U.S. Economic Comment

- FOMC preview: the Committee is on track to ease policy, but the magnitude of the first cut (and path of rates) is far from certain
- The Summary of Economic Projections: meaningful changes to the dot plot; modest revisions to economic data
- Recent data on inflation and the labor market: supportive of a cautious approach to adjusting monetary policy

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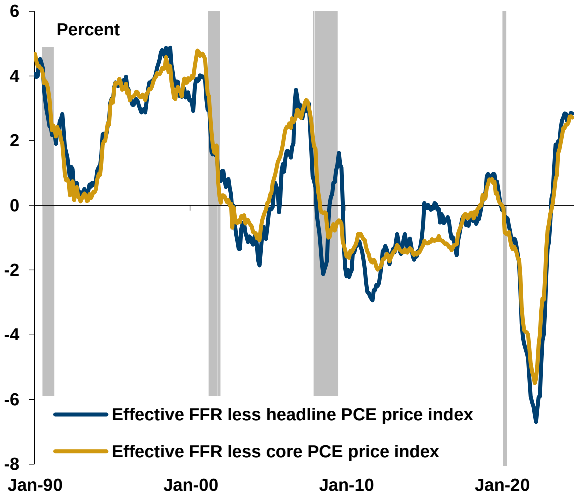
FOMC: The Upcoming Pivot

Given recent comments by Fed officials, including Chair Powell's unambiguous declaration at Jackson Hole -- "The time has come for policy to adjust…" -- the intentions of the Federal Open Market Committee are quite clear: the next move in the target range for the federal funds rate will be lower. The current stance of monetary policy is restrictive, and with inflation showing ongoing evidence of easing toward two percent, the constraint from elevated interest rates could intensify absent an adjustment (see the chart on the real fed funds rate, below left). Therefore, with a soft landing for the economy in sight amid slowing inflation (rare from the historical record when real rates are elevated akin to those today, with recessions often following periods of tight policy; see aforementioned chart), and downside risks to the labor market increasing, a recalibration toward a neutral stance of policy is both appropriate and timely.

At the same time, while market participants have internalized Chair Powell's guidance that "the direction of travel is clear," the steady flow of commentary by current and former policymakers post- Jackson Hole, not to mention relentless coverage by the financial press, has contributed to an unusually wide range of views not only about the anticipated move on September 18 (25 or 50 basis points) but also with respect to the speed of anticipated reductions in the federal funds rate. In that regard, as of mid-afternoon Friday, odds slightly favor a 50-basis-point cut (a shift from readings earlier in the day that tilted toward 25 basis points). And, given significant volatility around those odds, with the probability shifting from approximately 85 percent chance of smaller hike after a firmer-than-anticipated CPI print on Wednesday to current readings, one could posit that chances are almost evenly split between the two potential outcomes. Absent further signaling via the financial press, or additional meaningful data on inflation or the labor market, pre-meeting uncertainty could remain unusually high. We would add that such a state is undesirable. Clear guidance from the central bank is a necessary condition for shaping market expectations, thereby limiting unnecessary volatility, and the various outlook of economic actors.

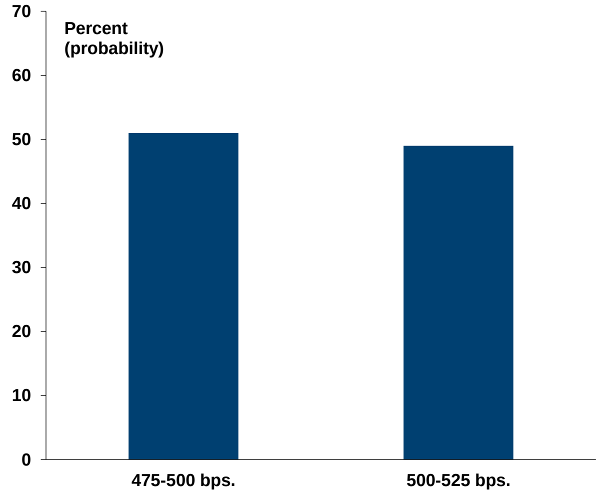
Real Federal Funds Rate*



** Effective federal funds rate less headline and core PCE price indexes. The shaded areas indicate periods of recession in the United States.*

Sources: Bureau of Economic Analysis, Federal Reserve Board, National Bureau of Economic Research via Haver Analytics; Daiwa Capital Markets America

Target Rate Probability for Sept. Fed Meeting*



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

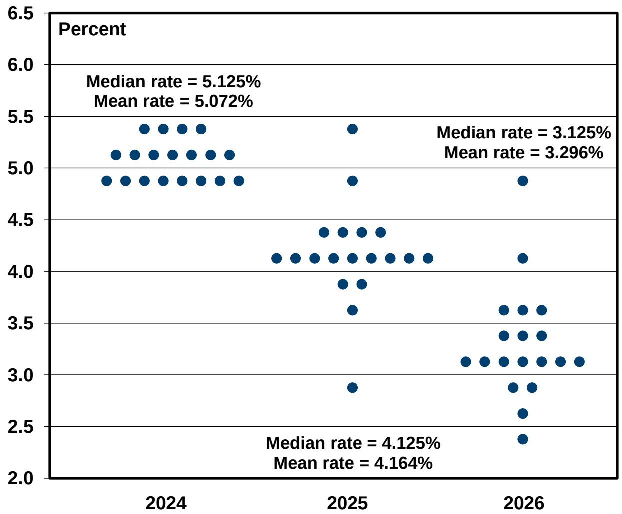
Source: CME Group, FedWatch Tool

The September Dot Plot

A new Summary of Economic Projections of Fed officials may help provide additional clarity about the path of rates beyond the September meeting. While forecasts are assembled by individual policymakers and are not illustrative of a Committee consensus, they can still provide useful insights into the broad leanings of the group. Thus, we will be keeping a close eye on the latest iteration of the dot plot (chart, below left). As of June, the construct indicated a 2024 year-end median of 5.125 percent, which would signal only one cut of 25 basis points by year-end. The year-end medians for 2025 and 2026 were each 100 basis points lower (4.125 percent and 3.125 percent, respectively), indicating a relatively shallow path for rates with adjustments culminating somewhere in the vicinity of neutral policy (i.e. the long-run median of 2.75 percent).

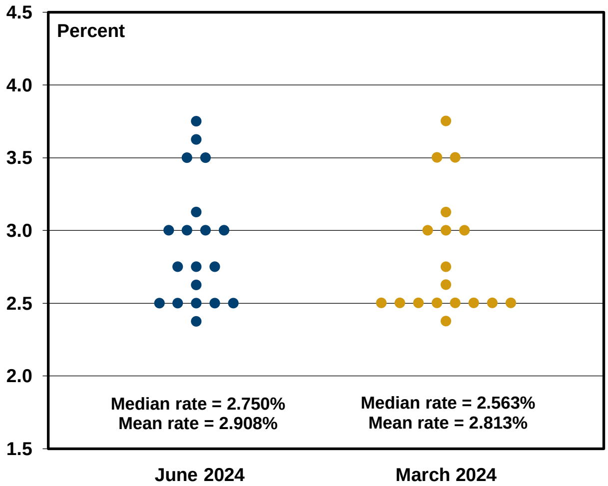
Projections from June almost certainly will change. The well-telegraphed shift in the balance of risks and pre-blackout statements of officials indicated as much. With that said, we see a wide dispersion of potential outcomes anchored by an underlying easing bias. A cut of 25 basis points (which we view as the slightly more likely outcome for September) coupled with year-end projections of 4.875 percent – our current Fed call which is unlikely to be realized and thus will be revised in the coming weeks – or 4.625 percent would project cautious cuts upfront, with the course either being maintained into 2025 (signaling ongoing measured moderation in economic activity and a shallow path back to neutral) or give way to more rapid cuts (also with an eye on neutral, but more so responsive to rapidly softening conditions in the labor market). A move of 50 basis points up front, in our view, would likely be accompanied by additional reductions of that magnitude at coming meetings, thereby tracking a more rapid approach to easier policy and perhaps signaling a murkier economic outlook. Of note, projections for 2027 also will be included in the September SEP. The inclusion does not have direct implications for near-term policy setting, but it could help inform views about anticipated economic outcomes and the corresponding longer-term policy setting in response to projected inflation and labor market conditions.

FOMC Rate View, June 2024*



** Each dot represents the expected federal funds rate of a Fed official at the end of the year.*
Source: Federal Open Market Committee, Summary of Economic Projections, June 2024

FOMC Rate View, Longer Run*



** Each dot represents the expected longer run level of the federal funds rate of a Fed official.*
Source: Federal Open Market Committee, Summary of Economic Projections, March 2024 & June 2024

As views for 2027 are likely to resemble a static state for the economy, with the unemployment rate at a level consistent with full employment and inflation in the vicinity of two percent, projections for the target range for the federal funds rate in that year -- and by extension its proximity to projections for the longer-run nominal rate -- bear watching. Again, forecasts that far in the future carry few implications for near-term policy, but they assist in forming opinions about total cuts for the cycle and the sharpness of those cuts, presuming neutral is the endgame. Additionally, monitoring both out-year projections and the longer-run view provide insights into thinking on r*, the longer-run real neutral rate. Fed forecasts (SEP medians) pegged this rate at three percent in September 2018 before moving lower in the pandemic-period and subsequent recovery to around 2.5 percent (and a lower median of

2.375 percent in March 2022). More recently, the median projection for the longer-term nominal rate has risen from 2.5 percent with the past two sets of projections (2.563 percent in March and 2.750 percent in June) and could be adjusted higher again in September (chart, prior page, right). Policymakers have stated recently that r* does not play a role in short-term policy adjustments, but it is a useful metric in understanding the potential path of policy over the medium term as well as market pricing for fixed income instruments.

Beyond projections on rates, we also will be watching views on key economic variables (see table on projections from June). We do not anticipate significant revisions to GDP and unemployment, particularly given officials' apparent adoption of the soft landing narrative and recent assessments of the labor market as solid despite downside risks. However, near-term inflation projections could be adjusted lower. Chair Powell and colleagues have clearly adopted more favorable views on inflation, particularly as the previously hot labor market has cooled, and recent declines in energy prices could provide an additional assist. With that said, we expect projections to align with the current narrative (solid economy, favorable labor market conditions, gradually moderating inflation).

Economic Projections of the FOMC, June 2024*

	2024	2025	2026	Longer Run
Change in Real GDP	2.1	2.0	2.0	1.8
Unemployment Rate	4.0	4.2	4.1	4.2
PCE Inflation	2.6	2.3	2.0	2.0
Core PCE Inflation	2.8	2.3	2.0	--
Federal Funds Rate	5.1	4.1	3.1	2.8

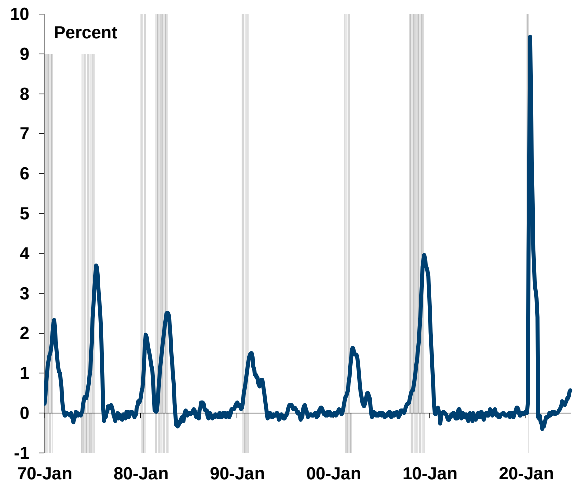
** Median projections*

Source: Federal Open Market Committee, Summary of Economic Projections, June 2024

And the Data?

Likely contributing to the wide dispersion of views, or at least providing support to those arguing for a more cautious approach to easing, have been the current data on both inflation and the labor market. With the well-telegraphed shift in the balance of risks assessment directing focus to the labor market, a brief review is very much in order. With payroll growth slowing notably in recent months (116,000 per month in the past three months versus 225,000 per month in the first five months of 2024) and the unemployment rate triggering the Sahm Rule, a well-known and reliable indicator of recession, when it rose from 3.7 percent in January to 4.3 percent in July (before retreating to 4.2 percent in August), caution seems warranted (chart, right).

Sahm Rule Recession Indicator*

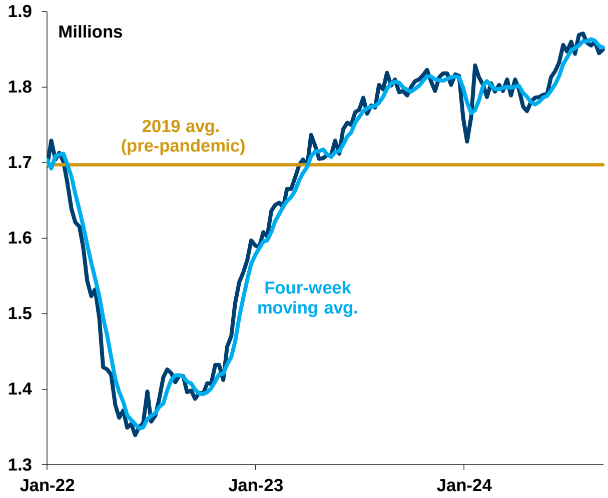


** The Sahm recession indicator, developed by Claudia Sahm formerly of the Federal Reserve, signals the start of a recession in the United States when the three-month moving average of the U3 unemployment rate rises by 0.50 percentage points or more relative to the minimum of the three-month averages in the prior 12 months. The shaded areas indicate periods of recession in the United States.*

Sources: Federal Reserve Board; Bureau of Labor Statistics, National Bureau of Economic Research via Haver Analytics

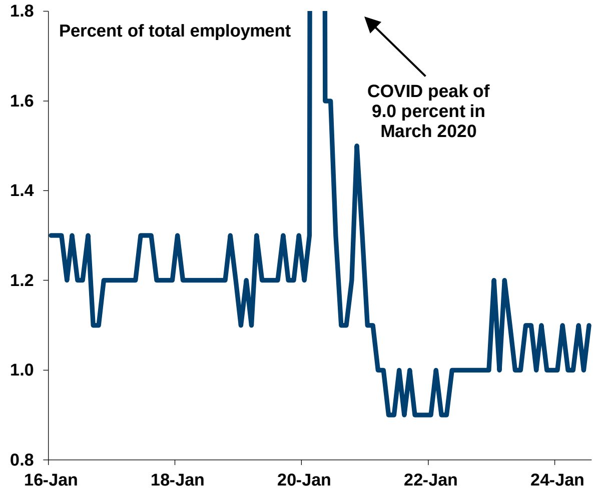
While caution aligns with prudent risk management, we hesitate to project significant downside risks to the labor market -- conditions that would prompt more aggressive cuts by the FOMC. We readily acknowledge that the labor market responds to monetary policy with a lag, and therefore some recalibration is necessary, but underlying fundamentals have been largely consistent with those in 2019 – when Fed officials considered the labor market to be on firm footing. With respect to the data informing that view, continuing claims for unemployment insurance are above the 2019 average of approximately 1.7 million, but the trend could still be viewed as sideways despite some softening around mid-year (chart, next page, below left). In characterizing the claims data, Fed Governor Waller indicated in remarks last week, "[T]he four-week moving average of initial claims for unemployment insurance has risen gradually since January but has changed little on net in the past two months, with initial claims remaining fairly low." Additionally, a measure of layoffs from the Job Openings and Labor Turnover Survey remains below readings in 2019 (chart, below right). To date, Fed officials have pointed to a slowdown in hiring concurrent with an increase in the supply of labor as driving the recent move higher in unemployment, necessary rather than troubling developments given previous tightness in the labor market.

Continuing Claims for Unemployment Insurance



Source: U.S. Department of Labor via Haver Analytics

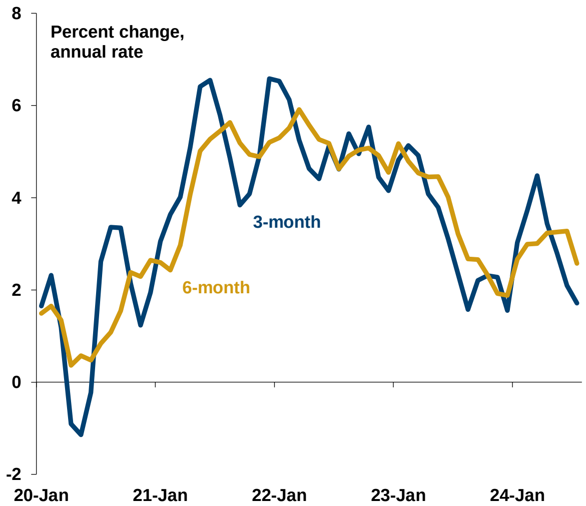
Layoffs & Discharges Rate



Source: Bureau of Labor Statistics via Haver Analytics

At the same time, inflation has slowed after a scare in Q1, but it has yet to return to two percent on a sustainable basis. The data are mostly favorable despite some ongoing concern regarding the prices of various services (housing services and insurance, for example), but a 0.3 percent increase in the core CPI in August suggest that the battle is not quite won. The charts below illustrate the progress measured by three and six-month annualized changes in the core price index for personal consumption expenditures and the measure for core services excluding housing. The footnotes contain potential outcomes for August based on inputs from this week's data on consumer and producer prices. Again, recent progress has allowed Fed officials to adjust their posture with respect to risks to the dual mandate, but one could easily envision a scenario where an inappropriately accommodative stance of policy could allow inflation to reaccelerate.

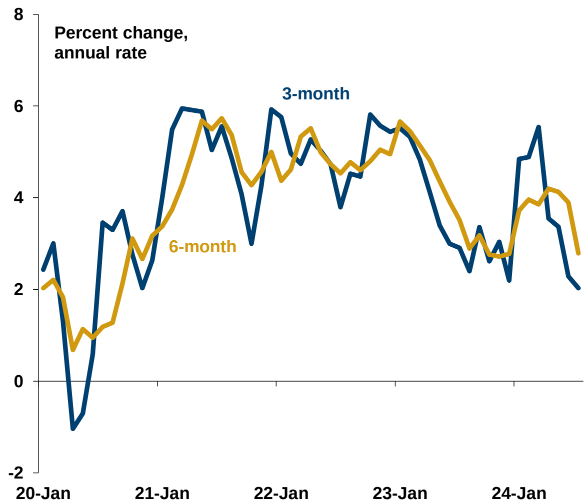
Core PCE Price Index*



** Assuming month-over-month growth of 0.20 percent for the index, the 3- & 6-month annualized growth rates for August would be 2.12 and 2.46 percent, respectively (versus 1.72 and 2.57 percent in July).*

Source: Bureau of Economic Analysis via Haver Analytics

PCE Price Index: Core Services Ex. Housing*



** Service prices excluding energy and housing services. Assuming month-over-month growth of 0.35 percent for the index, the 3- & 6-month annualized growth rates for August would be 2.92 and 3.14 percent, respectively (versus 2.03 and 2.79 percent in July).*

Source: Bureau of Economic Analysis via Haver Analytics

Thus, we’re at a juncture where a soft landing is in sight but significant risks remain. The FOMC will reduce interest rates beginning in September, but that doesn't necessarily mean that the fight against inflation is almost concluded. We maintain the view that exercising caution, at least initially, would be prudent. However, even as of writing, the market appears to be coalescing around the view of a more aggressive move, a development that would usher in possibly 150 basis points in easing by year-end 2024 (-50 basis points at each of the September, November, and December meetings).

The Week Ahead

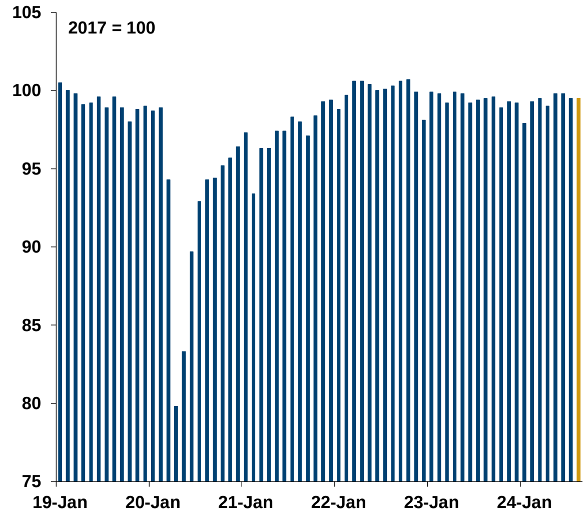
Retail Sales (August) (Tuesday)
Forecast: -0.2% Total, 0.1% Ex. Autos, 0.3% Ex. Autos & Gas

A decline in new vehicle sales in August suggests a soft performance in the motor vehicle and parts component of the retail sales report. Additionally, lower prices could depress the value of activity at gasoline service stations. Sales excluding autos and gasoline stations could ease somewhat after a strong performance in the past two months (growth of 0.4 percent following a jump of 0.8 percent in June), but wage growth remains firm and credit growth is still on a solid track – both of which are supportive of another month of active spending in this area.

Industrial Production (August) (Tuesday)
Forecast: +0.4% Total, 0.0% Manufacturing

Industrial production was constrained in July by Hurricane Beryl, thus a return to normal operating conditions raises the possibility of a rebound in activity in the latest month. Even with anticipated overall improvement, a cut of 24,000 in factory payrolls raises the prospect of a soft reading for the manufacturing component for the second consecutive month amid an ongoing sideways trend (chart, below left). Mining activity could turn in a significantly stronger performance, as a firm advance in aggregate hours suggests an increase beyond simply a retracement of last month's decline (chart, below right). Utility output often swings widely from month to month, with changes often reflecting swings in weather rather than economic fundamentals. As such, elevated home cooling usage amid elevated August temperatures suggest a brisk increase after a drop of 3.7 percent in July.

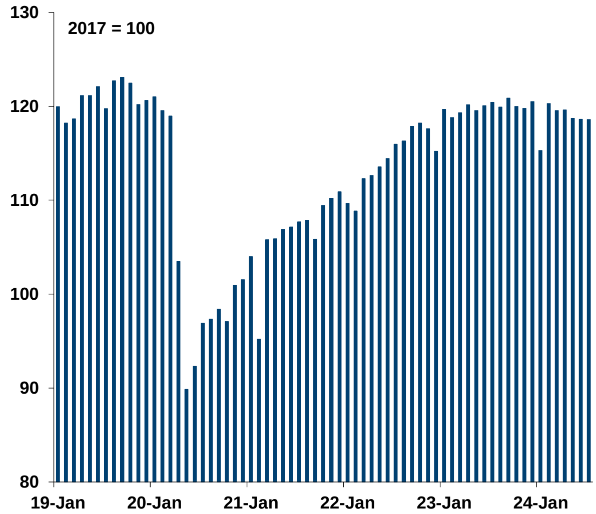
Industrial Production: Manufacturing*



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

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

Industrial Production: Mining

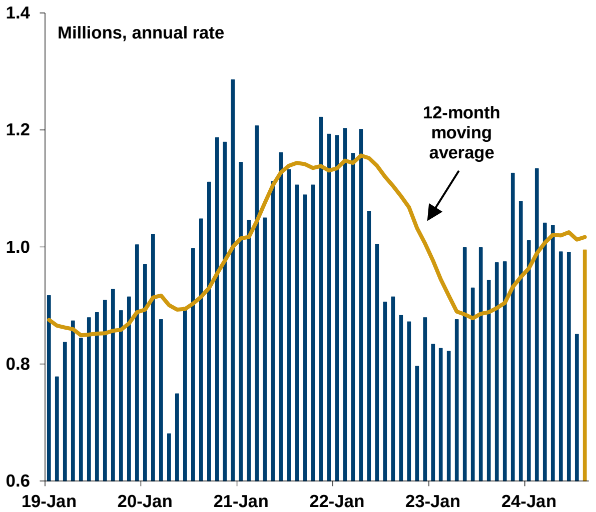


Source: Federal Reserve Board via Haver Analytics

Housing Starts (August) (Wednesday)
Forecast: 1.345 Million (+8.6%)

Although single-family building permit issuance has fallen in five of the past six months, the plunge of 14.1 percent in single-family starts in July to 0.851 million units, annual rate, was sharply below the underlying average (1.025 million average in the prior 12 months) and thus likely contained a dose of downside noise -- possibly tied to Hurricane Beryl, although this series can swing widely even in normal months. With that in mind, a rebound is possible in August. Multi-family starts, in contrast, could cool after a jump of 14.5 percent in July, particularly as financing costs for new projects remain high and demand for new rental stock has eased from earlier in the expansion (charts, top of the next page).

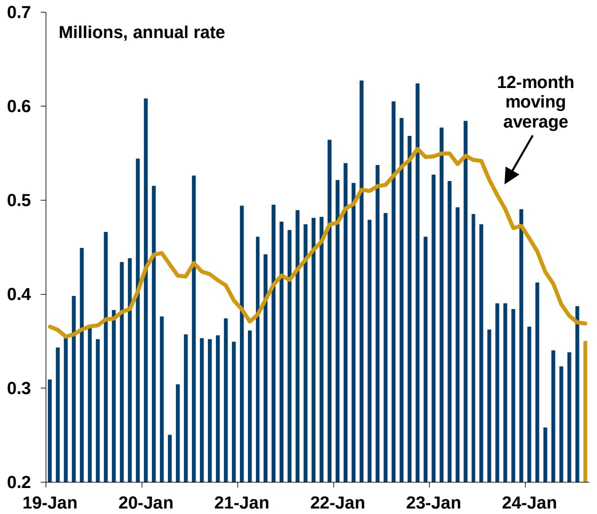
Single-Family Housing Starts*



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

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

Multi-Family Housing Starts*



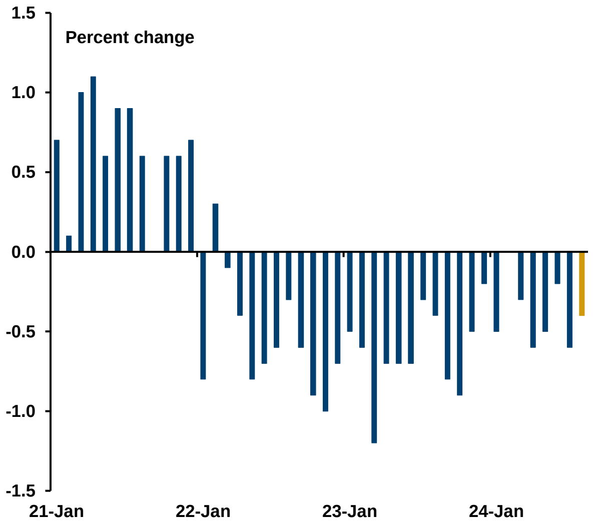
** The gold bar is a forecast for August 2024.*

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

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

Anticipated negative contributions from the ISM new orders index, slope of the yield curve, and consumer expectations raise the possibility that the Conference Board Leading Economic Index could contract in August for the 29th time in the past 30 months. If the forecast is realized, the August reading would be 15.7 percent below the cycle peak of 118.6 in December 2021. In previous business cycles, downtrends in the LEI similar to that currently in place are consistent with the U.S. economy being in recession (charts, below).

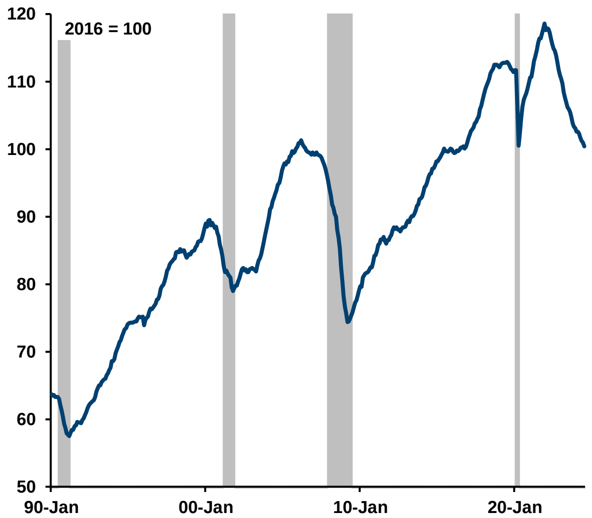
Index of Leading Economic Indicators*



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

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

Index of Leading Economic Indicators*



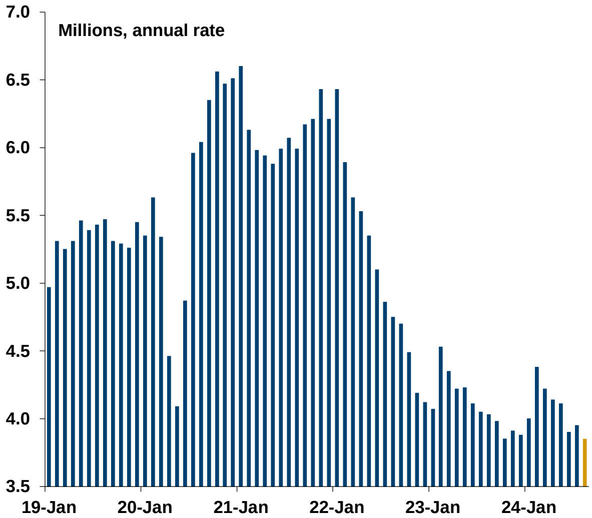
** The shaded areas indicate periods of recession in the United States.*

Sources: The Conference Board, National Bureau of Economic Research via Haver Analytics

Existing Home Sales (August) (Thursday)
Forecast: 3.85 Million (-2.5%)

A drop in the index of pending home sales in July to a record low suggests an easing in existing home sales in August after a pickup in the prior month. The projected pace of sales, which would be in the low end of the longer-term range, illustrates the still notable challenges facing the housing market (chart, below left). The severely constrained inventory of homes available for sale has eased somewhat in recent months (chart, below right), but elevated mortgage rates and high prices are still curtailing activity. (Note that existing home sales are based on closings; pending home sales, in most cases, close in one to three months.)

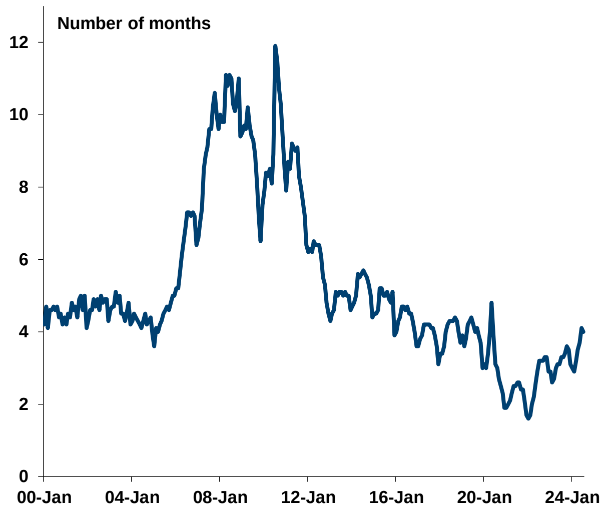
Existing Home Sales*



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

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

Months' Supply of Unsold Homes



Source: National Association of Realtors via Haver Analytics

Daiwa Capital Markets

Economic Indicators

September/October 2024

Monday	Tuesday	Wednesday	Thursday	Friday
9	10	11	12	13
WHOLESALE TRADE Inventories Sales May 0.5% 0.3% June 0.0% -0.3% July 0.2% 1.1% **CONSUMER CREDIT** May $11.7 billion June $5.2 billion July $25.5 billion	**NFIB SMALL BUSINESS OPTIMISM INDEX** June 91.5 July 93.7 Aug 91.2	**CPI** Total Core June -0.1% 0.1% July 0.2% 0.2% Aug 0.2% 0.3%	**UNEMPLOYMENT CLAIMS** Initial Continuing (millions) Aug 17 0.233 1.860 Aug 24 0.232 1.845 Aug 31 0.228 1.850 Sep 7 0.230 N/A **PPI** Final Demand Ex. Food & Energy June 0.2% 0.3% July 0.0% -0.2% Aug 0.2% 0.3% **FEDERAL BUDGET** 2024 2023 June -$71.0B -$227.8B July -$243.7B -$220.8B Aug -$380.1B $89.3B	**IMPORT/EXPORT PRICES** Non-Petrol Imports Nonagri. Exports June 0.2% -0.5% July 0.1% 0.8% Aug -0.1% -0.6% **CONSUMER SENTIMENT** July 66.4 Aug 67.9 Sep 69.0
16	17	18	19	20
EMPIRE MFG (8:30) July -6.6 Aug -4.7 Sep --	**RETAIL SALES (8:30)** Total Ex.Autos June -0.2% 0.5% July 1.0% 0.4% **Aug -0.2% 0.1%** **IP & CAP-U (9:15)** IP Cap.Util. June 0.3% 78.4% July -0.6% 77.8% **Aug 0.4% 77.9%** **NAHB HOUSING INDEX (10:00)** July 41 Aug 39 Sep -- **BUSINESS INVENTORIES (10:00)** Inventories Sales May 0.5% 0.0% June 0.3% 0.0% **July 0.3% 1.0%** **FOMC MEETING (FIRST DAY)**	**HOUSING STARTS (8:30)** June 1.329 million July 1.238 million **Aug 1.345 million** **FOMC RATE DECISION (2:00)** **TIC FLOWS (4:00)** Long-Term Total May -$54.1B $16.1B June $96.1B $107.5B July -- --	**UNEMP. CLAIMS (8:30)** **CURRENT ACCOUNT (8:30)** 23-Q4 -$221.8 bill. 24-Q1 -$237.6 bill. **24-Q2 -$261.0 bill.** **PHILADELPHIA FED MFG BUSINESS OUTLOOK (8:30)** July 13.9 Aug -7.0 Sep -- **EXISTING HOME SALES (10:00)** June 3.900 million July 3.950 million **Aug 3.850 million** **LEADING INDICATORS (10:00)** June -0.2% July -0.6% **Aug -0.4%**	
23	24	25	26	27
CHICAGO FED NATIONAL ACTIVITY INDEX	**FHFA HOME PRICE INDEX** **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** **CONFERENCE BOARD CONSUMER CONFIDENCE**	**NEW HOME SALES**	**UNEMP. CLAIMS** **REVISED Q2 GDP** **DURABLE GOODS ORDERS** **PENDING HOME SALES**	**PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX** **INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES** **REVISED CONSUMER SENTIMENT**
30	1	2	3	4
MNI CHICAGO BUSINESS BAROMETER	**ISM MFG. INDEX** **JOLTS DATA** **CONSTRUCTION** **VEHICLE SALES**	**ADP EMPLOYMENT**	**UNEMP. CLAIMS** **ISM SERVICES INDEX** **FACTORY ORDERS**	**EMPLOYMENT REPORT**

Forecasts in bold.

Treasury Financing

September/October 2024

Monday	Tuesday	Wednesday	Thursday	Friday
9	10	11	12	13
AUCTION RESULTS: Rate / Cover 13-week bills 4.895% 3.22 26-week bills 4.530% 2.98	**AUCTION RESULTS:** Rate / Cover 3-yr notes 3.440% 2.66 42-day CMBs 4.980% 2.97 **ANNOUNCE:** $60 billion 17-week bills for auction on Sep 11 $80 billion 4-week bills for auction on Sep 12 $80 billion 8-week bills for auction on Sep 12 **SETTLE:** $60 billion 17-week bills $80 billion 4-week bills $80 billion 8-week bills	**AUCTION RESULTS:** Rate / Cover 17-week bills 4.740% 2.74 10-yr notes 3.648% 2.64	**AUCTION RESULTS:** Rate / Cover 4-week bills 4.965% 2.92 8-week bills 4.990% 2.45 30-yr bonds 4.015% 2.38 **ANNOUNCE:** $146 billion 13-,26-week bills for auction on Sep 16 $13 billion 20-year bonds for auction on Sep 17 $17 billion 10-year TIPS for auction on Sep 19 $60 billion 42-day CMBs for auction on Sep 17 **SETTLE:** $146 billion 13-,26-week bills $60 billion 42-day CMBs	
16	17	18	19	20
AUCTION: $146 billion 13-,26-week bills **SETTLE:** $58 billion 3-year notes $39 billion 10-year notes $22 billion 30-year bonds	**AUCTION:** $13 billion 20-year bonds $60 billion 42-day CMBs **ANNOUNCE:** $60 billion* 17-week bills for auction on Sep 18 $80 billion* 4-week bills for auction on Sep 19 $80 billion* 8-week bills for auction on Sep 19 **SETTLE:** $60 billion 17-week bills $80 billion 4-week bills $80 billion 8-week bills	**AUCTION:** $60 billion* 17-week bills	**AUCTION:** $80 billion* 4-week bills $80 billion* 8-week bills $17 billion 10-year TIPS **ANNOUNCE:** $146 billion* 13-,26-week bills for auction on Sep 23 $69 billion* 2-year notes for auction on Sep 24 $70 billion* 5-year notes for auction on Sep 25 $44 billion* 7-year notes for auction on Sep 26 $28 billion* 2-year FRNs for auction on Sep 25 **SETTLE:** $146 billion 13-,26-week bills $60 billion 42-day CMBs	
23	24	25	26	27
AUCTION: $146 billion* 13-,26-week bills	**AUCTION:** $69 billion* 2-year notes **ANNOUNCE:** $60 billion* 17-week bills for auction on Sep 25 $80 billion* 4-week bills for auction on Sep 26 $80 billion* 8-week bills for auction on Sep 26 **SETTLE:** $60 billion* 17-week bills $80 billion* 4-week bills $80 billion* 8-week bills	**AUCTION:** $60 billion* 17-week bills $70 billion* 5-year notes $28 billion* 2-year FRNs	**AUCTION:** $80 billion* 4-week bills $80 billion* 8-week bills $44 billion* 7-year notes **ANNOUNCE:** $146 billion* 13-,26-week bills for auction on Sep 30 $46 billion* 52-week bills for auction on Oct 1 **SETTLE:** $146 billion* 13-,26-week bills	**SETTLE:** $28 billion* 2-year FRNs
30	1	2	3	4
AUCTION: $146 billion* 13-,26-week bills **SETTLE:** $13 billion 20-year bonds $17 billion 10-year TIPS $69 billion* 2-year notes $70 billion* 5-year notes $44 billion* 7-year notes	**AUCTION:** $46 billion* 52-week bills **ANNOUNCE:** $60 billion* 17-week bills for auction on Oct 2 $80 billion* 4-week bills for auction on Oct 3 $80 billion* 8-week bills for auction on Oct 3 **SETTLE:** $60 billion* 17-week bills $80 billion* 4-week bills $80 billion* 8-week bills	**AUCTION:** $60 billion* 17-week bills	**AUCTION:** $80 billion* 4-week bills $80 billion* 8-week bills **ANNOUNCE:** $146 billion* 13-,26-week bills for auction on Oct 7 $58 billion* 3-year notes for auction on Oct 8 $39 billion* 10-year notes for auction on Oct 9 $22 billion* 30-year bonds for auction on Oct 10 **SETTLE:** $146 billion* 13-,26-week bills $46 billion* 52-week bills	

**Estimate*