Daiwa Capital Markets

U.S. Economic Comment

- The U.S. consumer: still providing support
- Inflation expectations: perhaps easing

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U.S. Households: Still Favorable Fundamentals

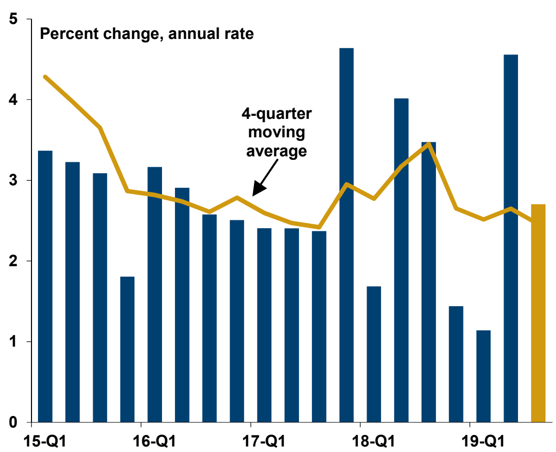
The minutes from the September meeting of the Federal Open Market Committee noted a concern among Fed officials about fading support from consumers. If restrained capital spending and export activities of businesses were to spread to their hiring decisions, the minutes noted, the income and spending of individuals also would probably begin to soften. A weak report on retail sales for September might stir thoughts that consumer support is indeed beginning to flag. However, we would not draw this conclusion.

To be sure, retail sales in September were soft (down 0.3 percent overall and flat excluding the volatile auto and gasoline components), but much of the weakness seemed to reflect payback for unusually strong results in the prior two months. Taking account of brisk results in July and further gains in August, real consumer spending in Q3 seems on track to increase approximately 2¾ percent, in line with the average performance of the past three years or so (chart, left).

Fundamentals for consumer spending also do not suggest meaningful slowing, as the labor market remains firm and the financial position of the household sector is strong in the aggregate.

The Labor Market. The pace of job growth has slowed this year, but the average advance of approximately 155,000 in recent months has been more than enough to absorb new entrants into the labor force, thereby gradually reducing unemployment. In addition, job security seems high, as consistently low readings on claims for unemployment insurance indicate that layoffs are not an issue at this time. Individuals apparently sense brisk conditions in the labor market, as the latest reading on job assessments from the Conference Board jumped to a new cyclical high in August – one only moderately below the record reading during the Tech boon in 2000 – and it gave back only a small portion of that advance in September (chart, right).

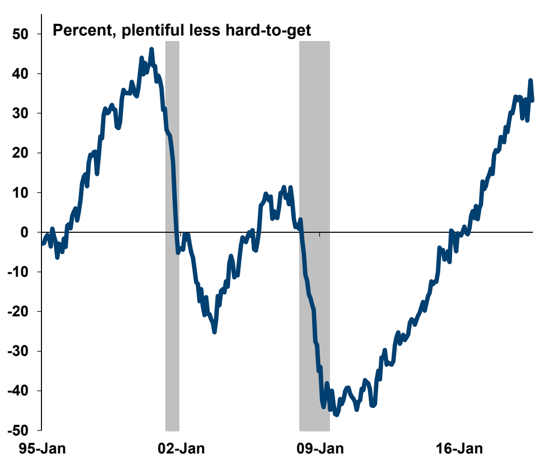
Consumer Spending Growth*



* The reading for 2019-Q3 (gold bar) is a projection based on available data.

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

Labor Market Assessment*



* The share of individuals reporting that jobs are plentiful less the share reporting that jobs are hard to get; the measure is taken from the Conference Board's Consumer Confidence Survey. The shaded areas on the chart show periods of recession in the U.S.

Source: The Conference Board and National Bureau of Economic Research via Haver Analytics

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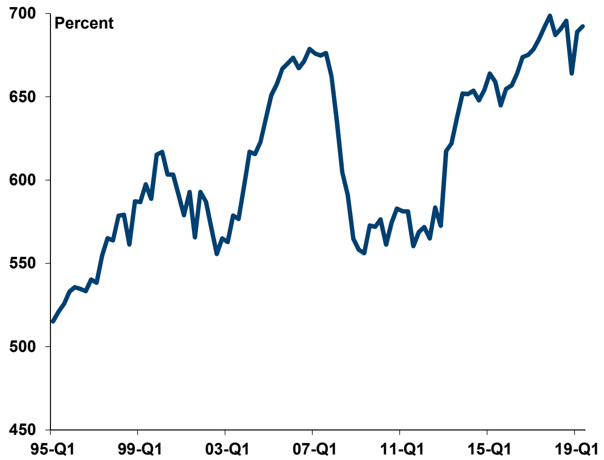
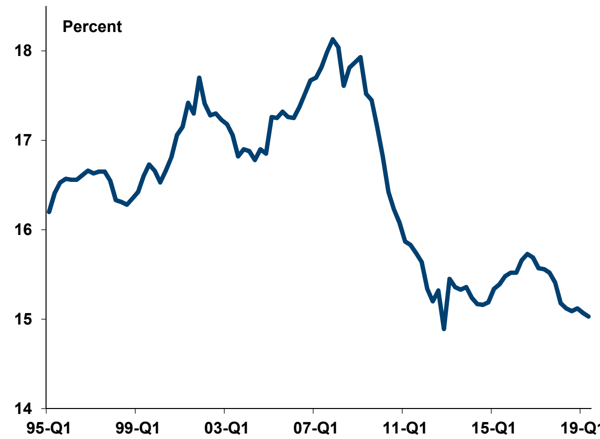
Household Net Worth*



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

Household Financial Obligations Ratio*



* *The ratio of financial obligations to disposable personal income. Financial obligations include required loan payments, lease payments, rental payments for tenant-occupied property, homeowners' insurance premiums, and property tax payments.*
Source: Federal Reserve Board via Haver Analytics

Financial Positions. The economic expansion has not boosted the fortunes of all individuals, but the household sector in total is financially sound. The net worth of all households has increased sharply since the end of the recession and has exceeded previous records by a comfortable margin (chart, left). The improvement in wealth has been driven primarily by the advance in the stock market and by the recovery in home values. In addition, individuals have used debt judiciously and have saved more diligently than they did before the financial crisis. Careful management of financial affairs, along with rock-bottom interest rates, has left most individuals with manageable debt burdens, as the financial obligations ratio is in the low potion of its historical range (chart, right). Sound financial positions also are evident in delinquency rates on consumer loans and mortgages, which are in the low portions of their historical ranges.

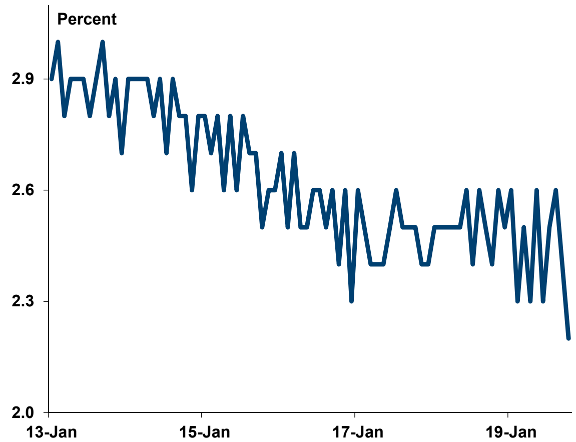
While traditional factors that drive consumer spending – the labor market and financial positions – are healthy, a tentative geopolitical environment might leave individuals uneasy and lead to hesitation in spending. There is no shortage of sources of uncertainty: the trade war with China, Brexit, slow global growth, unsettled conditions in the Mid-East. Consumers are certainly aware of uncertainties that have emerged, but they still feel reasonably comfortable about the current setting. The two leading measures of consumer attitudes -- the confidence index published by the Conference Board, and the sentiment index published by Reuters and the University of Michigan Survey Research Center -- are off highs for the current cycle, but they are still elevated by historical standards.

FOMC: Likely to Notice Inflation Expectations

A generally favorable outlook for consumer spending represents a strong argument for holding policy steady at the October 29-30 meeting of the FOMC, but other factors might prompt the Committee to act. Officials are likely to be concerned about downside risks in other areas, especially capital spending and net exports, and they will receive important reports on these fronts before they meet (orders for capital goods on October 24 and international trade in goods on October 28).

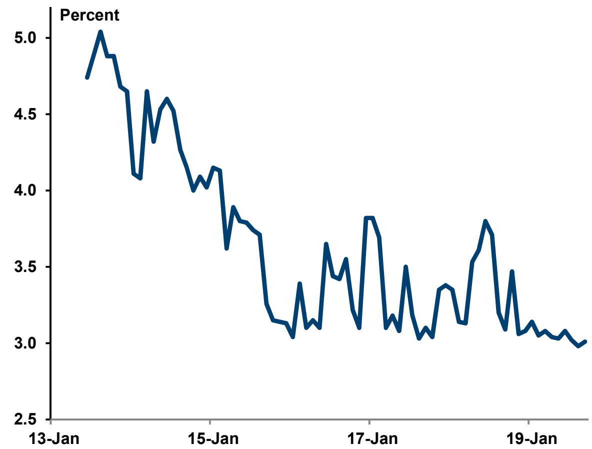
In addition, a subdued inflation environment is likely to lead several officials to favor additional easing. A tame CPI for September supports the view of limited inflation risks. More important, suggestions of diminishing inflation expectations could be cited as a strong argument for reducing interest rates again. Inflation expectations are difficult to measure, and thus shifts in any single measure should always be interpreted cautiously. However, if several measures move together, the change should be taken more seriously, and several key measures monitored by officials have softened recently.

Long-Term Inflation Expectations*



** The expected change in prices over the next five to 10 years.*
Source: University of Michigan Survey of Consumers via Haver Analytics

Median Three-Year-Ahead Inflation Rate*



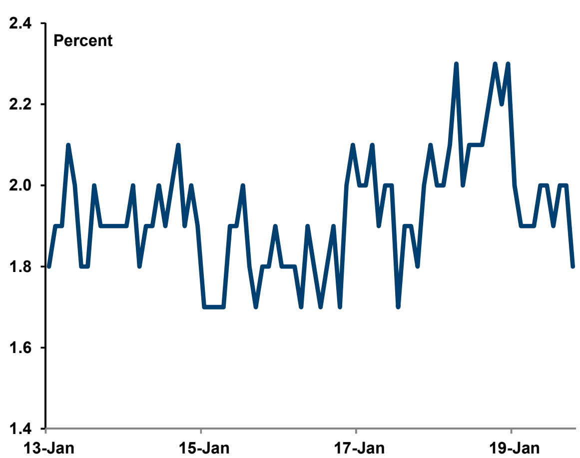
Source: Survey of Consumer Expectations, Federal Reserve Bank of New York via Haver Analytics

The long-term inflation gauge published by Reuters and the University of Michigan Survey Research Center has been drifting lower over the past few years, and the latest reading raises the possibility of another step lower (chart, above left). As noted, single observations should be interpreted cautiously, but other measures also have shown an easing in inflation expectations recently. The survey of consumers conducted by New York Fed has shown a downward drift in inflation expectations throughout the year, and the survey of business executives conducted by the Atlanta Fed has shown a marked decline in the past two months (charts, above right and below left). The Atlanta measure is still within the range of the current expansion, but very much in the low portion of that range.

In addition to various survey-based measures, the Fed keeps a close eye on market-based measures, and they too suggest restrained outlooks. Virtually all break-even rates on inflation-protected securities are in the low portions of their ranges, as shown by the five-year forward expectation (chart, below right).

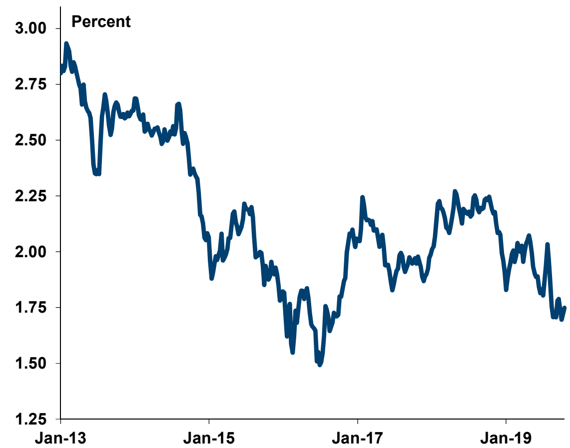
One cannot say unambiguously that inflation expectations have eased, but recent evidence is pointing in that direction.

Business Year-Ahead Mean Inflation Expectations



Source: Business Inflation Expectations Survey, Federal Reserve Bank of Atlanta via Haver Analytics

Five-Year, Five-Year-Forward Break-Even Rate*



** The five-year break-even inflation rate, five years from now. Weekly average data.*
Source: Bloomberg

Review

Week of October 14, 2019	Actual	Consensus	Comments
Retail Sales (September)	**-0.3% Total, -0.1% Ex-Autos**	**0.3% Total, 0.2% Ex-Autos**	Much of the softness in retail sales during September reflected changes that could be viewed as statistical noise in volatile areas (declines in the auto and building supply categories after surges in the prior month; a price-related drop in gasoline sales). A more surprising shift occurred in the nonstore area (primarily catalogue and internet), which fell 0.3%, a marked contrast to the usual advance of 0.7% to 1.0%. This drop might also be viewed as statistical noise, as results in the prior four months were unusually strong (average gain of 1.7%). Given these apparently special situations, the sluggish performance did not seem to signal diminishing support from consumers.
Housing Starts (September)	**1.256 Million (-3.2%)**	**1.320 Million (-9.4%)**	All of the softness in housing starts occurred in the volatile multi-family sector, and the drop of 28.2% could be viewed as normal volatility, as it followed a surge of 41.4% in the prior month. Single-family starts rose 0.3%. The change was modest, but it followed solid results in the prior month and left activity in the upper portion of the range for the current expansion. The gains in the past two months added to the net improvement from soft activity in the closing months of last year.
Industrial Production (September)	**-0.4%**	**-0.2%**	Both manufacturing and mining contributed to the decline in total industrial activity (off 0.5% and 1.3%, respectively). Output in the utility sector rose 1.4%, stirred by warmer-than-normal temperatures. The decline in the manufacturing sector was heavily influenced by a drop of 4.2% in the auto industry, which undoubtedly reflected the effects of the strike at General Motors. However, other activity also was soft, as shown by a drop of 0.2% excluding autos. Although manufacturing activity softened in September, the level of production remained above the recent low in April, and production in the third quarter increased at an annual rate of 1.2% after declining in the prior two quarters. The drop in mining activity occurred from an elevated reading in August and the level of production remained in the middle of the recent range and above levels seen throughout last year.
Leading Indicators (September)	**-0.1%**	**0.0%**	Negative contributions from ISM new orders, building permits, and the slope of the yield curve more than offset small positive contributions from several other components. The dip in the leading indicator index left only a marginal advance for the year thus far (0.7% at an annual rate), a notable shift from average annual growth of 3.8% from 2016 through 2018.

Source: U.S. Census Bureau (Retail Sales, Housing Starts); Federal Reserve Board (Industrial Production); The Conference Board (Leading Indicators); Consensus forecasts are from Bloomberg

Preview

Week of October 21, 2019	Projected	Comments
Existing Home Sales (September) (Tuesday)	**5.55 Million (+1.1%)**	Low mortgage interest rates have stirred home sales in recent months, pushing activity to the upper portion of the range in the current expansion. Attractive financing costs could lead to another advance in September, although moderate changes in pending home sales and mortgage applications do not suggest a breakout to a new cyclical high.
Durable Goods Orders (September) (Thursday)	**0.0%**	Soft exports and restrained capital spending have slowed activity in the manufacturing sector, which will probably translate to sluggish order flows.
New Home Sales (September) (Thursday)	**0.720 Million (+1.0%)**	Low mortgage rates should continue to support housing activity. The expected advance in September would push sales of new homes close to the cyclical high of 729,000 units registered in June.
Revised Consumer Sentiment (October) (Friday)	**96.0 (Unrevised)**	The news flow has not been striking enough to suspect a meaningful revision to the preliminary tally published on October 11.
Federal Budget (September) (One Day This Week)	**$85.0 Billion Surplus**	September typically involves strong revenue flows because of estimated tax payments by corporations and individuals, which usually leaves a monthly budget surplus. Available data suggest that receipts this year were strong (up approximately 9% from the same month last year). Outlays are likely to be substantially larger than the total from September 2018, but the jump reflects unusually light expenditures last year associated with a calendar configuration that moved some Social Security and Medicare spending from September to August. The expected surplus, if realized, would leave the budget deficit for FY2019 at $982 billion.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

October/November 2019

Monday	Tuesday	Wednesday	Thursday	Friday
14	15	16	17	18
COLUMBUS DAY **EMPIRE MFG** Aug 4.8 Sept 2.0 Oct 4.0		**RETAIL SALES** Total Ex.Autos July 0.7% 0.9% Aug 0.6% 0.2% Sept -0.3% -0.1% **NAHB HOUSING INDEX** Aug 67 Sept 68 Oct 71 **BUSINESS INVENTORIES** Inventories Sales June 0.0% 0.0% July 0.3% 0.2% Aug 0.0% 0.2% **OCTOBER BEIGE BOOK** "The U.S. economy expanded at a slight to modest pace since the prior report as business activity varied across the country." **TIC DATA** Total Net L-T June $21.0B $100.6B July $43.3B $83.8B Aug $70.5B -$41.1B	**INITIAL CLAIMS** Sept 28 220,000 Oct 05 210,000 Sept 12 214,000 **HOUSING STARTS** July 1.204 million Aug 1.386 million Sept 1.256 million **PHILLY FED INDEX** Aug 16.8 Sept 12.0 Oct 5.6 **IP & CAP-U** IP Cap.Util. July -0.2% 77.4% Aug 0.8% 77.9% Sept -0.4% 77.5%	**LEADING INDICATORS** July 0.4% Aug -0.2% Sept -0.1%
21	22	23	24	25
FEDERAL BUDGET (2:00) **(ONE DAY THIS WEEK)** 2019 2018 July -$119.7B -$76.9B Aug -$200.3B -$214.1B **Sept** **$85.0B** $119.1B	**EXISTING HOME SALES (10:00)** July 5.42 million Aug 5.49 million **Sept** **5.55 million**	**FHFA HOME PRICE INDEX (9:00)** June 0.2% July 0.4% Aug --	**INITIAL CLAIMS (8:30)** **DURABLE GOODS ORDERS (8:30)** July 2.1% Aug 0.2% **Sept** **0.0%** **NEW HOME SALES (10:00)** July 0.666 million Aug 0.713 million **Sept** **0.720 million**	**REVISED CONSUMER SENTIMENT (10:00)** Aug 89.8 Sept 93.2 Oct (p) 96.0
28	29	30	31	1
CHICAGO FED NATIONAL ACTIVITY INDEX **U.S. INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES**	**S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** **CONSUMER CONFIDENCE** **PENDING HOME SALES** **FOMC MEETING**	**ADP EMPLOYMENT REPORT** **Q3 GDP** **FOMC DECISION**	**INITIAL CLAIMS** **PERSONAL INCOME, CONSUMPTION, PRICES** **EMPLOYMENT COST INDEX** **CHICAGO PURCHASING MANAGERS' INDEX**	**EMPLOYMENT REPORT** **ISM MFG INDEX** **CONSTRUCTION SPEND.** **VEHICLE SALES**
4	5	6	7	8
FACTORY ORDERS	**TRADE BALANCE** **ISM NON-MFG INDEX** **JOLTS DATA**	**PRODUCTIVITY & COSTS**	**INITIAL CLAIMS** **CONSUMER CREDIT**	**CONSUMER SENTIMENT** **WHOLESALE TRADE**

Forecasts in Bold. (p) = preliminary

Treasury Financing

October/November 2019

Monday	Tuesday	Wednesday	Thursday	Friday
14	15	16	17	18
COLUMBUS DAY	**AUCTION RESULTS:** Rate / Cover 13-week bills 1.640% 2.58 26-week bills 1.620% 3.15 **ANNOUNCE:** $55 billion 4-week bills for auction on October 17 $40 billion 8-week bills for auction on October 17 **SETTLE:** $50 billion 4-week bills $40 billion 8-week bills $38 billion 3-year notes $24 billion 10-year notes $16 billion 30-year bonds		**AUCTION RESULTS:** Rate / Cover 4-week bills 1.720% 2.50 8-week bills 1.665% 2.99 5-year TIPS 0.054% 2.75 **ANNOUNCE:** $87 billion 13-,26-week bills for auction on October 21 $20 billion 2-year FRNs for auction on October 23 $40 billion 2-year notes for auction on October 22 $41 billion 5-year notes for auction on October 23 $32 billion 7-year notes for auction on October 24 **SETTLE:** $87 billion 13-,26-week bills	
21	22	23	24	25
AUCTION: $87 billion 13-,26-week bills	**AUCTION:** $40 billion 2-year notes **ANNOUNCE:** $55 billion* 4-week bills for auction on October 24 $40 billion* 8-week bills for auction on October 24 **SETTLE:** $55 billion 4-week bills $40 billion 8-week bills	**AUCTION:** $20 billion 2-year FRNs $41 billion 5-year notes	**AUCTION:** $55 billion* 4-week bills $40 billion* 8-week bills $32 billion 7-year notes **ANNOUNCE:** $87 billion* 13-,26-week bills for auction on October 28 **SETTLE:** $87 billion 13-,26-week bills	
28	29	30	31	1
AUCTION: $87 billion* 13-,26-week bills	**ANNOUNCE:** $55 billion* 4-week bills for auction on October 31 $40 billion* 8-week bills for auction on October 31 **SETTLE:** $55 billion* 4-week bills $40 billion* 8-week bills	**ANNOUNCE:** $38 billion* 3-year notes for auction on November 5 $27 billion* 10-year notes for auction on November 6 $19 billion* 30-year bonds for auction on November 7	**AUCTION:** $55 billion* 4-week bills $40 billion* 8-week bills **ANNOUNCE:** $87 billion* 13-,26-week bills for auction on November 4 $28 billion* 52-week bills for auction on November 5 **SETTLE:** $87 billion* 13-,26-week bills $17 billion 5-year TIPS $20 billion 2-year FRNs $40 billion 2-year notes $41 billion 5-year notes $32 billion 7-year notes	
4	5	6	7	8
AUCTION: $87 billion* 13-,26-week bills	**AUCTION:** $28 billion* 52-week bills $38 billion* 3-year notes **ANNOUNCE:** $55 billion* 4-week bills for auction on November 7 $40 billion* 8-week bills for auction on November 7 **SETTLE:** $55 billion* 4-week bills $40 billion* 8-week bills	**AUCTION:** $27 billion* 10-year notes	**AUCTION:** $55 billion* 4-week bills $40 billion* 8-week bills $19 billion* 30-year bonds **ANNOUNCE:** $87 billion* 13-,26-week bills for auction on November 12 **SETTLE:** $87 billion* 13-,26-week bills $28 billion* 52-week bills	

**Estimate*