U.S. Economic Comment

- Fiscal and monetary support: excessive?

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Fiscal Policy

Congress seems likely to approve a fiscal package similar to the $1.9 trillion proposal of President Biden. The Senate is prepared to advance the legislation under so-called budget reconciliation rules, which eliminates the possibility of a filibuster and therefore can be passed with 50 Democratic/independent votes (with Vice-President Harris casting the tie-breaking vote). Amendments will be allowed, leaving the final package uncertain, but it no doubt will be large.

Massive is probably a better description than large, especially considering that Congress approved a $900 billion stimulus package in December. None of the December support filtered into the economy last year, thus Congress will be providing approximately $2.8 trillion of fiscal stimulus this year, which represents 13 percent of Q4 GDP. Given the spurt in the economy in the third quarter and the respectable advance in the fourth quarter, this amount of support might seem excessive.

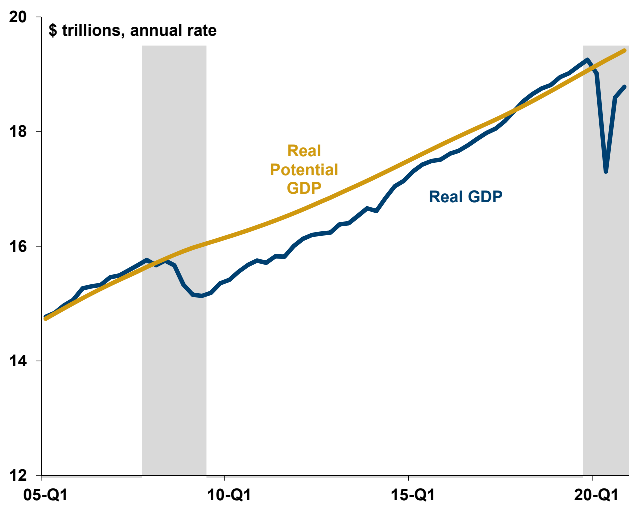
The largess of recent and pending legislation is evident in comparing the current level of GDP with the economy's potential. The current level of GDP trails estimated potential by approximately $630 billion (annual rate) or 3.4 percent. The recent and proposed support is more than four times the amount needed to close the gap (chart).

Congress can justify some stimulus in excess of the current GDP gap, as there will be leakage that prevents the full force of the stimulus from stirring the economy. For example, a portion of the support will be saved or used to pare debt, and some of the funds that flow to individuals or businesses will be used to purchase imports rather than domestically produced goods or services. Also, fiscal support often filters into the economy slowly; some of the proposed spending might not hit the economy until next year. Still, a package four times the size of the GDP gap represents an enormous push.

Commentary from Democratic supporters also suggests that the Biden proposal might be excessive. Lawrence Summers, Treasury Secretary in the Clinton Administration and Director of the National Economic Council in the Obama Administration, published an editorial in the *Washington Post* questioning the size of the package. Mr. Summers believes that the program could stir inflation and will absorb valuable fiscal space that will preempt needed infrastructure spending and other investments.

Other commentators have highlighted poor targeting in some components of the package. For example, the $1,400 rebate checks (approximately $465 billion in total) will go to many individuals that have not suffered income setbacks because of the

Real GDP (Actual & Potential)*



** The shaded areas indicate periods of recession in the United States.*

Sources: Bureau of Economic Analysis, Congressional Budget Office, and The National Bureau of Economic Research via Haver Analytics pandemic. Similarly, $350 billion will go to state and local governments, despite the fact that budget positions are better than expected at the onset of the pandemic. (Data from the Census Bureau show only a modest decline in revenues in the first three quarters of the year and an increase on a seasonally adjusted basis.)

Supporters of the package argue that Congress should “go big” to avoid the perceived mistakes in the fiscal stimulus passed during the Obama Administration. The Obama package, which totaled $787 billion or 5.4 percent of 2009-Q1 GDP, is now viewed as too small to have dealt with the deep recession at the time. In addition, many observers believe that the program was unwound too quickly. These views have merit, as GDP after the financial crisis did not come close to potential until 2015 and did not meet or exceed potential until the first quarter of 2018 (see p. 1 chart). Nevertheless, $2.8 trillion of stimulus strikes us as overkill.

Monetary Policy

The highly accommodative policy stance of the Federal Reserve has been generally well received by market participants and politicians, but it has not been immune to questions and challenges. Interestingly, two recent studies by economists at Reserve Banks have suggested that rationales offered for aggressive monetary policy are not as strong as officials have suggested.

Chair Powell has often noted that the Federal Reserve has responded aggressively to the pandemic in an effort to prevent long-term damage to the economy. Extended periods of unemployment, the argument goes, could lead to deterioration in worker skills and an erosion in networking relationships, which eventually would lead individuals to drop out of the labor force, thereby weakening the economy’s potential. This risk also has been mentioned often in the financial press, with analysts worrying that the pandemic could lead to “scarring” of the economy.

However, a recent study by economists at the Federal Reserve Bank of Richmond found that such risks are low (Luca Benati and Thomas A. Lubik, “Seek and Ye Shall Not Find: The Absence of Hysteresis in U.S. Macroeconomic Data”, available on the web site of the Richmond Fed). In reviewing cyclical movements in the U.S. economy over the past 60 years, this study found that economic shocks did not have long-term implications for the performance of the economy; macroeconomic variables tend to fluctuate around a stable long-term trend. A recession that drives the unemployment rate higher does not leave the jobless rate higher than it was before the shock. Thus, the economy is not likely to be scarred by a recession.

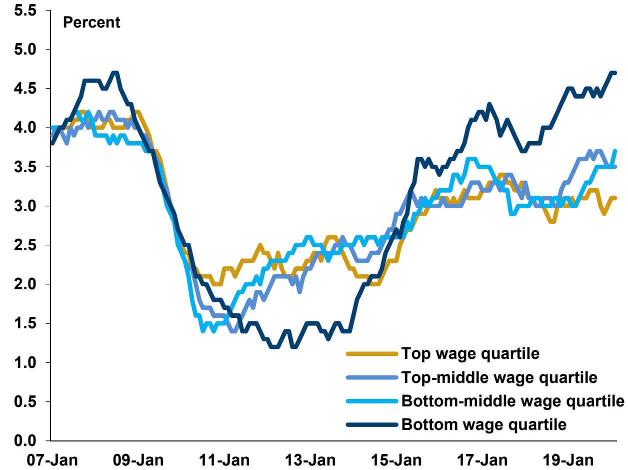
(Hysteresis in the study’s title is a term used in many scientific applications to describe situations where the future value of a variable will depend upon its path through time. Changes in one time period will influence where that variable will be in the future. In economics, hysteresis refers to the possibility of shocks having permanent or long-run effects: higher unemployment today could lead to structural changes that leave future unemployment rates above previous levels.)

A second study raised questions about the Fed’s ability to make meaningful progress in achieving broadly shared economic prosperity, which has become a new, implied goal of the Federal Reserve. The long-run strategy statement of the Fed adopted last August defined the goal of maximum employment as “a broad and inclusive” concept. This phrasing implies, and has been confirmed by numerous public comments, that Fed officials are seeking to promote more equitable distributions of income and wealth.

The New York Fed this week released a staff study dimming hopes for substantial strides on this front (Alina K. Bartscher, Moritz Kuhn, Moritz Schularick, and Paul Wachtel, “Monetary Policy and Racial Inequality”, available on the New York Fed’s web site). The study found that accommodative monetary policy increases employment among black households more so than white households, but the effects are small. At the same time, easy policy tends to worsen wealth disparities between blacks and whites because blacks have fewer financial assets that appreciate in response to easy monetary policy. The study’s conclusion was striking: “there is little reason to think that accommodative monetary policy plays a significant role in reducing racial inequities… On the contrary, it may well accentuate inequalities for extended periods.”

We do not expect these studies to have much influence on policy decisions in the months and quarters ahead. Although the Richmond Fed tells us that the risk of long-term damage is low, Fed officials seem to believe there is some downside potential. Similarly, the experience in the latest expansion, when tight labor markets benefitted low-wage workers and underserved communities, has led officials to believe that they can play some role in promoting equity, and thus they are likely to try.

Wage Growth for Low Earners Compared with Other Workers*



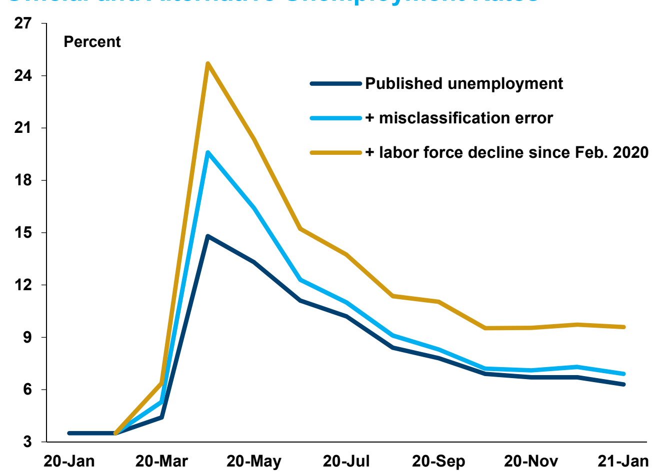
** Three-month moving average of the median 12-month change in individual wages. Data are from the Federal Reserve Bank of Atlanta, Wage Growth Tracker. The last observation is for February 2020.*

Source: Powell, Jerome H. “Getting Back to a Strong Labor Market.” 10 Feb. 2021. Federal Reserve Board: https://www.federalreserve.gov/newsevents/speech/powell20210210a.htm

The latest speech by Chair Powell certainly suggested that he believes the Fed can play a role in promoting shared prosperity. He highlighted faster wage growth for individuals in the low quartile of the wage distribution during the latter stages of the recent expansion (chart, above). Such a spurt probably would not have happened in a softer labor market.

Other elements of Chair Powell’s speech also suggested that he is fully committed to accommodative policy. For example, he was not impressed by the reduction in the unemployment rate since the peak in the spring. He noted that some of the reduction was the result of misreporting and some was the result of individuals dropping out of the labor force. Adjusting for these factors would leave the unemployment rate close to 10 percent, matching the peak seen during the financial crisis (chart, right).

Official and Alternative Unemployment Rates*



** The data are from the Bureau of Labor Statistics and Federal Reserve Board staff calculations.*

Source: Powell, Jerome H. “Getting Back to a Strong Labor Market.” 10 Feb. 2021. Federal Reserve Board: https://www.federalreserve.gov/newsevents/speech/powell20210210a.htm

Review

Week of February 8, 2021	Actual	Consensus	Comments
CPI (January)	**0.3% Total, 0.0% Core**	**0.3% Total, 0.2% Core**	The increase in in the headline CPI in January was led by the energy component (3.5%), driven by higher prices of gasoline and fuel oil. Food prices rose modestly (0.1%), as a decline of 0.1% in prices of food for home consumption offset a jump of 0.3% in the cost of food away from home. The core CPI was unchanged in January (third reading of 0.1% or less in the past four months). The pandemic continued to restrain prices in several areas, such as hotel fees, airfares, and rents. In the opposite direction, apparel prices jumped 2.2%, a sizeable break from offsetting ups and downs in the prior six months. On a year-over-year basis, the headline CPI increased 1.4%, unchanged from December but down from 2.5% in January of last year. The year-over-year advance in the core CPI slowed two ticks to 1.4%, down from a tight range of 1.6% to 1.7% in the second half of 2020.
Federal Budget (January)	**$162.8 Billion Deficit**	**$157.5 Billion Deficit**	Federal revenues in January grew 3.3% on a year-over-year basis, a less-than-robust pace but an improvement from the average of -0.4% in the first quarter of the current fiscal year (Oct to Dec). Outlays jumped 35.2% versus January 2020. Outlay growth would have been even heftier if not for a calendar configuration that shifted some spending from January into December. The deficit of $736 billion for the first four months of FY2021 was $347 billion wider than the shortfall in the same period in FY2020.
Consumer Sentiment (February)	**76.2 (-2.8 Index Pts.)**	**80.9 (+1.9 Index Pts.)**	Consumer sentiment fell 3.5% in early February (and 5.6% in the past two months), as the spread of Covid and slow distribution of vaccines apparently weighed on the minds of consumers. Despite hints of a pickup in the fall, slippage in the past two months has left sentiment only a little more than 6% above the virus-related low in April 2020 and almost 25% below the pre-pandemic high in February.

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

Preview

Week of February 15, 2021	Projected	Comments
Retail Sales (January) (Wednesday)	**1.2% Total, 1.0% Ex-Autos**	Firm sales of new vehicles will probably lift the auto component of the retail report, and higher prices of gasoline are likely to inflate reported activity at service stations. Elsewhere, the issuance of another round of rebate checks probably stirred sales after pauses in the prior three months.
PPI (January) (Wednesday)	**0.4% Total, 0.2% Ex-Food and Energy**	Higher prices of petroleum-based products are likely to be evident in the energy component, but food prices could ease from elevated readings in the prior three months. Outside of food and energy, goods prices should settle after a surprising jump in December, while the volatile service category is due for an increase after three months of little net change.
Industrial Production (January) (Wednesday)	**0.3%**	Although factory employment declined in January, a longer workweek probably led to a gain in manufacturing production. The previously soft mining sector is likely to post its third consecutive gain, as an increase in the rotary-rig count and longer hours of work point to firmer activity. The utility component, in contrast, could soften because of warmer-than-normal temperatures.
Housing Starts (January) (Thursday)	**1.600 Million (-4.1%)**	With sales of new homes off recent highs, builders are likely to slow the pace of new starts. A dip in the sentiment index of the National Association of Home Builders also suggests an easing in activity.
Existing Home Sales (January) (February)	**6.40 Million (-5.3%)**	Recent declines in pending home sales suggest that activity in the market for existing homes is likely to ease from the robust pace of the past four months (average of 6.725 million units, annual rate). Although sales are expected to decline on a month-to-month basis, they remain strong relative to standards of the past several years, easily better than the total of 5.527 million homes in 2017, which was the best year for existing home sales in the prior expansion.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

February/March 2021

Monday	Tuesday	Wednesday	Thursday	Friday
8	9	10	11	12
	NFIB SMALL BUSINESS OPTIMISM INDEX Nov 101.4 Dec 95.9 Jan 95.0 **JOLTS DATA** Openings (000) / Quit Rate Oct 6,632 2.2% Nov 6,572 2.2% Dec 6,646 2.3%	**CPI** Total / Core Nov 0.2% 0.2% Dec 0.2% 0.0% Jan 0.3% 0.0% **WHOLESALE TRADE** Inventories / Sales Oct 1.3% 1.7% Nov 0.0% 0.3% Dec 0.3% 1.2% **FEDERAL BUDGET** FY2021 / FY2020 Nov -$145.3B -$208.8B Dec -$143.6B -$13.3B Jan -$162.8B -$32.6B	**UNEMPLOYMENT CLAIMS** Initial / Continuing (Millions) Jan 16 0.875 4.785 Jan 23 0.812 4.690 Jan 30 0.812 4.545 Feb 06 0.793 N/A	**CONSUMER SENTIMENT** Dec 80.7 Jan 79.0 Feb 76.2
15	16	17	18	19
PRESIDENTS' DAY	**EMPIRE MFG (8:30)** Dec 4.9 Jan 3.5 Feb -- **TIC DATA (4:00)** Total / Net Long-Term Oct -$11.1B $51.9B Nov $214.1B $149.2B Dec -- --	**RETAIL SALES (8:30)** Total / Ex.Autos Nov -1.4% -1.3% Dec -0.7% -1.4% **Jan 1.2% 1.0%** **PPI (8:30)** Total / Ex. Food & Energy Nov 0.1% -0.1% Dec 0.3% 0.1% **Jan 0.4% 0.2%** **IP & CAP-U (9:15)** IP / Cap.Util. Nov 0.5% 73.4% Dec 1.6% 74.5% **Jan 0.3% 74.6%** **BUSINESS INVENTORIES (10:00)** Inventories / Sales Oct 0.8% 0.9% Nov 0.5% 0.0% **Dec 0.5% 0.9%** **NAHB HOUSING INDEX (10:00)** Dec 86 Jan 83 Feb -- **FOMC MINUTES (2:00)**	**INITIAL CLAIMS (8:30)** **HOUSING STARTS (8:30)** Nov 1.578 million Dec 1.669 million **Jan 1.600 million** **IMPORT/EXPORT PRICES (8:30)** Non-fuel Imports / Nonagri. Exports Nov -0.2% 0.3% Dec 0.4% 1.3% Jan -- -- **PHILLY FED INDEX (8:30)** Dec 9.1 Jan 26.5 Feb --	**EXISTING HOME SALES (10:00)** Nov 6.71 million Dec 6.76 million **Jan 6.40 million**
22	23	24	25	26
CHICAGO FED NATIONAL ACTIVITY INDEX **LEADING INDICATORS**	**FHFA HOME PRICE INDEX** **S&P CORELOGIC CASE-SHILLER HOME PRICE INDEX** **CONSUMER CONFIDENCE**	**NEW HOME SALES**	**INITIAL CLAIMS** **DURABLE GOODS ORDERS** **REVISED GDP** **PENDING HOME SALES**	**PERSONAL INCOME, CONSUMPTION, PRICE INDEXES** **U.S. INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES** **MNI CHICAGO PMI** **REVISED CONSUMER SENTIMENT**
1	2	3	4	5
ISM MFG INDEX **CONSTRUCTION SPEND.**	**VEHICLE SALES**	**ADP EMPLOYMENT REPORT** **ISM SERVICES INDEX** **BEIGE BOOK**	**INITIAL CLAIMS** **REVISED PRODUCTIVITY & COSTS** **FACTORY ORDERS**	**EMPLOYMENT REPORT** **TRADE BALANCE** **CONSUMER CREDIT**

Forecasts in Bold.

Treasury Financing

February/March 2021

Monday	Tuesday	Wednesday	Thursday	Friday
8	9	10	11	12
AUCTION RESULTS: Rate / Cover 13-week bills 0.035% 3.02 26-week bills 0.050% 2.99	**AUCTION RESULTS:** Rate / Cover 3-year notes 0.196% 2.39 6-week CMB 0.035% 3.43 17-week CMB 0.040% 3.80 **ANNOUNCE:** $30 billion 4-week bills for auction on February 11 $35 billion 8-week bills for auction on February 11 $25 billion 15-week CMBs for auction on February 10	**AUCTION RESULTS:** Rate / Cover 10-yr notes 1.155% 2.37 15-week CMB 0.045% 3.61 22-week CMB 0.055% 3.23 $30 billion 22-week CMBs for auction on February 10 **SETTLE:** $30 billion 4-week bills $35 billion 8-week bills $25 billion 15-week CMBs $30 billion 22-week CMBs	**AUCTION RESULTS:** Rate / Cover 4-week bills 0.030% 4.10 8-week bills 0.035% 3.39 30-yr bonds 1.933% 2.18 **ANNOUNCE:** $105 billion 13-,26-week bills for auction on February 16 $27 billion 20-year bonds for auction on February 17 $9 billion 30-year TIPS for auction on February 18	$30 billion 6-week CMBs for auction on February 16 $30 billion 17-week CMBs for auction on February 16 **SETTLE:** $105 billion 13-,26-week bills $30 billion 6-week CMBs $30 billion 17-week CMBs
15	16	17	18	19
PRESIDENTS' DAY	**AUCTION:** $105 billion 13-,26-week bills $30 billion 6-week CMBs $30 billion 17-week CMBs **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 $25 billion 15-week CMBs $30 billion 22-week CMBs	**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 $26 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 $30 billion* 6-week CMBs for auction on February 23 **SETTLE:** $105 billion 13-,26-week bills $30 billion 6-week CMBs $30 billion 17-week CMBs	
22	23	24	25	26
AUCTION: $105 billion* 13-,26-week bills	**AUCTION:** $34 billion* 52-week bills $60 billion* 2-year notes $30 billion* 6-week CMBs **ANNOUNCE:** $30 billion* 4-week bills for auction on February 25 $35 billion* 8-week bills for auction on February 25 $30 billion* 17-week CMBs for auction on February 24 **SETTLE:** $30 billion* 4-week bills $35 billion* 8-week bills	**AUCTION:** $26 billion* 2-year FRNs $61 billion* 5-year notes $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills $62 billion* 7-year notes **ANNOUNCE:** $105 billion* 13-,26-week bills for auction March 1 $30 billion* 6-week CMBs for auction on March 2 **SETTLE:** $105 billion* 13-,26-week bills $34 billion* 52-week bills $30 billion* 6-week CMBs	**SETTLE:** $9 billion 30-year TIPS $26 billion* 2-year FRNs
1	2	3	4	5
AUCTION: $105 billion* 13-,26-week bills **SETTLE:** $27 billion 20-year bonds	**AUCTION:** $30 billion* 6-week CMBs **ANNOUNCE:** $30 billion* 4-week bills for auction on March 4 $35 billion* 8-week bills for auction on March 4 $30 billion* 17-week CMBs for auction on March 3 **SETTLE:** $30 billion* 4-week bills $35 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills **ANNOUNCE:** $105 billion* 13-,26-week bills for auction March 8 $58 billion* 3-year notes for auction on March 9 $38 billion* 10-year notes for auction on March 10 $24 billion* 30-year bonds for auction on March 11 $30 billion* 6-week CMBs for auction on March 9 **SETTLE:** $105 billion* 13-,26-week bills $30 billion* 6-week CMBs	

**Estimate*