U.S. Economic Comment

- U.S. economy: on track in Q1
- Fiscal and monetary support: perhaps excessive

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U.S. Economy: Expanding Firmly in Q1

Not long ago, the outlook for the U.S. economy in early 2021 involved notable downside risks. The upward trajectory evident during the summer and early fall started to fade in the closing months of the year, and a surge in the number of new Covid cases raised the prospect of lockdowns and retrenchment by consumers and businesses.

The situation has changed. Not only did Congress provide additional fiscal support in late December, but the number of new Covid cases began to ease in early January and has plummeted in recent weeks (chart). The distribution of vaccines, although much slower than hoped, should reinforce the recent progress in fighting the virus.

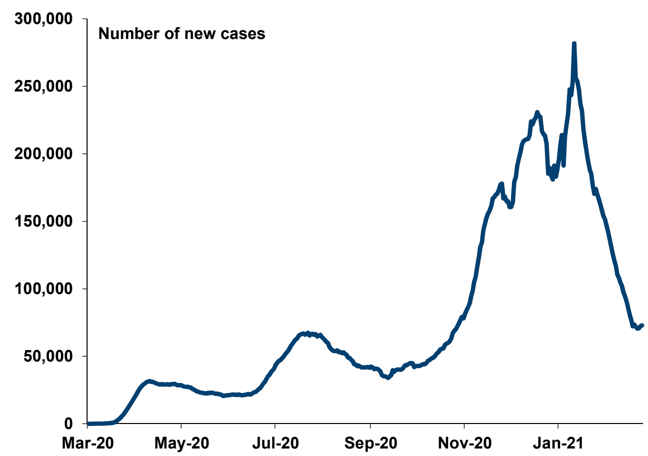
The drop in the number of Covid cases, along with the fiscal support approved in December, seems to have kept the economy on track, as many of the economic reports for January have been favorable. The ISM manufacturing index was close to 60 percent for the fourth consecutive month (58.7 percent in January), and the latest readings on orders for durable goods and industrial production also pointed to strength in manufacturing. Individuals do not seem to be severely constrained by the virus, as retail sales surged in January (helped by recovery rebate checks), and home sales and housing starts have remained elevated.

Prospects for the first quarter came into clearer focus this week with the release of statistics that feed directly into GDP. Most important, the report on personal income and consumption showed a jump of 2.0 percent in real consumer spending, which put activity on track for annual growth of approximately five percent in Q1. Real outlays have now regained 90 percent of the ground lost during the spring despite restrained activity in areas affected by Covid. The virus-related restrictions are evident in service consumption, where spending has retraced only 65 percent of the drop in the spring; spending on goods is 9.9 percent above the pre-pandemic peak.

The burst in consumer spending in January might be dismissed as fueled by recovery rebate checks and therefore temporary. The rebate checks certainly were a factor (along with enhanced unemployment benefits), but wage income also showed a solid gain (up 0.7 percent), with the latest total moving above the pre-pandemic peak in February (chart; next page, left).

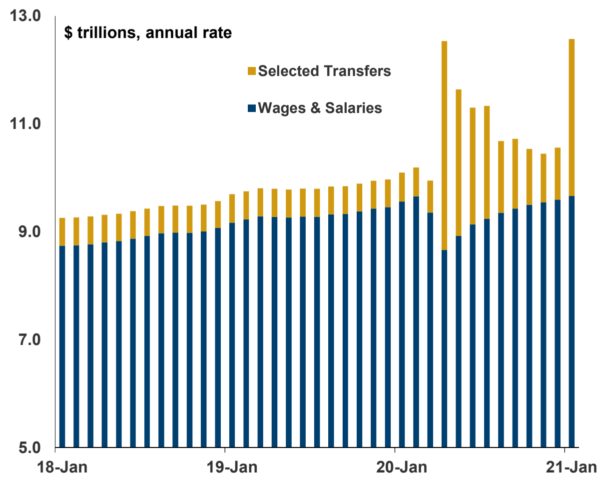
Business spending on new equipment provided a pleasant surprise in the fourth quarter, registering annual growth of more than 25 percent and sending outlays above pre-pandemic levels. That jump does not appear to be a one-off move, as new orders for capital goods other than aircraft posted another gain in January, which marked the ninth consecutive

New Covid-19 Cases in the U.S.*



** Seven-day moving average. Data as of February 24, 2021.*
Source: Johns Hopkins University & Medicine Coronavirus Resource Center via Bloomberg

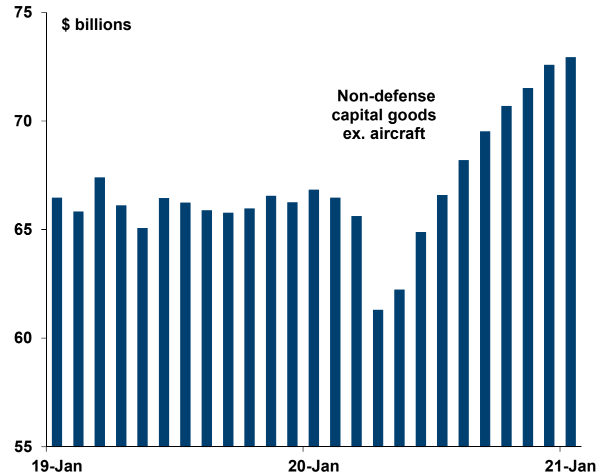
Personal Income: Wages & Selected Transfers*



** Selected transfers include unemployment insurance benefits and other government social benefits to persons.*

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

New Orders for Durable Goods

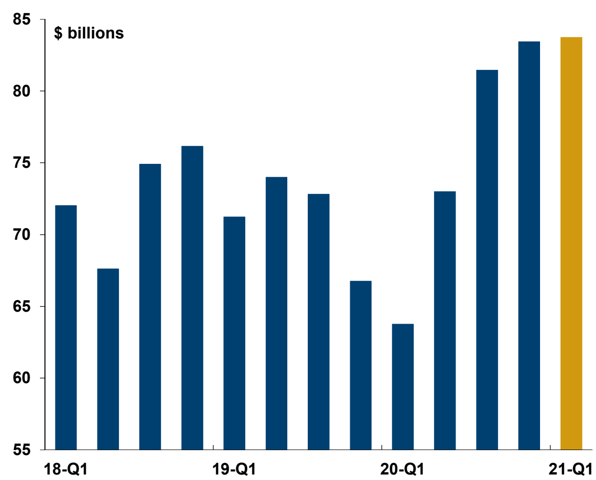


Source: U.S. Census Bureau via Haver Analytics

increase and pushed bookings 9.1 percent above the pre-pandemic peak (chart, above right). This strong order flow has generated a backlog that should lead to firm results for several more quarters, including another double-digit advance in Q1.

The report on international trade in goods for January was encouraging in that it showed both exports and imports continuing to recover from their declines in the spring. However, as in most other recent months, the increase in imports was larger and the trade deficit widened as a result. Recent slippage, though, has been modest, and the shortfall in January was only slightly wider than the average in the fourth quarter (chart). The slippage raises the prospect of another negative contribution from net exports to GDP growth, but the constraint should be considerably lighter than the drag in the second half of last year (probably less than one-half percentage point in Q1 versus an average of 2.4 percentage points in the third and fourth quarters).

Nominal Trade Deficit in Goods*



** Quarterly averages of monthly data. The last observation (gold bar) is the deficit for January 2021.*

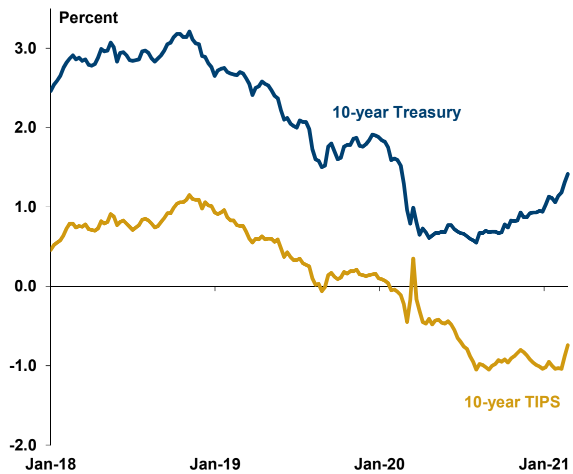
Source: U.S. Census Bureau via Haver Analytics; Daiwa Capital Markets America

With consumer spending, business investment in new equipment, and residential construction providing good support to the economy, and with net exports providing only a modest offset, the economy seems to be on a firm track in the first quarter. We hesitate to be too enthusiastic because weather was challenging in February, which probably generated a good many disruptions. Nevertheless, the reports in hand suggest growth in the neighborhood of four percent.

Heavy Duty Stimulus

With economic activity apparently being well maintained, one might wonder about the need for an additional $1.9 trillion of fiscal stimulus and the continuation of double-barreled monetary support (QE and a federal

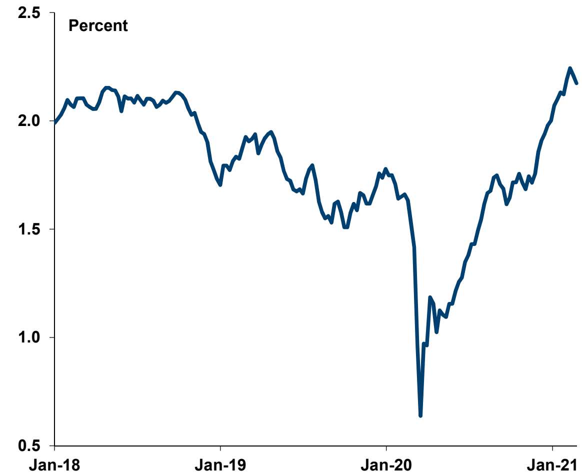
U.S. Treasury Interest Rates*



** Weekly average data, except for the last observations, which are the averages of daily rates for February 22 to February 25.*

Source: Federal Reserve Board via Haver Analytics

10-Year Break-Even Inflation Rate*



** The rate for 10-year nominal Treasury securities less the rate for 10-year TIPS. Weekly average data, except for the last observation, which is the average spread of daily rates for February 22 to February 25.*

Source: Federal Reserve Board via Haver Analytics

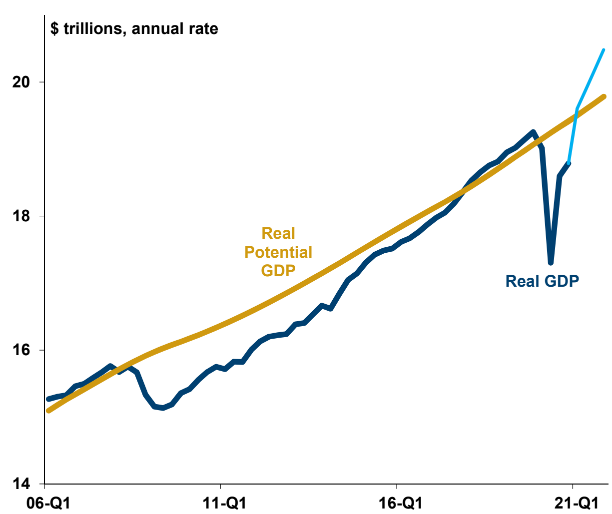
funds rate near zero percent). Market participants seem to be reassessing the implications of these policies, as interest rates have jumped and equity indexes have backed away from recent record readings.

The upward creep in interest rates that began in the summer initially seemed tied to the potential for a pickup in inflation, as the increase in inflation compensation built into 10-year nominal Treasury yields accounted for most of the jump in interest rates; the rate on Treasury inflation-protected securities (TIPS) showed little change (charts, above).

Fed Chair Jerome Powell makes a strong case for well-contained inflation by noting that price dynamics are favorable. Demographics, technology, and globalization are working together to generate a tame inflation environment. However, thoughts of faster inflation are not misplaced, as the heavy stimulus being applied to the economy could constrain the capacity to produce and generate price pressure.

GDP in the fourth quarter was approximately three percent below the potential level estimated by the Congressional Budget Office. The combination of the $900 billion package approved in December and the $1.9 trillion proposal of President Biden represents 13 percent of GDP. The full force of this stimulus will not hit the economy this year. Some support will not leave the Treasury until a future fiscal year, and there will be “leakage” from the transfers made by the federal government this year (i.e. some of the support will be saved or used to pare debt and some will be used to purchase imports rather than domestically produced goods and services). Still, even with small multipliers applied to the government support, the stimulus will most likely drive GDP above its potential (chart).

Real GDP: Actual & Potential*



** The projected levels of GDP in the four quarters of 2021 (light-blue line) assume growth of 4.0% in Q1 and 6.0% in each of the next three quarters. Calculations for potential GDP are made by the Congressional Budget Office.*

Source: Bureau of Economic Analysis and Congressional Budget Office via Haver Analytics; Daiwa Capital Markets America

The recent increase in interest rates has not been entirely related to inflation expectations. This past week real interest rates started to move higher as well, with the yield on 10-year TIPS jumping approximately 20 basis points on Thursday; volatile trading on Friday left little net change. Market participants have most likely noted the deceleration in the number of Covid cases and the resiliency of the economy. Adding heavy stimulus to a reasonably firm foundation is likely to generate vigorous real economic activity and associated pressure on real interest rates.

The nature of the fiscal package now before Congress also might have stirred real interest rates. Although the proposal of President Biden is billed as Covid relief, which would imply temporary federal support, the added federal spending is likely to be long-lasting. An evaluation of the Biden proposal published by the Congressional Budget Office showed that outlays would be spread over the next 10 years, with almost 40 percent of the $1.9 trillion occurring in some future fiscal year. In addition, some of the spending provisions in the legislation easily could be renewed. For example, many legislators could try to extend the one-year increase in the child tax credit. Similarly, the planned increase in subsidy payments for health insurance might be difficult to rescind. The legislation could be viewed as deepening an already unsustainable budget position, and this is before infrastructure and climate-change initiatives President Biden hopes to pursue (although he claims these will be paid for).

The recovery in the economy, with the sizeable boost from aggressive monetary and fiscal policies, could be a positive factor for the equity market because of the effect on profits. However, with the economy possibly accelerating and the budget outlook unfavorable, investors apparently are using higher discount rates to estimate the present value of profits and dividends. Thus, stock prices struggled this week.

Review

Week of Feb. 22, 2021	Actual	Consensus	Comments
Leading Indicators (January)	**0.5%**	**0.4%**	A jump in building permits, along with sizeable positive contributions from the manufacturing workweek, ISM new orders, stock prices, the leading credit index, and the slope of the yield curve, led to the ninth consecutive increase in the leading indicator index in January. The measure has now retraced 89% of its drop in the spring.
Consumer Confidence (February)	**91.3 (+2.4 Index Pts.)**	**90.0 (+0.7 Index Pt.)**	The Conference Board's measure of consumer confidence rose for the second consecutive month in February, but even with these increases, attitudes remained near the bottom of the range since the onset of the virus. The measure has recouped only 12% of the ground lost since February, lagging considerably the recoveries seen in other data.
New Home Sales (January)	**0.923 Million (+4.3%)**	**0.856 Million (+1.7%)**	Sales of new homes jumped in January, and results in the prior three months were revised upward (combined sales were 2.6% firmer than previously believed). The new total is strong relative to the performance in the prior expansion, although it lags the robust totals seen from July to October (average sales of 0.971 million, annual rate). With single-family housing starts strong in recent months, the number of new homes on the market rose sharply in both December and January (3.1% and 2.7%, respectively), but with sales strong, the months' supply of homes dipped from 4.1 to 4.0 months, a reading in the lower portion of the historical range.
Durable Goods Orders (January)	**3.4%**	**1.1%**	New orders for durable goods surged in January from upwardly revised results in the prior month (growth in December totaled 1.2% versus an initial estimate of 0.5%). The latest advance left bookings 4.2% above the pre-virus high in February 2020. Excluding the transportation component, which has been depressed by aircraft bookings, orders rose 1.4% and are now 8.5% above the pre-pandemic peak. Orders for nondefense capital goods other than aircraft, which provide insight into capital spending plans by businesses, also suggested underlying strength, increasing 0.5% and marking the ninth consecutive gain. The latest advance left bookings 9.1% above the pre-pandemic peak in January 2020.
Revised GDP (2020-Q4)	**4.1% (+0.1 Pct. Pt. Revision)**	**4.2% (+0.2 Pct. Pt. Revision)**	GDP growth posted an inconsequential revision in Q4. The various components of GDP also posted modest adjustments, with residential construction, business fixed investment, inventory investment, and government spending slightly firmer than initially estimated, while consumer spending and net exports were a tad softer. The general picture of the economy was essentially unchanged, with the advance powered by consumer spending, business investment, and residential construction.

Review

Week of February 22, 2021	Actual	Consensus	Comments
Personal Income, Consumption, Prices (January)	**10.0%, 2.4%, 0.3%**	**9.5%, 2.5%, 0.1%**	A brisk increase in wages and salaries (0.7%) contributed to the surge in personal income in January, as did an advance of 1.1% in rental income, but a jump in transfer payments (stimulus payments to families, enhanced unemployment benefits, and the annual cost-of-living adjustment to Social Security payments) made a huge contribution. Personal consumption expenditure rose 2.0% after adjusting for inflation, a performance that suggests a pickup in Q1 from real consumer spending growth of 2.4% in Q4. The core PCE price index increased 0.3% for the second consecutive month, but the jumps followed flat readings in the prior two months and year-over-year inflation increased only one tick to 1.5%.
U.S. International Trade in Goods (January)	**-$83.7 Billion ($0.5 Billion Wider Deficit)**	**-$83.0 Billion ($0.2 Billion Narrower Deficit)**	Exports of goods rose 1.4% in January and have retraced most of the ground lost during the spring. Imports also rose (up 1.1%), with the dollar volume of imports exceeding that in exports and leading to a modest widening in the goods deficit. The wider deficit suggests a modest negative contribution from net exports to GDP growth in Q1 after sharp negative contributions in the prior two quarters (-3.2 percentage points in Q3 and -1.6 percentage points in Q4).

Sources: The Conference Board (Leading Indicators, Consumer Confidence); U.S. Census Bureau (New Home Sales, Durable Goods Orders, U.S. International Trade in Goods); Bureau of Economic Analysis (Revised GDP, Personal Income, Consumption, Price Indexes); Consensus forecasts are from Bloomberg

Preview

Week of March 1, 2021	Projected	Comments
ISM Manufacturing Index (February) (Monday)	**58.0% (-0.7 Pct. Pt.)**	Most indicators tied to the manufacturing sector suggest recovery, which should lead to a firm reading on the ISM index. However, supply chain disruptions slowed deliveries and gave a misleading boost to the headline index in December and January. A correction could occur in February.
Construction Spending (January) (Monday)	**0.7%**	Brisk activity in the residential sector accounts for most of the expected advance in construction, but state and local governments have become more active in the past few months as revenue flows have improved somewhat. Private nonresidential activity has shown no sign of breaking from its soft trend.
ISM Services Index (February) (Wednesday)	**58.0% (-0.7 Pct. Pt.)**	The services index has shown little variation in recent months from the elevated level that emerged in June. December was a bit above the recent average, and thus a modest correction could occur, but the projected reading still signals solid results.
Revised Nonfarm Productivity (2020-Q4) (Thursday)	**-4.6% (0.2 Pct. Pt. Upward Revision)**	The output measure in the productivity report will probably follow the lead of GDP and show a modest pickup in growth, which will lead to an improvement in productivity (i.e. a slightly smaller decline). The income side of the GDP report showed slower growth in labor compensation, which combined with the improvement in productivity, will probably lead to a downward revision to unit labor cost (growth of 6.3% versus an initial estimate of 6.8%).
Factory Orders (January) (Thursday)	**2.5%**	The broad-based increase in orders for durable goods (3.4%, published Feb. 25) accounts for much of the expected advance in total factory bookings, but the nondurable component is likely to contribute as well (expected growth of 1.6%). Part of the increase in the nondurable sector is likely to be the result of higher petroleum prices, but with the manufacturing sector performing well, nondurable orders ex-petroleum should post their ninth consecutive advance.
Payroll Employment (February) (Friday)	**100,000**	A downward drift in the number of individuals receiving unemployment benefits suggests that new hiring exceeds layoffs, which should result in a moderate gain in employment. Although employment may be expanding, the size of the labor force could rebound after a surprising decline in January, leading to an uptick in the unemployment rate.
Trade Balance (January) (Friday)	**$67.2 Billion Deficit ($0.6 Billion Wider Deficit)**	The slippage of $0.5 billion in the goods trade deficit is likely to be reinforced by additional erosion in the surplus in service trade, which has narrowed for six consecutive months after sharp downward steps in January and March. All told, the service surplus narrowed from $24.3 billion in December 2019 to $17.5 billion this past December.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

February/March 2021

Monday	Tuesday	Wednesday	Thursday	Friday
22	23	24	25	26
CHICAGO FED NATIONAL ACTIVITY INDEX Monthly / 3-Mo. Avg. Nov 0.34 0.60 Dec 0.41 0.60 Jan 0.66 0.47 **LEADING INDICATORS** Nov 0.9% Dec 0.4% Jan 0.5%	**FHFA HOME PRICE INDEX** Oct 1.5% Nov 1.0% Dec 1.1% **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** SA / NSA Oct 1.6% 1.4% Nov 1.5% 1.1% Dec 1.3% 0.8% **CONFERENCE BOARD CONSUMER CONFIDENCE** Dec 87.1 Jan 89.3 Feb 93.0 **CHAIR POWELL'S MONETARY POLICY TESTIMONY (SENATE)**	**NEW HOME SALES** Nov 0.899 million Dec 0.885 million Jan 0.923 million **CHAIR POWELL'S MONETARY POLICY TESTIMONY (HOUSE)**	**UNEMPLOYMENT CLAIMS** Initial / Continuing (Millions) Jan 30 0.812 4.558 Feb 06 0.848 4.520 Feb 13 0.841 4.419 Feb 20 0.730 N/A **DURABLE GOODS ORDERS** Nov 1.3% Dec 1.2% Jan 3.4% **REVISED GDP** GDP / Chained Price 20-Q3 33.4% 3.5% 20-Q4(a) 4.0% 2.0% 20-Q4(p) 4.1% 2.1% **PENDING HOMES SALES** Nov -0.9% Dec 0.5% Jan -2.8%	**PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX** Inc. / Cons. / Core Nov -1.2% -0.6% 0.0% Dec 0.6% -0.4% 0.3% Jan 10.0% 2.4% 0.3% **U.S. INTERNATIONAL TRADE IN GOODS** Nov -$86.1 billion Dec -$83.2 billion Jan -$83.7 billion **ADVANCE INVENTORIES** Wholesale / Retail Nov 0.0% 0.8% Dec 0.5% 1.9% Jan 1.3% -0.6% **MNI CHICAGO PMI** Index / Prices Dec 58.7 73.5 Jan 63.8 75.2 Feb 59.5 75.3 **REVISED CONSUMER SENTIMENT** Dec 80.7 Jan 79.0 Feb(p) 76.2 Feb(r) 76.8
1	2	3	4	5
ISM INDEX (10:00) Index / Prices Dec 60.5 77.6 Jan 58.7 82.1 **Feb 58.0 75.0** **CONSTRUCTION SPEND. (10:00)** Nov 1.1% June 1.0% **Jan 0.7%**	**VEHICLE SALES** Dec 16.2 million Jan 16.6 million **Feb 16.4 million**	**ADP EMPLOYMENT REPORT (8:15)** Private Payrolls Dec -78,000 Jan 174,000 Feb -- **ISM SERVICES INDEX (10:00)** Index / Prices Dec 57.7 64.4 Jan 58.7 64.2 **Feb 58.0 64.0** **BEIGE BOOK (2:00)** **January 2021 Beige Book** "[E]conomic activity increased modestly since the previous Beige Book period…"	**INITIAL CLAIMS (8:30)** **REVISED PRODUCTIVITY & COSTS (8:30)** Productivity / Unit Labor Costs 20-Q3 5.1% -7.0% 20-Q4(p) -4.8% 6.8% **20-Q4(r) -4.6% 6.3%** **FACTORY ORDERS (10:00)** Nov 1.3% Dec 1.4% **Jan 2.5%**	**EMPLOYMENT REPORT (8:30)** Payrolls / Un. Rate Dec -227,000 6.7% Jan 49,000 6.3% **Feb 100,000 6.4%** **TRADE BALANCE (8:30)** Nov -$69.0 billion Dec -$66.6 billion **Jan -$67.2 billion** **CONSUMER CREDIT (3:00)** Nov $13.9 billion Dec $9.7 billion Jan --
8	9	10	11	12
WHOLESALE TRADE	**NFIB SMALL BUSINESS OPTIMISM INDEX**	**CPI** **FEDERAL BUDGET**	**INITIAL CLAIMS** **JOLTS DATA**	**PPI** **CONSUMER SENTIMENT**
15	16	17	18	19
EMPIRE MFG INDEX **TIC DATA**	**RETAIL SALES** **IMPORT/EXPORT PRICES** **IP & CAP-U** **BUSINESS INVENTORIES** **NAHB HOUSING INDEX** **FOMC MEETING**	**HOUSING STARTS** **FOMC DECISION**	**INITIAL CLAIMS** **PHILLY FED INDEX** **LEADING INDICATORS**	

Forecasts in Bold. (a) = advance (1st estimate of GDP); (p) = preliminary (2nd estimate of GDP); (r) = revised

Treasury Financing

February/March 2021

Monday	Tuesday	Wednesday	Thursday	Friday
22	**23**	**24**	**25**	**26**
AUCTION RESULTS: Rate / Cover 13-week bills 0.030% 2.88 26-week bills 0.045% 2.81	**AUCTION RESULTS:** Rate / Cover 52-week bills 0.070% 3.36 2-year notes 0.119% 2.44 6-week CMB 0.025% 3.24 **ANNOUNCE:** $30 billion 4-week bills for auction on February 25 $35 billion 8-week bills for auction on February 25 $30 billion 17-week CMBs for auction on February 24 **SETTLE:** $30 billion 4-week bills $35 billion 8-week bills	**AUCTION RESULTS:** Margin / Cover 2-year FRNs 0.045% 2.88 Rate / Cover 5-year notes 0.621% 2.24 17-week CMB 0.045% 3.16	**AUCTION RESULTS:** Rate / Cover 4-week bills 0.035% 3.30 8-week bills 0.040% 3.05 7-year notes 1.195% 2.04 **ANNOUNCE:** $105 billion* 13-,26-week bills for auction March 1 $30 billion 6-week CMBs for auction on March 2 **SETTLE:** $105 billion 13-,26-week bills $34 billion 52-week bills $30 billion 6-week CMBs	**SETTLE:** $9 billion 30-year TIPS $26 billion 2-year FRNs
1	**2**	**3**	**4**	**5**
AUCTION: $105 billion 13-,26-week bills **SETTLE:** $27 billion 20-year bonds $60 billion 2-year notes $61 billion 5-year notes $62 billion 7-year notes	**AUCTION:** $30 billion 6-week CMBs **ANNOUNCE:** $30 billion* 4-week bills for auction on March 4 $35 billion* 8-week bills for auction on March 4 $30 billion* 17-week CMBs for auction on March 3 **SETTLE:** $30 billion 4-week bills $35 billion 8-week bills $30 billion 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills **ANNOUNCE:** $105 billion* 13-,26-week bills for auction March 8 $58 billion* 3-year notes for auction on March 9 $38 billion* 10-year notes for auction on March 10 $24 billion* 30-year bonds for auction on March 11 $30 billion* 6-week CMBs for auction on March 9 **SETTLE:** $105 billion 13-,26-week bills $30 billion 6-week CMBs	
8	**9**	**10**	**11**	**12**
AUCTION: $105 billion* 13-,26-week bills	**AUCTION:** $58 billion* 3-year notes $30 billion* 6-week CMBs **ANNOUNCE:** $30 billion* 4-week bills for auction on March 11 $35 billion* 8-week bills for auction on March 11 $30 billion* 17-week CMBs for auction on March 10 **SETTLE:** $30 billion* 4-week bills $35 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $38 billion* 10-year notes $30 billion* 17-week CMBs	**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 March 15 $24 billion* 20-year bonds for auction on March 16 $13 billion* 10-year TIPS for auction on March 18 $30 billion* 6-week CMBs for auction on March 16 **SETTLE:** $105 billion* 13-,26-week bills $30 billion* 6-week CMBs	
15	**16**	**17**	**18**	**19**
AUCTION: $105 billion* 13-,26-week bills **SETTLE:** $58 billion* 3-year notes $38 billion* 10-year notes $24 billion* 30-year bonds	**AUCTION:** $24 billion* 20-year bonds $30 billion* 6-week CMBs **ANNOUNCE:** $30 billion* 4-week bills for auction on March 18 $35 billion* 8-week bills for auction on March 18 $30 billion* 17-week CMBs for auction on March 17 **SETTLE:** $30 billion* 4-week bills $35 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills $13 billion* 10-year TIPS **ANNOUNCE:** $105 billion* 13-,26-week bills for auction March 22 $34 billion* 52-week bills for auction on March 23 $26 billion* 2-year FRNs for auction on March 24 $60 billion* 2-year notes for auction on March 23 $61 billion* 5-year notes for auction on March 24 $62 billion* 7-year notes for auction on March 25 $30 billion* 6-week CMBs for auction on March 23	**SETTLE:** $105 billion* 13-,26-week bills $30 billion* 6-week CMBs

**Estimate*