Daiwa Capital Markets

U.S. Economic Comment

- May employment: brisk payroll growth, but uptick in unemployment rate opens door for officials to “skip” in June
- The debt ceiling: sanity prevails as bipartisan agreement avoids catastrophe

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May Employment: Possibly Setting the Stage for a “Skip” in June

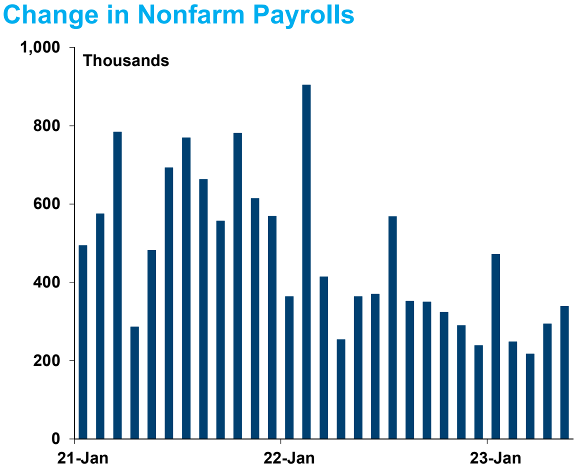
The May employment report contained elements to ratify the views of both hawks and doves on the Federal Open Market Committee. For those in the hawkish camp, still-brisk payroll and wage growth point to ongoing supply-demand imbalances in the labor market that could warrant additional tightening in the federal funds rate at the upcoming FOMC meeting. On the other hand, an increase of 0.3 percentage point in the unemployment rate supports the position that tight labor-market conditions could be easing; that is, the current policy setting is working to slow economic activity, and additional time should be taken to assess its effects on the incoming data. As of now, we are inclined to side with those who favor “skipping” a rate increase in June. However, we recognize the potential for the CPI release on the first day of the June FOMC meeting to upend current views on the potential outcome of the meeting and tip the scales in favor of a June hike. Moreover, we still suspect that the evolution of the data over the next few months could necessitate additional increases in the federal funds rate later this year (currently we project a terminal range for the federal funds rate of 5.50 percent to 5.75 percent).

Firm Elements of the Employment Data

Payroll growth was brisk in May, with the increase of 339,000 -- and upward revisions of 93,000 to results in the prior two months -- contrasting with the consensus view of payroll growth of 195,000 (chart, below left). Average payroll growth of 314,000 in the first five months of 2023 moderated notably from the monthly average of 445,000 in 2022-H1, but it was not far off the average of 345,000 in the final six months of the year.

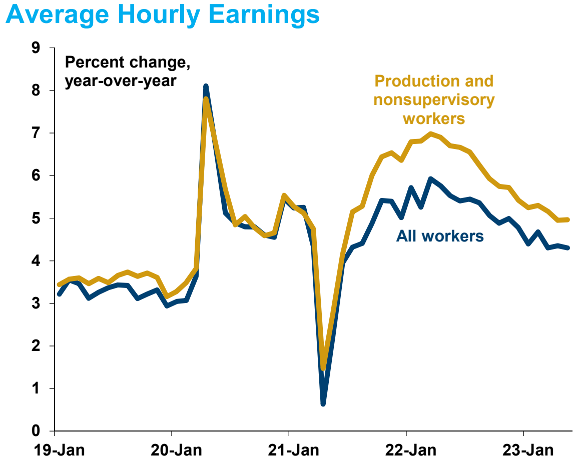
Broad-based hiring across industries added to the strong tone of the headline print in May, with the healthcare and business and professional services industries standing out (job growth of 75,000, and 64,000, respectively). The cyclically sensitive construction sector also added jobs at an above-average pace (25,000 in May versus an average of 15,000 in the prior six months). The pickup coincides with signs of recovery in both residential and business-related construction after soft performances for most of 2022. In contrast, the manufacturing sector, which has struggled for much of 2023, trimmed payrolls (-2,000), as did the information sector (tech-industry firms; -9,000). However, changes in these areas were relatively modest.

Change in Nonfarm Payrolls



Source: Bureau of Labor Statistics via Haver Analytics

Average Hourly Earnings



Source: Bureau of Labor Statistics via Haver Analytics

Continued wage pressure also supported the view that labor-market conditions remained tight. Average hourly earnings for all employees rose 0.3 percent, a tick slower than the reading in April and less than 0.1 percentage point slower than the average in the preceding 12 months (0.33 percent versus 0.36 percent, with less rounding). The monthly change for May translated to a year-over-year increase of 4.3 percent, down from a recent high of 5.9 percent in March 2022 but close to other recent observations. Wage pressure for production and nonsupervisory workers was more pronounced, increasing 0.5 percent (versus 0.4 percent in April), or 5.0 percent year-over-year (chart; prior page, right). Fed officials, including Chair Powell in his previous post-FOMC press conference, have acknowledge many times that current wage trends are inconsistent with a return to two-percent inflation.

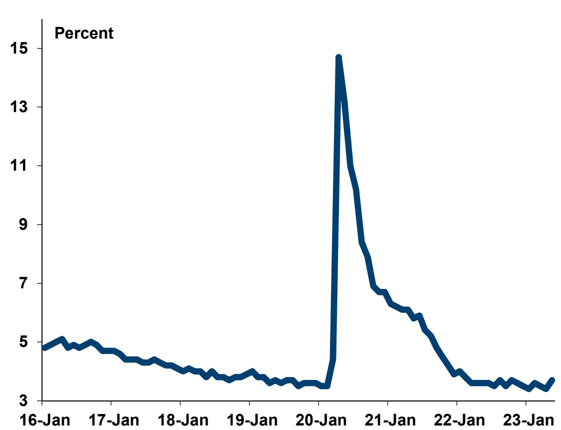
Reason to Skip?

Perhaps the most striking single element of the May employment report was the jump of 0.3 percentage point in the unemployment rate to 3.7 percent, as a drop of 310,000 in employment measured in the household survey offset growth in the labor force of 130,000. The latest reading was the highest since last October, but within the low range of 3.4 percent to 4.0 percent in the past 18 months (charts).

On one hand, it is easy to dismiss the latest move as attributable to random volatility. Employment growth from the household survey averaged 406,000 in the six months preceding May, but monthly changes often swung widely (range of -66,000 to 894,000). Averaging through the noise shows a still-favorable underlying trend. However, if data dependence is the current norm, that data point should at least give Fed officials pause. If the May result holds next month, or the unemployment rate edges higher, it could suggest that additional slack is developing in the labor market and that wage growth also could begin to moderate at a faster clip.

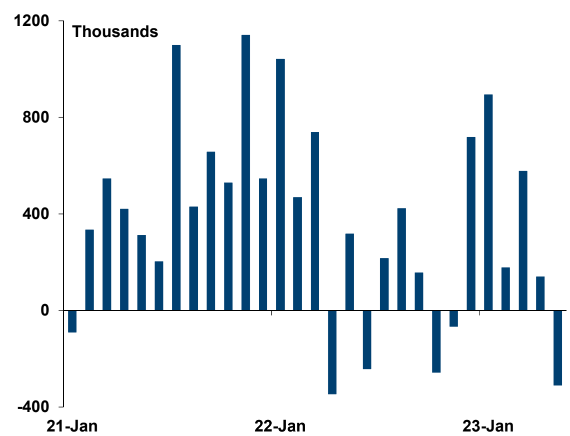
Focusing on one element of a report that otherwise suggests a strong labor market might seem off-the-mark, but it could tip the scales as the FOMC approaches the peak of the current tightening cycle. Comments from Fed officials in the past two weeks appeared evenly split on what to do at the June 13-14 FOMC meeting, but two key voices weighing in on May 31 offered support for a pause: vice-chair-designate and current Fed Governor Philip Jefferson and Philly Fed President Patrick Harker (a 2023 FOMC voter). Harker stated rather unambiguously: “I am in the camp increasingly coming into this meeting thinking that we really should skip…” A move of 0.3 percentage point in the unemployment rate, in our view, supports that assessment.

Unemployment Rate



Source: Bureau of Labor Statistics via Haver Analytics

Change in Household Employment



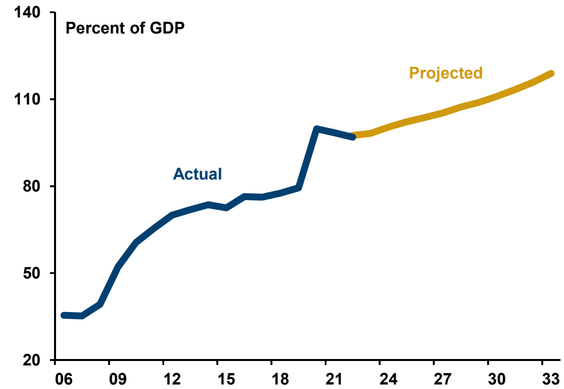
Source: Bureau of Labor Statistics via Haver Analytics

Debt Ceiling Developments

Whether one characterizes the 11th hour resolution of recent debt-ceiling drama as a bipartisan effort emblematic of sound government or borne out of necessity due to the looming June 5 debt ceiling deadline and dire warnings of incalculable economic fallout, the (soon to be enacted) Fiscal Responsibility Act of 2023 will avert potential economic calamity and punt the next fight over the debt limit to early 2025 (i.e. after the November 2024 election).

Broadly speaking, the Fiscal Responsibility Act of 2023 suspends the statutory limit on federal borrowing until January 1, 2025. To placate members of Congress who have (seemingly quite recently) become concerned with the fiscal trajectory of the United States, the legislation introduced statutory caps on discretionary funding for fiscal years 2024 and 2025 as well as enacted potential limits on discretionary funding from 2026 through 2029. The law also will claw back approximately $30 billion in unspent COVID funds, cut approximately $21 billion of newly allocated funding for the Internal Revenue Service, end the moratorium on federal student loan repayment, and expedite the permittance of certain energy-related projects, among other adjustments. In all, the Congressional Budget Office estimated that the legislation would reduce budget deficits by approximately $1.5 trillion over the 2023-2033 period versus its May 2023 baseline (Swagel, Phillip L. "CBO's Estimate of the Budgetary Effects of H.R. 3746, the Fiscal Responsibility Act of 2023" Congressional Budget Office. May 30, 2023: https://www.cbo.gov/system/files/2023-05/hr3746_Letter_McCarthy.pdf).

Publicly Held Debt as a Share of GDP*



** Fiscal year basis. Readings from 2023 to 2033 are projections from the Congressional Budget Office.*
Sources: U.S. Department of the Treasury via Haver Analytics; Congressional Budget Office, "An Update to the Budget Outlook: 2023 to 2033" (May 2023). https://www.cbo.gov/publication/59096

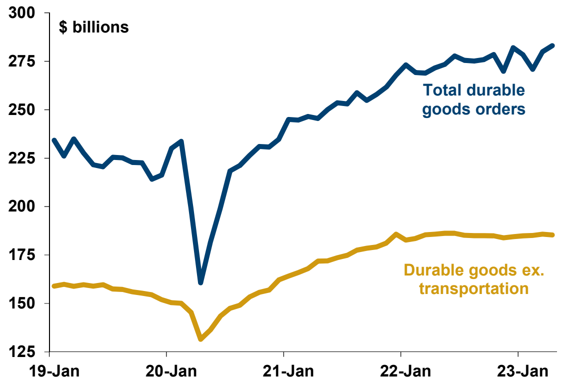
While we view the suspension of the debt ceiling as a near-term positive, eliminating a potential shock to the U.S. economy, the legislation does nothing to address the long-term fiscal health of the nation. As discussed in the May 19 edition of our U.S. Economic Comment, the CBO projects debt as a share of GDP to increase from just shy of 100 percent of GDP to almost 120 percent of GDP by 2033 and 200 percent by 2050 (chart). Politically difficult decisions on the taxation and spending priorities of government, not to mention cuts to programs such as Medicare and Social Security, will need to be enacted to return the budget to a sustainable path. Any path chosen by policymakers likely will have painful consequences for at least a subset of the population.

The Week Ahead

Factory Orders (April) (Monday)
Forecast: 0.5%

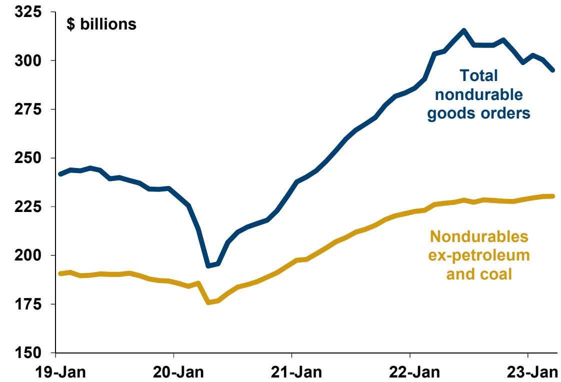
The jump of 1.1 percent in durable goods orders in April (reported on May 26) reflected primarily a jump of 3.7 percent in the transportation category. Durable bookings excluding transportation (-0.2 percent) continued their sideways trend since last summer (chart, left). Nondurable bookings (the new information in the factory orders report) are likely to be unimpressive (chart, right). Higher prices could boost the value of petroleum-related orders, but soft conditions in the factory sector could constrain orders for nondurable goods excluding petroleum.

New Orders for Durable Goods



Source: U.S. Census Bureau via Haver Analytics

New Orders for Nondurable Goods



Source: U.S. Census Bureau via Haver Analytics

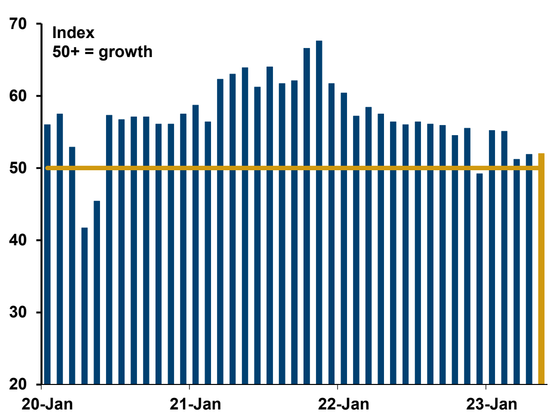
ISM Services Index (May) (Monday)
Forecast: 52.0 (+0.1 Index Point)

The service sector of the economy has proved resilient to restrictive monetary policy thus far, although it has shown signs of slowing in recent months. Thus, while the ISM services gauge is unlikely to signal contraction in May, it could remain close to the average of 51.6 in the past two months rather than return to previous range in the mid-50's that prevailed in much of 2022 and early 2023 (chart, below left).

Trade Balance (April) (Wednesday)
Forecast: -$78.0 Billion

The widening of $14.1 billion in the goods deficit (published May 26) is likely to translate to notable deterioration in the overall trade deficit for April. The surplus in service trade has shown little net change in the past two months after dropping by $1.9 billion in January (chart, below right).

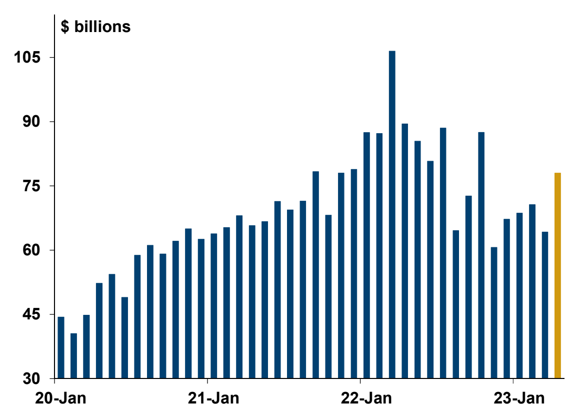
ISM Services Index*



** The gold bar is a forecast for May 2023.*

Sources: Institute for Supply Management *via Haver Analytics; Daiwa Capital Markets America*

Trade Deficit in Goods & Services*



** The gold bar is a forecast for April 2023.*

Sources: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

Economic Indicators

May/June 2023

Monday 29

MEMORIAL DAY

Tuesday 30

FHFA HOME PRICE INDEX

Jan	0.1%
Feb	0.7%
Mar	0.6%

S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX

Jan	-0.3%
Feb	-0.1%
Mar	0.5%

CONFERENCE BOARD CONSUMER CONFIDENCE

Mar	104.0
Apr	103.7
May	102.3

Wednesday 31

MNI CHICAGO BUSINESS BAROMETER

	Index	Prices
Mar	43.8	65.6
Apr	48.6	70.3
May	40.4	60.9

JOLTS DATA

	Openings (000)	Quit Rate
Feb	9,974	2.6%
Mar	9,745	2.5%
Apr	10,103	2.4%

BEIGE BOOK
May 2023
Economic activity was little changed overall in April and early May. Four Districts reported small increases in activity, six no change, and two slight to moderate declines.

Thursday 1

UNEMP. CLAIMS

	Initial	Continuing
	(millions)	
May 6	0.231	1.799
May 13	0.225	1.789
May 20	0.230	1.795
May 27	0.232	N/A

ADP EMPLOYMENT

	Private Payrolls
Mar	142,000
Apr	291,000
May	278,000

REVISED PRODUCTIVITY & COSTS

	Productivity	Unit Labor Costs
22-Q3	1.2%	6.9%
22-Q4	1.6%	-2.2%
23-Q1(p)	-2.7%	6.3%
23-Q1(r)	-2.1%	4.2%

ISM MFG. INDEX

	Index	Prices
Mar	46.3	49.2
Apr	47.1	53.2
May	46.9	44.2

CONSTRUCTION

Feb	2.4%
Mar	0.3%
Apr	1.2%

VEHICLE SALES

Mar	14.8 million
Apr	15.9 million
May	15.3 million

Friday 2

EMPLOYMENT REPORT

	Payrolls	Un. Rate
Mar	217,000	3.5%
Apr	294,000	3.4%
May	339,000	3.7%

Monday 5

FACTORY ORDERS (10:00)

Feb	-1.7%
Mar	0.7%
Apr	**0.5%**

ISM SERVICES INDEX (10:00)

	Index	Prices
Mar	51.2	59.5
Apr	51.9	59.6
May	**52.0**	**58.0**

Tuesday 6

Wednesday 7

TRADE BALANCE (8:30)

Feb	-$70.6 billion
Mar	-$64.2 billion
Apr	**-$78.0 billion**

CONSUMER CREDIT (3:00)

Feb	$15.0 billion
Mar	$26.5 billion
Apr	--

Thursday 8

UNEMP. CLAIMS (8:30)

WHOLESALE TRADE (10:00)

	Inventories	Sales
Feb	0.0%	0.4%
Mar	-0.3%	-2.1%
Apr	**-0.2%**	**-0.5%**

Friday 9

Monday 12

FEDERAL BUDGET

Tuesday 13

NFIB SMALL BUSINESS OPTIMISM INDEX

CPI

FOMC MEETING (FIRST DAY)

Wednesday 14

PPI

FOMC DECISION

Thursday 15

UNEMP. CLAIMS

RETAIL SALES

IMPORT/EXPORT PRICES

EMPIRE MFG

PHILLY FED INDEX

IP & CAP-U

BUSINESS INVENTORIES

TIC FLOWS

Friday 16

CONSUMER SENTIMENT

Monday 19

NAHB HOUSING INDEX

JUNETEENTH NATIONAL INDEPENDENCE DAY

Tuesday 20

HOUSING STARTS

Wednesday 21

Thursday 22

UNEMP. CLAIMS

CHICAGO FED NATIONAL ACTIVITY INDEX

CURRENT ACCOUNT

EXISTING HOME SALES

LEADING INDICATORS

Friday 23

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

Treasury Financing

May/June 2023

Monday	Tuesday	Wednesday	Thursday	Friday
29	30	31	1	2
MEMORIAL DAY	**AUCTION RESULTS:** Rate / Cover 13-week bills 5.300% 2.38 26-week bills 5.290% 2.58 161-day CMBs 5.340% 2.89 **ANNOUNCE:** $35 billion 4-week bills for auction on June 1 $35 billion 8-week bills for auction on June 1 $44 billion 17-week bills for auction on May 31 **SETTLE:** $35 billion 4-week bills $35 billion 8-week bills $42 billion 17-week bills	**AUCTION RESULTS:** Rate / Cover 17-week bills 5.325% 2.97 **ANNOUNCE:** $25 billion 3-day CMBs for auction on June 1 **SETTLE:** $15 billion 20-year bonds $15 billion 10-year TIPS $42 billion 2-year notes $43 billion 5-year notes $35 billion 7-year notes	**AUCTION RESULTS:** Rate / Cover 4-week bills 5.130% 2.85 8-week bills 5.220% 2.83 3-day CMBs 6.150% 2.38 **ANNOUNCE:** $15 billion 1-day CMBs for auction on June 2 **SETTLE:** $119 billion 13-,26-week bills $50 billion 161-day CMBs	**AUCTION RESULTS:** Rate / Cover 1-day CMBs 5.060% 4.11 38-day CMBs 5.250% 3.40 **ANNOUNCE:** $123 billion** 13-,26-week bills for auction on June 5 $50 billion 38-day CMBs for auction on June 2 $50 billion 44-day CMBs for auction on June 5 **SETTLE:** $25 billion 3-day CMBs
5	6	7	8	9
AUCTION: $123 billion** 13-,26-week bills $50 billion 44-day CMBs **SETTLE:** $15 billion 1-day CMBs $50 billion 38-day CMBs	**ANNOUNCE:** $35 billion* 4-week bills for auction on June 8 $35 billion* 8-week bills for auction on June 8 $44 billion* 17-week bills for auction on June 7 **SETTLE:** $35 billion 4-week bills $35 billion 8-week bills $44 billion 17-week bills $50 billion 44-day CMBs	**AUCTION:** $44 billion* 17-week bills	**AUCTION:** $35 billion* 4-week bills $35 billion* 8-week bills **ANNOUNCE:** $123 billion* 13-,26-week bills for auction on June 12 $36 billion* 52-week bills for auction on June 13 $40 billion* 3-year notes for auction on June 12 $32 billion* 10-year notes for auction on June 12 $18 billion* 30-year bonds for auction on June 13 **SETTLE:** $123 billion** 13-,26-week bills	
12	13	14	15	16
AUCTION: $123 billion* 13-,26-week bills $40 billion* 3-year notes $32 billion* 10-year notes	**AUCTION:** $36 billion* 52-week bills $18 billion* 30-year bonds **ANNOUNCE:** $35 billion* 4-week bills for auction on June 15 $35 billion* 8-week bills for auction on June 15 $44 billion* 17-week bills for auction on June 14 **SETTLE:** $35 billion* 4-week bills $35 billion* 8-week bills $44 billion* 17-week bills	**AUCTION:** $44 billion* 17-week bills	**AUCTION:** $35 billion* 4-week bills $35 billion* 8-week bills **ANNOUNCE:** $123 billion* 13-,26-week bills for auction on June 20 $12 billion* 20-year bonds for auction on June 21 $19 billion* 5-year TIPS for auction on June 22 **SETTLE:** $123 billion* 13-,26-week bills $36 billion* 52-week bills $40 billion* 3-year notes $32 billion* 10-year notes $18 billion* 30-year bonds	
19	20	21	22	23
JUNETEENTH NATIONAL INDEPENDENCE DAY	**AUCTION:** $123 billion* 13-,26-week bills **ANNOUNCE:** $35 billion* 4-week bills for auction on June 22 $35 billion* 8-week bills for auction on June 22 $44 billion* 17-week bills for auction on June 21 **SETTLE:** $35 billion* 4-week bills $35 billion* 8-week bills $44 billion* 17-week bills	**AUCTION:** $44 billion* 17-week bills $12 billion* 20-year bonds	**AUCTION:** $35 billion* 4-week bills $35 billion* 8-week bills $19 billion* 5-year TIPS **ANNOUNCE:** $123 billion* 13-,26-week bills for auction on June 26 $42 billion* 2-year notes for auction on June 26 $43 billion* 5-year notes for auction on June 27 $35 billion* 7-year notes for auction on June 28 $22 billion* 2-year FRNs for auction on June 28 **SETTLE:** $123 billion* 13-,26-week bills	

**Estimate*
***Treasury may postpone these auctions if President Biden has not signed the pending debt ceiling legislation by June 5, 2023.*