Daiwa Capital Markets

U.S. Economic Comment

- Federal budget: a deep deficit; a surge in debt; does it matter?
- Unemployment claims: disappointing, but not alarming

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The Federal Budget, Fiscal Year 2020

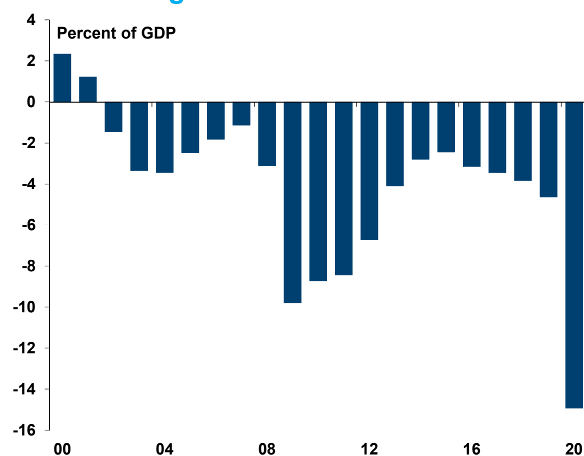
The Treasury Department on Friday afternoon published budget results for September, which completed the latest fiscal year. The annual deficit of $3.132 trillion was not surprising, as weak revenue flows and hefty outlays in earlier months left no doubt that the federal government was spilling massive amounts of red ink.

Still, the results were striking. Measured as a share of GDP, the shortfall will total approximately 15 percent of GDP (chart, left; a precise calculation is not possible until October 29, when Q3 GDP will be published). This tally is far wider than the 9.8 percent registered during the financial crisis and is exceeded only by the shortfall registered during World War II. Data for the 1940s is limited, but available figures suggest a deficit of more than 25 percent of GDP in 1943. Even the Great Depression did not generate anything close to the latest shortfall (an estimate of six to seven percent in 1934).

In one sense, the deficit, while huge, is not alarming. Most of the shortfall was the result of the extraordinary efforts by the federal government to fight the pandemic, and presumably, these activities will be temporary. As shown in the chart on the right, budget results for the first six months of the fiscal year were largely on track with those in fiscal year 2019, but receipts tumbled and outlays surged from April on. We expect the federal government to provide additional anti-Covid support in the months ahead, but it most likely will be less than that offered in fiscal 2020 and we expect (hope?) that little support will be needed in 2022.

At the same time, there are concerns. Although the budget deficit was not slipping badly before the onset of the pandemic, the government's fiscal position was not strong last year and it would have been unhealthy this year even if the virus had not occurred. The deficit in the absence of Covid probably would have topped $1.0 trillion in FY2020 or almost five percent of GDP, a poor showing for an economy that was operating close to, perhaps beyond, full employment.

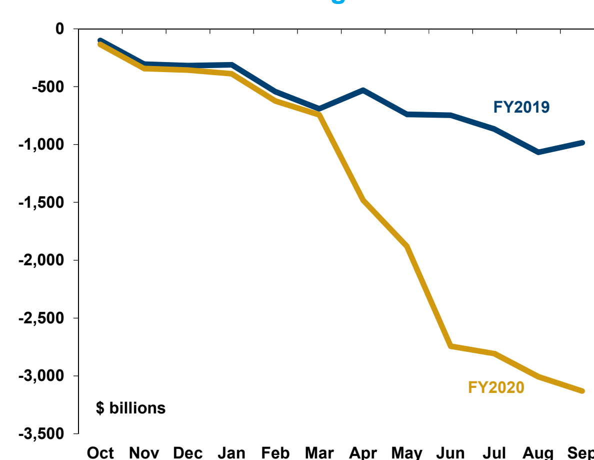
Federal Budget Balance*



** The federal budget deficit as a share of nominal GDP. The reading for FY2020 is an estimate based on available data.*

Source: Bureau of Economic Analysis and U.S. Treasury Department via Haver Analytics; Daiwa Capital Markets America

Cumulative Federal Budget Deficit



Source: U.S. Treasury Department via Haver Analytics

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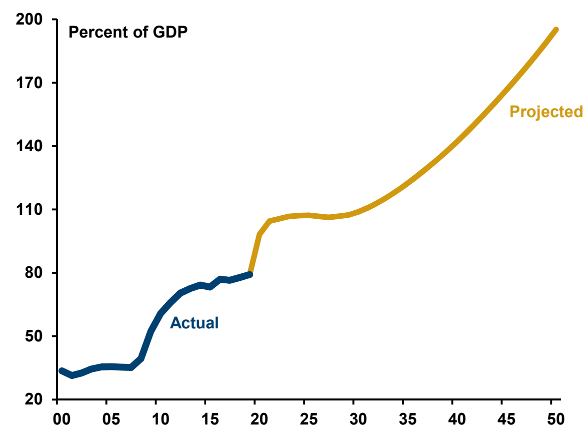
In addition, the budget outlook is not encouraging even if the virus is eradicated. The standard 10-year projections of the Congressional Budget Office show a deficit in excess of $1.0 trillion every year through 2030 and never dropping below four percent of GDP. Longer-term projections by the CBO (out to 2050) are more troubling, as CBO estimates that current law will gradually drive the deficit to more than 12 percent of GDP, readings close to the stunning total for fiscal 2020. Deficits of this magnitude will lead to an explosion of federal debt in coming years, with the CBO showing the ratio of debt-to-GDP approaching 200 percent (chart).

Debt Held by the Public as a Share of GDP*



** The readings for 2020-2050 are projections by the Congressional Budget Office.*

Source: Congressional Budget Office via Haver Analytics; The Long-Term Budget Outlook, September 2020. The Congressional Budget Office. https://www.cbo.gov/publication/56516

Does It Matter?

The figures are stunning, but several pundits these days are dismissing risks that might be associated with surging federal debt. We have attended two webinars in recent months, one sponsored by the Brookings Institution and one by IHS Markit, where participants advanced the benign view of federal debt. The crux of their argument is that the burden of debt rather than the level of obligations is the relevant consideration, and with interest rates at today's low levels, federal debt is easily manageable.

They have a point, as the net interest expense of the federal government has been well contained. Indeed, the new budget figures show that the net interest expense of the federal government declined 8.2 percent in the latest year despite the issuance of debt to fund a $3 trillion deficit. Also, the CBO expects that net interest as a share of GDP will move slightly lower over the next three years.

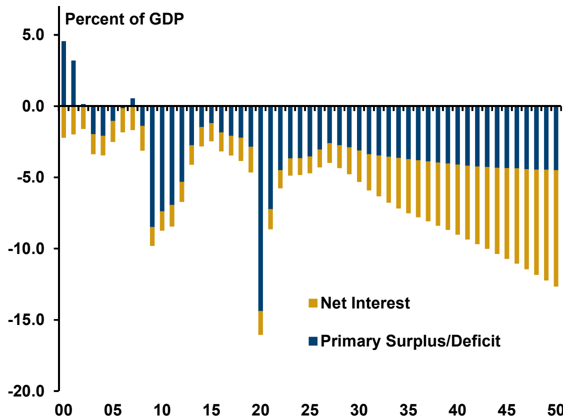
The benign view of debt is interesting, but restrained interest expense might be a short-term phenomenon, as interest rates are not likely to remain at current levels indefinitely. The quantitative easing program of the Federal Reserve is most likely playing a role in containing rates, and this policy will eventually end. In addition, the market forces that have pushed interest rates to low levels might carry less sway in the future. Finally, the natural compounding effect of debt and interest will drive expense higher in the future.

The long-term estimates of the Congressional Budget Office have interest rates moving closer to historical norms in the future, with the yield on 10-year Treasuries gradually increasing from 0.9 percent this year to an average of 4.4 percent in the decade leading up to 2050. This pickup, along with normal compounding, leads to a surge in interest expense. As shown in the two charts on the next page, interest expense is the most important consideration driving outlays and the deficit higher in coming years.

Enlarged deficits and debt also are a concern because they reduce the "fiscal space" of the government. That is, they limit the ability of the federal government to address issues such as recessions, wars, natural disasters, or other emergencies. As it stands, the government in the future will be reduced to providing health care and paying interest.

To be sure, Congress and the Administration need to contend with the pandemic. But officials also need to consider steps to counter some of the fiscal wreckage this year (and additional anti-pandemic efforts in the new fiscal year). Even the debt apologist at the IHS Markit webinar indicated that anti-deficit steps will be needed.

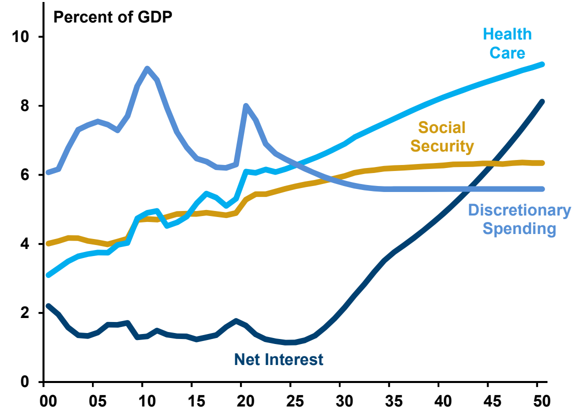
Primary Budget Balance & Net Interest*



** The primary budget balance excludes net interest expense. The readings for 2020-2050 are projections by the Congressional Budget Office.*

Source: Historical data are from the Congressional Budget Office; The Long-Term Budget Outlook, September 2020. The Congressional Budget Office. https://www.cbo.gov/publication/56516

Key Government Expenditures*



** The readings for 2020-2050 are projections by the Congressional Budget Office.*

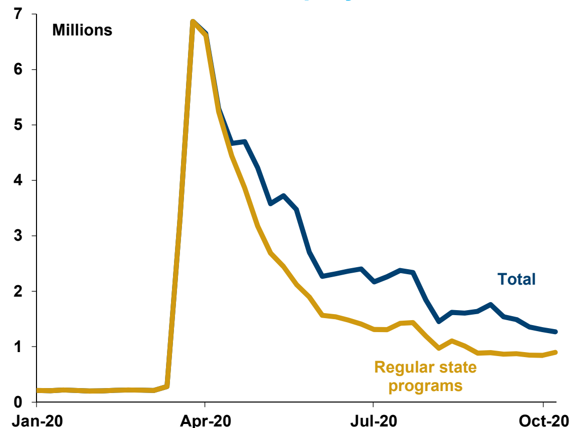
Source: Historical data are from the Congressional Budget Office; The Long-Term Budget Outlook, September 2020. The Congressional Budget Office. https://www.cbo.gov/publication/56516

Unemployment Claims

The latest weekly reading on initial claims for unemployment insurance received a good bit of media attention, as the latest figure showed a sizeable increase, suggesting renewed weakness in the labor market. Actually, the softening started several weeks ago, as initial claims have registered a slight net increase since late August.

The results are disappointing, but they are slightly less troubling than they might appear at first blush. While claims in the regular state-run programs have increased in recent weeks, claims associated with programs authorized by the CARES Act have moved lower. Total initial claims (regular plus CARES-related) still have a downward tilt (chart). The improvement is modest, and claims are still at a shocking level relative to historical standards, but the latest weekly reading on regular state claims overstates the recent weakening.

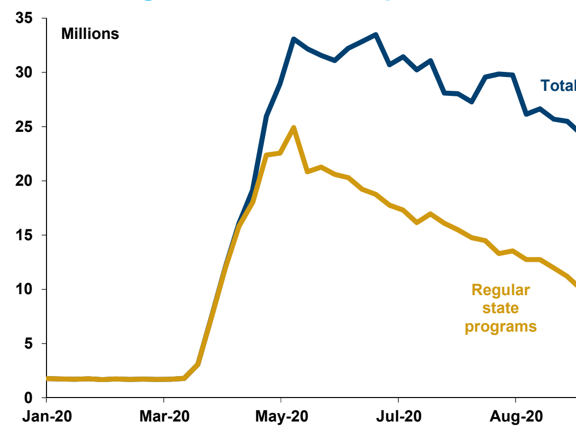
Initial Claims for Unemployment Insurance*



** Total initial claims include those filed under regular state programs and those filed under the Pandemic Unemployment Assistance (PUA) program.*

Source: U.S. Department of Labor, Employment & Training Administration via Haver Analytics

Continuing Claims for Unempl. Insurance*



** Total continuing claims include those filed under regular state programs, extended benefits programs, and the Pandemic Unemployment Assistance (PUA) and Pandemic Emergency Unemployment Compensation (PEUC) programs. Pandemic-related programs are lagged one week. The reading for total claims for October 3rd assumes no change in the level of pandemic-related claims from the week ended September 26th.*

Source: U.S. Department of Labor, Employment & Training Administration via Haver Analytics; Daiwa Capital Markets America

The latest data on continuing unemployment claims (i.e. the number of individuals receiving benefits) also paint a brighter picture, or at least a less troubling one. The number of recipients in regular state programs has declined sharply in recent weeks, by more than one million or 10.4 percent in the latest week and by an average of 4.0 percent in the prior 10 weeks. Some of these individuals have exhausted their benefits in the regular program and have shifted to programs offering extended benefits. In addition, the number of recipients in pandemic-related programs has increased noticeably in recent weeks. Nevertheless, total recipients (regular plus extended plus pandemic-related) are trending downward and progress in recent weeks has been favorable (chart, prior page, bottom right). The drop in the number of recipients suggests that payrolls are continuing to expand. That is, recalls or new hires exceed the number of new layoffs.

Review

Week of Oct. 12, 2020	Actual	Consensus	Comments
CPI (September)	**0.2% Total, 0.2% Core**	**0.2% Total, 0.2% Core**	Pandemic-related discounting led to declines in the CPI (both total and core) from March through May, followed by reversals and upward pressure from June through August. Consumer prices settled to a trend-like increase in September, but some components still showed an influence from the pandemic. On the high side, prices of used cars and trucks rose sharply for the third consecutive month. A shift from public transportation to individual driving has boosted demand for motor vehicles, with many buyers turning to the used market. College tuition, in contrast, fell for the second consecutive month, as some institutions apparently are offering concessions because of remote learning. The latest changes left the headline index up 1.4% on a year-over-year basis, while the core measure rose 1.7% in the past 12 months. Both measures were in the low portions of the ranges from the past few years.
PPI (September)	**0.4% Total, 0.4% Core***	**0.2% Total, 0.2% Core***	Prices have stirred at the producer level in the past few months, with both the headline index and prices excluding food and energy increasing at an average rate of 0.4% from July through September. However, prices were soft in several earlier months of the year, and as a result, year-over-year changes remain subdued (0.4% for the headline measure and 1.2% for the PPI excluding food and energy.)
Retail Sales (September)	**1.9% Total, 1.5% Ex-Autos**	**0.8% Total, 0.4% Ex-Autos**	Retail sales jumped in September from an upwardly revised level in August. Activity had already increased sharply in the prior four months (average gain of 13.4% in May/June and 0.8% in July/August), which pushed sales above pre-virus levels. The results suggest a sharp rebound in consumer spending in Q3.
Industrial Production (September)	**-0.6%**	**0.5%**	Much of the decline in industrial production in September was the result of a drop of 5.6% in the utility component, which most likely was driven by shifts in the weather rather than economic fundamentals. The manufacturing component also contributed to the soft headline figure, slipping 0.3% after firm increases in the prior four months. Mining activity provided a bright spot, increasing 1.7%. This advance offset most of the drop in the prior month and reinforced the moderate recovery that has emerged in recent months.
Consumer Sentiment (October)	**81.2 (+0.8 Index Pt.)**	**80.5 (+0.1 Index Pt.)**	Consumer sentiment edged higher in early October, but the measure remained 19.6% below its pre-virus peak in February.
Federal Budget (September)	**$124.6 Billion Deficit**	**$124.0 Billion Deficit**	Federal revenues fell again in September, but the drop of 0.2% from the same months last year was lighter than the average decline of 1.7% in the prior five months. Expenditures were again above the pre-virus average, but with government support to individuals and businesses much reduced, outlays were not far above the norm. September is the final month of the fiscal year, and the latest results left a deficit of $3.132 trillion for the full fiscal year.

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

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

Preview

Week of Oct. 19, 2020	Projected	Comments
Housing Starts (September) (Tuesday)	**1.500 Million (+5.9%)**	A 14-year high in sales of new homes and a record reading on the sentiment index of the National Association of Home Builders suggest that housing starts will add to the brisk net gain in the prior four months. Single-family starts are likely to post their fifth consecutive advance and could move above the cyclical high posted last December. Multi-family activity should rebound from an apparently random drop in August.
Existing Home Sales (September) (Thursday)	**6.15 Million (+2.5%)**	Sales of existing homes have already jumped above pre-virus levels, but a record reading on pending home sales and elevated readings on mortgage applications suggest that further gains are possible. The expected level of sales represents the best showing since December 2006, which was the latter part of the housing bubble.
Leading Indicators (September) (Thursday)	**0.6%**	An upward sloping yield curve, along with positive contributions from unemployment claims, ISM new orders, and building permits, should lead to the fifth consecutive increase in the leading indicator index. While building permits are likely to be a positive force, the magnitude of the influence is uncertain, as the figures will not be published until October 20. The estimate for leading indicators assumes a moderate increase in permits.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

October/November 2020

Monday	Tuesday	Wednesday	Thursday	Friday
12	13	14	15	16
COLUMBUS DAY	**NFIB SMALL BUSINESS OPTIMISM INDEX** July 98.8 Aug 100.2 Sept 104.0 **CPI** Total / Core July 0.6% / 0.6% Aug 0.4% / 0.4% Sept 0.2% / 0.2%	**PPI** Final Demand / Core* July 0.6% / 0.3% Aug 0.3% / 0.3% Sept 0.4% / 0.4%	**UNEMPLOYMENT CLAIMS** Initial / Continuing (Millions) Sept 19 0.873 / 11.979 Sept 26 0.849 / 11.183 Oct 03 0.845 / 10.018 Oct 10 0.898 / N/A **IMPORT/EXPORT PRICES** Non-petrol. Imports / Nonagri. Exports July 0.2% / 0.9% Aug 0.8% / 0.8% Sept 0.7% / 0.3% **EMPIRE MFG** Aug 3.7 Sept 17.0 Oct 10.5 **PHILLY FED INDEX** Aug 17.2 Sept 15.0 Oct 32.3	**RETAIL SALES** Total / Ex.Autos July 1.1% / 1.6% Aug 0.6% / 0.5% Sept 1.9% / 1.5% **IP & CAP-U** IP / Cap.Util. July 4.2% / 71.6% Aug 0.4% / 72.0% Sept -0.6% / 71.5% **CONSUMER SENTIMENT** Aug 74.1 Sept 80.4 Oct 81.2 **BUSINESS INVENTORIES** Inventories / Sales June -1.1% / 8.6% July 0.1% / 3.4% Aug 0.3% / 0.6% **FEDERAL BUDGET** 2020 / 2019 July -$63.0B / -$119.7B Aug -$200.0B / -$200.3B Sept -$124.6B / $82.8B **TIC DATA** Total / Net L-T June -$48.5B / $113.0B July -$89.5B / $11.3B Aug $86.3B / $27.8B
19	20	21	22	23
NAHB HOUSING INDEX (10:00) Aug 78 Sept 83 Oct --	**HOUSING STARTS (8:30)** July 1.492 million Aug 1.416 million **Sept 1.500 million**	**BEIGE BOOK (2:00)** **September Beige Book** "Economic activity increased among most Districts, but gains were generally modest and activity remained well below levels prior to the COVID-19 pandemic."	**INITIAL CLAIMS (8:30)** **EXISTING HOME SALES (10:00)** July 5.86 million Aug 6.00 million **Sept 6.15 million** **LEADING INDICATORS (10:00)** July 2.0% Aug 1.2% **Sept 0.6%**	
26	27	28	29	30
CHICAGO FED NATIONAL ACTIVITY INDEX **NEW HOME SALES**	**DURABLE GOODS ORDERS** **FHFA HOME PRICE INDEX** **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** **CONSUMER CONFIDENCE**	**U.S. INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES**	**INITIAL CLAIMS** **Q3 GDP** **PENDING HOME SALES**	**PERSONAL INCOME, CONSUMPTION & PRICES** **EMPLOYMENT COST INDEX** **CHICAGO PURCHASING MANAGERS' INDEX** **REVISED CONSUMER SENTIMENT**
2	3	4	5	6
ISM INDEX **CONSTRUCTION SPEND.**	**FACTORY ORDERS** **VEHICLE SALES**	**ADP EMPLOYMENT REPORT** **TRADE BALANCE** **ISM NON-MFG INDEX** **FOMC MEETING**	**INITIAL CLAIMS** **PRODUCTIVITY & COSTS** **FOMC DECISION**	**EMPLOYMENT REPORT** **WHOLESALE TRADE** **CONSUMER CREDIT**

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

Treasury Financing

October/November 2020

Monday	Tuesday	Wednesday	Thursday	Friday
12	13	14	15	16
COLUMBUS DAY	**AUCTION RESULTS:** Rate Cover 13-week bills 0.105% 2.72 26-week bills 0.115% 3.02 43-day CMB 0.095% 3.43 119-day CMB 0.110% 3.36 **ANNOUNCE:** $30 billion 4-week bills for auction on October 15 $35 billion 8-week bills for auction on October 15 $25 billion 105-day CMBs for auction on October 14 $30 billion 154-day CMBs for auction on October 14 **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 105-day CMB 0.105% 3.52 154-day CMB 0.120% 3.25	**AUCTION RESULTS:** Rate Cover 4-week bills 0.090% 3.29 8-week bills 0.095% 3.21 **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 $30 billion 42-day CMBs for auction on October 20 $30 billion 119-day CMBs for auction on October 20 **SETTLE:** $105 billion 13-,26-week bills $52 billion 3-year notes $35 billion 10-year notes $23 billion 30-year bonds $30 billion 43-day CMBs $30 billion 119-day CMBs	
19	20	21	22	23
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 22 $35 billion* 8-week bills for auction on October 22 **SETTLE:** $30 billion 4-week bills $35 billion 8-week bills $25 billion 105-day CMBs $30 billion 154-day CMBs	**AUCTION:** $22 billion 20-year bonds	**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills $17 billion 5-year TIPS **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on October 26 $26 billion* 2-year FRNs for auction on October 28 $54 billion* 2-year notes for auction on October 27 $55 billion* 5-year notes for auction on October 28 $53 billion* 7-year notes for auction on October 29 **SETTLE:** $105 billion 13-,26-week bills $30 billion 42-day CMBs $30 billion 119-day CMBs	
26	27	28	29	30
AUCTION: $105 billion* 13-,26-week bills	**AUCTION:** $54 billion* 2-year notes **ANNOUNCE:** $30 billion* 4-week bills for auction on October 29 $35 billion* 8-week bills for auction on October 29 **SETTLE:** $30 billion* 4-week bills $35 billion* 8-week bills	**AUCTION:** $26 billion* 2-year FRNs $55 billion* 5-year notes	**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills $53 billion* 7-year notes **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on November 2 $34 billion* 52-week bills for auction on November 3 **SETTLE:** $105 billion* 13-,26-week bills	**SETTLE:** $17 billion 5-year TIPS
2	3	4	5	6
AUCTION: $105 billion* 13-,26-week bills **SETTLE:** $22 billion 20-year bonds $26 billion* 2-year FRNs $54 billion* 2-year notes $55 billion* 5-year notes $53 billion* 7-year notes	**AUCTION:** $34 billion* 52-week bills **ANNOUNCE:** $30 billion* 4-week bills for auction on November 5 $35 billion* 8-week bills for auction on November 5 **SETTLE:** $30 billion* 4-week bills $35 billion* 8-week bills	**ANNOUNCE MID-QUARTER REFUNDING:** $54 billion* 3-year notes for auction on November 9 $40 billion* 10-yr notes for auction on November 10 $28 billion* 30-yr bonds for auction on November 12	**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on November 9 **SETTLE:** $105 billion* 13-,26-week bills $34 billion* 52-week bills	

**Estimate*