



# Helicopter Money

Market Viewpoint: April 30, 2020

*Summary: In the two months since COVID-19 has begun to make a significant impact on the American mainland, fiscal and monetary stimulus has begun to flow like it never has before. This expansion of the money supply has the potential to stave off deflation, and may be pushing traders to look beyond the virus' initial impact, focusing on the implications of money that is virtually falling from helicopters flying above. Stocks have already rebounded strongly and a broader recovery in inflation through the end of the year has implications not only for the economic recovery, but gold and the Greenback as well.*

In a 1969 collection of his essays, titled "The Optimum Quantity of Money.", Milton Friedman illustrates a scenario wherein a helicopter flies over a community and drops \$1000 in Dollar bills from the sky.

The helicopter, in this hypothetical, represents unorthodox action from a central bank to stimulate the supply of money, spurring inflation and economic output. When aggregate demand takes a hit, as it has from lockdowns and quarantine measures enacted in the wake of the Coronavirus, monetarist economists posit that expansion of the money supply is the most optimal approach to ward off deflation because, in the absence of the "helicopter", firms would have to continually depress their prices to find buyers.

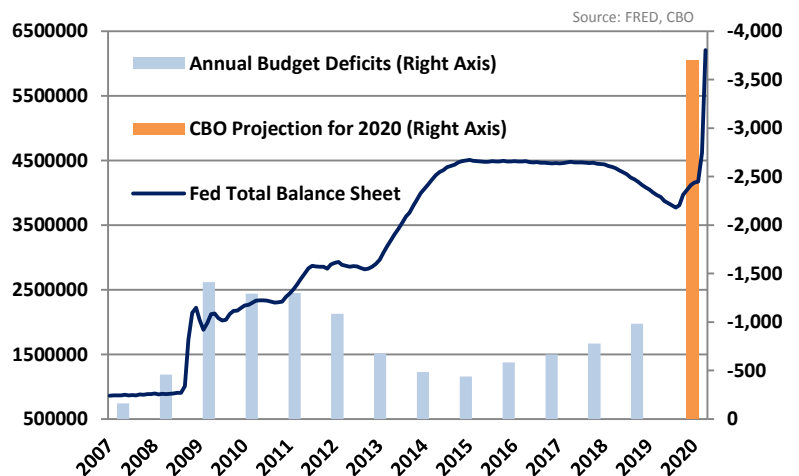
When prices fall, profits and wages follow. Debt obligations are not met and defaults surge, creating a deflationary spiral that is especially destructive and hard to overcome once it has begun. Therefore, the necessity for immediate, drastic action to stave off deflation is critical.

## Stimulus Surge Drives Up Fed Assets and US Government Budget Deficit

With seemingly endless fiscal stimulus programs flowing through congress over the last month, the Congressional Budget office now estimates that this year's deficit is on track to surpass \$3.7 trillion, a massive uptick from last year's comparatively meager \$984.4 billion.

Simultaneously, monetary stimulus is also booming. The Fed's balance sheet has ballooned to more than \$6.3 trillion just 8 months after the central bank ended their balance sheet shrinkage that had been in place since October 2018.

Fed Balance Sheet Assets & Federal Gov't Budget Deficits  
Jan 2008 - Apr 2020  
Source: FRED, CBO

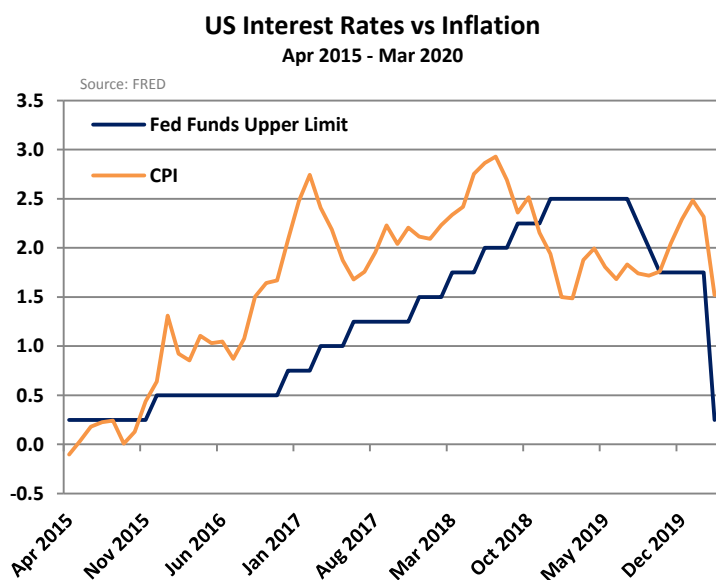


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Between then and September 2019, they managed to cut about \$700 billion from their total holdings. But since then, the balance sheet has exploded by around \$2.7 trillion, and most of that increase has been racked up in the past several weeks

It is “helicopter money” for sure!

The initial onus for the Fed to re-ignite securities purchases and initiate a new easing cycle was persistently low inflation and a slowdown in growth last year, perceived symptoms of hiking short-term rates too quickly. This time last year, the target range of the Fed Funds rate was at a cycle peak of 2.25% - 2.50%. Easing settled in slowly at first, with the FOMC cutting rates by 75bps through the end of 2019, a reasonable approach that bolstered asset prices and begun feeding through to much more robust inflation data.



Unfortunately, the ongoing outbreak of COVID-19 that slammed the US this year has seen any semblance of stable policy collapse. Rates were cut by 150bps in March alone, bringing the Fed Funds rate back to zero for the first time since 2015, and the headline CPI to just 1.5%, down sharply from the 2.5% inflation recorded for January.

The inflation story is much the same around the world, and worse in markets that were already suffering with sub-1% growth in prices.

China's CPI growth fell to 4.3% in March retreating steeply from 5.2% in February. India, thus far much less hard hit than China, saw their own inflation falter as well, declining to a four-month low of 5.9%.

Prices were just 0.7% higher than a year earlier across the Eurozone, down from a 1.2% rate of inflation in the prior month, raising fears of deflation in April, an almost certain reality for Japan. Inflation fell to just 0.4% in Japan, just half of what it was last December.

Though the inflation situation has not become as dire as in other developed markets, recent actions by the US Fed have already dwarfed their previously unprecedented reaction to the 2008 financial crisis. The Fed bought up \$41 billion in assets every day in the week ended April 15 and Evercore ISI estimates that the balance sheet's total assets could approach \$10 trillion when all is said and done. Per CNBC, the Fed intended to purchase \$625 billion in the final week of March alone, more than the entire \$600 billion second leg of quantitative easing that ran for eight months, from November 2010 to June 2011.

### Comparing the Most Recent Cash Drops

It's not so much of a surprise that the “COVID Crash” has already required more stimulus than 2008, considering the extremely differentiated nature of each crisis.

Unquestionably, the synchronous collapse of America's housing market and financial infrastructure was unprecedented and frightening for every American. However, the morning after Lehman Brothers declared bankruptcy for example, most still got out of bed and went to work. Anxiety gripped families, but most could still go out to dinner, the movies, or a ball game to ease the tension. The country kept on moving – much more slowly than it had been – but American life did not grind to a halt.

That is not the case this time around, as social distancing guidelines have shut down stores, venues, and essentially any large gatherings of people. More than 97% of the US population is currently under a stay-at-home or shelter-in-place order. Only "essential" businesses are exempt from closure in most states and restaurant food is available only for takeout. More than 30 million workers have had to claim unemployment over the course of just 5 weeks and millions of those fortunate enough to maintain employment have had to work from home. Effectively, a good portion of the economy is literally halted in place.

While those differences between 2008 and 2020 are evident, that does not mean we cannot observe some parallels.

The financial crisis is quite a pertinent example to look back at, considering it is, by far, the most recent example we have seen of a real-world helicopter money scenario. While quantitative easing (QE), base money, issued to finance large-scale purchases of financial assets and support the banking system, is considered a "helicopter" by some, including former Fed Chair Ben Bernanke, payments to the public were also part of the recovery.

As part of the Economic Stimulus Act of 2008, tax rebates, distributed as cash, were paid to individual U.S. taxpayers and households. While they were not literally dropped from a helicopter, checks were indeed delivered to millions of mailboxes. Most taxpayers below the income limit received a rebate of at least \$300 per person, or \$600 for married couples filing jointly. University of Michigan professors Joel Slemrod and Dr. Matthew Shapiro and Claudia Sahm of the Washington Center for Equitable Growth found the 2008 checks drove around \$32 billion in extra spending over the course of a year.

The Trump administration and congress revamped this policy in March as part of the \$2 trillion CARES act. Not only would up to \$1200 be sent to all taxpayers making less than a 6-figure income threshold (more than 3x the 2008 rebate, even when adjusted for inflation), but unemployment benefits would be bolstered by a \$600 per week enhancement through August. Though the stimulus checks are much larger to help cover living expenses, as opposed to just stimulating consumer spending like 2008's checks were meant to do, the sizable unemployment insurance makes it likely we could see an even substantially larger boost to consumer spending. The size of that boost will have a lot to do with how much longer nationwide social distancing restrictions last, but the advent of widespread e-commerce should be a much more significant factor this time around.

The latest IRS data estimates that they've paid out \$157.9 billion across more than 88.1 million stimulus checks distributed thus far. Total stimulus money set aside as part of the CARES Act totals \$290 billion.

When it comes to helicopter money, fiscal and monetary initiatives have already resulted in the largest distributions of all time and the aforementioned weak inflation data is sure to turn around sooner than later. That is the long-term risk.

## **Return of Inflation Will be Gradual**

Though the initiatives to put more money in the hands of American consumers have been bold, they are unlikely to have significant effects on inflation in the very short term.

It could be months before Americans feel confident to begin spending as they had before the lockdowns began. Uncertainty around their physical and financial health will push consumers to save more in the next few months until the smoke clears. In terms of a "recovery", we are looking toward a bottom in economic activity around Memorial Day, barring a massive rebound in US cases of COVID-19.

Though sales of most staple goods should be sustained, as well as some retail goods, it is impossible to predict any kind of timeline for a recovery in discretionary expenditures, especially on services, travel, and hospitality.

As of last week, national hotel occupancy stood at just 23%, per hospitality research firm STR. That's down nearly two-thirds from a year ago and STR now projects 2020 will be the worst year on record for occupancy. Average daily room

rates were just \$74.53 last week, down 42% year-over-year. And revenue per available room was \$17.43, an astonishing 79% drop.

Ticket prices for airlines are going to be heavily discounted for the foreseeable future as air travel has now dropped by more than 95% in the US. Delta and United Airlines have reported their first quarterly losses in more than five years. Delta's CEO, Ed Bastian, has said that revenue in the current quarter looks to be 90% lower than expected and that it could take two or three years for business to recover. The airline lost \$534 million in the first quarter, its first loss in just over five years. United Airlines earlier this week disclosed a \$2.1 billion pretax loss in the quarter ended March 31 because of the coronavirus.

Other airlines are expected to report similar data in upcoming weeks.

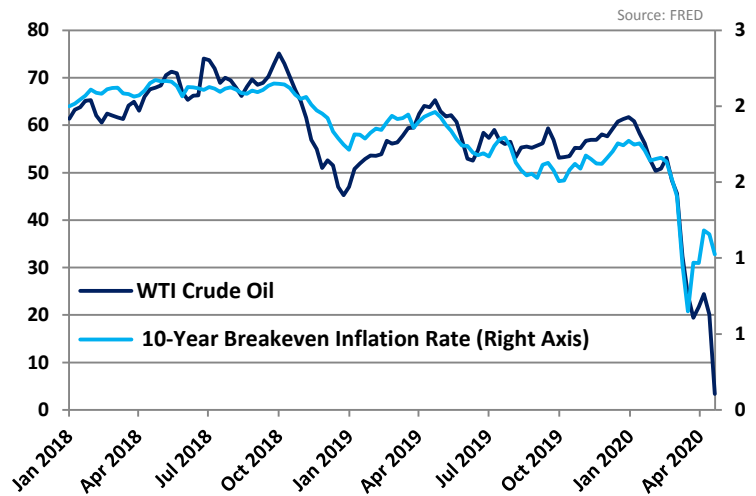
A downturn in travel is especially significant in terms of inflation because demand for transportation feeds through to energy prices as well, influencing the energy index within the headline CPI.

April's oil crash, [one so severe that it caused WTI crude prices enter negative territory for the first time in history](#), will undoubtedly play a role in dragging CPI growth down again this month. Demand remains stagnant for gasoline, jet fuel, and just about every other energy product across the board, and will remain that way until we see a global easing of Coronavirus-induced restrictions.

Until that happens, "deflationistas" will take time to run a few victory laps, suggesting that the latest rounds of price-crushing data will finally break any chance that inflation will return to 3%+ levels that preceded the Great Recession, and that we have entered a "lower for longer" period for inflation.

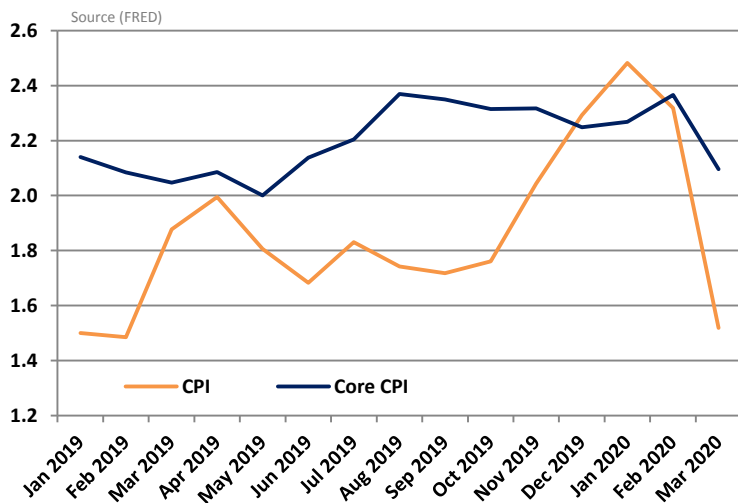
**Price of Crude vs 10-Year Breakeven Inflation**

Jan 2018 - Apr 2020



**Headline vs Core Inflation Rates**

Jan 2019 - Mar 2020



However, there are some signs that inflation's own quarantine could be short lived.

If we look at the Core CPI, which excludes energy and food prices, the downturn in prices has actually been milder as the downturn was less steep and YoY growth remains above 2% for now. Going forward, it's likely we will see higher and more consistent core data, as opposed to the headline numbers.

With all of that said, April could be as deep as the cut to inflation goes, and May could be a different story altogether, as a number of states are set to allow the strictest social distancing guidelines to expire.

As of April 24, Georgia became the first state to initiate the reopening of businesses for "minimum basic operations". Businesses cleared to restart operations include: gyms, bowling alleys, body art studios, hair salons, nail care, estheticians, and training schools. Alabama, Florida, Texas, Tennessee, and South Carolina will all allow their own stay-at-home orders to expire no later than April 30. Coronavirus case data for these states will be closely watched through the first couple weeks of May, and will set the tone for how quickly other states that have seen progress in "flattening the curve" begin their own re-opening.

The next few weeks are critical in determining the trajectory of America's economic indicators for months to come. Warmer weather and summer sunlight are expected to give a helping hand to states as they begin a long path toward normalcy, creating a dampening effect on the virus, per scientists from the Department of Homeland Security. William Bryan, science and technology adviser to DHS recently noted their most striking observation has been the "powerful effect that solar light appears to have on killing the virus - both surfaces and in the air... We've seen a similar effect with both temperature and humidity as well, where increasing the temperature and humidity or both is generally less favorable to the virus."

Even in virus hotspots, lockdown conditions are not expected to go beyond June. New York, the hardest hit state in the union, may see the state-wide lockdown expire on May 15, depending on NY Governor Andrew Cuomo's assessment of the situation. Earlier this week, the Governor said that restrictions would remain in place for some areas of the state, but not all. A bit more optimistically, Cuomo has recently said that he can envision baseball games being played without fans this summer at Yankee Stadium and the Mets' Citi Field.

When economic activity does enter a period of sustained recovery, it will do so with zero interest rates and plenty of easy money flowing through its veins. As mentioned earlier, the Fed was already in the midst of cutting interest rates before COVID came ashore. Huge liquidity injections and balance sheet expansion was already the norm and will likely stay the norm over the longer-term.

Last time interest rates had to be cut to zero, they stayed stuck to the floor for more than 5 years and many expect this recession to be significantly deeper than the depths of the last.

## Gold Over Greenbacks

The rapidly changing macroeconomic landscape calls for us to revisit a few key points MRP has made over the last year or so, primarily regarding inflation, the dollar, and precious metals.

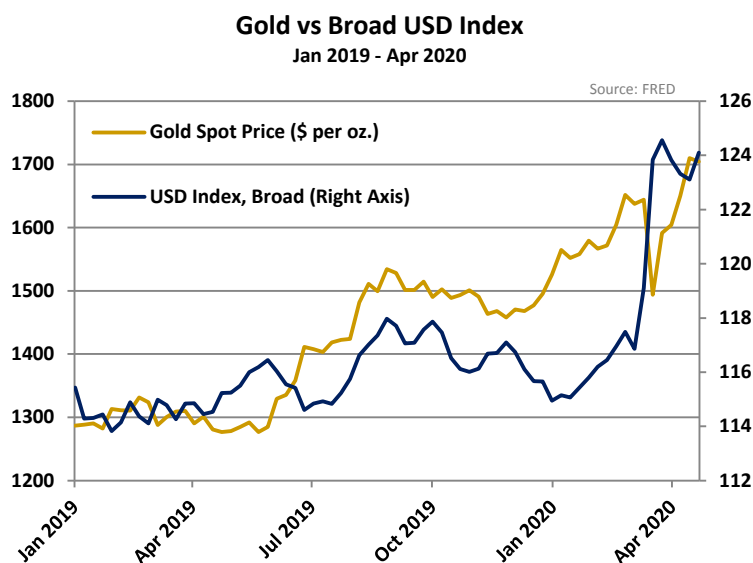
Way back in March of last year, MRP published "[Time for Gold](#)", we highlighted rising inflation, specifically its negative effect on real rates, as a key catalyst in the weakening of the dollar and strengthening of gold. Since then, Gold has surged by more than 30%, in spite of the recent rebound in the US Dollar.

[MRP's thesis](#) was spot on through the end of the year as gold broke above \$1500 for the first time since 2013 and the Dollar continued to struggle.

However, the spread of Coronavirus complicated things, generating a spike in safe-haven demand for Greenbacks and breaking the usually inverse relationship between precious metals and the Dollar.

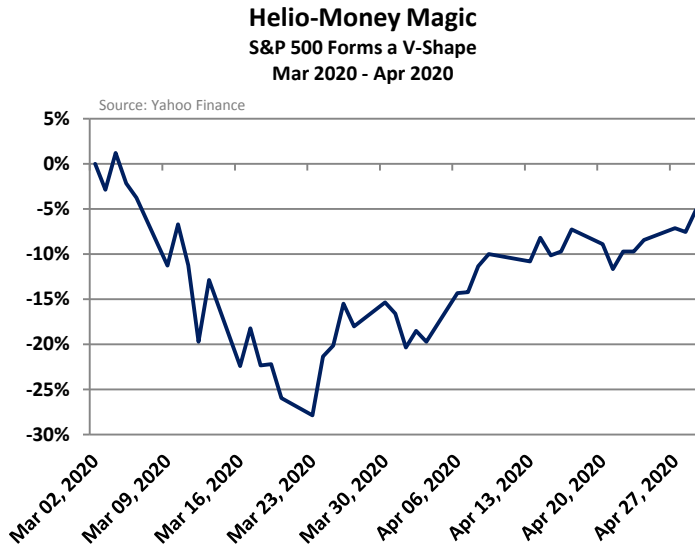
We believe this USD strength will not last. Zero interest rates, combined with a recovery in US inflation will likely send real US rates into negative territory, weakening the Greenback and propelling the next leg of the precious metals rally.

MRP transitioned our LONG Gold & Gold Miners theme to [LONG Silver & Silver](#) Miners last July. With the gold to silver ratio now surpassing 111, well above its 20-year average of about 60, a mean reversion could create huge upside in extremely undervalued silver assets.



## The Shape of the Recovery

In March, our sense was that we would see either a “V-shaped” market recovery following the “peak” of the virus, or a “W-shaped” one if a barrage of shocking economic data leads to a double bottom in share prices before mid-year. Thereafter, the pent-up demand from months of quarantines and isolations should result in a sharp rebound in economic activity, preceded by a roaring rally in share prices.



The earliest indications of economic growth for the first quarter are clearly foreshadowing a deep recession. GDP growth plunged 4.8% in the first quarter, much deeper than the 3.5% contraction economists were expecting. So, not only has growth officially descended into negative territory, the discrepancy between the estimates and the actual first read is quite a wide gap, indicating even greater uncertainty about just how rocky the data might get.

While we're going to have to wait longer for any real clarity on an economic recovery, you wouldn't know it from looking at stock market indices. We've already seen a rapid appreciation in equity prices since bottoming out March 23. Since then, the S&P 500 has rebounded by more than 32% and is forming a pretty solid V-shape thus far.

With that being said, it is clearly too early to claim victory.

Though stocks largely shrugged off Wednesday's atrocious GDP data, the first quarter really represents just one foot in the pool, considering Coronavirus did not actually begin to affect most parts of the economy until late February. Given the GDP is a lagging indicator, one could argue that traders are simply pricing in the bad data, assuming it is a more acute phenomenon that they are already looking beyond.

And at this point, who can really blame them?

In our March Viewpoint, we evoked the ideas of renowned economist Victor Zarnowitz, a long-time member of the NBER's business cycle dating committee. Zarnowitz long described a general rule that the steeper the plunge in economic activity the sharper would be the recovery. The so-called Zarnowitz rule does seem to prevail in most business cycles, but not always.

At the time, [MRP noted that we were betting on the Zarnowitz rule to prevail](#), leading to an economic rebound that rises as steeply as it fell. A month later, looking at the massive amount of bipartisan fiscal stimulus that has managed to pass, combined with monetary stimulus that is starting to look virtually unlimited, our conviction has not shifted.

Helicopter money is working its magic for now. But it is worth noting that the long-run consequences are likely to be negative – maybe very negative. Very few will worry about that in the months ahead though.

As Lord John Maynard Keynes reminds us: “In the long run, we are all dead.”

*Joe Mac*

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