Daiwa Capital Markets

U.S. Economic Comment

- CPI: hints of moderation, but still insufficient to meet price stability mandate
- Inflation data, and comments by Fed officials, suggest no near-term pivot
- Friday data: retail sales & industrial production ease

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CPI: Further Slowing Required

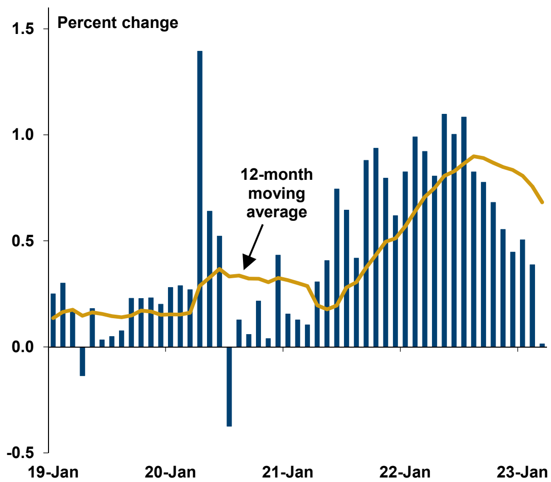
While we observed some encouraging developments in this week's CPI report, we maintain the view that the latest reading on consumer prices does not suggest a pivot to easier monetary policy in the second half of 2023. An additional rate hike of 25 basis points at the early-May FOMC meeting is already priced into market expectations, and more increases could be on the table if inflation does not decelerate meaningfully in coming months.

In the latest CPI release, we were most heartened by the food component, which rounded down to no change in March from the February level (chart, left). Deceleration in food inflation has been striking in the early months of 2023, with the average in Q1 of 0.3 percent (3.7 percent, annual rate) slowing from 0.6 percent (6.9 percent, annual rate) in 2022-Q4 and 0.9 percent (11.7 percent, annual rate) in the first nine months of last year. Given the sharp slowing, it appears safe to conclude that the recent period of brisk food inflation has leveled off.

The sizable decline of 3.5 percent in the energy component was also noteworthy, as prices of energy services fell for the second consecutive month after moving sharply higher in the prior two years. The declines in energy services of 2.3 percent and 1.7 percent in March and February, respectively, were led by drops in the costs of utility natural gas service. Prices of energy commodities (off 4.6 percent) continued on their downward trajectory after peaking last June, with softness in the latest month in part reflecting easing in gasoline prices.

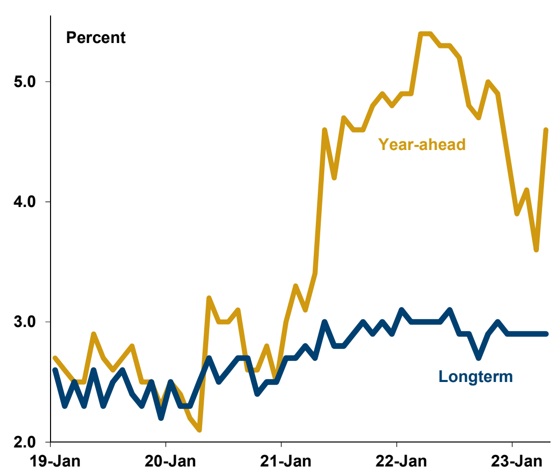
While shifts in the energy component were encouraging, we are more cautious in our assessment of this area. Recession later this year could lead to additional softening in broad energy prices; however, the trend could also shift in the other direction if conflict in Europe escalates (or begins in the Taiwan Strait) or if OPEC+ further curtails oil production. Moreover, moderate advances in retail energy prices run the risk of exercising significant influence on near-term inflation expectations. For example, a pickup in gasoline prices in early

CPI: Food



Source: Bureau of Labor Statistics via Haver Analytics

Consumer Inflation Expectations



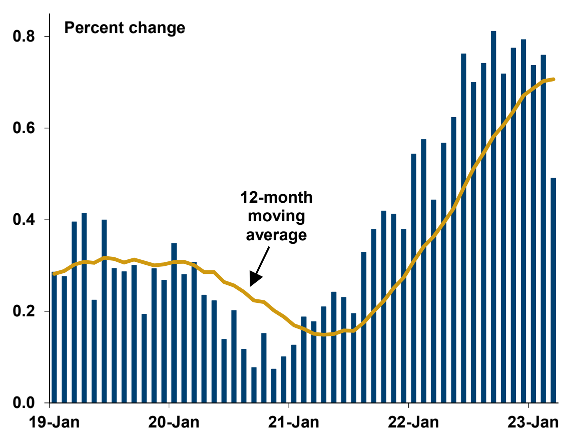
Source: University of Michigan Survey Research Center via Haver Analytics

April led to a reversal of much of the recent softening in the year-ahead inflation measure published by the University of Michigan (chart; prior page, right). Longer-term inflation expectations are still the key focus of Fed officials, and they have remained range-bound, but they could drift higher if short-term readings were to remain persistently elevated.

Other elements of the March inflation report were less impressive. The core CPI rounded up to 0.4 percent, and the three-month annualized growth rate quickened to 5.1 percent from 4.3 percent in Q4. Core goods prices rose moderately (0.2 percent), but much of the restraint was the result of another decline in used vehicle prices (off 14.8 percent since the recent peak in January 2022, but still well-above levels that prevailed prior to the onset of the pandemic). Broadly, core goods prices have flattened out rather than decelerating further.

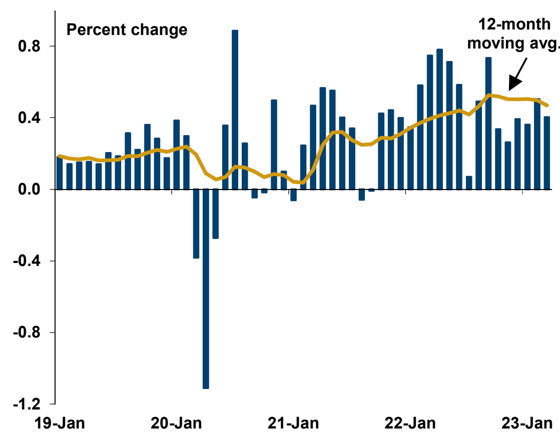
Prices of services excluding energy rose 0.5 percent, a reading in the lower portion of the elevated range of the past year, but still brisk. The costs of shelter have factored significantly into price pressure for more than a year. Rents eased somewhat in March (both rent of primary residence and owners' equivalent rent rose 0.5 percent versus six-month averages of 0.8 percent and 0.7 percent, respectively), but we need to see several months more data before safely concluding that pressure in rents is subsiding (chart, left). Prices of core services other than rents (which is watched closely by Fed officials) ticked lower in March after a high-side reading in the prior month, but it has not decelerated meaningfully from the underlying trend (chart, right). Wages play a key role in driving costs in this area, and officials' expectation (hope) is that prices will moderate further as pressure in the labor market eases. Wage growth has shown signs of slowing in recent employment reports, but more progress is needed.

CPI: Rent of Primary Residence



Source: Bureau of Labor Statistics via Haver Analytics

CPI: Core Services Ex. Housing



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

Underlying Inflation

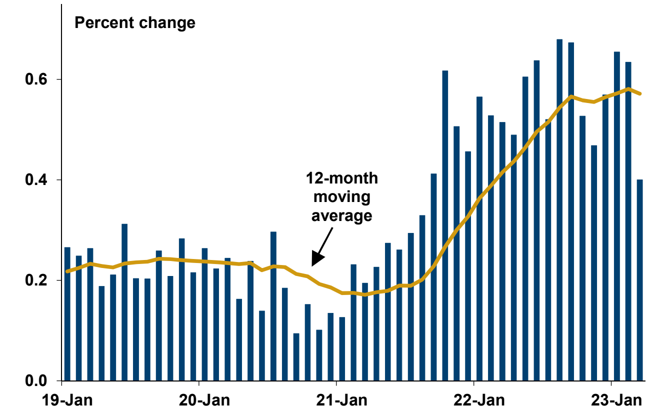
An analysis of the components of the CPIU suggests that broad assessments of inflation should be guarded, as does an analysis of underlying inflation.

We view the median CPI developed by the Federal Reserve Bank of Cleveland as a useful indicator because it shows the change in the middle point of the distribution of price shifts in a given month, exclusive of large shifts at the tails which often reflect special factors or random volatility.

The median CPI rose 0.4 percent in March, slower than the underlying average. Deceleration from here is possible, but we have seen other recent instances where the median has slowed and then jumped again in following months (chart, next page). In addition, the current pace is still inconsistent with two percent inflation.

Our key takeaway on how to interpret recent inflation developments is best summarized by remarks delivered by Fed Governor Christopher Waller this morning: “Whether you measure inflation using the CPI or the Fed’s preferred measure of personal consumption expenditures, it is still much too high and so my job is not done…as of now, monetary policy will need to remain tight for a substantial period of time, and longer than markets anticipate.” (Waller, Christopher. “Financial Stabilization and Macroeconomic Stabilization: Two Tools for Two Problems.” Graybar National Training Conference, 14 April 2023. https://www.federalreserve.gov).

Median CPI

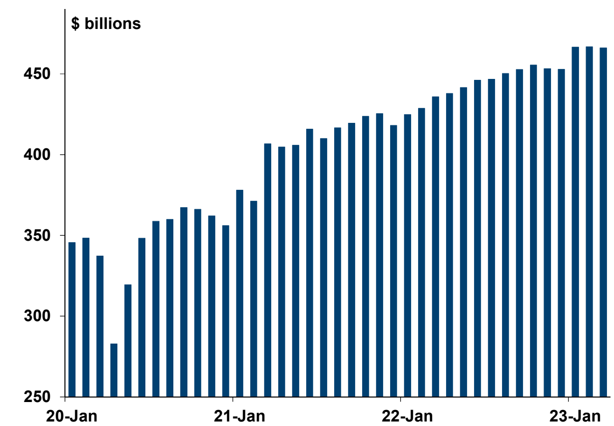


Source: Federal Reserve Bank of Cleveland via Haver Analytics

Today’s Economic Reports

Retail Sales. Today’s report on retail sales for March offered a view on consumer activity in the closing month of Q1. Although the report tilted to the soft side (headline retail sales fell 1.0 percent), a portion of the weakness reflected a drop of 5.5 percent at gasoline stations, which was partially the result of lower prices. Core retail sales were well maintained in the past two months after a spurt in January (chart). More broadly, real consumer spending – supported by a firm labor market and healthy balance sheet – is projected to make a large contribution to GDP growth in Q1. Our expectation of growth of 4.5 percent (annual rate) would be the fastest since the first half of 2021.

Retail Sales: Retail Control Group

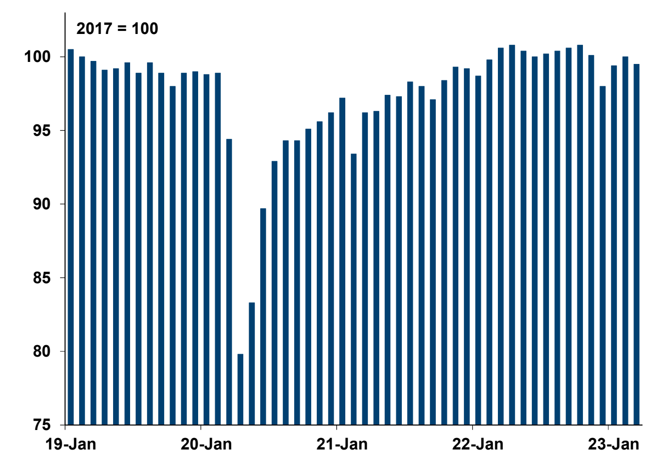


** Retail sales excluding transactions at gasoline stations, motor vehicle and parts dealers, and building materials, garden equipment & supply dealers.*

Source: U.S. Census Bureau via Haver Analytics

Industrial Production. Industrial production rose 0.4 percent in March which was the result of a surge of 8.4 percent in utility output. The shift was likely due to a swing in weather rather than economic fundamentals, as below-average temperatures in March stirred demand for home heating and boosted the component after back-to-back soft months. The manufacturing component was soft (off 0.5 percent), with 12 of 20 major industry groups declining. The change occurred from an upwardly revised level in February, but factory output is still tilting lower since last fall (chart). Mining activity also slipped 0.5 percent. Mining activity in the current expansion appears to have peaked and stalled below pre-COVID levels.

Industrial Production: Manufacturing



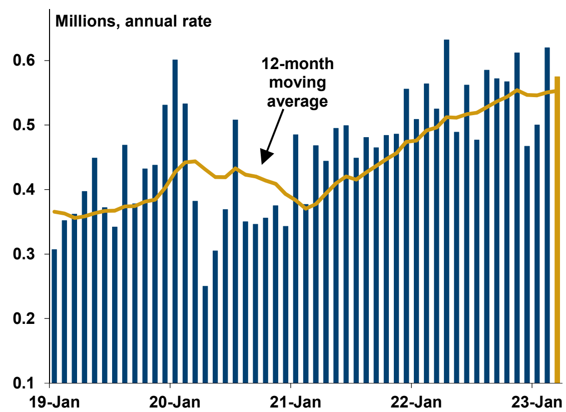
Source: Federal Reserve Board via Haver Analytics

The Week Ahead

Housing Starts (March) (Tuesday)
Forecast: 1.400 Million (-3.4%)

Multi-family housing, which has been a bright spot for the housing sector in a challenging economic environment, has been well supported as preferences of potential homebuyers and renters have shifted toward smaller, more affordable housing units. This firm underlying demand led to a spurt of 24 percent in multi-family housing starts in February, the second highest reading of the current expansion. With a surge in new projects entering the pipeline in the prior month, builders could trim multi-family starts in March (chart, left). Single-family activity also could be soft. Elevated inventories of unsold new homes and sluggish demand suggest that builders could cut single-family starts, maintaining activity near the bottom of the recent range (chart, right).

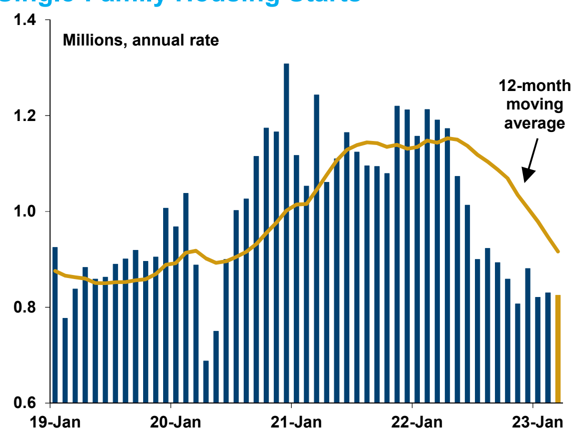
Multi-Family Housing Starts*



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

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

Single-Family Housing Starts*



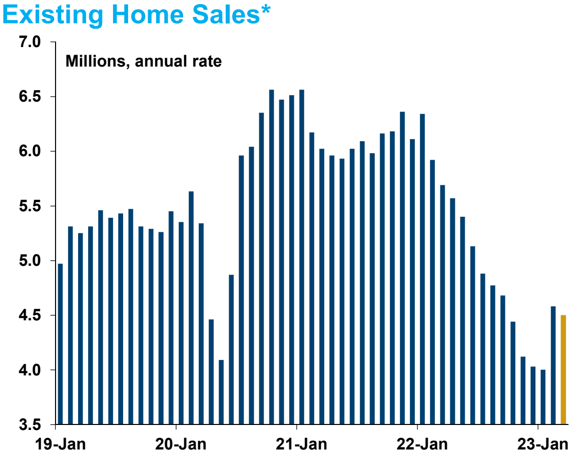
**The gold bar is a forecast for March 2023.*

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

Existing Home Sales (March) (Thursday)
Forecast: 4.500 Million (-1.8%)

Sales of existing homes, which are based on closings rather than contracts signed, jumped 14.5 percent in February in lagged response to transactions occurring around the turn of the year when mortgage interest rates dipped below seven percent. With affordability already presenting a challenge to many prospective buyers, and mortgage rates again drifting higher, sales could resume their downward trend in March (chart, left).

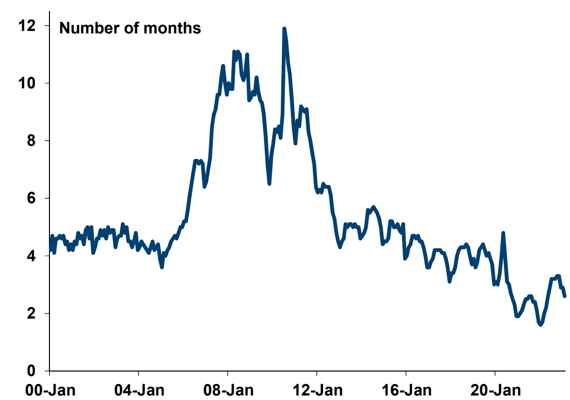
Existing Home Sales*



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

Sources: National Association of Realtors via Haver Analytics; Daiwa Capital Markets America

Months' Supply of Unsold Homes



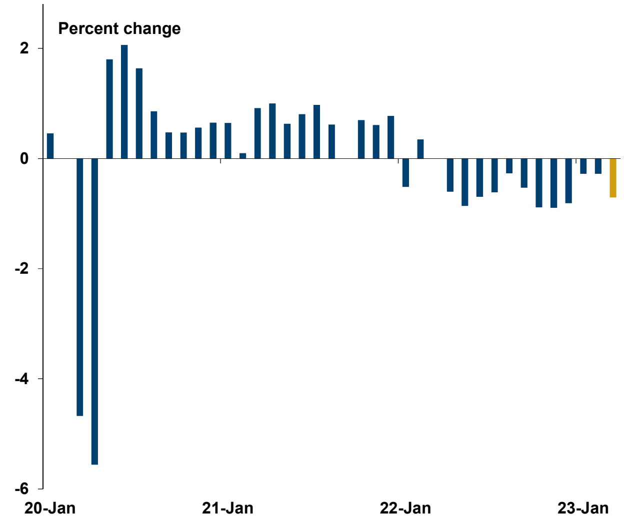
Source: National Association of Realtors via Haver Analytics

The months' supply of existing homes available for sale has remained in the low end of the historical range, supporting elevated prices and limiting available units for prospective buyers (chart; prior page, right).

Leading Indicators (March) (Thursday)
Forecast: -0.7%

Negative contributions from the ISM new orders index, consumer expectations, and unemployment claims appear likely to drag the index of leading economic indicators lower for the 12th consecutive month. If the forecast is realized, the decline would leave the measure 7.3 percent below the cycle high in December 2021.

Index of Leading Economic Indicators*



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

Sources: The Conference Board via Haver Analytics; Daiwa Capital Markets America

Economic Indicators

April/May 2023

Monday	Tuesday	Wednesday	Thursday	Friday
10	11	12	13	14
WHOLESALE TRADE Inventories / Sales Dec 0.0% -0.3% Jan -0.6% 0.4% Feb 0.1% 0.4%	**NFIB SMALL BUSINESS OPTIMISM INDEX** Jan 90.3 Feb 90.9 Mar 90.1	**CPI** Total / Core Jan 0.5% 0.4% Feb 0.4% 0.5% Mar 0.1% 0.4% **FEDERAL BUDGET** 2023 / 2022 Jan -\$38.8B \$118.7B Feb -\$262.4B -\$216.6B Mar -\$378.1B -\$192.6B **FOMC MINUTES**	**UNEMP. CLAIMS** Initial / Continuing (millions) Mar 18 0.247 1.817 Mar 25 0.246 1.823 Apr 1 0.228 1.810 Apr 8 0.239 N/A **PPI** Final Demand / Ex. Food & Energy Jan 0.4% 0.2% Feb 0.0% 0.2% Mar -0.5% -0.1%	**IMPORT/EXPORT PRICES** Non-petrol Imports / Nonagri. Exports Jan 0.3% 0.4% Feb -0.3% 0.3% Mar -0.6% -0.2% **RETAIL SALES** Total / Ex.Autos Jan 3.1% 2.3% Feb -0.2% 0.0% Mar -1.0% -0.8% **IP & CAP-U** IP / Cap.Util. Jan 0.9% 79.5% Feb 0.2% 79.6% Mar 0.4% 79.8% **BUSINESS INVENTORIES** Inventories / Sales Dec 0.2% -0.7% Jan -0.2% 1.2% Feb 0.2% 0.0% **CONSUMER SENTIMENT** Feb 67.0 Mar 62.0 Apr 63.5
17	18	19	20	21
EMPIRE MFG (8:30) Feb -5.8 Mar -24.6 Apr -- **NAHB HOUSING INDEX (10:00)** Feb 42 Mar 44 Apr -- **TIC FLOWS (4:00)** Long-Term / Total Dec \$152.8B \$26.7B Jan \$31.9B \$183.1B Feb -- --	**HOUSING STARTS (8:30)** Jan 1.321 million Feb 1.450 million **Mar 1.400 million**	**BEIGE BOOK (2:00)** **March Beige Book** "Overall economic activity increased slightly in early 2023."	**UNEMP. CLAIMS (8:30)** **PHILLY FED MFG INDEX (8:30)** Feb -24.3 Mar -23.2 Apr -- **EXISTING HOME SALES (10:00)** Jan 4.000 million Feb 4.580 million **Mar 4.500 million** **LEADING INDICATORS (10:00)** Jan -0.3% Feb -0.3% **Mar -0.7%**	
24	25	26	27	28
CHICAGO FED NATIONAL ACTIVITY INDEX	**FHFA HOME PRICE INDEX** **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** **NEW HOME SALES** **CONSUMER CONFIDENCE**	**U.S. INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES** **DURABLE GOODS ORDERS**	**UNEMP. CLAIMS** **Q1 GDP** **PENDING HOME SALES**	**EMPLOYMENT COST INDEX** **PERSONAL INCOME & CONSUMPTION** **REVISED CONSUMER SENTIMENT**
1	2	3	4	5
CONSTRUCTION **ISM MANUFACTURING**	**JOLTS** **FACTORY ORDERS** **VEHICLE SALES** **FOMC (FIRST DAY)**	**ADP EMPLOYMENT** **ISM SERVICES** **FOMC ANNOUNCEMENT**	**UNEMP. CLAIMS** **TRADE BALANCE** **PRODUCTIVITY & COSTS**	**EMPLOYMENT REPORT** **CONSUMER CREDIT**

Forecasts in Bold.

Treasury Financing

April/May 2023

Monday	Tuesday	Wednesday	Thursday	Friday
10	11	12	13	14
AUCTION RESULTS: Rate / Cover 13-week bills 4.980% 2.28 26-week bills 4.795% 2.70	**AUCTION RESULTS:** Rate / Cover 3-year notes 3.810% 2.59 **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 RESULTS:** Rate / Cover 17-week bills 4.980% 2.70 10-yr notes 3.455% 2.36	**AUCTION RESULTS:** Rate / Cover 4-week bills 4.030% 3.08 8-week bills 4.790% 2.52 30-yr bonds 3.661% 2.36 **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 FRNs for auction on Apr 26 **SETTLE:** $105 billion 13-,26-week bills $34 billion 52-week bills	
24	25	26	27	28
AUCTION: $105 billion* 13-,26-week bills	**AUCTION:** $42 billion* 2-year notes **ANNOUNCE:** $60 billion* 4-week bills for auction on Apr 27 $50 billion* 8-week bills for auction on Apr 27 $36 billion* 17-week bills for auction on Apr 26 **SETTLE:** $60 billion* 4-week bills $50 billion* 8-week bills $36 billion* 17-week bills	**AUCTION:** $36 billion* 17-week bills $43 billion* 5-year notes $24 billion* 2-year FRNs	**AUCTION:** $60 billion* 4-week bills $50 billion* 8-week bills $35 billion* 7-year notes **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on May 1 **SETTLE:** $105 billion* 13-,26-week bills	**SETTLE:** $21 billion* 5-year TIPS
1	2	3	4	5
AUCTION: $105 billion* 13-,26-week bills **SETTLE:** $12 billion 20-year bonds $42 billion* 2-year note $43 billion* 5-year notes $35 billion* 7-year notes $24 billion* 2-year FRNs	**ANNOUNCE:** $60 billion* 4-week bills for auction on May 4 $50 billion* 8-week bills for auction on May 4 $36 billion* 17-week bills for auction on May 3 **SETTLE:** $60 billion* 4-week bills $50 billion* 8-week bills $36 billion* 17-week bills	**AUCTION:** $36 billion* 17-week bills **ANNOUNCE:** $40 billion* 3-year notes for auction on May 9 $35 billion* 10-year notes for auction on May 10 $21 billion* 30-year bonds for auction on May 11	**AUCTION:** $60 billion* 4-week bills $50 billion* 8-week bills **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on May 8 **SETTLE:** $105 billion* 13-,26-week bills	

**Estimate*