Daiwa Capital Markets

U.S. Economic Comment

- April employment: solid payroll growth
- Tight labor-market conditions generate ongoing wage pressure
- The banking sector: stress likely to impact real economy

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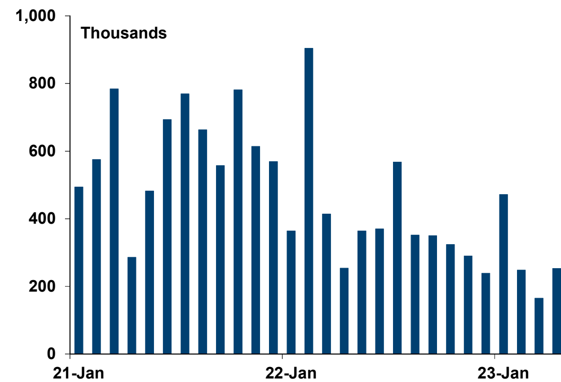
Firm Job Growth in April

Nonfarm payrolls rose 253,000 in April, contrasting with market expectations for a sub-200,000 reading. Downward revisions of 149,000 to job growth in the prior two months softened to a degree the tone of the latest increase, but the adjustment did not fundamentally alter our view that payroll growth is on solid footing and that labor market conditions remain tight despite headwinds facing the broader economy. Moreover, while payroll growth has been tilting lower since late last year (exclusive of what increasingly appears to be an aberrant burst of 472,000 of hiring in January), the average of 222,000 in the past three months (excluding the January result) is firmer than the pre-pandemic average of 177,000 in 2018-19, when the labor market could be viewed as on solid footing (chart). In the current context, the FOMC's description of the labor market as "robust" in this week's statement suggests that a restrictive policy setting could be required for some time to correct ongoing supply-demand imbalances that are generating wage pressure inconsistent with the Federal Reserve's two-percent inflation objective.

Change in Nonfarm Payrolls



Source: Bureau of Labor Statistics via Haver Analytics

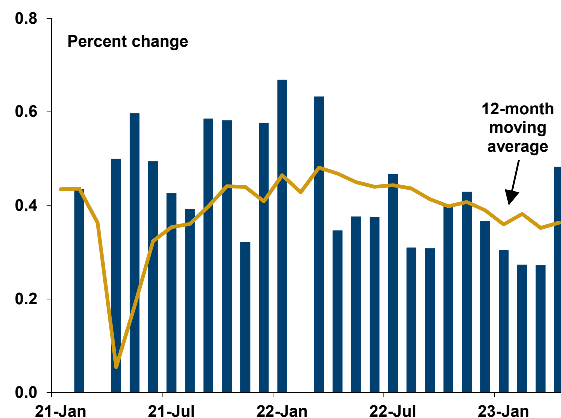
Job growth was distributed broadly in April, with service producing industries standing out on the firm side (+197,000). While hiring in the leisure and hospitality industry, a recent key contributor to growth of service sector employment, slowed (+31,000 versus 77,000 average in the prior 12 months), other areas performed well. For example, the healthcare industry added 64,000 jobs, modestly below the 12-month average of 70,000. In addition, the business services area added 43,000 jobs, exceeding the underlying average of 39,000, and the financial services sector boosted payrolls by 23,000 after modest net job cuts in the past three months. In the goods producing industries (+33,000 jobs added in April), both the cyclically sensitive manufacturing and construction industries hired actively (+11,000 and 15,000, respectively) after cutting jobs in March.

An Acceleration in Wage Growth

Firm underlying demand for labor generated brisk wage growth in April, with the increase of 0.48 percent exceeding the average of 0.28 percent in the prior three months. Recent observations had given a downward tilt to the trend, but that was reversed with the latest reading (chart).

Compositional shifts in hiring in April may have played a role in the latest jump in average earnings. That is, job gains in well-paying industries were firm in the latest month, which influenced the calculation of the average wage rate. This argument has some merit, but other measures of compensation also support the view that wage growth remains too fast.

Average Hourly Earnings



Source: Bureau of Labor Statistics via Haver Analytics

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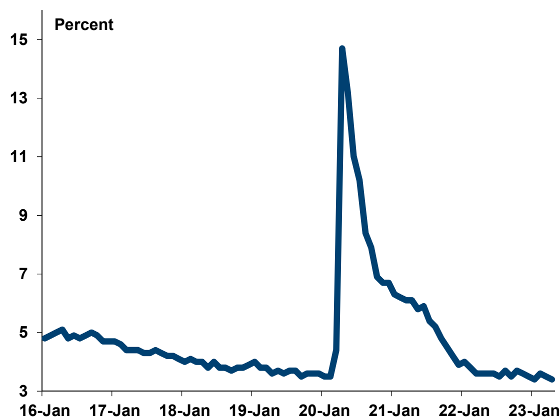
The employment cost index, which we view as the best measure of labor compensation, increased 1.2 percent in Q1 (4.9 percent, year-over-year), with the wage component advancing 1.2 percent (5.0 percent, year-over-year). Both measures slowed a bit on a year-over-year basis from readings in Q4 (5.1 percent for both), but they are still tracking well-above current year-over-year growth of 4.4 percent in average hourly earnings. More importantly, Chair Powell noted in his Wednesday press conference that wage growth of three percent (not four to five percent) is needed to be consistent with two percent inflation over a longer period.

Insights on the Supply-Demand Imbalance from the Household Survey

In the latest employment report, the unemployment rate best reflected tight labor market conditions, dipping 0.1 percentage point to 3.4 percent. In April, growth of 139,000 in employment, measured by the household survey, was joined by a contraction of 43,000 in the labor force. While the latest readings on the labor force and employment could be viewed as soft, we are more inclined to attribute them to a pause after brisk growth in the previous four months. Between December 2022 and March, household employment averaged growth of 577,000 and the labor force expanded at a 551,000 average pace. In a broad sense, new entrants into the labor force are finding jobs and the unemployment rate is currently more than one-half percentage point below the long-run estimate of 4.0 percent in the FOMC's March Summary of Economic Projections -- a reading that could be viewed as a proxy for the full-employment unemployment rate.

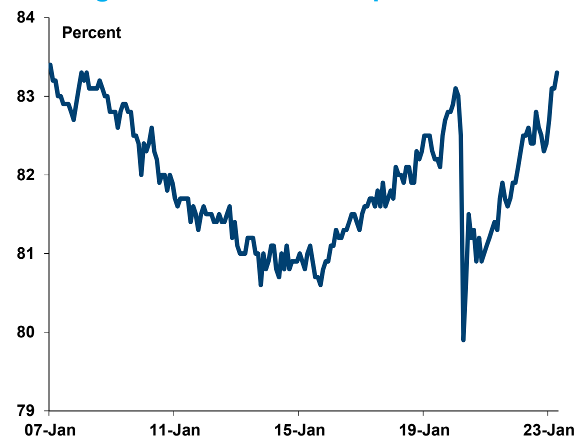
Supply-demand imbalances do exist in the labor market, however we do take note of developments that could help to ease conditions. While the overall labor force participation rate was unchanged in this month, the participation rate for prime-aged workers rose 0.2 percentage point to 83.3 percent, exceeding the pre-pandemic reading and supporting the view that the supply of labor is increasing (chart). In addition, this week's Job Openings and Labor Turnover Survey reported a decline of 384,000 openings in March and 1.644 million in Q1 combined. The latest reading of 9.590 million openings still far-exceeded the pre-pandemic high of 7.594 million in November 2018, but it suggests that restrictive monetary policy is working to slow demand for labor. Over time, further realignment may bring the labor force back into better balance and contribute to more sustainable wage growth.

Unemployment Rate



Source: Bureau of Labor Statistics via Haver Analytics

Prime Age Labor Force Participation Rate*



** Labor force participants aged 25 to 54 as a share of the civilian non-institutional population aged 25 to 54.*
Source: Bureau of Labor Statistics via Haver Analytics

Developments in the Banking Sector

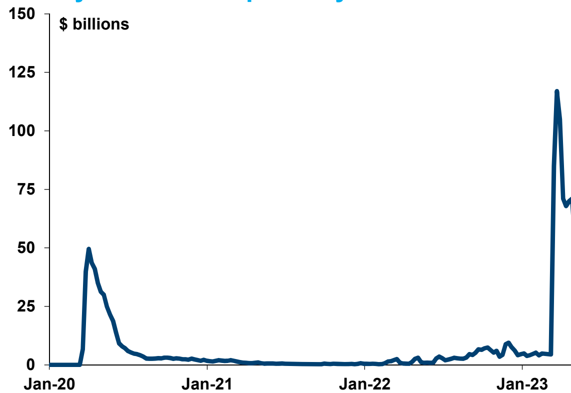
Perhaps one of the most notable emerging risks to the economic outlook is the recent stress in the banking sector that has led to three of the four largest bank failures in U.S. history -- Silicon Valley Bank and Signature Bank in March, and First Republic Bank this past Monday. For those interested, the largest failure was that of Washington Mutual Bank in September 1998, which had an asset base of more than $300 billion; First Republic and SVB had approximately $212 billion and $210 billion in assets, respectively, and Signature Bank $110 billion.

While the failures of these institutions and their possible causes have been well covered at this point, and we suspect that new legislative and regulatory initiatives will emerge when the dust has settled, it is important to

highlight two channels through which the turbulence in banking could filter through to the boarder economy and introduce additional downside risks to our forecast for a shallow recession later this year.

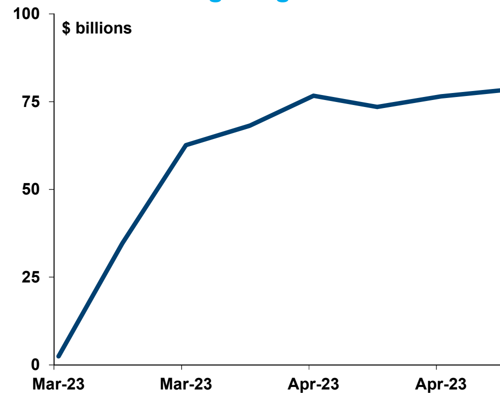
Pointing to recent usage of Fed credit facilities (the new Bank Term Funding Program and discount window borrowing) as evidence that broader risks have not escalated dramatically, we accept the assessment of Fed officials that the U.S. banking system is “sound and resilient” and we do not envision these risks taking the form of a run on deposits, or a cascading failure of banking institutions. Usage of the Bank Term Funding Program jumped in March, but uptake has increased only modestly in early May. Discount window borrowing peaked in March and has declined since. The drop in May, in part, likely reflects the termination of usage by First Republic, which is now part of JP Morgan Chase Bank, but other entities also may have curtailed usage as conditions eased (charts).

Primary Credit to Depository Institutions*



** Weekly average data.*
Source: Federal Reserve Board via Haver Analytics

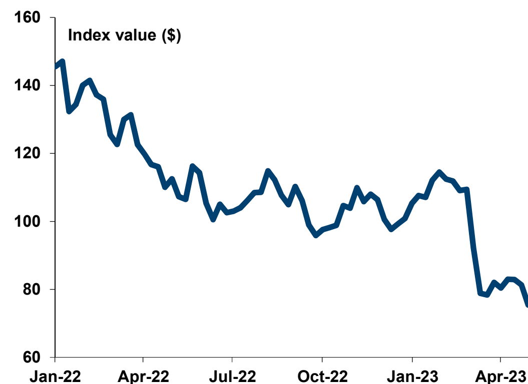
Bank Term Funding Program*



** Weekly average data.*
Source: Federal Reserve Board via Haver Analytics

The more meaningful impacts we anticipate are in the forms of damaged investor confidence and a broad tightening in credit conditions for households and businesses. With regard to the first channel, market participants reacted rapidly to events surrounding Monday developments, selling positions in a broad cross-section of banking institutions. The KBW Bank Index, which consists of 24 exchange-traded large and mid-sized banks, fell sharply in response to developments after already dropping in March. The measure is off 25.4 percent year-to-date and down 7.5 percent for the week as of Friday afternoon (chart). While this is a sector-specific development, damaged confidence in markets and caution in deployment of investment capital could filter through and have a constraining effect on the real economy. Perhaps more importantly, regional banks play a significant role in the extension of credit to households and businesses. Chair Powell acknowledged in his Wednesday press conference that tightening credit conditions will have a meaningful impact on the outlook, but he also conceded that it is too soon to assess the full extent of the impact. We suspect that the bout of volatility in the banking sector will soon subside but that ongoing macroeconomic effects will take longer to play out.

KBW Bank Index*



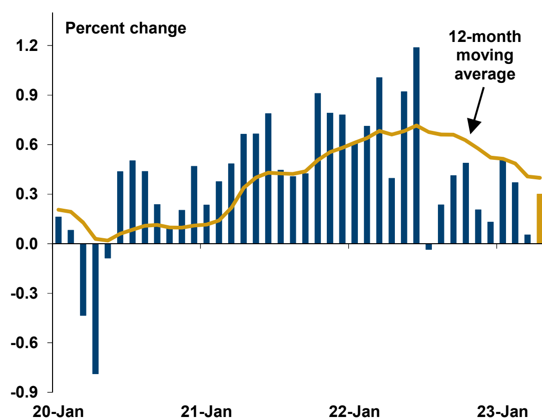
** Weekly data, except for the last observation which is a mid-day quote for May 5, 2023.*
Source: Nasdaq via Bloomberg

The Week Ahead

CPI (April) (Wednesday)
Forecast: 0.3% Headline, 0.3% Core

We suspect that the April CPI report is likely to signal little additional improvement in underlying price pressure despite recent moderation in food and energy prices. Available quotes suggest that energy prices could pick up in April, but the expected increase would follow a drop of 3.5 percent in the prior month. Energy prices have fallen 14.4 percent since the cyclical peak last June, although they remain well above pre-pandemic levels. Pressure in food prices has eased substantially in recent months, registering no change in March after an increase of 0.4 percent in February. The restrained readings in the past two months compare to an average of 0.8 percent per month in the 12-months ending January. In the core component, goods prices have moderated since a spike during the pandemic and early stages of the current expansion (average increase of 0.1 percent in the past 12 months), but prices of services excluding energy have remained under pressure (average advance of 0.6 percent in the past 12 months). Costs of services could again drive the projected firm increase in the core CPI.

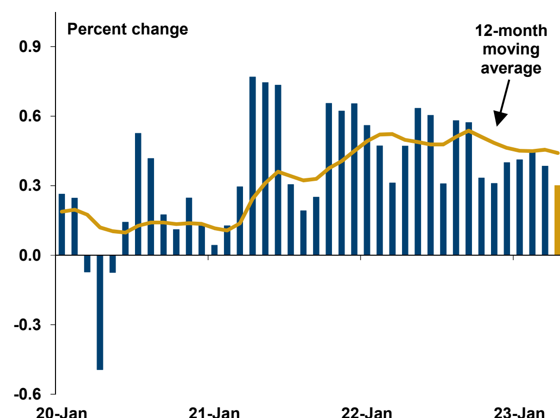
Headline CPI*



** The gold bar is a forecast for April 2023.*

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

Core CPI*



** The gold bar is a forecast for April 2023.*

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

Federal Budget (April) (Wednesday)
Forecast: $225 Billion Surplus

The financial position of the U.S. has deteriorated noticeably in the first six months of FY2023, with the deficit of $1.1 trillion running well ahead of the $668.2 billion tally in the same period in the prior fiscal year. Outlays are up almost 13 percent year-over-year, as Medicare spending surged almost 40 percent from the same month in FY2022 and a generous 8.7 percent cost-of-living adjustment in Social Security benefits contributed to a 21 percent jump in expenditures year-over-year. Additionally, aggressive tightening in monetary policy by the Federal Reserve played a role in interest expense increasing 28 percent compared to March 2022.

The revenue picture has softened as well, with net receipts falling 3.5 percent year-over-year -- including a decline of 8.5 percent in net individual income tax collections.

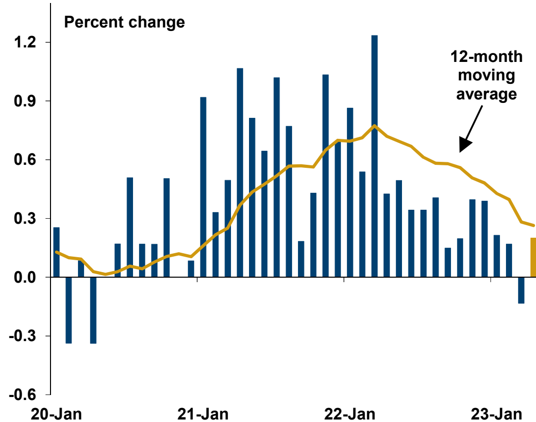
Available data signal that the federal government is on track to record its first surplus of FY2023 in April, buoyed by settlement of individual tax obligations for 2022. However, data in hand suggest a surplus of approximately $225 billion, well shy of the April 2022 tally of $308 billion.

PPI (April) (Thursday)
Forecast: 0.2% Total, 0.2% Ex. Food & Energy

Data from wholesale energy markets suggest that energy prices rose during the April survey period, but the projected increase would follow a plunge of 6.4 percent in March. Food prices have changed minimally on balance in the past six months despite large month-to-month shift. Prices excluding food and energy could post a moderate advance. Core goods prices have increased 0.3 percent per month in the past six months, while service prices

have averaged 0.15 percent (including a decline of 0.3 percent in March). Construction costs pose an upside risk to the projection for prices excluding food and energy, as they follow a distinct pattern of a brisk increase in the first month of a quarter and only modest changes in the following two months. If the pattern holds, a jump could occur in April.

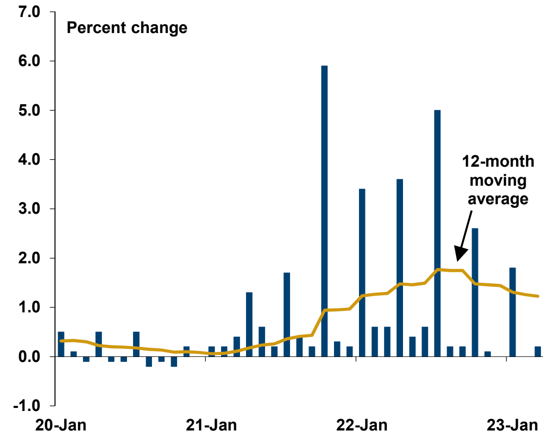
PPI Ex. Food & Energy*



** The gold bar is a forecast for April 2023.*

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

PPI: Construction



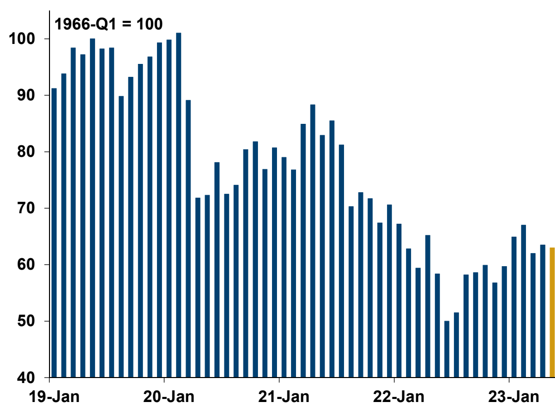
Source: Bureau of Labor Statistics via Haver Analytics

Consumer Sentiment (May) (Friday)
Forecast: 63.0 (-0.8%)

Concerns about rapid inflation have weighted on consumer sentiment for much of the past two years, but those fears showed evidence of easing in early 2023 as the year-ahead inflation gauge released with the University of Michigan report cooled and sentiment showed hints of recovery (charts). The focus of concerns shifted to the banking sector in the past two months, as attitudes soured over worries about deposit safety and increased prospects for recession in the aftermath of the failures of Silicon Valley Bank and Signature Bank. With inflation expectations again stirring (the year-ahead inflation measure jumped in April), and the recent failure of First Republic Bank, prospects seem limited for the resumption of the previous modest recovery in sentiment.

Despite recent fluctuation in the short-term inflation gauge, the longer-term measure has been relatively stable and viewed as consistent with a return to two percent inflation over time (chart, right).

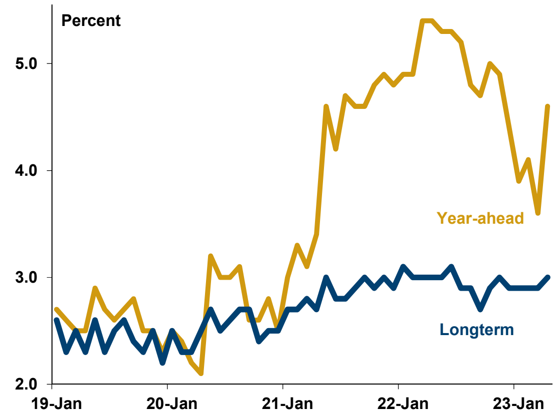
Consumer Sentiment*



** The gold bar is a forecast for May 2023.*

Sources: University of Michigan via Haver Analytics; Daiwa Capital Markets America

Inflation Expectations



Source: University of Michigan via Haver Analytics

Economic Indicators

May 2023

Monday	Tuesday	Wednesday	Thursday	Friday
1	2	3	4	5
CONSTRUCTION Jan -0.2% Feb -0.3% Mar 0.3% **ISM MFG. INDEX** Index / Prices Feb 47.7 / 51.3 Mar 46.3 / 49.2 Apr 47.1 / 53.2	**JOLTS DATA** Openings (000) / Quit Rate Jan 10,563 / 2.5% Feb 9,974 / 2.6% Mar 9,590 / 2.5% **FACTORY ORDERS** Jan -2.1% Feb -1.1% Mar 0.9% **VEHICLE SALES** Feb 14.9 million Mar 14.8 million Apr 15.9 million **FOMC (FIRST DAY)**	**ADP EMPLOYMENT** Private Payrolls Feb 261,000 Mar 142,000 Apr 296,000 **ISM SERVICES INDEX** Index / Prices Feb 55.1 / 65.6 Mar 51.2 / 59.5 Apr 51.9 / 59.6 **FOMC ANNOUNCEMENT**	**UNEMP. CLAIMS** Initial / Continuing (millions) Apr 8 0.240 / 1.861 Apr 15 0.246 / 1.843 Apr 22 0.229 / 1.805 Apr 29 0.242 / N/A **TRADE BALANCE** Jan -$68.7 billion Feb -$70.6 billion Mar -$64.2 billion **PRODUCTIVITY & COSTS** Productivity / Unit Labor Costs 22-Q3 1.2% / 6.9% 22-Q4 1.6% / 3.3% 23-Q1 -2.7% / 6.3%	**EMPLOYMENT REPORT** Payrolls / Un. Rate Feb 248,000 / 3.6% Mar 165,000 / 3.5% Apr 253,000 / 3.4% **CONSUMER CREDIT** Jan $23.4 billion Feb $15.0 billion Mar $26.5 billion
8	9	10	11	12
WHOLESALE TRADE (10:00) Inventories / Sales Jan -0.6% / 0.4% Feb 0.1% / 0.4% **Mar 0.1% / 0.3%**	**NFIB SMALL BUSINESS OPTIMISM INDEX (6:00)** Feb 90.9 Mar 90.1 Apr --	**CPI (8:30)** Total / Core Feb 0.4% / 0.5% Mar 0.1% / 0.4% **Apr 0.3% / 0.3%** **FEDERAL BUDGET (2:00)** 2023 / 2022 Feb -$262.4B / -$216.6B Mar -$378.1B / -$192.6B **Apr $225.0B** / $308.2B	**UNEMP. CLAIMS (8:30)** **PPI (8:30)** Final Demand / Ex. Food & Energy Feb 0.0% / 0.2% Mar -0.5% / -0.1% **Apr 0.2% / 0.2%**	**IMPORT/EXPORT PRICES (8:30)** Non-petrol. Imports / Nonagri. Exports Feb -0.3% / 0.3% Mar -0.6% / -0.2% Apr -- / -- **CONSUMER SENTIMENT (10:00)** Mar 62.0 Apr 63.5 **May 63.0**
15	16	17	18	19
EMPIRE MFG **TIC FLOWS**	**RETAIL SALES** **IP & CAP-U** **BUSINESS INVENTORIES** **NAHB HOUSING INDEX**	**HOUSING STARTS**	**UNEMP. CLAIMS** **PHILLY FED INDEX** **EXISTING HOME SALES** **LEADING INDICATORS**	
22	23	24	25	26
	NEW HOME SALES	**FOMC MINUTES**	**UNEMP. CLAIMS** **REVISED Q1 GDP** **CHICAGO FED NATIONAL ACTIVITY INDEX** **PENDING HOME SALES**	**PERSONAL INCOME, CONSUMPTION, PCE PRICE INDEXES** **INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES** **DURABLE GOODS** **REVISED CONSUMER SENTIMENT**

Forecasts in Bold. (p) = preliminary, (r) = revised

Treasury Financing

May 2023

Monday	Tuesday	Wednesday	Thursday	Friday
1	2	3	4	5
AUCTION RESULTS: Rate Cover 13-week bills 5.120% 2.44 26-week bills 4.900% 2.60	**AUCTION RESULTS:** Rate Cover 21-day CMB 4.490% 2.59 **ANNOUNCE:** $50 billion 4-week bills for auction on May 4 $45 billion 8-week bills for auction on May 4 $36 billion 17-week bills for auction on May 3 **SETTLE:** $50 billion 4-week bills $45 billion 8-week bills $36 billion 17-week bills	**AUCTION RESULTS:** Rate Cover 17-week bills 4.980% 2.95 **ANNOUNCE:** $40 billion 3-year notes for auction on May 9 $35 billion 10-year notes for auction on May 10 $21 billion 30-year bonds for auction on May 11	**AUCTION RESULTS:** Rate Cover 4-week bills 5.840% 2.51 8-week bills 5.400% 2.93 **ANNOUNCE:** $105 billion 13-,26-week bills for auction on May 8 **SETTLE:** $105 billion 13-,26-week bills $40 billion 21-day CMBs	
8	9	10	11	12
AUCTION: $105 billion 13-,26-week bills	**AUCTION:** $40 billion 3-year notes **ANNOUNCE:** $50 billion* 4-week bills for auction on May 11 $45 billion* 8-week bills for auction on May 11 $36 billion* 17-week bills for auction on May 10 **SETTLE:** $50 billion 4-week bills $45 billion 8-week bills $36 billion 17-week bills	**AUCTION:** $36 billion* 17-week bills $35 billion 10-year notes	**AUCTION:** $50 billion* 4-week bills $45 billion* 8-week bills $21 billion 30-year bonds **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on May 15 $34 billion* 52-week bills for auction on May 16 $15 billion* 20-year bonds for auction on May 17 $15 billion* 10-year TIPS for auction on May 18 **SETTLE:** $105 billion 13-,26-week bills	
15	16	17	18	19
AUCTION: $105 billion* 13-,26-week bills **SETTLE:** $40 billion 3-year notes $35 billion 10-year notes $21 billion 30-year bonds	**AUCTION:** $34 billion* 52-week bills **ANNOUNCE:** $50 billion* 4-week bills for auction on May 18 $45 billion* 8-week bills for auction on May 18 $36 billion* 17-week bills for auction on May 17 **SETTLE:** $50 billion* 4-week bills $45 billion* 8-week bills $36 billion* 17-week bills	**AUCTION:** $36 billion* 17-week bills $15 billion* 20-year bonds	**AUCTION:** $50 billion* 4-week bills $45 billion* 8-week bills $15 billion* 10-year TIPS **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on May 22 $42 billion* 2-year notes for auction on May 23 $43 billion* 5-year notes for auction on May 24 $35 billion* 7-year notes for auction on May 25 $22 billion* 2-year FRNs for auction on May 25 **SETTLE:** $105 billion* 13-,26-week bills $34 billion* 52-week bills	
22	23	24	25	26
AUCTION: $105 billion* 13-,26-week bills	**ANNOUNCE:** $42 billion* 2-year notes **ANNOUNCE:** $50 billion* 4-week bills for auction on May 25 $45 billion* 8-week bills for auction on May 25 $36 billion* 17-week bills for auction on May 24 **SETTLE:** $50 billion* 4-week bills $45 billion* 8-week bills $36 billion* 17-week bills	**AUCTION:** $36 billion* 17-week bills $43 billion* 5-year notes $22 billion* 2-year FRNs	**AUCTION:** $50 billion* 4-week bills $45 billion* 8-week bills $35 billion* 7-year notes **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on May 30 **SETTLE:** $105 billion* 13-,26-week bills	**SETTLE:** $22 billion* 2-year FRNs

**Estimate*