployment Rate 7.4%, Germany Retail Sales 0.1%_{m/m}/1.5%_{y/y}, UK M-PMI 47.0. **Thurs:** China Caixin NM-PMI 39.5, Germany & France Sovereign Debt to be Rates by S&P. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500 Buybacks ([link](#)): S&P 500 quarterly buybacks rose 3.2% q/q during Q4-2019 to a three-quarter high of \$181.6 billion from Q3's \$175.9 billion. They remain 18.6% below the record high of \$223.0 billion during Q4-2018. The \$181.6 billion reading is still the sixth-highest quarterly buyback amount on record, dating back 88 quarters to Q1-1998, and is back above the prior cycle's record high in Q3-2007. The four-quarter sum of buybacks was down for a third straight quarter for the first time since it fell for five quarters through Q2-2017. It fell 5.4% q/q to \$728.7 billion from \$770.1 billion, and is down 11.5% from a record high of \$823.2 billion in Q1-2019. S&P 500 buybacks in Q4-2019 edged down to 0.68% of the total market capitalization for the S&P 500 from 0.71% in Q3-2019. That compares to a six-quarter low of 0.67% in Q2-2019, a 29-quarter high of 1.06% in Q4-2018, and the record high of 1.28% during Q3-2007.

S&P 500 Sectors Buybacks ([link](#)): Buybacks rose q/q during Q3-2019 for six of the 11 sectors and fell for five, down from seven rising and four falling during Q3-2019. That compares to three rising and eight falling during Q2-2019 and Q1-2019, and eight rising and three falling during Q4-2018. The q/q percentage gainers among the 11 sectors during Q4-2019: Consumer Staples (up 25.6% q/q to \$9.4 billion from \$7.5 billion), Health Care (25.2%, to \$20.0 billion from \$16.0 billion), Communication Services (24.1%, to a record high of \$13.7 billion from \$11.0 billion), Information Technology (6.5%, to \$52.4 billion from \$49.2 billion), Financials (5.1%, to a record high of \$50.2 billion from \$47.8 billion), and Energy (3.0%, to a four-quarter high of \$5.0 billion from \$4.9 billion). The q/q decliners: Utilities (-73.1%, to a seven-quarter low of \$211 million from \$784 million), Materials (-42.3%, to \$3.1 billion from \$5.4 billion), Real Estate (-17.5%, to \$573 million from \$694 million), and Consumer Discretionary (-9.5%, to \$16.6 billion from \$18.4 billion). Tech accounted for the biggest portion of total S&P 500 buybacks in Q4-2019 for a ninth straight quarter, and rose to a 29% share from 28% during Q3-2019. Tech had held the top spot for 16 straight quarters through Q3-2016 before trading places with Financials and Health Care for four quarters through Q3-2017.

Financials' share was second for a sixth straight quarter, as it improved to a 14-year high of 28% from 27% in Q3-2019.

S&P 500 Cash Return & Buyback Yield ([link](#)): During Q4-2019, the S&P 500 companies continued their long-established trend of spending more on buybacks than dividends, as buybacks of \$181.6 billion outpaced the quarterly dividend payments of \$126.0 billion. Buybacks have exceeded dividends in 57 of the past 62 quarters back to Q3-2004, except during the financial crisis from Q4-2008 to Q4-2009, when all sectors cut buyback spending drastically. While the quarterly buyback and dividend amounts were both higher q/q in Q4-2019, the four-quarter sum of buybacks and dividends, or cash returned to investors, fell for a third straight quarter to a five-quarter low of \$1.212 trillion from \$1.247 trillion during Q3-2019, and is now 5.7% below its record high of \$1.285 trillion during Q1-2019. The S&P 500's buyback yield fell to a seven-quarter low of 2.72% from 3.12%, and is down from a 29-quarter high of 3.84% in Q4-2018. The dividend yield fell to 1.81% from 1.93%. Adding both Q4-2019 figures together, the buyback + dividend yield (or cash return) dropped to a seven-quarter low of 4.53% in Q4-2019 from 5.05% in Q3-2019, and is down from a 29-quarter high of 6.00% during Q4-2018.

US ECONOMIC INDICATORS

Consumer Confidence ([link](#)): Confidence sank to a 32-month low in March, and Lynn Franco, senior director of economic indicators at The Conference Board, noted: "March's decline in confidence is more in line with a severe contraction—rather than a temporary shock—and further declines are sure to follow." The consumer confidence index dropped from 132.6 in February to 120.0 in March—higher than consensus estimates of 110.0. The expectations (to 88.2 from 108.1) component dropped sharply last month, while the present situation (to 167.7 from 169.3) component remained relatively strong, though Franco warned "the intensification of COVID-19 and extreme volatility in the financial markets have increased uncertainty about the outlook for the economy and jobs." Consumers' appraisal of current business conditions barely budged last month, with both the percentage of respondents saying business conditions are good (to 39.6% from 39.7% in February), and those saying they are bad (11.4 from 10.8) little changed from February. In the meantime, there was a crack in expectations, with the percentage expecting business conditions to get better (18.2 from 20.6) slipping and the percentage expecting conditions to get worse (14.9 from 7.2) doubling. As for the labor market, the percentage of respondents saying jobs are plentiful (to 44.9% from 46.5%) slipped 1.6ppt in March, while those saying jobs are hard to get was unchanged at 13.9%. The job outlook,

however, was significantly less optimistic, with those expecting more jobs (15.5 from 16.6) declining 1.1ppt, while those anticipating fewer jobs (17.1 from 12.0) jumped 5.1ppts—the biggest monthly move up since the end of 2012.

GLOBAL ECONOMIC INDICATORS

Eurozone CPI Flash Estimate ([link](#)): March's CPI headline rate is expected to slow for the second month, to 0.7%, after accelerating the prior three months from 0.7% in October (which was the lowest since November 2016) to 1.4% in January. It would be the 16th consecutive month the headline rate was below 2.0%. Meanwhile, the core rate is expected to edge down from 1.2% to a six-month low of 1.0%. Looking at the main components, food, alcohol & tobacco (to 2.4% from 2.1% y/y) is expected to record the highest rate, followed by services (1.3 from 1.6)—with the former accelerating and the latter decelerating; the rate for non-energy industrial goods is forecast to hold at 0.5%. Meanwhile, the rate for energy prices is expected to fall again in March, to -4.3% y/y—down from January's 1.9%.

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