U.S. Economic Comment

- FOMC: behind the inflation curve, but racing to catch up
- New set of risks: war, not Covid

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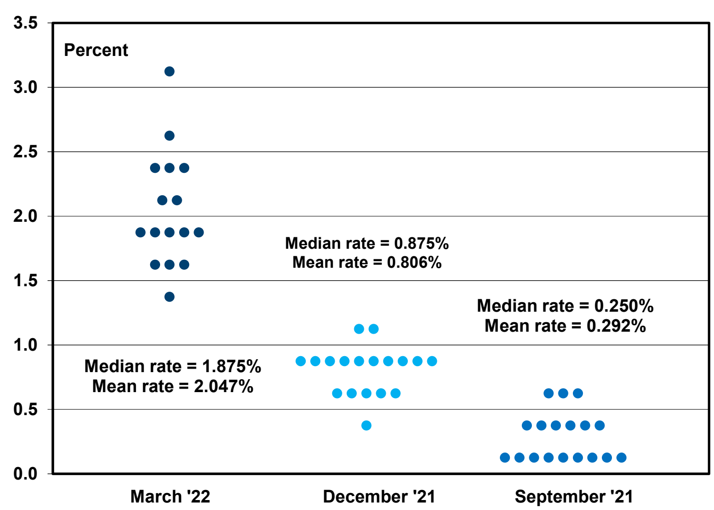
Monetary Policy

The Federal Open Market Committee has been pivoting away from its accommodative stance since last fall, but it was moving in baby steps: discussing the possibility of tapering the QE program in September, initiating a cut in asset purchases in November, accelerating the pace of tapering in December, and noting in January the intention to hike interest rates soon. Finally, the FOMC took a bold step at its latest meeting by raising the federal funds rate and signaling that several more changes are in the offing.

The increase in the funds rate was uneventful, as the magnitude of the change matched the usual shift of 25 basis points and the change was well anticipated by market participants. However, the degree of possible tightening in coming months was striking. The median dot suggested an additional change of 150 basis points, and several officials saw rates climbing notably more, with the most hawkish policymaker expecting an additional 275 basis points. We also took note of dots in the low end of the spectrum. The least hawkish Fed official saw rates climbing an additional 100 basis points, and there was only one policymaker with this expectation; the others expect an additional 125 basis points. The shift in the bottom portion of the distribution is notable because it signals little resistance to tighter policy.

The marked change in attitudes of Fed officials in recent months is apparent in the differences between the new dot plot and those in September and December. In September, the Committee was evenly divided between those who favored steady policy and those who expected to nudge rates higher (six looking for one hike and three expecting two). By December, all officials were on board for tightening, with the median dot suggesting three shifts of 25 basis points and the most aggressive officials (only two) looking for four moves. Note the stark difference between December and March: the most hawkish officials in December saw fewer policy changes than did the least hawkish in March.

FOMC Rate View: Year-End 2022*



** Each dot represents the expected federal funds rate of a Fed official at the end of 2022. 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 and December 2021 meetings; three were open at the March 2022 meeting.*

Source: Federal Open Market Committee, Summary of Economic Projections, September 2021, December 2021, and March 2022

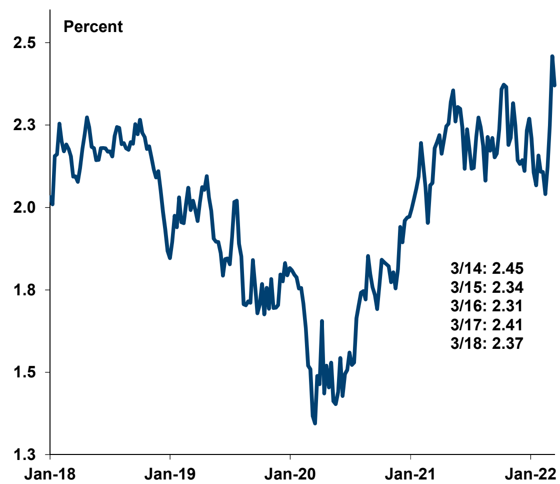
The dot plot showed new-found religion among Fed officials for countering inflation, but the hawkish bias was even more apparent in the press briefing of Chair Powell. He stated repeatedly that the Fed would use all its tools to insure that inflation returns to the Fed's two percent target, and he was dismissive of recession risks. Some notable comments from that briefing:

- I saw a committee that's acutely aware of the need to return the economy to price stability and determined to use our tools to do exactly that.
- We're not going to let high inflation become entrenched.
- the probability of a recession within the next year is not particularly elevated…the economy is very strong and well positioned to withstand tighter monetary policy.
- take a look at today's labor market, what you have is 1.7 plus job openings for every unemployed person. So that's a very, very tight labor market, tight to an unhealthy level, I would say.
- Tremendous momentum in the labor market. We expect growth to continue.

Some observers will not be impressed with the change in tack by the Federal Reserve. They will note that nearly all dots for 2022 are below the perceived level of the neutral rate; that is, the Fed will still be holding an accommodative stance at the end of this year. Viewed differently, given the current inflation rate and the projections of Fed officials, the real federal funds rate would still be less than zero at year end – hardly a stance that will arrest inflation.

Market participants apparently remained skeptical of the Fed's resolve, as inflation expectations have changed only modestly in the past week. The five-year/five-year forward break-even rate on inflation protected securities fell approximately 10 basis points on the first day of the FOMC meeting (Tuesday) and it fell a few basis points more after the Fed's announcement and Chair Powell's briefing on Wednesday, but the break-even rate retraced most of those shifts on Thursday and Friday and remained above readings in the past few years (chart).

Five-Year, Five-Year Forward Breakeven Rate*



** Expected average inflation per year in the five years that begin five years from now. Weekly end-of-period data.*

Source: Bloomberg

Despite the doubts among pundits and market participants, we were heartened by the change in attitudes among Fed officials. Monetary policy typically changes gradually because of uncertainty that is always present in the economic outlook (not to mention uncertainty regarding the neutral level of interest rates and the natural rate of unemployment). The current environment involves an unusually high degree of uncertainty because of the Russia-Ukraine conflict, and thus the FOMC will naturally be moving gingerly.

More important, we were encouraged that Fed officials now seem to recognize that they are behind the inflation curve and that bold moves are required. The dot plot, and Chair Powell's comments, suggest that the Fed will become more aggressive as the cloud of uncertainty dissipates. Policy should be in a restrictive position next year, which should begin to tame the demand-led portions of faster inflation. Progress in repairing damaged supply chains also should be helpful in the inflation fight.

Risks to Growth and Inflation

Chair Powell mentioned several times the high degree of uncertainty in the economic outlook, with the source of uncertainty apparently shifting from Covid to war. The policy statement, in a notable break from those issued after other recent FOMC meetings, did not mention Covid. Rather, the new statement carried a paragraph on the risks associated with the Russia-Ukraine conflict. Those risks, not surprisingly, were on the down-side for economic growth and the up-side for inflation.

The bias in risks is apparent in the range of forecasts shown in the Summary of Economic Projections and the deviation of high-side and low-side expectations from the median view. The median projection for GDP growth among Fed officials totaled 2.8 percent for 2022. The most optimistic official expects growth of 3.3 percent (0.5 percentage point firmer than the median), while the individual at the low end saw growth of 2.1 percent, a 0.7 percentage point deviation -- a bias, but not a striking one (-0.7 versus 0.5; table).

Views are more diverse on the inflation front, as the top end of the range for PCE inflation totals 5.5 percent, 1.2 percentage points more than the median of 4.3 percent, while the low-side view on inflation is only 0.6 percentage point below the median at 3.7 percent. Interestingly, the high side risks on inflation are driven entirely by the prices of food and energy, as there is a slight down-side bias on core inflation: a range of 3.6 to 4.5 percent around a median of 4.1 percent.

Economic Projections of the FOMC, March 2022*

	2022	2023	2024	Longer Run
Change in Real GDP	2.8	2.2	2.0	1.8
Range	2.1 - 3.3	2.0 - 2.9	1.5 - 2.5	1.6 - 2.2
Unemployment Rate	3.5	3.5	3.6	4.0
Range	3.1 -4.0	3.1 -4.0	3.1 -4.0	3.5 - 4.3
PCE Inflation	4.3	2.7	2.3	2.0
Range	3.7 - 5.5	2.2 - 3.5	2.0 - 3.0	2.0
Core PCE Inflation	4.1	2.6	2.3	--
Range	3.6 - 4.5	2.1 - 3.5	2.0 - 3.0	--
Federal Funds Rate	1.9	2.8	2.8	2.4
Range	1.4 - 3.1	2.1 - 3.6	2.1 - 3.6	2.0 - 3.0

** Median projections*

Source: Federal Open Market Committee, Summary of Economic Projections, March 2022

Review

Week of March 14, 2022	Actual	Consensus	Comments
PPI (February)	**0.8% Total, 0.2% Ex. Food & Energy**	**0.9% Total, 0.6% Ex. Food & Energy**	The sharp advance in the headline PPI in February matched the brisk underlying average of 0.8% in the prior 12 months; on a year-over year basis prices rose 10.0%. Food prices surged 1.9% after a jump of 1.7% in the prior month, leaving prices 13.7% higher in the past year. Energy prices also remained under pressure: 8.2% month-over-month, and 33.8% on a year-over-year basis. The advance in prices excluding food and energy slowed from the average of 0.7% per month in the past 12 months, but the year-over-year change was brisk at 8.4%.
Retail Sales (February)	**0.3% Total, 0.2% Ex. Autos**	**0.4% Total, 0.9% Ex. Autos**	The increase in retail sales in February was influenced by strong results in the auto and gasoline components (up 0.8% and 5.3%, respectively), with at least part of these advances caused by higher prices. Sales excluding autos and gasoline disappointed with a drop of 0.4%. Much of the weakness was concentrated in the nonstore category (-3.7%; mostly online sales, but also fuel-oil dealers), but this drop followed a surge in January and did little damage to a firm trend. Sales outside the nonstore category were mixed but up on balance (1.0%).
Housing Starts (February)	**1.769 Million (+6.8%)**	**1.700 Million (+3.8%)**	Housing starts jumped in February from upward-revised results in the prior two months (1.9% firmer than initially reported), reflecting solid performances in both multi-family and single-family activity. The jump of 9.3% in the multi-family area added to the firm performance in 2021. Single-family starts rose 5.7% to 1.215 million. The latest reading is off last year's high of 1.222 million in November, but it is 7.4% above last year's average of 1.131 million and compares favorably to readings in prior expansions (excluding those in the frothy period in the early-to-mid 2000s).
Industrial Production (February)	**0.5%**	**0.5%**	A gain of 1.2% in manufacturing activity led the advance in industrial production in February, with 17 of 20 major industries posting increases. Motor vehicles and the miscellaneous category were the only drags on manufacturing (off 3.5 % and 0.4%, respectively; one area showed no change). Mining activity rose 0.1%, continuing a slow recovery which has left activity 7.7% below its pre-pandemic level. Utility output dropped 2.7%, but the change reflected decreased usage amid warmer temperatures after a colder-than-normal January.
Existing Home Sales (February)	**6.02 Million (-7.2%)**	**6.10 Million (-6.2%)**	Higher interest rates and tight inventories constrained existing home sales in February, pushing activity to the bottom of the range of the past year and one-half. However, sales remained above all readings in the prior expansion. While inventories remained extremely tight, the situation improved slightly in February: the number of homes on the market rose 2.4% and the months' supply of homes for sale increased one tick to 1.7 months. Both figures, however, were still lean by historical standards.

Sources: Bureau of Labor Statistics (PPI); U.S. Census Bureau (Retail Sales, Housing Starts); Federal Reserve Board (Industrial Production); National Association of Realtors (Existing Home Sales); Consensus forecasts are from Bloomberg

Preview

Week of March 21, 2022	Projected	Comments
New Home Sales (February) (Wednesday)	**0.815 Million (+1.7%)**	Home builders reported a drop in buyer traffic in February, raising the possibility of a decline in sales of new homes, but the prospect of higher mortgage rates could push some fence-sitters to purchase a home. The expected total trails elevated activity in the second half of 2020 and the first quarter of 2021 (nine-month average of 932,000), but it would surpass all readings in the prior expansion (high of 756,000 in January 2020).
Current Account (2021-Q4) (Thursday)	**$220.0 Billion Deficit**	A deterioration in trade flows in Q4 suggests a widening in the current account deficit. The deficit has averaged 3.5% of GDP thus far in 2021 versus 3.0% in the prior year.
Durable Goods Orders (February) (Thursday)	**-0.5%**	Snarled supply chains and elevated input prices are notable headwinds for manufacturers, but the factory sector has held its own in recent months. A cooling in bookings for commercial aircraft is likely to restrain the headline figure in February, but orders excluding the volatile transportation component are likely to advance for the 21st time in the past 22 months.
Revised Consumer Sentiment (March) (Friday)	**59.7 (Unrevised)**	Elevated prices of groceries and gasoline limit the possibility of an upward revision to consumer sentiment in late March. The preliminary tally was the seventh in the past eight months below the recession low 71.8 in April 2020, and it was the lowest of the current expansion thus far.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

March/April 2022

Monday	Tuesday	Wednesday	Thursday	Friday
14	15	16	17	18
	PPI Final Demand / Ex. Food & Energy Dec 0.4% 0.6% Jan 1.2% 1.0% Feb 0.8% 0.2% **EMPIRE MFG** Jan -0.7 Feb 3.1 Mar -11.8 **TIC DATA** Total / Net L-T Nov $214.4B $137.9B Dec -$53.8B $114.5B Jan $294.2B $58.8B **FOMC MEETING**	**RETAIL SALES** Total / Ex.Autos Dec -2.7% -3.0% Jan 4.9% 4.4% Feb 0.3% 0.2% **IMPORT/EXPORT PRICES** Non-petrol Imports / Nonagri. Exports Dec 0.4% -1.9% Jan 1.3% 2.8% Feb 0.7% 3.0% **BUSINESS INVENTORIES** Inventories / Sales Nov 1.5% 1.1% Dec 2.4% -0.5% Jan 1.1% 3.7% **NAHB HOUSING INDEX** Jan 83 Feb 81 Mar 79 **FOMC DECISION** **CHAIR POWELL'S PRESS CONFERENCE**	**UNEMPLOYMENT CLAIMS** Initial / Continuing (Millions) Feb 19 0.233 1.469 Feb 26 0.216 1.490 Mar 05 0.229 1.419 Mar 12 0.214 N/A **HOUSING STARTS** Dec 1.754 million Jan 1.657 million Feb 1.769 million **PHILY FED INDEX** Jan 23.2 Feb 16.0 Mar 27.4 **IP & CAP-U** IP / Cap.Util. Dec -0.4% 76.3% Jan 1.4% 77.3% Feb 0.6% 77.6%	**EXISTING HOME SALES** Dec 6.09 million Jan 6.49 million Feb 6.02 million **LEADING INDICATORS** Dec 0.8% Jan -0.5% Feb 0.3%
21	22	23	24	25
CHICAGO FED NATIONAL ACTIVITY INDEX (8:30) Monthly / 3-Mo. Avg. Dec 0.07 0.46 Jan 0.69 0.42 Feb -- --		**NEW HOME SALES (10:00)** Dec 0.839 million Jan 0.801 million **Feb 0.815 million**	**INITIAL CLAIMS (8:30)** **CURRENT ACCOUNT (8:30)** 21-Q2 -$198.3 bill. 21-Q3 -$214.8 bill. **21-Q4 -$220.0 bill.** **DURABLE GOODS ORDERS (8:30)** Dec 1.2% Jan 1.6% **Feb -0.5%**	**PENDING HOME SALES (10:00)** Dec -2.3% Jan -5.7% Feb -- **REVISED CONSUMER SENTIMENT (10:00)** Jan 67.2 Feb 62.8 Mar(p) 59.7
28	29	30	31	1
U.S. INTERNATIONAL TRADE IN GOODS **ADVANCE INVENTORIES**	**FHFA HOME PRICE INDEX** **S&P CORELOGIC CASE-SHILLER HOME PRICE INDEX** **CONSUMER CONFIDENCE** **JOB OPENINGS & LABOR TURNOVER (JOLTS)**	**ADP EMPLOYMENT REPORT** **REVISED GDP**	**INITIAL CLAIMS** **PERSONAL INCOME, CONSUMPTION, PRICE INDEXES** **CHICAGO PURCHASING MANAGERS' INDEX**	**EMPLOYMENT REPORT** **ISM MFG INDEX** **CONSTRUCTION SPENDING** **VEHICLE SALES**
4	5	6	7	8
FACTORY ORDERS	**TRADE BALANCE** **ISM SERVICES INDEX**	**FOMC MINUTES**	**INITIAL CLAIMS** **CONSUMER CREDIT**	**WHOLESALE TRADE**

Forecasts in Bold. (p) = preliminary

Treasury Financing

March/April 2022

Monday	Tuesday	Wednesday	Thursday	Friday
14	15	16	17	18
AUCTION RESULTS: Rate Cover 13-week bills 0.450% 2.77 26-week bills 0.820% 3.08	**ANNOUNCE:** $45 billion 4-week bills for auction on March 17 $35 billion 8-week bills for auction on March 17 $35 billion 17-week CMBs for auction on March 16 **SETTLE:** $45 billion 4-week bills $35 billion 8-week bills $35 billion 17-week CMBs $48 billion 3-year notes $34 billion 10-year notes $20 billion 30-year bonds	**AUCTION RESULTS:** Rate Cover 17-week CMB 0.665% 3.68	**AUCTION RESULTS:** Rate Cover 4-week bills 0.190% 3.31 8-week bills 0.300% 3.45 **ANNOUNCE:** $105 billion 13-,26-week bills for auction on March 21 $34 billion 52-week bills for auction on March 22 $22 billion 2-year FRNs for auction on March 23 $16 billion 20-year bonds for auction on March 23 $14 billion 10-year TIPS for auction on March 24 **SETTLE:** $111 billion 13-,26-week bills	
21	22	23	24	25
AUCTION: $105 billion 13-,26-week bills	**AUCTION:** $34 billion 52-week bills **ANNOUNCE:** $45 billion* 4-week bills for auction on March 24 $35 billion* 8-week bills for auction on March 24 $35 billion* 17-week CMBs for auction on March 23 **SETTLE:** $45 billion 4-week bills $35 billion 8-week bills $35 billion 17-week CMBs	**AUCTION:** $22 billion 2-year FRNs $16 billion 20-year bonds $35 billion* 17-week CMBs	**AUCTION:** $45 billion* 4-week bills $35 billion* 8-week bills $14 billion 10-year TIPS **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on March 28 $50 billion* 2-year notes for auction on March 28 $51 billion* 5-year notes for auction on March 28 $47 billion* 7-year notes for auction on March 29 **SETTLE:** $105 billion 13-,26-week bills $34 billion 52-week bills	**SETTLE:** $22 billion 2-year FRNs
28	29	30	31	1
AUCTION: $105 billion* 13-,26-week bills $50 billion* 2-year notes $51 billion* 5-year notes	**AUCTION:** $47 billion* 7-year notes **ANNOUNCE:** $45 billion* 4-week bills for auction on March 31 $35 billion* 8-week bills for auction on March 31 $35 billion* 17-week CMBs for auction on March 30 **SETTLE:** $45 billion* 4-week bills $35 billion* 8-week bills $35 billion* 17-week CMBs	**AUCTION:** $35 billion* 17-week CMBs	**AUCTION:** $45 billion* 4-week bills $35 billion* 8-week bills **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on April 4 **SETTLE:** $105 billion* 13-,26-week bills $16 billion 20-year bonds $14 billion 10-year TIPS $50 billion 2-year notes $51 billion 5-year notes $47 billion 7-year notes	
4	5	6	7	8
AUCTION: $105 billion* 13-,26-week bills	**ANNOUNCE:** $45 billion* 4-week bills for auction on April 7 $35 billion* 8-week bills for auction on April 7 $35 billion* 17-week CMBs for auction on April 6 **SETTLE:** $45 billion* 4-week bills $35 billion* 8-week bills $35 billion* 17-week CMBs	**AUCTION:** $35 billion* 17-week CMBs	**AUCTION:** $45 billion* 4-week bills $35 billion* 8-week bills **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on April 11 $46 billion* 3-year notes for auction on April 11 $34 billion* 10-year notes for auction on April 12 $20 billion* 30-year bonds for auction on April 13 **SETTLE:** $105 billion* 13-,26-week bills	

**Estimate*