Daiwa Capital Markets

U.S. Economic Comment

- CPI preview: favorable noise, but still firm underlying pace
- Household balance sheets: still in reasonably good shape

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Consumer Prices

The consumer price index for August is likely to post its second consecutive restrained reading, with the change in the headline measure possibly moving into negative territory after showing no change in July. We look for the core component to be close to the 0.3 percent increase registered in July, which would represent a notable improvement from the average of 0.6 percent in the first six months of the year. The expected easing in inflation is certainly welcome, but an examination of the detail would be less encouraging because downside volatility in noisy areas is likely to account for most of the deceleration.

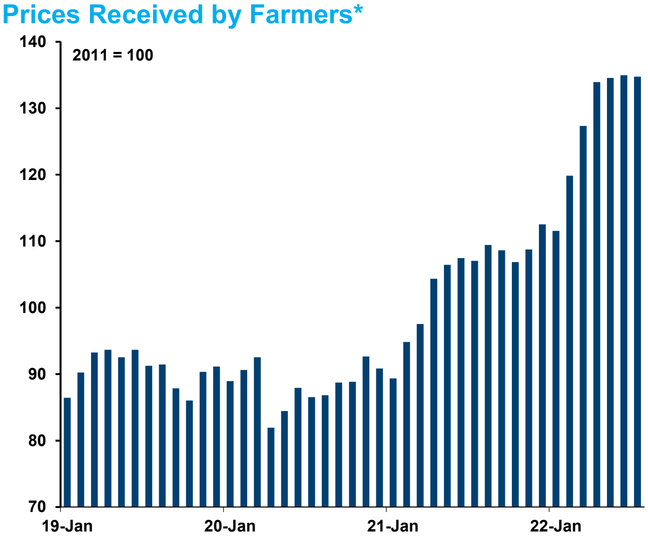
As in July, most of the restraint on headline inflation will be the result of lower energy prices, with the latest drop possibly exceeding the decline of 4.6 percent in July. The price of gasoline in August fell by more than it did in July, but available quotes suggest higher prices for natural gas. Of course, energy prices jump around; they easily could be higher in the months ahead.

Food prices have been on a tear this year, increasing 0.9 percent or more in each of the first seven months of 2022. We suspect that August will involve another firm reading, although we could see the rate of advance starting to slow, as prices in the early stages of the production process have stabilized or eased recently. The foodstuffs index published by the Commodity Research Bureau fell in July and gave back only a small portion of the decline in August. Data from the U.S. Department of Agriculture show that prices received by farmers have shown little net change since April after trending higher during 2021 and the early portion of 2022 (chart). Like energy prices, food prices often move erratically, and thus it is not clear if recent shifts represent random volatility or a fundamental change.

In the core component, much of the easing in July was the result of corrections in the prices of goods or services that had surged when the economy began to recover from the pandemic-related recession. For example, prices of household appliances surged in 2021 and the early months of 2022 as individuals upgraded their homes. In addition, travel-related expenses jumped once individuals began to venture out (airfares, car-rental charges, hotel fees). These items are now adjusting to values closer to pre-Covid norms, and they seem to have more downside potential (chart; next page, left). Once corrected, the downside pressure from these sources will disappear.

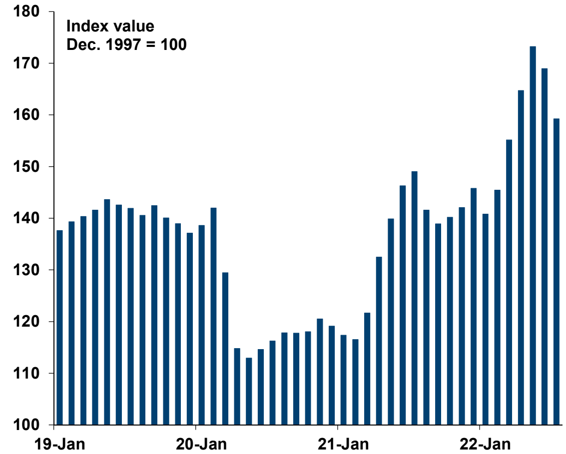
The traditional core component usually provides a clearer read on underlying inflation than the headline measure does, but it can also show a distorted picture if a few items post extreme changes that pull the average higher or lower. Better measures of underlying inflation are either median values or trimmed

Prices Received by Farmers*



** Includes prices of crops, meat animals, dairy products, and poultry & eggs.*
Source: U.S. Department of Agriculture via Haver Analytics

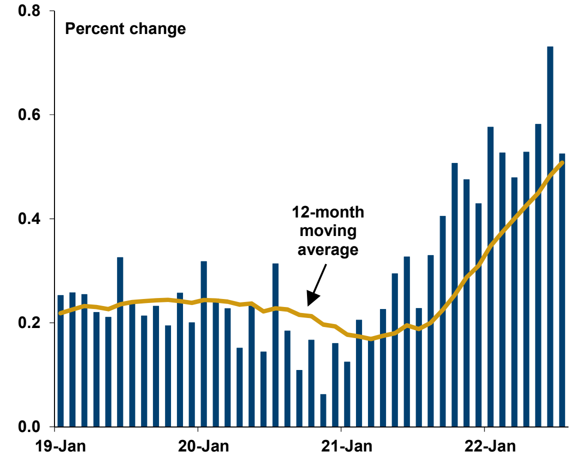
CPI: Travel-Related Expenses*



** A weighted average of the Car and Truck Rental, Airline Fare, and Other Lodging Away from Home Including Hotels/Motels components of the CPI. Weights are calculated based on the relative importance of each component in the CPI. The Airline Fare and Hotel indexes are rebased to equal 100 in December 1997.*

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

Median CPI



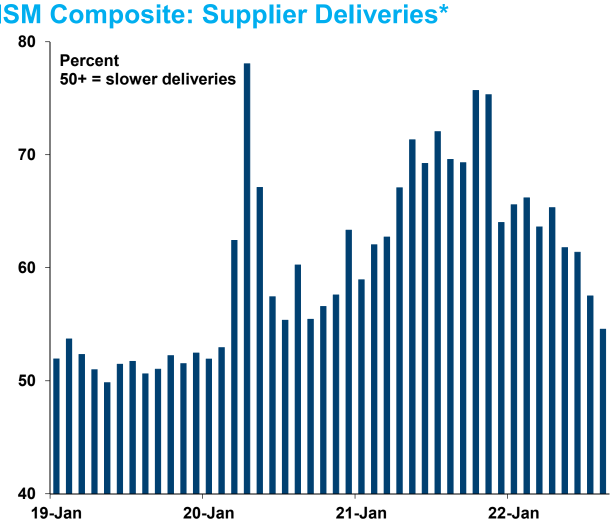
Source: Federal Reserve Bank of Cleveland via Haver Analytics

means (i.e. measures that eliminate the tails of the distribution of price changes). We prefer the weighted median CPI published by the Cleveland Fed, as this measure provides good insight into shifts in the overall distribution of price changes; that is, it represents a good read on underlying inflation.

The median CPI began to pickup in the spring of last year, with monthly changes moving from a range of 0.1 to 0.2 percent in the quietest period to readings of 0.5 to 0.7 percent so far this year (chart, above right). July showed a change in the low end of that range, but the reading was not soft enough to suggest that the underlying trend is beginning to ease. The median CPI suggests that underlying inflation remains an issue.

Although underlying inflation is moving along at a brisk clip, recent developments on the supply side might offer hope for some relief in the months ahead. The supplier delivery components of the purchasing managers' indexes provide insight into the difficulty or ease in obtaining parts and materials, with elevated readings signaling slow delivery times and thus supply-chain problems. These measures for both the manufacturing and service sectors have eased noticeably from elevated levels seen in the middle of last year, signaling faster delivery of parts and materials (chart). One could almost argue that the measures are back to normal.

ISM Composite: Supplier Deliveries*

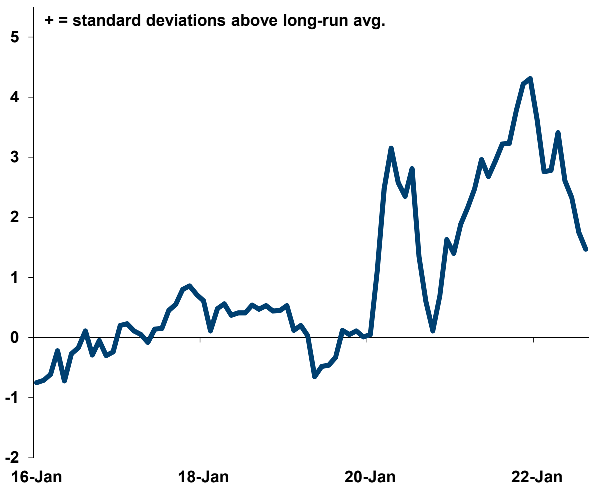


** A weighted average of the supplier deliveries components of the ISM manufacturing and ISM services indexes. Weights are calculated using GDP by industry data.*

Sources: Institute for Supply Management and Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

The global supply-chain pressure index of the New York Fed is a broad measure based on 27 variables from six countries and the euro area. This index peaked at the end of last year, but it has moved noticeably lower this year. The measure is still above its long-run average, but progress this year has been encouraging (chart, next page).

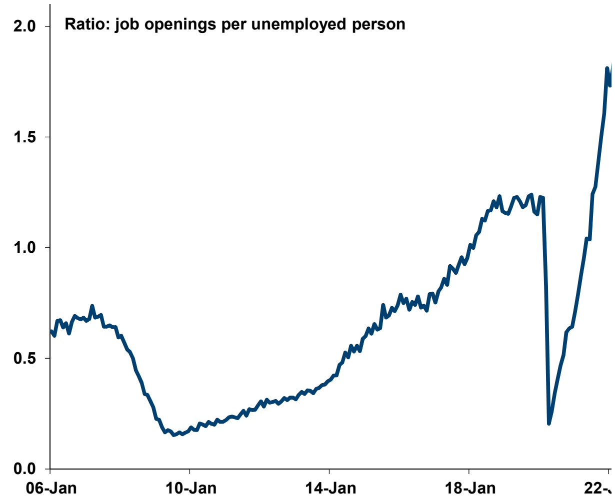
Global Supply Chain Pressure Index*



** The measure is constructed using 27 variables including: country-specific supply-chain variables from the Euro Area, China, Japan, South Korea, Taiwan, the U.K. and the U.S., global shipping rates and airfreight costs.*

Source: Federal Reserve Bank of New York via Haver Analytics

Job Openings Per Unemployed Person



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

The U.S. is perhaps beginning to see some movement in labor supply, as the labor force participation rate jumped 0.3 percentage point in August, a sharp change for this measure. However, we would not push this result too far, as random shifts occur frequently in the participation rate. In addition, the latest observation was still within the range of observations seen this year and it was still a full percentage point below the level before the onset of the pandemic. Labor supply should still be viewed as tight.

A notable imbalance between demand and supply in the labor market also is evident in the number of job openings and in the ratio of job openings to the number of unemployed (chart, above right). Both measures are shy of record readings seen earlier this year, but they are at stratospheric levels relative to historical norms. Interestingly, a recent study published by the Brookings Institution argued that the ratio of job openings to unemployment was a better measure than the unemployment rate for judging slack in the labor market and the likely pressure on wages. The near-record readings now evident, suggest that wage growth and prices are likely to remain under pressure for some time.

Fed Response

Market participants no doubt will scrutinize the August CPI and debate its implications for the policy decision of the Federal Open Market Committee at its September 21 meeting. A restrained reading, including a modest increase in the median CPI, could lead officials to limit the rate change to 50 basis points, but we believe that odds favor a shift of 75 basis points.

Fed officials have talked a tough game in recent weeks, emphasizing the importance of moving to a restrictive stance and of holding to a tight policy until they are convinced that inflation is on a path to two percent. If policymakers were to back away from the bold move, they would appear as paper tigers; their credibility as inflation fighters would be damaged.

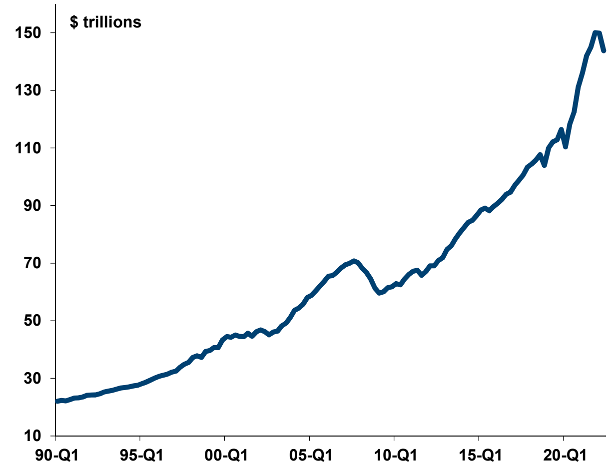
The Household Balance Sheet

Individuals in the U.S. have provided good support to the economy during the current expansion, with a strong labor market and healthy financial positions fueling a firm pace of spending. The correction in the stock market this year generates concern about the aggregate financial position of the household sector and a possible softening in consumer demand. However, the latest data from the financial accounts of the U.S. published by the Federal Reserve show that the damage was not extensive.

While the damage was not pronounced, financial positions certainly softened in the second quarter, with the aggregate net worth of the household sector falling 4.1 percent. The change from a year-ago totaled 1.2 percent, unimpressive, but in the plus column. Given the year-over-year advance, the long-term trend can still be described as upward (chart).

The stock market certainly took a toll in the second quarter, as the sum of direct equity holdings and mutual funds shares fell 16.0 percent from the first quarter and dropped 16.7 percent on a year-over-year basis. This soft spot was partially offset by continued gains in real estate holdings (3.2 percent quarter-to-quarter and 15.3 percent year-over-year). Holdings of debt securities increased slightly despite lower values that would be associated with increases in interest rates.

Household Net Worth



Source: Financial Accounts of the United States, Federal Reserve Board via Haver Analytics

Review

Week of Sept. 5, 2022	Actual	Consensus	Comments
ISM Services Index (August)	**56.9 (+0.2 Index Pt.)**	**55.3 (-1.4 Index Pts.)**	The second consecutive increase in the ISM services index suggested that the measure is stabilizing after trending down from the record reading of 68.4 last November. The new orders component led the advance in August with an increase of 1.9 index points to 61.8 -- the firmest reading of the year thus far and close to the robust average of 63.4 in 2021. With orders holding up well, the business activity index improved, rising 1.0 index point to 60.9. The employment index moved above the critical value of 50 in August (+1.1 index points to 50.2). This measure had been below 50 in four of the prior seven months. The supplier deliveries component fell 3.3 index points to 54.5 after a drop of 4.1 points in July. While the decline was a drag on the headline index, the downtrend since readings of 75.7 in October/November of last year suggests continued easing in supply constraints. The price index slipped 0.8 index point to 71.5, the fourth consecutive decline from the record high of 84.6 in April.
U.S. International Trade Balance (July)	**-$70.6 Billion ($10.3 Billion Narrower Deficit)**	**-$70.2 Billion ($9.4 Billion Narrower Deficit)**	Both sides of the trade ledger contributed to the notable improvement in the trade deficit in July, with total exports increasing 0.2% and imports falling 2.9%. The nominal goods deficit narrowed by $8.2 billion in July to $91.1 billion. The improvement, however, was a soft one in that lighter flows of exports (-0.2%) were swamped by a drop of 3.0% in imports. The surplus in service trade improved by $2.1 billion to $20.4 billion, with service exports increasing 1.1% and service imports dropping 2.2%. After falling noticeably during the worst of the pandemic, the surplus in service trade has ebbed and flowed, leaving an approximately flat trend in the past year or so. The marked improvement in the trade deficit in July raises the possibility of a positive contribution from net exports to GDP growth in Q3.
Consumer Credit (July)	**Growth of $23.8 Billion**	**Growth of $32.0 Billion**	The advance of $23.8 billion in consumer credit (6.4%, annual rate) lagged the robust average of $31.6 billion (8.7%, annual rate) in the first half of 2022, but it was comfortably within the range of the current expansion. Individuals used credit cautiously during the recession and early portion of the expansion, paying down credit card balances, but usage has picked up considerably this year. The acceleration in inflation has most likely played a role in boosting the nominal value of credit flows.

Sources: Bureau of Economic Analysis (Trade Balance); Institute for Supply Management (ISM Services Index); Federal Reserve Board (Consumer Credit); Consensus forecasts are from Bloomberg

Preview

Week of Sept. 12, 2022	Projected	Comments
CPI (August) (Tuesday)	**-0.1% Total, 0.4% Core**	Energy prices are likely to fall for the second consecutive month after a drop of 4.6% in July. Food prices could start to slow from their recent torrid pace (average increase of 0.9% in the past 12 months), but a still-sizeable increase is likely. In the core component, travel related expenses (airfares, hotel fees) could continue to ease from elevated levels, but pressure elsewhere suggests another firm increase overall after a subdued reading in July (0.3% increase versus 0.5% in the prior 12 months).
Federal Budget (August) (Tuesday)	**$215.0 Billion Deficit**	Available data suggest that that federal revenues in August rose briskly from the same month last year (up approximately 13%). Outlays also are likely to pickup from a light-side reading in August of last year, leaving year-over-year slippage in the budget deficit (vs. $170.6 billion in August 2021). Despite the slippage in August, the expected cumulative shortfall of approximately $941 billion in the first 11 months of FY2022 is sharply narrower than the $2.711 trillion in the same period last fiscal year.
PPI (August) (Wednesday)	**-0.2% Final Demand, 0.3% Ex. Food & Energy**	Available quotes suggest another drop in energy prices in August (off 9.0% in July after averaging increases of 5.6% in the first half of 2022). Food prices have shown hints of easing (average advance of 0.45% in the past three months versus an average of 1.9% from January thru April). An easing in supply-side constraints could limit pressure on prices outside of food and energy. (This component rose 0.2% in July after an average increase of 0.7% in the first half of 2022.)
Retail Sales (August) (Thursday)	**-0.1% Total, -0.5% Ex. Autos**	Sharply lower prices suggest a drop in the value of sales at gasoline stations in August, which could constrain headline retail sales. Cautious spending by individuals may limit outlays on discretionary items, although higher prices could inflate the value of nominal sales in other areas.
Industrial Production (August) (Thursday)	**0.1%**	A decline in the factory workweek suggests a negative contribution from the manufacturing component of industrial production in August, but increases in the rotary rig count and mining employment point to a firm increase in mining activity. Heavy usage of air conditioning amid elevated temperatures should boost utility output.
Consumer Sentiment (September) (Friday)	**60.0 (+3.1%)**	Additional easing in gasoline prices in early September from the recent high of $5 per gallon in mid-June could brighten moods, but rapid increases in prices of other essentials (groceries, utilities, insurance) and increasing borrowing costs because of tighter monetary policy should limit the projected pickup. While up from the record low of 50.0 in June, the expected reading for early September would still be near the bottom of the historical range.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

September 2022

Monday	Tuesday	Wednesday	Thursday	Friday
5	6	7	8	9
LABOR DAY	**ISM SERVICES INDEX** Index / Prices June 55.3 / 80.1 July 56.7 / 72.3 Aug 56.9 / 71.5	**TRADE BALANCE** May -$85.9 billion June -$80.9 billion July -$70.7 billion **BEIGE BOOK** **September Beige Book:** Economic activity was unchanged, on balance, since early July, with five Districts reporting slight to modest growth in activity and five others reporting slight to modest softening…	**UNEMP. CLAIMS** Initial / Continuing (millions) Aug 13 0.245 / 1.412 Aug 20 0.237 / 1.437 Aug 27 0.228 / 1.473 Sep 3 0.222 / N/A **CONSUMER CREDIT** May $23.5 billion June $39.1 billion July $23.8 billion	**WHOLESALE TRADE** Inventories / Sales May 1.9% / 0.7% June 1.9% / 1.6% July 0.8% / -1.4%
12	13	14	15	16
	NFIB SMALL BUSINESS OPTIMISM INDEX (6:00) June 89.5 July 89.9 Aug -- **CPI (8:30)** Total / Core June 1.3% / 0.7% July 0.0% / 0.3% **Aug -0.1% / 0.4%** **FEDERAL BUDGET (2:00)** 2022 / 2021 June -$88.8B / -$174.2B June $211.1B / -$302.1B **Aug -$215.0B** / -$170.6B	**PPI (8:30)** Final Demand / Ex. Food & Energy June 1.0% / 0.4% July -0.5% / 0.2% **Aug -0.2% / 0.3%**	**UNEMP. CLAIMS (8:30)** **RETAIL SALES (8:30)** Total / Ex.Autos June 0.8% / 0.9% July 0.0% / 0.4% **Aug -0.1% / -0.5%** **IMPORT/EXPORT PRICES (8:30)** Non Petrol / Nonagri Exports June -0.5% / 0.8% July -0.7% / -3.3% Aug -- / -- **EMPIRE MFG (8:30)** July 11.1 Aug -31.3 Sep -- **PHILADELPHIA FED MFG BUSINESS OUTLOOK (8:30)** July -12.3 Aug 6.2 Sep -- **IP & CAP-U (9:15)** IP / Cap.Util. June 0.0% / 79.9% July 0.6% / 80.3% **Aug 0.1% / 80.2%** **BUSINESS INVENTORIES (10:00)** Inventories / Sales May 1.6% / 1.0% June 1.4% / 1.1% **July 0.6% / -0.8%**	**CONSUMER SENTIMENT (10:00)** July 51.5 Aug 58.2 **Sept 60.0** **TIC DATA (4:00)** Net L-T / Total May $155.3B / 194.5B June $121.8B / $22.1B July -- / --
19	20	21	22	23
NAHB HOUSING INDEX	**HOUSING STARTS** **FOMC MEETING (1ST DAY)**	**EXISTING HOME SALES** **FOMC DECISION**	**UNEMP. CLAIMS** **CURRENT ACCOUNT** **LEADING INDICATORS**	
26	27	28	29	30
CHICAGO FED NATIONAL ACTIVITY INDEX	**DURABLE GOODS ORDERS** **FHFA HOME PRICE INDEX** **S&P CORELOGIC HOME PRICE INDEX** **NEW HOME SALES** **CONSUMER CONFIDENCE**	**INTERNATIONAL TRADE IN GOODS** **ADVANCED INVENTORIES** **PENDING HOME SALES**	**UNEMP. CLAIMS** **REVISED GDP**	**PERSONAL INCOME, CONSUMPTION, PRICES** **MNI CHICAGO BUSINESS BAROMETER** **REVISED CONSUMER SENTIMENT**

Forecasts in Bold.

Treasury Financing

September 2022

Monday	Tuesday	Wednesday	Thursday	Friday
5	6	7	8	9
LABOR DAY	**AUCTION RESULTS:** Rate Cover 13-week bills 2.965% 3.06 26-week bills 3.320% 3.14 52-week bills 3.460% 2.75 **ANOUNCE:** $50 billion 4-week bills for auction on Sep 8 $45 billion 8-week bills for auction on Sep 8 $30 billion 17-week CMBs for auction on Sep 7 **SETTLE:** $50 billion 4-week bills $50 billion 8-week bills $30 billion 17-week CMBs	**AUCTION RESULTS:** Rate Cover 17-week CMB 3.195% 3.63	**AUCTION RESULTS:** Rate Cover 4-week bills 2.500% 3.03 8-week bills 2.765% 2.93 **ANNOUNCE:** $96 billion 13-,26-week bills for auction on Sep 12 $41 billion 3-year notes for auction on Sep 12 $32 billion 10-year notes for auction on Sep 12 $18 billion 30-year bonds for auction on Sep 13 **SETTLE:** $96 billion 13-,26-week bills $34 billion 52-week bills	
12	13	14	15	16
AUCTION: $96 billion 13-,26-week bills $41 billion 3-year notes $32 billion 10-year notes	**AUCTION:** $18 billion 30-year bonds **ANNOUNCE** $50 billion* 4-week bills for auction on Sep 15 $45 billion* 8-week bills for auction on Sep 15 $30 billion* 17-week CMBs for auction on Sep 14 **SETTLE:** $50 billion 4-week bills $45 billion 8-week bills $30 billion 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs	**AUCTION:** $50 billion* 4-week bills $45 billion* 8-week bills **ANNOUNCE:** $96 billion* 13-,26-week bills for auction on Sep 19 12 billion* 20-year bonds for auction on Sep 20 $15 billion* 10-year TIPS for auction on Sep 22 **SETTLE:** $96 billion 13-,26-week bills $41 billion 3-year notes $32 billion 10-year notes $18 billion 30-year bonds	
19	20	21	22	23
AUCTION: $96 billion* 13-,26-week bills	**AUCTION:** $12 billion* 20-year bonds **ANNOUNCE:** $50 billion* 4-week bills for auction on Sep 22 $45 billion* 8-week bills for auction on Sep 22 $30 billion* 17-week CMBs for auction on Sep 21 **SETTLE:** $50 billion* 4-week bills $45 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs	**AUCTION:** $50 billion* 4-week bills $45 billion* 8-week bills $15 billion* 10-year TIPS **ANNOUNCE:** $96 billion* 13-,26-week bills for auction on Sep 26 $43 billion* 2-year notes for auction on Sep 26 $44 billion* 5-year notes for auction on Sep 27 $36 billion* 7-year notes for auction on Sep 28 $22 billion* 2-year FRNs for auction on Sep 28 **SETTLE:** $96 billion* 13-,26-week bills	
26	27	28	29	30
AUCTION: $96 billion* 13-,26-week bills $43 billion* 2-year notes	**AUCTION:** $96 billion* 13-,26-week bills $44 billion* 5-year notes **ANNOUNCE:** $50 billion* 4-week bills for auction on Sep 29 $45 billion* 8-week bills for auction on Sep 29 $30 billion* 17-week CMBs for auction on Sep 28 **SETTLE:** $50 billion* 4-week bills $45 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs $36 billion* 7-year notes $22 billion* 2-year FRNs	**AUCTION:** $50 billion* 4-week bills $45 billion* 8-week bills **ANNOUNCE:** $96 billion* 13-,26-week bills for auction on Oct 3 $34 billion* 52-week bills for auction on Oct 4 **SETTLE:** $96 billion* 13-,26-week bills	**SETTLE:** $12 billion* 20-year bonds $15 billion* 10-year TIPS $43 billion* 2-year notes $44 billion* 5-year notes $36 billion* 7-year notes $22 billion* 2-year FRNs

**Estimate*