U.S. Economic Comment

- Inflation: June data (CPI, import prices) suggest deceleration, but more work to be done
- Import prices: ally in fight against domestic inflation
- Consumer inflation expectations: modest deterioration, but contained

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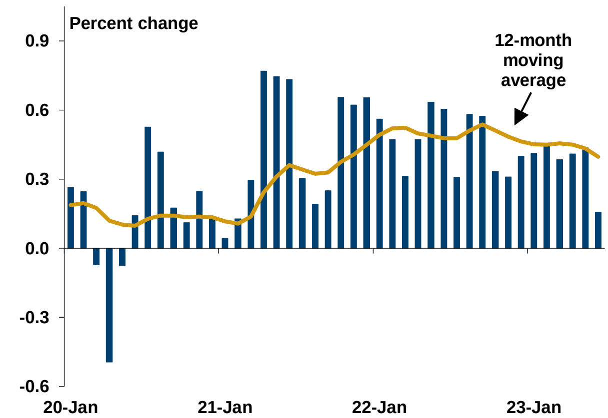
Inflation: Notable Developments, but Additional Policy Firming Likely

The barrage of price-related data released this week offered encouraging news in the fight against entrenched inflation. Most notably, the CPI for June printed below market expectations, with both the headline and core indexes increasing 0.2 percent versus the anticipated increases of 0.3 percent (chart, left). The year-over-year change in the headline CPI eased one percentage point to 3.0 percent, the slowest advance since the spring of 2021, while the increase in the core moderated to 4.8 percent from 5.3 percent (chart, right). Prices of core services excluding housing, an area of persistently sticky inflation that is being monitored closely by Fed officials, was unchanged month-over-month (a dip with less rounding), and the year-over-year change decelerated to 4.0 percent from 4.6 percent in May and a recent high of 6.5 percent in September 2022 (chart, right).

In the wake of the favorable report, multiple Fed officials moved to acknowledge the restrained reading but emphasized that there is more work to do to return inflation to two percent. Fed Governor Christopher Waller, whom we view as an important voice on the Federal Open Market Committee, offered in a speech yesterday evening that, “One data point does not make a trend.” In noting that labor market conditions remained tight and that the economy was still on a growth track he reaffirmed his June forecast calling for additional increases in the federal funds rate: “I see two more 25-basis-point hikes in the target range over the four remaining meetings this year as necessary to keep inflation moving toward our target. Furthermore, I believe we will need to keep policy restrictive for some time in order to have inflation settle down around our two percent target.” (Governor Christopher J. Waller, July 13, 2023, Big Shocks Travel Fast: Why Policy Lags May Be Shorter Than You Think. https://www.federalreserve.gov/newsevents/speech/waller20230713a.htm).

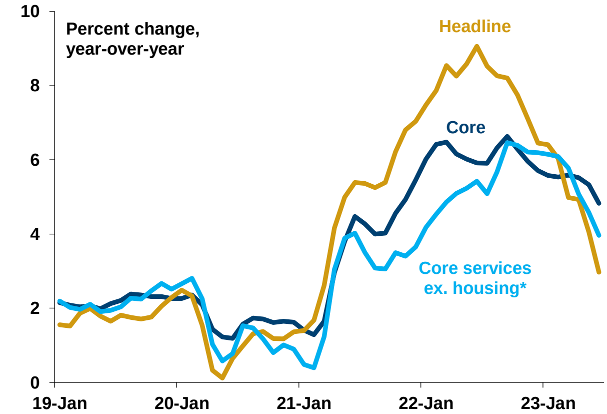
In context, Waller’s comments and those of his colleagues suggest little change in the trajectory of policy transmitted at the June FOMC meeting. The Fed Governor intimated during the post-speech Q&A session that a hike in July is highly likely -- and the implied probability of more than 95 percent suggested by futures markets supports that view -- and that upcoming meetings beyond July were “live.” The trajectory of incoming data will dictate the path of policy in coming months.

Core CPI



Source: Bureau of Labor Statistics via Haver Analytics

CPI



* Services excluding energy services and housing services. The index is calculated by Haver Analytics.

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

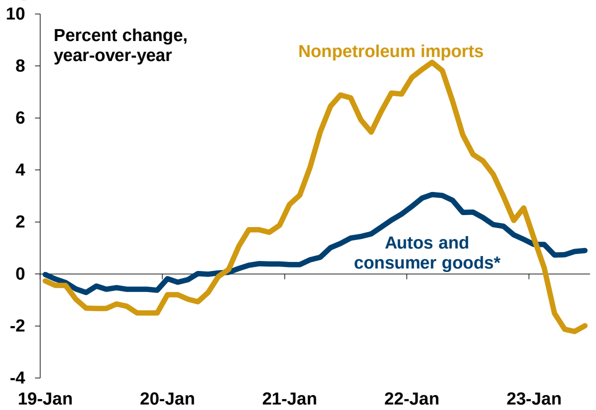
Import Prices: Disinflationary Impulse

Prices of imported goods represent another source of domestic disinflation that could aid the broader fight in the return to price stability. Headline import prices have fallen in 10 of the past 12 months (including a dip of 0.2 percent in June; -6.1 percent year-over-year), as healing in supply chains from acute congestion during the early stages of the pandemic and declines in energy prices after a spike in early 2022 at the onset of Russia's invasion of Ukraine have contributed importantly to the cooling.

We are most interested in the prices of imported goods excluding petroleum, as these are less volatile than energy prices and can factor significantly into direct costs for consumers. In a sign of softening, prices of nonpetroleum imports fell for the fifth consecutive month (-0.3 percent in June; -2.0 percent year-over-year). Focusing more closely on costs for consumers, an index of autos and consumer goods has increased a modest 0.1 percent per month in the past eight months (0.9 percent year-over-year; chart, below left).

The restrained performance in import prices could persist for some time, further aiding the fight against inflation. While off recent highs, the foreign exchange value of the dollar remains firm relative to the currencies of major trading partners (chart, below right). Additionally, foreign firms likely are controlling prices and sacrificing higher margins to maintain their market share in the United States, developments favorable to domestic inflation.

Import Prices



** The index of autos and consumer goods is calculated by Daiwa Capital Markets America using import shares of these goods into the United States.*

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

Trade-Weighted Dollar Index*

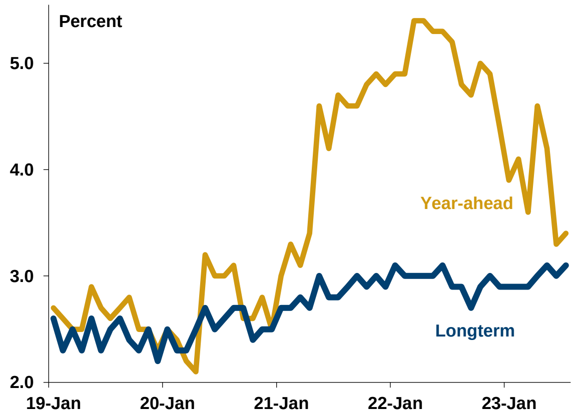
** Advanced foreign economies. Weekly data series that goes through Friday July 7, 2023.*

Source: Federal Reserve Board via Haver Analytics

Inflation Expectations

Two key sets of data on consumer inflation expectations were released this week, with June results from the New York Fed's Survey of Consumer Expectations and July readings from the University of Michigan Survey of Consumers offering broadly similar views: near-term expectations are off highs, but they have yet to return to low pre-pandemic levels, and longer-term views have slipped but are still consistent with well-anchored inflation in the medium term. Regarding the New York Fed Survey, the median year-ahead measure eased to 3.83 percent in June from 4.07 percent, down from the recent high of 6.78 percent in June 2022 but still tracking above readings centered around 2.5 percent in 2019-H2. The median three-year-ahead measure dipped three basis points to 2.95 percent – off the peak of 4.21 percent in October 2021 but also tracking above readings of approximately 2.5 percent in the second half of 2019 and early 2020. The Michigan data released

Consumer Inflation Expectations

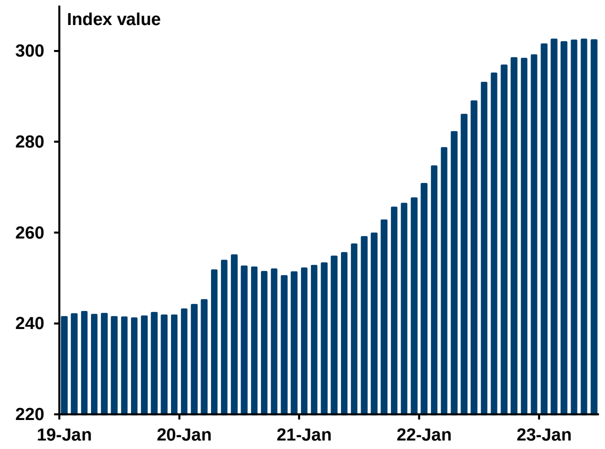


Source: University of Michigan via Haver Analytics this morning recorded year-ahead and longer-term inflation expectations for July that were both 0.1 percentage point higher than the June readings at 3.4 percent and 3.1 percent, respectively. The short-term measure is still among the lowest readings since the spring of 2021, while the longer-term reading moved to the upper end of the recent range (chart; prior page).

We view positively Fed officials' characterization of longer-term expectations as generally well-anchored. However, we suspect that inflation expectations over the next year or so are still influenced negatively by previous surges in the costs of household essentials even as inflation has more recently leveled off -- the dramatic shift in price levels left some costs markedly higher than they were a few years ago. A good illustration of this is the cost of food. The chart below (left) shows the food at home component of the CPI (i.e. groceries; a subset of the food component that excludes restaurant meals). One can view the index, which makes up approximately 8.6 percent of the basket of goods and services in the CPI, as the "cost" of a trip to the grocery store. Notably, while the index (costs) has tilted lower recently, it is still well-above levels of just a few years ago. On a more encouraging front, month-to-month shifts in this area have declined on average in the past four months (-0.1%), with the year-over-year increase tilting lower (chart, below right). A sharper deceleration in the finished consumer foods component of the PPI (a narrower subset of wholesale food prices that exclude prices of foods for export and prices of government-purchased foods) suggests additional cooling in price pressure at grocery stores in the months ahead.

The recent downward tilt in costs of essentials will have an impact on inflation expectations slowly, leaving open the possibility of near-term upward drift in measures of inflation expectations. However, with Fed officials laser-focused on a return to two-percent, and actual inflation showing signs of deceleration and wages slowly catching up, we can foresee inflation expectations returning to pre-pandemic norms over the next year or two. Consumer views will ultimately readjust to expect low, stable inflation, which will contribute to actual maintenance of low inflation.

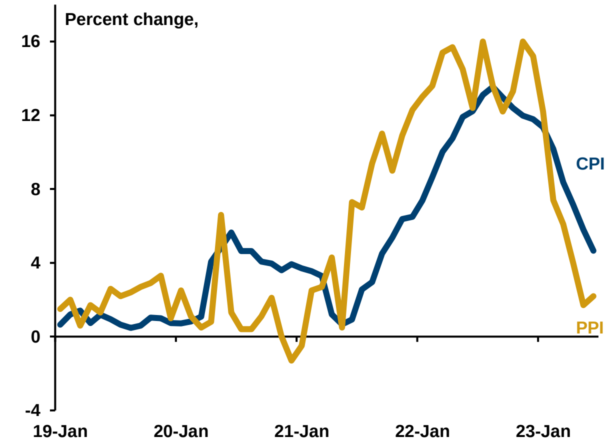
CPI: Food at Home



** The Food at Home area makes up approximately two thirds of the broad Food component of the CPI.*

Source: Bureau of Labor Statistics via Haver Analytics

Food Price Inflation*



** The CPI measure refers to the food at home index while the PPI measure refers to the finished consumer foods index (a component of the broad Final Demand Foods area).*

Sources: Bureau of Labor Statistics via Haver Analytics

The Week Ahead

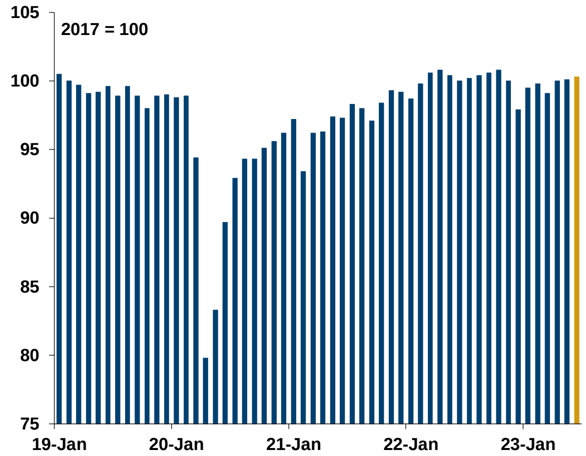
Retail Sales (June) (Tuesday)
Forecast: 0.5% Total, 0.1% Ex. Autos, 0.3% Ex. Autos and Gas

Available data on new vehicle transactions suggest an increase in the auto component of the retail sales report in June as expanded supply likely allowed buyers to replace aging vehicles, but lower prices after seasonal adjustment could depress the value of activity at gasoline service stations. Elevated prices after recent brisk inflation and an ongoing shift towards spending on services could constrain sales excluding autos and gasoline.

Industrial Production (June) (Tuesday)
Forecast: 0.0% Total, 0.2% Manufacturing

A pickup in factory sector employment in June suggests that the manufacturing component of industrial production could increase for the third consecutive month, although the index is likely to remain below the recent peak last fall (chart, right). Other components could provide an offset and leave total industrial production unchanged. A drop in the rotary rig count spurred by lower petroleum and gas prices suggests a decline in the mining component. In addition, available data on weather conditions (below-average temperatures) and home cooling usage suggest a drop in the utility component, which would be the fifth in the past six months.

Industrial Production: Manufacturing*

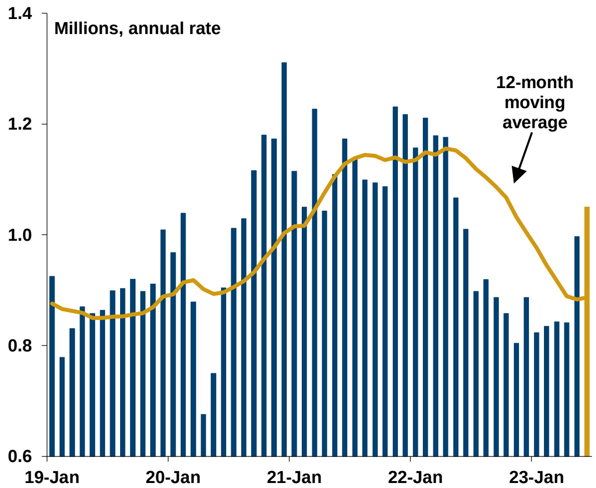


** The gold bar is a forecast for June 2023.*
Sources: Federal Reserve Board via Haver Analytics; Daiwa Capital Markets America

Housing Starts (June) (Wednesday)
Forecast: 1.600 Million (-1.9%)

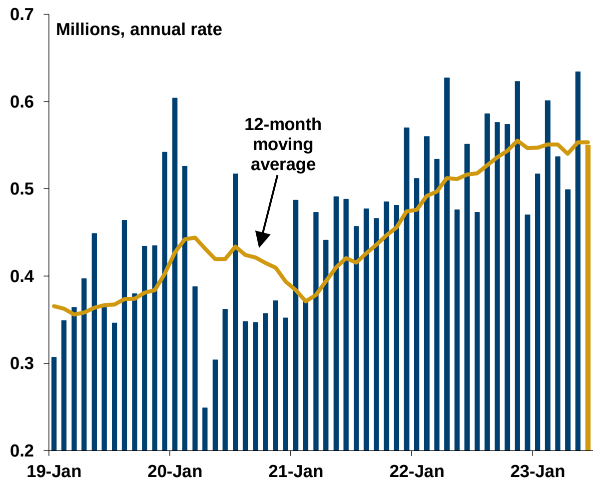
Recent increases in new home sales and a jump in single-family building permits suggest that single-family housing starts in June could increase again after surging 18.6 percent to 0.997 million in May (chart, below left). Multi-family activity also jumped in May to a new cycle high (+27.1 percent to 0.634 million), but this area is often volatile from month-to-month and permit issuance in the low end of the recent range suggests some cooling in June (chart, below right).

Single-Family Housing Starts*



** The gold bar is a forecast for June 2023.*
Sources: U.S. Census Bureau via Haver Analytics; Daiwa Capital Markets America

Multi-Family Housing Starts*

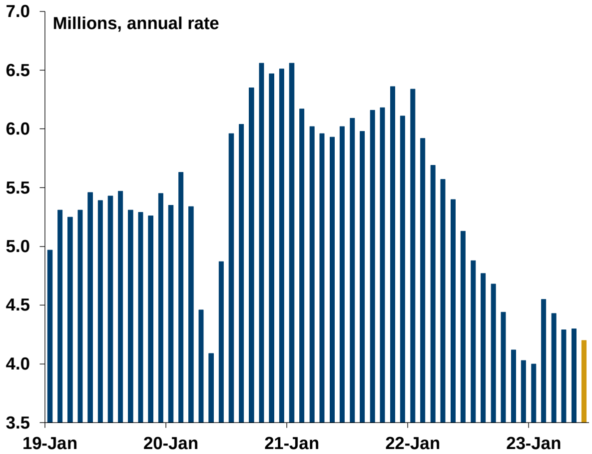


** The gold bar is a forecast for June 2023.*
Sources: U.S. Census Bureau via Haver Analytics; Daiwa Capital Markets America

Existing Home Sales (June) (Thursday)
Forecast: 4.20 Million (-2.3%)

Although the housing market has shown signs of life in recent months, the stirring has been concentrated in the market for new homes. Sales of existing homes failed to gain similar traction, declining in two of the past three months (and increasing only marginally in the other) after a jump in February. High prices and tight inventories could constrain activity again in June, a view supported by recent declines in the index of pending home sales (charts below).

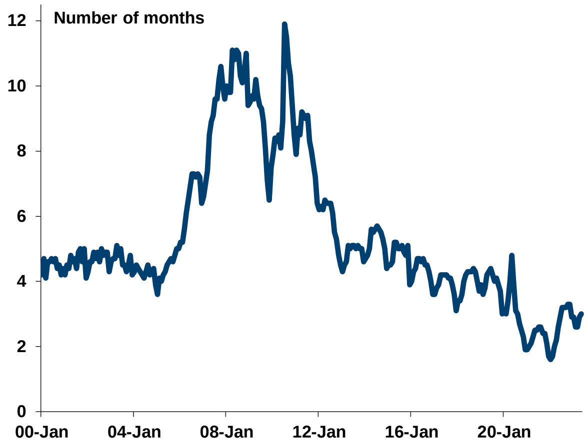
Existing Home Sales*



** The gold bar is a forecast for June 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

Leading Indicators (June) (Thursday)
Forecast: -0.6%

Expected negative contributions from the ISM new orders index, consumer expectations, and the slope of the yield curve suggest that the Conference Board's index of leading economic indicators is likely to decline for the 15th consecutive month. If the forecast is realized, the index will register a 10 percent cumulative decline from the cycle peak in December 2021.

Economic Indicators

July/August 2023

Monday	Tuesday	Wednesday	Thursday	Friday
10	11	12	13	14
WHOLESALE TRADE Inventories Sales Mar -0.2% -2.7% Apr -0.3% 0.0% May 0.0% -0.2% **CONSUMER CREDIT** Mar $19.1 billion Apr $20.3 billion May $7.2 billion	**NFIB SMALL BUSINESS OPTIMISM INDEX** Apr 89.0 May 89.4 June 91.0	**CPI** Total Core Apr 0.4% 0.4% May 0.1% 0.4% June 0.2% 0.2% **BEIGE BOOK** **June 2023 Beige Book:** "Overall economic activity increased slightly since late May. Five Districts reported slight or modest growth, five noted no change, and two reported slight and modest declines."	**UNEMPLOYMENT CLAIMS** Initial Continuing (millions) June 17 0.265 1.733 June 24 0.236 1.718 July 1 0.249 1.729 July 8 0.237 N/A **PPI** Final Demand Ex. Food & Energy Apr 0.1% 0.1% May -0.4% 0.1% June 0.1% 0.1% **FEDERAL BUDGET** 2023 2022 Apr $176.2B $308.2B May -$240.3B -$66.2B June -$227.8B -$88.8B	**IMPORT/EXPORT PRICES** Non-Petrol Imports Nonagri. Exports Apr -0.2% -0.1% May -0.2% -1.9% June -0.3% -0.9% **CONSUMER SENTIMENT** May 59.2 June 64.4 July 72.6
17	18	19	20	21
EMPIRE MFG (8:30) May -31.8 June 6.6 July --	**RETAIL SALES (8:30)** Total Ex.Autos Apr 0.4% 0.4% May 0.3% 0.1% **June 0.5% 0.1%** **IP & CAP-U (9:15)** IP Cap.Util. Apr 0.5% 79.8% May -0.2% 79.6% **June 0.0% 79.6%** **BUSINESS INVENTORIES (10:00)** Inventories Sales Mar -0.2% -1.5% Apr 0.1% -0.1% **May 0.2% 0.1%** **NAHB HOUSING INDEX (10:00)** May 50 June 55 July -- **TIC FLOWS (4:00)** Long-Term Total Mar $205.6B $129.0B Apr $127.8B $48.4B May -- --	**HOUSING STARTS (8:30)** Apr 1.340 million May 1.631 million **June 1.600 million**	**UNEMP. CLAIMS (8:30)** **PHILADELPHIA FED MFG BUSINESS OUTLOOK (8:30)** May -10.4 June -13.7 July -- **EXISTING HOME SALES (10:00)** Apr 4.290 million May 4.300 million **June 4.200 million** **LEADING INDICATORS (10:00)** Apr -0.6% May -0.7% **June -0.6%**	
24	25	26	27	28
CHICAGO FED NATIONAL ACTIVITY INDEX	**FHFA HOUSE PRICE INDEX** **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** **CONSUMER CONFIDENCE** **FOMC MEETING (FIRST DAY)**	**NEW HOME SALES** **FOMC DECISION**	**UNEMP. CLAIMS** **Q2 GDP** **DURABLE GOODS ORDERS** **INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES** **PENDING HOME SALES**	**PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX** **EMPLOYMENT COST INDEX** **REVISED CONSUMER SENTIMENT**
31	1	2	3	4
MNI CHICAGO BUSINESS BAROMETER	**CONSTRUCTION** **JOLTS DATA** **ISM MFG.** **VEHICLE SALES**	**ADP EMPLOYMENT**	**UNEMP. CLAIMS** **PRODUCTIVITY & COSTS** **FACTORY ORDERS** **ISM SERVICES**	**EMPLOYMENT REPORT**

Forecasts in bold.

Treasury Financing

July/August 2023

Monday	Tuesday	Wednesday	Thursday	Friday
10	11	12	13	14
AUCTION RESULTS: Rate Cover 13-week bills 5.250% 3.12 26-week bills 5.270% 2.93	**AUCTION RESULTS:** Rate Cover 52-week bills 5.130% 2.88 3-yr notes 4.534% 2.88 42-day CMBs 5.210% 2.81 **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 RESULTS:** Rate Cover 17-week bills 5.260% 3.13 10-yr notes 3.857% 2.53	**AUCTION RESULTS:** Rate Cover 4-week bills 5.210% 2.79 8-week bills 5.230% 2.87 30-yr bonds 3.910% 2.43 **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 $50 billion 42-day CMBs for auction on July 18 **SETTLE:** $123 billion 13-,26-week bills $38 billion 52-week bills $50 billion 42-day CMBs	
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	**AUCTION:** $50 billion 42-day CMBs **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 $50 billion 42-day CMBs	
24	25	26	27	28
AUCTION: $123 billion* 13-,26-week bills $42 billion* 2-year notes	**AUCTION:** $43 billion* 5-year notes **ANNOUNCE:** $70 billion* 4-week bills for auction on July 27 $60 billion* 8-week bills for auction on July 27 $46 billion* 17-week bills for auction on July 26 **SETTLE:** $70 billion* 4-week bills $60 billion* 8-week bills $46 billion* 17-week bills	**AUCTION:** $46 billion* 17-week bills $24 billion* 2-year FRNs	**AUCTION:** $70 billion* 4-week bills $60 billion* 8-week bills $35 billion* 7-year notes **ANNOUNCE:** $123 billion* 13-,26-week bills for auction on July 31 **SETTLE:** $123 billion* 13-,26-week bills	
31	1	2	3	4
AUCTION: $123 billion* 13-,26-week bills **SETTLE:** $12 billion 20-year bonds $17 billion 10-year TIPS $42 billion* 2-year notes $43 billion* 5-year notes $35 billion* 7-year notes $24 billion* 2-year FRNs	**ANNOUNCE:** $70 billion* 4-week bills for auction on Aug 3 $60 billion* 8-week bills for auction on Aug 3 $46 billion* 17-week bills for auction on Aug 2 **SETTLE:** $70 billion* 4-week bills $60 billion* 8-week bills $46 billion* 17-week bills	**AUCTION:** $46 billion* 17-week bills **ANNOUNCE:** $42 billion* 3-year notes for auction on Aug 8 $37 billion* 10-year notes for auction on Aug 9 $23 billion* 30-year bonds for auction on Aug 10	**AUCTION:** $70 billion* 4-week bills $60 billion* 8-week bills **ANNOUNCE:** $123 billion* 13-,26-week bills for auction on Aug 7 $38 billion* 52-week bills for auction on Aug 8 **SETTLE:** $123 billion* 13-,26-week bills	

*Estimate