U.S. Economic Comment

- FOMC: mystified by slow inflation, but firm in its view of returning to target
- The household sector: broad-based improvement in financial positions

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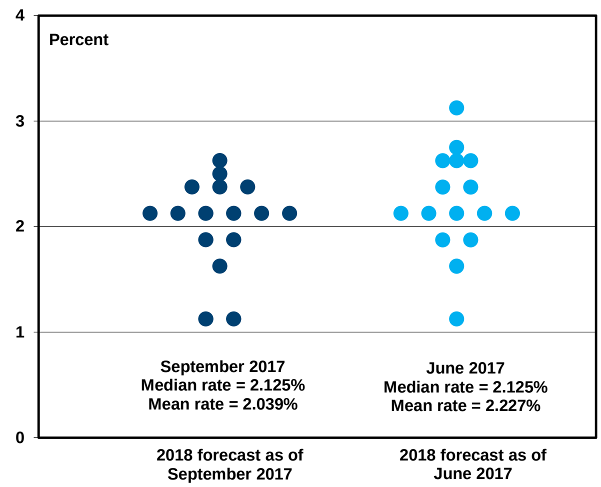
FOMC and Inflation

The slowdown in inflation this past spring and early summer apparently has had little influence on the views of Fed officials. Chair Yellen noted that she did not fully understand the forces that had eased price pressure, but she argued that the causes were not related to the broad economic environment.

The new forecasts of Fed officials also indicated that most policymakers had not shifted their views meaningfully in recent months. The median projection for the headline personal consumption price index for this year was steady at 1.6 percent and the expectation for next year inched only slightly lower (1.9 percent versus 2.0 percent). The projection for core inflation in 2017 fell 0.2 percentage point to 1.5 percent, but given results thus far, this view implies an expectation of 1.7 percent (annual rate) in the final five months of the year, identical to the full-year projection in June.

Expected Fed Funds Rate (Year-End 2018)*



* Each dot represents the expected federal funds rate of a Fed official. Normally, this graph would contain 19 projections (seven governors of the Federal Reserve Board and 12 reserve bank presidents), but three governorships were open at the times of the June and September meetings.
Source: Federal Open Market Committee

The interest rate projections of Fed officials also did not suggest a major shift in views. The dot plots shifted downward -- that is, the mean (average) interest rate projections were lower than those in June -- but the median projections for this year and next were unchanged. Thus, the dots continued to suggest an additional tightening this year and three next year (chart).

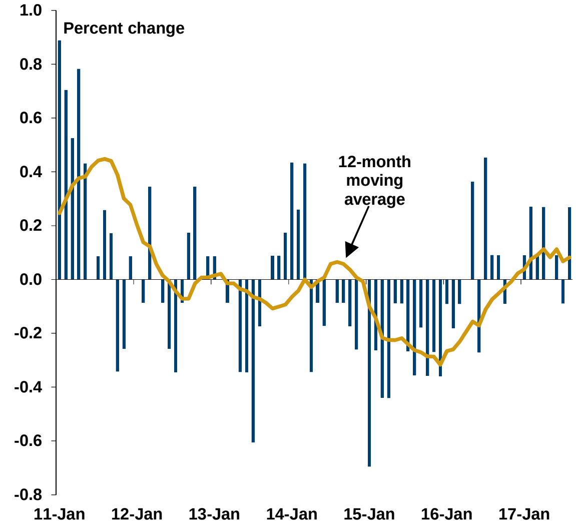
The plots had a slightly less hawkish tilt in that only five officials had an expectation of more than three tightenings next year while six were above the median in June; five were below the median this time versus four in June. Projections for the out years also were more friendly in that the outlook for 2019 now calls for two tightenings rather than three, and the median long-run expectation for the federal funds rate eased from 3.0 percent to 2.8 percent. Still, the Committee expects to remain active on the interest rate front this year and next.

Recent Inflation Developments

While inflation was tame in the spring and early summer, two recent developments support the Fed view that inflation is likely to return to target in the medium term. First, the CPI for August had a much firmer tone than the results in the prior five months. Energy prices rose 2.8 percent versus an average monthly decline of 1.3 percent from March to July. More important, core prices shifted gears, as the reported increase of 0.2 percent almost rounded up to 0.3 percent (0.248 percent), easily exceeding the minuscule increase in the prior five months (average of 0.049 percent). The detail of the report showed that several items believed to be transitory factors in the spring and summer were indeed losing force (cell phone charges, physicians' fees, and prices of new motor vehicles, prescription drugs, and apparel).

A shifting trend in import prices also could alter the tone of upcoming inflation reports. The appreciation of the foreign exchange value of the dollar that began in mid-2014 had been pushing the prices of nonpetroleum goods lower, but the lagged effects of the currency change, which typically last two to three years, are now fading. Prices of nonpetroleum imported goods have been up or steady in seven of the past eight months and are now up 1.0 percent on a year-over-year basis (chart). Prices of commodities other than petroleum could be pushing this measure higher, but an index of finished goods prices (motor vehicles, consumer goods, and capital goods) also has recently moved into positive territory on a year-over-year basis.

Non-Petroleum Import Prices



Source: Bureau of Labor Statistics

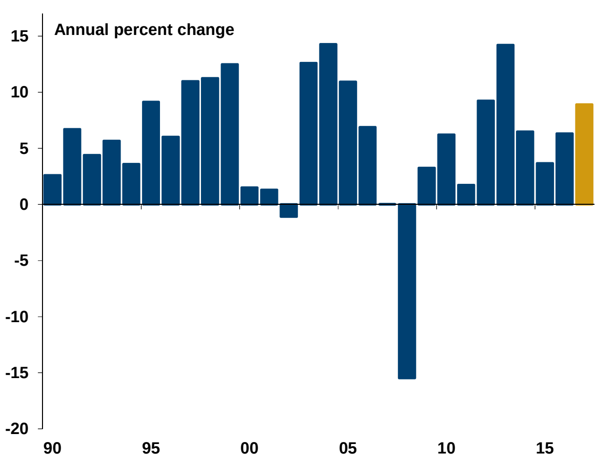
The Household Sector: Improving Fortunes

The Financial Accounts of the United States (previously called the Flow of Funds Accounts) released by the Federal Reserve Board this week showed marked improvement in the financial position of the household sector in the second quarter. The aggregate net worth of U.S households grew at an annual rate 7.4 percent in Q2 after a jump of 10.5 percent in the first quarter. The average increase of approximately nine percent in the first half represents one of the best performances of the current expansion (only the advance of 14.2 percent in 2013 was notably better). Results so far this year also represent a quickening from the average pace of 5.5 percent in the prior three years (chart, below left).

The level of household net worth in recent years has surged far above historical values, and it has even moved to a record level after scaling by the size of the economy. For example, net worth as a share of personal income in Q2 was 2.1 percent above the previous cyclical peak (chart, below right).

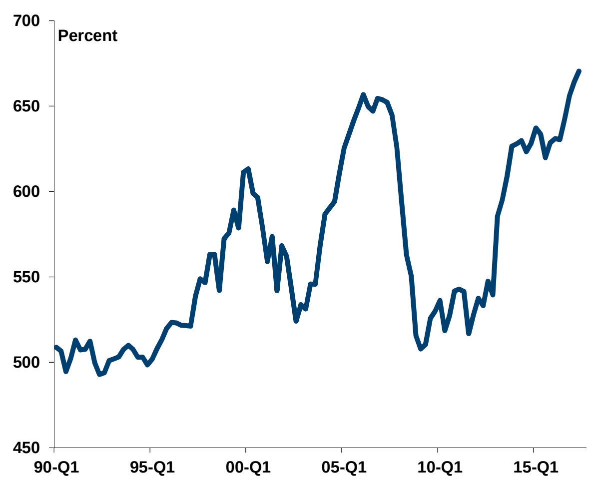
The gain in the second quarter (and in other recent quarters), was led by the advance in the stock market. Direct holdings of equities by households rose almost 21 percent (annual rate) in Q2; total equity-related

Household Net Worth*



* The reading for 2017 (gold bar) is average annual growth for the first two quarters of the year.
Source: Federal Reserve Board, Financial Accounts of the United States

Household Net Worth*



* Household net worth as a share of disposable personal income.
Source: Federal Reserve Board, Financial Accounts of the United States

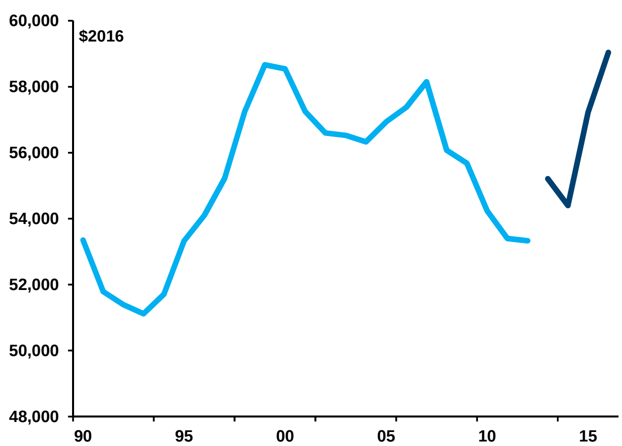
assets (including other accounts that might be influenced by the stock market such as mutual funds and pension accounts) jumped more than 12 percent. Real estate assets also contributed importantly (up 8.8 percent). Continued judicious use of debt also allowed net worth to climb (up 4.0 percent).

The net worth of the household sector has grown vigorously in the current expansion, but many observers note that the gains have not been widely distributed across the economy. This pattern, though, may be starting to change, as other reports offer hints that the benefits of the expansion are beginning to spread more broadly.

The annual report on income and poverty published by the Census Bureau last week showed that median real income rose for the second consecutive year, registering an advance of 4.5 percent in 2016 after a gain of 5.3 percent in the prior year, a marked improvement from the erosion that had been in place (chart, left). This report also showed a drop in the share of individuals living in poverty (12.7 percent in 2016 versus 13.5 percent in 2015 and down from readings in the neighborhood of 15 percent from 2010 through 2014).

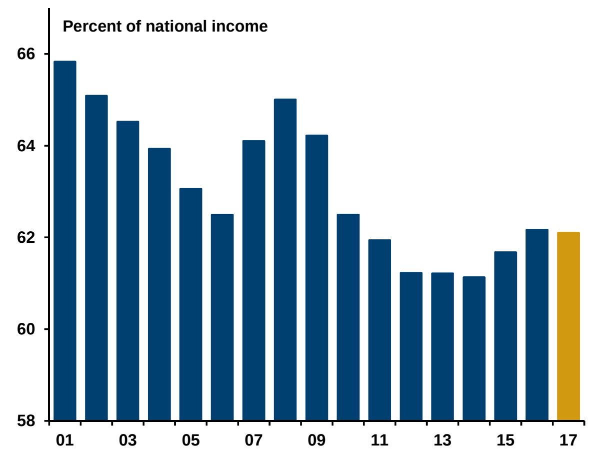
The GDP statistics also suggest stirring on a broad basis. The share of national income going to wages inched higher in 2015 and 2016 (chart, right), while the share going to profits lost some ground. The improvement has been modest thus far, and the wage share remains low from a historical perspective, but the U.S. might be at a phase of the business cycle where labor gains bargaining power and realizes advances in real compensation. In this regard, the labor share eased in the early phases of the prior expansion, but it jumped in the late stages (2006 and 2007, see chart). With the unemployment rate now in the low end of its historical range and below many estimates of full employment, the labor share of income could well continue to advance.

Median Household Income*



** The readings for 2013-2016 (dark blue line) reflect redesigned income questions and therefore are not directly comparable to prior results.*
Source: U.S. Census Bureau, Income and Poverty in the United States: 2016

Share of Nat'l. Income: Employee Comp.*



** Compensation of employees as a share of national income. The reading for 2017 is based on data for the first half of the year.*
Source: Federal Reserve Board, Financial Accounts of the United States

Review

Week of Sept. 18, 2017	Actual	Consensus	Comments
Housing Starts (August)	**1.180 Million (-0.8%)**	**1.174 Million (+1.7%)**	The multi-family sector (off 6.5%) accounted for all of the decline in housing starts. The decline occurred from an upward revised level in July, but nevertheless the drop reinforced the softer tone that began earlier this year. Multi-family starts seem to have topped after a strong recovery in the prior five years. Single-family starts rose 1.6%, but the change occurred from a downward revised level and thus activity did not break into new, higher territory. The longer-term trend in single-family starts can still be described as upward, although activity has changed little on balance in recent months.
Current Account (2017-Q2)	**$123.1 Billion ($9.6 Billion Wider Deficit)**	**$116.0 Billion ($0.8 Billion Narrower Deficit)**	Slippage in net income flows offset modest improvement in the nominal trade deficit, leaving a wider current account deficit in Q2. The new shortfall was the widest of the current expansion in dollar terms, but it was mid-range when measured as a share of GDP (2.56% versus an average of 2.50% for the current expansion).
Existing Home Sales (August)	**5.35 (-1.7%)**	**5.45 (+0.2%)**	Existing home sales declined for the third consecutive month in August (and fourth in the past five months), suggesting a loss of momentum in the market for existing homes. Hurricane Harvey likely had some influence on the results (sales in the South dropped 5.7%), but the National Association of Realtors again indicated that tight inventories were limiting sales in many markets. In this regard, the available stock of homes fell 2.1% in August.
Leading Indicators (August)	**0.4%**	**0.3%**	A jump in building permits made the largest positive contribution to the increase in the index of leading economic indicators in August. A steep yield curve and increases in consumer expectations, the ISM new orders index, and the manufacturing workweek also made noticeable contributions. An increase in initial claims in unemployment insurance provided a partial offset. The latest advance (12th in a row) left the level of the index 2.3% above the peak in the prior expansion.

Source: U.S. Census Bureau (Housing Starts); Bureau of Economic Analysis (Current Account); National Association of Realtors (Existing Home Sales); The Conference Board (Leading Indicators); Consensus forecasts are from Bloomberg

Preview

Week of Sept. 25, 2017	Projected	Comments
New Home Sales (August) (Tuesday)	**0.625 Million (+9.5%)**	With low interest rates and a firm job market, sales of new homes should rebound from the surprising plunge of 9.4% in July.
Conference Board Consumer Confidence (September) (Tuesday)	**121.0 (-1.9 Index Pts.)**	Low unemployment, contained inflation, and elevated equity values have left individuals feeling comfortable in the current economic environment, but dips in other measures of attitudes in early September (Bloomberg, Reuters/University of Michigan) suggest that the Conference Board index will not hold its elevated reading from the prior month.
Durable Goods Orders (August) (Wednesday)	**0.0%**	Recent improvement in the manufacturing sector should lead to firmer orders in several industries, but a drop in bookings for defense aircraft after a strong July is likely to provide an offset. In addition, Hurricane Harvey could have a dampening effect.
Revised GDP (2017-Q2) (Thursday)	**3.0% (Unrevised)**	The key economic statistics followed by market analysts suggest an insignificant revision to Q2 GDP, although the many esoteric items that feed into the final estimate could tilt growth in either direction.
U.S. International Trade in Goods (August) (Thursday)	**-$63.5 Billion ($0.4 Billion Narrower Deficit)**	Improved growth abroad and a softer dollar should provide support for exports. Imports are likely to advance as well, although by slightly less than exports. Higher prices of crude oil will probably boost the value of petroleum imports, and nonpetroleum imports are likely to continue moving along their gradual upward trend.
Personal Income, Consumption, and Core Price Index (August) (Friday)	**0.3%, 0.2%, 0.2%**	Modest employment growth in August, along with a minimal increase in average hourly earnings, should leave wages little changed. However, other sources of income (interest, dividends, proprietors' income) probably advanced. On the spending side, weak vehicle sales most likely led to a drop in outlays for durable goods, while a soft report on retail sales suggests modest growth in spending on nondurable goods. Outlays for services should grow moderately. Results from the CPI suggest that the core price index will break from the increases of 0.1% in the prior three months.

Source: Forecasts provided by Daiwa Capital Markets America

Daiwa Capital Markets

Economic Indicators

September/October 2017

Monday	Tuesday	Wednesday	Thursday	Friday
18	19	20	21	22
NAHB HOUSING INDEX July 64 Aug 67 Sept 64 **TIC DATA** Total / Net L-T May $54.7B $91.9B June $5.9B $34.4B July -$7.3B $1.3B	**HOUSING STARTS** June 1.217 million July 1.190 million Aug 1.180 million **IMPORT/EXPORT PRICES** Non-fuel Imports / Nonagri. Exports June 0.1% 0.0% July -0.1% 0.3% Aug 0.3% 0.7% **CURRENT ACCOUNT** 16-Q4 -$114.0 bill. 17-Q1 -$113.5 bill. 17-Q2 -$123.1 bill. **FOMC MEETING**	**EXISTING HOME SALES** June 5.51 million July 5.44 million Aug 5.35 million **FOMC DECISION** **YELLEN PRESS CONFERENCE**	**INITIAL CLAIMS** Sept 02 298,000 Sept 09 282,000 Sept 16 259,000 **PHILLY FED INDEX** July 19.5 Aug 18.9 Sept 23.8 **FHFA HOME PRICE INDEX** May 0.4% June 0.1% July 0.2% **LEADING INDICATORS** June 0.6% July 0.3% Aug 0.4%	
25	26	27	28	29
CHICAGO FED NATIONAL ACTIVITY INDEX (8:30) Monthly / 3-Mo. Avg. June 0.16 0.09 July -0.01 -0.05 Aug -- --	**S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX (9:00)** SA / NSA May 0.1% 0.9% June 0.1% 0.7% July -- -- **NEW HOME SALES (10:00)** June 0.630 million July 0.571 million **Aug 0.625 million** **CONFERENCE BOARD CONSUMER CONFIDENCE (10:00)** July 120.0 Aug 122.9 **Sept 121.0** **YELLEN SPEECH (12:45)**	**DURABLE GOODS ORDERS (8:30)** June 6.4% July -6.8% **Aug 0.0%** **PENDING HOMES SALES (10:00)** June 1.3% July -0.8% Aug --	**INITIAL CLAIMS (8:30)** **REVISED GDP (8:30)** GDP / Chained Price 17-Q1 1.2% 2.0% 17-Q2(p) 3.0% 1.0% **17-Q2(r) 3.0% 1.0%** **U.S. INTERNATIONAL TRADE IN GOODS (8:30)** June -$63.9 billion July -$63.9 billion **Aug -$63.5 billion** **ADVANCE INVENTORIES REPORT (8:30)** Wholesale / Retail June 0.6% 0.6% July 0.6% -0.1% Aug -- --	**PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX (8:30)** Inc. / Cons. / Core June 0.0% 0.2% 0.1% July 0.4% 0.3% 0.1% **Aug 0.3% 0.2% 0.2%** **CHICAGO PURCHASING MANAGERS' INDEX (9:45)** Index / Prices July 58.9 60.9 Aug 58.9 58.9 Sept -- -- **REVISED CONSUMER SENTIMENT (10:00)** July 93.4 Aug 96.8 Sept(p) 95.3
2	3	4	5	6
ISM MFG. INDEX **CONSTRUCTION SPEND.**	**VEHICLE SALES**	**ADP EMPLOYMENT REPORT** **ISM NON-MFG. INDEX**	**INITIAL CLAIMS** **TRADE BALANCE** **FACTORY ORDERS**	**EMPLOYMENT REPORT** **WHOLESALE TRADE** **CONSUMER CREDIT**
9	10	11	12	13
COLUMBUS DAY	**NFIB SMALL BUSINESS OPTIMISM**	**JOLTS DATA** **FOMC MINUTES**	**INITIAL CLAIMS** **PPI** **FEDERAL BUDGET (POSSIBLY POSTPONED)**	**CPI** **RETAIL SALES** **CONSUMER SENTIMENT** **BUSINESS INVENTORIES**

Forecasts in Bold (p) = preliminary (2nd estimate of GDP); (r) = revised (3rd estimate of GDP)

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Treasury Financing

September/October 2017

Monday	Tuesday	Wednesday	Thursday	Friday
18	19	20	21	22
AUCTION RESULTS: Rate / Cover 3-mo bills 1.045% 3.05 6-mo bills 1.180% 3.21 **ANNOUNCE:** $35 billion 4-week bills for auction on September 19	**AUCTION RESULTS:** Rate / Cover 4-week bills 0.960% 3.18		**AUCTION RESULTS:** Rate / Cover 10-yr TIPS 0.450% 2.32 **ANNOUNCE:** $78 billion 13-,26-week bills for auction on September 25 $13 billion 2-year FRNs for auction on September 27 $26 billion 2-year notes for auction on September 26 $34 billion 5-year notes for auction on September 27 $28 billion 7-year notes for auction on September 28 **SETTLE:** $78 billion 13-,26-week bills $35 billion 4-week bills	
25	26	27	28	29
AUCTION: $78 billion 13-,26-week bills **ANNOUNCE:** $35 billion* 4-week bills for auction on September 26	**AUCTION:** $35 billion* 4-week bills $26 billion 2-year notes	**AUCTION:** $13 billion 2-year FRNs $34 billion 5-year notes	**AUCTION:** $28 billion 7-year notes **ANNOUNCE:** $78 billion* 13-,26-week bills for auction on October 2 **SETTLE:** $78 billion 13-,26-week bills $35 billion* 4-week bills	**SETTLE:** $11 billion 10-year TIPS $13 billion 2-year FRNs
2	3	4	5	6
AUCTION: $78 billion* 13-,26-week bills **ANNOUNCE:** $35 billion* 4-week bills for auction on October 3 **SETTLE:** $26 billion 2-year notes $34 billion 5-year notes $28 billion 7-year notes	**AUCTION:** $35 billion* 4-week bills		**ANNOUNCE:** $78 billion* 13-,26-week bills for auction on October 10 $35 billion* 4-week bills for auction on October 10 $20 billion* 52-week bills for auction on October 10 $24 billion* 3-year notes for auction on October 11 $20 billion* 10-year notes for auction on October 11 $12 billion* 30-year bonds for auction on October 12 **SETTLE:** $78 billion* 13-,26-week bills $35 billion* 4-week bills	
9	10	11	12	13
COLUMBUS DAY	**AUCTION:** $78 billion* 13-,26-week bills $35 billion* 4-week bills $20 billion* 52-week bills	**AUCTION:** $24 billion* 3-year notes $20 billion* 10-year notes	**AUCTION:** $12 billion* 30-year bonds **ANNOUNCE:** $78 billion* 13-,26-week bills for auction on October 16 $5 billion* 30-year TIPS for auction on October 19 **SETTLE:** $78 billion* 13-,26-week bills $35 billion* 4-week bills $20 billion* 52-week bills	

**Estimate*