U.S. Economic Comment

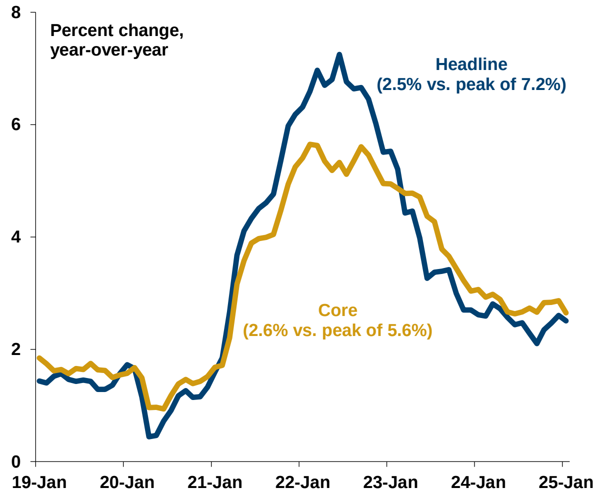
- January inflation: in line with expectations; caution still warranted
- Q1 growth: possible warning signs emerging

Lawrence Werther
lawrence.werther@us.daiwacm.com
+1-212-612-6393
Brendan Stuart
brendan.stuart@us.daiwacm.com
+1-212-612-6172

January Inflation: Further Improvement

Among the economic data released this week, the inflation data published in the Personal Income and Consumption Report adhered most closely to the prevailing narratives. That is, the latest reading – given recent results for the CPI and PPI – was expected to show ongoing improvement in underlying price dynamics, although not enough to justify near-term rate cuts – particularly amid heightened uncertainty stemming from the evolving policy priorities of the Trump administration. On the other hand, various other data suggested that the consensus view on economic growth could be off the mark (discussed below). With respect to inflation readings, both the headline and core price indexes for personal consumption expenditures (PCE) rose 0.3 percent, aligning with median expectations in the Bloomberg survey panel (consistent with year-over-year increases of 2.5 percent and 2.6 percent for the headline and core, respectively, versus 2.6 percent and 2.9 percent in the prior month; chart). Importantly, services-related components, which have been identified by Chair Powell in recent comments as likely to contribute to ongoing improvement in inflation, moderated further in January.

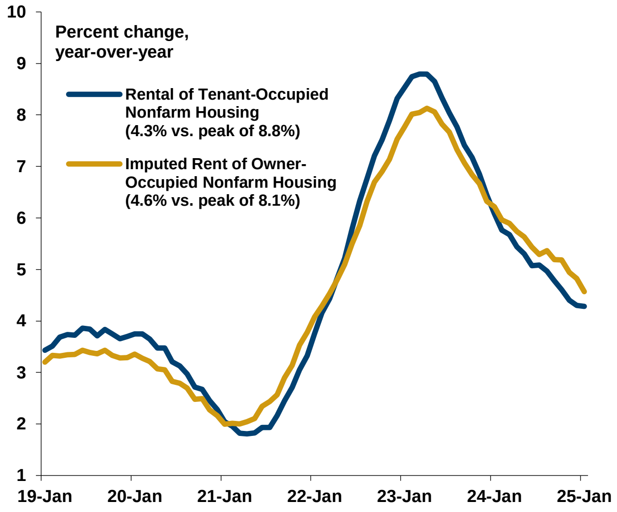
PCE Inflation



Source: Bureau of Economic Analysis via Haver Analytics

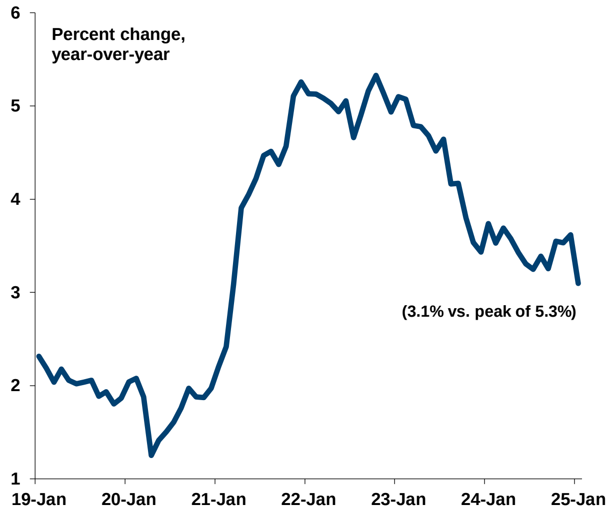
Most notable, price changes in the primary housing components are now aligning with what had previously been observed in measures of market rents – inflation moving toward the pre-pandemic trend, which was consistent with 2 percent overall price growth. Specifically, the rent of tenant-occupied nonfarm housing component rose 0.3 percent, the fifth consecutive advance of 0.2 or 0.3 percent, and the imputed rent of owner-occupied nonfarm housing area increased 0.3 percent for the fourth time in the past five months (with the other reading a gain of 0.4 percent). The changes have corresponded with a significant easing in the year-over-year trend that is now approaching the pre-pandemic pace (chart, next page, left). At the same time, core service inflation excluding housing, which correlates with wage dynamics, has also moderated as previously tight labor market conditions have adjusted in response to restrictive monetary policy. This area increased 0.2 percent in January, the second subdued advance in the past three months. The latest read corresponded with a year-over-year increase of 3.1 percent, down from 3.6 percent in December, and signaled the resumption of the decelerating trend after progress showed signs of reversing in the back half of last year (chart, next page, right). These developments are welcome as it appears that further disinflation is unlikely in the goods sector after a return to a subdued trend with the reversal of pandemic-related imbalances. In January, core goods inflation rose 0.4 percent, in part on account of a jump of 2.2 percent in used car prices – a reemergent source of price pressure in recent months. On a year-over-year basis, core goods prices rose 0.3 percent, the first positive reading since November 2023. We are not overly concerned by this development, but it does suggest that further progress toward the 2 percent mandate will most likely not come from the goods sector.

PCE Inflation: Rents



Source: Bureau of Economic Analysis via Haver Analytics

PCE Inflation: Core Services Ex. Housing*



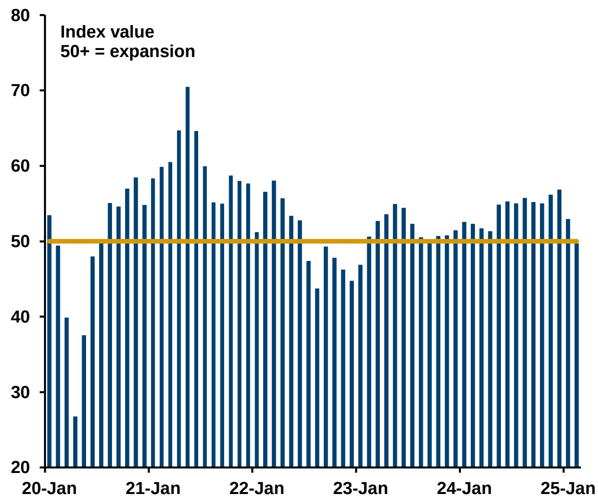
** Service prices excluding energy and housing services.*
Source: Bureau of Economic Analysis via Haver Analytics

All told, we're inclined to view the latest PCE price data as favorable. That said, the easing we've seen so far in service prices is not yet sufficient to induce further action by the FOMC in terms of additional rate cuts. Further compounding the complicated monetary policy setting process at this juncture is the ongoing uncertainty in the current outlook – magnified by the mercurial nature of President Trump and his on-again/off-again threats regarding tariffs, which could have meaningful implications for domestic inflation. As such, Beth Hammack of the Cleveland Fed, a 2026 voter, captured well in remarks this week prevailing sentiments in the FOMC amid the heightened uncertainty: "We have made good progress, but 2 percent inflation is not in sight just yet. A patient approach will allow us time to monitor the trajectories for the labor market and inflation and how the economy in general is performing in the current rate environment."

Hesitation in Early Q1

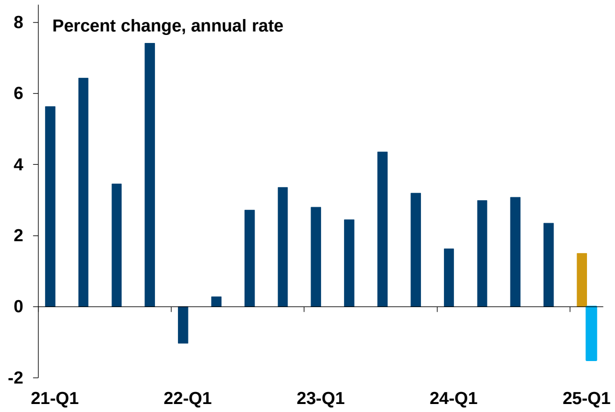
While the inflation data are evolving mostly as anticipated, we have been mildly surprised by the soft tone of growth-related statistics in early 2025. We first took notice last week when the S&P Global U.S. Services PMI fell below 50.0 (which separates expansion from contraction) after a strong run since May 2024 (chart, right), with our concern heightened after disappointing results for most data this week. Specifically, the first round of international trade statistics and real consumer spending results for January raise the possibility of downward revisions to our expectations of GDP growth in Q1, which were previously for growth of approximately 2.0 percent. With that said, we do urge caution in jumping to conclusions about the trajectory of the U.S. economy. To highlight this point, we note the latest iteration of the Atlanta Fed's GDPNow model published earlier today. After signaling earlier this week expected Q1 growth of 2.3 percent, today's estimate plunged to a contraction of 1.5 percent, with consumer spending now expected to contribute 0.87 percentage point to growth (versus +1.53 percentage points previously) and net exports to subtract a massive 3.70 percentage points (versus -0.41 percentage point previously, which would have been within the recent range of observations in the BEA's statistics; charts, next page).

US PMI: Services



Source: S&P Global via Haver Analytics

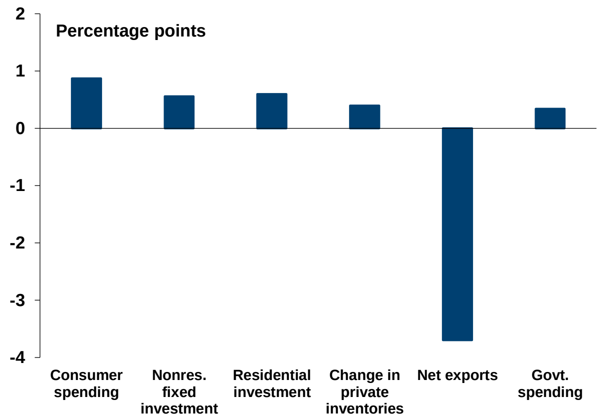
GDP Growth*



** The gold and light blue bars are forecasts for 2025-Q1 from DCMA and the Atlanta Fed's GDPNow model, respectively.*

Sources: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America; Federal Reserve Bank of Atlanta

GDPNow: Projected Contributions to Q1 Growth*



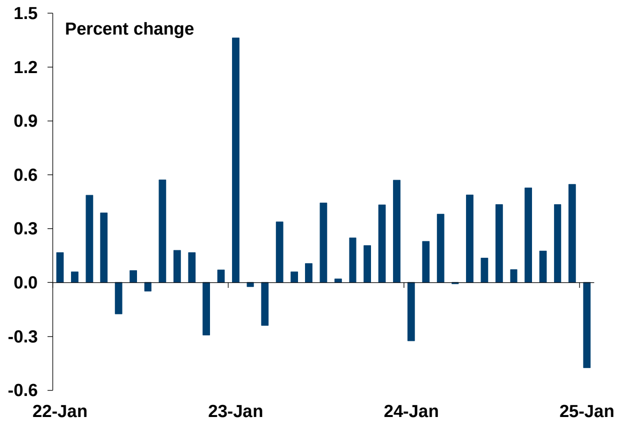
** Estimate for 2025-Q1 as of February 28, 2025.*

Source: Federal Reserve Bank of Atlanta

We would especially urge caution in assessing the latest trade data. The nominal goods deficit widened sharply in January (+$31.2 billion to $153.3 billion – the largest monthly goods deficit on record). An increase of $3.3 billion (2.0 percent) in U.S. exports was far outstripped by a surge of $34.6 billion (11.9 percent) in imports. On the import side, a jump of $22.0 billion (32.7 percent) in the industrial supply category played a significant role in the deterioration in the deficit. In light of the data, we would offer several points. First, the recent strong performance in import flows into the U.S. could be related to firms attempting to front-run tariffs, which would raise the possibility of significant slowing at some point in the near future. Additionally, part of the increase in the industrial supply area (nominal data in this report) could be related to higher prices, which would not translate one-to-one in real import flows. Finally, we stress that today's trade statistics were only the first glimpse of Q1 data, and the picture could change appreciably in the months ahead. That is to say, we expect net exports to be a drag on growth but one unlikely large enough to prompt a contraction in GDP growth in Q1.

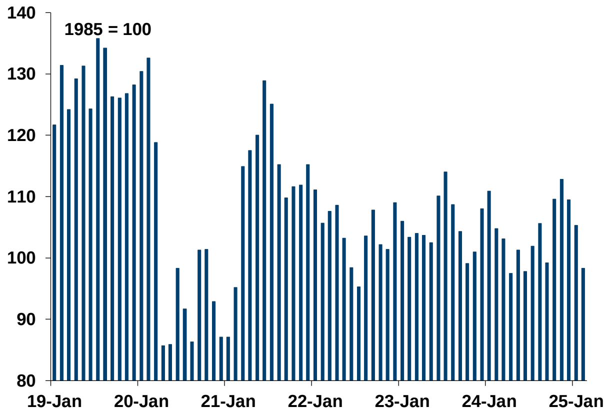
We hold a similarly aligned view regarding the consumer spending data from today's Income and Consumption Report. Real consumer spending fell 0.5 percent month-to-month after a strong performance in Q4 (annual growth of 4.2 percent, a contribution of 2.79 percentage points to growth, among the better results of the current expansion; chart on month-to-month growth, below left). The move coincided with a softening in consumer confidence in February (chart, below right). Thus, some of the poor performance could be the result of newly developing caution among consumers, but winter storms likely influenced activity in January (particularly constraining vehicle sales) and a lull after a burst of holiday-related shopping also could be at play. Therefore, we acknowledge the softening tone of the data, but we are withholding judgment on the economy. It's imperative to not let one month of bad data be taken as a signal of a reversal in prevailing conditions. We need several more months of data before giving serious consideration to the idea that underlying economic activity is deteriorating sharply.

Real Consumer Spending Growth



Source: Bureau of Economic Analysis via Haver Analytics

Consumer Confidence



Source: The Conference Board via Haver Analytics

The Week Ahead

ISM Manufacturing Index (February) (Monday)
Forecast: 51.0% (+0.1 Pct. Pt.)

Lackluster order flows and elevated interest rates have weighed on activity in the factory sector for much of the current expansion. However, following the election of President Trump, the ISM index showed signs of life, surpassing 50.0 percent (the critical threshold that separates expansion from contraction) for the first time since October 2022. We anticipate improved expectations among survey respondents supporting an above-50 reading again in February, although those expectations will have to be ratified by pro-growth policies in order for the improvement to be sustained longer term (chart).

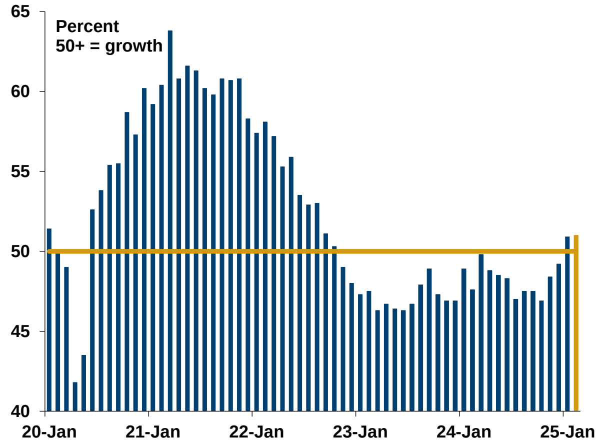
ISM Services Index (February) (Wednesday)
Forecast: 52.0% (-0.8 Pct. Pt.)

With the U.S. economy remaining on a growth track, the ISM services index appears poised to remain in expansionary territory for the eighth consecutive month in February. Following an advance of 1.5 percentage points to 54.0 percent in the previous month, the measure declined 1.2 percentage points to 52.8 percent in January, reflecting marked declines in the business activity and new orders subcomponents. Of note, a decrease in the S&P Global services PMI below the critical threshold (-3.2 points to 49.7 as of the February preliminary estimate) hints at some downside risk to the projection (chart).

Factory Orders (January) (Wednesday)
Forecast: +1.7%

Following a decline of 1.8 percent in the prior month, durable goods orders rose 3.1 percent in January. Recent shifts in the headline have mainly reflected changes in the often-volatile transportation category, with aircraft bookings jumping 62.0 percent in the latest month. Looking deeper, the civilian aircraft component (a subset of total aircraft orders) surged 93.9 percent after falling 28.9 percent in December, with recent production issues at Boeing contributing to the swings. Excluding transportation, orders have drifted moderately higher on balance in the past 12 months (+1.6 percent). Preliminary shipments data released with the Advance Report on Durable Goods on February 27 indicate a modest increase in the nondurable area (chart).

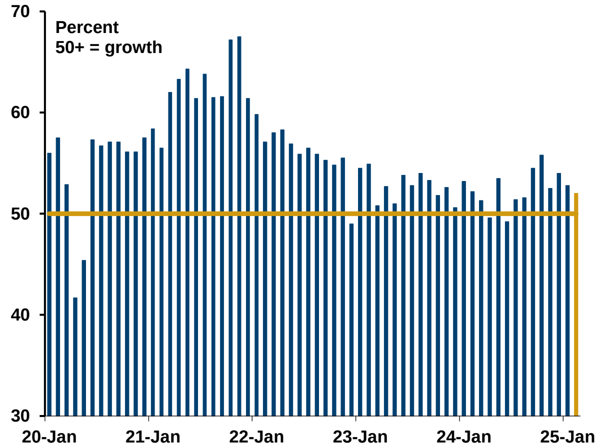
ISM Manufacturing Index*



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

Sources: Institute for Supply Management via Haver Analytics; Daiwa Capital Markets America

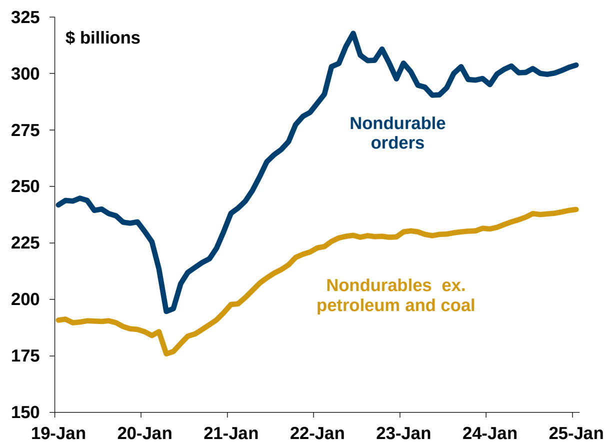
ISM Services Index*



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

Sources: Institute for Supply Management via Haver Analytics; Daiwa Capital Markets America

New Orders for Nondurable Goods

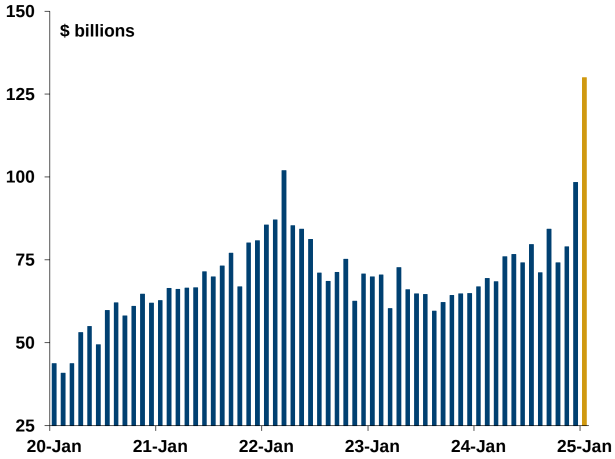


Source: U.S. Census Bureau via Haver Analytics

Trade Balance (January) (Thursday)
Forecast: -$130.0 Billion ($31.6 Billion Wider Deficit)

The increase of $31.2 billion in the goods deficit (published February 28) suggests similar widening in the total trade shortfall in January. The expected change, if realized, follow the $19.5 billion widening in December, with results thus far in the first month of Q1 suggesting that net exports could be significant a drag on GDP after contributing 0.1 percentage point to growth in Q4 (charts, below).

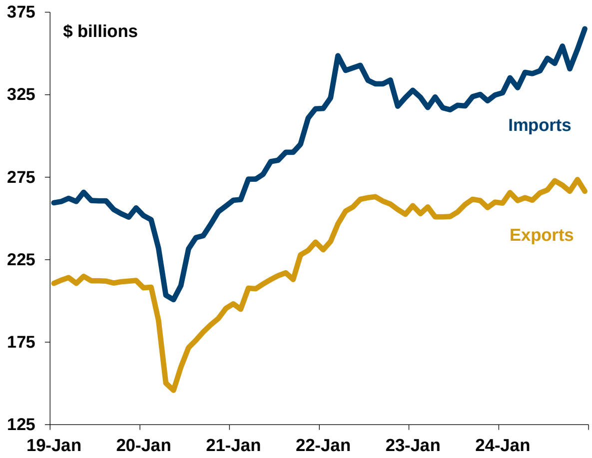
Trade Deficit in Goods & Services*



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

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

Imports & Exports of Goods & Services

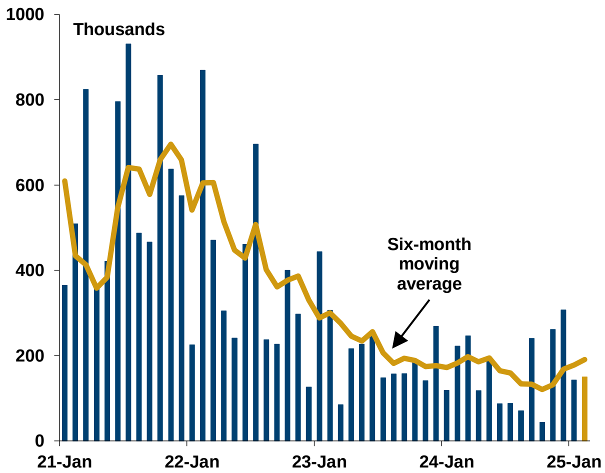


Source: Bureau of Economic Analysis via Haver Analytics

Payroll Employment (February) (Friday)
Forecast: 150,000

Payroll growth of 143 000 in January lagged firm performances in the closing months of 2024 (261,000 and 307,000 in November and December, respectively), but the results were possibly influenced by inclement weather. Additionally, ongoing normalization in underlying labor market conditions suggest that the strong results in late 2024 were more so the outliers and the run-rate for monthly payroll growth is closer to 150,000 (a still-solid performance from a longer-term perspective and one likely to sustain the unemployment rate at 4.0 percent). After an outsized advance in the prior month (+0.5 percent), growth of average hourly earnings could revert to its underlying average of 0.3 percent (associated with a year-over-year increase of 4.2 percent, which would be one tick faster than January's observation; charts, below).

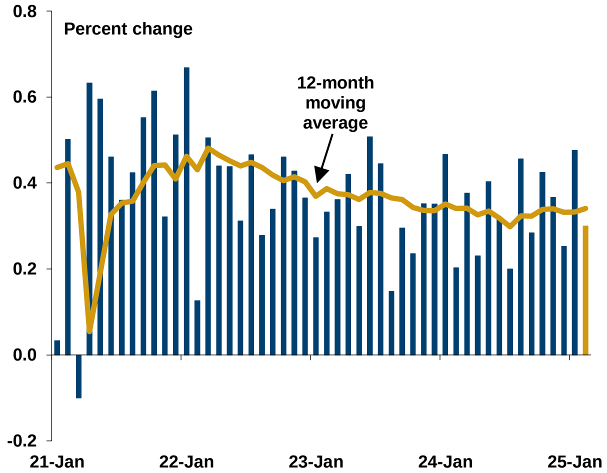
Change in Nonfarm Payrolls*



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

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

Average Hourly Earnings*



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

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

Daiwa Capital Markets

Economic Indicators

February/March 2025

Monday 24

CHICAGO FED NATIONAL ACTIVITY INDEX

	Monthly	3-Mo. Avg.
Nov	-0.05	-0.25
Dec	0.18	-0.13
Jan	-0.03	0.03

Tuesday 25

FHFA HOME PRICE INDEX

Oct	0.5%
Nov	0.4%
Dec	0.4%

S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX

Oct	0.4%
Nov	0.4%
Dec	0.5%

CONFERENCE BOARD CONSUMER CONFIDENCE

Dec	109.5
Jan	105.3
Feb	98.3

Wednesday 26

NEW HOME SALES

Nov	0.679 million
Dec	0.734 million
Jan	0.657 million

Thursday 27

UNEMPLOYMENT CLAIMS

	Initial (millions)	Continuing
Jan 18	0.223	1.850
Jan 25	0.208	1.886
Feb 1	0.220	1.850
Feb 8	0.213	N/A

GDP

	GDP	Chained Price
24-Q3	3.1%	1.9%
24-Q4(a)	2.3%	2.2%
24-Q4(p)	2.3%	2.4%

DURABLE GOODS ORDERS

Nov	-2.0%
Dec	-1.8%
Jan	3.1%

PENDING HOME SALES

Nov	0.8%
Dec	-4.1%
Jan	-4.6%

Friday 28

PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX

	Inc.	Cons.	Core
Nov	0.3%	0.5%	0.1%
Dec	0.4%	0.8%	0.2%
Jan	0.9%	-0.2%	0.3%

INTERNATIONAL TRADE IN GOODS

Nov	-$104.1 billion
Dec	-$122.0 billion
Jan	-$153.3 billion

ADVANCE INVENTORIES

	Wholesale	Retail
Nov	-0.1%	0.1%
Dec	-0.4%	-0.5%
Jan	0.7%	-0.1%

MNI CHICAGO BUSINESS BAROMETER

	Index	Prices
Dec	36.9	62.9
Jan	39.5	60.2
Feb	45.5	77.1

Monday 3

ISM MFG. INDEX (10:00)

	Index	Prices
Dec	49.2	52.5
Jan	50.9	54.9
Feb	**51.0**	**55.0**

CONSTRUCTION (10:00)

Nov	0.2%
Dec	0.5%
Jan	**-0.2%**

VEHICLE SALES

Dec	16.9 million
Jan	15.6 million
Feb	**15.9 million**

Tuesday 4

Wednesday 5

ADP EMPLOYMENT (8:15)

	Private Payrolls
Dec	176,000
Jan	183,000
Feb	--

ISM SERVICES INDEX (10:00)

	Index	Prices
Dec	54.0	64.4
Jan	52.8	60.4
Feb	**52.0**	**60.0**

FACTORY ORDERS (10:00)

Nov	-0.8%
Dec	-0.7%
Jan	**1.7%**

BEIGE BOOK (2:00)
January 2025:
"Economic activity increased slightly to moderately across the twelve Federal Reserve Districts in late November and December

Thursday 6

UNEMP. CLAIMS (8:30)

TRADE BALANCE (8:30)

Nov	-$78.9 billion
Dec	-$98.4 billion
Jan	**-$130.0 billion**

REVISED PRODUCTIVITY & COSTS (8:30)

	Productivity	Unit Labor Costs
24-Q3	2.3%	0.5%
24-Q4(p)	1.2%	3.0%
24-Q4(r)	**1.2%**	**3.0%**

WHOLESALE TRADE (10:00)

	Inventories	Sales
Nov	-0.1%	0.9%
Dec	-0.4%	1.0%
Jan	**0.7%**	**0.0%**

Friday 7

EMPLOYMENT REPORT (8:30)

	Payrolls	Un. Rate
Dec	307,000	4.1%
Jan	143,000	4.0%
Feb	**150,000**	**4.0%**

CONSUMER CREDIT (3:00)

Nov	-$5.4 billion
Dec	$40.8 billion
Jan	--

Monday 10

Tuesday 11

NFIB SMALL BUSINESS OPTIMISM INDEX

JOLTS DATA

Wednesday 12

CPI

FEDERAL BUDGET

Thursday 13

UNEMP. CLAIMS

PPI

Friday 14

CONSUMER SENTIMENT

Monday 17

RETAIL SALES

EMPIRE MFG

NAHB HOUSING INDEX

BUSINESS INVENTORIES

Tuesday 18

HOUSING STARTS

IMPORT/EXPORT PRICES

IP & CAP-U

FOMC MEETING (FIRST DAY)

Wednesday 19

FOMC RATE DECISION

TIC FLOWS

Thursday 20

UNEMP. CLAIMS

CURRENT ACCOUNT

PHILLY FED INDEX

EXISTING HOME SALES

LEADING INDICATORS

Friday 21

Forecasts in bold. (a) = advance (1st estimate of GDP), (p) = preliminary (2nd estimate of GDP), (r) = revised

Daiwa Capital Markets

Treasury Financing

February/March 2025

Monday	Tuesday	Wednesday	Thursday	Friday
24	25	26	27	28
AUCTION RESULTS: Rate / Cover 13-week bills 4.195% 2.90 26-week bills 4.180% 3.05 2-yr notes 4.169% 2.56	**AUCTION RESULTS:** Rate / Cover 6-week bills 4.230% 3.05 5-yr notes 4.123% 2.42 **ANNOUNCE:** $60 billion 17-week bills for auction on Feb 26 $80 billion 4-week bills for auction on Feb 27 $75 billion 8-week bills for auction on Feb 27 **SETTLE:** $60 billion 17-week bills $85 billion 4-week bills $80 billion 8-week bills	**AUCTION RESULTS:** Rate / Cover 17-week bills 4.200% 2.78 7-yr notes 4.194% 2.64 Margin / Cover 2-yr FRNs 0.090% 2.72	**AUCTION RESULTS:** Rate / Cover 4-week bills 4.235% 3.10 8-week bills 4.235% 2.98 **ANNOUNCE:** $144 billion 13-,26-week bills for auction on Mar 3 $70 billion 6-week bills for auction on Mar 4 $40 billion 12-day CMBs for auction on Mar 4 **SETTLE:** $144 billion 13-,26-week bills $75 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: $144 billion 13-,26-week bills	**AUCTION:** $70 billion 6-week bills $40 billion 12-day CMBs **ANNOUNCE:** $60 billion* 17-week bills for auction on Mar 5 $80 billion* 4-week bills for auction on Mar 6 $75 billion* 8-week bills for auction on Mar 6 **SETTLE:** $60 billion 17-week bills $80 billion 4-week bills $75 billion 8-week bills	**AUCTION:** $60 billion* 17-week bills	**AUCTION:** $80 billion* 4-week bills $75 billion* 8-week bills **ANNOUNCE:** $144 billion* 13-,26-week bills for auction on Mar 10 $70 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:** $144 billion 13-,26-week bills $70 billion 6-week bills $40 billion 12-day CMBs
10	11	12	13	14
AUCTION: $144 billion* 13-,26-week bills	**AUCTION:** $70 billion* 6-week bills $58 billion* 3-year notes **ANNOUNCE:** $60 billion* 17-week bills for auction on Mar 12 $80 billion* 4-week bills for auction on Mar 13 $75 billion* 8-week bills for auction on Mar 13 **SETTLE:** $60 billion* 17-week bills $80 billion* 4-week bills $75 billion* 8-week bills	**AUCTION:** $60 billion* 17-week bills $39 billion* 10-year notes	**AUCTION:** $80 billion* 4-week bills $75 billion* 8-week bills $22 billion* 30-year bonds **ANNOUNCE:** $144 billion* 13-,26-week bills for auction on Mar 17 $70 billion* 6-week bills for auction on Mar 18 $48 billion* 52-week bills for auction on Mar 18 $13 billion* 20-year bonds for auction on Mar 18 $18 billion* 10-year TIPS for auction on Mar 20 **SETTLE:** $144 billion* 13-,26-week bills $70 billion* 6-week bills	
17	18	19	20	21
AUCTION: $144 billion* 13-,26-week bills **SETTLE:** $58 billion* 3-year notes $39 billion* 10-year notes $22 billion* 30-year bonds	**AUCTION:** $70 billion* 6-week bills $48 billion* 52-week bills $13 billion* 20-year bonds **ANNOUNCE:** $60 billion* 17-week bills for auction on Mar 19 $80 billion* 4-week bills for auction on Mar 20 $75 billion* 8-week bills for auction on Mar 20 **SETTLE:** $60 billion* 17-week bills $80 billion* 4-week bills $75 billion* 8-week bills	**AUCTION:** $60 billion* 17-week bills	**AUCTION:** $80 billion* 4-week bills $75 billion* 8-week bills $18 billion* 10-year TIPS **ANNOUNCE:** $144 billion* 13-,26-week bills for auction on Mar 24 $70 billion* 6-week bills for auction on Mar 25 $69 billion* 2-year notes for auction on Mar 25 $70 billion* 5-year notes for auction on Mar 26 $44 billion* 7-year notes for auction on Mar 27 $28 billion* 2-year FRNs for auction on Mar 26 **SETTLE:** $144 billion* 13-,26-week bills $70 billion* 6-week bills $48 billion* 52-week bills	

*Estimate