Financial Markets and Updated Economic Forecasts

as of 3/23/2020

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Federal Reserve

Please see SSW's March 23 morning release titled, "Fed Alert: Fed Emergency Decision".

10 Year U.S. Treasury Market

When the Fed announced their 100 bps Fed Funds rate cut on Sunday, March 15, the 10-year U.S. Treasury rallied with the rate dropping from near 1.00% to 0.60%. During the week, the 10-Year sold off and rates rose to 1.25% by Thursday, March 19. Over the past four days, the 10-Year has reversed again with the rate declining to 0.71% this morning (Monday).

U.S. Equity Markets

While market volatility remained high last week, investors reacted negatively to most Federal Reserve market intervention. The market is showing stability this morning in the wake of the Fed's most recent announcement on open-ended quantitative easing. The next test for the market will be the relief package currently being debated in Congress.

We expect volatility to remain high in the next two to three weeks as the market absorbs news on new infection rates in the U.S. as testing continues to ramp up. The market will be very sensitive to any positive news of a decline in the rate of infection or any significant biological advancement leading to possible treatment.

We also expect jobless claims to be watched closely by all investors. Bloomberg consensus is for 1.45 million in new unemployment claims, but this number may increase in the days prior to the March 26th release as more economists update their internal models. For instance, David Choi, an economist from Goldman Sachs, says initial claims for the week ending March 21 may jump to a seasonally adjusted 2.25 million. His analysis is based on recent anecdotes from press reports as well as company announcements. Over 30 states have provided preliminary data.

Goldman Sachs Commentary

Goldman Sachs is now is forecasting a 24% decline in economic activity next quarter, compared to their previous forecast for a 5% decline. That's because U.S. economic data (specifically manufacturing data) have already started to miss economist estimates, even before Americans started to stay home to avoid spreading the coronavirus. A drop of that size would set a record - it would be nearly 2 1/2 times the 10% drop seen in 1958. "Early data points over the last week strengthen our confidence that a dramatic slowdown is indeed already underway," the Goldman Sachs economist Jan Hatzius wrote in a Friday note.

There are three main reasons Goldman slashed its GDP forecast. The first is that the firm expects spending in face-to-face service industries to take a more severe hit as consumers are increasingly encouraged to practice social distancing and stay at home. Second, Goldman is forecasting a major contraction in manufacturing, with reduced domestic demand for non-food goods; reduced foreign demand for US goods exports; supply-chain disruptions; and plant closures.

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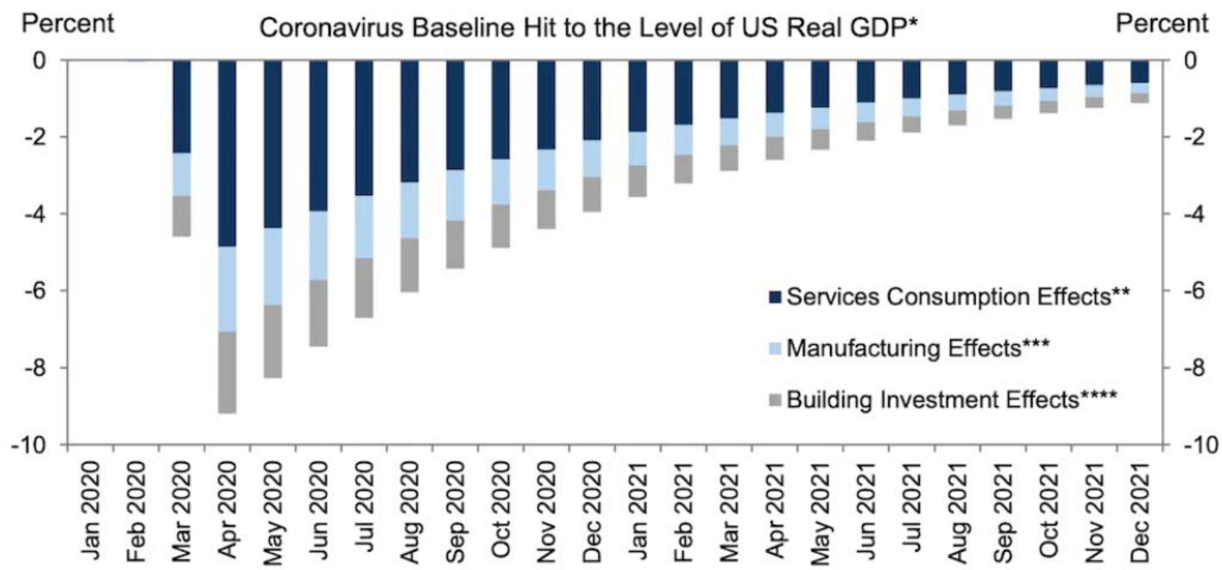
The firm also said it foresees a slowdown in the US housing sector, from construction through real estate, similar to data in Asia. Goldman said the hits would lower US GDP by as much as 10% in April. It now expects full-year growth in the US of -3.8% on an annual average basis.

Exhibit 2: We Expect a Nearly 10% Peak Hit to the Level of GDP in April That Fades Only Gradually



* Relative to a counterfactual of 1.75% potential growth.
** Includes cutbacks to consumption categories requiring face-to-face interaction.
*** Includes reduced domestic and foreign demand for goods, supply chain disruptions, and plant shutdowns.
**** Includes cutbacks to structures investment, homebuilding, and home sales.

Goldman Sachs

The firm expects that after April that drag on the economy will gradually fade by about 10% per month. "While the exact timing is highly uncertain and relapses are plausible, the assumption of a gradual recovery reflects the potential contributions from factors such as effective mitigation and testing actions, weather effects, medical breakthroughs or adaptation by firms and consumers," Hatzius said, adding that the slow pace of recovery even in 2021 would mean longer-lasting scarring for businesses and workers. The downward revision in growth also sharply increased Goldman's unemployment-rate forecasts. The firm expects the unemployment rate to increase to 9% from 3.5% over the next couple of quarters.

JPMorgan Commentary

JPMorgan Chase & Co. said last week it expects GDP to shrink 14% in the April-June period. JPMorgan says the bottom fell out of its global GDP growth forecast this week as it revises numbers across the board. The firm slashes its view for Q1 global GDP to -12% vs. -1.5% prior forecast. U.S. GDP is seen falling 4.0% in Q1 and Europe GDP is forecast to drop 15.0%. "We now think activity will contract more severely across major economies as the virus shuts down activity in major sectors. Following a recession in 1H20, we still look for a rebound in 3Q."

JPMorgan now believes that China's economy will shrink by 40% compared to the previous quarter between January and March, the biggest contraction recorded over the past 50 years at least. The shock to the United States and Europe, meanwhile, is expected to be concentrated between April and June as daily life grinds to a standstill. The bank thinks US GDP will shrink an annualized rate of 14% in the second quarter, far worse than in the fourth quarter of 2008, which yielded the steepest contraction of the Great Recession.

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JPMorgan predicts this will force the US unemployment rate up from 3.5% to 6.25% by the middle of the year, before falling to 5.25% by the end of 2020.

The situation looks even worse in Europe, which is now the epicenter of the pandemic. The eurozone economy is forecast to shrink 22% during the second quarter, while the UK economy is expected to contract 30%.

Morgan Stanley Commentary

Morgan Stanley economists said the coronavirus will inflict a deeper recession on the U.S. than previously expected, including a record 30.1% drop in gross domestic product in the second quarter. Less than a week since forecasting a 4% contraction in April through June, the economists led by Ellen Zentner said they now anticipated a steeper drop and that unemployment will average 12.8% and consumption will fall 31% in the quarter. “Economic activity has come to a near standstill in March,” the economists said in a report to clients on Sunday. “As social distancing measures increase in a greater number of areas and as financial conditions tighten further, the negative effects on near-term GDP growth become that much greater.” The Morgan Stanley team predicts GDP will fall 2.4% in the current quarter, but will begin to recover in the third quarter. Overall, they project the U.S. economy to contract 2.3% on a fourth quarter to fourth quarter basis in 2020, taking full-year global growth down to just 0.3%.

Global Interest Rates (as of 8:25 am on 3/23/2020)

10 Year Government Rates	
Brazil	8.82%
Mexico	7.38%
India	6.35%
Greece	2.38%
South Korea	1.66%
Italy	1.59%
Singapore	1.53%
Hong Kong	1.06%
Portugal	0.95%
New Zealand	0.92%
Australia	0.89%
U.S.	**0.86%**
Canada	0.79%
Spain	0.75%
U.K.	0.48%
France	0.09%
Japan	0.05%
Netherlands	-0.13%
Germany	-0.38%
Switzerland	-0.46%