U.S. Economic Comment

- Despite growth risks, broad-based inflation leads the Fed to remove accommodation
- Slow progress in removing supply-side sources of inflation

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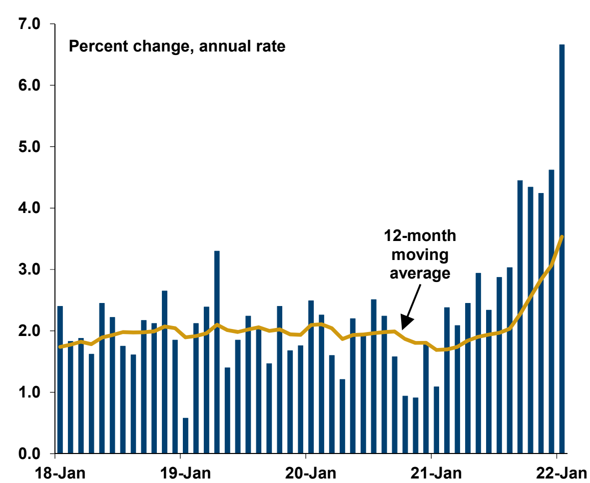
The Fed: Focused on Inflation

Federal Reserve Chair Jerome Powell deserves high marks for clarity in communication, as his testimony on monetary policy this week left little doubt that the Federal Open Market Committee would start to remove monetary accommodation at its meeting on March 15-16. Mr. Powell recognized that fallout from the war between Russia and Ukraine could slow economic growth, but the outcome of the conflict and the implications for growth are highly uncertain, and the Fed is faced with an immediate problem of rapid inflation. Thus, the Fed will push ahead with its plans to tighten monetary policy. It will move gingerly because of the uncertainty, but it will be moving.

The Fed's pivot toward less accommodative policy began last fall when price pressures started to spread beyond a limited number of items influenced by the pandemic. The broadening of inflation was apparent in the trimmed-mean price index for personal consumption expenditures published by the Federal Reserve Bank of Dallas. This measure excludes both high-side and low-side price changes in calculating the inflation rate, thus eliminating the influence of outliers. If inflation was indeed being driven by a small number of pandemic-affected items, these pressure points would most likely drop out of the inflation calculation, leaving a stable rate. However, this index took a noticeable step higher in September, and it has remained elevated since, signaling a rightward shift in the distribution of price changes – that is, a broadening in inflation (chart).

The Monetary Policy Report published in conjunction with Chair Powell's testimony this week provided more compelling evidence of broadening price pressure. A special section in this report took a detailed look at consumer inflation by dividing personal consumption expenditures into 146 different groups, and then measuring the inflation rate in each group. Results showed distinct changes in recent months: fewer items with price declines, and a notable drop in items with price increases in a range of 1 to 4 percent, a considerable increase in the number of items showing 12-month price increases of 5 to 12 percent, a moderate increase in goods or services posting increases of 13 to 24 percent, and a surge in the number of items showing price increases of 25 percent or more. We presume this last group involved items most affected by the pandemic.

Trimmed Mean 1-Month PCE Inflation*



** PCE = personal consumption expenditures*
Source: Federal Reserve Bank of Dallas via Haver Analytics

The report included an interesting chart that showed clearly the broadening in price pressure (copied and pasted on the next page). This plot shows the share of the 146 groups in the study that posted year-over-year price changes of more than three percent, with this grouping now exceeding 60 percent. This share is still well below the 90-plus percent seen in the 1970s, but it is the highest in three decades.

The above discussion, and nearly all other commentary on inflation, focuses on the prices of consumer goods and services. If there is a genuine inflation impulse running through the economy, it should also be evident in prices paid by businesses and governments, and indeed that is the case.

Share of Personal Consumption Expenditure Product Categories with Inflation Over 3 Percent*

** The series is created from 146 product categories. Each product category is weighted by its expenditure share in personal consumption expenditures. The series is derived from 12-month price changes. The data extend through December 2021. The flat line marks where 50 percent of product categories experience inflation over 3 percent.*

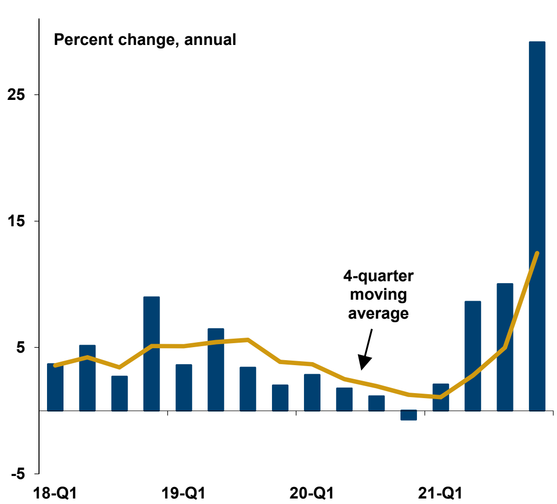
Source: "Monetary Policy Report" Federal Reserve Board, February 25, 2022, https://www.federalreserve.gov/monetarypolicy/2022-02-mpr-part1.htm.

The producer price index includes measures of construction costs and prices of business capital equipment, and both are showing noticeable pressure. The series on construction costs shows a high degree of monthly volatility, and thus we focus on quarterly averages to reduce the noise. A few high-side readings were evident before the pandemic (e.g. 9.0 percent, annual rate, in 2018-Q4), but the situation was calm in 2019 before Covid took hold. However, pressure emerged last year with both Q2 and Q3 showing high-side readings before Q4 exploded with annual growth of more than 29 percent (chart).

The January reading suggested that 2022-Q1 will also be problematic, as construction costs jumped at an annual rate of 44 percent. (Results in February and March will probably be much slower, as this series tends to show marked increases in the first month of a quarter. October 2021, for example, posted an increase of 71 percent, annual rate, but November and December followed with an average increase of 3.9 percent.)

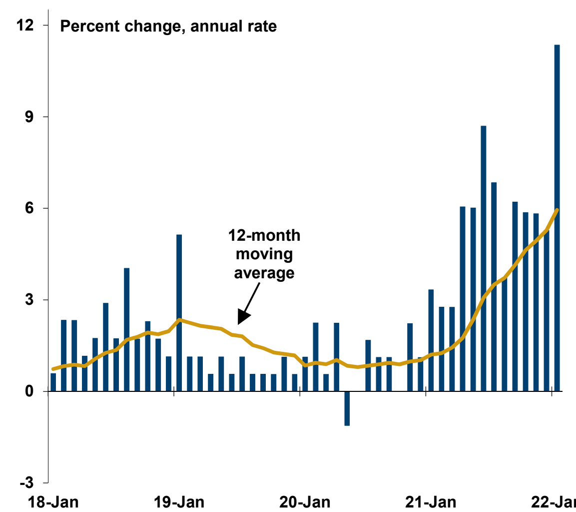
Prices of capital equipment purchased by businesses are now surging. Like construction costs, equipment prices were tame in 2019 and soft in most of 2020, but the pace picked up last year, with the year-over-year increase climbing to 7.4 percent in January (chart, right).

PPI: Final Demand Construction



Source: Bureau of Labor Statistics via Haver Analytics

PPI: Final Demand Private Capital Equipment



Source: Bureau of Labor Statistics via Haver Analytics

The pressure on construction costs and equipment prices also is evident in the GDP price indexes, as these measures for business structures, business equipment, and residential construction have all accelerated. Price indexes for government spending also have surged. Inflation has indeed become broadly based.

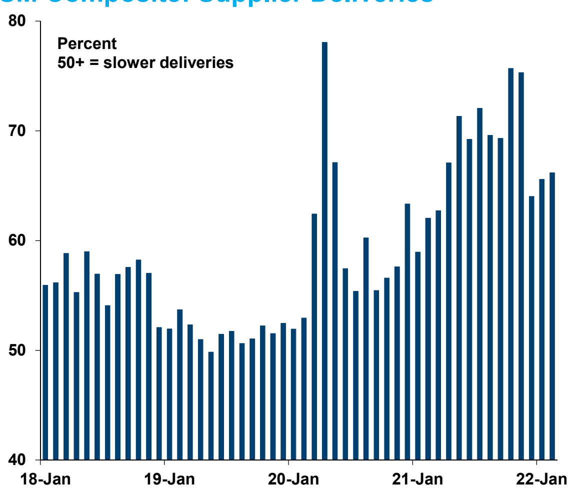
Supply-Side Constraints: Still an Issue

The acceleration in inflation reflects strong demand stirred by aggressive fiscal and monetary policies as well as disruptions to supply chains. The Fed will soon start addressing demand-side causes, while disruptions on the supply side will have to be resolved largely by the private sector. We have seen progress on the supply side, although improvement has been slow and conditions remain far from normal.

The supplier delivery components of the manufacturing and service indexes published by the Institute for Supply Management provide insights, with the reductions from stratospheric readings last year signaling faster delivery times (chart, left). The levels of these measures, though, remain noticeably above historical norms, and they have increased in the past two months. The recent pickups could be viewed as inconsequential statistical noise, but they were still disappointing in that they signaled stalled progress.

The Federal Reserve Bank of New York has constructed a composite measure of supply-side pressures using data on shipping rates and statistics similar to the supplier delivery indexes. This gauge is broad in scope, as it includes 27 indicators and involves global coverage. This measure, which the NY Fed calls the Global Supply Chain Pressure Index, points to the same conclusion as the supplier delivery indexes: a decline from the high in December indicates progress, but the index is still well above historical norms (chart). The unit of measure in this index is the number of standard deviations from the average, and the February reading totaled more than three standard deviations. (Recall from basic statistics that only five percent of observations in a normal distribution are outside plus or minus two standard deviations; observations more than three standard deviations from the mean are true outliers).

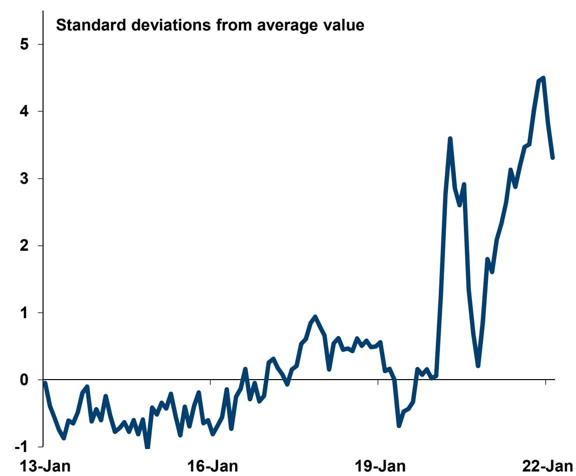
ISM Composite: Supplier Deliveries*



** A weighted average of the supplier deliveries components of the ISM manufacturing and ISM services indexes. Weights are calculated using GDP by industry data.*

Sources: Institute for Supply Management and Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

Global Supply Chain Pressure Index*

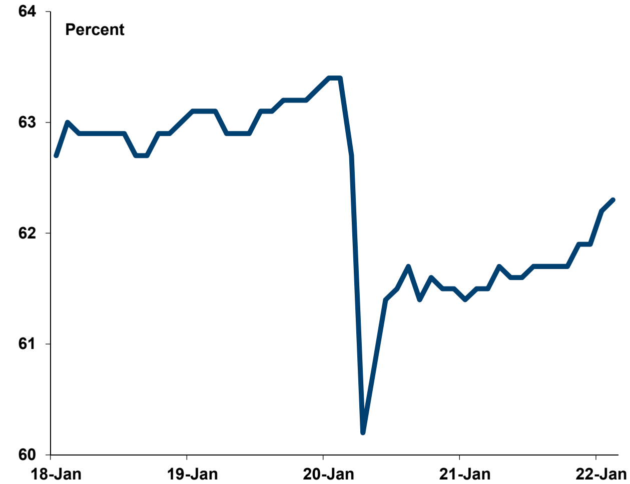


The measure is constructed using 27 variables including: country-specific supply-chain variables from the Euro Area, China, Japan, South Korea, Taiwan, the U.K. and the U.S., global shipping rates and airfreight costs.

Source: Gianluca Benigno, Julian di Giovanni, Jan J. J. Groen, and Adam I. Noble, "Global Supply Chain Pressure Index: March 2022 Update" Federal Reserve Bank of New York Liberty Street Economics, March 3, 2022, https://libertystreeteconomics.newyorkfed.org/2022/03/global-supply-chain-pressure-index-march-2022-update/.

Some of the constraints on the supply side come from the labor market, as many individuals dropped out of the labor force when Covid emerged, and now businesses are facing labor shortages. Here, the news is somewhat more encouraging, as the labor force has posted sizeable increases in recent months, and the labor force participation rate has taken a turn upward. The participation rate had been drifting upward at a painfully slow pace, but it has jumped 0.6 percentage point in the past four months, double the cumulative gain in the prior 16 months. The measure, though, still has ground to cover, as it remains 1.1 percentage points below the pre-pandemic level (chart).

Labor Force Participation Rate



Sources: Bureau of Labor Statistics via Haver Analytics

Review

Week of Feb. 28, 2022	Actual	Consensus	Comments
U.S. International Trade in Goods (January)	**-$107.6 Billion ($7.1 Billion Wider Deficit)**	**-$99.5 Billion ($1.0 Billion Narrower Deficit)**	Both sides of the trade ledger contributed to the sharp widening in the goods trade deficit in January, as imports rose 1.7% and exports fell 1.8%. The performance of imports has been striking in the past three months, as solid advances have led to cumulative growth of 9.0% over the November-January period. Exports have performed well during most of the current expansion, although they have generally not kept pace with imports and they have inched lower in the past three months. While January goods trade is only a piece of the trade puzzle for Q1, the marked widening in the trade deficit sets the stage for a potentially large negative contribution from net exports to GDP growth.
ISM Manufacturing Index (February)	**58.6% (+1.0 Pct. Pt.)**	**58.0% (+0.4 Pct. Pt.)**	The pickup in the ISM index in February followed declines in the prior three months that left a cumulative drop of 3.2 percentage points, leaving the level of the index shy of strong readings seen throughout last year (average of 60.6% in 2021). However, the latest reading still represented a strong showing relative to historical standards. The new orders component led the advance in February with an increase of 3.8 percentage points to 61.7%. The favorable order flow led to a modest gain in the production index (up 0.7 percentage point to 58.5%). The employment index fell 1.6 percentage points to 52.9%, a soft result likely related to difficulty in finding workers. The supplier delivery component rose 1.5 percentage points to 66.1% (increases represent slower deliveries), signaling that supply-chain disruptions remain an issue.
Construction Spending (January)	**1.3%**	**0.1%**	Construction activity in January increased from an upwardly revised level in the prior month. Private nonresidential building led the increase in January (up 1.8%), resuming its upward trend after slipping in the closing months of last year. Private residential activity (up 1.3%) added to its sharp upward trend with its sixth consecutive advance (and 11th in the past 13 months). Public construction contributed with a gain of 0.6%, although the trend has been sideways. The increase in January, while apparently favorable, might not translate to a strong performance in real terms, as the PPI for January showed an increase in construction-related prices of 3.6%.
Revised Nonfarm Productivity (2021-Q4)	**6.6% (Unrevised)**	**6.7% (+0.1 Pct. Pt. Revision)**	Output growth was a touch lighter than initially estimated in Q1 (9.1% rather than 9.2%) but hours worked apparently dipped as well (the report showed no revision at 2.4%, but rounding was undoubtedly an issue). Labor compensation per hour showed an upward revision, with growth now totaling 7.5% rather than 6.9%. The adjustment to compensation per hour led to an upward revision to unit labor costs (0.9% versus 0.3%). This report included benchmark revisions, which showed modest net adjustments: average productivity growth in the past 12 quarters now totals 2.4% rather than 2.3%. Compensation per hour has increased at an average annual rate of 6.2% in the past 12 quarters rather than 5.9%.

Review Continued

Week of Feb. 28, 2022	Actual	Consensus	Comments
ISM Services Index (February)	**56.5% (-3.4 Pct. Pts.)**	**61.1% (+1.2 Pct. Pts.)**	The ISM services index fell for the third consecutive month, with the cumulative changes pushing the index to the low portion of the range from the current expansion. The softness was broadly based among the components, as new orders, business activity, and employment all eased noticeably and moved to the low portions of their recent ranges. The employment index posted the smallest decline at 3.8 percentage points, but it fell below the 50% threshold that separates expansion from contraction. This decline perhaps reflected difficulty in finding workers rather than soft demand. The supplier deliveries index ticked higher (+0.5 percentage point to 66.2%), indicating that supply-chain problems remain an issue.
Factory Orders (January)	**1.4%**	**0.7%**	A jump of 1.6% in durable goods orders (published Feb. 25) was influenced by a surge of 15.6% in civilian aircraft bookings, but orders excluding transportation also posted a sold gain of 0.7% (the 20th advance in the past 21 months). Nondurable bookings rose 1.2%, pushed higher by an increase of 2.8% in the petroleum and coal category. Bookings excluding petroleum and coal also contributed with an increase of 0.8%, the 20th gain in the past 21 months. Higher prices have most likely played a role in recent nominal increases for both durable and nondurable goods.
Payroll Employment (February)	**678,000**	**423,000**	Nonfarm payroll growth in February easily beat the average of 559,000 in the prior 12 months. In addition, upward revisions of 92,000 added to the firm tone of the report. The unemployment rate declined 0.2 percentage point to 3.8%. The change reflected a jump of 548,000 in employment as measured by the household survey that exceeded the increase of 304,000 in the size of the labor force. The increase in the labor force was not overwhelming, but it was solid and it followed a surge of 1.4 million in the prior month. The latest results have quickened what had been a mild upward drift in the labor force participation rate. Average hourly earnings were unchanged in February, but the flat reading followed a large increase in January (up 0.6%). Even with no month-to-month change in February, the year-over-year increase in average hourly earnings totaled 5.1%.

Sources: U.S. Census Bureau (U.S. International Trade in Goods, Construction Spending, Factory Orders); Institute for Supply Management (ISM Manufacturing Index, ISM Services Index); Bureau of Labor Statistics (Revised Nonfarm Productivity, Payroll Employment); Consensus forecasts are from Bloomberg

Preview

Week of March 7, 2022	Projected	Comments
Trade Balance (January) (Tuesday)	**-\$89.5 Billion (\$8.8 Billion Wider Deficit)**	The January trade report is likely to be dominated by the already reported widening of \$7.2 billion in the goods trade deficit. The surplus in services has improved since the summer, but possible cooling in travel and tourism because of Omicron could constrain results in January.
CPI (February) (Thursday)	**0.7% Total, 0.5% Core**	Available quotes suggest that energy prices jumped in February after increases slowed around the turn of the year (energy prices rose 2.3% on average in the first 11 months of 2021 before advancing 0.9% in both December and January). Food prices also appear likely to remain under pressure (food prices increased 0.7% per month in the second half of 2021 and 0.9% in January). In the core component, strong demand and continued supply disruptions are likely to contribute to price pressure. In addition, increases in residential rents have quickened in recent months.
Federal Budget (February) (Thursday)	**-\$225.0 Billion**	Year-over-year growth in federal revenues slowed sharply from the recent performance (4.0% expected versus advances ranging from 19% to 41% per month from August thru January). Gross tax collections remained firm, but refunds increased sharply from last February. Outlays have eased substantially from lofty levels during the worst of the pandemic, but they remain elevated relative to historical norms. If the forecast is realized, the deficit for the first five months of FY2022 would total \$484 billion, down from \$1.05 trillion in the same period in FY2021.
Consumer Sentiment (March) (Friday)	**62.0 (-1.3%)**	Surging gasoline prices and rising prices of groceries, along with a barrage of negative headlines about war in the Ukraine, suggest that consumer sentiment will register its seventh reading in the past eight months below the recession low of 71.8 in April 2020.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

February / March 2022

Monday	Tuesday	Wednesday	Thursday	Friday
28	1	2	3	4
U.S. INTERNATIONAL TRADE IN GOODS Nov -$97.3 billion Dec -$100.5 billion Jan -$107.6 billion **ADVANCE INVENTORIES** Wholesale / Retail Nov 1.7% 2.0% Dec 2.3% 4.7% Jan 0.8% 1.9% **MNI CHICAGO BUSINESS BAROMETER INDEX** Index / Prices Dec 64.3 90.9 Jan 65.2 89.0 Feb 56.3 86.5	**ISM INDEX** Index / Prices Dec 58.8 68.2 Jan 57.6 76.1 Feb 58.6 75.6 **CONSTRUCTION SPEND.** Nov 1.0% Dec 0.8% Jan 1.3% **VEHICLE SALES** Dec 12.5 million Jan 15.0 million Feb 14.1 million	**ADP EMPLOYMENT REPORT** Private Payrolls Dec 780,000 Jan 509,000 Feb 475,000 **CHAIR POWELL'S MONETARY POLICY TESTIMONY (HOUSE)** **MARCH BEIGE BOOK** "Economic activity has expanded at a modest to moderate pace since mid-January."	**UNEMPLOYMENT CLAIMS** Initial / Continuing (Millions) Feb 05 0.225 1.589 Feb 12 0.249 1.474 Feb 19 0.233 1.476 Feb 25 0.215 N/A **REVISED PRODUCTIVITY & COSTS** Productivity / Unit Labor Costs 21-Q3 -3.9% 10.6% 21-Q4(p) 6.6% 0.3% 21-Q4(r) 6.6% 0.9% **ISM SERVICES INDEX** Index / Prices Dec 62.3 83.9 Jan 59.9 82.3 Feb 56.5 83.1 **FACTORY ORDERS** Nov 1.8% Dec 0.7% Jan 1.4% **CHAIR POWELL'S MONETARY POLICY TESTIMONY (SENATE)**	**EMPLOYMENT REPORT** Payrolls / Un. Rate Dec 588,000 3.9% Jan 481,000 4.0% Feb 678,000 3.8%
7	8	9	10	11
CONSUMER CREDIT (3:00) Nov $38.8 billion Dec $18.9 billion Jan --	**NFIB SMALL BUSINESS OPTIMISM INDEX (6:00)** Dec 98.9 Jan 97.1 Feb -- **TRADE BALANCE (8:30)** Nov -$79.3 billion Dec -$80.7 billion **Jan -$89.5 billion** **WHOLESALE TRADE (10:00)** Inventories / Sales Nov 1.7% 1.7% Dec 2.3% 0.2% **Jan 0.8% 1.0%**	**JOLTS DATA (10:00)** Openings (000) / Quit Rate Nov 10,775 3.0% Dec 10,925 2.9% Jan -- --	**INITIAL CLAIMS (8:30)** **CPI (8:30)** Total / Core Dec 0.6% 0.6% Jan 0.6% 0.6% **Feb 0.7% 0.5%** **FEDERAL BUDGET (2:00)** FY2022 / FY2021 Dec -$21.3B -$143.6B Jan $118.7B -$162.8B **Feb -$225.0B** -$310.9B	**CONSUMER SENTIMENT (10:00)** Jan 67.2 Feb 62.8 **Mar 62.0**
14	15	16	17	18
	PPI **EMPIRE MFG INDEX** **TIC DATA** **FOMC MEETING**	**RETAIL SALES** **IMPORT/EXPORT PRICES** **BUSINESS INVENTORIES** **NAHB HOUSING INDEX** **FOMC DECISION**	**INITIAL CLAIMS** **HOUSING STARTS** **PHILY FED INDEX** **IP & CAP-U**	**EXISTING HOME SALES** **LEADING INDICATORS**
21	22	23	24	25
CHICAGO FED NATIONAL ACTIVITY INDEX		**NEW HOME SALES**	**INITIAL CLAIMS** **CURRENT ACCOUNT** **DURABLE GOODS ORDERS**	**PENDING HOME SALES** **REVISED CONSUMER SENTIMENT**

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

Treasury Financing

February / March 2022

Monday	Tuesday	Wednesday	Thursday	Friday
28	1	2	3	4
AUCTION RESULTS: Rate Cover 13-week bills 0.360% 2.85 26-week bills 0.670% 3.12 **SETTLE:** $19 billion 20-year bonds $9 billion 30-year TIPS $52 billion 2-year notes $53 billion 5-year notes $50 billion 7-year notes	**ANNOUNCE:** $45 billion 4-week bills for auction on March 3 $35 billion 8-week bills for auction on March 3 $35 billion 17-week CMBs for auction on March 2 **SETTLE:** $45 billion 4-week bills $35 billion 8-week bills $35 billion 17-week CMBs	**AUCTION RESULTS:** Rate Cover 17-week CMB 0.535% 4.20	**AUCTION RESULTS:** Rate Cover 4-week bills 0.165% 2.48 8-week bills 0.205% 3.69 **ANNOUNCE:** $111 billion 13-,26-week bills for auction on March 7 $48 billion 3-year notes for auction on March 8 $34 billion 10-year notes for auction on March 9 $20 billion 30-year bonds for auction on March 10 **SETTLE:** $111 billion 13-,26-week bills	
7	8	9	10	11
AUCTION: $111 billion 13-,26-week bills	**AUCTION:** $48 billion 3-year notes **ANNOUNCE:** $45 billion* 4-week bills for auction on March 10 $35 billion* 8-week bills for auction on March 10 $35 billion* 17-week CMBs for auction on March 9 **SETTLE:** $45 billion 4-week bills $35 billion 8-week bills $35 billion 17-week CMBs	**AUCTION:** $34 billion 10-year notes $35 billion* 17-week CMBs	**AUCTION:** $45 billion* 4-week bills $35 billion* 8-week bills $20 billion 30-year bonds **ANNOUNCE:** $111 billion* 13-,26-week bills for auction on March 14 **SETTLE:** $111 billion 13-,26-week bills	
14	15	16	17	18
AUCTION: $111 billion* 13-,26-week bills	**ANNOUNCE:** $45 billion* 4-week bills for auction on March 17 $35 billion* 8-week bills for auction on March 17 $35 billion* 17-week CMBs for auction on March 16 **SETTLE:** $45 billion* 4-week bills $35 billion* 8-week bills $35 billion* 17-week CMBs $48 billion 3-year notes $34 billion 10-year notes $20 billion 30-year bonds	**AUCTION:** $35 billion* 17-week CMBs	**AUCTION:** $45 billion* 4-week bills $35 billion* 8-week bills **ANNOUNCE:** $111 billion* 13-,26-week bills for auction on March 21 $34 billion* 52-week bills for auction on March 22 $22 billion* 2-year FRNs for auction on March 23 $16 billion* 20-year bonds for auction on March 23 $14 billion* 10-year TIPS for auction on March 24 **SETTLE:** $111 billion* 13-,26-week bills	
21	22	23	24	25
AUCTION: $111 billion* 13-,26-week bills	**AUCTION:** $34 billion* 52-week bills **ANNOUNCE:** $45 billion* 4-week bills for auction on March 24 $35 billion* 8-week bills for auction on March 24 $35 billion* 17-week CMBs for auction on March 23 **SETTLE:** $45 billion* 4-week bills $35 billion* 8-week bills $35 billion* 17-week CMBs	**AUCTION:** $22 billion* 2-year FRNs $16 billion* 20-year bonds $35 billion* 17-week CMBs	**AUCTION:** $45 billion* 4-week bills $35 billion* 8-week bills $14 billion* 10-year TIPS **ANNOUNCE:** $111 billion* 13-,26-week bills for auction on March 28 $50 billion* 2-year notes for auction on March 28 $51 billion* 5-year notes for auction on March 28 $47 billion* 7-year notes for auction on March 29 **SETTLE:** $111 billion* 13-,26-week bills $34 billion* 52-week bills	**SETTLE:** $22 billion* 2-year FRNs

**Estimate*