Daiwa Capital Markets

U.S. Economic Comment

- Taper prospects: dampened by the slow job growth in August…
  …and by a likely easing in Q3 GDP growth

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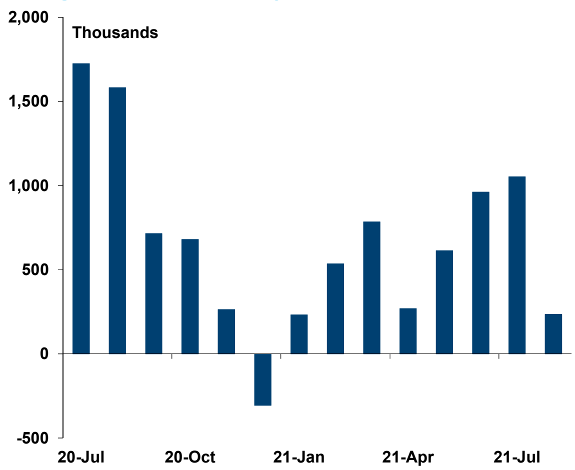
Tapering Still on Track, But Likely Delayed

Despite disappointing employment growth in August (235,000), we suspect that some Fed officials will continue to push for tapering the asset purchase program sometime this year. Policymakers no doubt recognize that economic statistics contain an element of random volatility, and thus developments are best assessed by focusing on underlying averages rather than monthly observations. From this perspective, recent job growth can be described as favorable, as gains have averaged 750,000 in the past three months and 586,000 in the first eight months of the year (chart, below left). Moreover, while payroll growth was soft in August, the overall report was not disastrous. Unemployment continued to move lower, and average hourly earnings rose sharply. All told, it is not a stretch to argue that the labor market has made “substantial” progress in recent months.

Nevertheless, the August employment report will probably weigh heavily on the minds of several Fed officials. Those in the dovish camp will most likely want to see consistent gains in employment before they deem progress as “substantial”, and an easing to 235,000 lacks consistency. More important, the reacceleration in the number of Covid cases seemed to play a role in slowing job growth (no change in the leisure and hospitality category), which argues for delaying the decision on tapering to observe the path of the virus and its effect on the economy.

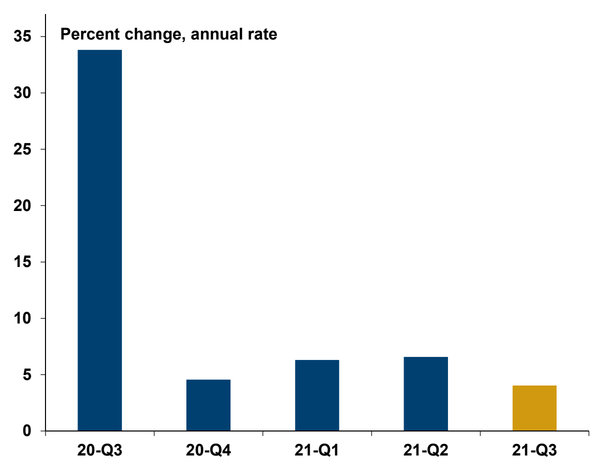
Equally important, the tapering decision will not depend on employment alone. Officials will review the broad array of economic statistics in making their decision, and they are not likely to be pleased with recent developments. It is still early in the third quarter, but available data suggest a noticeable slowing in the rate of growth in the third quarter. We are currently thinking of growth of approximately four percent (chart, right), down from an average of 6.5 percent in the first half and our projection of 5.5 percent one month ago. Growth of less than four percent would not be shocking.

Change in Nonfarm Payrolls



Source: Bureau of Labor Statsitics via Haver Analytics

GDP Growth*



** The reading for 2021-Q3 (gold bar) is a forecast.*

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

A growth pace of three to four percent would be respectable, even strong, if the economy were at full employment, but with employment still 5.3 million below the pre-pandemic total in February 2020, Fed officials will probably view it as disappointing. Certainly, it is slower than the rate implied by the projections of Fed officials in June. Policymakers at that time expected GDP growth over the four quarters of 2021 to total 7.0 percent. With growth of 6.5 percent in H1, officials would need to see growth of 7.5 percent in the second half to have their expectation fulfilled. That pace now seems out of reach.

An Early Read on Q3

Consumers have powered the economy in the past few quarters, and they are likely to strongly influence the pace of growth in the quarters immediately ahead. Recent results have not been encouraging. The report on income and consumption published on August 27 showed that real outlays fell in July. The drop was modest at 0.1 percent, but it set the stage for a slow third quarter.

Consumer spending could revive in August and September to leave respectable results for the quarter, but a marked rebound seems unlikely given soft sales of new vehicles in August (a paltry total of 13.1 million cars and light trucks, annual rate). The softness in vehicle sales was probably more the result of limited supply rather than weak demand, but it still represents a constraint on growth.

Of course, other sectors could pickup and offset the softness in consumer spending, but warning signs have emerged elsewhere as well. Residential construction has lost momentum. After a vigorous rebound in the second half of last year and the first quarter, home construction fell in Q2, and little net change in housing starts this year suggests a slow third quarter, possibly another decline.

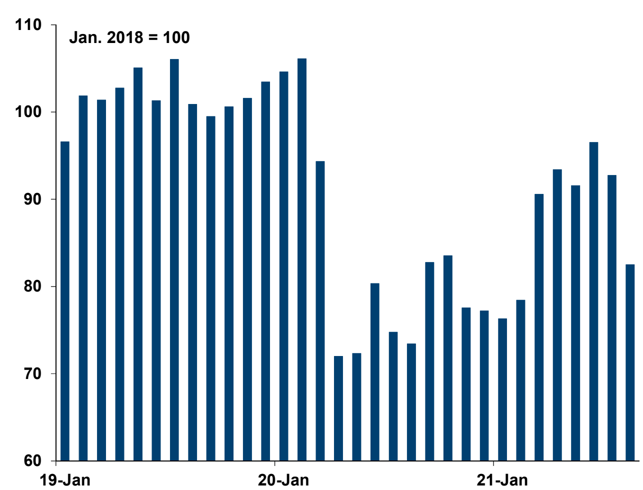
Business fixed investment has been highly supportive in the current expansion, increasing 13.3 percent over the past four quarters, and we expect it to remain in the plus column in the third quarter. Manufacturers of capital goods have accumulated a large backlog of unfilled orders, and shipments have continued to move along an upward trend. However, imports of capital goods have stalled in the past three months, which could dampen domestic outlays. Of course, the easing of imported capital goods will improve the performance of the trade sector, but the latest report on international trade does not suggest a sizeable positive contribution to GDP growth from net exports.

Inventory investment could spur growth in the third quarter, as businesses have drawn down existing stocks to meet demand in an environment of supply constraints. Figures for July show an increase in inventories, with the rate of growth faster than the average in Q2. However, given price pressures from supply-chain disruptions, the nominal advance might not translate to a powerful boost in real terms.

Causes

There are two obvious causes of the deceleration in economic growth: Covid and supply-chain disruptions. Covid seems to have influenced consumer spending, although not dramatically so. Consumer attitudes have softened, as both the confidence index from the Conference Board and the sentiment gauge from the University of Michigan Survey Research Center softened in August (chart; the chart shows an average of these two measures). Also, individuals have reduced travel by air recently, as airport throughput (the

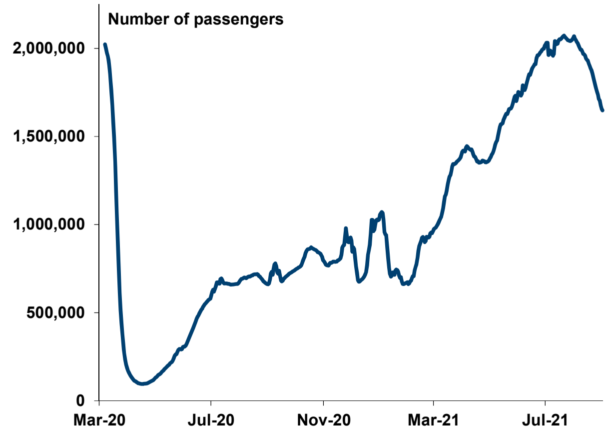
Consumer Attitudes*



** An average of the University of Michigan and Conference Board measures of consumer attitudes. Both series are reindexed to equal 100 in January 2018.*

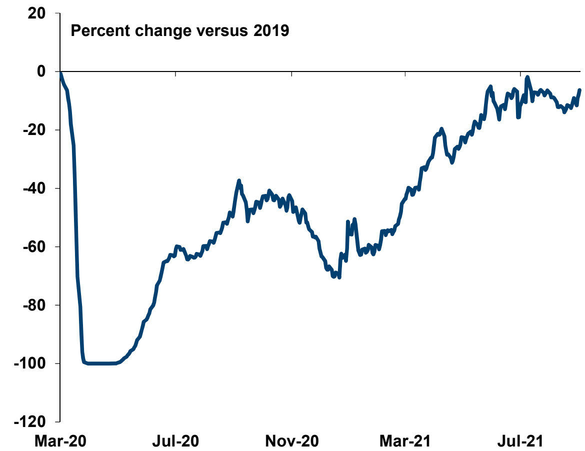
Source: The Conference Board and University of Michigan Survey Research Center via Haver Analytics; Daiwa Capital Markets America

Airport Throughput*



** Seven-day moving average. The last observation is for September 1, 2021.*
Source: Transportation Security Administration (TSA) via Bloomberg

Restaurant Seatings*



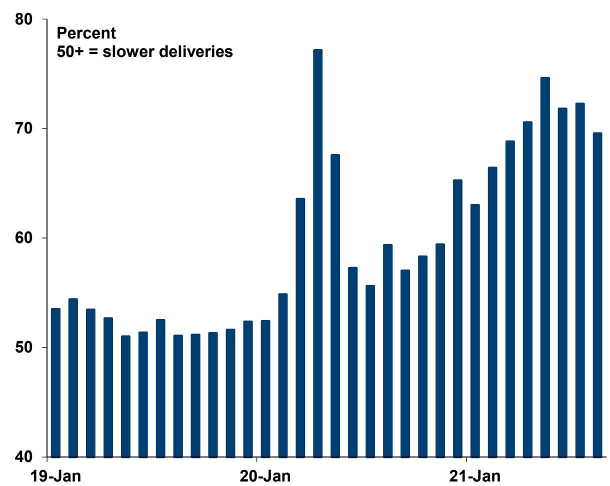
** Seven-day moving average. The last observation is for September 2, 2021.*
Source: OpenTable via Bloomberg

number of individuals passing through a security checkpoint) has declined noticeably in recent weeks (chart, above left). However, other measures have held up well. Dining in restaurants has declined only marginally in recent weeks (chart, above right), and credit or debit card spending (although available only through mid-August) has been well maintained. Thus, we are reluctant to blame Covid alone for the slowing in consumer spending. Perhaps tight supplies are playing a role; certainly, this is the case for new cars and light trucks. Alternatively, pent-up demand may have been nearly satisfied, which would represent a troubling development for the economic outlook.

It is difficult to assess the influence of supply-chain disruptions, but indexes of supplier deliveries from the Institute of Supply Management provide insights. Both the manufacturing and services indexes have improved recently, indicating progress in addressing supply shortages. However, these measures remain well above historical norms, suggesting that problems are deep-seeded and not likely to be corrected in the near term.

The likely persistence of supply chain difficulties, and the uncertainty associated with Covid, muddies the outlook and supports the case for patience in making a decision on tapering the Fed's QE program.

Supplier Deliveries Index*



** An average of the supplier deliveries components of the ISM manufacturing and services indexes.*
Source: The Institute for Supply Management via Haver Analytics; Daiwa Capital Markets America

Review

Week of August 30, 2021	Actual	Consensus	Comments
Consumer Confidence (August)	**113.8 (-11.3 Index Pts.)**	**123.0 (-6.1 Index Pts.)**	Consumer confidence fell 9.0% in August, most likely influenced by the reacceleration in the number of Covid cases. This index was subdued in the early stages of the current recovery, but it showed signs of life in the spring and early summer. The decline in August offset a good portion of the recent gains. For comparison, the latest reading is 14.2% below the pre-Covid peak of 132.6 in February 2020 and 11.7% below the recent high of 128.9 in June.
ISM Manufacturing Index (August)	**59.9% (+0.4 Pct. Pt.)**	**58.5% (-1.0 Pct. Pt.)**	The ISM index rose modestly in August from an already elevated level, signaling firm activity in the manufacturing sector. An increase of 1.8 percentage points in the new orders component stood out, and the level of 66.7% was impressive. With orders strong, production was well maintained, with this component increasing 1.6 percentage points to 60.0%. Although orders and production were brisk, employment lagged, with this measure falling 3.9 percentage points to 49.0%. The supplier delivery index also fell (off 3.0 percentage points), but this might be viewed as a positive development, as it suggests progress in resolving supply-chain disruptions, although the elevated level of the index still indicates problems.
Construction Spending (July)	**0.3%**	**0.2%**	Private residential building led the advance in total construction activity in July, increasing for the 13th time in the past 14 months, although the latest gain was moderate at 0.5%. Building by state and local governments rose 0.8%, but the advance represented only a modest offset to sharp declines in the prior two months. Private nonresidential building continued to decline (off 0.2%, the 14th decline in the past 18 months).
U.S. International Trade Balance (July)	**-$70.1 Billion ($3.1 Billion Narrower Deficit)**	**-$70.9 Billion ($4.8 Billion Narrower Deficit)**	The trade balance in goods and services narrowed in July, with exports gaining 1.3% and imports slipping 0.2%. In addition, trade flows in the prior six months were revised in favor of the U.S., led by improvement in the service surplus. In the latest month, the deficit reflected noticeable improvement in goods trade and slippage in service trade. The pickup in goods trade was the result of a jump in exports and a decline imports, a welcome break from the pattern of the past year or so, when imports of goods were noticeably stronger than exports. The slippage in service trade was heavily influenced by a special factor: a large payment to Japan for the broadcast rights to the summer Olympics.

Review Continued

Week of August 30, 2021	Actual	Consensus	Comments
Factory Orders (July)	**0.3%**	**0.4%**	All of the advance in factory orders in July occurred in the nondurable area, where bookings rose 0.9%. Some of this advance was the result of a price-led increase of 1.6% in the petroleum and coal category, but orders elsewhere also were strong (up 0.7% excluding petroleum and coal). Orders ex-petrol have now increased in 14 of the past 15 months and have moved well above pre-pandemic totals. Orders for durable goods fell 0.1%, influenced by a drop of more than 48% in the volatile aircraft category. Durable orders excluding transportation rose 0.8%, continuing to move along an upward trend (up in 14 of the past 15 months, with the level of bookings far above the pre-pandemic norm).
Payroll Employment (August)	**235,000**	**733,000**	Payroll employment rose only moderately in August, trailing the average advance of 636,000 in the first seven months of the year. Several industries, including leisure and hospitality, healthcare, and construction, contributed to the lackluster results. The unemployment rate declined 0.2 percentage point to 5.2%. The decline reflected a decent gain in employment as measured by the household survey (up 509,000) that exceeded the increase in the size of the labor force (up 190,000). Average hourly earnings surged 0.6% in August. The lack of employment growth in the leisure and hospitality sector (a low-wage area) probably contributed some to the increase in this measure, but the gain was sizeable enough to suggest that genuine wage increases played a role.
ISM Services Index (August)	**61.7% (-2.4 Pct. Pts.)**	**61.6% (-2.5 Pct. Pts.)**	Although the ISM services index declined in August, the change occurred from a record reading in the prior month, and thus the index remained quite strong by historical standards. A decline of 6.9 percentage points in the business activity component to 60.1% led the drop in August. Despite the drop, the level of the index remained impressive. The new orders and employment components posted modest declines (off 0.5 and 0.1 percentage point, respectively). The orders component remained in the upper portion of its historical range, while the employment index was mid-range. The supplier delivery index merits special attention at this time because of insights it provides on supply chain disruptions. This measure fell 2.4 percentage points, suggesting progress in resolving disruptions, but the measure remained far above normal readings.

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

Preview

Week of Sept. 6, 2021	Projected	Comments
Job Openings (July) (Wednesday)	**9.600 Million**	Active hiring by businesses in July (1.053 million) probably chipped away at the record level of job openings in June, but strong demand for labor will probably keep the number of postings far above previous norms. The quit rate also was high in June and is likely to remain elevated given the wide availability of jobs (the 2.7% reading for the quit rate in June was just shy of the record of 2.8% in April and comfortably above the record of 2.4% before the current recovery). Note: statistics in this report lag the regular employment data by one months; the upcoming report is for July.
Consumer Credit (July) (Wednesday)	**$22.0 Billion**	After declining during the recession and advancing only modestly in the early stages of the recovery, individuals have recently started to use credit more actively. Monthly growth averaged $20.0 billion from February to April (or 0.5%) before stepping up to an average of $37.2 billion in May and June (or 0.9%). A favorable economic outlook might encourage the continued use of credit, although nominal consumer spending rose only moderately in July (0.3%), and thus credit growth will probably not match the increases in May and June.
PPI (August) (Friday)	**0.5% Total, 0.6% Ex. Food & Energy**	Energy prices rose August, but only slightly more than seasonal norms, thus the energy component should rise only moderately after seasonal adjustment. Food prices started to cool in July after six months of sharp increases, and the still-elevated level of the food index suggests more downside potential. Prices excluding food and energy have surged recently, increasing at an average rate of 0.9% in the past four months. Presumably, some of this pressure was transitory and should begin to fade in August, but a good portion likely reflects problems with supply chains and could linger for a time.

Source: Forecasts provided by Daiwa Capital Markets America

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Economic Indicators

August/September 2021

Monday	Tuesday	Wednesday	Thursday	Friday
30	31	1	2	3
PENDING HOMES SALES May 8.3% June -2.0% July -1.8%	**FHFA HOME PRICE INDEX** Apr 1.9% May 1.8% June 1.6% **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** SA NSA Apr 1.7% 2.2% May 1.8% 2.1% June 1.8% 2.0% **MNI CHICAGO BUSINESS BAROMETER INDEX** Index Prices June 66.1 91.9 July 73.4 91.6 Aug 66.8 93.9 **CONFERENCE BOARD CONSUMER CONFIDENCE** June 128.9 July 125.1 Aug 113.8	**ADP EMPLOYMENT REPORT** Private Payrolls June 741,000 July 326,000 Aug 374,000 **ISM INDEX** Index Prices June 60.6 92.1 July 59.5 85.7 Aug 59.9 79.4 **CONSTRUCTION SPEND.** May 0.7% June 0.0% July 0.3% **NEW VEHICLE SALES** June 15.5 million July 14.6 million Aug 13.1 million	**UNEMPLOYMENT CLAIMS** Initial Continuing (Millions) Aug 07 0.377 2.865 Aug 14 0.349 2.908 Aug 21 0.354 2.748 Aug 28 0.340 N/A **REVISED PRODUCTIVITY & COSTS** Productivity Unit Labor Costs 21-Q1 4.3% -2.8% 21-Q2(p) 2.3% 1.0% 21-Q2(r) 2.1% 1.3% **TRADE BALANCE** May -$68.5 billion June -$73.2 billion July -$70.1 billion **FACTORY ORDERS** May 2.3% June 1.5% July 0.4%	**EMPLOYMENT REPORT** Payrolls Un. Rate June 962,000 5.9% July 1,053,000 5.4% Aug 235,000 5.2% **ISM SERVICES INDEX** Index Prices June 60.1 79.5 July 64.1 82.3 Aug 61.7 75.4
6	7	8	9	10
LABOR DAY		**JOLTS DATA (10:00)** Openings (000) Quit Rate May 9,483 2.5% June 10,073 2.7% **July 9,600 2.6%** **BEIGE BOOK (2:00)** **July Beige Book** "The U.S. economy strengthened further from late May to early July, displaying moderate to robust growth." **CONSUMER CREDIT (3:00)** May $36.7 billion June $37.7 billion **July $22.0 billion**	**INITIAL CLAIMS (8:30)**	**PPI (8:30)** Final Demand Ex. Food & Energy June 1.0% 1.0% July 1.0% 1.0% **Aug 0.5% 0.6%** **WHOLESALE TRADE (10:00)** Inventories Sales May 1.3% 0.8% June 1.2% 2.0% **July 0.6% 0.8%**
13	14	15	16	17
FEDERAL BUDGET	**NFIB SMALL BUSINESS OPTIMISM INDEX** **CPI**	**EMPIRE MANUFACTURING** **IMPORT/EXPORT PRICES** **IP & CAP-U**	**INITIAL CLAIMS** **RETAIL SALES** **PHILLY FED INDEX** **BUSINESS INVENTORIES** **TIC DATA**	**CONSUMER SENTIMENT**
20	21	22	23	24
NAHB HOUSING MARKET INDEX	**HOUSING STARTS** **CURRENT ACCOUNT** **FOMC MEETING**	**EXISTING HOME SALES** **FOMC DECISION**	**INITIAL CLAIMS** **CHICAGO FED NATIONAL ACTIVITY INDEX** **LEADING INDICATORS**	**NEW HOME SALES**

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

Treasury Financing

August/September 2021

Monday	Tuesday	Wednesday	Thursday	Friday
30	31	1	2	3
AUCTION RESULTS: Rate / Cover 13-week bills 0.045% 3.78 26-week bills 0.055% 3.16	**AUCTION RESULTS:** Rate / Cover 21-day CMB 0.040% 2.88 **ANNOUNCE:** $25 billion 4-week bills for auction on September 2 $30 billion 8-week bills for auction on September 2 $30 billion 17-week CMBs for auction on September 1 **SETTLE:** $30 billion 4-week bills $30 billion 8-week bills $30 billion 17-week CMBs $8 billion 30-year TIPS $27 billion 20-year bonds $60 billion 2-year notes $61 billion 5-year notes $62 billion 7-year notes	**AUCTION RESULTS:** Rate / Cover 17-week CMB 0.045% 4.99	**AUCTION RESULTS:** Rate / Cover 4-week bills 0.035% 3.85 8-week bills 0.065% 3.02 **ANNOUNCE:** $99 billion 13-,26-week bills for auction on Sept. 7 $34 billion 52-week bills for auction on September 7 $58 billion 3-year notes for auction on September 7 $38 billion 10-year notes for auction on September 8 $24 billion 30-year bonds for auction on September 9 $45 billion 21-day CMBs for auction on September 7 **SETTLE:** $99 billion 13-,26-week bills $45 billion 21-day CMBs	
6	7	8	9	10
LABOR DAY	**AUCTION:** $99 billion 13-,26-week bills $34 billion 52-week bills $58 billion 3-year notes $45 billion 21-day CMBs **ANNOUNCE:** $25 billion* 4-week bills for auction on September 9 $30 billion* 8-week bills for auction on September 9 $30 billion* 17-week CMBs for auction on September 8 **SETTLE:** $25 billion 4-week bills $30 billion 8-week bills $30 billion 17-week CMBs	**AUCTION:** $38 billion 10-year notes $30 billion* 17-week CMBs	**AUCTION:** $25 billion* 4-week bills $30 billion* 8-week bills $24 billion 30-year bonds **ANNOUNCE:** $99 billion* 13-,26-week bills for auction on September 13 **SETTLE:** $99 billion 13-,26-week bills $34 billion 52-week bills $45 billion 21-day CMBs	
13	14	15	16	17
AUCTION: $99 billion* 13-,26-week bills	**ANNOUNCE:** $25 billion* 4-week bills for auction on September 16 $30 billion* 8-week bills for auction on September 16 $30 billion* 17-week CMBs for auction on September 15 **SETTLE:** $25 billion* 4-week bills $30 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs **SETTLE:** $58 billion 3-year notes $38 billion 10-year notes $24 billion 30-year bonds	**AUCTION:** $25 billion* 4-week bills $30 billion* 8-week bills **ANNOUNCE:** $99 billion* 13-,26-week bills for auction on September 20 $26 billion* 2-year FRNs for auction on September 22 $24 billion* 20-year bonds for auction on September 21 $14 billion* 10-year TIPS for auction on September 23 **SETTLE:** $99 billion* 13-,26-week bills	
20	21	22	23	24
AUCTION: $99 billion* 13-,26-week bills	**AUCTION:** $24 billion* 20-year bonds **ANNOUNCE:** $25 billion* 4-week bills for auction on September 23 $30 billion* 8-week bills for auction on September 23 $30 billion* 17-week CMBs for auction on September 22 **SETTLE:** $25 billion* 4-week bills $30 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs $26 billion* 2-year FRNs	**AUCTION:** $25 billion* 4-week bills $30 billion* 8-week bills $14 billion* 10-year TIPS **ANNOUNCE:** $99 billion* 13-,26-week bills for auction on September 27 $60 billion* 2-year notes for auction on September 27 $61 billion* 5-year notes for auction on September 27 $62 billion* 7-year notes for auction on September 28 **SETTLE:** $99 billion* 13-,26-week bills	**SETTLE:** $26 billion* 2-year FRNs

*Estimate