Daiwa Capital Markets

U.S. Economic Comment

- September inflation: tilting to the high side but still consistent with a return to two percent

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Inflation: On Track to Two Percent?

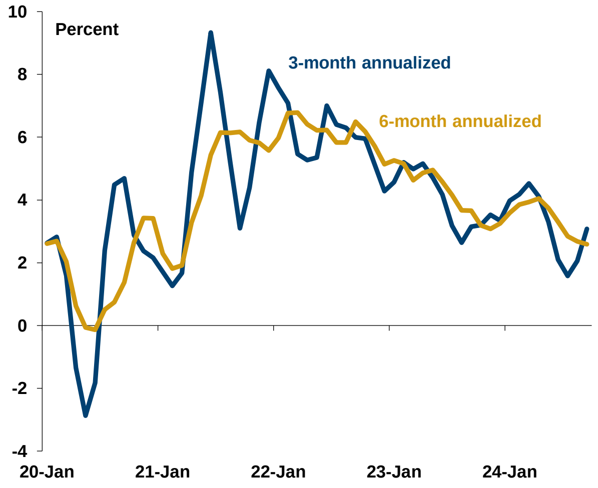
The first round of inflation data for September has raised some concern about the path of interest rates, particularly following a firm labor market report released on October 4. The FOMC cut the target range for the federal funds rate at its September gathering by 50 basis points, informed by the view that risks to the dual mandate had moved into better balance as inflation slowed and labor market conditions normalized. Moreover, even amid upside surprises to the data and attendant repricing in Treasuries to reflect a slower path of easing, messaging by Fed officials has remained fairly consistent – acknowledging risks to both the labor market and inflation mandates and stressing a cautious approach to further policy adjustments with an eye on neutral. We would add that, in our view, the recent data have done little to refute such a position.

The CPI

The headline consumer price index advanced 0.2 percent in the latest month, despite a drop of 1.9 percent in the energy component, and the core jumped 0.3 percent – the second consecutive increase of that magnitude (versus the Bloomberg median expectation of increases of 0.1 percent and 0.2 percent, respectively). Despite the upturn on recent core readings, however, the decelerating trend remained more-or-less intact. The three-month annualized growth rate rose to 3.1 percent from 2.1 percent in August, but the 6-month rate showed incremental improvement, easing 0.1 percentage point to 2.6 percent (chart, below left). Furthermore, while year-over-year progress in the core stalled (+3.3 percent in September, a tick faster than the prior month's reading), core goods inflation remained on a deflationary track despite an uptick in the latest month. Moreover, core service inflation (core services ex. energy services) improved amid slowing in rental inflation and despite outsized moves in a few areas (chart, below right).

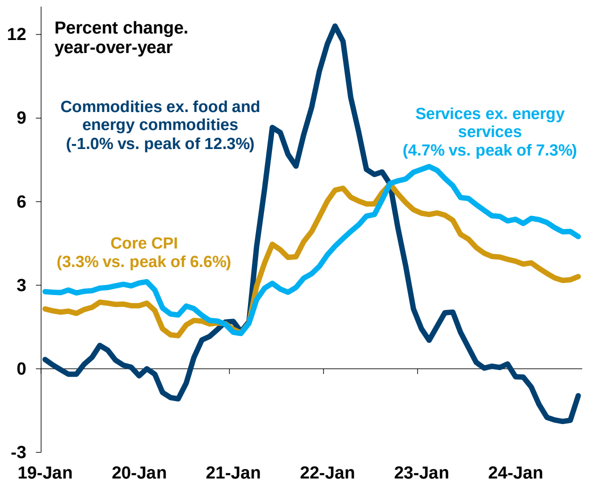
Delving into various components of the CPI report further supports our assessment that the recent data are not suggestive of a reacceleration in underlying inflation. Most encouraging, observed cooling in market rent indexes appears to finally be filtering into the inflation metrics. In the latest month, the rent of primary residence index rose 0.3 percent – the second month in the past four when the change rounded up to that reading versus other recent prints in the range of 0.4 percent to 0.5 percent (chart, next page, left). Similarly, the owners' equivalent rent of

Core CPI



Source: Bureau of Labor Statistics via Haver Analytics

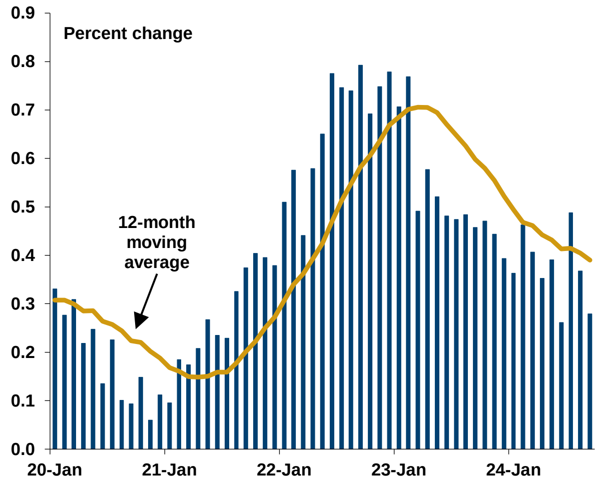
Decomposition of Core CPI



Source: Bureau of Labor Statistics via Haver Analytics

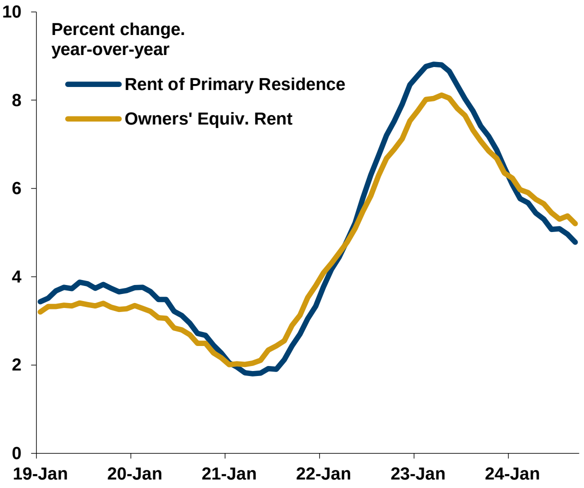
residences index recorded an increase of 0.3 percent. The increases equated to year-over-year advances of 4.8 percent and 5.2 percent, respectively, each down 0.2 percentage point from observations in the previous month (chart, below right). The trend in rental inflation has not returned to the pre-pandemic rate in the vicinity of three and one-half percent, but it has now made considerable progress from readings on primary rents and OER that exceeded eight percent at their recent peaks.

CPI: Rent of Primary Residence



Source: Bureau of Labor Statistics via Haver Analytics

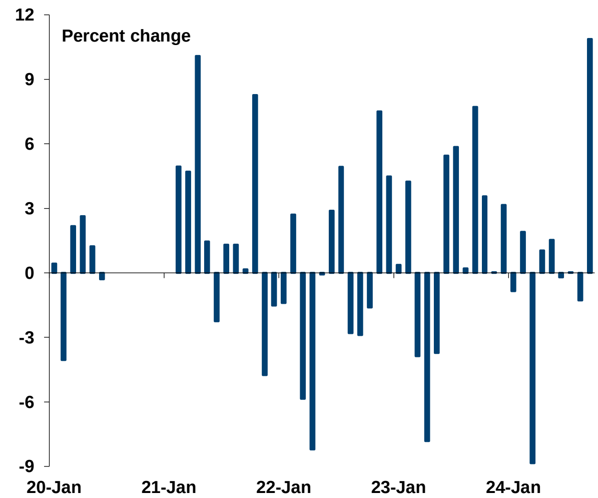
CPI: Primary Housing Components



Source: Bureau of Labor Statistics via Haver Analytics

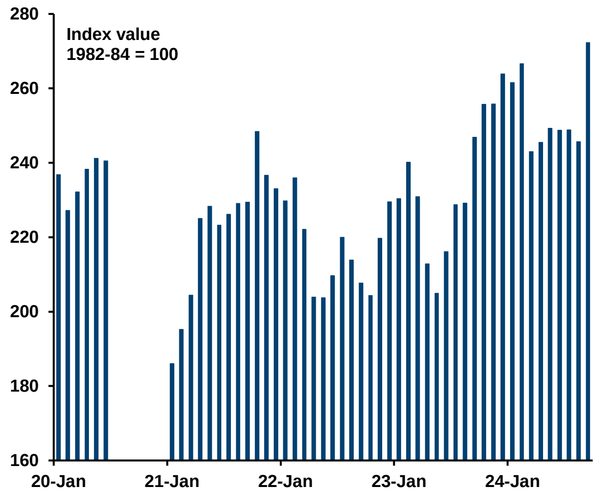
In another vein, we are not overly concerned about movements in other areas. In the latest CPI report a few areas posted unusually large increases: apparel in the goods area and sporting events admissions (captured in services). Regarding apparel prices, the index jumped 1.1 percent in September – the second increase in the past six months exceeding one percent – which has contributed to pushing the level of the apparel index well above those directly preceding the pandemic. Even so, clothing prices make up a relatively small share of the CPI (about 2.6 percent) and movements in other areas have contributed to the ongoing favorable trend in core goods inflation. The admissions to sporting events index posted a far more striking move in September, surging 10.9 percent to a record high (not seasonally adjusted; charts below). Recent readings could signal an adjustment higher of the costs of attending live events, or an instance of upside volatility. From our point of view, the data emphasize three key points: 1. the path back to two percent is well underway, although progress will occur perhaps more slowly than hoped by market participants; 2. previously sticky housing inflation is moderating more convincingly; and 3. attempting to project with great accuracy smaller often volatile subindexes, and fretting over their often-large shifts, can distract from significant progress already achieved.

CPI: Admissions to Sporting Events*



Source: Bureau of Labor Statistics via Haver Analytics

CPI: Admissions to Sporting Events*

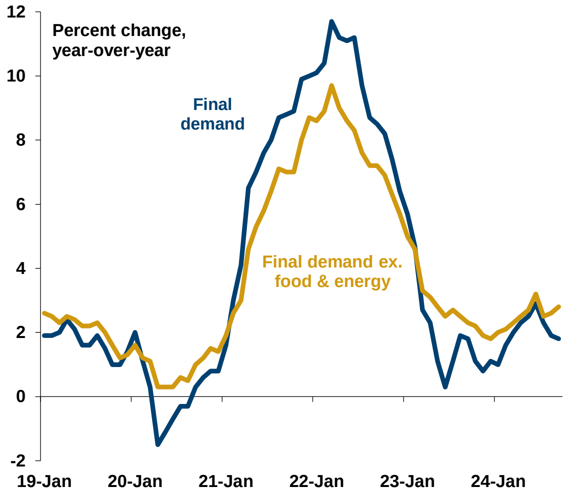


** No observations available between June and December 2020 due to pandemic-related venue closures. Not seasonally adjusted data.*
Source: Bureau of Labor Statistics via Haver Analytics

The PPI

Friday data on producer prices further solidified our view that inflation is on a sustainable path back to two percent, as the report both illustrated that pipeline inflation has moderated sharply from the post-pandemic peak and firms' abilities to pass through higher prices to consumers have been curtailed sharply. With respect to the latest topline data, the headline PPI rounded down to 0.0 percent (+0.048 percent with less rounding) and final demand excluding food and energy rose 0.2 percent (+0.161 percent with less rounding). The changes corresponded to year-over-year advances of 1.8 percent for the headline PPI (versus 1.9 percent in August) and 2.8 percent for prices excluding food and energy (up from 2.6 percent in August but within the range of recent observations and well below the recent peak of 9.7 percent in March 2022; chart, right).

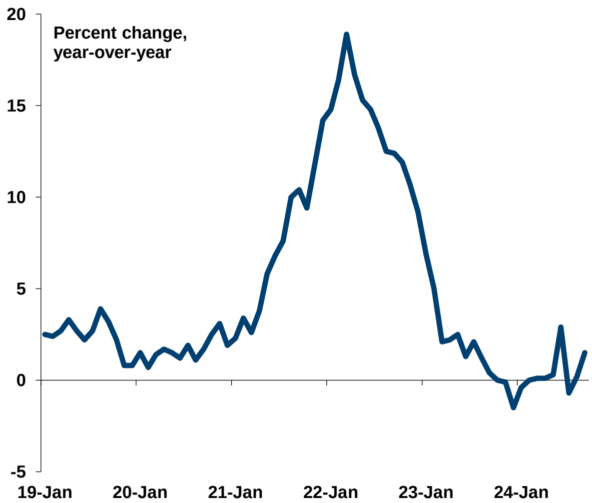
PPI



Source: Bureau of Labor Statistics via Haver Analytics

We also would draw attention to the trade services component of the broader final demand services area, which tracks margin growth at the wholesale and retail levels. The measure provides good insight into pricing power of sellers by tracking their abilities to either pass through higher costs or grow profits. That said, the metric shows marked monthly volatility (range of -1.8 percent to +1.9 percent in 2024 thus far, including a reading of +0.2 percent in September), but the trend remains subdued (+1.5 percent year-over-year; charts). Moreover, the story told here is supported by anecdotal reports from both news sources and the Fed (see the latest FOMC minutes) that consumers are pushing back on price increases and many firms are either avoiding price increases or discounting to maintain market share. Such a dynamic underscores the return of a healthy inflation environment.

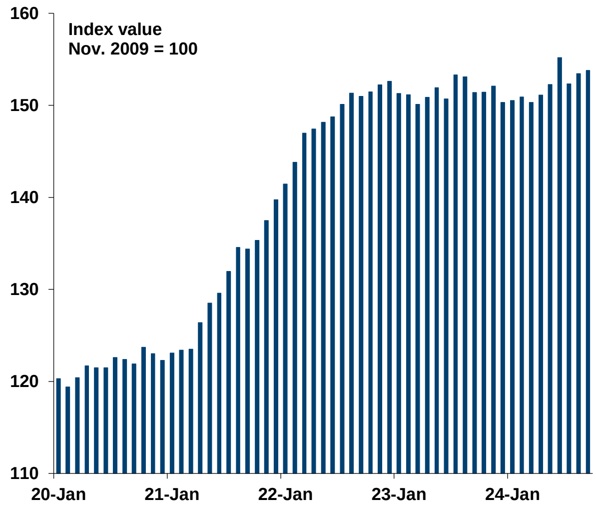
PPI: Final Demand, Trade Services*



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

Source: Bureau of Labor Statistics via Haver Analytics

PPI: Final Demand, Trade Services

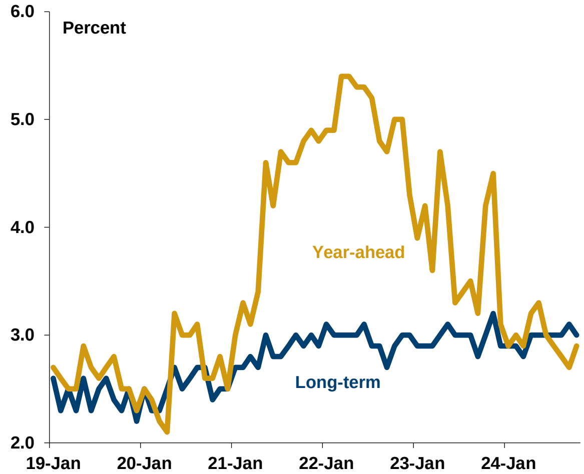


Source: Bureau of Labor Statistics via Haver Analytics

Inflation Expectations

Beyond the hard data, the consumer inflation expectations data published with the early October iteration of the University of Michigan's Survey of Consumers affirmed that they remained anchored. The year-ahead measure rose 0.2 percentage point to 2.9 percent, but it remained within the subdued 2024 range (2.7 to 3.3 percent) and well below the recent high of 5.4 percent in the spring of 2022. Perhaps more important, the longer-term measure, which correlates with actual inflation over time, dipped to 3.0 percent from 3.1 percent (chart). Although slightly above levels that prevailed prior to the onset of the pandemic, the sideways trajectory of this series suggests that consumers do not fear that inflation will become unglued. On the contrary, it conveys a confidence that still-restrictive monetary policy is working.

Consumer Inflation Expectations



Source: University of Michigan via Haver Analytics

Thus, taking the monthly gyrations of the data in context, we're inclined to agree with the sentiments of New York Fed President John Williams in a speech delivered on Thursday: "There's still some distance to go to reach our goal of 2 percent, but we're definitely moving in the right direction." Restrictive monetary policy has contributed to the correction pandemic-related imbalances in the economy and contributed to easing labor market conditions – factors that far outweigh any singular data point.

Note to readers:

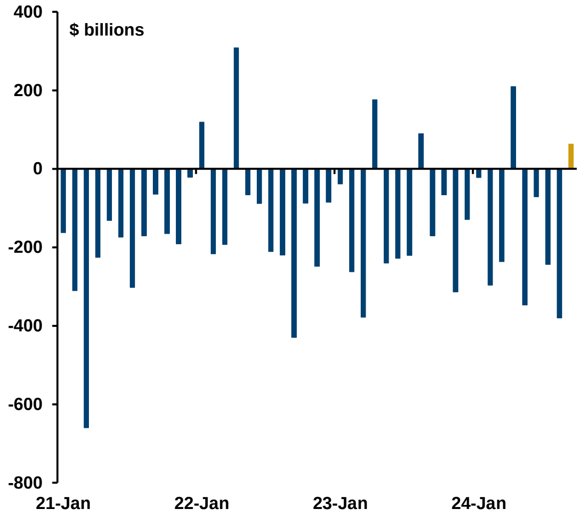
The next Weekly Economic Comment will be published on October 25, 2024.

The Week Ahead

Federal Budget (September) (October 15-25)
Forecast: $63.0 Billion Surplus

The Congressional Budget Office released on October 8th its Monthly Budget Review, which contained an assessment of the FY2024 financial position of the U.S. government. For the full fiscal year, the CBO estimated that federal revenues rose 11 percent year-over-year to $4.9 trillion, in part led by payments of 2023 obligations that had been postponed on account of natural disasters but also reflecting firm performances in corporate and individual income tax collections (+26 percent and +11 percent, respectively). On the other side of the ledger, outlays surged (+10 percent to $6.8 trillion). The move in part reflected brisk increases in net interest expense on federal debt (+34 percent year-over-year), as well as growing obligations for various income support programs and age-related benefits (spending on Social Security rose 8 percent, for example). Thus, even with an anticipated surplus of $63 billion in September, the anticipated deficit of $1.8 trillion will exceed the total in FY2023 (approximately $1.7 trillion; chart). The U.S. remains on an unsustainable fiscal path.

Federal Budget Deficit/Surplus*



** The gold bar is a forecast from the CBO for September 2024.*
Source: U.S. Treasury Department via Haver Analytics; Congressional Budget Office

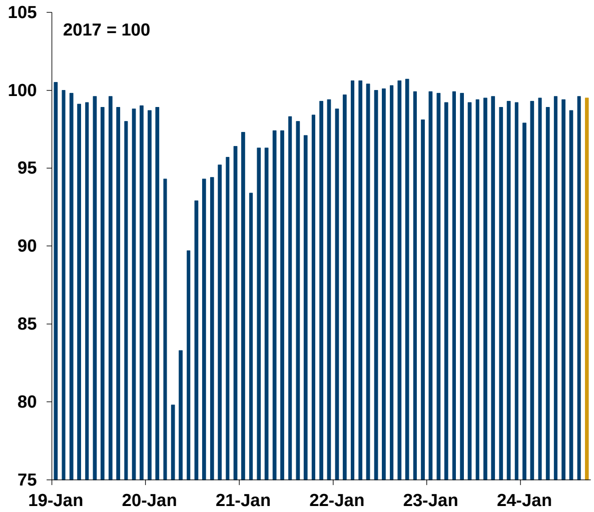
Retail Sales (September) (Thursday)
Forecast: 0.0% Total, -0.1% Ex. Autos, +0.3% Ex. Autos & Gas

Lower gasoline prices could depress the value of sales at gasoline stations (the retail sales report tracks nominal rather than price-adjusted data), which could act as a constraint on headline retail activity. Additionally, effects on consumer behavior from previous hurricanes (Beryl) and more recently Helene in late September may have impacted the distribution of purchases (i.e. skewing activity toward grocery stores and building materials outlets and away from those dealing with discretionary items). With that said, the aggregate consumer sector has proved resilient in the current expansion despite some evidence stress at the margin (higher delinquency rates for some types of loans and hesitancy in spending for those at lower end of the income distribution), with real consumer spending in Q3 likely to remain on a firm growth trajectory.

Industrial Production (September) (Thursday)
Forecast: 0.0% Total, -0.1% Manufacturing

The manufacturing component of industrial production jumped in August after Hurricane Beryl depressed activity in the prior month, but factory firms face an environment of ongoing soft demand and have trimmed payrolls in response in both August and September. Thus, a soft reading is expected in the latest month amid a sideways trend (chart, next page, left). The mining component could perform a bit better, although little change in the rotary rig count suggest that the projected increase should be modest. Moreover, the upward trend in this area may be plateauing after a firm recovery for most of the current expansion (chart, next page, right). The utility component is often volatile (changes of -3.0 percent to +3.6 percent in the past six months), influenced by swings in the weather rather than economic fundamentals.

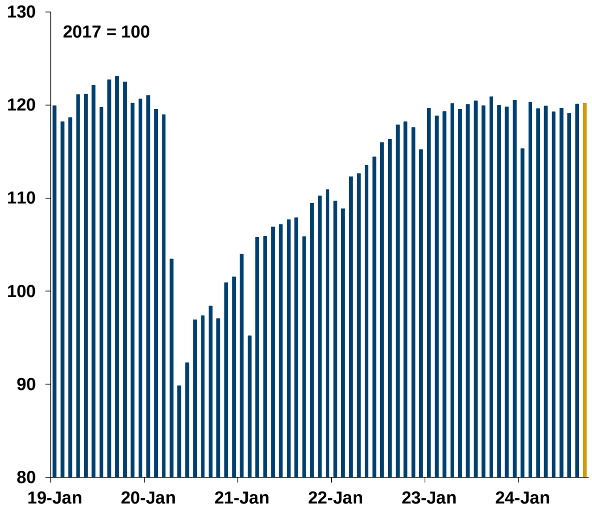
Industrial Production: Manufacturing*



** The gold bar is the level of the index based on a projected month-to-month decline of 0.1 percent.*

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

Industrial Production: Mining*



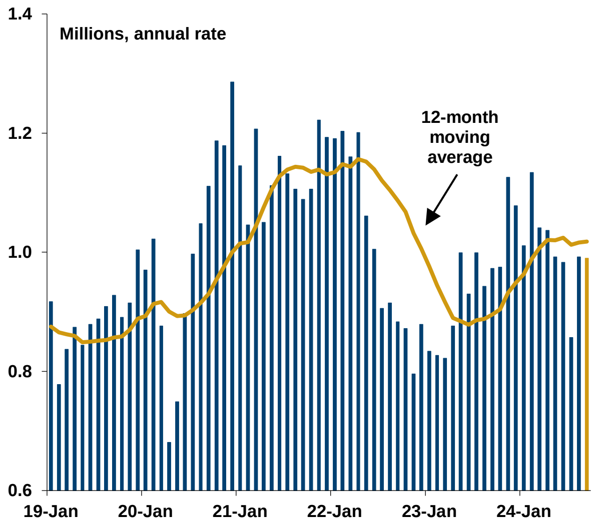
** The gold bar is the level of the index based on a projected month-to-month increase of 0.1 percent.*

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

Housing Starts (September) (Friday)
Forecast: 1.340 Million (-1.2%)

Recent storms introduced (and will for the next several months) a good bit of volatility into the housing starts data, which even excluding special factors often swings widely and is subject to large revisions. With that said, single-family starts appear to have stabilized somewhat above already favorable pre-COVID norms, while multi-family starts have softened a good bit from earlier in the expansion (charts, below).

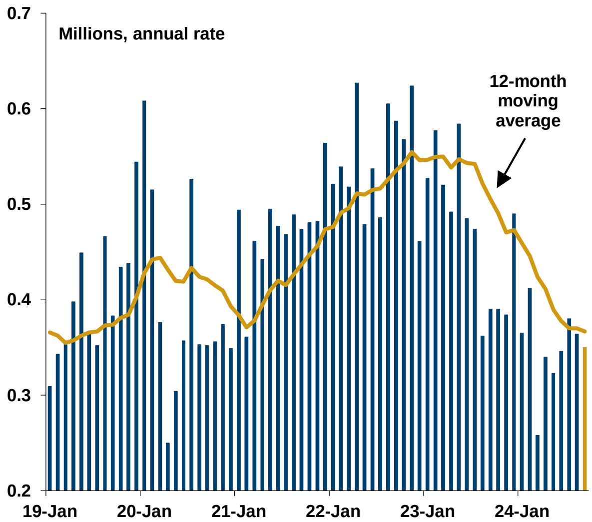
Single-Family Housing Starts*



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

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

Multi-Family Housing Starts*



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

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

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Economic Indicators

October/November 2024

Monday	Tuesday	Wednesday	Thursday	Friday
7	8	9	10	11
CONSUMER CREDIT June $3.2 billion July $26.6 billion Aug $8.9 billion	**NFIB SMALL BUSINESS OPTIMISM INDEX** July 93.7 Aug 91.2 Sep 91.5 **TRADE BALANCE** June -$73.0 billion July -$78.9 billion Aug -$70.4 billion	**WHOLESALE TRADE** Inventories / Sales June 0.0% / -0.3% July 0.2% / 1.1% Aug 0.1% / -0.1% **FOMC MINUTES**	**UNEMPLOYMENT CLAIMS** Initial / Continuing (millions) Sep 14 0.222 / 1.827 Sep 21 0.219 / 1.819 Sep 28 0.225 / 1.861 Oct 5 0.258 / N/A **CPI** Total / Core July 0.2% / 0.2% Aug 0.2% / 0.3% Sep 0.2% / 0.3%	**PPI** Final Demand / Ex. Food & Energy July 0.0% / -0.1% Aug 0.2% / 0.3% Sep 0.0% / 0.2% **CONSUMER SENTIMENT** Aug 67.9 Sep 70.1 Oct 68.9
14	15	16	17	18
COLUMBUS DAY	**EMPIRE MFG (8:30)** Aug -4.7 Sep 11.5 Oct -- **FEDERAL BUDGET (10/15–10/25)** 2024 / 2023 July -$243.7B / -$220.8B Aug -$380.1B / $89.3B **Sep** **$63.0B** / -$170.7B	**IMPORT/EXPORT PRICES (8:30)** Non-Petrol Imports / Nonagri. Exports July 0.1% / 0.8% Aug -0.1% / -0.6% Sep -- / --	**UNEMP. CLAIMS (8:30)** **RETAIL SALES (8:30)** Total / Ex.Autos July 1.1% / 0.4% Aug 0.1% / 0.1% **Sep 0.0% / -0.1%** **PHILADELPHIA FED MFG BUSINESS OUTLOOK (8:30)** Aug -7.0 Sep 1.7 Oct -- **IP & CAP-U (9:15)** IP / Cap.Util. July -0.9% / 77.4% Aug 0.8% / 78.0% **Sep 0.0% / 77.8%** **NAHB HOUSING INDEX (10:00)** Aug 39 Sep 41 Oct -- **BUSINESS INVENTORIES (10:00)** Inventories / Sales June 0.3% / 0.0% July 0.3% / 1.1% **Aug 0.3% / -0.2%** **TIC FLOWS (4:00)** Long-Term / Total June $80.5B / $92.0B July $135.4B / $156.5B Aug -- / --	**HOUSING STARTS (8:30)** July 1.237 million Aug 1.356 million **Sep 1.340 million**
21	22	23	24	25
LEADING INDICATORS		**EXISTING HOME SALES** **BEIGE BOOK**	**UNEMP. CLAIMS** **CHICAGO FED NATIONAL ACTIVITY INDEX** **NEW HOME SALES**	**DURABLE GOODS ORDERS** **REVISED CONSUMER SENTIMENT**
28	29	30	31	1
	INTERNATIONAL TRADE IN GOODS **ADVANCE INVENTORIES** **FHFA HOME PRICE INDEX** **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** **CONFERENCE BOARD CONSUMER CONFIDENCE** **JOLTS DATA**	**ADP EMPLOYMENT** **Q3 GDP** **PENDING HOME SALES**	**UNEMP. CLAIMS** **PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX** **EMPLOYMENT COST INDEX** **MNI CHICAGO BUSINESS BAROMETER**	**EMPLOYMENT REPORT** **ISM MFG. INDEX** **CONSTRUCTION** **VEHICLE SALES**

Forecasts in bold (the September projection for the federal budget provided by the Congressional Budget Office).

Treasury Financing

October/November 2024

Monday	Tuesday	Wednesday	Thursday	Friday
7	8	9	10	11
AUCTION RESULTS: Rate / Cover 13-week bills 4.550% 2.62 26-week bills 4.305% 3.38	**AUCTION RESULTS:** Rate / Cover 3-yr notes 3.878% 2.45 42-day CMBs 4.720% 2.96 **ANNOUNCE:** $64 billion 17-week bills for auction on Oct 9 $95 billion 4-week bills for auction on Oct 10 $90 billion 8-week bills for auction on Oct 10 **SETTLE:** $64 billion 17-week bills $95 billion 4-week bills $90 billion 8-week bills	**AUCTION RESULTS:** Rate / Cover 17-week bills 4.430% 3.31 10-yr notes 4.066% 2.48	**AUCTION RESULTS:** Rate / Cover 4-week bills 4.750% 2.74 8-week bills 4.640% 2.92 30-yr bonds 4.389% 2.50 **ANNOUNCE:** $153 billion 13-,26-week bills for auction on Oct 15 $80 billion 43-day CMBs for auction on Oct 15 **SETTLE:** $153 billion 13-,26-week bills $80 billion 42-day CMBs	
14	15	16	17	18
COLUMBUS DAY	**AUCTION:** $153 billion 13-,26-week bills $80 billion 43-day CMBs **ANNOUNCE:** $64 billion* 17-week bills for auction on Oct 16 $95 billion* 4-week bills for auction on Oct 17 $90 billion* 8-week bills for auction on Oct 17 **SETTLE:** $64 billion 17-week bills $95 billion 4-week bills $90 billion 8-week bills $58 billion 3-year notes $39 billion 10-year notes $22 billion 30-year bonds	**AUCTION:** $64 billion* 17-week bills	**AUCTION:** $95 billion* 4-week bills $90 billion* 8-week bills **ANNOUNCE:** $153 billion* 13-,26-week bills for auction on Oct 21 $13 billion* 20-year bonds for auction on Oct 23 $24 billion* 5-year TIPS for auction on Oct 24 **SETTLE:** $153 billion 13-,26-week bills $80 billion 43-day CMBs	
21	22	23	24	25
AUCTION: $153 billion* 13-,26-week bills	**ANNOUNCE:** $64 billion* 17-week bills for auction on Oct 23 $95 billion* 4-week bills for auction on Oct 24 $90 billion* 8-week bills for auction on Oct 24 **SETTLE:** $64 billion* 17-week bills $95 billion* 4-week bills $90 billion* 8-week bills	**AUCTION:** $64 billion* 17-week bills $13 billion* 20-year bonds	**AUCTION:** $95 billion* 4-week bills $90 billion* 8-week bills $24 billion* 5-year TIPS **ANNOUNCE:** $153 billion* 13-,26-week bills for auction on Oct 28 $48 billion* 52-week bills for auction on Oct 29 $69 billion* 2-year notes for auction on Oct 28 $70 billion* 5-year notes for auction on Oct 28 $44 billion* 7-year notes for auction on Oct 29 $30 billion* 2-year FRNs for auction on Oct 29 **SETTLE:** $153 billion* 13-,26-week bills	
28	29	30	31	1
AUCTION: $153 billion* 13-,26-week bills $69 billion* 2-year notes $70 billion* 5-year notes	**AUCTION:** $48 billion* 52-week bills $44 billion* 7-year notes $30 billion* 2-year FRNs **ANNOUNCE:** $64 billion* 17-week bills for auction on Oct 30 $95 billion* 4-week bills for auction on Oct 31 $90 billion* 8-week bills for auction on Oct 31 **SETTLE:** $64 billion* 17-week bills $95 billion* 4-week bills $90 billion* 8-week bills	**AUCTION:** $64 billion* 17-week bills **ANNOUNCE:** $58 billion* 3-year notes for auction on Nov 4 $39 billion* 10-year notes for auction on Nov 5 $22 billion* 30-year bonds for auction on Nov 6	**AUCTION:** $95 billion* 4-week bills $90 billion* 8-week bills **ANNOUNCE:** $153 billion* 13-,26-week bills for auction on Nov 4 **SETTLE:** $153 billion* 13-,26-week bills $48 billion* 52-week bills $13 billion* 20-year bonds $24 billion* 5-year TIPS $69 billion* 2-year notes $70 billion* 5-year notes $44 billion* 7-year notes $30 billion* 2-year FRNs	

**Estimate*