U.S. Economic Comment

- Inflation: favorable developments in May
- Consumer spending: on track in Q2 thus far, but contingent on solid labor market

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May Inflation

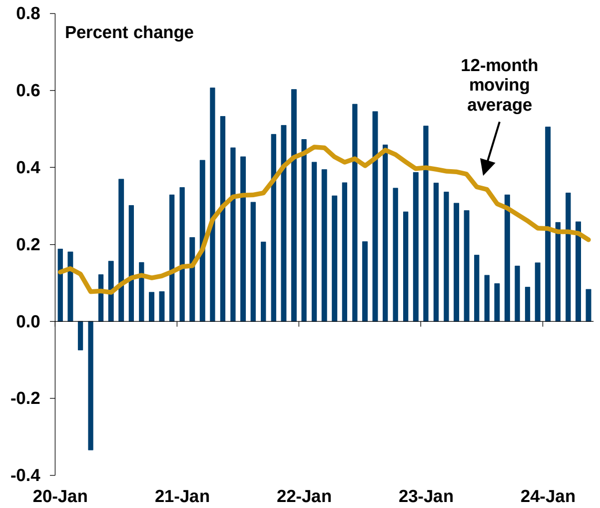
Although the PCE price data for May are likely insufficient to prompt policymakers to cut the target range for the federal funds rate at the July 30-31 FOMC meeting, with such a move appearing particularly premature after a shift in the June Summary of Economic Projections (median expectation of one cut in 2024 versus two as of March), we are inclined to view the latest report as strengthening the case for a move in September (our current baseline expectation). Many elements of the inflation statistics were favorable, and additional progress over the next month or so could provide at least a critical mass of officials the confidence required to believe that inflation is on a sustainable path back to two percent. On the point, Chair Powell reiterated in June press conference that rates are "restrictive" and on the way to achieving desired policy outcomes rather than playing into the idea that policy was not well positioned to address inflation. Additionally, some of his colleagues have more recently expressed increasing concern about undesirable labor market outcomes should rates stay too high for too long. Thus, if the data continue to cooperate, a move could materialize sooner rather than later.

Parsing the May Data

Both the headline and core PCE prints (0.0 percent and +0.1 percent, respectively, with both equating to year-over-year increases of 2.6 percent) ratified market expectations that had been shaped by earlier benign readings on both the CPI and PPI. Inflation edged lower in April after a disquieting performance in Q1, and the May results provided additional evidence of cooling amid an ongoing realignment of pandemic-related imbalances and gradual slowing in economic activity (chart on core PCE index, right).

Among topline components, energy prices fell 2.1 percent after brisk increases in the previous three months, although they rose 4.8 percent year-over-year. Food prices rose 0.1 percent (1.2 percent year-over-year) after a dip of 0.2 percent in the previous month. Food prices, especially, have settled back to their restrained pre-pandemic trend.

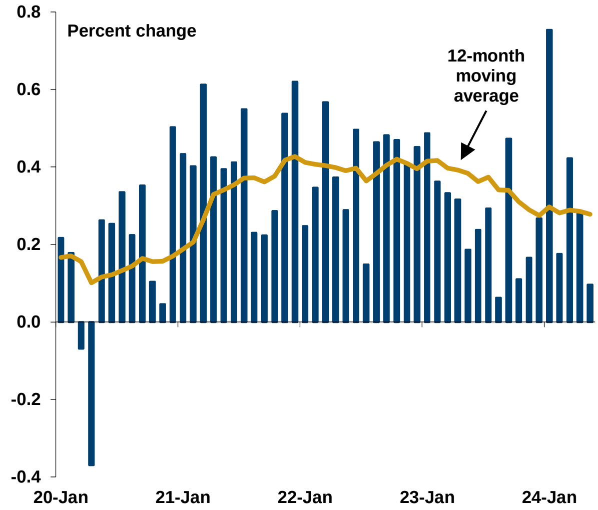
Core PCE Price Index



Source: Bureau of Economic Analysis via Haver Analytics

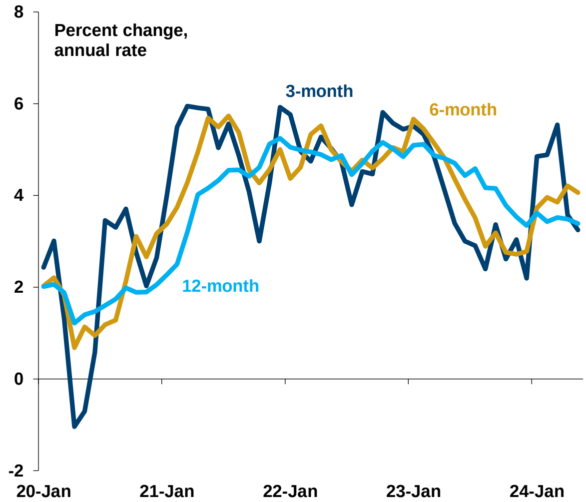
The performance in core, as indicated above, was particularly noteworthy. Goods prices excluding food and energy dipped 0.2 percent in May after modest increases in the previous three months. The year-over-year decline of 1.1 percent stood in stark contrast to the recent peak of 7.6 percent in February 2022 and indicated that core goods prices have resumed their pre-pandemic disinflationary trajectory. More critical to assessing conditions for the timing of a pivot to lower rates, core service inflation excluding housing (also known as the "supercore" measure) rose 0.1 percent (chart, next page, top left). Importantly, longer-term readings, at various points highlighted by Fed officials, are again trending in the right direction after deterioration in Q1. The three-month annualized growth rate decelerated to 3.2 percent in May from 3.6 percent in the prior month, and the six-month annualized growth rate eased 0.1 percentage point to 4.1 percent (chart, next page, top right). On a 12-month basis, supercore inflation rose 3.4 percent, down 0.1 percentage point from the April reading and well below the cycle peak of 5.2 percent in October 2022.

PCE: Core Services Ex. Housing Price Index*



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

PCE: Core Services Ex. Housing Price Index

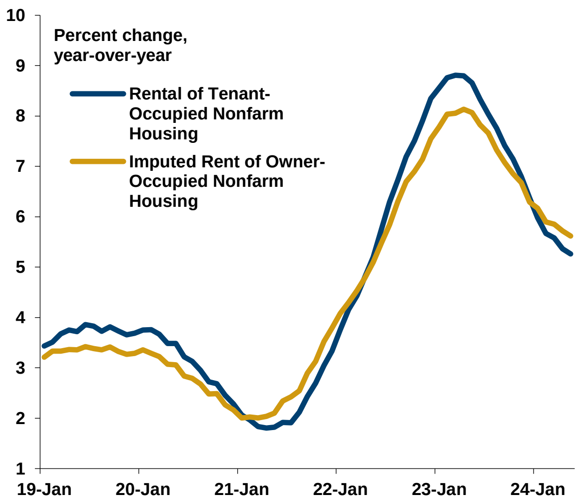


Source: Bureau of Economic Analysis via Haver Analytics

In contrast to renewed progress in other areas, inflation in housing services has remained fairly sticky with both the rental of tenant-occupied nonfarm housing and imputed rent of owner-occupied nonfarm housing components advancing 0.4 percent (+5.3 percent and +5.6 percent year-over-year, respectively; chart on rents, right). Year-over-year growth has slowed from recent peaks of 8.8 percent and 8.1 percent, respectively, in the spring of 2023, but the current trend is still inconsistent with achieving two percent inflation; in the pre-pandemic period, housing-related inflation tracked at approximately three and one-half percent. Interestingly, in a speech delivered on June 27, President Raphael Bostic of the Atlanta Fed expressed ongoing concern about housing inflation. He noted that, "[h]ousing prices and rents, meanwhile, have decreased more slowly than most anticipated," and that "shelter prices have behaved differently in this inflationary episode than history suggests they would." He expressed some confidence that current market rents would eventually show up in the price data and slow inflation, but he emphasized that "development has been slow in coming." Thus, caution is still warranted as this area could be a potential impediment to a return to price stability. (For more information, see: Bostic, Raphael. "Renewed Hope on Inflation but More Confidence Needed," Federal Reserve Bank of Atlanta, June 27, 2024. https://www.atlantafed.org/about/atlantafed/executive-leadership-committee/bostic-raphael/message-from-the-president.)

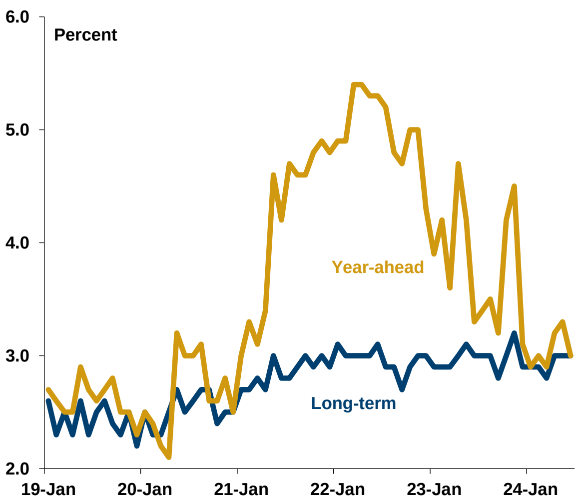
Moving beyond the PCE data, we were also encouraged today by the release of revised consumer sentiment figures from the University of Michigan. Specifically, we took note of the inflation expectations figures published

PCE Inflation: Rents



Source: Bureau of Economic Analysis via Haver Analytics

Consumer Inflation Expectations

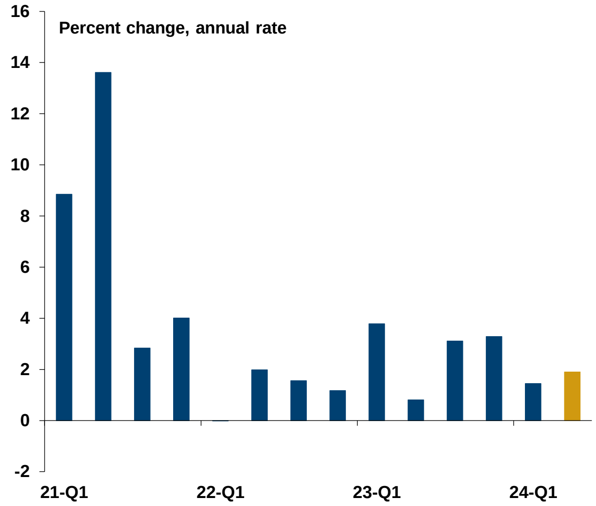


Source: University of Michigan via Haver Analytics with the report. Year-ahead and longer-term inflation expectations that had previously been reported at 3.3 percent and 3.1 percent, respectively, were adjusted to 3.0 percent (chart, previous page). Longer-term inflation expectations are still about one-half percentage point above were they were prior to the onset of the pandemic, but they have stabilized. The data validate the assessment of Fed officials that inflation expectations are anchored, thus allowing monetary policy to effectively run its course.

Consumer Spending

An active consumer sector is essential for the economy to remain in a solid growth trajectory into mid-year, but some concerning developments have emerged in recent months. Research by the Federal Reserve Bank of San Francisco suggests that pandemic-related excess savings have been exhausted, and revolving credit growth has slowed to a trickle recently (annualized growth of 0.5 percent in March/April versus 8.8 percent in the 12 months ended February) while delinquency rates have crept higher. (For more information, see: Abdelrahman, Hamza et al. "Pandemic Savings Are Gone: What's Next for U.S. Consumers?" Federal Reserve Bank of San Francisco, May 3, 2024. https://www.frbsf.org/research-and-insights/blog/sf-fed-blog/2024/05/03/pandemic-savings-are-gone-whats-next-for-us-consumers.) Moreover, growth of real consumer spending was revised lower by one-half percentage point to 1.5 percent, annual rate, in the Bureau of Economic Analysis' third estimate of Q1 GDP published yesterday. With that in mind, we were anxious to review the consumer spending data in today's Personal Income and Consumption Report. Real consumer spending jumped 0.3 percent, a strong rebound after a dip of 0.1 percent in April that leaves consumer spending in Q2 on track to expand at a pace a bit below 2.0 percent – a performance slightly slower than the 2.2 percent rate in 2023 and admirable given headwinds from inflation and elevated interest rates (chart).

Real Consumer Spending Growth*

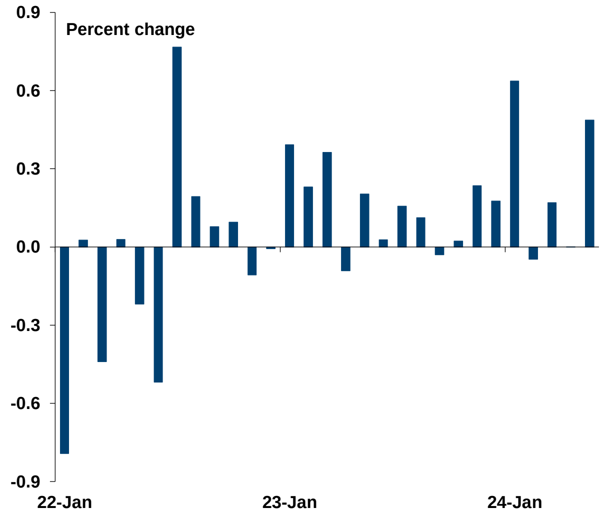


** The gold bar is a forecast for 2024-Q2.*

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

Given the depletion of pandemic-related excess savings and slowdown in credit growth, much of the support for current spending is likely provided by wage income, which has grown briskly amid ongoing firm demand for labor. On the point, nominal personal income rose 0.5 percent in May (+4.6 percent year-over-year), supported by a jump of 0.7 percent in wages and salaries (+5.1 percent year-over-year). The nominal increase in personal income translated to a real advance of 0.5 percent, which along with the jump of 0.6 percent in January 2024 were among the largest of the past few years (chart).

Real Personal Income Growth



Source: Bureau of Economic Analysis via Haver Analytics

Necessarily, additional cooling in labor market conditions generated by restrictive policy could temper wage (and by extension, income) growth and slow consumer spending. Moreover, the process could be disorderly the longer policy remains restrictive. Mary Daly of the San Francisco Fed discussed this concern at length in a recent speech. A key excerpt illustrates the point, "[S]o far, the labor market has adjusted slowly, and the unemployment rate has only edged up. But we are getting nearer to a point where that benign outcome could be less likely." (For more information on these remarks, see: Daly, Mary. "Getting It Right: Meeting Uncertainty with Conditionality," Federal

Reserve Bank of San Francisco, June 24, 2024. https://www.frbsf.org/news-and-media/speeches/mary-c-daly/2024/06/getting-it-right-meeting-uncertainty-with-conditionality.) That is to say, the economy is performing well currently, in part because of a resilient consumer, but risks from restrictive monetary policy have intensified. And, if those risks are realized in a disorderly correction in the labor market, the potential for a hard landing increases, an outcome that the Fed would obviously like to avoid.

The Week Ahead

ISM Manufacturing Index (June) (Monday)
Forecast: 49.0% (+0.3 Pct. Pt.)

Although key regional manufacturing indexes showed some improvement in June, with the Chicago Business Barometer increasing to 47.4 from 35.4 in May and the general business conditions assessment from the New York Fed's Empire survey rising to -6.0 from -15.6, tight credit conditions and subdued demand are still weighing on the factory sector. Thus, the ISM manufacturing gauge could register a contractionary reading for the 19th time in a 20-month span beginning in November 2022 (chart).

Construction (May) (Monday)
Forecast: -0.1%

With housing starts trending lower, private residential construction could ease in May after a choppy performance in recent months. Moreover, private nonresidential and public-sector construction both appear to be plateauing after firm performances for much of the current expansion.

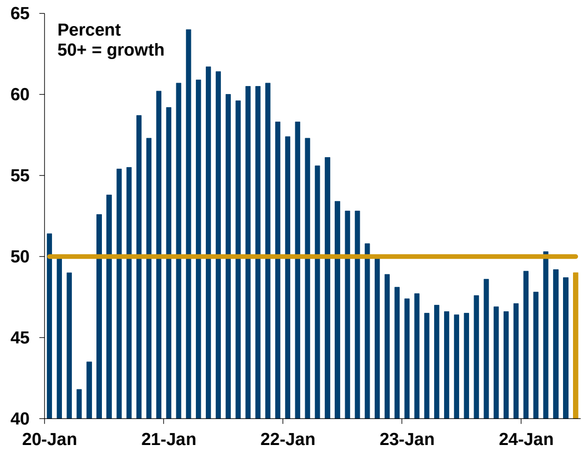
Trade Balance (May) (Wednesday)
Forecast: -$77.0 Billion ($2.4 Billion Wider Deficit)

The widening of $2.7 billion in the goods deficit (published June 27) suggests similar slippage in the total trade shortfall in May. The expected change would follow deterioration of $6.0 billion in April, with results thus far for Q2 suggesting that net exports will be a notable drag on GDP growth – possibly subtracting more than 1.0 percentage points from growth (chart).

ISM Services Index (June) (Wednesday)
Forecast: 52.0% (-1.8 Pct. Pt.)

With the U.S. economy likely to exceed annualized growth in excess of 1.5 percent in the first half of 2024, we suspect that the ISM services index remained on an expansionary track in June. That said, the business activity component surged 10.3 points to 61.2 in May, a reading well above the 55.3 average in the first four months of 2024. With that in mind, we look for the business activity component to cool in June, possibly nudging the headline index lower (chart).

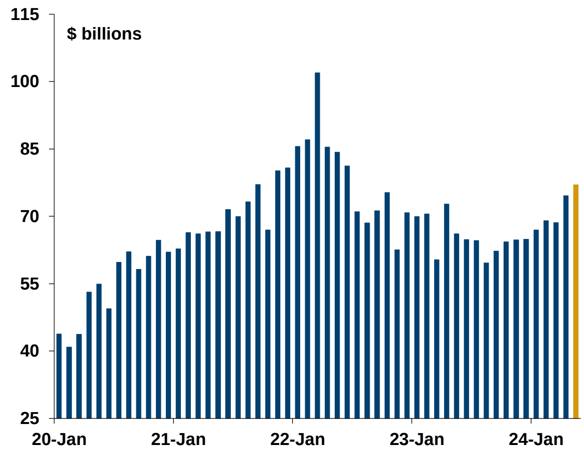
ISM Manufacturing Index*



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

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

Trade Deficit in Goods & Services*



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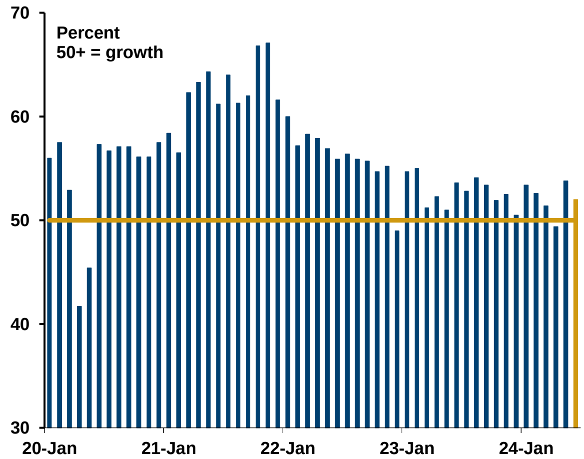
ISM Services Index*



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

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

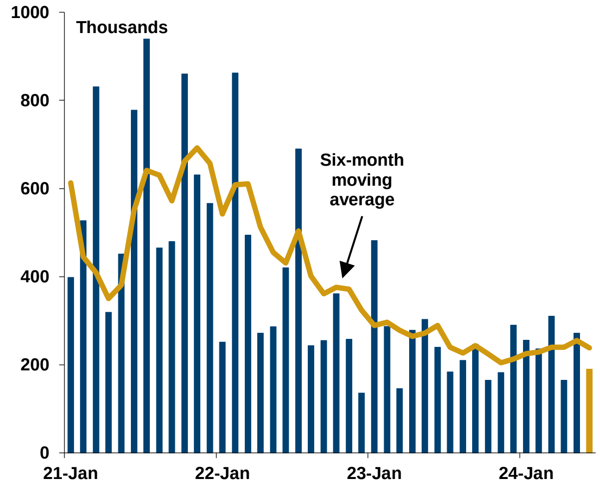
Factory Orders (May) (Wednesday)
Forecast: -0.5%

Durable goods orders rose 0.1 percent in May, the fourth consecutive increase after a combined plunge of 8.0 percent in December 2023 and January 2024. Excluding volatility in the transportation category, bookings dipped 0.1 percent, which maintained the essentially sideways trend in place since mid-2022. Preliminary shipments data released with the Advance Report on Durable Goods on June 27 call for a drop of 1.1 percent in the nondurable area after three consecutive advances.

Payroll Employment (June) (Friday)
Forecast: 190,000

With a recent upward drift in unemployment claims suggesting that the labor market is losing its sharp edge, we anticipate payroll growth cooling from the brisk average of 248,000 in the first five months of 2024. With the labor market remaining on track despite some expected slowing in hiring, growth of average hourly earnings could remain close to its firm average of +0.3 percent per month in the past 12 months (chart, below right; associated with a projected year-over-year increase of 3.9 percent).

Change in Nonfarm Payrolls*



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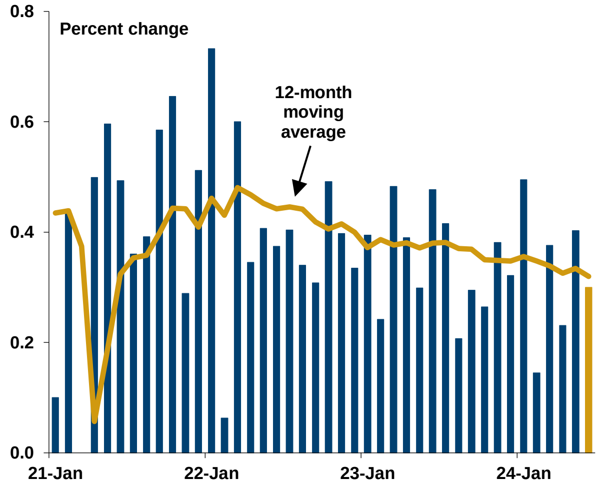
Sources: Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America

Average Hourly Earnings*



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Daiwa Capital Markets

Economic Indicators

June/July 2024

Monday	Tuesday	Wednesday	Thursday	Friday
24	25	26	27	28
	CHICAGO FED NATIONAL ACTIVITY INDEX Monthly / 3-Mo. Avg. Mar -0.18 / -0.23 Apr -0.26 / -0.05 May 0.18 / -0.09 **FHFA HOME PRICE INDEX** Feb 1.3% Mar 0.0% Apr 0.2% **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** Feb 0.6% Mar 0.3% Apr 0.4% **CONFERENCE BOARD CONSUMER CONFIDENCE** Apr 97.5 May 101.3 June 100.4	**NEW HOME SALES** Mar 0.684 million Apr 0.698 million May 0.619 million	**UNEMPLOYMENT CLAIMS** Initial / Continuing (millions) June 1 0.229 / 1.813 June 8 0.243 / 1.821 June 15 0.239 / 1.839 June 22 0.233 / N/A **REVISED GDP** GDP / Chained Price 23-Q4 3.4% / 1.6% 24-Q1(p) 1.3% / 3.0% 24-Q1(r) 1.4% / 3.1% **DURABLE GOODS ORDERS** Mar 0.8% Apr 0.2% May 0.1% **INTERNATIONAL TRADE IN GOODS** Mar -$92.2 billion Apr -$98.0 billion May -$100.6 billion **ADVANCE INVENTORIES** Wholesale / Retail Mar -0.5% / 0.1% Apr 0.2% / 0.7% May 0.6% / 0.7% **PENDING HOME SALES** Mar 3.6% Apr -7.7% May -2.1%	**PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX** Inc. / Cons. / Core Mar 0.5% / 0.7% / 0.3% Apr 0.3% / 0.1% / 0.3% May 0.5% / 0.2% / 0.1% **MNI CHICAGO BUSINESS BAROMETER** Index / Prices Apr 37.9 / 69.3 May 35.4 / 68.4 June 47.4 / 56.5 **REVISED CONSUMER SENTIMENT** May 69.1 June(p) 65.6 June(r) 68.2
1	2	3	4	5
ISM MFG. INDEX (10:00) Index / Prices Apr 49.2 / 60.9 May 48.7 / 57.0 **June 49.0 / 56.0** **CONSTRUCTION (10:00)** Mar -0.2% Apr -0.1% **May -0.1%**	**JOLTS DATA (10:00)** Openings (000) / Quit Rate Mar 8,355 / 2.2% Apr 8,059 / 2.2% May -- / -- **VEHICLE SALES** Apr 15.8 million May 15.9 million **June 15.9 million**	**ADP EMPLOYMENT (8:15)** Private Payrolls Apr 188,000 May 152,000 June -- **UNEMP. CLAIMS (8:30)** **TRADE BALANCE (8:30)** Mar -$68.6 billion Apr -$74.6 billion **May -$77.0 billion** **ISM SERVICES INDEX (10:00)** Index / Prices Apr 49.4 / 59.2 May 53.8 / 58.1 **June 52.0 / 56.0** **FACTORY ORDERS (10:00)** Mar 0.7% Apr 0.5% **May -0.5%** **FOMC MINUTES (2:00)**	***INDEPENDENCE DAY***	**EMPLOYMENT REPORT (8:30)** Payrolls / Un. Rate Apr 165,000 / 3.9% May 272,000 / 4.0% **June 190,000 / 4.0%**
8	9	10	11	12
CONSUMER CREDIT	**NFIB SMALL BUSINESS OPTIMISM INDEX**	**WHOLESALE TRADE**	**UNEMP. CLAIMS** **CPI** **FEDERAL BUDGET**	**PPI** **CONSUMER SENTIMENT**
15	16	17	18	19
EMPIRE MFG	**RETAIL SALES** **IMPORT/EXPORT PRICES** **NAHB HOUSING INDEX** **BUSINESS INVENTORIES**	**HOUSING STARTS** **IP & CAP-U** **BEIGE BOOK**	**UNEMP. CLAIMS** **PHILLY FED INDEX** **LEADING INDICATORS** **TIC FLOWS**	

Forecasts in bold. (p) = preliminary (2nd estimate of GDP), (r) = revised (3rd estimate of GDP)

Treasury Financing

June/July 2024

Monday	Tuesday	Wednesday	Thursday	Friday
24	25	26	27	28
AUCTION RESULTS: Rate / Cover 13-week bills 5.235% 2.85 26-week bills 5.140% 3.16	**AUCTION RESULTS:** Rate / Cover 2-yr notes 4.706% 2.75 42 day CMBs 5.250% 2.87 **ANNOUNCE:** $60 billion 17-week bills for auction on June 26 $80 billion 4-week bills for auction on June 27 $75 billion 8-week bills for auction on June 27 **SETTLE:** $60 billion 17-week bills $70 billion 4-week bills $70 billion 8-week bills	**AUCTION RESULTS:** Rate / Cover 17-week bills 5.220% 2.75 5-yr notes 4.331% 2.35 Margin / Cover 2-yr FRNs 0.155% 2.92	**AUCTION RESULTS:** Rate / Cover 4-week bills 5.270% 2.55 8-week bills 5.260% 2.84 7-yr notes 4.276% 2.58 **ANNOUNCE:** $143 billion 13-,26-week bills for auction on July 1 $65 billion 41-day CMBs for auction on July 2 **SETTLE:** $140 billion 13-,26-week bills $60 billion 42-day CMBs	**SETTLE:** $21 billion 5-year TIPS $28 billion 2-year FRNs
1	2	3	4	5
AUCTION: $143 billion 13-,26-week bills **SETTLE:** $13 billion 20-year bonds $69 billion 2-year notes $70 billion 5-year notes $44 billion 7-year notes	**AUCTION:** $65 billion 41-day CMBs **ANNOUNCE:** $60 billion* 17-week bills for auction on July 3 $80 billion* 4-week bills for auction on July 3 $75 billion* 8-week bills for auction on July 3 **SETTLE:** $60 billion 17-week bills $80 billion 4-week bills $75 billion 8-week bills	**AUCTION:** $60 billion* 17-week bills $80 billion* 4-week bills $75 billion* 8-week bills **ANNOUNCE:** $143 billion* 13-,26-week bills for auction on July 8 $46 billion* 52-week bills for auction on July 9 $58 billion* 3-year notes for auction on July 9 $39 billion* 10-year notes for auction on July 10 $22 billion* 30-year bonds for auction on July 11	***INDEPENDENCE DAY***	**SETTLE:** $143 billion 13-,26-week bills $65 billion 41-day CMBs
8	9	10	11	12
AUCTION: $143 billion* 13-,26-week bills	**AUCTION:** $46 billion* 52-week bills $58 billion* 3-year notes **ANNOUNCE:** $60 billion* 17-week bills for auction on July 10 $80 billion* 4-week bills for auction on July 11 $75 billion* 8-week bills for auction on July 11 **SETTLE:** $60 billion* 17-week bills $80 billion* 4-week bills $75 billion* 8-week bills	**AUCTION:** $60 billion* 17-week bills $39 billion* 10-year notes	**AUCTION:** $80 billion* 4-week bills $75 billion* 8-week bills $22 billion* 30-year bonds **ANNOUNCE:** $143 billion* 13-,26-week bills for auction on July 15 $13 billion* 20-year bonds for auction on July 17 $19 billion* 10-year TIPS for auction on July 18 **SETTLE:** $143 billion* 13-,26-week bills $46 billion* 52-week bills	
15	16	17	18	19
AUCTION: $143 billion* 13-,26-week bills **SETTLE:** $58 billion* 3-year notes $39 billion* 10-year notes $22 billion* 30-year bonds	**ANNOUNCE:** $60 billion* 17-week bills for auction on July 17 $80 billion* 4-week bills for auction on July 18 $75 billion* 8-week bills for auction on July 18 **SETTLE:** $60 billion* 17-week bills $80 billion* 4-week bills $75 billion* 8-week bills	**AUCTION:** $60 billion* 17-week bills $13 billion* 20-year bonds	**AUCTION:** $80 billion* 4-week bills $75 billion* 8-week bills $19 billion* 10-year TIPS **ANNOUNCE:** $143 billion* 13-,26-week bills for auction on July 22 $69 billion* 2-year notes for auction on July 23 $70 billion* 5-year notes for auction on July 24 $44 billion* 7-year notes for auction on July 25 $30 billion* 2-year FRNs for auction on July 24 **SETTLE:** $143 billion* 13-,26-week bills	

**Estimate*