

# U.S. Economic Comment

- December employment: concentrated softness; reasonably favorable in several areas...  
...but even the favorable areas are lagging other economic indicators
- Budget reconciliation: a path to fiscal stimulus

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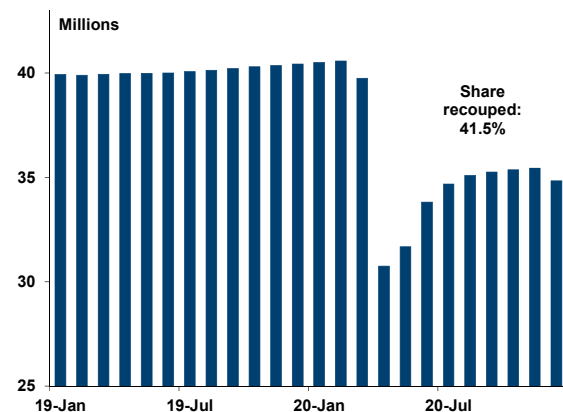
## The Two-Tiered Labor Market

Many observers have highlighted the uneven nature of the burdens and losses generated by the pandemic, with workers in certain industries and in lower wage brackets bearing much of the burden. That pattern was painfully evident in the December employment report, where the drop of 140,000 in nonfarm payrolls was concentrated in three sectors: leisure & hospitality, educational services, and state & local governments. These areas reduced payrolls by 612,000; other areas boosted employment by 472,000, a total slightly firmer than the average in the prior three months.

The skewed distribution of employment changes has left these three virus-sensitive sectors noticeably behind other industries, as they have recouped only 41.5 percent of the job cuts in March and April; other areas have recouped two-thirds of the lost ground (charts). The latest change in average hourly earnings of 0.8 percent also indicated a bias in the effects of the pandemic. The surge undoubtedly reflected job cuts among lower-wage workers, as the absence of their wage rates in the calculation would naturally push the average higher.

The decline in total employment and the sharp cuts among lower-paid individuals was troubling, but the latest report also contained some encouraging elements. Continued job growth in sectors less sensitive to the virus suggested underlying improvement in the economy. In addition, the unemployment rate held steady at 6.7 percent, as the job tabulation from the survey of households (the source of the jobless rate) was better than that from the survey of business establishments (although still underwhelming at 21,000). The household survey also showed a decline in the broad unemployment rate (U-6, which fell 0.3 percentage point to 11.7 percent), and the number of permanent job cuts fell 348,000 or 9.4 percent.

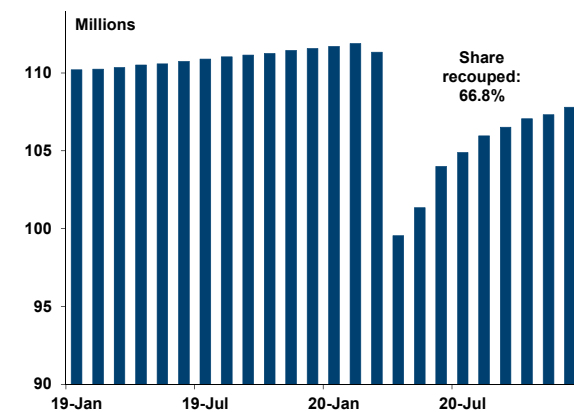
### Nonfarm Payrolls: Virus-Sensitive Sectors\*



\* The level of payrolls in virus-sensitive sectors of the economy. Virus-sensitive sectors include payrolls in the leisure and hospitality industry, payrolls in the educational services industry, and payrolls of state and local governments.

Source: Bureau of Labor Statistics via Haver Analytics

### Nonfarm Payrolls Ex. Virus-Sensitive Sectors



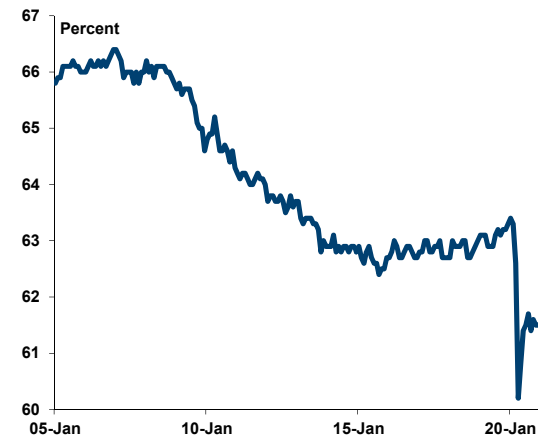
Source: Bureau of Labor Statistics via Haver Analytics

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## But Still Lagging

We view several aspects of the December employment report as favorable, but even with the recent advances, the labor market seems to be lagging other elements of the economy. For example, real consumer spending through November regained more than 84 percent of the ground lost during the worst of the recession; the stronger areas cited above have recouped only 67 percent of the jobs lost during the spring. Similarly, the manufacturing component of industrial production was almost 82 percent of the way back to pre-pandemic levels in November, and we expect that figure to approach 85 percent in December. Some indicators have eclipsed their pre-pandemic levels, such as key groupings of factory orders and retail sales. Nearly all housing-related indicators are far above pre-Covid readings.

### Labor Force Participation Rate



Source: Bureau of Labor Statistics via Haver Analytics

We do not claim to have all the answers behind the lagging labor market, but we can offer three possible explanations. Some of the shortfall probably reflects supply-side factors; that is, individuals deciding not to return to work at this time. Many households face new child-care responsibilities because of school closures and requirements for remote learning, leaving them unable to work at this time. Others may have decided to stay away from work because of health concerns.

Soft readings on the labor force participation rate offer support for the view that individuals are unable or hesitant to work at this time. This measure has dropped from 63.4 percent before the onset of Covid, falling to a low of 60.2 percent in April before climbing to 61.5 percent in the past two months (chart). Skeptics might argue that labor force participation is down because individuals believe that they are not able to find employment. However, the number of discouraged workers has increased only 300,000 to 400,000 since the start of the pandemic, a pittance relative to the drop of approximately four million in the size of the labor force.

Labor demand is undoubtedly playing a role, with two factors most likely leading businesses to restrain payrolls. The uncertain path of the virus and the associated downside risks to the economy are probably leading businesses to proceed cautiously in rebuilding payrolls. In addition, some businesses may be implementing structural changes to their business models that involve smaller payrolls. Periods of steady or strong economic growth would lead many business executives to maintain the status quo or to expand within the current structure of the business; they would naturally hesitate to tinker with a model that is working. However, a recession or crisis might force businesses to adapt or rethink optimal business models. The availability of technologies that enable new types of work arrangements also might be contributing to structural changes in business models.

Businesses may be developing new models and techniques that involve leaner payrolls, but that does not imply a stagnant labor market. The economy, although slowing because of the acceleration in Covid cases, still seems to be moving ahead, and broad distributions of vaccines will most likely lead to solid growth later in the year. The labor market will eventually catch up.

## Budget Reconciliation

The latest week brought clarity on the political front. There was little doubt previously, but now there is no doubt that Joe Biden will be the next president of the United States. In addition, we learned that Democrats will control both houses of Congress. With both Democratic challengers in Georgia winning runoff elections, the Senate is now split 50/50 between Republicans and Democrats (actually, 48 Democrats and two left-

leaning independents). Democrats can be viewed as having a majority because Vice President Kamala Harris will cast any needed tie-breaking votes.

Democratic control of government opens a door to potentially sizeable fiscal stimulus. Republicans in the Senate are not without power because they can filibuster most legislation that they oppose. That is, they can call for open discussion of a bill until a majority of 60 or more calls for an end to the debate; without 60 or more votes to end debate (“cloture” in the Senate lexicon), a bill cannot be brought to a floor vote. However, there is one avenue, known as “budget reconciliation”, that will allow Democrats to preempt a filibuster on a stimulus package.

The first step in the annual budget process in Congress is to pass (hopefully early in the calendar year) a so-called budget resolution, which is an outline or blueprint for the budget that will take effect in the fiscal year beginning in October. The resolution might contain so-called reconciliation instructions, which are directives to certain Congressional committees to increase or decrease spending, revenues, or the debt limit. If the budget resolution contains such directives, the official legislation will move through Congress under a special set of rules that will expedite the normal legislative process.

The most important of the special rules is the limit on the length of debate to 20 hours. This provision effectively eliminates the possibility of filibustering a bill advanced under budget reconciliation. Rules regarding amendments also can hasten the approval process. Amendments are allowed, but they must be germane to the legislation, which eliminates the possibility of adding controversial provisions that would be challenged in stand-alone legislation. A similar provision – the Byrd Rule, named after former Senator Robert Byrd of West Virginia – allows Senators to block provisions that are “extraneous” to the basic purpose of the budget bill.

The reconciliation process is powerful and effective, but it has limits. First, it can only be used in matters relating to the budget; that is, it can only be applied to legislation that involves spending, taxation, and the debt limit. Second, it can only be used if Congress has approved a budget resolution with reconciliation instructions. Congress has sometimes skipped the passage of a resolution in forming a budget, which would eliminate the ability to use the reconciliation process. Third, reconciliation can be used only once per year for each of the three budget parameters (spending, taxation, debt limit). Congress cannot alter its decisions in subsequent legislation for the fiscal year in question. (Technically, Congress could advance subsequent bills under reconciliation rules, but that would require returning to square one with the passage of a new budget resolution, which would be difficult.)

Republicans will likely oppose much of what President-Elect Biden or the Democratic Congress might propose, but the new president and the majority in Congress will be able to achieve some of their fiscal objectives through the reconciliation process. However, they must design their strategy wisely because they will have only one chance to do so this year.

## Review

Week of Jan. 4, 2021	Actual	Consensus	Comments
<b>Construction Spending (November)</b>	<b>0.9%</b>	<b>1.0%</b>	Private residential building led the advance in total construction activity in November with a gain of 2.7%, which marked the sixth consecutive increase and pushed results 11.0% above the pre-pandemic high in February. Government-related construction fell 0.2%, driven by a retreat of 4.2% at the federal level. Construction programs of state and local governments (which are much larger than those of the federal government) rose 0.1% after an advance of 0.8% in October, perhaps suggesting that pandemic-related revenue constraints are easing. Private nonresidential construction remained weak. The drop of 0.8% represented the 10th decline in the past 12 months.
<b>ISM Manufacturing Index (December)</b>	<b>60.7% (+3.2 Pct. Pts.)</b>	<b>56.8% (-0.7 Pct. Pt.)</b>	The jump in the ISM manufacturing index in December pushed the measure near the top of the range seen the past three expansions. All five components contributed to the pickup. The production index was robust with an increase of 4.0 percentage points to 64.8%. The strong pace of production was influenced by brisk order flows, as this component rose 2.8 percentage points to 67.9%. Like the headline index, these measures were exceeded by only a handful of observations from the past 30 years. The <i>level</i> of the employment index was less impressive, but the <i>increase</i> of 3.1 percentage points to 51.5% was encouraging.
<b>Factory Orders (November)</b>	<b>1.0%</b>	<b>0.7%</b>	The increase of 1.0% in orders for durable goods in November marked the seventh consecutive advance, with the cumulative changes retracing 98% of the drop in the spring. The headline results were constrained much of the year by weak bookings for commercial aircraft. Excluding the transportation component, durable orders rose 0.4% and are now 4.7% above the pre-virus high in January. Nondurable bookings rose 1.1% in November, influenced by a surge of 4.4% in orders for petroleum and coal products, which likely reflected higher prices. Nondurable orders ex-petrol rose 0.5%, which marked the seventh consecutive advance and left bookings 0.8% above the pre-virus peak in March.
<b>Trade Balance (November)</b>	<b>-\$68.1 Billion (\$5.0 Billion Wider Deficit)</b>	<b>-\$67.3 Billion (\$4.2 Billion Wider Deficit)</b>	Both exports and imports rose in November for the sixth consecutive month. As in other recent months, the change in imports dominated (2.9% versus 1.2% for exports), leading to a wider trade deficit. With imports improving more than exports in the past six months, the trade deficit has widened noticeably, with the shortfall of \$68.1 billion in November dwarfing the average of \$48.1 billion from last year and the pre-pandemic average of \$42.2 billion in Q1. The real goods deficit so far in the fourth quarter is wider than that in Q3, suggesting a drag of three-quarters to a full percentage point on GDP growth in Q4 after a negative contribution of 3.2 percentage points in Q3.

## Review Continued

Week of Jan. 4, 2021	Actual	Consensus	Comments
<b>ISM Services Index (December)</b>	<b>57.2% (+1.3 Pct. Pts.)</b>	<b>54.5% (-1.4 Pct. Pts.)</b>	The advance in the ISM services index in December left the measure shy of the best reading of the year (58.1% in July), but the latest reading still represented a fine performance. The supplier deliveries index led the overall advance with an increase of 5.8 percentage points to 62.8%. This jump could be the result of pandemic-related disruptions to supply chains, but gains in new orders and business activity suggest that firm demand also played a role. Like the headline index, new orders and business activity did not move to new highs for the year, but they were elevated. In contrast to other components, the employment index disappointed with a drop of 3.3 percentage points. The decline pushed the measure below 50% after three consecutive months above this threshold.
<b>Payroll Employment (December)</b>	<b>-140,000</b>	<b>50,000</b>	Nonfarm payrolls declined in December, but the weakness was concentrated in three areas: leisure and hospitality, state and local governments, and education services. Other elements of the report were mildly encouraging. Upward revisions to the prior two months were sizeable at 135,000, and several industries posted solid gains (472,000 excluding the three soft sectors). The unemployment rate was steady at 6.7%, as the survey of households, the source of the unemployment rate, showed little change in both employment and the size of the labor force, which left joblessness essentially unchanged.

Sources: U.S. Census Bureau (Construction Spending, Factory Orders); Institute for Supply Management (ISM Manufacturing Index, ISM Services Index); Bureau of Economic Analysis (Trade Balance); Bureau of Labor Statistics (Payroll Employment); Consensus forecasts are from Bloomberg

## Preview

Week of Jan. 11, 2021	Projected	Comments
<b>CPI (December) (Wednesday)</b>	<b>0.3% Total, 0.1% Core</b>	The increase in gasoline prices in December is likely to be magnified by seasonal adjustment, which should push the energy component and the headline index higher. Restrained demand because of Covid-related lockdowns (mandated and voluntary) will probably dampen price increases elsewhere.
<b>Federal Budget (December) (Wednesday)</b>	<b>\$190.0 Billion Deficit</b>	Available data suggest that revenues in December were approximately 2% firmer than the total in the same month last year, a better showing than the average decline of 2.8% in the first two months of the current fiscal year. Outlays are likely to surge on a year-over-year basis, partly because of continued fiscal support but also because of a calendar configuration that pulled a portion of the January Social Security payment into December. The expected jump of approximately 50% in outlays will leave the monthly deficit noticeably wider than the average of \$18.4 billion in the prior five Decembers.
<b>Retail Sales (December) (Friday)</b>	<b>0.3% Total, 0.1% Ex-Autos</b>	A pickup in vehicle sales and higher prices of gasoline will probably boost the headline figure, but cautious spending will probably lead to little change in other areas for the third consecutive month. While sales excluding autos and gasoline are likely to be flat, the level will remain comfortably above pre-pandemic levels because of brisk activity during the summer.
<b>PPI (December) (Friday)</b>	<b>0.3% Total, 0.1% Ex-Food and Energy</b>	Early-month energy quotes used in the PPI show moderate increases, but seasonal adjustment is likely to boost the reported increase. Food prices are likely to cool from elevated readings in October and November, while prices of goods and services other than food and energy are likely to be subdued because of slower growth triggered by the acceleration in the number of Covid cases.
<b>Industrial Production (December) (Friday)</b>	<b>0.7%</b>	A solid gain in employment and a longer workweek for production workers suggest that the manufacturing component of industrial production performed well in December. In addition, increases in employment and the rotary rig count point to another increase in mining activity (the third in the past four months). Temperatures were warmer than normal in December, but by less so than in November; thus, demand for heating services could boost utility output.
<b>Consumer Sentiment (January) (Friday)</b>	<b>81.0 (+0.3 Index Pt.)</b>	Record reading on major indexes of stock prices could boost consumer sentiment, but individuals seem concerned about the pandemic, and the surge in Covid cases will probably offset the effect of equity gains and leave sentiment little changed.

Source: Forecasts provided by Daiwa Capital Markets America

## Economic Indicators

January 2021				
Monday	Tuesday	Wednesday	Thursday	Friday
4	5	6	7	8
<b>CONSTRUCTION SPEND.</b> Sept -0.2% Oct 1.6% Nov 0.9%	<b>ISM MANUFACTURING INDEX</b> Index Prices Oct 59.3 65.5 Nov 57.5 65.4 Dec 60.7 77.6  <b>VEHICLE SALES</b> Oct 16.4 million Nov 15.6 million Dec 16.3 million	<b>ADP EMPLOYMENT REPORT</b> Private Payrolls Oct 409,000 Nov 304,000 Dec -123,000  <b>FACTORY ORDERS</b> Sept 1.3% Oct 1.3% Nov 1.0%  <b>FOMC MINUTES</b>	<b>UNEMPLOYMENT CLAIMS</b> Initial Continuing (Millions) Dec 12 0.892 5.322 Dec 19 0.806 5.198 Dec 26 0.790 5.072 Jan 03 0.787 N/A  <b>TRADE BALANCE</b> Sept -\$62.1 billion Oct -\$63.1 billion Nov -\$68.1 billion  <b>ISM SERVICES INDEX</b> Index Prices Oct 56.6 63.9 Nov 55.9 66.1 Dec 57.2 64.8	<b>EMPLOYMENT REPORT</b> Payrolls Un. Rate Oct 654,000 6.9% Nov 336,000 6.7% Dec -140,000 6.7%  <b>WHOLESALE TRADE</b> Inventories Sales Sept 0.9% 0.4% Oct 1.3% 1.7% Nov 0.0% 0.2%  <b>CONSUMER CREDIT</b> Sept \$15.0 billion Oct \$4.5 billion Nov \$15.3 billion
11	12	13	14	15
	<b>NFIB SMALL BUSINESS OPTIMISM INDEX (6:00)</b> Oct 104.0 Nov 101.4 Dec --  <b>JOLTS DATA (10:00)</b> Openings (000) Quit Rate Sept 6,494 2.2% Oct 6,652 2.2% Nov -- --	<b>CPI (8:30)</b> Total Core Oct 0.0% 0.0% Nov 0.2% 0.2% <b>Dec 0.3% 0.1%</b>  <b>FEDERAL BUDGET (2:00)</b> 2020 2019 Oct -\$284.1B -\$134.5B Nov -\$145.3B -\$208.8B <b>Dec -\$190.0B -\$13.3B</b>  <b>BEIGE BOOK (2:00)</b> <b>December 2020 Report</b> "Most Federal Reserve Districts have characterized economic expansion as modest or moderate since the prior Beige Book period."	<b>INITIAL CLAIMS (8:30)</b>  <b>IMPORT/EXPORT PRICES (8:30)</b> Non-petrol. Nonagri. Imports Exports Oct -0.1% -0.1% Nov 0.0% 0.3% Dec -- --	<b>RETAIL SALES (8:30)</b> Total Ex. Autos Oct -0.1% -0.1% Nov -1.1% -0.9% <b>Dec 0.3% 0.1%</b>  <b>PPI (8:30)</b> Ex. Food & Energy Oct 0.3% 0.1% Nov 0.1% 0.1% <b>Dec 0.3% 0.1%</b>  <b>EMPIRE MFG (8:30)</b> Nov 6.3 Dec 4.9 Jan --  <b>IP &amp; CAP-U (9:15)</b> IP Cap.Util. Oct 0.9% 73.0% Nov 0.4% 73.3% <b>Dec 0.7% 73.8%</b>  <b>CONSUMER SENTIMENT (10:00)</b> Nov 76.9 Dec 80.7 <b>Jan 81.0</b>  <b>BUSINESS INVENTORIES (10:00)</b> Inventories Sales Sept 0.8% 0.9% Oct 0.8% 1.0% <b>Nov 0.5% 0.0%</b>
18	19	20	21	22
<b>MARTIN LUTHER KING JR DAY</b>	<b>TIC DATA</b>	<b>NAHB HOUSING MARKET INDEX</b>	<b>INITIAL CLAIMS</b> <b>HOUSING STARTS</b> <b>PHILLY FED INDEX</b>	<b>EXISTING HOME SALES</b>
25	26	27	28	29
<b>CHICAGO FED NATIONAL ACTIVITY INDEX</b>	<b>FHFA HOME PRICE INDEX</b> <b>S&amp;P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX</b> <b>CONSUMER CONFIDENCE</b> <b>FOMC MEETING</b>	<b>DURABLE GOODS ORDERS</b> <b>FOMC DECISION</b>	<b>INITIAL CLAIMS</b> <b>GDP</b> <b>U.S. INTERNATIONAL TRADE IN GOODS</b> <b>ADVANCE INVENTORIES</b> <b>NEW HOME SALES</b> <b>LEADING INDEX</b>	<b>PERSONAL INCOME, CONSUMPTION, PRICE INDEXES</b> <b>EMPLOYMENT COST INDEX</b> <b>MNI CHICAGO REPORT</b> <b>PENDING HOME SALES</b> <b>REVISED CONSUMER SENTIMENT</b>

Forecasts in Bold.)



## Treasury Financing

January 2021																																								
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<b>AUCTION RESULTS:</b> <table border="1"> <thead> <tr> <th></th> <th>Rate</th> <th>Cover</th> </tr> </thead> <tbody> <tr> <td>13-week bills</td> <td>0.090%</td> <td>2.95</td> </tr> <tr> <td>26-week bills</td> <td>0.090%</td> <td>3.24</td> </tr> </tbody> </table>		Rate	Cover	13-week bills	0.090%	2.95	26-week bills	0.090%	3.24	<b>AUCTION RESULTS:</b> <table border="1"> <thead> <tr> <th></th> <th>Rate</th> <th>Cover</th> </tr> </thead> <tbody> <tr> <td>42-day CMB</td> <td>0.085%</td> <td>3.13</td> </tr> <tr> <td>119-day CMB</td> <td>0.085%</td> <td>3.93</td> </tr> </tbody> </table> <b>ANNOUNCE:</b> \$30 billion 4-week bills for auction on January 7 \$35 billion 8-week bills for auction on January 7 \$25 billion 105-day CMBs for auction on January 6 \$30 billion 154-day CMBs for auction on January 6 <b>SETTLE:</b> \$30 billion 4-week bills \$35 billion 8-week bills \$25 billion 105-day CMBs \$30 billion 154-day CMBs		Rate	Cover	42-day CMB	0.085%	3.13	119-day CMB	0.085%	3.93	<b>AUCTION RESULTS:</b> <table border="1"> <thead> <tr> <th></th> <th>Rate</th> <th>Cover</th> </tr> </thead> <tbody> <tr> <td>105-day CMB</td> <td>0.090%</td> <td>3.73</td> </tr> <tr> <td>154-day CMB</td> <td>0.090%</td> <td>3.57</td> </tr> </tbody> </table>		Rate	Cover	105-day CMB	0.090%	3.73	154-day CMB	0.090%	3.57	<b>AUCTION RESULTS:</b> <table border="1"> <thead> <tr> <th></th> <th>Rate</th> <th>Cover</th> </tr> </thead> <tbody> <tr> <td>4-week bills</td> <td>0.080%</td> <td>3.46</td> </tr> <tr> <td>8-week bills</td> <td>0.085%</td> <td>3.81</td> </tr> </tbody> </table> <b>ANNOUNCE:</b> \$105 billion 13-,26-week bills for auction on January 11 \$58 billion 3-year notes for auction on January 11 \$38 billion 10-year notes for auction on January 12 \$24 billion 30-year bonds for auction on January 13 \$30 billion 42-day CMBs for auction on January 12 \$30 billion 119-day CMBs for auction on January 12 <b>SETTLE:</b> \$105 billion 13-,26-week bills \$30 billion 42-day CMBs \$30 billion 119-day CMBs		Rate	Cover	4-week bills	0.080%	3.46	8-week bills	0.085%	3.81	
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\*Estimate