Daiwa Capital Markets

U.S. Economic Comment

- FOMC preview: a hawkish pause with new dot plot potentially signaling fewer cuts in out years

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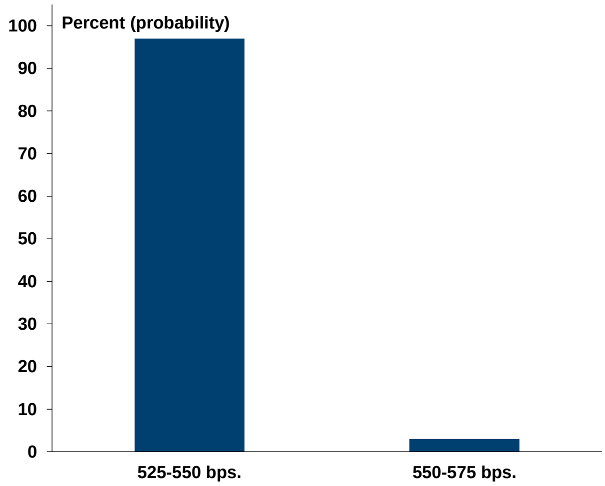
FOMC Preview

Looking ahead to next week's FOMC meeting, we strongly suspect that the policy decision at its conclusion is likely to ratify the market expectation of no change in the target range for the federal funds rate, which is currently 5.25 to 5.50 percent (chart, left). In recent statements, officials have made it clear that the rate hike cycle is likely nearing completion. Fed Chair Jerome Powell noted in his August 5th address at the Jackson Hole Symposium that officials will "proceed carefully" when assessing the need for additional rate hikes. Additionally, John Williams of the New York Fed, a key voice on the Committee, argued in a September 7th interview that monetary policy is "in a good place," i.e., sufficiently restrictive to slow economic activity and return inflation to two percent. Recent shifts in real rates, which suggest meaningful tightening in financial conditions, support the conclusion of President Williams and allow officials to lean into the rather nebulous concept of data dependence without worrying about falling behind in the fight against inflation (chart, right).

Indeed, recent shifts in the data – specifically, softening in the August employment data but a brisk increase in the CPI – have failed to provide a clear edge to either of the two emerging camps within the Federal Open Market Committee. On one side, hawkish-leaning officials appear eager to hike the federal funds rate by 25 basis points once more in 2023 as an "insurance policy" against sticky inflation. Should that hike prove excessive and begin to cause unwanted fallout for the economy, they posit that the additional restriction can be easily removed. On the other side, some are increasingly concerned that risks to growth and inflation are becoming more balanced. They likely view gains made on the inflation fight while the economy has remained resilient as enough evidence to adopt a more conservative approach. Their arguments imply that additional damage done to economic conditions – both broadly and to the labor market more specifically -- would be unnecessary considering progress already made. Moreover, these policymakers are likely to hold the view that the constraining effects of past hikes have not yet fully diffused through to the economy and thus more restraint could be coming even without additional rate hikes.

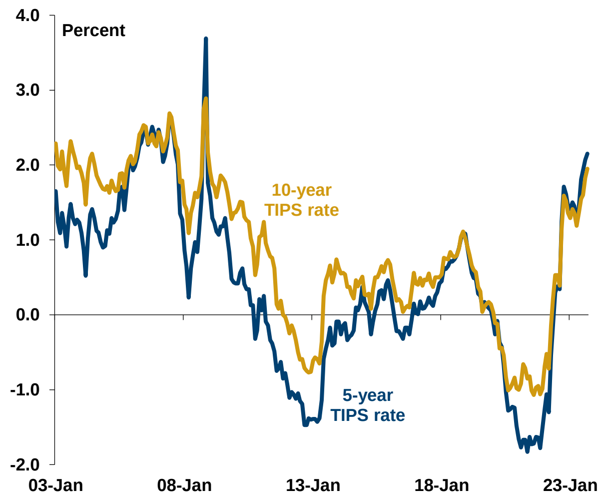
Probabilities for the Fed. Funds Rate, Sept. 2023*



** The probabilities assigned to either no change or an increase of 25 basis points in the target range for the federal funds rate as implied by fed funds futures contracts. The chart shows a reading for September 15, 2023.*

Source: CME Fed Watch Tool, CME Group

Real Interest Rates*



** Monthly average data except for the latest observation which is a daily quote from September 14 2023.*

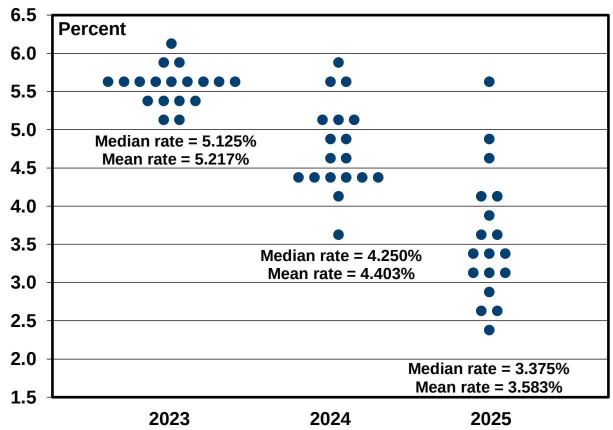
Source: Federal Reserve Board via Haver Analytics

Highlighting the arguments above is not meant to imply that there are significant divisions among members of the FOMC. Rather, this emphasizes that differences can emerge as the Committee enters a period of fine tuning of the federal funds rate before maintaining it in restrictive territory well into next year, especially following 18 months of rapid rate hikes. Critically, all members of the FOMC remain focused on inflation, which they still characterize as too high. That focus, in our view, keeps open the chance for a final hike in 2023, which we're currently projecting to occur at the October 31/November 1 FOMC meeting, and suggests that the tone of the September policy statement will still tilt hawkish. Optionality is essential when inflation may again accelerate, or stall near current levels, or the labor market fails to show additional signs of easing.

A New Summary of Economic Projections

A new quarterly installment of Fed officials' economic projections will be published alongside the policy statement at the conclusion of next week's meeting. regarding the dot plot, we are not anticipating a dramatic surprise akin to when the 2023 median shifted from 5.125 percent in March to 5.625 percent in June, but we could envision a scenario wherein hawkish forward guidance is transmitted with the maintenance of a median projection of one additional hike in 2023 and perhaps more gradual cuts in out years. Modest increases by two or three officials could nudge the 2024 median from the current 4.625 percent to perhaps 4.750 percent with a parallel shift higher in 2025 (current median of 3.375 percent; see chart for current dot plot). The new plot will also include projection for 2026, which we expect to show movement toward the long-run neutral (currently 2.5 percent).

FOMC Rate View*



** 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)

Consistent with our assumptions regarding the dot plot, we expect tweaks to the summary of economic projections. Most likely, the recent strong economic performance should dictate an upward revision to the median expectation of GDP growth of 1.0 percent in the June SEP (table). Similarly, with Fed staff forecasts no longer calling for recession, growth in 2024 could be adjusted higher as well, but only modestly, as officials look for restrictive policy to usher in below-trend growth before a reversion back toward potential in out years. In addition, the recent jump of 0.3 percentage point in the unemployment rate to 3.8 percent could signal more rapid cooling in the labor market than previously forecast, which could result in revisions to the 2023/24 projections for the unemployment rate. Inflation, as of now, appears to be evolving somewhat in line with current projections. As with the dot plot, forecasts of economic variables in 2026 also will be released. Given the convergence we've already seen between 2025 projections and the longer run view, it would be reasonable to assume that 2026 readings would be similar, except for employment, potentially tilting closer to 4.0 percent rather than 4.5 percent. We do not necessarily share the rosy view of the current SEP (or that potentially shown in the September update), as we foresee restrictive policy tipping the economy into recession next year, but Fed officials appear increasingly confident in their ability to engineer a soft landing and the September SEP could convey that.

Economic Projections of the FOMC, June 2023*

	2023	2024	2025	Longer Run
Change in Real GDP	1.0	1.1	1.8	1.8
Unemployment Rate	4.1	4.5	4.5	4.0
PCE Inflation	3.2	2.5	2.1	2.0
Core PCE Inflation	3.9	2.6	2.2	--
Federal Funds Rate	5.6	4.6	3.4	2.5

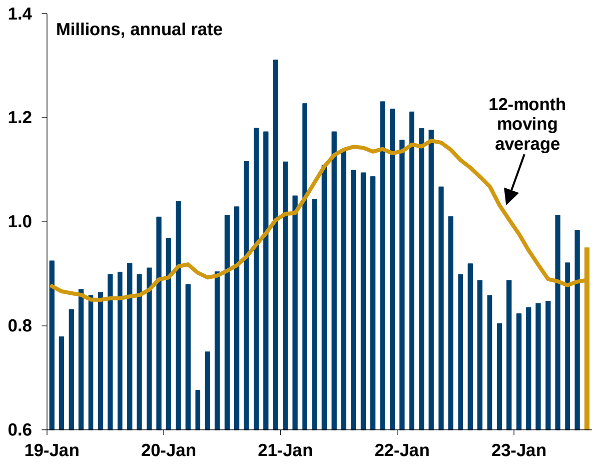
** Median projections*
Source: Federal Open Market Committee, Summary of Economic Projections (June 2023)

The Week Ahead

Housing Starts (August) (Tuesday)
Forecast: 1.430 Million (-1.5%)

Recent stirring in new home sales has boosted single-family housing starts since the spring, but elevated inventories of new homes available for sale amid a challenging affordability conditions could lead builders to curtail activity after a jump in July (chart, left). Multi-family building appears to have peaked, with declines in four of the past five months pushing activity to the low portion of the recent range (chart, right).

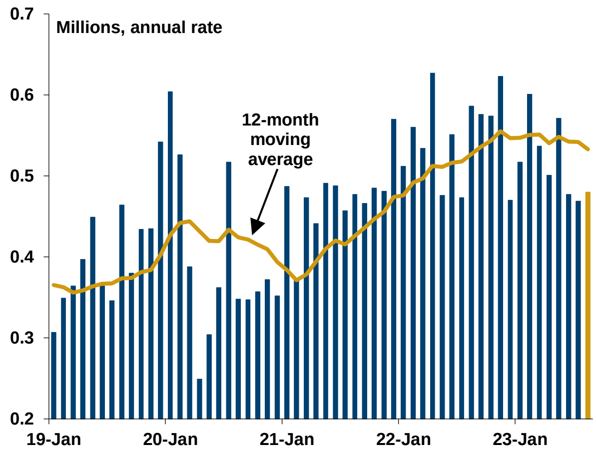
Single-Family Housing Starts*



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

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

Multi-Family Housing Starts*



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

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

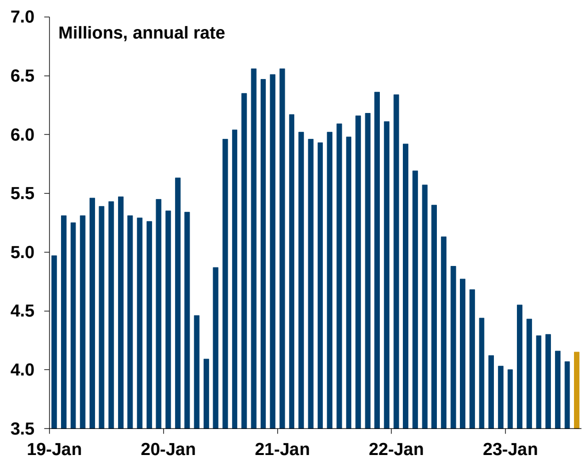
Current Account (23-Q2) (Thursday)
Forecast: -$222.5 Billion (vs. -$219.3 Billion in 23-Q1)

Available data suggest that the U.S international trade deficit widened in Q2, which could drive further deterioration in the current account deficit. The projection would equate to 3.3 percent of nominal GDP in 23-Q2, wider than the average of 2.1 percent in the four quarters preceding the onset of COVID, but close to readings since the middle of last year and much improved from the average of 4.3 percent in the first half of 2022.

Existing Home Sales (August) (Thursday)
Forecast: 4.15 Million (+2.0%)

Although mortgage rates have surged above seven percent and mortgage applications for a home purchase have fallen, recent upticks in the index of pending home sales suggest a modest increase in existing home sales in August. Even if sales do edge higher, the expected level of activity would remain in the lower portion of the longer-term range (chart). Inventories in the existing home market remain razor-thin, as current homeowners are unwilling to move amid higher financing costs, and potential first-time buyers are likely struggling with high costs. The market could remain depressed for the foreseeable future.

Existing Home Sales*



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

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

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

Negative contributions from the ISM new orders index, consumer expectations, and the slope of the yield curve raise the possibility of August marking the 16th consecutive decline in the index of leading economic indicators. The forecast, if realized, would leave the level of the index 10.7 percent below the cycle peak in December 2021.

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Economic Indicators

September/October 2023

Monday	Tuesday	Wednesday	Thursday	Friday
11	12	13	14	15
	NFIB SMALL BUSINESS OPTIMISM INDEX June 91.0 July 91.9 Aug 91.3	**CPI** Total / Core June 0.2% 0.2% July 0.2% 0.2% Aug 0.6% 0.3% **FEDERAL BUDGET** 2023 / 2022 June -$227.8B -$88.8B July -$220.8B -$211.1B Aug $89.3B -$219.6B	**UNEMPLOYMENT CLAIMS** Initial / Continuing (millions) Aug 19 0.232 1.719 Aug 26 0.229 1.684 Sep 2 0.217 1.688 Sep 9 0.220 N/A **PPI** Final Demand / Ex. Food & Energy June -0.1% -0.1% July 0.4% 0.4% Aug 0.7% 0.2% **RETAIL SALES** Total / Ex.Autos June 0.2% 0.1% July 0.5% 0.7% Aug 0.6% 0.6% **BUSINESS INVENTORIES** Inventories / Sales May 0.0% 0.1% June -0.1% -0.2% July 0.0% 0.6%	**EMPIRE MFG** July 1.1 Aug -19.0 Sep 1.9 **IMPORT/EXPORT PRICES** Non-Petrol Imports / Nonagri. Exports June -0.3% -0.5% July 0.0% 0.6% Aug 0.0% 1.7% **IP & CAP-U** IP / Cap.Util. June -0.4% 79.0% July 0.7% 79.5% Aug 0.4% 79.7% **CONSUMER SENTIMENT** July 71.6 Aug 69.5 Sep 67.7
18	19	20	21	22
NAHB HOUSING INDEX (10:00) July 56 Aug 50 Sep -- **TIC FLOWS (4:00)** Long-Term / Total May $23.6B -$161.6B June $195.9B $147.8B July -- --	**HOUSING STARTS (8:30)** June 1.398 million July 1.452 million **Aug 1.430 million** **FOMC MEETING (FIRST DAY)**	**FOMC DECISION (2:00)** **POWELL PRESS CONFERENCE (2:30)**	**UNEMP. CLAIMS (8:30)** **CURRENT ACCOUNT (8:30)** 22-Q4 -$216.2 bill. 23-Q1 -$219.3 bill. **23-Q2 -$222.5 bill.** **PHILADELPHIA FED MFG BUSINESS OUTLOOK (8:30)** July -13.5 Aug 12.0 Sep -- **EXISTING HOME SALES (10:00)** June 4.160 million July 4.070 million **Aug 4.150 million** **LEADING INDICATORS (10:00)** June -0.7% July -0.4% **Aug -0.6%**	
25	26	27	28	29
CHICAGO FED NATIONAL ACTIVITY INDEX	**FHFA HOME PRICE INDEX** **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** **NEW HOME SALES** **CONSUMER CONFIDENCE**	**DURABLE GOODS ORDERS**	**UNEMP. CLAIMS** **REVISED Q2 GDP** **PENDING HOME SALES**	**PERSONAL INCOME, CONSUMPTION, AND PCE PRICE INDEX** **INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES** **MNI CHICAGO BUSINESS BAROMETER** **REVISED CONSUMER SENTIMENT**
2	3	4	5	6
ISM MFG. INDEX **CONSTRUCTION**	**JOLTS DATA** **VEHICLE SALES**	**ADP EMPLOYMENT** **ISM SERVICES INDEX** **FACTORY ORDERS**	**UNEMP. CLAIMS** **TRADE BALANCE**	**EMPLOYMENT REPORT** **CONSUMER CREDIT**

Forecasts in bold.

Treasury Financing

September/October 2023

Monday	Tuesday	Wednesday	Thursday	Friday
11	12	13	14	15
AUCTION RESULTS: Rate / Cover 13-week bills 5.315% 2.98 26-week bills 5.300% 3.15 3-yr notes 4.660% 2.75	**AUCTION RESULTS:** Rate / Cover 10-yr notes 4.289% 2.52 42-day CMBs 5.285% 3.04 **ANNOUNCE:** $50 billion 17-week bills for auction on Sep 13 $80 billion 4-week bills for auction on Sep 14 $70 billion 8-week bills for auction on Sep 14 **SETTLE:** $50 billion 17-week bills $80 billion 4-week bills $70 billion 8-week bills	**AUCTION RESULTS:** Rate / Cover 17-week bills 5.330% 2.95 30-yr bonds 4.345% 2.46	**AUCTION RESULTS:** Rate / Cover 4-week bills 5.285% 2.66 8-week bills 5.295% 2.77 **ANNOUNCE:** $131 billion 13-,26-week bills for auction on Sep 18 $13 billion 20-year bonds for auction on Sep 19 $15 billion 10-year TIPS for auction on Sep 21 $60 billion 42-day CMBs for auction on Sep 19 **SETTLE:** $131 billion 13-,26-week bills $60 billion 42-day CMBs	**SETTLE:** $44 billion 3-year notes $35 billion 10-year notes $20 billion 30-year bonds
18	19	20	21	22
AUCTION: $131 billion 13-,26-week bills	**AUCTION:** $13 billion 20-year bonds $60 billion 42-day CMBs **ANNOUNCE:** $50 billion* 17-week bills for auction on Sep 20 $80 billion* 4-week bills for auction on Sep 21 $70 billion* 8-week bills for auction on Sep 21 **SETTLE:** $50 billion 17-week bills $80 billion 4-week bills $70 billion 8-week bills	**AUCTION:** $50 billion* 17-week bills	**AUCTION:** $80 billion* 4-week bills $70 billion* 8-week bills $15 billion 10-year TIPS **ANNOUNCE:** $131 billion* 13-,26-week bills for auction on Sep 25 $48 billion* 2-year notes for auction on Sep 26 $49 billion* 5-year notes for auction on Sep 27 $37 billion* 7-year notes for auction on Sep 28 $24 billion* 2-year FRNs for auction on Sep 27 **SETTLE:** $131 billion 13-,26-week bills $60 billion 42-day CMBs	
25	26	27	28	29
AUCTION: $131 billion* 13-,26-week bills	**AUCTION:** $48 billion* 2-year notes **ANNOUNCE:** $50 billion* 17-week bills for auction on Sep 27 $80 billion* 4-week bills for auction on Sep 28 $70 billion* 8-week bills for auction on Sep 28 **SETTLE:** $50 billion* 17-week bills $80 billion* 4-week bills $70 billion* 8-week bills	**AUCTION:** $50 billion* 17-week bills $49 billion* 5-year notes $24 billion* 2-year FRNs	**AUCTION:** $80 billion* 4-week bills $70 billion* 8-week bills $37 billion* 7-year notes **ANNOUNCE:** $131 billion* 13-,26-week bills for auction on Oct 2 $42 billion* 52-week bills for auction on Oct 3 **SETTLE:** 131 billion* 13-,26-week bills	**SETTLE:** $15 billion 10-year TIPS $24 billion* 2-year FRNs
2	3	4	5	6
AUCTION: $131 billion* 13-,26-week bills **SETTLE:** $13 billion 20-year bonds $48 billion* 2-year notes $49 billion* 5-year notes $37 billion* 7-year notes	**AUCTION:** $42 billion* 52-week bills **ANNOUNCE:** $50 billion* 17-week bills for auction on Oct 4 $80 billion* 4-week bills for auction on Oct 5 $70 billion* 8-week bills for auction on Oct 5 **SETTLE:** $50 billion* 17-week bills $80 billion* 4-week bills $70 billion* 8-week bills	**AUCTION:** $50 billion* 17-week bills	**AUCTION:** $80 billion* 4-week bills $70 billion* 8-week bills **ANNOUNCE:** $131 billion* 13-,26-week bills for auction on Oct 10 $46 billion* 3-year notes for auction on Oct 10 $35 billion* 10-year notes for auction on Oct 11 $20 billion* 30-year bonds for auction on Oct 12 **SETTLE:** $131 billion* 13-,26-week bills $42 billion* 52-week bills	

**Estimate*