Daiwa Capital Markets

U.S. Economic Comment

- CPI: the case for transitory pressure weakens
- Real consumer spending: slow in Q3, but favorable prospects

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Consumer Prices

The increase of 0.2 percent in the core CPI in September might tempt one to conclude that Fed views on inflation were correct: upward pressure in prior months might indeed be transitory. However, digging through the detail of the report reveals cause for concern.

First, in the current environment, we would not ignore the prices of food and energy. Analysts and market participants focus on the core component because prices of food and energy are volatile and changes are often transitory. However, in this instance, pressure on food and energy prices has been persistent and could well have further to go. Food prices, for example, have increased at least 0.4 percent in each of the past six months, with an average advance of 0.6 percent over this span. Pressure is apparently global in nature, as prices of imported food have increased at an average monthly rate of 1.3 percent so far this year. Given delivery and supply problems, it is difficult to imagine a near-term reversal in this trend.

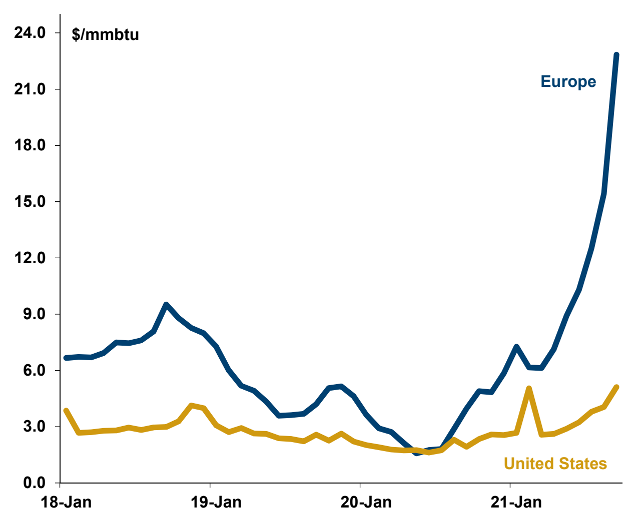
Energy prices displayed considerable pandemic-related volatility last year, tumbling during the spring of 2020 before recovering with the economy in the summer and fall. Upward pressure has continued this year, with the energy component of the CPI moving above the pre-pandemic norm. Limited supply is an issue for petroleum-related products, as OPEC+ plans to increase production gradually, and production in the U.S. has increased only modestly in response to higher prices and remains 12 percent below pre-Covid levels.

The price of natural gas also has become an issue, as the price at wellhead in the U.S. has surged to the upper end of the range from the past 12 years, with the current price only exceeded by what proved to be temporary spikes. This shift has pushed the natural gas component of the CPI to a 12-year high.

The latest surge in the price of natural gas is likely to be more than just a spike, as supplies are tight around the world, with prices in Europe and Asia exceeding those in the U.S. by a wide margin (chart). The U.S. is not likely to be fully insulated from the pressure abroad; we suspect that arbitrage will narrow the gap between U.S. and foreign prices. Facilities for trading natural gas internationally are not as well developed as those for crude oil, but trade does occur, and price differentials will probably lead to a shifting of supplies and price adjustments (higher in the U.S. and lower in Europe and Asia).

Prices of food and energy are important because they are among the most salient purchases of consumers. Thus, extended pressure has the potential to stir inflation expectations.

Domestic & Foreign Natural Gas Prices*

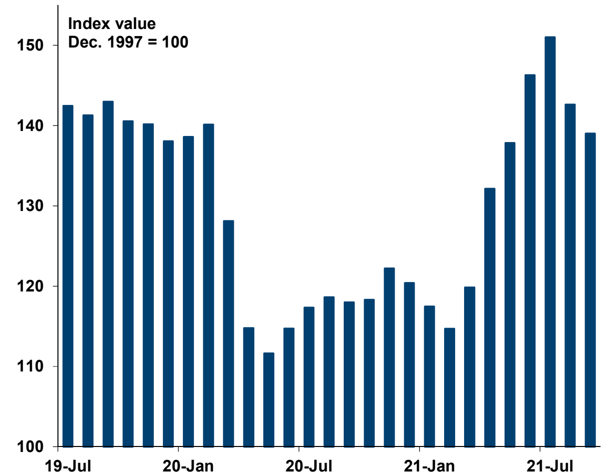


** MMBtu = Metric Million British Thermal Units. Monthly data. The last observation is for September 2021.*

Sources: The World Bank: World Bank Commodity Price Data: Bloomberg, The Wall Street Journal, Thomson Reuters Datastream, and World Gas Intelligence

The core component also involves some high-side risks. Pandemic-related noise drove core prices higher in the spring and summer, which led to claims of transitory pressure. The effect of the pandemic reversed in September, as but the spread of the Delta variant led to discounting in virus-sensitive areas. For example, the cost of travel-related services showed a notable downward move, as airfares, hotel charges, and car-rental fees all declined. Car-rental fees and hotel charges have some additional down-side potential, but airfares are low and likely to climb once individuals feel more comfortable traveling by air. As a group, these three items are in line with pre-pandemic norms (chart), and thus are not likely to restrain the core index like they did in September.

CPI: Travel-Related Services*



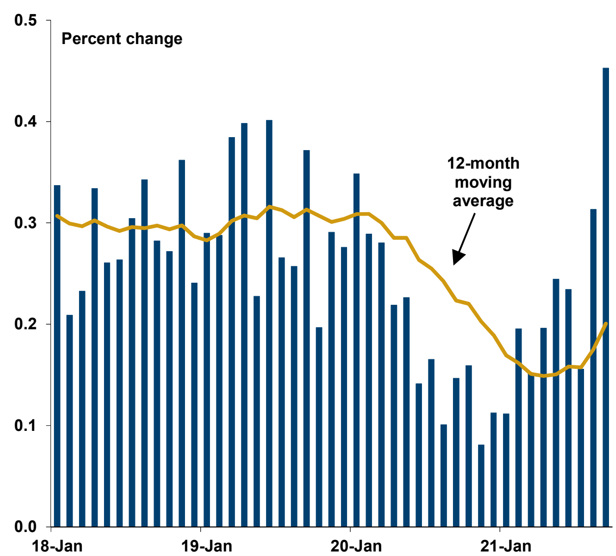
** The Travel-Related Services index is a weighted average of the Car and Truck Rental, Airline Fare, and Other Lodging Away from Home incl. Hotels/Motels components of the CPI. The Airline Fare and Hotel/Motel components are rebased to equal 100 in December 1997. Weights are calculated based on the relative importance of each component in the CPI.*

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

Prices of apparel also have been sensitive to Covid, and they too fell in September. Like airfares, they remain below pre-pandemic levels and are likely to increase when socializing and work routines return to normal.

Rental rates, in our view, represented the most notable aspect of the core CPI in September and point to upside risks in coming months. The rate of increase in rent of primary residence slowed after the onset of Covid, increasing at an annual rate of 2.1 percent from February 2020 through July 2021, noticeably slower than the average of 3.6 percent in 2018 and 2019. However, rental rates are perhaps beginning to stir, as they rose 0.3 percent in August and jumped 0.5 percent in September (chart, annual rate of 4.6 percent in the past two months). With housing prices having surged in the past year, a large gap between the cost of owning and renting has opened, and we could see a series of sharp increases in rents to close the gap.

CPI: Rent of Primary Residence



Source: Bureau of Labor Statistics via Haver Analytics

We also wonder about health-care costs, which have increased only 0.4 percent in the past year, a sharp break from the normal increase of 2.0 to 4.0 percent per year (and touching 5.0 percent at times). We suspect that pressure has eased because of a drop in elective procedures. As concern over the virus fades, this source of demand is likely to revive.

Consumer Spending: Nominal versus Real

Alan Greenspan used to view price stability as an environment where expected changes in prices do not affect the decisions of individuals and businesses. An amended definition might be an environment where an economist can take a nominal economic report at face value; that is, the analyst does not need to make meaningful adjustments for inflation. At least for the time being, we are not in such an environment.

The latest report on retail sales is a case in point. The results were impressive at first blush, with total activity increasing 0.7 percent. However, a portion of this advance was driven by higher prices. The auto component, for example, posted a gain of 0.5 percent, an apparently strong showing considering the tight supply conditions in this market, but the performance was less impressive in light of the 1.3 percent increase in the prices of new cars and light trucks (CPI data). Similarly, activity at restaurants and bars rose 0.3 percent despite the constraining influence of the Delta variant of Covid, but the change will probably translate to a decline in real terms given the increase of 0.5 percent in the price of food away from home. Food stores and gasoline service stations posted solid results (up 0.7 percent and 1.8 percent, respectively), but these changes will either decline or show a modest increase after adjusting for inflation.

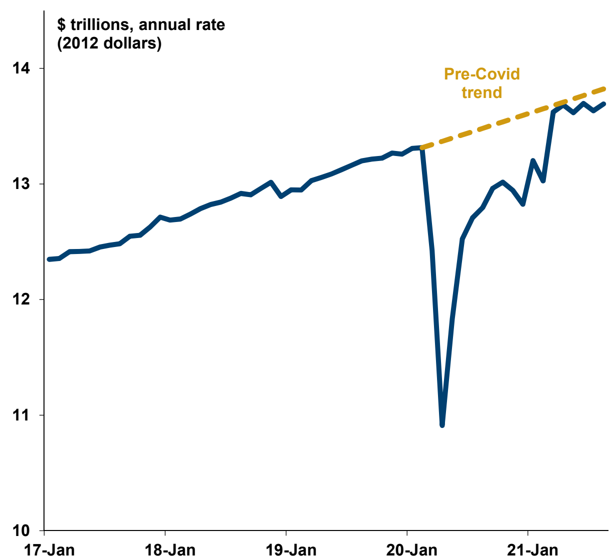
The report on retail sales was still favorable, as several components posted strong advances that surely will translate to gains in real terms (general merchandise stores up 2.0 percent, clothing stores up 1.1 percent, sporting goods stores up 3.7 percent). However, taking account of inflation, the overall results were less than vigorous.

Strong or Weak?

The likely underwhelming performance of total real consumer spending in September (i.e. spending on both goods and services adjusted for inflation) follows slow results in July and August, when real outlays over the two months combined showed little net change. The third quarter, then, is likely to show little growth in real consumer spending in the next GDP report, with outlays likely to advance approximately 1.0 percent.

This modest increase might suggest that support from consumers is stalling, but we would not rush to this conclusion. After annual growth in real consumer spending of 11.7 percent in the first half of the year, a pause would be neither surprising nor troubling. The rapid advance in prior quarters pushed real outlays close to the pre-pandemic trend (chart), and thus some slowing should be expected.

Real Personal Consumption Expenditures*



** The pre-Covid trend assumes an annual growth rate of 2.5 percent.*
Sources: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

In the quarters ahead, we would expect spending to at least move in line with the pre-Covid trend, which involved annual growth of approximately 2.5 percent. We can easily envision even faster growth, as job growth will most likely exceed the pre-Covid trend for a time, and households have a large pool of savings that can be drawn on to finance activity. In addition, there is probably considerable pent-up demand for the consumption of services, as individuals will be anxious to travel and attend entertainment events once the virus becomes a nonissue.

Review

Week of Oct. 11, 2021	Actual	Consensus	Comments
CPI (September)	**0.4% Total, 0.2% Core**	**0.3% Total, 0.2% Core**	Food prices at the consumer level jumped 0.9% in September, adding an accent to average advances of 0.5% in the prior five months. Energy prices also posted a firm increase, with all major components contributing to the jump of 1.3%. Core prices posted a moderate increase, as many areas sensitive to the virus fell in price (airfares, car-rental fees, and hotel charges all fell in September). On a year-over-year basis, core prices rose 5.4%, matching the recent high in June/July, which was the fastest advance since 2008.
PPI (September)	**0.5% Total, 0.2% Ex. Food & Energy**	**0.6% Total, 0.5% Ex. Food & Energy**	The latest in the headline PPI, although brisk, slowed from the average advance of 0.9% in the first eight months of 2021. Food prices have been a major source of pressure this year, rising 2.0% in September and averaging changes of 1.2% in the prior eight months. Energy prices at the producer level also have shown sustained pressure this year (up 2.8% in September and 36.3% on a year-over-year basis). The monthly change in prices excluding food and energy slowed from the average advance of 0.7% per month in the first eight months of the year; on a year-over-year basis, prices ex food and energy rose 6.8%.
Retail Sales (September)	**0.7% Total, 0.8% Ex. Autos**	**-0.2% Total, 0.5% Ex. Autos**	Retail sales showed surprising strength September, but the change partly reflected higher prices. The auto component, for example, rose 0.5%, but given the increase of 1.3% in new car prices (CPI data), sales probably fell after adjusting for inflation. Sales at food stores, restaurants, and gasoline stations also seemed to be influenced by higher prices. The report was still favorable, as other areas showed strength that undoubtedly will translate to gains in real terms.
Consumer Sentiment (October)	**71.4 (-1.4 Index Pts.)**	**73.1 (+0.3 Index Pt.)**	The drop in consumer sentiment occurred from an already low level, which left the measure only slightly above the recent low of 70.3 in August and below the recession trough of 71.8 in April 2020. Concerns about Covid and inflation seem to have dampened moods. On the inflation front, the year-ahead measure, which is heavily influenced by consumer energy prices, rose two ticks to 4.8% -- the fastest reading since 2008. The long-term measure slipped to 2.8% from 3.0%, but it remained elevated relative to readings in other recent years.

Sources: Bureau of Labor Statistics (CPI, PPI); U.S. Census Bureau (Retail Sales); University of Michigan Survey Research Center (Consumer Sentiment); Consensus forecasts are from Bloomberg

Preview

Week of Oct. 18, 2021	Projected	Comments
Industrial Production (September) (Monday)	**0.2%**	Increases in the rotary rig count and payroll employment suggest that mining output rose in September. Manufacturers were able to find workers in the latest month, but they trimmed work time for existing employees, and thus production probably rose only moderately. Utility output is likely to decline from a high-side level in August, as comfortable temperatures restrained demand for both heating and cooling services.
Housing Starts (September) (Tuesday)	**1.600 Million (-0.9%)**	Hints of improvement in home sales might lead builders to pick up the pace of single-family starts, although inventories of unsold homes are high, and thus the change is likely to be small. Multi-family activity has been strong in recent months, but activity could cool from the unusually firm reading in August.
Existing Home Sales (September) (Thursday)	**6.10 Million (+3.7%)**	A jump in pending home sales in August suggests that the housing market might be starting to revive after softening from November through May.
Leading Indicators (September) (Thursday)	**0.5%**	Positive contributions from ISM new orders, the leading credit index, and the slope of the yield curve should offset negative contributions from the manufacturing workweek and orders for consumer goods, resulting in the 16th increase in the past 17 months (no change in the other month).
Federal Budget (September) (One Day This Week)	**$60.0 Billion Deficit**	Available data suggest that federal revenues in September rose sharply on a year-over-year basis (up approximately 20%), which should leave the deficit lighter than the shortfall of $125 billion in the same month last year. September marks the final month of the government's fiscal year, and the expected monthly deficit would leave the annual shortfall at $2,771 billion, an improvement from a deficit of $3,132 billion in FY2020.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

October/November 2021

Monday 11

COLUMBUS DAY

Tuesday 12

NFIB SMALL BUSINESS OPTIMISM INDEX

July	99.7
Aug	100.1
Sept	99.1

JOLTS DATA

	Openings (000)	Quit Rate
June	10,185	2.7%
July	11,098	2.7%
Aug	10,439	2.9%

Wednesday 13

CPI

	Total	Core
July	0.5%	0.3%
Aug	0.3%	0.1%
Sept	0.4%	0.2%

FOMC MINUTES

Thursday 14

UNEMPLOYMENT CLAIMS

	Initial (Millions)	Continuing
Sept 18	0.351	2.811
Sept 25	0.364	2.727
Oct 02	0.329	2.593
Oct 09	0.293	N/A

PPI

	Final Demand	Ex. Food & Energy
July	1.0%	1.0%
Aug	0.7%	0.6%
Sept	0.5%	0.2%

Friday 15

RETAIL SALES

	Total	Ex.Autos
July	-1.6%	-0.9%
Aug	0.9%	2.0%
Sept	0.7%	0.8%

IMPORT/EXPORT PRICES

	Non-petrol. Imports	Nonagri. Exports
July	0.2%	1.4%
Aug	-0.1%	0.3%
Sept	0.1%	0.3%

EMPIRE MFG

Aug	18.3
Sept	34.3
Oct	19.8

CONSUMER SENTIMENT

Aug	70.3
Sept	72.8
Oct	71.4

BUSINESS INVENTORIES

	Inventories	Sales
June	0.9%	1.6%
July	0.6%	0.5%
Aug	0.6%	-0.1%

Monday 18

IP & CAP-U (9:15)

	IP	Cap.Util.
July	0.8%	76.2%
Aug	0.4%	76.4%
Sept	**0.2%**	**76.5%**

NAHB HOUSING INDEX (10:00)

Aug	75
Sept	76
Oct	--

TIC DATA (4:00)

	Net L-T	Total
June	$93.6B	$27.0B
July	$1.7B	$106.3B
Aug	--	--

FEDERAL BUDGET (2:00) (ONE DAY THIS WEEK)

	2021	2020
July	-$302.1B	-$63.0B
Aug	-$170.6B	-$200.0B
Sept	**-$60.0B**	-$124.6B

Tuesday 19

HOUSING STARTS (8:30)

July	1.554 million
Aug	1.615 million
Sept	**1.600 million**

Wednesday 20

BEIGE BOOK (2:00)

September Beige Book

"Economic growth downshifted slightly to a moderate pace in early July through August."

Thursday 21

INITIAL CLAIMS (8:30)

PHILLY FED INDEX (8:30)

Aug	19.4
Sept	30.7
Oct	--

EXISTING HOME SALES (10:00)

July	6.00 million
Aug	5.88 million
Sept	**6.10 million**

LEADING INDICATORS (10:00)

July	0.8%
Aug	0.9%
Sept	**0.5%**

Friday 22

Monday 25

CHICAGO FED NATIONAL ACTIVITY INDEX

Tuesday 26

FHFA HOME PRICE INDEX

S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX

NEW HOME SALES

CONSUMER CONFIDENCE

Wednesday 27

U.S. INTERNATIONAL TRADE IN GOODS

ADVANCE INVENTORIES

DURABLE GOODS ORDERS

Thursday 28

INITIAL CLAIMS

Q3 GDP

PENDING HOME SALES

Friday 29

PERSONAL INCOME, CONSUMPTION, PRICES

EMPLOYMENT COST INDEX

MNI CHICAGO BUSINESS BAROMETER INDEX

REVISED CONSUMER SENTIMENT

Monday 1

ISM MANUFACTURING INDEX

CONSTRUCTION SPEND.

Tuesday 2

NEW VEHICLE SALES

FOMC MEETING

Wednesday 3

ADP EMPLOYMENT REPORT

ISM SERVICES INDEX

FACTORY ORDERS

FOMC DECISION

Thursday 4

INITIAL CLAIMS

PRODUCTIVITY & COSTS

TRADE BALANCE

Friday 5

EMPLOYMENT REPORT

CONSUMER CREDIT

Forecasts in Bold.

Treasury Financing

October/November 2021

Monday	Tuesday	Wednesday	Thursday	Friday
11	12	13	14	15
COLUMBUS DAY	**AUCTION RESULTS:** Rate / Cover 13-week bills 0.050% 3.46 26-week bills 0.055% 3.99 3-year notes 0.635% 2.36 10-yr notes 1.584% 2.58 **ANNOUNCE:** $25 billion 4-week bills for auction on October 14 $25 billion 8-week bills for auction on October 14 $35 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 RESULTS:** Rate / Cover 30-yr bonds 2.049% 2.36 17-week CMB 0.050% 3.93 **ANNOUNCE:** $60 billion 39-day CMBs for auction on October 14	**AUCTION RESULTS:** Rate / Cover 4-week bills 0.035% 3.58 8-week bills 0.080% 3.11 39-day CMB 0.055% 3.00 **ANNOUNCE:** $93 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 $60 billion 40-day CMBs for auction on October 19 **SETTLE:** $84 billion 13-,26-week bills	**SETTLE:** $58 billion 3-year notes $38 billion 10-year notes $24 billion 30-year bonds
18	19	20	21	22
AUCTION: $93 billion 13-,26-week bills **SETTLE:** $60 billion 39-day CMBs	**AUCTION:** $60 billion 40-day CMBs **ANNOUNCE:** $30 billion* 4-week bills for auction on October 21 $30 billion* 8-week bills for auction on October 21 $35 billion* 17-week CMBs for auction on October 20 **SETTLE:** $25 billion 4-week bills $25 billion 8-week bills $35 billion 17-week CMBs	**AUCTION:** $24 billion 20-year bonds $35 billion* 17-week CMBs	**AUCTION:** $30 billion* 4-week bills $30 billion* 8-week bills $19 billion 5-year TIPS **ANNOUNCE:** $99 billion* 13-,26-week bills for auction on October 25 $28 billion* 2-year FRNs for auction on October 27 $60 billion* 2-year notes for auction on October 26 $61 billion* 5-year notes for auction on October 27 $62 billion* 7-year notes for auction on October 28 **SETTLE:** $93 billion 13-,26-week bills $60 billion 40-day CMBs	
25	26	27	28	29
AUCTION: $99 billion* 13-,26-week bills	**AUCTION:** $60 billion* 2-year notes **ANNOUNCE:** $30 billion* 4-week bills for auction on October 28 $30 billion* 8-week bills for auction on October 28 $35 billion* 17-week CMBs for auction on October 27 **SETTLE:** $30 billion* 4-week bills $30 billion* 8-week bills $35 billion* 17-week CMBs	**AUCTION:** $28 billion* 2-year FRNs $61 billion* 5-year notes $35 billion* 17-week CMBs	**AUCTION:** $30 billion* 4-week bills $30 billion* 8-week bills $62 billion* 7-year notes **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on Nov. 1 $34 billion* 52-week bills for auction on November 2 **SETTLE:** $99 billion* 13-,26-week bills	**SETTLE:** $19 billion 5-year TIPS
1	2	3	4	5
AUCTION: $105 billion* 13-,26-week bills **SETTLE:** $24 billion 20-year bonds $28 billion* 2-year FRNs $60 billion* 2-year notes $61 billion* 5-year notes $62 billion* 7-year notes	**AUCTION:** $34 billion* 52-week bills **ANNOUNCE:** $30 billion* 4-week bills for auction on November 4 $30 billion* 8-week bills for auction on November 4 $35 billion* 17-week CMBs for auction on November 3 **SETTLE:** $30 billion* 4-week bills $30 billion* 8-week bills $35 billion* 17-week CMBs	**AUCTION:** $35 billion* 17-week CMBs **ANNOUNCE:** $56 billion* 3-year notes for auction on November 8 $37 billion* 10-year notes for auction on November 9 $24 billion* 30-year bonds for auction on November 10	**AUCTION:** $30 billion* 4-week bills $30 billion* 8-week bills **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on Nov. 8 **SETTLE:** $105 billion* 13-,26-week bills $34 billion* 52-week bills	

**Estimate*