Daiwa Capital Markets

U.S. Economic Comment

- The November employment report: not so bad
- Bank profits: an encouraging sign

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The Labor Market

Most observers will be deeply disappointed in the November employment report, as job growth of 245,000 was paltry relative to the losses in the spring and the ground that needs to be regained. At the November pace, payroll employment would not return to its pre-virus peak until March 2023! Many also will decry the drop of 0.2 percentage point in the unemployment rate to 6.7 percent, noting that the improvement was the result of individuals dropping out of the labor force rather than finding work.

Certainly, the report was well shy of brisk, but at the same time, it is easy to overstate the degree of softness. For example, the drop in the size of the labor force (off 400,000) that led to the decline in joblessness followed a jump of 724,000 in the prior month. This measure often moves erratically, and the latest changes most likely reflect normal volatility. The key takeaway should be a respectable gain in the past two months that added to solid advances in the prior several months. The employment number from the survey of households that accompanies the labor force statistic also merits attention. November appeared weak with a decline of 74,000, but this drop followed a surge of 2.2 million in October. The past two months combined signal strong employment gains.

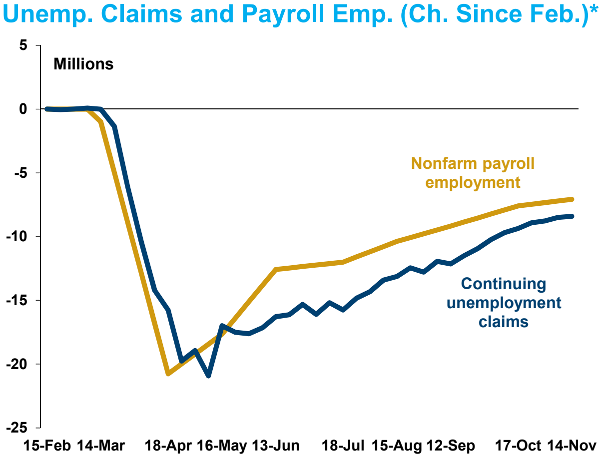
The household survey also was interesting in that it showed little change in the number of permanent job cuts in the past two months. This measure had moved noticeably higher in the six months from April to September, but it dipped on balance in October and November.

The modest increase in nonfarm payrolls cannot be explained away by special factors, but context matters. The latest advance, although weak relative to gains in other recent months, occurred at a time when the number of new Covid cases was surging and when lockdown restrictions were being (re)imposed in many areas. Even a modest gain in such an environment can be viewed as encouraging, a sign that businesses and individuals are seeking to adapt rather than to retreat.

We also were heartened by the latest weekly report on claims for unemployment benefits, which showed declines in both the number of initial claims and the number of individuals receiving unemployment benefits (so-called continuing claims). Perhaps we should discount these statistics because a review published by the Government Accountability Office this week indicated meaningful inaccuracies in unemployment claims.

The GAO report, along with indications of processing problems at state employment agencies and suggestions of numerous instances of fraud, has led us to downplay the significance of this usually reliable report. Nevertheless, we still see a germ of

Unemp. Claims and Payroll Emp. (Ch. Since Feb.)*



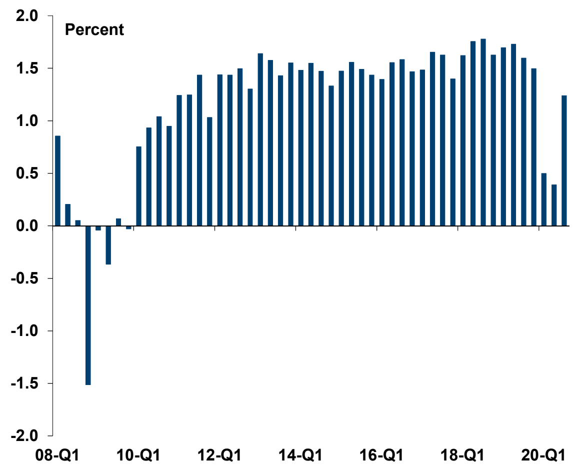
** The blue line (continuing unemployment claims) shows the change in the number of individuals receiving benefits under regular state programs and the Pandemic Emergency Unemployment Compensation program since mid-February (weekly observations). The gold line (nonfarm payroll employment) shows the change in the level of total nonfarm payrolls since February (monthly observations centered on the survey week for the employment report, with weekly interpolation between these dates).*

Source: Bureau of Labor Statistics and U.S. Department of Labor, Employment and Training Administration via Haver Analytics; Daiwa Capital Markets America information in the claims data. Specifically, as shown in the chart on page 1, changes since February in nonfarm payrolls and continuing claims for unemployment benefits have traced similar paths. Recent problems in the insurance programs generate some gaps between the two series, but the correlation remains high. Some of the problems mentioned in the GAO report have been addressed by state employment agencies, and thus we look for continuing claims to remain a useful source of information, and the trend in continuing claims remains decidedly downward (off 569,000 or 9.3 percent in the latest week).

Bank Profits

The Federal Deposit Insurance Corporation (FDIC) this week released profit results for federally insured banks and saving institutions during the third quarter. The results were favorable, as profits rebounded from weak results in the first and second quarters. Earnings as a share of average assets (a common metric in the banking industry) remained below pre-virus levels, but the degree of recovery was impressive (chart).

Return on Assets of FDIC-Insured Institutions*



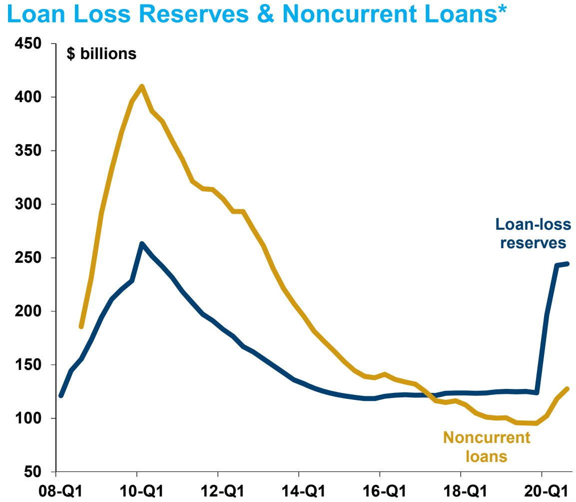
** Net income (including gains or losses on securities and extraordinary items) as a percentage of average total assets.*

Source: Quarterly Banking Profile, Federal Deposit Insurance Corporation (FDIC)

Perhaps more important than the recovery in general was the source of the improvement and its implications for the current economic setting. The weakness in the second quarter and the rebound in Q3 were largely driven by provisions for loan losses. The onset of the pandemic led institutions in Q2 to prepare for a wave of defaults by boosting provisions for loan losses, which are recorded as an expense on the income statement and depress reported income. Bank executives apparently felt more comfortable in the third quarter, as they made only modest provisions for losses.

The relaxed view in the industry emerged because the expected acceleration in defaults, at least so far, has not become an issue. The number of noncurrent loans has increased in recent months, but the change has been modest and has occurred from a low level (chart). This series would suggest that loan defaults are not especially threatening. Moreover, after heavy provisions for loan losses in Q2 and minimal exercise of these provisions in Q3, the stock of loan loss reserves is quite high by historical standards and far larger than noncurrent loans (chart).

Loan Loss Reserves & Noncurrent Loans*



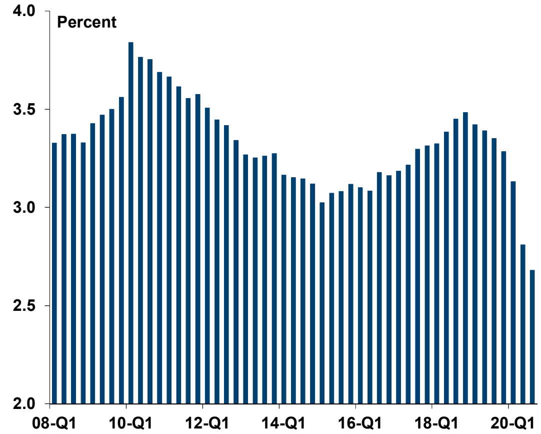
** The series on noncurrent loans begins in 2008-Q3.*

Source: Quarterly Banking Profile, Federal Deposit Insurance Corporation (FDIC)

The pandemic generated an economic crisis that led to dramatic declines in employment and production. The economic contraction had the potential to generate a financial crisis associated with loan defaults. Thus far, that has not occurred. Of course, defaults could emerge in the months ahead, but banks and savings institutions seem well prepared to weather a storm.

While the recent report on profits of financial institutions was generally encouraging, all is not well in this industry. The low level of interest rates and the narrow slope of the yield curve have reduced the net interest margins of depository institutions. Indeed, the spread between the rates of interest paid and earned moved to a record low in the third quarter (chart). The tight margin helps to explain why profits remained below pre-virus levels despite minimal provisions for loan losses.

Net Interest Margin of FDIC-Insured Institutions*



** Net interest margin is the difference between interest and dividends earned on interest-bearing assets and interest paid to depositors and other creditors, expressed as a percentage of average earning assets.*

Source: Quarterly Banking Profile, Federal Deposit Insurance Corporation (FDIC)

Review

Week of Nov. 30, 2020	Actual	Consensus	Comments
ISM Manufacturing Index (November)	**57.5% (-1.8 Pct. Pts.)**	**58.0% (-1.3 Pct. Pts.)**	The dip in the ISM manufacturing index in November occurred from an elevated level in the prior month, and thus the latest observation still signaled firm conditions in the factory sector. The latest reading was above all observations from 2019 and was comfortably within the range from 2018, which was the best year of the previous expansion for this measure. The new orders component fell 2.8 percentage points to 65.1%, but the new level still represented a strong showing. The production index also eased (off 2.2 percentage points to 60.8%), but its level remained elevated by historical standards. The employment index disappointed, declining 4.8 percentage points to 48.4%. Except for the tally of 53.2% in October, the employment index has been below 50% since August 2019.
Construction Spending (October)	**1.3%**	**0.8%**	Private residential building led the overall gain in construction activity in October with an increase of 2.9%, continuing a strong trend that began in the spring. Private nonresidential construction fell 0.7%, marking the ninth decline in the past 11 months. Pandemic-related uncertainty seems to be constraining activity in this sector. Building by state and local governments rose less than 0.1%. The trivial increase did little to alter the downward trend that began in the spring.
ISM Services Index (November)	**55.9% (-0.7 Pct. Pt.)**	**55.8% (-0.8 Pct. Pt.)**	The ISM services index slipped for the third time in the past four months, but the changes have not been especially large and the level of the index is consistent with a solid pace of activity (a touch above the average of 55.5% from last year, although lagging the average of 59.0% in 2018, the best year of the current expansion). The business activity component led the decline, falling 3.2 percentage points to 58.0%. The new level is shy of the very best readings in this index (e.g. 67.2% in July), but it still represents a firm showing by historical standards. The easing in business activity was probably driven by slower order flows, as the new orders component slipped 1.6 percentage points to 57.2%. The employment index increased 1.4 percentage points to 51.5%, a level that is not especially impressive by historical standards.
Payroll Employment (November)	**245,000**	**475,000**	In most circumstances, the November advance in nonfarm payrolls would be viewed as brisk, but it should be considered modest in this case because of the substantial ground that needs to be regained after the virus-related drop in the spring. With the latest increase, the labor market has now regained 56 percent of the jobs lost after the onset of the pandemic. The unemployment rate fell 0.2 percentage point to 6.7%, but it was a “soft” decline in that a drop in the size of the labor force (off 400,000) outweighed a decline in employment as measured by the household survey (off 74,000). These declines, however, were not troubling because they followed huge increases in the prior month (2.2 million for employment and 724,000 for the labor force). The latest shift could be viewed as normal volatility.

Review Continued

Week of Nov. 30, 2020	Actual	Consensus	Comments
Trade Balance (October)	**-$63.1 Billion ($1.0 Billion Wider Deficit)**	**-$64.8 Billion ($0.9 Billion Wider Deficit)**	Both exports and imports rose in October (up 2.2% and 2.1%, respectively). While exports showed a larger percentage change, imports dominated in dollar terms and the deficit widened as a result. Trade in goods is recovering noticeably from the pandemic-related drop in the spring. Imports have essentially returned to pre-virus levels, while exports have regained 75% of lost ground. Trade in services, in contrast, has barely improved, and the U.S. surplus in service trade has continued to erode. The trade deficit widened in October, but the change relative to the average in Q3 was modest, and thus, the figures in hand suggest little influence from international trade on GDP growth in Q4.
Factory Orders (October)	**1.0%**	**0.8%**	The advance in factory orders in October reflected an increase of 1.3% in the durable-goods sector (essentially unrevised from the preliminary estimate released last week) and a gain of 0.7% in the nondurable area. The increase in bookings for nondurable goods reflected gains of 0.7% in both petroleum products (despite lower prices) and nonpetroleum items. Order flows in general have been favorable in recent months. Total orders in the durable sector are close to pre-virus levels despite pronounced weakness in bookings for commercial aircraft. Durable orders ex-transportation are noticeably above pre-virus levels. Orders for nondurable goods remain shy of early-year totals, but much of the softness has occurred in the petroleum category. Nondurable orders ex-petroleum have moved slightly above pre-virus levels.

Sources: Institute for Supply Management (ISM Manufacturing Index, ISM Nonmanufacturing 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

Daiwa Capital Markets

Preview

Week of Dec. 7, 2020	Projected	Comments
Revised Nonfarm Productivity (2020-Q3) (Tuesday)	**4.1% (-0.8 Pct. Pt. Revision)**	Revised figures on GDP suggest that the output measure in the productivity report will be little changed from the preliminary estimate. However, hours worked could be revised upward, which would leave a smaller gain in productivity. The downward adjustment to productivity, along with a possible upward revision to compensation per hour, is likely to leave a smaller decline in unit labor cost (-7.2% rather than -8.9%).
CPI (November) (Thursday)	**0.1% Total, 0.2%Core**	Gasoline prices fell in November, but the drop was about in line with seasonal norms, which should leave the energy component little changed after seasonal adjustment. The food component also is likely to be tame, as additional softening in the prices of food for home consumption offsets upward pressure on the cost of meals away from home. Some of the pandemic-related discounting that restrained the core CPI in October is likely to be reversed in November, leaving one of the firmer increases of the year.
Federal Budget (November) (Thursday)	**-$200.0 Billion**	Available data suggest that federal revenues were soft in November, likely falling 4.0% from the same month last year. Outlays also could be on the light side, partly because support authorized by the CARES Act is fading and partly because of a calendar configuration that shifted some outlays scheduled for November into October. Weakness in revenues and expenditures should be about offsetting, which would leave the deficit close to the $209 billion recorded in November 2019.
PPI (November) (Friday)	**0.2% Total, 0.2% Ex. Food & Energy**	The decline in energy prices at the producer level seemed lighter than the seasonal norm, which should lead to an increase after seasonal adjustment. Core goods prices, although flat in October, have showed signs of stirring in other recent months. Service prices, which often move erratically, have provided high-side surprises lately.
Consumer Sentiment (December) (Friday)	**77.5 (+0.6 Index Pt.)**	Record readings in the stock market might brighten moods, but an uncertain economic outlook because of the acceleration in the number of Covid cases is likely to work in the opposite direction. The expected level of the index is up slightly from that in November, but it is within the tight range of the past several months and well shy of pre-virus readings (the index level in February was 101.0).

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

November/December 2020

Monday	Tuesday	Wednesday	Thursday	Friday
30	1	2	3	4
CHICAGO PURCHASING MANAGERS' INDEX Index / Prices Sept 62.4 / 64.7 Oct 61.1 / 64.6 Nov 58.2 / 74.4 **PENDING HOMES SALES** Aug 8.8% Sept -2.0% Oct -1.1%	**ISM MANUFACTURING INDEX** Index / Prices Sept 55.4 / 62.8 Oct 59.3 / 65.5 Nov 57.5 / 65.4 **CONSTRUCTION SPEND.** Aug 2.0% Sept -0.5% Oct 1.3% **VEHICLE SALES** Sept 16.3 million Oct 16.2 million Nov 15.6 million	**ADP EMPLOYMENT REPORT** Private Payrolls Sept 754,000 Oct 404,000 Nov 307,000 **BEIGE BOOK** "Most Federal Reserve Districts have characterized economic expansion as modest or moderate..."	**UNEMPLOYMENT CLAIMS** Initial / Continuing (Millions) Nov 07 0.711 / 6.370 Nov 14 0.748 / 6.089 Nov 21 0.787 / 5.520 Nov 28 0.712 / N/A **ISM SERVICES INDEX** Index / Prices Sept 57.8 / 59.0 Oct 56.6 / 63.9 Nov 55.9 / 66.1	**EMPLOYMENT REPORT** Payrolls / Un. Rate Sept 711,000 / 7.9% Oct 610,000 / 6.9% Nov 245,000 / 6.7% **TRADE BALANCE** Aug -$64.9 billion Sept -$62.1 billion Oct -$63.1 billion **FACTORY ORDERS** Aug 0.6% Sept 1.3% Oct 1.0%
7	8	9	10	11
CONSUMER CREDIT (3:00) Aug -$6.9 billion Sept $16.2 billion Oct --	**NFIB SMALL BUSINESS OPTIMISM INDEX (6:00)** Sept 104.0 Oct 104.0 Nov -- **PRODUCTIVITY & COSTS (8:30)** Productivity / Unit Labor Costs 20-Q2 10.6% / 8.5% 20-Q3(p) 4.9% / -8.9% **20-Q3(r) 4.1% / -7.2%**	**WHOLESALE TRADE (10:00)** Inventories / Sales Aug 0.5% / 1.2% Sept 0.7% / 0.1% **Oct 0.9% / 0.5%** **JOLTS DATA (10:00)** Openings (000) / Quit Rate Aug 6,352 / 2.0% Sept 6,436 / 2.1% Oct -- / --	**INITIAL CLAIMS (8:30)** **CPI (8:30)** Total / Core Sept 0.2% / 0.2% Oct 0.0% / 0.0% **Nov 0.1% / 0.2%** **FEDERAL BUDGET (2:00)** 2020 / 2019 Sept -$124.6B / $82.8B Oct -$284.1B / -$134.5B **Nov -$200.0B** / -$208.8B	**PPI (8:30)** Total / Ex. Food & Energy Sept 0.4% / 0.4% Oct 0.3% / 0.1% **Nov 0.2% / 0.2%** **CONSUMER SENTIMENT (10:00)** Oct 81.8 Nov 76.9 **Dec 77.5**
14	15	16	17	18
	EMPIRE MFG. INDEX **IMPORT/EXPORT PRICES** **IP & CAP-U** **TIC DATA** **FOMC MEETING**	**RETAIL SALES** **BUSINESS INVENTORIES** **NAHB HOUSING MARKET INDEX** **FOMC DECISION**	**INITIAL CLAIMS** **HOUSING STARTS** **PHILLY FED INDEX**	**CURRENT ACCOUNT** **LEADING INDICATORS**
21	22	23	24	25
CHICAGO FED NATIONAL ACTIVITY INDEX	**REVISED GDP** **CONSUMER CONFIDENCE** **EXISTING HOME SALES**	**PERSONAL INCOME, CONSUMPTION, AND PRICE INDEXES** **FHFA HOME PRICE INDEX** **REVISED CONSUMER SENTIMENT** **NEW HOME SALES**	**INITIAL CLAIMS** **DURABLE GOODS ORDERS**	***CHRISTMAS DAY***

Forecasts in Bold. *(p) = preliminary; (r) = revised*

Treasury Financing

November/December 2020

Monday	Tuesday	Wednesday	Thursday	Friday
30	1	2	3	4
AUCTION RESULTS: Rate Cover 13-week bills 0.085% 2.93 26-week bills 0.090% 3.20 **SETTLE:** $27 billion 20-year bonds $12 billion 10-year TIPS $56 billion 2-year notes $57 billion 5-year notes $56 billion 7-year notes	**AUCTION RESULTS:** Rate Cover 52-week bills 0.110% 3.73 42-day CMB 0.080% 3.34 119-day CMB 0.090% 3.57 **ANNOUNCE:** $30 billion 4-week bills for auction on December 3 $35 billion 8-week bills for auction on December 3 $25 billion 105-day CMBs for auction on December 2 $30 billion 154-day CMBs for auction on December 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 0.085% 3.94 154-day CMB 0.090% 3.84	**AUCTION RESULTS:** Rate Cover 4-week bills 0.075% 3.37 8-week bills 0.075% 3.35 **ANNOUNCE:** $105 billion 13-,26-week bills for auction on December 7 $56 billion 3-year notes for auction on December 8 $38 billion 10-year notes for auction on December 9 $24 billion 30-year bonds for auction on December 10 $30 billion 42-day CMBS for auction on December 8 $30 billion 119-day CMBs for auction on December 8 **SETTLE:** $105 billion 13-,26-week bills $34 billion 52-week bills $30 billion 42-day CMBs $30 billion 119-day CMBs	
7	8	9	10	11
AUCTION: $105 billion 13-,26-week bills	**AUCTION:** $56 billion 3-year notes $30 billion 42-day CMBs $30 billion 119-day CMBs **ANNOUNCE:** $30 billion* 4-week bills for auction on December 10 $35 billion* 8-week bills for auction on December 10 **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 $24 billion 30-year bonds **ANNOUNCE:** $105 billion* 13-,26-week bills for auction December 14 **SETTLE:** $105 billion 13-,26-week bills $30 billion 42-day CMBs $30 billion 119-day CMBs	
14	15	16	17	18
AUCTION: $105 billion* 13-,26-week bills	**ANNOUNCE:** $30 billion* 4-week bills for auction on December 17 $35 billion* 8-week bills for auction on December 17 **SETTLE:** $30 billion* 4-week bills $35 billion* 8-week bills $56 billion 3-year notes $38 billion 10-year notes $24 billion 30-year bonds		**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills **ANNOUNCE:** $105 billion* 13-,26-week bills for auction December 21 $24 billion* 2-year FRNs for auction on December 23 $24 billion* 20-year bonds for auction on December 21 $15 billion* 5-year TIPS for auction on December 22 **SETTLE:** $105 billion* 13-,26-week bills	
21	22	23	24	25
AUCTION: $105 billion* 13-,26-week bills $24 billion* 20-year bonds	**AUCTION:** $15 billion* 5-year TIPS **ANNOUNCE:** $30 billion* 4-week bills for auction on December 24 $35 billion* 8-week bills for auction on December 24 **SETTLE:** $30 billion* 4-week bills $35 billion* 8-week bills	**AUCTION:** $24 billion* 2-year FRNs	**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills **ANNOUNCE:** $105 billion* 13-,26-week bills for auction December 28 $34 billion* 52-week bills for auction on December 29 $58 billion* 2-year notes for auction on December 28 $59 billion* 5-year notes for auction on December 28 $59 billion* 7-year notes for auction on December 29 **SETTLE:** $105 billion* 13-,26-week bills	***CHRISTMAS DAY***

**Estimate*