U.S. Economic Comment

- FOMC: additional policy firming likely next week
- GDP preview: U.S. economy on growth trajectory in Q2

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U.S. Monetary Policy

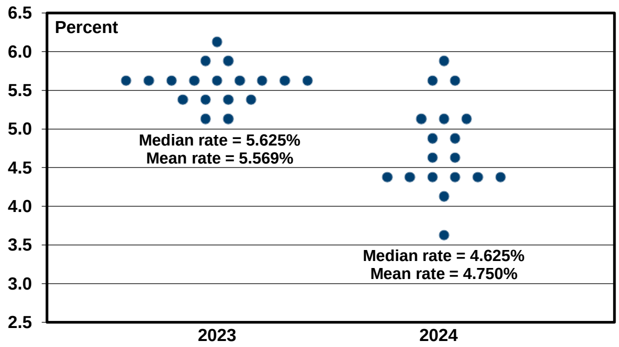
Next week's meeting of the Federal Open Market Committee is unlikely to involve significant surprises: forward guidance provided in June, along with more recent comments by Fed officials, suggest that policymakers are likely to hike the federal funds rate by 25 basis points to a range of 5.25 percent to 5.50 percent. Favorable results on the CPI and other inflation data released last week, which seemingly could have shifted views in a dovish direction ahead of the July meeting, were mostly dismissed by officials as insufficient to deter policy action.

Even with the softening in recent inflation statistics, other economic data and developments suggest that while the federal funds rate is likely approaching its peak, more tightening could be required at one of the remaining three FOMC meetings for 2023 beyond July. The new dot plot published with the June Summary of Economic Projections showed 12 of 18 Fed officials anticipating a terminal federal funds rate at or above the median expectation of 5.625 percent, a view that very much still has merit based on the data (chart, left).

One statistic that we have been monitoring closely is a broad measure of financial conditions. The National Financial Conditions Index compiled by the Federal Reserve Bank of Chicago is exceptionally wide in breadth, as it incorporates 105 financial variables. This measure had moved from the low end of the historical range during the height of the pandemic to close to its long-run average, which might be viewed as a neutral position, but it has eased since March (chart, right).

We posit three inferences from recent readings on the financial conditions index. First, while the index came within striking distance of what could be considered neutral, it has not indicated particularly tight conditions. In that vein, while the index peaked in March during the height of stress at small and mid-sized banks, this measure suggests that the volatility has had only a modest influence beyond March rather than ongoing impacts on credit conditions as initially feared. Secondly, we suspect that there is merit to the argument that "long and variable lags" usually associated with the transmission of monetary policy were shorter in the current episode. Transmission of policy aims through forward guidance and other market communication has led to real-time repricing in financial markets to reflect forward-looking views on policy. Third, we see evidence in the real economy of the waning impact of previous rate hikes.

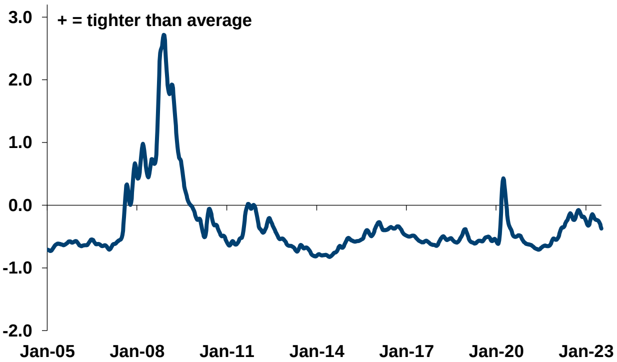
FOMC Rate View, June 2023*



** Each dot represents the expected federal funds rate of a Fed official at the end of the year.*

Source: Federal Open Market Committee, Summary of Economic Projections, June 2023

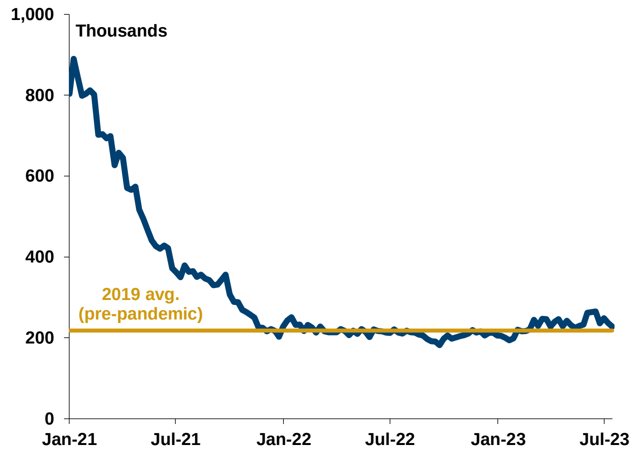
National Financial Conditions Index



Source: Federal Reserve Bank of Chicago via Haver Analytics

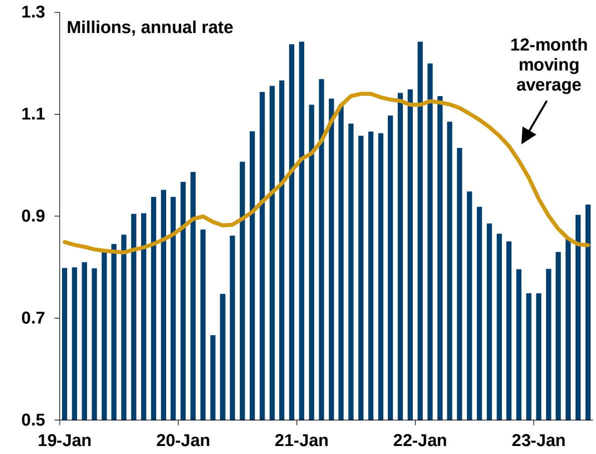
With regard to the economic data, we would highlight initials claims and single-family building permits released earlier this week as suggesting resilience despite restrictive policy. Initial claims offer one of the best real-time assessments of the labor market and are useful in detecting shifts in underlying trends. While initial claims have drifted above the underlying average prior to the onset of the pandemic and showed concerning deterioration in June (average of 255k versus 230k in May), they declined in the opening weeks of July, moving back to 228k (chart, left). Thus, when taken in context of job growth of 209k in June and an unemployment rate of 3.7 percent, labor market conditions appear to be on firm footing (and still too tight to generate meaningful downward pressure on wages). Like a resilient labor market, housing seems to be stirring despite mortgage rates that are about double the recent lows. Sales of new homes jumped in recent months and single-family construction has picked up in response. The trajectory of single-family building permits suggests additional projects are in the planning stages (chart, right). In other words, activity in an interest-sensitive sector is stirring rather than remaining in the doldrums -- another factor that speaks to diminished constraints from previous rate hikes.

Initial Claims for Unemployment Insurance



Source: U.S. Department of Labor via Haver Analytics

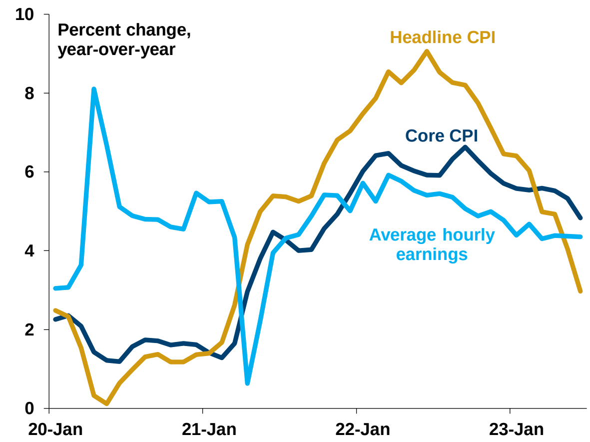
Single-Family Building Permits



Source: U.S. Census Bureau via Haver Analytics

Circling back to tight labor market conditions and wages, we have been watching with keen interest recent negotiations between UPS employees organized under the International Brotherhood of Teamsters and the parcel delivery firms. While a multitude of issues underpin the tense negotiations that could lead to a strike by August 1, wages are of course the paramount consideration. As the chart to the right illustrates, even as inflation has slowed somewhat, wage gains in recent years have lagged and led to notable declines in real incomes. Given the disparity, and the potential for sticky wage inflation (UPS alone employs 340,000 unionized workers clamoring for higher pay), we suspect Fed officials will remain vigilant regarding labor market conditions and potential spillovers into the broader inflation fight.

Wages & Inflation



Source: Bureau of Labor Statistics via Haver Analytics

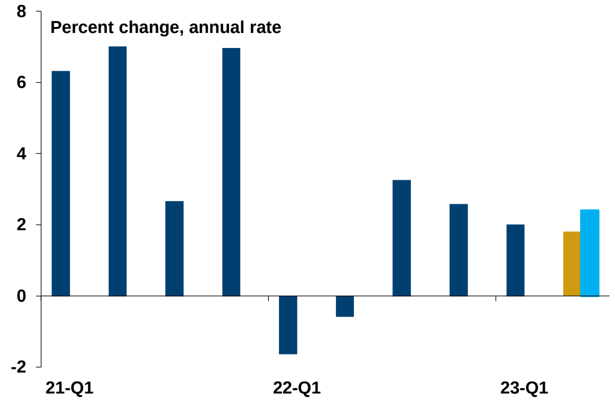
GDP Preview: No Sign of Recession

The upcoming report on second quarter GDP also could stir thoughts of economic momentum inconsistent with additional gains on the inflation front, and push our expectation for a mild recession further out on the forecast horizon —-into Q4 or possibly early 2024. The GDPNow metric published by the Federal Reserve Bank of Atlanta has caught the attention of market participants by suggesting output growth in the neighborhood of 2.4 percent. We're not quite as optimistic at the Atlanta Fed "nowcast" model, although our view of 1.8 percent growth still points to a favorable performance (chart).

As we crunch the numbers, consumer spending appears on track to expand in the low-one-percent area, a sharp slowing from 4.2 percent (annual rate in Q1) but respectable given brisk inflation, elevated borrowing costs, and the expected resumption of student loan payments.

The business sector could post a more notable performance, as data on construction activity and shipments of capital equipment raise the possibility of double-digit growth in both areas, continuing a recovery for business construction and marking perhaps the beginning of a turnaround in equipment spending after contractions in the previous two quarters (charts, below).

GDP Growth*

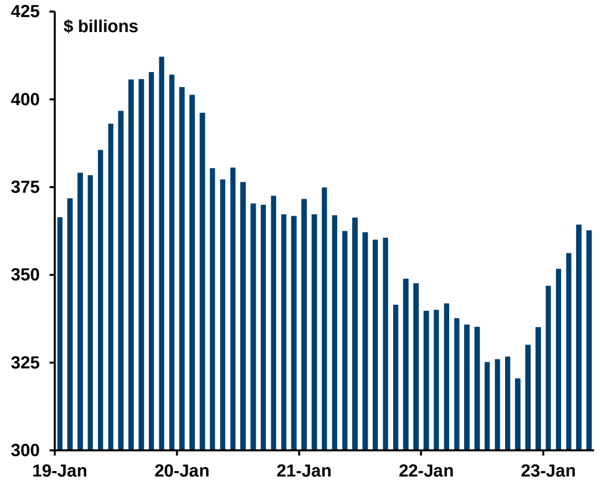


** The gold and light blue bars are forecasts for 2023-Q2 released by DCMA and the Federal Reserve Bank of Atlanta's GDPNow model, respectively.*

Sources: Bureau of Economic Analysis via Haver Analytics; Federal Reserve Bank of Atlanta; Daiwa Capital Markets America

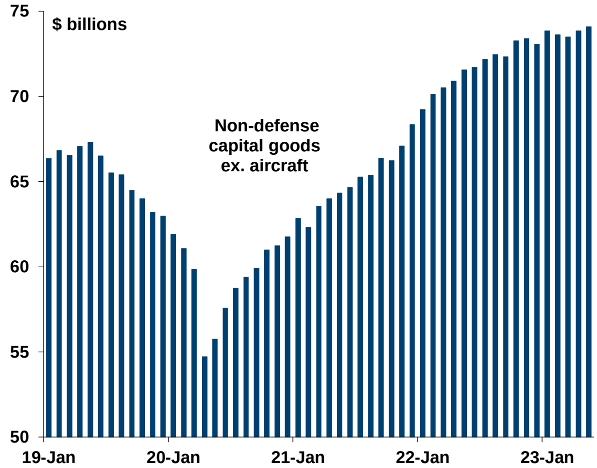
Inventory investment by businesses could contribute approximately one-half percentage point to growth, although the expected positive contribution would follow a drag of 2.1 percentage points in Q1. Additionally, inventories at the current time appear somewhat heavy relative to sales, suggesting a potential drag beyond Q2.

Business-Related Construction



Source: U.S. Census Bureau via Haver Analytics

Shipments of Durable Goods



Source: U.S. Census Bureau via Haver Analytics

Moreover, activity at state and local governments appears to be stirring, as previously allocated funds from the pandemic are deployed in new projects and the expansion of payrolls. This projected activity, combined with anticipated growth in the consumer and business sectors, implies growth of gross domestic purchases (i.e. domestic demand) of approximately two and one-half percent, a fine performance.

On the soft side, trade data suggest a drag of approximately three-quarters of a percentage point on growth, as sluggish demand abroad led to a soft performance on exports.

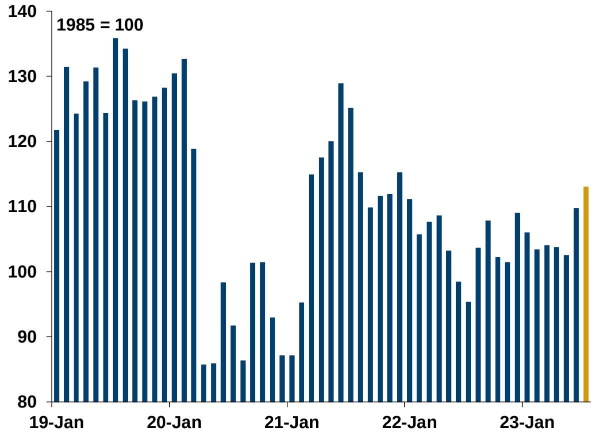
Taking a step back, we do not intend to signal an "all clear" for the U.S. economy, as the Fed is still singularly focused to returning inflation to target and problems could be percolating under the surface in the commercial real estate sector and in private credit, but we have been pleasantly surprised by the resilience of the economy thus far in 2023. Perhaps that degree of resilience may ultimately require additional tightening by the Fed.

The Week Ahead

Consumer Confidence (July) (Tuesday)
Forecast: 113.0 (+3.3 Index Points / 3.0%)

With the labor market on firm footing and the costs of household essentials (gasoline and groceries) stabilizing, consumer confidence appears positioned to increase in July -- a view supported by the recently reported jump in the University of Michigan's sentiment gauge (chart, left). Regarding the labor market, assessments by survey respondents remain highly favorable. The net reading on the labor market, while off recent highs, is elevated from a long-term perspective (chart, right).

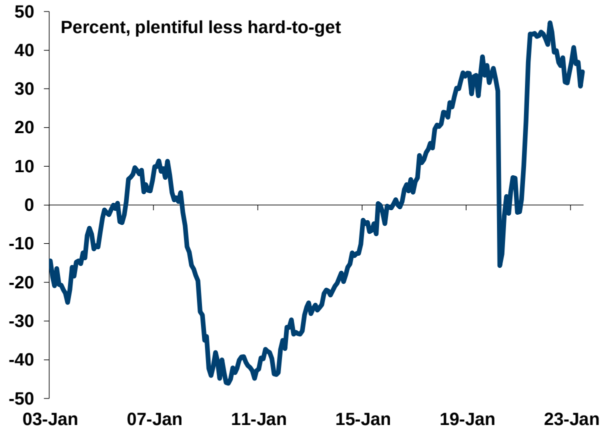
Consumer Confidence*



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

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

Labor Market Differential*



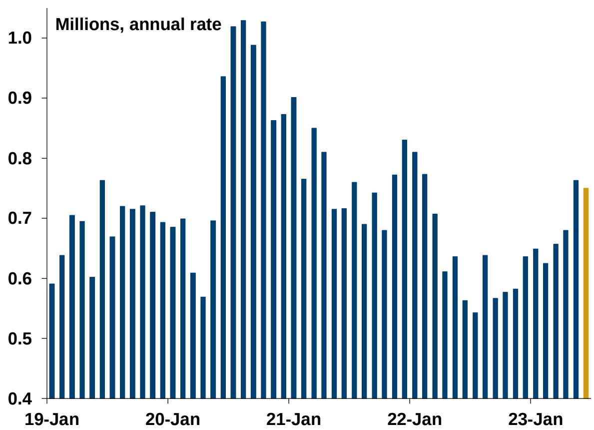
** The share of survey respondents reporting that jobs are plentiful less the share indicating that jobs are hard to get.*

Source: The Conference Board via Haver Analytics

New Home Sales (June) (Wednesday)
Forecast: 0.750 Million (-1.7%)

Sales of new homes have undergone a revival of late, surging 22.1 percent in the past three months, including a spurt of 12.1 percent in May. The dramatic move left the level of underlying activity close to that in the previous expansion (chart, left). The upswing in activity versus stalled sales in the market for existing homes is likely underpinned by abundant inventories (chart, right) and more favorable pricing in the new home market. Even so, sales are often volatile month-to-month, and we suspect that the recent surge in activity may have overstated the degree of underlying strength. Thus, we anticipate some cooling in sales in June.

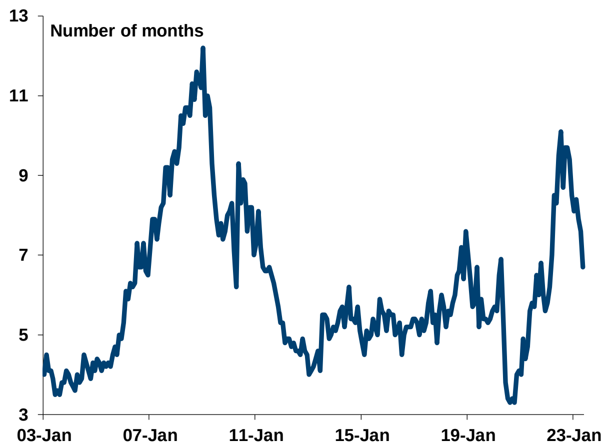
New Home Sales*



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

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

Months' Supply of Unsold Homes



Source: U.S. Census Bureau via Haver Analytics

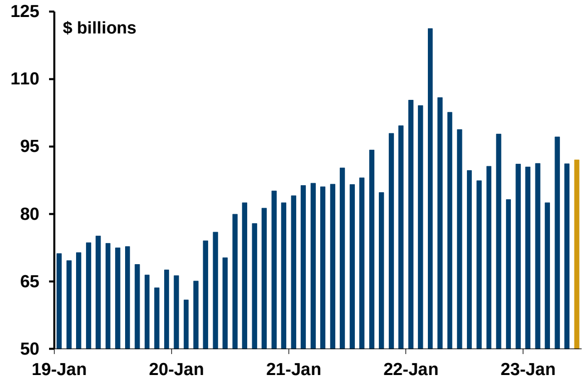
Durable Goods Orders (June) (Thursday)
Forecast: 2.0% Total, 0.3% Ex. Transportation

A jump in new orders reported by Boeing raises the possibility of a fourth consecutive monthly increase in the civilian aircraft component of the durable goods report. With aggressive monetary policy constraining broad economic activity, bookings excluding transportation could remain on their flat trend, although order flows could be in the very early stages of a rebound.

U.S. International Trade in Goods (June) (Thursday)
Forecast: -$92.0 Billion

The trade deficit in goods could widen modestly in June, as a pickup in customs duties suggests an increase in imports while sluggish demand abroad points to a third consecutive contraction in U.S. exports (chart). As a whole, our calculations suggest that next exports in Q2 could subtract three-quarters of one percentage point from GDP growth.

Nominal Trade Deficit in Goods*

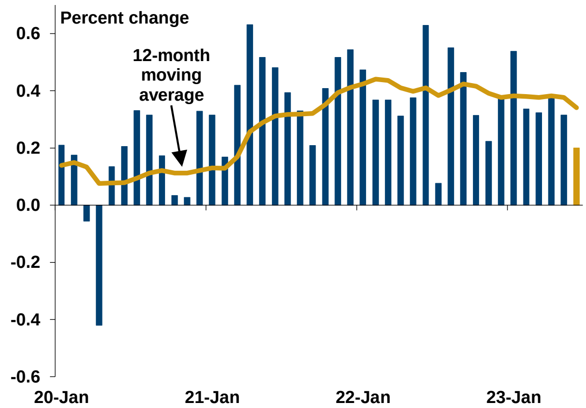


** The gold bar is a forecast for June 2023.*
Sources: U.S. Census Bureau via Haver Analytics; Daiwa Capital Markets America

Personal Income, Consumption, PCE Price Indexes (June) (Friday)
Forecast: 0.5% Income, 0.5% Consumption, 0.2%/0.2% Headline & Core Price Indexes

Increases in average hourly earnings and aggregate hours suggest a firm advance in the wages and salaries component of personal income. In addition, growth of investment income has been supported by elevated interest rates. On the spending side, outlays for durable goods could be boosted by a solid month for sales of new vehicles, while a pickup in spending in key retail categories could boost outlays for nondurable items. Spending for services has remained on a firm trajectory in recent months. Results for the CPI suggest subdued increases in the PCE price indexes (chart on core index, right).

Core PCE Price Index*

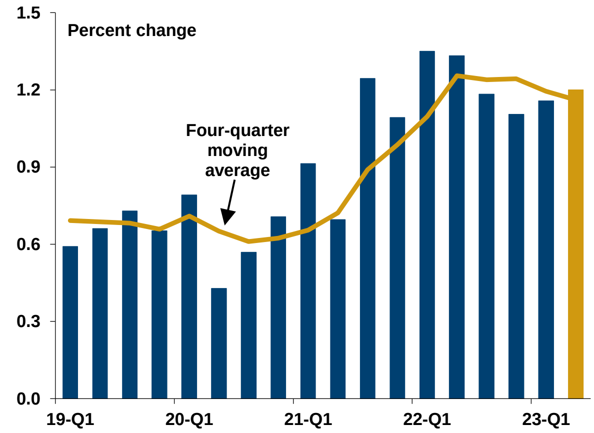


** The gold bar is a forecast for June 2023.*
Sources: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

Employment Cost Index (2023-Q2) (Friday)
Forecast: 1.2%

With tight labor market conditions, the quarterly increase in average hourly earnings from the employment report suggests that Q2 wage growth measured by the ECI was close to the brisk average of 1.2 percent since the second half of 2021. Benefit costs over the same period also have also increased rapidly (+1.1 percent per quarter). With both wage and benefit costs expected to remain on their recent trajectories, growth of total compensation costs are likely to remain firmer than the pre-pandemic norm of growth centered on 0.7 percent (chart).

Employment Cost Index*



** The gold bar is a forecast for 2023-Q2.*
Sources: Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America

Economic Indicators

July/August 2023

Monday	Tuesday	Wednesday	Thursday	Friday
17	18	19	20	21
EMPIRE MFG May -31.8 June 6.6 July 1.1	**RETAIL SALES** Total Ex.Autos Apr 0.4% 0.3% May 0.5% 0.3% June 0.2% 0.2% **IP & CAP-U** IP Cap.Util. Apr 0.6% 79.9% May -0.5% 79.4% June -0.5% 78.9% **BUSINESS INVENTORIES** Inventories Sales Mar -0.2% -1.5% Apr 0.1% -0.1% May 0.2% 0.2% **NAHB HOUSING INDEX** May 50 June 55 June 56 **TIC FLOWS** Long-Term Total Mar $205.6B $114.7B Apr $127.8B $35.3B May $25.8B -$167.6B	**HOUSING STARTS** Apr 1.348 million May 1.559 million June 1.434 million	**UNEMPLOYMENT CLAIMS** Initial Continuing (millions) June 24 0.236 1.718 July 1 0.249 1.721 July 8 0.237 1.754 July 15 0.228 N/A **PHILADELPHIA FED MFG BUSINESS OUTLOOK** May -10.4 June -13.7 July -13.5 **EXISTING HOME SALES** Apr 4.290 million May 4.300 million June 4.160 million **LEADING INDICATORS** Apr -0.7% May -0.6% June -0.7%	
24	25	26	27	28
CHICAGO FED NATIONAL ACTIVITY INDEX (8:30) Monthly 3-Mo. Avg. Apr 0.14 -0.20 May -0.15 -0.14 June -- --	**FHFA HOME PRICE INDEX (9:00)** Mar 0.5% Apr 0.7% May -- **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX (9:00)** Mar 0.4% Apr 0.9% May -- **CONFERENCE BOARD CONSUMER CONFIDENCE (10:00)** May 102.5 June 109.7 **July 113.0** **FOMC MEETING (FIRST DAY)**	**NEW HOME SALES (10:00)** Apr 0.680 million May 0.763 million **June 0.750 million** **FOMC DECISION (2:00)**	**UNEMP. CLAIMS (8:30)** **GDP (8:30)** GDP Chained Price 22-Q4 2.6% 3.9% 23-Q1 2.0% 4.1% **23-Q2 1.9% 3.2%** **DURABLE GOODS ORDERS (8:30)** Apr 1.2% May 1.8% **June 2.0%** **INTERNATIONAL TRADE IN GOODS (8:30)** Apr -$97.5 billion May -$91.9 billion **June -$92.0 billion** **ADVANCE INVENTORIES (8:30)** Wholesale Retail Apr -0.3% 0.3% May 0.0% 0.7% June -- -- **PENDING HOME SALES (10:00)** Apr -0.4% May -2.7% June --	**PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX (8:30)** Inc. Cons. Core Apr 0.3% 0.6% 0.4% May 0.4% 0.1% 0.3% **June 0.5% 0.5% 0.2%** **EMPLOYMENT COST INDEX (8:30)** Comp. Wages 22-Q4 1.1% 1.2% 23-Q1 1.2% 1.2% **23-Q2 1.2% 1.2%** **REVISED CONSUMER SENTIMENT (10:00)** May 59.2 June 64.4 July(p) 72.6
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**
7	8	9	10	11
CONSUMER CREDIT	**NFIB SMALL BUSINESS OPTIMISM INDEX** **TRADE BALANCE** **WHOLESALE TRADE**		**UNEMP. CLAIMS** **CPI** **FEDERAL BUDGET**	**PPI** **CONSUMER SENTIMENT**

Forecasts in bold. (p) = preliminary

Daiwa Capital Markets

Treasury Financing

July/August 2023

Monday	Tuesday	Wednesday	Thursday	Friday
17	18	19	20	21
AUCTION RESULTS: Rate / Cover 13-week bills 5.250% 3.11 26-week bills 5.250% 3.05 **SETTLE:** $40 billion 3-year notes $32 billion 10-year notes $18 billion 30-year bonds	**AUCTION RESULTS:** Rate / Cover 42-day CMBs 5.240% 3.19 **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 RESULTS:** Rate / Cover 17-week bills 5.270% 3.29 20-yr bonds 4.036% 2.68	**AUCTION RESULTS:** Rate / Cover 4-week bills 5.255% 2.66 8-week bills 5.255% 2.99 10-yr TIPS 1.495% 2.51 **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 $50 billion 42-day CMBs for auction on July 25 **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 $50 billion 42-day CMBs **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 $50 billion 42-day CMBs	
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	
7	8	9	10	11
AUCTION: $123 billion* 13-,26-week bills	**AUCTION:** $38 billion* 52-week bills $42 billion* 3-year notes **ANNOUNCE:** $70 billion* 4-week bills for auction on Aug 10 $60 billion* 8-week bills for auction on Aug 10 $46 billion* 17-week bills for auction on Aug 9 **SETTLE:** $70 billion* 4-week bills $60 billion* 8-week bills $46 billion* 17-week bills	**AUCTION:** $46 billion* 17-week bills $37 billion* 10-year notes	**AUCTION:** $70 billion* 4-week bills $60 billion* 8-week bills $23 billion* 30-year bonds **ANNOUNCE:** $123 billion* 13-,26-week bills for auction on Aug 14 **SETTLE:** $123 billion* 13-,26-week bills $38 billion* 52-week bills	

**Estimate*