U.S. Economic Comment

- Employment growth: can it last?
- Business loans at commercial banks: less-than-pronounced softening

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

The Labor Market: Likely to Stay on Track

Nonfarm payrolls posted another fine performance in July. The latest gain of 1.763 million trailed the average of 3.758 million in the prior two months, but that pace would have been difficult to sustain in any environment, and some easing was to be expected in light of the acceleration in Covid-19 cases.

The recent improvement has been notable, but the labor market still has far to go before it is back to normal. Recent gains, while sizeable, have retraced only 42 percent of the 22 million jobs lost from March through April (chart). One wonders if improvement can be sustained with the number of new Covid cases at an elevated level. However, digging deep into the labor market data leads us to be cautiously optimistic.

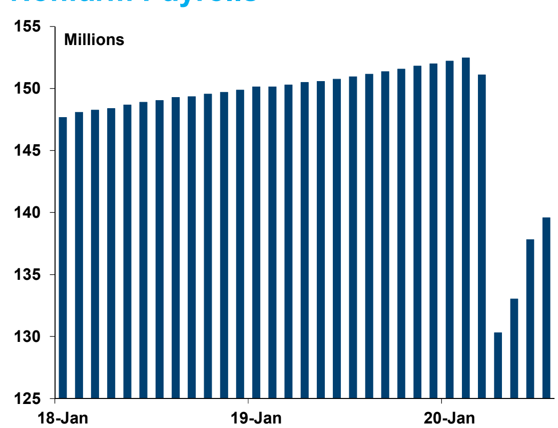
One of the most esoteric elements of the monthly employment report is the so-called status flows from the household survey. This set of statistics traces the flow of individuals through the various possible categories of employment status. For example, the figures show the number of individuals that shifted from unemployment to employment in the latest month, or from employment to unemployment, or from employment to not in the labor force.

The statistics on status flows can be used to calculate the probability of finding a job, which will provide insights into the likelihood of further job growth. This probability is defined as the number of individuals moving from unemployment to employment as a percent of total unemployment in the prior month. This figure has posted wild swings in recent months, plunging in April only to surge in June. It settled some in the current month, but it still remained on the firm side, with the current reading of 28.6 percent a full percentage point above the average from 2019, when job growth was well maintained (chart; next page, left).

We were interested in another element of the employment report based on the household survey: the number of permanent job losses. If the degree of weakness in the economy was intensifying, the number of unemployed individuals because of permanent reductions would probably be on the rise. This series, however, held approximately steady in July (chart; next page, right). It did increase in the prior four months, but this is not entirely surprising, as some managers might reassess their business model in response to a shock and make structural changes in their work force. We view a steady reading in the aftermath of a shock as encouraging.

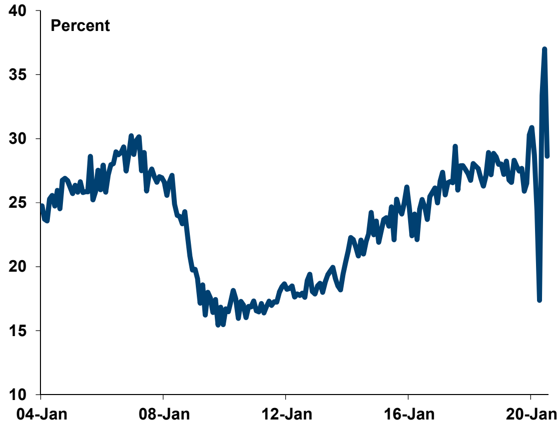
Recent high-frequency data also could be viewed as tilting on the optimistic side. Initial claims for unemployment insurance fell in the latest week, more than offsetting increases in the prior two weeks. The drop in initial claims was even larger on a not seasonally adjusted basis, and the renewed downward trend was even more distinct. We nearly always favor seasonally adjusted data, but NSA figures should be

Nonfarm Payrolls



Source: Bureau of Labor Statistics via Haver Analytics

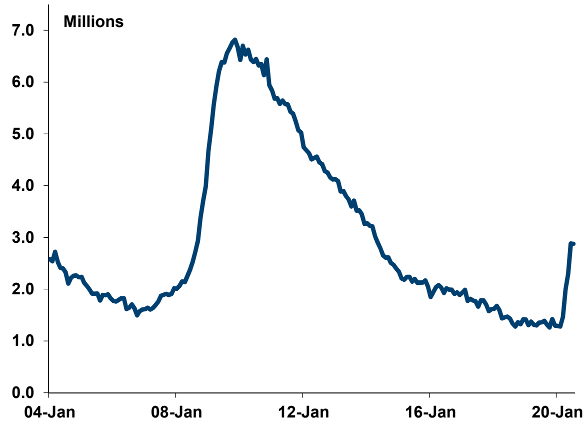
Labor Market Flows: Unemployed to Employed*



** The share of unemployed individuals gaining employment as a share of unemployed individuals in the prior month.*

Source: Bureau of Labor Statistics via Haver Analytics

Permanent Job Cuts



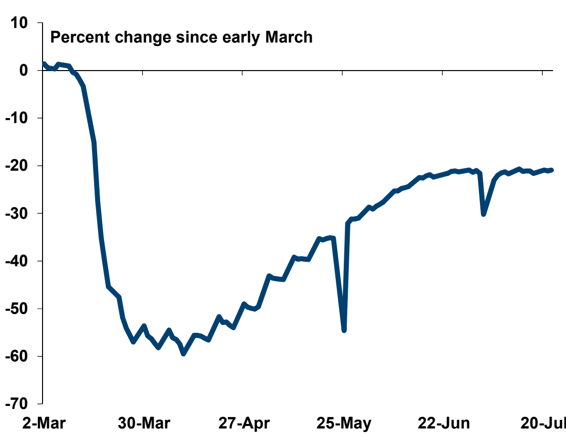
Source: Bureau of Labor Statistics via Haver Analytics

monitored in the current environment. Layoffs are being driven primarily by the spread of the coronavirus, and seasonal factors based on virus-free periods in earlier years might not be appropriate. The situation is akin to an unusual weather pattern, which can influence economic behavior and lead to NSA changes well outside the norm, which then translate to strange results on a seasonally adjusted basis.

The high-frequency series on the number of workers at small businesses now being published by Homebase shows employment holding steady (chart, below left). This partially filled glass can be viewed as either half-empty or half full. Those with pessimistic leanings note that hiring at small businesses has stalled. True, but these firms are vulnerable to risks associated with the coronavirus, and managing to hold steady at a time when the number of new virus cases had doubled from the experience in the spring is impressive. It seems as though employers are adapting and learning to cope with the virus rather than retreating.

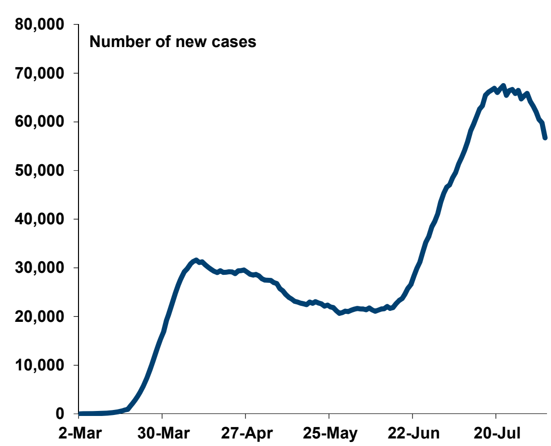
Perhaps the most important development in assessing the outlook for employment growth is the course of the virus. The latest news has been favorable, as the seven-day average of new cases has turned lower (chart, below right). It is still high, but it is moving in the right direction.

Covid Impact on Employees Working



Source: Homebase via Haver Analytics

New U.S. Covid-19 Cases*



** Seven-day moving average.*

Source: Johns Hopkins University and Medicine Coronavirus Resource Center via Bloomberg

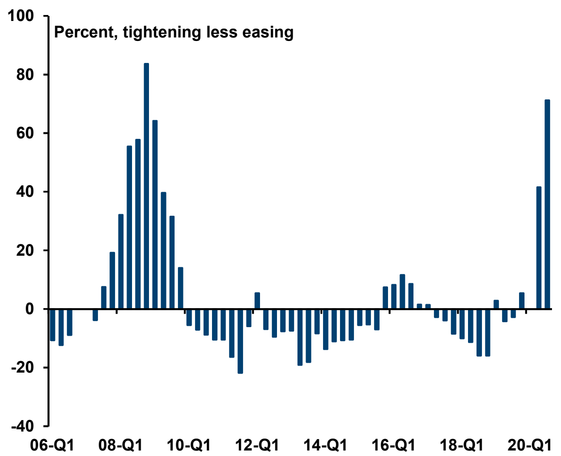
C&I Loans

The Federal Reserve Board this week released its quarterly survey of bank lending officers. The results seemed to signal difficult times for business borrowers, as a sizeable majority of loan officers (71 percent) indicated that they had tightened standards on commercial and industrial (C&I) loans; none had eased standards (chart, left). Tighter standards might seem to be biting, as the volume of C&I loans has contracted in the past two to three months after a surge in the spring (chart, right).

These developments certainly do not represent good news, but the results are not as troubling as they might appear at first blush. The report on lending standards gives an inkling of the magnitude of the shift by allowing loan officers to indicate if the standards were tightened “considerably” or “somewhat.” Those tightening “somewhat” carried the day by a wide margin (60 percent versus 11 percent for those tightening “considerably”). This characterization still leaves only a vague notion of the degree of tightening, but the current environment does not seem to involve a radical change. Also, some tightening should be expected with the economy slipping into recession.

The decline in the volume of C&I loans could be viewed as a favorable development. Much of the increase in the spring reflected the drawdown of bank lines of credit, as businesses took steps to insure they had adequate cash balances during potentially difficult times. With the economy beginning to improve in May and June, those precautionary balances were probably viewed as unnecessary by many financial officers, which led them to repay the loans. Also, some of the decline probably reflected the transfer of some loans to the Federal Reserve’s credit facility for the Paycheck Protection Program. The Fed has absorbed approximately $70 billion of these loans, which represents 30 percent of the decline in C&I loans since mid-May. Considering the repayment of lines of credit and the transfer of PPP loans, the drop in C&I loans is perhaps understandable. Also, we should not forget that the economy peaked in February, and loan demand naturally eases in a recession.

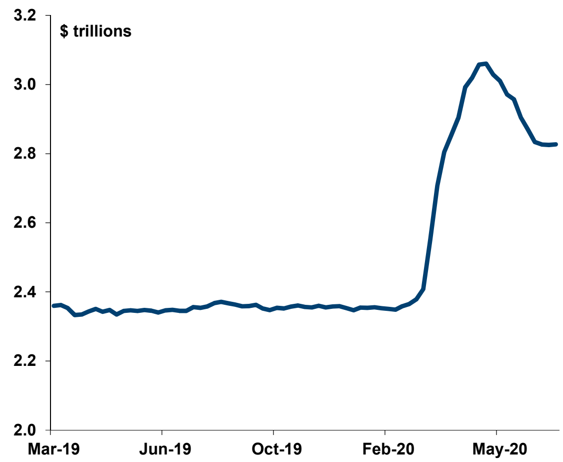
Lending Standards for C&I Loans*



** The share of respondents indicating that lending standards were tightened on commercial and industrial loans for large firms less the share indicating that lending standards were eased.*

Source: Senior Loan Officer Opinion Survey on Bank Lending Practices (Federal Reserve Board) via Haver Analytics

Commercial & Industrial Loans



Source: Federal Reserve Board via Haver Analytics

Review

Week of August 3, 2020	Actual	Consensus	Comments
ISM Manufacturing Index (July)	**54.2% (+1.6 Pct. Pts.)**	**53.6% (+1.0 Pct. Pt.)**	The ISM manufacturing index jumped to its best reading in more than a year. The new orders component led the advance in the headline measure with a jump of 5.1 percentage points to 61.5%. The level was better than all readings from last year and only a touch below the averages of 61.6% in 2018 and 62.1% in 2017. With orders firm, production jumped 4.8 percentage points to 62.1%, stronger than the averages of 60.9% in both 2018 and 2017. Despite jumps in orders and production, manufacturers remained cautious in hiring, as the employment index increased only 2.2 percentage points to 44.3%.
Construction Spending (June)	**-0.7%**	**1.0%**	Although housing starts rose in May and June, weakness from February to April continued to constrain total residential building (off 1.5%). Private nonresidential construction (business, educational, and religious) rose 0.2%, but it represented an inconsequential wiggle after declines in the prior four months. Government-sponsored building fell 0.7%, as a drop in state and local activity offset a jump in federal construction. Government-sponsored building has fluctuated randomly in recent months leaving little net change on balance.
Factory Orders (June)	**6.2%**	**5.0%**	The advance in factory orders in June followed an increase of 7.7% in May, with the combined results retracing 48% of the swoon in the prior two months. The durable component rose 7.6%. The increase in June was broadly based, but orders for motor vehicles stood out (up 86.2%). Excluding the volatile transportation category, durable orders rose 3.6% in June and have retraced approximately 65% of the ground lost in March and April. Orders for nondurable goods rose 5.0%, led by a price-inflated surge of 27% in petroleum bookings. Orders for nondurable goods excluding petroleum rose 1.7%, which combined with a gain of 0.6% in May, offset 58% of the ground lost in March and April.
Trade Balance (June)	**-$50.7 Billion ($4.1 Billion Narrower Deficit)**	**-$50.2 Billion ($4.4 Billion Narrower Deficit)**	Both exports and imports rose in June (9.4% and 4.7%, respectively), partly offsetting marked declines in prior months driven by the coronavirus. Trade in goods (published last week) accounted for most of the improvement, with the auto component standing out (both imports and exports of autos more than doubled). The trade surplus in services improved slightly, ending a slide in the prior three months when the coronavirus led to a plunge in travel and transportation services. The new trade figures were close to the assumptions in the initial estimate of Q2 GDP, thus today's report will not have a meaningful influence on revised economic growth.

Review Continued

Week of August 3, 2020	Actual	Consensus	Comments
ISM Nonmanufacturing Index (July)	**58.1% (+1.0 Pct. Pt.)**	**55.0% (-2.1 Pct. Pts.)**	The advance in the ISM nonmanufacturing index in July followed a strong increase in June and pushed the measure close to the average of 59.0% 2018, which was the best year of the previous expansion for this indicator. A jump of 6.1 percentage points in the new orders component to a record high of 67.7% led the advance. Given robust order flows, business activity also was strong (+1.2 percentage points to 67.2%, the second strongest in the history of the series). While the report overall was strong, the employment component disappointed, falling 1.0 percentage point to 42.1%.
Nonfarm Payrolls (July)	**1,763,000**	**1,480,000**	Nonfarm payrolls rose briskly for the third consecutive month, although the latest monthly tally lagged the average increase of 3.758 million in May and June. The improvement in the past three months has been notable, but total payrolls are still 12.881 million (or 8.4%) below the peak in February. The unemployment rate fell 0.9 percentage point to 10.2% in the latest month, down sharply from the peak of 14.7% in April, but still well above the pre-virus low of 3.5%. Average hourly earnings rose 0.2% in July after declines in the prior two months. This series has not provided accurate insight into wage changes in recent months, as shifts have been dominated by compositional changes in the workforce (disproportionate job cuts among low-wage earners) rather than by changes in wage rates.

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

Preview

Week of August 10, 2020	Projected	Comments
PPI (July) (Tuesday)	**0.3% Total, 0.2% Core***	Higher prices of gasoline and petroleum-related products will probably push the energy component higher. Food prices are likely to remain settled after noise in the prior two months (surge in May and correction in June). Prices of core goods are likely to remain tame, but prices of transportation services (airfares) and construction-related items will probably lead to a noticeable increase in the overall core component.
CPI (July) (Wednesday)	**0.3% Total, 0.2% Core**	Available quotes suggest that the energy component of the CPI rose for the second consecutive month after declining in the first five months of the year. The food component should begin to settle after registering virus-related surges in the prior three months. Further retracing of reductions in airfares, hotel fees, and apparel prices is likely to lead to another firm reading in the core index.
Federal Budget (July) (Wednesday)	**$75.0 Billion Deficit**	Federal revenues in July appear to have more than doubled from the total in the same month last year, as the Treasury Department collected taxes postponed from due dates in April and June. Outlays were again heavy because of Covid-related expenditures, but the revenue inflow is likely to leave a modest deficit.
Retail Sales (July) (Friday)	**0.7% Total, 0.9% Ex-Autos**	Robust increases in May and June pushed retail sales close to its pre-virus levels. Some sectors still have upside potential, which should lead to a firm showing.
Nonfarm Productivity (2020-Q2) (Friday)	**-1.0%**	Adjustments likely to be made by the Bureau of Labor Statistics to account for the effects of the coronavirus on hours worked add a high degree of uncertainty to the productivity report. Output fell sharply in Q2, probably by more than (BLS-adjusted) hours worked, which will leave a soft reading on productivity. The hours adjustment could leave a high-side reading on compensation per hour and unit labor costs.
Industrial Production (July) (Friday)	**1.5%**	An increase in factory employment, while much lighter than gains in May and June, still suggests moderate growth in manufacturing output. Utility output probably made a moderate positive contribution, as demand for cooling services probably increased because of above-average temperatures. Declines in employment and the rotary rig could point to the sixth consecutive decline in the mining sector, although the drop will probably be lighter than the average of 3.8% in the prior five months.
Consumer Sentiment (August) (Friday)	**75.0 (+2.5 Index Pts.)**	With the equity market advancing in the past few weeks, and with virus-related news improving slightly, the sentiment index could regain a portion of its modest decline in July.

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

Economic Indicators

August 2020

Monday	Tuesday	Wednesday	Thursday	Friday
3	4	5	6	7
ISM INDEX Index Prices May 43.1 40.8 June 52.6 51.3 July 54.2 53.2 **CONSTRUCTION SPEND.** Apr -3.4% May -1.7% June -0.7% **VEHICLE SALES** May 12.2 million June 13.1 million July 14.5 million	**FACTORY ORDERS** Apr -13.5% May 7.7% June 6.2%	**ADP EMPLOYMENT REPORT** Private Payrolls May 3,341,000 June 4,314,000 July 167,000 **TRADE BALANCE** Apr -$49.8 billion May -$54.8 billion June -$50.7 billion **ISM NON-MFG INDEX** Index Prices May 45.4 55.6 June 57.1 62.4 July 58.1 57.6	**UNEMPLOYMENT CLAIMS** Initial Continuing (Millions) July 11 1.308 16.151 July 18 1.422 16.951 July 25 1.435 16.107 Aug 01 1.186 N/A	**EMPLOYMENT REPORT** Payrolls Un. Rate May 2,725,000 13.3% June 4,791,000 11.1% July 1,763,000 10.2% **WHOLESALE TRADE** Inventories Sales Apr 0.2% -16.4% May -1.2% 5.7% June -1.4% 8.8% **CONSUMER CREDIT** Apr -$65.3 billion May -$14.4 billion June $8.9 billion
10	11	12	13	14
JOLTS DATA (10:00) Openings (000) Quit Rate Apr 4,996 1.4% May 5,397 1.6% June -- --	**NFIB SMALL BUSINESS OPTIMISM INDEX (6:00)** May 94.4 June 100.6 July -- **PPI (8:30)** Final Demand Core* May 0.4% 0.1% June -0.2% 0.3% **July 0.3% 0.2%**	**CPI (8:30)** Total Core May -0.1% -0.1% June 0.6% 0.2% **July 0.3% 0.2%** **FEDERAL BUDGET (2:00)** 2020 2019 May -$398.8B -$207.8B June -$864.1B -$8.5B **July -$75.0B** -$119.7B	**INITIAL CLAIMS (8:30)** **IMPORT/EXPORT PRICES (8:30)** Non-petrol Imports Nonagri. Exports May 0.2% 0.5% June 0.3% 1.4% July -- --	**RETAIL SALES (8:30)** Total Ex.Autos May 18.2% 12.1% June 7.5% 7.3% **July 0.7% 0.9%** **PRODUCTIVITY & COSTS (8:30)** Productivity Unit Labor Costs 19-Q4 1.2% 2.2% 20-Q1 -0.9% 5.1% **20-Q2 -1.0% 8.0%** **IP & CAP-U (9:15)** IP Cap.Util. May 1.4% 65.1% June 5.4% 68.6% **July 1.5% 69.8%** **CONSUMER SENTIMENT (10:00)** June 78.1 July 72.5 **Aug 75.0** **BUSINESS INVENTORIES (10:00)** Inventories Sales Apr -1.4% -14.4% May -2.4% 8.5% **June -1.1% 8.3%**
17	18	19	20	21
EMPIRE MFG INDEX **NAHB HOUSING INDEX** **TIC DATA**	**HOUSING STARTS**	**FOMC MINUTES**	**INITIAL CLAIMS** **PHILLY FED INDEX** **LEADING INDICATORS**	**EXISTING HOME SALES**
24	25	26	27	28
CHICAGO FED NATIONAL ACTIVITY INDEX	**FHFA HOME PRICE INDEX** **S&P CASE-SHILLER 20-CITY HOME PRICE INDEX** **CONSUMER CONFIDENCE** **NEW HOME SALES**	**DURABLE GOODS ORDERS**	**INITIAL CLAIMS** **REVISED GDP** **PENDING HOME SALES**	**PERSONAL INCOME, CONSUMPTION, CORE PRICE INDEX** **U.S. INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES** **CHICAGO PURCHASING MANAGERS' INDEX** **REVISED CONSUMER SENTIMENT**

Forecasts in Bold.

Treasury Financing

August 2020

Monday	Tuesday	Wednesday	Thursday	Friday
3	4	5	6	7
AUCTION RESULTS: Rate / Cover 13-week bills 0.100% 2.80 26-week bills 0.105% 2.91	**AUCTION RESULTS:** Rate / Cover 42-day CMB 0.085% 3.45 119-day CMB 0.100% 3.45 **ANNOUNCE:** $30 billion 4-week bills for auction on August 6 $35 billion 8-week bills for auction on August 6 $25 billion 105-day CMBs for auction on August 5 $30 billion 154-day CMBs for auction on August 5 **SETTLE:** $30 billion 4-week bills $35 billion 8-week bills $25 billion 105-day CMBs $30 billion 154-day CMBs	**AUCTION RESULTS:** Rate / Cover 105-day CMB 0.105% 3.34 154-day CMB 0.110% 2.91 **ANNOUNCE:** $48 billion 3-year notes for auction on August 11 $38 billion 10-year notes for auction on August 12 $26 billion 30-year bonds for auction on August 13	**AUCTION RESULTS:** Rate / Cover 4-week bills 0.080% 3.76 8-week bills 0.100% 2.88 **ANNOUNCE:** $105 billion 13-,26-week bills for auction on August 10 $34 billion 52-week bills for auction on August 11 $30 billion 42-day CMBs for auction on August 11 $30 billion 119-day CMBs for auction on August 11 **SETTLE:** $105 billion 13-,26-week bills $30 billion 42-day CMBs $30 billion 119-day CMBs	
10	11	12	13	14
AUCTION: $105 billion 13-,26-week bills	**AUCTION:** 34 billion 52-week bills $48 billion 3-year notes $30 billion 42-day CMBs $30 billion 119-day CMBs **ANNOUNCE:** $30 billion* 4-week bills for auction on August 13 $35 billion* 8-week bills for auction on August 13 **SETTLE:** $30 billion 4-week bills $35 billion 8-week bills $25 billion 105-day CMBs $30 billion 154-day CMBs	**AUCTION:** $38 billion 10-year notes	**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills $26 billion 30-year bonds **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on August 17 $25 billion* 20-year bonds for auction on August 19 $7 billion* 30-year TIPS for auction on August 20 **SETTLE:** $105 billion 13-,26-week bills $34 billion 52-week bills $30 billion 42-day CMBs $30 billion 119-day CMBs	
17	18	19	20	21
AUCTION: $105 billion* 13-,26-week bills **SETTLE:** $48 billion 3-year notes $38 billion 10-year notes $26 billion 30-year bonds	**ANNOUNCE:** $30 billion* 4-week bills for auction on August 20 $35 billion* 8-week bills for auction on August 20 **SETTLE:** $30 billion* 4-week bills $35 billion* 8-week bills	**AUCTION:** $25 billion* 20-year bonds	**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills $7 billion* 30-year TIPS **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on August 24 $22 billion* 2-year FRNs for auction on August 26 $50 billion* 2-year notes for auction on August 25 $51 billion* 5-year notes for auction on August 26 $47 billion* 7-year notes for auction on August 27 **SETTLE:** $105 billion* 13-,26-week bills	
24	25	26	27	28
AUCTION: $105 billion* 13-,26-week bills	**AUCTION:** $50 billion* 2-year notes **ANNOUNCE:** $30 billion* 4-week bills for auction on August 27 $35 billion* 8-week bills for auction on August 27 **SETTLE:** $30 billion* 4-week bills $35 billion* 8-week bills	**AUCTION:** $22 billion* 2-year FRNs $51 billion* 5-year notes	**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills $47 billion* 7-year notes **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on August 31 **SETTLE:** $105 billion* 13-,26-week bills	**SETTLE:** $22 billion* 2-year FRNs

*Estimate