Daiwa Capital Markets

U.S. Economic Comment

- The U.S. economy: an abrupt turn; possible help from fiscal policy
- The Fed's new facilities: in active use, but not overwhelmed

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The Slowdown Begins

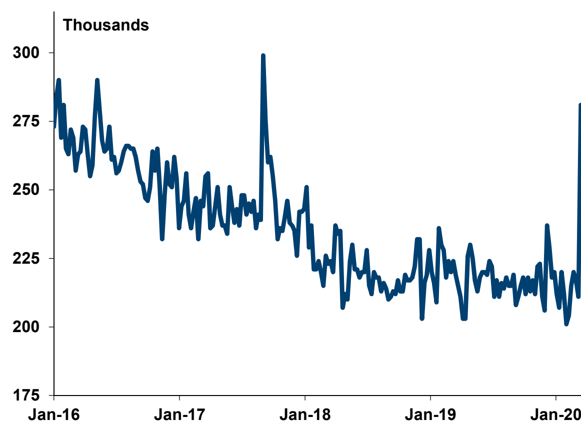
Economic reports through February indicated that the U.S. economy was performing well. If activity in March were to resemble that in the first two months of the year, the economy in the first quarter would probably register growth of slightly more than two percent. However, the results for March will be dreadful, which is likely to lead to sub-two-percent growth. We are hopeful that growth will remain above one percent in the first quarter, but there is an element of hope involved in this view.

The first indication of poor results for March emerged this week, with claims for unemployment insurance jumping 70,000 (33 percent; chart, left). The surge was especially telling because of tight conditions in the labor market and the reported difficulty in finding qualified workers. In such an environment, we expected the initial reaction to a drop in demand to involve shorter workweeks rather than a reduction in payrolls, but apparently the pullback is occurring quickly.

The manufacturing indexes published by the Federal Reserve Banks of New York and Philadelphia also showed a pronounced shift (chart, right). Wide swings in these measures occur frequently, and thus changes should be interpreted cautiously. However, the drop well into negative territory for both measures leaves little doubt that the recent changes were more than statistical noise. (The chart shows an average of the New York and Philadelphia indexes. These measures can range from -100 to +100, with zero separating expansion from contraction.)

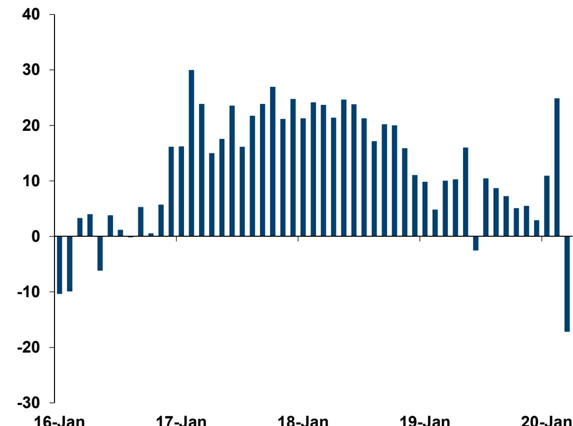
We have received numerous requests for a revised forecast, but we hesitate to offer a definitive view because of the extreme uncertainty now present. One can only speculate about the duration and severity of the coronavirus and its influence on the economy. In addition, Congress seems likely to add a dose of fiscal stimulus, but the timing and magnitude are not perfectly clear at this point.

Initial Claims for Unemployment Insurance



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

Regional Federal Reserve Mfg. Indexes*



** An average of the Philly Fed's Manufacturing Business Outlook Survey's general business conditions and the New York Fed's Empire State Manufacturing Survey's general business conditions. Both indexes range from -100 to +100, with 0 being the dividing line between growth and contraction.*

Source: Federal Reserve Bank of New York and Federal Reserve Bank of Philadelphia via Haver Analytics; Daiwa Capital Markets America

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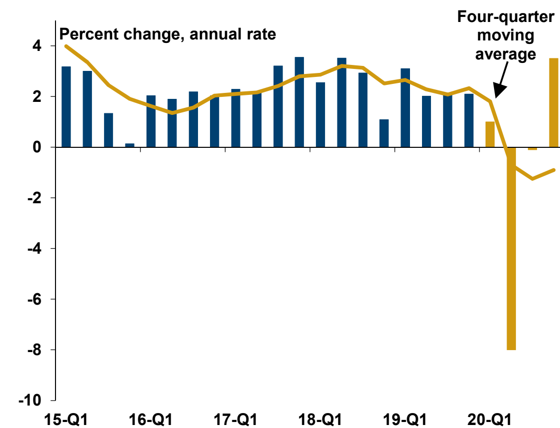
We assume (hope) that the spread of the virus will dissipate during the spring and die out in the early summer months; we also expect Congress to provide sizeable support. Under such conditions, we can offer a pattern or path that the economy is likely to follow, but the magnitudes of change are highly uncertain.

Given the wave of cancellations and closures that has occurred, the economy is on track to decline sharply in the second quarter. Softness most likely will continue into the third quarter, but we also would expect to see signs of a bottoming and an upturn. With the virus out of the way and fiscal stimulus kicking in, full-fledged recovery would probably emerge in the closing months of the year.

The chart to the right provides a view on GDP growth, although we are only comfortable with the general pattern rather than the specific magnitudes (the chart shows Q2 down 8.0 percent, close to the -8.4 percent seen in the early stages of the Great Recession; Q3 off marginally; Q4 up 3.5 percent). Given the unprecedented nature of the current situation, we have a low level of confidence in any set of point estimates; we are only comfortable with the general pattern: sharp decline in Q2 and noticeable pickup by Q4.

GDP Growth*



** The readings for 2020-Q1 to 2020-Q4 (gold bars) are estimates.*

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

The Federal Reserve obviously is doing its part to promote growth. It has pushed short-term interest rates to the effective lower bound, restarted quantitative easing (yes, we view the latest effort as a new round of QE), and resurrected various credit facilities used during the financial crisis. We expect the Fed to err on the side of accommodation, although we also can envision the Fed beginning to unwind its efforts by the end of the year or in early 2021. Fed officials were pleased with the economy's performance before the virus hit the U.S., and we suspect that they will not see a need for the current level of support if the virus in fact dies out. If the pattern noted above unfolds, we would look for the federal funds rate to be at 0.625 percent at the end of the year and for market interest rates to be slightly higher than current levels.

Fiscal Policy

The Trump Administration and Congress are actively discussing a stimulus package, with officials talking of support in the neighborhood of $1.0 trillion. This bill will mark the third effort to fight the coronavirus. The first bill provided $8.3 billion in supplemental appropriations to various government agencies to intensify their efforts in dealing with the virus and developing a vaccine. The second bill increased unemployment benefits, mandated paid sick leave, increased funding for Medicaid and other security programs, and provided for free virus testing.

The package now under discussion is sizeable, although a bit less ambitious than the American Recovery and Reinvestment Act of 2009, which was passed in the aftermath of the financial crisis. The $836 billion price tag of the 2009 package represented 5.7 percent of nominal GDP in 2008-Q4. A package of $1.0 trillion would represent 4.6 percent of current nominal GDP.

Officials are considering aid to distressed industries ($50 billion to the airline industry, for example), and direct payments to individuals (talk of $1,200 per individual earning less than $75,000 per year). While the totals are sizeable, we wonder about effectiveness.

Direct payments to individuals will perhaps represent the largest element of the bill, and it will involve a large amount of assistance that is not needed. With a broad distribution of the checks, funds will flow to individuals working normal hours and receiving normal pay rather than only to those furloughed or working

reduced hours. In addition, with individuals limiting their activities, only a small portion of the funds will be spent quickly.

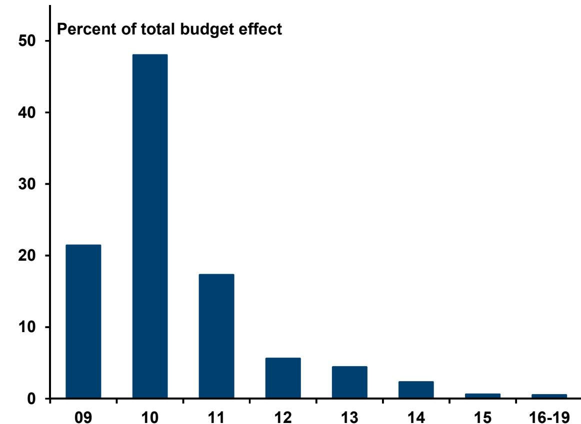
Even after individuals begin to resume normal activities, a good portion of the funds are likely to be saved. Studies of similar programs adopted in 2001 and 2008 led the Congressional Budget Office to conclude that only about 40 percent of the payments were spent within six months ("Did the 2008 Tax Rebates Stimulate Short-Term Growth", CBO, June 10, 2009).

More generally, fiscal policy tends to act slowly, as government agencies often are not able to spend funds quickly; there are few projects that are truly "shovel ready". Behavioral responses to tax changes also can take time.

The experience with the American Recovery and Reinvestment Act provides a glimpse into the slow moving nature of fiscal policy. The Congressional Budget Office estimates that the provisions of the act widened the budget deficit by $836 billion over fiscal years 2009 to 2019 (the bill was passed in February 2009, when the fiscal year was already in its fifth month). Only 21 percent of the stimulus was felt over the balance of FY2009, and approximately half was realized in the following year. The remaining 30 percent trickled out over the next nine years (chart).

Perhaps the influence of the new bill will be faster, but still the effects are not likely to be rapid. The most forceful portion of the stimulus is not likely to be felt until 2021.

Fiscal Stimulus of 2009



Source: Congressional Budget Office; Daiwa Capital Markets America

The Fed's New Efforts

The Fed has made a strong effort to keep credit flowing. It has been especially aggressive with its purchases of Treasury and mortgage-backed securities. In only one week, it has purchased more than half of the planned $500 billion of Treasury securities ($275 billion). It is moving more slowly in the mortgage market, but it is still quite active, with approximately $64 billion of the planned $200 billion acquired in the past week.

The Fed has encouraged depository institutions to utilize the discount window, and some have taken the offer, with total borrowing of $28.2 billion on March 28. (The Fed's balance sheet data is published on Thursdays and involves data for the week ended the prior Wednesday. The Fed presents both weekly average totals and the one-day totals for Wednesday.)

Discount window borrowing in the past several years has often been zero and seldom has exceeded $0.5 billion. During the financial crisis, discount window borrowing was close to $450 billion during the worst of the turmoil and gradually eased to approximately $50 billion by the end of 2010. Borrowing diminished further during 2011 and 2012 to the minuscule totals seen recently. Use of the discount window probably has an element of stigma associated with it, and use might pick up as this constraint fades.

The Fed and the financial press have highlighted the liquidity swap facilities arranged with foreign central banks, but the program has not been utilized more fully thus far. The total value of such transactions on the Fed's balance sheet was $45 million on March 18 (yes, million, not billion), a total comfortably within the range of recent observations.

The latest balance sheet data did not contain separate information on the new credit facilities to support the commercial paper market and primary dealers (nor money market mutual funds, announced after the Wednesday balance sheet date).

The Fed is prepared to add huge amounts of reserves to the banking system through the use of repurchase agreements, and the program is being actively used by primary dealers. However, usage is far below totals offered by the Fed. The central bank is willing to arrange up to $175 billion of overnight transactions, and a few RPs recently have been in the triple-digit region, but none in the past week have reached the max. A two-week RP this week was oversubscribed ($46.6 billion bids submitted, $45.0 billion accepted). The three-month RP offered on Friday was well undersubscribed ($31.25 billion of bids versus the upper limit of $500 billion).

The fact that the RP facility is being actively used indicates that liquidity issues exist in the money market, but the moderate totals sought by dealers suggest that conditions are not extreme.

Review

Week of March 16, 2020	Actual	Consensus	Comments
Retail Sales (February)	**-0.5% Total, -0.4% Ex-Autos**	**0.2% Total, 0.1% Ex-Autos**	Some of the softness in retail sales in February can be downplayed. For example, the drop of 2.8% in the gasoline component was heavily influenced by lower prices. Similarly, the decline of 0.9% in the auto component might be viewed as normal volatility in a noisy area. However, the drop of 0.2% in sales excluding autos and gasoline is difficult to dismiss, as the decline interrupted an apparent revival in the prior two months after a lull in the summer and early fall. Sales ex-autos and gasoline have increased only modestly since August.
Industrial Production (February)	**0.6%**	**0.4%**	Industrial production posted a solid advance in February, but most of the growth was the result of a weather-related jump of 7.1% in utility output. Manufacturing output rose only 0.1%, leaving little net change in the past several months and a downward tilt from the level of activity in late 2018. Mining output fell 1.5%, offsetting nearly all of the increases in the prior two months and reestablishing the flat trend that began last spring. Mining activity is elevated relative to historical standards, but it has stopped growing.
Housing Starts (February)	**1.599 Million (-1.5%)**	**1.500 Million (-4.3%)**	The modest drop in housing starts in February kept activity close to the elevated readings in the prior two months and far above the averages in the prior few years. All of the drop occurred in the multi-family sector (-14.9%), but the decline occurred from an unusually strong reading in the prior month and the new level was still above all other observations in the current cycle before December. Single-family starts were robust, increasing 6.7% and climbing to the highest level of the current expansion. Results next month will be interesting. The low level of interest rates might lead builders to maintain an elevated level of activity in anticipation of strong sales. At the same time, the uncertainty associated with the coronavirus might lead to hesitation (or lack of labor might force restraint).
Current Account (2019-Q4)	**-$109.8 Billion ($15.6 Billion Narrower Deficit)**	**-$108.6 Billion ($15.5 Billion Narrower Deficit)**	The current account deficit in Q4 was among the narrowest of the current expansion. A sharply narrower trade deficit led the improvement, as trade flows improved by $18.6 billion (soft imports because of tariffs). The shift in trade flows was partly offset by slippage of $4.0 billion in income flows. As a share of GDP, the current account deficit narrowed to 2.0%, marking the fourth consecutive improvement from a reading of 2.8% in 2018-Q4.

Review Continued

Week of March 16, 2020	Actual	Consensus	Comments
Leading Indicators (February)	**0.1%**	**0.1%**	Positive contributions from the manufacturing workweek, consumer expectations, and the leading credit index offset negative contributions from ISM new orders and building permits. The small increase followed a jump of 0.7% in January, but the index had been lethargic in other recent months and thus it has increased only marginally since late 2018. The effects of the coronavirus will probably lead to a sharp decline in the index next month (negative contributions from stock prices, unemployment claims, and consumer expectations).
Existing Home Sales (February)	**5.77 Million (+6.5%)**	**5.51 Million (+0.9%)**	Sales of existing homes jumped February. The change occurred from a downward revised level (sales in January were 0.7% lighter than previously estimated), but the increase was still strong enough to push activity to the highest level of the current expansion (previous high was 5.67 million homes in January 2017. The number of homes for sale also rose in February (5.0%). Although the number of homes on the market rose noticeably, the jump in sales kept the months' supply of homes steady at 3.1, a reading near the bottom of the historical range.

Sources: U.S. Census Bureau (Retail Sales, Housing Starts); Federal Reserve Board (Industrial Production); Bureau of Economic Analysis (Current Account); The Conference Board (Leading Indicators); National Association of Realtors (Existing Home Sales);; Consensus forecasts are from Bloomberg

Preview

Week of March 23, 2020	Projected	Comments
New Home Sales (February) (Tuesday)	**0.750 Million (-1.8%)**	Low interest rates and a firm job market should lead to another month of brisk home sales. The expected total for February is lower than that for January, but it represents the second strongest of the current expansion and is 2.9% higher than the third best.
Durable Goods Orders (February) (Wednesday)	**-1.0%**	With Boeing still facing difficulties, bookings for commercial aircraft will probably decline after a surprising jump in January. With underlying conditions in the manufacturing sector soft, durable orders ex-transportation will probably give back some of the surprising increase of 0.8% in the prior month.
U.S. International Trade in Goods (February)	**$65.0 Billion Deficit ($0.9 Billion Narrower Deficit)**	Both exports and imports probably fell in February, partly because of lower petroleum prices, but also because of soft demand and fallout from tariff wars. The drop in imports is likely to be slightly larger, leaving a modest narrowing in the monthly deficit.
Revised GDP (2019-Q4) (Wednesday)	**2.1% (Unrevised)**	Recent economic statistics have been largely in line with the estimates built into preliminary GDP, suggesting little revision to economic growth in Q4.
Personal Income, Consumption, Core Price Index (February) (Friday)	**0.4%, 0.2%, 0.2%**	Strong job growth in February and a brisk increase in average hourly earnings should lead to a jump in wages and salaries. Rental income and nonfarm proprietors' income are likely to continuing moving along firm trends. Investment income could be soft, as dividends cool after an above-average increase in January and interest income continues to show little net change. Consumer spending is likely to advance modestly. A dip in sales of new vehicles will probably restrain outlays for durable goods, and the retail sales report suggested light spending on nondurable goods. Inflation should be tame again.
Revised Consumer Sentiment (March) (Friday)	**92.0 (-3.9 Index Pt. Revision)**	The news on coronavirus worsened as the month progressed, as did weakness and volatility in the equity market. More recent responses to the survey are likely to show deeper concern about both personal and economic health.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

March/April 2020

Monday	Tuesday	Wednesday	Thursday	Friday
16	17	18	19	20
EMPIRE MFG Jan 4.8 Feb 12.9 Mar -21.5 **TIC DATA** Total / Net L-T Nov $77.1B / $27.1B Dec $78.7B / $85.6B Jan $122.9B / $20.9B	**RETAIL SALES** Total / Ex.Autos Dec 0.0% / 0.5% Jan 0.6% / 0.6% Feb -0.5% / -0.4% **IP & CAP-U** IP / Cap.Util. Dec -0.4% / 77.1% Jan -0.5% / 76.6% Feb 0.6% / 77.0% **BUSINESS INVENTORIES** Inventories / Sales Nov -0.2% / 0.5% Dec 0.0% / 0.1% Jan -0.1% / 0.6% **JOLTS DATA** Openings (000) / Quit Rate Nov 6,793 / 2.3% Dec 6,552 / 2.3% Jan 6,963 / 2.3% **NAHB HOUSING INDEX** Jan 75 Feb 74 Mar 72	**HOUSING STARTS** Dec 1.601 million Jan 1.624 million Feb 1.599 million	**INITIAL CLAIMS** Feb 29 217,000 Mar 07 211,000 Mar 14 281,000 **CURRENT ACCOUNT** 19-Q2 -$126.3 bill. 19-Q3 -$125.4 bill. 19-Q4 -$109.8 bill. **PHILLY FED INDEX** Jan 17.0 Feb 36.7 Mar -12.7 **LEADING INDICATORS** Dec -0.3% Jan 0.7% Feb 0.1%	**EXISTING HOME SALES** Dec 5.53 million Jan 5.42 million Feb 5.77 million
23	24	25	26	27
CHICAGO FED NATIONAL ACTIVITY INDEX (8:30) Monthly / 3-Mo. Avg. Dec -0.51 / -0.23 Jan -0.25 / -0.09 Feb -- / --	**NEW HOME SALES (10:00)** Dec 0.708 million Jan 0.764 million **Feb 0.750 million**	**DURABLE GOODS ORDERS (8:30)** Dec 2.8% Jan -0.2% **Feb -1.0%** **FHFA HOME PRICE INDEX (9:00)** Nov 0.3% Dec 0.6% Jan --	**INITIAL CLAIMS (8:30)** **U.S. INTERNATIONAL TRADE IN GOODS (8:30)** Dec -$68.5 billion Jan -$65.9 billion **Feb -$65.0 billion** **ADVANCE INVENTORIES REPORT (8:30)** Wholesale / Retail Dec -0.3% / -0.1% Jan -0.4% / 0.0% Feb -- / -- **REVISED GDP (8:30)** GDP / Chained Price 19-Q3 2.1% / 1.8% 19-Q4(p) 2.1% / 1.3% **19-Q4(r) 2.1% / 1.3%**	**PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX (8:30)** Inc. / Cons. / Core Dec 0.1% / 0.4% / 0.2% Jan 0.6% / 0.2% / 0.1% **Feb 0.4% / 0.2% / 0.2%** **REVISED CONSUMER SENTIMENT (10:00)** Jan 99.8 Feb 101.0 Mar(p) 95.9 **Mar(r) 92.0**
30	31	1	2	3
PENDING HOME SALES	**S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** **CHICAGO PURCHASING MANAGERS' INDEX** **CONSUMER CONFIDENCE**	**ADP EMPLOYMENT REPORT** **CONSTRUCTION SPEND.** **ISM MANUFACTURING INDEX** **VEHICLE SALES**	**INITIAL CLAIMS** **TRADE BALANCE** **FACTORY ORDERS**	**EMPLOYMENT REPORT** **ISM NONMANUFACTURING INDEX**
6	7	8	9	10
	JOLTS DATA **CONSUMER CREDIT**	**FOMC MINUTES**	**INITIAL CLAIMS** **PPI** **CONSUMER SENTIMENT** **WHOLESALE TRADE**	**CPI**

Forecasts in Bold. (p) = preliminary (2nd estimate of GDP); (r) = revised (3rd estimate of GDP)

Treasury Financing

March/April 2020

Monday	Tuesday	Wednesday	Thursday	Friday
16	17	18	19	20
AUCTION RESULTS: Rate Cover 13-week bills 0.290% 2.58 26-week bills 0.300% 2.78 **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 $40 billion 8-week bills for auction on March 19 $20 billion 79-day CMBs for auction on March 19 **SETTLE:** $50 billion 4-week bills $40 billion 8-week bills		**AUCTION RESULTS:** Rate Cover 4-week bills 0.030% 2.91 8-week bills 0.030% 2.99 79-day CMB 0.050% 3.03 10-yr TIPS 0.680% 2.32 **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:** $78 billion 13-,26-week bills	
23	24	25	26	27
AUCTION: $84 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 $40 billion* 8-week bills for auction on March 26 **SETTLE:** $50 billion 4-week bills $40 billion 8-week bills $20 billion 79-day CMBs	**AUCTION:** $41 billion 5-year notes $18 billion 2-year FRNs	**AUCTION:** $50 billion* 4-week bills $40 billion* 8-week bills $32 billion 7-year notes **ANNOUNCE:** $84 billion* 13-,26-week bills for auction on March 30 **SETTLE:** $84 billion 13-,26-week bills $26 billion 52-week bills	**SETTLE:** $18 billion 2-year FRNs
30	31	1	2	3
AUCTION: $84 billion* 13-,26-week bills	**ANNOUNCE:** $55 billion* 4-week bills for auction on April 2 $45 billion* 8-week bills for auction on April 2 **SETTLE:** $50 billion* 4-week bills $40 billion* 8-week bills $12 billion 10-year TIPS $40 billion 2-year notes $41 billion 5-year notes $32 billion 7-year notes		**AUCTION:** $55 billion* 4-week bills $45 billion* 8-week bills **ANNOUNCE:** $84 billion* 13-,26-week bills for auction on April 6 $38 billion* 3-year notes for auction on April 7 $24 billion* 10-year notes for auction on April 8 $16 billion* 30-year bonds for auction on April 9 **SETTLE:** $84 billion* 13-,26-week bills	
6	7	8	9	10
AUCTION: $84 billion* 13-,26-week bills	**AUCTION:** $38 billion* 3-year notes **ANNOUNCE:** $55 billion* 4-week bills for auction on April 9 $45 billion* 8-week bills for auction on April 9 **SETTLE:** $55 billion* 4-week bills $45 billion* 8-week bills	**AUCTION:** $24 billion* 10-year notes	**AUCTION:** $55 billion* 4-week bills $45 billion* 8-week bills $16 billion* 30-year bonds **ANNOUNCE:** $84 billion* 13-,26-week bills for auction on April 13 **SETTLE:** $84 billion* 13-,26-week bills	

**Estimate*