U.S. Economic Comment

- FOMC: driving with cruise control; no changes on the horizon
- FOMC: the meaning of "maximum employment"
- GDP preview: still on track in Q4

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Monetary Policy

The upcoming meeting of the Federal Open Market Committee will probably be short because officials do not have much to talk about. All of their policy levers are switched to highly accommodative positions, and officials seem comfortable with such a stance; changes are unlikely for some time.

The prior two meetings were mildly interesting because officials reviewed their asset-purchase program and came to (vague) conclusions on how to proceed with the effort. Policymakers saw their security purchases as providing substantial accommodation and decided to maintain the program until they had achieved "substantial further progress" toward their policy goals. This phrasing does not provide much guidance, but public comments by officials in the past few weeks suggest that they are likely to maintain the effort through much, possibly all, of the year.

The minutes from the December meeting indicated that officials planned to end the program gradually, following a pattern similar to the one used in the aftermath of the financial crisis. That unwinding lasted 10 months (January 2014 to October), and the Committee hiked interest rates two months later.

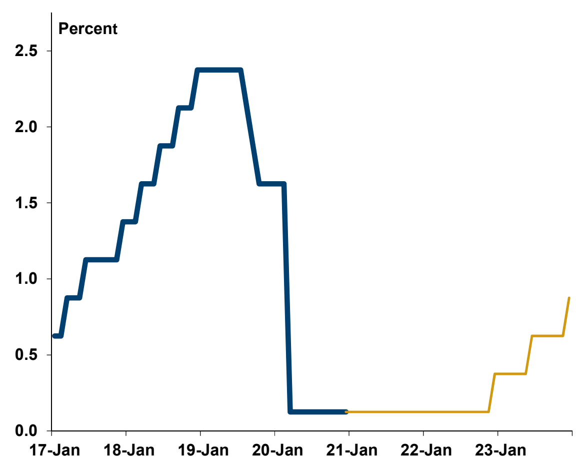
Such a time line suggests that our view of the first rate hike (mid 2022) was too aggressive. If the current QE program extends throughout the year, followed by a lengthy period of tapering, the Committee would not be in position to raise rates in mid 2022. Accordingly, we have pushed back our anticipated date of the first hike to late 2022 (chart). This view is still aggressive, as the latest dot plot shows only one Fed official expecting higher rates in 2022. But we expect the economy to be in good shape by then, and the dot plot has not been a good predictor of actual Fed policy.

The Meaning of Maximum Employment

The timing of the first rate hike is difficult to assess in this cycle because the Fed's new strategic framework has some fuzzy elements. Most notable, the Fed will not raise interest rates until it has ceased buying securities in the open market, and it plans to continue buying until "substantial further progress has been made toward the Committee's maximum employment and price stability goals." Such guidance is close to vacuous because it leaves one wondering about the meaning of "substantial further progress."

The meaning of "maximum employment" also is elusive. This has always been the case, as the Fed has long recognized that the natural rate of unemployment will vary over time because of

Federal Funds Target Rate*



** The readings for 2021-2023 (gold line) are forecasts.*

Source: Federal Reserve Board via Haver Analytics; Daiwa Capital Markets America demographic shifts and other possible structural changes in the labor market. Given this uncertainty, officials have avoided specifying a particular target for the unemployment rate or other labor market metrics.

The situation has become more complicated because the Fed now indicates that maximum employment is “a broad-based and inclusive goal”, a phrasing that suggests the Fed sees itself as having a role to play in promoting a more equitable distribution of income and stronger labor markets in underserved communities.

Public statements also suggest that the Fed is seeking to promote social justice. Officials have noted that one of the prominent lessons from the “Fed Listens” tour was the benefit realized by low- and moderate-income communities from strong labor markets, and Chair Powell confirmed in his recent Q&A session at Princeton University that the FOMC will take into consideration inequality issues. Fed Governor Lael Brainard suggested in her latest speech that economic equality was high on her list of priorities: “Lifting the lives of working people is at the heart of economic policymaking…particularly for low- and moderate-income workers”.

It seems clear that the Fed is now sensitive to social justice issues, but it is not clear how officials will monitor the situation and what weight social measures will receive relative to traditional labor-market metrics. We suspect that traditional indicators will receive most attention, but still, there is a new dimension to policy decisions that must be added to the mix.

Perhaps there is a shortcut to monitoring labor market conditions and assessing the implications for monetary policy. Fed Governor Richard Clarida in a recent speech offered an interesting definition of maximum employment: “the highest level of employment that does not generate sustained pressures that put the price-stability mandate at risk.” In other words, wage and price pressure will inform the Fed when maximum employment has been reached, and therefore, it is inflation that will drive policy decisions in the future.

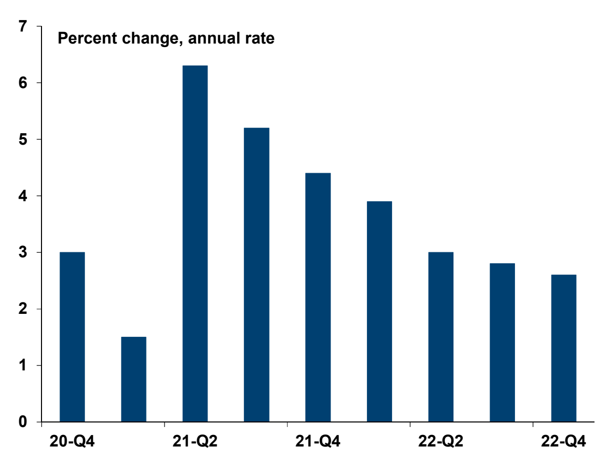
This is an interesting perspective, but still, we are a bit in the dark because the Fed will allow some variation in inflation rates before it alters policy. In the current setting, officials will allow inflation to run “moderately” above the target of two percent “for some time”. Because the Fed has not provided insight into the meaning of “moderate” and “for some time”, we have to guess how much above two percent the Fed will tolerate and for how long.

The Fed’s new strategic framework was a needed adjustment in light of structural shifts in the economy and financial markets (low equilibrium interest rates; insensitivity of inflation to economic slack). It also entails a new reaction function of the FOMC, and officials have provided only vague descriptions of how they will respond to events in the future. We will have to learn by observing as time passes.

Q4 GDP: Preview

The financial press has recently carried numerous stories about a stalling in the recovery. Certainly, activity has slowed, but stalling is perhaps too strong. Also, the easing in activity occurred in the latter part of the fourth quarter; the economy entered Q4 with a fair degree of momentum, and the favorable start is likely to result in continued growth for the quarter as a whole. The magnitude of change involves a good bit of uncertainty because of the unique nature of the pandemic economy, but we expect the advance to be in the neighborhood of three percent (chart).

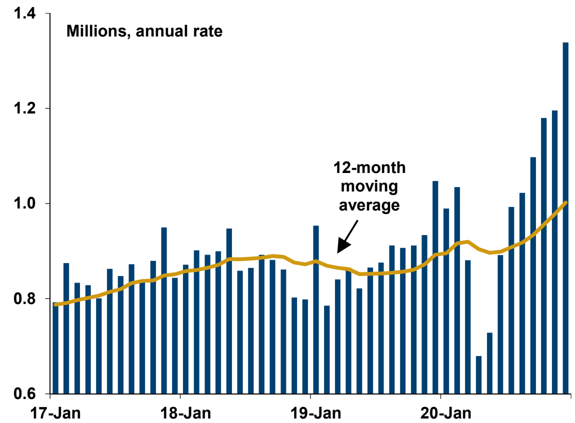
The Outlook for U.S. GDP Growth



Source: Daiwa Capital Markets America

In terms of components, residential construction is likely to standout with growth possibly exceeding 25 percent after growth of 63 percent in the prior quarter (annual rates). The jump in Q3 already pushed residential activity above the pre-pandemic level; the latest change will push new construction far above levels seen throughout the previous expansion. The results will mirror those for single-family housing starts, where the December report published this week showed a surge from an already elevated level (chart).

Single-Family Housing Starts



Source: U.S. Census Bureau via Haver Analytics

Business outlays for new equipment should also be brisk, as shipments of capital goods other than commercial aircraft were strong, as were imports of equipment. Businesses also were active in rebuilding inventories, which leads us to expect a contribution from inventory investment to GDP growth of approximately 1.0 percent. The contribution pales in comparison to the boost of 6.6 percentage points in the prior quarter, but that situation was unique; a contribution of 1.0 percentage point is solid by historical standards. While businesses were active on the equipment and inventory fronts, they hesitated in undertaking new construction projects. Outlays for business structures will probably decline.

Consumers provided support in Q4, but they also showed signs of caution. As a result, consumer outlays are likely to advance only moderately (about two percent by our reckoning). This component will be less than impressive, but it will most likely be firmer than government activity, where spending cuts by state and local governments are likely to lead to a decline.

The easing in economic activity that occurred during Q4 poses challenges for the first quarter of the current year. If slow results were to be maintained, the economy could contract in the first three months of the year. However, we are hopeful that the support from the $900 billion stimulus package passed in December will be sufficient to keep the economy on track. We suspect that growth will be slow (1.5 percent), but it will probably be in the plus column.

We expect brisk growth in Q2 and beyond, partly because distribution of vaccines should allow a pickup in activity (although early results on distribution have not been encouraging) and partly because we suspect that Congress will approve a portion of the Biden stimulus proposal. In fact, we have upped our projection of growth for the year because of prospects for additional fiscal stimulus (4.3 percent on average over the four quarters of 2021 versus previous forecast of 3.2 percent).

Review

Week of Jan. 18, 2021	Actual	Consensus	Comments
Housing Starts (December)	**1.669 Million (+5.8%)**	**1.560 Million (+0.8%)**	Housing starts jumped in December from upwardly revised levels in the prior two months (the November level was 2.0% firmer than previously believed), with the latest change pushing starts above weather-aided levels in late 2019 and early 2020. All of the gain in December occurred in the single-family area, where starts jumped 12.0% to 1.338 million units. The new level was well shy of totals during the bubble period, but it was easily the best of the post-bubble years and in the upper portions of the ranges seen before the housing bubble. Multi-family starts, in contrast, fell 13.6% from a mediocre level in November. Activity in this sector has been underwhelming in recent months. The pandemic seems to have dampened demand for clustered living, and thus multi-family construction has idled.
Existing Home Sales (December)	**6.76 Million (+0.7%)**	**6.56 Million (-1.9%)**	Sales of existing homes rose in December from an upwardly revised level (sales in November were 0.3% firmer than previously believed). The level of sales in December was quite strong by historical standards, far above readings during the previous expansion and within the range seen during the housing bubble. December marked the fourth consecutive month that sales were at this robust level. The brisk pace of sales led to a drop in the number of homes on the market, with the month-to-month change totaling -16.4%. Inventory typically declines in December (the series is not seasonally adjusted), but the latest results represented a sharper-than-normal change (average of -10.8% in the prior 10 years). With homes for sale down, the months' supply of homes fell to 1.9 months, a record low.

Sources: U.S. Census Bureau (Housing Starts); National Associational of Realtors (Existing Home Sales); Consensus forecasts are from Bloomberg

Preview

Week of Jan. 25, 2021	Projected	Comments
Consumer Confidence (January) (Tuesday)	**88.0 (-0.6 Index Pt.)**	The weekly index of consumer attitudes published by Bloomberg, along with the University of Michigan sentiment index for early January, suggest that concern about Covid outweighs the potentially positive influence of record readings on major stock indexes.
Durable Goods Orders (December) (Wednesday)	**0.5%**	Most indicators tied to the manufacturing sector continue to suggest that the recovery remains on track. Accordingly, orders for durable goods are likely to register their eighth consecutive increase, although the acceleration in the number of Covid cases could slow the rate of advance from the average of 5.7% in the prior seven months and 1.3% in the prior four.
GDP (2020-Q4) (Thursday)	**3.0%**	Strong housing activity and robust business investment in equipment and inventories, supplemented by moderate growth in consumer spending, should more than offset drags from net exports and spending by state and local governments.
U.S. International Trade in Goods (December) (Thursday)	**-$83.0 Billion ($2.5 Billion Narrower Deficit)**	After six consecutive advances that pushed imports of goods above their pre-pandemic level, foreign purchases are likely to ease in December. Exports are still noticeably shy of the pre-pandemic levels, and thus could post another advance.
New Home Sales (December) (Thursday)	**0.875 Million (+4.0%)**	Most indicators tied to the housing market show robust activity, leading one to suspect that the drop of 11% in new home sales in November was an aberration. An offset is likely in December.
Leading Indicators (December) (Thursday)	**0.3%**	Strong positive contributions from ISM new orders, stock prices, and building permits should easily offset a drag from unemployment claims, leaving the eighth consecutive increase in the leading indicator index, although the expected gain is the lightest in the recent string.
Personal Income, Consumption, Core Prices (December) (Friday)	**0.0%, -0.7%, 0.1%**	Income is likely to be constrained in December by a drop in the income support programs of the federal government (primarily recovery rebate checks). Farm income also faces downside risks after subsidy-related strength in the prior two months. On the spending side, a pickup in vehicles sales should boost outlays for durable goods, but a weak retail sales report suggests a decline in the nondurable area, and the spread of the coronavirus probably constrained service consumption.
Employment Cost Index (2020-Q4) (Friday)	**0.4%**	Subpar conditions in the labor market are likely to lead to a modest advance in employment costs.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

January/February 2021

Monday	Tuesday	Wednesday	Thursday	Friday
18	19	20	21	22
MARTIN LUTHER KING JR DAY	**TIC DATA** Total / Net L-T Sept -$79.0B / $108.9B Oct -$11.1B / $51.9B Nov $214.1B / $149.2B	**NAHB HOUSING INDEX** Nov 90 Dec 86 Jan 83	**UNEMPLOYMENT CLAIMS** Initial / Continuing (Millions) Dec 26 0.790 / 5.072 Jan 02 0.784 / 5.181 Jan 09 0.926 / 5.054 Jan 16 0.900 / N/A **HOUSING STARTS** Oct 1.530 million Nov 1.578 million Dec 1.669 million **PHILLY FED INDEX** Nov 20.7 Dec 9.1 Jan 26.5	**EXISTING HOME SALES** Oct 6.86 million Nov 6.71 million Dec 6.76 million
25	26	27	28	29
CHICAGO FED NATIONAL ACTIVITY INDEX (8:30) Monthly / 3-Mo. Avg. Oct 1.01 / 0.85 Nov 0.27 / 0.56 Dec -- / --	**FHFA HOME PRICE INDEX (9:00)** Sept 1.7% Oct 1.5% Nov -- **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX (9:00)** SA / NSA Sept 1.4% / 1.3% Oct 1.6% / 1.3% Nov -- / -- **CONFERENCE BOARD CONSUMER CONFIDENCE (10:00)** Nov 92.9 Dec 88.6 **Jan 88.0** **FOMC MEETING**	**DURABLE GOODS ORDERS (8:30)** Oct 1.8% Nov 1.0% **Dec 0.5%** **FOMC DECISION (2:00)** **POWELL PRESS CONFERENCE (2:30)**	**INITIAL CLAIMS (8:30)** **GDP (8:30)** GDP / Chained Price 20-Q2 -31.4% / -1.8% 20-Q3 33.4% / 3.5% **20-Q4 3.0% / 2.0%** **U.S. INTERNATIONAL TRADE IN GOODS (8:30)** Oct -$80.4 billion Nov -$85.5 billion **Dec -$83.0 billion** **ADVANCE INVENTORIES REPORT (8:30)** Wholesale / Retail Oct 1.3% / 0.9% Nov 0.0% / 0.7% Dec -- / -- **NEW HOME SALES (10:00)** Oct 0.945 million Nov 0.841 million **Dec 0.875 million** **LEADING INDICATORS (10:00)** Oct 0.8% Nov 0.6% **Dec 0.3%**	**PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX (8:30)** Inc. / Cons. / Core Oct -0.6% / 0.3% / 0.0% Nov -1.1% / -0.4% / 0.0% **Dec 0.0% / -0.7% / 0.1%** **EMPLOYMENT COST INDEX (8:30)** Comp. / Wages 20-Q2 0.5% / 0.4% 20-Q3 0.5% / 0.4% **20-Q4 0.4% / 0.4%** **MNI CHICAGO REPORT (9:45)** Index / Prices Nov 57.8 / 72.2 Dec 58.7 / 73.5 Jan -- / -- **PENDING HOMES SALES (10:00)** Oct -0.9% Nov -2.6% Dec -- **REVISED CONSUMER SENTIMENT (10:00)** Nov 76.9 Dec 80.7 Jan(p) 79.2
1	2	3	4	5
ISM MFG INDEX **CONSTRUCTION SPEND.**	**NEW VEHICLE SALES**	**ADP EMPLOYMENT REPORT** **ISM SERVICES INDEX**	**INITIAL CLAIMS** **PRODUCTIVITY & COSTS** **FACTORY ORDERS**	**EMPLOYMENT REPORT** **TRADE BALANCE** **CONSUMER CREDIT**
8	9	10	11	12
	NFIB SMALL BUSINESS OPTIMISM INDEX **JOLTS DATA**	**CPI** **WHOLESALE TRADE** **FEDERAL BUDGET**	**INITIAL CLAIMS**	**CONSUMER SENTIMENT**

Forecasts in Bold. *(p) = preliminary*

Treasury Financing

January/February 2021

Monday	Tuesday	Wednesday	Thursday	Friday
18	19	20	21	22
MARTIN LUTHER KING JR DAY	**AUCTION RESULTS:** Rate / Cover 13-week bills 0.085% 2.99 26-week bills 0.095% 3.09 42-day CMB 0.085% 3.34 119-day CMB 0.090% 3.78 **ANNOUNCE:** $30 billion 4-week bills for auction on January 21 $35 billion 8-week bills for auction on January 21 $25 billion 105-day CMBs for auction on January 20 $30 billion 154-day CMBs for auction on January 20 **SETTLE:** $30 billion 4-week bills $35 billion 8-week bills $25 billion 105-day CMBs $30 billion 154-day CMBs	**AUCTION RESULTS:** Rate / Cover 20-yr bonds 1.657% 2.28 105-day CMB 0.085% 4.21 154-day CMB 0.090% 3.63	**AUCTION RESULTS:** Rate / Cover 4-week bills 0.070% 3.95 8-week bills 0.080% 3.50 10-yr TIPS -0.987% 2.68 **ANNOUNCE:** $105 billion 13-,26-week bills for auction on January 25 $34 billion 52-week bills for auction on January 26 $28 billion 2-year FRNs for auction on January 27 $60 billion 2-year notes for auction on January 25 $61 billion 5-year notes for auction on January 26 $62 billion 7-year notes for auction on January 28 $30 billion 42-day CMBs for auction on January 26 $30 billion 119-day CMBs for auction on January 26 **SETTLE:** $105 billion 13-,26-week bills $30 billion 42-day CMBs $30 billion 119-day CMBs	
25	26	27	28	29
$105 billion 13-,26-week bills $60 billion 2-year notes	**AUCTION:** $34 billion 52-week bills $61 billion 5-year notes $30 billion 42-day CMBs $30 billion 119-day CMBs **ANNOUNCE:** $30 billion* 4-week bills for auction on January 28 $35 billion* 8-week bills for auction on January 28 **SETTLE:** $30 billion 4-week bills $35 billion 8-week bills $25 billion 105-day CMBs $30 billion 154-day CMBs	**AUCTION:** $28 billion 2-year FRNs	**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills $62 billion 7-year notes **ANNOUNCE:** $105 billion* 13-,26-week bills for auction February 1 **SETTLE:** $105 billion 13-,26-week bills $34 billion 52-week bills $30 billion 42-day CMBs $30 billion 119-day CMBs	**SETTLE:** $15 billion 10-year TIPS
1	2	3	4	5
AUCTION: $105 billion* 13-,26-week bills **SETTLE:** $24 billion 20-year bonds $28 billion 2-year FRNs $60 billion 2-year notes $61 billion 5-year notes $62 billion 7-year notes	**ANNOUNCE:** $30 billion* 4-week bills for auction on February 4 $35 billion* 8-week bills for auction on February 4 **SETTLE:** $30 billion* 4-week bills $35 billion* 8-week bills	**ANNOUNCE MID-QUARTER REFUNDING:** $58 billion* 3-year notes for auction on February 9 $41 billion* 10-year notes for auction on February 10 $27 billion* 30-year bonds for auction on February 11	**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills **ANNOUNCE:** $105 billion* 13-,26-week bills for auction February 8 **SETTLE:** $105 billion* 13-,26-week bills	
8	9	10	11	12
AUCTION: $105 billion* 13-,26-week bills	**AUCTION:** $58 billion* 3-year notes **ANNOUNCE:** $30 billion* 4-week bills for auction on February 11 $35 billion* 8-week bills for auction on February 11 **SETTLE:** $30 billion* 4-week bills $35 billion* 8-week bills	**AUCTION:** $41 billion* 10-year notes	**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills $27 billion* 30-year bonds **ANNOUNCE:** $105 billion* 13-,26-week bills for auction February 16 $27 billion* 20-year bonds for auction on February 17 $9 billion* 30-year TIPS for auction on February 18 **SETTLE:** $105 billion* 13-,26-week bills	

**Estimate*