U.S. Economic Comment

- The coronavirus and monetary policy: finger on the trigger
- The U.S. economy: modest room to absorb downside risks

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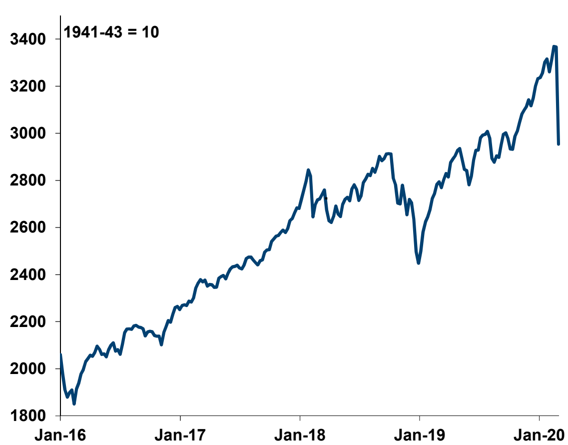
Monetary Policy: Waiting for Evidence

It will be difficult for the U.S. economy to avoid fallout from the coronavirus. Already, many businesses have restricted travel, and some tourists (both U.S. and foreign) have most likely altered plans as well. Disruptions to supply chains could force production cuts, and sporting and other events could be cancelled, as they have been in parts of Europe and Asia. Even if events are not cancelled, attendance is likely to fall short of norms. In addition, the retreat in the equity market has added another dimension, as the swoon could shake confidence and trigger wealth-related cuts in spending by both individuals and businesses.

Risks to the outlook have moved to the downside, which might call for an insurance move from the Federal Reserve. However, both the magnitude and the duration of the virus's effects are highly uncertain at this point, and thus the Fed will probably not act until it has a clearer sense the outlook. Fed Vice-Chair Richard Clarida suggested steady policy in the near term, as he indicated this week that it is too soon to even speculate about the influence of the virus. In addition, the statement by Chair Powell on Friday afternoon suggested that officials wish to gather more information on the effects of the virus before they act. ("The Federal Reserve is closely monitoring developments and their implications for the economic outlook. We will use our tools and act as appropriate to support the economy.")

The decision this week by the Bank of Korea to hold policy steady also supports the notion that central bankers will not rush to judgment on the proper policy response to the virus. Officials in Korea could have justified a cut in interest rates because of the elevated number of infections and concrete signs of economic fallout. However, persistence also is a key consideration. If the spread of the virus were to diminish, the softening in the economy would most likely abate quickly and much of the lost activity could easily be recovered. Policymakers most likely will wish to have some insight into the duration of the economic effects before they respond.

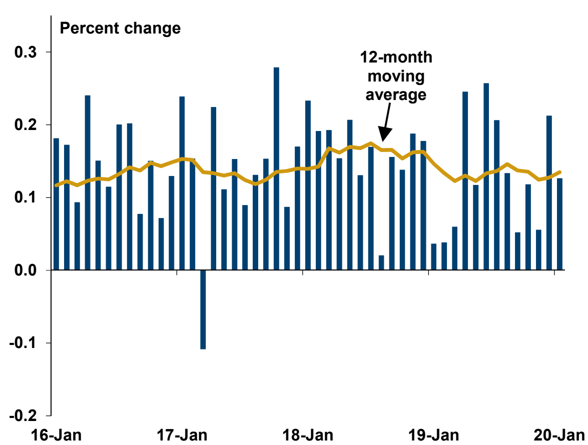
S&P 500 Index*



* Weekly average data through February 21, 2020. The last observation is a closing quote for February 28, 2020.

Sources: Standard and Poor's via Haver Analytics; Bloomberg

Core PCE Price Index



PCE = personal consumption expenditures

Source: Bureau of Economic Analysis via Haver Analytics

Some observers have argued that easier monetary policy would be fruitless in the current environment, and therefore the Fed should hold its fire power. Their point has merit, as businesses and consumers are not likely to undertake risky travel because interest rates are lower. Similarly, lower interest rates will not be helpful in addressing shortages of inputs because of broken supply chains.

Nevertheless, we look for the Fed and other central banks to respond if the virus does not appear to be dying out quickly. Some economic activity will be sensitive to lower interest rates, and policymakers will seek to stir those areas and provide offsets to sectors that will weaken. In addition, contained inflation argues for erring on the side of policy accommodation.

In this regard, the latest reading on the price index for personal consumption expenditures was tame, as both the headline and core measures rose only 0.1 percent in January. The modest advance in the core index was a surprise, as analysts were looking for an increase of 0.2 percent with some thought of the measure rounding up to 0.3 percent. The monthly change in the core index pushed the year-over-year increase higher, but the change was modest (1.6 percent versus 1.5 percent in December) and it remained below the Fed's target of 2.0 percent (chart, prior page).

The Starting Point: On Track, but Little Downside Tolerance

Underlying conditions in the economy will have an influence on the response of central banks to virus risks. Data for the United States in January were mixed, with some areas showing vigor, others posting less than brisk results but improving, and some tilting on the soft side. All told, the economy in early 2020 seemed on track for growth of approximately two percent, a pace close to potential. This would represent a fine performance for this stage of the business cycle if there were no obvious risks on the horizon, but the coronavirus has emerged as a wild card.

Housing activity has been vigorous, as both sales of new homes and starts surged to new cyclical highs in December or January, easily exceeding previous peaks (charts, p. 4). Sales of existing homes have been less impressive, but these figures are based on completed transactions rather than contracts signed, and closings can take some time. A pickup in pending home sales in January suggests that sales of existing homes will jump in February or March.

Business fixed investment has disappointed in recent quarters because of uncertainties associated with slower global growth and the trade policies of the Trump Administration. Recent figures do not suggest a marked pickup, but activity seems to have improved slightly. New orders for nondefense capital goods other than aircraft rose 1.1 percent in January, one of the better showings in the past two years, and shipments have picked up as well. Trade figures for January showed a sharp decline in exports of capital goods, implying that most of the shipments of capital goods remained in the U.S. and will support capital spending. After declining in the third and fourth quarters (and showing only marginal net growth in the first half of the year), outlays for new business equipment could return to the plus column in the first quarter.

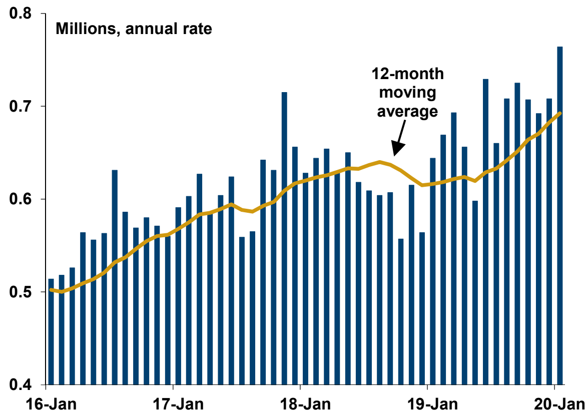
The January trade report in total showed a noticeable narrowing in the monthly deficit, with the shortfall of $65.5 billion representing an improvement of $3.2 billion from December and $1.0 from the average in the fourth quarter -- and the average in Q3 represented a marked improvement from Q2 (chart, p. 4). The improvement from Q4 raises the possibility of a positive contribution to GDP growth from net exports in Q1, although adjusting for inflation and adding trade in services could change the picture (the full trade report on March 6 will show real exports and imports of goods and nominal flows in service trade). We hesitate to portray the narrowing in the trade deficit in Q4 and January as positive developments, as they reflected declines in both exports and imports (larger declines in imports), which could reflect weak demand in both the U.S. and abroad. Still, narrower deficits represent a plus for the U.S. in that softness in the United States is transmitted abroad rather than absorbed domestically.

Consumer spending tilted on the soft side in January. Real outlays grew only 0.1 percent in the first month of the year, which put spending on a track for growth of approximately 1.8 percent in Q1 after advancing 1.7 percent in Q4 (annual rates). Such a pace is respectable, but it represents an easing from the advance of 2.9 percent in the first three quarters of last year and 2.6 percent in 2018.

The retreat in the equity market this week could shake confidence and lead to additional caution on the part of households, although thus far individuals seem to remain upbeat. The University of Michigan sentiment index for February was revised a tad higher from the preliminary estimate published at mid-month, with the measure close to the peak of the current cycle. Moods will probably slip in March given heightened coverage of the virus and the retreat in share values, but sentiment is starting at an elevated level.

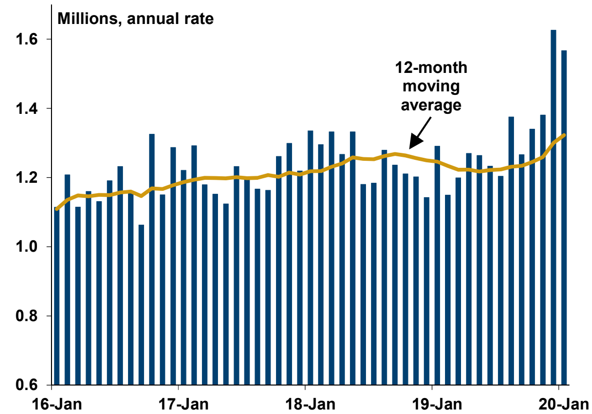
Thus, the economy, in total, was performing reasonably well in January. However, obvious risks from the coronavirus and potential changes in behavior because of the drop in equity values could lead to noticeable deceleration going forward. We suspect the Fed will wait until it has a clearer view on the spread of the virus and the effects on the economy, but the bar for easing is not high.

New Home Sales



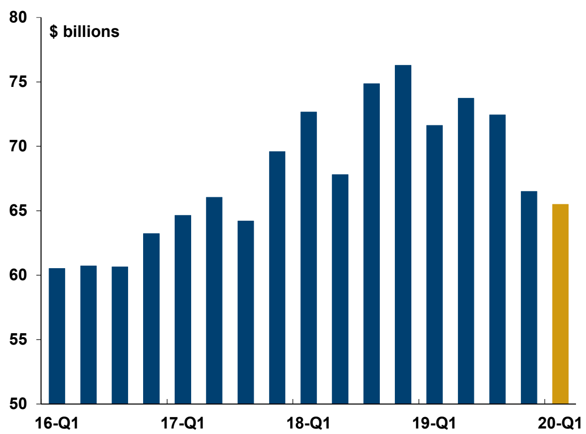
Sources: U.S. Census Bureau via Haver Analytics

Housing Starts



Source: U.S. Census Bureau Haver Analytics

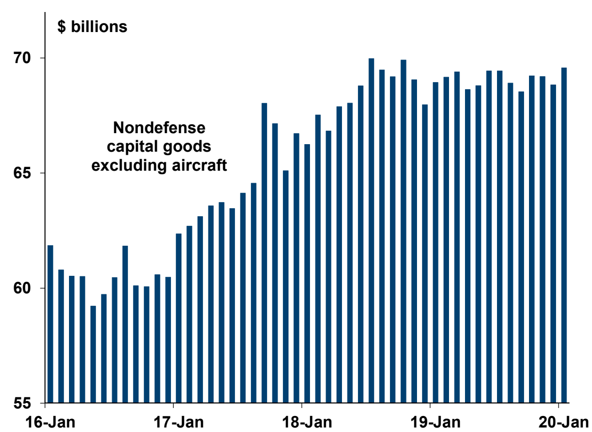
U.S. Merchandise Trade Deficit*



** Quarterly averages of monthly data. The reading for 2020-Q1 (gold bar) is the monthly deficit for January 2020.*

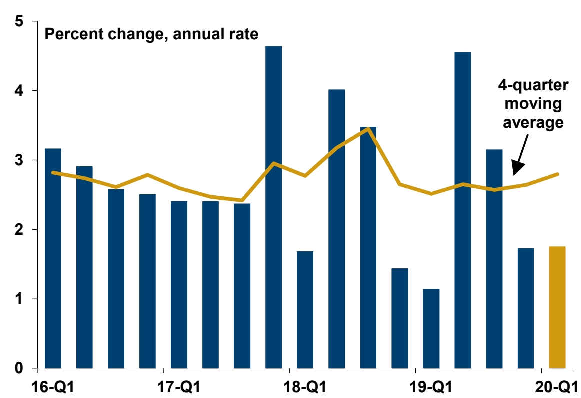
Sources: U.S. Census Bureau via Haver Analytics; Daiwa Capital Markets America

New Orders for Durable Goods



Source: U.S. Census Bureau via Haver Analytics

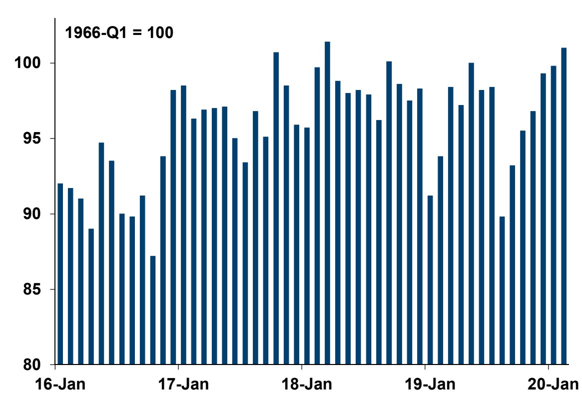
Growth of Consumer Spending*



** The reading for 2020-Q1 (gold bar) is a forecast based on data for January.*

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

Consumer Sentiment



Source: University of Michigan via Haver Analytics

Review

Week of Feb. 24, 2020	Actual	Consensus	Comments
Consumer Confidence (February)	**130.7 (0.2%)**	**132.2 (0.5%)**	Consumer confidence rose only modestly from a downwardly revised level in January, but nevertheless the index remained in the upper portion of the range from the current expansion, exceeding the averages of 130.1 in 2018 and 128.3 in 2019. While the latest reading was firm, it was tabulated ahead of significant downside volatility in the equity market, and thus confidence may slip in March.
New Home Sales (January)	**0.764 Million (+7.9%)**	**0.718 Million (+3.5%)**	The jump in new home sales in January occurred from an upwardly revised level in December, with the combined changes easily pushing activity to a new high for the current expansion (4.8% above the previous peak registered last summer). The drop in interest rates in January apparently motivated fence sitters to commit to a home purchase.
Durable Goods Orders (January)	**-0.2**	**-1.4%**	The modest decline in orders for durable goods was heavily influenced by a drop in the volatile transportation category (off 2.2%). Bookings for durable goods ex-transportation rose 0.9%. From a longer-term perspective, total orders continued to drift lower, but the pickup ex-transportation kept order flows on a sideways trend. The manufacturing sector cannot be viewed as strong, but it is holding its own despite notable headwinds. Orders for nondefense capital goods excluding aircraft jumped 1.1%, one of the better performances of the past year or so. This series, which provides valuable insight into capital spending, is trending sideways, but in light of recent softness in business investment, sideways is good.
Revised GDP (2019-Q4)	**2.1% (Unrevised)**	**2.1% (Unrevised)**	The various components of GDP showed modest and offsetting revisions, leaving GDP growth in Q4 steady at 2.1%. The most notable revision occurred in business fixed investment, which showed a larger decline than initially estimated (-2.3% rather than -1.5%). Consumer spending was revised slightly lower (growth of 1.7% versus 1.8%), but estimates of residential construction and net exports were nudged higher and inventory investment was less of a drag than first reported.

Review Continued

Week of Feb. 24, 2020	Actual	Consensus	Comments
Personal Income, Consumption, Core Prices (January)	**0.6%, 0.2%, 0.1%**	**0.4%, 0.3%, 0.2%**	The increase in personal income exceeded the average monthly advance of 0.3% in 2019, led by an above-average increase of 0.5% in wages and salaries. Rental income (0.5%) and dividend income (1.1%) also were firm. Nominal consumer spending posted a below-average gain, as increases in outlays for durable goods and services were partially offset by a drop in spending on nondurable items. After adjusting for inflation, consumer spending rose 0.1%, suggesting moderate growth in Q1. The core PCE price index was restrained in the latest month (0.1%). The year-over-year change in the core PCE index increased one tick to 1.6%, a reading in the middle of the range of observations in the prior year (range of 1.5% to 1.8%), but below readings in the 2%-area in the second half of 2018.
U.S. International Trade in Goods (January)	**-$65.5 Billion ($3.22 Billion Narrower Deficit)**	**-$68.5 Billion ($0.2 Billion Narrower Deficit)**	Both imports and exports slipped in January, and while the decline in imports eclipsed that in exports leading to a narrowing in the monthly deficit, the results should not be viewed favorably as they signal slack demand. Imports fell 2.2%, adding to the downward trend in place since the fall of 2018. Exports slipped 1.0% after posting increases in the prior two months, but shipments abroad also have been trending lower for the past year and one-half.

Sources: The Conference Board (Consumer Confidence); U.S. Census Bureau (New Home Sales, Durable Goods Orders, U.S. International Trade in Goods); Bureau of Economic Analysis (Revised GDP, Personal Income, Consumption, Core Price Index); Consensus forecasts are from Bloomberg

Preview

Week of March 2, 2020	Projected	Comments
ISM Manufacturing Index (February) (Monday)	**51.0% (+0.1 Pct. Pt.)**	Firm readings on regional manufacturing indexes suggest that the ISM index will exceed the critical value of 50% for the second consecutive month after sub-50 tallies from August to December.
Construction Spending (January) (Monday)	**1.0%**	Robust readings on housing starts in December and January should fuel residential building. State and local governments have become more active recently after a lull from May to October. Cautious spending by businesses is likely to constrain private nonresidential construction.
ISM Nonmanufacturing Index (February) (Wednesday)	**56.0% (+0.5 Pct. Pt.)**	With recent economic reports suggesting another quarter of approximately 2% growth, the ISM nonmanufacturing index should remain in the mid-50 percent area. The expected reading is in line with the average of 55.5% for 2019, although shy of the 59.0% average in 2018.
Revised Nonfarm Productivity (2019-Q4) (Thursday)	**1.0% (-0.4 Pct. Pt. revision)**	Two recent developments point to a downward revision to productivity growth in Q4. The revised GDP report suggested that the output as measured in the productivity report will be nudged lower, and other data suggest that firms required more labor input to produce this output. A downward revision to the growth of compensation per hour should about match the adjustment in productivity, which would leave the growth of unit labor costs close to the initial estimate of 1.4%.
Factory Orders (January) (Thursday)	**-0.3%**	Orders for nondurable goods are likely to decline slightly, reflecting primarily a price-led drop in the petroleum and coal category. Other nondurable areas are likely to continue the recent pattern of modest monthly changes and a flat trend. The preliminary report on orders for durable goods showed a decline of 0.2%, driven primarily by the volatile transportation component.
Payroll Employment (February) (Friday)	**175,000**	Recent easings on job postings suggest that the brisk increase in payrolls in January (225K) contained an element of upside volatility. The February tally is likely to move closer to the average of 170K in the prior 12 months. The household survey is likely to show much better results than the employment decline of 89K in January, but the labor force also is likely to increase by more than it did in the prior month (50K), which should leave the unemployment rate unchanged at 3.6%.
Trade Balance (January) (Friday)	**-$45.7 Billion ($3.2 Billion Narrower Deficit)**	The surplus in trade services could narrow some because of a virus-led drop in international travel, but the total trade balance is still likely to improve, as the goods deficit narrowed by $3.2 billion.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

February/March 2020

Monday	Tuesday	Wednesday	Thursday	Friday
24	25	26	27	28
CHICAGO FED NATIONAL ACTIVITY INDEX Monthly / 3-Mo. Avg. Nov 0.49 / -0.23 Dec -0.51 / -0.23 Jan -0.25 / -0.09	**FHFA HOME PRICE INDEX** Oct 0.3% Nov 0.3% Dec 0.6% **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** SA / NSA Oct 0.5% / 0.1% Nov 0.5% / 0.1% Dec 0.4% / 0.0% **CONFERENCE BOARD CONSUMER CONFIDENCE** Dec 128.2 Jan 130.4 Feb 130.7	**NEW HOME SALES** Nov 0.692 million Dec 0.708 million Jan 0.764 million	**INITIAL CLAIMS** Feb 08 206,000 Feb 15 211,000 Feb 22 219,000 **DURABLE GOODS ORDERS** Nov -3.1% Dec 2.9% Jan -0.2% **REVISED GDP** GDP / Chained Price 19-Q3 2.1% / 1.8% 19-Q4(a) 2.1% / 1.4% 19-Q4(p) 2.1% / 1.3% **PENDING HOMES SALES** Nov 0.7% Dec -4.3% Jan 5.2%	**PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX** Inc. / Cons. / Core Nov 0.5% / 0.3% / 0.1% Dec 0.1% / 0.4% / 0.2% Jan 0.6% / 0.2% / 0.1% **U.S. INTERNATIONAL TRADE IN GOODS** Nov -\$63.7 billion Dec -\$68.7 billion Jan -\$65.5 billion **ADVANCE INVENTORIES REPORT** Wholesale / Retail Nov 0.1% / -0.9% Dec -0.3% / -0.1% Jan -0.2% / 0.0% **CHICAGO PURCHASING MANAGERS' INDEX** Index / Prices Dec 48.2 / 58.1 Jan 42.9 / 56.1 Feb 49.0 / 52.9 **REVISED CONSUMER SENTIMENT** Dec 99.3 Jan 99.8 Feb 101.0
2	3	4	5	6
ISM MFG INDEX (10:00) Index / Prices Dec 47.8 / 51.7 Jan 50.9 / 53.3 **Feb 51.0 / 51.0** **CONSTRUCTION SPEND. (10:00)** Nov 0.7% Dec -0.2% **Jan 1.0%**	**VEHICLE SALES** Dec 16.6 million Jan 16.8 million **Feb 16.8 million**	**ADP EMPLOYMENT REPORT (8:15)** Private Payrolls Dec 199,000 Jan 291,000 Feb -- **ISM NON-MFG INDEX (10:00)** Index / Prices Dec 54.9 / 59.3 Jan 55.5 / 55.5 **Feb 56.0 / 58.0** **BEIGE BOOK (2:00)** **January Beige Book** "Economic activity generally continued to expand modestly in the final six weeks of 2019."	**INITIAL CLAIMS (8:30)** **REVISED PRODUCTIVITY & COSTS (8:30)** Productivity / Unit Labor Costs 19-Q3 -0.2% / 2.5% 19-Q4(p) 1.4% / 1.4% **19-Q4(r) 1.0% / 1.4%** **FACTORY ORDERS (10:00)** Nov -1.2% Dec 1.8% **Jan -0.3%**	**EMPLOYMENT REPORT (8:30)** Payrolls / Un. Rate Dec 147,000 / 3.5% Jan 225,000 / 3.6% **Feb 175,000 / 3.6%** **TRADE BALANCE (8:30)** Nov -\$43.7 billion Dec -\$48.9 billion **Jan -\$45.7 billion** **WHOLESALE TRADE (10:00)** Inventories / Sales Nov 0.1% / 0.9% Dec -0.3% / -0.7% **Jan -0.2% / -0.2%** **CONSUMER CREDIT (3:00)** Nov \$11.8 billion Dec \$22.1 billion Jan --
9	10	11	12	13
	NFIB SMALL BUSINESS OPTIMISM INDEX	**CPI** **FEDERAL BUDGET**	**INITIAL CLAIMS** **PPI**	**IMPORT/EXPORT PRICES** **CONSUMER SENTIMENT**
16	17	18	19	20
EMPIRE MFG INDEX **TIC DATA**	**RETAIL SALES** **IP & CAP-U** **BUSINESS INVENTORIES** **JOLTS DATA** **NAHB HOUSING INDEX** **FOMC MEETING**	**HOUSING STARTS** **FOMC DECISION**	**INITIAL CLAIMS** **CURRENT ACCOUNT** **PHILLY FED INDEX** **LEADING INDICATORS**	**EXISTING HOME SALES**

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

Treasury Financing

February/March 2020

Monday	Tuesday	Wednesday	Thursday	Friday
24	25	26	27	28
AUCTION RESULTS: Rate Cover 13-week bills 1.505% 2.88 26-week bills 1.440% 3.02	**AUCTION RESULTS:** Rate Cover 52-week bills 1.270% 3.56 2-year notes 1.188% 2.45 **ANNOUNCE:** $50 billion 4-week bills for auction on February 27 $45 billion 8-week bills for auction on February 27 **SETTLE:** $50 billion 4-week bills $45 billion 8-week bills	**AUCTION RESULTS:** Margin Cover 2-year FRN 0.160% 2.49 Rate Cover 5-year notes 1.150% 2.46	**AUCTION RESULTS:** Rate Cover 4-week bills 1.530% 2.59 8-week bills 1.500% 2.71 7-year notes 1.247% 2.49 **ANNOUNCE:** $84 billion 13-,26-week bills for auction on March 2 **SETTLE:** $84 billion 13-,26-week bills $26 billion 52-week bills	**SETTLE:** $8 billion 30-year TIPS $18 billion 2-year FRNs
2	3	4	5	6
AUCTION: $84 billion 13-,26-week bills **SETTLE:** $40 billion 2-year notes $41 billion 5-year notes $32 billion 7-year notes	**ANNOUNCE:** $50 billion* 4-week bills for auction on March 5 $45 billion* 8-week bills for auction on March 5 **SETTLE:** $50 billion 4-week bills $45 billion 8-week bills		**AUCTION:** $50 billion* 4-week bills $45 billion* 8-week bills **ANNOUNCE:** $84 billion* 13-,26-week bills for auction on March 9 $38 billion* 3-year notes for auction on March 10 $24 billion* 10-year notes for auction on March 11 $16 billion* 30-year bonds for auction on March 12 **SETTLE:** $84 billion 13-,26-week bills	
9	10	11	12	13
AUCTION: $84 billion* 13-,26-week bills	**AUCTION:** $38 billion* 3-year notes **ANNOUNCE:** $50 billion* 4-week bills for auction on March 12 $45 billion* 8-week bills for auction on March 12 **SETTLE:** $50 billion* 4-week bills $45 billion* 8-week bills	**AUCTION:** $24 billion* 10-year notes	**AUCTION:** $50 billion* 4-week bills $45 billion* 8-week bills $16 billion* 30-year bonds **ANNOUNCE:** $84 billion* 13-,26-week bills for auction on March 16 $12 billion* 10-year TIPS for auction on March 19 **SETTLE:** $84 billion* 13-,26-week bills	
16	17	18	19	20
AUCTION: $84 billion* 13-,26-week bills **SETTLE:** $38 billion* 3-year notes $24 billion* 10-year notes $16 billion* 30-year bonds	**ANNOUNCE:** $50 billion* 4-week bills for auction on March 19 $45 billion* 8-week bills for auction on March 19 **SETTLE:** $50 billion* 4-week bills $45 billion* 8-week bills		**AUCTION:** $50 billion* 4-week bills $45 billion* 8-week bills $12 billion* 10-year TIPS **ANNOUNCE:** $84 billion* 13-,26-week bills for auction on March 23 $26 billion* 52-week bills for auction on March 24 $18 billion* 2-year FRNs for auction on March 25 $40 billion* 2-year notes for auction on March 24 $41 billion* 5-year notes for auction on March 25 $32 billion* 7-year notes for auction on March 26 **SETTLE:** $84 billion* 13-,26-week bills	

**Estimate*