Daiwa Capital Markets

U.S. Economic Comment

- January employment: robust payroll growth; benchmark revisions had little effect on recent trends
- Household data: suggestive of ongoing tight labor market conditions
- Wage growth: strong, but likely influenced by inclement weather

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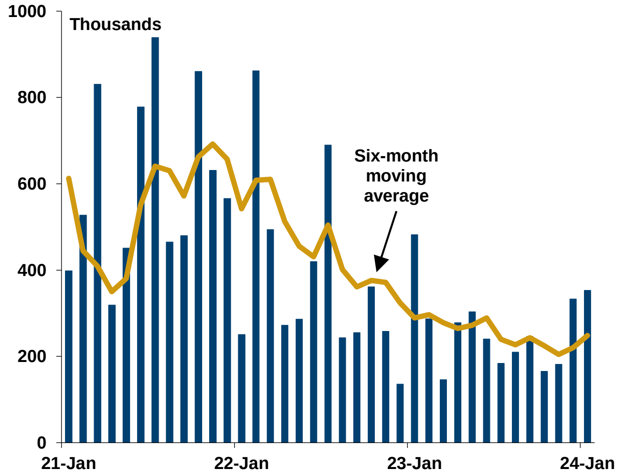
January Employment

When Chair Powell was asked during the post-FOMC press conference on Wednesday if he thought that discussion of a near-term (March) rate cut was “a little premature,” he responded that it was “probably not the most likely case or what we would call the base case.” In the context of today’s employment report, the reply probably comes across as an understatement; even at more than six weeks away, all else equal, a pivot at the March FOMC meeting strikes us as approaching a probability of zero. And, from a market perspective, while the door is still open to the possibility of cut in March, according to the CME’s FedWatch Tool, it slipped to 20.5 percent today from 46.2 percent last Friday (https://www.cmegroup.com/markets/interest-rates/cme-fedwatch-tool.html). In fairness to the Fed Chair, few saw the possibility of such a strong result for the employment data – a print that more closely aligns with our view of a mid-year pivot to lower rates. The highest payrolls estimate among economists polled by Bloomberg was growth of 300,000 (range of 120k to 300k), with a median expectation of 185,000. A few forecasters were in range, but most (ourselves included) were off the mark.

The payroll print of 353,000 for January far exceeded the average of 220,000 in the prior six months, with few areas registering soft results (chart, below left). Private-sector payroll jumped 317,000 (versus an average of 170,000 in the July-to-December period), as hiring in both goods and service-producing industries exceeded recent averages (28,000 and 289,000, respectively, versus six-month averages of 21,000 and 149,000). On an industry-by-industry basis, the professional and business services area added 74,000 positions (versus and average of 3,500 in the prior six months) and the cyclically sensitive transportation and warehousing area added 15,500 jobs after concerning cuts occurred for much of 2023 (average decline of 7,700 in the prior six months).

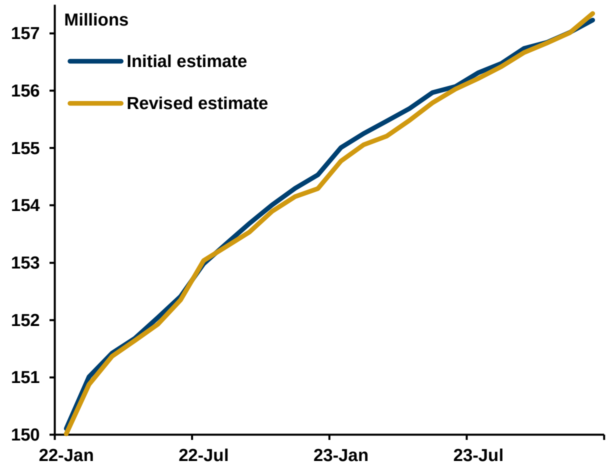
Benchmark revisions published with the January data also did little to temper previously strong employment trends, and payroll growth post the March 2023 benchmark was revised higher by 381,000 positions – including 117,000 in December. Regarding the annual benchmark revisions to payroll data, which incorporate data collected during the Quarterly Census of Employment and Wages for March 2023, results indicated that seasonally adjusted payroll growth from the spring of 2022 to March 2023 was 266,000 lower than previously believed (chart, right).

Change in Nonfarm Payrolls



Source: Bureau of Labor Statistics via Haver Analytics

Change in Nonfarm Payrolls



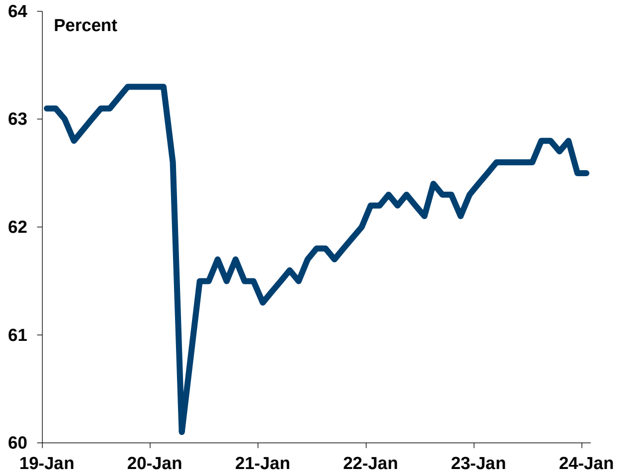
Source: Bureau of Labor Statistics via Haver Analytics

However, payroll growth in the post-benchmark period (April-to-December 2023) was stronger. To quantify revisions in terms average monthly payroll growth, monthly job gains averaged 377,000 per month in 2022 (versus 399,000 previously), and they improved to 255,000 per month in 2023 (versus a pre-revised average of 225,000). Broadly speaking, the labor market has cooled in response to restrictive monetary policy, but not as much as previously believed; job growth remained firm last year and actually picked up in the second half. (For reference, monthly job growth averaged 166,000 in 2019, the year preceding the pandemic, which was at the time viewed as a favorable performance for the labor market.)

The Household Data Suggest Ongoing Tightness in the Labor Market

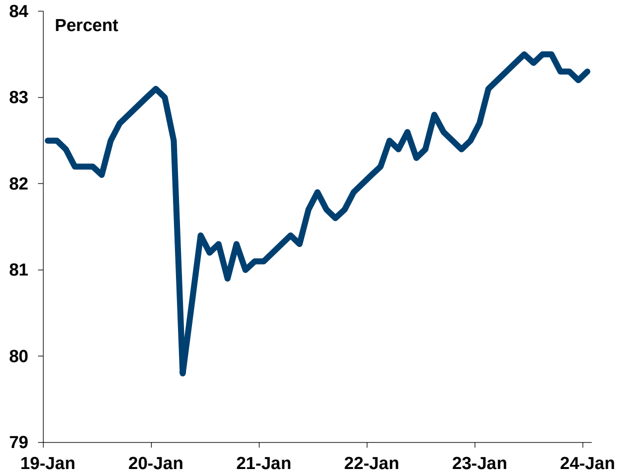
In addition to robust job growth in January, data from the household survey suggest that labor market conditions remained tight. The unemployment rate printed at 3.7 percent for the third consecutive month. Employment slipped 31,000 after a plunge of 683,000 in December, but the change was exceeded by a decline of 175,000 in the labor force that followed a drop of 676,000 in the prior month. The recent declines in the labor force, in particular, cast doubt on the view that additional labor supply may help to further alleviate ongoing imbalances in the labor market. In that regard, the labor force participation rate was unchanged at 62.5 percent after easing 0.3 percentage point in December from the current expansion high of 62.8 percent (chart, below left). The prime-age participation rate, which had been supporting the broader expansion in the labor force, increased to 83.3 percent after dipping in December, but it too is off the recent high of 83.5 percent and signaling a flattening in trend (chart, below right).

Labor Force Participation 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.*

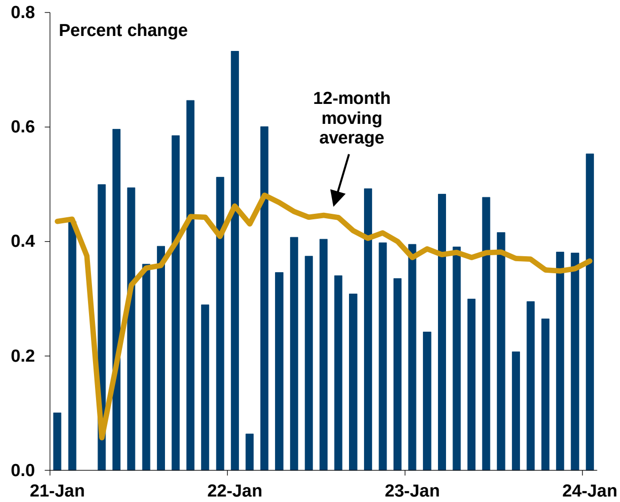
Source: Bureau of Labor Statistics via Haver Analytics

Revisions to household survey data in the form of new population controls also were incorporated in today's report, rendering prior data from the household survey not directly comparable to the January figures. The updated 2024 population controls indicated a smaller civilian noninstitutional population and labor force, with adjustments of -625,000 and -299,000, respectively. Had the new population controls not been implemented, the unemployment rate still would have been maintained at 3.7 percent, but the report would have shown changes in employment and the labor force of 239,000 and 124,000, respectively, rather than the declines of 31,000 and 175,000.

Weather Effects in Average Hourly Earnings

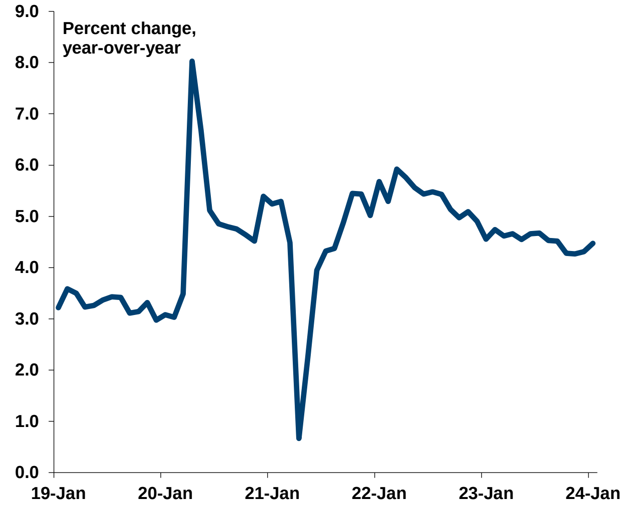
The jump of 0.6 percent in average hourly earnings grabbed headlines this morning, as it was strong in its own right and also followed brisk increases of 0.4 percent in each of the prior two months. The latest advance translated to a year-over-year increase of 4.5 percent, well off the cycle peak of 5.9 percent in March 2022 but faster than readings of 4.3 percent in Q4 and still above what we view as consistent with the Federal Reserve achieving its two-percent inflation target (charts, next page).

Average Hourly Earnings



Source: Bureau of Labor Statistics via Haver Analytics

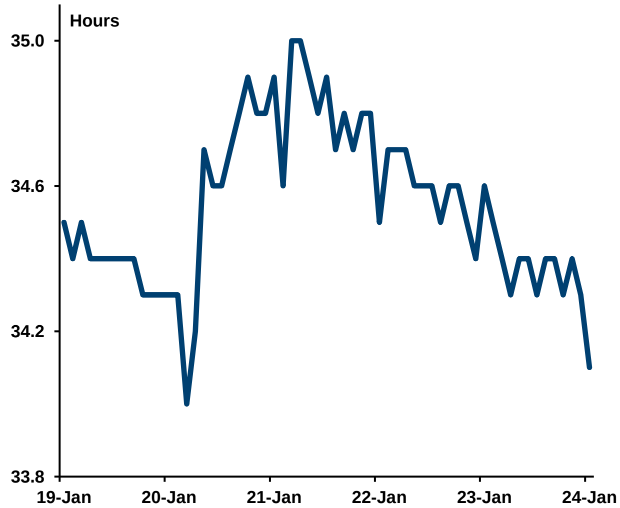
Average Hourly Earnings



Source: Bureau of Labor Statistics via Haver Analytics

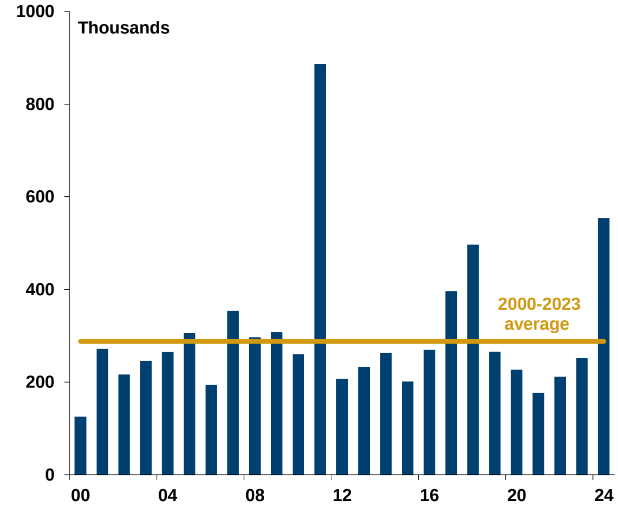
Although the results were striking, we suspect that inclement weather during the January survey period played a significant role in the latest result. The length of the average workweek dropped 0.2 hours to 34.1 hours, the lowest reading since the economy was constrained by pandemic-related disruptions (chart, below left). Although the workweek is often adjusted to influence production – either increasing or constraining output without shifting headcounts – that does not appear to be the case in this instance. Nonagricultural employees out of work due to weather in January 2024 totaled 553,000, almost double the average of 288,000 in the prior 24 years (chart, below right). Since average hourly earnings is calculated by dividing payrolls by industry group by total worker hours plus one-half overtime hours, a drop in hours, all else equal, would boost average earnings. Average hourly earnings had been firm before January, but we are not inclined to read too much into the latest observation.

Length of the Average Workweek



Source: Bureau of Labor Statistics via Haver Analytics

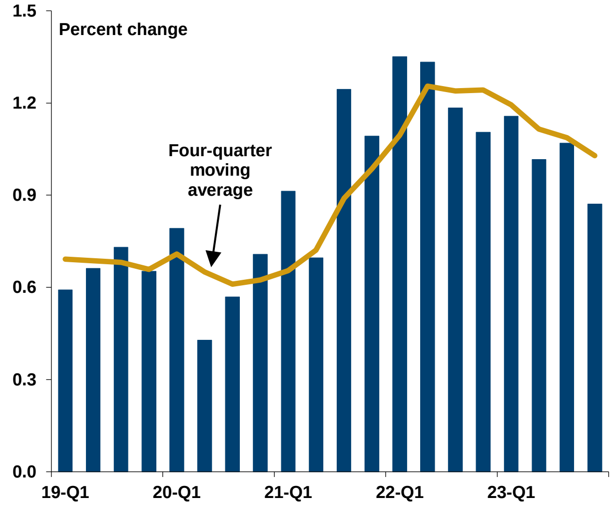
Employees Not at Work Due to Bad Weather*



*Employees in non-agricultural industries. Monthly readings for January of each year shown.
Source: Bureau of Labor Statistics via Haver Analytics

More likely, compensation costs are currently growing in the low four-percent area – as suggested by the employment cost index (Q4 results were released on January 31; total compensation costs rose 0.9 percent, not annualized in Q4, or 4.2 percent year-over-year and wages increased 0.9 percent or 4.3 percent year-over-year; see chart on quarterly compensation on the next page). Although the employment cost index is lagged versus other data on employee compensation, this metric is watched more closely by Fed officials and is viewed among the most reliable measures of labor costs. As opposed to average hourly earnings, the employment cost index better tracks changes in labor costs for the same jobs over time and it is not influenced by issues such as shifts in the composition of employment between high and low-wage industries. Thus, while only available through the fourth quarter of last year, we suspect that Fed officials are currently weighing the ECI more heavily than average earnings, with the metric showing gradual but steady moderation in compensation.

Employment Cost Index



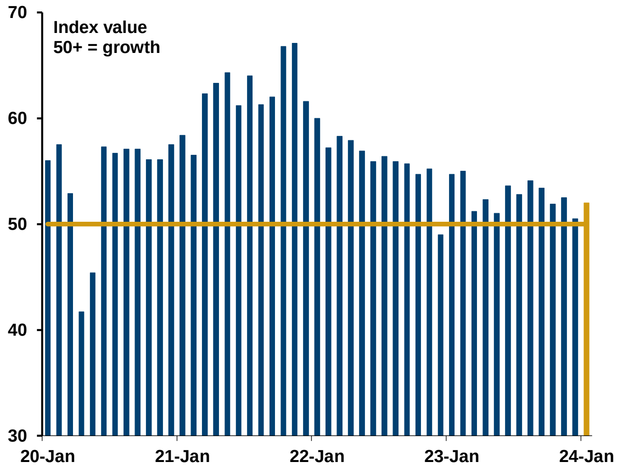
Source: Bureau of Labor Statistics via Haver Analytics

The Week Ahead

ISM Services Index (January) (Monday)
Forecast: 52.0 (+1.5 Index Pts.)

The service sector of the economy has remained on a growth track, but a drop in December left the level of the index close to the critical value of 50.0 (which separates expansion from contraction). Although restrictive monetary policy has weighed on economic activity, we suspect that the degree of softening may have been overstated in December – particularly as the decline was tied to a plunge of 6.8 index points in the employment component to 43.8, by far the lowest reading of 2023 (charts). In light of a surge of 289k in service sector payrolls in January (and total private payroll growth of 317k), we suspect that a rebound after the previous downside volatility could boost the headline in January. Moreover, we would add that GDP growth of 3.3 percent in Q4 suggested solid underlying momentum in the economy heading into 2024, not an ISM reading consistent with a stalling activity.

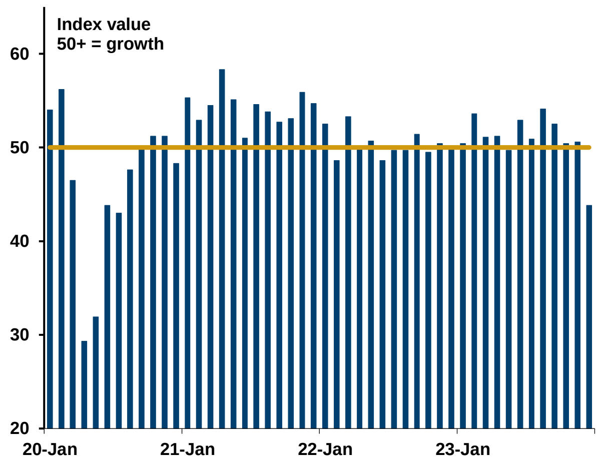
ISM Services: Headline Index*



** The gold bar is a forecast for January 2024.*

Sources: Institute for Supply Management via Haver Analytics; Daiwa Capital Markets America

ISM Services: Employment Index

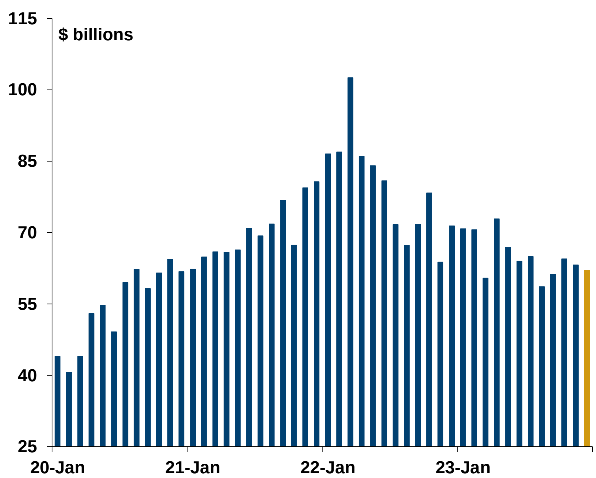


Source: Institute for Supply Management via Haver Analytics

Trade Balance (December) (Wednesday)
Forecast: -$62.1 Billion ($1.1 Billion Narrower Deficit)

The narrowing of $0.9 billion in the goods deficit (released on January 25) suggests similar improvement in the total trade deficit for December (chart, below left). The surplus in service trade increased by $1.0 billion in the past two months combined to $26.2 billion, augmenting the strong performance in 2023 thus far (chart, below right).

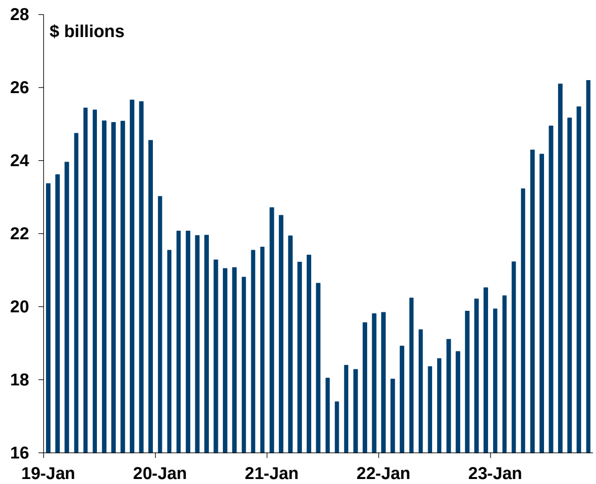
Trade Deficit in Goods & Services*



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

Sources: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

Trade Surplus in Services



Source: Bureau of Economic Analysis via Haver Analytics

Economic Indicators

January/February 2024

<table>
<tr><th>Monday</th><th>Tuesday</th><th>Wednesday</th><th>Thursday</th><th>Friday</th></tr>
<tr><td>29</td><td>30</td><td>31</td><td>1</td><td>2</td></tr>
<tr>
<td></td>
<td>FHFA HOME PRICE INDEX
Sep 0.7%
Oct 0.3%
Nov 0.3%
S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX
Sep 0.6%
Oct 0.6%
Nov 0.1%
CONFERENCE BOARD CONSUMER CONFIDENCE
Nov 101.0
Dec 108.0
Jan 114.8
JOLTS DATA
Openings (000) / Quit Rate
Oct 8,852 2.3%
Nov 8,925 2.2%
Dec 9,026 2.2%
FOMC MEETING (FIRST DAY)</td>
<td>ADP EMPLOYMENT
Private Payrolls
Nov 104,000
Dec 158,000
Jan 107,000
EMPLOYMENT COST INDEX
Comp. / Wages
23-Q2 1.0% 1.0%
23-Q3 1.1% 1.2%
23-Q4 0.9% 0.9%
MNI CHICAGO BUSINESS BAROMETER
Index / Prices
Nov 55.6 61.5
Dec 47.2 68.0
Jan 46.0 63.9
FOMC RATE DECISION</td>
<td>UNEMPLOYMENT CLAIMS
Initial / Continuing (millions)
Jan 6 0.203 1.806
Jan 13 0.189 1.828
Jan 20 0.215 1.898
Jan 27 0.224 N/A
PRODUCTIVITY & COSTS
Productivity / Unit Labor Costs
23-Q2 3.6% 2.6%
23-Q3 4.9% -1.1%
23-Q4 3.2% 0.5%
ISM MFG. INDEX
Index / Prices
Nov 46.6 49.9
Dec 47.1 45.2
Jan 49.1 52.9
CONSTRUCTION
Oct 2.1%
Nov 0.9%
Dec 0.9%
VEHICLE SALES
Nov 15.5 million
Dec 16.1 million
Jan 15.0 million</td>
<td>EMPLOYMENT REPORT
Payrolls / Un. Rate
Nov 182,000 3.7%
Dec 333,000 3.7%
Jan 353,000 3.7%
FACTORY ORDERS
Oct -3.4%
Nov 2.6%
Dec 0.2%
REVISED CONSUMER SENTIMENT
Dec 69.7
Jan (p) 78.8
Jan (r) 79.0</td>
</tr>
<tr><td>5</td><td>6</td><td>7</td><td>8</td><td>9</td></tr>
<tr>
<td>ISM SERVICES INDEX (10:00)
Index / Prices
Nov 52.5 57.6
Dec 50.5 56.7
Jan 52.0 57.5
SENIOR LOAN OFFICER OPINION SURVEY ON BANK LENDING PRACTICES (2:00)</td>
<td></td>
<td>TRADE BALANCE (8:30)
Oct -$64.5 billion
Nov -$63.2 billion
Dec -$62.1 billion
CONSUMER CREDIT (3:00)
Oct $5.8 billion
Nov $23.8 billion
Dec --</td>
<td>UNEMP. CLAIMS (8:30)
WHOLESALE TRADE (10:00)
Inventories / Sales
Oct -0.3% -1.5%
Nov -0.4% 0.0%
Dec 0.4% 0.2%</td>
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<tr><td>12</td><td>13</td><td>14</td><td>15</td><td>16</td></tr>
<tr>
<td>FEDERAL BUDGET</td>
<td>NFIB SMALL BUSINESS OPTIMISM INDEX
CPI</td>
<td></td>
<td>UNEMP. CLAIMS
RETAIL SALES
IMPORT/EXPORT PRICES
EMPIRE MFG
PHILLY FED INDEX
IP & CAP-U
NAHB HOUSING INDEX
BUSINESS INVENTORIES
TIC FLOWS</td>
<td>PPI
HOUSING STARTS
CONSUMER SENTIMENT</td>
</tr>
<tr><td>19</td><td>20</td><td>21</td><td>22</td><td>23</td></tr>
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<td>PRESIDENTS' DAY</td>
<td>LEADING INDICATORS</td>
<td>FOMC MINUTES</td>
<td>UNEMP. CLAIMS
CHICAGO FED NATIONAL ACTIVITY INDEX
EXISTING HOME SALES</td>
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Forecasts in bold. (p) = preliminary, (r) = revised

Daiwa Capital Markets

Treasury Financing

January/February 2024

Monday	Tuesday	Wednesday	Thursday	Friday
29	30	31	1	2
AUCTION RESULTS: Rate / Cover 13-week bills 5.210% 2.84 26-week bills 4.985% 3.14	**AUCTION RESULTS:** Rate / Cover 42 day CMBs 5.280% 2.70 **ANNOUNCE:** $60 billion 17-week bills for auction on Jan 31 $95 billion 4-week bills for auction on Feb 1 $90 billion 8-week bills for auction on Feb 1 **SETTLE:** $60 billion 17-week bills $90 billion 4-week bills $90 billion 8-week bills	**AUCTION RESULTS:** Rate / Cover 17-week bills 5.150% 2.69 **ANNOUNCE:** $54 billion 3-year notes for auction on Feb 6 $42 billion 10-year notes for auction on Feb 7 $25 billion 30-year bonds for auction on Feb 8 **SETTLE:** $13 billion 20-year bonds $18 billion 10-year TIPS $60 billion 2-year notes $61 billion 5-year notes $41 billion 7-year notes $28 billion 2-year FRNs	**AUCTION RESULTS:** Rate / Cover 4-week bills 5.280% 2.78 8-week bills 5.265% 2.75 **ANNOUNCE:** $149 billion 13-,26-week bills for auction on Feb 5 $80 billion 42-day CMBs for auction on Feb 6 **SETTLE:** $149 billion 13-,26-week bills $80 billion 42-day CMBs	
5	6	7	8	9
AUCTION: $149 billion 13-,26-week bills	**AUCTION:** $54 billion 3-year notes $80 billion 42-day CMBs **ANNOUNCE:** $60 billion* 17-week bills for auction on Feb 7 $95 billion* 4-week bills for auction on Feb 8 $90 billion* 8-week bills for auction on Feb 8 **SETTLE:** $60 billion 17-week bills $95 billion 4-week bills $90 billion 8-week bills	**AUCTION:** $60 billion* 17-week bills $42 billion 10-year notes	**AUCTION:** $95 billion* 4-week bills $90 billion* 8-week bills $25 billion 30-year bonds **ANNOUNCE:** $149 billion* 13-,26-week bills for auction on Feb 12 **SETTLE:** $149 billion 13-,26-week bills $80 billion 42-day CMBs	
12	13	14	15	16
AUCTION: $149 billion* 13-,26-week bills	**ANNOUNCE:** $60 billion* 17-week bills for auction on Feb 14 $95 billion* 4-week bills for auction on Feb 15 $90 billion* 8-week bills for auction on Feb 15 **SETTLE:** $60 billion* 17-week bills $95 billion* 4-week bills $90 billion* 8-week bills	**AUCTION:** $60 billion* 17-week bills	**AUCTION:** $95 billion* 4-week bills $90 billion* 8-week bills **ANNOUNCE:** $149 billion* 13-,26-week bills for auction on Feb 20 $46 billion* 52-week bills for auction on Feb 20 $16 billion* 20-year bonds for auction on Feb 21 $9 billion* 30-year TIPS for auction on Feb 22 $28 billion* 2-year FRNs for auction on Feb 21 **SETTLE:** $149 billion* 13-,26-week bills $54 billion 3-year notes $42 billion 10-year notes $25 billion 30-year bonds	
19	20	21	22	23
PRESIDENTS' DAY	**AUCTION:** $149 billion* 13-,26-week bills $46 billion* 52-week bills **ANNOUNCE:** $60 billion* 17-week bills for auction on Feb 21 $95 billion* 4-week bills for auction on Feb 22 $90 billion* 8-week bills for auction on Feb 22 **SETTLE:** $60 billion* 17-week bills $95 billion* 4-week bills $90 billion* 8-week bills	**AUCTION:** $60 billion* 17-week bills $16 billion* 20-year bonds $28 billion* 2-year FRNs	**AUCTION:** $95 billion* 4-week bills $90 billion* 8-week bills $9 billion* 30-year TIPS **ANNOUNCE:** $149 billion* 13-,26-week bills for auction on Feb 26 $63 billion* 2-year notes for auction on Feb 26 $64 billion* 5-year notes for auction on Feb 26 $42 billion* 7-year notes for auction on Feb 27 **SETTLE:** $149 billion* 13-,26-week bills $46 billion* 52-week bills	**SETTLE:** $28 billion* 2-year FRNs

*Estimate