Daiwa Capital Markets

U.S. Economic Comment

- The labor market: lagging by some measures, robust by others
- Inflation risks: supply-chain disruptions remain an issue

Michael Moran
Daiwa Capital Markets America
212-612-6392
michael.moran@us.daiwacm.com

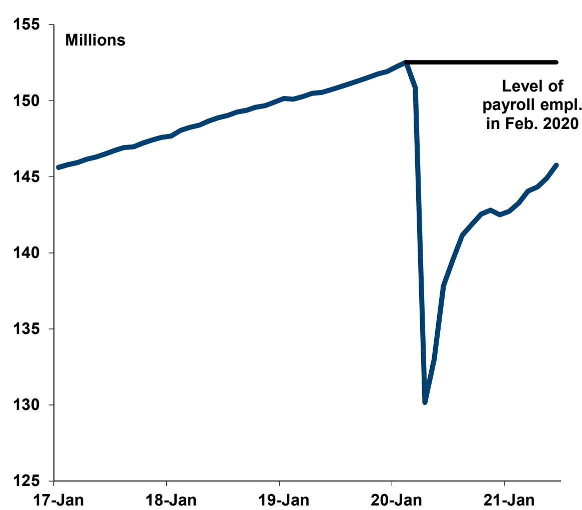
Substantial Further Progress: Are We There Yet?

The Federal Open Market Committee has provided only the vaguest of guidance on its asset purchase program, indicating that it needs to see "substantial further progress" toward its policy goals before it begins to taper the current pace of asset purchases. The Committee provided an ounce of additional information in the minutes from the April meeting, noting that the base for evaluating substantial progress is December. Still, one is left wondering what constitutes substantial progress.

Public comments from some Fed officials have shed a little light. A few have noted that nonfarm payrolls remain well below pre-pandemic levels (6.8 million shy as of June, having recouped only 70 percent of the ground lost at the start of the pandemic; chart, left). Several also have noted that the unemployment rate, although down 0.8 percentage point from the designated benchmark in December, is still 2.4 percentage points above the pre-pandemic level. Taking account of possible reporting errors and the number of individuals that have dropped out of the labor force, the gap between the current and December base is 1.5 percentage points, and the gap with the pre-pandemic unemployment rate is 4.7 percentage points (chart, right). Other measures, such as the employment-population ratio and the labor force participation rate, paint a similar picture.

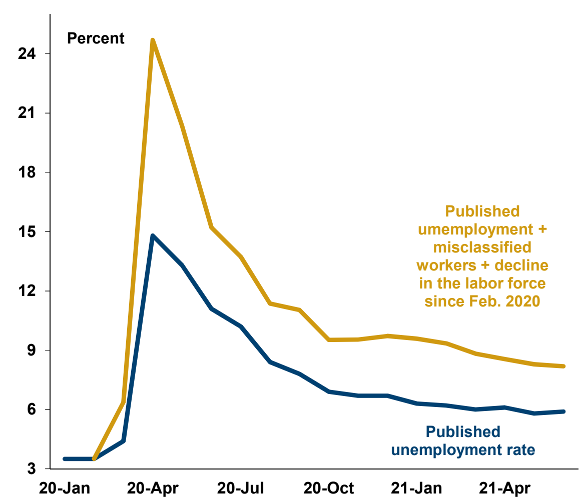
Despite the sub-par conditions in the labor market, some Fed officials have indicated a preference for altering the purchase program in the near future. This sentiment is partly driven by firm conditions in the housing market and bubble-like increases in home prices – signals that the Fed does not need to be buying mortgage-backed securities. The labor market also might be playing a role, as other figures suggest that conditions might be viewed as normal.

Nonfarm Payrolls



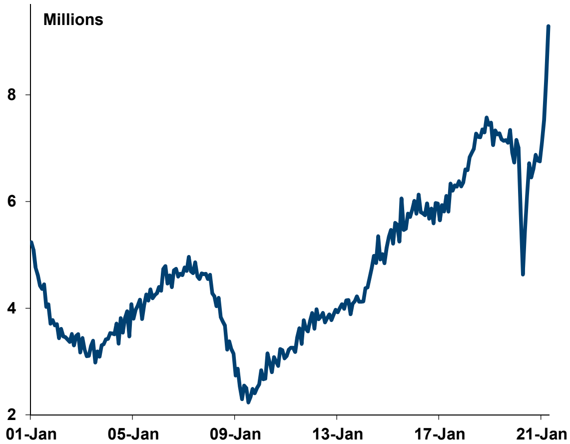
Source: Bureau of Labor Statistics via Haver Analytics

Unemployment Rate



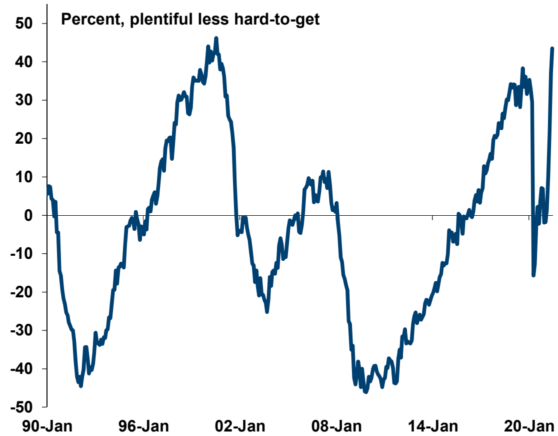
Source: Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America

Job Openings



Source: Bureau of Labor Statistics via Haver Analytics

Labor Market Assessment*



** The share of survey respondents indicating that jobs are plentiful less the share indicating that jobs are hard-to-get.*

Source: The Conference Board via Haver Analytics

The number of job openings has jumped to a striking level, easily surpassing the record set in the prior expansion (chart, left). The number of job openings (9.3 million) is not quite large enough to absorb all of the unemployed, but the ratio of openings to unemployment of 0.95 is extreme by historical standards and not far below the record of 1.24 set at the peak of the previous expansion.

Individuals are aware of the strong demand for labor, as the Conference Board survey of consumers shows a highly favorable assessment of the labor market. Numerous individuals view jobs as plentiful, while few see jobs as hard to get. The net assessment (the share indicating that jobs are plentiful less the share indicating that jobs are hard to get) is only a tad shy of the record set during the tech boom in 2000 (chart, right).

By these metrics, one could argue that the labor market is normal, perhaps exuberant, and therefore quantitative easing should be dialed back.

The contrast between statistics from the employment report and the measures of job openings and labor market assessment are not especially puzzling. Most observers recognize that virus-related issues (fear of contracting the illness and dependent-care responsibilities), along with generous government support, are preventing many jobless individuals from searching for or accepting a position. The commentary, though, often describes these restraints on employment as alternatives: it is either virus-related issues or generous unemployment benefits that are constraining job growth. In our view, the two work hand-in-hand.

Individuals have numerous obligations and priorities that must be balanced. If budgets are tight, securing a job and maintaining income flow would move to the top of the list. If financial cushions exist, individuals will tend to emphasize nonfinancial priorities, such as maintaining health or providing high-level dependent care, perhaps even leisure. Government support has provided a financial cushion for many, and thus accepting a job has inched lower on the priority list.

Many commentators also focus on unemployment benefits when discussing the gap between job openings and job growth, but the focus should be on total government support. Through various rounds of legislation, especially the CARES Act and the American Rescue Plan, the federal government has provided wide-ranging support, including recovery rebate checks, rental assistance, coverage of Covid-related funeral expenses, suspension of student loan payments, and increases in the child tax credit, dependent-care credit and health care subsidies. The financial cushion is broad and deep, and individuals are exercising the flexibility it offers to pursue priorities other than income flow.

Federal supplements to regular state unemployment insurance programs expire in early September, and many states began terminating the programs in June. The loss of benefits will most likely nudge some individuals back into the labor force, but given the sizeable cushion offered by the federal government, the flood of returning workers might not be precipitous in the next few months.

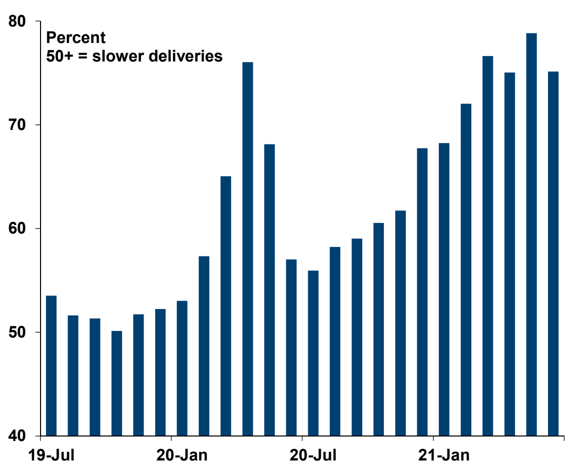
Supply Chains

We typically do not put great weight on the supplier delivery component of the ISM index, but in the current setting, we view it as an important indicator. Supply shortages have become issues in many industries, and this measure provides insights into difficulties in obtaining inputs. (The index increases as supplies tighten and delivery times slow. Like the headline measure, this index ranges from 0 to 100 with 50 representing a neutral reading: delivery times neither speeding nor slowing.)

The measure rose to a 47-year high last spring with the initial shut-down of the economy because of the pandemic, but it subsequently eased to less-than-troubling levels. However, as the economy gathered steam, the index rose even higher than the shutdown-related spike in April 2020 (chart, left). The index dipped in June, suggesting greater availability of supplies, but the change was marginal and the level of the index (75.1 percent) still indicated problems on the supply side of the economy.

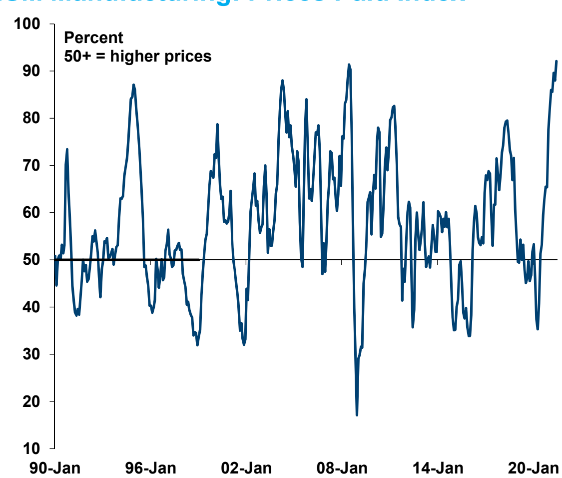
Tight supplies naturally involve inflation risks, and pressure seems to have emerged, as the price index published with the ISM report surged to 92.1 percent. The latest reading is not a record, but only a handful of observations in the history of the series (dating back to 1948) are higher (chart, right).

ISM Manufacturing: Supplier Deliveries Index



Source: Institute for Supply Management via Haver Analytics

ISM Manufacturing: Prices Paid Index



Source: Institute for Supply Management via Haver Analytics

Review

Week of June 28, 2021	Actual	Consensus	Comments
Consumer Confidence (June)	**127.3 (+7.3 Index Pts.)**	**119.0 (+1.8 Index Pts.)**	After a sluggish performance during most of the recovery period, the confidence index finally began to gain traction this past spring. The measure jumped 20.7% in March and added to that surge in each of the next three months. All told, the measure has climbed 33.7% in the past four months. Despite this recent burst, the index has still not regained all of the ground lost during the worst of the pandemic. The measure needs to advance another 4.2% to move above the pre-virus reading of 132.6 in February 2020.
ISM Manufacturing Index (June)	**60.6% (-0.6 Pct. Pt.)**	**60.9% (-0.3 Pct. Pt.)**	Although the ISM index lost ground in June, it was still quite high by historical standards and signaled firm activity in the manufacturing sector. The headline figure was constrained by a decline of 3.7 percentage points in the supplier delivery index, but this decline should be viewed as a positive development, as it suggests an element of repair to supply-chain disruptions. With input restraints easing, the production index rose 2.3 percentage point to 60.8%, strong by historical standards. Although production improved in June, the employment index fell 1.0 percentage point to 49.9%. The decline might be related to difficulty in finding workers rather than an intention to reduce payrolls. Price pressure remains an issue in the manufacturing sector, as the price index rose 4.1 percentage points to 92.1%, the firmest showing since July 1973.
Construction Spending (May)	**-0.3%**	**0.4%**	After considerable improvement from July through January, construction activity has eased on balance over the past four months. Private residential building is still increasing, but only modestly so. Private nonresidential building has been moving along a downward trend since January of last year, while government-related construction has been on an easing trend since the spring of 2020.
Payroll Employment (June)	**850,000**	**720,000**	The increase in nonfarm payrolls in June was the firmest advance since the early stages of the recovery period, but the results were not especially impressive. A large portion of the gain reflected seasonal anomalies in the education sector. Employment throughout the private sector rose 662,000, a respectable performance but lighter than one might hope for at this stage of the current cycle. The unemployment rate rose 0.1 percentage point to 5.9%. Employment as measured by the household survey posted a surprising decline of 18,000, while the size of the labor force rose by 151,000. The broad unemployment rate, in contrast, fell 0.4 percentage point to 9.8%, as declines in the number of individuals working part time involuntarily and the number of marginally attached workers offset the influence of the increase in the traditional unemployment rate.

Daiwa Capital Markets

Review Continued

Week of June 28, 2021	Actual	Consensus	Comments
Trade Balance (May)	**-$71.2 Billion ($2.1 Billion Wider)**	**-$71.3 Billion ($2.4 Billion Wider)**	The nominal trade deficit in goods widened by $2.3 billion in May, as an increase in imports of 1.2% exceeded growth of 0.3% in exports. The price-adjusted deficit in goods also widened considerably, but the average shortfall so far in Q2 is slightly better than that in Q1, raising the possibility of a positive contribution to GDP growth from net exports. The surplus in service trade showed little change for the third consecutive month, an encouraging sign that the downward trend that began in late 2019 is nearing an end.
Factory Orders (May)	**1.7%**	**1.6%**	Orders for durable goods were unrevised from the preliminary tally of 2.3% (published June 24). This advance was led by a jump of 7.7% in the transportation category (aided by a firm showing in orders for commercial aircraft), but bookings ex-transportation contributed moderately (up 0.3%). An increase of 1.0% in nondurable orders was driven by a 2.5% gain in the petroleum and coal category, no doubt influenced by higher prices. Bookings for nondurables ex-petroleum rose 0.6%, the 12th increase in the past 13 months, which left this category 5.1% above its pre-Covid high in March.

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

Preview

Week of July 5, 2021	Projected	Comments
ISM Services Index (June) (Tuesday)	**64.0% (Unchanged)**	With the service sectors of the economy reviving, the ISM index should be able to remain close to the record reading in May. The supplier delivery index could decline in response to progress in resolving supply-chain issues, but the employment component should improve from its mediocre performance in May (55.3%).
Job Openings (May) (Wednesday)	**No Forecast**	Job growth of 583,000 in May should have absorbed a portion of the 9.286 million openings in April (this reports lags the regular employment report by one month), leaving a lower (but still stratospheric) level of job openings.
Consumer Credit (May) (Thursday)	**No Forecast**	Individuals in the past year have used a portion of their support from the federal government to pay down credit card debt, but small adjustments in the past few months suggest a waning in this drag. With credit card debt possibly advancing, and with other borrowing moving along its upward trend, total consumer credit likely posted an above-average increase in May (average of $10.2 billion in the past 11 months).

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

June/July 2021

Monday	Tuesday	Wednesday	Thursday	Friday
28	29	30	1	2
	FHFA HOME PRICE INDEX Feb 1.1% Mar 1.6% Apr 1.8% **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** SA NSA Feb 1.3% 1.3% Mar 1.6% 2.2% Apr 1.6% 2.1% **CONFERENCE BOARD CONSUMER CONFIDENCE** Apr 117.5 May 120.0 June 127.3	**ADP EMPLOYMENT REPORT** Private Payrolls Apr 622,000 May 886,000 June 692,000 **MNI CHICAGO BUSINESS BAROMETER** Index Prices Apr 72.1 91.5 May 75.2 88.4 June 66.1 91.9 **PENDING HOME SALES** Mar 1.7% Apr -4.4% May 8.0%	**UNEMPLOYMENT CLAIMS** Initial Continuing (Millions) June 05 0.374 3.528 June 12 0.418 3.413 June 19 0.415 3.469 June 26 0.364 N/A **ISM INDEX** Index Prices Apr 60.7 89.6 May 61.2 88.0 June 60.6 92.1 **CONSTRUCTION SPEND.** Mar 1.0% Apr 0.1% May -0.3% **VEHICLE SALES** Apr 18.6 million May 17.0 million June 15.4 million	**EMPLOYMENT REPORT** Payrolls Un. Rate Apr 269,000 6.1% May 583,000 5.8% June 850,000 5.9% **TRADE BALANCE** Mar -$75.0 billion Apr -$69.1 billion May -$71.2 billion **FACTORY ORDERS** Mar 1.4% Apr -0.1% May 1.7%
5	6	7	8	9
INDEPENDENCE DAY (OBSERVED)	**ISM SERVICES INDEX (10:00)** Index Prices Apr 62.7 76.8 May 64.0 80.6 **June 64.0 82.0**	**JOLTS DATA (10:00)** Openings (000) Quit Rate Mar 8,288 2.5% Apr 9,286 2.7% May -- -- **FOMC MINUTES (2:00)**	**INITIAL CLAIMS (8:30)** **CONSUMER CREDIT (3:00)** Mar $18.6 billion Apr $18.6 billion May --	**WHOLESALE TRADE (10:00)** Inventories Sales Mar 1.2% 4.3% Apr 1.0% 0.9% **May 1.1% 0.3%**
12	13	14	15	16
	NFIB SMALL BUSINESS OPTIMISM INDEX **CPI** **FEDERAL BUDGET**	**PPI** **BEIGE BOOK**	**INITIAL CLAIMS** **IMPORT/EXPORT PRICES** **EMPIRE MFG INDEX** **PHILLY FED INDEX** **IP & CAP-U**	**RETAIL SALES** **BUSINESS INVENTORIES** **CONSUMER SENTIMENT** **TIC DATA**
19	20	21	22	23
NAHB HOUSING INDEX	**HOUSING STARTS**		**INITIAL CLAIMS** **CHICAGO FED NATIONAL ACTIVITY INDEX** **LEADING INDICATORS** **EXISTING HOME SALES**	

Forecasts in Bold.

Treasury Financing

June/July 2021

Monday	Tuesday	Wednesday	Thursday	Friday
28	29	30	1	2
AUCTION RESULTS: Rate Cover 13-week bills 0.050% 3.62 26-week bills 0.055% 3.60	**AUCTION RESULTS:** Rate Cover 6-week CMB 0.050% 3.43 **ANNOUNCE:** $40 billion 4-week bills for auction on July 1 $40 billion 8-week bills for auction on July 1 $35 billion 17-week CMBs for auction on June 30 **SETTLE:** $40 billion 4-week bills $40 billion 8-week bills $35 billion 17-week CMBs	**AUCTION RESULTS:** Rate Cover 17-week CMB 0.050% 4.16	**AUCTION RESULTS:** Rate Cover 4-week bills 0.050% 3.46 8-week bills 0.045% 4.46 **ANNOUNCE:** $111 billion 13-,26-week bills for auction on July 6 $40 billion 6-week CMBs for auction on July 6 **SETTLE:** $111 billion 13-,26-week bills $40 billion 6-week CMBs	
5	6	7	8	9
INDEPENDENCE DAY (OBSERVED)	**AUCTION:** $111 billion 13-,26-week bills $40 billion 6-week CMBs **ANNOUNCE:** $40 billion* 4-week bills for auction on July 8 $40 billion* 8-week bills for auction on July 8 $35 billion* 17-week CMBs for auction on July 7 **SETTLE:** $40 billion 4-week bills $40 billion 8-week bills $35 billion 17-week CMBs	**AUCTION:** $35 billion* 17-week CMBs	**AUCTION:** $40 billion* 4-week bills $40 billion* 8-week bills **ANNOUNCE:** $111 billion* 13-,26-week bills for auction on July 12 $34 billion* 52-week bills for auction on July 13 $58 billion* 3-year notes for auction on July 12 $38 billion* 10-year notes for auction on July 12 $24 billion* 30-year bonds for auction on July 13 $40 billion* 6-week CMBs for auction on July 13 **SETTLE:** $111 billion 13-,26-week bills $40 billion 6-week CMBs	
12	13	14	15	16
AUCTION: $111 billion* 13-,26-week bills $58 billion* 3-year notes $38 billion* 10-year notes	**AUCTION:** $34 billion* 52-week bills $24 billion* 30-year bonds $40 billion* 6-week CMBs **ANNOUNCE:** $40 billion* 4-week bills for auction on July 15 $40 billion* 8-week bills for auction on July 15 $35 billion* 17-week CMBs for auction on July 14 **SETTLE:** $40 billion* 4-week bills $40 billion* 8-week bills $35 billion* 17-week CMBs	**AUCTION:** $35 billion* 17-week CMBs	**AUCTION:** $40 billion* 4-week bills $40 billion* 8-week bills **ANNOUNCE:** $111 billion* 13-,26-week bills for auction on July 19 $24 billion* 20-year bonds for auction on July 21 $16 billion* 10-year TIPS for auction on July 22 $40 billion* 6-week CMBs for auction on July 20 **SETTLE:** $111 billion* 13-,26-week bills $34 billion* 52-week bills	$58 billion* 3-year notes $38 billion* 10-year notes $24 billion* 30-year bonds $40 billion* 6-week CMBs
19	20	21	22	23
AUCTION: $111 billion* 13-,26-week bills	**AUCTION:** $40 billion* 6-week CMBs **ANNOUNCE:** $40 billion* 4-week bills for auction on July 22 $40 billion* 8-week bills for auction on July 22 $35 billion* 17-week CMBs for auction on July 21 **SETTLE:** $40 billion* 4-week bills $40 billion* 8-week bills $35 billion* 17-week CMBs	**AUCTION:** $24 billion* 20-year bonds $35 billion* 17-week CMBs	**AUCTION:** $40 billion* 4-week bills $40 billion* 8-week bills $16 billion* 10-year TIPS **ANNOUNCE:** $111 billion* 13-,26-week bills for auction on July 26 $28 billion* 2-year FRNs for auction on July 28 $60 billion* 2-year notes for auction on July 26 $61 billion* 5-year notes for auction on July 27 $62 billion* 7-year notes for auction on July 28 $40 billion* 6-week CMBs for auction on July 27 **SETTLE:** $111 billion* 13-,26-week bills $40 billion* 6-week CMBs	

**Estimate*