U.S. Economic Comment

- Fed call: multiple cuts in 2025, but more likely in H2
- Friday data: soft retail sales; industrial production boosted by utility output

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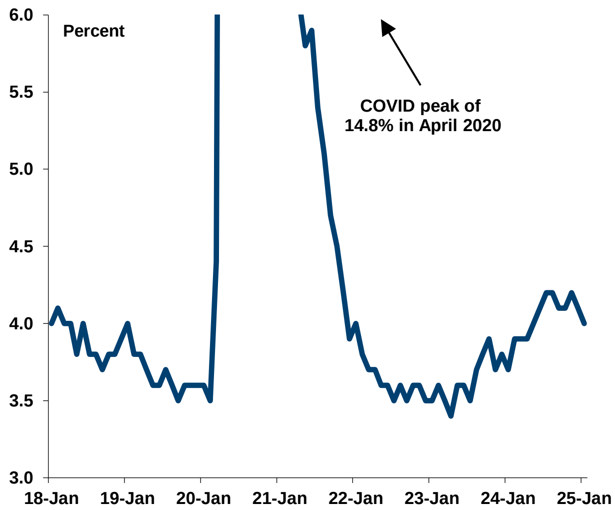
Fed Call: Cuts in Back Half of 2025

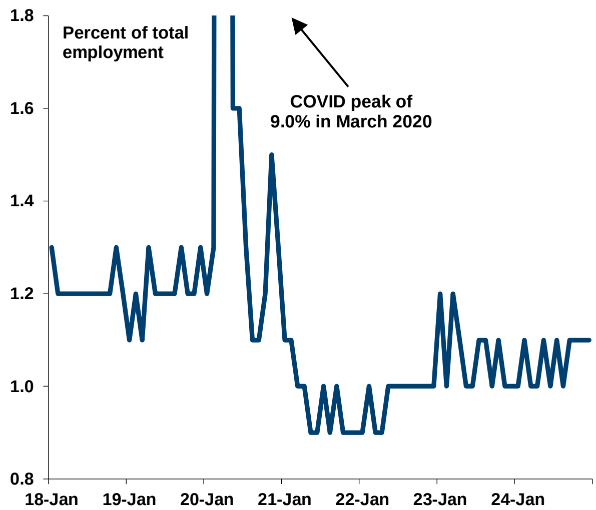
Chair Powell's remarks this week in his Semiannual Monetary Policy Testimony were broadly aligned with those following the January FOMC meeting. The latest statement noted, "With our policy stance now significantly less restrictive than it had been and the economy remaining strong, we do not need to be in a hurry to adjust our policy stance…As the economy evolves, we will adjust our policy stance in a manner that best promotes our maximum-employment and price-stability goals." We had previously interpreted past iterations as keeping open the possibility of additional reductions in the federal funds rate in the first half of 2025, but that scenario no longer seems appropriate given recent economic developments. With respect to the employment side of the mandate, officials acknowledged that unemployment was low but appeared concerned that a low hiring rate raised the possibility for a potentially sharp move higher in unemployment should layoffs accelerate (charts, below). On the inflation side, Powell argued forcefully that preconditions for a further easing toward the 2 percent target were in place. With that said, the latest round of inflation data (January CPI on Wednesday and PPI on Thursday) negated the chance of a reduction at the March 18-19 FOMC meeting while also creating a high hurdle for adjustments in both May and June.

Civilian Unemployment Rate



Source: Bureau of Labor Statistics via Haver Analytics

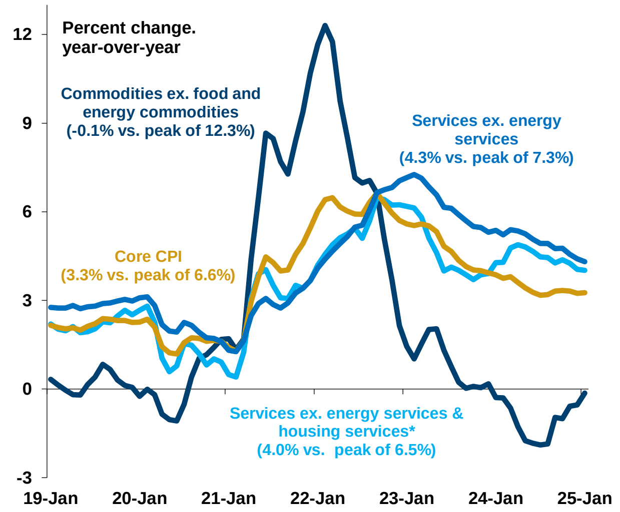
Layoffs & Discharges Rate



Source: Bureau of Labor Statistics via Haver Analytics

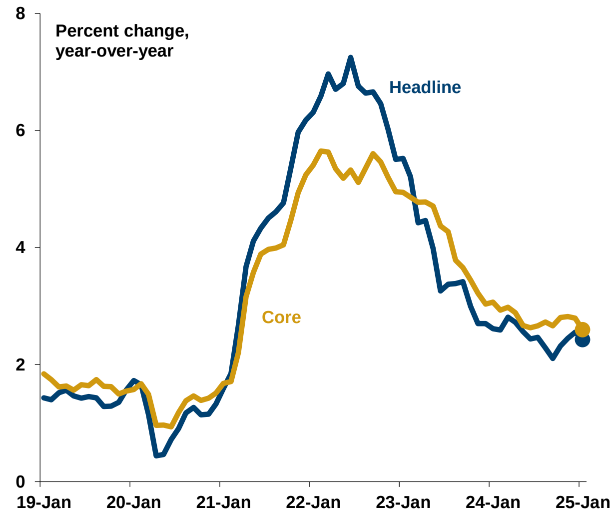
The results for the CPI were particularly jarring, as advances of 0.5 percent and 0.4 percent in the headline and core (which exceeded the Bloomberg median expectations of +0.3 percent for both) were joined by a surge of 0.8 percent in the supercore area (services ex. energy, rent of primary residence, and owners' equivalent rent of residences). Results for year-over-year growth rates were equally unfavorable, with the headline and core each increasing by one tick to 3.0 percent and 3.3 percent, respectively, while the supercore was unchanged after rounding (+4.017 percent in January versus +4.049 percent in December 2024). The release of the PPI the following day helped to temper concerns. While increases were firm (+0.4 percent for headline, and +0.3 percent excluding food and energy), and year-over-year growth rates remained elevated (+3.5 and +3.6 percent, respectively), components that feed into the calculation of the price index for personal consumption expenditures – the Fed's preferred inflation metric – recorded more modest shifts. The combined inputs suggested increases of 0.3 percent in both the headline and core PCE indexes (to be released on February 28), which would slow the year-over-year changes to +2.4 and +2.6 percent (versus +2.6 percent and +2.8 percent, respectively, in December; charts, below). Thus, the expected results could be viewed as ratifying Fed messaging about ongoing progress on inflation but also underscoring need for caution given proximity from 2 percent and potential inflation headwinds stemming from the Trump administration's trade policy.

Decomposition of Core CPI



Source: Bureau of Labor Statistics via Haver Analytics

PCE Inflation*

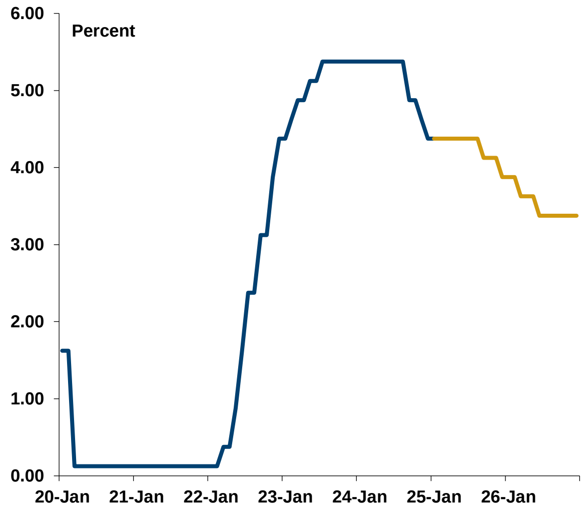


* The forecasts for January 2025 (dots) are based on an assumption of an increase of 0.3 percent for both indexes.

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

In light of the aforementioned inflation developments, we are adjusting our expectations for the timing, but not the overall size, of rate cuts this year and next. Our anticipation of further reductions of 100 basis points in cuts spread over 2025 and 2026 is informed by what we view as an implicit desire by officials to return to a neutral policy setting. Policymakers likely want to preserve the current status quo in the labor market (low unemployment, moderate real wage growth) – what we view as their dominant aim – as many but the most hawkish on the Committee appear reasonably assured that inflation will return to 2 percent soon. In this regard, Chair Powell in his January press conference emphasized that the labor market is no longer a source of price pressure (as supply and demand have come into better balance) and that further disinflation is to be achieved by further slowing in rents. That is, the necessary preconditions are now in place to return to 2 percent with time being the key ongoing variable. Trade policy could add a wrinkle to this equation, but considering almost daily shifts by the Trump team – and a previous episode in 2016-18 that yielded only modest consumer inflation pressure – we remain cautiously optimistic that tariffs are a tail risk to inflation that may not be realized. Even so, actual inflation readings in early 2025 point to later action. Therefore, we now expect cuts of 25 basis points at the September and December 2025 FOMC meetings, followed by additional same-sized reductions in March and June 2026. Importantly, while ongoing expansion remains our baseline scenario, we expect growth to slow into next year and unemployment to approach 4.5 percent. In context, that slippage and potential realized further gains on the price front will allow for removal of further monetary policy restriction.

Federal Funds Target Rate*



* The gold line shows the projected path for the federal funds rate through year-end 2026.

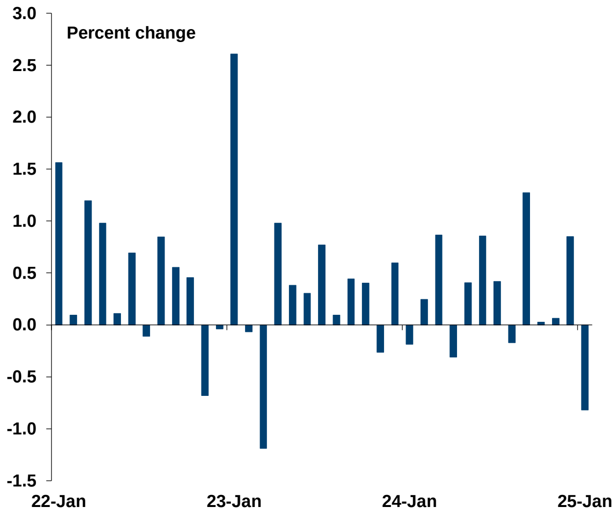
Sources: Federal Reserve Board via Haver Analytics; Daiwa Capital Markets America

The Friday Data: Retail Sales and Industrial Production

There was little in the way of positive information in the January retail sales report. The headline measure dropped 0.9 percent (versus the Bloomberg median expectation of -0.2 percent), with the retail control – which correlates with consumer outlays on goods in the GDP data – fell 0.8 percent (versus an expected pickup of 0.3 percent; chart, below left). A variety of factors were offered by pundits to explain the disappointing results, some less-than-troubling and others raising the possibility of a looming slowdown in consumer spending. On the benign side, the pullback in January could be indicative of households pausing after active spending during the holiday shopping season (recall brisk growth of real consumer spending of 4.2 percent, annual rate, in Q4 –among the best quarters of the past few years). Concurrently, wildfires in California and severe winter weather in parts of the country may have temporarily depressed activity – possibly setting the stage for a rebound in coming months. On the problematic side, the January plunge could represent the start of a pullback in response to persistent inflation or some other financial strain.

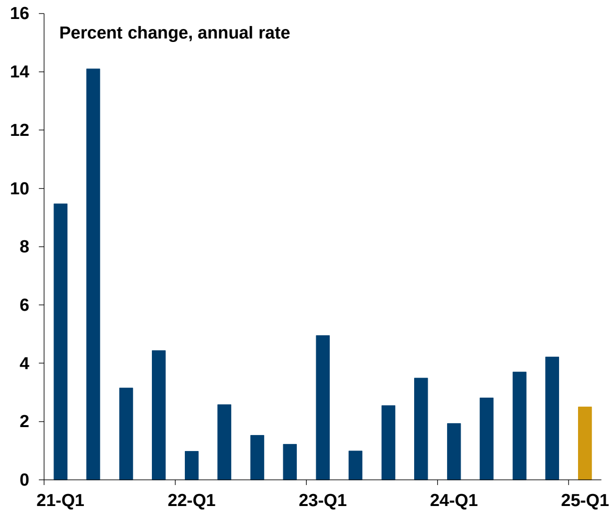
As of now, we're inclined to view things from a more optimistic lens. The job market is solid, the aggregate household balance sheet is well positioned (elevated net worth positions and restrained debt levels), and consumer delinquencies are not yet problematic. And, previously mentioned special factors offer a plausible explanation for the latest results – particularly after well-maintained spending in Q4. Time will tell, but we could easily see rebounds in the subsequent two months contributing to real consumer spending growth exceeding two percent in Q1 (chart, below right). The results would be respectable from a longer-term view – and consistent with GDP growth in the area of 2 percent.

Retail Sales: Retail Control*



** Retail sales excluding sales from motor vehicle dealers, gasoline stations, and building materials, garden equipment, and supply dealers.*
Source: U.S. Census Bureau via Haver Analytics

Real Consumer Spending Growth*

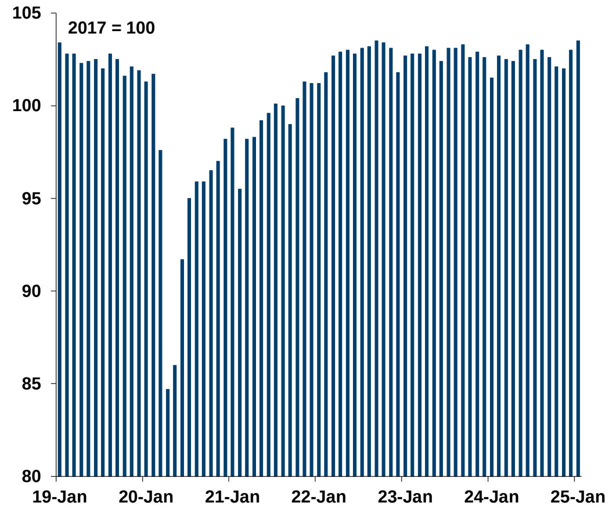


** The gold bar is a forecast for 2025-Q1.*
Sources: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

Moving on to the other major economic release of today, industrial production registered an increase of 0.5 percent (+2.0 percent year-over-year) in January -- a bit firmer than the Bloomberg median expectation of a 0.3 percent uptick, but downward revisions to prior months' data tempered to a degree the latest results (chart, next page, left). Moreover, the internals of the report were mixed: the manufacturing and mining components both softened in the latest month while utility output posted one of its strongest gains in recent years (which likely reflected demand for home heating amid adverse weather conditions).

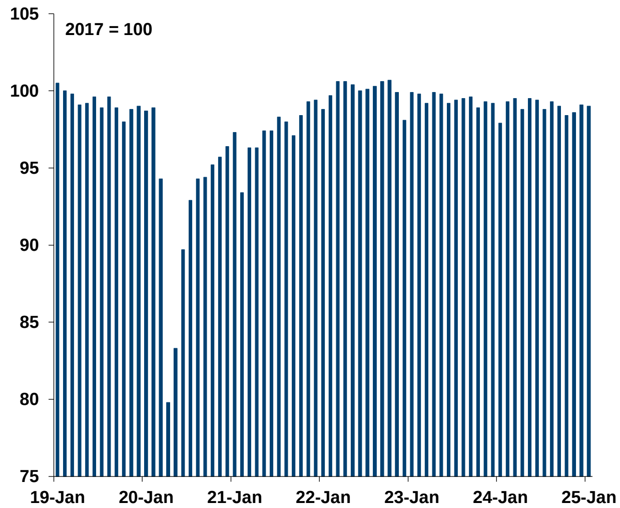
Manufacturing activity decreased 0.1 percent in the latest month (+1.0 percent year-over-year; chart, next page, right). A portion of that weakness was the result of a stark 5.2 percent drop in motor vehicles and parts (-5.9 percent year-over-year), a decline that appears at least partially attributable to extreme weather events. Activity excluding autos, on the other hand, rose 0.2 percent (+1.6 percent year-over-year), with 9 of 19 non-auto manufacturing industries registering increases in January. Of note, the aircraft and parts component surged for the second consecutive month, advancing 6.0 percent after posting an increase of 6.8 percent in December (contributing 0.2 percentage point to total industrial production growth). That said, as mentioned in the official release, this rebound in the aerospace sector likely reflects some payback following the resolution of the Boeing worker strike back in November versus an acceleration in underlying aircraft production.

Industrial Production: Headline



Source: Federal Reserve Board via Haver Analytics

Industrial Production: Manufacturing

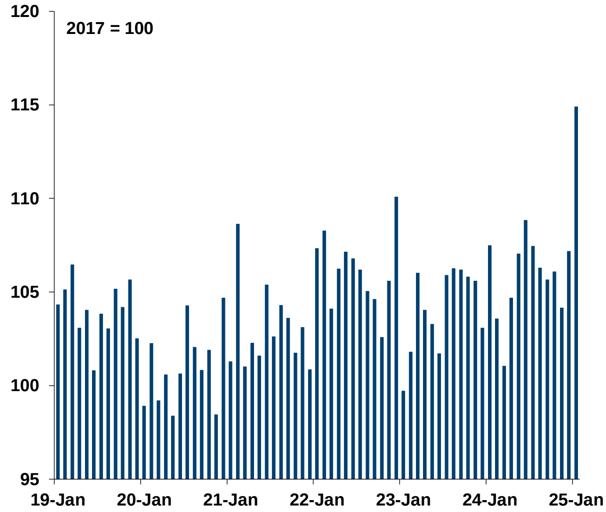


Source: Federal Reserve Board via Haver Analytics

Mining output decreased 1.2 percent in January (+3.4 percent year-over-year), its fourth decline in the past five months. Activity in the current cycle peaked in the fall of 2023 and has since moderated on balance – coinciding with the easing seen in energy commodity prices (-1.4 percent from the cycle peak of 120.9 in September 2023).

Utility output posted its largest month-to-month increase in three years in January, surging 7.2 percent (+6.9 percent year-over-year; chart). As mentioned earlier, the full onset of winter weather played a pivotal role as colder-than-average temperatures boosted demand for heating. With that in mind, this area can exhibit marked volatility, with changes often reflecting swings in weather rather than in underlying economic conditions. Thus, the latest results, on balance, were unimpressive, though we don't view them as necessarily setting the tone for 2025.

Industrial Production: Utilities



Source: Federal Reserve Board via Haver Analytics

Note to readers:

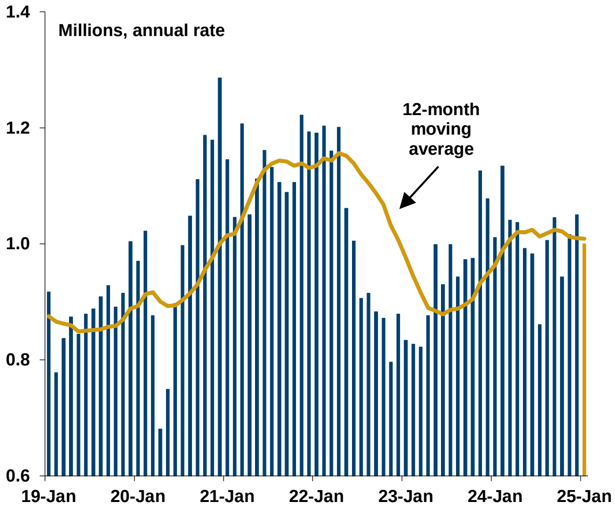
The next U.S. economic comment will be published on February 28, 2025.

The Week Ahead

Housing Starts (January) (Wednesday)
Forecast: 1.400 Million (-6.6%)

Elevated inventories of unsold new homes suggest that builders will remain cautious in initiating new single-family housing projects in early 2025, likely resulting in the pace of starts holding within the recent range (0.861 to 1.050 million units, annual rate, over the past six months; chart, below left). Multi-family starts, in contrast, often exhibit marked volatility, evidenced by the 61.5 percent surge to 0.449 million units in the final month of 2024 – a reading well above the trailing six-month average of 0.352 million (chart, below right). Thus, in light of the recent pattern of permit issuance, which included declines in four of the past six months, we expect a pullback in January.

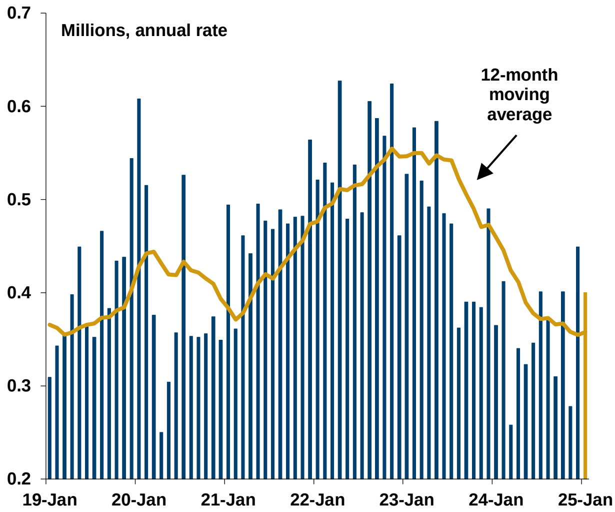
Single-Family Housing Starts*



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

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

Multi-Family Housing Starts*



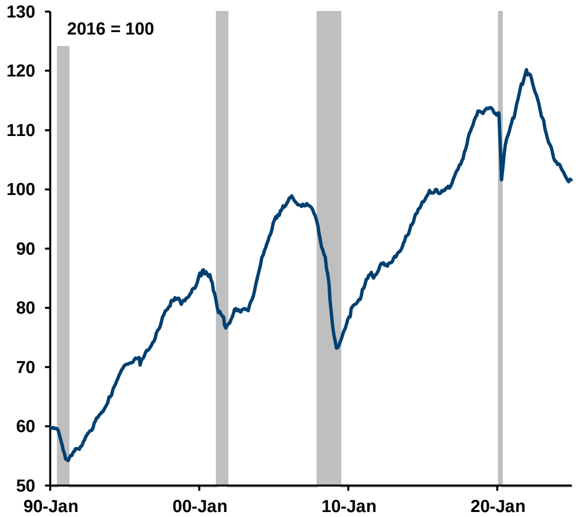
** The gold bar is a forecast for January 2025.*

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

Leading Indicators (January) (Thursday)
Forecast: -0.2%

Anticipated negative contributions from the factory workweek and consumer expectations are likely to offset a positive contribution from unemployment claims, thus raising the possibility of a contraction in the Conference Board Leading Economic Index in January for the 33rd time in the past 35 months. If the forecast is realized, the index would be 15.6 percent below the cycle peak of 120.2 in December 2021. While the easing seen over the past two years would typically be consistent with the economy entering recession, available data still indicate ongoing expansion despite headwinds generated by previously restrictive monetary policy (chart).

Index of Leading Economic Indicators*



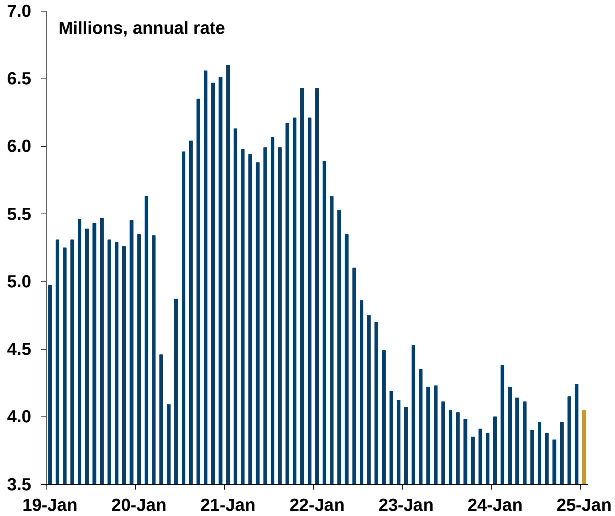
** The shaded areas indicate periods of recession in the United States.*

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

Existing Home Sales (January) (Friday)
Forecast: 4.05 Million (-4.5%)

A contraction in the index of pending home sales in December raises the possibility of a decline in existing home sales in January following advances in the prior three months. In context, constrained inventories coupled with elevated financing costs have contributed to reduced affordability for prospective buyers, thus leaving the current pace of activity in the low end of the longer-term range (charts, below).

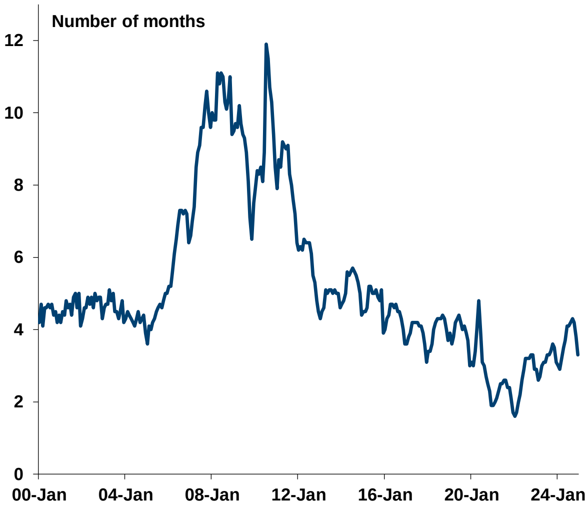
Existing Home Sales*



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

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

February/March 2025

Monday	Tuesday	Wednesday	Thursday	Friday
10	11	12	13	14
	NFIB SMALL BUSINESS OPTIMISM INDEX Nov 101.7 Dec 105.1 Jan 102.8 **CHAIR POWELL SEMI-ANNUAL MONETARY POLICY TESTIMONY (SENATE)**	**CPI** Total / Core Nov 0.3% 0.3% Dec 0.4% 0.2% Jan 0.5% 0.4% **FEDERAL BUDGET** FY2025 / FY2024 Nov -$366.8B -$314.0B Dec -$86.7B -$129.4B Jan -$128.6B -$21.9B **CHAIR POWELL SEMI-ANNUAL MONETARY POLICY TESTIMONY (HOUSE)**	**UNEMPLOYMENT CLAIMS** Initial / Continuing (millions) Jan 18 0.223 1.850 Jan 25 0.208 1.886 Feb 1 0.220 1.850 Feb 8 0.213 N/A **PPI** Final Demand / Ex. Food & Energy Nov 0.2% 0.1% Dec 0.5% 0.4% Jan 0.4% 0.3%	**RETAIL SALES** Total / Ex.Autos Nov 0.7% 0.1% Dec 0.7% 0.7% Jan -0.9% -0.4% **IMPORT/EXPORT PRICES** Non-Petrol Imports / Nonagri. Exports Nov 0.2% 0.0% Dec 0.2% 0.4% Jan 0.1% 1.5% **IP & CAP-U** IP / Cap.Util. Nov -0.1% 76.8% Dec 1.0% 77.5% Jan 0.5% 77.8% **BUSINESS INVENTORIES** Inventories / Sales Oct 0.0% 0.0% Nov 0.1% 0.6% Dec -0.2% 0.8%
17	18	19	20	21
PRESIDENTS' DAY	**EMPIRE MFG (8:30)** Dec 2.1 Jan -12.6 Feb -- **NAHB HOUSING INDEX (10:00)** Dec 46 Jan 47 Feb -- **TIC FLOWS (4:00)** Long-Term / Total Oct $159.1B $201.8B Nov $79.0B $159.9B Dec -- --	**HOUSING STARTS (8:30)** Nov 1.294 million Dec 1.499 million **Jan 1.400 million** **FOMC MINUTES (2:00)**	**UNEMP. CLAIMS (8:30)** **PHILADELPHIA FED MFG BUSINESS OUTLOOK (8:30)** Dec -10.9 Jan 44.3 Feb -- **LEADING INDICATORS (10:00)** Nov 0.4% Dec -0.1% **Jan -0.2%**	**EXISTING HOME SALES (10:00)** Nov 4.150 million Dec 4.240 million **Jan 4.050 million** **REVISED CONSUMER SENTIMENT (10:00)** Dec 74.0 Jan 71.1 Feb(p) 67.8
24	25	26	27	28
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 Q4 GDP** **DURABLE GOODS ORDERS** **PENDING HOME SALES**	**PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX** **INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES** **MNI CHICAGO BUSINESS BAROMETER**
3	4	5	6	7
ISM MFG. INDEX **CONSTRUCTION** **VEHICLE SALES**		**ADP EMPLOYMENT** **ISM SERVICES INDEX** **FACTORY ORDERS** **BEIGE BOOK**	**UNEMP. CLAIMS** **TRADE BALANCE** **REVISED PRODUCTIVITY & COSTS** **WHOLESALE TRADE**	**EMPLOYMENT REPORT** **CONSUMER CREDIT**

Forecasts in bold. (p) = preliminary

Daiwa Capital Markets

Treasury Financing

February/March 2025

Monday	Tuesday	Wednesday	Thursday	Friday
10	**11**	**12**	**13**	**14**
AUCTION RESULTS: Rate / Cover 13-week bills 4.225% 3.01 26-week bills 4.185% 2.86	**AUCTION RESULTS:** Rate / Cover 3-yr notes 4.300% 2.79 6-week CMBs 4.260% 2.91 **ANNOUNCE:** $62 billion 17-week bills for auction on Feb 12 $90 billion 4-week bills for auction on Feb 13 $85 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 RESULTS:** Rate / Cover 17-week bills 4.230% 3.38 10-yr notes 4.632% 2.48	**AUCTION RESULTS:** Rate / Cover 4-week bills 4.250% 2.93 8-week bills 4.240% 2.94 30-yr bonds 4.748% 2.33 **ANNOUNCE:** $150 billion 13-,26-week bills for auction on Feb 18 $80 billion 6-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 $85 billion 6-week CMBs
17	**18**	**19**	**20**	**21**
PRESIDENTS' DAY	**AUCTION:** $150 billion 13-,26-week bills $80 billion 6-week bills $48 billion 52-week bills **ANNOUNCE:** $62 billion* 17-week bills for auction on Feb 19 $90 billion* 4-week bills for auction on Feb 20 $85 billion* 8-week bills for auction on Feb 20 **SETTLE:** $62 billion 17-week bills $90 billion 4-week bills $85 billion 8-week bills $58 billion 3-year notes $42 billion 10-year notes $25 billion 30-year bonds	**AUCTION:** $62 billion* 17-week bills $16 billion 20-year bonds	**AUCTION:** $90 billion* 4-week bills $85 billion* 8-week bills $9 billion 30-year TIPS **ANNOUNCE:** $150 billion* 13-,26-week bills for auction on Feb 24 $80 billion* 6-week bills for auction on Feb 25 $69 billion* 2-year notes for auction on Feb 24 $70 billion* 5-year notes for auction on Feb 25 $44 billion* 7-year notes for auction on Feb 26 $28 billion* 2-year FRNs for auction on Feb 26 **SETTLE:** $150 billion 13-,26-week bills $80 billion 6-week bills $48 billion 52-week bills	
24	**25**	**26**	**27**	**28**
AUCTION: $150 billion* 13-,26-week bills $69 billion* 2-year notes	**AUCTION:** $80 billion* 6-week bills $70 billion* 5-year notes **ANNOUNCE:** $62 billion* 17-week bills for auction on Feb 26 $90 billion* 4-week bills for auction on Feb 27 $85 billion* 8-week bills for auction on Feb 27 **SETTLE:** $62 billion* 17-week bills $90 billion* 4-week bills $85 billion* 8-week bills	**AUCTION:** $62 billion* 17-week bills $44 billion* 7-year notes $28 billion* 2-year FRNs	**AUCTION:** $90 billion* 4-week bills $85 billion* 8-week bills **ANNOUNCE:** $150 billion* 13-,26-week bills for auction on Mar 3 $80 billion* 6-week bills for auction on Mar 4 **SETTLE:** $150 billion* 13-,26-week bills $80 billion* 6-week bills	**SETTLE:** $16 billion 20-year bonds $9 billion 30-year TIPS $69 billion* 2-year notes $70 billion* 5-year notes $44 billion* 7-year notes $28 billion* 2-year FRNs
3	**4**	**5**	**6**	**7**
AUCTION: $150 billion* 13-,26-week bills	**AUCTION:** $80 billion* 6-week bills **ANNOUNCE:** $62 billion* 17-week bills for auction on Mar 5 $90 billion* 4-week bills for auction on Mar 6 $85 billion* 8-week bills for auction on Mar 6 **SETTLE:** $62 billion* 17-week bills $90 billion* 4-week bills $85 billion* 8-week bills	**AUCTION:** $62 billion* 17-week bills	**AUCTION:** $90 billion* 4-week bills $85 billion* 8-week bills **ANNOUNCE:** $150 billion* 13-,26-week bills for auction on Mar 10 $80 billion* 6-week bills for auction on Mar 11 $58 billion* 3-year notes for auction on Mar 11 $39 billion* 10-year notes for auction on Mar 12 $22 billion* 30-year bonds for auction on Mar 13 **SETTLE:** $150 billion* 13-,26-week bills $80 billion* 6-week bills	

*Estimate