U.S. Economic Comment

- Inflation expectations: stirring, but not surging
- Biden fiscal policy: restrictive, stimulative, or neutral?

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Inflation Expectations: A Near-Term Increase

Expectations of inflation are among the most important considerations in assessing the outlook for inflation. If the public begins to expect persistent inflation, behavioral changes would almost insure that the underlying inflation rate would remain elevated. Individuals would spend more rapidly to beat future price increases, and they would negotiate more aggressively for wage increases.

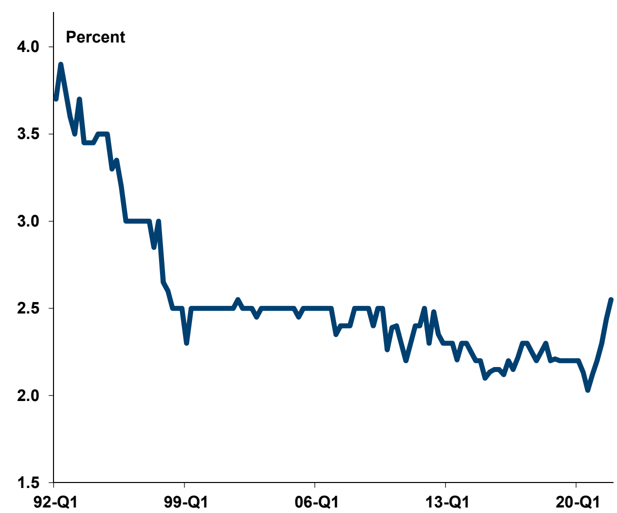
Numerous measures of inflation expectations are available, including both survey-based and market-based readings. Our favorite measure is the long-term expectations of professional economic forecasters published by the Federal Reserve Bank of Philadelphia. Respondents to this survey carefully monitor developments relating to inflation, and they presumably have a good grasp of the key forces that might drive inflation. Surveys of consumers, in contrast, often move erratically and reflect a narrow range of influences, such as recent movement in food or energy prices. Market-based measures, such as spreads between interest rates on nominal and inflation-protected securities have the disadvantage of shifting with risk and liquidity preferences of investors and traders.

The median estimate for CPI inflation over the next 10 years from the Philadelphia Fed Survey of Professional Forecasters shows a striking pickup recently, increasing more than 40 basis points in the past four quarters and more than one-half percentage point since the low in 2020-Q3 (chart). The jump follows a long period of generally stable expectations, even a downward drift in the past 10 years or so. The increase in the past several quarters is comparable in magnitude to declines that occurred in 1995 and 1998 when expectations were in retreat.

The pickup in long-term inflation expectations is notable, but it is not necessarily alarming. Other figures in the report from the Philadelphia Fed indicate pressure is intense this year, but it will begin to settle thereafter, moving from 5.8 percent over the four quarters of this year to 2.7 percent next year and 2.4 percent in 2023.

The Philadelphia Fed does not provide yearly projections beyond 2023, but it does publish the average expected rate over the next five years (2021-25). This measure, along with the full 10-year expectation, allows one to extract average expected inflation in six to 10 years. The average of 2.90 in the latest five-year period and 2.55 percent over the full 10 years, implies an average of 2.2 percent six to 10 years from now, a reading in the low end of the range from the past few years (chart, next page).

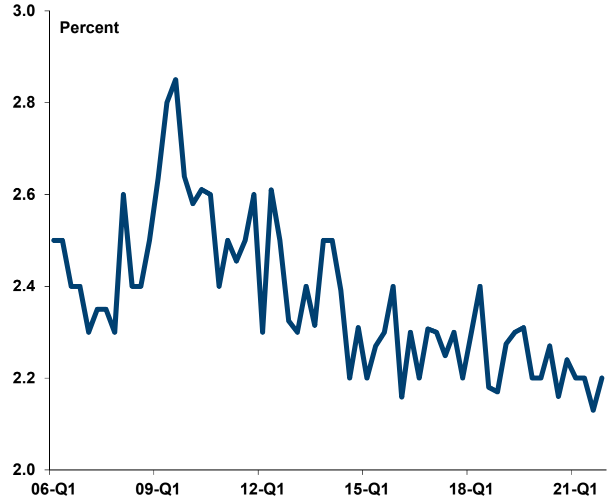
Forecasters' Long-Term View on Inflation*



** Expected yearly CPI inflation over the next 10 years. Median estimate.*
Source: Survey of Professional Forecasters, Federal Reserve Bank of Philadelphia

While this survey shows inflation settling, we would still not describe the current episode as "transitory". Chair Powell in his latest press briefing talked of inflation easing in the second or third quarters of next year, but the Philly Fed survey shows the settling process over a period of two years. Also, we would not be surprised by upward revisions to the views of forecasters. In this regard, the outlook for the current year is likely to be too low. The CPI for October is already 6.0 percent above the average in 2020-Q4; the CPI would need to decline over the November-December period to match the expectation of 5.8 percent. It is difficult to envision a decline in CPI given that gasoline prices are suggesting another jump in the energy component while supply-chain disruptions and firm demand are pressuring other areas.

Five-Year, Five-Year Forward Inflation Expectations*



** Expected yearly CPI inflation six to 10 year from now. Median estimate.*
Source: Survey of Professional Forecasters, Federal Reserve Bank of Philadelphia; Daiwa Capital Markets America

Expectations of inflation also could increase if the Fed is slow to react to potential upside risks on inflation. Chair Powell gave some ground in his latest press briefing by noting that price pressure has been more persistent than he expected, but he still saw recent elevated readings on inflation as driven by pandemic-related disruptions. Also, he believed that the labor market still had an element of slack, and he was not willing to consider interest-rate lift-off until the economy has reached maximum employment. Ignoring the lags in policy and eschewing any preemptive move is likely to leave the Fed behind the inflation curve.

Biden Fiscal Policy

While pandemic-related disruptions are certainly playing a role in the acceleration in inflation this year, we believe that aggressive fiscal and monetary policies also have pushed prices higher. The Fed has taken the first step in unwinding its accommodative stance by tapering its quantitative easing program, and we suspect that it will begin to hike interest rates next year. (Our latest forecast involves one hike in late 2022, but given recent developments, that modest change will probably not be sufficient to contain inflation. Our revised forecast in December will involve a more aggressive tack from the Fed in the second half of next year).

The impact of fiscal policy next year is muddled. The waning effects of pandemic support from the federal government will lead some forecasters to view fiscal policy as a constraining force. However, Congress has recently passed the Infrastructure Investment and Jobs Act and is making progress on the Build Back Better plan of President Biden. Both legislative efforts could provide a lift and add to the inflation impulse. Weighing these effects, we conclude that fiscal policy has the potential to nudge the economy forward and inflation higher next year and beyond.

At first blush, a marked narrowing in the budget deficit in the current fiscal year seems to have the potential slow the economy considerably. The July estimate of the Congressional Budget Office shows a deficit of $1.153 trillion in the current fiscal year, down from $2.772 trillion in FY2021 (table, next page). However, the full impact of the budget deficit in fiscal year 2021 is yet to be felt. While the federal government expended huge sums in fiscal years 2020 and 2021, the outlays were largely transfers to individuals, state and local governments, and businesses, and a large share of these funds have not been spent. Individuals, for example, have accumulated $2.5 trillion in excess savings (i.e. savings in excess of the amount implied by the pre-pandemic trend). Similarly, The Committee for a Responsible Budget estimates that state and local governments have received $885 billion in federal support, but they apparently have spent only a fraction of this total, as nominal outlays (GDP basis) have increased only $180 billion in the current recovery. Tapping these unspent funds this year easily could offset the drag that ordinarily would be associated with a narrower budget deficit.

The Infrastructure Investment and Jobs Act authorized $550 billion in new spending, a hefty total, but the expenditures will be spread over a period of at least 10 years. In addition, the programs will take time to get off the ground, and thus only a small share will be spent in the current fiscal year. In fact, the estimates of the Congressional Budget Office show the new Act reducing the budget deficit marginally in the current fiscal year, as various pay-fors offset the new spending that is likely to trickle out.

CBO Scoring*

	2021	2022	2022-31
		$ Billions	
Baseline Budget Deficit	2,772	1,153	12,093
IIJA	--	-4	256
BBB	--	155	160

** The baseline budget shows the actual deficit for fiscal year 2021 and the July estimate of the Congressional Budget Office for fiscal year 2022 and the ten-year total for fiscal years 2022 through 2031. The other figures are the effects on the deficit of the Infrastructure Investment and Jobs Act (IIJA) and the Build Back Better (BBB) legislation now before Congress (negative figures show a reduction in the deficit). The estimates for BBB include the CBO's view on likely revenue inflow from $80 billion of additional funding for tax enforcement by the Internal Revenue Service.*

Sources: U.S. Treasury Department via Haver Analytics; Congressional Budget Office

Build Back Better is a wild card. While the House of Representatives approved the legislation on Friday, passage in the Senate in its current form is not assured. Moderate Senators are pressuring for a deficit-neutral bill, but the scoring by the CBO shows the legislation adding $155 billion to the deficit in the current year (0.7 percent of GDP) and $160 billion over the 10-year budget window. This would provide a moderate lift to the economy (and inflation) this year and a possibly neutral influence in subsequent years.

The effect in coming years, though, will depend on how the legislation is altered down the road. The current bill is loaded with outlays or tax breaks that phase out over time or sunset at some future date, but Congress will most likely make an effort to extend such provisions as their expiration dates approach. If all provisions were to be extended, the 10-year budget effect would be in the trillions.

Review

Week of Nov. 15, 2021	Actual	Consensus	Comments
Retail Sales (October)	**1.7% Total, 1.7% Ex. Autos**	**1.4% Total, 1.0% Ex. Autos**	Higher prices undoubtedly played a role in the advance in retail sales in October (the report is not adjusted for inflation), but the results also were firm enough to suggest gains after price adjustments. The influence of higher prices was most noticeable in the gasoline component, which rose 3.9%, a hefty advance but lighter than the 6.1% increase in the gasoline component of the CPI. Similarly, sales at food stores rose 0.9%, a bit softer than the increase of 1.0% in the food-at-home component of the CPI. However, increases across many retail categories that added to results that surpassed pre-pandemic norms point to gains in real activity well.
Industrial Production (October)	**1.6%**	**0.9%**	About half of the jump of in industrial production in October was the result of a recovery from Hurricane Ida, but the report carried a firm tone even after accounting for this special factor. Both the manufacturing and mining components (up 1.2% and 4.1%, respectively) moved to new highs for the current expansion, and the manufacturing component rose further above the pre-pandemic level in early 2020. Utility output rose 1.2%, but changes in this sector typically reflect swings in temperatures rather than economic fundamentals.
Housing Starts (October)	**1.520 Million (-0.7%)**	**1.579 Million (1.5%)**	The softness in housing starts in October was concentrated in the single-family sector, where starts fell 3.9%. After rallying in the second half of last year, single-family starts have edged lower this year, with the October total now the lightest of the year thus far. The level of activity is still respectable relative to pre-pandemic norms, but this sector has lost the vigor seen in the closing months of 2020. Multi-family starts rose 7.1% in October. Activity has fluctuated from month-to-month in 2021, but the level of multi-family starts has generally been firm. Indeed, the average number of starts in the first 10 months of the year is the best since the late 1980s.
Leading Indicators (October)	**0.9%**	**0.8%**	A sizeable positive contribution from unemployment claims, along with support from the slope of the yield curve and ISM new orders led to the 17th increase in the leading indicator index in the past 18 months. The latest increase left the measure 5.6% above the pre-pandemic high in January 2020.

Sources: U.S. Census Bureau (Retail Sales, Housing Starts); Federal Reserve Board (Industrial Production); The Conference Board (Leading Indicators); Consensus forecasts are from Bloomberg

Preview

Week of Nov. 22, 2021	Projected	Comments
Existing Home Sales (October) (Monday)	**6.35 Million (+1.0%)**	Recent shifts in pending home sales and mortgage applications suggest that sales have picked up from the lows in the spring and summer, but they still lag the firm results late last year and early this year.
Revised GDP (2021-Q3) (Wednesday)	**2.2% (+0.2 Pct. Pt. Revision)**	Upward adjustments to inventory investment and construction activity (i.e. smaller declines in each) should lead to slightly stronger GDP growth in Q3.
Durable Goods Orders (October) (Wednesday)	**-1.0%**	Solid gains in employment and production suggest that the manufacturing sector is performing well, which should translate to firm order flows in several industries. However, a drop in orders for defense-related aircraft after a high-side surprise in September and a supply-constrained drop in bookings for motor vehicles are likely to provide offsets.
U.S. International Trade in Goods (October) (Wednesday)	**-$95.0 Billion ($2.0 Billion Narrower Deficit)**	The sharp decline in exports in September (off 4.7%), possibly related to shipping delays and port congestion, should at least partially reverse in October, leading to an improvement in the monthly deficit. Despite backups at ports, imports have managed to move along a gradual upward trend in recent months.
Personal Income, Consumption, Core PCE Price Index (October) (Wednesday)	**0.2%, 1.0%, 0.5%**	The drag on personal income from waning transfer payments is fading, but a residual influence is likely to be present in October to partly offset moderate growth in wages. On the outlay side of the ledger, a pickup in vehicle sales and a brisk report on retail activity point to a solid advance in consumption expenditures (at least in nominal terms). Results on the CPI suggest a high-side reading on the price index for personal consumption expenditures.
New Home Sales (October) (Wednesday)	**0.830 Million (+3.8%)**	Three consecutive increases in buyer traffic and builder sentiment (measures published by the National Association of Home Builders) suggest that sales will improve further from their lows in the spring and summer, although the level of activity is likely to remain shy of results seen in the second half of last year and the start of this year.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

November / December 2021

Monday	Tuesday	Wednesday	Thursday	Friday
15	16	17	18	19

Monday 15

EMPIRE MFG

Sept	34.3
Oct	19.8
Nov	30.9

Tuesday 16

RETAIL SALES

	Total	Ex.Autos
Aug	1.2%	2.2%
Sept	0.8%	0.7%
Oct	1.7%	1.7%

IMPORT/EXPORT PRICES

	Non-petrol. Imports	Nonagri. Exports
Aug	0.0%	0.3%
Sept	0.2%	0.6%
Oct	0.5%	1.5%

IP & CAP-U

	IP	Cap.Util.
Aug	0.0%	76.2%
Sept	-1.3%	75.2%
Oct	1.6%	76.4%

Wednesday 17

HOUSING STARTS

Aug	1.573 million
Sept	1.530 million
Oct	1.520 million

BUSINESS INVENTORIES

	Inventories	Sales
July	0.6%	0.5%
Aug	0.8%	0.1%
Sept	0.7%	0.9%

NAHB HOUSING MARKET INDEX

Sept	76
Oct	80
Nov	83

TIC DATA

	Total	Net L-T
July	$131.2B	$1.9B
Aug	$91.1B	$79.3B
Sept	-$26.8B	$26.3B

Thursday 18

UNEMPLOYMENT CLAIMS

	Initial (Millions)	Continuing
Oct 23	0.283	2.101
Oct 30	0.271	2.209
Nov 06	0.269	2.080
Nov 13	0.268	N/A

PHILADELPHIA FED MFG BUSINESS OUTLOOK

Sept	30.7
Oct	23.8
Nov	39.0

LEADING INDICATORS

Aug	0.7%
Sept	0.1%
Oct	0.9%

Friday 19

Monday	Tuesday	Wednesday	Thursday	Friday
22	23	24	25	26

Monday 22

CHICAGO FED NATIONAL ACTIVITY INDEX (8:30)

	Monthly	3-Mo. Avg.
Aug	0.05	0.38
Sept	-0.13	0.25
Oct	--	--

EXISTING HOME SALES (10:00)

Aug	5.88 million
Sept	6.29 million
Oct	**6.35 million**

Tuesday 23

Wednesday 24

INITIAL CLAIMS (8:30)

REVISED GDP (8:30)

	GDP	Chained Price
21-Q2	6.7%	6.1%
21-Q3(a)	2.0%	5.7%
21-Q3(p)	**2.2%**	**5.7%**

DURABLE GOODS ORDERS (8:30)

Aug	1.3%
Sept	-0.3%
Oct	**-1.0%**

U.S. INTERNATIONAL TRADE IN GOODS (8:30)

Aug	-$88.0 billion
Sept	-$97.0 billion
Oct	**-$95.0 billion**

ADVANCE INVENTORIES (8:30)

	Wholesale	Retail
Aug	1.3%	0.2%
Sept	1.4%	-0.2%
Oct	--	--

PERSONAL INCOME, CONSUMPTION, AND CORE PCE PRICE INDEX (10:00)

	Inc.	Cons.	Core
Aug	0.2%	1.0%	0.3%
Sept	-1.0%	0.6%	0.2%
Oct	**0.2%**	**1.0%**	**0.5%**

NEW HOME SALES (10:00)

Aug	0.702 million
Sept	0.800 million
Oct	**0.830 million**

REVISED CONSUMER SENTIMENT (10:00)

Sep	72.8
Oct	71.7
Nov(p)	66.8

FOMC MINUTES (2:00)

Thursday 25

THANKSGIVING

Friday 26

Monday	Tuesday	Wednesday	Thursday	Friday
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**
6	7	8	9	10
	REVISED PRODUCTIVITY & COSTS **TRADE BALANCE** **CONSUMER CREDIT**	**JOB OPENINGS & LABOR TURNOVER (JOLTS)**	**INITIAL CLAIMS** **WHOLESALE TRADE**	**CPI** **CONSUMER SENTIMENT** **FEDERAL BUDGET**

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

Treasury Financing

November / December 2021

Monday	Tuesday	Wednesday	Thursday	Friday
15	16	17	18	19
AUCTION RESULTS: Rate Cover 13-week bills 0.045% 3.32 26-week bills 0.065% 3.41 **SETTLE:** $56 billion 3-year notes $39 billion 10-year notes $25 billion 30-year bonds	**AUCTION RESULTS:** Rate Cover 14-day CMB 0.055% 2.76 **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 $40 billion 22-day CMBs for auction on November 17 **SETTLE:** $10 billion 4-week bills $25 billion 8-week bills $40 billion 17-week CMBs	**AUCTION RESULTS:** Rate Cover 20-yr bonds 2.065% 2.34 17-week CMB 0.055% 3.11 22-day CMB 0.130% 2.65	**AUCTION RESULTS:** Rate Cover 4-week bills 0.110% 4.34 8-week bills 0.045% 4.43 10-yr TIPS -1.145% 2.43 **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 $40 billion 35-day CMBs 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 $40 billion 35-day CMBs **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 $40 billion 22-day 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 $40 billion 35-day CMBs
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	
6	7	8	9	10
AUCTION: $108 billion* 13-,26-week bills	**AUCTION:** $54 billion* 3-year notes **ANNOUNCE:** $10 billion* 4-week bills for auction on December 9 $25 billion* 8-week bills for auction on December 9 $40 billion* 17-week CMBs for auction on December 8	**AUCTION:** $36 billion* 10-year notes $40 billion* 17-week CMBs **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 $22 billion* 30-year bonds **ANNOUNCE:** $108 billion* 13-,26-week bills for auction on Dec. 13 **SETTLE:** $108 billion* 13-,26-week bills	

Estimate