Daiwa Capital Markets

U.S. Economic Comment

- The labor market: still improving, still far to go
- Risk areas: not extreme, except for air travel

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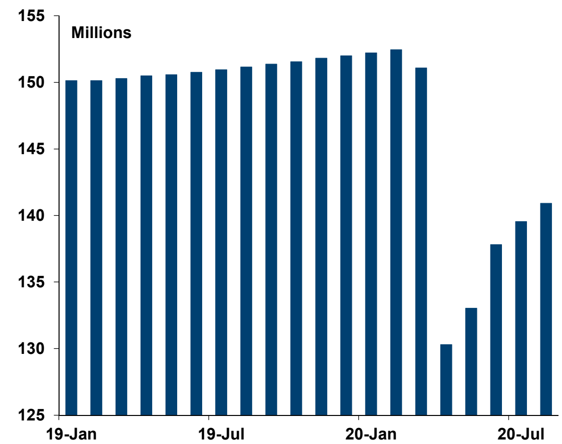
Employment

We viewed the August labor market report as favorable, although not overwhelmingly so. Job growth of 1.371 million (1.133 million excluding temporary census workers) was solid, although it trailed the advance of 1.734 million in the prior month and the brisk average of 3.080 million from May through July. In addition, despite recent gains, total employment remains well shy of the level seen before the onset of the pandemic. Thus far, the U.S. has regained only 48 percent of the jobs lost in March and April; it needs to add an additional 11.5 million positions to return to the February total (chart).

Nonfarm Payrolls



Source: Bureau of Labor Statistics via Haver Analytics

Although the report in total was less than stellar, we were encouraged by recent gains in sectors that were severely affected by the pandemic. Retail trade, for example, posted job growth of 1.7 percent in August (versus a gain of 1.0 percent overall) and has now recouped 73 percent of the ground lost in March and April (table). The leisure industry, the area most affected by the pandemic, has recovered half of the jobs lost during the spring, a better-than-average rebound. The "other" service category also has done well with a 61 percent recovery. The leisure and other sectors, however, suffered severe losses in March and April and are still well below February levels. Employment in the transportation sector (think airlines) showed signs of life in August with a gain of 1.1 percent, but this sector has thus far recouped only 18 percent of the job cuts in March and April, and some air carriers this week announced pending layoffs.

Change in Nonfarm Payrolls

	Percent change Feb. to April	Ground regained (percent)*	Percent change Feb. to Aug.
Total	-14.5	48	-7.6
Mining	-8.5	-59	-13.6
Construction	-14.2	61	-5.6
Manufacturing	-10.6	47	-5.6
Retail Trade	-15.2	73	-4.2
Transportation	-10.8	18	-8.8
Information	-9.8	-9	-10.8
Financial Activities	-3.2	32	-2.2
Business Services	-10.7	36	-6.8
Education	-13.3	42	-7.8
Health	-10.9	49	-5.6
Leisure	-49.3	50	-24.5
Other Services	-23.1	61	-8.9
State Governments	-4.0	-6	-4.2
Local Governments	-5.4	-15	-6.2

** Job growth from May through August as a share of payroll cuts in March and April.*

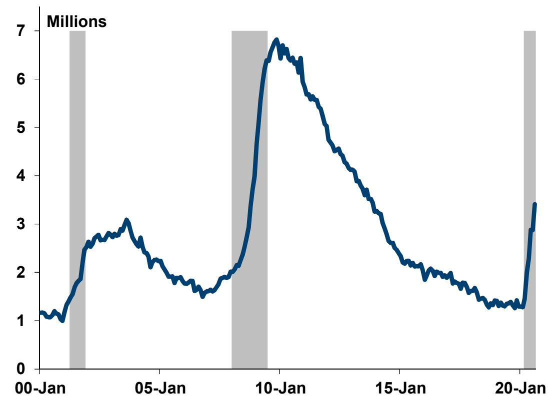
Source: Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America

A few areas posted disappointing performances in August. The construction and manufacturing sectors added noticeably to payrolls in May and June, but they have slowed the pace of hiring in the past two months. State and local governments added to payrolls in the past two months, but these gains represented only partial offsets to cuts in May and June; employment is still shy of the low level in April. The mining industry and the information sector seem to be dealing with structural change, as both have trimmed employment further after the cuts in March and April. (The information sector is a broad area covering activities that include publishing, movie production, television and radio broadcasting, internet services, and telecommunications.)

The unemployment rate fell sharply in August, dropping 1.8 percentage points to 8.4 percent. It was a "strong" decline in that it reflected a surge in employment as measured by the household survey (up 3.756 million) that exceeded the jump in the size of the labor force (968,000). The sizeable changes might have been the result of random volatility, as data from the household survey often move erratically. We also wonder if the expiration of the extra $600 per week in unemployment compensation played a role. While the extra payment was a lifeline for many individuals, it also was an incentive for some to pursue activities other than work.

While joblessness fell sharply in August, it was still elevated relative to pre-virus levels. Some observers have expressed concern that temporary layoffs could evolve into permanent cuts. This is not an idle concern because the number of permanent reductions has increased in the past few months, with August showing another jump. Permanent cuts are well shy of those seen during the financial crisis but they are above those in the early 2000s (chart).

Permanent Job Cuts*



** The shaded areas indicate periods of recession.*

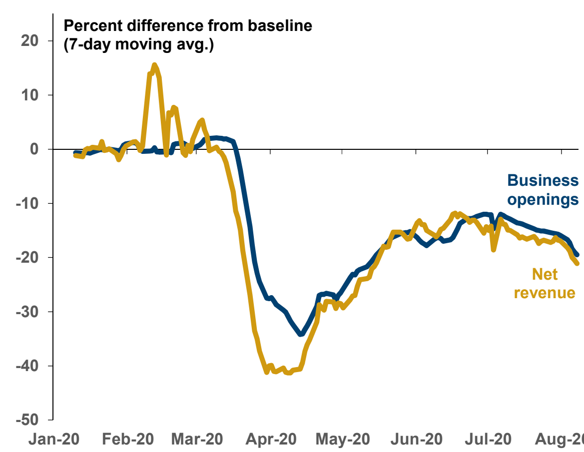
Source: Bureau of Labor Statistics and National Bureau of Economic Research via Haver Analytics

Some increase in permanent cuts is to be expected. As noted above, structural changes apparently are underway in the mining and information sectors, and associated adjustments most likely would involve permanent reductions. Also, the pandemic has most likely led some executives to rethink their business models and make changes they might not consider otherwise. Managers might be content to go with the flow when activity is firm, but slowdowns could stir thoughts of new methods of operation or new business ventures. Never waste a crisis.

Other Risk Areas

Permanent job cuts are a risk in the outlook, and a closely related concern is the possible closure of small businesses. Again, this does not appear to be an idle threat, as figures on the number of small businesses currently open has turned lower after a brief rally in the early summer (chart). However, the situation is not necessarily desperate, as a breakdown by industry shows that softness is concentrated in the leisure and transportation sectors; other areas, although far from robust, are holding up reasonably well. Considering the surge in the virus in June and July, the performance might be viewed as good; certainly, it is far better than the swoon in the spring (see chart).

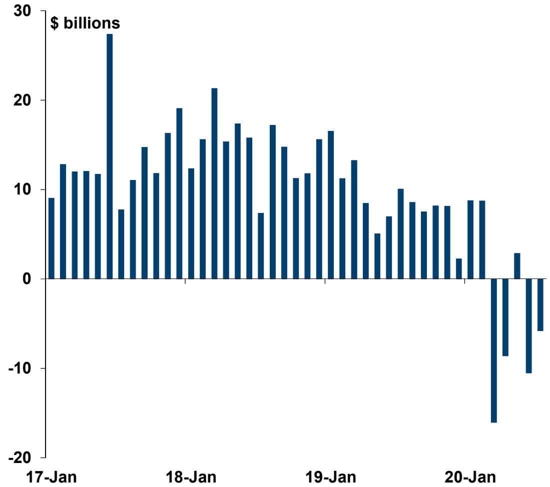
Small Business Openings & Revenue



Source: Womply via Opportunity Insights and Haver Analytics

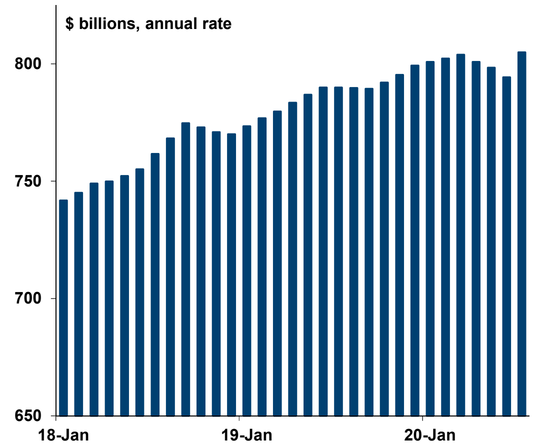
The leisure and transportation sectors have been hit hard by the pandemic, and a second-round effect of this weakness might be slow activity at manufacturers of transportation equipment. Certainly, the aircraft industry is experiencing a difficult time. The monthly report on factory orders has shown negative bookings (i.e. net cancellations) for commercial aircraft in four of the past five months (chart; next page, left). Net cancellations are not unprecedented, but they are rare. A dip occurred during the financial crisis, and a slightly larger negative reading occurred in the early stages of the recovery after the financial crisis. The recent softening is larger and more persistent.

New Orders for Nondefense Aircraft



Source: U.S. Census Bureau via Haver Analytics

Rental Income



Source: Bureau of Economic Analysis via Haver Analytics

Elevated unemployment has stirred concern about individuals missing rental or mortgage payments and facing evictions from their homes. Indeed, Congress provided a temporary moratorium on evictions, and the Center for Disease Control is attempting to issue a regulation prohibiting evictions that might be connected to the pandemic. Missed payments, however, do not appear to be an issue thus far. The monthly report on personal income includes data on rental income, and it has performed reasonably well in recent months. Payments softened some from April through June, but the dips were more than offset with a jump in July (chart, right). The longer-term upward trend has lost momentum, but at this point it is hard to make the case that rental delinquencies are a problem.

Review

Week of August 31, 2020	Actual	Consensus	Comments
ISM Manufacturing Index (August)	**56.0% (+1.8 Pct. Pts.)**	**54.8% (+0.6 Pct. Pts.)**	The advance in the ISM index pushed the measure well above the pre-virus average of 50.5% in January/February to the best reading since November 2018. The new orders component led the advance in the headline index with an increase of 6.1 percentage points to 67.6%, the highest reading since early 2004. With orders strong, production remained firm. The increase of 1.2 percentage points occurred from an already elevated level, leaving the index at 63.3%, a reading in the upper portion of its historical range. The employment index registered its fourth consecutive increase, but it remained soft at 46.4%.
Construction Spending (July)	**0.1%**	**1.0%**	The uptick in construction in July ended a four-month slide, but the modest advance did not alter the picture of sluggish activity. Private residential construction showed a hint of revival with an increase of 2.1%, but building was still well shy of pre-virus levels. Business related activity fell 1.0%, adding to the net decline since January. Public construction (mostly building by state and local governments) fell 1.3% in the latest month. This area has been choppy this year, showing little net change.
Factory Orders (July)	**6.4%**	**6.1%**	New orders for durable goods accounted for most of the increase in total factory bookings in July with an advance of 11.4%. The transportation category was especially strong (up 35.7%), but bookings for durable goods ex-transportation also contributed with an increase of 2.6%. Orders for durable goods excluding transportation are now close to the range in place before the onset of the pandemic, having retraced approximately 90% of the ground lost during the spring. Nondurable bookings rose 1.8%. Part of this increase was the result of an increase of 6.5% in the petroleum and coal category, which was probably influenced by higher prices, but orders for other nondurable goods also contributed with an increase of 0.9%. The gain ex-petrol marked the third consecutive increase and pushed bookings close to the pre-virus range.
Trade Balance (July)	**-$63.6 Billion ($10.1 Billion Wider Deficit)**	**-$58.0 Billion ($7.1 Billion Wider Deficit)**	International trade in goods accounted for most of the widening in the monthly trade deficit. Both exports and imports of goods rose sharply (up 11.9% and 12.3%, respectively), but the sharper change in imports (and larger volume of goods) led to the significant widening in the deficit. Trade in services, where the U.S. enjoys a surplus, provided a downside surprise. In addition to a smaller surplus in July, results in the prior six months were revised lower. The poor trade performance in July sets the stage for a noticeable drag from net exports on GDP growth in Q3. If August and September do not show improvement, international trade is likely to subtract approximately two percentage points from GDP growth.

Review Continued

Week of August 31, 2020	Actual	Consensus	Comments
ISM Nonmanufacturing Index (August)	**56.9% (-1.2 Pct. Pts.)**	**57.0% (-1.1 Pct. Pts.)**	Although the ISM nonmanufacturing index slipped in August, the new total was still consistent with a good performance in the nonmanufacturing sectors of the economy. 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%) and seemed likely to correct. The employment component, in contrast, rose 5.8 percentage points, but it remained below the critical value of 50% (47.9%).
Payroll Employment (August)	**1,371,000**	**1,350,000**	Nonfarm payrolls in August posted their fourth consecutive monthly gain of more than one million new jobs. The latest advances signal that the economy remains on a recovery track, although the labor market is still far from normal, as gains in the past four months have recouped only 48% of the jobs lost in March and April. The unemployment rate was a more impressive element of the report, as the measure fell 1.8 percentage points to 8.4%. It was a “strong” reduction in that it was led by a surge in employment as measured by the household survey (3.756 million) that exceeded the solid increase in the size of the labor force (968,000).

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 (Payroll Employment); Consensus forecasts are from Bloomberg

Preview

Week of Sept. 7, 2020	Projected	Comments
PPI (August) (Thursday)	**0.1% Total, 0.2% Core***	Gasoline prices eased in August, which should push the energy component of the PPI slightly lower. The dip in energy prices would follow three consecutive increases that offset about half of the drop from February through May. Food prices have moved erratically in recent months, but they have posted little net change, leading one to expect a modest shift in August. Core goods prices had been well restrained before a jump of 0.3% in July, but given the still-soft economic environment, that increase was probably a random move rather than an indication of emerging pressure. Soft results will probably return in August. Service prices, in contrast, face upside potential, reflecting additional recovery in the transportation and warehousing component, which fell sharply from January through April.
CPI (August) (Friday)	**0.3% Total, 0.2% Core**	Gasoline prices edged lower in August, but they fell by less than seasonal norms, which should lead to an increase after seasonal adjustment. Charges for electricity and natural gas, which have been calm in recent months, could catch up with the higher prices of gasoline and fuel oil. Prices of food for home consumption started to ease in July after pandemic-related pressure in the prior several months, and the softening probably continued into August. In the core component, further unwinding of discounting that pushed prices lower from March through May should lead to another firm increase, although well shy of the shocking jump of 0.6% in July.
Federal Budget (August) (Friday)	**$250.0 Billion Deficit**	With economic activity running below levels from a year ago, federal revenues in August are likely to fall shy of collections in the same month last year, with available data suggesting a drop of approximately four percent. With Congress failing to pass additional legislation to counter the effects of the pandemic, outlays are likely to ease from the massive totals in the prior four months, which should leave the deficit only moderately wider than the $200 billion shortfall registered in August 2019. The expected deficit for August would leave the cumulative shortfall in the first 11 months of the year at $3.120 trillion. September is typically a favorable month for the federal budget (strong revenue flows because of estimated tax payments), and thus the full fiscal year deficit should be close to the 11-month total in August.

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

Source: Forecasts provided by Daiwa Capital Markets America

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Economic Indicators

August/September 2020

Monday	Tuesday	Wednesday	Thursday	Friday
31	1	2	3	4
	ISM INDEX Index Prices June 52.6 51.3 July 54.2 53.2 Aug 56.0 59.5 **CONSTRUCTION SPEND.** May -1.3% June -0.5% July 0.1% **VEHICLE SALES** June 13.0 million July 14.6 million Aug 15.2 million	**ADP EMPLOYMENT REPORT** Private Payrolls June 4,485,000 July 212,000 Aug 428,000 **FACTORY ORDERS** May 7.7% June 6.4% July 6.4% **BEIGE BOOK** "Economic activity increased among most Districts, but gains were generally modest and activit remained well below levels prior to the COVID-19 pandemic."	**UNEMPLOYMENT CLAIMS** Initial Continuing (Millions) Aug 08 0.971 14.759 Aug 15 1.104 14.492 Aug 22 1.001 13.254 Aug 29 0.881 N/A **TRADE BALANCE** May -$57.9 billion June -$53.5 billion July -$63.6 billion **REVISED PRODUCTIVITY & COSTS** Productivity Unit Labor Costs 20-Q1 -0.3% 9.6% 20-Q2(p) 7.3% 12.2% 20-Q2(r) 10.1% 9.0% **ISM NON-MFG INDEX** Index Prices June 57.1 62.4 July 58.1 57.6 Aug 56.9 64.2	**EMPLOYMENT REPORT** Payrolls Un. Rate June 4,781,000 11.1% July 1,734,000 10.2% Aug 1,371,000 8.4%
7	8	9	10	11
LABOR DAY	**NFIB SMALL BUSINESS OPTIMISM INDEX (6:00)** June 100.6 July 98.8 Aug -- **CONSUMER CREDIT (3:00)** May -$14.4 billion June $8.9 billion July --	**JOLTS DATA (10:00)** Openings (000) Quit Rate May 5,371 1.6% June 5,889 1.9% July -- --	**INITIAL CLAIMS (8:30)** **PPI (8:30)** Final Demand Core* June -0.2% 0.3% July 0.6% 0.3% **Aug 0.1% 0.2%** **WHOLESALE TRADE (10:00)** Inventories Sales May -1.2% 5.7% June -1.3% 8.8% **July -0.1% 4.0%**	**CPI (8:30)** Total Core June 0.6% 0.2% July 0.6% 0.6% **Aug 0.3% 0.2%** **FEDERAL BUDGET (2:00)** 2020 2019 June -$864.1B -$8.5B July -$63.0B -$119.7B **Aug -$250.0B** -$200.3B
14	15	16	17	18
	EMPIRE MFG INDEX **IMPORT/EXPORT PRICES** **IP & CAP-U** **FOMC MEETING**	**RETAIL SALES** **BUSINESS INVENTORIES** **NAHB HOUSING MARKET INDEX** **FOMC DECISION** **TIC DATA**	**INITIAL CLAIMS** **HOUSING STARTS** **PHILLY FED INDEX**	**CURRENT ACCOUNT** **LEADING INDICATORS** **CONSUMER SENTIMENT**
21	22	23	24	25
CHICAGO FED NATIONAL ACTIVITY INDEX	**EXISTING HOME SALES**	**FHFA HOME PRICE INDEX**	**INITIAL CLAIMS** **NEW HOME SALES**	**DURABLE GOODS ORDERS**

*Forecasts in Bold. (p) = preliminary; (r) = revised * The core PPI excludes food, energy, and trade services.*

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Treasury Financing

August/September 2020

Monday	Tuesday	Wednesday	Thursday	Friday
31	1	2	3	4
AUCTION RESULTS: Rate Cover 13-week bills 0.105% 2.71 26-week bills 0.115% 3.23 **SETTLE:** $25 billion 20-year bonds $7 billion 30-year TIPS $50 billion 2-year notes $51 billion 5-year notes $47 billion 7-year notes	**AUCTION RESULTS:** Rate Cover 42-day CMB 0.090% 3.42 119-day CMB 0.115% 3.21 **ANNOUNCE:** $30 billion 4-week bills for auction on September 3 $35 billion 8-week bills for auction on September 3 $25 billion 105-day CMBs for auction on September 2 $30 billion 154-day CMBs for auction on September 2 **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 0.115% 3.54 154-day CMB 0.120% 3.26	**AUCTION RESULTS:** Rate Cover 4-week bills 0.090% 3.83 8-week bills 0.100% 3.14 **ANNOUNCE:** $105 billion 13-,26-week bills for auction on September 8 $34 billion 52-week bills for auction on September 8 $50 billion 3-year notes for auction on September 8 $35 billion 10-year notes for auction on September 9 $23 billion 30-year bonds for auction on September 10 $30 billion 42-day CMBs for auction on September 8 $30 billion 119-day CMBs for auction on September 8 **SETTLE:** $105 billion 13-,26-week bills $30 billion 42-day CMBs $30 billion 119-day CMBs	
7	8	9	10	11
LABOR DAY	**AUCTION:** $105 billion 13-,26-week bills $34 billion 52-week bills $50 billion 3-year notes $30 billion 42-day CMBs $30 billion 119-day CMBs **ANNOUNCE:** $30 billion* 4-week bills for auction on September 10 $35 billion* 8-week bills for auction on September 10 **SETTLE:** $30 billion 4-week bills $35 billion 8-week bills $25 billion 105-day CMBs $30 billion 154-day CMBs	**AUCTION:** $35 billion 10-year notes	**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills $23 billion 30-year bonds **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on September 14 $22 billion* 20-year bonds for auction on September 15 $12 billion* 10-year TIPS for auction on September 17 **SETTLE:** $105 billion 13-,26-week bills $34 billion 52-week bills $30 billion 42-day CMBs $30 billion 119-day CMBs	
14	15	16	17	18
AUCTION: $105 billion* 13-,26-week bills	**AUCTION:** $22 billion* 20-year bonds **ANNOUNCE:** $30 billion* 4-week bills for auction on September 17 $35 billion* 8-week bills for auction on September 17 **SETTLE:** $30 billion* 4-week bills $35 billion* 8-week bills $50 billion 3-year notes $35 billion 10-year notes $23 billion 30-year bonds		**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills $12 billion* 10-year TIPS **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on September 21 $22 billion* 2-year FRNs for auction on September 23 $52 billion* 2-year notes for auction on September 22 $53 billion* 5-year notes for auction on September 23 $50 billion* 7-year notes for auction on September 24 **SETTLE:** $105 billion* 13-,26-week bills	
21	22	23	24	25
AUCTION: $105 billion* 13-,26-week bills	**AUCTION:** $52 billion* 2-year notes **ANNOUNCE:** $30 billion* 4-week bills for auction on September 24 $35 billion* 8-week bills for auction on September 24 **SETTLE:** $30 billion* 4-week bills $35 billion* 8-week bills	**AUCTION:** $22 billion* 2-year FRNs $53 billion* 5-year notes	**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills $50 billion* 7-year notes **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on September 28 **SETTLE:** $105 billion* 13-,26-week bills	**SETTLE:** $22 billion* 2-year FRNs

**Estimate*