U.S. Economic Comment

- Improving trade balance: ambiguous implications
- The labor market: December results suggest still some slack

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Sliding Imports: Weak demand or Production Shifts?

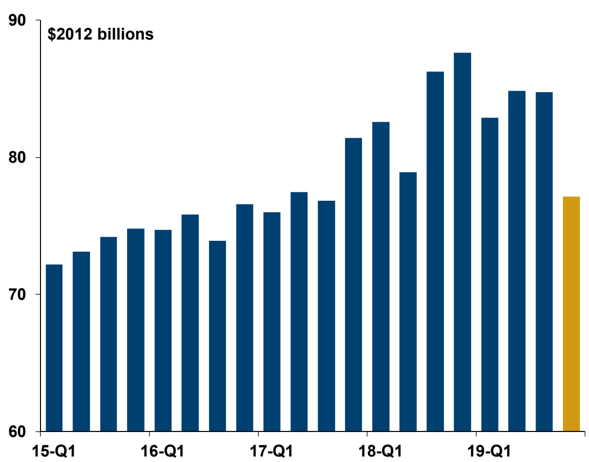
The international trade sector of the U.S. economy faces some notable challenges: slow growth in the economies of major trading partners, a firm foreign exchange value of the dollar, and potential fallout from trade disputes. Despite these hurdles, the trade balance of the United States has improved in 2019, with the latest monthly results (available only through November) suggesting a marked shift in the fourth quarter.

A narrower deficit, all else equal, represents a positive factor in the calculation of GDP, and the improvement in recent months sets the stage for a sizeable contribution to the level and growth of output in the final months of the year. The potential influence is evident in the real trade deficit in goods, where the average in October and November was notably smaller than readings in other recent quarters (chart, left). If results for December match the average for October and November, and if trade in services does not provide a surprise, net exports would add approximately 1¾ percentage point to GDP growth.

This calculation assumes that all else remains equal, but that might not be the case. If the narrowing of the deficit reflects weak domestic demand and an associated drop in imports, GDP growth could still prove to be soft; the improvement in trade would merely offset the weak domestic demand rather than boost the rate of growth. The influence is still welcome because it transfers the effect of weak demand to another economy and thus insulates the domestic economy, but it is still different than a spark that lifts growth to a faster pace.

The improvement in trade flows so far in Q4 has in fact occurred on the import side, as real imports of goods are on track to decline at an annual rate of almost 14 percent (chart, right), much sharper than the fall of approximately 2.5 percent in the real export of goods. Part of the slide in imports might be attributed to soft demand. Imports of capital goods, for example, have eased, no doubt because of the reluctance of business executives to invest in an uncertain economic environment.

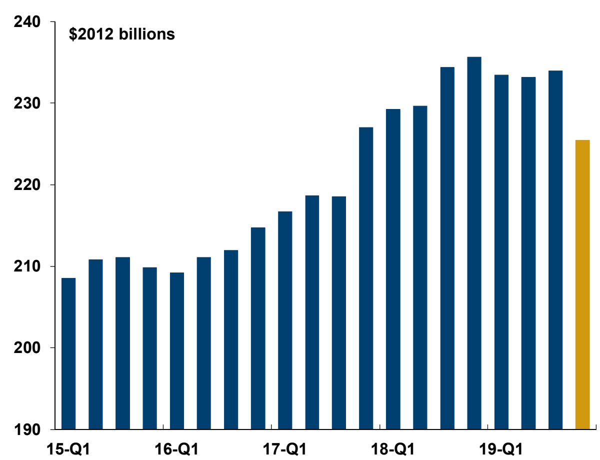
Real Goods Trade Deficit*



** Quarterly averages of monthly data. The reading for 2019-Q4 (gold bar) is the average of the real trade deficit in goods for October and November.*

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

Real Imports of Goods*

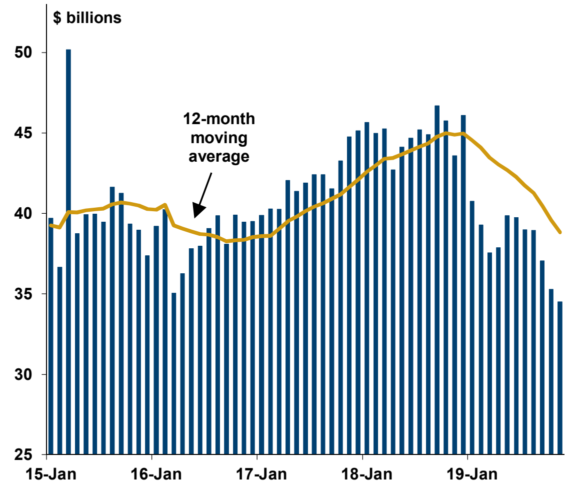


** Quarterly averages of monthly data. The reading for 2019-Q4 (gold bar) is the average of real imports of goods for October and November.*

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

A larger share of the decline in imports, though, seems to reflect the influence of tariffs, as most of the retreat has involved trade with China. After peaking in late 2018, imports from China have eased in most months of 2019 and have moved to multi-year lows (chart). Demand in the U.S. has not dropped to this degree, and thus the collapse in imports from China reflects the influence of tariffs and would seem to have the potential to boost activity elsewhere. However, it is not obvious who has benefitted from China's diminished exports to the United States.

Imports of Goods from China



Source: Bureau of Economic Analysis via Haver Analytics

China's loss could represent gains to other countries, but this does not seem to be the case, as such a shift would leave overall imports steady, with China losing ground and others capturing market share. However, imports ex-China also have declined.

The decline in imports might imply that production was shifting to the United States, the outcome President Trump undoubtedly had in mind when he began his trade war. However, it is hard to argue that a pronounced shift has occurred. Such a change would boost manufacturing activity in the U.S., but most reports related to the factory sector have remained soft. Order flows ex-transportation (to eliminate volatility and softness related to Boeing) have been moving sideways for more than a year, and production has been stagnant as well. Employment in the factory sector has increased only modestly since the spring. This sector posted a respectable net gain in payrolls in October and November (13,000), but it gave nearly all of the advance back in December with a drop of 12,000.

Another possibility, and perhaps the most likely, is that slow imports into the U.S. have represented timing changes rather than fundamental shifts. Specifically, firms in China seemed to rush goods into the U.S. in 2018 before tariffs became effective, and they are now drawing down inventories as a substitute for new shipments into the United States. The pattern of imports from China (strong during much of 2018 and notably soft in 2019) supports this view, as does a decline in wholesale inventories in Q3 and possibly Q4.

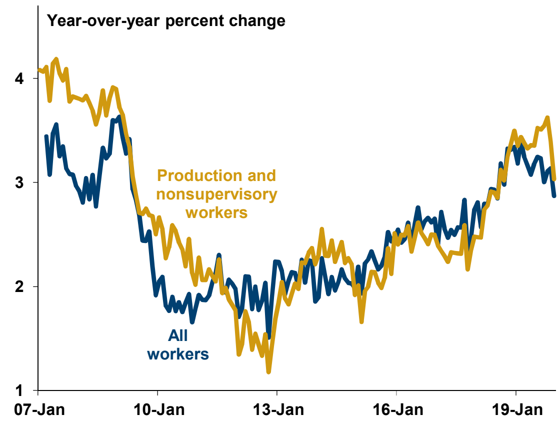
The ultimate effects of the tariffs are still evolving and most likely will take years rather than months to unfold. We suspect that the largest change will involve an increase in imports from other developing nations, followed by a small pickup in production in the United States. China could regain some of its lost ground, as a weak yuan will allow some reduction in prices that can offset the effects of tariffs and limit China's loss of competitiveness.

The Labor Market: Rising Prime-Age Participation; Moderate Wage Growth

We were not bothered by the moderate increase in payroll employment in December (145,000), as such an advance at a time of low unemployment is a respectable performance. Also, we suspect that below-average performances in some key industries represented random volatility rather than fundamental shifts (health care and business services stand out in this regard). These areas will most likely post firmer results in coming months.

While job growth was not troubling, we were disappointed with another aspect of the report: the meager increase in average hourly earnings (0.1 percent). Soft readings will occur from time to time, but the modest increase in December represented the second slow month in the past four, and it left the year-over-year change at 2.9 percent, down from 3.2 percent in August and a cyclical peak of 3.4 percent in February. Initially, the softness was concentrated among managerial or supervisory workers. Increases for so-called production workers remained firm for a time, but these workers also have seen soft results in the past two months. Indeed, year-over-year wage growth for production workers has tumbled in the past two months, retreating to 3.0 percent in December from a cyclical peak of 3.6 percent in October (chart).

Average Hourly Earnings



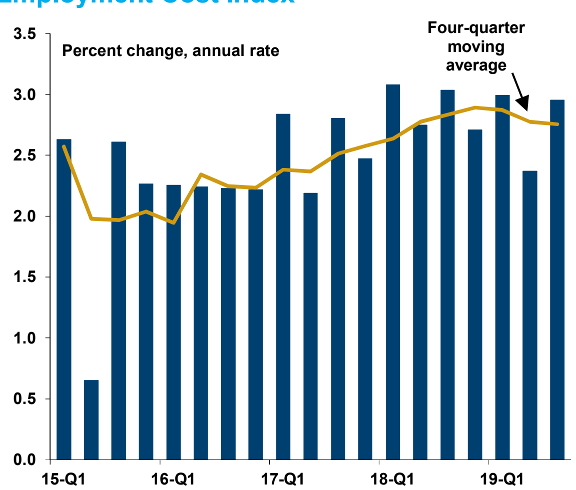
Source: Bureau of Labor Statistics via Haver Analytics

Some of the softness in average hourly earnings might be the result of a compositional change in employment. This measure is not a fixed-weight gauge; that is, readings will change as the composition of the labor force shifts. Brisk job growth in higher-paying positions will pull the measure higher even if wage rates are unchanged, while rapid advances in lower-paying positions will restrain the average. Employment in the leisure and hospitality sector has been strong in the past few months, and many of the positions in this industry are low paying. The retail trade industry also has posted solid job growth in the past four months, and wages in this area also are typically below the national average.

While the composition of employment has probably restrained the average earnings figure, we would not push this explanation too far, as another measure of labor compensation -- the employment cost index -- also has started to hesitate lately. Growth in this measure, which is fixed-weight and therefore a better guide than average hourly earnings, was trending higher during 2017 and 2018 but it has eased so far this year (chart, below left; data available only through the third quarter). Thus, recent shifts in both average hourly earnings and the employment cost index suggest that wage pressure is not intense.

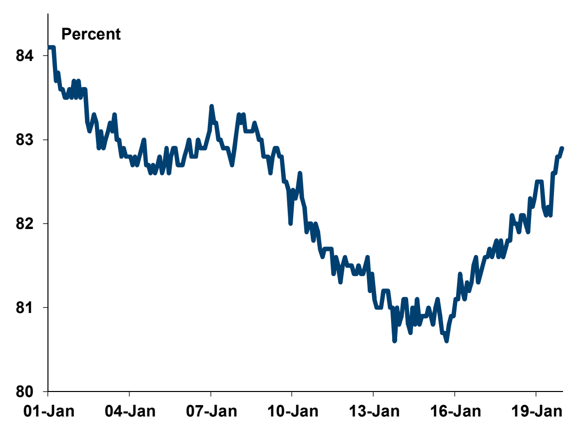
Some observers, including some Fed officials, have argued that labor markets are not especially tight despite the low level of the unemployment rate. They see the labor market as having some remaining slack. Another element of the employment report provides support for this view, as the labor force participation rate for prime age workers has surged in recent months and returned to the range from the prior expansion (chart, below right). A drop in this measure in the early months of the year had suggested a tightness that easily

Employment Cost Index



Sources: Bureau of Labor Statistics via Haver Analytics

Labor-Force Participation: Prime-Age Workers*



* *Labor-force participants aged 25 to 54 as a share of the civilian noninstitutional population aged 25 to 54.*

Source: Bureau of Labor Statistics via Haver Analytics could push wages noticeably higher. Recent results, though, suggest that firms have additional workers to draw from.

Interestingly, the overall labor force participation rate has not changed appreciably this year. The pickup has been modest because retiring baby boomers have offset most of the advance of those in their prime working years. This compositional/demographic shift offers another explanation for the limited upward pressure on wage growth. Retiring individuals are probably at or close to their peak earning years, and they are now being replaced by individuals at lower levels on the pay scale. As a result, the overall wage bill of businesses and average wage rates will not be under notable pressure despite a solid performance in the economy and healthy job growth.

Review

Week of Jan. 6, 2020	Actual	Consensus	Comments
Trade Balance (November)	**-$43.1 Billion ($3.8 Billion Narrower Deficit)**	**-$43.6 Billion ($3.6 Billion Narrower Deficit)**	The month-to-month improvement in the trade deficit reflected changes on both sides of the trade ledger (exports up 0.7%, imports off 1.0%). The improvement followed noticeable narrowing of the deficit for October, leaving results so far in Q4 much improved from the performance in Q3. The results suggest that net exports will make a sharp positive contribution to GDP growth in the fourth quarter.
ISM Nonmanufacturing Index (December)	**55.0% (+1.1 Pct. Pts.)**	**54.5% (+0.6 Pct. Pt.)**	The December reading on the ISM nonmanufacturing index was about in the middle of the range of the past few months, but it lagged the firmer results seen in the prior year (average of 58.9% in 2018). The business activity index rose sharply (5.6 percentage points), but the change occurred from a low level and thus the new reading was not especially impressive (57.2%). Other components were subdued. The new orders index fell 2.2 percentage points to 54.9%, a reading in the low portion of the recent range. The employment index eased 0.3 percentage point to 55.2%, continuing to hover in the middle of the recent range.
Factory Orders (November)	**-0.7%**	**-0.8%**	The retreat in factory orders for November was concentrated in the durable component, which fell 2.1%. Most of this decline reflected a drop of 35.5% in aircraft bookings, but orders elsewhere also lacked vigor (up only 0.1% ex aircraft). The November results outside of aircraft continued a pattern of ups and downs that has traced an essentially flat trend. Nondurable orders rose 0.6%. Much of this increase occurred in the petroleum and coal category and was probably influenced by higher prices. Orders for nondurable goods other than petroleum and coal rose 0.1%. This area has stalled in the past three months after a firm advance in the late spring and summer.
Payroll Employment (December)	**145,000**	**160,000**	The payroll report carried a soft tone, as the increase in nonfarm payrolls trailed the average of 223,000 in 2018 and 178,000 in the first 11 months of 2019. In addition, results in the prior two months were revised lower by 14,000 combined. The increase of only 0.1% in average hourly earnings represented the most disappointing aspect of the report. The feeble increase marked the second soft showing in the past four months (unchanged in September), which has moved the year-over-year change to 2.9%, down from 3.2% in August and 3.4% in February. A steady reading on the unemployment rate was a “strong” performance in that it reflected a solid increase in the size of the labor force (209,000) that was exceeded by an increase in employment as measured by the household survey (267,000).

Source: Bureau of Economic Analysis (Trade Balance); Institute for Supply Management (ISM Nonmanufacturing Index); U.S. Census Bureau (Factory Orders); Bureau of Labor Statistics (Payroll Employment); Consensus forecasts are from Bloomberg

Preview

Week of Jan. 13, 2020	Projected	Comments
Federal Budget (December) (Monday)	**$20 Billion Deficit**	Available data suggest sold growth in federal revenues (up approximately 7.0% from the same month last year), but outlays also are likely to be firm, leaving the monthly deficit slightly wider than the $13.5 billion registered in December 2018. The expected shortfall would leave the running 12-month deficit at slightly more than $1.0 trillion for the third consecutive month.
CPI (December) (Tuesday)	**0.3% Total, 0.2% Core**	The drop in gasoline prices at the consumer level was smaller than the seasonal norm, which should result in an increase in energy prices after seasonal adjustment. Pickups in rent and apparel prices after two soft months will probably lead to the third consecutive increase of 0.2% in the core CPI.
PPI (December) (Wednesday)	**0.1% Total, 0.1% Core***	The energy component of the producer price index is likely to be little changed, as the drop in gasoline prices was about in line with the seasonal norm. The food component could ease after outsized increases in the prior two months, and core goods prices are likely to remain on their subdued path (up less than 0.1% on average in the past 12 months). Service prices have the potential to surprise, but they have shown little net change in recent months.
Retail Sales (December) (Thursday)	**0.2% Total, 0.3% Ex-Autos**	Press reports of favorable holiday sales suggest firm results in several categories of the retail report (clothing, general merchandise, sporting goods, on-line), but a drop in sales of new vehicles could constrain the auto component, and lower prices of gasoline could limit the value of sales at service stations.
Housing Starts (December) (Friday)	**1.380 Million (+1.1%)**	Firm sales of new homes and comfortable inventories should lead to a gain in housing starts, a view supported by elevated readings on builder sentiment. The expected reading represents a new high for the current cycle.
Industrial Production (December) (Friday)	**-0.2%**	A sharp drop in the ISM production index and soft factory employment suggest that the manufacturing component of IP will decline. A drop in the rotary rig count points to a fourth consecutive decline in mining activity (although the declines have been small). A below-average reading on heating degree days should lead to a drop in utility output.
Consumer Sentiment (January) (Friday)	**99.0 (-0.3 Index Pt.)**	Record equity prices are likely to cheer many individuals, but tensions in the Mideast could leave others concerned.

** The core PPI excludes food, energy, and trade services.*
Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

January 2020

Monday 6

Tuesday 7

TRADE BALANCE

Sept	-$51.1 billion
Oct	-$46.9 billion
Nov	-$43.1 billion

ISM NON-MFG INDEX

	Index	Prices
Oct	54.7	56.6
Nov	53.9	58.5
Dec	55.0	58.5

FACTORY ORDERS

Sept	-0.8%
Oct	0.2%
Nov	-0.7%

Wednesday 8

ADP EMPLOYMENT REPORT

	Private Payrolls
Oct	151,000
Nov	124,000
Dec	202,000

CONSUMER CREDIT

Sept	$8.9 billion
Oct	$19.0 billion
Nov	$12.5 billion

Thursday 9

INITIAL CLAIMS

Dec 21	224,000
Dec 28	223,000
Jan 04	214,000

Friday 10

EMPLOYMENT REPORT

	Payrolls	Un. Rate
Oct	152,000	3.6%
Nov	256,000	3.5%
Dec	145,000	3.5%

WHOLESALE TRADE

	Inventories	Sales
Sept	-0.7%	-0.1%
Oct	0.1%	-0.9%
Nov	-0.1%	1.5%

Monday 13

FEDERAL BUDGET (2:00)

	2019	2018
Oct	-$134.5B	-$100.5B
Nov	-$208.8B	-$204.9B
Dec	**-$20.0B**	-$13.5B

Tuesday 14

NFIB SMALL BUSINESS OPTIMISM INDEX (6:00)

Oct	102.4
Nov	104.7
Dec	--

CPI (8:30)

	Total	Core
Oct	0.4%	0.2%
Nov	0.3%	0.2%
Dec	**0.3%**	**0.2%**

Wednesday 15

PPI (8:30)

	Final Demand	Core*
Oct	0.4%	0.1%
Nov	0.0%	0.0%
Dec	**0.1%**	**0.1%**

EMPIRE MFG (8:30)

Nov	2.9
Dec	3.5
Jan	--

BEIGE BOOK (2:00)

November Beige Book

"Economic activity expanded modestly from October through mid-November…"

Thursday 16

INITIAL CLAIMS (8:30)

RETAIL SALES (8:30)

	Total	Ex.Autos
Oct	0.4%	0.3%
Nov	0.2%	0.1%
Dec	**0.2%**	**0.3%**

IMPORT/EXPORT PRICES (8:30)

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

PHILLY FED INDEX (8:30)

Nov	8.4
Dec	2.4
Jan	--

BUSINESS INVENTORIES (10:00)

	Inventories	Sales
Sept	-0.1%	-0.4%
Oct	0.1%	-0.1%
Nov	**-0.2%**	**0.7%**

NAHB HOUSING INDEX (10:00)

Nov	71
Dec	76
Jan	--

TIC DATA (4:00)

	Total	Net L-T
Sept	-$38.1B	$49.5B
Oct	-$48.3B	$32.5B
Nov	--	--

Friday 17

HOUSING STARTS (8:30)

Oct	1.323 million
Nov	1.365 million
Dec	**1.380 million**

IP & CAP-U (9:15)

	IP	Cap.Util.
Oct	-0.9%	76.6%
Nov	1.1%	77.3%
Dec	**-0.2%**	**77.0%**

CONSUMER SENTIMENT (10:00)

Nov	96.8
Dec	99.3
Jan	**99.0**

JOLTS DATA (10:00)

	Openings (000)	Quit Rate
Sept	7,032	2.3%
Oct	7,267	2.3%
Nov	--	--

Monday 20

MARTIN LUTHER KING JR. DAY

Tuesday 21

Wednesday 22

CHICAGO FED NATIONAL ACTIVITY INDEX

FHFA HOME PRICE INDEX

EXISTING HOME SALES

Thursday 23

INIITIAL CLAIMS

LEADING INDICATORS

Friday 24

Monday 27

NEW HOME SALES

Tuesday 28

DURABLE GOODS ORDERS

S&P CORELOGIC CASE-SHILLER HOME PRICE INDEX

CONSUMER CONFIDENCE

FOMC MEETING

Wednesday 29

U.S. INTERNATIONAL TRADE IN GOODS

ADVANCE INVENTORIES

PENDING HOME SALES

FOMC DECISION

Thursday 30

INIITIAL CLAIMS

Q4 GDP

Friday 31

PERSONAL INCOME, CONSUMPTION, PRICES

EMPLOYMENT COST INDEX

CHICAGO PURCHASING MANAGERS' INDEX

REVISED CONSUMER SENTIMENT

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

Treasury Financing

January 2020

Monday	Tuesday	Wednesday	Thursday	Friday
6	7	8	9	10
AUCTION RESULTS: Rate Cover 13-week bills 1.520% 2.94 26-week bills 1.520% 3.09	**AUCTION RESULTS:** Rate Cover 3-year notes 1.567% 2.45 **ANNOUNCE:** $35 billion 4-week bills for auction on January 9 $35 billion 8-week bills for auction on January 9 **SETTLE:** $35 billion 4-week bills $35 billion 8-week bills	**AUCTION RESULTS:** Rate Cover 10-yr notes 1.869% 2.45	**AUCTION RESULTS:** Rate Cover 4-week bills 1.490% 3.38 8-week bills 1.515% 2.99 30-yr bonds 2.341% 2.54 **ANNOUNCE:** $78 billion 13-,26-week bills for auction on January 13 **SETTLE:** $78 billion 13-,26-week bills	
13	14	15	16	17
AUCTION: $78 billion 13-,26-week bills	**ANNOUNCE:** $35 billion* 4-week bills for auction on January 16 $35 billion* 8-week bills for auction on January 16 **SETTLE:** $35 billion 4-week bills $35 billion 8-week bills	**SETTLE:** $38 billion 3-year notes $24 billion 10-year notes $16 billion 30-year bonds	**AUCTION:** $35 billion* 4-week bills $35 billion* 8-week bills **ANNOUNCE:** $78 billion* 13-,26-week bills for auction on January 21 $14 billion* 10-year TIPS for auction on January 23 **SETTLE:** $78 billion 13-,26-week bills	
20	21	22	23	24
MARTIN LUTHER KING JR. DAY	**AUCTION:** $78 billion* 13-,26-week bills **ANNOUNCE:** $45 billion* 4-week bills for auction on January 23 $40 billion* 8-week bills for auction on January 23 **SETTLE:** $35 billion* 4-week bills $35 billion* 8-week bills		**AUCTION:** $45 billion* 4-week bills $40 billion* 8-week bills $14 billion* 10-year TIPS **ANNOUNCE:** $78 billion* 13-,26-week bills for auction on January 27 $26 billion* 52-week bills for auction on January 28 $20 billion* 2-year FRNs for auction on January 28 $40 billion* 2-year notes for auction on January 27 $41 billion* 5-year notes for auction on January 27 $32 billion* 7-year notes for auction on January 28 **SETTLE:** $78 billion* 13-,26-week bills	
27	28	29	30	31
AUCTION: $78 billion* 13-,26-week bills $40 billion* 2-year notes $41 billion* 5-year notes	**AUCTION:** $26 billion* 52-week bills $20 billion* 2-year FRNs $32 billion* 7-year notes **ANNOUNCE:** $45 billion* 4-week bills for auction on January 30 $40 billion* 8-week bills for auction on January 30 **SETTLE:** $45 billion* 4-week bills $40 billion* 8-week bills		**AUCTION:** $45 billion* 4-week bills $40 billion* 8-week bills **ANNOUNCE:** $78 billion* 13-,26-week bills for auction on February 3 **SETTLE:** $78 billion* 13-,26-week bills $26 billion* 52-week bills	**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

*Estimate