U.S. Economic Comment

- December inflation: notable month-to-month improvement
- Business sentiment: election-related bounce
- The Friday data: stronger than expected housing starts & industrial production, but caution warranted

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Inflation Data Give Reason for Optimism

After several months of little net movement towards the Federal Reserve's two percent inflation target – and facing significant unknowns surrounding price effects of a potential tariff program by the Trump administration -- policymakers preached caution with respect to further interest rate cuts, signaling that a pause is likely at least at the January 28-29 FOMC meeting. In response, the fixed income market repriced to reflect the reality that further reductions could occur in the back half of 2025 (if at all). Namely, the two-year Treasury rate rose from 4.28 percent on Monday January 6 to 4.40 percent on Monday January 13 and the 10-year increased by 17 basis points to 4.79 percent over the same span – the highest reading in more than a year (Fed constant-maturity basis).

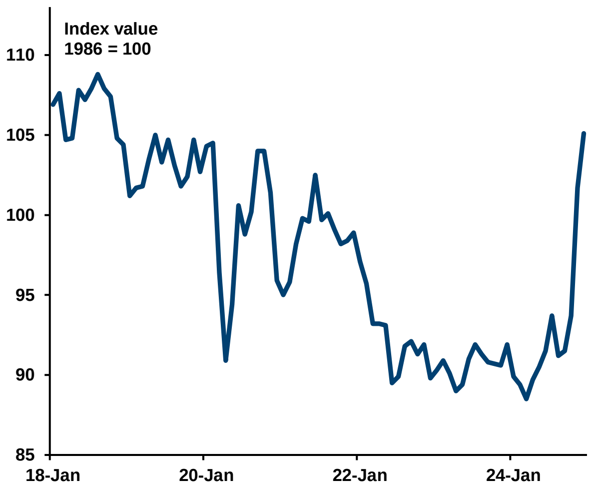
However, prospects improved with unexpected results on December inflation reports. The PPI printed below expectations on Tuesday, with increases in the headline and core (PPI excluding food, energy, and trade services) of 0.2 percent and 0.1 percent, respectively, falling shy of the Bloomberg medians of 0.4 percent and 0.3 percent. More important, while the headline advance in the CPI on Wednesday matched expectations on account of higher energy prices (+0.4 percent), the core came in 0.1 percentage point below the consensus view at 0.2 percent. On a year-over-year basis, the headline CPI accelerated to 2.9 percent from 2.7 percent, while the core advance slowed to 3.2 percent from 3.3 percent previously.

Encouragingly, the internals of the CPI were favorable, including a modest increase in the prices of housing services (both primary rents and owners' equivalent rent rose 0.3 percent after modest increases in November) and supercore services (that is, service prices excluding energy services, primary rents, and OER; +0.2 percent). With respect to the inflation results, Fed Governor Chris Waller in an interview on Thursday indicated, "If we continue getting numbers like this, it's reasonable to think rate cuts could happen in the first half of the year." He followed up by stating that the possibility existed for a cut in March – although we got the sense that was not his baseline expectation. Yields eased into week end in response to the data and possibly the dovish comments, with Fed data for Friday pegging the 2-year constant maturity yield at 4.27 percent and the 10-year at 4.61 percent. The data, and tariff-related developments, may push the FOMC to the sidelines for most of the year (although our house view calls for two cuts of 25 basis points in H1), but Fed action will be determined by the data, which at least for December were better than anticipated.

Resurgent Small Business Sentiment

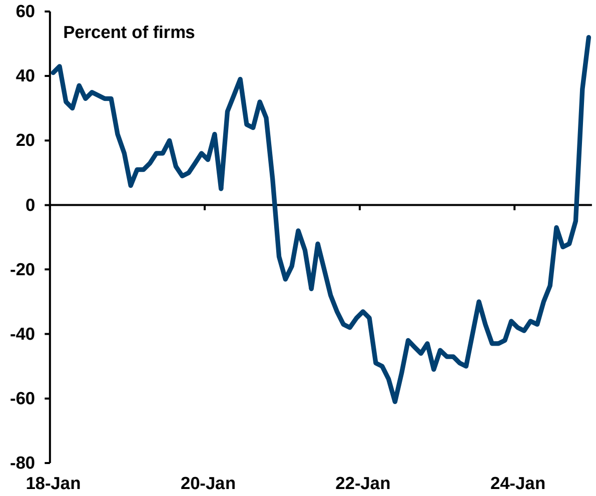
We were struck earlier this week by the resurgence of the National Federation of Independent Business Small Business Optimism Index. The measure has jumped since the election of President Trump, climbing from 93.7 in October (a reading in the upper end of the previously subdued 2022-2024 range) to 105.1 in December – the highest observation since the summer of 2018 -- after back-to-back increases (+8.0 index points in November to 101.7, followed by the latest gain of 3.4 index points; chart, next page, above left). The heath of small businesses is critical to that of the U.S. economy, as the U.S. Chamber of Commerce indicates that small businesses account for over 40 percent of GDP and almost 46 percent of employment. Thus, a notable shift in sentiment suggests a favorable economic performance in the months ahead, provided that the new administration ratifies views with policy initiatives (reauthorization of tax cuts, deregulation, etc.) In this regard, NFIB Chief Economist Bill Dunkelberg noted in comments published with the December report: "Small business owners feel more certain and hopeful about the economic agenda of the new administration. Expectations for economic growth, lower inflation, and positive business conditions have increased in anticipation of pro-business policies and legislation in the new year."

NFIB: Small Business Optimism Index



Source: National Federation of Independent Business via Haver Analytics

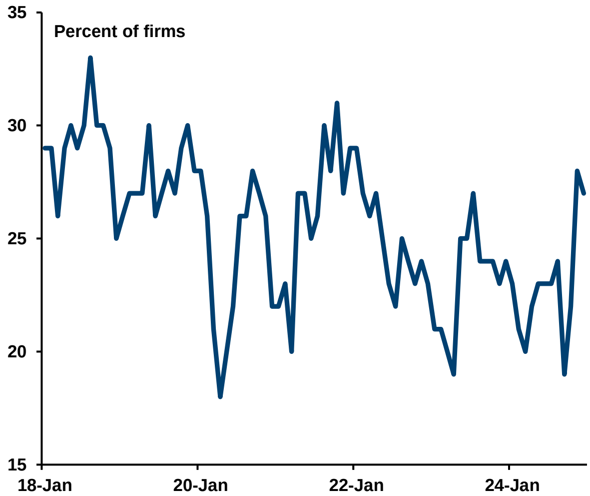
NFIB: Firms Expecting Economy to Improve



Source: National Federation of Independent Business via Haver Analytics

Among the 10 components that factor into the headline measure, we note three. Particularly impressive, the share of firms expecting the economy to improve (less the share expecting it to weaken) rose to the top of the range of the past 25 years (trailing only a reading of 53 percent in March 2020). The measure rose from -5 percent in October to 36 percent following the election and 52 percent in the latest month (versus a 2024 low of -39 percent in February; chart, above right). Additionally, while the net share of firms planning capital expenditures in the next three to six months dipped one percentage point to 27 percent, it had previously recorded the best reading since early 2022 (chart, below left). Broadly speaking, we monitor this category because it correlates with statistics on capital goods bookings. Finally, the net share of firms planning to increase employment rose for the second consecutive month – from 15 percent in October to 18 percent in November and 19 percent in the latest month. The December observation lagged by a wide margin the expansion high of 32 percent in August 2021, when the labor market was tighter, but it was consistent with pre-pandemic readings and suggests stabilization of solid underlying labor market conditions rather than raising the possibility of pending deterioration (chart, below right). Again, the recent improvement in the NFIB index is tied to expectations regarding the Trump administration's economic agenda, and if policy objectives are realized, it appears that small businesses will respond favorably with respect to investment and hiring, thereby providing a welcomed boost to output and helping to sustain the current expansion.

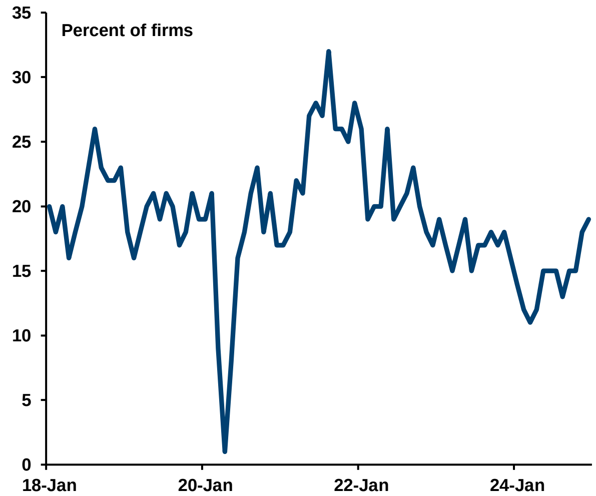
NFIB: Firms Planning Capital Expenditures*



** Next 3 to 6 months*

Source: National Federation of Independent Business via Haver Analytics

NFIB: Firms Planning to Increase Employment



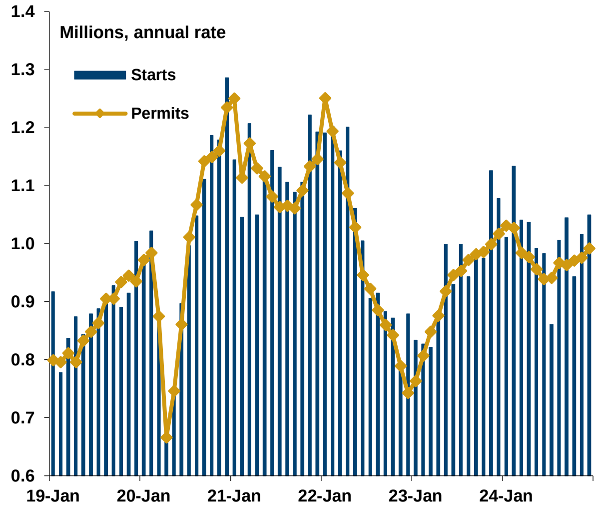
Source: National Federation of Independent Business via Haver Analytics

Upside Surprises on Housing Starts and Industrial Production

Friday releases of data on housing starts and industrial production for December were firm, a welcome development, although we suspect that the latest reading overstated underlying strength in residential construction and manufacturing – two cyclical areas that have faced challenges on account of restrictive monetary policy.

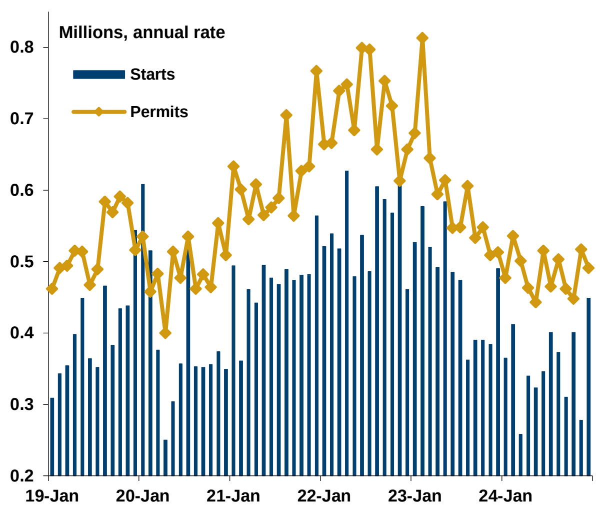
Although we currently project residential construction to be a drag on economic growth in 2025, and expect headwinds to remain for the housing market, we were pleasantly surprised that housing starts in December printed well above the Bloomberg median expectation (+15.8 percent to 1.499 million, annual rate, versus a pace of 1.327 million projected). Both single-and multi-family activity contributed to the latest advance, increasing 3.3 percent to 1.050 million and 61.5 percent to 0.499 million, respectively. Both readings were below the best of the current cycle but comparable to those that prevailed prior to the onset of the pandemic (charts, below).

Single-Family Housing Starts & Permits



Source: U.S. Census Bureau via Haver Analytics

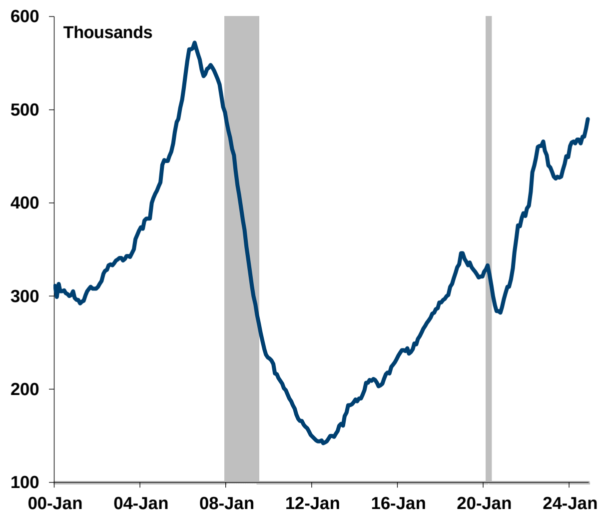
Multi-Family Housing Starts & Permits



Source: U.S. Census Bureau via Haver Analytics

Despite the strong reading on housing starts and ongoing recovery in the National Association of Home Builders Housing Market Index from the 2024 low of 39 to 47 in January (latest results released on January 16), caution is warranted. Importantly, building permit issuance slipped in December (-0.7 percent). Single-family authorizations rose (+1.6 percent to 0.992 million, annual rate), while multi-family permits fell (-5.0 percent to 0.491 million). The recent pattern of permit issuance for the single-family sector suggests that the current pace of starts may be maintained, but is unlikely to break out of the recent range (see charts above). Additionally, with inventories of new homes available for sale elevated from a long-term perspective, builders may proceed cautiously to avoid a further buildup (chart, right). Given the drop in permits and cooling in at least some major rental markets, multi-family starts may give back at least a portion of the December gain over the next few months. Moreover, we would emphasize that starts are inherently volatile and that some of the largest gains in December occurred in the South – where hurricanes in recent months may have contributed to previous downside volatility and the large gain in December. Thus, interpret cautiously.

Inventory of Unsold New Homes*

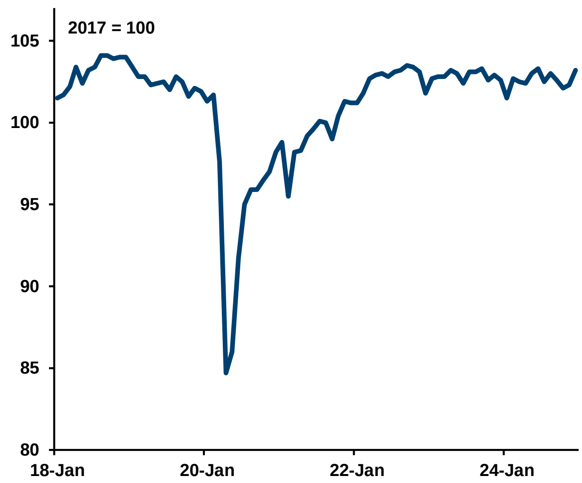


** The shaded areas indicate periods of recession in the United States.*

Sources: U.S. Census Bureau, National Bureau of Economic Research via Haver Analytics

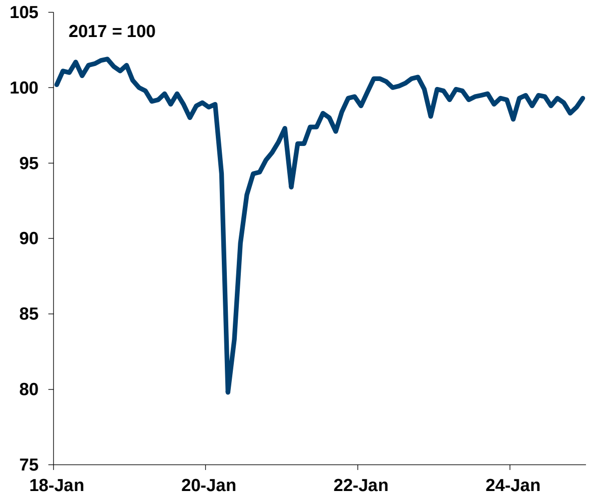
Industrial production similarly exceeded the Bloomberg consensus median with an advance of 0.9 percent (versus +0.3 percent projected). The series tilted higher on a year-over-year basis (+0.5 percent), but the trend is unimpressive (chart, right). The two key industry groups in the report – manufacturing and mining – rose briskly (+0.6 percent and +1.8 percent, respectively, corresponding with tepid year-over-year changes: 0.0 percent and +0.3 percent; charts, below). Mining activity may again be picking up as oil prices have risen recently and prospects for industry deregulation have increased given the Trump administration's pro-drilling stance. The bounce in manufacturing, however, may ease. Manufacturing sentiment gauges (the ISM index, for example) remain in contraction territory, and the potential for tariffs and a trade war may have pulled forward some production while posing headwinds for activity later next year. Additionally, a portion of the December strength in manufacturing was tied to a surge of 6.3 percent in the aerospace industry, which likely represented a ramp-up of activity after resolution of strikes – a transient burst. Thus, as with housing starts, the December data were strong, but the performance may not be sustained into Q1.

Industrial Production: Total



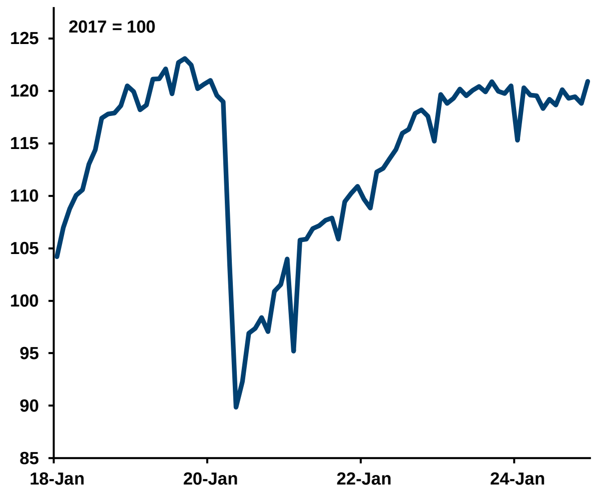
Source: Federal Reserve Board via Haver Analytics

Industrial Production: Manufacturing



Source: Federal Reserve Board via Haver Analytics

Industrial Production: Mining



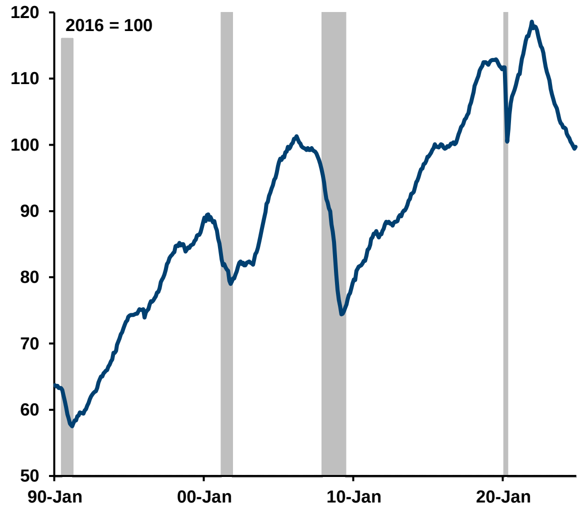
Source: Federal Reserve Board via Haver Analytics

The Week Ahead

Leading Indicators (December) (Wednesday)
Forecast: -0.1%

Anticipated negative contributions from consumer expectations and the ISM new orders index are likely to offset positive contributions from stock prices and the factory workweek, thus raising the possibility of a contraction in the Conference Board Leading Economic Index in December for the 32nd time in the past 34 months. If the forecast is realized, the latest reading would be 16.0 percent below the cycle peak of 118.6 in December 2021. Although the easing seen over the past two years would typically be consistent with the U.S. economy entering recession, economic data still point to ongoing expansion despite still-restrictive monetary policy (chart).

Index of Leading Economic Indicators*



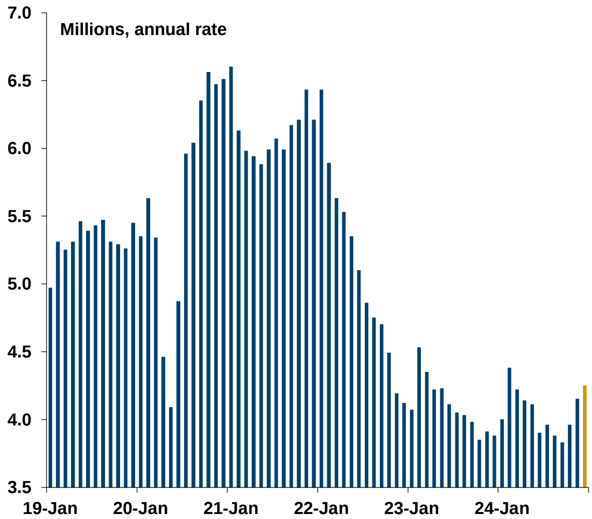
** The shaded areas indicate periods of recession in the United States.*

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

Existing Home Sales (December) (Friday)
Forecast: 4.25 Million (+2.4%)

Recent increases in the index of pending home sales raise the possibility of a third consecutive pickup in existing home sales in December (note that existing home sales are based on closings, with pending home sales usually translating to closings in the next one to three months; chart, below left). The projected pace of sales, however, would still be in the low end of the long-run range, with affordability constraints generated by elevated mortgage rates and tight inventories still constraining this segment of the housing market (chart, below right).

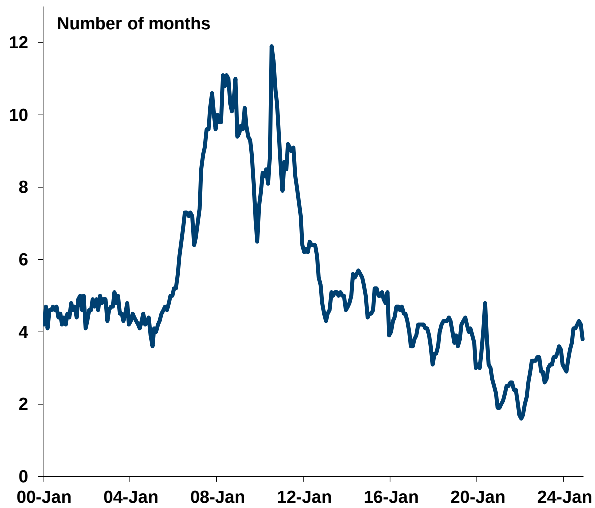
Existing Home Sales*



** The gold bar is a forecast for December 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

Economic Indicators

January/February 2025

Monday	Tuesday	Wednesday	Thursday	Friday
13	14	15	16	17
	NFIB SMALL BUSINESS OPTIMISM INDEX Oct 93.7 Nov 101.7 Dec 105.1 **PPI** Final Demand / Ex. Food & Energy Oct 0.2% 0.2% Nov 0.4% 0.2% Dec 0.2% 0.0% **FEDERAL BUDGET** 2024 / 2023 Oct -$257.5B -$66.6B Nov -$366.8B -$314.0B Dec -$86.7B -$129.4B	**CPI** Total / Core Oct 0.2% 0.3% Nov 0.3% 0.3% Dec 0.4% 0.2% **EMPIRE MFG** Nov 20.2 Dec 2.1 Jan -12.6 **BEIGE BOOK** **January 2025:** "Economic activity increased slightly to moderately across the twelve Federal Reserve Districts in late November and December."	**UNEMPLOYMENT CLAIMS** Initial / Continuing (millions) Dec 21 0.220 1.834 Dec 28 0.211 1.877 Jan 4 0.203 1.859 Jan 11 0.217 N/A **RETAIL SALES** Total / Ex.Autos Oct 0.6% 0.2% Nov 0.8% 0.2% Dec 0.4% 0.4% **IMPORT/EXPORT PRICES** Non-Petrol Imports / Nonagri. Exports Oct 0.2% 0.9% Nov 0.2% 0.0% Dec 0.2% 0.3% **PHILADELPHIA FED MFG BUSINESS OUTLOOK** Nov -4.4 Dec -10.9 Jan 44.3 **NAHB HOUSING INDEX** Nov 46 Dec 46 Jan 47 **BUSINESS INVENTORIES** Inventories / Sales Sep 0.0% 0.3% Oct 0.0% 0.0% Nov 0.1% 0.5%	**HOUSING STARTS** Oct 1.344 million Nov 1.294 million Dec 1.499 million **IP & CAP-U** IP / Cap.Util. Oct -0.5% 77.0% Nov 0.2% 77.0% Dec 0.9% 77.6% **TIC FLOWS** Long-Term / Total Sep $216.1B $398.5B Oct $159.1B $201.8B Nov $79.0B $159.9B
20	21	22	23	24
MARTIN LUTHER KING JR DAY		**LEADING INDICATORS (10:00)** Oct -0.4% Nov 0.3% **Dec -0.1%**	**UNEMP. CLAIMS (8:30)**	**EXISTING HOME SALES (10:00)** Oct 3.960 million Nov 4.150 million **Dec 4.250 million** **REVISED CONSUMER SENTIMENT (10:00)** Nov 71.8 Dec 74.0 Jan (p) 73.2
27	28	29	30	31
CHICAGO FED NATIONAL ACTIVITY INDEX **NEW HOME SALES**	**DURABLE GOODS ORDERS** **FHFA HOME PRICE INDEX** **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** **CONFERENCE BOARD CONSUMER CONFIDENCE** **FOMC MEETING (FIRST DAY)**	**INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES** **FOMC RATE DECISION**	**UNEMP. CLAIMS** **Q4 GDP** **PENDING HOME SALES**	**PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX** **EMPLOYMENT COST INDEX** **MNI CHICAGO BUSINESS BAROMETER**
3	4	5	6	7
ISM MFG. INDEX **CONSTRUCTION** **VEHICLE SALES**	**FACTORY ORDERS** **JOLTS DATA**	**ADP EMPLOYMENT** **TRADE BALANCE** **ISM SERVICES INDEX**	**UNEMP. CLAIMS** **PRODUCTIVITY & COSTS**	**EMPLOYMENT REPORT** **CONSUMER SENTIMENT** **WHOLESALE TRADE** **CONSUMER CREDIT**

Forecasts in bold. (p) = preliminary

Treasury Financing

January/February 2025

Monday	Tuesday	Wednesday	Thursday	Friday
13	14	15	16	17
AUCTION RESULTS: Rate Cover 13-week bills 4.225% 3.09 26-week bills 4.180% 2.81	**AUCTION RESULTS:** Rate Cover 42-day CMBs 4.240% 2.92 **ANNOUNCE:** $64 billion 17-week bills for auction on Jan 15 $95 billion 4-week bills for auction on Jan 16 $90 billion 8-week bills for auction on Jan 16 **SETTLE:** $64 billion 17-week bills $95 billion 4-week bills $90 billion 8-week bills	**AUCTION RESULTS:** Rate Cover 17-week bills 4.210% 3.19 **SETTLE:** $58 billion 3-year notes $39 billion 10-year notes $22 billion 30-year bonds	**AUCTION RESULTS:** Rate Cover 4-week bills 4.240% 2.74 8-week bills 4.235% 2.89 **ANNOUNCE:** $156 billion 13-,26-week bills for auction on Jan 21 $48 billion 52-week bills for auction on Jan 21 $13 billion 20-year bonds for auction on Jan 22 $20 billion 10-year TIPS for auction on Jan 23 $85 billion 42-day CMBs for auction on Jan 21 $65 billion 33-day CMBs for auction on Jan 22 **SETTLE:** $156 billion 13-,26-week bills $85 billion 42-day CMBs	
20	21	22	23	24
MARTIN LUTHER KING JR DAY	**AUCTION:** $156 billion 13-,26-week bills $48 billion 52-week bills $85 billion 42-day CMBs **ANNOUNCE:** $64 billion* 17-week bills for auction on Jan 22 $95 billion* 4-week bills for auction on Jan 23 $90 billion* 8-week bills for auction on Jan 23 **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 $65 billion 33-day CMBs	**AUCTION:** $95 billion* 4-week bills $90 billion* 8-week bills $20 billion 10-year TIPS **ANNOUNCE:** $156 billion* 13-,26-week bills for auction on Jan 27 $69 billion* 2-year notes for auction on Jan 27 $70 billion* 5-year notes for auction on Jan 27 $44 billion* 7-year notes for auction on Jan 28 $30 billion* 2-year FRNs for auction on Jan 28 **SETTLE:** $156 billion 13-,26-week bills $48 billion 52-week bills $85 billion 42-day CMBs $65 billion 33-day CMBs	
27	28	29	30	31
AUCTION: $156 billion* 13-,26-week bills $69 billion* 2-year notes $70 billion* 5-year notes	**AUCTION:** $44 billion* 7-year notes $30 billion* 2-year FRNs **ANNOUNCE:** $64 billion* 17-week bills for auction on Jan 29 $95 billion* 4-week bills for auction on Jan 30 $90 billion* 8-week bills for auction on Jan 30 **SETTLE:** $64 billion* 17-week bills $95 billion* 4-week bills $90 billion* 8-week bills	**AUCTION:** $64 billion* 17-week bills	**AUCTION:** $95 billion* 4-week bills $90 billion* 8-week bills **ANNOUNCE:** $156 billion* 13-,26-week bills for auction on Feb 3 **SETTLE:** $156 billion* 13-,26-week bills	**SETTLE:** $13 billion 20-year bonds $20 billion 10-year TIPS $69 billion* 2-year notes $70 billion* 5-year notes $44 billion* 7-year notes $30 billion* 2-year FRNs
3	4	5	6	7
AUCTION: $156 billion* 13-,26-week bills	**ANNOUNCE:** $64 billion* 17-week bills for auction on Feb 5 $95 billion* 4-week bills for auction on Feb 6 $90 billion* 8-week bills for auction on Feb 6 **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 Feb 11 $42 billion* 10-year notes for auction on Feb 12 $25 billion* 30-year bonds for auction on Feb 13	**AUCTION:** $95 billion* 4-week bills $90 billion* 8-week bills **ANNOUNCE:** $156 billion* 13-,26-week bills for auction on Feb 10 **SETTLE:** $156 billion* 13-,26-week bills	

**Estimate*