Daiwa Capital Markets

U.S. Economic Comment

- FOMC: set to move in September; soft data raise market speculation of aggressive action
- July employment: disappointing payroll growth; upward move in unemployment rate

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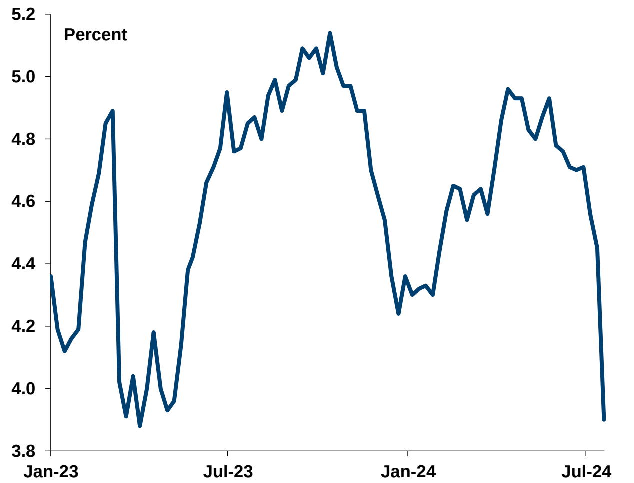
The FOMC: On Track for Another Policy Mistake?

The narrative surrounding the U.S. economy and interest rates has undergone a dizzying shift in recent months, transitioning from acute concern over a spike in inflation in Q1 after notable improvement in the back half of last year to as of mid-week focusing on the increasing probability a soft landing and easing toward a neutral stance of monetary policy (with the first cut in the federal funds rate on track for the September 17-18 FOMC meeting). Indeed, although Fed Chair Jay Powell at his post-meeting press conference demurred from providing a timetable for prospective rate cuts, the Chairman's comments strongly implied that the economy was in a good place after weathering a treacherous inflation storm and therefore cuts to the policy rate could soon materialize: "Recent indicators suggest that economic activity has continued to expand at a solid pace… I'll tell you, it's a pretty, the picture is not one of a slowing or a really bad economy… the total scope of the data suggest a normalizing labor market." Developments following the FOMC meeting, however, pushed back on the narrative of the Fed Chair and contributed to rampant speculation about cuts ranging from 75 to 125 basis points by year-end, which was accompanied by a two-day plunge of approximately 46 basis points in the two-year yield to 3.87 percent as of Friday afternoon (chart). (For more information on Powell's testimony, please see: Powell, Jerome H. "Transcript of Chair Powell's FOMC Press Conference," Federal Reserve Board, July 31, 2024. https://www.federalreserve.gov/mediacenter/files/fomcpresconf20240731.pdf)

2-Year Treasury Note Yield*



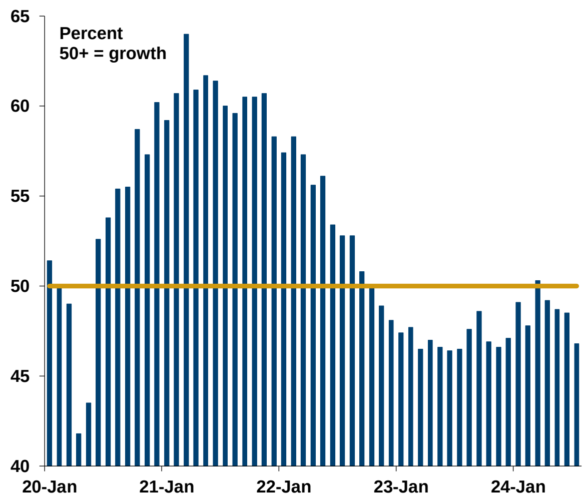
** Weekly average data, except for the latest observation which is a midday quote from August 2, 2024.*

Sources: Federal Reserve Board via Haver Analytics; Bloomberg

Disappointing Employment Data, with Caveats

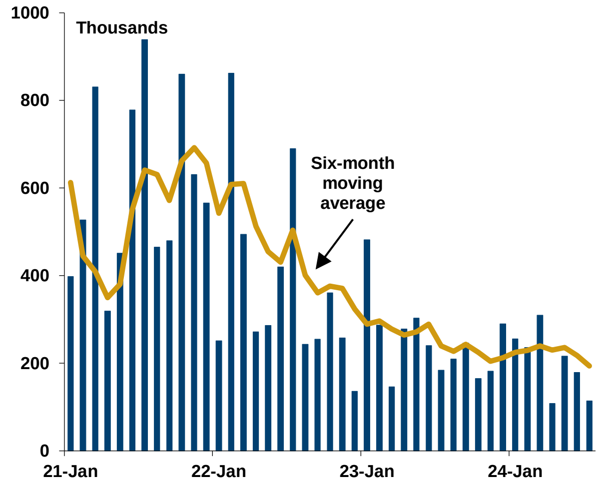
The turn toward a full embrace of the bearish economic scenario by market participants began on Thursday with the release of the July ISM manufacturing data. The latest reading suggested material softening in the manufacturing sector versus other recent readings that merely implied an interest rate sensitive sector operating at stall speed (46.8 in July versus an average of 48.9 in 24-H1; chart, right). Then concern reached a crescendo on Friday, as payroll growth missed expectations by a wide margin. Hiring of 114,000 trailed the Bloomberg median expectation of 175,000 and lagged the first half average of 218,000 (chart, next page, left) despite the Bureau of Labor Statistics indicating little discernable impact on the data from Hurricane Beryl – a storm that hit Texas during the payroll survey week and had the potential to have a negative effect on the data. On the contrary, the

ISM Manufacturing Index



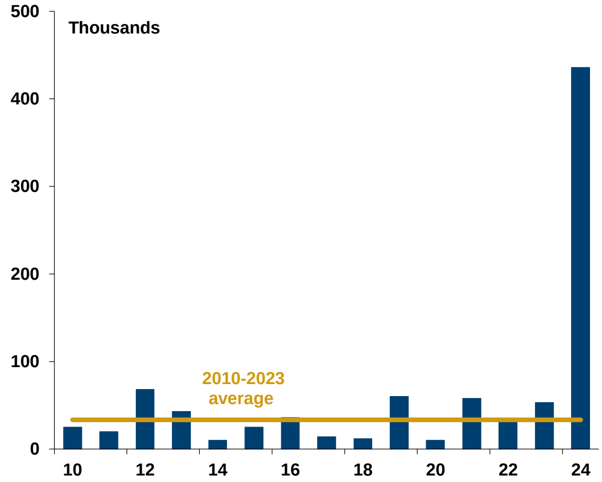
Source: Institute for Supply Management via Haver Analytics construction industry, an area that could see cuts amid weather-related disruptions, added 25,000 positions in July – exceeding the trailing six-month average of +19,000. Other areas, which most likely would not have been influenced by the storm, were less favorable. For example, the Health and Social Assistance area, which has been an engine of growth in recent months, had hiring slow to 64,000 from almost 82,000 per month in the prior six months. The Business Services area also saw a decline of 1,000 positions versus adding on average 18,500 per month in 2024-H1. In our view, the results (all else equal) potentially suggest cooling in the labor market beyond what would be viewed as acceptable by Fed officials. With that said, we have not fully closed the door to the possibility that the July data understate the underlying strength of the labor market and that weather effects were indeed present. On the point, an ancillary series on nonagricultural workers not at work because of bad weather from the Current Population Survey surged to 462,000 in July 2024 versus a July average of approximately 33,360 from 2010 to 2023 (chart, below right). On face, it appears that weather did impact work in July, which may have influenced survey counts, despite a statement to the contrary in the employment release.

Change in Nonfarm Payrolls



Source: Bureau of Labor Statistics via Haver Analytics

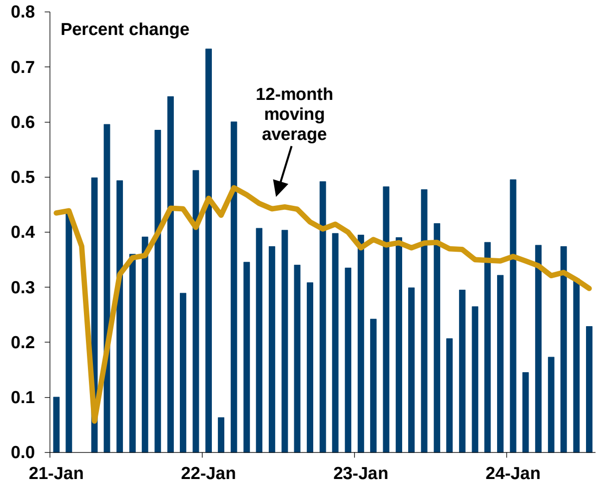
Employees Not at Work Due to Bad Weather*



* July data; those employed in nonagricultural industries
Source: Bureau of Labor Statistics

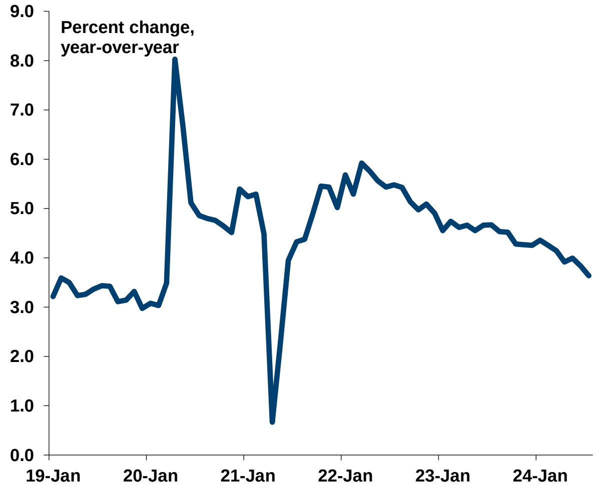
Considerations of possible weather effects aside, data on average hourly earnings also indicated additional softening in demand for labor. Wages rose 0.2 percent month-to-month in July, one tick slower than the 0.3 percent average in the prior 12 months. Year-over-year growth eased to 3.6 percent from 3.8 percent in June and the recent high of 5.9 percent in March 2022 (charts, below). Along with an updated Employment Cost Index, which showed year-over-year compensation growth of 4.1 percent in Q2 – down one tick from Q1 results and a percentage point

Average Hourly Earnings



Source: Bureau of Labor Statistics via Haver Analytics

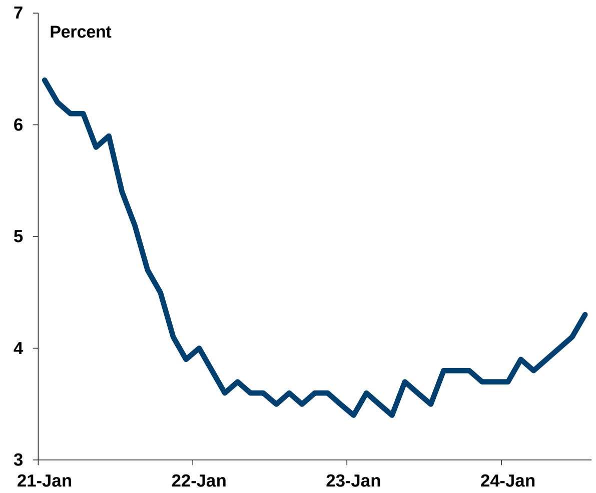
Average Hourly Earnings



Source: Bureau of Labor Statistics via Haver Analytics slower than the peak of 5.1 percent in 2022-Q2 – the compensation data are moving in a direction consistent with the Federal Reserve's two percent inflation objective. The question now is whether growth stabilizes in a 3.0-3.5 percent area that is both favorable to workers and consistent with the Fed's inflation mandate, or if deterioration in labor demand leads to additional undesirable slowing. Here, too, additional data is required.

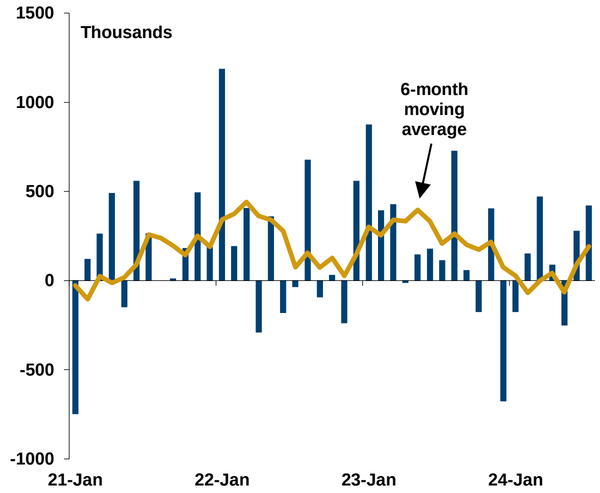
A final piece of data from today's employment report that likely stoked fears of broader economic slowdown was the unemployment rate, which rose 0.2 percentage point to 4.3 percent (and a cumulative 0.6 percentage point since readings of 3.7 percent around the turn of the year; chart, below left). This metric bears close watching as it is a reliable indicator of recession, but we again hesitate to jump to conclusions. Fed officials have argued recently that the unemployment rate has remained relatively low and that a large portion of recent moves are attributable to increases in the size of the labor force. Indeed, the labor force surged 420,000 in the latest month (a favorable development for the supply side) which suggests new entrants still perceive that gainful opportunities are available. Moreover, the prime-age participation rate jumped 0.3 percentage point to 84.0 percent (exceeding a readings of approximately 82.5 to 83.0 percent just before the onset of the pandemic) while the overall rate rose by one tick to 62.7 percent. If the supply-side explanation is in fact the correct one, then the rise in unemployment is at least partially explained by the thesis that a healthy realignment is still underway in the labor market.

Civilian Unemployment Rate



Source: Bureau of Labor Statistics via Haver Analytics

Change in the Labor Force



Source: Bureau of Labor Statistics via Haver Analytics

Thus, the rather benign view of today's employment report is not meant to fully dismiss its soft tone. Underlying economic conditions may well be softening, and the FOMC could be forced to respond with aggressive rate cuts to avert, or at least mitigate, a potential recession. However, amid inherent volatility in monthly data – not to mention core PCE inflation still at +2.6 percent year-over-year and the November election looming – we suspect that policymakers will want to see additional data before rushing to conclusions about the state of the economy and the potential path of interest rates. Chair Powell has always maintained that there is a path to a soft landing, although he was adamant that it was one potential outcome among several. He also reiterated in his Wednesday press conference, as he has multiple times in recent months, that monetary policy is well positioned to respond to emergent risks, either to resurgent inflation or deterioration in the labor market. Regardless, we suspect additional data is yet required to assess the underlying path of the economy, and for the time being we are maintaining our current call on interest rates: cuts of 25 basis points each in September and December followed by additional quarterly reductions of 25 basis points in 2025. However, given recent developments, we could foresee the need for additional, and more rapid, reductions in 2025.

Note to readers:

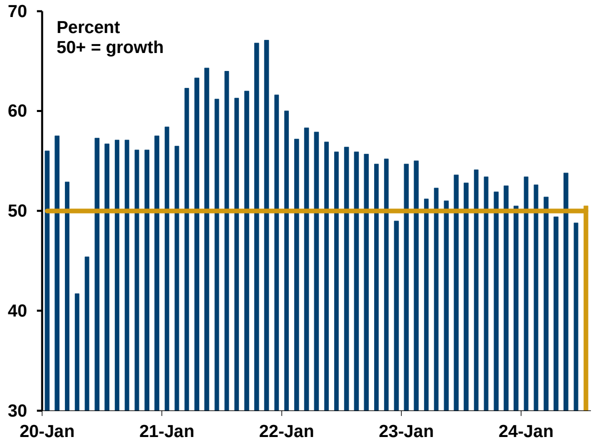
The next Weekly Economic Comment will be published on August 16, 2024.

The Week Ahead

ISM Services Index (July) (Monday)
Forecast: 50.5 (+1.7 Index Pts.)

Although GDP growth of 2.8 percent in Q2 strongly suggests that the U.S. economy is not currently in recession, other recent indicators point to slowing in activity (i.e. employment growth of 114,000 in July versus 218,000 average in the prior six months). With that said, we suspect the drop of 5.0 percentage points in the ISM services index to 48.8 in June (versus an average of 52.1 in the prior five months) likely overstates the degree of underlying softening. In particular, the plunge of 11.6 percentage points in the business activity index to 49.6 could experience a partial retracement in July (perhaps closer to, but still shy of, the trailing five-month average of 56.5), which would nudge the headline back above the critical value of 50.0 (charts).

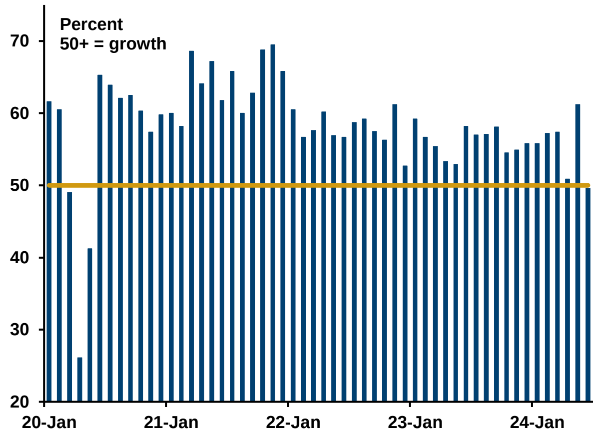
ISM Services: Headline Index*



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

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

ISM Services: Business Activity Index

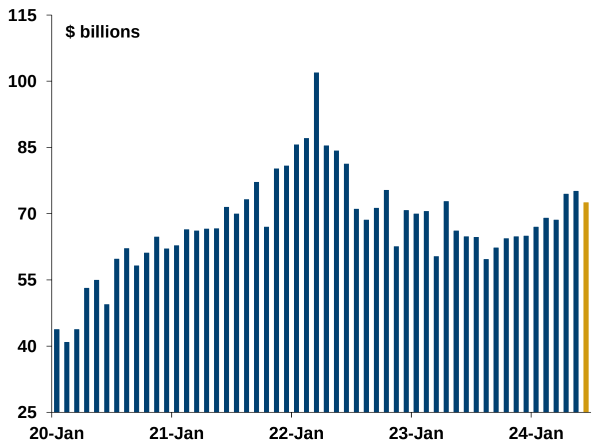


Source: Institute for Supply Management via Haver Analytics

Trade Balance (June) (Tuesday)
Forecast: -$72.5 Billion ($2.6 Billion Narrower Deficit)

The narrowing of $2.5 billion in the goods deficit in June (published July 24) suggests improvement in the total (goods and services) shortfall. The expected improvement would follow net deterioration of $6.5 billion in the nominal trade deficit in goods and services in the prior two months that equated to a drag of 0.7 percentage point on GDP growth in Q2 (which matched the constraint in Q1). With that said, if modest improvement in the goods deficit is realized in June, the drag from net exports on GDP growth in the second quarter would likely be revised lower with the second estimate (charts).

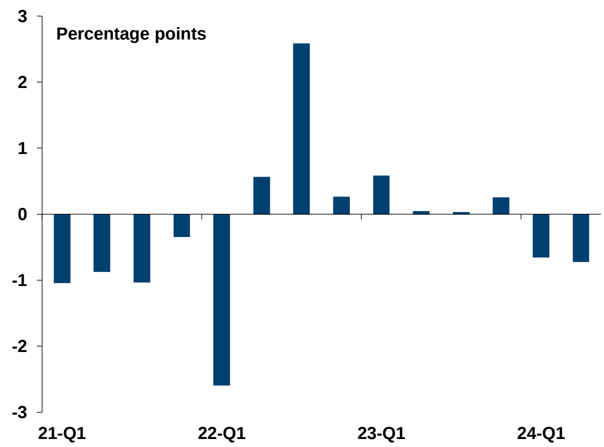
Trade Deficit in Goods & Services*



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

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

Net Exports of Goods & Services*



** Contribution to real GDP percentage change*

Source: Bureau of Economic Analysis via Haver Analytics

Economic Indicators

July/August 2024

Monday	Tuesday	Wednesday	Thursday	Friday
29	30	31	1	2
	FHFA HOME PRICE INDEX Mar 0.1% Apr 0.3% May 0.0% **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** Mar 0.3% Apr 0.4% May 0.3% **CONFERENCE BOARD CONSUMER CONFIDENCE** May 101.3 June 97.8 July 100.3 **JOLTS DATA** Openings (000) / Quit Rate Apr 7,919 / 2.2% May 8,230 / 2.1% June 8,184 / 2.1% **FOMC MEETING (FIRST DAY)**	**ADP EMPLOYMENT** Private Payrolls May 157,000 June 155,000 July 122,000 **EMPLOYMENT COST INDEX** Comp. / Wages 23-Q4 0.9% / 1.1% 24-Q1 1.2% / 1.1% 24-Q2 0.9% / 0.9% **MNI CHICAGO BUSINESS BAROMETER** Index / Prices May 35.4 / 68.4 June 47.4 / 56.5 July 45.3 / 55.8 **PENDING HOME SALES** Apr -7.7% May -1.9% June 4.8% **FOMC RATE DECISION**	**UNEMPLOYMENT CLAIMS** Initial / Continuing (millions) June 29 0.239 / 1.847 July 6 0.223 / 1.860 July 13 0.245 / 1.851 July 20 0.235 / N/A **PRODUCTIVITY & COSTS** Productivity / Unit Labor Costs 23-Q4 3.5% / -2.8% 24-Q1 0.4% / 3.8% 24-Q2 2.3% / 0.9% **ISM MFG. INDEX** Index / Prices May 48.7 / 57.0 June 48.5 / 52.1 July 46.8 / 52.9 **CONSTRUCTION** Apr 1.3% May -0.4% June -0.3% **VEHICLE SALES** May 16.0 million June 15.2 million July 15.8 million	**EMPLOYMENT REPORT** Payrolls / Un. Rate May 216,000 / 4.0% June 179,000 / 4.1% July 114,000 / 4.3% **FACTORY ORDERS** Apr 0.4% May -0.5% June -3.3%
5	6	7	8	9
ISM SERVICES INDEX (10:00) Index / Prices May 53.8 / 58.1 June 48.8 / 56.3 **July 50.5 / 54.0** **SENIOR LOAN OFFICER OPINION SURVEY ON BANK LENDING PRACTICES (2:00)**	**TRADE BALANCE (8:30)** Apr -$74.5 billion May -$75.1 billion **June -$72.5 billion**	**CONSUMER CREDIT (3:00)** Apr $6.5 billion May $11.4 billion June --	**UNEMP. CLAIMS (8:30)** **WHOLESALE TRADE (10:00)** Inventories / Sales Apr 0.2% / 0.2% May 0.6% / 0.4% **June 0.2% / 0.3%**	
12	13	14	15	16
FEDERAL BUDGET	**NFIB SMALL BUSINESS OPTIMISM INDEX** **PPI**	**CPI**	**UNEMP. CLAIMS** **RETAIL SALES** **EMPIRE MFG** **PHILLY FED INDEX** **IMPORT/EXPORT PRICES** **IP & CAP-U** **NAHB HOUSING INDEX** **BUSINESS INVENTORIES** **TIC FLOWS**	**HOUSING STARTS** **CONSUMER SENTIMENT**
19	20	21	22	23
LEADING INDICATORS		**FOMC MINUTES**	**UNEMP. CLAIMS** **CHICAGO FED NATIONAL ACTIVITY INDEX** **EXISTING HOME SALES**	**NEW HOME SALES**

Forecasts in bold.

Treasury Financing

July/August 2024

Monday	Tuesday	Wednesday	Thursday	Friday
29	30	31	1	2
AUCTION RESULTS: Rate Cover 13-week bills 5.145% 3.01 26-week bills 4.930% 2.95	**AUCTION RESULTS:** Rate Cover 42 day CMBs 5.280% 2.93 **ANNOUNCE:** $60 billion 17-week bills for auction on July 31 $90 billion 4-week bills for auction on Aug 1 $85 billion 8-week bills for auction on Aug 1 **SETTLE:** $60 billion 17-week bills $90 billion 4-week bills $85 billion 8-week bills	**AUCTION RESULTS:** Rate Cover 17-week bills 5.090% 3.24 **ANNOUNCE:** $58 billion 3-year notes for auction on Aug 6 $42 billion 10-year notes for auction on Aug 7 $25 billion 30-year bonds for auction on Aug 8 **SETTLE:** $13 billion 20-year bonds $19 billion 10-year TIPS $69 billion 2-year notes $70 billion 5-year notes $44 billion 7-year notes $30 billion 2-year FRNs	**AUCTION RESULTS:** Rate Cover 4-week bills 5.285% 2.87 8-week bills 5.230% 2.74 **ANNOUNCE:** $146 billion 13-,26-week bills for auction on Aug 5 $46 billion 52-week bills for auction on Aug 6 $75 billion 42-day CMBs for auction on Aug 6 **SETTLE:** $146 billion 13-,26-week bills $70 billion 42-day CMBs	
5	6	7	8	9
AUCTION: $146 billion 13-,26-week bills	**AUCTION:** $46 billion 52-week bills $58 billion 3-year notes $75 billion 42-day CMBs **ANNOUNCE:** $60 billion* 17-week bills for auction on Aug 7 $90 billion* 4-week bills for auction on Aug 8 $85 billion* 8-week bills for auction on Aug 8 **SETTLE:** $60 billion 17-week bills $90 billion 4-week bills $85 billion 8-week bills	**AUCTION:** $60 billion* 17-week bills $42 billion 10-year notes	**AUCTION:** $90 billion* 4-week bills $85 billion* 8-week bills $25 billion 30-year bonds **ANNOUNCE:** $146 billion* 13-,26-week bills for auction on Aug 12 **SETTLE:** $146 billion 13-,26-week bills $46 billion 52-week bills $75 billion 42-day CMBs	
12	13	14	15	16
AUCTION: $146 billion* 13-,26-week bills	**ANNOUNCE:** $60 billion* 17-week bills for auction on Aug 14 $90 billion* 4-week bills for auction on Aug 15 $85 billion* 8-week bills for auction on Aug 15 **SETTLE:** $60 billion* 17-week bills $90 billion* 4-week bills $85 billion* 8-week bills	**AUCTION:** $60 billion* 17-week bills	**AUCTION:** $90 billion* 4-week bills $85 billion* 8-week bills **ANNOUNCE:** $146 billion* 13-,26-week bills for auction on Aug 19 $16 billion* 20-year bonds for auction on Aug 21 $8 billion* 30-year TIPS for auction on Aug 22 **SETTLE:** $146 billion* 13-,26-week bills $58 billion 3-year notes $42 billion 10-year notes $25 billion 30-year bonds	
19	20	21	22	23
AUCTION: $146 billion* 13-,26-week bills	**ANNOUNCE:** $60 billion* 17-week bills for auction on Aug 21 $90 billion* 4-week bills for auction on Aug 22 $85 billion* 8-week bills for auction on Aug 22 **SETTLE:** $60 billion* 17-week bills $90 billion* 4-week bills $85 billion* 8-week bills	**AUCTION:** $60 billion* 17-week bills $16 billion* 20-year bonds	**AUCTION:** $90 billion* 4-week bills $85 billion* 8-week bills $8 billion* 30-year TIPS **ANNOUNCE:** $146 billion* 13-,26-week bills for auction on Aug 26 $69 billion* 2-year notes for auction on Aug 27 $70 billion* 5-year notes for auction on Aug 28 $44 billion* 7-year notes for auction on Aug 29 $28 billion* 2-year FRNs for auction on Aug 28 **SETTLE:** $146 billion* 13-,26-week bills	

**Estimate*