U.S. Economic Comment

- FOMC: distinct shift in tone, but the market may be getting ahead of itself
- Yellen comments: poor timing relative to Fed announcement
- Friday data: a sluggish performance in manufacturing, but the broader economy remains on track in Q4

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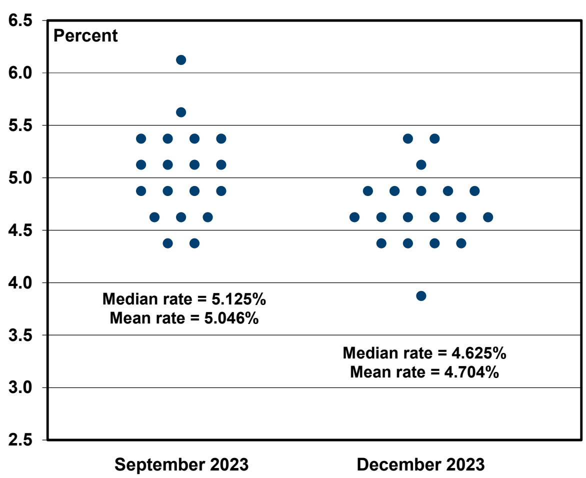
FOMC: Dovish, but Pivot not Imminent

Fed officials left unchanged the target range for the federal funds rate at 5.25 to 5.50 percent at the conclusion of their two-day policy meeting on Wednesday. However, commentators and market participants seized on the new dot plot -- and subsequent comments by Chair Powell -- as raising the distinct possibility of a pivot to lower rates in the near-term. Specifically with regard to the dot plot, the new iteration removed a previously projected final hike in 2023 and now signaled further reductions of 75 basis points in 2024 (chart, below left; the previous dot plot implied two 25-basis-point rate cuts in 2024 from a higher terminal rate of 5.625 percent). In response, the 2-year Treasury yield fell to 4.44 percent as of Friday afternoon (versus 4.72 percent last Friday), and rates moved lower across the Treasury curve. The path for the federal funds rate implied by futures contracts currently shows a pivot in the spring and a federal funds rate of approximately 4.0 percent by next December, well below the median dot for 2024 (chart, below right).

The market response to Fed action, while accurately reflecting the potential for rate cuts in coming months, perhaps overestimated both the timing and magnitude of those anticipated shifts. Financial conditions are tight, with significantly elevated real rates persisting even after Wednesday's announcement, which is appropriate given that inflation is moderating (possibly rapidly) but not back to the Fed's two percent target (charts, next page). Thus, it makes sense for officials to anticipate an upcoming transition to lower rates, because maximal policy restriction will not be required at some point in the near future. However, given current rhetoric by officials, including John Williams of the New York Fed, who today indicated that discussion of a pivot is "premature," and Raphael Bostic of the Atlanta Fed, a 2024 voter, who offered his view that the first cut could come in 2024-Q3, it seems more likely that the pivot could occur later, beyond the spring.

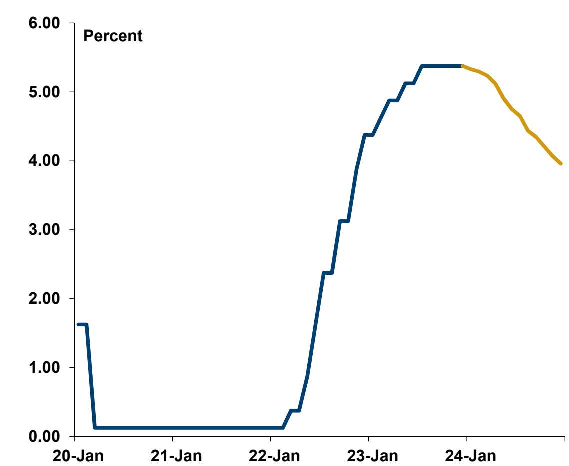
FOMC Rate View, Year-End 2024*



** Each dot represents the expected federal funds rate of a Fed official at the end of 2024.*

Source: Federal Open Market Committee, Summary of Economic Projections, September 2023 & December 2023

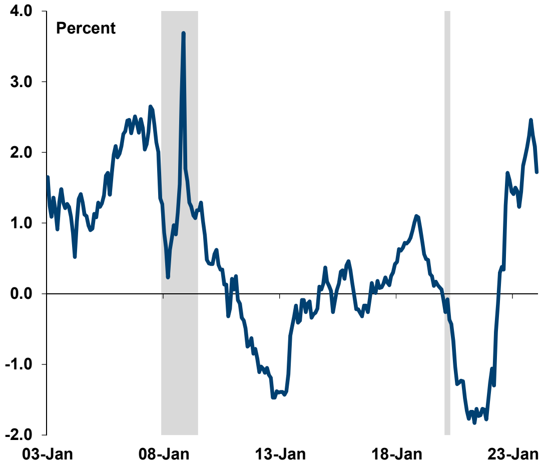
Federal Funds Target Rate*



** The gold line shows the projected path of the federal funds target rate based on futures contracts as of December 15, 2023.*

Sources: Federal Reserve Board via Haver Analytics; Bloomberg

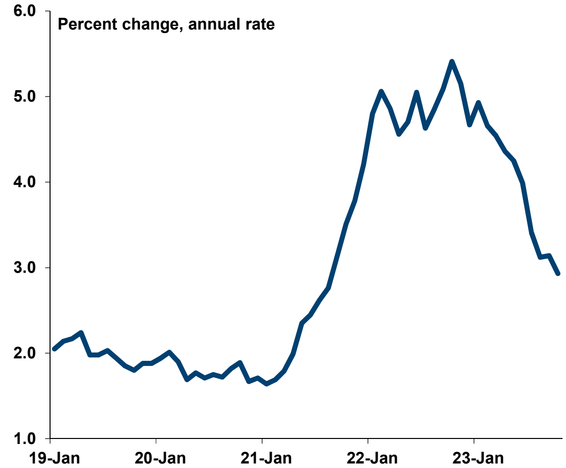
Real 5-Year Treasury Yield*



** Monthly average data, except for the last two observations which is a weekly average quote for the week ended Friday December 8, 2023 and a daily quote for December 14, 2023. The shaded areas indicate periods of recession in the United States.*

Source: Federal Reserve Board via Haver Analytics

Trimmed-Mean PCE Inflation*



** This measure is calculated by excluding the lowest 24 percent and highest 31 percent of price changes (determined by expenditure weight) to provide a more stable indicator of underlying inflation trends. The blue line illustrates the six-month change in the price level, annual rate.*

Source: Federal Reserve Bank of Dallas via Haver Analytics

As an aside, our view on the federal funds rate for year-end 2024 is more aligned with market expectations (a target range of 4.00 to 4.25 percent in December), anchored by the assessment that risks to growth are tilted to the downside and that a mild recession could develop in the first half of next year. The slowdown, if realized, could prompt sharper rate cuts by the FOMC than projected in the current Summary of Economic Projections. Should a scenario more closely aligned with that in the December SEP materialize – 2024 growth of 1.4 percent, an upward drift in unemployment to 4.1 percent, core inflation at 2.4 percent – then a shallower path of cuts would appear to be the more likely outcome.

Timing of Treasury Secretary Yellen's Comments Pose another Challenge for Fed

Treasury Secretary Janet Yellen spoke on CNBC's "Squawk on the Street" program on the morning of December 13. On face, this interview provided keen insights from a distinguished academic and former Fed Chair to market participants. However, as it was the second day of the FOMC's December meeting, presumably when policymakers were concluding discussions before their 2pm announcement, the timing of the Secretary's comments led some commentators ex post facto to characterize the Committee's perceived dovish turn as succumbing to political pressure.

While we view this characterization as incorrect, perceptions of the independence of central bankers and their impartiality in striving to meet their mandates -- maximum employment and price stability -- are critical for maintaining the confidence of market participants and the broader citizenry. Any appearance of outside political influence, intentional or not, adds to the already difficult task of maintaining trust and credibility. As a former Fed official herself, we would expect that the Treasury Secretary has a keen understanding of this. Avoiding direct commentary on monetary policy on the day of an FOMC decision would go a long way in preventing the suggestion of political influence on the Committee's deliberations.

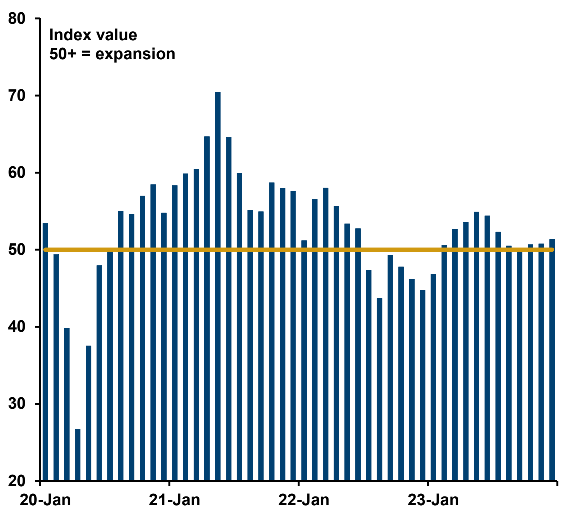
We encourage a review of the entire interview transcript, available on CNBC's website: https://www.cnbc.com/2023/12/13/cnbc-exclusive-cnbc-transcript-united-states-treasury-secretary-janet-yellen-speaks-with-cnbcs-sara-eisen-on-squawk-on-the-street-today.html

S&P PMIs and Industrial Production

After favorable data on retail spending earlier this week suggested that the consumer remained active in Q4, we turned with anticipation to Friday data that provide a wider view of underlying economic conditions. The economy remained strong in Q3, registering growth of 5.2 percent, but more recent data point to a slowdown as restrictive monetary policy has constrained activity. Friday releases, the S&P Global U.S. Manufacturing and Services PMIs for December and Industrial Production as of November, ratified that view: continued moderation in activity with particular weakness in some of the most interest-rate-sensitive sectors.

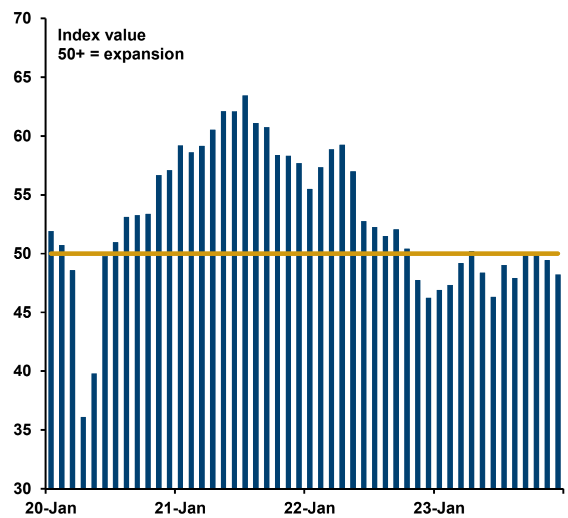
Regarding the S&P Global PMIs, the December flash estimate for the service sector index rose to 51.3 from 50.8, the highest reading since the 52.3 print in July (chart, below left). A growth signal from this indicator provides useful insight into economic conditions, as private service producing industries contribute about 70 percent of value added to GDP. Were the PMI to signal contraction on a sustained basis, it would raise the likelihood that the economy had entered a recession. Thus, all clear for now. The manufacturing index was less encouraging, falling to 48.2 from a final November reading of 49.4. Moreover, this measure has been below 50.0, signaling contraction, in 12 of the last 14 months (chart, below right). On one hand, the factory sector is a bellwether for the broader economy in that it is highly cyclical in nature, but other indicators (labor market metrics, for instance) imply that the expansion is still on track -- at least for now.

US PMI: Services



Source: S&P Global via Haver Analytics

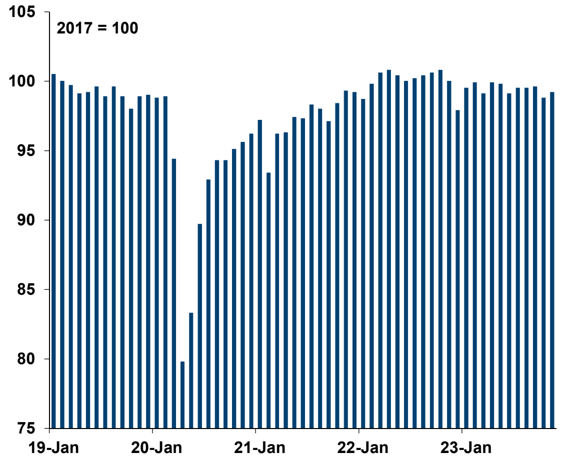
US PMI: Manufacturing



Source: S&P Global via Haver Analytics

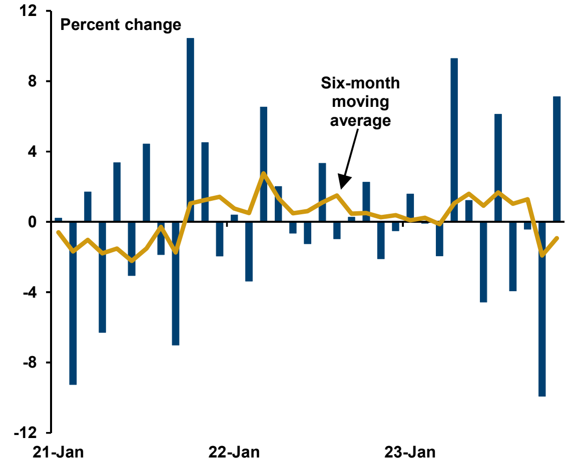
Further insight into conditions in the factory sector was available in today's report on industrial production. While lagged by one month versus the PMIs, the industrial production report provides a quantitative assessment of output which tracks more closely to growth metrics. Total industrial production rose 0.2 percent in November after a drop of 0.9 percent in the prior month. Mining activity ticked higher (+0.3 percent), having returned to pre-pandemic levels; utility output, in contrast, fell for the third consecutive month (-0.4 percent), although this area reflects shifts in weather rather than underlying economic conditions. Manufacturing output, the key focus, rose 0.3 percent after a downwardly revised drop of 0.8 percent in October. Even with the latest pickup, the index has drifted lower since last November (a year-over-year decline of 0.8 percent; chart, next page, left). The previous drop mostly reflected strike-related shutdowns in the auto industry, with motor vehicle and parts production swooning 9.9 percent in October before increasing 7.1 percent in the latest month (chart, right; motor vehicle production is volatile in general, and pandemic-related semiconductor shortages exacerbated the volatility in the past few years, but movements in the past two months were particularly large). However, there has been additional notable softening which has been obscured by the swings in vehicle production. Manufacturing production excluding motor vehicles fell 0.2 percent in November after a dip of 0.1 percent in October (-1.1 percent year-over-year in November). In the latest month, 13 of 19 non-auto manufacturing components declined. Again, the results don't necessarily suggest recession, but they do imply slack demand—even as previous monetary policy tightening has yet to come into full force.

Industrial Production: Manufacturing



Source: Federal Reserve Board via Haver Analytics

Industrial Production: Motor Vehicles & Parts



Source: Federal Reserve Board via Haver Analytics

The Week Ahead

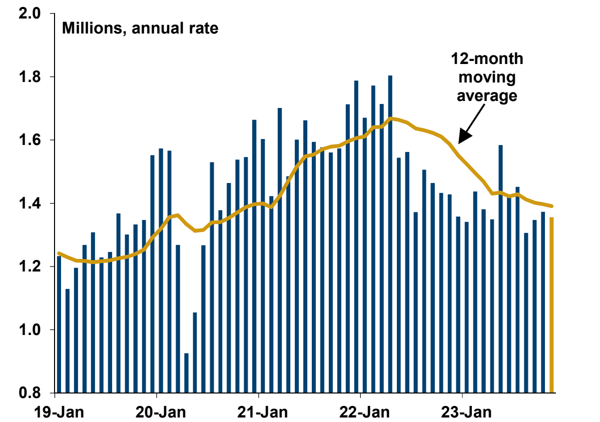
Housing Starts (November) (Tuesday)
Forecast: 1.355 Million (-1.2%)

The recent pattern of permit issuance suggests little chance of a meaningful near-term recovery in housing starts. Builders may curtail single-family activity amid elevated inventories of homes available for sale, while tight lending standards and elevated interest rates appear to have cooled new multi-family construction.

Existing Home Sales (November) (Wednesday)
Forecast: 3.75 Million (-1.1%)

Even with mortgage rates ticking lower in November, tight inventories and elevated prices, along with more stringent lending standards, are likely to constrain sales in the existing home market. Furthermore, the index of pending home sales, which correlates with sales of existing homes in the following few months, moved to a record low in October, which speaks to the weakness in this (significantly larger) portion of the housing market.

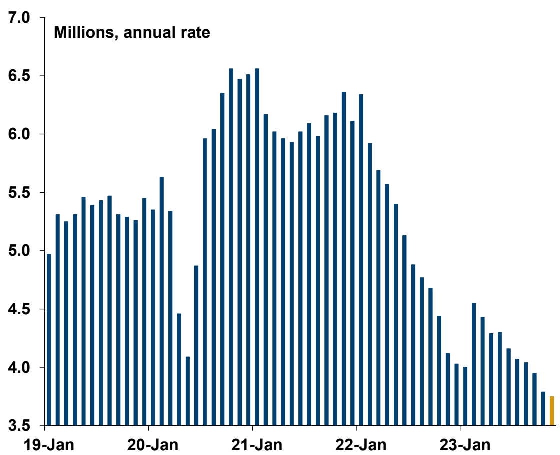
Housing Starts*



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

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

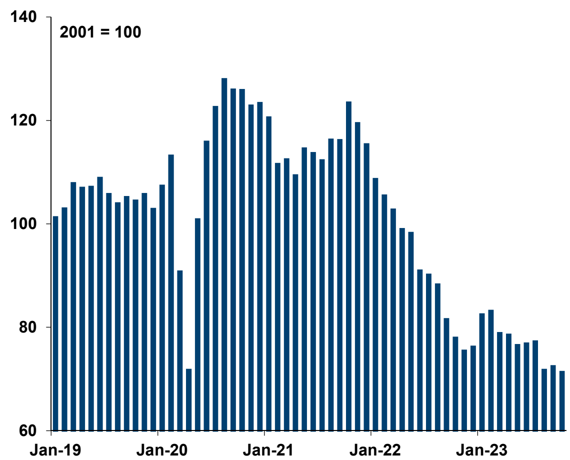
Existing Home Sales*



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

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

Pending Home Sales



Source: National Association of Realtors via Haver Analytics

Consumer Confidence (December) (Wednesday)
Forecast: 105.0 (+2.9% or +3.0 Pct. Pt.)

Lower gasoline prices and a still-solid job market could boost consumer attitudes in December, a view supported by a brisk increase in the early-month read from the University of Michigan sentiment survey. However, even with the expected advance, the projected level of confidence would still be in the lower end of the range of the current expansion.

Revised GDP (2023-Q3) (Thursday)
Forecast: 4.8% (-0.4 Pct. Pt. Revision)

New information received since the publication of the second estimate of GDP suggests a downward revision to growth in the third quarter of 2023. Specifically, consumer spending could be nudged lower from robust growth of 3.6 percent, annual rate, previously reported, and the contribution of inventory investment to GDP growth (1.4 percentage points in the 2nd estimate) may be lighter than initially indicated (but still firm: we expect a contribution of 1.2 percentage points; a downward adjustment of 0.2 percentage point).

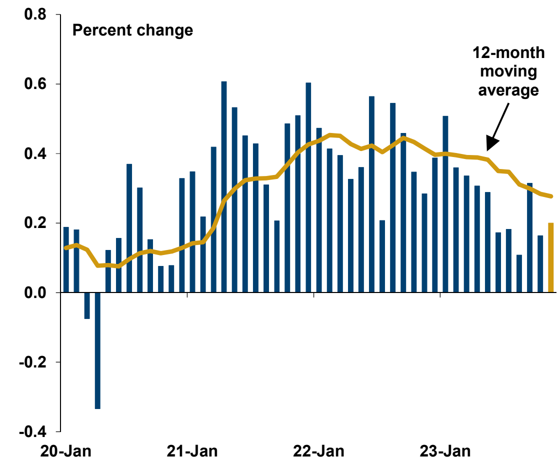
Leading Indicators (November) (Thursday)
Forecast: -0.5%

Negative contributions from consumer expectations, the ISM new orders index, and the slope of the yield curve are likely to offset a positive contribution from stock prices and lead to the 20th consecutive decline in the Conference Board's index of leading economic indicators. If the forecast is realized, the measure will have declined 12.2 percent from the cycle peak in December 2021.

Personal Income, Consumption, & PCE Price Indexes (November) (Friday)
Forecast: 0.4% Income, 0.2% Consumption, 0.0% Headline Price Index, 0.2% Core Price Index

Firm increases in average hourly earnings and aggregate hours suggest a brisk advance in the wages and salaries component of personal income. Additionally, elevated interest rates raise the possibility of a strong advance in personal interest income. On the spending side, a solid advance in key retail categories implies respectable spending on nondurable items, although a dip in vehicle sales implies restrained outlays for durable items. Spending on services has remained on a respectable trend since the economy has normalized post-COVID. Results for the headline CPI suggest little change in the PCE price index; while the core CPI rounded up to 0.3 percent, we suspect that the core PCE measure could move in the opposite direction (+0.2 percent anticipated).

Core PCE Price Index*



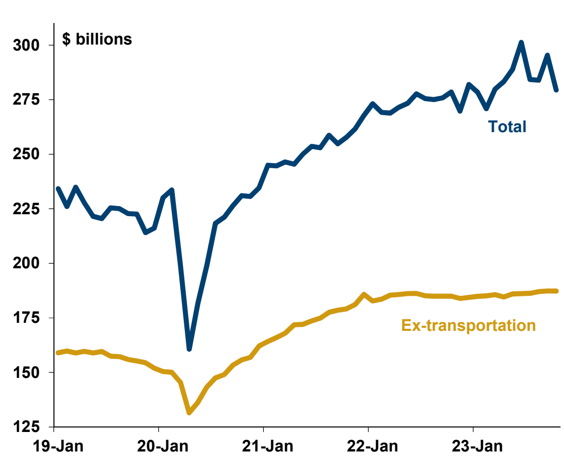
** The gold bar is a forecast for November 2023.*

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

Durable Goods Orders (November) (Friday)
Forecast: 3.0% Total, 0.2% Ex. Transportation

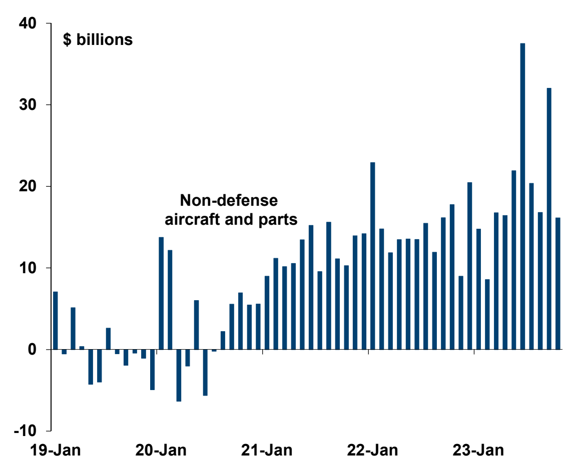
A jump in orders reported by Boeing raises the possibility of another large shift in the civilian aircraft component in November, continuing the recent pattern that has introduced significant volatility to headline durable goods orders. Durable bookings outside of the transportation category are likely to be constrained by an uncertain outlook amid high interest rates.

New Orders for Durable Goods



Source: U.S. Census Bureau via Haver Analytics

New Orders for Durable Goods



Source: U.S. Census Bureau via Haver Analytics

New Home Sales (November) (Friday)
Forecast: 0.685 Million (+0.9%)

Although the inventory situation is better than that in the existing home market, elevated mortgage rates and tight lending standards are likely to leave sales range-bound in November.

Economic Indicators

December 2023 / January 2024

Monday 11

Tuesday 12

NFIB SMALL BUSINESS OPTIMISM INDEX

Sep	90.8
Oct	90.7
Nov	90.6

CPI

	Total	Core
Sep	0.4%	0.3%
Oct	0.0%	0.2%
Nov	0.1%	0.3%

FEDERAL BUDGET

	2023	2022
Sep	-$170.7B	-$429.8B
Oct	-$66.6B	-$87.9B
Nov	-$314.0B	-$248.5B

FOMC MEETING (FIRST DAY)

Wednesday 13

PPI

	Final Demand	Ex. Food & Energy
Sep	0.4%	0.2%
Oct	-0.4%	0.0%
Nov	0.0%	0.0%

FOMC DECISION

Thursday 14

UNEMPLOYMENT CLAIMS

	Initial (millions)	Continuing (millions)
Nov 18	0.211	1.925
Nov 25	0.219	1.856
Dec 2	0.221	1.876
Dec 9	0.202	N/A

RETAIL SALES

	Total	Ex.Autos
Sep	0.8%	0.8%
Oct	-0.2%	0.0%
Nov	0.3%	0.2%

IMPORT/EXPORT PRICES

	Non-Petrol Imports	Nonagri. Exports
Sep	-0.2%	0.8%
Oct	-0.2%	-1.0%
Nov	0.2%	-1.0%

BUSINESS INVENTORIES

	Inventories	Sales
Aug	0.4%	1.4%
Sep	0.2%	0.9%
Oct	-0.1%	-1.0%

Friday 15

EMPIRE MFG

Oct	-4.6
Nov	9.1
Dec	-14.5

IP & CAP-U

	IP	Cap.Util.
Sep	0.1%	79.5%
Oct	-0.9%	78.7%
Nov	0.2%	78.8%

Monday 18

NAHB HOUSING INDEX (10:00)

Oct	40
Nov	34
Dec	--

Tuesday 19

HOUSING STARTS (8:30)

Sep	1.346 million
Oct	1.372 million
Nov	**1.355 million**

TIC FLOWS (4:00)

	Long-Term	Total
Aug	$62.2B	$131.0B
Sep	-$1.7B	-$67.4B
Oct	--	--

Wednesday 20

CURRENT ACCOUNT (8:30)

23-Q1	-$214.5 bill.
23-Q2	-$212.1 bill.
23-Q3	**-$200.0 bill.**

EXISTING HOME SALES (10:00)

Sep	3.950 million
Oct	3.790 million
Nov	**3.750 million**

CONFERENCE BOARD CONSUMER CONFIDENCE (10:00)

Oct	99.1
Nov	102.0
Dec	**105.0**

Thursday 21

UNEMP. CLAIMS (8:30)

REVISED GDP (8:30)

	GDP	Chained Price
23-Q2	2.1%	1.7%
23-Q3 (p)	5.2%	3.6%
23-Q3 (r)	**4.8%**	**3.6%**

PHILADELPHIA FED MFG BUSINESS OUTLOOK (8:30)

Oct	-9.0
Nov	-5.9
Dec	--

LEADING INDICATORS (10:00)

Sep	-0.7%
Oct	-0.8%
Nov	**-0.5%**

Friday 22

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

	Inc.	Cons.	Core
Sep	0.4%	0.7%	0.3%
Oct	0.2%	0.2%	0.2%
Nov	**0.4%**	**0.2%**	**0.2%**

DURABLE GOODS ORDERS (8:30)

Sep	4.0%
Oct	-5.4%
Nov	**3.0%**

NEW HOME SALES (10:00)

Sep	0.719 million
Oct	0.679 million
Nov	**0.685 million**

REVISED CONSUMER SENTIMENT (10:00)

Oct	63.8
Nov	61.3
Dec (p)	69.4

Monday 25

CHRISTMAS

Tuesday 26

CHICAGO FED NATIONAL ACTIVITY INDEX

FHFA HOME PRICE INDEX

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

Wednesday 27

Thursday 28

UNEMP. CLAIMS

INTERNATIONAL TRADE IN GOODS

ADVANCE INVENTORIES

PENDING HOME SALES

Friday 29

MNI CHICAGO BUSINESS BAROMETER

Monday 25

NEW YEAR'S DAY

Tuesday 26

CONSTRUCTION

Wednesday 27

ISM MFG. INDEX

JOLTS DATA

FOMC MINUTES

VEHICLE SALES

Thursday 28

UNEMP. CLAIMS

ADP EMPLOYMENT

Friday 29

EMPLOYMENT REPORT

TRADE BALANCE

ISM SERVICES INDEX

FACTORY ORDERS

Forecasts in bold. (p) = preliminary, (r) = revised

Treasury Financing

December 2023 / January 2024

Monday	Tuesday	Wednesday	Thursday	Friday
11	12	13	14	15
AUCTION RESULTS: Rate / Cover 13-week bills 5.260% 2.99 26-week bills 5.190% 3.03 3-yr notes 4.490% 2.42 10-yr notes 4.296% 2.53	**AUCTION RESULTS:** Rate / Cover 30-yr bonds 4.344% 2.43 42-day CMBs 5.285% 2.85 **ANNOUNCE:** $56 billion 17-week bills for auction on Dec 13 $80 billion 4-week bills for auction on Dec 14 $80 billion 8-week bills for auction on Dec 14 **SETTLE:** $56 billion 17-week bills $80 billion 4-week bills $80 billion 8-week bills	**AUCTION RESULTS:** Rate / Cover 17-week bills 5.250% 2.84	**AUCTION RESULTS:** Rate / Cover 4-week bills 5.270% 2.86 8-week bills 5.275% 2.83 **ANNOUNCE:** $143 billion 13-,26-week bills for auction on Dec 18 $13 billion 20-year bonds for auction on Dec 20 $20 billion 5-year TIPS for auction on Dec 21 $70 billion 42-day CMBs for auction on Dec 19 **SETTLE:** $143 billion 13-,26-week bills $70 billion 42-day CMBs	**SETTLE:** $50 billion 3-year notes $37 billion 10-year notes $21 billion 30-year bonds
18	19	20	21	22
AUCTION: $143 billion 13-,26-week bills	**AUCTION:** $70 billion 42-day CMBs **ANNOUNCE:** $56 billion* 17-week bills for auction on Dec 20 $80 billion* 4-week bills for auction on Dec 21 $80 billion* 8-week bills for auction on Dec 21 **SETTLE:** $56 billion 17-week bills $80 billion 4-week bills $80 billion 8-week bills	**AUCTION:** $56 billion* 17-week bills $13 billion 20-year bonds	**AUCTION:** $80 billion* 4-week bills $80 billion* 8-week bills $20 billion 5-year TIPS **ANNOUNCE:** $143 billion* 13-,26-week bills for auction on Dec 26 $44 billion* 52-week bills for auction on Dec 26 $57 billion* 2-year notes for auction on Dec 26 $58 billion* 5-year notes for auction on Dec 27 $40 billion* 7-year notes for auction on Dec 28 $26 billion* 2-year FRNs for auction on Dec 27 **SETTLE:** $143 billion 13-,26-week bills $70 billion 42-day CMBs	
25	26	27	28	29
CHRISTMAS	**AUCTION:** $143 billion* 13-,26-week bills $44 billion* 52-week bills $57 billion* 2-year notes **ANNOUNCE:** $56 billion* 17-week bills for auction on Dec 27 $80 billion* 4-week bills for auction on Dec 28 $80 billion* 8-week bills for auction on Dec 28 **SETTLE:** $56 billion* 17-week bills $80 billion* 4-week bills $80 billion* 8-week bills	**AUCTION:** $$56 billion* 17-week bills $58 billion* 5-year notes $26 billion* 2-year FRNs	**AUCTION:** $80 billion* 4-week bills $80 billion* 8-week bills $40 billion* 7-year notes **ANNOUNCE:** $143 billion* 13-,26-week bills for auction on Jan 2 **SETTLE:** $143 billion* 13-,26-week bills $44 billion* 52-week bills	**SETTLE:** $20 billion 5-year TIPS $26 billion* 2-year FRNs
1	2	3	4	5
NEW YEAR'S DAY	**AUCTION:** $143 billion* 13-,26-week bills **ANNOUNCE:** $56 billion* 17-week bills for auction on Jan 3 $80 billion* 4-week bills for auction on Jan 4 $80 billion* 8-week bills for auction on Jan 4 **SETTLE:** $56 billion* 17-week bills $80 billion* 4-week bills $80 billion* 8-week bills $13 billion 20-year bonds $57 billion* 2-year notes $58 billion* 5-year notes $40 billion* 7-year notes	**AUCTION:** $56 billion* 17-week bills	**AUCTION:** $80 billion* 4-week bills $80 billion* 8-week bills **ANNOUNCE:** $143 billion* 13-,26-week bills for auction on Jan 8 $52 billion* 3-year notes for auction on Jan 9 $37 billion* 10-year notes for auction on Jan 10 $21 billion* 30-year bonds for auction on Jan 11 **SETTLE:** $143 billion* 13-,26-week bills	

*Estimate