

U.S. Economic Comment

- U.S. data on growth & inflation: favorable developments
- Employee compensation costs: slower growth, but still brisk

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A Soft Landing?

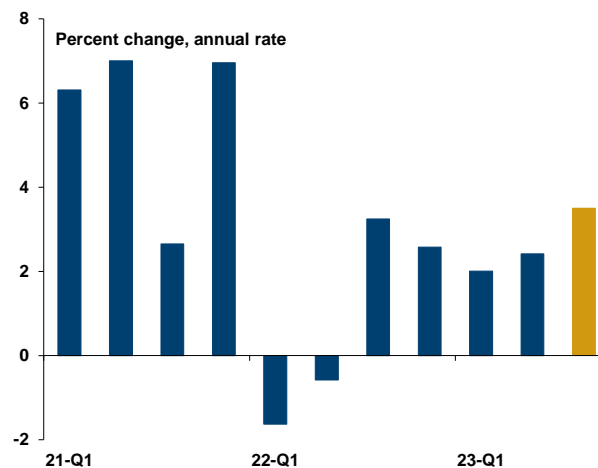
We're not particularly enamored by aviation metaphors in economics, but if we embrace the terminology which has been tossed about a good deal in recent months and apply it to developments in the past few weeks, it would seem that the U.S. economy is on track for a "soft landing" despite a cumulative increase of 525 basis points in the federal funds rate since March 2022. Economic growth was solid in the second quarter, with Q2 GDP growth of 2.4 percent exceeding the consensus expectation of 1.8 percent and an early read form the Atlanta Fed's GDPNow model suggesting growth of 3.5 percent (!) in Q3 (chart). The Atlanta Fed reading is likely to evolve in coming weeks, but economic activity appears to be stirring rather than moderating.

Progress in the Fed's Preferred Inflation Gauge

An update for the price indexes for personal consumption expenditures was released with the June report on personal income and consumption, with moderate increases of 0.2 percent in both the headline and core price indexes translating to year-over-year increases of 3.0 percent and 4.1 percent, down from 3.8 percent and 4.6 percent, respectively. The latest readings were well below the 7.0 percent peak in the headline index last June and 5.4 percent in the core in March 2022, but they are still well above the Federal Reserve's two-percent target (chart).

Although both headline and core inflation remain well above target, monthly shifts in the core and super-core measures offer reason for guarded optimism. The increase of 0.2 percent in the core slowed from the average of 0.4 percent in the 12 months ending May (chart; next page, left). Core service prices excluding the costs of housing services was restrained for the second consecutive month with back-to-back readings of 0.2 percent (chart; next page, right). We emphasize the views of Chair Powell and others on the FOMC that one or two favorable inflation readings do not make a trend, and, moreover, that prices could stir again in coming months (gasoline prices have increased recently, for instance), but it would be foolish to dismiss out-of-hand the improved data.

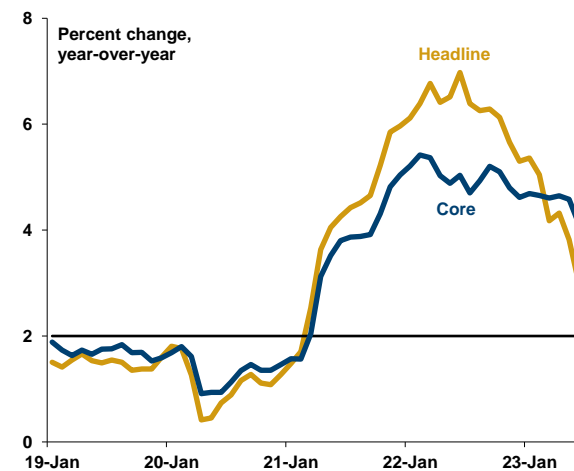
GDP Growth*



* The gold bar is a forecast for 2023-Q3 from the Federal Reserve Bank of Atlanta's GDPNow model.

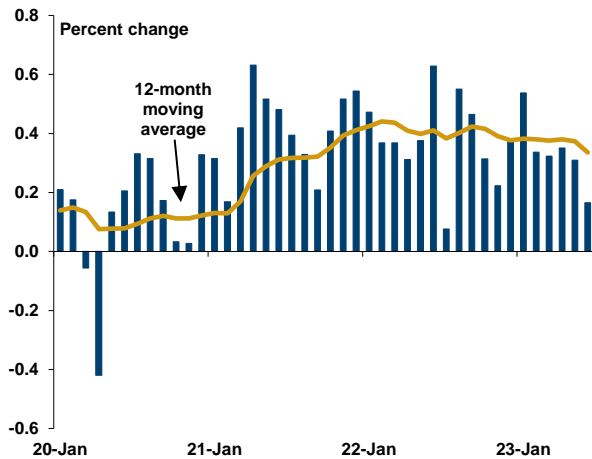
Sources: Bureau of Economic Analysis via Haver Analytics; Federal Reserve Bank of Atlanta

PCE Price Indexes



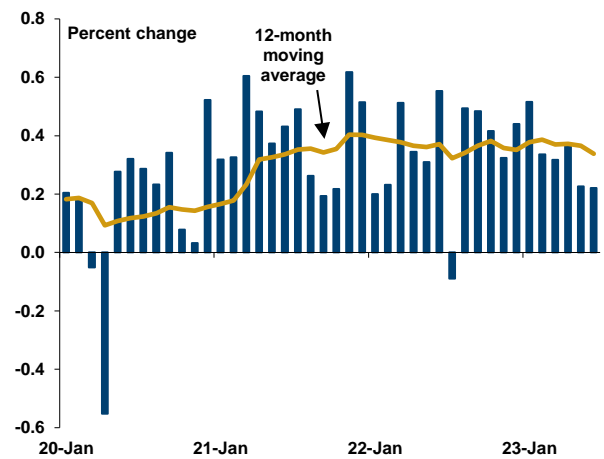
Source: Bureau of Economic Analysis via Haver Analytics

Core PCE Price Index*



* PCE = personal consumption expenditures
Source: Bureau of Economic Analysis via Haver Analytics

PCE Price Index: Core Services Ex. Housing*



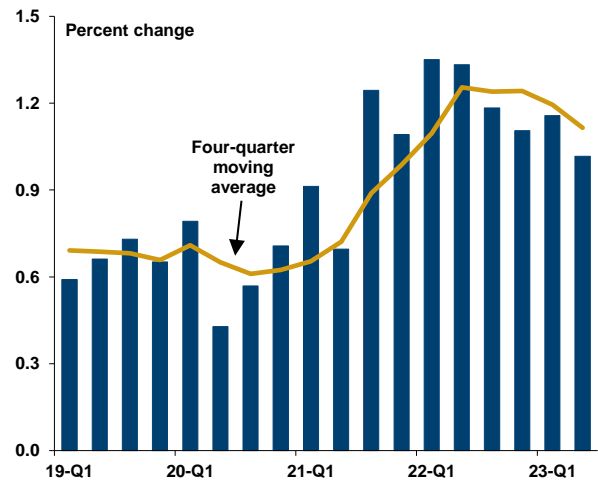
* Service prices excluding energy services and housing services.
Sources: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

Employment Costs: Brisk, but Hints of Easing

The employment cost index, released earlier today, is our preferred measure of compensation growth. While the series is less timely than average hourly earnings, as it is released quarterly rather than monthly, we view it as a superior measure because it is not affected by compositional shifts in employment between industries or between jobs with varying wage rates within industries. Instead, it offers insight into growth of labor costs for the same jobs over time.

The ECI showed some moderation in compensation growth in Q2, slowing to 1.0 percent from 1.2 percent in the prior quarter and an average of 1.2 percent over the four quarters of last year (chart). Year-over-year growth decelerated to 4.5 percent from 4.9 percent in Q1 and a recent high of 5.1 percent in the second quarter of last year. The wage component increased 1.0 percent on a quarterly basis versus 1.2 percent in Q1 (4.6 percent year-over-year, down from 5.0 percent in Q1), with benefit costs matching the quarter-to-quarter changes in wages but slowing to 4.2 percent year-over-year from 4.5 percent in Q1.

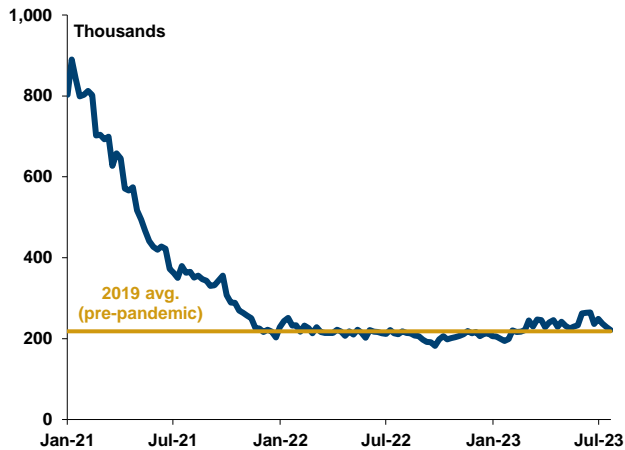
Employment Cost Index



Source: Bureau of Labor Statistics via Haver Analytics

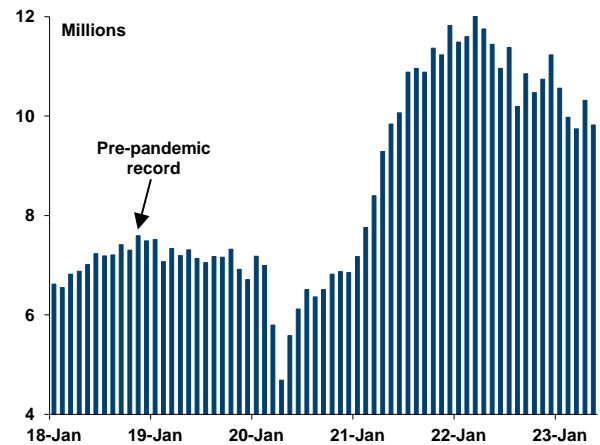
The changes were encouraging, giving credence to Chair Powell’s assessment in his post-FOMC press conference that supply and demand in the labor market are coming into better balance, but caution is warranted. The Fed Chair has said on numerous occasions that compensation growth exceeding four percent is still broadly inconsistent with the two-percent inflation mandate. Moreover, we still view labor market conditions as fairly tight. Layoffs have eased recently, with initial claims for unemployment insurance for the week ended July 22 easing to 221k from 228k in the prior week, down from an average of 255k in June and close to low pre-pandemic average of 218k (chart; next page, left). In addition, job openings of 9.824 million (1.6 jobs per unemployed person) are 2.2 million below the record high of 12.027 million last March, but they are well above the pre-pandemic record of 7.594 million in November 2018 and signal that demand for labor remains firm (chart; next page, right). Updated views on job openings for June and employment for July released next week could change perceptions on the labor market, but data in hand suggest that underlying conditions are still supportive of brisk wage growth.

Initial Claims for Unemployment Insurance



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

Job Openings



Source: Bureau of Labor Statistics via Haver Analytics

The Fed: Mission Complete?

After Chair Powell's press conference on Wednesday, some commentators were quick to conclude that the FOMC was likely done hiking rates, and that a pivot to easier policy could soon follow early next year. We readily admit that the FOMC is approaching the terminal rate for this cycle, but we are inclined to take officials at their word that the next steps by the Committee will be dictated by the totality of the incoming data.

While the inflation data are moving in the right direction, indicators on the labor market suggest that supply-demand imbalances are still generating considerable wage pressure, and growth-related metrics imply that economic activity is picking up, possibly rapidly if the GDPNow projection is realized. If economic growth in Q3 approximates the initial read from the Atlanta Fed and job gains remains solid, inflation could stir and the Fed would have to address the shifts in the data with additional policy restriction. A broad reacceleration in growth and inflation turning higher are not our baseline expectations at this time, but an insurance hike of 25 basis points at one of the next two FOMC meetings (either in September 19-20 or the following meeting on October 31/November 1) and a restrictive stance of policy well into 2024 to prevent new excesses from developing in the economy seems a likely scenario.

Note to readers:

The next U.S. Economic Comment will be published on August 11, 2023.

The Week Ahead

Construction Spending (June) (Tuesday)

Forecast: 1.0%

Recent strengthening in single-family housing starts raises the possibility of a firm advance in private residential construction and business-related activity has moved sharply higher since last fall. Public construction (mostly building by state and local governments) also has been on a firm upward trend.

ISM Manufacturing (July) (Tuesday)

Forecast: 46.5 (+0.5 Index Pt.)

Many indicators tied to the manufacturing sector have been signaling soft activity, suggesting that the ISM index is likely to remain in contractionary territory in July (chart).

Nonfarm Productivity (2023-Q2) (Thursday)

Forecast: 2.5%

Nonfarm businesses achieved a solid increase in output in Q2 with only a minimal change in hours worked, raising the possibility of a firm increase in productivity. Although the increase would be a welcome development, productivity has been soft in recent quarters, dropping 2.1 percent in Q1 and 1.6 percent in 2022. An expected surge of 5.8 percent in compensation per hour and moderate increase in productivity suggest an advance of 2.5 percent in unit labor cost (versus an increase of 4.2 percent in Q1).

Factory Orders (June) (Thursday)

Forecast: 2.3%

The surge of 4.7 percent in durable goods orders in June (published July 27) was influenced heavily by an advance of 12.1 percent in the transportation category, which received a notable boost from a jump of 69.4 percent in civilian aircraft bookings. Bookings excluding transportation (up 0.6 percent in June) are starting to tilt higher after moving sideways since last summer. Nondurable bookings (the new information in the factory orders report) could tick higher after declining in six of the past seven months, but the pickup is unlikely to reverse the soft underlying trend.

ISM Services (July) (Thursday)

Forecast: 53.5 (-0.4 Index Pt.)

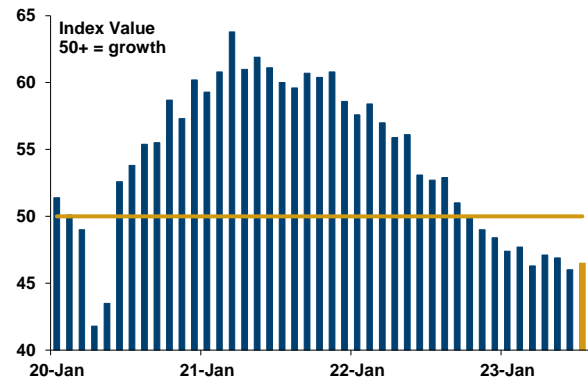
The service sector of the economy has proved resilient to aggressive tightening in monetary policy, although the average of 52.9 in 2023-H1 lagged the firm performance last year (56.1 in 2022). With the report on Q2 GDP released yesterday showing that economic growth remained on track, the services index is likely to remain in growth territory in July (chart, above).

Nonfarm Payrolls (July) (Friday)

Forecast: 200,000

A downward drift in initial claims for unemployment insurance and still-elevated job openings suggest that demand for labor remains firm. Hiring has decelerated from the 312k monthly pace in Q1, but hiring close to the 244k average in Q2 is possible (chart).

ISM Manufacturing Index*



Economic Indicators

July/August 2023																																																																																																																																																						
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CHICAGO FED NATIONAL ACTIVITY INDEX <table border="1"> <thead> <tr> <th></th> <th>Monthly</th> <th>3-Mo. Avg.</th> </tr> </thead> <tbody> <tr> <td>Apr</td> <td>0.13</td> <td>-0.22</td> </tr> <tr> <td>May</td> <td>-0.28</td> <td>-0.21</td> </tr> <tr> <td>June</td> <td>-0.32</td> <td>-0.16</td> </tr> </tbody> </table>		Monthly	3-Mo. Avg.	Apr	0.13	-0.22	May	-0.28	-0.21	June	-0.32	-0.16	FHFA HOME PRICE INDEX <table border="1"> <thead> <tr> <th></th> <th></th> </tr> </thead> <tbody> <tr> <td>Mar</td> <td>0.6%</td> </tr> <tr> <td>Apr</td> <td>0.7%</td> </tr> <tr> <td>May</td> <td>0.7%</td> </tr> </tbody> </table> S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX <table border="1"> <thead> <tr> <th></th> <th></th> </tr> </thead> <tbody> <tr> <td>Mar</td> <td>0.5%</td> </tr> <tr> <td>Apr</td> <td>0.9%</td> </tr> <tr> <td>May</td> <td>1.0%</td> </tr> </tbody> </table> CONFERENCE BOARD CONSUMER CONFIDENCE <table border="1"> <thead> <tr> <th></th> <th></th> </tr> </thead> <tbody> <tr> <td>May</td> <td>102.5</td> </tr> <tr> <td>June</td> <td>110.1</td> </tr> <tr> <td>July</td> <td>117.0</td> </tr> </tbody> </table> FOMC MEETING (FIRST DAY)			Mar	0.6%	Apr	0.7%	May	0.7%			Mar	0.5%	Apr	0.9%	May	1.0%			May	102.5	June	110.1	July	117.0	NEW HOME SALES <table border="1"> <thead> <tr> <th></th> <th></th> </tr> </thead> <tbody> <tr> <td>Apr</td> <td>0.671 million</td> </tr> <tr> <td>May</td> <td>0.715 million</td> </tr> <tr> <td>June</td> <td>0.697 million</td> </tr> </tbody> </table> FOMC DECISION			Apr	0.671 million	May	0.715 million	June	0.697 million	UNEMPLOYMENT CLAIMS <table border="1"> <thead> <tr> <th></th> <th>Initial</th> <th>Continuing</th> </tr> </thead> <tbody> <tr> <td></td> <td colspan="2">(millions)</td> </tr> <tr> <td>July 1</td> <td>0.249</td> <td>1.721</td> </tr> <tr> <td>July 8</td> <td>0.237</td> <td>1.749</td> </tr> <tr> <td>July 15</td> <td>0.228</td> <td>1.690</td> </tr> <tr> <td>July 22</td> <td>0.221</td> <td>N/A</td> </tr> </tbody> </table> GDP <table border="1"> <thead> <tr> <th></th> <th>GDP</th> <th>Chained Price</th> </tr> </thead> <tbody> <tr> <td>22-Q4</td> <td>2.6%</td> <td>3.9%</td> </tr> <tr> <td>23-Q1</td> <td>2.0%</td> <td>4.1%</td> </tr> <tr> <td>23-Q2</td> <td>2.4%</td> <td>2.2%</td> </tr> </tbody> </table> DURABLE GOODS ORDERS <table border="1"> <thead> <tr> <th></th> <th></th> </tr> </thead> <tbody> <tr> <td>Apr</td> <td>1.2%</td> </tr> <tr> <td>May</td> <td>2.0%</td> </tr> <tr> <td>June</td> <td>4.7%</td> </tr> </tbody> </table> INTERNATIONAL TRADE IN GOODS <table border="1"> <thead> <tr> <th></th> <th></th> </tr> </thead> <tbody> <tr> <td>Apr</td> <td>-\$97.5 billion</td> </tr> <tr> <td>May</td> <td>-\$91.9 billion</td> </tr> <tr> <td>June</td> <td>-\$87.8 billion</td> </tr> </tbody> </table> ADVANCE INVENTORIES <table border="1"> <thead> <tr> <th></th> <th>Wholesale</th> <th>Retail</th> </tr> </thead> <tbody> <tr> <td>Apr</td> <td>-0.3%</td> <td>0.3%</td> </tr> <tr> <td>May</td> <td>-0.3%</td> <td>0.7%</td> </tr> <tr> <td>June</td> <td>-0.3%</td> <td>0.7%</td> </tr> </tbody> </table> PENDING HOME SALES <table border="1"> <thead> <tr> <th></th> <th></th> </tr> </thead> <tbody> <tr> <td>Apr</td> <td>-0.4%</td> </tr> <tr> <td>May</td> <td>-2.5%</td> </tr> <tr> <td>June</td> <td>0.3%</td> </tr> </tbody> </table>		Initial	Continuing		(millions)		July 1	0.249	1.721	July 8	0.237	1.749	July 15	0.228	1.690	July 22	0.221	N/A		GDP	Chained Price	22-Q4	2.6%	3.9%	23-Q1	2.0%	4.1%	23-Q2	2.4%	2.2%			Apr	1.2%	May	2.0%	June	4.7%			Apr	-\$97.5 billion	May	-\$91.9 billion	June	-\$87.8 billion		Wholesale	Retail	Apr	-0.3%	0.3%	May	-0.3%	0.7%	June	-0.3%	0.7%			Apr	-0.4%	May	-2.5%	June	0.3%	PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX <table border="1"> <thead> <tr> <th></th> <th>Inc.</th> <th>Cons.</th> <th>Core</th> </tr> </thead> <tbody> <tr> <td>Apr</td> <td>0.3%</td> <td>0.6%</td> <td>0.4%</td> </tr> <tr> <td>May</td> <td>0.5%</td> <td>0.2%</td> <td>0.3%</td> </tr> <tr> <td>June</td> <td>0.3%</td> <td>0.5%</td> <td>0.2%</td> </tr> </tbody> </table> EMPLOYMENT COST INDEX <table border="1"> <thead> <tr> <th></th> <th>Comp.</th> <th>Wages</th> </tr> </thead> <tbody> <tr> <td>22-Q4</td> <td>1.1%</td> <td>1.2%</td> </tr> <tr> <td>23-Q1</td> <td>1.2%</td> <td>1.2%</td> </tr> <tr> <td>23-Q2</td> <td>1.0%</td> <td>1.0%</td> </tr> </tbody> </table> REVISED CONSUMER SENTIMENT <table border="1"> <thead> <tr> <th></th> <th></th> </tr> </thead> <tbody> <tr> <td>June</td> <td>64.4</td> </tr> <tr> <td>July(p)</td> <td>72.6</td> </tr> <tr> <td>July(r)</td> <td>71.6</td> </tr> </tbody> </table>		Inc.	Cons.	Core	Apr	0.3%	0.6%	0.4%	May	0.5%	0.2%	0.3%	June	0.3%	0.5%	0.2%		Comp.	Wages	22-Q4	1.1%	1.2%	23-Q1	1.2%	1.2%	23-Q2	1.0%	1.0%			June	64.4	July(p)	72.6	July(r)	71.6
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