Daiwa Capital Markets

U.S. Economic Comment

- U.S. consumers: still active despite rapid inflation
- Budget update: slippage in FY2023 (and beyond)
- Fed remittances to the Treasury Department: contributing to budget slippage

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Consumers on Track

Consumer spending showed signs of faltering in the fourth quarter of last year, as real outlays fell in both November and December, leaving annual growth of real consumption expenditures of only 1.4 percent in Q4. Media coverage and the commentary of many analysts painted a dark outlook, highlighting inflation-constrained budgets, dwindling savings balances, and heavy reliance on credit card debt. Such views, while not entirely off the mark, seem exaggerated.

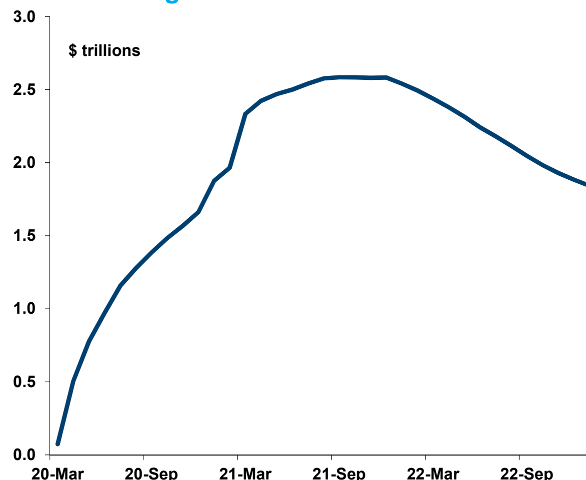
The latest report on consumer spending showed brisk activity in January. The jump of 1.1 percent in real outlays more than offset the contractions in the final two months of last year and put spending on track to exceed three percent in Q1. Consumption growth in the first quarter is likely to be the best since the early stages of the expansion, when spending surged after Covid-related lockdowns began to ease. The softness in late 2022 seems to reflect statistical noise, possibly generated by adverse weather or early holiday shopping; whatever the explanation, it does not seem to be a case of retrenchment by households.

Many of the negative views on consumer spending were driven by the presumption that individuals had about exhausted the excess savings balances accumulated during the worst of the pandemic. Consumers have indeed drawn on the saving balances accumulated in 2020 and 2021, but individuals are hardy tapped out. At their peak, so-called excess savings (i.e. accumulated balances less what might have occurred in the absence of Covid) totaled $2.6 trillion; they now total $1.8 trillion, a still-sizeable cushion (7.0 percent of nominal GDP and 10.3 percent of nominal consumer spending; chart). Certainly, many individuals will seek to preserve a sizeable share of these balances to maintain a healthy financial position, but they are likely to use the funds rather than allow finances to become stressed.

Concern about excessive credit card usage also seems misplaced. Admittedly, the rate of growth in credit card debt has been brisk in the past two years, but much of this growth reflects payback for the decline in debt during the worst of the pandemic. With individuals locked down and unable to spend during much of 2020, they used stimulus checks to pare credit card balances. As consumes returned to normal activity in 2021 and 2022, they naturally used credit cards more frequently. The rate of growth since early 2021 could be viewed as striking, but outstanding debt is still lower than the extrapolated pre-pandemic trend (chart; next page, left).

The current level of credit card debt does not seem to have generated stress in the household sector, as delinquency rates are low relative to

Excess Savings*



** Accumulated savings of the consumer sector less what might have occurred in the absence of Covid. The counterfactual (saving in the absence of Covid) assumes that disposable personal income continued to grow at the 2018-19 pace and that the saving rate held steady at 7.5 percent.*

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

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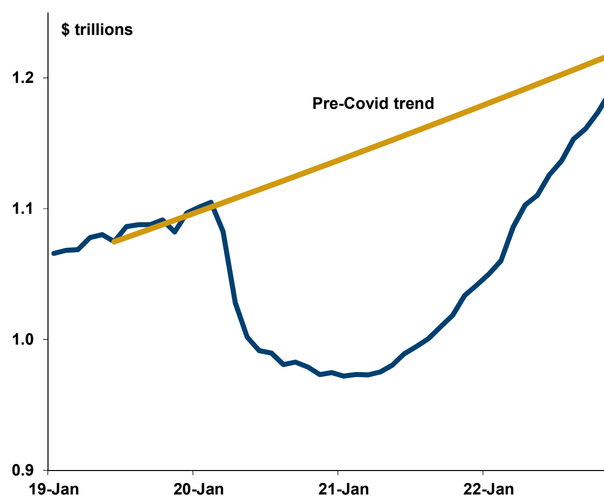
historical standards (chart, below right). Late payments have picked up in the past year, but the change started from a record low level and delinquencies are still below pre-Covid readings, which were already low by historical standards. Despite the pickup, we would describe delinquency rates as comfortable, even favorable.

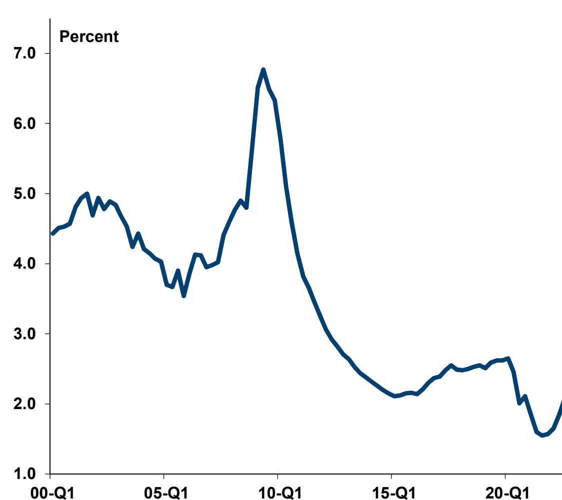
We don't mean to sound optimistic about the economic outlook; we still believe that tight monetary policy will trigger a recession this year. However, we expect the downturn to be mild. The primary reason for limited weakness is modest adjustments in the household sector. With financial positions not strained and with the labor market generally firm, consumer spending is not likely to soften substantially. The January data support this view.

Revolving Consumer Credit*



** The pre-Covid trend assumes that credit card debt continued growing at the 2019-19 pace.*
Sources: Federal Reserve Board via Haver Analytics; Daiwa Capital Markets America

Delinquency Rates on Revolving Credit



Source: Federal Reserve Board via Haver Analytics

Federal Budget Update

We find the debates on the debt ceiling tiresome. They involve excessive political posturing, and they always have the same ending: Congress kicks the political football around for several months before finding some solution at the eleventh hour. In the current setting, though, the debate might prove useful, as it could lead Congress to adopt a needed element of fiscal discipline.

The budget deficit, in our view, has become unmoored. The huge shortfalls during the pandemic were understandable, but with the economy largely adjusted to the virus, one might hope that the federal government would seek to offset some of the largess with more cautious fiscal management. That has not been the case thus far, as the deficit in fiscal year 2022 exceeded by a wide margin the expectations at mid-year: The Congressional Budget Office in May 2022 projected a deficit of $1.036 trillion in FY2022; the actual shortfall totaled $1.375 trillion.

The current fiscal year, now four months old, is off to a bad start. Revenues in the first four months of the year declined 2.9 percent from the collections in the same period in fiscal 2022. Outlays have jumped 8.8 percent, and that advance was constrained by a calendar configuration that shifted some spending from FY2023 into FY2022. (October 1, the first day of FY2023, fell on Saturday, which led to some funds to be disbursed on the prior business day, which was the last day of FY2022. Without this fiscal year shift, outlays would have increased 12 percent.)

Some of the spending increase this year could be viewed as the result of technical factors. Last year the government collected $81 billion from the auction of rights to the electromagnetic spectrum, and the absence of such activity this year pushed outlays higher. (Proceeds from such auctions are recorded as negative outlays in the government's accounting framework, and the absence of a negative outlay translates to an increase in spending.)

Still, spending was heavy excluding the shift in auction proceeds, and the sizeable increase occurred despite some additional declines in outlays related to the pandemic. Two jumps are worthy of note because of implications for future spending. Social Security outlays in the first four months of the fiscal year rose $37 billion or 10 percent, influenced by a sizeable cost of living adjustment, an indication that inflation will have adverse budget consequences. In addition, interest on the public debt jumped $58 billion or 41 percent, reflecting both the surge in debt during the pandemic and increases in interest rates.

The weak revenue flow was broadly based. The federal government collected little from individuals. Taxes withheld from paychecks and estimated payments by individuals rose moderately, but refunds were up by about the same amount, leaving a minuscule gain. Corporate taxes decreased slightly, and customs duties and taxes to fund unemployment programs retreated as well. The Federal Reserve played an important role in the revenue decline, as remittances to the Treasury fell substantially (discussed below).

The widening in the budget deficit in the first four months of the year is not likely to be temporary. The new estimate for the full fiscal year released by the Congressional Budget Office on February 15 showed a shortfall of $1.410 trillion, notably wider than the estimate of $984 billion published last May. Deficits in subsequent years are wider than previously expected as well. All told, the cumulative shortfall for fiscal years 2023 to 2032 is $3.1 trillion wider than previously estimated (now $18.8 trillion versus $15.7 trillion).

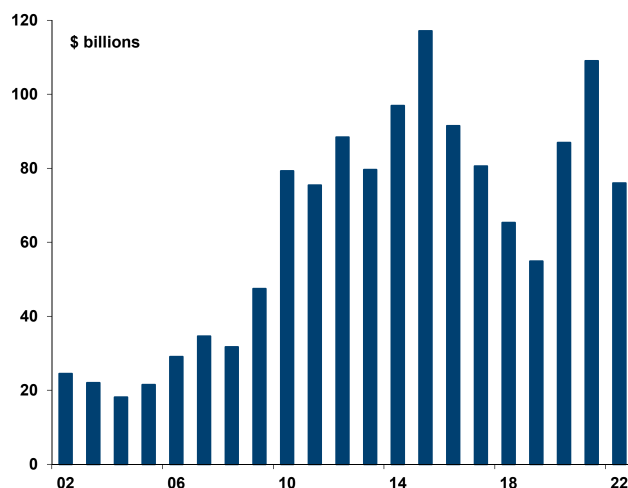
Budget Deficits: The Fed's Role

Over the years, the Federal Reserve has consistently added to federal revenues by remitting to the Treasury Department its excess net interest income. That is, the Fed uses the interest earned on its portfolio of securities to cover operating expenses, to pay dividends to member banks of the Federal Reserve System, and to maintain a specified level of surplus (or capital). Any net interest income in excess of these requirements is remitted to the Treasury. (In terms of dividends, the Federal Reserve is "owned" by member commercial banks. Banks purchase stock in the Fed when they join the system, and the Fed pays a six percent annual dividend on that stock.)

Remittances to the Treasury have picked up in recent years. The quantitative easing programs of the Fed during the financial crisis and pandemic enlarged its portfolio and boosted its interest income, allowing large payments to the Treasury (chart). The Fed's record of steady (and sizeable) remittances is likely to come to an end this calendar year. Interest receipts will be dwindling, and interest payments picking up, leaving little or no excess net interest income.

Interest payments will increase considerably this year because of the tightening in monetary policy. The Federal Reserve pays interest on reserve balances of depository institutions held at the Fed as well as on reverse RPs arranged with its counterparties. As the Fed hikes short term interest rates, these expenses grow.

Federal Reserve Remittances to the U.S. Treasury

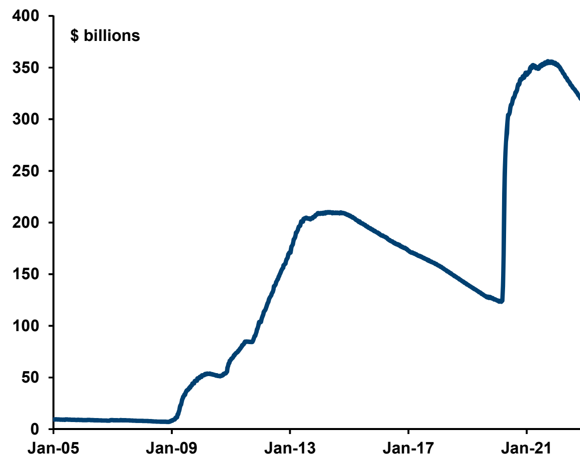


Source: Federal Reserve Board via Haver Analytics

The Fed will be losing interest income because its portfolio is shrinking under its Quantitative Tightening program. In addition, the Fed will be gradually absorbing losses associated with its purchase of securities during its Quantitative Easing effort. That is, most of the securities purchased during the pandemic carried coupon rates above prevailing market rates, and thus they traded at prices above the par value of the note or bond. These premiums must absorbed at some point, and the Fed does so by amortizing the value of the premiums. Interest income in the Fed's accounting framework is defined as payments collected less amortized premiums.

The deduction of amortized premiums from interest receipts is likely to be large, as the aggregate value of the premiums surged to a peak of $356 billion in November 2021 (chart). The absorption is now underway, which is limiting net revenue and slowing the remittances to the Treasury. Indeed, interest income has not been sufficient to cover operating expenses, dividends, and contributions to surplus since late last year. Thus, remittances to the Treasury this year will probably be zero. Given the size of the aggregate premium on the Fed's portfolio, it is likely to be a considerable time before the Fed resumes its remittances.

Unamortized Premiums on Securities



Source: Federal Reserve Board via Haver Analytics

Review

Week of Feb. 20, 2023	Actual	Consensus	Comments
Existing Home Sales (January)	**4.00 Million (-0.7%)**	**4.10 Million (+2.0%)**	The latest easing in sales of existing homes marked the 12th consecutive decline in activity, with the level of 4.00 million units (annual rate) holding below the pandemic-related trough of 4.09 million in May 2020 for the second consecutive month. One has to go back to the years following the financial crisis to find softer sales activity.
Revised GDP (2022-Q4)	**2.7% (-0.2 Pct. Pt. Revision)**	**2.9% (Unrevised)**	Most of the adjustment in the revised estimate of GDP for the fourth quarter of 2022 was the result of a downward revision to consumer spending (growth of 1.4% versus 2.1% first reported). Other components registered smaller changes (some upside, some downside). Net exports also were revised down, contributing 0.5 percentage point rather than 0.6 percentage points to growth. On the positive side, business fixed investment was firmer than previously believed (growth of 3.3% versus a preliminary estimate of 0.7%). Outlays for structures stood out, with growth now tallying 8.5% rather than 0.4%. Other components posted modest changes. Residential construction was a bit better, but still extremely soft. Government spending was a tad weaker, as outlays at the federal level were revised lower.
Personal Income, Consumption, Core Price Index (January)	**0.6%, 1.8%, 0.6%**	**1.0%, 1.4%, 0.4%**	Personal income rose in January, led by firm advances in wages, proprietors' income, and rents. Social Security payments also surged, reflecting a cost of living adjustment of 8.7% in January, but the expiration of various refundable tax credits left total transfers little changed on balance. After adjusting for inflation, total income declined marginally. Households spent actively in January, with outlays increasing 1.8% (1.1% after adjusting for inflation). Demand for motor vehicles stood out (up 11.9% in real terms), which left an overall advance of 5.2% in the durable goods sector. Spending on nondurable goods and services also was firm (up 0.5% and 0.6%, respectively, in real terms). Both the headline and core price indexes for personal consumption expenditures (PCE) rose 0.6% in January, which translated to year-over-year increases of 5.4% and 4.7%, respectively. These are down from recent peaks of 7.0% and 5.4%, but still far above levels consistent with the Fed's target of 2.0% inflation.
New Home Sales (January)	**0.670 Million (+7.2%)**	**0.620 Million (+0.7%)**	Sales of new homes surged in January from an upward revised reading in December (0.625 million versus 0.616 million, a revision of 1.5%). The gain returned sales the range in place before the onset of Covid. However, activity was still shy of levels that would be considered brisk, such as results in 2020 and portions of 2021 (peak of 1.036 million in August 2020; average of 0.822 million in 2020 and the first half of 2021). Easing in mortgage rates in December and January undoubtedly boosted sales, although this may be only a short-term bounce, as rates have stirred again in February.

Sources: National Association of Realtors (Existing Home Sales); Bureau of Economic Analysis (Revised GDP, Personal Income, Consumption & Core Price Index); U.S. Census Bureau (New Home Sales); Consensus forecasts are from Bloomberg

Preview

Week of Feb.27, 2023	Projected	Comments
Durable Goods Orders (January) (Monday)	**-4.0%**	The report on durable goods orders will probably be dominated by a correction in the aircraft category after a surge in December (a combined increase of 88.6% in commercial and defense-related aircraft). Excluding the transportation category, recent softening in the manufacturing sector will probably lead to little change in bookings, which would continue the largely sideways movement of the past six months.
International trade in Goods (January) (Tuesday)	**-$89.0 Billion ($0.7 Billion Narrower Deficit)**	With economic activity across the globe having lost momentum, exports and imports are likely to remain on their recent downward paths. An offset to a surprising increase in December gives more downside potential to imports, which could lead to a month-to-month narrowing in the merchandise trade deficit.
Consumer Confidence (February) (Tuesday)	**108.0 (+0.8%)**	An increase in gasoline prices has the potential to dampen consumer moods, but the improvement in the equity market in early 2023 and a still-strong labor market could provide offsets and reverse the dip in confidence in January. The expected reading is in the upper portion of the range seen during 2022, but it trails firmer readings in 2021 (average of 112.7).
ISM Manufacturing Index (February) (Wednesday)	**47.0 (-0.4 Index Pt.)**	The cyclically sensitive manufacturing sector has reacted to tighter monetary policy, as the ISM index trended lower throughout last year and has been below the 50 threshold since October. With business managers concerned about the possibility of recession, another subpar reading is likely in February.
Construction (January) (Wednesday)	**0.3%**	Single-family home construction is likely to register its ninth consecutive decline, although the pace of easing could be less pronounced than the average of -2.8% in the prior eight months. Multi-family residential construction is likely to provide at least a partial offset, and private nonresidential building and government-related activity could contribute positively as well, although some of the reported increase is likely to reflect higher prices.
Revised Nonfarm Productivity (22-Q4) (Thursday)	**2.0% (-1.0 Percentage Point Revision)**	The downward revision to GDP growth suggests that the output measure in the productivity report also will be lighter than previously believed. In addition, other data point to an upward adjustment to hours worked. The combination of slower output growth and more hours worked translates to a downward revision of approximately 1.0 percentage point to productivity growth. Growth of compensation per hour is likely to be firmer than previously believed, and when combined with slower productivity growth, will lead to a sharp upward revision to unit labor cost.
ISM Services Index (February) (Friday)	**54.0 (-1.2 Index Points)**	Slight softening in elevated readings for new orders and business activity could lead to a downward wiggle in the services index. The expected reading, although below the average of 57.1 last year, is still consistent with a respectable rate of growth.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

February/March 2023

Monday	Tuesday	Wednesday	Thursday	Friday
20	21	22	23	24
PRESIDENTS' DAY HOLIDAY	**EXISTING HOME SALES** Nov 4.12 million Dec 4.03 million Jan 4.00 million	**FOMC MINUTES**	**UNEMP. CLAIMS** Initial / Continuing (millions) Jan 28 0.186 1.680 Feb 4 0.195 1.691 Feb 11 0.195 1.654 Feb 18 0.192 N/A **REVISED GDP** GDP / Chained Price 22-Q3 3.2% 4.4% 22-Q4(a) 2.9% 3.5% 22-Q4(p) 2.7% 3.9% **CHICAGO FED NATIONAL ACTIVITY INDEX** Monthly / 3-Mo. Avg. Nov -0.56 -0.18 Dec -0.46 -0.34 Jan 0.23 -0.26	**PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX** Inc. / Cons. / Core Nov 0.4% -0.2% 0.2% Dec 0.3% -0.1% 0.4% Jan 0.6% 1.8% 0.6% **NEW HOME SALES** Nov 0.583 million Dec 0.625 million Jan 0.670 million **REVISED CONSUMER SENTIMENT** Dec 59.7 Jan 64.9 Feb(p) 66.4 Feb(r) 67.0
27	28	1	2	3
DURABLE GOODS ORDERS (8:30) Nov -1.8% Dec 5.6% **Jan -4.0%** **PENDING HOME SALES (10:00)** Nov -2.6% Dec 2.5% Jan --	**INTERNATIONAL TRADE IN GOODS (8:30)** Nov -$82.1 billion Dec -$89.7 billion **Jan -$89.0 billion** **ADVANCE INVENTORIES (8:30)** Wholesale / Retail Nov 0.9% 0.0% Dec 0.1% 0.7% Jan -- -- **FHFA HOME PRICE INDEX (9:00)** Oct 0.0% Nov -0.1% Dec -- **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX (9:00)** Oct -0.5% Nov -0.5% Dec -- **MNI CHICAGO BUSINESS BAROMETER (9:45)** Index / Prices Dec 45.1 65.1 Jan 44.3 72.5 Feb -- -- **CONFERENCE BOARD CONSUMER CONFIDENCE (10:00)** Dec 109.0 Jan 107.1 **Feb 108.0**	**ISM MFG. INDEX (10:00)** Index / Prices Dec 48.4 39.4 Jan 47.4 44.5 **Feb 47.0 45.0** **CONSTRUCTION (10:00)** Nov 0.5% Dec -0.4% **Jan 0.3%** **VEHICLE SALES** Dec 13.4 million Jan 15.7 million **Feb 14.8 million**	**UNEMP. CLAIMS (8:30)** **REVISED PRODUCTIVITY & COSTS (8:30)** Productivity / Unit Labor Costs 22-Q2 -4.1% 6.7% 22-Q3 1.4% 2.0% 22-Q4(p) 3.0% 1.1% **22-Q4(r) 2.0% 3.5%**	**ISM SERVICES INDEX (10:00)** Index / Prices Dec 49.2 68.1 Jan 55.2 67.8 **Feb 54.0 65.0**
6	7	8	9	10
FACTORY ORDERS	**WHOLESALE TRADE** **CONSUMER CREDIT**	**ADP EMPLOYMENT** **INTERNATIONAL TRADE** **JOLTS** **BEIGE BOOK**	**UNEMP. CLAIMS**	**EMPLOYMENT REPORT** **FEDERAL BUDGET**
13	14	15	16	17
	NFIB SMALL BUSINESS OPTIMISM **CPI**	**PPI** **RETAIL SALES** **EMPIRE MFG INDEX** **BUSINESS INVENTORIES** **NAHB HOUSING INDEX** **TIC FLOWS**	**UNEMP. CLAIMS** **HOUSING STARTS** **IMPORT PRICES** **PHILY FED MFG. INDEX**	**INDUSTRIAL PRODUCTION** **CONSUMER SENTIMENT** **LEADING INDICATORS**

Forecasts in Bold. (a) = advance (1st estimate of GDP); (p) = preliminary (2nd estimate of GDP); (r) = revised

Treasury Financing

February/March 2023

Monday	Tuesday	Wednesday	Thursday	Friday
20	21	22	23	24
PRESIDENTS' DAY HOLIDAY	**AUCTION RESULTS:** Rate / Cover 13-week bills 4.720% 2.72 26-week bills 4.915% 2.71 52-week bills 4.795% 2.89 2-year notes 4.673% 2.61 **ANNOUNCE:** $75 billion 4-week bills for auction on Feb 23 $60 billion 8-week bills for auction on Feb 23 $36 billion 17-week bills for auction on Feb 22 **SETTLE:** $75 billion 4-week bills $60 billion 8-week bills $36 billion 17-week bills	**AUCTION RESULTS:** Rate / Cover 17-week bills 4.830% 2.93 5-year notes 4.109% 2.48 Margin / Cover 2-year FRNs 0.160% 3.29	**AUCTION RESULTS:** Rate / Cover 4-week bills 4.515% 2.63 8-week bills 4.660% 2.64 7-year notes 4.062% 2.49 16-day CMB 4.460% 2.93 **ANNOUNCE:** $108 billion 13-,26-week bills for auction on Feb 27 **SETTLE:** $108 billion 13-,26-week bills $34 billion 52-week bills	**SETTLE:** $22 billion 2-year FRNs
27	28	1	2	3
AUCTION: $108 billion 13,26-week bills	**ANNOUNCE:** $75 billion* 4-week bills for auction on Mar 2 $60 billion* 8-week bills for auction on Mar 2 $36 billion* 17-week bills for auction on Mar 1 **SETTLE:** $75 billion 4-week bills $60 billion 8-week bills $36 billion 17-week bills 15 billion 20-year bonds $9 billion 30-year TIPS $42 billion 2-year notes $43 billion 5-year notes $35 billion 7-year notes $15 billion 16-day CMBs	**AUCTION:** $36 billion* 17-week bills	**AUCTION:** $75 billion* 4-week bills $60 billion* 8-week bills **ANNOUNCE:** $108 billion* 13-,26-week bills for auction on Mar 6 $40 billion* 3-year notes for auction on Mar 7 $32 billion* 10-year notes for auction on Mar 8 $18 billion* 30-year bonds for auction on Mar 9 **SETTLE:** $108 billion 13-,26-week bills	
6	7	8	9	10
AUCTION: $108 billion* 13-,26 week bills	**AUCTION:** $40 billion* 3-year notes **ANNOUNCE:** $75 billion* 4-week bills for auction on Mar 9 $60 billion* 8-week bills for auction on Mar 9 $36 billion* 17-week bills for auction on Mar 8 **SETTLE:** $75 billion* 4-week bills $60 billion* 8-week bills $36 billion* 17-week bills	**AUCTION:** $36 billion* 17-week bills $32 billion* 10-year notes	**AUCTION:** $75 billion* 4-week bills $60 billion* 8-week bills $18 billion* 30-year bonds **ANNOUNCE:** $108 billion* 13-,26-week bills for auction on Mar 13 Settle: $108 billion* 13-,26-wk bills	
13	14	15	16	17
AUCTION: $108 billion* 13-,26 week bills	**ANNOUNCE:** $75 billion* 4-week bills for auction on Mar 16 $60 billion* 8-week bills for auction on Mar 16 $36 billion* 17-week bills for auction on Mar 15 **SETTLE:** $75 billion* 4-week bills $60 billion* 8-week bills $36 billion* 17-week bills	**AUCTION:** $36 billion* 17-week bills **SETTLE:** $40 billion* 3-year notes $32 billion* 10-year notes $18 billion* 30-year bonds	**AUCTION:** $75 billion* 4-week bills $60 billion* 8-week bills **ANNOUNCE:** $108 billion* 13-,26-week bills for auction on Mar 20 $34 billion* 52-week bills for auction on Mar 21 $12 billion* 20-year bonds for auction on Mar 21 $15 billion* 10-year TIPS for auction on Mar 23 **SETTLE:** $108 billion* 13-,26-week bills	

**Estimate*