U.S. Economic Comment

- Recovery rebate checks: supporting both elevated saving and brisk spending
- Upcoming inflation: probably transitory, but some potential for a fundamental pickup

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More Signs of Recovery, Fueled by a Massive Budget Deficit

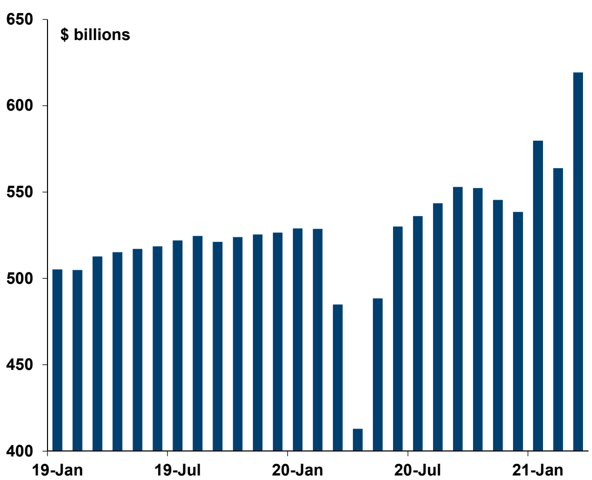
Like the prior two weeks, the latest week brought another batch of strong economic statistics. Retail sales and housing starts surged, partly because of rebounds from weather-constrained results in February, but also driven by favorable fundamentals. Measures of attitudes among individuals and executives at small businesses picked up, apparently in response to an easing in Covid restrictions and the expectation of a gradual return to normal conditions in the economy. Claims for unemployment insurance tumbled in the latest week, although our confidence in this indicator has been shaken in the past year because of processing errors and gaming of the system.

We were most interested in the retail sales report because of the potential boost from the latest round of recovery rebate checks. The outcome did not disappoint, as activity surged 9.8 percent with all major components contributing. The level of sales was far above any other recent reading (chart), and after favorable results in January and February, consumer spending in the first quarter no doubt grew rapidly (eight percent would be a conservative estimate).

This degree of vigor might seem surprising in light of information on the tendency of individuals to save large portions of their rebate checks. Surveys conducted by the Federal Reserve Bank of New York showed that individuals planned to spend only 25 to 30 percent of the support from the government, with the balance being saved or used to pare debt, which is functionally equivalent to saving.

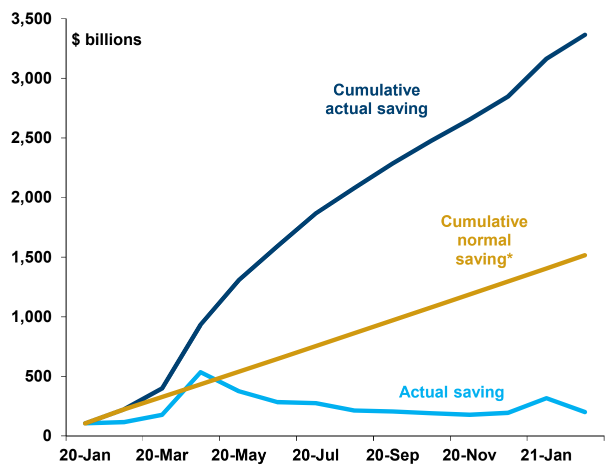
Saving has indeed been elevated, as the personal saving rate from April 2020 (when strong federal support began) through February 2021 averaged 17.9 percent, up from 7.5 percent in 2019. The combination of a heightened saving rate and strong income flows because of federal support has led the household sector to accumulate almost $3.5 trillion of savings since the start of last year, a total that is more than $1.8 trillion

Retail Sales



Source: U.S. Census Bureau via Haver Analytics

Personal Saving

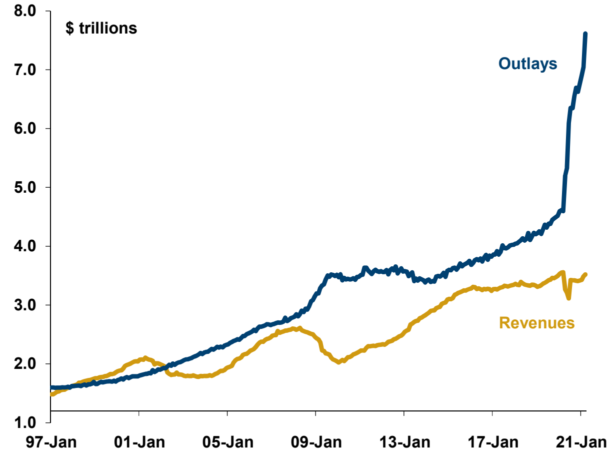


** Cumulative normal saving assumes that disposable personal income continued to grow at the 2018-19 pace and that the saving rate held steady at 7.5 percent.*

Source: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America higher than what might have occurred in the absence of the pandemic (chart, prior page; cumulative normal saving is the total that would have emerged if personal disposable income had continued to grow at its pre-pandemic pace and if the saving rate had remained steady at 7.5 percent).

The robust spending and saving observed in the past year is striking, but it is not surprising. The high degree of support offered by the federal government has been strong enough to fuel both spending and saving. The magnitude of the stimulus offered by Congress is apparent in the budget results, and the Treasury Department this week published results for March, which completed the first half of the current fiscal year. The budget deficit in the past six months totaled $1.7 trillion, a pace that puts the budget on track for a deficit of approximately $4 trillion for the full fiscal year, up from $3.1 trillion in fiscal year 2020.

Federal Outlays & Revenues*



** 12-month running totals.*
Source: U.S. Treasury Department via Haver Analytics

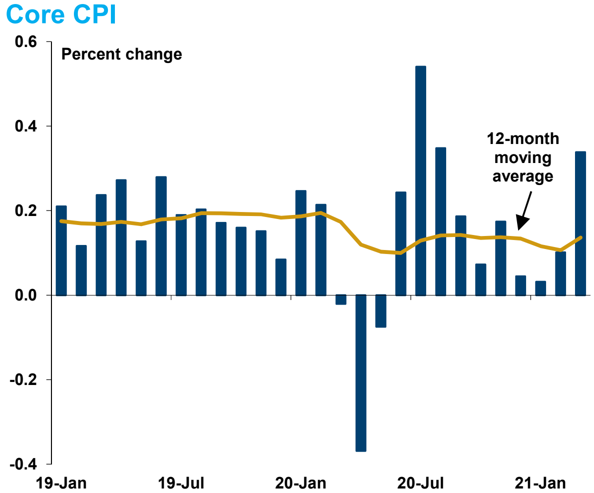
Federal revenues have held up reasonably well in the past year; the deterioration in the budget position has largely occurred on the outlay side, where spending has exploded since Covid relief began in April of last year (chart, above). Some observers have argued that federal support has been poorly targeted and therefore is excessive. The trend in federal spending shown in the chart lends support to this view.

Transitory Inflation

The latest week also brought the March report on the consumer price index, which showed jumps of 0.6 percent overall and 0.3 percent excluding food and energy. These high-side readings might be viewed as signs of a pickup in underlying inflation, but the pressure was more likely a reflection of the random volatility that sometimes emerges in the inflation data. Energy prices often swing widely, and that was the case in this instance with an increase of 5.0 percent. The price of crude oil started to settle in late March, and that easing should soon filter through to the CPI.

The increase of 0.3 percent in the core component was not troubling, as this jump followed minuscule increases in the prior three months (an average of less than 0.1 percent), leaving a still subdued underlying pace (chart). Also, much of the increase in core prices occurred in areas where prices had moved to unusually low levels, and the changes merely represented steps toward normal levels (e.g. hotel stays, financial services, and admission tickets to entertainment events).

Core CPI



Source: Bureau of Labor Statistics via Haver Analytics

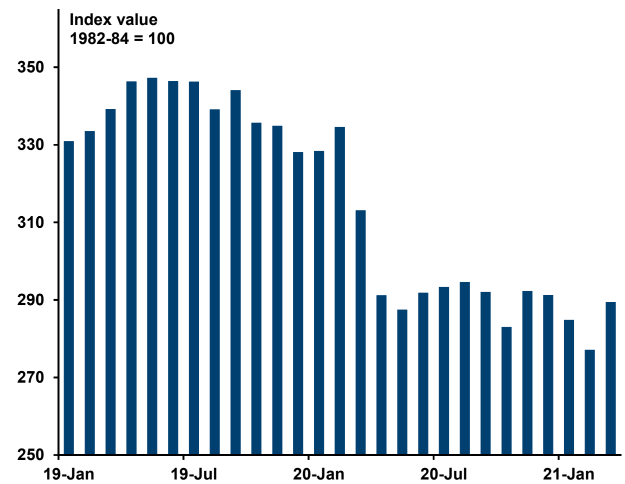
The high-side reading on the CPI for March, while not troubling, will probably not be an isolated event. Other factors in coming months are likely to lead to a noticeable pickup in the inflation rate. For the most part, the coming pressure could be viewed as transitory, although the potential for a lingering influence is high. The coming sources of pressure could be divided into three categories: pure base effects, price normalization, and pent-up demand (supported by aggressive fiscal and monetary policies).

Base Effects. Market participants no doubt are familiar with base effects. They occur when the effects of unusual events in prior months drop out of the year-over-year changes and lead to sudden shifts in 12-month figures. Base effects played a role in the March CPI, as core prices were flat in March 2020 versus an increase of 0.3 percent this March. The substitution of March 2021 for March 2020 led to a 0.3 percentage point pickup in the year-over-year inflation rate (1.6 percent versus 1.3 percent in the prior month).

April and May are likely to show pronounced base effects, as core prices fell in both months last year. If the core index increases 0.2 percent in each of the next two months (a reasonable estimate of the underlying inflation rate), the year-over-year change in the core CPI will climb to 2.5 percent, a striking advance relative to the 1.3 percent seen in February.

Price Normalization. The possible jump to 2.5 percent in the next few months assumes increases of 0.2 percent in the core CPI, but the unwinding of pandemic-related discounts could lead to sharper increases. For example, the cost of a hotel stay is still far below pre-pandemic norms (chart), and airline tickets are still dirt cheap. Prices of clothing and admission tickets have recovered some lost ground, but they are still well shy of pre-virus norms. Price normalization in these areas could lead to month-to-month changes in excess of 0.2 percent and year-over-year changes of more than 2.5 percent.

CPI: Hotel Fees



Source: Bureau of Labor Statistics via Haver Analytics

Pent-Up Demand. Prices of goods and services that were discounted during the pandemic would be expected to return to their normal levels, but it is not difficult to envision prices of these items and others moving above norms. Pent-up demand is likely to be sizeable in the months ahead, both because individuals will be anxious to become active after more than a year of limited spending and because many will have the wherewithal to do so. As noted above, much of the financial support provided by the federal government has been saved by households, and these funds could be tapped to fuel outlays. In addition, we should not forget about potential wealth effects from the advance in the equity market.

While pent-up demand could be powerful in the months ahead, and price consequences could emerge, there is a limit to this push. Excess saving is sizeable, but individuals most likely will want to retain some of this in their financial portfolios, and the balance at some point will be exhausted. Thus, demand-related price pressure eventually should ease.

At the same time, there is upside risk from demand pressures that could lead to a fundamental pickup in inflation. The Federal Reserve is running a highly aggressive monetary policy, and it plans to remain accommodative for some time. In addition, the American Jobs Plan of President Biden and the upcoming American Families Plan could involve additional fiscal stimulus. This combination of fiscal and monetary policies could stir underlying inflation.

In addition, if price pressure from pent-up demand and aggressive fiscal and monetary policies were to linger, inflation expectations could shift, which would add another dimension to inflation that could not be dismissed as transitory. Such a development is not far-fetched, as some measures of inflation expectations have already started to shift in response to the signs of a recovering economy.

Officials at the Fed and in the Biden Administration are not concerned about inflation, but they should be careful.

Review

Week of April 12, 2021	Actual	Consensus	Comments
Federal Budget (March)	**$659.6 Billion Deficit**	**$658.0 Billion Deficit**	Federal revenues in March rose 13.0% from the same month last year, reflecting a respectable advance in wages despite still-high unemployment (an extra business day this year also helped). Outlays surged 160.6% from the same month last year, mostly because of spending authorized by the American Rescue Plan. The shortfall in March left the deficit in the first six months of the current fiscal year at $1.7 trillion, putting it on track for a shortfall close to $4 trillion for the full fiscal year, up from $3.1 trillion in FY2020.
CPI (March)	**0.6% Total, 0.3% Core**	**0.5% Total, 0.2% Core**	An increase of 5.0% in the energy component accounted for most of the increase in the headline CPI. Food prices continued to increase modestly (0.1%, matching the average in the prior seven months). The core CPI provided a bit of a high-side surprise, but in light of an average increase of less than 0.1% in the prior three months, the results were not troubling. On a year-over-year basis, the headline CPI jumped to 2.6% from 1.7% in the prior month, the fastest reading since a print of 2.9% in mid-2018. The core increased three ticks to 1.6%, in line with results in the second half of 2020.
Retail Sales (March)	**9.8% Total, 8.4% Ex-Autos**	**5.8% Total, 5.0% Ex-Autos**	Households received most of the recovery rebate checks authorized by the American Rescue Plan during March, which stirred spending. Activity also received a push from a rebound after weather-related disruptions in February. Not only was the magnitude of the change impressive in March, so too was the breadth, as every major category advanced, with most registering sizeable changes.
Industrial Production (March)	**1.4%**	**2.5%**	The gain of 2.7% in manufacturing activity in March was firm when viewed in isolation, but it represented only a partial offset to the weather-related decline in February. Mining activity jumped as the weather brightened in March, with the advance of 5.7% reversing nearly all of the decline in February. Utility output, in contrast, tumbled 11.4%, reflecting a shift in temperatures from colder-than-normal in February to warmer-than-normal in March.
Housing Starts (March)	**1.739 Million (+19.4%)**	**1.613 Million (+13.5%)**	Both single-family and multi-family housing starts contributed to the surge in activity in March with increases of 15.3% and 30.8%, respectively. The jump in multi-family starts pushed new construction to its highest level since the onset of the pandemic, although it lagged the best readings before the virus became an issue. The increase in single-family starts pushed activity to the second best reading in the current recovery and above all observations in the previous expansion.
Consumer Sentiment (April)	**86.5 (+1.6 Index Pts.)**	**89.0 (+4.1 Index Pts.)**	Consumer sentiment rose 1.9% to its highest level of 2021, likely stirred by the latest round of rebate checks and the advance in the stock market. However, it has failed to show the same brisk recovery as other economic indicators, as it has recouped only 50% of the ground lost last spring.

Sources: U.S. Treasury Department (Federal Budget); Bureau of Labor Statistics (CPI); U.S. Census Bureau (Retail Sales, Housing Starts); Federal Reserve Board (Industrial Production); University of Michigan Survey Research Center (Consumer Sentiment); Consensus forecasts are from Bloomberg

Preview

Week of April 19, 2021	Projected	Comments
Existing Home Sales (March) (Thursday)	**6.50 Million (+4.5%)**	Activity should rebound from what appeared to be a weather-related slowdown in February, but with mortgage interest rates about one-half percentage point higher than recent lows, sales will probably not match the brisk totals seen around the turn of the year (an average of 6.658 million from October through January).
Leading Indicators (March) (Thursday)	**1.0%**	Positive contributions from initial claims for unemployment insurance, the ISM new orders index, and the slope of the yield curve point to the 11th consecutive advance in the index of leading economic indicators. If the forecast is realized, the measure will have recovered 98% of the ground lost in the spring.
New Home Sales (March) (Friday)	**0.880 Million (+13.5%)**	Sales of new homes may have cooled from the frenetic pace in the summer and fall (an average of 972,000 from July through October), but a rebound from weather-constrained results in February seems likely.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

April/May 2021

Monday 12

FEDERAL BUDGET

	2021	2020
Jan	-$162.8B	-$32.6B
Feb	-$310.9B	-$235.3B
Mar	-$659.6B	-$119.0B

Tuesday 13

NFIB SMALL BUSINESS OPTIMISM INDEX

Jan	95.0
Feb	95.8
Mar	98.2

CPI

	Total	Core
Jan	0.3%	0.0%
Feb	0.4%	0.1%
Mar	0.6%	0.3%

Wednesday 14

IMPORT/EXPORT PRICES

	Non-petrol. Imports	Nonagri. Exports
Jan	0.9%	2.3%
Feb	0.5%	1.5%
Mar	0.9%	2.0%

BEIGE BOOK

"National economic activity accelerated to a moderate pace from late February to early April."

Thursday 15

UNEMPLOYMENT CLAIMS

	Initial	Continuing (Millions)
Mar 20	0.658	3.753
Mar 27	0.729	3.727
Apr 03	0.769	3.731
Apr 10	0.576	N/A

RETAIL SALES

	Total	Ex.Autos
Jan	7.7%	8.4%
Feb	-2.7%	-2.5%
Mar	9.8%	8.4%

EMPIRE MFG

Feb	12.1
Mar	17.4
Apr	26.3

PHILLY FED INDEX

Feb	28.7
Mar	44.5
Apr	50.2

IP & CAP-U

	IP	Cap.Util.
Jan	0.9%	75.3%
Feb	-2.6%	73.4%
Mar	1.4%	74.4%

NAHB HOUSING MARKET INDEX

Feb	84
Mar	82
Apr	83

BUSINESS INVENTORIES

	Inventories	Sales
Dec	0.7%	0.9%
Jan	0.4%	4.5%
Feb	0.5%	-1.9%

TIC DATA

	Total	Net L-T
Dec	$7.6B	$121.1B
Jan	$105.8B	$91.0B
Feb	$72.6B	$4.2B

Friday 16

HOUSING STARTS

Jan	1.642 million
Feb	1.457 million
Mar	1.739 million

CONSUMER SENTIMENT

Feb	76.8
Mar	84.9
Apr	86.5

Monday 19

Tuesday 20

Wednesday 21

Thursday 22

INITIAL CLAIMS (8:30)

CHICAGO FED NATIONAL ACTIVITY INDEX (8:30)

	Monthly	3-Mo. Avg.
Jan	0.75	0.46
Feb	-1.09	-0.02
Mar	--	--

EXISTING HOME SALES (10:00)

Jan	6.66 million
Feb	6.22 million
Mar	**6.50 million**

LEADING INDICATORS (10:00)

Jan	0.5%
Feb	0.2%
Mar	**1.0%**

Friday 23

NEW HOME SALES (10:00)

Jan	0.948 million
Feb	0.775 million
Mar	**0.880 million**

Monday 26

DURABLE GOODS ORDERS

Tuesday 27

FHFA HOME PRICE INDEX
S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX
CONSUMER CONFIDENCE
FOMC MEETING

Wednesday 28

U.S. INTERNATIONAL TRADE IN GOODS
ADVANCE INVENTORIES
FOMC DECISION

Thursday 29

INITIAL CLAIMS
GDP
PENDING HOME SALES

Friday 30

PERSONAL INCOME, CONSUMPTION & PRICES
EMPLOYMENT COST INDEX
MNI CHICAGO BUSINESS BAROMETER INDEX
REVISED CONSUMER SENTIMENT

Monday 3

ISM MFG. INDEX
CONSTRUCTION SPEND.
VEHICLE SALES

Tuesday 4

TRADE BALANCE
FACTORY ORDERS

Wednesday 5

ADP EMPLOYMENT REPORT
ISM SERVICES INDEX

Thursday 6

INITIAL CLAIMS
PRODUCTIVITY & COSTS

Friday 7

EMPLOYMENT REPORT
WHOLESALE TRADE
CONSUMER CREDIT

Forecasts in Bold.

Treasury Financing

April/May 2021

Monday	Tuesday	Wednesday	Thursday	Friday
12	13	14	15	16
AUCTION RESULTS: Rate / Cover 13-week bills 0.020% 3.02 26-week bills 0.040% 3.39 3-year notes 0.376% 2.32 10-yr notes 1.680% 2.36	**AUCTION RESULTS:** Rate / Cover 30-yr bonds 2.320% 2.47 6-week CMB 0.015% 3.34 **ANNOUNCE:** $40 billion 4-week bills for auction on April 15 $40 billion 8-week bills for auction on April 15 $35 billion 17-week CMBs for auction on April 14 **SETTLE:** $40 billion 4-week bills $40 billion 8-week bills $35 billion 17-week CMBs	**AUCTION RESULTS:** Rate / Cover 17-week CMB 0.025% 3.60	**AUCTION RESULTS:** Rate / Cover 4-week bills 0.010% 3.64 8-week bills 0.015% 2.99 **ANNOUNCE:** $111 billion 13-,26-week bills for auction on April 19 $34 billion 52-week bills for auction on April 20 $24 billion 20-year bonds for auction on April 21 $18 billion 5-year TIPS for auction on April 22 $40 billion 6-week CMBs for auction on April 20 **SETTLE:** $111 billion 13-,26-week bills $58 billion 3-year notes $38 billion 10-year notes $24 billion 30-year bonds $40 billion 6-week CMBs	
19	20	21	22	23
AUCTION: $111 billion 13-,26-week bills	**AUCTION:** $34 billion 52-week bills $40 billion 6-week CMBs **ANNOUNCE:** $40 billion* 4-week bills for auction on April 22 $40 billion* 8-week bills for auction on April 22 **SETTLE:** $40 billion 4-week bills $40 billion 8-week bills $35 billion 17-week CMBs	**AUCTION:** $24 billion 20-year bonds	**AUCTION:** $40 billion* 4-week bills $40 billion* 8-week bills $18 billion 5-year TIPS **ANNOUNCE:** $111 billion* 13-,26-week bills for auction April 26 $28 billion* 2-year FRNs for auction on April 27 $60 billion* 2-year notes for auction on April 26 $61 billion* 5-year notes for auction on April 26 $62 billion* 7-year notes for auction on April 27 **SETTLE:** $111 billion 13-,26-week bills $34 billion 52-week bills $40 billion 6-week CMBs	
26	27	28	29	30
AUCTION: $111 billion* 13-,26-week bills $60 billion* 2-year notes $61 billion* 5-year notes	**AUCTION:** $28 billion* 2-year FRNs $62 billion* 7-year notes **ANNOUNCE:** $40 billion* 4-week bills for auction on April 29 $40 billion* 8-week bills for auction on April 29 **SETTLE:** $40 billion* 4-week bills $40 billion* 8-week bills		**AUCTION:** $40 billion* 4-week bills $40 billion* 8-week bills **ANNOUNCE:** $111 billion* 13-,26-week bills for auction on May 3 **SETTLE:** $111 billion* 13-,26-week bills	**SETTLE:** $24 billion 20-year bonds $18 billion 5-year TIPS $28 billion* 2-year FRNs $60 billion* 2-year notes $61 billion* 5-year notes $62 billion* 7-year notes
3	4	5	6	7
AUCTION: $111 billion* 13-,26-week bills	**ANNOUNCE:** $40 billion* 4-week bills for auction on May 6 $40 billion* 8-week bills for auction on May 6 **SETTLE:** $40 billion* 4-week bills $40 billion* 8-week bills	**ANNOUNCE MID-QUARTER REFUNDING:** $58 billion* 3-year notes for auction on May 11 $41 billion* 10-year notes for auction on May 12 $27 billion* 30-year bonds for auction on May 13	**AUCTION:** $40 billion* 4-week bills $40 billion* 8-week bills **ANNOUNCE:** $111 billion* 13-,26-week bills for auction on May 10 **SETTLE:** $111 billion* 13-,26-week bills	

**Estimate*