U.S. Economic Comment

- FOMC preview: lots of discussion, but no conclusions, on QE
- GDP preview: firm results in Q2; still on track in H2

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Monetary Policy

The Federal Open Market Committee is likely to give scant consideration to possible interest rate changes, but possible adjustments to the asset purchase program are likely to be discussed extensively. However, we do not expect the Committee to reach any decisions on the future of quantitative easing.

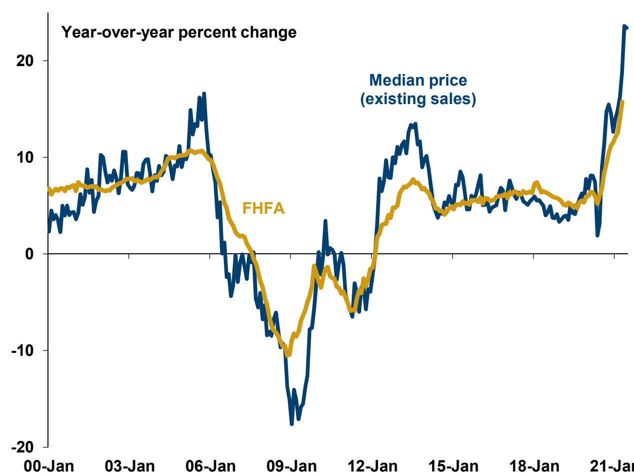
The Committee began to discuss possible adjustments to QE at the June FOMC meeting, but Officials generally agreed that the standard of "substantial further progress" toward the Committee's policy goals had not been met. They expected good progress toward their goals in the months ahead, but policymakers still felt they should be "patient" in announcing changes because incoming economic reports were not providing a clear signal about underlying economic momentum. The economic situation is likely to be viewed as even more opaque in the current setting because of the pickup in the number of Covid cases. Thus, status quo for now.

While the Committee is likely to easily agree that purchases should not be trimmed in the near term, we suspect policymakers will spend more time discussing how to proceed once the time for adjustment arrives. Specifically, some policymakers will wish to trim purchases of mortgage-backed securities before they begin to withdraw from the Treasury market; others will prefer to alter the two efforts simultaneously.

The case for beginning the taper process with mortgage-backed securities is straightforward (and compelling in our view). The housing market does not seem to need special support at this time, as the environment already is robust. Sales have eased in recent months, but the softening seems to be the result of lean inventories of homes for sale and elevated prices that have squeezed some buyers out of the market. The Fed's MBS purchases could be a factor in the price pressure in the housing market, and thus reduced support seems appropriate. More generally, many (including us) believe that the Fed should not seek to allocate capital to any particular market or sector.

The price performance has been striking, as shown by the 23.4 percent increase in the median price of existing homes in the past year. This measure will fluctuate with the composition of sales, and some of the increase undoubtedly reflects activity in more expensive markets or in larger-sized homes. However, measures that track price changes by focusing on repeat sales (effectively holding composition steady) also show marked pressure. The measure published by the Federal Housing Finance Agency, for example, rose 15.7 percent in the 12 months ended in April. Both of these measures have increased more than they did during the housing boom in the early 2000s (chart).

Home Prices*



** Data for the FHFA measure are available through April (versus June for the measure published by the NAR).*

Source: Federal Housing Finance Agency and National Association of Realtors via Haver Analytics

While the housing market does not seem to need support, some Fed officials prefer to remain active in the MBS market because they see purchases as promoting overall financial accommodation. They apparently view longer-term fixed-income securities has highly substitutable, and therefore, activity in one market will have ripple effects in other markets. Thus, purchases of mortgage-backed securities, by this view, will have a broad-based influence on financial conditions in general.

Reporters at Chair Powell's press briefing raised the issue of tapering several times, including the possibility of beginning cutbacks with mortgage-backed securities. Mr. Powell was noncommittal on start date, but he did not seem in a rush to begin pulling back. With regard to early tapering of MBS, we viewed his comments as slightly favoring simultaneously tapering. John Williams, President of the New York Fed and Vice-Chair of the FOMC, also has expressed a preference for simultaneous cutbacks.

Messrs. Powell and Williams will have a strong influence on the FOMC's decisions, but we would keep the door open to the possibility of tapering MBS purchases before Treasuries. If home prices continue to advance at their recent pace, the housing market will increasingly be viewed as bubble-like, and special support from the Fed will be questioned by many observers. We would not be surprised if the Fed began tapering its MBS purchases in the fourth quarter. The Fed will need to see good progress in reducing unemployment before it starts to trim Treasury purchases, but we see the economy continuing to improve in the second half, which should lead to enough improvement in the labor market to trigger the tapering of Treasuries in early 2022.

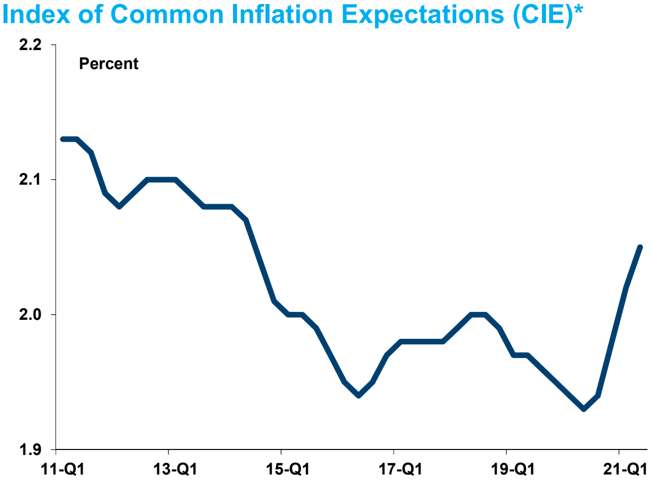
Possible interest rate adjustments are not likely to be on the agenda at the upcoming FOMC meeting. The lack of discussion might seem surprising given the pickup in inflation, but most Fed officials seem to embrace the view that recent price pressure will be transitory. Fed views could change if inflation expectations begin to stir, but so far results have been mixed.

Consumers seem concerned about price pressure, as survey measures of inflation expectations from both the New York Fed and the University of Michigan Survey Research Center have jumped recently. However, these measures are often influenced by shifts in the prices of food and energy, and they can be volatile. Market participants, in contrast, seem to share the Fed's view that price pressure will be transitory, as breakeven rates on inflation-protected securities have not changed appreciably in recent months despite high-side readings on the CPI and PCE price indexes.

The staff of the Federal Reserve Board of Governors has developed a composite measure of inflation expectations that provides a useful summary when various measures show divergent movements. The so-called index of common inflation expectations incorporates 21 measures of expectations, thus providing a broad view. The measure seems to be attracting the attention of Fed officials, as several policymakers have referenced the index in recent comments, and it was noted in the minutes of some recent FOMC meetings.

This index has picked up in recent quarters (it is available only quarterly), but the changes have occurred from a low level registered during the worst of the pandemic. The latest reading was shy of most observations before 2014, and the staff noted at the June meeting that the index was still at a level that prevailed when inflation was modest (chart).

Index of Common Inflation Expectations (CIE)*



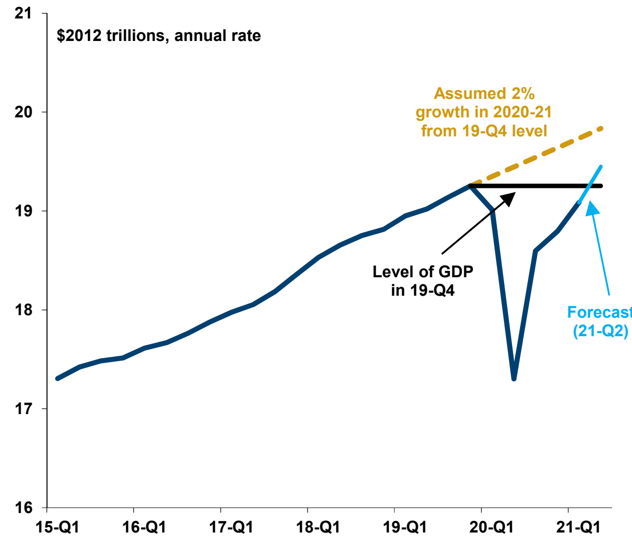
** The CIE is a model-based inflation gauge that utilizes 21 inflation expectation indicators (TIPS spreads, Blue Chip consensus, etc.) projected onto a baseline series derived from 10-year-ahead PCE (personal consumption expenditures) inflation expectations from the Philadelphia Fed's Survey of Professional Forecasters.*

Source: Ahn, Hie Joo, and Chad Fulton (2020). "Index of Common Inflation Expectations," FEDS Notes. Washington: Board of Governors of the Federal Reserve System, September 02, 2020,https://doi.org/10.17016/2380-7172.2551. Federal Reserve Board via Haver Analytics

GDP Preview

The Department of Commerce will publish on July 29 its first estimate of second quarter GDP. The results are likely to be favorable, as our tally shows real growth of 8.0 percent. The advance will mark the third consecutive increase, and significantly, it will push the level of real GDP above the pre-pandemic level in 2019-Q4 (chart).

Real GDP



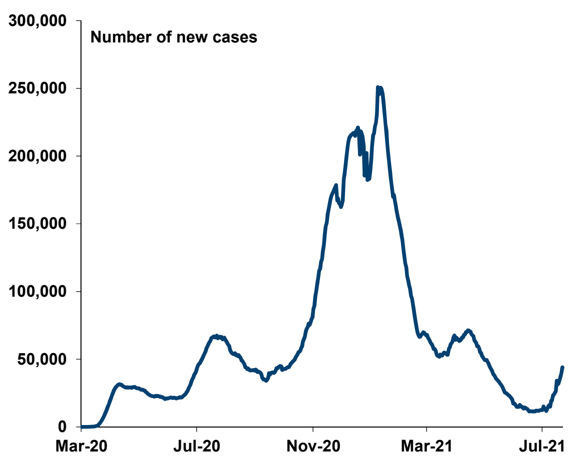
Source: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

Consumer spending is likely to lead the advance, with real growth in double-digit territory for the second consecutive quarter. Businesses are likely to provide support with moderate growth in fixed investment. The expected increase of approximately 5.0 percent is well shy of the brisk advances in the prior three quarters (average growth of almost 16 percent), but capital expenditures in the first quarter had already moved above the pre-pandemic level, and thus some easing in the rate of advance seemed likely. One area that was quite soft in other recent quarters is likely to shift gears. Net exports, which subtracted an average of 2.1 percentage points from GDP growth in the prior three quarters, likely had an approximately neutral influence in the second quarter.

Two areas are likely to stand out on the soft side. Residential construction seems to have cooled down after growing at a stunning pace of almost 38 percent in the prior three quarters and moving far above pre-pandemic levels. Inventory investment, reflecting a sharp drawdown of stocks in the auto sector, likely constrained economic growth in the second quarter, although the drag is likely to be considerably smaller than the negative contribution of 2.7 percentage points in the first quarter.

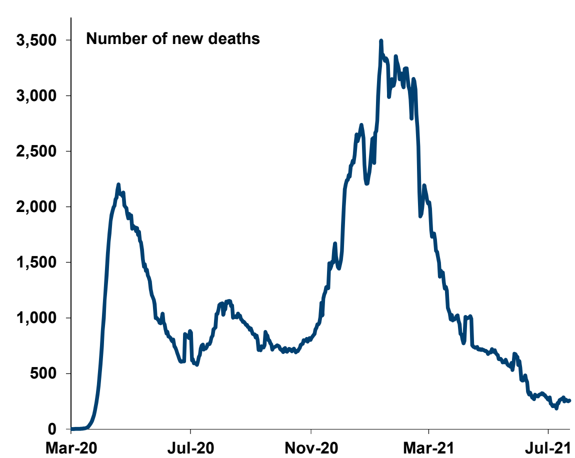
Economic activity was brisk in the second quarter, but questions arise about the rate of growth in the second half, partly because of the pickup in the spread of Covid and partly because of waning fiscal stimulus

New Covid-19 Cases*



** Seven-day moving average.*
Source: Johns Hopkins University & Medicine via Bloomberg

New Covid-Related Deaths*



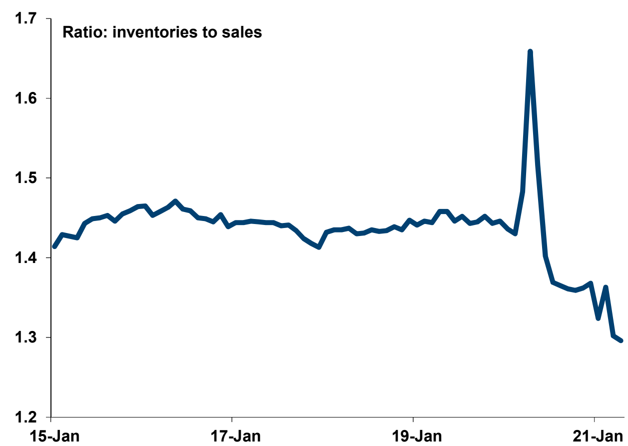
** Seven-day moving average*
Source: Johns Hopkins University & Medicine via Bloomberg

and a natural easing in momentum. The spread of Covid certainly involves downside risks, but we suspect the fallout will be less pronounced than it was earlier. First, the number of new cases, while up noticeably, remain below levels seen earlier. In addition, the number of deaths has barely moved, partly because of improved therapeutics and partly because vaccines seem to limit the severity of the disease (charts, prior page). Against this background, businesses and individuals are likely to remain anxious to return to normal and allow those who refuse vaccines to bear the consequences of their decisions.

We also are not deeply concerned about a loss of momentum. The household sector has accumulated a large pool of saving over the past year, and those funds can be drawn on to finance continued activity. In addition, strong job growth and elevated wealth positions because of record equity values will encourage spending.

Support from state and local governments is likely to pickup in the second half. This group limited activity in the past year because of concern about weak revenue flows. However, receipts have improved recently and strong federal support started to flow during the second quarter. Thus, state and local governments, in the aggregate, should be on firm financial ground and able to become more active. We also are hopeful that inventory investment can contribute positively. The ratio of inventories to sales has slipped noticeably in the past year (chart), and businesses most likely will attempt to rebuild positions if supply-chain difficulties can be eased.

Real Inventories/Sales Ratio (All Industries)



Source: Bureau of Economic Analysis via Haver Analytics

Review

Week of July 19, 2021	Actual	Consensus	Comments
Housing Starts (June)	**1.643 Million (+6.3%)**	**1.590 Million (+1.2%)**	Housing starts advanced for the second consecutive month in June, pushing activity to the upper portion of the recent range (third best of the current recovery period). Both single-family and multi-family starts contributed about equally to the overall advance (up 6.3% and 6.2%, respectively). The increase in single-family starts offset a good portion of the net softening that occurred in recent months, whereas multi-family starts maintained their recent firm performance.
Existing Home Sales (June)	**5.86 Million (+1.4%)**	**5.90 Million (+1.7%)**	The increase in sales of existing homes ended a four-month slide in activity. The new total was firmer than results before the onset of the pandemic, but it lagged the strong pace late last year and early this year. Sales in recent months have faced two challenges: light inventories and elevated prices. The inventory situation improved slightly in June, as the months' supply of homes inched up to 2.6 from 2.5 in May and the record low of 1.9 around the turn of the year. Still, supply was lean relative to historical standards (homes on the market usually represent a four-to-five months' supply). The median sales price rose 3.7% in June, which left prices up 23.4% in the past year.
Leading Indicators (June)	**0.7%**	**0.8%**	Large positive contributions from unemployment claims, ISM new orders, and the leading credit index offset a negative contribution from building permits, as the index of leading economic indicators increased for the 13th time in the past 14 months (with the other month registering no change). The index first exceeded the pre-pandemic high in April, and the gain in June left the measure 2.8% above the reading prior to the onset of the pandemic.

Sources: U.S. Census Bureau (Housing Starts); National Association of Realtors (Existing Home Sales); The Conference Board (Leading Indicators); Consensus forecasts are from Bloomberg

Preview

Week of July 26, 2021	Projected	Comments
New Home Sales (June) (Monday)	**0.8250 Million (+7.3%)**	Although elevated prices represent a challenge for many potential buyers, recent declines in interest rates should pull some individuals into the housing market, leading to a pickup in sales after a net decline in the prior four months.
Durable Goods Orders (June) (Tuesday)	**1.0%**	Disruptions to supply chains could have a dampening effect on order flows, but continued recovery in the economy should dominate and lead to another advance, resulting in the 13th increase in the past 14 months. A large order at Boeing for the 737 Max adds to the upside potential.
Consumer Confidence (July) (Tuesday)	**123.0 (-4.3 Index Pts.)**	After notable improvement in the prior four months, likely influenced by a favorable labor market and record equity values, a pickup in inflation may have dampened moods in July.
U.S. International Trade in Goods (June) (Wednesday)	**-$87.0 Billion ($1.2 Billion Narrower Deficit)**	Both exports and imports have fully recovered from pandemic-related retreats, with imports posting the stronger showing. Recent readings on imports seem to have jumped above the underlying trend, possibly leading to an adjustment in June and slight improvement in the monthly trade deficit.
GDP (2021-Q2) (Thursday)	**8.0%**	Strong growth in consumer spending and a moderate advance in business fixed investment should offset a soft performance in residential construction and a possible negative contribution from inventory investment. Net exports, which have been a pronounced drag in the prior three quarters (subtracting 2.1 percentage points from GDP growth, on average), should have an approximately neutral influence in Q2.
Personal Income, Consumption, Core Prices (June) (Friday)	**0.2%, 0.3%, 0.6%**	Waning government support to households probably led to a drop in transfer payments, but other sources of income (wages, interest , dividends, rent, proprietors' income) should provide an offset and leave a slight gain overall. On the spending side, slow vehicle sales probably led to a drop in outlays for durable goods, but increases in spending on nondurables and services should lead to an overall gain. Results on the CPI suggest another high-side reading on the price index for personal consumption expenditures.
Employment Cost Index (2021-Q2) (Friday)	**0.9%**	Efforts to attract workers probably led to firm advances in wages and benefits in the second quarter, with the expected increase in total compensation matching the advance in the first quarter and exceeding the pre-pandemic average of 0.7% in 2019.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

July/August 2021

Monday	Tuesday	Wednesday	Thursday	Friday
19	20	21	22	23
NAHB HOUSING INDEX May 83 June 81 July 80	**HOUSING STARTS** Apr 1.514 million May 1.546 million June 1.643 million		**UNEMPLOYMENT CLAIMS** Initial / Continuing (Millions) June 26 0.368 3.367 July 03 0.386 3.265 July 10 0.368 3.236 July 17 0.419 N/A **CHICAGO FED NATIONAL ACTIVITY INDEX** Monthly / 3-Mo. Avg. Apr -0.16 0.16 May 0.26 0.80 June 0.09 0.06 **LEADING INDICATORS** Apr 1.3% May 1.2% June 0.7% **EXISTING HOME SALES** Apr 5.85 million May 5.78 million June 5.86 million	
26	27	28	29	30
NEW HOME SALES (10:00) Apr 0.817 million May 0.769 million **June 0.825 million**	**DURABLE GOODS ORDERS (8:30)** Apr -0.7% May 2.3% **June 1.0%** **FHFA HOME PRICE INDEX (9:00)** Mar 1.6% Apr 1.8% May -- **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX (9:00)** SA / NSA Mar 1.6% 2.2% Apr 1.6% 2.1% May -- -- **CONFERENCE BOARD CONSUMER CONFIDENCE (10:00)** May 120.0 June 127.3 **July 123.0** **FOMC MEETING**	**ADVANCE INVENTORIES (8:30)** Wholesale / Retail Apr 1.1% -1.7% May 1.3% -0.8% June -- -- **U.S. INTERNATIONAL TRADE IN GOODS (8:30)** Apr -\$85.9 billion May -\$88.2 billion **June -\$87.0 billion** **FOMC DECISION (2:00)**	**INITIAL CLAIMS (8:30)** **GDP (8:30)** GDP / Chained Price 20-Q4 4.3% 2.0% 21-Q1 6.4% 4.3% **21-Q2 8.0% 5.0%** **PENDING HOMES SALES (10:00)** Apr -4.4% May 8.0% June --	**PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX (8:30)** Inc. / Cons. / Core Apr -13.1% 0.9% 0.7% May -2.0% 0.0% 0.5% **June 0.2% 0.3% 0.6%** **EMPLOYMENT COST INDEX (8:30)** Comp. / Wages 20-Q4 0.7% 0.8% 21-Q1 0.9% 1.0% **21-Q2 0.9% 0.9%** **MNI CHICAGO PURCHASING MANAGERS' INDEX (9:45)** Index / Prices May 75.2 88.4 June 66.1 91.9 July -- -- **REVISED CONSUMER SENTIMENT (10:00)** May 82.9 June 85.5 July(p) 80.8
2	3	4	5	6
ISM MFG INDEX **CONSTRUCTION SPEND.**	**FACTORY ORDERS** **VEHICLE SALES**	**ADP EMPLOYMENT REPORT** **ISM SERVICES INDEX**	**INITIAL CLAIMS** **TRADE BALANCE**	**EMPLOYMENT REPORT** **WHOLESALE TRADE** **CONSUMER CREDIT**
9	10	11	12	13
JOLTS DATA	**NFIB SMALL BUSINESS OPTIMISM INDEX** **PRODUCTIVITY & COSTS**	**CPI** **FEDERAL BUDGET**	**INITIAL CLAIMS** **PPI**	**IMPORT/EXPORT PRICES** **CONSUMER SENTIMENT**

Forecasts in Bold. (p) = preliminary

Treasury Financing

July/August 2021

Monday	Tuesday	Wednesday	Thursday	Friday
19	20	21	22	23
AUCTION RESULTS: Rate Cover 13-week bills 0.050% 3.44 26-week bills 0.050% 3.50	**AUCTION RESULTS:** Rate Cover 6-week CMB 0.045% 3.97 **ANNOUNCE:** $40 billion 4-week bills for auction on July 22 $35 billion 8-week bills for auction on July 22 $30 billion 17-week CMBs for auction on July 21 **SETTLE:** $40 billion 4-week bills $35 billion 8-week bills $35 billion 17-week CMBs	**AUCTION RESULTS:** Rate Cover 20-yr bonds 1.890% 2.33 17-week CMB 0.050% 4.18	**AUCTION RESULTS:** Rate Cover 4-week bills 0.045% 3.41 8-week bills 0.045% 4.17 10-yr TIPS -1.016% 2.50 **ANNOUNCE:** $105 billion 13-,26-week bills for auction on July 26 $28 billion 2-year FRNs for auction on July 28 $60 billion 2-year notes for auction on July 26 $61 billion 5-year notes for auction on July 27	$62 billion 7-year notes for auction on July 29 $20 billion 6-week CMBs for auction on July 27 Settle: $105 billion 13-,26-week bills $35 billion 6-week CMBs
26	27	28	29	30
AUCTION: $105 billion 13-,26-week bills $60 billion 2-year notes	**AUCTION:** $61 billion 5-year notes $20 billion 6-week CMBs **ANNOUNCE:** $40 billion* 4-week bills for auction on July 29 $35 billion* 8-week bills for auction on July 29 $30 billion* 17-week CMBs for auction on July 28 **SETTLE:** $40 billion 4-week bills $35 billion 8-week bills $30 billion 17-week CMBs	**AUCTION:** $28 billion 2-year FRNs $30 billion* 17-week CMBs	**AUCTION:** $40 billion* 4-week bills $35 billion* 8-week bills $62 billion 7-year notes **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on August 2 $20 billion* 6-week CMBs for auction on August 3 **SETTLE:** $105 billion 13-,26-week bills $20 billion* 6-week CMBs	**SETTLE:** $16 billion 10-year TIPS
2	3	4	5	6
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	**AUCTION:** $20 billion* 6-week CMBs **ANNOUNCE:** $40 billion* 4-week bills for auction on August 5 $35 billion* 8-week bills for auction on August 5 $30 billion* 17-week CMBs for auction on August 4 **SETTLE:** $40 billion* 4-week bills $35 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs **ANNOUNCE MID-QUARTER REFUNDING:** $58 billion* 3-year notes for auction on August 10 $41 billion* 10-year notes for auction on August 11 $27 billion* 30-year bonds for auction on August 12	**AUCTION:** $40 billion* 4-week bills $35 billion* 8-week bills **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on August 9 $34 billion* 52-week bills for auction on August 10 $20 billion* 6-week CMBs for auction on August 10 **SETTLE:** $105 billion* 13-,26-week bills $20 billion* 6-week CMBs	
9	10	11	12	13
AUCTION: $105 billion* 13-,26-week bills	**AUCTION:** $34 billion* 52-week bills $58 billion* 3-year notes $20 billion* 6-week CMBs **ANNOUNCE:** $40 billion* 4-week bills for auction on August 12 $35 billion* 8-week bills for auction on August 12 $30 billion* 17-week CMBs for auction on August 11 **SETTLE:** $40 billion* 4-week bills $35 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $41 billion* 10-year notes $30 billion* 17-week CMBs	**AUCTION:** $40 billion* 4-week bills $35 billion* 8-week bills $27 billion* 30-year bonds **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on August 16 $27 billion* 20-year bonds for auction on August 18 $8 billion* 30-year TIPS for auction on August 19 $20 billion* 6-week CMBs for auction on August 17 **SETTLE:** $105 billion* 13-,26-week bills $34 billion* 52-week bills $20 billion* 6-week CMBs	

**Estimate*