

U.S. Economic Comment

- Wage growth: not so bad
- Business investment: a soft spot

Michael Moran

Daiwa Capital Markets America
 212-612-6392
michael.moran@us.daiwacm.com

Wage Growth

The employment report for October was surprisingly favorable. The published figure for payroll growth was underwhelming at 128,000, but this result was constrained by 46,000 striking workers at General Motors and by the loss of 20,000 temporary jobs associated with the 2020 census. Moreover, results in the prior two months were revised upward, with payrolls for these two months combined 95,000 larger than previously believed. All things considered, job growth in the past few months could be viewed as brisk.

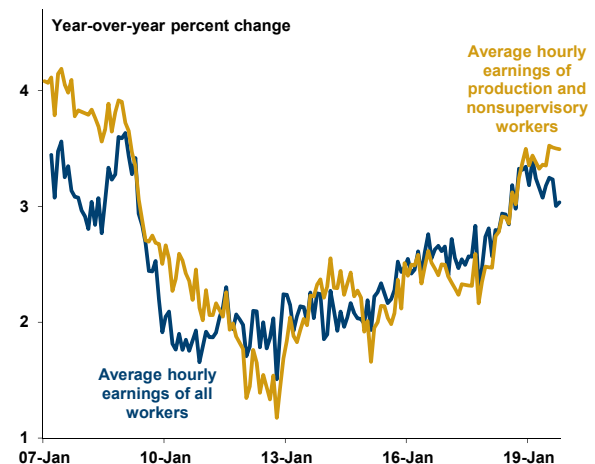
The unemployment rate also looked soft at first blush (up 0.1 percentage point to 3.6 percent). However, it was a bullish increase -- that is, the jobless rate rose because a jump in the size of the labor force (325,000) exceeded the healthy gain in employment as measured by the household survey (241,000). Firm job growth and rising labor force participation represent positive developments for the economy.

A soft reading on a third key component of the employment report -- average hourly earnings -- is more difficult to explain away. Still, its performance is not as disappointing as it might appear. Wage growth by this measure seems to have eased, as it rose only 0.2 percent in October after no change in September. Year-over-year growth has dropped from a peak of 3.4 percent in February to 3.0 percent in the past two months (chart). We cannot cite special factors that restrained this figure, but digging into the details, and monitoring other figures, suggests that wage growth is being reasonably well maintained.

The headline figure for average hourly earnings covers all workers, including managers and supervisors. It appears as though the recent hesitation in wage growth is concentrated among the higher-paid individuals at the supervisory level. Another series on average hourly earnings -- one that covers only production workers -- has continued to advance at a solid pace (0.2 percent in October and 0.3 percent in September). Year-over-year growth, although not accelerating, has held steady at 3.5 percent (chart).

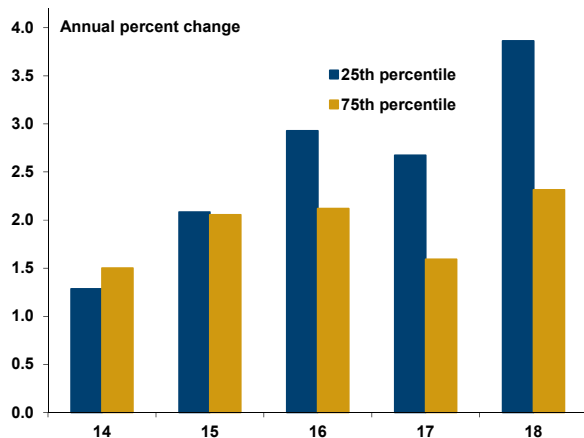
Continued favorable results on wage growth for production workers suggests that individuals in the low end of the pay scale might be realizing noticeable gains in their standards of living and improving their standing relative to those at higher income levels. Fed Chairman Powell has noted on several occasions that individuals from low- and middle-income communities in their "Fed Listens" tour have highlighted improved economic environments. Another data source provides concrete evidence that economic gains are being more widely dispersed. The Labor Department collects annual data on employment and pay in various occupations, and the figures show income gains at various income levels. Figures for the past three years that indicate income gains in the lower end of the wage spectrum (25th percentile) have outpaced those at higher levels (75th percentile; chart, next page).

Average Hourly Earnings



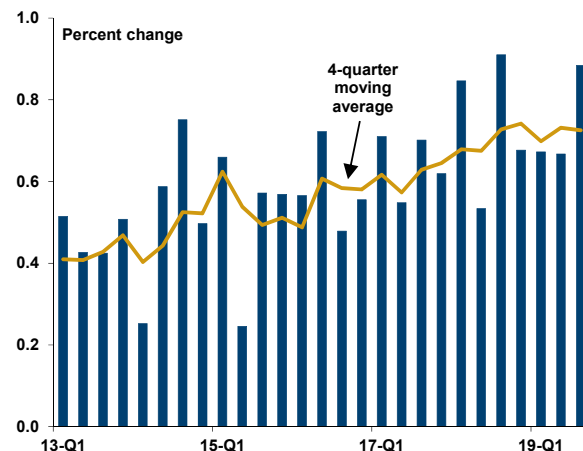
Source: Bureau of Labor Statistics via Haver Analytics

Hourly Wage Growth



Source: Occupational Employment Statistics, Bureau of Labor Statistics via Haver Analytics

Employment Cost Index: Wage Component



Source: Bureau of Labor Statistics via Haver Analytics

Another measure of labor compensation, the employment cost index (ECI), also suggests that wage growth remains on track. The wage component of the ECI rose 0.9 percent in the third quarter, one of the sharpest advances of the current cycle (chart, right). The latest change kept year-over-year growth comfortably within its recent range.

The weight of recent evidence on compensation leads us to downplay the recent soft readings on average hourly earnings.

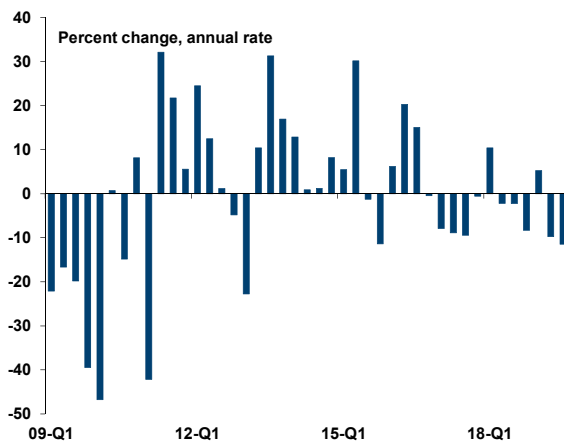
Cap-Ex: Hesitation

The U.S. economy performed reasonably well in the third quarter, expanding at an annual rate of 1.9 percent and leaving growth for the first three quarters of the year at 2.3 percent. Despite the respectable performance, many analysts and Fed officials are concerned about downside risks to the outlook. Fallout from the trade war and slow growth in foreign economies could easily dampen growth or lead to a downturn. Their effects would most likely be felt in the international trade sector, but an indirect influence also is likely to be evident in business investment. That is, businesses could delay or cancel capital spending because of the soft and uncertain economic environment.

Trade has been a net drag on economic growth since the middle of last year, subtracting an average of one-half percentage point from GDP growth in the past five quarters (although a modest influence in Q3, -0.08 percentage point). Now, business fixed investment is perhaps beginning to falter as well, as real outlays have declined for two consecutive quarters (-1.0 percent in Q2 and -3.0 percent in Q3). Investment in intellectual property has been well maintained, but spending on business structures has declined in four of the past five quarters, and outlays for new equipment dropped in Q3 after minimal growth in the prior two quarters.

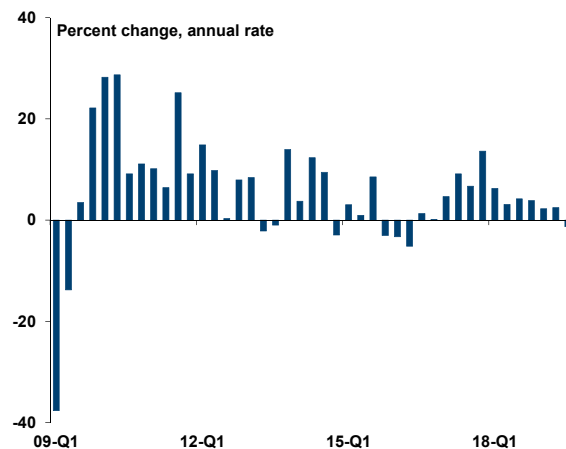
Some of the softening in outlays for structures has been related to a cutback in drilling for petroleum and natural gas because of lower energy prices. It is tempting to view such softening as a special factor, but with fracking now an important element of the U.S. economy, and with petroleum prices influenced by global economic activity, such changes are more properly viewed as fundamental. Slow global growth is likely to put downward pressure on prices of petroleum products, and lower prices will lead to cutbacks in energy production and related investment. This channel has been in play in the past year or so, as lower energy prices have led to five consecutive quarterly declines in outlays for shafts and wells (considered business structures).

Business Investment in Structures Ex. Mining



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

Business Equipment Spending Ex. Aircraft



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

The softening in investment in structures has not been limited to oil drilling, as outlays in other areas have eased in 10 of the past 12 quarters (chart). With this softness extending back a few years, more than the influence of slow global growth and uncertainty associated with the trade war is involved. Nevertheless, the rate of decline has picked up recently, suggesting that the current environment is having an influence (chart, left).

Equipment spending has taken a turn for the worse, declining in the third quarter after minimal growth in the first half of the year. An obvious special factor has contributed to the slowing: Boeing halted shipments of the 737 Max aircraft in the spring, which would depress domestic investment in equipment (exports also would be affected). As with outlays for structures, this slowing is not one-dimensional. Outlays for equipment excluding aircraft also have softened in the past year and they fell in the third quarter (chart, right).

Thus, concern about downside risks seems warranted. Capital spending is likely to be a key factor influencing the pace of U.S. economic growth, and the current uncertain environment leads one to be wary. Despite encouragement from phase one of a trade deal, we are not optimistic about a near-term (or even medium-term) agreement on trade with China. Slow growth in Europe also remains an issue, which is being complicated by Brexit uncertainty.

Review

Week of October 28, 2019	Actual	Consensus	Comments
U.S. International Trade in Goods (September)	-\$70.4 Billion (\$2.7 Billion Narrower Deficit)	-\$73.5 Billion (\$0.4 Billion Wider Deficit)	The goods trade deficit narrowed in September, but it was not an impressive shift, as the improvement reflected a drop in imports (-2.3%) that exceeded the decline in exports (-1.6%). Retreats on both sides of the trade ledger suggest a soft global economic environment. Moreover, the declines did not seem to be random shifts, as exports and imports have been sluggish since the middle of last year.
Consumer Confidence (October)	125.9 (-0.3%)	128.0 (+2.3%)	The retreat in consumer confidence in October pushed the index to the lower portion of the range of the past two years, although the measure remained high by historical standards. Although news on impeachment proceedings and the trade war likely weighed on the attitudes of consumers, positive views on the job market held firm; net job assessment (share indicating plentiful jobs less share indicating limited opportunities) increased 1.6 percentage points to 35.1%, off the high of 38.3% in August but among the best readings of the current expansion.
GDP (2019-Q3)	1.9%	1.6%	The household sector contributed importantly to GDP growth in the third quarter, led by an increase of 2.9% in consumer spending and a gain of 5.1% in residential investment. Government spending also contributed positively (2.0%). On the negative side, business fixed investment disappointed with a decline of 3.0%. Outlays for new structures led the retreat (-15.3%). Equipment spending also was soft (-3.8%), with much of the weakness reflecting a drop in shipments of the 737 Max aircraft. Net exports also represented a weak area, but results were not especially troubling. Exports managed to post a small gain (0.7%), which was exceeded only slightly by growth of 1.2% in imports. As a result, net exports made only a small negative contribution to GDP growth (-0.08 percentage point).
Personal Income, Consumption, Core Prices (September)	0.3%, 0.2%, 0.0%	0.3%, 0.3%, 0.1%	Personal income rose at a slightly slower pace than the 0.4% monthly average of the past year, but results were constrained by a flat reading on wages and salaries, reflecting lost income by autoworkers because of the strike at General Motors. The increase in consumer spending in September also was below average, but results for the third quarter as a whole were comfortably within the range of recent observations. The core PCE price index has moved erratically this year, increasing only modestly in the first three months of the year before quickening in the spring and summer only to ease again in September (0.0%). The year-over-year change in the core index smooths much of this erratic movement and shows a steady inflation rate slightly less than 2.0% (1.7% in September, down from 1.8% in August and the high of 2.1% for the current cycle in July of last year).

Review Continued

Week of October 28, 2019	Actual	Consensus	Comments
Employment Cost Index (2019-Q3)	0.7%	0.7%	The increase in the employment cost index in Q3, while one of the firmer readings in the past several years, followed a moderate gain in Q2 and left little change in underlying trend (year-over-year growth totaled 2.8%, the same as in Q2 and a touch below the recent peak of 2.9% in the fourth quarter of last year). The wage component of compensation posted a brisk advance (0.9%), but this jump, like that for the headline figure, did not alter the underlying trend, as year-over-year growth slowed marginally from the advance in Q2 and was slightly slower than the recent peak of 3.0% in 2018-Q4. Costs associated with employee benefits rose 0.6%, a change in the middle of the recent range which translated to year-over-year growth of 2.4%.
Payroll Employment (October)	128,000	85,000	Payroll employment in October seemed unimpressive, but the strike at General Motors restrained this total by 46,000. In addition, employment in the federal government was constrained by the loss of 20,000 census-related jobs. In addition, prior results were revised upward by 95,000. The unemployment rate rose 0.1 percentage point to 3.6%, but it was a bullish increase. That is, the change reflected a solid increase in the size of the labor force (325,000) that exceeded firm employment growth as measured by the household survey (241,000). Average hourly earnings were mildly disappointing, as they rose only 0.2% after registering no change in the prior month. Year-over-year growth of 3.0% trailed most readings for 2019 (peak of 3.4% in February).
ISM Manufacturing Index (October)	48.3% (+0.5 Pct. Pt.)	48.9% (+1.1 Pct. Pts.)	The ISM manufacturing index improved in October, but the latest result marked the third consecutive month of sub-50% readings. The new orders component accounted for much of the increase in the headline index, as it rose 1.8 percentage points to 49.1%. Although new orders improved, production did not follow this lead, as this component fell 1.1 percentage points to 46.2%, the third consecutive month of sub-50% readings. The employment index rose 1.4 percentage points, but it too was below 50% for the third consecutive month (47.7%).
Construction Spending (September)	0.5%	0.2%	Growth of public-sector construction led the advance in total activity in September (1.5%), continuing the firm performance in the past year. Private residential activity rose for the third consecutive month (0.6%), but recent increases merely signaled a stabilizing in activity after sharp slippage since last summer. Business-related construction slipped 0.3%, continuing its choppy downward trend since last fall.

Source: U.S. Census Bureau (U.S. International Trade in Goods, Construction Spending); The Conference Board (Consumer Confidence); Bureau of Economic Analysis (GDP, Personal Income, Consumption, Core Price Index); Bureau of Labor Statistics (Employment Cost Index, Payroll Employment); Institute for Supply Management (ISM Manufacturing Index); Consensus forecasts are from Bloomberg

Preview

Week of Nov. 4, 2019	Projected	Comments
Factory Orders (September) (Monday)	-0.3%	The already reported drop of 1.1% in orders for durable goods is likely to account for all of the expected drop in factory orders. This drop was led by commercial aircraft (off 11.8%), but other areas also contributed (-0.3% ex transportation). Orders for nondurable goods are likely to grow moderately (0.5% expected). Much of this growth will reflect higher prices of petroleum products, but nondurable bookings ex-petroleum could record their fifth consecutive advance (average gain of 0.4% in the prior four months).
Trade Balance (September) (Tuesday)	-\$52.0 Billion (\$2.9 Billion Narrower Deficit)	The generally stable surplus in service trade is likely to remain close to the reading of \$19.5 billion in August. Thus, the improvement of \$2.7 billion in the goods deficit should account for nearly all of the shift in the overall trade balance.
ISM Nonmanufacturing Index (October) (Tuesday)	54.5% (+1.9 Pct. Pts.)	The pockets of softness that have emerged recently seem to be concentrated in the manufacturing sector. With other areas performing well, the low side-reading on the nonmanufacturing index in September was probably an aberration, which should at least partially reverse in October.
Nonfarm Productivity (2019-Q3) (Wednesday)	0.9%	Firms needed to boost labor input by slightly more than 1.0% in Q3 to achieve output growth of approximately 2.0%, leaving productivity growth slower than the 1.8% advance in the prior four quarters.
Consumer Sentiment (November) (Friday)	96.5 (+1.0%)	A new record high in the S&P500 could push the sentiment index to the upper portion of its recent range. The expected reading for early November is firmer than the average of 95.6 in the first 10 months of the year, although it is still lags the average of 98.4 from 2018.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

October/November 2019				
Monday	Tuesday	Wednesday	Thursday	Friday
28	29	30	31	1
CHICAGO FED NATIONAL ACTIVITY INDEX Monthly 3-Mo. Avg. July -0.41 -0.15 Aug 0.15 -0.06 Sept -0.45 -0.24 U.S. INTERNATIONAL TRADE IN GOODS Jul -\$72.4 billion Aug -\$73.1 billion Sept -\$70.4 billion ADVANCE INVENTORIES REPORT Wholesale Retail July 0.2% 0.7% Aug 0.0% -0.2% Sept -0.3% 0.3%	S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX SA NSA June 0.1% 0.4% July 0.0% 0.2% Aug -0.2% 0.0% CONFERENCE BOARD CONSUMER CONFIDENCE Aug 134.2 Sept 126.3 Oct 125.9 PENDING HOMES SALES July -2.5% Aug 1.4% Sept 1.5% FOMC MEETING	ADP EMPLOYMENT REPORT Private Payrolls Aug 157,000 Sept 135,000 Oct 135,000 GDP GDP Chained Price 19-Q1 3.1% 1.1% 19-Q2 2.0% 2.4% 19-Q3 1.9% 1.7% FOMC DECISION POWELL PRESS CONFERENCE	INITIAL CLAIMS Oct 12 218,000 Oct 19 213,000 Oct 26 218,000 PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX Inc. Cons. Core July 0.1% 0.5% 0.2% Aug 0.5% 0.2% 0.1% Sept 0.3% 0.2% 0.0% EMPLOYMENT COST INDEX Comp. Wages 19-Q1 0.7% 0.7% 19-Q2 0.6% 0.7% 19-Q3 0.7% 0.9% CHICAGO PURCHASING MANAGERS' INDEX Index Prices Aug 50.4 59.8 Sept 47.1 57.3 Oct 43.2 54.8	EMPLOYMENT REPORT Payrolls Un. Rate Aug 219,000 3.7% Sept 180,000 3.5% Oct 128,000 3.6% ISM INDEX Index Prices Aug 49.1 46.0 Sept 47.8 49.7 Oct 48.3 45.5 CONSTRUCTION SPEND. July 0.5% Aug -0.3% Sept 0.5% VEHICLE SALES Aug 17.0 million Sept 17.2 million Oct 17.0 million
4	5	6	7	8
FACTORY ORDERS (10:00) July 1.4% Aug 0.0% Sept -0.3%	TRADE BALANCE (8:30) July -\$54.0 billion Aug -\$54.9 billion Sept -\$52.0 billion ISM NON-MFG INDEX (10:00) Index Prices Aug 56.4 58.2 Sept 52.6 60.0 Oct 54.5 58.0 JOLTS DATA (10:00) Openings (000) Quit Rate July 7,174 2.4% Aug 7,051 2.3% Sept -- --	PRODUCTIVITY & COSTS (8:30) Productivity Unit Labor Costs 19-Q1 3.5% 5.7% 19-Q2 2.3% 2.6% 19-Q3 0.9% 1.3%	INITIAL CLAIMS (8:30) CONSUMER CREDIT (3:00) July \$23.0 billion Aug \$17.9 billion Sept --	CONSUMER SENTIMENT (10:00) Sept 93.2 Oct 95.5 Nov 96.5 WHOLESALE TRADE (10:00) Inventories Sales Jul 0.2% 0.2% Aug 0.0% 0.0% Sept -0.3% 0.2%
11	12	13	14	15
VETERANS DAY	NFIB SMALL BUSINESS OPTIMISM INDEX	CPI FEDERAL BUDGET	INITIAL CLAIMS PPI	RETAIL SALES IMPORT/EXPORT PRICES EMPIRE MFG INDEX IP & CAP-U BUSINESS INVENTORIES
18	19	20	21	22
NAHB HOUSING INDEX TIC DATA	HOUSING STARTS	FOMC MINUTES	INITIAL CLAIMS PHILLY FED INDEX EXISTING HOME SALES LEADING INDICATORS	REVISED CONSUMER SENTIMENT

Forecasts in Bold.

Treasury Financing

October/November 2019				
Monday	Tuesday	Wednesday	Thursday	Friday
28	29	30	31	1
AUCTION RESULTS: Rate Cover 13-week bills 1.620% 3.10 26-week bills 1.610% 3.23	ANNOUNCE: \$55 billion 4-week bills for auction on October 31 \$40 billion 8-week bills for auction on October 31 SETTLE: \$55 billion 4-week bills \$40 billion 8-week bills	ANNOUNCE: \$38 billion 3-year notes for auction on November 5 \$27 billion 10-year notes for auction on November 6 \$19 billion 30-year bonds for auction on November 7	AUCTION RESULTS: Rate Cover 4-week bills 1.570% 2.83 8-week bills 1.560% 3.21 ANNOUNCE: \$87 billion 13-,26-week bills for auction on November 4 \$28 billion 52-week bills for auction on November 5 SETTLE: \$87 billion 13-,26-week bills \$17 billion 5-year TIPS \$20 billion 2-year FRNs \$40 billion 2-year notes \$41 billion 5-year notes \$32 billion 7-year notes	
4	5	6	7	8
AUCTION: \$87 billion 13-,26-week bills	AUCTION: \$28 billion 52-week bills \$38 billion 3-year notes ANNOUNCE: \$55 billion* 4-week bills for auction on November 7 \$40 billion* 8-week bills for auction on November 7 SETTLE: \$55 billion 4-week bills \$40 billion 8-week bills	AUCTION: \$27 billion 10-year notes	AUCTION: \$55 billion* 4-week bills \$40 billion* 8-week bills \$19 billion 30-year bonds ANNOUNCE: \$87 billion* 13-,26-week bills for auction on November 12 SETTLE: \$87 billion 13-,26-week bills \$28 billion 52-week bills	
11	12	13	14	15
VETERANS DAY	AUCTION: \$87 billion* 13-,26-week bills ANNOUNCE: \$55 billion* 4-week bills for auction on November 14 \$40 billion* 8-week bills for auction on November 14 SETTLE: \$55 billion* 4-week bills \$40 billion* 8-week bills		AUCTION: \$55 billion* 4-week bills \$40 billion* 8-week bills ANNOUNCE: \$87 billion* 13-,26-week bills for auction on November 18 \$12 billion* 10-year TIPS for auction on November 21 SETTLE: \$87 billion* 13-,26-week bills	SETTLE: \$38 billion 3-year notes \$27 billion 10-year notes \$19 billion 30-year bonds
18	19	20	21	22
AUCTION: \$87 billion* 13-,26-week bills	ANNOUNCE: \$55 billion* 4-week bills for auction on November 21 \$40 billion* 8-week bills for auction on November 21 SETTLE: \$55 billion* 4-week bills \$40 billion* 8-week bills		AUCTION: \$55 billion* 4-week bills \$40 billion* 8-week bills \$12 billion* 10-year TIPS ANNOUNCE: \$87 billion* 13-,26-week bills for auction on November 25 \$18 billion* 2-year FRNs for auction on November 26 \$40 billion* 2-year notes for auction on November 25 \$41 billion* 5-year notes for auction on November 26 \$32 billion* 7-year notes for auction on November 27 SETTLE: \$87 billion* 13-,26-week bills	

*Estimate