U.S. Economic Comment

- Q3 GDP: strong performance anticipated
- Consumer spending, net exports, and inventory investment to drive firm headline

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The U.S. Economy: On Track in Q3

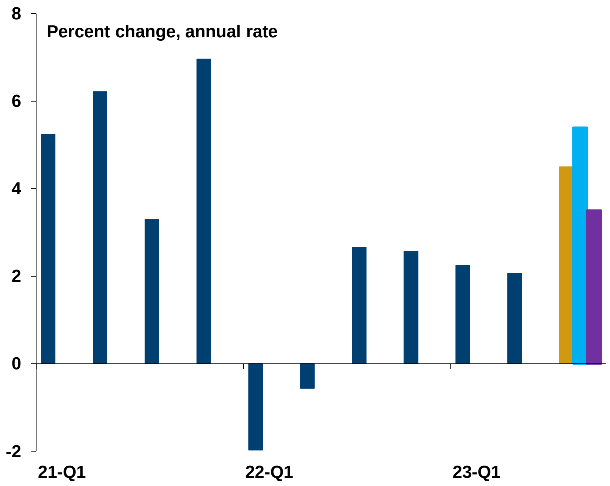
The U.S. economy may well be approaching a crossroads. The Fed has raised interest rates aggressively in response to rapid inflation, with the full force of the associated tightening in financial conditions only now starting to weigh on the economy. Moreover, if the expectations of Fed officials, which were articulated in the September Summary of Economic Projections, are ratified, a restrictive stance of policy will remain in force for a long period. Further, it may intensify pressures in problematic areas such as commercial real estate, the residential housing market, and the federal government (regarding financing substantially larger deficits via bond issuance).

At the same time, a struggling Chinese economy and raging conflict in both Europe and the Middle East could reverberate back to the U.S. Considering these factors, the outlook is murky at best. Despite these risks, both realized and perceived, the U.S. economy has proved resilient to a surprising degree in 2023 thus far, with growth in Q3 expected to surpass by a wide margin the already firm performance in H1 (growth of 2.2 percent, annual rate, exceeding potential growth projected in the 1.7 to 2.0 percent range). Estimates vary widely, but even the left tail of the distribution of estimates (Blue Chip consensus view of 3.5 percent) would indicate a strong performance (chart, below left).

The Consumer Sector

A key driver of the strength in Q3 is the consumer sector, with our calculations suggesting real growth of 3.5 percent, annual rate, or a contribution of 2.4 percentage points to GDP growth after a modest advance of 0.8 percent in Q2 (chart, below right). Real consumer spending burst out of the gate in early Q3, with a monthly increase of 0.6 percent in July, the sharpest increase since a jump of 1.0 percent in January and among the firmer performances of the current expansion. Real spending moderated in August, easing to a growth rate of less than 0.1 percent, but concerns about further easing after the July burst appear to be premature. While the monthly retail sales report

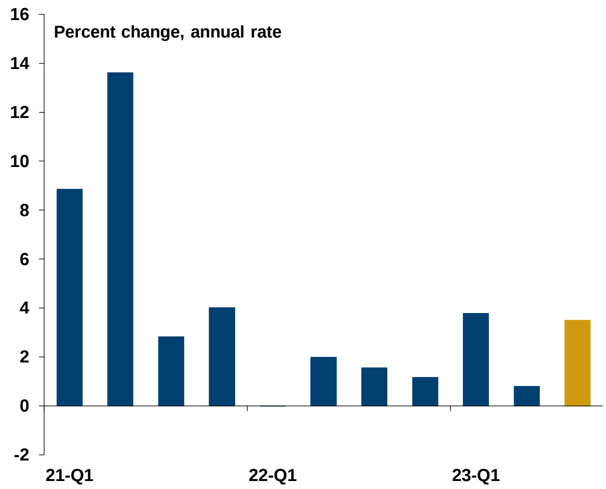
GDP Growth*



** The gold, light blue and purple bars are estimates for 2023-Q3 from DCMA, the Federal Reserve Bank of Atlanta's GDPNow model and the October 2023 issue of Blue Chip Economic Indicators, respectively.*

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

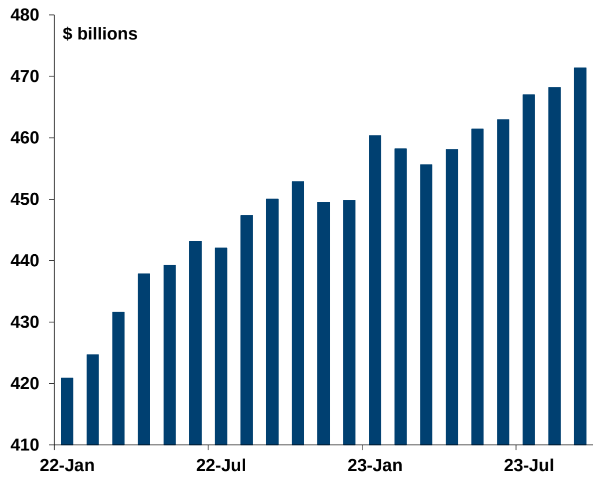
Real Consumer Spending Growth*



** The gold bar is a forecast for 2023-Q3.*

Sources: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America paints a limited picture of consumer activity in any given month, the September report published Tuesday implied an impressive close to the third quarter. The so-called retail control, which excludes sales at auto parts and dealers, gasoline stations, and building materials and supply dealers, and correlates well with outlays for nondurable goods in the GDP accounts, jumped 0.7 percent from an upwardly revised reading in August (chart). Thus, although the view for September is incomplete until the release of the Personal Income and Consumption Report for September next Friday, data thus far have been highly favorable and ratify the view that spending for the quarter will be strong.

Retail Control*



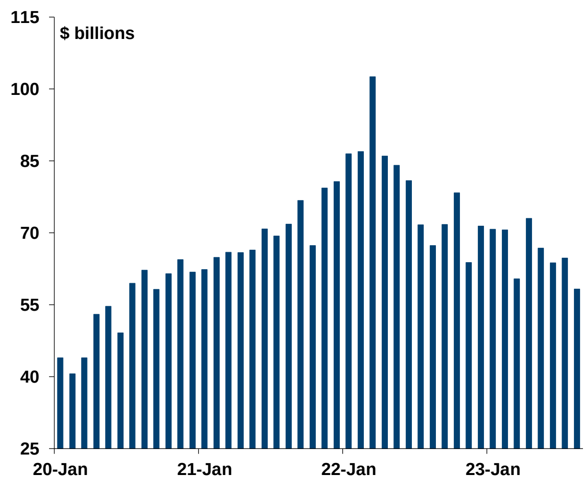
** Retail sales excluding sales from motor vehicle dealers, gasoline stations, and building materials, garden equipment, and supply dealers.*
Source: U.S. Census Bureau via Haver Analytics

Notably, a new report this week from the Federal Reserve Bank of New York shed light on a key concern about the consumer sector: the resumption of student loan repayments. The story, Borrower Expectations for the Return of Student Loan Repayment, posted to the Bank's Liberty Street Economics blog offered a more sanguine view on the resumption of student loan payments than some of the dire predictions floating around in the financial press. The authors concluded that resumption of payments "suggest only modest reductions in spending for borrowers entering repayment (of approximately 0.1 percentage point of August PCE) and likelihood of missed student loan payments roughly in line with pre-pandemic levels." We maintain the view that tight financial conditions and diminished excess saving point to material challenges for the consumer sector next year, but we strongly encourage readership to review the NY Fed's piece; at minimum, it provides good insight into the (apparently modest) near-term impacts of a potential stumbling block for the consumer: https://libertystreeteconomics.newyorkfed.org/2023/10/borrower-expectations-for-the-return-of-student-loan-repayment/.

The Trade Sector

Trade flows through August suggest that net exports could augment brisk consumer spending with a firm contribution to GDP growth, perhaps adding three-quarters to one percentage point to the tally. The U.S. monthly trade deficit narrowed by $6.4 billion in August to $58.3 billion after widening slightly in the opening month of the quarter (chart). Much of the improvement reflected a growth in the service surplus, while real exports and imports of goods have moved mostly sideways in recent months. Results for September could change the magnitude of the expected contribution, but not likely the direction. Thus, net exports could make a sixth consecutive positive contribution to growth after acting as a drag from the second half of 2020 through 2021-Q1.

Nominal Trade Deficit in Goods & Services



Source: Bureau of Economic Analysis via Haver Analytics

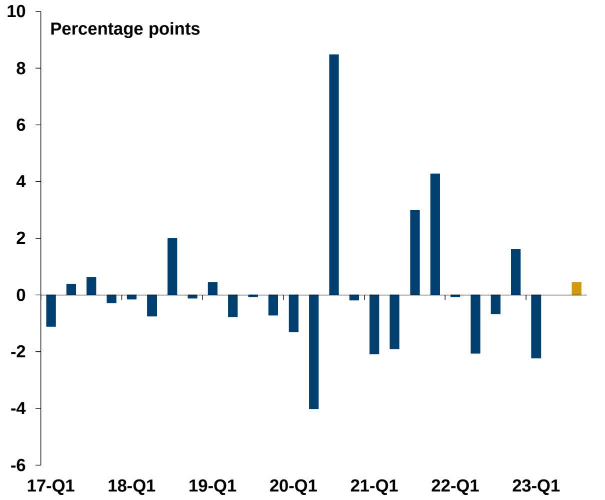
Inventory Investment

The onset of COVID ushered in a period of supply-chain disruptions followed by a spike in demand for goods as homebound citizens used government stimulus to upgrade their living spaces with various items (televisions, exercise equipment, etc.). In the near term, with supply chains normalizing and supply and demand dynamics returning to a more normal state, we're less likely to see wide swings in the contribution of inventory investment to

GDP growth (as we did earlier in the pandemic period), but available data raise the possibility of a solid contribution to growth (approximately one-half percentage point; chart, below left).

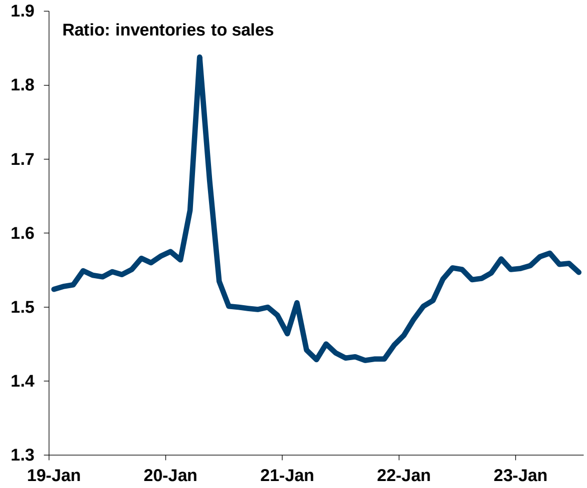
Although favorable in the context of the current quarter, the inventory build opens the possibility of a modest drag in the final quarter of 2024. Inventories relative to sales increased in 2022, and with the demand outlook becoming less certain, firms may seek to prevent additional unwanted accumulation of stocks by proceeding with caution in the coming months (chart, below right).

Change in Private Inventories*



** Contribution to real GDP growth. The gold bar is a forecast for 2023-Q3.*
Sources: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

Real Inventory-to-Sales Ratio

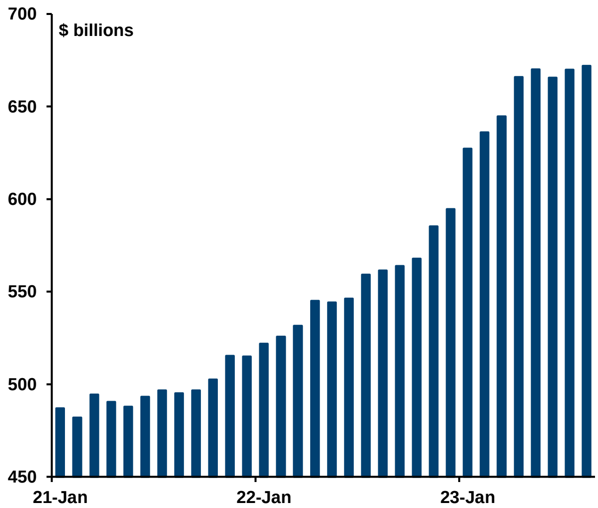


Source: Bureau of Economic Analysis via Haver Analytics

Other Sectors (Business Investment and Residential Construction)

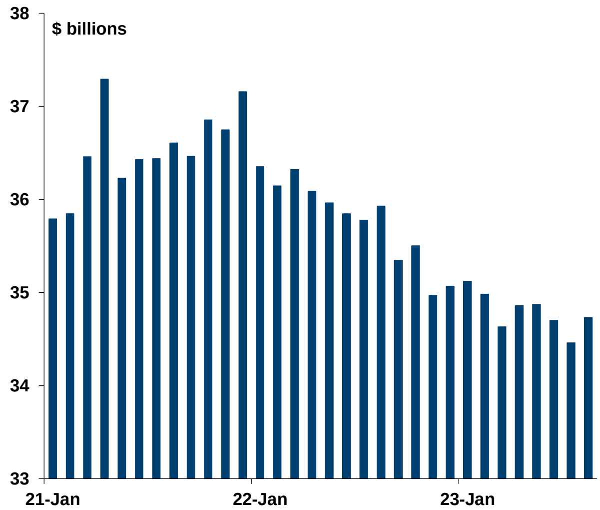
The business sector averaged growth of 6.6 percent, annual rate, per quarter in the first half of 2023 after annual growth of 5.2 percent in 2022. Investment in structures has regained its footing recently, including annualized growth of 30.3 percent in Q1 and 16.1 percent in Q2, after mixed results in the prior two years. Much of the recent resurgence in business construction is tied to investment spurred by the CHIPS Act (facilities for domestic semiconductor production) and the Inflation Reduction Act. We expect growth in Q3 to slow from the brisk pace in the first half of 2023 but remain in positive territory (chart on monthly business-related construction, below left).

Nominal Private Nonresidential Construction



Source: U.S. Census Bureau via Haver Analytics

New Orders for Durable Goods*



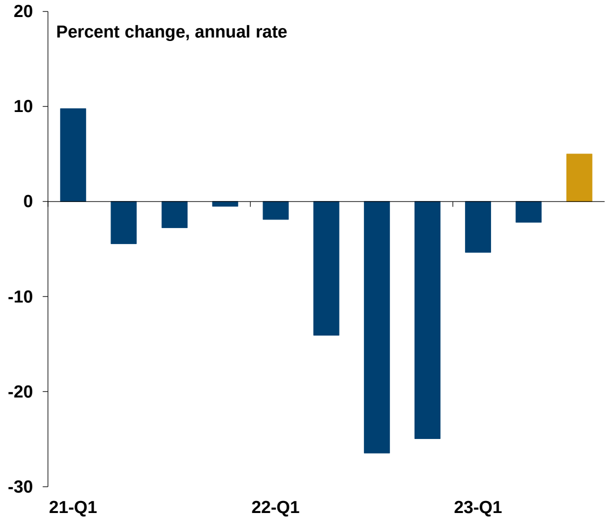
** Nominal orders of nondefense capital goods excluding aircraft adjusted by the private capital equipment component of the producer price index.*
Sources: Bureau of Labor Statistics and U.S. Census Bureau via Haver Analytics; Daiwa Capital Markets America

Equipment spending is likely to face ongoing challenges given tight lending standards, a high cost of capital for new projects, and a mixed picture of demand. Equipment spending rose 7.7 percent, annual rate, in Q2, but declined in 2023-Q1 and 2022-Q4 (off 4.1 and 5.0 percent, respectively). Real orders for nondefense capital goods excluding aircraft, the pipeline for shipments of capital goods (which feeds into the calculation of GDP), have been sluggish (chart, previous page, below right). Moreover, actual shipments have been soft as well in real time, implying that equipment spending in Q3 is likely to be a drag that provides a partial offset to investment in new structures.

Data on housing starts and construction in place suggest that residential construction could make a modest positive contribution to GDP growth in the July-to-September quarter, the first after declines in the previous nine quarters, but the outlook is bleak (chart, below left). Housing is one of the most interest-rate-sensitive sectors of the economy, and the jump in mortgage rates in September to almost eight percent has contributed to the market essentially seizing. The concurrent drop in builder sentiment suggests that firms will cut construction in an attempt to control already elevated inventories of new housing stock (chart, below right).

While the business sector faces near-term challenges and the near-term outlook for the residential sector borders on bleak, the economy appears to be on solid footing despite the aggressive campaign of higher rates by the Fed. Conditions may shift in coming quarters, but the term “resilient” often used in recent weeks to describe the current state of the economy appears appropriate ahead of GDP growth that stands a non-zero chance of eclipsing five percent.

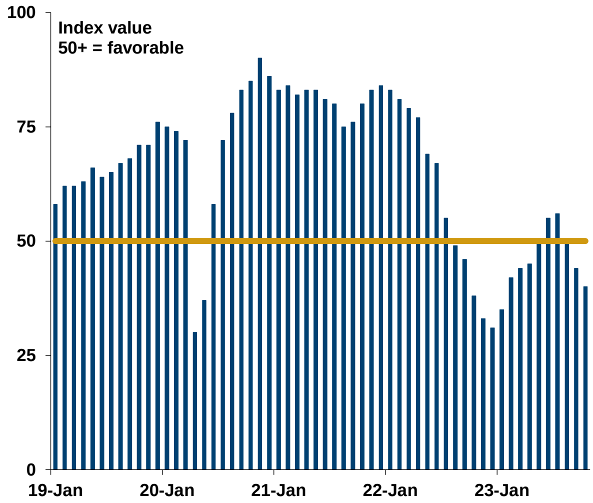
Real Residential Construction Growth*



** The gold bar is a forecast for 2023-Q3.*

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

Housing Market Index



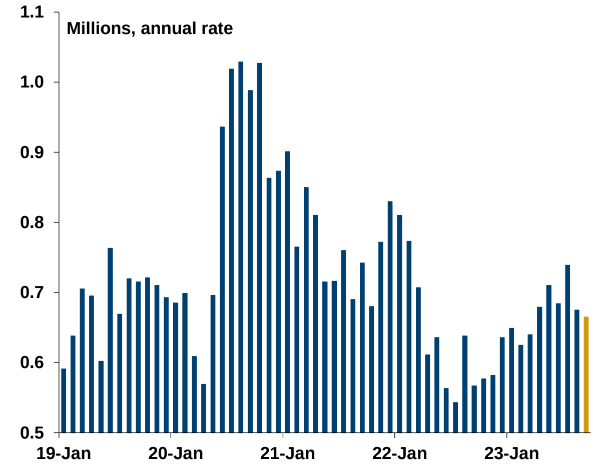
Source: National Association of Home Builders via Haver Analytics

The Week Ahead

New Home Sales (September) (Wednesday)
Forecast: 0.665 Million (-1.5%)

Drops in prospective buyer traffic and mortgage applications for a home purchase amid elevated mortgage interest rates and tight lending standards suggest that new home sales declined for the second consecutive month after registering the 2023 high thus far in July (chart, right).

New Home Sales*

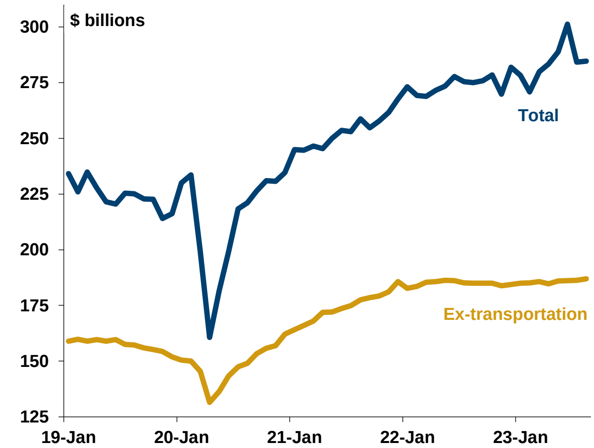


** The gold bar is a forecast for September 2023.*
Sources: U.S. Census Bureau via Haver Analytics; Daiwa Capital Markets America

Durable Goods Orders (September) (Thursday)
Forecast: 2.0% Total, 0.1% Ex. Transportation

A jump in new orders reported by Boeing could lead to a surge in transportation-related bookings in September. However, with the cost of capital high and the business outlook uncertain amid Fed efforts to slow the economy, order flows outside of the volatile transportation category could be little changed after a pickup in the prior month (chart, middle right).

Durable Goods Orders



Source: U.S. Census Bureau via Haver Analytics

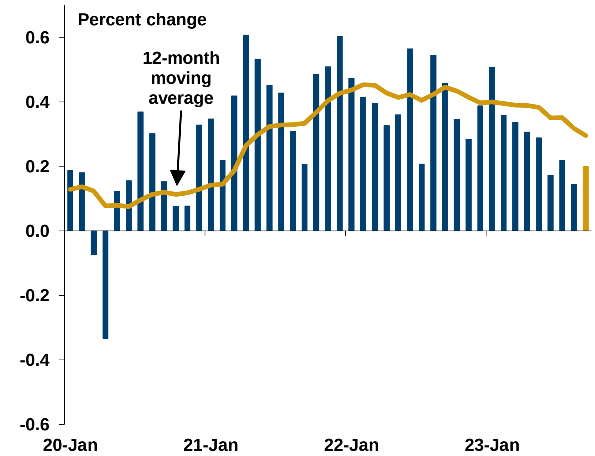
International Trade in Goods (September) (Thursday)
Forecast: -$86.5 Billion ($1.9 Billion Wider Deficit)

Higher prices of petroleum products could boost the value of both exports and imports of industrial supplies. Exports growth excluding industrial supplies could struggle, as a strong foreign exchange value of the dollar hurts foreign demand for American products. The capital goods excluding autos category appears especially vulnerable after a surge in recent months. Imports into the United States have trended lower since peaking in the spring of last year, but the expected increase in the value of imports of industrial supplies, along with a recovery in the "other goods" category after a below-trend reading in August, could sufficiently boost imports to lead to a widening in the monthly trade deficit in goods after a narrowing of $6.3 billion in August.

Personal Income, Consumption, PCE Price Index (September) (Friday)
Forecast: 0.3% Income, 0.5% Consumption, 0.3%/0.2% Headline & Core Price Indexes

Moderate increases in average hourly earnings and aggregate hours suggest a solid advance in the wages and salaries component of personal income. Additionally, elevated interest rates raise the possibility of a brisk advance in personal interest income. On the spending side, a jump in key retail categories implies robust spending on nondurable items, while a recovery in vehicle sales after a dip in August implies an advance in spending on durable items. Spending on services has remained on a firm trajectory as the economy has reopened. Results for the CPI suggest firm results for both the headline and core price indexes for personal consumption expenditures, although they could lag somewhat the 0.4%/0.3% reads on those price measures.

Core PCE Price Index*



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

Economic Indicators

October/November 2023

Monday 16

EMPIRE MFG

Aug	-19.0
Sep	1.9
Oct	-4.6

Tuesday 17

RETAIL SALES

	Total	Ex.Autos
July	0.6%	0.8%
Aug	0.8%	0.9%
Sep	0.7%	0.6%

IP & CAP-U

	IP	Cap.Util.
July	1.0%	79.6%
Aug	0.0%	79.5%
Sep	0.3%	79.7%

NAHB HOUSING INDEX

Aug	50
Sep	44
Oct	40

BUSINESS INVENTORIES

	Inventories	Sales
June	-0.1%	-0.2%
July	0.1%	0.8%
Aug	0.4%	1.3%

Wednesday 18

HOUSING STARTS

July	1.451 million
Aug	1.269 million
Sep	1.358 million

BEIGE BOOK

October 2023:
"Most Districts indicated little to n change in economic activity since the September report."

TIC FLOWS

	Long-Term	Total
June	$186.1B	$138.0B
July	$9.5B	$141.4B
Aug	$63.5B	$134.4B

Thursday 19

UNEMPLOYMENT CLAIMS

	Initial	Continuing
	(millions)	
Sep 23	0.205	1.672
Sep 30	0.209	1.705
Oct 7	0.211	1.734
Oct 14	0.198	N/A

PHILADELPHIA FED MFG BUSINESS OUTLOOK

Aug	12.0
Sep	-13.5
Oct	-9.0

EXISTING HOME SALES

July	4.070 million
Aug	4.040 million
Sep	3.960 million

LEADING INDICATORS

July	-0.3%
Aug	-0.5%
Sep	-0.7%

Friday 20

FEDERAL BUDGET

	2023	2022
July	-$220.8B	-$211.1B
Aug	$89.3B	-$219.6B
Sep	-$171.0B	-$429.8B

Monday 23

CHICAGO FED NATIONAL ACTIVITY INDEX (8:30)

	Monthly	3-Mo. Avg.
July	0.07	-0.15
Aug	-0.16	-0.14
Sep	--	--

Tuesday 24

Wednesday 25

NEW HOME SALES (10:00)

July	0.739 million
Aug	0.675 million
Sep	**0.665 million**

Thursday 26

UNEMP. CLAIMS (8:30)

GDP (8:30)

	GDP	Chained Price
23-Q1	2.2%	3.9%
23-Q2	2.1%	1.7%
23-Q3	**4.5%**	**2.7%**

DURABLE GOODS ORDERS (8:30)

July	-5.6%
Aug	0.1%
Sep	**2.0%**

INTERNATIONAL TRADE IN GOODS (8:30)

July	-$90.9 billion
Aug	-$84.6 billion
Sep	**-$86.5 billion**

ADVANCE INVENTORIES (8:30)

	Wholesale	Retail
July	-0.3%	0.5%
Aug	-0.1%	1.0%
Sep	--	--

PENDING HOME SALES (10:00)

July	0.5%
Aug	-7.1%
Sep	--

Friday 27

PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX (8:30)

	Inc.	Cons.	Core
July	0.2%	0.9%	0.2%
Aug	0.4%	0.4%	0.1%
Sep	**0.3%**	**0.5%**	**0.2%**

REVISED CONSUMER SENTIMENT (10:00)

Aug	69.5
Sep	68.1
Oct (p)	63.0

Monday 30

Tuesday 31

EMPLOYMENT COST INDEX

FHFA HOME PRICE INDEX

S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX

MNI CHICAGO BUSINESS BAROMETER

CONFERENCE BOARD CONSUMER CONFIDENCE

FOMC MEETING (FIRST DAY)

Wednesday 1

ADP EMPLOYMENT

ISM MFG. INDEX

CONSTRUCTION

JOLTS DATA

FOMC DECISION

VEHICLE SALES

Thursday 2

UNEMP. CLAIMS

PRODUCTIVITY & COSTS

FACTORY ORDERS

Friday 3

EMPLOYMENT REPORT

ISM SERVICES INDEX

Monday 6

Tuesday 7

TRADE BALANCE

CONSUMER CREDIT

Wednesday 8

WHOLESALE TRADE

Thursday 9

UNEMP. CLAIMS

Friday 10

CONSUMER SENTIMENT

FEDERAL BUDGET

Forecasts in bold. (p) = preliminary

Treasury Financing

October/November 2023

Monday	Tuesday	Wednesday	Thursday	Friday
16	17	18	19	20
AUCTION RESULTS: Rate Cover 13-week bills 5.340% 3.16 26-week bills 5.335% 2.91 **SETTLE:** $46 billion 3-year notes $35 billion 10-year notes $20 billion 30-year bonds	**AUCTION RESULTS:** Rate Cover 42-day CMBs 5.325% 3.12 **ANNOUNCE:** $56 billion 17-week bills for auction on Oct 18 $95 billion 4-week bills for auction on Oct 19 $85 billion 8-week bills for auction on Oct 19 **SETTLE:** $56 billion 17-week bills $95 billion 4-week bills $85 billion 8-week bills	**AUCTION RESULTS:** Rate Cover 17-week bills 5.355% 3.27 20-yr bonds 5.245% 2.59	**AUCTION RESULTS:** Rate Cover 4-week bills 5.305% 2.98 8-week bills 5.325% 2.63 5-yr TIPS 2.440% 2.36 **ANNOUNCE:** $143 billion 13-,26-week bills for auction on Oct 23 $51 billion 2-year notes for auction on Oct 24 $52 billion 5-year notes for auction on Oct 25 $38 billion 7-year notes for auction on Oct 26 $26 billion 2-year FRNs for auction on Oct 25 $75 billion 42-day CMBs for auction on Oct 24 **SETTLE:** $143 billion 13-,26-week bills $75 billion 42-day CMBs	
23	24	25	26	27
AUCTION: $143 billion 13-,26-week bills	**AUCTION:** $51 billion 2-year notes $75 billion 42-day CMBs **ANNOUNCE:** $56 billion* 17-week bills for auction on Oct 25 $95 billion* 4-week bills for auction on Oct 26 $85 billion* 8-week bills for auction on Oct 26 **SETTLE:** $56 billion 17-week bills $95 billion 4-week bills $85 billion 8-week bills	**AUCTION:** $56 billion* 17-week bills $52 billion 5-year notes $26 billion 2-year FRNs	**AUCTION:** $95 billion* 4-week bills $85 billion* 8-week bills $38 billion 7-year notes **ANNOUNCE:** $143 billion* 13-,26-week bills for auction on Oct 30 $44 billion* 52-week bills for auction on Oct 31 **SETTLE:** $143 billion 13-,26-week bills $75 billion 42-day CMBs	
30	31	1	2	3
AUCTION: $143 billion* 13-,26-week bills	**AUCTION:** $44 billion* 52-week bills **ANNOUNCE:** $56 billion* 17-week bills for auction on Nov 1 $95 billion* 4-week bills for auction on Nov 2 $85 billion* 8-week bills for auction on Nov 2 **SETTLE:** $56 billion* 17-week bills $95 billion* 4-week bills $85 billion* 8-week bills $13 billion 20-year bonds $22 billion 5-year TIPS $51 billion* 2-year notes $52 billion* 5-year notes $38 billion* 7-year notes $26 billion* 2-year FRNs	**AUCTION:** $56 billion* 17-week bills **ANNOUNCE:** $48 billion* 3-year notes for auction on Nov 7 $41 billion* 10-year notes for auction on Nov 8 $25 billion* 30-year bonds for auction on Nov 9	**AUCTION:** $95 billion* 4-week bills $85 billion* 8-week bills **ANNOUNCE:** $143 billion* 13-,26-week bills for auction on Nov 6 **SETTLE:** $143 billion* 13-,26-week bills $44 billion* 52-week bills	
6	7	8	9	10
AUCTION: $143 billion* 13-,26-week bills	**AUCTION:** $48 billion* 3-year notes **ANNOUNCE:** $56 billion* 17-week bills for auction on Nov 8 $95 billion* 4-week bills for auction on Nov 9 $85 billion* 8-week bills for auction on Nov 9 **SETTLE:** $56 billion* 17-week bills $95 billion* 4-week bills $85 billion* 8-week bills	**AUCTION:** $56 billion* 17-week bills $41 billion* 10-year notes	**AUCTION:** $95 billion* 4-week bills $85 billion* 8-week bills $25 billion* 30-year bonds **ANNOUNCE:** $143 billion* 13-,26-week bills for auction on Nov 13 **SETTLE:** $143 billion* 13-,26-week bills	

**Estimate*