U.S. Economic Comment

- U.S. economy: after a weak H1, a random pickup in Q3 obscures a slowing trend
- Inflation watch: another troubling reading on the PCE price index

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A Slow First Half; A (Brief) Pickup in Q3

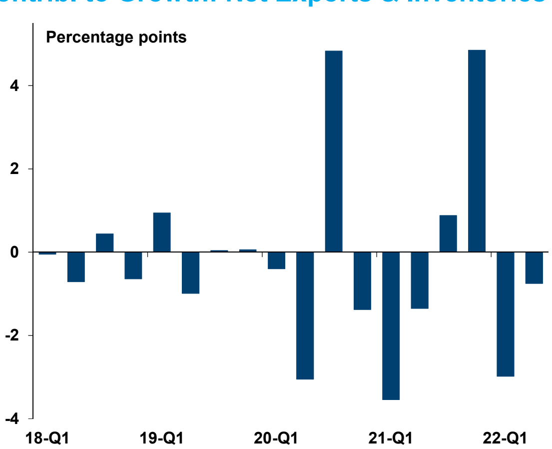
Revised data on GDP, including annual benchmark revisions, confirm that the U.S. economy contracted in the first half of the year (off 1.1 percent). The retreat seems peculiar in light of firm job growth and other signs of expansion, such as the advance of 5.0 percent in industrial production (2021-Q4 to 2022-Q2, annual rate). We attribute the puzzling results to swings in volatile areas that became especially erratic because of the pandemic. Specifically, inventory investment and net exports have been on wild rides that have fueled growth in some quarters and restrained it in others. Inventories served as a buffer for businesses as demand fluctuated, and the breakdown in supply chains led to marked swings in exports and imports.

The chart below shows the combined contribution of inventory investment and net exports to GDP growth. These areas boosted GDP growth by an average of 2.9 percentage points in the second half of last year while subtracting 1.9 percentage points in the first half of this year. Final sales to domestic purchasers, which is GDP less inventory investment and net exports, provides a clear view on underlying growth in the economy. This measure has continued to advance, although the pace of growth is slowing: 1.9 percent in 2021-H2 and 0.7 percent in the first half of this year. The results in the first quarter were respectable (1.3 percent), but activity in the second quarter disappointed (0.2 percent).

Available data suggest that final sales to domestic purchasers will remain weak in the third quarter, probably showing no growth or a slight decline. However, GDP growth is likely to be respectable, with the economy advancing at a rate of approximately 2.0 percent. The spurt is likely to reflect additional volatility in international trade, as recent data suggest that net exports could add more than two percentage points to GDP growth (a boost of three percentage points is possible if September results remain favorable).

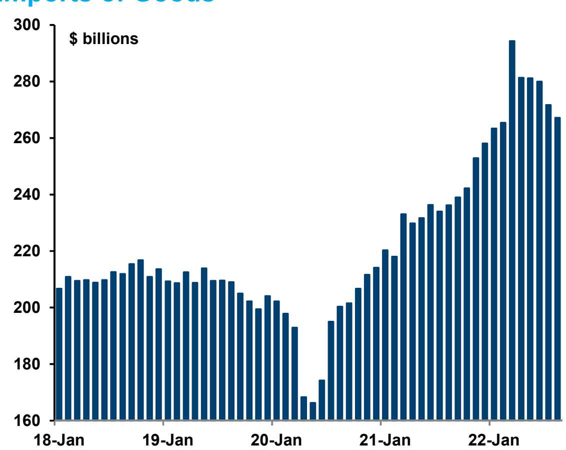
The improvement in international trade in recent months has been driven by a marked easing in imports, which probably reflects ebbs and flows related to supply-chain disruptions (strength in late 2021 and early this year as supply-chain disruptions eased; a return to underlying trend in recent months; chart, right). Whatever the cause, the data in hand point to a sizeable contribution from net exports to GDP growth in Q3.

Contrib. to Growth: Net Exports & Inventories



Source: Bureau of Economic Analysis via Haver Analytics

Imports of Goods



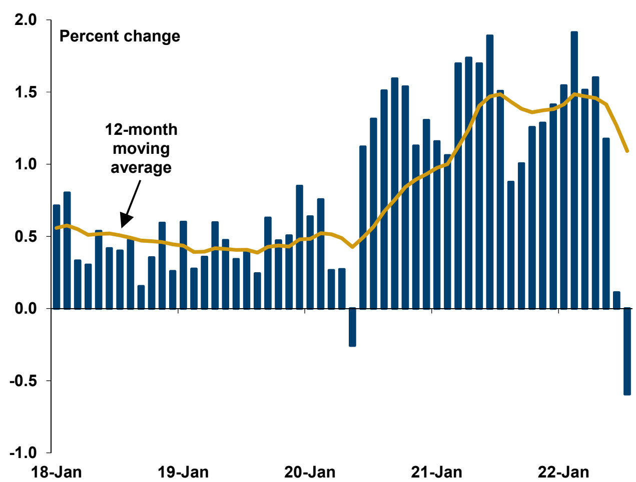
Source: U.S. Census Bureau via Haver Analytics

While net exports are likely to make a sizeable contribution to GDP growth in Q3, we are not excited about the favorable swing in international trade. We view the improvement as residual volatility associated with the pandemic, and we are concerned about a shift in fundamentals that will work against the United States. Key trading partners, especially those in Europe, are likely to experience recessions in coming quarters, which will slow exports. In addition, the recent surge in the foreign exchange value of the dollar will weaken the competitive position of U.S. producers.

Outside of international trade, we do not see any engines of growth in the third quarter, which will probably lead to a feeble performance in final sales to domestic purchasers. We do not expect much support from consumers. The latest report on income and consumption showed only a small increase in real consumer expenditures in August (0.1 percent) after a dip in July (revised down from a modest increase). All told, real consumer spending in Q3 will probably advance at an annual rate of less than one percent. With inflation restraining the budgets of many households, and with news reports of possible recession, individuals are likely to remain cautious spenders in coming months. Higher interest rates because of the Fed's tightening campaign represent another constraint on consumer spending.

The effect of higher interest rates already is being felt in the housing market. Sales of existing homes have declined for seven consecutive months and have returned to the low range seen in the early stages of the pandemic. Sales of new homes showed a surprising jump in August, but the increase followed an unusually soft result in July and thus was probably a random shift; average sales of new homes in the past two months also have retreated to early-pandemic levels. The slow pace of sales and rising inventories of unsold homes have led to a drop in single-family housing starts, which will most likely lead to a pronounced contraction in the residential construction component of GDP (a decline in the neighborhood of 25 percent, very much in the low end of the historical range).

FHFA Home Price Index



Source: Federal Housing Finance Agency via Haver Analytics

While essentially all housing-related measures are indicating weakness, the softness is perhaps most evident in the sudden shift in home prices. After increasing at an average monthly rate of 1.4 percent from mid-2020 through May of this year, prices rose only 0.1 percent in June and fell 0.6 percent in July (latest available, chart).

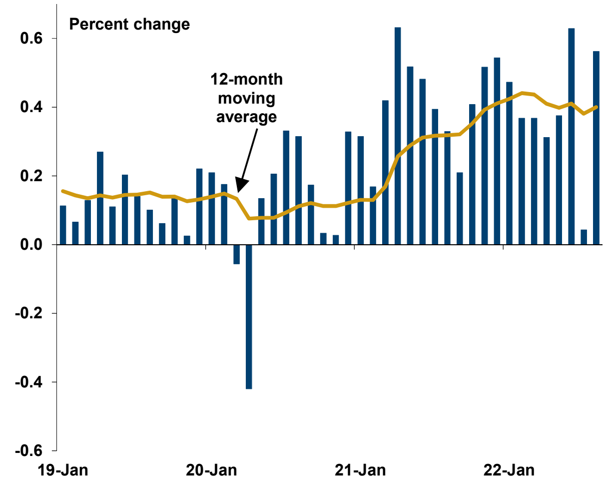
Business fixed investment, like consumer spending, will probably be in the plus column when calculating GDP growth, but the contribution is likely to be only moderate. Orders and shipments of capital goods have been advancing throughout the year, but nominal gains have barely kept pace with price increases, suggesting little growth in real outlays for new equipment. Business outlays for new structures have contracted for five consecutive quarters, and they are likely to remain soft given the uncertainty in the economic outlook. Investment in intellectual property has been steady in recent years (only one quarterly decline during the worst of the pandemic), and it will probably account for most of the growth in capital spending in Q3 and beyond.

All told, respectable growth in Q3 will be driven largely by a favorable shift in net exports, which is likely to be temporary. Activity elsewhere will probably be flat or down. Beyond Q3, without a boost from net exports, the economy will probably be soft. If a recession does not begin in the closing months of this year, one will probably emerge in early 2023.

Inflation Watch

As widely expected, energy prices fell again in August, dropping 5.5 percent after a decline of 4.9 percent in July. However, prices elsewhere remained under pressure, with food prices jumping 0.8 percent and the core component increasing 0.6 percent. The increase in the food component was lighter than the average of 1.2 percent in the prior six months, but it was still fast enough to leave consumers uncomfortable.

Core PCE Price Index*



** PCE = personal consumption expenditures*

Source: Bureau of Economic Analysis via Haver Analytics

We viewed the increase in the core component as troubling. Not only was the increase sizeable, but prices jumped despite downward pressure on some key items. Some of the goods or services that had surged in price during the worst of the pandemic have been easing in recent months, and they were off again in August (used motor vehicles, household appliances, televisions, vehicle rentals). Despite this downward pressure, core prices still advanced 0.6 percent, signaling that price pressure extends across a broad array of items and suggesting that rapid inflation has become embedded. The year-over-year change of 4.9 percent in core prices is off from the peak of 5.4 percent in February and March, but it has shown essentially no moderation since May (chart). As several Fed officials have indicated in recent public statements, they have more work to do.

Review

Week of Sept. 26, 2022	Actual	Consensus	Comments
Durable Goods Orders (August)	**-0.2% Total, 0.2% Ex. Trans.**	**-0.3% Total, 0.2% Ex. Trans.**	Downside volatility in orders for nondefense aircraft accounted for much of the easing in headline durable goods orders in August. Bookings excluding transportation rose for the 27th time in the past 28 months, although recent increases have been modest after a robust performance last year. In addition, rapid inflation in recent months most likely accounted for much of the nominal growth in orders ex-transportation. Orders for nondefense capital goods excluding aircraft, which provide insight into capital spending plans by businesses, rose 1.3% in August, a change large enough to suggest a real (inflation-adjusted) advance in orders.
New Home Sales (August)	**0.685 Million (Annual Rate) (+28.8%)**	**0.500 Million (Annual Rate) (-2.2%)**	Sales of new homes surged in August, reversing a portion of the sharp decline in the spring and early summer. However, the jump followed an unusually soft reading in July, which suggests random volatility rather than a sign of fundamental improvement. The average pace of sales in the past two months was still within the range seen in Q2 and consistent with a softening trend.
Consumer Confidence (September)	**108.0 (+4.2%)**	**104.6 (+1.4%)**	Although consumer confidence rose for the second consecutive month in September, the combined increase of 12.7 index points (13.3%) offset only a portion of the 19.9 point (17.3%) decline in the first seven months of the year. While concern about rapid inflation and a potential recession likely are contributing to sour moods, views on the labor market remain solid. The net labor market assessment of survey respondents (share responding that jobs are plentiful less the share indicating that they are hard to get) rose 1.8 percentage points to 49.4%, off from the record reading of 56.7% in March but still quite high by historical standards.
U.S. International Trade in Goods (August)	**-$87.3 Billion ($2.9 Billion Narrower Deficit)**	**-$89.0 Billion ($1.2 Billion Narrower Deficit)**	Both imports and exports of goods slipped in August, with the drop of 1.7% in imports exceeding the decline of 0.9% in exports, leaving improvement of $2.9 billion in the monthly trade deficit. Imports have softened considerably in recent months after surging in the second half of last year and in early 2022, while exports have performed well this year before easing in the most recent month. The recent changes left an average trade deficit of $88.7 billion for the first two months of Q3, much narrower that in Q2 ($103.1 billion). The improvement raised the possibility of a notable positive contribution from net exports to GDP growth in Q3 -- possibly in the neighborhood of two to three percentage points.

Review Continued

Week of Sept. 26, 2022	Actual	Consensus	Comments
Revised GDP (22-Q2)	**-0.6% (Unrevised)**	**-0.6% (Unrevised)**	The final (third) estimate of Q2 GDP growth was unrevised from the preliminary tally, although compositional shifts in some areas were notable. Consumer spending stood out on the positive side, with growth revised higher by 0.5 percentage point to 2.0%. On the soft side, the contribution of net exports to GDP growth was revised lower by 0.2 percentage point to 1.2%. Other areas (business fixed investment, residential construction, government spending) were adjusted modestly. Benchmark revisions released with the report covered years dating from 2017 through the first quarter of this year. While data for Q1 were unrevised (contraction of 1.6%), the new results showed firmer activity in 2020 and 2021. The contraction in the economy in 2020 was smaller than previously believed, now showing a drop of 2.8% rather than 3.4%, and the advance in 2021 was a touch stronger than previously believed (5.9% versus 5.7%).
Personal Income, Consumption, Core PCE Price Index (August)	**0.3%, 0.4%, 0.6%**	**0.3%, 0.2%, 0.5%**	The advance in wages and salaries in August matched the unimpressive gain in total personal income (unchanged in real terms), and rental income showed signs of cooling after brisk increases earlier in the year. Farm income and investment income slipped. On the spending side, a moderate advance in nominal outlays translated to a pickup of only 0.1% after adjusting for inflation. The gain, combined with a dip in July, suggested a modest advance in the consumer spending component of GDP in Q3 (less than 1.0%, annual rate). The core personal consumption expenditure price index jumped in August, resuming its brisk advance after a flat reading in July. On a year-over-year basis, the measure rose 4.9%, off the recent high of 5.4% in February but still far above the Fed's target of 2.0%.

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

Preview

Week of Oct. 3, 2022	Projected	Comments
ISM Manufacturing Index (September) (Monday)	**52.0 (-0.8 Index Pt.)**	Tight financial conditions and rising prospects of a recession suggest that the ISM index will continue to move along the downward path that began around the turn of the year. A sharp retreat in a purchasing managers' index for the Chicago area also points to a decline in the national measure.
Construction Spending (August) (Monday)	**-0.7%**	Although single-family housing starts rose in August, sharp cuts in other recent months suggest that residential construction is likely to be soft. Business-related activity has moved sideways since the start of the year, and postponement of new projects amid slowing growth poses downside risks. Government-sponsored activity has drifted upward since last fall, but higher costs could be boosting the value of projects rather than increases in real activity.
Factory Orders (August) (Tuesday)	**-0.3%**	The already-reported dip of 0.2% in new orders for durable goods is likely to be joined by a decline in the nondurable area, which is likely to be driven by lower prices of petroleum and coal products. Nondurable bookings ex-petroleum and coal could rise slightly, as higher prices offset softening real activity.
Trade Balance (August) (Wednesday)	**-$68.0 Billion ($2.7 Billion Narrower Deficit)**	The narrowing of $2.9 billion in the goods trade deficit (published September 28) should dominate the report on total international trade. The surplus in service trade has been volatile from month-to-month, but it has drifted higher on balance since last summer.
ISM Services Index (September) (Wednesday)	**56.0 (-0.9 Index Pt.)**	The ISM services index, while off a record high of 68.4 in November of last year, has held up well despite tighter financial conditions and slowing economic activity. The resiliency could begin to fade in September, as the effects of recent tightening of financial conditions begin to take hold.
Payroll Employment (September) (Friday)	**375,000**	Low unemployment claims and elevated job openings suggest a solid pace of hiring in August. While payrolls are unlikely to match robust average growth of 562,000 in 2021, hiring close to the average of 381,000 in the past six months is not out of the question. While the expected pace of job gains ordinarily would be firm enough to nudge the unemployment rate lower, the possibility of workers returning to the labor force is likely to leave the jobless rate unchanged at 3.7%.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

September / October 2022

Monday	Tuesday	Wednesday	Thursday	Friday
26	27	28	29	30
CHICAGO FED NATIONAL ACTIVITY INDEX Monthly 3-Mo. Avg. Jun -0.27 -0.08 Jul 0.29 -0.08 Aug 0.00 0.01	**DURABLE GOODS ORDERS** Jun 2.3% Jul -0.1% Aug -0.2% **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** SA NSA May 1.2% 1.5% June 0.2% 0.4% July -0.4% -0.8% **FHFA HOME PRICE INDEX** May 1.2% June 0.1% July -0.6% **NEW HOME SALES** June 0.582 million July 0.532 million Aug 0.685 million **CONFERENCE BOARD CONSUMER CONFIDENCE** July 95.3 Aug 103.6 Sep 108.0	**INTERNATIONAL TRADE IN GOODS** June -$99.1 billion July -$90.2 billion Aug -$87.3 billion **ADVANCE INVENTORIES** Wholesale Retail June 1.8% 2.0% July 0.6% 1.1% Aug 1.3% 1.4% **PENDING HOME SALES** June -8.9% July -0.6% Aug -2.0%	**UNEMP. CLAIMS** Initial Continuing (millions) Sep 3 0.218 1.400 Sep 10 0.208 1.376 Sep 17 0.209 1.347 Sep 24 0.193 N/A **REVISED GDP** GDP Chained Price 22-Q1 -1.6% 8.3% 22-Q2(p) -0.6% 8.9% 22-Q2(r) -0.6% 9.0%	**PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX** Inc. Cons. Core June 0.6% 1.2% 0.6% July 0.3% -0.1% 0.0% Aug 0.3% 0.4% 0.6% **MNI CHICAGO BUSINESS BAROMETER** Index Prices July 52.1 81.9 Aug 52.2 81.8 Sep 45.7 74.1 **CONSUMER SENTIMENT** July 51.5 Aug 58.2 Sep(p) 59.5 Sep(r) 58.6
3	4	5	6	7
ISM INDEX (10:00) Index Prices July 52.8 60.0 Aug 52.8 52.5 **Sep 52.0 52.0** **CONSTRUCTION SPEND. (10:00)** June -0.5% July -0.4% **Aug -0.7%** **VEHICLE SALES** July 13.3 million Aug 13.2 million **Sep 13.5 million**	**FACTORY ORDERS (10:00)** June 1.8% July -1.0% **Aug -0.3%** **JOLTS DATA (10:00)** Openings (000) Quit Rate June 11,040 2.8% July 11,239 2.7% Aug -- --	**ADP EMPLOYMENT REPORT (8:15)** Private Payrolls July 268,000 Aug 132,000 Sep -- **TRADE BALANCE (8:30** June -$80.9 billion July -$70.7 billion **Aug -$68.0 billion** **ISM SERVICES INDEX (10:00)** Index Prices July 56.7 72.3 Aug 56.9 71.5 **Sep 56.0 65.0**	**UNEMP. CLAIMS (8:30)**	**EMPLOYMENT REPORT (8:30)** Payrolls Un. Rate July 526,000 3.5% Aug 315,000 3.7% **Sep 375,000 3.7%** **WHOLESALE TRADE (10:00)** Inventories Sales June 1.8% 1.6% July 0.6% -1.5% **Aug 1.3% 0.5%** **CONSUMER CREDIT (3:00)** June $39.1 billion July $23.8 billion Aug --
10	11	12	13	14
COLUMBUS DAY	**NFIB SMALL BUSINESS OPTIMISM INDEX** **FEDERAL BUDGET (LIKELY POSTPONED)**	**PPI** **FOMC MINUTES**	**UNEMP. CLAIMS** **CPI**	**RETAIL SALES** **IMPORT PRICES** **BUSINESS INVENTORIES** **CONSUMER SENTIMENT**
17	18	19	20	21
EMPIRE MFG INDEX	**INDUSTRIAL PRODUCTION** **NAHB HOUSING INDEX** **TIC FLOWS**	**HOUSING STARTS** **BEIGE BOOK**	**UNEMP. CLAIMS** **PHILY FED MFG IINDEX** **EXISTING HOME SALES** **LEADING INDICATORS**	

Forecasts in Bold. (p) = preliminary (2nd estimate of GDP), (r) = revised (3rd estimate of GDP)

Treasury Financing

September / October 2022

Monday	Tuesday	Wednesday	Thursday	Friday
26	27	28	29	30
AUCTION RESULTS: Rate Cover 13-week bills 3.270% 2.56 26-week bills 3.850% 2.68 2-year notes 4.290% 2.51	**AUCTION RESULTS:** Rate Cover 5-year notes 4.228% 2.27 **ANOUNCE:** $50 billion 4-week bills for auction on Sep 29 $45 billion 8-week bills for auction on Sep 29 $30 billion 17-week CMBs for auction on Sep 28 **SETTLE:** $50 billion 4-week bills $45 billion 8-week bills $30 billion 17-week CMBs	**AUCTION RESULTS:** Rate Cover 17-wk CMB 3.590% 3.05 7-yr notes 3.898% 2.57 Margin Cover 2-yr FRNs 0.037% 2.84	**AUCTION RESULTS:** Rate Cover 4-week bills 2.660% 2.54 8-week bills 3.065% 2.57 **ANNOUNCE:** $96 billion 13-,26-week bills for auction on Oct 3 $34 billion 52-week bills for auction on Oct 4 **SETTLE:** $96 billion 13-,26-week bills	**SETTLE:** $12 billion 20-year bonds $15 billion 10-year TIPS $43 billion 2-year notes $44 billion 5-year notes $36 billion 7-year notes $22 billion 2-year FRNs
3	4	5	6	7
AUCTION: $96 billion 13-,26-week bills	**AUCTION:** $34 billion 52-week bills **ANNOUNCE** $50 billion* 4-week bills for auction on Oct 6 $45 billion* 8-week bills for auction on Oct 6 $30 billion* 17-week CMBs for auction on Oct 5 **SETTLE:** $50 billion 4-week bills $45 billion 8-week bills $30 billion 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs	**AUCTION:** $50 billion* 4-week bills $45 billion* 8-week bills **ANNOUNCE:** $96 billion* 13-,26-week bills for auction on Oct 11 $40 billion* 3-year notes for auction on Oct 11 $32 billion* 10-year notes for auction on Oct 12 $18 billion* 30-year bonds for action on Oct 13 **SETTLE:** $96 billion 13-,26-week bills $34 billion 52-week bills	
10	11	12	13	14
COLUMBUS DAY	**AUCTION:** $96 billion* 13-,26-week bills $40 billion* 3-year notes **ANNOUNCE:** $50 billion* 4-week bills for auction on Oct 13 $45 billion* 8-week bills for auction on Oct 13 $30 billion* 17-week CMBs for auction on Oct 12 **SETTLE:** $50 billion* 4-week bills $45 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs $32 billion* 10-year notes	**AUCTION:** $50 billion* 4-week bills $45 billion* 8-week bills $18 billion* 30-year bonds **ANNOUNCE:** $96 billion* 13-,26-week bills for auction on Oct 17 $12 billion* 20-year bonds for auction on Oct 19 $21 billion* 5-year TIPS for auction on Oct 20 **SETTLE:** $96 billion* 13-,26-week bills	
17	18	19	20	21
AUCTION: $96 billion* 13-,26-week bills **SETTLE:** $40 billion* 3-year notes $32 billion* 10-year notes $18 billion* 30-year bonds	**ANNOUNCE:** $50 billion* 4-week bills for auction on Oct 20 $45 billion* 8-week bills for auction on Oct 20 $30 billion* 17-week CMBs for auction on Oct 19 **SETTLE:** $50 billion* 4-week bills $45 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs $12 billion* 20-year bonds	**AUCTION:** $50 billion* 4-week bills $45 billion* 8-week bills $21 billion* 5-year TIPS **ANNOUNCE:** $96 billion* 13-,26-week bills for auction on Oct 24 $42 billion* 2-year notes for auction on Oct 25 $43 billion* 5-year notes for auction on Oct 26 $35 billion* 7-year notes for auction on Oct 27 $24 billion* 2-year FRNs for auction on Oct 26 **SETTLE:** $96 billion* 13-,26-week bills	

*Estimate