Daiwa Capital Markets

# U.S. Economic Comment

- A possible Fed put? Not this time
- Potential inflation brakes: perhaps not so forceful

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## The Stock Market and Monetary Policy

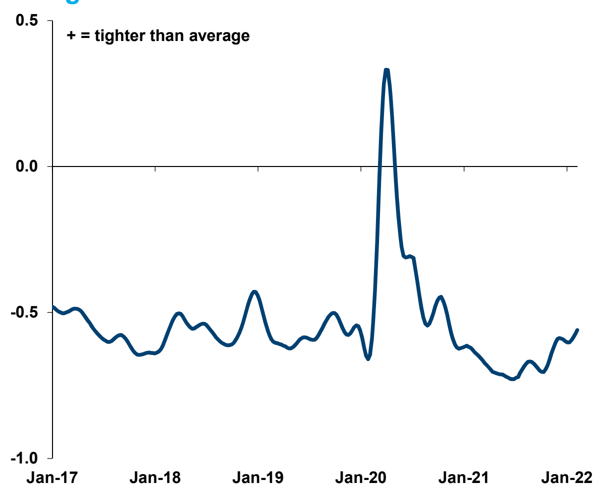
The current rapid inflation rate, along with some strong economic reports for January (employment, retail sales), raise the prospects of aggressive tightening by the Federal Reserve. Such thoughts also were stirred by hawkish comments from some Federal Reserve officials. James Bullard of the St. Louis Fed mentioned an increase of 100 basis points in short-term interest rates by July, and Esther George of the Kansas City Fed talked of potential sales of securities from the Fed's portfolio.

We believe the Fed will start boldly, adopting either a 50 basis point hike in March or (more likely) consecutive changes of 25 basis points in March, May, and June. One might wonder, however, if the volatility and net softening in the equity market might lead officials to proceed cautiously. A reporter raised this issue at Jerome Powell's latest press conference, and the Fed Chair obliquely indicated that the Fed would not be deferred from raising interest rates: "we look at broader financial conditions, not one or two things".

Taking a broad view like Mr. Powell suggests would support the case for a forceful approach. The Federal Reserve Bank of Chicago publishes a broad-based measure of financial conditions that incorporates 105 financial variables, including numerous interest rates, interest rate spreads, measures of asset values and their volatility, volumes of securities outstanding or newly issued, lending standards, delinquency rates and other measures related to bank loans, and more. The measure is constructed to have an average value of zero, with negative readings indicating easy financial conditions and positive values showing restrictive environments.

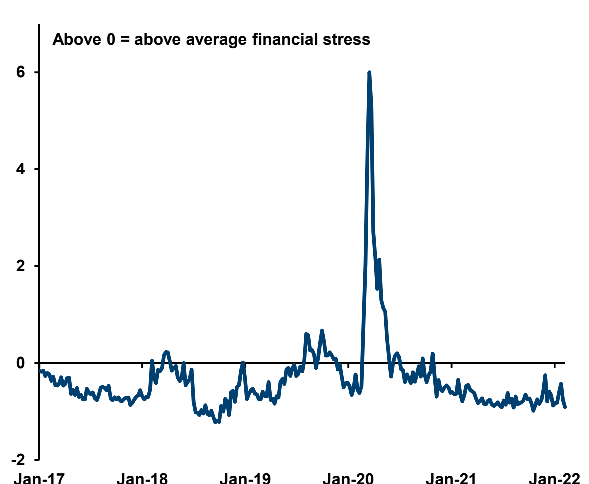
The Chicago index has been in negative territory throughout the recent period of easy monetary policy, and it has picked up only modestly this year despite the easing in the equity market, indicating still-highly accommodative financial conditions (chart, left). This series, although published weekly, contains numerous monthly and quarterly indicators, which could cause the index to change slowly or to lag the market

### Chicago Fed Financial Conditions Index




*Source: Federal Reserve Bank of Chicago via Haver Analytics*

### St. Louis Fed Financial Stress Index




*Source: Federal Reserve Bank of St. Louis via Haver Analytics*

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environment if conditions are changing rapidly (as they often do). Another index published by the St. Louis Fed has fewer variables than the Chicago measure (18 versus 105), but they are all sensitive to near-term shifts in financial markets (interest rates, interest rate spreads, volatility measures, and equity values). This index also has been range bound recently, indicating still-friendly financial conditions (chart, prior page, right).

A long-term view of equity prices also would make the recent decline look less than troubling. Although the market has eased more than nine percent from the recent high in January, the S&P 500 is still up almost 30 percent from its level before the onset of the pandemic (chart).

**S&P 500 Index***

** Weekly average data, except for the last observation which is a quote for February 18, 2022.*
*Sources: Standard and Poor's via Haver Analytics; Bloomberg*

## Inflation: Likely to be Sticky

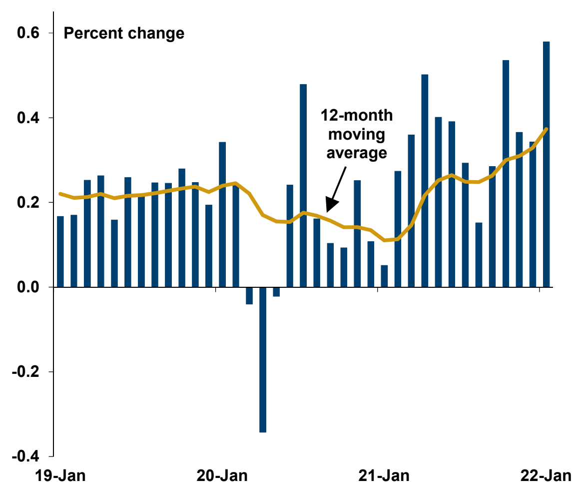
Even if the financial environment were showing notably tighter conditions, the Fed would probably need to move away from its highly accommodative stance, as it might be difficult to push inflation back to a rate in the neighborhood of two percent. Some analysts expecting an easing in inflation this year cite two factors that are likely to limit price pressure: a shift from robust goods consumption to currently restrained service consumption; and base effects, which could trim the year-over-year inflation rate. Neither is likely to push inflation back into a tolerable range; the combined effect also is likely to fall shy of the desired easing in inflation.

Once the federal government started to provide financial support during the pandemic, spending on goods soared, as did their prices (with tight supplies also playing a role). At the same time, mandated or voluntary lockdowns limited the consumption of services and left a tamer inflation environment (at least for a time).

A pivot toward service consumption has already started, but there is still a distinct bias in favor of goods, as shown by the strong report on retail sales published this week (up 3.8 percent in January). Real service consumption, while strengthening in the past year, is still below levels evident before the onset of Covid and far below levels that would exist if the pre-virus trend had been maintained.

We embrace the view that spending on services will continue to strengthen this year while goods consumption eases and price pressure on goods subsides. However, strong demand for services could easily push these prices higher. In fact, service inflation has already picked up despite a lag in spending. The year-over-year increase in prices of consumer services totaled 4.6 percent in the CPI in January; excluding energy services (primarily charges for electricity and piped natural gas), annual inflation totaled 4.1 percent (chart). Additional demand for services could push this rate higher. In this regard, an article in the February 18 *Wall Street Journal* focused on a

**CPI: Services**




*Source: Bureau of Labor Statistics via Haver Analytics*

recent pickup in travel and noted that individuals are spending lavishly during their excursions. Strong demand.

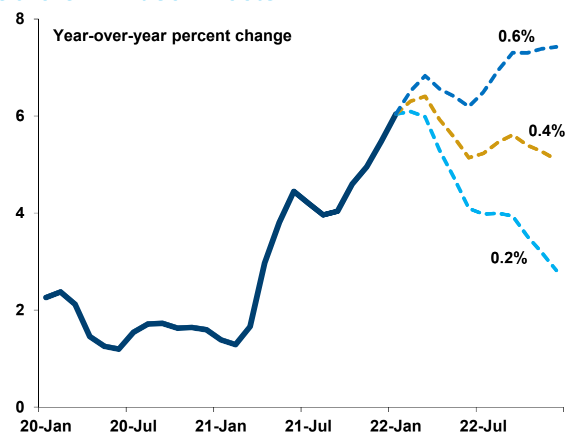
Favorable base effects will be in play this year. That is, the effects of high-side readings on monthly inflation in 2021 will drop out of the year-over-year calculations, possibly leaving a slower inflation rate. However, we do not expect the influence to be pronounced.

There were indeed some elevated monthly inflation readings last year: an average of 0.7 percent from March through June and this same pace again in the final three months of the year. However, there also were some light readings last year, and the soft months will tend to dampen any favorable base effects.

For example, the core CPI rose 0.6 percent in January. If this pace were maintained over the balance of the year, base effects would be essentially nonexistent, as the year-over-year increase in the core CPI would total 7.4 percent in December. A pace of 0.4 percent in the next 11 months would leave the annual change in December at 5.1 percent -- still troubling. A monthly pace of 0.2 percent would leave year-over-year inflation at 2.8 percent in December (chart). This outcome no doubt would be welcome by all observers because of the tame monthly observations, but the still-elevated annual total shows that slower inflation will need to occur because of monthly deceleration; base effects alone will not suffice.

Against this background, it becomes clear why a retreat in the equity market is not likely to interrupt the Fed's tightening campaign. Inflation will not recede easily. While supply-side problems have played a key role in the burst of inflation, and these pressures most likely will ease this year, demand-side factors also have been a factor. Strong fiscal support and highly accommodative monetary policy have fueled demand and pushed up the underlying rate of inflation. The Fed will have to do its part to cool the demand-driven portion of inflation.

**Core CPI: Base Effects***




** The readings from February 2022 to December 2022 are hypotheticals.*
*Sources: Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America*

# Review

| Week of Feb. 14, 2022 | Actual | Consensus | Comments |
|---|---|---|---|
| **PPI (January)** | **1.0% Total, 0.8% Ex. Food & Energy** | **0.5% Total, 0.5% Ex. Food & Energy** | Food and energy prices in January resumed their upward trajectories after dipping in the prior month (up 1.6% and 2.5%, respectively). Prices of other goods and services surged, with the January result surpassing the average of 0.7% per month in 2021. Year-over-year advances eased slightly from December results, but both the headline index and prices ex. food and energy rose at brisk clips (up 9.7% and 8.3%, respectively). |
| **Retail Sales (January)** | **3.8% Total, 3.3% Ex. Autos** | **2.0% Total, 1.0% Ex. Autos** | The sharp advance in retail activity in January offset a drop of 2.5% in December and maintained the elevated and upward drifting path that has been in place since early in last year, signaling that consumers remained active in early 2022. Much of the growth in January occurred in the auto category (+5.7%). This pickup is especially encouraging, as it could represent a signal of progress in resolving supply-chain issues in this industry. Sales excluding autos performed well (3.3%), as nonstore retailers (primarily online merchants), building materials stores, and general merchandise outlets all recovered after pullbacks in December. |
| **Industrial Production (January)** | **1.4%** | **0.5%** | Much of the growth in industrial production in January reflected a surge of 9.9% in utility output, which was driven by below-average temperatures rather than economic fundamentals. The mining sector performed well with an increase of 1.0%, although it has recovered only 72% of the ground lost during the recession. The manufacturing sector rose only modestly (0.2%). The auto industry restrained activity in the past two months, falling 0.9% in January after a dip of 0.4% in December; component shortages have prevented a more meaningful recovery in this area. Excluding autos, manufacturing activity rose 0.3%, with 12 of the 19 non-auto industries covered in the report showing gains. |
| **Housing Starts (January)** | **1.638 Million (-4.1%)** | **1.695 Million (-0.4%)** | Both single-family and multi-family activity contributed to the decline in housing starts in January, although most of the shift occurred in the single-family area, which fell 5.6%. The decline in single-family activity followed solid results in the prior two months, and thus the level of activity was still respectable -- only slightly below the average from 2021 (1.116 million units versus 1.130 in 2021). Multi-family starts fell only modestly (off 0.8%) from the best reading thus far in the current expansion. The firm results continued the strong performance seen throughout last year, with builders responding to strong demand and upward movement in rental rates. |

# Review Continued

| Week of Feb. 14, 2022 | Actual | Consensus | Comments |
|---|---|---|---|
| **Existing Home Sales (January)** | **6.50 Million (6.7%)** | **6.10 Million (-1.3%)** | Sales of existing homes jumped in January despite high prices and limited inventories, as the prospect of higher interest rates probably motivated potential buyers to act. The pickup in sales pushed activity back to the elevated range seen in late 2020 and the start of 2021, and this range was noticeably stronger than results in the prior expansion, although it lagged activity in the early 2000s. Lean inventories have been a constraint on sales for some time, and this situation worsened slightly in January. The number of homes for sale fell 2.3%, and with the pickup in sales, the months' supply of homes on the market eased to 1.6 months, down from 1.7 in January and a new record low. |
| **Leading Indicators (January)** | **-0.3%** | **0.2%** | The index of leading economic indicators declined for only the second time in the past 21 months, pulled lower by negative contributions from unemployment claims, consumer expectations, stock prices, and the factory workweek. The latest move should prove temporary, as claims were heavily influenced by the surge in Omicron, which has receded in recent weeks. |

*Sources: Bureau of Labor Statistics (PPI); U.S. Census Bureau (Retail Sales, Housing Starts); Federal Reserve Board (Industrial Production); National Association of Realtors (Existing Home Sales); The Conference Board (Leading Indicators); Consensus forecasts are from Bloomberg*

Daiwa Capital Markets

# Preview

| Week of Feb. 21, 2022 | Projected | Comments |
|---|---|---|
| **Conference Board Consumer Confidence (February) (Tuesday)** | **108.0 (-5.1%)** | Softer equity values and higher prices of key consumer goods (gasoline and groceries) likely weighed on confidence in February, a view supported by a drop in the University of Michigan index published mid-month. |
| **Revised GDP (2021-Q4) (Thursday)** | **7.5% (+0.6 Pct. Pt. Revision)** | Available data point to an upward adjustment to an already large contribution from inventory investment to revised GDP growth in Q4. Net exports also could make a small positive contribution (rather than neutral influence), and business and residential construction appear likely to be revised higher (less negative). |
| **New Home Sales (January) (Thursday)** | **0.780 Million (-3.8%)** | Although the prospect of higher interest rates could push some fence-sitters into the market for a home, a dip in buyer traffic suggests that sales of new homes could ease in January after back-to-back brisk increases to close 2021. The expected reading would trail the strong performance from mid-2020 to January 2021 (average 956,000 annual rate), but it would exceed all observations in the prior expansion. |
| **Personal Income, Consumption, Core Price Index (January) (Friday)** | **-0.3%, 1.5%, 0.5%** | Average hourly earnings rose briskly in January, but a cut in hours suggests only a moderate increase in wages and salaries. The surge in Omicron in January and its effect on commerce raises the prospect of a negative contribution from proprietors' income, and the expiration of the enhanced child tax credit points to a decline in government transfer payments. On the outlay side, jumps in new vehicle sales and retail activity suggest a firm month for consumer spending. Results for the CPI suggest another brisk increase in the price index for personal consumption expenditures. |
| **Durable Goods Orders (January) (Friday)** | **0.8%** | The manufacturing sector seems to be holding its own despite headwinds from Omicron, suggesting a pickup in new orders for durable goods after a dip in December. A rebound in the volatile aircraft sector is expected to be an important factor in the increase. |

*Source: Forecasts provided by Daiwa Capital Markets America*

# Economic Indicators

## February / March 2022

### Monday 14

### Tuesday 15

**PPI**

| | Final Demand | Ex. Food & Energy |
|---|---|---|
| Nov | 0.9% | 0.9% |
| Dec | 0.4% | 0.6% |
| Jan | 1.0% | 0.8% |

**EMPIRE MFG**

| | |
|---|---|
| Dec | 31.9 |
| Jan | -0.7 |
| Feb | 3.1 |

**TIC DATA**

| | Total | Net L-T |
|---|---|---|
| Oct | $146.9B | $7.1B |
| Nov | $216.8B | $137.9B |
| Dec | -$52.4B | $114.5B |

### Wednesday 16

**RETAIL SALES**

| | Total | Ex.Autos |
|---|---|---|
| Nov | 0.7% | 0.7% |
| Dec | -2.5% | -2.8% |
| Jan | 3.8% | 3.3% |

**IMPORT/EXPORT PRICES**

| | Non-petrol. Imports | Nonagri. Exports |
|---|---|---|
| Nov | 0.7% | 0.6% |
| Dec | 0.4% | -1.9% |
| Jan | 1.4% | 2.9% |

**IP & CAP-U**

| | IP | Cap.Util. |
|---|---|---|
| Nov | 0.9% | 76.7% |
| Dec | -0.1% | 76.6% |
| Jan | 1.4% | 77.6% |

**BUSINESS INVENTORIES**

| | Inventories | Sales |
|---|---|---|
| Oct | 1.3% | 2.2% |
| Nov | 1.5% | 1.1% |
| Dec | 2.1% | -0.7% |

**NAHB HOUSING INDEX**

| | |
|---|---|
| Dec | 84 |
| Jan | 83 |
| Feb | 82 |

**FOMC MINUTES**

### Thursday 17

**UNEMPLOYMENT CLAIMS**

| | Initial (Millions) | Continuing |
|---|---|---|
| Jan 22 | 0.261 | 1.621 |
| Jan 29 | 0.239 | 1.619 |
| Feb 05 | 0.225 | 1.593 |
| Feb 12 | 0.248 | N/A |

**HOUSING STARTS**

| | |
|---|---|
| Nov | 1.703 million |
| Dec | 1.708 million |
| Jan | 1.638 million |

**PHILY FED INDEX**

| | |
|---|---|
| Dec | 15.4 |
| Jan | 23.2 |
| Feb | 16.0 |

### Friday 18

**EXISTING HOME SALES**

| | |
|---|---|
| Nov | 6.33 million |
| Dec | 6.09 million |
| Jan | 6.50 million |

**LEADING INDICATORS**

| | |
|---|---|
| Nov | 0.8% |
| Dec | 0.7% |
| Jan | -0.3% |

### Monday 21

*PRESIDENTS' DAY*

### Tuesday 22

**FHFA HOME PRICE INDEX (9:00)**

| | |
|---|---|
| Oct | 1.1% |
| Nov | 1.1% |
| Dec | -- |

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

| | SA | NSA |
|---|---|---|
| Oct | 1.0% | 0.8% |
| Nov | 1.2% | 1.0% |
| Dec | -- | -- |

**CONFERENCE BOARD CONSUMER CONFIDENCE (10:00)**

| | |
|---|---|
| Dec | 115.2 |
| Jan | 113.8 |
| **Feb** | **108.0** |

### Wednesday 23

### Thursday 24

**INITIAL CLAIMS (8:30)**

**REVISED GDP (8:30)**

| | GDP | Chained Price |
|---|---|---|
| 21-Q3 | 2.3% | 6.0% |
| 21-Q4(a) | 6.9% | 6.9% |
| **21-Q4(p)** | **7.5%** | **6.9%** |

**CHICAGO FED NATIONAL ACTIVITY INDEX (8:30)**

| | Monthly | 3-Mo. Avg. |
|---|---|---|
| Nov | 0.44 | 0.40 |
| Dec | -0.15 | 0.33 |
| Jan | -- | -- |

**NEW HOME SALES (10:00)**

| | |
|---|---|
| Nov | 0.725 million |
| Dec | 0.811 million |
| **Jan** | **0.780 million** |

### Friday 25

**PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX (8:30)**

| | Inc. | Cons. | Core |
|---|---|---|---|
| Nov | 0.5% | 0.4% | 0.5% |
| Dec | 0.3% | -0.6% | 0.5% |
| **Jan** | **-0.3%** | **1.5%** | **0.5%** |

**DURABLE GOODS ORDERS (8:30)**

| | |
|---|---|
| Nov | 3.2% |
| Dec | -0.7% |
| **Jan** | **0.8%** |

**PENDING HOME SALES (10:00)**

| | |
|---|---|
| Nov | -2.3% |
| Dec | -3.8% |
| Jan | -- |

**REVISED CONSUMER SENTIMENT (10:00)**

| | |
|---|---|
| Dec | 70.6 |
| Jan | 67.2 |
| Feb(p) | 61.7 |

### Monday 28

**U.S. INTERNATIONAL TRADE IN GOODS**

**ADVANCE INVENTORIES**

**MNI CHICAGO PURCHASING MANAGERS' INDEX**

### Tuesday 1

**ISM MFG INDEX**

**CONSTRUCTION SPENDING**

**NEW VEHICLE SALES**

### Wednesday 2

**ADP EMPLOYMENT REPORT**

**BEIGE BOOK**

### Thursday 3

**INITIAL CLAIMS**

**REVISED PRODUCTIVITY & COSTS**

**ISM SERVICES INDEX**

**FACTORY ORDERS**

### Friday 4

**EMPLOYMENT REPORT**

### Monday 7

**CONSUMER CREDIT**

### Tuesday 8

**NFIB SMALL BUSINESS OPTIMISM**

**TRADE BALANCE**

**WHOLESALE TRADE**

### Wednesday 9

**JOB OPENINGS & LABOR TURNOVER SURVEY**

### Thursday 10

**INITIAL CLAIMS**

**CPI**

**FEDERAL BUDGET**

### Friday 11

**CONSUMER SENTIMENT**

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

# Treasury Financing

## February / March 2022

| Monday | Tuesday | Wednesday | Thursday | Friday |
|---|---|---|---|---|
| 14 | 15 | 16 | 17 | 18 |
| **AUCTION RESULTS:**<br>Rate / Cover<br>13-week bills 0.440% 3.06<br>26-week bills 0.770% 2.99 | **ANNOUNCE:**<br>$50 billion 4-week bills for auction on February 17<br>$40 billion 8-week bills for auction on February 17<br>$40 billion 17-week CMBs for auction on February 16<br>**SETTLE:**<br>$50 billion 4-week bills<br>$40 billion 8-week bills<br>$40 billion 17-week CMBs<br>$50 billion 3-year notes<br>$37 billion 10-year notes<br>$23 billion 30-year bonds | **AUCTION RESULTS:**<br>Rate / Cover<br>20-yr bonds 2.396% 2.44<br>17-week CMB 0.550% 2.99 | **AUCTION RESULTS:**<br>Rate / Cover<br>4-week bills 0.080% 3.48<br>8-week bills 0.250% 3.12<br>30-yr TIPS 0.195% 2.17<br>**ANNOUNCE:**<br>$111 billion 13-,26-week bills for auction on Feb. 22<br>$34 billion 52-week bills for auction on February 22<br>$22 billion 2-year FRNs for auction on February 23<br>$52 billion 2-year notes for auction on February 22<br>$53 billion 5-year notes for auction on February 23<br>$50 billion 7-year notes for auction on February 24<br>**SETTLE:**<br>$111 billion 13-,26-week bills | |
| 21 | 22 | 23 | 24 | 25 |
| ***PRESIDENTS' DAY*** | **AUCTION:**<br>$111 billion 13-,26-week bills<br>$34 billion 52-week bills<br>$52 billion 2-year notes<br>**ANNOUNCE:**<br>$50 billion* 4-week bills for auction on February 24<br>$40 billion* 8-week bills for auction on February 24<br>$40 billion* 17-week CMBs for auction on February 23<br>**SETTLE:**<br>$50 billion 4-week bills<br>$40 billion 8-week bills<br>$40 billion 17-week CMBs | **AUCTION:**<br>$22 billion 2-year FRNs<br>$53 billion 5-year notes<br>$40 billion* 17-week CMBs | **AUCTION:**<br>$50 billion* 4-week bills<br>$40 billion* 8-week bills<br>$50 billion 7-year notes<br>**ANNOUNCE:**<br>$111 billion* 13-,26-week bills for auction on Feb. 28<br>**SETTLE:**<br>$111 billion 13-,26-week bills<br>$34 billion 52-week bills | **SETTLE:**<br>$22 billion 2-year FRNs |
| 28 | 1 | 2 | 3 | 4 |
| **AUCTION:**<br>$111 billion* 13-,26-week bills<br>**SETTLE:**<br>$19 billion 20-year bonds<br>$9 billion 30-year TIPS<br>$52 billion 2-year notes<br>$53 billion 5-year notes<br>$50 billion 7-year notes | **ANNOUNCE:**<br>$50 billion* 4-week bills for auction on March 3<br>$40 billion* 8-week bills for auction on March 3<br>$40 billion* 17-week CMBs for auction on March 2<br>**SETTLE:**<br>$50 billion* 4-week bills<br>$40 billion* 8-week bills<br>$40 billion* 17-week CMBs | **AUCTION:**<br>$40 billion* 17-week CMBs | **AUCTION:**<br>$50 billion* 4-week bills<br>$40 billion* 8-week bills<br>**ANNOUNCE:**<br>$111 billion* 13-,26-week bills for auction on March 7<br>$48 billion* 3-year notes for auction on March 8<br>$34 billion* 10-year notes for auction on March 9<br>$20 billion* 30-year bonds for auction on March 10<br>**SETTLE:**<br>$111 billion* 13-,26-week bills | |
| 7 | 8 | 9 | 10 | 11 |
| **AUCTION:**<br>$111 billion* 13-,26-week bills | **AUCTION:**<br>$48 billion* 3-year notes<br>**ANNOUNCE:**<br>$50 billion* 4-week bills for auction on March 10<br>$40 billion* 8-week bills for auction on March 10<br>$40 billion* 17-week CMBs for auction on March 9<br>**SETTLE:**<br>$50 billion* 4-week bills<br>$40 billion* 8-week bills<br>$40 billion* 17-week CMBs | **AUCTION:**<br>$34 billion* 10-year notes<br>$40 billion* 17-week CMBs | **AUCTION:**<br>$50 billion* 4-week bills<br>$40 billion* 8-week bills<br>$20 billion* 30-year bonds<br>**ANNOUNCE:**<br>$111 billion* 13-,26-week bills for auction on March 14<br>**SETTLE:**<br>$111 billion* 13-,26-week bills | |

*Estimate