U.S. Economic Comment

- A worker shortage, of sorts
- Insights from brisk vehicle sales

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The Labor Market

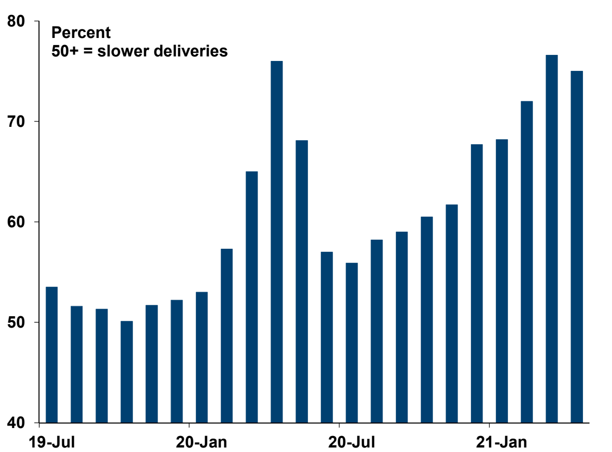
Pundits will be working overtime to explain the meager gain in payroll employment in April. While several interesting views will be advanced, don't discount the likelihood of random volatility. The employment figures often move erratically, and given the unusual nature of the recession and recovery, the random elements in this cycle are most likely large. We suspect that upcoming reports, like those in recent months, will surge in some instances and cool in others.

Supply disruptions also are likely to be cited as an important consideration. The effect of the shortage in semiconductors was apparent in the auto industry, where employment fell 27,000. Elevated readings on the supplier delivery components of the ISM indexes suggest that supply-chain problems exist elsewhere as well (chart, left).

The most popular explanation is likely to be the existence of a shortage of labor. Indeed, the financial press in the past two weeks has carried several reports indicating that businesses are unable to find workers. The April employment report carried some information lending support to this view. For example, the average workweek, which has been tilting on the high side throughout this cycle, moved to the top of the recent range to a level well above all observations in the prior expansion. Longer workweeks would be a natural response if businesses were unable to find workers.

The latest reading on average hourly earnings, which jumped 0.7 percent in April, perhaps shows tightness in labor markets (chart, right). We have been downplaying this measure during this cycle because its movement has been dominated by shifts in the composition of the work force rather than by changes in wage rates. That is, the average jumped when lower-wage workers dominated payroll cuts, and it fell when these workers were recalled to their jobs.

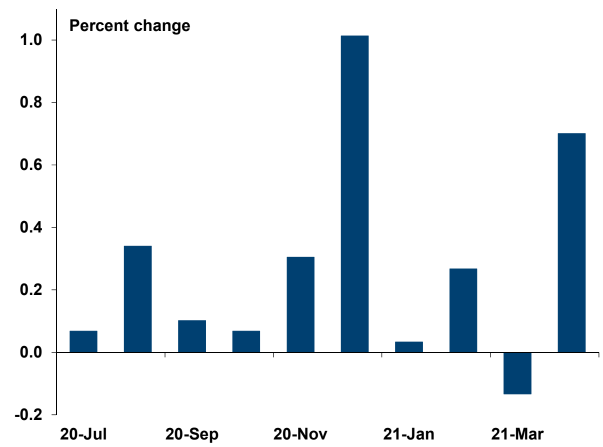
ISM Manufacturing: Supplier Deliveries*



** An index value above 50 percent indicates slower deliveries, whereas a value below 50 percent indicates faster deliveries.*

Source: Institute for Supply Management via Haver Analytics

Average Hourly Earnings*



**We are showing a short history because wide swings early in the pandemic hide the magnitude of recent readings.*

Source: Bureau of Labor Statistics via Haver Analytics

However, in this instance, two factors suggest that a strong increase in wage rates pushed the measure higher. First, the largest employment gain in April occurred in the leisure and hospitality sector, which generally pays below-average wages. A sharp employment gain in a low-wage industry, all else equal, would push average earnings lower. The fact that the average rose despite the employment jump in a low-wage sector suggests that an increase in wage rates more than offset the compositional change in employment.

A second factor involves the breadth of the change. Most industries posted solid increases in average hourly earnings. Indeed, 10 of 13 major industries posted increases of 0.5 percent or more; six of the 13 posted increases in excess of 1.0 percent. Compositional influences would be less of a factor within an industry group, and thus the sharp gains within individual industries were most likely wage driven.

We could add a third factor: corroborating evidence from the employment cost index. This measure of labor compensation is a fixed-weight construct, where compositional changes are not a factor. This index rose 0.9 percent in the first quarter (published last week), firmer than the best readings in the prior expansion and suggestive of strong efforts to attract workers.

While one can make a case that workers are difficult to find, we hesitate to call the current situation a “labor shortage”. Individuals are out there; it is only a question of motivating them or finding them.

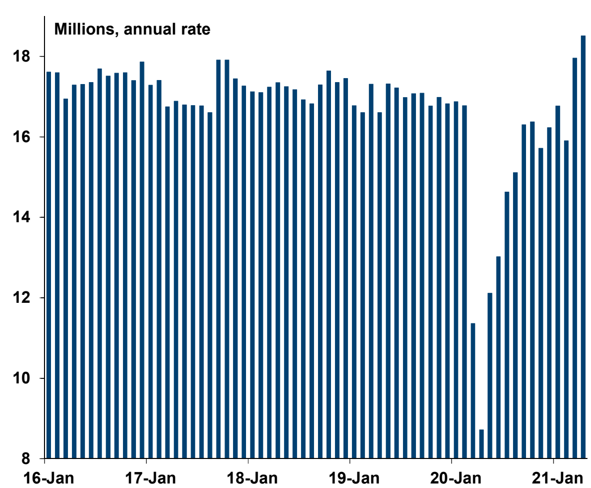
In terms of motivation, the pandemic and the government’s response has led some individuals to stop seeking work. Some are fearful of contracting the virus or have dependent-care responsibilities because of the virus. Others are content to collect generous unemployment benefits, supplemented with Economic Impact Payments, rather than return to work. These potential workers will return to their previous jobs (or find new ones) once benefits run out and dependent-care responsibilities ease.

We also suspect that the labor market is dealing with a high degree of “friction”. That is, the pandemic has generated structural changes in the economy, which will require contraction in some industries and expansion in others. Similarly, some geographic locales will contract while others will expand. In such an environment, individuals will not move seamlessly from one job to another. Potential workers will need to identify new areas of interest and most likely will need to obtain training in these areas. In addition, some workers will need to relocate. Such efforts take time, and during the adjustment process, it might seem like there is a shortage of workers.

Vehicle Sales

The employment report disappointed, but sales of new vehicles surprised on the upside. The latest tally of 18.5 million cars and light trucks (annual rate) was stronger than all observations in the prior expansion and was exceeded by only five observations in earlier years. Moreover, this striking performance followed sales of 18.0 million in March, also firmer than all observations in the prior expansion and in the upper reaches of the historical range (chart).

New Vehicle Sales



Source: Bureau of Economic Analysis via Haver Analytics

We drew three key takeaways from this performance. First, it shows the powerful spending power now present in the household sector. The fiscal stimuli authorized by Congress in December and March added to the accumulated savings of individuals throughout last year, leaving many financially flush. There was already no doubt that households have the ability to provide support, as other reports on consumer spending have been strong, but car sales have added to the evidence.

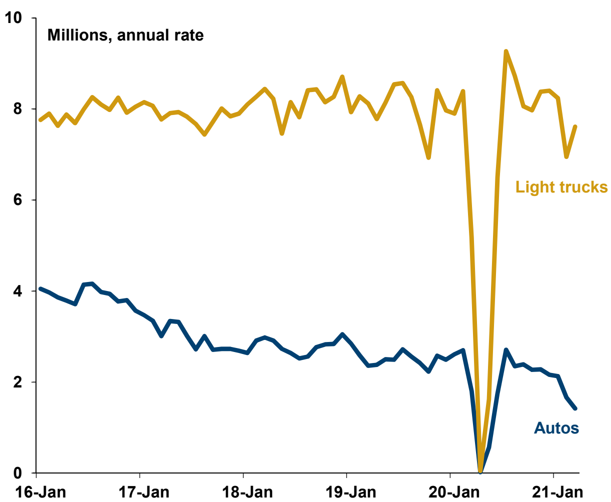
Second, vehicle manufacturers seem to be adapting reasonably well to the shortage of semiconductors. Production has declined, but not precipitously so. Output of total light vehicles as of March (latest available) has dropped approximately 14 percent from the average in the fourth quarter, with most of the decline occurring in cars rather than light trucks (approximately eight percent for light trucks and almost 37 percent for cars; chart, below left). This breakdown seems to have a strategic element, as most of the sales and profits of vehicle manufacturers comes from their truck lines. Slower production thus far has had little influence on sales, as dealers drew from inventories to meet demand.

While manufacturers have coped thus far, their challenges are intensifying. The employment report showed a noticeable decline in employment in the motor vehicle industry (off 27,000), suggesting that the shortage of semiconductors is forcing sharper production cuts. Manufacturers and dealers can draw from inventories to sustain sales, but they are losing flexibility on this front. Dealers have a 33-day supply of vehicles, down from 42 days in March and a norm of 50 to 60 days.

Our third takeaway deals with inflation rather than the vehicle industry. Fed officials have been arguing that price pressure likely to emerge in the months ahead will be temporary, and the situation in the car and light truck sector offers a germ of support for that view.

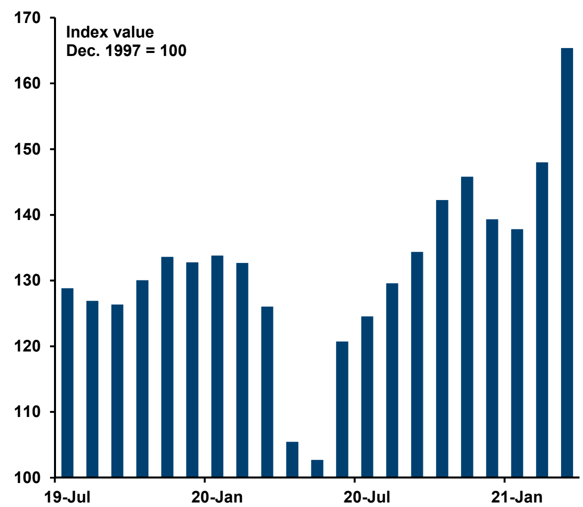
A pressure point on inflation has already emerged: rental rates for cars and trucks, which started to increase last fall and have surged in February and March (chart, below right; April results will be published next week with the CPI). Sharp increases have occurred because rental agencies cut their purchases of vehicles during the worst of the pandemic and now have a lean stock of cars and trucks to rent. However, we suspect that a portion of the strength in vehicle sales in March and April involved fleet sales to rental agencies. Once stocks are back to normal, rental fees should recede. Transitory pressure, at least in this area.

Motor Vehicle Assemblies



Source: Federal Reserve Board via Haver Analytics

CPI: Car and Truck Rentals*



** The chart shows the level of the index rather than the month-to-month percent change.*

Source: Bureau of Labor Statistics via Haver Analytics

Review

Week of May 3, 2021	Actual	Consensus	Comments
ISM Manufacturing Index (April)	**60.7% (-4.0 Pct. Pts.)**	**65.0% (+0.3 Pct. Pt.)**	Although the ISM manufacturing index eased in April, the change occurred from an unusually strong reading in March (3.9 percentage points above the best observation in the prior expansion and the firmest showing in more than 37 years). All five components contributed to the decline in the headline index, but all five were still solid readings. The production index posted the largest drop (off 5.6 percentage points), but at 62.5% it was still in the upper portion of its long-run range, as was the index of new orders (off 3.7 percentage points to 64.3%). The employment component fell 4.5 percentage points to 55.1%, which is best described as a mid-range showing. The supplier delivery index fell only modestly from a strikingly high level in March (-1.6 percentage points to 75.0%), signaling that supply-chain issues remain.
Construction Spending (March)	**0.2%**	**1.6%**	Total construction activity wiggled higher from a downward revised level that left activity in February 0.5% lighter than previously believed. Private residential activity performed reasonably well, increasing 1.7% from a level that showed little weather-related softness in February. However, private nonresidential construction continued to move along its downward trend (off in 13 of the past 16 months), and activity among state and local governments fell for the third consecutive month after a brief rally in the final three months of last year.
Trade Balance (March)	**-$74.4 Billion ($3.9 Billion Wider Deficit)**	**-$74.4 Billion ($3.3 Billion Wider Deficit)**	Both exports and imports rose in March, easily offsetting small declines in the prior month and resuming their upward trends (exports rose 6.6% and imports increased 6.3%). As in most other recent months, the dollar value of the increase in imports was larger than that for exports, resulting in a wider deficit. The results were close to the assumptions built into the first estimate of Q1 GDP, signaling only a minimal revision to the -0.9 percentage point contribution made by net exports to GDP growth.
Factory Orders (March)	**1.1%**	**1.3%**	The durable goods component of factory orders rose only moderately (0.8%, revised from a preliminary estimate of 0.5%), but the results were constrained by a drop of 38.3% in the volatile aircraft component. Durable orders excluding transportation rose 1.9%, offsetting a dip in February and reinforcing a strong upward trend that left bookings 10.7% above the pre-pandemic high in January 2020. Nondurable orders rose 1.5%, but a good portion of the advance reflected a price-led jump of 4.4% in the petroleum and coal category. Excluding petroleum and coal, nondurable orders rose 0.8%. This advance barely offset the dip in the prior month and left orders only marginally above the January total, although they were 2.8% above the pre-Covid high in March 2020.

Review Continued

Week of May 3, 2021	Actual	Consensus	Comments
ISM Services Index (April)	**62.7% (-1.0 Pct. Pt.)**	**64.1% (+0.4 Pct. Pt.)**	Despite a dip, the ISM services index posted an outstanding result in April. The change occurred from a record level in March, and the new reading was still above the previous record (62.0% in August 1997; series began in July 1997). The business activity index accounted for most of the decline with a drop of 6.7 percentage points. However, the level of the index, at 62.7%, was still in the upper portion of the recent and historical range. The slowdown in business activity occurred as orders eased (down 4.0 percentage points to 63.2%, still high historically). Although orders and business activity eased, service firms hired actively, as the employment index rose 1.6 percentage points to 58.8%, a reading in the upper portion of its historical range. The supplier delivery index rose 5.1 percentage points to 66.1% (fourth highest on record), indicating that supply-chain issues remain.
Nonfarm Productivity (2021-Q1)	**5.4%**	**4.3%**	Hours worked rose in the first quarter (2.9%, annual rate), but the increase was dwarfed by the jump of 8.4% in output, which led to a sharp increase in nonfarm productivity. Labor compensation posted a firm advance (5.1%), but it trailed the increase in productivity, which led to a dip of 0.3% in unit labor cost.
Payroll Employment (April)	**266,000**	**1,000,000**	Payroll growth was modest in April relative to the expected increase of 1.0 million, with downward revisions of 78,000 in the prior two months adding to the lackluster tone of the report. While the overall results were disappointing, there were hints of encouragement in the report. We were impressed with the leisure and hospitality category, where employment jumped 331,000, signaling a continued reopening of the economy. The unemployment rate rose 0.1 percentage point to 6.1%, but it should be viewed favorably as a pickup in the size of the labor force of 430,000 exceeded a gain of 328,000 in employment as measured by the household survey. Moreover, the broad unemployment rate fell 0.3 percentage point to 10.4%, reflecting a sharp decline in the number of individuals working part time involuntarily. Average hourly earnings jumped 0.7% in April. We have been downplaying this measure during the pandemic because it has been driven primarily by compositional changes rather than shifts in wage rates, but this advance might have involved sizeable wage-related increases. Gains were healthy across several industry categories, and compositional changes would be less of an issue within industries.

Sources: 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 (Nonfarm Productivity, Payroll Employment); Consensus forecasts are from Bloomberg

Preview

Week of May 10, 2021	Projected	Comments
CPI (April) (Wednesday)	**0.2% Total, 0.2% Core**	Available quotes suggest that gasoline prices rose less than seasonal norms, which should restrain the energy component after 10 consecutive monthly increases. In the core component, some pandemic-affected areas are likely to show upward pressure in response to a recovering economy, such as apparel and hotel stays, but other areas could remain tame for a time, such as rent of primary residence. Base effects will be apparent in the year-over-year changes, as prices in April 2020 fell 0.5% overall and 0.4% excluding food and energy.
Federal Budget (April) (Wednesday)	**-$100.0 Billion**	Federal revenues in April probably rose sharply from the same month last year, partly because of postponement of the tax filing deadline in 2020 but primarily because of the pronounced loss of jobs in the early stages of the pandemic. While revenues are likely to be strong, hefty outlays associated with the American Rescue Plan are likely to keep the government in the red.
PPI (April) (Thursday)	**0.2% Total, 0.3% Ex. Food & Energy**	Gasoline prices probably fell after seasonal adjustment, which should contain the energy component and the headline index. However, the recovering economy seems to be stirring service prices and the prices of goods other than food and energy.
Retail Sales (April) (Friday)	**0.8% Total, 0.5% Ex. Autos**	Retail sales were remarkably strong in March, which ordinarily would suggest a correction in April. However, rebate checks continued to flow to households in the latest month, and late recipients in March may not have had time to spend actively. Thus, some follow through to government support seems likely.
Industrial Production (April) (Friday)	**0.0%**	Increases in employment and the rotary rig count suggest that mining activity could inch higher, and demand for heating services probably pushed utility output higher (temperatures fell from warmer-than-normal to normal). However, these changes will probably be offset by a drop in manufacturing output, led by the auto industry and its difficulties with semiconductors.
Consumer Sentiment (May) (Friday)	**90.0 (+1.7 Index Pts.)**	Economic Impact Payments authorized by the American Rescue Plan continued to trickle out in early May. In addition, the equity market has continued to perform well and job growth has been strong. Thus, the sentiment index is likely to add to the solid gains in March and April.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

May 2021

Monday	Tuesday	Wednesday	Thursday	Friday
3	4	5	6	7
ISM INDEX Index / Prices Feb 60.8 / 86.0 Mar 64.7 / 85.6 Apr 60.7 / 89.6 **CONSTRUCTION SPEND.** Jan 0.6% Feb -0.6% Mar 0.2% **NEW VEHICLE SALES** Feb 15.9 million Mar 18.0 million Apr 18.5 million	**TRADE BALANCE** Jan -$67.8 billion Feb -$70.5 billion Mar -$74.4 billion **FACTORY ORDERS** Jan 2.7% Feb -0.5% Mar 1.1%	**ADP EMPLOYMENT REPORT** Private Payrolls Feb 180,000 Mar 565,000 Apr 742,000 **ISM SERVICES INDEX** Index / Prices Feb 55.3 / 71.8 Mar 63.7 / 74.0 Apr 62.7 / 76.8	**UNEMPLOYMENT CLAIMS** Initial / Continuing (Millions) Apr 10 0.586 / 3.652 Apr 17 0.566 / 3.653 Apr 24 0.590 / 3.690 May 01 0.498 / N/A **PRODUCTIVITY & COSTS** Productivity / Unit Labor Costs 20-Q3 4.2% / -9.6% 20-Q4 -3.8% / 5.6% 21-Q1 5.4% / -0.3%	**EMPLOYMENT REPORT** Payrolls / Un. Rate Feb 536,000 / 6.2% Mar 770,000 / 6.0% Apr 266,000 / 6.1% **WHOLESALE TRADE** Inventories / Sales Jan 1.4% / 4.4% Feb 1.0% / 0.0% Mar 1.3% / 4.6% **CONSUMER CREDIT** Jan $1.6 billion Feb $26.1 billion Mar $25.8 billion
10	11	12	13	14
	NFIB SMALL BUSINESS OPTIMISM INDEX (6:00) Feb 95.8 Mar 98.2 Apr -- **JOLTS DATA (10:00)** Openings (000) / Quit Rate Jan 7,099 / 2.3% Feb 7,367 / 2.3% Mar -- / --	**CPI (8:30)** Total / Core Feb 0.4% / 0.1% Mar 0.6% / 0.3% **Apr 0.2% / 0.2%** **FEDERAL BUDGET (2:00)** 2021 / 2020 Feb -$310.9B / -$235.3B Mar -$659.6B / -$119.0B **Apr -$100.0B** / -$738.0B	**INITIAL CLAIMS (8:30)** **PPI (8:30)** Final Demand / Ex. Food & Energy Feb 0.5% / 0.2% Mar 1.0% / 0.7% **Apr 0.2% / 0.3%**	**RETAIL SALES (8:30)** Total / Ex.Autos Feb -2.9% / -2.7% Mar 9.7% / 8.4% **Apr 0.8% / 0.5%** **IMPORT/EXPORT PRICES (8:30)** Ex. Petrol Imports / Nonagri. Exports Feb 0.5% / 1.5% Mar 0.9% / 2.0% Apr -- / -- **IP & CAP-U (9:15)** IP / Cap.Util. Feb -2.6% / 73.4% Mar 1.4% / 74.4% **Apr 0.0% / 74.2%** **CONSUMER SENTIMENT (10:00)** Mar 84.9 Apr 88.3 **May 90.0** **BUSINESS INVENTORIES (10:00)** Inventories / Sales Jan 0.6% / 4.5% Feb 0.6% / -1.6% **Mar 0.3% / 5.4%**
17	18	19	20	21
EMPIRE MFG INDEX **NAHB HOUSING MARKET INDEX** **TIC DATA**	**HOUSING STARTS**	**FOMC MINUTES**	**INITIAL CLAIMS** **PHILLY FED INDEX** **LEADING INDICATORS**	**EXISTING HOME SALES**
24	25	26	27	28
CHICAGO FED NATIONAL ACTIVITY INDEX	**FHFA HOME PRICE INDEX** **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** **NEW HOME SALES** **CONSUMER CONFIDENCE**		**INITIAL CLAIMS** **DURABLE GOODS ORDERS** **REVISED Q1 GDP** **PENDING HOME SALES**	**U.S. INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES** **PERSONAL INCOME, CONSUMPTION. PRICE INDEXES** **MNI CHICAGO BUSINESS BAROMETER INDEX** **REVISED CONSUMER SENTIMENT**

Forecasts in Bold.

Daiwa Capital Markets

Treasury Financing

May 2021

Monday	Tuesday	Wednesday	Thursday	Friday
3	4	5	6	7
AUCTION RESULTS: Rate / Cover 13-week bills 0.015% 3.05 26-week bills 0.035% 2.72	**AUCTION RESULTS:** Rate / Cover 6-week CMB 0.010% 3.58 **ANNOUNCE:** $40 billion 4-week bills for auction on May 6 $40 billion 8-week bills for auction on May 6 $35 billion 17-week CMBs for auction on May 5 **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% 3.62 **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 RESULTS:** Rate / Cover 4-week bills 0.010% 3.48 8-week bills 0.010% 3.59 **ANNOUNCE:** $111 billion 13-,26-week bills for auction on May 10 $40 billion 6-week CMBs for auction on May 11 **SETTLE:** $111 billion 13-,26-week bills $40 billion 6-week CMBs	
10	11	12	13	14
AUCTION: $111 billion 13-,26-week bills	**AUCTION:** $58 billion 3-year notes $40 billion 6-week CMBs **ANNOUNCE:** $40 billion* 4-week bills for auction on May 13 $40 billion* 8-week bills for auction on May 13 $35 billion* 17-week CMBs for auction on May 12 **SETTLE:** $40 billion 4-week bills $40 billion 8-week bills $35 billion 17-week CMBs	**AUCTION:** $41 billion 10-year notes $35 billion* 17-week CMBs	**AUCTION:** $40 billion* 4-week bills $40 billion* 8-week bills $27 billion 30-year bonds **ANNOUNCE:** $111 billion* 13-,26-week bills for auction May 17 $34 billion* 52-week bills for auction on May 18 $27 billion* 20-year bonds for auction on May 19 $13 billion* 10-year TIPS for auction on May 20 $40 billion* 6-week CMBs for auction on May 18 **SETTLE:** $111 billion 13-,26-week bills $40 billion 6-week CMBs	
17	18	19	20	21
AUCTION: $111 billion* 13-,26-week bills **SETTLE:** $58 billion 3-year notes $41 billion 10-year notes $27 billion 30-year bonds	**AUCTION:** $34 billion* 52-week bills $40 billion* 6-week CMBs **ANNOUNCE:** $40 billion* 4-week bills for auction on May 20 $40 billion* 8-week bills for auction on May 20 $35 billion* 17-week CMBs for auction on May 19 **SETTLE:** $40 billion* 4-week bills $40 billion* 8-week bills $35 billion* 17-week CMBs	**AUCTION:** $27 billion* 20-year bonds $35 billion* 17-week CMBs	**AUCTION:** $40 billion* 4-week bills $40 billion* 8-week bills $13 billion* 10-year TIPS **ANNOUNCE:** $111 billion* 13-,26-week bills for auction on May 24 $26 billion* 2-year FRNs for auction on May 26 $60 billion* 2-year notes for auction on May 25 $61 billion* 5-year notes for auction on May 26 $62 billion* 7-year notes for auction on May 27 $40 billion* 6-week CMBs for auction on May 25 **SETTLE:** $111 billion* 13-,26-week bills $34 billion* 52-week bills $40 billion* 6-week CMBs	
24	25	26	27	28
AUCTION: $111 billion* 13-,26-week bills	**AUCTION:** $60 billion* 2-year notes $40 billion* 6-week CMBs **ANNOUNCE:** $40 billion* 4-week bills for auction on May 27 $40 billion* 8-week bills for auction on May 27 $35 billion* 17-week CMBs for auction on May 26 **SETTLE:** $40 billion* 4-week bills $40 billion* 8-week bills $35 billion* 17-week CMBs	**AUCTION:** $26 billion* 2-year FRNs $61 billion* 5-year notes $35 billion* 17-week CMBs	**AUCTION:** $40 billion* 4-week bills $40 billion* 8-week bills $62 billion* 7-year notes **ANNOUNCE:** $111 billion* 13-,26-week bills for auction on June 1 $40 billion* 6-week CMBs for auction on June 1 **SETTLE:** $111 billion* 13-,26-week bills $40 billion* 6-week CMBs	**SETTLE:** $13 billion* 10-year TIPS $26 billion* 2-year FRNs

**Estimate*