Daiwa Capital Markets

U.S. Data Review

- Income, consumption, prices: faster inflation -- headline close to 2% yr/yr
- ISM: strong orders push the headline index to the upper portion of its recent range
- Construction: moderate gain in residential; soft business and government

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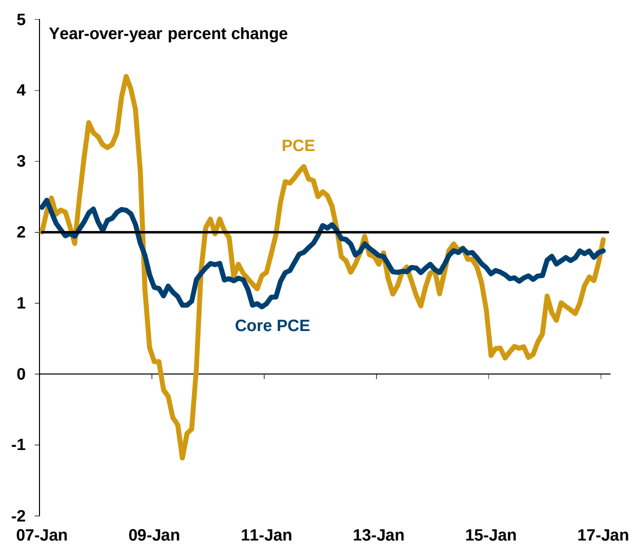
Income, Consumption, Prices

With Fed officials talking about policy normalization, the price indexes for personal consumption expenditures released today merit scrutiny. The results for January were close to expectations (up 0.4 percent overall and 0.3 percent excluding food and energy), and thus the results were not surprising. However, the increases were above the recent averages and suggestive of some stirring on the inflation front. Indeed, the year-over-year change in the headline index totaled 1.9 percent, nearly equal to the Fed's inflation objective. The move could be temporary, reflective of noise in the energy sector, but the core index also was close to target at 1.7 percent. If Fed officials are leaning toward tighter policy, these inflation numbers would not lead them to hesitate. The move in market expectations yesterday, with Fed funds futures showing a probability of more than 75 percent of a rate hike in March, also might encourage the FOMC to move.

Personal income rose 0.4 percent in January, one tick better than expected. Wage and salary income posted a respectable advance with an increase of 0.4 percent, and proprietors' income contributed as well with an increase of 0.8 percent. Farm income played a role in the proprietors' category, as the January increase of 2.1 percent (from a very low level) ended a 15-month slide. Rental income continued along a firm upward trend, and interest income rose again (13th consecutive increase). Dividend income provided a partial offset to these gains, as it fell for the third consecutive month.

Consumer spending was light in January, with the increase of 0.2 percent a touch shy of the expected increase of 0.3 percent. Moreover, with prices up 0.4 percent on the month, the modest nominal increase translated to a drop of 0.3 percent in real terms. Much of the softness occurred in the durable-goods sector, where a drop in vehicle sales constrained activity. Nominal outlays for nondurable goods jumped 1.0 percent, but higher prices played a major role in the increase. In real terms, outlays for nondurable goods were flat. Outlays for services were flat in nominal terms and down 0.2 percent after adjusting for inflation. The slow start to consumer spending in the first quarter raises the prospect of modest growth in the GDP accounts. Even if real growth rebounds to 0.2 percent per month in the next two months, growth of real consumer spending in Q1 would total less than 1.0 percent (annual rate).

PCE Price Indexes*



** PCE = personal consumption expenditures. The horizontal line at two percent is the inflation target of the Federal Reserve.*

Source: Bureau of Economic Analysis

ISM Manufacturing Index

The ISM manufacturing index jumped 1.7 percentage points in February, beating the expected increase of 0.2 percentage point. The new level of the index (57.7 percent) was in the upper end of the range from the current expansion. One reading in 2014 was slightly higher (August = 57.9 percent); otherwise, the February observation was the best since April 2011.

A surge in the new orders component led the advance in the headline index with an increase of 4.7 percentage points to 65.1 percent. Only one observation in the current expansion was higher than that for February (August 2009 = 66.6 percent; December 2013 matched the February reading). With orders strong, production schedules were well maintained, with this component increasing 1.5 percentage points to 62.9 percent. Like the headline number and the orders index, and the production component was in the upper end of the range from the current expansion. We do not put much weight in the inventory index, but it jumped 3.0 percentage points in February to 51.5 percent. This marked the first reading above 50 percent since June 2015.

The employment index fell 1.9 percentage points to 54.2 percent. However, the change occurred from an elevated level in January and the new level still compared favorably with results in the past few years. Thus, the drop was only mildly disappointing, and the report overall was quite favorable.

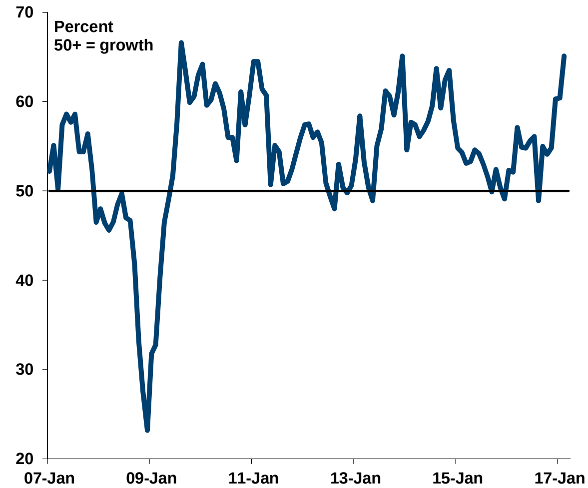
ISM Manufacturing -- Monthly Indexes

	Oct-16	Nov-16	Dec-16	Jan-17	Feb-17
ISM Mfg. Composite	52.0	53.5	54.5	56.0	57.7
New orders	54.1	54.8	60.3	60.4	65.1
Production	54.4	55.6	59.4	61.4	62.9
Employment	51.8	52.5	52.8	56.1	54.2
Supplier deliveries	52.2	55.5	53.0	53.6	54.8
Inventories	47.5	49.0	47.0	48.5	51.5
Prices paid*	54.5	54.5	65.5	69.0	68.0

** The prices paid index is not seasonally adjusted. The measure is not part of the ISM manufacturing composite index.*

Source: Institute for Supply Management

ISM Manufacturing -- New Orders Index



Source: Institute for Supply Management

Construction Spending

While the ISM index was favorable, the report on construction was disappointing, as the drop of 1.0 percent in January was well shy of the expected gain of 0.6 percent. The disappointment was tempered to a degree by an upward revision equivalent to 0.9 percent in the prior two months, but still, January was not a strong month for new building.

Private residential construction performed reasonably well, as an increase of 0.5 percent in January was joined by an upward revision of 1.5 percent in the prior two months. The building of new homes was favorable in January with an increase of 1.3 percent, but this was partially offset by a drop of 1.0 percent in improvements to existing homes (which is a highly volatile component).

Private nonresidential activity was unchanged in January, continuing a flat pattern that began last summer. Nonresidential activity was revised up by 1.2 percent in the prior two months, but that revision did little to offset the minimal net change in recent months.

Government-related construction was clearly weak, as a drop of 5.0 percent in January occurred from downward revised results in November and December (off by the equivalent of 0.6 percent). Government-sponsored activity has moved in a series of waves since mid-2015, with the ups and downs tracing a net downward trend. The January results reinforced that net downward movement.