Daiwa Capital Markets

U.S. Economic Comment

- Forecast update: avoiding recession

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US Economy: Likely to Remain on Track

We were hoping to avoid making a revision to our late-2021 economic forecast until some of the uncertainty that has entered the picture fades. However, we have received numerous questions regarding the outlook, and thus we cannot avoid the issue. We would not have great confidence in any set of numbers that might be put together at this time; indeed, forecast revisions will probably be a common occurrence for all forecasters over the balance of the year. However, we feel comfortable in arguing that the U.S. economy will avoid a recession this year and next.

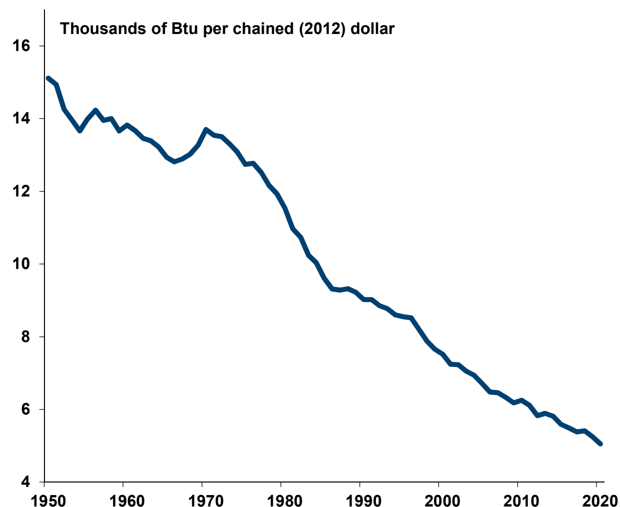
Economic growth undoubtedly will slow, as fallout from the Russia-Ukraine conflict in the form of high energy prices and shortages of key raw materials will constrain activity. In addition, the tightening of monetary policy by the Federal Reserve (likely aggressive) will be a drag as well. Finally, Covid has been pushed to the background by other recent developments, but it has not disappeared as a risk factor. Our new set of projections shows GDP growth of approximately 2.0 percent, down from 3.0 percent envisioned late last year. We are expecting growth of 1.5 percent in 2023, down from a view of 2.5 percent previously (table, p. 3).

The Bright Side

The challenges are notable, but the U.S. also has a lot working in its favor. Perhaps most important, the economy is currently in a strong position and can absorb some shocks. Real GDP in the fourth quarter was comfortably above its pre-pandemic level and only slightly below an extrapolation of the pre-pandemic trend. Before the Russian invasion, we were looking for GDP to move above the pre-pandemic extrapolation. In addition, the labor market is strong, and given the elevated number of job openings, payroll growth seems likely to be well maintained despite an easing in economic growth.

The recent jump in energy prices is the most immediate constraint on growth, but we do not view the surge thus far as especially daunting. Earlier shocks stirred efforts by individuals and businesses to improve energy efficiency, and the U.S. has made great progress, as energy usage per dollar of GDP has tumbled over the past several decades and is now less than 40 percent of the total at the time of the first oil shock in the early 1970s (chart). In addition, the current price shock is not especially jarring, as we have been here before. The price of crude oil was close to current readings from 2011 to 2014, and the economy continued to move forward in that cycle. Activity hesitated with dips in a few quarters, but year-over-year growth was in positive territory throughout.

Primary Energy Consumption*



** Total energy usage per dollar of real GDP. Energy usage is measured in terms of British thermal units.*

Source: Energy Information Administration via Haver Analytics

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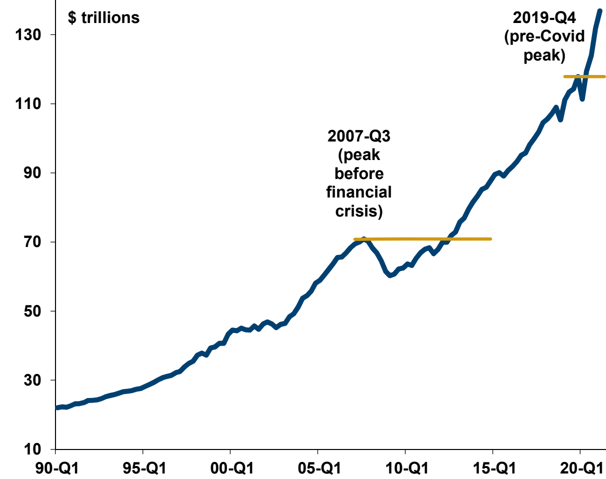
The household sector dealt with elevated energy prices in the 2011-14 episode, and it should have an easier time coping with the current episode, as its financial position is much stronger than it was then. The economy was recovering from the financial crisis in the prior cycle, and balance sheets were strained by depressed home values and losses in the equity market. The net worth of the household sector did not return to its pre-crisis peak until 2012-Q3, five years after problems emerged (chart). Today, elevated home prices and equity values have bolstered financial positions, and households have accumulated a large pool of excess savings during the pandemic (i.e. savings above what might have been amassed in the absence of the pandemic), leaving many households financially flush.

Household Net Worth

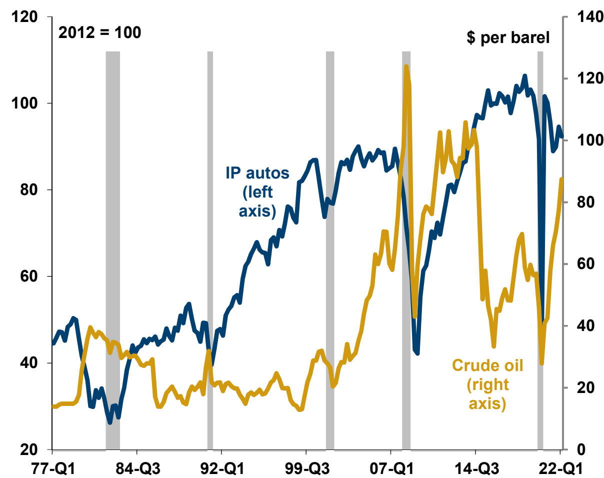


Source: Financial Accounts of the United States, Federal Reserve Board via Haver Analytics

Developments in the auto industry also lead us to suspect that the current experience with high oil prices will be different than in the past. In previous episodes, much of the easing in consumer spending involved reductions in outlays for motor vehicles, either because individuals were driving less or because the industry could not easily shift to more fuel-efficient vehicles desired by potential buyers (chart, left). In the current instance, the auto industry has already cut production because of limited availability of semiconductors, which has left a supply-demand imbalance that has pushed prices notably higher. A reduction in demand for motor vehicles at this time would represent a welcome development, as it would leave a better supply-demand balance and ease some of the upward pressure on the prices of new cars and light trucks.

A final factor that could limit the constraining influence of high energy prices involves oil production. Because of technological advances in hydraulic fracturing (fracking) the U.S. is now a major oil producer, with daily output more than double the volume only 10 years ago (chart. right). Higher prices will benefit this sector

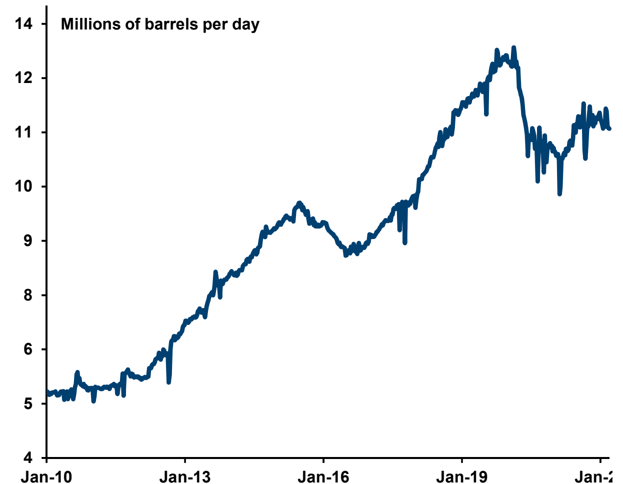
Industrial Prod. (Autos & Parts) & Oil Prices*



** The observations for industrial production and crude oil prices for 2022-Q1 are averages of monthly data for January and February. The shaded areas indicate periods of recession in the United States.*

Sources: Energy Information Administration, Federal Reserve Board, and the National Bureau of Economic Research via Haver Analytics

Crude Oil Production



Source: Energy Information Administration via Haver Analytics

of the economy, offsetting a portion of the softening influence in other areas. Oil production also alters the trade picture, as the U.S. now has only a modest trade deficit in petroleum products, which essentially eliminates a transfer of purchasing power from the U.S. to other nations that accompanied higher prices in the past.

Policy Risks

We are hopeful that the U.S. will weather the energy-price storm, but it also must contend with tighter monetary policy. This, of course, heightens downside risks, especially because recent signals from the Fed suggest that officials plan to be aggressive in removing accommodation. The latest dot plot from the Federal Open Market Committee indicated several rate hikes this year and next, which would leave monetary policy in a restrictive stance next year. In addition, the Fed could be moving quickly, as the latest speech by Chair Powell raised the prospect of a 50-basis-point rate hike at the FOMC meeting in May. In fact, we viewed the speech as an effort to prepare market participants for a 50-basis-point shift, just as his monetary policy testimony prepared the market for liftoff this month.

The recent flow of information from the Federal Reserve, including the Summary of Economic Projections, the testimony of Chair Powell, and the public comments of other Fed officials, have given us the sense that the priorities of policymakers have changed. Previously, Fed officials were focused on containing damage from the pandemic and promoting diverse gains in the labor market; now, they seem intent on corralling inflation. The Summary of Economic Projections does not show a meaningful increase in unemployment, but we sense that officials will tolerate a pickup in joblessness in order to get inflation under control.

Despite the potential for a downside policy mistake, we still tilt on the optimistic side because of the starting point. The economy has a strong foundation and monetary policy is currently highly accommodative. Thus, the Fed has considerable room to raise rates before tighter financial conditions begin to bite meaningfully. Given this cushion, policymakers should be able to sense that economic conditions are softening before the damage becomes extensive. To be sure, soft landings are difficult, but the Fed has a chance to achieve one in this cycle.

U.S. Economic Outlook

(Percent change annual rate, unless otherwise noted)

		2022				2023			
Item		**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**
1	Gross Domestic Product	0.8	2.7	2.6	2.1	1.7	1.7	1.4	1.0
2	Personal Consumption Expenditures	3.0	2.7	2.5	2.0	1.8	1.6	1.3	1.0
3	Business Fixed Investment	7.5	2.9	3.1	3.2	2.7	2.7	2.5	2.2
4	Residential Construction	6.0	2.0	0.0	-1.0	-2.0	-3.0	-5.0	-6.0
5	Change in Business Inventories *(Contribution to growth)*	-1.3	0.4	0.0	-0.2	-0.4	-0.3	-0.3	-0.4
6	Government Spending	0.8	2.3	3.0	3.0	2.9	2.9	2.7	2.7
7	Net Exports *(Contribution to growth)*	-1.3	-0.4	0.0	0.0	0.1	0.2	0.2	0.2
	Inflation and Unemployment								
8	Core PCE Price Index *(Annual rate)*	5.9	4.5	4.3	4.0	3.8	3.3	3.1	2.9
9	Unemployment Rate	3.9	3.8	3.7	3.7	3.8	3.9	4.0	4.2
	Interest Rates (End of Period)								
10	Federal Funds Target (midpoint)	0.38	1.13	1.63	2.13	2.38	2.88	3.13	3.38
11	2-year Treasury	2.20	2.60	2.90	3.10	3.20	3.50	3.60	3.70
12	10-year Treasury	2.35	2.75	3.00	3.20	3.25	3.55	3.60	3.70
13	30-year Fixed-Rate Mortgages	4.15	4.70	4.95	5.20	5.25	5.40	5.45	5.60

Source: Daiwa Capital Markets America

Review

Week of March 21, 2022	Actual	Consensus	Comments
New Home Sales (February)	**0.772 Million (-2.0%)**	**0.810 Million (+1.1%)**	The decline in new home sales in February marked the second consecutive retreat, cutting short a brief rally in late 2021 and suggesting that elevated prices and higher interest rates weighed on activity in early 2022. Sales in February were below the elevated readings in the second half of 2020 and first quarter of 2021 (932,000 average per month over the nine-month span), but they were comfortably above all readings in the prior expansion. With the slowing in sales, the months' supply of homes available for sale rose to 6.3 months from 6.1, a reading in line with historical norms and one that signals less of a strain than conditions in the market for existing homes, where the months' supply is at the bottom of the historical range (1.7 months).
Current Account (2021-Q4)	**$217.9 Billion Deficit ($2.0 Billion Narrower Deficit)**	**$218.0 Billion Deficit ($3.2 Billion Wider Deficit)**	The current account deficit narrowed slightly in Q4, but the improvement occurred from downward revised results in the prior quarter (a deficit of $219.9 billion versus a first-reported shortfall of $214.8 billion). The trade portion of the current account deficit widened in the fourth quarter, but this slippage was more than offset by an improvement in income flows.
Durable Goods Orders (February)	**-2.2%**	**-0.6%**	A portion of the soft headline result for durable goods orders in February reflected a drop of 30.4% in bookings for commercial aircraft, but the result was not particularly troubling as large changes are common in this volatile area and the retreat followed strong results in the prior three months. Orders excluding transportation slipped 0.6%, with real activity probably falling by a larger amount (this is a nominal report, and recent results likely have been inflated by higher prices). Orders for nondefense capital goods excluding aircraft, which provide insight into capital spending plans by businesses, declined for only the second time in the past 22 months (off 0.3%). Shipments of nondefense capital goods ex-aircraft rose 0.5% after a jump of 2.1% in January. The solid results in the first two months of the year suggest that capital spending in the GDP accounts will be strong in Q1.
Revised Consumer Sentiment (March)	**59.4 (-0.5 Pct. Pt. Revision)**	**59.7 (Unrevised)**	Consumer sentiment in late March was nudged lower from an already weak preliminary tally. Elevated prices of groceries and gasoline seem to have soured moods. The preliminary tally was the seventh in the past eight months below the recession low 71.8 in April 2020, and it was the lowest of the current expansion thus far.

Sources: U.S. Census Bureau (New Home Sales, Durable Goods Orders); Bureau of Economic Analysis (Current Account); University of Michigan Survey Research Center (Revised Consumer Sentiment); Consensus forecasts are from Bloomberg

Preview

Week of March 28, 2022	Projected	Comments
U.S. International Trade in Goods (February) (Monday)	**-$105.0 Billion ($2.6 Billion Narrower Deficit)**	Exports of goods are likely to continue the modest upward drift that has been evident throughout the year, while imports could pause after vigorous growth in the prior three months (average advance of 2.9%).
Conference Board Consumer Confidence (March) (Tuesday)	**108.0 (-2.3%)**	Jumps in prices of gasoline and groceries are likely to dampen consumer confidence in March, a view supported by a sizeable drop in the University of Michigan sentiment index.
Revised GDP (2021-Q4) (Wednesday)	**7.0% (Unrevised)**	Although components may shift modestly, the final estimate (2nd revision) of GDP growth is often close to prior estimates. This is likely to be the case with the 21-Q4 results, with inventory investment remaining the primary driver of activity.
Personal Income, Consumption, Core PCE Price Index (February) (Thursday)	**0.5%, 0.4%, 0.4%**	A brisk increase in average hourly earnings and strong job growth suggest a firm advance in wages and salaries. On the outlay side, a decline in new vehicle sales suggests sluggish spending on durable goods and a modest increase in retail activity implies tepid spending on nondurable items. Results for the CPI suggest brisk increases for both the headline and core price indexes for personal consumption expenditures.
Payroll Employment (March) (Friday)	**500,000**	Although payroll growth in March is likely to ease from the surge of 678k in February, strong demand for labor should support hiring close to the 556k average in the past 12 months. Employment growth reported by the household survey also is likely to be strong, but an increase in the labor force could provide an offset and leave the unemployment rate unchanged at 3.8%.
ISM Manufacturing Index (March) (Friday)	**58.0 (-0.6 Pct. Pt.)**	The manufacturing sector has held up well despite headwinds from supply-chain disruptions and Omicron, raising the prospect of a solid showing for the ISM index in March. However, elevated readings on the orders and production components in February raise the prospect of some cooling in the latest month.
Construction Spending (February) (Friday)	**0.8%**	A strong performance in housing starts in recent months points to private residential construction adding to its upward trend in February (average gain of 1.1% in the past 12 months). Private nonresidential building started to stir in the second half of 2021 and early 2022 (average gain of 1.2% in the past six months), although much of the recent gain probably reflects higher prices.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

March/April 2022

Monday 21

CHICAGO FED NATIONAL ACTIVITY INDEX

	Monthly	3-Mo. Avg.
Dec	-0.04	0.44
Jan	0.59	0.37
Feb	0.51	0.35

Tuesday 22

Wednesday 23

NEW HOME SALES

Dec	0.860 million
Jan	0.788 million
Feb	0.772 million

Thursday 24

UNEMPLOYMENT CLAIMS

	Initial	Continuing (Millions)
Feb 26	0.216	1.490
Mar 05	0.229	1.417
Mar 12	0.215	1.350
Mar 19	0.187	N/A

CURRENT ACCOUNT

21-Q2	-$196.4 bill.
21-Q3	-$219.9 bill.
21-Q4	-$217.9 bill.

DURABLE GOODS ORDERS

Dec	1.2%
Jan	1.6%
Feb	-2.2%

Friday 25

PENDING HOME SALES

Dec	-2.3%
Jan	-5.8%
Feb	-4.1%

REVISED CONSUMER SENTIMENT

Jan	67.2
Feb	62.8
Mar(p)	59.7
Mar(r)	59.4

Monday 28

U.S. INTERNATIONAL TRADE IN GOODS (8:30)

Dec	-$100.5 billion
Jan	-$107.6 billion
Feb	**-$105.0 billion**

ADVANCE INVENTORIES (8:30)

	Wholesale	Retail
Dec	2.6%	4.7%
Jan	0.8%	2.0%
Feb	--	--

Tuesday 29

FHFA HOME PRICE INDEX (9:00)

Nov	1.2%
Dec	1.2%
Jan	--

S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX (9:00)

	SA	NSA
Nov	1.2%	1.0%
Dec	1.5%	1.1%
Jan	--	--

CONFERENCE BOARD CONSUMER CONFIDENCE (10:00)

Jan	111.1
Feb	110.5
Mar	**108.0**

JOLTS DATA (10:00)

	Openings (000)	Quit Rate
Dec	11,448	3.0%
Jan	11,263	2.8%
Feb	--	--

Wednesday 30

ADP EMPLOYMENT REPORT (8:15)

	Private Payrolls
Jan	509,000
Feb	475,000
Mar	--

REVISED GDP (8:30)

	GDP	Chained Price
21-Q3	2.3%	6.0%
21-Q4(p)	7.0%	7.1%
21-Q4(r)	**7.0%**	**7.1%**

Thursday 31

INITIAL CLAIMS (8:30)

PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX (8:30)

	Inc.	Cons.	Core
Dec	0.4%	-0.8%	0.5%
Jan	0.0%	2.1%	0.5%
Feb	**0.5%**	**0.4%**	**0.4%**

MNI CHICAGO BUSINESS BAROMETER INDEX (9:45)

	Index	Prices
Jan	65.2	89.0
Feb	56.3	86.5
Mar	--	--

Friday 1

EMPLOYMENT REPORT (8:30)

	Payrolls	Un. Rate
Jan	481,000	4.0%
Feb	678,000	3.8%
Mar	**500,000**	**3.8%**

ISM INDEX (10:00)

	Index	Prices
Jan	57.8	76.1
Feb	58.6	75.6
Mar	**58.0**	**80.0**

CONSTRUCTION SPEND. (10:00)

Dec	0.8%
Jan	1.3%
Feb	**0.8%**

VEHICLE SALES

Jan	15.0 million
Feb	14.1 million
Mar	**13.9 million**

Upcoming

Monday	Tuesday	Wednesday	Thursday	Friday
4	5	6	7	8
FACTORY ORDERS	TRADE BALANCE ISM SERVICES INDEX	FOMC MINUTES	INITIAL CLAIMS CONSUMER CREDIT	WHOLESALE TRADE
11	12	13	14	15
	NFIB SMALL BUSINESS OPTIMISM INDEX CPI FEDERAL BUDGET	PPI	INITIAL CLAIMS RETAIL SALES IMPORT/EXPORT PRICES CONSUMER SENTIMENT BUSINESS INVENTORIES	EMPIRE MFG INDEX IP & CAP-U TIC DATA

Forecasts in Bold. *(p) = preliminary (2nd estimate of GDP); (r) = revised (3rd estimate of GDP)*

Treasury Financing

March/April 2022

Monday	Tuesday	Wednesday	Thursday	Friday
21	22	23	24	25
AUCTION RESULTS: Rate Cover 13-week bills 0.480% 2.60 26-week bills 0.870% 3.17	**AUCTION RESULTS:** Rate Cover 52-week bills 1.590% 3.29 **ANNOUNCE:** $35 billion 4-week bills for auction on March 24 $30 billion 8-week bills for auction on March 24 $30 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 RESULTS:** Margin Cover 2-year FRN -0.055% 3.75 Rate Cover 20-yr bonds 2.651% 2.72 17-week CMB 0.710% 3.65	**AUCTION RESULTS:** Rate Cover 4-week bills 0.135% 2.93 8-week bills 0.300% 2.99 10-yr TIPS -0.589% 2.43 **ANNOUNCE:** $105 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:** $105 billion 13-,26-week bills	**SETTLE:** $22 billion 2-year FRNs
28	29	30	31	1
28 **AUCTION:** $105 billion 13-,26-week bills $50 billion 2-year notes $51 billion 5-year notes	**AUCTION:** $47 billion 7-year notes **ANNOUNCE:** $35 billion* 4-week bills for auction on March 31 $30 billion* 8-week bills for auction on March 31 $30 billion* 17-week CMBs for auction on March 30 **SETTLE:** $35 billion 4-week bills $30 billion 8-week bills $30 billion 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs	**AUCTION:** $35 billion* 4-week bills $30 billion* 8-week bills **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on April 4 **SETTLE:** $105 billion* 13-,26-week bills $16 billion 20-year bonds $14 billion 10-year TIPS $50 billion 2-year notes $51 billion 5-year notes $47 billion 7-year notes	
4	5	6	7	8
AUCTION: $105 billion* 13-,26-week bills	**ANNOUNCE:** $35 billion* 4-week bills for auction on April 7 $30 billion* 8-week bills for auction on April 7 $30 billion* 17-week CMBs for auction on April 6 **SETTLE:** $35 billion* 4-week bills $30 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs	**AUCTION:** $35 billion* 4-week bills $30 billion* 8-week bills **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on April 11 $46 billion* 3-year notes for auction on April 11 $34 billion* 10-year notes for auction on April 12 $20 billion* 30-year bonds for auction on April 13 **SETTLE:** $105 billion* 13-,26-week bills	
11	12	13	14	15
AUCTION: $105 billion* 13-,26-week bills $46 billion* 3-year notes	**AUCTION:** $34 billion* 10-year notes **ANNOUNCE:** $35 billion* 4-week bills for auction on April 14 $30 billion* 8-week bills for auction on April 14 $30 billion* 17-week CMBs for auction on April 13 **SETTLE:** $35 billion* 4-week bills $30 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs $20 billion* 30-year bonds	**AUCTION:** $35 billion* 4-week bills $30 billion* 8-week bills **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on April 18 $34 billion* 52-week bills for auction on April 19 $16 billion* 20-year bonds for auction on April 20 $20 billion* 5-year TIPS for auction on April 21 **SETTLE:** $105 billion* 13-,26-week bills	

**Estimate*