U.S. Economic Comment

- Consumer inflation: hints of easing in April, but the underlying rate remains brisk
- Recession risks: economists are hopeful for a soft landing
- The federal budget: a revenue surge in April

Michael Moran
Lawrence Werther
Daiwa Capital Markets America
michael.moran@us.daiwacm.com
lawrence.werther@us.daiwacm.com

Inflation

A review of the April report on consumer prices might lead one to suspect that inflation has peaked. The year-over-year change in both the headline and core measures inched lower in the latest month, and perhaps more important, prices of several goods or services sensitive to Covid could be stable or moving lower in the months ahead. For example, airfares and clothing prices are now above their pre-pandemic levels, suggesting that price increases to reverse pandemic-driven discounting may have run their course. In addition, goods in high demand during the worst of the pandemic could be giving back some of their earlier price increases. Prices of used motor vehicles, for example, have declined for two consecutive months (although only modestly so in April), and a drop in the household appliance component ended a string of 11 consecutive increases.

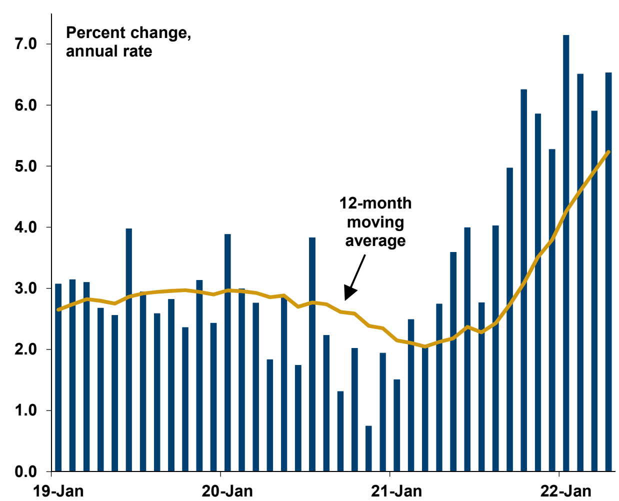
We would not quarrel with the view that inflation has peaked. The washing out of pandemic-related noise will most likely lead to some easing in price pressure. However, a peaking in the inflation rate is not the relevant issue; the key consideration is whether or not inflation is on a path to return to two percent, and this does not seem to be the case. Various measures show that underlying inflation has picked up, which will require a period of restrictive monetary policy and sub-par growth or recession to get inflation under control.

Measures of inflation excluding food and energy provide insight into underlying inflation, but this gauge can still be influenced by temporary factors or random shifts in a few prices. Better measures, in our view, are those that focus on the middle portion of the distribution of price changes. These measures will show meaningful changes only if inflation is broadly based; that is, only if underlying inflation has changed.

The weighted median CPI published by the Federal Reserve Bank of Cleveland is the ultimate measure of mid-distribution price changes. This gauge includes only one item in the consumer price index, the one that separates slowly rising prices on goods and services whose weights cumulate to 50 percent from the 50 percent with faster rising prices. That is, it shows the midpoint of the distribution of price changes.

This measure still shows some month-to-month variation, but in the years preceding the pandemic those fluctuations were centered on a rate of approximately two percent, suggesting stable underlying inflation. Recent readings of approximately 6.5 percent leave little doubt that underlying inflation has picked up (chart).

Median CPI



Source: Federal Reserve Bank of Cleveland via Haver Analytics

The Federal Reserve Bank of Atlanta shows on its web site a dashboard of nine measures of underlying inflation (including the Cleveland Fed weighted median), and all indicate rapid inflation. The average of the nine measures is 5.2 percent with a range of 3.7 to 6.4 percent. The Federal Reserve Bank of New York also seeks to uncover the underlying inflation rate, with two measures constructed by staff economists, one based on prices alone and the other including the influence of non-price economic data. The price only measure is showing underlying inflation of 5.8 percent, while the measure with price and non-price data is showing a rate of 4.9 percent.

Inflation Expectations

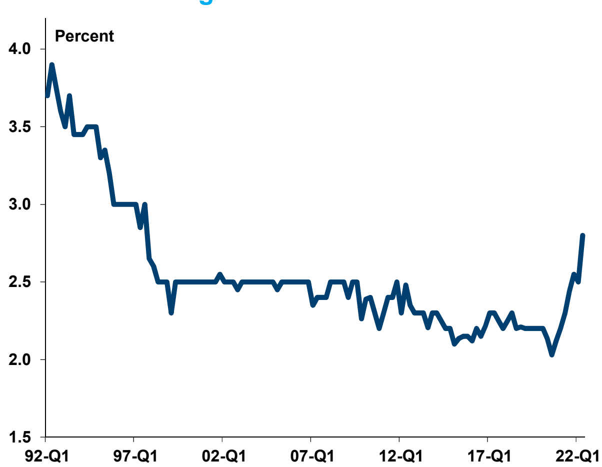
Despite the pickup in underlying inflation, market participants do not see inflation getting out of hand in the long run. The break-even inflation rate on 10-year Treasury inflation protected securities now stands at approximately 2.7 percent. This implied inflation rate is noticeably above the range of 1.8 to 2.2 percent in the years preceding the pandemic, but most of the pressure occurs in the first five years of this span (break-even rates of 2.9 to 3.0 percent on 5-year TIPS). The 5-year/5-year forward expectation now totals approximately 2.3 percent, only marginally above pre-Covid readings of 1.8 to 2.2 percent and largely consistent with the Fed's target of 2.0 percent on the price index for personal consumption expenditures.

The break-even rates on TIPS have improved in the past few weeks, as the 5-year measure of approximately 3.0 percent has eased from readings as high as 3.7 percent in March. The 10-year break-even rate of 2.7 percent is down from a peak of 3.0 percent in April. The 50-basis-point hike by the Fed in early May (and the suggestion of more 50-basis-point changes to come) apparently has tempered long-term inflation concerns to a degree.

The economics community also has a sanguine long-term view on inflation, at least according to the Survey of Professional Forecasters conducted by the Federal Reserve Bank of Philadelphia. We put special weight on the inflation projections in this report because the respondents (approximately 40 economic forecasters) supposedly have theoretically sound views on the inflation process, and hopefully they are adept at assessing the Fed's commitment to containing inflation.

The long-term view on inflation from this group of forecasters has picked up in the past few quarters, with an average increase of 2.8 percent in the CPI over the next 10 years jumping out of the range in place since the late 1990s (chart, left). However, essentially all of the pressure occurs in the next year or two. The annual breakdown shows an expected inflation rate of 6.1 percent this year and rates of 2.9 percent and 2.3 percent in the next two years. The expected inflation rate six to 10 years from now (i.e. the 5-year/5-year forward rate) totals 2.2 percent, a comfortable pace (chart, right).

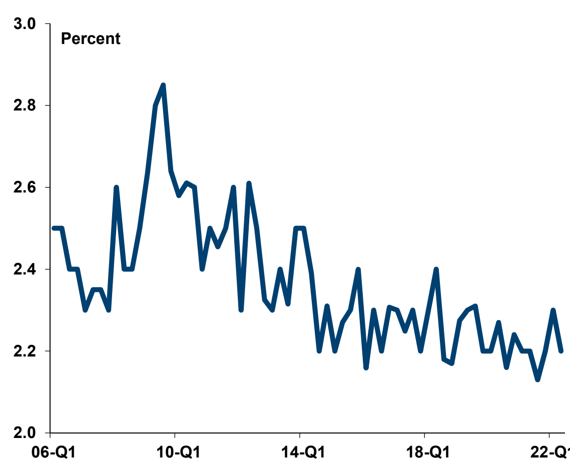
Forecasters' Long-Term View on Inflation*



** Expected yearly inflation over the next 10 years as measured by the CPI. Median estimate.*

Source: Survey of Professional Forecasters, Federal Reserve Bank of Philadelphia

Forecasters' 5-Year Forward View on Inflation*



** Expected yearly inflation six to 10 years from now as measured by the CPI. Median estimate.*

Source: Survey of Professional Forecasters, Federal Reserve Bank of Philadelphia

Recession Risks

Such a quick reduction in inflation might seem to require highly restrictive monetary policy and possibly a recession, but forecasters in the Phily survey see growth being well maintained over the next few years. The median projection shows GDP growth of 2.5 percent this year, followed by 2.3 percent and 2.0 percent in 2023 and 2024, respectively. The unemployment rate barely moves according to this survey, with the jobless rate moving from an average of 3.6 percent this year and next to 3.8 percent in 2024.

The survey contained another bit of information that suggested limited concern about a recession. The Phily Fed asked for views on the probability of a decline in GDP over each of the next five quarters, and the most pessimistic view was a 28 percent chance in the first quarter of next year.

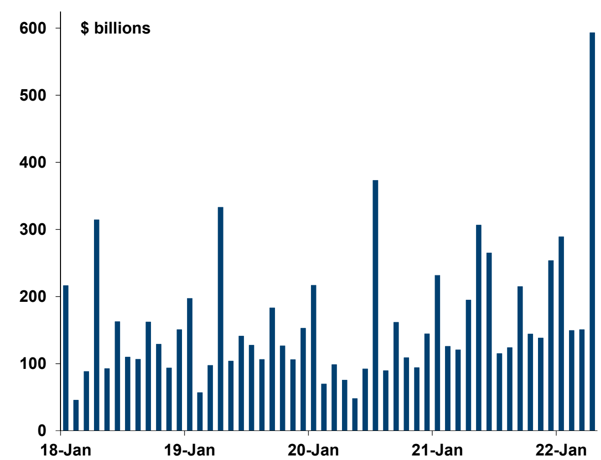
The Blue Chip survey in May also showed a favorable view for growth and inflation among economists. This survey asked if participants expected a period of "stagflation" to develop; only 18 percent responded yes.

The views in these surveys strike us as too optimistic. With underlying inflation now elevated, reducing price pressure will most likely require restrictive monetary policy and very slow growth or a recession. It is difficult to envision inflation retreating to the low-two-percent area with economic growth at or above potential and unemployment remaining close to cyclical lows. We are hopeful that the U.S. can avoid a recession in the next year or two, but we see growth slowing to the neighborhood of 1.0 percent and unemployment rising at least a percentage point by 2024. If economic growth remains at 2.0 percent or above, inflation is not likely to recede meaningfully.

Federal Budget: a Revenue Surge in April

The federal government registered strong revenue flows in the first half of the fiscal year (October through March), with the six-month total approximately 25 percent larger than the amount collected in the same period in FY2021. Results for April were even stronger, as receipts jumped almost 97 percent from the collections in April 2021.

Individual Income Tax Receipts



Source: U.S. Treasury Department via Haver Analytics

Income taxes from individuals accounted for much of the surge, with total receipts far eclipsing any other previous month (chart). Taxes withheld from paychecks were respectable, but they were a bit below the average in the first half of the year. The surge came from direct payments by individuals, either to settle obligations from 2021 or to make estimated payments for 2022. Final payments on income from 2021 would be expected to be large because of capital gains generated by the advance in equity values last year. Generous unemployment benefits, which are taxable, also may have had an influence.

While the payment of personal income taxes dominated the revenue flow, profit taxes from corporations also were strong, as were several smaller revenue sources (estate taxes, customs duties, Fed remittances).

The strength in revenue flows (and an easing in Covid-related expenditures) has led to considerable improvement in the overall budget situation of the federal government. The deficit in the first seven months of the fiscal year totaled $360 billion, down from $1,932 billion in the same period in the prior fiscal year. Results thus far suggest that the shortfall for the whole fiscal year will be less than $1.0 trillion; in fact, we would be thinking in terms of $600 billion to $800 billion, much better than the CBO estimate of $1,153 billion published last July.

Review

Week of May 9, 2022	Actual	Consensus	Comments
CPI (April)	**0.3% Total, 0.6% Core**	**0.2% Total, 0.4% Core**	The increase in the CPI in April trailed the average advance of 0.8% in the prior six months, restrained by a drop of 2.7% in the energy component. Food prices rose 0.9%, in line with jumps of 1.0% in February and March and firmer than the average of 0.7% in the 6 months before February. In the core component, travel-related expenses played a key role in pushing prices higher, as airfares surged 18.6%. Housing costs are another area of concern, as rent of primary residence rose 0.6% and owners' equivalent rent increased 0.5%. A few areas provided some price relief: apparel prices declined 0.8%, prices of used vehicles eased 0.4%, and admissions to sporting events dropped 8.2% (not seasonally adjusted). On balance, monthly changes in April were a bit slower than the recent averages, which led to a modest slowdown in year-over-year shifts (8.3% for the headline index down from 8.5% in March; 6.2% for core versus 6.5% in March).
Federal Budget (April)	**$308.2 Billion Surplus**	**$260.0 Billion Surplus**	Federal revenues in April surged 96.6% on a year-over-year basis, but much of the spectacular growth reflected the postponement last year of the tax filing deadline for final payments on 2020 obligations. A strong economy and firm income growth, along with capital gains generated by rising asset values, also contributed to the massive gain in receipts. Outlays, while elevated relative to historical norms, fell 16.4% on a year-over-year basis, as expenditures in April 2021 were still inflated by pandemic-related programs. The deficit for the first seven months of the fiscal year totaled $360 billion, down from $1,932 billion in the same period in FY2021.
PPI (April)	**0.5% Total, 0.4% Ex. Food & Energy**	**0.5% Total, 0.7% Ex. Food & Energy**	Wholesale energy prices increased 1.7% in April, a brisk advance but slower than the average of 2.7% in the prior 12 months. Food prices jumped 1.5%; the rate of increase in food prices has quickened recently, averaging 1.9% in the first four months of 2022 versus 1.0% last year. Goods prices excluding food and energy added to their brisk upward trend in April, with an advance of 1.0% that exceeded the average of 0.8% in the prior 12 months. Prices in the volatile service area were flat in the latest month, which helped to restrain broad measures of producer inflation. Monthly changes in April left the year-over-year advance in the headline index at 11.0%, down from 11.5% in March. Prices excluding food and energy advanced 8.8% versus 9.6% in March.
Consumer Sentiment (May)	**59.1 (-9.4%)**	**64.0 (-1.8%)**	Increased prices of gasoline and groceries weighed heavily on consumer sentiment in early May, as did pronounced downside volatility in the equity market. The latest reading on consumer sentiment was the lowest of the current expansion thus far, trailing an average reading of 77.6 in 2021 and a reading of 101.0 prior to the onset of Covid.

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

Preview

Week of May 16, 2022	Projected	Comments
Retail Sales (April) (Tuesday)	**0.6% Total, 0.2% Ex. Autos**	A jump in new vehicle sales in April could boost the auto component of the retail report, while lower prices could lead to a decline in sales at gasoline stations. Sales excluding autos and gasoline are likely to be mixed, with higher prices boosting the nominal value of sales in some areas and inflation-constrained budgets limiting activity in others.
Industrial Production (April) (Tuesday)	**0.5%**	A jump in factory payrolls raises the prospect of a firm contribution from the manufacturing sector to industrial production in April. Increases in mining employment and the rotary rig count suggest a gain in mining activity. Below-average temperatures in April could boost heating usage and lead to a pickup in utility output.
Housing Starts (April) (Wednesday)	**1.740 Million (-3.0%)**	With homebuilders holding an elevated inventory of unsold properties and with higher mortgage rates and elevated prices weighing on sales, builders may trim single-family housing starts in April. The volatile multi-family sector surged 15.8% in the prior two months to the highest level of the current expansion. The recent strong performance raises the possibility of some easing in April.
Existing Home Sales (April) (Thursday)	**5.70 Million (-1.2%)**	Five consecutive declines in pending home sales suggest that higher mortgage rates and elevated prices are constraining demand. Tight inventories also have limited activity in the market for existing homes. The expected decline in April would be the fourth in the past five months, with sales moving to their lowest level in almost two years.
Leading Indicators (April) (Thursday)	**-0.1%**	Consumer expectations, initial claims for unemployment insurance, and the factory workweek are likely to make negative contributions to the index of leading economic indicators in April, offsetting a positive contribution from the slope of the yield curve. The expected dip would be only the third negative reading in the past two years.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

May / June 2022

Monday	Tuesday	Wednesday	Thursday	Friday
9	10	11	12	13
WHOLESALE TRADE Inventories / Sales Jan 1.2% 5.0% Feb 2.8% 1.5% Mar 2.3% 1.7%	**NFIB SMALL BUSINESS OPTIMISM INDEX** Feb 95.7 Mar 93.2 Apr 93.2	**CPI** Total / Core Feb 0.8% 0.5% Mar 1.2% 0.3% Apr 0.3% 0.6% **FEDERAL BUDGET** 2022 / 2021 Feb -$216.6B -$310.9B Mar -$192.6B -$659.6B Apr $308.2B -$225.6B	**UNEMPLOYMENT CLAIMS** Initial / Continuing (Millions) Apr 16 0.185 1.403 Apr 23 0.181 1.387 Apr 30 0.202 1.343 May 07 0.203 N/A **PPI** Final Demand / Ex. Food & Energy Feb 1.1% 0.5% Mar 1.6% 1.2% Apr 0.5% 0.4%	**IMPORT/EXPORT PRICES** Non-petrol. Imports / Nonagri. Exports Feb 0.8% 3.3% Mar 1.2% 4.1% Apr 0.4% 0.5% **CONSUMER SENTIMENT** Mar 59.4 Apr 65.2 May 59.1
16	17	18	19	20
EMPIRE MFG (8:30) Mar -11.8 Apr 24.6 May -- **TIC DATA (4:00)** Net L-T / Total Jan $58.8B $287.4B Feb $141.7B $162.6B Mar -- --	**RETAIL SALES (8:30)** Total / Ex.Autos Feb 1.7% 1.8% Mar 0.7% 1.4% **Apr 0.6% 0.2%** **IP & CAP-U (9:15)** IP / Cap.Util. Feb 0.9% 77.7% Mar 0.9% 78.3% **Apr 0.5% 78.7%** **BUSINESS INVENTORIES (10:00)** Inventories / Sales Jan 1.2% 3.4% Feb 1.8% 1.3% **Mar 1.9% 1.6%** **NAHB HOUSING INDEX (10:00)** Mar 79 Apr 77 May --	**HOUSING STARTS (8:30)** Feb 1.788 million Mar 1.793 million **Apr 1.740 million**	**INITIAL CLAIMS (8:30)** **PHILY FED INDEX (8:30)** Mar 27.4 Apr 17.6 May -- **EXISTING HOME SALES (10:00)** Feb 5.93 million Mar 5.77 million **Apr 5.70 million** **LEADING INDICATORS (10:00)** Feb 0.6% Mar 0.3% **Apr -0.1%**	
23	24	25	26	27
CHICAGO FED NATIONAL ACTIVITY INDEX	**NEW HOME SALES**	**DURABLE GOODS ORDERS** **FOMC MINUTES**	**INITIAL CLAIMS** **REVISED GDP** **PENDING HOME SALES**	**U.S. INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES** **PERSONAL INCOME, CONSUMPTION, PRICE INDEXES** **REVISED CONSUMER SENTIMENT**
30	31	1	2	3
MEMORIAL DAY	**FHFA HOME PRICE INDEX** **S&P CORELOGIC CASE-SHILLER HOME PRICES** **CHICAGO PURCHASING MANAGERS' INDEX** **CONSUMER CONFIDENCE**	**ISM MFG INDEX** **CONSTRUCTION SPEND.** **JOB OPENINGS & LABOR TURNOVER (JOLTS)** **BEIGE BOOK** **NEW VEHICLE SALES**	**ADP EMPLOYMENT REPORT** **INITIAL CLAIMS** **REVISED PRODUCTIVITY & COSTS** **FACTORY ORDERS**	**EMPLOYMENT REPORT** **ISM SERVICES INDEX**

Forecasts in Bold.

Treasury Financing

May / June 2022

Monday	Tuesday	Wednesday	Thursday	Friday
9	10	11	12	13
AUCTION RESULTS: Rate Cover 13-week bills 0.900% 3.18 26-week bills 1.385% 2.72	**AUCTION RESULTS:** Rate Cover 3-year notes 2.809% 2.59 **ANNOUNCE:** $35 billion 4-week bills for auction on May 12 $30 billion 8-week bills for auction on May 12 $30 billion 17-week CMBs for auction on May 11 **SETTLE:** $35 billion 4-week bills $30 billion 8-week bills $30 billion 17-week CMBs	**AUCTION RESULTS:** Rate Cover 17-week CMB 1.160% 3.29 10-yr notes 2.943% 2.49	**AUCTION RESULTS:** Rate Cover 4-week bills 0.600% 2.70 8-week bills 0.755% 3.02 30-yr bonds 2.997% 2.38 **ANNOUNCE:** $87 billion 13-,26-week bills for auction on May 16 $34 billion 52-week bills for auction on May 17 $17 billion 20-year bonds for auction on May 18 $14 billion 10-year TIPS for auction on May 19 **SETTLE:** $87 billion 13-,26-week bills	
16	17	18	19	20
AUCTION: $87 billion 13-,26-week bills **SETTLE:** $45 billion 3-year notes $36 billion 10-year notes $22 billion 30-year bonds	**AUCTION:** $34 billion 52-week bills **ANNOUNCE:** $35 billion* 4-week bills for auction on May 19 $30 billion* 8-week bills for auction on May 19 $30 billion* 17-week CMBs for auction on May 18 **SETTLE:** $35 billion 4-week bills $30 billion 8-week bills $30 billion 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs $17 billion 20-year bonds	**AUCTION:** $35 billion* 4-week bills $30 billion* 8-week bills $14 billion 10-year TIPS **ANNOUNCE:** $87 billion* 13-,26-week bills for auction on May 23 $22 billion* 2-year FRNs for auction on May 25 $47 billion* 2-year notes for auction on May 24 $48 billion* 5-year notes for auction on May 25 $42 billion* 7-year notes for auction on May 26 **SETTLE:** $87 billion 13-,26-week bills $34 billion 52-week bills	
23	24	25	26	27
AUCTION: $87 billion* 13-,26-week bills	**AUCTION:** $47 billion* 2-year notes **ANNOUNCE:** $35 billion* 4-week bills for auction on May 26 $30 billion* 8-week bills for auction on May 26 $30 billion* 17-week CMBs for auction on May 25 **SETTLE:** $35 billion* 4-week bills $30 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs $22 billion* 2-year FRNs $48 billion* 5-year notes	**AUCTION:** $35 billion* 4-week bills $30 billion* 8-week bills $42 billion* 7-year notes **ANNOUNCE:** $87 billion* 13-,26-week bills for auction on May 31 **SETTLE:** $87 billion* 13-,26-week bills	**SETTLE:** $22 billion* 2-year FRNs
30	31	1	2	3
MEMORIAL DAY	**AUCTION:** $87 billion* 13-,26-week bills **ANNOUNCE:** $35 billion* 4-week bills for auction on June 2 $30 billion* 8-week bills for auction on June 2 $30 billion* 17-week CMBs for auction on June 1 **SETTLE:** $35 billion* 4-week bills $30 billion* 8-week bills $30 billion* 17-week CMBs $17 billion 20-year bonds $14 billion 10-year TIPS $47 billion* 2-year notes $48 billion* 5-year notes $42 billion* 7-year notes	**AUCTION:** $30 billion* 17-week CMBs	**AUCTION:** $35 billion* 4-week bills $30 billion* 8-week bills **ANNOUNCE:** $87 billion* 13-,26-week bills for auction on June 6 $44 billion* 3-year notes for auction on June 7 $33 billion* 10-year notes for auction on June 8 $19 billion* 30-year bonds for auction on June 9 **SETTLE:** $87 billion* 13-,26-week bills	

*Estimate