Daiwa Capital Markets

U.S. Economic Comment

- Economic forecasters: hoping for a soft landing
- Inflation expectations: still contained in the long run; creeping up in the short run

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The Consensus Economic Forecast: A Soft(ish) Landing

The hawkish tone of Chair Powell at his latest press conference led us to revise our expectations for interest rates upward and prospects for economic activity downward. With Fed officials prepared to raise interest rates to a level above the 4.625 percent suggested by the September dot plot, we expect a recession in the U.S. to unfold next year (a drop of 0.8 percent in real GDP over the four quarters of next year and an increase in the unemployment rate to 5.0 percent).

The economic forecasting community has a more optimistic view, as the latest results from two well-regarded surveys show the economy continuing to advance next year. Two quarters in one of the surveys show modest declines in total output, but on average, GDP is in the plus column for 2023 (table).

We monitor (and participate in) the quarterly Survey of Professional Forecasters conducted by the Federal Reserve Bank of Philadelphia. The latest projection shows the economy growing at an average rate of 0.9 percent over the four quarters of next year. It borders on recession in the first half of the year with annual growth of only 0.2 percent, but revival begins in the second half of the year with growth of 0.9 percent in Q3 and 2.1 percent in Q4.

Unemployment increases in this slow environment, but not dramatically so, with the jobless rate climbing to 4.4 percent by the fourth quarter. Although GDP continues to expand and the unemployment increases only moderately, the Phily analysts see good progress in reducing inflation, with the core price index for personal consumption expenditures increasing 3.0 percent on a Q4-to-Q4 basis; in the final quarter of next year, core inflation is running at a 2.7 percent annual rate. This pace is still above the Fed's target, but we suspect that officials would be pleased with such progress.

The Blue Chip survey published by Wolters Kluwer is less optimistic (we also participate in this survey). One could reasonably argue that it involves a recession, as GDP growth is expected to decline 0.6 percent in Q1 and 0.3 percent in Q2 (annual rates). These dips are offset by growth of 0.4 percent and 0.9 percent in the next two quarters to leave an average advance of 0.1 percent in 2023. With negligible economic growth, the Blue Chip survey shows a larger jump in unemployment than the Phily survey does, although the change could still be viewed as moderate. The average inflation rate for the year is about the same as in the Phily projection, although the pace in Q4 is a touch slower (2.5 percent versus 2.7 percent).

Our projection deviates noticeably from the survey averages, as we expect the economy to contract over the year and for the unemployment rate to reach 5.0 percent during the fourth quarter. The inflation rate eases, but by less than expected in the surveys.

2023 Economic Forecasts*

	GDP	Unemp.	Core PCE Prices
Daiwa	-0.8	5.0	3.6
Phily SPF	0.9	4.4	3.1
Blue Chip	0.1	4.7	3.1

** Figures on GDP and core prices for personal consumption expenditures are annual changes over the four quarters of 2023. The unemployment rate is the average in the fourth quarter of 2023.*

Sources: Survey of Professional Forecasters, Federal Reserve Bank of Philadelphia; Wolters Kluwer's Blue Chip Forecast; Daiwa Capital Markets America

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We are not uncomfortable with this weaker-than-consensus view, as history shows that inflation is difficult to squeeze from the system once it becomes embedded. In the early 1980s, the last time the Fed waged a battle against inflation, GDP contracted 2.5 percent and the unemployment rate jumped more than 3-1/2 percentage points to 10.8 percent. Admittedly, inflation at that time was more problematic than it is currently (a peak of almost 10 percent in the core PCE price index), but nevertheless the experience indicates that inflation is a difficult foe and requires a concerted effort from the Federal Reserve.

Much of the difference between our view and those in the surveys involves assumptions about the degree of tightening in monetary policy. Neither the Phily Fed nor the Blue Chip surveys collect expectations on the federal funds rate, but they do ask for views on the three-month Treasury bill, whose rate is usually close to that on federal funds. Analysts in the Phily Fed survey see the bill rate peaking at 4.6 percent in the second and third quarters before easing to 4.3 percent in the fourth quarter (a Fed pivot). The Blue Chip survey shows a similar pattern: a peak of 4.7 percent in Q2 and easing to 4.5 percent and 4.3 percent in the next two quarters.

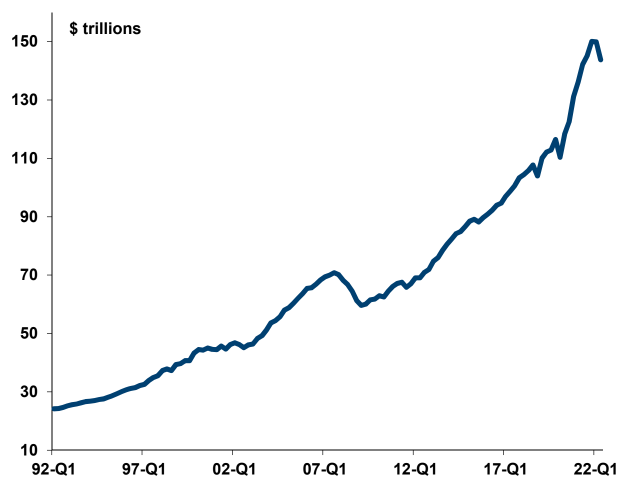
We expect a bolder move by the Fed, which will be maintained for a considerable period. We look for the fed funds rate (and the three-month bill rate) to peak at approximately 5.6 percent in mid-2023 (range of 5.50 percent to 5.75 percent), which will probably be maintained through the balance of the year. Fed officials have highlighted several times the dangers of pivoting too soon, which could allow inflation to reignite. Thus, policymakers are likely to maintain a restrictive stance until they are certain that inflation is on a path to two percent.

Our forecast is weaker than consensus, but it is not a wild one. The Blue Chip survey also provides statistics on the average of the 10 highest and lowest responses for each indicator. The pessimistic camp sees GDP contracting 1.8 percent over the course of the year, which drives the unemployment rate steadily higher, peaking at 5.7 percent in Q4. The increase in unemployment apparently limits tightening by the Fed, as the three-month bill rate peaks at 5.2 percent in Q2 and remains at that level over the balance of the year. Apparently, little progress in reducing inflation prevents a pivot by the Fed: the survey shows average core PCE inflation of 4.0 percent for all of 2023 and still well above target in Q4 at 3.2 percent).

Why Mild?

Compared with the pessimistic view in the Blue Chip survey, our expected recession is mild. The main reason for the limited downturn is financial strength in the household sector. The large pool of savings accumulated by individuals during the pandemic, which is still sizeable, will provide a cushion and prevent a marked reduction in consumer spending. An elevated level of net worth (even after the drop in stock prices this year) also indicates a strong financial position in the household sector (chart).

Household Net Worth

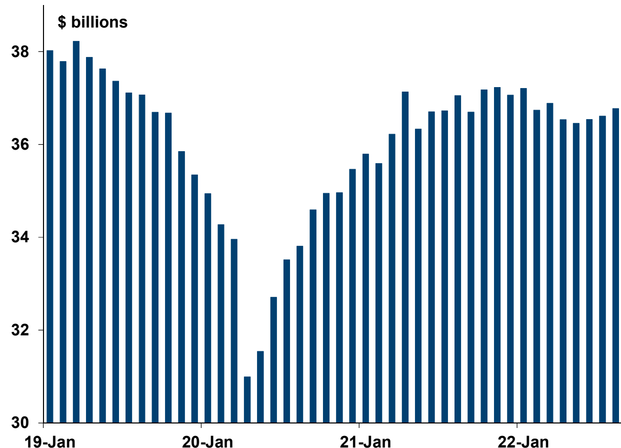


Source: Federal Reserve Board via Haver Analytics

We are hopeful that adjustments by businesses will be only moderate. Inventories in some areas are a bit heavy, but we do not see a need for a major correction. We also expect only a modest drop in business outlays for new equipment. New orders for capital goods have been holding up well, with continued growth in nominal bookings translating to a near-steady flow after adjusting for inflation (chart, next page). We suspect that business investment will be supported to a degree by efforts to strengthen supply chains, which will involve rerouting investment from foreign countries to the U.S.

Activity by state and local governments sometimes moves in a pro-cyclical pattern, slowing during soft economic periods because of weak revenue flows. However, like households, state and local governments have some financial cushion from unspent funds advanced by Congress during the pandemic. We do not expect much fiscal support from the federal government, especially with a now-divided Congress, but legislators are discussing some tweaks to the tax code that could provide support (enhancing the child tax credit, extending some business tax breaks).

Real Orders for Nondefense Capital Goods Ex. Aircraft*



** New orders for nondefense capital goods excluding aircraft adjusted for inflation using the private capital equipment component of the PPI.*
Sources: Bureau of Labor Statistics and U.S. Census Bureau via Haver Analytics

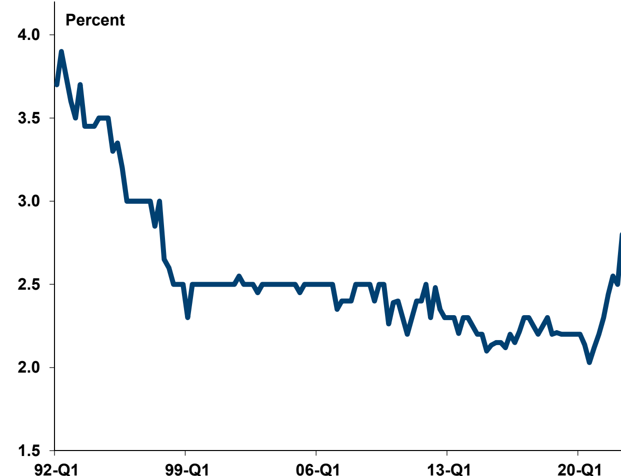
There are risk areas. The housing market has already weakened considerably, and it will probably continue to slip in the quarters ahead. Business demand for office space will probably be weak, as remote working is likely to remain popular. The combination of a strong foreign exchange value of the dollar and weak foreign economies will probably lead to a poor export performance.

Thus, the economy is likely to be contracting next year, but only moderately so.

Inflation Expectations

We keep a close eye on the Survey of Professional Forecasters from the Philadelphia Fed because of the information it provides on inflation expectations. It not only provides a good long-term view (the expected average inflation rate over the next ten years), it also allows a breakdown between the first five years and the second five years of that long-term span.

Forecasters' Long-Term View on Inflation*

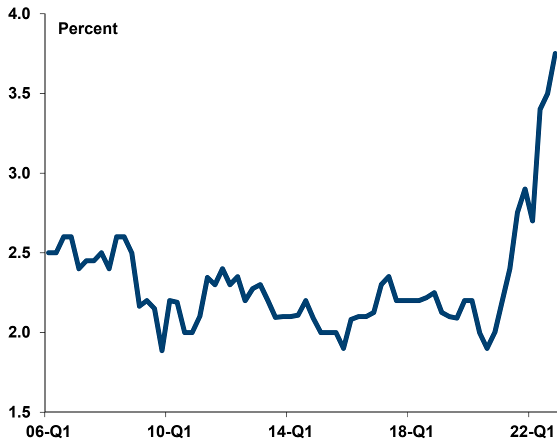


** Expected yearly CPI inflation over the next 10 years. Median estimate.*
Source: Survey of Professional Forecasters, Federal Reserve Bank of Philadelphia

The expected rate over the next ten years has increased considerably in the current cycle, increasing from readings of approximately 2.25 percent in the years before the pandemic to 2.95 percent in the latest survey (chart). The shift appears troubling, but most of the change occurs in the first five years. The five-year/five-year forward view (i.e. years six to ten) shows little change in views. In fact, the forward expectation shows a downward tilt (charts, next page). Fed officials have frequently cited this view in arguing that long-term expectations remain well anchored.

While long-term expectations are contained, the near-term acceleration should not be ignored. If inflation does not begin to slow soon, the elevated rates expected in the near term will begin to creep into more distant years, eventually leading to slippage in years six to ten. As Chair Powell has noted, well-anchored long-term expectations are not an excuse for complacency.

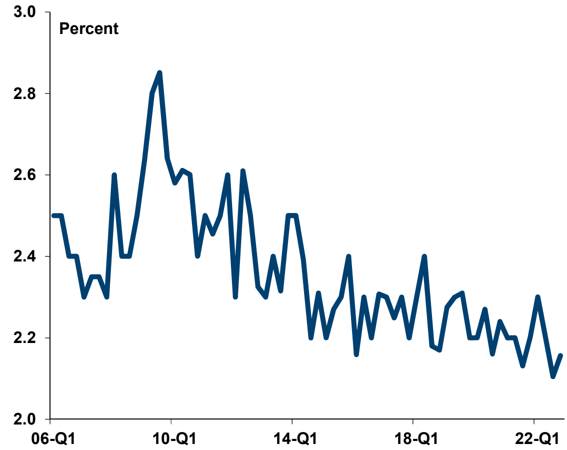
Five-Year View on Inflation*



** Expected yearly CPI inflation over the next five years. Median estimate.*

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

5-Yr., 5-Yr. Forward Infl. Expectations*



** Expected yearly CPI inflation six to 10 year from now. Calculated based on the median estimates for 5-year and 10-year views on expected inflation.*

Sources: Survey of Professional Forecasters, Federal Reserve Bank of Philadelphia; Daiwa Capital Markets America

Review

Week of Nov. 14, 2022	Actual	Consensus	Comments
PPI (October)	**0.2% Total, 0.0% Ex. Food & Energy**	**0.4% Total, 0.3% Ex. Food & Energy**	Prices of food and energy rose noticeably in October (up 0.5% and 2.7%, respectively), but prices elsewhere were unchanged on balance. The flat reading outside of food and energy was striking, although much of the restraint was the result of declines in prices of goods destined for export, likely reflecting the efforts of exporters to offset the effect of a strong dollar. Services prices were subdued, although these are often marked by a strong dose of volatility. Other areas offered hints of encouragement: increases in prices of capital goods and consumer goods other than food and energy are slowing a bit from recent averages.
Retail Sales (October)	**1.3% Total, 1.3% Ex. Autos**	**1.0% Total, 0.5% Ex. Autos**	The retail sales report carried a favorable tone in October, signaling that consumer were still active despite higher borrowing costs and elevated inflation. The auto and gasoline components contributed noticeably (up 1.3% and 4.1%, respectively), and sales at gasoline stations were heavily influenced by higher prices, but other areas also were strong, showing a combined increase of 0.9%. Sales at restaurants stood out on the firm side, adding to a notable upward trend in 2022. Nonstore retailers (mostly online), building-supply stores, and health and personal care outlets also recorded strong results.
Industrial Production (October)	**-0.1%**	**0.1%**	An increase of 0.1 percent in the manufacturing component of industrial production offset only a small portion of sluggish results in the prior five months, leaving a net downward tilt in production since April. Mining activity fell 0.4%, led by a drop of 0.9% in oil and gas extraction that offset a respectable gain in other mining activity. The trend in mining activity might still be described as upward, but it has hesitated in the past few months. Utility output fell 1.5% in October, but changes in this sector are nearly always driven by shifts in the weather and temperatures rather than economic fundamentals.
Housing Starts (October)	**1.425 Million (-4.2%)**	**1.410 Million (-2.0%)**	Most of the decline in housing starts in October was the result of a drop of 6.1% in single-family activity. The latest shift marked the seventh decline in the past eight months, which pushed single-family starts to their lowest level since the early months of the expansion. Multi-family starts fell 1.2% in October after a drop of 1.4% in the prior month. These recent declines occurred from an elevated level in August, and thus the level of activity remained in the upper portion of the recent range. That range has been firm, as sky-high prices of single-family homes and elevated interest rates have pushed many potential buyers into the rental market.

Review Continued

Week of Nov. 14, 2022	Actual	Consensus	Comments
Existing Home Sales (October)	**4.43 Million (-5.9%)**	**4.40 Million (-6.6%)**	Sales of existing homes fell for the ninth consecutive month in October, as a drop in affordability caused by elevated mortgage rates and home prices fueled an ongoing correction in the housing market. The latest shift pushed sales to their lowest level since May 2020, when the country was dealing with the early stages of the Covid pandemic.
Leading Indicators (October)	**-0.8%**	**-0.4%**	Negative contributions from consumer expectations, initial claims for unemployment insurance, stock prices, and the ISM new orders index offset a positive contributions from the slope of the yield curve. The drop in October was the largest month-to-month change in the recent series of eight consecutive declines, which left the level of the leading index 3.8% below the cyclical peak in February.

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

Preview

Week of Nov. 21, 2022	Projected	Comments
Durable Goods Orders (October) (Wednesday)	**-0.5%**	A cooling in civilian aircraft bookings in October after a jump in the prior month could weigh on headline durable goods orders. Higher prices might inflate the value of orders in some categories, but concern about pending recession could outweigh potential price effects and nudge orders excluding transportation lower.
New Home Sales (October) (Wednesday)	**0.575 Million (-4.6%)**	Against a backdrop of elevated interest rates and slowing demand, declines in mortgage applications and prospective buyer traffic raise the possibility of additional slippage in sales of new homes in October after a cumulative drop of 28.1% in the first nine months of 2022.
Revised Consumer Sentiment (November) (Wednesday)	**54.7 (Unrevised)**	Increased chatter about a potential recession next year suggests that the final estimate of consumer sentiment for November will remain close to the depressed preliminary tally. Keep an eye on the measure of long-term inflation expectations released with the sentiment report, which ticked higher in early November. The latest reading of 3.0% was in the upper end of the range of recent observations (2.7% to 3.1%).

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

November / December2022

Monday	Tuesday	Wednesday	Thursday	Friday
14	15	16	17	18
	PPI Final Demand / Ex. Food & Energy Aug 0.0% 0.4% Sep 0.2% 0.2% Oct 0.2% 0.0% **EMPIRE MFG** Sep -1.5 Oct -9.1 Nov 4.5	**RETAIL SALES** Total / Ex.Autos Aug 0.7% 0.2% Sep 0.0% 0.1% Oct 1.3% 1.3% **IMPORT/EXPORT PRICES** Non-petrol Imports / Nonagri. Exports Aug -0.2% -1.4% Sep -0.3% -1.6% Oct -0.2% -0.3% **IP & CAP-U** IP / Cap.Util. Aug -0.1% 80.0% Sep 0.1% 80.1% Oct -0.1% 79.9% **NAHB HOUSING INDEX** Sep 46 Oct 38 Nov 33 **BUSINESS INVENTORIES** Inventories / Sales July 0.5% -1.0% Aug 0.9% 0.3% Sep 0.4% 0.2% **TIC FLOWS** Long-Term / Total July $21.3B $153.9B Aug $198.3B $277.2B Sep $118.0B $30.9B	**UNEMP. CLAIMS** Initial / Continuing (millions) Oct 22 0.218 1.487 Oct 29 0.218 1.494 Nov 5 0.226 1.507 Nov 12 0.222 N/A **HOUSING STARTS** Aug 1.508 million Sep 1.488 million Oct 1.425 million **PHILADELPHIA FED MFG BUSINESS OUTLOOK** Sep -9.9 Oct -8.7 Oct -19.4	**EXISTING HOME SALES** Aug 4.78 million Sep 4.71 million Oct 4.43 million **LEADING INDICATORS** Aug -0.1% Sep -0.5% Oct -0.8%
21	22	23	24	25
CHICAGO FED NATIONAL ACTIVITY INDEX (8:30) Monthly / 3-Mo. Avg. Aug 0.10 0.04 Sep 0.10 0.17 Oct -- --		**UNEMP. CLAIMS (8:30)** **DURABLE GOODS ORDERS (8:30)** Aug 0.2% Sep 0.4% **Oct -0.5%** **NEW HOME SALES (10:00)** Aug 0.677 million Sep 0.603 million **Oct 0.575 million** **REVISED CONSUMER SENTIMENT (10:00)** Sep 58.6 Oct 59.9 Nov(p) 54.7 **FOMC MINUTES (2:00)**	***THANKSGIVING***	
28	29	30	1	2
	FHFA HOME PRICE INDEX **S&P CORELOGIC HOME PRICE INDEX** **CONSUMER CONFIDENCE**	**ADP EMPLOYMENT** **REVISED Q3 GDP** **INTERNATIOAL TRADE IN GOODS** **ADVANCE INVENTORIES** **MNI CHICAGO BUSINESS BAROMETER** **JOLTS** **PENDING HOME SALES** **BEIGE BOOK**	**UNEMP. CLAIMS** **PERSONAL INCOME, CONSUMPTION, PRICES** **ISM MANUFACTURING** **CONSTRUCTION** **VEHICLE SALES**	**EMPLOYMENT REPORT**
5	6	7	8	9
FACTORY ORDERS **ISM SERVICES**	**TRADE BALANCE**	**REVISED Q3 PRODUCTIVITY** **CONSUMER CREDIT**	**UNEMP. CLAIMS**	**PPI** **CONSUMER SENTIMENT** **WHOLESALE TRADE**

Forecasts in Bold. *(p) = preliminary*

Daiwa Capital Markets

Treasury Financing

November / December 2022

Monday	Tuesday	Wednesday	Thursday	Friday
14	15	16	17	18
AUCTION RESULTS: Rate / Cover 13-week bills 4.155% 2.63 26-week bills 4.440% 2.86	**ANNOUNCE:** $65 billion 4-week bills for auction on Nov 17 $55 billion 8-week bills for auction on Nov 17 $33 billion 17-week bills for auction on Nov 16 $40 billion 16-day CMBs for auction on Nov 17 **SETTLE:** $65 billion 4-week bills $55 billion 8-week bills $33 billion 17-week bills $40 billion 3-year notes $35 billion 10-year notes $21 billion 30-year bonds	**AUCTION RESULTS:** Rate / Cover 17-week bills 4.320% 3.15 20-yr bonds 4.072% 2.64	**AUCTION RESULTS:** Rate / Cover 4-week bills 3.795% 2.54 8-week bills 4.020% 2.46 10-year TIPS 1.485% 2.25 16-day CMB 3.800% 2.38 **ANNOUNCE:** $99 billion 13-,26-week bills for auction on Nov 21 $42 billion 2-year notes for auction on Nov 21 $43 billion 5-year notes for auction on Nov 21 $35 billion 7-year notes for auction on Nov 22 $22 billion 2-year FRNs for auction on Nov 22 **SETTLE:** $102 billion 13-,26-week bills	
21	22	23	24	25
AUCTION: $99 billion 13-,26-week bills $42 billion 2-year notes $43 billion 5-year notes	**AUCTION:** $35 billion 7-year notes $22 billion 2-year FRNs **ANNOUNCE** $65 billion* 4-week bills for auction on Nov 23 $55 billion* 8-week bills for auction on Nov 23 $33 billion* 17-week bills for auction on Nov 23 **SETTLE:** $65 billion 4-week bills $55 billion 8-week bills $33 billion 17-week bills $40 billion 16-day CMBs	**AUCTION:** $33 billion* 17-week bills $65 billion* 4-week bills $55 billion* 8-week bills **ANNOUNCE:** $99 billion* 13-,26-week bills for auction on Nov 28 $34 billion* 52-week bills for auction on Nov 29	***THANKSGIVING***	**SETTLE:** $99 billion 13-,26-wk bills $22 billion 2-year FRNs
28	29	30	1	2
AUCTION: $99 billion* 13-,26-wk bills	**AUCTION:** $34 billion* 52-week bills **ANNOUNCE:** $65 billion* 4-week bills for auction on Dec 1 $55 billion* 8-week bills for auction on Dec 1 $33 billion* 17-week bills for auction on Nov 30 **SETTLE:** $65 billion* 4-week bills $55 billion* 8-week bills $33 billion* 17-week bills	**AUCTION:** $33 billion* 17-week bills **SETTLE:** $15 billion 20-year bonds $15 billion 10-year TIPS $42 billion 2-year notes $43 billion 5-year notes $35 billion 7-year notes	**AUCTION:** $65 billion* 4-week bills $55 billion* 8-week bills **ANNOUNCE:** $99 billion* 13-,26-week bills for auction on Dec 5 **SETTLE:** $99 billion* 13-,26-wk bills $34 billion* 52-week bills	
5	6	7	8	9
AUCTION: $99 billion* 13-,26-wk bills	**ANNOUNCE:** $65 billion* 4-week bills for auction on Dec 8 $55 billion* 8-week bills for auction on Dec 8 $33 billion* 17-week bills for auction on Dec 7 **SETTLE:** $65 billion* 4-week bills $55 billion* 8-week bills $33 billion* 17-week bills	**AUCTION:** $33 billion* 17-week bills	**AUCTION:** $65 billion* 4-week bills $55 billion* 8-week bills **ANNOUNCE:** $99 billion* 13-,26-week bills for auction on Dec 12 $40 billion* 3-year notes for auction on Dec 12 $32 billion* 10-year notes for auction on Dec 12 $18 billion* 30-year bonds for auction on Dec 13 **SETTLE:** $99 billion* 13-,26-wk bills	

**Estimate*