Daiwa Capital Markets

U.S. Economic Comment

- What type of recovery: V, U, W, L?
- Upcoming report on personal income: insights into government support

Michael Moran
Daiwa Capital Markets America
212-612-6392
michael.moran@us.daiwacm.com

The Recovery

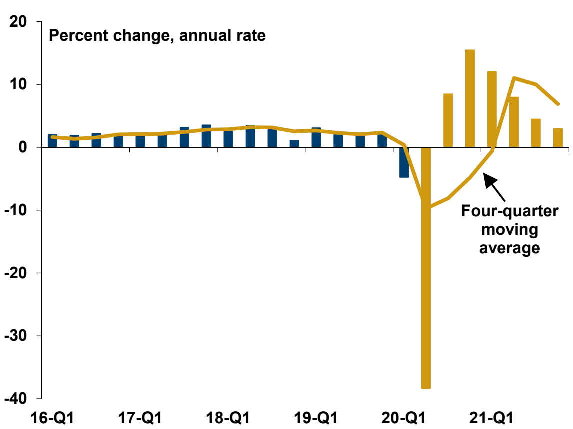
The U.S. economy is starting to reopen, as all 50 states in the U.S. have now loosened their sheltering-in-place restrictions. Many observers are concerned about a reacceleration in the spread of the virus, but early results suggest that risks are not extreme. Georgia, which led the easing of restrictions, has registered a slight decline in the number of new cases in the past few weeks according to data published by a leading newspaper, the Atlanta Journal-Constitution (seven-day average of new cases totaled 669 on May 21 versus 735 on April 23, the day before the easing of restrictions, and a peak of 866 on April 13).

The easing of restrictions has occurred earlier than we expected, and we find the results in Georgia encouraging. As a result, we have altered slightly our outlook for the economy. Previously, we expected additional softening of economic activity to creep into the third quarter after the dramatic retreat in Q2. However, with the second quarter ending on a brighter note, the economy is more likely to expand in Q3 than contract. We had previously expected a dip of 1.8 percent in the summer quarter, but with restrictions being lifted, we should see the beginnings of a recovery (chart, left).

Apparently, we are not alone in taking a more optimistic slant. The financial press is raising the prospect of recovery, and the questions we are receiving from reporters and clients are focused on the timing and extent of the pickup. Often (even usually) the questions are framed in terms of the "shape" of the cycle: V (sharp decline followed by quick return to normal), U (softness and stagnation before the beginning of recovery), W (a double-dip recession), and L (extended weakness and possible permanent damage to the economy). Many are calling for a so-called swoosh cycle, one resembling the Nike logo.

Our response when asked to pick a shape is "none of the above". Each one fall shorts as a description of the pattern shown in the left chart below. A V-shape seems to come close because the sharp downturn is followed by a sizeable bounce. However, a genuine V-shape would involve a quick return to pre-virus levels, and as shown in the chart to the right, the level of real GDP at the end of next year is still below the peak in

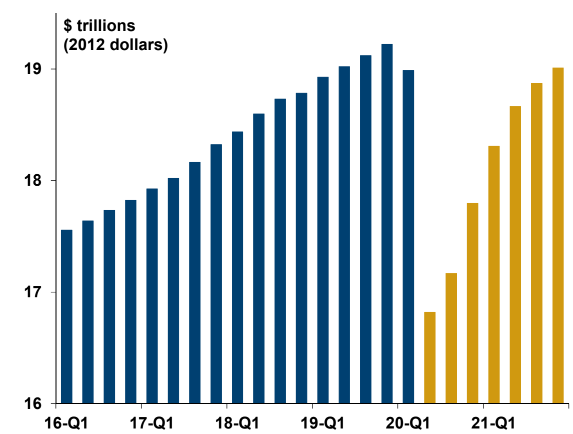
Real GDP Growth*



** The readings for 2020-Q2 to 2021-Q4 (gold bars) are forecasts by Daiwa Capital Markets America.*

Source: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

Real GDP*



** The readings for 2020-Q2 to 2021-Q4 (gold bars) are forecasts by Daiwa Capital Markets America.*

Source: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

2019-Q4. The “U” does not fit the bill because of the quick pickup after the second quarter. We view an L-shaped recovery as a low-probability outcome. We expect the virus to lead to structural changes in the economy (more telecommuting, changes in delivery of health care, heavier government involvement in the economy), but we do not see the changes leading to stagnation. A “W” is possible, but that would require a second phase of the virus, and the likelihood of such an occurrence involves a heavy dose of speculation.

Many (probably most) observers are embracing the swoosh pattern, but we believe this falls short because it does not capture the dramatic drop in economic activity during the spring, and it misses the bounce that will likely occur in Q3 and Q4. The pattern we envision is some combination of a V and the swoosh. The cycle starts like a V (sharp decline and a bounce), but then shifts to more gradual expansion (the latter part of the swoosh).

Other Views. This general pattern of the economy over the next year might be viewed as the consensus expectation, as three broad-based surveys of economists showed results similar to those presented in the charts on page 1. For example, the Survey of Professional Forecasters conducted by the Federal Reserve Bank of Philadelphia (48 participants this round) showed an expected decline of 32.2 percent in real GDP during the second quarter, followed by growth in the next four quarters of 10.6, 6.5, 6.8, and 4.1 percent. The Blue Chip consensus forecast was similar in nature to these figures, as were the mean estimates from a group of New-York based economists (the Forecasting Club of NY; we are members of this group).

While a clear consensus view on the economy has emerged, there is uncertainty and some variation in expectations. For example, the survey from the Philadelphia Fed asked for the perceived probability of a decline in GDP in the quarters ahead. While the consensus view calls for growth of 10.6 percent in the third quarter, the forecasters saw a 43.8 percent probability of a decline. Similarly, the Forecasters Club of NY shows expected growth of 13.0 percent in Q3, but estimates among the 51 participants ranged from -12.0 percent to 30 percent; three forecasters are looking for a double-dip. Thus, the economy seems headed toward a growth track beginning in Q3, but sustained expansion is not assured.

Data Preview: Personal Income, More Important Than Usual

The report on personal income, consumption, and prices typically does not capture the attention of market participants; equity and fixed-income prices seldom move in response. However, the report provides valuable information on the economy. Indeed, it is the best source of information on the consumer sector, as the spending figures offer a broader view on consumer activity than the report on retail sales does, and the income figures provide insights into the sustainability of expenditures. (The price index in the report also is valuable because it is the measure targeted by the Federal Reserve. However, the price index seldom involves surprises because of clues available from the consumer price index.)

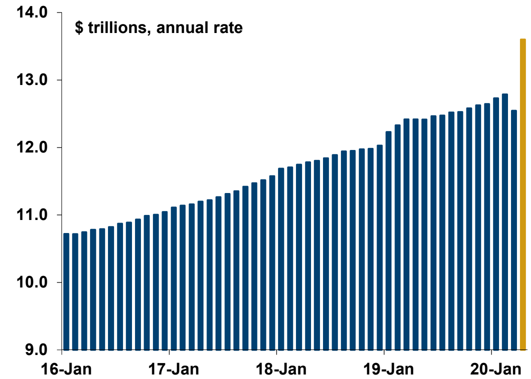
The upcoming report is likely to show signs of extreme weakness, but it also is likely to provide a reason for an optimistic tilt.

On the negative side, consumer expenditures are likely to decline sharply because of stay-at-home restrictions. In addition, several income components are likely to be notably soft. Wages and salaries should drop sharply because of the surge in layoffs, and low interest rates are likely to constrain investment income. Rental income could decline because of missed payments by unemployed individuals and closed businesses.

While most of the report will be decidedly weak, it is likely to include one notable positive element. Federal outlays authorized by the CARES Act started to flow from the Treasury Department in April, and many of these expenditures (unemployment benefits and $1,200 rebate checks) are likely to be included as income (so-called transfer payments).

Figures from the Treasury Department suggest that such outlays were large. Daily data released by the Treasury indicate that unemployment benefits in April were more than 17-times larger than the average in the first six months of the fiscal year ($48.4 billion versus $2.8 billion). More important, available monthly data suggest that rebate payments exceeded $200 billion. We expect the sum of these support payments to exceed the drop in wages and salaries, which would push the combination of wages and transfer payments above the pre-crisis level (chart). Such a development would enliven the debate on additional stimulus, as some hesitating legislators argue that many individuals are better off receiving government benefits than they would be by returning to work. The upcoming data could provide some support for that view.

Personal Income*



** A sum of the wages and salaries and personal current transfer receipts components of personal income. The reading for April 2020 (gold bar) is a forecast by Daiwa Capital Markets America.*

Source: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

Review

Week of May 18, 2020	Actual	Consensus	Comments
Housing Starts (April)	**0.891 Million (-30.2%)**	**0.900 Million (-26.0%)**	The decline in housing starts in April followed a retreat of 18.6% in March, with the combined changes pushing starts close to the lows seen in most previous recessions. However, activity remained noticeably above levels seen during the financial crisis and in the early years of the latest expansion. Both single-family and multi-family starts contributed to the decline in the headline total, with single-family starts dropping 25.4% and multi-family falling 40.5%. Like total starts, both components were low by long-run historical standards, but they were above readings during the financial crisis and the early years of the latest expansion.
Existing Home Sales (April)	**4.33 Million (-17.8%)**	**4.22 Million (-19.9%)**	The lockdown in the economy led to a second consecutive drop in sales of existing homes, with the decline in April following a drop of 8.5% in March. The back-to-back declines pushed sales to their lowest level since July 2011, although they remained above the low of 3.77 million registered during the financial crisis. The virus apparently led many individuals to take their homes off the market, as the number of houses for sale fell 1.3%, a marked contrast to the normal tendency for inventory to increase in the spring (this series is not seasonally adjusted, and the average increase in April in the prior 10 years totaled 9.4%).
Leading Indicators (April)	**-4.4%**	**-5.4%**	The decline in the index of leading economic indicators followed a retreat of 7.4% in March, with these two months representing the weakest in the history of the series (the next softest was a drop of 3.4% in October 2008). Four of the 10 components contributed positively to the latest monthly change, but the contributions were small and they were swamped by pronounced negative contributions in other components, especially the manufacturing workweek, unemployment claims, building permits, and ISM new orders.

Sources U.S. Census Bureau (Housing Starts); National Association of Realtors (Existing Home Sales); The Conference Board (Leading Indicators); Consensus forecasts are from Bloomberg

Preview

Week of May 25, 2020	Projected	Comments
Conference Board Consumer Confidence (May) (Tuesday)	**80.0 (-6.9 Index Pts.)**	Most of the influence of the coronavirus on confidence was probably reflected in the April reading, but the labor market weighs heavily on this measure, and continued deterioration in the employment situation is likely to lead to further souring of moods.
New Home Sales (April) (Tuesday)	**0.500 Million (-20.3%)**	A sharp decline in the buyer traffic index published by the National Association of Home Builders suggests that few individuals were involved in contract talks for a new home purchase in April. New home sales, which are based on contracts signed, probably tumbled.
Revised GDP (2020-Q1) (Thursday)	**-4.8% (Unrevised)**	The growth of business fixed investment is likely to be firmer than initially estimated (i.e. less negative), and consumer spending could be nudged higher as well. However, downward adjustments to residential construction and inventory investment are likely to provide offsets, leaving GDP growth little changed from the advanced view.
Durable Goods Orders (April) (Thursday)	**-8.0%**	Orders flows for most industries showed little slippage in March in response to the coronavirus, but they will probably move in line with the rest of the economy in April by registering sharp declines. However, the commercial aircraft sector could provide a sizeable offset, as this industry is not likely to repeat its dismal performance in March (net cancellations that translated to a drop of 286%).
U.S. International Trade in Goods (April) (Friday)	**-$58.0 Billion ($6.4 Billion narrower Deficit)**	Low oil prices will probably constrain both sides of the trade ledger, as will demand and supply disruptions associated with the coronavirus. As in other recent months, the effect on imports will probably be larger, leading to a narrower trade deficit.
Personal Income, Consumption, Core Prices (April) (Wednesday)	**5.0%, -10.0%, -0.3%**	The weak employment situation is likely to depress wages and salaries, and low interest rates are likely to constrain investment income. Rental income could decline as unemployed individuals and closed businesses miss payments. However, income support programs authorized by the CARES Act surged in April, which could be firm enough to keep the growth of total personal income in positive territory. Consumer spending should fall sharply because of sheltering restrictions.
Revised Consumer Sentiment (May) (Friday)	**73.7 (Unrevised)**	In the absence of breaking news, the revised estimate of consumer sentiment will probably be close to the preliminary tally.

Source: *Forecasts provided by Daiwa Capital Markets America*

Economic Indicators

May/June 2020

Monday	Tuesday	Wednesday	Thursday	Friday
18	19	20	21	22
NAHB HOUSING INDEX Mar 72 Apr 30 May 37	**HOUSING STARTS** Feb 1.567 million Mar 1.276 million Apr 0.891 million	**FOMC MINUTES**	**UNEMPLOYMENT CLAIMS** Initial / Continuing (Millions) Apr 25 3.867 22.377 May 02 3.176 22.548 May 09 2.687 25.073 May 16 2.438 N/A **PHILLY FED INDEX** Mar -12.7 Apr -56.6 May -43.1 **EXISTING HOME SALES** Feb 5.76 million Mar 5.27 million Apr 4.33 million **LEADING INDICATORS** Feb -0.2% Mar -7.4% Apr -4.4%	
25	26	27	28	29
MEMORIAL DAY	**CHICAGO FED NATIONAL ACTIVITY INDEX (8:30)** Monthly / 3-Mo. Avg. Feb 0.06 -0.20 Mar -4.19 -1.47 Apr -- -- **FHFA HOME PRICE INDEX (9:00)** Jan 0.5% Feb 0.7% Mar -- **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX (9:00)** SA / NSA Jan 0.3% 0.0% Feb 0.4% 0.5% Mar -- -- **CONFERENCE BOARD CONSUMER CONFIDENCE (10:00)** Mar 118.8 Apr 86.9 **May 80.0** **NEW HOME SALES (10:00)** Feb 0.741 million Mar 0.627 million **Apr 0.500 million**	**BEIGE BOOK (2:00)** **April Beige Book** Economic activity contracted sharply and abruptly across all regions in the United States as a result of the COVID-19 pandemic. The hardest-hit industries -- because of social distancing measures and mandated closures -- were leisure and hospitality, and retail aside from essential goods.	**INITIAL CLAIMS (8:30)** **REVISED GDP (8:30)** GDP / Chained Price 19-Q4 2.1% 1.3% 20-Q1(a) -4.8% 1.3% **20-Q1(p) -4.8% 1.3%** **DURABLE GOODS ORDERS (8:30)** Feb 2.0% Mar -15.3% **Apr -8.0%** **PENDING HOMES SALES (10:00)** Feb 2.3% Mar -20.8% Apr --	**U.S. INTERNATIONAL TRADE IN GOODS (8:30)** Feb -\$59.7 billion Mar -\$64.4 billion **Apr -\$58.0 billion** **ADVANCE INVENTORIES REPORT (8:30)** Wholesale / Retail Feb -0.7% -0.3% Mar -0.8% 1.0% Apr -- -- **PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX (8:30)** Inc. / Cons. / Core Feb 0.6% 0.2% 0.2% Mar -2.0% -7.5% -0.1% **Apr 5.0% -10.0% -0.3%** **CHICAGO PURCHASING MANAGERS' INDEX (9:45)** Index / Prices Mar 47.8 56.7 Apr 35.4 48.4 May -- -- **REVISED CONSUMER SENTIMENT (10:00)** Mar 89.1 Apr 71.8 May(p) 73.7
1	2	3	4	5
ISM MFG INDEX **CONSTRUCTION SPEND.**	**VEHICLE SALES**	**ADP EMPLOYMENT REPORT** **ISM NON-MFG INDEX** **FACTORY ORDERS**	**INITIAL CLAIMS** **TRADE BALANCE** **REVISED PRODUCTIVITY & COSTS**	**EMPLOYMENT REPORT** **CONSUMER CREDIT**
8	9	10	11	12
	NFIB SMALL BUSINESS OPTIMISM INDEX **JOLTS DATA** **WHOLESALE TRADE** **FOMC MEETING**	**CPI** **FEDERAL BUDGET** **FOMC DECISION**	**INITIAL CLAIMS** **PPI**	**IMPORT/EXPORT PRICES** **CONSUMER SENTIMENT**

Forecasts in Bold. (a) = advance (1st estimate of GDP); (p) = preliminary (2nd estimate of GDP); (r) = revised

Treasury Financing

May/June 2020

Monday	Tuesday	Wednesday	Thursday	Friday
18	19	20	21	22
AUCTION RESULTS: Rate Cover 13-week bills 0.130% 2.91 26-week bills 0.150% 3.13	**AUCTION RESULTS:** Rate Cover 52-week bills 0.160% 3.30 42-day CMB 0.105% 2.90 119-day CMB 0.140% 3.10 **ANNOUNCE:** $80 billion 4-week bills for auction on May 21 $70 billion 8-week bills for auction on May 21 $40 billion 105-day CMBs for auction on May 20 $40 billion 154-day CMBs for auction on May 20 **SETTLE:** $80 billion 4-week bills $70 billion 8-week bills $35 billion 105-day CMBs $40 billion 154-day CMBs	**AUCTION RESULTS:** Rate Cover 105-day CMB 0.140% 3.04 154-day CMB 0.150% 2.93 20-yr bonds 1.220% 2.53	**AUCTION RESULTS:** Rate Cover 4-week bills 0.090% 2.75 8-week bills 0.105% 2.65 10-yr TIPS -0.470% 2.39 **ANNOUNCE:** $117 billion 13-,26-week bills for auction on May 26 $20 billion 2-year FRNs for auction on May 27 $44 billion 2-year notes for auction on May 26 $45 billion 5-year notes for auction on May 27 $38 billion 7-year notes for auction on May 28 $65 billion 42-day CMBs for auction on May 26 $40 billion 119-day CMBs for auction on May 27 $25 billion 273-day CMBs for auction on May 27	**SETTLE:** $117 billion 13-,26-week bills $31 billion 52-week bills $65 billion 42-day CMBs $40 billion 119-day CMBs
25	26	27	28	29
MEMORIAL DAY	**AUCTION:** $117 billion 13-,26-week bills $44 billion 2-year notes $65 billion 42-day CMBs **ANNOUNCE:** $80 billion* 4-week bills for auction on May 28 $70 billion* 8-week bills for auction on May 28 **SETTLE:** $80 billion 4-week bills $70 billion 8-week bills $40 billion 105-day CMBs $40 billion 154-day CMBs	**AUCTION:** $40 billion 119-day CMBs $25 billion 273-day CMBs $20 billion 2-year FRNs $45 billion 5-year notes	**AUCTION:** $80 billion* 4-week bills $70 billion* 8-week bills $38 billion 7-year notes **ANNOUNCE:** $117 billion* 13-,26-week bills for auction on June 1 **SETTLE:** $117 billion 13-,26-week bills $65 billion 42-day CMBs $40 billion 119-day CMBs $25 billion 273-day CMBs	**SETTLE:** $12 billion 10-year TIPS $20 billion 2-year FRNs
1	2	3	4	5
AUCTION: $117 billion* 13-,26-week bills **SETTLE:** $44 billion 2-year notes $45 billion 5-year notes $38 billion 7-year notes $20 billion 20-year bonds	**ANNOUNCE:** $80 billion* 4-week bills for auction on June 4 $70 billion* 8-week bills for auction on June 4 **SETTLE:** $80 billion* 4-week bills $70 billion* 8-week bills		**AUCTION:** $80 billion* 4-week bills $70 billion* 8-week bills **ANNOUNCE:** $117 billion* 13-,26-week bills for auction on June 8 $44 billion* 3-year notes for auction on June 8 $29 billion* 10-year notes for auction on June 9 $19 billion* 30-year bonds for auction on June 11 **SETTLE:** $117 billion* 13-,26-week bills	
8	9	10	11	12
AUCTION: $117 billion* 13-,26-week bills $44 billion* 3-year notes	**AUCTION:** $29 billion* 10-year notes **ANNOUNCE:** $80 billion* 4-week bills for auction on June 11 $70 billion* 8-week bills for auction on June 11 **SETTLE:** $80 billion* 4-week bills $70 billion* 8-week bills		**AUCTION:** $80 billion* 4-week bills $70 billion* 8-week bills $19 billion* 30-year bonds **ANNOUNCE:** $117 billion* 13-,26-week bills for auction on June 15 $34 billion* 52-week bills for auction on June 16 $17 billion* 20-year bonds for auction on June 17 $15 billion* 5-year TIPS for auction on June 18 **SETTLE:** $117 billion* 13-,26-week bills	

**Estimate*