U.S. Economic Comment

- Revised fed funds call: two cuts in 2024 followed by quarterly reductions in 2025
- The latest inflation data require vigilance

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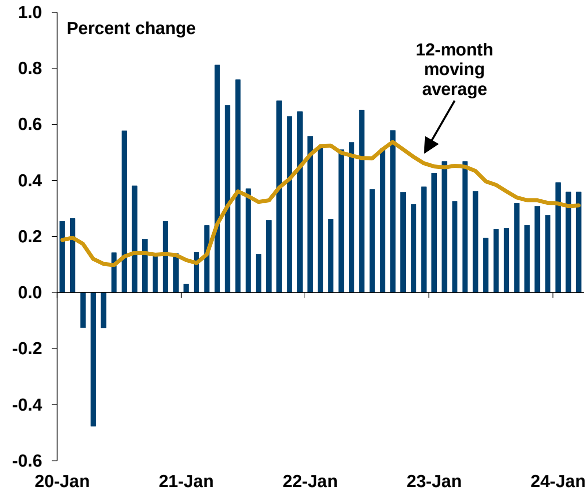
Two Cuts in 2024

In an unwelcome development this week, the CPI for March printed above market expectations with both the headline and core indexes increasing 0.4 percent. For the core, this was the third consecutive month that the index rounded up to that brisk increase (chart, below left). The surprise reading spurred a prompt reassessment of the path of monetary policy by market participants, as Treasury yields jumped (including a surge of 24 basis points in the two year Treasury rate to 4.98 percent before easing on Friday amid geopolitical developments) and fed funds futures contracts adjusted to price in 50 basis points of easing in the federal funds rate by year-end 2024 versus 75 basis points as of Friday, April 5 (chart, below right). The next move by the FOMC is still anticipated to be a cut, but comments by officials since the CPI release suggest that the adjustment will come later this year – including remarks today by Atlanta Fed President Raphael Bostic (a 2024 voter), who raised the possibility of only one cut this year.

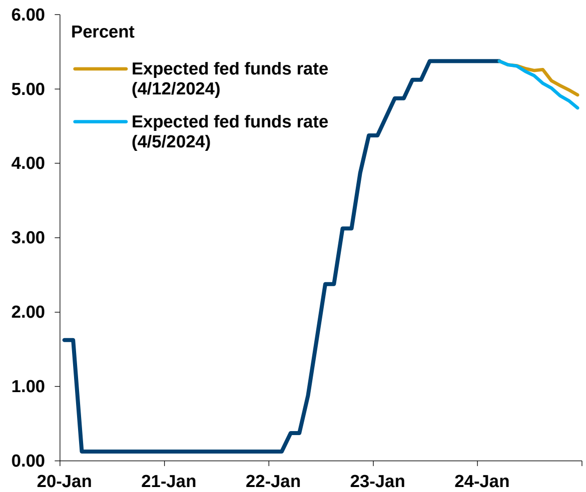
We, too, felt compelled to adjust our Fed call in light Wednesday's report. Rather than three cuts of 25 basis points in 2024, we expect the FOMC to move only twice. Our current projection calls for the first cut to come in September, as five additional CPI readings (April-August) ahead of the mid-month meeting may provide enough evidence that inflation has resumed its previous decelerating trend. Additionally, a new Summary of Economic Projections will be released at that meeting, providing officials another tool with which to shape market expectations along with the potential policy shift. Perhaps more important, the meeting is approximately seven weeks ahead of the November 5 presidential election, which creates at least some buffer against (in our view off-base) criticisms that officials are attempting the influence the election through policy adjustments. We then project another cut in December, followed by quarterly cuts in 2025 that align with SEP updates (March, June, September, and December). If realized, the forecast would leave the target range for the federal funds rate at 3.75 percent to 4.00 percent by year-end 2025. Two additional cuts of 25 basis points in 2026 are currently penciled in (versus three in our previous forecast), in part reflecting revised thinking on the longer-run neutral rate, but we emphasize that marked uncertainty (even in the near-term) could lead to a material rethink on projections in the back-end of the forecast horizon.

Core CPI



Source: Bureau of Labor Statistics via Haver Analytics

Federal Funds Target Rate*



** The projected path of the federal funds rate based on futures contracts as of April 12 & April 5, 2024.*

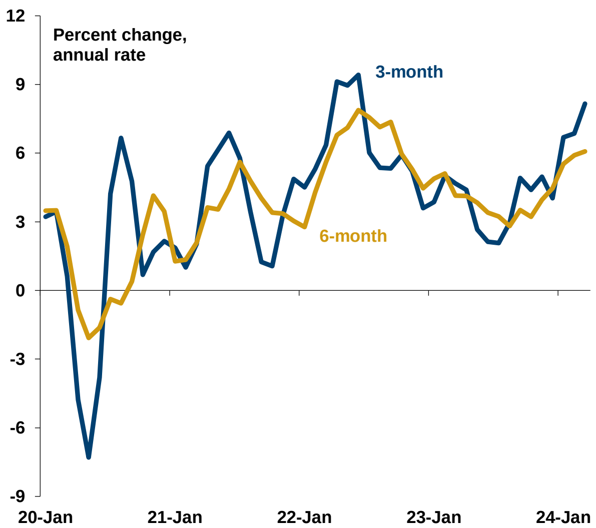
Sources: Federal Reserve Board via Haver Analytics; Bloomberg

Our shift in view does not reflect a lack of confidence in the FOMC's resolve in achieving two percent inflation in the medium term. Rather, it acknowledges that a solid pace of economic activity and tight labor market conditions are slowing a return to target after pandemic-related imbalances spurred the earlier surge in inflation. As Chair Powell argued in a recent speech, the trajectory of inflation is on a "sometimes bumpy path." Thus, patience is required with respect to the upcoming pivot to lower rates. Officials seem content to be patient until they gain "greater confidence" that inflation is again moderating – which may take some time to materialize.

The March CPI Read: Easily Dismissed?

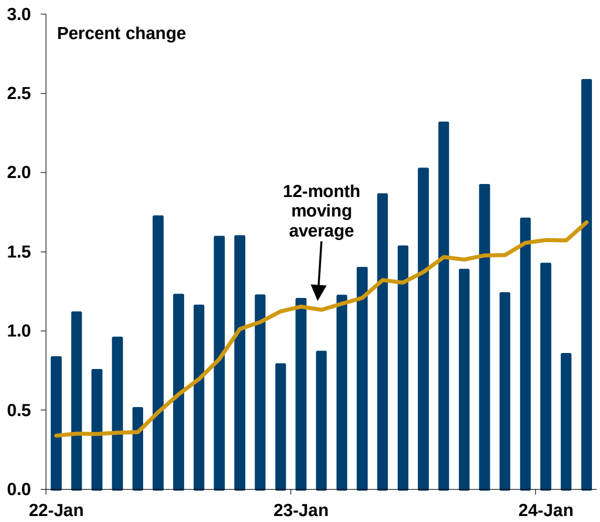
We were struck by some commentary that sought to downplay the latest CPI print by noting first that pressure was present in only a few areas and then by asserting that that the full force of those changes were unlikely to translate to the upcoming March reading for the PCE price index (to be published on April 26). In a sense, the first argument is correct. Core goods prices are easing, falling 1.4 percent annual rate, in the past three months (-0.7 percent year-over-year). That is to say, the trajectory of prices in this area have returned to the pre-pandemic trend. Similarly, food inflation has moderated after a sharp price level shift from the spring of 2021 through the spring of 2023. The three-month annualized growth rate of 2.1 percent (2.2 percent year-over-year) also is in line with the pre-COVID trend. That said, "supercore" inflation (service inflation excluding energy services, rents, and owners' equivalent rent of residences), which has been identified by Fed officials as an ongoing source of pressure, has surged in recent months. The three-month annualized growth rate surged to 8.2 percent in March from a recent low of 4.0 percent in December, and the six-month annualized growth rate accelerated to 6.1 percent from 4.5 percent; evidently, progress noted by Fed officials early in 2024 has reversed (chart, below left). Moreover, some have pointed out that the recent jump is attributable to a few areas. Namely, auto insurance premiums stand out (up 22.2 percent in the past 12 months, including an advance of 2.6 percent in March; chart, below right). This, however, is a reductive view. Hoping that inflation in one area will cool in the subsequent month ignores supply and demand dynamics, labor costs, and a multitude of other economic factors that all influence inflation.

CPI: Core Services Ex. Housing*



** Service prices excluding energy services, rent of primary residence, and owners' equivalent rent of residences.*
Source: Bureau of Labor Statistics via Haver Analytics

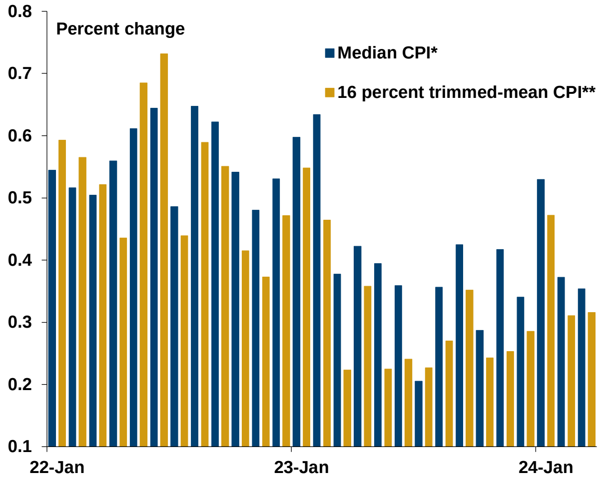
CPI: Motor Vehicle Insurance



Source: Bureau of Labor Statistics via Haver Analytics

To control for outliers (or observe the central price change in the distribution) in a given month, and get a better sense of underlying inflation, we encourage readership to monitor trimmed-mean or median estimates of the CPI or PCE Price index. The latest monthly change in the Cleveland Fed's trimmed-mean CPI of 0.3 percent matched the average in 2023 (no additional deceleration). The year-over-year change of 3.6 percent in March is well below the peak of 7.2 percent in September 2022 but still far from two percent. Results are similar for the weighted-median measure: monthly growth of 0.35 percent versus an average of 0.4 percent in 2023, and a year-over-year advance of 4.6 percent versus a peak of 7.1 percent in February 2023 (charts, next page). In our view, these measures suggest that inflation dynamics have not yet moderated to the point of allowing for easier policy.

CPI: Median vs. Trimmed-Mean

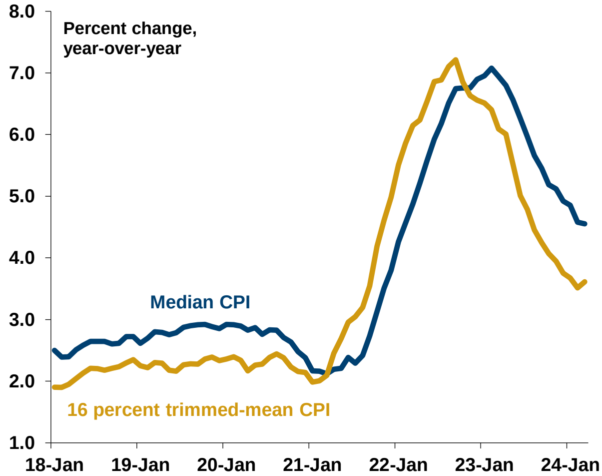


** A measure of inflation that provides insight into underlying trends by capturing the middle point of price changes for the broad set of goods and services in the CPI.*

*** A weighted average of one month inflation rates of CPI components whose expenditure weights fall below the 92nd percentile and above the 8th percentile of price changes.*

Source: Federal Reserve Bank of Cleveland via Haver Analytics

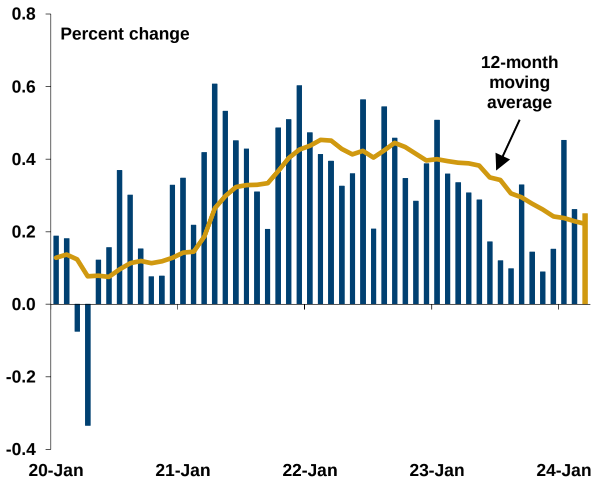
CPI: Median vs. Trimmed-Mean



Source: Federal Reserve Bank of Cleveland via Haver Analytics

We also hesitate to temper concern about the latest CPI print on account of it translating to a less threatening advance in the price index for personal consumption expenditures. Because of index design, changes in the PCE index will generally be smaller than those in the CPI. Thus, in the latest month, results for the CPI (also informed by components of the PPI) imply an advance in the core PCE price index in the range of 0.25 to 0.30 percent (versus 0.36 percent for the core CPI), which equates to three and six-month annualized growth rates of 3.9 percent and 2.7 percent, respectively (charts, below). Imputing index values based on monthly growth in the 0.20-0.25 percent range in the April-to-June period suggests annualized three and six-month growth rates of 2.6 percent and 3.3 percent, respectively (chart, below right). Inflation may decelerate between now and the summer, but readings within the recent range would still leave annual inflation well above target and put officials in an uncomfortable position of having to justify a premature cut. Regardless of inflation tracking slightly higher on a CPI basis or at the pace suggested by this exercise, an early pivot would hurt Fed credibility and possibly fuel deterioration in consumer inflation expectations. Thus, if growth and inflation moderate as expected, the fall may provide a better time to begin the transition to a lower federal funds rate.

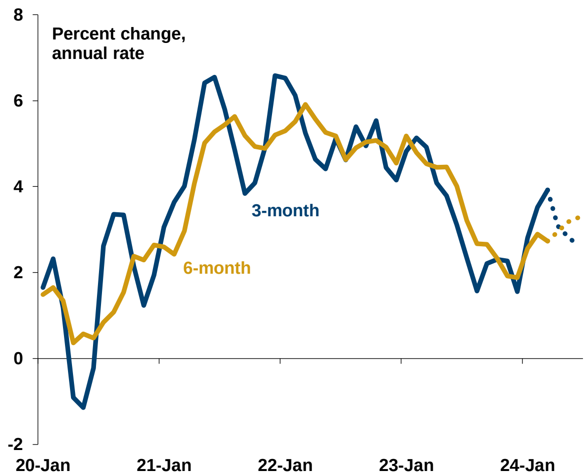
Core PCE Price Index*



** The reading for March 2023 (gold bar) is a forecast of 0.25 percent based on recent results from the CPI and components of the PPI that factor into PCE inflation.*

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

Core PCE Price Index*



** Readings beyond February (dashed lines) are forecasts based on the assumption that the core PCE price index will increase 0.25 percent in March and April and 0.2 percent in May and June.*

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

The Week Ahead

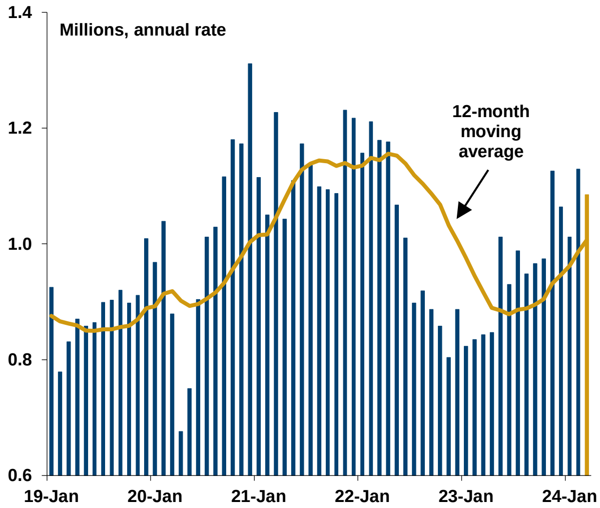
Retail Sales (March) (Monday)
Forecast: 0.3% Total, 0.4% Ex. Autos, 0.3% Ex. Autos & Gas

A decline in new auto sales in March suggests a dip in the motor vehicle and parts component of the retail sales report in March, although higher prices cold nudge the gasoline component up. Activity excluding autos and gas has eased in recent months after a firm performance through the fall of 2023.

Housing Starts (March) (Tuesday)
Forecast: 1.485 Million (-2.4%)

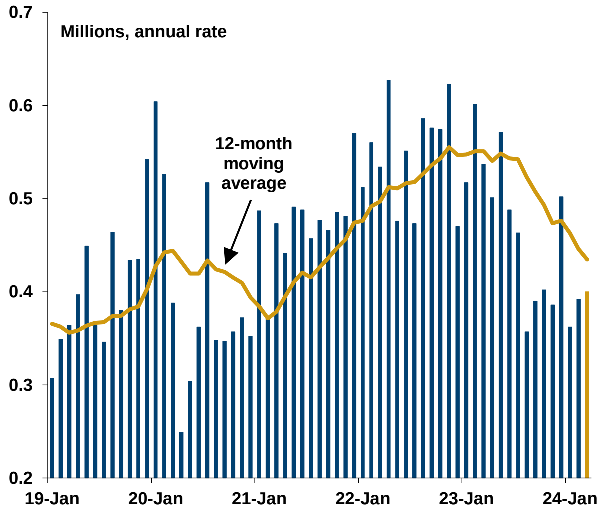
Although the recent pattern of single-family permit issuance has been firm, elevated inventories of new homes available for sale suggest that builders could trim starts after a burst of 11.6 percent in February pushed activity to the upper end of the range of the past three years (chart, below left). Multi-family starts have been subdued after previous strong demand for new rental housing drove brisk activity earlier in the expansion (chart, below right).

Single-Family Housing Starts*



* The gold bar is a forecast for March 2024.
Sources: U.S. Census Bureau via Haver Analytics; Daiwa Capital Markets America

Multi-Family Housing Starts*

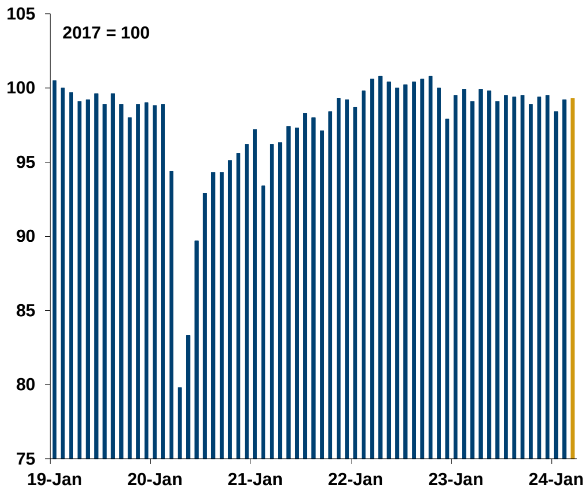


* The gold bar is a forecast for March 2024.
Sources: U.S. Census Bureau via Haver Analytics; Daiwa Capital Markets America

Industrial Production (March) (Tuesday)
Forecast: 0.4% Total, 0.1% Manufacturing

With factory employment in March little changed from that in the prior month and the workweek for production workers only slightly higher, the manufacturing component of industrial production is likely to increase only modestly after weather-related volatility influenced results in recent months (chart, right). In contrast, increases in the rotary rig count and aggregate hours worked suggest a brisk advance in mining output. Utility output, which swings widely on account of shifts in weather rather than in response to underlying economic conditions, may pick up after a swoon of 7.5 percent in February.

Industrial Production: Manufacturing*



* The gold bar is a forecast for March 2024.
Sources: Federal Reserve Board via Haver Analytics; Daiwa Capital Markets America

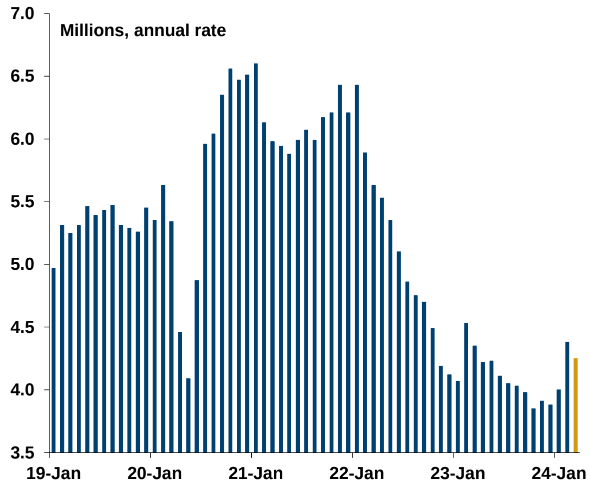
Existing Home Sales (March) (Thursday)
Forecast: 4.25 Million (-3.0%)

With affordability constrained by elevated prices and mortgage interest rates, and the supply of available homes for sale remaining tight, existing homes sales could ease in March after a combined jump of 12.9 percent in the prior two months – a view supported by a choppy performance in pending home sales over January and February (chart, right).

Leading Indicators (March) (Thursday)
Forecast: -0.1%

Negative contributions from the slope of the yield curve and consumer expectations appear likely to offset a positive contribution from stock prices and the factory workweek. If the forecast for March is realized, the Leading Indicators index will resume its downtrend after a pickup in February. If the forecast is realized, the March reading will be 13.4 percent below the cyclical peak of 118.6 in December 2021 (charts).

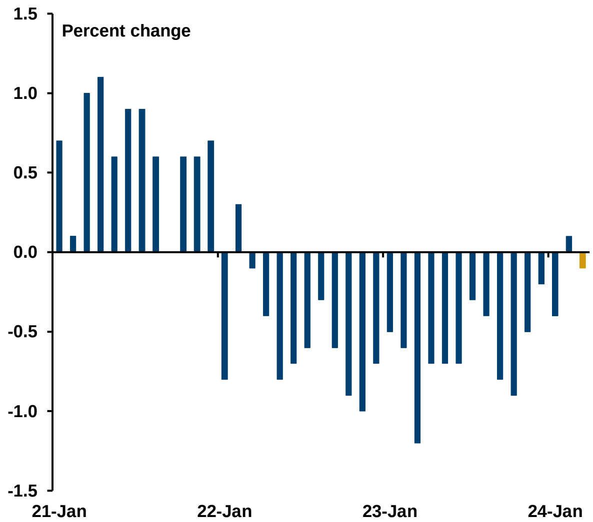
Existing Home Sales*



** The gold bar is a forecast for March 2024.*

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

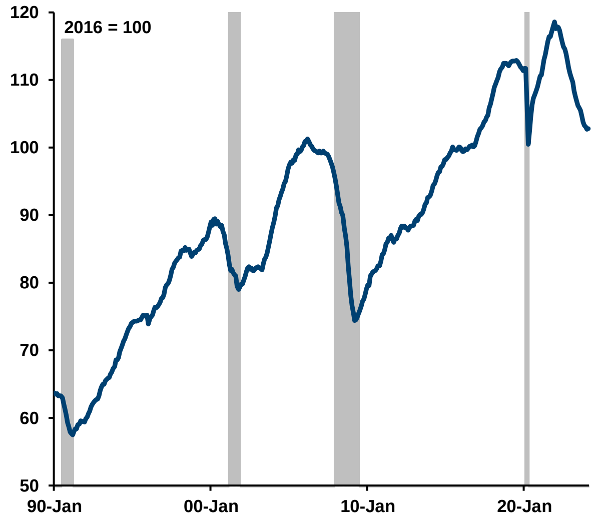
Index of Leading Economic Indicators*



** The gold bar is a forecast for March 2024.*

Sources: The Conference Board via Haver Analytics; Daiwa Capital Markets 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

April/May 2024

Monday	Tuesday	Wednesday	Thursday	Friday
8	9	10	11	12
	NFIB SMALL BUSINESS OPTIMISM INDEX Jan 89.9 Feb 89.4 Mar 88.5	**CPI** Total Core Jan 0.3% 0.4% Feb 0.4% 0.4% Mar 0.4% 0.4% **WHOLESALE TRADE** Inventories Sales Dec 0.5% 0.6% Jan -0.2% -1.4% Feb 0.5% 2.3% **FOMC MINUTES** **FEDERAL BUDGET** 2024 2023 Jan -$21.9B -$38.8B Feb -$296.3B -$262.4B Feb -$236.5B -$378.4B	**UNEMPLOYMENT CLAIMS** Initial Continuing (millions) Mar 16 0.212 1.810 Mar 23 0.212 1.789 Mar 30 0.222 1.817 Apr 6 0.211 N/A **PPI** Final Demand Ex. Food & Energy Jan 0.4% 0.5% Feb 0.6% 0.3% Mar 0.2% 0.2%	**IMPORT/EXPORT PRICES** Non-Petrol Imports Nonagri. Exports Jan 0.6% 1.0% Feb 0.1% 0.6% Mar 0.0% 0.4% **CONSUMER SENTIMENT** Feb 76.9 Mar 79.4 Apr 77.9
15	16	17	18	19
RETAIL SALES (8:30) Total Ex.Autos Jan -1.1% -0.8% Feb 0.6% 0.3% **Mar 0.3% 0.4%** **EMPIRE MFG (8:30)** Feb -2.4 Mar -20.9 Apr -- **NAHB HOUSING INDEX (10:00)** Feb 48 Mar 51 Apr -- **BUSINESS INVENTORIES (10:00)** Inventories Sales Dec 0.3% 0.1% Jan 0.0% -1.1% **Feb 0.4% 1.5%**	**HOUSING STARTS (8:30)** Jan 1.374 million Feb 1.521 million **Mar 1.485 million** **IP & CAP-U (9:15)** IP Cap.Util. Jan -0.5% 78.3% Feb 0.1% 78.3% **Mar 0.4% 78.4%**	**BEIGE BOOK (2:00)** **March 2024:** “Economic activity increased slightly, on balance, since early January, with eight Districts reporting slight to modest growth in activity, three others reporting no change, and one District noting a slight softening.” **TIC FLOWS (4:00)** Long-Term Total Dec $158.6B $137.4B Jan $36.1B -$8.8B Feb -- --	**UNEMP. CLAIMS (8:30)** **PHILADELPHIA FED MFG BUSINESS OUTLOOK (8:30)** Feb 5.2 Mar 3.2 Apr -- **EXISTING HOME SALES (10:00)** Jan 4.000 million Feb 4.380 million **Mar 4.250 million** **LEADING INDICATORS (10:00)** Jan -0.4% Feb 0.1% **Mar -0.1%**	
22	23	24	25	26
CHICAGO FED NATIONAL ACTIVITY INDEX	**NEW HOME SALES**	**DURABLE GOODS ORDERS**	**UNEMP. CLAIMS** **Q1 GDP** **INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES** **PENDING HOME SALES**	**PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX** **REVISED CONSUMER SENTIMENT**
29	30	1	2	3
	EMPLOYMENT COST INDEX **FHFA HOME PRICE INDEX** **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** **MNI CHICAGO BUSINESS BAROMETER** **CONFERENCE BOARD CONSUMER CONFIDENCE** **FOMC MEETING (FIRST DAY)**	**ADP EMPLOYMENT** **ISM MFG. INDEX** **JOLTS DATA** **CONSTRUCTION** **FOMC RATE DECISION** **VEHICLE SALES**	**UNEMP. CLAIMS** **TRADE BALANCE** **PRODUCTIVITY & COSTS** **FACTORY ORDERS**	**EMPLOYMENT REPORT** **ISM SERVICES INDEX**

Forecasts in bold.

Treasury Financing

April/May 2024

Monday	Tuesday	Wednesday	Thursday	Friday
8	9	10	11	12
AUCTION RESULTS: Rate Cover 13-week bills 5.225% 2.79 26-week bills 5.120% 3.00	**AUCTION RESULTS:** Rate Cover 3-yr notes 4.548% 2.50 42 day CMBs 5.275% 2.93 **ANNOUNCE:** $60 billion 17-week bills for auction on Apr 10 $70 billion 4-week bills for auction on Apr 11 $75 billion 8-week bills for auction on Apr 11 **SETTLE:** $60 billion 17-week bills $70 billion 4-week bills $75 billion 8-week bills	**AUCTION RESULTS:** Rate Cover 17-week bills 5.230% 3.12 10-yr notes 4.560% 2.34	**AUCTION RESULTS:** Rate Cover 4-week bills 5.270% 2.95 8-week bills 5.270% 3.14 30-yr bonds 4.671% 2.37 **ANNOUNCE:** $140 billion 13-,26-week bills for auction on Apr 15 $46 billion 52-week bills for auction on Apr 16 $13 billion 20-year bonds for auction on Apr 17 $23 billion 5-year TIPS for auction on Apr 18 $65 billion 42-day CMBs for auction on Apr 16 **SETTLE:** $140 billion 13-,26-week bills $65 billion 42-day CMBs	
15	16	17	18	19
AUCTION: $140 billion 13-,26-week bills **SETTLE:** $58 billion 3-year notes $39 billion 10-year notes $22 billion 30-year bonds	**AUCTION:** $46 billion 52-week bills $65 billion 42-day CMBs **ANNOUNCE:** $60 billion* 17-week bills for auction on Apr 17 $70 billion* 4-week bills for auction on Apr 18 $75 billion* 8-week bills for auction on Apr 18 **SETTLE:** $60 billion 17-week bills $70 billion 4-week bills $75 billion 8-week bills	**AUCTION:** $60 billion* 17-week bills $13 billion 20-year bonds	**AUCTION:** $70 billion* 4-week bills $75 billion* 8-week bills $23 billion 5-year TIPS **ANNOUNCE:** $140 billion* 13-,26-week bills for auction on Apr 22 $69 billion* 2-year notes for auction on Apr 23 $70 billion* 5-year notes for auction on Apr 24 $44 billion* 7-year notes for auction on Apr 25 $30 billion* 2-year FRNs for auction on Apr 24 **SETTLE:** $140 billion 13-,26-week bills $46 billion 52-week bills $65 billion 42-day CMBs	
22	23	24	25	26
AUCTION: $140 billion* 13-,26-week bills	**AUCTION:** $69 billion* 2-year notes **ANNOUNCE:** $60 billion* 17-week bills for auction on Apr 24 $70 billion* 4-week bills for auction on Apr 25 $75 billion* 8-week bills for auction on Apr 25 **SETTLE:** $60 billion* 17-week bills $70 billion* 4-week bills $75 billion* 8-week bills	**AUCTION:** $60 billion* 17-week bills $70 billion* 5-year notes $30 billion* 2-year FRNs	**AUCTION:** $70 billion* 4-week bills $75 billion* 8-week bills $44 billion* 7-year notes **ANNOUNCE:** $140 billion* 13-,26-week bills for auction on Apr 29 **SETTLE:** $140 billion* 13-,26-week bills	
29	30	1	2	3
AUCTION: $140 billion* 13-,26-week bills	**ANNOUNCE:** $60 billion* 17-week bills for auction on May 1 $70 billion* 4-week bills for auction on May 2 $75 billion* 8-week bills for auction on May 2 **SETTLE:** $60 billion* 17-week bills $70 billion* 4-week bills $75 billion* 8-week bills $13 billion 20-year bonds $23 billion 5-year TIPS $69 billion* 2-year notes $70 billion* 5-year notes $44 billion* 7-year notes $30 billion* 2-year FRNs	**AUCTION:** $60 billion* 17-week bills **ANNOUNCE:** $58 billion* 3-year notes for auction on May 7 $42 billion* 10-year notes for auction on May 8 $25 billion* 30-year bonds for auction on May 9	**AUCTION:** $70 billion* 4-week bills $75 billion* 8-week bills **ANNOUNCE:** $140 billion* 13-,26-week bills for auction on May 6 **SETTLE:** $140 billion* 13-,26-week bills	

**Estimate*