U.S. Economic Comment

- Employment: one-third of the way back
- The manufacturing sector: rebounding, but not surging
- International trade: hit hard by the pandemic
- FOMC: leaning toward more forward guidance, but not yield curve control

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The Labor Market in June

The U.S. registered another month of strong job growth in June, adding 4.8 million new jobs after a gain of 2.7 million in the prior month. Of course, the U.S. had considerable room for improvement after combined job cuts of 22.2 million in March and April. The recent increases retraced approximately one-third of the deterioration in employment and left payrolls in June 9.6 percent below the total in February (chart, below, and table on page 5).

Job growth was broadly based in June as shown by the reading of 75.2 percent for the monthly diffusion index (constructed like the ISM index, a range of 0 to 100 with 50 separating expansion and contraction). This reading was not far from the record of 78.5 percent in June 1994 and was well above the average of 58.8 percent last year and better than the best annual average of the latest expansion (65.0 percent in 2014).

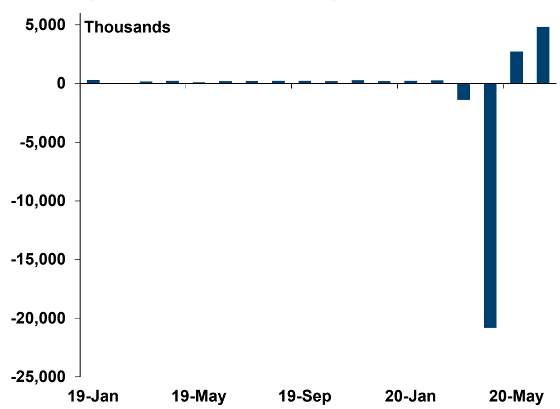
While the increase was broadly based, some industries stood out. The leisure and hospitality sector added 2.1 million workers, which represented an advance of 21.0 percent, the strongest among all major industries and well above the monthly increase of 3.6 percent for total nonfarm payrolls. The increase was substantial, and followed a strong performance in May (up 1.4 million or 16.4 percent). However, this sector suffered badly in March and April, and payrolls were still 28.6 percent below their level in February (versus a net drop of 9.6 percent for total payrolls). The "other" service category also performed poorly in March and April. Gains of 5.7 percent and 7.4 percent in May and June allowed this sector to regain 45 percent of its lost ground, but employment was still 12.7 percent below the February total.

The retail trade sector was strong in June, adding 739,000 new jobs (5.4 percent). This sector, also hit hard by the virus, has now regained 47 percent of its slippage and is 8.1 percent below its February peak (better than the shortfall for total payrolls). Manufacturing and construction also were strong, with triple-digit job gains and better-than-average results relative to the February peak (5.9 percent below February for manufacturing and 6.2 percent for construction).

A few areas, although improving, posted unimpressive advances (information, business services, education). Some areas continued to perform poorly. Mining employment fell for the fourth consecutive month (and for the seventh time in the past eight). Firms in the air and rail transportation industries also continued to cut employment.

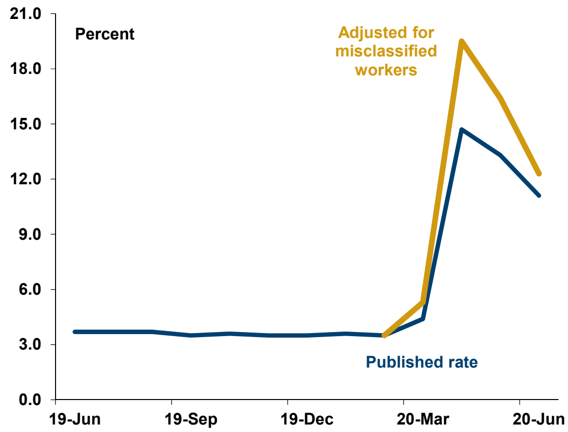
Average hourly earnings fell 1.2 percent in June after a drop of 1.0 percent in May, but these declines could be viewed as favorable developments. The softness reflects the recall of workers earning below average wages. Virus-related job cuts had a disproportionate effect on lower-wage individuals (which lifted average earnings in

Change in Nonfarm Payrolls



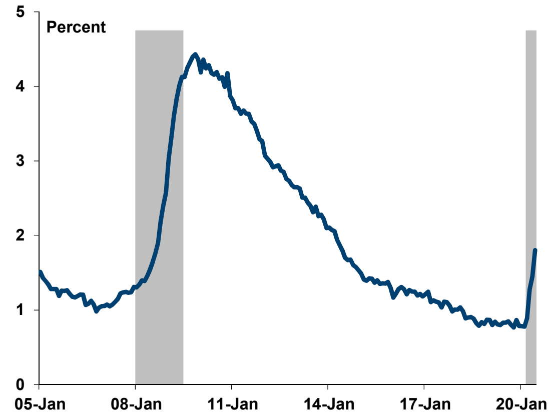
Source: Bureau of Labor Statistics via Haver Analytics

Unemployment Rate



Source: Bureau of Labor Statistics via Haver Analytics

Permanent Job Cuts*



** Permanent job losers as a share of the civilian labor force. The shaded areas indicate periods of recession in the United States.*

Source: Bureau of Labor Statistics and The National Bureau of Economic Research via Haver Analytics; Daiwa Capital Markets America

March and April as these individuals dropped out of the calculation); now, with these individuals returning to work and reentering the calculation of average earnings, the overall average naturally falls.

The unemployment rate fell 2.2 percentage points in June after a drop of 1.5 percentage points in May, leaving the jobless rate at 11.1 percent. The actual unemployment situation is worse than suggested by the published totals, but the recent improvement has been more pronounced than suggested by the official figures. Confused? It's easily explained.

The unemployment rate in recent months has been distorted (restrained) by a misclassification of individuals in the monthly survey of households. Workers furloughed because of the coronavirus should be classified as unemployed (temporary layoff). However, many individuals affected by the virus indicated that they were employed but not currently on the job. (There are numerous reasons why an employed individual might not be working: vacation, illness, bad weather, strike. The Bureau of Labor Statistics also includes an "other" category in its list of reasons to be employed but not working. Many individuals apparently see themselves returning to their previous jobs when the economy reopens, and thus they indicated that they were employed but not working for "other" reasons.)

Officials at the Bureau of Labor Statistics have strived to limit such misclassification, and they indicated that results in June had improved considerably. The estimated understatement of the unemployment rate totaled 4.8 percentage points in April and 3.1 percentage points in May, but officials believe it eased to 1.2 percentage points in June. Thus, if the rate were error-free, it would have declined 3.4 percentage points in June rather than 2.2 percentage points, and would be down 7.2 percentage points from the peak in April rather than the published drop of 3.6 percentage points (chart, above left).

Recent shifts in employment statistics have primarily been in positive directions, but an adverse development has emerged in the past few months in the form of an increase in permanent job cuts. Measured as a share of the labor force, permanent cuts have jumped from 0.8 to 1.8 percent, shy of readings seen during the financial crisis, but a distinct shift nonetheless (chart, above right). The increase suggests that some business have closed or that managers are rethinking business models in response to the virus and restructuring their operations.

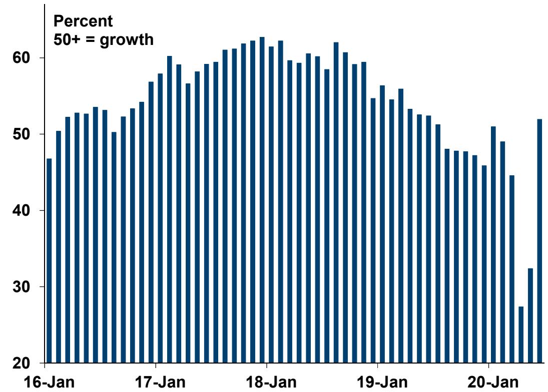
Manufacturing: Vigorous or Moderate?

The ISM index showed a striking increase in June, with the measure jumping 9.5 percentage points and moving above the 50-percent threshold (52.6 percent). The increase occurred despite a drop of 11.1

percentage points in the supplier delivery index, which returned to its normal range after elevated readings in the prior few months because of virus-related disruptions to supply chains. An average of the three key components of the ISM index (new orders, production, and employment) removes the distortion from the supplier delivery index and offers a clearer picture of fundamental developments. This average surged from a record low in April to a comfortable position noticeably above 50 percent in June (chart, right).

The results suggest a boom in the manufacturing sector, but we are skeptical. The ISM index provides good insight into the direction of change, but it is not especially helpful in gauging the magnitude of change. This measure should be supplemented with other manufacturing-related statistics.

ISM Mfg. Index: Key Components*



* An average of the employment, new orders, and production components of the ISM manufacturing index.

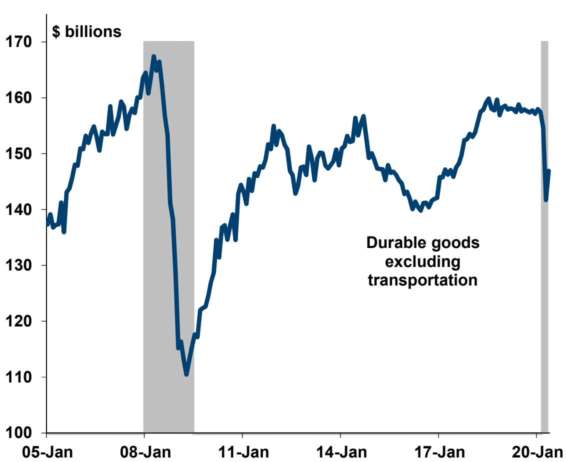
Source: Institute for Supply Management via Haver Analytics; Daiwa Capital Markets America

The employment report provides a useful perspective. Increases in employment and a lengthening in the average workweek after declines in March and April show that this sector is recovering, but it is still well shy of pre-virus readings (both employment and total hours worked have retraced approximately 44 percent of the ground lost in March and April).

Order flows in the manufacturing sector provide a picture similar to that in the employment report. Bookings for durable goods excluding the transportation category (to eliminate the statistical noise generated by aircraft and ships) fell in March and April and have retraced one-third of that retreat -- an improvement, but still a sub-par performance (chart, below left). Orders for nondurable goods excluding petroleum (to eliminate the effects of swings in oil prices) fell only moderately in the spring, which is encouraging, but they posted only a small increase in May and offset only a small portion of the drop in April (chart, below right). Like orders for durable goods ex-transportation, nondurable bookings ex-petroleum are suggesting still-less-than-normal activity.

Results on employment and orders show that manufacturing activity is recovering, but it cannot be viewed as a boom. The ISM index is providing a misleading view on the degree of strength in this sector.

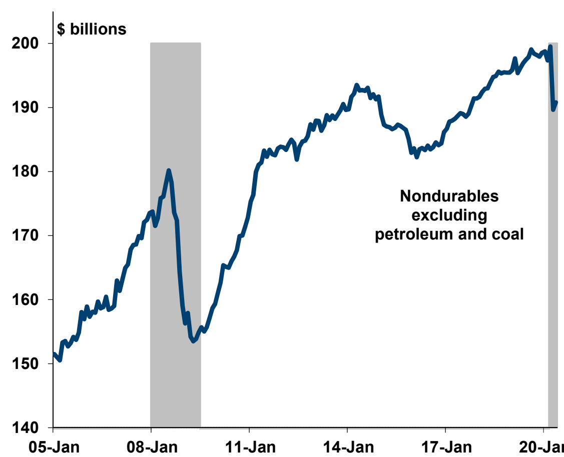
Manufacturers' New Orders*



* The shaded areas indicate periods of recession in the United States.

Source: U.S. Census Bureau and The National Bureau of Economic Research via Haver Analytics

Manufacturers' New Orders*



* The shaded areas indicate periods of recession in the United States.

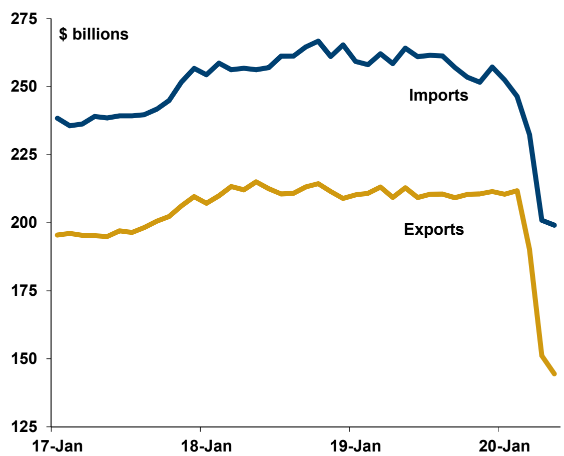
Source: U.S. Census Bureau and The National Bureau of Economic Research via Haver Analytics

International Trade: Pandemic Stricken

International trade is suffering in the current environment. Like most economic statistics, exports and imports tumbled in April, but unlike many other measures, they did not begin to recover in May. The declines in the latest month were much smaller than those in April, but exports and imports were still in retreat (chart, below left). Both goods and services on both sides of the trade ledger have deteriorated.

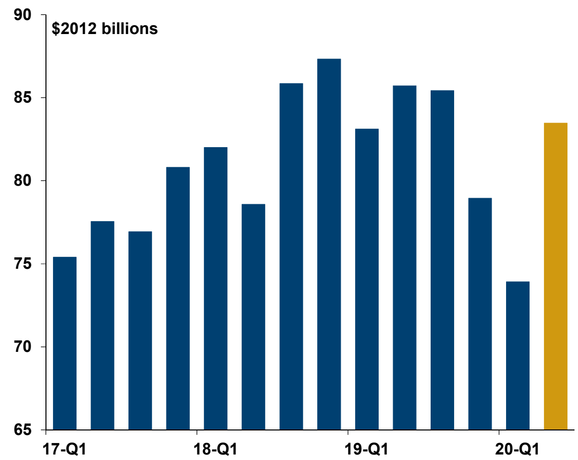
The slippage in exports has been notably larger than that for imports, and the U.S. trade deficit has widened as a result. The shortfall in the real goods deficit in the first two months of the second quarter, while not as pronounced as those in portions of 2018 and 2019, has deteriorated considerably from results in the fourth quarter of last year and the first quarter of this year (chart, below right). The latest tally suggests that net exports will add to other weak areas in the U.S. and constrain GDP growth in Q2. If exports and imports for June match the averages for April and May, net exports would subtract approximately three percentage points from GDP growth.

Imports & Exports of Goods & Services



Source: Bureau of Economic Analysis via Haver Analytics

Real Goods Trade Deficit*

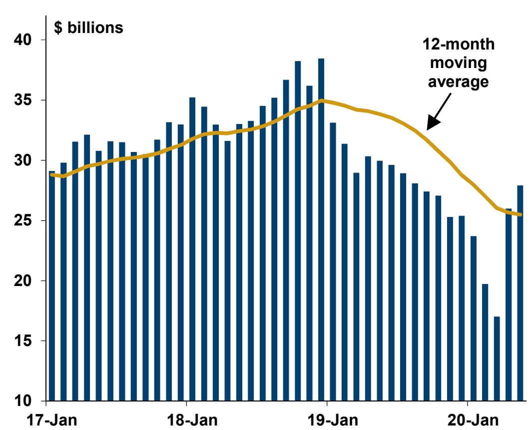


** Quarterly averages of monthly data. The reading for 2020-Q2 is the average of the monthly deficits for April and May.*

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

Interestingly, and surprisingly, trade flows with China have picked up in the past two months. The dollar value of imports has increased more than that for exports, leaving a wider trade deficit. Still, the shortfall is not as pronounced as that in place in 2018, before the constraining influence of tariffs took hold (chart).

Goods Trade Deficit with China



Source: U.S. Census Bureau via Haver Analytics

FOMC: Cool on YCC

Many market participants have been wondering about additional tools that the Fed might employ if the economy were to need additional support. A common view is that the Federal Open Market Committee could shift to so-called yield curve control (YCC); that is, the pegging of Treasury yields at some low level. Some Fed officials have noted the possibility of adopting such a policy, suggesting that it could be an attractive supplement to forward guidance (e.g. if officials were envisioning steady policy for three years, they could peg Treasury rates out to the three-year maturity horizon).

Despite receptive comments from some Fed officials, the minutes from the June FOMC meeting indicated most policymakers were not inclined to move in this direction. “Many” officials noted that if the Committee provided credible forward guidance, pegging interest rates would not provide meaningful additional support. In addition, officials were concerned about a possible loss of control over the size of the Fed’s balance sheet and possible difficulties in unwinding such policies at some future date. Some also expressed concern about a loss of Fed independence, as yield curve control would create a tight link between monetary and fiscal issues. “All” Fed officials felt that the staff should “conduct further analysis” of the design and implementation of such policies. In other words, this proposal is not happening anytime soon.

While the FOMC is not likely to begin pegging Treasury rates in the foreseeable future, it could well provide more explicit forward guidance, as the June minutes suggested broad support for clearer communication. Various officials noted that it was “important” to provide greater clarity regarding the likely path of the federal funds rate and plans for asset purchases. Officials seemed most interested in outcome-based guidance, where future policy changes would be dictated by policy variables reaching certain threshold levels. Inflation attracted the most attention as the key variable in guidance, with some policymakers suggesting the possibility of allowing “a modest temporary overshooting of the Committee’s longer-run inflation goal”. Some signaled a preference for forward guidance tied to the unemployment rate. Whatever policy variable is selected, the minutes offered a strong hint that the Committee soon will be more explicit in its guidance: “Participants agreed that the current stance of monetary policy remained appropriate, but many noted that the Committee could, at upcoming meetings, further clarify its intentions with respect to its future monetary policy decisions as the economic outlook becomes clearer.”

Employment Report

	Nonfarm Payrolls (Chg., Thousands)	Private-Sector Payrolls	Unemp. Rate (Percent)	Broad Unemp. Rate	Household Emp. (Chg., Thousands)	Labor Force	Emp.-Population Ratio (Pct.)	Median Duration of Unemp. (Weeks)	Part-Time Econ. Reasons (Thou.)	Avg. Hourly Earnings % Chg.	Avg. Workweek (Hours)
Annual Average											
2017	176	170	4.3	8.5	147	69	60.1	10.1	5,254	0.2	34.4
2018	193	183	3.9	7.7	237	214	60.4	9.3	4,779	0.3	34.5
2019	178	162	3.7	7.1	165	120	60.8	9.2	4,407	0.2	34.4
2020	-2,366	-2,132	8.4	14.1	-2,770	-771	56.8	8.1	7,475	0.6	34.4
Qtrly. Average											
19-Q3	203	171	3.6	7.0	383	306	60.9	9.1	4,230	0.2	34.4
19-Q4	210	200	3.5	6.8	168	168	61.0	9.1	4,278	0.2	34.3
20-Q1	-303	-319	3.8	7.5	-1,010	-548	60.8	8.5	4,755	0.4	34.3
20-Q2	-4,429	-3,945	13.0	20.7	-4,530	-994	52.9	7.8	10,194	0.8	34.5
2019 Monthly											
Oct.	185	190	3.6	6.9	246	350	61.0	9.2	4,397	0.3	34.4
Nov.	261	247	3.5	6.8	-8	-54	61.0	9.2	4,288	0.4	34.3
Dec.	184	164	3.5	6.7	267	209	61.0	9.0	4,148	0.1	34.3
2020 Monthly											
Jan.	214	179	3.6	6.9	-89	50	61.2	9.3	4,182	0.2	34.3
Feb.	251	220	3.5	7.0	45	-60	61.1	9.1	4,318	0.3	34.4
Mar.	-1,373	-1,356	4.4	8.7	-2,987	-1,633	60.0	7.0	5,765	0.6	34.1
Apr.	-20,787	-19,835	14.7	22.8	-22,369	-6,432	51.3	2.0	10,887	4.7	34.2
May	2,699	3,232	13.3	21.2	3,839	1,746	52.8	7.7	10,633	-1.0	34.7
June	4,800	4,767	11.1	18.0	4,940	1,705	54.6	13.6	9,062	-1.2	34.5

Source: Bureau of Labor Statistics via Haver Analytics

Review

Week of June 29, 2020	Actual	Consensus	Comments
Consumer Confidence (June)	**98.1 (+12.2 Index Pts.)**	**91.5 (+4.9 Index Pts.)**	The Conference Board's index of consumer confidence jumped in June, recouping about one-quarter of the ground lost with the onset of the coronavirus. The easing of lockdown restrictions and the expectation of a pickup in economic activity apparently drove the increase in June, as the current conditions index rose 26.0% and accounted for most of the increase in the headline measure. The expectations component registered only a moderately negative response to the virus, and the increase of 8.6% in June returned the measure to the middle of the range of the past few years.
ISM Manufacturing Index (June)	**52.6% (+9.5 Pct. Pts.)**	**49.8% (+6.7 Pct. Pts.)**	The surge in the ISM manufacturing index in June occurred despite a drop of 11.1 percentage points in the supplier delivery index, which returned to its normal range after elevated readings in the prior few months triggered by virus-related disruptions to supply chains. Strong showings in both the new orders and production components drove the advance in the headline index, as both rose slightly more than 24 percentage points and moved comfortably above the 50-percent threshold. The employment index posted a solid increase (10.0 percentage points), although the level remained unimpressive at 42.1%.
Construction Spending (May)	**-2.1%**	**1.0%**	A decline of 4.0% in private residential building accounted for much of the drop in total construction activity in May. Home construction has now declined for three consecutive months, but a sharp advance in building permits in May offers hope for improvement in coming months. Private nonresidential construction also was weak (-2.4%), dropping for the fifth time in the past six months. Government-sponsored construction continued an irregular upward drift with an increase of 1.2%.
Trade Balance (May)	**-$54.6 Billion ($4.8 Billion Wider Deficit)**	**-$53.2 Billion ($3.8 Billion Wider Deficit)**	The widening of $4.2 billion in the goods trade deficit (revised from $3.6 billion; preliminary results published last week) accounted for most of the slippage in the total trade balance in May, with the drop of 5.8% in exports dwarfing the decline of 0.8% in imports. The services surplus contributed slightly, narrowing by $0.6 billion. The deterioration reflected a decline in exports of 2.0% that exceeded slippage in imports of 1.4%.

Review Continued

Week of June 29, 2020	Actual	Consensus	Comments
Payroll Employment (June)	**4,800,000**	**3,230,000**	The jump in nonfarm payrolls in June was joined by net upward revisions of 90,000 in the prior two months. The rebounds in areas that saw sharp cuts in prior months continued in June, led by a surge of 2.1 million in the leisure and hospitality industry. Retail trade jumped 740,000. In addition, the business services and manufacturing industries both added more than 300,000 jobs, and the construction industry hired 158,000. The household survey showed strong results, with employment gains totaling 4.9 million. This increase exceeded an advance of 1.7 million in the size of the labor force, which led to a drop of 2.2 percentage points in the unemployment rate to 11.1%.
Factory Orders (May)	**8.0%**	**8.6%**	The already reported jump of 15.7% in bookings for durable goods accounted for most of the increase in total factory orders in May. Nondurable bookings contributed as well with an increase of 2.0%. The petroleum component surged 12.1%, reflecting both higher prices and more energy usage as economic activity began to stir with the easing of lockdown restrictions. The improvement in economic activity also boosted orders for nondurable goods ex-petroleum (0.6%).

The Conference Board (Consumer Confidence); Institute for Supply Management (ISM Manufacturing 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 July 6, 2020	Projected	Comments
ISM Nonmanufacturing Index (June) (Monday)	**50.0% (+4.6 Percentage Pts.)**	Employment statistics and the ISM manufacturing index suggest that the economy continued to improve in June, which should lift the nonmanufacturing index.
PPI (June) (Friday)	**0.3% Total, 0.1% Core***	Led by gasoline prices, the energy component is likely to rise sharply for the second consecutive month, although food prices could give back some of the surge seen in April because of supply disruptions. Core goods prices are likely to remain contained, although service prices in the transportation category could give back some of the discounting seen from January through April.

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

Economic Indicators

June/July 2020

Monday	Tuesday	Wednesday	Thursday	Friday
29	30	1	2	3
PENDING HOMES SALES Mar -20.8% Apr -21.8% May 44.3%	**S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** SA NSA Feb 0.5% 0.5% Mar 0.5% 1.1% Apr 0.3% 0.9% **CHICAGO PURCHASING MANAGERS' INDEX** Index Prices Apr 35.4 48.4 May 32.3 53.8 June 36.6 55.2 **CONFERENCE BOARD CONSUMER CONFIDENCE** Apr 85.7 May 85.9 June 98.1	**ADP EMPLOYMENT REPORT** Private Payrolls Apr -19,409,000 May 3,065,000 June 2,369,000 **ISM INDEX** Index Prices Apr 41.5 35.3 May 43.1 40.8 June 52.6 51.3 **CONSTRUCTION SPEND.** Mar -0.3% Apr -3.5% May -2.1% **FOMC MINUTES** **VEHICLE SALES** Apr 8.7 million May 12.3 million June 13.0 million	**UNEMPLOYMENT CLAIMS** Initial Continuing (Millions) June 06 1.566 20.289 June 13 1.540 19.231 June 20 1.482 19.290 June 27 1.427 N/A **EMPLOYMENT REPORT** Payrolls Un. Rate Apr -20,787,000 14.7% May 2,699,000 13.3% June 4,800,000 11.1% **TRADE BALANCE** Mar -$42.3 billion Apr -$49.8 billion May -$54.6 billion **FACTORY ORDERS** Mar -11.0% Apr -13.5% May 8.0%	***INDEPENDENCE DAY (OBSERVED)***
6	7	8	9	10
ISM NON-MFG INDEX (10:00) Index Prices Apr 41.8 55.1 May 45.4 55.6 **June 50.0 55.0**	**JOLTS DATA (10:00)** Openings (000) Quit Rate Mar 6,011 1.8% Apr 5,046 1.4% May -- --	**CONSUMER CREDIT (3:00)** Mar -$6.8 billion Apr -$68.8 billion May --	**INITIAL CLAIMS (8:30)** **WHOLESALE TRADE (10:00)** Inventories Sales Mar -1.1% -5.1% Apr 0.2% -16.9% **May -1.2% 5.0%**	**PPI (8:30)** Final Demand Core* Apr -1.3% -0.9% May 0.4% 0.1% **June 0.3% 0.1%**
13	14	15	16	17
FEDERAL BUDGET	**NFIB SMALL BUSINESS OPTIMISM INDEX** **CPI**	**IMPORT/EXPORT PRICES** **EMPIRE MFG INDEX** **IP & CAP-U** **BEIGE BOOK**	**INITIAL CLAIMS** **RETAIL SALES** **PHILLY FED INDEX** **BUSINESS INVENTORIES** **NAHB HOUSING INDEX** **TIC DATA**	**HOUSING STARTS** **CONSUMER SENTIMENT**
20	21	22	23	24
	CHICAGO FED NATIONAL ACTIVITY INDEX	**FHFA HOME PRICE INDEX** **EXISTING HOME SALES**	**INITIAL CLAIMS** **LEADING INDICATORS**	**NEW HOME SALES**

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

Treasury Financing

June/July 2020

Monday	Tuesday	Wednesday	Thursday	Friday
29	30	1	2	3
AUCTION RESULTS: Rate Cover 13-week bills 0.150% 2.86 26-week bills 0.165% 2.99	**AUCTION RESULTS:** Rate Cover 42-day CMB 0.130% 3.27 119-day CMB 0.155% 3.17 **ANNOUNCE:** $45 billion 4-week bills for auction on July 2 $45 billion 8-week bills for auction on July 2 $25 billion 105-day CMBs for auction on July 1 $30 billion 154-day CMBs for auction on July 1 **SETTLE:** $50 billion 4-week bills $50 billion 8-week bills $17 billion 20-year bonds $15 billion 5-year TIPS $46 billion 2-year notes $47 billion 5-year notes $41 billion 7-year notes $30 billion 105-day CMBs $35 billion 154-day CMBs	**AUCTION RESULTS:** Rate Cover 105-day CMB 0.140% 3.91 154-day CMB 0.155% 3.18	**AUCTION RESULTS:** Rate Cover 4-week bills 0.115% 3.19 8-week bills 0.135% 2.91 **ANNOUNCE:** $105 billion 13-,26-week bills for auction on July 6 $46 billion 3-year notes for auction on July 7 $29 billion 10-year notes for auction on July 8 $19 billion 30-year bonds for auction on July 9 $35 billion 42-day CMBs for auction on July 7 $35 billion 119-day CMBs for auction on July 7 **SETTLE:** $105 billion 13-,26-week bills $35 billion 42-day CMBs $35 billion 119-day CMBs	***INDEPENDENCE DAY (OBSERVED)***
6	7	8	9	10
AUCTION: $105 billion 13-,26-week bills	**AUCTION:** $46 billion 3-year notes $35 billion 42-day CMBs $35 billion 119-day CMBs **ANNOUNCE:** $45 billion* 4-week bills for auction on July 9 $45 billion* 8-week bills for auction on July 9 **SETTLE:** $45 billion 4-week bills $45 billion 8-week bills $25 billion 105-day CMBs $30 billion 154-day CMBs	**AUCTION:** $29 billion 10-year notes	**AUCTION:** $45 billion* 4-week bills $45 billion* 8-week bills $19 billion 30-year bonds **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on July 13 $34 billion* 52-week bills for auction on July 14 **SETTLE:** $105 billion 13-,26-week bills $35 billion 42-day CMBs $35 billion 119-day CMBs	
13	14	15	16	17
AUCTION: $105 billion* 13-,26-week bills	**AUCTION:** $34 billion* 52-week bills **ANNOUNCE:** $45 billion* 4-week bills for auction on July 16 $45 billion* 8-week bills for auction on July 16 **SETTLE:** $45 billion* 4-week bills $45 billion* 8-week bills	**SETTLE:** $46 billion 3-year notes $29 billion 10-year notes $19 billion 30-year bonds	**AUCTION:** $45 billion* 4-week bills $45 billion* 8-week bills **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on July 20 $17 billion* 20-year bonds for auction on July 22 $14 billion* 10-year TIPS for auction on July 23 **SETTLE:** $105 billion* 13-,26-week bills $34 billion* 52-week bills	
20	21	22	23	24
AUCTION: $105 billion* 13-,26-week bills	**ANNOUNCE:** $45 billion* 4-week bills for auction on July 23 $45 billion* 8-week bills for auction on July 23 **SETTLE:** $45 billion* 4-week bills $45 billion* 8-week bills	**AUCTION:** $17 billion* 20-year bonds	**AUCTION:** $45 billion* 4-week bills $45 billion* 8-week bills $14 billion* 10-year TIPS **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on July 27 $24 billion* 2-year FRNs for auction on July 28 $48 billion* 2-year notes for auction on July 27 $49 billion* 5-year notes for auction on July 27 $44 billion* 7-year notes for auction on July 28 **SETTLE:** $105 billion* 13-,26-week bills	

*Estimate