U.S. Economic Comment

- Q4 GDP: A firm performance ahead of slowdown in 2024
- Qualitative data: often volatile, but useful in assessing economic momentum
- Consumer sentiment: a favorable turn?

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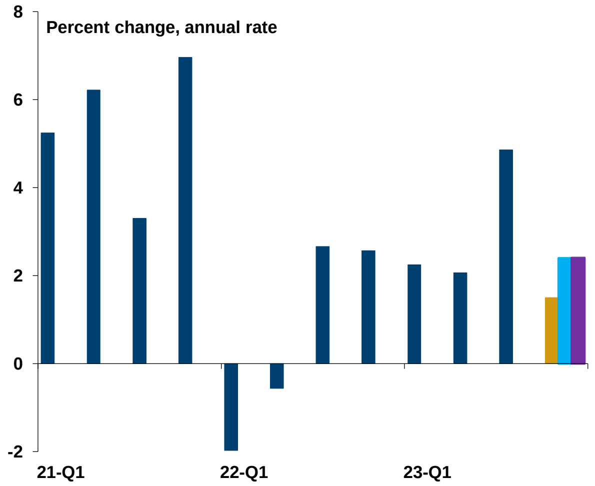
The U.S. Economy: On Track in Q4

Data in hand suggest that the U.S. economy remained on a growth trajectory in Q4 after a strong performance earlier in the year despite notable headwinds. Our expectation of growth of 1.5 percent, annual rate, trails model-derived projections from the Federal Reserve banks of Atlanta and New York, but it is still a respectable performance (the 1st estimate of Q4 GDP will be released on January 25; chart, below left). Moreover, our projection of Q4/Q4 growth of 2.7 percent is approximately 1.0 percentage point above the economy's projected long-term growth rate (the median expectation of Fed officials in the December Summary of Economic Projections was 1.8 percent, with a range of 1.6 to 2.5 percent). Final sales to domestic purchasers, which excludes the effects of inventory investment and net exports and gives insight into domestic demand, could be even stronger; we anticipate growth of 2.7 percent, annual rate, after a jump of 3.5 percent in Q3 (chart, below right).

A key driver of our expectation for solid growth (and impressive domestic demand) was active consumer spending in the closing months of 2023. We had entertained the prospect of a slowdown in December, with consumers potentially pulling back after early holiday shopping, but the retail sales report this week suggested otherwise with strong spending indicated in many discretionary categories. That report, along with a pickup in new vehicle sales, sets the stage for growth of real consumer spending in excess of two percent after a brisk 3.1 percent pace in Q3 (chart, next page, left). In the opposite direction, we expect inventory investment to exert a drag of more than one percentage point on growth after contributing 1.3 percentage points in Q3 (chart, next page, right). Inventory investment was uneven earlier in the expansion on account of supply-chain disruptions, and while those have largely abated, caution amid a sluggish demand outlook could further constrain inventory accumulation heading into next year. That said, while we covered the 2024 outlook extensively in last week's economic comment -- and we are less optimistic about the economy's performance in this year – all signs point to firm domestic demand in the closing months of 2023.

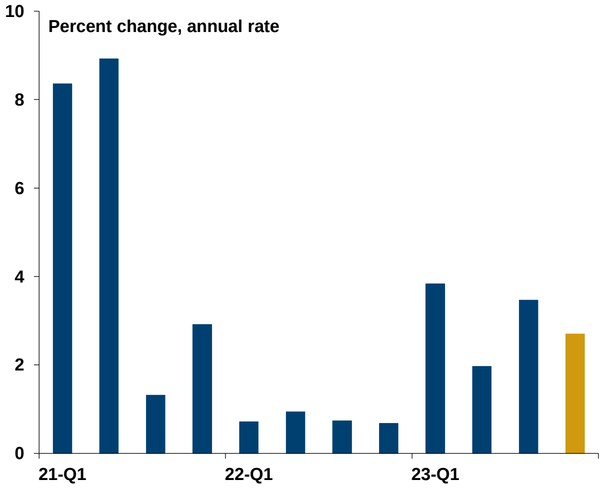
GDP Growth*



** The gold, light blue, and purple bars are forecasts for 2023-Q4 from DCMA, the Atlanta Fed's GDPNow model, and the New York Fed's Nowcast model.*

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

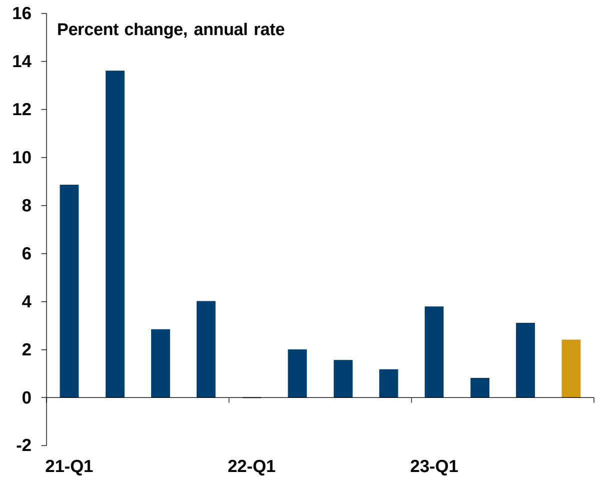
Final Sales to Domestic Purchasers*



** Gross domestic purchases less change in private inventories and net exports. The gold bar is a forecast for 2023-Q4.*

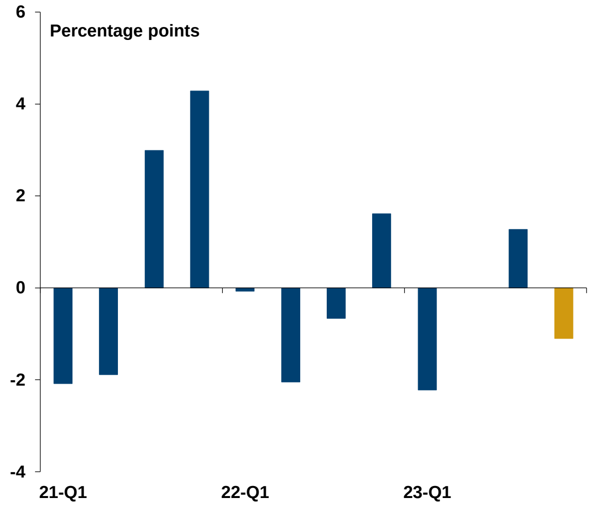
Sources: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

Real Consumer Spending*



** The gold bar is a forecast for 2023-Q4.*
Sources: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

Change in Private Inventories*



** The gold bar is a forecast for 2023-Q4.*
Sources: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

Don’t Ignore the So-Called “Soft” Data

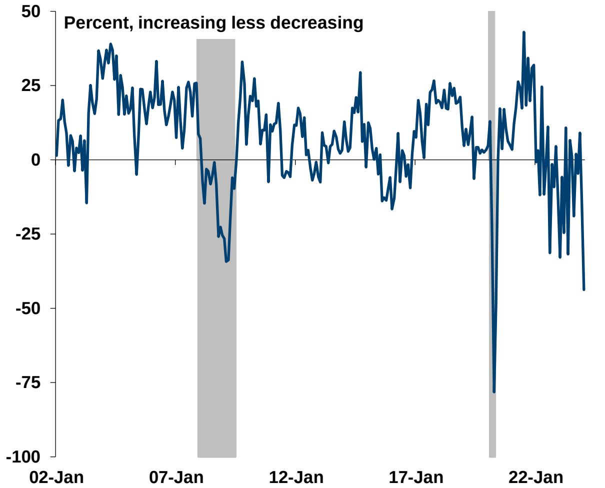
Patrick Harker, President of the Federal Reserve Bank of Philadelphia, provided useful insight this week on how, as a policymaker, he incorporates both so-called “hard” and “soft” data into his outlook for the economy. While the hard data (inflation indexes and labor market data, for example) are essential elements for analysis, they are backward looking in nature and thus provide an incomplete picture. Therefore, incorporating qualitative assessments – input from business contacts, surveys, etc. -- assist in formulating prospective views on the direction of the economy and thus better inform expectations. (see: Harker, Patrick T. “Carefully Balancing Both Hard and Soft Data in Policy Discussions,” Federal Reserve Bank of Philadelphia, Jan. 2024. https://www.philadelphiafed.org/the-economy/monetary-policy/carefully-balancing-both-hard-and-soft-data-in-policy-discussions).

We received several “soft” data points this week, including the Beige Book and regional manufacturing indexes from the Federal Reserve Banks of New York and Philadelphia. The Fed’s Beige Book report, in our view, carried a guardedly optimistic tone. Although growth across the 12 Federal Reserve Districts currently ranged from declining “moderately” to expanding “modestly,” the report also noted that “numerous contacts” saw the prospect of falling interest rates as “a source of optimism.” Thus, economic activity is currently being constrained by tight financial conditions, but the outlook is more favorable. (for additional detail, see: “The Beige Book: Summary of Commentary on Current Economic Conditions by Federal Reserve District,” Federal Reserve Board, Jan. 2024. https://www.federalreserve.gov/monetarypolicy/publications/beige-book-default.htm).

A less sanguine view was offered by the regional manufacturing indexes. The New York Fed’s Empire State Manufacturing survey fell to -43.7 from -14.5, the lowest reading since mid-2020, while the Philly Fed’s Manufacturing Business Outlook headline was a less dire but still soft -10.6 (versus -12.8 in December 2023). Keep in mind that these measures are volatile from month-to-month, and expectations measures included with both surveys suggested hope for better conditions in the future, but on face readings for a good while have been consistent with an economy in recession.

That said, the economy is likely not in recession currently (see GDP preview above), but incorporating qualitative assessments on the economy suggest that the picture has perhaps softened to a degree since Q4 and that the possible distribution of outcomes for this year is wide.

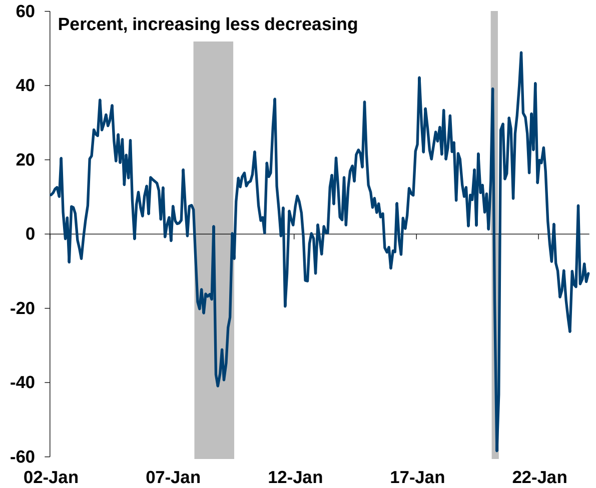
Empire Manufacturing Survey*



** The general business conditions measure is a separate question in the survey that takes the difference between respondents that report improving activity and those who report deteriorating activity (as opposed to a weighted average like the ISM gauge). The shaded areas indicate periods of recession in the United States.*

Sources: Federal Reserve Bank of New York, National Bureau of Economic Research via Haver Analytics

Manufacturing Business Outlook*



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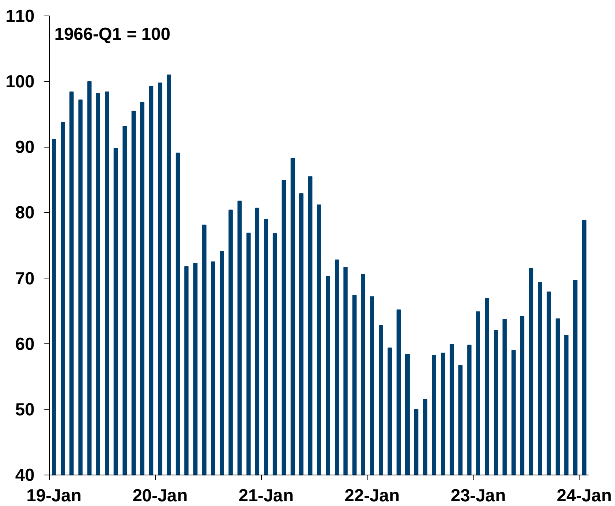
Sources: Federal Reserve Bank of Philadelphia, National Bureau of Economic Research via Haver Analytics

Incremental Improvement in Consumer Sentiment

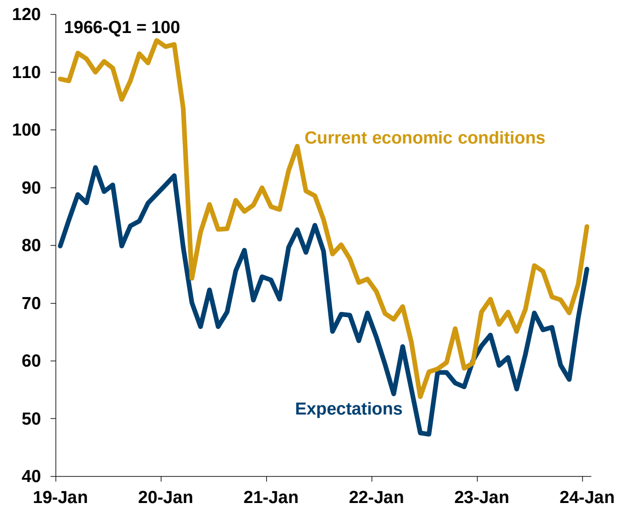
While certain qualitative assessments are sending warning signals regarding the U.S. economy, one measure providing insight on the consumer sector moved in the opposite direction in early January. The Survey of Consumers from the University of Michigan (released Friday) surged 9.1 index points (+13.1 percent) to 78.8 after a jump of 8.4 index points (+13.7 percent) in December. The back-to-back gains left the sentiment at its highest level since July 2021 (81.2), when the economy was still reopening after the COVID shutdowns and ahead of the most acute phase of the recent bout of inflation (chart, below left). Encouragingly, both the current conditions and expectations components contributed to the sharp improvement, with the current conditions index rising 10.0 index points (+13.6 percent in January; +22.0 percent or 15 index points in the past two months combined) and the expectations component advancing 8.5 index points after a burst of 10.6 index points in December (+12.6 percent in January; +33.6 percent in December and January combined). The current conditions index, although at the upper end of the range of the current expansion, is still well below pre-pandemic readings; however, the level of the expectations component is more favorable and closer to pre-pandemic norms (chart, below right).

Consumer Sentiment



Source: University of Michigan via Haver Analytics

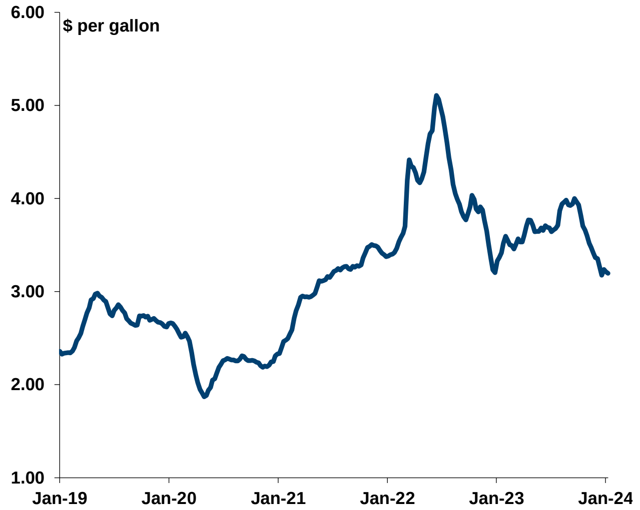
Expectations vs. Current Economic Conditions



Source: University of Michigan via Haver Analytics

Undoubtedly, a recalibration of views on both current inflation and inflation expectations are contributing to the recent improvement in attitudes. After brisk inflation for much of the past two years likely influenced moods despite well-maintained consumer spending and appeared to filter into at least short-term inflation expectations, consumers seem to be finally acknowledging that inflation pressure has peaked and is beginning to recede. Prices paid at the gasoline pump, along with those at the grocery store, provide a useful signpost for consumers regarding shifts in costs, as transactions at service stations and supermarkets occur frequently and compose a non-trivial share of monthly budgets. Regarding gasoline prices, the average retail cost per gallon across grades has fallen for four consecutive months, with the average thus far in January of approximately $3.20 per gallon more than 19 percent below the September average (prices peaked above $4.00 per gallon mid-month; chart, below left). The tangible retreat in the costs of necessities (fuel and food) has led to a settling in both year-ahead and longer term inflation expectations. The year-ahead measure released with the Michigan report eased to 2.9 percent from 3.1 percent in December, suggesting that the recent jump to 4.5 percent in November was merely transient; the long-term gauge eased one tick to 2.8 percent, an observation in the low end of the recent range (chart, below right). As grounded inflation expectations are a necessary condition for the Fed to achieve two-percent inflation in the medium-term, the retreat in inflation expectations should not be overlooked.

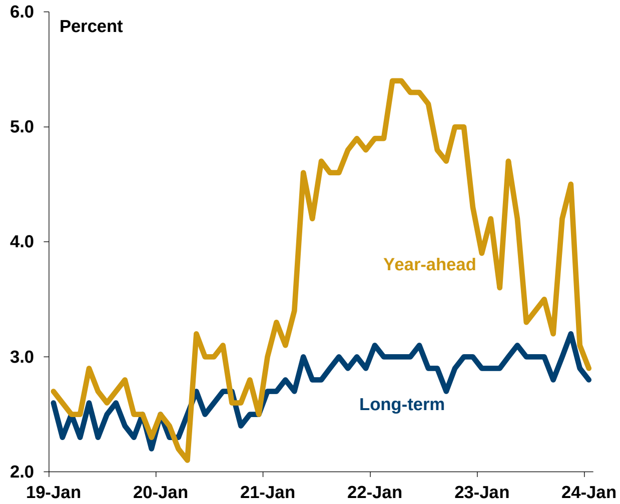
U.S. Gasoline Price: All Grades*



** Weekly average data, with the latest observation occurring the week ended January 12, 2024.*

Source: Energy Information Administration, U.S. Department of Energy via Haver Analytics

Consumer Inflation Expectations



Source: University of Michigan via Haver Analytics

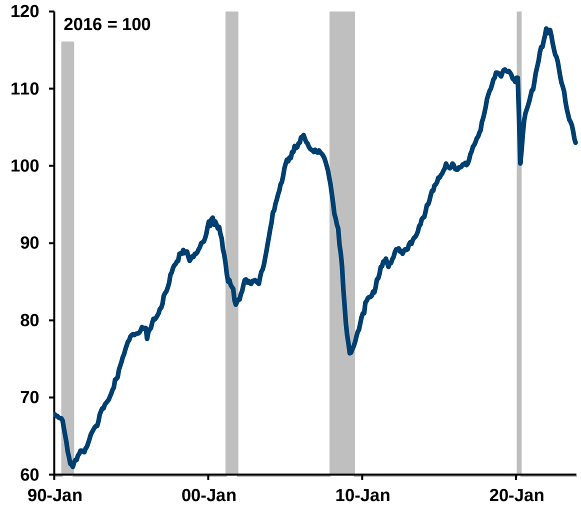
Favorable signals on sentiment aside, we still maintain a somewhat bearish view on the consumer into 2024. We have consistently argued that three factors have spurred robust consumer spending in the current expansion despite rapid inflation: a large pool of excess saving tied to pandemic-period government support, readily available credit, and a strong labor market. We suspect that savings have been mostly exhausted and that credit growth will be curtailed in coming months. And, the labor market could soften further as previous monetary policy tightening comes into full force. That said, shifts in the consumer outlook, with improved expectations for the future, could blunt to a degree the slowdown in spending that we have incorporated into our forecast. If households anticipate better economic conditions and slower inflation a year or two hence, they may remain more active amid a near-term slowdown than previously anticipated. Time will tell.

The Week Ahead

Leading Indicators (December) (Monday)
Forecast: -0.2%

Negative contributions from the ISM new orders index, the slope of the yield curve, and consumer expectations are likely to offset positive contributions from stock prices and unemployment claims, which raises the prospect of a 21st consecutive monthly decline in the Conference Board's index of leading economic indicators. If the forecast is realized, the measure will have fallen 12.7 percent from the cycle peak in December 2021 (chart).

Index of Leading Economic Indicators*

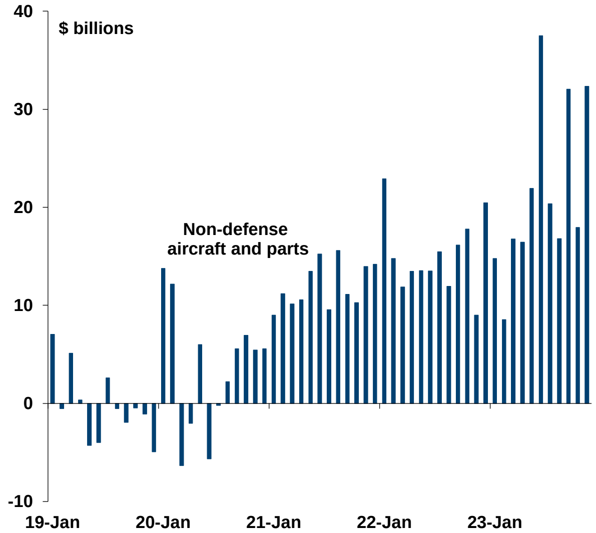


** The shaded areas indicate periods of recession in the United States.*
Sources: The Conference Board, National Bureau of Economic Research via Haver Analytics

Durable Goods Orders (December) (Thursday)
Forecast: 1.5% Total, 0.1% Ex. Transportation

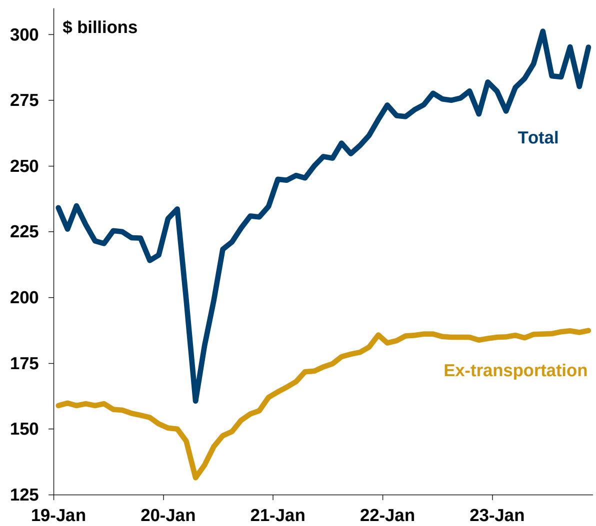
A second consecutive jump in orders reported by Boeing raises the prospect of another large move in the civilian aircraft component in December, continuing a pattern that has incorporated significant month-to-month volatility into headline durable goods orders (charts). That said, orders excluding transportation have only tilted marginally higher in 2023 amid an uncertain demand outlook (chart, below left).

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

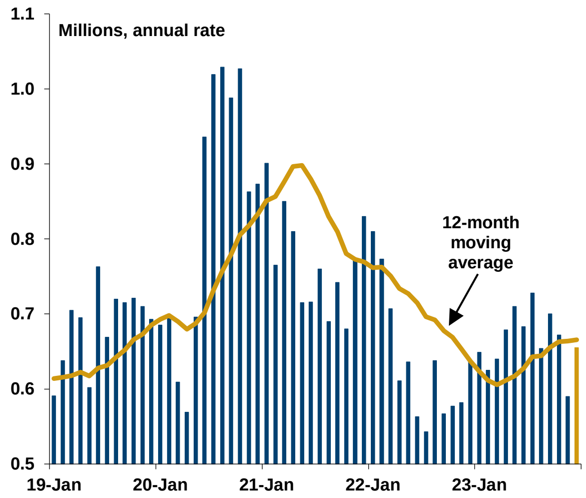
International Trade in Goods (December) (Thursday)
Forecast: -$88.0 Billion ($1.3 Billion Narrower Deficit)

Lower prices of petroleum products in December could depress the value of both U.S. exports and imports of industrial supplies. Outside of industrial supplies, U.S. exports could pick up, led by the auto and consumer goods categories which had fallen in the past few months to the bottoms of their recent ranges. Imports could be light in the latest month, a view supported by light collections of customs duties.

New Home Sales (December) (Thursday)
Forecast: 0.655 Million (+11.0%)

Although affordability constraints and tight lending standards have posed notable challenges to the housing market, the plunge of 12.2 percent to 0.590 million, annual rate, in new home sales in November (the lowest reading of the year thus far) could well be a dose of random volatility rather than a sign of further deterioration. With that in mind, pickups in builder sentiment and prospective buyer traffic, along with lower mortgage rates, suggest a reversion back to the average of 0.674 million per month in the first 10 months of 2023 (chart).

New Home Sales*

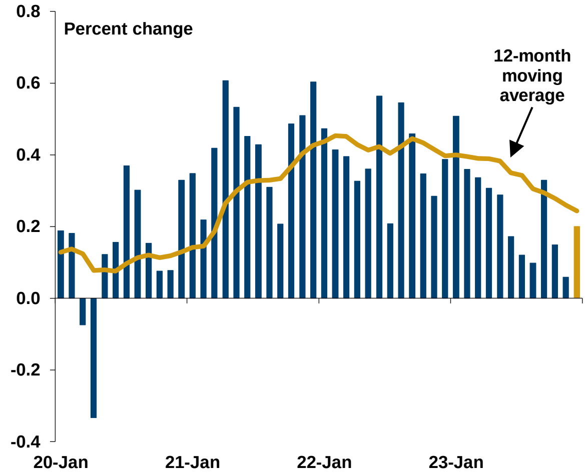


** The gold bar is a forecast for December 2023.*
Sources: U.S. Census Bureau via Haver Analytics; Daiwa Capital Markets America

Personal Income, Consumption, Price Indexes
Forecast: 0.2% Income, 0.4% Consumption, 0.2% Headline Price Index, 0.2% Core Price Index

Although growth of average hourly earnings was firm in December, a decline in aggregate hours raises the possibility of only a modest increase in the wages and salaries component of personal income. On the spending side, a strong advance in key retail categories implies brisk spending on nondurable items, and an increase in sales of new vehicle sales suggests a solid increase in outlays for durable items. Spending on services has remained on a favorable trend for much of 2023. Results for recent inflation indicators suggest moderate increases for both the headline and core price indexes for personal consumption expenditures (chart on the core PCE index, right).

Core PCE Price Index*



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

Daiwa Capital Markets

Economic Indicators

January/February 2024

Monday	Tuesday	Wednesday	Thursday	Friday
15	16	17	18	19
MARTIN LUTHER KING JR DAY	**EMPIRE MFG** Nov 9.1 Dec -14.5 Jan -43.7 **BUSINESS INVENTORIES** Inventories / Sales Sep 0.2% 0.9% Oct -0.1% -1.1% Nov -0.1% 0.2% **BEIGE BOOK (2:00)** **December 2023:** "A majority of the twelve Federal Reserve Districts reported little or no change in economic activity since the prior Beige Book period."	**RETAIL SALES** Total / Ex.Autos Oct -0.3% -0.1% Nov 0.3% 0.2% Dec 0.6% 0.4% **IMPORT/EXPORT PRICES** Non-Petrol Imports / Nonagri. Exports Oct -0.2% -0.9% Nov 0.2% -1.0% Dec 0.0% -0.9% **IP & CAP-U** IP / Cap.Util. Oct -0.8% 78.7% Nov 0.0% 78.6% Dec 0.1% 78.6% **NAHB HOUSING INDEX** Nov 34 Dec 37 Jan 44	**UNEMPLOYMENT CLAIMS** Initial / Continuing (millions) Dec 23 0.220 1.868 Dec 30 0.203 1.832 Jan 6 0.203 1.806 Jan 13 0.187 N/A **HOUSING STARTS** Oct 1.376 million Nov 1.525 million Dec 1.460 million **PHILADELPHIA FED MFG BUSINESS OUTLOOK** Nov -8.0 Dec -12.8 Jan -10.6	**CONSUMER SENTIMENT** Nov 61.3 Dec 69.7 Jan 78.8 **EXISTING HOME SALES** Oct 3.790 million Nov 3.820 million Dec 3.780 million **TIC FLOWS** Long-Term / Total Sep -\$0.7B -\$62.7B Oct \$3.4B -\$62.2B Nov \$126.1B \$260.2B
22	23	24	25	26
LEADING INDICATORS (10:00) Oct -1.0% Nov -0.5% **Dec -0.2%**		**ADVANCE INVENTORIES (8:30)** Wholesale / Retail Oct -0.3% 0.0% Nov -0.2% -0.1% Dec -- -- **NEW HOME SALES (10:00)** Oct 0.672 million Nov 0.590 million **Dec 0.655 million**	**UNEMP. CLAIMS (8:30)** **GDP (8:30)** GDP / Chained Price 23-Q2 2.1% 1.7% 23-Q3 4.9% 3.3% **23-Q4 1.5% 2.2%** **DURABLE GOODS ORDERS (8:30)** Oct -5.1% Nov 5.4% **Dec 1.5%** **INTERNATIONAL TRADE IN GOODS (8:30)** Oct -\$89.7 billion Nov -\$89.3 billion **Dec -\$88.0 billion** **CHICAGO FED NATIONAL ACTIVITY INDEX (8:30)** Monthly / 3-Mo. Avg. Oct -0.66 -0.26 Nov 0.03 -0.20 Dec -- --	**PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX (8:30)** Inc. / Cons. / Core Oct 0.3% 0.1% 0.1% Nov 0.4% 0.2% 0.1% **Dec 0.2% 0.4% 0.2%** **PENDING HOME SALES (10:00)** Oct -1.2% Nov 0.0% Dec --
29	30	31	1	2
	FHFA HOME PRICE INDEX **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** **CONFERENCE BOARD CONSUMER CONFIDENCE** **JOLTS DATA** **FOMC MEETING (FIRST DAY)**	**ADP EMPLOYMENT** **EMPLOYMENT COST INDEX** **MNI CHICAGO BUSINESS BAROMETER** **FOMC RATE DECISION**	**UNEMP. CLAIMS** **PRODUCTIVITY & COSTS** **ISM MFG. INDEX** **CONSTRUCTION** **VEHICLE SALES**	**EMPLOYMENT REPORT** **FACTORY ORDERS** **REVISED CONSUMER SENTIMENT**
5	6	7	8	9
ISM SERVICES INDEX		**TRADE BALANCE** **CONSUMER CREDIT**	**UNEMP. CLAIMS** **WHOLESALE TRADE**	

Forecasts in bold.

Treasury Financing

January/February 2024

Monday	Tuesday	Wednesday	Thursday	Friday
15	16	17	18	19
MARTIN LUTHER KING JR DAY	**AUCTION RESULTS:** Rate / Cover 13-week bills 5.225% 2.99 26-week bills 4.975% 3.17 42 day CMBs 5.285% 2.89 **ANNOUNCE:** $58 billion 17-week bills for auction on Jan 17 $85 billion 4-week bills for auction on Jan 18 $85 billion 8-week bills for auction on Jan 18 **SETTLE:** $56 billion 17-week bills $80 billion 4-week bills $80 billion 8-week bills $52 billion 3-year notes $37 billion 10-year notes $21 billion 30-year bonds	**AUCTION RESULTS:** Rate / Cover 17-week bills 5.185% 3.22 20-yr bonds 4.423% 2.53	**AUCTION RESULTS:** Rate / Cover 4-week bills 5.285% 2.81 8-week bills 5.275% 3.06 10-yr TIPS 1.810% 2.62 **ANNOUNCE:** $147 billion 13-,26-week bills for auction on Jan 22 $46 billion 52-week bills for auction on Jan 23 $60 billion 2-year notes for auction on Jan 23 $61 billion 5-year notes for auction on Jan 24 $41 billion 7-year notes for auction on Jan 25 $28 billion 2-year FRNs for auction on Jan 24 $75 billion 42-day CMBs for auction on Jan 23	**SETTLE:** $143 billion 13-,26-week bills $70 billion 42-day CMBs
22	23	24	25	26
AUCTION: $147 billion 13-,26-week bills	**AUCTION:** $46 billion 52-week bills $60 billion 2-year notes $75 billion 42-day CMBs **ANNOUNCE:** $58 billion* 17-week bills for auction on Jan 24 $85 billion* 4-week bills for auction on Jan 25 $85 billion* 8-week bills for auction on Jan 25 **SETTLE:** $58 billion 17-week bills $85 billion 4-week bills $85 billion 8-week bills	**AUCTION:** $58 billion* 17-week bills $61 billion 5-year notes $28 billion 2-year FRNs	**AUCTION:** $85 billion* 4-week bills $85 billion* 8-week bills $41 billion 7-year notes **ANNOUNCE:** $147 billion* 13-,26-week bills for auction on Jan 29 **SETTLE:** $147 billion 13-,26-week bills $46 billion 52-week bills $75 billion 42-day CMBs	
29	30	31	1	2
AUCTION: $147 billion* 13-,26-week bills	**ANNOUNCE:** $58 billion* 17-week bills for auction on Jan 31 $85 billion* 4-week bills for auction on Feb 1 $85 billion* 8-week bills for auction on Feb 1 **SETTLE:** $58 billion* 17-week bills $85 billion* 4-week bills $85 billion* 8-week bills	**AUCTION:** $58 billion* 17-week bills **ANNOUNCE:** $54 billion* 3-year notes for auction on Feb 6 $42 billion* 10-year notes for auction on Feb 7 $25 billion* 30-year bonds for auction on Feb 8 **SETTLE:** $13 billion 20-year bonds $18 billion 10-year TIPS $60 billion 2-year notes $61 billion 5-year notes $41 billion 7-year notes $28 billion 2-year FRNs	**AUCTION:** $85 billion* 4-week bills $85 billion* 8-week bills **ANNOUNCE:** $147 billion* 13-,26-week bills for auction on Feb 5 **SETTLE:** $147 billion* 13-,26-week bills	
5	6	7	8	9
AUCTION: $147 billion* 13-,26-week bills	**AUCTION:** $54 billion* 3-year notes **ANNOUNCE:** $58 billion* 17-week bills for auction on Feb 7 $85 billion* 4-week bills for auction on Feb 8 $85 billion* 8-week bills for auction on Feb 8 **SETTLE:** $58 billion* 17-week bills $85 billion* 4-week bills $85 billion* 8-week bills	**AUCTION:** $58 billion* 17-week bills $42 billion* 10-year notes	**AUCTION:** $85 billion* 4-week bills $85 billion* 8-week bills $25 billion* 30-year bonds **ANNOUNCE:** $147 billion* 13-,26-week bills for auction on Feb 12 **SETTLE:** $147 billion* 13-,26-week bills	

**Estimate*