Daiwa Capital Markets

U.S. Economic Comment

- The March FOMC meeting: no change in policy amid heightened uncertainty; cuts possible later in 2025
- Recent data: solid labor market allows for "patient" approach on inflation; inflation expectations show signs of deterioration
- Summary of economic projections: upward adjustment to inflation forecasts?
- Quantitative tightening: reserves "abundant"; debt ceiling impasse may prompt adjustment to current program

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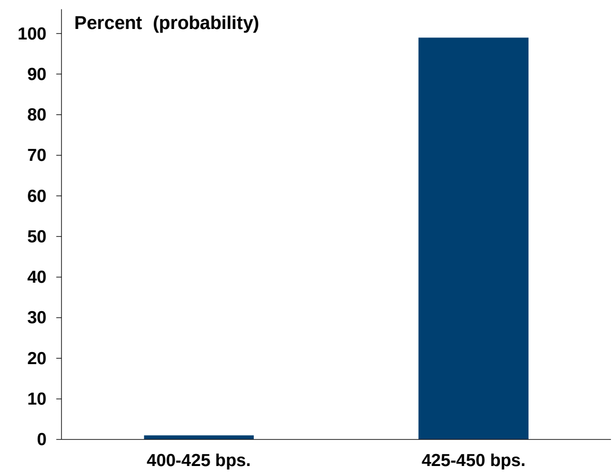
March FOMC Preview

The FOMC is likely to leave unchanged the target range for the federal funds rate at next week's meeting, which is reflected as a near certainty in market expectations (chart, below left), although that clarity will give way to discussion of critical decisions about the longer-term path of policy in an environment of heightened uncertainty generated by policies of the Trump administration. What has become increasingly clear recently is that the president appears committed to pursuing an economic vision that incorporates potentially broad-based tariffs as a tool to correct trade imbalances, support domestic industry, and achieve additional policy aims (e.g., stemming the flow of migrants and illicit drugs across U.S. borders with Canada and Mexico). By extension, he has shown a willingness to tolerate both financial market volatility and a potential growth slowdown to achieve those perceived aims. As such, policymakers will have to assess in real time how these initiatives will influence inflation and the labor market – especially with inflation expectations showing hints of deterioration and firms suggesting that layoffs could pick up if economic conditions slow meaningfully. Moreover, we have noted with interest that terms such as "stagflation" and "recession" have trickled back into discussions of the economy, although we (and likely Fed officials) do not assume those potential outcomes in baseline scenarios.

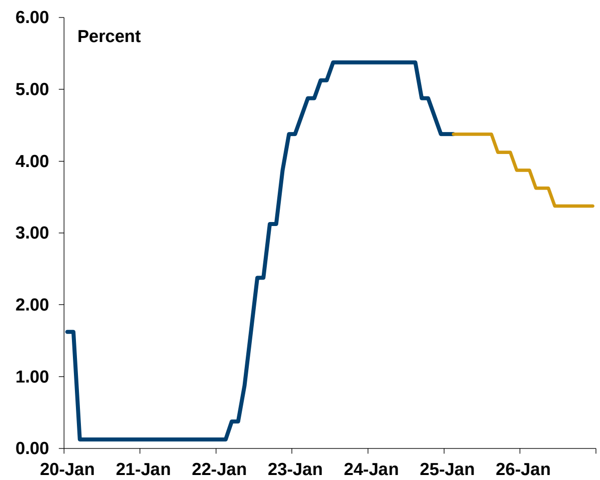
Despite recent developments, we retain our current call for two cuts in the back half of 2025 (September and December), with an additional 50 basis points in easing in the first half of 2026 (a view aligning with the broad contours of the December SEP median of 100 basis points of rate cuts over 2025 and 2026; chart, below right). We could easily envision scenarios where tariff-generated inflation or slippage in longer-term inflation expectations prompt policymakers to dial back on projected reductions in 2025, or conversely cut further (possibly three times) in light of undesirable softening in labor market conditions. In any case, it is too soon to form firm views on the longer-

Target Rate Probability for March Fed Meeting*



** The implied target range for the federal funds rate based on futures pricing data as of March 14, 2025.*
Source: CME Group, FedWatch Tool

Federal Funds Target Rate*



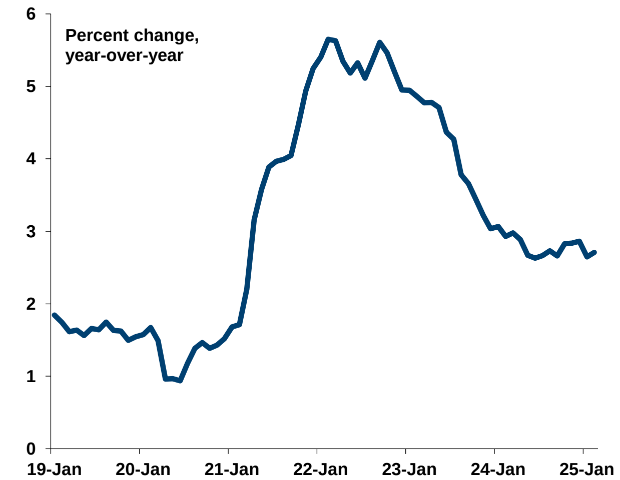
** The gold line shows the forecasted path for the federal funds rate through year-end 2026.*
Sources: Federal Reserve Board via Haver Analytics; Daiwa Capital Markets America

term effects of Trump policies on the labor market and inflation. In that regard, we expect little in the way of updated forward guidance in Chair Powell's post-meeting remarks or in the new Summary of Economic Projections. Given reliance on incoming data for new insights on the path of the economy, we see little chance of a move before June – with the fall, in our view, still more likely.

Recent Data

Amid emergent concerns about the trajectory of the U.S. economy, policymakers have not lost sight of the inflation side of the Federal Reserve's dual mandate. Officials have maintained confidence that inflation is on a path back to 2 percent amidst ongoing moderating trends in rents and in core services excluding housing, but they need to see further realized improvement before trimming the policy rate. In that regard, they probably did not receive sufficient evidence this week with the release of the February CPI. Both headline and core inflation printed below consensus estimates (+0.2 percent for each versus +0.3 percent expected), which translated to year-over-year increases of 2.8 percent and 3.1 percent (versus 3.0 percent and 3.3 percent, respectively, in January), but the results combined with inputs from the PPI point to a sideways move in the price index for personal consumption expenditures released later this month. (The current Bloomberg median expectation for the core PCE index is an advance of 0.3 percent, which translates to an uptick in the year-over-year rate to 2.7 percent versus 2.6 percent previously; chart, below left). Additionally, readings on consumer inflation expectations in today's University of Michigan consumer survey were not encouraging, with the likely culprit views on tariff policy and the implications for households. Year-ahead expectations surged 0.6 percentage point in March to 4.9 percent – among the worst readings of the current expansion and consistent with those at the peak of the recent bout of brisk inflation. More concerning, the longer-term measure rose to 3.9 percent from 3.5 percent, the highest in 32 years (chart, below right). Readings from the New York Fed Survey of Consumer Expectations, however, were a bit better as of February, with three and five-year medians of 3.00 percent and 2.98 percent, respectively, essentially unchanged from January observations but showing deterioration since the fall. Although Chair Powell may not concede that longer-term inflation expectations have come unanchored, he and his colleagues must be looking at the latest data with some concern. Keep in mind, inflation expectations play a key role in determining actual inflation, so any debasing could potentially jeopardize the Fed's 2 percent inflation objective.

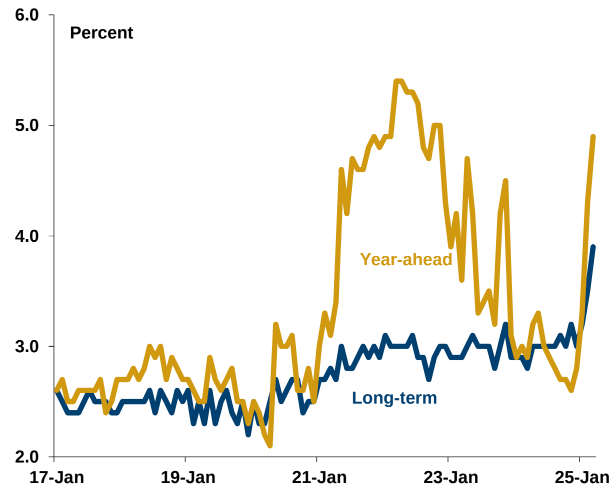
Core PCE Price Index*



** The observation for February 2025 is based on the Bloomberg survey median forecast of +0.3 percent month-to-month, associated with a year-over-year read of +2.7 percent (versus +2.6 percent in January).*

Sources: Bureau of Economic Analysis via Haver Analytics; Bloomberg

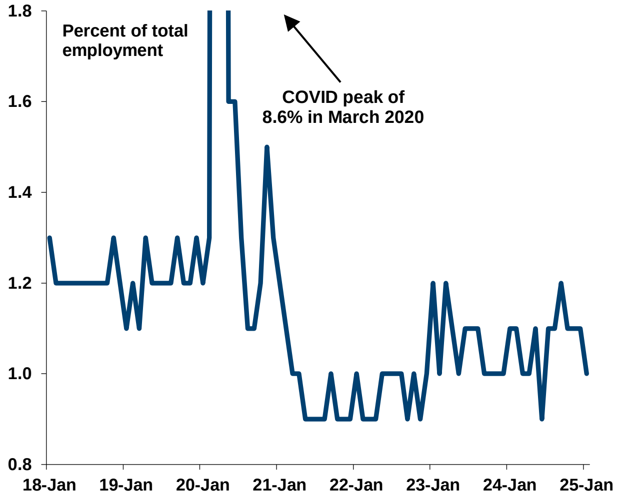
Consumer Inflation Expectations



Source: University of Michigan via Haver Analytics

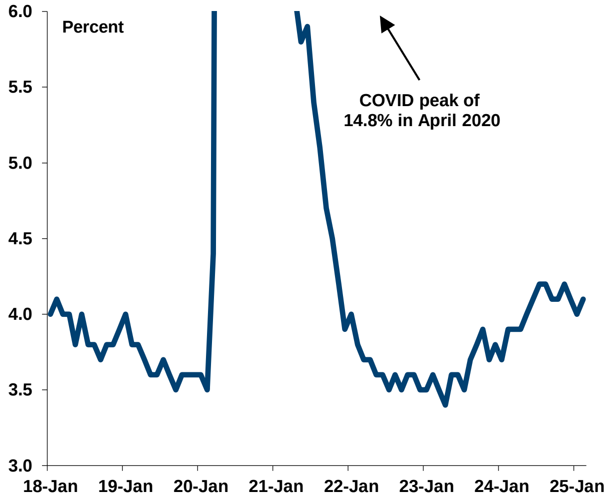
Fortunately, the labor market has remained resilient amid an ongoing realignment in supply and demand, which has allowed policymakers to be patient in waiting for further progress on the inflation front. Job growth of 151,000 in February was solid relative to the trailing six-month average of 177,000 and layoffs have remained below pre-pandemic trends even as demand for labor has fallen in many industries (chart on layoffs through January 2025, next page, left). Admittedly, this dynamic may change in the months ahead, which could exert upward pressure on the unemployment rate (4.1 percent as of February; the previous SEP looks for it to move to 4.3 percent by year-end; chart, below right). Labor market conditions were favorable for some time, but feedback effects from policy uncertainty could be felt in the months ahead, with firms finally trimming payrolls in response to slowing demand and murkier outlooks. This could pose a challenge for the FOMC, as sticky inflation could preclude a sufficient policy response to buoy the labor market (the aforementioned stagflation scenario), but developments as of now do not point in this direction. Currently, we expect that policymakers are monitoring conditions but not yet ready to alter outlooks.

Layoffs & Discharges Rate



Source: Bureau of Labor Statistics via Haver Analytics

Unemployment Rate



Source: Bureau of Labor Statistics via Haver Analytics

The Summary of Economic Projections

Turning next to the Summary of Economic Projections, we expect some changes to 2025 given the evolution of the data since the December release. Considering soft Q1 data thus far, and tariffs curtailing household and business activity later this year, we could easily foresee the median expectation for GDP adjusted below 2.0 percent from 2.1 percent as of December (table). Regarding the unemployment rate, the previous median of 4.3 percent could be appropriate given current realities in the labor market, but the median could shift modestly (perhaps 0.1 percentage point higher to 4.4 percent) to align with a slower-growth scenario.

Economic Projections of the FOMC, Dec. 2024*

	2024	2025	2026	2027	Longer Run
Change in Real GDP	2.5	2.1	2.0	1.9	1.8
Unemployment Rate	4.2	4.3	4.3	4.3	4.2
PCE Inflation	2.4	2.5	2.1	2.0	2.0
Core PCE Inflation	2.8	2.5	2.2	2.0	--
Federal Funds Rate	4.4	3.9	3.4	3.1	3.0

**Median projections*

Source: Federal Open Market Committee, Summary of Economic Projections, December 2024

On the inflation front, we look for the FOMC to adjust higher previous projections. The prior year-end medians of 2.5 percent for both the headline and core indexes do not reflect the potential price pressure generated by the Trump administration's tariff program. In this regard, we could see the median for the core index rising 0.1 or 0.2 percentage point, which would leave it in line with our house view of 2.7 percent. Absent further data, we strongly suspect that the path of inflation for 2026-27 will be unaltered in the March SEP.

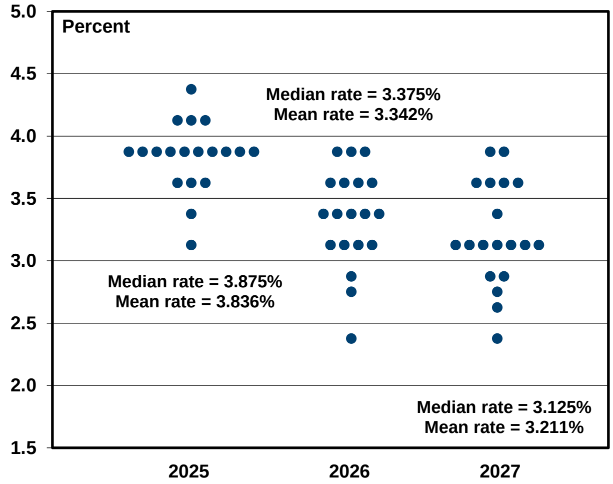
The anticipated changes to the SEP, in our view, are unlikely to translate to significant shifts in the new dot plot. On that point, we suspect that policymakers, in an attempt to prevent market instability, will seek to maintain the appearance of remaining patient in the face of heightened uncertainty. A shift in the median to showing three cuts in 2025, already a high bar with 10 of 19 participants coalescing around two cuts, could be perceived by market participants as overly dovish given inflation risks from tariffs, which could contribute to further slippage in inflation expectations. In contrast, removing previously projected cuts from 2025 or 2026 amid signs of some softening in underlying economic conditions could be perceived as unnecessarily hawkish and could prompt further undesirable volatility in financial markets. All told, we look for little change: a further 100 basis points in easing in 2025-26 with an eye on neutral as inflation gradually slows to 2 percent.

QT: An End in Sight?

Absent further clear guidance from Fed officials, we expect that balance sheet reduction, or quantitative tightening (QT), will be left unaltered at the March FOMC meeting. In other words, portfolio runoff, which is currently capped at $25 billion per month of U.S. Treasury securities and $35 billion of agency mortgage-backed securities, will continue for a time and allow for a further decline in aggregate holdings from the current $6.4 trillion (down approximately $2 trillion from the 2022 peak).

All else equal, policymakers appeared poised to possibly allow the program to run well into the second half of 2025 despite uptake in the reverse repurchase facility, which we view as a proxy for excess liquidity in the banking system, falling to $134 billion in mid-March from approximately $2.4 trillion (chart, right). Even as RRP uptake dropped and reserves eased to $3.4 trillion from the peak of $4.3 trillion, both Chair Powell and more recently Roberto Perli, Manager of the System Open Market Account (SOMA) at the New York Fed, indicated that reserves remained "abundant," not yet in the range of "ample" that would generate an adjustment to the program (chart, next page, left). From Perli's point of view, "For now, taken together, the indicators are telling us that reserve conditions are currently abundant, as they have been for quite some time." The view, while contrasting with our assessment that reserves are approaching the range of ample (which would portend an earlier end – an announcement in May and end in June), is consistent with money market rates operating well within the target range for the federal funds rate (chart, next page, right). Even so, the duration of the program and looming debt ceiling issue could signal an upcoming pause (or end consistent with our forecast). The SOMA manager added further: "Put simply, the longer balance sheet runoff continues while the debt ceiling situation persists, the higher the risk that, upon the resolution of the debt ceiling, reserves could rapidly decline to levels that could result in considerable volatility in money markets. As noted in the minutes of the January 2025 FOMC meeting, various participants thought it may be appropriate to consider pausing or slowing balance sheet runoff until the resolution of the debt ceiling situation." That is, when the debt ceiling is eventually lifted or suspended, a potential surge in T-bill issuance to replenish the depleted Treasury General Account could lead to a significant reserve drain capable of prompting a rapid tightening in money market conditions. Such a development could cause a pause, or end, of the program. Even if such developments do not transpire, Perli's remarks, along with those of other Fed officials, indicate that policymakers are contemplating in earnest a cessation of QT and considering the longer-term composition of the SOMA portfolio. (For further reading, see: Perli, Roberto. "Current Issues in Monetary Policy Implementation," Federal Reserve Bank of New York, March 5, 2025. https://www.newyorkfed.org/newsevents/speeches/2025/per250305)

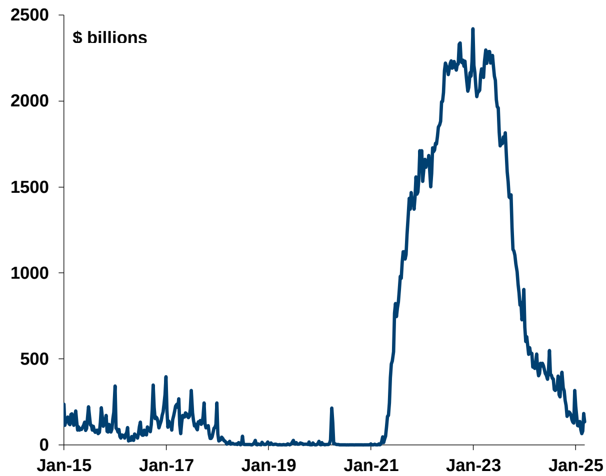
FOMC Rate View, Dec. 2024*



** 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

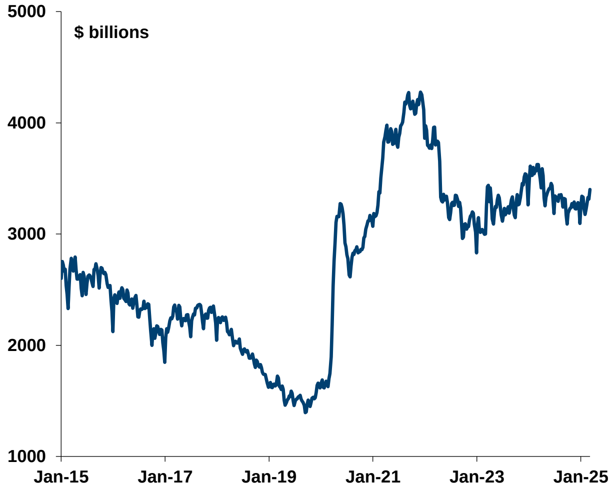
Reverse Repurchase Agreements*



** Average of week ending Wednesday. Excludes transactions with foreign official institutions.*

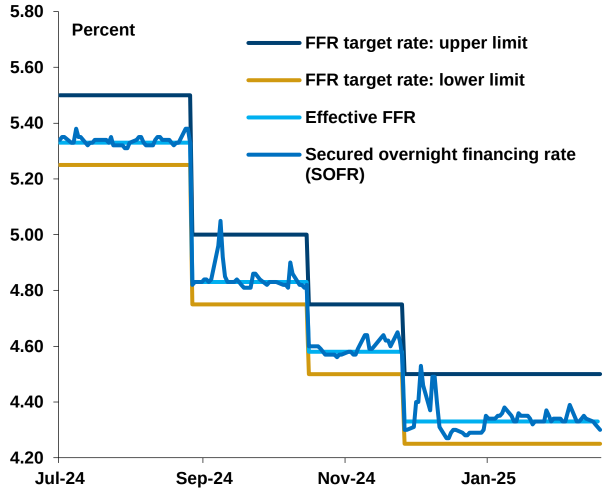
Source: H.4.1 Report, Federal Reverse Board via Haver Analytics

Reserve Balances with Federal Reserve Banks



** Average of week ending Wednesday*
Source: H.4.1 Report, Federal Reverse Board via Haver Analytics

Money Market Rates & the Target Range



Sources: Federal Reserve Board, Federal Reserve Bank of New York via Haver Analytics

The Week Ahead

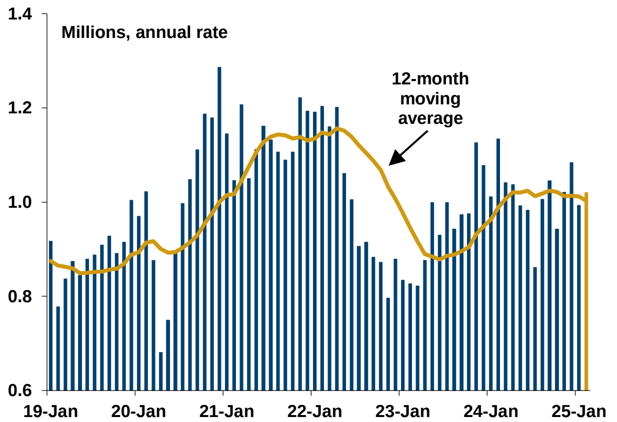
Retail Sales (February) (Monday)
Forecast: 0.6% Total, 0.5% Ex Autos

An increase in prices at the pump could boost the gasoline component of retail sales. Additionally, following a weather-related decline in the prior month, new vehicle sales rebounded in February, raising the possibility of an advance in the motor vehicle area. Looking past volatility around the turn of the year, which may have in part reflected a post-holiday lull that was magnified by disruptive winter storms, sales excluding autos and gas could rebound in February.

Housing Starts (February) (Tuesday)
Forecast: 1.390 Million (+1.8%)

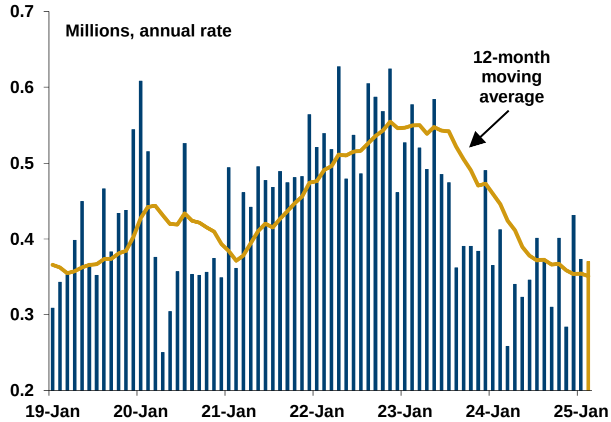
Elevated inventories of unsold new homes suggest that builders will remain vigilant in initiating new single-family housing projects in February. However, given the recent pattern of permit issuance, which includes increases in four of the past six months, a pickup seems in line after inclement weather at least in part influenced last month's poor performance (chart, below left). Multi-family starts typically exhibit marked volatility on a month-to-month basis, evidenced by the 13.5 percent drop to 0.373 million units in January. That said, considering that previous strong demand for new rental units has been met, starts could remain rangebound in February (0.354 million to 0.373 million units, annual rate, in the past six months; chart, below right).

Single-Family Housing Starts*



** The gold bar is a forecast for February 2025.*
Sources: U.S. Census Bureau via Haver Analytics; Daiwa Capital Markets America

Multi-Family Housing Starts*

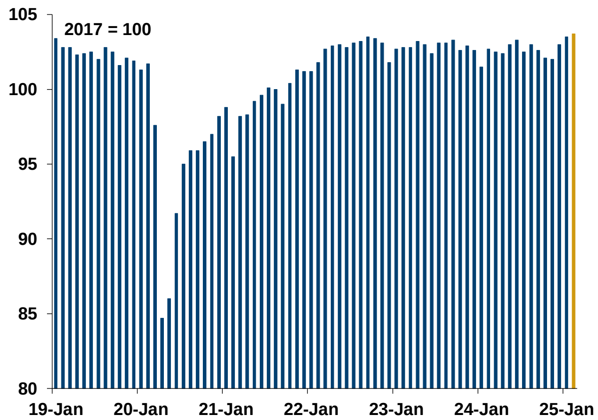


** The gold bar is a forecast for February 2025.*
Sources: U.S. Census Bureau via Haver Analytics; Daiwa Capital Markets America

Industrial Production (February) (Tuesday)
Forecast: +0.2% Headline, +0.4% Manufacturing; 77.8% Cap-U

An increase in manufacturing employment and the average workweek for production workers suggest improvement in the manufacturing component of industrial production after a weather-related drop in January, though the reversion would likely do little to augment the prevailing unimpressive trend. The mining sector could also turn in a positive performance on account of an increase in payrolls and an uptick in the rotary rig count. On the other hand, following weather-related spikes in the prior two months, utility output could contract in February. Keep in mind that swings in this category often reflect shifts in weather rather than economic fundamentals, with a return to normal conditions in February therefore raising the prospect of softening in this component (chart).

Industrial Production*

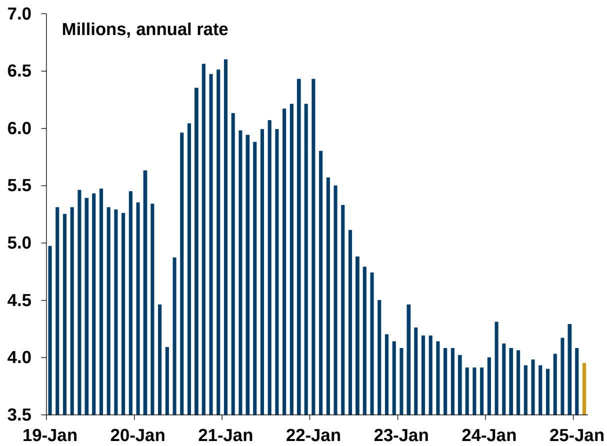


** The gold bar is a forecast for February 2025.*
Sources: Federal Reserve Board via Haver Analytics; Daiwa Capital Markets America

Existing Home Sales (February) (Thursday)
Forecast: 3.95 Million (-3.2%)

Back-to-back contractions in the index of pending home sales raise the possibility of existing home sales declining again in February after a drop of 4.9 percent in January (note that existing home sales are based on closings, with pending home sales usually translating to closings in the next one to three months). Broadly speaking, constrained inventories paired with elevated financing costs have reduced affordability for prospective buyers, thus leaving the current pace of activity in the low end of the longer-term range (charts, below).

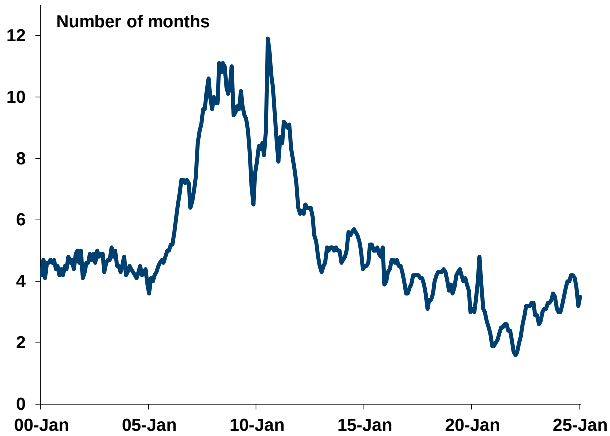
Existing Home Sales*



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

Sources: National Association of Realtors via Haver Analytics; Daiwa Capital Markets America

Months' Supply of Unsold Homes

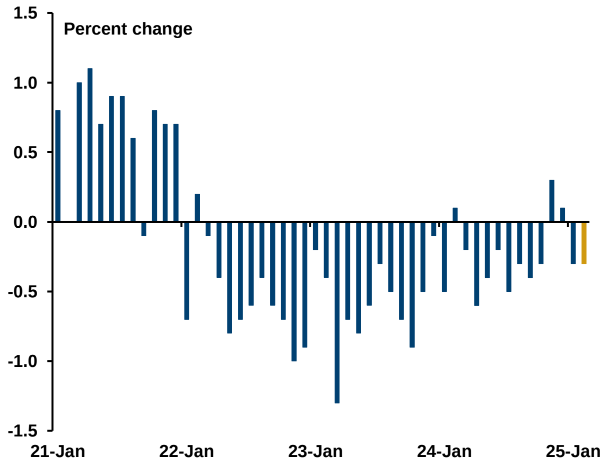


Source: National Association of Realtors via Haver Analytics

Leading Indicators (February) (Thursday)
Forecast: -0.3%

Anticipated negative contributions from consumer expectations and the ISM new orders index point to the Conference Board's Leading Economic Index contracting for the 33rd time in the past 36 months. If the forecast is realized, the index would be 15.8 percent below the cycle peak of 120.2 in December 2021. While the easing seen over the past three years would typically be consistent with the economy entering recession, available data still indicate ongoing expansion despite headwinds facing the economy (charts, below).

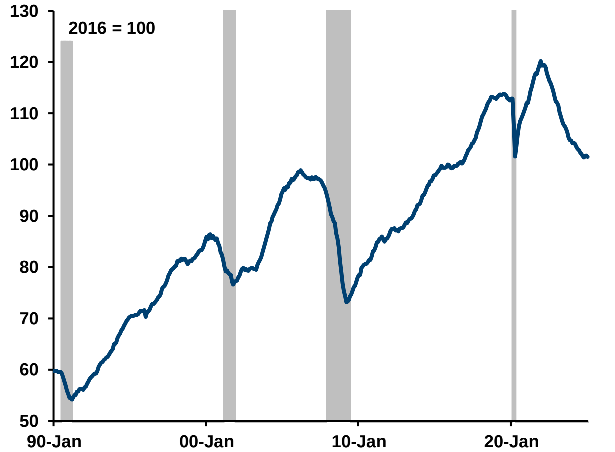
Index of Leading Economic Indicators*



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

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

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

Economic Indicators

March/April 2025

Monday	Tuesday	Wednesday	Thursday	Friday
10	11	12	13	14
	NFIB SMALL BUSINESS OPTIMISM INDEX Dec 105.1 Jan 102.8 Feb 100.7 **JOLTS DATA** Openings (000) Quit Rate Nov 8,031 1.9% Dec 7,508 1.9% Jan 7,740 2.1%	**CPI** Total Core Dec 0.4% 0.2% Jan 0.5% 0.4% Feb 0.2% 0.2% **FEDERAL BUDGET** FY2025 FY2024 Dec -$86.7B -$129.4B Jan -$128.6B -$21.9B Feb -$307.0B -$296.3B	**UNEMPLOYMENT CLAIMS** Initial Continuing (millions) Feb 8 0.214 1.867 Feb 15 0.220 1.855 Feb 22 0.242 1.897 Mar 1 0.221 N/A **PPI** Final Demand Ex. Food & Energy Dec 0.5% 0.4% Jan 0.6% 0.5% Feb 0.0% -0.1%	**CONSUMER SENTIMENT** Jan 71.7 Feb 64.7 Mar 57.9
17	18	19	20	21
RETAIL SALES (8:30) Total Ex.Autos Dec 0.7% 0.7% Jan -0.9% -0.4% **Feb 0.6% 0.5%** **EMPIRE MFG (8:30)** Jan -12.6 Feb 5.7 Mar -- **NAHB HOUSING INDEX (10:00)** Jan 47 Feb 42 Mar -- **BUSINESS INVENTORIES (10:00)** Inventories Sales Nov 0.1% 0.6% Dec -0.2% 1.0% **Jan 0.3% -0.7%**	**HOUSING STARTS (8:30)** Dec 1.515 million Jan 1.366 million **Feb 1.390 million** **IMPORT/EXPORT PRICES (8:30)** Non-Petrol Imports Nonagri. Exports Dec 0.2% 0.4% Jan 0.1% 1.5% Feb -- -- **IP & CAP-U (9:15)** IP Cap.Util. Dec 1.0% 77.5% Jan 0.5% 77.8% **Feb 0.2% 77.8%** **FOMC MEETING (FIRST DAY)**	**FOMC RATE DECISION (2:00)** **TIC FLOWS (4:00)** Long-Term Total Nov $53.2B $134.1B Dec $72.0B $87.1B Jan -- --	**UNEMP. CLAIMS (8:30)** **CURRENT ACCOUNT (8:30)** 24-Q2 -$275.0 bill. 24-Q3 -$310.9 bill. **24-Q4 -$340.0 bill.** **PHILADELPHIA FED MFG BUSINESS OUTLOOK (8:30)** Jan 44.3 Feb 18.1 Mar -- **EXISTING HOME SALES (10:00)** Dec 4.290 million Jan 4.080 million **Feb 3.950 million** **LEADING INDICATORS (10:00)** Dec 0.1% Jan -0.3% **Feb -0.3%**	
24	25	26	27	28
CHICAGO FED NATIONAL ACTIVITY INDEX	**FHFA HOME PRICE INDEX** **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** **NEW HOME SALES** **CONFERENCE BOARD CONSUMER CONFIDENCE**	**DURABLE GOODS ORDERS**	**UNEMP. CLAIMS** **REVISED Q4 GDP** **INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES** **PENDING HOME SALES**	**PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX** **REVISED CONSUMER SENTIMENT**
31	1	2	3	4
MNI CHICAGO BUSINESS BAROMETER	**ISM MFG. INDEX** **JOLTS DATA** **CONSTRUCTION** **VEHICLE SALES**	**ADP EMPLOYMENT** **FACTORY ORDERS**	**UNEMP. CLAIMS** **TRADE BALANCE** **ISM SERVICES INDEX**	**EMPLOYMENT REPORT**

Forecasts in bold.

Treasury Financing

March/April 2025

Monday	Tuesday	Wednesday	Thursday	Friday
10	11	12	13	14
AUCTION RESULTS: Rate Cover 13-week bills 4.200% 2.82 26-week bills 4.075% 3.03	**AUCTION RESULTS:** Rate Cover 6-week bills 4.235% 2.97 3-yr notes 3.908% 2.70 **ANNOUNCE:** $60 billion 17-week bills for auction on Mar 12 $75 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 $75 billion 4-week bills $75 billion 8-week bills	**AUCTION RESULTS:** Rate Cover 17-week bills 4.175% 3.29 10-yr notes 4.310% 2.59	**AUCTION RESULTS:** Rate Cover 4-week bills 4.225% 3.05 8-week bills 4.220% 3.04 30-yr bonds 4.623% 2.37 **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 $75 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 $75 billion 4-week bills $75 billion 8-week bills	**AUCTION:** $60 billion* 17-week bills	**AUCTION:** $75 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
24	25	26	27	28
AUCTION: $144 billion* 13-,26-week bills	**AUCTION:** $70 billion* 6-week bills $69 billion* 2-year notes **ANNOUNCE:** $60 billion* 17-week bills for auction on Mar 26 $75 billion* 4-week bills for auction on Mar 27 $75 billion* 8-week bills for auction on Mar 27 **SETTLE:** $60 billion* 17-week bills $75 billion* 4-week bills $75 billion* 8-week bills	**AUCTION:** $60 billion* 17-week bills $70 billion* 5-year notes $28 billion* 2-year FRNs	**AUCTION:** $75 billion* 4-week bills $75 billion* 8-week bills $44 billion* 7-year notes **ANNOUNCE:** $144 billion* 13-,26-week bills for auction on Mar 31 $70 billion* 6-week bills for auction on Apr 1 **SETTLE:** $144 billion* 13-,26-week bills $70 billion* 6-week bills	**SETTLE:** $28 billion* 2-year FRNs
31	1	2	3	4
AUCTION: $144 billion* 13-,26-week bills **SETTLE:** $13 billion 20-year bonds $18 billion 10-year TIPS $69 billion* 2-year notes $70 billion* 5-year notes $44 billion* 7-year notes	**AUCTION:** $70 billion* 6-week bills **ANNOUNCE:** $60 billion* 17-week bills for auction on Apr 2 $75 billion* 4-week bills for auction on Apr 3 $75 billion* 8-week bills for auction on Apr 3 **SETTLE:** $60 billion* 17-week bills $75 billion* 4-week bills $75 billion* 8-week bills	**AUCTION:** $60 billion* 17-week bills	**AUCTION:** $75 billion* 4-week bills $75 billion* 8-week bills **ANNOUNCE:** $144 billion* 13-,26-week bills for auction on Apr 7 $70 billion* 6-week bills for auction on Apr 8 $58 billion* 3-year notes for auction on Apr 8 $39 billion* 10-year notes for auction on Apr 9 $22 billion* 30-year bonds for auction on Apr 10 **SETTLE:** $144 billion* 13-,26-week bills $70 billion* 6-week bills	

**Estimate*