U.S. Economic Comment

- U.S. economy: still on track
- Inflation: still contained

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Recent Economic Developments

Much of the commentary in the financial press has portrayed the U.S. economy as stalling or lacking momentum. We view such assessments as off the mark. To be sure, economic activity has slowed from the brisk pace seen in June, but it is continuing to advance. Moreover, further gains have occurred despite an acceleration in the number of new Covid cases. This second wave of the virus easily could have led to a double-dip in the economy, but businesses and consumers have adapted, which has kept the economy on track. Consider some of the recent developments:

Retail sales posted another advance in July after robust increases in May and June. Total retail sales are now above the pre-virus peak in January, as are most of the various sub-indexes monitored by market participants, such as the retail control and sales excluding autos & gasoline (chart, left).

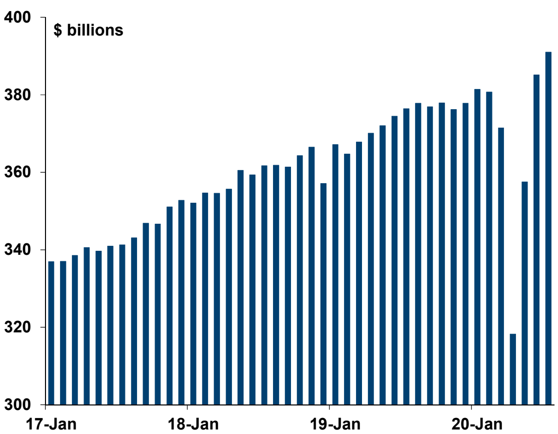
Industrial production continued to advance in July despite the acceleration in the virus. The manufacturing component is still shy of its pre-virus levels, but it has regained 60 percent of the ground lost in March and April.

Housing activity is stirring, as sales of new homes have moved above their recent high in January and pending home sales have jumped from a record low in April to a 14-year high in June (latest available).

Initial claims for unemployment insurance, while still extremely high by historical standards, are again moving lower after a brief pickup in late July. In addition, although the flow of initial claimants remains above historical norms, workers are being recalled at a faster pace, as shown by a drop in continuing unemployment claims (down in 10 of the past 12 weeks).

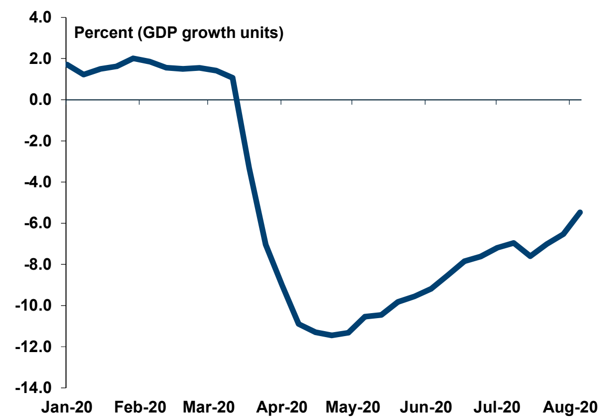
High frequency economic indicators -- daily or weekly data published with short lags -- continue to show improvement. A summary measure of 10 such indicators published by the New York Fed hesitated in July but is again moving upward (chart, right).

Retail Sales Ex. Autos & Gasoline



Source: U.S. Census Bureau via Haver Analytics

Weekly Economic Index



Source: Federal Reserve Bank of New York via Haver Analytics

The measure devised by the New York Fed is designed to mimic the four-quarter growth of real GDP. After showing a net decline of 13.3 percent (annual rate) in the prior three quarters, the current reading of -5.5 percent suggests a brisk advance in the third quarter.

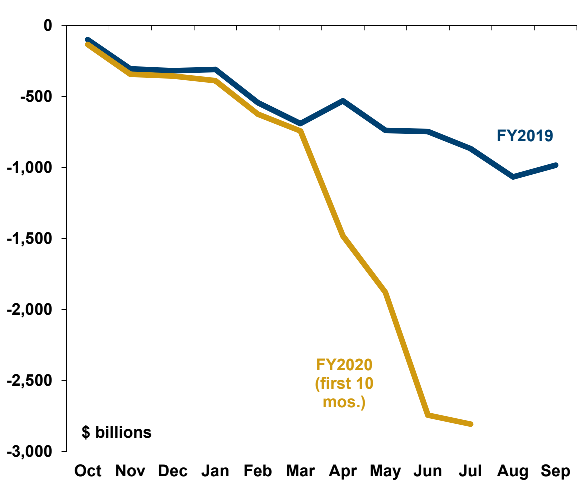
Strong support from fiscal and monetary authorities has played a key role in supporting the economy. The boost provided by the federal government is evident in the distinct shift in the budget deficit that has occurred in the past several months. As shown in the chart below, the federal deficit in the first six months of the current fiscal year (October through March) was tracking the results from fiscal year 2019 closely, but a pronounced widening has occurred in the past four months. Indeed, the budget shortfall from April through July was $1.9 trillion larger than that in the same period last year. Some of this shift reflects the normal cyclical movement of the budget rather than discretionary changes by Congress, but such “automatic stabilizers” can be viewed as a form of fiscal policy.

The chart shows only modest widening of the deficit in the latest month (the July shortfall totaled $63 billion versus $120 billion in the same month last year and an average of $648 billion in the prior three months). Some of the slowing reflects a diminution in outlays (no more recovery rebate checks, and much of the financial support for health-care providers, state and local governments, and air carriers has already gone out the door). In addition, a large portion was the result of hefty tax inflows because of the shift in tax-payment dates from April and June to July.

The Fed responded aggressively to the pandemic by reducing interest rates, restarting quantitative easing, and establishing various credit programs. The credit programs do not seem to be providing much of a push, as the facilities designed to promote credit flows have shown no net change in the past several weeks after a flurry in their early stages (chart, right). Also, the volume of activity (less than $200 billion) is well shy of the capacity of more than $4 trillion suggested when the Fed introduced the programs.

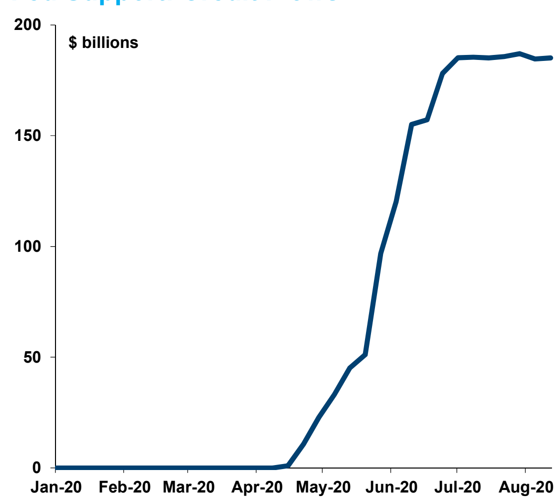
Many observers argue that take-up has been slow because the programs are restrictive and expensive. This is most likely the case, but this is as it should be. The Fed’s role is not to provide bargain financing to private-sector entities (or state and local governments in the case of the municipal credit facility). Subsidized lending would involve picking winners and losers, which should be a fiscal decision made by elected officials. The Fed’s role should be providing backstops for lending in the event of market breakdown.

Cumulative Federal Budget Deficit



Source: U.S. Treasury Department via Haver Analytics

Fed Support: Credit Flows*



** The sum of: Paycheck Protection Program Liquidity Facility, Commercial Paper Funding Facility, Corporate Credit Facilities, Main Street Facilities, Municipal Liquidity Facility, TALF II.*

Source: Federal Reserve Board via Haver Analytics; Daiwa Capital Markets America

A guideline offered long ago by Walter Bagehot, a British commentator in the mid-1800s, holds that in times of crisis central banks should lend generously against good collateral and at penalty interest rates. The Fed has not forgotten the good-collateral and penalty-rate aspects of this guideline.

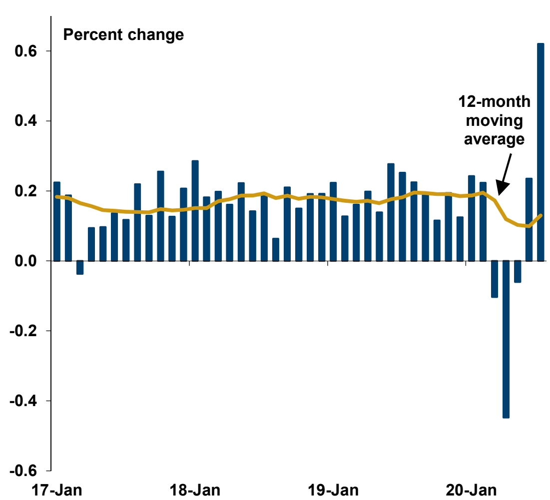
Inflation: Still Well Contained

The consumer price index for July provided a surprise, as the headline and core component both jumped 0.6 percent, easily exceeding the expected increases of 0.3 percent for the headline measure and 0.2 percent for the core component (chart, left). One might begin to wonder about price pressure emerging because of aggressive fiscal and monetary policies, but a review of the detail from the report shows that inflation is well contained.

Much of the surprise in both the headline and core indexes was the result of partial unwinding of price discounting that emerged in the early stages of the pandemic. Areas sensitive to the virus, such as air travel, hotel stays, and clothes shopping, saw marked declines in demand and businesses responded by offering sharp discounts on their goods or services. As the economy reopened in May and June, some of those discounts were reversed. However, price increases were limited, and the charges for these items remained far below pre-virus levels (chart, right). It is still cheap to fly or stay in a hotel, and prices of clothing on average are at their lowest level in more than 30 years.

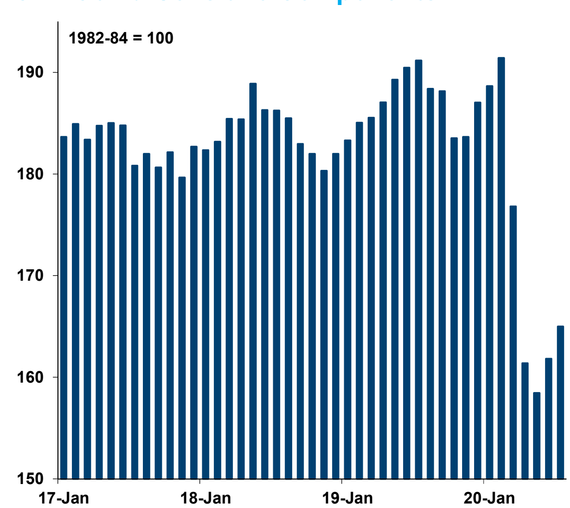
Some of the pressure in July also seemed to reflect random shifts or one-time price changes. The prices of used motor vehicles, for example, jumped 2.3 percent, but they had declined by almost the same amount over the prior three months. Tobacco prices sometimes show erratic swings, and they rose in both June and July after discounts in the prior two months. Charges for wireless telephone services, which showed almost no change during 2019 and the first half of this year (after discounting in 2017 and 2018), suddenly jumped 3.6 percent in July.

Core CPI



Source: Bureau of Labor Statistics via Haver Analytics

CPI: Covid-Sensitive Components*



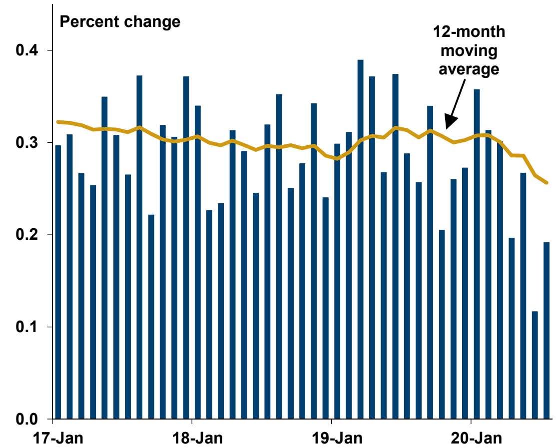
** A weighted average of the Airline Fare, Apparel, and Other Lodging Away from Home Including Hotels/Motels components of the CPI. Weights are calculated from the relative importance of each component in the overall CPI.*

Source: Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America

Some areas that might be sensitive to the slow economic environment and the potential effects of the virus did not react at the onset of the pandemic, but they might be softening now. Rental rates for primary residences rose 0.2 percent or less for the third time in the past four months. This area had been increasing at rates of 0.3 percent or more in most prior months (chart). With large gatherings either discouraged or prohibited because of the virus, prices of recreation services fell 1.2 percent, led by discounts on admission fees and club dues.

In his latest press conference, Fed Chair Jerome Powell argued that the pandemic was fundamentally a deflationary event. The recent results for the CPI, despite a surge of 0.6 percent in July, tend to support his view, as prices of items sensitive to the virus are soft and stirrings elsewhere seem to reflect random volatility.

CPI: Rent of Primary Residence



Source: Bureau of Labor Statistics via Haver Analytics

Review

Week of August 10, 2020	Actual	Consensus	Comments
PPI (July)	**0.6% Total, 0.3% Core***	**0.3% Total, 0.2% Core***	Food prices declined 0.5% after apparently random shifts in the prior two months (up 6.0% in May and down 5.2% in June). Energy prices advanced 5.3% after sharp gains in the prior two months, but energy prices are still 13.8% below the January level. Core goods prices rose 0.3% after a modest net decline in the previous three months. Increases in construction costs and prices of government services also helped to push the core index higher. Despite the increases in the headline and core indexes, the PPI remained in negative territory on a year-over-year basis (off 0.4%). The year-over-year change in the core component crept into positive territory, but only slightly so (0.1%).
CPI (July)	**0.6% Total, 0.6% Core**	**0.3% Total, 0.2% Core**	Food prices slipped 0.4% in July after a combined jump of 2.4% in the prior three months, but the decline was overwhelmed by jumps in the energy and core components (up 2.5% and 0.6%, respectively). Much of the increase in the core component represented partial reversals of discounting that occurred in the initial stages of the pandemic. Airfares, hotel fees, and apparel prices all rose sharply in July, although the levels of these components remained well below readings before the onset of Covid. Despite the upward pressure in July, year-over year changes remained subdued (1.0% for the headline index and 1.6% for the core component).
Federal Budget (July)	**$63.0 Billion Deficit**	**$90.0 Billion Deficit**	Federal revenues in July surged 124.2% from the same month last year, as the Treasury Department collected taxes postponed from due dates in April and June. Outlays jumped 68.8% on a year-over-year basis, fueled by Covid-related expenditures. The cumulative deficit for the first 10 months of FY2020 totaled $2.8 trillion, a total that dwarfed the shortfall of $866.8 billion in the same period in FY2019.
Retail Sales (July)	**1.2% Total, 1.9% Ex-Autos**	**2.1% Total, 1.3% Ex-Autos**	The third consecutive increase in retail sales did not match the robust advances in the prior two months, but it was still strong enough to push activity above the pre-virus peak in January. Sales excluding autos and gasoline (to eliminate volatile areas) also posted impressive results, with the latest reading 2.5% above the January level. While the report was favorable, it also included a few hints that consumer behavior was still different than pre-virus norms. For example, sales at nonstore vendors (primarily on line) rose 0.7% from an already vigorous level, indicating that some consumers were still avoiding brick and mortar outlets. In addition, while restaurants saw a good gain in July, the level of activity was still well below pre-virus norms.

Review Continued

Week of August 10, 2020	Actual	Consensus	Comments
Nonfarm Productivity (2020-Q2)	**7.3%**	**1.5%**	The effects of shutdowns related to Covid-19 caused output to fall sharply in Q2 (-38.9%), but hours worked fell by a larger amount (-43.0%) leading to the jump in productivity. The sharp advance in productivity was striking, but one wonders about potential distortions generated by the coronavirus and possible offsets in the future.
Industrial Production (July)	**3.0%**	**3.0%**	All three major components of industrial production contributed to the advance in in July. Output in the manufacturing sector rose 3.4%, adding to gains totaling 11.5% in the prior two months. The manufacturing sector has recouped 60% of the swoon during the spring. Mining activity increased 0.8% after declines in the prior five months, although activity remained well below levels earlier in the year. Utility output rose 3.3%, but this gain was more a function of the weather (above-normal temperatures) than economic fundamentals.
Consumer Sentiment (August)	**72.8 (+0.3 Index Pt.)**	**72.0 (-0.5 Index Pt.)**	Consumer sentiment rose slightly in early August, but the latest shift did not meaningfully change the recent picture on attitudes. Like other economic indicators, sentiment fell noticeably in the spring; unlike other indicators, it has not regained lost ground in recent months. The level of the index is not shockingly low (above the troughs in all previous recessions since 1975 and well above the low of 55.3 during the financial crisis), but it is noticeably below the reading of 101 in February.

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

Source: Bureau of Labor Statistics (PPI, CPI, Nonfarm Productivity); U.S. Treasury Department (Federal Budget); U.S. Census Bureau (Retail Sales); Federal Reserve Board (Industrial Production); University of Michigan Survey Research Center (Consumer Sentiment); Consensus forecasts are from Bloomberg

Preview

Week of August 17, 2020	Projected	Comments
Housing Starts (July) (Tuesday)	**1.240 Million (+4.6%)**	A heavy flow of buyer traffic and surprisingly strong sales of new homes in June (above the pre-virus peak in January) probably led builders to boost starts for the third consecutive month. The expected total in July is well shy of the brisk results around the turn of the year (average of 1.59 million from December through February), but it is within the upper portion of the range evident during much of 2018 and 2019.
Leading Indicators (July) (Thursday)	**0.9%**	Positive contributions from the length of the factory workweek and unemployment claims will account for much of the expected increase in the index of leading economic indicators; ISM new orders and stock prices are likely to contribute positively as well. The expected increase follows solid gains in the prior two months (a combined advance of 5.3%), but the measure would still need an additional increase of 8.8% to return to the pre-virus peak in January.
Existing Home Sales (July) (Friday)	**5.00 Million (+5.9%)**	Increases in pending home sales and mortgage applications point to another gain in sales of existing homes after a jump of 20.7% in June. Although sales in the past two months were probably strong, the level of activity expected in July would still trail the January-February average by 10.6%.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

August/September 2020

Monday	Tuesday	Wednesday	Thursday	Friday
10	11	12	13	14
JOLTS DATA Openings (000) Quit Rate Apr 4,996 1.4% May 5,371 1.6% June 5,889 1.9%	**NFIB SMALL BUSINESS OPTIMISM INDEX** May 94.4 June 100.6 July 98.8 **PPI** Final Demand Core* May 0.4% 0.1% June -0.2% 0.3% July 0.6% 0.3%	**CPI** Total Core May -0.1% -0.1% June 0.6% 0.2% July 0.6% 0.6% **FEDERAL BUDGET** 2020 2019 May -$398.8B -$207.8B June -$864.1B -$8.5B July -$63.0B -$119.7B	**UNEMPLOYMENT CLAIMS** Initial Continuing (Millions) July 18 1.422 16.951 July 25 1.435 16.090 Aug 01 1.191 15.486 Aug 08 0.963 N/A **IMPORT/EXPORT PRICES** Non-petrol Imports Nonagri. Exports May 0.2% -0.1% June 0.3% 1.2% July 0.2% 0.7%	**RETAIL SALES** Total Ex.Autos May 18.3% 12.3% June 8.4% 8.3% July 1.2% 1.9% **PRODUCTIVITY & COSTS** Productivity Unit Labor Costs 19-Q4 1.6% 1.7% 20-Q1 -0.3% 9.8% 20-Q2 7.3% 12.2% **IP & CAP-U** IP Cap.Util. May 0.9% 64.8% June 5.7% 68.5% July 3.0% 70.6% **CONSUMER SENTIMENT** June 78.1 July 72.5 Aug 72.8 **BUSINESS INVENTORIES** Inventories Sales Apr -1.4% -14.4% May -2.3% 8.5% June -1.1% 8.4%
17	18	19	20	21
EMPIRE MFG (8:30) June -0.2 July 17.2 Aug -- **NAHB HOUSING INDEX (10:00)** June 58 July 72 Aug -- **TIC DATA (4:00)** Total Net L-T Apr $121.7B -$130.8B May -$4.5B $127.0B June -- --	**HOUSING STARTS (8:30)** May 1.011 million June 1.186 million **July 1.240 million**	**FOMC MINUTES (2:00)**	**INITIAL CLAIMS (8:30)** **PHILLY FED INDEX (8:30)** June 27.5 July 24.1 Aug -- **LEADING INDICATORS (10:00)** May 3.2% June 2.0% **July 0.9%**	**EXISTING HOME SALES (10:00)** May 3.91 million June 4.72 million **July 5.00 million**
24	25	26	27	28
CHICAGO FED NATIONAL ACTIVITY INDEX	**FHFA HOME PRICE INDEX** **S&P CASE-SHILLER 20-CITY HOME PRICE INDEX** **CONSUMER CONFIDENCE** **NEW HOME SALES**	**DURABLE GOODS ORDERS**	**INITIAL CLAIMS** **REVISED GDP** **PENDING HOME SALES**	**PERSONAL INCOME, CONSUMPTION, CORE PRICE INDEX** **U.S. INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES** **CHICAGO PURCHASING MANAGERS' INDEX** **REVISED CONSUMER SENTIMENT**
31	1	2	3	4
	ISM INDEX **CONSTRUCTION SPEND.** **VEHICLE SALES**	**ADP EMPLOYMENT REPORT** **FACTORY ORDERS** **BEIGE BOOK**	**INITIAL CLAIMS** **TRADE BALANCE** **REVISED PRODUCTIVITY & COSTS** **ISM NON-MFG-INDEX**	**EMPLOYMENT REPORT**

*Forecasts in Bold. * The Core PPI excludes food, energy, and trade services.*

Treasury Financing

August/September 2020

Monday	Tuesday	Wednesday	Thursday	Friday
10	11	12	13	14
AUCTION RESULTS: Rate Cover 13-week bills 0.105% 2.75 26-week bills 0.120% 2.98	**AUCTION RESULTS:** Rate Cover 52-week bills 0.140% 3.32 3-year notes 0.179% 2.44 42-day CMB 0.095% 3.19 119-day CMB 0.110% 3.39 **ANNOUNCE:** $30 billion 4-week bills for auction on August 13 $35 billion 8-week bills for auction on August 13 $25 billion 105-day CMBs for auction on August 12 $30 billion 154-day CMBs for auction on August 12 **SETTLE:** $30 billion 4-week bills $35 billion 8-week bills $25 billion 105-day CMBs $30 billion 154-day CMBs	**AUCTION RESULTS:** Rate Cover 10-yr notes 0.677% 2.41 105-day CMB 0.110% 3.42 154-day CMB 0.120% 3.28	**AUCTION RESULTS:** Rate Cover 4-week bills 0.085% 3.36 8-week bills 0.100% 3.03 30-yr bonds 1.406% 2.14 **ANNOUNCE:** $105 billion 13-,26-week bills for auction on August 17 $25 billion 20-year bonds for auction on August 19 $7 billion 30-year TIPS for auction on August 20 $30 billion 42-day CMBs for auction on August 18 $30 billion 119-day CMBs for auction on August 18 **SETTLE:** $105 billion 13-,26-week bills $34 billion 52-week bills $30 billion 42-day CMBs $30 billion 119-day CMBs	
17	18	19	20	21
AUCTION: $105 billion 13-,26-week bills **SETTLE:** $48 billion 3-year notes $38 billion 10-year notes $26 billion 30-year bonds	**AUCTION:** $30 billion 42-day CMBs $30 billion 119-day CMBs **ANNOUNCE:** $30 billion* 4-week bills for auction on August 20 $35 billion* 8-week bills for auction on August 20 **SETTLE:** $30 billion 4-week bills $35 billion 8-week bills $25 billion 105-day CMBs $30 billion 154-day CMBs	**AUCTION:** $25 billion* 20-year bonds	**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills $7 billion 30-year TIPS **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on August 24 $22 billion* 2-year FRNs for auction on August 26 $50 billion* 2-year notes for auction on August 25 $51 billion* 5-year notes for auction on August 26 $47 billion* 7-year notes for auction on August 27 **SETTLE:** $105 billion 13-,26-week bills $30 billion 42-day CMBs $30 billion 119-day CMBs	
24	25	26	27	28
AUCTION: $105 billion* 13-,26-week bills	**AUCTION:** $50 billion* 2-year notes **ANNOUNCE:** $30 billion* 4-week bills for auction on August 27 $35 billion* 8-week bills for auction on August 27 **SETTLE:** $30 billion* 4-week bills $35 billion* 8-week bills	**AUCTION:** $22 billion* 2-year FRNs $51 billion* 5-year notes	**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills $47 billion* 7-year notes **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on August 31 **SETTLE:** $105 billion* 13-,26-week bills	**SETTLE:** $22 billion* 2-year FRNs
31	1	2	3	4
AUCTION: $105 billion* 13-,26-week bills **SETTLE:** $25 billion 20-year bonds $7 billion 30-year TIPS $50 billion* 2-year notes $51 billion* 5-year notes $47 billion* 7-year notes	**ANNOUNCE:** $30 billion* 4-week bills for auction on September 3 $35 billion* 8-week bills for auction on September 3 **SETTLE:** $30 billion* 4-week bills $35 billion* 8-week bills		**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on September 8 $34 billion* 52-week bills for auction on September 8 $50 billion* 3-year notes for auction on September 8 $35 billion* 10-year notes for auction on September 9 $23 billion* 30-year bonds for auction on September 10 **SETTLE:** $105 billion* 13-,26-week bills	

**Estimate*