Daiwa Capital Markets

U.S. Economic Comment

- PCE Inflation: hints of improvement in February
- Consumer spending: firm pace of outlays suggests solid performance for Q1 GDP

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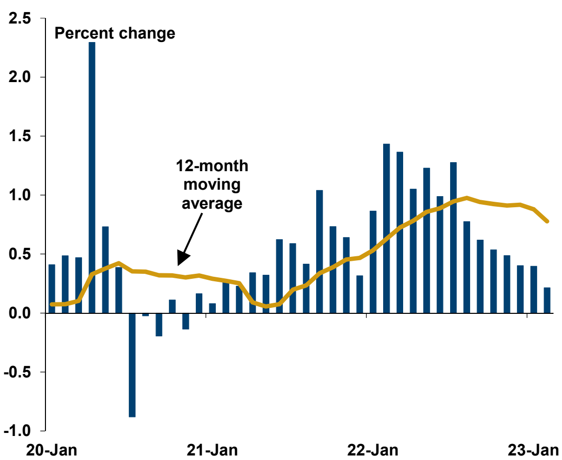
PCE Inflation: Positive Developments

Fed officials have closely watched developments on the inflation front, with Chair Powell noting in his latest post-FOMC press conference that the Fed's job is still far from complete in returning the economy to a state of price stability centered on two percent inflation. The February report on personal income and consumption provided another data point on the Fed's preferred measure of inflation: the price index for personal consumption expenditures. In assessing the latest report, we agree with the Fed Chair that there is more work to do in taming entrenched inflation, but we identified some potentially favorable developments that hinted at an easing in underlying price pressure.

The headline PCE price index rose moderately in February, with the advance of 0.3 percent (0.263 percent with less rounding) well below the average of 0.436 percent in the previous 12 months. The energy component slipped 0.4 percent, continuing the irregular downward trend in place since the energy index peaked last summer. More notably, food prices rose only 0.2 percent in the latest month. The food index has decelerated recently after coming under sustained pressure for much of 2022. The modest change in February followed advances of 0.4 percent in January and December and changes averaging 0.5 percent in the two months prior to that. Food prices had previously surged 1.1 percent per month on average in the first nine months of last year (chart, left).

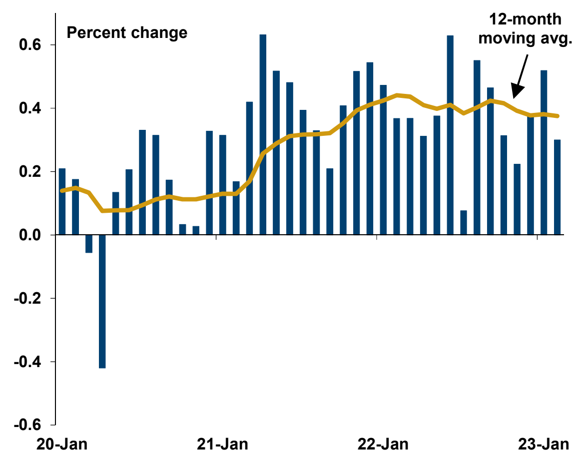
The core component registered an increase of 0.3 percent from a downwardly revised reading in January (0.5 percent versus a preliminary jump of 0.6 percent), slipping below the average of 0.4 percent in the prior 12 months (chart, right). Below the surface, the results were a bit harder to interpret, as components showed a wide dispersion of movement in price. On the soft side, prices of used motor vehicles continued easing, falling 2.8 percent after averaging declines of 1.5 percent in the prior six months. Similarly, the costs of appliances fell 0.7 percent after averaging monthly declines of 0.5 percent in the previous six months. In the opposite direction, costs of accounting and legal services jumped (up 3.1 and 1.0 percent, respectively) and rents remained under pressure, matching the recent average with an increase of 0.8 percent.

PCE Price Index: Food



Source: Bureau of Economic Analysis via Haver Analytics

Core PCE Price Index*

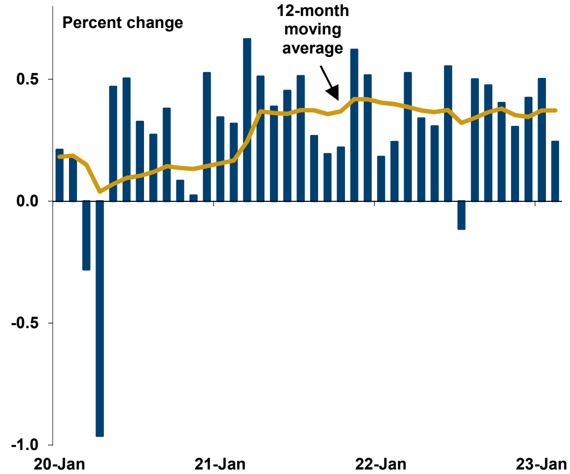


** PCE = personal consumption expenditures.*

Sources: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

While interpretation of movement in the core presented challenges, perhaps a clearer way to evaluate progress in the fight against inflation is through the new metric tracked by Fed officials: core services excluding housing services. Chair Powell has described inflation as best viewed in three categories: goods inflation, which has moderated as supply chains normalized and the economy reopened post-Covid; housing services, which are expected to slow later this year; and the costs of services excluding housing, which are influenced mainly by the growth of wages. The core services measure excluding housing, which had registered brisk increases for much of last year, rose 0.2 percent in February, moving below the underlying average (chart). We hesitate to read too much into one monthly observation, but the latest reading may suggest that restrictive monetary policy is having the desired influence.

PCE Price Index: Core Services Ex. Housing*



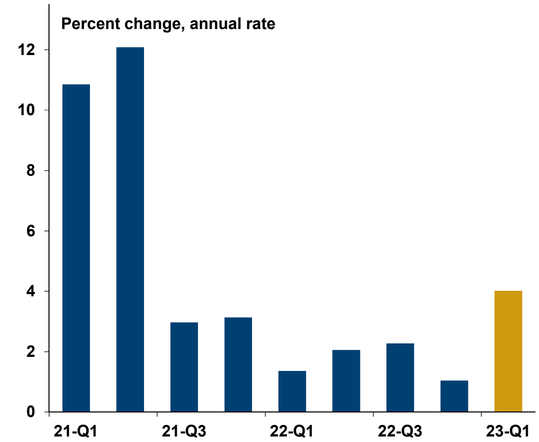
** The PCE price index for services excluding energy services and housing services.*

Source: Bureau of Economic Analysis via Haver Analytics

Q1 GDP Update: Firm Consumer Spending; Challenges Elsewhere

The economy faces notable challenges in the months ahead, as the lagged effects of restrictive monetary policy and fallout from recent volatility in the banking sector filter through to the real economy in the forms of higher interest rates for consumers and businesses and a restricted flow of credit. Ultimately, we expect these challenges, and perhaps other emerging headwinds including a downturn in the commercial real estate sector, to constrain activity to the point of tipping the economy into recession later this year. However, the data for 2023 thus far suggest that the economy has yet to enter into contraction and growth is likely to exceed 1.0 percent in Q1, possibly by a wide margin.

Growth of Real Consumer Spending*



** The observation for 23-Q1 is based on results for real consumer spending in January and February.*

Sources: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

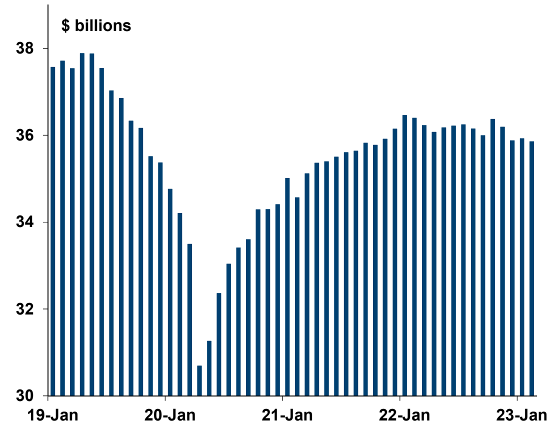
Today's report on income and consumption provided a view on real consumer spending in February. The latest monthly result (a decline of 0.1 percent) trailed the brisk increase of 1.5 percent in January. While a portion of the strong results in January had reflected a burst in new vehicle sales, outlays in other categories also were firm. It would have been challenging to follow the broad-based increase with another solid performance in the latest month. Payback did follow, but the retreat was not large and the combined results suggested consumer spending growth of more than 4.0 percent in the first quarter, the best performance since the first half of 2021 (chart). Consumers, buoyed by a strong labor market, the use of savings acquired during the pandemic, and strong credit growth, are still spending actively.

Other areas of the economy, while not matching the expected strength in consumer spending, could lend support. Businesses have continued to invest in research and development, which has supported investment in intellectual property. Moreover, an upward revision to business investment in structures in Q4 implies that this previously soft area could be turning a corner.

Recent data suggest softness in some areas. Real shipments of nondefense capital goods excluding aircraft for the past two months point to a lackluster performance for capex (chart, next page). Other notable drags could come from inventory investment and residential construction. Inventory investment added 1.5 percentage points to growth in Q4, and cautious management amid expectations of a slowing economy could lead to a notable drag in Q1 (perhaps subtracting more than one percentage point from growth) and beyond. In addition, while recent data imply a contraction in residential construction far less than the average of 26.1 percent in the second half of last year, tight financial conditions should continue to prevent a broad recovery in the housing market.

All told, momentum in Q1 remains positive, despite some slow areas.

Real Shipments of Durable Goods*



** Shipments of nondefense capital goods excluding aircraft adjusted by the private capital equipment component of the PPI.*

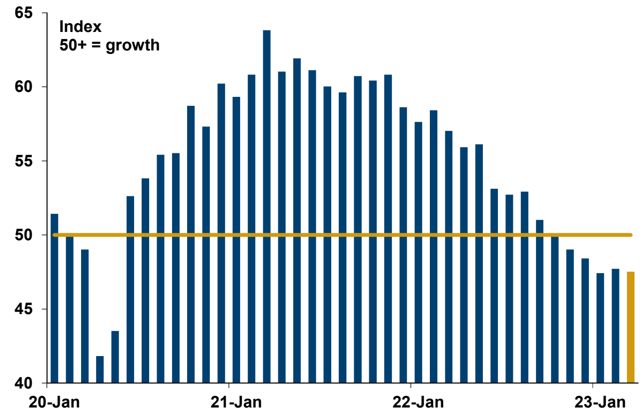
Source: U.S. Census Bureau and Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America

The Week Ahead

ISM Manufacturing Index • (March) • (Monday)
Forecast: 47.5 (-0.2 Index Pt.)

Tight financial conditions have started to weigh on the cyclically sensitive manufacturing sector, as most indicators tied to this area have tilted lower since the Fed embarked on its program of aggressive rate hikes. The ISM manufacturing index has followed suit, falling in 11 of the past 14 month and signaling outright contraction (a reading below 50) since November. With expectations for recession increasing, prospects for a near-term rebound appear limited (chart).

ISM Manufacturing Index*



** The gold bar is a forecast for March 2023.*

Sources: Institute for Supply Management via Haver Analytics; Daiwa Capital Markets America

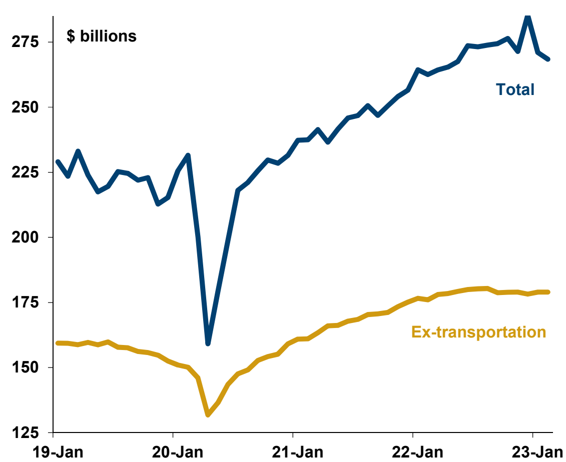
Construction • (February) • (Monday)
Forecast: 0.2%

A pickup in single-family housing starts in February could lessen the expected drag on total construction activity from the residential component, as could a firm nominal performance in multi-family building. Business-related building has trended higher since last summer, as has government-sponsored activity. Available construction price indexes suggest that inflation has boosted nominal activity, but business investment in new structures and investment by state and local governments also have registered real gains in recent months.

Factory Orders • (February) • (Tuesday)
Forecast: -0.7%

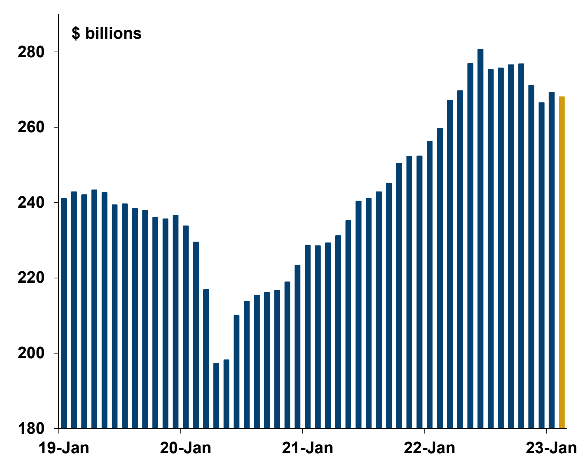
The already reported drop of 1.0 percent in durable goods orders reflected downside volatility in the aircraft component for the second consecutive month. Aircraft orders fell 50.3 percent in the past two months combined after a jump of 82.7 percent in December. Durable orders excluding transportation were flat in February and have tilted lower on balance since last summer (chart, left). Nondurable bookings (the new information in this report) also could be soft, as lower prices could depress the value of petroleum orders. In addition, softness in the factory sector will probably dampen nondurable bookings excluding petroleum (chart, right).

New Orders for Durable Goods



Source: U.S. Census Bureau via Haver Analytics

New Orders for Nondurable Goods*



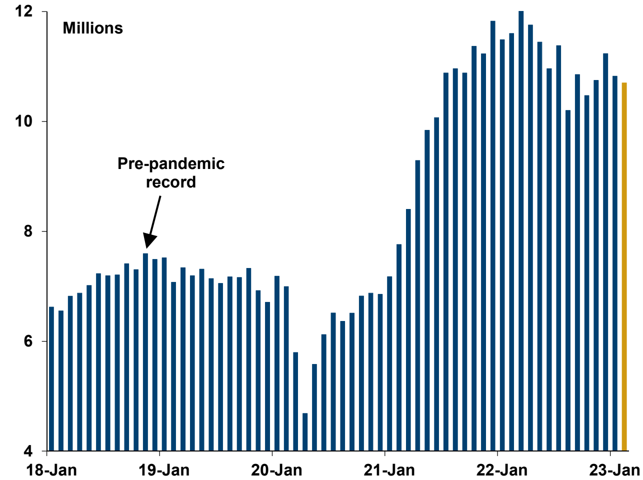
** The reading for February 2023 is a forecast (expected decline of 0.5 percent).*

Sources: U.S. Census Bureau via Haver Analytics; Daiwa Capital Markets America

Job Openings • (February) • (Tuesday)
Forecast: 10.700 million (-1.1 percent)

Job openings, which provide insight into demand for labor, surged after the pandemic to levels that far exceeded all prior observations (the pre-pandemic record was 7.594 million versus the recent high of 12.027 million in March of last year). Openings have eased by approximately 1.2 million since registering the high last March, but the January level suggested that demand remained firm. With certain industries starting to trim payrolls and rethink hiring plans amid increased prospects for recession, the measure could ease in February after a decline of 3.7 percent in the prior month (chart). (Note that data on job openings lag those in the employment report by one month.)

Job Openings*

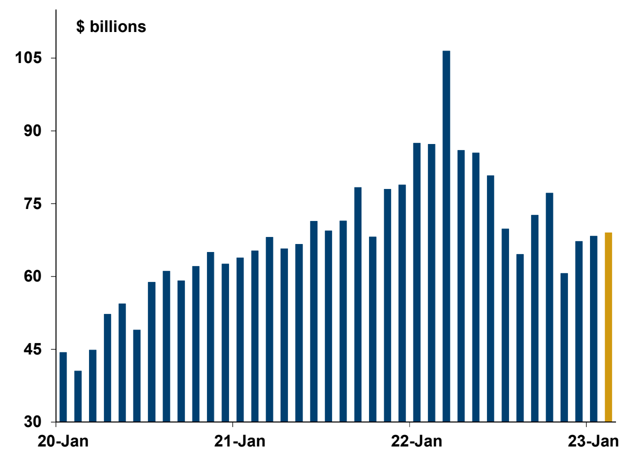


* The reading for February 2023 is a forecast.
Sources: Bureau of Labor Statistics Haver Analytics; Daiwa Capital Markets America

Trade Balance • (February) • (Wednesday)
Forecast: -$69.0 billion ($0.7 billion wider deficit)

The widening of $0.5 billion in the goods deficit (published March 28) is likely to contribute importantly to the expected deterioration in trade flows in February. The surplus in services eased in January after three consecutive increases pushed it to the top of the post-pandemic range, and the still-elevated level of the service surplus raises the possibility of further narrowing in February. Although trade flows have slipped in the past two months, they are close to the average in Q4 of last year, which suggests an approximately neutral influence from net exports on GDP growth in Q1.

Trade Deficit in Goods & Services*

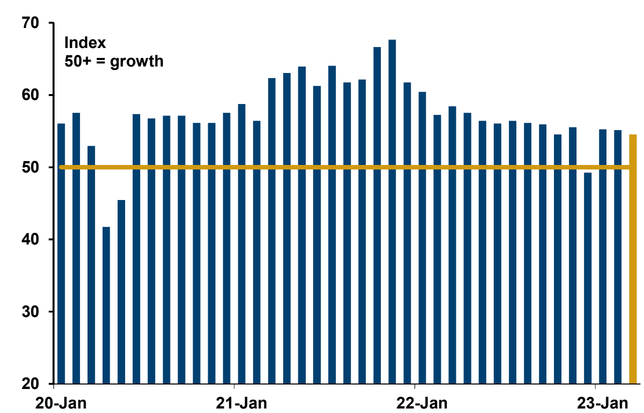


* The reading for February 2023 is a forecast.
Sources: Bureau of Economic Analysis Haver Analytics; Daiwa Capital Markets America

ISM Services Index • (March) • (Wednesday)
Forecast: 54.5 (-0.6 Index Pt.)

Although the ISM services index has held up well in early 2023, the steadying tightening of monetary policy and credit conditions are creating an increasingly challenging business environment. The new orders component looks particularly vulnerable to a correction, as it posted a surprising jump in February to the upper-portion of the range from the current expansion. Keep a close eye on the prices index, which does not contribute to the calculation of the headline. The reading of 65.6 in February is off the recent high of 83.2 in April of last year, but it remained elevated from a longer-term perspective.

ISM Services Index*



* The reading for March 2023 is a forecast.
Sources: Institute for Supply Haver Analytics; Daiwa Capital Markets America

Employment Report • (March) • (Friday)

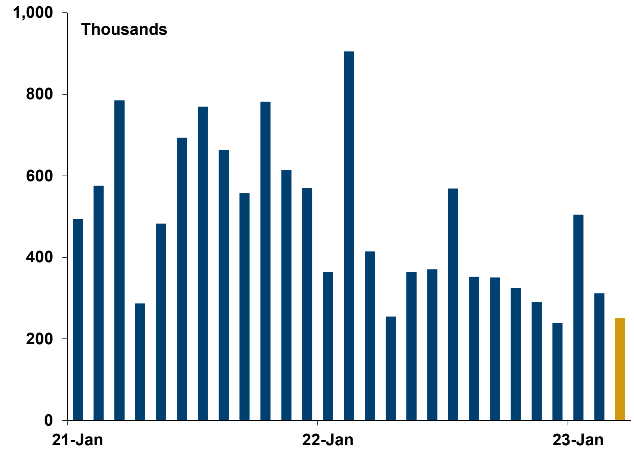
Forecast: 250,000

Low levels of initial claims for unemployment insurance suggest that layoffs have not increased substantially (or that fired workers are quickly finding new opportunities), but increased caution in hiring could leave net job growth below the brisk average of 336,000 in the past six months (including a spike of 504,000 in January).

The unemployment rate rose 0.2 percentage point to 3.6 percent in February, as a jump of 419,000 in the size of the labor force exceeded an increase of 177,000 in employment measured by the household survey. While the employment measure from the household survey could increase from a below average reading in February, new entries into the labor force have been accelerating recently and could again offset employment growth and leave the unemployment rate unchanged at 3.6 percent in March (chart on the labor force, below left).

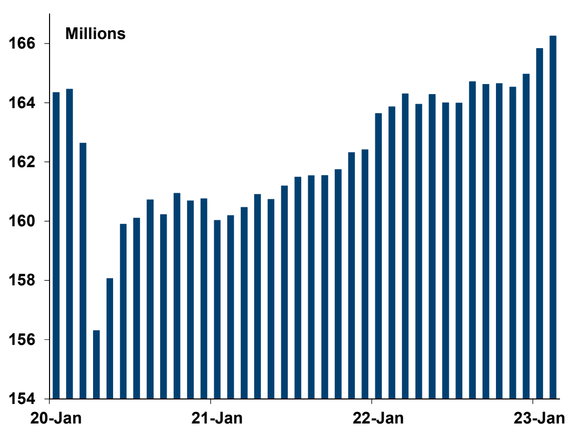
Tightness in the labor market has led to wage growth that Fed officials still characterize as inconsistent with two percent inflation, but average hourly earnings have shown hints of easing in recent months (chart, below right).

Change in Nonfarm Payrolls*



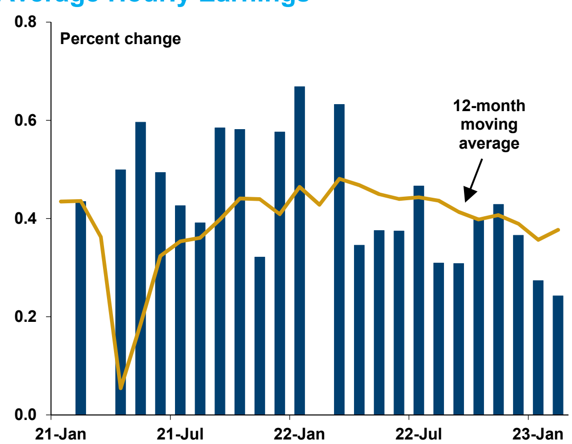
** The reading for March 2023 is a forecast.*
Sources: Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America

Civilian Labor Force



Source: Bureau of Labor Statistics via Haver Analytics

Average Hourly Earnings



Source: Bureau of Labor Statistics via Haver Analytics

Economic Indicators

March/April 2023

Monday	Tuesday	Wednesday	Thursday	Friday
27	28	29	30	31
	INTERNATIONAL TRADE IN GOODS Dec -$89.9 billion Jan -$91.1 billion Feb -$91.6 billion **ADVANCE INVENTORIES** Wholesale / Retail Dec 0.0% / 0.4% Jan -0.5% / 0.1% Feb 0.2% / 0.8% **FHFA HOME PRICE INDEX** Nov -0.1% Dec -0.1% Jan -0.2% **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** Nov -0.5% Dec -0.5% Jan -0.4% **CONFERENCE BOARD CONSUMER CONFIDENCE** Jan 106.0 Feb 103.4 Mar 104.2	**PENDING HOME SALES** Dec 1.1% Jan 8.1% Feb 0.8%	**UNEMP. CLAIMS** Initial / Continuing (millions) Mar 4 0.212 / 1.680 Mar 11 0.192 / 1.685 Mar 18 0.191 / 1.689 Mar 25 0.198 / N/A **REVISED Q4 GDP** GDP / Chained Price 22-Q3 3.2% / 4.4% 22-Q4(p) 2.7% / 3.9% 22-Q4(r) 2.6% / 3.9%	**PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX** Inc. / Cons. / Core Dec 0.3% / 0.0% / 0.4% Jan 0.6% / 2.0% / 0.5% Feb 0.3% / 0.2% / 0.3% **MNI CHICAGO BUSINESS BAROMETER** Index / Prices Jan 44.3 / 72.5 Feb 43.6 / 65.3 Mar 43.8 / 65.6 **REVISED CONSUMER SENTIMENT** Feb 67.0 Mar(p) 63.4 Mar(r) 62.0
3	4	5	6	7
ISM MFG. INDEX (10:00) Index / Prices Jan 47.4 / 44.5 Feb 47.7 / 51.3 **Mar 47.5 / 51.0** **CONSTRUCTION (10:00)** Dec -0.7% Jan -0.1% **Feb 0.2%** **VEHICLE SALES** Jan 15.9 million Feb 14.9 million **Mar 14.9 million**	**FACTORY ORDERS (10:00)** Dec 1.7% Jan -1.9% **Feb -0.7%** **JOLTS DATA (10:00)** Openings (000) / Quit Rate Dec 11,234 / 2.6% Jan 10,824 / 2.5% **Feb 10,700 / 2.5%**	**ADP EMPLOYMENT (8:15)** Private Payrolls Jan 119,000 Feb 242,000 Mar -- **TRADE BALANCE (8:30)** Dec -$67.2 billion Jan -$68.3 billion **Feb -$69.0 billion** **ISM SERVICES INDEX (10:00)** Index / Prices Jan 55.2 / 67.8 Feb 55.1 / 65.6 **Mar 54.5 / 65.0**	**UNEMP. CLAIMS (8:30)**	**EMPLOYMENT REPORT (8:30)** Payrolls / Un. Rate Jan 504,000 / 3.4% Feb 311,000 / 3.6% **Mar 250,000 / 3.6%** ***GOOD FRIDAY***
10	11	12	13	14
WHOLESALE TRADE **CONSUMER CREDIT**	**NFIB SMALL BUSINESS OPTIMISM INDEX**	**CPI** **FEDERAL BUDGET** **FOMC MINUTES**	**UNEMP. CLAIMS** **PPI**	**IMPORT/EXPORT PRICES** **RETAIL SALES** **IP & CAP-U** **BUSINESS INVENTORIES** **CONSUMER SENTIMENT**
17	18	19	20	21
EMPIRE MFG **NAHB HOUSING INDEX** **TIC FLOWS**	**HOUSING STARTS**	**BEIGE BOOK**	**UNEMP. CLAIMS** **PHILADELPHIA FED MFG BUSINESS OUTLOOK** **EXISTING HOME SALES** **LEADING INDICATORS**	

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

Daiwa Capital Markets

Treasury Financing

March/April 2023

Monday	Tuesday	Wednesday	Thursday	Friday
27	28	29	30	31
AUCTION RESULTS: Rate / Cover 13-week bills 4.675% 2.51 26-week bills 4.650% 2.85 2-year notes 3.954% 2.44	**AUCTION RESULTS:** Rate / Cover 7-day CMB 4.050% 2.39 17-day CMB 4.700% 2.04 5-year notes 3.665% 2.48 **ANNOUNCE:** $60 billion 4-week bills for auction on Mar 30 $50 billion 8-week bills for auction on Mar 30 $36 billion 17-week bills for auction on Mar 29 **SETTLE:** $60 billion 4-week bills $50 billion 8-week bills $36 billion 17-week bills	**AUCTION RESULTS:** Rate / Cover 17-week bills 4.780% 2.63 7-year notes 3.626% 2.39 Margin / Cover 2-year FRN 0.190 % 3.51	**AUCTION RESULTS:** Rate / Cover 4-week bills 4.600% 2.63 8-week bills 4.600% 2.47 **ANNOUNCE:** $105 billion 13-,26-week bills for auction on Apr 3 **SETTLE:** $105 billion 13-,26-week bills $30 billion 7-day CMB	**SETTLE:** $45 billion 17-day CMB $42 billion 2-year notes $43 billion 5-year notes $35 billion 7-year notes $12 billion 20-year bonds $22 billion 2-year FRN $15 billion 10-year TIPS
3	4	5	6	7
AUCTION: $105 billion 13-,26-week bills	**ANNOUNCE:** $60 billion* 4-week bills for auction on Apr 6 $50 billion* 8-week bills for auction on Apr 6 $36 billion* 17-week bills for auction on Apr 5 **SETTLE:** $60 billion 4-week bills $50 billion 8-week bills $36 billion 17-week bills	**AUCTION:** $36 billion* 17-week bills	**AUCTION:** $60 billion* 4-week bills $50 billion* 8-week bills **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on Apr 10 $40 billion* 3-year notes for auction on Apr 11 $32 billion* 10-year notes for auction on Apr 12 $18 billion* 30-year bonds for auction on Apr 13 **SETTLE:** $105 billion 13-,26-week bills	***GOOD FRIDAY***
10	11	12	13	14
AUCTION: $105 billion* 13-,26 week bills	**AUCTION:** $40 billion* 3-year notes **ANNOUNCE:** $60 billion* 4-week bills for auction on Apr 13 $50 billion* 8-week bills for auction on Apr 13 $36 billion* 17-week bills for auction on Apr 12 **SETTLE:** $60 billion* 4-week bills $50 billion* 8-week bills $36 billion* 17-week bills	**AUCTION:** $36 billion* 17-week bills $32 billion* 10-year notes	**AUCTION:** $60 billion* 4-week bills $50 billion* 8-week bills $18 billion* 30-year bonds **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on Apr 17 $34 billion* 52-week bills for auction on Apr 18 $12 billion* 20-year bonds for auction on Apr 19 $21 billion* 5-year TIPS for auction on Apr 20 **SETTLE:** $105 billion* 13-,26-week bills	
17	18	19	20	21
AUCTION: $105 billion* 13-,26 week bills **SETTLE:** $40 billion* 3-year notes $32 billion* 10-year notes $18 billion* 30-year bonds	**AUCTION:** $34 billion* 52 week bills **ANNOUNCE:** $60 billion* 4-week bills for auction on Apr 20 $50 billion* 8-week bills for auction on Apr 20 $36 billion* 17-week bills for auction on Apr 19 **SETTLE:** $60 billion* 4-week bills $50 billion* 8-week bills $36 billion* 17-week bills	**AUCTION:** $36 billion* 17 week bills $12 billion* 20-year bonds	**AUCTION:** $60 billion* 4-week bills $50 billion* 8-week bills $21 billion* 5-year TIPS **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on Apr 24 $42 billion* 2-year note for auction on Apr 25 $43 billion* 5-year notes for auction on Apr 26 $35 billion* 7-year notes for auction on Apr 27 $24 billion* 2-year FRN for auction on Apr 26 **SETTLE:** $105 billion* 13-,26 week bills $34 billion* 52 week bills	

**Estimate*