US Economic Research 12 November 2021

Daiwa Capital Markets

U.S. Economic Comment

- Inflation: concentrated or broad-based; transitory or persistent?
- Consumer moods: sour despite favorable economic developments

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Inflation: More Than a Handful of Items

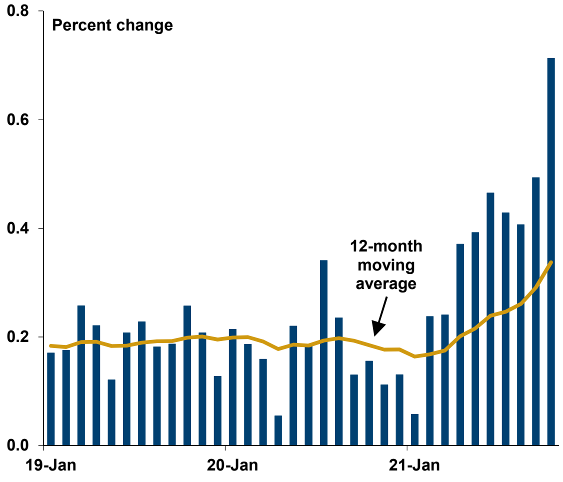
Fed officials and many market commentators in recent months have argued that the pickup in inflation this year has been driven by price surges in a limited number of items influenced by the pandemic or supply shortages. To a large extent this is true, as shown by the explosions in the prices of new and used motor vehicles and by jumps in hotel fees and car rental rates. Ticket prices to sporting events also have skyrocketed.

However, other items also are stirring in price, which has led to an uptick in underlying inflation. The broad-based nature of the pickup is evident in measures of inflation that exclude results in the upper and lower tails of the distribution of price changes. The resulting focus on the middle portion of the distribution eliminates the influence of sharp changes in a small number of items and thus provides a view on underlying inflation.

The 16-percent trimmed-mean index published by the Federal Reserve Bank of Cleveland is such a measure. Based on the CPI, this index eliminates the eight percent of goods and services showing the largest and smallest price changes in a particular month, leaving the internal portion of the distribution comprising 84 percent of the CPI (based on component weights rather than number of items). If a “handful” of goods or services were driving headline inflation in recent months, their likely exclusion from the trimmed-mean index would leave steady results. Recent months, though, have shown a distinct pickup in this measure, increasing at an average rate of 0.5 percent in the past seven months, including a jump of 0.7 percent in October (chart, left). This burst has pushed the year-over-year change to 4.1 percent, up from the pre-pandemic rate of 2.4 percent in 2019.

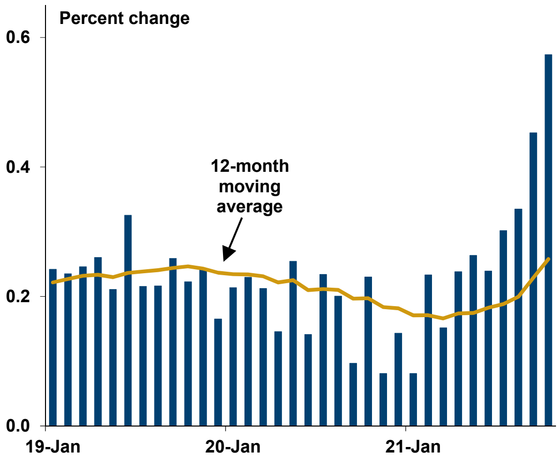
The Cleveland Fed also publishes a measure that can be viewed as the ultimate in trimming: the weighted median CPI, which shows the price change of the single item whose expenditure weight falls in the middle of the distribution of price changes. This measure was stable in the spring when the pandemic-related increases started to influence headline inflation (and inflation excluding food and energy). At that time, it seemed to be

16% Trimmed Mean CPI



Source: Federal Reserve Bank of Cleveland via Haver Analytics

Median CPI



Source: Federal Reserve Bank of Cleveland via Haver Analytics the case that a handful of items were the source of price pressure. However, as the inflation impulse strengthened, the median CPI has started to move. It has picked up in each of the past four months, moving from an average of 0.2 percent in 2019-20 to 0.6 percent in October (chart, p.1, right). The year-over-year change totaled 3.1 percent, moving above the peak of 3.0 percent in the previous expansion.

The recent pickup in inflation, along with extensive media coverage of the acceleration, is beginning to stir inflation expectations, with surveys of consumers show a distinct pickup in recent months. The year-ahead measure of expectations published by the University of Michigan Survey Research Center shows a jump to 4.9 percent in recent months, up considerably from observations centered on 2.5 to 3.0 percent in the prior few years. Individuals apparently see some transitory influence, as the longer-term expectation is lower at 2.9 percent, but this measure also has picked up, increasing about one-half percentage point in recent months. The measure of consumer expectations published by the New York Fed also has jumped, with the three-year ahead index climbing to 4.2 percent in October, up from an average of 2.7 percent last year (see charts on p. 4).

Market participants also seem to be expecting faster inflation over the next few years, as the breakeven rate on five-year inflation-protected securities has moved from approximately 2.5 percent during most of the summer to slightly more than 3.0 percent recently. The breakeven rate on 10-year TIPS has increased to a lesser degree, suggesting that investors expect some settling in inflation over time (the five-year forward rate has not changed appreciably; charts, p. 4). Still, recent movement in the five-year breakeven rate suggests that investors see more than temporary pandemic-related pressure.

Without question, transitory price pressures related to the pandemic are an important factor behind the pickup in inflation this year, and these pressures will fade in the months (quarters?) ahead. However, the shift in the trimmed measures of inflation suggest that the recent acceleration has a broad base and reflects factors other than the pandemic. In our view, the heavy dose of stimulus provided by Congress and the Federal Reserve is playing a role in pushing prices higher, and the upward movement in inflation expectations could add momentum to the recent acceleration.

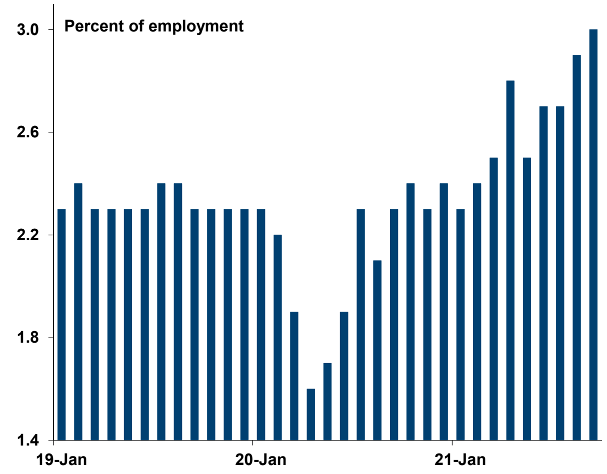
Consumer Attitudes: Upbeat by Some Measures, Downbeat by Others

With the stock market climbing to record levels and jobs readily available, one might suspect that individuals would feel comfortable in the current environment, and by some measures they do. For example, individuals apparently feel confident in their ability to find employment, as the quit rate has increased or held steady in seven of the first nine months of the year. The quit rate of 3.0 percent in September easily exceeded the pre-pandemic record high of 2.4 percent (chart; next page, left). (The report on Job Openings and Labor Turnover, the source of the quit rate, also showed a striking number of job openings: 10.4 million in September and an average of 10.7 million in the past three months. Recent totals have exceeded by a wide margin the pre-pandemic record of 7.6 million in November 2018.)

Other measures, in contrast, indicate gloom in the household sector. The index of consumer sentiment from the University of Michigan Survey Research Center, for example, fell in early November from an already low level in October. In fact, the new reading (and three of the readings in the past four months) were below the recession low in April 2020 (chart; next page, right). The confidence index from the Conference Board has been firmer than the one from the University of Michigan, but it too has registered an unimpressive recovery from the recession, retracing only 60 percent of the ground lost in the spring of 2020 and remaining 14 percent below the pre-pandemic high in February 2020.

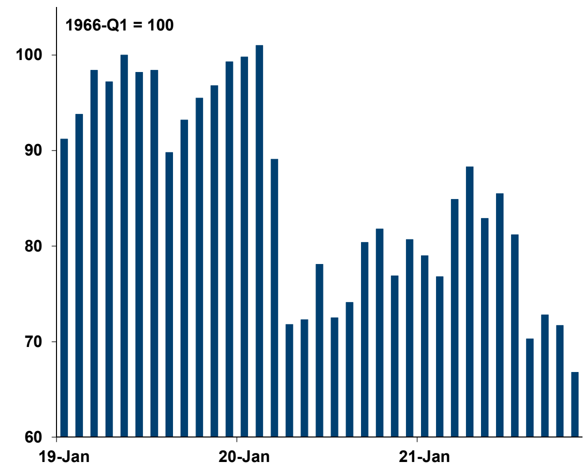
We suspect that the pickup in inflation this year has weighed heavily on the minds of individuals, and we would put special emphasis on the prices of food and energy. Economists often exclude these prices when assessing inflation because of their marked volatility, but if pressure persists the changes can be especially important for individuals. For many households these purchases are made frequently and represent substantial shares of their monthly budgets. When higher prices create strains, moods will sour, and prices of food and energy have increased noticeably.

Quit Rate



Source: Bureau of Labor Statistics via Haver Analytics

Consumer Sentiment

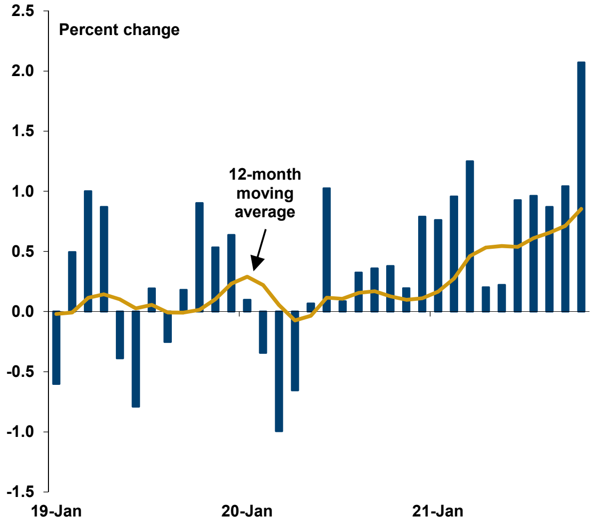


Source: University of Michigan Survey Research Center via Haver Analytics

Energy prices have climbed during most of the current recovery, increasing in 15 of the 17 months from April 2020 through October 2021 (with the other two months showing dips of less than 0.1 percent). The average monthly increase over this period totaled 2.1 percent. Food prices started to stir in the spring and the pace has picked up in the past five months, registering an average advance of 0.7 percent from June through October. Prices of food and energy combined have increased at an average rate of 1.2 percent in the past five months and have jumped 10.7 percent in the past year (chart).

We view inflation as a key factor in dampening moods, but other influences are undoubtedly in play as well. The extended period of disruptions to normal lifestyles because of the pandemic certainly has been trying, and shortages of goods that have developed recently add to these woes. A loss of confidence in the ability of Congress and the Administration to govern effectively has probably affected attitudes. This year has brought a string of events that easily could shake confidence (the January 6 assault on the Capitol, the chaotic withdrawal from Afghanistan, mayhem at the Southern border, political squabbling between Republicans and Democrats and internal conflicts within the Democratic Party).

CPI: Food & Energy Index*

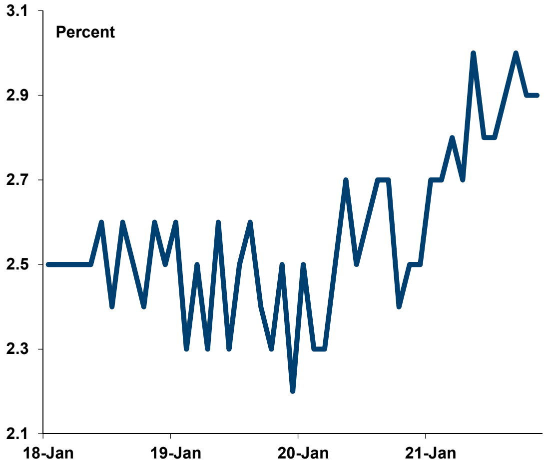


** The food and energy index is a weighted average of the food and energy components of the CPI. Weights are calculated based on the relative importance of each component in the CPI.*

Sources: Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America

The disconnect between a generally good economic performance and strained attitudes perhaps offers insight into the upward creep of inflation. The bitter moods of individuals in most instances would probably constrain spending, but individuals have provided good support in the current cycle. The strong demand from households despite depressed attitudes suggests that heavy fiscal support and highly accommodative financial conditions are outweighing the constraining influence of weak sentiment. If fiscal support and monetary accommodation are strong enough to counter depressed attitudes, they are probably strong enough to push inflation higher.

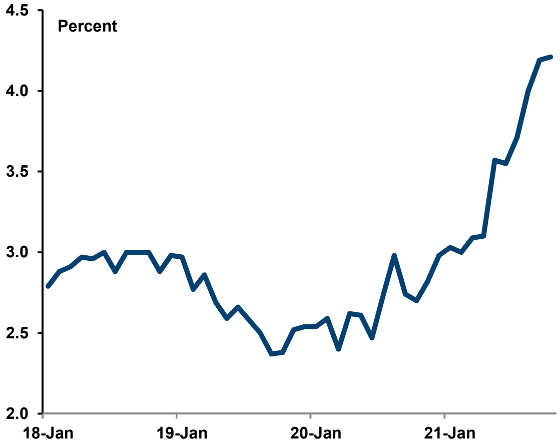
Long-Term Inflation Expectations*



** The' expected average increase in inflation per year over the next five to 10 years.*

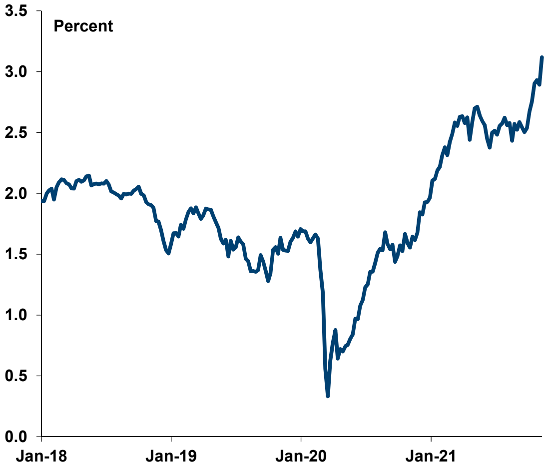
Source: University of Michigan Survey Research Center via Haver Analytics

Median 3-Year Ahead Expected Infl. Rate



Source: Survey of Consumer Expectations, Federal Reserve Bank of New York via Haver Analytics

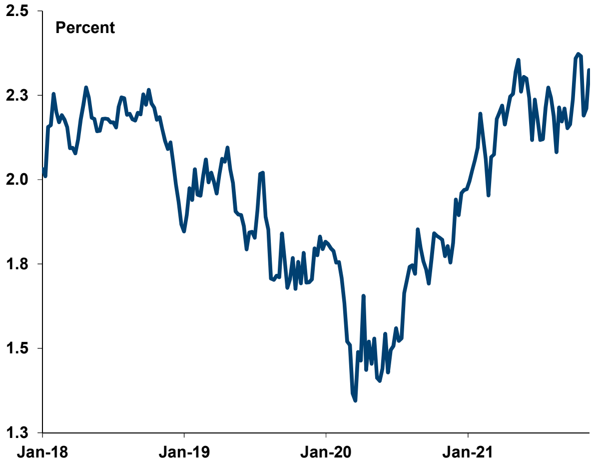
Five-Year Breakeven Inflation Rate*



** Expected average inflation per year over the next five years. The rate on five-year nominal Treasury securities less the rate on five year Treasury inflation-protected securities (TIPS). Weekly end-of-period data.*

Source: Bloomberg

5-Yr., 5-Yr. Forward Breakeven Inflation Rate*



** Expected average inflation per year in the five years that begin five years from now. The rate is calculated using nominal and inflation-adjusted U.S. Treasury securities. Weekly end-of-period data.*

Source: Bloomberg

Review

Week of Nov. 8, 2021	Actual	Consensus	Comments
PPI (October)	**0.6% Total, 0.4% Ex. Food & Energy**	**0.6% Total, 0.5% Ex. Food & Energy**	Food prices dipped 0.1% at the producer level after averaging increases of 1.3% per month in the first nine months of 2021. Energy prices, in contrast, surged 4.8%, adding to increases that averaged 2.7% per month from January through September. The PPI excluding food and energy returned to a fast track after a moderate increase in September (0.2%); the latest increase was shy of the average of 0.7% from January through August, but still brisk. On a year-over-year basis, the headline PPI rose 8.6%, while prices excluding food and energy were up 6.8%.
CPI (October)	**0.9% Total, 0.6% Core**	**0.6% Total, 0.4% Core**	The food and energy components of the CPI remained under pressure in October, with food prices jumping 0.9% and the energy prices surging 4.8%. The average increases in the past five months have now totaled 0.7% in the food area and 2.2% in the energy sector. The core CPI rose sharply again after two calm months (0.1% in August and 0.2% in September). Much of the pressure on core prices occurred in areas sensitive to Covid-19 (e.g. car rental fees and hotel charges). Rent of primary residence also rose noticeably (up 0.4% after a jump of 0.5% in September), suggesting that rents may be starting to catch up with the surge in home prices in the past year. The October results left a year-over-year advance of 6.2% in the headline index and 4.6% in the core measure, with both posting the sharpest increases in more than 30 years.
Federal Budget (October)	**$165.1 Billion Deficit**	**$179.0 Billion Deficit**	Federal revenues jumped 19.4% on a year-over year basis in the first month of FY2022, led by increases in individual income and payroll taxes. Outlays declined 14.0% from the same month last year, as pandemic-related spending continued to ease. The shifts left the budget deficit notably narrower than $284 billion shortfall October 2020.
Consumer Sentiment (November)	**66.8 (-4.9 Index Pts.)**	**72.5 (+0.8 Index Pt.)**	Consumer sentiment plunged 6.8% in early November to its lowest level since the onset of Covid-19. The latest reading is 7.0% below the trough of 71.8 (April 2020) during the brief recession of early 2020 and 33.9% below the pre-Covid peak of 101.0 in February 2020. The continued presence of the virus and the recent surge in inflation likely are contributing the dim views of survey respondents. On the inflation front, the year-ahead measure rose one tick to 4.9%, the fastest pace since mid-2008; the long-term inflation gauge held at 2.9%, a shade below the recent peak of 3.0% in September, but elevated from a longer-term perspective.
Job Openings (September)	**10.438 Million**	**10.300 Million**	Job openings slipped 191,000 (1.8%) in September, but the latest reading was the third highest in the history, exceeded only by observations in the prior two months. The pre-pandemic record was 7.574 million in November 2018. The quits rate, a measure of workers' willingness to seek alternative employment, increased one tick to a record 3.0%. The pre-pandemic peak was 2.4%.

Sources: Bureau of Labor Statistics (PPI, CPI, Job Openings); U.S. Treasury Department (Federal Budget); University of Michigan Survey Research Center (Consumer Sentiment); Consensus forecasts are from Bloomberg

Preview

Week of Nov. 15, 2021	Projected	Comments
Retail Sales (October) (Tuesday)	**1.0% Total, 0.8% Ex. Autos**	Higher prices are likely to boost the nominal values of several components of the retail report, with autos, food, and gasoline all susceptible to price effects. In other areas, firm job growth and healthy financial positions should support active spending.
Industrial Production (October) (Tuesday)	**0.5%**	Solid employment gains in manufacturing and mining raise the possibility of strong advances in output, but shorter workweeks in both areas will probably limit the increases. Warmer-than-normal temperatures probably reduced demand for heating services, which is likely to lead to a decline in utility output.
Housing Starts (October) (Wednesday)	**1.545 Million (-0.6%)**	Multi-family activity should be able to remain in the elevated range seen in other recent months, but slow sales and an elevated inventory of unsold homes will probably discourage single-family building.
Leading Indicators (October) (Thursday)	**0.7%**	A sizeable positive contribution from unemployment claims, along with good support from the slope of the yield curve and ISM new orders, should lead to the 17th increase in the leading indicator index in the past 18 months (no change in the other month). The expected increase would leave the measure 5.6% above the pre-pandemic high in January 2020.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

November / December 2021

Monday	Tuesday	Wednesday	Thursday	Friday
8	9	10	11	12
	NFIB SMALL BUSINESS OPTIMISM INDEX Aug 100.1 Sept 99.1 Oct 98.2 **PPI** Final Demand / Ex. Food & Energy Aug 0.7% 0.6% Sept 0.5% 0.2% Oct 0.6% 0.4%	**UNEMPLOYMENT CLAIMS** Initial / Continuing (Millions) Oct 16 0.291 2.239 Oct 23 0.283 2.101 Oct 30 0.271 2.160 Nov 06 0.267 N/A **CPI** Total / Core Aug 0.3% 0.1% Sept 0.4% 0.2% Oct 0.9% 0.6% **WHOLESALE TRADE** Inventories / Sales July 0.6% 2.1% Aug 1.3% -0.9% Sept 1.4% 1.1%	***VETERANS DAY*** **FEDERAL BUDGET** 2021 / 2020 Aug -$170.6B -$200.0B Sept -$61.6B -$124.6B Oct -$165.1B -$284.1B	**JOLTS DATA** Openings (000) / Quit Rate July 11,098 2.7% Aug 10,629 2.9% Sept 10,438 3.0% **CONSUMER SENTIMENT** Sept 72.8 Oct 71.7 Nov 66.8
15	16	17	18	19
EMPIRE MFG (8:30) Sept 34.3 Oct 19.8 Nov --	**RETAIL SALES (8:30)** Total / Ex.Autos Aug 0.9% 2.0% Sept 0.7% 0.8% **Oct 1.0% 0.8%** **IMPORT/EXPORT PRICES (8:30)** Non-petrol. Imports / Nonagri. Exports Aug -0.1% 0.3% Sept 0.1% 0.3% Oct -- -- **IP & CAP-U (9:15)** IP / Cap.Util. Aug -0.1% 76.2% Sept -1.3% 75.2% **Oct 0.5% 75.5%** **BUSINESS INVENTORIES (10:00)** Inventories / Sales July 0.6% 0.5% Aug 0.8% 0.0% **Sept 0.7% 0.8%** **NAHB HOUSING MARKET INDEX (10:00)** Sept 76 Oct 80 Nov -- **TIC DATA (4:00)** Total / Net L-T July $164.1B $2.0B Aug $91.0B $79.3B Sept -- --	**HOUSING STARTS (8:30)** Aug 1.580 million Sept 1.555 million **Oct 1.545 million**	**INITIAL CLAIMS (8:30)** **PHILADELPHIA FED MFG BUSINESS OUTLOOK (8:30)** Sept 30.7 Oct 23.8 Nov -- **LEADING INDICATORS (10:00)** Aug 0.8% Sept 0.2% **Oct 0.7%**	
22	23	24	25	26
CHICAGO FED NATIONAL ACTIVITY INDEX **EXISTING HOME SALES**		**INITIAL CLAIMS** **REVISED GDP** **DURABLE GOODS ORDERS** **PERSONAL INCOME, CONSUMPTION, PRICES** **U.S. INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES** **NEW HOME SALES** **REVISED CONSUMER SENTIMENT** **FOMC MINUTES**	***THANKSGIVING***	
29	30	1	2	3
PENDING HOME SALES	**FHFA HOME PRICE INDEX** **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** **MNI CHICAGO BUSINESS BAROMETER INDEX** **CONFERENCE BOARD CONSUMER CONFIDENCE**	**ADP EMPLOYMENT REPORT** **ISM MANUFACTURING INDEX** **CONSTRUCTION SPEND.** **BEIGE BOOK** **NEW VEHICLE SALES**	**INITIAL CLAIMS**	**EMPLOYMENT REPORT** **ISM SERVICES INDEX** **FACTORY ORDERS**

Forecasts in Bold.

Treasury Financing

November / December 2021

Monday	Tuesday	Wednesday	Thursday	Friday
8	9	10	11	12
AUCTION RESULTS: Rate Cover 13-week bills 0.045% 3.26 26-week bills 0.065% 3.31 3-year notes 0.750% 2.33	**AUCTION RESULTS:** Rate Cover 10-yr notes 1.444% 2.35 **ANNOUNCE:** $10 billion 4-week bills for auction on November 10 $25 billion 8-week bills for auction on November 10 $40 billion 17-week CMBs for auction on November 10 **SETTLE:** $10 billion 4-week bills $25 billion 8-week bills $40 billion 17-week CMBs	**AUCTION RESULTS:** Rate Cover 4-week bills 0.050% 5.21 8-week bills 0.060% 3.36 30-yr bonds 1.940% 2.20 17-week CMB 0.055% 3.64 **ANNOUNCE:** $108 billion 13-,26-week bills for auction on Nov. 15 $23 billion 20-year bonds for auction on November 17 $14 billion 10-year TIPS for auction on November 18 $60 billion 14-day CMBs for auction on November 16	***VETERANS DAY***	**SETTLE:** $102 billion 13-,26-week bills
15	16	17	18	19
AUCTION: $108 billion 13-,26-week bills **SETTLE:** $56 billion 3-year notes $39 billion 10-year notes $25 billion 30-year bonds	**AUCTION:** $60 billion 14-day CMBs **ANNOUNCE:** $10 billion* 4-week bills for auction on November 18 $25 billion* 8-week bills for auction on November 18 $40 billion* 17-week CMBs for auction on November 17 **SETTLE:** $10 billion 4-week bills $25 billion 8-week bills $40 billion 17-week CMBs	**AUCTION:** $23 billion 20-year bonds $40 billion* 17-week CMBs	**AUCTION:** $10 billion* 4-week bills $25 billion* 8-week bills $14 billion 10-year TIPS **ANNOUNCE:** $108 billion* 13-,26-week bills for auction on Nov. 22 $24 billion* 2-year FRNs for auction on November 23 $58 billion* 2-year notes for auction on November 22 $59 billion* 5-year notes for auction on November 22 $59 billion* 7-year notes for auction on November 23 **SETTLE:** $108 billion 13-,26-week bills $60 billion 14-day CMBs	
22	23	24	25	26
AUCTION: $108 billion* 13-,26-week bills $58 billion* 2-year notes $59 billion* 5-year notes	**AUCTION:** $24 billion* 2-year FRNs $59 billion* 7-year notes **ANNOUNCE:** $10 billion* 4-week bills for auction on November 24 $25 billion* 8-week bills for auction on November 24 $40 billion* 17-week CMBs for auction on November 24 **SETTLE:** $10 billion* 4-week bills $25 billion* 8-week bills $40 billion* 17-week CMBs	**AUCTION:** $10 billion* 4-week bills $25 billion* 8-week bills $40 billion* 17-week CMBs **ANNOUNCE:** $108 billion* 13-,26-week bills for auction on Nov. 29 $34 billion* 52-week bills for auction on November 30	***THANKSGIVING***	**SETTLE:** $108 billion* 13-,26-week bills $24 billion* 2-year FRNs
29	30	1	2	3
AUCTION: $108 billion* 13-,26-week bills	**AUCTION:** $34 billion* 52-week bills **ANNOUNCE:** $10 billion* 4-week bills for auction on December 2 $25 billion* 8-week bills for auction on December 2 $40 billion* 17-week CMBs for auction on December 1 **SETTLE:** $10 billion* 4-week bills $25 billion* 8-week bills $23 billion 20-year bonds $14 billion 10-year TIPS $58 billion* 2-year notes $59 billion* 5-year notes $59 billion* 7-year notes $40 billion* 17-week CMBs	**AUCTION:** $40 billion* 17-week CMBs	**AUCTION:** $10 billion* 4-week bills $25 billion* 8-week bills **ANNOUNCE:** $108 billion* 13-,26-week bills for auction on Dec. 6 $54 billion* 3-year notes for auction on December 7 $36 billion* 10-year notes for auction on December 8 $22 billion* 30-year bonds for auction on December 9 **SETTLE:** $108 billion* 13-,26-week bills $34 billion* 52-week bills	

**Estimate*