Daiwa Capital Markets

U.S. Economic Comment

- Monetary policy update: hawkish comments by Powell affirm dot plot projections
- PCE price index: little moderation in underlying inflation
- Personal income & consumption: firm income growth, but spending stalls

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Monetary Policy: Restrictive for Longer

Recently, Chair Powell had several opportunities to adjust the hawkish signal transmitted in the June dot plot, where the median expectation of Fed officials for the federal funds rate shifted to 5.625 percent from 5.125 percent in March. Rather than modify the message, first in the Semiannual Monetary Policy Testimony to Congress two weeks ago and again this week, the Fed Chair reaffirmed the guidance that additional policy increases were likely at upcoming FOMC meetings (we suspect July and September) and that restrictive policy could remain in place for an extended period.

On Wednesday, while appearing on a policy panel at the ECB Forum on Central Banking in Sintra, Portugal, the Fed Chair indicated that additional hikes were likely, and that restrictive policy was needed for some time, commenting: “Although policy is restrictive it may not be restrictive enough and it has not been restrictive for long enough.” He further argued that these hikes could occur at “consecutive meetings.” In a speech on Thursday given at the Banco de Espana Conference on Financial Stability, he reiterated the message, referring to the Summary of Economic Projections from June and noting that “a strong majority of Committee participants expect that it will be appropriate to raise interest rates two or more times by the end of the year.”

We are hopeful that the clear and consistent messaging from the Fed Chair puts aside the need to debate the subtleties of “skips” versus “pauses” and extends the timeframe associated with “data dependence” beyond market participants anxiously awaiting the very next economic release. Policy operates with long and variable lags, and the economy will take time (more than one data cycle) to respond to central bank action. This more definitive guidance has allowed market expectations to shift and interest rates to perhaps better reflect the likely trajectory of monetary policy.

If we were to share one reservation about recent actions by Fed officials, it would be regarding the decision to hold rates steady in June. We are sympathetic the view that policy acts with lags, and that Fed officials want time to assess the cumulative effects of policy tightening thus far, but perhaps hiking in June and July ahead of a pause in the fall would have circumvented any confusion from a very brief interlude before the resumption of hikes. Given the hawkish shift in the dot plot and subsequent comments by Chair Powell, it appears that a hike in June would have both aligned with the views of many policymakers and found easy justification given readings on the labor market and inflation.

May Inflation: Still Brisk

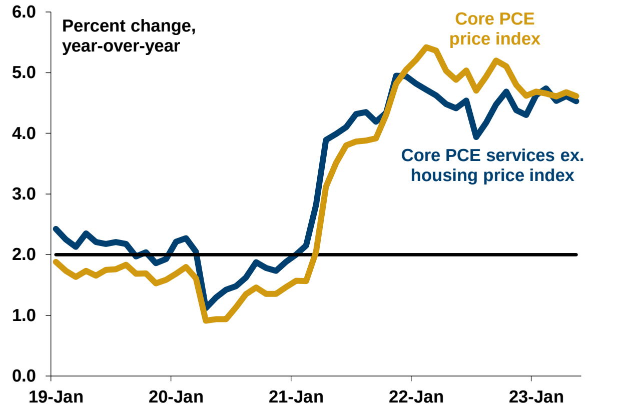
The personal income and consumption report for May, released on Friday, was one of the most anticipated of the week as it provided an update on Fed officials’ preferred inflation gauge – the price index for personal consumption expenditures. The inflation data were in line with market expectations, as the headline PCE index increased 0.1 percent and the core index rose 0.3 percent. The changes translated to a year-over-year advance of 3.8 percent in the headline measure (down from 4.3 percent in April) and 4.6 percent in the core (versus 4.7 percent in April).

Although energy prices fell (off 3.9 percent) and food prices were restrained (up 0.1 percent), the advance in the core was close to the brisk underlying average of 0.4 percent in the prior 12 months. Prices of used motor vehicles surged 4.5 percent for the second consecutive month after discounting in the prior nine months, and the rental components remained on their firm trajectory as rents of tenant-occupied housing and imputed rents of owner-occupied housing both rose 0.5 percent.

The so-called "super-core" index that tracks service inflation excluding energy services and housing services garnered some attention, as the month-to-month increase decelerated to 0.2 percent in May after averaging 0.4 percent per month in the prior 12-months. Labor costs factor importantly into non-housing service costs, and slowing advances in this index could be a signal that labor-market conditions are loosening and wage pressure is starting to abate.

We would be cautious in reading too much into the latest reading, however. Fed officials have indicated that they are continuing to monitor this inflation metric while also clarifying that they need to see compelling evidence of slowing. When viewed from a longer-term perspective, the measure of core services excluding housing – like the core PCE price index – has shown scant evidence of trending toward the Fed's inflation target (chart, right). The data give further support to Chair Powell's hawkish rhetoric this week.

Core Inflation Measures*



** The horizontal line is the Federal Reserve's long-term inflation target.*
Sources: Federal Reserve Board; Bureau of Economic Analysis via Haver Analytics

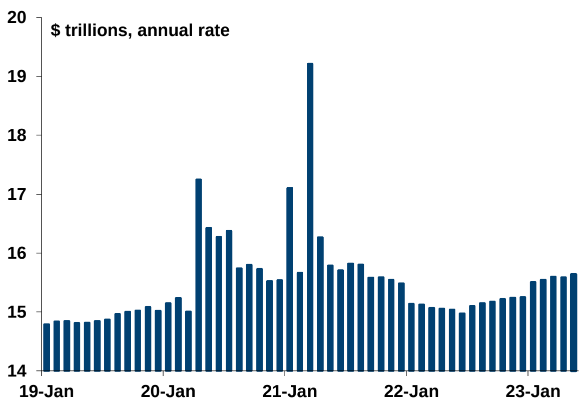
A View on Consumer Spending

While today's inflation data likely drew significant attention, we also received important information on the performance of the consumer in Q2. Nominal personal income rose 0.4 percent, with firm support from a jump of 0.5 percent in wages and salaries. The advance held after adjusting for inflation, as real disposable income increased 0.3 percent. Disposable personal income has been elevated recently, which signals continued near-term support to consumer spending (chart, left).

While the income data were positive, real consumer spending slipped fractionally (-0.026 percent) after a downward adjusted increase of 0.2 percent in April. The results thus far suggest consumer spending in the GDP accounts in Q2 is less than 1.0 percent after a burst in Q1. In other words, the consumer has been active in the current expansion thus far, but the latest data suggest a loss of momentum (chart, right).

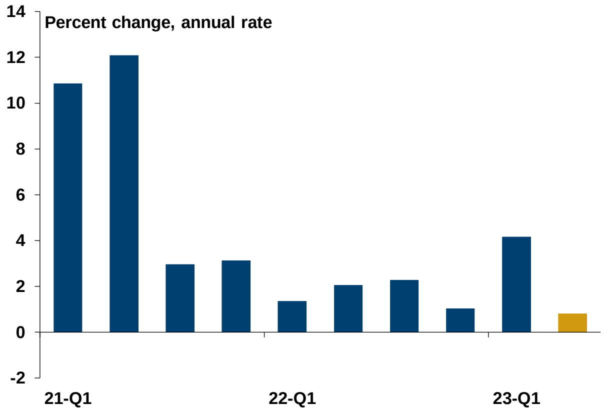
While the consumer spending data still point to growth in Q2, challenges are likely to intensify. Income growth could falter as the labor market softens, access to credit could be limited as banks tighten lending standards, and recent research suggests that a large portion of pandemic-related savings has been utilized (see last week's newsletter). Moreover, student loan payments are set to resume in coming months and the Supreme Court today struck down the Biden Administration's attempts to forgive a significant portion of federal student loan debt. We maintain that these factors could tip consumer spending into contraction in coming months.

Real Disposable Personal Income



Source: Bureau of Economic Analysis via Haver Analytics

Growth in Real Consumer Spending*



** The observation for 23-Q2 is based on results for real consumer spending in April and May.*
Sources: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

The Week Ahead

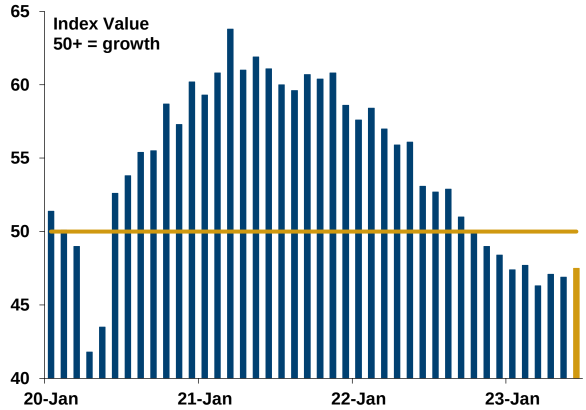
Construction Spending (May) (Monday)
Forecast: 0.8 percent

A jump in housing starts in May suggests that private residential construction could be turning a corner, while business-related and government-sponsored activity have been on firm upward trends since the summer of 2022. Moreover, available construction price indexes suggest that recent nominal gains in business and government construction likely translated to increases in real activity.

ISM Manufacturing Index (June) (Monday)
Forecast: 47.5 (+0.6 index point)

With many indicators tied to the manufacturing sector signaling a slowdown, and with prospects rising for a prolonged period of restrictive monetary policy, a near-term rebound in the ISM manufacturing seems unlikely in June. If the forecast is realized, June would mark the eighth consecutive sub-50 reading for the factory gauge.

ISM Manufacturing Index*



** The gold bar is a forecast for June 2023.*
Sources: Institute for Supply Management via Haver Analytics; Daiwa Capital Markets America

Factory Orders (May) (Wednesday)
Forecast: 0.3 percent

The jump of 1.7 percent in durable goods orders in May (reported on June 27) reflected in part an advance of 9.9 percent in the transportation category. Durable bookings excluding transportation rose 0.6 percent, but the advance merely offset a similar decline in April. Orders ex-transportation have moved sideways since last summer. Nondurable bookings (the new information in the factory orders report) could ease for the fifth consecutive month. Lower prices appear likely to depress the value of petroleum-related orders, while soft conditions in the factory sector could constrain orders for nondurable goods excluding petroleum.

Trade Balance (May) (Thursday)
Forecast: -$68.5 billion

The narrowing of $6.0 billion in the goods deficit (published June 27) is likely to translate to similar improvement in the overall trade deficit in May. The surplus in service trade has trended higher since last fall with a net increase of $2.8 billion since September 2022.

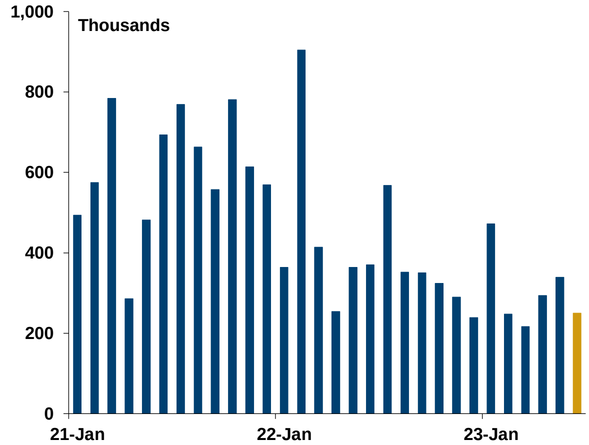
ISM Services Index (June) (Thursday)
Forecast: 51.5 (+1.2 index points)

The service sector of the economy has proved resilient to aggressive tightening by the Fed, although it has slowed since early 2023, including a reading only marginally above 50 in May. We suspect the degree of weakness was overstated to a degree, as the employment index fell to 49.2 in May despite brisk payroll growth. A modest rebound could nudge the headline services index high in the latest month, although we expect it to remain below the Q1 average of 53.8 and well off the 2022 average of 56.1.

Payroll Employment (June) (Friday)
Forecast: 250,000

Upward movement in initial claims for unemployment insurance suggest that payroll growth could lag the average of 314,000 in the first five months of the year, although elevated levels of job openings suggest that demand for labor remains relatively firm.

Change in Nonfarm Payrolls*



** The gold bar is a forecast for June 2023.*
Source: Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America

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Economic Indicators

June/July 2023

Monday	Tuesday	Wednesday	Thursday	Friday
26	27	28	29	30
	DURABLE GOODS ORDERS Mar 3.3% Apr 1.2% May 1.7% FHFA HOME PRICE INDEX Feb 0.9% Mar 0.5% Apr 0.7% S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX Feb 0.0% Mar 0.4% Apr 0.9% NEW HOME SALES Mar 0.657 million Apr 0.680 million May 0.763 million CONFERENCE BOARD CONSUMER CONFIDENCE Apr 103.7 May 102.5 June 109.7	INTERNATIONAL TRADE IN GOODS Mar -$82.5 billion Apr -$97.1 billion May -$91.1 billion ADVANCE INVENTORIES Wholesale / Retail Mar -0.2% 0.4% Apr -0.3% 0.3% May -0.1% 0.8%	UNEMPLOYMENT CLAIMS Initial / Continuing (millions) June 3 0.262 1.772 June 10 0.264 1.761 June 17 0.265 1.742 June 24 0.239 N/A REVISED GDP GDP / Chained Price 22-Q4 2.6% 3.9% 23-Q1(p) 1.3% 4.2% 23-Q1(r) 2.0% 4.1% PENDING HOME SALES Mar -5.2% Apr -0.4% May -2.7%	PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX Inc. / Cons. / Core Mar 0.4% 0.1% 0.3% Apr 0.3% 0.6% 0.4% May 0.4% 0.1% 0.3% MNI CHICAGO BUSINESS BAROMETER Index / Prices Apr 48.6 70.3 May 40.4 60.9 June 41.5 53.5 REVISED CONSUMER SENTIMENT May 59.2 June(p) 63.9 June(r) 64.4
3	4	5	6	7
CONSTRUCTION (10:00) Mar 0.3% Apr 1.2% **May 0.8%** ISM MFG. INDEX (10:00) Index / Prices Apr 47.1 53.2 May 46.9 44.2 **June 47.5 45.0** VEHICLE SALES Apr 16.1 million May 15.0 million **June 15.4 million**	INDEPENDENCE DAY	FACTORY ORDERS (10:00) Mar 0.6% Apr 0.5% **May 0.3%** FOMC MINUTES (2:00)	UNEMP. CLAIMS (8:30) ADP EMPLOYMENT (8:15) Private Payrolls Apr 291,000 May 278,000 June -- TRADE BALANCE (8:30) Mar -$60.6 billion Apr -$74.6 billion **May -$68.5 billion** JOLTS DATA (10:00) Openings (000) / Quit Rate Mar 9.745 2.5% Apr 10,103 2.4% May -- -- ISM SERVICES INDEX (10:00) Index / Prices Apr 51.9 59.6 May 50.3 56.2 **June 51.5 55.0**	EMPLOYMENT REPORT (8:30) Payrolls / Un. Rate Apr 294,000 3.4% May 339,000 3.7% **June 250,000 3.7%**
10	11	12	13	14
WHOLESALE TRADE CONSUMER CREDIT	NFIB SMALL BUSINESS OPTIMISM INDEX	CPI BEIGE BOOK	UNEMP. CLAIMS PPI FEDERAL BUDGET	IMPORT/EXPORT PRICES CONSUMER SENTIMENT
17	18	19	20	21
EMPIRE MFG	RETAIL SALES IP & CAP-U BUSINESS INVENTORIES NAHB HOUSING INDEX TIC FLOWS	HOUSING STARTS	UNEMP. CLAIMS PHILLY FED INDEX EXISTING HOME SALES LEADING INDICATORS	

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

Treasury Financing

June/July 2023

Monday	Tuesday	Wednesday	Thursday	Friday
26	27	28	29	30
AUCTION RESULTS: 13-week bills 5.180% 2.99 26-week bills 5.215% 2.73 2-yr notes 4.670% 2.86	**AUCTION RESULTS:** 5-yr notes 4.019% 2.52 42-day CMBs 5.105% 2.79 **ANNOUNCE:** $70 billion 4-week bills for auction on June 29 $60 billion 8-week bills for auction on June 29 $46 billion 17-week bills for auction on June 28 **SETTLE:** $70 billion 4-week bills $60 billion 8-week bills $46 billion 17-week bills	**AUCTION RESULTS:** Rate Cover 17-week bills 5.225% 3.44 7-yr notes 3.839% 2.65 Margin Cover 2-yr FRNs 0.134% 3.39	**AUCTION RESULTS:** Rate Cover 4-week bills 5.085% 2.53 8-week bills 5.190% 2.61 **ANNOUNCE:** $123 billion 13-,26-week bills for auction on July 3 $50 billion 42-day CMBs for auction on July 3 **SETTLE:** $123 billion 13-,26-week bills $50 billion 42-day CMBs	**SETTLE:** $12 billion 20-year bonds $19 billion 5-year TIPS $42 billion 2-year notes $43 billion 5-year notes $35 billion 7-year notes $22 billion 2-year FRNs
3	4	5	6	7
AUCTION: $123 billion 13-,26-week bills $50 billion 42-day CMBs **ANNOUNCE:** $$70 billion* 4-week bills for auction on July 6 $60 billion* 8-week bills for auction on July 6 $46 billion* 17-week bills for auction on July 5	**INDEPENDENCE DAY**	**AUCTION:** $46 billion* 17-week bills **SETTLE:** $70 billion 4-week bills $60 billion 8-week bills $46 billion 17-week bills	**AUCTION:** $70 billion* 4-week bills $60 billion* 8-week bills **ANNOUNCE:** $123 billion* 13-,26-week bills for auction on July 10 $38 billion* 52-week bills for auction on July 11 $40 billion* 3-year notes for auction on July 11 $32 billion* 10-year notes for auction on July 12 $18 billion* 30-year bonds for auction on July 13 **SETTLE:** $123 billion 13-,26-week bills $50 billion 42-day CMBs	
10	11	12	13	14
AUCTION: $123 billion* 13-,26-week bills	**AUCTION:** $38 billion* 52-week bills $40 billion* 3-year notes **ANNOUNCE:** $70 billion* 4-week bills for auction on July 13 $60 billion* 8-week bills for auction on July 13 $46 billion* 17-week bills for auction on July 12 **SETTLE:** $70 billion* 4-week bills $60 billion* 8-week bills $46 billion* 17-week bills	**AUCTION:** $46 billion* 17-week bills $32 billion* 10-year notes	**AUCTION:** $70 billion* 4-week bills $60 billion* 8-week bills $18 billion* 30-year bonds **ANNOUNCE:** $123 billion* 13-,26-week bills for auction on July 17 $12 billion* 20-year bonds for auction on July 19 $17 billion* 10-year TIPS for auction on July 20 **SETTLE:** $123 billion* 13-,26-week bills $38 billion* 52-week bills	
17	18	19	20	21
AUCTION: $123 billion* 13-,26-week bills **SETTLE:** $40 billion* 3-year notes $32 billion* 10-year notes $18 billion* 30-year bonds	**ANNOUNCE:** $70 billion* 4-week bills for auction on July 20 $60 billion* 8-week bills for auction on July 20 $46 billion* 17-week bills for auction on July 19 **SETTLE:** $70 billion* 4-week bills $60 billion* 8-week bills $46 billion* 17-week bills	**AUCTION:** $46 billion* 17-week bills $12 billion* 20-year bonds	**AUCTION:** $70 billion* 4-week bills $60 billion* 8-week bills $17 billion* 10-year TIPS **ANNOUNCE:** $123 billion* 13-,26-week bills for auction on July 24 $42 billion* 2-year notes for auction on July 24 $43 billion* 5-year notes for auction on July 25 $35 billion* 7-year notes for auction on July 27 $24 billion* 2-year FRNs for auction on July 26 **SETTLE:** $123 billion* 13-,26-week bills	

*Estimate