Daiwa Capital Markets

U.S. Economic Comment

- Q2 U.S. GDP: strong consumer spending, soft business spending
- Trade developments: firm tariff collections, only fractionally paid by China

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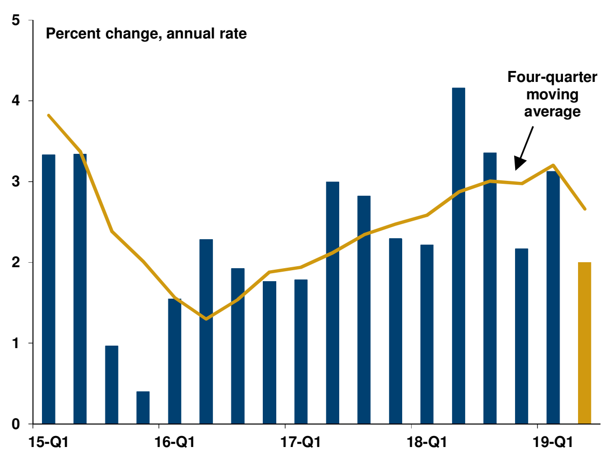
The U.S. Economy in Q2

The U.S. Commerce Department will publish its first estimate of Q2 GDP in the coming week (July 26). Expected growth of approximately 2.0 percent might appear disappointing compared with the advance of 3.1 percent in the first quarter and the average of 3.0 percent over the four quarters of last year (chart, left). However, this pace is close to the economy's growth potential at a time of full employment, which should be viewed as a favorable performance. In addition, inventory investment probably constrained growth in Q2, possibly subtracting a full percentage point, and this drag could be viewed as a random shift after positive contributions in the prior three quarters.

Growth of approximately three percent in final demand (GDP less inventory investment) is likely to reflect a mix of pluses and minuses. We look for consumer spending to stand out on the favorable side, as real outlays probably grew in the neighborhood of four percent. This jump could be viewed as a catch-up with the underlying trend after a slow first quarter (0.9 percent growth), but it nevertheless shows that consumer spending remains on a solid track. With the labor market strong and the aggregate financial position of the household sector healthy -- especially with equity values touching record levels -- consumers are likely to remain active.

We are expecting good support from state and local governments, as they have gone on a construction spending binge in recent months, led by road repairs and other infrastructure projects (chart, right). The federal government also might make a positive contribution, as defense-related outlays rose noticeably in the second quarter, and federal employment grew more than in other recent months.

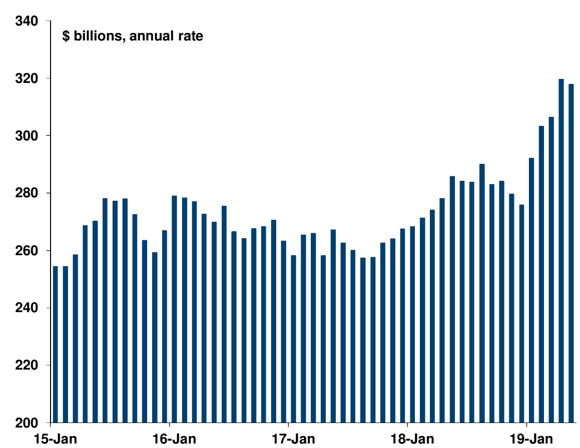
U.S. GDP Growth*



* The Gold bar is a forecast for the second quarter

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

Construction Outlays of State & Local Gov'ts



Source: U.S. Census via Haver Analytics

The report is likely to contain some disappointing aspects. Most important, business fixed investment is likely to show limited, if any, growth. If this component remains in the plus column, the advance will be driven by continued growth in intellectual property (primarily research & development and software); available data suggest that outlays for new equipment and construction were soft. Fed officials have expressed concern about weak capital spending because of uncertainties associated with trade tensions, and the GDP report will probably reinforce those concerns. Trade tensions and slow economic growth abroad represent downside risks for international trade, and we suspect that net exports will make a negative contribution.

We have not been impressed with the housing sector. Home sales have picked up in response to low interest rates, but they had lost considerable ground in the second half of last year, and levels in recent months were still below those in 2017 and early 2018. More important, housing starts have not picked up meaningfully. Multi-family activity jumped in the second quarter, but single-family starts were essentially flat. Improvements to existing homes weakened in Q2. All told, residential construction is likely to show little change

Trade War Developments

Press reports this week suggested that trade negotiations between the U.S. and China were progressing slowly. Discussions have been limited to telephone conversations among key participants; negotiators reportedly have not met face-to-face since the Presidents Trump and Xi agreed in late June to reopen talks. The new set of negotiations is likely to be a long, drawn-out affair.

President Trump is perhaps in no rush to reach a trade agreement because he views tariffs as a boon -- a substantial revenue generator for the federal government. The U.S. has indeed seen a noticeable pickup in customs duties in the past year-and-one-half. In years past, tariffs generated approximately $3.0 billion per month in federal revenue; in the past 12 months, those collections have ranged from approximately $4.0 to $6.5 billion (average of $5.3 billion). (Mr. Trump started his tariff campaign in February 2018 with duties on washing machines and solar panels. He added charges on aluminum and steel in March, and his aggressive action with China began in July of last year. The table below shows the amounts collected under the various efforts. Total collections of $29.5 billion from these programs represent 37.3 percent of all customs duties collected from February 2018 through June 2019.)

Tariff Receipts*

Tariff Source	Amount Collected $ Billions
Washing Machines	0.2
Solar Panels	0.7
Steel	5.9
Aluminum	1.9
China	20.8
Total	29.5

**Tariffs on washing machines and solar panels began in February 2018; tariffs on aluminium and steel became effective in March 2018; President Trump's tariffs on Chinese goods started in July 2018. The reported figures are total collections from inception through June 2019.*

Source: U.S. Customs and Border Protection

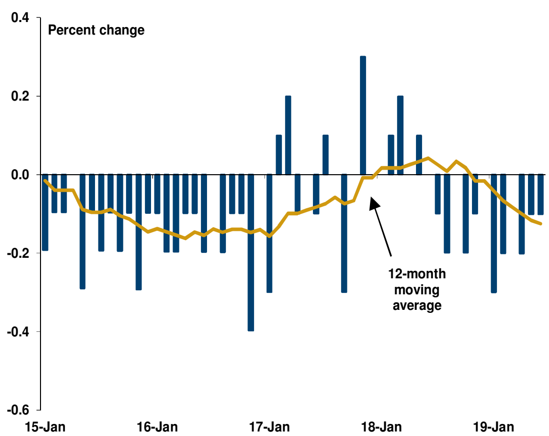
While the federal government has collected a notable amount of additional revenue, there is disagreement over who is bearing the burden. President Trump claims that China is paying the tariffs, but many scoff at this contention. President Trump is not entirely off base on this issue, as China is absorbing some of the burden through lower prices. Pre-tariff prices of goods from China have been declining in the past year, with the cumulative drop totaling 1.5 percent (chart, next page, left). This decline is modest relative to tariffs of 25 percent, but nevertheless it shows that China is absorbing some of the cost. (This cumulative price change is for all goods from China, those with tariffs and those without. Possibly, even likely, the reported change reflects modest declines or price increases for goods without tariffs and larger declines for goods with tariffs.) With China bearing only a small portion of the burden from tariffs, most is absorbed by U.S. entities -- either wholesalers and retailers through narrower profit margins or households and businesses through higher prices.

Even if China were bearing a substantial share of the cost of the tariffs, the net benefit to the U.S. would be small, at least in the near term. President Trump and the Department of Agriculture have allocated $28 billion of support to farmers because of losses suffered from retaliation by China. The collection of $20 billion in tariffs is not much of a bargain in light of the support provided to farmers.

China's exports of goods to the United States held up reasonably well during 2018, as shipments in Q4 were only marginally below the level in the first quarter. The resiliency might have reflected efforts to rush goods out of the country before heavy tariffs became effective. (Duties on $200 billion of goods were not imposed until September 2018 and they were introduced at 10 percent rather than 25 percent; these tariffs were boosted to 25 percent in May.) Although Chinese exports (U.S. imports) were well maintained for a time, they have softened this year, with the March total 16.8 percent below the average in the fourth quarter of last year. Chinese exports to the U.S. picked up in April and May, but the May total was still 11.7 percent below the Q4 value.

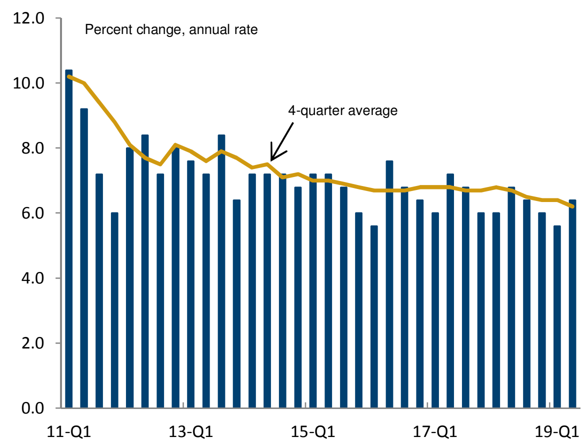
Although Chinese exports are starting to feel a pinch from U.S. tariffs, the overall Chinese economy has not yet paid a high cost. Recently published figures on GDP showed a slight pickup in growth from the pace in Q1 (1.6 percent versus 1.4 percent, not annualized). Year-over-year growth eased, but only marginally so (6.2 percent versus 6.4 percent). The U.S. financial press highlighted the drop in year-over-year growth, emphasizing that the Chinese economy moved to its slowest pace in more than 25 years. Such statements are factual, but misleading. The latest annual growth rate was only marginally slower than results in other recent years. We would describe Chinese growth in recent years as easing slowly. To be sure, one has to question the reliability of Chinese statistics, and the economy benefited from a round of stimulus in early 2019, but nevertheless, we found U.S. press coverage puzzling.

Prices of U.S. Imports from China*



Source: Bureau of Labor Statistics via Haver Analytics

Real GDP Growth in China



Source: China National Bureau of Statistics via Haver Analytics

Review

Week of July 15, 2019	Actual	Consensus	Comments
Retail Sales (June)	**0.4% Total, 0.4% Ex-Autos**	**0.2% Total, 0.2% Ex-Autos**	The advance in retail sales was broadly based, as only two of 13 major categories posted declines. The gasoline component fell 2.8%, undoubtedly influenced by lower prices, and activity at electronic stores remained on a downward trend with a drop of 0.3%. Results elsewhere were generally favorable, but two areas stood out on the firm side: nonstore retailers (primarily catalog and online) posted a gain of 1.7%, while activity at restaurants and bars rose 0.9%. The report suggests that real consumer spending rebounded strongly in Q2 after slow results in Q1 (approximately 4.0% in Q2 versus 0.9% in Q1).
Industrial Production (June)	**0.0%**	**0.1%**	A temperature-related drop of 3.6% in the utility sector restrained overall industrial activity in June. Manufacturing output rose for the second consecutive month (0.4% in June and 0.2% in May), reversing approximately one-third of the drop in the first four months of the year. Mining activity rose for the third consecutive month (0.2% in May and June after a spurt of 2.6% in April). The recent changes more than offset a retreat earlier in the year and reestablished an upward trend in the mining sector.
Housing Starts (June)	**1.253 Million (-0.9%)**	**1.260 Million (-0.7%)**	All of the drop in housing starts occurred in the volatile multi-family sector, where the decline of 9.2 percent could be viewed as random volatility. Activity had jumped to an elevated level in May and moved back in line with the recent average in June. Single-family starts rose 3.5 percent, marking the third gain in the past four months. Despite the recent improvement, single-family starts still trailed the average from last year (847,000 units in June versus an average of 873,000 in 2018). Building permits did not offer much hope for marked improvement, as single-family authorizations rose only 0.4% and multi-family permits tumbled 16.8%.
Leading Indicators (June)	**-0.3%**	**0.1%**	Notable negative contributions from building permits (released after forecasts in the consensus), ISM new orders, and unemployment claims more than offset positive contributions from the leading credit index, the manufacturing workweek, and stock prices. The index has been essentially flat in the past nine months, a contrast to the average monthly increase of 0.5% in 2017 and the first three quarters of 2018.0
Consumer Sentiment (July)	**98.4 (+0.2 pt.)**	**98.8 (+0.6 pt.)**	With the labor market firm and the equity market reaching record levels, consumer sentiment improved slightly in early July. The new level matches the average reading from last year and is high relative to historical standards.

Source: U.S. Census Bureau (Retail Sales, Housing Starts); Federal Reserve Board (Industrial Production); The Conference Board (Leading Indicators); University of Michigan Survey Research Center (Consumer Sentiment); Consensus forecasts are from Bloomberg

Preview

Week of July 22, 2019	Projected	Comments
Existing Home Sales (June) (Tuesday)	**5.45 Million (2.1%)**	The low level of interest rates that has evolved in recent months should give a lift to sales of existing homes. Activity has improved noticeably in recent months, but sales lost considerable ground last year, and the expected level of activity in June remains below most readings in 2017 and 2018.
New Home Sales (June) (Wednesday)	**0.660 Million (5.4%)**	Sales of new homes are likely to improve in response to lower interest rates. The expected level of sales is in the upper end of the range from the current expansion, although a bit shy of the best readings.
Durable Goods Orders (June) (Thursday)	**0.5%**	The manufacturing sector showed signs of life in June (both factory employment and the manufacturing component of industrial production increased), which should translate to an advance in orders. The expected increase, however, offsets only a portion of the three declines in the prior four months and leaves bookings below levels around the turn of the year.
U.S. International Trade in Goods (June) (Thursday)	**$72.5 Billion Deficit ($2.5 Billion Narrower)**	Both exports and imports seem likely to correct after surging in May and moving to levels that seem out of line with underlying trends. Imports are likely to post the larger change, with the auto and miscellaneous categories especially vulnerable to downside risk. The expected deficit would leave the average in the second quarter wider than that in Q1, suggesting a drag from net exports on GDP growth.
GDP (2019-Q2) (Friday)	**2.0%**	Robust growth in consumer spending, probably in the neighborhood of 4.0%, is likely to be partially offset by negative contributions to growth from inventory investment and net exports, leaving a moderate advance in Q2 GDP. Government spending, both federal and state & local, is likely to be firm, while business fixed investment will probably post modest, if any, growth. This report will include benchmark revisions to data in the prior five years.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

July/August 2019

Monday	Tuesday	Wednesday	Thursday	Friday
15	16	17	18	19
EMPIRE MFG (8:30) May 17.8 June -8.6 July 4.3	**RETAIL SALES** Total Ex.Autos Apr 0.4% 0.6% May 0.4% 0.4% June 0.4% 0.4% **IMPORT/EXPORT PRICES** Non-fuel Imports Nonagri. Exports Apr -0.1% 0.2% May -0.3% -0.2% June -0.3% -1.1% **IP & CAP-U** IP Cap.Util. Apr -0.5% 77.9% May 0.4% 78.1% June 0.0% 77.9% **NAHB HOUSING INDEX** May 66 June 64 July 65 **BUSINESS INVENTORIES** Inventories Sales Mar 0.0% 1.3% Apr 0.5% -0.2% May 0.3% 0.2% **TIC DATA** Total Net L-TI Mar $32.5B -$25.9B Apr -$9.0B $46.9B May $32.9B $3.5B	**HOUSING STARTS** Apr 1.270 million May 1.265 million June 1.253 million **JULY BEIGE BOOK** "Economic activity continued to expand at a modest pace overall from mid-May through early July, with little change from the prior reporting period."	**INITIAL CLAIMS** June 29 222,000 July 06 208,000 July 13 216,000 **PHILLY FED INDEX** May 16.6 June 0.3 July 21.8 **LEADING INDICATORS** Apr 0.1% May 0.0% June -0.3%	**CONSUMER SENTIMENT** May 100.0 June 98.2 July 98.4
22	23	24	25	26
CHICAGO FED NATIONAL ACTIVITY INDEX (8:30) Monthly 3-Mo. Avg. Apr -0.48 -0.37 May -0.05 -0.17 June -- --	**FHFA HOME PRICE INDEX (9:00)** Mar 0.2% Apr 0.4% May -- **EXISTING HOME SALES (10:00)** Apr 5.21 million May 5.34 million **June 5.45 million**	**NEW HOME SALES (10:00)** Apr 0.679 million May 0.626 million **June 0.660 million**	**INITIAL CLAIMS (8:30)** **DURABLE GOODS ORDERS (8:30)** Apr -2.8% May -1.3% **June 0.5%** **U.S. INTERNATIONAL TRADE IN GOODS (8:30)** Apr -$70.9 billion May -$75.0 billion **June -$72.5 billion** **ADVANCE INVENTORIES REPORT (8:30)** Wholesale Retail Apr 0.8% 0.6% May 0.4% 0.4% June -- --	**GDP (8:30)** GDP Chained Price 18-Q4 2.2% 1.7% 19-Q1 3.1% 0.9% **19-Q2 2.0% 2.0%**
29	30	31	1	2
	PERSONAL INCOME, CONSUMPTION, PRICES **S&P CORELOGIC CASE-SHILLER HOME PRICE INDEX** **PENDING HOME SALES** **CONSUMER CONFIDENCE** **FOMC MEETING**	**ADP EMPLOYMENT REPORT** **EMPLOYMENT COST INDEX** **CHICAGO PURCHASING MAMAGERS' INDEX** **FOMC DECISION** **POWELL PRESS CONFERENCE**	**INITIAL CLAIMS** **ISM INDEX** **CONSTRUCTION SPEND.** **VEHICLE SALES**	**EMPLOYMENT REPORT** **TRADE BALANCE** **FACTORY ORDERS** **REVISED CONSUMER SENTIMENT**
5	6	7	8	9
ISM NON-MFG INDEX	**JOLTS DATA**	**CONSUMER CREDIT**	**INITIAL CLAIMS** **WHOLESALE TRADE**	**PPI**

Forecasts in Bold

Treasury Financing

July/August 2019

Monday	Tuesday	Wednesday	Thursday	Friday
15	16	17	18	19
AUCTION RESULTS: Rate Cover 13-week bills 2.115% 2.88 26-week bills 2.010% 3.22 **SETTLE:** $38 billion 3-year notes $24 billion 10-year notes $16 billion 30-year bonds	**AUCTION RESULTS:** Rate Cover 52-week bills 1.915% 2.87 **ANNOUNCE:** $35 billion 4-week bills for auction on July 18 $35 billion 8-week bills for auction on July 18 **SETTLE:** $35 billion 4-week bills $35 billion 8-week bills		**AUCTION RESULTS:** Rate Cover 4-week bills 2.090% 2.93 8-week bills 2.120% 2.45 10-yr TIPS 0.282% 2.28 **ANNOUNCE:** $72 billion 13-,26-week bills for auction on July 22 $20 billion 2-year FRNs for auction on July 24 $40 billion 2-year notes for auction on July 23 $41 billion 5-year notes for auction on July 24 $32 billion 7-year notes for auction on July 25 **SETTLE:** $72 billion 13-,26-week bills $26 billion 52-week bills	
22	23	24	25	26
AUCTION: $72 billion 13-,26-week bills	**AUCTION:** $40 billion 2-year notes **ANNOUNCE:** $35 billion* 4-week bills for auction on July 25 $35 billion* 8-week bills for auction on July 25 **SETTLE:** $35 billion 4-week bills $35 billion 8-week bills	**AUCTION:** $20 billion 2-year FRNs $41 billion 5-year notes	**AUCTION:** $35 billion* 4-week bills $35 billion* 8-week bills $32 billion 7-year notes **ANNOUNCE:** $72 billion* 13-,26-week bills for auction on July 29 **SETTLE:** $72 billion 13-,26-week bills	
29	30	31	1	2
AUCTION: $72 billion* 13-,26-week bills	**ANNOUNCE:** $35 billion* 4-week bills for auction on August 1 $35 billion* 8-week bills for auction on August 1 **SETTLE:** $35 billion* 4-week bills $35 billion* 8-week bills	**ANNOUNCE:** $38 billion* 3-year notes for auction on August 6 $27 billion* 10-year notes for auction on August 7 $19 billion* 30-year bonds for auction on August 8 **SETTLE:** $14 billion 10-year TIPS $20 billion 2-year FRNs $40 billion 2-year notes $41 billion 5-year notes $32 billion 7-year notes	**AUCTION:** $35 billion* 4-week bills $35 billion* 8-week bills **ANNOUNCE:** $72 billion* 13-,26-week bills for auction on August 5 **SETTLE:** $72 billion* 13-,26-week bills	
5	6	7	8	9
AUCTION: $72 billion* 13-,26-week bills	**AUCTION:** $38 billion* 3-year notes **ANNOUNCE:** $35 billion* 4-week bills for auction on August 8 $35 billion* 8-week bills for auction on August 8 **SETTLE:** $35 billion* 4-week bills $35 billion* 8-week bills	**AUCTION:** $27 billion* 10-year notes	**AUCTION:** $35 billion* 4-week bills $35 billion* 8-week bills $19 billion* 30-year bonds **ANNOUNCE:** $72 billion* 13-,26-week bills for auction on August 12 $26 billion* 52-week bills for auction on August 13 **SETTLE:** $72 billion* 13-,26-week bills	

**Estimate*