Daiwa Capital Markets

U.S. Economic Comment

- FOMC: still viewing price pressure as transitory, but wavering
- The household sector: robust financial positions

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Monetary Policy: Adjustments Coming Into View

The latest Summary of Economic Projections from the Federal Open Market Committee showed a notable pickup in expected inflation over the four quarters of this year: 3.4 percent for the headline measure, up a full percentage point from the forecast in March. Excluding food and energy, Fed officials expect inflation to total 3.0 percent, up from the estimate of 2.2 percent in March.

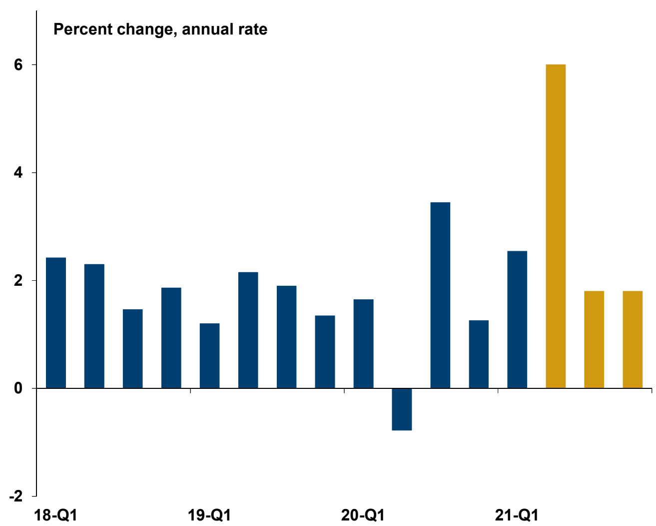
The new projections might seem like a striking shift in views, but unpacking the figures shows that policymakers continue to believe that recent price pressure will be temporary. Given the price changes seen thus far in 2021, the projections imply only moderate increases in the second half of the year. The core price index for personal consumption expenditures, for example, rose at an annual rate of 2.5 percent in the first quarter and is on track to more than double that pace in Q2. If the consensus estimate of 0.6 percent for the core PCE price index in May is realized, followed by a tame reading in June, say 0.2 percent, the annual rate for the second quarter would total 6.0 percent. Inflation, then, would need to recede to 1.8 percent in the second half of the year to match the 3.0 percent rate in the Summary of Economic Projections (chart).

Such a pattern could unfold, as much of the pressure seen in the past two months has clearly been temporary. Hotel fees and airfares have jumped as discounts seen during lockdown periods have partially unwound. Similarly, prices of new and used motor vehicles have surged because of pandemic-related peculiarities. However, there also are forces in play that could lead to persistent price increases. For example, the growth of labor compensation has quickened, and disruptions to supply chains might not be resolved quickly. Perhaps most important, a possible pickup in inflation expectations could lead to an extended period of price pressure.

Chair Powell seems to recognize the upside risks, as the tone of his comments in the press briefing changed noticeably from the views advanced in prior months. Previously, he argued that pandemic-related price changes would be short-lived, and he emphasized the influence of fundamental underlying forces that had restrained inflation in the past two to three decades (demographics, technology, globalization). He noted these fundamental factors again this week, but he also indicated that inflation could be more persistent than previously expected, and he mentioned the possibility of an increase in inflation expectations.

Other Fed officials apparently share Mr. Powell's views, as the shift in the dot plot indicated that policymakers are rethinking the appropriate interest rate path (the median dot showed a 50-basis-point increase in the

Core PCE Price Index*



** PCE = personal consumption expenditures. The three gold bars (2021-Q2 to 2021-Q4) represent estimates. The observation for the second quarter of 2021 is based on the core PCE price index for April and insights from the core consumer price index (CPI). The estimates for Q3 and Q4 are rates needed to obtain the 3.0 percent inflation rate shown in the latest Summary of Economic Projections of the Federal Open Market Committee.*

Source: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America federal funds rate in 2023, versus no change in the previous plot). We also took note of the shift in dots for 2022, where seven officials now expect to hike rates, up from four in March. Dot plots in the past have shifted slowly, and thus we suspect that additional changes could unfold in the months ahead. Indeed, we believe that interest rate liftoff will occur next year. We look for price pressure to linger and for inflation expectations to begin moving upward, which will leave an uncomfortable inflation environment and force a tightening in policy to maintain Fed credibility.

Shifting views on the economy and inflation also prompted a tweak in the guidance relating to quantitative easing. The formal position of the FOMC did not change; the program will continue at its current pace until officials see “substantial further progress” toward their policy goals. However, Chair Powell indicated in his press conference that the Committee discussed the program at this meeting and will continue to do so at upcoming meetings. We look for hints of tapering to become more frequent and more definitive in the weeks and months ahead. We expect the Fed to begin slowing the pace of Treasury purchases in early 2022; we would not be surprised to see tapering in the purchase of mortgage-backed securities to begin late this year.

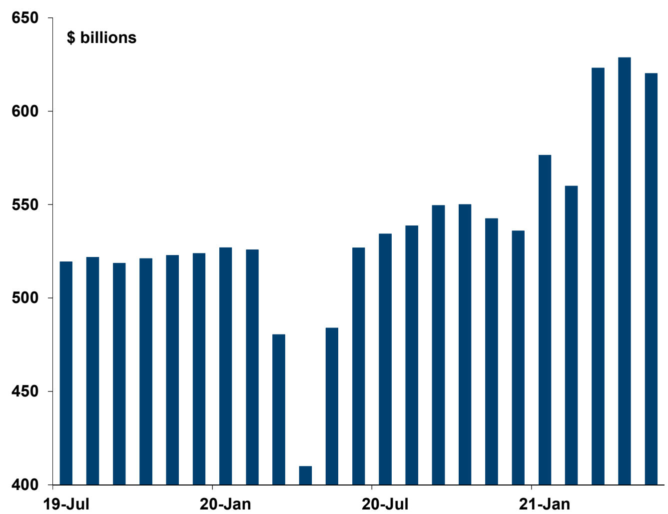
We are encouraged by the shifting views of Fed officials. We had been wondering about a potential policy error in the Fed’s new policy strategy and the tack outlined by Fed officials. Several policymakers have emphasized that they do not plan to tighten policy until they have achieved maximum employment or until inflation begins to accelerate. They need to see results; they do not plan to react to forecasts.

This approach violates one of the bedrock principles of monetary policy: lags are long and variable, and therefore, policy must begin to adjust before a problem becomes apparent. If policymakers wait until an imbalance has emerged, they have waited too long. The shifts in the dots and the new tone in the press conference suggest that policymakers have not abandoned this principle entirely.

The Household Sector: Financially Secure

The retail sales report for May could be easily be misinterpreted. Activity fell 1.3 percent, which might be viewed as a sign of flagging consumer demand. However, the drop should be viewed as a modest offset to unusual strength in the prior two months sparked by a heavy flow of rebate checks from the federal government. Despite the drop in May, retail activity remained at a level well above pre-pandemic standards (chart). Indeed, the level seen in May could be difficult to sustain, but we look for continued support from individuals because of unusually strong financial positions.

Retail Sales



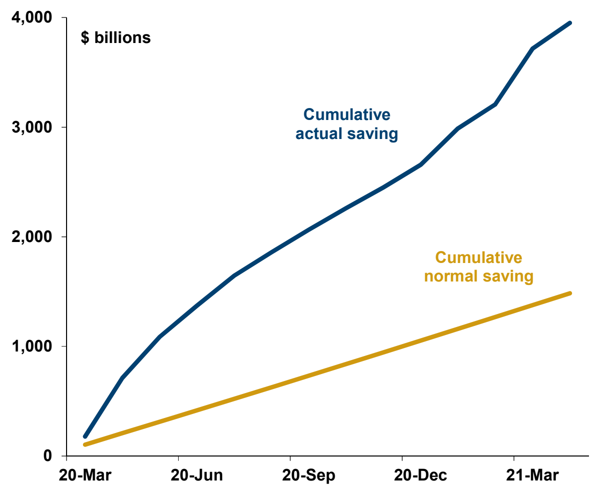
Source: U.S. Census Bureau via Haver Analytics

The spending power is apparent in what might be called excess saving -- the cumulative saving that occurred in the past year or so versus what might have happened if the pandemic had not occurred. The blue line in the chart on the next page shows the amount of actual saving that accumulated since March of last year. The gold line is a counterfactual -- what would have occurred if income growth and the saving rate had remained on their pre-pandemic paths. The difference represents financial resources that probably would not have been envisioned before the onset of Covid and which could now be drawn on to support spending. This “excess savings” totals $2.5 trillion, more than 11 percent of nominal GDP.

The strong financial position of the household sector also is evident in the net worth total published by the Federal Reserve in the Financial Accounts of the United States (previously called the Flow of Funds Accounts). This measure had been growing along an impressive upward trend, but the pace has quickened in the past year, increasing 23 percent in the past four quarters versus an average of 6.6 percent in the prior 10 years (chart, right).

Three factors account for the surge in net worth. First, the advance in equity prices has boosted the values of directly held stocks as well as mutual fund shares and pension reserves. Second, generous government support has allowed individuals to build deposits and pay down credit-card debt. Finally, the surge in home prices has lifted the value of real estate holdings. All told, many households are strong financially.

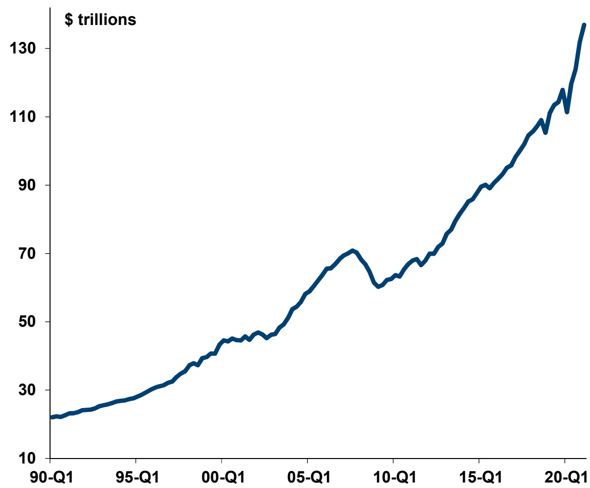
Personal Saving*



** Cumulative normal saving assumes that disposable personal income continued to grow at the 2018-19 pace and that the saving rate held steady at 7.5 percent.*

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

Household Net Worth



Source: Federal Reserve Board via Haver Analytics

Review

Week of June 14, 2021	Actual	Consensus	Comments
Retail Sales (May)	**-1.3% Total, -0.7% Ex. Autos**	**-0.8% Total, 0.4% Ex. Autos**	Total retail sales slipped in May, but the decline occurred from unusually strong (and upwardly revised) results in the prior two months, with the previous burst in activity fueled by recovery rebate checks and the reopening of the economy. With the flow of recovery rebate checks easing in May, it was natural to see sales slow as well. Despite the slowing, the level of sales in May remained far above prior readings.
PPI (May)	**0.8% Total, 0.7% Ex. Food & Energy**	**0.5% Total, 0.5% Ex. Food & Energy**	The food and energy components contributed significantly the jump in producer prices (up 2.6% and 2.2%, respectively). The core component was under pressure as well, increasing 0.7% for the third consecutive month. On a year-over-year basis, the headline index increased 6.6%, far above the peak of 4.5% in the previous expansion. Prices excluding food and energy surged 4.8% from the same month last year, easily eclipsing the peak of 3.0% in the previous expansion.
Industrial Production (May)	**0.8%**	**0.7%**	All three components (mining, manufacturing, and utilities) contributed to the advance in industrial production in May. The latest reading pushed the level of the index to the best of the current recovery period, although it was still 1.4% below the pre-pandemic peak in February of last year. Mining was the strongest area, registering a gain of 1.2%, although the level of mining activity remained far shy of results prior to the onset of the virus. Manufacturing activity also was firm, with an increase of 0.9% that left activity only slightly below the pre-pandemic high. Utility output rose 0.2%, driven by temperatures that were slightly cooler than normal.
Housing Starts (May)	**1.572 Million (+3.6%)**	**1.630 Million (+3.9%)**	Housing starts rose in May, but the change occurred from downward revised levels in the prior two months (March and April combined were 1.8% lighter than previously believed). The latest results reinforced a choppy pattern that has emerged this year, which has left little net change in the number of new starts. Single-family starts rose 4.2%, a decent performance when viewed in isolation, but the change offset only a small portion of the net easing in the first four months of the year. Multi-family starts rose 2.4%. This sector has held up reasonably well so far this year, as starts in May and the average in the first five months of the year exceeded the totals in other recent years.
Leading Indicators (May)	**1.3%**	**1.3%**	Led by strong positive contributions from initial claims for unemployment insurance and the ISM new orders index, the index of leading economic indicators posted its third consecutive brisk advance (up either 1.3% or 1.4% in each of the past three months). The measure has now increased or held steady for 13 consecutive months (12 gains and one reading of no change) and moved 2.2% above the pre-virus high in January 2020.

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

Preview

Week of June 21, 2021	Projected	Comments
Existing Home Sales (May) (Tuesday)	**5.75 Million (-1.7%)**	Softness in pending home sales and mortgage applications suggests a loss of momentum in the housing market, although much of the adjustment in sales of existing homes has probably occurred with declines in the prior three months.
Current Account (2021-Q1) (Wednesday)	**-$207.0 Billion ($18.5 Billion Wider Deficit)**	A widening in the trade deficit in Q1 will probably be joined by slippage in net income flows, leaving noticeable deterioration in the current account deficit.
New Home Sales (May) (Wednesday)	**0.860 Million (-0.3%)**	Like activity in the market for existing homes, sales of new homes have softened in recent months, although the recent choppy pattern has left a modest net decline from the brisk results last summer and early fall.
Durable Goods Orders (May) (Thursday)	**2.5%**	Supply-chain disruptions could lead to slow order flows in some industries, but a generally solid performance in the manufacturing sector should lead to a pickup in bookings after a dip in April.
U.S International Trade in Goods (May) (Thursday)	**-$89.0 Billion ($3.3 Billion Wider Deficit)**	Demand in the U.S. is probably strong enough to sustain the elevated levels of imports seen in March and April, but given less economic vigor among many trading partners, exports will probably give back some of the sharp gains registered in the prior two months.
Revised GDP (2021-Q1) (Thursday)	**6.5% (+0.1 Pct. Pt. Revision)**	Revisions to retail sales suggest that consumer spending was even stronger than the prevailing estimate of 11.3%, which should nudge GDP growth higher.
Personal Income, Consumption, & Core Price Index (May) (Friday)	**-3.5%, 0.5%, 0.5%**	Increases in hours worked and average earnings are likely to lift wage income, and proprietors' income has firmed recently as well. However, as in the prior month, a drop in transfer payments from the federal government is likely to lead to a decline in total personal income. On the spending side, a decline in sales of new vehicles will constrain outlays for durable goods, and a drop in retail sales points to a possible decline in the nondurable area. However, a pickup in service consumption should lead to an advance overall. The price index for personal consumption expenditures will probably follow the lead of the CPI and post a sharp increase.

Source: Forecasts provided by Daiwa Capital Markets America

Daiwa Capital Markets

Economic Indicators

June/July 2021

Monday	Tuesday	Wednesday	Thursday	Friday
14	15	16	17	18
	RETAIL SALES Total / Ex.Autos Mar 11.3% 9.8% Apr 0.9% 0.0% May -1.3% -0.7% **PPI** Final Demand / Ex. Food & Energy Mar 1.0% 0.7% Apr 0.6% 0.7% May 0.8% 0.7% **EMPIRE MFG** Apr 26.3 May 24.3 June 17.4 **IP & CAP-U** IP / Cap.Util. Mar 2.6% 74.6% Apr 0.1% 74.6% May 0.8% 75.2% **BUSINESS INVENTORIES** Inventories / Sales Feb 0.6% -1.6% Mar 0.2% 5.8% Apr -0.2% 0.6% **NAHB HOUSING INDEX** Apr 83 May 83 June 81 **TIC DATA** Total / Net L-T Feb $73.8B $4.5B Mar $146.7B $262.4B Apr $101.2B $100.7B **FOMC MEETING**	**HOUSING STARTS** Mar 1.725 million Apr 1.517 million May 1.572 million **IMPORT/EXPORT PRICES** Non-petrol. Imports / Nonagri. Exports Mar 0.9% 2.5% Apr 0.7% 1.2% May 0.9% 1.7% **FOMC DECISION** **POWELL PRESS CONFERENCE**	**UNEMPLOYMENT CLAIMS** Initial / Continuing (Millions) May 22 0.405 3.769 May 29 0.388 3.517 June 05 0.375 3.518 June 12 0.412 N/A **PHILLY FED INDEX** Apr 50.2 May 31.5 June 30.7 **LEADING INDICATORS** Mar 1.4% Apr 1.3% May 1.3%	
21	22	23	24	25
CHICAGO FED NATIONAL ACTIVITY INDEX (8:30) Monthly / 3-Mo. Avg. Mar 1.71 0.35 Apr 0.24 0.07 May -- --	**EXISTING HOME SALES (10:00)** Mar 6.01 million Apr 5.85 million **May 5.75 million**	**CURRENT ACCOUNT (8:30)** 20-Q3 -$180.9 bill. 20-Q4 -$188.5 bill. **21-Q1 -$207.0 bill.** **NEW HOME SALES (10:00)** Mar 0.917 million Apr 0.863 million **May 0.860 million**	**INITIAL CLAIMS (8:30)** **DURABLE GOODS ORDERS (8:30)** Mar 1.3% Apr -1.3% **May 2.5%** **U.S. INTERNATIONAL TRADE IN GOODS (8:30)** Mar -$91.9 billion Apr -$85.7 billion **May -$89.0 billion** **ADVANCE INVENTORIES (8:30)** Wholesale / Retail Mar 1.2% -1.4% Apr 0.8% -1.8% May -- -- **REVISED GDP (8:30)** GDP / Chained Price 20-Q4 4.3% 2.0% 21-Q1(p) 6.4% 4.3% **21-Q1(r) 6.5% 4.3%**	**PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX (8:30)** Inc. / Cons. / Core Mar 20.9% 4.7% 0.4% Apr -13.1% 0.5% 0.7% **May -3.5% 0.5% 0.5%** **REVISED CONSUMER SENTIMENT (10:00)** Apr 88.3 May 82.9 June(p) 86.4
28	29	30	1	2
	FHFA HOME PRICE INDEX **S&P CORELOGIC CASE-SHILLER HOME PRICE INDEX** **CONSUMER CONFIDENCE**	**ADP EMPLOYMENT REPORT** **MNI CHICAGO PURCHASING MANAGERS' INDEX** **PENDING HOME SALES**	**INITIAL CLAIMS** **ISM MANUFACTURING INDEX** **CONSTRUCTION SPEND.** **VEHICLE SALES**	**EMPLOYMENT REPORT** **TRADE BALANCE** **FACTORY ORDERS**
5	6	7	8	9
INDEPENDENCE DAY (OBSERVED)	**ISM SERVICES INDEX**	**JOB OPENINGS & LABOR TURNOVER** **FOMC MINUTES**	**INITIAL CLAIMS** **CONSUMER CREDIT**	**WHOLESALE TRADE**

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

Treasury Financing

June/July 2021

Monday	Tuesday	Wednesday	Thursday	Friday
14	15	16	17	18
AUCTION RESULTS: Rate / Cover 13-week bills 0.025% 3.45 26-week bills 0.040% 3.32	**AUCTION RESULTS:** Rate / Cover 52-week bills 0.070% 3.19 20-yr bonds 2.120% 2.40 6-week CMB 0.015% 3.22 **ANNOUNCE:** $40 billion 4-week bills for auction on June 17 $40 billion 8-week bills for auction on June 17 $35 billion 17-week CMBs for auction on June 16 **SETTLE:** $40 billion 4-week bills $40 billion 8-week bills $58 billion 3-year notes $38 billion 10-year notes $24 billion 30-year bonds $35 billion 17-week CMBs	**AUCTION RESULTS:** Rate / Cover 17-week CMB 0.035% 3.72	**AUCTION RESULTS:** Rate / Cover 4-week bills 0.045% 3.48 8-week bills 0.035% 3.92 5-year TIPS -1.416% 2.67 **ANNOUNCE:** $111 billion 13-,26-week bills for auction on June 21 $26 billion 2-year FRNs for auction on June 23 $60 billion 2-year notes for auction on June 22 $61 billion 5-year notes for auction on June 23 $62 billion 7-year notes for auction on June 24 $40 billion 6-week CMBs for auction on June 22 **SETTLE:** $111 billion 13-,26-week bills $34 billion 52-week bills $40 billion 6-week CMBs	
21	22	23	24	25
AUCTION: $111 billion 13-,26-week bills	**AUCTION:** $60 billion 2-year notes $40 billion 6-week CMBs **ANNOUNCE:** $40 billion* 4-week bills for auction on June 24 $40 billion* 8-week bills for auction on June 24 $35 billion* 17-week CMBs for auction on June 23 **SETTLE:** $40 billion 4-week bills $40 billion 8-week bills $35 billion 17-week CMBs	**AUCTION:** $26 billion 2-year FRNs $61 billion 5-year notes $35 billion* 17-week CMBs	**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 June 28 $40 billion* 6-week CMBs for auction on June 29 **SETTLE:** $111 billion 13-,26-week bills $40 billion 6-week CMBs	**SETTLE:** $26 billion 2-year FRNs
28	29	30	1	2
AUCTION: $111 billion* 13-,26-week bills	**AUCTION:** $40 billion* 6-week CMBs **ANNOUNCE:** $40 billion* 4-week bills for auction on July 1 $40 billion* 8-week bills for auction on July 1 $35 billion* 17-week CMBs for auction on June 30 **SETTLE:** $40 billion* 4-week bills $40 billion* 8-week bills $35 billion* 17-week CMBs	**AUCTION:** $35 billion* 17-week CMBs **SETTLE:** $24 billion 20-year bonds $16 billion 5-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 July 6 $40 billion* 6-week CMBs for auction on July 6 **SETTLE:** $111 billion* 13-,26-week bills $40 billion* 6-week CMBs	
5	6	7	8	9
INDEPENDENCE DAY (OBSERVED)	**AUCTION:** $111 billion* 13-,26-week bills $40 billion* 6-week CMBs **ANNOUNCE:** $40 billion* 4-week bills for auction on July 8 $40 billion* 8-week bills for auction on July 8 $35 billion* 17-week CMBs for auction on July 7 **SETTLE:** $40 billion* 4-week bills $40 billion* 8-week bills $35 billion* 17-week CMBs	**AUCTION:** $35 billion* 17-week CMBs	**AUCTION:** $40 billion* 4-week bills $40 billion* 8-week bills **ANNOUNCE:** $111 billion* 13-,26-week bills for auction on July 12 $34 billion* 52-week bills for auction on July 13 $58 billion* 3-year notes for auction on July 12 $38 billion* 10-year notes for auction on July 12 $24 billion* 30-year bonds for auction on July 13 $40 billion* 6-week CMBs for auction on July 13 **SETTLE:** $111 billion* 13-,26-week bills $40 billion* 6-week CMBs	

**Estimate*