Daiwa Capital Markets

U.S. Economic Comment

- Labor force participation: still lagging, but some upside potential
- Chair Powell's change of heart

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The Labor Market and Labor Force Participation

The employment report for November was generally underwhelming, as nonfarm payrolls rose only 210,000 and average hourly earnings increased by less than their recent average (0.3 percent rather than 0.4 percent). However, the report contained one notable positive development: a drop of 0.4 percentage point in the unemployment rate to 4.2 percent. The decline was "strong" in that it showed a sizeable increase in the labor force (594,000) that was swamped by a surge in employment as measured by the survey of households (1.136 million). The employment surge was striking, but we would note that employment from the household survey is highly volatile, and thus the latest change probably involves a large random element.

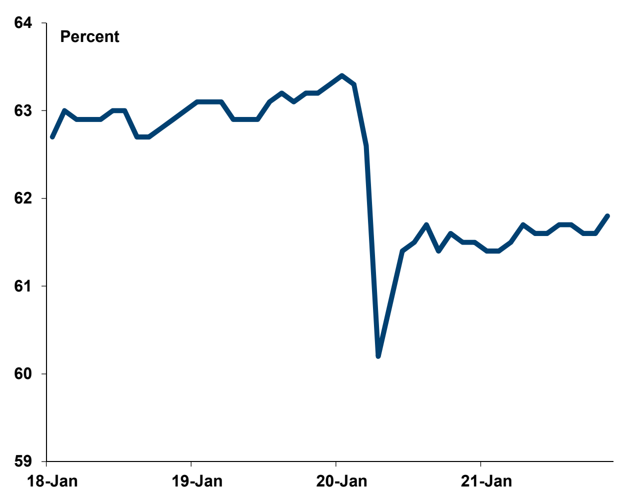
The size of the labor force also moves erratically from month-to-month, so we would interpret the November jump cautiously. The performance of labor force participation in the current expansion also would lead one to reserve judgment about the significance of the change in November. The labor force participation rate fell noticeably during the recession, and it recovered only modestly in the early stages of the expansion. It has moved sideways in the past year or so and remains noticeably below its pre-pandemic level (chart).

The lagging nature of the participation rate explains much of the apparent tightness in the labor market. If the participation rate had returned to its pre-Covid level, an additional 4.2 million individuals would be in the labor force. If they all found jobs, payroll employment would be above its level before the onset of the pandemic and the number of job openings would be well below the 10.4 million now evident.

One wonders where the workers are. The Federal Reserve Bank of Atlanta has developed a useful interactive tool that provides insights into the causes of subdued labor market participation. The tool is based on microdata from the survey of households in the monthly employment report, and it allows the user to tally the causes of non-participation both overall and by numerous sub groups based on age, gender, education, and race. The tool also allows the user to examine changes in participation over different periods of time. (See: https://www.atlantafed.org/chcs/labor-force-participation-dynamics).

The Atlanta Fed tool shows a decline of 1.3 percentage points in the labor force participation rate since the onset of the pandemic (based on quarterly averages of not seasonally adjusted data). Much of this decline was the result of retirements (chart, next page), and naturally most of the individuals retiring were in the upper age bracket (participation in the 55 and over age bracket fell 1.9 percentage points, with 2.1 percentage points because of retirement).

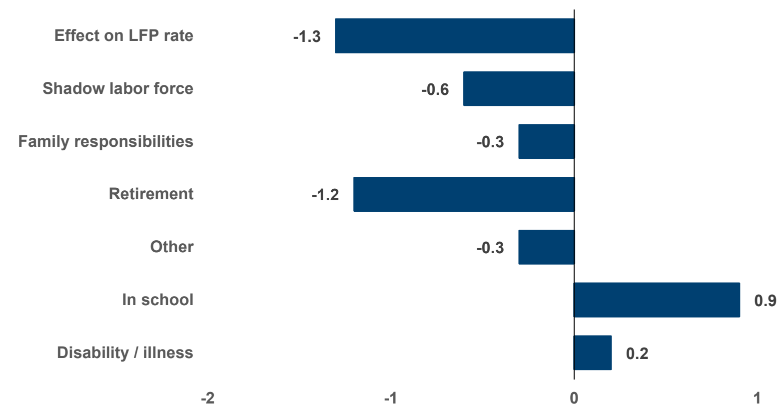
Labor Force Participation Rate



Source: Bureau of Labor Statistics via Haver Analytics

In addition to retirement, the so-called shadow labor force accounted for much of the drop in participation. This grouping consists of individuals that would like a job but are not searching for employment. Several reasons might be cited for not looking. They might view jobs as difficult to find, although with more than 10 million job openings in the U.S., the number of discouraged workers is low. Some will have logistical issues (e.g. lack of transportation), and skills or geographic mismatches are most likely issues as well.

Contributions to Total Change in Labor Force Participation by Nonparticipation Category*



** Since 2019-Q4*
Source: Federal Reserve Bank of Atlanta

Covid also could be having an influence, as some individuals are probably not looking for work because of the risk of contracting the virus, or they might have care giving responsibilities. (Family responsibilities are listed as a separate cause of non-participation, but that grouping is for individuals that do not want a job; the shadow labor force is for individuals that would like to work. Care giving responsibilities are most likely present in both groupings.)

We suspect that generous fiscal support to the household sector has boosted the shadow labor force. The household sector in the aggregate has built up a large pool of savings because of the heavy flow of transfer payments from the federal government, and some most likely are using the financial flexibility to explore next-best options to working. As savings are depleted, or if other options are not viewed as attractive, they could well return to the labor force.

We also wonder about the surge in retirements. In is not uncommon for individuals to have second thoughts about retirement, and thus we see the possibility that some individuals will un-retire. No doubt, Covid has led many to reassess priorities and to pursue other interests, but some will become bored or be lured back to work by attractive offers. Such actions also could boost labor force participation.

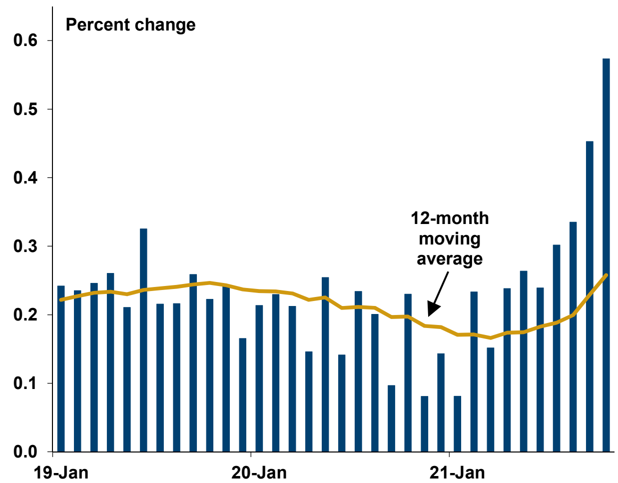
While the return of older workers might boost participation in the months ahead, we cannot expect much from young individuals. Interestingly, participation in the youngest age grouping in the Atlanta data base has increased 2.5 percentage points since the fourth quarter of 2019. A shift in preferences for work over school has been the driving force for this change. The “in school” category added five percentage points to the labor force participation rate among 16-24 year-old individuals, easily offsetting negative influences elsewhere. That is, fewer individuals are pursuing additional education and more are working, most likely because of the ease of finding a job with an attractive compensation package. (This shift in preferences also explains the contribution of 0.9 percentage point from the “in school” category in overall participation; see chart.)

Powell’s About Face

Fed Chair Jerome Powell this week put forth a striking change in view by noting that “transitory” should be retired when discussing inflation and that the Federal Open Market Committee will discuss the possibility of speeding the pace of QE tapering. After these comments, it is difficult to imagine the FOMC not ending its purchases of Treasuries and mortgage-back securities sooner than initially planned.

Several factors probably led to Mr. Powell’s hawkish shift. Most obvious, price pressure has persisted longer than officials had previously expected and it has broadened in scope. The faster inflation rates that first appeared in the spring were downplayed as reflecting base effects and pandemic-related changes in a limited number of goods. Those explanations now seem thin, as base effects have not been a factor in recent months, and price pressure no longer seems tied to a handful of goods. The broad nature of recent inflation is evident in the monthly change in the median CPI, which jumped 0.6 percent in October and averaged 0.5 percent in the past three months (chart). The acceleration in the median index indicates that the distribution of price changes among the components of the CPI has shifted to the right – that is, sharper price increases.

Median CPI

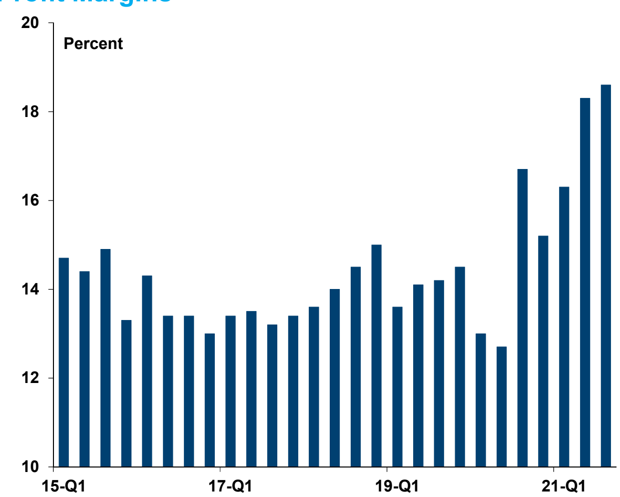


Source: Federal Reserve Bank of Cleveland via Haver Analytics

Chair Powell also might be concerned about an increase in pricing power by businesses. The minutes from the November FOMC meeting noted that several policymakers had detected greater scope for businesses to pass along higher costs. The recent profit performance of corporations is notable in this regard. The latest report on GDP for Q3 showed strong earnings for nonfinancial corporations, with the hefty gains largely attributable to wider profit margins (chart). Businesses have faced higher costs of materials and labor recently, but they are more than covering the added expense.

We suspect that Chair Powell also might be concerned about Fed credibility. Weak readings on measures of consumer attitudes and sharp increases in the expectations of inflation among individuals indicate that inflation is weighing heavily on the minds of the public. Continuing to push the view of transitory inflation would show the Fed to be out of touch and sow doubts about the Fed's handling of the economy.

Profit Margins*



** Profits as a share of gross value added by nonfinancial corporations.*
Source: Bureau of Economic Analysis via Haver Analytics

Mr. Powell may also have doubts about the current setting of monetary policy, and thus he is perhaps setting the stage to back away from the current stance. The economy seems on firm ground, as GDP is above its pre-pandemic level and unemployment is low, yet the Fed is holding to a policy designed to counter a deep recession.

Review

Week of Nov. 29, 2021	Actual	Consensus	Comments
Consumer Confidence (November)	**109.5 (-2.1 Index Pts.)**	**110.9 (-2.9 Index Pts.)**	Consumer confidence declined in November for the fourth time in the past five months, with the cumulative drop of 15.1% pushing the level of the measure to the middle of the range during the current recovery (a reading 17.4% below the pre-Covid reading of 132.6 in February 2020). Views on inflation likely led to the souring in moods, as the year-ahead inflation gauge rose five ticks to 7.6%, a reading just below the record of 7.7% in May/June 2008. Despite the soft reading on confidence, views on the labor market remained highly favorable. The labor market differential (share of survey respondents reporting that jobs were plentiful less the share indicating that jobs were hard to get) rose 3.1 percentage points to a record 46.9%.
ISM Manufacturing Index (November)	**61.1% (+0.3 Pct. Pt.)**	**61.2% (+0.4 Pct. Pt.)**	The change in the ISM manufacturing index in November was modest, but it occurred from an already elevated level. The new orders component rose 1.7 percentage points to 61.5%, a reading in the low end of the recent range, but strong from a longer-term perspective. The firm order flow led to a pickup in production, with this component increasing 2.2 percentage points to 61.5%, a little shy of the best readings in the current cycle. The employment index rose for the third consecutive month (up 1.3 percentage points), but the level of the index remained unimpressive at 53.3%. The supplier delivery index fell 3.4 percentage points to 72.2%. The shift made a negative contribution to the headline index, but in the current setting this change should be viewed as favorable, as it suggests that supply-chain disruptions have eased somewhat.
Construction Spending (October)	**0.2%**	**0.4%**	Private residential construction fell 0.5% in October, marking the third decline in the past four months and turning a firm upward trend into a downward tilt. Private nonresidential construction rose 0.2% from an upwardly revised level. The sector is improving modestly on balance this year after notable softening in 2020. Building by state and local governments rose 0.9%, marking the fourth consecutive advance and possibly signaling the beginning of an upward trend after a generally soft performance during much of the current expansion.

Review Continued

Week of Nov. 29, 2021	Actual	Consensus	Comments
Payroll Employment (November)	**210,000**	**550,000**	A modest increase in nonfarm payrolls was tempered to a degree by upward adjustments of 82,000 in the prior two months, but the November print trailed by a wide margin the average gain of 590,000 in the first 10 months of 2021. The unemployment rate sent a more favorable signal, with a decline of 0.4 percentage point to 4.2%. A surge of 1.136 million in employment as reported by the household survey eclipsed a gain of 594,000 in the size of the labor force. Average hourly earnings rose 0.3%, a change that would be viewed as firm in many settings. However, it is a bit light relative to other recent readings (an average of 0.4% in the prior 12 months) and shy of what might be expected if firms are seeking to attract workers.
ISM Services Index (November)	**69.1% (+2.4 Pct. Pts.)**	**65.0% (-1.7 Pct. Pts.)**	The change in the ISM services index in November was solid when viewed in isolation, but it was striking when viewed against the record reading in the prior month. The new reading is stratospheric compared with other peaks. The new orders index was unchanged in November, but the level of 69.7% represents the best on record. With orders remaining strong, business activity also was brisk, as this component rose 4.8 percentage points to a record 74.6%. The employment component rose 4.9 percentage points to 56.5%, a solid performance. The supplier delivery index was unchanged at 75.7%, signaling that supply-chain difficulties remain an issue.
Factory Orders (October)	**1.0%**	**0.5%**	All of the gain in factory orders in October occurred in the nondurable area, where bookings rose 2.4%. Much of this advance was the result of a surge of 8.5% in the petroleum and coal category, which undoubtedly was heavily influenced by higher prices. Nondurable orders ex-petroleum also advanced, increasing 0.8% and marking their 17th gain in the past 18 months. Orders for durable goods fell 0.4%, but the drop was concentrated in the volatile aircraft category. Durable bookings ex-transportation rose 0.5%, their 17th increase in the past 18 months.

Sources: The Conference Board (Consumer Confidence); Institute for Supply Management (ISM Manufacturing Index, ISM Services Index); U.S. Census Bureau (Construction Spending, Factory Orders); Bureau of Labor Statistics (Payroll Employment); Consensus forecasts are from Bloomberg

Preview

Week of Dec. 6, 2021	Projected	Comments
Revised Nonfarm Productivity (2021-Q3) (Tuesday)	**-5.2% (-0.2 Pct. Pt. Revision)**	The revised GDP report for Q3 suggests that output in the nonfarm business sector grew slightly more than initially estimated, but labor market data point to a larger adjustment in hours worked, implying a downward revision to an already soft productivity performance. The downward revision to productivity, along with an upward adjustment to labor compensation, should lead to a noticeable upward shift in the growth of unit labor cost (9.0% versus an initial estimate of 8.3%).
Trade Balance (October) (Tuesday)	**-$66.5 Billion ($14.4 Billion Narrower Deficit)**	The surplus in services, although trending downward in the past few years, typically does not show pronounced month-to-month changes. Thus, the October trade report will probably be dominated by the improvement of $14.1 billion in the goods trade deficit. The expected reading on the overall trade balance would represent the second best of the year thus far, trailing only the deficit of $65.7 billion in January.
CPI (November) (Friday)	**0.6% Total, 0.4% Core**	The price of natural gas inched lower in November, but gasoline prices remained under pressure and probably drove the energy component higher for the sixth consecutive month. Food prices probably remained under pressure as well, reflecting both supply restrictions and firm demand. Supply-demand imbalances are also likely to be evident in the core component, where the expected increase marks the fifth increase of 0.4% or more in the past eight months.
Consumer Sentiment (December) (Friday)	**68.0 (+0.6 Index Pt.)**	After posting only a moderate recovery in the first year of the expansion, consumer sentiment has lost ground since the spring. With inflation and the Omicron variant dominating the news, moods likely remained sour in early December. The expected reading remains below the recession trough of 71.8 in April 2020.
Federal Budget (November) (Friday)	**$225.0 Billion Deficit**	Available data suggest another month of robust revenue growth (fourth consecutive month of year-over-year growth in the neighborhood of 20%). Outlays also are likely to be on the firm side, which should counter the revenue flow and leave a deficit that is approximately $80 billion wider than the shortfall in the same month last year.

Source: Forecasts provided by Daiwa Capital Markets America

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Economic Indicators

November / December 2021

Monday	Tuesday	Wednesday	Thursday	Friday
29	30	1	2	3
PENDING HOME SALES Aug 8.1% Sept -2.4% Oct 7.5%	**FHFA HOME PRICE INDEX** July 1.4% Aug 1.0% Sept 0.9% **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** SA NSA July 1.5% 1.5% Aug 1.2% 0.9% Sept 1.0% 0.8% **MNI CHICAGO BUSINESS BAROMETER INDEX** Index Prices Sept 64.7 90.7 Oct 68.4 94.3 Nov 61.8 93.8 **CONFERENCE BOARD CONSUMER CONFIDENCE** Sept 109.8 Oct 111.6 Nov 109.5	**ADP EMPLOYMENT REPORT** Private Payrolls Sept 526,000 Oct 570,000 Nov 534,000 **ISM MFG INDEX** Index Prices Sept 61.1 81.2 Oct 60.8 85.7 Nov 61.1 82.4 **CONSTRUCTION SPEND.** Aug 1.0% Sept -0.1% Oct 0.2% **DECEMBER BEIGE BOOK** "Economic activity grew at a modest to moderate pace in most Federal Reserve Districts during October and early November." **NEW VEHICLE SALES** Sept 12.3 million Oct 13.0 million Nov 12.9 million	**UNEMPLOYMENT CLAIMS** Initial Continuing (Millions) Nov 06 0.269 2.109 Nov 13 0.270 2.063 Nov 20 0.194 1.956 Nov 27 0.222 N/A	**EMPLOYMENT REPORT** Payrolls Un. Rate Sept 379,000 4.8% Oct 546,000 4.6% Nov 210,000 4.2% **ISM SERVICES INDEX** Index Prices Sept 61.9 77.5 Oct 66.7 82.9 Nov 69.1 82.3 **FACTORY ORDERS** Aug 1.0% Sept 0.5% Oct 1.0%
6	7	8	9	10
	REVISED PRODUCTIVITY & COSTS (8:30) Productivity Unit Labor Costs 21-Q2 2.4% 1.1% 21-Q3(p) -5.0% 8.3% **21-Q3(r) -5.2% 9.0%** **TRADE BALANCE (8:30)** Aug -$72.8 billion Sept -$80.9 billion **Oct -$66.5 billion** **CONSUMER CREDIT (3:00)** Aug $13.8 billion Sept $29.9 billion Oct --	**JOB OPENINGS & LABOR TURNOVER (10:00)** Openings (000) Quit Rate Aug 10,629 2.9% Sept 10,438 3.0% Oct -- --	**INITIAL CLAIMS (8:30)** **WHOLESALE TRADE (10:00)** Inventories Sales Aug 1.3% -0.9% Sept 1.4% 1.1% **Oct 2.2% 1.0%**	**CPI (8:30)** Total Core Sept 0.4% 0.2% Oct 0.9% 0.6% **Nov 0.6% 0.4%** **CONSUMER SENTIMENT (10:00)** Oct 71.7 Nov 67.4 **Dec 68.0** **FEDERAL BUDGET (2:00)** 2021 2020 Sept -$61.6B -$124.6B Oct -$165.1B -$284.1B **Nov -$225.0B** -$145.3B
13	14	15	16	17
	NFIB SMALL BUSINESS OPTIMISM INDEX **PPI** **FOMC MEETING**	**EMPIRE MFG INDEX** **RETAIL SALES** **IMPORT/EXPORT PRICES** **BUSINESS INVENTORIES** **NAHB HOUSING INDEX** **FOMC DECISION** **TIC DATA**	**INITIAL CLAIMS** **HOUSING STARTS** **PHILADELPHIA FED MFG BUSINESS OUTLOOK** **IP & CAP-U**	
20	21	22	23	24
LEADING INDICATORS	**CURRENT ACCOUNT**	**CHICAGO FED NATIONAL ACTIVITY INDEX** **REVISED GDP** **CONSUMER CONFIDENCE** **EXISTING HOME SALES**	**INITIAL CLAIMS** **PERSONAL INCOME, CONSUMPTION, PCE PRICES** **DURABLE GOODS ORDERS** **NEW HOME SALES** **REVISED CONSUMER SENTIMENT**	***CHRISTMAS DAY (OBSERVED)***

Forecasts in Bold. (p) = preliminary; (r) = revised

Treasury Financing

November / December 2021

Monday	Tuesday	Wednesday	Thursday	Friday
29	30	1	2	3
AUCTION RESULTS: Rate Cover 13-week bills 0.050% 3.13 26-week bills 0.090% 2.99	**AUCTION RESULTS:** Rate Cover 52-week bills 0.240% 3.01 21-day CMB 0.160% 2.79 **ANNOUNCE:** $10 billion 4-week bills for auction on December 2 $25 billion 8-week bills for auction on December 2 $40 billion 17-week CMBs for auction on December 1 $40 billion 8-day CMBs for auction on December 1 **SETTLE:** $10 billion 4-week bills $25 billion 8-week bills $23 billion 20-year bonds $14 billion 10-year TIPS $58 billion 2-year notes $59 billion 5-year notes $59 billion 7-year notes $40 billion 17-week CMBs $60 billion 14-day CMBs	**AUCTION RESULTS:** Rate Cover 17-week CMB 0.075% 2.97 8-day CMB 0.160% 2.55	**AUCTION RESULTS:** Rate Cover 4-week bills 0.040% 4.83 8-week bills 0.045% 3.33 **ANNOUNCE:** $108 billion 13-,26-week bills for auction on Dec. 6 $54 billion 3-year notes for auction on December 7 $36 billion 10-year notes for auction on December 8 $22 billion 30-year bonds for auction on December 9 **SETTLE:** $108 billion 13-,26-week bills $34 billion 52-week bills $30 billion 21-day CMBs	
6	7	8	9	10
AUCTION: $108 billion 13-,26-week bills	**AUCTION:** $54 billion 3-year notes **ANNOUNCE:** $10 billion* 4-week bills for auction on December 9 $25 billion* 8-week bills for auction on December 9 $40 billion* 17-week CMBs for auction on December 8 **SETTLE:** $10 billion 4-week bills $25 billion 8-week bills $40 billion 17-week CMBs $40 billion 8-day CMBs	**AUCTION:** $36 billion 10-year notes $40 billion* 17-week CMBs	**AUCTION:** $10 billion* 4-week bills $25 billion* 8-week bills $22 billion 30-year bonds **ANNOUNCE:** $108 billion* 13-,26-week bills for auction on Dec. 13 **SETTLE:** $108 billion 13-,26-week bills	
13	14	15	16	17
AUCTION: $108 billion* 13-,26-week bills	**ANNOUNCE:** $10 billion* 4-week bills for auction on December 16 $25 billion* 8-week bills for auction on December 16 $40 billion* 17-week CMBs for auction on December 15 **SETTLE:** $10 billion* 4-week bills $25 billion* 8-week bills $40 billion* 17-week CMBs	**AUCTION:** $40 billion* 17-week CMBs **SETTLE:** $54 billion 3-year notes $36 billion 10-year notes $22 billion 30-year bonds	**AUCTION:** $10 billion* 4-week bills $25 billion* 8-week bills **ANNOUNCE:** $108 billion* 13-,26-week bills for auction on Dec. 20 $20 billion* 20-year bonds for auction on December 21 $17 billion* 5-year TIPS for auction on December 22 **SETTLE:** $108 billion* 13-,26-week bills	
20	21	22	23	24
AUCTION: $108 billion* 13-,26-week bills	**AUCTION:** $20 billion* 20-year bonds **ANNOUNCE:** $10 billion* 4-week bills for auction on December 23 $25 billion* 8-week bills for auction on December 23 $40 billion* 17-week CMBs for auction on December 22 **SETTLE:** $10 billion* 4-week bills $25 billion* 8-week bills $40 billion* 17-week CMBs	**AUCTION:** $17 billion* 5-year TIPS $40 billion* 17-week CMBs	**AUCTION:** $10 billion* 4-week bills $25 billion* 8-week bills **ANNOUNCE:** $108 billion* 13-,26-week bills for auction on Dec. 27 $34 billion* 52-week bills for auction on December 28 $24 billion* 2-year FRNs for auction on December 29 $56 billion* 2-year notes for auction on December 27 $57 billion* 5-year notes for auction on December 28 $56 billion* 7-year notes for auction on December 29 **SETTLE:** $108 billion* 13-,26-week bills	***CHRISTMAS DAY (OBSERVED)***

**Estimate*