Daiwa Capital Markets

U.S. Economic Comment

- FOMC preview: a friendlier Fed
- Inflation: hints of a pickup, but a non-issue at this time

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FOMC Preview

The Federal Open Market Committee is likely to validate at its meeting on September 18 the wide-spread expectation of a 25 basis point reduction in the federal funds rate. The more important aspect of the meeting will be the clues sent by officials regarding possible changes in coming months. We expect the Fed to send a friendlier message than it did after the rate cut in July.

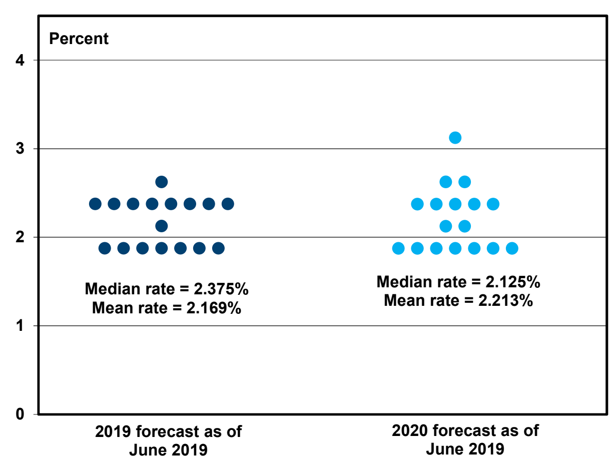
Although the Fed cut interest rates in July, officials did not seem to be on an aggressive track. Chair Powell in his press conference characterized the change as a "mid-cycle adjustment," and he hinted that he did not see the shift as the first in a long series of changes. Since that time, the environment has changed. Trade tensions have intensified, as President Trump announced additional tariffs on imports from China and increased the duties already in place. In addition, slow global growth has become more of an issue, evident with the downward revisions to the staff forecast of the European Central Bank and the additional policy accommodation provided by the Governing Council of the ECB. Finally, geopolitical risks have become more prominent, with prospects for Brexit more uncertain and disruptions in Hong Kong in the news.

Against this background, we doubt that Chair Powell will be talking about mid-cycle adjustments. Rather, he is likely to emphasize uncertainty in the outlook and note that the Fed is prepared to provide additional support. John Williams, the President of the New York Fed and the Vice Chair of the FOMC, suggested in his latest speech that he is prepared to be aggressive: "my number one goal is to keep the expansion on track."

We also expect notable changes in the dot plot of the FOMC. Specifically, we look for the dots to shift downward and for the dispersions to tighten. We view the dispersions of the dots as important -- perhaps the most important aspect of the plots -- as they signal the degree of unanimity among Fed officials. Tight dispersions suggest that policymakers are of like mind, and therefore they are likely to follow through on the expected policy changes. Wide dispersions indicate contrasting views and a limited probability of reaching agreement. Market participants tend to focus on the median dot, but this dot is almost meaningless if dispersions are wide.

The dot plot and policy statement in June indicated that officials were not fully committed to policy easing: although seven policymakers envisioned two rate cuts before the end of the year, the median dot suggested no change in policy and one official expected to hike interest rates (chart). The new plot, we suspect, will show a tight dispersion for 2019 and the possibility of the federal funds rate moving to 1.625 percent by the end of this year (versus 2.125 currently). We look for the 2020 dots to show additional easing, although the expected adjustment is likely to be modest -- Fed officials are loath to suggest a slowing economy and a need for support.

FOMC Rate View: Year-End 2019 & 2020*



** Each dot represents the expected federal funds rate of a Fed official at the end of 2019 and 2020. Normally, this graph would contain 19 projections (seven governors of the Federal Reserve Board and 12 reserve bank presidents), but two governorships were open at the June 2019 meeting.*

Source: Federal Open Market Committee, Summary of Economic Projections, June 2019

Inflation

Recent readings on the consumer price index might lead some Fed officials to resist further easing of policy, as the core component has increased 0.3 percent for three consecutive months. Some of the surge represents payback for soft readings in the early months of the year (four of the first five months of 2019 showed increases of 0.1 percent), but more is involved because the year-over-year change has jumped to 2.4 percent, matching the fastest pace of the current expansion.

While the pickup is notable, we do not view the recent shifts as threatening. A good portion of the pressure occurred in volatile areas that are likely to follow their normal course and settle in the months ahead (apparel, used vehicles, airfares). In addition, a few items posted sudden, sharp increases that had the feel of one-off changes (hospital fees, cable charges, computers). Increases of 0.2 percent in the median and trimmed-mean CPIs calculated by the Federal Reserve Bank of Cleveland support the view that idiosyncratic factors played a role in August.

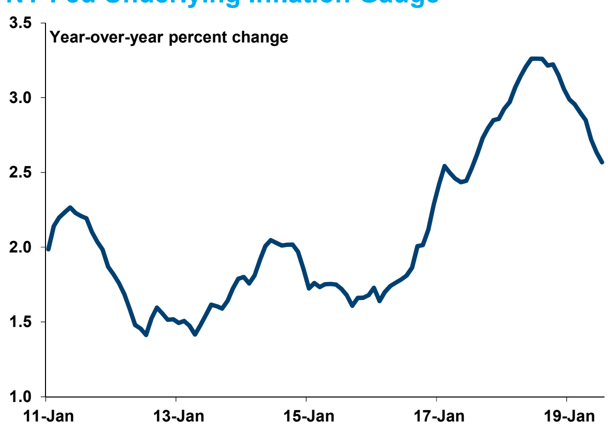
Moreover, other inflation-related indicators have not sent troubling signals. The price index for personal consumption expenditures -- the measure targeted by the Fed -- has not stirred this year. The headline index has averaged increases of 0.1 percent per month so far this year, with the year-over-year change totaling 1.4 percent. The core PCE price index, like the core CPI, started the year slow, but it has not yet registered an increase of 0.3 percent. The average monthly increase so far this year has totaled 0.1 percent and the year-over-year change is below target at 1.6 percent.

Import prices will have a bearing on U.S. inflation, and recent developments suggest a soft environment. Prices of nonfuel imports have been flat or down for six consecutive months and in 13 of the past 15 months. A broad measure published by the Federal Reserve Bank of New York -- one that includes prices as well as economic and financial variables that influence prices -- has taken a friendly turn. After increasing from mid-2016 to mid-2018, the index has eased in the past year (chart, left).

Fed officials also will be monitoring inflation expectations in making their policy decisions, and results here are universally tame, perhaps too soft. Break-even rates on inflation-protected securities have eased since last fall and are in the low portions of their ranges. Survey-based measures also are contained. The long-term measure in the Reuters/University of Michigan survey of consumers has moved lower in the past few years and monthly gyrations are now tracing a steady trend (chart, right). The survey of professional forecasters conducted by the Federal Reserve Bank of Philadelphia also has been rock steady.

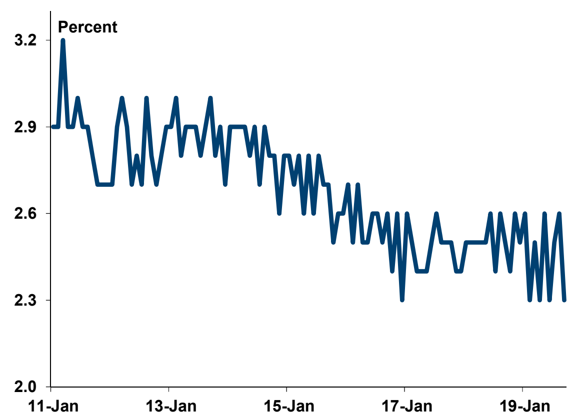
Thus, rather than representing a constraint on policy easing, recent inflation developments support the case for additional rate cuts.

NY Fed Underlying Inflation Gauge



Source: Federal Reserve Bank of New York via Haver Analytics

Long-Term Inflation Expectations*



** Median inflation expectations over the next five to 10 years.*
Source: University of Michigan Survey of Consumers via Haver Analytics

Review

Week of Sept. 9, 2019	Actual	Consensus	Comments
PPI (August)	**0.1% Total, 0.4% Core***	**0.0% Total, 0.2% Core***	Prices of both food and energy declined in August (-0.6% and -2.5%, respectively), but this softness was more than offset by the jump in the core component. The pressure in the core component was concentrated in the erratic service category, especially services less trade, transportation, and warehousing (0.5%). Prices of core goods were unchanged, marking the seventh consecutive month of either a decline of 0.1%, no change, or an increase of only 0.1%.
CPI (August)	**0.1% Total, 0.3% Core**	**0.1% Total, 0.2% Core**	Prices of food and energy were well contained in August (unchanged and down 1.9%, respectively), although the core component provided an upside surprise with its third consecutive increase of 0.3%. The pickup in the core CPI might be viewed as a sign of accelerating inflation, but some of the quickening represents an offset to soft readings on inflation in the early months of the year. In addition, some of the pressure came in volatile areas and might prove to be temporary, and a few items posted sudden, sharp increases that had the feel of one-off changes.
Federal Budget (August)	**$200.3 Billion Deficit**	**$200.0 Billion Deficit**	Revenues rose 4.0 % from the same month last year, shy of the average of 7.5% in the prior six months, but still a respectable advance. Outlays eased 1.1% on a year-over-year basis, but the drop was largely the result of an odd calendar configuration in 2018 that pulled much of the Social Security payment for September into August and left an elevated base for the year-over-year calculation. The deficit in the first 11 months of the fiscal year totaled $1,067 billion. The federal government typically runs a budget surplus in September, which could leave the deficit for the full fiscal year shy of $1.0 trillion.
Retail Sales (August)	**0.4% Total, 0.0% Ex-Autos**	**0.2% Total, 0.1% Ex-Autos**	The auto component of retail sales posted a firm advance (1.8%), but several other areas registered soft results. The flat reading ex-autos was neither surprising nor troubling, as the report in the prior month was quite strong (1.0% ex-autos), and the average advance in the past two months was consistent with good support from the consumer sector. While several areas gave back some of the strength in July, nonstore retailers continued to roar ahead. The average increase of 1.9% from May through August was notably stronger than the typical advance of 0.8 to 1.0% per month.
Consumer Sentiment (September)	**92.0 (+2.4%)**	**90.8 (+1.1%)**	The increase in the consumer sentiment index reversed only a portion of 8.7% decline in August and kept the measure in the low portion of the range from the past few years.

** The core PPI excludes food, energy, and trade services.*

Source: Bureau of Labor Statistics (PPI, CPI); U.S. Treasury Department (Federal Budget); U.S. Census Bureau (Retail Sales); University of Michigan Survey of Consumers (Consumer Sentiment); Consensus forecasts are from Bloomberg

Preview

Week of Sept. 16, 2019	Projected	Comments
Industrial Production (August) (Tuesday)	**0.3%**	With payrolls slightly larger and the average workweek longer, the manufacturing sector is likely post a gain, but declines in mining employment and the rotary rig count suggest a drop in mining activity. With temperatures close to normal, utility output should be little changed.
Housing Starts (August) (Wednesday)	**1.220 Million (+2.4%)**	Unimpressive sales in July and ample inventories of unsold homes probably led builders to limit the number of single-family homes started. Multi-family starts, however, are likely to rebound from a low-side reading in July and pull overall starts higher.
Current Account (2019-Q2) (Thursday)	**$118.0 Billion Deficit ($12.4 Billion Narrower Deficit)**	The trade balance slipped in the second quarter, but this deterioration should be more than offset by a sizeable pickup in net income flows, leading to a narrower current account deficit.
Existing Home Sales (August) (Thursday)	**5.40 Million (-0.4%)**	The interest rate environment is favorable, but a dip in pending home sales in July and soft readings on mortgage applications for home purchases suggest that home buyers have not responded enthusiastically. Sales should be able to remain close to their level in July, which is much improved from the lull in late 2018 but shy of the best readings of the current expansion.
Leading Indicators (August) (Thursday)	**-0.2%**	The leading credit index is likely to add 0.1 percentage point to the LEI, but this contribution will probably be offset by negative influences from ISM new orders, stock prices, unemployment claims, and the slope of the yield curve. The expected reading, if realized, would continue a choppy pattern that has left a modest net increase in the past year.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

September/October 2019

Monday	Tuesday	Wednesday	Thursday	Friday
9	10	11	12	13
CONSUMER CREDIT May $16.8 billion June $13.8 billion July $23.3 billion	**NFIB SMALL BUSINESS OPTIMISM INDEX** June 103.3 July 104.7 Aug 103.1 **JOLTS DATA** Openings (000) Quit Rate May 7,384 2.3% June 7,248 2.3% July 7,217 2.4%	**PPI** Final Demand Core* June 0.1% 0.0% July 0.2% -0.1% Aug 0.1% 0.4% **WHOLESALE TRADE** Inventories Sales May 0.4% -0.6% June -0.1% -0.3% July 0.2% 0.3%	**INITIAL CLAIMS** Aug 24 216,000 Aug 31 219,000 Sept 07 204,000 **CPI** Total Core June 0.1% 0.3% July 0.3% 0.3% Aug 0.1% 0.3% **FEDERAL BUDGET** 2019 2018 June -$8.5B -$74.9B July -$119.7B -$76.9B Aug -$200.3B -$214.1B	**RETAIL SALES** Total Ex.Autos June 0.4% 0.3% July 0.8% 1.0% Aug 0.4% 0.0% **IMPORT/EXPORT PRICES** Non-fuel Imports Nonagri. Exports June -0.3% -0.9% July 0.0% 0.2% Aug 0.0% -0.4% **CONSUMER SENTIMENT** July 98.4 Aug 89.8 Sept 92.0 **BUSINESS INVENTORIES** Inventories Sales May 0.3% -0.1% June 0.0% 0.0% July 0.4% 0.3%
16	17	18	19	20
EMPIRE MFG (8:30) July 4.3 Aug 4.8 Sept --	**IP & CAP-U (9:15)** IP Cap.Util. June 0.2% 77.8% July -0.2% 77.5% **Aug 0.3% 77.6%** **NAHB HOUSING INDEX (10:00)** July 65 Aug 66 Sept -- **TIC DATA (4:00)** Total Net L-T May $37.6B $4.6B June $1.7B $99.1B July -- -- **FOMC MEETING**	**HOUSING STARTS (8:30)** June 1.241 million July 1.191 million **Aug 1.220 million** **FOMC DECISION (2:00)** **POWELL PRESS CONFERENCE (2:30)**	**INITIAL CLAIMS (8:30)** **CURRENT ACCOUNT (8:30)** 18-Q4 -$143.9 bill. 19-Q1 -$130.4 bill. **19-Q2 -$118.0 bill.** **PHILLY FED INDEX (8:30)** July 21.8 Aug 16.8 Sept -- **EXISTING HOME SALES (10:00)** June 5.29 million July 5.42 million **Aug 5.40 million** **LEADING INDICATORS (10:00)** June -0.1% July 0.5% **Aug -0.2%**	
23	24	25	26	27
CHICAGO FED NAT'L ACTIVITY INDEX	**FHFA HOME PRICE INDEX** **S&P CORELOGIC CASE-SHILLER HOME PRICE INDEX** **CONSUMER CONFIDENCE**	**NEW HOME SALES**	**INITIAL CLAIMS** **REVISED GDP** **US INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES** **PENDING HOME SALES**	**PERSONAL INCOME, CONSUMPTION, PRICES** **DURABLE GOODS ORDERS** **REVISED CONSUMER SENTIMENT**
30	1	2	3	4
CHICAGO PURCHASING MANAGERS' INDEX	**ISM INDEX** **CONSTRUCTION SPEND.** **VEHICLE SALES**	**ADP EMPLOYMENT REPORT**	**INITIAL CLAIMS** **FACTORY ORDERS** **ISM NON-MFG INDEX**	**EMPLOYMENT REPORT** **TRADE BALANCE**

*Forecasts in Bold * The core PPI excludes food, energy, and trade services.*

Treasury Financing

September/October 2019

Monday	Tuesday	Wednesday	Thursday	Friday
9	10	11	12	13
AUCTION RESULTS: Rate / Cover 13-week bills 1.920% 3.05 26-week bills 1.825% 2.98	**AUCTION RESULTS:** Rate / Cover 52-week bills 1.740% 2.81 3-year notes 1.573% 2.42 **ANNOUNCE:** $50 billion 4-week bills for auction on September 12 $40 billion 8-week bills for auction on September 12 **SETTLE:** $55 billion 4-week bills $40 billion 8-week bills	**AUCTION RESULTS:** Rate / Cover 10-yr notes 1.739% 2.46	**AUCTION RESULTS:** Rate / Cover 4-week bills 1.940% 2.81 8-week bills 1.920% 2.87 30-yr bonds 2.270% 2.22 **ANNOUNCE:** $87 billion 13-,26-week bills for auction on September 16 $12 billion 10-year TIPS for auction on September 19 **SETTLE:** $87 billion 13-,26-week bills $28 billion 52-week bills	
16	17	18	19	20
AUCTION: $87 billion 13-,26-week bills **SETTLE:** $38 billion 3-year notes $24 billion 10-year notes $16 billion 30-year bonds	**ANNOUNCE:** $50 billion* 4-week bills for auction on September 19 $40 billion* 8-week bills for auction on September 19 **SETTLE:** $50 billion 4-week bills $40 billion 8-week bills		**AUCTION:** $50 billion* 4-week bills $40 billion* 8-week bills $12 billion 10-year TIPS **ANNOUNCE:** $87 billion* 13-,26-week bills for auction on September 23 $18 billion* 2-year FRNs for auction on September 25 $40 billion* 2-year notes for auction on September 24 $41 billion* 5-year notes for auction on September 25 $32 billion* 7-year notes for auction on September 26 **SETTLE:** $87 billion 13-,26-week bills	
23	24	25	26	27
AUCTION: $87 billion* 13-,26-week bills	**AUCTION:** $40 billion* 2-year notes **ANNOUNCE:** $50 billion* 4-week bills for auction on September 26 $40 billion* 8-week bills for auction on September 26 **SETTLE:** $50 billion* 4-week bills $40 billion* 8-week bills	**AUCTION:** $18 billion* 2-year FRNs $41 billion* 5-year notes	**AUCTION:** $50 billion* 4-week bills $40 billion* 8-week bills $32 billion* 7-year notes **ANNOUNCE:** $87 billion* 13-,26-week bills for auction on September 30 **SETTLE:** $87 billion* 13-,26-week bills	**SETTLE:** $18 billion* 2-year FRNs
30	1	2	3	4
AUCTION: $87 billion* 13-,26-week bills **SETTLE:** $12 billion 10-year TIPS $40 billion* 2-year notes $41 billion* 5-year notes $32 billion* 7-year notes	**ANNOUNCE:** $50 billion* 4-week bills for auction on October 3 $40 billion* 8-week bills for auction on October 3 **SETTLE:** $50 billion* 4-week bills $40 billion* 8-week bills		**AUCTION:** $50 billion* 4-week bills $40 billion* 8-week bills **ANNOUNCE:** $87 billion* 13-,26-week bills for auction on October 7 $28 billion* 52-week bills for auction on October 8 $38 billion* 3-year notes for auction on October 8 $24 billion* 10-year notes for auction on October 9 $16 billion* 30-year bonds for auction on October 10 **SETTLE:** $87 billion* 13-,26-week bills	

**Estimate*