Daiwa Capital Markets

U.S. Data Review

- International trade: notable slippage in early Q3, adding to softness in Q2
- ISM nonmanufacturing: modest correction to a firm reading in the prior month
- Unemployment claims: notable improvement in latest week, largely statistically induced

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International Trade

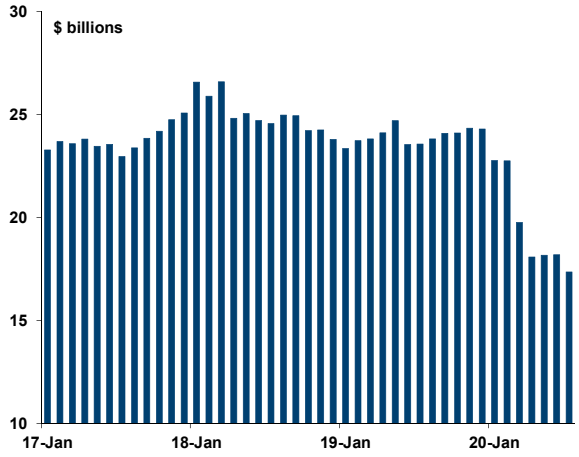
The U.S. trade deficit widened noticeably in July, with the shortfall jumping by $10.1 billion from the reading in the prior month. Analysts were looking for a wider deficit because of a soft report on goods trade published last week, but the published change was sharper than the expected widening of $7.3 billion. Moreover, the noticeable shift occurred from a downward revision in the prior month, with the shortfall $2.8 billion wider than previously believed. All told, the trade deficit for July was $12.9 billion wider than the previous estimate for June.

Much of the surprise in the report involved trade in services, where the U.S. runs a healthy surplus. All of the downward revision to previous results occurred in the service area, where cumulative revisions in the prior six months left the surplus in June $3.3 billion lighter than previously believed. July brought additional slippage, with the service surplus sliding another $0.8 billion to $17.4 billion (chart, left). Last year, the surplus in service trade averaged $24 billion. One might try to give a positive spin to the deterioration by noting that both exports and imports of trade in services are starting to pick up after pandemic-related deterioration in the spring, but this is a stretch. With imports of services increasing by a larger amount than exports, the results point to softer economic activity in the U.S.

The marked widening in goods trade in July reported last week was even more pronounced than that initial estimate, with the month-to-month change now totaling -$9.3 billion rather than -$8.3 billion. Today's report included price-adjusted results for goods trade, and the nominal slippage also was evident in real goods trade, with the price-adjusted deficit widening by $10.1 billion. The July real deficit in goods trade of $90.5 billion was noticeably wider than the average of $82.3 billion in the second quarter (chart, right). This slippage, if maintained, combined with likely deterioration in real service trade, would result in a sharp drag from net exports on GDP growth. If trade results for August and September were to match those for July, the drag would amount to more than two percentage points on GDP growth, worse than the 0.9 percentage point constraint in Q2.

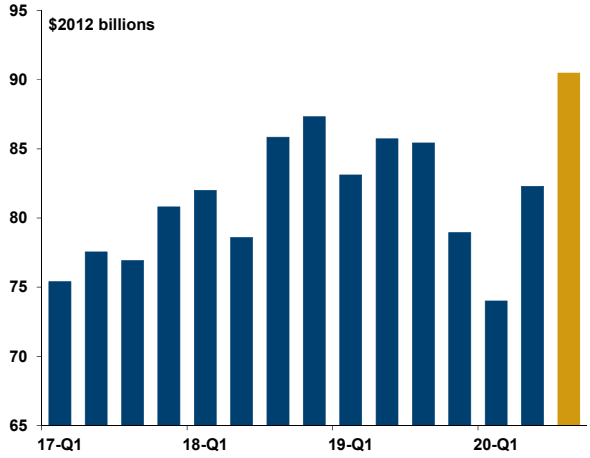
All told, a disappointing report.

U.S. Surplus in Services Trade



Source: Bureau of Economic Analysis via Haver Analytics

Real Goods Trade Deficit*



** Quarterly averages of monthly data. The reading for 2020-Q3 (gold bar) is the real goods deficit for July.*

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

ISM Nonmanufacturing Index

The ISM nonmanufacturing index slipped 1.2 percentage points in August to 56.9 percent. The latest result was nearly identical to the expected reading of 57.0 percent. Although the index fell in the latest month, the change occurred from an elevated reading; the new total was still consistent with a good performance in the nonmanufacturing sectors of the economy.

ISM Nonmanufacturing: Monthly Indexes

	Apr-20	May-20	Jun-20	Jul-20	Aug-20
ISM Nonmfg. Composite	41.8	45.4	57.1	58.1	56.9
Business activity	26.0	41.0	66.0	67.2	62.4
New orders	32.9	41.9	61.6	67.7	56.8
Employment	30.0	31.8	43.1	42.1	47.9
Supplier deliveries*	78.3	67.0	57.5	55.2	60.5
Prices	55.1	55.6	62.4	57.6	64.2

** The supplier deliveries index is not seasonally adjusted. The index differs from the other components of the composite measure (business activity, new orders, employment) in interpretation. An index above 50 percent indicates slower deliveries and readings below 50 percent indicate faster deliveries.*

Source: Institute for Supply Management via Haver Analytics

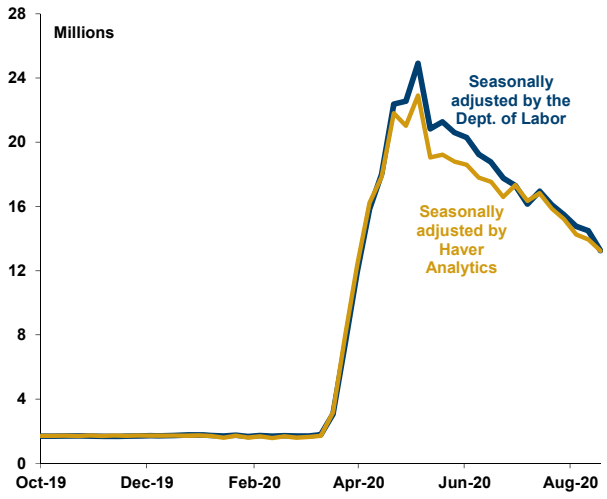
Not surprisingly, the dip in the headline index was the result shifts in the new orders and business activity components (off 10.9 and 4.8 percentage points, respectively). These measures were unusually firm in the prior month (above 67 percent) and seemed likely to correct. The new levels were still firm by historical standards. In contrast to new orders and business activity, the employment component seemed low in July given that payrolls were improving. It seemed due for a pick up, and it jumped 5.8 percentage points in August, although it remained below the critical value of 50 percent (47.9).

The supplier delivery index rose 5.3 percentage points to 60.5 percent. This component had declined in the prior three months, retreating from an unusually high level because of slow deliveries associated with disrupted supply chains. We suspect the pickup in August was more the result of firm business activity rather than new disruptions to supply chains.

Unemployment Claims

The latest report on claims for unemployment insurance showed notable improvement in both initial and continuing claims: initial filings fell 130,000 to 881,000 while the number of individuals receiving benefits dropped 1.238 million to 13.254 million (regular state programs, excluding special programs authorized by the CARES Act). The changes were striking, but they largely reflected a change in the seasonal adjustment process, as the Labor Department began using additive seasonal factors rather than multiplicative factors. Not seasonally adjusted figures showed much smaller changes (down 7,600 for initial claims and 765,000 for continuing claims).

Continuing Claims for Unemployment Insurance



Source: Employment and Training Administration, U.S. Department of Labor via Haver Analytics

Multiplicative seasonal factors are appropriate when the amount of seasonal movement is proportional to the level of the series. Seasonal adjustment in this case should apply a certain percentage change to the not seasonally adjusted series. If seasonal movement is not proportional to the level of the series, applying a percentage change to a not seasonally adjusted series that has suddenly moved will result in a distorted seasonally adjusted change. That has been the case this year. Unemployment claims surged because of the pandemic, but the boost to claims was not related to the normal seasonal movement in the labor market. Applying multiplicative factors (percentage changes) to such series would amount to over adjustment. Additive seasonal factors add a certain amount rather than adjusting by a percent change, thus sharp

changes in the level of the series are not overly inflated or deflated by the seasonal adjustment process.

The effect is shown in the chart, which shows continuing claims adjusted with both multiplicative and additive factors (the series with additive factors was calculated by Haver Analytics, a data base firm). Multiplicative adjustment was leading to higher-than-appropriate readings.

Some observers might argue that the shift to additive factors was made to dampen the series and paint a more favorable picture of the labor market. This view is wrong. The Labor Department had been using an inappropriate seasonal adjustment procedure for the situation now in place. Pandemic-related changes in unemployment claims are not related to the normal seasonal movement of the economy, and thus they should not be adjusted as if they followed the normal ebb and flow.