Daiwa Capital Markets

U.S. Economic Comment

- Powell at Jackson Hole: noncommittal on rates, but probably supportive
- The federal budget outlook: even wider deficits
- Job growth: less robust than previously believed, but still favorable

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

The Jackson Hole Speech

Fed Chairman Jerome Powell was vague in discussing policy prospects at the Jackson Hole conference, merely indicating that officials are "carefully watching developments" and "will act as appropriate to sustain the expansion". Nevertheless, one might infer that the Fed will be providing additional support to the economy with another rate cut.

Mr. Powell indicated that the Fed was focusing on three factors in its policy discussions: the pace of global growth, uncertainties generated by trade policies, and the rate of inflation. He argued that related news since the July FOMC meeting has been "eventful". Signs of slower global growth have emerged, especially in Germany and China, and the imposition of new tariffs has intensified trade tensions. Although not trade related, Mr. Powell also highlighted geopolitical developments that might weigh on the outlook (the growing possibility of a hard Brexit, rising tensions in Hong Kong, and the dissolution of the Italian government). The rate of inflation has quickened recently, but it does not appear problematic. Thus, based on the three criteria noted by Chairman Powell, little is standing in the way of another rate reduction.

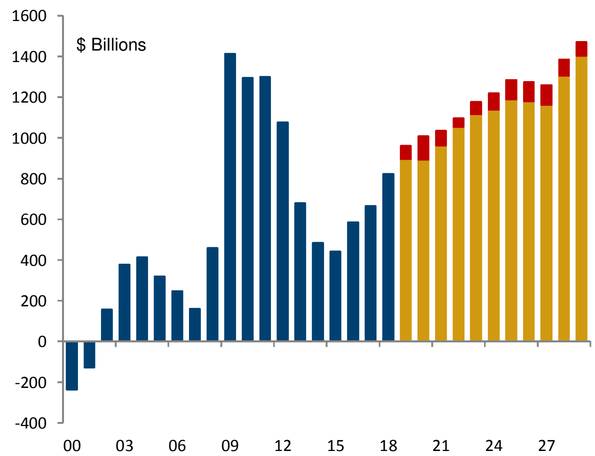
The guarded views offered by the Fed Chair are understandable in light of the minutes from the July FOMC meeting, which showed diverse policy preferences among meeting participants: some favored a rate cut of 50 basis points in July while others argued for steady policy. The lack of a consensus forced Mr. Powell to tread carefully in his speech. At the same time, the divergence of views leads us to look for another rate cut. A shift of 25 basis points seems to represent a natural compromise between those favoring a 50-basis-point shift and those preferring steady policy.

We also believe that market expectations will make it difficult for the Fed to remain on the sidelines. Futures contracts on federal funds show a 100 percent probability of a rate cut in September. Failure to validate this expectation undoubtedly would generate pronounced disruption in both the fixed-income and equity markets. The Fed's response to the equity adjustments in December and May (public comments suggesting friendlier policy) indicated clearly that such market developments are unwelcome.

The Budget Outlook

Market commentators often speak of the limited policy space of the Federal Reserve and other central banks -- that is, officials have little room to lower interest rates. The federal government also has limited policy space in the fiscal realm. This issue was in the news this week, as President Trump raised the prospect of tax cuts to support the economy. At the same time, the new budget estimates from the Congressional Budget Office raised doubts about the wisdom of such action. The CBO already was expecting historically wide deficits over the next 10 years, and the new figures show even larger shortfalls.

Federal Budget Deficit*



* The blue bars are actuals and the gold baps are projections as of May 2019. The red portions of the bars are revisions published this week. The projections are adjusted for timing shifts (i.e. outlays moving between fiscal years because of the calendar configuration).
Source: Congressional Budget Office

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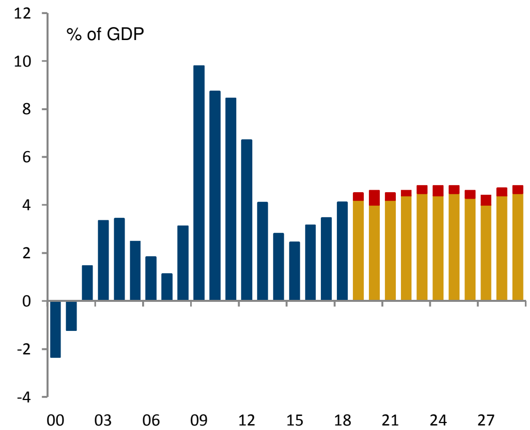

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Source: Congressional Budget Office

The CBO expects the budget deficit to total $960 billion in the current fiscal year, which ends in September (the deficit totaled $867 billion through July). Thereafter, the deficit grows steadily and exceeds $1.0 trillion every year through the forecast horizon (chart, left). The new annual projections (2019 through 2029), on average, are $79 billion wider than estimates made in May, with the total cumulating to $872 billion over this 11-year span.

Most of the revision was the result of the enlarged outlays authorized by the budget agreement passed by Congress in early August. CBO estimates that the legislation will boost spending from its previous projections by $95 billion in FY2020 and $128 billion in FY2021. Thereafter, outlays grow from the 2021 level at the rate of inflation, which CBO sees at 2.0 to 2.1 percent. Outlays also were boosted by legislation that provided disaster assistance and funding for security at the Southern border of the United States.

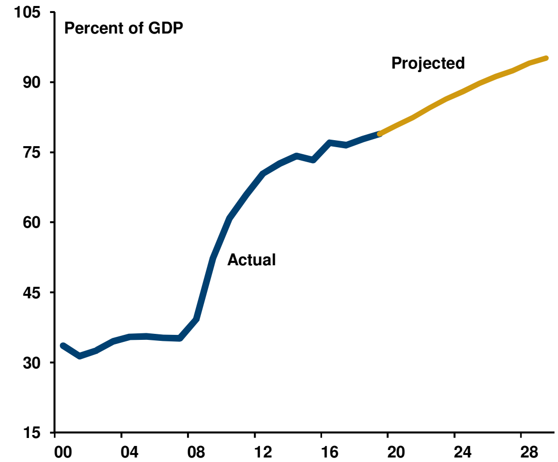
The upward revision to spending from new legislation was partially offset by a revised view on interest expense. The CBO now sees interest rates staying low for an extended period. The projection in May assumed that the interest rate on government debt would average 3.3 percent from 2020 through 2029. The new projection is based on an average interest rate of 2.7 percent.

The budget outlook, while unsettling, could be viewed as an optimistic take. The projection assumes that Congress adheres to current laws, and most important in this regard is the expiration of last year’s personal tax cuts in 2026. The expiration of the cuts, if allowed, would lead to a jump in revenues and a narrowing of the deficit. However, Congress most likely will extend at least some of the provisions, and thus revenue flows are likely to be lighter than suggested by the CBO. In addition, The CBO assumed that the economy grows steadily over the next 10 years, but a recession -- which would bring adverse consequences for the budget -- will probably develop at some point.

The budget picture is perhaps less troubling if the deficit is measured as a share of GDP, as the shortfall is steady in a range of 4.0 to 4.5 percent (chart, right). The situation is still disquieting, however, as deficits of this magnitude are wide by historical standards, and the risks of adverse developments noted above (extension of tax cuts, recession) apply here as well.

More important, persistent deficits will lead to an accumulation of debt, and the ratio of debt to GDP will continue to expand. CBO projections show this ratio moving out to 95 percent by 2029, up noticeably from 79 percent expected at the end of the current fiscal year and a shocking total relative to the average of 34 percent from 2000 to 2007 (chart). The reading of 95 percent is not far from the record of 106 percent in 1946, when the funding of World War II led to a spike in federal indebtedness.

Federal Debt*



* Federal debt held by the public as a share of GDP.
Source: Congressional Budget Office

Labor Market: Less Robust Than Previously Believed, but Still Firm

The monthly figures on payroll employment are based on data collected from a sample of business establishments (689,000 work sites covering approximately one-third of total employment). Being sample-based, the monthly reports naturally contain an element of error. The Bureau of Labor Statistics, however, keeps the series on track with its annual benchmark revisions. That is, once every year the BLS does a universe count of all payrolls, and it then reworks the monthly totals to keep them in line with the precise total collected annually. The annual tally is done in March of every year, and the processing of the data occurs over the next several months. The BLS releases a preliminary estimate of the annual revision in August, and the final results are published in February with the monthly employment report for January.

This past week the BLS released its initial assessment of the total job count, with results showing that payroll employment as of March 2019 was 501,000 lower than previously believed. That is, the monthly employment data showed that payroll employment in March totaled 150.8 million, but the revised figure is likely to be 150.3 million (data are still being processed, so this is not a final figure).

This adjustment is large by historical standards, but it is not unprecedented; a few scattered years in the past have involved larger revisions. The magnitude of the adjustment might strike many observers as massive, but the error represents the cumulative miss over a 12 month period -- an average of 42,000 per month, a less-than-shocking amount. From another perspective, the error represents only 0.3 percent of total employment -- modest.

The adjustment is more meaningful in its effect on the tone of monthly job growth. Existing figures show average job growth of 210,000 in the 12 months ended March 2019, but if the preliminary assessment of the benchmark revision is accurate (and it is usually close to the mark), the new average will total 168,000. Monthly job growth since March has averaged 159,000. Thus, job growth has decelerated. The U.S. is no longer consistently generating more than 200,000 jobs per month. Still, results are favorable -- firm enough to lead to slight reductions in unemployment over time.

Next Comment

Because of travel (vacation!) plans, the next Economic Comment will be published on September 6.

Review

Week of August 19, 2019	Actual	Consensus	Comments
Existing Home Sales (July)	**5.42 Million (+2.5%)**	**5.39 Million (+2.3%)**	After softening during much of last year, sales of existing homes have responded to the drop in interest rates that began last fall, as activity in July was 5.4% above the average in the fourth quarter of 2018. Despite the improvement, conditions cannot be described as booming; sales still lag the 5.531 million total in 2017, which represents the best year for existing sales thus far in the current expansion. The National Association of Realtors has frequently noted that tight inventories are limiting sales in certain markets, and that remained the case in July, as the number of homes on the market slipped 1.6 percent and the months' supply of homes eased from 4.4 to 4.2 months.
Leading Indicators (July)	**0.5%**	**0.3%**	Sizeable positive contributions from building permits, unemployment claims, stock prices, the leading credit index, and consumer expectations easily offset small negative or neutral contributions in the other five components, leaving the sharpest monthly advance since last September. Despite the brisk advance in July, the measure has not changed meaningfully since last fall (up at an annual rate of 0.8% since September, versus average annual growth of 4.3% from December 2015 through September 2018).
New Home Sales (July)	**0.635 Million (-12.8%)**	**0.640 Million (-0.9%)**	An upward revision of 12.7% to new home sales in June represented the most notable aspect of the July report. The June reading shifted from being merely good to being the best of the expansion thus far. Unfortunately, July brought some payback, with activity dropping slightly below the expected level and bit below the average of 665,000 in the first half of the year. Nevertheless, the June total was respectable in that it exceeded averages in other years of the current expansion. Large revisions and sharp month-to-month swings are common for this series.

Source: National Association of Realtors (Existing Home Sales); The Conference Board (Leading Indicators); U.S. Census Bureau (New Home Sales); Consensus forecasts are from Bloomberg

Preview

Week of August 26, 2019	Projected	Comments
Durable Goods Orders (July) (Monday)	**1.0%**	With the manufacturing sector struggling because of trade tensions, several industries are likely to show soft order flows. However, a pickup in orders at Boeing after three weak months is likely to lead to a jump in the aircraft sector that pulls the headline figure higher. Orders for defense-related aircraft also could jump from a low-side reading in June.
Consumer Confidence (August) (Tuesday)	**130.0 (-5.7 index pts)**	A steady flow of news suggesting trade tensions, along with the associated volatility in the equity market, is likely to dampen consumer confidence.
Revised GDP (2019-Q2) (Thursday)	**1.9% (-0.2 pct. pt. revision)**	Consumer spending and business investment in new structures will probably be revised upward, but downward adjustments to residential construction, inventory investment, and government spending (primarily state and local) will provide offsets that are likely to lead to a net downward revision to GDP growth.
U.S. International Trade in Goods (July) (Thursday)	**-$75.5 Billion**	Both exports and imports are softening in response to tariffs and trade tensions. Exports face additional challenges in the form of a firm currency and slow economic growth in foreign countries. The extra burdens on exports are likely to be felt again in July, as another drop is likely to lead to a widening in the deficit.
Personal Income, Consumption, Core Price Index (July) (Friday)	**0.2%, 0.4%, 0.2%**	Average hourly earnings posted a respectable increase in July, but a shorter workweek will probably leave modest growth in wages and salaries. Proprietors' income and rental income have been firm in recent months and could provide a lift again in July. On the spending side, a decline in sales of new motor vehicles will probably constrain outlays for durable goods, but strong retail activity points to firm results for nondurable goods, and outlays for services should continue to advance. Results for the CPI raise the possibility of a sharp advance in core PCE price index, but we look for the change to round down to 0.2 percent.

Source: Forecasts provided by Daiwa Capital Markets America

Daiwa Capital Markets

Economic Indicators

August/September 2019

Monday	Tuesday	Wednesday	Thursday	Friday
19	20	21	22	23
		EXISTING HOME SALES May 5.36 million June 5.29 million July 5.42 million **FOMC MINUTES**	**INITIAL CLAIMS** Aug 03 211,000 Aug 10 221,000 Aug 17 209,000 **LEADING INDICATORS** May -0.1% June -0.1% July 0.5%	**NEW HOME SALES** May 0.602 million June 0.728 million July 0.635 million
26	27	28	29	30
DURABLE GOODS ORDERS (8:30) May -2.3% June 1.9% **July 1.0%** **CHICAGO FED NATIONAL ACTIVITY INDEX (8:30)** Monthly / 3-Mo. Avg. May -0.03 / -0.27 June -0.02 / -0.26 July -- / --	**FHFA HOME PRICE INDEX (9:00)** Apr 0.4% May 0.1% June -- **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX (9:00)** SA / NSA Apr 0.0% / 0.8% May 0.1% / 0.6% June -- / -- **CONFERENCE BOARD CONSUMER CONFIDENCE (10:00)** June 124.3 July 135.7 **Aug 130.0**		**INITIAL CLAIMS (8:30)** **REVISED GDP (8:30)** GDP / Chained Price 19-Q1 3.1% / 1.1% 19-Q2(a) 2.1% / 2.4% **19-Q2(p) 1.9% / 2.4%** **U.S. INTERNATIONAL TRADE IN GOODS (8:30)** May -$74.8 billion June -$74.2 billion **July -$75.5 billion** **ADVANCE INVENTORIES REPORT (8:30)** Wholesale / Retail May 0.4% / 0.3% June 0.0% / -0.3% July -- / -- **PENDING HOMES SALES (10:00)** May 1.1% June 2.8% July --	**PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX (8:30)** Inc. / Cons. / Core May 0.4% / 0.5% / 0.2% June 0.4 % / 0.3% / 0.2% **July 0.2% / 0.4% / 0.2%** **CHICAGO PURCHASING MANAGERS' INDEX (9:45)** Index / Prices June 49.7 / 56.4 July 44.4 / 56.1 Aug -- / -- **REVISED CONSUMER SENTIMENT (10:00)** June 98.2 July 98.4 Aug(p) 92.1
2	3	4	5	6
LABOR DAY	**ISM MFG INDEX** **CONSTRUCTION SPEND.**	**TRADE BALANCE** **BEIGE BOOK** **VEHICLE SALES**	**ADP EMPLOYMENT REPORT** **INITIAL CLAIMS** **REVISED PRODUCTIVITY & COSTS** **ISM NON-MFG INDEX** **FACTORY ORDERS**	**EMPLOYMENT REPORT**
9	10	11	12	13
CONSUMER CREDIT	**NFIB SMALL BUSINESS OPTIMISM INDEX** **JOLTS DATA**	**PPI** **WHOLESALE TRADE**	**INITIAL CLAIMS** **CPI** **FEDERAL BUDGET**	**RETAIL SALES** **IMPORT/EXPORT PRICES** **CONSUMER SENTIMENT** **BUSINESS INVENTORIES**

Forecasts in Bold (a) = advance (1st estimate of GDP); (p) = preliminary (2nd estimate of GDP)

Treasury Financing

August/September 2019

Monday	Tuesday	Wednesday	Thursday	Friday
19	20	21	22	23
AUCTION RESULTS: Rate / Cover 13-week bills 1.900% 2.51 26-week bills 1.840% 2.86	**ANNOUNCE:** $55 billion 4-week bills for auction on August 22 $40 billion 8-week bills for auction on August 22 **SETTLE:** $55 billion 4-week bills $40 billion 8-week bills		**AUCTION RESULTS:** Rate / Cover 4-week bills 2.060% 2.59 8-week bills 1.895% 2.86 30-yr TIPS 0.501% 2.70 **ANNOUNCE:** $87 billion 13-,26-week bills for auction on August 26 $18 billion 2-year FRNs for auction on August 28 $40 billion 2-year notes for auction on August 27 $41 billion 5-year notes for auction on August 28 $32 billion 7-year notes for auction on August 29 **SETTLE:** $87 billion 13-,26-week bills	
26	27	28	29	30
AUCTION: $87 billion 13-,26-week bills	**AUCTION:** $40 billion 2-year notes **ANNOUNCE:** $55 billion* 4-week bills for auction on August 29 $40 billion* 8-week bills for auction on August 29 **SETTLE:** $55 billion 4-week bills $40 billion 8-week bills	**AUCTION:** $18 billion 2-year FRNs $41 billion 5-year notes	**AUCTION:** $55 billion* 4-week bills $40 billion* 8-week bills $32 billion 7-year notes **ANNOUNCE:** $87 billion* 13-,26-week bills for auction on September 3 **SETTLE:** $87 billion 13-,26-week bills	**SETTLE:** $7 billion 30-year TIPS $18 billion 2-year FRNs
2	3	4	5	6
LABOR DAY	**AUCTION:** $87 billion* 13-,26-week bills **ANNOUNCE:** $55 billion* 4-week bills for auction on September 5 $40 billion* 8-week bills for auction on September 5 **SETTLE:** $55 billion* 4-week bills $40 billion* 8-week bills $40 billion 2-year notes $41 billion 5-year notes $32 billion 7-year notes		**AUCTION:** $55 billion* 4-week bills $40 billion* 8-week bills **ANNOUNCE:** $87 billion* 13-,26-week bills for auction on September 9 $28 billion* 52-week bills for auction on September 10 $38 billion* 3-year notes for auction on September 10 $24 billion* 10 year notes for auction on September 11 $16 billion* 30-year bonds for auction on September 12 **SETTLE:** $87 billion* 13-,26-week bills	
9	10	11	12	13
AUCTION: $87 billion* 13-,26-week bills	**AUCTION:** $28 billion* 52-week bills $38 billion* 3-year notes **ANNOUNCE:** $55 billion* 4-week bills for auction on September 12 $40 billion* 8-week bills for auction on September 12 **SETTLE:** $55 billion* 4-week bills $40 billion* 8-week bills	**AUCTION:** $24 billion* 10 year notes	**AUCTION:** $55 billion* 4-week bills $40 billion* 8-week bills $16 billion* 30-year bonds **ANNOUNCE:** $87 billion* 13-,26-week bills for auction on September 16 $12 billion* 10-year TIPS for auction on September 19 **SETTLE:** $87 billion* 13-,26-week bills $28 billion* 52-week bills	

**Estimate*