U.S. Economic Comment

- (Weak GDP) + (Strong Employment) = Dreadful Productivity
- Recession or No Recession?

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The GDP/Employment Puzzle

The latest GDP statistics, showing two consecutive declines in total production, suggest the U.S. is close to (or already in) a recession. Employment data, in contrast, are signaling robust activity. What gives?

Possibly, one or both sets of figures could contain errors or misestimates that will be revised away. For example, an alternative measure of total production for the first quarter (gross domestic income rather than gross domestic product) showed growth of 1.8 percent in contrast to the drop of 1.6 percent in GDP (GDI for Q2 is not available at this time). We will be looking for an upward revision to Q1 GDP when benchmark revisions are published in September. Similarly, payroll growth of 528,000 in July may have involved a dose of high-side volatility, as other recent labor-market indicators have suggested some cooling (job openings have declined for three consecutive months and initial claims for unemployment insurance have crept higher since the spring).

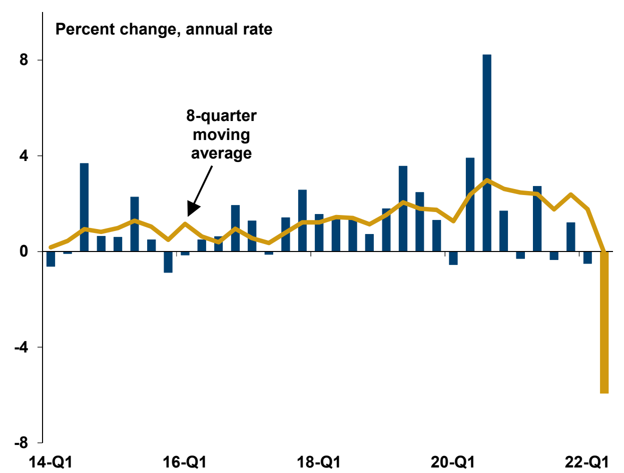
While data errors are possible, we doubt that misestimates will explain entirely the contrasting results. The bridge that will resolve the puzzle is productivity. Businesses might be hiring actively, but if workers are not productive, production will disappoint.

Indeed, productivity seems to be lacking. Output per labor hour in the nonfarm business sector – the most frequently cited measure of productivity -- fell at an annual rate of 7.3 percent in the first quarter, the second weakest reading in the history of the series. The weakest observation (-11.7 percent in 1947-Q3) seemed to be an aberration, as it was preceded by growth of 9.5 percent in 1947-Q2 and followed by growth of 18.0 percent in 1947-Q4.

Productivity for the second quarter will be published on August 9, and available data suggest another weak reading, a drop of 4.5 percent in our view. If realized, this estimate would leave a two-quarter average of -5.9 percent, the softest in the history of the series. The next lowest two-quarter reading (-3.1 percent) was not even close (chart).

Productivity growth is often erratic, and thus lengthy moving averages should be used to smooth the noise. We typically focus on eight-quarter averages, and this picture also shows weak results. Our estimate of -4.5 percent for Q2 would push the eight-quarter average slightly into negative territory, a reading last seen in 1994 and exceeded on the downside only during recession periods, when productivity growth is typically weak because firms have shifted to suboptimal levels of production.

Growth of Nonfarm Productivity*



** The bars show 2-quarter moving averages of productivity growth. The reading for 22-Q2 (gold bar) is the average of results for 22-Q1 and Daiwa's projection for productivity growth in Q2 (-4.5 percent, annual rate).*

Sources: Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America

While weak productivity represents a bridge that spans the gap between employment and production, it begs the question: why has productivity tumbled? We do not claim to have the answer to this question, but we suspect that fallout from the pandemic is a factor.

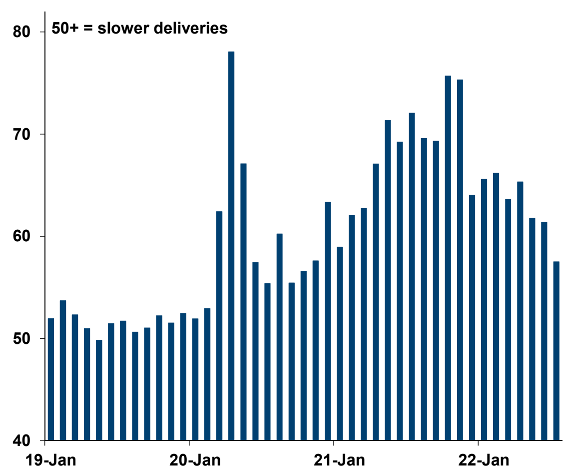
Covid has triggered a wave of early retirements, and the exit of experienced (and hence productive) workers is now being felt. Similarly, the pandemic has led many individuals to rethink career choices and move to new occupations. Such workers most likely would be in the low portions of learning curves and therefore not especially productive. Remote working could be compounding this effect because of reduced interaction among experienced workers and new employees.

Supply-chain disruptions are perhaps playing a role, as shortages of parts and materials could lead to downtime for workers and reductions in production. This influence, though, should be diminishing. The supplier delivery components of the ISM indexes (both manufacturing and services) have declined in recent months, indicating faster delivery times for inputs. The global supply-chain pressure index published by the Federal Reserve Bank of New York also has eased (charts).

Shifting consumer demand from goods to services is probably an important factor. Measuring productivity in the service sector is difficult, and so too is generating gains in productivity. Thus, a quick and sizeable shift to service consumption easily could sway productivity figures. Slower spending on goods also could be important, as retailers would most likely need to alter their inventory positions, which would entail reductions in production. In this regard, inventory investment made negative contributions to GDP growth in both the first and second quarters – and a sizeable constraint in Q2 (2.0 percentage points).

We should note again the possibility of data revisions. Adjustments in coming months might show firmer GDP growth or weaker employment statistics, which could leave productivity in a firmer position. Still, even with data revisions, we suspect that the recent productivity performance will be unimpressive.

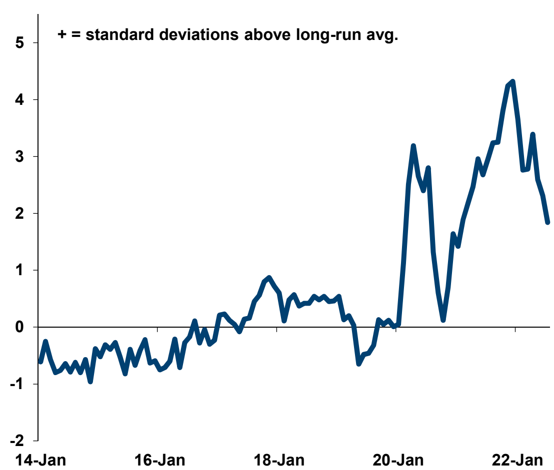
ISM Composite: Supplier Deliveries*



** A weighted average of the supplier deliveries components of the ISM manufacturing and ISM services indexes. Weights are calculated using GDP by industry data.*

Sources: Institute for Supply Management and Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

Global Supply Chain Pressure Index*



** The measure is constructed using 27 variables including: country-specific supply-chain variables from the Euro Area, China, Japan, South Korea, Taiwan, the U.K. and the U.S., global shipping rates and airfreight costs.*

Source: Federal Reserve Bank of New York via Haver Analytics

Recession or Expansion?

It is easy to offer an explanation for the gap between employment and GDP, but the dating committee of the National Bureau of Economic Research (the arbiter of expansions and contractions in the U.S.) at some point will need to make a judgement on whether the economy is expanding or contracting; that is, whether employment or GDP provides the best insight into the performance of the economy. This decision will probably not be made soon. The committee usually does not issue its designation until several months after a turning point has been reached. The delay allows the committee to have a clear view on the economy because potential data revisions will be less of a factor. In addition, the committee will have the benefit of data sources that might be available only with long lags.

If the committee had to make a decision at this time, we suspect it would indicate that the economy is still in an expansion phase. The declines in GDP in the first and second quarters seemed to be influenced by factors that might be fleeting (pronounced slippage in net exports in Q1 and a reduction in inventory investment in Q2). The committee will probably need to see broader-based weakness for a longer period of time before it declares a recession.

We suspect that a recession will eventually develop in response to tighter monetary policy. The Fed seems intent on squeezing inflation from the system, and public statements suggest that policymakers are willing to tolerate a recession to accomplish this goal. Officials are most likely going to err on the side of policy restraint, which will generate the recession needed to reduce inflation. However, that is a development that will most likely unfold next year; the economy can probably muddle through the balance of this year.

Review

Week of Aug. 1, 2022	Actual	Consensus	Comments
ISM Manufacturing Index (July)	**52.8 (-0.2 Index Pt.)**	**52.0 (-1.0 Index Pt.)**	While the July reading for the ISM index implied continued growth in the manufacturing sector of the economy, the measure has trended lower since last fall and is off sharply from the 2021 average of 60.6. The production index eased 1.4 index points in July to 53.5, down noticeably from last year's average of 61.0. Production has softened in response to slow order flows, as the new orders component has been declining since mid-2021 and has now been below the critical value of 50 for two consecutive months. The employment index increased to 49.9 from 47.3 despite slow orders and production. The supplier deliveries index made a negative contribution to the headline measure in July (-2.1 index points to 55.2), but the drop was a welcome development, as it signaled continued healing in supply chains. The prices index fell 18.5 index points in July to 60.0 (versus the recent high of 87.1 in March), suggesting easing in persistently elevated input costs.
Construction Spending (June)	**-1.1%**	**0.1%**	Private residential building led the decline in total construction activity in June with a retreat of 1.6%. A drop of 3.1% in single-family activity made the largest negative contribution to residential activity, as builders adjusted to an environment of higher interest rates and slowing demand; multi-family starts, in contrast, edged higher. The two other major components of the report also fell, with private nonresidential building and government-related activity both declining 0.5%. The reported declines in all three sectors undoubtedly will translate to much sharper falls in real terms, as construction costs have surged in recent months.
Job Openings (June)	**10.698 Million**	**11.000 Million**	Job openings fell for the third consecutive month in June, but the changes occurred from a record reading in March and are still far above all observations prior to those in the current expansion (previous record of 7.558 million in November 2018). There are 1.8 job openings per unemployed person, only marginally below the record of 2.0 in March.
Factory Orders (June)	**2.0%**	**1.2%**	The durable and nondurable components contributed about equally to the gain in total factory orders in June. Orders for defense-related aircraft accounting for much of the advance of 2.0% in durable bookings. Other durable areas showed moderate growth, with durable bookings ex-transportation increasing 0.4%. Orders for nondurable goods also rose 2.0%, led by an increase of 6.0% in the petroleum and coal category. Nondurable orders excluding petroleum and coal rose 0.7%, marking the 25th increase in the past 26 months. Much of this growth reflected higher prices rather than real activity, but the gain in June might have involved a touch of growth in real terms.

Review Continued

Week of Aug. 1, 2022	Actual	Consensus	Comments
ISM Services Index (July)	**56.7 (+1.4 Index Pts.)**	**53.5 (-1.8 Index Pts.)**	The ISM services index trailed the robust average of 64.4 in the second half of last year, but the current level of 56.7 was indicative of a solid performance. The new orders component led the advance in July, posting a gain of 4.3 index points to 59.9 -- softer than the average of 65.3 in the second half of last year, but firm in an absolute sense. With orders increasing, the business activity index rose 3.8 points to 59.9. The employment index increased 1.7 points, but that advance was not large enough to push the measure above the 50-point threshold (49.1 in July). The supplier delivery index fell 4.1 points to 57.8, continuing a downward trajectory from 75.7 in October and November of last year. The decline made a negative contribution to the headline index, but the retreat should be viewed as a favorable development for the economy, as it suggests continued easing in supply constraints. The price index also suggested some improvement on the supply side, as it fell 7.8 points to 72.3, still high but better than the record reading of 84.6 in April.
Trade Balance (June)	**-$79.6 Billion ($5.3 Billion Narrower Deficit)**	**-$80.0 Billion ($5.5 Billion Narrower Deficit)**	Both sides of the trade ledger contributed to the improvement in the deficit in June, with exports increasing 1.7% and imports slipping 0.3%. The goods deficit narrowed by $4.9 billion; the service sector made a modest positive contribution, with the surplus in services widening by $0.3 billion. June marked the third consecutive improvement in the nominal trade balance, although the shifts followed a surge in the deficit in March that left results in Q2 far wider than those in other recent quarters. The initial publication of GDP for Q2 reported a positive contribution from net exports to growth of 1.4 percentage points, and the latest data suggest that the contribution could be revised modestly higher, but the change followed a drag of 3.2 percentage points in Q1.
Payroll Employment (July)	**528,000**	**250,000**	The jump in nonfarm payrolls in July occurred from an upwardly revised level, with the gains pushing the level of payrolls above the pre-pandemic total in February 2020. The strong demand for labor pushed wages higher, as hourly earnings in July rose slightly faster than the average in the prior 12 months (0.467% versus the average of 0.427%). The year-over-year change in hourly earnings totaled 5.2%, down from the recent high of 5.6% in March, but still firm. The unemployment rate fell 0.1 percentage point to 3.5%. However, it was not a "strong" drop in joblessness. That is, employment as measured by the household survey rose only moderately (179,000), and the size of the labor force fell by 63,000.

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

Preview

Week of Aug. 8, 2022	Projected	Comments
Nonfarm Productivity (22-Q2) (Tuesday)	**-4.5%**	Output declined in Q2 despite increases in employment and hours worked, suggesting a sharp drop in productivity after a contraction of 7.3% in the prior quarter. The expected decline in productivity and brisk growth in compensation per hour raise the prospect of a jump in unit labor costs (9.5% expected after a surge of 12.6% in Q1).
CPI (July) (Wednesday)	**0.3% Total, 0.5% Core**	Energy prices could cool in July after a surge of 7.5% in June, but food prices at the consumer level have shown no signs of slowing (average increase of 0.8% in the past year, including jumps averaging 1.1% in May and June). Broad price pressure, including brisk increases in rents, travel-related expenses, and medical-care costs, raise the possibility of another pronounced advance in the core index.
Federal Budget (July) (Wednesday)	**-$175.0 Billion**	Available data suggest that federal revenues in July rose moderately from the same month last year (approximately 6%), while outlays could ease further with the continued phase-out of pandemic-related spending. The combined results point to a noticeable narrowing in the budget deficit from the $302 billion shortfall in July 2021.
PPI (July) (Thursday)	**0.2% Total, 0.4% Ex. Food & Energy**	Available quotes suggest a decline in energy prices after an average monthly advance of 5.7% in the first half of 2022. Food prices have shown hints of easing (average increase of 0.3% in the past two months versus 1.9% in the January-April period). Slower gains in the prices of core goods and services raise the possibility of a decelerating in prices ex food and energy from the average of 0.6% in the past six months.
Consumer Sentiment (August) (Friday)	**52.0 (+1.0%)**	Gasoline prices eased in early August, raising the possibility of a pickup in consumer sentiment, but persistent talk of a looming recession suggests that the change could be small and that the level of sentiment will remain close to the record low of 50 in June.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

August 2022

Monday	Tuesday	Wednesday	Thursday	Friday
1	2	3	4	5
ISM INDEX Index / Prices May 56.1 / 82.2 June 53.0 / 78.5 July 52.8 / 60.0 **CONSTRUCTION SPEND.** Apr 0.7% May 0.1% June -1.1%	**JOLTS DATA** Openings (000) / Quit Rate Apr 11,681 / 2.9% May 11,303 / 2.8% June 10,698 / 2.8% **VEHICLE SALES** May 12.8 million June 13.0 million July 13.3 million	**FACTORY ORDERS** Apr 0.7% May 1.8% June 2.0% **ISM SERVICES INDEX** Index / Prices May 55.9 / 82.1 June 55.3 / 80.1 July 56.7 / 72.3	**UNEMP. CLAIMS** Initial / Continuing (millions) July 9 0.244 / 1.384 July 16 0.261 / 1.368 July 23 0.254 / 1.416 July 30 0.260 / N/A **TRADE BALANCE** Apr -$86.7 billion May -$84.9 billion June -$79.6 billion	**EMPLOYMENT REPORT** Payrolls / Un. Rate May 386,000 / 3.6% June 398,000 / 3.6% July 528,000 / 3.5% **CONSUMER CREDIT** Apr $35.0 billion May $23.8 billion June $40.2 billion
8	9	10	11	12
	NFIB SMALL BUSINESS OPTIMISM INDEX (6:00) May 93.1 June 89.5 July -- **PRODUCTIVITY & COSTS (8:30)** Productivity / Unit Labor Costs 21-Q4 6.3% / 3.9% 22-Q1 -7.3% / 12.6% **22-Q2 -4.5% / 9.5%**	**CPI (8:30)** Total / Core May 1.0% / 0.6% June 1.3% / 0.7% **July 0.3% / 0.5%** **WHOLESALE TRADE (10:00)** Inventories / Sales Apr 2.3% / 0.8% May 1.9% / 0.5% **June 1.9% / 0.5%** **FEDERAL BUDGET (2:00)** 2022 / 2021 May -$66.2B / -$132.0B June -$88.8B / -$174.2B July **-$175.0B** / -$302.1B	**UNEMP. CLAIMS (8:30)** **PPI (8:30)** Final Demand / Ex. Food & Energy May 0.9% / 0.6% June 1.1% / 0.4% **July 0.2% / 0.4%**	**IMPORT/EXPORT PRICES (8:30)** Non-petrol. Imports / Nonagri. Exports May -0.2% / 3.0% June -0.4% / 0.9% July -- / -- **CONSUMER SENTIMENT (10:00)** June 50.0 July 51.5 **Aug 52.0**
15	16	17	18	19
EMPIRE MFG. INDEX **NAHB HOUSING INDEX** **TIC FLOWS**	**HOUSING STARTS** **INDUST. PRODUCTION**	**RETAIL SALES** **BUSINESS INVENTORIES** **FOMC MINUTES**	**UNEMP. CLAIMS** **PHILY FED INDEX** **EXISTING HOME SALES** **LEADING INDICATORS**	
22	23	24	25	26
CHICAGO FED NATIONAL ACTIVITY INDEX	**NEW HOME SALES**	**DURABLE GOODS ORDERS** **PENDING HOME SALES**	**UNEMP. CLAIMS** **REVISED GDP**	**PERSONAL INCOME, CONSUMPTION, PRICES** **INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES** **REVISED CONSUMER SENTIMENT**

Forecasts in Bold.

Treasury Financing

August 2022

Monday	Tuesday	Wednesday	Thursday	Friday
1	2	3	4	5
AUCTION RESULTS: Rate Cover 13-week bills 2.490% 2.63 26-week bills 2.850% 2.91 **SETTLE:** $14 billion 20-year bonds $24 billion 2-year FRN $45 billion 2-year notes $46 billion 5-year notes $38 billion 7-year notes	**ANNOUNCE:** $55 billion 4-week bills for auction on Aug 4 $50 billion 8-week bills for auction on Aug 4 $30 billion 17-week CMBs for auction on Aug 3 **SETTLE:** $55 billion 4-week bills $50 billion 8-week bills $30 billion 17-week CMBs	**AUCTION RESULTS:** Rate Cover 17-week CMB 2.730% 3.35 **ANNOUNCE:** $42 billion 3-year notes for auction on Aug 9 $35 billion 10-year notes for auction on Aug 10 $21 billion 30-year bonds for auction on Aug 11	**AUCTION RESULTS:** Rate Cover 4-week bills 2.110% 2.80 8-week bills 2.280% 2.54 **ANNOUNCE:** $96 billion 13-,26-week bills for auction on Aug 8 $34 billion 52-week bills for auction on Aug 9 **SETTLE:** $96 billion 13-,26-week bills	
8	9	10	11	12
AUCTION: $96 billion 13-,26-week bills	**AUCTION:** $34 billion 52-week bills $42 billion 3-year notes **ANNOUNCE:** $55 billion* 4-week bills for auction on Aug 11 $50 billion* 8-week bills for auction on Aug 11 $30 billion* 17-week CMBs for auction on Aug 10 **SETTLE:** $55 billion 4-week bills $50 billion 8-week bills $30 billion 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs $35 billion 10-year notes	**AUCTION:** $55 billion* 4-week bills $50 billion* 8-week bills $21 billion 30-year bonds **ANNOUNCE:** $96 billion* 13-,26-week bills for auction on Aug 15 $15 billion* 20-year bonds for auction on Aug 17 $8 billion* 30-year TIPS for auction on Aug 18 **SETTLE:** $96 billion 13-,26-week bills $34 billion 52-week bills	
15	16	17	18	19
AUCTION: $96 billion* 13-,26-week bills **SETTLE:** $42 billion 3-year notes $35 billion 10-year notes $21 billion 30-Year bonds	**ANNOUNCE:** $55 billion* 4-week bills for auction on Aug 18 $50 billion* 8-week bills for auction on Aug 18 $30 billion* 17-week CMBs for auction on Aug 17 **SETTLE:** $55 billion* 4-week bills $50 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs $15 billion* 20-year bonds	**AUCTION:** $55 billion* 4-week bills $50 billion* 8-week bills $8 billion* 30-year TIPS **ANNOUNCE:** $96 billion* 13-,26-week bills for auction on Aug 22 $22 billion* 2-year FRNs for auction on Aug 24 $44 billion* 2-year notes for auction on Aug 23 $45 billion* 5-year notes for auction on Aug 24 $37 billion* 7-year notes for auction on Aug 25 **SETTLE:** $96 billion* 13-,26-week bills	
22	23	24	25	26
AUCTION: $96 billion* 13-,26-week bills	**AUCTION:** $44 billion* 2-year notes **ANNOUNCE:** $55 billion* 4-week bills for auction on Aug 25 $50 billion* 8-week bills for auction on Aug 25 $30 billion* 17-week CMBs for auction on Aug 24 **SETTLE:** $55 billion* 4-week bills $50 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs $22 billion* 2-year FRNs $45 billion* 5-year notes	**AUCTION:** $55 billion* 4-week bills $50 billion* 8-week bills $37 billion* 7-year notes **ANNOUNCE:** $96 billion* 13-,26-week bills for auction on Aug 29 **SETTLE:** $96 billion* 13-,26-week bills	**SETTLE:** $22 billion* 2-year FRNs

**Estimate*