U.S. Economic Comment

- Has inflation peaked?
- Gasoline sales: the price system works

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Inflation: Still a Challenge

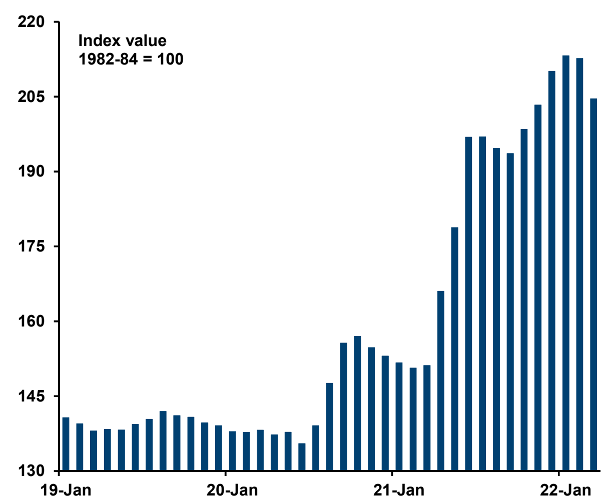
The latest report on the consumer price index included possibly encouraging news on the outlook for inflation: the core component rose only 0.3 percent, noticeably shy of the 0.5 percent average in the prior 12 months. Moreover, there could be more restraint in the months ahead given the source of the softness in March. A decline of 3.8 percent in the prices of used motor vehicles played a key role, as the core index would have increased 0.5 percent without this drop.

Given the still-elevated level of prices for used cars and trucks, this component of the CPI is probably in the early stages of a correction (chart, left; the chart shows the level of the index rather than the percent change). Also, there are other items that surged in price during the worst of the pandemic and could correct as activity returns to normal (new cars, vehicle rentals, household appliances). The easing in the core rate in March, and the possibility of similar shifts in coming months, has led some market participants to wonder if inflation has peaked.

To be sure, there will be favorable developments in the months ahead. Although the Fed has retired the term "transitory" when assessing inflation, the price indexes have been influenced by factors that will fade and in some cases reverse. However, the U.S. has also seen an increase in underlying inflation that needs to be addressed with tighter policy.

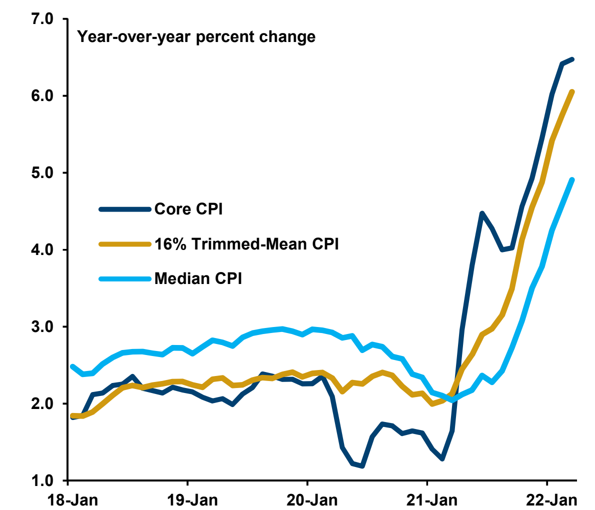
The chart on the right provides insight into what degree the current inflation rate is the result of pandemic-related forces versus underlying demand; the pandemic-related factors will fade or reverse, while demand-driven sources will be longer lasting. The top line shows the year-over-year increase in the core CPI, a measure that includes pressure that eventually will disappear. The other two lines show inflation measures that exclude outlying observations, which minimize or eliminate the influence of special factors and provide a view on underlying inflation.

CPI: Used Cars & Trucks



Source: Bureau of Labor Statistics via Haver Analytics

CPI



Sources: Bureau of Labor Statistics and Federal Reserve Bank of Cleveland via Haver Analytics

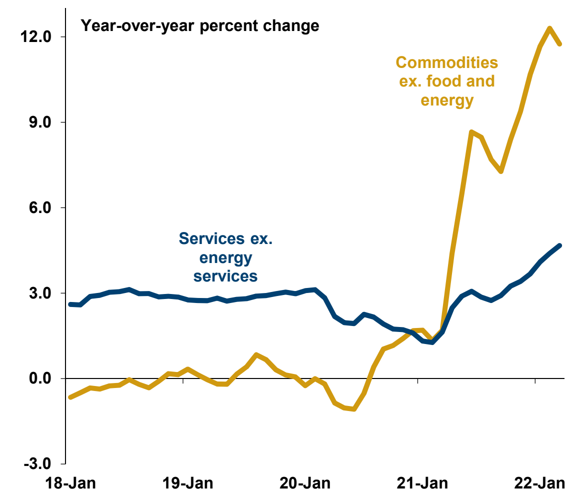
The trimmed mean CPI shown on the chart drops 16 percent of the individual goods or services that enter the calculation of the CPI (the highest and lowest eight percent). Without these extreme readings, which in many cases reflect idiosyncratic factors, the measure gives a sense of underlying pressure. The median CPI goes further by focusing on the single good or service in the middle of the distribution of price changes. It might be viewed as the ultimate measure of underlying inflation, as it gives a clear read on whether the distribution of price changes is shifting to the right or the left (i.e. toward faster or slower inflation).

If the economy were to stay on its present course, we would look for the core CPI to gravitate toward one of the underlying measures on the chart, most likely the median CPI. The latest year-over-year increase of 4.9 percent on the median index represents a marked improvement from the 6.5 percent surge in the core CPI, but there are few policymakers or politicians or consumers who would find this pace acceptable.

Service Inflation

Some analysts have argued in recent months that a shift in consumer spending away from goods and toward services could bring inflation relief. The argument has intuitive appeal because heavy spending on goods during the worst of the pandemic drove prices notably higher (core goods prices up 11.7 percent in the past year; chart), while service prices increased at a slower rate. However, service inflation is no bargain at 4.7 percent, and the rate could pickup as demand shifts in this direction.

CPI



Source: Bureau of Labor Statistics via Haver Analytics

Also, we should take into account that services have a greater weight in the CPI than goods do. A deceleration in demand for goods would be expected to reduce price pressure, but the related pickup in demand for services would boost their prices. Given the greater weight on services, overall inflation could accelerate rather than cool.

The influence of the weight differential has been evident in the past year. Goods inflation has been considerably faster than that for service inflation (11.7 percent versus 4.7 percent), but because of its greater weight, the contribution to core and overall inflation from services is slightly larger than that for goods.

Base Effects

Base effects are likely to capture a good bit of attention over the next few months. The core CPI increased sharply in the April-June period of last year (0.9, 0.7, and 0.8 percent). These results will drop out of the year-over-year calculations beginning next month, which will leave a smaller year-over-year change if the new month-to-month shifts are less than the ones from a year ago.

We suspect that the new monthly changes will be lighter than the year-ago results, and thus year-over-year inflation rates will ease. However, the slowing is not likely to be dramatic. The chart on the next page shows the paths that will result from various monthly inflation rates over the balance of the year, and the easing is probably not pronounced enough to remove inflation as an issue. Also, the restraint from base effects could be temporary, as monthly core inflation cooled to a degree in the three months after June of last year (0.3, 0.2, 0.3 percent).

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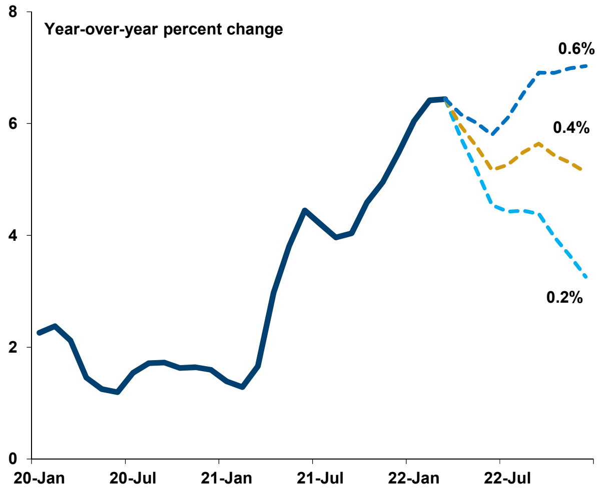
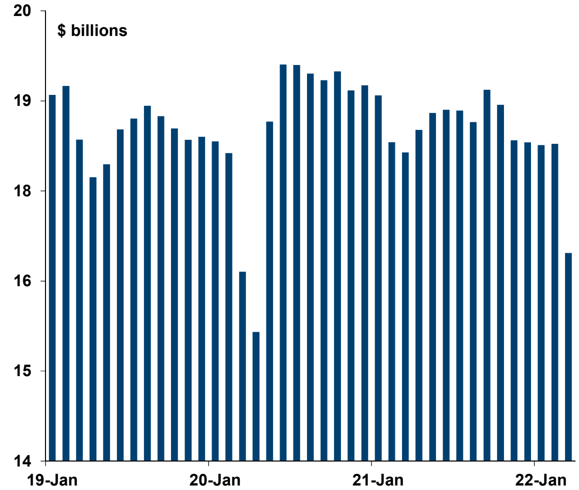
Core CPI: Base Effects



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

Real Gasoline Sales*



** The nominal value of sales at gasoline stations (from the monthly retail sales report) adjusted for inflation using the gasoline component of the CPI.*

Sources: Bureau of Labor Statistics and U.S. Census Bureau via Haver Analytics; Daiwa Capital Markets America

Gasoline Prices

While inflation in general has been an issue for consumers, the surge of 48 percent in the price of gasoline in the past year, and more than 18 percent in March alone, has weighed most heavily on household budgets. While some households can carry on with normal lifestyles by saving less than they normally would, others will have to make more meaningful changes in behavior. Some will draw down existing savings, others will be forced to reduce spending, either for gasoline or other items.

The report on retail sales for March suggested that individuals have started to drive substantially less. The report showed a surge of 8.9 percent in spending at gasoline service stations, a striking monthly increase, but with prices up 18.3 percent in the month, the change represented a marked decline in real terms. Indeed, inflation-adjusted sales were close to the lows seen during the recession when lockdowns led to limited travel (chart).

The drop in reported sales of gasoline perhaps overstates the degree to which individuals have reduced driving, as some retailers other than service stations also sell gasoline. Most important, many big-box outlets sell motor fuel, and results at these stores would be recorded in the general merchandise category rather than the service-station grouping. Sales at general merchandise stores were strong in March, possibly influenced by gasoline. Still, we suspect that the cumulative change in gasoline prices in the past year or so is starting to bite, forcing notable changes in behavior.

The experience with high gasoline prices leads us to wonder about prospects for fighting climate change and promoting a green revolution. In one sense the experience has been encouraging, as it shows that higher energy prices will lead to changes in behavior and a reduction in the usage of fossil fuels. If legislators are willing to allow market mechanisms to alter energy usage, progress can be made. In another sense the experience is discouraging, as it shows little willingness to pursue such avenues. The efforts of state governments to suspend gasoline taxes suggest dim prospects for market-based solutions, and we doubt that genuine progress is possible without price incentives.

Review

Week of April 11, 2022	Actual	Consensus	Comments
CPI (March)	**1.2% Total, 0.3% Core**	**1.2% Total, 0.5% Core**	Led by surges in the prices of gasoline and fuel oil, the increase of 11.0% in the energy component represented the second strongest reading on record. Food prices also contributed to the jump in the headline index with an increase of 1.0%, which matched the sharpest increase of the past year. The surprisingly soft reading on the core component was largely the result of a drop of 3.8% in the prices of used motor vehicles. Absent this decline, the core component would have matched the expected increase of 0.5%, with sizeable increases in the prices of numerous goods and services contributing.
Federal Budget (March)	**$192.7 Billion Deficit**	**$190.0 Billion Deficit**	Federal revenues continued to grow at a brisk pace in March, up 17.8% from the same month last year, which left growth in the first half of the fiscal year at 24.5%. Federal outlays were far below the total from March 2021 (off 45.2%), but year-ago expenditures were boosted by the third round of recovery rebates. The level of spending in the latest month was in the upper portion of the range so far this fiscal year. The combination of brisk revenue growth and an easing in pandemic-related support has led to marked improvement in the budget deficit: a shortfall of $668 billion in the first half of the current fiscal year versus $1,706 billion in the same period in FY2021.
PPI (March)	**1.4% Total, 1.0% Ex. Food & Energy**	**1.1% Total, 0.5% Ex. Food & Energy**	Both the food and energy components posted changes in the upper ends of their recent ranges (2.4% and 5.7%, respectively versus averages of 1.1% and 2.5% in the prior 12 months). Outside of food and energy, much of this pressure came in prices of goods destined for export and goods purchased by governments (1.7% and 1.3%, respectively), but prices of core consumer goods also contributed with an increase of 0.7%, and prices of services continued to move along a brisk path (up 0.9%).
Retail Sales (March)	**0.5% Total, 1.1% Ex. Autos**	**0.6% Total, 1.0% Ex. Autos**	A surge of 8.9% in the gasoline category led the advance in retail sales in March, but the change reflected higher prices more so than real activity (the gasoline component of the CPI rose 18.3% in March). Excluding gasoline, retail sales fell 0.3%. A decline of 1.9% in the auto category accounted for much of the retreat ex-gasoline, and this softness can perhaps be blamed on supply constraints. Sales in the nonstore category (mostly online) also were weak in March (off 6.4%) and have shown little net change since last fall.

Review Continued

Week of April 11, 2022	Actual	Consensus	Comments
Consumer Sentiment (April)	**65.7 (10.6%)**	**59.0 (-0.7%)**	Consumer sentiment in April increased for the first time this year, although the latest observation was the eighth in the past nine months below the recession low of 71.8 in April 2020. Higher prices have been playing a key role in restraining sentiment. The year-ahead and longer-term inflation gauges released with the report were unchanged from the prior month at 5.4% and 3.0%, respectively, but they were elevated from a longer-term perspective.
Industrial Production (March)	**0.9%**	**0.4%**	After showing little net change around the turn of the year, the manufacturing component of industrial production rose 0.9% in March after a jump of 1.2% in February. The recent increases were broadly based, with 14 of 20 major industries advancing in March and 18 posting gains in February. Mining activity also contributed positively to headline IP with a gain of 1.5%. Mining output remains below pre-pandemic levels, but higher prices of oil and gas appear to be stimulating increased activity. Utility output, which is often volatile and reflects swings in the weather rather than economic fundamentals, rose 0.4% -- a surprise given a shift toward warmer temperatures in March.

Sources: Bureau of Labor Statistics (CPI, PPI); U.S. Treasury Department (Federal Budget); U.S. Census Bureau (Retail Sales); University of Michigan Survey Research Center (Consumer Sentiment); Federal Reserve Board (Industrial Production); Consensus forecasts are from Bloomberg

Preview

Week of April 18, 2022	Projected	Comments
Housing Starts (March) (Tuesday)	**1.700 Million (-3.9%)**	With the inventory of unsold homes at a comfortable level, and with higher mortgage rates possibly dampening sales, builders are not likely to be aggressive in starting new single-family homes. Multi-family starts, which often swing widely, could ease from their high-side reading in February.
Existing Home Sales (March) (Wednesday)	**5.90 Million (-2.0%)**	Four consecutive declines in pending home sales, all sizeable, suggest that elevated home prices and higher mortgage rates have dampened demand. The expected reading, if realized, would represent the third decline in the past four months and push sales to their lowest level since the early months of the current expansion.
Leading Indicators (March) (Thursday)	**0.2%**	The slope of the yield curve, unemployment claims, and the factory workweek are likely to make positive contributions to the leading indicators index in March, but consumer expectations should provide a partial offset. The expected increase will be the 21st in the past 23 months (with one decline and one month rounding down to no change).

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

April / May 2022

Monday	Tuesday	Wednesday	Thursday	Friday
11	12	13	14	15
	NFIB SMALL BUSINESS OPTIMISM INDEX Jan 97.1 Feb 95.7 Mar 93.2 **CPI** Total Core Jan 0.6% 0.6% Feb 0.8% 0.5% Mar 1.2% 0.3% **FEDERAL BUDGET** 2022 2021 Jan $118.7B -$162.8B Feb -$216.6B -$310.9B Mar -$192.7B -$659.6B	**PPI** Final Demand Ex. Food & Energy Jan 1.2% 0.9% Feb 0.9% 0.4% Mar 1.4% 1.0%	**UNEMPLOYMENT CLAIMS** Initial Continuing (Millions) Mar 19 0.166 1.506 Mar 26 0.171 1.523 Apr 02 0.167 1.475 Apr 09 0.185 N/A **RETAIL SALES** Total Ex.Autos Jan 5.1% 4.6% Feb 0.8% 0.6% Mar 0.5% 1.1% **IMPORT/EXPORT PRICES** Non-petrol Imports Nonagri. Exports Jan 1.5% 2.7% Feb 0.7% 3.0% Mar 1.1% 4.5% **CONSUMER SENTIMENT** Feb 62.8 Mar 59.4 Apr 65.7 **BUSINESS INVENTORIES** Inventories Sales Dec 2.4% -0.7% Jan 1.3% 4.1% Feb 1.5% 1.0%	***GOOD FRIDAY*** **EMPIRE MFG** Feb 3.1 Mar -11.8 Apr 24.6 **IP & CAP-U** IP Cap.Util. Jan 1.0% 77.0% Feb 0.9% 77.7% Mar 0.9% 78.3% **TIC DATA** Total Net L-T Dec -$57.5B $114.5B Jan $287.4B $58.8B Feb $162.6B $141.7B
18	19	20	21	22
NAHB HOUSING INDEX (10:00) Feb 81 Mar 79 Apr --	**HOUSING STARTS (8:30)** Jan 1.657 million Feb 1.769 million **Mar 1.700 million**	**EXISTING HOME SALES (10:00)** Jan 6.49 million Feb 6.02 million **Mar 5.90 million** **BEIGE BOOK (2:00)** **March Beige Book** "Economic activity has expanded at a modest to moderate pace since mid-January."	**INITIAL CLAIMS (8:30)** **PHILY FED INDEX (8:30)** Feb 16.0 Mar 27.4 Apr -- **LEADING INDICATORS (10:00)** Jan -0.5% Feb 0.3% **Mar 0.2%**	
25	26	27	28	29
CHICAGO FED NATIONAL ACTIVITY INDEX	**DURABLE GOODS ORDERS** **FHFA HOME PRICE INDEX** **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** **CONSUMER CONFIDENCE** **NEW HOME SALES**	**U.S. INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES** **PENDING HOME SALES**	**INITIAL CLAIMS** **GDP**	**EMPLOYMENT COST INDEX** **PERSONAL INCOME, CONSUMPTION, PCE PRICE INDEXES** **CHICAGO PURCHASING MANAGERS' INDEX** **REVISED CONSUMER SENTIMENT**
2	3	4	5	6
ISM MANUFACTURING INDEX **CONSTRUCTION SPEND.**	**FACTORY ORDERS** **JOB OPENINGS & LABOR TURNOVER (JOLTS)** **NEW VEHICLE SALES** **FOMC MEETING**	**ADP EMLOYMENT REPORT** **TRADE BALANCE** **ISM SERVICES INDEX** **FOMC DECISION**	**INITIAL CLAIMS** **PRODUCTIVITY & COSTS**	**EMPLOYMENT REPORT** **CONSUMER CREDIT**

Forecasts in Bold.

Treasury Financing

April / May 2022

Monday	Tuesday	Wednesday	Thursday	Friday
11	12	13	14	15
AUCTION RESULTS: Rate Cover 13-week bills 0.785% 2.64 26-week bills 1.220% 3.32 3-year notes 2.738% 2.48	**AUCTION RESULTS:** Rate Cover 10-yr notes 2.720% 2.43 **ANNOUNCE:** $35 billion 4-week bills for auction on April 14 $30 billion 8-week bills for auction on April 14 $30 billion 17-week CMBs for auction on April 13 **SETTLE:** $35 billion 4-week bills $30 billion 8-week bills $30 billion 17-week CMBs	**AUCTION RESULTS:** Rate Cover 17-week CMB 0.965% 3.59 30-yr bonds 2.815% 2.30	**AUCTION RESULTS:** Rate Cover 4-week bills 0.370% 2.84 8-week bills 0.570% 3.56 **ANNOUNCE:** $105 billion 13-,26-week bills for auction on April 18 $34 billion 52-week bills for auction on April 19 $16 billion 20-year bonds for auction on April 20 $20 billion 5-year TIPS for auction on April 21 **SETTLE:** $105 billion 13-,26-week bills	***GOOD FRIDAY***
18	19	20	21	22
AUCTION: $105 billion 13-,26-week bills **SETTLE:** $46 billion 3-year notes $34 billion 10-year notes $20 billion 30-year bonds	**AUCTION:** $34 billion 52-week bills **ANNOUNCE:** $35 billion* 4-week bills for auction on April 21 $30 billion* 8-week bills for auction on April 21 $30 billion* 17-week CMBs for auction on April 20 **SETTLE:** $35 billion 4-week bills $30 billion 8-week bills $30 billion 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs $16 billion 20-year bonds	**AUCTION:** $35 billion* 4-week bills $30 billion* 8-week bills $20 billion 5-year TIPS **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on April 25 $24 billion* 2-year FRNs for auction on April 27 $48 billion* 2-year notes for auction on April 26 $49 billion* 5-year notes for auction on April 27 $44 billion* 7-year notes for auction on April 28 **SETTLE:** $105 billion 13-,26-week bills $34 billion 52-week bills	
25	26	27	28	29
AUCTION: $105 billion* 13-,26-week bills	**AUCTION:** $48 billion* 2-year notes **ANNOUNCE:** $35 billion* 4-week bills for auction on April 28 $30 billion* 8-week bills for auction on April 28 $30 billion* 17-week CMBs for auction on April 27 **SETTLE:** $35 billion* 4-week bills $30 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs $24 billion* 2-year FRNs $49 billion* 5-year notes	**AUCTION:** $35 billion* 4-week bills $30 billion* 8-week bills $44 billion* 7-year notes **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on May 2 **SETTLE:** $105 billion* 13-,26-week bills	**SETTLE:** $20 billion 5-year TIPS
2	3	4	5	6
AUCTION: $105 billion* 13-,26-week bills **SETTLE:** $16 billion 20-year bonds $24 billion* 2-year FRNs $48 billion* 2-year notes $49 billion* 5-year notes $44 billion* 7-year notes	**ANNOUNCE:** $35 billion* 4-week bills for auction on May 5 $30 billion* 8-week bills for auction on May 5 $30 billion* 17-week CMBs for auction on May 4 **SETTLE:** $35 billion* 4-week bills $30 billion* 8-week bills $30 billion* 17-week CMBs	**ANNOUNCE:** $45 billion* 3-year notes for auction on May 10 $36 billion* 10-year notes for auction on May 11 $22 billion* 30-year bonds for auction on May 12 **AUCTION:** $30 billion* 17-week CMBs	**AUCTION:** $35 billion* 4-week bills $30 billion* 8-week bills **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on May 9 **SETTLE:** $105 billion* 13-,26-week bills	

**Estimate*