U.S. Economic Comment

- Sources of support: vigorous rebound in housing; improvement in capital spending
- Financial positions of households and businesses: deceiving

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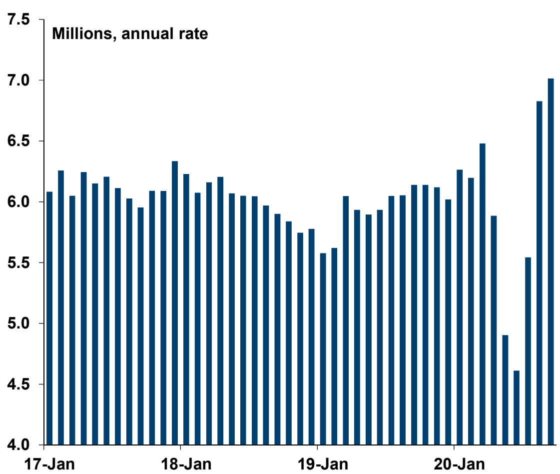
Favorable Developments: Housing and CapEx

We were struck by the positive tone to Fed Chair Jerome Powell's press briefing on September 16. In his prepared remarks, he emphasized the pickup in economic activity in the third quarter and the upward revisions to the outlooks of Fed officials in all of 2020, a contrast to commentary in the financial press that typically describes the expansion as stalling. He noted the pickup in consumer spending on goods, which has moved above pre-virus peaks, and he mentioned signs of improvement in housing and capital spending by businesses.

Statistics released this week supported Chair Powell's upbeat view. The results on housing were especially impressive, as sales of both new and existing homes rose for the fourth consecutive month. Activity in both areas in July had already moved above the pre-virus highs, and the additional gain in August pushed sales into the low portion of the range seen during the housing bubble (the best level since December 2006; chart, left). The pronounced increase in the past few months might lead one to suspect that recent activity represents a flurry that will soon fade, but the National Association of Realtors (the source of data on existing home sales) reported that plenty of buyers are in the pipeline ready to enter the market.

Recent sales activity should stir new home construction. Housing starts already have improved a good deal, with single-family starts moving to the elevated levels seen around the turn of the year when favorable weather helped to stir activity. A record reading on the sentiment index published by the National Association of Home Builders also bodes well for new construction, as does a lean inventory of homes for sale. The number of new homes for sale has declined for five consecutive months, and these declines, combined with brisk sales, have pushed the months' supply of homes for sale to a record low (chart, right).

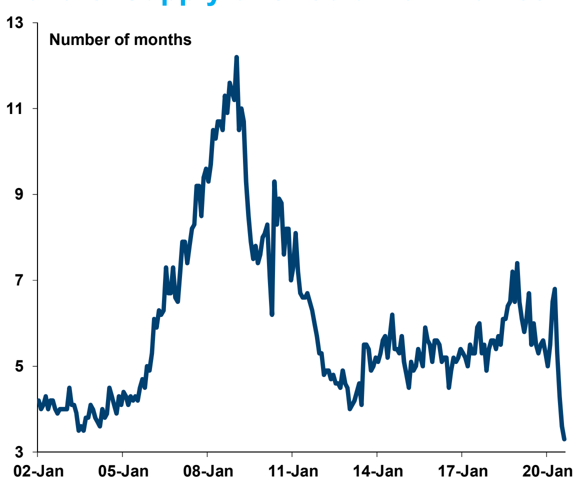
Total Home Sales*



** Sales of existing and new homes.*

Source: U.S. Census Bureau and National Association of Realtors via Haver Analytics

Months' Supply of Unsold New Homes

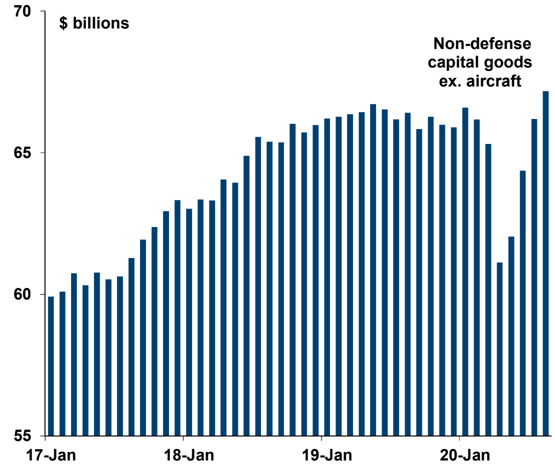


Source: U.S. Census Bureau via Haver Analytics

We would not be wildly optimistic about the outlook for capital spending, as the pandemic has injected a strong element of uncertainty in the economic outlook, and business executives tend to be cautious in undertaking capital projects during uncertain times.

Still, recent developments have offered encouragement. New orders for nondefense capital goods other than aircraft, a series that provides insight into outlays for new equipment in coming months, has posted a solid recovery from the spring swoon, with bookings in August moving above levels seen just before the onset of the pandemic (although still shy of some of the best observations from the previous expansion).

Shipments of Durable Goods



Source: U.S. Census Bureau via Haver Analytics

New orders provide insight into what lies ahead. Shipments of nondefense capital goods other than aircraft provide clues on likely spending in the current quarter. Here, too, the rebound has been impressive, with the August total moving above pre-virus norms (chart). Growth in July and August relative to the second quarter totals more than 35 percent at an annual rate. Imports of capital equipment also seem to be on a firm track, as July totals were far above the second quarter average (August figures will be published on September 29). Recent shipments and imports of capital goods point to vigorous results on equipment spending in Q3. This strong performance has occurred despite weak results in the aircraft sector, where manufacturers have seen negative order flows (i.e. net cancellations) in five of the past six months.

We should not get too carried away about prospects for capital spending, as equipment outlays represent only a bit more than 40 percent of business fixed investment (investment in new structures and intellectual property represent the balance). Activity on intellectual property front is difficult to track in real time, but available data on business-related construction show still-weak results.

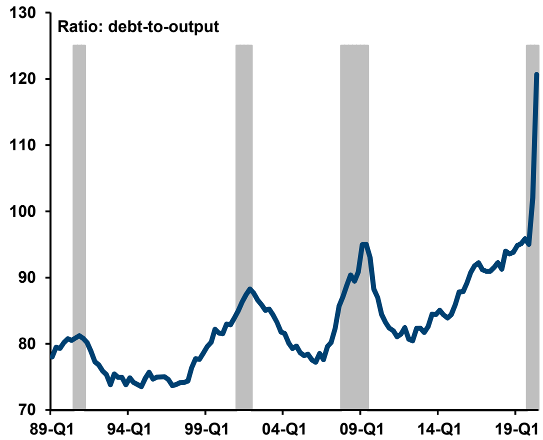
Household and Corporate Financial Positions: Muddled Pictures

The Federal Reserve released this week the Financial Accounts of the U.S. for the second quarter (formerly called the flow of funds accounts). Data showed distinct shifts in the financial standing of households and businesses (positive for households and negative for businesses), but unique pandemic-related influences played a role and left distorted pictures of underlying conditions.

The shift in the corporate sector was pronounced, as debt rose at an annual rate of 13.3 percent in the second quarter after a surge of 28.4 percent in the first three months of the year. The combined changes led to an explosion in the ratio of debt to output in the corporate sector (chart, next page). Digging into the details, though, shows that the situation is not especially troubling.

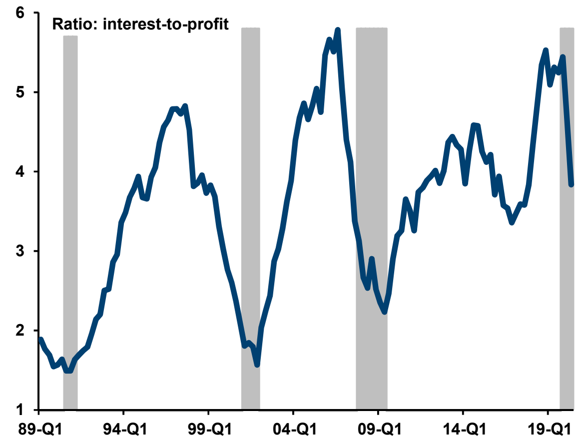
Most of the expansion in debt in the first quarter involved loans, and the loans primarily represented the drawdown of lines of credit to insure that firms had adequate cash balances in the uncertain environment generated by the coronavirus. It was not a reckless borrowing spree by financial managers. With the environment now a bit more settled, commercial and industrial loans at banks have been declining, most likely because firms see less need for precautionary balances and are trimming the exercised credit lines.

Corporate Debt Relative to Output*



** The shaded areas indicate periods of recession in the United States.*
Source: Federal Reserve Board, Financial Accounts of the United States and National Bureau of Economic Research via Haver Analytics

Interest Coverage Ratio*



** The shaded areas indicate periods of recession in the United States.*
Source: Federal Reserve Board, Financial Accounts of the United States and National Bureau of Economic Research via Haver Analytics

The increase in debt in the second quarter largely involved the issuance of corporate bonds, and this issuance was probably driven by the desire to take advantage of the unusually low level of interest rates. Debt issuance at this time might be viewed as a strategy that leaves a corporation better off in the long-run. Loans through the Paycheck Protection Program might have been a small factor in Q2. However, the figures shown in the charts are for the corporate sector, and PPP support (supposedly) went to small- and medium-sized businesses rather than corporations.

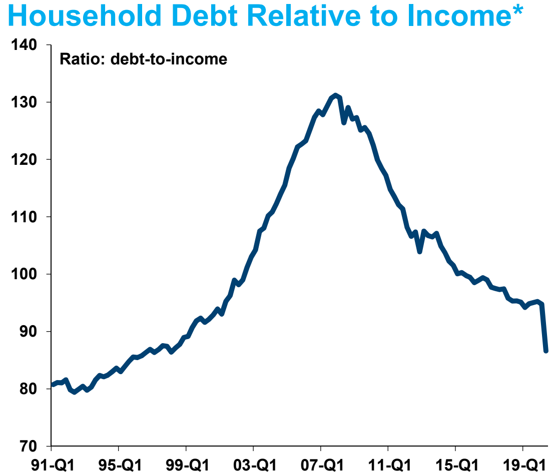
Much of the surge in the ratio of debt-to-output reflected a sharp decline in output during the second quarter (recall that GDP fell at an annual rate of 31.7 percent in Q2). Available data suggest that production will rebound briskly in Q3, with corporations most likely accounting for much of the advance (small- and medium-sized businesses are having a more difficult time with the virus). A brisk rebound in output will trim this ratio considerably.

With low interest rates, corporations should be able to service the debt with little difficulty. The interest coverage ratio (profits-to-interest payments) slipped in Q2, but it remained in the middle of its historical range despite a precipitous drop in profits (chart, above right). If profits return to a historically normal level in the post-virus era, the coverage ratio will move back to the upper portion of its historical range.

Households seemed to move in the opposite direction with the ratio of debt-to-personal income taking a noticeable step downward (chart). Certainly, individuals were cautious with debt usage in the second quarter, as total obligations rose only modestly (annual rate of 0.8 percent). Mortgage debt grew at a pace in line with advances in other recent quarters (3.1 percent), but individuals paid down consumer credit, largely because of lockdowns and limited use of credit cards.

While debt growth was soft, the primary reason for the drop in the ratio of debt-to-income was a jump in income. The advance in income, in turn, was fueled by transfer payments from the federal government (recovery rebate checks and enhanced unemployment benefits). Without such support, the debt-to-income ratio would have changed little, and if Congress does not authorize more support, the ratio will return to its previous range in Q3.

Household Debt Relative to Income*



** Household debt as a share of disposable personal income.*
Source: Bureau of Economic Analysis and Federal Reserve Board, Financial Accounts of the United States via Haver Analytics

Review

Week of Sept. 21, 2020	Actual	Consensus	Comments
Existing Home Sales (August)	**6.00 Million (+2.4%)**	**6.00 Million (+2.4%)**	The increase in existing home sales in August marked the third consecutive gain and added an accent to the robust advances in June and July (up 20.2% and 24.7%, respectively). Sales in July had already moved above the pre-virus high in February, and the addition in August moved sales 4.2% above the February total and to the highest level since December 2006. The pickup in sales and a decline in inventories (-0.7%), pushed the months' supply of homes available for sale to 3.0 months, down from 3.1 in the prior month and a reading near the bottom of the historical range.
New Home Sales (August)	**1.011 Million (4.8%)**	**0.890 Million (-1.2%)**	After strong gains in the prior three months that had already pushed sales above pre-virus levels, the jump in new home sales in August (and upward revisions in the prior three months) left activity 30.6% above the pre-virus peak in January. The level of sales in August was still lower than most observations during the bubble period in the early-to-mid 2000s, but it was in the upper portion of the range of sales excluding the bubble period. The brisk pace of sales cleared numerous homes from the market, as the number of homes for sale fell for the fifth consecutive month. With inventory down and sales up, the months' supply of homes for sale eased to 3.3 months, a record low reading for this measure of inventories.
Durable Goods Orders (August)	**0.4%**	**1.5%**	New orders for durable goods rose for the fourth consecutive month in August, although the latest increase was modest and pushed bookings only marginally closer to pre-virus norms. As of August, orders retraced 83% of the ground lost during the spring. Orders for durable goods in recent months have been restrained by the transportation category, which has been influenced by poor results for commercial aircraft. Excluding transportation, durable orders rose 0.4% but the increase was enough to push bookings above the pre-virus level. Orders for nondefense capital goods other than aircraft posted firm results with an increase of 1.8%. This series also moved above its pre-virus peak, boding well for capital spending in the months ahead.

Sources: National Association of Realtors (Existing Home Sales); U.S. Census Bureau (New Home Sales, Durable Goods Orders); Consensus forecasts are from Bloomberg

Preview

Week of Sept. 28, 2020	Projected	Comments
U.S. International Trade in Goods (August) (Tuesday)	**$78.0 Billion Deficit ($1.9 Billion Wider Deficit)**	Imports have regained more than 80% of the ground lost from the slowdown in trade during the spring, and thus they seem to have limited upside potential in August. Exports, in contrast, have recouped only about half of the virus-related slippage, and therefore could show noticeable improvement. Despite the expected improvement in the goods trade balance, the shortfall in the first two months of the third quarter would still be noticeably wider than that in Q2, suggesting a sizeable drag from net exports on GDP growth, possibly larger than the average constraint of 1.2 percentage points in the prior three quarters.
Consumer Confidence (September) (Tuesday)	**84.0 (-0.8 Index Pt.)**	The contrasting influences of improvement in the labor market and the retreat in equity prices are likely to lead to little change in the Conference Board's measure of consumer confidence.
Revised GDP (2020-Q2) (Wednesday)	**-31.0% (+0.7 Pct. Pt. Revision)**	The numerous obscure reports that feed into the final estimate of GDP could tilt growth in either direction, but the major economic statistics suggest a modest upward revision (i.e. a smaller decline). In terms of components, firmer consumer spending and residential construction are likely to more than offset softer net exports.
Personal Income, Consumption, Prices (August) (Thursday)	**-2.5%, 1.0%, 0.3%**	Job growth in August will probably push wages and salaries higher, but a drop in transfer payments, especially unemployment compensation, is likely to more than offset the increase in wages. On the spending side, further gains in vehicle sales and another favorable report on retail activity suggest firm growth. Outlays for services are likely to contribute positively as well, although they will continue to lag spending on goods by a wide margin. The reversal of discounts seen during the spring should lead to another above-average increase in the core price index.
ISM Manufacturing Index (September) (Thursday)	**54.0% (-2.0 Pct. Pts.)**	The manufacturing sector is in recovery mode, but the pace of activity seems to be easing from that in the late spring and early summer, and thus the elevated reading in the ISM index for August (the best since late 2018) will be difficult to sustain. Readings of more than 60% in the new orders and production components seem vulnerable on the downside. The employment component, in contrast, could improve from the low-side observation of 44.4% in August.
Construction Spending (August) (Thursday)	**0.5%**	Business-related construction has been soft throughout the year, and tight budgets seem to be having a constraining effect on building by state and local governments. However, firm housing starts in the past two months suggest that a jump in residential activity will provide an offset to the soft areas. The expected increase in total construction, while welcome, would offset only a small portion of the declines from March to June.

Preview Continued

Week of Sept. 28, 2020	Projected	Comments
Payroll Employment (September) (Friday)	**900,000**	The downward trend in the number of individuals receiving unemployment benefits suggests that worker recalls exceed the still-elevated number of layoffs, which should lead to another strong advance in employment, although lighter than the average of 1.55 million in the prior two months. The household survey is likely to show a much smaller employment gain than the 3.756 million in August, which should leave the unemployment rate little changed. Average hourly earnings in August were still well above the pre-virus trend, and the recall of lower-wage workers could lead to a drop in September.
Revised Consumer Sentiment (September) (Friday)	**78.0 (-0.9 Index Pt. Revision)**	With new orders for durable goods increasing only 0.4% in August (published September 25), total factory bookings will most likely trail by a wide margin the average increase of 6.9% in the prior three months. The nondurable sector is likely to contribute to the deceleration with an expected increase of 0.8%. Part of the increase in the nondurable area will reflect higher prices of petroleum products. Excluding petroleum, orders for nondurable goods will probably follow the lead in the durable area and advance moderately.
Factory Orders (August) (Friday)	**0.6%**	The drop in equity values in the second half of September raises the possibility of a downward revision to the sentiment index. The initial estimate was not impressive, as it was only moderately above the April low and 21.9% below the pre-virus peak in February.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

September/October 2020

Monday	Tuesday	Wednesday	Thursday	Friday
21	22	23	24	25
CHICAGO FED NATIONAL ACTIVITY INDEX Monthly / 3-Mo. Avg. June 5.84 -2.55 July 2.54 4.23 Aug 0.79 3.05	**EXISTING HOME SALES** June 4.70 million July 5.86 million Aug 6.00 million	**FHFA HOME PRICE INDEX** May -0.2% June 1.0% July 1.0%	**UNEMPLOYMENT CLAIMS** Initial / Continuing (Millions) Aug 29 0.884 13.544 Sept 05 0.893 12.747 Sept 12 0.866 12.580 Sept 19 0.870 N/A **NEW HOME SALES** June 0.841 million July 0.965 million Aug 1.011 million	**DURABLE GOODS ORDERS** June 7.7% July 11.7% Aug 0.4%
28	29	30	1	2
	U.S. INTERNATIONAL TRADE IN GOODS (8:30) June -$71.0 billion July -$80.1 billion **Aug -$78.0 billion** **ADVANCE INVENTORIES REPORT (8:30)** Wholesale / Retail June -1.3% -2.7% July -0.3% 1.2% Aug -- -- **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX (9:00)** SA / NSA May 0.0% 0.3% June 0.0% 0.2% July -- -- **CONFERENCE BOARD CONSUMER CONFIDENCE (10:00)** July 91.7 Aug 84.8 **Sept 84.0**	**ADP EMPLOYMENT REPORT (8:15)** Private Payrolls July 212,000 Aug 428,000 Sept -- **REVISED GDP (8:30)** GDP / Chained Price 20-Q1 -5.0% 1.4% 20-Q2(p) -31.7% -2.0% **20-Q2(r) -31.0% -2.0%** **CHICAGO PURCHASING MANAGERS' INDEX (9:45)** Index / Prices July 51.9 56.9 Aug 51.2 55.0 Sept -- -- **PENDING HOMES SALES (10:00)** June 15.8% July 5.9% Aug --	**INITIAL CLAIMS (8:30)** **PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX (8:30)** Inc. / Cons. / Core June -1.0% 6.2% 0.3% July 0.4% 1.9% 0.3% **Aug -2.5% 1.0% 0.3%** **ISM INDEX (10:00)** Index / Prices July 54.2 53.2 Aug 56.0 59.5 **Sept 54.0 58.0** **CONSTRUCTION SPEND. (10:00)** June -0.5% July 0.1% **Aug 0.5%** **VEHICLE SALES** July 14.6 million Aug 15.2 million **Sept 15.5 million**	**EMPLOYMENT REPORT (8:30)** Payrolls / Un. Rate July 1,734,000 10.2% Aug 1,371,000 8.4% **Sept 900,000 8.4%** **REVISED CONSUMER SENTIMENT (10:00)** July 72.5 Aug 74.1 Sept(p) 78.9 **Sept(r) 78.0** **FACTORY ORDERS (10:00)** June 6.4% July 6.5% **Aug 0.6%**
5	6	7	8	9
ISM NON-MFG INDEX	**TRADE BALANCE** **JOLTS DATA**	**FOMC MINUTES** **CONSUMER CREDIT**	**INITIAL CLAIMS**	**WHOLESALE TRADE**
12	13	14	15	16
COLUMBUS DAY	**NFIB SMALL BUSINESS OPTIMISM INDEX** **CPI** **FEDERAL BUDGET (POSSIBLY POSTPONED)**	**PPI**	**INITIAL CLAIMS** **IMPORT/EXPORT PRICES** **EMPIRE MFG. INDEX** **PHILLY FED INDEX**	**RETAIL SALES** **IP & CAP-U** **CONSUMER SENTIMENT** **BUSINESS INVENTORIES** **TIC DATA**

Forecasts in Bold. (p) = preliminary (2nd estimate of GDP); (r) = revised (3rd estimate of GDP)

Treasury Financing

September/October 2020

Monday	Tuesday	Wednesday	Thursday	Friday
21	22	23	24	25
AUCTION RESULTS: Rate Cover 13-week bills 0.100% 2.89 26-week bills 0.105% 3.23	**AUCTION RESULTS:** Rate Cover 2-year notes 0.136% 2.42 42-day CMB 0.085% 3.61 119-day CMB 0.095% 3.95 **ANNOUNCE:** $30 billion 4-week bills for auction on September 24 $35 billion 8-week bills for auction on September 24 $25 billion 105-day CMBs for auction on September 23 $30 billion 154-day CMBs for auction on September 23 **SETTLE:** $30 billion 4-week bills $35 billion 8-week bills $25 billion 105-day CMBs $30 billion 154-day CMBs	**AUCTION RESULTS:** Margin Cover 2-year FRN 0.058% 2.88 Rate Cover 5-year notes 0.275% 2.52 105-day CMB 0.090% 4.08 154-day CMB 0.100% 3.29	**AUCTION RESULTS:** Rate Cover 4-week bills 0.075% 3.88 8-week bills 0.090% 3.60 7-year notes 0.462% 2.42 **ANNOUNCE:** $105 billion 13-,26-week bills for auction on September 28 $30 billion 42-day CMBs for auction on September 29 $30 billion 119-day CMBs for auction on September 29 **SETTLE:** $105 billion 13-,26-week bills $30 billion 42-day CMBs $30 billion 119-day CMBs	
28	29	30	1	2
AUCTION: $105 billion 13-,26-week bills	**AUCTION:** $30 billion 42-day CMBs $30 billion 119-day CMBs **ANNOUNCE:** $30 billion* 4-week bills for auction on October 1 $35 billion* 8-week bills for auction on October 1 **SETTLE:** $30 billion 4-week bills $35 billion 8-week bills $25 billion 105-day CMBs $30 billion 154-day CMBs	**SETTLE:** $22 billion 20-year bonds $12 billion 10-year TIPS $52 billion 2-year notes $53 billion 5-year notes $50 billion 7-year notes	**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on October 5 $34 billion* 52-week bills for auction on October 6 $52 billion* 3-year notes for auction on October 6 $35 billion* 10-year notes for auction on October 7 $23 billion* 30-year bonds for auction on October 8 **SETTLE:** $105 billion 13-,26-week bills $30 billion 42-day CMBs $30 billion 119-day CMBs	
5	6	7	8	9
AUCTION: $105 billion* 13-,26-week bills	**AUCTION:** $34 billion* 52-week bills $52 billion* 3-year notes **ANNOUNCE:** $30 billion* 4-week bills for auction on October 8 $35 billion* 8-week bills for auction on October 8 **SETTLE:** $30 billion* 4-week bills $35 billion* 8-week bills	**AUCTION:** $35 billion* 10-year notes	**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills $23 billion* 30-year bonds **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on October 13 **SETTLE:** $105 billion* 13-,26-week bills $34 billion* 52-week bills	
12	13	14	15	16
COLUMBUS DAY	**AUCTION:** $105 billion* 13-,26-week bills **ANNOUNCE:** $30 billion* 4-week bills for auction on October 15 $35 billion* 8-week bills for auction on October 15 **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 October 19 $22 billion* 20-year bonds for auction on October 21 $17 billion* 5-year TIPS for auction on October 22 **SETTLE:** $105 billion* 13-,26-week bills $52 billion* 3-year notes $35 billion* 10-year notes $23 billion* 30-year bonds	

*Estimate