Daiwa Capital Markets

U.S. Economic Comment

- Employment data: insights into the softest spots
- Treasury funding: shifting to a longer-turn strategy

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Broad-Based Weakness

The monthly employment data released today confirmed the extreme weakness in the labor market suggested by the weekly figures on unemployment claims. More important, the new report provided additional insights into the state of the economy and the impact of the coronavirus by providing industry breakdowns for both employment and the length of the average workweek. The length of the workweek is an underappreciated component of the labor market data. Businesses can boost or limit their output by altering work times while holding employment levels constant. To get sharp insights into shifting economic conditions, one should focus on both employment totals and the length of the workweek.

The industry breakdown in the table below is meant to show where the virus is hitting hardest. The first two columns show the change in payroll employment, the arithmetic change in the first column and the percent change in the second column. The percent change is more useful for comparisons because industry sizes vary considerably. The third column shows the arithmetic change in the length of the workweek, measured in hours. The final column, the percent change in the index of total hours worked, is the most useful because it combines the influences of changes in both employment and the length of the workweek. All figures in the table are changes over the past two months to pick up the softness evident in both March and April.

The row for the total private sector shows a retreat of approximately 16 percent (not annualized) in total hours worked in March and April. Results for total hours worked are likely to correlate highly with production or GDP, and the weak start to the second quarter sets the stage for a drop of 40 to 50 percent in Q2 GDP. Parts of the economy are beginning to reopen, and thus the picture might brighten with results for May and June, but the data in hand suggest a pronounced retreat in the economy in the second quarter.

Interestingly, the table shows that the goods-producing and service-producing sectors of the economy have shared about equally in absorbing the retrenchment. Much of the media coverage has suggested a sharper retreat in the service sector, but the data show that the goods-producing sector is suffering as well. To be sure, the leisure industry is desperate, as is the miscellaneous service area, but other service industries are holding up reasonably well. The drop of only 3.0 percent in the financial services industry stands out. The three key industries in the goods-producing sector have registered similar soft performances.

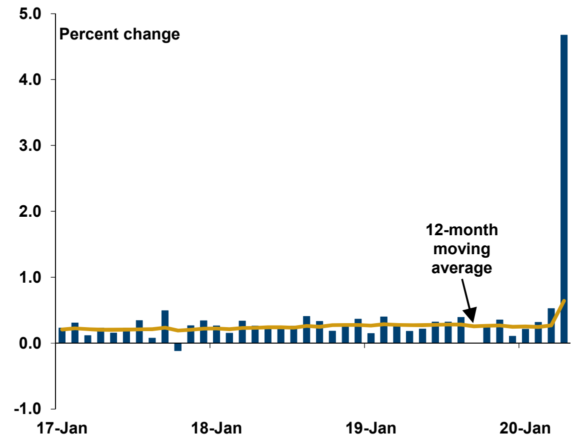
Employment Report: Key Metrics

	Change in Payrolls (Thousands)	Change in Payrolls (Percent)	Change in Average Workweek (Hours)	Change in Aggregate Hours Worked (Percent)
	April versus February			
Private Sector Payrolls	**-20,362**	**-15.7**	**-0.2**	**-16.2**
Goods-producing	**-2,429**	**-11.5**	**-2.1**	**-16.1**
Mining and Logging	-57	-8.0	-2.5	-13.0
Construction	-1,008	-13.2	-1.5	-16.5
Manufacturing	-1,364	-10.6	-2.4	-15.8
Service Producing	**-17,933**	**-16.5**	**0.2**	**-16.0**
Trade, Transportation, & Utilities	-3,111	-11.2	-0.4	-12.2
Information	-258	-8.9	0.2	-8.3
Financial Activities	-265	-3.0	0.0	-3.0
Professional & Business Services	-2,197	-10.2	-0.3	-11.0
Education & Healthcare Services	-2,645	-10.8	-0.6	-12.4
Leisure & Hospitality	-8,152	-48.3	-1.6	-51.5
Other Services	-1,305	-22.0	0.2	-21.4

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

The change in average hourly earnings provides another insight into the effects of the coronavirus. This wage measure posted a stunning month-to-month increase of 4.7 percent (not annualized). The surge, no doubt, reflected a compositional change in employment rather than an increase in wage rates. That is, the sharp decline in employment in the leisure and miscellaneous service industries affected primarily low-wage workers, and the absence of their wage rates in the calculation of the average naturally led to an increase in the average wage of remaining workers. This jump in average hourly earnings shows the cruelty of the virus – it is affecting most severely those least able to absorb the impact.

Average Hourly Earnings



Source: Bureau of Labor Statistics via Haver Analytics

The unemployment rate most likely will capture a good bit of attention in both the popular and financial press. The increase of 15.9 million in the number of unemployed individuals and the jump of 10.3 percentage points in the jobless rate to 14.7 percent were troubling, but these shifts were less pronounced than those for other elements of the labor market report (the drop of 20.5 million in payroll employment, for example).

However, the published unemployment rate no doubt understated the true extent of joblessness. The unemployment rate is based on a survey of households, and many individuals seem to have mischaracterized their employment situation in the survey. Large numbers of individuals indicated that they were employed but were currently on unpaid leave. If their absence was because of the coronavirus, they should have been classified as on temporary layoff and therefore unemployed. The Bureau of Labor Statistics indicated that if individuals were properly classified, the unemployment rate might have been five percentage points higher.

The effect of misreporting also was evident in the plunge of 6.4 million in the size of the labor force. Many individuals furloughed because of the virus probably indicated in the survey that they were not searching for a job and therefore were counted as not in the labor force. If these individuals had been properly classified as on temporary layoff, the unemployment rate would have been in the neighborhood of 18 percent.

While the unemployment rate was understated, the published figure nevertheless indicated extreme weakness in the labor market.

Treasury Funding: Shifting to the Longer-End of the Maturity Spectrum

The Coronavirus Aid, Relief, and Economic Security (CARES) Act presented the Treasury Department with a monumental challenge: raise a mind-boggling volume of funds in a short period of time without disrupting financial markets. Treasury officials revealed this week that they saw a need to raise $2,999 billion of funds during the April-June quarter, a volume more than twice the size of the largest annual deficit ever registered by the federal government ($1,413 billion in fiscal year 2009). This total includes the effects of the underlying budget deficit (most likely revised upward because of the slow economy), the additional shortfall generated by the CARES Act, a temporary gap generated by the postponement of the April 15 tax filing deadline, and a precautionary increase in the Treasury's cash balance because of the heightened uncertainty regarding revenues and outlays. The estimated funding burden will ease in the July-September quarter, but it is still sizeable at $677 billion.

It appears as though the Treasury Department is making good progress in meeting its challenge. The quarter is about at the half-way mark, and the government's debt managers have raised approximately 60 percent of the needed funds, and interest rates have barely moved since the funding barrage began. However, challenges lie ahead.

The Treasury has raised most of the funds in the short-end of the maturity spectrum. It increased the auction sizes in its regular cycle of bills (one, two, three, six and 12-month issues), which brought in a moderate amount of new cash. The more forceful move was the issuance of a large number of cash management bills, which are add-ons to bills in the regular cycle. From late March through May 7, the Treasury announced 34 such issues totaling $1.39 trillion.

Some observers might view heavy use of cash management bills as a bizarre strategy; locking in today's rock bottom level of interest rates with longer-term issues would seem to be a wiser course. However, the Treasury needed to raise a huge volume of funds quickly, which would have required enormous increases in the auction sizes of longer-term securities and most likely would have disrupted financial markets. The Treasury, instead, turned to frequent auctions of moderate size in the short end of the maturity spectrum.

The market environment also may have had an influence in the decision to rely on cash management bills. Because of heightened economic uncertainty generated by the coronavirus, demand for safe, liquid assets has been strong, which led to active bidding for the Treasury's short-term issues.

Challenges Ahead. Active use of the short-end of the market served the Treasury Department well in the past several weeks, but it is not an optimal long-run strategy. The Treasury would no doubt prefer an approach that locks-in today's low interest rates and eases the burden of rolling over large volumes of short-term debt. The Treasury is now moving to such a strategy, as it announced this week noticeable increases in the auction sizes of most of its coupon securities. The so-called mid-quarter refunding (issuance of 3-year, 10-year, and 30-year securities) will be $12 billion larger than the previous effort in February. In addition, the Treasury indicated that it will continue to boost the sizes of these issues through July, as it will with 2-year, 5-year, 7-year, and 2-year-floating-rate notes. The Treasury also introduced a new 20-year bond that will be auctioned every month (a new issue every February, May, August, and November, and reopenings of the new issues in the following two months).

Treasury Funding Requirements*

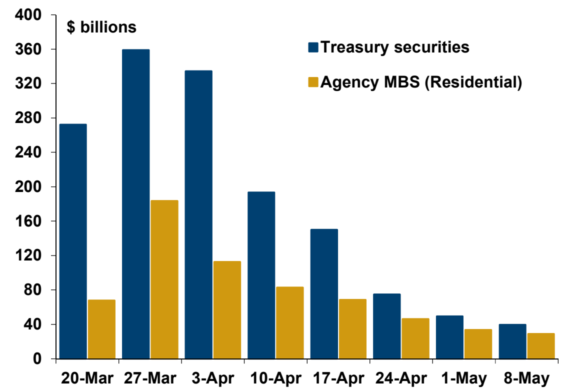
	Funding Requirements	Bills (Regular + CMB)	Coupon Securities
		$ billions	
April - June	**2,999**	**2,669**	**330**
Through May 15	1,770	1,707	63
May 16 to June 30	1,229	962	267
July - September	**677**	**184**	**493**

* *The table shows net new funds raised by the Treasury in the bill sector (one year or less) and the coupon sector (two years to 30 years).*
Source: U.S. Treasury Department; Daiwa Capital Markets America

While it is not clear how the Treasury will adjust auction sizes in the months ahead, the announcement at the mid-quarter refunding implied that officials are seeking to shift from the short-end to the long-end of the maturity spectrum. That is, debt managers seem to believe they have raised enough cash to meet the emergency funding needs generated by the CARES Act, and they can now begin moving to a balanced longer-term funding strategy. The table above assumes that the Treasury will continue to increase coupon auction sizes through September at the same pace it did at the mid-quarter refunding. Under this assumption, the amount of funds raised through bills (both regular weekly issues and cash management bills) will diminish, while funds raised through coupon securities will increase.

Help from the Fed. A close meshing of market demand and Treasury issuance undoubtedly contributed to smooth market functioning during the period of heavy funding by the federal government, but the Federal Reserve played a role as well. The Fed was aggressive in its quantitative easing efforts in the latter half of March and it remained active in April and is continuing to purchase in May. Its purchases through April totaled more than $1.4 trillion, almost three-quarters of the new issuance by the Treasury. The Fed's purchases were spread across the yield curve rather than focused on the short-end of the market tapped by the Treasury. Nevertheless, the heavy presence by the Fed most likely helped the tone of the market.

Fed Securities Purchases



Source: Federal Reserve Bank of New York

Review

Week of May 4, 2020	Actual	Consensus	Comments
Factory Orders (March)	**-10.3%**	**-9.7%**	Durable goods orders tumbled 14.7% in March (revised from -14.4% first published April 28), but the decline was concentrated in the transportation category, where problems in the commercial aircraft sector led to a stunning decline of 296.2%, driven by a negative reading on new orders (i.e. net cancellations). Excluding transportation items, orders for durable goods fell 0.4%, a respectable reading in the current environment. Nondurable bookings fell 5.8%, but the drop was concentrated in the petroleum and coal category (-30.3%), where lower prices most likely accounted for much of the decline. Orders for nondurable goods excluding petroleum and coal rose 0.6%, offsetting most of the drop in the prior month and preserving a flat trend.
Trade Balance (March)	**-$44.4 Billion ($4.6 Billion Wider Deficit)**	**-$44.2 Billion ($4.3 Billion Wider Deficit)**	Both exports and imports fell in March (-9.6% and -6.2%, respectively), with the larger shift in exports leading to a widening in the monthly trade deficit. The already published results for trade in goods accounted for most of the slippage, as this shortfall widened by $4.6 billion. The surplus in services in March was little changed, but the stability masked sharp declines in both exports and imports (off 15.3% and 21.8%, respectively). Most of the adjustment occurred in travel and tourism, not surprising given the influence of the virus. The trade results for March were close to the assumptions built into the initial estimate of Q1 GDP, suggesting little influence on the revised estimate of growth to be published later this month.
ISM Nonmanufacturing Index (April)	**41.8% (-11.7 Pct. Pts.)**	**38.0% (-14.5 Pct. Pts.)**	The ISM nonmanufacturing index in April was supported by a jump of 16.2 percentage points in the supplier deliveries index to 78.3% (a new record high). The slow delivery times signaled by this surge were probably the result of disruptions associated with business closures rather than strong demand and order backlogs. Other components (new orders, business activity, and employment) all moved to record lows. An average of these three indexes totaled 29.6%, softer than the previous record low of 33.9% seen during the financial crisis.

Review Continued

Week of May 4, 2020	Actual	Consensus	Comments
Nonfarm Productivity (2020-Q1)	**-2.5%**	**-5.5%**	Hours worked fell 3.8% in Q1, reflecting the effects of business closures, but output fell by a larger amount (6.2%) leading to the drop in productivity. Productivity growth had shown signs of picking up in recent quarters (up 1.8% over the four quarters of 2019 versus 1.3% in the prior two years and an average of 0.7% from 2014 to 2016), but the tendency for productivity to move pro-cyclically seemed to be the dominant factor in the first quarter.
Nonfarm Payrolls (April)	**-20,500,000**	**-22,000,000**	The magnitude of job losses in April was huge, with cuts spanning all of the 13 major private-sector industries published in the payroll report. Comparisons across industries are best made by focusing on percent changes. Total payrolls fell 13.5%, with the service sector contracting 15.9% and the goods-producing sector declining 11.1%. The unemployment rate jumped 10.3 percentage points to 14.7%, but the Bureau of Labor Statistics highlighted an oddity in the figures that points to an undercount. Specifically, numerous individuals were classified as employed, but absent from work. Most of these individuals were probably absent because of the coronavirus and should have been classified as on temporary layoff and therefore unemployed. If they had been properly classified, the BLS noted that the jobless rate would have been approximately five percentage points higher. Average hourly earnings posted a stunning month-to-month increase of 4.7% (not annualized). The surge reflects a marked compositional shift in employment, with job losses concentrated among lower-wage workers.

Sources U.S. Census Bureau (Factory Orders); Bureau of Economic Analysis (Trade Balance); Institute for Supply Management (ISM Nonmanufacturing Index); Bureau of Labor Statistics (Nonfarm Productivity, Nonfarm Payrolls); Consensus forecasts are from Bloomberg

Preview

Week of May 11, 2020	Projected	Comments
CPI (April) (Tuesday)	**-0.5% Total, 0.0% Core**	Food prices are likely to increase noticeably because of strong demand in the early stages of the virus crisis, but lower energy prices should easily dominate and push the headline index lower. A tame core component also should help to contain the overall CPI, as many of the items affected by the coronavirus are likely to be soft again in April (air travel, hotel stays, recreation services, motor vehicles).
Federal Budget (April) (Tuesday)	**$750.0 Billion Deficit**	Net receipts collected by the federal government were probably minuscule in April, largely because of the postponement of the due date for final payment on 2019 obligations. In addition, the relief payments to individuals authorized by the CARES Act are likely to be booked as tax refunds rather than outlays. Finally, the surge in layoffs will generate a sharp decline in taxes withheld from paychecks. Outlays are likely to be boosted by efforts to fight the coronavirus and to provide relief.
PPI (April) (Tuesday)	**-0.5% Total, 0.0% Core***	The sharp decline in energy prices is likely to drive the headline PPI noticeably lower. In addition, the volatile trade services category is due for a drop after a high-side reading in March. Trade services are excluded from the core measure published by the Bureau of Labor Statistics, which should dampen the downward pressure on this component.
Retail Sales (April) (Friday)	**-9.0% Total, -8.0% Ex-Autos**	The drop in sales of new motor vehicles should lead to a marked decline in the auto component, and lower prices and limited driving because of the lockdown are likely to depress gasoline sales. Other areas also are likely to be depressed by stay-at-home restrictions, as the limits did not become pronounced until the second half of March, delaying the full force to April. Online sales are likely to be strong, but they will probably provide only a partial offset to softness elsewhere.
Industrial Production (April) (Friday)	**-10.0%**	The manufacturing component of IP fell sharply in March, but residual fallout from the coronavirus is likely to be felt in April. In addition, low petroleum prices are likely to constrain oil drilling.
Consumer Sentiment (May) (Friday)	**65.0 (-6.8 Index Pts.)**	Strains and frustrations from sheltering- in-place probably dampened moods further in early May.

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

Economic Indicators

May 2020

Monday	Tuesday	Wednesday	Thursday	Friday
4	5	6	7	8
FACTORY ORDERS Jan -0.5% Feb -0.1% Mar -10.3%	**TRADE BALANCE** Jan -$45.5 billion Feb -$39.8 billion Mar -$44.4 billion **ISM NON-MFG INDEX** Index / Prices Feb 57.3 / 50.8 Mar 52.5 / 50.0 Apr 41.8 / 55.1	**ADP EMPLOYMENT REPORT** Private Payrolls Feb 147,000 Mar -149,000 Apr -20,236,000	**UNEMPLOYMENT CLAIMS** Initial / Continuing (Millions) Apr 11 5.237 / 15.819 Apr 18 4.442 / 18.011 Apr 25 3.846 / 22.647 May 02 3.169 / N/A **PRODUCTIVITY & COSTS** Productivity / Unit Labor Costs 19-Q3 -0.3% / 0.2% 19-Q4 1.2% / 0.9% 20-Q1 -2.5% / 4.8% **CONSUMER CREDIT** Jan $10.3 billion Feb $19.9 billion Mar -$12.0 billion	**EMPLOYMENT REPORT** Payrolls / Un. Rate Feb 230,000 / 3.5% Mar -870,000 / 4.4% Apr -20,500,000 / 14.7% **WHOLESALE TRADE** Inventories / Sales Jan -0.6% / 1.3% Feb -0.7% / -0.7% Mar -0.8% / -5.2%
11	12	13	14	15
	NFIB SMALL BUSINESS OPTIMISM INDEX (6:00) Feb 104.5 Mar 96.4 Apr -- **CPI (8:30)** Total / Core Feb 0.1% / 0.2% Mar -0.4% / -0.1% **Apr -0.5% / %0.0** **FEDERAL BUDGET (2:00)** 2020 / 2019 Feb -$235.3B / -$234.0B Mar -$119.1B / -$146.9B **Apr -$750.0B** / $160.3B	**PPI (8:30)** Final Demand / Core* Feb -0.6% / -0.1% Mar -0.2% / -0.2% **Apr -0.5% / 0.0%**	**INITIAL CLAIMS (8:30)** **IMPORT/EXPORT PRICES (8:30)** Non-fuel Imports / Nonagri. Exports Feb 0.3% / -1.1% Mar 0.0% / -1.5% Apr -- / --	**RETAIL SALES (8:30)** Total / Ex.Autos Feb -0.4% / -0.4% Mar -8.4% / -4.2% **Apr -9.0% / -8.0%** **EMPIRE MFG (8:30)** Mar -21.5 Apr -78.2 May -- **IP & CAP-U (9:15)** IP / Cap.Util. Feb 0.5% / 77.0% Mar -5.4% / 72.7% **Apr -10.0% / 65.0%** **BUSINESS INVENTORIES (10:00)** Inventories / Sales Jan -0.3% / 0.5% Feb -0.5% / -0.5% **Mar -0.2% / -5.4%** **JOLTS DATA (10:00)** Openings (000) / Quit Rate Jan 7,012 / 2.3% Feb 6,882 / 2.3% Mar -- / -- **CONSUMER SENTIMENT (10:00)** Mar 89.1 Apr 71.8 **May 65.0** **TIC DATA (4:00)** Total / Net L-T Jan $127.3B / $21.8B Feb -$13.4B / $49.4B Mar -- / --
18	19	20	21	22
NAHB HOUSING INDEX	**HOUSING STARTS**	**FOMC MINUTES**	**INITIAL CLAIMS** **PHILLY FED INDEX** **EXISTING HOME SALES** **LEADING INDICATORS**	
25	26	27	28	29
MEMORIAL DAY	**CHICAGO FED NATIONAL ACTIVITY INDEX** **FHFA HOME PRICE INDEX** **CORELOGIC CASE-SHILLER HOME PRICE INDEX** **CONSUMER CONFIDENCE** **NEW HOME SALES**	**BEIGE BOOK**	**INITIAL CLAIMS** **REVISED GDP** **DURABLE GOODS ORDERS** **PENDING HOME SALES**	**U.S. INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES** **PERSONAL INCOME, SPENDING, PRICES** **CHICAGO PURCHASING MANAGERS' INDEX** **REVISED CONSUMER SENTIMENT**

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

Daiwa Capital Markets

Treasury Financing

May 2020

Monday	Tuesday	Wednesday	Thursday	Friday
4	5	6	7	8
AUCTION RESULTS: Rate Cover 13-week bills 0.110% 3.00 26-week bills 0.130% 2.99 105-day CMB 0.115% 3.35	**AUCTION RESULTS:** Rate Cover 42-day CMB 0.115% 2.74 119-day CMB 0.130% 3.38 **ANNOUNCE:** $80 billion 4-week bills for auction on May 7 $70 billion 8-week bills for auction on May 7 $35 billion 154-day CMBs for auction on May 6 $30 billion 105-day CMBs for auction on May 7 **SETTLE:** $90 billion 4-week bills $70 billion 8-week bills $30 billion 154-day CMBs $30 billion 105-day CMBs	**AUCTION RESULTS:** Rate Cover 154-day CMB 0.150% 2.91 **ANNOUNCE MID-QTR REFUNDING:** $42 billion 3-year notes for auction on May 11 $32 billion 10-year notes for auction on May 12 $22 billion 30-year bonds for auction on May 13	**AUCTION RESULTS:** Rate Cover 4-week bills 0.095% 2.87 8-week bills 0.110% 2.89 105-day CMB 0.125% 3.00 **ANNOUNCE:** $117 billion 13-,26-week bills for auction on May 11 $65 billion 42-day CMBs for auction on May 12 $35 billion 119-day CMBs for auction on May 12 **SETTLE:** $111 billion 13-,26-week bills $65 billion 42-day CMBs $30 billion 119-day CMBs	
11	12	13	14	15
AUCTION: $117 billion 13-,26-week bills $42 billion 3-year notes	**AUCTION:** $32 billion 10-year notes $65 billion 42-day CMBs $35 billion 119-day CMBs **ANNOUNCE:** $80 billion* 4-week bills for auction on May 14 $70 billion* 8-week bills for auction on May 14 **SETTLE:** $80 billion 4-week bills $70 billion 8-week bills $35 billion 154-day CMBs $30 billion 105-day CMBs	**AUCTION:** $22 billion 30-year bonds	**AUCTION:** $80 billion* 4-week bills $70 billion* 8-week bills **ANNOUNCE:** $117 billion* 13-,26-week bills for auction on May 18 $30 billion* 52-week bills for auction on May 19 $20 billion* 20-year bonds for auction on May 20 $12 billion* 10-year TIPS for auction on May 21 **SETTLE:** $117 billion 13-,26-week bills $65 billion 42-day CMBs $35 billion 119-day CMBs	**SETTLE:** $42 billion 3-year notes $32 billion 10-year notes $22 billion 30-year bonds
18	19	20	21	22
AUCTION: $117 billion* 13-,26-week bills	**AUCTION:** $30 billion* 52-week bills **ANNOUNCE:** $80 billion* 4-week bills for auction on May 21 $70 billion* 8-week bills for auction on May 21 **SETTLE:** $80 billion* 4-week bills $70 billion* 8-week bills	**AUCTION:** $20 billion* 20-year bonds	**AUCTION:** $80 billion* 4-week bills $70 billion* 8-week bills $12 billion* 10-year TIPS **ANNOUNCE:** $117 billion* 13-,26-week bills for auction on May 26 $20 billion* 2-year FRNs for auction on May 27 $44 billion* 2-year notes for auction on May 26 $45 billion* 5-year notes for auction on May 27 $38 billion* 7-year notes for auction on May 28 **SETTLE:** $117 billion* 13-,26-week bills $30 billion* 52-week bills	
25	26	27	28	29
MEMORIAL DAY	**AUCTION:** $117 billion* 13-,26-week bills $44 billion* 2-year notes **ANNOUNCE:** $80 billion* 4-week bills for auction on May 28 $70 billion* 8-week bills for auction on May 28 **SETTLE:** $80 billion* 4-week bills $70 billion* 8-week bills	**AUCTION:** $20 billion* 2-year FRNs $45 billion* 5-year notes	**AUCTION:** $80 billion* 4-week bills $70 billion* 8-week bills $38 billion* 7-year notes **ANNOUNCE:** $117 billion* 13-,26-week bills for auction on June 1 **SETTLE:** $117 billion* 13-,26-week bills	**SETTLE:** $12 billion* 10-year TIPS $20 billion* 2-year FRNs

**Estimate*