Daiwa Capital Markets

U.S. Economic Comment

- Labor market: subtle signs of strength
- The Biden budget proposal: (partially) tax and spend

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Employment: Moderate Improvement, but Underlying Strength

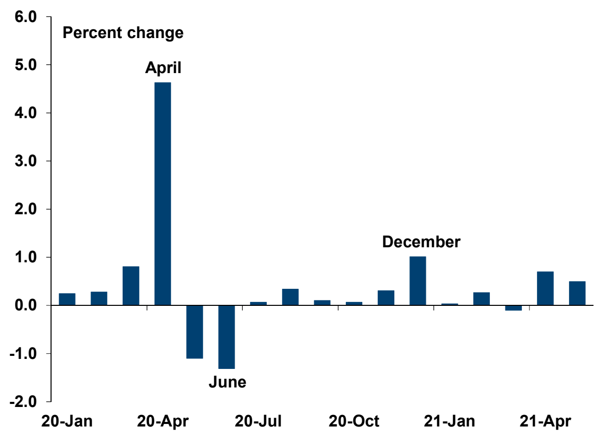
Given the nature of the current economic cycle – a monumental plunge followed by a vigorous recovery – the recent employment gains might be viewed as only moderate. Total output is on track to exceed its pre-pandemic level in the current quarter, but payroll employment is still 7.6 million shy of its level before the onset of Covid. At the current pace of job growth (an average of 478,000 per month so far this year), employment would not return to its pre-virus level until September 2022.

Although job growth has been underwhelming, businesses seem anxious to hire, and there are signs of underlying strength. We have been impressed with the jump in average hourly earnings in the past two months (up 0.5 percent in May and 0.7 percent in April). These advances are not unprecedented, as gains were stronger in March and April of last year (chart, left). However, recent changes seem to represent genuine wage increases designed to attract workers rather than shifts related to compositional changes in the labor force.

The series on average hourly earnings is not a fixed-weight measure, which means that changes in the composition of employment can alter the measure even if wage rates remain unchanged. Job growth in above-average wage industries will push the measure higher, all else unchanged, while brisk growth in low-wage areas will restrain average earnings.

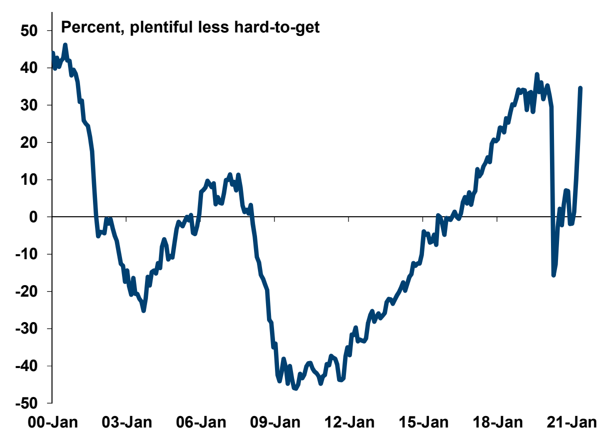
The effect of compositional changes was clearly evident last year. Rapid growth in average hourly earnings in March and April 2020, a time when employment was collapsing, reflected disproportionate job losses in low-wage areas (e.g. leisure and hospitality), which left a larger share of above-average workers in the calculation. Average earnings fell sharply in May and June when some low-wage workers were recalled to their jobs. December 2020 showed a noticeable jump in average hourly earnings, reflecting job cuts of 498,000 in leisure and hospitality and a jump of 159,000 in business services (an above-average wage sector).

Average Hourly Earnings



Source: Bureau of Labor Statistics via Haver Analytics

Labor Market Assessment*



** The share of survey respondents indicating that jobs are plentiful less the share indicating that jobs are hard to get.*

Source: The Conference Board via Haver Analytics

The latest increases in average hourly earnings were interesting because they occurred at a time when employment growth in leisure and hospitality exceeded the overall average. This compositional change would tend to push the average lower, but reported earnings rose sharply despite this downward influence. Thus, the latest increases seem to reflect genuine wage gains.

Individuals seem to have taken notice of the strength of the labor market, as survey results showed a dramatic turn in May. The Conference Board survey of consumers includes a question on the labor market: are jobs plentiful or hard to get? Since the onset of the pandemic, the net reading from the question (the share indicating that jobs are plentiful less the share indicating that jobs are hard to get) fluctuated around zero. However, in May, the net reading surged to 34.6 percent, with 46.8 percent of respondents indicating that jobs were plentiful. The latest observation was in line with the strong labor market before the spread of Covid (chart, p. 1).

The Biden Budget: A Push for Big Government

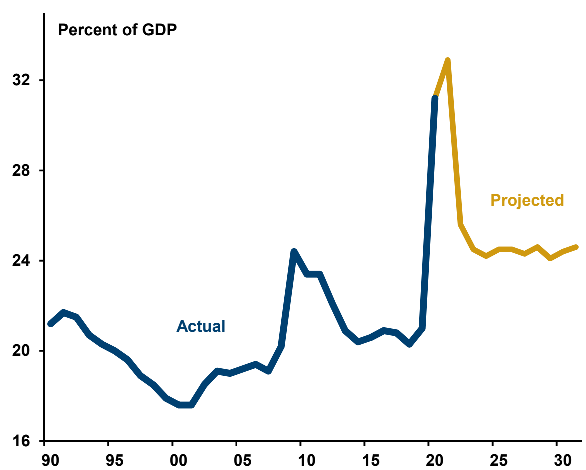
The release of the budget proposal by the Biden Administration on May 28 was uneventful in two respects. First, it was not especially revealing because the substance of the President's policies had already been presented in the American Jobs Plan and the American Families Plan. Second, the proposal could be viewed as irrelevant because it is likely to be altered considerably by Congress. Presidential budgets merely serve as a starting point for discussions among legislators; Congress ultimately writes and approves the final budget. Already, the Republican counter proposals have signaled strong resistance to the President's plan, and some Democrats seem to have misgivings as well. In addition, a recent ruling by the Senate parliamentarian will make it difficult to utilize reconciliation rules that allow passage in the Senate with a simple majority rather than the 60 votes needed to end a filibuster.

From another perspective, Mr. Biden's proposal is important. It added details to the broad outlines presented in the Jobs and Families Plans, and it provided a view on how these policies will affect budgets and the financial position of the federal government in coming years. The revealing longer-term picture shows a major shift in the role of the federal government in the economy and a notable weakening in the financial position of the United States.

The enhanced role of the federal government is evident in the outlays proposed by President Biden. Spending naturally recedes in future years from the elevated totals in 2020 and 2021 which were driven by efforts to fight Covid, but they remain high by historical standards. Measured as a share of GDP to allow comparisons over time, outlays settle at approximately 24 percent of GDP, noticeably above the norm of 17 to 20 percent evident in other recent non-recession years. The only other fiscal year in recent history close to the new norm presented by President Biden was 2009, when the Obama stimulus to counter the financial crisis pushed spending to 24.4 percent of GDP (chart).

The President plans to pay for part of his spending by raising taxes on corporations and upper-income individuals, which will raise the aggregate tax burden to nearly 20 percent of GDP (chart; next page, left). As with spending, the tax burden exceeds historical norms and has been rarely matched in other recent years.

Federal Outlays*



** Observations for 1990 to 2020 are actual results calculated by the Congressional Budget Office. The readings for 2021-2031 are projections included with the Biden budget proposal.*

Source: Congressional Budget Office via Haver Analytics; "President Biden's Full FY 2022 Budget." 28 May 2021. Committee For A Responsible Federal Budget: https://www.crfb.org/papers/president-bidens-full-fy-2022-budget

Despite the increase in taxes, the heavy spending leaves wide budget deficits, with the shortfalls ranging from $1.3 to $1.8 trillion over the next 10 years (4.2 to 7.8 percent of GDP). Not long ago, most observers would view such budget positions as troubling, but they would be the new normal under the Biden proposal. The elevated deficit would drive the outstanding debt of the government notably higher, with debt as a share of GDP climbing to 117 percent by 2031, a shocking total relative to the average of approximately 35 percent before the financial crisis (chart, right).

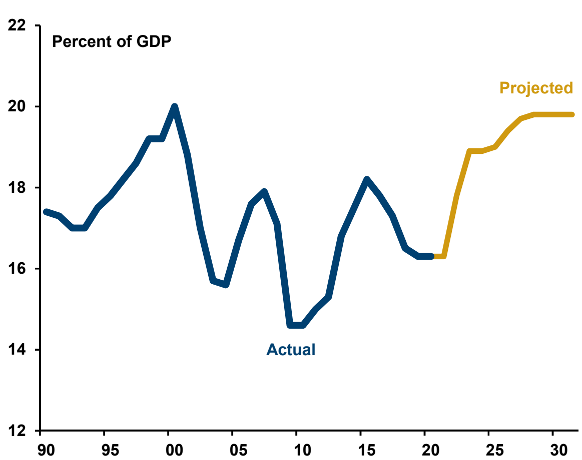
President Biden's advisers (Shalanda Young, acting director of the Office of Management and Budget; and Cecilia Rouse, Chair of the Council of Economic Advisers) emphasized in a press conference that the enlarged deficits were not deeply concerning because of the low level of interest rates. In addition, they noted that projections beyond 2031 show deficits beginning to recede and spending under the Jobs and Families Plans fully paid for over a 15-year horizon. We do not view either argument as compelling.

The projections assume that interest rates remain low throughout the forecast horizon, with the 10-year Treasury rate gradually increasing to 2.8 percent in 2028 and then holding steady at that level thereafter. Such a view involves a healthy dose of wishful thinking. Given the inflation assumptions in the budget documents, an interest rate of 2.8 percent involves a real return of only 0.5 to 0.8 percent (depending on the inflation gauge used), far below the average of approximately 2.3 percent during the expansion in the early 2000s and the average of approximately 3.5 percent during the 1990s. To be sure, equilibrium real rates are currently low, but there are no assurances that they will remain so.

The expected reduction in the budget deficit after 2031 occurs because tax increases remain in place while infrastructure projects are completed and spending recedes. However, once in place, spending programs are difficult to eliminate. Future presidents and legislators will be tempted to continue programs at their current or higher levels.

We are currently facing an analogous situation on the tax side of the budget. Personal tax reductions authorized by the Tax Cuts and Jobs Act of 2017 are scheduled to end after 2025, but members of Congress have not been bashful in announcing their desire to extend the tax benefits for at least some individuals. Congress cannot be trusted to follow through on promised spending cuts or tax increases.

Federal Revenues*



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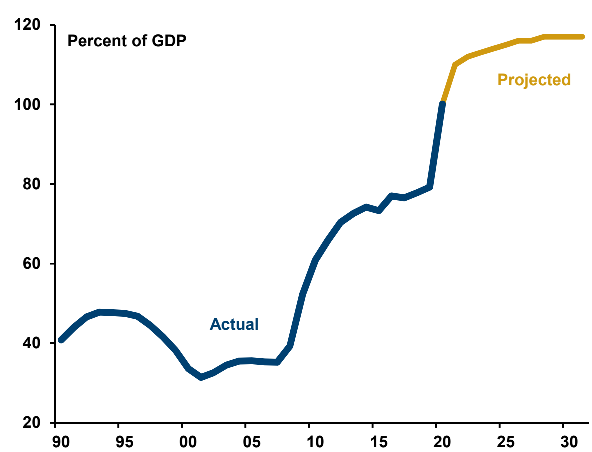
Source: Congressional Budget Office via Haver Analytics; "President Biden's Full FY 2022 Budget." 28 May 2021. Committee For A Responsible Federal Budget: https://www.crfb.org/papers/president-bidens-full-fy-2022-budget

Federal Debt Held by the Public*



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Source: Congressional Budget Office via Haver Analytics; "President Biden's Full FY 2022 Budget." 28 May 2021. Committee For A Responsible Federal Budget: https://www.crfb.org/papers/president-bidens-full-fy-2022-budget

Review

Week of May 31, 2021	Actual	Consensus	Comments
ISM Manufacturing Index (May)	**61.2% (+0.5 Pct. Pt.)**	**61.0% (+0.3 Pct. Pt.)**	Although the ISM manufacturing index rose only modestly in May, the change occurred from an already elevated level and thus represented an impressive performance. The latest observation was shy of the best reading in the current cycle (64.7% in March), but it was above all other totals in the current recovery period and firmer than all observations in the previous expansion. The new orders component registered a strong performance, with an increase of 2.7 percentage points to 67.0%. On the soft side, the production index declined 4.0 percentage points to 58.5%, likely a reflection of supply-chain problems, and the employment component slipped 4.2 percentage points to 50.9%.
Construction Spending (April)	**0.2%**	**0.5%**	Private residential building led the advance in total construction activity in April, with an increase of 1.0%, which marked the 10th increase in the past 11 months. Private nonresidential construction fell 0.5%, continuing a downward trend that began in late 2019. Public construction fell 0.6%. This component (mostly building by state and local governments) rallied in the closing months of last year but has declined in the past four months.
Revised Nonfarm Productivity (2021-Q1)	**5.4% (Unrevised)**	**5.5% (+0.1 Pct. Pt. Revision)**	Output in the nonfarm business sector was revised higher in Q1 (8.6% annual rate versus 8.4%), but so too were hours worked (3.0% versus 2.9%), which left productivity growth unchanged from the preliminary tally. Although productivity growth has been volatile as the economy has recovered from Covid, year-over-year growth of 4.1% represents a strong performance. Unit labor costs also were revised higher (+1.7% versus -0.3%), as real compensation per hour grew 3.3% rather than 1.3%. More notable was the upward revision in Q4, where unit labor costs surged 14.0% rather than the already-firm reading of 5.6%.
ISM Services Index (May)	**64.0% (+1.3 Pct. Pts.)**	**63.2% (+0.5 Pct. Pt.)**	The pickup in the ISM services index in May occurred from an already elevated level and was firm enough to push the measure to a new record, inching above the previous record of 63.7% set two months ago. The supplier delivery component led the latest increase in the headline index with an increase of 4.3 percentage points to 70.4%. The jump and elevated level most likely reflect difficulties with bottlenecks and supply chains. Two other components also were strong. The new orders index rose 0.7 percentage point to 63.9%, a reading in the upper portion of the historical range. The firm pace of orders led to an increase of 3.5 percentage points in the business activity component to 66.2%, the third strongest on record. The employment index was a bit light, as it fell 3.5 percentage points to 55.3%, a reading in the mid-portion of the historical range.

Review Continued

Week of May 31, 2021	Actual	Consensus	Comments
Payroll Employment (May)	**559,000**	**675,000**	Although job growth was lighter than expected, the gain nevertheless represented a reasonable pace of improvement. Payroll employment is now 7.6 million shy of the total before the onset of the pandemic, having recouped 66 percent of the ground lost last spring. The unemployment rate fell 0.3 percentage point to 5.8%. However, part of the decline was the result of a dip in the size of the labor force (off 53,000). Average hourly earnings rose 0.5%, a strong increase after a jump of 0.7% in the prior month. Recent increases seemed to represent genuine gains in wage rates rather than shifts related to compositional changes in employment (see discussion in main text).
Factory Orders (April)	**-0.6%**	**-0.2%**	A drop of 1.3% in durable goods orders pulled total factory bookings lower in April, but the weakness reflected downside volatility in the transportation category (autos and defense-related aircraft). Durable bookings excluding transportation rose 1.0%, adding to a strong upward trend. Nondurable orders edged 0.1% higher, restrained by a decline of 1.2% in bookings for petroleum and coal products (which likely reflected lower prices). Bookings ex. petrol and coal rose 0.4%, the 11th increase in the past 12 months.

Sources: Institute for Supply Management (ISM Manufacturing Index, ISM Services Index); U.S. Census Bureau (Construction Spending, Factory Orders); Bureau of Labor Statistics (Revised Nonfarm Productivity, Payroll Employment); Consensus forecasts are from Bloomberg

Preview

Week of June 7, 2021	Projected	Comments
Trade Balance (April) (Tuesday)	**$69.0 Billion Deficit**	The downward trend in the service surplus that began in early 2020 seems to be stabilizing, and thus the full trade balance for April is likely to be dominated by the already reported improvement of $6.8 billion in the goods trade deficit.
CPI (May) (Thursday)	**0.3% Total, 0.3% Core**	The average price of gasoline rose in May, but the increase was only moderately larger than seasonal norms, thus the energy component should be reasonably well contained. In the core component, some prices of goods and services affected by the pandemic are likely to continue recovering lost ground, which could lead to a high-side reading. However, prices of some items could pause for a time, and apparently aberrant shifts in April could at least partially reverse in May (like the 10.0% jump in the prices of used vehicles and the 16.2% surge in car rental fees).
Federal Budget (May) (Thursday)	**$130.0 Billion Deficit**	The postponement of the tax filing deadline from April to May for final 2020 settlements probably led to spectacular year-over-year growth in federal revenues. The improvement in the economy and resulting pickup in income most likely had an influence on tax receipts as well. Outlays also are likely to be hefty because of fiscal support provided by the American Rescue Plan, but the revenue flows should lead to the lightest monthly deficit thus far in the current fiscal year.
Consumer Sentiment (June) (Friday)	**84.5 (+1.6 Index Pts.)**	Elevated equity prices and a strong job market could boost consumer sentiment in early June, but concerns about an acceleration in inflation may limit the increase.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

<table>
<tr><th colspan="5">May/June 2021</th></tr>
<tr><th>Monday</th><th>Tuesday</th><th>Wednesday</th><th>Thursday</th><th>Friday</th></tr>
<tr><td>31</td><td>1</td><td>2</td><td>3</td><td>4</td></tr>
<tr>
<td>MEMORIAL DAY</td>
<td>ISM INDEX
Index Prices
Mar 64.7 85.6
Apr 60.7 89.6
May 61.2 88.0
CONSTRUCTION SPEND.
Feb -0.8%
Mar 1.0%
Apr 0.2%</td>
<td>BEIGE BOOK
“The national economy expanded at a moderate pace from early April to late May, a somewhat faster rate than the prior reporting period.”
VEHICLE SALES
Mar 18.0 million
Apr 18.8 million
May 17.0 million</td>
<td>UNEMPLOYMENT CLAIMS
Initial Continuing
(Millions)
May 08 0.478 3.738
May 15 0.444 3.602
May 22 0.405 3.771
May 30 0.385 N/A
ADP EMPLOYMENT REPORT
Private Payrolls
Mar 519,000
Apr 654,000
May 978,000
REVISED PRODUCTIVITY & COSTS
Productivity Unit Labor Costs
20-Q4 -3.8% 14.0%
21-Q1(p) 5.4% -0.3%
21-Q1(r) 5.4% 1.7%
ISM SERVICES INDEX
Index Prices
Mar 63.7 74.0
Apr 62.7 76.8
May 64.0 80.6</td>
<td>EMPLOYMENT REPORT
Payrolls Un. Rate
Mar 785,000 6.0%
Apr 278,000 6.1%
May 559,000 5.8%
FACTORY ORDERS
Feb 0.4%
Mar 1.4%
Apr -0.6%</td>
</tr>
<tr><td>7</td><td>8</td><td>9</td><td>10</td><td>11</td></tr>
<tr>
<td>CONSUMER CREDIT (3:00)
Feb $26.1 billion
Mar $25.8 billion
Apr --</td>
<td>NFIB SMALL BUSINESS OPTIMISM INDEX (6:00)
Mar 98.2
Apr 99.8
May --
TRADE BALANCE (8:30)
Feb -$70.5 billion
Mar -$74.4 billion
Apr -$69.0 billion
JOLTS DATA (10:00)
Openings (000) Quit Rate
Feb 7,526 2.4%
Mar 8,123 2.4%
Apr -- --</td>
<td>WHOLESALE TRADE (10:00)
Inventories Sales
Feb 1.0% 0.0%
Mar 1.1% 4.6%
Apr 0.8% 1.0%</td>
<td>INITIAL CLAIMS (8:30)
CPI (8:30)
Total Core
Mar 0.6% 0.3%
Apr 0.8% 0.9%
May 0.3% 0.3%
FEDERAL BUDGET (2:00)
2021 2020
Mar -$659.6B -$119.0B
Apr -$225.6B -$738.0B
May -$130.0B -$398.8B</td>
<td>CONSUMER SENTIMENT (10:00)
Apr 88.3
May 82.9
June 84.5</td>
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<tr><td>14</td><td>15</td><td>16</td><td>17</td><td>18</td></tr>
<tr>
<td></td>
<td>RETAIL SALES
PPI
EMPIRE MFG INDEX
IP & CAP-U
BUSINESS INVENTORIES
NAHB HOUSING INDEX
TIC DATA
FOMC MEETING</td>
<td>HOUSING STARTS
IMPORT/EXPORT PRICES
FOMC DECISION</td>
<td>INITIAL CLAIMS
PHILLY FED INDEX
LEADING INDICATORS</td>
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<td>CHICAGO FED NATIONAL ACTIVITY INDEX</td>
<td>EXISTING HOME SALES</td>
<td>CURRENT ACCOUNT
NEW HOME SALES</td>
<td>INITIAL CLAIMS
DURABLE GOODS ORDERS
U.S. INTERNATIONAL TRADE IN GOODS
ADVANCE INVENTORIES
REVISED GDP</td>
<td>PERSONAL INCOME, CONSUMPTION, PRICES
REVISED CONSUMER SENTIMENT</td>
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Forecasts in Bold. (p) = preliminary; (r) = revised

Treasury Financing

May/June 2021

Monday	Tuesday	Wednesday	Thursday	Friday
31	1	2	3	4
MEMORIAL DAY	**AUCTION RESULTS:** Rate / Cover 13-week bills 0.020% 2.74 26-week bills 0.035% 3.10 6-week CMB 0.005% 3.46 **ANNOUNCE:** $40 billion 4-week bills for auction on June 3 $40 billion 8-week bills for auction on June 3 $35 billion 17-week CMBs for auction on June 2 **SETTLE:** $40 billion 4-week bills $40 billion 8-week bills $27 billion 20-year bonds $60 billion 2-year notes $61 billion 5-year notes $62 billion 7-year notes $35 billion 17-week CMBs	**AUCTION RESULTS:** Rate / Cover 17-week CMB 0.030% 3.29	**AUCTION RESULTS:** Rate / Cover 4-week bills 0.000% 3.73 8-week bills 0.015% 2.97 **ANNOUNCE:** $111 billion 13-,26-week bills for auction on June 7 $58 billion 3-year notes for auction on June 8 $38 billion 10-year notes for auction on June 9 $24 billion 30-year bonds for auction on June 10 $40 billion 6-week CMBs for auction on June 8 **SETTLE:** $111 billion 13-,26-week bills $40 billion 6-week CMBs	
7	8	9	10	11
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 June 10 $40 billion* 8-week bills for auction on June 10 $35 billion* 17-week CMBs for auction on June 9 **SETTLE:** $40 billion 4-week bills $40 billion 8-week bills $35 billion 17-week CMBs	**AUCTION:** $38 billion 10-year notes $35 billion* 17-week CMBs	**AUCTION:** $40 billion* 4-week bills $40 billion* 8-week bills $24 billion 30-year bonds **ANNOUNCE:** $111 billion* 13-,26-week bills for auction June 14 $34 billion* 52-week bills for auction on June 15 $24 billion* 20-year bonds for auction on June 15 $16 billion* 5-year TIPS for auction on June 17 $40 billion* 6-week CMBs for auction on June 15 **SETTLE:** $111 billion 13-,26-week bills $40 billion 6-week CMBs	
14	15	16	17	18
AUCTION: $111 billion* 13-,26-week bills	**AUCTION:** $34 billion* 52-week bills $24 billion* 20-year bonds $40 billion* 6-week CMBs **ANNOUNCE:** $40 billion* 4-week bills for auction on June 17 $40 billion* 8-week bills for auction on June 17 $35 billion* 17-week CMBs for auction on June 16	**AUCTION:** $35 billion* 17-week CMBs **SETTLE:** $40 billion* 4-week bills $40 billion* 8-week bills $58 billion 3-year notes $38 billion 10-year notes $24 billion 30-year bonds $35 billion* 17-week bills	**AUCTION:** $40 billion* 4-week bills $40 billion* 8-week bills $16 billion* 5-year TIPS **ANNOUNCE:** $111 billion* 13-,26-week bills for auction on June 21 $26 billion* 2-year FRNs for auction on June 23 $60 billion* 2-year notes for auction on June 22 $61 billion* 5-year notes for auction on June 23	$62 billion* 7-year notes for auction on June 24 $40 billion* 6-week CMBs for auction on June 22 **SETTLE:** $111 billion* 13-,26-week bills $34 billion* 52-week bills $40 billion* 6-week CMBs
21	22	23	24	25
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 June 24 $40 billion* 8-week bills for auction on June 24 $35 billion* 17-week CMBs for auction on June 23 **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 28 $40 billion* 6-week CMBs for auction on June 29 **SETTLE:** $111 billion* 13-,26-week bills $40 billion* 6-week CMBs	**SETTLE:** $26 billion* 2-year FRNs

**Estimate*