Financial Markets and Updated Economic Forecasts
as of 3/30/2020

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Federal Reserve

Comments from Capital Economics

"The Fed's balance sheet has ballooned by more than $1 trillion in the past three weeks, reaching $5.2 trillion this past Wednesday. Last week alone, it bought close to $350 billion of Treasury securities, made $50 billion in discount window loans to banks, extended $28 billion via the primary dealer credit facility, $31 billion through the money market mutual fund loan facility and boosted its dollar swaps with other central banks to $206 billion."

10 Year U.S. Treasury Market

The 10-Year UST was more range bound last week versus recent weeks fluctuating between 72 and 88 bps. After a rally and mid-day sell off on Tuesday, the market matched the path of the equity markets in Tuesday, Wednesday and Thursday rallying from 86 bps to 78 bps. We have opened with a stronger mood today with the 10-Year at 65 bps (8:00 am CST).

Overall, the Federal Reserve's QE actions have seemed to calm the volatility of the bond market. Initially pundits said that unlimited QE will open the door for future inflation (or stagflation), but the market seemed to shake off those sentiments or believe that is a worry for much later down the road.

U.S. Equity Markets

Equity investors found comfort in the Federal Reserve's and Congressional action last week. Mid-week saw the largest three-day rally since the 1930s. Pundits opined the price action was fueled by short-covering increasing the point movement. Friday's decline was generally expected with some investors taking profits, others seeing it as an opportunity to lower exposure and still others reducing long positions over a weekend period with heightened risk of negative news.

The medical community still believes the United States is several weeks away from seeing the apex of coronavirus infections. With that overhang, investors may be leery about making a hard commitment into equities though there are many attractive offerings. With so many unanswered questions about where economic output will be in six to twelve months, investors are struggling with predicting corporate revenues and earnings.

Capital Economics Commentary

• We now expect second-quarter real GDP to fall at a 40% annualized pace, with employment declining by 14 million and the unemployment rate spiking to 12%. That 40% annualized decline in GDP is significantly larger than our previous forecast of a 10% fall. But the latter was based on a view that the number of cases nationally would peak in the tens of thousands. As it stands now, if the number of cases continues to double every three days, New York alone will have more than 100,000 cases in less than a week's time. The virus will inevitably spread aggressively to other states requiring widespread economic closures to try and contain it and limit the number of deaths. Admittedly, our forecast is slightly more pessimistic than other US forecasters (at least today), but it is broadly in line with the impact we expect in other countries

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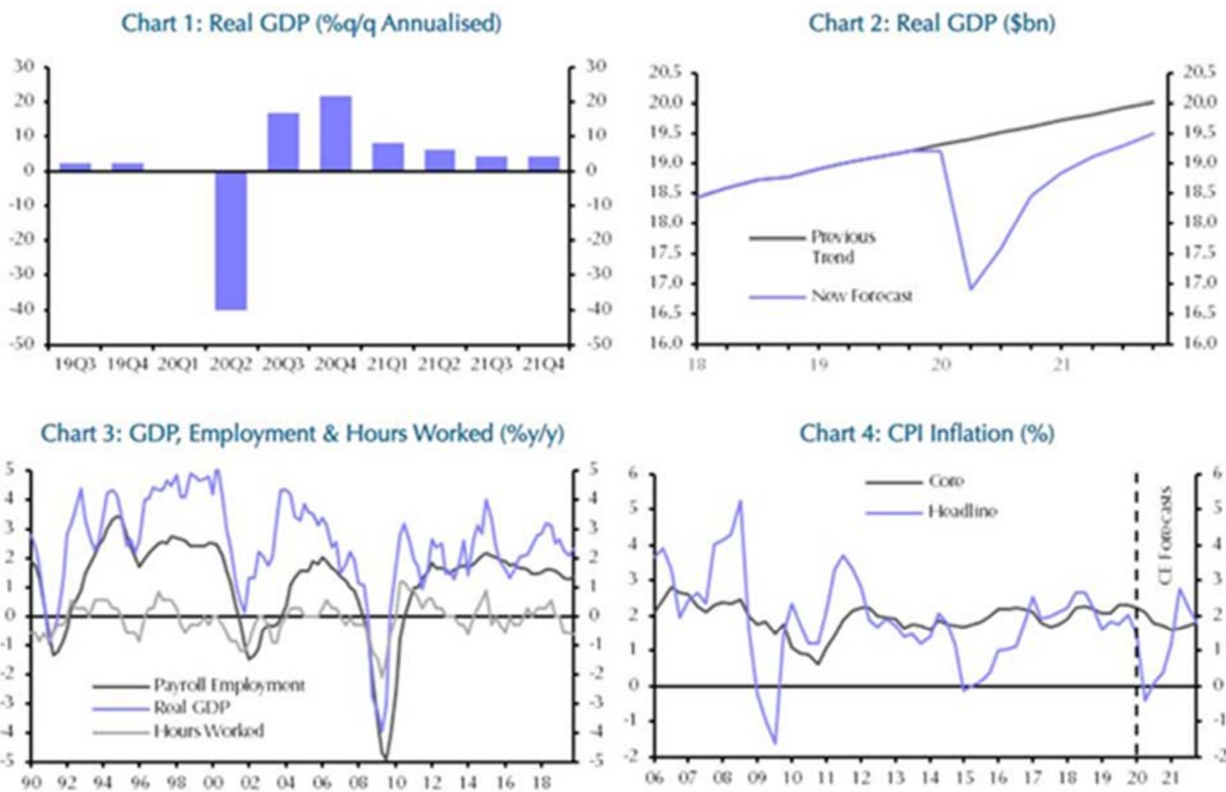
• We then assume that real GDP rebounds by 4% in the third quarter (17% annualized) and by 5% in the fourth (22% annualized). Although the second quarter may see the biggest hit, in a country the size of the US, it makes sense that the epicenters of the outbreak will shift gradually from state to state; meaning that the third-quarter rebound could be relatively disappointing.

Overall, we now expect real GDP to decline by 5.5% in 2020 before rebounding by 6.5% in 2021. Nevertheless, that would still leave the level of GDP at end-2021 slightly lower than it otherwise would have been without the coronavirus impact.

• We have assumed that within each sector the percentage decline in employment is half the size of the decline in GDP. (i.e. if GDP falls by 80% in the food services industry, then employment falls by 40%. Nevertheless, the impact on employment is still very substantial because the worst affected sectors – retail, food services – account for much bigger shares of total employment than output. The total decline in employment is likely to be around 14 million, with retail, food services and accommodation accounting for 10 million of that total. That would nearly triple the number of unemployed and push the unemployment rate up to 12%, slightly higher than its post-GFC peak.

• Finally, the slump in energy prices means that we now expect headline CPI inflation to briefly fall below zero this year but, with the Phillips curve still flat, we don't expect the surge in the unemployment rate to generate anything more than a modest decline in core inflation.



JPMorgan Commentary

The US recession that JPMorgan economists forecast a week ago will be worse than expected, the bank said in a Wednesday note. The bank revised its first-half GDP estimates lower, citing recent developments in the coronavirus outbreak and containment measures' economic costs. JPMorgan dragged its first-quarter growth estimate to -10% from -4% and dropped its second-quarter estimate to -25% from -14%.

The pandemic will also push unemployment as high as 8.5%, the bank said, echoing record-high unemployment data released Thursday morning.

The economists don't see the deeper economic trough giving way to a similarly rapid recovery. Companies' weaker balance sheets and strong financial headwinds suggest the economic rebound will look more like the era after the 2008 financial crisis than after a weather disaster, the bank said.

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Global Interest Rates (as of 8:00 am on 3/30/2020) and Week over Week Change

10 Year Government Rates

Brazil	n/a	Last week 8.82%
Mexico	7.07%	(25 bps)
India	6.18%	(17 bps)
South Korea	1.57%	(9 bps)
Greece	1.56%	(82 bps)
Italy	1.43%	(18 bps)
Singapore	1.21%	(32 bps)
New Zealand	0.99%	+7 bps
Australia	0.76%	(13 bps)
Hong Kong	0.66%	(40 bps)
Portugal	0.66%	(29 bps)
Canada	0.65%	(14 bps)
U.S.	0.64%	(22 bps)
Spain	0.53%	(22 bps)
U.K.	0.31%	(17 bps)
Japan	-0.02%	(7 bps)
France	-0.11%	(20 bps)
Netherlands	-0.29%	(16 bps)
Switzerland	-0.44%	+2 bps
Germany	-0.54%	(16 bps)