U.S. Economic Comment

- Tapering: still on track…
  …although Fed officials might be disappointed with GDP growth in Q3

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The Labor Market and Tapering QE

[F]or me, it wouldn't take a knockout, great, super strong employment report. It would take a reasonably good employment report for me to feel like that test [for tapering] is met. And others on the Committee, many on the Committee, feel that the test is already met.

-- Jerome Powell, September 22, 2021 press briefing

The employment report for September certainly was not a knock out, showing job growth of 194,000, the smallest gain of the year thus far and well below the average of 607,000 in the prior eight months. Nevertheless, we would rate the report as reasonably good. While job growth disappointed, consider these favorable aspects:

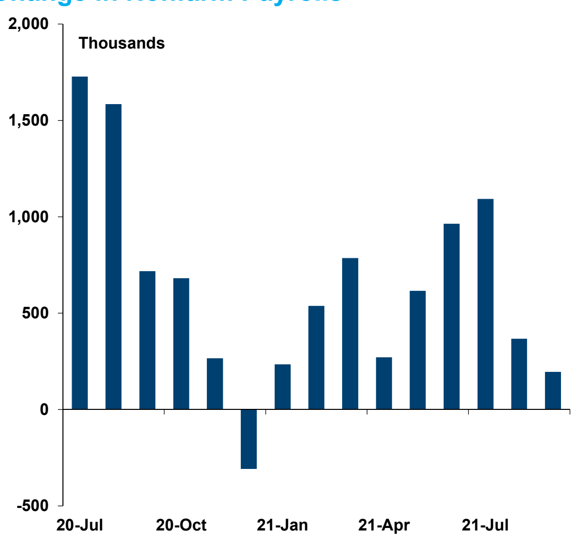
Upward revisions in the prior two months were sizeable at 169,000.

Unemployment fell sharply, primarily because of a jump in employment of 526,000 as measured by the household survey (and somewhat because of a drop in the size of the labor force, off 183,000).

Average hourly earnings continued to grow briskly (up 0.6 percent), which left year-over-year growth at 4.6 percent.

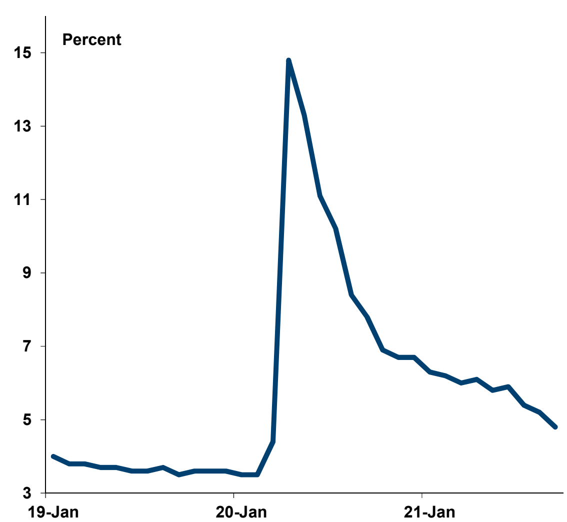
The length of the average workweek lengthened by 0.2 hour, which could allow for a healthy increase in production despite mediocre employment growth.

Change in Nonfarm Payrolls



Source: Bureau of Labor Statistics via Haver Analytics

Unemployment Rate



Source: Bureau of Labor Statistics via Haver Analytics

Job growth in total was soft by recent norms, but the industry breakdown contained some encouraging elements. Manufacturing and construction – both cyclically sensitive areas – registered solid gains. Air transportation, an area that could be severely weakened by Covid, continued on a steady recovery path. Similarly, the leisure and hospitality sector was in the plus column in September and results in the prior two months showed a net upward revision. Job growth in leisure and hospitality was well shy of recent norms, but considering the potential effects of the Delta variant, modest growth could be viewed as favorable. We would downplay the notably weak results in education (both public and private). This sector is in disarray because of Covid, and the effect of large seasonal factors at this time of year could lead to sharp swings unrelated to economic fundamentals.

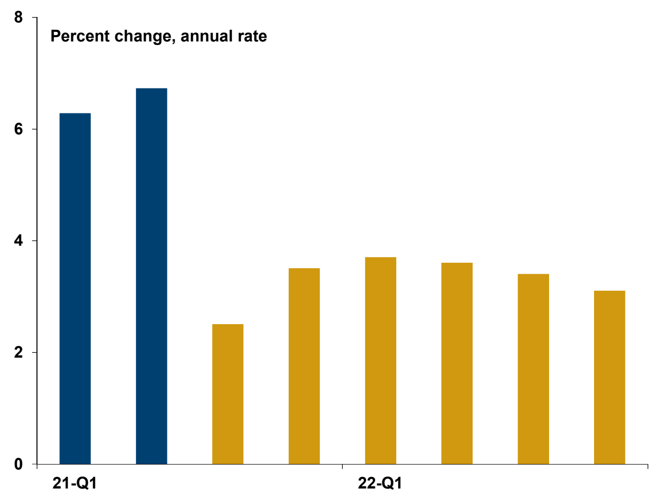
Against this background, the Fed officials who already viewed the labor market as firm enough to justify tapering are not likely to alter their views. Those that needed a reasonably good report might hesitate, but they will probably conclude that tapering is warranted. We would not be surprised to see dissents from dovish officials, but we look for the majority to favor a reduction in asset purchases.

The U.S. Economy in Q3: Deceleration

The September employment report was the most important consideration before the Fed's next discussion on tapering, but some officials also might wish to review third quarter GDP before making a decision. (The first estimate of Q3 GDP will be released on October 28, one week before the November 3 FOMC meeting.)

The results are likely to be viewed as disappointing. After growing at an annual rate of 6.5 percent in the first half of the year, available data point to growth of less than three percent in Q3. Our latest crunching of the numbers shows 2.5 percent (chart). The latest set of projections from Fed officials implied that the median forecast was looking for growth of 5.3 percent in the second half of the year (after growth of 6.5 percent in the first half, an advance of 5.3 percent in H2 would generate the Q4/Q4 projection of 5.9 percent).

GDP Growth*



** The readings for 2021-Q3 to 2022-Q4 (gold bars) are projections by Daiwa Capital Markets America.*
Sources: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

Consumer spending will account for much of the slowdown, as available data point to outlay growth of less than one percent in Q3, a marked shift from 11.7 percent in the first half and 16.2 percent in the prior four quarters. Several factors account for the deceleration. A natural easing seemed likely given the surge in the first year of the expansion. Consumer expenditures had already exceeded their pre-Covid level in the first quarter, and they moved above an extrapolated trend in the second quarter. Some easing was to be expected.

Supply constraints also emerged as an issue in recent months, especially in the motor vehicle sector where a lack of inventory has led to a plunge in sales. Covid also has played a role by limiting activity in the service sector, especially services related to travel and entertainment. However, the constraint in total was not pronounced, as real growth in service spending is on track to exceed seven percent in Q3.

Housing activity also is likely to contribute to the slowdown in economic growth. After a burst in the second half of last year and the start of this year, home sales slowed over the next several months, and builders reacted by trimming single-family starts. Multi-family building has held up well, but it was probably not strong enough to offset the drag from the single-family area.

Households do not account for all of the deceleration in economic growth; the business sector also seems to have shifted gears. After four quarters of brisk activity, outlays for new equipment could decline in the third quarter. Shipments of capital goods by domestic manufacturers rose in the first two months of the third quarter, but the increase was only moderate and may have reflected higher prices more so than real activity. (The producer price index has shown a marked increase in the price of private capital equipment in recent months – an annual rate of almost eight percent in the first two months of the third quarter.)

Higher prices also are a factor in business inventories. Firms have added to their stocks in nominal terms, but the advances have been driven by higher prices rather than real additions. Real inventories have declined for six consecutive months (latest observation is for July), as businesses have been forced to draw down stocks to contend with supply-chain disruptions. Inventory investment could make a positive contribution to GDP growth in the third quarter, but only because the drawdown is likely to be less than it was in the second quarter (a smaller draw down becomes a plus when calculating growth rates).

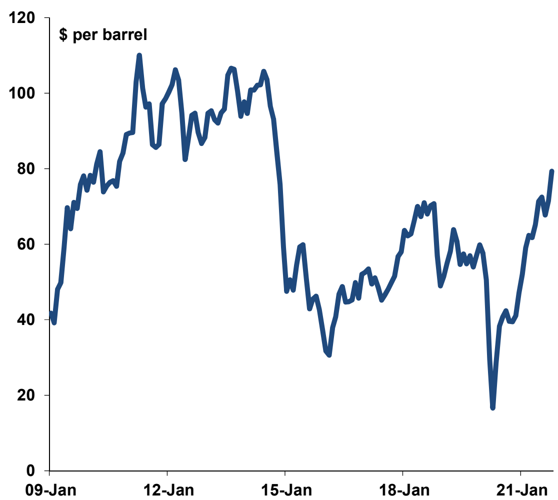
The trade sector has been a drag on the economy in the past four quarters, and it is likely to constrain growth again in Q3. However, the influence is not likely to be pronounced, probably less than one-half percentage point on GDP growth, and the slippage will be at least partly due to a special factor (the payment to Japan for broadcast rights to the summer Olympics, which is recorded in the GDP accounts as a large inflow of service imports).

Beyond Q3

We are hopeful that economic activity will pick up from the pace in the third quarter. Consumers have pulled to the sidelines recently, but they have a large pool of savings that could support firmer activity in the months ahead. Also, the number of Covid cases, while still elevated, is now moving downward and should become less of a constraint. Home sales have shown a hint of revival in the past month or two, and thus housing should be less of a negative, and perhaps will provide a slight push. We also look for business investment to return to a growth track, as adaptation to a post-Covid world should stir demand for new types of equipment.

While we tilt on the optimistic side, there are two notable challenges on the horizon: fiscal drag because of dwindling support from Covid-related legislation, and supply constraints. We are not deeply concerned about

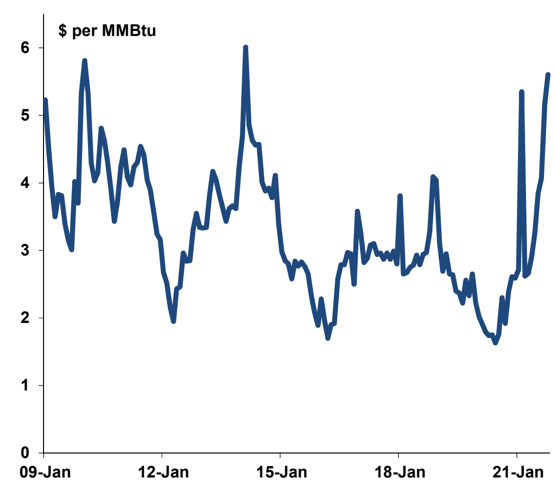
Spot Oil Price: West Texas Intermediate Crude*



** Monthly average data, except for the last observation which is a quote for October 8, 2021.*

Sources: Energy Information Administration, Department of Energy and Chicago Mercantile Exchange via Haver Analytics; Bloomberg

Spot Natural Gas Price: Henry Hub, Louisiana*



** MMBtu = Metric Million British Thermal Unit. Monthly average data, except for the last observation which is a quote for October 8, 2021.*

Sources: The Wall Street Journal via Haver Analytics; Bloomberg fiscal drag. While direct support from the federal government related to Covid is diminishing, a sizeable share is still in the hands of consumers, state and local governments, and possibly small businesses. The utilization of these funds will represent new demand in the economy. In addition, the infrastructure and social spending bills now before Congress could stir activity.

Supply constraints are more of an issue, as progress in correcting the disruptions to supply chains seems slow. The auto industry is struggling because of the shortage of semiconductors, ships are still backed up in ports, and businesses are reporting slow delivery times. The latest shortage to emerge – energy – could have severe consequences. Not only do tight supplies of natural gas, coal, and crude oil have the potential to slow production, they also will drive prices higher.

The U.S. seems less vulnerable in this regard than nations in Europe and Asia. With the U.S. now producing sizeable amounts of crude oil and natural gas, supplies are not as tight as they are in several other countries and price pressure has not been as severe. In addition, prices so far in the U.S. have not moved above levels seen in other recent years. Crude oil prices, for example, were higher in 2018 (chart), and the economy managed well at that time. Natural gas prices also are still within the range from the past several years (chart). Given the range-bound nature of prices in the U.S., it is probably premature to call this an energy shock.

However, prices of energy products elsewhere have shot through peaks seen in recent years, and these items trade in global commodity markets. Thus, one might expect pressures seen abroad to seep into the United States markets. Even if the U.S. escapes extreme price pressure, the economic effects of elevated energy prices in other countries will reverberate here, both slowing growth and feeding inflation.

Review

Week of Oct. 4, 2021	Actual	Consensus	Comments
Factory Orders (August)	**1.2%**	**1.0%**	Much of the advance in total factory orders in August was the result of a jump of 1.8% in the durable component, and this increase, in turn, was fueled by a surge of 77.9% in bookings for commercial aircraft. Durable orders excluding the transportation category rose 0.3%, the 15th advance in the past 16 months, which has left bookings far above pre-Covid levels. Orders for nondurable goods rose 0.6%. The petroleum category provided an upside surprise with an increase of 1.1%. Excluding petrol and coal, nondurable orders rose 0.5%, the 15th advance in the past 16 months.
Trade Balance (August)	**-$73.3 Billion ($2.9 Billion Wider Deficit)**	**-$70.8 Billion ($0.7 Billion Wider Deficit)**	Both exports and imports rose in August, but as in many other recent months, the change in imports was larger (1.4% versus 0.5% for exports), which led to a widening in the trade deficit and reinforced the widening trend seen since the onset of the pandemic. The latest results carried negative implications for third quarter GDP. If results for September were to match those for July and August, net exports would subtract ¼ to ½ percentage point from GDP growth.
ISM Services Index (September)	**61.9% (+0.2 Pct. Pt.)**	**59.9% (-1.8 Pct. Pts.)**	The modest increase in the ISM services index in September occurred from an already elevated level, which left the measure in the upper portion of its historical range (only five observations in the history of the series were higher, with four of them occurring in the current expansion). The business activity index led the advance with an increase of 2.2 percentage points to 62.3%, a reading in the upper reaches of the historical range. The strength in business activity was supported by a firm order flow (up 0.3 percentage point to 63.5%). The supplier delivery index fell 0.8 percentage point, suggesting slight improvement in supply chain disruptions. On the soft side, the employment index disappointed with a dip of 0.7 percentage point to 53.0%.
Payroll Employment (September)	**194,000**	**500,000**	Nonfarm payrolls trailed the average advance of 607,000 in the first eight months of 2021, but the results were not deeply disappointing. Upward revisions in the prior two months were sizable at 169,000, and much of the softness in September occurred in education, where pandemic-related disruptions to normal school patterns combined with ordinary seasonal adjustment have generated noise. The unemployment rate was perhaps the most notable aspect of the report, as the headline measure fell 0.4 percentage point to 4.8%. Some of the drop was the result of individuals dropping out of the labor force (off 183,000), but employment as measured by the household survey accounted for most of the decline (up 526,000). Average hourly earnings rose 0.6%, one of the firmest readings in the current expansion.

Sources: U.S. Census Bureau (Factory Orders); Bureau of Economic Analysis (Trade Balance); Institute for Supply Management (ISM Services Index); Bureau of Labor Statistics (Payroll Employment); Consensus forecasts are from Bloomberg

Preview

Week of Oct. 11, 2021	Projected	Comments
CPI (September) (Wednesday)	**0.3% Total, 0.2% Core**	Available quotes suggest that gasoline prices rose only moderately in September, but seasonal adjustment will probably give an extra boost. In addition, natural gas prices are likely to add to energy pressure. Food prices have been on a tear lately, increasing at an average rate of 0.5% in the past five months. Upward pressure on the prices of many core items is likely to be evident, but discounting on Covid-sensitive services (hotel fees, airfares, car rental rates) is likely to limit the advance.
Federal Budget (September) (Wednesday) (Possibly Postponed)	**$60.0 Billion Deficit**	Available data suggest that federal revenues in September rose sharply on a year-over-year basis (up approximately 20%), which should leave the deficit lighter than the shortfall of $125 billion in the same month last year. September marks the final month of the government's fiscal year, and the expected monthly deficit would leave the annual shortfall at $2,771 billion, an improvement from a deficit of $3,132 billion in FY2020.
PPI (September) (Thursday)	**0.6% Total, 0.6% Ex. Autos**	Producer prices have surged this year, with the headline index increasing at an average rate of 0.9% in the past eight months; excluding food and energy, the average pace has totaled 0.7%. A slight easing in August (0.7% total, 0.6% ex food & energy) suggested that pandemic-related noise was beginning to diminish, but supply shortages are likely to remain a factor in September.
Retail Sales (September) (Friday)	**-0.4% Total, 0.0% Ex. Autos**	A drop in sales of new vehicles will probably constrain the auto component of the retail report, and outlays for other goods, which have moved well above of the pre-Covid trend, seem to have little upside potential. Virus concerns could end the six-month string of gains at restaurants and bars.
Consumer Sentiment (October) (Friday)	**74.0 (+1.2 Index Pts.)**	With the economy and labor market continuing to improve, one might expect consumer sentiment to pick up noticeably from the low readings in the past two months (August was below the April 2020 trough of 71.8 and September was only slightly higher). However, the spread of Covid and the pickup in inflation seem to be dampening moods; thus, a modest gain seems likely.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

October 2021

Monday	Tuesday	Wednesday	Thursday	Friday
4	5	6	7	8
FACTORY ORDERS June 1.5% July 0.7% Aug 1.2%	**TRADE BALANCE** June -$73.2 billion July -$70.3 billion Aug -$73.3 billion **ISM SERVICES INDEX** Index Prices July 64.1 82.3 Aug 61.7 75.4 Sept 61.9 77.5	**ADP EMPLOYMENT REPORT** Private Payrolls July 322,000 Aug 340,000 Sept 568,000	**UNEMPLOYMENT CLAIMS** Initial Continuing (Millions) Sept 11 0.335 2.820 Sept 18 0.351 2.811 Sept 25 0.364 2.714 Oct 02 0.326 N/A **CONSUMER CREDIT** June $38.2 billion July $17.2 billion Aug $14.4 billion	**EMPLOYMENT REPORT** Payrolls Un. Rate July 1,091,000 5.4% Aug 366,000 5.2% Sept 194,000 4.8% **WHOLESALE TRADE** Inventories Sales June 1.2% 2.3% July 0.6% 2.1% Aug 1.2% -1.1%
11	12	13	14	15
COLUMBUS DAY	**NFIB SMALL BUSINESS OPTIMISM INDEX (6:00)** July 99.7 Aug 100.1 Sept -- **JOLTS DATA (10:00)** Openings (000) Quit Rate June 10,185 2.7% July 10,934 2.7% Aug -- --	**CPI (8:30)** Total Core July 0.5% 0.3% Aug 0.3% 0.1% **Sept 0.3% 0.2%** **FEDERAL BUDGET (2:00) (LIKELY POSTPONED)** 2021 2020 July -$302.1B -$63.0B Aug -$170.6B -$200.0B **Sept -$60.0B** -$124.6B **FOMC MINUTES (2:00)**	**INITIAL CLAIMS (8:30)** **PPI (8:30)** Final Demand Ex. Food & Energy July 1.0% 1.0% Aug 0.7% 0.6% **Sept 0.6% 0.6%**	**RETAIL SALES (8:30)** Total Ex.Autos July -1.8% -1.0% Aug 0.7% 1.8% **Sept -0.4% 0.0%** **IMPORT/EXPORT PRICES (8:30)** Non-petrol. Imports Nonagri. Exports July 0.3% 1.4% Aug -0.1% 0.2% Sept -- -- **EMPIRE MFG (8:30)** Aug 18.3 Sept 34.3 Oct -- **CONSUMER SENTIMENT (10:00)** Aug 70.3 Sept 72.8 **Oct 74.0** **BUSINESS INVENTORIES (10:00)** Inventories Sales June 0.9% 1.6% July 0.6% 0.5% **Aug 0.6% -0.1%**
18	19	20	21	22
IP & CAP-U **NAHB HOUSING INDEX** **TIC DATA**	**HOUSING STARTS**	**BEIGE BOOK**	**INITIAL CLAIMS** **PHILLY FED INDEX** **EXISTING HOME SALES** **LEADING INDICATORS**	
25	26	27	28	29
CHICAGO FED NATIONAL ACTIVITY INDEX	**FHFA HOME PRICE INDEX** **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** **NEW HOME SALES** **CONSUMER CONFIDENCE**	**U.S. INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES** **DURABLE GOODS ORDERS**	**INITIAL CLAIMS** **Q3 GDP** **PENDING HOME SALES**	**PERSONAL INCOME, CONSUMPTION, PRICES** **EMPLOYMENT COST INDEX** **MNI CHICAGO BUSINESS BAROMETER INDEX** **REVISED CONSUMER SENTIMENT**

Forecasts in Bold.

Treasury Financing

October 2021

Monday	Tuesday	Wednesday	Thursday	Friday
4	5	6	7	8
AUCTION RESULTS: Rate Cover 13-week bills 0.040% 3.45 26-week bills 0.055% 3.30 **ANNOUNCE:** $25 billion 8-day CMBs for auction on October 5	**AUCTION RESULTS:** Rate Cover 52-week bills 0.090% 3.37 8-day CMBs 0.140% 3.00 **ANNOUNCE:** $10 billion 4-week bills for auction on October 7 $25 billion 8-week bills for auction on October 7 $30 billion 17-week CMBs for auction on October 6 $40 billion 64-day CMBs for auction on October 6 **SETTLE:** $10 billion 4-week bills $25 billion 8-week bills $30 billion 17-week CMBs	**AUCTION RESULTS:** Rate Cover 17-week CMB 0.055% 3.60 64-day CMB 0.050% 3.26	**AUCTION RESULTS:** Rate Cover 4-week bills 0.035% 5.81 8-week bills 0.110% 3.05 **ANNOUNCE:** $84 billion 13-,26-week bills for auction on October 12 $58 billion 3-year notes for auction on October 12 $38 billion 10-year notes for auction on October 12 $24 billion 30-year bonds for auction on October 13 **SETTLE:** $84 billion 13-,26-week bills $34 billion 52-week bills $25 billion 8-day CMBs	
11	12	13	14	15
COLUMBUS DAY	**AUCTION:** $84 billion 13-,26-week bills $58 billion 3-year notes $38 billion 10-year notes **ANNOUNCE:** $10 billion* 4-week bills for auction on October 14 $25 billion* 8-week bills for auction on October 14 $30 billion* 17-week CMBs for auction on October 13 **SETTLE:** $10 billion 4-week bills $25 billion 8-week bills $30 billion 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs $24 billion 30-year bonds **SETTLE:** $40 billion 64-day CMBs	**AUCTION:** $10 billion* 4-week bills $25 billion* 8-week bills **ANNOUNCE:** $84 billion* 13-,26-week bills for auction on October 18 $24 billion* 20-year bonds for auction on October 20 $19 billion* 5-year TIPS for auction on October 21 **SETTLE:** $84 billion 13-,26-week bills	**SETTLE:** $58 billion 3-year notes $38 billion 10-year notes $24 billion 30-year bonds
18	19	20	21	22
AUCTION: $84 billion* 13-,26-week bills	**ANNOUNCE:** $35 billion* 4-week bills for auction on October 21 $25 billion* 8-week bills for auction on October 21 $30 billion* 17-week CMBs for auction on October 20 **SETTLE:** $10 billion* 4-week bills $25 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $24 billion* 20-year bonds $30 billion* 17-week CMBs	**AUCTION:** $35 billion* 4-week bills $25 billion* 8-week bills $19 billion* 5-year TIPS **ANNOUNCE:** $96 billion* 13-,26-week bills for auction on October 25 $28 billion* 2-year FRNs for auction on October 27 $60 billion* 2-year notes for auction on October 26 $61 billion* 5-year notes for auction on October 27 $62 billion* 7-year notes for auction on October 28 **SETTLE:** $84 billion* 13-,26-week bills	
25	26	27	28	29
AUCTION: $96 billion* 13-,26-week bills	**AUCTION:** $60 billion* 2-year notes **ANNOUNCE:** $35 billion* 4-week bills for auction on October 28 $25 billion* 8-week bills for auction on October 28 $30 billion* 17-week CMBs for auction on October 27 **SETTLE:** $35 billion* 4-week bills $25 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $28 billion* 2-year FRNs $61 billion* 5-year notes $30 billion* 17-week CMBs	**AUCTION:** $35 billion* 4-week bills $25 billion* 8-week bills $62 billion* 7-year notes **ANNOUNCE:** $96 billion* 13-,26-week bills for auction on November 1 $34 billion* 52-week bills for auction on November 2 **SETTLE:** $96 billion* 13-,26-week bills	**SETTLE:** $19 billion* 5-year TIPS

*Estimate