U.S. Economic Comment

- Q2 growth: early data suggest ongoing moderation in economic activity
- April inflation: favorable after an ugly Q1

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An Early Read on Q2

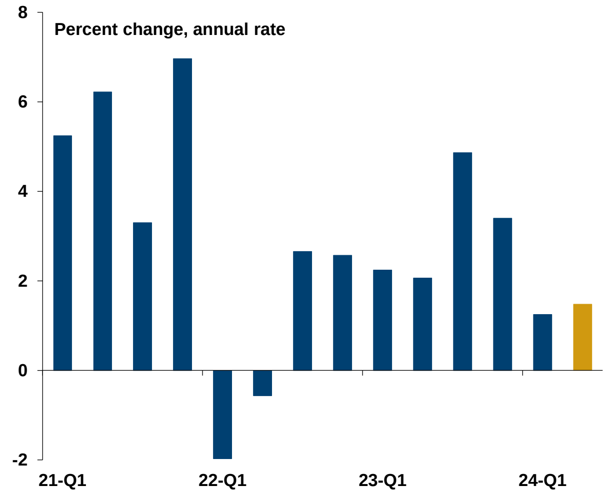
Data on consumer spending and international trade released this week allowed us to begin dialing in our views on economic activity in Q2. The picture almost certainly will evolve as reports beyond those for April become available, but data in hand have led us to nudge lower our expectation for GDP growth from our baseline estimate (current expectation of 1.5 percent, annual rate, versus 1.8 percent previously; chart, below left). While results for Q2 thus far were softer than first anticipated, we do not yet view the shift from baseline as deeply problematic. Up until this point, underlying domestic demand appears to remain on track, and gradual easing in economic growth is consistent with a restrictive stance of monetary policy that helps return inflation to the Federal Reserve's two-percent target.

Consumer Spending

The consumer sector has been on our radar since mid-May, with the retail sales report for April suggesting a lackluster performance in the opening month of Q2 and softer results than previously anticipated in the January-to-March period. Our initial interpretation of that release was ratified in data published on Friday in the Bureau of Economic Analysis' Personal Income and Consumption report, with real consumer outlays falling 0.1 percent in April. Expenditures on services rose modestly, with the increase of 0.1 percent the softest monthly reading since the fractional decline that rounded to no change in August 2023. Spending on goods, in contrast, fell 0.4 percent. The results were disappointing, but goods expenditures had jumped 0.9 percent in the prior month (although they were down for Q1 as a whole) and they often exhibit a good bit of month-to-month volatility. With that in mind, modest rebounds in the following two months, perhaps real growth of total outlays of 0.15 percent per month, would leave real expenditures on pace to advance 1.9 percent, annual rate, in Q2 – modestly below the 2.0 percent pace in Q1 and, all else equal, a favorable performance (chart, below right).

While we currently anticipate growth of consumer spending in Q2 to be close to that in the prior quarter, we also note that consumers were less active in Q1 than previously believed. Specifically, revised Q1 GDP data published Thursday indicated that consumer spending on Q1 was one-half percentage point lower than first reported (2.0

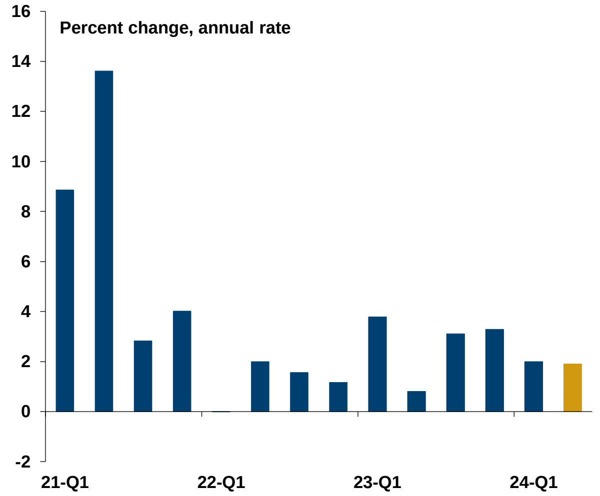
GDP Growth*



** The gold bar is a forecast for 2024-Q2.*

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

Real Consumer Spending Growth*



** The gold bar is a forecast for 2024-Q2.*

Sources: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America percent versus 2.5 percent). Real consumer outlays for goods contracted 1.9 percent, annual rate, in Q1 versus the preliminary estimate of a dip of 0.4 percent. Spending on services, in contrast, drove outlays (+3.9 percent versus initially reported growth of 4.0 percent). Discussed above, results for April were similar compositionally, although the pace of spending in the latest month eased from that in Q1 (+0.1 percent, not annualized, versus 0.3 percent per month, on average, in Q1).

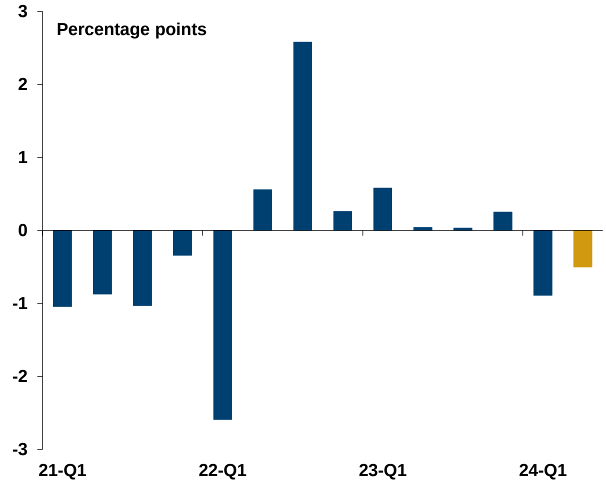
Again, while the latest data tilted soft, we are inclined to remain mostly optimistic regarding the consumer sector. The job market remains on firm footing, with payroll growth averaging 246,000 per month in 2024 thus far, and growth of average hourly earnings remains brisk at 3.9 percent year-over-year as of April. Moreover, many households are locked into low-rate mortgages and can draw on home equity if needed. There are some signs of stress emerging among a subset of consumers (an uptick in loan delinquencies, for instance), but at this juncture, problems are not widespread enough to suggest a broad retreat in spending.

International Trade

International trade flows for April also provided a surprise and led to an adjustment in our expectations for GDP, with trade now likely acting as a notable rather than modest drag on growth in Q2 (expected drag of 0.5 percentage point on GDP growth versus baseline estimate of -0.1 percentage point; chart, right). In the latest month, imports of goods surged 3.1 percent while exports rose a more modest 0.5 percent. The combined shifts led to a marked widening of $7.1 billion in the monthly goods deficit to $99.4 billion (charts below).

While possibly a substantial constraint on Q2 growth, we emphasize that the preliminary data on goods trade are only a small piece of the trade puzzle. The picture could change noticeably in the months ahead, particularly after taking into account the usually sizable surplus in service trade maintained by the U.S., as well as inflation adjustments made to the nominal trade figures (which could mitigate the widening in the goods deficit). Moreover, we would note that brisk import growth into the U.S. indicates that domestic demand is firm. Part of that demand is being satisfied by externally produced goods, which is unfavorable with regard to GDP, but it does suggest that demand across sectors is steady and that the domestic economy remains on a positive trajectory.

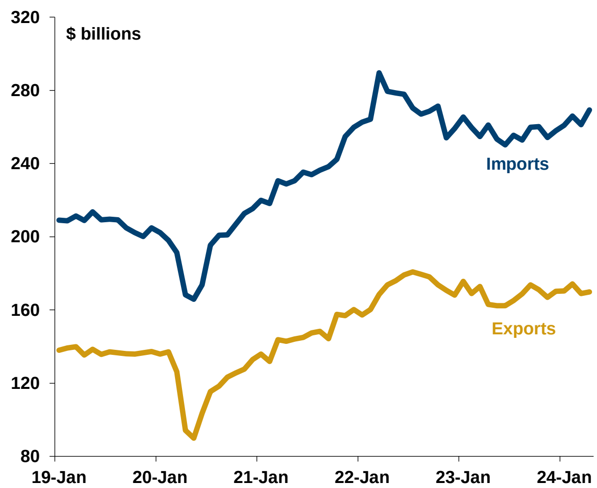
Net Exports of Goods & Services*



** Contribution to GDP growth. The gold bar is a forecast for 2024-Q2.*

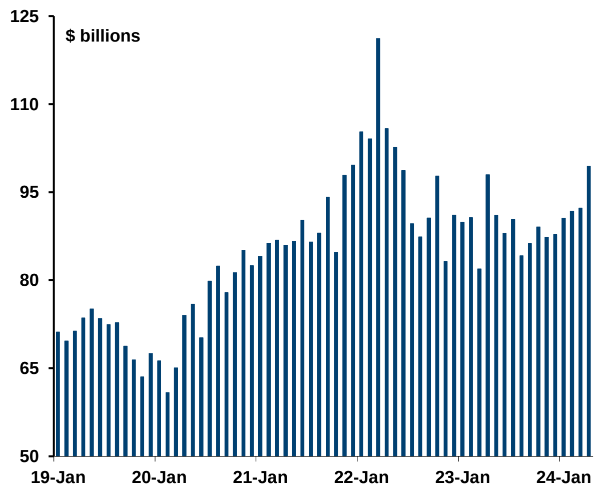
Sources: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

Imports & Exports of Goods



Source: U.S. Census Bureau via Haver Analytics

Nominal Trade Deficit in Goods

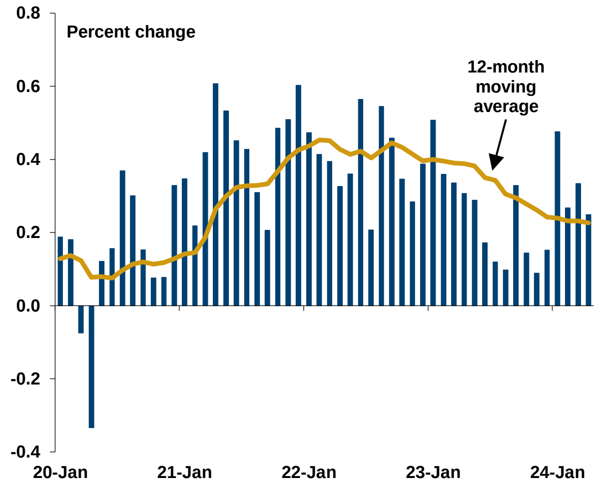


Source: U.S. Census Bureau via Haver Analytics

Inflation: Back on Track

We hesitate assigning too much weight to a singular favorable inflation read after concerning results in Q1, but we are cautiously optimistic that April results for the price index for personal consumption expenditures signal a return to the disinflationary trend in place at the end of 2023, particularly as economic growth appears to be moderating and imbalances in the labor market show signs of unwinding.

Core PCE Price Index

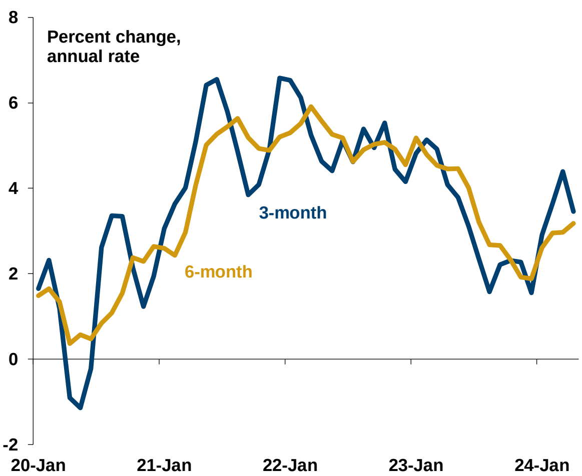


Source: Bureau of Economic Analysis via Haver Analytics

In the latest month, the headline index rose 0.3 percent (0.257 percent with less rounding), versus an average of 0.4 percent (0.359 percent) in Q1. Perhaps more important, the core advance rounded down to 0.2 percent (0.249 percent with less rounding) versus an average monthly increase of 0.359 percent in Q1 (chart, right). Goods prices excluding food and energy rose modestly (+0.1 percent month-over-month) continuing along its subdued trend, but more notable was the change in service prices excluding costs of energy and housing services. Moderation in this so-called “supercore” area is essential for the Fed to ultimately achieve a sustainable return to two percent inflation, as other areas such as food and core goods inflation have already returned to muted pre-pandemic trajectories. The measure took a significant step in the right direction in April, with the increase of 0.3 percent (0.264 percent with less rounding) much improved from the monthly average of 0.439 percent in Q1.

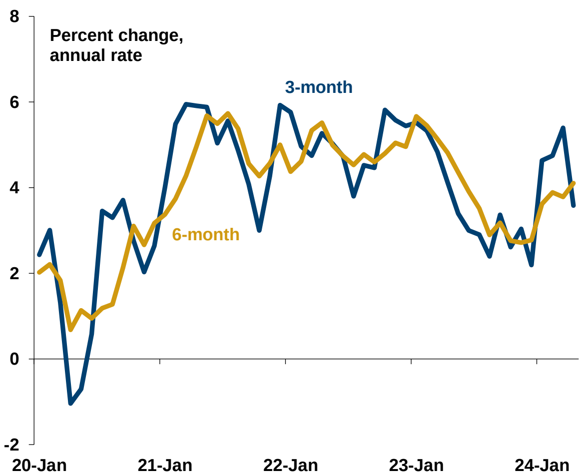
Even with inflation again making progress, Fed officials will likely need to see additional improvement before cutting interest rates. The previously emphasized three and six month annualized growth rates illustrate the point well. The core PCE index recorded readings of 3.5 and 3.2 percent in March versus three and six month readings of 4.4 percent and 3.0 percent, respectively, in March – still well above December three and six-month observations of 1.6 and 1.9 percent (chart, below left). For the supercore measure, the three-month annualized growth rate fell to 3.6 percent from 5.4 percent (versus a recent low of 2.2 percent in December 2023), but the six-month growth rate picked up to 4.1 percent from 3.8 percent (versus 2.8 percent in December; chart, below right). Inflation has again likely returned on a trajectory back toward two-percent, but additional progress will be slow and nonlinear (as we have previously emphasized). Thus, we suspect that Fed officials were heartened by April results, but they need to gain greater confidence in that trajectory before cutting. As Fed Governor Waller indicated in a speech last week, "I need to see several more months of good inflation data before I would be comfortable supporting an easing in the stance of monetary policy." (For more, see: Waller, Christopher J. “Little by Little, Progress Seems to be Resuming,” Federal Reserve Board, May 21, 2024. https://www.federalreserve.gov/newsevents/speech/waller20240521a.htm.)

Core PCE Price Index



Source: Bureau of Economic Analysis via Haver Analytics

PCE Price Index: Core Services Ex. Housing*



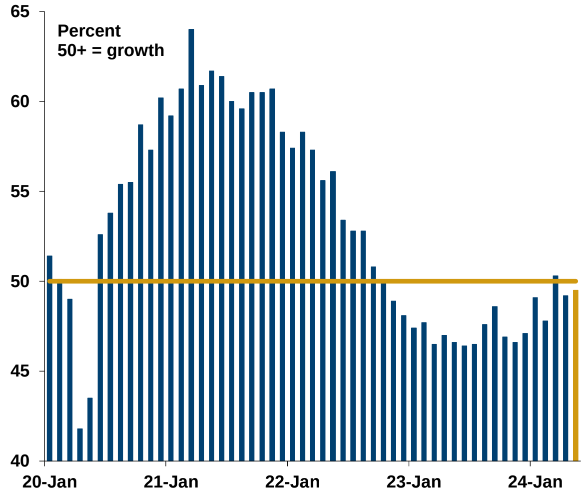
** Service prices excluding energy and housing services.*
Source: Bureau of Economic Analysis via Haver Analytics

The Week Ahead

ISM Manufacturing Index (May) (Monday)
Forecast: 49.5% (+0.3 Pct. Pt.)

Soft results in May for key regional manufacturing gauges, including readings of -15.6 for the New York Fed's Empire State Manufacturing Survey and 35.4 for the MNI Chicago Business Barometer, raise the possibility of the ISM index registering a sub-50 print for the 18th time in the past 19 months (chart).

ISM Manufacturing Index*



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

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

Construction (April) (Monday)
Forecast: 0.0%

With private residential construction moving sideways since last fall, and both business-related and government-sponsored building appearing to have peaked after strong performances from late 2022 through December of last year, total construction activity may fail to reestablish upward momentum in April after a dip in Q1.

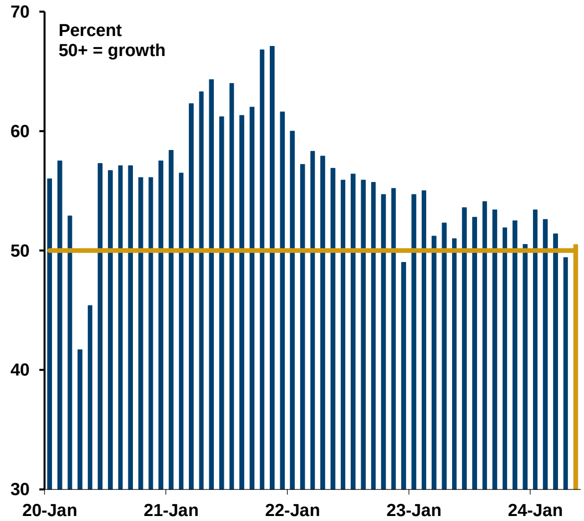
Factory Orders (April) (Tuesday)
Forecast: 0.7%

Durable goods orders rose 0.7 percent in April, the third consecutive increase after a combined plunge of 8.0 percent in December 2023 and January 2024. Excluding volatility in the transportation category tied to sharp moves in the civilian aircraft component, bookings have only tilted only marginally higher in the past year. Preliminary shipments data released with the Advance Report on Durable Goods on May 24 point to a third consecutive gain in that area (+0.8 percent expected for April).

ISM Services Index (May) (Wednesday)
Forecast: 50.5% (+0.9 Pct. Pt.)

We suspect that the ISM services index could again return to growth territory in May after a drop of two percentage points to 49.4 percent in April (chart). The business activity component swooned in April (50.9 versus an average of 56.8 in Q1), which appears inconsistent with a moderate underlying growth rate in the economy and raises the possibility of a recovery in May. Additionally, last month's 45.9 percent reading for the employment index (versus an average of 49.0 percent in Q1) appears contrary to an economy that last added 175,000 jobs in April.

ISM Services Index*



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

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

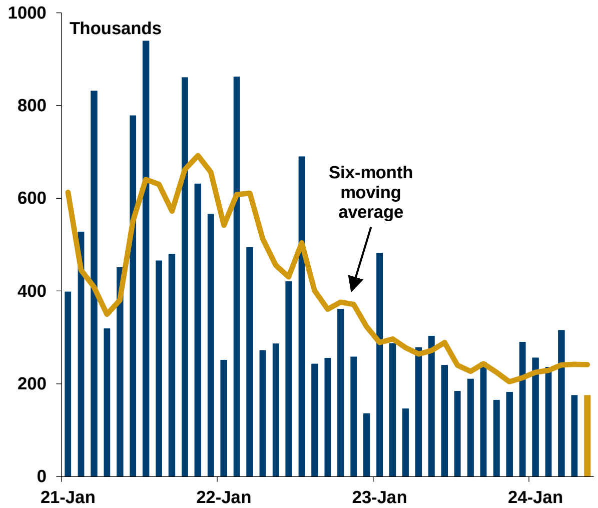
Trade Balance (April) (Thursday)
Forecast: -$76.0 Billion ($6.6 Billion Wider Deficit)

The widening of $7.1 billion in the goods deficit (released May 30) suggests similar deterioration in the total trade deficit in April. Moreover, the surplus in services trade narrowed by a combined $1.3 billion in Q1 after moving in favor of the U.S. for much of 2023.

Payroll Employment (May) (Friday)
Forecast: 175,000

Payroll growth of 175,000 in April trailed the average of 269,000 in Q1, a reading consistent with slowing (but still solid) economic growth. Absent evidence of a sharp slowdown in labor demand (unemployment claims and layoff announcements have remained subdued), job growth similar to last month's total appears likely in May (chart, below left). With the labor market remaining on track, growth of average hourly earnings could return to its underlying average (+0.3 percent per month from April 2023-March 2024) after a low-side reading of 0.2 percent in April (associated with a projected year-over-year increase of 3.9 percent; chart, below right).

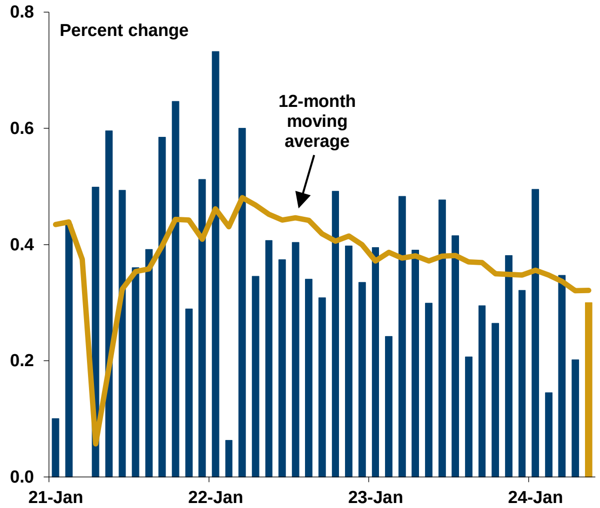
Change in Nonfarm Payrolls*



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

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

Average Hourly Earnings*



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Economic Indicators

May/June 2024

Monday	Tuesday	Wednesday	Thursday	Friday
27	28	29	30	31
MEMORIAL DAY	**FHFA HOME PRICE INDEX** Jan -0.1% Feb 1.2% Mar 0.1% **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** Jan 0.2% Feb 0.6% Mar 0.3% **CONFERENCE BOARD CONSUMER CONFIDENCE** Mar 103.1 Apr 97.5 May 102.0	**BEIGE BOOK** **May 2024:** “National economic activity continued to expand from early April to mid-May; however, conditions varied across industrie and Districts. Most Districts reported slight or modest growth, while two noted no change in activity.”	**UNEMPLOYMENT CLAIMS** Initial / Continuing (millions) May 4 0.232 1.786 May 11 0.223 1.787 May 18 0.216 1.791 May 25 0.219 N/A **REVISED GDP** GDP / Chained Price 23-Q4 3.4% 1.6% 24-Q1(a) 1.6% 3.1% 24-Q1(p) 1.3% 3.0% **INTERNATIONAL TRADE IN GOODS** Feb -$91.8 billion Mar -$92.3 billion Apr -$99.4 billion **ADVANCE INVENTORIES** Wholesale / Retail Feb 0.2% 0.3% Mar -0.4% 0.1% Apr 0.2% 0.7% **PENDING HOME SALES** Feb 1.6% Mar 3.6% Apr -7.7%	**PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX** Inc. / Cons. / Core Feb 0.3% 0.7% 0.3% Mar 0.5% 0.7% 0.3% Apr 0.3% 0.2% 0.2% **MNI CHICAGO BUSINESS BAROMETER** Index / Prices Mar 41.4 62.6 Apr 37.9 69.3 May 35.4 68.4
3	4	5	6	7
ISM MFG. INDEX (10:00) Index / Prices Mar 50.3 55.8 Apr 49.2 60.9 **May 49.5 60.0** **CONSTRUCTION (10:00)** Feb 0.0% Mar -0.2% **Apr 0.0%** **VEHICLE SALES** Mar 15.6 million Apr 15.8 million **May 15.8 million**	**FACTORY ORDERS (10:00)** Feb 1.4% Mar 0.7% **Apr 0.7%** **JOLTS DATA (10:00)** Openings (000) / Quit Rate Feb 8,813 2.2% Mar 8,488 2.1% Apr -- --	**ADP EMPLOYMENT (8:15)** Private Payrolls Mar 208,000 Apr 192,000 May -- **ISM SERVICES INDEX (10:00)** Index / Prices Mar 51.4 53.4 Apr 49.4 59.2 **May 50.5 59.0**	**UNEMP. CLAIMS (8:30)** **TRADE BALANCE (8:30)** Feb -$69.5 billion Mar -$69.4 billion **Apr -$76.0 billion** **REVISED PRODUCTIVITY & COSTS (8:30)** Productivity / Unit Labor Costs 23-Q4 3.5% 0.0% 24-Q1(p) 0.3% 4.7% **24-Q1(r) 0.0% 4.9%**	**EMPLOYMENT REPORT (8:30)** Payrolls / Un. Rate Mar 315,000 3.8% Apr 175,000 3.9% **May 175,000 3.9%** **WHOLESALE TRADE (10:00)** Inventories / Sales Feb 0.2% 2.0% Mar -0.4% -1.3% **Apr 0.2% 0.5%** **CONSUMER CREDIT (3:00)** Feb $15.0 billion Mar $6.3 billion Apr --
10	11	12	13	14
	NFIB SMALL BUSINESS OPTIMISM INDEX **FOMC MEETING (FIRST DAY**	**CPI** **FEDERAL BUDGET** **FOMC RATE DECISION**	**UNEMP. CLAIMS** **PPI**	**IMPORT/EXPORT PRICES** **CONSUMER SENTIMENT**
17	18	19	20	21
EMPIRE MFG	**RETAIL SALES** **IP & CAP-U** **BUSINESS INVENTORIES** **TIC FLOWS**	**NAHB HOUSING INDEX** ***JUNETEENTH NATIONAL INDEPENDENCE DAY***	**UNEMP. CLAIMS** **HOUSING STARTS** **CURRENT ACCOUNT** **PHILLY FED INDEX**	**EXISTING HOME SALES** **LEADING INDICATORS**

Forecasts in bold. (a) = advance (1st estimate of GDP), (p) = preliminary (2nd estimate of GDP), (r) = revised

Treasury Financing

May/June 2024

Monday	Tuesday	Wednesday	Thursday	Friday
27	28	29	30	31
MEMORIAL DAY	**AUCTION RESULTS:** Rate Cover 13-week bills 5.255% 2.87 26-week bills 5.170% 3.06 2-yr notes 4.917% 2.41 5-yr notes 4.553% 2.30 42 day CMBs 5.275% 3.07 **ANNOUNCE:** $60 billion 17-week bills for auction on May 29 $70 billion 4-week bills for auction on May 30 $70 billion 8-week bills for auction on May 30 **SETTLE:** $60 billion 17-week bills $80 billion 4-week bills $80 billion 8-week bills	**AUCTION RESULTS:** Rate Cover 17-week bills 5.240% 2.80 7-yr notes 4.650% 2.43 Margin Cover 2-yr FRNs 0.139% 3.40	**AUCTION RESULTS:** Rate Cover 4-week bills 5.270% 2.83 8-week bills 5.275% 2.94 **ANNOUNCE:** $140 billion 13-,26-week bills for auction on June 3 $60 billion 42-day CMBs for auction on June 4 **SETTLE:** $140 billion 13-,26-week bills $65 billion 42-day CMBs	**SETTLE:** $16 billion 20-year bonds $16 billion 10-year TIPS $69 billion 2-year notes $70 billion 5-year notes $44 billion 7-year notes $28 billion 2-year FRNs
3	4	5	6	7
AUCTION: $140 billion 13-,26-week bills	**AUCTION:** $60 billion 42-day CMBs **ANNOUNCE:** $60 billion* 17-week bills for auction on June 5 $70 billion* 4-week bills for auction on June 6 $70 billion* 8-week bills for auction on June 6 **SETTLE:** $60 billion 17-week bills $70 billion 4-week bills $70 billion 8-week bills	**AUCTION:** $60 billion* 17-week bills	**AUCTION:** $70 billion* 4-week bills $70 billion* 8-week bills **ANNOUNCE:** $140 billion* 13-,26-week bills for auction on June 10 $46 billion* 52-week bills for auction on June 11 $58 billion* 3-year notes for auction on June 10 $39 billion* 10-year notes for auction on June 11 $22 billion* 30-year bonds for auction on June 13 **SETTLE:** $140 billion 13-,26-week bills $60 billion 42-day CMBs	
10	11	12	13	14
AUCTION: $140 billion* 13-,26-week bills $58 billion* 3-year notes	**AUCTION:** $46 billion* 52-week bills $39 billion* 10-year notes **ANNOUNCE:** $60 billion* 17-week bills for auction on June 12 $70 billion* 4-week bills for auction on June 13 $70 billion* 8-week bills for auction on June 13 **SETTLE:** $60 billion* 17-week bills $70 billion* 4-week bills $70 billion* 8-week bills	**AUCTION:** $60 billion* 17-week bills	**AUCTION:** $70 billion* 4-week bills $70 billion* 8-week bills $22 billion* 30-year bonds **ANNOUNCE:** $140 billion* 13-,26-week bills for auction on June 17 $13 billion* 20-year bonds for auction on June 18 $21 billion* 5-year TIPS for auction on June 20 **SETTLE:** $140 billion* 13-,26-week bills $46 billion* 52-week bills	
17	18	19	20	21
AUCTION: $140 billion* 13-,26-week bills **SETTLE:** $58 billion* 3-year notes $39 billion* 10-year notes $22 billion* 30-year bonds	**AUCTION:** $13 billion* 20-year bonds **ANNOUNCE:** $60 billion* 17-week bills for auction on June 20 $70 billion* 4-week bills for auction on June 20 $70 billion* 8-week bills for auction on June 20 **SETTLE:** $60 billion* 17-week bills $70 billion* 4-week bills $70 billion* 8-week bills	***JUNETEENTH NATIONAL INDEPENDENCE DAY***	**AUCTION:** $60 billion* 17-week bills $70 billion* 4-week bills $70 billion* 8-week bills $21 billion* 5-year TIPS **ANNOUNCE:** $140 billion* 13-,26-week bills for auction on June 24 $69 billion* 2-year notes for auction on June 25 $70 billion* 5-year notes for auction on June 26 $44 billion* 7-year notes for auction on June 27 $28 billion* 2-year FRNs for auction on June 26 **SETTLE:** $140 billion* 13-,26-week bills	

**Estimate*