U.S. Economic Comment

- U.S. economy: favorable prospects for Q2 after a slow Q1… …bigger challenges thereafter
- QT: unwinding a massive program

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The U.S. Economy

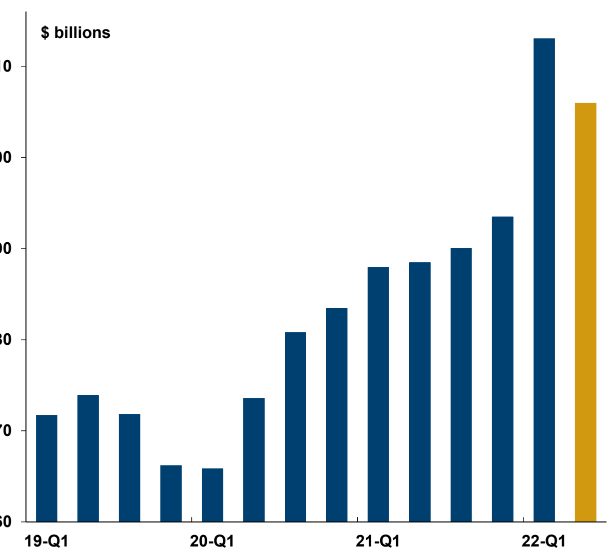
Revised GDP estimates confirmed that the United States economy started the year on a soft note, as output declined 1.5 percent (versus an initial estimate of -1.4 percent). The contraction represented a marked shift from a favorable performance in 2021, when the economy grew 5.5 percent over the four quarters of the year. However, the retreat in Q1 largely reflected pronounced shifts in net exports and inventory investment, components of GDP that often move erratically. We suspect that much of the constraining influence in the first quarter represented statistical noise that will reverse in the second quarter and leave a respectable pace of growth. We expect growth in Q2 to exceed two percent, but we see three percent as a reach.

Economic reports on Friday brought the first bit of information on these volatile components for the second quarter. We were most interested in net exports because they had the strongest influence on GDP growth in Q1, subtracting 3.2 percentage points from overall growth. Results in April indeed suggested that noise played a role in the first quarter. Imports fell sharply in April, reversing much of what now appears to be an aberrant surge in March. Exports performed well, posting solid growth after a jump in March and adding substantially to what had been a mild upward trend.

The nominal trade deficit in goods remained quite wide in April, but it improved substantially from that in Q1 (chart), raising the possibility of a positive contribution in Q2. The figures for April are not price adjusted, and the picture could look much different in real terms. However, the changes appeared strong enough to suggest improvement after adjusting for inflation.

We also saw figures on inventories for April. Businesses continued to add to stocks at a brisk pace, which will add to the *level* of GDP. However the rate of increase was slower than the average in the first quarter (1.1 percent versus an average of 1.8 percent in Q1), which suggests a slowing in the *growth* of GDP. Given this configuration, the early results suggest another negative contribution from inventory investment to GDP growth. It's early and the picture easily could change, but the April figure suggests a drag similar to, possibly larger than, the subtraction of 1.1 percentage points in the first quarter.

Nominal Goods Trade Deficit*

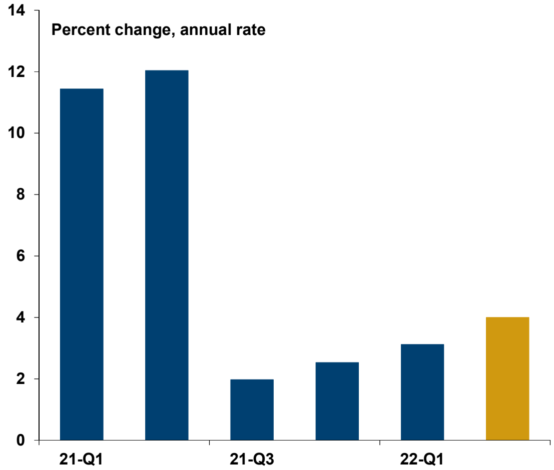


** Quarterly averages of monthly data. The reading for 2022-Q2 (gold bar) is the monthly result for April.*
Sources: U.S. Census Bureau via Haver Analytics; Daiwa Capital Markets America

Consumer spending was a bright spot in the first quarter, advancing 3.1 percent, and the April report on income and consumption raises the prospect of even firmer support in the second quarter. The report on income and consumption released on Friday showed a nominal advance in consumer expenditures of 0.9 percent in April, which translated to a real gain of 0.7 percent. Given this strong start to the quarter, we are thinking in terms of four-to-five percent growth in real consumer spending in Q2 (chart, left).

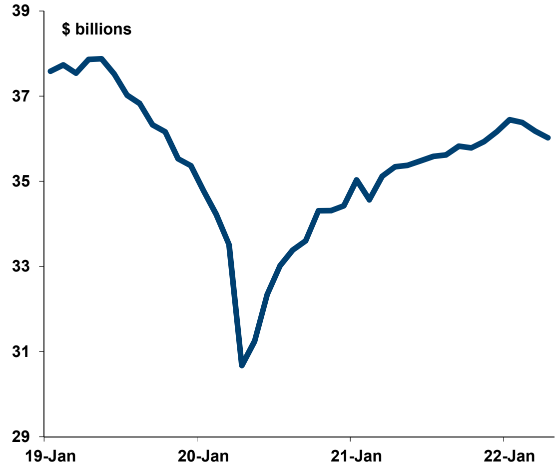
Business investment in new equipment was another bright spot in Q1, but we are less hopeful for the second quarter. Shipments of nondefense capital goods other than aircraft rose 0.8 percent in April, but this advance most likely was driven by higher prices rather than real activity (the PPI for capital goods rose 1.2 percent in April). The downward tilt now evident in real shipments of capital goods suggests a soft outlook for equipment spending (chart, right).

Real Consumer Spending*



** The reading for 2022-Q2 (gold bar) is a projection based on results for April.*
Sources: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

Real Shipments of Nondefense Capital Goods*



** Nominal shipments of nondefense capital goods excluding aircraft adjusted by the final demand: private capital equipment component of the PPI.*
Sources: Bureau of Labor Statistics and U.S. Census Bureau via Haver Analytics; Daiwa Capital Markets America

Beyond Q2

After a good performance in the second quarter, we expect growth to slow in the second half of the year to a pace of 1.0 to 1.5 percent. Additional tightening in monetary policy represents the most important factor slowing the economy. Higher short-term interest rates will tighten financial conditions in a broad sense (higher long-term rates, wider credit spreads, lower asset prices, and a firmer foreign exchange value of the dollar). Several sectors are likely to slow in response, including housing, consumer durable goods, and business investment.

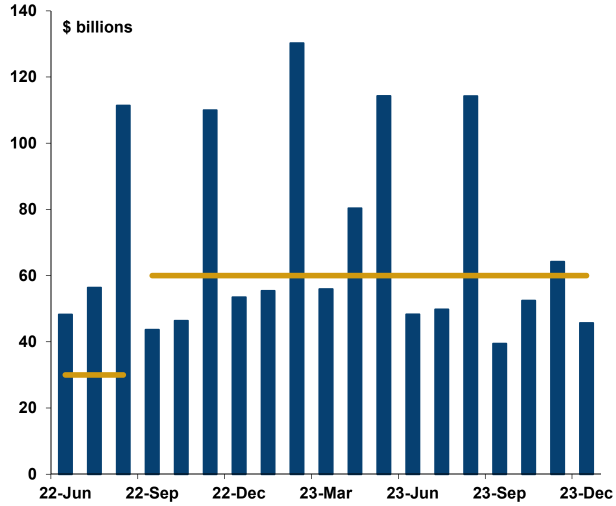
We also would note that the degree of uncertainty now present seems higher than normal. With Covid still lurking as an issue, and with the Russia-Ukraine conflict ongoing, the outlook is especially hazy, which could constrain activity further. In this regard, the minutes from the FOMC's May meeting noted that "business contacts were reportedly hesitant to expand capacity or had postponed construction projects."

Quantitative Tightening

After abandoning its quantitative easing effort in the latter part of March, the Federal Reserve will soon begin to reverse the process by redeeming maturing Treasury securities and repayments of mortgage backed securities. The first redemption of Treasuries will occur on June 15, when the Fed's holdings of $14.9 billion of three-year notes mature. The second round will occur at the end of the month, when two-year, five-year, and seven-year issues mature. Maturing Treasuries in the Fed's portfolio are above the $30 billion cap for redemptions over the next three months. Thereafter, when the cap jumps to $60 billion, several months will have a lighter volume of maturing coupon securities (chart, next page). In such instances, the Fed will redeem some of its holdings of $326 billion of bills to reach the $60 billion of planned monthly redemptions.

The trading desk of the New York Fed will announce on June 13 (the ninth business day of the month) the anticipated amount of MBS repayments and its plans for redemption or reinvestment, with the desk redeeming $17.5 billion and reinvesting any repayments above this cap. The required MBS transactions will take place over the balance of June and into early July, when a new set of plans will be announced on the ninth business day of the month (and on all subsequent ninth business days). The cap of $17.5 billion will be in place through August, then jump to $35 billion.

Fed Portfolio: Maturing Treasury Securities*



** The gold lines show the caps on redemptions of maturing Treasury securities ($30 billion for June through August and then $60 billion thereafter).*

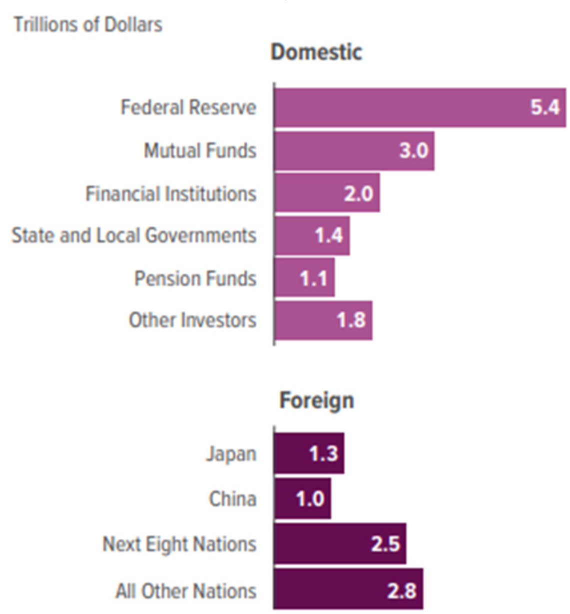
Sources: Federal Reserve Bank of New York and Federal Open Market Committee

Quantitative easing and tightening are relatively new instruments in the Fed's tool kit, and officials view them as a supplementary source of support or constraint; the federal funds rate is the preferred policy variable. The Fed prefers interest rate control because its long history of operating under this framework gives it a good sense of how the economy might respond to policy changes; officials are less certain of how QE and QT might influence the economy. We suspect, however, that the latest round of QE provided a good push to the economy (and QT might now provide notable restraint). The quick recovery from the Covid-related recession and the recent spurt of inflation suggest that QE provided stimulus; elevated asset prices also support this view.

The budget report from the Congressional Budget Office published this week offered another reason to believe that QE has provided substantial economic support. The CBO report discussed federal debt extensively, including a graphic on the investors in Treasury securities (see below). The role of the Federal Reserve is striking, as it is the dominant investor in the market, holding approximately one-quarter of Treasury debt held by the public. Commentators sometimes note the large volume of Treasury securities held by Japanese and Chinese investors, often fretting about the potential influence of these investors on the market. However, the Fed's portfolio dwarfs the aggregate investment of the Japanese and Chinese, and its potential influence is thus far larger.

It was quantitative easing that led to the Fed's elevated holdings of Treasury securities. Before the start of the first episode of asset purchases in 2009, the Fed held approximately 8.2 percent of outstanding marketable Treasury securities, which would put it in the middle of the pack of key investors. That share ballooned to 19.9 percent in late 2014 when the QE effort ended, and it eased back to 12.9 percent in late 2019 after a two-year period of security redemptions. The Covid-related purchase program was much more aggressive than the effort after the financial crisis, and thus the Fed now stands out as the elephant in the middle of the Treasury market.

Holders of Federal Debt, 2021



Source: The Budget and Economic Outlook: 2022 to 2032. (2022, May). Congressional Budget Office. https://www.cbo.gov/publication/58147

Fed officials do not have extensive experience with quantitative easing, but they are likely to make good progress in climbing the QE/QT learning curve during this cycle.

Review

Week of May 23, 2022	Actual	Consensus	Comments
New Home Sales (April)	**0.591 Million (-16.6%)**	**0.748 Million (-2.0%)**	Sales of new homes slumped in April to the lowest level since the recession trough of 582,000 in April 2020. Elevated prices were an issue in the past year or so, and the recent surge in mortgage interest rates further damaged affordability and slammed the breaks on transactions in April. A sharp increase in inventories in April (up 8.3% to 444,000), along with the drop sales, led to a jump in the months' supply of new homes available for sale from 6.9 months to 9.0 months, the highest reading in more than a decade.
Durable Goods Orders (April)	**0.4%**	**0.6%**	Although headline durable goods orders rose modestly in April, results in the prior month were revised lower and bookings on balance have flattened out in early 2022. Aircraft bookings (up 3.5%) boosted total transportation orders, but the gain offset only a portion of the drag from aircraft orders in March. While orders excluding transportation rose for the 23rd time in the past 24 months (up 0.3%), the pace of advance has slowed. Bookings for nondefense capital goods excluding aircraft, which provide insight into capital spending plans by businesses, increased for the 20th time in the past 24 months. However, the change was modest at 0.3%, which most likely represents a drop in real terms.
Revised GDP (22-Q1)	**-1.5% (-0.1 Pct. Pt. Revision)**	**-1.3% (+0.1 Pct. Pt. Revision)**	Consumer spending stood out on the firm side in the latest estimate of Q1 GDP (3.1% versus 2.7% first reported), but residential construction was revised lower (growth of 0.4% versus 2.1%), and inventory investment subtracted 1.1 percentage points from growth rather than 0.8 percentage point. Net exports were little changed from the preliminary tally, but the drag of 3.2 percentage points on growth remained substantial.
U.S. International Trade in Goods (April)	**-$105.9 Billion ($20.0 Billion Narrower Deficit)**	**-$114.9 Billion ($12.2 Billion Narrower Deficit)**	Exports jumped 3.1% in April from an upward revised level in March, while imports fell 5.0% from a downward revised level in the prior month. The combined changes left a monthly trade deficit in goods of $105.9 billion, a pronounced improvement from a shortfall of $125.9 billion in March and an average of $113.0 billion in Q1. The figures raise the possibility of a positive contribution from net exports to GDP growth in the second quarter, a sharp reversal after a drag of 3.2 percentage points in Q1.
Personal Income, Consumption, Core PCE Price Index (April)	**0.4%, 0.9%, 0.3%**	**0.5%, 0.8%, 0.3%**	Increases in wages, rental income and investment income contributed to the advance in total income in April. A brisk advance of 0.9% in nominal consumer spending translated to a gain of 0.7% after adjusting for inflation. The April result suggests a firm pace of consumer spending in Q2, possibly in excess of 4.0%. The core price index for personal consumption expenditures rose 0.3% for the third consecutive month, moderating from rapid increases around the turn of the year (0.5% per month from October '21 to January '22). The core index rose 4.9% on a year-over-year basis, down three ticks from the March reading.

Sources: U.S. Census Bureau (New Home Sales, Durable Goods Orders, U.S. International Trade in Goods); Bureau of Economic Analysis (Revised GDP, Personal Income, Consumption, Core PCE Price Index); Consensus forecasts are from Bloomberg

Preview

Week of May 30, 2022	Projected	Comments
Conference Board Consumer Confidence (May) (Tuesday)	**102.0 (-4.9%)**	Higher prices of gasoline and groceries, as well as volatility in the equity market, are likely to weigh on consumer confidence in May, a view supported by a drop in the University of Michigan sentiment index.
ISM Manufacturing Index (May) (Wednesday)	**55.0 (-0.4 Index Pt.)**	Softening trends in new orders and production point to a decline in the ISM manufacturing index in May, although an increase in the supplier deliveries component (deterioration in supply chain performance) could provide a partial offset.
Construction Spending (April) (Wednesday)	**0.7%**	A strong performance in multifamily housing starts, along with work on previously started single-family units, suggests another firm advance in residential construction. Moreover, a surge in construction costs could boost nominal activity in all three main categories (residential, business-related, and government).
Revised Nonfarm Productivity (22-Q1) (Thursday)	**-7.4% (+0.1 Pct. Pt. Revision)**	A modest upward revision to the output measure that feeds through to productivity suggest a small improvement (less negative reading). Firmer than first reported compensation costs raise the prospect of a sharper increase in unit labor costs.
Factory Orders (April) (Thursday)	**0.4%**	Durable goods orders rose modestly (0.4%; published May 25th), supported by a rebound in aircraft bookings; orders ex-transportation increased 0.3%, the 23rd gain in the past 24 months. In the nondurable area, lower prices are likely to depress the value of petroleum bookings, but nondurable orders excluding petroleum could increase in nominal terms, boosted by higher prices.
Payroll Employment (May) (Friday)	**400,000**	Although job openings remain elevated, a pickup in initial claims for unemployment insurance suggest that job growth will lag the average of 552,000 in the prior 12 months. A rebound in employment measured by the household survey after a drop of 353,000 in April could nudge the unemployment rate lower.
ISM Services Index (May) (Friday)	**58.0 (+0.9 Index Pt.)**	Pickups in the new orders and employment indexes from low levels could boost the ISM services index in May, although it should remain well below the recent high of 68.4 in November of last year.

Source: Forecasts provided by Daiwa Capital Markets America

Daiwa Capital Markets

Economic Indicators

May / June 2022

Monday	Tuesday	Wednesday	Thursday	Friday
23	24	25	26	27
CHICAGO FED NATIONAL ACTIVITY INDEX Monthly 3-Mo. Avg. Feb 0.59 0.39 Mar 0.36 0.49 Apr 0.47 0.48	**NEW HOME SALES** Feb 0.792 million Mar 0.709 million Apr 0.591 million	**DURABLE GOODS ORDERS** Feb -0.7% Mar 0.6% Apr 0.4% **FOMC MINUTES**	**UNEMPLOYMENT CLAIMS** Initial Continuing (Millions) Apr 30 0.202 1.342 May 07 0.197 1.315 May 14 0.218 1.346 May 21 0.210 N/A **REVISED GDP** GDP Chained Price 21-Q4 6.9% 7.1% 22-Q1(a) -1.4% 8.0% 22-Q1(p) -1.5% 8.1% **PENDING HOME SALES** Feb -4.0% Mar -1.6% Apr -3.9%	**U.S. INTERNATIONAL TRADE IN GOODS** Feb -$105.9 billion Mar -$125.9 billion Apr -$105.9 billion **ADVANCE INVENTORIES** Wholesale Retail Feb 2.8% 1.6% Mar 2.7% 3.0% Apr 2.1% 0.7% **PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX** Inc. Cons. Core Feb 0.6% 0.6% 0.3% Mar 0.6% 1.4% 0.3% Apr 0.4% 0.9% 0.3% **REVISED CONSUMER SENTIMENT** Mar 59.4 Apr 65.2 May(p) 59.1 May(r) 58.4
30	31	1	2	3
MEMORIAL DAY	**FHFA HOME PRICE INDEX (9:00)** Jan 1.6% Feb 2.1% Mar -- **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX (9:00)** SA NSA Jan 1.7% 1.4% Feb 2.4% 2.4% Mar -- -- **CHICAGO PURCHASING MANAGERS' INDEX (9:45)** Index Prices Mar 62.9 85.7 Apr 56.4 86.1 May -- -- **CONFERENCE BOARD CONSUMER CONFIDENCE (10:00)** Mar 107.6 Apr 107.3 **May 102.0**	**ISM MFG INDEX (10:00)** Index Prices Mar 57.1 87.1 Apr 55.4 84.6 **May 55.0 80.0** **CONSTRUCTION SPEND. (10:00)** Feb 0.5% Mar 0.1% **Apr 0.7%** **JOLTS DATA (10:00)** Openings (000) Quit Rate Feb 11,344 2.9% Mar 11,549 3.0% Apr -- -- **BEIGE BOOK (2:00)** **April Beige Book** "Economic activity expanded at a moderate pace since mid-February." **VEHICLE SALES** Mar 13.4 million Apr 14.3 million **May 14.5 million**	**INITIAL CLAIMS (8:30)** **ADP EMPLOYMENT REPORT (8:15)** Private Payrolls Mar 479,000 Apr 247,000 May -- **PRODUCTIVITY & COSTS (8:30)** Productivity Unit Labor Costs 21-Q4 6.3% 1.0% 22-Q1(p) -7.5% 11.6% **22-Q1(r) -7.4% 12.2%** **FACTORY ORDERS (10:00)** Feb 0.3% Mar 1.7% **Apr 0.4%**	**EMPLOYMENT REPORT (8:30)** Payrolls Un. Rate Mar 428,000 3.6% Apr 428,000 3.6% **May 400,000 3.5%** **ISM SERVICES INDEX (10:00)** Index Prices Mar 58.3 83.8 Apr 57.1 84.6 **May 58.0 80.0**
6	7	8	9	10
	TRADE BALANCE **CONSUMER CREDIT**	**WHOLESALE TRADE**	**INITIAL CLAIMS**	**CPI** **CONSUMER SENTIMENT** **FEDERAL BUDGET**
13	14	15	16	17
	NFIB SMALL BUSINESS OPTIMISM INDEX **PPI** **FOMC MEETING**	**RETAIL SALES** **IMPORT/EXPORT PRICES** **EMPIRE MFG INDEX** **BUSINESS INVENTORIES** **NAHB HOUSING MARKET INDEX** **FOMC DECISION** **TIC DATA**	**INITIAL CLAIMS** **HOUSING STARTS** **PHILY FED INDEX**	**IP & CAP-U** **LEADING INDICATORS**

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

Treasury Financing

May / June 2022

Monday	Tuesday	Wednesday	Thursday	Friday
23	24	25	26	27
AUCTION RESULTS: Rate Cover 13-week bills 1.060% 3.06 26-week bills 1.530% 3.07	**AUCTION RESULTS:** Rate Cover 2-year notes 2.519% 2.61 **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 RESULTS:** Rate Cover 17-week CMB 1.280% 3.21 5-year notes 2.736% 2.44 Margin Cover 2-year FRNs 0.000% 3.22	**AUCTION RESULTS:** Rate Cover 4-week bills 0.740% 2.79 8-week bills 0.915% 3.36 7-year notes 2.777% 2.69 **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
30	31	1	2	3
MEMORIAL DAY	**AUCTION:** $87 billion 13-,26-week bills **ANNOUNCE:** $35 billion* 4-week bills for auction on June 2 $30 billion* 8-week bills for auction on June 2 $30 billion* 17-week CMBs for auction on June 1 **SETTLE:** $35 billion 4-week bills $30 billion 8-week bills $30 billion 17-week CMBs $17 billion 20-year bonds $14 billion 10-year TIPS $47 billion 2-year notes $48 billion 5-year notes $42 billion 7-year notes	**AUCTION:** $30 billion* 17-week CMBs	**AUCTION:** $35 billion* 4-week bills $30 billion* 8-week bills **ANNOUNCE:** $87 billion* 13-,26-week bills for auction on June 6 $44 billion* 3-year notes for auction on June 7 $33 billion* 10-year notes for auction on June 8 $19 billion* 30-year bonds for auction on June 9 **SETTLE:** $87 billion 13-,26-week bills	
6	7	8	9	10
AUCTION: $87 billion* 13-,26-week bills	**AUCTION:** $44 billion* 3-year notes **ANNOUNCE:** $35 billion* 4-week bills for auction on June 9 $30 billion* 8-week bills for auction on June 9 $30 billion* 17-week CMBs for auction on June 8 **SETTLE:** $35 billion* 4-week bills $30 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs $33 billion* 10-year notes	**AUCTION:** $35 billion* 4-week bills $30 billion* 8-week bills $19 billion* 30-year bonds **ANNOUNCE:** $87 billion* 13-,26-week bills for auction on June 13 $34 billion* 52-week bills for auction on June 14 **SETTLE:** $87 billion* 13-,26-week bills	
13	14	15	16	17
AUCTION: $87 billion* 13-,26-week bills	**AUCTION:** $34 billion* 52-week bills **ANNOUNCE:** $35 billion* 4-week bills for auction on June 16 $30 billion* 8-week bills for auction on June 16 $30 billion* 17-week CMBs for auction on June 15 **SETTLE:** $35 billion* 4-week bills $30 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs **SETTLE:** $44 billion* 3-year notes $33 billion* 10-year notes $19 billion* 30-year bonds	**AUCTION:** $35 billion* 4-week bills $30 billion* 8-week bills **ANNOUNCE:** $87 billion* 13-,26-week bills for auction on June 21 $22 billion* 2-year FRNs for auction on June 22 $14 billion* 20-year bonds for auction on June 22 $18 billion* 5-year TIPS for auction on June 23 **SETTLE:** $87 billion* 13-,26-week bills $34 billion* 52-week bills	

*Estimate