U.S. Economic Comment

- June employment: easing recession fears; private sector fully recovered (sort of)
- Inflation expectations: high on the Fed's watch list

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The U.S. Labor Market

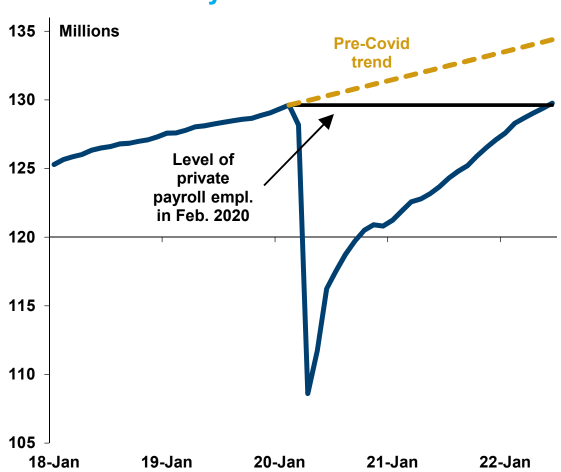
Job growth in the United States is decelerating, as gains in the past four months have averaged 381,000, down from averages of 562,000 in 2021 and 609,000 in the first two months of this year. However, the recent pace is still firm by historical standards, and it might be viewed as remarkable given talk about recession and the caution it might have triggered among hiring executives. In addition, with job openings still in the stratosphere, prospects for continued firm job growth seem favorable, at least until the Fed moves to a restrictive policy stance.

The June statistics also were notable in that total employment in the private sector breached its pre-pandemic level for the first time, exceeding the February 2020 level by 140,000 or 0.1 percent (chart, left). Total employment was still 524,000 (or 0.3 percent) below its pre-pandemic total, reflecting lagging results among state and local governments (primarily local). Employment in this sector remains 656,000 (or 3.3 percent) below the February 2020 total.

While private-sector employment has finally regained the ground lost with the onset of Covid, it is still lagging what might have occurred in the absence of the pandemic. If job growth had continued to grow at the average pace seen in 2019 and early 2020, private-sector payrolls would now total approximately 134 million, 4.2 million above the current reading. The shortfall is not a reflection of soft demand, as 11.3 million job openings suggests that the extrapolated trend was easily reachable.

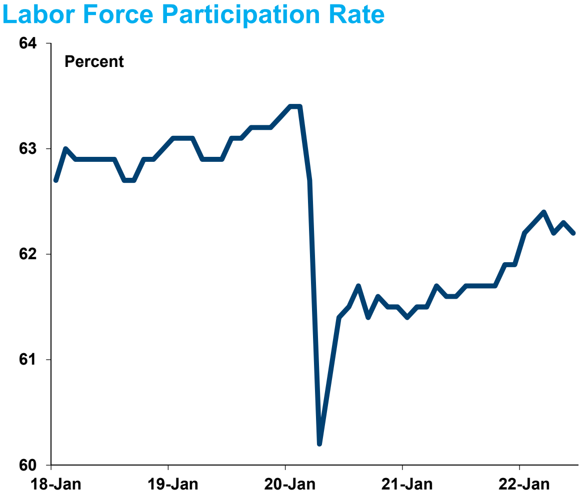
Individuals dropping out of the labor force account for the shortfall, as the labor force participation rate is still 1.2 percentage points below its pre-Covid level (chart, right). A recent stalling in the upward trend of the participation rate suggests slow progress in returning to norms before the pandemic. A good portion of the shortfall in labor force participation has been the result of retirements, but prime-age participation also has failed to recover lost ground (0.7 percentage point below the pre-Covid level of 83.0 percent). The prime-age measure, like the total participation rate, has hesitated in recent months.

Private Sector Payrolls



Sources: Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America

Labor Force Participation Rate



Source: Bureau of Labor Statistics via Haver Analytics

Interpreting Inflation Expectations

The favorable employment report opens the door for another sizeable rate hike by the Federal Reserve. A calm CPI released on July 13 could limit the rate change at the July 27 FOMC meeting to 50 basis points, but odds at this time favor a shift of 75 basis points. In addition to the CPI, Fed officials no doubt will be carefully monitoring measures of inflation expectations, partly because most Fed officials believe that expectations are a key determinant of actual inflation, and partly because expectations can be viewed as a measure of Fed credibility.

Fed officials seem concerned about credibility, as suggested by a telling passage in the minutes from the June FOMC meeting:

> Many participants [i.e. both voting and non-voting Fed officials] judged that a significant risk now facing the Committee was that elevated inflation could become entrenched if the public began to question the resolve of the Committee to adjust the stance of policy as warranted.

Fortunately for the Fed, various measures of inflation expectations show that long-term views have not changed appreciably. Still, there are risks, as near-term views (the next one to three years) have shown a pickup in inflation expectations, and such perceptions could creep into more distant years if the Fed does not take concerted action. In fact, another passage in the minutes expressed concern about a lengthening of elevated expectations: “many participants raised the concern that longer-run inflation expectations could be beginning to drift up to levels inconsistent with the 2 percent objective.”

Thus, with actual inflation and the Fed’s credibility at stake, policymakers no doubt will be monitoring inflation expectations carefully. One convenient measure noted in recent FOMC minutes and sometimes mentioned in public comments of Fed officials is the so-called index of Common Inflation Expectations (CIE). This measure was developed by the staff of the Federal Reserve Board of Governors and represents a composite of 21 gauges of inflation expectations (see below for an explanation).

This index has jumped in the past five quarters, but it is still within the range evident in the early and mid-2000s – in fact, it is in the low end of that range (chart, top left, p.4). Given such a reading, one can credibly argue that inflation expectations are still anchored.

The CIE, while useful, has a disadvantage in that the time span underlying the measure is ambiguous. The various components of the index have perspectives ranging from one year to 10 years. Observers will be looking at an undefined average of near-term and long-term expectations, and it is not clear whether short-term or long-term views are dominating.

The Survey of Professional Forecasters conducted by the Federal Reserve Bank of Philadelphia lessens this disadvantage by providing both intermediate (5-year) and long-term (10-year) expectations. These two measures can be used to extract the implied forecast for average inflation 6 to 10 years from now (the 5-year/5-year forward rate). This survey also is beneficial in that it involves approximately 40 individuals in the forecasting business – individuals that presumably are well informed and are carefully considering the inflation outlook.

The Philadelphia survey shows a jump in average expected inflation rate over the next 10 years, with expectations breaking out of the range than had been in place in the prior 20 years, a shift that might be viewed as troubling (chart, top right, p.4). However, all of the pressure is seen as occurring over the first five years of this span (chart, middle left, p.4). Derived expectations for years 6 through 10 have shown only normal variation and have remained within the recent range (chart, middle right, p.4). The analysts in the survey apparently believe that the Federal Reserve will be successful in taming inflation in the next few years.

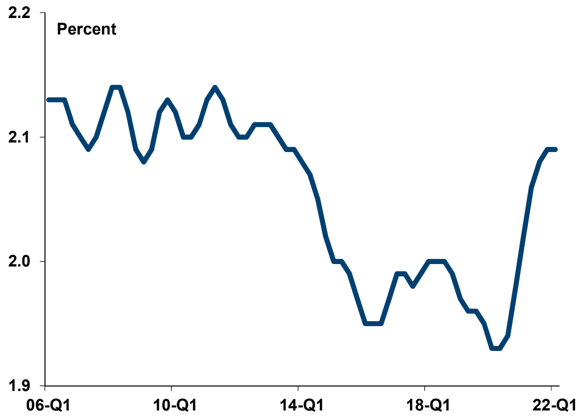
Break-even rates on Treasury inflation-protected securities also allow for a breakdown of expectations between the next five years and in years six to 10. In addition, as with the Phily survey, the expectations from the TIPS market is likely to be a carefully considered view (investors have skin in the game). Break-even rates display some random volatility because of shifts in liquidity and risk premiums, but broad trends provide good insight into inflation expectations. The 5-year/5-year forward break-even inflation rate stirred for a time in the early portion of the current recovery, but it has returned to the pre-pandemic range (bottom chart, p.4).

CIE Explained

The index of Common Inflation Expectations is derived from a statistical technique (a dynamic factor model) that seeks to find co-movements among the variables under study, in this case various measures of inflation expectations. The focus on common shifts in the variables under consideration heightens the probability of extracting expectations of inflation rather than random changes.

The output from a dynamic factor model has a mean of zero, which does not have a clear economic interpretation. To generate a series that has an economic context, the output from the Fed's model is "projected" onto one of the components of the constructed index; that is, the zero mean of the model's output assumes the mean of the chosen component, and individual values of the constructed series from the model are driven by the movement and variation in the model's output. That is, the standard deviation of the CIE will be the same as that of the model's output. In the graph on page 4, and in most references in Fed documents or speeches, the model's output is projected onto the 10-year expectations for PCE inflation from the Philadelphia Fed Survey of Professional Forecasters.

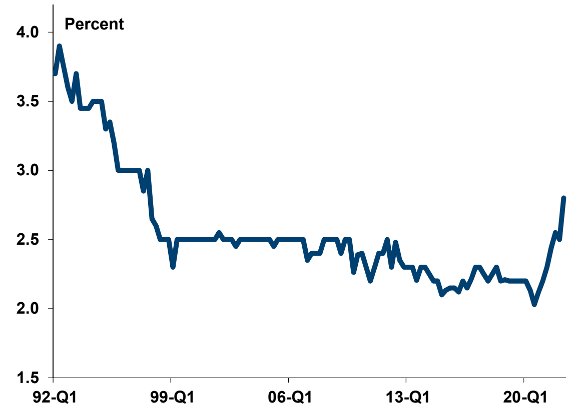
Common Inflation Expectations Index*



** Projected onto the Philadelphia Fed's Survey of Professional Forecasters 10-year-ahead PCE (personal consumption expenditures) inflation expectations.*

Source: Federal Reserve Board via Haver Analytics

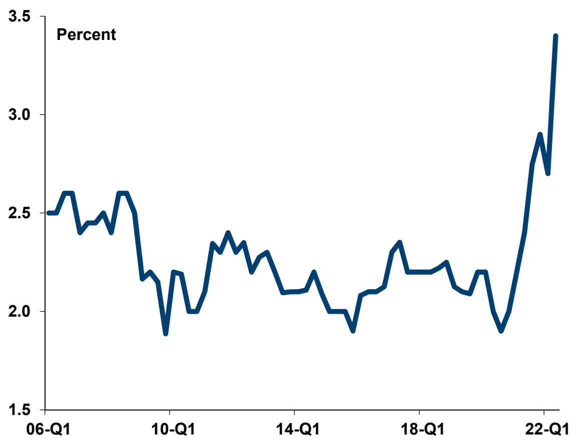
Forecasters' 10-Year View on Inflation*



** Expected yearly inflation over the next 10 years as measured by the CPI. Median estimate.*

Source: Survey of Professional Forecasters, Federal Reserve Bank of Philadelphia

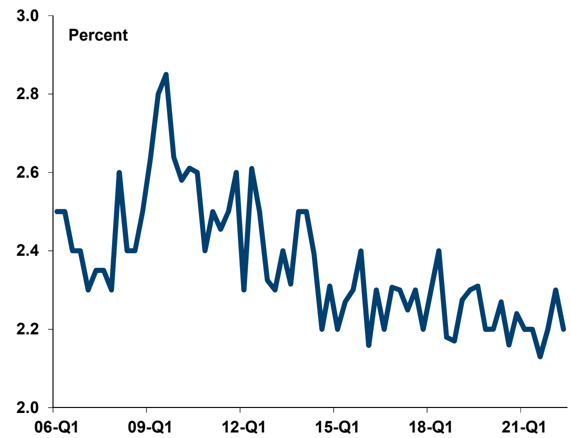
Forecasters' 5-Year View on Inflation*



** Expected yearly inflation over the next five years as measured by the CPI. Median estimate.*

Source: Survey of Professional Forecasters, Federal Reserve Bank of Philadelphia

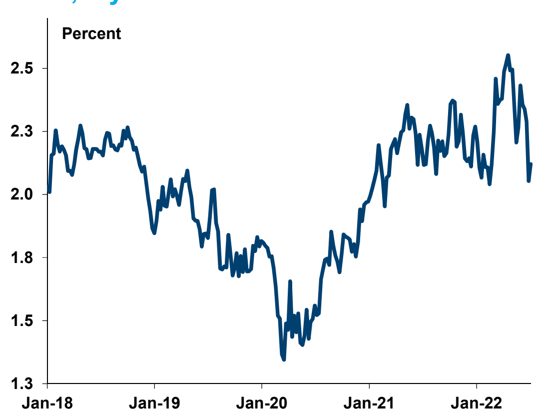
Forecasters' 5-Year Forward View on Inflation*



** Expected yearly inflation six to 10 years from now as measured by the CPI. Median estimate.*

Source: Survey of Professional Forecasters, Federal Reserve Bank of Philadelphia

5-Year, 5-year Forward Breakeven Inflation Rate*



** Weekly end-of-period data.*

Source: Bloomberg

Review

Week of July 4, 2022	Actual	Consensus	Comments
Factory Orders (May)	**1.6%**	**0.5%**	New orders for durable goods increased 0.8% (versus a preliminary estimate of 0.7% published on June 27). Transportation orders rose 1.0%, led by gains in defense aircraft and motor vehicles; orders ex-transportation advanced 0.7%, the 24th increase in the past 25 months. Nondurable bookings jumped 2.3%, with much of the gain reflecting a surge of 8.9% in petroleum and coal bookings. Excluding petroleum and coal products, orders for nondurable goods rose 0.4%, continuing their upward trend (up in 24 of the past 25 months). As in other recent months, both durable and nondurable bookings likely were inflated by higher prices. Petrol and coal bookings stand out in this regard, as the price of crude oil (West Texas intermediate) rose 7.4% in May.
ISM Services Index (June)	**55.3 (-0.6 Index Pt.)**	**54.0 (-1.9 Index Pts.)**	The services index published by the Institute for Supply Management eased for the sixth time in the past seven months, with activity in June off sharply from the record high of 68.4 in November of last year. The business activity index rose modestly (+1.6 index points to 56.1), although it remained in the low end of the range from the past two years. Both new orders and employment eased (-2.0 index points to 55.6 and -2.8 index points to 47.4, respectively). The employment component has now been below 50 in three of the past five months. The supplier deliveries index increased modestly in June (+0.6 index point to 61.9), with the pickup and the still-elevated reading signaling that supply chain disruptions remain an issue. The prices index remained elevated at 80.1 (versus 82.1 in May).
Job Openings (May)	**11.254 Million**	**11.000 Million**	Despite the decline in May, job openings remained stratospheric relative to historical standards, exceeding all observations before December of last year. (The record prior to that in the current expansion was 7.558 million in November 2018.) The U.S. now has 1.89 jobs for each unemployed individual. The quit rate totaled 2.8%, down slightly from 2.9% in the prior month and the record high of 3.0% in November and December of last year.
Trade Balance (May)	**-\$85.5 Billion (\$1.1 Billion Narrower Deficit)**	**-\$84.7 Billion (\$2.4 Billion Narrower Deficit)**	Both exports and imports increased in May, with the advance of 1.2% in exports exceeding the increase of 0.6% in imports. The improvement in trade during May occurred in the goods sector (improvement of \$2.9 billion), as the surplus in services slipped by \$1.7 billion. May marked the second consecutive improvement in the trade balance. The recent performance suggests that net exports will make a positive contribution to GDP growth in Q2, with the figures in hand pointing to a contribution of approximately 1-3/4 percentage points. This contribution, however, will follow a drag of 3.2 percentage points in Q1. For the first half of the year, net exports will represent a notable soft spot.

Review Continued

Week of July 4, 2022	Actual	Consensus	Comments
Payroll Employment (June)	**372,000**	**265,000**	The advance in payrolls in June was countered to a degree by downward adjustments of 74,000 in the prior two months, but it still suggests a strong pace of hiring (average of 381,000 in the past four months) -- albeit one that trails the torrid pace of 562,000 in 2021 and 609,000 in the first two months of 2022. The unemployment rate was unchanged in June at 3.6%, as the size of the labor force and employment as measured by the household survey declined by similar amounts. Average hourly earnings rose 0.3%, a tick slower than the average advance of 0.4% in the prior six months. The increase left a year-over-year gain of 5.1%, down from 5.3% in May and a recent peak of 5.6% in March.

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

Preview

Week of July 11, 2022	Projected	Comments
CPI (June) (Wednesday)	**0.9% Total, 0.5% Core**	Available data suggest that energy prices jumped in June after increasing 3.9% in the prior month. Food prices have shown no sign of slowing from their recent brisk pace (up 1.2% in May after averaging 1.0% in the first four months of 2022). Excluding food and energy, continued pressure from rents, travel-related expenses, and costs of medical care services suggests another rapid increase in the core component.
Federal Budget (June) (Wednesday)	**$75.0 Billion Deficit**	Federal revenues in June appear to have risen modestly from the same month last year. Outlays are likely to be noticeably lighter on a year-over-year basis because of the continued phase-out of pandemic-related spending. The combined effects point to a sizable improvement in the budget deficit from the $174 billion shortfall in June 2021.
PPI (June) (Thursday)	**0.7% Total, 0.3% Ex. Food & Energy**	Available quotes point to another jump in the energy component of the PPI in June after increases averaging 3.1% in the prior 12 months. Food prices at the producer level have surged in the past year, but no change in May perhaps signaled that pressure is starting to abate. Similarly, moderation in service prices in April and May raise the possibility of an easing in pressure on the core component.
Retail Sales (June) (Friday)	**1.0% Total, 0.8% Ex. Autos**	An increase in new vehicle sales suggests an advance in the auto component of the retail sales report in June, and higher prices could inflate the value of activity at gasoline service stations. Higher prices probably boosted the value of sales at other outlets, but consumers may have trimmed spending in some discretionary categories because of strained budgets.
Industrial Production (June) (Friday)	**0.0%**	Factory employment increased in June, but hours worked were cut; thus, the manufacturing component of industrial production is likely to be little changed after a dip in the previous month. Increases in mining employment and the rotary rig count suggest that high petroleum and gas prices spurred mining output. An easing in temperatures probably led to a drop in demand for cooling services and a decline in utility output.
Consumer Sentiment (July) (Friday)	**51.0 (+2.0%)**	Elevated gasoline prices and increasing talk of recession suggest that consumer sentiment in July could be little changed from the record low reading of 50.0 in June.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

July 2022

Monday, 4

INDEPENDENCE DAY

Tuesday, 5

FACTORY ORDERS

Mar	1.8%
Apr	0.7%
May	1.6%

Wednesday, 6

ISM SERVICES INDEX

	Index	Prices
Apr	57.1	84.6
May	55.9	82.1
June	55.3	80.1

JOLTS DATA

	Openings (000)	Quit Rate
Mar	11,855	2.9%
Apr	11,681	2.9%
May	11,254	2.8%

FOMC MINUTES

Thursday, 7

UNEMPLOYMENT CLAIMS

	Initial (Millions)	Continuing
June 11	0.231	1.331
June 18	0.233	1.324
June 25	0.231	1.375
July 2	0.235	N/A

TRADE BALANCE

Mar	-$107.7 billion
Apr	-$86.7 billion
May	-$85.5 billion

Friday, 8

EMPLOYMENT REPORT

	Payrolls	Un. Rate
Apr	368,000	3.6%
May	384,000	3.6%
June	372,000	3.6%

WHOLESALE TRADE

	Inventories	Sales
Mar	2.7%	1.8%
Apr	2.3%	0.8%
May	1.8%	0.5%

CONSUMER CREDIT

Mar	$47.5 billion
Apr	$36.8 billion
May	$22.3 billion

Monday, 11

Tuesday, 12

NFIB SMALL BUSINESS OPTIMISM INDEX (6:00)

Apr	93.2
May	93.1
June	--

Wednesday, 13

CPI (8:30)

	Total	Core
Apr	0.3%	0.6%
May	1.0%	0.6%
June	**0.9%**	**0.5%**

FEDERAL BUDGET (2:00)

	2022	2021
Apr	$308.2B	-$225.6B
May	-$66.2B	-$132.0B
June	**-$75.0B**	-$174.2B

BEIGE BOOK (2:00)

May/June Beige Book

"All twelve Federal Reserve Districts have reported continued economic growth since the prior Beige Book period, with a majority indicating slight or modest growth…"

Thursday, 14

INITIAL CLAIMS (8:30)

PPI (8:30)

	Final Demand	Ex. Food & Energy
Apr	0.4%	0.2%
May	0.8%	0.5%
June	**0.7%**	**0.3%**

Friday, 15

RETAIL SALES (8:30)

	Total	Ex.Autos
Apr	0.7%	0.4%
May	-0.3%	0.5%
June	**1.0%**	**0.8%**

EMPIRE MFG (8:30)

May	-11.6
June	-1.2
July	--

IMPORT/EXPORT PRICES (8:30)

	Non-petrol. Imports	Nonagri. Exports
Apr	0.5%	0.7%
May	-0.1%	2.9%
June	--	--

IP & CAP-U (9:15)

	IP	Cap.Util.
Apr	1.3%	80.9%
May	0.1%	80.8%
June	**0.0%**	**80.6%**

BUSINESS INVENTORIES (10:00)

	Inventories	Sales
Mar	2.4%	1.6%
Apr	1.3%	0.6%
May	**1.4%**	**0.6%**

CONSUMER SENTIMENT (10:00)

May	58.4
June	50.0
July	**51.0**

Monday, 18

NAHB HOUSING MARKET INDEX

TIC DATA

Tuesday, 19

HOUSING STARTS

Wednesday, 20

EXISTING HOME SALES

Thursday, 21

INITIAL CLAIMS

PHILY FED INDEX

LEADING INDICATORS

Friday, 22

Monday, 25

CHICAGO FED NATIONAL ACTIVITY INDEX

Tuesday, 26

FHFA HOME PRICE INDEX

S&P CORELOGIC CASE-SHILLER HOME PRICES

CONSUMER CONFIDENCE

NEW HOME SALES

FOMC MEETING

Wednesday, 27

U.S. INTERNATIONAL TRADE IN GOODS

ADVANCE INVENTORIES

DURABLE GOODS ORDERS

PENDING HOME SALES

FOMC DECISION

Thursday, 28

INITIAL CLAIMS

GDP

Friday, 29

PERSONAL INCOME, CONSUPTION, PCE PRICE INDEXES

EMPLOYMENT COST INDEX

CHICAGO PURCHASING MANAGERS' INDEX

REVISED CONSUMER SENTIMENT

Forecasts in Bold.

Treasury Financing

July 2022

Monday	Tuesday	Wednesday	Thursday	Friday
4	5	6	7	8
INDEPENDENCE DAY	**AUCTION RESULTS:** Rate / Cover 13-week bills 1.850% 2.53 26-week bills 2.500% 2.57 **ANNOUNCE:** $35 billion 4-week bills for auction on July 7 $30 billion 8-week bills for auction on July 7 $30 billion 17-week CMBs for auction on July 6 **SETTLE:** $35 billion 4-week bills $30 billion 8-week bills $30 billion 17-week CMBs	**AUCTION RESULTS:** Rate / Cover 17-week CMB 2.230% 3.40	**AUCTION RESULTS:** Rate / Cover 4-week bills 1.530% 2.87 8-week bills 1.840% 2.77 **ANNOUNCE:** $93 billion 13-,26-week bills for auction on July 11 $34 billion 52-week bills for auction on July 12 $43 billion 3-year notes for auction on July 11 $33 billion 10-year notes for auction on July 12 $19 billion 30-year bonds for auction on July 13 **SETTLE:** $87 billion 13-,26-week bills	
11	12	13	14	15
AUCTION: $93 billion 13-,26-week bills $43 billion 3-year notes	**AUCTION:** $34 billion 52-week bills $33 billion 10-year notes **ANNOUNCE:** $35 billion* 4-week bills for auction on July 14 $30 billion* 8-week bills for auction on July 14 $30 billion* 17-week CMBs for auction on July 13 **SETTLE:** $35 billion 4-week bills $30 billion 8-week bills $30 billion 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs $19 billion 30-year bonds	**AUCTION:** $35 billion* 4-week bills $30 billion* 8-week bills **ANNOUNCE:** $93 billion* 13-,26-week bills for auction on July 18 $14 billion* 20-year bonds for auction on July 20 $17 billion* 10-year TIPS for auction on July 21 **SETTLE:** $93 billion 13-,26-week bills $34 billion 52-week bills	**SETTLE:** $43 billion 3-year notes $33 billion 10-year notes $19 billion 30-year bonds
18	19	20	21	22
AUCTION: $93 billion* 13-,26-week bills	**ANNOUNCE:** $35 billion* 4-week bills for auction on July 21 $30 billion* 8-week bills for auction on July 21 $30 billion* 17-week CMBs for auction on July 20 **SETTLE:** $35 billion* 4-week bills $30 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs $14 billion* 20-year bonds	**AUCTION:** $35 billion* 4-week bills $30 billion* 8-week bills $17 billion* 10-year TIPS **ANNOUNCE:** $93 billion* 13-,26-week bills for auction on July 25 $24 billion* 2-year FRNs for auction on July 27 $45 billion* 2-year notes for auction on July 25 $46 billion* 5-year notes for auction on July 26 $38 billion* 7-year notes for auction on July 28 **SETTLE:** $93 billion* 13-,26-week bills	
25	26	27	28	29
AUCTION: $93 billion* 13-,26-week bills $45 billion* 2-year notes	**AUCTION:** $46 billion* 5-year notes **ANNOUNCE:** $35 billion* 4-week bills for auction on July 28 $30 billion* 8-week bills for auction on July 28 $30 billion* 17-week CMBs for auction on July 27 **SETTLE:** $35 billion* 4-week bills $30 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs $24 billion* 2-year FRNs	**AUCTION:** $35 billion* 4-week bills $30 billion* 8-week bills $38 billion* 7-year notes **ANNOUNCE:** $93 billion* 13-,26-week bills for auction on August 1 **SETTLE:** $93 billion* 13-,26-week bills	**SETTLE:** $17 billion* 10-year TIPS

**Estimate*