Daiwa Capital Markets

U.S. Economic Comment

- October payrolls: notable easing; downward revisions soften previously hot September print
- Wage growth: both the employment cost index and average hourly earnings suggest cooling
- The Fed: possibly done, although vigilant for premature easing in financial conditions

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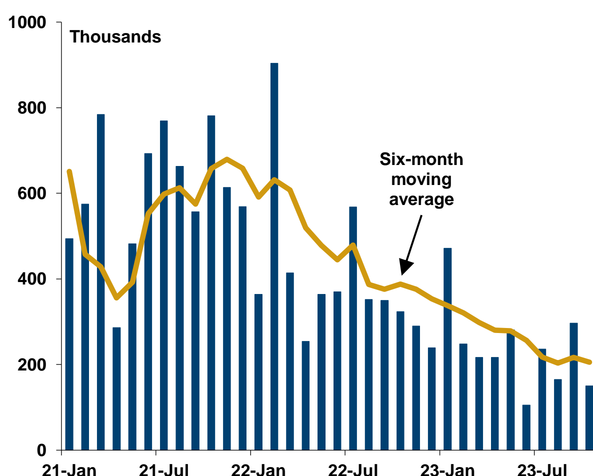
October Employment

Analysts dialed down expectations for employment growth in October after a brisk increase in the prior month (a preliminary reading of 336,000 jobs added), with the Bloomberg consensus estimate calling for job gains of 180,000. The realized tally was softer than anticipated (150,000) and results in the prior two months were revised lower by 101,000. The revision was especially notable, as it blunted the strength of the previous high-side reading in September (revised to 297,000 from the aforementioned 336,000) and pushed lower the August result (growth of 165,000 versus 227,000 first reported). This was not entirely unexpected, considering the aberrant high-side reading in the leisure and hospitality area (highlighted in last month's review of the labor market) which inflated September results and we interpreted as likely to revert back to the (softer) underlying trend. Moreover, we have watched closely the manufacturing component ahead of this month's release for any signs of strike activity at auto plants possibly depressing results (discussed below). However, fundamental slowing in labor market conditions is likely at play as well. Average job growth of 206,000 in the six months ending in October is likely still too brisk for Fed officials targeting a more dramatic economic slowdown, but the trend is moving in the right direction to further ease supply-demand imbalances in the labor market (chart, below left).

Of note, the drop in manufacturing employment stood out as a potential one-off factor in influencing payrolls (chart, below right). While the manufacturing sector has struggled amid tight financial conditions, evidenced by a softening in the ISM manufacturing index from 49.0 to 46.7 in October, the drop in payrolls was unusually large. Indeed, the change resulted from ongoing strike activity in the auto sector (payrolls fell 33,000), which could reverse next month as automakers and the UAW appear close to resolving tense contract negotiations. Even without the strike effect, however, payroll growth of 180,000 would have still marked a significant deceleration from job growth in the prior month.

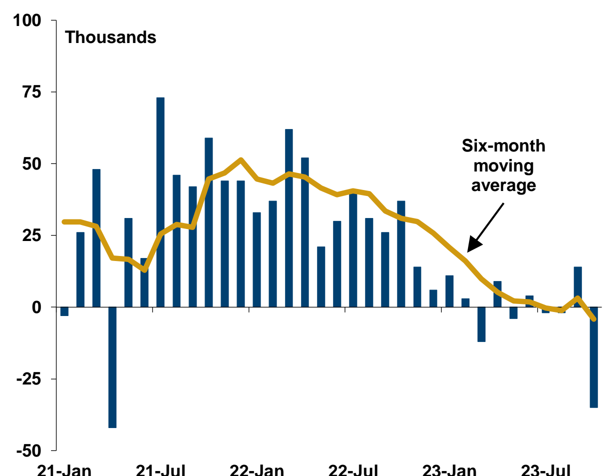
We had been keeping a close eye on two other areas after the publication of the previous employment report: the leisure and hospitality industry and state and local governments. Hiring in the leisure and hospitality sector had

Change in Nonfarm Payrolls



Source: Bureau of Labor Statistics via Haver Analytics

Change in Manufacturing Payrolls



Source: Bureau of Labor Statistics via Haver Analytics

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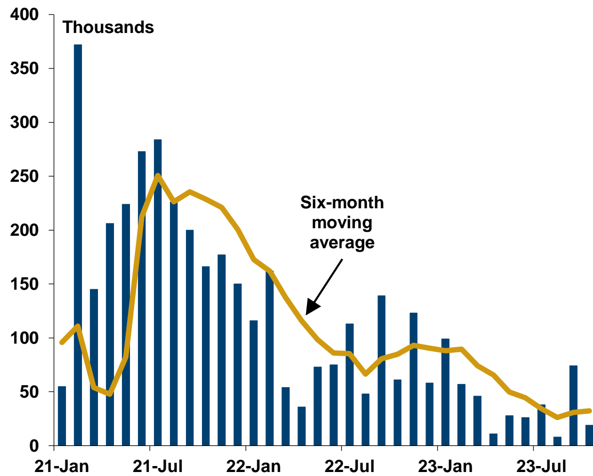
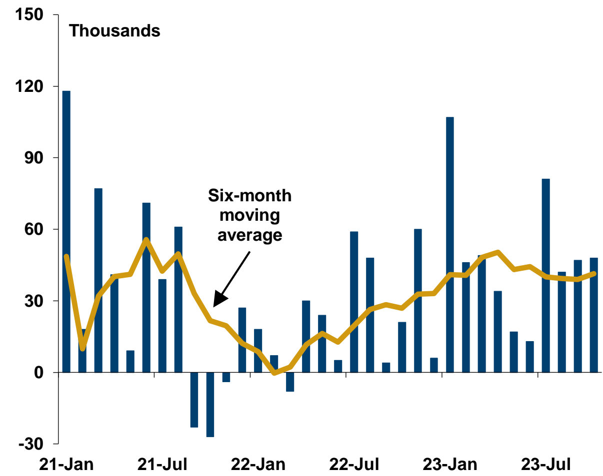
moderated after an initial burst in 2021 (when firms struggled to replace workers fired during the pandemic), but the trend then slowed even more sharply before a jump of 96,000 in September (revised with this report to 74,000; chart, below left). Indeed, we strongly suspect that the September reading (which contributed to the broader high-side reading in total employment) was an outlier; growth of 19,000 in October was much closer to the average of 26,000 in the six months preceding September. In the other direction, we have been watching closely persistent strength in hiring by state and local governments (up 48,000 in October, matching the average in the first nine months of 2023; chart, below right). We still expect restraint in this area as tax revenues slow amid a downturn in growth, but at least for now, previously unspent COVID funds are supporting a burst in hiring.

Change in Leisure & Hospitality Payrolls



Source: Bureau of Labor Statistics via Haver Analytics

Change in State & Local Government Payrolls



Source: Bureau of Labor Statistics via Haver Analytics

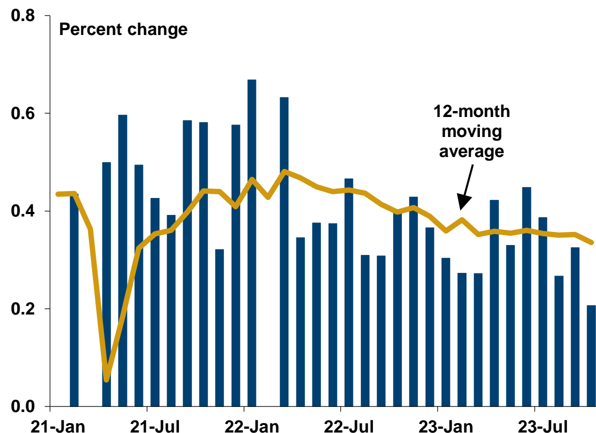
Ignoring near-term variation in hiring in the aforementioned sectors, we view the broader trend in hiring as slowing. The information sector, which incorporates cyclically sensitive tech jobs, saw job cuts for the sixth consecutive month (including a loss of 9,000 in October). Similarly, while temp jobs, which are usually cut before permanent positions, rose modestly in October (+7,000), they had fallen in the previous eight months. Several other industries either hired modestly or cut payrolls as well (mining, retail trade, transportation and warehousing).

Moderating Wage Growth Suggests Easing in Tight Labor Market Conditions

Although Fed Chair Powell suggested in his post-FOMC press conference on Wednesday that strong wage growth was not the primary driver of the recent (and ongoing) episode of rapid underlying inflation, he and his colleagues nonetheless remain attentive to inflation pressures generated by labor costs, particularly on the prices of services.

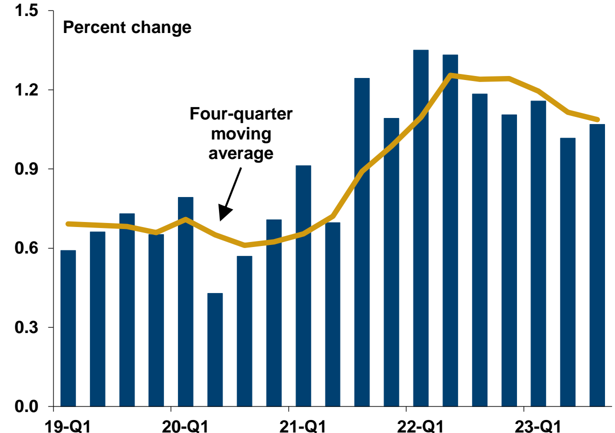
Easing in labor market conditions has started to filter through to slowing wages, with two measures published this week suggesting that compensation growth is decelerating toward a trajectory more consistent with the Federal Reserve's two-percent inflation objective. Average hourly earnings rose 0.2 percent in October, a notable slowing from the 0.35 percent average in the previous 12 months (chart, below left). Wages rose 4.1 percent on a year-over-year basis, down from 4.3 percent in September and the recent high of 5.9 percent in March 2022. Further evidence of the deceleration in the underlying trend was present in the employment cost index published on Tuesday. Although this measure is released less frequently (quarterly), we prefer it to average hourly earnings because it is not influenced by monthly compositional shifts in hiring like average hourly earnings are. Compensation costs rose 1.1 percent in Q3, matching the average in 23-H1 and down from the average of 1.2 percent last year (chart, below right). Compensation growth has fallen to 4.4 percent on a year-over-year basis from 4.5 percent in Q2 and the cycle high of 5.1 percent in 22-Q2. The results support those from average hourly earnings and again point to conditions in the labor market coming into better balance.

Average Hourly Earnings



Source: Bureau of Labor Statistics via Haver Analytics

Employment Cost Index



Source: Bureau of Labor Statistics via Haver Analytics

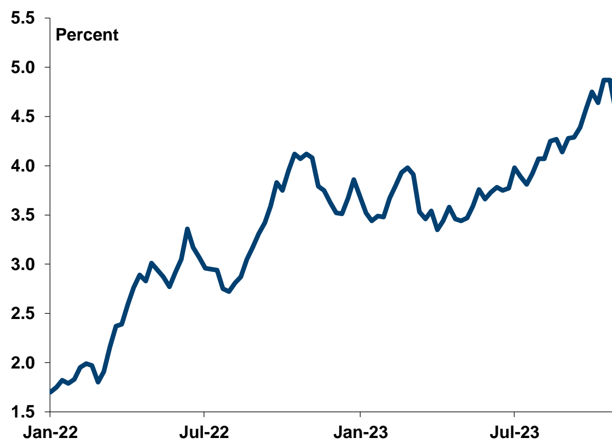
The Fed and Financial Conditions

The hesitancy of Fed officials to hike rates at the meeting earlier this week and subsequent data on the labor market raise the distinct possibility that the target range for the federal funds rate will peak at the current level of 5.25 to 5.50 percent. That policy setting, which was confirmed as "restrictive" by the Fed Chair in his post-meeting press conference, could constrain economic activity enough in coming months to keep inflation on its trajectory back to two-percent.

Market participants seized on the "hold" by the FOMC and the subsequent data as implying peak rates, with both equities and Treasuries rallying. As of Friday afternoon, the S&P 500 jumped almost six percent versus last Friday's close after recently moving into correction territory, and the 10-year Treasury yield fell from 4.84 percent on October 27 to 4.57 percent today.

Real-time repricing is on one hand a sign of market efficiency and liquidity, but we are concerned that easing in financial conditions caused by the recovery in equities and reversal in yields could undermine the market view (and the Fed mission). Chair Powell on Wednesday spoke to the recent tightening in financial conditions as key to slowing the economy. However, he cautioned that the tightening must be persistent to have both the desired outcome on the economy and also eliminate the need for additional rate hikes. A rapid reversal in equity prices and bond yields could force the Fed to again adopt a more hawkish position – and put another rate hike back on the table.

10-Year Treasury Yield*



** Weekly average data except for the latest observation which is a midday reading from November 3, 2023.*
Sources: Federal Reserve Board via Haver Analytics; Bloomberg

S&P 500*

** Weekly average data except for the latest observation which is a midday reading from November 3, 2023.*
Sources: Standard & Poor's via Haver Analytics; Bloomberg

Note to readers:

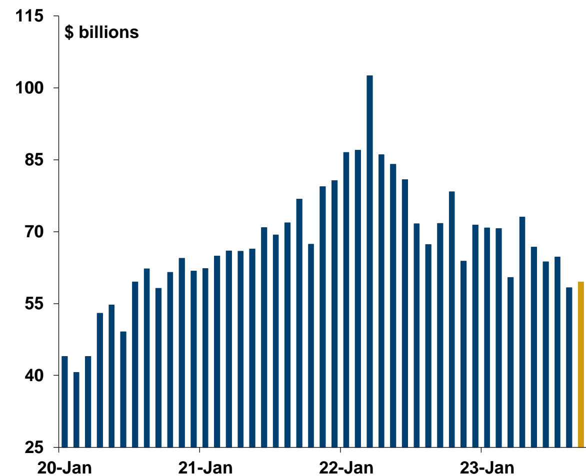
Next week's U.S. economic comment is cancelled. Publication will resume on November 17, 2023.

The Week Ahead

Trade Balance (September) (Tuesday)
Forecast: -$59.5 Billion ($1.2 Billion Wider Deficit)

The widening of $1.1 billion in the goods deficit (published on October 26) is likely to translate to similar deterioration in the total trade deficit in September (chart). The service surplus has surged since early 2023 and returned to the pre-COVID range, opening the door to a pause in the latest month.

Trade Balance in Goods & Services*



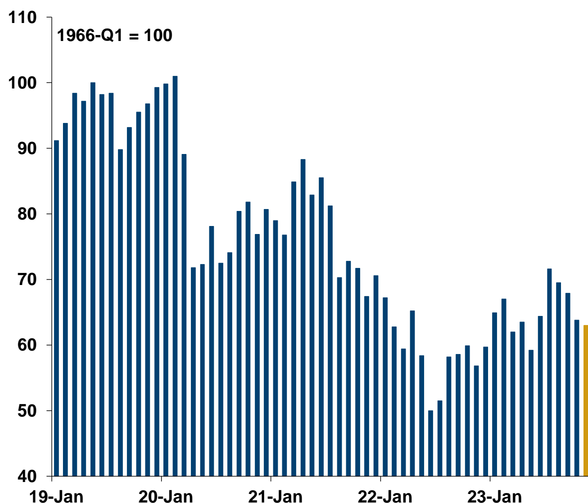
** The gold bar is a forecast for September 2023.*
Sources: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

Consumer Sentiment (November) (Friday)
Forecast: 63.0 (-0.8 Index Pt. or -1.3%)

Higher borrowing costs and a cooler job market are likely to raise concerns among consumers, which suggests a fourth consecutive decline in sentiment in early November (chart, below left).

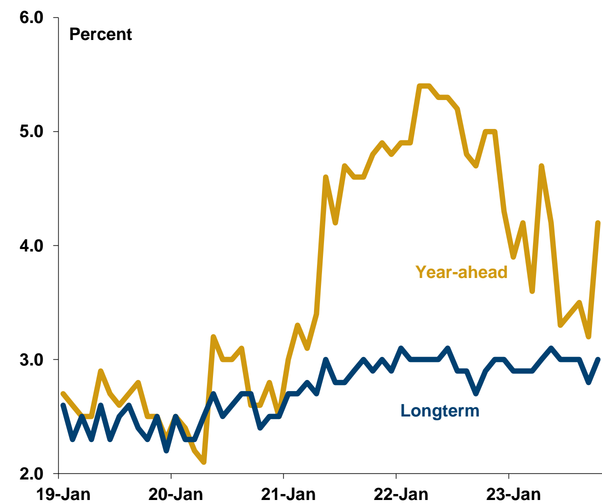
Keep an eye on the year-ahead and long-term inflation expectations measures published with the Michigan report. Year-ahead inflation expectations jumped 1.0 percentage point to 4.2 percent in October after falling in September to the lowest reading since the spring of 2021 (3.2 percent), while long-term expectations rose 0.2 percentage point to 3.0 percent (chart, below right).

Consumer Sentiment*



** The gold bar is a forecast for November 2023.*
Sources: University of Michigan via Haver Analytics; Daiwa Capital Markets America

Consumer Inflation Expectations



Source: University of Michigan via Haver Analytics

Federal Budget (October) (Friday)
Forecast: -$70.0 Billion

While available data suggest that revenue flows in October were firm on a year-over-year basis, federal outlays appear likely to remain on their brisk trend, which opens the door to the FY2024 opening with a deficit. The federal government recorded a deficit of $1.695 trillion for FY2023 (6.3 percent of GDP) versus $1.376 trillion in FY2022 (5.4 percent of GDP).

Economic Indicators

October/November 2023

Monday 30

Tuesday 31

EMPLOYMENT COST INDEX

	Comp.	Wages
23-Q1	1.2%	1.2%
23-Q2	1.0%	1.0%
23-Q3	1.1%	1.2%

FHFA HOME PRICE INDEX

June	0.5%
July	0.8%
Aug	0.6%

S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX

June	0.9%
July	0.8%
Aug	1.0%

MNI CHICAGO BUSINESS BAROMETER

	Index	Prices
Aug	48.7	74.0
Sep	44.1	59.5
Oct	44.0	60.1

CONFERENCE BOARD CONSUMER CONFIDENCE

Aug	108.7
Sep	104.3
Oct	102.6

FOMC MEETING (FIRST DAY)

Wednesday 1

ADP EMPLOYMENT

	Private Payrolls
Aug	180,000
Sep	89,000
Oct	113,000

ISM MFG. INDEX

	Index	Prices
Aug	47.6	48.4
Sep	49.0	43.8
Oct	46.7	45.1

CONSTRUCTION

July	0.7%
Aug	1.0%
Sep	0.4%

JOLTS DATA

	Openings (000)	Quit Rate
July	8,920	2.3%
Aug	9,497	2.3%
Sep	9,553	2.3%

FOMC DECISION

VEHICLE SALES

Aug	15.3 million
Sep	15.7 million
Oct	15.5 million

Thursday 2

UNEMPLOYMENT CLAIMS

	Initial	Continuing
	(millions)	
Oct 7	0.211	1.727
Oct 14	0.200	1.783
Oct 21	0.212	1.818
Oct 28	0.217	N/A

PRODUCTIVITY & COSTS

	Productivity	Unit Labor Costs
23-Q1	-0.8%	7.4%
23-Q2	3.6%	3.2%
23-Q3	4.7%	-0.8%

FACTORY ORDERS

July	-2.1%
Aug	1.0%
Sep	2.8%

Friday 3

EMPLOYMENT REPORT

	Payrolls	Un. Rate
Aug	165,000	3.8%
Sep	297,000	3.8%
Oct	150,000	3.9%

ISM SERVICES INDEX

	Index	Prices
Aug	54.5	58.9
Sep	53.6	58.9
Oct	51.8	58.6

Monday 6

Tuesday 7

TRADE BALANCE (8:30)

Jul	-$64.7 billion
Aug	-$58.3 billion
Sep	**-$59.5 billion**

CONSUMER CREDIT (3:00)

July	$11.0 billion
Aug	-$15.6 billion
Aug	--

Wednesday 8

WHOLESALE TRADE (10:00)

	Inventories	Sales
Jul	-0.3%	1.2%
Aug	-0.1%	1.8%
Sep	**0.0%**	**0.5%**

Thursday 9

UNEMP. CLAIMS (8:30)

Friday 10

CONSUMER SENTIMENT (10:00)

Sep	67.9
Oct	63.8
Nov	**63.0**

FEDERAL BUDGET (2:00)

	2023	2022
Aug	$89.3B	-$219.6B
Sep	-$171.0B	-$429.8B
Oct	**-$70.0B**	-$87.9B

Monday 13

Tuesday 14

NFIB SMALL BUSINESS OPTIMISM INDEX

CPI

Wednesday 15

PPI

RETAIL SALES

EMPIRE MFG

BUSINESS INVENTORIES

Thursday 16

UNEMP. CLAIMS

IMPORT/EXPORT PRICES

PHILLY FED INDEX

IP & CAP-U

NAHB HOUSING INDEX

TIC FLOWS

Friday 17

HOUSING STARTS

Monday 20

LEADING INDICATORS

Tuesday 21

CHICAGO FED NATIONAL ACTIVITY INDEX

EXISTING HOME SALES

FOMC MINUTES

Wednesday 22

UNEMP. CLAIMS

DURABLE GOODS ORDERS

REVISED CONSUMER SENTIMENT

Thursday 23

THANKSGIVING

Friday 24

Forecasts in bold.

Treasury Financing

October/November 2023

Monday	Tuesday	Wednesday	Thursday	Friday
30	31	1	2	3
AUCTION RESULTS: Rate / Cover 13-week bills 5.325% 2.78 26-week bills 5.320% 2.90	**AUCTION RESULTS:** Rate / Cover 52-week bills 5.135% 2.89 42-day CMBs 5.295% 2.81 **ANNOUNCE:** $56 billion 17-week bills for auction on Nov 1 $95 billion 4-week bills for auction on Nov 2 $85 billion 8-week bills for auction on Nov 2 **SETTLE:** $56 billion 17-week bills $95 billion 4-week bills $85 billion 8-week bills $13 billion 20-year bonds $22 billion 5-year TIPS $51 billion 2-year notes $52 billion 5-year notes $38 billion 7-year notes $26 billion 2-year FRNs	**AUCTION RESULTS:** Rate / Cover 17-week bills 5.340% 2.89 **ANNOUNCE:** $48 billion 3-year notes for auction on Nov 7 $40 billion 10-year notes for auction on Nov 8 $24 billion 30-year bonds for auction on Nov 9	**AUCTION RESULTS:** Rate / Cover 4-week bills 5.290% 2.91 8-week bills 5.300% 2.70 **ANNOUNCE:** $143 billion 13-,26-week bills for auction on Nov 6 $75 billion 42-day CMBs for auction on Nov 7 **SETTLE:** $143 billion 13-,26-week bills $44 billion 52-week bills $75 billion 42-day CMBs	
6	7	8	9	10
AUCTION: $143 billion 13-,26-week bills	**AUCTION:** $48 billion 3-year notes $75 billion 42-day CMBs **ANNOUNCE:** $56 billion* 17-week bills for auction on Nov 8 $95 billion* 4-week bills for auction on Nov 9 $85 billion* 8-week bills for auction on Nov 9 **SETTLE:** $56 billion 17-week bills $95 billion 4-week bills $85 billion 8-week bills	**AUCTION:** $56 billion* 17-week bills $40 billion 10-year notes	**AUCTION:** $95 billion* 4-week bills $85 billion* 8-week bills $24 billion 30-year bonds **ANNOUNCE:** $143 billion* 13-,26-week bills for auction on Nov 13 **SETTLE:** $143 billion 13-,26-week bills $75 billion 42-day CMBs	
13	14	15	16	17
AUCTION: $143 billion* 13-,26-week bills	**ANNOUNCE:** $56 billion* 17-week bills for auction on Nov 15 $95 billion* 4-week bills for auction on Nov 16 $85 billion* 8-week bills for auction on Nov 16 **SETTLE:** $56 billion* 17-week bills $95 billion* 4-week bills $85 billion* 8-week bills	**AUCTION:** $56 billion* 17-week bills **SETTLE:** $48 billion 3-year notes $40 billion 10-year notes $24 billion 30-year bonds	**AUCTION:** $95 billion* 4-week bills $85 billion* 8-week bills **ANNOUNCE:** $143 billion* 13-,26-week bills for auction on Nov 20 $16 billion* 20-year bonds for auction on Nov 20 $15 billion* 10-year TIPS for auction on Nov 21 $26 billion* 2-year FRNs for auction on Nov 21 **SETTLE:** $143 billion* 13-,26-week bills	
20	21	22	23	24
AUCTION: $143 billion* 13-,26-week bills $16 billion* 20-year bonds	**AUCTION:** $15 billion* 10-year TIPS $26 billion* 2-year FRNs **ANNOUNCE:** $56 billion* 17-week bills for auction on Nov 22 $95 billion* 4-week bills for auction on Nov 22 $85 billion* 8-week bills for auction on Nov 22 **SETTLE:** $56 billion* 17-week bills $95 billion* 4-week bills $85 billion* 8-week bills	**AUCTION:** $56 billion* 17-week bills $95 billion* 4-week bills $85 billion* 8-week bills **ANNOUNCE:** $143 billion* 13-,26-week bills for auction on Nov 27 $44 billion* 52-week bills for auction on Nov 28 $54 billion* 2-year notes for auction on Nov 27 $55 billion* 5-year notes for auction on Nov 27 $39 billion* 7-year notes for auction on Nov 28	***THANKSGIVING***	**SETTLE:** $143 billion* 13-,26-week bills $26 billion* 2-year FRNs

**Estimate*