U.S. Economic Comment

- PCE inflation: transitory pressure, but still upside risks
- Q2 insights: continued consumer support; possible boost from trade

Michael Moran
Daiwa Capital Markets America
212-612-6392
michael.moran@us.daiwacm.com

Inflation Watch

Like the CPI, the price index for personal consumption expenditures jumped in April, advancing 0.6 percent overall and 0.7 percent excluding food and energy. The changes left the year-over-year increases at 3.6 percent for the headline measure and 3.1 percent for the core index (chart, left for the core index).

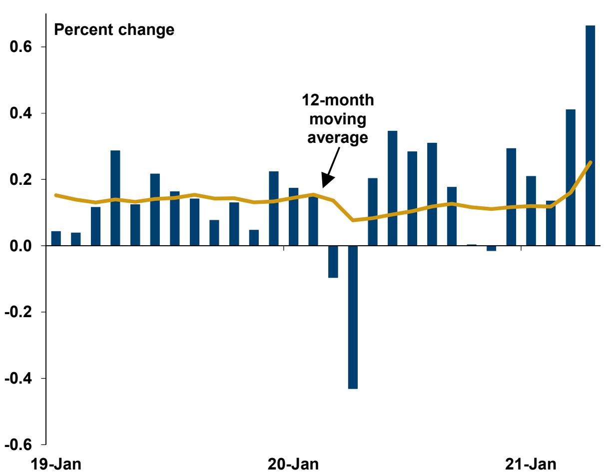
Also like the CPI, Fed officials will have little difficulty dismissing the pressure in the PCE price index as transitory. Much of the surge was the result of sharp increases in the prices of items that had weakened during the pandemic. With economic activity returning to normal, so too are prices.

Pressure was especially pronounced in areas related to travel. For example, air fares jumped 10.0 percent (not annualized) and hotel fees rose 8.8 percent after an increase of 4.4 percent in March. Both have further ground to cover before reaching pre-pandemic levels. Car-rental fees rose 16.2 percent after an average increase of 9.5 percent in the prior two months. In addition to traveling domestically, individuals seem to be venturing abroad, as expenses associated with foreign travel rose 6.6 percent in April.

After being locked down for more than a year, individuals are seeking entertainment. Admission fees to sporting events jumped 10.1 percent in April, and prices of recreation goods also were up noticeably (0.8 percent for durable goods and 1.1 percent for nondurable goods).

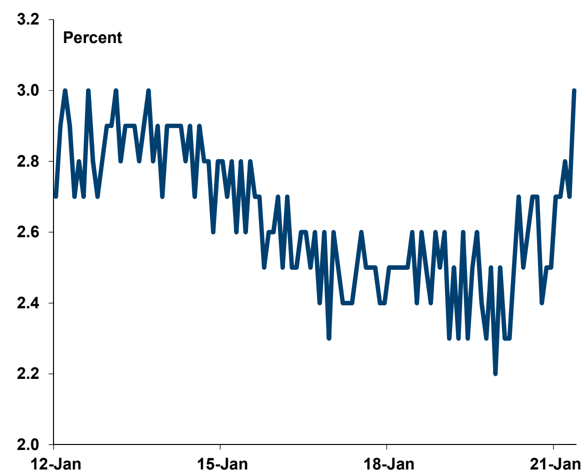
The consumer price index showed an unusually sharp increase in the prices of used motor vehicles (up 10.0 percent), and notable pressure was evident in the PCE price index as well (up 6.7 percent). The sharp increases perhaps reflected a preference for personal travel over public transportation, or possibly a limited selection of new cars and light trucks because of supply-chain disruptions. The shift also might have been the result of random variation. Whatever the cause, the levels of the indexes were far above other recent observations and are likely to ease in the months ahead.

Core PCE Price Index*



** PCE = personal consumption expenditures*
Source: Bureau of Economic Analysis via Haver Analytics

Long-Term Consumer Inflation Expectations*



** The expected average increase in inflation per year during the next five to 10 years.*
Source: University of Michigan Survey Research Center via Haver Analytics

This report is issued by Daiwa Securities Group Inc. through its relevant group companies. Daiwa Securities Group Inc. is the global brand name of Daiwa Securities Co. Ltd., Tokyo ("Daiwa Securities") and its subsidiaries worldwide that are authorized to do business within their respective jurisdictions. These include: Daiwa Capital Markets Hong Kong Ltd. (Hong Kong), regulated by the Hong Kong Securities and Futures Commission, Daiwa Capital Markets Europe Limited (London), regulated by the Financial Conduct Authority and a member of the London Stock Exchange, and Daiwa Capital Markets America Inc. (New York), a U.S. brokerdealer registered with the U.S. Securities and Exchange Commission, a futures commission merchant regulated by the U.S. Commodity Futures Trading Commission, and a primary dealer in U.S. government securities. The data contained in this report were taken from statistical services, reports in our possession, and from other sources believed to be reliable. The opinions and estimates expressed are our own, and we make no representation or guarantee either as to accuracy, completeness or as to the existence of other facts or interpretations that might be significant.

While there were notable transitory influences in both the CPI and PCE price index, signs of potential underlying pressure also have become evident recently. Measures of labor compensation have jumped, with both average hourly earnings and the employment cost index advancing sharply. In addition, inflation expectations seem to be stirring. The May reading on long-term inflation views in the survey of consumers from the University of Michigan Survey Research Center jumped to the upper end of the range from the past 10 years (chart, p. 1). This measure can be volatile and thus should be interpreted cautiously. However, the survey of professional forecasters conducted by the Federal Reserve Bank of Philadelphia wiggled higher in Q2, and break-even rates on inflation-protected securities are elevated.

Thus, while transitory influences will fade, firm readings on inflation could linger for a time.

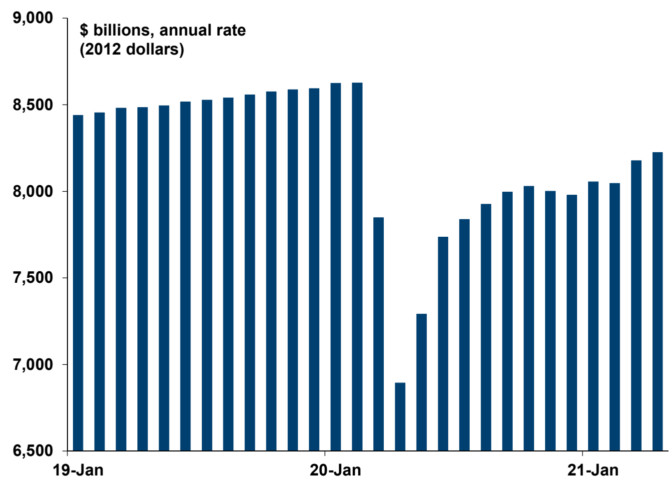
Q2 GDP: Friday's Reports Suggest Strong Advance

Today's report on consumer activity merits close attention because of its inflation measures, but it also provides valuable information on income and spending. At first blush, the report might appear discouraging because of a drop of 13.1 percent in personal income (-13.7 percent after adjusting for inflation, not annualized). However, that decline followed an advance of 20.9 percent in the prior month (20.2 percent in real terms), with the sharp swings tied mainly to transfer payments from the federal government (dominated by Economic Impact Payments and unemployment compensation).

Other sources of income were firm. Most notable, wages and salaries rose 1.0 percent, and nonfarm proprietors' income jumped 2.9 percent. Investment income advanced 0.5 percent, with both dividends and interest contributing.

Personal spending might be viewed as soft, as real outlays fell 0.1 percent. But again, the apparently soft results merely reflected a natural cooling after a surge of 4.1 percent in March. Also, there is good reason to expect firm results in coming months. The advances in wages and other income provided encouragement, and the household sector in the aggregate has a large pool of savings that can be drawn on to support spending. Finally, individuals are starting to spend more actively on services, and they have considerable ground to cover to return to pre-Covid norms (chart).

Real Consumer Outlays for Services



Source: Bureau of Economic Analysis via Haver Analytics

Given the April results, Q2 should provide firm results on consumer spending. Even if outlays showed no further change in May and June, real consumer expenditures in the GDP accounts would post an increase of approximately 9.0 percent (annual rate). Continued improvement in service consumption could lead to a stronger advance.

The April report on international trade in goods provided a pleasant surprise, with an increase of 1.2 percent in exports and a drop of 2.2 percent in imports leading to a noticeable improvement in the monthly trade deficit. The April deficit of $85.2 billion represented a shift from the average shortfall of $88.2 billion in the first quarter, raising the possibility of a positive contribution from net exports to GDP growth. A boost from trade certainly would be welcome, as net exports have been a drag on activity for three consecutive quarters, subtracting 2.0 percentage points from GDP on average over this span.

Review

Week of May 24, 2021	Actual	Consensus	Comments
New Home Sales (April)	**0.863 Million (-5.9%)**	**0.950 Million (-7.0%)**	Sales of new homes fell in April from downwardly revised results in the prior three months. Several factors likely played a role in the soft results, including elevated prices, modestly higher interest rates, and tight inventories. With regards to inventories, although the months' supply of homes available for sale rose from 4.0 months to 4.4 months because of the slowdown in sales, the number of homes on the market remained low from a longer-term perspective.
Consumer Confidence (May)	**117.2 (-0.3 Index Pt.)**	**118.8 (-2.9 Index Pts.)**	The dip in consumer confidence in May put a dent in the sharp advances in March and April (up 20.7% and 2.3%, respectively). While the measure has improved on balance in recent months, it has yet to regain its pre-Covid footing (the level of the confidence index in May was 11.6% below the reading of 132.6 in February 2020). Concerns about the inflation outlook could be driving the restrained performance in confidence. Survey respondents' views on expected inflation in the next 12 months ticked up to 6.5% from 6.2% in April, matching the recent high in February. By comparison, the expected rate of inflation averaged 5.6% last year and 4.6% in 2019. In contrast to views on the inflation outlook, attitudes regarding the labor market improved sharply. The share of individuals reporting that jobs were plentiful less the share indicating that jobs were hard to get rose to 34.6%, a strong reading by historical standards.
Durable Goods Orders (April)	**-1.3%**	**0.8%**	Downside volatility in the transportation component (off 6.7%) depressed total durable goods orders in April, but excluding transportation, the report carried a solid tone. Bookings ex-transportation rose 1.0%, marking the 11th increase in the past 12 months and moving orders well above their pre-pandemic level. New orders for nondefense capital goods excluding aircraft, a series that provides good insight into capital spending by businesses, rose 2.3%. The advance continued a strong upward trend and left orders well above pre-pandemic levels.
Revised GDP (2021-Q1)	**6.4% (Unrevised)**	**6.5% (0.1 Pct. Pt. Upward Revision)**	Offsetting adjustments to various components left the revised estimate of Q1 GDP unchanged from the preliminary tally. On the positive side, consumer spending was revised higher from an already firm performance (11.3%, annual rate versus 10.7%). In addition, residential construction was adjusted upward, as was business investment in intellectual property. In contrast, several components (unexpectedly) added accents to already soft performances. Net exports stood out in this regard, subtracting 1.2 percentage points from GDP growth versus a drag of 0.9 percentage point in the advance estimate. Inventory investment also unexpectedly was adjusted downward, subtracting 2.8 percentage points from growth rather than 2.6 percentage points. Business investment in equipment and outlays by state and local governments also were revised slightly lower.

Review Continued

Week of May 24, 2021	Actual	Consensus	Comments
U.S. International Trade in Goods (April)	**-$85.2 Billion ($6.8 Billion Narrower Deficit)**	**-$92.0 Billion ($0.4 Billion Wider Deficit)**	Exports of goods jumped 1.2% in April, while imports slipped 2.2%. The shifts in trade flows led to notable narrowing in the monthly trade deficit. While it is only the first glimpse at trade statistics for Q2, the monthly deficit for April was $3.0 billion narrower than the average for Q1, suggesting a positive contribution from trade to GDP growth after large negative contributions in the prior three quarters (net exports subtracted 2.0 percentage points per quarter, on average, from GDP growth). However, one should interpret the results cautiously, as data on services trade and real goods trade for April, and results for upcoming months, could change the picture appreciably.
Personal Income, Consumption, Core Prices (April)	**-13.1%, 0.5%, 0.7%**	**-14.2%, 0.5%, 0.6%**	Wage income rose 1.0% in April, and other components posted solid advances (proprietors' income, rental income, interest and dividends), but a drop in government transfers (payback after payment of Recovery Rebate Checks) overwhelmed increases elsewhere and pulled total income sharply lower. Nominal consumer spend increased moderately, led by outlays for durable goods and services; spending on nondurable items declined. Perhaps the most notable aspects of the April report were shifts in the PCE price indexes. The headline measure jumped 0.6%, which translated to a year-over-year advance of 3.6% -- the fastest since the fall of 2008. The core index surged 0.7%, or 3.1% year-over-year (the fastest pace since 1992).
Revised Consumer Sentiment (May)	**82.9 (+0.1 Index Pt. Revision)**	**83.0 (+0.2 Index Pt. Revision)**	The miniscule upward adjustment to consumer did little to blunt the disappointing drop of 6.1% in May. Although the economy and job market have continued to improve as Covid has receded, inflation worries seem to have affected the moods of consumers. The short-term inflation measure published with the report was unrevised at 4.6% in late May (up from 3.4% in April and an average of 2.7% in 2020), a reading in the upper end of the long-term range. Long-term inflation expectations were revised down one tick to 3.0%, but the final result was still in the upper portion of the range from the past 10 years.

Sources: U.S. Census Bureau (New Home Sales, Durable Goods Orders, U.S. International Trade in Goods); The Conference Board (Consumer Confidence); Bureau of Economic Analysis (Revised GDP, Personal Income, Consumption, Prices); University of Michigan Survey Research Center (Revised Consumer Sentiment) ; Consensus forecasts are from Bloomberg

Preview

Week of May 31, 2021	Projected	Comments
ISM Manufacturing Index (May) (Tuesday)	**61.0% (+0.3 Pct. Pt.)**	The manufacturing sector is performing well, which suggests a strong performance for the ISM index in May. While upside may be limited because of the already elevated reading, rebounds in the production and inventory components could nudge the index higher in the latest month.
Construction Spending (April) (Tuesday)	**0.5%**	Residential construction is likely to remain on its upward trend, although recent figures on housing starts suggest that the rate of advance could slow. Business-related activity is unlikely to deviate from its downward trend, while respectable revenue flows and upcoming federal support could lead to a rebound in government-sponsored activity (mostly state and local) after a weak first quarter.
Revised Nonfarm Productivity (2021-Q1) (Thursday)	**5.4% (Unrevised)**	With GDP growth unrevised in Q1, productivity growth will probably show little or no adjustment. However, an upward revision to employee compensation raises the prospect of an upward adjustment to unit labor cost.
ISM Services Index (May) (Thursday)	**62.5% (-0.2 Pct. Pt.)**	The recovery in the service sectors of the U.S. economy likely continued apace in May, but with key components (new orders, business activity, employment) already elevated, the ISM services index seemingly lacks a catalyst to push it above the record reading of 63.7% in March.
Payroll Employment (May) (Friday)	**650,000**	Record job openings and firm readings on the ISM employment indexes suggest that payroll growth could rebound after posting sluggish growth in April. Strong job growth and a slowing in labor force expansion after a jump in April point to a decline in the unemployment rate.
Factory Orders (April) (Friday)	**-0.5%**	Durable goods orders (published May 27) declined 1.3%, but the disappointing headline result reflected downside volatility in the transportation category. In the nondurable area, lower prices likely depressed the value of petroleum and coal bookings, but orders ex-petroleum and coal likely continued on their upward trajectory.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

May/June 2021

Monday	Tuesday	Wednesday	Thursday	Friday
24	25	26	27	28

Monday 24

CHICAGO FED NATIONAL ACTIVITY INDEX

	Monthly	3-Mo. Avg.
Feb	-1.75	-0.11
Mar	1.71	0.35
Apr	0.24	0.07

Tuesday 25

FHFA HOME PRICE INDEX

Jan	1.0%
Feb	1.1%
Mar	1.4%

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

	SA	NSA
Jan	1.3%	0.9%
Feb	1.2%	1.3%
Mar	1.6%	2.2%

NEW HOME SALES

Feb	0.854 million
Mar	0.917 million
Apr	0.863 million

CONFERENCE BOARD CONSUMER CONFIDENCE

Mar	114.9
Apr	117.5
May	117.2

Wednesday 26

Thursday 27

UNEMPLOYMENT CLAIMS

	Initial	Continuing
	(Millions)	
May 01	0.507	3.640
May 08	0.478	3.738
May 15	0.444	3.642
May 22	0.406	N/A

DURABLE GOODS ORDERS

Feb	1.3%
Mar	1.3%
Apr	-1.3%

REVISED GDP

	GDP	Chained Price
20-Q4	4.3%	2.0%
21-Q1(a)	6.4%	4.1%
21-Q1(p)	6.4%	4.3%

PENDING HOMES SALES

Feb	-11.5%
Mar	1.7%
Apr	-4.4%

Friday 28

U.S. INTERNATIONAL TRADE IN GOODS

Feb	-$88.2 billion
Mar	-$92.0 billion
Apr	-$85.2 billion

ADVANCE INVENTORIES

	Wholesale	Retail
Feb	1.0%	0.1%
Mar	1.1%	-1.4%
Apr	0.8%	-1.6%

PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX

	Inc.	Cons.	Core
Feb	-6.9%	-1.0%	0.1%
Mar	20.9%	4.7%	0.4%
Apr	-13.1%	0.5%	0.7%

MNI CHICAGO BUSINESS BAROMETER INDEX

	Index	Prices
Mar	66.3	80.4
Apr	72.1	91.5
May	75.2	88.4

CONSUMER SENTIMENT

Mar	84.9
Apr	88.3
May(p)	82.8
May(r)	82.9

Monday	Tuesday	Wednesday	Thursday	Friday
31	1	2	3	4

Monday 31

MEMORIAL DAY

Tuesday 1

ISM INDEX (10:00)

	Index	Prices
Mar	64.7	85.6
Apr	60.7	89.6
May	**61.0**	**89.0**

CONSTRUCTION SPEND. (10:00)

Feb	-0.6%
Mar	0.2%
Apr	**0.5%**

Wednesday 2

BEIGE BOOK (2:00)

April Beige Book

"National economic activity accelerated to a moderate pace from late February to early April."

VEHICLE SALES

Mar	18.0 million
Apr	18.5 million
May	**17.9 million**

Thursday 3

INITIAL CLAIMS (8:30)

ADP EMPLOYMENT REPORT (8:15)

	Private Payrolls
Mar	565,000
Apr	742,000
May	--

REVISED PRODUCTIVITY & COSTS (8:30)

	Productivity	Unit Labor Costs
20-Q4	-3.8%	5.6%
21-Q1(p)	5.4%	-0.3%
21-Q1(r)	**5.4%**	**-0.1%**

ISM SERVICES INDEX (10:00)

	Index	Prices
Mar	63.7	74.0
Apr	62.7	76.8
May	**62.5**	**76.0**

Friday 4

EMPLOYMENT REPORT (8:30)

	Payrolls	Un. Rate
Mar	770,000	6.0%
Apr	266,000	6.1%
May	**650,000**	**5.9%**

FACTORY ORDERS (10:00)

Feb	0.4%
Mar	1.2%
Apr	**-0.5%**

Monday	Tuesday	Wednesday	Thursday	Friday
7	8	9	10	11
CONSUMER CREDIT	**NFIB SMALL BUSINESS OPTIMISM INDEX** **TRADE BALANCE** **JOLTS REPORT**	**WHOLESALE TRADE**	**INITIAL CLAIMS** **CPI** **FEDERAL BUDGET**	**CONSUMER SENTIMENT**
14	15	16	17	18
	RETAIL SALES **PPI** **EMPIRE MFG INDEX** **IP & CAP-U** **BUSINESS INVENTORIES** **NAHB HOUSING INDEX** **TIC DATA** **FOMC MEETING**	**HOUSING STARTS** **IMPORT/EXPORT PRICES** **FOMC DECISION**	**INITIAL CLAIMS** **PHILLY FED INDEX** **LEADING INDICATORS**	

Forecasts in Bold. (a) = advance (1st estimate of GDP); (p) = preliminary (2nd estimate of GDP); (r) = revised

Treasury Financing

May/June 2021

Monday	Tuesday	Wednesday	Thursday	Friday
24	25	26	27	28
AUCTION RESULTS: Rate Cover 13-week bills 0.015% 2.88 26-week bills 0.030% 2.78	**AUCTION RESULTS:** Rate Cover 2-year notes 0.152% 2.74 6-week CMB 0.005% 3.60 **ANNOUNCE:** $40 billion 4-week bills for auction on May 27 $40 billion 8-week bills for auction on May 27 $35 billion 17-week CMBs for auction on May 26 **SETTLE:** $40 billion 4-week bills $40 billion 8-week bills $35 billion 17-week CMBs	**AUCTION RESULTS:** Margin Cover 2-year FRN 0.030% 3.03 Rate Cover 5-year notes 0.788% 2.49 17-week CMB 0.020% 3.12	**AUCTION RESULTS:** Rate Cover 4-week bills 0.000% 4.06 8-week bills 0.005% 3.23 7-year notes 1.285% 2.41 **ANNOUNCE:** $111 billion 13-,26-week bills for auction on June 1 $40 billion 6-week CMBs for auction on June 1 **SETTLE:** $111 billion 13-,26-week bills $40 billion 6-week CMBs	**SETTLE:** $13 billion 10-year TIPS $26 billion 2-year FRNs
31	1	2	3	4
MEMORIAL DAY	**AUCTION:** $111 billion 13-,26-week bills $40 billion 6-week CMBs **ANNOUNCE:** $40 billion* 4-week bills for auction on June 3 $40 billion* 8-week bills for auction on June 3 $35 billion* 17-week CMBs for auction on June 2 **SETTLE:** $40 billion 4-week bills $40 billion 8-week bills $27 billion 20-year bonds $60 billion 2-year notes $61 billion 5-year notes $62 billion 7-year notes $35 billion 17-week CMBs	**AUCTION:** $35 billion* 17-week CMBs	**AUCTION:** $40 billion* 4-week bills $40 billion* 8-week bills **ANNOUNCE:** $111 billion* 13-,26-week bills for auction June 7 $58 billion* 3-year notes for auction on June 8 $38 billion* 10-year notes for auction on June 9 $24 billion* 30-year bonds for auction on June 10 $40 billion* 6-week CMBs for auction on June 8 **SETTLE:** $111 billion 13-,26-week bills $40 billion 6-week CMBs	
7	8	9	10	11
AUCTION: $111 billion* 13-,26-week bills	**AUCTION:** $58 billion* 3-year notes $40 billion* 6-week CMBs **ANNOUNCE:** $40 billion* 4-week bills for auction on June 10 $40 billion* 8-week bills for auction on June 10 $35 billion* 17-week CMBs for auction on June 9 **SETTLE:** $40 billion* 4-week bills $40 billion* 8-week bills $35 billion* 17-week bills	**AUCTION:** $38 billion* 10-year notes $35 billion* 17-week CMBs	**AUCTION:** $40 billion* 4-week bills $40 billion* 8-week bills $24 billion* 30-year bonds **ANNOUNCE:** $111 billion* 13-,26-week bills for auction on June 14 $34 billion* 52-week bills for auction on June 15 $24 billion* 20-year bonds for auction on June 15 $16 billion* 5-year TIPS for auction on June 17 $40 billion* 6-week CMBs for auction on June 15	**SETTLE:** $111 billion* 13-,26-week bills $40 billion* 6-week CMBs
14	15	16	17	18
AUCTION: $111 billion* 13-,26-week bills	**AUCTION:** $34 billion* 52-week bills $24 billion* 20-year bonds $40 billion* 6-week CMBs **ANNOUNCE:** $40 billion* 4-week bills for auction on June 17 $40 billion* 8-week bills for auction on June 17 $35 billion* 17-week CMBs for auction on June 16 **SETTLE:** $40 billion* 4-week bills $40 billion* 8-week bills $58 billion* 3-year notes $38 billion* 10-year notes $24 billion* 30-year bonds $35 billion* 17-week CMBs	**AUCTION:** $35 billion* 17-week CMBs	**AUCTION:** $40 billion* 4-week bills $40 billion* 8-week bills $16 billion* 5-year TIPS **ANNOUNCE:** $111 billion* 13-,26-week bills for auction on June 21 $26 billion* 2-year FRNs for auction on June 23 $60 billion* 2-year notes for auction on June 22 $61 billion* 5-year notes for auction on June 23 $62 billion* 7-year notes for auction on June 24 $40 billion* 6-week CMBs for auction on June 22	**SETTLE:** $111 billion* 13-,26-week bills $34 billion* 52-week bills $40 billion* 6-week CMBs

*Estimate