Daiwa Capital Markets

U.S. Economic Comment

- FOMC: a QE meeting; SEP merits attention
- High-frequency indicators: softening, but not signaling a downturn
- Productivity: perhaps some fundamental improvement; more likely a flurry

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FOMC

We suspect that the Federal Open Market Committee will wish to show additional economic support at its meeting on December 15-16. With Congress dithering on another round of fiscal stimulus, and with the Treasury Department having snubbed the Fed by ending the 13(3) credit facilities, policymakers will probably see a need to do something. With short-term interest rates already at their effective lower bound, and with forward guidance already altered substantially in September, quantitative easing emerges as the likely candidate for a change.

The FOMC began a discussion of quantitative easing in November, which laid the ground work for potential changes at future meetings. The minutes from the November meeting noted that officials could provide more stimulus by increasing the pace of purchases, by concentrating purchases in the long end of the maturity spectrum, or by lengthening the horizon over which purchases would be made. The Fed has not provided any information on the planned horizon for the program, and thus guidance along these lines might be viewed as providing an element of accommodation. We would expect a long horizon. The minutes noted that market participants expected the existing QE effort to be continued through 2021 with reduced purchases in subsequent years. Officials did not seem to feel that such a view was excessive.

Increasing the volume of activity in the long end of the maturity spectrum also has a high probability. While the Fed has purchased across the maturity spectrum, most of the buying has occurred in the intermediate range. Indeed, the share of long-term Treasury securities in the Fed's portfolio has declined since the current QE effort began in March (table). The recent actions of the Treasury Department to increase the issuance of longer-term securities offers another reason for the Fed to buy more in the long end.

Fed Projections

Officials will release a new set of economic projections at the upcoming meeting, and the results are likely to show a more favorable outlook. The unemployment rate already is nearly a percentage point below the expectation for Q4 published in September (6.7 percent in October versus a projection for Q4 of 7.6 percent). The outlook for GDP growth also now seems too pessimistic. The median projection in September called for a Q4-over-Q4 change of -3.7 percent. The year-over-year change as of Q3 was -2.9 percent, and results for Q4 are likely to lessen that decline.

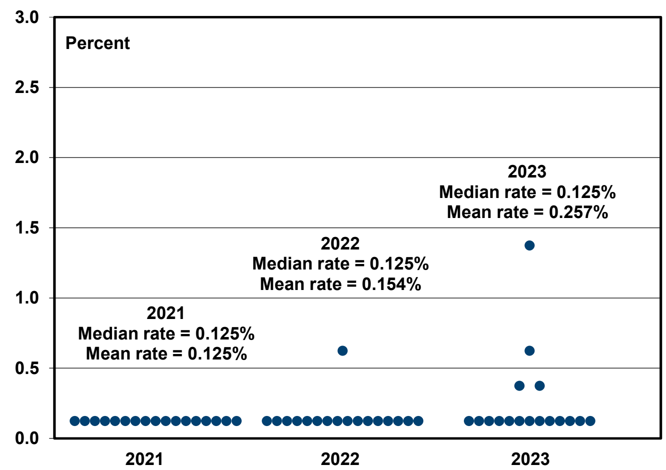
Fed Treasury Holdings By Remaining Maturity on March 11 and Dec. 9

	1 Year or Less	1 to 5 Years	5 to 10 Years	More Than 10 Yrs.	Total
$ Volume as of March 11 ($ billions)	621.8	915.1	327.9	658.2	2,523.0
Share of Total (%)	24.6	36.3	13.0	26.1	100.0
$ Volume as of December 9 ($ billions)	1,023.5	1,737.5	830.7	1,038.9	4,630.5
Share of Total (%)	22.1	37.5	17.9	22.4	100.0

Source: H.4.1 Factors Affecting Reserve Balances of Depository Institutions and Condition Statement of Federal Reserve Banks, Federal Reserve Board

These adjustments will be interesting and noteworthy, but market participants will probably focus on the interest rate outlook (the dot plot). The September results suggested no change in the federal funds rate though 2023. Four officials expected higher rates at the end of that year, but the median dot showed a fed funds rate of 0.125 percent. With the economy recovering faster than expected in September, and with the Covid vaccine supporting a favorable outlook, we look for more officials to expect higher rates in 2023, with the median dot showing liftoff from the current level of 0.125 percent. We also suspect that the new plot for 2022, unlike the one in September, will show more than a single policymaker expecting higher interest rates by the end of that year.

FOMC Rate View: Year-End 2021, 2022, & 2023*



** Each dot represents the expected federal funds rate of a Fed official at the ends of 2021, 2022, and 2023. Normally, this graph would contain 19 projections (seven governors of the Federal Reserve Board and 12 reserve bank presidents), but two governorships were open at the September 2020 meeting.*

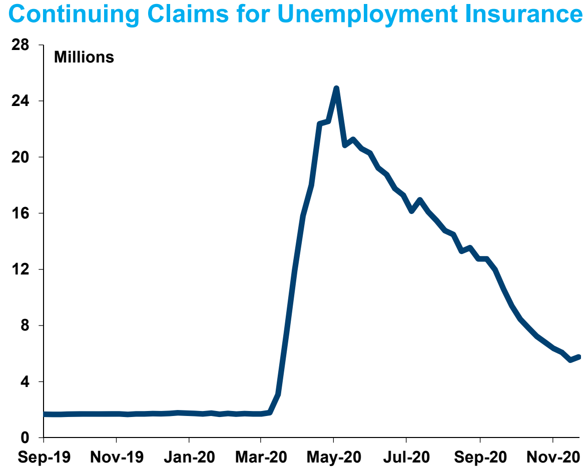
Source: Federal Open Market Committee, Summary of Economic Projections, September 2020

High-Frequency Data: Mixed Results

We were troubled this week by the latest results on claims for unemployment insurance. Initial and continuing claims under regular state programs rose by 137,000 and 230,000 in their respective weeks (December 5 for initial and November 28 for continuing; chart).

We have been putting more weight on continuing claims because they provide insights into both sides of labor market flows (layoffs and reemployment). Continuing claims had been tracing a distinct downward trend, signaling net improvement in the labor market despite still-elevated layoffs. The latest figures, however, raised questions about that view. While the increase could be random (three other observations since September also showed increases that were subsequently offset), but given the downside economic risks associated with the acceleration in Covid cases, the latest increase would seem to have some signal value.

Continuing Claims for Unemployment Insurance



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

A review of other high-frequency economic indicators would be helpful in assessing the economic effect of the acceleration in Covid cases (see charts on p. 4). The average number of job openings tumbled in early December, providing additional evidence that the labor market has shifted gears. Figures on the number of restaurant seatings booked through OpenTable also raises questions. However, the downward shift in this series might simply reflect the onset of cold weather and a natural drop in outdoor dining rather than a change in behavior by individuals.

The number of individuals traveling by air has eased a bit in the past week or so, but this series is not seasonally adjusted, and we suspect that a natural lull would occur between Thanksgiving and Christmas. A seasonally adjusted series would probably show steady activity. In this regard, the mobility index published by the Federal Reserve Bank of Dallas has shown little change in recent weeks, indicating that individuals are still getting out and about.

Individuals also seem to be spending at a good pace, as transactions with debit and credit cards have picked up recently and are now close to pre-virus levels, although we wonder about seasonal movements in this series. The recent pickup might simply be a reflection of normal holiday activity rather than a fundamental change.

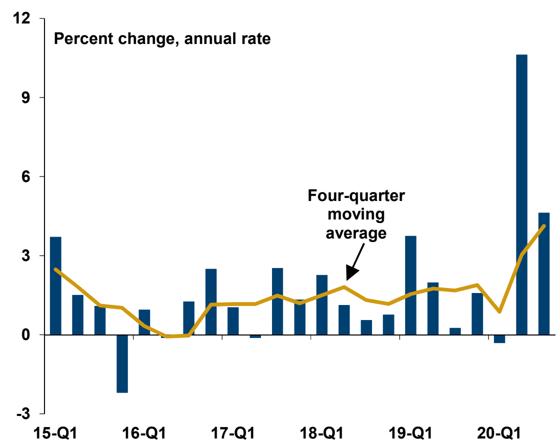
Many observers are concerned about the fate of small businesses during the pandemic. Figures on the number of small businesses currently in operation and the revenues of these enterprises have softened a bit, but the change is modest relative to the surge in the virus.

The weight of this evidence leads us to conclude that the acceleration in the number of Covid cases has dampened activity, with the drag intensifying in the past few weeks, but the expansion has not been derailed; GDP in the fourth quarter is likely to expand. The economy faces a greater challenge in the first quarter, as the virus will probably remain rampant, and support from the CARES Act will largely be exhausted. The economy could easily contract if Congress does not provide further fiscal support, although we would be shocked if Congress does not act. More times than not, agreements among legislators on contentious issues come at the 11th hour.

Productivity Growth: Fundamental or Random?

Productivity in the nonfarm business sector has surged recently, increasing 4.6 percent in the third quarter after a jump of 10.6 percent in Q2, easily surpassing the average of 1.3 percent in the five years from 2015 through 2019. Productivity often moves erratically, and thus the recent increases could simply reflect random shifts. However, the increases are far larger than the usual statistical noise, and thus other factors seem to be in play.

Growth of Nonfarm Productivity



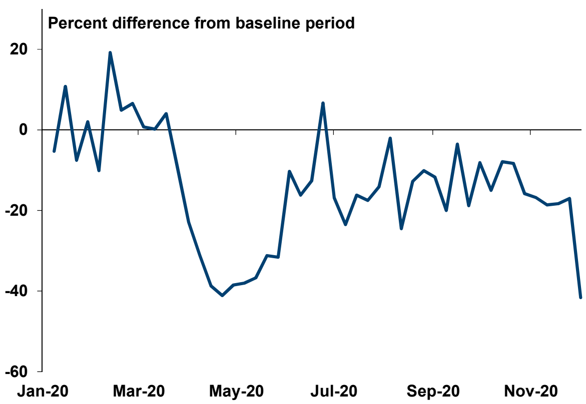
Source: Bureau of Labor Statistics via Haver Analytics

The increase could reflect a fundamental step up in productivity. Crises often lead business executives to rethink their business models, which could trigger more efficient methods of production. Such changes might not occur in the midst of an expansion, as favorable results lead managers to stick with what is working; faced with challenges, they might innovate. The marked shift to remote and virtual working in the current episode is an example of a fundamental shift that could boost productivity.

Another factor is probably also at work: scrambling or straining. That is, the sharp change in the business environment might have led business executives to make sudden, extreme changes, such as trimming work forces to bare-bones levels and requiring greater efforts from remaining employees. Such efforts can maintain business activity for a time, and with a reduced workforce, translate to an increase in productivity. However, such a situation would probably not represent a long-run equilibrium; eventually, the employer would need to return to sustainable work schedules, which would leave less impressive productivity results.

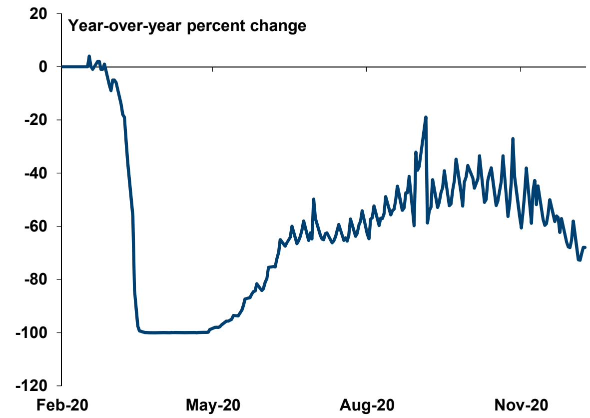
The pandemic will probably lead to fundamental changes in business practices, which will carry long-run productivity benefits, but we also suspect that scrambling is generating a temporary burst in productivity.

Average Job Postings*



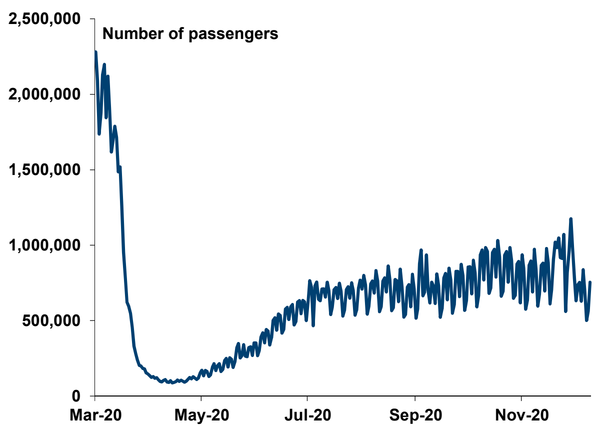
** Average job postings relative to the baseline from January 4 to 31, 2020.*
Sources: Burning Glass via Opportunity Insights/Haver Analytics

Restaurant Seatings



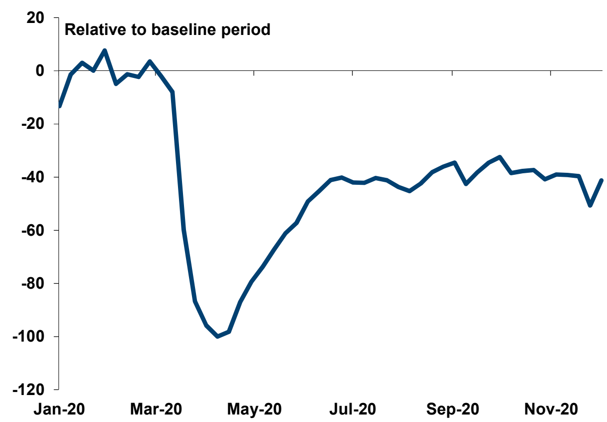
Sources: OpenTable via Bloomberg

Airport Passenger Throughput



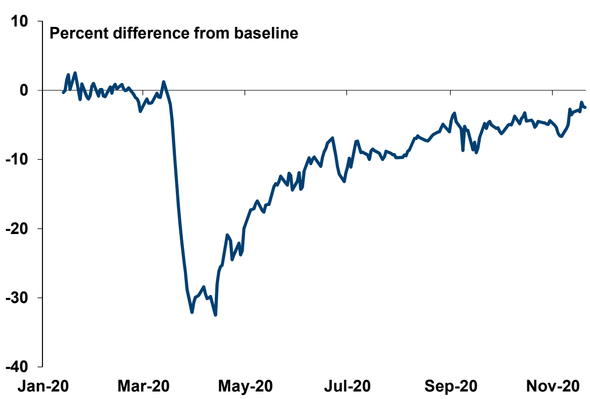
Sources: Transportation Security Administration (TSA) via Bloomberg

Mobility & Engagement Index*



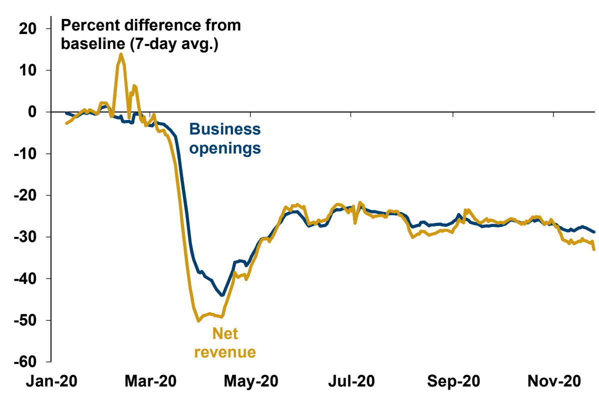
** The index averages zero over January-February 2020 and is -100 for the week ending April 11 2020.*
Source: Federal Reserve Bank of Dallas and SafeGraph via Haver Analytics

Credit & Debit Card Spending*



** Credit and debit card spending relative to the average value from January 4 to 31, 2020.*
Source: Affinity Solutions/Opportunity Insights via Haver Analytics

Small Business Openings & Net Revenue*



** Seasonally adjusted and indexed to January 4-31, 2020.*
Source: Womply via Opportunity Insights/Haver Analytics

Review

Week of Dec. 7, 2020	Actual	Consensus	Comments
Revised Nonfarm Productivity (2020-Q3)	**4.6% (-0.3 Pct. Pt. Revision)**	**4.9% (Unrevised)**	A modest downward revision to output and a small upward adjustment to hours worked combined to nudge nonfarm productivity growth lower from the preliminary tally for Q3. The downward adjustment to productivity, along with an upward revision to compensation per hour (-2.3% versus -4.4%), led to a smaller decline in unit labor costs (-6.6% rather than -8.9%).
CPI (November)	**0.2% Total, 0.2%Core**	**0.1% Total, 0.1%Core**	The energy component of the CPI rose 0.4% in November, as higher prices of natural gas and electricity services offset a drop in gasoline prices. The food component slipped 0.1%, continuing a largely sideways trend since July after pandemic-related demand drove prices higher from April through June. The increase in the core component in November was influenced by reversals of Covid-related discounting that had occurred in earlier months. Airfares, hotel fees, and apparel prices all rose noticeably after marked reductions in prior months. Year-over-year increases leaned on the soft side, with the headline measure rising 1.2% and the core component increasing 1.6%. Both readings were the same as in the prior month and down from firmer results in early 2020 (January showed an increase of 2.5% for the headline index while the core component was up 2.4% in February).
Federal Budget (November)	**$145.3 Billion Deficit**	**$198.5 Billion Deficit**	Federal revenues in November fell 2.5% on a year-over-year basis, reflecting declines in both personal and corporate taxes. Outlays also were soft, dropping 15.9% year-over-year. Support authorized by the CARES Act is fading, which played a role in the soft performance, but calendar configurations that shifted some outlays between months also had a strong influence (boosting outlays in November 2019 and restraining them this year). The budget deficit in the first two months of FY2021 totaled $429.3 billion, $86 billion more than the result in the same period of the prior fiscal year.
PPI (November)	**0.1% Total, 0.1% Ex. Food & Energy**	**0.1% Total, 0.2% Ex. Food & Energy**	Food prices at the producer level rose 0.5% in November, adding to a jump of 2.4% in October and pushing the index well above most other recent readings. Energy prices rose 1.2%, marking the sixth increase in the past seven months, but the index remained 12.5% below the recent peak in February. Prices excluding food and energy increased less than 0.1% for the second consecutive month after stirring from July through September. The latest monthly changes left muted increases on a year-over-year basis (0.8% for the headline index and 1.4% for prices ex food and energy).
Consumer Sentiment (December)	**81.4 (+4.5 Index Pts.)**	**76.0 (-0.9 Index Pt.)**	Consumer sentiment rose in December despite a resurgence of Covid, with the gain of 5.9% nearly offsetting the drop in the prior month. While the latest shift should be viewed as favorable in light of the negative news on the virus, sentiment has underperformed the rebound in many other economic indicators. The University of Michigan measure is 19.4% below the pre-virus peak in January and 15.2% below the average in 2019.

Sources: Bureau of Labor Statistics (Revised Nonfarm Productivity, CPI, PPI); U.S. Treasury Department (Federal Budget); University of Michigan Survey Research Center (Consumer Sentiment); Consensus forecasts are from Bloomberg

Preview

Week of Dec. 14, 2020	Projected	Comments
Industrial Production (November) (Tuesday)	**0.2%**	Moderate growth in factory employment should boost the manufacturing component of industrial production, but the increase is not likely to be large given that the length of the average workweek dipped. An increase in the rotary-rig count, along with an advance in employment, point to a moderate gain in mining activity.
Retail Sales (November) (Wednesday)	**-0.2% Total, 0.0% Ex-Autos**	A drop in sales of new motor vehicles is likely to constrain the auto component of the retail report, and other areas that recovered briskly in the summer and early fall could cool. Although the month-to-month change will appear lethargic, the level of activity overall and in key components will probably remain noticeably above pre-virus levels.
Housing Starts (November) (Thursday)	**1.520 Million (-0.7%)**	Strong sales and lean inventories of new homes represent a favorable environment for new construction, but the elevated level of starts in October could be difficult to sustain. The expected total, although off on a month-to-month basis, would still represent a firm showing by historical standards, exceeding all observations in the previous expansion and lying comfortably within the range seen during the 1990s expansion (although well below readings during the housing bubble).
Current Account (2020-Q3) (Friday)	**-$185.0 Billion ($14.5 Billion Wider Deficit)**	The trade balance slipped in the third quarter, and this deterioration is likely to generate a wider current account deficit, although improvement in income flows will provide a partial offset. The expected deficit is not dramatically different than the shortfall of $170 billion in the second quarter, but it is far wider than the quarterly average $120 billion in 2019.
Leading Indicators (November) (Friday)	**0.5%**	Positive contributions from ISM new orders, unemployment claims, stock prices, and the leading credit index are likely to more than offset negative contributions from the length of the manufacturing workweek and consumer expectations. The expected reading, if realized, would represent the seventh consecutive advance, with the cumulative changes offsetting 77% of the deterioration in the spring.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

December 2020/January 2021

Monday	Tuesday	Wednesday	Thursday	Friday
7	8	9	10	11
CONSUMER CREDIT Aug -$8.6 billion Sept $15.0 billion Oct $7.2 billion	**NFIB SMALL BUSINESS OPTIMISM INDEX** Sept 104.0 Oct 104.0 Nov 101.4 **PRODUCTIVITY & COSTS** Productivity / Unit Labor Costs 20-Q2 10.6% 12.3% 20-Q3(p) 4.9% -8.9% 20-Q3(r) 4.6% -6.6%	**WHOLESALE TRADE** Inventories / Sales Aug 0.5% 1.2% Sept 0.9% 0.4% Oct 1.1% 1.8% **JOLTS DATA** Openings (000) / Quit Rate Aug 6,352 2.0% Sept 6,494 2.2% Oct 6,652 2.2%	**UNEMPLOYMENT CLAIMS** Initial / Continuing (Millions) Nov 14 0.748 6.089 Nov 21 0.787 5.527 Nov 28 0.716 5.757 Dec 05 0.853 N/A **CPI** Total / Core Sept 0.2% 0.2% Oct 0.0% 0.0% Nov 0.2% 0.2% **FEDERAL BUDGET** 2020 / 2019 Sept -$124.6B $82.8B Oct -$284.1B -$134.5B Nov -$145.3B -$208.8B	**PPI** Total / Excluding Food & Energy Sept 0.4% 0.4% Oct 0.3% 0.1% Nov 0.1% 0.1% **CONSUMER SENTIMENT** Oct 81.8 Nov 76.9 Dec 81.4
14	15	16	17	18
	EMPIRE MFG (8:30) Oct 10.5 Nov 6.3 Dec -- **IMPORT/EXPORT PRICES (8:30)** Non-petrol Imports / Nonagri. Exports Sept 0.6% 0.3% Oct 0.0% 0.0% Nov -- -- **IP & CAP-U (9:15)** IP / Cap.Util. Sept -0.4% 72.0% Oct 1.1% 72.8% **Nov 0.2% 72.9%** **TIC DATA (4:00)** Total / Net L-T Aug $85.0B $27.8B Sept -$79.9B $108.9B Oct -- -- **FOMC MEETING**	**RETAIL SALES (8:30)** Total / Ex.Autos Sept 1.6% 1.2% Oct 0.3% 0.2% **Nov -0.2% 0.0%** **BUSINESS INVENTORIES (10:00)** Inventories / Sales Aug 0.3% 0.9% Sept 0.8% 0.8% Oct 0.7% 1.0% **NAHB HOUSING INDEX (10:00)** Oct 85 Nov 90 Dec -- **FOMC DECISION (2:00)**	**INITIAL CLAIMS (8:30)** **HOUSING STARTS (8:30)** Sept 1.459 million Oct 1.530 million **Nov 1.520 million** **PHILLY FED INDEX (8:30)** Oct 32.3 Nov 26.3 Dec --	**CURRENT ACCOUNT (8:30)** 20-Q1 -$111.5 bill. 20-Q2 -$170.5 bill. **20-Q3 -$185.0 bill.** **LEADING INDICATORS (10:00)** Sept 0.7% Oct 0.7% **Nov 0.5%**
21	22	23	24	25
CHICAGO FED NATIONAL ACTIVITY INDEX	**REVISED GDP** **CONSUMER CONFIDENCE** **EXISTING HOME SALES**	**PERSONAL INCOME, CONSUMPTION, AND PRICE INDEXES** **FHFA HOME PRICE INDEX** **REVISED CONSUMER SENTIMENT** **NEW HOME SALES**	**INITIAL CLAIMS** **DURABLE GOODS ORDERS**	***CHRISTMAS DAY***
28	29	30	31	1
	S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX	**U.S. INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES** **MNI CHICAGO REPORT** **PENDING HOME SALES**	**INITIAL CLAIMS**	***NEW YEAR'S DAY***

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

Treasury Financing

December 2020/January 2021

Monday	Tuesday	Wednesday	Thursday	Friday
7	8	9	10	11
AUCTION RESULTS: Rate Cover 13-week bills 0.080% 3.11 26-week bills 0.090% 3.32	**AUCTION RESULTS:** Rate Cover 3-year notes 0.211% 2.28 42-day CMB 0.070% 3.81 119-day CMB 0.080% 3.58 **ANNOUNCE:** $30 billion 4-week bills for auction on December 10 $35 billion 8-week bills for auction on December 10 $25 billion 105-day CMBs for auction on December 9 $30 billion 154-day CMBs for auction on December 9 **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 0.951% 2.33 105-day CMB 0.085% 3.70 154-day CMB 0.090% 3.51	**AUCTION RESULTS:** Rate Cover 4-week bills 0.065% 3.64 8-week bills 0.075% 3.38 30-yr bonds 1.665% 2.48 **ANNOUNCE:** $105 billion 13-,26-week bills for auction on December 14 $30 billion 42-day CMBS for auction on December 15 $30 billion 119-day CMBs for auction on December 15 **SETTLE:** $105 billion 13-,26-week bills $30 billion 42-day CMBs $30 billion 119-day CMBs	
14	15	16	17	18
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 December 17 $35 billion* 8-week bills for auction on December 17 **SETTLE:** $30 billion 4-week bills $35 billion 8-week bills $56 billion 3-year notes $38 billion 10-year notes $24 billion 30-year bonds $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 December 21 $24 billion* 2-year FRNs for auction on December 23 $24 billion* 20-year bonds for auction on December 21 $15 billion* 5-year TIPS for auction on December 22 **SETTLE:** $105 billion 13-,26-week bills $30 billion 42-day CMBs $30 billion 119-day CMBs	
21	22	23	24	25
AUCTION: $105 billion* 13-,26-week bills $24 billion* 20-year bonds	**AUCTION:** $15 billion* 5-year TIPS **ANNOUNCE:** $30 billion* 4-week bills for auction on December 24 $35 billion* 8-week bills for auction on December 24 **SETTLE:** $30 billion* 4-week bills $35 billion* 8-week bills	**AUCTION:** $24 billion* 2-year FRNs	**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills **ANNOUNCE:** $105 billion* 13-,26-week bills for auction December 28 $34 billion* 52-week bills for auction on December 29 $58 billion* 2-year notes for auction on December 28 $59 billion* 5-year notes for auction on December 28 $59 billion* 7-year notes for auction on December 29 **SETTLE:** $105 billion* 13-,26-week bills	***CHRISTMAS DAY***
28	29	30	31	1
AUCTION: $105 billion* 13-,26-week bills $58 billion* 2-year notes $59 billion* 5-year notes **SETTLE:** $24 billion* 2-year FRNs	**AUCTION:** $34 billion* 52-week bills $59 billion* 7-year notes **ANNOUNCE:** $30 billion* 4-week bills for auction on December 31 $35 billion* 8-week bills for auction on December 31 **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 January 4 **SETTLE:** $105 billion* 13-,26-week bills $34 billion* 52-week bills $24 billion* 20-year bonds $15 billion* 5-year TIPS $58 billion* 2-year notes $59 billion* 5-year notes $59 billion* 7-year notes	***NEW YEAR'S DAY***

**Estimate*