Daiwa Capital Markets

U.S. Economic Comment

- Lingering effects of February weather
- FOMC: flawed guidance, but clear signals

Michael Moran
Daiwa Capital Markets America
212-612-6392
michael.moran@us.daiwacm.com

February Weather: More Than Ephemeral Effects

The latest week brought three economic reports that showed marked declines in February: retail sales tumbled 3.0 percent, while industrial production sank 2.2 percent and housing starts plummeted 10.3 percent. However, we did not view the results as troubling. All these measures were elevated in January, and a natural cooling after strong results probably accounts for some of the weakness. More important, challenges posed by adverse weather were most likely the driving force behind the changes.

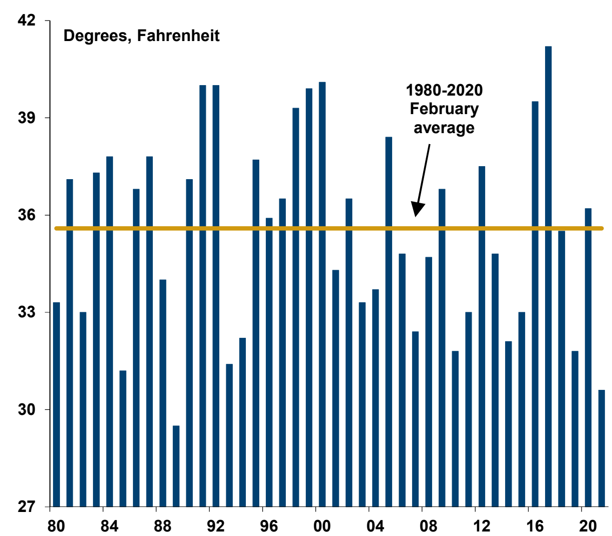
Weather conditions certainly were severe, as shown by the national average temperature of 30.6℉ (-1℃), which was five degrees colder than the long-run average for February and the second coldest since 1980 (chart). Even this does not do justice to the severity, as the mid-section of the U.S., especially Texas, absorbed most of the blow from the storm. Texas normally experiences temperatures in the neighborhood of 40℉ (-4℃) during February, but it registered a low of 15℉ (-9℃) on February 15.

With temperatures seldom reaching such levels in Texas, the weather generated extreme damage to insufficiently-protected infrastructure. Estimates place losses in the neighborhood of $195 billion, which would mark the costliest natural disaster in Texas history, a remarkable development considering that Texas has been beaten up over the years by notable hurricanes.

Much of the damage occurred at businesses tied to the petroleum industry, many that provide inputs to other firms throughout the economy. For example, the Federal Reserve noted in its report on industrial production that petroleum refineries, petrochemical facilities, and plastic resin plants closed during the worst of the storm (February 13-17) and remained offline for the remainder of the month. The *Wall Street Journal* reported this week that closures extended into March. The resulting disruptions to supply chains will add to disturbances associated with the pandemic, including shortages of semiconductors, which have caused cutbacks in auto production (the motor vehicle component of industrial production fell 8.3 percent in February).

Supply shortages would be expected to both restrain production and to have price consequences. Price pressure already is beginning to appear. For example, the producer price index shows that the prices of inputs into the late stages of production processes surged in January and February after inching up during the summer and fall (chart, next page). Similar patterns are evident in other measures of commodity prices.

National Average Temperature: February

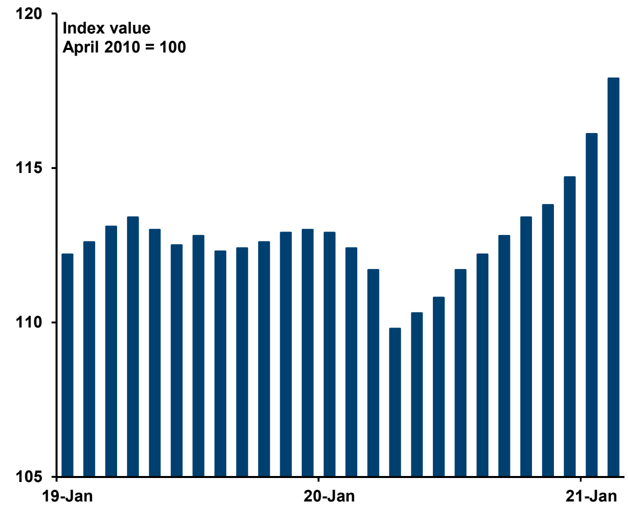


Source: National Climatic Data Center via Haver Analytics

This report is issued by Daiwa Securities Group Inc. through its relevant group companies. Daiwa Securities Group Inc. is the global brand name of Daiwa Securities Co. Ltd., Tokyo (“Daiwa Securities”) and its subsidiaries worldwide that are authorized to do business within their respective jurisdictions. These include: Daiwa Capital Markets Hong Kong Ltd. (Hong Kong), regulated by the Hong Kong Securities and Futures Commission, Daiwa Capital Markets Europe Limited (London), regulated by the Financial Conduct Authority and a member of the London Stock Exchange, and Daiwa Capital Markets America Inc. (New York), a U.S. brokerdealer registered with the U.S. Securities and Exchange Commission, a futures commission merchant regulated by the U.S. Commodity Futures Trading Commission, and a primary dealer in U.S. government securities. The data contained in this report were taken from statistical services, reports in our possession, and from other sources believed to be reliable. The opinions and estimates expressed are our own, and we make no representation or guarantee either as to accuracy, completeness or as to the existence of other facts or interpretations that might be significant.

This pressure could well feed through to prices of finished products, but it seems as though such a development would not alarm Fed officials. Chair Powell indicated in his latest press conference that such pressure is likely to be temporary, as supply chains will be repaired and inputs will again flow through normal channels.

PPI: Stage 4 Intermediate Demand Goods



Source: Bureau of Labor Statistics via Haver Analytics

FOMC: Forward (Mis)Guidance

Something seems amiss with the forward guidance offered by the Federal Open Market Committee: it does not mesh with the projections and policy expectations of Fed Officials.

The Committee has offered three criteria that must be met before officials begin to unwind their current policy stance: employment must reach its maximum level, inflation must reach the Committee's target of two percent, and inflation must be on track to exceed two percent for some time. The latest set of projections published by the FOMC suggest that officials expect such conditions to be in place by the end of 2023. The unemployment rate at that time is expected to be 3.5 percent, below the long-run (and presumably full-employment) level of 4.0 percent. In addition, inflation will be at or above two percent for two consecutive years (table).

The dot plot (next page), however, indicated that the Committee would not have sufficient votes to hike interest rates. Seven individuals expect to raise interest rates given the expected economic performance, but 11 were planning to remain on the sidelines – steady policy despite guidance that rates would be lifted in the environment expected in 2023.

Economic Projections of the FOMC, March 2021*

	2021	2022	2023	Longer Run
Change in Real GDP	6.5	3.3	2.2	1.8
December projection	4.2	3.2	2.4	1.8
Unemployment Rate	4.5	3.9	3.5	4.0
December projection	5.0	4.2	3.7	4.1
PCE Inflation	2.4	2.0	2.1	2.0
December projection	1.8	1.9	2.0	2.0
Core PCE Inflation	2.2	2.0	2.1	--
December projection	1.8	1.9	2.0	--
Federal Funds Rate	0.1	0.1	0.1	2.5
December projection	0.1	0.1	0.1	2.5

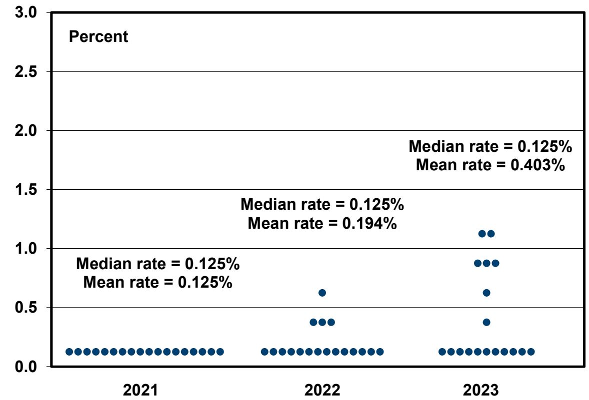
** Median projections*
Source: Federal Open Market Committee, Summary of Economic Projections, March 2021

One might speculate about explanations for the inconsistency between the Committee's forward guidance and its preference for steady policy. Maximum employment is now a fuzzy concept in the minds of Fed officials. It is "a broad-based and inclusive goal that is not directly measurable and changes over time". The unemployment rate is too narrow of a metric under the new policy strategy, and perhaps some officials do not anticipate sufficient progress in whatever labor-market indicators they favor.

Alternatively, inflation might be holding some officials back. While the median forecast shows inflation above two percent, it exceeds this threshold by only a marginal amount (2.1 percent, see table). The Committee also shows the range of forecasts of Fed officials and even the most extreme view shows only a modest breach of two percent (2.3 percent). Given the undershoot of inflation from target in recent years, officials might feel that such rates are tolerable.

Although these explanations are reasonable, they were not offered by Chair Powell when questioned during his press briefing. He merely noted that the economic outlook that far into the future is uncertain and that the dot plot was not meant to pinpoint the date of lift-off.

FOMC Rate View: Year-End 2021, 2022, & 2023*



** Each dot represents the expected federal funds rate of a Fed official at the ends of 2021, 2022, and 2023. Normally, this graph would contain 19 projections (seven governors of the Federal Reserve Board and 12 reserve bank presidents), but one governorship was open at the March 2021 meeting.*

Source: Federal Open Market Committee, Summary of Economic Projections, March 2021

Although the forward guidance in the Committee's policy statement does not seem to be a reliable guide to future policy changes, the signal from this meeting was clear: the current makeup of the FOMC has a strong dovish tilt. This group will probably not tighten policy until the labor market is truly robust and until inflation has clearly broken above two percent and perhaps until inflation expectations have stepped higher. We suspect that this group would not mind getting behind the curve.

We found another interesting aspect to the latest set of forecasts: the current projection shows inflation of 2.4 percent in the fourth quarter of this year before easing back to 2.0 percent in 2022. The pickup suggests that officials see supply-chain disruptions and base effects (i.e restrained, pandemic-related inflation rates dropping out of year-over-year calculations) as having a temporary influence on inflation. Any price pressure this year will be billed as transitory.

Review

Week of March 15, 2021	Actual	Consensus	Comments
Retail Sales (February)	**-3.0% Total, -2.7% Ex. Autos**	**-0.5% Total, 0.1% Ex. Autos**	The drop in retail sales in February should not be viewed as a sign of weakness. The change occurred from upwardly revised results in January, with growth in the prior month 2.3 percentage points stronger than previously believed (7.6% versus 5.3%; December was revised lower, but modestly so, still leaving a net shift of 1.9 percentage points). In addition, the change could be viewed as a natural (and partial) offset to stimulus-related strength in January. Challenging weather also likely played a role in the February results, as severe storms most likely dampened activity. Moreover, a new round of $1,400 stimulus checks will most likely stir a rebound in activity in March and April.
Industrial Production (February)	**-2.2%**	**0.3%**	Industrial production tumbled in February, pulled lower by weather-related disruptions in the manufacturing and mining components (off 3.1% and 5.4%, respectively). If not for the influence of inclement weather, the Federal Reserve estimated that manufacturing activity would have dipped 0.5% while mining output would have increased 0.5%. In addition to weather-related issues, another special factor influenced the factory sector: a shortage of semiconductors constrained auto production, which fell 8.3%. Utility output moved in the opposite direction of manufacturing and mining, but the surge of 7.4% reflected increased heating usage amid unusually cold temperatures rather than economic fundamentals.
Housing Starts (February)	**1.421 Million (-10.3%)**	**1.560 Million (-1.3%)**	Both multi-family and single-family activity contributed to the decline in housing starts. Multi-family starts fell 15.0%, but the drop occurred from an elevated level in January and the new reading was still in line with results in the closing months of last year. Considering the potential influence of adverse weather, this result seems favorable. Results in the single-family sector were more questionable. Activity fell 8.5%, much less than in the multi-family area, but the drop was enough to push results below the average in the fourth quarter of last year. The low reading raises the possibility that housing might be losing some of the sharp edge seen in December and January, but we would not jump to this conclusion because of the likely influence of challenging weather.
Leading Indicators (February)	**0.2%**	**0.3%**	Sizeable positive contributions from ISM new orders and unemployment claims, along with moderate boosts from the slope of the yield curve, the leading credit index, and stock prices, offset notable drags from building permits and the manufacturing workweek. The increase in February marked the 10th consecutive gain, with the cumulative change retracing 90% of the ground lost in the spring.

Sources: 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 March 22, 2021	Projected	Comments
Existing Home Sales (February) (Monday)	**6.45 Million (-3.6%)**	Adverse weather probably inhibited home sales in February. Even before the challenging weather arrived, a drop in pending home sales in January suggested that the market might be losing a bit of its sharp edge.
Current Account (2020-Q4) (Tuesday)	**-$185.0 Billion ($6.5 Billion Wider Deficit)**	A pickup in net international income flows may have benefited the U.S. in the fourth quarter, but slippage in trade is likely to dominate this report and leave a wider current account deficit.
New Home Sales (February) (Tuesday)	**0.870 Million (-5.7%)**	As in the market for existing homes, adverse weather probably added a strong accent to what might have been a moderate fundamental easing from the robust pace in the prior several months.
Durable Goods Orders (February) (Wednesday)	**-1.0%**	Disruptions to supply chains, partly driven by challenging weather, probably slowed the brisk recovery now underway in the manufacturing sector.
Revised GDP (2020-Q4) (Thursday)	**4.3% (+0.2 Pct. Revision)**	An upward revision to inventory investment will probably more than offset a slight downward adjustment to consumer spending, leaving Q4 GDP a touch firmer than the preliminary estimate.
U.S. International Trade in Goods (February) (Friday)	**-$86.0 Billion ($1.4 Billion Wider Deficit)**	An easing in Covid cases and gradual improvement in the economies of trading partners should reinforce the upward trends in both exports and imports. As in most other recent months, the increase in imports will probably be greater than that for exports, resulting in a wider trade deficit in goods.
Personal Income, Consumption, and Core Prices (February) (Friday)	**-6.5%, -0.7%, 0.1%**	A sharp decline in transfer payments after the rebate-related surge in January is likely to account for most of the expected decline in personal income, but wage growth also is likely to be unimpressive because of shorter workweeks. Figures on vehicle sales and retail activity suggest that adverse weather had a noticeable effect on consumer spending. A natural cooling after a jump in January stirred by rebate checks undoubted played a role as well.
Revised Consumer Sentiment (March) (Friday)	**84.0 (+1.0 Index Pt. Revision)**	The passage of the American Rescue Plan and the distribution of the $1,400 stimulus checks probably brightened moods in the second half of March.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

March/April 2021

Monday	Tuesday	Wednesday	Thursday	Friday
15	16	17	18	19
EMPIRE MFG Jan 3.5 Feb 12.1 Mar 17.4 TIC DATA Total / Net L-T Nov $115.4B / $149.2B Dec $8.0B / $121.0B Jan $106.3B / $90.8B	RETAIL SALES Total / Ex.Autos Dec -1.3% / -2.1% Jan 7.6% / 8.3% Feb -3.0% / -2.7% IMPORT/EXPORT PRICES Non-Petrol Imports / Nonagri. Exports Dec 0.4% / 1.3% Jan 0.9% / 2.2% Feb 0.5% / 1.5% IP & CAP-U IP / Cap.Util. Dec 1.0% / 74.6% Jan 1.1% / 75.5% Feb -2.2% / 73.8% BUSINESS INVENTORIES Inventories / Sales Nov 0.5% / 0.0% Dec 0.8% / 1.0% Jan 0.3% / 4.7% NAHB HOUSING INDEX Jan 83 Feb 84 Mar 82 FOMC MEETING	HOUSING STARTS Dec 1.670 million Jan 1.584 million Feb 1.421 million FOMC DECISION POWELL PRESS CONFERENCE	UNEMPLOYMENT CLAIMS Initial / Continuing (Millions) Feb 20 0.736 / 4.337 Feb 27 0.754 / 4.142 Mar 06 0.725 / 4.124 Mar 13 0.770 / N/A PHILLY FED INDEX Jan 26.5 Feb 23.1 Mar 51.8 LEADING INDICATORS Dec 0.4% Jan 0.5% Feb 0.2%	
22	23	24	25	26
CHICAGO FED NATIONAL ACTIVITY INDEX (8:30) Monthly / 3-Mo. Avg. Dec 0.41 / 0.60 Jan 0.66 / 0.47 Feb -- / -- EXISTING HOME SALES (10:00) Dec 6.65 million Jan 6.69 million **Feb 6.45 million**	CURRENT ACCOUNT (8:30) 20-Q2 -$161.4 bill. 20-Q3 -$178.5 bill. **20-Q4 -$185.0 bill.** NEW HOME SALES (10:00) Dec 0.885 million Jan 0.923 million **Feb 0.870 million**	DURABLE GOODS ORDERS (8:30) Dec 1.2% Jan 3.4% **Feb -1.0%**	INITIAL CLAIMS (8:30) REVISED GDP (8:30) GDP / Chained Price 20-Q3 33.4% / 3.5% 20-Q4(p) 4.1% / 2.1% **20-Q4(r) 4.3% / 2.1%**	U.S. INTERNATIONAL TRADE IN GOODS (8:30) Dec -$83.2 billion Jan -$84.6 billion **Feb -$86.0 billion** ADVANCE INVENTORIES REPORT (8:30) Wholesale / Retail Dec 0.6% / 1.7% Jan 1.3% / -0.5% Feb -- / -- PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX (8:30) Inc. / Cons. / Core Dec 0.6% / -0.4% / 0.3% Jan 10.0% / 2.4% / 0.3% **Feb -6.5% / -0.7% / 0.1%** REVISED CONSUMER SENTIMENT (10:00) Jan 79.0 Feb 76.8 Mar(p) 83.0 **Mar(r) 84.0**
29	30	31	1	2
	FHFA HOME PRICE INDEX S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX CONSUMER CONFIDENCE	ADP EMPLOYMENT REPORT MNI CHICAGO PMI PENDING HOME SALES	INITIAL CLAIMS ISM MFG INDEX CONSTRUCTION SPEND. NEW VEHICLE SALES	*GOOD FRIDAY* EMPLOYMENT REPORT
5	6	7	8	9
ISM SERVICES INDEX FACTORY ORDERS	JOLTS DATA	TRADE BALANCE FOMC MINUTES CONSUMER CREDIT	INITIAL CLAIMS	PPI WHOLESALE TRADE

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

Treasury Financing

March/April 2021

Monday	Tuesday	Wednesday	Thursday	Friday
15	16	17	18	19
AUCTION RESULTS: Rate Cover 13-week bills 0.030% 3.31 26-week bills 0.055% 2.94 **SETTLE:** $58 billion 3-year notes $38 billion 10-year notes $24 billion 30-year bonds	**AUCTION RESULTS:** Rate Cover 20-yr bonds 2.290% 2.51 6-week CMB 0.015% 3.75 **ANNOUNCE:** $40 billion 4-week bills for auction on March 18 $40 billion 8-week bills for auction on March 18 $35 billion 17-week CMBs for auction on March 17 **SETTLE:** $30 billion 4-week bills $35 billion 8-week bills $30 billion 17-week CMBs	**AUCTION RESULTS:** Rate Cover 17-week CMB 0.040% 3.42	**AUCTION RESULTS:** Rate Cover 4-week bills 0.005% 3.30 8-week bills 0.010% 3.10 10-yr TIPS -0.580% 2.42 **ANNOUNCE:** $111 billion 13-,26-week bills for auction March 22 $34 billion 52-week bills for auction on March 23 $26 billion 2-year FRNs for auction on March 24 $60 billion 2-year notes for auction on March 23 $61 billion 5-year notes for auction on March 24 $62 billion 7-year notes for auction on March 25 $40 billion 6-week CMBs for auction on March 23 **SETTLE:** $111 billion 13-,26-week bills $35 billion 6-week CMBs	
22	23	24	25	26
AUCTION: $111 billion 13-,26-week bills	**AUCTION:** $34 billion 52-week bills $60 billion 2-year notes $40 billion 6-week CMBs **ANNOUNCE:** $40 billion* 4-week bills for auction on March 25 $40 billion* 8-week bills for auction on March 25 $40 billion* 17-week CMBs for auction on March 24 **SETTLE:** $40 billion 4-week bills $40 billion 8-week bills $35 billion 17-week CMBs	**AUCTION:** $40 billion* 17-week CMBs $26 billion 2-year FRNs $61 billion 5-year notes	**AUCTION:** $40 billion* 4-week bills $40 billion* 8-week bills $62 billion 7-year notes **ANNOUNCE:** $111 billion* 13-,26-week bills for auction March 29 **SETTLE:** $111 billion 13-,26-week bills $34 billion 52-week bills $40 billion 6-week CMBs	**SETTLE:** $26 billion 2-year FRNs
29	30	31	1	2
AUCTION: $111 billion* 13-,26-week bills	**ANNOUNCE:** $40 billion* 4-week bills for auction on April 1 $40 billion* 8-week bills for auction on April 1 **SETTLE:** $40 billion* 4-week bills $40 billion* 8-week bills $40 billion* 17-week CMBs	**SETTLE:** $24 billion 20-year bonds $13 billion 10-year TIPS $60 billion 2-year notes $61 billion 5-year notes $62 billion 7-year notes	**AUCTION:** $40 billion* 4-week bills $40 billion* 8-week bills **ANNOUNCE:** $111 billion* 13-,26-week bills for auction on April 5 **SETTLE:** $111 billion* 13-,26-week bills	***GOOD FRIDAY***
5	6	7	8	9
AUCTION: $111 billion* 13-,26-week bills	**ANNOUNCE:** $40 billion* 4-week bills for auction on April 8 $40 billion* 8-week bills for auction on April 8 **SETTLE:** $40 billion* 4-week bills $40 billion* 8-week bills		**AUCTION:** $40 billion* 4-week bills $40 billion* 8-week bills **ANNOUNCE:** $111 billion* 13-,26-week bills for auction on April 12 $58 billion* 3-year notes for auction on April 12 $38 billion* 10-year notes for auction on April 12 $24 billion* 30-year bonds for auction on April 13 **SETTLE:** $111 billion* 13-,26-week bills	

*Estimate