

U.S. Economic Comment

- Powell testimony: a dovish tilt with a keen eye on both sides of the dual mandate
- Inflation: further progress in June, notably in the CPI
- Inflation expectations: incremental improvement in early July; longer-run expectations remain anchored

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

Powell on Capitol Hill

At his semiannual monetary policy testimony earlier this week, Fed Chair Jerome Powell faced questions on an array of topics, ranging from monetary policy to regulatory issues. A few contentious exchanges aside, at least with regard to monetary policy, the testimony covered little in the way of new information. Indeed, the Fed Chair at one point during his Senate testimony on Tuesday indicated a distinct unwillingness to provide additional context for potential policy changes at upcoming FOMC meetings. In response to one Senator's question on the potential timing of rate cuts, the Fed Chair responded bluntly, "I'm today not going to be sending any signals about the timing of any future actions." Even so, while Chair Powell maintained that policymakers don't expect to cut the target range for the federal funds rate until they "have gained greater confidence that inflation is moving sustainably toward 2 percent," he also indicated in his opening statement that, "At the same time, in light of the progress made both in lowering inflation and in cooling the labor market over the past two years, elevated inflation is not the only risk we face. Reducing policy restraint too late or too little could unduly weaken economic activity and employment." Evidently, risks have become two-sided, with the labor market clearly on the Committee's radar.

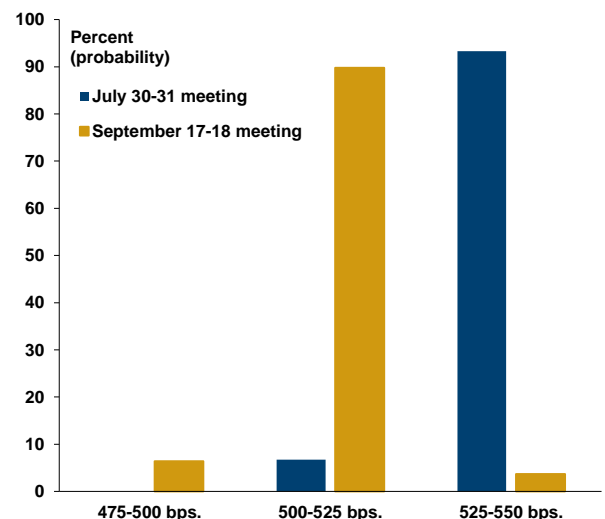
Powell doubled down on that assessment throughout his testimony, indicating a broadening in variables monitored beyond inflation to account for shifts in labor market conditions. On the point, he stated in response to various questions, "So, I think that the upshot of that really is that we're well aware that we now face two-sided risks and have for some time..." and "...the latest data do show that we've had considerable cooling in the labor market." While clearly not an exhaustive list, and despite indications in the Semiannual Monetary Policy Report to the Congress that the labor market is in a favorable position akin to that in 2019, potential for an undesirable deterioration in labor market conditions concerns policymakers. (For more information, please see: Powell, Jerome H. "Semiannual Monetary Policy Report to the Congress," Federal Reserve Board, July 9, 2024. <https://www.federalreserve.gov/newsevents/testimony/powell20240709a.htm>.)

Amid these concerns, and mostly friendly inflation reads this week (see below), market expectations have more forcefully aligned with the view that the FOMC will first cut the federal funds rate in September versus December as previously anticipated after the June Summary of Economic Projections indicated a median projection of one 25-basis-point cut by year-end 2024 (chart). A shift at the July 30-31 meeting, correspondingly, remains unlikely, as officials likely still want to see a bit more data before transitioning to easier monetary policy. On the point, there will be two additional months' worth of PCE price index data ahead of the September FOMC meeting.

The June Inflation Data

Of the two inflation reports published this week (the CPI for June on Thursday and the PPI today), the CPI displayed clearer evidence of improvement. The headline CPI dipped 0.1 percent (+3.0 percent year-over-year), while the core measure posted a modest increase of

Target Rate Probability for FOMC Meetings*



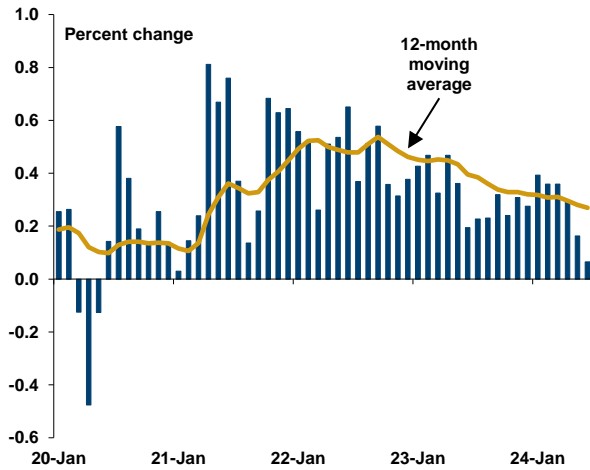
* The implied target range for the federal funds rate based on futures pricing data.

Source: FedWatch Tool, CME Group

This report is issued by Daiwa Securities Group Inc. through its relevant group companies. Daiwa Securities Group Inc. is the global brand name of Daiwa Securities Co. Ltd., Tokyo ("Daiwa Securities") and its subsidiaries worldwide that are authorized to do business within their respective jurisdictions. These include: Daiwa Capital Markets Hong Kong Ltd. (Hong Kong), regulated by the Hong Kong Securities and Futures Commission, Daiwa Capital Markets Europe Limited (London), regulated by the Financial Conduct Authority and a member of the London Stock Exchange, and Daiwa Capital Markets America Inc. (New York), a U.S. brokerdealer registered with the U.S. Securities and Exchange Commission, a futures commission merchant regulated by the U.S. Commodity Futures Trading Commission, and a primary dealer in U.S. government securities. The data contained in this report were taken from statistical services, reports in our possession, and from other sources believed to be reliable. The opinions and estimates expressed are our own, and we make no representation or guarantee either as to accuracy, completeness or as to the existence of other facts or interpretations that might be significant.

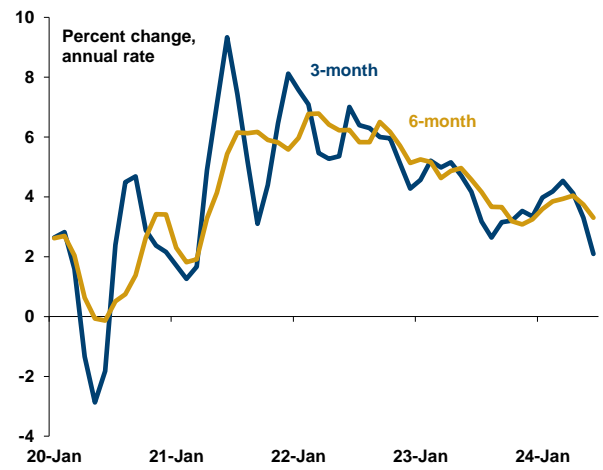
0.1 percent (+3.3 percent year-over-year). Moreover, the three-month growth rate for the core CPI fell to 2.1 percent from 3.3 percent in May, and the six-month rate eased to 3.3 percent from 3.7 percent, ongoing measurable improvement after deterioration in Q1 (charts, below). Importantly, service inflation excluding energy services showed signs of moderation in June (+0.131 percent, the slowest increase since an uptick of 0.094 percent in August 2021; year-over-year growth of 5.1 percent). Along with slowing inflation in rents, core service inflation excluding rents and owners' equivalent rent (i.e. supercore) dipped 0.1 percent (-0.052 percent, associated with a year-over-year increase of 4.6 percent) after a miniscule decline in May (-0.043 percent month-over-month, +5.5 percent year-over-year).

Core CPI



Source: Bureau of Labor Statistics via Haver Analytics

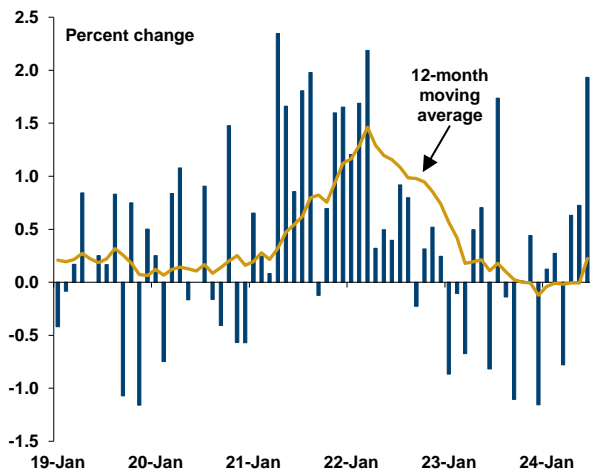
Core CPI



Source: Bureau of Labor Statistics via Haver Analytics

The reading on the PPI was somewhat less impressive, with final demand increasing 0.2 percent and final demand excluding food and energy rising 0.4 percent (consistent with year-over-year advances of 2.6 percent and 3.0 percent, respectively, versus 2.4 and 2.6 percent in May). However, a good portion of the latest advance was tied to a month-to-month surge of 1.9 percent in the trade services component (a measure of wholesale and retail margins) after a miniscule average monthly change of -0.01 percent in the trailing 12-month period (chart, below left). Removing changes in volatile categories (food, -0.3 percent; energy, -2.6 percent; and trade services, +1.9 percent) left the residual (i.e. "core" measure) flat on a month-to-month basis and up 3.1 percent year-over-year (versus 3.3 percent in May; chart, below right). Thus, when accounting for pressure in trade services, this report too suggests a disinflationary impulse. All in all, while readings on inflation have been more favorable in Q2, Fed officials likely aren't ready to declare victory just yet. Given resurgent prints in the first three months in 2024, FOMC participants will exhibit caution to avoid being caught flat footed by another potential head fake.

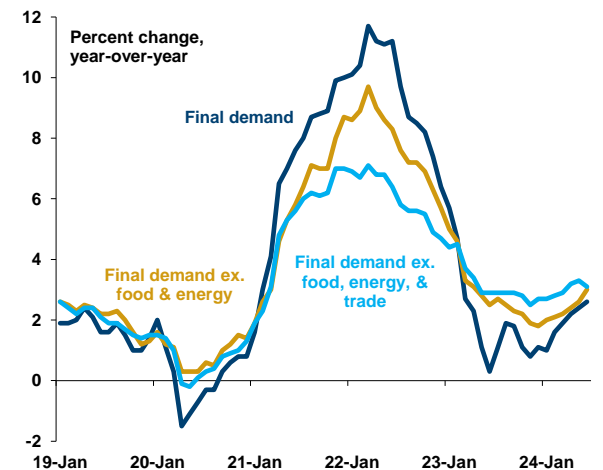
PPI: Trade Services*



* The trade services index measures margins received by wholesalers and retailers.

Source: Bureau of Labor Statistics via Haver Analytics

PPI



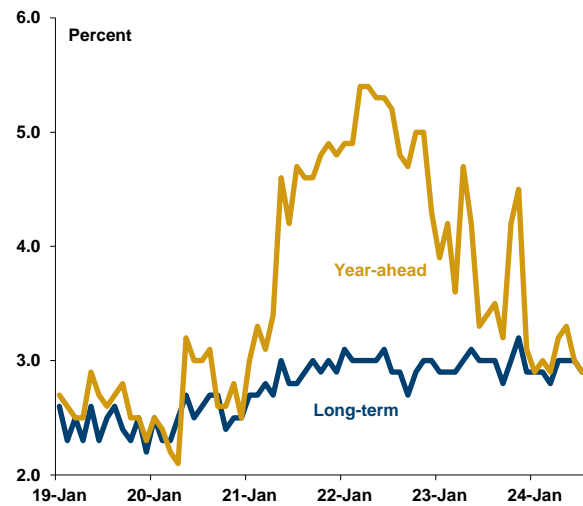
Source: Bureau of Labor Statistics via Haver Analytics

Anchored Inflation Expectations

The release of new readings on consumer inflation expectations alongside the early-July consumer sentiment data from the University of Michigan provide additional evidence that expectations for future inflation are not becoming unmoored. Rather, the maintenance of restrictive monetary policy by the Federal Reserve in the face of the recent bout of price pressure has prevented an inflationary mindset (one orientated to expect rapid price changes in the consumer marketplace) from taking hold and have, in the views of Fed officials, anchored expectations to the central bank's two percent inflation target.

Specifically, both year-ahead and long-term inflation expectations gauges dipped 0.1 percentage point to 2.9 percent (chart). The year-ahead measure returned to the 2024 low – a reading consistent with those in the years preceding the pandemic and well below the current expansion peak of 5.4 percent in the spring of 2022 (when inflation pressure was still intense). Longer-term inflation expectations have not returned readings in the low-to-mid two's that prevailed prior to the onset of the pandemic, or even the 2024 year-to-date low of 2.8 percent, but the measure is off the expansion peak of 3.2 percent in November 2023 and has moved in an otherwise tight range. Thus, in this case, the relatively narrow range of readings sends the critical signal. Namely, expectations have stabilized rather than marching higher, which should provide an additional assist to the Fed as officials seek to ease the federal funds rate in coming months.

Consumer Inflation Expectations



Source: University of Michigan via Haver Analytics

Interestingly, the long-term inflation expectations measure has garnered some attention in recent months on account of a divergence between mean and median long-run inflation expectations. Of note, a “wedge” has developed between the mean and median, with the mean tracking sharply higher during the recent bout of brisk inflation. Consequently, an analysis by Joanne Hsu, the director of the University of Michigan's Surveys of Consumers, indicated that the signal value of the survey question remained intact and that the shift in the mean was at least in part attributable to a methodological change (a shift from phone to web-based interviews). And, it concluded, “we continue to interpret the data as reflecting stable long-run expectations that remain elevated relative to the period prior to the pandemic.” Again, that assessment appears roughly aligned with views of Fed officials that characterize longer-run inflation expectations as “anchored.” (For more information, please see: Hsu, Joanne. “Interpreting Recent Trends in Long-Run Inflation Expectations,” Surveys of Consumers, University of Michigan, July 12, 2024. <https://data.sca.isr.umich.edu/fetchdoc.php?docid=760820>.)

The Week Ahead

Retail Sales (June) (Tuesday)

Forecast: -0.1% Total, +0.1% Ex. Autos, +0.3% Ex. Autos & Gas

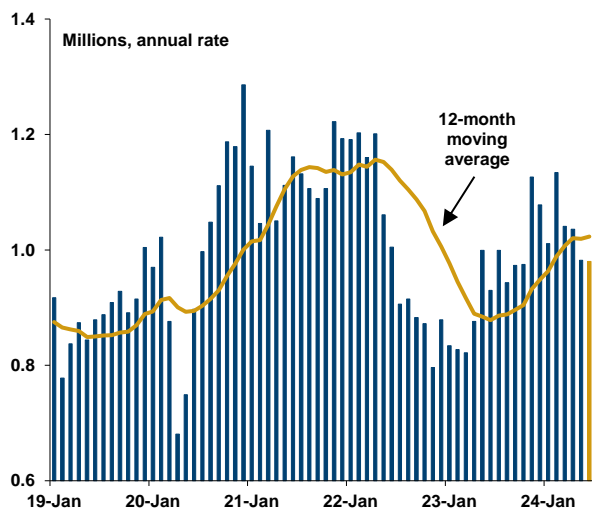
An easing in new automobile sales in June suggests a decline in the motor vehicle and parts component of the retail sales report in June. Additionally, lower prices could depress the value of the gasoline component. Activity excluding autos and gas could pick up for the second consecutive month after a contraction in April, although the expected increase would likely not be enough to alter the sideways trend since the fall of 2023.

Housing Starts (June) (Wednesday)

Forecast: 1.290 Million (+1.0%)

Elevated builder inventories of new homes available for sale suggest that builders will be cautious initiating single-family housing starts in June, a view supported by subdued permit issuance. Multi-family starts, which are volatile from month-to-month, could rebound modestly after a drop in May. However, activity would likely remain near the bottom of the range of the current expansion amid cooling demand for new rental stock and challenges from high financing costs – a view supported by a downward trend in multi-family permit issuance (charts, below).

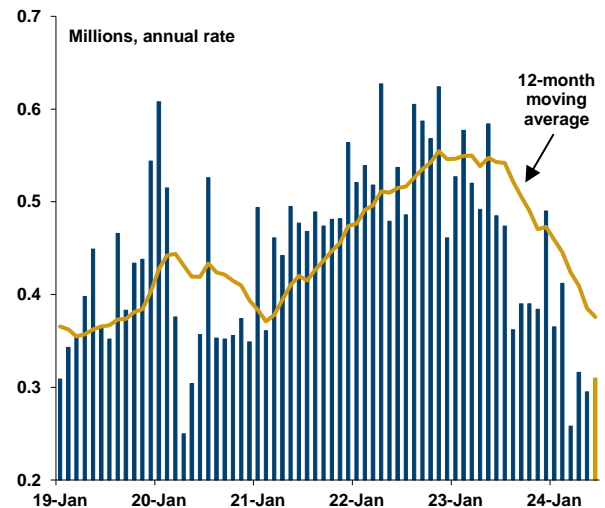
Single-Family Housing Starts*



* The gold bar is a forecast for June 2024.

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

Multi-Family Housing Starts*



* The gold bar is a forecast for June 2024.

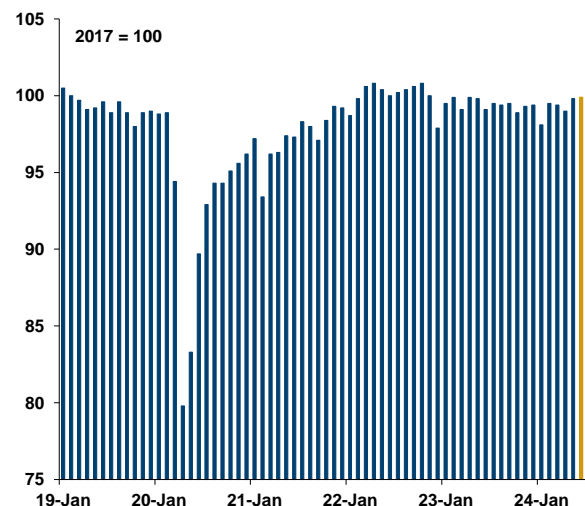
Sources: U.S. Census Bureau via Haver Analytics; Daiwa Capital Markets America

Industrial Production (June) (Wednesday)

Forecast: +0.2% Total, +0.1% Manufacturing

An increase in aggregate hours in the factory sector amid longer workweeks despite a reduction in payrolls suggests a pickup in the manufacturing component of industrial production in June, although the trend would remain unimpressive despite the expected gain (chart). Moreover, an uptick in hours in the mining sector suggest an advance in output in that area as well. Additionally, above-average temperatures raise the possibility of a third consecutive jump in utility output. While the expected swing could be large, it would almost exclusively reflect a shift in weather rather than in underlying economic conditions.

Industrial Production Manufacturing*



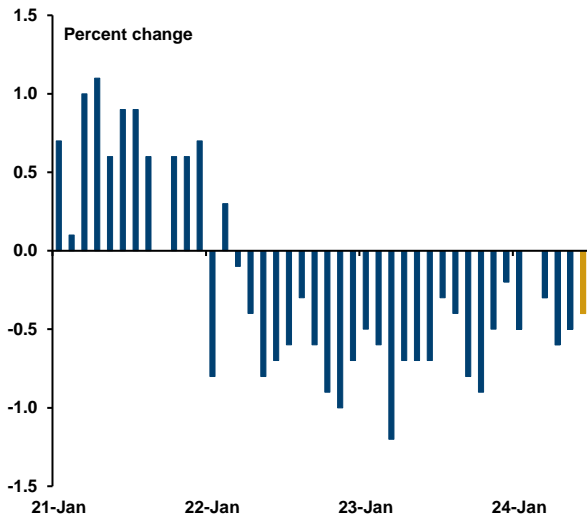
* The gold bar is a forecast for June 2024.

Sources: Federal Reserve Board via Haver Analytics; Daiwa Capital Markets America

Leading Indicators (June) (Thursday)
Forecast: -0.4%

Negative contributions from consumer expectations, the slope of the yield curve, and the ISM new orders index are likely to be only partially offset by a positive contribution from stock prices. If the forecast is realized, the Leading Indicators index will decline for the 27th time in the past 28 months – a reading 15.0 percent below the cycle peak of 118.6 in December 2021. In previous business cycles, downtrends akin to that currently in place are consistent with the U.S. economy entering recession (charts).

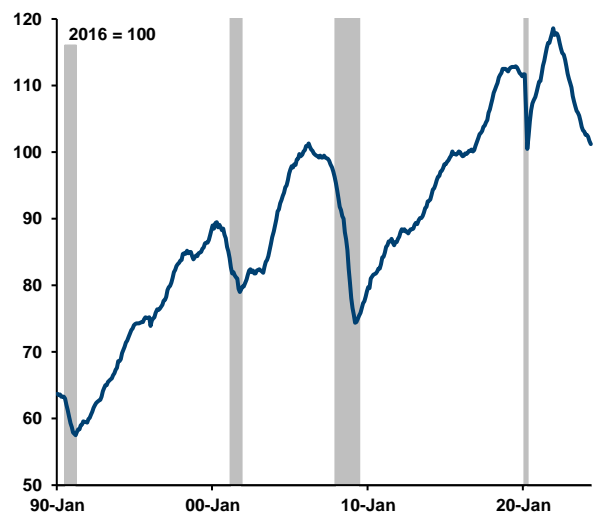
Index of Leading Economic Indicators*



* The gold bar is a forecast for June 2024.

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

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

Economic Indicators

July/August 2024				
Monday	Tuesday	Wednesday	Thursday	Friday
8	9	10	11	12
CONSUMER CREDIT Mar -\$1.2 billion Apr \$6.5 billion May \$11.4 billion	NFIB SMALL BUSINESS OPTIMISM INDEX Apr 89.7 May 90.5 June 91.5 POWELL MONETARY POLICY TESTIMONY (SENATE)	WHOLESALE TRADE Inventories Sales Mar -0.5% -1.3% Apr 0.2% 0.2% May 0.6% 0.4% POWELL MONETARY POLICY TESTIMONY (HOUSE)	UNEMPLOYMENT CLAIMS Initial Continuing (millions) June 15 0.239 1.832 June 22 0.234 1.856 June 29 0.239 1.852 July 6 0.222 N/A CPI Total Core Apr 0.3% 0.3% May 0.0% 0.2% June -0.1% 0.1% FEDERAL BUDGET 2024 2023 Apr \$209.5B \$176.2B May -\$347.1B -\$240.3B June -\$66.0B -\$227.8B	PPI Final Demand Ex. Food & Energy Apr 0.5% 0.5% May 0.0% 0.3% June 0.2% 0.4% CONSUMER SENTIMENT May 69.1 June 68.2 July 66.0
15	16	17	18	19
EMPIRE MFG (8:30) May -15.6 June -6.0 July --	RETAIL SALES (8:30) Total Ex. Autos Apr -0.2% -0.1% May 0.1% -0.1% June -0.1% 0.1% IMPORT/EXPORT PRICES (8:30) Non-Petrol Nonagri. Exports Apr 0.6% 0.7% May -0.3% -0.8% June -- -- NAHB HOUSING INDEX (10:00) May 45 June 43 July -- BUSINESS INVENTORIES (10:00) Inventories Sales Mar -0.1% -0.2% Apr 0.3% 0.2% May 0.5% 0.0%	HOUSING STARTS (8:30) Apr 1.352 million May 1.277 million June 1.290 million IP & CAP-U (9:15) IP Cap.Util. Apr -0.1% 77.7% May 0.7% 78.2% June 0.2% 78.2% BEIGE BOOK (2:00) May 2024: "National economic activity continued to expand from early April to mid-May; however, conditions varied across industries and Districts. Most Districts reported slight or modest growth, while two noted no change in activity."	UNEMP. CLAIMS (8:30) PHILADELPHIA FED MFG BUSINESS OUTLOOK (8:30) May 4.5 June 1.3 July -- LEADING INDICATORS (10:00) Apr -0.6% May -0.5% June -0.4% TIC FLOWS (4:00) Long-Term Total Mar \$102.6B \$104.2B Apr \$123.1B \$66.2B May -- --	
22	23	24	25	26
CHICAGO FED NATIONAL ACTIVITY INDEX	EXISTING HOME SALES	INTERNATIONAL TRADE IN GOODS ADVANCE INVENTORIES NEW HOME SALES	UNEMP. CLAIMS Q2 GDP DURABLE GOODS ORDERS	PERSONAL INCOME, CONSUMPTION, AND PCE PRICE INDEX REVISED CONSUMER SENTIMENT
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 PENDING HOME SALES FOMC RATE DECISION	UNEMP. CLAIMS PRODUCTIVITY & COSTS ISM MFG. INDEX CONSTRUCTION VEHICLE SALES	EMPLOYMENT REPORT FACTORY ORDERS

Forecasts in bold.

Treasury Financing

July/August 2024																																														
Monday	Tuesday	Wednesday	Thursday	Friday																																										
8	9	10	11	12																																										
<p>AUCTION RESULTS:</p> <table border="1"> <thead> <tr> <th></th> <th>Rate</th> <th>Cover</th> </tr> </thead> <tbody> <tr> <td>13-week bills</td> <td>5.230%</td> <td>2.84</td> </tr> <tr> <td>26-week bills</td> <td>5.080%</td> <td>2.95</td> </tr> </tbody> </table>		Rate	Cover	13-week bills	5.230%	2.84	26-week bills	5.080%	2.95	<p>AUCTION RESULTS:</p> <table border="1"> <thead> <tr> <th></th> <th>Rate</th> <th>Cover</th> </tr> </thead> <tbody> <tr> <td>52-week bills</td> <td>4.775%</td> <td>2.85</td> </tr> <tr> <td>3-yr notes</td> <td>4.399%</td> <td>2.67</td> </tr> <tr> <td>42 day CMBs</td> <td>5.270%</td> <td>2.92</td> </tr> </tbody> </table> <p>ANNOUNCE: \$60 billion 17-week bills for auction on July 10 \$90 billion 4-week bills for auction on July 11 \$85 billion 8-week bills for auction on July 11</p> <p>SETTLE: \$60 billion 17-week bills \$85 billion 4-week bills \$80 billion 8-week bills</p>		Rate	Cover	52-week bills	4.775%	2.85	3-yr notes	4.399%	2.67	42 day CMBs	5.270%	2.92	<p>AUCTION RESULTS:</p> <table border="1"> <thead> <tr> <th></th> <th>Rate</th> <th>Cover</th> </tr> </thead> <tbody> <tr> <td>17-week bills</td> <td>5.195%</td> <td>3.16</td> </tr> <tr> <td>10-yr notes</td> <td>4.276%</td> <td>2.58</td> </tr> </tbody> </table>		Rate	Cover	17-week bills	5.195%	3.16	10-yr notes	4.276%	2.58	<p>AUCTION RESULTS:</p> <table border="1"> <thead> <tr> <th></th> <th>Rate</th> <th>Cover</th> </tr> </thead> <tbody> <tr> <td>4-week bills</td> <td>5.270%</td> <td>2.69</td> </tr> <tr> <td>8-week bills</td> <td>5.260%</td> <td>2.63</td> </tr> <tr> <td>30-yr bonds</td> <td>4.405%</td> <td>2.30</td> </tr> </tbody> </table> <p>ANNOUNCE: \$146 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 \$70 billion 42-day CMBs for auction on July 16</p> <p>SETTLE: \$146 billion 13-,26-week bills \$46 billion 52-week bills \$70 billion 42-day CMBs</p>		Rate	Cover	4-week bills	5.270%	2.69	8-week bills	5.260%	2.63	30-yr bonds	4.405%	2.30	
	Rate	Cover																																												
13-week bills	5.230%	2.84																																												
26-week bills	5.080%	2.95																																												
	Rate	Cover																																												
52-week bills	4.775%	2.85																																												
3-yr notes	4.399%	2.67																																												
42 day CMBs	5.270%	2.92																																												
	Rate	Cover																																												
17-week bills	5.195%	3.16																																												
10-yr notes	4.276%	2.58																																												
	Rate	Cover																																												
4-week bills	5.270%	2.69																																												
8-week bills	5.260%	2.63																																												
30-yr bonds	4.405%	2.30																																												
15	16	17	18	19																																										
<p>AUCTION: \$146 billion 13-,26-week bills</p> <p>SETTLE: \$58 billion 3-year notes \$39 billion 10-year notes \$22 billion 30-year bonds</p>	<p>AUCTION: \$70 billion 42-day CMBs</p> <p>ANNOUNCE: \$60 billion* 17-week bills for auction on July 17 \$90 billion* 4-week bills for auction on July 18 \$85 billion* 8-week bills for auction on July 18</p> <p>SETTLE: \$60 billion 17-week bills \$90 billion 4-week bills \$85 billion 8-week bills</p>	<p>AUCTION: \$60 billion* 17-week bills \$13 billion 20-year bonds</p>	<p>AUCTION: \$90 billion* 4-week bills \$85 billion* 8-week bills \$19 billion 10-year TIPS</p> <p>ANNOUNCE: \$146 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</p> <p>SETTLE: \$146 billion 13-,26-week bills \$70 billion 42-day CMBs</p>																																											
22	23	24	25	26																																										
<p>AUCTION: \$146 billion* 13-,26-week bills</p>	<p>AUCTION: \$69 billion* 2-year notes</p> <p>ANNOUNCE: \$60 billion* 17-week bills for auction on July 24 \$90 billion* 4-week bills for auction on July 25 \$85 billion* 8-week bills for auction on July 25</p> <p>SETTLE: \$60 billion* 17-week bills \$90 billion* 4-week bills \$85 billion* 8-week bills</p>	<p>AUCTION: \$60 billion* 17-week bills \$70 billion* 5-year notes \$30 billion* 2-year FRNs</p>	<p>AUCTION: \$90 billion* 4-week bills \$85 billion* 8-week bills \$44 billion* 7-year notes</p> <p>ANNOUNCE: \$146 billion* 13-,26-week bills for auction on July 29</p> <p>SETTLE: \$146 billion* 13-,26-week bills</p>																																											
29	30	31	1	2																																										
<p>AUCTION: \$146 billion* 13-,26-week bills</p>	<p>ANNOUNCE: \$60 billion* 17-week bills for auction on July 31 \$90 billion* 4-week bills for auction on Aug 1 \$85 billion* 8-week bills for auction on Aug 1</p> <p>SETTLE: \$60 billion* 17-week bills \$90 billion* 4-week bills \$85 billion* 8-week bills</p>	<p>AUCTION: \$60 billion* 17-week bills</p> <p>ANNOUNCE: \$58 billion* 3-year notes for auction on Aug 6 \$42 billion* 10-year notes for auction on Aug 7 \$25 billion* 30-year bonds for auction on Aug 8</p> <p>SETTLE: \$13 billion 20-year bonds \$19 billion 10-year TIPS \$69 billion* 2-year notes \$70 billion* 5-year notes \$44 billion* 7-year notes \$30 billion* 2-year FRNs</p>	<p>AUCTION: \$90 billion* 4-week bills \$85 billion* 8-week bills</p> <p>ANNOUNCE: \$146 billion* 13-,26-week bills for auction on Aug 5 \$46 billion* 52-week bills for auction on Aug 6</p> <p>SETTLE: \$146 billion* 13-,26-week bills</p>																																											

*Estimate