U.S. Economic Comment

- Inflation and consumer attitudes
- Bright spots in the deteriorating trade balance
- Favorable budget news (of sorts)

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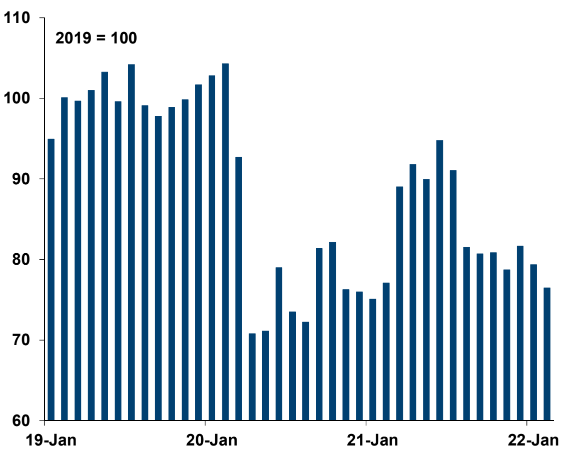
Inflation Weighs on Sentiment

One might suspect that measures of consumer attitudes would be sky-high in the current economic setting. The labor market is robust and the financial positions of many households are strong, partly because of the surge in savings in the past two years and partly because of the advances in home values and equity prices (recent declines notwithstanding).

However, moods are sour. The sentiment index published by the University of Michigan Survey Research Center eased in early February from an already low level. This measure has now been below the recession low in April 2020 in six of the past seven months, and it is only moderately above the softest reading during the Great Recession in 2008-09. The confidence index from the Conference Board has been firmer than the gauge from the University of Michigan, but its recovery could be described as feeble (still 14.2 percent below its pre-Covid reading). An average of the two indexes suggests a good bit of angst among households (chart, left).

Several factors most likely have affected consumer attitudes. The disruption of normal lifestyles because of the pandemic might be first on the list, and a loss of confidence in the government because of sharp partisan divides could be playing a role as well. We believe that elevated inflation also is having an influence. The advance in prices could be neutralizing the influence of a strong labor market, as many individuals see an erosion in purchasing power rather than an increase in standards of living. More generally, inflation generates an air of uncertainty that undoubtedly would trouble many individuals.

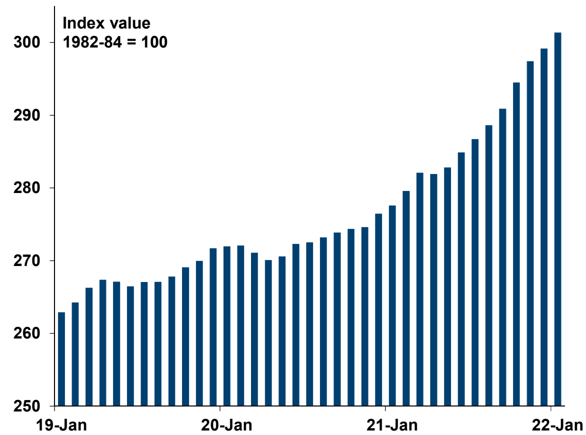
Consumer Attitudes*



** The chart shows an average of the University of Michigan's Consumer Sentiment index and the Conference Board's Consumer Confidence index. Both indicators are rebased to equal 100 in 2019. A reading for the Conference Board index is not yet available for February 2022, but we input a reading that assumed no change in the Conference Board measure.*

Sources: The Conference Board and the University of Michigan Survey Research Center via Haver Analytics; Daiwa Capital Markets America

CPI: Food, Energy, & Rent of Primary Residence*



** The chart shows a weighted-average index of the Food, Energy, and Rent of Primary Residence 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 sources of price pressure would most likely reinforce the negative effect of inflation on consumer attitudes. Much of the acceleration in the past year has been the result of higher prices of food and energy, which have increased at annual rates of 8.7 percent and 11.5 percent in the past six months. Many individuals purchase these items on a weekly basis, and thus rising prices are constantly in view.

Rental rates for housing have recently joined in pushing the CPI notably higher. Rent of primary residence jumped 0.5 percent in January after increases of 0.3 to 0.4 percent in the prior five months. During most of the pandemic, rents rose 0.1 to 0.2 percent per month. Owners' equivalent rent also has accelerated.

Thus, the three most important purchases for many households – food, shelter, and energy – have become costly. As shown in the chart on the prior page, a weighted average of prices for these items have traced an exponential-like path in the past year. (The chart shows the level of the index rather than the percent change; the vertical axis shows a measure akin to a price.)

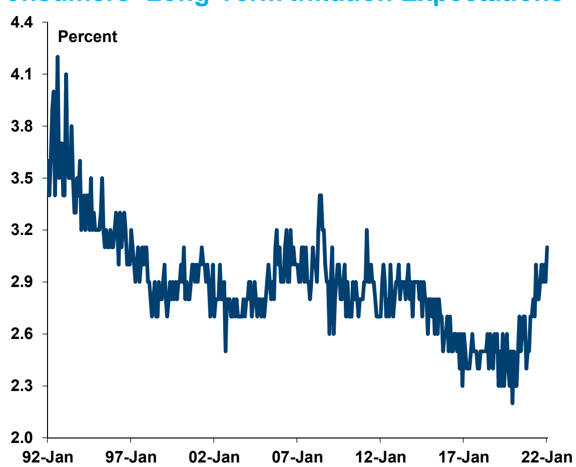
These prices, because of their high visibility, have the potential to increase inflation expectations, and they already have had an influence, as both the year-ahead and long-term measures from the University of Michigan survey have moved to the upper ends of the ranges from the past few decades (chart, left). The three-year ahead measure of inflation expectations from the New York Fed also has climbed in the past year. The shifts in inflation expectations could trigger changes in behavior (rapid spending, aggressive wage negotiations) that lead to the persistence of elevated inflation.

Economists Hold the Line

Most individuals expect continued pressure on prices, but professional economists are more sanguine. The Federal Reserve Bank of Philadelphia surveys professional economic forecasters quarterly, and inflation views thus far have changed only moderately. The expected average inflation rate over the next 10 years has moved from the bottom portion of the recent range to the top, but it can still be described as range-bound (chart, right). This moderate pickup reflects faster inflation in the first five years of the 10-year horizon, but expectations in years six to 10 have barely budged from pre-Covid readings.

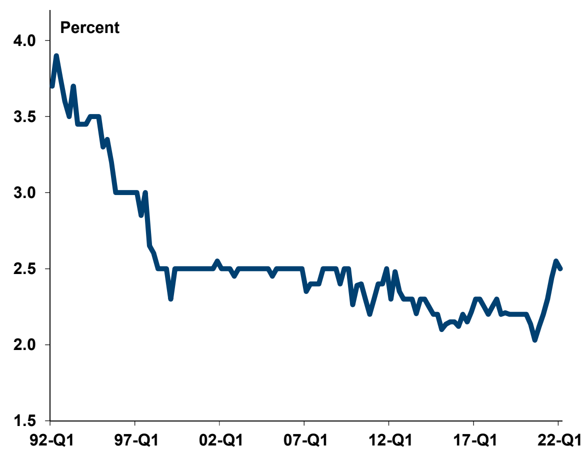
Economic forecasters apparently believe that supply-chain problems will be resolved and that tighter policy from the Federal Reserve will dampen demand pressure. The recent hawkish turn of the Fed apparently had an influence on the views of economists, as the 10-year inflation outlook eased a tick from the view in the prior survey.

Consumers' Long-Term Inflation Expectations*



** Average annual inflation over the next five to 10 years.*
Source: University of Michigan Survey Research Center via Haver Analytics

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

International Trade: A Wider Deficit, but Other Favorable Developments

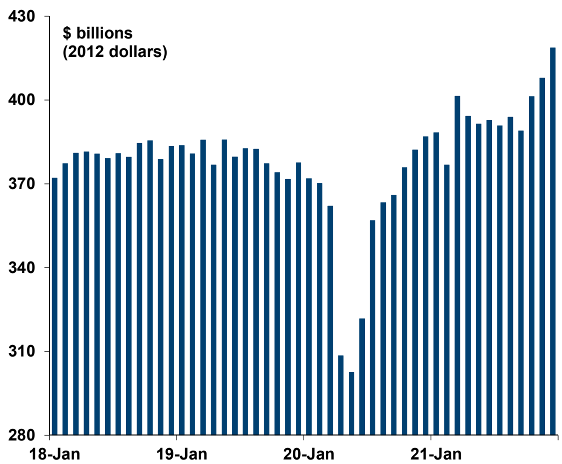
After tumbling during the recession, both exports and imports improved steadily in the second half of 2020 and throughout 2021, moving comfortably above pre-pandemic levels. The change in imports has been larger, and thus the trade deficit has widened noticeably ($859 billion or 3.7 percent of GDP in 2021 versus $576 billion in 2019, 2.7 percent of GDP).

The pattern of solid growth on both sides of the trade ledger leading to wider deficits continued in the fourth quarter. The increase in the deficit was disappointing, but Q4 results brought other favorable news: a hint of easing in port congestion, and a revival in service exports.

While exports and imports were improving throughout most of 2020 and 2021, the pace picked up in the fourth quarter. Total real trade flows of goods (that is, the sum of exports and imports, adjusted for price changes) stepped noticeably higher in the closing months of the year (chart, left). We viewed the pickup as a sign that port congestion had eased to a degree. We doubt that the problem with congestion has been solved, but trade flows point to progress.

We also were impressed with a pickup in the export of services in the past two months. Like trade in goods, service trade has been growing throughout the expansion, but at a slower rate, especially on the export side. However, exports jumped in both November and December, resulting in solid gains in the service surplus (chart, right). The pickup was largely the result of more international travel and the use of services that travel entails. Exports of financial services also picked up. Service trade, especially on the export side, is still below pre-pandemic levels and well shy of the peak in early 2018, but again, progress.

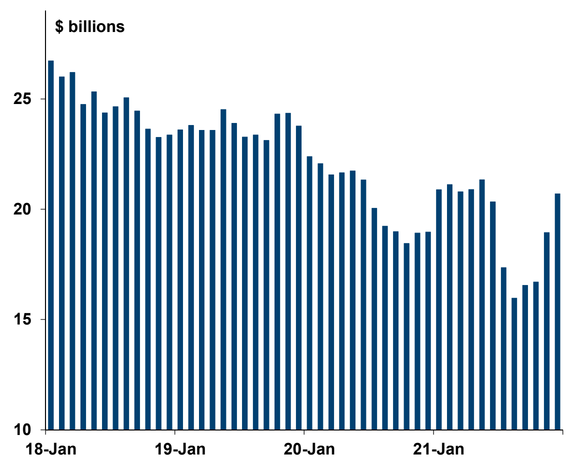
Real Trade Flows*



** The sum of real exports and imports of goods.*

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

Nominal Surplus in Service Trade



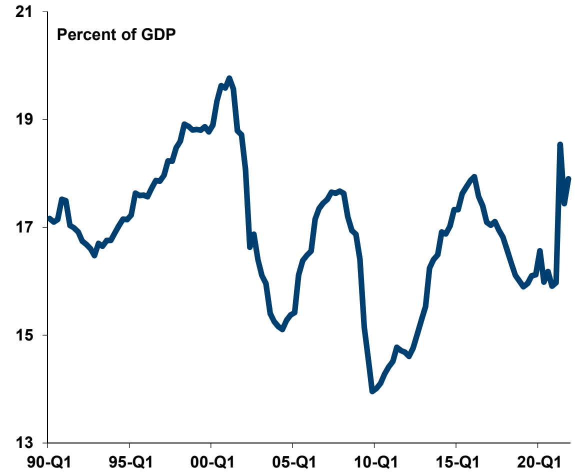
Source: Bureau of Economic Analysis via Haver Analytics

Surging Federal Revenues

The federal government registered a budget surplus of $118.7 billion in January. The results were not shocking, as January is typically one of the stronger months for budget results because of estimated tax payments by individuals. Still, the performance involved an element of surprise because the surplus exceeded the consensus estimate of a $23 billion by a wide margin. Both receipts and outlays contributed to the favorable results, as federal revenues rose 20.9 percent from the same month last year, and outlays were notably below the recent average (and naturally lighter than spending in January 2021, when pandemic-related support was a factor).

The jump in revenues in January was not an isolated event, as flows have been strong in each of the past six months, averaging year-over-year growth of 25.4 percent. This strong showing left receipts in the fourth quarter at 17.5 percent of GDP, a reading near the top of the historical range (chart).

Federal Revenues*



** A four-quarter moving average of federal revenues as a share of nominal GDP.*
Sources: U.S. Treasury Department and Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

While the recent revenue performance has been impressive, we would not be highly optimistic about the outlook, as some of the sources of strength are likely to be temporary. A pandemic-related change in earlier months that restrained revenue growth is now working in the opposite direction. The CARES Act allowed businesses to defer their share of certain payroll taxes from late March through December 2020. Businesses are now catching up with those deferred obligations. Revenues also have been boosted by efforts of states to replenish their unemployment trust funds, which were depleted during the period of high unemployment and supplemental jobless benefits.

Remittances from the Federal Reserve also have been firm because of the interest income on the Fed's portfolio, which has surged because of the asset purchase program (quantitative easing). Fed remittances to the Treasury Department will gradually ease in the months ahead because the central bank is likely to begin shrinking its portfolio sometime this year and because it will be paying higher rates on bank reserves once it starts to lift the federal funds rate.

We also would curb our enthusiasm on the budget outlook because outlays remain elevated. Spending is dramatically lower than it was during the worst of the pandemic, but relative to GDP, it remains in the upper portion of its historical range, and we do not sense any meaningful effort by Congress to tighten its purse strings.

Although the budget deficit in the first four months of the current fiscal year might not be a good representation of what is to follow, the shortfall in FY2022 nevertheless will improve dramatically from the Covid-led deficits of \$3.1 trillion in FY2020 and \$2.8 trillion in FY2021. The latest estimate from the Congressional Budget Office (July) showed a deficit of \$1.153 trillion for FY2022. We suspect that the shortfall will be narrower than this total.

Review

Week of Feb. 7, 2022	Actual	Consensus	Comments
Trade Balance (December)	**-$80.7 Billion ($1.4 Billion Wider Deficit)**	**-$83.0 Billion ($2.8 Billion Wider Deficit)**	Imports and exports both jumped in December (up 1.6% and 1.5%, respectively), but the volume of imports was significantly larger and therefore the deficit widened. All of the deterioration occurred in goods trade, where the deficit widened by $3.2 billion. If one were to give the result a positive spin, the jump in the flow of goods points to some easing of port congestion. Services trade provided a partial offset, with the surplus improving by $1.8 billion after a jump of $2.2 billion in November. A key factor behind the revival in service trade has been a pickup in international travel. While the total deficit widened in December, the results were still better than the assumptions initially built into Q4 GDP, suggesting a small positive contribution to economic growth from net exports rather than the neutral influence evident in the first estimate of GDP.
CPI (January)	**0.6% Total, 0.6% Core**	**0.4% Total, 0.5% Core**	Changes in the prices of food and energy were notable in January, with both increasing 0.9% and continuing to move along firm upward trends. Core prices also remained under pressure. Some of the pressure in January was again related to Covid, as discounts that emerged during the worst of the pandemic continued to reverse (apparel, airfares). Also, areas that saw strong demand as the virus spread continued to jump in price (used motor vehicles, household appliances, sporting goods). Pressure has started to seep into other areas, with rent of primary residence standing out (up 0.5%). On a year-over-year basis, the headline measure rose 7.5% and the core component advanced 6.0%. Both represented the sharpest increases since 1982.
Federal Budget (January)	**$118.7 Billion Surplus**	**$23.0 Billion Surplus**	Federal revenues jumped 20.9% in January, continuing a series of strong revenue gains (sixth consecutive advance in excess of 19% year-over-year). Outlays remain elevated in an absolute sense, but the expiration of pandemic-related support led to a year-over-year decline of 36.7%. The deficit in the first four months of FY2022 totaled $259 billion, down from $736 billion in the same period in FY2021.
Consumer Sentiment (February)	**61.7 (-8.2%)**	**67.0 (-0.3%)**	Consumer sentiment dropped 5.5 index points in early February. The latest reading was the sixth in the past seven months below the recession low of 71.8 in April 2020 and the lowest of the current expansion thus far. Inflation is likely a key driver of depressed sentiment. The year-ahead inflation gauge increased one tick to 5.0%, the highest reading since 1982. The measure moved in a range of 3.0% to 4.9% last year. The long-term measure was unchanged at 3.1%, an elevated reading from a longer-term perspective; in 2021, the gauge moved in a range of 2.7% to 3.0%.

Sources: Bureau of Economic Analysis (Trade Balance); Bureau of Labor Statistics (CPI); U.S. Treasury Department (Federal Budget); University of Michigan Survey Research Center (Consumer Sentiment); Consensus forecasts are from Bloomberg

Preview

Week of Feb. 14, 2022	Projected	Comments
PPI (January) (Tuesday)	**0.5% Total, 0.5% Ex. Food & Energy**	Price quotes on wholesale energy products suggest a dip in January, but upward pressure on food prices should provide an offset. Excluding food and energy, goods prices are likely again to be influenced by supply-side disruptions and strong demand (average increase of 0.8% per month in 2021). Services prices also have shown upward pressure, averaging advances of 0.6% per month last year.
Retail Sales (January) (Wednesday)	**1.8% Total, 1.5% Ex. Autos**	A strong rebound in new vehicle sales is likely to boost retail activity in January, and higher prices could boost the gasoline component. Sales excluding autos and gasoline could rebound after a retreat of 2.5% in December. Rapid inflation in recent months suggests that a portion of the expected increase in sales reflects higher prices.
Industrial Production (January) (Wednesday)	**0.3%**	Utility output is likely to make the largest positive contribution to industrial production in January, reflecting increased home heating amid below-average temperatures. A pickup in factory employment suggests only a modest positive contribution from manufacturing production, while a cut in mining employment raises the prospect of a dip in mining activity.
Housing Starts (January) (Thursday)	**1.640 Million (-3.6%)**	An elevated inventory of unsold homes suggest that single-family housing starts could cool in January for the second consecutive month. The volatile multi-family sector surged to its best level of the current expansion in December, raising the possibility of an offset in January.
Existing Home Sales (January) (Friday)	**6.10 Million (-1.3%)**	The prospect of higher interest rates might have pulled some fence-sitters into the market for a home, but exceedingly tight inventories and sky-high prices probably constrained sales of existing homes.
Leading Indicators (January) (Friday)	**-0.3%**	Available data suggest that the index of leading economic indicators is likely to decline for only the second time in the past 21 months, pulled lower by negative contributions from unemployment claims, consumer expectations, and stock prices. Despite the expected slippage, the reading for January would be 7.2% above the pre-recession peak in February 2020.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

February / March 2022

Monday	Tuesday	Wednesday	Thursday	Friday
7	8	9	10	11
CONSUMER CREDIT Oct $14.7 billion Nov $38.8 billion Dec $18.9 billion	**NFIB SMALL BUSINESS OPTIMISM INDEX** Nov 98.4 Dec 98.9 Jan 97.1 **TRADE BALANCE** Oct -$66.5 billion Nov -$79.3 billion Dec -$80.7 billion	**WHOLESALE TRADE** Inventories / Sales Oct 2.5% 2.5% Nov 1.7% 1.7% Dec 2.2% 0.2%	**UNEMPLOYMENT CLAIMS** Initial / Continuing (Millions) Jan 15 0.290 1.672 Jan 22 0.261 1.621 Jan 29 0.239 1.621 Feb 05 0.223 N/A **CPI** Total / Core Nov 0.7% 0.5% Dec 0.6% 0.6% Jan 0.6% 0.6% **FEDERAL BUDGET** FY2022 / FY2021 Nov -$191.3B -$145.3B Dec -$21.3B -$143.6B Jan $118.7B -$162.8B	**CONSUMER SENTIMENT** Dec 70.6 Jan 67.2 Feb 61.7
14	15	16	17	18
	PPI (8:30) Final Demand / Ex. Food & Energy Nov 1.0% 0.9% Dec 0.2% 0.5% **Jan 0.5% 0.5%** **EMPIRE MFG (8:30)** Dec 31.9 Jan -0.7 Feb -- **TIC DATA (4:00)** Total / Net L-T Oct $139.3B $7.1B Nov $223.9B $137.4B Dec -- --	**RETAIL SALES (8:30)** Total / Ex.Autos Nov 0.2% 0.1% Dec -1.9% -2.3% **Jan 1.8% 1.5%** **IMPORT/EXPORT PRICES (8:30)** Non-petrol. Imports / Nonagri. Exports Nov 0.7% 0.6% Dec 0.3% -2.1% Jan -- -- **IP & CAP-U (9:15)** IP / Cap.Util. Nov 0.7% 76.6% Dec -0.1% 76.5% **Jan 0.3% 76.5%** **BUSINESS INVENTORIES (10:00)** Inventories / Sales Oct 1.3% 2.2% Nov 1.5% 0.9% **Dec 2.1% -0.5%** **NAHB HOUSING INDEX (10:00)** Dec 84 Jan 83 Feb -- **FOMC MINUTES (2:00)**	**INITIAL CLAIMS (8:30)** **HOUSING STARTS (8:30)** Nov 1.678 million Dec 1.702 million **Jan 1.640 million** **PHILY FED INDEX(8:30)** Dec 15.4 Jan 23.2 Feb --	**EXISTING HOME SALES (10:00)** Nov 6.48 million Dec 6.18 million **Jan 6.10 million** **LEADING INDICATORS (10:00)** Nov 0.7% Dec 0.8% **Jan 0.3%**
21	22	23	24	25
PRESIDENTS' DAY	**FHFA HOME PRICE INDEX** **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** **CONSUMER CONFIDENCE**		**INITIAL CLAIMS** **REVISED GDP** **CHICAGO FED NAT'L ACTIVITY INDEX** **NEW HOME SALES**	**PERSONAL INCOME, CONSUMPTION, PRICE INDEXES** **DURABLE GOODS ORDERS** **PENDING HOME SALES** **REVISED CONSUMER SENTIMENT**
28	1	2	3	4
U.S. INTERNATIONAL TRADE IN GOODS **ADVANCE INVENTORIES** **MNI CHICAGO PURCHASING MANAGERS' INDEX**	**ISM MFG INDEX** **CONSTRUCTION SPENDING** **NEW VEHICLE SALES**	**ADP EMPLOYMENT REPORT** **BEIGE BOOK**	**INITIAL CLAIMS** **PRODUCTIVITY & COSTS** **ISM SERVICES INDEX** **FACTORY ORDERS**	**EMPLOYMENT REPORT**

Forecasts in Bold.

Treasury Financing

February / March 2022

Monday	Tuesday	Wednesday	Thursday	Friday
7	8	9	10	11
AUCTION RESULTS: Rate Cover 13-week bills 0.290% 3.00 26-week bills 0.580% 3.13	**AUCTION RESULTS:** Rate Cover 3-year notes 1.592% 2.45 **ANNOUNCE:** $50 billion 4-week bills for auction on February 10 $40 billion 8-week bills for auction on February 10 $40 billion 17-week CMBs for auction on February 9 **SETTLE:** $50 billion 4-week bills $40 billion 8-week bills $40 billion 17-week CMBs	**AUCTION RESULTS:** Rate Cover 10-yr notes 1.904% 2.68 17-week CMB 0.430% 3.17	**AUCTION RESULTS:** Rate Cover 4-week bills 0.020% 3.18 8-week bills 0.250% 2.97 30-yr bonds 2.340% 2.30 **ANNOUNCE:** $111 billion 13-,26-week bills for auction on Feb. 14 $19 billion 20-year bonds for auction on February 16 $9 billion 30-year TIPS for auction on February 17 **SETTLE:** $111 billion 13-,26-week bills	
14	15	16	17	18
AUCTION: $111 billion 13-,26-week bills	**ANNOUNCE:** $50 billion* 4-week bills for auction on February 17 $40 billion* 8-week bills for auction on February 17 $40 billion* 17-week CMBs for auction on February 16 **SETTLE:** $50 billion 4-week bills $40 billion 8-week bills $40 billion 17-week CMBs $50 billion 3-year notes $37 billion 10-year notes $23 billion 30-year bonds	**AUCTION:** $19 billion 20-year bonds $40 billion* 17-week CMBs	**AUCTION:** $50 billion* 4-week bills $40 billion* 8-week bills $9 billion 30-year TIPS **ANNOUNCE:** $111 billion* 13-,26-week bills for auction on Feb. 22 $34 billion* 52-week bills for auction on February 22 $22 billion* 2-year FRNs for auction on February 23 $52 billion* 2-year notes for auction on February 22 $53 billion* 5-year notes for auction on February 23 $50 billion* 7-year notes for auction on February 24 **SETTLE:** $111 billion 13-,26-week bills	
21	22	23	24	25
PRESIDENTS' DAY	**AUCTION:** $111 billion* 13-,26-week bills $34 billion* 52-week bills $52 billion* 2-year notes **ANNOUNCE:** $50 billion* 4-week bills for auction on February 24 $40 billion* 8-week bills for auction on February 24 $40 billion* 17-week CMBs for auction on February 23 **SETTLE:** $50 billion* 4-week bills $40 billion* 8-week bills $40 billion* 17-week CMBs	**AUCTION:** $22 billion* 2-year FRNs $53 billion* 5-year notes $40 billion* 17-week CMBs	**AUCTION:** $50 billion* 4-week bills $40 billion* 8-week bills $50 billion* 7-year notes **ANNOUNCE:** $111 billion* 13-,26-week bills for auction on Feb. 28 **SETTLE:** $111 billion* 13-,26-week bills $34 billion* 52-week bills	**SETTLE:** $22 billion* 2-year FRNs
28	1	2	3	4
AUCTION: $111 billion* 13-,26-week bills **SETTLE:** $19 billion 20-year bonds $9 billion 30-year TIPS $52 billion* 2-year notes $53 billion* 5-year notes $50 billion* 7-year notes	**ANNOUNCE:** $50 billion* 4-week bills for auction on March 3 $40 billion* 8-week bills for auction on March 3 $40 billion* 17-week CMBs for auction on March 2 **SETTLE:** $50 billion* 4-week bills $40 billion* 8-week bills $40 billion* 17-week CMBs	**AUCTION:** $40 billion* 17-week CMBs	**AUCTION:** $50 billion* 4-week bills $40 billion* 8-week bills **ANNOUNCE:** $111 billion* 13-,26-week bills for auction on Match 7 $48 billion* 3-year notes for auction on March 8 $34 billion* 10-year notes for auction on March 9 $20 billion* 30-year bonds for auction on March 10 **SETTLE:** $111 billion* 13-,26-week bills	

*Estimate