U.S. Economic Comment

- A puzzling decline in interest rates
- American Rescue Plan, recent developments:
  - Another form of support for households
  - Aid to state and local governments
  - Unemployment claims: the pullback begins

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Interest Rates

We are mystified by the recent decline in interest rates. One would think that a recovering economy and hints of faster inflation would push interest rates higher, but the 10-year Treasury yield has eased approximately 40 basis points since late March to 1.35 percent as of Friday afternoon. About half of this shift has occurred in the past two weeks.

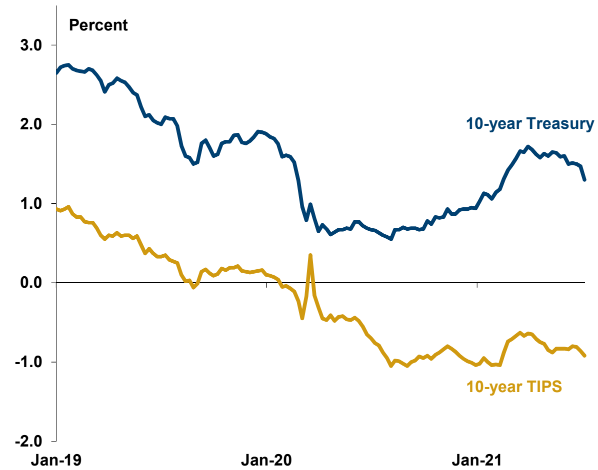
One logical explanation might be that the emergence of the delta variant of the coronavirus has jeopardized the current recovery and eliminated the threat of inflation. However, close inspection of recent changes in interest rates does not offer strong support for this view. Short-term rates, which we would expect to react to downside growth risks and prospects for an easing in inflation, have changed only modestly. The shift in rates has largely been confined to the intermediate and long ends of the maturity spectrum, and the changes reflect a decline in real interest rates rather than an easing in inflation expectations. That is, rates on Treasury inflation-protected securities (TIPS), which represents a real interest rate, have moved in step with nominal Treasury yields (chart).

Thus, the drop in interest rates would seem to represent a reassessment of long-term growth prospects for the U.S. economy. However, this explanation also is lacking, as indexes of stock prices have climbed to record highs during the period of falling rates. Equity investors apparently expect a solid economic performance in the years ahead.

We can think of other factors that might be pushing interest rates lower, but their degree of influence is not clear. Prospects for President Biden's ambitious fiscal program might have dimmed, which would reduce the amount of expected debt issuance in the years ahead. Global pressures might be in play, as similar rate changes have occurred in most other developed countries. Perhaps the agreement among finance ministers on a minimum corporate tax rate has influenced long-term views on growth and sovereign debt issuance. Finally, we would not discount the possibility of random volatility that sometimes creeps into financial markets. Changes in risk assessments or coincidental position squaring among a group of investors sometimes drives interest rates away from their underlying equilibriums.

At this point, we would favor explanations that view the rate decline as a temporary deviation from equilibrium. The strong performance of the economy and the robust tone in the equity market are at odds with the recent movement in Treasury yields.

10-Year Treasury Interest Rates*



** Weekly average data, except for the last quotes, which are daily observations for July 8, 2021.*

Source : Federal Reserve Board via Haver Analytics

Fiscal Stimulus

Recovery rebate checks, which surged in March and led to a flurry of retail spending, have slowed to a trickle ($6.6 billion in June and $0.4 billion so far in July versus $317.6 billion in April). However, another dose of financial support for consumers will be starting this month.

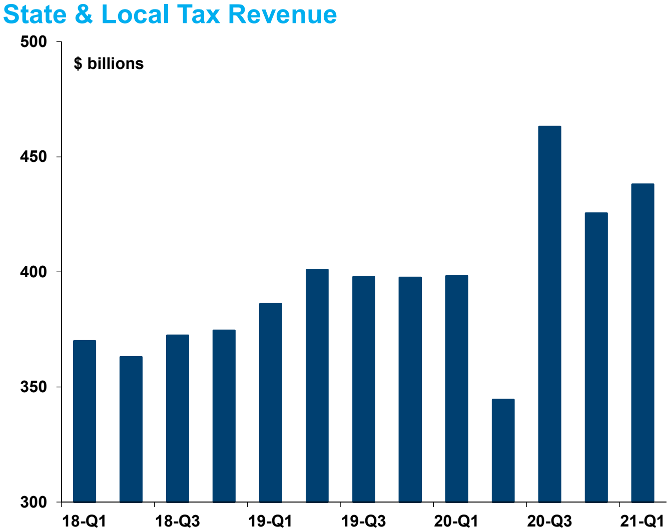
The American Rescue Plan enhanced the Child Tax Credit by increasing the amount of the benefit from $2,000 per child to $3,600 per child under 6 years of age and $3,000 for children aged 6 to 17. In addition, half of the credit will be paid in monthly installments rather than credited toward tax payments when the family files its annual tax return. The first of six monthly payments will be sent on July 15. The payments will total $300 per child under 6 and $250 for others.

There are income limits on families eligible for the credit, and thus the precise number of families and children receiving aid is not knowable before the fact, but we have seen estimates that approximately 65 million children will be covered. Assuming most of them are over 6 years old, monthly payments will be in the neighborhood of $17 billion. The total is significant. If all of the funds were to be spent at outlets included in the retail sales report, the activity would add more than 2.5 percentage points to reported growth.

The American Rescue Plan also provided aid to state and local governments ($350 billion in total), and these funds have already started to flow. The Treasury disbursed a trivial amount in April (less than $1.0 billion), but it delivered $131 billion in May and $65 billion in June.

This support should trigger a marked shift in the role of state and local governments in the current expansion. After constraining GDP growth in the final three quarters of last year and contributing only marginally in the first quarter (adding less than 0.1 percentage point to Q1 GDP growth), state and local governments will now have the financial wherewithal to spend actively. Normal revenue flows had already shown notable improvement after a tumble with the onset of the pandemic (chart); the additional support from the federal government will leave many in strong financial positions. Governors or legislators could decide to "save" the federal support (e.g. shoring up pension funds or adding to emergency reserve balances), but they also will be in a good position to spend.

State & Local Tax Revenue



Source : Quarterly Summary of State & Local Tax Revenue (QTAX), U.S. Census Bureau

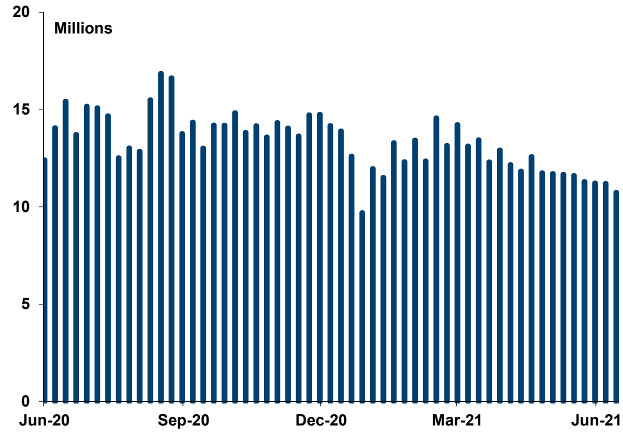
Unemployment Claims

The American Rescue Plan extended the federally funded elements of unemployment insurance through early September (the $300 per week supplement; Pandemic Unemployment Assistance (PUA), a program for those not eligible for regular state benefits; Pandemic Emergency Unemployment Compensation (PEUC), a program for those who have exhausted regular benefits).

Because the system for unemployment insurance is administered by state authorities, states have flexibility in setting rules for their program, including the ability to decline the assistance from the federal government or to discontinue its use. Numerous states, 26 at the latest count, have announced plans to discontinue participation in the federal efforts because of the perceived labor shortage. Four states withdrew as of June 12 (Iowa, Missouri, Mississippi, Alaska), and the others will follow over the next five weeks.

The latest figures on the number of individuals receiving benefits under PUA and PEUC are for the week of June 19. This date is significant, as it is the first week where some states were no longer participating, and thus the number of individuals receiving benefits would be expected to drop, perhaps notably. Actually, the decline was moderate (off 465,000 or 4.2 percent), a change within the range of observations seen this year (chart).

Continuing Claims for Unemployment Insurance*



** Continuing claims for unemployment insurance under the Pandemic Unemployment Assistance (PUA) and Pandemic Emergency Unemployment Compensation (PEUC) programs.*

Source : Employment & Training Administration, U.S. Department of Labor via Haver Analytics

Interestingly, even states that discontinued the programs reported recipients in the latest week. This oddity was because of backlogs in processing claims or delays in filing for benefits. If an individual was eligible for benefits while the programs were in place, and if they had not received benefits because of processing delays or late filing, payments would still be made after the designated termination date of the programs.

The initial effects of the early terminations were moderate, but the influence should pick up over the next several weeks, both because backlogs should diminish and because the number of states withdrawing will increase.

Review

Week of July 5, 2021	Actual	Consensus	Comments
ISM Services Index (June)	**60.1% (-3.9 Pct. Pts.)**	**63.5% (-0.5 Pct. Pt.)**	Although the ISM services index fell in June, it still represented a firm reading by historical standards. Indeed, the current reading is only marginally below the record before the robust results in the current recovery period (previous record of 62.0% in August 1997). All four major components contributed to the decline in the headline index. New orders fell only moderately and remained at a solid level (off 1.8 percentage points to 62.1%). The business activity index posted a sharp decline (off 5.8 percentage points) but the change occurred from an elevated level and the new reading remained strong at 60.4%. The employment index also fell sharply and moved below the critical value of 50% (off 6.0 percentage points to 49.3%). While the reading on employment was disappointing, we wonder if a limited supply of workers was more of a factor than soft demand. The supplier deliveries index fell 1.9 percentage points to 68.5%. Despite a dip, the elevated level of the index suggest that shortages and supply-chain disruptions remain an issue.
Job Openings (May)	**9.209 Million**	**9.325 Million**	Job openings rose modestly in May (16,000) after surging in the prior four months (average monthly increase of 610,000 from January through April). The cumulative change over this period pushed the level of openings well above the prior record of 7.574 million in November 2018. The quit rate, another key metric published with the JOLTS report, showed a willingness of individuals to leave their current positions to seek new employment. This measure fell from a record 2.8% of employment in April to 2.5% in May, but the latest reading matched that in March and was above all other observations in the history of the series (dating back to late 2000).
Consumer Credit (May)	**$35.3 Billion**	**$18.0 Billion**	Consumer credit outstanding jumped in May after averaging increases of $10.8 billion in the prior 11 months. Individuals in the past year have used a portion of their support from the federal government to pay down credit card debt, but this pattern reversed in the latest month with an increase of $9.2 billion. Other borrowing continued along its strong upward trend with a surge of $26.1 billion in the latest month.

Sources: Institute for Supply Management (ISM Services Index); Bureau of Labor Statistics (JOLTS Job Openings); Federal Reserve Board (Consumer Credit); Consensus forecasts are from Bloomberg

Preview

Week of July 12, 2021	Projected	Comments
CPI (June) (Tuesday)	**0.5% Total, 0.4% Core**	Available quotes suggest that energy prices resumed their advance after pauses in the prior two months, while food prices continued to move along their moderate upward trend. The core component is likely to cool from striking increases in the prior two months (up 0.8% on average), but the unwinding of pandemic-related discounts and generally strong demand is likely to lead to another sizeable increase.
Federal Budget (June) (Tuesday)	**$175.0 Billion Deficit**	The postponement of the April tax filing deadline to mid-June will lead to a huge increase in revenues relative to the total in the same month last year. Federal spending is likely to decline sharply on a year-over-year basis, as outlays last June were boosted by a surge in activity under the Paycheck Protection Program. All told the monthly budget deficit will be well shy of the $864 billion shortfall in June 2020.
PPI (June) (Wednesday)	**0.5% Total, 0.4% Ex. Food & Energy**	Food prices seem due to cool after sharp increases in the prior five months (average increase of 1.6%), but prices of gasoline and other petroleum-related products suggest a sizeable increases in the energy component that will push the headline index higher. Pandemic-related shifts are likely to lead to another high-side reading in prices excluding food and energy (average increase of 0.6% in the prior five months).
Industrial Production (June) (Thursday)	**0.4%**	A modest Increase in factory employment and a shorter workweek suggest soft results in the manufacturing sector, but an increase in the rotary rig count points to a gain in mining activity. Warmer-than-normal temperatures could boost demand for utility services (air conditioning).
Retail Sales (June) (Friday)	**-0.3% Total, 0.2% Ex. Autos**	A drop in vehicle sales is likely to constrain the auto component of the retail report, and an easing in government income support will probably dampen activity in other areas. Even if government support had been well maintained, a shift to service consumption, which is not well represented in this report, would dampen reported totals.
Business Inventories (May) (Friday)	**0.6%**	Preliminary estimates show a decline in inventories at the retail level, led by motor vehicles, but noticeable increases at the manufacturing and wholesale levels more than offset that retreat. After little change in April, the average increase in total inventories so far in Q2 trails that in the first quarter, suggesting a drag from inventory investment on GDP growth.
Consumer Sentiment (July) (Friday)	**90.0 (+4.5 Index Pts.)**	A strong labor market and elevated equity prices could boost consumer sentiment in early July.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

July 2021

Monday 5

INDEPENDENCE DAY (OBSERVED)

Tuesday 6

ISM SERVICES INDEX

	Index	Prices
Apr	62.7	76.8
May	64.0	80.6
June	60.1	79.5

Wednesday 7

JOLTS DATA

	Openings (000)	Quit Rate
Mar	8,288	2.5%
Apr	9,193	2.8%
May	9,209	2.5%

FOMC MINUTES

Thursday 8

UNEMPLOYMENT CLAIMS

	Initial (Millions)	Continuing
June 12	0.418	3.421
June 19	0.416	3.484
June 23	0.371	3.339
July 03	0.373	N/A

CONSUMER CREDIT

Mar	$19.3 billion
Apr	$20.0 billion
May	$35.3 billion

Friday 9

WHOLESALE TRADE

	Inventories	Sales
Mar	1.2%	4.3%
Apr	1.1%	1.1%
May	1.3%	0.8%

Monday 12

Tuesday 13

NFIB SMALL BUSINESS OPTIMISM INDEX (6:00)

Apr	99.8
May	99.6
June	--

CPI (8:30)

	Total	Core
Apr	0.8%	0.9%
May	0.6%	0.7%
June	**0.5%**	**0.4%**

FEDERAL BUDGET (2:00)

	2021	2020
Apr	-$225.6B	-$738.0B
May	-$132.0B	-$398.8B
June	**-$175.0B**	-$864.1B

Wednesday 14

PPI (8:30)

	Final Demand	Ex. Food & Energy
Apr	0.6%	0.7%
May	0.8%	0.7%
June	**0.5%**	**0.4%**

CHAIR POWELL'S MONETARY POLICY TESTIMONY (HOUSE) (12:00)

BEIGE BOOK (2:00)

June 2021 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."

Thursday 15

INITIAL CLAIMS (8:30)

IMPORT/EXPORT PRICES (8:30)

	Non-petrol. Imports	Nonagri. Exports
Apr	0.7%	1.2%
May	0.9%	1.7%
June	--	--

EMPIRE MFG (8:30)

May	24.3
June	17.4
July	--

PHILLY FED INDEX (8:30)

May	31.5
June	30.7
July	--

IP & CAP-U (9:15)

	IP	Cap.Util.
Apr	0.1%	74.6%
May	0.8%	75.2%
June	**0.4%**	**75.4%**

CHAIR POWELL'S MONETARY POLICY TESTIMONY (SENATE) (9:30)

Friday 16

RETAIL SALES (8:30)

	Total	Ex.Autos
Apr	0.9%	0.0%
May	-1.3%	-0.7%
June	**-0.3%**	**0.2%**

BUSINESS INVENTORIES (10:00)

	Inventories	Sales
Mar	0.2%	5.8%
Apr	0.1%	0.6%
May	**0.6%**	**-0.1%**

CONSUMER SENTIMENT (10:00)

May	82.9
June	85.5
July	**90.0**

TIC DATA (4:00)

	Total	Net L-T
Mar	$146.7B	$262.4B
Apr	$101.2B	$100.7B
May	--	--

Monday 19

NAHB HOUSING INDEX

Tuesday 20

HOUSING STARTS

Wednesday 21

Thursday 22

INITIAL CLAIMS

CHICAGO FED NATIONAL ACTIVITY INDEX

LEADING INDICATORS

EXISTING HOME SALES

Friday 23

Monday 26

NEW HOME SALES

Tuesday 27

DURABLE GOODS ORDERS

FHFA HOME PRICE INDEX

S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX

CONSUMER CONFIDENCE

FOMC MEETING

Wednesday 28

ADVANCE INVENTORIES

U.S. INTERNATIONAL TRADE IN GOODS

FOMC DECISION

Thursday 29

INITIAL CLAIMS

Q2 GDP

PENDING HOME SALES

Friday 30

PERSONAL INCOME, CONSUMPTION & PRICES

EMPLOYMENT COST INDEX

MNI CHICAGO PURCHASING MANAGERS' INDEX

REVISED CONSUMER SENTIMENT

Forecasts in Bold.

Treasury Financing

July 2021

Monday	Tuesday	Wednesday	Thursday	Friday
5	6	7	8	9
INDEPENDENCE DAY (OBSERVED)	**AUCTION RESULTS:** Rate Cover 13-week bills 0.050% 2.92 26-week bills 0.050% 3.59 6-week CMB 0.045% 3.70 **ANNOUNCE:** $40 billion 4-week bills for auction on July 8 $40 billion 8-week bills for auction on July 8 $35 billion 17-week CMBs for auction on July 7 **SETTLE:** $40 billion 4-week bills $40 billion 8-week bills $35 billion 17-week CMBs	**AUCTION RESULTS:** Rate Cover 17-week CMB 0.050% 3.81	**AUCTION RESULTS:** Rate Cover 4-week bills 0.050% 3.37 8-week bills 0.045% 4.15 **ANNOUNCE:** $105 billion 13-,26-week bills for auction on July 12 $34 billion 52-week bills for auction on July 13 $58 billion 3-year notes for auction on July 12 $38 billion 10-year notes for auction on July 12 $24 billion 30-year bonds for auction on July 13 $35 billion 6-week CMBs for auction on July 13 **SETTLE:** $111 billion 13-,26-week bills $40 billion 6-week CMBs	
12	13	14	15	16
AUCTION: $105 billion 13-,26-week bills $58 billion 3-year notes $38 billion 10-year notes	**AUCTION:** $34 billion 52-week bills $24 billion 30-year bonds $35 billion 6-week CMBs **ANNOUNCE:** $35 billion* 4-week bills for auction on July 15 $35 billion* 8-week bills for auction on July 15 $30 billion* 17-week CMBs for auction on July 14 **SETTLE:** $40 billion 4-week bills $40 billion 8-week bills $35 billion 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs	**AUCTION:** $35 billion* 4-week bills $35 billion* 8-week bills **ANNOUNCE:** $100 billion* 13-,26-week bills for auction on July 19 $24 billion* 20-year bonds for auction on July 21 $16 billion* 10-year TIPS for auction on July 22 $35 billion* 6-week CMBs for auction on July 20 **SETTLE:** $105 billion 13-,26-week bills $34 billion 52-week bills $58 billion 3-year notes $38 billion 10-year notes $24 billion 30-year bonds $35 billion 6-week CMBs	
19	20	21	22	23
AUCTION: $100 billion* 13-,26-week bills	**AUCTION:** $35 billion* 6-week CMBs **ANNOUNCE:** $30 billion* 4-week bills for auction on July 22 $30 billion* 8-week bills for auction on July 22 $30 billion* 17-week CMBs for auction on July 21 **SETTLE:** $35 billion* 4-week bills $35 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $24 billion* 20-year bonds $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 4-week bills $30 billion* 8-week bills $16 billion* 10-year TIPS **ANNOUNCE:** $100 billion* 13-,26-week bills for auction on July 26 $28 billion* 2-year FRNs for auction on July 28 $60 billion* 2-year notes for auction on July 26 $61 billion* 5-year notes for auction on July 27	$62 billion* 7-year notes for auction on July 29 $35 billion* 6-week CMBs for auction on July 27 **SETTLE:** $100 billion* 13-,26-week bills $35 billion* 6-week CMBs
26	27	28	29	30
AUCTION: $100 billion* 13-,26-week bills $60 billion* 2-year notes	**AUCTION:** $61 billion* 5-year notes $35 billion* 6-week CMBs **ANNOUNCE:** $30 billion* 4-week bills for auction on July 29 $30 billion* 8-week bills for auction on July 29 $30 billion* 17-week CMBs for auction on July 28 **SETTLE:** $30 billion* 4-week bills $30 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $28 billion* 2-year FRNs $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 4-week bills $30 billion* 8-week bills $62 billion* 7-year notes **ANNOUNCE:** $100 billion* 13-,26-week bills for auction on August 2 $35 billion* 6-week CMBs for auction on August 3 **SETTLE:** $100 billion* 13-,26-week bills $35 billion* 6-week CMBs	**SETTLE:** $16 billion* 10-year TIPS

**Estimate*