U.S. Economic Comment

- U.S. economy: support from businesses…
  …but are consumers in retreat?
- Inflation watch: noise in the PCE price indexes

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Bright Signs in Q4 GDP Report

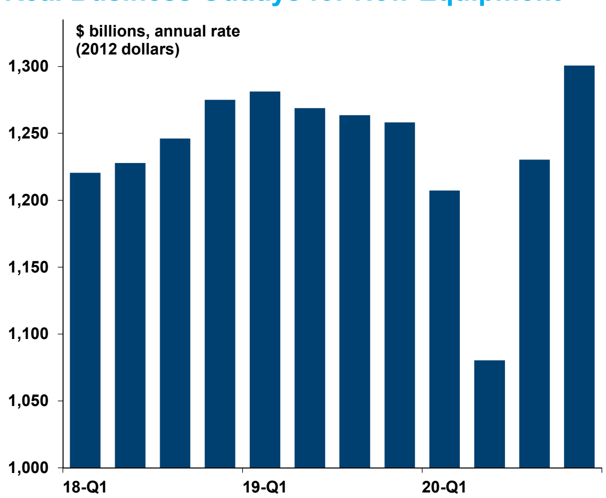
Most forecasts of the U.S. economy for 2021 show brisk growth after a slow start, with the acceleration led by a burst of pent-up demand from the household sector. We have confidence in this view of the consumer (discussed below), and the latest GDP report showed another reason to be optimistic about the outlook: the business sector seems to be providing a good bit of support.

Business investment in new equipment had becomes a soft area in the economy, with outlays edging lower in 2019 before collapsing with the onset of the pandemic. However, spending surged in the third quarter and posted strong results in the final months of the year as well. Changes in the past two months have pushed outlays above the pre-pandemic peak in 2019-Q1 (chart, left). Most of the growth has occurred in the information-processing category, most likely reflecting the efforts of businesses to incorporate technology that allows remote working.

Such outlays might be viewed as a one-time step-up that leaves little prospect for sustained growth. However, the pandemic also might trigger new business models that are implemented over time and lead to an extended period of growth. Recent order flows for capital goods other than aircraft support the view that the recent improvement in investment spending could be long-lasting. New orders for capital goods have increased for eight consecutive months and have moved well above pre-pandemic levels. The surge in new bookings has led to a sizeable backlog of orders for capital goods (chart, right).

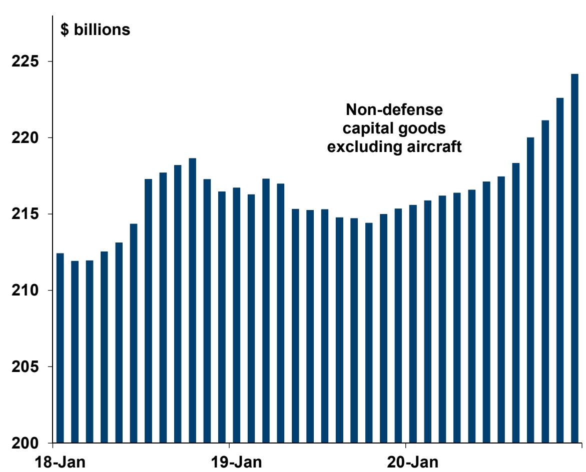
The series in the chart excludes transportation goods because of distorting effects generated by pronounced weakness in orders for commercial aircraft. With the public avoiding air travel because of Covid, new bookings for aircraft have more than collapsed; they moved into negative territory in five of the six months from March to August -- that is, manufacturers registered net cancellations of orders.

Real Business Outlays for New Equipment



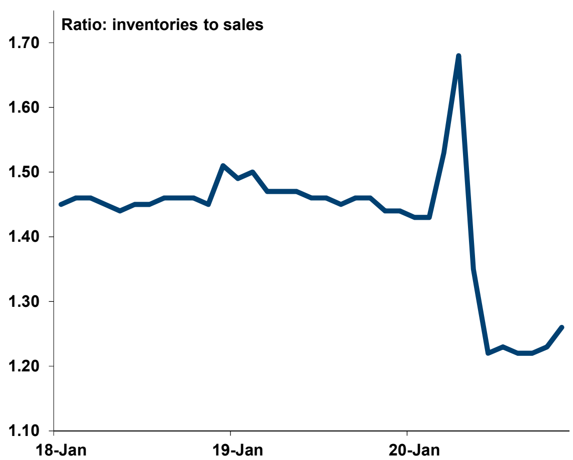
Source: Bureau of Economic Analysis via Haver Analytics

Unfilled Orders for Durable Goods



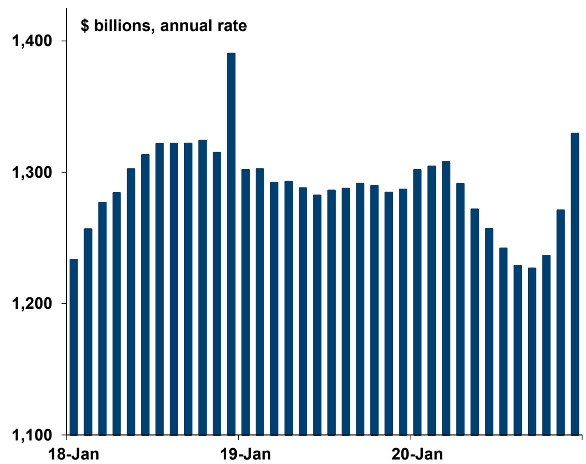
Source: U.S. Census Bureau via Haver Analytics

Retail Inventory/Sales Ratio



Source: U.S. Census Bureau via Haver Analytics

Dividend Income



Source: Bureau of Economic Analysis via Haver Analytics

However, this troubled area might have found a bottom, as orders have moved back into positive territory in the past four months. The volume of bookings is low relative to pre-pandemic standards, but flows have been strong enough to suggest that a corner has been turned, which adds another ray of hope for business investment (or exports if orders are from foreign air carriers).

Businesses also have boosted economic activity in the past two quarters by rebuilding inventories, as inventory investment added 1.0 percentage point to GDP growth in Q4 after a contribution of 6.6 percentage points in the prior quarter. Businesses are probably not done rebuilding, as inventories are lean at the retail level (chart, left). If individuals ever get back into stores, vendors will need to bolster their stocks of goods.

Friday's report on personal income and consumption contained an element that would reinforce a positive view on the business sector. Dividend income rose sharply in December, adding considerably to gains in the prior two months and pushing dividends above pre-Covid levels (chart, right). Businesses cut dividends during most of the spring and summer, most likely in an effort to preserve capital at a time when profits could falter. Apparently, executives are now more confident about their ability to cope with the virus.

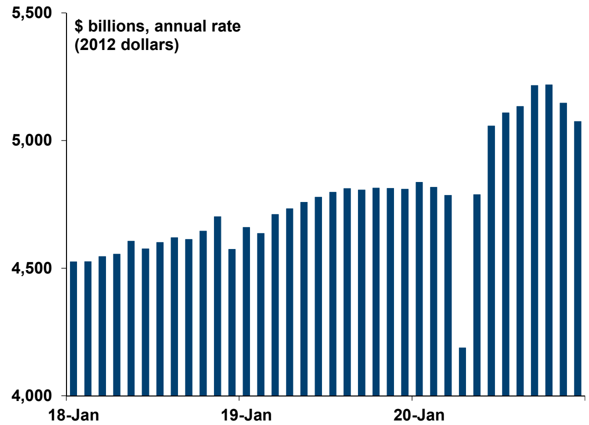
We do not want to get too carried away with the business sector, as one aspect of capital spending remains weak: investment in new structures. Activity began to soften even before the pandemic, dipping in late 2019 and early 2020 before tumbling in the second and third quarters. Outlays rose in the fourth quarter, but the increase was modest (3.0 percent, annual rate) and occurred from a low level; activity remained depressed relative to historical standards. This area might not recover for some time, as infrastructure needs of businesses are likely to be lighter under post-pandemic business models.

The Consumer

With most optimistic forecasts for the economy based on brisk consumer spending, the December report on income and consumption might generate concern, as household expenditures fell for the second consecutive month. The changes were sizeable in real terms (off 0.7 percent in November and 0.6 percent in December).

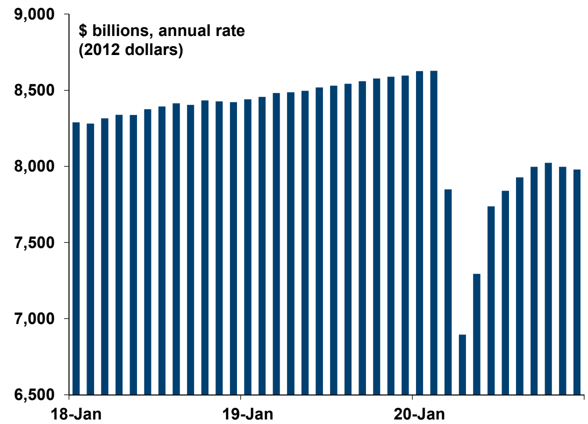
Real spending still rose in Q4 because of good results in October, but recent softness raises the possibility of a decline in the first quarter of this year. Real outlays in December were below the average in the fourth quarter; if spending held at the December level for the next three months, average outlays for Q1 would translate to an annual rate of decline in personal consumption expenditures of 2.5 percent. Real outlays need

Real Consumption of Goods



Source: Bureau of Economic Analysis via Haver Analytics

Real Consumption of Services



Source: Bureau of Economic Analysis via Haver Analytics

to grow slightly more than 0.3 percent per month for the next three months to pull even with the fourth quarter average and register zero growth. A challenge.

Despite the recent softness, we would maintain a positive view on household spending. We view the recent declines as the result of a natural correction in spending on goods and limited activity in the service area because of virus-related risks. Observers should recall that spending on goods was quite strong from June through October, with outlays moving well above the previous underlying trend (chart, left); a correction seemed likely at some point. One might say that individuals were tapped out on the goods front.

Service spending has improved since the spring, but it remains well below the pre-pandemic level because of mandated or voluntary lockdowns (chart, right). As virus-related risks dissipate, we are likely to see pent-up demand unleashed in the service area. Individuals will wish to travel, attend concerts and plays, and dine in restaurants.

Households in the aggregate will have the financial wherewithal to spend actively. The income and consumption report showed a solid gain in wages that pushed this component of income above its pre-pandemic peak in February. Also, as noted above, dividend income has rebounded in recent months, and another round of support payments from the federal government began in January ($600 recovery rebates, enhanced unemployment benefits, and PPP loans that will convert to grants). We also would note that a good portion of the first wave of government support authorized by the Cares Act was saved or used to pare debt. These changes are evident in a surge in bank deposit accounts and a sharp reduction in outstanding credit card debt.

Individuals are likely to be financially strong and ready to spend when virus risks dissipate.

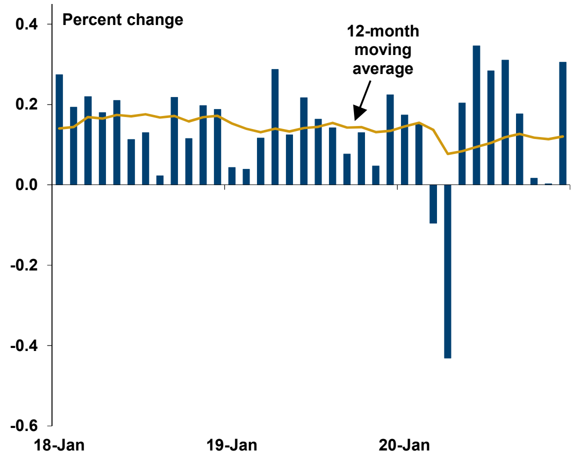
PCE Price Indexes

The headline price index for personal consumption expenditures was a tad firmer than expected (0.4 percent rather than 0.3 percent), and the core component provided a bigger surprise with a jump of 0.3 percent, versus an expectation of 0.1 percent. The increase might stir inflation fears, but a review of the detail in the report should ease any concerns that observers might have.

First, note that the increase followed two months of no change (chart, next page). Results in the past three months could be viewed as lumpiness or random volatility that sometimes occurs in economic data. A review of items that pushed the measure higher would support this view, as much of the pressure occurred in areas where heavy discounting had occurred in earlier months because of the coronavirus. For example, prices of recreation goods and clothing both rose more than 1.0 percent in December but were still lower on a year-over-year basis because of earlier discounting. Prices of financial services also contributed to the jump in the core index, but this component often posts sharp month-to-month swings.

Fed Chair Jerome Powell is not likely to be alarmed about the increase in core prices. He noted in his press briefing this week that inflation might show transitory increases because of the unwinding of earlier discounting associated with the pandemic. More generally, he argued that price dynamics in recent years favored restrained inflation, and these forces (demographics, technology, and globalization), he argued, were likely to change slowly.

Core PCE Price Index



PCE = personal consumption expenditures
Source: Bureau of Economic Analysis via Haver Analytics

Review

Week of Jan. 25, 2021	Actual	Consensus	Comments
Consumer Confidence (January)	**89.3 (+2.2 Index Pts.)**	**89.0 (+0.4 Index Pt.)**	Although consumer confidence increased in January (2.5%), the measure remained close to the bottom of the range since the onset of the pandemic (32.7% below the pre-virus high of 132.6 last February). The flaring of the virus in recent months and slow distribution of vaccines seem to have weighed on attitudes.
Durable Goods Orders (December)	**0.2%**	**1.0%**	New orders for durable goods increased only modestly in December, but activity in the prior month was revised higher and weakness in the latest month was concentrated in the commercial aircraft sector. Excluding the transportation component, orders rose 0.7%, which pushed bookings ex-transportation further above pre-pandemic levels (5.9% above the January high). New orders for nondefense capital goods other than aircraft, a series that provides good insight into business investment in new equipment, rose 0.6%, the eighth consecutive increase. Bookings are now 7.4% above the pre-Covid peak in January.
GDP (2020-Q4)	**4.0%**	**4.2%**	GDP rose solidly in the fourth quarter, but the virus-related slump in the first half of the year left a moderate decline for the year as a whole (off 3.5%, measured on an annual average basis; the change from the fourth quarter of 2019 to 2020-Q4 totaled -2.5%). Residential construction jumped 33.5% after an advance of 63.0% in Q3. The recent changes pushed the residential construction component of GDP well ahead of the pre-pandemic level in 2019-Q4. Businesses were active on several fronts. Outlays for equipment were brisk, registering growth of 24.9% after a surge of 68.2% in the prior quarter. These striking advances pushed the level of spending on new equipment slightly above pre-pandemic totals. Business spending on intellectual property also was firm, as was inventory investment (which added 1.0 percentage point to GDP growth after a contribution of 6.6 percentage points in Q3). Consumer spending grew moderately in Q4, up 2.5%. Net exports stood out on the soft side, subtracting 1.5 percentage points from growth.
U.S. International Trade in Goods (December)	**-$82.5 Billion ($2.3 Billion Narrower Deficit)**	**-$84.0 Billion ($1.5 Billion Narrower Deficit)**	Both exports and imports continued to recover in December, registering advances of 4.6% and 1.4%, respectively. The jump in exports was broadly based, but imports showed mixed results across categories. Although the deficit improved in December, the shortfall for the fourth quarter widened, which led to the negative contribution to GDP growth.
New Home Sales (December)	**0.842 Million (+1.6%)**	**0.870 Million (+3.5%)**	Sales of new homes rose in December from downward revised results in November. The combination of the modest increase and the downward revision left the level of sales only marginally above the preliminary tally in November and noticeably below the hefty totals from July to October (an average pace of 967,500, annual rate). This recent softening, we suspect, reflects better perceived opportunities in the market for existing homes, where sales have been vigorous.

Review Continued

Week of Jan. 25, 2021	Actual	Consensus	Comments
Leading Indicators (December)	**0.3%**	**0.3%**	Positive contributions from ISM new orders, stock prices, and building permits offset a drag from unemployment claims and consumer expectations, and pushed the index of leading economic indicators higher for the eighth consecutive month in December. The measure has recovered substantial ground after the virus-related drop in the spring and is only 2.2% below the recent high in January/February.
Employment Cost Index (2020-Q4)	**0.7%**	**0.5%**	A jump of 0.9% (not annualized) in wages and salaries led the advance in the employment cost index in Q4 after virus-related slack in the labor market restrained growth in the middle of the year (average growth of 0.4% in Q2/Q3). Benefit growth of 0.6% matched the average of the past two years.
Personal Income, Consumption, Core Price Index (December)	**0.6%, -0.2%, 0.3%**	**0.1%, -0.4%, 0.1%**	Wages and salaries rose solidly in December (0.5%), and income support programs from the government continued to provide a boost for households, but nonfarm proprietors income (-4.3%) and rental income (-0.2%) slipped. Spending by households declined for the second consecutive month, as a drop in outlays for goods outweighed a pickup in spending on services. The core PCE price index published with the report jumped 0.3%, but the increase followed two months of no change and had little effect on the underlying inflation rate (a year-over-year rate of 1.5% in December versus 1.4% in the prior month and 1.9% in February).

Sources: The Conference Board (Consumer Confidence, Leading Indicators); U.S. Census Bureau (Durable Goods Orders, U.S. International Trade in Goods, New Home Sales); Bureau of Economic Analysis (GDP, Personal Income, Consumption, Core Price Index); Bureau of Labor Statistics (Employment Cost Index); Consensus forecasts are from Bloomberg

Preview

Week of February 1, 2021	Projected	Comments
ISM Manufacturing Index (January) (Monday)	**59.5% (-1.0 Pct. Pt.)**	Most indicators tied to the manufacturing sector continue to perform well (e.g. factory employment, industrial production, and durable goods orders ex-transportation), suggesting that the ISM index for January should remain close to the elevated readings of the past three months (average of 59.0% in Q4 with a high of 60.5% in December).
Construction Spending (December) (Monday)	**1.0%**	Strength in single-family housing should be strong enough to offset continued softness in private nonresidential and government-related building.
ISM Services Index (January) (Wednesday)	**55.5% (-2.2 Pct. Pts.)**	The ISM services index recovered quickly from its pandemic-related drop in the spring (increasing 14.9 percentage points over May and June), and it remained elevated throughout the summer and fall. The spread of the coronavirus and its disproportionate effect on the service sector raises risks for January, but many service areas have found ways to adapt, and thus the measure should remain reasonably close to recent readings.
Nonfarm Productivity (2020-Q4) (Thursday)	**-1.5%**	The economy grew at a respectable pace in the fourth quarter, but businesses had to boost hours worked by a considerable amount to achieve the gain in output, which suggests that productivity fell in the final months of the year. The decline is disappointing when viewed in isolation, but this indicator often moves erratically, and it followed increases of 10.6% and 4.6% in Q2 and Q3, respectively.
Factory Orders (December) (Thursday)	**1.0%**	Orders for durable goods rose only modestly in December (0.2%, constrained by a drop in bookings for commercial aircraft), but orders for nondurable goods are likely to post a sharper advance and pull total bookings higher. Much of the gain in the nondurable area will probably be driven by higher prices of petroleum products, but with manufacturing activity generally performing well, nondurable orders ex-petrol also are likely to post a gain, which would mark the eighth consecutive advance and leave nondurable orders ex-petrol more than 1.0% above their pre-pandemic high.
Payroll Employment (January) (Friday)	**50,000**	An upward shift in the number of initial claims for unemployment insurance raises the prospect of another drop in payrolls. However, continued downward drift in continuing unemployment claims suggests that a good bit of hiring and worker recalls also have occurred, which favors a small gain in employment. This report will include annual benchmark revisions based on a comprehensive count of jobs as of March 2020. A preliminary report by the Bureau of Labor Statistics indicated a downward adjustment of 173,000.
Trade Balance (December) (Friday)	**-$65.2 Billion ($2.9 Billion Narrower Deficit)**	The surplus in service trade has trended downward in the past year, but a modest change in November raises the prospect of a bottom. If so, the already reported improvement of $3.0 billion in the goods trade deficit will account for essentially all of the narrowing in the overall trade shortfall.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

January/February 2021

Monday	Tuesday	Wednesday	Thursday	Friday
25	26	27	28	29
CHICAGO FED NATIONAL ACTIVITY INDEX Monthly 3-Mo. Avg. Oct 1.01 0.86 Nov 0.31 0.59 Dec 0.52 0.61	**FHFA HOME PRICE INDEX** Sept 1.7% Oct 1.5% Nov 1.0% **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** SA NSA Sept 1.5% 1.3% Oct 1.6% 1.3% Nov 1.4% 1.1% **CONFERENCE BOARD CONSUMER CONFIDENCE** Nov 92.9 Dec 87.1 Jan 89.3 **FOMC MEETING**	**DURABLE GOODS ORDERS** Oct 1.8% Nov 1.2% Dec 0.2% **FOMC DECISION** **POWELL PRESS CONFERENCE**	**UNEMPLOYMENT CLAIMS** Initial Continuing (Millions) Jan 02 0.784 5.175 Jan 09 0.927 4.974 Jan 16 0.914 4.771 Jan 23 0.847 N/A **GDP** GDP Chained Price 20-Q2 -31.4% -1.8% 20-Q3 33.4% 3.5% 20-Q4 4.0% 2.0% **U.S. INTERNATIONAL TRADE IN GOODS** Oct -$80.4 billion Nov -$85.5 billion Dec -$82.5 billion **ADVANCE INVENTORIES REPORT** Wholesale Retail Oct 1.3% 0.9% Nov 0.0% 0.8% Dec 0.1% 1.0% **NEW HOME SALES** Oct 0.949 million Nov 0.829 million Dec 0.842 million **LEADING INDICATORS** Oct 0.9% Nov 0.7% Dec 0.3%	**PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX** Inc. Cons. Core Oct -0.7% 0.3% 0.0% Nov -1.3% -0.7% 0.0% Dec 0.6% -0.2% 0.3% **EMPLOYMENT COST INDEX** Comp. Wages 20-Q2 0.5% 0.4% 20-Q3 0.5% 0.4% 20-Q4 0.7% 0.9% **MNI CHICAGO REPORT** Index Prices Nov 57.8 72.2 Dec 58.7 73.5 Jan 63.8 75.2 **PENDING HOMES SALES** Oct -0.9% Nov -2.5% Dec -0.3% **REVISED CONSUMER SENTIMENT** Nov 76.9 Dec 80.7 Jan (p) 79.2 Jan (r) 79.0
1	2	3	4	5
ISM INDEX (10:00) Index Prices Nov 57.7 65.4 Dec 60.5 77.6 **Jan 59.5 76.0** **CONSTRUCTION SPEND. (10:00)** Oct 1.6% Nov 0.9% **Dec 1.0%**	**VEHICLE SALES** Nov 15.6 million Dec 16.3 million **Jan 16.1 million**	**ADP EMPLOYMENT REPORT (8:15)** Private Payrolls Nov 304,000 Dec -123,000 Jan -- **ISM SERVICES INDEX (10:00)** Index Prices Nov 56.8 63.9 Dec 57.7 64.4 **Jan 55.5 64.5**	**INITIAL CLAIMS (8:30)** **PRODUCTIVITY & COSTS (8:30)** Productivity Unit Labor Costs 20-Q2 10.6% 12.3% 20-Q3 4.6% -6.6% **20-Q4 -1.5% 3.5%** **FACTORY ORDERS (10:00)** Oct 1.3% Nov 1.1% **Dec 1.0%**	**EMPLOYMENT REPORT (8:30)** Payrolls Un. Rate Nov 336,000 6.7% Dec -140,000 6.7% **Jan 50,000 6.7%** **TRADE BALANCE (8:30)** Oct -$63.1 billion Nov -$68.1 billion **Dec -$65.2 billion** **CONSUMER CREDIT (3:00)** Oct $4.5 billion Nov $15.3 billion Dec --
8	9	10	11	12
	NFIB SMALL BUSINESS OPTIMISM INDEX **JOLTS DATA**	**CPI** **WHOLESALE TRADE** **FEDERAL BUDGET**	**INITIAL CLAIMS**	**CONSUMER SENTIMENT**
15	16	17	18	19
PRESIDENTS' DAY	**EMPIRE MFG INDEX** **TIC DATA**	**RETAIL SALES** **PPI** **IP & CAP-U** **BUSINESS INVENTORIES** **NAHB HOUSING INDEX** **FOMC MINUTES**	**INITIAL CLAIMS** **HOUSING STARTS** **IMPORT/EXPORT PRICES** **PHILLY FED INDEX**	**EXISTING HOME SALES**

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

Treasury Financing

January/February 2021

Monday	Tuesday	Wednesday	Thursday	Friday
25	26	27	28	29
AUCTION RESULTS: Rate Cover 13-week bills 0.080% 2.92 26-week bills 0.085% 3.48 2-year notes 0.125% 2.67	**AUCTION RESULTS:** Rate Cover 52-week bills 0.090% 3.92 5-year notes 0.424% 2.34 42-day CMB 0.070% 3.94 119-day CMB 0.075% 3.95 **ANNOUNCE:** $30 billion 4-week bills for auction on January 28 $35 billion 8-week bills for auction on January 28 $25 billion 105-day CMBs for auction on January 27 $30 billion 154-day CMBs for auction on January 27 **SETTLE:** $30 billion 4-week bills $35 billion 8-week bills $25 billion 105-day CMBs $30 billion 154-day CMBs	**AUCTION RESULTS:** Spread Cover 2-year FRN 0.049% 2.82 Rate Cover 105-day CMB 0.075% 4.07 154-day CMB 0.080% 3.59	**AUCTION RESULTS:** Rate Cover 4-week bills 0.055% 3.91 8-week bills 0.065% 3.83 7-year notes 0.754% 2.30 **ANNOUNCE:** $105 billion 13-,26-week bills for auction on February 1 $30 billion 42-day CMBs for auction on February 2 $30 billion 119-day CMBs for auction on February 2 **SETTLE:** $105 billion 13-,26-week bills $34 billion 52-week bills $30 billion 42-day CMBs $30 billion 119-day CMBs	**SETTLE:** $15 billion 10-year TIPS
1	2	3	4	5
AUCTION: $105 billion 13-,26-week bills **SETTLE:** $24 billion 20-year bonds $28 billion 2-year FRNs $60 billion 2-year notes $61 billion 5-year notes $62 billion 7-year notes	**AUCTION:** $30 billion 42-day CMBs $30 billion 119-day CMBs **ANNOUNCE:** $30 billion* 4-week bills for auction on February 4 $35 billion* 8-week bills for auction on February 4 **SETTLE:** $30 billion 4-week bills $35 billion 8-week bills $25 billion 105-day CMBs $30 billion 154-day CMBs	**ANNOUNCE MID-QUARTER REFUNDING:** $58 billion* 3-year notes for auction on February 9 $41 billion* 10-year notes for auction on February 10 $27 billion* 30-year bonds for auction on February 11	**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills **ANNOUNCE:** $105 billion* 13-,26-week bills for auction February 8 **SETTLE:** $105 billion 13-,26-week bills $30 billion 42-day CMBs $30 billion 119-day CMBs	
8	9	10	11	12
AUCTION: $105 billion* 13-,26-week bills	**AUCTION:** $58 billion* 3-year notes **ANNOUNCE:** $30 billion* 4-week bills for auction on February 11 $35 billion* 8-week bills for auction on February 11 **SETTLE:** $30 billion* 4-week bills $35 billion* 8-week bills	**AUCTION:** $41 billion* 10-year notes	**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills $27 billion* 30-year bonds **ANNOUNCE:** $105 billion* 13-,26-week bills for auction February 16 $27 billion* 20-year bonds for auction on February 17 $9 billion* 30-year TIPS for auction on February 18 **SETTLE:** $105 billion* 13-,26-week bills	
15	16	17	18	19
PRESIDENTS' DAY	**AUCTION:** $105 billion* 13-,26-week bills **ANNOUNCE:** $30 billion* 4-week bills for auction on February 18 $35 billion* 8-week bills for auction on February 18 **SETTLE:** $30 billion* 4-week bills $35 billion* 8-week bills $58 billion* 3-year notes $41 billion* 10-year notes $27 billion* 30-year bonds	**AUCTION:** $27 billion* 20-year bonds	**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills $9 billion* 30-year TIPS **ANNOUNCE:** $105 billion* 13-,26-week bills for auction February 22 $34 billion* 52-week bills for auction on February 23 $24 billion* 2-year FRNs for auction on February 24 $60 billion* 2-year notes for auction on February 23 $61 billion* 5-year notes for auction on February 24 $62 billion* 7-year notes for auction on February 25 **SETTLE:** $105 billion* 13-,26-week bills	

*Estimate