COLUMBIA THREADNEEDLE INVESTMENTS

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THE CONSEQUENCES OF THE SHUTDOWN

A recession has been confirmed. But recent employment data was unexpectedly positive.

In April, we wrote about an inevitable contraction in the U.S. economy as a result of the COVID-19 intentional shutdown. Now the data is in, and it's official. The National Bureau of Economic Research (NBER), the agency that officially designates recessionary periods, has made its call: the longest economic expansion since the 1800s ended in February, and the U.S. economy entered a recession. In its announcement, NBER noted: "A peak in monthly economic activity occurred in the U.S. economy in February 2020. The peak marks the end of the expansion that began in June 2009 and the beginning of a recession. The expansion lasted 128 months, the longest in the history of U.S. business cycles dating back to 1854."

While that expansion was notable for its length, no one will eulogize its vigor. At 2.3% annualized growth, it was the weakest recovery on record.

Exhibit 1: The longest economic expansion since the 1800s comes to an end

Rank	Start of expansionary period	End of expansionary period	Length of expansion (quarters)	Average GDP quarterly change (ann.)	Cumulative GDP growth
1	Q3-2009	Q4-2019	42	2.3%	27.0%
2	Q2-1991	Q1-2001	40	3.6%	42.6%
3	Q2-1961	Q4-1969	35	4.9%	51.9%
4	Q1-1983	Q3-1990	31	4.3%	38.2%
5	Q1-2002	Q4-2007	24	2.9%	18.7%
6	Q2-1975	Q1-1980	20	4.3%	23.2%
7	Q1-1950	Q2-1953	14	7.7%	29.3%
8	Q3-1954	Q3-1957	13	4.1%	13.7%
9	Q1-1971	Q4-1973	12	5.2%	16.1%
10	Q3-1958	Q2-1960	8	5.6%	11.4%

Source: Federal Reserve Economic Data, Bureau of Economic Analysis, Columbia Threadneedle Investments

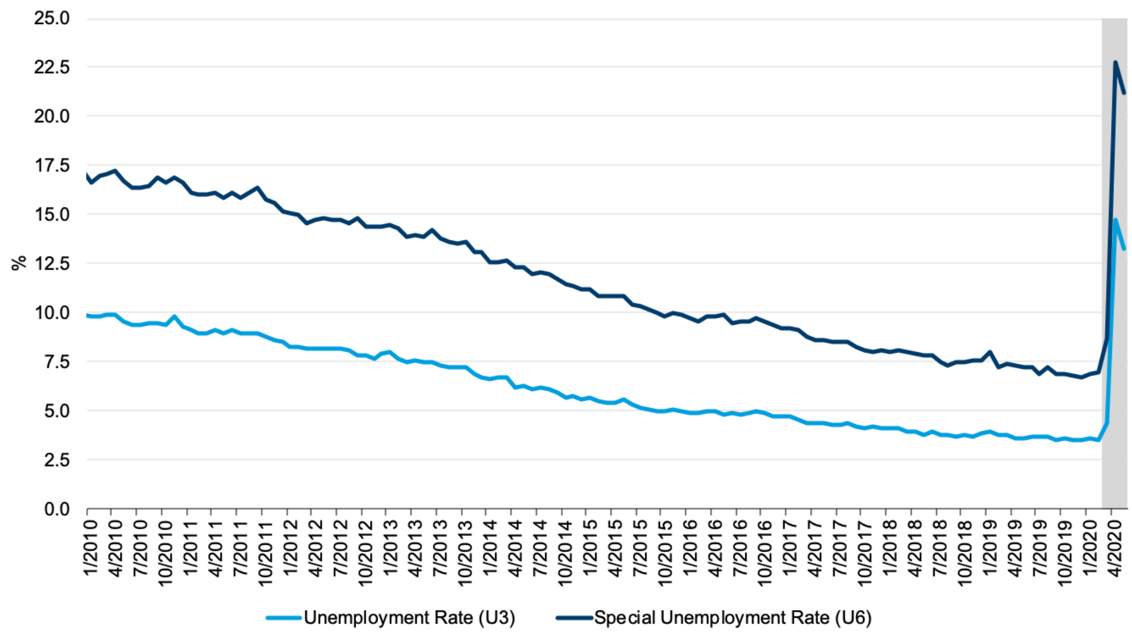
The mandated shutdown had an enormous impact on the economy. No one should be surprised at the deeply negative news flow on employment, retail sales and other data releases. But more recently, as states have moved to reopen their economies, there has been a marginal improvement in data, such as the most recent jobs report, which greatly exceeded expectations.

Better data on employment

The latest payroll report from the Bureau of Labor Statistics showed a surprising rise in employment and came amid expectations of a large decline. Payroll data showed an increase in employment by 2.5 million versus a consensus expectation of 7.5 million job losses. The headline unemployment rate fell to 13.3% from 14.7% in April, and the labor force participation rate rebounded. How did they get it so wrong? In our view, consensus estimates are highly suspect in periods of dislocation when the statistical accuracy of predictive models breaks down. A combination of reopening and the disbursement of Paycheck Protection Program loans—which are conditional on maintaining payroll—likely contributed to employment gains. Leisure and the hospitality sector, recently devastated by the collapse of tourism and business travel, saw the greatest gains (1.2 million), while the government sector continued to shed jobs.

Exhibit 2: A positive surprise in payroll data

Unemployment rates



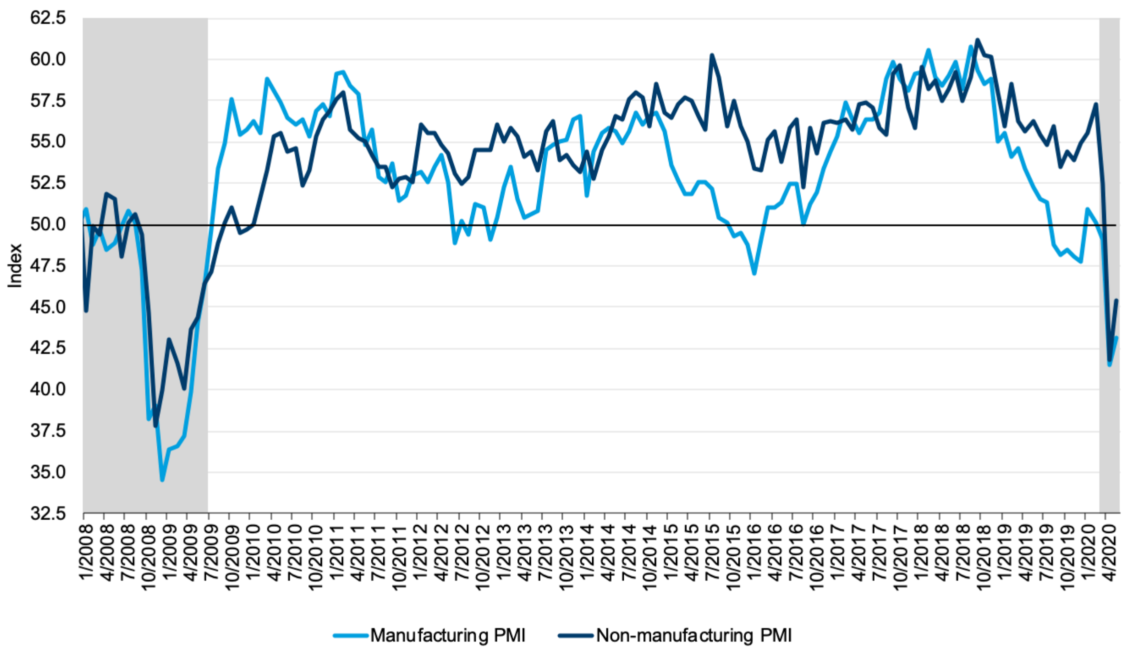
Source: Bureau of Labor Statistics; Columbia Threadneedle Investments, based on data through 05/01/2020. U3 is the official unemployment rate. U6 includes discouraged workers, other marginally attached workers and those who are part-time due to economic reasons.

The headline may belie the underlying story, but only to a degree. The Bureau of Labor statistics also reported that an additional 4.9 million people indicated that they were "not at work for other reasons." These workers were misclassified as employed. Counting these folks as unemployed would have suggested an official unemployment rate (referred to as U3) closer to 17% in May (down from about 20% in April). Regardless of whether we count this category or not, the trend in May suggests that hiring is back up, and about 10% of the total job losses were recovered in May. Despite the positive surprise in payroll—suggesting the beginning of the normalization phase—there are many workers leaving the labor force, as indicated by the decline in the participation rate. This will likely keep wage gains low for several months and the Federal Reserve on the sidelines for a long time to come.

Better data on business activity

Outside of the positive jobs data, manufacturing and services—whose business activity is measured by the Purchasing Managers Indexes (PMI)—have rebounded from their lows as the economy has reopened. April may have been the bottom in PMIs, but recovery possibly began in May.

Exhibit 3: Business activity has rebounded



Source: IHS Markit; Columbia Threadneedle Investments, based on data though 5/1/2020. PMI is a measure of economic activity based on monthly surveys of private sectors companies conducted by the Institute of Supply Management.

Bottom line: Data is encouraging, but keep an eye on the pandemic

It's important to keep a discerning view of the data. The recession declared by NBER is likely to be severe but short, with a long period until we see a recovery to 2019 levels (with significant variation by industry). The data is encouraging, but we continue to hold to our view that the path and pace of recovery is contingent on infection rates. We're seeing better economic data now, but a continuation is dependent on no further viral outbreaks or mandated shutdowns, particularly in large economic centers.

Past performance does not guarantee future results.

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