U.S. Economic Comment

- FOMC: finally, some concrete information on QE
- Housing: another shift in preferences?

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FOMC and QE

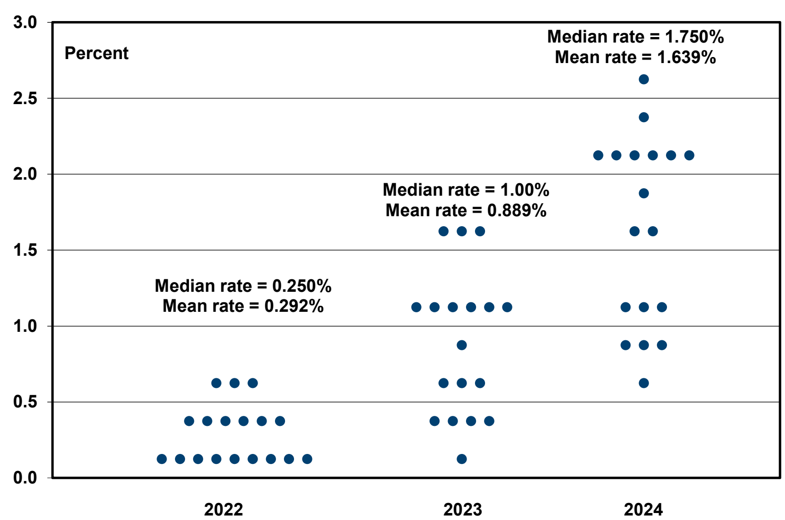
The Federal Open Market Committee hinted in its latest policy statement that officials will soon decide to begin reducing their monthly purchases of Treasury and mortgage-backed securities. Chair Powell was more forthcoming in his press briefing, noting that the announcement of tapering could occur at the next meeting. Officials will probably want to review the September employment report before making a decision, but Mr. Powell indicated that it would not take a “knock out” report to convince him that tapering is warranted; reasonably good results would suffice.

Chair Powell also provided insight into the likely pace of tapering, noting that the process would likely be completed by the middle of next year. Assuming the FOMC makes an announcement after its November 3 meeting and begins the process in December, monthly reductions of $10 billion for Treasuries and $5 billion for mortgage-backed securities would complete the process in July. Alternatively, the Fed could begin in November and finish in June, although this might break Mr. Powell’s promise to provide ample notice of changes in the program.

One might wonder about the Fed trimming the size of its portfolio by selling or redeeming securities once tapering is completed. We doubt this will occur any time soon. The Fed still seems intent on maintaining a high degree of accommodation, and trimming would represent a form of tightening. Chair Powell also offered a subtle suggestion that the Fed intended to maintain the size of its portfolio, as he noted in his prepared remarks at the press briefing that the Fed’s elevated holdings would continue to provide accommodation. The experience after the financial crisis also offers some guidance on this issue. The Fed did not sell any securities in the aftermath of that episode, and it did not begin redeeming maturing issues until three years after its last purchase.

Chair Powell emphasized that the beginning of tapering does not represent a signal that increases in the Fed’s target interest rate will soon follow. Interest rate liftoff, he noted, is subject to a more stringent test than tapering is. However, the new dot plot released by the FOMC signaled that a rate hike is possible next year, as half of the 18 officials participating at the meeting now expect to raise interest rates in 2022 (chart).

FOMC Rate View: Year-End 2022, 2023, & 2024*



** Each dot represents the expected federal funds rate of a Fed official at the ends of 2022, 2023, and 2024. 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 September 2021 meeting.*

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

The shift in dots follows a ratcheting up of inflation views among policymakers, as the median inflation projection for next year has moved from 1.9 percent last December to 2.3 percent currently (table). That pace meets the inflation criteria set by the Committee for interest rate liftoff (inflation has risen to 2 percent and is on track to moderately exceed 2 percent for some time). Interest rate policy will still be highly accommodative next year (an expected federal funds rate of 0.375 percent), although the potential for more action in 2023 is notable, with the median dot showing a fed funds rate of 1.0 percent and three officials anticipating a rate of 1.625 percent.

FOMC Views: Core Inflation*

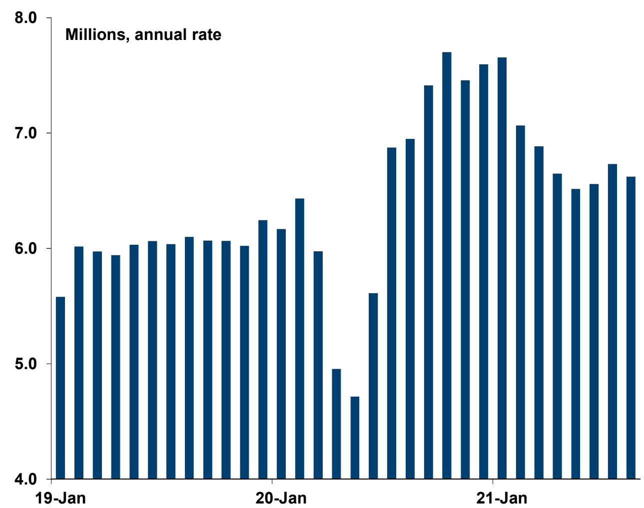
	2021	2022	2023
December	1.8	1.9	2.0
March	2.2	2.0	2.1
June	3.0	2.1	2.1
September	3.7	2.3	2.2

** The table shows the median projection of Fed officials for the core price index for personal consumption expenditures.*
Source: Federal Open Market Committee, Summary of Economic Projections

Housing: Own or Rent? City or Suburb?

The Covid pandemic, for a time, seemed to trigger a shift in housing preferences. The ability to work remotely, along with heightened virus risks from living in congested city centers, led many individuals to seek housing in the suburbs and exurbs. Sales of both new and existing homes jumped in the later part of last year (chart), and construction of new homes responded to the pickup in demand, as single-family housing starts also rose.

Total Home Sales*



** Sales of new and existing homes.*
Sources: National Association of Realtors and U.S. Census Bureau via Haver Analytics; Daiwa Capital Markets America

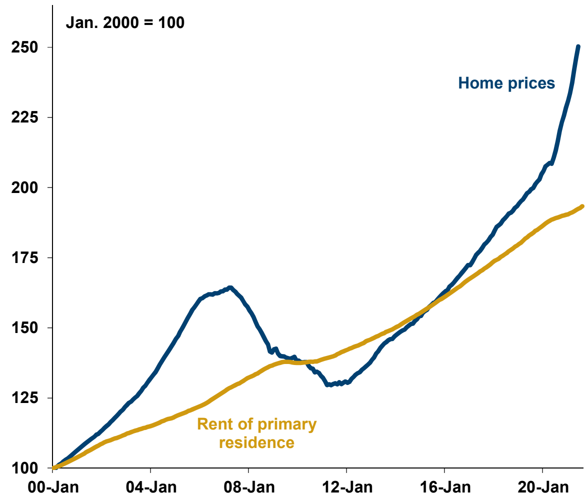
The shift in demand also generated a price response. The index of home prices published by the Federal Housing Finance Agency increased at an annual rate of 16.9 percent in the second half of last year and 19.2 percent so far this year. At the same time, the apparent exodus from city centers dampened the rate of growth in rental rates. The measure of rents in the CPI (rent of primary residence) rose only 1.5 percent in the second half of 2020, a marked contrast to changes of 3.5 to 4.0 percent in the five years before 2020.

The divergent movement between home prices and rents has opened an enormous gap between the costs of these two forms of shelter. The left chart on the next page reindexes these measures to equal 100 in January 2000 and shows home ownership now carrying a 30 percent premium.

The price differential now seems to be cooling the shift from city centers to the suburbs, as home sales have softened since the start of the year. Activity is still slightly firmer than before the onset of the pandemic, and home prices are still rising, but the market has lost a degree of vigor.

The slowing in the shift from cities to suburbs is more apparent in construction activity. Both permits and starts of single-family homes have eased this year while multi-family starts (apartments) have jumped. The shift in multi-family activity has been striking, as activity has climbed to its highest level since the mid-1980s when tax advantages (short depreciation schedules) spurred multi-family development (chart, next page; the

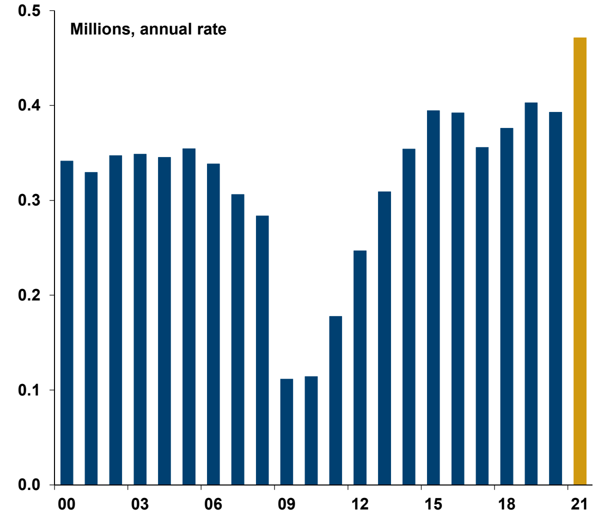
Home Prices Versus Rents*



** Both the FHFA home price index and rent of primary residence component of the CPI are rebased to equal 100 in January 2000.*

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

Multi-Family Housing Starts*



** The reading for 2021 (gold bar) is an average of results for the first eight months of the year.*

Sources: U.S. Census Bureau via Haver Analytics; Daiwa Capital Markets America

chart shows annual totals for multi-family starts because month-to-month and quarter-to-quarter swings are often pronounced in this sector). Builders apparently are sensing a shift in demand.

Inflation Implications

The cost differential between owning and renting has implications for the inflation outlook. Because the two sources of shelter are substitutes, deviations in free markets should not persist; price advantages in one market will attract clients from the other, which should lead to price adjustments and the narrowing of gaps. Rents are a sizeable component of both the CPI and the price index for personal consumption expenditures. If the gap between the cost of owning and renting narrows because of rising rents, pressure on key inflation measures could be pronounced.

One might argue that the lion’s share of the adjustment will be driven by falling home prices rather than rising rents. Most of the widening in the gap was the result of surging home prices, and thus the cost of owning might be expected to bear most of the burden of adjustment. In addition, one could point to history and note that the gap in the mid-2000s was largely closed by declining home prices (see the chart).

The experience in the mid-2000s, though, was materially different than the current episode. The housing market at that time was spurred by speculative activity and reckless lending; excesses needed to be squeezed from the market. Such speculative elements are lacking at this time. Also, rents were tame during the recession and early portion of the expansion, and they have recently showed signs of moving back to their pre-pandemic pace. We suspect that both home prices and rents will be moving. It is not clear which will dominate, but we are likely to see sizeable movements in one or both.

Review

Week of Sept. 20, 2021	Actual	Consensus	Comments
Housing Starts (August)	**1.615 Million (+3.9%)**	**1.550 Million (+1.0%)**	All of the advance in housing starts in August occurred in the multi-family sector, where activity jumped 20.6% from an upwardly revised level in the prior month. Average multi-family starts in the first eight months of the year have totaled 470,000 units (annual rate), easily better than the total of 403,000 in 2019, which was the strongest year of the previous expansion for multi-family starts. Single-family starts eased 2.8%, continuing a choppy pattern that has left a downward drift this year. The net decline in single-family starts this year is surprising given low interest rates and a recovering labor market, but slow sales because of high prices are likely a constraint.
Current Account (2021-Q2)	**-$190.3 Billion**	**-$190.8 Billion**	The current account deficit showed little change in Q2 from a downwardly revised level in Q1 (i.e. a narrower deficit because of improved trade flows). The near-steady reading in Q2 reflected slippage in trade that was mostly offset by improvement in income flows. As a share of GDP, the deficit narrowed slightly (3.35% versus 3.44%) but it was much larger than the average of 2.2% in 2019.
Existing Home Sales (August)	**5.88 Million (-2.0%)**	**5.89 Million (-1.7%)**	Sales of existing homes in August gave back a good portion of the modest gains registered in June and July, leaving activity well shy of brisk totals late last year. Sales were still firmer than pre-pandemic totals, but the market has lost a degree of vigor. The National Association of Realtors emphasized that limited inventories and elevated prices are constraining sales despite favorable interest rates.
Leading Indicators (August)	**0.9%**	**0.7%**	Sizable positive contributions from initial claims for unemployment insurance, ISM new orders, and building permits led the advance in the index of leading economic indicators. The index has now advanced in 15 of the past 16 months (with the other month showing no change).
New Home Sales (August)	**0.740 Million (+1.5%)**	**0.715 Million (+1.0%)**	The increase in new home sales in August represented the second consecutive advance, but the gains represented only a modest offset to the slide that occurred from February through June. The level of sales in the latest month was in line with pre-Covid totals, but it was well shy of brisk results evident in the latter part of 2020 and the start of this year. Higher prices seem to be a major factor behind the easing, as a jump of 20.1% in the median prices of a new home in the past year has probably squeezed some potential buyers from the market.

Sources: U.S. Census Bureau (Housing Starts, New Home Sales); Bureau of Economic Analysis (Current Account); National Association of Realtors (Existing Home Sales); The Conference Board (Leading Indicators); Consensus forecasts are from Bloomberg

Preview

Week of Sept. 27, 2021	Projected	Comments
Durable Goods Orders (August) (Monday)	**0.7%**	A solid gain in factory employment in August suggests that the manufacturing sector remains on track, which should lead to another increase in factory orders. The expected increase would represent the 14 gain in the past 16 months and easily offset an aircraft-led dip in July.
U.S. International Trade in Goods (August) (Tuesday)	**-$85.0 Billion ($1.8 Billion Narrower Deficit)**	Clogged ports and shipping delays could constrain both exports and imports, but imports are likely to experience more difficulties, which should lead to slight improvement in the monthly trade deficit.
Consumer Confidence (September) (Tuesday)	**113.0 (-0.8 Index Pt.)**	The spread of the Delta variant and the pickup in inflation may have dampened consumer moods, but brisk retail activity in August suggests minimal damage to confidence.
Revised GDP (2021-Q2) (Thursday)	**6.8% (+0.2 Pct. Pt. Revision)**	The final estimate of GDP is usually close to the preliminary tally, but slightly firmer results for business construction and inventory investment (i.e. smaller drags) could nudge growth higher.
Personal Income, Consumption, Core Price Index (August) (Friday)	**0.2%, 0.4%, 0.1%**	Wage growth, along with increases in rental and investment income, should lead to a respectable gain in personal income. Government transfer payments will probably have a minimal influence. Strong retail sales bodes well for spending on nondurable goods, but weak auto sales will probably constrain outlays for durable goods, and the spread of Covid probably restrained service consumption. The CPI suggests that the price indexes will ease from high-side readings in recent months.
Revised Consumer Sentiment (September) (Friday)	**71.0 (Unrevised)**	An upward revision would not be surprising given the low level of the sentiment index (below the recession low in April 2020), but the revised figure is usually close to the preliminary estimate.
ISM Manufacturing Index (September) (Friday)	**60.0% (+0.1 Pct. Pt.)**	Given the strong labor market, the employment component of the ISM index should rebound from its sub-50 reading, which could offset downward wiggles from elevated readings in the other components.
Construction Spending (August) (Friday)	**0.2%**	Recent strength in multi-family housing starts should fuel residential building, and federal support payments under the American Rescue Plan could stir activity among state and local governments. The downward trend in private nonresidential construction that emerged with the onset of the pandemic seems to be bottoming, but it is probably too soon to expect a pickup.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

September/October 2021

Monday	Tuesday	Wednesday	Thursday	Friday
20	21	22	23	24
NAHB HOUSING INDEX July 80 Aug 75 Sept 76	**HOUSING STARTS** June 1.657 million July 1.554 million Aug 1.615 million **CURRENT ACCOUNT** 20-Q4 -$175.1 bill. 21-Q1 -$189.4 bill. 21-Q2 -$190.3 bill. **FOMC MEETING**	**EXISTING HOME SALES** June 5.87 million July 6.00 million Aug 5.88 million **FOMC DECISION** **POWELL PRESS CONFERENCE**	**UNEMPLOYMENT CLAIMS** Initial Continuing (Millions) Aug 28 0.345 2.852 Sept 04 0.312 2.714 Sept 11 0.335 2.845 Sept 18 0.351 N/A **CHICAGO FED NATIONAL ACTIVITY INDEX** Monthly 3-Mo. Avg. June 0.24 0.07 July 0.75 0.36 Aug 0.29 0.43 **LEADING INDICATORS** June 0.6% July 0.8% Aug 0.9%	**NEW HOME SALES** June 0.685 million July 0.729 million Aug 0.740 million
27	28	29	30	1
DURABLE GOODS ORDERS (8:30) June 0.8% July -0.1% **Aug 0.7%**	**U.S. INTERNATIONAL TRADE IN GOODS (8:30)** June -$92.0 billion July -$86.8 billion **Aug -$85.0 billion** **ADVANCE INVENTORIES (8:30)** Wholesale Retail June 1.2% 0.5% July 0.6% 0.4% Aug -- -- **FHFA HOME PRICE INDEX (9:00)** May 1.8% June 1.6% July -- **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX (9:00)** SA NSA May 1.8% 2.1% June 1.8% 2.0% July -- -- **CONFERENCE BOARD CONSUMER CONFIDENCE (10:00)** July 125.1 Aug 113.8 **Sept 113.0**	**PENDING HOMES SALES (10:00)** June -2.0% July -1.8% Aug --	**INITIAL CLAIMS (8:30)** **GDP (8:30)** GDP Chained Price 21-Q1 6.3% 4.3% 21-Q2(p) 6.6% 6.1% **21-Q2(r) 6.8% 6.1%** **CHICAGO PURCHASING MANAGERS' INDEX (9:45)** Index Prices July 73.4 91.6 Aug 66.8 93.9 Sept -- --	**PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX (8:30)** Inc. Cons. Core June 0.2% 1.1% 0.5% July 1.1% 0.3% 0.3% **Aug 0.2% 0.4% 0.1%** **REVISED CONSUMER SENTIMENT (10:00)** July 81.2 Aug 70.3 Sept(p) 71.0 **ISM INDEX (10:00)** Index Prices July 59.5 85.7 Aug 59.9 79.4 **Sept 60.0 79.0** **CONSTRUCTION SPEND. (10:00)** June 0.0% July 0.3% **Aug 0.2%** **VEHICLE SALES** July 14.6 million Aug 13.1 million **Sept 13.4 million**
4	5	6	7	8
FACTORY ORDERS	**TRADE BALANCE** **ISM SERVICES INDEX**	**ADP EMPLOYMENT REPORT**	**INITIAL CLAIMS** **CONSUMER CREDIT**	**EMPLOYMENT REPORT** **WHOLESALE TRADE**
11	12	13	14	15
COLUMBUS DAY	**NFIB SMALL BUSINESS OPTIMISM INDEX** **JOLTS REPORT**	**CPI** **FEDERAL BUDGET** **FOMC MINUTES**	**INITIAL CLAIMS** **PPI**	**RETAIL SALES** **EMPIRE MFG. SURVEY** **IMPORT/EXPORT PRICES** **CONSUMER SENTIMENT** **BUSINESS INVENTORIES**

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

Daiwa Capital Markets

Treasury Financing

September/October 2021

Monday	Tuesday	Wednesday	Thursday	Friday
20	21	22	23	24
AUCTION RESULTS: Rate / Cover 13-week bills 0.035% 3.74 26-week bills 0.045% 3.62	**AUCTION RESULTS:** Rate / Cover 20-yr bonds 1.795% 2.36 **ANNOUNCE:** $10 billion 4-week bills for auction on September 23 $25 billion 8-week bills for auction on September 23 $30 billion 17-week CMBs for auction on September 22 **SETTLE:** $15 billion 4-week bills $30 billion 8-week bills $30 billion 17-week CMBs	**AUCTION RESULTS:** Margin / Cover 2-year FRN 0.026% 2.84 Rate / Cover 17-week CMB 0.035% 3.37	**AUCTION RESULTS:** Rate / Cover 4-week bills 0.050% 4.74 8-week bills 0.035% 3.90 10-yr TIPS -0.939% 2.55 **ANNOUNCE:** $84 billion 13-,26-week bills for auction on September 27 $60 billion 2-year notes for auction on September 27 $61 billion 5-year notes for auction on September 27 $62 billion 7-year notes for auction on September 28 **SETTLE:** $90 billion 13-,26-week bills	**SETTLE:** $26 billion 2-year FRNs
27	28	29	30	1
AUCTION: $84 billion 13-,26-week bills $60 billion 2-year notes $61 billion 5-year notes	**AUCTION:** $62 billion 7-year notes **ANNOUNCE:** $10 billion* 4-week bills for auction on September 30 $25 billion* 8-week bills for auction on September 30 $30 billion* 17-week CMBs for auction on September 29 **SETTLE:** $10 billion 4-week bills $25 billion 8-week bills $30 billion 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs	**AUCTION:** $10 billion* 4-week bills $25 billion* 8-week bills **ANNOUNCE:** $84 billion* 13-,26-week bills for auction on October 4 $34 billion* 52-week bills for auction on October 5 **SETTLE:** $84 billion 13-,26-week bills $24 billion 20-year bonds $14 billion 10-year TIPS $60 billion 2-year notes $61 billion 5-year notes $62 billion 7-year notes	
4	5	6	7	8
AUCTION: $84 billion* 13-,26-week bills	**AUCTION:** $34 billion* 52-week bills **ANNOUNCE:** $10 billion* 4-week bills for auction on October 7 $25 billion* 8-week bills for auction on October 7 $30 billion* 17-week CMBs for auction on October 6 **SETTLE:** $10 billion* 4-week bills $25 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs	**AUCTION:** $10 billion* 4-week bills $25 billion* 8-week bills **ANNOUNCE:** $84 billion* 13-,26-week bills for auction on October 12 $58 billion* 3-year notes for auction on October 12 $38 billion* 10-year notes for auction on October 12 $24 billion* 30-year bonds for auction on October 13 **SETTLE:** $84 billion* 13-,26-week bills $34 billion* 52-week bills	
11	12	13	14	15
COLUMBUS DAY	**AUCTION:** $84 billion* 13-,26-week bills $58 billion* 3-year notes $38 billion* 10-year notes **ANNOUNCE:** $10 billion* 4-week bills for auction on October 14 $25 billion* 8-week bills for auction on October 14 $30 billion* 17-week CMBs for auction on October 13 **SETTLE:** $10 billion* 4-week bills $25 billion* 8-week bills $30 billion* 17-week CMBs	**AUCTION:** $30 billion* 17-week CMBs $24 billion* 30-year bonds	**AUCTION:** $10 billion* 4-week bills $25 billion* 8-week bills **ANNOUNCE:** $84 billion* 13-,26-week bills for auction on October 18 $24 billion* 20-year bonds for auction on October 20 $19 billion* 5-year TIPS for auction on October 21 **SETTLE:** $84 billion* 13-,26-week bills	**SETTLE:** $58 billion* 3-year notes $38 billion* 10-year notes $24 billion* 30-year bonds

**Estimate*