Daiwa Capital Markets

U.S. Economic Comment

- Next week's Fed meeting: no change in policy expected, but increasing likelihood of a cut in September
- PCE inflation: ongoing progress; broadening disinflation
- The employment mandate: the labor market is in a good place, but caution warranted

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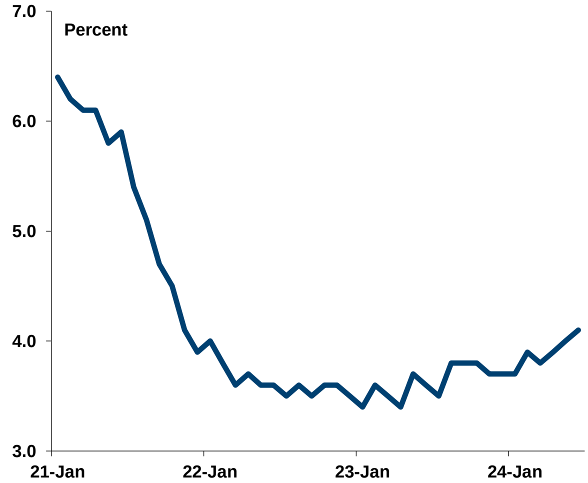
Priming the Market for Rate Cuts

The recent tonal shift of Fed rhetoric, in our view, is prepping market participants for the eventuality of a near-term rate cut. Ahead of the blackout period preceding next week's FOMC meeting (July 30-31), officials including Fed Chair Jay Powell argued that antecedent conditions for a transition away from restrictive monetary policy are close to being met. Aggregate demand is being constrained by tight financial conditions, with the ongoing restraint allowing underlying supply and demand to move into better balance – both as pandemic-related factors continue to unwind and as behavior shifts in response to the current policy setting. Indeed, while economic growth in Q2 was firm at 2.8 percent (published Thursday), we suspect activity will moderate in H2 and settle closer to 1.5 percent. Concurrently, labor market conditions have softened and inflation has moderated. And, amid this rebalancing, policymakers have observed that risks to achieving both the inflation and employment mandates have become more balanced.

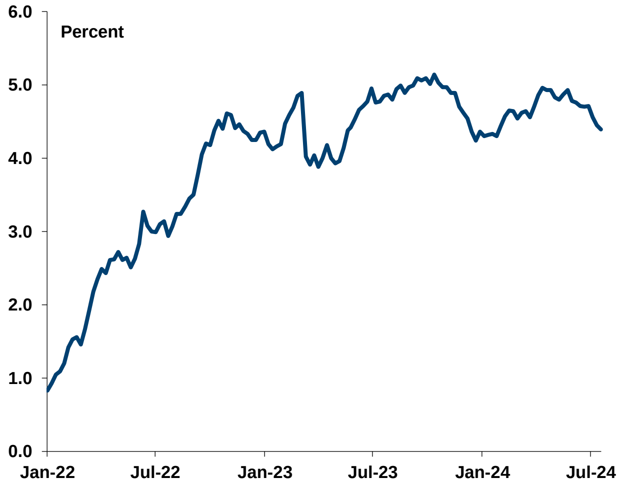
In the midst of this transition in Fed rhetoric, we've seen arguments emerge favoring a cut at next week's FOMC meeting. Specifically, various commentators have argued that recent softening in labor market conditions (specifically an upward drift in the unemployment rate; chart, below left) may portend potential adverse economic outcomes rather than the soft landing that we suspect officials are still holding as a possible outcome. The view holds intuitive appeal – as it suggests appropriate risk management considerations amid evolving economic conditions – but other issues also are at play. Namely, officials don't want to be caught offsides again with respect to inflation. In that regard, notable inroads have been made in the fight against rapid underlying price pressure (see below), but the Committee will receive two additional CPI reports, along with one PCE release, before the September meeting that should help provide additional confidence that inflation is moving sustainably back to two percent. If the data should deviate from that expectation, then upcoming cuts could be delayed and credibility maintained. Additionally, postponing beyond July may assist in bringing holdout hawks into the fold, thereby limiting the prospects for dissents and maintaining what had been a series of unanimous decisions throughout the now likely completed tightening cycle. Again, while not essential for policymaking, consensus among FOMC members would lend credence to the decision.

Civilian Unemployment Rate



Source: Bureau of Labor Statistics via Haver Analytics

2-Year Treasury Note Yield*



** Weekly average data, except for the latest reading which is a midday quote from July 26, 2024.*

Sources: Federal Reserve Board via Haver Analytics; Bloomberg

Beyond the ability to gather additional data and enhance optics surrounding an upcoming decision, we note the recent signaling by FOMC members as influencing financial conditions – the primary transmission mechanism of monetary policy to the real economy – through shifts in interest rates. Market rates, to a degree, already reflect easing despite the target range for the federal funds rate still at 5.25 to 5.50 percent. The yield on the two-year note fell from a bit below five percent in late April to the vicinity of four and three-quarters percent in late June, and it has declined sharply more recently (4.39 percent as of Friday afternoon; chart, prior page, below right). 10-year rates, a more important driver of consumer interest rates, also have eased since late April (down approximately 50 basis points to 4.20 percent on Friday), although the shift has not yet equated to meaningfully lower borrowing costs. With that said, however, the process of rate normalization is underway, albeit in its early stages, even without overt action from the FOMC.

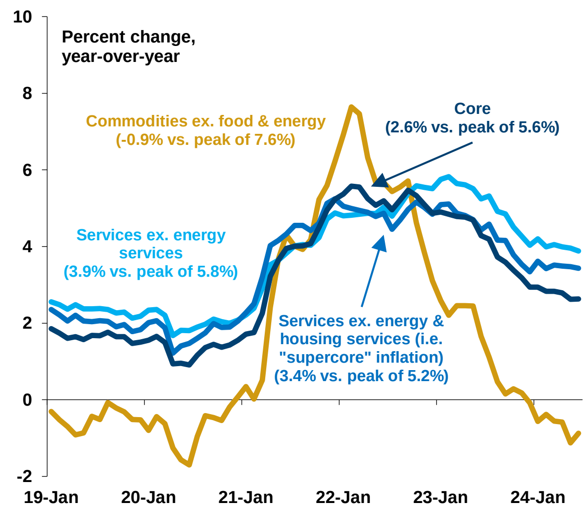
Thus, while the July FOMC statement is likely to be similar in phrasing to other recent iterations, indicating vigilance on inflation and emphasizing the need for additional favorable data, we anticipate Chair Powell utilizing his press conference to prime the market for a cut in September.

Inflation

Although the price index for personal consumption expenditures for June released earlier today was a bit less favorable than the earlier CPI data (increases of 0.1 percent in the headline PCE index and 0.2 percent in the core versus -0.1 percent and 0.1 percent, respectively, for the CPI), the preferred inflation metric of Fed officials offered credence to both the notions that inflation is likely back on a path to two percent after a deviation in 2024-Q1 and disinflation is broadening into services.

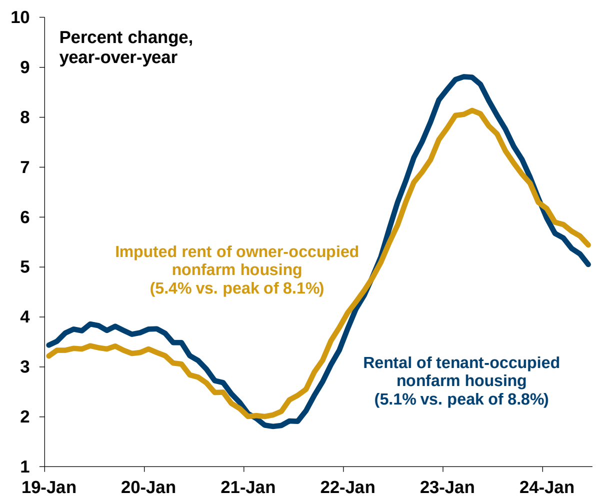
Specifically with regard to the June PCE data, the changes translated to year-over year increases of 2.5 percent for the headline index (versus 2.6 percent in May) and 2.6 percent for the core (up marginally; 2.630 percent versus 2.621). Within the core component, goods inflation ticked higher (+0.1 percent month-over-month), and the year-over-year decline moderated to -0.9 percent from -1.1 percent. Even with the stalling in core goods deflation, the subdued trend was still in line with the favorable pre-pandemic performance (when supply chains were functioning normally and acute supply-demand imbalances were absent). On a more encouraging note, core service inflation excluding housing rose 0.2 percent for the second consecutive month (rounding up), and the year-over-year increase slowed to 3.4 percent from 3.5 percent in May – with both readings well off the peak of 5.2 percent in December 2021 (and a similar increase in October 2022; chart, below left). Moreover, previous cooling in market rents appears to be filtering through to the housing components of the inflation data. In the latest month, the Rental of Tennant-Occupied Nonfarm Housing and Imputed Rent of Owner-Occupied Nonfarm Housing components rose 0.26 percent and 0.27 percent, respectively, versus six-month average increases of 0.39 percent and 0.45 percent, respectively.

Decomposition of Core PCE Inflation



Source: Bureau of Economic Analysis via Haver Analytics

PCE Inflation: Rents



Source: Bureau of Economic Analysis via Haver Analytics

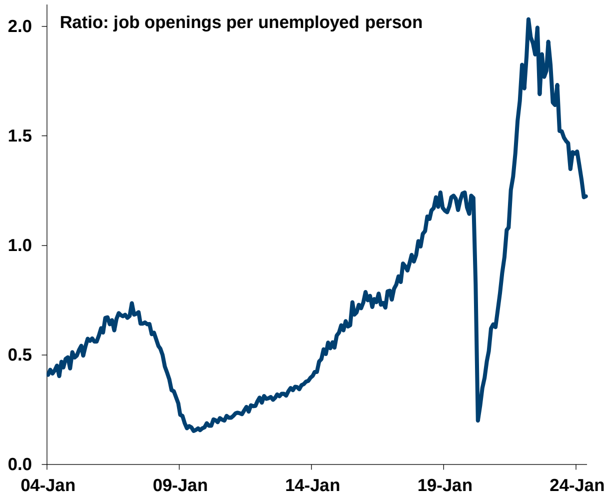
The latest changes equated to year-over-year advances of 5.1 and 5.4 percent (versus 5.3 percent and 5.6 percent, respectively). The housing components have not yet returned to their pre-pandemic baselines, but recent evidence suggests that they are on their way (chart, prior page, below right). Again, significant progress that is likely to be emphasized next week.

Employment

We will refrain here from giving a lengthy review of the employment situation, as both JOLTS data for June and the Employment Report for July will be released next week (see preview on employment below), but a mention is necessary as Fed officials have been emphasizing positive developments regarding labor market conditions in recent weeks. In that regard, Chair Powell has been comparing the current labor market to that in 2018-19 when conditions were viewed as highly favorable and wage growth was sustainably firm. Currently, supply and demand have come back into better balance and wage growth has slowed to a more sustainable pace (3.9 percent year-over-year growth in average hourly earnings as of June, which is expected to slow further in July).

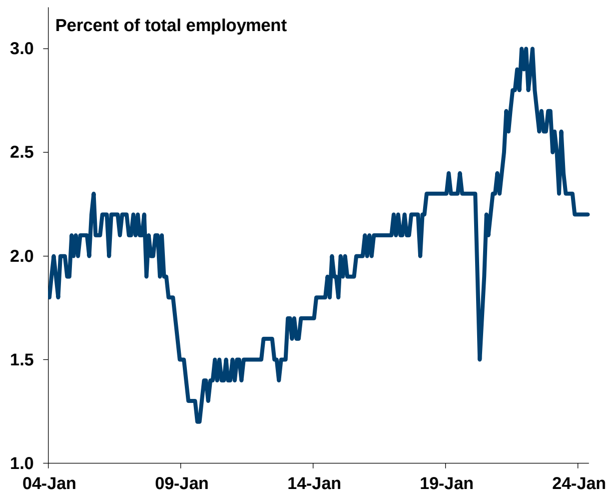
Focusing on easing in demand in the current episode, which has played a key role in the transition from a tight to a firm-but-balanced labor market, we highlight two elements of the JOLTS data through May: the ratio of job openings to unemployed individuals and the quits rate (i.e. the willingness of a person to leave a current position in the hope of finding more lucrative opportunities elsewhere). The openings per unemployed ratio has eased from a peak of 2.0 percent in March 2022 to 1.2 in May (comparable to the pre-pandemic norm; chart, below left) and the quits rate has eased back to 2.2 percent from a high of 3.0 percent (chart, below right). Moreover, the softening in demand has occurred while the unemployment rate remained low at 4.1 percent. In other words, moderation that has facilitated wage growth more consistent with two percent inflation.

Job Openings per Unemployed



Source: Bureau of Labor Statistics via Haver Analytics

Quits Rate



Source: Bureau of Labor Statistics via Haver Analytics

All told, Fed officials are approaching a potentially critical juncture relating to upcoming decisions. On the one hand, an earlier pivot to lower rates could tilt the economy toward a soft landing (i.e. lowering inflation back to target without causing any unnecessary harm to the economy). Conversely, if restrictive policy was maintained for longer than necessary, recession risks may intensify. With that in mind, and in light of progress achieved with respect to inflation and the labor market, we expect a signal next week pointing to easier policy in the months ahead.

The Week Ahead

Consumer Confidence (July) (Tuesday)
Forecast: 99.0 (-1.4% or -1.4 Index Pts.)

Although inflation has moderated, many consumers are likely experiencing spending fatigue after previous rapid price increases, which could dampen views among respondents to the Conference Board's Consumer Confidence Survey. Moreover, recent softening in labor market conditions could introduce additional concern about the outlook. Thus, against this backdrop we expect confidence to ease for the second consecutive month in July, adding to the downward tilt in the series (chart).

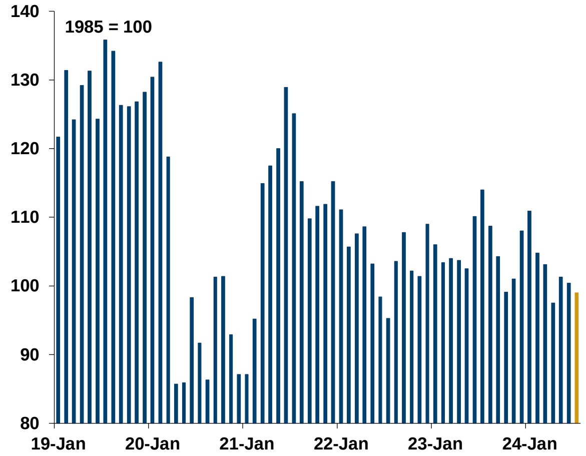
Employment Cost Index (24-Q2) (Wednesday)
Forecast: +0.9%

A gradual easing in tight labor market conditions and associated deceleration in average hourly earnings suggest that compensation growth could slow from the 1.2 percent (not annualized) pace in Q1 (chart). If the projection is realized, year-over-year growth in the ECI would ease one tick to 4.1 percent – down modestly from the prior quarter's observation but well below the cycle peak of 5.1 percent in 2022-Q2.

Nonfarm Productivity (24-Q2) (Thursday)
Forecast: +1.7%

The output measure that feeds into the calculation of nonfarm productivity grew briskly in Q2 (nonfarm gross value added; +3.3 percent, annual rate), with available data suggesting that hours worked increased at a slower pace (+1.6 percent, annual rate, projected). Thus, productivity growth appears on track to accelerate after a modest increase in Q1 (+0.2 percent; chart), although it will lag the Q4/Q4 advance of 2.7 percent in 2023. That said, productivity growth is volatile from quarter-to-quarter and the projection would represent a fine performance. Additionally, data on employee pay suggest a firm reading on compensation per hour (+3.5 percent, annual rate, projected), although slower than the increase of 4.2 percent in Q1 and the Q4/Q4 change of +4.4 percent in 2023. The projections for the combined shifts in productivity growth and compensation per hour suggest growth of 1.7 percent in unit labor costs (versus +4.0 percent in Q1 and matching the Q4/Q4 increase in 2023).

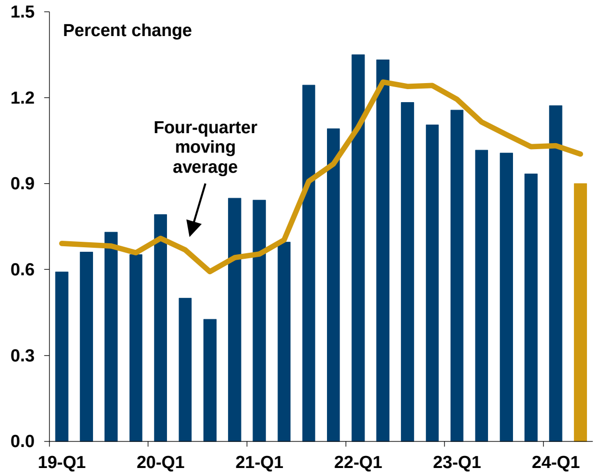
Consumer Confidence*



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

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

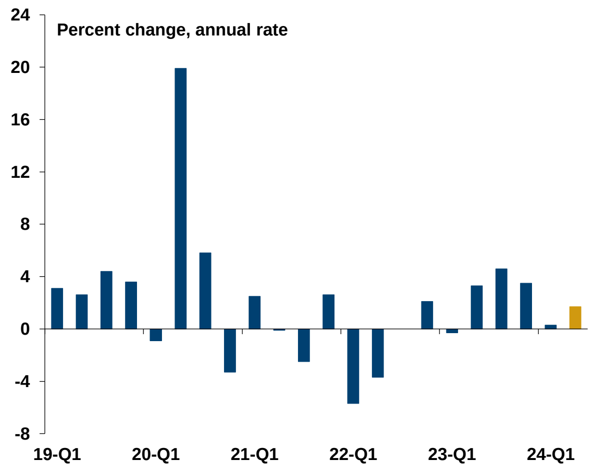
Employment Cost Index*



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

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

Nonfarm Productivity*



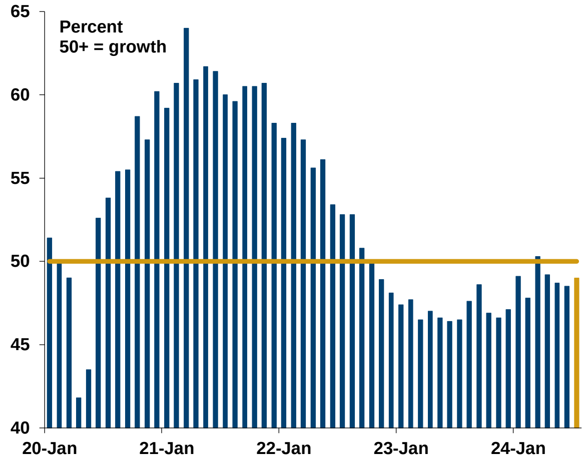
** The gold bar is a forecast for 2024-Q2.*

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

ISM Manufacturing Index (July) (Thursday)
Forecast: 49.0 (+0.5 Pct. Pt.)

While readings on key regional manufacturing indexes sent mixed signals in July (a favorable reading for the Philadelphia Fed index but negative readings on the Richmond and New York Fed Measures), we suspect that tight financial conditions and elevated borrowing costs, along with subdued demand, are still weighing on the broader manufacturing sector. Therefore, amid challenging conditions, the ISM index could remain below 50.0 for the fourth consecutive month (and for the 20th time in the past 21 months; chart).

ISM Manufacturing Index*



* The gold bar is a forecast for July 2024.
Sources: The Institute for Supply Management via Haver Analytics; Daiwa Capital Markets America

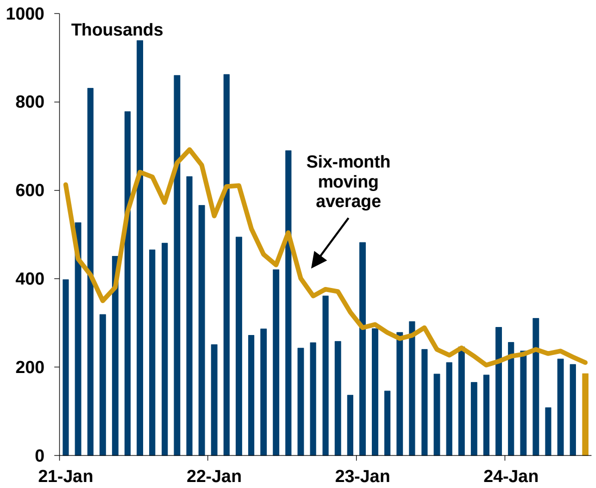
Construction (June) (Thursday)
Forecast: +0.3%

With housing starts mixed, private residential construction may continue its choppy performance amid a sideways trend. Similarly, business-related construction has flattened out after a strong performance for much of the current expansion. Government-sponsored activity has continued on a growth trajectory, although a more moderate one than the surge from mid-2022 through year-end 2023.

Payroll Employment (July) (Friday)
Forecast: 185,000

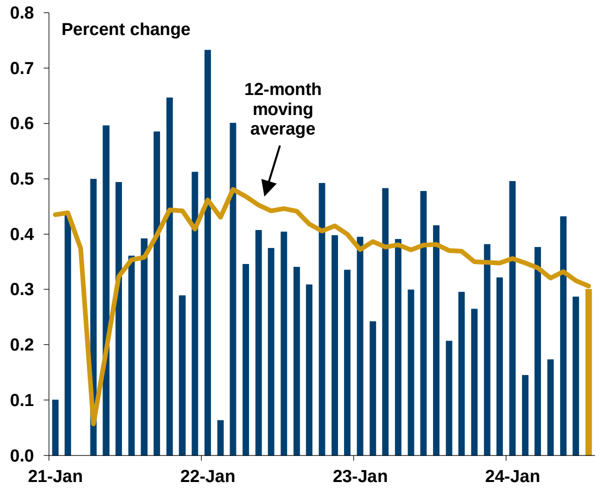
With initial claims for unemployment insurance establishing a new, modestly higher range in the June/July period of 223,000-to-245,000 (versus 208,000-to-232,000 I the previous two months), we suspect that labor market conditions are softening but still favorable – a view consistent with recent comments of Fed officials. Thus, we suspect that underlying payroll growth is likely solid but lagging both the 2023 average of 251,000 per month and 222,000 in the January-to-June period, particularly in light of large downward revisions published with the June data (-111,000 in April and May combined; chart, below left). 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 3.7 percent versus 3.9 percent in June).

Change in Nonfarm Payrolls*



* The gold bar is a forecast for July 2024.
Sources: Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America

Average Hourly Earnings*

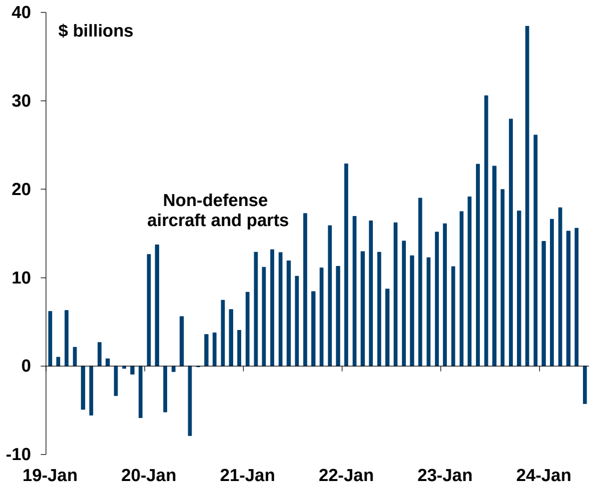


* The gold bar is a forecast for July 2024.
Sources: Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America

Factory Orders (June) (Friday)
Forecast: -3.3%

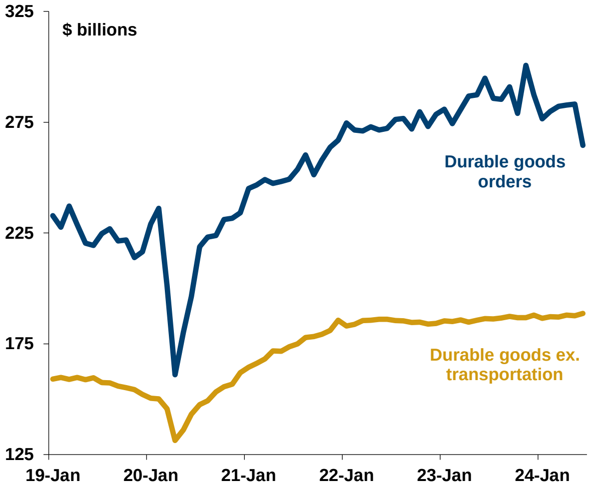
Durable goods orders plunged 6.6 percent in June to the lowest level since late 2021, although the weakness mostly reflected net cancellations in civilian aircraft orders tied to ongoing issues at Boeing (chart, below left). Orders excluding transportation rose 0.5 percent, which gave an upward tilt to the series in recent months (chart, below right). Preliminary shipments data released with the Advance Report on Durable Goods on July 25 call for a dip in the nondurable area that would leave little changed the sideways trend in the past year.

New Orders for Durable Goods



Source: U.S. Census Bureau via Haver Analytics

New Orders for Durable Goods



Source: U.S. Census Bureau via Haver Analytics

Daiwa Capital Markets

Economic Indicators

July/August 2024

Monday	Tuesday	Wednesday	Thursday	Friday
22	23	24	25	26
CHICAGO FED NATIONAL ACTIVITY INDEX Monthly / 3-Mo. Avg. Apr -0.30 / -0.06 May 0.23 / -0.08 June 0.05 / -0.01	**EXISTING HOME SALES** Apr 4.140 million May 4.110 million June 3.890 million	**INTERNATIONAL TRADE IN GOODS** Apr -\$98.2 billion May -\$99.4 billion June -\$96.8 billion **ADVANCE INVENTORIES** Wholesale / Retail Apr 0.2% / 0.8% May 0.6% / 0.6% June 0.2% / 0.7% **NEW HOME SALES** Apr 0.730 million May 0.621 million June 0.617 million	**UNEMPLOYMENT CLAIMS** Initial / Continuing (millions) June 29 0.239 / 1.847 July 6 0.223 / 1.860 July 13 0.245 / 1.851 July 20 0.235 / N/A **GDP** GDP / Chained Price 23-Q4 3.4% / 1.6% 24-Q1 1.4% / 3.1% 24-Q2(a) 2.8% / 2.3% **DURABLE GOODS ORDERS** Apr 0.2% May 0.1% June -6.6%	**PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX** Inc. / Cons. / Core Apr 0.2% / 0.2% / 0.3% May 0.4% / 0.4% / 0.1% June 0.2% / 0.3% / 0.2% **REVISED CONSUMER SENTIMENT** June 68.2 July(p) 66.0 July(r) 66.4
29	30	31	1	2
	FHFA HOME PRICE INDEX (9:00) Mar 0.0% Apr 0.2% May -- **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX (9:00)** Mar 0.3% Apr 0.4% May -- **CONFERENCE BOARD CONSUMER CONFIDENCE (10:00)** May 101.3 June 100.4 **July 99.0** **JOLTS DATA (10:00)** Openings (000) / Quit Rate Apr 7,919 / 2.2% May 8,140 / 2.2% June -- / -- **FOMC MEETING (FIRST DAY)**	**ADP EMPLOYMENT (8:15)** Private Payrolls May 157,000 June 150,000 July -- **EMPLOYMENT COST INDEX (8:30)** Comp. / Wages 23-Q4 0.9% / 1.1% 24-Q1 1.2% / 1.1% **24-Q2 0.9% / 1.1%** **MNI CHICAGO BUSINESS BAROMETER (9:45)** Index / Prices May 35.4 / 68.4 June 47.4 / 56.5 July -- / -- **PENDING HOME SALES (10:00)** Apr -7.7% May -2.1% June -- **FOMC RATE DECISION (2:00)**	**UNEMP. CLAIMS (8:30)** **PRODUCTIVITY & COSTS (8:30)** Productivity / Unit Labor Costs 23-Q4 3.5% / -2.8% 24-Q1 0.2% / 4.0% **24-Q2 1.7% / 1.7%** **ISM MFG. INDEX (10:00)** Index / Prices May 48.7 / 57.0 June 48.5 / 52.1 **July 49.0 / 52.0** **CONSTRUCTION (10:00)** Apr 0.3% May -0.1% **June 0.3%** **VEHICLE SALES** May 15.9 million June 15.3 million **July 16.0 million**	**EMPLOYMENT REPORT (8:30)** Payrolls / Un. Rate May 218,000 / 4.0% June 206,000 / 4.1% **July 185,000 / 4.1%** **FACTORY ORDERS (10:00)** Apr 0.4% May -0.5% **June -3.3%**
5	6	7	8	9
ISM SERVICES INDEX **SENIOR LOAN OFFICER OPINION SURVEY ON BANK LENDING PRACTICES**	**TRADE BALANCE**	**CONSUMER CREDIT**	**UNEMP. CLAIMS (8:30)** **WHOLESALE TRADE**	
12	13	14	15	16
FEDERAL BUDGET	**NFIB SMALL BUSINESS OPTIMISM INDEX** **PPI**	**CPI**	**UNEMP. CLAIMS** **RETAIL SALES** **EMPIRE MFG** **PHILLY FED INDEX** **IMPORT/EXPORT PRICES** **IP & CAP-U** **NAHB HOUSING INDEX** **BUSINESS INVENTORIES** **TIC FLOWS**	**HOUSING STARTS** **CONSUMER SENTIMENT**

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

Treasury Financing

July/August 2024

Monday	Tuesday	Wednesday	Thursday	Friday
22	23	24	25	26
AUCTION RESULTS: Rate / Cover 13-week bills 5.190% 3.08 26-week bills 4.990% 2.85	**AUCTION RESULTS:** Rate / Cover 2-yr notes 4.434% 2.81 42 day CMBs 5.270% 2.76 **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 RESULTS:** Rate / Cover 17-week bills 5.115% 3.00 5-yr notes 4.121% 2.40 Spread / Cover 2-yr FRNs 0.182% 3.25	**AUCTION RESULTS:** Rate / Cover 4-week bills 5.285% 2.77 8-week bills 5.260% 2.89 7-yr notes 4.162% 2.64 **ANNOUNCE:** $146 billion 13-,26-week bills for auction on July 29 $70 billion 42-day CMBs for auction on July 30 **SETTLE:** $146 billion 13-,26-week bills $70 billion 42-day CMBs	
29	30	31	1	2
AUCTION: $146 billion 13-,26-week bills	**AUCTION:** $70 billion 42-day CMBs **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 $70 billion 42-day CMBs	
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	
12	13	14	15	16
AUCTION: $146 billion* 13-,26-week bills	**ANNOUNCE:** $60 billion* 17-week bills for auction on Aug 14 $90 billion* 4-week bills for auction on Aug 15 $85 billion* 8-week bills for auction on Aug 15 **SETTLE:** $60 billion* 17-week bills $90 billion* 4-week bills $85 billion* 8-week bills	**AUCTION:** $60 billion* 17-week bills	**AUCTION:** $90 billion* 4-week bills $85 billion* 8-week bills **ANNOUNCE:** $146 billion* 13-,26-week bills for auction on Aug 19 $16 billion* 20-year bonds for auction on Aug 21 $8 billion* 30-year TIPS for auction on Aug 22 **SETTLE:** $146 billion* 13-,26-week bills $58 billion* 3-year notes $42 billion* 10-year notes $25 billion* 30-year bonds	

**Estimate*