Daiwa Capital Markets

U.S. Economic Comment

- The labor market: a hint of softer demand; still-tight supply
- New policymakers at the Fed: they seem to be on board with tightening (for now)
- Is policy restrictive?

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Labor Market Developments

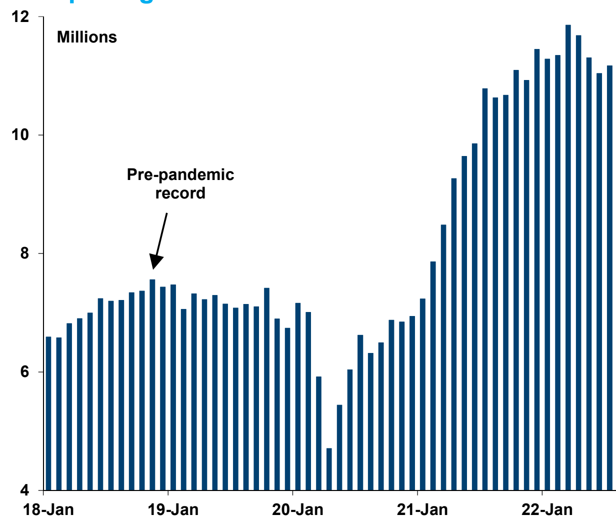
A debate, of sorts, has emerged in the economics community in recent months about the influence of tighter monetary policy on the labor market. One camp, led by Fed Governor Christopher Waller, argues that tight policy and slow economic activity will take the form of a reduction in job openings rather than a pickup in layoffs, resulting in a smaller-than-normal increase in the unemployment rate. Others, most notably Lawrence Summers, believe that the Fed will have to engineer a noticeable increase in the unemployment rate to drive inflation lower.

The Fed is in the early stages of the inflation fight, and thus this issue is far from settled, but the first round went to Governor Waller. The latest reading on job openings (August) showed a marked break from stratospheric readings in other recent months (off more than one million or -10.0 percent, chart). In addition, recent readings on claims for unemployment insurance (both initial and continuing) have not changed appreciably in recent months, signaling no meaningful pickup in layoffs. (The latest weekly readings on unemployment claims wiggled higher, but the changes were within the normal range of volatility.)

The employment report for September might also seem to support the “reduced-openings” camp, as the unemployment rate fell in the latest month (September). However, this case is less clear cut because some of the reduction was the result of individuals dropping out of the labor force (off 57,000, resulting in a dip in the labor force participation rate). Also, the payroll figures hinted that layoffs might be starting to pick up, as a few industries showed declines in employment (retail trade, financial services, transportation & warehousing).

The drop in the size of the labor force was disappointing, as some observers, including many Fed officials, are expecting (hoping?) that an increase in labor supply will ease the supply-demand imbalance, helping to contain wage and price pressure. However, the overall participation rate has not changed meaningfully since the spring. The prime age participation rate (ages 25 to 54) has increased recently, but it is not surging and is still below its pre-pandemic level. Some observers have suggested that individuals who retired during the worst of the pandemic might return to work. However, the participation rate for the 55+ group remains noticeably below its pre-Covid level and has not picked up meaningfully (charts, next page).

Job Openings



Source: Bureau of Labor Statistics via Haver Analytics

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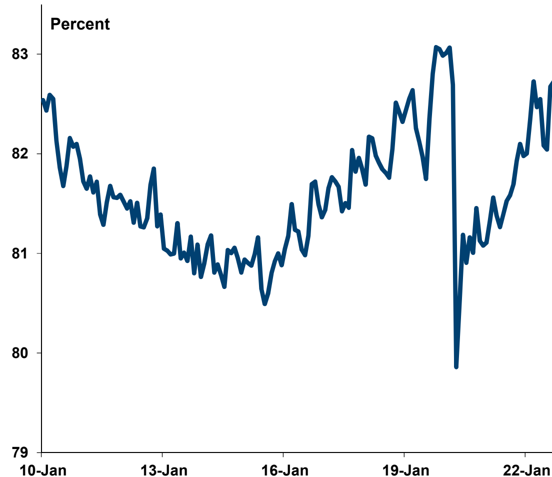
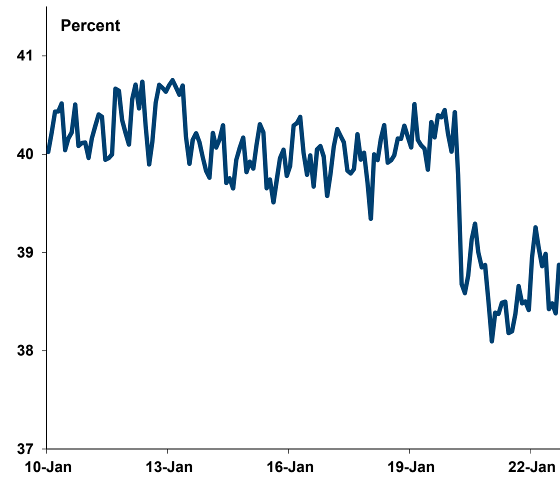
Labor Force Participation Rate: Ages 25-54



Source: Bureau of Labor Statistics via Haver Analytics

Labor Force Participation Rate: 55+



Source: Bureau of Labor Statistics via Haver Analytics

The New FOMC

Four new policymakers have recently joined the Federal Reserve System. Philip Jefferson and Lisa Cook are new members of the Board of Governors, while Susan Collins has taken over as the president of the Federal Reserve Bank of Boston, and Lorie Logan is now heading the Federal Reserve Bank of Dallas. Three of the officials have recently delivered their first public comments, allowing observers to begin positioning them along the hawk-dove spectrum.

It is too early to make definitive evaluations because most of the individuals are just becoming familiar with the policy process, but market participants can begin to form opinions. Our initial view is that none of new officials will resist the additional tightening efforts likely in the months ahead, but we are not convinced that they will be willing to tolerate a marked slowing in the economy that might be needed to reduce inflation.

Governor Jefferson's speech was short and dealt primarily with the role of technology in coping with the pandemic, but he touched on the economic setting and noted that inflation was the problem that concerned him most. He indicated that the FOMC was "resolute" in its determination to reduce inflation to two percent and to keep inflation expectations in check. However, we were left wondering about the degree of pain he might be willing to tolerate, as he only noted the possibility of below-trend growth in fighting inflation – no mention of recession or rising unemployment.

Governor Cook noted the benefits that a strong labor market brought before the onset of the pandemic (allowing those on the margins of the labor force to develop skills), perhaps suggesting that she might give priority to the Fed's employment mandate. However, she emphasized the burdens of rapid inflation on lower- and middle-income families, and thus she was focused on taming inflation. She supported the front-loading of tight policy and noted that the Fed would probably need to maintain a restrictive stance for some time in order to reach the two percent inflation target.

We viewed Governor Cook's speech as the strongest anti-inflation statement among the new appointees. Susan Collins of the Boston Fed offered the weakest. She made all the points one would expect from a Fed official (committed to achieving two percent inflation; important to keep inflation expectations contained). However, she also emphasized the supply-side sources of price pressure and noted that the Fed cannot influence such factors. In addition, she was hopeful that the Fed could achieve its inflation objective with only a modest slowdown in the economy. Such a view might suggest that she would argue for a pivot if the downturn in the economy started to move beyond modest.

Lorie Logan of the Dallas Fed has made a few public appearances, but none have involved a prepared statement, and press coverage of her remarks has been lacking. However, because she has moved to Dallas from a senior position at the New York Fed, we suspect that her policy views will be similar to those of John Williams, the president of the NY Fed and the vice-chair of the FOMC. She will probably be fully on board with the aggressive tack now in progress.

The Tightening Process: How Far Along?

The Fed's plan, in simplest terms, is to move to a restrictive policy stance and hold to that position until it has convincing evidence that inflation is on a path to two percent. So, are we there yet? Is policy restrictive?

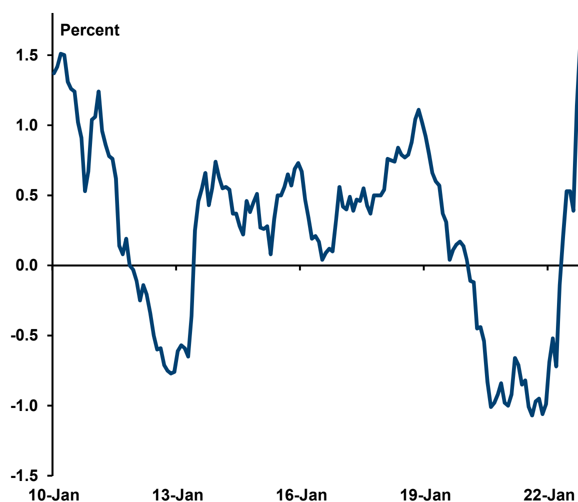
There are several ways to assess the current stance. The easiest is to compare the current target rate for the federal funds rate with the long-run view shown in the FOMC's Summary of Economic Projections (SEP). The long-run view (currently 2.5 percent) is the collective assessment of the neutral policy rate among Fed officials. With a target rate of 3.0 to 3.25 percent exceeding the perceived neutral rate, one could argue that policy is now restrictive. Chair Powell expressed such a view in his latest press conference.

This view, however, is less than satisfying because there is no assurance that the long-run rate shown in the SEP is in fact a neutral setting; it is merely a summary of opinions (guesses?) among Fed officials. As an alternative, some policymakers have recently noted that real interest rates might be used to assess the Fed's policy stance, and the rates on Treasury inflation-protected securities (TIPS) can be used as a measure of real interest rates.

By this metric, the Fed has made good progress. The rate on 10-year TIPS was negative during the Covid recession and most of the current recovery, but it has jumped slightly above the peak seen before the onset of the pandemic (chart, left). The 5-year TIPS rate shows a more pronounced shift, moving noticeably above the peak in the previous expansion. These rates are still below levels seen during the expansion in the early and mid-2000s, but equilibrium rates have probably moved lower since then. Thus, focusing on real rates, one can probably argue that policy is restrictive.

This view, though, might not be fully convincing, because it is one dimensional. Several Fed official have noted that they are taking a broad view when assessing financial conditions, and thus one might also want to

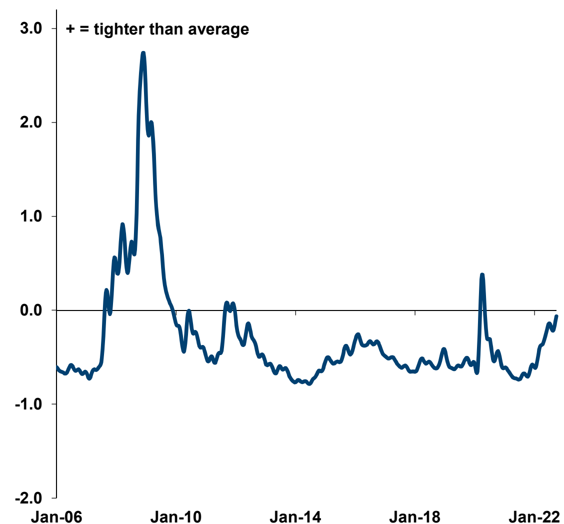
10-Year TIPS Rate*



** The rate on 10-year inflation-protected U.S. Treasury securities. Monthly average data, except for the last observation which is a quote for October 6, 2022.*

Source: Federal Reserve Board via Haver Analytics

National Financial Conditions Index



Source: Federal Reserve Bank of Chicago via Haver Analytics

include measure such as stock prices, credit spreads, credit availability, and foreign exchange rates. With the stock market down this year and credit spreads and the foreign exchange value of the dollar up, financial conditions can probably be viewed as tight.

Financial conditions have indeed tightened, but they might not be tight enough. The Chicago Fed publishes a broad index of financial conditions, and this measure has jumped this year, signaling tighter conditions. However, it is still marginally in negative territory, indicating that conditions are easier than the long-run average (chart; prior page, right). The negative value is not deeply troubling because the components holding it down relate to less-than-troubling debt or leverage positions of households and businesses. Other components have moved into territory signaling tight conditions. Still, the other components are only barely in positive (restrictive) territory. With inflation at a 40-year high, officials might wish to have a more restrictive stance than the one currently in place.

Review

Week of Oct. 3, 2022	Actual	Consensus	Comments
ISM Manufacturing Index (September)	**50.9 (-1.9 Index Pts.)**	**52.0 (-0.8 Index Pt.)**	Although the ISM manufacturing index remained above 50 in September, it has eased sharply in recent months after averaging 60.6 last year. The production index edged higher in the latest month (0.2 index point to 50.6), but both new orders (-4.2 index points to 47.1) and employment (-5.5 index points to 48.7) slipped into contractionary territory. The supplier deliveries index declined 2.7 index points in September to 52.4, moving into a range that could be considered normal and signaling continued supply-chain repair. The price index also suggested supply-side improvement (dipping 0.8 index point to 51.7, down from a 2022 high of 87.1 in March).
Construction Spending (August)	**-0.7%**	**-0.3%**	Private single-family construction stood out on the soft side in August, dropping for the third consecutive month. Multi-family building edged higher, preserving its sideways trend, and improvements to existing homes continued to move upward. Private nonresidential construction dipped in the past two months. However, revised data show a sizeable gain in June, which has left a solid performance in the past three months combined. Building by state and local governments eased, but the drop followed strong gains in the prior two months and did little damage to the upward trend. The results noted above all involve changes in nominal terms. Translations to real activity will likely lead to notably softer results for construction activity in the GDP accounts for Q3.
Factory Orders (August)	**0.0%**	**0.0%**	The flat reading on factory orders suggested that tight financial conditions are starting to weigh on the manufacturing sector. Durable bookings dipped 0.2%. Downside volatility in orders for civilian aircraft accounted for much of the drag, but nominal orders ex-transportation rose only 0.3%. Total nondurable bookings rose 0.2%, offsetting only a small portion of a drop in July. Lower prices restrained the petroleum and coal category, which eased 1.1% after a plunge of 6.9% in July. Nondurable orders excluding petroleum inched higher in August, but they have declined on balance in the past two months.
Job Openings (August)	**10.053 Million (-1.117 Million)**	**11.088 Million (-0.151 Million)**	The number of job openings tumbled 1.117 million in August (-10.0%), and results in the prior month were revised lower by 69,000. Openings remain elevated relative to historical standards, but the magnitude of the shift suggests that employers are beginning to rethink appropriate staffing levels. The drop in openings led to a similar movement in the ratio of openings to the number of unemployed individuals (1.672 opportunities for each unemployed person, down from 1.970 in July and the record high of 1.992 in March).

Review Continued

Week of Oct. 3, 2022	Actual	Consensus	Comments
Trade Balance (August)	**-$67.4 Billion ($3.1 Billion Narrower Deficit)**	**-$67.7 Billion ($3.0 Billion Narrower Deficit)**	Both imports and exports fell in August (off 1.1% and 0.3%, respectively), but the larger shift in imports led to narrowing in the monthly trade deficit. Total exports have shown little net change in the past two months, breaking from an upward trend in the prior two years. Imports have fallen sharply in the past three months, returning to trend after a surge late last year and early this year driven by catchup from supply chain disruptions. The real (inflation-adjusted) goods deficit published with the trade report also narrowed, raising the prospect of a large positive contribution from net exports to GDP growth in Q3 – possibly more than three percentage points. The expected increase would follow a positive contribution of 1.2 percentage points in Q2, although net exports subtracted 3.1 percentage points from growth in Q1 and were a drag on growth in the prior two years.
ISM Services Index (September)	**56.7 (-0.2 Index Pt.)**	**56.0 (-0.9 Index Pt.)**	Although the ISM services index is down sharply from the record high of 68.4 in November of last year, it has held up relatively well despite a tightening in financial conditions. The business activity component slipped 1.8 index points in September to 59.1, and the new orders component declined 1.2 index points to 60.6. Both trailed the robust averages for 2021 (64.5 for business activity and 63.4 for new orders), but they remained firm relative to historical norms. The employment component provided a positive surprise, increasing 2.8 index points to 53.0, the third consecutive improvement after a recent low of 47.4 in June. The supplier deliveries component declined 0.6 index point to 53.9, a drag on the headline index but indicating further normalization of supply chains.
Payroll Employment (September)	**263,000**	**255,000**	The September increase in payrolls lagged the average of 383,000 in the prior six months, but the gain still represented a respectable performance. The unemployment rate fell 0.2 percentage point to 3.5%, returning to the recent low. The change reflected an increase of 204,000 in employment as measured by the household survey and a drop of 57,000 in the size of the labor force. The decline in the size of the labor force resulted in a dip of 0.1 percentage point in the labor force participation rate (62.3%). The prime-age participation rate also fell 0.1 percentage point (82.7%). Average hourly earnings rose 0.3%. The change left the year-over-year increase at 5.0%, down from 5.2% in the prior month and a recent high of 5.6% in March, but still brisk.

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, Payroll Employment); Bureau of Economic Analysis (Trade Balance); Consensus forecasts are from Bloomberg

Preview

Week of Oct. 10, 2022	Projected	Comments
Federal Budget (September) (Tuesday) (Likely Postponed)	**$50.0 Billion Deficit**	Available data suggest that federal revenues rose approximately 6% on a year-over-year basis in September, which should leave the monthly deficit narrower than the $65 billion shortfall in the same month last year. September is the final month of the federal government's fiscal year, and the expected monthly deficit would leave a cumulative shortfall of $996 billion, down from the Covid-influenced deficit of $2.776 trillion in FY2021.
PPI (September) (Wednesday)	**0.1% Total, 0.3% Ex. Food & Energy**	Energy prices at the producer level appear likely to ease for the third consecutive month in September (off 7.5% on average in the past two months after an average advance of 5.5% in H1). Increases in food prices have shown some signs of slowing, with an average increase of 0.4% per month in the past three months versus 1.6% in the first five months of 2022. Moderating demand and easing in supply constraints appear to be limiting pressure on prices excluding food and energy, which have averaged increases of 0.4% per month in the past three months versus 0.7% from January through May.
CPI (September) (Thursday)	**0.2% Total, 0.4% Core**	Energy prices could fall for the third consecutive month after a cumulative drop of 9.3% in July and August. Food prices appear likely to post another brisk increase, although they could cool from the rapid average of 0.9% in the past 12 months. Broad underlying price pressure suggests a reading in the core component close to the 12-month average of 0.5%.
Retail Sales (September) (Friday)	**0.4% Total, 0.2% Ex. Autos**	A pickup in sales of new vehicles could boost the auto component of the retail report in September, although lower prices could constrain the value of sales at gasoline service stations. Cautious behavior by consumers is likely to limit spending in non-essential areas, but higher prices could inflate the value of sales.
Consumer Sentiment (October) (Friday)	**59.0 (+0.7%)**	While gasoline prices are notably off their highs, which could brighten moods, rapid inflation in the costs of other household essentials (food and utilities), along with increased chatter in the press about recession, could provide an offset and leave the University of Michigan sentiment gauge little changed at a low level.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

October 2022

Monday	Tuesday	Wednesday	Thursday	Friday
3	4	5	6	7
ISM INDEX Index Prices July 52.8 60.0 Aug 52.8 52.5 Sep 50.9 51.7 **CONSTRUCTION SPEND.** June 0.6% July -0.6% Aug -0.7% **VEHICLE SALES** July 13.3 million Aug 13.1 million Sep 13.5 million	**FACTORY ORDERS** June 1.8% July -1.0% Aug 0.0% **JOLTS DATA** Openings (000) Quit Rate June 11,040 2.8% July 11,170 2.7% Aug 10,053 2.7%	**ADP EMPLOY. REPORT** Private Payrolls July 268,000 Aug 185,000 Sep 208,000 **TRADE BALANCE** June -$80.9 billion July -$70.5 billion Aug -$67.4 billion **ISM SERVICES INDEX** Index Prices July 56.7 72.3 Aug 56.9 71.5 Sep 56.7 68.7	**UNEMP. CLAIMS** Initial Continuing (millions) Sep 10 0.208 1.376 Sep 17 0.209 1.346 Sep 24 0.190 1.361 Oct 1 0.219 N/A	**EMPLOYMENT REPORT** Payrolls Un. Rate July 537,000 3.5% Aug 315,000 3.7% Sep 263,000 3.5% **WHOLESALE TRADE** Inventories Sales June 1.8% 1.6% July 0.6% -1.5% Aug 1.3% 0.1% **CONSUMER CREDIT** June $39.7 billion July $26.1 billion Aug $32.2 billion
10	11	12	13	14
COLUMBUS DAY	**NFIB SMALL BUSINESS OPTIMISM INDEX (6:00)** July 89.9 Aug 91.8 Sep -- **FEDERAL BUDGET (2:00) (LIKELY POSTPONED)** 2022 2021 July -$211.1B -$302.1B Aug -$219.6B -$170.6B **Sep** **-$50.0B** -$64.9B	**PPI (8:30)** Final Demand Ex. Food & Energy July -0.4% 0.3% Aug -0.1% 0.4% **Sep** **0.1%** **0.3%** **FOMC MINUTES (2:00)**	**UNEMP. CLAIMS (8:30)** **CPI (8:30)** Total Core July 0.0% 0.3% Aug 0.1% 0.6% **Sep** **0.2%** **0.4%**	**RETAIL SALES (8:30)** Total Ex.Autos July -0.4% 0.0% Aug 0.3% -0.3% **Sep** **0.4%** **0.2%** **IMPORT/EXPORT PRICES (8:30)** Non-Petrol Imports Nonagri. Exports July -0.7 % -3.8% Aug -0.2 % -1.8% Sep -- -- **BUSINESS INVENTORIES (10:00)** Inventories Sales June 1.4% 1.2% July 0.5% -1.0% **Aug** **0.8%** **0.2%** **CONSUMER SENTIMENT (10:00)** Aug 58.2 Sep 58.6 **Oct** **59.0**
17	18	19	20	21
EMPIRE MFG INDEX	**INDUSTRIAL PRODUCTION** **NAHB HOUSING INDEX** **TIC FLOWS**	**HOUSING STARTS** **BEIGE BOOK**	**UNEMP. CLAIMS** **PHILY FED MFG INDEX** **EXISTING HOME SALES** **LEADING INDICATORS**	
24	25	26	27	28
CHICAGO FED NATIONAL ACTIVITY INDEX	**FHFA HOME PRICE INDEX** **S&P CORELOGIC HOME PRICE INDEX** **CONSUMER CONFIDENCE**	**INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES** **NEW HOME SALES**	**UNEMP. CLAIMS** **Q3 GDP** **DURABLE GOODS ORDERS**	**PERSONAL INCOME, CONSUMPTION, PRICES** **EMP. COST INDEX** **CONSUMER SENTIMENT** **PENDING HOME SALES**

Forecasts in Bold.

Treasury Financing

October 2022

Monday	Tuesday	Wednesday	Thursday	Friday
3	4	5	6	7
AUCTION RESULTS: Rate / Cover 13-week bills 3.340% 2.56 26-week bills 3.850% 2.62	**AUCTION RESULTS:** Rate / Cover 52-week bills 3.955% 2.68 **ANOUNCE:** $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 RESULTS:** Rate / Cover 17-wk CMB 3.700% 3.19	**AUCTION RESULTS:** Rate / Cover 4-week bills 2.920% 2.75 8-week bills 3.230% 2.53 **ANNOUNCE:** $102 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:** $102 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:** $102 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:** $102 billion 13-,26-week bills	
17	18	19	20	21
AUCTION: $102 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 bills 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 bills $12 billion* 20-year bonds	**AUCTION:** $50 billion* 4-week bills $45 billion* 8-week bills $21 billion* 5-year TIPS **ANNOUNCE:** $102 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:** $102 billion* 13-,26-week bills	
24	25	26	27	28
AUCTION: $102 billion* 13-,26-week bills	**AUCTION:** $42 billion* 2-year notes **ANNOUNCE:** $50 billion* 4-week bills for auction on Oct 27 $45 billion* 8-week bills for auction on Oct 27 $30 billion* 17-week bills for auction on Oct 26 **SETTLE:** $50 billion* 4-week bills $45 billion* 8-week bills $30 billion* 17-week bills	**AUCTION:** $30 billion* 17-week bills $43 billion* 5-year notes $24 billion* 2-year FRNs	**AUCTION:** $50 billion* 4-week bills $45 billion* 8-week bills $35 billion* 7-year notes **ANNOUNCE:** $102 billion* 13-,26-week bills for auction on Oct 31 $34 billion* 52-week bills for auction on Nov 1 **SETTLE:** $102 billion* 13-,26-week bills	

**Estimate*