U.S. Economic Comment

- Q2 GDP preview: growth at potential, led by solid underlying domestic demand
- Food inflation: pandemic-related rise in grocery prices mainly attributable to surge in commodity prices and wages

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

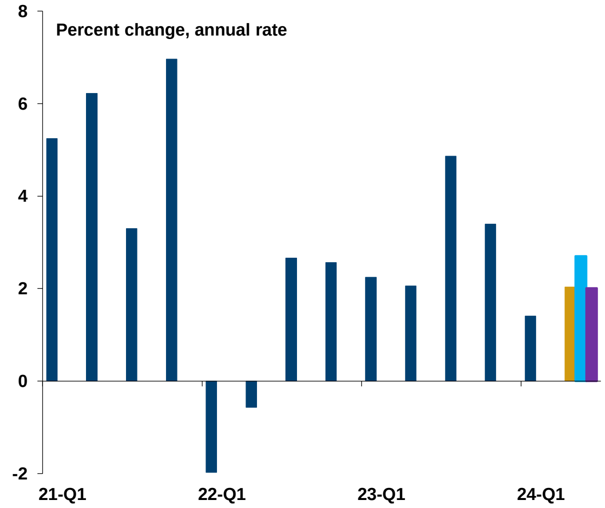
Q2 Growth on Track

With the effects of restrictive monetary policy contributing to an ongoing moderation in economic activity, we expect growth in the second half of 2024 to be closer to that in Q1 (1.4 percent, annual rate) than the firm 2.5 percent pace last year (Q4/Q4 growth of 3.1 percent). With that in mind, growth in the second quarter appears poised to surpass that pace. The range of estimates is wide, with the Bloomberg consensus panel showing projections ranging from growth of 1.2 to 2.6 percent, underscoring a good bit of uncertainty about an economy transitioning to a slower growth trajectory, but model-driven estimates generated by the Federal Reserve Banks of New York and Atlanta come in on the side of activity – at least in the near term – tilting to the firmer side of (or exceeding) economists' expectations. As of this morning, the Federal Reserve Bank of New York's GDP Nowcast is projecting growth of 2.0 percent, a tick higher than the Bloomberg median expectation of 1.9 percent, while the Atlanta Fed's GDPNow model (as of July 17) indicated a 2.7 percent growth rate (chart, below left).

Underpinning our expectation of growth of 2.0 percent is once again resilient underlying domestic demand. We expect final sales to domestic purchasers (GDP less the contributions of inventory investment and net exports) to increase at an annual rate of 2.2 percent – well below the 3.5 percent pace in the second half of last year but close to the 2.4 percent pace in Q1 and respectable given constraints facing households and businesses (chart, below right).

Central to our estimate is a favorable performance by consumers despite evidence of strain in some households (a recent increase in delinquency rates, for example). Until recently, we were unsure as to whether real consumer outlays could outpace growth of 1.5 percent in Q1, a solid but unspectacular performance after annualized growth of 3.2 percent in the second half of last year. However, a firm performance in key categories of the June retail sales report (published on July 16) raised the possibility of a better performance. The retail control, which excludes sales at gasoline stations, auto dealers, and building supply outlets, and correlates well with goods spending in the GDP

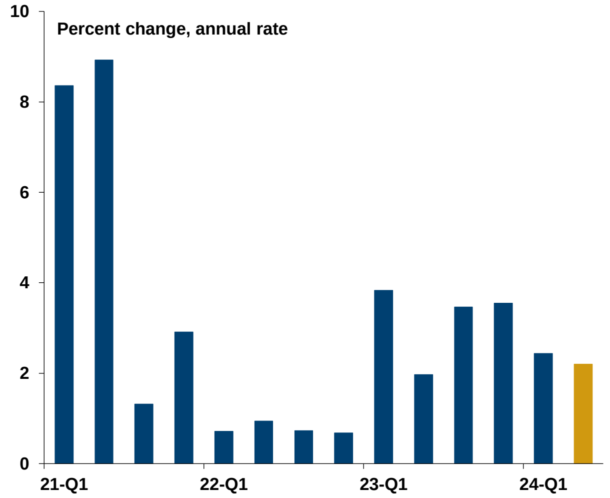
GDP Growth*



** The gold, light blue, and purple bars are forecasts for 2024-Q2 provided by DCMA, the Federal Reserve Bank of Atlanta's GDPNow model, and the Federal Reserve Bank of New York's GDP Nowcast, respectively.*

Sources: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America; Federal Reserve Banks of Atlanta & New York

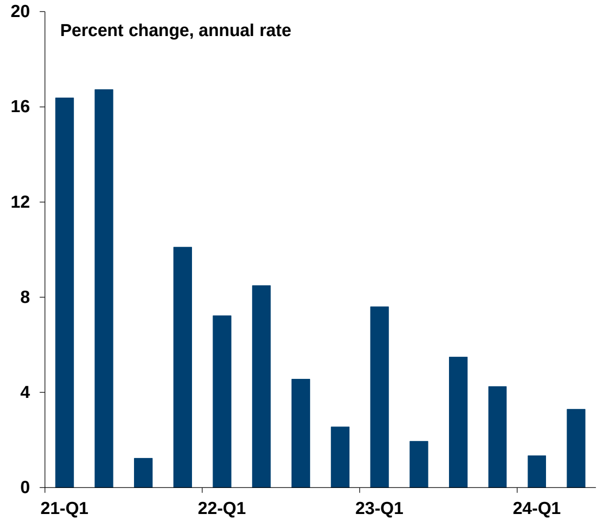
Final Sales to Domestic Purchasers*



** Excludes the contributions of net exports and inventory investment. The gold bar is a forecast for 2024-Q2.*

Sources: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America accounts, jumped 0.9 percent month-over-month (associated with a three-month average annualized growth rate of 3.3 percent; chart, below left). That information raised the possibility that growth of real consumer outlays was about one-half percentage point firmer than that in Q1 (chart, right).

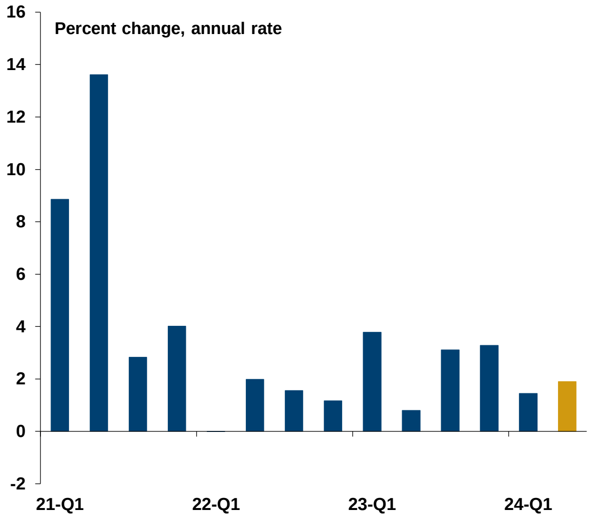
Retail Sales: Retail Control*



** Retail sales excluding sales from motor vehicle dealers, gasoline stations, and building materials, garden equipment, and supply dealers.*

Source: U.S. Census Bureau via Haver Analytics

Real Consumer Spending Growth*

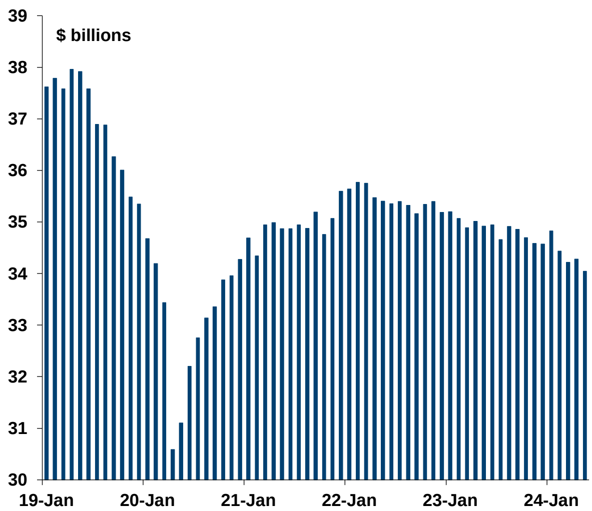


** The gold bar is a forecast for 2024-Q2.*

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

Beyond the consumer sector, performances of various components may vary widely. In the plus column, data through May on shipments of nondefense capital goods excluding aircraft suggest that real equipment spending increased at a 10.5 percent clip after modest growth of 1.6 percent in Q1 (chart on shipments, below left). Equipment spending has been unimpressive (annual contraction of 0.3 percent in 2023) as firms have slowed investment amid high interest rates, but the second quarter is shaping up fairly well thus far. Nonresidential investment in structures, in contrast, could contract in Q2 (-3.2 percent, annual rate, expected) after moderate growth of 3.4 percent in Q1 and a burst of 13.2 percent in 2023. Spending fueled by the CHIPS Act and Inflation Reduction Act spurred new building of factory facilities (semiconductors and batteries for EVs and other green tech), but that boost has faded and construction activity could be a drag over the balance of the year. Similarly, residential construction appears to again be slowing after annualized growth of 16.0 percent in Q1.

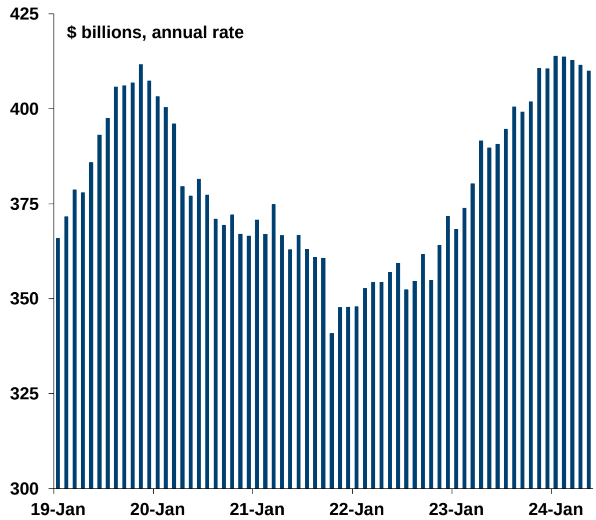
Real Shipments of Durable Goods*



** Nominal shipments of nondefense capital goods excluding aircraft adjusted by the Private Capital Equipment component of the PPI.*

Sources: Bureau of Labor Statistics, U.S. Census Bureau via Haver Analytics; Daiwa Capital Markets America

Real Private Nonresidential Construction*

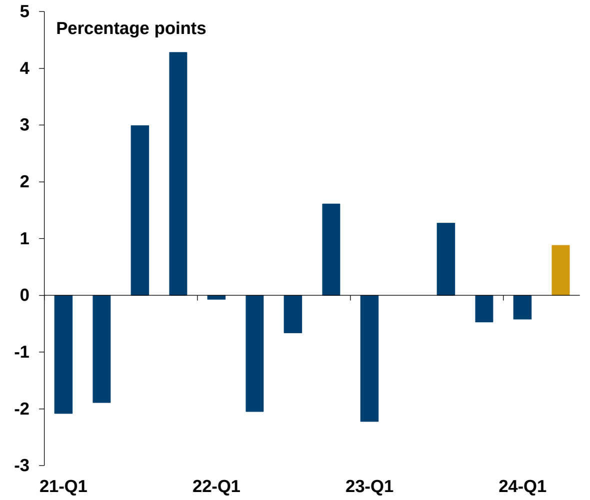


** Nominal value of business-related construction deflated by the Final Demand Construction for Private Capital Investment component of the PPI.*

Sources: Bureau of Labor Statistics, U.S. Census Bureau via Haver Analytics; Daiwa Capital Markets America

Outside of final domestic demand, we anticipate large and mostly offsetting contributions to growth from inventory investment and net exports. Data in hand point to an inventory build in Q2 of approximately 0.9 percentage point after back-to-back drags of 0.4 percentage point and 0.5 percentage point per quarter, respectively, in 24-Q1 and 23-Q4 (chart). While the latest inventory build will boost activity in Q2, firms have managed inventories cautiously amid an expected easing in growth and a drawdown is possible next quarter. Conversely, net exports is likely to be a notable drag on growth for a second consecutive quarter. Imports appear to have jumped in the latest quarter while U.S. exports have moved sideways, with the shifts suggesting that net exports will subtract approximately 1.0 percentage points from growth in Q2 after shaving off 0.65 percentage point in Q1 (charts, below).

Change in Private Inventories*

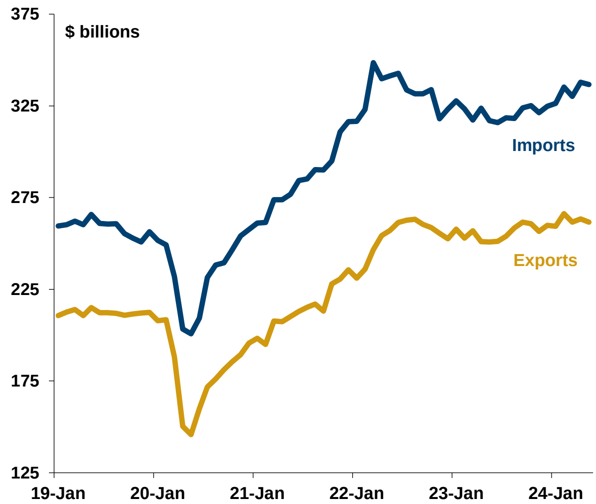


** Contribution to real GDP percentage change. The gold bar is a forecast for 2024-Q2.*

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

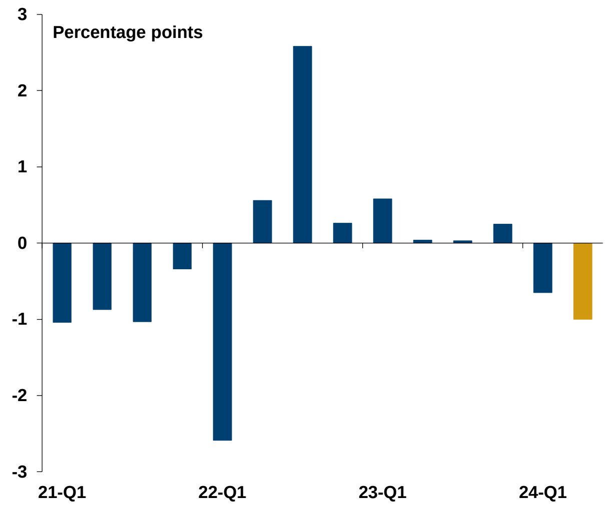
All told, growth appears to have remained on a moderate trajectory in the first half of 2024. Activity should continue to ease into the second half amid restrictive monetary policy and ongoing adjustments by households and businesses, but the data as of now suggest that the Federal Reserve may have engineered a soft landing despite aggressive action taken to subdue rapid inflation.

Exports & Imports of Goods & Services



Source: Bureau of Economic Analysis via Haver Analytics

Net Exports of Goods & Services*



** Contribution to real GDP percentage change. The gold bar is a forecast for 2024-Q2.*

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

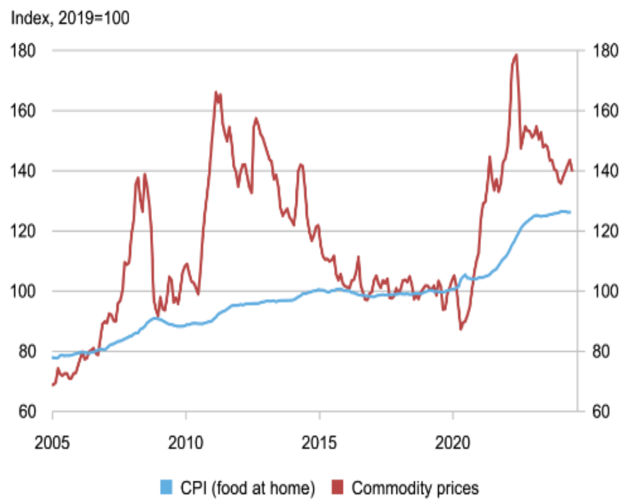
A Study in the Recent Bout of Food Inflation

With consumers still feeling the sting of sharply higher grocery prices in the past-pandemic period, and the issue drawing scrutiny from politicians and policymakers alike, economists at the Federal Bank of New York recently examined the issue to clarify whether the surge was linked to pandemic-related factors (a disruption in supply chains and attendant spike in commodity prices) and later tight labor-market conditions, or opportunistic tactics by businesses. The findings are of importance, as they can aid in assessing whether monetary policy or potentially government intervention is the best ongoing tool to address this area of the previous inflation shock.

While food inflation has recently moderated to a more benign trend comparable to what was seen prior to the onset of the pandemic, the food at home component of the consumer price index (i.e. groceries) rose notably higher than the total price index during the inflation onslaught (cycle peak of 13.5 percent year-over-year in August 2022 versus a high of 9.1 percent in June 2022 for the headline). This disparity has fueled discussion surrounding the possibility of price gouging playing a major role in pushing up inflation since early 2020. Namely, as some politicians have suggested, corporations used the COVID pandemic as an excuse to increase prices in the grocery aisle and expand profit margins. However, the New York Fed's research pushes against this notion.

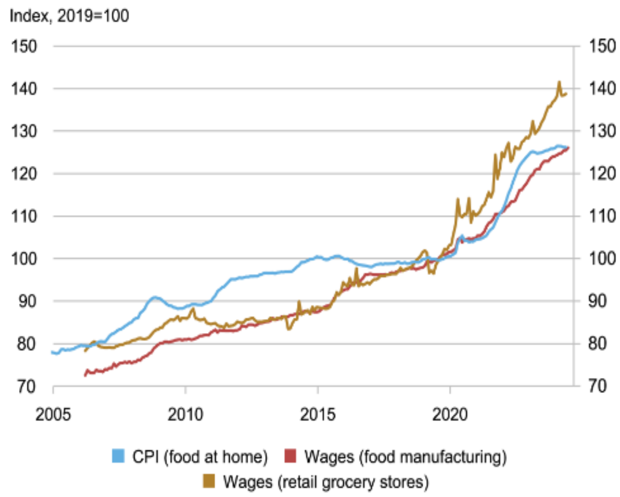
The economists' findings suggest that the dramatic jump in food prices was primarily influenced by increases in both commodity prices and wages for grocery store workers – primarily factors related to the pandemic and its aftermath. Moreover, the relative stability of grocery prices prior to the pandemic highlights the significant impact of these factors in recent years. As observed by Thomas Klitgaard of the Federal Reserve Bank of New York in his study for Liberty Street Economics, grocery prices appear to move noticeably when there are large shifts in raw commodity prices (chart, below left). Consequently, the recent easing in food inflation can be attributed to the latest decline in commodity prices. With that said, the surge in food prices from 2020 to 2022 was markedly larger than those seen in prior episodes. This difference can be at least partially explained by wages, the other factor behind the cost of groceries. Specifically, since 2019, wage inflation for retail grocery workers has notably outpaced those for the food manufacturing sector, which speaks to tight labor market conditions that have only recently started to ease (chart, below right).

Commodity and Food Inflation*



** Commodity prices are measured by the S&P GSCI Agriculture and Livestock Index.*
Source: Klitgaard, Thomas, "What Was Up with Grocery Prices?," Federal Reserve Bank of New York Liberty Street Economics, July 16, 2024, https://libertystreeteconomics.newyorkfed.org/2024/07/what-was-up-with-grocery-prices/

Wage and Food Inflation*



** Wages are average hourly earnings.*
Source: Klitgaard, Thomas, "What Was Up with Grocery Prices?," Federal Reserve Bank of New York Liberty Street Economics, July 16, 2024, https://libertystreeteconomics.newyorkfed.org/2024/07/what-was-up-with-grocery-prices/

Circling back to the other potential cause of the inflation alleged price gouging – the data doesn't necessarily reinforce this idea. While profit margins for grocery stores have indeed gone up, the actual increase doesn't appear significant enough to be a major contributor to food inflation (or nefarious action on the part of businesses). According to the same study, in 2023, operating costs and revenues for grocery stores were up 18 and 20 percent, respectively, since 2019. Correspondingly, the profit margin (net profit divided by total revenue) advanced to 4.4 percent in 2023 from 2.9 percent in 2019, a relatively small increase when compared to the 25 percent jump in grocery prices over the same period.

Thus, the analysis suggests that rapid inflation at grocery stores, notable for its effects on household budgets, was mostly accounted for by pandemic-related disruptions. As such, an unwinding of said disruptions, as well as an aggressive tack by the Federal Reserve, have contributed to a return to more normal price increases in this area.

(For more information, please see: Klitgaard, Thomas, "What Was Up with Grocery Prices?" Federal Reserve Bank of New York Liberty Street Economics, July 16, 2024, https://libertystreeteconomics.newyorkfed.org/2024/07/what-was-up-with-grocery-prices.)

The Week Ahead

Existing Home Sales (June) (Tuesday)
Forecast: 4.05 Million (-1.5%)

Recent declines in the index of pending home sales suggest another disappointing month for existing home sales in June, with tight inventories and elevated mortgage rates acting as key constraints on activity. (Note that existing home sales are based on closings; pending home sales, in most cases, close in one to three months.)

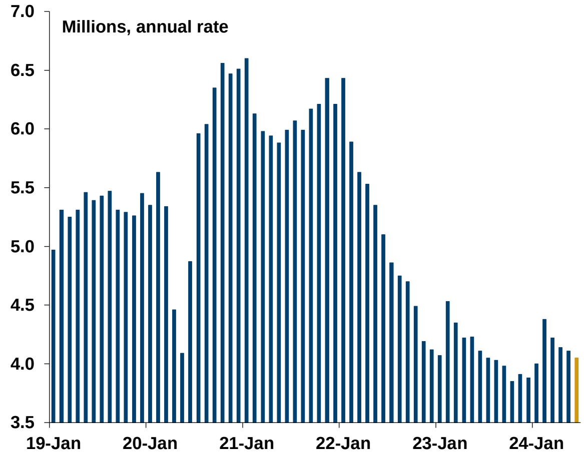
International Trade in Goods (June) (Wednesday)
Forecast: -$97.5 Billion ($1.9 Billion Narrower Deficit)

Trade flows are often volatile on a month-to-month basis, with both U.S. exports and imports of goods easing in May after jumps in the opening month of Q2 (-1.8 percent and -0.7 percent, respectively, after increases of 1.2 percent and 3.1 percent). Even amid that volatility, however, imports have been stronger thus far in 2024, setting the stage for a drag of approximately 1.0 percentage point on growth in Q2 (see GDP discussion above; based on data through May) after a 0.65 percentage point constraint in the first quarter. That said, a jump in customs duties in June raises the possibility of some narrowing in the monthly goods deficit after notable widening in the previous two months (chart).

New Home Sales (June) (Wednesday)
Forecast: 0.640 Million (+3.4%)

A pickup in mortgage applications for home purchases in June raises the possibility of an advance in new home sales, which are based on contracts signed rather than closings. While the expected pickup would retrace only a portion of the 11.3 percent swoon in the prior month, we view this portion of the housing market as holding up somewhat better than the segment for existing homes. Broadly speaking, the housing market is constrained by tight financial conditions and elevated prices, but buyers have, in some cases, found more favorable opportunities in the new home market, which (prior to the unexpected drop in May) had supported a relatively solid pace of activity in this significantly smaller component of sales.

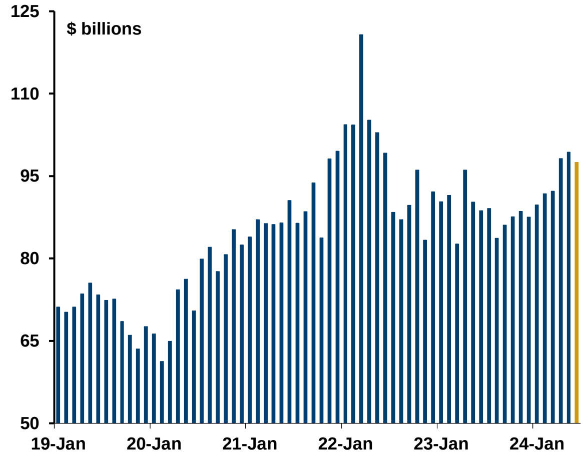
Existing Home Sales*



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

Sources: National Association of Realtors via Haver Analytics; Daiwa Capital Markets America

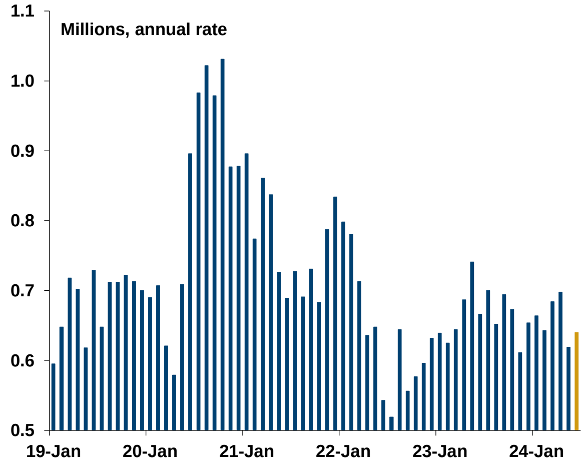
Nominal Trade Deficit in Goods*



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

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

New Home Sales*



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

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

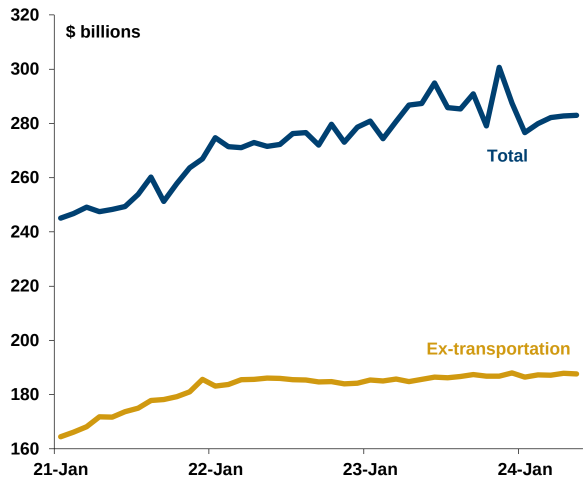
Durable Goods Orders (June) (Thursday)
Forecast: -0.5% Total, +0.2% Ex. Transportation

Headline durable goods orders are likely to be constrained in June due to paltry order flows reported by Boeing amid an ongoing probe into quality control issues. Bookings excluding transportation have been choppy in recent months, with the flat trend suggesting that restrictive monetary policy is continuing to constrain new investment in capital equipment (chart).

Personal Income, Consumption, and Price Indexes (June) (Friday)
Forecast: +0.5% Income, +0.3% Consumption, +0.1% Headline, +0.1% Core

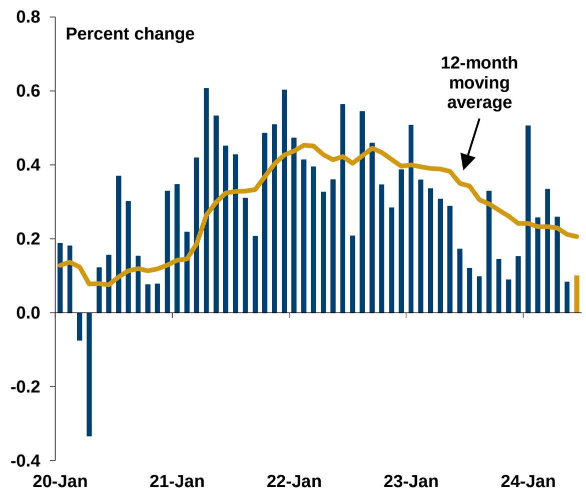
An increase of 0.3 percent in average hourly earnings and an advance in aggregate hours suggest a moderate gain in wages and salaries in June. Additionally, growth in investment income (interest and dividends) has been firm in Q2 thus far. On the spending side, results from the June retail sales report imply a brisk increase in outlays for nondurable items, but a drop in vehicle sales raises the prospect of a soft reading on outlays for durable goods. Spending on services has remained on a favorable trend in 2024 thus far. Results for recent inflation indicators suggest modest increases in both the headline and core PCE price indexes. The projected readings would translate to year-over-year advances of 2.5 percent in both the headline and core indexes after the two measures registered 2.6 percent advances in the prior month.

New Orders for Durable Goods



Source: U.S. Census Bureau via Haver Analytics

Core PCE Price Index*



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

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

Daiwa Capital Markets

Economic Indicators

July/August 2024

Monday, 15

EMPIRE MFG

May	-15.6
June	-6.0
July	-6.6

Tuesday, 16

RETAIL SALES

	Total	Ex.Autos
Apr	-0.2%	0.1%
May	0.3%	0.1%
June	0.0%	0.4%

IMPORT/EXPORT PRICES

	Non-Petrol Imports	Nonagri. Exports
Apr	0.6%	0.7%
May	-0.3%	-0.8%
June	0.2%	-0.6%

NAHB HOUSING INDEX

May	45
June	43
July	42

BUSINESS INVENTORIES

	Inventories	Sales
Mar	-0.1%	-0.2%
Apr	0.3%	0.2%
May	0.5%	0.0%

Wednesday, 17

HOUSING STARTS

Apr	1.377 million
May	1.314 million
June	1.353 million

IP & CAP-U

	IP	Cap.Util.
Apr	0.0%	77.7%
May	0.9%	78.3%
June	0.6%	78.8%

BEIGE BOOK

July 2024:

"Economic activity maintained a slight to modest pace of growth in a majority of Districts this reporting cycle. However, while seven Districts reported some level of increase in activity, five noted flat or declining activity—three more than in the prior reporting period."

Thursday, 18

UNEMPLOYMENT CLAIMS

	Initial (millions)	Continuing (millions)
June 22	0.234	1.856
June 29	0.239	1.847
July 6	0.223	1.867
July 13	0.243	N/A

PHILADELPHIA FED MFG BUSINESS OUTLOOK

May	4.5
June	1.3
July	13.9

LEADING INDICATORS

Apr	-0.6%
May	-0.4%
June	-0.2%

TIC FLOWS

	Long-Term	Total
Mar	$108.9B	$111.4B
Apr	$123.3B	$64.2B
May	-$54.6B	$15.8B

Friday, 19

Monday, 22

CHICAGO FED NATIONAL ACTIVITY INDEX (8:30)

	Monthly	3-Mo. Avg.
Apr	-0.26	-0.05
May	0.18	-0.09
June	--	--

Tuesday, 23

EXISTING HOME SALES (10:00)

Apr	4.140 million
May	4.110 million
June	**4.050 million**

Wednesday, 24

INTERNATIONAL TRADE IN GOODS (8:30)

Apr	-$98.2 billion
May	-$99.4 billion
June	**-$97.5 billion**

ADVANCE INVENTORIES (8:30)

	Wholesale	Retail
Apr	0.2%	0.8%
May	0.6%	0.6%
June	--	--

NEW HOME SALES (10:00)

Apr	0.698 million
May	0.619 million
June	**0.640 million**

Thursday, 25

UNEMP. CLAIMS (8:30)

GDP (8:30)

	GDP	Chained Price
23-Q4	3.4%	1.6%
24-Q1	1.4%	3.1%
24-Q2(a)	**2.0%**	**2.6%**

DURABLE GOODS ORDERS (8:30)

Apr	0.2%
May	0.1%
June	**-0.5%**

Friday, 26

PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX (8:30)

	Inc.	Cons.	Core
Apr	0.3%	0.1%	0.3%
May	0.5%	0.2%	0.1%
June	**0.5%**	**0.3%**	**0.1%**

REVISED CONSUMER SENTIMENT (10:00)

May	69.1
June	68.2
July(p)	66.0

Monday, 29

Tuesday, 30

FHFA HOME PRICE INDEX

S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX

CONFERENCE BOARD CONSUMER CONFIDENCE

JOLTS DATA

FOMC MEETING (FIRST DAY)

Wednesday, 31

ADP EMPLOYMENT

EMPLOYMENT COST INDEX

MNI CHICAGO BUSINESS BAROMETER

PENDING HOME SALES

FOMC RATE DECISION

Thursday, 1

UNEMP. CLAIMS (8:30)

PRODUCTIVITY & COSTS

ISM MFG. INDEX

CONSTRUCTION

VEHICLE SALES

Friday, 2

EMPLOYMENT REPORT

FACTORY ORDERS

Monday, 5

ISM SERVICES INDEX

SENIOR LOAN OFFICER OPINION SURVEY ON BANK LENDING PRACTICES

Tuesday, 6

TRADE BALANCE

Wednesday, 7

CONSUMER CREDIT

Thursday, 8

UNEMP. CLAIMS

WHOLESALE TRADE

Friday, 9

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

Treasury Financing

July/August 2024

Monday	Tuesday	Wednesday	Thursday	Friday
15	16	17	18	19
AUCTION RESULTS: Rate / Cover 13-week bills 5.195% 2.69 26-week bills 4.985% 2.85 **SETTLE:** $58 billion 3-year notes $39 billion 10-year notes $22 billion 30-year bonds	**AUCTION RESULTS:** Rate / Cover 42 day CMBs 5.265% 2.92 **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 **SETTLE:** $60 billion 17-week bills $90 billion 4-week bills $85 billion 8-week bills	**AUCTION RESULTS:** Rate / Cover 17-week bills 5.135% 3.12 20-yr bonds 4.466% 2.68	**AUCTION RESULTS:** Rate / Cover 4-week bills 5.270% 2.59 8-week bills 5.260% 2.68 10-yr TIPS 1.883% 2.38 **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 $70 billion 42-day CMBs for auction on July 23 **SETTLE:** $146 billion 13-,26-week bills $70 billion 42-day CMBs	
22	23	24	25	26
AUCTION: $146 billion 13-,26-week bills	**AUCTION:** $69 billion 2-year notes $70 billion 42-day CMBs **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 **SETTLE:** $60 billion 17-week bills $90 billion 4-week bills $85 billion 8-week bills	**AUCTION:** $60 billion* 17-week bills $70 billion 5-year notes $30 billion 2-year FRNs	**AUCTION:** $90 billion* 4-week bills $85 billion* 8-week bills $44 billion 7-year notes **ANNOUNCE:** $146 billion* 13-,26-week bills for auction on July 29 **SETTLE:** $146 billion 13-,26-week bills $70 billion 42-day CMBs	
29	30	31	1	2
AUCTION: $146 billion* 13-,26-week bills	**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 **SETTLE:** $60 billion* 17-week bills $90 billion* 4-week bills $85 billion* 8-week bills	**AUCTION:** $60 billion* 17-week bills **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 **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	**AUCTION:** $90 billion* 4-week bills $85 billion* 8-week bills **ANNOUNCE:** $146 billion* 13-,26-week bills for auction on Aug 5 $46 billion* 52-week bills for auction on Aug 6 **SETTLE:** $146 billion* 13-,26-week bills	
5	6	7	8	9
AUCTION: $146 billion* 13-,26-week bills	**AUCTION:** $58 billion* 3-year notes $46 billion* 52-week bills **ANNOUNCE:** $60 billion* 17-week bills for auction on Aug 7 $90 billion* 4-week bills for auction on Aug 8 $85 billion* 8-week bills for auction on Aug 8 **SETTLE:** $60 billion* 17-week bills $90 billion* 4-week bills $85 billion* 8-week bills	**AUCTION:** $60 billion* 17-week bills $42 billion* 10-year notes	**AUCTION:** $90 billion* 4-week bills $85 billion* 8-week bills $25 billion* 30-year bonds **ANNOUNCE:** $146 billion* 13-,26-week bills for auction on Aug 12 **SETTLE:** $146 billion* 13-,26-week bills $46 billion* 52-week bills	

Estimate