Daiwa Capital Markets

U.S. Economic Comment

- FOMC minutes: on track for 50 basis points in December
- Recession watch: mixed results in cyclically sensitive sectors (manufacturing & housing)

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Monetary Policy

A restrained reading (by recent standards) on the consumer price index for October increased the likelihood of the Federal Open Market Committee downshifting to a rate hike of 50 basis points in December. Even before the release of the CPI, the minutes from the November FOMC meeting suggested that Fed officials were leaning toward a change of 50 rather than 75 basis points at the next policy meeting.

Fed Officials in November viewed inflation as “unacceptably high” and they seemed concerned about the possible persistence of inflation given tight labor markets, brisk wage growth, and slow growth of productivity. Against this background, “various” Fed officials noted that the terminal federal funds rate in the current cycle would probably be higher than previously believed (the dot plot in September suggested a terminal rate of 4.625 percent). At the same time, officials noted that the cumulative change in policy had been substantial and that lags in policy should be taken into consideration in future decisions. Accordingly, “a substantial majority of participants judged that a slowing in the pace of increase would likely soon be appropriate.”

Some Fed officials also believed that a slower pace of tightening would reduce the risk of triggering financial instability. Officials apparently were influenced by volatility generated by fiscal proposals in the United Kingdom, as the disruptions from this episode in October were reviewed at this meeting.

Fed officials remained on a tightening path in November despite a sub-par performance in the economy. The staff presented a downbeat forecast, with the baseline view involving below-potential growth. The staff also recognized the possibility of a recession next year, with such an outcome almost as likely as the baseline forecast. Fed officials also expected slow growth with risks on the downside, but they were pushing on with the tightening campaign because of an unacceptable inflation rate.

The U.S. Economy: Muddling Along

Thanksgiving-Eve brought two reports involving cyclically-sensitive sectors of the economy: durable goods orders and new home sales. Both indicators were better than expected, suggesting resiliency in the economy, although they were not as impressive as casual inspection might suggest.

Manufacturing

New orders for durable goods rose 1.0 percent in October, easily beating the expected advance of 0.4 percent. Much of the surprise occurred in the transportation category, reflecting a jump in bookings for commercial aircraft that added to a surge in September. The two-month average for commercial aircraft orders was easily the best of the current expansion and the firmest since mid-2017. Orders for defense aircraft and motor vehicles also rose, adding to the strength in the transportation category. The increase of 0.6 percent in orders for motor vehicles in October followed a gain of 2.4 percent in the prior month, reinforcing an upward trend that has developed since the spring and suggesting that supply constraints in this industry are easing.

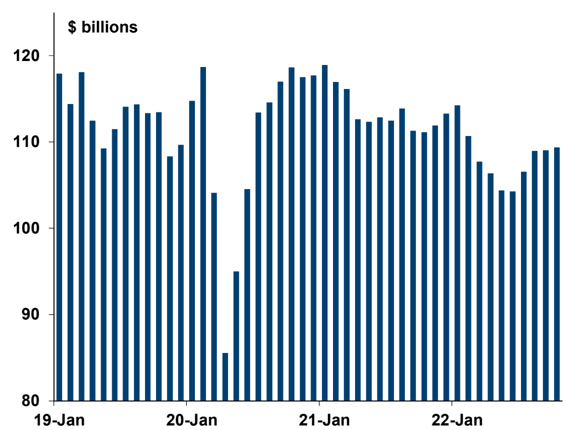
Excluding transportation items, new orders for durable goods rose 0.5 percent, a seemingly respectable advance. However, the increase followed a drop of 0.9 percent in the prior month and probably translated to a decline in real terms (the producer price index for manufacturing rose 0.7 percent in October).

The likely decline in real orders ex-transportation raises questions about the influence of inflation on order flows in general. The PPI for the manufacturing sector, which is volatile even in normal times, has been especially wild during the recession and subsequent recovery (the year-over-year change moved from a low of -6.6 percent in April 2020 to a peak of 20.4 percent in June of this year).

Deflating orders for durable goods by the PPI for manufacturing indeed shows a markedly different pattern than nominal orders do. Nominal bookings have moved along an upward trend throughout the current expansion, but inflation-adjusted figures started to soften in the spring of 2021 and moved noticeably lower in the first half of this year. However, orders have revived recently, stepping up in July and August and holding those firmer levels in September and October (chart, left). This performance meshes well with that of GDP in the U.S., which fell in the first half of the year before recovering in Q3. Real orders in October were a bit above the average for the third quarter, suggesting that the economy is still on a growth track.

The manufacturing component of the industrial production index provides another window on the manufacturing sector. This measure is based on physical production, and thus it is akin to an inflation-adjusted statistic. Its recent path has been similar to that for real orders. The IP index started to soften in the spring (off in May and June), but it recovered in the next four months (chart, right). The reading for October was 0.4 percent above the third quarter average, supporting the notion of continued growth in the final months of the year.

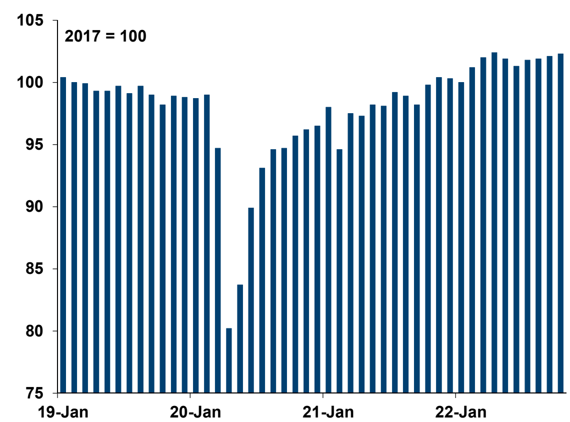
Real Orders for Durable Goods*



** New orders for durable goods adjusted for inflation using the PPI manufacturing index.*

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

Industrial Production: Manufacturing



Source: Federal Reserve Board via Haver Analytics

Housing

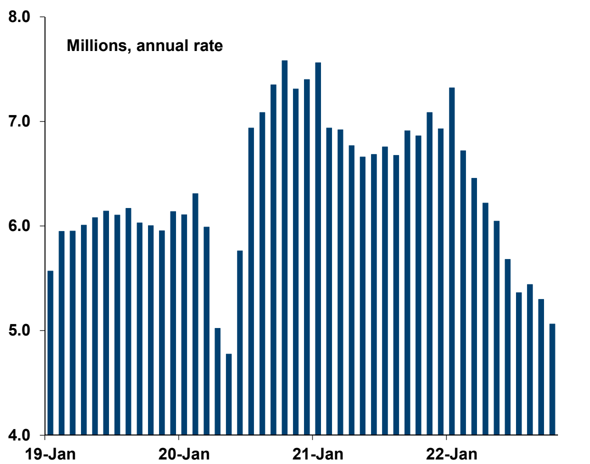
Sales of new homes rose 7.5 percent in October, markedly better than the expected *decline* of 5.5 percent. The increase occurred from downward revised results in the prior three months, but the new level of sales (632,000 homes) was still above the preliminary reading of 603,000 in September and far better than the expected level of 570,000.

While the results were striking, we find it difficult to get excited about the report because it runs counter to the weakness seen in nearly every other housing-related statistic, leading us to suspect a random shift that could be revised away (sizeable revisions are common). Three developments in particular fuel our doubt: sales of existing homes, prices of existing homes, and attitudes of home builders.

The market for existing homes is far larger than that for new homes (sales usually are more than seven times the total in the new-home market), and thus it provides a better view on demand for homeownership. Sales of existing homes have tumbled this year, declining for nine consecutive months and moving to a level last seen during the early stages of the pandemic, when lockdowns limited housing activity. The dominant position of existing homes has pushed total home sales to a decidedly weak position (chart, left).

The recent movement in home prices also shows that conditions in the housing market have slipped considerably. Prices as measured by the index of the Federal Housing Finance Agency have shifted abruptly from an average increase of 1.4 percent from July 2020 through May of this year to an average decline of 0.6 percent in July and August (chart, right).

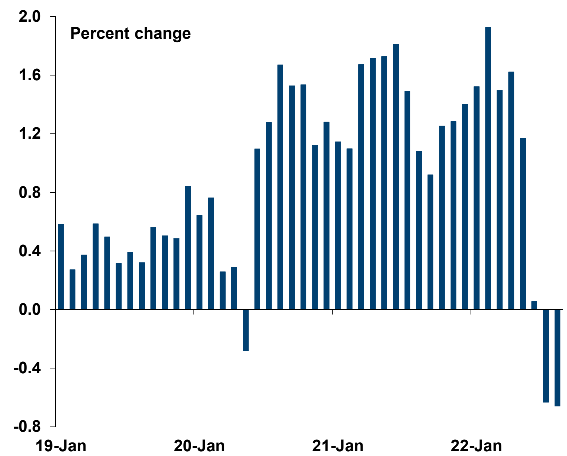
Home Sales*



** Sales of new and existing homes.*

Sources: National Association of Realtors and U.S. Census Bureau via Haver Analytics; Daiwa Capital Markets America

Home Price Index



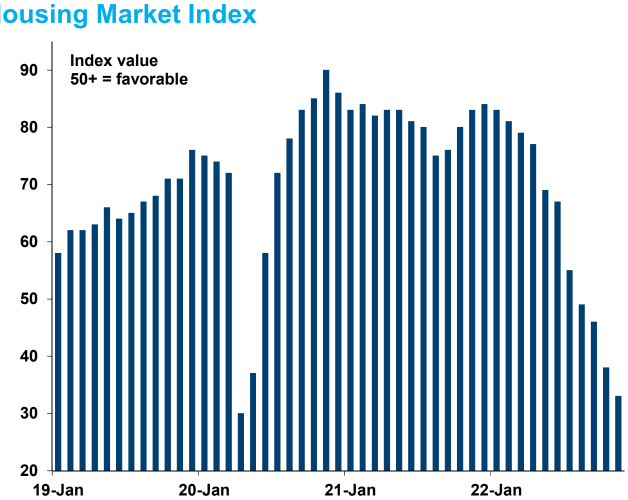
Source: Federal Housing Finance Agency via Haver Analytics

Home builders are involved with renovations to existing homes, but their main line of business is the construction of new homes, and thus this group would be keenly aware of conditions in the market. The sentiment index published by the industry's trade association (the National Association of Home Builders) is signaling trouble, as the measure has tumbled from a near-record reading of 84 in December of last year to 33 in November (chart, below; like the ISM index, this indicator can range from 0 to 100, with 50 separating expansion from contraction).

We have searched for housing-related statistics that might be sending less than dire signals. We found two measures that have softened recently but they nevertheless remain favorable relative to historical norms. During the heated market of the prior two years, homes were selling quickly, with the number of days on the market moving to a record low of 19 in mid-2020. This indicator has moved to 33 days in September, indicating slower activity, but it is still low relative to pre-pandemic readings (an average of 45 days in 2019; chart, next page).

The red-hot market in 2021 also involved many homes selling above the asking price. Indeed, the average ratio of sale price to list

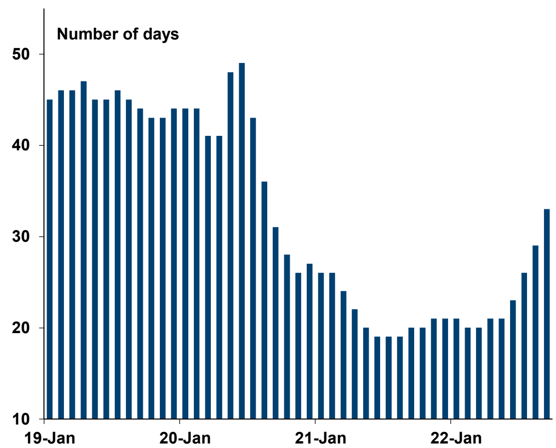
Housing Market Index



Source: National Association of Home Builders via Haver Analytics price in 2021 was 101.1 percent. This measure has cooled, but only to 100.0 percent in September, still above the pre-pandemic norm (chart, right).

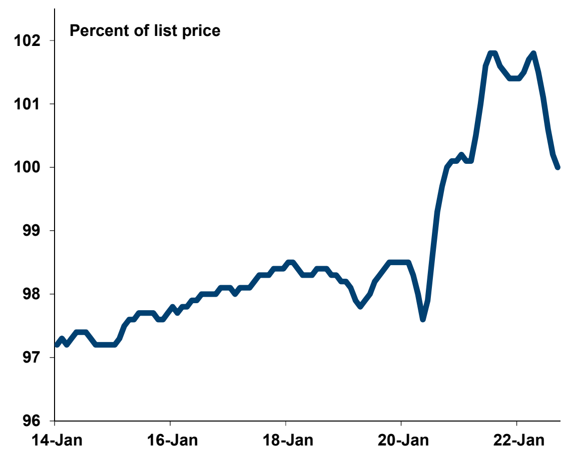
We find these statistics interesting, but they are not profound enough to counter the view that the housing market is in the doldrums.

Housing Inventory: Days on Market



Source: Redfin Housing Market Data via Haver Analytics

Home Price: Average Sale to List*



** The ratio of home sale prices to list prices.*
Source: Redfin Housing Market Data via Haver Analytics

Preview

Week of Nov. 28, 2022	Projected	Comments
Conference Board Consumer Confidence (November) (Tuesday)	**100.0 (-2.4%)**	Increasing news reports about corporate layoffs and economic headwinds in 2023 carry the potential to further erode consumer confidence in November.
Revised GDP (2022-Q3) (Wednesday)	**3.0% (+0.4 Pct. Pt. Revision)**	Data released since the preliminary estimate of Q3 GDP suggest that upward adjustments to consumer spending and business-related construction (a less-negative reading) could offset a downward revision to equipment spending, leaving economic growth firmer than first reported.
International Trade in Goods (October) (Wednesday)	**-$91.0 Billion ($0.9 Billion Narrower Deficit)**	Lower prices of petroleum products could reduce the value of exported industrial supplies in October, and a strong foreign exchange value of the dollar and slow growth abroad could weaken other categories of exports. Imports of industrial supplies also could cool, along with those of capital goods after a jump in September. On balance, the projected decline in imports is likely to exceed that in exports and lead to a narrowing in the monthly goods trade deficit.
Personal Income, Consumption, Core Prices (October) (Thursday)	**0.3%, 0.9%, 0.3%**	Data on average hourly earnings and worktimes suggest a moderate increase in wages and salaries, and higher interest rates could boost investment income. A firm performance in retail spending, along with an increase in vehicle sales, points to a strong nominal gain in outlays for goods. Nominal spending on services has been firm in most months this year. A 0.3% increase in the core CPI in October points to slower advance in the core PCE price index than jumps of 0.5% per month in the prior two months.
ISM Manufacturing Index (November) (Thursday)	**50.0 (-0.2 Index Pt.)**	With restrictive monetary policy pushing the economy toward recession, the ISM manufacturing index is likely to continue on the downward trend that began late last year.
Construction Spending (October) (Thursday)	**0.1%**	A decline in single-family housing starts in October suggests that residential construction could be soft, although a well-maintained pace of multi-family activity could limit the expected easing. Business-related activity has picked up in recent months despite a challenging environment, but higher costs could be playing a role in the advance. Government sponsored activity had been moving higher since last fall before dipping in the past two months.
Payroll Employment (November) (Friday)	**200,000**	A pickup in initial claims for unemployment insurance through mid-November and an increase in announcements of corporate layoffs suggest softening in the labor market. Thus, hiring could slow notably from the 289k pace in the prior three months. With the labor market expected to soften, the unemployment rate could tick higher.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

November / December2022

Monday	Tuesday	Wednesday	Thursday	Friday
21	22	23	24	25
CHICAGO FED NATIONAL ACTIVITY INDEX Monthly / 3-Mo. Avg. Aug 0.14 0.04 Sep 0.17 0.19 Oct -0.05 0.09		**UNEMP. CLAIMS** Initial / Continuing (millions) Oct 29 0.218 1.498 Nov 5 0.226 1.503 Nov 12 0.223 1.551 Nov 19 0.240 N/A **DURABLE GOODS ORDERS** Aug 0.2% Sep 0.3% Oct 1.0% **NEW HOME SALES** Aug 0.661 million Sep 0.588 million Oct 0.632 million **REVISED CONSUMER SENTIMENT** Sep 58.6 Oct 59.9 Nov(p) 54.7 Nov(r) 56.8 **FOMC MINUTES**	***THANKSGIVING***	
28	29	30	1	2
	FHFA HOME PRICE INDEX (9:00) July -0.6% Aug -0.7% Sep -- **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX (9:00)** July -0.7% Aug -1.3% Sep -- **CONFERENCE BOARD CONSUMER CONFIDENCE (10:00)** Sep 107.8 Oct 102.5 **Nov 100.0**	**ADP EMPLOYMENT REPORT (8:15)** Private Payrolls Sep 192,000 Oct 239,000 Nov -- **REVISED GDP (8:30)** GDP / Chained Price 22-Q2 -0.6% 9.0% 22-Q3(a) 2.6% 4.1% **22-Q3(p) 3.0% 4.1%** **INTERNATIONAL TRADE IN GOODS (8:30)** Aug -$85.8 billion Sep -$91.9 billion **Oct -$91.0 billion** **ADVANCE INVENTORIES (8:30)** Wholesale / Retail Aug 1.4% 1.4% Sep 0.6% 0.4% Oct -- -- **MNI CHICAGO BUSINESS BAROMETER (9:45)** Index / Prices Sept 45.7 74.1 Oct 45.2 74.8 Nov -- -- **JOLTS DATA (10:00)** Openings (000) / Quit Rate Aug 10,280 2.7% Sep 10,717 2.7% Oct -- -- **PENDING HOME SALES (10:00)** **BEIGE BOOK (2:00)**	**UNEMP. CLAIMS (8:30)** **PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX (8:30)** Inc. / Cons. / Core Aug 0.4% 0.6% 0.5% Sep 0.4% 0.6% 0.5% **Oct 0.3% 0.9% 0.3%** **ISM MFG. INDEX (10:00)** Index / Prices Sep 50.9 51.7 Oct 50.2 46.6 **Nov 50.0 48.0** **CONSTRUCTION (10:00)** Aug -0.6% Sep 0.2% **Oct 0.1%** **VEHICLE SALES** Sep 13.6 million Oct 14.9 million **Nov 14.9 million**	**EMPLOYMENT REPORT (8:30)** Payrolls / Un. Rate Sep 315,000 3.5% Oct 261,000 3.7% **Nov 200,000 3.8%**
5	6	7	8	9
FACTORY ORDERS **ISM SERVICES**	**TRADE BALANCE**	**REVISED Q3 PRODUCTIVITY** **CONSUMER CREDIT**	**UNEMP. CLAIMS**	**PPI** **CONSUMER SENTIMENT** **WHOLESALE TRADE**
12	13	14	15	16
FEDERAL BUDGET	**NFIB SMALL BUSINESS OPTIMISM IINDEX** **CPI** **FOMC (1ST DAY)**	**IMPORT/EXPORT PRICES** **FOMC DECISION**	**UNEMP. CLAIMS** **RETAIL SALES** **EMPIRE MFG. INDEX** **PHILY FED MFG. INDEX** **INDUSTRIAL PROD.** **BUSINESS INVENTORIES** **TIC FLOWS**	

Forecasts in Bold. (a) = advance (1st estimate of GDP); (p) = preliminary (2nd estimate of GDP); (r) = revised

Treasury Financing

November / December 2022

Monday	Tuesday	Wednesday	Thursday	Friday
21	22	23	24	25
AUCTION RESULTS: Rate / Cover 13-week bills 4.220% 2.64 26-week bills 4.520% 3.03 2-year notes 4.505% 2.64 5-year notes 3.974% 2.39	**AUCTION RESULTS:** Rate / Cover 7-year notes 3.890% 2.33 Margin / Cover 2-year FRNs 0.220% 2.45 **ANNOUNCE:** $55 billion 4-week bills for auction on Nov 23 $50 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 RESULTS:** Rate / Cover 17-week bills 4.440% 3.24 4-week bills 3.970% 2.55 8-week bills 4.120% 2.81 **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-week bills $22 billion 2-year FRNs
28	29	30	1	2
AUCTION: $99 billion 13-,26-week bills	**AUCTION:** $34 billion 52-week bills **ANNOUNCE** $55 billion* 4-week bills for auction on Dec 1 $50 billion* 8-week bills for auction on Dec 1 $33 billion* 17-week bills for auction on Nov 30 **SETTLE:** $55 billion 4-week bills $50 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:** $55 billion* 4-week bills $50 billion* 8-week bills **ANNOUNCE:** $99 billion* 13-,26-week bills for auction on Dec 5 **SETTLE:** $99 billion 13-,26-week bills $34 billion 52-week bills	
5	6	7	8	9
AUCTION: $99 billion* 13-,26-week bills	**ANNOUNCE:** $55 billion* 4-week bills for auction on Dec 8 $50 billion* 8-week bills for auction on Dec 8 $33 billion* 17-week bills for auction on Dec 7 **SETTLE:** $55 billion* 4-week bills $50 billion* 8-week bills $33 billion* 17-week bills	**AUCTION:** $33 billion* 17-week bills	**AUCTION:** $55 billion* 4-week bills $50 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-week bills	
12	13	14	15	16
AUCTION: $99 billion* 13-,26-week bills $40 billion* 3-year notes $32 billion* 10-year notes	**AUCTION:** $18 billion* 30-year bonds **ANNOUNCE:** $55 billion* 4-week bills for auction on Dec 15 $50 billion* 8-week bills for auction on Dec 15 $33 billion* 17-week bills for auction on Dec 14 **SETTLE:** $55 billion* 4-week bills $50 billion* 8-week bills $33 billion* 17-week bills	**AUCTION:** $33 billion* 17-week bills	**AUCTION:** $55 billion* 4-week bills $50 billion* 8-week bills **ANNOUNCE:** $99 billion* 13-,26-week bills for auction on Dec 19 $12 billion* 20-year bonds for auction on Dec 21 $19 billion* 5-year TIPS for auction on Dec 22 **SETTLE:** $99 billion* 13-,26-week bills $40 billion* 3-year notes $32 billion* 10-year notes $18 billion* 30-year bonds	

*Estimate