U.S. Economic Comment

- Data watch: focus on unemployment claims, not payrolls
- Other indicators: all showing marked retreat
- Fed: in high gear
- International trade: favorable recently, but only on the surface

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

The Labor Market

The monthly employment report, although signaling notable weakness with a drop of 701,000 in nonfarm payrolls and a jump of 0.9 percentage point in the unemployment rate, is lagging the rapid changes unfolding in the economy. These figures represent a snapshot of the labor market for the pay period or week that contains the 12th of the month, and with the economy rapidly decelerating, they are not providing an accurate picture of the latest conditions.

Fortunately, claims for unemployment insurance provide an accurate and timely picture of the economic setting, although there is a bit of a lag here as well. Initial claims for unemployment insurance totaled almost 10 million in the final two weeks of March, signaling an alarming retreat in the economy and foretelling pronounced weakness in upcoming payroll reports. Initial claims will also provide good insight into when the wave of layoffs is starting to abate, although they will not necessarily move in perfect step with employment totals. In recent weeks, for example, the large drop in March payroll employment indicated that many workers were furloughed in the early part of the month but had delayed filing for unemployment benefits.

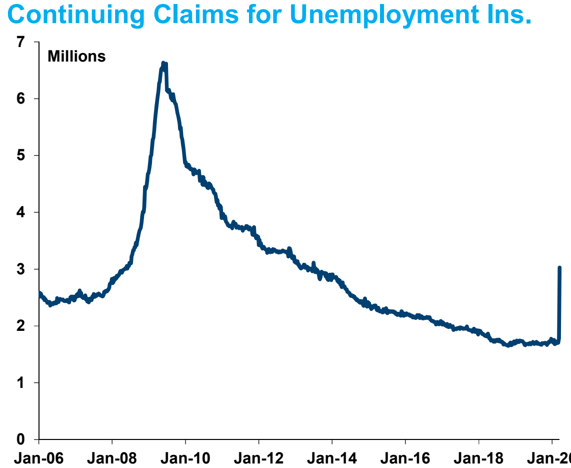
Continuing claims (the number of individuals receiving unemployment benefits) do not receive as much attention as initial claims do, but they merit close attention in this instance. This series will be helpful in assessing how high the unemployment rate might climb. The latest reading suggests a pronounced advance but still far from the level seen during the Great Recession (although it's still early; see chart). More important, continuing claims will provide clues on when workers are being recalled to their jobs. We are hopeful that the virus will dissipate during the spring and early summer, which should lead to rapid recalls of workers. Continuing claims will provide clues into whether such an outcome is unfolding and how quickly it is developing.

Other Recent Data

We saw an interesting mixture of reports relating to the consumer this week. The confidence index published by the Conference Board lost ground in March, dropping 9.5 percent, but the change occurred from an elevated reading and the measure remained at a respectable level relative to historical standards (chart, next page; note the index in March was above all readings in the prior expansion (2002-07); it was also in line with the best readings during the long expansion in the 1980s).

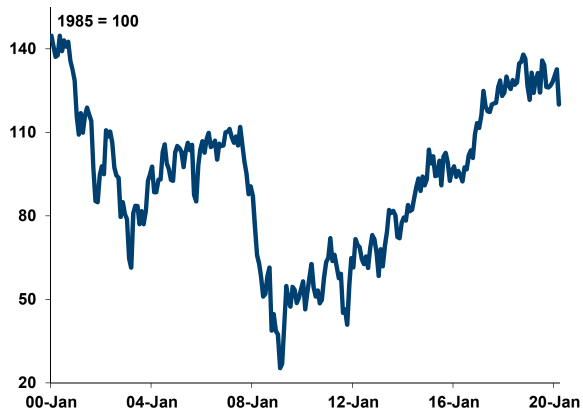
The confidence report also indicated that individuals had a favorable view of the current economic setting. The present-situation component of the headline index fell only marginally and remained comfortably within the range of recent observations. In addition, assessments

Continuing Claims for Unemployment Ins.



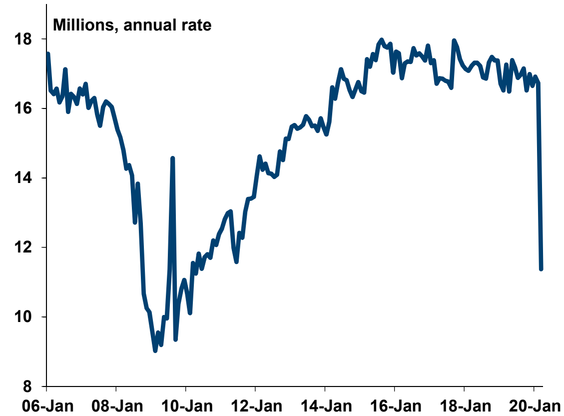
Source: U.S. Department of Labor via Haver Analytics

Consumer Confidence



Sources: The Conference Board via Haver Analytics

New Vehicle Sales



Source: Bureau of Economic Analysis via Haver Analytics

of the labor market remained favorable. The drop in the headline measure was almost entirely the result of a retreat in the expectations component, which fell 18.4 percent, suggesting deep concern about the potential effects of the coronavirus as well as the collapse in equity values.

Although individuals felt comfortable in the current economic setting, they were not active in the market for new motor vehicles, as sales of cars and trucks moved to a recession-like level in March (chart; 11.4 million cars and light trucks, down from averages of 16.9 million last year and 17.2 million in 2018).

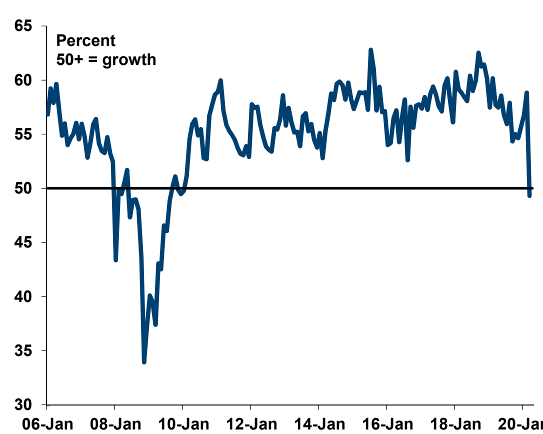
We can offer two explanations for the divergence between confidence and spending, and both are most likely in play at this time. First, although individuals are comfortable in the current setting, limits to activities because of sheltering in place and social distancing will slow spending. Second, expectations are probably more important than current conditions in determining outlays, especially for big-ticket and discretionary items.

While most indicators suggest the economy is deteriorating rapidly, the ISM indexes, both manufacturing and nonmanufacturing, seem to offer a brighter picture. Both fell in March, but the changes were modest considering the potential effects of the coronavirus. The manufacturing index fell only one percentage point and moved only slightly below 50 percent (49.1 percent). The nonmanufacturing index posted a sharper decline (off 4.8 percentage points), but it remained above the critical value of 50 percent (52.5 percent).

However, both of these measures showed unusually strong readings for the supplier delivery component (i.e. deliveries were slower than normal), which undoubtedly represents a distortion. Usually, slow deliveries are the result of brisk demand, but in this instance they are more likely the result of disruptions to supply chains because of tariffs – hardly a favorable development.

Index values based on the three (in our opinion) most important components (new orders, production, and employment) paint a different picture. This contrived measure fell 4.4 percentage points in the manufacturing sector to 44.6 percent, which represents the lowest reading since the recession. The nonmanufacturing

ISM Nonmanufacturing: Key Components*



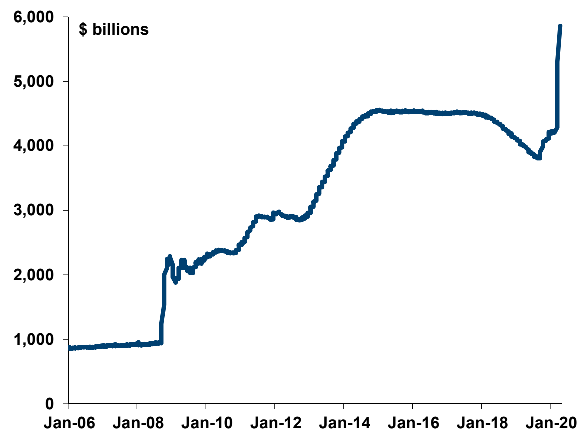
** An average of the business activity, new orders, and production components of the ISM nonmanufacturing index.*

Source: Institute for Supply Management via Haver Analytics; Daiwa Capital Markets America sector is more vulnerable to the effects of the virus (think restaurants, hotels, airlines), and this abbreviated measure shows a marked change in March, declining 9.5 percentage points. The measure moved only slightly below 50 percent (49.3 percent), but it represented the lowest reading since the early months of the expansion (chart, prior page).

Fed Update

The economy is slipping noticeably, but the Fed is doing its part to keep activity on track. The shift in its balance sheet since mid-March, when the Fed moved to unconventional policies, shows the aggressive tack it has taken. Assets as of April 1 totaled $5.9 trillion, up $1.5 trillion or 34 percent from their level only three weeks earlier (chart). (The Fed releases its balance sheet on Thursday, showing figures for both the prior Wednesday and the weekly average for the week ended Wednesday.)

Fed Balance Sheet: Total Assets*



* *Wednesday data.*
Source: Federal Reserve Board via Haver Analytics

Most of the expansion has been the result of purchases of Treasury and mortgage-backed securities, up $0.9 trillion in the past three weeks. This increase does not include purchases of approximately $162 billion on April 2 and 3. Other assets also have shifted noticeably: discount window borrowing jumped to $44 billion as of April 1, up from essentially zero in prior weeks (even years), while liquidity swap lines with foreign central banks climbed to $350 billion, also up from zero. Combined use of the new credit facilities totaled $86 billion on April 1 (total for the primary dealer and money market fund facilities; nothing at this time for the corporate bond facilities).

It is no coincidence that we have not seen disparaging tweets from President Trump.

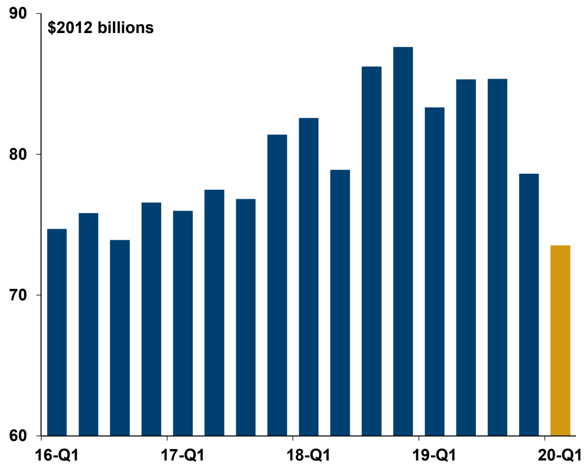
International Trade: A Source of Support, or a Sign of Disruption?

Recent reports on international trade, at first blush, look highly encouraging. The trade deficit for February narrowed by $5.6 billion from the tally in the prior month, and the shortfall for January had improved by $1.1 billion from the fourth quarter average. Moreover, changes were notably larger after adjusting these nominal figures for price changes. The real trade deficit in goods in the first two months of the year was $5.1 billion (or 6.5 percent) narrower than the fourth quarter average, and the Q4 reading was $6.7 billion (or 7.9 percent) better than that in Q3 (chart, next page; the chart shows goods trade only; price-adjusted figures for services are not available).

The marked improvement in the trade deficit represents a positive factor in the calculation of GDP. Net exports contributed 1.5 percentage points to GDP growth of 2.1 percent in the fourth quarter, and figures in hand suggest a contribution in the neighborhood of 1¼ percentage points in the first quarter.

These top-line figures are impressive, but digging slightly below the surface raises questions. The improvement largely reflects weakness in imports rather than strength in exports. In fact, nominal exports have been drifting downward since early 2018 (when trade tensions began), and real exports of goods have shown little net change in the past several months and are below levels in early 2018. The improvement in the trade deficit has largely been the result of weak imports, and weak imports most likely reflect either soft domestic demand or disruptions from tariffs.

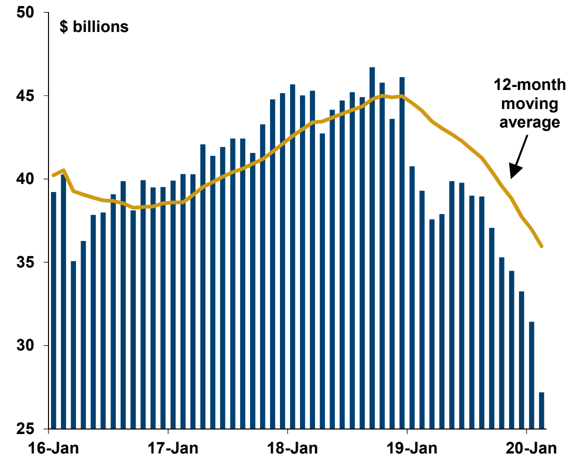
Real Goods Trade Deficit*



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

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

Imports of Goods from China into the U.S.



Source: Bureau of Economic Analysis via Haver Analytics

Soft domestic demand might be playing a small role in restraining imports, as business investment in new equipment, much of which is imported, declined in the second half of last year after increasing only marginally in the first half. Consumer spending, while continuing to advance, decelerated in the fourth quarter (growth of 1.8 percent in Q4 versus an average of 2.9 percent in the first three quarters of last year). The rate of advance in January and February remained close to that in Q4, even a bit slower.

The trade dispute undoubtedly is playing a much larger role, as the retreat in imports has been dominated by shipments from China. Total imports of goods in January and February were off 4.6 percent from the average in the first quarter of 2018, reflecting a drop of 35 percent from China and an increase of 4.4 percent ex-China.

This change in trade flows would be beneficial to the United States if a pickup in domestic production represented the flipside of the shrinkage in imports. This does not seem to be the case, however, as the manufacturing sector has shown little net change since early 2018. The manufacturing component of the industrial production index improved in the second half of 2018, but it eased during most of 2019 and offset essentially all of the gain in 2018.

Some of the drop in trade with China seems to reflect a shift in supply chains to other countries, as imports ex-China are up on balance since early 2018. In addition, firms in the U.S. seem to be drawing on inventories as a substitute for purchases from China. Inventory investment contributed negatively to GDP growth in the last three quarters of last year, and available data suggest another drag in the first quarter. Perhaps domestic production will pickup when firms get to rock bottom levels of inventory, but thus far, the reduction in the U.S. trade deficit has not represented a marked plus for the U.S. economy.

Review

Week of March 30, 2020	Actual	Consensus	Comments
Consumer Confidence (March)	**120.0 (-12.6 Index Pts.)**	**110.0 (-20.7 Index Pts.)**	Although the Conference Board's measure of consumer confidence fell noticeably in March, it remained reasonably firm by historical standards – still above all observations in the prior expansion (2002-07) and in line with the best observations during the long 1980s expansion. Individuals maintained a favorable view of the economic environment, as the present-situation index fell only modestly from an elevated level. However, a plunge of 18.4% in the expectations component indicated they were deeply concerned about the potential effects of the coronavirus and the collapse in equity values.
Construction Spending (February)	**-1.3%**	**0.6%**	The report on construction activity was soft in February, as all three major components declined. Private residential construction fell 0.6%. Construction of new homes was strong with growth of 3.3%, but improvements to existing homes tumbled 7.2% and provided an offset. Private nonresidential building fell 2.0%, continuing a zig-zag pattern that has left a flat trend. Government-related construction fell 1.5%, but the drop occurred from an elevated reading in January and the new level was still firm.
ISM Manufacturing Index (March)	**49.1% (-1.0 Pct. Pt)**	**44.5% (-5.6 Pct. Pts.)**	The ISM index slipped only slightly below the critical value of 50% in March, but a high-side reading on the supplier delivery component distorted this measure. Rather than signaling delivery issues because of brisk demand, the 65.0% reading on delivery times probably reflected disruptions to supply chains because of tariffs. Other portions of the report were less favorable, as shown by a sharp decline in the average value of new orders, production and employment (down 4.4 percentage points to 44.6%, the lowest level of the current expansion).
Trade Balance (February)	**-$39.9 Billion ($5.6 Billion Narrower Deficit)**	**-$40.0 Billion ($5.5 Billion Narrower Deficit)**	Softer imports and firmer exports led to marked improvement in the trade deficit in February. The improvement was even more pronounced after adjusting for price changes in goods trade, and the narrowing in the deficit added to favorable flows in January. Results in the first two months of the year suggest a sizeable contribution to GDP growth from net exports. While a positive contribution is welcome, we would restrain our enthusiasm because most of the improvement reflects soft imports rather than strong exports. Soft imports, in turn, have probably been influenced by disruptions associated with tariffs.

Review Continued

Week of March 30, 2020	Actual	Consensus	Comments
Factory Orders (February)	**0.0%**	**0.2%**	The flat reading on factory orders in February reflected an increase of 1.2% in bookings for durable goods that was offset by a drop of the same magnitude in orders for nondurable goods. Some of the weakness in the nondurable area was the result of a price-led decline of 3.9% in the petroleum and coal category, but orders for nondurable goods other than petroleum and coal disappointed with a decline of 0.5%, which gave a downward tilt to a previously flat trend. The brisk increase in durable orders was less impressive than it might appear, as the advance was concentrated in the volatile transportation category, which was driven by a huge increase in orders for ships and boats (up 124.7%). Durable orders excluding transportation fell 0.6%, reinforcing a downward drift.
Payroll Employment (March)	**-701,000**	**-100,000**	The drop in nonfarm payrolls in March was joined by downward revisions in the prior two months of 57,000. The payroll weakness was broadly based in March, but the leisure and hospitality industry stood out with cuts of 459,000. Most of the decline (417,000) occurred at food service and drinking places (i.e. restaurants and bars), but accommodations (i.e. hotels) also contributed with cuts of 29,000. The unemployment rate jumped 0.9 percentage point to 4.4%, a sharper change than any seen during the Great Recession (max change at that time was 0.5 percentage point for three consecutive months, December 2008 to February 2009). Average hourly earnings rose 0.4%, an apparently favorable development for workers. However, the increase most likely reflected a shift in the composition of employment rather than higher wage rates.
ISM Nonmanufacturing Index (March)	**52.5% (-4.8 Pct. Pts.)**	**43.0% (-14.3 Pct. Pts.)**	The surprisingly favorable result for the ISM nonmanufacturing index in March was influenced by an increase of 9.7 percentage points in the supplier delivery component to 62.1%. Increases in this measure usually reflect slow delivery times because of strong demand, but in this instance disruptions to supply chains were probably the source of delays in delivery. Other key elements of the report were softer than the headline figure. An average of new orders, business activity, and employment posted a drop of 9.5 percentage points to 49.3%.

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

Preview

Week of April 6, 2020	Projected	Comments
PPI (March) (Thursday)	**-0.1% Total, 0.1% Core***	The energy component is likely to constrain the headline index, as both gasoline and fuel oil prices fell noticeably. Core goods prices are likely to be tame, although they could retrace some of their 0.1% decline in February. The volatile service category always has the potential for surprise, as shown by their jump of 0.7% in January and drop of 0.3% in February.
Consumer Sentiment (April) (Thursday)	**80.0 (-9.1 Index Pts.)**	The consumer sentiment index for March seemed to reflect a combination mild virus-related concerns early in the month and more negative views in the latter half. The April measure is likely to reflect the full impact of the concerns that emerged in the second half of March and which most likely carried into the first part of April.
CPI (March) (Thursday)	**-0.1% Total, 0.1% Core**	Energy prices are likely to restrain the headline index, and early discounting in areas affected by the coronavirus could limit pressure in the core component (airfares, hotel stays, recreation services).

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

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

March/April 2020

Monday	Tuesday	Wednesday	Thursday	Friday
30	31	1	2	3
PENDING HOMES SALES Dec -4.3% Jan 5.3% Feb 2.4%	**S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** SA NSA Nov 0.5% 0.1% Dec 0.4% 0.0% Jan 0.3% 0.0% **CHICAGO PURCHASING MANAGERS' INDEX** Index Prices Jan 42.9 56.1 Feb 49.0 52.9 Mar 47.8 56.7 **CONFERENCE BOARD CONSUMER CONFIDENCE** Jan 130.4 Feb 132.6 Mar 120.0	**ADP EMPLOYMENT REPORT** Private Payrolls Jan 205,000 Feb 179,000 Mar -27,000 **CONSTRUCTION SPEND.** Dec 0.4% Jan 2.8% Feb -1.3% **ISM INDEX** Index Prices Jan 50.9 53.3 Feb 50.1 45.9 Mar 49.1 37.4 **VEHICLE SALES** Jan 16.9 million Feb 16.7 million Mar 11.4 million	**INITIAL CLAIMS** Mar 14 282,000 Mar 21 3,307,000 Mar 28 6,648,000 **TRADE BALANCE** Dec -\$48.6 billion Jan -\$45.5 billion Feb -\$39.9 billion **FACTORY ORDERS** Dec 1.9% Jan -0.5% Feb 0.0%	**EMPLOYMENT REPORT** Payrolls Un. Rate Jan 214,000 3.6% Feb 275,000 3.5% Mar -701,000 4.4% **ISM NON-MFG INDEX** Index Prices Jan 55.5 55.5 Feb 57.3 50.8 Mar 52.5 50.0
6	7	8	9	10
	JOLTS DATA (10:00) Openings (000) Quit Rate Dec 6,552 2.3% Jan 6,963 2.3% Feb -- -- **CONSUMER CREDIT (3:00)** Dec \$20.3 billion Jan \$12.0 billion Feb --	**FOMC MINUTES (2:00)**	**INITIAL CLAIMS (8:30)** **PPI (8:30)** Final Demand Core Jan 0.5% 0.4% Feb -0.6% -0.1% **Mar -0.1% 0.1%** **CONSUMER SENTIMENT (10:00)** Feb 101.0 Mar 89.1 **Apr 80.0** **WHOLESALE TRADE (10:00)** Inventories Sales Dec 0.0% -0.4% Jan -0.5% 1.6% **Feb -0.5% 0.2%**	***GOOD FRIDAY*** **CPI (8:30)** Total Core Jan 0.1% 0.2% Feb 0.1% 0.2% **Mar -0.1% 0.1%**
13	14	15	16	17
FEDERAL BUDGET	**NFIB SMALL BUSINESS OPTIMISM INDEX** **IMPORT/EXPORT PRICES**	**RETAIL SALES** **EMPIRE MFG INDEX** **IP & CAP-U** **BUSINESS INVENTORIES** **NAHB HOUSING INDEX** **BEIGE BOOK** **TIC DATA**	**INITIAL CLAIMS** **HOUSING STARTS** **PHILLY FED INDEX**	**LEADING INDICATORS**
20	21	22	23	24
CHICAGO FED NAT'L ACTIVITY INDEX	**EXISTING HOME SALES**	**FHFA HOME PRICE INDEX**	**INITIAL CLAIMS** **MARKIT MANUFACTURING PMI** **MARKIT SERVICES PMI** **NEW HOME SALES**	**DURABLE GOODS ORDERS** **REVISED CONSUMER SENTIMENT**

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

Forecasts in Bold.

Treasury Financing

March/April 2020

Monday	Tuesday	Wednesday	Thursday	Friday
30	**31**	**1**	**2**	**3**
AUCTION RESULTS: Rate / Cover 13-week bills 0.085% 2.52 26-week bills 0.100% 2.72 37-day CMB 0.025% 2.88 **ANNOUNCE:** $60 billion 37-day CMBs for auction on March 30 $45 billion 69-day CMBs for auction on March 31	**AUCTION RESULTS:** Rate / Cover 42-day CMB 0.080% 2.79 **ANNOUNCE:** $80 billion 4-week bills for auction on April 2 $60 billion 8-week bills for auction on April 2 $40 billion 119-day CMBs for auction on April 1 $40 billion 154-day CMBs for auction on April 2 $45 billion 39-day CMBs for auction on April 1 **SETTLE:** $60 billion 4-week bills $50 billion 8-week bills $12 billion 10-year TIPS $40 billion 2-year notes $41 billion 5-year notes $32 billion 7-year notes $60 billion 37-day CMBs	**AUCTION RESULTS:** Rate / Cover 119-day CMB 0.130% 2.99 39-day CMB 0.080% 3.07 **ANNOUNCE:** $40 billion 102-day CMBs for auction on April 2 **SETTLE:** $45 billion 69-day CMBs	**AUCTION RESULTS:** Rate / Cover 4-week bills 0.090% 3.00 8-week bills 0.095% 2.85 102-day CMB 0.125% 3.06 154-day CMB 0.150% 2.90 **ANNOUNCE:** $99 billion 13-,26-week bills for auction on April 6 $40 billion 3-year notes for auction on April 7 $25 billion 10-year notes for auction on April 8 $17 billion 30-year bonds for auction on April 9 **SETTLE:** $93 billion 13-,26-week bills $60 billion 42-day CMBs $40 billion 119-day CMBs	**ANNOUNCE:** $60 billion 43-day CMBs for auction on April 6 $40 billion 119-day CMBs for auction on April 7 **SETTLE:** $45 billion 39-day CMBs $40 billion 102-day CMBs
6	**7**	**8**	**9**	**10**
AUCTION: $99 billion 13-,26-week bills $60 billion 43-day CMBs	**AUCTION:** $40 billion 3-year notes $40 billion 119-day CMBs **ANNOUNCE:** $80 billion* 4-week bills for auction on April 9 $60 billion* 8-week bills for auction on April 9 **SETTLE:** $80 billion 4-week bills $60 billion 8-week bills $40 billion 154-day CMBs	**AUCTION:** $25 billion 10-year notes **SETTLE:** $60 billion 43-day CMBs	**AUCTION:** $80 billion* 4-week bills $60 billion* 8-week bills $17 billion 30-year bonds **ANNOUNCE:** $99 billion* 13-,26-week bills for auction on April 13 **SETTLE:** $99 billion 13-,26-week bills $40 billion 119-day CMBs	***GOOD FRIDAY***
13	**14**	**15**	**16**	**17**
AUCTION: $99 billion* 13-,26-week bills	**ANNOUNCE:** $80 billion* 4-week bills for auction on April 16 $60 billion* 8-week bills for auction on April 16 **SETTLE:** $80 billion* 4-week bills $60 billion* 8-week bills	**SETTLE:** $40 billion 3-year notes $25 billion 10-year notes $17 billion 30-year bonds	**AUCTION:** $80 billion* 4-week bills $60 billion* 8-week bills **ANNOUNCE:** $99 billion* 13-,26-week bills for auction on April 20 $28 billion* 52-week bills for auction on April 21 $17 billion* 5-year TIPS for auction on April 23 **SETTLE:** $99 billion* 13-,26-week bills	
20	**21**	**22**	**23**	**24**
AUCTION: $99 billion* 13-,26-week bills	**AUCTION:** $28 billion* 52-week bills **ANNOUNCE:** $80 billion* 4-week bills for auction on April 23 $60 billion* 8-week bills for auction on April 23 **SETTLE:** $80 billion* 4-week bills $60 billion* 8-week bills		**AUCTION:** $80 billion* 4-week bills $60 billion* 8-week bills $17 billion* 5-year TIPS **ANNOUNCE:** $99 billion* 13-,26-week bills for auction on April 27 $20 billion* 2-year FRNs for auction on April 28 $42 billion* 2-year notes for auction on April 27 $42 billion* 5-year notes for auction on April 27 $33 billion* 7-year notes for auction on April 28 **SETTLE:** $99 billion* 13-,26-week bills $28 billion* 52-week bills	

**Estimate*