U.S. Economic Comment

- Labor market: individuals are entering the labor market, and finding jobs
- 10-year/2-year yield spread: recession signal or benign?
- Corporate profits: little growth in Q4, but still impressive

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The Labor Market

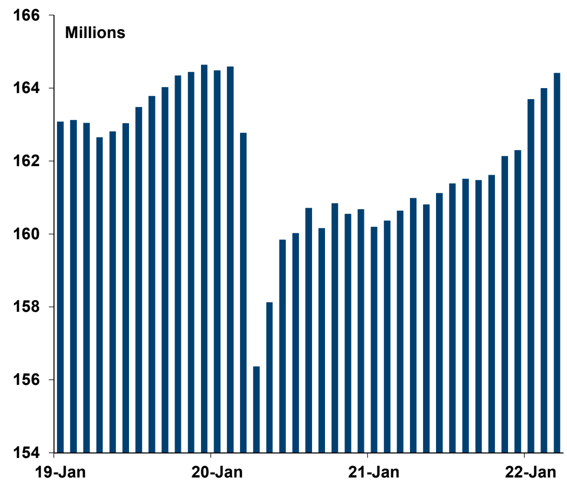
The figures on nonfarm payrolls from the monthly employment report usually capture the attention of market participants, and those results for March were favorable, with job growth totaling 431,000 and figures in the prior two months showing upward revisions of 95,000. A separate set of statistics from the report based on a survey of households also merits attention, as it has shown striking results on job growth in recent months: an average monthly gain of 761,000 since last July, including an advance of 736,000 in March.

We typically interpret results from the household survey cautiously because the figures tend to be volatile from month-to-month. However, the persistence of strength in employment leads us to wonder if the payroll figures are undercounting jobs. Perhaps the labor market is even stronger than suggested by average payroll growth of 541,000 in the past 12 months.

The results from the household survey also are notable because of impressive growth in the size of the labor force in recent months. Many individuals dropped out of the labor force during the worst of the pandemic, and they have been slow to return. However, the pace of new entrants or reentrants has picked up recently, with the average gain totaling 560,000 in the past five months, a remarkable improvement from the average of 65,000 in the 12 months before the recent burst. The size of the labor force is now almost back to the pre-pandemic peak in December 2019 (only 224,000 shy; chart, left).

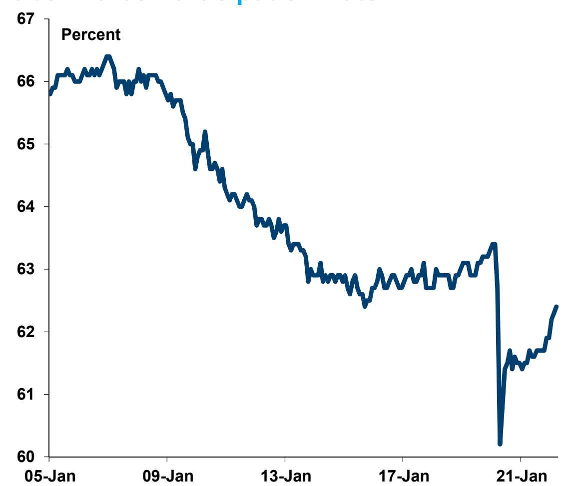
The population also has been growing, so the labor force participation rate has been slower to advance than the labor force itself. Still, it has shown notable improvement in recent months, increasing 0.7 percentage point in the past five months to 62.4 percent. This measure had been showing only the slightest of upward drifts during most of 2020 and 2021 (chart, right).

Civilian Labor Force



Source: Bureau of Labor Statistics via Haver Analytics

Labor Force Participation Rate



Source: Bureau of Labor Statistics via Haver Analytics

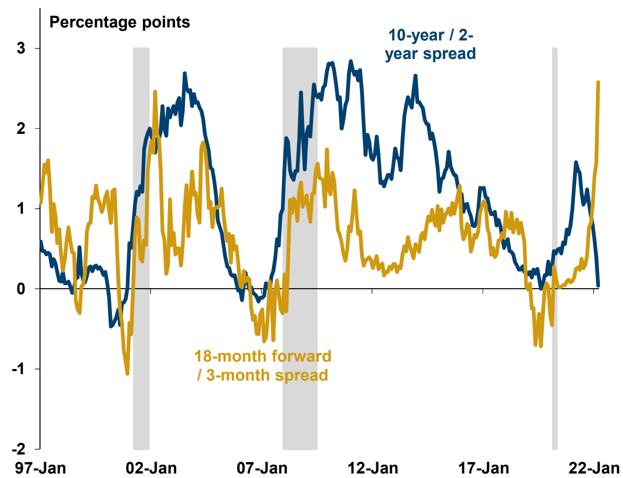
The Yield Curve

The intention of the Federal Reserve to aggressively tighten monetary policy has led to notable shifts in interest rates, with the 2-year Treasury rate climbing more than 200 basis points since September, when serious thoughts of tighter monetary policy emerged. The yield on 10-year Treasury securities has climbed approximately 100 basis points over this span, which has left the 10-year/2-year yield spread slightly inverted (-0.06 percent Friday afternoon).

An inverted yield curve is viewed by most market participants as a reliable indicator of a looming recession, and thus the recent readings have many observers concerned. However, Chair Powell noted in his recent press briefing that yield spreads in the short end of the maturity spectrum have provided more reliable signals of recession risks than the 10-2 spread has, and such measures, he noted, are suggesting minimal risk.

A new research paper by the staff of the Federal Reserve Board added substance to Mr. Powell's vague comments (Engstrom, Eric C., and Steven A. Sharpe (2022). "(Don't Fear) The Yield Curve, Reprise," FEDS Notes. Washington: Board of Governors of the Federal Reserve System, March 25, 2022, https://doi.org/10.17016/2380-7172.3099.) This paper highlighted the spread between the 18-month forward rate and the current rate on 3-month Treasury bills (that is, the expected 3-month bill rate 18 months from now less the current 3-month rate). The authors offer statistical evidence that this measure provides more accurate reads on the likelihood of recession, and as Mr. Powell indicated, this spread has widened recently, suggesting minimal recession risks if not a favorable economic outlook (chart).

Yield Curves*



** The blue line shows the spread between the 10-year and 2-year Treasury rates. The gold line shows the spread between the 18-month forward 3-month rate and the current 3-month Treasury bill rate. Monthly end-of-period data, except for the March observations, which are Friday quotes. The shaded areas indicate periods of recession in the United States.*

Sources: Federal Reserve Board and The National Bureau of Economic Research via Haver Analytics; Bloomberg; Daiwa Capital Markets America

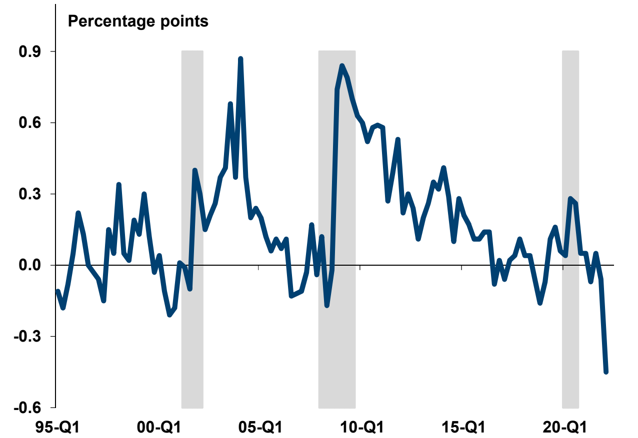
These indicators in the past have usually sent similar signals of recession risks; their divergence in this instance is curious. We suspect the expected path of monetary policy is playing a role in boosting the short-term spread favored by Mr. Powell. Monetary policy remains highly accommodative despite the rate hike in March; thus, the current 3-month rate is still low. At the same time, the latest dot plot suggests that Fed officials plan to move aggressively this year and next; thus, the expected rate 18 months from now is elevated, leaving a wide spread. The failure of the measure to signal recession seems to be the result of the low starting point for short-term interest rates. Given the low current level of interest rates, the policy path suggested by the dot plot would still not put the Fed in a restrictive stance 18 months from now. Thus, no recession signal.

We believe inflation expectations are helping to contain the 10-year 2-year rate spread. Various surveys and market-based measures indicate that the public expects the current inflation rate to persist for a few years, but to subside down the road and to return to the contained rate seen in the 20 years before the recent burst. The divergence between the near-term and long-term inflation views is unusually wide. For example, the University of Michigan survey of consumers in recent months has shown expected inflation of approximately 5.0 percent over the next year versus 3.0 percent six to 10 years in the future, the spread of 2.0 percentage points is the widest since monthly observations began in 1990. Similarly, the survey of professional forecasters conducted by the Federal Reserve Bank of Philadelphia shows an unusually wide spread between the expected inflation rate over the next year and the average for the next 10 years (chart).

The elevated near term expectation would lead to sizeable inflation premiums in the short end of the curve and notably smaller ones in the long end. Hence, a flat 10-year/2-year yield curve.

So, what to believe, the inversion of the 10-2 spread or the favorable reading on the spread in the short end of the curve? We do not find the wide spread in the short-term measure deeply comforting. The measure looks only 18 months ahead (late 2023), and policy is likely to be in an accommodative stance during most of this period. The dot plot has the Fed in a restrictive position at the end of 2023, but only a mildly restrictive one (a median dot of 2.75 percent versus a perceived neutral rate of 2.375 percent). Tight policy, therefore, might not bite until sometime in 2024.

Inflation Expectations*



** Median long-term inflation expectations of professional forecasters (expected average inflation per year measured by the CPI over the next 10 years) less median short-term expectations (year-ahead view on CPI inflation). The shaded areas indicate periods of recession in the United States.*

Sources: Survey of Professional Forecasters, Federal Reserve Bank of Philadelphia and The National Bureau of Economic Research via Haver Analytics; Daiwa Capital Markets America

We are not deeply concerned about the inversion of the 10-2 spread. The tightness is more the result of the unusual configuration of inflation expectations rather than tight policy. Thus, we don't see pronounced near-term risks of the economy turning lower. The momentum in the labor market also leads us to suspect that the economy will remain on track this year. Certainly, the favorable employment report for March would lead one to have an upbeat outlook.

Our conclusion is that neither measure is sending a clear signal at this time. After unpacking likely explanations for each measure, both seem to suggest that the economy will avoid a recession in the next year or so. However, we wonder what the implications are for longer periods. Neither measure, in our view, is sending a definitive signal beyond one year.

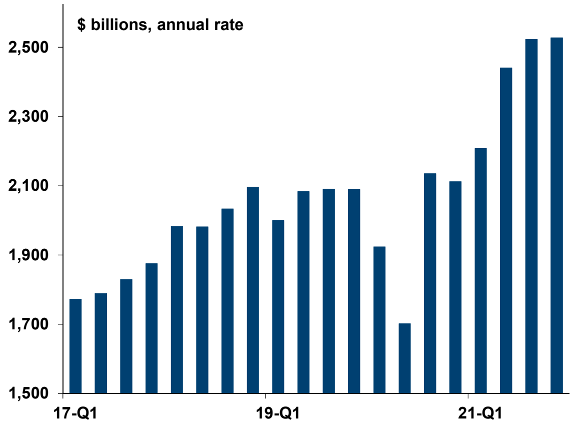
Corporate Profits: Elevated Despite Cost Pressure

The final estimate of US GDP for the fourth quarter brought the first look at aggregate corporate profits for the final three months of the year. After-tax earnings showed little growth in Q4, but results in the prior two quarters were robust, and holding those elevated levels should be viewed as a solid performance.

The strength in the second and third quarters was fueled by a pickup in corporate activity (output rose at an annual rate of 6.2 percent in the two quarters), as well as by a widening in profit margins. Corporate profits per unit of output, a measure of profit margins, rose two percentage points in those quarters (from 16.3 percent to a record level of 18.3 percent). Profit growth slowed in the final quarter of the year, partly because production in the corporate sector decelerated (growth of 3.9 percent) and partly because profit margins eased to 18.2 percent.

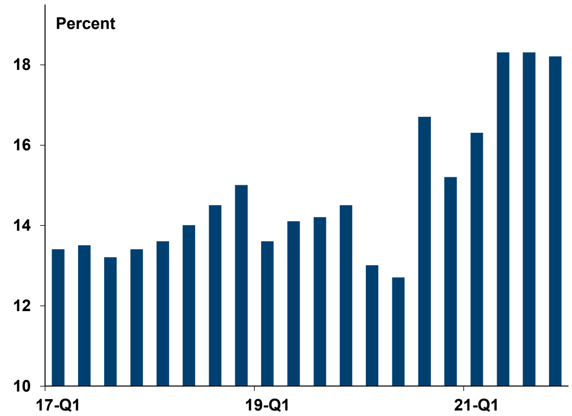
Although the aggregate profit margin narrowed in Q4, it was still quite high by historical standards. Indeed, the Q4 measure was only one tick shy of the record readings in the prior two quarters and far above the average of 13.8 percent in the prior expansion. Record or near-record margins in the current setting are especially impressive because of the rising costs of labor and material inputs faced by corporations. The jump in margins in Q2 and Q3 meant that businesses were able to more than cover their rising costs, and essentially sustaining the wide margin in Q4 signaled pricing power by corporations (charts, next page).

After-Tax Corporate Profits



Source: Bureau of Economic Analysis via Haver Analytics

Profit Margins*



** Corporate profits per unit of real nonfinancial corporate business gross value added.*

Source: Bureau of Economic Analysis via Haver Analytics

Review

Week of March 28, 2022	Actual	Consensus	Comments
U.S. International Trade in Goods (February)	**-$106.6 Billion ($1.0 Billion Narrower Deficit)**	**-$106.5 Billion ($1.1 Billion Narrower Deficit)**	An advance of 1.3% in exports outpaced a pickup of 0.3% in imports, leaving a modest narrowing in the monthly trade deficit. The increase in exports represented only a partial offset to a drop in the prior month and continued a choppy pattern that has left little net change since a surge in October. While the goods deficit improved slightly in February, the nominal deficit so far in Q1 is noticeably wider than that in Q4, raising the prospect of a notable negative contribution from net exports to GDP growth in Q1.
Consumer Confidence (March)	**107.2 (+1.4%)**	**107.0 (-3.2%)**	Consumer confidence rose modestly in March, but the change occurred from a downwardly revised reading in February (105.7 versus 110.5 first reported). The latest reading trailed by a wide margin the recent high of 128.9 in June of last year and by a lesser amount the average of 112.7 for all of 2021. Inflation seemed to play a significant role in souring moods, as the year-ahead expectation jumped to 7.9% from 7.1% in February, the highest since the series started in 1987. Consumers viewed the labor market much more favorably, as the labor market differential (share of respondents reporting jobs are plentiful less the share reporting that they are hard-to-find) rose 5.9 percentage points to 47.4%, a record high.
Revised GDP (2021-Q4)	**6.9% (-0.1 Pct. Pt. Revision)**	**7.0% (Unrevised)**	A downward adjustment to consumer spending stood out on the soft side in the final revision to Q4 GDP growth (2.5% versus 3.1% in the preliminary tally). Net exports also were revised lower (a drag of 0.23 percentage point on growth versus 0.07 percentage point in the previous estimate). On the firmer side, inventory investment was even more robust than previously reported (a contribution of 5.3 percentage points to growth versus 4.9 percentage points). Residential construction was a tad firmer, led by brokerage commissions and improvements on existing homes.
Personal Income, Consumption, Core PCE Price Index (February)	**0.5%, 0.2%, 0.4%**	**0.5%, 0.5%, 0.4%**	Wages and salaries and rental income led the advance in personal income in February (up 0.8% and 0.7%, respectively). Transfer payments and dividends both dipped (off 0.3% and 0.2%, respectively), providing a partial offset. The pickup of 0.2% in consumer spending translated to drop of 0.4% after adjusting for inflation. Although results were soft in February, real consumer spending grew briskly in the prior month. The results in total suggest a solid pace of real consumer spending in Q1, something in the neighborhood of 3½%.

Review Continued

Week of March 28, 2022	Actual	Consensus	Comments
Payroll Employment (March)	**431,000**	**490,000**	The gain in nonfarm payrolls in March trailed the average of 564,000 in the prior 12 months, but the moderate advance was not particularly disappointing, as the report also showed upward revisions in the prior two months totaling 95,000. Results for the household survey were more impressive, as job growth tallied 736,000 and continued a strong performance since last summer (average growth of 761,000 since last July). These gains pushed the unemployment rate 2.3 percentage points lower to 3.6%, including a drop of 0.2 percentage point in the latest month. Average hourly earnings rose 0.4%, in line with the recent average. The increase left the year-over-year advance at 5.6%, the firmest gain in the current cycle.
ISM Manufacturing Index (March)	**57.1% (-1.5 Pct. Pts.)**	**59.0% (+0.4 Pct. Pt.)**	The March reading for the ISM index trailed last year's average of 60.6%, but it was still respectable by historical standards. The new orders component led the decline in the headline measure with a drop of 7.9 percentage points to 53.8%. While the reading was the softest in more than a year and a half, the ISM report noted that the slowdown stemmed in part from "panelists' order books being full," rather than a slowdown in underlying demand. On the positive side, the employment component registered a strong increase (up 3.4 percentage points to 56.3%). Supply-chain disruptions remained an issue in March. While the supplier deliveries component eased 0.7 percentage point to 65.4%, it was still elevated from a longer-term perspective. Supply pressures also were evident in the prices index, which surged 11.5 percentage points to 87.1%, a reading in the upper-end of the historical range.
Construction Spending (February)	**0.5%**	**1.0%**	Construction activity in February posted a moderate increase, and results in the prior two months were revised sharply higher (the level of total construction activity in January was 1.1% firmer than previously reported; both private residential and business-related activity contributed importantly to the adjustment). Private residential construction led the advance in February, continuing along its sharp upward trend (gain of 1.1% in February; average advance of 1.3% in the past 12 months). Business-related building rose modestly (0.2%), but activity rebounded sharply in the second half of last year after falling during the pandemic and early states of the recovery (average monthly gain of 1.1% since July 2021). Government-sponsored construction declined 0.4%; activity in this sector has drifted lower since late 2020.

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

Preview

Week of April 4, 2022	Projected	Comments
Factory Orders (February) (Monday)	**-0.2%**	A decline of 2.2% in durable goods orders (published March 24) is likely to dominate the report on total factory bookings. This drop was influenced by a plunge of 30.4% in commercial aircraft bookings, although the reading was not especially troubling as it followed a cumulative gain of 95% in the prior three months. Durable orders excluding transportation slipped, but the soft reading was only the second negative print in the past 22 months. Nondurable bookings are likely to offset the weakness in the durable area. Higher prices probably led to a sharp increase in the petroleum and coal category. Orders excluding petroleum and coal are likely to post their 21st increase in the past 22 months, although higher prices may play a role as well.
U.S. Trade Balance (February) (Tuesday)	**-$88.5 Billion ($1.2 Billion Narrower Deficit)**	The already reported narrowing of $1.0 billion in the goods deficit suggests improvement in the overall trade deficit in February. The service surplus has improved in recent months after weakening in the summer and fall of last year. A rebound in travel after a drop in January (probably Omicron-related) could provide an additional boost.
ISM Services Index (March) (Tuesday)	**59.0% (+2.5 Pct. Pts)**	Back-to-back drops in the ISM services index probably overstated the influence of Omicron on underlying activity in the services sectors of the economy. A rebound in the employment index in March after a sub-50 reading, along with increases in the business activity and new orders components after below-average results, account for the expected increase.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

March/April 2022

Monday	Tuesday	Wednesday	Thursday	Friday
28	29	30	31	1
U.S. INTERNATIONAL TRADE IN GOODS Dec -$100.7 billion Jan -$107.6 billion Feb -$106.6 billion **ADVANCE INVENTORIES** Wholesale / Retail Dec 2.5% 4.7% Jan 1.1% 1.9% Feb 2.1% 1.1%	**FHFA HOME PRICE INDEX** Nov 1.2% Dec 1.3% Jan 1.6% **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** SA / NSA Nov 1.3% 1.0% Dec 1.4% 1.1% Jan 1.8% 1.4% **CONFERENCE BOARD CONSUMER CONFIDENCE** Jan 111.1 Feb 105.7 Mar 107.2 **JOLTS DATA** Openings (000) / Quit Rate Dec 11,448 3.0% Jan 11,283 2.8% Feb 11,266 2.9%	**ADP EMPLOYMENT REPORT** Private Payrolls Jan 512,000 Feb 486,000 Mar 455,000 **REVISED GDP** GDP / Chained Price 21-Q3 2.3% 6.0% 21-Q4(p) 7.0% 7.1% 21-Q4(r) 6.9% 7.1%	**UNEMPLOYMENT CLAIMS** Initial / Continuing (Millions) Mar 05 0.229 1.417 Mar 12 0.215 1.342 Mar 19 0.188 1.307 Mar 26 0.202 N/A **PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX** Inc. / Cons. / Core Dec 0.4% -0.9% 0.5% Jan 0.1% 2.7% 0.5% Feb 0.5% 0.2% 0.4% **MNI CHICAGO BUSINESS BAROMETER INDEX** Index / Prices Jan 65.2 89.0 Feb 56.3 86.5 Mar 62.9 85.7	**EMPLOYMENT REPORT** Payrolls / Un. Rate Jan 504,000 4.0% Feb 750,000 3.8% Mar 431,000 3.6% **ISM INDEX** Index / Prices Jan 57.6 76.1 Feb 58.6 75.6 Mar 57.1 87.1 **CONSTRUCTION SPEND.** Dec 1.6% Jan 1.6% Feb 0.5% **VEHICLE SALES** Jan 15.0 million Feb 14.1 million Mar 13.3 million
4	5	6	7	8
FACTORY ORDERS (10:00) Dec 0.7% Jan 1.4% **Feb -0.2%**	**TRADE BALANCE (8:30)** Dec -$82.0 billion Jan -$89.7 billion **Feb -$88.5 billion** **ISM SERVICES INDEX (10:00)** Index / Prices Jan 59.9 82.3 Feb 56.5 83.1 **Mar 59.0 85.0**	**FOMC MINUTES (2:00)**	**INITIAL CLAIMS (8:30)** **CONSUMER CREDIT (3:00)** Dec $22.4 billion Jan $6.8 billion Feb --	**WHOLESALE TRADE (10:00)** Inventories / Sales Dec 2.5% 0.1% Jan 1.1% 4.4% **Feb 2.1% 1.0%**
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**	***GOOD FRIDAY*** **EMPIRE MFG INDEX** **IP & CAP-U** **TIC DATA**
18	19	20	21	22
NAHB HOUSING MARKET INDEX	**HOUSING STARTS**	**EXISTING HOME SALES** **BEIGE BOOK**	**INITIAL CLAIMS** **PHILY FED INDEX** **LEADING INDICATORS**	

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
28	29	30	31	1
AUCTION RESULTS: Rate / Cover 13-week bills 0.605% 2.65 26-week bills 1.050% 3.00 2-year notes 2.365% 2.46 5-year notes 2.543% 2.53	**AUCTION RESULTS:** Rate / Cover 7-year notes 2.499% 2.44 **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 RESULTS:** Rate / Cover 17-week CMB 0.805% 3.15	**AUCTION RESULTS:** Rate / Cover 4-week bills 0.135% 3.10 8-week bills 0.380% 2.75 **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	***GOOD FRIDAY***
18	19	20	21	22
AUCTION: $105 billion* 13-,26-week bills **SETTLE:** $46 billion* 3-year notes $34 billion* 10-year notes $20 billion* 30-year bonds	**AUCTION:** $34 billion* 52-week bills **ANNOUNCE:** $35 billion* 4-week bills for auction on April 21 $30 billion* 8-week bills for auction on April 21 $30 billion* 17-week CMBs for auction on April 20 **SETTLE:** $35 billion* 4-week bills $30 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs $16 billion* 20-year bonds	**AUCTION:** $35 billion* 4-week bills $30 billion* 8-week bills $20 billion* 5-year TIPS **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on April 25 $24 billion* 2-year FRNs for auction on April 27 $48 billion* 2-year notes for auction on April 26 $49 billion* 5-year notes for auction on April 27 $44 billion* 7-year notes for auction on April 28 **SETTLE:** $105 billion* 13-,26-week bills $34 billion* 52-week bills	

**Estimate*