U.S. Economic Comment

- FOMC: policy rate expected to remain at 5.375%, but changes to QT possible
- The March inflation data: not as bad as feared, but progress toward 2% has stalled

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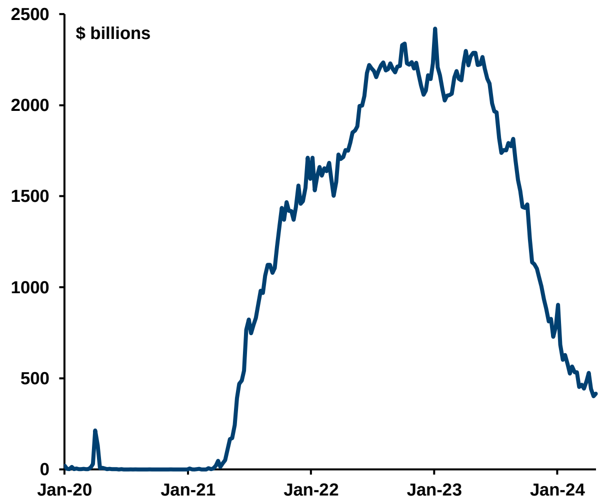
Next Week's FOMC Meeting

A deluge of comments by Fed officials last week ahead of the pre-FOMC blackout period left little doubt about the path of interest rates in the near-term, with the inflation data for March released earlier today cementing that view. Policymakers, at least publically, express confidence that monetary policy is well calibrated to return to two percent inflation over time but have also acknowledged that further progress on inflation will be slow and that adjustments to the target range for the federal funds rate would be inappropriate at this time. Cuts to the policy rate may occur later this year, although market expectations for the timing of the anticipated move have shifted from the summer previously to the fall (or possibly as late as December).

An issue more likely to be addressed again at next week's FOMC meeting is balance sheet policy and potential adjustments to quantitative tightening (QT) as the transition is made from an abundant reserves regime to one of ample reserves. Discussion surrounding the balance sheet took on a more urgent tone in recent months as uptake at the Fed's Reverse Repurchase Facility fell sharply from $2.4 trillion in January 2023 to $416 billion in the latest week (chart, below left). The RRP Facility is useful in gauging excess liquidity in the banking system, and the rapid drain raised the distinct possibility that bank reserves, at some point in the near future, could decline to the point of generating unwelcome pressure in money markets, thereby pushing short term rates higher. That point almost certainly has not yet been reached, as Fed officials likely still assess reserves of $3.3 trillion as "abundant" rather than "ample," but we suspect that that transition to ample will begin to materialize as reserves ease toward $3.0 trillion (chart, below right). Thus, with balances in the RRP continuing to decline, albeit at a somewhat slower pace in April than in other recent months, and with reserves starting to move lower, a decision may soon be made regarding portfolio runoff on the asset side of the Fed's balance sheet.

The Minutes from the March FOMC meeting did not offer specific guidance on the timing of a formal announcement for the taper of QT, but we suspect that it will occur at either next week's FOMC meeting or in June (our current call). We suspect that policymakers could move quickly to amend the program, but given that discussions only started in earnest in March, and RRP runoff has moderated in April, we could easily envision

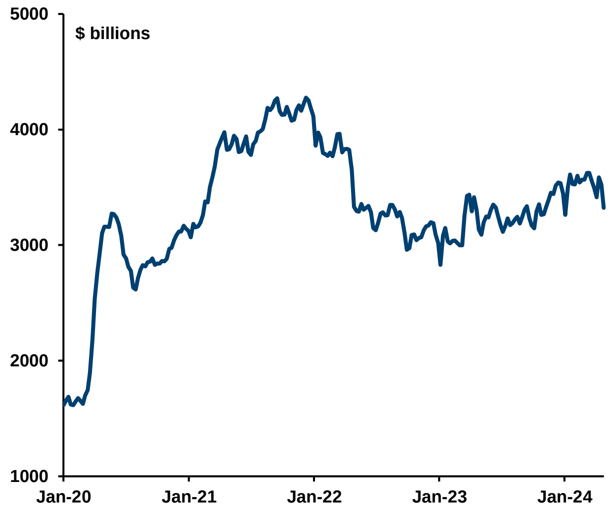
Reverse Repurchase Agreements*



** Weekly average data. Excludes transactions with foreign official institutions.*

Source: H.4.1 Report, Federal Reserve Board via Haver Analytics

Reserve Balances with Federal Reserve Banks*

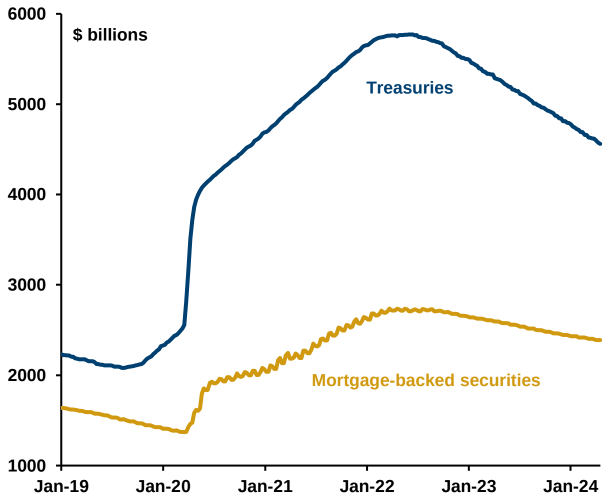


** Weekly average data*

Source: H.4.1 Report, Federal Reserve Board via Haver Analytics additional proposals being discussed before market participants are alerted to changes at the conclusion of the June 11-12 FOMC meeting. Regarding QT specifically, redemptions of $60 billion per month have reduced Treasury holdings from a peak of $5.77 trillion in June 2022 to approximately $4.54 trillion in late April, and MBS holdings have fallen from $2.74 trillion in April 2022 to $2.39 trillion in the most recent week (well shy of the $35 billion monthly redemption caps; chart, below left).

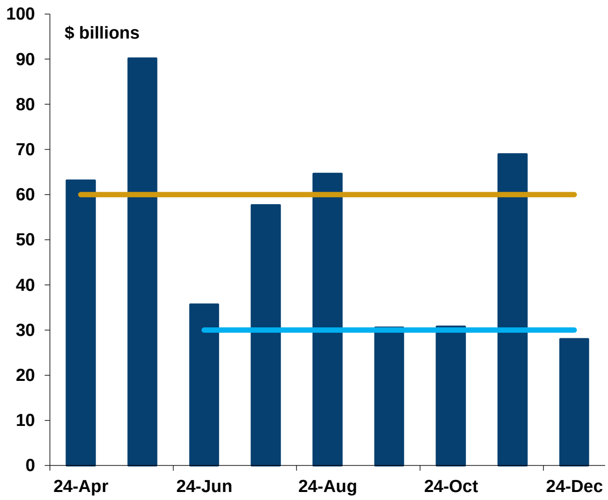
On the point of redemption caps, the March minutes indicated the desire to reduce redemptions by half, with the entirety of the change coming in Treasuries. This may be interpreted either one of two ways: the cap on Treasury redemptions will be reduced to $30 billion per month after the announcement, or possibly by some larger amount that incorporates fluctuating MBS redemptions in the total. For example, if we assume that MBS redemptions total $20 billion per month currently (a high-side estimate), the monthly Treasury cap would be reduced to perhaps $20 billion with one half of the total of $80 billion being accounted for by reduced Treasury redemptions. That said, we still suspect that officials have yet to arrive at a precise figure for new redemption caps. Regardless, lowering the cap on Treasury redemptions suggests that the T-bill portion of the Fed's portfolio could stabilize just below $200 billion versus the peak of $320 billion from April 2020 through September 2022. A lower cap on Treasury redemptions (shown by the light blue line on the chart below right) suggests that maturing coupon securities in most upcoming months will likely meet or exceed the projected cap on redemptions. Until a formal change is enacted, bills are redeemed along with coupon securities when coupons fall below $60 billion in a particular month. Moreover, with a lower cap likely in place in coming months, Treasury will be able to stabilize coupon auction sizes with the Fed reinvesting more maturing securities at auction. The anticipated dynamic will limit to a degree the need for Treasury to raise cash from the private sector. That said, additional clarity on adjustments to QT is likely forthcoming by June.

Fed Portfolio*



** Weekly average data*
Source: H.4.1 Report, Federal Reserve Board via Haver Analytics

Fed Portfolio: Maturing Securities Per Month*

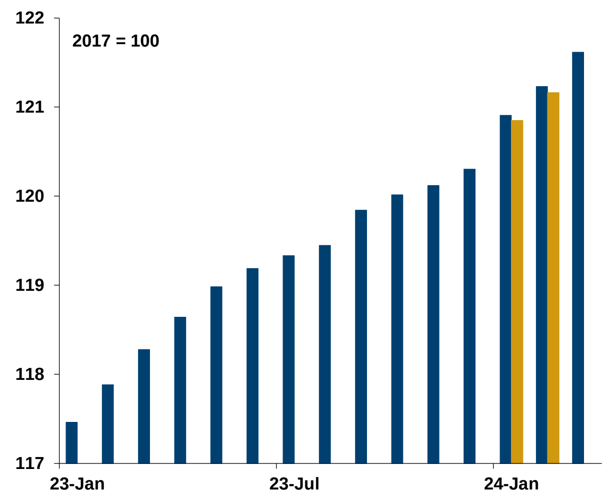


** Coupon securities.*
Source: Federal Reserve Bank of New York

March Inflation

Quarterly inflation data released with yesterday's GDP report spooked marked participants, with the core price index for personal consumption expenditures showing annualized growth of 3.7 percent in the first quarter -- up from 2.0 percent in 2023-Q4 and faster than the Bloomberg median expectation of 3.4 percent. All else equal, the quarterly result suggested that the core PCE price index jumped approximately 0.5 percent in March. However, the monthly breakdown of the Personal Income & Consumption Report released today was a bit less problematic, although still worrisome. Revisions to data for January and February revealed that core inflation increased 0.502 percent in the opening month of 2024 rather than 0.452 percent, and that the index advanced 0.266 percent in February rather than 0.261 percent. Core inflation rose 0.317 percent in March, a brisk advance but notably less than 0.5 percent (charts, next page).

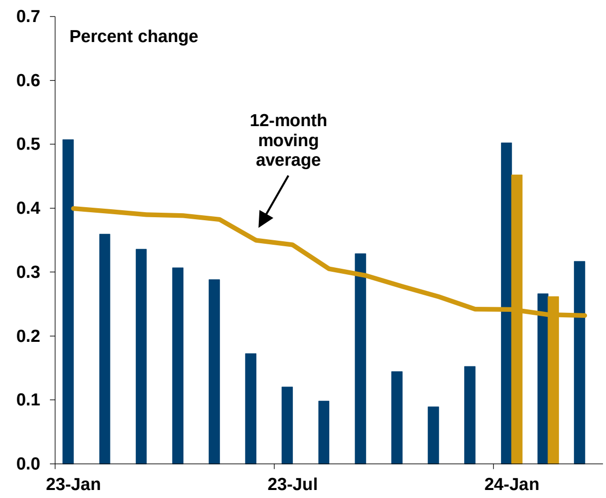
Core PCE Price Index*



** The gold bars show the preliminary readings for January and February of 120.849 and 121.165, respectively (revised up to 120.909 and 121.231).*

Source: Bureau of Economic Analysis via Haver Analytics

Core PCE Price Index*

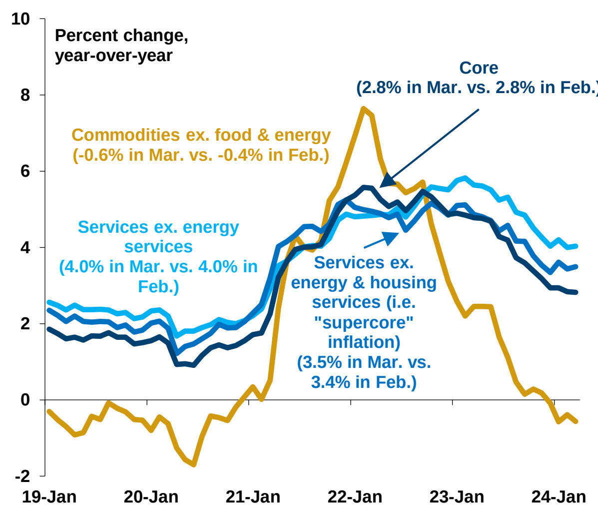


** The gold bars show the preliminary readings for January and February of 0.452% and 0.261%, respectively.*

Source: Bureau of Economic Analysis via Haver Analytics

With the prospect of a 0.5 percent increase in March off the table, a sense of relief seemed to permeate various commentary. The latest inflation report was more of the same; core goods inflation has returned to the previous subdued trend while pressure remained in service prices excluding energy services (chart, right). As indicated by Chair Powell in his comments last week, inflation would get back to target, but the process will take time.

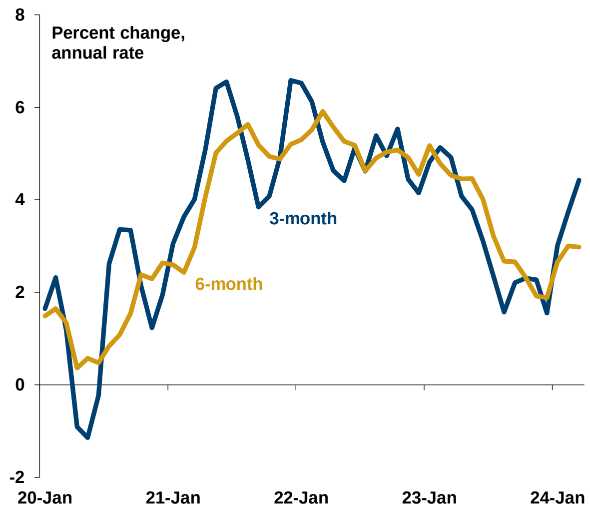
Decomposition of Core PCE



Source: Bureau of Economic Analysis via Haver Analytics

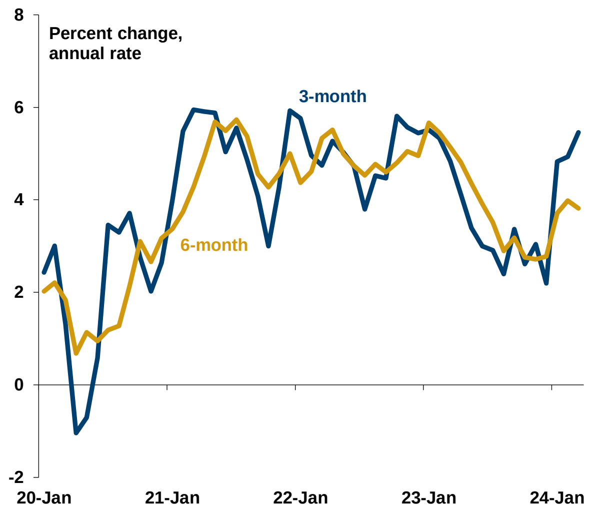
Compared to some market commentators, we are somewhat less sanguine in our view of the latest data. Although we have yet to revise higher our forecast that calls for an ongoing gradual moderation in inflation, and are still looking for 50 basis points in cuts to the federal funds rate later this year (reductions of 25 basis points each in September and December), we are not quick to dismiss the recent inflation figures. On that point, the three-month annual growth rate of core PCE inflation surged to 4.4 percent in March from 1.6 percent in December 2023, and the six-month rate rose to 3.0 percent from 1.9 percent. More concerning, the three-month annualized growth rate of core service inflation excluding housing (a metric tracked closely by Fed officials and mentioned by the Fed Chair on numerous occasions) jumped to 5.5 percent in March from 2.2 percent in December, and the six-month change rose by 100 basis points to 3.8 percent (charts, next page). We are not yet ready to conclude that inflation is positioning to reaccelerate, but we do concede that it is proving to be stickier than believed around the turn of the year.

Core PCE Price Index



Source: Bureau of Economic Analysis via Haver Analytics

PCE: Core Services Ex. Housing*



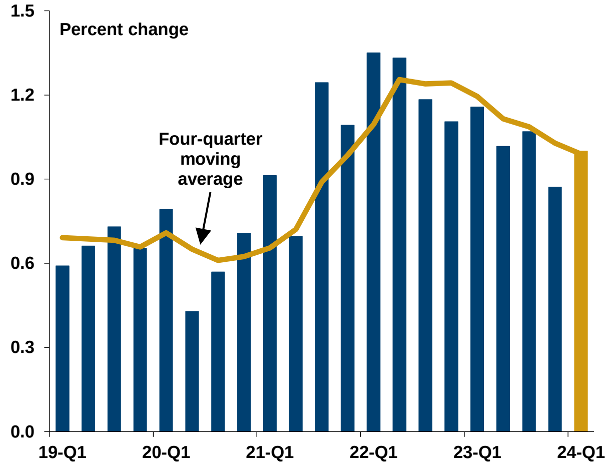
** Service prices excluding energy and housing services.*
Source: Bureau of Economic Analysis via Haver Analytics

The Week Ahead

Employment Cost Index (24-Q1) (Tuesday)
Forecast: +1.0%

Readings on average hourly earnings from the employment report suggest that wage growth remained close to the firm quarterly average of 1.1 percent (not annualized) in 2023 but slower than the 1.2 percent average in 2022 (4.3 percent Q4/Q4 in 2023 and 5.1 percent in 2022). Growth of benefit costs eased a bit more, averaging 0.9 percent in 2023 versus 1.2 percent in 2022 (3.8 percent Q4/Q4 in 2023 and 4.9 percent in 2022). Expectations for wages and benefits suggest total compensation growth of 1.0 percent in Q1, a reading likely still inconsistent with the Federal Reserve's two percent inflation target but slower than the averages of 1.1 percent in 2023 and 1.2 percent in 2022 (4.2 percent Q4/Q4 in 2023 and 5.1 percent in 2022).

Employment Cost Index*



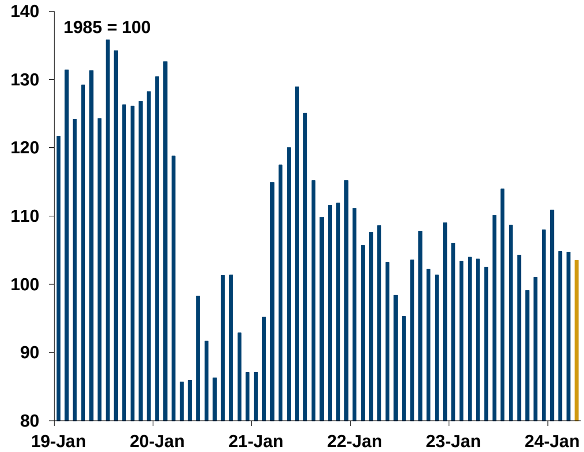
** The gold bar is a forecast for 2024-Q1.*

Sources: Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America

Consumer Confidence (April) (Tuesday)
Forecast: 103.5 (-1.2 Index Pts. or -1.1%)

With gasoline prices on the rise and the economic outlook remaining uncertain, the Conference Board's index of consumer confidence could ease for the third consecutive month – a view supported by a dip in the University of Michigan sentiment gauge (chart).

Consumer Confidence*



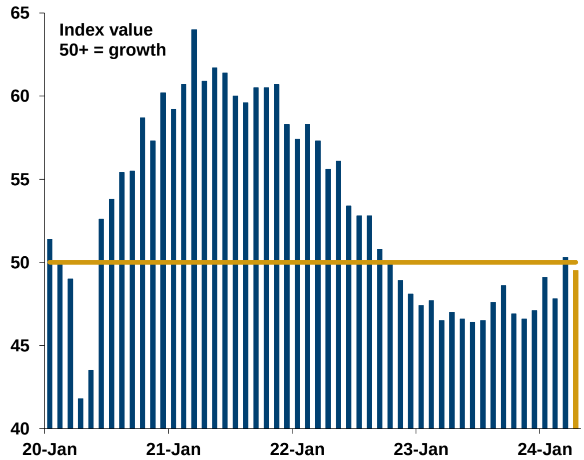
** The gold bar is a forecast for April 2024.*

Sources: The Conference Board via Haver Analytics; Daiwa Capital Markets America

ISM Manufacturing Index (April) (Wednesday)
Forecast: 49.5 (-0.8 Index Pt.)

Although the ISM manufacturing index moved into expansion territory in March after indicating contraction for 16 consecutive months, the broader performance in the factory sector remains uneven amid a subdued demand outlook. The recent performance for key regional manufacturing gauges supports this assessment, as the general conditions question from the Philly Fed's Manufacturing Business Outlook Survey recorded a positive reading for the third consecutive month (+15.5 in April) while that from the New York Fed's Empire State Manufacturing survey registered its fifth consecutive negative reading (-14.3 in April).

ISM Manufacturing Index*



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

Sources: Institute for Supply Management via Haver Analytics; Daiwa Capital Markets America

Construction (March) (Wednesday)
Forecast: +0.3%

The recent performance in single-family housing starts raises the possibility of a fourth consecutive increase in private residential construction, but both private non-residential and government-sponsored building may be losing momentum after trending sharply higher from late 2022 and peaking in December of last year.

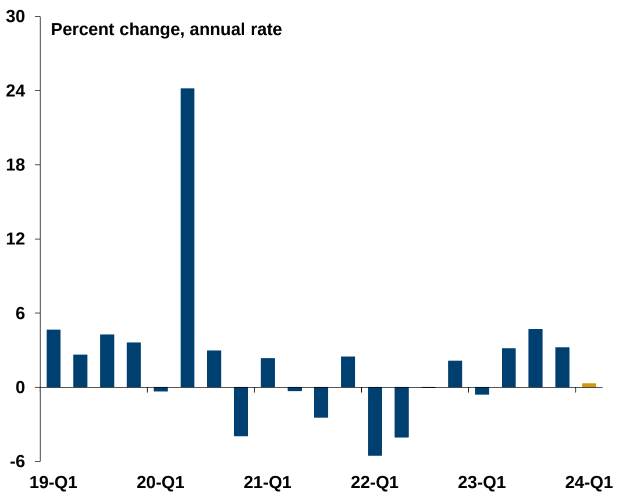
Trade Balance (March) (Thursday)
Forecast: -$70.5 Billion ($1.6 Billion Wider Deficit)

The widening of $1.5 billion in the goods deficit (released April 25) suggests similar deterioration in the total trade deficit in March. Moreover, the surplus in services trade narrowed by a combined $2.0 trillion in the past three months after moving in favor of the U.S. for much of 2023.

Nonfarm Productivity (24-Q1) (Thursday)
Forecast: +0.3%

The output measure that feeds into the calculation of nonfarm productivity rose moderately in Q1 (nonfarm gross value added; +1.3 percent, annual rate), with available data suggesting that hours worked grew at a similar rate (+1.0 percent, annual rate, projected). Thus, productivity growth appears on track to slow markedly in Q1 from the average of 3.7 percent in the prior three quarters (including 3.2 percent in Q4; Q4/Q4 growth of 2.6 percent in 2023). The anticipated result for Q1, as well as the performance in recent quarters, highlights the inherent volatility in the productivity data (chart, below left). Additionally, data on employee pay suggest a jump in compensation per hour (+5.5 percent, annual rate, projected). The combination of potentially anemic productivity growth and a brisk increase in wages suggest a jump in unit labor costs (+4.7 percent expected; chart, below right) after a pickup of 0.4 percent in Q4 (+2.5 percent Q4/Q4 in 2023).

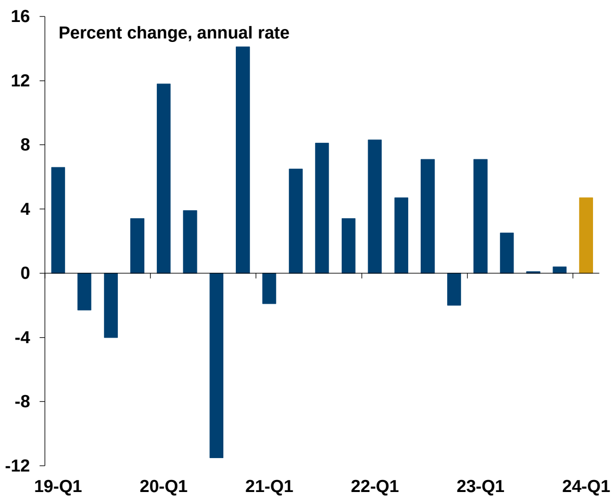
Nonfarm Productivity*



** The gold bar is a forecast for 2024-Q1.*

Sources: Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America

Unit Labor Cost*



** The gold bar is a forecast for 2024-Q1.*

Sources: Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America

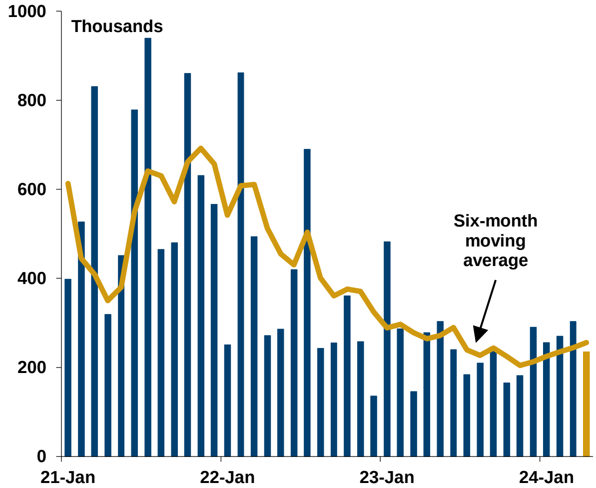
Factory Orders (March) (Thursday)
Forecast: +1.7%

Durable goods orders jumped 2.6 percent in March, the second consecutive increase after a plunge of 6.9 percent in January. As in other recent months, the volatility reflected swings in the transportation area (+7.7 percent in March), which in turn resulted from large moves in the civilian aircraft component. Durable bookings excluding transportation tilted higher for the second consecutive month (+0.2 percent in March), but the trend in the past two years has been essentially sideways. Nondurable bookings, the new information in the factory orders report, could register a moderate increase. Higher prices could boost the value of bookings in the petroleum and coal category. Additionally, orders ex. petrol may advance after offsetting shifts in the past two months have left these bookings little changed since the turn of the year.

Payroll Employment (April) (Friday)
Forecast: +235,000 Payrolls, 3.8% Unemployment Rate, +0.3% Average Hourly Earnings (+4.0% Yr/Yr)

Average payroll growth of 276,000 in Q1 (including +303k in March) has picked up from the 251,000 average in 2023, with the recent results suggesting that the labor market may be finding an equilibrium where underlying supply-demand conditions are still generating wage growth inconsistent with the Federal Reserve's price stability mandate (chart, below left). With that in mind, an anticipated solid pace of hiring could support growth of average hourly earnings at a pace close to the 24-Q1 average of +0.3 percent (associated with a projected year-over-year increase of 4.0 percent; chart, below right).

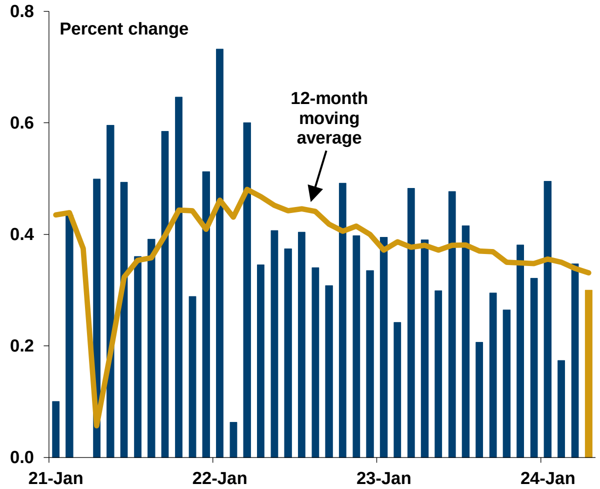
Change in Nonfarm Payrolls*



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

Sources: Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America

Average Hourly Earnings*



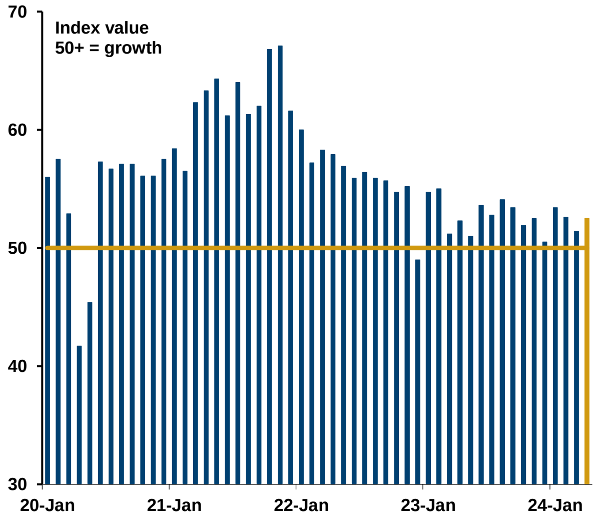
** The gold bar is a forecast for April 2024.*

Sources: Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America

ISM Services Index (April) (Friday)
Forecast: 52.5 (+1.1 Index Pt.)

With the Q1 GDP report implying solid domestic demand and other indicators of broad economic activity indicating positive momentum, the ISM services index likely remained in growth territory in April. Indeed, we suspect the index could increase in the latest month, as sub-50 readings for the employment component in the past two months appear inconsistent with private-sector payrolls averaging monthly gains of 212k in Q1.

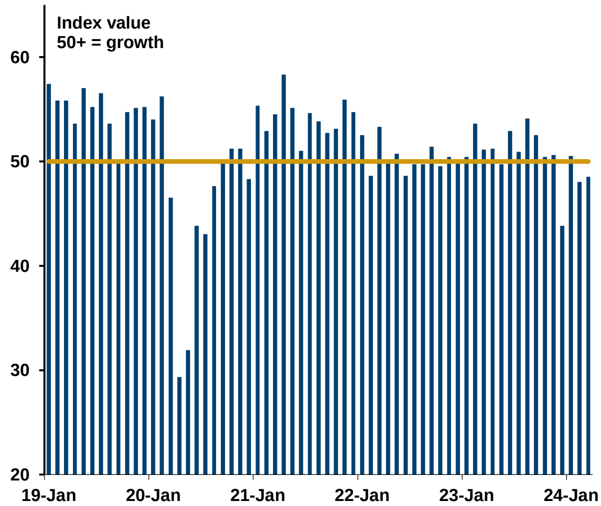
ISM Services: Headline Index*



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

Sources: Institute for Supply Management via Haver Analytics; Daiwa Capital Markets America

ISM Services: Employment Index



Source: Institute for Supply Management via Haver Analytics

Economic Indicators

April/May 2024

Monday	Tuesday	Wednesday	Thursday	Friday
22	23	24	25	26
CHICAGO FED NATIONAL ACTIVITY INDEX Monthly / 3-Mo. Avg. Jan -0.81 -0.24 Feb 0.09 -0.28 Mar 0.15 -0.19	**NEW HOME SALES** Jan 0.671 million Feb 0.637 million Mar 0.693 million	**DURABLE GOODS ORDERS** Jan -6.9% Feb 0.7% Mar 2.6%	**UNEMPLOYMENT CLAIMS** Initial / Continuing (millions) Mar 30 0.222 1.810 Apr 6 0.212 1.796 Apr 13 0.212 1.781 Apr 20 0.207 N/A **GDP** GDP / Chained Price 23-Q3 4.9% 3.3% 23-Q4 3.4% 1.6% 24-Q1 1.6% 3.1% **INTERNATIONAL TRADE IN GOODS** Jan -$90.6 billion Feb -$90.3 billion Mar -$91.8 billion **ADVANCE INVENTORIES** Wholesale / Retail Jan -0.2% 0.4% Feb 0.4% 0.5% Mar -0.4% 0.3% **PENDING HOME SALES** Jan -4.7% Feb 1.6% Mar 3.4%	**PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX** Inc. / Cons. / Core Jan 1.0% 0.1% 0.5% Feb 0.3% 0.8% 0.3% Mar 0.5% 0.8% 0.3% **REVISED CONSUMER SENTIMENT** Mar 79.4 Apr(p) 77.9 Apr(r) 77.2
29	30	1	2	3
	EMPLOYMENT COST INDEX (8:30) Comp. / Wages 23-Q3 1.1% 1.2% 23-Q4 0.9% 0.9% **24-Q1 1.0% 1.1%** **FHFA HOME PRICE INDEX (9:00)** Dec 0.1% Jan -0.1% Feb -- **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX (9:00)** Dec 0.3% Jan 0.1% Feb -- **MNI CHICAGO BUSINESS BAROMETER (9:45)** Index / Prices Feb 44.0 64.7 Mar 41.4 62.6 Apr -- -- **CONFERENCE BOARD CONSUMER CONFIDENCE (10:00)** Feb 104.8 Mar 104.7 **Apr 103.5** **FOMC MEETING (FIRST DAY)**	**ADP EMPLOYMENT (8:15)** Private Payrolls Feb 155,000 Mar 184,000 Apr -- **ISM MFG. INDEX (10:00)** Index / Prices Feb 47.8 52.5 Mar 50.3 55.8 **Apr 49.5 55.0** **JOLTS DATA (10:00)** Openings (000) / Quit Rate Jan 8,748 2.2% Feb 8,756 2.2% Mar -- -- **CONSTRUCTION (10:00)** Jan -0.2% Feb -0.3% **Mar 0.3%** **FOMC RATE DECISION (2:00)** **VEHICLE SALES** Feb 15.7 million Mar 15.5 million **Apr 15.7 million**	**UNEMP. CLAIMS (8:30)** **TRADE BALANCE (8:30)** Jan -$67.6 billion Feb -$68.9 billion **Mar -$70.5 billion** **PRODUCTIVITY & COSTS (8:30)** Productivity / Unit Labor Costs 23-Q3 4.6% 0.1% 23-Q4 3.3% 0.4% **24-Q1 0.3% 4.7%** **FACTORY ORDERS (10:00)** Jan -3.8% Feb 1.2% **Mar 1.7%**	**EMPLOYMENT REPORT (8:30)** Payrolls / Un. Rate Feb 270,000 3.9% Mar 303,000 3.8% **Apr 235,000 3.8%** **ISM SERVICES INDEX (10:00)** Index / Prices Feb 52.6 58.6 Mar 51.4 53.4 **Apr 52.5 53.5**
6	7	8	9	10
SENIOR LOAN OFFICER OPINION SURVEY ON BANK LENDING PRACTICES	**CONSUMER CREDIT**	**WHOLESALE TRADE**	**UNEMP. CLAIMS**	**CONSUMER SENTIMENT** **FEDERAL BUDGET**
13	14	15	16	17
	NFIB SMALL BUSINESS OPTIMISM INDEX **PPI**	**CPI** **RETAIL SALES** **EMPIRE MFG** **NAHB HOUSING INDEX** **BUSINESS INVENTORIES** **TIC FLOWS**	**UNEMP. CLAIMS** **HOUSING STARTS** **PHILLY FED INDEX** **IMPORT/EXPORT PRICES** **IP & CAP-U**	**LEADING INDICATORS**

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

Daiwa Capital Markets

Treasury Financing

April/May 2024

Monday	Tuesday	Wednesday	Thursday	Friday
22	23	24	25	26
AUCTION RESULTS: Rate Cover 13-week bills 5.255% 2.78 26-week bills 5.160% 2.80	**AUCTION RESULTS:** Rate Cover 2-yr notes 4.898% 2.66 42 day CMBs 5.285% 2.83 **ANNOUNCE:** $60 billion 17-week bills for auction on Apr 24 $70 billion 4-week bills for auction on Apr 25 $75 billion 8-week bills for auction on Apr 25 **SETTLE:** $60 billion 17-week bills $70 billion 4-week bills $75 billion 8-week bills	**AUCTION RESULTS:** Rate Cover 17-week bills 5.240% 2.80 5-yr notes 4.659% 2.39 Spread Cover 2-yr FRNs 0.150% 3.33	**AUCTION RESULTS:** Rate Cover 4-week bills 5.275% 3.14 8-week bills 5.275% 3.02 7-yr notes 4.716% 2.48 **ANNOUNCE:** $140 billion 13-,26-week bills for auction on Apr 29 $65 billion 42-day CMBs for auction on Apr 30 **SETTLE:** $140 billion 13-,26-week bills $65 billion 42-day CMBs	
29	30	1	2	3
AUCTION: $140 billion 13-,26-week bills	**AUCTION:** $65 billion 42-day CMBs **ANNOUNCE:** $60 billion* 17-week bills for auction on May 1 $70 billion* 4-week bills for auction on May 2 $75 billion* 8-week bills for auction on May 2 **SETTLE:** $60 billion 17-week bills $70 billion 4-week bills $75 billion 8-week bills $13 billion 20-year bonds $23 billion 5-year TIPS $69 billion 2-year notes $70 billion 5-year notes $44 billion 7-year notes $30 billion 2-year FRNs	**AUCTION:** $60 billion* 17-week bills **ANNOUNCE:** $58 billion* 3-year notes for auction on May 7 $42 billion* 10-year notes for auction on May 8 $25 billion* 30-year bonds for auction on May 9	**AUCTION:** $70 billion* 4-week bills $75 billion* 8-week bills **ANNOUNCE:** $140 billion* 13-,26-week bills for auction on May 6 **SETTLE:** $140 billion 13-,26-week bills $65 billion 42-day CMBs	
6	7	8	9	10
AUCTION: $140 billion* 13-,26-week bills	**AUCTION:** $58 billion* 3-year notes **ANNOUNCE:** $60 billion* 17-week bills for auction on May 8 $70 billion* 4-week bills for auction on May 9 $75 billion* 8-week bills for auction on May 9 **SETTLE:** $60 billion* 17-week bills $70 billion* 4-week bills $75 billion* 8-week bills	**AUCTION:** $60 billion* 17-week bills $42 billion* 10-year notes	**AUCTION:** $70 billion* 4-week bills $75 billion* 8-week bills $25 billion* 30-year bonds **ANNOUNCE:** $140 billion* 13-,26-week bills for auction on May 13 $46 billion* 52-week bills for auction on May 14 **SETTLE:** $140 billion* 13-,26-week bills	
13	14	15	16	17
AUCTION: $140 billion* 13-,26-week bills	**AUCTION:** $46 billion* 52-week bills **ANNOUNCE:** $60 billion* 17-week bills for auction on May 15 $70 billion* 4-week bills for auction on May 16 $75 billion* 8-week bills for auction on May 16 **SETTLE:** $60 billion* 17-week bills $70 billion* 4-week bills $75 billion* 8-week bills	**AUCTION:** $60 billion* 17-week bills **SETTLE:** $58 billion* 3-year notes $42 billion* 10-year notes $25 billion* 30-year bonds	**AUCTION:** $70 billion* 4-week bills $75 billion* 8-week bills **ANNOUNCE:** $140 billion* 13-,26-week bills for auction on May 20 $16 billion* 20-year bonds for auction on May 22 $16 billion* 10-year TIPS for auction on May 23 **SETTLE:** $140 billion* 13-,26-week bills $46 billion* 52-week bills	

**Estimate*