U.S. Economic Comment

- Fed Preview: a tonal shift by policymakers, along with data developments, point to no change in the federal funds rate
- Growth in 2024: Q4 GDP potentially softer than consensus, but firm performance expected for the year

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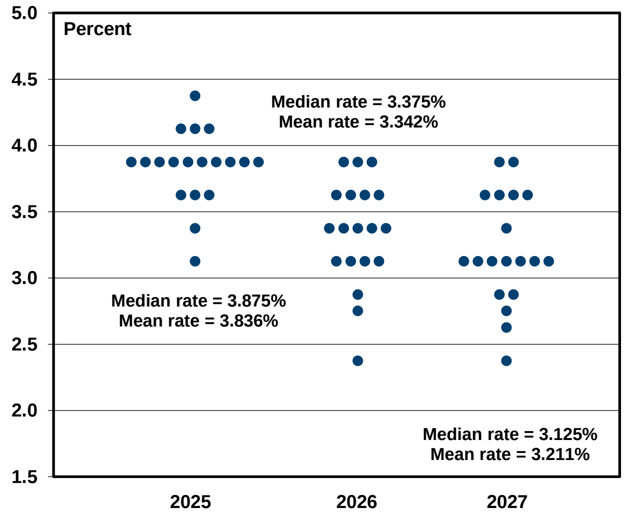
Next Week's FOMC Meeting

We see limited prospects for a surprise outcome at the January 28-29 FOMC meeting, with officials likely to maintain the federal funds rate in a range of 4-1/4 to 4-1/2 percent after reducing the policy rate by 100 basis points over the final three gatherings of 2024. Inflation and labor market data have changed little since the mid-December meeting, when officials were already debating whether further cuts were appropriate given recent economic developments. At the time, Chair Powell responded to a reporter's question by indicating that the decision "was a closer call," and the minutes from the meeting later noted that "participants indicated that the Committee was at or near the point at which it would be appropriate to slow the pace of policy easing" and "a majority of participants noted that their judgments about this meeting's appropriate policy action had been finely balanced." Importantly, those views contributed to a shift in the December dot plot to show a median expectation for two cuts in 2025 (3.875 percent midpoint for the federal funds rate versus 4.375 percent currently), up from a 2025 year-end expectation of 3.375 percent as of September (chart, below left). The tonal shift, along with comments by policymakers ahead of the blackout period, have contributed to futures pricing implying an almost 100 percent chance of no change in the fed funds rate at the upcoming meeting (chart, below right).

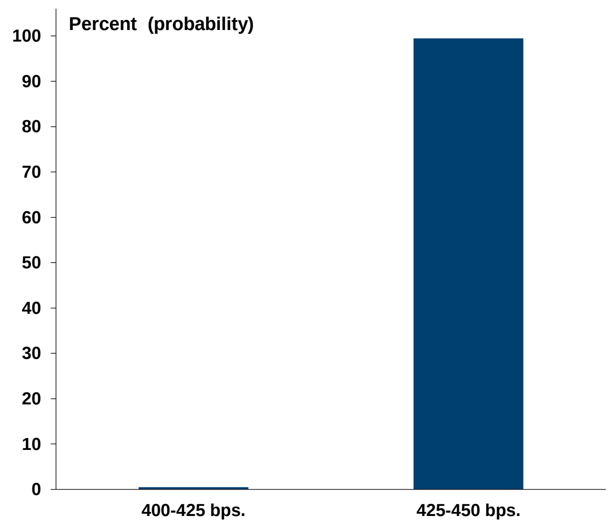
FOMC Rate View, December 2024*



** 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, December 2024

Target Rate Probability for Jan. Fed Meeting*

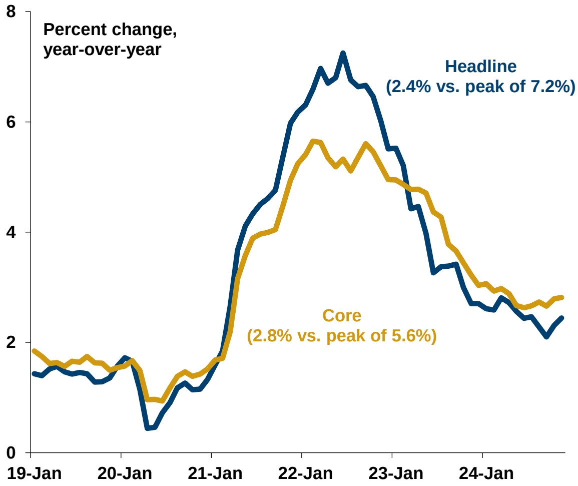


** The implied target range for the federal funds rate following the January 28-29, 2025 meeting based on futures pricing data as of midday January 24, 2025.*

Source: CME Group, FedWatch tool

Officials' assessments are unsurprising in light of the recent data. Inflation measured by the price index for personal consumption expenditures, the Federal Reserve's preferred inflation gauge, fell from a cycle peak of 7.2 percent year-over-year in June 2022 to 2.1 percent in September 2024 before ticking higher 2.4 percent in November (latest available). Perhaps worthy of closer attention, core inflation – while down from the cycle high of 5.6 percent in February 2022 – had been moving sideways since the summer before ticking higher more recently, predominately because of sticky inflation in the services area (+2.8 percent year-over-year in November; chart, next page, right). Moreover, based on results for the consumer and producer price indexes, we estimate that both measures are unlikely to show improvement in December (see writeup on the personal income and consumption, below). Concurrently, although labor market conditions have cooled, they have not shown signs of undesirable deterioration. Job growth averaged 186,000 per month in 2024, moderately better than the 166,000 average in 2019 – a period identified by Fed Chair Powell as having highly favorable labor market conditions wherein underlying wage growth did not generate unsustainable inflationary pressures. Similarly, while the unemployment rate has increased from 3.7 percent to 4.1 percent in December, it remained below officials' longer-run estimates (4.2 percent median in the December Summary of Economic Projections). In other words, a solid labor market will allow policymakers to be patient and leave the federal funds rate unchanged at a still somewhat restrictive level in response to sticky inflation.

PCE Price Indexes



Source: Bureau of Economic Analysis via Haver Analytics

The Committee Statement & Powell's Press Conference

Given that a new Summary of Economic Projections is not due until March, we will have to rely on the Committee's statement and the Fed Chair's press conference for signals on the future path of monetary policy. With respect to the statement, we expect few changes -- none of which are likely to be material. Given the latest growth and employment-related data, the first paragraph of the statement is likely to maintain language from December 2024 indicating that "economic activity has continued to expand at a solid pace" and that unemployment "remains low." Moreover, absent further progress on inflation, we suspect previous language also will be kept: "Inflation has made progress toward the Committee's 2 percent objective but remains somewhat elevated." Importantly, we look for the third paragraph to again include what we interpret as a bias toward lower rates: "In considering the extent and timing of additional adjustments…" That language does not indicate specific direction, but read in context of officials' ongoing attentiveness to labor market conditions (and their regular discussion of neutral policy and a desire to move toward it), such an interpretation appears appropriate.

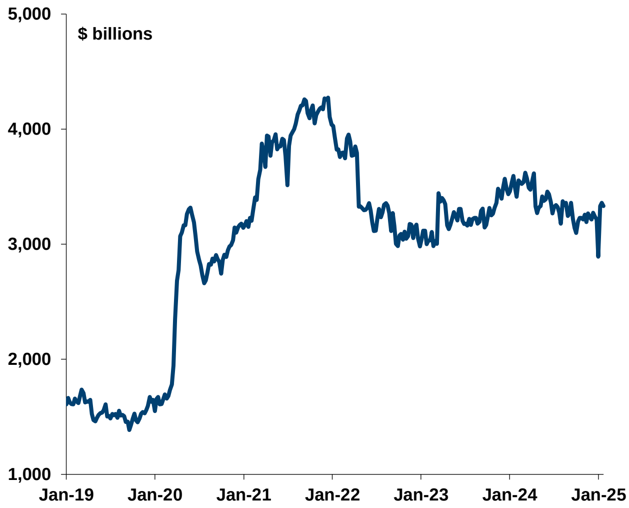
The press conference, in our view, is more likely to provide useful, forward-looking information. The Fed Chair is again inclined to reiterate that the economy is in a good place and that the path of policy will be determined, in part, by the incoming data. Moreover, he could again emphasize that risks to the outlook are roughly in balance and that monetary policy remains well positioned to deal with either upside risks to inflation or downside developments in the labor market. We will be most keen to see if Chair Powell gives clues about Committee leanings at upcoming meetings, with Governor Waller recently suggesting he was open to further cuts in the first half of the year while others like New York Fed President John Williams suggesting that he was content to be patient. Additionally, we hope to learn if policymakers are proactively calibrating views on what President Trump's agenda will mean for the conduct of monetary policy – and to see if they will respond to his recent bluster in Davos about demanding that the FOMC cut the policy rate. We hope for clarity beyond the indication that some officials used placeholder assumptions in their forecasts, but in fairness, we still have few clues on how the President will proceed with respect to tariffs.

Quantitative Tightening: Changes Pending?

While formal updates on quantitative tightening are probably not on tap until the spring, preliminary discussions concerning the end of the program are probably taking place behind the scenes. The Fed's securities portfolio has fallen by $2 trillion to $6.5 trillion, with monthly runoff caps of $25 billion for Treasuries (previously $60 billion until June 2024) and $35 billion for mortgage-backed securities. Redemptions have concurrently drained reserves from the banking system, with Fed officials endeavoring to transition from an "abundant" to "ample" reserves regime. On the point, the precise definitions of "abundant" and "ample" are somewhat murky, with policymakers aware of the risks to market function if reserves become scarce and are thus likely to slow or end the program if signs of stress emerge in money markets. To date, Fed officials are happy to let the program proceed but will probably err on the side of caution if they see deterioration in market function (akin to what was seen during the September 2019 episode when repo rates spiked and required forceful emergency action by the Fed to calm markets).

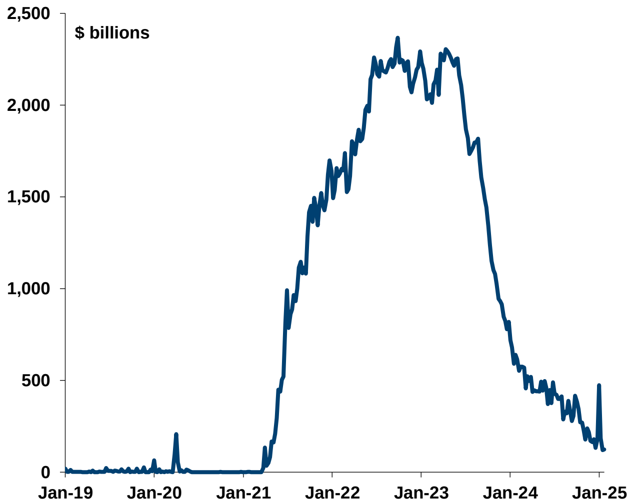
The charts below illustrate the steady drain in reserves consistent with portfolio runoff. Uptake at the RRP facility, which absorbed excess funds beyond those required by banks, has fallen from a peak of approximately $2.4 trillion in September 2022 to $124 billion as of January 22 (end-of-period data). Bank reserves are currently in the area of $3.3 trillion (charts). In context, we view prior comments by Fed officials as contributing to the view that the program will end sometime around mid-year (June, by our current calculations) – when reserves approach $3.0 trillion or approximately 10 percent of nominal GDP. At that time, we project that officials will allow continued runoff of MBS (with a desire to return to a Treasuries-only portfolio), and that maturing securities will be rolled into Treasuries. Over time, additional Treasury purchases (probably shorter-dated coupons) may occur as the economy grows, as to maintain the reserves-to-GDP ratio at 10 percent. With that said, we again emphasize that market function will be the most critical determinant of ongoing QT.

Reserve Balances with Federal Reserve Banks*



** Weekly end-of-period data as of Wednesday*
Source: H.4.1 Report, Federal Reserve Board via Haver Analytics

Reverse Repurchase Agreements*



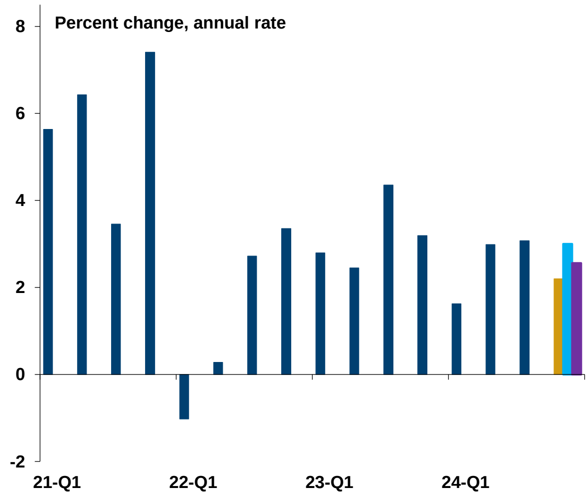
** Weekly end-of-period data as of Wednesday. Excludes transactions with foreign official institutions.*
Source: H.4.1 Report, Federal Reserve Board via Haver Analytics

The U.S. Economy: On Solid Footing Entering 2025

The first estimate of Q4 GDP (releasing on January 30) is likely to suggest that the economy remained on a solid track in the closing months of the year, with the performance setting the stage for a similar trajectory in early 2025. In essence, the U.S. economy is in the midst of the soft landing scenario previously viewed by Fed officials as an unlikely outcome when policymakers first raised interest rates to counter entrenched inflation. Despite previous risk generated by a rapid and sustained increase in monetary policy, economic expansion has evolved into what we view as the baseline scenario for 2025.

Taking a granular view, our final tracking estimate of monthly data suggests GDP growth of 2.2 percent, annual rate. The estimate lags the Atlanta Fed GDPNow projection of 3.0 percent (as of January 17) and the New York Fed Staff's Nowcast of 2.56 percent (January 24 estimate), but it is within the range of projections submitted to the Bloomberg survey of economists (median forecast of

GDP Growth*

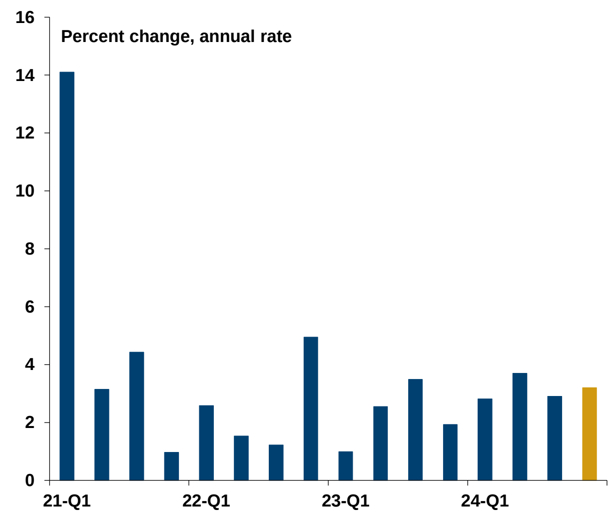


** The gold, light blue, and purple bars are forecasts for 2024-Q4 from DCMA, the Atlanta Fed's GDPNow model, and the New York Fed's Nowcast model, respectively.*
Sources: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America; Federal Reserve Banks of Atlanta & New York

+2.6 percent, with a range of +1.9 percent to +2.8 percent; chart, prior page, bottom right). Moreover, our forecast is consistent with firm Q4/Q4 growth of 2.5 percent – a reading that is well above both Fed officials' and the Congressional Budget Office's views on longer-term growth. In that regard, the median expectation of longer-run growth in the FOMC's December Summary of Economic Projections was 1.8 percent, while the CBO's *The Budget and Economic Outlook: 2025 to 2035* projected real potential growth to average 2.0 percent over the forecast horizon – including an average of 2.2 percent from 2025 to 2029 (https://www.cbo.gov/publication/60870).

Underpinning our projection is firm domestic demand driven by brisk consumer spending. We would not have been shocked if households had taken pause after brisk outlays drove growth of real consumer spending of 3.7 percent, annual rate, in Q3, but our calculations imply another strong performance in Q4 (+3.2 percent expected, consistent with Q4/Q4 growth of 2.9 percent; chart, below left). The business sector, in contrast, is likely to turn in a soft performance (a contraction of 1.5 percent in business fixed investment expected, consistent with Q4/Q4 growth of 2.7 percent). Notably, after back-to-back strong quarters, equipment spending could hit a soft spot (a contraction of 8.0 percent anticipated after average growth of 10.3 percent Q2 and Q3). With that said, we are hopeful that capital expenditures will turn higher next year. The question on capital goods plans in the National Federation of Independent Business' Small Business Economic Trends report, which correlates with durable goods orders, had jumped in response to the election of President Trump (chart, below right). Thus, if the Trump administration ratifies the expectations of the business community with sound policy, the business sector may rebound next year from the expected disappointing results for Q4. All this to say, we look for momentum from 2024 to carry into next year, sustaining an economic expansion that has persisted though numerous challenges – although with some slowing likely given previous monetary policy restraint.

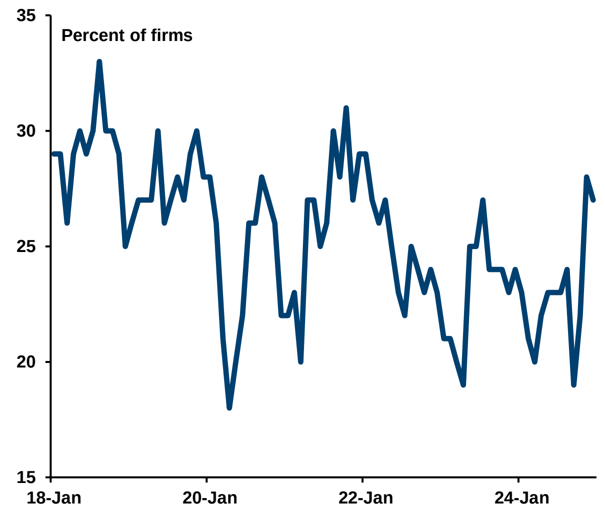
Growth of Real Consumer Spending*



** The gold bar is a forecast for 2024-Q4.*

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

NFIB: Firms Planning Capital Expenditures*



** Next 3 to 6 months*

Source: National Federation of Independent Business via Haver Analytics

Note to readers:

The next U.S. economic comment will be published on February 7, 2025.

The Week Ahead

New Home Sales (December) (Monday)
Forecast: 0.665 Million (+0.2%)

Modest changes in mortgage applications for a home purchase and potential buyer traffic suggest that new home sales remained rangebound in December after an increase of 5.9 percent to 0.664 million units, annual rate, in the prior month. If the projection is realized, the pace of activity would remain close to the middle of the recent range (average of 0.681 million, annual rate in 2024 thus far, with a range of 0.627 million to 0.736 million; chart). Keep in mind, however, that this data is often volatile from month-to-month.

Durable Goods Orders (December) (Tuesday)
Forecast: +1.5% Headline, +0.3% Ex. Transportation

New aircraft bookings reported by Boeing indicate that the civilian aircraft component could advance in December after falling 7.0 percent in the prior month, raising the possibility of a jump of headline index after a decline of 1.2 percent in November. That said, orders excluding the volatile transportation category have been unimpressive thus far in 2024 (+0.7 percent year-to-date).

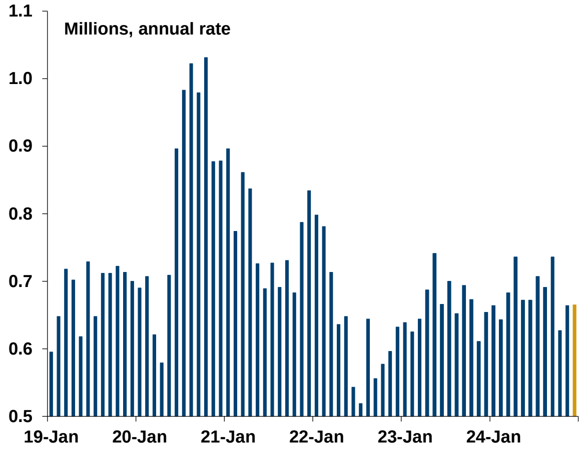
Consumer Confidence (January) (Tuesday)
Forecast: 108.0 (+3.2%)

With the U.S. economy on a firm growth track and the labor market remaining on solid footing, along with the conclusion of the 2024 election cycle, the Conference Board's measure of consumer confidence appears poised to improve in the first month of 2025 following a decline of 7.2 percent last December. While the expected reading would be in the upper end of observations in the current expansion, it would still lag results seen prior to the onset of the pandemic (chart).

International Trade in Goods (December) (Wednesday)
Forecast: -$107.0 Billion ($3.5 Billion Wider Deficit)

Trade flows are often volatile from month to month, with jumps in both imports and exports of goods in November (+4.3 and +3.3 percent, respectively; Census basis) following plunges in the prior month (-5.5 and -2.6 percent). With that said, strong domestic demand could continue to drive import flows (which have been firm, on balance, amid the aforementioned volatility), but fundamentals (sluggish demand abroad and a firm foreign exchange value of the dollar) favor a cooling in exports (chart).

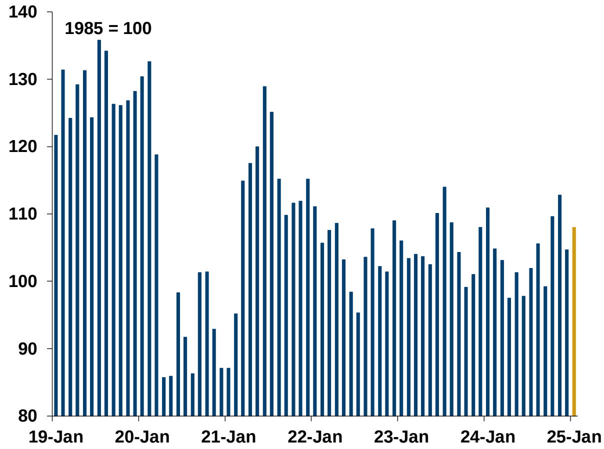
New Home Sales*



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

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

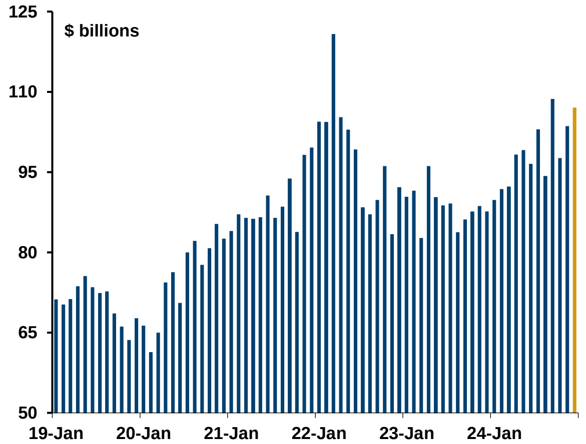
Consumer Confidence*



** The gold bar is a forecast for January 2025.*

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

Nominal Trade Deficit in Goods*



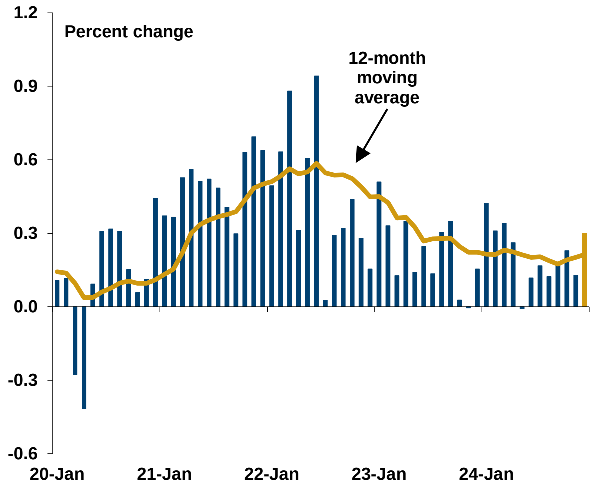
** The gold bar is a forecast for December 2024.*

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

Personal Income, Consumption, Price Indexes (December) (Friday)
Forecast: +0.4% Income, +0.5% Consumption, +0.3% Headline, +0.2% Core

An advance of 0.3 percent in average hourly earnings suggests a favorable performance in overall income growth in December. On the spending side, solid results from the latest retail sales report portend well for outlays on nondurable goods. A modest increase in vehicle sales, however, suggests only a restrained increase for durable goods outlays. Spending on services has remained on an upward trajectory in 2024 thus far. Results for the CPI and PPI point to increases of 0.3 percent for the headline PCE price index and 0.2 percent for the core (charts, below). The projected readings would translate to year-over-year advances of 2.6 percent for the headline (versus 2.4 percent in November) and 2.8 percent for the core (essentially unchanged from the prior month).

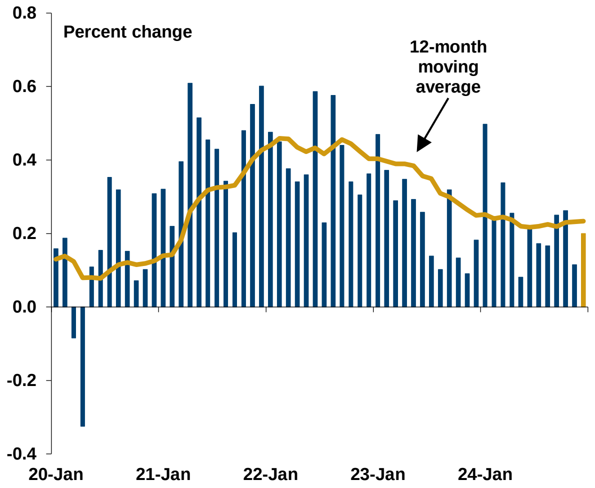
Headline PCE Price Index*



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

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

Core PCE Price Index*



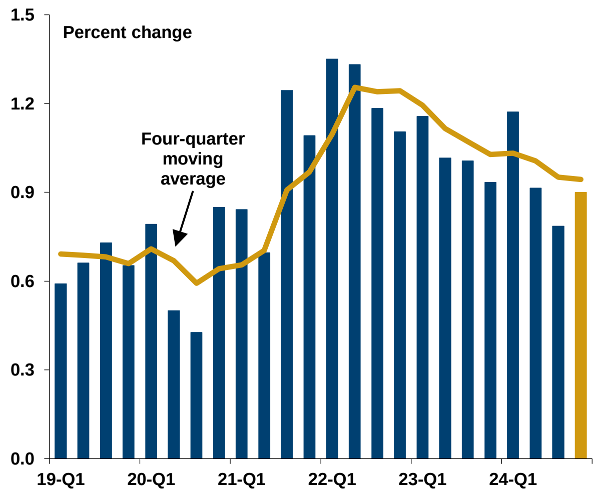
** The gold bar is a forecast for December 2024.*

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

Employment Cost Index (24-Q4) (Friday)
Forecast: +0.9%

Readings on average hourly earnings from the employment report suggest that compensation growth in Q4 could be closer to readings of 0.8 and 0.9 percent (not annualized) in Q3 and Q2, respectively, versus +1.2 percent advance in Q1 (chart). If the projection is realized, annual growth in the ECI (Q4/Q4 basis) would register 4.1 percent in 2024 (0.1 percentage point below the 4.2 percent observation in 2023 and well below growth of 5.1 percent in 2022), a reading consistent with assessments by Fed officials that the labor market is no longer a source of undesirable inflation pressure.

Employment Cost Index*



** The gold bar is a forecast for 2024-Q4.*

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

Economic Indicators

January/February 2025

Monday	Tuesday	Wednesday	Thursday	Friday
20	21	22	23	24
MARTIN LUTHER KING JR DAY		**LEADING INDICATORS** Oct -0.3% Nov 0.4% Dec -0.1%	**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	**EXISTING HOME SALES** Oct 3.960 million Nov 4.150 million Dec 4.240 million **REVISED CONSUMER SENTIMENT** Dec 74.0 Jan (p) 73.2 Jan (r) 71.1
27	28	29	30	31
CHICAGO FED NATIONAL ACTIVITY INDEX (8:30) Monthly 3-Mo. Avg. Oct -0.50 -0.27 Nov -0.12 -0.31 Dec -- -- **NEW HOME SALES (10:00)** Oct 0.627 million Nov 0.664 million **Dec 0.665 million**	**DURABLE GOODS ORDERS (8:30)** Oct 0.7% Nov -1.2% **Dec 1.5%** **FHFA HOME PRICE INDEX (9:00)** Sep 0.7% Oct 0.4% Nov -- **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX (9:00)** Sep 0.2% Oct 0.3% Nov -- **CONFERENCE BOARD CONSUMER CONFIDENCE (10:00)** Nov 112.8 Dec 104.7 **Jan 108.0** **FOMC MEETING (FIRST DAY)**	**INTERNATIONAL TRADE IN GOODS (8:30)** Oct -$97.5 billion Nov -$103.5 billion **Dec -$107.0 billion** **ADVANCE INVENTORIES (8:30)** Wholesale Retail Oct 0.0% 0.2% Nov -0.2% 0.2% Dec -- -- **FOMC RATE DECISION (2:00)**	**UNEMP. CLAIMS (8:30)** **GDP (8:30)** GDP Chained Price 24-Q2 3.0% 2.5% 24-Q3 3.1% 1.9% **24-Q4 (a) 2.2% 2.4%** **PENDING HOME SALES (10:00)** Oct 1.8% Nov 2.2% Dec --	**PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX (8:30)** Inc. Cons. Core Oct 0.7% 0.3% 0.3% Nov 0.3% 0.4% 0.1% **Dec 0.4% 0.5% 0.2%** **EMPLOYMENT COST INDEX (8:30)** Comp. Wages 24-Q2 0.9% 0.9% 24-Q3 0.8% 0.8% **24-Q4 0.9% 0.9%** **MNI CHICAGO BUSINESS BAROMETER (9:45)** Index Prices Nov 40.2 66.1 Dec 36.9 60.3 Jan -- --
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**
10	11	12	13	14
	NFIB SMALL BUSINESS OPTIMISM INDEX	**CPI** **FEDERAL BUDGET**	**UNEMP. CLAIMS** **PPI**	**RETAIL SALES** **IMPORT/EXPORT PRICES** **IP & CAP-U** **BUSINESS INVENTORIES**

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

Treasury Financing

January/February 2025

Monday	Tuesday	Wednesday	Thursday	Friday
20	21	22	23	24
MARTIN LUTHER KING JR DAY	**AUCTION RESULTS:** Rate / Cover 13-week bills 4.215% 2.80 26-week bills 4.165% 3.04 52-week bills 4.025% 3.14 42-day CMBs 4.250% 2.69 **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 RESULTS:** Rate / Cover 17-week bills 4.205% 3.28 20-yr bonds 4.900% 2.75 33-day CMBs 4.265% 2.70	**AUCTION RESULTS:** Rate / Cover 4-week bills 4.265% 2.88 8-week bills 4.250% 2.75 10-yr TIPS 2.243% 2.48 **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 $85 billion 42-day CMBs 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 $85 billion 42-day CMBs **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 $85 billion 42-day CMBs	**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	
10	11	12	13	14
AUCTION: $156 billion* 13-,26-week bills	**AUCTION:** $58 billion* 3-year notes **ANNOUNCE:** $64 billion* 17-week bills for auction on Feb 12 $95 billion* 4-week bills for auction on Feb13 $90 billion* 8-week bills for auction on Feb 13 **SETTLE:** $64 billion* 17-week bills $95 billion* 4-week bills $90 billion* 8-week bills	**AUCTION:** $64 billion* 17-week bills $42 billion* 10-year notes	**AUCTION:** $95 billion* 4-week bills $90 billion* 8-week bills $25 billion* 30-year bonds **ANNOUNCE:** $156 billion* 13-,26-week bills for auction on Feb 18 $48 billion* 52-week bills for auction on Feb 18 $16 billion* 20-year bonds for auction on Feb 19 $9 billion* 30-year TIPS for auction on Feb 20 **SETTLE:** $156 billion* 13-,26-week bills	

**Estimate*