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Market Update: 3rd April 2020

US Jobs data reveals the virus impact on the US economy so far

With most of the global economy now in some form of lockdown or emerging from one (in China's case), leading economic indicators such as labour market data will remain firmly in the spotlight in the coming weeks, as governments and central banks grapple with the coronavirus threat. Compared with China, the restrictions on movement elsewhere are generally less severe, suggesting that the short-term damage to domestic activity in individual economies may be lower than in China, however economic evidence such as surging US jobless claims points to enormous costs for key economies.

Despite efforts from the US government and the Fed to cushion the negative impact of economic disruption on consumers, the lagged government reaction to the growing virus threat in the US remains a source of criticism, with the US now recording the largest number of cases across the world. As it stands, the US has 245,373 cases and 6,095 deaths, with no signs that the number of virus cases has yet peaked in the country. With the US now taking steps to reduce the spread of the virus via lockdown measures, this is beginning to have a disastrous effect on the US economy, causing jobless numbers to rocket in the two weeks since the lockdowns began. It appears that the US economy is much more exposed to weakness than other countries such as the UK due to a high reliance in key states on the gig economy and lack of worker protection, with businesses able to quickly lay off workers during periods of cash flow stress.

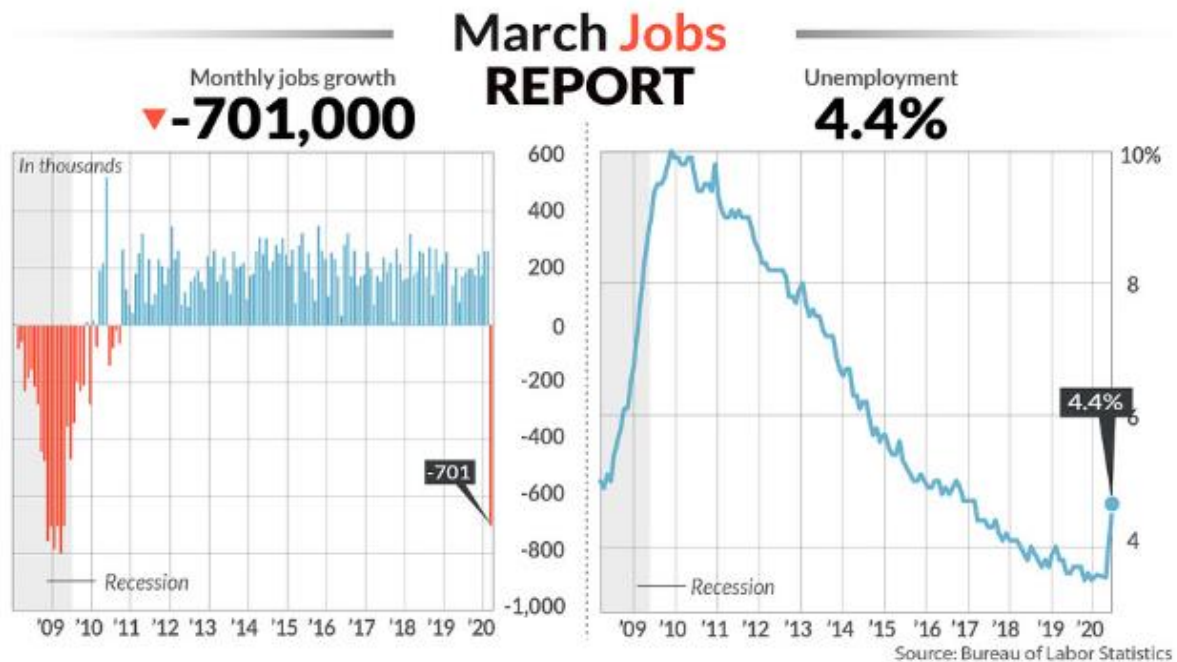
Surging jobless claims

Leading economic data suggests that America's once-robust labour market is collapsing faster than at any point in the last century. This week's jobs data provided a more detailed look at the economic impact of the coronavirus on the labour market. They also underscore the range of industries where business is slowing or companies have been forced to close down to curb the spread of the virus. So far, around 10 million people have submitted jobless claims in the past two weeks, as government-mandated shutdowns to contain the coronavirus force companies large and small and industries from restaurants to manufacturers to close their doors. This figure equals the total claims for the first six and a half months of the 2007-2009 financial crisis, highlighting the scale of the impact on the economy only two weeks into the lockdown measures. This week's figure of 6.65 million was a record high.

March Payrolls

March's US payrolls data released today posted a decline for the first time since 2010, as the early impacts of the pandemic began to move through the economy. According to the Labour Department data, payrolls fell 701,000 from the prior month, compared with the median forecasts of a decline of 100,000. While this does show a significant inflection point, it should be noted that the reference for the data ended just before business closures, along with employee layoffs and furloughs, became more widespread, meaning that reports in the coming months will provide a more comprehensive and detailed picture of how containment measures are crippling the nation's jobs market. Today's official

jobless rate jumped to 4.4%, the highest since 2017 from a century low of 3.5%, however it is expected to surge above 10% in the coming months as the extent of the lockdown impact feeds through.



Key figures from the Bureau of Labour Statistics:

- Employment in leisure and hospitality sectors fell by 459,000 in March, reflecting the initial effects of the coronavirus outbreak
- Private payrolls overall dropped by 713,000. Government jobs rose by 12,000 (including the 17,000 rise in census temporary workers)
- Average hourly earnings rose 0.4% from the prior month and were up 3.1% from a year earlier
- Average hours worked fell 0.2 hours to 34.2 hours

Limitations of March jobs data

As mentioned above, due to the reference points of the survey, today's figure does not capture the extreme job loss that has clearly occurred in the last few weeks, with the April employment report on 8th May expected to show the full extent of US Labour market weakness. Besides the timing of the survey however, there are several reasons to take the March payrolls with a grain of salt.

- Statistical Limitations

The extent to which companies are completely going out of business can play havoc with the payrolls count. The Bureau of Labour Statistics adjusts the jobs numbers by accounting for business "births" and "deaths", but uses a statistical model to do so, given that determining how many new businesses open and shut down in real time is extremely challenging, if not impossible. The problem is exacerbated now, since firm "births" typically drop sharply in bad times, leading to potential challenges in accurately presenting the data. While this model works well in normal expansion times, it doesn't work as well during turning points.

- ***A Reduced Survey Sample***

The figures on the payrolls may also be less reliable than usual because stretched or shuttered businesses might skip responding to the monthly survey. Typically, the numbers are based on voluntary responses from about 145,000 businesses and government agencies.

- ***Census Workers***

Also impacting this month's figures was the 17,000 temporary government census workers added to the March payrolls, temporarily inflating the figure. Looking ahead, even the anticipated surge in census hiring in the coming months is unlikely to offset the millions of Americans out of work.

- ***Average Wage Impacts***

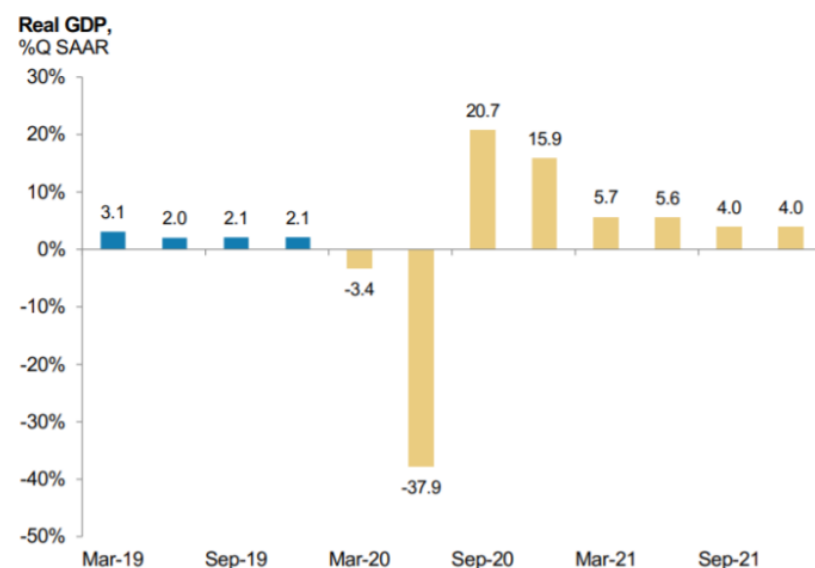
The downturn hitting low wage employees harder, such as those working in restaurants in hotels, is likely to distort the wage data in the coming months, acting to boost average hourly earnings, even if underlying wage growth isn't strong. This is likely to have resulted in the 0.4% increase in average wage in the March figures.

Over the coming months, as we do start to see a more comprehensive picture of the impact on the US labour market, the jobless rate is expected to surge, with some estimates expecting it to rise into the mid-teens- above the financial crisis era's 10% peak. As it stands, hiring is unlikely to resume anytime soon except in a few jobs or industries that are benefitting from changing consumer behaviour or surging demand for food or other household staples.

What this means

Overall, it is clear that this month's official jobs data should be carefully interpreted, with the weekly jobless count likely to provide a much more meaningful insight into the US economy in the near term. With corporates continuing to suspend forward guidance and initiating cost cutting measures to deal with cashflow squeezes, as the situation worsens across the US, Morgan Stanley now forecasts that Q1 GDP will fall 3.4%, before a 38% decline in Q2 growth on lockdown disruption. As shown in the below chart, Q3 and Q4 GDP is expected to benefit from a recovery. According to its forecasts, bank now expects to see 21 million job losses in Q2 and an unemployment rate in the quarter of 15.7%.

Exhibit 2: US Economic Outlook: Quarterly Growth Profile



Source: Bureau of Economic Analysis, Morgan Stanley Research forecasts

What is clear (even from this preliminary data) is that the US is quickly sliding into recession. What's less clear is how deep the economy sinks and how long the downturn lasts. This should become clearer over the coming weeks as more economic data feeds through into expectations, and as we start to see whether containment efforts have been effective in reducing the coronavirus threat. Until then, we remain content in our current extremely defensive positioning, and continue to watch from the sidelines as economic conditions continue to deteriorate.

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