U.S. Economic Comment

- Updated Fed call: FOMC likely done hiking rates; no pivot expected until mid-2024
- Key economic data: slowing in inflation and some softening in labor market

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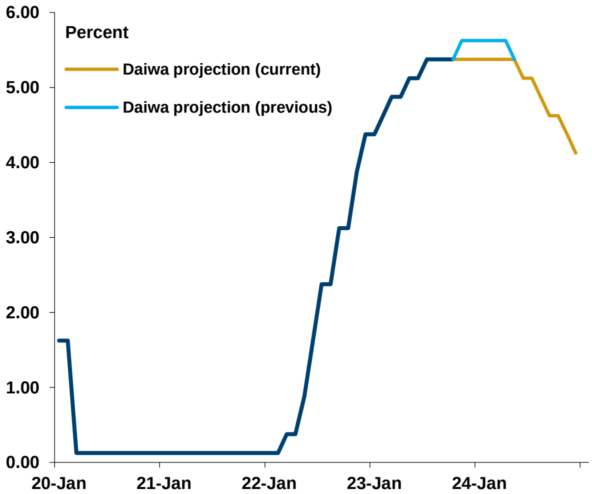
FOMC: On Hold in Restrictive Territory

Since the Fed embarked on its aggressive rate hike campaign in March 2022, we have held the view that a restrictive stance of monetary policy would be required to tame rapid inflation and prevent erosion in inflation expectations of businesses and households. For much of the past year, we had anticipated that the current campaign would culminate in a final increase of 25 basis points in the target range for the federal funds rate to 5.50 to 5.75 percent, with the last change occurring in late 2023, before maintaining the policy rate in restrictive territory for several months. In light of more recent developments, we have become less confident in anticipating any further increase. The Federal Open Market Committee last hiked the federal funds rate in July, and comments by various officials since then, in our view, have turned decidedly more cautious. Moreover, while inflation is still well above target and various indicators suggest that supply and demand imbalances persist in the labor market, we see increasing evidence on both fronts that give officials more leeway to wait for restrictive policy to work (with the much discussed long and variable lags). Thus, while maintaining the broad contours of our prior forecast, we are refining it to better reflect evolving economic conditions.

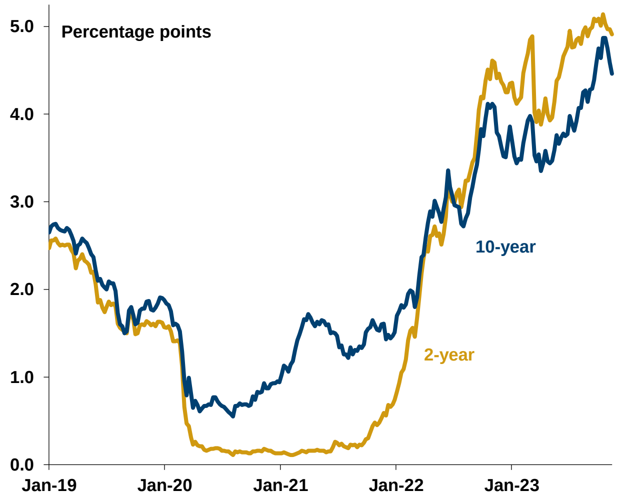
As of now, and despite the constant reminders from Fed officials that more hikes are possible, we suspect that the FOMC is done tightening monetary policy (i.e., a terminal target range of 5.25 to 5.50 percent). However, while this represents a shift in our Fed call, it is not a material one. We still project policymakers holding the federal funds rate at the terminal rate well into 2024-Q2 to ensure that inflation is convincingly on a path back toward two percent. As inflation decelerates further and the economy struggles amid still-tight financial conditions, we expect the FOMC to begin its slow transition to easier policy. That said, rather than projecting a first cut of 25 basis points to come at the April 30/May 1 FOMC meeting, we now look for the change to occur at the June 11-12 gathering (chart, below left). We then look for the Committee to continue easing by 25-basis-point increments at each of the final four meetings of 2024, leading to a year-end target range of 4.00 to 4.25 percent (consistent with our previous forecast).

Federal Funds Target Rate



Sources: Federal Reserve Board via Haver Analytics; Daiwa Capital Markets America

Nominal Treasury Yields*



** Weekly average data except for the latest observations which are midday quotes from November 17, 2023.*

Sources: Federal Reserve Board via Haver Analytics; Bloomberg

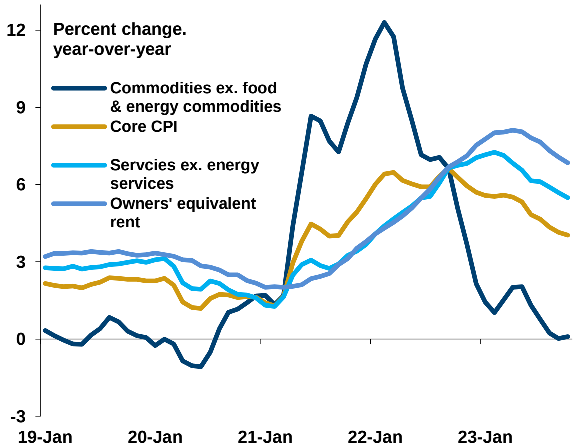
Messaging is likely to present a key challenge for officials in coming months despite what we (and likely Fed officials) view as a sufficiently restrictive monetary policy. Financial conditions are the primary transmission mechanism of monetary policy to the real economy, and while the economy has responded (in some areas quite forcefully) to tight financial conditions, maintenance of the current constraints on economic activity is essential to achieve desired policy outcomes, i.e., stable prices and maximum sustainable employment. Evidence of the challenge awaiting officials emerged as markets repriced to incorporate evolving expectations for monetary policy. The S&P 500 has rallied more than nine percent since its recent low on October 27, erasing much of the easing in the August-to-October period. Much of the change followed the "hold" by the FOMC at the October 31-November 1 policy meeting. Moreover, softening data and the perception that the Fed is done hiking interest rates contributed to a 16-basis-point drop in the 2-year yield from last Friday's close to 4.90 percent and a plunge of 21 basis points in the 10-year yield to 4.44 percent (as of mid-day Friday; chart, below right). Consequently, additional easing in financial conditions, despite the maintenance of restrictive policy, could jeopardize further progress toward policy objectives.

Moderating Inflation & Easing Labor Market Conditions

A near-term catalyst for movements in financial markets, and key contributory factor in the revision of our Fed call, was data this week that pointed more decidedly toward progress in inflation and easing in tight labor market conditions. On the inflation front, the CPI for October printed below expectations. The headline was flat while the core increased 0.2 percent, versus expected increases of 0.1 percent and 0.3 percent, respectively. Moreover, risks tilted to the upside as many analysts were concerned that changes to the calculation of health insurance costs implemented with the October report could lead to an upswing in a previously subdued area. Health insurance costs did jump (+1.1 percent, not seasonally adjusted) after a year of sharp discounting, but cost pressures eased in other areas.

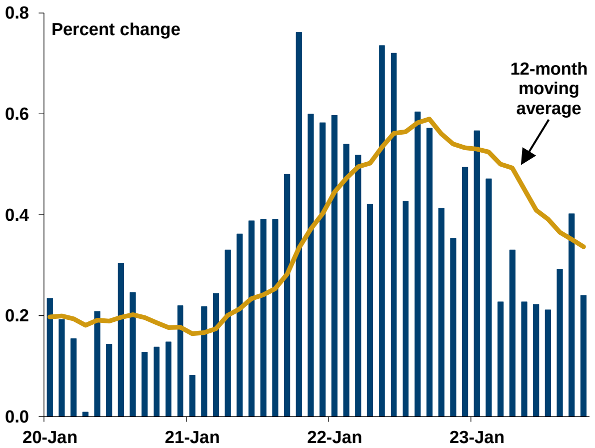
The chart on year-over-year core inflation (below left) provides a useful view on progress made thus far on the inflation front. Headline CPI inflation (not shown) has fallen from a peak of 9.1 percent in June 2022 to 3.2 percent in October, including a slowing of five ticks in the past month. Energy costs have dropped and increases in food prices have decelerated sharply. Improvement in the core component has been measurable, but less dramatic, as prices rose 4.0 percent in October versus 4.2 percent in September (down from the peak of 6.6 percent in September 2022). Additionally, Fed officials rightly view core inflation as still well above the two percent target. Core goods inflation has returned to the pre-2020 trend after the unwinding of pandemic-related supply-demand imbalances (year-over-year growth of 0.1 percent as of October), but more improvement is required in core services where year-over-year growth has slowed from a peak of 7.3 percent in February 2023 but is still elevated at 5.5 percent. Housing costs (illustrated by owners' equivalent rent in the chart) is still a key contributor to core service costs and is widely expected to moderate only over time.

Core CPI



Source: Bureau of Labor Statistics via Haver Analytics

16% Trimmed Mean CPI*



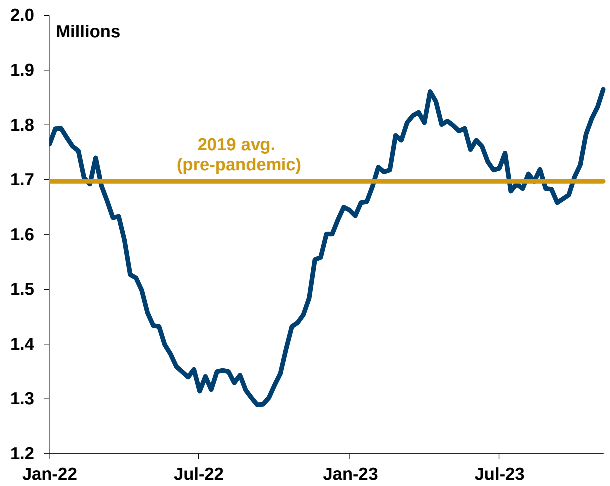
** A weighted average of one month inflation rates of CPI components whose expenditure weights fall below the 92nd percentile and above the 8th percentile of price changes.*

Source: Federal Reserve Bank of Cleveland via Haver Analytics

A helpful illustration of near-term progress on inflation, even if year-over-year data has yet to convey it, is the recent month-to-month performance of the trimmed-mean CPI. (We view this measure as offering a better perspective of underlying inflation as it eliminates price changes at the tails of the monthly distribution.) On a year-over-year basis, this measure has remained elevated (growth of 4.1 percent versus 4.3 percent in September), but the far better near-term performance indicates a more forceful easing in underlying inflation (increases of 0.2 percent in five of the past eight months; chart, previous, page, below right).

Data on unemployment claims (published Thursday) also suggest a slowdown in the real economy that should further dull the underlying inflation impulse, while also emphasizing that risks to the outlook have become more two-sided. That is, the risks of doing too little to combat entrenched inflation must now be weighed against the risks of overtightening and doing unnecessary damage to the economy. While initial claims increased by 13,000 to 231,000 in the week of November 11, a reading above the pre-pandemic average of 218,000, which suggested a labor market on firm footing, they were still relatively low from a longer-term perspective. More important, and perhaps somewhat concerning, was the jump of 32,000 in continuing unemployment claims to 1.865 million in the week of November 4 (chart). Over the past eight weeks, continuing claims have risen by a cumulative 207,000 to the highest level in almost two years. On one hand, this development speaks to an ongoing rebalancing in a tight labor market; on the other hand, it may be the beginning of an uptrend that usually presents prior to the onset of a recession. Again, this development speaks to postponing further hikes, both because policy goals appear more attainable with the current level of monetary restraint and because caution is warranted as the economy possibly nears an inflection point.

Continuing Claims for Unemployment Insurance



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

Note to readers:

Due to the Thanksgiving holiday in the United States, we will not release an economic comment next week. Publication will resume on December 1, 2023.

The Week Ahead

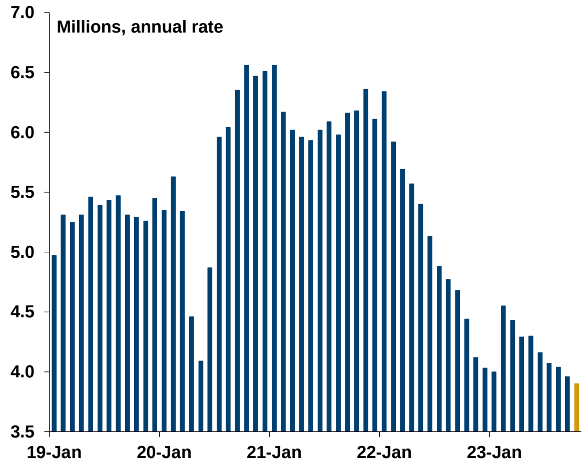
Leading Indicators (October) (Monday)
Forecast: -0.7%

Negative contributions from the ISM new orders index, consumer expectations and stock prices are likely to contribute to an anticipated 19th consecutive decline in the Leading Indicators index. If the forecast is realized, the index will have dropped almost 12 percent from the cycle peak in December 2021.

Existing Home Sales (October) (Tuesday)
Forecast: 3.90 Million (-1.5%)

Elevated interest rates and tight lending standards are likely to constrain activity in the housing market again in October, raising the possibility of a fifth consecutive decline in sales of existing homes. Even if the market were to stabilize in October rather than soften further, the 3.960 million annualized sales pace in September (the current cycle low) is below that directly following the brief (but sharp) 2020 recession (4.090 million in May 2020) and comparable to those during the 2008-09 recession following the housing bust.

Existing Home Sales*

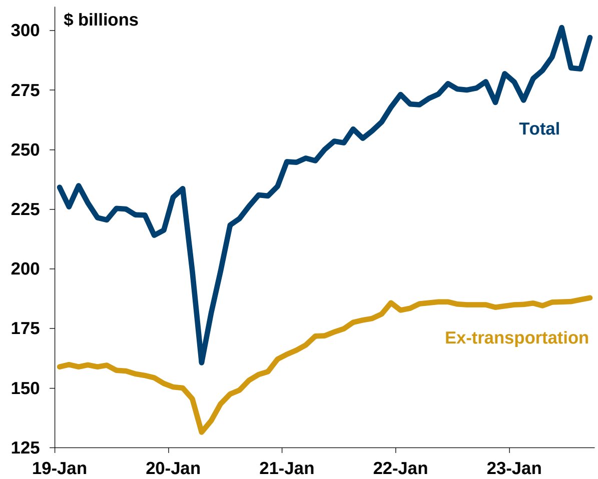


** The gold bar is a forecast for October 2023.*
Sources: National Association of Realtors via Haver Analytics; Daiwa Capital Markets America

Durable Goods Orders (October) (Wednesday)
Forecast: -2.0% Total, +0.3% Ex. Transportation

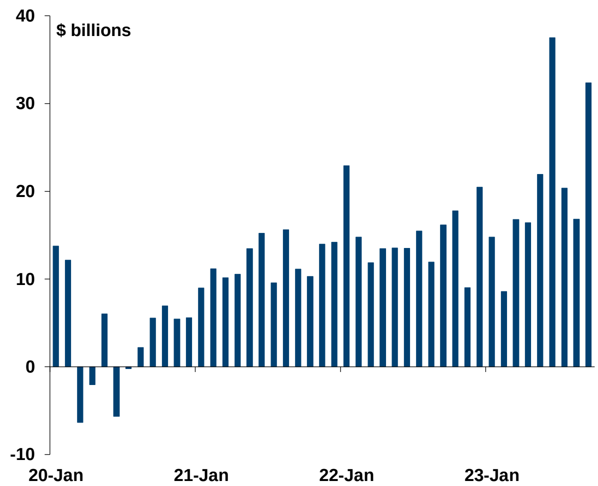
While orders reported by Boeing were brisk in October, they lagged those in the prior month. Thus, headline durable goods bookings appear vulnerable to a drop after a surge of 4.6 percent in September (see dark blue line on left chart for total durable bookings; the chart to the right shows civilian aircraft orders). Orders outside of the transportation category are likely to be constrained by an uncertain outlook amid Fed efforts to slow the economy.

New Orders for Durable Goods



Source: U.S. Census Bureau via Haver Analytics

New Orders for Nondefense Aircraft & Parts



Source: U.S. Census Bureau via Haver Analytics

Daiwa Capital Markets

Economic Indicators

November/December 2023

Monday	Tuesday	Wednesday	Thursday	Friday
13	14	15	16	17
FEDERAL BUDGET 2023 2022 Aug $89.3B -$219.6B Sep -$170.7B -$429.8B Oct -$66.6B -$87.9B	**NFIB SMALL BUSINESS OPTIMISM INDEX** Aug 91.3 Sep 90.8 Oct 90.7 **CPI** Total Core Aug 0.6% 0.3% Sep 0.4% 0.3% Oct 0.0% 0.2%	**PPI** Final Demand Ex. Food & Energy Aug 0.8% 0.2% Sep 0.4% 0.2% Oct -0.5% 0.0% **RETAIL SALES** Total Ex.Autos Aug 0.7% 0.8% Sep 0.9% 0.8% Oct -0.1% 0.1% **EMPIRE MFG** Sep 1.9 Oct -4.6 Nov 9.1 **BUSINESS INVENTORIES** Inventories Sales July 0.1% 0.8% Aug 0.4% 1.4% Sep 0.4% 1.1%	**UNEMPLOYMENT CLAIMS** Initial Continuing (millions) Oct 21 0.212 1.812 Oct 28 0.220 1.833 Nov 4 0.218 1.865 Nov 11 0.231 N/A **IMPORT/EXPORT PRICES** Non-Petrol Imports Nonagri. Exports Aug -0.2% 1.6% Sep -0.2% 0.7% Oct -0.2% -1.0% **PHILADELPHIA FED MFG BUSINESS OUTLOOK** Sep -13.5 Oct -9.0 Nov -5.9 **IP & CAP-U** IP Cap.Util. Aug 0.0% 79.5% Sep 0.1% 79.5% Oct -0.6% 78.9% **NAHB HOUSING INDEX** Sep 44 Oct 40 Nov 34 **TIC FLOWS** Long-Term Total July $9.5B $106.9B Aug $62.2B $131.0B Sep -$1.7B -$67.4B	**HOUSING STARTS** Aug 1.305 million Sep 1.346 million Oct 1.372 million
20	21	22	23	24
LEADING INDICATORS (10:00) Aug -0.5% Sep -0.7% **Oct -0.7%**	**CHICAGO FED NATIONAL ACTIVITY INDEX (8:30)** Monthly 3-Mo. Avg. Aug -0.22 -0.14 Sep 0.02 0.00 Oct -- -- **EXISTING HOME SALES (10:00)** Aug 4.040 million Sep 3.960 million **Oct 3.900 million** **FOMC MINUTES (2:00)**	**UNEMP. CLAIMS (8:30)** **DURABLE GOODS ORDERS (8:30)** Aug -0.1% Sep 4.6% **Oct -2.0%** **REVISED CONSUMER SENTIMENT (10:00)** Sep 67.9 Oct 63.8 Nov (p) 60.4	***THANKSGIVING***	
27	28	29	30	1
NEW HOME SALES	**FHFA HOME PRICE INDEX** **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** **CONFERENCE BOARD CONSUMER CONFIDENCE**	**REVISED Q3 GDP** **INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES** **BEIGE BOOK**	**UNEMP. CLAIMS** **PERSONAL INCOME, CONSUMPTION, AND PCE PRICE INDEXES** **MNI CHICAGO BUSINESS BAROMETER** **PENDING HOME SALES**	**ISM MFG. INDEX** **CONSTRUCTION** **VEHICLE SALES**
4	5	6	7	8
FACTORY ORDERS	**ISM SERVICES INDEX** **JOLTS DATA**	**ADP EMPLOYMENT** **TRADE BALANCE** **REVISED PRODUCTIVITY & COSTS**	**UNEMP. CLAIMS** **WHOLESALE TRADE** **CONSUMER CREDIT**	**EMPLOYMENT REPORT** **CONSUMER SENTIMENT**

Forecasts in bold. (p) = preliminary

Treasury Financing

November/December 2023

Monday	Tuesday	Wednesday	Thursday	Friday
13	14	15	16	17
AUCTION RESULTS: Rate / Cover 13-week bills 5.285% 2.76 26-week bills 5.270% 2.75	**AUCTION RESULTS:** Rate / Cover 42-day CMBs 5.290% 2.64 **ANNOUNCE:** $56 billion 17-week bills for auction on Nov 15 $95 billion 4-week bills for auction on Nov 16 $85 billion 8-week bills for auction on Nov 16 **SETTLE:** $56 billion 17-week bills $95 billion 4-week bills $85 billion 8-week bills	**AUCTION RESULTS:** Rate / Cover 17-week bills 5.255% 3.17 **SETTLE:** $48 billion 3-year notes $40 billion 10-year notes $24 billion 30-year bonds	**AUCTION RESULTS:** Rate / Cover 4-week bills 5.290% 2.75 8-week bills 5.280% 2.63 **ANNOUNCE:** $143 billion 13-,26-week bills for auction on Nov 20 $16 billion 20-year bonds for auction on Nov 20 $15 billion 10-year TIPS for auction on Nov 21 $26 billion 2-year FRNs for auction on Nov 21 $75 billion 41-day CMBs for auction on Nov 21 **SETTLE:** $143 billion 13-,26-week bills $75 billion 42-day CMBs	
20	21	22	23	24
AUCTION: $143 billion 13-,26-week bills $16 billion 20-year bonds	**AUCTION:** $15 billion 10-year TIPS $26 billion 2-year FRNs $75 billion 41-day CMBs **ANNOUNCE:** $56 billion* 17-week bills for auction on Nov 22 $95 billion* 4-week bills for auction on Nov 22 $85 billion* 8-week bills for auction on Nov 22 **SETTLE:** $56 billion 17-week bills $95 billion 4-week bills $85 billion 8-week bills	**AUCTION:** $56 billion* 17-week bills $95 billion* 4-week bills $85 billion* 8-week bills **ANNOUNCE:** $143 billion* 13-,26-week bills for auction on Nov 27 $44 billion* 52-week bills for auction on Nov 28 $54 billion* 2-year notes for auction on Nov 27 $55 billion* 5-year notes for auction on Nov 27 $39 billion* 7-year notes for auction on Nov 28	***THANKSGIVING***	**SETTLE:** $143 billion 13-,26-week bills $26 billion 2-year FRNs $75 billion 41-day CMBs
27	28	29	30	1
AUCTION: $143 billion* 13-,26-week bills $54 billion* 2-year notes $55 billion* 5-year notes	**AUCTION:** $44 billion* 52-week bills $39 billion* 7-year notes **ANNOUNCE:** $56 billion* 17-week bills for auction on Nov 29 $95 billion* 4-week bills for auction on Nov 30 $85 billion* 8-week bills for auction on Nov 30 **SETTLE:** $56 billion* 17-week bills $95 billion* 4-week bills $85 billion* 8-week bills	**AUCTION:** $56 billion* 17-week bills	**AUCTION:** $95 billion* 4-week bills $85 billion* 8-week bills **ANNOUNCE:** $143 billion* 13-,26-week bills for auction on Dec 4 **SETTLE:** $143 billion* 13-,26-week bills $44 billion* 52-week bills $16 billion 20-year bonds $15 billion 10-year TIPS $54 billion* 2-year notes $55 billion* 5-year notes $39 billion* 7-year notes	
4	5	6	7	8
AUCTION: $143 billion* 13-,26-week bills	**ANNOUNCE:** $56 billion* 17-week bills for auction on Dec 6 $95 billion* 4-week bills for auction on Dec 7 $85 billion* 8-week bills for auction on Dec 7 **SETTLE:** $56 billion* 17-week bills $95 billion* 4-week bills $85 billion* 8-week bills	**AUCTION:** $56 billion* 17-week bills	**AUCTION:** $95 billion* 4-week bills $85 billion* 8-week bills **ANNOUNCE:** $143 billion* 13-,26-week bills for auction on Dec 11 $50 billion* 3-year notes for auction on Dec 11 $37 billion* 10-year notes for auction on Dec 11 $21 billion* 30-year bonds for auction on Dec 12 **SETTLE:** $143 billion* 13-,26-week bills	

**Estimate*