Daiwa Capital Markets

U.S. Economic Comment

- The U.S. labor market: hints of softening, but still tight
- The U.S. economy: on track (for now)
- Doubts regarding a 2023 Fed pivot

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A Still-Firm Labor Market

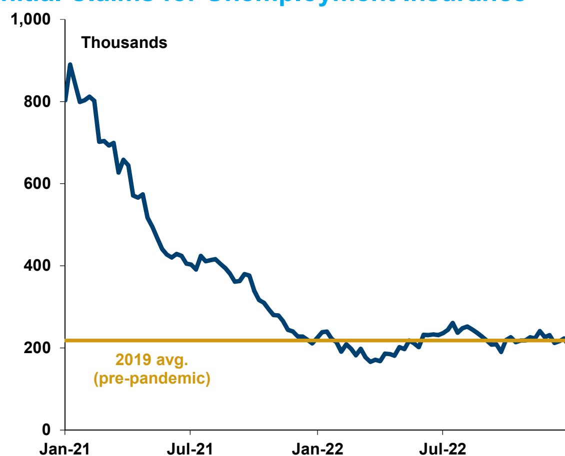
Nonfarm payrolls posted another solid gain in December, advancing 223,000. The increase was smaller than the average of 444,000 in the first half of the year and 562,000 in 2021, but those results were influenced by continued recovery from the pandemic-related swoon in employment. Increases in recent months have been respectable, even firm, relative to pre-Covid norms (job growth has averaged 261,000 in the past five months versus 164,000 in 2019 and 191,000 in 2018).

Tight monetary policy should ease the supply-demand imbalance in the labor market, and hints of softening are starting to emerge, but an abrupt shift to slower job growth does not appear to be in the offing. Recent readings on initial claims for unemployment insurance suggest that layoffs have not picked up, and the elevated level of job openings indicates that firms are still looking for workers (charts).

Search efforts by businesses, though, might be starting to ease. While initial claims for unemployment insurance have been stable, continuing claims (i.e. the number of individuals receiving jobless benefits) have picked up from their lows in the fall (chart, next page). The level is still low from a historical perspective, but the trend has changed. The upward drift suggests that unemployed individuals are not finding jobs as quickly as they were previously.

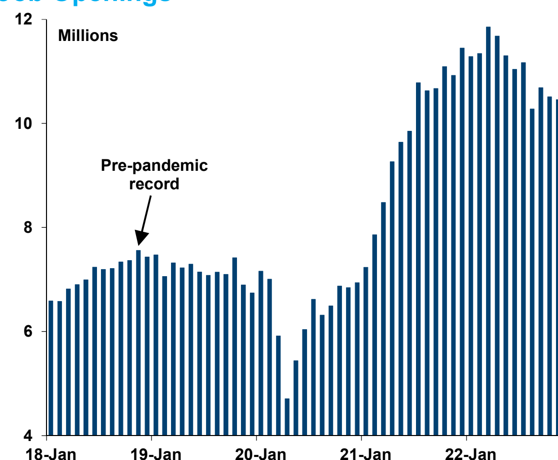
Recent changes in average hourly earnings also suggest that employers have become less aggressive in trying to attract workers. After touching 5.6 percent in March of last year, the year-over-year growth of average hourly earnings eased to 4.6 percent in December (chart, next page). This series can be volatile, and thus conclusions should be guarded, but the deceleration seems sharp enough to suggest that the labor market has lost a degree of vigor.

Initial Claims for Unemployment Insurance



Source: U.S. Department of Labor via Haver Analytics

Job Openings



Source: Bureau of Labor Statistics via Haver Analytics

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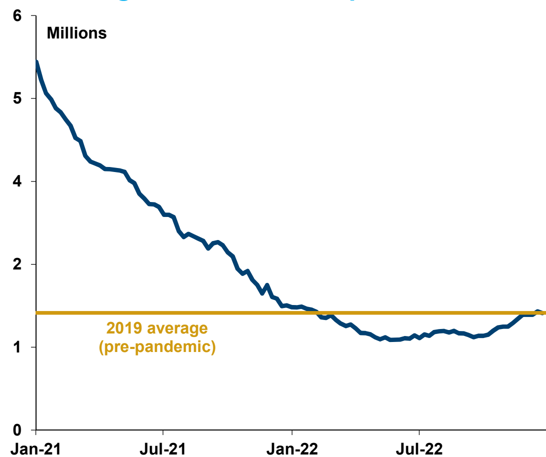
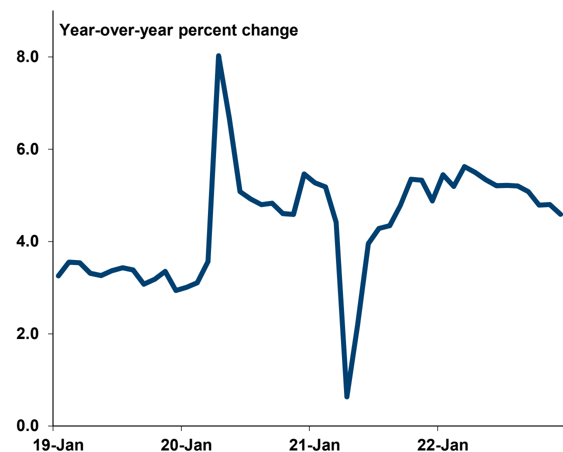
Continuing Claims for Unempl. Insurance



Source: U.S. Department of Labor via Haver Analytics

Average Hourly Earnings



Source: Bureau of Labor Statistics via Haver Analytics

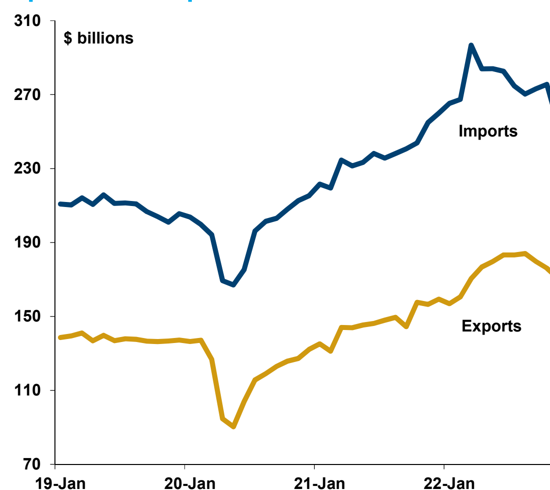
The Economy: Advancing in Q4, but Starting to Fade

The condition of the overall U.S. economy is similar to that in the labor market: activity is currently being well maintained, but it is perhaps starting to soften. We currently expect GDP growth of slightly more than two percent in the fourth quarter after an advance of 3.2 percent in Q3, a solid performance, but we expect a turn south in Q1.

The fourth quarter started on a soft note, as the figures for October led us to look for GDP growth of less than one percent. However, the picture brightened with November data, which led us to revise up our estimate of GDP growth to more than two percent. However, the sources of our adjustment were not especially encouraging.

The two most notable changes involved net exports and inventory investment. October data suggested a pronounced drag on economic growth from net exports (two to three percentage points), but a marked narrowing in the trade deficit in November suggested a drag of approximately one-half percentage point, and a neutral influence or slight boost to growth is possible if December also shows a restrained deficit. The improvement in the November deficit, however, was a “soft” one. That is, it reflected declines in both exports and imports, with the drop in imports outweighing the weakness in exports and leading to a narrower deficit. Declines in both exports and imports could be viewed as a sign of fading economic strength both domestically and abroad (chart).

Imports and Exports of Goods



Source: Bureau of Economic Analysis via Haver Analytics

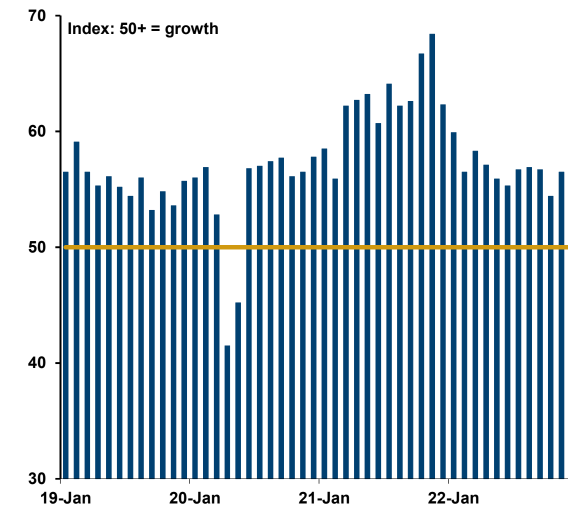
Our initial estimate of Q4 GDP growth involved a negative contribution from inventory investment, but results for November were better than expected, and it now looks as though inventory investment will be contributing to economic growth. We wonder, however, if some of the addition to inventories represents

unplanned expansion because of soft demand. Accumulation in Q4 might lead to an inventory correction in early 2023.

Another aspect of the employment report reinforced our concern for the economic outlook this year. While businesses are adding to payrolls at a solid pace, they also are trimming the length of their workweeks. The average workweek in December totaled 34.3 hours, down from a recent high of 35 hours in January and several observations of 34.9 hours in surrounding months. The length of the average workweek is an underappreciated statistic from the employment report; businesses can alter production noticeably by lengthening or shortening the workweek. Recent movement suggests that businesses are beginning to slow production.

We also were struck by the December observation on the services index published by the Institute for Supply Management (ISM), which tumbled 6.9 index points and breached the 50 threshold that separates expansion from contraction (49.6; chart). The orders component of the headline index, which provides insight into future activity, posted a shocking drop of 10.8 points to 45.2.

ISM Services Index



Source: Institute for Supply Management via Haver Analytics

Dim Prospects for a Pivot

The hints of economic slippage might seem to provide strong support for the consensus view in financial markets that the Federal Reserve will begin to move away from its restrictive policy stance in the second half of the year. However, we would not look for such a shift until the first half of 2024.

The minutes from the December meeting of the Federal Open Market Committee threw cold water on the likelihood of a pivot. Despite some encouraging inflation reports in hand at the meeting, policymakers believed that they needed “substantially more evidence” of slower inflation before they consider lower interest rates.

The interest rate expectations of Fed officials in December (i.e. the dot plot) also would discourage observers from expecting easier policy later this year, as the median view was 50 basis points higher than the corresponding one in September. More telling, the minutes added some color to the dot plot by noting that no policymaker felt that it would be appropriate to begin reducing the federal funds rate in 2023. We viewed this as a striking revelation. In addition, “several” Fed officials commented that history cautions against easing policy prematurely.

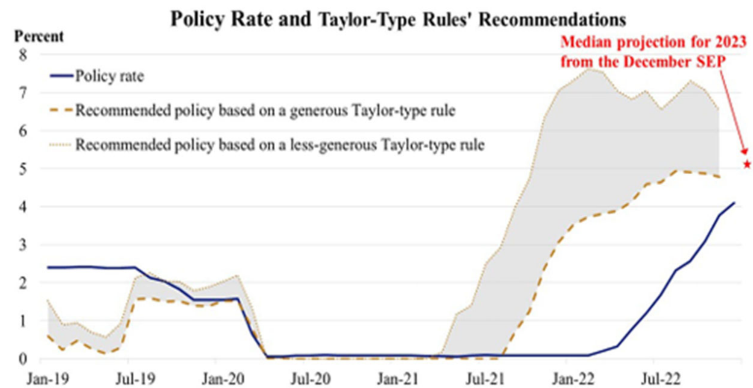
James Bullard of the St. Louis Fed captured attention this week for comments that many market participants viewed as supporting the case for a pivot. We do not believe he presented a strong case.

On the surface, Mr. Bullard’s remarks seemed market friendly, as he argued that the FOMC will soon be in a policy stance that might be “sufficiently restrictive” (new buzz words from the Fed) to return inflation to the target of two percent. He provided a chart showing a range of values for the federal funds rate that represent a sufficiently restrictive stance (chart, next page), and he noted that the median dot from the latest Summary of Economic Projections was within this range. Thus, he implied, the Fed is nearing the end of its tightening cycle.

We did not find his chart encouraging. The median dot is indeed within the range of restrictive policy, but very much in the low portion of that range. Moreover, the lower bound of that range is based on a “generous” Taylor rule. The upper bound of the range is based on a “less generous” Taylor rule (perhaps “realistic” is a more apt description), and the median dot is more than a percentage point below this level. We viewed the chart as suggesting that the FOMC is likely to do more tightening than currently implied by the median dot.

Even if the median dot for 2023 (5.125 percent) is sufficient to put inflation on a path toward two percent, the chart (and Mr. Bullard’s comments) offer no insights into how long the Fed will need to maintain that stance in order to achieve price stability. Fed officials apparently do not plan an early exit, as they have been preaching that policy will need to remain restrictive “for some time” in order to return inflation to target on a sustained basis. The minutes carried the same message:

The Sufficiently Restrictive Zone [Of Monetary Policy]



Source: Bullard, James. (2023 January 5). *The Prospects for Disinflation in 2023*. Presented to the CFA Society of St. Louis. https://www.stlouisfed.org/from-the-president/speeches-and-presentations/2023/the-prospects-for-disinflation-in-2023

“Participants generally observed that a restrictive policy stance would need to be maintained until the incoming data provided confidence that inflation was on a sustained downward path to 2 percent, which was ***likely to take some time***. In view of the persistent and unacceptably high level of inflation, several participants commented that ***historical experience cautioned against prematurely loosening monetary policy***.” (Emphasis added.)

The Fed next year is likely to find itself in an unusual situation. The economy is likely to be sputtering or in recession, but at the same time, because of the desire of businesses to retain scarce labor resources, conditions in the labor market are likely to be reasonably favorable. The Fed will need to decide on whether to base policy decisions on the soft economy or a firm labor market. We believe conditions in the labor market will dominate, and they are likely to support the case for restrictive policy.

Review

Week of Jan. 2, 2023	Actual	Consensus	Comments
Construction (November)	**0.2%**	**-0.4%**	Total construction activity inched upward in November, but it has moved sideways on balance since the summer after trending higher in the first half of the year. Private residential activity fell for the fifth consecutive month, as weakness in single-family building offset firm growth in multi-family building and improvements to existing structures. Private-non-residential activity jumped from upwardly revised readings in prior months, in part reflecting higher prices but also possibly signaling a gain in real activity. Public construction dipped after a strong performance in other recent months.
ISM Manufacturing Index (December)	**48.4 (-0.6 Index Pt.)**	**48.5 (-0.5 Index Pt.)**	The ISM manufacturing index signaled contraction for the second consecutive month in December after registering readings in expansionary territory for the prior 29 months. The production measure dropped 3.0 index points in December to 48.5. The new orders index also was soft, easing 2.0 index points to 45.2, the fourth consecutive month in contractionary territory. The employment index provided an upside surprise, increasing 3.0 index points to 51.4. The supplier deliveries measure was below 50 for the third consecutive month (45.1, a decline of 2.1 index points), signaling substantial progress in resolving supply-chain disruptions.
Job Openings (November)	**10.458 Million (-0.054 Million)**	**10.050 Million (-0.284 Million)**	The number of job openings in the U.S. eased in November, but the change was small (0.054 million) and occurred from an upward revised level in October (10.512 million versus 10.334 million). Because of the revision and small change, the November total was larger than the preliminary observation for October, and it remained far above the pre-pandemic record of 7.558 million in November 2018. The number of job openings per unemployed individuals remained elevated and steady at 1.7.
Trade Balance (November)	**-$61.5 Billion ($16.3 Billion Narrower Deficit)**	**-$63.0 Billion ($15.2 Billion Narrower Deficit)**	The sharp narrowing in the monthly trade deficit in November occurred because of a deterioration in overall trade flows: a plunge of 6.4% in imports exceeded a drop of 2.0% in exports. The weakness in exports and imports occurred primarily on the goods side of the trade ledger; service exports rose, while imports declined only moderately. Despite the improvement in the November deficit, the real goods shortfall so far in Q4 is slightly wider than that for Q3, suggesting a negative contribution to GDP growth from international trade (approximately 0.5 percentage point if results for December match the average for October and November).

Review Continued

Week of Jan. 2, 2023	Actual	Consensus	Comments
Payroll Employment (December)	**223,00**	**203,000**	The advance in nonfarm payrolls in December slowed from the average of 270,000 in the prior four months, and it was joined by downward revisions of 28,000 in the prior two months, but the latest increase could still be viewed favorably as hiring has proved resilient despite aggressive action by the Fed to slow economic activity. The unemployment rate declined 0.1 percentage point to 3.5% from a downward-revised reading in November (3.6% versus 3.7% previously reported). The drop in unemployment was a strong one; that is, a surge of 717,000 in employment measured by the household survey outpaced growth of 439,000 in the size of the labor force. Average hourly earnings rose 0.3% from a downwardly revised reading in the prior month (0.4% versus 0.6%). The shifts led to a slowing in the year-over-year increase to 4.6% from 4.8% in November (revised from 5.1%), and a recent high of 5.6% in March.
ISM Services Index (December)	**49.6 (-6.9 Index Pts.)**	**55.0 (-1.5 Index Pts.)**	The drop in the ISM services index into contractionary territory was led by a plunge of 10.8 index points in the new orders index to 45.2. The business activity index also dropped after jumping to a 2022 high in November, although it remained above 50 (-10.0 index points to 54.7). The employment index has bounced between expansion and contraction for much of 2022. It eased back into contraction territory in December, falling 1.7 index points to 49.8. The prices index was down from a record of 84.6 in April, but it is elevated from a longer-term perspective (-2.4 index points to 67.6). Labor rather than raw materials and commodities figure more importantly into costs in the services industries, and employee earnings growth remained firm.
Factory Orders (November)	**-1.8%**	**-1.0%**	Both major areas of the factory orders report were weak in November. The previously reported decline of 2.1% in durable orders was led by a drop of 6.3% in the transportation component (published December 23rd). Excluding transportation, the increase of 0.1% was not enough to offset the downward drift since the summer. Nondurable bookings fell 1.8%. Much of the retreat in the nondurable area reflected a drop of 5.5% in orders for petroleum and coal products, which was influenced by lower prices. Orders for nondurable goods other than petroleum and coal products fell 0.1%. The change was small, but it marked the third consecutive decline after increasing in 26 of the prior 28 months.

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

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Preview

Week of Jan. 9, 2023	Projected	Comments
CPI (December) (Thursday)	**-0.1% Total, 0.2% Core**	A drop in gasoline prices suggests that the energy component in December will decline for the second consecutive month. Increases in food prices have shown hints of slowing recently (average advance of 0.55% in the past two months versus 0.95% in the first nine months of 2022), suggesting that underlying pressure is diminishing. Broad underlying price pressure drove robust advances in the CPI for most of 2022 (0.53% average through September), but continued slowing in core goods prices after back-to-back declines could partially offset pressure in services prices and lead to an increase in core prices close to the October/November average of 0.24%.
Federal Budget (December) (Thursday)	**$60.0 Billion Deficit**	Available data suggest that federal revenues fell approximately 8% on a year-over-year basis, with a drop in remittances by the Federal Reserve to the Treasury accounting for a notable portion of the decline. Collection of income and employment taxes also appear to have slowed from last December. With revenue collections down and outlays expected to remain on their firm trajectory, the monthly federal budget shortfall for December is likely to widen from the deficit of $21.3 billion in December 2021.
Consumer Sentiment (January) (Friday)	**61.0 (+2.2%)**	Gasoline prices around the turn of the year remained well below those in the fall, which could brighten moods in early January, but increased chatter about a recession later this year and a pickup in reports of corporate layoffs could raise concern and limit the possibility of a meaningful recovery in sentiment.

Source: Forecasts provided by Daiwa Capital Markets America

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Economic Indicators

January 2023

Monday	Tuesday	Wednesday	Thursday	Friday
2	3	4	5	6
NEW YEAR'S HOLIDAY	**CONSTRUCTION** Sep 0.5% Oct -0.2% Nov 0.2%	**ISM MFG. INDEX** Index / Prices Oct 50.2 / 46.6 Nov 49.0 / 43.0 Dec 48.4 / 39.4 **JOLTS DATA** Openings (000) / Quit Rate Sep 10,687 / 2.7% Oct 10,512 / 2.6% Nov 10,458 / 2.7% **FOMC MINUTES** **VEHICLE SALES** Oct 15.2 million Nov 14.2 million Dec 13.3 million	**UNEMP. CLAIMS** Initial / Continuing (millions) Dec 10 0.212 / 1.669 Dec 17 0.216 / 1.718 Dec 24 0.223 / 1.694 Dec 31 0.204 / N/A **ADP EMP. REPORT** Private Payrolls Oct 239,000 Nov 182,000 Dec 235,000 **TRADE BALANCE** Sep -$74.1 billion Oct -$77.8 billion Nov -$61.5 billion	**EMPLOYMENT REPORT** Payrolls / Un. Rate Oct 263,000 / 3.7% Nov 256,000 / 3.6% Dec 223,000 / 3.5% **ISM SERVICES INDEX** Index / Prices Oct 54.4 / 70.7 Nov 56.5 / 70.0 Dec 49.6 / 67.6 **FACTORY ORDERS** Sep 0.3% Oct 0.4% Nov -1.8%
9	10	11	12	13
CONSUMER CREDIT (3:00) Sep $25.8 billion Oct $27.1 billion Nov --	**NFIB SMALL BUSINESS OPTIMISM INDEX (6:00)** Oct 91.3 Nov 91.9 Dec -- **WHOLESALE TRADE (10:00)** Inventories / Sales Sep 0.6% / 0.1% Oct 0.6% / 0.4% **Nov 1.0% / 0.2%**		**UNEMP. CLAIMS (8:30)** **CPI (8:30)** Total / Core Oct 0.4% / 0.3% Nov 0.1% / 0.2% **Dec -0.1% / 0.2%** **FEDERAL BUDGET (2:00)** 2022 / 2021 Oct -$87.9B / -$165.1B Nov -$248.5B / -$191.3B **Dec -$60.0B** / -$21.3B	**IMPORT/EXPORT PRICES (8:30)** Non-petrol. Imports / Nonagri. Exports Oct -0.2% / -0.3% Nov -0.3% / -0.6% Dec -- / -- **CONSUMER SENTIMENT (10:00)** Nov 56.8 Dec 59.7 **Jan 61.0**
16	17	18	19	20
MARTIN LUTHER KING JR. DAY	**EMPIRE MFG INDEX**	**RETAIL SALES** **PPI** **IP & CAP-U** **BUSINESS INVENTORIES** **NAHB HOUSING INDEX** **BEIGE BOOK** **TIC FLOWS**	**UNEMP. CLAIMS** **HOUSING STARTS** **PHILY FED INDEX**	**EXISTING HOME SALES**
23	24	25	26	27
LEADING ECONOMIC INDICATORS			**UNEMP. CLAIMS** **Q4 GDP** **INTERNATIONAL TRADE IN GOODS** **DURABLE GOODS ORDERS** **ADVANCE INVENTORIES** **CHICAGO FED NATIONAL ACTIVITY INDEX** **NEW HOME SALES**	**PERSONAL INCOME, CONSUMPTION, PRICES** **PENDING HOME SALES** **CONSUMER SENTIMENT**

Forecasts in Bold.

Treasury Financing

January 2023

Monday	Tuesday	Wednesday	Thursday	Friday
2	3	4	5	6
NEW YEAR'S HOLIDAY	**AUCTION RESULTS:** Rate / Cover 13-week bills 4.410% 2.50 26-week bills 4.635% 2.78 **ANNOUNCE:** $45 billion 4-week bills for auction on Jan 5 $45 billion 8-week bills for auction on Jan 5 $33 billion 17-week bills for auction on Jan 4 **SETTLE:** $45 billion 4-week bills $45 billion 8-week bills $33 billion 17-week bills $42 billion 2-year notes $43 billion 5-year notes $35 billion 7-year notes $12 billion 20-year bonds	**AUCTION RESULTS:** Rate / Cover 17-wk bills 4.570% 3.10	**AUCTION RESULTS:** Rate / Cover 4-week bills 4.100% 2.79 8-week bills 4.430% 2.29 **ANNOUNCE:** $105 billion 13-,26-week bills for auction on Jan 9 $40 billion 3-year notes for auction on Jan 10 $32 billion 10-year notes for auction on Jan 11 $18 billion 30-year bonds for auction on Jan 12 **SETTLE:** $99 billion 13-,26-week bills	
9	10	11	12	13
AUCTION: $105 billion 13-,26-week bills	**AUCTION:** $40 billion 3-year notes **ANNOUNCE:** $45 billion* 4-week bills for auction on Jan 12 $45 billion* 8-week bills for auction on Jan 12 $33 billion* 17-week bills for auction on Jan 11 **SETTLE:** $45 billion 4-week bills $45 billion 8-week bills $33 billion 17-week bills	**AUCTION:** $33 billion* 17-week bills $32 billion 10-year notes	**AUCTION:** $45 billion* 4-week bills $45 billion* 8-week bills $18 billion 30-year bonds **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on Jan 17 $12 billion* 20-year bonds for auction on Jan 18 $17 billion* 10-year TIPS for auction on Jan 19 **SETTLE:** $105 billion 13-,26-week bills	
16	17	18	19	20
MARTIN LUTHER KING JR. DAY	**AUCTION:** $105 billion* 13-,26-week bills **ANNOUNCE:** $45 billion* 4-week bills for auction on Jan 19 $45 billion* 8-week bills for auction on Jan 19 $33 billion* 17-week bills for auction on Jan 18 **SETTLE:** $45 billion* 4-week bills $45 billion* 8-week bills $33 billion* 17-week bills $40 billion 3-year notes $32 billion 10-year notes $18 billion 30-year bonds	**AUCTION:** $33 billion* 17-week bills $12 billion* 20-year bonds	**AUCTION:** $45 billion* 4-week bills $45 billion* 8-week bills $17 billion* 10-year TIPS **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on Jan 23 $34 billion* 52-week bills for auction on Jan 24 $24 billion* 2-year FRNs for auction on Jan 25 $42 billion* 2-year notes for auction on Jan 24 $43 billion* 5-year notes for auction on Jan 25 $35 billion* 7-year notes for auction on Jan 26 **SETTLE:** $105 billion* 13-,26-wk bills	
23	24	25	26	27
AUCTION: $105 billion* 13-,26-week bills	**AUCTION:** $34 billion* 52-week bills $42 billion* 2-year notes **ANNOUNCE:** $45 billion* 4-week bills for auction on Jan 26 $45 billion* 8-week bills for auction on Jan 26 $33 billion* 17-week bills for auction on Jan 25 **SETTLE:** $45 billion* 4-week bills $45 billion* 8-week bills $33 billion* 17-week bills	**AUCTION:** $33 billion* 17-week bills $24 billion* 2-year FRNs $43 billion* 5-year notes	**AUCTION:** $45 billion* 4-week bills $45 billion* 8-week bills $35 billion* 7-year notes **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on Jan 30 **SETTLE:** $105 billion* 13-,26-week bills $34 billion* 52-week bills	

**Estimate*