U.S. Economic Comment

- The labor market: a muddled picture, but probably on the mend
- FOMC: no policy change, but more guidance, either explicit or implicit
- CBO economic outlook: not so radical

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

The U.S. Labor Market: What to Believe?

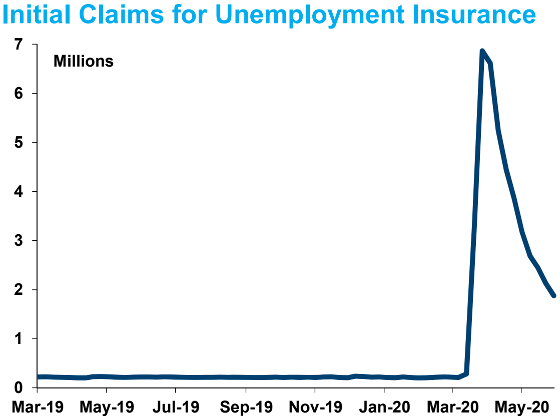
Available data are showing two radically different pictures of the labor market. Initial claims for unemployment insurance, although receding, are extremely high, signaling still-deep problems in the labor market. The latest payroll report, in contrast, showed an amazing surge in employment in May, suggesting that the economy may have turned a corner (charts).

We are inclined to put more weight on the payroll figures. We have seen numerous reports of processing problems at state employment offices because of overwhelming numbers of individuals filing for benefits. Such a swell creates the potential for errors. More important, difficulty in keeping pace with the number of filers most likely would create a backlog in claims. Possibly, even likely, claims reported in recent weeks involved layoffs several weeks ago and are not providing a clear picture of the latest developments. Initial claims are probably lagging reality.

In addition, it seems reasonably clear that businesses have started to recall workers. Continuing claims for unemployment insurance (i.e. the number of individuals receiving benefits) has declined on balance in the past few weeks (chart, next page). This series reflects both the number of individuals moving on to unemployment rolls and the number rolling off. The decline indicates that those rolling off have dominated. Some of the drop might reflect individuals exhausting their benefits, but the number of individuals receiving compensation last year and early this year (and would now be exhausting) are not large enough to explain the overall drop in continuing claimants.

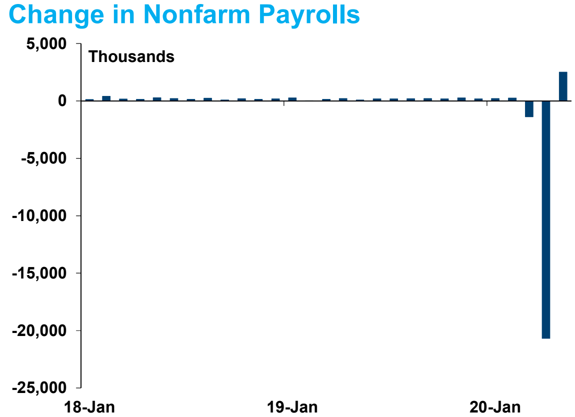
The potential for processing delays also raises the prospect that the continuing claims are understating the number of individuals recalled to their jobs. The workloads at state employment offices could be so heavy that the agencies are not able to track individuals that have returned to work. Some individuals could be both working and receiving benefits (they will have to return the benefits if the state agencies can straighten out their records).

Initial Claims for Unemployment Insurance



Source: U.S. Department of Labor via Haver Analytics

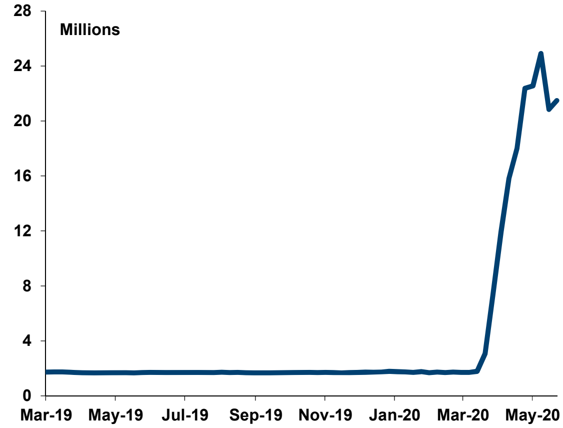
Change in Nonfarm Payrolls



Source: Bureau of Labor Statistics via Haver Analytics

We also would note a consistency between the payroll and household surveys in the labor market report. These are two independent data sources, and they are telling the same story: a solid rebound in employment. The survey of business establishments showed job growth of 2.5 million, and the household survey was even firmer at 3.8 million new jobs.

Continued Claims for Unemployment Insurance



Source: U.S. Department of Labor via Haver Analytics

The detail of the household survey also indicated that worker recalls were underway. Specifically, the number of individuals that were on temporary layoff, which had swelled as the pandemic took hold, fell sharply in May. In addition, many individuals in April were reported as employed but not at work. Officials at the Labor Department suspect that these individuals were misclassified as employed when they should have been reported as on temporary layoff because of the virus. This figure also fell sharply in May, suggesting worker recalls.

Thus, our conclusion is that the labor market improved notably in May. At the same time, we would not get carried away with a positive assessment. Random volatility could have had an influence, and setbacks could easily occur in coming months. Still, the latest figures were encouraging.

FOMC: No Action Expected, but a Notable Meeting Nonetheless

The Federal Open Market Committee is not likely to make a fundamental change in policy at its meeting on June 9-10. Given the strong resistance of policymakers to negative interest rates, there is almost no chance of reducing the federal funds rate. Some market participants wonder about the possibility of so-called yield-curve control (i.e. pegging Treasury rates at some specified level), but rates already are quite low, and thus there seems to be little need.

While interest rates are not likely to change, the outcome of the meeting could be meaningful nonetheless. Specifically, we expect to gain insights into how policy might evolve over the next year or two. Currently, the forward guidance provided by the Committee is vague, specifying only that the Fed will keep interest rates low until policymakers are confident that the goals of maximum employment and price stability are within reach. The Committee could provide explicit guidance; if not, implicit guidance can be extracted from the Summary of Economic Projections scheduled to be released after this meeting.

At the FOMC meeting in April, officials discussed the possibility of adopting explicit guidance, either date-based or outcome-based. Date-based guidance would commit the Committee to a particular policy stance (or an easier one) for some specified period of time. Outcome-based guidance would specify a threshold for some key economic variable as a trigger for a policy change. Officials seemed open to explicit guidance in April, although they made no commitments.

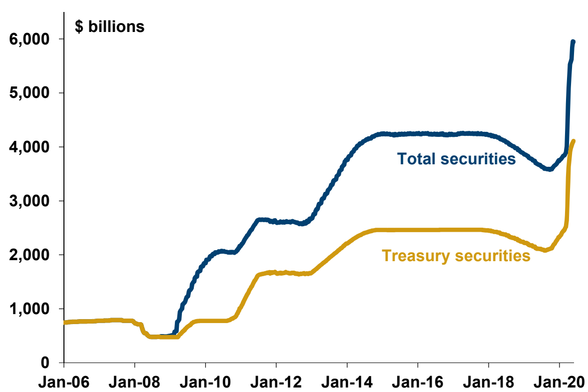
In the absence of explicit guidance, the new forecasts provided by the Committee will provide insights. That is, the projections can serve as a substitute for outcome-based guidance, with the expected federal funds rate (the dot plot) and the projected unemployment rate representing the critical variables. Given the dramatic shift in the labor market, the unemployment rate will probably be the key variable driving policy decisions in the months ahead. The level of the projected unemployment rate when the dots begin to move higher could be viewed as the threshold for policy tightening. We suspect that some Fed officials will wish to begin the normalization process when the jobless rate nears eight percent, but broader support is not likely to emerge until seven percent, or possibly six percent.

Officials might discuss altering or adding to the credit facilities established in response to the coronavirus. However, we don't expect considerable effort along these lines because most of the programs are under the purview of the Board of Governors rather than the FOMC. But we suspect the Governors would be open to suggestions.

Suggestions are perhaps needed because the domestic programs have not captured much interest. Officials talked of trillions of dollars of support when the programs were introduced, but so far the domestic efforts have totaled only $152 billion (chart). Perhaps the low volumes of Fed lending represent good news; that is, the market might be providing an adequate flow of credit. Also, the Main Street Lending Facility is currently not operational, and that program could stir considerable activity among small and medium-sized businesses. A Fed effort to support credit flows in foreign markets has drawn more interest, as currency swap lines with foreign central banks have jumped to almost $450 billion.

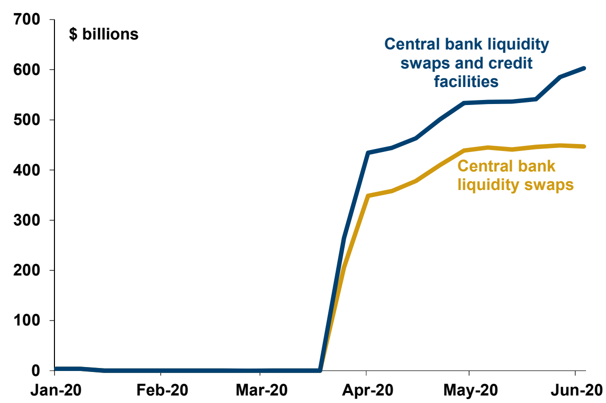
The Fed ran an aggressive quantitative easing program in late March and early April, but security purchases have slowed recently. Indeed, in the latest week the Fed's portfolio expanded by only $1.4 billion, reflecting $21.2 billion of Treasury purchases and redemptions of mortgage-backed securities totaling $19.9 billion. The Fed has not announced a shift in its intentions for purchasing MBS; thus, we suspect the decline in holdings in the latest week was the result of unexpected prepayments on mortgages.

The Fed's Securities Portfolio*



* Total securities include: U.S. Treasury securities, federal agency securities, and agency mortgage-backed securities.
Source: Federal Reserve Board via Haver Analytics

Federal Reserve Credit Facilities*



* Credit facilities include: Primary Dealer Credit Facility, Money Market Mutual Fund Liquidity Facility, Paycheck Protection Program Liquidity Facility, Commercial Paper Funding Facility II LLC, Corporate Credit Facility LLC, and Municipal Liquidity Facility LLC.
Source: Federal Reserve Board via Haver Analytics

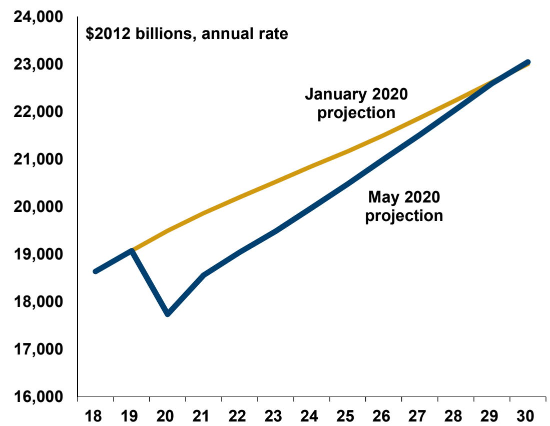
The CBO Outlook

In response to a request from Senator Chuck Schumer, the Congressional Budget Office this week published a comparison of its current (post-COVID) forecast with one that it had released in January. The results showed that the Budget Office did not see the economy returning to its previous path until 2030. The review and portrayal in the financial press was dour, with coverage suggesting a decade of struggle and strain. In fact, other than the sharp contraction in the first half of this year, we view the new picture painted by the CBO as reasonably favorable.

The January forecast of the CBO involved a fully employed economy growing without interruption at its potential rate. This is a strong economic performance. To get back to this path, the economy not only has to recoup the ground lost during the downturn, it must also grow at a pace faster than potential to make up for the growth that might have been occurring while the economy was in recession. In other words, it is a tall order to return to the previous path because the economy is chasing a moving target -- one that is always running ahead.

Another benchmark for evaluating the recovery path is the pre-virus level of economic activity -- the level of real GDP before the onset of the virus. The chart to the right is derived from the data published with the January forecast of the CBO along with the figures provided by the Budget Office in its letter to Senator Schumer. Indeed, the economy does not return to the previous path until approximately 2030. However, it returns to the 2019 level of real GDP in late 2022 or early 2023. Continued growth eventually puts the economy where it would have been if the virus had not occurred.

Real GDP*



** The readings for 2020 to 2030 are forecasts by the Congressional Budget Office.*

Source: Bureau of Economic Analysis via Haver Analytics and Congressional Budget Office

We should keep in mind that the economy was performing well in 2019 (Chair Powell and other Fed officials told us often that we were "in a good place"). Most observers would be reasonably content to be back in this position with a positive outlook going forward. To be sure, the economy and standards of living are likely to lag for several years where they might have been in the absence of the virus, but getting to a comfortable position in a few years and eventually erasing all the economic effects of the virus, in our view, represents a fine economic performance.

Review

Week of June 1, 2020	Actual	Consensus	Comments
ISM Manufacturing Index (May)	**43.1% (+1.6 Pct. Pts.)**	**43.8% (+2.3 Pct. Pts.)**	The ISM manufacturing index remained well above the low levels seen during the financial crisis, although an anomalous reading on the supplier delivery component has provided support for the overall figure. Elevated readings on the supplier delivery component in March and April reflected damaged supply chains that slowed delivery times -- a different situation from the normal movement when strong demand and order backlogs lead to slower deliveries and generate high-side readings on this component. Apparently, supply chains were repaired to a degree, as the supplier-delivery component fell 8.0 percentage points. We focus more closely on new orders, production, and employment. All three of these showed modest improvement from readings at or near record lows in April.
Construction Spending (April)	**-2.9%**	**-7.0%**	Construction activity has slipped recently, but it has been less affected by the coronavirus than most sectors of the economy, as shown by the moderate drop in April. Private residential building led the decline in April (off 4.5%), but even with this retreat, the level of residential construction remained within the range of the past two years. Private nonresidential building fell 1.3% and remained comfortably within its recent range. Government-related building also remained range bound despite a drop of 2.5%
ISM Nonmanufacturing Index (May)	**45.4% (+3.6 Pct. Pts.)**	**44.4% (+2.6 Pct. Pts.)**	The ISM nonmanufacturing index improved in May, but it continued to signal pronounced weakness. The business activity index made the largest contribution to the improvement in the headline figure, as it rose 15.0 percentage points to 41.0%, but it remained in the low end of its historical range. The new orders index rose 9.0 percentage points to 41.9%, also a low reading by historical standards. The employment index rose 1.8 percentage points to 31.8%, which matched the low registered during the financial crisis and represented the second lowest level in the history of the series (exceeding only the April reading).
Factory Orders (April)	**-13.0%**	**-13.4%**	The already published durable goods component accounted for much of the decline in total factory orders in April, as these bookings fell 17.7% (revised from -17.2%). Much of this softness was the result of pronounced weakness in the commercial aircraft sector, which registered negative order flows (i.e. net cancellations) in both March and April. Excluding transportation, durable orders fell 7.7%, but they remained within the range of the past few years and were well above readings during the financial crisis and early years of the recovery. Orders for nondurable goods fell 9.0% in April after a drop of 5.4% in March, but they too were still within the range of the past few years. In addition, much of the softness has occurred in the petroleum and coal category (-52.1% in the past two months), where lower prices have played a role. Excluding petroleum and coal, orders for nondurable goods have declined moderately.

Review Continued

Week of June 1, 2020	Actual	Consensus	Comments
Trade Balance (April)	**-$49.4 Billion ($7.1 Billion Wider Deficit)**	**-$49.4 Billion ($5.0 Billion Wider Deficit)**	Both exports and imports dropped sharply in April (off 20.5% and 13.7%, respectively), with the larger change in exports leading to the marked deterioration in the trade deficit. Much of the weakness was the result in broad-based slippage in goods flows (preliminary results published last week), but the services surplus also narrowed. Unsurprisingly, travel restrictions caused by the coronavirus led to sharp deterioration in travel and transportation services.
Revised Nonfarm Productivity (2020-Q1)	**-0.9% (1.6 Pct. Pts. Upward Revision)**	**-2.7% (0.2 Pct. Pt. Downward Revision)**	The measure of output that feeds into the calculation of productivity was revised lower in Q1, but hours worked were revised lower by a larger amount, leading to an improvement in productivity growth. While the results are better than the preliminary tally, the softening in the economy seems to have arrested an improving trend in productivity growth (growth of 1.9% in 2019 versus average growth of 1.35% in the prior two years).
Nonfarm Payrolls (May)	**2,509,000**	**-7,500,000**	The stunning jump in employment in May was broadly based, although some sectors continued to shed workers (mining, information, government). Job gains were sharpest in the areas that had cut employment in prior months. The leisure industry and retail sector posted large gains, as did the miscellaneous service area. The construction and manufacturing sectors also posted firm results. The household survey also showed positive results, with employment gains totaling 3.8 million. This increase outstripped a jump of 1.7 million in the size of the labor force, which led to a drop of 1.4 percentage points in the unemployment rate to 13.3%. Average hourly earnings fell 1.0% following a jump of 4.7% in the prior month. These changes reflect shifts in the composition of employment more so than changes in wage rates. Large job cuts among in lower-paid workers led to an increase in the average in April, and the return of these workers in May pushed the average a bit lower.

Sources Institute for Supply Management (ISM Manufacturing Index, ISM Nonmanufacturing Index); U.S. Census Bureau (Construction Spending, Factory Orders); Bureau of Economic Analysis (Trade Balance); Bureau of Labor Statistics (Revised Nonfarm Productivity, Payroll Employment); Consensus forecasts are from Bloomberg

Preview

Week of June 8, 2020	Projected	Comments
CPI (May) (Wednesday)	**0.0% Total, 0.1% Core**	The food component will probably ease after a surge in April that was driven by virus-related buying. Market quotes show higher energy prices, but the increases seem less than seasonal norms, suggesting a dip after seasonal adjustment. The core component is likely to increase after two consecutive declines, but the shift will probably be minimal because of slack demand.
Federal Budget (May) (Wednesday)	**$500.0 Billion Deficit**	The coronavirus will weigh heavily on the budget deficit of the federal government, as elevated unemployment limits tax collections and support payments spur outlays. The expected shortfall exceeds by a substantial margin the deficit of $208 billion in the same month last year, and if accurate, would leave the deficit in the first eight months of the fiscal year at $1,981 billion, wider than the $739 billion for the same period in FY2019.
PPI (May) (Wednesday)	**0.1% Total, 0.1% Core***	Unlike the situation in the CPI, food prices did not surge in April, but they are likely to jump in May because of supply disruptions and shortages. Energy prices seem to have settled after declining in the prior three months. Core prices are likely to be subdued because of the soft economic environment, but they could retrace some of the sharp decline in April (off 0.9%).
Consumer Sentiment (June) (Friday)	**75.0 (+2.7 Index Pts.)**	An easing in virus-related lockdowns and continued improvement in the stock market are likely to brighten consumer moods.

** The core PPI excludes food, energy, and trade services.*
Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

June 2020

Monday	Tuesday	Wednesday	Thursday	Friday
1	2	3	4	5
ISM INDEX Index Prices Mar 49.1 37.4 Apr 41.5 35.3 May 43.1 40.8 **CONSTRUCTION SPEND.** Feb 0.2% Mar 0.0% Apr -2.9%	**VEHICLE SALES** Mar 11.4 million Apr 8.7 million May 12.2 million	**ADP EMPLOYMENT REPORT** Private Payrolls Mar -302,000 Apr -19,557,000 May -2,760,000 **ISM NON-MFG INDEX** Index Prices Mar 52.5 50.0 Apr 41.8 55.1 May 45.4 55.6 **FACTORY ORDERS** Feb 0.2% Mar -11.0% Apr -13.0%	**UNEMPLOYMENT CLAIMS** Initial Continuing (Millions) May 09 2.687 24.912 May 16 2.446 20.838 May 23 2.126 21.487 May 30 1.877 N/A **TRADE BALANCE** Feb -$34.7 billion Mar -$42.3 billion Apr -$49.4 billion **REVISED PRODUCTIVITY & COSTS** Productivity Unit Labor Costs 19-Q4 1.2% 2.2% 20-Q1(p) -2.5% 4.8% 20-Q1(r) -0.9% 5.1%	**EMPLOYMENT REPORT** Payrolls Un. Rate Mar -1,373,000 4.4% Apr -20,687,000 14.7% May 2,509,000 13.3% **CONSUMER CREDIT** Feb $19.5 billion Mar -$6.8 billion Apr -$68.8 billion
8	9	10	11	12
	NFIB SMALL BUSINESS OPTIMISM INDEX (6:00) Mar 96.4 Apr 90.9 May -- **JOLTS DATA (10:00)** Openings (000) Quit Rate Feb 7,004 2.3% Mar 6,191 1.8% Apr -- -- **WHOLESALE TRADE (10:00)** Inventories Sales Feb -0.7% -0.7% Mar -1.0% -5.2% **Apr 0.4% -2.0%** **FOMC MEETING**	**CPI (8:30)** Total Core Mar -0.4% -0.1% Apr -0.8% -0.4% **May 0.0% 0.1%** **FEDERAL BUDGET (2:00)** 2020 2019 Mar -$119.0B -$146.9B Apr -$737.9B $160.3B **May -$500.0B** -$207.8B **FOMC DECISION (2:00)**	**INITIAL CLAIMS (8:30)** **PPI (8:30)** Final Demand Core* Mar -0.2% -0.2% Apr -1.3% -0.9% **May 0.1% 0.1%**	**IMPORT/EXPORT PRICES (8:30)** Non-fuel Imports Nonagri. Exports Mar 0.0% -1.7% Apr -0.5% -3.3% May -- -- **CONSUMER SENTIMENT (10:00)** Apr 71.8 May 72.3 **June 75.0**
15	16	17	18	19
EMPIRE MFG. INDEX **TIC DATA**	**RETAIL SALES** **IP & CAP-U** **BUSINESS INVENTORIES** **NAHB HOUSING INDEX**	**HOUSING STARTS**	**INITIAL CLAIMS** **PHILLY FED INDEX** **LEADING INDICATORS**	**CURRENT ACCOUNT**
22	23	24	25	26
CHICAGO FED NATIONAL ACTIVITY INDEX **EXISTING HOME SALES**	**NEW HOME SALES**	**FHFA HOME PRICE INDEX**	**INITIAL CLAIMS** **REVISED GDP** **DURABLE GOODS ORDERS** **U.S. INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES**	**PERSONAL INCOME, CONSUMPTION, PRICES** **REVISED CONSUMER SENTIMENT**

* *The core PPI excludes food, energy, and trade services.*

Forecasts in Bold. (p) = preliminary; (r) = revised

Treasury Financing

June 2020

Monday	Tuesday	Wednesday	Thursday	Friday
1	2	3	4	5
AUCTION RESULTS: Rate / Cover 13-week bills 0.150% 2.94 26-week bills 0.170% 2.72 **SETTLE:** $44 billion 2-year notes $45 billion 5-year notes $38 billion 7-year notes $20 billion 20-year bonds	**AUCTION RESULTS:** Rate / Cover 42-day CMB 0.135% 2.83 119-day CMB 0.165% 3.10 **ANNOUNCE:** $80 billion 4-week bills for auction on June 4 $70 billion 8-week bills for auction on June 4 $40 billion 105-day CMBs for auction on June 3 $40 billion 154-day CMBs for auction on June 3 **SETTLE:** $80 billion 4-week bills $70 billion 8-week bills $40 billion 105-day CMBs $40 billion 154-day CMBs	**AUCTION RESULTS:** Rate / Cover 105-day CMB 0.170% 3.25 154-day CMB 0.180% 3.11	**AUCTION RESULTS:** Rate / Cover 4-week bills 0.125% 2.77 8-week bills 0.145% 2.60 **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 $60 billion 42-day CMBs for auction on June 9 $40 billion 119-day CMBs for auction on June 9 **SETTLE:** $117 billion 13-,26-week bills $65 billion 42-day CMBs $40 billion 119-day CMBs	
8	9	10	11	12
AUCTION: $117 billion 13-,26-week bills $44 billion 3-year notes	**AUCTION:** $29 billion 10-year notes $60 billion 42-day CMBs $40 billion 119-day CMBs **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 $40 billion 105-day CMBs $40 billion 154-day CMBs		**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 $60 billion 42-day CMBs $40 billion 119-day CMBs	
15	16	17	18	19
AUCTION: $117 billion* 13-,26-week bills **SETTLE:** $44 billion 3-year notes $29 billion 10-year notes $19 billion 30-year bonds	**AUCTION:** $34 billion* 52-week bills **ANNOUNCE:** $80 billion* 4-week bills for auction on June 18 $70 billion* 8-week bills for auction on June 18 **SETTLE:** $80 billion* 4-week bills $70 billion* 8-week bills	**AUCTION:** $17 billion* 20-year bonds	**AUCTION:** $80 billion* 4-week bills $70 billion* 8-week bills $15 billion* 5-year TIPS **ANNOUNCE:** $117 billion* 13-,26-week bills for auction on June 22 $20 billion* 2-year FRNs for auction on June 24 $46 billion* 2-year notes for auction on June 23 $47 billion* 5-year notes for auction on June 24 $41 billion* 7-year notes for auction on July 25 **SETTLE:** $117 billion* 13-,26-week bills $34 billion* 52-week bills	
22	23	24	25	26
AUCTION: $117 billion* 13-,26-week bills	**AUCTION:** $46 billion* 2-year notes **ANNOUNCE:** $80 billion* 4-week bills for auction on June 25 $70 billion* 8-week bills for auction on June 25 **SETTLE:** $80 billion* 4-week bills $70 billion* 8-week bills	**AUCTION:** $20 billion* 2-year FRNs $47 billion* 5-year notes	**AUCTION:** $80 billion* 4-week bills $70 billion* 8-week bills $41 billion* 7-year notes **ANNOUNCE:** $117 billion* 13-,26-week bills for auction on June 29 **SETTLE:** $117 billion* 13-,26-week bills	**SETTLE:** $20 billion* 2-year FRNs

**Estimate*