Daiwa Capital Markets

U.S. Economic Comment

- Inflation developments: some easing, but pressure remains

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A Host of Inflation Indicators

The latest week brought a wealth of information on price developments, with the new data showing mixed results that could support either optimistic or pessimistic views on the inflation outlook. Some transitory effects have started to fade, supporting an optimistic view, but inflation remained brisk and some elements pointed to further pressure in coming months. We tilt on the pessimistic side. Supply-chain disruptions remain an issue, and aggressive fiscal and monetary policies are likely to generate strong demand, which is likely to have inflation consequences.

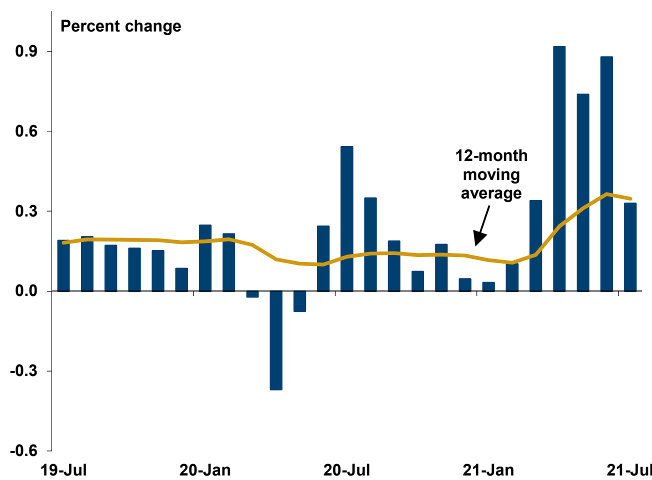
Consumer Prices

The Consumer Price Index cooled in July, with the increase of 0.5 percent overall and 0.3 percent excluding food and energy slowing from the averages of 0.7 percent (headline) and 0.8 percent (core) in the prior three months (chart). Pandemic-affected areas that had driven the measures higher in prior months accounted for the slowing in July and supported the view that sharp advances in recent months were transitory. Most notable, rental fees for motor vehicles fell 4.6 percent (not annualized) after surging at an average rate of 10.5 percent in the prior five months. Prices of used motor vehicles have exploded in recent months (average of 9.3 percent from April to June), but they rose only 0.2 percent in July, perhaps signaling a peak. Airfares dipped 0.1 percent, a welcome break from an average change of 6.6 percent in the prior three months. Apparel prices were flat after advancing at an average rate of 0.7 percent in the prior three months (see charts on page 5).

While the latest report on consumer prices brought encouraging news, it also contained hints that price pressure would continue for a time. Airfares and apparel prices were calm in July, but both remain noticeably below pre-pandemic levels, suggesting additional increases in coming months. In addition, some items suggested that strong demand fueled by fiscal support and low interest rates could have inflationary consequences. Hotel fees have already climbed well above pre-pandemic levels after sharp discounting last year. In addition, prices of recreation goods and services are moving along a firm upward trend. These results suggest that individuals are anxious to get out and about.

We have taken note of food prices in the CPI, which rose 0.8 percent in June and 0.7 percent in July after increases of 0.4 percent in April and May. We wonder if more pressure is in the pipeline, as food prices have increased at a torrid pace at the producer level in recent months (up 1.5 percent on average from January to June). Food prices fell 2.1 percent at the producer level in July, but cumulative changes this year are still well ahead of those at the consumer level, suggesting possible pass through in coming months. Sharply rising food prices have the potential to affect consumer expectations of inflation.

Core CPI



Source: Bureau of Labor Statistics via Haver Analytics

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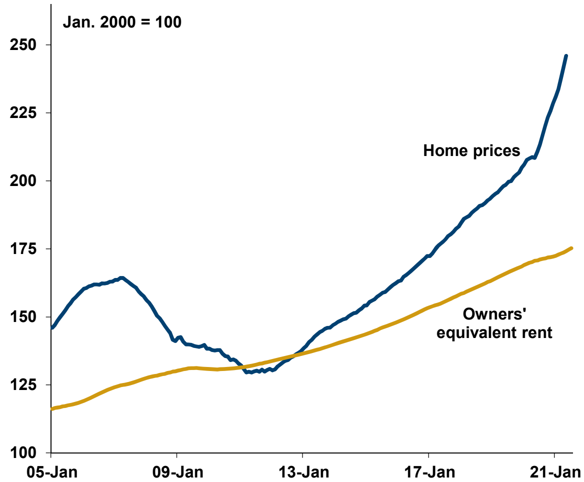
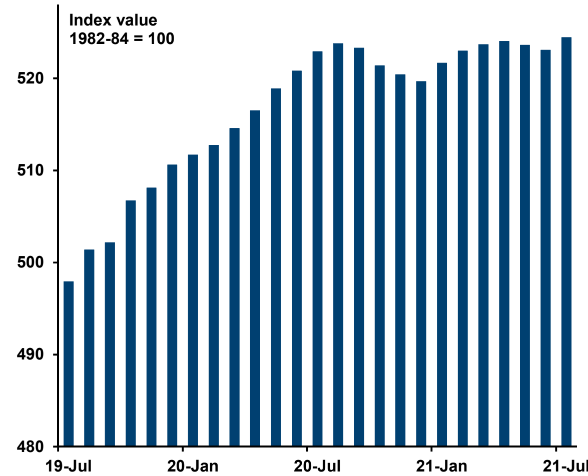
Home Prices Versus Rents*



** The index of home prices published by the Federal Housing Finance Agency and the owners' equivalent rent component of the CPI, both reindexed to equal 100 in 2000. Data for the FHFA index are only available through May 2021 (versus July for the CPI).*

Sources: Federal Housing Finance Agency and Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America

CPI: Medical Care



Source: Bureau of Labor Statistics via Haver Analytics

Observers (and policymakers) favoring the transitory view on inflation argue that pressure will subside when pandemic-related discounts are reversed and when supply-chain disruptions are resolved. Certainly, such pressure will ease, but other items have been tame recently and could move notably higher in price when conditions are finally normalized. Two areas stand out in this regard: rent and health care.

Before the pandemic, rent for primary residence was a sizeable and persistent contributor to the monthly advance in the CPI, with monthly changes averaging 0.3 percent. A pandemic-induced shift in housing preferences away from city centers and dense living conditions has eased the pressure on rents, with monthly changes since last spring now averaging about half the previous pace. Moreover, a large gap has emerged between housing prices and rental rates, which arbitrage should close over time (chart, left). The gap could be closed by housing prices retreating, but we suspect that higher rental rates will play a role as well.

Health care costs, like rents, were a persistent source of price pressure before the onset of Covid, but they have been remarkably tame in the past year or so (chart, right). The mild ups and downs have left a net increase of only 0.1 percent in health-care costs in the past year. We suspect that a reduction in elective medical procedures is playing a role in the subdued trend. As conditions return to normal, elective procedures will most likely pickup and health-care costs will probably resume an upward trend.

Producer Prices

We typically do not put much weight on the PPI when evaluating the inflation environment. It tends to move erratically, and month-to-month changes often are out of step with other inflation indicators. However, we would not ignore persistent movements in the index, and upward pressures in the past several months have been notable. The headline measure has climbed to an average rate of 0.9 percent in the past seven months, including jumps of 1.0 percent in both June and July. The volatile food and energy components account for much of the pressure, but prices excluding food and energy also are up sharply (a monthly average of 0.7 percent so far this year, including changes of 1.0 percent in June and July; chart, page 5). Year-over-year changes have climbed to 7.8 percent overall and 6.2 percent excluding food and energy.

Import Prices

Domestic considerations will probably be the primary determinant of U.S. inflation, but global influences also could be a factor, and thus import prices should be monitored (chart, page 5).

Import prices had been moving higher since late last year, with the headline measure published by the Bureau of Labor Statistics increasing at an average monthly rate of 1.2 percent from December through June. Much of the pressure was the result of higher prices of petroleum products, but prices of nonpetroleum products also moved noticeably higher, increasing 0.7 percent on average over the same December to June period.

Price increases cooled in July, with the headline measure rising 0.3 percent and nonpetroleum prices increasing only 0.1 percent. However, we would not take great comfort in this deceleration, as most of the slowing occurred in nonpetroleum commodity prices, which can be volatile and thus the easing might be temporary. We focus on prices of finished manufactured goods to reduce monthly volatility and to obtain a better view of the underlying trend. An index of motor vehicles, non-auto consumer goods, and capital goods has started to stir this year, increasing 0.2 or 0.3 percent every month from March to July. Last year, this measure rose at an average monthly rate of less than 0.1 percent; in 2019 (pre-Covid) this index fell at an average rate of 0.1 percent.

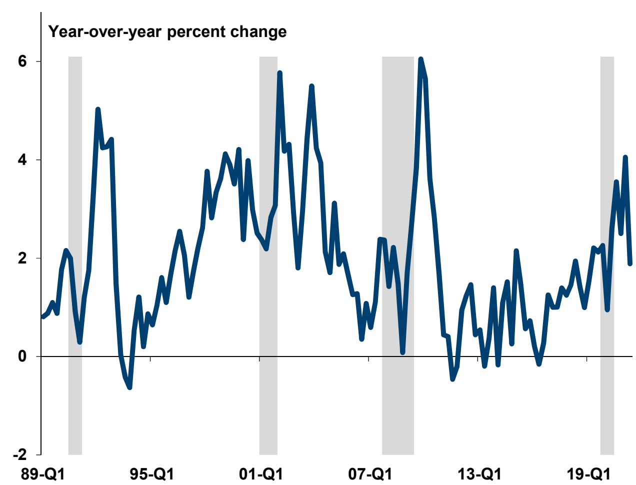
Productivity

Although the unemployment rate remains well above its pre-pandemic low, a stunning level of job postings suggests a certain tightness in the labor market that has the potential to fuel wage growth that might be passed on to prices. Faster wage growth already is apparent, as shown by the year-over-year increase of 4.0 percent in average hourly earnings, up from a pre-pandemic norm of slightly more than 3.0 percent. The wage component of the employment cost index also has jumped in the first and second quarters (up 1.0 percent in Q1 and 0.9 percent in Q2 versus a pre-Covid norm of 0.7 percent). The acceleration in wages would not be troubling if it were matched by a gain in productivity, but we have not been impressed with the recent productivity performance.

Nonfarm productivity rose 2.3 percent (annual rate) in the second quarter, which left the advance in the first four quarters of the current expansion at 1.9 percent. This represents a favorable performance in that it exceeds the underlying trend before Covid (an average of 1.3 percent in the five years before 2020). However, it is not especially strong for the early stages of a recovery. While productivity often moves randomly from quarter-to-quarter, it also shows a distinct cyclical pattern: rising sharply in the early stages of recovery and fading as the expansion matures (chart).

The burst in productivity occurs in the early stages of a cycle partly because businesses return to optimal levels of production after operating at lower and less efficient levels during recessions. In addition, many businesses, in efforts to survive a downturn, will often alter business models and adopt more efficient techniques. They also are likely to shed their least efficient workers during a downturn. As shown in the chart, productivity gains in the range of four to six percent were the norm in the prior three recoveries. The advance of two to four percent thus far in the current cycle is soft by comparison.

Nonfarm Productivity*



** The shaded areas indicate periods of recession in the United States.*

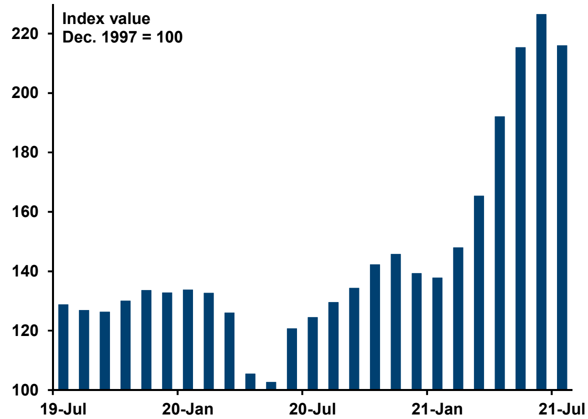
Sources: Bureau of Labor Statistics and National Bureau of Economic Research via Haver Analytics

Although productivity has fallen shy of the normal cyclical shift, unit labor costs (labor compensation adjusted for productivity) have been restrained, advancing only 0.1 percent in the past year. However, the ride has been wild, with year-over-year growth as rapid as 5.8 percent in 2020-Q4 before easing to 0.1 percent in the latest quarter. The noise is the result of the labor compensation measure used in this calculation, which shows pronounced volatility. Average hourly earnings or the wage component of the employment cost index adjusted for productivity changes would show early cycle pressure.

Next Comment:

Because of vacation plans, the next Economic Comment will be published on August 27, 2021.

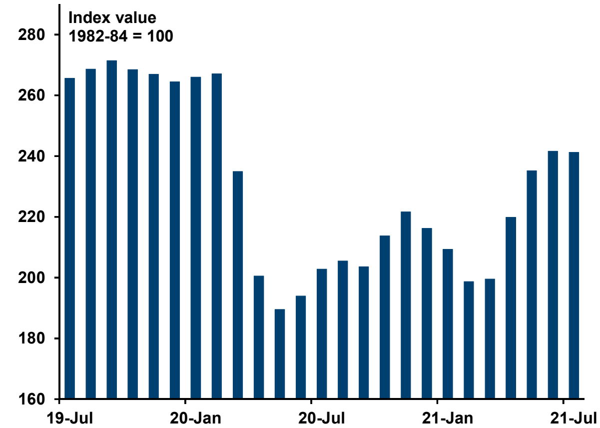
CPI: Car & Truck Rental Fees*



* The chart shows the level of the index rather than the percent change.

Source: Bureau of Labor Statistics via Haver Analytics

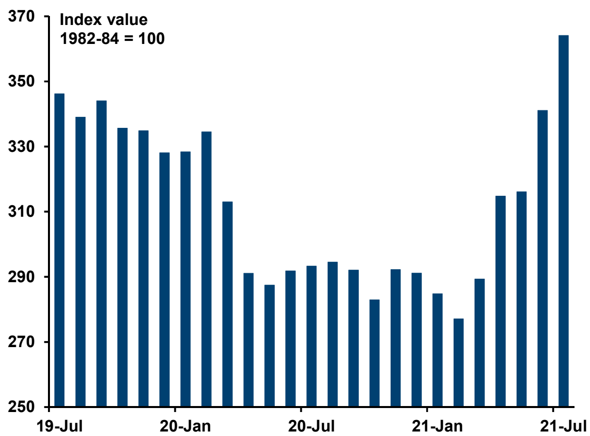
CPI: Airline Fares*



* The chart shows the level of the index rather than the percent change.

Source: Bureau of Labor Statistics via Haver Analytics

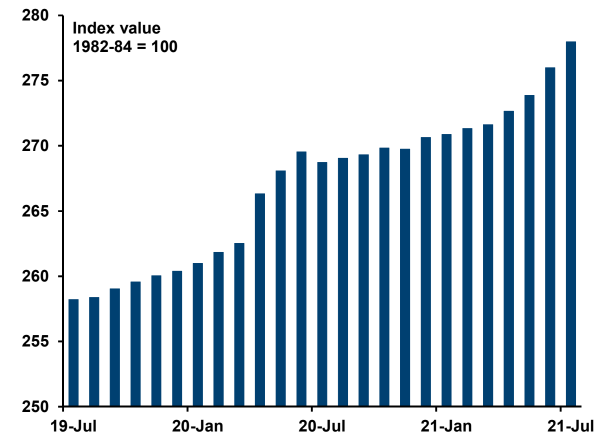
CPI: Lodging Away From Home (Hotel Fees)*



* The chart shows the level of the index rather than the percent change.

Source: Bureau of Labor Statistics via Haver Analytics

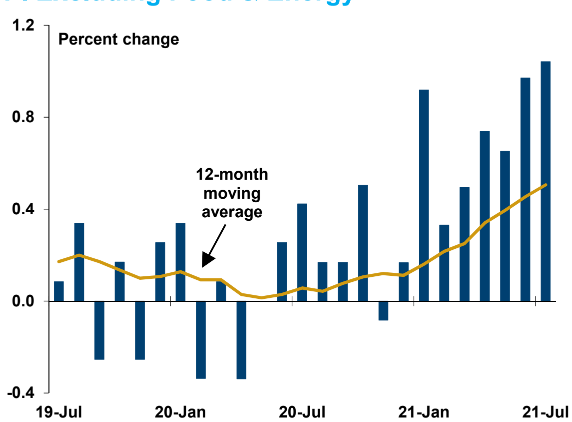
CPI: Food*



* The chart shows the level of the index rather than the percent change.

Source: Bureau of Labor Statistics via Haver Analytics

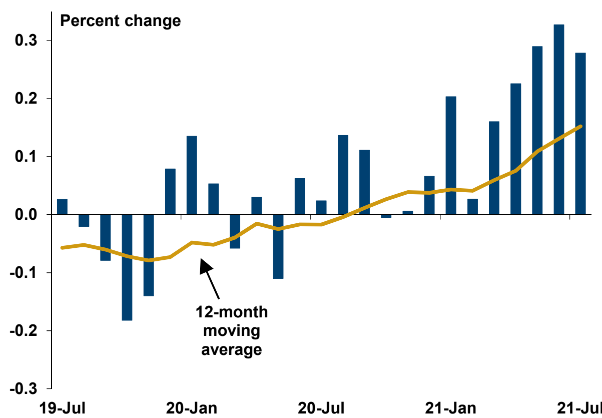
PPI Excluding Food & Energy*



* In contrast to the charts above, the chart on the PPI shows the month-to-month percent change in the index.

Source: Bureau of Labor Statistics via Haver Analytics

Key Import Prices*



* A weighted average of the prices of imported autos, capital goods, and consumer goods. Weights are calculated based on import shares into the United States. In contrast to the charts above, the chart shows the month-to-month percent change in the index of import prices.

Sources: Bureau of Economic Analysis and Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America

Review

Week of August 9, 2021	Actual	Consensus	Comments
Nonfarm Productivity (2021-Q2)	**2.3%**	**3.2%**	Hours worked grew briskly in Q2 (5.5%, annual rate), but output increased at a faster pace, leaving a moderate advance in productivity. The latest reading left the increase in the first four quarters of the current expansion at 2.0%, faster than the average of 1.3% in the five years before the onset of the pandemic, but not especially rapid for the early stages of an expansion. Compensation per hour rose 3.3% at an annual rate in Q2, but when combined with the increase in productivity, it led to a subdued increase of 1.0% in unit labor costs, leaving little net change in the past four quarters (0.1%).
CPI (July)	**0.5% Total, 0.3% Core**	**0.5% Total, 0.4% Core**	Food prices showed signs of pressure for the fourth consecutive month, increasing 0.7% after an advance of 0.8% in June and pickups of 0.4% in April and May. Energy prices rose 1.6% after increasing 1.5% in June and are up 16.2% in the first seven months of the year. The core component moderated somewhat after surging 0.8% per month, on average, in the prior three months. The easing in core inflation during July to a large degree reflected smaller increases or declines in items that had surged with the recovery in the economy (vehicle rental fees, airfares, apparel prices, for example). The latest monthly change left the year-over-year increase in the headline index at 5.4%, the same as in June, while the core index was up 4.3% versus 4.5% in June.
Federal Budget (July)	**$302.1 Billion Deficit**	**$294.0 Billion Deficit**	Federal revenues in July fell 53.5% from the same month last year, but the change reflected unusually large collections in July 2020 because of a shift in the tax filing deadlines from April and June to July. Outlays fell 10.0% from last July, but they remained elevated in an absolute sense. In the latest month, a calendar configuration shifted some expenditures from August to July. In addition, the first round of enhanced child tax credits was sent out this month. The deficit in the first 10 months of FY2021 totaled $2.54 trillion, smaller than the cumulative deficit of $2.81 trillion in the same period of FY2020, but huge relative to historical standards.
PPI (July)	**1.0% Total, 1.0% Ex. Food & Energy**	**0.6% Total, 0.5% Ex. Food & Energy**	Energy prices at the producer continued their climb, with July marking the 13th increase in the past 15 months. The latest change of 2.6% was a touch lighter than the average of 3.1% over this span. Food prices cooled in July, although the decline of 2.1% provided only a partial offset to the cumulative increase of 7.5% in the prior five months. Prices excluding food and energy surged 1.0% for the second consecutive month, with the readings eclipsing the already brisk average advance of 0.6% per month from January to May. On a year-over-year basis, headline prices jumped 7.8% in July, up from 7.3% in June. Prices excluding food and energy rose 6.2% after an advance of 5.6% in the prior month.

Review Continued

Week of August 9, 2021	Actual	Consensus	Comments
Import Prices (July)	**0.3%**	**0.6%**	The increase in import prices in July was modest relative to the average advance of 1.2% in the prior seven months. Some of the deceleration was the result of lower petroleum prices, but prices on nonpetroleum products also were subdued (up 0.1% versus an average of 0.7% in the prior seven months). The nonpetroleum easing, in turn, was heavily influenced by lower prices of nonpetroleum commodities. Prices of finished goods (motor vehicles, non-auto consumer goods, capital goods) rose 0.3%, in line with results in the prior four months and up from changes centered on zero growth last year and immediately before the pandemic.
Consumer Sentiment (August)	**70.2 (-11.0 Index Pts.)**	**81.2 (Unchanged)**	Consumer sentiment tumbled 13.5% in early August, with the latest retreat pushing the index to a new low since the onset of Covid. Both the current conditions and expectations components contributed to the decline (off 7.8% and 17.5%, respectively). The spread of the Delta variant of Covid is an obvious explanation for the drop in sentiment, with the larger change in the expectations component suggesting that individuals are concerned about the long-range effects of the virus. Concern about inflation also might be an issue. The year-ahead expectation of inflation edged down 0.1 percentage point from the July reading to 4.6%, but readings in the past four months have been notably higher than they were in the early portion of the year (average of 3.2% from January to April). Long-term expectations of inflation rose 0.2 percentage point to 3.0%, returning to the recent high in May.

Sources: Bureau of Labor Statistics (Nonfarm Productivity, CPI, PPI, Import Prices); U.S. Treasury Department (Federal Budget); University of Michigan Survey Research Center (Consumer Sentiment); Consensus forecasts are from Bloomberg

Preview

Week of August 16, 2021	Projected	Comments
Retail Sales (July) (Tuesday)	**-0.2% Total, 0.4% Ex. Autos**	A drop in sales of new motor vehicles is likely to constrain the auto component of the retail report, and other areas are likely to show less vigor than they did in response to rebate payments in the spring. However, a large pool of accumulated savings and the first installment of enhanced child tax credits should allow for moderate growth.
Industrial Production (July) (Tuesday)	**0.4%**	Utility output is likely to decline as temperatures returned to normal in July after high-side readings in June, but solid employment gains in the manufacturing and mining sectors suggest that these components of IP will more than offset the softness in utilities and lead to the 13th increase in the past 15 months. Some of the increases during this span were modest, and thus the expected increase would leave the headline measure 0.8% below the pre-pandemic high in February 2020.
Housing Starts (July) (Wednesday)	**1.530 Million (-6.9%)**	With sales of new home softening and inventories climbing, builders were probably cautious in starting new single-family units. The volatile multi-family sector could ease from its high-side reading in June.
Leading Indicators (July) (Thursday)	**0.7%**	With few components making negative contributions, and with ISM new orders, stock prices, and the slope of the yield curve making noticeable positive contributions, the leading indicator index is likely to post its 14th increase in the past 15 months (no change in the other month). The expected increase would leave the index 3.5% above the pre-pandemic high in January 2020.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

August/September 2021

Monday	Tuesday	Wednesday	Thursday	Friday
9	10	11	12	13
JOLTS DATA Openings (000) Quit Rate Apr 9,193 2.8% May 9,483 2.5% June 10,073 2.7%	**NFIB SMALL BUSINESS OPTIMISM INDEX** May 99.6 June 102.5 July 99.7 **PRODUCTIVITY & COSTS** Productivity / Unit Labor Costs 20-Q4 -3.4% 13.3% 21-Q1 4.3% -2.8% 21-Q2 2.3% 1.0%	**CPI** Total Core May 0.6% 0.7% June 0.9% 0.9% July 0.5% 0.3% **FEDERAL BUDGET** 2021 2020 May -\$132.0B -\$398.8B June -\$174.2B -\$864.1B July -\$302.1B -\$63.0B	**UNEMPLOYMENT CLAIMS** Initial Continuing (Millions) July 17 0.424 3.296 July 24 0.399 3.298 July 31 0.387 2.866 Aug 07 0.375 N/A **PPI** Final Demand / Ex. Food & Energy May 0.8% 0.7% June 1.0% 1.0% July 1.0% 1.0%	**IMPORT/EXPORT PRICES** Non-petrol. Imports / Nonagri. Exports May 1.0% 1.8% June 0.7% 1.1% July 0.1% 1.6% **CONSUMER SENTIMENT** June 85.5 July 81.2 Aug 70.2
16	17	18	19	20
EMPIRE MFG (8:30) June 17.4 July 43.0 Aug -- **TIC DATA (4:00)** Total Net L-T Apr \$100.1B \$100.7B May \$105.3B -\$30.2B June -- --	**RETAIL SALES (8:30)** Total Ex.Autos May -1.7% -0.9% June 0.6% 1.3% **July -0.2% 0.4%** **IP & CAP-U (9:15)** IP Cap.Util. May 0.7% 75.1% June 0.4% 75.4% **July 0.4% 75.6%** **BUSINESS INVENTORIES (10:00)** Inventories Sales Apr 0.1% 0.6% May 0.6% -0.3% **June 0.8% 1.3%** **NAHB HOUSING INDEX (10:00)** June 81 July 80 Aug --	**HOUSING STARTS (8:30)** May 1.546 million June 1.643 million **July 1.530 million** **FOMC MINUTES (2:00)**	**INITIAL CLAIMS (8:30)** **PHILLY FED INDEX (8:30)** June 30.7 July 21.9 Aug -- **LEADING INDICATORS (10:00)** May 1.2% June 0.7% **July 0.7%**	
23	24	25	26	27
CHICAGO FED NATIONAL ACTIVITY INDEX **EXISTING HOME SALES**	**NEW HOME SALES**	**DURABLE GOODS ORDERS**	**INITIAL CLAIMS** **REVISED GDP**	**U.S INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES** **PERSONAL INCOME, CONSUMPTION, PRICES** **REVISED CONSUMER SENTIMENT**
30	31	1	2	3
PENDING HOME SALES	**FHFA HOME PRICE INDEX** **S&P CORELOGIC CASE-SHILLER HOME PRICES** **CHICAGO PURCHASING MANAGERS' INDEX** **CONSUMER CONFIDENCE**	**ADP EMPLOYMENT REPORT** **ISM MANUFACTURING INDEX** **CONSTRUCTION SPEND.** **NEW VEHICLE SALES**	**INITIAL CLAIMS** **REVISED PRODUCTIVITY & COSTS** **TRADE BALANCE** **FACTORY ORDERS**	**EMPLOYMENT REPORT** **ISM SERVICES INDEX**

Forecasts in Bold.

Treasury Financing

August/September 2021

Monday	Tuesday	Wednesday	Thursday	Friday
9	10	11	12	13
AUCTION RESULTS: Rate / Cover 13-week bills 0.050% 3.16 26-week bills 0.050% 3.59	**AUCTION RESULTS:** Rate / Cover 52-week bills 0.080% 3.62 3-year notes 0.465% 2.54 6-week CMB 0.040% 4.00 **ANNOUNCE:** $40 billion 4-week bills for auction on August 12 $35 billion 8-week bills for auction on August 12 $30 billion 17-week CMBs for auction on August 11 **SETTLE:** $40 billion 4-week bills $35 billion 8-week bills $30 billion 17-week CMBs	**AUCTION RESULTS:** Rate / Cover 10-yr notes 1.340% 2.65 17-week CMB 0.045% 4.45	**AUCTION RESULTS:** Rate / Cover 4-week bills 0.045% 3.30 8-week bills 0.055% 3.23 30-yr bonds 2.040% 2.21 **ANNOUNCE:** $99 billion 13-,26-week bills for auction on August 16 $27 billion 20-year bonds for auction on August 18 $8 billion 30-year TIPS for auction on August 19 $20 billion 6-week CMBs for auction on August 17 $50 billion 57-day CMBs for auction on August 17 **SETTLE:** $105 billion 13-,26-week bills $34 billion 52-week bills $20 billion 6-week CMBs	
16	17	18	19	20
AUCTION: $99 billion 13-,26-week bills **SETTLE:** $58 billion 3-year notes $41 billion 10-year notes $27 billion 30-year bonds	**AUCTION:** $20 billion 6-week CMBs $50 billion 57-day CMBs **ANNOUNCE:** $40 billion* 4-week bills for auction on August 19 $35 billion* 8-week bills for auction on August 19 $30 billion* 17-week CMBs for auction on August 18 **SETTLE:** $40 billion 4-week bills $35 billion 8-week bills $30 billion 17-week CMBs	**AUCTION:** $27 billion 20-year bonds $30 billion* 17-week CMBs	**AUCTION:** $40 billion* 4-week bills $35 billion* 8-week bills $8 billion 30-year TIPS **ANNOUNCE:** $99 billion* 13-,26-week bills for auction on August 23 $26 billion* 2-year FRNs for auction on August 25 $60 billion* 2-year notes for auction on August 24 $61 billion* 5-year notes for auction on August 25 $62 billion* 7-year notes for auction on August 26 **SETTLE:** $99 billion 13-,26-week bills $20 billion 6-week CMBs $50 billion 57-day CMBs	
23	24	25	26	27
AUCTION: $99 billion* 13-,26-week bills	**AUCTION:** $60 billion* 2-year notes **ANNOUNCE:** $40 billion* 4-week bills for auction on August 26 $35 billion* 8-week bills for auction on August 26 $30 billion* 17-week CMBs for auction on August 25 **SETTLE:** $40 billion* 4-week bills $35 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $26 billion* 2-year FRNs $61 billion* 5-year notes $30 billion* 17-week CMBs	**AUCTION:** $40 billion* 4-week bills $35 billion* 8-week bills $62 billion* 7-year notes **ANNOUNCE:** $99 billion* 13-,26-week bills for auction on August 30 **SETTLE:** $99 billion* 13-,26-week bills	**SETTLE:** $26 billion* 2-year FRNs
30	31	1	2	3
AUCTION: $99 billion* 13-,26-week bills	**ANNOUNCE:** $40 billion* 4-week bills for auction on September 2 $35 billion* 8-week bills for auction on September 2 $30 billion* 17-week CMBs for auction on September 1 **SETTLE:** $40 billion* 4-week bills $35 billion* 8-week bills $30 billion* 17-week CMBs $8 billion 30-year TIPS $27 billion 20-year bonds $60 billion* 2-year notes $61 billion* 5-year notes $62 billion* 7-year notes	**AUCTION:** $30 billion* 17-week CMBs	**AUCTION:** $40 billion* 4-week bills $35 billion* 8-week bills **ANNOUNCE:** $99 billion* 13-,26-week bills for auction on Sept. 7 $34 billion* 52-week bills for auction on September 7 $58 billion* 3-year notes for auction on September 7 $38 billion* 10-year notes for auction on September 8 $24 billion* 30-year bonds for auction on September 9 **SETTLE:** $99 billion* 13-,26-week bills	

**Estimate*