U.S. Economic Comment

- Consumer spending: service outlays on track despite Covid
- PCE price index: still pressure

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Consumer Spending: Favorable News Despite a Slow Q3

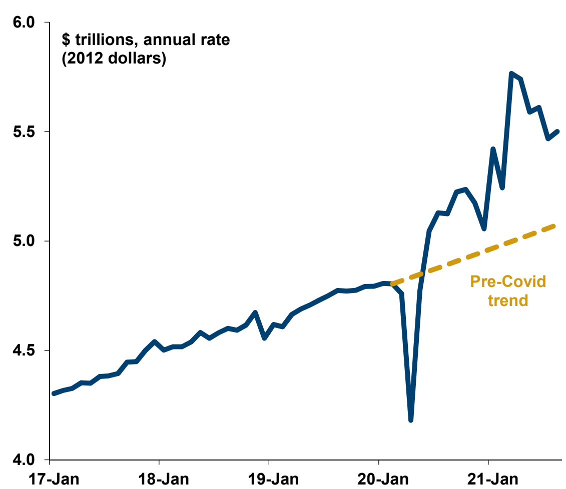
The third quarter GDP report is likely to show slow growth in consumer spending – probably less than 1.0 percent (annual rate). With consumers supposedly leading the recovery in the economy, that paltry advance might seem to suggest problems on the horizon. However, we viewed the latest results on household spending as encouraging.

The modest growth expected in Q3 is largely the result of a slow start to the quarter (real outlays in July fell 0.4 percent). August results published on Friday offset the July drop and returned spending to the elevated levels seen in Q2. Merely holding to levels comparable to those in Q2 implies little growth, but with activity well above pre-pandemic totals, sustaining the Q2 level represents a fine performance and signals that households are remaining active.

The breakdown of spending between goods and services was even more encouraging. The apparent slowdown in July and August was largely the result of a drop in goods consumption, and slower activity in this area is not surprising given earlier strength. Outlays for goods surged as the recovery began, with total expenditures rising far above the pre-Covid trend (chart, left). An easing at some point should have been expected. Moreover, much of the deceleration has occurred in the motor vehicle area, where the reduction is more the result of supply shortages than flagging demand.

Outlays for services have been less than vigorous in the current expansion, and they remain well below the pre-pandemic trend (chart, right). However, they are continuing to advance, with real service expenditures increasing 0.3 percent in August after a jump of 0.7 percent in July. Continued growth in the service area was especially notable because of downside risks generated by the spread of the Delta variant of Covid. Consumers seem to be soldiering on rather than retrenching in the face of the virus.

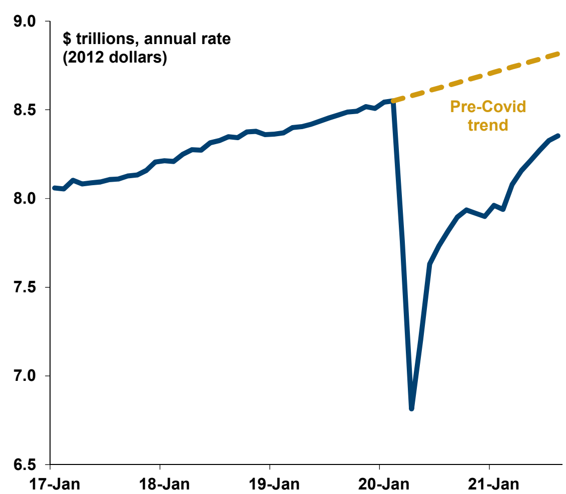
Real Consumer Spending: Goods*



** The pre-Covid trend assumes annual growth of 3.7 percent in real consumer spending on goods.*

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

Real Consumer Spending: Services*



** The pre-Covid trend assumes annual growth of 2.0 percent in real consumer spending on services.*

Sources: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets Americ

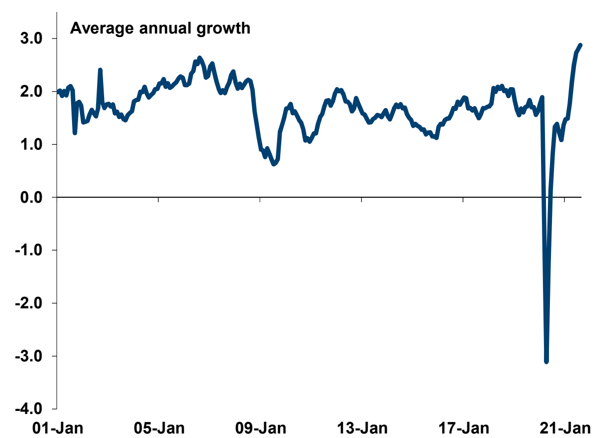
In the months ahead, outlays for goods will probably continue to regress toward the underlying pre-Covid trend, but the service sector apparently has a substantial amount of pent-up demand, and households have a large pool of savings to draw on to satisfy that demand. A firm labor market also bodes well for spending on services and for a gradual deceleration in goods consumption.

PCE Prices

Most Fed officials continue to view the pickup in inflation as transitory, arguing that much of the pressure has occurred in a limited number of goods and services affected by the pandemic. To be sure, Covid has triggered some wild swings in prices, and some of the recent sharp increases are starting to recede, supporting the view of temporary pressure. For example, prices of used cars and trucks, along with fees for vehicle rental, have declined sharply for two consecutive months. Similarly, the cost of a hotel stay fell in August after torrid increases from March through July (an average monthly increase of 5.7 percent).

However, it seems a stretch to argue that recent pressure is solely the result of pandemic-related noise. A simple way to minimize swings related to Covid is to calculate the change in prices at an annual rate from the pre-pandemic base in February. This calculation will eliminate price jumps in recent months that merely offset discounting during the pandemic. The latest reading totaled 2.9 percent, less troubling than the year-over-year increase of 3.6 percent in the core PCE index, but above the norms of the prior two decades (chart).

Core PCE Price Index*



** PCE = personal consumption expenditures.*

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

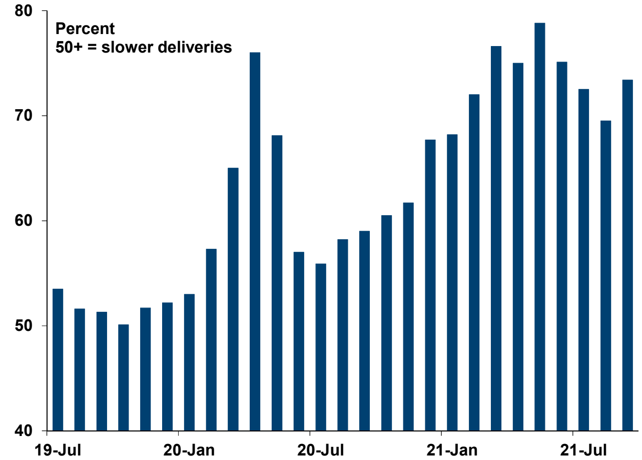
It also seems inaccurate to describe pressure as coming from a limited number of goods and services. The trimmed-mean PCE price index calculated by the Federal Reserve Bank of Dallas eliminates price changes in both tails of the distribution (24 percent from the lower tail and 31 percent from the upper tail). This measure would certainly eliminate upside pressure if it were the result of a limited number of items. However, it rose at an annual rate of 2.8 percent in August and has averaged 2.6 percent in the past seven months. The Cleveland Fed publishes a similar measure based on the CPI but involving less chopping from the tails (eight percent from both the upper and lower ends of the distribution), and this measure in August rose at an annual rate of 5.0 percent and has averaged increases of 5.1 percent in the past five months. Seems like more than a handful of items are rising in price.

Price pressure cannot be explained by pandemic-related shifts alone; strong demand and supply-chain disruptions also are important contributors. The elevated level of spending on goods and the resiliency of demand for services indicate firm demand, and the latest purchasing managers' index published by the Institute for Supply Management (ISM) suggests that supply-chain disruptions are not being resolved quickly.

The headline ISM index totaled 61.1 percent in September, a reading in the upper end of the range from the current expansion and above all observations from the previous expansion. All components were firm, but the supplier delivery index stood out with a reading of 73.4 percent (chart, next page). The September observation on deliveries was not the highest of the past two years, but it was extreme by historical standards, signaling slow delivery times as the result of continued problems with a supply chains. Limited supplies naturally had price consequences, as the price index included with the report totaled 81.2 percent, off the high of 92.1 percent in June but in the upper end of the historical range.

While Fed officials continue to view price pressure as transitory, several have also noted recently that price pressure could be longer-lasting than previously expected. Indeed, the lingering problems with supply chains, along with strong consumer demand, are likely to lead to firm readings on inflation in the months ahead.

ISM Manufacturing: Supplier Deliveries Index



Sources: Institute for Supply Management via Haver Analytics

Review

Week of Sept. 27, 2021	Actual	Consensus	Comments
Durable Goods Orders (August)	**1.8%**	**0.7%**	New orders for durable goods jumped from an upwardly revised level in July (up 0.5% versus -0.1%), but much of the advance was the result of a surge of 77.1% in in the volatile commercial aircraft category. Other transportation categories were weak (defense aircraft bookings fell 17.8%, and motor vehicle orders declined 3.1%). Elsewhere, the report was mediocre, as orders excluding all the noise from transportation rose 0.2%. On the positive side, new orders for nondefense capital goods excluding aircraft, which provide insight into capital spending plans of businesses, rose 0.5%, adding to a strong upward trend (up in 15 of the past 16 months to a level well above all observations in the previous expansion).
U.S. International Trade in Goods (August)	**-$87.6 Billion ($0.8 Billion Wider Deficit)**	**-$87.3 Billion ($0.5 Billion Wider Deficit)**	Both exports and imports rose in August (0.7% and 0.8%, respectively), with the larger gain in imports leading to a slight month-to-month widening in the trade deficit. However, viewed from a slightly longer perspective, the deficit has started to stabilize after sliding noticeably during the early portions of the pandemic. In fact, the average shortfall in the first two months of the third quarter shows some improvement from the average in Q2, which raises the possibility of a positive contribution from net exports to GDP growth in Q3.
Consumer Confidence (September)	**109.3 (-5.9 Index Pts.)**	**115.0 (+1.2 Index Pts.)**	The drop in consumer confidence in September marked the third consecutive pullback, with the cumulative decline totaling 15.2%. The pickup in inflation and the spread of the Delta variant of Covid have probably been important factors dampening consumer moods. Perceived conditions in the labor market played a small role. The labor market assessment published with the report (the share of survey participants responding that jobs are plentiful less the share reporting that jobs are hard to get) declined 1.9 percentage points to a still-high reading of 42.5%.
Revised GDP (2021-Q2)	**6.7% (+0.1 Pct. Pt. Revision)**	**6.6% (Unrevised)**	The various components of GDP showed modest adjustments to preliminary tallies. Consumer spending was firmer than previously reported (growth of 12.0%, annual rate, versus 11.9%). In addition, business investment in new equipment was revised higher (growth of 12.1% versus 11.6%), and outlays for new structures were less of a drag than previously reported. Total government spending and residential construction were both softer than previously reported.

Review Continued

Week of Sept. 27, 2021	Actual	Consensus	Comments
Personal Income, Consumption, Core Price Index (August)	**0.2%, 0.8%, 0.3%**	**0.2%, 0.7%, 0.2%**	A respectable advance in wages and salaries (+0.5%) led the increase in personal income in August, with rents (0.5%) also contributing positively. Government transfer payments also rose, reflecting primarily payments of the monthly installment of the child tax credit. Investment income (interest and dividends) was flat, and proprietors' income slipped 1.5% because of the waning influence of the Paycheck Protection Program. On the spending side, outlays for durable goods slipped (-0.4%), pulled lower by sluggish vehicle sales, but expenditures on nondurable items (2.1%) and services (0.6%) were solid. The core price index for personal consumption expenditures matched the July total, with the pace easing from the average monthly change of 0.5% from March through June. The core index rose 3.6% on a year-over-year basis, matching the reading in July and the fastest pace in about 30 years.
Revised Consumer Sentiment (September)	**72.8 (+1.8 Index Pts. Revision)**	**71.0 (Unrevised)**	Consumer sentiment was revised higher in late September by 2.5%, but the results did little to reverse the disappointing results of recent months. The latest reading is 27.9% below the pre-Covid peak of 101.0 in February 2020 and off 17.6% from the recent high of 88.3 in May. In fact, the average of 71.2 in the past two months is below the Covid-related trough of 71.8 in April of last year.
ISM Manufacturing Index (September)	**61.1% (+1.2 Pct. Pts.)**	**59.5% (-0.4 Pct. Pt.)**	The advance in the ISM manufacturing index in September reversed a modest drop in July/August, with the latest reading matching the elevated H1 average. The supplier deliveries component made the largest positive contribution (up 3.9 percentage points to 73.4%), indicating that supply constraints remain a significant issue. The new orders index was unchanged but remained robust at 66.7%. Production, although off 0.6 percentage point, remained elevated at 59.4%. The employment index was unimpressive. The measure rose 1.2 percentage points, but its level of 50.2% signaled little new hiring. Comments in the ISM report suggested difficulty in finding suitable workers. The price index increased to 81.2% from 79.4%, off the recent high of 92.1% in June, but near the top of the historical range.
Construction Spending (August)	**0.0%**	**0.3%**	Private residential construction rose 0.4% in August, adding to the strong upward trend. New building (both single and multi-family) slipped, but improvements to existing homes offset the weakness. Private nonresidential activity slipped 1.0%; activity has been flat this year on balance after a jump in January. Government-related building rose 0.5%, but the increase did little to offset the downward move in the past year and one-half.

Sources: U.S. Census Bureau (Durable Goods Orders, U.S. International Trade in Goods, Construction Spending); The Conference Board (Consumer Confidence); Bureau of Economic Analysis (Revised GDP, Personal Income, Consumption, Core Price Index); University of Michigan Survey Research Center (Revised Consumer Sentiment); Institute for Supply Management (ISM Manufacturing Index); Consensus forecasts are from Bloomberg

Preview

Week of Oct. 4, 2021	Projected	Comments
Factory Orders (August) (Monday)	**0.8%**	The already published increase of 1.8% in durable goods orders accounts for all of the expected increase in total factory orders. Bookings for nondurable goods are likely to decline slightly in August, as a price-led drop in orders for petroleum products offsets a moderate advance in nondurable orders ex-petroleum. Although only moderate, the expected increase in nondurable bookings ex-petroleum would mark the 15th increase in the past 16 months and leave orders well above pre-pandemic totals.
Trade Balance (August) (Tuesday)	**-$68.0 Billion ($2.0 Billion Narrower Deficit)**	The goods trade balance slipped $0.8 billion in August (published Sept 28), but a likely rebound in the service surplus after an Olympics-related drop in August (payment of broadcast rights to Japan) should provide an offset. In addition, an improvement in the so-called balance of payments adjustment (inclusion of exports and imports that do not flow through ordinary customs channels) should also contribute to a narrowing in the monthly trade deficit.
ISM Services Index (September) (Wednesday)	**60.0 (-1.7 Pct. Pts.)**	The spread of the Delta variant could weigh heavily on the service sector, dampening orders and business activity and slowing hiring. In addition, improvement in supply chains, a positive development for the economy, could have the perverse effect of reducing the supplier delivery component.
Payroll Employment (September) (Friday)	**400,000**	The spread of the Delta variant is probably constraining employment, and thus job growth is likely to fall short of the average of 636,000 in the first seven months of the year. At the same time, we suspect that the modest results in August (235,000) probably involved an element of downside random volatility, which should be absent in September. The expected pace of job growth should be strong enough to push the unemployment rate 0.2 percentage point lower to 5.0%.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

September/October 2021

Monday	Tuesday	Wednesday	Thursday	Friday
27	28	29	30	1
DURABLE GOODS ORDERS June 0.8% July 0.5% Aug 1.8%	**U.S. INTERNATIONAL TRADE IN GOODS** June -$92.0 billion July -$86.8 billion Aug -$87.6 billion **ADVANCE INVENTORIES** Wholesale / Retail June 1.2% 0.5% July 0.6% 0.4% Aug 1.2% 0.1% **FHFA HOME PRICE INDEX** May 1.9% June 1.7% July 1.4% **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** SA / NSA May 1.8% 2.1% June 1.8% 2.0% July 1.5% 1.5% **CONFERENCE BOARD CONSUMER CONFIDENCE** July 125.1 Aug 115.2 Sept 109.3	**PENDING HOMES SALES** June -2.0% July -2.0% Aug 8.1%	**UNEMPLOYMENT CLAIMS** Initial / Continuing (Millions) Sept 04 0.312 2.715 Sept 11 0.335 2.820 Sept 18 0.351 2.802 Sept 25 0.362 N/A **GDP** GDP / Chained Price 21-Q1 6.3% 4.3% 21-Q2(p) 6.6% 6.1% 21-Q2(r) 6.7% 6.1% **MNI-CHICAGO BUSINESS BAROMETER** Index / Prices July 73.4 91.6 Aug 66.8 93.9 Sept 64.7 90.7	**PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX** Inc. / Cons. / Core June 0.2% 1.1% 0.5% July 1.1% -0.1% 0.3% Aug 0.2% 0.8% 0.3% **REVISED CONSUMER SENTIMENT** July 81.2 Aug 70.3 Sept(p) 71.0 Sept(r) 72.8 **ISM INDEX** Index / Prices July 59.5 85.7 Aug 59.9 79.4 Sept 61.1 81.2 **CONSTRUCTION SPEND.** June 1.0% July 0.3% Aug 0.0% **VEHICLE SALES** July 14.6 million Aug 13.1 million **Sept 13.0 million**
4	5	6	7	8
FACTORY ORDERS (10:00) June 1.5% July 0.7% **Aug 0.8%**	**TRADE BALANCE (8:30)** June -$73.2 billion July -$70.1 billion **Aug -$68.0 billion** **ISM SERVICES INDEX (10:00)** Index / Prices July 64.1 82.3 Aug 61.7 75.4 **Sept 60.0 76.0**	**ADP EMPLOYMENT REPORT (8:15)** Private Payrolls July 326,000 Aug 374,000 Sept --	**INITIAL CLAIMS (8:30)** **CONSUMER CREDIT (3:00)** June $37.9 billion July $17.0 billion Aug --	**EMPLOYMENT REPORT (8:30)** Payrolls / Un. Rate July 1,053,000 5.4% Aug 235,000 5.2% **Sept 400,000 5.0%** **WHOLESALE TRADE (10:00)** Inventories / Sales June 1.2% 2.3% July 0.6% 2.0% **Aug 1.2% 0.5%**
11	12	13	14	15
COLUMBUS DAY	**NFIB SMALL BUSINESS OPTIMISM INDEX** **JOLTS REPORT**	**CPI** **FEDERAL BUDGET** **FOMC MINUTES**	**INITIAL CLAIMS** **PPI**	**RETAIL SALES** **EMPIRE MFG. SURVEY** **IMPORT/EXPORT PRICES** **CONSUMER SENTIMENT** **BUSINESS INVENTORIES**
18	19	20	21	22
IP & CAP-U **NAHB HOUSING INDEX** **TIC DATA**	**HOUSING STARTS**	**BEIGE BOOK**	**INITIAL CLAIMS** **PHILLY FED INDEX** **EXISTING HOME SALES** **LEADING INDICATORS**	

Forecasts in Bold. *(p) = preliminary (2nd estimate of GDP); (r) = revised (3rd estimate of GDP)*

Treasury Financing

September/October 2021

Monday	Tuesday	Wednesday	Thursday	Friday
27	28	29	30	1
AUCTION RESULTS: Rate Cover 13-week bills 0.035% 3.36 26-week bills 0.050% 3.24 2-year notes 0.310% 2.28 5-year notes 0.990% 2.37	**AUCTION RESULTS:** Rate Cover 7-year notes 1.332% 2.24 **ANNOUNCE:** $10 billion 4-week bills for auction on September 30 $25 billion 8-week bills for auction on September 30 $30 billion 17-week CMBs for auction on September 29 **SETTLE:** $10 billion 4-week bills $25 billion 8-week bills $30 billion 17-week CMBs	**AUCTION RESULTS:** Rate Cover 17-week CMB 0.050% 2.92	**AUCTION RESULTS:** Rate Cover 4-week bills 0.045% 4.59 8-week bills 0.040% 3.71 **ANNOUNCE:** $84 billion 13-,26-week bills for auction on October 4 $34 billion 52-week bills for auction on October 5 **SETTLE:** $84 billion 13-,26-week bills $24 billion 20-year bonds $14 billion 10-year TIPS $60 billion 2-year notes $61 billion 5-year notes $62 billion 7-year notes	
4	5	6	7	8
AUCTION: $84 billion 13-,26-week bills	**AUCTION:** $34 billion 52-week bills **ANNOUNCE:** $10 billion* 4-week bills for auction on October 7 $25 billion* 8-week bills for auction on October 7 $30 billion* 17-week CMBs for auction on October 6 **SETTLE:** $10 billion 4-week bills $25 billion 8-week bills $30 billion 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs	**AUCTION:** $10 billion* 4-week bills $25 billion* 8-week bills **ANNOUNCE:** $84 billion* 13-,26-week bills for auction on October 12 $58 billion* 3-year notes for auction on October 12 $38 billion* 10-year notes for auction on October 12 $24 billion* 30-year bonds for auction on October 13 **SETTLE:** $84 billion 13-,26-week bills $34 billion 52-week bills	
11	12	13	14	15
COLUMBUS DAY	**AUCTION:** $84 billion* 13-,26-week bills $58 billion* 3-year notes $38 billion* 10-year notes **ANNOUNCE:** $10 billion* 4-week bills for auction on October 14 $25 billion* 8-week bills for auction on October 14 $30 billion* 17-week CMBs for auction on October 13 **SETTLE:** $10 billion* 4-week bills $25 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs $24 billion* 30-year bonds	**AUCTION:** $10 billion* 4-week bills $25 billion* 8-week bills **ANNOUNCE:** $84 billion* 13-,26-week bills for auction on October 18 $24 billion* 20-year bonds for auction on October 20 $19 billion* 5-year TIPS for auction on October 21 **SETTLE:** $84 billion* 13-,26-week bills	**SETTLE:** $58 billion* 3-year notes $38 billion* 10-year notes $24 billion* 30-year bonds
18	19	20	21	22
AUCTION: $84 billion* 13-,26-week bills	**ANNOUNCE:** $10 billion* 4-week bills for auction on October 21 $25 billion* 8-week bills for auction on October 21 $30 billion* 17-week CMBs for auction on October 20 **SETTLE:** $10 billion* 4-week bills $25 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $24 billion* 20-year bonds $30 billion* 17-week CMBs	**AUCTION:** $10 billion* 4-week bills $25 billion* 8-week bills $19 billion* 5-year TIPS **ANNOUNCE:** $84 billion* 13-,26-week bills for auction on October 25 $28 billion* 2-year FRNs for auction on October 27 $60 billion* 2-year notes for auction on October 26 $61 billion* 5-year notes for auction on October 27 $62 billion* 7-year notes for auction on October 28 **SETTLE:** $84 billion* 13-,26-week bills	

**Estimate*