Daiwa Capital Markets

U.S. Economic Comment

- Powell at Jackson Hole: little new information on tapering…
  …but a strong dovish tone

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Jackson Hole

The Jackson Hole speech of Fed Chair Jerome Powell offered little new information on plans for altering the Fed's asset purchase program. Mr. Powell simply repeated the possible change mentioned in the minutes of the July meeting of the Federal Open Market Committee: if the labor market conditions evolve as Fed officials expect, they would be willing to begin reducing purchases this year.

Policymakers believe that the criterion for tapering ("substantial further progress" toward policy objectives) has been satisfied with respect to inflation and is close to being satisfied with respect to employment. We suspect that officials will need to see strong employment results for August and possibly September before they rate progress in the labor market as substantial. Thus, we look for the announcement of tapering to occur at the September 22 or November 3 FOMC meetings. Mr. Powell has indicated several times that officials would provide ample notice of changes in the purchase program. We view the information in the July minutes and the Jackson Hole speech as signals that tapering is on the horizon. Ample notice has been provided.

While Chair Powell provided little new information in asset purchases, we viewed the following sentence from his talk as revealing:

> Even after our asset purchases end, our elevated holdings of longer-term securities will continue to support accommodative financial conditions.

The statement implies that the Fed does not intend to sell or redeem its security holdings after the current effort ends, a different tack than that followed after the QE program associated with the financial crisis. New information.

Interest Rate Liftoff

Mr. Powell was careful to note that tapering (and ending) the QE program does not have any implications for the normalization of interest rates. He emphasized that the FOMC has set "a different and substantially more stringent test" for raising interest rates. The tone of his talk, in our view, implied that he is hesitant to raise interest rates and will resist early efforts to tighten policy. Consider these snippets from his speech:

- Labor market conditions are improving but turbulent
- We have much ground to cover to reach maximum employment
- …the pandemic continues to threaten…economic activity
- The early days of stabilization policy in the 1950s taught monetary policymakers not to attempt to offset what are likely to be temporary fluctuations in inflation. Indeed, responding may do more harm than good
- For now, I believe that policy is well positioned

Powell's Defense of Transitory Inflation

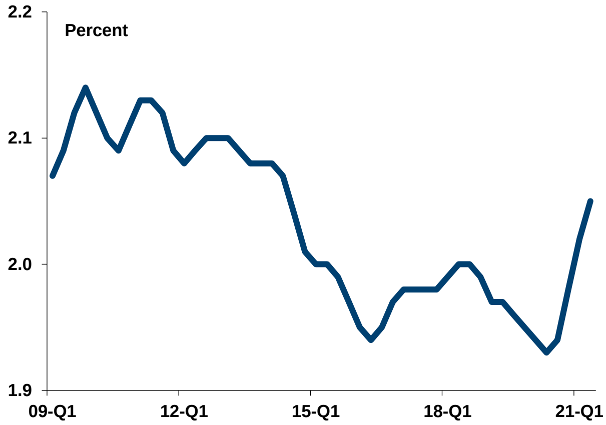
Chair Powell devoted most of his talk to a defense of his view that recent inflation pressure will be transitory. His arguments were interesting, but not entirely convincing.

His lead argument was that recent price pressures were not broadly based; rather, recent inflation was driven by a "narrow group of goods and services that have been directly affected by the pandemic and the reopening of the economy." As support for this view, he showed the annual change over the past 18 month in the PCE price index for durable goods excluding food and energy (chart, right). This metric involves a good bit of smoothing and excluding, and such exercises have the potential to obscure potentially important information. Even with the manipulations that supposedly generated calm results, the measure has increased noticeably and moved above the Fed's target of two percent.

Mr. Powell also argued that growth of wage measures not affected by the composition of employment, such as the employment cost index, were consistent with the Fed's longer-term inflation objective. This is a curious view given that the wage component of the ECI rose 0.9 percent in the second quarter after an increase of 1.0 percent in Q1 (a compound annual advance of 3.9 percent). The norm before this year was 0.7 percent.

Perhaps the most important consideration in the outlook for inflation is the behavior of inflation expectations. If consumers and business executives believe that inflation will remain contained, they will behave in a way that fosters stable inflation. Mr. Powell noted that the Fed monitors several measures of inflation expectations, highlighting the index of common inflation expectations, a composite of 21 indicators developed by the Staff of the Board of Governors (chart, left). Mr. Powell was pleased that the measure had moved from its sub-two percent level in the preceding few years. However, we view the suddenness of the shift and the movement above two percent as a little disconcerting. We would think the acceleration would alert Fed officials to high-side risks.

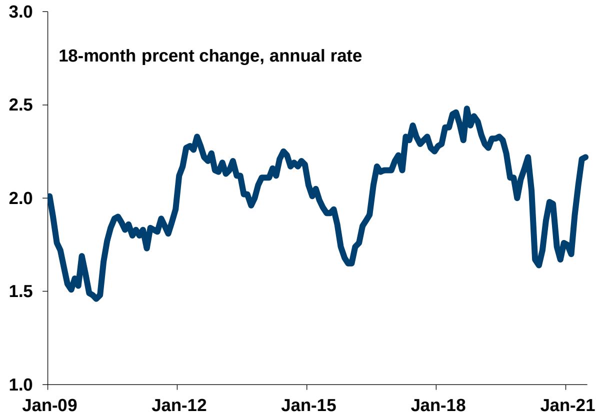
Index of Common Inflation expectations*



** An index of inflation expectations developed by the staff of the Federal Reserve Board based on 21 indicators of inflation expectations*

Source: Federal Reserve Board via Haver Analytics

PCE Inflation: Core Ex-Durable-Goods



Source: Federal Reserve Board staff calculations. Presented in Jerome Powell's Jackson Hole speech, August 27, 2021

Review

Week of August 23, 2021	Actual	Consensus	Comments
Existing Home Sales (July)	**5.99 Million (2.0%)**	**5.83 Million (-0.5%)**	The increase in sales of existing homes marked the second consecutive advance, although the gains offset only a small portion of the declines from February through May. Sales remained 10.1 percent below their level in January. Two factors seem to account for the easing in the spring: elevated prices and a lean inventory of homes for sale. High prices remain an issue (up 17.8% in the past year), but the Inventory situation has improved slightly, as the months' supply of homes for sale totaled 2.6 months in July, up from 1.9 in December and January but still low by historical standards.
New Home Sales (July)	**0.708 Million (+1.0%)**	**0.700 Million (+3.6%)**	Sales of new homes in July were a touch better than expected, but the upside surprise did not alter the general picture: after a burst of activity in the second half of last year, sales have eased considerably in the past several months. Sales in June had moved to the lowest level of the current expansion, and they were only moderately higher in July. In contrast to the market for existing homes, lean inventories do not appear to be a constraint on sales. The number of new homes for sale has increased in eight of the past nine months, including increases of more than five percent in both June and July. Elevated prices, however, represent a high hurdle for many buyers.
Durable Goods Orders (July)	**-0.1%**	**-0.3%**	The transportation component softened noticeably in July (off 2.2%), as a sharp decline in the volatile commercial aircraft category more than offset a surprising 5.8% increase in bookings for motor vehicles. Excluding transportation, order flows posted another solid performance. Bookings ex-transportation had already moved far above all historical readings in prior months, and they advanced another 0.7 percent in July. The new level of orders was 8.7 percent above the previous record set in 2008.
Revised GDP (2021-Q2)	**6.6% (+0.1 Pct. Pt. Revision)**	**6.7% (+0.2 Pct. Pt. Revision)**	GDP showed an inconsequential revision in the second quarter, and the sources of growth also did not change meaningfully. The economy in Q2 was powered by consumer spending and business fixed investment, with these components showing slightly better results than initially believed. Other components (inventory investment, residential construction, government spending, and net exports) were soft, with most of them showing even weaker results (net exports were a tad firmer).

Review Continued

Week of August 23, 2021	Actual	Consensus	Comments
U.S. International Trade in Goods (July)	**-$86.4 Billion ($5.7 Billion Narrower Deficit)**	**-$90.5 Billion ($1.6 Billion Narrower Deficit)**	Both sides of the trade ledger contributed to the notable improvement in the monthly trade deficit, as exports rose 1.5% and imports fell 1.4%. On the export side, consumer goods, capital goods, and motor vehicles all posted strong advances; industrial supplies and consumer goods accounted for most of the decline in imports. Although it is early in the third quarter, the results raise the possibility of a positive contribution from net exports to GDP growth, which would end a string of four quarterly constraints from international trade on U.S. GDP growth.
Personal Income, Consumption, Core Prices (July)	**1.1%, 0.3%, 0.3%**	**0.1%, 0.4%, 0.3%**	Strong wage growth (up 1.0%) played a key role in fueling the advance in personal income, and a jump of 2.9% in transfer payments, reflecting the first installment of the advanced child tax credit, had a strong influence as well. Rents and investment income rose moderately, while proprietors' income dipped. On the spending side, a jump of 1.0 percent in outlays for services more than offset declines in spending on durable and nondurable Goods. While overall spending rose moderately, the advance translated to a drop of 0.1% after adjusting for inflation. The headline inflation index for personal consumption rose 0.4%, a bit slower than the average of 0.6 percent in the prior four months, while core prices rose 0.3 percent, down from the average of 0.5% in the prior four months.
Revised Consumer Sentiment (August)	**70.3 (+0.1 Index Pt. Revision)**	**71.0 (+0.8 Index Pt. Revision)**	The paltry revision in the consumer sentiment index maintained the third decline in the past four months and left the measure below the trough of 71.8 registered during the recession. Apparently the reacceleration of Covid and the pickup in inflation have weighed on consumer moods.

Sources: National Association of Realtors (Existing Home Sales); U.S. Census Bureau (New Home Sales, Durable Goods Orders, U.S. International Trade in Goods); 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 August 30, 2021	Projected	Comments
Consumer Confidence (August) (Tuesday)	**125.0 (-4.1 Index Pts.)**	A pickup in inflation and the reacceleration of Covid probably dampened confidence in August after considerable improvement from March through July.
ISM Manufacturing Index (August) (Wednesday)	**58.0% (-1.5 Pct. Pts.)**	With economic growth now easing from the robust pace of the past four quarters, the manufacturing index is likely to ease a bit from recent elevated readings.
Construction Spending (July) (Wednesday)	**0.0%**	Private residential construction, while likely to advance in July, has lost the vigor it had in the second half of last year. Private nonresidential building and government-sponsored construction are likely to remain on the soft paths seen in the past year.
Revised Nonfarm Productivity (2021-Q2) (Thursday)	**2.5% (0.2 Pct. Pt. Revision)**	The upward revision to GDP growth in Q2 will probably feed through to productivity, leaving a slightly larger advance.
U.S. International Trade Balance (July) (Thursday)	**-$70.5 Billion ($5.2 Billion Narrower Deficit)**	The surplus in service trade will probably shrink considerably because of the payment for broadcast rights to the Tokyo Olympics, but the surprising improvement in the goods trade deficit ($5.7 billion improvement from June to July) should easily offset the slippage in service trade.
Factory Orders (July) (Thursday)	**0.3%**	With orders for durable goods showing little change (-0.1%, reported August 25), an expected increase of 0.7 percent in the nondurable area accounts for all of the expected gain in total bookings. The advance in the nondurable area is likely to reflect higher prices of petroleum products, but continued growth in orders ex-petroleum is likely to play a role as well.
Payroll Employment (August) (Friday)	**750,000**	With economic growth easing somewhat, payrolls are not likely to match the increases of more than 900,000 in June and July. However, with generous government support fading, more individuals are likely to enter the labor force and accept employment, which should allow job growth to exceed the average of 487,000 in the first five months of the year. Job growth should be firm enough to push the unemployment rate lower, although a jump in the size of the labor force is likely to limit the drop (5.3% in August versus 5.4% in July).
ISM Services Index (August) (Friday)	**61.0% (-3.1 Pct. Pts.)**	The reacceleration of Covid is likely to dampen activity in the service sectors of the economy, which is likely to lead to a drop in the ISM services index from the record high in July.

Source: Forecasts provided by Daiwa Capital Markets America

Daiwa Capital Markets

Economic Indicators

August/September 2021

Monday 23

CHICAGO FED NATIONAL ACTIVITY INDEX

	Monthly	3-Mo. Avg.
May	0.15	0.79
June	-0.01	0.01
July	0.53	0.23

EXISTING HOME SALES

May	5.78 million
June	5.87 million
July	5.99 million

Tuesday 24

NEW HOME SALES

May	0.720 million
June	0.701 million
July	0.708 million

Wednesday 25

DURABLE GOODS ORDERS

May	3.2%
June	0.8%
July	-0.1%

Thursday 26

UNEMPLOYMENT CLAIMS

	Initial	Continuing (Millions)
July 31	0.387	2.899
Aug 07	0.377	2.865
Aug 14	0.349	2.862
Aug 21	0.353	N/A

REVISED GDP

	GDP	Chained Price
21-Q1	6.3%	4.3%
21-Q2(a)	6.5%	6.0%
21-Q2(p)	6.6%	6.1%

Friday 27

U.S. INTERNATIONAL TRADE IN GOODS

May	-$88.1 billion
June	-$92.1 billion
July	-$86.4 billion

ADVANCE INVENTORIES REPORT

	Wholesale	Retail
May	1.3%	-0.9%
June	1.2 %	0.5%
July	0.6%	0.4%

PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX

	Inc.	Cons.	Core
May	-2.1%	0.1%	0.6%
June	0.2%	1.1%	0.5%
July	1.1%	0.3%	0.3%

REVISED CONSUMER SENTIMENT

June	85.5
July	81.2
Aug(p)	70.2
Aug(r)	70.3

POWELL SPEECH AT JACKSON HOLE

Monday 30

PENDING HOMES SALES (10:00)

May	8.3%
June	-1.9%
July	--

Tuesday 31

FHFA HOME PRICE INDEX (9:00)

Apr	1.8%
May	1.7%
June	--

S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX (9:00)

	SA	NSA
Apr	1.7%	2.2%
May	1.8%	2.1%
June	--	--

MNI CHICAGO BUSINESS BAROMETER INDEX (9:45)

	Index	Prices
June	66.1	91.9
July	73.4	91.6
Aug	--	--

CONFERENCE BOARD CONSUMER CONFIDENCE (10:00)

June	128.9
July	129.1
Aug	**125.0**

Wednesday 1

ADP EMPLOYMENT REPORT (8:15)

	Private Payrolls
June	680,000
July	330,000
Aug	--

ISM INDEX (10:00)

	Index	Prices
June	60.6	92.1
July	59.5	85.7
Aug	**58.0**	**84.0**

CONSTRUCTION SPEND. (10:00)

May	-0.2%
June	0.1%
July	**0.0%**

NEW VEHICLE SALES

June	15.4 million
July	14.8 million
Aug	**14.5 million**

Thursday 2

INITIAL CLAIMS (8:30)

REVISED PRODUCTIVITY & COSTS (8:30)

	Productivity	Unit Labor Costs
21-Q1	4.3%	-2.8%
21-Q2(p)	2.3%	1.0%
21-Q2(r)	**2.5%**	**0.9%**

TRADE BALANCE (8:30)

May	-$71.0 billion
June	-$75.7 billion
July	**-$70.5 billion**

FACTORY ORDERS (10:00)

May	2.3%
June	1.4%
July	**0.3%**

Friday 3

EMPLOYMENT REPORT (8:30)

	Payrolls	Un. Rate
June	938,000	5.9%
July	943,000	5.4%
Aug	**750,000**	**5.3%**

ISM SERVICES INDEX (10:00)

	Index	Prices
June	60.1	79.5
July	64.1	82.3
Aug	**61.0**	**80.0**

Monday 6

LABOR DAY

Tuesday 7

Wednesday 8

JOLTS DATA

BEIGE BOOK

CONSUMER CREDIT

Thursday 9

INITIAL CLAIMS

Friday 10

PPI

WHOLESALE TRADE

Monday 13

FEDERAL BUDGET

Tuesday 14

NFIB SMALL BUSINESS OPTIMISM INDEX

CPI

Wednesday 15

EMPIRE MANUFACTURING

IMPORT/EXPORT PRICES

IP & CAP-U

Thursday 16

INITIAL CLAIMS

RETAIL SALES

PHILLY FED INDEX

BUSINESS INVENTORIES

TIC DATA

Friday 17

CONSUMER SENTIMENT

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

Treasury Financing

August/September 2021

Monday	Tuesday	Wednesday	Thursday	Friday
23	24	25	26	27
AUCTION RESULTS: Rate Cover 13-week bills 0.055% 3.30 26-week bills 0.050% 3.02	**AUCTION RESULTS:** Rate Cover 2-year notes 0.242% 2.65 67-day CMB 0.060% 2.87 **ANNOUNCE:** $30 billion 4-week bills for auction on August 26 $30 billion 8-week bills for auction on August 26 $30 billion 17-week CMBs for auction on August 25 **SETTLE:** $35 billion 4-week bills $30 billion 8-week bills $30 billion 17-week CMBs	**AUCTION RESULTS:** Margin Cover 2-year FRN 0.026% 3.17 Rate Cover 5-year notes 0..831% 2.35 17-week CMB 0.050% 3.88	**AUCTION RESULTS:** Rate Cover 4-week bills 0.035% 3.83 8-week bills 0.060% 3.45 7-year notes 1.155% 2.34 **ANNOUNCE:** $99 billion 13-,26-week bills for auction on August 30 $45 billion 21-day CMBs for auction on August 31 **SETTLE:** $99 billion 13-,26-week bills $40 billion 67-day CMBs	**SETTLE:** $26 billion 2-year FRNs
30	31	1	2	3
AUCTION: $99 billion 13-,26-week bills	**ANNOUNCE:** $30 billion* 4-week bills for auction on September 2 $30 billion* 8-week bills for auction on September 2 $30 billion* 17-week CMBs for auction on September 1 **AUCTION:** $45 billion 21-day CMBs **SETTLE:** $30 billion 4-week bills $30 billion 8-week bills $30 billion 17-week CMBs $8 billion 30-year TIPS $27 billion 20-year bonds $60 billion 2-year notes $61 billion 5-year notes $62 billion 7-year notes	**AUCTION:** $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 4-week bills $30 billion* 8-week bills **ANNOUNCE:** $99 billion* 13-,26-week bills for auction on Sept. 7 $34 billion* 52-week bills for auction on September 7 $58 billion* 3-year notes for auction on September 7 $38 billion* 10-year notes for auction on September 8 $24 billion* 30-year bonds for auction on September 9 **SETTLE:** $99 billion 13-,26-week bills $45 billion 21-day CMBs	
6	7	8	9	10
LABOR DAY	**AUCTION:** $99 billion* 13-,26-week bills $34 billion* 52-week bills $58 billion* 3-year notes **ANNOUNCE:** $30 billion* 4-week bills for auction on September 9 $30 billion* 8-week bills for auction on September 9 $30 billion* 17-week CMBs for auction on September 8 **SETTLE:** $30 billion* 4-week bills $30 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $38 billion* 10-year notes $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 4-week bills $30 billion* 8-week bills $24 billion* 30-year bonds **ANNOUNCE:** $99 billion* 13-,26-week bills for auction on September 13 **SETTLE:** $99 billion* 13-,26-week bills $34 billion* 52-week bills	
13	14	15	16	17
AUCTION: $99 billion* 13-,26-week bills	**ANNOUNCE:** $30 billion* 4-week bills for auction on September 16 $30 billion* 8-week bills for auction on September 16 $30 billion* 17-week CMBs for auction on September 15 **SETTLE:** $30 billion* 4-week bills $30 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs **SETTLE:** $58 billion* 3-year notes $38 billion* 10-year notes $24 billion* 30-year bonds	**AUCTION:** $30 billion* 4-week bills $30 billion* 8-week bills **ANNOUNCE:** $99 billion* 13-,26-week bills for auction on September 20 $26 billion* 2-year FRNs for auction on September 22 $24 billion* 20-year bonds for auction on September 21 $14 billion* 10-year TIPS for auction on September 23 **SETTLE:** $99 billion* 13-,26-week bills	

*Estimate