U.S. Economic Comment

- November employment: solid payroll growth; drop in the unemployment rate
- Fed Preview: FOMC to proceed cautiously; no suggestion of imminent pivot
- Consumer Sentiment: rebound in December; inflation expectations settle

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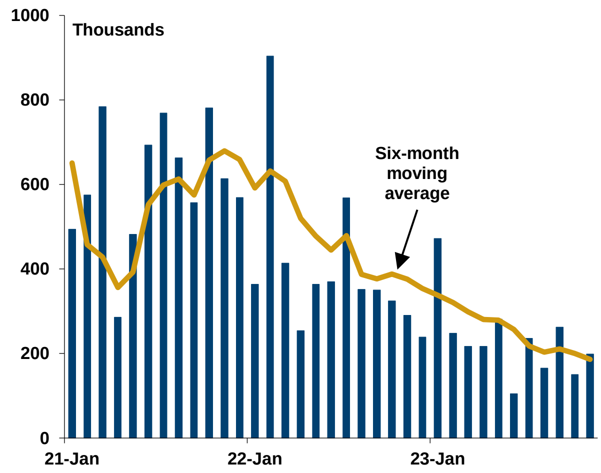
November Payrolls

Payroll growth in November registered a firm gain of 199,000, although the results were tempered to a degree by downward revisions of 35,000 in the prior two months. Growth in the past six months averaged 186,000, down from 287,000 in the first five months of the year and 399,000 gains per month in 2022 (chart, below left). The latest results suggest that labor market conditions are easing, but that additional softening may be required to help bring wage growth back to a pace consistent with two percent inflation.

We viewed several elements of the payroll data as noteworthy, and possibly indicating job growth that was less favorable than implied by the headline. Job growth in manufacturing, a cyclically sensitive area offers support of this view. Results in the past two months swung widely on account of strike activity in the automobile industry, with payrolls falling by 35,000 in October before increasing by 28,000 in November. Notably, the trend has been moving sideways, a performance consistent with sluggish activity in the factory sector (+1,000 per month in the past six months; chart, below right). Additionally, job growth in the private service-providing area, which incorporates a broad cross-section of industries and currently accounts for more than 70 percent of payrolls, recorded unimpressive growth at 121,000, off the average of 159,000 in the first 10 months of the year and well-below the 318,000 per month average in 2022. Moreover, a significant portion of that was accounted for by a surge of 93,000 in the healthcare and social assistance industry (charts, next page). Hiring in healthcare is not responsive to shifts in the business cycle; hiring is likely to remain firm amid increased demand on account of an aging population. Other areas trimmed payrolls (retail trade at -38,000; professional and business services at -9,000) or added cautiously. State and local government hiring remained strong amid a tailwind from previously allocated federal government support from the COVID period (+49,000 jobs in November). Absent a few areas, job growth was uninspiring.

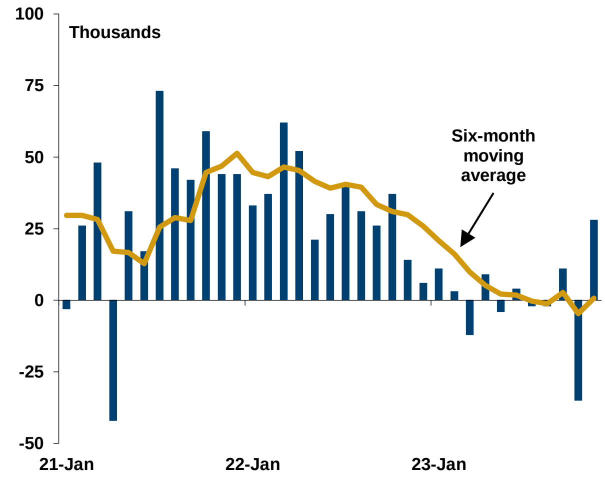
The unemployment rate, in contrast to what we viewed as lackluster payroll growth, registered a strong decline (-0.2 percentage point to 3.7 percent) and suggested that labor market conditions remained on firm footing. Employment measured by the household survey jumped 747,000 after a drop of 348,000 in the prior month, and it has averaged a firm 248,000 pace in 2023 thus far. That growth outstripped a jump of 532,000 in the labor force, which is also registering impressive underlying growth (an average monthly increase of 299,000 in 2023 thus far).

Change in Nonfarm Payrolls



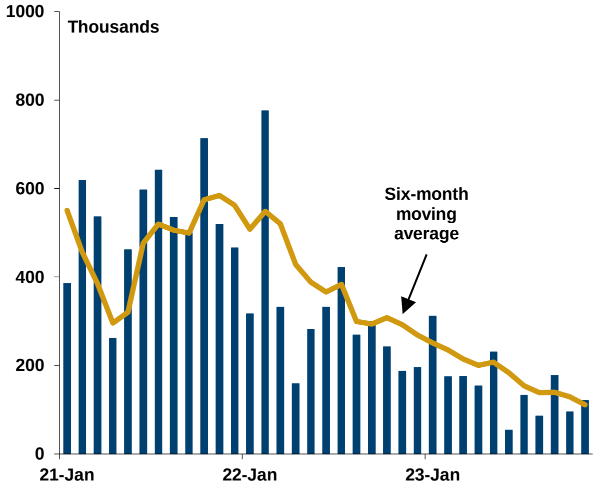
Source: Bureau of Labor Statistics via Haver Analytics

Change in Manufacturing Payrolls



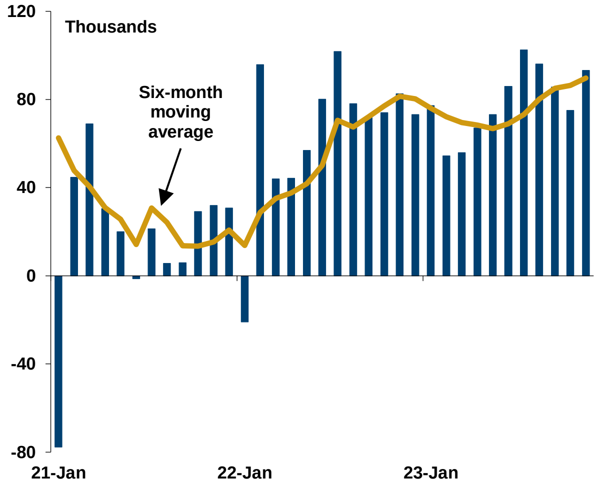
Source: Bureau of Labor Statistics via Haver Analytics

Change in Private Service-Producing Payrolls



Source: Bureau of Labor Statistics via Haver Analytics

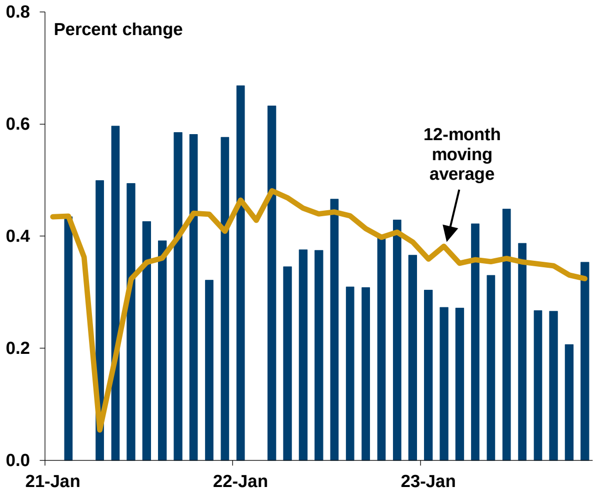
Change in Health Care & Social Assist. Payrolls



Source: Bureau of Labor Statistics via Haver Analytics

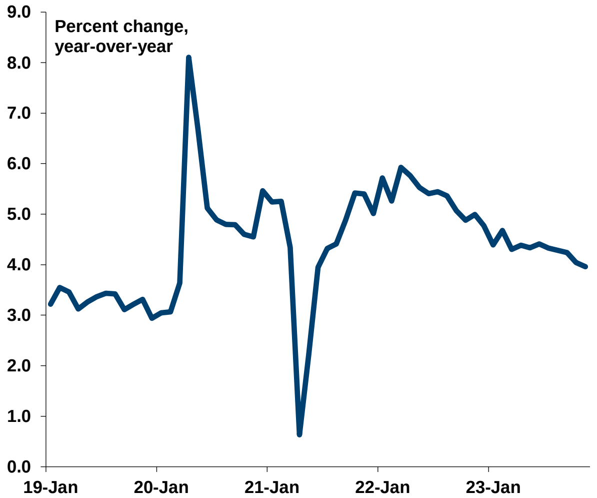
Other elements of the report tilted to the firm side. Average hourly earnings rose 0.4 percent in November, rebounding from a 0.2 percent reading in the previous month. The year-over-year advance was unchanged at 4.0 percent (charts, below). In addition, the average workweek increased by 0.1 hour to 34.4 hours and the aggregate hours index, a proxy for production, rose 0.3 percent – rebounding after a dip in October. Again, conditions in the labor market have moderated, but not yet by enough to achieve the Fed's dual mandate.

Average Hourly Earnings



Source: Bureau of Labor Statistics via Haver Analytics

Average Hourly Earnings



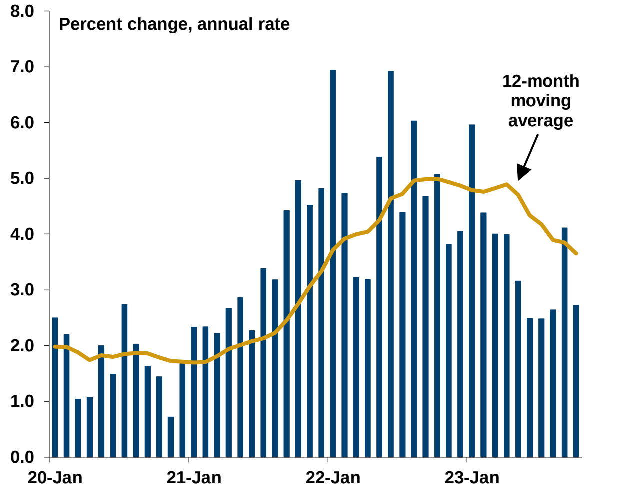
Source: Bureau of Labor Statistics via Haver Analytics

FOMC Preview: Maintenance of a Restrictive Stance of Policy amid Cautious Approach

Recent data, including readings on the PCE price indexes, suggest that the Federal Open Market Committee has made notable progress in taming rapid underlying inflation while bringing supply and demand in the economy into better balance. Indeed, the response of inflation to the current restrictive stance of monetary policy is allowing officials to proceed carefully in calibrating policy in coming months, as risks to taming entrenched inflation must increasingly be weighed against inflicting unnecessary damage to the economy (chart on underlying inflation, next page). With both the inflation target and growth risks in mind, officials appear poised to leave the target range for the federal funds rate unchanged at 5.25 to 5.50 percent for the third consecutive policy meeting – a signal, along with comments from various officials, that the next move by the FOMC is likely a pivot to a lower policy rate.

Although we readily acknowledge that the next move by the FOMC is a rate cut, we hold firm to the idea that the shift to lower rates is still more likely than not to occur in Q2. Recent market chatter seemed to focus on the possibility of earlier, sharp rates cuts possibly beginning in Q1, but we view that as a low-probability outcome – particularly in light of today's labor market data (see prior story). In light of the firm data into week-end, we anticipate only modest changes to next week's FOMC statement. The first paragraph could perhaps note that economic activity has moderated after expanding at a "strong pace" in Q3, but the employment report for November supports the characterization of employment gains as "strong." Additionally, while inflation has slowed, a year-over-year change in the core PCE price index of 3.5 percent in October seems to still warrant a characterization of inflation as "elevated." Thus, the Committee seems unlikely to drop language keeping open the door to additional hikes in the federal funds rate, even if the probability of such a move is low.

Trimmed-Mean PCE Inflation



** This measure is calculated by excluding the lowest 24 percent and highest 31 percent of price changes (determined by expenditure weight) to provide a more stable indicator of underlying inflation trends.*
Source: Federal Reserve Bank of Dallas via Haver Analytics

More likely than adjustments to the upcoming FOMC statement are possible changes to the new Summary of Economic Projections. With robust economic growth of 5.2 percent in Q3, forecasts for Q4/Q4 growth in 2023 almost certainly will be revised higher, which will equate to a higher median expectation, even if growth were expected to decelerate sharply in Q4 (table showing prior SEP). In light of the strong performance in H2-23 possibly pulling some activity forward, and considering that lagged effects of prior rate hikes could intensify early next year, perhaps expectations for growth of 1.5 percent for 2024 (near the SEP median estimate of the economy's long-run growth rate of 1.8 percent) will be nudged lower. Additionally, recent readings on inflation could lead to downward adjustments for year-end expectations for both the headline and core PCE price indexes. However, given that officials have yet to view entrenched inflation as vanquished, they may refrain from revising forecasts in 2024-25 to avoid signaling to the market a premature easing in policy. Finally, with regard to the target range for the federal funds rate, the 2023 projection will in all likelihood eliminate the final rate hike incorporated in the September SEP. Moreover, given that inflation is starting to show a response to restrictive policy, we could see policymakers projecting a third cut of 25 basis points in 2024. (The September SEP implied 50 basis points in cuts in 2024, with the target range at year-end falling to 5.125. Assuming that those are maintained in the forecast despite a lower peak in the federal funds rate, that reduction would imply a year-end median of 4.875 percent. If dovish-leaning officials influence the median by lowering forecasts further, a third cut would push the year-end projection to 4.625 percent.) Even if the SEP were to project lower rates across the forecast horizon, we expect Chair Powell in his post-meeting press conference to emphasize the Committee's unwavering commitment to achieving its policy objectives.

Economic Projections of the FOMC, September 2023*

	2023	2024	2025	2026	Longer Run
Change in Real GDP	2.1	1.5	1.8	1.8	1.8
Unemployment Rate	3.8	4.1	4.1	4.0	4.0
PCE Inflation	3.3	2.5	2.2	2.0	2.0
Core PCE Inflation	3.7	2.6	2.3	2.0	--
Federal Funds Rate	5.6	5.1	3.9	2.9	2.5

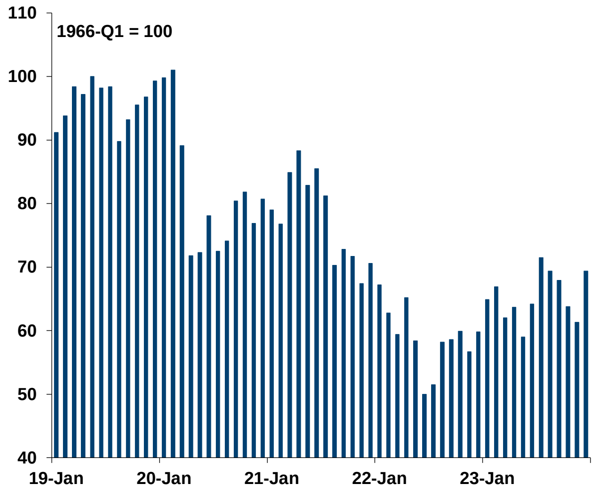
** Median projections*
Source: Federal Open Market Committee, Summary of Economic Projections, September 2023

Consumer Sentiment Improves in December

We have been monitoring closely measures of consumer attitudes, as these indicators provide useful insight into the health of the consumer sector and the propensities of households to spend. One such indicator, the University of Michigan sentiment index, has offered mixed views throughout the current expansion, failing to rebound to pre-COVID levels even as conditions returned to normal and households spent actively (chart, next page, left). The subdued responses likely reflected concerns about inflation, particularly those in the year-ahead. The short-term inflation gauge peaked in the spring of 2022 and has moved irregularly lower since then amid several spikes (chart, right).

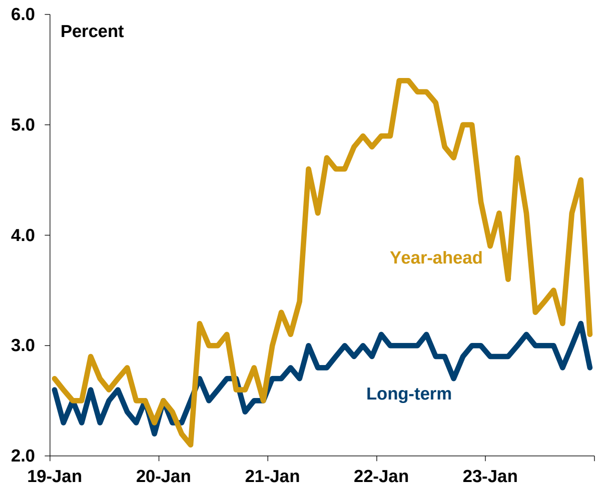
The latest stirring in inflation expectation began in October, with the near-term gauge jumping from a recent low of 3.2 percent in the prior month to 4.2 percent. At the same time, the longer-term metric showed deterioration, increasing by 0.2 percentage point to 3.0 percent. Further slippage occurred in November, with the year-ahead indicator jumping to 4.5 percent and the longer-term gauge touching a new high for the current cycle (3.2 percent). That pressure reversed in December, with the year-ahead gauge falling to 3.1 percent and the long-term measure dropping back to 2.8 percent, coinciding with a spurt of 13.2 percent (8.1 index points) in sentiment that reversed softening in the previous four months. We hesitate to draw broad implications from the latest sentiment survey, as we view the consumer as facing challenges next year and we anticipate the Fed having to remain vigilant to ensure that inflation expectations remain grounded amid gradual slowing in actual inflation. However, we see the early-December data as painting a notably less worrisome picture than that suggested by results in the past couple of months – both with regard to consumer attitudes and inflation expectations.

Consumer Sentiment



Source: University of Michigan via Haver Analytics

Consumer Inflation Expectations



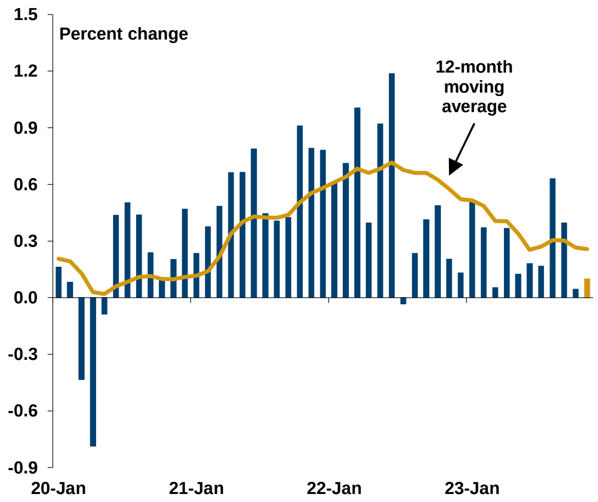
Source: University of Michigan via Haver Analytics

The Week Ahead

CPI (November) (Tuesday)
Forecast: 0.1% Total, 0.3% Core

Gasoline prices eased during the November survey period, raising the possibility of a second consecutive decline in the energy component of the CPI. The expected increase in food prices could decelerate back to the recent trend rate of 0.2 percent after a 0.3 percent reading in October. That said, the 2023 performance is still much improved from the average monthly increase of 0.8 percent in 2022. Increases in the core component have decelerated from an average of 0.4 percent in the first five months of 2023 to 0.2 percent in the June-to-October period. We suspect that the core component could tilt on the firmer end of the recent range in November, as increases in rents and owner-occupied housing costs remain on their still-strong upward trend and discounting in used vehicle prices moderates from that in recent months.

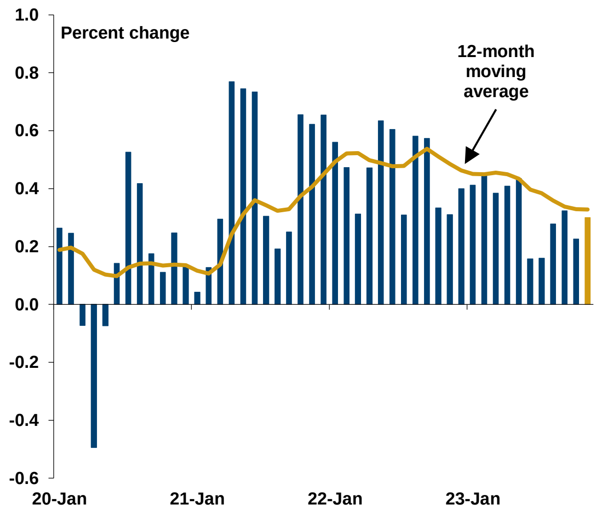
Headline CPI*



* The gold bar is a forecast for November 2023.

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

Core CPI*



* The gold bar is a forecast for November 2023.

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

Federal Budget (November) (Tuesday)
Forecast: -$250 Billion

Although available data suggest that revenue growth in November was solid on a year-over-year basis, outlays also appear to have remained on their brisk trajectory which opens the door to another sizable deficit for the federal government. If the forecast is realized, the shortfall of $316.6 billion in the first two months of FY2024 would be about $20 billion shy of the -$336.4 billion tally in the same period last fiscal year – an improvement in a strict sense, but still indicative of an unsustainable budgetary trajectory.

PPI (November) (Wednesday)
Forecast: 0.0% Total, 0.2% Ex. Food & Energy

Available data suggest that energy prices at the producer level fell during the November survey period after a drop of 6.5 percent in October. Food prices reported in the PPI are often volatile, although they have declined in seven of the past 10 months, including a dip of 0.2 percent in October. Core goods prices have increased 0.2 percent per month, on average, in the first 10 months of 2023, while service prices have advanced at a similar clip (0.16 percent and 0.19 percent, respectively, with less rounding). Construction costs have averaged monthly increases of less than 0.1 percent in 2023 thus far.

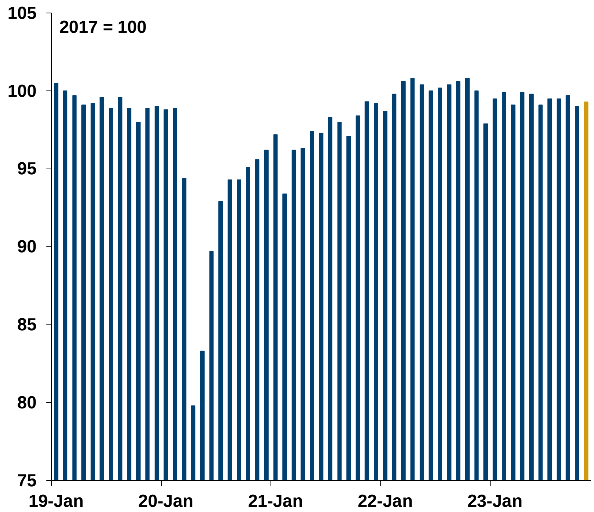
Retail Sales (November) (Thursday)
Forecast: -0.2% Total, 0.3% Ex. Autos

A dip in vehicle sales raises the possibility of a soft performance in the auto component of retail sales (which also includes auto parts and tire stores). Additionally, the gasoline component could dip; retail gasoline prices fell, but the change at gasoline stations could be small after seasonal adjustment. Activity excluding autos and gas could increase only modestly for the second consecutive month after a jump in September, as consumers likely acted with caution amid a cloudy outlook. Press reports indicated robust Cyber Week sales via online purchases, but assessments of activity at brick and mortar outlets appeared more guarded.

Industrial Production (November) (Friday)
Forecast: 0.3% Total, 0.3% Manufacturing

Data on employment and hours worked in the factory sector suggest a partial rebound in the manufacturing component after strike activity in the auto sector influenced a plunge of 0.7 percent in October. The upward trend in mining activity over the past two years has left the index at pre-pandemic levels. That said, with the rotary rig count little changed but hours worked up, mining activity could increase moderately in November. Utility output has swung widely for much of 2023, but the shifts reflected swings in weather rather than economic fundamentals. Data on home heating usage amid colder temperatures suggests an increase after declines in the previous two months.

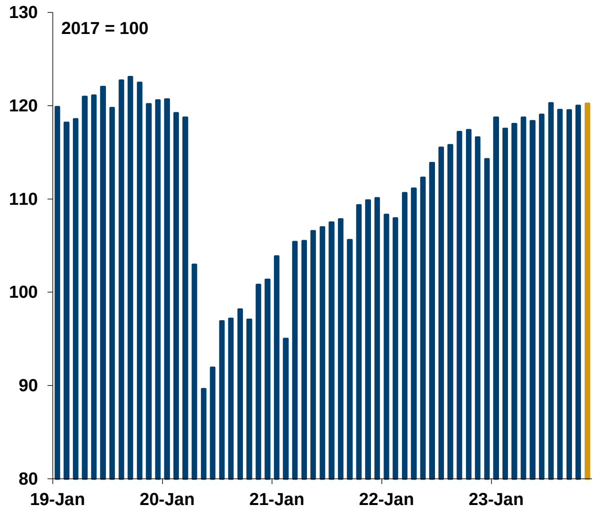
Industrial Production: Manufacturing*



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

Sources: Federal Reserve Board via Haver Analytics; Daiwa Capital Markets America

Industrial Production: Mining*



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

Sources: Federal Reserve Board via Haver Analytics; Daiwa Capital Markets America

Economic Indicators

December 2023

Monday	Tuesday	Wednesday	Thursday	Friday
4	5	6	7	8
FACTORY ORDERS Aug 1.0% Sep 2.3% Oct -3.6%	**ISM SERVICES INDEX** Index Prices Sep 53.6 58.9 Oct 51.8 58.6 Nov 52.7 58.3 **JOLTS DATA** Openings (000) Quit Rate Aug 9,497 2.3% Sep 9,350 2.3% Oct 8,733 2.3%	**ADP EMPLOYMENT** Private Payrolls Sep 89,000 Oct 106,000 Nov 103,000 **TRADE BALANCE** Aug -$58.6 billion Sep -$61.2 billion Oct -$64.3 billion **REVISED PRODUCTIVITY & COSTS** Productivity Unit Labor Costs 23-Q2 3.6% 2.6% 23-Q3 (p) 4.7% -0.8% 23-Q3 (r) 5.2% -1.2%	**UNEMPLOYMENT CLAIMS** Initial Continuing (millions) Nov 11 0.233 1.841 Nov 18 0.211 1.925 Nov 25 0.219 1.861 Dec 2 0.220 N/A **WHOLESALE TRADE** Inventories Sales Aug -0.1% 2.0% Sep 0.0% 2.0% Oct -0.4% -1.3% **CONSUMER CREDIT** Aug -$12.4 billion Sep $12.2 billion Oct $5.1 billion	**EMPLOYMENT REPORT** Payrolls Un. Rate Sep 262,000 3.8% Oct 150,000 3.9% Nov 199,000 3.7% **CONSUMER SENTIMENT** Oct 63.8 Nov 61.3 Dec 69.4
11	12	13	14	15
	NFIB SMALL BUSINESS OPTIMISM INDEX (6:00) Sep 90.8 Oct 90.7 Nov -- **CPI (8:30)** Total Core Sep 0.4% 0.3% Oct 0.0% 0.2% **Nov 0.1% 0.3%** **FEDERAL BUDGET (2:00)** 2023 2022 Sep -$170.7B -$429.8B Oct -$66.6B -$87.9B **Nov -$250.0B** -$248.5B **FOMC MEETING (FIRST DAY)**	**PPI (8:30)** Final Demand Ex. Food & Energy Sep 0.4% 0.2% Oct -0.5% 0.0% **Nov 0.0% 0.2%** **FOMC DECISION (2:00)**	**UNEMP. CLAIMS (8:30)** **RETAIL SALES (8:30)** Total Ex.Autos Sep 0.9% 0.8% Oct -0.1% 0.1% **Nov 0.2% 0.3%** **IMPORT/EXPORT PRICES (8:30)** Non-Petrol Imports Nonagri. Exports Sep -0.2% 0.7% Oct -0.2% -1.0% Nov -- -- **BUSINESS INVENTORIES (10:00)** Inventories Sales Aug 0.4% 1.4% Sep 0.2% 1.0% **Oct -0.1% -1.0%**	**EMPIRE MFG (8:30)** Oct -4.6 Nov 9.1 Dec -- **IP & CAP-U (9:15)** IP Cap.Util. Sep 0.1% 79.5% Oct -0.6% 78.9% **Nov 0.3% 79.1%** **TIC FLOWS (4:00)** Long-Term Total Aug $62.2B $131.0B Sep -$1.7B -$67.4B Oct -- --
18	19	20	21	22
NAHB HOUSING INDEX	**HOUSING STARTS**	**CURRENT ACCOUNT** **EXISTING HOME SALES** **CONFERENCE BOARD CONSUMER CONFIDENCE**	**UNEMP. CLAIMS** **REVISED GDP** **PHILLY FED INDEX** **LEADING INDICATORS**	**PERSONAL INCOME, CONSUMPTION, AND PCE PRICE INDEX** **DURABLE GOODS ORDERS** **NEW HOME SALES** **REVISED CONSUMER SENTIMENT**
25	26	27	28	29
CHRISTMAS	**CHICAGO FED NATIONAL ACTIVITY INDEX** **FHFA HOME PRICE INDEX** **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX**		**UNEMP. CLAIMS** **INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES** **PENDING HOME SALES**	**MNI CHICAGO BUSINESS BAROMETER**

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

Daiwa Capital Markets

Treasury Financing

December 2023

Monday	Tuesday	Wednesday	Thursday	Friday
4	5	6	7	8
AUCTION RESULTS: Rate Cover 13-week bills 5.250% 2.98 26-week bills 5.190% 2.66	**AUCTION RESULTS:** Rate Cover 42-day CMBs 5.285% 3.04 **ANNOUNCE:** $56 billion 17-week bills for auction on Dec 6 $80 billion 4-week bills for auction on Dec 7 $80 billion 8-week bills for auction on Dec 7 **SETTLE:** $56 billion 17-week bills $85 billion 4-week bills $80 billion 8-week bills	**AUCTION RESULTS:** Rate Cover 17-week bills 5.240% 2.97	**AUCTION RESULTS:** Rate Cover 4-week bills 5.285% 3.08 8-week bills 5.275% 2.82 **ANNOUNCE:** $143 billion 13-,26-week bills for auction on Dec 11 $50 billion 3-year notes for auction on Dec 11 $37 billion 10-year notes for auction on Dec 11 $21 billion 30-year bonds for auction on Dec 12 $70 billion 42-day CMBs for auction on Dec 12 **SETTLE:** $143 billion 13-,26-week bills $70 billion 42-day CMBs	
11	12	13	14	15
AUCTION: $143 billion 13-,26-week bills $50 billion 3-year notes $37 billion 10-year notes	**AUCTION:** $21 billion 30-year bonds $70 billion 42-day CMBs **ANNOUNCE:** $56 billion* 17-week bills for auction on Dec 13 $80 billion* 4-week bills for auction on Dec 14 $80 billion* 8-week bills for auction on Dec 14 **SETTLE:** $56 billion 17-week bills $80 billion 4-week bills $80 billion 8-week bills	**AUCTION:** $56 billion* 17-week bills	**AUCTION:** $80 billion* 4-week bills $80 billion* 8-week bills **ANNOUNCE:** $143 billion* 13-,26-week bills for auction on Dec 18 $13 billion* 20-year bonds for auction on Dec 20 $20 billion* 5-year TIPS for auction on Dec 21 **SETTLE:** $143 billion 13-,26-week bills $70 billion 42-day CMBs	**SETTLE:** $50 billion 3-year notes $37 billion 10-year notes $21 billion 30-year bonds
18	19	20	21	22
AUCTION: $143 billion* 13-,26-week bills	**AUCTION:** $21 billion* 30-year bonds **ANNOUNCE:** $56 billion* 17-week bills for auction on Dec 20 $80 billion* 4-week bills for auction on Dec 21 $80 billion* 8-week bills for auction on Dec 21 **SETTLE:** $56 billion* 17-week bills $80 billion* 4-week bills $80 billion* 8-week bills	**AUCTION:** $56 billion* 17-week bills $13 billion* 20-year bonds	**AUCTION:** $80 billion* 4-week bills $80 billion* 8-week bills $20 billion* 5-year TIPS **ANNOUNCE:** $143 billion* 13-,26-week bills for auction on Dec 26 $44 billion* 52-week bills for auction on Dec 26 $57 billion* 2-year notes for auction on Dec 26 $58 billion* 5-year notes for auction on Dec 27 $40 billion* 7-year notes for auction on Dec 28 $26 billion* 2-year FRNs for auction on Dec 27 **SETTLE:** $143 billion* 13-,26-week bills	
25	26	27	28	29
CHRISTMAS	**AUCTION:** $143 billion* 13-,26-week bills $44 billion* 52-week bills $57 billion* 2-year notes **ANNOUNCE:** $56 billion* 17-week bills for auction on Dec 27 $80 billion* 4-week bills for auction on Dec 28 $80 billion* 8-week bills for auction on Dec 28 **SETTLE:** $56 billion* 17-week bills $80 billion* 4-week bills $80 billion* 8-week bills	**AUCTION:** $56 billion* 17-week bills $58 billion* 5-year notes $26 billion* 2-year FRNs	**AUCTION:** $80 billion* 4-week bills $80 billion* 8-week bills $40 billion* 7-year notes **ANNOUNCE:** $143 billion* 13-,26-week bills for auction on Jan 2 **SETTLE:** $143 billion* 13-,26-week bills $44 billion* 52-week bills	**SETTLE:** $20 billion* 5-year TIPS $26 billion* 2-year FRNs

*Estimate