Daiwa Capital Markets

U.S. Economic Comment

- U.S. economy: on track despite Omicron
- Inflation and growth risks from the Russia-Ukraine situation

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The U.S. Economy: Holding Up Well

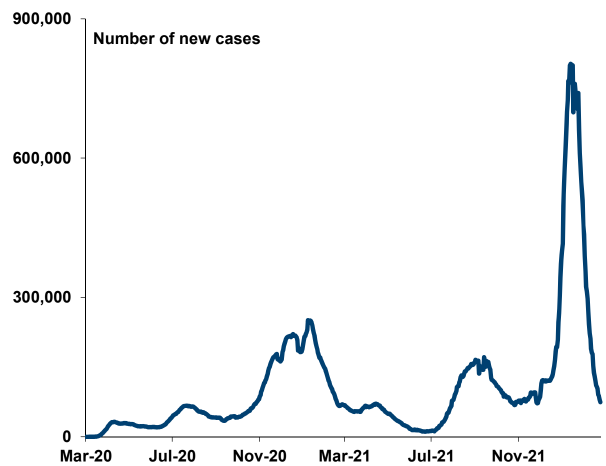
Just as the Delta variant of Covid-19 slowed U.S. economic activity in the third quarter of last year (GDP growth of 2.3 percent) and had a residual influence in Q4 (final sales growth of 2.0 percent), the Omicron variant has the potential to restrain activity in the first quarter of the year. However, the spread of the virus is slowing rapidly (chart, left), and the economy seemed to be holding up well even before the number of new cases started to tumble.

The resiliency is not likely to be evident in GDP, as growth in the first quarter of the year is likely to be only moderate – probably close to the pace in the third quarter of last year. However, the moderate pace will most likely be influenced by volatility in inventory investment: a sizeable negative contribution after a surge in the fourth quarter. GDP growth excluding inventory investment (final sales) should be well maintained, probably advancing in a range of three to four percent, a notable pickup from 1.0 percent in the second half of 2021.

High-frequency indicators support the case for solid underlying growth in early 2022. We keep a close eye on airport throughput (the number of individuals passing through a security checkpoint) and restaurant seatings booked through the online service OpenTable. Both measures involve discretionary activity and close public interaction. These measures weakened in late December and early January when Omicron became an issue, but they have surged in the past few weeks as the spread of the virus has slowed (charts, below right and next page).

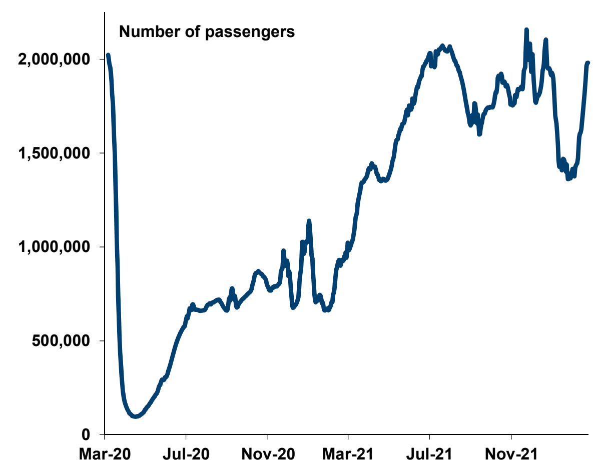
We also have been impressed with two composite measures designed to track economic growth, one from the Chicago Fed and one from the New York Fed. The so-called National Activity Index published by the Federal Reserve Bank of Chicago combines 83 largely coincident economic indicators. The broad-based nature of the measure suggests that it will give good insight into the economy. The index is constructed to have a value of zero when the economy is growing at its potential rate, which would represent a fine performance when at or close to full employment.

New Covid-19 Cases*



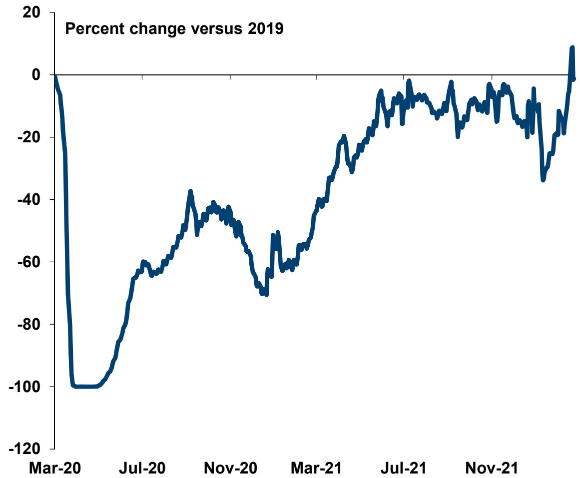
** Seven-day moving average. The last observation is for February 24, 2022.*
Source: Johns Hopkins University & Medicine via Bloomberg

Airport Passenger Throughput*



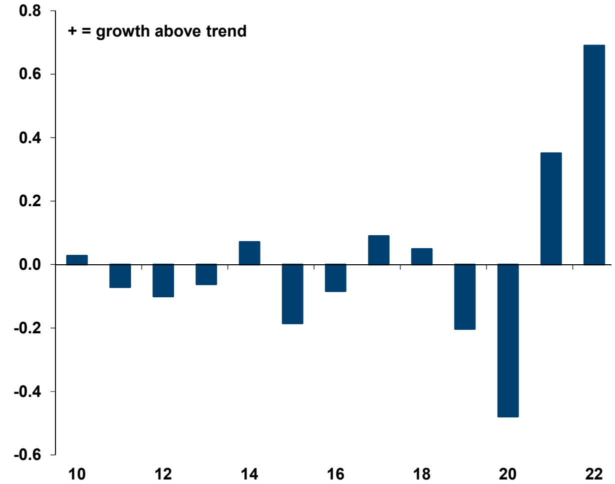
** Seven-day moving average. The last observation is for February 24, 2022.*
Source: Transportation Security Administration (TSA) via Bloomberg

Restaurant Seatings*



** Seven-day moving average. The last observation is for February 24, 2022.*
Source: OpenTable via Bloomberg

National Activity Index*



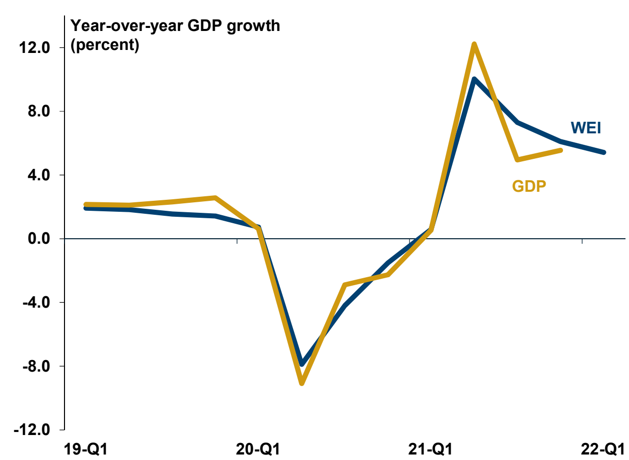
** Annual average data. The reading for 2022 is the observation for February.*
Source: Federal Reserve Bank of Chicago via Haver Analytics

The latest reading on the National Activity Index totaled 0.69, a strikingly high number by historical standards. The index sometimes moves randomly, and thus the Chicago Fed suggests monitoring a three-month moving average. This measure also was strong in January, totaling a still-vigorous 0.42. To provide perspective, 2017 and 2018 were the two strongest years in the previous economic expansion, and the average readings for these years were 0.09 and 0.08 (faster than potential growth). During the tech boom in the late 1990s, the best annual reading was 0.36 in 1997 (chart, above right).

The New York Fed also has a measure worth monitoring: the Weekly Economic Index. The staff of the NY Fed developed this statistic during the early stages of the pandemic in order to monitor the economy in something close to real time. This measure combines 10 indicators that are available on a daily or weekly basis, and it is constructed to track the year-over-year change in GDP growth. As shown in the chart on the right, quarterly averages of this weekly measure do indeed move quite closely with the four-quarter change in GDP.

The WEI so far in Q1 has averaged 5.4 percent, suggesting growth in line with the pace seen last year. The picture could change as weeks pass and additional data become available, but the figures thus far suggest a fine performance in the first quarter.

Weekly Economic Index & GDP*



** The plot for the Weekly Economic Index shows quarterly averages of weekly readings. The observation 2022-Q1 is an average through February 19, 2022. Data for GDP is only available thru 2021-Q4.*
Sources: Bureau of Economic Analysis and Federal Reserve Bank of New York via Haver Analytics

Sources of Growth

Monthly economic reports published on Friday surprised on the upside and provided insights into sources of economic growth in the first quarter. The report on income and consumption showed a jump of 1.5 percent (not annualized!) in real consumer expenditures in January. The unusually large increase followed soft results in the prior month (off 1.3 percent), but the recent data nevertheless set the stage for a solid increase in consumer spending in Q1. Moderate growth in the next two months, say 0.2 to 0.3

percent, would leave the growth of real consumer expenditures in the neighborhood of 3.5 percent in the first three months of the year.

It is not difficult to envision consumer spending advancing at a faster rate than 0.2 to 0.3 percent in February and March. The job market is strong, and the financial positions of many households are healthy. The fiscal support provided by the federal government in 2020 and 2021 allowed for a heavy accumulation of savings, and increases in equity values and home prices have boosted the net worth of many individuals. Even with the recent retreat in stock prices, equity portfolios are far above pre-pandemic levels.

We also are hopeful that business investment in new equipment will support economic growth. After increasing strongly in the early stages of the expansion, outlays for new equipment stalled in the second half of last year (a modest increase in Q4 offset a dip in Q3). That flat performance is surprising in light of a favorable economic outlook and accommodative financial conditions. We suspect that uncertainty generated by the emergence of the Delta variant constrained activity. Virus-related fears seem to be fading, which could open a door to firmer investment spending.

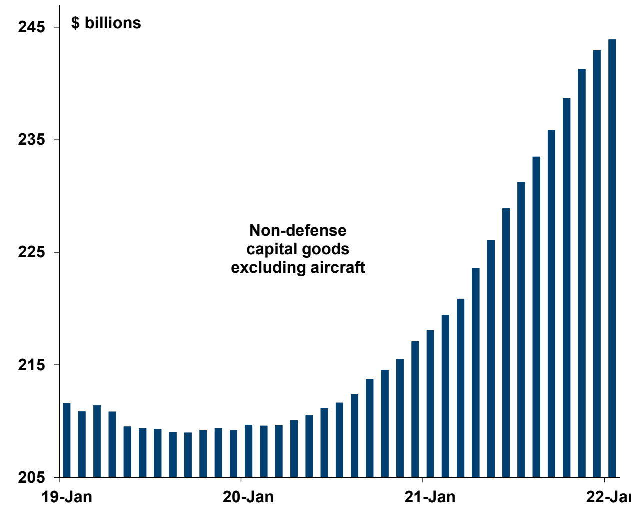
Orders for capital goods other than aircraft also support an optimistic slant on capital spending, as new bookings have increased in 20 of the past 21 months (an inconsequential decline in the other month). We recognize that the rate of growth in orders is beginning to ease and that some of the advance in the past year reflects higher prices. Still, the flow has been strong enough to suspect that real gains are in the pipeline.

Unfilled orders for capital goods offer a more compelling case for growth in equipment spending, as backlogs have traced an exponential-like path in the past two years or so (chart, right). The rate of growth in backlogs also is slowing, and higher prices have undoubtedly played a role in the advance, but a level far above pre-pandemic trends suggests strong activity at some point.

We will be monitoring capital spending by businesses, but inventory investment might have a larger effect on activity. Businesses reacted to supply chain difficulties by drawing down inventories, and stocks are now lean both absolutely and relative to sales (chart). Businesses undoubtedly will be seeking to rebuild inventories this year, but unfortunately, the path is not likely to be smooth. Inventories in ordinary circumstance involve a high degree of volatility, and the random element could be more pronounced in the current setting because of persistent issues on the supply side.

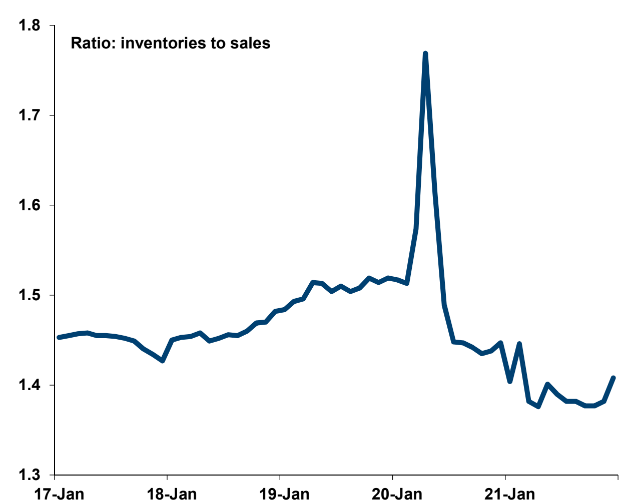
Thus, inventory investment should be a net plus in 2022, and possibly a large one, but soft

Unfilled Orders for Durable Goods



Source: U.S. Census Bureau via Haver Analytics

Real Inventory/Sales Ratio



Source: Bureau of Economic Analysis via Haver Analytics periods will emerge. The first quarter, for example, will probably involve a large negative contribution from inventory investment, reflecting a pause after substantial rebuilding in Q4 (inventory investment accounted for 4.9 percentage points of the 7.0 percent growth in the fourth quarter).

Energy Prices – A Source of Risk

While the economic outlook seems favorable, the jump in energy prices that has accompanied Russia's invasion of Ukraine represents a wild card. The increase will intensify inflation pressure and will constrain economic growth. Some analysts, no doubt, will be talking of stagflation.

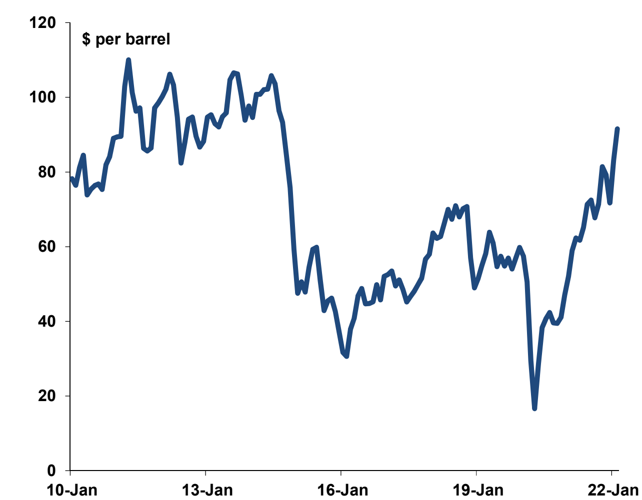
We would not be thinking of stagflation or recession at this point. A crude rule of thumb to guide thinking on the influence of oil prices is that the constraint becomes meaningful when prices exceed previous peaks. Although the previous peak occurred several years ago, the price of West Texas intermediate crude oil is still below prices in the neighborhood of $110 from 2011 to 2014 (chart). Those prices did not disrupt the previous expansion.

Nevertheless, the economy will run cooler with oil prices at the current level of approximately $90 per barrel versus the range of $50 to $75 in the first portion of last year. An increase of this magnitude, if sustained, would lead us to trim the growth outlook by a quarter percentage point or slightly more. We don't see prices at $90 per barrel derailing the expansion.

The conflict between Russia and Ukraine also could slow economic activity by disrupting trade flows. The immediate effect, however, is likely to be negligible, as the U.S. trades little with these nations. Only 0.4 percent of U.S. merchandise exports went to Russia in 2021, and only 1.0 percent of U.S. imports came from Russia. Among the imports, almost 60 percent involved energy related items (crude oil, refined products, and natural gas). Presumably, domestic producers could make up for any energy shortfall from Russia. Trade with Ukraine is almost nonexistent (only 0.1 percent of both exports and imports).

If the conflict persists, the trade consequences could become more severe. European economies will most likely slow because of close trade ties to Russia, and their slowdown will feed back on the United States. However, the high degree of uncertainty surrounding the situation only allows for speculation about such outcomes rather than informed forecasts. Conceivably, fighting could push parties to the negotiating table in the near term, but one can also envision tensions (hot war or cold war) extending for several years.

West Texas Intermediate Crude Oil*



** Monthly average data. The last observation (February) is a quote for February 25, 2022.*

Sources: Energy Information Administration, U.S. Department of Energy and Chicago Mercantile Exchange via Haver Analytics; Bloomberg

Review

Week of Feb. 21, 2022	Actual	Consensus	Comments
Consumer Confidence (February)	**110.5 (-0.5%)**	**110.0 (-3.3%)**	Elevated prices of gasoline and groceries, as well as volatility in the equity market, apparently weighed on consumer moods in February, as the confidence index remained will shy of readings in the upper-120s and low-130s prior to the onset of Covid. Inflation is playing a key role depressing attitudes, but survey respondents view the employment situation much more favorably. The labor market assessment (share of survey respondents reporting that jobs are plentiful less the share indicating that jobs are hard to get) eased in February, but the reading of 42.0% was still among the best in the history of the series.
Revised GDP (2021-Q4)	**7.0% (+0.1 Pct. Pt. Revision)**	**7.0% (+0.1 Pct. Pt. Revision)**	The upward adjustment to Q4 GDP growth was led by construction, as both residential and business-related building were stronger than previously believed. Residential construction inched into the plus column with growth of 1.0% versus an initial estimate of -0.8%. Business-related construction remained weak, but less so than initially estimated (-9.4% versus -11.4%). Growth of consumer spending (3.1% versus 3.3%) and exports (23.6% versus 24.5%) were revised lower, although both still represented firm performances.
New Home Sales (January)	**0.801 Million (-4.5%)**	**0.803 Million (-1.0%)**	Sales of new homes fell in January, but the change occurred from upwardly revised levels in the prior three months (the combined adjustment was equivalent to 3.5 percentage points of growth). The new level of sales trailed brisk readings in the second half of 2020 and first quarter of 2021 (average of 932k, annual rate), but they were above all readings in the prior expansion.
Personal Income, Consumption, Core Price Index (January)	**0.0%, 2.1%, 0.5%**	**-0.3%, 1.6%, 0.5%**	Personal income was constrained in January by a drop in transfer payments because of the expiration of the enhanced child tax credit, but wages and salaries posted a respectable nominal advance (0.5%), and investment and farm income rose as well. On the outlay side, the brisk increase of 2.1% in consumer spending translated to a jump of 1.5% after adjusting for inflation, a reading that sets the stage for solid consumer spending in Q1 (perhaps growth of 3.5%). Jumps in the headline and core PCE price indexes left the year-over-year advances at 6.1% and 5.2%, respectively.
Durable Goods Orders (January)	**1.6%**	**1.0%**	The advance in durable goods orders in January was joined by a notable upward revision to December data (growth of 1.2% versus a decline of 0.7%). Both the gain in January and the revision to December were influenced by orders for commercial aircraft, which rose 15.6% in January; results for December now show an advance of 23.9% rather than a decline of 14.4%. Excluding all transportation items, bookings for durable goods rose 0.7%. The report this month was probably influenced by higher prices across most categories of orders, although a pickup in real activity is likely as well.

Sources: The Conference Board (Consumer Confidence); Bureau of Economic Analysis (Revised GDP, Personal Income, Consumption, Core Price Index); U.S. Census Bureau (New Home Sales, Durable Goods Orders); Consensus forecasts are from Bloomberg

Preview

Week of Feb. 28, 2022	Projected	Comments
U.S. International Trade in Goods (January) (Monday)	**-$98.5 Billion ($2.0 Billion Narrower Deficit)**	Imports of goods could cool in January after a surge of 10.7% in the prior two months, and exports could post a modest increase, led by shipments of automobiles.
ISM Manufacturing Index (February) (Tuesday)	**58.0% (+0.4 Pct. Pt.)**	Omicron likely had an influence on the manufacturing sector in early 2022, but sharp declines in the new orders and production components in January probably overstated the dampening effect.
Construction Spending (January) (Tuesday)	**0.7%**	A firm performance in housing starts in recent months points to a continuation of the upward trend in private residential construction in January (average monthly increase of 1.2% in 2021). Business-related activity has shown improvement in the second half of 2021, averaging increases of 1.0% per month from July thru November before pausing in December, although higher prices are probably a key factor driving the increases.
Revised Nonfarm Productivity (2021-Q4) (Thursday)	**6.6% (Unrevised)**	The output measure that feeds through to the calculation of nonfarm productivity was little changed from the preliminary tally (published with revised GDP on Feb. 24), suggesting that the revised reading on productivity will be close to the first estimate of 6.6%. While productivity growth in Q4 was strong, quarter-to-quarter volatility left a moderate advance of 1.9% for all of 2021.
ISM Services Index (February) (Thursday)	**61.0% (+1.1 Pct. Pts.)**	The sizable drop in the ISM services index in January probably overstated Covid-related softness. The business activity component is likely to rebound in February after a drop of 8.4 index points in the prior month.
Factory Orders (January) (Thursday)	**1.8%**	A jump of 1.6% in durable goods orders (published Feb. 25) was influenced by a surge of 15.6% in civilian aircraft bookings, but orders excluding transportation also posted a sold gain of 0.7% (the 20th advance in the past 21 months). Orders for nondurable goods are likely to mirror the firm performance in durable bookings. Higher prices should boost the petroleum and coal category, and orders ex-petroleum are likely to post their 20th increase in the past 21 months, although higher prices could play a role here as well.
Payroll Employment (February) (Friday)	**450,000**	A drop in Omicron cases and strong demand for labor suggest that payroll growth will nearly match the average of 467k in the prior 12 months. Employment growth reported in the household survey also is likely to be firm, but an increase in the labor force could provide an offset and leave the unemployment rate unchanged at 4.0%.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

February / March 2022

Monday	Tuesday	Wednesday	Thursday	Friday
21	22	23	24	25
PRESIDENTS' DAY	**FHFA HOME PRICE INDEX** Oct 1.1% Nov 1.2% Dec 1.2% **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** SA NSA Oct 1.0% 0.9% Nov 1.2% 1.0% Dec 1.5% 1.1% **CONFERENCE BOARD CONSUMER CONFIDENCE** Dec 115.2 Jan 111.1 Feb 110.5		**UNEMPLOYMENT CLAIMS** Initial Continuing (Millions) Jan 29 0.239 1.619 Feb 05 0.225 1.588 Feb 12 0.249 1.476 Feb 19 0.232 N/A **REVISED GDP** GDP, Chained Price 21-Q3 2.3% 6.0% 21-Q4(a) 6.9% 6.9% 21-Q4(p) 7.0% 7.1% **CHICAGO FED NATIONAL ACTIVITY INDEX** Monthly 3-Mo. Avg. Nov 0.51 0.42 Dec 0.07 0.46 Jan 0.69 0.42 **NEW HOME SALES** Nov 0.749 million Dec 0.839 million Jan 0.801 million	**PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX** Inc. Cons. Core Nov 0.6% 0.6% 0.5% Dec 0.4% -0.8% 0.5% Jan 0.0% 2.1% 0.5% **DURABLE GOODS ORDERS** Nov 3.2% Dec 1.2% Jan 1.6% **PENDING HOME SALES** Nov -2.9% Dec -2.3% Jan -5.7% **REVISED CONSUMER SENTIMENT** Dec 70.6 Jan 67.2 Feb(p) 61.7 Feb(r) 62.8
28	1	2	3	4
U.S. INTERNATIONAL TRADE IN GOODS (8:30) Nov -\$97.3 billion Dec -\$100.5 billion **Jan -\$98.5 billion** **ADVANCE INVENTORIES (8:30)** Wholesale Retail Nov 1.7% 2.0% Dec 2.2% 4.2% Jan -- -- **MNI CHICAGO BUSINESS BAROMETER INDEX (9:45)** Index Prices Dec 64.3 90.9 Jan 65.2 89.0 Feb -- --	**ISM INDEX (10:00)** Index Prices Dec 58.8 68.2 Jan 57.6 76.1 **Feb 58.0 75.0** **CONSTRUCTION SPEND. (10:00)** Nov 0.6% Dec 0.2% **Jan 0.7%** **VEHICLE SALES** Dec 12.5 million Jan 15.0 million **Feb 14.4 million**	**ADP EMPLOYMENT REPORT (8:15)** Private Payrolls Dec 776,000 Jan -301,000 Feb -- **CHAIR POWELL'S MONETARY POLICY TESTIMONY (HOUSE) (10:00)** **BEIGE BOOK (2:00)** **January 2022 Beige Book** "Economic activity across the United States expanded at a modest pace in the final weeks of 2021. Contacts from many Districts indicated growth continued to be constrained by ongoing supply chain disruptions and labor shortages."	**INITIAL CLAIMS (8:30)** **REVISED PRODUCTIVITY & COSTS (8:30)** Productivity Unit Labor Costs 21-Q3 -5.0% 9.3% 21-Q4(p) 6.6% 0.3% **21-Q4(r) 6.6% 0.3%** **ISM SERVICES INDEX (10:00)** Index Prices Dec 62.3 83.9 Jan 59.9 82.3 **Feb 61.0 80.0** **FACTORY ORDERS (10:00)** Nov 1.8% Dec 0.5% **Jan 1.8%** **CHAIR POWELL'S MONETARY POLICY TESTIMONY (SENATE) (10:00)**	**EMPLOYMENT REPORT (8:30)** Payrolls Un. Rate Dec 510,000 3.9% Jan 467,000 4.0% **Feb 450,000 4.0%**
7	8	9	10	11
CONSUMER CREDIT	**NFIB SMALL BUSINESS OPTIMISM** **TRADE BALANCE** **WHOLESALE TRADE**	**JOB OPENINGS & LABOR TURNOVER SURVEY**	**INITIAL CLAIMS** **CPI** **FEDERAL BUDGET**	**CONSUMER SENTIMENT**
14	15	16	17	18
	PPI **EMPIRE MFG INDEX** **TIC DATA** **FOMC MEETING**	**RETAIL SALES** **IMPORT/EXPORT PRICES** **BUSINESS INVENTORIES** **NAHB HOUSING INDEX** **FOMC DECISION**	**INITIAL CLAIMS** **HOUSING STARTS** **PHILY FED INDEX** **IP & CAP-U**	**EXISTING HOME SALES** **LEADING INDICATORS**

Forecasts in Bold. (a) = advance (1st estimate of GDP); (p) = preliminary (2nd estimate of GDP); (r) = revised

Treasury Financing

February / March 2022

Monday	Tuesday	Wednesday	Thursday	Friday
21	22	23	24	25
PRESIDENTS' DAY	**AUCTION RESULTS:** Rate / Cover 13-week bills 0.380% 3.07 26-week bills 0.710% 2.75 52-week bills 1.145% 2.81 2-year notes 1.553% 2.64 **ANNOUNCE:** $45 billion 4-week bills for auction on February 24 $35 billion 8-week bills for auction on February 24 $35 billion 17-week CMBs for auction on February 23 **SETTLE:** $50 billion 4-week bills $40 billion 8-week bills $40 billion 17-week CMBs	**AUCTION RESULTS:** Margin / Cover 2-year FRN -0.050% 3.22 Rate / Cover 5-year notes 1.880% 2.49 17-week CMB 0.570% 3.16	**AUCTION RESULTS:** Rate / Cover 4-week bills 0.050% 2.78 8-week bills 0.200% 3.70 7-year notes 1.905% 2.36 **ANNOUNCE:** $111 billion 13-,26-week bills for auction on Feb. 28 **SETTLE:** $111 billion 13-,26-week bills $34 billion 52-week bills	**SETTLE:** $22 billion 2-year FRNs
28	1	2	3	4
AUCTION: $111 billion 13-,26-week bills **SETTLE:** $19 billion 20-year bonds $9 billion 30-year TIPS $52 billion 2-year notes $53 billion 5-year notes $50 billion 7-year notes	**ANNOUNCE:** $45 billion* 4-week bills for auction on March 3 $35 billion* 8-week bills for auction on March 3 $35 billion* 17-week CMBs for auction on March 2 **SETTLE:** $45 billion 4-week bills $35 billion 8-week bills $35 billion 17-week CMBs	**AUCTION:** $35 billion* 17-week CMBs	**AUCTION:** $45 billion* 4-week bills $35 billion* 8-week bills **ANNOUNCE:** $111 billion* 13-,26-week bills for auction on March 7 $48 billion* 3-year notes for auction on March 8 $34 billion* 10-year notes for auction on March 9 $20 billion* 30-year bonds for auction on March 10 **SETTLE:** $111 billion 13-,26-week bills	
7	8	9	10	11
AUCTION: $111 billion* 13-,26-week bills	**AUCTION:** $48 billion* 3-year notes **ANNOUNCE:** $45 billion* 4-week bills for auction on March 10 $35 billion* 8-week bills for auction on March 10 $35 billion* 17-week CMBs for auction on March 9 **SETTLE:** $45 billion* 4-week bills $35 billion* 8-week bills $35 billion* 17-week CMBs	**AUCTION:** $34 billion* 10-year notes $35 billion* 17-week CMBs	**AUCTION:** $45 billion* 4-week bills $35 billion* 8-week bills $20 billion* 30-year bonds **ANNOUNCE:** $111 billion* 13-,26-week bills for auction on March 14 **SETTLE:** $111 billion* 13-,26-week bills	
14	15	16	17	18
AUCTION: $111 billion* 13-,26-week bills	**ANNOUNCE:** $45 billion* 4-week bills for auction on March 17 $35 billion* 8-week bills for auction on March 17 $35 billion* 17-week CMBs for auction on March 16 **SETTLE:** $45 billion* 4-week bills $35 billion* 8-week bills $35 billion* 17-week CMBs $48 billion* 3-year notes $34 billion* 10-year notes $20 billion* 30-year bonds	**AUCTION:** $35 billion* 17-week CMBs	**AUCTION:** $45 billion* 4-week bills $35 billion* 8-week bills **ANNOUNCE:** $111 billion* 13-,26-week bills for auction on March 21 $34 billion* 52-week bills for auction on March 22 $22 billion* 2-year FRNs for auction on March 23 $16 billion* 20-year bonds for auction on March 23 $14 billion* 10-year TIPS for auction on March 24 **SETTLE:** $111 billion* 13-,26-week bills	

**Estimate*