Daiwa Capital Markets

U.S. Economic Comment

- Monetary policy: notable tightening still in store
- Labor market: another perspective on tightness

Michael Moran
Lawrence Werther
Daiwa Capital Markets America
michael.moran@us.daiwacm.com
lawrence.werther@us.daiwacm.com

FOMC: Still Hawkish

Many market participants, at least initially, viewed Fed Chair Powell as sending market friendly signals in his latest press conference, which led to a stock market surge on Wednesday afternoon. We view this interpretation as badly misplaced. The essence of Chair Powell's message was that the Fed is disturbed by the recent inflation performance and the Federal Open Market Committee is focused on moving to a policy setting that will reduce price pressure. He set this theme in his opening comment ("It is essential that we bring inflation down if we are to have a sustained period of strong labor market conditions that benefit all"), and he carried it throughout the Q&A session.

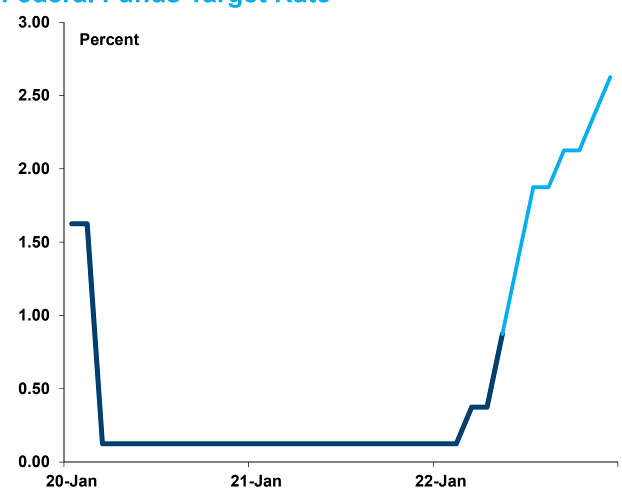
Those who saw dovish leanings must have been focusing on headlines that trickled across wire services, which could be misleading if taken out of context. Individuals listening to the conference most likely would have concluded that considerable policy tightening is likely in the months ahead.

To be sure, Mr. Powell made some remarks that lent themselves to misinterpretation. For example, he argued that the U.S. is not experiencing a wage-price spiral, and he indicated that he expects job growth to slow from the recent brisk pace. Most notable, he indicated that the Federal Open Market Committee was not actively considering changes of 75 basis points.

However, he also noted that changes of 50 basis points would be on the table at the next two FOMC meetings, which we viewed as a signal that such changes were all but certain. Also, he said that the Committee would be moving "expeditiously" to a suitable policy stance. ("Expeditious" seems to be a new buzzword for Fed officials, as it appeared in the minutes of the March FOMC meeting, and Chair Powell used the term freely in his press conference.)

Reporters at the press conference asked, in several different ways, about moving to a restrictive policy stance and about the possibility of triggering a recession. Chair Powell argued that there was a path to a soft landing, and he was hopeful that Fed officials could navigate the difficult course. However, he also recognized that the path was a narrow one and that downside risks were considerable. He noted that he was willing to move to a restrictive stance if this was necessary to contain inflation. He was careful to avoid the R-word, but we viewed his comments as suggesting that a downturn was a better outcome than allowing inflation to become engrained into the economy.

Federal Funds Target Rate*



** The light blue line is Daiwa's projection for the federal funds target rate.*
Sources: Federal Reserve Board via Haver Analytics; Daiwa Capital Markets America

Chair Powell frequently mentioned inflation expectations and the importance of keeping them contained. A reporter asked Mr. Powell if he sensed that inflation psychology had changed recently. The Chair indicated that short-term expectations had increased but long-term views were still reasonably well contained. However, he also noted that he had no basis to feel comfortable about expectations remaining stable. He seemed to recognize that long-term expectations could become unmoored if inflation did not decelerate soon.

We were struck by Chair Powell's views on the sources of inflation. He noted the usual supply-side factors (Covid-related lockdowns, damaged supply chains, the Russian invasion of Ukraine), but he also indicated that demand was playing a key role in driving prices higher ("there is a job to do on demand"). This is as close as the Fed will get to admitting that it has played a role in the current bout of inflation. Recognizing the Fed's role in fueling inflation, Mr. Powell seemed to be accepting responsibility for undoing the damage.

Given these views at the press conference, we are hard pressed to see how anyone could conclude that Chair Powell was starting to edge away from plans for aggressive tightening.

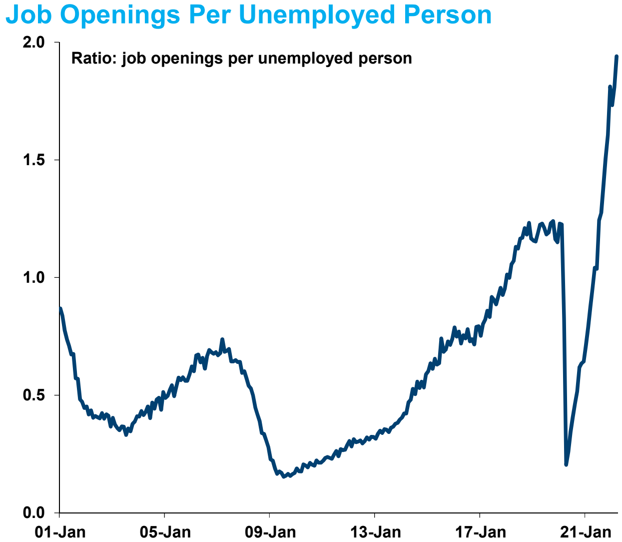
The Tight Labor Market: A New Perspective

Chair Powell, as he has in the past, highlighted tight conditions in the labor market as a sign of underlying strength in the economy and as a justification for a shift in monetary policy. The Bureau of Labor Statistics had just published another record reading on job openings to support the Chair's view, and Mr. Powell noted the lofty reading on the ratio of job openings to the number of unemployed: 1.9 jobs for every unemployed person, far above any tally in the past (chart, below left).

Chair Powell on two occasions in the press conference mentioned a related construct: the so-called Beveridge curve. The Beveridge curve is derived from a scatter plot of the job opening rate and the unemployment rate. Such a plot reveals a curve that slopes downward and to the right: periods of high unemployment are associated with few job openings, while elevated job openings are associated with low unemployment (chart, below right).

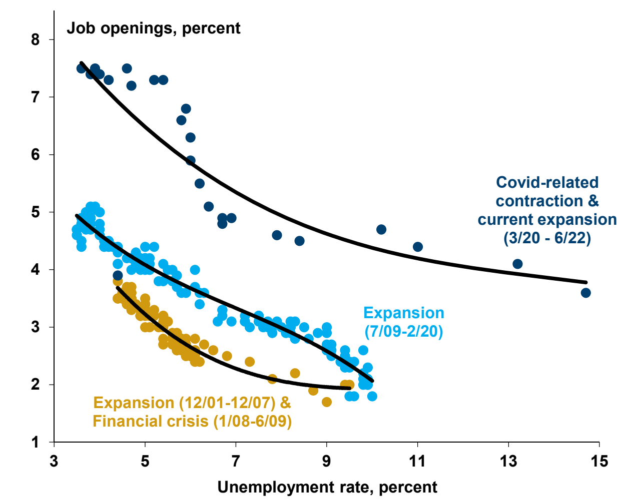
The inverse relationship between the job-opening rate and the unemployment rate is not especially illuminating, but shifts in the curve can provide insights into underlying changes in the economy. For example, outward shifts in the curve away from the origin show some type of impediment in the hiring process. That is, a given job-opening rate is associated with more unemployment than existed in another period. As shown in the chart below (right), the curve shifted outward in the expansion after the financial crisis, perhaps because

Job Openings Per Unemployed Person



Source: Bureau of Labor Statistics via Haver Analytics

Beveridge Curve



Sources: Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America employers were more cautious in hiring after the deep downturn in 2008-09. Alternatively, with technological frontiers moving outward, workers might not have had the skills needed for jobs available at that time.

The curve has made a dramatic shift in the current cycle, signaling profound changes in the labor market. Explanations for the shift are generally well understood. Covid has led many individuals to drop out of the labor force, either because of dependent-care responsibilities or fear of catching the virus, which has led to low unemployment and greater efforts by businesses to replace these individuals. Covid also has led many workers to reevaluate life's priorities, which has led them to retire earlier than they would have otherwise. The generous support provided by the federal government, along with pronounced increases in asset values, has provided the financial wherewithal for some to pursue other alternatives for a time. Whatever the cause, the marked shift in the Beveridge curve shows that the labor market is markedly different (tighter) than in the past. The Fed views potential wage pressure in this setting as a marked inflation risk.

Review

Week of May 2, 2022	Actual	Consensus	Comments
ISM Manufacturing Index (April)	**55.4 (-1.7 Index Pts.)**	**57.6 (+0.5 Index Pt.)**	The drop in the ISM manufacturing index marked the fourth meaningful decline in the past five months. The level of the headline index was still respectable by historical standards, but recent shifts signal a loss of vigor in manufacturing. The employment index led the drop with a decline of 5.4 index points. The decline might be viewed as random volatility, as it followed a high-side reading in March, but the level of the index at 50.9 was disappointing. The new orders and production components fell only modestly in April, but they had lost ground in earlier months and the new levels of approximately 53.5 were less than impressive. The supplier delivery index contributed positively to the headline measure with an increase of 1.8 index points to 67.2, but this elevated reading signaled continued problems in supply chains rather than positive news for the manufacturing sector.
Construction Spending (March)	**0.1%**	**0.8%**	Private residential building accounted for all of the increase in total construction activity in March with a gain of 1.0%, which added to a solid upward trend. Private non-residential construction fell 1.2%, ending a string of eight monthly increases. Government-related building dipped 0.3%, continuing a pattern of small changes that has traced a sideways path in the past five months.
Factory Orders (March)	**2.2%**	**1.2%**	Orders for durable goods rose 1.1% in March (revised from 0.8% published last week). Aircraft orders (civilian and defense combined) fell 13.7%, which constrained total durable orders; bookings ex transportation rose 1.4% (revised from 1.1% in the preliminary report), the 21st increase in the past 23 months. Nondurable bookings jumped 3.2%. A large portion of the gain reflected a surge of 11.9% in orders for petroleum and coal products, much of which likely was the result of higher prices. Orders excluding petroleum and coal advanced 0.6%, the 22nd gain in the past 23 months. As in the petroleum and coal category, higher prices likely boosted the value of nominal bookings of both durable and nondurable goods.
Job Openings & Labor Turnover (March)	**11.549 Million Job Openings**	**11.200 Million Job Openings**	The JOLTS report again showed robust conditions in the labor market, with job openings in March representing a new record high. The latest tally inched above the previous record of 11.448 million in December of last year, and it exceeded by a wide margin the pre-pandemic record of 7.558 million in November 2018. With jobs readily available, workers quit in record numbers in March (4.536 million versus the previous record of 4.510 million last November and the pre-pandemic high of 3.624 million in July 2019). The quit rate matched the record high of 3.0%.

Review Continued

Week of May 2, 2022	Actual	Consensus	Comments
Trade Balance (March)	**-$109.8 ($20.0 Billion Wider Deficit)**	**-$107.1 ($17.9 Billion Wider Deficit)**	Both sides of the trade ledger showed strong results in March, as exports rose 5.6% and imports surged 10.3%, but the notably larger advance imports led to pronounced deterioration in the monthly trade deficit. The slippage was evident in the Q1 GDP report, where net exports subtracted 3.2 percentage points from GDP growth.
ISM Services Index (April)	**57.1 (-1.2 Index Pts.)**	**58.5 (+0.2 Index Pt.)**	The decline in the ISM services index in April was the fourth in the past five months, with the latest observation off sharply from the record high reading of 68.4 in November of last year. However, the April reading was solid from a longer-term perspective, topping the average reading of 55.5 in the prior expansion. The new orders index made the largest negative contribution, falling 5.5 index points to 54.6, a reading in the low portion of the range of the current expansion. The employment index also made a notable negative contribution, sliding 4.5 index points to 49.5. In contrast to new orders and employment, the business activity index remained on firm ground, with a gain of 3.6 index points to 59.1. The supplier deliveries component rose 1.7 index points to 65.1, indicating that supply-chain issues remain problematic. Moreover, supply and logistics constraints and elevated input prices contributed to the price index jumping to a new record (84.6).
Nonfarm Productivity (22-Q1)	**-7.5%**	**-5.3%**	A jump in hours worked (5.5%, annual rate) and decline in output (-2.4%) led to the weak reading on productivity in Q1. The results in Q1 were disappointing, but they should be interpreted cautiously because productivity growth often moves erratically. A longer-term moving average (8-quarter perspective), which smooths quarter-to-quarter volatility, totaled 1.8%. This pace is respectable from a longer term perspective, but it is less-than-impressive for the early stages of a business expansion, when business restructurings and new-found efficiencies typically generate productivity jumps in the neighborhood of 3% to 4%. With productivity growth soft in Q1, unit labor costs surged 11.6%, a reading is in the upper portion of the historical range.
Payroll Employment (April)	**428,000**	**380,000**	The advance in nonfarm payrolls in April lagged by a wide margin the average advance of 593,000 in the prior six months. Combined downward revisions of 39,000 in February and March added an element of softness. The unemployment rate held steady in April at 3.6%, reflecting nearly identical declines in employment as measured by the household survey and the size of the labor force (off 353,000 and 363,000, respectively). The declines were disappointing, but these series often move erratically and prior months had shown strong results. Average hourly earnings rose 0.3%, below the recent average of 0.4% and light considering the degree of tightness in the labor market. The change left the year-over-year increase at 5.5%, one tick lower than the reading in March but above all other months in the past year.

Sources: Institute for Supply Management (ISM Manufacturing Index, ISM Services Index); U.S. Census Bureau (Construction Spending, Factory Orders); Bureau of Labor Statistics (Job Openings & Labor Turnover, Nonfarm Productivity, Payroll Employment); Bureau of Economic Analysis (Trade Balance); Consensus forecasts are from Bloomberg

Preview

Week of May 9, 2022	Projected	Comments
CPI (April) (Wednesday)	**0.2% Total, 0.3% Core**	Available quotes suggest that energy prices cooled in April, but food prices are likely to continue moving along a sharp upward trajectory (average gain of 0.8% in the past nine months, including increases of 1.0% in February and March). In the core component, residential rents could remain under pressure, but prices of used cars and hotel stays may have peaked and could provide a partial offset to expected increases elsewhere.
Federal Budget (April) (Wednesday)	**$300.0 Billion Surplus**	Federal revenues in April appear likely to almost double on a year-over-year basis, but much of the spectacular growth reflects the postponement last year of the tax filing deadline for final payments of 2020 obligations. A strong economy and firm income growth, along with capital gains generated by rising asset values, also contributed to revenue growth. Recent spending by the federal government has been elevated relative to historical norms, but it has eased substantially from levels during the pandemic. If the forecast is realized, the deficit for the first seven months of FY2022 would total $368 billion, down from $1.93 trillion in the same period in FY2021.
PPI (April) (Thursday)	**0.5% Total, 0.7% Ex. Food & Energy**	Prices of wholesale energy products likely eased in April after increasing at an average rate of 2.6% in the prior 12 months. Food prices are likely to remain under pressure (up 1.3% per month on average since April 2021). Goods prices excluding food and energy have surged (+0.8% per month in the past year, including an increase of 1.1% in March). Higher input prices and supply disruptions are likely to sustain price pressures in goods ex. food and energy in April. Services prices have increased briskly as well (average increase of 0.7% per month in the past year).
Consumer Sentiment (May) (Friday)	**64.0 (-1.8%)**	Elevated prices of gasoline and groceries suggest that consumer sentiment will remain depressed in early May. The retreat in equity values also could sour moods. The expected reading will be the 9th in the past 10 months below the recession low of 71.8 in April 2022.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

May 2022

Monday 2

ISM INDEX

	Index	Prices
Feb	58.6	75.6
Mar	57.1	87.1
Apr	55.4	84.6

CONSTRUCTION SPEND.

Jan	3.0%
Feb	0.5%
Mar	0.1%

Tuesday 3

FACTORY ORDERS

Jan	1.5%
Feb	0.1%
Mar	2.2%

JOLTS DATA

	Openings (000)	Quit Rate
Jan	11,283	2.8%
Feb	11,344	2.9%
Mar	11,549	3.0%

VEHICLE SALES

Feb	14.0 million
Mar	13.4 million
Apr	14.3 million

FOMC MEETING

Wednesday 4

ADP EMPLOYMENT REPORT

	Private Payrolls
Feb	601,000
Mar	479,000
Apr	247,000

TRADE BALANCE

Jan	-$89.2 billion
Feb	-$89.8 billion
Mar	-$109.8 billion

ISM SERVICES INDEX

	Index	Prices
Feb	56.5	83.1
Mar	58.3	83.8
Apr	57.1	84.6

FOMC DECISION

POWELL PRESS CONFERENCE

Thursday 5

UNEMPLOYMENT CLAIMS

	Initial (Millions)	Continuing
Apr 09	0.186	1.407
Apr 16	0.185	1.403
Apr 23	0.181	1.384
Apr 30	0.200	N/A

PRODUCTIVITY & COSTS

	Productivity	Unit Labor Costs
21-Q3	-3.9%	10.6%
21-Q4	6.3%	1.0%
22-Q1	-7.5%	11.6%

Friday 6

EMPLOYMENT REPORT

	Payrolls	Un. Rate
Feb	714,000	3.8%
Mar	428,000	3.6%
Apr	428,000	3.6%

CONSUMER CREDIT

Jan	$17.0 billion
Feb	$37.7 billion
Mar	$52.4 billion

Monday 9

WHOLESALE TRADE (10:00)

	Inventories	Sales
Jan	1.2%	5.0%
Feb	2.6%	1.7%
Mar	**2.3%**	**1.5%**

Tuesday 10

NFIB SMALL BUSINESS OPTIMISM INDEX (6:00)

Feb	95.7
Mar	93.2
Apr	--

Wednesday 11

CPI (8:30)

	Total	Core
Feb	0.8%	0.5%
Mar	1.2%	0.3%
Apr	**0.2%**	**0.3%**

FEDERAL BUDGET (2:00)

	2022	2021
Feb	-$216.6B	-$310.9B
Mar	-$192.7B	-$659.6B
Apr	**$300.0B**	-$225.6B

Thursday 12

INITIAL CLAIMS (8:30)

PPI (8:30)

	Final Demand	Ex. Food & Energy
Feb	0.9%	0.4%
Mar	1.4%	1.0%
Apr	**0.5%**	**0.7%**

Friday 13

IMPORT/EXPORT PRICES (8:30)

	Non-petrol. Imports	Nonagri. Exports
Feb	0.7%	3.0%
Mar	1.1%	4.5%
Apr	--	--

CONSUMER SENTIMENT (10:00)

Mar	59.4
Apr	65.2
May	**64.0**

Monday 16

EMPIRE MFG INDEX

TIC DATA

Tuesday 17

RETAIL SALES

IP & CAP-U

BUSINESS INVENTORIES

NAHB HOUSING INDEX

Wednesday 18

HOUSING STARTS

Thursday 19

INITIAL CLAIMS

PHILY FED INDEX

EXISTING HOME SALES

LEADING INDICATORS

Friday 20

Monday 23

CHICAGO FED NATIONAL ACTIVITY INDEX

Tuesday 24

NEW HOME SALES

Wednesday 25

DURABLE GOODS ORDERS

FOMC MINUTES

Thursday 26

INITIAL CLAIMS

REVISED GDP

PENDING HOME SALES

Friday 27

U.S. INTERNATIONAL TRADE IN GOODS

ADVANCE INVENTORIES

PERSONAL INCOME, CONSUMPTION, PRICE INDEXES

REVISED CONSUMER SENTIMENT

Forecasts in Bold.

Treasury Financing

May 2022

Monday	Tuesday	Wednesday	Thursday	Friday
2	3	4	5	6
AUCTION RESULTS: Rate Cover 13-week bills 0.910% 3.27 26-week bills 1.420% 2.99 **SETTLE:** $16 billion 20-year bonds $24 billion 2-year FRNs $48 billion 2-year notes $49 billion 5-year notes $44 billion 7-year notes	**ANNOUNCE:** $35 billion 4-week bills for auction on May 5 $30 billion 8-week bills for auction on May 5 $30 billion 17-week CMBs for auction on May 4 **SETTLE:** $35 billion 4-week bills $30 billion 8-week bills $30 billion 17-week CMBs	**AUCTION RESULTS:** Rate Cover 17-week CMB 1.225% 3.31 **ANNOUNCE MID-QUARTER REFUNDING:** $45 billion 3-year notes for auction on May 10 $36 billion 10-year notes for auction on May 11 $22 billion 30-year bonds for auction on May 12	**AUCTION RESULTS:** Rate Cover 4-week bills 0.490% 3.06 8-week bills 0.710% 3.55 **ANNOUNCE:** $87 billion 13-,26-week bills for auction on May 9 **SETTLE:** $87 billion 13-,26-week bills	6
9	10	11	12	13
AUCTION: $87 billion 13-,26-week bills	**AUCTION:** $45 billion 3-year notes **ANNOUNCE:** $35 billion* 4-week bills for auction on May 12 $30 billion* 8-week bills for auction on May 12 $30 billion* 17-week CMBs for auction on May 11 **SETTLE:** $35 billion 4-week bills $30 billion 8-week bills $30 billion 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs $36 billion 10-year notes	**AUCTION:** $35 billion* 4-week bills $30 billion* 8-week bills $22 billion 30-year bonds **ANNOUNCE:** $87 billion* 13-,26-week bills for auction on May 16 $34 billion* 52-week bills for auction on May 17 $17 billion* 20-year bonds for auction on May 18 $14 billion* 10-year TIPS for auction on May 19 **SETTLE:** $87 billion 13-,26-week bills	
16	17	18	19	20
AUCTION: $87 billion* 13-,26-week bills **SETTLE:** $45 billion 3-year notes $36 billion 10-year notes $22 billion 30-year bonds	**AUCTION:** $34 billion* 52-week bills **ANNOUNCE:** $35 billion* 4-week bills for auction on May 19 $30 billion* 8-week bills for auction on May 19 $30 billion* 17-week CMBs for auction on May 18 **SETTLE:** $35 billion* 4-week bills $30 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs $17 billion* 20-year bonds	**AUCTION:** $35 billion* 4-week bills $30 billion* 8-week bills $14 billion* 10-year TIPS **ANNOUNCE:** $87 billion* 13-,26-week bills for auction on May 23 $22 billion* 2-year FRNs for auction on May 25 $47 billion* 2-year notes for auction on May 24 $48 billion* 5-year notes for auction on May 25 $42 billion* 7-year notes for auction on May 26 **SETTLE:** $87 billion* 13-,26-week bills $34 billion* 52-week bills	
23	24	25	26	27
AUCTION: $87 billion* 13-,26-week bills	**AUCTION:** $47 billion* 2-year notes **ANNOUNCE:** $35 billion* 4-week bills for auction on May 26 $30 billion* 8-week bills for auction on May 26 $30 billion* 17-week CMBs for auction on May 25 **SETTLE:** $35 billion* 4-week bills $30 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs $22 billion* 2-year FRNs $48 billion* 5-year notes	**AUCTION:** $35 billion* 4-week bills $30 billion* 8-week bills $42 billion* 7-year notes **ANNOUNCE:** $87 billion* 13-,26-week bills for auction on May 31 **SETTLE:** $87 billion* 13-,26-week bills	**SETTLE:** $22 billion* 2-year FRNs

*Estimate