U.S. Economic Comment

- Labor market: good progress, but not quite "substantial"
- Forecast update: somewhat slower growth, but still on track

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The Labor Market: (Substantial?) Further Progress

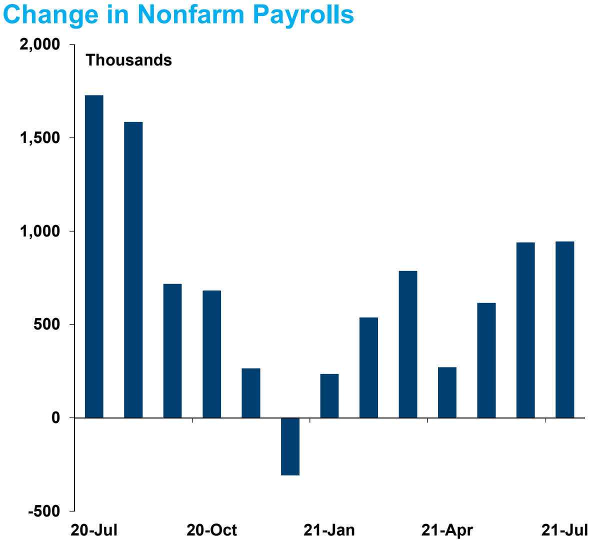
Chair Powell indicated in his latest press conference that Fed officials expect the labor market to continue improving, although he believes that progress thus far is shy of "substantial" – the criteria established by the Federal Open Market Committee to begin tapering its asset-purchase program. The employment report for July represented a big step toward substantial progress, as job growth was strong and unemployment fell sharply.

The increase of 943,000 new jobs in July followed an advance of 938,000 in June, making them the two strongest months since the early stages of the recovery (chart). Some of the latest gains were the result of a statistical artifact: local school employment jumped on a seasonally adjusted basis because actual summer layoffs were lighter than normal because of weak pandemic-related hiring during the school year. Still, job growth was firm even without this artificial lift. Payroll employment has now regained almost three-quarters of the ground lost during the recession and is only 3.7 percent below the pre-pandemic peak.

An unusually strong burst of employment as measured by the household survey drove the unemployment rate 0.5 percentage point lower to 5.4 percent. Some of this gain most likely reflected month-to-month volatility that is common for this series, as the latest jump could be viewed as a counter to the employment drop of 18,000 in the prior month. Still, average job growth (household survey) of more than 500,000 in the past two months is a solid performance. In addition, the broad unemployment rate fell 0.6 percentage point to 9.2 percent, as the number of individuals working part time for economic reasons fell and joined the influence of the traditional jobless rate.

Chair Powell also emphasized in his press conference that Fed officials are monitoring numerous labor-market indicators, and they will take a broad view in evaluating progress. The July report had plenty to offer in addition to strong job growth and lower unemployment to suggest broad-based improvement: average hourly earnings rose 0.4 percent in July, marking the fourth consecutive month of brisk results; the employment-population ratio jumped to a new high for the current cycle and returned to the low portion of the range from the previous expansion; the prime-age labor force participation rate is now trending higher after stalling in the latter part of last year; the number of permanent job cuts fell for the third consecutive month and for the fifth time in the past six months; many individuals that experienced extended unemployment in this cycle apparently found jobs in July, as the median duration of unemployment fell 4.6 weeks (a drop of 23.2 percent).

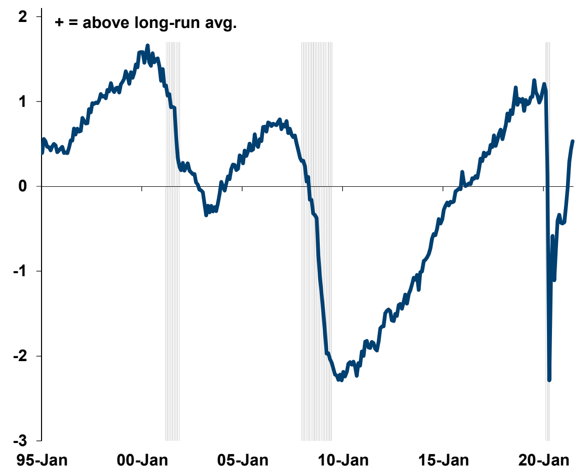
Change in Nonfarm Payrolls



Source: Bureau of Labor Statistics via Haver Analytics

The Federal Reserve Bank of Kansas City publishes a convenient metric that provides a broad view of the labor market. This measure, which the KC Fed calls the labor market conditions index, is a composite of 24 labor market indicators from both government and private-sector sources. The measure is constructed to have a mean of zero, a middle ground between weakness during recessions and strength during expansions. The value as of June was 0.53, solidly in positive territory but well shy of the peak of 1.25 in the previous expansion (chart). The reading for July will be published on August 10, and given the strong employment report, it will probably post a sizeable increase.

Labor Market Conditions Index: Activity*



** The Labor Market Conditions Index (LMCI) is a monthly measure of labor market activity that is based on 24 labor market variables. A positive reading indicates that labor market conditions are above their long-run average, whereas a negative value indicates that conditions are below their long-run average. The shaded areas on the graph indicate periods of recession in the United States.*

Source: Federal Reserve Bank of Kansas City and National Bureau of Economic Research via Haver Analytics

The labor market conditions index also is constructed to have a standard deviation of 1.0, which allows for another helpful interpretation. In a normal probability distribution, two-thirds of all observations lie within plus-or-minus one standard deviation of the mean and 95 percent lie within plus-or-minus two standard deviations of the mean. Thus, an index above zero but less than one is favorable in that it is in positive territory, but it is fairly close to the mean and therefore an ordinary outcome. The measure would need to be above one and approaching two before it indicates brisk conditions. We doubt that Fed officials would begin the tapering process with a value of less than one.

At least some Fed officials will be monitoring this index, as it was noted in a speech this week by Fed governor Richard Clarida, who we view as an influential member of the FOMC. He did not have much to say about tapering asset purchases, but he expects labor market conditions in late 2022 to be strong enough to warrant interest rate lift-off in early 2023 (waiting until early 2023 to have December results in hand).

Most of Mr. Clarida's speech had a hawkish tone. Although he believes that much of the recent price pressure is transitory, he saw upside risks on inflation. He also noted that an inflation rate of three percent is faster than the "moderately above two percent" that officials are willing to tolerate for a time – useful information; more definitive than the vague guidance offered by official statements.

Forecast Update: Shifting Sources of Growth

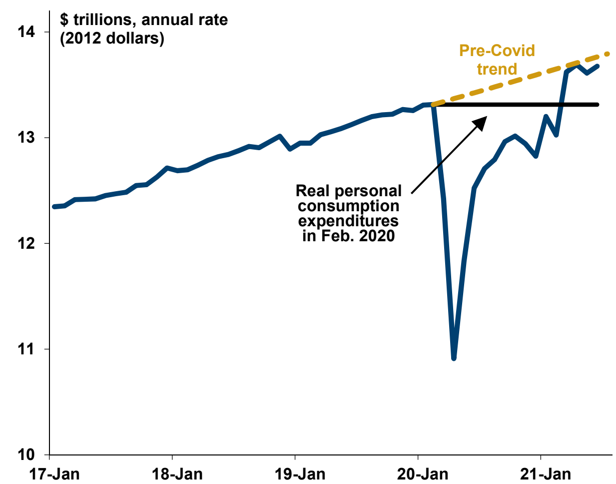
We look for the U.S. economy to remain on track in the second half of the year and into 2022, although growth is likely to ease from the pace of 6.4 percent in the first half to approximately 5.0 percent in H2. The slower pace will relieve inflation pressure somewhat, but the expected advance is still brisk for a time when bottlenecks and supply shortages are still present, and thus inflation is likely to remain an issue. With growth on track and inflation uncomfortable (close to the 3.0 percent that Governor Clarida views as excessive), we look for the Fed to begin tapering its asset purchases early next year and to hike the federal funds rate in the fourth quarter of 2022 (see the table on p. 4).

Not only is the rate of growth likely to ease in the second half, but the sources of growth are likely to change. Consumers powered the economy in the first half with outlay growth of 11.6 percent, but spending growth is likely to slow to perhaps one-quarter of that pace over the balance of the year. Part of the easing is likely to be the result of cautious behavior by individuals because of the Delta variant of Covid-19. However, the more important factor is that pent-up demand has been nearly satisfied. After double-digit growth in three of the past four quarters, real consumer expenditures are now close to their pre-pandemic trend (chart, p.3).

Of course, spending could move above trend, fueled by the huge pool of savings accumulated in the past year and by wealth gains associated with surges in equity and home prices. Still, we are not likely to see a repeat of the first-half performance.

While the growth of consumer spending is likely to slow, other areas are likely to improve. Inventory investment stands out in this regard. Businesses reduced inventories in both the first and second quarters, which pushed the ratio of real inventories-to-sales noticeably below the pre-pandemic norm and subtracted a combined 3.75 percentage points from GDP growth (chart, below). Firms will need to rebuild depleted stocks in coming months and quarters.

Real Personal Consumption Expenditures*



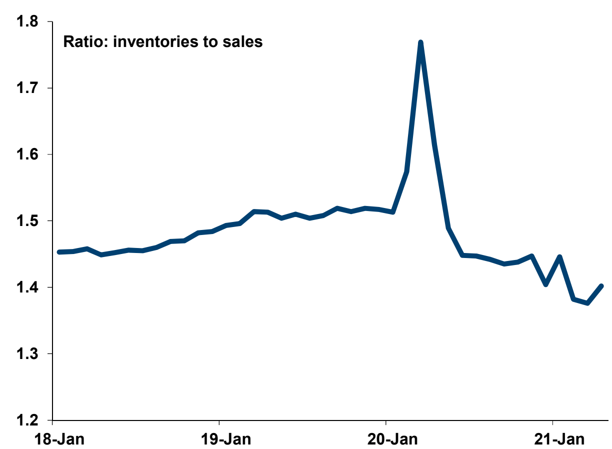
** The pre-Covid trend assumes an annual growth rate of 2.5 percent.*

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

Supply-chain disruptions are likely to remain an issue and prevent a rapid rebuilding of inventories. In fact, we suspect that businesses will have to draw down inventories in the third and possibly fourth quarters. However, the reductions are likely to be smaller than they were in the first two quarters, and in calculating growth rates, smaller reductions are equivalent to gains. Thus, we expect positive contributions to GDP growth from inventory investment in the quarters ahead.

State and local governments are likely to become more active after providing little support in the past year. Largely because of cutbacks in big-ticket investment projects, outlays by state and local governments grew only 0.5 percent in the past four quarters. However, tax collections have improved, and the American Rescue Plan provided $350 billion in direct aid to state and local governments (more than 14 percent of annual spending), along with funds for schools and transit systems, which often flow through government agencies. The direct aid is now flowing to state and local governments ($212 billion from April through July), which should begin boosting activity during the third quarter and could well extend into next year.

Real Inventories/Sales Ratio



Source: Bureau of Economic Analysis via Haver Analytics

The housing sector disappointed during the second quarter, registering a decline of 9.8 percent. We are not expecting great things from residential activity, but the performance is likely to be better than the results in Q2. That decline was primarily the result of a drop in brokerage commissions, which in turn, was associated with slower sales because of tight inventories and elevated prices. We do not expect continued erosion in sales, and new construction is likely to continue growing (it advanced 4.8 percent in Q2 and 16.2 percent in the first half). Thus, we look for residential activity to return to the plus column in the quarters ahead.

All told, somewhat slower economic growth, but fast enough to keep inflation in the headlines.

Daiwa Capital Markets

U.S. Economic Outlook*

(Percent change annual rate, unless otherwise noted)

		2021				2022			
Item		**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**
1	Gross Domestic Product	6.3	6.5	5.5	4.5	4.0	3.7	3.5	3.3
2	Personal Consumption Expenditures	11.4	11.8	3.0	2.8	2.8	2.6	2.5	2.4
3	Business Fixed Investment	12.9	8.0	6.3	5.3	5.1	4.8	4.6	4.8
4	Residential Construction	13.3	-9.8	3.0	6.0	5.5	4.5	4.0	3.5
5	Change in Business Inventories	-2.6	-1.1	2.1	1.0	0.4	0.3	0.1	0.1
	(Contribution to growth)								
6	Government Spending	4.2	-1.5	3.7	3.8	4.4	4.5	4.5	3.8
7	Net Exports	-1.6	-0.4	-0.2	-0.1	-0.1	0.0	0.1	0.1
	(Contribution to growth)								
	Inflation and Unemployment								
8	Core PCE Price Index	2.7	6.1	3.6	3.5	3.2	3.0	2.9	2.8
	(Annual rate)								
9	Unemployment Rate	6.2	5.9	5.3	5.1	4.8	4.6	4.4	4.2
	Interest Rates (End of Period)								
10	Federal Funds Target (midpoint)	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.38
11	2-year Treasury	0.14	0.25	0.20	0.25	0.30	0.35	0.40	0.60
12	10-year Treasury	1.65	1.50	1.25	1.30	1.50	1.65	1.85	2.00
13	30-year Fixed-Rate Mortgages	3.17	3.02	2.75	2.80	3.05	3.25	3.50	3.70

** Actual data for 2021-Q1 & Q2.*

Source: Bureau of Economic Analysis (GDP, Core PCE Price Index); Bureau of Labor Statistics (Unemployment Rate); Federal Reserve Board (Interest Rates); Freddie Mac (Mortgage Rates); Forecasts by Daiwa Capital Markets America

Review

Week of August 2, 2021	Actual	Consensus	Comments
ISM Manufacturing Index (July)	**59.5% (-1.1 Pct. Pts.)**	**61.0% (+0.4 Pct. Pt.)**	Although the ISM manufacturing index slipped in July, the level of the index remained firm by historical standards and signaled a solid pace of activity in the manufacturing sector. The supplier delivery component led the decline with a drop of 2.6 percentage points to 72.5%. This decline, though, could be viewed as a favorable development, as it suggests some improvement to supply-chain disruptions, although the still-high reading indicated that problems remain. Declines in the inventory and production indexes despite an elevated reading on orders (64.9%) also suggested supply-side difficulties. The employment index rebounded from a sub-50 reading in June (up 3.0 percentage points to 52.9%).
Construction Spending (June)	**0.1%**	**0.4%**	The rebound in construction activity in the second half of last year has stalled, as new building has shown little net change since January. Private residential construction has continued to move higher, as the increase of 1.1% in June represented the 12th increase in the past 13 months. However, private nonresidential construction and government-sponsored building are trending downward. Private nonresidential construction fell 0.7%, marking the 14th decline in the past 17 months. Government building fell 1.2%, the 10th decline in the past 13 months.
Factory Orders (June)	**1.5%**	**1.0%**	The increase of 0.9% in durable goods orders (published last week; revised from 0.8%) was influenced by a jump of 17.0% in booking for commercial aircraft, while orders excluding transportation rose moderately (0.5%) and are well above pre-pandemic levels. Nondurable bookings jumped 2.1%, influenced by a surge of 8.1% in the petroleum and coal category, which in part reflected higher prices. Excluding the petroleum and coal category, nondurable orders rose 0.7%, the 13th increase in the past 14 months, and they have now moved 5.9% above the pre-pandemic peak.
ISM Services Index (July)	**64.1% (+4.0 Pct. Pts.)**	**60.5% (+0.4 Pct. Pt.)**	All four components contributed to the advance in the ISM services index in July, led by a surge of 6.6 percentage points in the business activity index to 67.0%. The new orders component rose moderately (up 1.6 percentage points to 63.7%), but it was in the upper portion of its long-run range. The brisk pace of activity led to more hiring, as the employment component rebounded from a sub-50 reading with a jump of 4.5 percentage points to 53.8%. The supplier delivery component rose 3.5 percentage points to 72.0%, signaling slow deliveries because of supply-chain difficulties.

Review Continued

Week of August 2, 2021	Actual	Consensus	Comments
Trade Balance (June)	**-$75.7 Billion ($4.7 Billion Wider Deficit)**	**-$74.2 Billion ($3.0 Billion Wider Deficit)**	Both exports and imports increased in June (up 0.6% and 2.1%, respectively), with the larger change in imports leading to a noticeable widening in the deficit. Most of deterioration in the deficit occurred in goods trade, although the surplus in service trade resumed its downward trajectory after slight improvement in the prior two months. The results were close to the assumptions built into the initial estimate of GDP, and thus net exports are likely to have little influence on revised GDP.
Payroll Employment (July)	**943,000**	**870,000**	The employment report for July was strong in all respects, as the latest increase was the firmest of the year and exceeded the monthly average advance of 563k in the first half of 2021. Moreover, the latest results were joined by upward revisions of 119k in May and June combined. The unemployment rate fell 0.5 percentage point to 5.4%, as a surge in employment as measured by the household survey (up 1.043 million) far exceeded a respectable advance in the size of the labor force (up 261,000). Average hourly earnings rose 0.4%, marking the fourth consecutive month of solid growth (range of 0.4% to 0.7% over this span). On a year-over-year basis, average hourly earnings rose 4.0%, up from 3.7% in June.

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

Preview

Week of August 9, 2021	Projected	Comments
Nonfarm Productivity (2021-Q2) (Tuesday)	**3.0%**	Average monthly payroll growth of 607,000 in the second quarter led to brisk growth in hours worked, but output grew at an even faster pace, leaving a solid advance in productivity. The expectation for Q2 exceeds the average of 1.6% in the prior three quarters and the average of 1.3% in the five years before the onset of the pandemic.
CPI (July) (Wednesday)	**0.5% Total, 0.4% Core**	Higher prices of gasoline and other petroleum products probably drove the energy component higher in July, and pressure on food prices at the producer level suggests upside potential at the consumer level. Extreme increases in the prices of pandemic-affected goods and services should begin to abate (hotel stays, motor vehicles, vehicle rentals), but strong demand and supply shortages are likely to generate pressure in other areas.
Federal Budget (July) (Wednesday)	**$325.0 Billion Deficit**	Federal revenues in July will fall precipitously from the total in the same month last year, but the change reflects unusually large collections in July 2020 because of a shift in the tax filing deadline from April to July. Outlays are likely to be above the recent average, partly because of a calendar configuration that shifted some expenditures from August to July but also because the first round of enhanced child tax credits was sent in July.
PPI (July) (Thursday)	**0.5% Total, 0.4% Ex. Food & Energy**	The combination of pandemic effects and supply shortages have generated high-side readings on the PPI in recent months. Much of the pressure is probably transitory, but there are likely to be lingering effects in July. Energy prices also continued to advance in July.
Import Prices (July) (Friday)	**0.7%**	Market quotes suggest that prices of petroleum imports rose for the ninth consecutive month in July. Other commodity prices also are likely to show upward pressure, while prices of finished manufactured goods (capital goods, consumer goods, motor vehicles) probably rose modestly. Food prices could cool after sharp increases in five of the prior six months.
Consumer Sentiment (August) (Friday)	**83.0 (+1.8 Index Pts.)**	Sentiment has posted a feeble recovery in the past year or so (still almost 20% below the pre-pandemic peak in February 2020), and the picture is not likely to change appreciable in early August. Record readings in the stock market might brighten moods, but higher energy prices and faster inflation in general could provide an offset.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

August 2021

Monday	Tuesday	Wednesday	Thursday	Friday
2	3	4	5	6
ISM INDEX Index / Prices May 61.2 / 88.0 June 60.6 / 92.1 July 59.5 / 85.7 **CONSTRUCTION SPEND.** Apr 0.3% May -0.2% June 0.1%	**FACTORY ORDERS** Apr -0.1% May 2.3% June 1.5% **VEHICLE SALES** May 16.9 million June 15.4 million July 14.8 million	**ADP EMPLOYMENT REPORT** Private Payrolls May 882,000 June 680,000 July 330,000 **ISM SERVICES INDEX** Index / Prices May 64.0 / 80.6 June 60.1 / 79.5 July 64.1 / 82.3	**UNEMPLOYMENT CLAIMS** Initial / Continuing (Millions) July 10 0.368 / 3.262 July 17 0.424 / 3.296 July 24 0.399 / 2.930 July 31 0.385 / N/A **TRADE BALANCE** Apr -$69.1 billion May -$71.0 billion June -$75.7 billion	**EMPLOYMENT REPORT** Payrolls / Un. Rate May 614,000 / 5.8% June 938,000 / 5.9% July 943,000 / 5.4% **WHOLESALE TRADE** Inventories / Sales Apr 1.1% / 1.1% May 1.3% / 0.8% June 1.1% / 2.0% **CONSUMER CREDIT** Apr $18.9 billion May $36.7 billion June $37.7 billion
9	10	11	12	13
JOLTS DATA (10:00) Openings (000) / Quit Rate Apr 9,193 / 2.8% May 9,209 / 2.5% June -- / --	**NFIB SMALL BUSINESS OPTIMISM INDEX (6:00)** May 99.6 June 102.5 July -- **PRODUCTIVITY & COSTS (8:30)** Productivity / Unit Labor Costs 20-Q4 -3.8% / 14.0% 21-Q1 4.5% / 1.7% **21-Q2 3.0% / -0.5%**	**CPI (8:30)** Total / Core May 0.6% / 0.7% June 0.9% / 0.9% **July 0.5% / 0.4%** **FEDERAL BUDGET (2:00)** 2021 / 2020 May -$132.0B / -$398.8B June -$174.2B / -$864.1B **July -$325.0B** / -$63.0B	**INITIAL CLAIMS (8:30)** **PPI (8:30)** Final Demand / Ex. Food & Energy May 0.8% / 0.7% June 1.0% / 1.0% **July 0.5% / 0.4%**	**IMPORT/EXPORT PRICES (8:30)** Non-petrol. Imports / Nonagri. Exports May 0.9% / 1.8% June 0.7% / 1.1% July -- / -- **CONSUMER SENTIMENT (10:00)** June 85.5 July 81.2 **Aug 83.0**
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**	
23	24	25	26	27
CHICAGO FED NATIONAL ACTIVITY INDEX **EXISTING HOME SALES**	**NEW HOME SALES**	**DURABLE GOODS ORDERS**	**INITIAL CLAIMS** **REVISED GDP**	**U.S INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES** **PERSONAL INCOME, CONSUMPTION, PRICES** **REVISED CONSUMER SENTIMENT**

Forecasts in Bold.

Treasury Financing

August 2021

Monday	Tuesday	Wednesday	Thursday	Friday
2	3	4	5	6
AUCTION RESULTS: Rate Cover 13-week bills 0.050% 3.03 26-week bills 0.055% 3.25 **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 RESULTS:** Rate Cover 6-week CMB 0.040% 4.35 **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 RESULTS:** Rate Cover 17-week CMB 0.050% 4.11 **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 RESULTS:** Rate Cover 4-week bills 0.040% 3.34 8-week bills 0.050% 3.42 **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 **SETTLE:** $105 billion* 13-,26-week bills $20 billion* 6-week CMBs	
23	24	25	26	27
AUCTION: $105 billion* 13-,26-week bills	**AUCTION:** $60 billion* 2-year notes **ANNOUNCE:** $40 billion* 4-week bills for auction on August 26 $35 billion* 8-week bills for auction on August 26 $30 billion* 17-week CMBs for auction on August 25 **SETTLE:** $40 billion* 4-week bills $35 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $26 billion* 2-year FRNs $61 billion* 5-year notes $30 billion* 17-week CMBs	**AUCTION:** $40 billion* 4-week bills $35 billion* 8-week bills $62 billion* 7-year notes **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on August 30 **SETTLE:** $105 billion* 13-,26-week bills	**SETTLE:** $26 billion* 2-year FRNs

**Estimate*