U.S. Economic Comment

- The U.S. economy in H2: challenges and promises
- Inflation watch: deceleration in PCE price index; acceleration in wages

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The U.S. Economy in the Second Half

The U.S. economy grew at an annual rate of 6.4 percent in the first half of the year, a solid performance that pushed the level of GDP above the pre-pandemic total in 2019-Q4. The economy faces some challenges in the second half, but it also has some promising aspects. On balance, the expansion is likely to slow from the pace in the first half, but we expect it to remain on track. We will fine-tune our projection next week and provide detail in our Economic Comment on August 6.

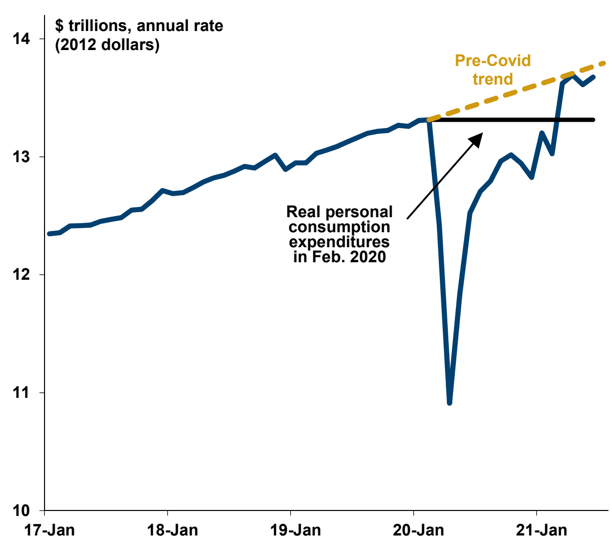
The biggest challenge is the spread of the Delta variant of Covid, but we agree with the view advanced this week by Fed Chair Jerome Powell that the economy is less sensitive to the virus than it was in earlier waves. We suspect that vaccinated individuals will be less fearful of Covid and will continue to resume normal activities. Many individuals not vaccinated apparently did not have deep fear to begin with and thus are not likely to withdraw completely from economic activity.

While we do not expect a pronounced pullback by individuals, we see challenges with respect to consumer spending. Individuals spent briskly in the past year (16.2 percent growth in the past four quarters, including an advance of 11.6 percent in the first half of this year), which has pushed real outlays well above the pre-pandemic level and close to an extrapolated long-term trend (chart).

One might argue that consumer activity is now close to normal and that pent-up demand has largely been satisfied. Thus, growth of consumer spending will probably be markedly slower than it was in the first half of the year. Deceleration already is apparent in monthly figures on consumer spending, as real outlays have increased only modestly on balance in the past three months (an annual rate of 1.6 percent from April to June).

The main engine of U.S. economic growth is likely to be slowing over the balance of the year, but we still expect some support from consumers. Outlays are close to their pre-virus trend, but we can easily envision activity moving above trend for a time. With strong financial support from the federal government and limited spending last year, the household sector in the aggregate has accumulated a huge pool of savings that can be drawn on to support spending. In addition, although total spending is close to trend, outlays for services are still below pre-pandemic levels and far below trend. There could be a pivot toward services (think travel, entertainment) that continues to fuel growth, although at a much slower pace than the annual advance of 11.6 percent in the first half.

Real Personal Consumption Expenditures*

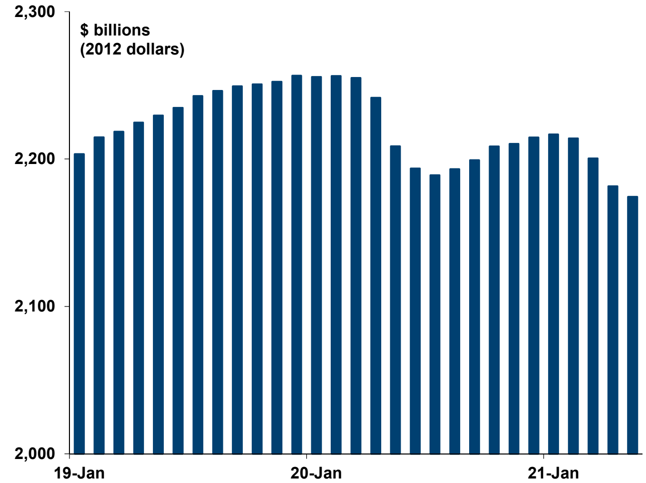


** The pre-Covid trend assumes an annual growth rate of 2.5 percent.*

Source: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

Consumer spending will slow, but other areas are likely to pickup. Inventory investment stands out on the potentially positive side, as stocks have dropped noticeably in the past year and ratios of inventories to sales are lean. The initial drop in inventories in early 2020 was probably in anticipation of weak demand, and firms made an effort to rebuild in the summer. In recent months, however, the drawdowns have probably been unintended changes to meet demand while facing supply constraints on the production side (chart, right). Supply chain disruptions remain an issue, and thus inventory rebuilding might not proceed as quickly as desired, but inventory investment will become a positive force at some point.

Real Manufacturing & Trade Inventories

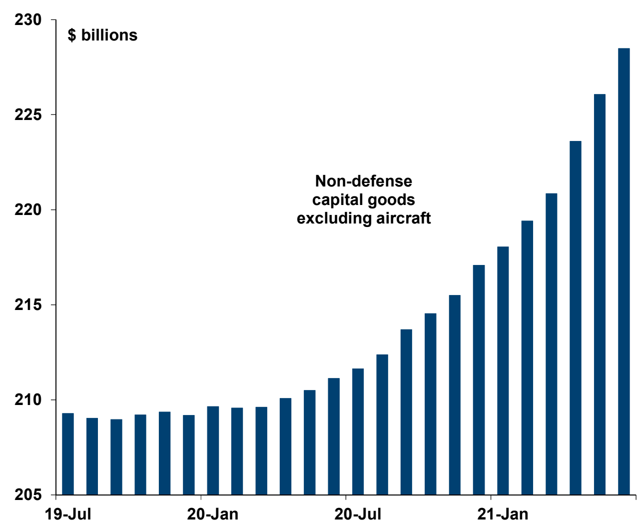


Source: Bureau of Economic Analysis via Haver Analytics

Business fixed investment rose 8.0 percent in Q2, as double-digit advances in equipment and intellectual property easily offset a drop in investment in new structures. A large backlog of unfilled orders (chart, below) suggests that equipment spending will continue to advance, and we see the possibility of improvement in the structures component. We suspect that weakness in structures was related to Covid uncertainty and the reluctance by businesses to undertake long-term projects in such an environment. As uncertainty about Covid fades, businesses are likely to become more active on the construction front.

We also look for a shift in spending by state and local governments. This group has provided little support in the past year, as real outlays have increased only 0.5 percent in the past four quarters after plunging in the second quarter of last year. However, revenue flows have picked up and the American Rescue Plan provided $350 billion of federal support. Those funds are now being disbursed, and they should leave most state and local governments on solid financial ground and allow them to begin moving back toward pre-pandemic levels of support.

Unfilled Orders for Durable Goods



Source: U.S. Census Bureau via Haver Analytics

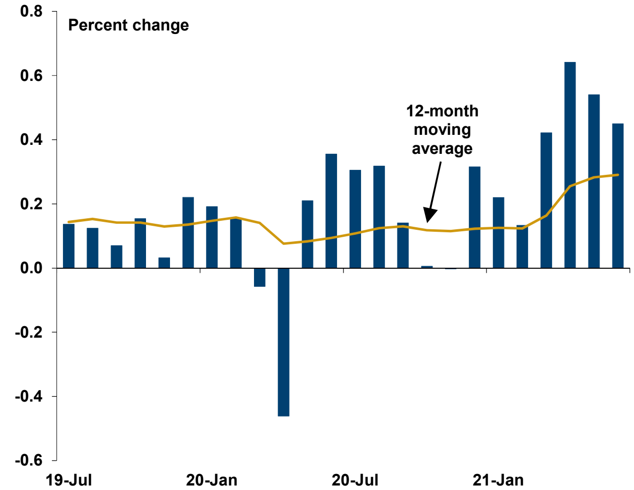
Residential construction fell 9.8 percent in the second quarter, a strange development given reports of a tight supply of homes. However, the drop was primarily the result of a sharp decline in brokerage commissions associated with an easing in home sales. The drop in sales, in turn, was driven by a limited number of homes for sale and by elevated prices that squeezed some individuals from the market. The construction of new homes was in the plus column, and we look for continued moderate growth in new building. If home sales stabilize, the drop in brokerage commissions should abate and return the housing component of GDP to positive territory.

All told, despite an easing in the growth of consumer spending, we look for the economy to remain on track. A quick first pass suggests a pace in the neighborhood of 5.0 percent, but we'll take a closer look next week.

Inflation Developments

The price index for personal consumption expenditures rose 0.5 percent in June while the core component advanced 0.4 percent (chart). Both readings were firm relative to standards of recent years, although they were lighter than expected.

Core PCE Price Index*



** PCE = personal consumption expenditures*

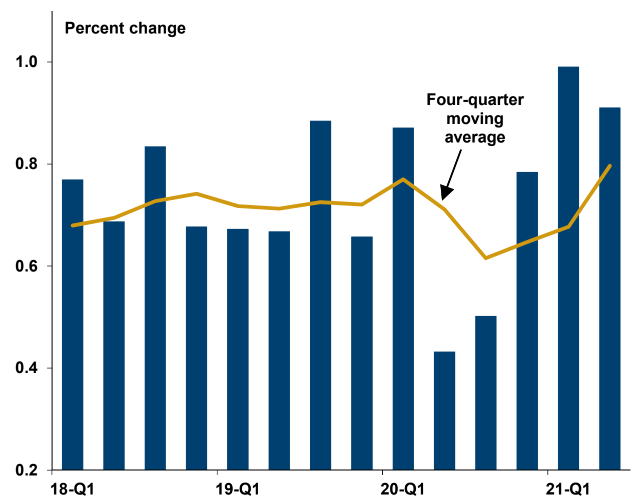
Source: Bureau of Economic Analysis via Haver Analytics

Many of the items that drove inflation higher in other recent months remained an issue in June (new and used motor vehicles, vehicle rentals, air travel, hotel stays). The latest month, however, showed some easing in the prices of recreational goods and admissions to sporting and entertainment events. A rare decline in the healthcare component also contributed to the deceleration in June. In fact, an index excluding food, energy and healthcare rose 0.6 percent, in line with other recent observations.

One of the factors that could generate longer-lasting price pressure is an increase in labor costs. The latest reading on the employment cost index (arguably the best measure of compensation available in the U.S.) provided some comfort on this front, but only a mild amount. The headline index rose 0.7 percent in Q2, slower than the jump of 0.9 percent in the first quarter and in line with the pre-pandemic average.

The detail, though, was less encouraging. Wage pressure was evident, rising 0.9 percent after a jump of 1.0 percent in the first quarter (chart, right). The headline index was contained because of a modest rise in the cost of benefits (0.4 percent). A soft reading on health-care costs seemed to be in play. An unpublished series on the 12-month change in health care costs suddenly dropped to a change of 0.4 percent in the second quarter after hovering in a range of 1.5 to 2.3 percent in the prior several years. A drop in elective procedures during the pandemic might be a possible explanation; if so, benefit costs are not likely to remain restrained.

Employment Cost Index: Wages & Salaries



Source: Bureau of Labor Statistics via Haver Analytics

Review

Week of July 26, 2021	Actual	Consensus	Comments
New Home Sales (June)	**0.676 Million (-6.6%)**	**0.796 Million (+3.5%)**	New home sales fell in June, with a combined downward revision of 3.6% in the prior three months adding to the soft tone of the report. However, while activity in the past five months has eased sharply from results late last year and the start of this year, it remained comfortably within the range of observations in place before the onset of the pandemic. With the slowing in sales in June, the months' supply of homes available for sale jumped to 6.3 months from 5.5. The latest reading represented the seventh increase in the past eight months and an observation in line with historical norms (versus a restrictive inventory situation in the market for existing homes).
Durable Goods Orders (June)	**0.8%**	**2.2%**	A jump of 17.0% in the commercial aircraft sector led the advance in new orders for durable goods in June. The aircraft sector weighed on durable bookings with a dismal performance last year, but orders have improved recently. The latest gain was the best since 2019 and suggests that the sector is now on track. Durable orders ex-transportation rose 0.3%. The rate of increase in orders ex-transportation seems to be easing (up an average of 0.9% in the past three months versus 1.5% from August to March), but with bookings ex-transportation now well above pre-pandemic levels, some easing should be expected. New orders for nondefense capital goods excluding aircraft, which gives insights into capital spending plans by businesses, rose 0.5%. This series has been firm throughout the current recovery period and is now well above pre-pandemic levels.
Consumer Confidence (July)	**129.1 (+0.2 Index Pt.)**	**123.9 (-3.4 Index Pts.)**	The index of consumer confidence rose modestly in July (0.2%), but the change occurred from an upwardly revised level in June (1.3% firmer than previously believed). The index has now increased for six consecutive months, including brisk advances in February and March. The measure lingered at a low level for much of the early part of the expansion, and thus it is still shy of pre-pandemic levels (2.6% below the level in February 2020). However, recent progress is encouraging, especially because the recent acceleration in inflation had the potential to dampen moods.
U.S. International Trade in Goods (June)	**-$91.2 Billion ($3.0 Billion Wider Deficit)**	**-$88.0 Billion ($0.2 Billion Narrower Deficit)**	After deteriorating noticeably in the early portion of the recovery, the U.S. merchandise trade deficit showed hints of stabilizing in recent months. However, the previous pattern of a widening trade deficit reemerged in June. The latest slippage, like that in the early portion of the recovery, involved increases in both exports and imports (up 0.3% and 1.5%, respectively), with the outperformance in imports leading to the deterioration in the deficit. The soft performance in June contributed to a negative contribution from net exports to GDP in Q2 (see below).

Review Continued

Week of July 26, 2021	Actual	Consensus	Comments
GDP (2021-Q2)	**6.5%**	**8.4%**	A surge of 11.8% (annual rate) in consumer spending led the advance in GDP growth in Q2, with growth of 8.0% in business investment spending also contributing positively. Some areas provided notable downside surprises. Net exports subtracted 0.4 percentage point from GDP growth, the fourth consecutive negative contribution but less than the average quarterly drag of 2.2 percentage points in the prior three quarters. Inventory investment also was a major drag on GDP again, subtracting 1.1 percentage points from GDP growth after a constraint of 2.6 percentage points in the prior quarter. Government spending slipped as well (-1.5%, annual rate), led by a decline of 5.0% at the federal level.
Personal Income, Consumption, Core Prices (June)	**0.1%, 1.0%, 0.4%**	**-0.3%, 0.7%, 0.6%**	Wages and salaries advanced sharply for the fourth consecutive month in June (0.8%). Proprietors' income and investment income also contributed positively (1.1% and 0.5%, respectively), but a decline in transfer payments (-2.0%) restrained the overall advance. On the spending side, consumers were active in June. Outlays for durable goods fell 1.5%, reflecting sluggish vehicle sales, but spending on nondurable goods (1.8%) and services (1.2%) performed well. The year-over-year increase in the headline price index was unchanged at 4.0% in June, the fastest increase since 2008. The core index also posted a high-side reading (3.5% year-over-year).
Employment Cost Index (2021-Q2)	**0.7%**	**0.9%**	Employment costs in Q2 slowed from a reading of 0.9% in the prior quarter and returned to the underlying average in the prior two years. Wages rose briskly (0.9% after an advance of 1.0% in Q1), but the increase in benefit costs slowed to 0.4% (versus an average quarterly increase of 0.6% in the prior two years).

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

Preview

Week of August 2, 2021	Projected	Comments
ISM Manufacturing Index (July) (Monday)	**60.0% (-0.6 Pct. Pt.)**	The ISM index has been above 60% for five consecutive months and in six of the past seven. With the supply side striving to keep up with demand, activity should be firm enough to generate another elevated reading. The supplier delivery component merits special attention because of insights it might provide on supply-chain developments. We also will be interested in the employment component, hoping for a pickup from the sub-50% reading in June.
Construction Spending (June) (Monday)	**0.5%**	Single-family starts have softened in recent months, but continued work on units started in earlier months should sustain activity. Multi-family building has been well maintained recently. The downtrend in private nonresidential construction seems to be stabilizing, while building by state and local governments remains soft.
Factory Orders (June) (Tuesday)	**0.9%**	An increase of approximately 1.0% in orders for nondurable goods should reinforce the already reported gain of 0.8% in bookings for durable goods. Part of the increase in the nondurable sector will be the result of higher prices of petroleum products, but firm activity in manufacturing suggests that orders for nondurable goods ex-petroleum will register their 13th increase in the past 14 months.
ISM Services Index (July) (Wednesday)	**60.0% (-0.1 Pct. Pt.)**	With consumer demand beginning to tilt toward services, this index should be able to remain close to the elevated level of 60.1% in June. A rebound in the employment component after a sub-50% reading should help to maintain high-side results for the headline measure.
Trade Balance (June) (Thursday)	**-$74.2 Billion ($3.0 Billion Wider Deficit)**	The downward trend in the service surplus that began in late 2019 seems to be drawing to a close (little change in the past two months), and thus the change in the overall trade balance is likely to be driven by the already reported widening of $3.0 billion in the goods trade deficit.
Payroll Employment (July) (Friday)	**750,000**	The record level of job openings raises the possibility of robust job growth, but sub-50% readings on both ISM indexes suggest problems in matching workers with positions. Thus, the employment gain is likely to be less than spectacular, although strong by normal standards and robust enough to reduce the unemployment rate.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

July/August 2021

Monday	Tuesday	Wednesday	Thursday	Friday
26	27	28	29	30
NEW HOME SALES Apr 0.785 million May 0.724 million June 0.676 million	**DURABLE GOODS ORDERS** Apr -0.7% May 3.2% June 0.8% **FHFA HOME PRICE INDEX** Mar 1.6% Apr 1.8% May 1.7% **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** SA NSA Mar 1.7% 2.3% Apr 1.7% 2.2% May 1.8% 2.1% **CONFERENCE BOARD CONSUMER CONFIDENCE** May 120.0 June 128.9 July 129.1 **FOMC MEETING**	**ADVANCE INVENTORIES** Wholesale Retail Apr 1.1% -1.7% May 1.3% -0.8% June 0.8% 0.3% **U.S. INTERNATIONAL TRADE IN GOODS** Apr -$85.9 billion May -$88.2 billion June -$91.2 billion **FOMC DECISION**	**UNEMPLOYMENT CLAIMS** Initial Continuing (Millions) July 03 0.386 3.265 July 10 0.368 3.262 July 17 0.424 3.269 July 24 0.400 N/A **GDP** GDP Chained Price 20-Q4 4.5% 2.2% 21-Q1 6.3% 4.3% 21-Q2 6.5% 6.0% **PENDING HOMES SALES** Apr -4.4% May 8.3% June -1.9%	**PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX** Inc. Cons. Core Apr -13.6% 1.1% 0.6% May -2.2% -0.1% 0.5% June 0.1% 1.0% 0.4% **EMPLOYMENT COST INDEX** Comp. Wages 20-Q4 0.7% 0.8% 21-Q1 0.9% 1.0% 21-Q2 0.7% 0.9% **MNI CHICAGO PURCHASING MANAGERS' INDEX** Index Prices May 75.2 88.4 June 66.1 91.9 July 73.4 91.6 **REVISED CONSUMER SENTIMENT** May 82.9 June 85.5 July(p) 80.8 July(r) 81.2
2	3	4	5	6
ISM INDEX (10:00) Index Prices May 61.2 88.0 June 60.6 92.1 **July 60.0 88.0** **CONSTRUCTION SPEND. (10:00)** Apr 0.1% May -0.3% **June 0.5%**	**FACTORY ORDERS (10:00)** Apr -0.1% May 2.1% **June 0.9%** **VEHICLE SALES** May 17.0 million June 15.4 million **July 15.6 million**	**ADP EMPLOYMENT REPORT (8:15)** Private Payrolls May 886,000 June 692,000 July -- **ISM SERVICES INDEX (10:00)** Index Prices May 64.0 80.6 June 60.1 79.5 **July 60.0 79.0**	**INITIAL CLAIMS (8:30)** **TRADE BALANCE (8:30)** Apr -$69.1 billion May -$71.2 billion **June -$74.2 billion**	**EMPLOYMENT REPORT (8:30)** Payrolls Un. Rate May 583,000 5.8% June 850,000 5.9% **July 750,000 5.7%** **WHOLESALE TRADE (10:00)** Inventories Sales Apr 1.1% 1.1% May 1.3% 0.8% June -- -- **CONSUMER CREDIT (3:00)** Apr $20.0 billion May $35.3 billion June --
9	10	11	12	13
JOLTS DATA	**NFIB SMALL BUSINESS OPTIMISM INDEX** **PRODUCTIVITY & COSTS**	**CPI** **FEDERAL BUDGET**	**INITIAL CLAIMS** **PPI**	**IMPORT/EXPORT PRICES** **CONSUMER SENTIMENT**
16	17	18	19	20
EMPIRE MFG INDEX **TIC DATA**	**RETAIL SALES** **IP & CAP-U** **BUSINESS INVENTORIES** **NAHB HOUSING INDEX**	**HOUSING STARTS** **FOMC MINUTES**	**INITIAL CLAIMS** **PHILLY FED INDEX** **LEADING INDICATORS**	

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

Treasury Financing

July/August 2021

Monday	Tuesday	Wednesday	Thursday	Friday
26	27	28	29	30
AUCTION RESULTS: Rate Cover 13-week bills 0.050% 3.37 26-week bills 0.050% 3.18 2-year notes 0.213% 2.47	**AUCTION RESULTS:** Rate Cover 5-year notes 0.710% 2.36 6-week CMB 0.040% 4.41 **ANNOUNCE:** $40 billion 4-week bills for auction on July 29 $35 billion 8-week bills for auction on July 29 $30 billion 17-week CMBs for auction on July 28 **SETTLE:** $40 billion 4-week bills $35 billion 8-week bills $30 billion 17-week CMBs	**AUCTION RESULTS:** Spread Cover 2-year FRN 0.029% 3.04 Rate Cover 17-week CMB 0.050% 3.50	**AUCTION RESULTS:** Rate Cover 4-week bills 0.045% 3.45 8-week bills 0.045% 3.52 7-year notes 1.050% 2.23 **ANNOUNCE:** $105 billion 13-,26-week bills for auction on August 2 $20 billion 6-week CMBs for auction on August 3 **SETTLE:** $105 billion 13-,26-week bills $20 billion 6-week CMBs	**SETTLE:** $16 billion 10-year TIPS
2	3	4	5	6
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:** $20 billion 6-week CMBs **ANNOUNCE:** $40 billion* 4-week bills for auction on August 5 $35 billion* 8-week bills for auction on August 5 $30 billion* 17-week CMBs for auction on August 4 **SETTLE:** $40 billion 4-week bills $35 billion 8-week bills $30 billion 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs **ANNOUNCE MID-QUARTER REFUNDING:** $58 billion* 3-year notes for auction on August 10 $41 billion* 10-year notes for auction on August 11 $27 billion* 30-year bonds for auction on August 12	**AUCTION:** $40 billion* 4-week bills $35 billion* 8-week bills **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on August 9 $34 billion* 52-week bills for auction on August 10 $20 billion* 6-week CMBs for auction on August 10 **SETTLE:** $105 billion 13-,26-week bills $20 billion 6-week CMBs	
9	10	11	12	13
AUCTION: $105 billion* 13-,26-week bills	**AUCTION:** $34 billion* 52-week bills $58 billion* 3-year notes $20 billion* 6-week CMBs **ANNOUNCE:** $40 billion* 4-week bills for auction on August 12 $35 billion* 8-week bills for auction on August 12 $30 billion* 17-week CMBs for auction on August 11 **SETTLE:** $40 billion* 4-week bills $35 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $41 billion* 10-year notes $30 billion* 17-week CMBs	**AUCTION:** $40 billion* 4-week bills $35 billion* 8-week bills $27 billion* 30-year bonds **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on August 16 $27 billion* 20-year bonds for auction on August 18 $8 billion* 30-year TIPS for auction on August 19 $20 billion* 6-week CMBs for auction on August 17 **SETTLE:** $105 billion* 13-,26-week bills $34 billion* 52-week bills $20 billion* 6-week CMBs	
16	17	18	19	20
AUCTION: $105 billion* 13-,26-week bills **SETT;E:** $58 billion* 3-year notes $41 billion* 10-year notes $27 billion* 30-year bonds	**AUCTION:** $20 billion* 6-week CMBs **ANNOUNCE:** $40 billion* 4-week bills for auction on August 19 $35 billion* 8-week bills for auction on August 19 $30 billion* 17-week CMBs for auction on August 18 **SETTLE:** $40 billion* 4-week bills $35 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $27 billion* 20-year bonds $30 billion* 17-week CMBs	**AUCTION:** $40 billion* 4-week bills $35 billion* 8-week bills $8 billion* 30-year TIPS **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on August 23 $26 billion* 2-year FRNs for auction on August 25 $60 billion* 2-year notes for auction on August 24 $61 billion* 5-year notes for auction on August 25 $62 billion* 7-year notes for auction on August 26 $20 billion* 6-week CMBs for auction on August 24 **SETTLE:** $105 billion* 13-,26-week bills $20 billion* 6-week CMBs	

**Estimate*