Daiwa Capital Markets

U.S. Economic Comment

- Inflation watch: pressure at the producer level
- Inflation views: Fed officials versus the Beige Book

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Producer Prices

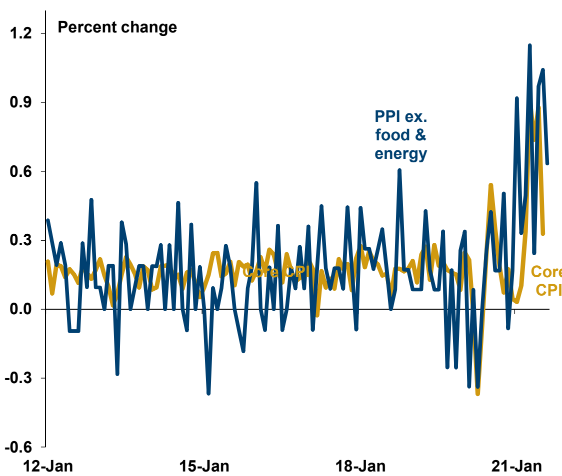
We do not typically give much weight to the producer price index when assessing the inflation environment. The measure tends to move erratically, and it does not correlate well with other inflation measures in the short run (note the marked volatility relative to the CPI in the left chart). Much of the monthly noise in the PPI washes out over time and correlation is higher in the longer run. Still, the PPI is more volatile than other measures (chart, right).

While we do not give the PPI close consideration, we do not ignore it. Notable, persistent changes would lead us to suspect that trends might be shifting, and pressure has been both notable and persistent this year. The headline index has increased at least 0.5 percent every month so far this year, with the average monthly advance totaling 0.9 percent. Excluding food and energy, two months were reasonably tame (0.2 percent in May and 0.3 percent in February), but changes in other months this year have ranged from 0.5 percent to 1.1 percent, with the average in the first eight months of the year totaling 0.7 percent. The year-over-year changes in August totaled 8.3 percent overall and 6.7 percent excluding food and energy (chart, right).

Results in August cooled to a degree, as the increase ex food and energy trailed the average and was notably slower than observations in the firmest months. The deceleration suggests that transitory influences have been in play, but the still-brisk advance in August also supports the view that price pressure is lingering.

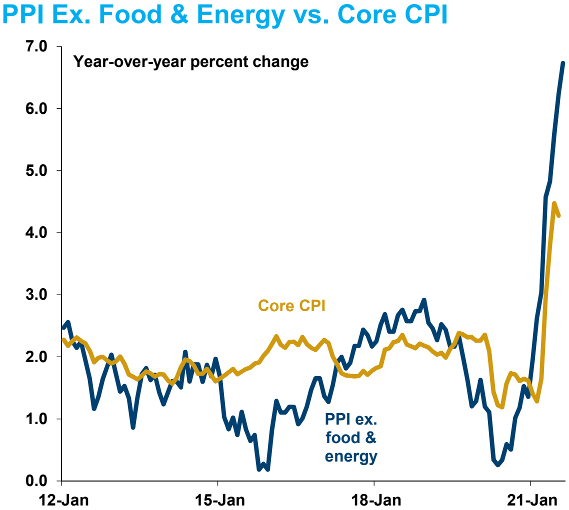
Prices included in the PPI are likely to be more sensitive to supply-chain difficulties than those in the CPI, and this sensitivity could explain the high-side readings on the PPI. However, this does not provide great comfort. The persistence of supply disruptions could eventually feed through to consumer prices, and price changes at the producer level suggest that supply constraints might not be resolved quickly. Thus, while transitory influences in the CPI seem to be fading (core CPI rose 0.3 percent in July; August results published on September 14), supply-chain disruptions could generate high-side readings in the months ahead.

PPI Ex. Food & Energy vs. Core CPI



Source: Bureau of Labor Statistics via Haver Analytics

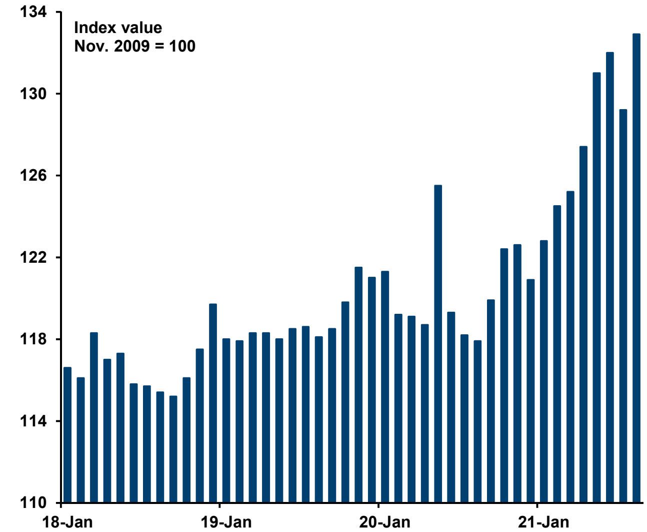
PPI Ex. Food & Energy vs. Core CPI



Source: Bureau of Labor Statistics via Haver Analytics

The charts and discussion above focus on prices excluding food and energy in order to eliminate the noise generated by these volatile components. However, as with the overall PPI, persistent changes could be meaningful, and food prices have moved sharply higher this year. Prices fell in July, which raised the possibility of a peak and perhaps a reversal, but this component jumped again in August, offsetting the drop in the prior month and reestablishing the pronounced upward trend (chart; the chart shows the level of the food index rather than the percent change; the vertical axis might be viewed as the cost of a typical grocery store run).

PPI: Final Demand Foods



Source: Bureau of Labor Statistics via Haver Analytics

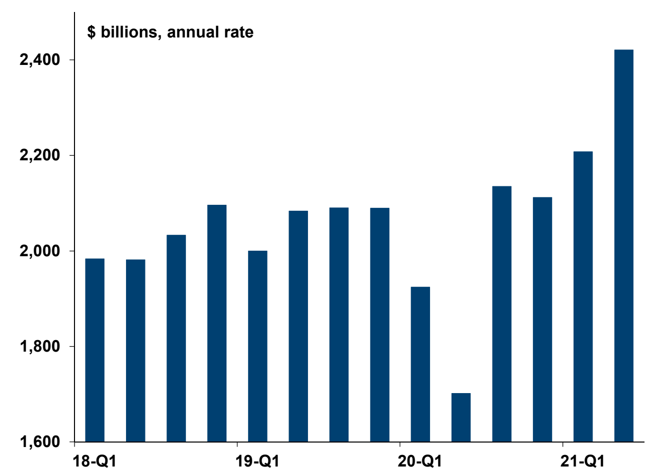
We often downplay shifts in food prices because of their high degree of volatility, but persistent changes can have an important influence on the inflation environment. Individuals have close and frequent exposure to food prices, and thus persistent changes can have an effect on inflation expectations. Inflation expectations, in turn, are a key determinant of underlying inflation. If inflation expectations were to change in a meaningful way, recent pressures are not likely to be transitory. Pressure on food prices also has been evident in the CPI (up 0.4 percent in April and May, and 0.8 percent and 0.7 percent in June and July, respectively).

Inflation Views From the Fed

Most Fed officials seem to be holding fast to the view that the recent pickup in inflation will be transitory. The latest expression of this belief came in a speech this week from John Williams, President of the New York Fed. Mr. Williams argued that most of the recent price pressure came from two sources: prices of goods and services that had been discounted during the worst of the pandemic, and surges in the prices of used cars. He expects inflation to ease to two percent next year.

The Beige Book published this week provided a less-sanguine perspective. This collection of anecdotal evidence noted tight labor markets and an acceleration in wages, with most districts describing wage growth as strong. The report also highlighted widespread pressure on input prices, and noted that businesses were finding it easier to pass along cost increases. Several districts indicated that executives anticipate significant hikes in the selling prices of their products in the months ahead.

After-Tax Corporate Profits



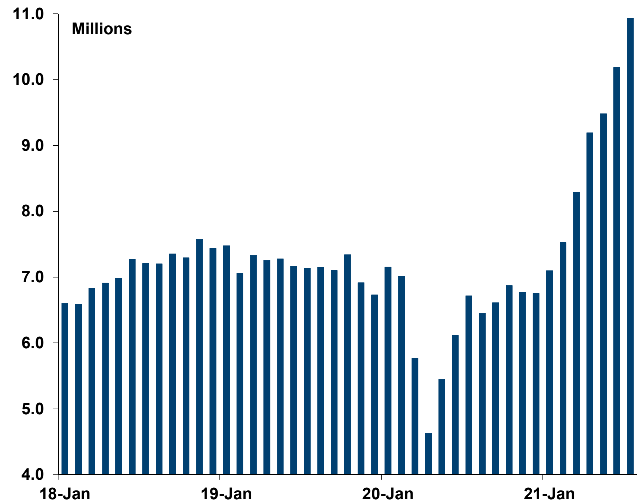
Source: Bureau of Economic Analysis via Haver Analytics

The ease of passing along higher prices was an interesting observation in light of the recent GDP report. The second quarter report on GDP included the first estimate of corporate profits, and earnings soared in Q2 (chart). The solid pace of economic activity played a role in boosting profits, but the dominant influence was a jump in margins; that is, businesses charging higher prices. Perhaps pricing power is reviving.

About that Payroll Report…

The financial press gave extensive coverage to the disappointing employment report for August, attributing essentially all of the slowdown in job growth to the spread of the Delta variant of Covid. The virus undoubtedly had a strong influence, but it was not the only factor at work. We would also emphasize normal statistical variation in economic data. Monthly figures tend to jump around their underlying averages, with some months showing robust activity and others showing disappointing results. Against this background, we view the increase of only 235,000 new jobs in August as partly a natural ebb after a flow of approximately one million new jobs in both June and July. The past three months have posted average job growth of 750,000, hardly a sign of a faltering labor market.

Job Openings



Source: Bureau of Labor Statistics via Haver Analytics

The report on job openings published this week lends support to the more favorable assessment of the August payroll figures. The number of job postings in July climbed further from the record reading in June, surging far above historical norms. The new tally of 10.934 million exceeded by a wide margin the record of 7.574 million that existed before the current expansion (chart; see November 2018 for the best reading before the current expansion).

We also took note of the jump in average hourly earnings in August (up 0.6 percent), faster than the average of 0.3 percent in the first seven months of the year and the pre-pandemic average of 0.2 percent in 2019. Some of this advance most likely reflected the composition of employment growth in August (few jobs created in low-wage areas). Nevertheless, the increase was hefty enough to suggest genuine increases in wages. With job postings in the stratosphere and wage gains strong, businesses are making strong efforts to boost payrolls, which should lead to firm employment reports in the months ahead.

Review

Week of Sept. 6, 2021	Actual	Consensus	Comments
Job Openings (July)	**10.934 Million**	**10.049 Million**	A jump of more than one million new jobs in July had the potential to reduce the record number of open positions in June. However, job openings surged again in July, moving far above historical norms. To give perspective, the record reading before the latest string of lofty results was 7.574 million in November 2018. The quit rate remained elevated at 2.7%, shy of the record of 2.8% in April, but well above the highs of 2.4% registered in previous expansions.
Consumer Credit (July)	**$17.0 Billion**	**$25.0 Billion**	The increase in consumer credit in July was much softer than the average advance of $36.4 billion in the prior two months, but May and June were outliers on the high side. The increase in July was in the upper portion of the range before May and June and suggested a pickup in the willingness of individuals to use credit after restrained borrowing in the early stages of the expansion.
PPI (August)	**0.7% Total, 0.6% Ex. Food & Energy**	**0.6% Total, 0.6% Ex. Food & Energy**	Energy prices inched higher in August (up 0.4%, tame compared with the average of 3.0% in the first seven months of the year). Food prices jumped again, increasing 2.9% and marking the seventh increase in the past eight months. Food prices so far this year have increased at an average monthly rate of 1.2%. Prices excluding food and energy rose 0.6% in July, a touch slower than the average of 0.7% in the first seven months of the year, but still suggestive of pressures.

Sources: Bureau of Labor Statistics (Job Openings, PPI); Federal Reserve Board (Consumer Credit); Consensus forecasts are from Bloomberg

Preview

Week of Sept. 13, 2021	Projected	Comments
Federal Budget (August) (Monday)	**$175.0 Billion Deficit**	Available data suggest that federal revenues rose sharply in August relative to the same month last year (up approximately 20%). Federal outlays remained hefty, but the surge in revenues is likely to leave a narrower deficit than the $200 billion shortfall in August 2020. The expected deficit for August would leave a cumulative shortfall of $2.715 trillion in the first 11 months of the fiscal year, an improvement from the deficit of $3.007 trillion in the same period of in FY2020.
CPI (August) (Tuesday)	**0.4% Total, 0.3% Core**	Available quotes indicate that energy prices moved higher in August, which would mark the 13th increase in the past 15 months (along with one reading of no change and one minuscule decline). Food prices have started to show pressure (up 0.4% to 0.8% in the past four months). Transitory effects in the core component are beginning to lessen, but there were likely lingering influences in August.
Industrial Production (August) (Wednesday)	**0.7%**	Solid employment gains in the manufacturing and mining sectors suggest firm increases in production in these areas. Above-normal temperatures likely stirred demand for cooling services, which should lead to an increase in utility output.
Retail Sales (August) (Thursday)	**-0.5% Total, -0.1% Ex. Autos**	A decline in sales of new vehicles and a drop in activity at restaurants and bars are likely to weigh heavily on the retail sales report. Higher prices of food and gasoline will probably inflate nominal sales in these components, and on-line sales could increase because of the spread of the Delta variant, but the soft areas are likely to dominate.
Consumer Sentiment (September) (Friday)	**72.0 (+1.7 Index Pts.)**	The sentiment index should be able to rebound from its surprisingly soft reading in August (lower than the trough in April 2020), but given the spread of the Delta variant and the negative reviews of the latest employment report, the pickup is likely to be feeble.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

September/October 2021

Monday	Tuesday	Wednesday	Thursday	Friday
6	7	8	9	10
LABOR DAY		**JOLTS DATA** Openings (000) Quit Rate May 9,483 2.5% June 10,185 2.7% July 10,934 2.7% **SEPTEMBER BEIGE BOOK** "Economic growth downshifted slightly to a moderate pace in early July through August." **CONSUMER CREDIT** May $35.0 billion June $37.9 billion July $17.0 billion	**UNEMPLOYMENT CLAIMS** Initial Continuing (Millions) Aug 14 0.349 2.908 Aug 21 0.354 2.805 Aug 28 0.345 2.783 Sept 04 0.310 N/A	**PPI** Final Demand Ex. Food & Energy June 1.0% 1.0% July 1.0% 1.0% Aug 0.7% 0.6% **WHOLESALE TRADE** Inventories Sales May 1.3% 0.8% June 1.2% 2.3% July 0.6% 2.0%
13	14	15	16	17
FEDERAL BUDGET (2:00) 2021 2020 June -$174.2B -$864.1B July -$302.1B -$63.0B **Aug -$175.0B** -$200.0B	**NFIB SMALL BUSINESS OPTIMISM INDEX (6:00)** June 102.5 July 99.7 Aug -- **CPI (8:30)** Total Core June 0.9% 0.9% July 0.5% 0.3% **Aug 0.4% 0.3%**	**IMPORT/EXPORT PRICES (8:30)** Nonpetrol. Imports Nonagri. Exports June 0.7% 1.1% July 0.1% 1.6% Aug -- -- **EMPIRE MFG (8:30)** July 43.0 Aug 18.3 Sept -- **IP & CAP-U (9:15)** IP Cap.Util. June 0.2% 75.4% July 0.9% 76.1% **Aug 0.7% 76.5%**	**INITIAL CLAIMS (8:30)** **RETAIL SALES (8:30)** Total Ex.Autos June 0.7% 1.6% July -1.1% -0.4% **Aug -0.5% -0.1%** **PHILLY FED INDEX (8:30)** July 21.9 Aug 19.4 Sept -- **BUSINESS INVENTORIES (10:00)** Inventories Sales May 0.6% -0.2% June 0.9% 1.6% **July 0.5% 0.7%** **TIC DATA (4:00)** Total Net Long-Term May $98.3B -$30.0B June $31.5B $110.9B July -- --	**CONSUMER SENTIMENT (10:00)** July 81.2 Aug 70.3 **Sept 72.0**
20	21	22	23	24
NAHB HOUSING MARKET INDEX	**HOUSING STARTS** **CURRENT ACCOUNT** **FOMC MEETING**	**EXISTING HOME SALES** **FOMC DECISION**	**INITIAL CLAIMS** **CHICAGO FED NATIONAL ACTIVITY INDEX** **LEADING INDICATORS**	**NEW HOME SALES**
27	28	29	30	1
DURABLE GOODS ORDERS	**U.S. INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES** **FHFA HOME PRICE INDEX** **S&P CORELOGIC CASE-SHILLER HOME PRICES** **CONSUMER CONFIDENCE**	**PENDING HOME SALES**	**INITIAL CLAIMS** **REVISED GDP** **CHICAGO PURCHASING MANAGERS' INDEX**	**PERSONAL INCOME, CONSUMPTION & PRICES** **REVISED CONSUEMR SENTIMENT** **ISM MFG. INDEX** **CONSTRUCTION SPEND.** **VEHICLE SALES**

Forecasts in Bold.

Treasury Financing

September/October 2021

Monday	Tuesday	Wednesday	Thursday	Friday
6	7	8	9	10
LABOR DAY	**AUCTION RESULTS:** Rate / Cover 13-week bills 0.045% 3.84 26-week bills 0.050% 3.79 52-week bills 0.075% 3.75 3-year notes 0.447% 2.45 21-day CMB 0.050% 3.39 **ANNOUNCE:** $20 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:** $25 billion 4-week bills $30 billion 8-week bills $30 billion 17-week CMBs	**AUCTION RESULTS:** Rate / Cover 10-yr notes 1.338% 2.59 17-week CMB 0.045% 4.38	**AUCTION RESULTS:** Rate / Cover 4-week bills 0.060% 4.29 8-week bills 0.065% 3.21 30-yr bonds 1.910% 2.49 **ANNOUNCE:** $93 billion 13-,26-week bills for auction on Sept. 13 **SETTLE:** $99 billion 13-,26-week bills $34 billion 52-week bills $45 billion 21-day CMBs	
13	14	15	16	17
AUCTION: $93 billion 13-,26-week bills	**ANNOUNCE:** $20 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:** $20 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:** $20 billion* 4-week bills $30 billion* 8-week bills **ANNOUNCE:** $93 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:** $93 billion 13-,26-week bills	
20	21	22	23	24
AUCTION: $93 billion* 13-,26-week bills	**AUCTION:** $24 billion* 20-year bonds **ANNOUNCE:** $20 billion* 4-week bills for auction on September 23 $30 billion* 8-week bills for auction on September 23 $30 billion* 17-week CMBs for auction on September 22 **SETTLE:** $20 billion* 4-week bills $30 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs $26 billion* 2-year FRNs	**AUCTION:** $20 billion* 4-week bills $30 billion* 8-week bills $14 billion* 10-year TIPS **ANNOUNCE:** $93 billion* 13-,26-week bills for auction on September 27 $60 billion* 2-year notes for auction on September 27 $61 billion* 5-year notes for auction on September 27 $62 billion* 7-year notes for auction on September 28 **SETTLE:** $93 billion* 13-,26-week bills	**SETTLE:** $26 billion* 2-year FRNs
27	28	29	30	1
AUCTION: $93 billion* 13-,26-week bills $60 billion* 2-year notes $61 billion* 5-year notes	**AUCTION:** $62 billion* 7-year notes **ANNOUNCE:** $20 billion* 4-week bills for auction on September 30 $30 billion* 8-week bills for auction on September 30 $30 billion* 17-week CMBs for auction on September 29 **SETTLE:** $20 billion* 4-week bills $30 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs	**AUCTION:** $20 billion* 4-week bills $30 billion* 8-week bills **ANNOUNCE:** $93 billion* 13-,26-week bills for auction on October 4 $34 billion* 52-week bills for auction on October 5 **SETTLE:** $93 billion* 13-,26-week bills $24 billion* 20-year bonds $14 billion* 10-year TIPS $60 billion* 2-year notes $61 billion* 5-year notes $62 billion* 7-year notes	

*Estimate