

U.S. Economic Comment

- Q3 GDP: implications for Q4 and beyond
- Employment costs: a surge in Q3 after high-side readings in Q1 and Q2
- FOMC: let the tapering begin

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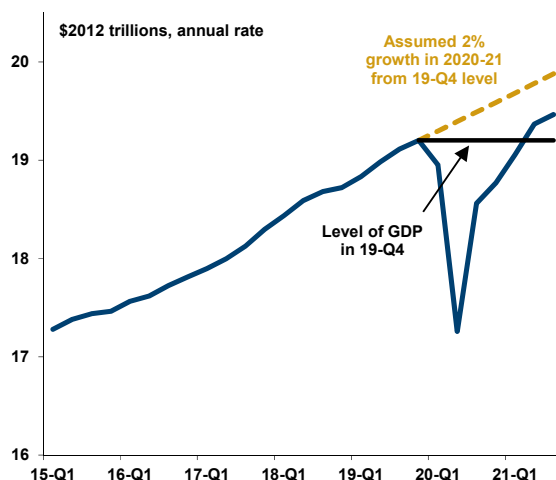
Pickup in Economic Growth Likely

Third quarter GDP growth of 2.0 percent would be a respectable performance if the economy was already at par, but the level of output is still below where it might have been if the pandemic had not occurred (see the extrapolated trend on the chart). In the current setting, one would hope for a performance in line with growth of 6.5 percent in the first half of the year. That pace is probably out of reach given supply shortages and residual restraint from Covid-19, but several factors will probably lead to firmer results in Q4 and beyond. Our new estimate puts growth in Q4 at 5.0 percent and an average of 3.5 percent over the four quarters of 2022 (chart, right).

Consumer spending stood out in Q3 as a key element in the slowdown, expanding only 1.6 percent after a burst of 11.7 percent in the first half of the year. The easing in Q3 reflected a natural pause after the flurry in the first half, as well as restraints associated with Covid-19. Supply constraints also had an influence, as shown by a tumble in sales of new motor vehicles. The outlook for the final months of the year is brighter. Consumers have most likely caught their breath after the summer pause, and the spread of the virus is diminishing. Thus, individuals should be more active.

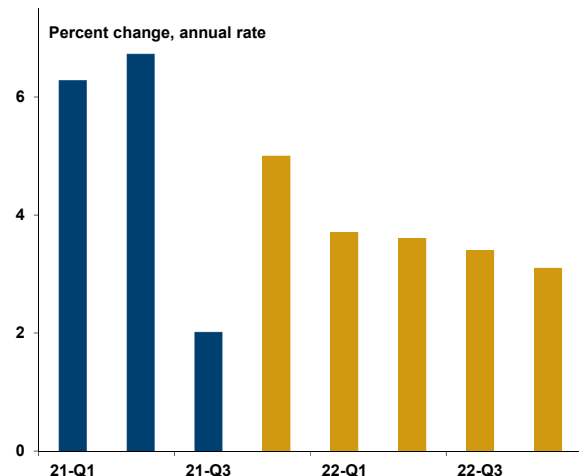
The report on consumer spending for September (released on Friday) offered encouragement, as outlays jumped 0.6 percent, which translated to a real gain of 0.3 percent. Given this advance, spending in September was already above the third quarter average. If consumer outlays merely held their September level over the next three months, consumption in Q4 would register annual growth of 1.6 percent; moderate growth over the next three months, say 0.2 percent, would push annual growth over three percent. Consumer spending growth above four percent is conceivable.

Real GDP



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

GDP Growth*



* The readings for 2021-Q4 to 2022-Q4 (gold bars) are forecasts.

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

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We are hopeful that residential construction will outperform the soft result in the third quarter, when activity fell 7.7 percent. Sales of new homes have shown signs of life after sliding in the spring and summer, which should stir new construction. We also look for business fixed investment to pick up from the modest advance of 1.8 percent in Q3. With new and unfilled orders for capital goods strong, investment outlays should easily outpace the growth in the summer quarter.

At some point in the future, inventory investment will make a sizeable contribution to growth, although the timing of the boost will depend on progress in repairing supply chains. Businesses thus far have coped with supply-chain disruptions by drawing down inventories, which is evident in the GDP accounts, where inventory investment has been negative for three consecutive quarters. Inventory investment made a positive contribution to GDP growth in the third quarter (adding 2.1 percentage points), but that boost occurred because the drawdown was smaller than that in the prior quarter (a smaller negative yields a positive value when calculating changes or growth rates). Businesses will need to replenish depleted inventories when supply chains improve (positive inventory investment), and a shift from negative to positive could generate a huge contribution to GDP growth (or a series of favorable contributions over several quarters).

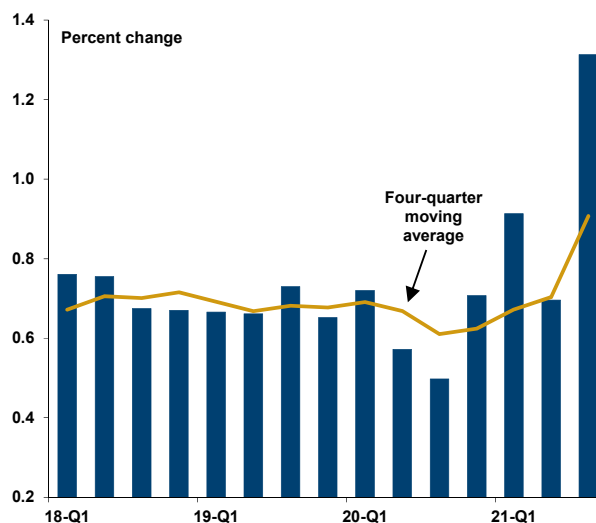
Employment Costs

Although payroll employment is five million shy of its pre-pandemic level, labor markets are tight. With many workers having dropped out of the labor force for various reasons, businesses are having difficulty attracting workers. But managers are making a best effort to fill positions, as shown by a surge in the employment cost index in the third quarter (up 1.3 percent; chart, left).

The wage component of total compensation rose 1.5 percent, just one tick shy of the sharpest advance in the history of the series. That record reading occurred in 1982, when the economy was coming out of a round of double-digit inflation. The latest increase followed high-side readings in the prior two quarters (1.0 percent and 0.9 percent in the first and second quarters). This recent pressure has pushed the year-over-year increase to 4.2 percent, the sharpest advance since 1990.

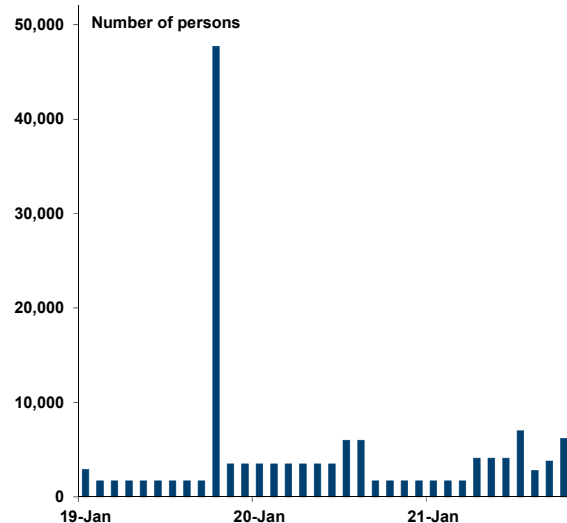
The benefit component of labor compensation rose 0.9 percent, a reading in the upper end of the range from the past 10 years. This increase, though, followed light results in the prior two quarters, and thus the year-over-year change was unremarkable at 2.5 percent. At the same time, it is interesting that businesses have also started to use benefits as a means to attract workers.

Employment Cost Index



Source: Bureau of Labor Statistics via Haver Analytics

Strike Activity



The financial press has highlighted worker strikes at several businesses, noting that the tightness in the labor market is emboldening unions and worker groups. The individual stories have been interesting, but in the aggregate, strike activity has not changed meaningfully. The labor department keeps a tally of the number of workers on strike, and the recent totals of 3,800 in September and 6,200 in October are within the bounds of recent norms (chart, prior page, right). The upward pressure on wages and benefits has occurred without a push from strikes.

The acceleration in wages and benefits heightens inflation risk and dampens the relief on risks that might have occurred because of a tame reading on the price index for personal consumption expenditures. This measure rose 0.3 percent overall in September and 0.2 percent excluding food and energy (chart). In the prior six months, the headline and core indexes both rose at an average rate of 0.5 percent.

The PCE price index, however, was not quite as tame as it would appear on the surface. Much of the restraint came in areas sensitive to the pandemic, with discounting put in place in response to actual or anticipated reductions in demand. For example, fees for air travel, car rentals, hotel stays, movie going, and live entertainment attendance (ex-sporting events) all fell noticeably in September. An area with high-side risks, rental rates for housing, rose 0.3 percent, firmer than increases of 0.1 or 0.2 percent that were common much of last year and earlier this year.

Thus, the tame reading on the PCE price index does not allow one to conclude that price pressure is receding. It does not necessarily support the Fed's view that the pickup in inflation will be transitory.

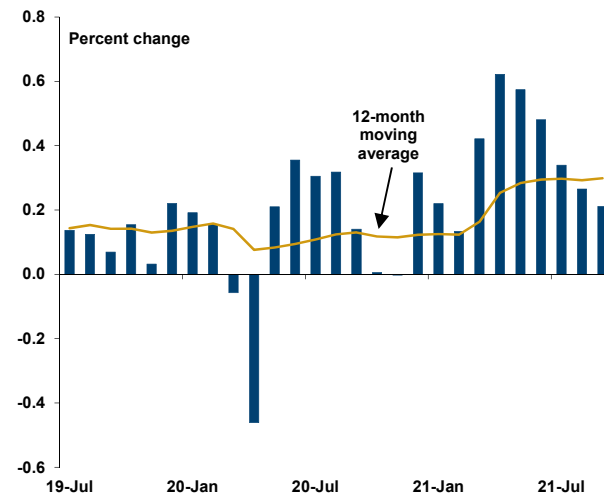
FOMC: Finally, Tapering

In most instances before an FOMC meeting, we would lead off our weekly comment with our expectation for the outcome of that deliberation. In this case, however, there is not much mystery about the Committee's decisions. Officials will most likely announce their plans for winding down the asset purchase program that has been in place since March 2020. In fact, it would be shocking if the FOMC did not announce its plans for tapering.

Not only is an announcement a near certainty, but market participants also have a reasonably clear view on how the Fed will proceed. The minutes from the September FOMC meeting described a plan for tapering offered by the staff, and that plan seemed to be well received by policymakers. The staff suggested reducing purchases by \$15 billion per month (\$10 billion of Treasuries and \$5 billion of mortgage-backed securities). The tapering could begin in either mid-November or mid-December.

We originally favored mid-December as a start date, which would be in keeping with the Committee's intention to provide ample notice of changes to the program. However, with the employment cost index showing distinct wage pressure and with supply-chain disruptions apparently lingering, officials most likely will wish to signal that they recognize inflation risks. Thus, the Committee will probably slow the pace of buying immediately. Given the plan indicated in the September minutes, a November start would leave May 2022 as the last month for Fed buying; June would be the first month involving no purchases.

Core PCE Price Index*



* PCE = personal consumption expenditures.

Source: Bureau of Economic Analysis via Haver Analytics

One remaining issue related to the asset purchase program is the fate of the balance sheet when the tapering process is finished. Specifically, will the Fed maintain the existing size of the balance sheet or begin to reverse the quantitative easing effort by selling or redeeming securities. The issue was raised at the September press briefing, and Chair Powell indicated that the Committee was not focused on that issue at this time.

The Fed has offered no clues on its plans for the balance sheet, but we would be surprised if officials started to reduce its size within the next year. We would not be surprised if the Fed maintained the existing size indefinitely and allowed the economy to catch up with the enlarged balance sheet. Even in normal times, the Fed needs to have its balance sheet expanding to provide an adequate supply of reserves to the banking system. Rather than making occasional outright purchases to facilitate a gradual increase in the size of its balance sheet, we see the Fed tolerating an overabundance of securities in its portfolio until the economy and banking system catch up. Thereafter, the Fed will shift to occasional purchases and a gradual expansion.

Review

Week of Oct. 25, 2021	Actual	Consensus	Comments
New Home Sales (September)	0.800 Million (+14.0%)	0.756 Million (+2.2%)	The jump in new home sales in September occurred from downwardly revised results (the level of activity in August was 5.1% lighter than previously believed), but the change marked the second advance in the past three months and the gains offset a good portion of the sharp slide earlier in the year. The increase in activity led to a drop in the months' supply of homes available for sale in September (5.7 months versus 6.5 in August), but the latest reading was still comfortably within the pre-pandemic range.
Consumer Confidence (October)	113.8 (+4.0 Index Pts.)	108.0 (-1.3 Index Pts.)	The increase in the confidence index published by the Conference Board ended a three-month slide, but the pickup offset only a portion of the cumulative decline of 14.8% (19.1 index points) in the prior three months. Moreover, the level of the index before the recent softening was not especially impressive and the latest reading was still noticeably below the pre-pandemic reading of 132.6 in February 2020. Despite an unimpressive level of confidence, survey respondents remained optimistic about the job market. The net reading on the labor market question (the share of individuals reporting that jobs are plentiful less those indicating that jobs are hard-to-get) moved to a new high for the current cycle (45.0%).
U.S. International Trade in Goods (September)	-\$96.3 Billion (\$8.1 Billion Wider Deficit)	-\$88.3 Billion (\$0.1 Billion Wider Deficit)	Exports tumbled 4.7% in September and imports rose 0.5%, leading to a sharp widening in the trade deficit in goods. The new reading on the deficit broke out of the range from the first eight months of the year – a range that suggested that the trade deficit was beginning to stabilize after widening during much of 2020. The latest move in the deficit set the stage for the fifth consecutive quarterly drag from net exports on GDP growth (see below).
Durable Goods Orders (September)	-0.4%	-1.1%	Although durable goods orders dipped in September, the retreat in total bookings was not especially troubling, as the decline was concentrated in the transportation sector and was heavily influenced by a drop of 27.9% in orders for commercial aircraft after a high-side reading in the prior month. Bookings for motor vehicles also contributed with a semiconductor-related drop of 2.9%. Excluding transportation, orders rose 0.4%, reinforcing the upward trend that has been in place throughout the year. Orders for nondefense capital goods excluding aircraft, which provide insight into capital spending by businesses, rose 0.8%. This series has posted only one monthly decline since May 2020.

Review Continued

Week of Oct. 25, 2021	Actual	Consensus	Comments
GDP (2021-Q3)	2.0%	2.6%	Consumer spending stood out as leading the slowdown in growth in Q3, as expenditures rose 1.6% versus 12.0% in Q2. Business fixed investment also disappointed with an increase of only 1.8%. Outlays for equipment and new structures fell, but a jump in investment in intellectual property provided an offset. Businesses contributed to growth through inventory investment (adding 2.07 percentage points to GDP growth). However, firms are still depleting stocks because of shortages; the positive contribution reflected a smaller drawdown than that in Q2. The trade sector was a drag on growth again in Q3, marking the fifth consecutive quarter where net exports made a negative contribution to growth (a drag of 1.14 percentage points in Q3 versus an average of -1.66 percentage points in the prior four quarters).
Personal Income, Consumption, Core Price Index (September)	-1.0%, 0.6%, 0.2%	-0.3%, 0.6%, 0.2%	Wage income posted a firm advance in September (0.8%), as did rental income (1.3%), but government transfers, especially unemployment benefits, fell sharply (-7.2%) and pulled total income lower. On the spending side, outlays for durable goods dipped 0.2%, influenced by lower spending on vehicles, but outlays for nondurable goods and services rose briskly (0.9% and 0.6%, respectively). The nominal increase in spending translated to a gain of 0.3% in real terms. The headline PCE price index rose 0.3%, with both food and energy posting sharp increases (1.1% and 1.3%, respectively). On a year-over-year basis, the headline index rose 4.4%, the fastest pace since 1990. The increase in the core PCE index cooled in September after averaging advances of 0.5% in the prior six months. The core index rose 3.6% on a year-over-year basis, matching the brisk increases in the prior three months.
Employment Cost Index (2021-Q3)	1.3%	0.9%	The brisk advance in the employment cost index in Q3 was driven by a surge of 1.5% (not annualized) in wages and salaries, the fastest quarterly advance since 1984. On a year-over-year basis, wages and salaries rose 4.2%, up one percentage point from the reading in in Q2 and the sharpest year-over-year increases in the past two decades. Benefit costs also rose briskly in the third quarter (up 0.9%), but the gain followed a light reading in Q2 and thus the year-over-year change of 2.5% remained within the range of the past few years.

Sources: U.S. Census Bureau (New Home Sales, U.S. International Trade in Goods, Durable Goods Orders); The Conference Board (Consumer Confidence); Bureau of Economic Analysis (GDP, Personal Income, Consumption, Prices); Bureau of Labor Statistics (Employment Cost Index); Consensus forecasts are from Bloomberg

Preview

Week of Nov. 1, 2021	Projected	Comments
ISM Manufacturing Index (October) (Monday)	60.0% (-1.1 Pct. Pts.)	Shortages of goods and labor are likely to have a dampening effect on manufacturing activity, but firm underlying conditions should allow for continued elevated readings on the ISM index (above 58 for 10 consecutive months; above 60 for 7 of those 10 months).
Construction Spending (September) (Monday)	0.5%	New single-family housing construction has lost momentum recently, but multi-family activity and improvements to existing homes have performed well. Government-related building is perhaps beginning to stir (up in July and August after six consecutive declines). Private nonresidential construction will probably remain on the flat path that has been in place since early in the year.
ISM Services Index (October) (Wednesday)	61.0% (-0.9 Pct. Pt.)	The services index was resilient in the past several months despite the acceleration in the number of Covid-19 cases, and the measure should continue to perform well now that the spread of the virus is diminishing.
Factory Orders (September) (Wednesday)	0.5%	The already reported decline of 0.4% in orders for durable goods (influenced by softness in commercial aircraft and motor vehicles) is likely to be more than offset by an estimated increase of 1.3% in nondurable bookings. The advance in the nondurable area will partly reflect higher prices of petroleum products, but nondurable orders ex-petroleum are likely to post their seventh consecutive increase (and 16th in the past 17 months).
Nonfarm Productivity (2021-Q3) (Thursday)	-3.5%	Employment statistics showed a sizeable increase in hours worked during Q3 while the GDP report showed only moderate growth in output. The disconnect suggests a decline in productivity. A drop in productivity, in turn, will probably leave a sizeable increase in unit labor costs (7.0% expected, annual rate).
Trade Balance (September) (Thursday)	-\$78.5 Billion (\$5.2 Billion Wider Deficit)	The surplus in service trade is likely to improve from its unusually soft reading in August, but the already reported slippage of \$8.1 billion in the goods trade deficit is likely to dominate.
Payroll Employment (October) (Friday)	500,000	The slowing in the spread of Covid-19 should allow for faster job growth in several service industries, especially leisure and hospitality, and the seasonal distortions that restrained education-related employment in September should be largely absent. The increase in payrolls is likely to be strong enough to reduce the unemployment rate, although an increase in the size of the labor force after a drop in September could limit the decline.
Consumer Credit (September) (Friday)	\$16.0 Billion	After judicious use of credit during the recession and early phase of the recovery, households have started to borrow more freely in recent months (average increase of \$23 billion per month in the past seven months versus an average paydown of \$3 billion per month from March 2020 through January 2021).

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

October/November 2021				
Monday	Tuesday	Wednesday	Thursday	Friday
25	26	27	28	29
CHICAGO FED NATIONAL ACTIVITY INDEX Monthly 3-Mo. Avg. July 0.83 0.40 Aug 0.05 0.38 Sept -0.13 0.25	FHFA HOME PRICE INDEX June 1.7% July 1.4% Aug 1.0% S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX SA NSA June 1.8% 2.0% July 1.5% 1.5% Aug 1.2% 0.9% NEW HOME SALES July 0.712 million Aug 0.702 million Sept 0.800 million CONFERENCE BOARD CONSUMER CONFIDENCE Aug 115.2 Sept 109.8 Oct 113.8	U.S. INTERNATIONAL TRADE IN GOODS July -\$86.9 billion Aug -\$88.2 billion Sept -\$96.3 billion ADVANCE INVENTORIES Wholesale Retail July 0.6% 0.4% Aug 1.2% 0.2% Sept 1.1% -0.2% DURABLE GOODS ORDERS July 0.5% Aug 1.3% Sept -0.4%	UNEMPLOYMENT CLAIMS Initial Continuing (Millions) Oct 02 0.329 2.603 Oct 09 0.296 2.480 Oct 16 0.291 2.243 Oct 23 0.281 N/A GDP Chained Price 21-Q1 6.3% 4.3% 21-Q2 6.7% 6.1% 21-Q3 2.0% 5.7% PENDING HOME SALES July -2.0% Aug 8.1% Sept -2.3%	PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX Inc. Cons. Core July 1.1% 0.1% 0.3% Aug 0.2% 1.0% 0.3% Sept -1.0% 0.6% 0.2% EMPLOYMENT COST INDEX Comp. Wages 21-Q1 0.9% 1.0% 21-Q2 0.7% 0.9% 21-Q3 1.3% 1.5% MNI CHICAGO BUSINESS BAROMETER INDEX Index Prices Aug 66.8 93.9 Sept 64.7 90.7 Oct 68.4 94.3 REVISED CONSUMER SENTIMENT Aug 70.3 Sept 72.8 Oct(p) 71.4 Oct(r) 71.7
1	2	3	4	5
ISM INDEX (10:00) Index Prices Aug 59.9 79.4 Sept 61.1 81.2 Oct 60.0 80.0 CONSTRUCTION SPEND. (10:00) July 0.3% Aug 0.0% Sept 0.5%	VEHICLE SALES Aug 13.0 million Sept 12.2 million Oct 12.5 million FOMC MEETING	ADP EMPLOYMENT REPORT (8:15) Private Payrolls Aug 340,000 Sept 568,000 Oct -- ISM SERVICES INDEX (10:00) Index Prices Aug 61.7 75.4 Sept 61.9 77.5 Oct 61.0 76.0 FACTORY ORDERS (10:00) July 0.7% Aug 1.0% Sept 0.5% FOMC DECISION (2:00) POWELL PRESS CONFERENCE (2:30)	INITIAL CLAIMS (8:30) PRODUCTIVITY & COSTS (8:30) Unit Labor Costs 21-Q1 4.3% -2.8% 21-Q2 2.1% 1.3% 21-Q3 -3.5% 7.0% TRADE BALANCE (8:30) July -\$70.3 billion Aug -\$73.3 billion Sept -\$78.5 billion	EMPLOYMENT REPORT (8:30) Payrolls Un. Rate Aug 366,000 5.2% Sept 194,000 4.8% Oct 500,000 4.7% CONSUMER CREDIT (3:00) July \$17.3 billion Aug \$14.4 billion Sept \$16.0 billion
8	9	10	11	12
	NFIB SMALL BUSINESS OPTIMISM INDEX PPI	INITIAL CLAIMS CPI WHOLESALE TRADE FEDERAL BUDGET	VETERANS DAY	JOLTS DATA CONSUMER SENTIMENT
15	16	17	18	19
EMPIRE MFG INDEX	RETAIL SALES IMPORT/EXPORT PRICES IP & CAP-U BUSINESS INVENTORIES NAHB HOUSING MARKET INDEX TIC DATA	HOUSING STARTS	INITIAL CLAIMS PHILADELPHIA FED MFG BUSINESS OUTLOOK LEADING INDICATORS	

Forecasts in Bold. (p) = preliminary (r) = revised

Treasury Financing

October/November 2021																																		
Monday	Tuesday	Wednesday	Thursday	Friday																														
25	26	27	28	29																														
AUCTION RESULTS: <table><tr><td>Rate</td><td>Cover</td></tr><tr><td>13-week bills 0.055%</td><td>3.34</td></tr><tr><td>26-week bills 0.060%</td><td>3.34</td></tr></table>	Rate	Cover	13-week bills 0.055%	3.34	26-week bills 0.060%	3.34	AUCTION RESULTS: <table><tr><td>Rate</td><td>Cover</td></tr><tr><td>2-year notes 0.481%</td><td>2.69</td></tr><tr><td>48-day CMB 0.100%</td><td>2.72</td></tr></table> ANNOUNCE: <p>\$60 billion 4-week bills for auction on October 28</p> <p>\$25 billion 8-week bills for auction on October 28</p> <p>\$40 billion 17-week CMBs for auction on October 27</p> SETTLE: <p>\$60 billion 4-week bills</p> <p>\$25 billion 8-week bills</p> <p>\$40 billion 17-week CMBs</p>	Rate	Cover	2-year notes 0.481%	2.69	48-day CMB 0.100%	2.72	AUCTION RESULTS: <table><tr><td>Spread</td><td>Cover</td></tr><tr><td>2-year FRNs 0.035%</td><td>2.99</td></tr></table> <table><tr><td>Rate</td><td>Cover</td></tr><tr><td>5-year notes 1.157%</td><td>2.55</td></tr><tr><td>17-week CMB 0.055%</td><td>3.62</td></tr></table>	Spread	Cover	2-year FRNs 0.035%	2.99	Rate	Cover	5-year notes 1.157%	2.55	17-week CMB 0.055%	3.62	AUCTION RESULTS: <table><tr><td>Rate</td><td>Cover</td></tr><tr><td>4-week bills 0.055%</td><td>3.44</td></tr><tr><td>8-week bills 0.095%</td><td>3.45</td></tr><tr><td>7-year notes 1.461%</td><td>2.25</td></tr></table> ANNOUNCE: <p>\$102 billion 13-,26-week bills for auction on November 01</p> <p>\$34 billion 52-week bills for auction on November 2</p> SETTLE: <p>\$102 billion 13-,26-week bills</p> <p>\$40 billion 48-day CMBs</p>	Rate	Cover	4-week bills 0.055%	3.44	8-week bills 0.095%	3.45	7-year notes 1.461%	2.25	SETTLE: <p>\$19 billion 5-year TIPS</p>
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*Estimate