Daiwa Capital Markets

U.S. Economic Comment

- FOMC preview: odds favor another cut
- GDP preview: further easing in Q3, but still respectable

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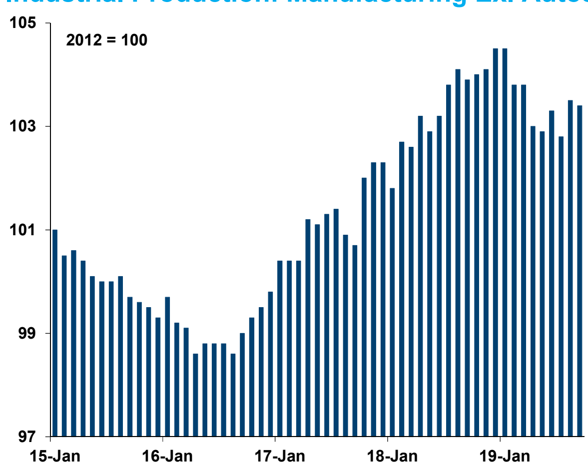
FOMC Preview

The Federal Open Market Committee faces a difficult decision at its upcoming meeting. The economy is performing reasonably well and the current financial environment is friendly, and thus the economy does not have a pressing need for additional monetary accommodation. At the same time, the outlook is uncertain and risks are skewed to the downside; additional insurance against a sluggish performance or recession is perhaps prudent. While the call is a close one, we believe that odds favor another rate cut, which will probably be the last one of the year.

Some of the recent economic statistics might lead Fed officials to favor steady policy. If the economy were to falter, the softening would most likely be the result of weak exports and feeble investment spending, both of which would be evident in soft manufacturing activity. However, recent reports related to the manufacturing sector have not been especially troubling. For example, the manufacturing component of industrial production (ex-autos to eliminate the effects of the strike at General Motors) fell only modestly in September after a pickup in August (chart, left). The results in the past two months suggest that activity is stabilizing or perhaps improving. Similarly, new orders for durable goods (ex-aircraft to eliminate the drag from Boeing) have been moving sideways in the past year or so. Of course, an expansion would be better, but order flows are not pointing to a retreat in activity.

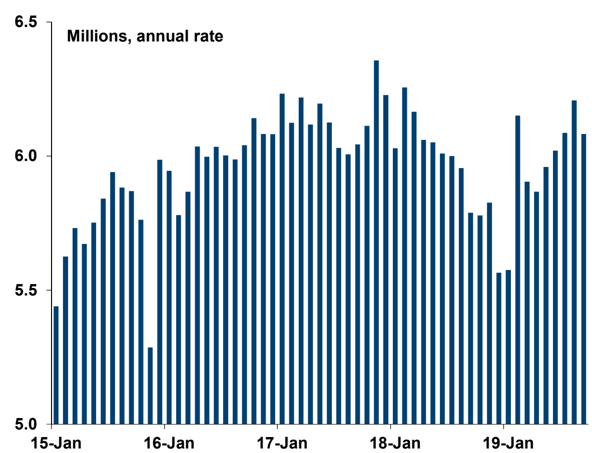
The housing market also has provided a bit of encouragement. After losing ground much of last year, home sales have picked up in response to lower interest rates and moved back to the upper portion of the range of the past several years (chart, right). Firmer sales have stirred home construction, as single-family housing starts also have moved to the upper end of their range. Available data suggests that residential construction in the GDP accounts expanded in the third quarter after declining in the prior six quarters (and in eight of the past nine quarters).

Industrial Production: Manufacturing Ex. Autos



Source: Federal Reserve Board via Haver Analytics

Total Home Sales*



** Sales of existing and new homes*

Source: National Association of Realtors and U.S. Census Bureau via Haver Analytics

The labor market suggests that the economy remains on track. Job growth has decelerated this year, but the average advance of 154,000 in the past six months is still fast enough to lead to a gradual reduction in the unemployment rate. Also, elevated job postings and minimal claims for unemployment insurance suggest that firm job growth will be well maintained for a time.

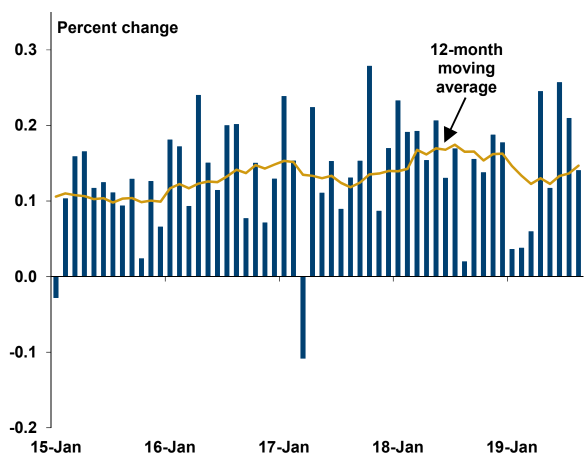
Fed officials realize that the economy is currently performing reasonably well; Chair Powell and Vice-Chair Clarida still describe the economy as being in a good place. It is downside risks that have prompted the Fed to begin easing policy, and the potential for a sluggish economy remains a concern. Officials frequently mention slowing global growth as a potential problem, and the recent downward revision to the global outlook published by the International Monetary Fund will reinforce that concern. (The IMF now expects growth of 3.0 percent this year, down from its forecast of 3.2 percent in the spring and 3.6 percent last year.)

Also, the third quarter GDP report for the U.S. -- published on October 30, the day of the interest rate decision -- might give policymakers pause. That report could well show growth totaling less than 2.0 percent (1.8 percent by our calculations, down from 3.1 in Q1 and 2.0 in Q2). In addition, the two key risk areas of the U.S. -- net exports and capital spending -- are likely to register soft performances, reinforcing the concern of Fed officials about downside risks to the outlook.

While a potential slowing in economic growth will play into the Fed's decision, the inflation environment is probably a bigger factor. The inflation rate has been difficult to read this year, as price pressure has been erratic. The core price index for personal consumption expenditures (PCE) rose at an annual rate of only 0.5 percent in the first three months of the year, followed by a jump of 2.5 percent in the next four months. Pressure seems to have eased again, as the core PCE index rose only 0.1 percent in August, and results for the CPI suggest another subdued advance in September (likely 0.1 percent, published on October 31; chart, left). Averaging through the month-to-month volatility would show an inflation rate below the Fed's target of 2.0 percent, providing a green light for additional easing.

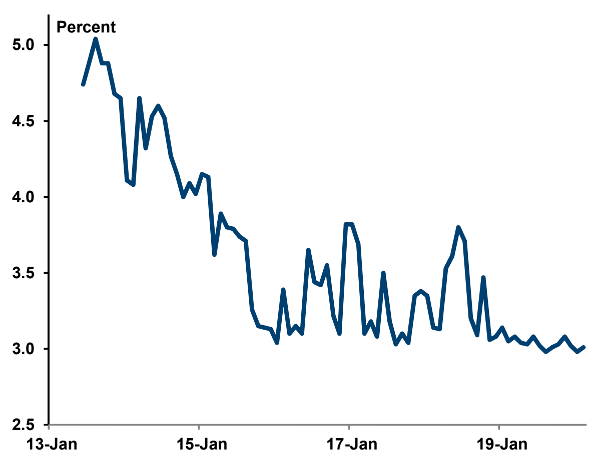
Inflation expectations also will feed into the Fed's decision, and here too recent results open a door for additional easing. Surveys of consumers show well contained expectations of inflation. The three-year view captured by the survey of the New York Fed, for example, ended last year at the bottom of its historical range and has drifted lower this year (chart, right). The long-term measure from the Reuters/University of Michigan survey also is at the bottom of its range. The year-ahead expectation of business executives from the Atlanta Fed survey fell to 1.8 percent in September from 2.0 percent in August (although it remained

Core PCE Price Index



PCE = personal consumption expenditures
Source: Bureau of Economic Analysis via Haver Analytics

Median Three-Year-Ahead Inflation Rate



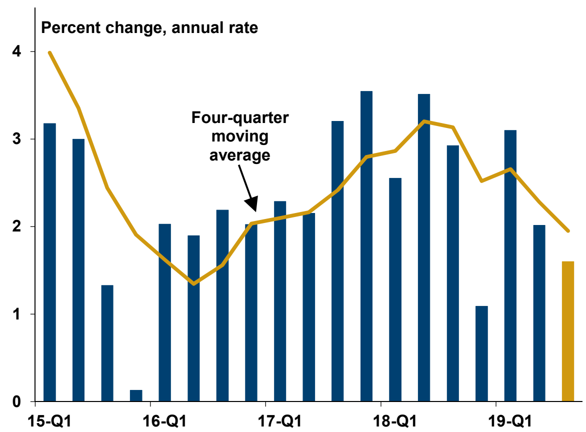
Source: Survey of Consumer Expectations, Federal Reserve Bank of New York via Haver Analytics above the record low of 1.7 percent). Market-based measures of expected inflation (e.g. breakeven rates on inflation-protected securities) also are lean.

All things considered, we view the case for additional easing to be stronger than that for steady policy. The economy is currently in a reasonably good place, but downside risks are prevalent, and the inflation setting is subdued. More insurance.

Q3 GDP

The upcoming report on GDP for the third quarter is likely to contain some clearly positive developments. Consumer spending is likely to remain on track, with real outlays likely to grow at an annual rate of approximately 2.7 percent, a reading in line with the recent average (range of 2.4 percent to 3.4 percent since 2016, with an average of 2.8 percent). The outlook also would seem favorable, with job growth fast enough to absorb new entrants to the labor force and the aggregate financial position of the household sector strong. Individuals also provided support through the housing market in the third quarter, as residential construction likely posted its first increase since the fourth quarter of 2017.

GDP Growth*



* *The reading for 2019-Q3 (gold bar) is a forecast.*

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

While the report will have its positive aspects, its softer elements will probably attract most of the attention. Many analysts and Fed officials view business fixed investment as a risk area for the economy, and available data suggest a decline is possible. Shipments of capital goods contracted sharply in the third quarter, suggesting notable weakness in equipment spending. Much of the drop was the result of Boeing suspending the delivery of 737 Max aircraft, but shipments of capital goods other than aircraft also fell. Spending on business structures is likely to be soft, as construction outlays eased in the third quarter and the rotary rig count declined. Investment in intellectual property could provide an offset to the expected declines in equipment and structures, but overall business investment could post its second consecutive quarterly decline.

Many observers will attribute the softness in capital spending to uncertainties associated with the trade war. The results for Q3 might suggest that such concerns are exaggerated, as both exports and imports, after adjusting for price changes, probably grew. The advance in imports appears to have been larger, and thus the trade deficit will widen and net exports will contribute negatively to GDP growth. Despite the increases on both sides of the trade ledger, the negative contribution to growth will probably capture most attention and reinforce concern about fallout from the trade war.

Inventory investment represents a wild card. Only two months of data for Q3 are available, and thus one must guess at what might unfold in September. In addition, the Commerce Department does considerable massaging of the monthly data on inventories for the GDP accounts, which heightens the possibility of forecast error. For what it's worth, our calculations show an approximately neutral influence from inventory investment, but we would not be surprised by a nudge in either direction.

Review

Week of October 21, 2019	Actual	Consensus	Comments
Existing Home Sales (September)	**5.38 Million (-2.2%)**	**5.45 Million (-0.7%)**	The dip in home sales in September occurred from a firm reading in August, and thus the level of activity was still among the best thus far in 2018-19. However, activity was still shy of the average from 2017 (the best year for housing in the current cycle), and one might have hoped that low interest rates would stir activity. Affordability is likely an issue, as prices have steadily advanced since 2012 and are noticeably above levels during the bubble period. Lean inventories are contributing to the upward pressure on prices, as the National Association of Realtors again noted that the lack of supply was inhibiting sales and pushing prices higher.
Durable Goods Orders (September)	**-1.1%**	**-0.7%**	Much of the weakness in the durable goods report in September occurred in the transportation category, where a drop of 11.8% in bookings for commercial aircraft influenced the results. Motor vehicles also contributed to the retreat in the transportation category (off 1.6%). Results elsewhere lacked vigor, as shown by a dip of 0.3% ex-transportation. Bookings ex-transportation have been moving sideways since the middle of last year, an interruption in the upward trend during 2017 and early 2018 but not a recession-like movement. New orders for nondefense capital goods other than aircraft fell 0.5% after a drop of 0.6% in August. The latest changes occurred from respectable showings in the prior two months, and thus the downward trend can be described as mild.
New Home Sales (September)	**0.701 Million (-0.7%)**	**0.702 Million (-1.5%)**	Although sales of new homes eased in September, the level was still among the best of the current cycle (the fourth best of the current expansion, and not far below the high of 729,000 in June of this year). Although the performance compared favorably with most recent observations, it was light by historical standards. Sales averaged more than one million per year during the bubble period, and they moved in a range of approximately 800,000 to 900,000 in the early portion of the 2000s.
Federal Budget (September)	**$82.8 Billion Surplus**	**$83.0 Billion Surplus**	September typically involves strong revenue flows because of estimated tax payments by corporations and individuals, and results this year were especially favorable (up 8.9% year-over-year). Outlays also rose sharply from the results in September 2018 (29.8%), but the jump reflected unusually light expenditures last year associated with a calendar configuration that moved some Social Security and Medicare spending from September to August. The September surplus left the budget deficit for FY2019 at $984.4 billion, $205.4 billion wider than the shortfall in FY2018.

Source: National Association of Realtors (Existing Home Sales); U.S. Census Bureau (Durable Goods Orders, New Home Sales); U.S. Treasury Department (Federal Budget); Consensus forecasts are from Bloomberg

Preview

Week of October 28, 2019	Projected	Comments
U.S. International Trade in Goods (September) (Monday)	**-$73.5 Billion ($0.4 Billion Wider Deficit)**	The downward drifts in exports and imports that began with the imposition of tariffs are likely to continue in September. A firm dollar and slow economic growth abroad are likely to lead to a larger drop in exports and a slightly wider trade deficit.
Consumer Confidence (October) (Tuesday)	**130.0 (+3.9%)**	With equity indexes near record levels and the job market generally healthy, consumer confidence should recoup some of the ground lost in September, when the measure fell 6.8% and moved to the low portion of the recent range.
GDP (2019-Q3) (Wednesday)	**1.8%**	Available data suggest that consumer spending remained firm in the third quarter, and residential construction is likely to end a string of six quarterly declines. However, capital spending and net exports will probably be soft, leaving a sub-two-percent rate of growth.
Personal Income, Consumption, Core Prices (September) (Thursday)	**0.4%, 0.3%, 0.1%**	Farm income and interest income are likely to remain soft, but employment growth was probably firm enough to boost wages and salaries. Dividends and rental income also are likely to advance. A pickup in vehicle sales should offset slow retail activity, leaving moderate growth in consumer spending. A modest change in the CPI in September points to a tame reading on the PCE price index.
Employment Cost Index (2019-Q3) (Thursday)	**0.6%**	A soft reading on average hourly earnings for September raises the prospect of a below-average increase in the employment cost index. (Wage growth as measured by the ECI averaged 0.7% in the past four quarters; benefit growth averaged 0.6%.)
Payroll Employment (October) (Friday)	**100,000**	Elevated job postings and low claims for unemployment benefits bode well for job growth, although the strike at General Motors is likely to constrain the reported total. The size of labor force is likely to post a noticeable increase after a low-side advance in September, which could lead to an increase in the unemployment rate.
ISM Manufacturing Index (October) (Friday)	**50.0% (+2.2 Pct. Pts.)**	The manufacturing sector, while slow, has shown signs of stabilizing after a slide in the first half of the year, which could lead to an improvement in the views of purchasing managers.
Construction Spending (September) (Friday)	**0.0%**	A pickup in single-family housing starts should fuel the residential component of the construction report, but activity in the private nonresidential area (primarily business) seems to be in a soft patch. Construction activity of state and local governments seems to be cooling after a surge in the early months of the year.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

October/November 2019

Monday	Tuesday	Wednesday	Thursday	Friday
21	22	23	24	25
	EXISTING HOME SALES July 5.42 million Aug 5.50 million Sept 5.38 million	**FHFA HOME PRICE INDEX** June 0.2% July 0.4% Aug 0.2%	**INITIAL CLAIMS** Oct 05 210,000 Oct 12 218,000 Oct 19 212,000 **DURABLE GOODS ORDER** July 2.1% Aug 0.3% Sept -1.1% **NEW HOME SALES** July 0.665 million Aug 0.706 million Sept 0.701 million	**REVISED CONSUMER SENTIMENT** Aug 89.8 Sept 93.2 Oct 95.5 **FEDERAL BUDGET** 2019 2018 July -$119.7B -$76.9B Aug -$200.3B -$214.1B Sept $82.8B $119.1B
28	29	30	31	1
CHICAGO FED NATIONAL ACTIVITY INDEX (8:30) Monthly 3-Mo. Avg. July -0.41 -0.14 Aug 0.10 -0.06 Sept -- -- **U.S. INTERNATIONAL TRADE IN GOODS (8:30)** Jul -$72.4 billion Aug -$73.1 billion **Sept -$73.5 billion** **ADVANCE INVENTORIES REPORT (8:30)** Wholesale Retail July 0.2% 0.7% Aug 0.2% -0.1% Sept -- --	**S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX (9:00)** SA NSA June 0.1% 0.4% July 0.0% 0.1% Aug -- -- **CONFERENCE BOARD CONSUMER CONFIDENCE (10:00)** Aug 134.2 Sept 125.1 **Oct 130.0** **PENDING HOMES SALES (10:00)** July -2.5% Aug 1.6% Sept -- **FOMC MEETING**	**ADP EMPLOYMENT REPORT (8:15)** Private Payrolls Aug 157,000 Sept 135,000 Oct -- **GDP (8:30)** GDP Chained Price 19-Q1 3.1% 1.1% 19-Q2 2.0% 2.4% **19-Q3 1.8% 2.0%** **FOMC DECISION (2:00)** **POWELL PRESS CONFERENCE (2:30)**	**INITIAL CLAIMS (8:30)** **PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX (8:30)** Inc. Cons. Core July 0.1% 0.5% 0.2% Aug 0.4% 0.1% 0.1% **Sept 0.4% 0.3% 0.1%** **EMPLOYMENT COST INDEX (8:30)** Comp. Wages 19-Q1 0.7% 0.7% 19-Q2 0.6% 0.7% **19-Q3 0.6% 0.6%** **CHICAGO PURCHASING MANAGERS' INDEX (9:45)** Index Prices Aug 50.4 59.8 Sept 47.1 57.3 Oct -- --	**EMPLOYMENT REPORT (8:30)** Payrolls Un. Rate Aug 168,000 3.7% Sept 136,000 3.5% **Oct 100,000 3.6%** **ISM INDEX (10:00)** Index Prices Aug 49.1 46.0 Sept 47.8 49.7 **Oct 50.0 50.0** **CONSTRUCTION SPEND. (10:00)** July 0.0% Aug 0.1% **Sept 0.0%** **VEHICLE SALES** Aug 17.0 million Sept 17.2 million **Oct 17.0 million**
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**
11	12	13	14	15
VETERANS DAY	**NFIB SMALL BUSINESS OPTIMISM INDEX**	**CPI** **FEDERAL BUDGET**	**INITIAL CLAIMS** **PPI**	**RETAIL SALES** **IMPORT/EXPORT PRICES** **EMPIRE MFG INDEX** **IP & CAP-U** **BUSINESS INVENTORIES**

Forecasts in Bold.

Treasury Financing

October/November 2019

Monday	Tuesday	Wednesday	Thursday	Friday
21	22	23	24	25
AUCTION RESULTS: Rate / Cover 13-week bills 1.630% 3.01 26-week bills 1.600% 2.73	**AUCTION RESULTS:** Rate / Cover 2-year notes 1.594% 2.70 **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 RESULTS:** Spread / Cover 2-year FRNs 0.300% 2.58 Rate / Cover 5-year notes 1.570% 2.41	**AUCTION RESULTS:** Rate / Cover 4-week bills 1.710% 2.75 8-week bills 1.680% 2.85 7-year notes 1.657% 2.46 **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	
11	12	13	14	15
VETERANS DAY	**AUCTION:** $87 billion* 13-,26-week bills **ANNOUNCE:** $55 billion* 4-week bills for auction on November 14 $40 billion* 8-week bills for auction on November 14 **SETTLE:** $55 billion* 4-week bills $40 billion* 8-week bills		**AUCTION:** $55 billion* 4-week bills $40 billion* 8-week bills **ANNOUNCE:** $87 billion* 13-,26-week bills for auction on November 18 $12 billion* 10-year TIPS for auction on November 21 **SETTLE:** $87 billion* 13-,26-week bills	**SETTLE:** $38 billion* 3-year notes $27 billion* 10-year notes $19 billion* 30-year bonds

**Estimate*