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DYNAMIC ECONOMIC STRATEGY



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Road to Recovery Continues

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Dynamic Economic Strategy

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Cycle Signals: Slower But Still Solid 4Q Growth

- **Jobless Claims—Steady Declines Signal Steady Job Gains**
 - Continuing claims also down
 - Claims represent less than one percent of pre-crisis employment
 - Employment: September gain reflects re-openings—especially for Leisure & Entertainment
- **ISM-Manufacturing—Signals of Recovery**
 - ISM- Man 55.4 (Sep.), above 1Q average, orders, supplier deliveries, and production above break even
 - Employment moves upward but below 50 breakeven
 - Prices paid above 60 break even-deflation fears diminished
- **Factory Orders (August)—up last three months**
 - Non-defense, ex-aircraft, orders and shipments both up
- **Building Permits—Solid Gain September: Single family up last three months**
 - Pending Home Sales lower in Sep. but +20% YOY, Home prices up 5.7% YOY
- **Confidence (Conf Bd) October lower: present-up and expectations-lower**
 - Jobs plentiful up a touch, jobs hard to get lower



Cycle Signals: Financials Lead the Real Economy— Indicate Continued Expansion

- Equity Market: SPX 500 @ 3269.96(10/30), up 1.2% YTD
 - Global Impact---One-third of S&P 500 revenues earned abroad
 - OECD outlook: Global growth down 4.5% 2020, up 4% in 2021 more than 2009
- Dollar Index: DXY @ 93.88 (10/30), down 2.6% YTD, flight to safety trade over
 - Yet trade-weighted dollar still above the average of 2016-2019
- Corporate Profits (2Q 2020): Pre-tax down 11% YA 1Q, down 18% versus YA
 - compared to 3.4% gain in 2019
- Ten-Year (0.79% Oct. 30) and Two-Year (0.16% Oct. 30) : Yields up slightly, more rational pricing
- Leading Index: up last five months as of August, steady improvement
- Quality Spreads: IG (AA) and ICE HY Master spreads
 - both up recently, better pricing of risk after Fed buying



So What Does All This Mean? Recovery at a Pace Dictated by Government Shutdowns

- **Four Sector Model: No V-shaped Recovery—Still the Theme**
- Risk –volatility in existing paradigm--versus uncertainty—China virus changes the paradigm for global growth, trade and commodity prices---very true.
- Growth: Continued declines in jobless claims and rise in jobs signal recovery
 - FRB NY Nowcast, 3% \$Q, 5% 1Q 2021
 - China recovery, Euro 3Q rebound after shutdowns lifted- but U.K., Japan continues weak
- Inflation: Core PCE Deflator (+1.5%, YOY) picking up, but still below the Fed's 2% target
- Interest Rates: Benchmark UST 10-Y, 2-Y rates very low
 - Near record lows indicate mispricing of assets, underpricing of risk
- Corporate Earnings: Pre-tax profits slowdown in 2019, but decline in 2020
- Dollar: Year-to-date now down, flight to safety trade over



Financial Benchmarks

- **Bank Credit**

- Net Percent Tighter CRE up 3Q, Increased Spreads for Loans
- Net Percent Tighter Standards and Consumer Demand Down

- **Corporate Indicators**

- Debt to Net Worth up 1Q, 2Q, above 2019 average
- Short-term debt up relative to Long-term debt
- Pre-tax profits slowdown 1Q, 2Q 2020, headed for decline in 2020
- Dollar Value down Year-to-date, flight to safety eliminated
- Commodity Prices---WTI lower, Copper up over last three months
- Credit spreads slight increase—better pricing of risk
- CBO deficit, % of GDP average 2021-2030 above 2021-25



Not a Return to Normal for Many—Still a Theme

- **CBO downshifts potential growth to 1.6% in 2020 from 1.9% last year**
- **Job Losses by Education- Shutdowns Impact Significant**
- **Commercial Real Estate—trends in place now accelerated**
 - Retail—consumer on-line shopping
 - Work from home
 - Suburban Office space more—central city less
- **Technology assisted-security/communication/shopping**
- **Sustained Lower inflation, continued Fed/ECB easing**
- **Lower Credit Spreads, Central Bank buying favors debt finance**



Challenge to Return to Normal

- **Non-Bank Finance Continues to Gain Market Share**
 - Bank Loans to Non-Financial Corp 30% 1982, 12% 2017
 - Asset managers in \$300bn drive to build private lending funds
- **Corporate Finance**
 - Pandemic debt binge creates new generation of 'zombie' companies 09 14 2020 FT
 - Upbeat bond market at odds with banks over scale of Covid risks
 - Earnings Season: A Disappointing Encore WSJ 10/07/2020
- **Credit Cycle**
 - Leveraged loans: the unbearable liteness of covenants, 10/21/20 FT
 - Risky PIK deals pitched by private equity to yield-hungry investors 10/23/20 FT

