U.S. Economic Comment

- Coronavirus and the US economy: searching for clues
- The Fed on March 18: flip a coin

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

The Virus: Little Evidence of Fallout Thus Far

It's early. We should not expect to find much evidence of a faltering economy because of the coronavirus, and that is indeed the case.

Initial claims for unemployment insurance are perhaps the most valuable indicator to monitor at this time, as they are timely, accurate, and sensitive to shifts in the economic environment. If firms were cutting activity, claims would most likely be increasing. The latest reading -- that for the week ending February 29, when the virus was dominating the news -- was comfortably within the recent range of observations, suggesting no impact thus far (chart, left).

The latest labor market report also showed little apparent effect from the virus. The overall report was vigorous (273,000 new jobs in February and upward revisions in the prior two months totaling 85,000), and three areas especially vulnerable to a slowdown associated with the virus -- manufacturing, transportation and warehousing, and leisure and hospitality -- also showed firm results (chart, right).

Leisure and hospitality was the strongest of this group, with job growth of 51,000 representing one of the best performances of the past few years. The increase of 15,000 in the manufacturing sector merely offset a portion of the drop of 20,000 in the prior month, but the rebound was enough to preserve an approximately flat trend in an area that is facing strong headwinds. The transportation and warehousing industry trimmed payrolls, but nearly all of the decline occurred in rail transportation and pipeline transportation. Air transportation, the area most at risk, posted a small increase in employment.

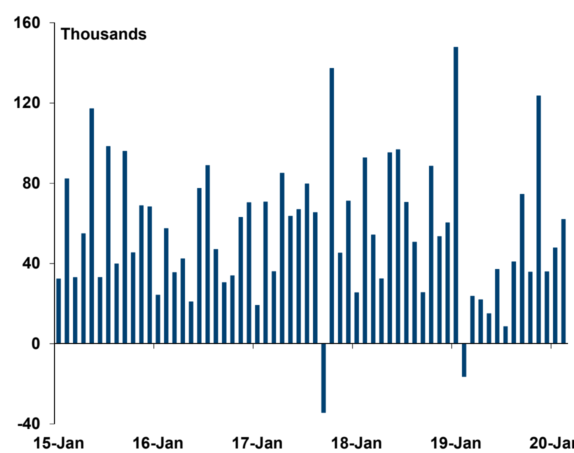
We would not push the payroll figures too far at this time because they represent a snapshot in the middle of the month, which is probably too soon to reflect an influence from the virus (employers report the number of workers for the pay period that contains the 12th of the month). In addition, with the labor market tight and

Initial Claims for Unemployment Insurance*

* *Four-week moving average*

Sources: U.S. Department of Labor via Haver Analytics

Job Growth: Industries at Risk*

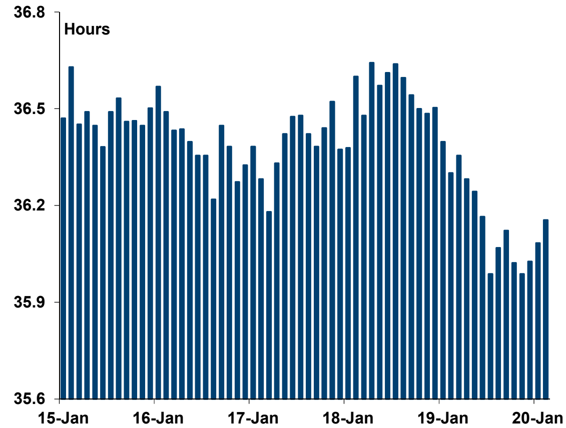


* *The sum on employment changes in the manufacturing, leisure and hospitality, and transportation and warehousing industries.*

Source: Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America firms reportedly having difficulty finding qualified individuals, executives would probably be reluctant to lay off workers. Even if the labor market were not tight, the initial response to a reduction in output would probably be a reduction in hours worked rather than layoffs.

Here, too, February did not show signs of softening. The same three vulnerable sectors -- manufacturing, leisure and hospitality, transportation and warehousing -- showed a slight uptick in the length of the average workweek (chart, right). An increase of 0.2 hour in manufacturing offset a dip of less than 0.1 hour in transportation and warehousing.

Workweek: Industries at Risk*



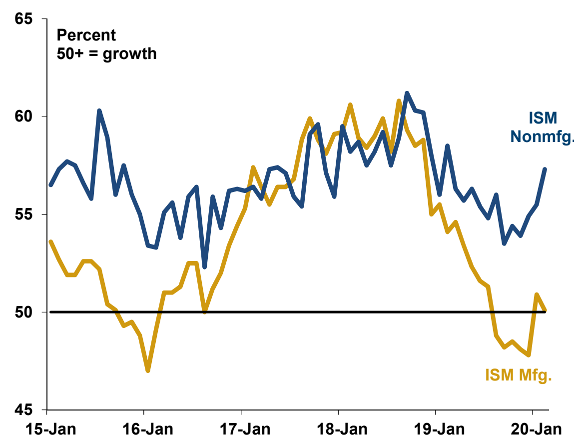
* A weighted average of the average workweeks of the manufacturing, leisure and hospitality, and transportation and warehousing industries.

Source: Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America

The ISM indexes provide useful information, and they brought mixed results in February. The manufacturing index moved slightly lower to a level only marginally above the critical value of 50 percent (chart, below). This soft reading might seem at odds with the firm increase in payroll employment, but recall that manufacturing payrolls have changed little on balance in recent months. Thus, both measures are pointing to a flat performance, which is disappointing in an absolute sense but respectable considering the headwinds facing this sector.

The ISM nonmanufacturing index was unambiguously firm in February, with the headline measure increasing almost two percentage points and moving into the upper-50-percent area (chart, next page). The new orders index was just shy of the peak in the current cycle, and the employment and business activity components were above their recent averages.

ISM Indexes

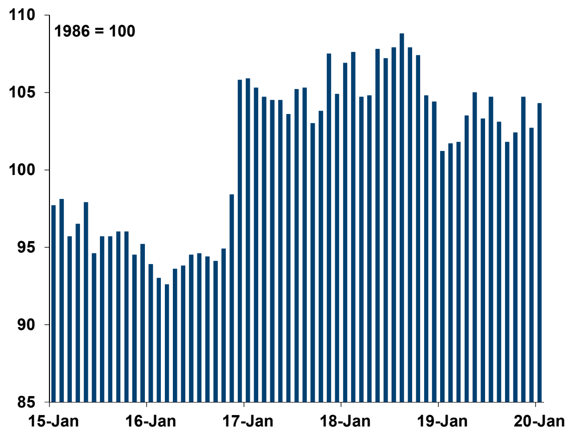


Source: Institute for Supply Management via Haver Analytics

We are interested in the business sentiment index that will be published by The National Federation of Independent Business on March 10. The headline index will provide insight into the degree of concern among executives at small enterprises, and the various components will show if hiring or investment plans are being reconsidered. The headline measure lost some ground last year but it remained elevated relative to historical standards (chart). We would view a drop in the headline index below 100 as a sign that the coronavirus is beginning to have an influence on the economy.

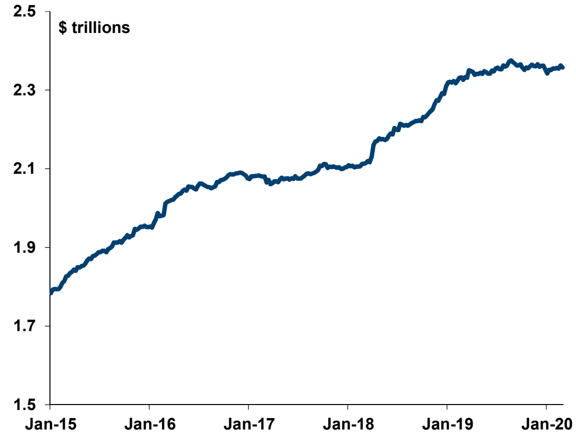
This measure of small business sentiment is important at this time because firms in this segment of the economy face the risk of restricted credit flow, which could force cuts in investment spending or hiring. Chair Powell noted in his press conference this week that such issues did not seem present at this time. The latest readings on business loans at commercial banks provide support for this view. This category of loans had been drifting downward since last summer, although they have inched ahead in the first two months of the year. The latest observation fell slightly (off 0.2 percent in the week ended February 26), but that dip offset only a portion of the increase in the prior week. The latest tally is second best of 2020 (chart, next page, right).

Small Business Optimism Index



Sources: National Federation of Independent Business via Haver Analytics

Commercial & Industrial Loans



Source: Federal Reserve Board via Haver Analytics

The Fed

We have been bombarded this week with questions regarding the next step for the Federal Reserve. We view the bar for additional easing as low, and we expect at least one additional cut this year. However, we are ambivalent about prospects for the March 18 meeting. The lack of evidence on economic fallout from the virus, along with the fact that the Fed has already made an insurance move, leads us to think that officials will remain on the sideline at this time. Fiscal support likely provided by Congress also lessens the need for the Fed to act at this time. Fiscal action is especially relevant because health-related spending is likely to be more effective in supporting the economy than lower interest rates would be.

At the same time, we would not be even mildly surprised if the Fed lowered interest rates again at its upcoming meeting. Market participants have priced in a near–term reduction in rates, and failure to ratify this expectation could result in needless market volatility. Given the apparent nervousness in financial markets, another rate reduction would probably do no harm and could prove beneficial.

Perhaps the situation will be clearer on March 18. Information on the likely spread of the virus might be more definitive, and economic or financial data might provide better guidance on the appropriate policy path. As of now, we view steady/easy prospects as a 50-50 proposition. If forced to take a stand, we would look for the Fed to remain on the sideline at this time, but nothing would surprise us.

Review

Week of March 2, 2020	Actual	Consensus	Comments
ISM Manufacturing Index (February)	**50.1% (-0.8 Pct. Pt.)**	**50.5% (-0.4 Pct. Pt.)**	The ISM manufacturing index exceeded 50% for the second consecutive month after sub-50 readings from August through December. However, it was only marginally above the critical value, and most components carried a negative tone. New orders fell 2.2 percentage points to 49.8%, and with orders soft, the production index tumbled 4.0 percentage points to 50.3%. The employment index rose, but the increase was modest and the level was well below the critical value (up 0.3 percentage point to 46.9%).
Construction Spending (January)	**1.8%**	**0.6%**	Strong housing starts in recent months led to a jump of 2.1% in private home building. Private nonresidential construction grew 0.8% from a sharp upwardly revised level in December. This area had been drifting lower, but the new figures now suggest more of a sideways movement. Public construction rose 2.6%, with both federal and state and local governments contributing. The surge of 9.9% at the federal level added a sharp accent to what had been an upwardly drifting trend. The increase of 2.0% among state and local governments continued a firm underlying trend.
ISM Nonmanufacturing Index (February)	**57.3% (+1.8 Pct. Pts.)**	**54.8% (-0.7 Pct. Pt.)**	The new level of the ISM nonmanufacturing index exceeded the average of 55.5% in 2019 and was firmer than all but one observation from last year (58.5% in February 2019), although it still trailed the average of 59.0% from 2018. A surge in the new orders component led the advance in the headline index, increasing 6.9 percentage points to 61.1% and moving to the upper portion of the range from the current expansion. Although new orders climbed, the business activity index (a measure of production) eased 3.1 percentage points. However, the drop occurred from an elevated level, and the index remained firm at 57.8%. The employment index rebounded from a disappointing performance in the prior month, increasing 2.5 percentage points to 55.6%, a reading slightly higher than the average of 55.0% from last year and not far from the average of 56.9% in 2018.
Factory Orders (January)	**-0.5%**	**-0.1%**	Although bookings declined in January, the report on factory orders was mildly encouraging, as the softness was concentrated in volatile areas. The decline of 0.2% in the durable sector reflected sharp declines in bookings for defense-related aircraft and ships after firm readings in December. Durable orders ex-transportation rose 0.8%. Nondurable bookings fell 0.8%, influenced heavily by a price-driven decline in the petroleum and coal category. Other nondurable bookings advanced 0.1% after an increase of 0.3% in December, leaving an upward tilt to what had been a flat trend.

Review Continued

Week of March 2, 2020	Actual	Consensus	Comments
Payroll Employment (February)	**273,000**	**175,000**	The jump in nonfarm payrolls in February was joined by combined upward revisions of 85,000 in the prior two months, adding an accent to the firm tone of the report. However, the figures should be interpreted cautiously, as the payroll survey was conducted prior to the acceleration of coronavirus infections in the United States. The unemployment rate fell 0.1 percentage point to 3.5%, but was less impressive than the payroll totals. The measure fell only marginally when calculated with more precision (3.517% versus 3.579% in January). More important, employment as measured by the household survey rose only 45,000 while the size of the labor force contracted by 60,000. Average hourly earnings rose 0.3% in February after disappointing results in the prior two months. The increase left the year-over-year change at 3.0% for the third consecutive month, shy of the firmer showings in early 2019 (3.5%).
Trade Balance (January)	**-$45.3 Billion ($3.3 Billion Narrower Deficit)**	**-$46.1 Billion ($2.8 Billion Narrower Deficit)**	Both exports and imports fell in January, with imports showing the larger retreat (-1.6% versus -0.4% for exports), which led to a narrower trade deficit. The results were not entirely surprising, as the goods trade deficit published last week narrowed noticeably. The report, however, showed a pleasant surprise in the form of an increase in the surplus in trade services. Exports of services rose 0.7% while imports of services fell 0.2%. The resulting surplus of $21.7 billion was among the best of the past few years. The deficit in January was narrower than the average in the fourth quarter of last year, raising the prospect of a positive contribution to GDP growth from net exports. If flows in the next two months were to match those for January, net exports would add one-quarter to one-half percentage point to GDP growth.

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

Preview

Week of March 9, 2020	Projected	Comments
CPI (February) (Wednesday)	**0.1% Total, 0.2% Core**	Gasoline prices fell noticeably in February, which will most likely push the energy component lower and restrain the headline figure. Underlying price pressure is limited, and thus the core component should remain comfortably within its recent range (0.1% or 0.2% in 22 of the past 24 months).
Federal Budget (February) (Wednesday)	**$210.0 Billion Deficit**	Available data suggest that revenues jumped approximately 13% from the same month last year, a considerable improvement from the advance of 6.0% in the first four months of the fiscal year. The strong revenue flow is likely to leave the deficit shy of the $234 billion shortfall in February 2019, but with spending on the firm side recently, (up approximately 10% in the first four months of the fiscal year), the improvement will probably be moderate.
PPI (February) (Thursday)	**-0.3% Total, -0.1% Core***	Lower prices of gasoline will probably lead to a drop in the energy component, and food prices seem to be stabilizing after stepping upward in October and November. Prices of core goods are perhaps beginning to stir (up 0.3% in January and 0.2% in December after showing little net change in the prior 10 months), but the volatile service sector could give back some of its jump of 0.7% in January.
Consumer Sentiment (March) (Friday)	**97.0 (-4.0 Index Points)**	The steady flow of troubling news on the coronavirus is likely to weigh on the minds of individuals. The related swoon in the equity market is likely to reinforce concern.

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

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

March 2020

Monday	Tuesday	Wednesday	Thursday	Friday
2	3	4	5	6
ISM MFG INDEX Index Prices Dec 47.8 51.7 Jan 50.9 53.3 Feb 50.1 45.9 **CONSTRUCTION SPEND.** Nov 1.6% Dec 0.2% Jan 1.8%	**VEHICLE SALES** Dec 16.7 million Jan 16.9 million Feb 16.8 million	**ADP EMPLOYMENT REPORT** Private Payrolls Dec 167,000 Jan 209,000 Feb 183,000 **ISM NON-MFG INDEX** Index Prices Dec 54.9 59.3 Jan 55.5 55.5 Feb 57.3 50.8 **BEIGE BOOK** "Economic activity expanded at a modest to moderate rate over the past several weeks, according to the majority of Federal Reserve Districts."	**INITIAL CLAIMS** Feb 15 211,000 Feb 22 219,000 Feb 29 216,000 **REVISED PRODUCTIVITY & COSTS** Productivity Unit Labor Costs 19-Q3 -0.3% 0.2% 19-Q4(p) 1.4% 1.4% 19-Q4(r) 1.2% 0.9% **FACTORY ORDERS** Nov -1.2% Dec 1.9% Jan -0.5%	**EMPLOYMENT REPORT** Payrolls Un. Rate Dec 184,000 3.5% Jan 273,000 3.6% Feb 273,000 3.5% **TRADE BALANCE** Nov -$43.8 billion Dec -$48.6 billion Jan -$45.3 billion **WHOLESALE TRADE** Inventories Sales Nov 0.1% 0.9% Dec -0.3% -0.2% Jan -0.4% 1.6% **CONSUMER CREDIT** Nov $9.5 billion Dec $20.3 billion Jan $12.0 billion
9	10	11	12	13
	NFIB SMALL BUSINESS OPTIMISM INDEX (6:00) Dec 102.7 Jan 104.3 Feb --	**CPI (8:30)** Total Core Dec 0.2% 0.1% Jan 0.1% 0.2% **Feb 0.1% 0.2%** **FEDERAL BUDGET (2:00)** FY2020 FY2019 Dec -$13.3B -$13.5B Jan -$32.6B $8.7B **Feb -$210.0B** -$234.0B	**INITIAL CLAIMS (8:30)** **PPI (8:30)** Final Demand Core* Dec 0.2% 0.2% Jan 0.5% 0.4% **Feb -0.3% -0.1%**	**IMPORT/EXPORT PRICES (8:30)** Non-fuel Imports Nonagri. Exports Dec 0.2% -0.2% Jan 0.2% 0.7% Feb -- -- **CONSUMER SENTIMENT (10:00)** Jan 99.8 Feb 101.0 **Mar 97.0**
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**
23	24	25	26	27
CHICAGO FED NATIONAL ACTIVITY INDEX	**NEW HOME SALES**	**DURABLE GOODS ORDERS** **FHFA HOUSE PRICE INDEX**	**INITIAL CLAIMS** **U.S. INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES** **REVISED Q4 GDP**	**PERSONAL INCOME, CONSUMPTION, CORE PRICES** **REVISED CONSUMER SENTIMENT**

Forecasts in Bold. (p) = preliminary; (r) = revised   * *The core PPI excludes food, energy, and trade services.*

Treasury Financing

March 2020

Monday	Tuesday	Wednesday	Thursday	Friday
2	3	4	5	6
AUCTION RESULTS: Rate Cover 13-week bills 1.155% 3.02 26-week bills 1.010% 3.11 **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 RESULTS:** Rate Cover 4-week bills 0.925% 2.66 8-week bills 0.820% 2.73 **ANNOUNCE:** $78 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: $78 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:** $78 billion* 13-,26-week bills for auction on March 16 $12 billion* 10-year TIPS for auction on March 19 **SETTLE:** $78 billion 13-,26-week bills	
16	17	18	19	20
AUCTION: $78 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:** $78 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:** $78 billion* 13-,26-week bills	
23	24	25	26	27
AUCTION: $78 billion* 13-,26-week bills	**AUCTION:** $26 billion* 52-week bills $40 billion* 2-year notes **ANNOUNCE:** $50 billion* 4-week bills for auction on March 26 $45 billion* 8-week bills for auction on March 26 **SETTLE:** $50 billion* 4-week bills $45 billion* 8-week bills	**AUCTION:** $41 billion* 5-year notes $18 billion* 2-year FRNs	**AUCTION:** $50 billion* 4-week bills $45 billion* 8-week bills $32 billion* 7-year notes **ANNOUNCE:** $78 billion* 13-,26-week bills for auction on March 30 **SETTLE:** $78 billion* 13-,26-week bills $26 billion* 52-week bills	**SETTLE:** $18 billion* 2-year FRNs

**Estimate*