Daiwa Capital Markets

U.S. Economic Comment

- Policy restraint thus far: moderate outside of housing
- Federal budget FY2022: solid revenue growth, light Covid spending

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The U.S. Economy: Inching Along

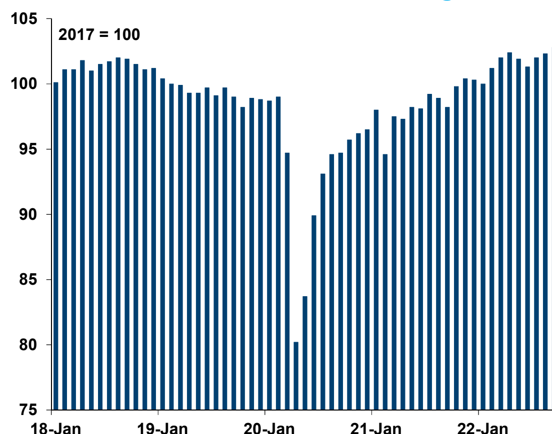
The Federal Reserve began to tighten monetary policy seven months ago, long enough to begin seeing the effects. Signs of slower economic activity have indeed emerged, although they are merely pointing to slower growth rather than contraction.

The report on industrial production, especially the manufacturing component, provides useful insights because it is a highly cyclical area: it will move with, and sometimes lead, the overall economy. In addition, because it is based on physical production, it is a real variable; analysts do not have to deal with separating the price and quantity components of nominal indicators.

Manufacturing activity by this measure is continuing to advance. Production rebounded to its pre-pandemic level in mid-2021, and it has moved irregularly higher since then (chart, left). The rate of advance has slowed in recent months, as the increase of 1.9 percent in the third quarter lagged the average of 3.4 percent in the first half of the year (annual rates). Still, the sector is moving ahead. Some of the resilience is a result of production in the motor vehicle sector, where manufacturers are making an effort to replenish inventories depleted by supply-chain disruptions. Other areas, though, are doing reasonably well, with activity growing 1.6 percent in Q3 versus an average of 2.8 percent in the first half.

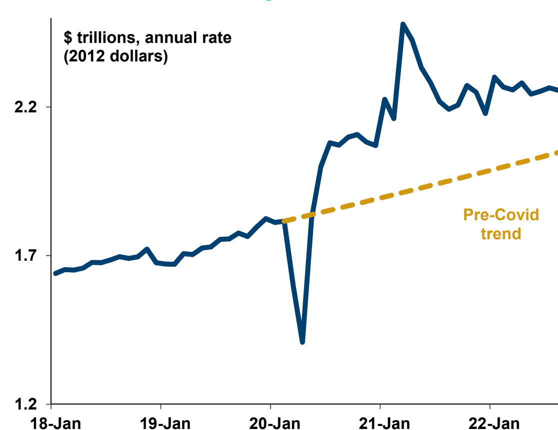
We should keep an eye on the mining component of industrial production. Mining is a small share of GDP (approximately two percent), but it could nudge GDP growth in either direction. This sector performed well in Q3, advancing at an annual rate of 12.4 percent, firmer than 7.1 percent in the first half and 10.8 over the four quarters of last year. The solid performance in recent months is not surprising, as mining activity is likely to be more sensitive to commodity prices than to interest rates. With tight supplies of oil and natural gas an issue, and with prices still elevated despite recent easing, miners are pumping away.

Industrial Production: Manufacturing



Source: Federal Reserve Board via Haver Analytics

Real Consumer Outlays for Durable Goods*



** The pre-Covid trend assumes that real outlays for durable goods continued to grow at the 2018-19 pace (0.4 percent per month).*

Sources: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

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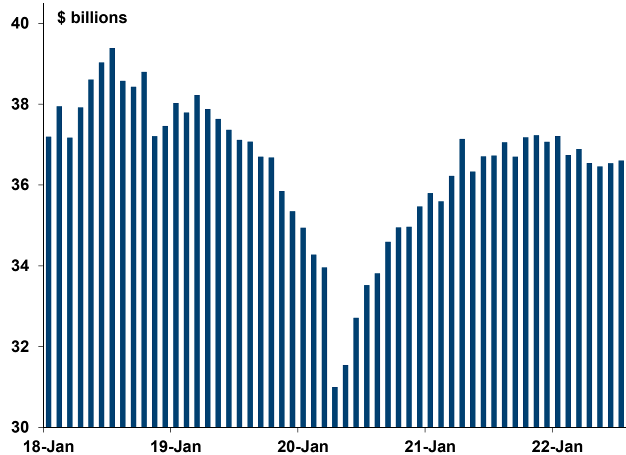
The industrial sector is holding up reasonably well, and so too are some interest-sensitive sectors of the economy. Outlays for consumer durable goods seem weak at first blush (on track for growth of less than 1.0 percent in Q3 after a decline of 2.8 percent in Q2), but considering the surge in the early part of the expansion, we view recent activity as respectable. Spending on durable goods in late 2020 and early 2021 surged well above the pre-pandemic trend, and a cooling seemed likely even if interest rates had remained at low levels (chart; prior page, right). The gradual change in the face of tight financial conditions suggests that households in the aggregate are not in retreat, at least thus far.

Businesses are hesitating to invest in new equipment, but they are not pulling back. Outlays for new equipment dipped in the second quarter, but the decline followed a double-digit advance in the first quarter, leaving a favorable performance in H1 (average growth of 4.7 percent). Shipments of capital goods other than aircraft have been moving along a smooth upward trend, suggesting continued growth, although one wonders about the breakdown between prices and quantities. The producer price index for capital goods suggests that most of the advance reflected higher prices, but the series also seems to have inched ahead in real terms. In addition, businesses have purchased a fair amount of capital goods from foreign producers. Purchases from abroad will not boost domestic production, but they show that businesses are interested in new investment.

Durable Goods Orders*



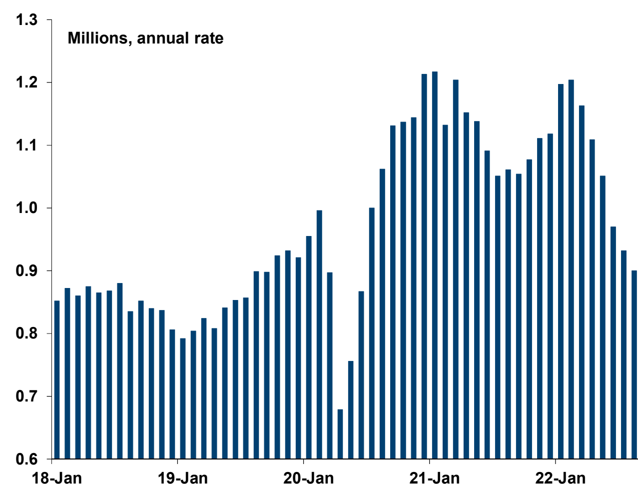
** Real bookings for nondefense capital goods excluding aircraft. The nominal series is adjusted for inflation using the Private Capital Equipment component of the PPI.*

Sources: U.S. Census Bureau and Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America

New orders for capital goods are perhaps more important than shipments because they provide information on likely developments in coming quarters. Like shipments, nominal bookings are advancing, but deflating with the PPI for capital goods shows that bookings started to slide in the spring. They have revived to a degree in recent months, leaving only a small net decline (chart, above). This near-steady flow of new orders, along with a sizeable backlog of unfilled orders, could sustain growth for a time, but with financial conditions tightening and with the economic outlook involving downside risks, this area is likely to face challenges next year.

While some key areas are muddling along, the housing sector is in full-scale retreat. The increase of more than four percentage points in mortgage interest rates in the past year has quickly cooled demand. Sales of existing homes have declined for eight consecutive months and have moved to their lowest level since the early months of the current expansion, when activity was still constrained by pandemic-related shutdowns. Sales of new homes also have moved to levels last seen at the start of the current expansion.

Single-Family Building Permits



Sources: U.S. Census Bureau via Haver Analytics

The slow pace of sales and a buildup of unsold new homes has led builders to reconsider their construction plans. Permits for single family housing starts, which provide a clear view on underlying trends, have declined for seven consecutive months, and like sales, have returned to levels last seen in the early stages of the recovery (chart, prior page).

Business-related construction also is weak. This sector has performed poorly in recent years, declining in nine of the past 11 quarters. Available data suggest another soft showing in Q3, as a respectable advance in nominal activity will probably translate to another decline after adjusting for inflation. This soft performance is primarily is the result of uncertainty in the economic outlook rather than tight financial conditions. With business executives unsure of office and retail requirements in a post-Covid world, they are holding back on major construction projects. Tight financial conditions represent another constraint.

Q3 GDP

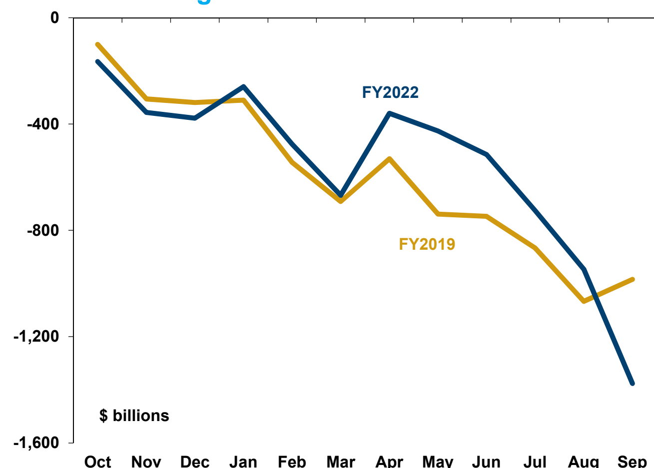
The combination of weak construction spending (residential and business) and only moderate growth in consumer spending and business investment in new equipment will probably lead to a decline in domestic demand. However, net exports are likely to favor the U.S. in Q3, with a contribution to growth of approximately three percentage points. Thus, overall GDP growth is likely to be in the neighborhood of two percent.

The strong showing in net exports reflected both a solid gain in exports and a marked contraction in imports. Trade results in subsequent quarters are likely to be less favorable, as slow growth among major trading partners will weaken exports, and the strong foreign exchange value of the dollar could shift U.S. demand in favor of imports.

The Federal Budget

Budget results for September published by the Treasury Department on Friday morning rounded out the fiscal year, with the final monthly tally leaving an annual deficit of $1.375 trillion, a marked improvement from $2.776 trillion in FY2021 and $3.132 trillion in FY2020. Of course, the deficits in the prior two fiscal years were heavily influenced by pandemic-related expenses. A better comparison would involve the pre-Covid shortfall of $984 billion in fiscal year 2019. Measured as a share of GDP, this year's deficit is likely to total approximately 5.5 percent, up from 4.6 percent in FY2019 and hefty by historical standards.

Cumulative Budget Balance: FY2022 vs FY2019



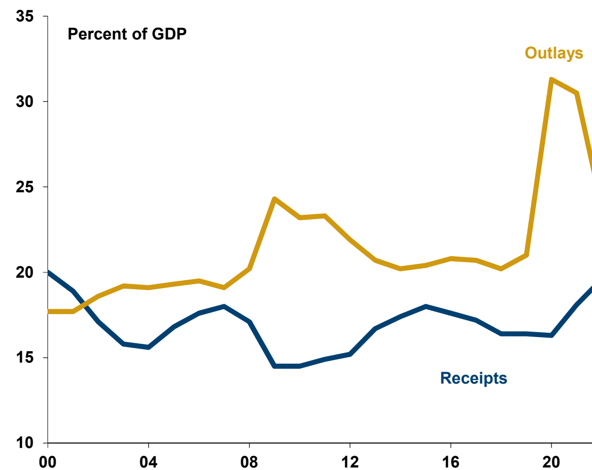
Source: U.S. Treasury Department via Haver Analytics

Results for the current year had been showing improvement from those in 2019. However, the Treasury Department recorded in September anticipated losses associated with the forgiveness of student loans. The Department of Education showed expenses associated with student loans of $432 billion. In the absence of this forgiveness, the deficit would have been a tad narrower than that for FY2019, and as a share of GDP it would have represented an improvement of 0.8 percentage point (3.8 percent versus 4.6 percent).

Both outlays and revenues contributed to year-to-year the improvement in the deficit. On the outlay side, the unwinding of pandemic-related support programs accounted for most of the 8.1 percent reduction in total spending. Energy–related activity also helped, reflecting sales of crude oil from the Strategic Petroleum Reserve (recorded as a negative outlay). Auction of rights to the electromagnetic spectrum also are recorded

as negative outlays and helped to constrain spending. Some outlay categories surged. The $432 billion associated with student-loan forgiveness represented a huge addition to outlays. In addition, spending for international assistance jumped $24.7 billion (52.7 percent), heavily influenced by support for Ukraine. Finally, the surge of debt issuance in the past few years led to a jump of $122.9 billion (34.9 percent) in interest expense.

Federal Receipts & Outlays*



** Federal receipts and outlays as a share of nominal GDP. Fiscal-year basis. The readings for 2022 include an estimate of nominal GDP for the fourth quarter of FY2022.*

Source: U.S. Treasury Department and Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

Individual tax receipts were robust (up 28.8 percent), reflecting strong job growth and firm wage gains. In addition, final tax payments in the spring to settle 2021 obligations were strong, undoubtedly influenced by the strong stock market (before this year) and the payment of capital gains taxes. Corporate receipts also were brisk (13.6 percent), and excise taxes and customs duties posted double-digit increases as well. Interestingly, the miscellaneous category, which includes remittances from the Federal Reserve, rose only 1.6 percent. The Fed is now paying higher interest on reserve balances, which is reducing its profits and limiting the amount of funds it can return to the Treasury. Reducing its portfolio under quantitative tightening also will restrain profits and remittances. In fact, the Fed might begin to record losses in coming months.

Review

Week of Oct. 17, 2022	Actual	Consensus	Comments
Industrial Production (September)	**0.4%**	**0.1%**	The key components of industrial output (manufacturing and mining) rose in September from upwardly revised levels, giving a solid tone to the production report. Manufacturing activity advanced 0.4%, marking the third consecutive increase and offsetting a soft patch in May and June. The level of activity easily exceeds pre-pandemic levels. The mining component increased 0.6%. This sector continues to recover from a deep slump during the recession, although activity remains shy of pre-pandemic levels. Utility output fell 0.3%, but changes in this component nearly always reflect shifts in weather and temperatures rather than economic fundamentals.
Housing Starts (September)	**1.439 Million (-8.1%)**	**1.461 Million (-7.2%)**	In an attempt to contain inventories amid sluggish demand, builders cut single-family housing starts in September for the eighth time in the past 10 months. The latest decline of 4.7% pushed single-family starts to their lowest reading since mid-2020, when the economy was reopening from pandemic-driven shutdowns. Multi-family housing starts also slipped (off 13.2%), but the change occurred from the second firmest level of the current expansion, leaving activity at a still-strong level. Preferences have shifted away from more expensive single-family dwellings, supporting demand for rental units.
Existing Home Sales (September)	**4.71 Million (-1.5%)**	**4.70 Million (-2.1%)**	Mortgage interest rates of almost 7% (versus less than 3% at times last year) joined already elevated prices and tight inventories to slam the brakes on activity in the housing market. Amid these headwinds, sales of existing homes fell for the eighth consecutive month to the low end of the range of the current expansion.
Leading Indicators (September)	**-0.4%**	**-0.3%**	The index of leading economic indicators slipped for the sixth time in the past seven months in September (the other month registered no change), as negative contributions from stock prices, consumer expectations, and the ISM new orders index were only partially offset by positive contributions from initial claims for unemployment insurance, the slope of the yield curve, and the factory workweek. The result for September left the measure 2.9% below the cyclical peak in February.
Federal Budget (September)	**$429.7 Billion Deficit**	**$424.0 Billion Deficit**	The budget report for September included results for full FY2022. Receipts for the year rose 21.0%, led by jumps in individual and corporate income taxes. Outlays fell by 8.1%, as spending wound down on pandemic-related programs (recovery rebates, enhanced child tax credit, Small Business Administration programs, unemployment insurance). Outlays would have fallen by a larger amount, but costs associated with the Biden Administration's student loan forgiveness program were added to monthly results for September ($432 billion). The deficit of $1.375 trillion for the full fiscal year, while hefty by historical standards, was about half of the $2.776 trillion pandemic-driven shortfall in FY 2021.

Sources: Federal Reserve Board (Industrial Production); U.S. Census Bureau (Housing Starts); National Association of Realtors (Existing Home Sales); The Conference Board (Leading Indicators); U.S. Treasury Department (Federal Budget); Consensus forecasts are from Bloomberg

Preview

Week of Oct. 24, 2022	Projected	Comments
Consumer Confidence (October) (Tuesday)	**107.0 (-0.9%)**	The recent increase in the price of gasoline in an environment of still-elevated costs of essentials (food and utilities) could nudge consumer confidence lower in October.
International Trade in Goods (September) (Wednesday)	**-$87.8 Billion ($0.5 Billion Wider Deficit)**	Lower prices of petroleum products could reduce the value of exported industrial supplies in September, and exports of miscellaneous items could ease after sharp increases in July and August. Imports of industrial supplies also could cool, but the expected easing in total exports could exceed that in imports and lead to a modest widening in the monthly goods trade deficit. Even with the month-to-month slippage, net exports are expected to make a large positive contribution to GDP growth in Q3 (see below).
New Home Sales (September) (Wednesday)	**0.625 Million (-8.8%)**	Notable weakness in the housing market suggests that the surge of 28.8% in August was an aberration. The downward trend in new home sales is likely to resume in September.
GDP (2022-Q3) (Thursday)	**2.0%**	Available data on trade flows suggest that net exports could make a sizable positive contribution to GDP growth for the second consecutive quarter (approximately three percentage points expected) after acting as a drag on growth during much of the current expansion. Inventory investment, in contrast could be a drag again after subtracting 1.9 percentage points from growth in Q2. Final domestic demand is likely to be disappointing, with modest increases in consumer spending and business investment in equipment offset by weakness in construction spending (both residential and business-related).
Durable Goods Orders (September) (Thursday)	**-0.2%**	Civilian aircraft orders could pick up in September after a low-side reading in the prior month. Elsewhere, higher prices might boost the value of orders in some categories, but uncertainty about the economic outlook is likely to outweigh price effects and nudge bookings ex. transportation lower.
Personal Income, Consumption, Core Price Index (September) (Friday)	**0.3%, 0.4%, 0.5%**	Data on average hourly earnings and worktimes suggest a moderate increase in wages and salaries. The growth of rental income has cooled in recent months, but remains in positive territory. A restrained performance in retail spending suggests only modest growth in outlays for nondurable items, but an increase in vehicle sales suggests a better performance in durable spending. Nominal spending on services has been firm in most months this year. Lower energy prices should provide a partial offset to a sharp increase in food prices and constrain the expected increase in the headline PCE price index, but a surge in the core CPI points to another rapid advance in the prices excluding food and energy.
Employment Cost Index (2022-Q3) (Friday)	**1.2%**	A tight labor market in Q3 raises the prospect of brisk increases in wages and benefits, a view supported by a firm quarterly advance in average hourly earnings.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

October / November 2022

Monday 17

EMPIRE MFG

Aug	-31.3
Sep	-1.5
Oct	-9.1

Tuesday 18

IP & CAP-U

	IP	Cap.Util.
July	0.7%	80.3%
Aug	-0.1%	80.1%
Sep	0.4%	80.3%

NAHB HOUSING INDEX

Aug	49
Sep	46
Oct	38

TIC FLOWS

	Long-Term	Total
June	$121.8B	-$5.0B
July	$21.4B	$154.0B
Aug	$197.9B	$275.6B

Wednesday 19

HOUSING STARTS

July	1.377 million
Aug	1.566 million
Sep	1.439 million

BEIGE BOOK

"National economic activity expanded modestly on net since the previous report; however, conditions varied across industries and Districts."

Thursday 20

UNEMP. CLAIMS

	Initial	Continuing
	(millions)	
Sep 24	0.190	1.365
Oct 1	0.219	1.364
Oct 8	0.226	1.385
Oct 15	0.214	N/A

PHILADELPHIA FED MFG BUSINESS OUTLOOK

Aug	6.2
Sep	-9.9
Oct	-8.7

EXISTING HOME SALES

July	4.82 million
Aug	4.78 million
Sep	4.71 million

LEADING INDICATORS

July	-0.6%
Aug	0.0%
Sep	-0.4%

Friday 21

FEDERAL BUDGET

	2022	2021
July	-$211.1B	-$302.1B
Aug	-$219.6B	-$170.6B
Sep	-$429.7B	-$64.9B

Monday 24

CHICAGO FED NATIONAL ACTIVITY INDEX (8:30)

	Monthly	3-Mo. Avg.
July	0.29	-0.08
Aug	0.00	0.01
Sep	--	--

Tuesday 25

FHFA HOME PRICE INDEX (9:00)

June	0.1%
July	-0.6%
Aug	--

S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX (9:00)

	SA	NSA
June	0.2%	0.4%
July	-0.4%	-0.8%
Aug	--	--

CONFERENCE BOARD CONSUMER CONFIDENCE (10:00)

Aug	103.6
Sep	108.0
Oct	**107.0**

Wednesday 26

INTERNATIONAL TRADE IN GOODS (8:30)

July	-$90.2 billion
Aug	-$87.3 billion
Sep	**-$87.8 billion**

ADVANCE INVENTORIES (8:30)

	Wholesale	Retail
July	0.6%	1.0%
Aug	1.3%	1.3%
Sep	--	--

NEW HOME SALES (10:00)

July	0.532 million
Aug	0.685 million
Sep	**0.625 million**

Thursday 27

UNEMP. CLAIMS (8:30)

GDP (8:30)

	GDP	Chained Price
22-Q1	-1.6%	8.3%
22-Q2	-0.6%	9.0%
22-Q3	**2.0%**	**4.8%**

DURABLE GOODS ORDERS (8:30)

July	-0.1%
Aug	-0.2%
Sep	**-0.2%**

Friday 28

PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX (8:30)

	Inc.	Cons.	Core
July	0.3%	-0.2%	0.0%
Aug	0.3%	0.4%	0.6%
Sep	**0.3%**	**0.4%**	**0.5%**

EMPLOYMENT COST INDEX (8:30)

	Comp.	Wages
22-Q1	1.4%	1.2%
22-Q2	1.3%	1.4%
22-Q3	**1.2%**	**1.2%**

REVISED CONSUMER SENTIMENT (10:00)

Aug	58.2
Sep	58.6
Oct(p)	59.8

PENDING HOME SALES (10:00)

July	-0.6%
Aug	-2.0%
Sep	--

Monday 31

MNI CHICAGO BUSINESS BAROMETER

Tuesday 1

JOLTS

ISM MANUFACTURING

CONSTRUCTION

VEHICLE SALES

FOMC (1ST DAY)

Wednesday 2

ADP EMPLOYMENT

FOMC DECISION

Thursday 3

UNEMP. CLAIMS

INTERNATIONAL TRADE

PRODUCTIVITY & COSTS

ISM SERVICES

FACTORY ORDERS

Friday 4

EMPLOYMENT REPORT

Monday 7

CONSUMER CREDIT

Tuesday 8

NFIB SMALL BUSINESS OPTIMISM INDEX

Wednesday 9

WHOLESALE TRADE

Thursday 10

UNEMP. CLAIMS

CPI

FEDERAL BUDGET

Friday 11

CONSUMER SENTIMENT

VETERANS DAY

Forecasts in Bold. (p) = preliminary

Treasury Financing

October / November 2022

Monday	Tuesday	Wednesday	Thursday	Friday
17	18	19	20	21
AUCTION RESULTS: Rate / Cover 13-week bills 3.820% 2.49 26-week bills 4.245% 2.66 **SETTLE:** $40 billion 3-year notes $32 billion 10-year notes $18 billion 30-year bonds	**ANOUNCE:** $65 billion 4-week bills for auction on Oct 20 $55 billion 8-week bills for auction on Oct 20 $33 billion 17-week bills for auction on Oct 19 **SETTLE:** $60 billion 4-week bills $50 billion 8-week bills $33 billion 17-week CMBs	**AUCTION RESULTS:** Rate / Cover 17-week bills 4.140% 2.93 20-yr bonds 4.395% 2.50	**AUCTION RESULTS:** Rate / Cover 4-week bills 3.430% 2.35 8-week bills 3.690% 2.49 5-year TIPS 1.732% 2.38 **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** $65 billion* 4-week bills for auction on Oct 27 $55 billion* 8-week bills for auction on Oct 27 $33 billion* 17-week bills for auction on Oct 26 **SETTLE:** $65 billion 4-week bills $55 billion 8-week bills $33 billion 17-week bills	**AUCTION:** $33 billion* 17-week bills $43 billion 5-year notes $24 billion 2-year FRNs	**AUCTION:** $65 billion* 4-week bills $55 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	
31	1	2	3	4
AUCTION: $102 billion* 13-,26-week bills **SETTLE:** $12 billion 20-year bonds $21 billion 5-year TIPS $42 billion 2-year notes $43 billion 5-year notes $35 billion 7-year notes $24 billion 2-year FRNs	**AUCTION:** $34 billion* 52-week bills **ANNOUNCE:** $65 billion* 4-week bills for auction on Nov 3 $55 billion* 8-week bills for auction on Nov 3 $33 billion* 17-week bills for auction on Nov 2 **SETTLE:** $65 billion* 4-week bills $55 billion* 8-week bills $33 billion* 17-week CMBs	**AUCTION:** $33 billion* 17-week bills **ANNOUNCE:** $40 billion* 3-year notes for auction on Nov 8 $35 billion* 10-year notes for auction on Nov 9 $21 billion* 30-year bonds for auction on Nov 10	**AUCTION:** $65 billion* 4-week bills $55 billion* 8-week bills **ANNOUNCE:** $102 billion* 13-,26-week bills for auction on Nov 7 **SETTLE:** $102 billion* 13-,26-week bills $34 billion* 52-week bills	
7	8	9	10	11
AUCTION: $102 billion* 13-,26-week bills	**AUCTION:** $40 billion* 3-year notes **ANNOUNCE:** $65 billion* 4-week bills for auction on Nov 10 $55 billion* 8-week bills for auction on Nov 10 $33 billion* 17-week bills for auction on Nov 11 **SETTLE:** $65 billion* 4-week bills $55 billion* 8-week bills $33 billion* 17-week bills	**AUCTION:** $33 billion* 17-week bills $35 billion* 10-year notes	**AUCTION:** $65 billion* 4-week bills $55 billion* 8-week bills $21 billion* 30-year bonds **ANNOUNCE:** $102 billion* 13-,26-week bills for auction on Nov 14 $15 billion* 20-year bonds for auction on Nov 16 $15 billion* 10-year TIPS for auction on Nov 17 **SETTLE:** $102 billion* 13-,26-week bills	***VETERANS DAY***

*Estimate