U.S. Economic Comment

- FOMC: more tightening on the way; marked uncertainty regarding the eventual pivot

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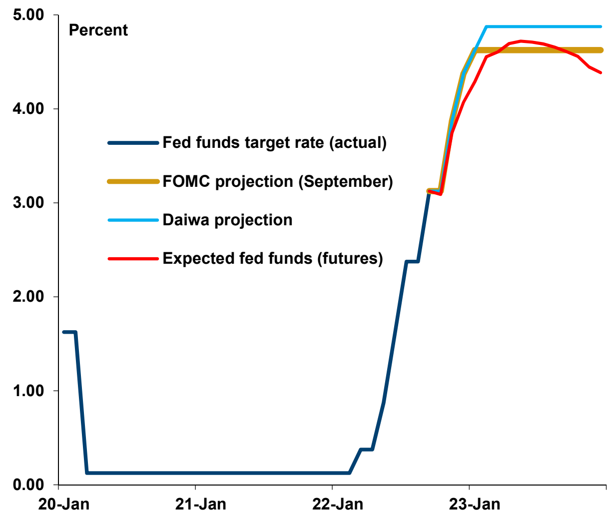
Monetary Policy: A Focus on Inflation, if Unemployment remains below 5%

The Fed is making progress in getting its message of restrictive policy across to market participants. Futures contracts on the federal funds rate now show a peak of approximately 4.7 percent next year, close to the peak median dot in 2023 shown in the latest Summary of Economic Projections. However, investors and traders are still not fully on board with the Fed's policy expectations: fed funds futures show the Fed beginning to ease policy in mid-2023, but the dot plot indicates that the Fed is not anticipating rate cuts until 2024 (charts).

Market participants apparently believe that Fed officials will lose their inflation-fighting resolve once unemployment begins to increase. The market view perhaps has merit, as the Summary of Economic Projections (SEP) shows the unemployment rate rising to only 4.4 percent over the next two years before edging down to 4.3 percent in 2025 (table, next page). Chair Powell admitted in his press briefing that the increase in joblessness was "relatively mild", leaving unanswered the question on how much pain officials are willing to tolerate.

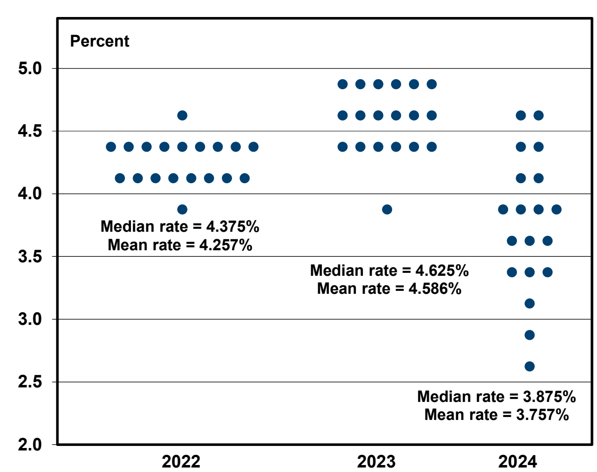
The modest increase in unemployment shown in the SEP seems related to the view expressed by some Fed officials that slack in the labor market in response to tight monetary policy will take the form of a reduction in job openings rather than job cuts. Chair Powell raised this possibility in an earlier press briefing, and he mentioned it again in the Q&A session this past week. He also noted that job openings, along with the number

Federal Funds Target Rate



Sources: Federal Reserve Board via Haver Analytics; Federal Open Market Committee; Bloomberg; Daiwa Capital Markets America.

FOMC Rate View: Year-End 2022, 2023, 2024*



** Each dot represents the expected federal funds rate of a Fed official at the ends of 2022, 2023, and 2024.*

Source: Federal Open Market Committee, Summary of Economic Projections, September 2022 of individuals quitting their jobs, provide valuable insights into the degree of tightness in the labor market. Elevated readings in these measures indicate that the current cycle is different than expansions in the past and thus unemployment could behave differently in response to tighter policy. Thus, the Fed view has merit as well; perhaps the pain will be mild.

Economic Projections of the FOMC, September 2022*

	2022	2023	2024	2025	Longer Run
Change in Real GDP	0.2	1.2	1.7	1.8	1.8
Unemployment Rate	3.8	4.4	4.4	4.3	4.0
PCE Inflation	5.4	2.8	2.3	2.0	2.0
Core PCE Inflation	4.5	3.1	2.3	2.1	--
Federal Funds Rate	4.4	4.6	3.9	2.9	2.5

** Median projections*

Source: Federal Open Market Committee, Summary of Economic Projections, September 2022

If the Fed view is correct and the pain associated with tight policy is not intense, officials seem willing to remain restrictive until inflation is close to the target of two percent. The SEP shows that Fed officials expect core inflation to total 3.1 percent in 2023. This rate is the average over the four quarters of next year, and with inflation expected to decelerate during the year, presumably the rate would be below 3.0 percent in the fourth quarter. Sub-three-percent inflation with no easing certainly suggests inflation-fighting resolve, but again, the maintenance of a restrictive stance is based on the presumption of mild pain.

The dot plot for 2024 also suggests policy easing will be slow to unfold (as long as pain remains mild). Expectations for 2024 show an easing in policy, but views vary widely. Indeed, the range of expectations spans two percentage points – some officials will want to proceed quickly with policy easing, while others will want to drag their feet (chart, p.1, right).

We view the wide dispersion of views for 2024 as important. Widely divergent views indicate a lack of consensus and therefore a small probability of a policy change. When dots are concentrated, like they are for this year and next, the probability of the FOMC following through on the intentions built into the plot are high. Thus, we should expect aggressive tightening over the next several months, but the dispersion for 2024 suggests that policymakers are going to have difficulty in reaching agreement on how to back away from a restrictive policy stance, which could delay the easing process.

Our View

We were mildly surprised at the elevated level of the terminal rate evident in the new dot plot (4.625 percent, nearly a percentage point higher than the expectation of 3.75 percent in June). In addition, we were struck by the fact that the dots for 2023 show no evidence of policy easing. Even the lone dovish official with the dot at the bottom of the 2022 range apparently intends to hold policy steady in 2023. These developments led us to nudge higher (again) our view of the terminal rate. We now look for the funds rate to peak at 4.875 percent in the first quarter of next year (versus 4.625 percent previously), and we expect the Fed to hold this position until early 2024.

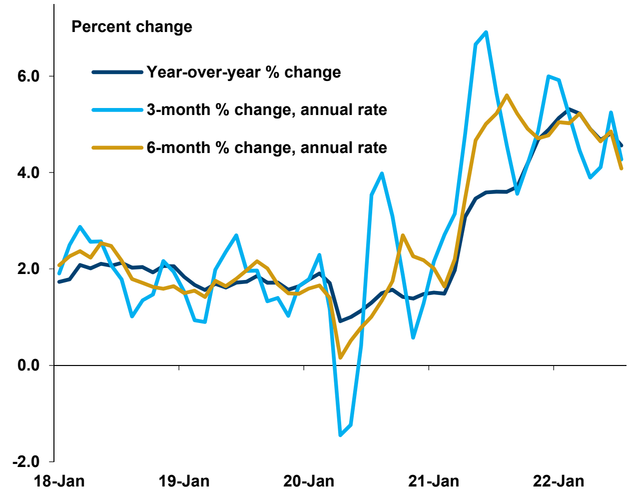
We look for the Fed to tolerate more pain associated with unemployment than currently shown in the SEP. Specifically, we suspect that officials will tolerate an unemployment rate as high as 5.0 percent, and we look for this level to be breeched in early 2024. The inflation rate is likely to be less than three percent at that time, which will probably allow Fed officials to conclude that inflation is on a path to return to two percent. Thus, easing begins in early 2024.

Monitoring Developments

Reporters at the latest press conference of Chair Powell asked several questions regarding the criteria for further tightening and the eventual pivot toward easing: How will you know when to slow the pace of tightening? How will you know if you’ve gone too far?

In his prepared remarks, Mr. Powell left no doubt about the focus of the FOMC: “we will be looking for compelling evidence that inflation is moving down, consistent with inflation returning to 2 percent.” Interestingly, he did not mention economic growth or unemployment. Thus, the focus at this time is inflation and only inflation.

Core PCE Price Index*



** PCE = personal consumption expenditures*

Source: Bureau of Economic Analysis via Haver Analytics

In the Q&A session, Chair Powell indicated that Fed officials also will be watching economic growth and unemployment, but only from the perspective of their influence on inflation. That is, officials will be looking for economic growth to slow to a rate below potential and for the labor market to show signs of slack either through higher unemployment or fewer job openings. Inflation will be the driving force behind Fed decisions for some time.

Chair Powell offered an interesting perspective to assess progress in reducing inflation. He suggested comparing inflation rates over periods of three months, six months, and one year. If inflation is on a downward trajectory, the three-month pace will be slower than the six-month rate, and both will trail the year-over-year change.

So far, this is not happening. The three-month and six-month changes lag the year-over-year increase, but only marginally so (chart). In addition, the three-month change is slightly larger than the shift over the past six months, signaling an upward wiggle in inflation in the past few months. This pattern suggests that recent movements in inflation represent random volatility rather than a meaningful shift in trend. This perspective suggests no meaningful progress in taming inflation.

Review

Week of Sept. 19, 2022	Actual	Consensus	Comments
Housing Starts (August)	**1.575 Million (12.2%)**	**1.450 Million (0.3%)**	Both multi-family and single-family housing starts rose in August, with the surge of 28.0% in multi-family activity to 640,000 units (annual rate) standing out. The latest reading on multi-family starts, which was a new high for the current cycle, probably involved an element of random volatility, although activity has been strong on average in the past year. The firm performance signals a shift by individuals from the market for single-family homes to rental units or more affordable dwellings for purchase. Single-family starts rose 3.4% to 935,000, but the gain offset only a small portion of the declines in the prior five months, and the underlying trend is still decidedly downward. Demand for single family homes has been weakened by the recent surge in interest rates; builders will likely attempt to control (already elevated) inventories in this challenging environment.
Existing Home Sales (August)	**4.80 Million (-0.4%)**	**4.70 Million (-2.3%)**	The dip in existing home sales in August, although modest, marked the seventh consecutive decline and followed changes that averaged -4.8% in the prior six months. The cumulative decline of 26% from January left sales at their lowest level since the early stages of the current expansion. The combination of sky-high prices and elevated mortgage rates are weighing heavily on the housing market.
Current Account (2022-Q2)	**-$251.1 Billion ($31.5 Billion Narrower Deficit)**	**-$260.0 Billion ($31.4 Billion Narrower Deficit)**	Improvements in trade and primary income flows led to a narrowing in the current account in Q2 from a downwardly revised total in Q1 (a revised deficit of $282.5 billion versus $291.4 billion first reported). While narrower than the result for Q1, the Q2 deficit was still sharply wider than the pre-pandemic norm (an average deficit of $110.7 billion in 2018-19). The latest result translated to 4.0% of GDP, off from 4.6% in Q1, but well above the 2018-19 average of 2.1%.
Leading Indicators (August)	**-0.3%**	**-0.1%**	Negative contributions from consumer expectations, building permits, the factory workweek and the ISM new orders index offset positive contributions from initial claims for unemployment insurance and stock prices, pushing the index of leading economic indicators lower for the sixth consecutive month. Declines have averaged 0.45% over this span, leaving the level of the index 2.7% below the cyclical peak in February.

Sources: U.S. Census Bureau (Housing Starts); National Association of Realtors (Existing Home Sales); Bureau of Economic Analysis (Current Account); The Conference Board (Leading Indicators); Consensus forecasts are from Bloomberg

Preview

Week of Sept. 26, 2022	Projected	Comments
Durable Goods Orders (August) (Tuesday)	**-1.0% Total, 0.0% Ex. Transportation**	Orders for nondefense aircraft could cool in August after an above-average reading in July. Higher prices might boost the value of new orders ex-transportation, but uncertainty about the economic outlook could limit the volume of real bookings, leaving the published total little changed.
New Home Sales (August) (Tuesday)	**0.500 Million (Annual Rate) (-2.2%)**	A surge in mortgage interest rates from approximately 3¼% around the turn of the year to approximately 5½% in recent weeks raises the possibility of the seventh decline in new home sales in the past 8 months. The expected reading would be a new low for the current expansion.
Conference Board Consumer Confidence (September) (Tuesday)	**105.0 (+1.7%)**	Further declines in gasoline prices below $4 per gallon and continued strength in the labor market could brighten consumer moods in September, although concern about rapid inflation in other essentials (utilities and food) may constrain the expected advance and keep the level of confidence in the low end of the range of the current expansion.
U.S. International Trade in Goods (August) (Wednesday)	**-$94.0 Billion ($3.8 Billion Wider Deficit)**	Lower prices of petroleum products and other inputs could constrain the value of both imports and exports of industrial supplies, suggesting little change in the deficit, but a rebound in imports of consumer goods after a surprising drop in July raises the prospect of a widening in the nominal goods trade deficit in August.
Revised GDP (22-Q2) (Thursday)	**-0.6% (Unrevised)**	Additional data received in the past month suggest that the final tally of Q2 GDP growth is likely to be close to the second estimate. Benchmark revisions to data from 2017 through 2022-Q1 will be published with next week's report. Revisions to Q1 data should be watched closely, as GDP data showed a contraction in the economy (-1.6%, annual rate) but an alternate measure of output, Gross Domestic Income (GDI), showed growth of 1.8%.
Personal Income, Consumption, Core PCE Price Index (August) (Friday)	**0.1%, 0.3%, 0.5%**	Data on hourly earnings and worktimes suggest only a modest increase in wages and salaries in August. A decline in rental income in July implies some cooling after a surge in the prior year. Soft data on vehicle sales and retail spending suggest that outlays for goods will be a drag on total consumer spending, but an expected increase in expenditures on services could boost total outlays. Lower energy prices should constrain the headline PCE price index, but a brisk increase in the core CPI points to another rapid advance in the prices excluding food and energy.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

September / October 2022

Monday	Tuesday	Wednesday	Thursday	Friday
19	20	21	22	23
NAHB HOUSING INDEX July 55 Aug 49 Sep 46	**HOUSING STARTS** June 1.575 million July 1.404 million Aug 1.575 million **FOMC (1ST DAY)**	**EXISTING HOME SALES** June 5.11 million July 4.82 million Aug 4.80 million **FOMC DECISION**	**UNEMP. CLAIMS** Initial Continuing (millions) Aug 27 0.228 1.402 Sep 3 0.218 1.401 Sep 10 0.208 1.379 Sep 17 0.213 N/A **CURRENT ACCOUNT** 21-Q4 -$224.8 bill. 22-Q1 -$282.5 bill. 22-Q2 -$251.1 bill. **LEADING INDICATORS** June -0.7% July -0.5% Aug -0.3%	
26	27	28	29	30
CHICAGO FED NATIONAL ACTIVITY INDEX (8:30) Monthly 3-Mo. Avg. Jun -0.25 -0.09 Jul 0.27 -0.09 Aug -- --	**DURABLE GOODS ORDERS (8:30)** Jun 2.3% Jul -0.1% **Aug -1.0%** **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX (9:00)** SA NSA May 1.2% 1.5% June 0.4% 0.4% July -- -- **FHFA HOME PRICE INDEX (9:00)** May 1.3% June 0.1% July -- **NEW HOME SALES (10:00)** June 0.585 million July 0.511 million **Aug 0.500 million** **CONFERENCE BOARD CONSUMER CONFIDENCE (10:00)** July 95.3 Aug 103.2 **Sep 105.0**	**INTERNATIONAL TRADE IN GOODS (8:30)** June -$99.1 billion July -$90.2 billion **Aug -$94.0 billion** **ADVANCE INVENTORIES (8:30)** Wholesale Retail June 1.8% 2.0% July 0.6% 1.2% Aug -- -- **PENDING HOME SALES (10:00)** June -8.9% July -1.0% Aug --	**UNEMP. CLAIMS (8:30)** **REVISED GDP (8:30)** GDP Chained Price 22-Q1 -1.6% 8.2% 22-Q2(p) -0.6% 8.9% **22-Q2(r) -0.6% 8.9%**	**PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX (8:30)** Inc. Cons. Core June 0.7% 1.0% 0.6% July 0.2% 0.1% 0.1% **Aug 0.1% 0.3% 0.5%** **MNI CHICAGO BUSINESS BAROMETER (9:45)** Index Prices July 52.1 81.9 Aug 52.2 81.8 Sep -- -- **CONSUMER SENTIMENT (10:00)** July 51.5 Aug 58.2 Sep(p) 59.5
3	4	5	6	7
ISM MANUFACTURING **CONSTRUCTION** **VEHICLE SALES**	**FACTORY ORDERS** **JOLTS**	**ADP EMPLOYMENT** **INTERNATIONAL TRADE** **ISM SERVICES**	**UNEMP. CLAIMS**	**EMPLOYMENT REPORT** **WHOLESALE TRADE** **CONSUMER CREDIT**
10	11	12	13	14
COLUMBUS DAY	**NFIB SMALL BUSINESS OPTIMISM INDEX** **FEDERAL BUDGET (LIKELY POSTPONED)**	**PPI** **FOMC MINUTES**	**UNEMP. CLAIMS** **CPI**	**RETAIL SALES** **IMPORT PRICES** **BUSINESS INVENTORIES** **CONSUMER SENTIMENT**

Forecasts in Bold. (p) = preliminary (2nd estimate of GDP), (r) = revised (3rd estimate of GDP)

Treasury Financing

September / October 2022

Monday	Tuesday	Wednesday	Thursday	Friday
19	20	21	22	23
AUCTION RESULTS: Rate / Cover 13-week bills 3.270% 2.57 26-week bills 3.780% 2.75	20 **AUCTION RESULTS:** Rate / Cover 20-yr bonds 3.820% 2.65 **ANOUNCE:** $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 RESULTS:** Rate / Cover 17-week CMB 3.590% 3.76	**AUCTION RESULTS:** Rate / Cover 4-week bills 2.660% 2.82 8-week bills 2.990% 2.60 10-yr TIPS 1.248% 2.54 **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:** $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
3	4	5	6	7
AUCTION: $96 billion* 13-,26-week bills	**AUCTION:** $34 billion* 52-week bills **ANNOUNCE:** $50 billion* 4-week bills for auction on Oct 6 $45 billion* 8-week bills for auction on Oct 6 $30 billion* 17-week CMBs for auction on Oct 5 **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 Oct 11 $40 billion* 3-year notes for auction on Oct 11 $32 billion* 10-year notes for auction on Oct 12 $18 billion* 30-year bonds for auction on Oct 13 **SETTLE:** $96 billion* 13-,26-week bills $34 billion* 52-week bills	
10	11	12	13	14
COLUMBUS DAY	**AUCTION:** $96 billion* 13-,26-week bills $40 billion* 3-year notes **ANNOUNCE:** $50 billion* 4-week bills for auction on Oct 13 $45 billion* 8-week bills for auction on Oct 13 $30 billion* 17-week CMBs for auction on Oct 12 **SETTLE:** $50 billion* 4-week bills $45 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs $32 billion* 10-year notes	**AUCTION:** $50 billion* 4-week bills $45 billion* 8-week bills $18 billion* 30-year bonds **ANNOUNCE:** $96 billion* 13-,26-week bills for auction on Oct 17 $12 billion* 20-year bonds for auction on Oct 19 $21 billion* 5-year TIPS for auction on Oct 20 **SETTLE:** $96 billion* 13-,26-week bills	

**Estimate*