Daiwa Capital Markets

U.S. Economic Comment

- Fed credit facilities: winding down
- Inflation expectations: a new measure to guide Fed decisions
- Recent economic statistics: not so bad

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A Treasury-Fed Tiff

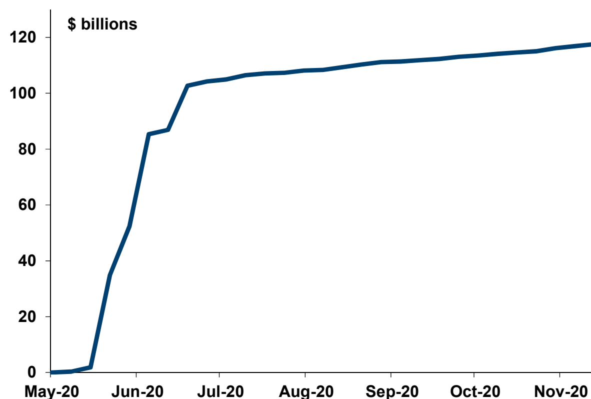
The Treasury Department this week announced that it will discontinue after December 31 four of the special credit facilities established in the wake of the Covid pandemic. The facilities were designed and run by the Federal Reserve with the backing of capital from the Treasury Department. Fed officials wished to extend the programs past their scheduled expiration date at year end, but because of the financial backing, the Treasury Department had the upper hand in determining the fate of the programs.

Treasury Secretary Steven Mnuchin argued that the programs had served their purpose and were no longer needed. The tumultuous conditions evident in the credit markets during the spring have settled, and credit is readily available through normal channels. The financial support from the Treasury, therefore, could be reallocated by Congress to other efforts that might provide a stronger economic boost. Fed officials argue that the programs support private credit flows by boosting confidence and serving as a backstop to activity through normal channels.

The Treasury Department has a point in that the discontinued facilities, which supported corporate bonds, municipal securities, asset-backed securities and small-business lending, were not used extensively. Assets from these efforts held by the Fed currently total $118 billion, a sizeable amount but well short of the $2 trillion that Treasury backing might have supported.

The Fed has a point in that the facilities, although not used extensively, were not dormant. Balances held by the Fed are tracing a moderate upward trend (chart, left). Most of the expansion in the past three months reflected lending associated with the Main Street lending facility (i.e. support for small businesses), arguably the sector of the economy most in need of support.

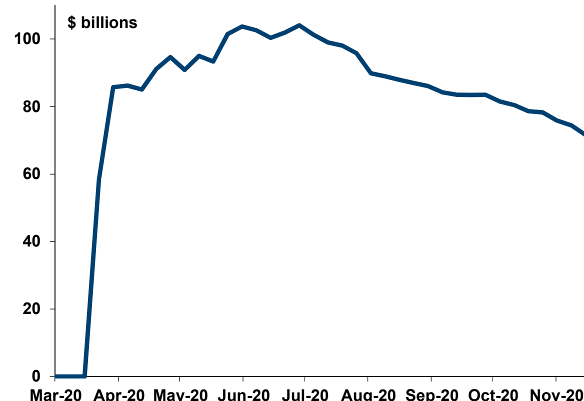
Expiring Federal Reserve Credit Facilities*



** Weekly end-of-period data for the week ended Wednesday. The chart includes the net portfolio holdings of the following Fed facilities: Corporate Credit Facility LLC (Primary Market and Secondary Market Credit Facilities), Main Street Facilities LLC, Municipal Liquidity Facility LLC, and Term Asset-Backed Securities Loan Facility (TALF II) LLC. These programs are set to expire on December 31, 2020.*

Source: Federal Reserve Board via Haver Analytics

Ongoing Federal Reserve Credit Facilities*



** Weekly end-of-period data for the week ended Wednesday. The chart includes the net portfolio holdings of the following Fed facilities: Commercial Paper Funding Facility II, Money Market Mutual Fund Liquidity Facility, Paycheck Protection Program Liquidity Facility, and Primary Dealer Credit Facility. The U.S. Treasury Department requested that the authorization for these facilities extend 90 days beyond the end of the year.*

Source: Federal Reserve Board via Haver Analytics

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The facilities being discontinued were only those supported by funds authorized by the CARES Act and advanced by the Treasury Department to the Fed. Some programs either required no support from the Treasury (e.g. the Paycheck Protection facility because of backing from the Small Business Administration) or were supported by Treasury sources other than CARES Act funds (specifically the Exchange Stabilization Fund). These programs, although easing lately, are still being used, and they will be extended for another 90 days (chart; prior page, right).

If the economy and credit market were to falter because of the acceleration in the spread of the coronavirus, the discontinued programs could be revived. Funds authorized by the CARES Act would not be available, but the Treasury Department could tap the Exchange Stabilization Fund to provide the capital backing required by the Fed, or Congress could appropriate new funding.

Inflation Expectations: A New View

Richard Clarida, the Vice-Chair of the Federal Reserve Board, delivered a speech this week on the implications of the Fed's new long-run strategy for short-term policy decisions. He made several interesting observations, but one that stood out involved the role of inflation expectations in policy changes and a new guide he intends to monitor to gauge changes in inflation expectations.

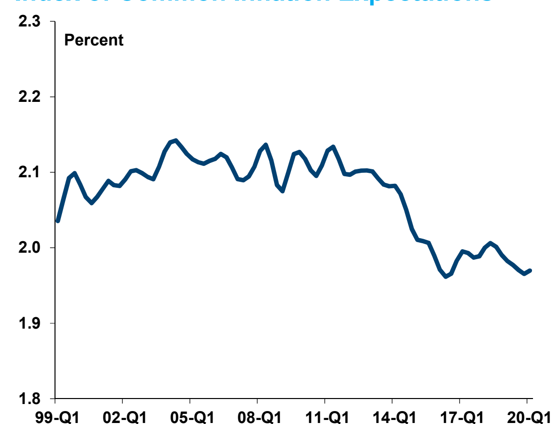
The new statement on policy strategy noted that Fed officials do not intend to raise interest rates in response to tight labor markets alone. Because of the loose linkage that has evolved between low unemployment and inflation, officials will need to see some evidence of faster inflation before they raise interest rates. With a tight labor market no longer a major factor in the inflation outlook, expectations of inflation would seem to be the key driving force behind actual inflation.

In assessing shifts in inflation expectations, Governor Clarida indicated that he intends to monitor a new index developed by the staff of the Federal Reserve Board: the index of Common Inflation Expectations (CIE). This index is derived from 21 measures of inflation expectations, both survey-based and market-based indicators. The CIE is estimated with the use of a dynamic factor model, a statistical technique that reveals co-movement among various economic indicators. While the measure is the result of high-level statistical estimation, it can be viewed as a weighted average of the indicators involved in the calculation.

Because the 21 measures included in the calculation relate to different measures of inflation over different time periods, their values are reindexed or standardized to put them on common ground. The reindexing, along with the normal workings of dynamic factor models, produces results with a mean of zero. Thus, the raw output of the model is not an inflation rate, and as a result, the level does not have an intuitive economic meaning. However, observed changes in the model's output indicate the direction of movement in inflation expectations. In addition, observations from the model can be "projected" onto a measure of inflation, which will provide an intuitive reading of the model's output and give a sense of the magnitude of the change in inflation expectations.

The chart to the right shows the model's output "projected" onto the inflation measure from the Philadelphia Fed's Survey of Professional Forecasters. This measure shows that inflation expectations were generally stable from 1999 through 2012, but they have eased slightly since then. Although the easing is modest (only 0.1 percentage point; note the scale on the chart),

Index of Common Inflation Expectations*



** Projected onto the Philadelphia Fed's Survey of Professional Forecasters 10-year-ahead PCE (personal consumption expenditures) inflation expectations.*

Source: Ahn, Hie Joo, and Chad Fulton (2020). "Index of Common Inflation Expectations," FEDS Notes. Washington: Board of Governors of the Federal Reserve System, September 02, 2020, https://doi.org/10.17016/2380-7172.2551.

the direction of change after a long period of stability is likely to be viewed as significant in the minds of Fed officials. Governor Clarida seemed to view the change as notable.

With slack no longer the focus of Fed officials in assessing the inflation outlook, we suspect that policymakers will talk frequently of inflation expectations. This new measure could well receive considerable attention. The article from the Fed staff on the measure is available on the Board of Governors web site. It's short and readable (https://www.federalreserve.gov/econres/notes/ feds-notes/index-of-common-inflation-expectations-20200902.htm).

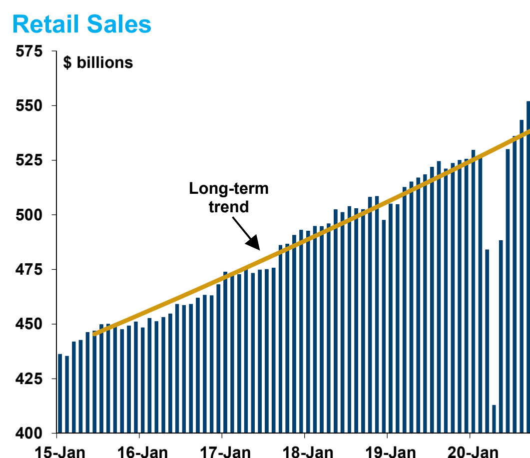
(Mis)interpreting Economic Data

Market participants will no doubt be scrutinizing economic statistics in an effort to assess the effect of the acceleration in Covid cases on the economy and financial markets. We suspect that many observers will assume a negative bias because of the experience in the spring, when the economy collapsed with the onset of the virus. Such a bias could lead to a misinterpretation of recent and upcoming developments.

The report on retail sales released this week, in our view, provided a good example of a data set that was cast in an excessively negative light. Sales rose 0.3 percent, which many viewed as disappointing because it was lighter than the expected increase of 0.5 percent and was slower than the average gain of 1.4 percent in the prior three months (not to mention the average surge of 13.4 percent in May and June). The headline in the *Wall Street Journal* read "*Retail Sales Growth Loses Steam*".

To be sure, a nominal gain of 0.3 percent is less than vigorous, but put in its proper context, the results were favorable. Solid gains in prior months had already pushed sales well above their pre-virus level and above their long-term trend (see the line in the chart). Given the elevated level of activity, one might have expected a drop in sales and a reversion to trend, but consumers added to their hefty spending totals in the prior months.

Retail Sales



Source: U.S. Census Bureau via Haver Analytics; Daiwa Capital Markets America

We can make a similar case with initial claims for unemployment insurance, which rose 31,000 (4.4 percent) in the latest week. The *Wall Street Journal* noted that the increase in claims signaled a recovery in check. Perhaps. The increase was disappointing, but initial claims have a strong random component, and the shift might have reflected normal volatility. The fact that the pickup represented only a partial offset to a drop of 46,000 in the prior week, and that it was smaller than three other increases that emerged during the recovery in the summer and early fall, leads one to be cautious in drawing conclusions.

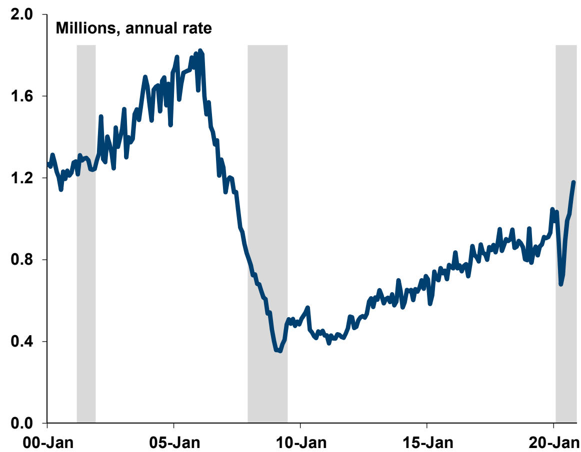
We could also note that continuing claims for unemployment insurance continued to decline in the latest week. These figures lag initial claims by one week, so they would not include the effect of the increase in initial claims, but the sizeable declines in the number of individuals receiving benefits (an average of 717,000 in the past 10 weeks) suggests that recalls of workers exceed layoffs by a healthy margin.

There was no misinterpretation of the housing statistics released this week, as it is hard to overstate the degree of vigor apparent in several reports. The sentiment index published by the National Association of Home Builders moved to a record level for the third consecutive month, with the latest reading of 90 percent almost hard to imagine. (This measure is constructed like the ISM index; it can range from 0 to 100 with 50 percent separating expansion and contraction). Robust conditions in the housing market normally generate readings in the upper 60s or low 70s; a reading of 90 is remarkable.

Builders acted on their positive moods, as single-family housing starts rose for the sixth consecutive month and moved above all observations in the previous expansion (chart, left). The number of single-family starts remained well below results in the mid-2000s (the housing bubble), but activity moved into the middle of the range seen during the expansion in the 1990s.

Strong demand for housing was evident in sales of existing homes, which rose for the fifth consecutive month and moved into the range seen during the bubble period (chart, right). Results varied geographically, but all four major regions posted sales noticeably above the peaks in the prior expansion. Sales in the Midwest and South were especially strong, as they moved above peaks seen during the bubble.

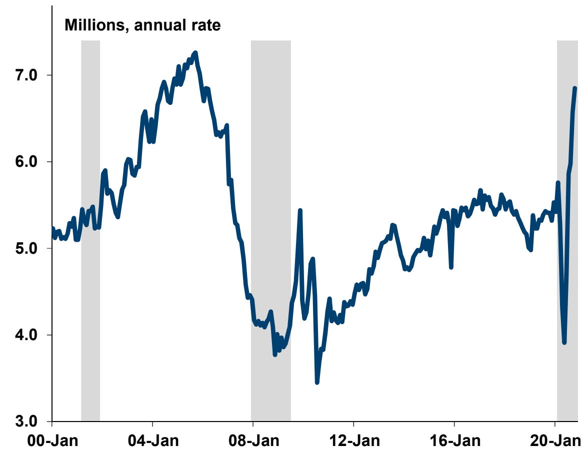
Single-Family Housing Starts*



The shaded areas indicate periods of recession.

Source: U.S. Census Bureau and National Bureau of Economic Research via Haver Analytics

Existing Home Sales*



The shaded areas indicate periods of recession.

Source: National Association of Realtors and National Bureau of Economic Research via Haver Analytics

Review

Week of Nov. 16, 2020	Actual	Consensus	Comments
Retail Sales (October)	**0.3% Total, 0.2% Ex-Autos**	**0.5% Total, 0.6% Ex-Autos**	Retail sales rose only moderately in October, but the change occurred from an already elevated level that was revised upward (sales in September were 0.5% firmer than previously believed). Results in October varied widely across categories, with some areas posting brisk increases (auto dealers, nonstore retailers, building material outlets). Other store-types eased slightly after strong performances in prior months (furniture, sporting goods, health-care, general merchandise). Most areas reported sales that were close to or above pre-virus totals, although some areas remained below results at the start of the year: gasoline stations (because of reduced travel), restaurants (because of restrictions on indoor gatherings), clothing stores (because of remote working).
Industrial Production (October)	**1.1%**	**1.0%**	A jump of 3.9% in utility output, which was driven by a swing in temperatures rather than economic fundamentals, contributed to the October increase in industrial production, but manufacturing activity also was firm with an increase of 1.0%. The latest advance in the manufacturing sector represented the sixth consecutive gain, with the cumulative changes retracing 76% of the retreat in the spring. The mining sector lost ground, reporting a drop of 0.6%. This sector has improved only modestly since the drop in the spring, with low oil prices likely playing a key role.
Housing Starts (October)	**1.530 Million (+4.9%)**	**1.460 Million (+3.2%)**	Housing starts rose briskly in October, led by a jump of 6.4% in the single-family area. The latest increase in single family activity left starts above all readings in the prior expansion. Multi-family starts were unchanged for the second consecutive month and remained in the low portion of the recent range. The soft results in multi-family activity might simply represent a dose of downside volatility (this sector is often erratic), but builders are probably sensing a shift in demand away from congested living because of the pandemic.
Existing Home Sales (October)	**6.85 Million (4.3%)**	**6.47 Million (-1.1%)**	The surprising jump in sales of existing homes, combined with an upward revision to results in September (0.5% firmer than previously believed), pushed activity far above all observations in the previous expansion and moved sales into the middle of the range seen during the housing bubble. The strong pace in sales and decline in already lean inventories pushed the months' supply of unsold homes to a record low of 2.5 months, down from an average of 3.9 months in 2019 and 3.7 months in the first half of this year.
Leading Indicators (October)	**0.7%**	**0.7%**	With sizeable positive contributions from ISM new orders and claims for unemployment insurance, the index of leading economic indicators registered its sixth consecutive increase in October. The index has now recouped 73% of the ground lost during the spring.

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

Preview

Week of Nov. 23, 2020	Projected	Comments
Consumer Confidence (November) (Tuesday)	**100.0 (-0.9 Index Pt.)**	The surge in the number of Covid cases has the potential to depress confidence, but the news on the vaccines and the pickup in the stock market could brighten moods. The push and pull of these factors is likely to leave little net change in the Conference Board index.
U.S. International Trade in Goods (October) (Wednesday)	**-$78.0 Billion ($1.4 Billion Narrower Deficit)**	Imports seem fully recovered from their pandemic-related decline, and thus do not have great upside potential. Exports, in contrast, are still well shy of their pre-virus level but are gaining ground steadily. October could bring the fifth consecutive increase in exports that leads to a slight narrowing in the goods trade deficit.
Durable Goods Orders (October) (Wednesday)	**0.7%**	New orders for durable goods have already recouped approximately 90% of their Covid-related decline, but a strong reading on the ISM index and a solid gain in factory employment suggest that the recovery in the manufacturing sector is ongoing, which should generate the sixth consecutive increase in orders for durable goods.
Revised GDP (2020-Q3) (Wednesday)	**33.5% (0.4 Pct. Pt. Revision)**	Available data suggest modest adjustments to most components of GDP, resulting in a small net upward revision. Firmer results for consumer spending, residential construction, and inventory investment should offset by a small margin downward revisions to business investment in new structures and spending by state and local governments.
Personal Income, Consumption, Core Price Index (October) (Wednesday)	**-0.5%, 0.5%, 0.0%**	A solid gain in employment should lead to a firm increase in wages and salaries, but a decline in government transfer payments is likely to provide an offset. Farm income also faces downside risks after elevated readings in the prior two months associated with subsidy payments. On the spending side, a dip in sales of new vehicles and a modest increase in retail activity suggest slow activity, but outlays for services are gradually coming back to life. Results for the CPI point to restrained changes in the price indexes for personal consumption expenditures.
New Home Sales (October) (Wednesday)	**0.980 Million (+2.2%)**	Record readings on builder attitudes published by the National Association of Home Builders suggest strong demand for new homes, and thus sales should be able to remain close to the elevated readings of the past three months (the best three-month performance since late 2006, the tail-end of the housing bubble).

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

November/December 2020

Monday 16

EMPIRE MFG

Sept	17.0
Oct	10.5
Nov	6.3

Tuesday 17

RETAIL SALES

	Total	Ex.Autos
Aug	1.4%	1.5%
Sept	1.6%	1.2%
Oct	0.3%	0.2%

IMPORT/EXPORT PRICES

	Non-petrol Imports	Nonagri. Exports
Aug	0.8%	0.9%
Sept	0.6%	0.3%
Oct	0.0%	0.0%

IP & CAP-U

	IP	Cap.Util.
Aug	0.7%	72.2%
Sept	-0.4%	72.0%
Oct	1.1%	72.8%

BUSINESS INVENTORIES

	Inventories	Sales
Jul	0.1%	3.4%
Aug	0.3%	0.9%
Sept	0.7%	0.6%

Wednesday 18

HOUSING STARTS

Aug	1.373 million
Sept	1.459 million
Oct	1.530 million

NAHB HOUSING INDEX

Sept	83
Oct	85
Nov	90

TIC DATA

	Total	Net L-T
July	-$97.2B	$11.3B
Aug	$85.0B	$27.8B
Sept	-$79.9B	$108.9B

Thursday 19

UNEMPLOYMENT CLAIMS

	Initial (Millions)	Continuing
Oct 24	0.758	7.222
Oct 31	0.757	6.801
Nov 07	0.711	6.372
Nov 14	0.742	N/A

PHILLY FED INDEX

Sept	15.0
Oct	32.3
Nov	26.3

EXISTING HOME SALES

Aug	5.98 million
Sept	6.57 million
Oct	6.85 million

LEADING INDICATORS

Aug	1.6%
Sept	0.7%
Oct	0.7%

Friday 20

Monday 23

CHICAGO FED NATIONAL ACTIVITY INDEX (8:30)

	Monthly	3-Mo. Avg.
Aug	1.11	3.22
Sept	0.27	1.33
Oct	--	--

Tuesday 24

FHFA HOME PRICE INDEX (9:00)

July	1.1%
Aug	1.5%
Sept	--

S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX (9:00)

	SA	NSA
July	0.7%	0.8%
Aug	0.5%	1.1%
Sept	--	--

CONFERENCE BOARD CONSUMER CONFIDENCE (10:00)

Sept	101.3
Oct	100.9
Nov	**100.0**

Wednesday 25

INITIAL CLAIMS (8:30)

U.S. INTERNATIONAL TRADE IN GOODS (8:30)

Aug	-$83.1 billion
Sept	-$79.4 billion
Oct	**-$78.0 billion**

ADVANCE INVENTORIES REPORT (8:30)

	Wholesale	Retail
Aug	0.5%	0.5%
Sept	0.4%	1.7%
Oct	--	--

REVISED GDP (8:30)

	GDP	Chained Price
20-Q2	-31.4%	-1.8%
20-Q3(a)	33.1%	3.6%
20-Q3(p)	**33.5%**	**3.6%**

DURABLE GOODS ORDERS (8:30)

Aug	0.4%
Sept	1.9%
Oct	**0.7%**

PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX (8:30)

	Inc.	Cons.	Core
Aug	-2.5%	1.0%	0.3%
Sept	0.9%	1.4%	0.2%
Oct	**-0.5%**	**0.5%**	**0.0%**

NEW HOME SALES (10:00)

Aug	0.994 million
Sept	0.959 million
Oct	**0.980 million**

REVISED CONSUMER SENTIMENT (10:00)

Sept	80.4
Oct	81.8
Nov(p)	77.0

FOMC MINUTES (2:00)

Thursday 26

THANKSGIVING

Friday 27

Monday 30

CHICAGO PURCHASING MANAGERS' INDEX

PENDING HOME SALES

Tuesday 1

ISM MANUFACTURING INDEX

CONSTRUCTION SPEND.

VEHICLE SALES

Wednesday 2

ADP EMPLOYMENT REPORT

BEIGE BOOK

Thursday 3

INITIAL CLAIMS

ISM SERVICES INDEX

Friday 4

EMPLOYMENT REPORT

TRADE BALANCE

FACTORY ORDERS

Monday 7

CONSUMER CREDIT

Tuesday 8

NFIB SMALL BUSINESS OPTIMISM INDEX

REVISED PRODUCTIVITY & COSTS

Wednesday 9

WHOLESALE TRADE

JOLTS DATA

Thursday 10

INITIAL CLAIMS

CPI

FEDERAL BUDGET

Friday 11

PPI

CONSUMER SENTIMENT

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

Treasury Financing

November/December 2020

Monday	Tuesday	Wednesday	Thursday	Friday
16	17	18	19	20
AUCTION RESULTS: Rate / Cover 13-week bills 0.090% 3.14 26-week bills 0.100% 3.18 **SETTLE:** $54 billion 3-year notes $41 billion 10-year notes $27 billion 30-year bonds	**AUCTION RESULTS:** Rate / Cover 42-day CMB 0.095% 3.76 119-day CMB 0.095% 3.82 **ANNOUNCE:** $30 billion 4-week bills for auction on November 19 $35 billion 8-week bills for auction on November 19 $25 billion 105-day CMBs for auction on November 18 $30 billion 154-day CMBs for auction on November 18 **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 20-yr bonds 1.422% 2.27 105-day CMB 0.090% 3.90 154-day CMB 0.090% 3.47	**AUCTION RESULTS:** Rate / Cover 4-week bills 0.070% 3.53 8-week bills 0.070% 3.23 10-yr TIPS -0.867% 2.71 **ANNOUNCE:** $105 billion 13-,26-week bills for auction on November 23 $24 billion 2-year FRNs for auction on November 24 $56 billion 2-year notes for auction on November 23 $57 billion 5-year notes for auction on November 23 $56 billion 7-year notes for auction on November 24 $30 billion 41-day CMBs for auction on November 24 $30 billion 118-day CMBs for auction on November 24 **SETTLE:** $105 billion 13-,26-week bills $30 billion 42-day CMBs $30 billion 119-day CMBs	
23	24	25	26	27
AUCTION: $105 billion 13-,26-week bills $56 billion 2-year notes $57 billion 5-year notes	**AUCTION:** $24 billion 2-year FRNs $56 billion 7-year notes $30 billion 41-day CMBs $30 billion 118-day CMBs **ANNOUNCE:** $30 billion* 4-week bills for auction on November 25 $35 billion* 8-week bills for auction on November 25 **SETTLE:** $30 billion 4-week bills $35 billion 8-week bills $25 billion 105-day CMBs $30 billion 154-day CMBs	**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on November 30 $34 billion* 52-week bills for auction on December 1	***THANKSGIVING***	**SETTLE:** $105 billion 13-,26-week bills $24 billion 2-year FRNs $30 billion 41-day CMBs $30 billion 118-day CMBs
30	1	2	3	4
AUCTION: $105 billion* 13-,26-week bills **SETTLE:** $27 billion 20-year bonds $12 billion 10-year TIPS $56 billion 2-year notes $57 billion 5-year notes $56 billion 7-year notes	**AUCTION:** $34 billion* 52-week bills **ANNOUNCE:** $30 billion* 4-week bills for auction on December 3 $35 billion* 8-week bills for auction on December 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 December 7 $56 billion* 3-year notes for auction on December 8 $38 billion* 10-year notes for auction on December 9 $24 billion* 30-year bonds for auction on December 10 **SETTLE:** $105 billion* 13-,26-week bills $34 billion* 52-week bills	
7	8	9	10	11
AUCTION: $105 billion* 13-,26-week bills	**AUCTION:** $56 billion* 3-year notes **ANNOUNCE:** $30 billion* 4-week bills for auction on December 10 $35 billion* 8-week bills for auction on December 10 **SETTLE:** $30 billion* 4-week bills $35 billion* 8-week bills	**AUCTION:** $38 billion* 10-year notes	**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills $24 billion* 30-year bonds **ANNOUNCE:** $105 billion* 13-,26-week bills for auction December 14 **SETTLE:** $105 billion* 13-,26-week bills	

**Estimate*