Daiwa Capital Markets

U.S. Economic Comment

- The U.S. economy: insights from employment and personal income

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U.S. Economy: Brisk in Q3; Slower, but Still Up, in Q4

The final estimate of second quarter GDP showed an inconsequential pickup from the preliminary tally and confirmed that the U.S. economy registered a dreadful performance in the spring (-31.4 percent versus a preliminary estimate of -31.7 percent). However, a burst of activity in May and June, and a continued good performance in July and August, suggest that GDP grew vigorously in the third quarter, with growth likely to total 25 to 30 percent. The focus of analysts and market participants will now turn to the fourth quarter. Two reports published this week -- employment and personal income -- offer insights into challenges and prospects for the new quarter.

Employment

The increase of 661,000 in nonfarm payrolls represented a marked slowing from the average of 2.689 million in the prior four months and even the average of 1.625 million in July and August. The picture is somewhat less troubling if one considers that upward revisions to prior data totaled 145,000 and that a shift in employment related to the decennial census accounted for some of the deceleration in job growth (the federal government hired 238,000 census workers in August and trimmed 41,000 in September). Still, the latest figures pointed to an easing in the pace of economic growth. We would not conclude that the recovery is stalling, as a breakdown of job growth by industry offered some encouraging signs. This perspective also revealed some challenges.

The construction industry did well in September and has now recouped more than 60 percent of the ground lost in the spring. With housing sales strong, this area should continue to perform well. The manufacturing industry also is holding its own, and a solid reading on the ISM index for September offered encouragement for the outlook. The retail trade sector, which had been contracting in the past few years, has posted a sharp recovery from the swoon in the spring, retracing approximately 80 percent of its lost ground. This area seems to be responding to active spending by consumers on goods, which has moved above pre-virus levels.

We also have been mildly impressed with the performance of the leisure and hospitality sector. This area was easily the hardest hit by the pandemic, but its degree of recovery is in line with that of the overall economy, retracing almost 54 percent of its virus-related decline. Some areas within this group are still suffering (performing arts and museums), but other areas are recovering, even restaurants and bars. It is

Change in Nonfarm Payrolls

	Percent change Feb. to April	Ground regained (percent)*	Percent change Feb. to Sept.
Private Sector	-16.3	54	-7.6
Goods Producing	-11.8	54	-5.4
Mining	-8.5	-66	-14.1
Construction	-14.2	64	-5.2
Manufacturing	-10.6	53	-5.0
Service Producing	-17.2	54	-8.0
Retail Trade	-15.2	80	-3.1
Transportation	-10.8	28	-7.8
Information	-9.8	3	-9.5
Financial Activities	-3.2	42	-1.8
Business Services	-10.7	40	-6.4
Education	-13.3	31	-9.3
Health	-10.9	54	-5.0
Leisure	-49.3	54	-22.8
Other Services	-23.1	64	-8.3
State Governments	-4.0	-28	-5.1
Local Governments	-5.4	-19	-6.4

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

Source: Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America still the softest sector of the economy (off 23 percent from February), but the public seems to be adapting and learning to live (sort of) with the virus.

To be sure, there are challenges. While leisure and hospitality have kept pace, announcements of large layoffs by Disney this week indicated that results for this sector could soften in the months ahead. Major airlines also warned of layoffs this week, which would worsen an already dismal performance in the travel industry. The business-service sector also is a concern. This is a broad area that typically moves in step with the overall economy. In this instance, however, it is lagging, having recouped only 40 percent of its slide in the spring. Several components of business services have been weak, including legal, advertising, temporary help. The information sector (publishing, broadcasting, motion pictures, telecommunications) has barely shown any recovery.

All things considered, months with job growth in excess of one million might be over, but payrolls will most likely continue to advance at a respectable pace.

Personal Income

The monthly report on personal income and consumption is not scrutinized by most market participants, but it is one of the most useful sets of statistics published by the Commerce Department. Not only does it include the inflation measures targeted by the Federal Reserve, it also provides the best view on consumer spending, which is the largest component of final demand by far. Thus, it provides the strongest clues to the pace of overall economic growth.

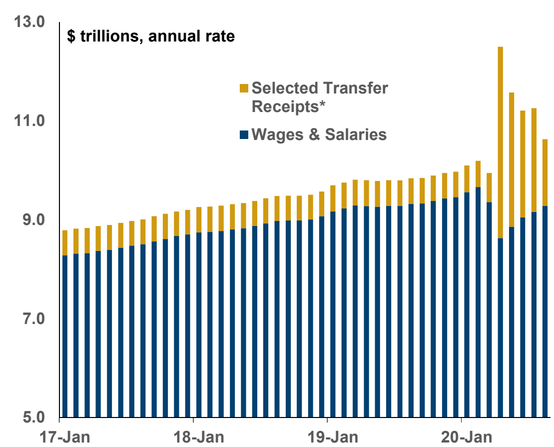
The latest figures from the income and consumption report show why Q3 GDP will most likely exceed 25 percent. After finishing Q2 on a strong note, real consumer spending rose 1.1 percent in July and 0.7 percent in August. These advances translate to annual growth of more than 35 percent when using the averaging and growth formulas from the GDP accounts. (Growth of 8.5 percent in May and 5.9 percent in June after a collapse in April will play a role in the brisk Q3 advance. These sharp increases left an elevated jumping off point for the third quarter which will raise the third quarter average relative to that in Q2.)

Many observers took note of the September report on income and consumption because it showed a drop of 2.7 percent in personal income, which stirred concern about a loss of economic support from households. However, the decline by itself does not necessarily indicate that spending will weaken. It is important to take note of income levels in prior months and of the sources of the decline in income.

As shown in the chart, income surged in April because of government support in the form of recovery rebate checks and enhanced unemployment benefits. It is the fading of these support payments that led to the drop in income. Even with the loss of this support, income remained elevated in August, close to levels that would have been achieved if the pre-virus trend had remained in place.

If Congress approves another stimulus package, it most likely would contain additional support for households, which would drive personal income to an elevated level and stir consumer spending. If Congress fails to act, individuals will not necessarily begin to retrench. A good portion of the income that flowed to households in the past few months has been saved, a development shown by a heightened saving rate and by

Personal Income



** The sum of government unemployment insurance benefits and other social benefits. Other social benefits have been dominated in recent months by recovery rebate payments.*

Source: Bureau of Economic Analysis via Haver Analytics a surge in deposits at commercial banks and saving institutions. Individuals could draw on these balances to maintain spending for a time.

Also, income might continue to grow because of advances in wages. As shown in the lower bars on the chart, wage income is increasing because of the improvement in employment in the past five months. It is possible that wage income will recover enough in the months ahead to offset the loss of government support.

Other sources of income could be helpful to some households. For example, proprietors' income has picked up recently, retracing approximately 64 percent of its spring slide, a signal that small and medium sized businesses are on firmer ground. Interest income has increased in July and August after declining steadily in the first half of the year, no doubt boosted by the increase in deposit accounts generated by government support. Rental income jumped in July and August, more than offsetting declines from April to June. The pickup is beneficial to landlords, but it also might represent favorable news by indicating that missed rental payments and evictions have not emerged as a major issue.

Review

Week of Sept. 28, 2020	Actual	Consensus	Comments
U.S. International Trade in Goods (August)	**$82.9 Billion Deficit ($2.8 Billion Wider Deficit)**	**$81.8 Billion Deficit ($1.7 Billion Wider Deficit)**	Both exports and imports continued to recover from their pandemic-related retreats in the spring. As in the prior month, the increase in imports (3.1%) was larger than that for exports (2.8%), resulting in a wider trade deficit in goods. The average deficit of $81.5 billion for the first two months of Q3 is noticeably wider than that in Q2, suggesting that net exports are likely to subtract more than two percentage points from GDP growth in the third quarter.
Consumer Confidence (September)	**101.8 (+15.5 Index Pts.)**	**90.0 (+5.2 Index Pts.)**	After showing little net change from May through August, the consumer confidence index jumped 18.0% in September. The increase, though, occurred from a low level and kept the measure well shy of pre-virus peak of 132.6 in February. A sub-par labor market seems to be influencing attitudes, as only a small share of individuals indicated that jobs were plentiful; a large share indicated that jobs were hard to get.
Revised GDP (2020-Q2)	**-31.4% (+0.3 Pct. Pt. Revision)**	**-31.7% (Unrevised)**	Modest upward revisions to consumer spending and residential construction more than offset downward adjustments to exports and government spending, leaving GDP a touch better than previously believed (i.e. a smaller decline).
Personal Income, Consumption, Core Prices (August)	**-2.7%, 1.0%, 0.3%**	**-2.5%, 0.8%, 0.3%**	Several income categories posted solid performances in August (wages and salaries rose 1.3% and nonfarm proprietors rose 1.1%), but fading government support in the form of lower unemployment compensation and fewer rebate checks more than offset these gains. Although government support is fading, it is still sizeable and helped to support a firm increase in consumer spending. The core price index for personal consumption expenditures rose sharply for the third consecutive month, but the jumps followed declines in March and April. These largely offsetting changes left the year-over-year increase in core prices at 1.6%, a reading in the middle of the range from the past several years.
ISM Manufacturing Index (September)	**55.4% (-0.6 Pct. Pt.)**	**56.5% (+0.5 Pct. Pt.)**	The ISM manufacturing index eased in September, but the decline was small and the level of the index remained firm. The new orders component led the decline in the headline index with a drop of 7.4 percentage points. However, the change occurred from an unusually high level and the new reading of 60.2% remained strong relative to historical standards. With orders easing, the production index softened, but it also remained elevated at 61.0%. The employment index had been lagging, but it showed a notable increase in September (up 3.2 percentage points to 49.6%).

Review Continued

Week of Sept. 28, 2020	Actual	Consensus	Comments
Construction Spending (August)	**1.4%**	**0.7%**	The advance in construction activity in August was joined by upward revisions that left the level of activity in July 2.1% above the preliminary tally. Private residential activity (up 3.7%) advanced for the third consecutive month and has regained all of the ground lost in the spring. Private nonresidential construction dipped 0.3%, continuing the erosion that began early in the year. Government-sponsored building edged 0.1% higher, reinforcing the sideways trend that has been in place since January.
Payroll Employment (September)	**661,000**	**859,000**	A moderate increase in payrolls and upward revisions totaling 145,000 in the prior two months combined added to the recovery in employment, but in total the report did not have the same degree of vigor that was evident from May to August. Job growth in the past five months has now totaled 11.417 million, a retracing of slightly more than half of the 22.160 million cuts in March and April. The unemployment rate fell 0.5 percentage point to 7.9%, but the shift was a "soft" decline. That is, most of the drop was the result of a decline of 695,000 in the size of the labor force. Employment as measured by the household survey rose, but the advance was mediocre at 275,000.
Factory Orders (August)	**0.7%**	**0.9%**	Bookings for durable goods rose 0.5%, slightly stronger than the preliminary estimate of 0.4% published last week. The increase in durable orders included a gain of 1.9% in orders for nondefense capital goods other than aircraft, which pushed this measure above its pre-virus level. Orders for nondurable goods rose 0.8%, but most of the advance was the result of a jump of 4.2% in the petroleum and coal category, which was probably influenced by higher prices. Orders for nondurable goods other than petroleum and coal rose only 0.2%. Nondurable orders ex-petroleum and coal are close to their pre-virus levels, but they are still lagging a bit.
Revised Consumer Sentiment (September)	**80.4 (+1.5 Index Pts. Revision)**	**79.0 (+0.1 Index Pt. Revision)**	The upward revision in the University of Michigan Index of Consumer Sentiment in September, while welcome, did not meaningfully alter the picture on attitudes. The recovery from the swoon in the spring has been modest, with the measure recouping only 30% of the ground lost from the pre-virus peak of 101.0 in February.

Sources: U.S. Census Bureau (U.S. International Trade in Goods, Construction Spending, Factory Orders); The Conference Board (Consumer Confidence); Bureau of Economic Analysis (Revised GDP, Personal Income, Consumption, and Core Prices); Institute for Supply Management (ISM Manufacturing Index); Bureau of Labor Statistics (Payroll Employment); University of Michigan Survey Research Center (Revised Consumer Sentiment); Consensus forecasts are from Bloomberg

Preview

Week of Oct , 2020	Projected	Comments
ISM Nonmanufacturing Index (September) (Monday)	**56.0% (-0.9 Pct. Pt.)**	The service sector of the economy is especially vulnerable to the coronavirus, and the uptick in the number of new Covid cases since mid-September could lead to a dampening in the nonmanufacturing index. The expected reading represents the second consecutive decline, although the changes are small and the level of the index is still firm (only 0.4 index point lower than the pre-virus average in January/February).
Trade Balance (August) (Tuesday)	**-$66.2 Billion ($2.6 Billion Wider Deficit)**	The already reported widening of $2.8 billion in the goods trade deficit for August is likely to account for most of the shift in the total trade shortfall. The surplus in service trade fell sharply in the spring and has eased a bit further in recent months. With travel and transportation still restrained because of the pandemic, prospects for a meaningful pickup in exports and imports of services are limited.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

September/October 2020

Monday	Tuesday	Wednesday	Thursday	Friday
28	29	30	1	2
	U.S. INTERNATIONAL TRADE IN GOODS June -$71.0 billion July -$80.1 billion Aug -$82.9 billion **ADVANCE INVENTORIES REPORT** Wholesale Retail June -1.3% -2.7% July -0.1% 1.2% Aug 0.5% 0.8% **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** SA NSA May 0.0% 0.3% June 0.0% 0.3% July 0.6% 0.6% **CONFERENCE BOARD CONSUMER CONFIDENCE** July 91.7 Aug 86.3 Sept 101.8	**ADP EMPLOYMENT REPORT** Private Payrolls July 216,000 Aug 481,000 Sept 749,000 **REVISED GDP** GDP Chained Price 20-Q1 -5.0% 1.4% 20-Q2(p) -31.7% -2.0% 20-Q2(r) -31.4% -1.8% **CHICAGO PURCHASING MANAGERS' INDEX** Index Prices July 51.9 56.9 Aug 51.2 55.0 Sept 62.4 64.7 **PENDING HOMES SALES** June 15.8% July 5.9% Aug 8.8%	**UNEMPLOYMENT CLAIMS** Initial Continuing (Millions) Sept 05 0.893 12.747 Sept 12 0.866 12.747 Sept 19 0.873 11.767 Sept 26 0.837 N/A **PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX** Inc. Cons. Core June -1.2% 6.5% 0.3% July 0.5% 1.5% 0.4% Aug -2.7% 1.0% 0.3% **ISM INDEX** Index Prices July 54.2 53.2 Aug 56.0 59.5 Sept 55.4 62.8 **CONSTRUCTION SPEND.** June 1.0% July 0.7% Aug 1.4% **VEHICLE SALES** July 14.6 million Aug 15.2 million Sept 16.3 million	**EMPLOYMENT REPORT** Payrolls Un. Rate July 1,761,000 10.2% Aug 1,489,000 8.4% Sept 661,000 7.9% **REVISED CONSUMER SENTIMENT** July 72.5 Aug 74.1 Sept(p) 78.9 Sept(r) 80.4 **FACTORY ORDERS** June 6.4% July 6.5% Aug 0.7%
5	6	7	8	9
ISM NON-MFG INDEX (10:00) Index Prices July 58.1 57.6 Aug 56.9 64.2 **Sept 56.0 64.0**	**TRADE BALANCE (8:30)** June -$53.5 billion July -$63.6 billion **Aug -$66.2 billion** **JOLTS DATA (10:00)** Openings (000) Quit Rate June 6,001 1.9% July 6,618 2.1% Aug -- --	**FOMC MINUTES** **CONSUMER CREDIT (3:00)** June $11.4 billion July $12.3 billion Aug --	**INITIAL CLAIMS (8:30)**	**WHOLESALE TRADE (10:00)** Inventories Sales June -1.3% 9.0% July -0.1% 4.6% **Aug 0.5% 1.0%**
12	13	14	15	16
COLUMBUS DAY	**NFIB SMALL BUSINESS OPTIMISM INDEX** **CPI** **FEDERAL BUDGET (POSSIBLY POSTPONED)**	**PPI**	**INITIAL CLAIMS** **IMPORT/EXPORT PRICES** **EMPIRE MFG. INDEX** **PHILLY FED INDEX**	**RETAIL SALES** **IP & CAP-U** **CONSUMER SENTIMENT** **BUSINESS INVENTORIES** **TIC DATA**
19	20	21	22	23
NAHB HOUSING INDEX	**HOUSING STARTS**	**BEIGE BOOK**	**INITIAL CLAIMS** **EXISTING HOME SALES** **LEADING INDICATORS**	

Forecasts in Bold. (p) = preliminary (2nd estimate of GDP); (r) = revised (3rd estimate of GDP)

Treasury Financing

September/October 2020

Monday	Tuesday	Wednesday	Thursday	Friday
28	29	30	1	2
AUCTION RESULTS: Rate / Cover 13-week bills 0.100% 2.88 26-week bills 0.105% 3.11	**AUCTION RESULTS:** Rate / Cover 42-day CMB 0.085% 3.42 119-day CMB 0.090% 4.19 **ANNOUNCE:** $30 billion 4-week bills for auction on October 1 $35 billion 8-week bills for auction on October 1 $25 billion 105-day CMBs for auction on September 30 $30 billion 154-day CMBs for auction on September 30 **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 0.095% 3.61 154-day CMB 0.105% 3.53 **SETTLE:** $22 billion 20-year bonds $12 billion 10-year TIPS $52 billion 2-year notes $53 billion 5-year notes $50 billion 7-year notes	**AUCTION RESULTS:** Rate / Cover 4-week bills 0.085% 3.33 8-week bills 0.085% 3.61 **ANNOUNCE:** $105 billion 13-,26-week bills for auction on October 5 $34 billion 52-week bills for auction on October 6 $52 billion 3-year notes for auction on October 6 $35 billion 10-year notes for auction on October 7 $23 billion 30-year bonds for auction on October 8 $30 billion 42-day CMBs for auction on October 6 $30 billion 119-day CMBs for auction on October 6	**SETTLE:** $105 billion 13-,26-week bills $30 billion 42-day CMBs $30 billion 119-day CMBs
5	6	7	8	9
AUCTION: $105 billion 13-,26-week bills	**AUCTION:** $34 billion 52-week bills $52 billion 3-year notes $30 billion 42-day CMBs $30 billion 119-day CMBs **ANNOUNCE:** $30 billion* 4-week bills for auction on October 8 $35 billion* 8-week bills for auction on October 8 **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 October 13 **SETTLE:** $105 billion 13-,26-week bills $34 billion 52-week bills $30 billion 42-day CMBs $30 billion 119-day CMBs	
12	13	14	15	16
COLUMBUS DAY	**AUCTION:** $105 billion* 13-,26-week bills **ANNOUNCE:** $30 billion* 4-week bills for auction on October 15 $35 billion* 8-week bills for auction on October 15 **SETTLE:** $30 billion* 4-week bills $35 billion* 8-week bills		**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on October 19 $22 billion* 20-year bonds for auction on October 21 $17 billion* 5-year TIPS for auction on October 22 **SETTLE:** $105 billion* 13-,26-week bills $52 billion 3-year notes $35 billion 10-year notes $23 billion 30-year bonds	
19	20	21	22	23
AUCTION: $105 billion* 13-,26-week bills	**ANNOUNCE:** $30 billion* 4-week bills for auction on October 22 $35 billion* 8-week bills for auction on October 22 **SETTLE:** $30 billion* 4-week bills $35 billion* 8-week bills	**AUCTION:** $22 billion* 20-year bonds	**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills $17 billion* 5-year TIPS **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on October 26 $26 billion* 2-year FRNs for auction on October 28 $54 billion* 2-year notes for auction on October 27 $55 billion* 5-year notes for auction on October 28 $53 billion* 7-year notes for auction on October 29 **SETTLE:** $105 billion* 13-,26-week bills	

**Estimate*