# U.S. Economic Comment

- Trade agreements: likely mixed results on trade flows
- FOMC: steady for now; door remains open to additional easing

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

## Trade Breakthroughs

There was no gridlock in Washington this week, as Congress and the Trump Administration moved forward on three fronts: budget leaders in the House and Senate agreed in principle on spending provisions for the 2020 discretionary budget; despite impeachment-related acrimony, President Trump and House officials found common ground on the U.S. Mexico Canada Trade Agreement (USMCA); U.S. and Chinese negotiators completed phase-one of a trade agreement.

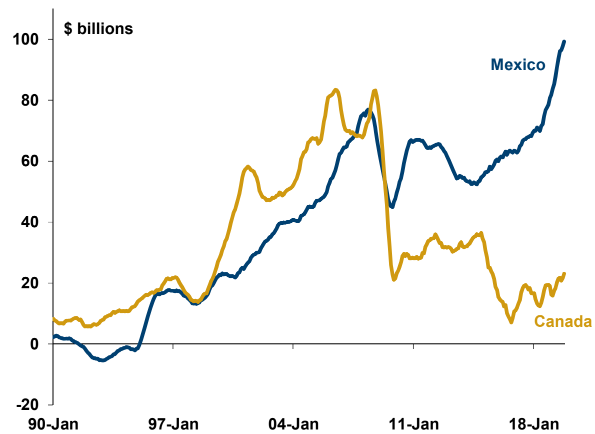
The budget agreement, while notable, was less than momentous. The probability of a government shutdown in the absence of an agreement was low; officials most likely would have kept the government running with a series of temporary budgets. Still, the agreement removes a cloud over Congress and allows legislators to begin addressing other issues.

The agreement on USMCA was more noteworthy because it assures that close economic ties among the three nations will be maintained, which will provide businesses with an element of clarity in developing investment plans and affirming or establishing supply chains. The maintenance of a trade agreement was not assured, and a failure to approve the new deal would have caused disruptions that could have hampered economic growth.

Critics of the original trade agreement (North American Free Trade Agreement, NAFTA) argue that the free flow of goods among the countries promoted the outsourcing of production from the U.S., especially to Mexico because of its low-cost labor. This view has some merit, as the trade deficit with both Canada and Mexico widened noticeably after NAFTA became effective in 1994 (chart). The U.S. trade deficit with Canada has narrowed some in the past 10 years or so, but it has continued to slip with Mexico.

The new agreement could tilt trade flows in favor of the United States, but dramatic shifts are not likely. The new pact gives U.S. producers greater access to the highly protected dairy market in Canada, although restrictions are still quite high. Prospects for trade improvement with Mexico are greater because of provisions relating to the auto sector and to the strengthening of labor unions in Mexico. These changes should reduce the cost advantage of Mexican manufactures, which might result in more production in the United States. At the same time, the changes will increase the cost of producing motor vehicles in North America, which could lead to production shifts to Europe or Asia, or lead to a loss of market share to European and Asian firms.

**U.S. Trade Deficit (Surplus)***

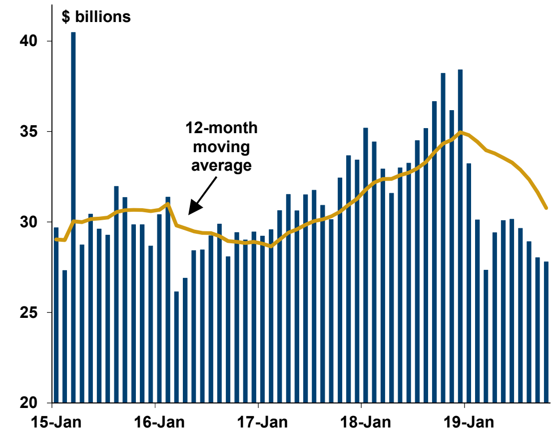



** Goods trade deficit. 12-month moving totals of not seasonally adjusted data. Negative values are trade surpluses.*

*Source: U.S. Census Bureau via Haver Analytics*

We are skeptical about the alleged trade agreement with China. We suspect that the pact will have vague elements that could leave the U.S. and China with different interpretations of their obligations under the agreement. We anticipate charges and counter charges of violations to the agreement in the year ahead. Such disagreements will limit progress on phase-two of negotiations, which would have been difficult in any event. Phase-one involved the easy elements of trade negotiations, and progress here was slow and difficult.

**Monthly Trade Deficit with China***




** Goods trade deficit. Seasonally adjusted data.*

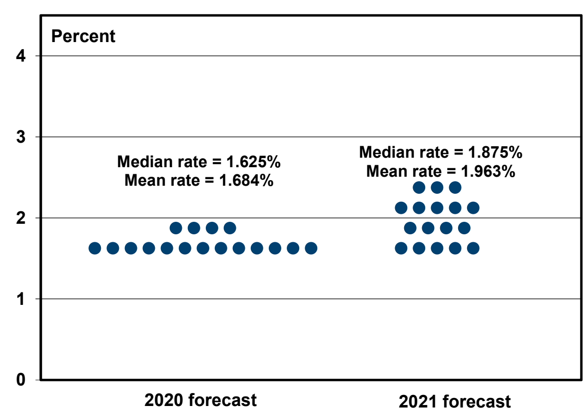
*Source: U.S. Census Bureau via Haver Analytics*

We are hard pressed to draw firm conclusions about the likely influence of the trade agreement. Exports will probably pickup because of promised purchases by China, but imports could rebound as well. As shown in the chart, the trade deficit in goods with China has narrowed since late last year because a drop in imports from China has exceeded a softening in exports to China. Some of the drop in imports reflected an earlier surge to beat the imposition of tariffs, but much of the softness probably reflected the rerouting of supply chains, and here lies the uncertainty: some firms might move activity back to China because of the agreement, but others might continue to utilize their new facilities. In fact, one might imagine that businesses continue to explore alternative supply chains because of strains in the U.S./Chinese relationship. We would look for further narrowing in the U.S. trade deficit with China because of the likely increase in exports and the search for new supply chains, but we do not have a high degree of confidence in this view.

## FOMC: On Hold (For Now)

The latest policy statement and dot plot from the Federal Open Market Committee suggested that the Fed has ended its easing efforts. The statement noted that the current stance of policy is “appropriate” and it dropped a reference to uncertainties in the economic outlook. Thus, officials seem confident that the economy is on track and that it does not need further stimulation. The dot plot supports this view, as no official anticipates additional easing in next year, while four individuals expect to raise interest rates (chart).

**FOMC Rate View: Year-End 2020 & 2021***




** Each dot represents the expected federal funds rate of a Fed official at the ends of 2020 and 2021. Normally, this graph would contain 19 projections (seven governors of the Federal Reserve Board and 12 reserve bank presidents), but two governorships were open at the December 2019 meeting.*

*Source: Federal Open Market Committee, Summary of Economic Projections, December 2019*

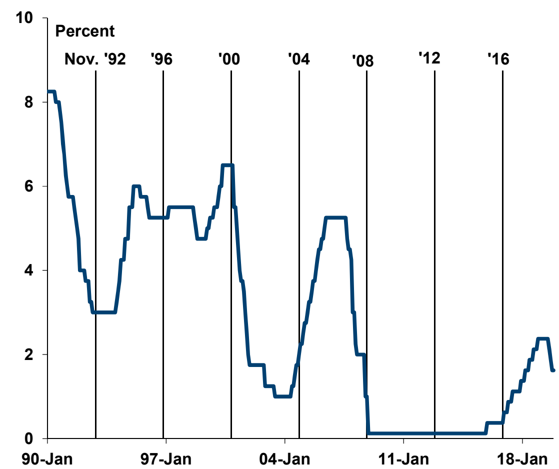
Despite the apparently clear signals, we are not inclined to alter our view that the FOMC will cut rates twice next year. We put no weight on the fact that the dot plot showed steady or higher interest rates next year. We would expect officials to be reluctant to suggest a need for lower interest rates at this time. A projection of lower rates would suggest a failure to keep the economy on track and invite criticism for not easing now in order to avert a downturn. A projection of lower rates also might shake the confidence of business executives and consumers, which could then generate slower growth or a contraction.

The statement did indeed signal steady policy for now. However, it also left open a door for additional easing. That is, the statement noted that officials will be monitoring “global developments and muted inflation pressures” in making its policy decisions. We viewed the reference to global developments as an indirect way of highlighting downside risks associated with slow activity in foreign economies or fallout from the trade war. Risks from the trade war have perhaps diminished because of the possible agreement with China, but as noted above, the effects of that agreement are not clear.

Inflation will have a strong influence on Fed actions in the coming year. If pressures remain muted, officials will respond aggressively to hints of slower economic activity. As noted by Chair Powell in his July 31 press conference, the “overarching goal” of the FOMC is to sustain the economic expansion.

Some analysts will argue the presidential election in 2020 will keep the Fed on the sidelines. Our view is that Fed officials would prefer to remain idle in an election year, but they would shift policy if the economy needed either support or restraint. For example, the Fed showed little variation in its tightening path in 2004 despite the contest between George W. Bush and John Kerry (chart).

**Federal Funds Target Rate**




*Source: Federal Open Market Committee via Haver Analytics; Daiwa Capital Markets America*

There are instances where political motivations might seem in play, but a review of history would show an absence of favoritism. In 1992, for example, the Fed eased throughout the year, ending the cycle shortly before the election. One might conclude that the Fed was making an effort to aid George H.W. Bush in the runoff with Bill Clinton. However, Mr. Bush claimed that he was the victim of Fed bias because the central bank did not ease enough.

The experience in 2000 was interesting, as the Fed was tightening during much of the year, but stopped before the election (last hike was in May). The easing cycle started in January 2001 with a bold move: a 50 basis point change between FOMC meetings. Al Gore might feel that the Fed favored George W. Bush, but one can offer an explanation. The last change in May was aggressive, a 50 basis point shift, perhaps an effort to remain idle during the heart of the election season in the summer and fall. The easing cycle was probably triggered by a sense that the labor market was beginning to deteriorate, which was confirmed by a 0.3 percentage point increase in the unemployment rate in January to 4.2 percent.

The Fed will make an effort to remain politically neutral, but this is a secondary consideration. Officials will alter policy if it is not well calibrated to the economic setting.

# Review

| Week of Dec. 9, 2019 | Actual | Consensus | Comments |
|---|---|---|---|
| **Revised Nonfarm Productivity (2019-Q3)** | **-0.2% (0.1 Pct. Pt. Upward Revision)** | **-0.1% (0.2 Pct. Pt. Upward Revision)** | A modest upward adjustment to the growth of output (2.3% versus 2.1%) exceeded the revision to the growth of hours worked (2.5% versus 2.4%) in the third quarter, resulting in a small upward revision to productivity growth. The revision did little to alter the disappointing tone of the Q3 results after average growth of 3.0% in the first two quarters of 2019. The previous performance suggested a stirring in productivity growth after gains of only slightly more than 1% annually in the prior two years, but the latest results raised doubts about a pickup in the underlying trend. |
| **CPI (November)** | **0.3% Total, 0.2% Core** | **0.2% Total, 0.2% Core** | Energy prices increased 0.8% in November after a spike of 2.7% in the prior month, but shifts in this component are often large and prices have drifted lower on balance since the recent peak in October of last year. Food prices rose only 0.1%, continuing a soft pattern that began in the spring and offsetting pressure seen in the early months of the year. The increase in the core component was a “firm” 0.2%; that is, it rounded down to the published total (0.230%), marking a reversal of the prior month, when the change was less than 0.2% but rounded up to that total (0.157%). Some items posted firm increases (medical care services, recreation services), while others showed notable restraint (new vehicle prices declined for the fifth consecutive month). The latest monthly results left the year-over-year change in the headline index at 2.1%, the firmest reading of the year thus far, but still below most observations in 2018. The core component rose 2.3% in the past 12 months, a reading in the upper portion of the recent range (just a touch below the cyclical high of 2.4% in August and September). |
| **Federal Budget (November)** | **$208.8 Billion Deficit** | **$206.2 Billion Deficit** | Federal revenues jumped 9.3% on a year-over-year basis in November, rebounding from a drop of 2.8% in October and faster than average year-over-year growth of 5.8% in the first nine months of calendar year 2019. The shift reflected primarily firm increases in individual income and payroll taxes, with customs duties also contributing. Outlays rose 5.6% year-over-year, slower than the average of 9.8% in the first 10 months of calendar year 2019. The cumulative deficit of $343 billion in the first 2 months of FY2020 widened by $38 billion versus the same period in FY2019. |

## Review Continued

| Week of Dec. 9, 2019 | Actual | Consensus | Comments |
|---|---|---|---|
| **PPI (November)** | **0.0% Total, 0.0% Core*** | **0.2% Total, 0.2% Core*** | Food prices jumped 1.1% in November after a similar-sized increase in October, hinting at some upward pressure after little change in the first nine months of the year. Energy prices advanced 0.6% after a jump of 2.8% in the prior month, but swings in this volatile component have shown little net change since the summer. In the core component, prices of goods rose 0.2%, but they remain contained from a longer term perspective, showing little net change in the prior ten months. Services prices slipped 0.3%, led by a drop of 0.6% in the volatile trade services category. The year-over-year change in the headline PPI was unchanged from the October reading at 1.1%, down from the recent peak of 3.4% in July of last year. The change in the core PPI declined two ticks to 1.3%, down from the recent peak of 3.1% in September of last year and the slowest increase since the fall of 2016. |
| **Retail Sales (November)** | **0.2% Total, 0.1% Ex-Autos** | **0.5% Total, 0.4% Ex-Autos** | Unimpressive retail sales November and small net downward revisions in the prior two months suggest a lull in consumer activity. New vehicle sales rose 0.5%, and sales at gasoline service stations increased 0.7% (likely reflecting higher prices rather than firmer activity). However, other key areas were weak on balance, as sales excluding autos and gasoline registered no change in the latest month. On the soft side, sales at clothing stores dropped (-0.6%), and activity at restaurants declined for the second consecutive month (-0.3%). Sales at nonstore retailers (+0.8%), in contrast, provided some offset by continuing along its firm upward trend. We are surprised at the soft performance given positive fundamentals for consumer spending (strong labor market and healthy financial positions). We suspect that activity will improve in coming months. A similar soft patch occurred earlier this year (January to March), but sales revived from April through August. |

* *The core PPI excludes food, energy, and trade services.*

*Source: Bureau of Labor Statistics (Revised Nonfarm Productivity, CPI, PPI); U.S. Treasury Department (Federal Budget); U.S. Census Bureau (Retail Sales); Consensus forecasts are from Bloomberg*

# Preview

| Week of Dec. 16, 2019 | Projected | Comments |
|---|---|---|
| **Housing Starts (November) (Tuesday)** | **1.340 Million (+2.0%)** | Firm sales of new homes in September and October will probably stir the construction of single-family homes, while multi-family activity is likely to pick up from a below-average performance in October. |
| **Industrial Production (November) (Tuesday)** | **0.7%** | The return of striking workers at General Motors should lead to a jump in the manufacturing component of industrial production. In addition, an increase in employment in other manufacturing-related industries raises the possibility of small increases elsewhere in the factory sector. An above-average number of heating-degree days in November suggests an increase in utility output, while a drop in the rotary rig count points to soft mining activity. |
| **Current Account (2019-Q3) (Thursday)** | **-$120.0 Billion ($8.2 Billion Narrower Deficit)** | A narrower trade deficit and a slight pickup in income flows will probably lead to an improvement in the current account deficit in Q3. |
| **Existing Home Sales (November) (Thursday)** | **5.50 Million (+0.7%)** | Mortgage interest rates have increased from their lows in September, but they are probably still attractive enough to provide additional support to the housing market. |
| **Leading Indicators (November) (Thursday)** | **0.0%** | An increase in stock prices is likely to offset the influence of a drop in the new orders component of the ISM index, leaving little or no change in the leading indicators index. A modest change would reinforce the nearly flat trend of the past year. |
| **Revised GDP (2019-Q3) (Friday)** | **2.2% (+0.1 Pct. Pt. Revision)** | Small upward adjustments to business investment in structures, state and local construction, and exports of services will probably more than offset downward revisions to residential construction and inventory investment, leaving GDP growth slightly stronger than previously estimated. |
| **Personal Income, Consumption, Core Price Index (November) (Friday)** | **0.4%, 0.3%, 0.1%** | Strong job growth in November will probably fuel the wage and salary component of personal income, while rental income and dividends are likely to contribute positively as well. A pickup in vehicle sales and strong on-line spending should boost outlays despite slow activity at brick and mortar outlets. Results from the CPI suggest that PCE inflation will remain range bound. |
| **Revised Consumer Sentiment (December) (Friday)** | **99.2 (Unrevised)** | The strong reading on the labor market in November and the steady performance of the equity market should hold the sentiment close to the elevated reading in the preliminary estimate published on December 6. |

*Source: Forecasts provided by Daiwa Capital Markets America*

# Economic Indicators

## December 2019 / January 2020

### Monday 9

### Tuesday 10

**NFIB SMALL BUSINESS OPTIMISM INDEX**

| | |
|---|---|
| Sept | 101.8 |
| Oct | 102.4 |
| Nov | 104.7 |

**REVISED PRODUCTIVITY & COSTS**

| | Productivity | Unit Labor Costs |
|---|---|---|
| 19-Q2 | 2.5% | 0.1% |
| 19-Q3(p) | -0.3% | 3.6% |
| 19-Q3(r) | -0.2% | 2.5% |

**FOMC MEETING**

### Wednesday 11

**CPI**

| | Total | Core |
|---|---|---|
| Sept | 0.0% | 0.1% |
| Oct | 0.4% | 0.2% |
| Nov | 0.3% | 0.2% |

**FEDERAL BUDGET**

| | 2019 | 2018 |
|---|---|---|
| Sept | $82.8B | $119.1B |
| Oct | -$134.5B | -$100.5B |
| Nov | -$208.8B | -$204.9B |

**FOMC DECISION**

**POWELL PRESS CONFERENCE**

### Thursday 12

**INITIAL CLAIMS**

| | |
|---|---|
| Nov 23 | 213,000 |
| Nov 30 | 203,000 |
| Dec 07 | 252,000 |

**PPI**

| | Final Demand | Core* |
|---|---|---|
| Sept | -0.3% | 0.0% |
| Oct | 0.4% | 0.1% |
| Nov | 0.0% | 0.0% |

### Friday 13

**RETAIL SALES**

| | Total | Ex.Autos |
|---|---|---|
| Sept | -0.4% | -0.2% |
| Oct | 0.4% | 0.3% |
| Nov | 0.2% | 0.1% |

**IMPORT/EXPORT PRICES**

| | Non-fuel Imports | Nonagri. Exports |
|---|---|---|
| Sept | -0.1% | -0.2% |
| Oct | -0.2% | -0.2% |
| Nov | -0.1% | 0.0% |

**BUSINESS INVENTORIES**

| | Inventories | Sales |
|---|---|---|
| Aug | -0.1% | 0.1% |
| Sept | -0.1% | -0.4% |
| Oct | 0.2% | -0.1% |

### Monday 16

**EMPIRE MFG (8:30)**

| | |
|---|---|
| Oct | 4.0 |
| Nov | 2.9 |
| Dec | -- |

**NAHB HOUSING INDEX (10:00)**

| | |
|---|---|
| Oct | 71 |
| Nov | 70 |
| Dec | -- |

**TIC DATA (4:00)**

| | Total | Net L-T |
|---|---|---|
| Aug | $41.9B | -$41.2B |
| Sept | -$37.6B | $49.5B |
| Oct | -- | -- |

### Tuesday 17

**HOUSING STARTS (8:30)**

| | |
|---|---|
| Sept | 1.266 million |
| Oct | 1.314 million |
| **Nov** | **1.340 million** |

**IP & CAP-U (9:15)**

| | IP | Cap.Util. |
|---|---|---|
| Sept | -0.3% | 77.5% |
| Oct | 0.8% | 76.7% |
| **Nov** | **0.7%** | **77.5%** |

**JOLTS DATA (10:00)**

| | Openings (000) | Quit Rate |
|---|---|---|
| Aug | 7,301 | 2.4% |
| Sept | 7,024 | 2.3% |
| Oct | -- | -- |

### Wednesday 18

### Thursday 19

**INITIAL CLAIMS (8:30)**

**CURRENT ACCOUNT (8:30)**

| | |
|---|---|
| 19-Q1 | -$136.2 bill. |
| 19-Q2 | -$128.2 bill. |
| **19-Q3** | **-$120.0 bill.** |

**PHILLY FED INDEX (8:30)**

| | |
|---|---|
| Oct | 5.6 |
| Nov | 10.4 |
| Dec | -- |

**EXISTING HOME SALES (10:00)**

| | |
|---|---|
| Sept | 5.36 million |
| Oct | 5.46 million |
| **Nov** | **5.50 million** |

**LEADING INDICATORS (10:00)**

| | |
|---|---|
| Sept | -0.2% |
| Oct | -0.1% |
| **Nov** | **0.0%** |

### Friday 20

**REVISED GDP (8:30)**

| | GDP | Chained Price |
|---|---|---|
| 19-Q2 | 2.0% | 2.4% |
| 19-Q3(p) | 2.1% | 1.8% |
| **19-Q3(r)** | **2.2%** | **1.8%** |

**PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX (8:30)**

| | Inc. | Cons. | Core |
|---|---|---|---|
| Sept | 0.3% | 0.2% | 0.0% |
| Oct | 0.0% | 0.3% | 0.1% |
| **Nov** | **0.4%** | **0.3%** | **0.1%** |

**REVISED CONSUMER SENTIMENT (10:00)**

| | |
|---|---|
| Oct | 95.5 |
| Nov | 96.8 |
| Dec(p) | 99.2 |

### Monday 23

**CHICAGO FED NATIONAL ACTIVITY INDEX**

**NEW HOME SALES**

### Tuesday 24

**DURABLE GOODS ORDERS**

### Wednesday 25

***CHRISTMAS DAY***

### Thursday 26

**INITIAL CLAIMS**

### Friday 27

### Monday 30

**U.S. INTERNATIONAL TRADE IN GOODS**

**ADVANCE INVENTORIES**

**CHICAGO PURCHASING MANAGERS' INDEX**

**PENDING HOME SALES**

### Tuesday 31

**FHFA HOME PRICE INDEX**

**S&P CORELOGIC CASE-SHILLER HOME PRICE INDEX**

**CONSUMER CONFIDENCE**

### Wednesday 1

***NEW YEAR'S DAY***

### Thursday 2

**INIITIAL CLAIMS**

### Friday 3

**ISM MANUFACTURING INDEX**

**CONSTRUCTION SPEND.**

**FOMC MINUTES**

**VEHICLE SALES**

* *The core PPI excludes food, energy, and trade services.*

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

# Treasury Financing

## December 2019 / January 2020

| Monday | Tuesday | Wednesday | Thursday | Friday |
|---|---|---|---|---|
| 9 | 10 | 11 | 12 | 13 |
| **AUCTION RESULTS:**<br>Rate Cover<br>13-week bills 1.520% 2.77<br>26-week bills 1.520% 2.98<br>3-year notes 1.632% 2.56 | **AUCTION RESULTS:**<br>Rate Cover<br>10-yr notes 1.842% 2.43<br>**ANNOUNCE:**<br>$40 billion 4-week bills for auction on December 12<br>$35 billion 8-week bills for auction on December 12<br>**SETTLE:**<br>$40 billion 4-week bills<br>$35 billion 8-week bills | | **AUCTION RESULTS:**<br>Rate Cover<br>4-week bills 1.540% 2.59<br>8-week bills 1.540% 2.69<br>30-yr bonds 2.307% 2.46<br>**ANNOUNCE:**<br>$78 billion 13-,26-week bills for auction on December 16<br>$18 billion 2-year FRNs for auction on December 18<br>$15 billion 5-year TIPS for auction on December 19<br>**SETTLE:**<br>$78 billion 13-,26-week bills | |
| 16 | 17 | 18 | 19 | 20 |
| **AUCTION:**<br>$78 billion 13-,26-week bills<br>**SETTLE:**<br>$38 billion 3-year notes<br>$24 billion 10-year notes<br>$16 billion 30-year bonds | **ANNOUNCE:**<br>$40 billion* 4-week bills for auction on December 19<br>$35 billion* 8-week bills for auction on December 19<br>**SETTLE:**<br>$40 billion 4-week bills<br>$35 billion 8-week bills | **AUCTION:**<br>$18 billion 2-year FRNs | **AUCTION:**<br>$40 billion* 4-week bills<br>$35 billion* 8-week bills<br>$15 billion 5-year TIPS<br>**ANNOUNCE:**<br>$78 billion* 13-,26-week bills for auction on December 23<br>$40 billion* 2-year notes for auction on December 23<br>$41 billion* 5-year notes for auction on December 24<br>$32 billion* 7-year notes for auction on December 26<br>**SETTLE:**<br>$78 billion 13-,26-week bills | |
| 23 | 24 | 25 | 26 | 27 |
| **AUCTION:**<br>$78 billion* 13-,26-week bills<br>$40 billion* 2-year notes | **AUCTION:**<br>$41 billion* 5-year notes<br>**ANNOUNCE:**<br>$40 billion* 4-week bills for auction on December 26<br>$35 billion* 8-week bills for auction on December 26<br>**SETTLE:**<br>$40 billion* 4-week bills<br>$35 billion* 8-week bills | ***CHRISTMAS DAY*** | **AUCTION:**<br>$40 billion* 4-week bills<br>$35 billion* 8-week bills<br>$32 billion* 7-year notes<br>**ANNOUNCE:**<br>$78 billion* 13-,26-week bills for auction on December 30<br>$26 billion* 52-week bills for auction on December 30<br>**SETTLE:**<br>$78 billion* 13-,26-week bills | **SETTLE:**<br>$18 billion* 2-year FRNs |
| 30 | 31 | 1 | 2 | 3 |
| **AUCTION:**<br>$78 billion* 13-,26-week bills<br>$26 billion* 52-week bills | **ANNOUNCE:**<br>$40 billion* 4-week bills for auction on January 2<br>$35 billion* 8-week bills for auction on January 2<br>**SETTLE:**<br>$40 billion* 4-week bills<br>$35 billion* 8-week bills<br>$40 billion* 2-year notes<br>$41 billion* 5-year notes<br>$32 billion* 7-year notes<br>$15 billion 5-year TIPS | ***NEW YEAR'S DAY*** | **AUCTION:**<br>$40 billion* 4-week bills<br>$35 billion* 8-week bills<br>**ANNOUNCE:**<br>$78 billion* 13-,26-week bills for auction on January 6<br>$38 billion* 3-year notes for auction on January 7<br>$24 billion* 10-year notes for auction on January 8<br>$16 billion* 30-year bonds for auction on January 9<br>**SETTLE:**<br>$78 billion* 13-,26-week bills<br>$26 billion* 52-week bills | |

*Estimate