U.S. Economic Comment

- CPI revisions: modest changes; decelerating trend remained intact
- Forecasters' inflation expectations: anchored at two percent
- The U.S. budget outlook: dire with little hope for near-term course correction

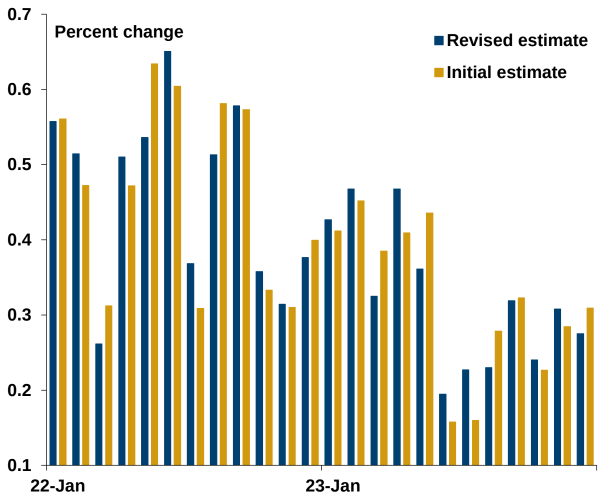
Lawrence Werther
Daiwa Capital Markets America
212-612-6393
lawrence.werther@us.daiwacm.com

CPI Revisions Come In as Expected

In general, the release of new seasonal factors by the Bureau of Labor Statistics for the CPI and revisions to prior five years' data carries little risk of moving markets significantly. Revisions typically are small, and more attention is paid to the publication of January data the following week (due on Tuesday, February 13). The dynamic changed this year when Fed Governor Chris Waller emphasized in a recent speech that he was waiting intently for the publication of the updated data: "One piece of data I will be watching closely is the scheduled revisions to CPI inflation due next month. Recall that a year ago, when it looked like inflation was coming down quickly, the annual update to the seasonal factors erased those gains. In mid-February, we will get the January CPI report and revisions for 2023, potentially changing the picture on inflation. My hope is that the revisions confirm the progress we have seen, but good policy is based on data and not hope" (Waller, Christopher J. "Almost as Good as It Gets…But Will It Last?" Federal Reserve Board, January 16, 2024. https://www.federalreserve.gov/newsevents/speech/waller20240116a.htm). He was almost certainly alluding to the performance of the core CPI in 2022-Q4. Preliminary results indicated that that core inflation rose at a 3.1 percent annual rate in the fourth quarter of 2022, but the application of new seasonal factors left a revised growth rate of 4.3 percent – a striking adjustment.

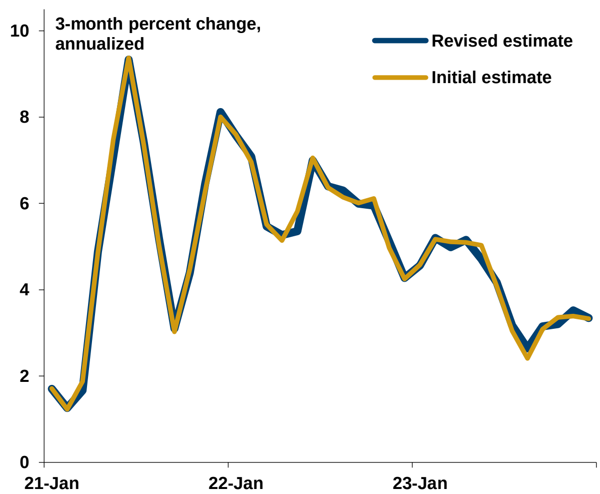
Market participants avoided a similar unfavorable surprise this year as the revised data more closely aligned with the longer-term precedent of showing only modest changes vis-à-vis preliminary results. Month-to-month changes in the core CPI for 2023-Q4 were close to preliminary prints, still rounding to 0.2 percent in October and 0.3 percent in both November and December, and the three-month annualized growth rate in December remained at 3.3 percent (charts). Importantly, the revised data preserved the decelerating trend that has allowed Fed officials to indicate that they have made significant progress in the fight to return inflation to two percent. The Fed Chair and his colleagues have emphasized that they still require "greater confidence" that inflation is moderating back toward target, but now they may more fully focus on upcoming inflation data rather than reverting to reassess the inflation performance in the back half of last year.

Core CPI



Source: Bureau of Labor Statistics via Haver Analytics

Core CPI



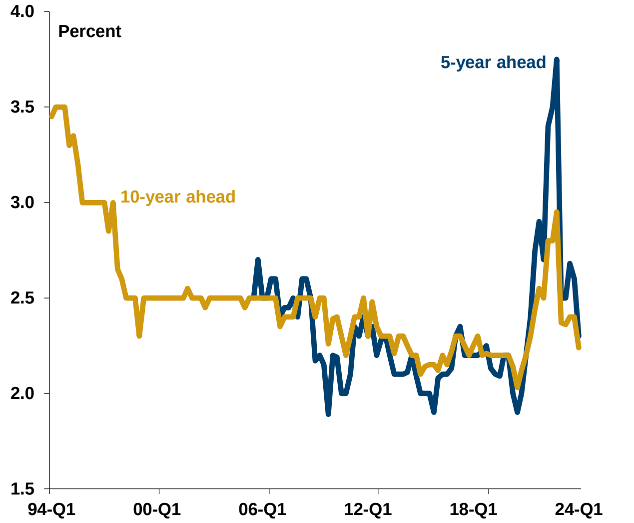
Source: Bureau of Labor Statistics via Haver Analytics

An Updated View on Inflation Expectations

Possibly overlooked today amid the publication of CPI revisions was the posting of the Federal Reserve Bank of Philadelphia's Survey of Professional Forecasters for 2024-Q1, which included an updated view on inflation expectations. Well-anchored inflation expectations are of critical importance to the central bank achieving its price stability mandate, as the behaviors of economic actors are influenced heavily by views on future inflation. Wage negotiations, price setting by corporations, and consumption patterns, for example, are all influenced by views on the trajectory of future costs.

Encouragingly, survey participants – who represent a broad cross-section of financial and academic institutions – recognized progress made on subduing previously rapid inflation and expressed confidence in the Fed's ability to maintain stable prices in the future. The median five-year ahead CPI inflation expectation measure eased to 2.3 percent per year in Q1 from 2.6 percent in 2023-Q4 and a recent high of 3.75 percent in 2022-Q4. The long-term indicator slipped to 2.24 percent from 2.4 percent in Q4 and the recent high of 2.95 percent in 2022-Q4 (chart). Expectations for the price index for personal consumption expenditures were similarly favorable, with the five-year projection easing to 2.05 percent per year from 2.46 percent and the 10-year measure falling from 2.22 percent in Q4 to 2.00 percent in Q1 – consistent with the Federal Reserve's inflation target. In other words, a forceful monetary policy response by the Federal Reserve and realized progress on inflation have strengthened the convictions of market participants that the central bank will fulfill its price stability mandate.

Forecasters' View on Inflation*



** Median estimate of expected yearly CPI inflation over the next 5 and 10 years. Quarterly data for short-term inflation is only available from 2005-Q3 onwards.*

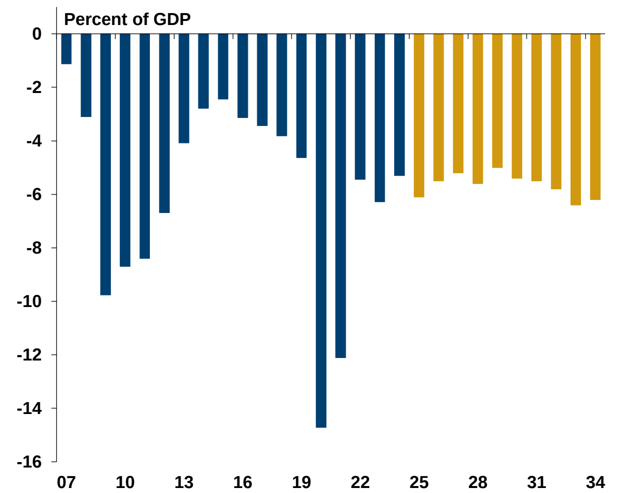
Source: Survey of Professional Forecasters, Federal Reserve Bank of Philadelphia

In Memoriam: Fiscal Responsibility

The fast approaching presidential election in November undoubtedly will stir increasingly strident debates about the fiscal position of the United States and the country's ability to both meet obligations to its citizenry and service a massive – and growing – debt load. With politicians unwilling to damage prospects for reelection by discussing the potential for painful cuts to social programs and substantial increases in taxes, the likelihood of a near-term transition to a more sustainable budgetary path appears unlikely.

The Congressional Budget Office's The Budget and Economic Outlook: 2024 to 2034, released on Wednesday February 7, underscored the magnitude of the challenges facing policymakers and debt managers in the years ahead. According to the CBO's baseline budget projections, the federal budget deficit will grow from $1.5 trillion, or 5.3 percent of GDP in FY2024 to $2.6 trillion (6.2 percent of GDP) in FY2034. The deficits are smaller than those during the years following the financial crisis and more recently those at the height of the pandemic, but they are astounding in the context of a productive economy that should remain on a moderate growth track over time (chart).

Federal Deficit as a Share of GDP*



** Fiscal year basis. Readings from 2024 to 2034 are projections from the Congressional Budget Office.*

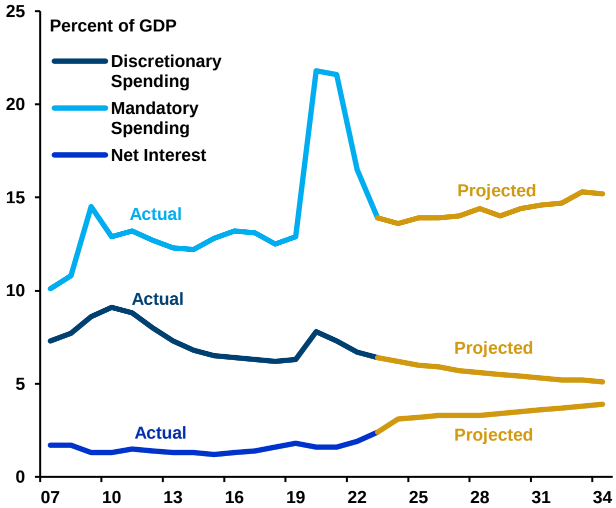
Sources: U.S. Department of the Treasury via Haver Analytics; Congressional Budget Office, "An Update to the Budget Outlook: 2024 to 2034" (February 2024).

https://www.cbo.gov/publication/59710

Over the forecast horizon, revenues are expected to remain in a range of 17 to 18 percent of GDP, but outlays are anticipated to grow from 22.9 percent of GDP in FY2024 to 24.1 percent of GDP in FY2034. Moreover, the composition of outlays is projected to shift, with mandatory expenditures (including Medicare and Social Security) and interest expense increasing from 13.6 and 3.1 percent of GDP, respectively, in FY2024 to 15.2 percent and 3.9 percent in FY2034. Costs associated with an aging population and debt service, all else equal, will crowd out investment in infrastructure, education, and technology, while also limiting the government's ability to stimulate growth in a downturn. Thus, discretionary spending is forecast to ease from 6.2 percent of GDP in 2024 to 5.1 percent in FY2034 (chart, below left).

The growth of debt over time from around 99 percent of GDP in FY2024 to 116 percent of GDP in FY2034 and 172 percent of GDP by FY2054 will pose risks beyond that of interest expense crowding out other budgetary priorities (chart, below right). Investors could well balk at the prospect of financing the federal government amid an ever lager debt burden, or at least demand higher interest rates as compensation for the increased risk. In any one of a variety of scenarios, the unsustainable fiscal path of the United States could become a destabilizing force that demands a far more painful remedy than what could be implemented before the problem becomes acute. (For more information on budgetary challenges faced by the federal government [e.g. spending on Medicare, Social Security, etc.] see: "The Budget and Economic Outlook: 2024 to 2034," Congressional Budget Office, February 7, 2024. https://www.cbo.gov/publication/59710.)

Federal Spending as a Share of GDP*

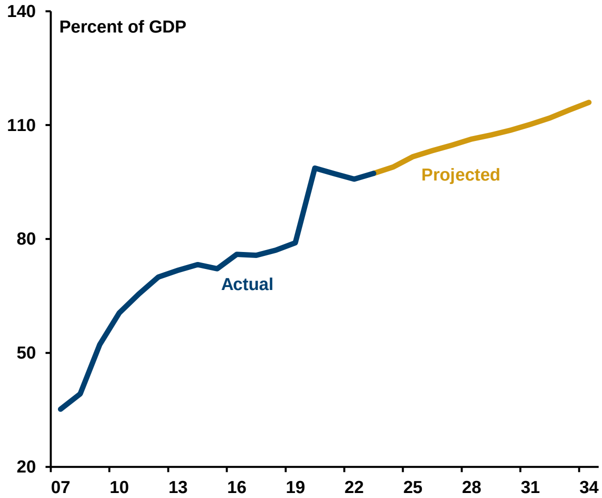


** Fiscal year basis. Readings from 2024 to 2034 are projections from the Congressional Budget Office.*

Sources: U.S. Department of the Treasury via Haver Analytics; Congressional Budget Office, "An Update to the Budget Outlook: 2024 to 2034" (February 2024).

https://www.cbo.gov/publication/59710

Publicly Held Debt as a Share of GDP*



** Fiscal year basis. Readings from 2024 to 2034 are projections from the Congressional Budget Office.*

Sources: U.S. Department of the Treasury via Haver Analytics; Congressional Budget Office, "An Update to the Budget Outlook: 2024 to 2034" (February 2024).

https://www.cbo.gov/publication/59710

The Week Ahead

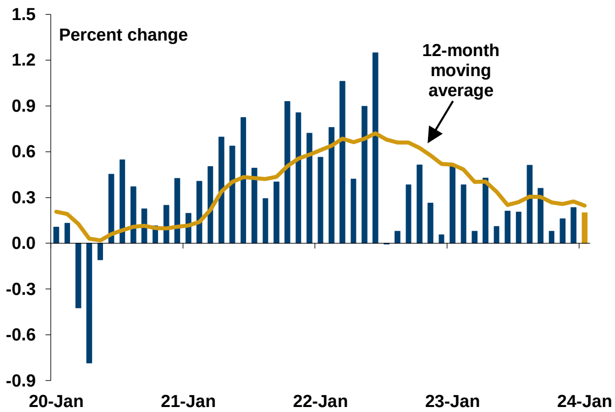
Federal Budget (January) (Monday)
Forecast: $20.0 Billion Deficit

Available data suggest that federal revenue growth was firm in January, increasing approximately seven percent year-over-year, but outlays rose solidly as well (up about three percent year-over-year). Strong flows of individual income and payroll taxes likely contributed importantly to growth of revenues, while brisk expenditures for Medicare and Social Security (2024 cost-of-living adjustment) stood out as boosting outlays. If the forecast is realized, the cumulative deficit of $530 billion for the first four months for FY2024 will exceed that in the same period in FY2023 by $70 billion.

CPI (January) (Tuesday)
Forecast: 0.2% Total, 0.3% Core

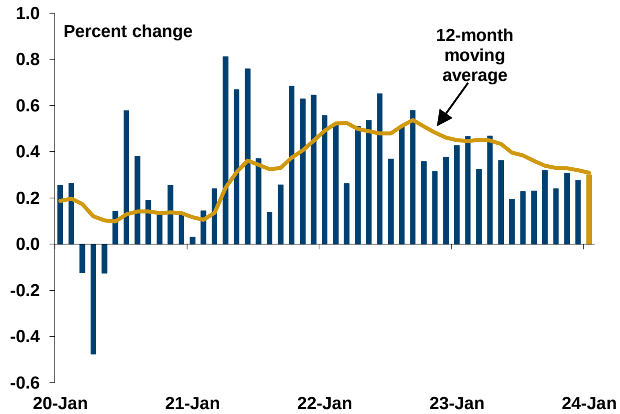
Available data suggest that the energy component could ease in January, while the food component could post another subdued increase (average monthly change of 0.2 percent in 2023 versus 0.8 percent in 2022). Core inflation could increase 0.3 percent for the third consecutive month, matching the average in 2023 but well below the 2022 average of 0.5 percent per month. Core goods prices have declined for seven consecutive months (and averaged readings of 0.0 percent for 2023), but core service prices have remained under pressure (average monthly increase of 0.4 percent in 2023) – in part reflecting continued firm (but moderating) advances in rents and owner-occupied housing costs.

Headline CPI*



** The gold bar is a forecast for January 2024.*
Sources: Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America

Core CPI*



** The gold bar is a forecast for January 2024.*
Sources: Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America

Retail Sales (January) (Thursday)
Forecast: -0.2% Total, 0.2% ex. Autos, 0.2% ex. Autos & Gasoline

A decline in new vehicle sales suggests a soft performance in the auto component of retail sales in January. The gasoline component, in contrast, could edge higher. Nominal prices were down month-to-month, but strong seasonal effects may lead to a positive reading in the retail report. Sales excluding autos and gasoline could edge higher, mostly on anticipated strength of online activity, but transactions at brick and mortar outlets may have been disrupted by winter storms.

Industrial Production (January) (Thursday)
Forecast: 0.0% Total, -0.1% Manufacturing

Hiring in the factory sector jumped in January, but shorter worktimes suggest that inclement weather disrupted production and led to a dip in the manufacturing component of industrial production. The mining sector also could be soft, a view supported by both a cut in aggregate hours and a decline in the rotary rig count. In contrast, below average temperatures and above-average precipitation raise the possibility of a jump in utility output after declines in the previous four months. Keep in mind, however, that swings in this area often reflect shifts in weather rather than economic fundamentals.

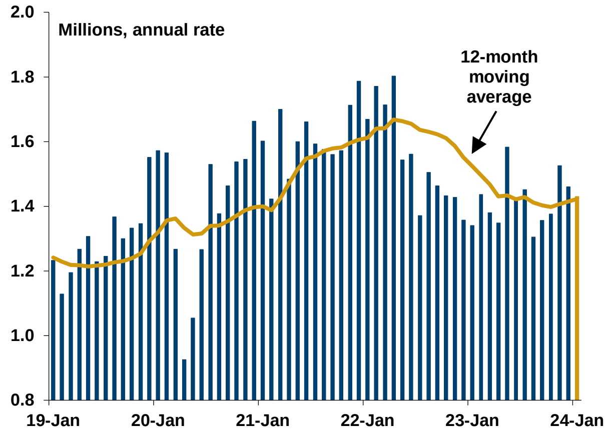
PPI (January) (Friday)
Forecast: 0.0% Total, 0.1% Ex. Food & Energy

Available data suggest that energy prices at the producer level could decline for the fourth consecutive month. Food prices reported in the PPI are often volatile from month-to-month, although they averaged monthly declines of 0.4 percent in 2023 (range of +0.7 to -2.3 percent). Goods prices excluding food and energy have increased 0.1 percent per month, on average, in 2023, as have service prices. Construction costs have increased slightly on balance in 2023 (average monthly change of +0.04 percent).

Housing Starts (January) (Friday)
Forecast: 1.430 Million (-2.1%)

Single-family housing starts could ease for a second consecutive month in January after a surge of 15.4 percent to 1.124 million, annual rate, in November pushed activity well above the average of 0.917 million in the first 10 months of 2023. Multi-family starts increased further in December from recent lows (0.357 million in August), but subdued permit issuance in recent months suggests little prospect of further improvement in January. Robust multi-family starts in 2022 and early 2023 appear to have satisfied a large portion of previous firm demand for rental units. Keep in mind that winter weather may also have disrupted both single and multi-family starts in January.

Housing Starts*



** The gold bar is a forecast for January 2024.*

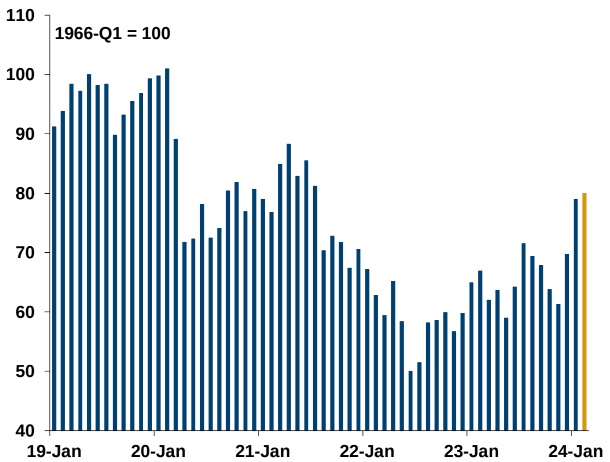
Sources: U.S. Census Bureau via Haver Analytics; Daiwa Capital Markers America

Consumer Sentiment (February) (Friday)
Forecast: 80.0 (+1.0 Index Pt. or 1.3%)

While lower gasoline prices and moderating inflation likely contributed to a surge of 17.7 index points (28.9 percent) in consumer sentiment in the past two months, signs of softening in the labor market (an uptick in unemployment claims, reduced quits, etc.) could lead to more cautious views among some survey respondents and cause a more subdued increase in February.

With regard to inflation, the year-ahead measure of inflation expectations eased 0.2 percentage point to 2.9 percent in January, positioning itself in the upper end of readings in the year or two preceding the pandemic but well below the recent high of 5.4 percent in March 2022. The long-term measure was reported at 2.9 percent in the past two months, above readings of 2.2 to 2.6 percent in the two years before the pandemic. However, while somewhat higher than pre-pandemic observations, recent readings are still viewed by Fed officials as well-anchored and consistent with a return to two percent inflation over time.

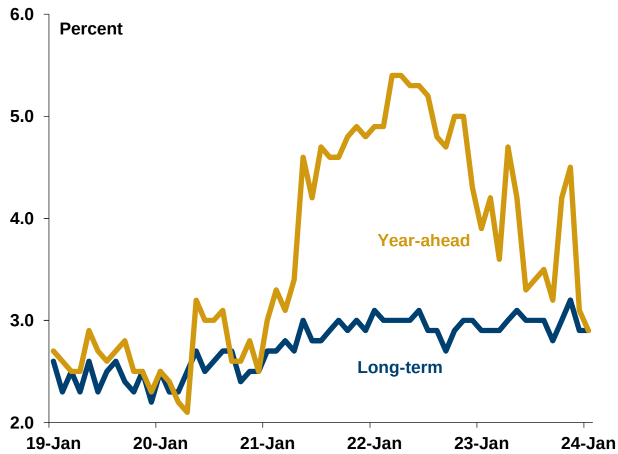
Consumer Sentiment*



** The gold bar is a forecast for February 2024.*

Sources: University of Michigan via Haver Analytics; Daiwa Capital Markets America

Consumer Inflation Expectations



Source: University of Michigan via Haver Analytics

Economic Indicators

February/March 2024

Monday	Tuesday	Wednesday	Thursday	Friday
5	6	7	8	9
ISM SERVICES INDEX Index / Prices Nov 52.5 / 57.6 Dec 50.5 / 56.7 Jan 53.4 / 64.0 **SENIOR LOAN OFFICER OPINION SURVEY ON BANK LENDING PRACTICES**		**TRADE BALANCE** Oct -$63.9 billion Nov -$61.9 billion Dec -$62.2 billion **CONSUMER CREDIT** Oct $7.1 billion Nov $23.5 billion Dec $1.6 billion	**UNEMPLOYMENT CLAIMS** Initial / Continuing (millions) Jan 13 0.189 / 1.828 Jan 20 0.215 / 1.894 Jan 27 0.227 / 1.871 Feb 3 0.218 / N/A **WHOLESALE TRADE** Inventories / Sales Oct -0.3% / -1.5% Nov -0.4% / -0.1% Dec 0.4% / 0.7%	
12	13	14	15	16
FEDERAL BUDGET (2:00) 2024/2023 / 2023/2022 Nov -$314.0B / -$248.5B Dec -$129.4B / -$85.0B **Jan -$20.0B** / -$38.8B	**NFIB SMALL BUSINESS OPTIMISM INDEX (6:00)** Nov 90.6 Dec 91.9 Jan -- **CPI (8:30)** Total / Core Nov 0.2% / 0.3% Dec 0.2% / 0.3% **Jan 0.2% / 0.3%**	**NAHB HOUSING INDEX (10:00)** Dec 37 Jan 44 Feb -- **BUSINESS INVENTORIES (10:00)** Inventories / Sales Oct -0.1% / -1.1% Nov -0.1% / 0.2% **Dec 0.4% / 0.5%** **TIC FLOWS (4:00)** Long-Term / Total Oct $3.4B / -$62.2B Nov $126.1B / $260.2B Dec -- / --	**UNEMP. CLAIMS (8:30)** **RETAIL SALES (8:30)** Total / Ex.Autos Nov 0.3% / 0.2% Dec 0.6% / 0.4% **Jan -0.2% / 0.2%** **IMPORT/EXPORT PRICES (8:30)** Non-Petrol Imports / Nonagri. Exports Nov 0.2% / -1.0% Dec 0.0% / -0.9% Jan -- / -- **EMPIRE MFG (8:30)** Dec -14.5 Jan -43.7 Feb -- **PHILADELPHIA FED MFG BUSINESS OUTLOOK (8:30)** Dec -12.8 Jan -10.6 Feb -- **IP & CAP-U (9:15)** IP / Cap.Util. Nov 0.0% / 78.6% Dec 0.1% / 78.6% **Jan 0.0% / 78.4%**	**PPI (8:30)** Final Demand / Ex. Food & Energy Nov -0.1% / 0.0% Dec -0.1% / 0.0% **Jan 0.0% / 0.1%** **HOUSING STARTS (8:30)** Nov 1.525 million Dec 1.460 million **Jan 1.430 million** **CONSUMER SENTIMENT (10:00)** Dec 69.7 Jan 79.0 **Feb 80.0**
19	20	21	22	23
PRESIDENTS' DAY	**LEADING INDICATORS**	**FOMC MINUTES**	**UNEMP. CLAIMS** **CHICAGO FED NATIONAL ACTIVITY INDEX** **EXISTING HOME SALES**	
26	27	28	29	1
NEW HOME SALES	**DURABLE GOODS ORDERS** **FHFA HOME PRICE INDEX** **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** **CONFERENCE BOARD CONSUMER CONFIDENCE**	**REVISED Q4 GDP** **INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES**	**UNEMP. CLAIMS** **PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX** **MNI CHICAGO BUSINESS BAROMETER** **PENDING HOME SALES**	**ISM MFG. INDEX** **REVISED CONSUMER SENTIMENT** **CONSTRUCTION** **VEHICLE SALES**

Forecasts in bold.

Treasury Financing

February/March 2024

Monday	Tuesday	Wednesday	Thursday	Friday
5	6	7	8	9
AUCTION RESULTS: Rate Cover 13-week bills 5.235% 2.91 26-week bills 5.045% 2.91	**AUCTION RESULTS:** Rate Cover 3-yr notes 4.169% 2.58 42 day CMBs 5.280% 2.87 **ANNOUNCE:** $60 billion 17-week bills for auction on Feb 7 $95 billion 4-week bills for auction on Feb 8 $90 billion 8-week bills for auction on Feb 8 **SETTLE:** $60 billion 17-week bills $95 billion 4-week bills $90 billion 8-week bills	**AUCTION RESULTS:** Rate Cover 17-week bills 5.180% 2.97 10-yr notes 4.093% 2.56	**AUCTION RESULTS:** Rate Cover 4-week bills 5.280% 2.97 8-week bills 5.270% 2.75 30-yr bonds 4.360% 2.40 **ANNOUNCE:** $149 billion 13-,26-week bills for auction on Feb 12 $80 billion 42-day CMBs for auction on Feb 13 **SETTLE:** $149 billion 13-,26-week bills $80 billion 42-day CMBs	
12	13	14	15	16
AUCTION: $149 billion 13-,26-week bills	**AUCTION:** $80 billion 42-day CMBs **ANNOUNCE:** $60 billion* 17-week bills for auction on Feb 14 $95 billion* 4-week bills for auction on Feb 15 $90 billion* 8-week bills for auction on Feb 15 **SETTLE:** $60 billion 17-week bills $95 billion 4-week bills $90 billion 8-week bills	**AUCTION:** $60 billion* 17-week bills	**AUCTION:** $95 billion* 4-week bills $90 billion* 8-week bills **ANNOUNCE:** $149 billion* 13-,26-week bills for auction on Feb 20 $46 billion* 52-week bills for auction on Feb 20 $16 billion* 20-year bonds for auction on Feb 21 $28 billion* 2-year FRNs for auction on Feb 21 $9 billion* 30-year TIPS for auction on Feb 22	**SETTLE:** $149 billion 13-,26-week bills $54 billion 3-year notes $42 billion 10-year notes $25 billion 30-year bonds $80 billion 42-day CMBs
19	20	21	22	23
PRESIDENTS' DAY	**AUCTION:** $149 billion* 13-,26-week bills $46 billion* 52-week bills **ANNOUNCE:** $60 billion* 17-week bills for auction on Feb 21 $95 billion* 4-week bills for auction on Feb 22 $90 billion* 8-week bills for auction on Feb 22 **SETTLE:** $60 billion* 17-week bills $95 billion* 4-week bills $90 billion* 8-week bills	**AUCTION:** $60 billion* 17-week bills $16 billion* 20-year bonds $28 billion* 2-year FRNs	**AUCTION:** $95 billion* 4-week bills $90 billion* 8-week bills $9 billion* 30-year TIPS **ANNOUNCE:** $149 billion* 13-,26-week bills for auction on Feb 26 $63 billion* 2-year notes for auction on Feb 26 $64 billion* 5-year notes for auction on Feb 26 $42 billion* 7-year notes for auction on Feb 27 **SETTLE:** $149 billion* 13-,26-week bills $46 billion* 52-week bills	**SETTLE:** $28 billion* 2-year FRNs
26	27	28	29	1
AUCTION: $149 billion* 13-,26-week bills $63 billion* 2-year notes $64 billion* 5-year notes	**AUCTION:** $42 billion* 7-year notes **ANNOUNCE:** $60 billion* 17-week bills for auction on Feb 28 $95 billion* 4-week bills for auction on Feb 29 $90 billion* 8-week bills for auction on Feb 29 **SETTLE:** $60 billion* 17-week bills $95 billion* 4-week bills $90 billion* 8-week bills	**AUCTION:** $60 billion* 17-week bills	**AUCTION:** $95 billion* 4-week bills $90 billion* 8-week bills **ANNOUNCE:** $149 billion* 13-,26-week bills for auction on Mar 4 **SETTLE:** $149 billion* 13-,26-week bills $16 billion* 20-year bonds $9 billion* 30-year TIPS $63 billion* 2-year notes $64 billion* 5-year notes $42 billion* 7-year notes	

**Estimate*