U.S. Economic Comment

- FOMC preview: another hike despite bank uncertainty

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Monetary Policy: Inflation Likely to Dominate

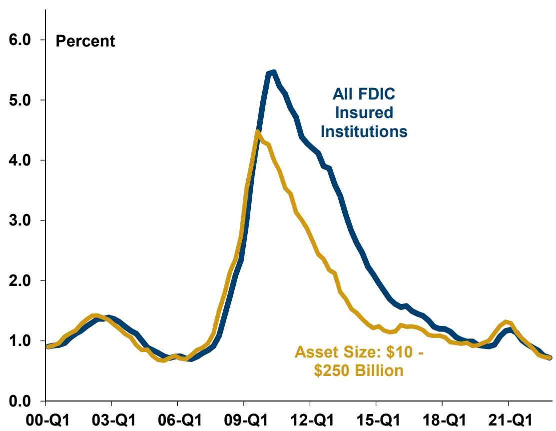
We would not be shocked if the Federal Open Market Committee held policy steady at its meeting on March 22, but we are looking for an increase of 25 basis points in the federal funds rate. We suspect that Fed officials will conclude that problems now evident in the banking system reflect managerial shortfalls at isolated institutions rather than fundamental weakness throughout the industry. In addition, the February report on consumer prices was troubling, suggesting a need to act decisively in the fight against inflation.

Industry-wide statistics show a financially strong banking system. Loan portfolios are healthy, as the share of noncurrent loans (i.e. at least 90 days late or in nonaccrual status) is near the bottom of the historical range (chart). Net interest margins are comfortably within the normal range, as are ratios of income to average assets. If commercial banks were to experience financial difficulty, they have substantial capital to absorb losses.

The banking industry in the aggregate seems on solid financial ground, although problems could still develop. The crucial issue at this time involves the confidence of depositors in the health of their bank. If individuals or businesses were to have doubts about the safety and soundness of their institution, they could withdraw their funds, thereby generating problems.

Regulators already have addressed this potential problem by effectively guaranteeing all deposits and by offering generous lending programs that will allow commercial banks to satisfy sizeable withdrawal requests. The blanket guarantee of deposits offered by the Federal Deposit Insurance Corporation this week only applies to Silicon Valley Bank and Signature Bank, but it is difficult to imagine that the FDIC would not respond in the same way to another institution. Regulators have effectively guaranteed all deposits, at least for the time being. We wonder if this episode will trigger legislation that permanently extends deposit insurance.

U.S. Banks: Noncurrent Loans



Source: Federal Deposit Insurance Corporation

Fed Lending

	March 15 Total (Billions of Dollars)	March 8 Total (Billions of Dollars)
Bank Term Funding Program	11.9	0.0
Primary Credit	152.9	4.6
Other Credit Extensions	142.8	0.0

Sources: Federal Reserve Board via Haver Analytics

The implicit guarantee seems to have been effective, as the new lending program offered by the Federal Reserve to meet deposit withdrawals was lightly used in its initial days. Indeed, as of Wednesday March 15, only $11.9 billion had been tapped by depository institutions (table, page 1).

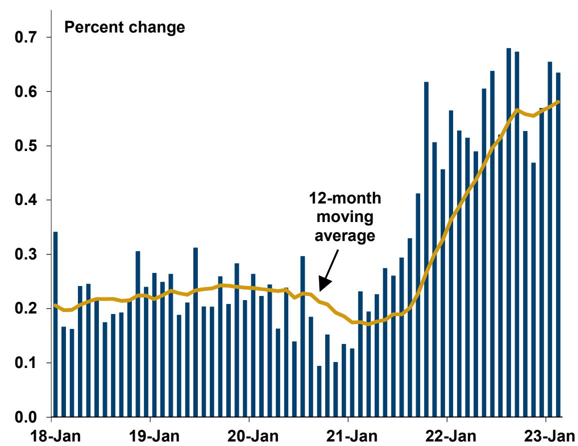
Although the new program was barely touched, total lending by the Fed exploded in the latest week. “Other credit extensions” jumped to $142.8 billion as of March 15 from nothing as of the prior Wednesday. A footnote attached to the Fed data suggested that this credit was related to the closures of Silicon Valley Bank and Signature Bank. Borrowing through the traditional discount window also rose sharply in the latest week (up $148.3 billion to $152.9 billion), most likely because of loans to Republic National Bank.

The limited usage of the new lending facility could well be interpreted by Fed officials as a sign that financial difficulties in the banking industry were isolated, offering a green light to continue the inflation fight. The market response to the hike of 50 basis points by the European Central Bank also might encourage Fed officials to push ahead with their tightening campaign. Stock prices and interest rates fluctuated a good bit after the announcement by the ECB, but by Friday they were little changed from their levels on the day before the ECB meeting.

An easing in concern about developments in the banking sector will allow Fed officials to focus on the economy and inflation when making their policy decision, and the latest news will probably lead officials to support another rate hike. The consumer price index for February was troubling. The increase of 0.5 percent in the core index was a touch quicker than results in the prior four months and in the middle of the range of observations from last year, suggesting little meaningful improvement in inflation in recent months.

Other measures of underlying inflation also remained elevated. The median CPI rose 0.6 percent, a reading in the upper end of the recent range (chart). The year-over-year change in the median index totaled 7.2 percent, a record high for this measure, although data extend back to only 1983. The new metric being followed by Fed officials (core services ex-housing) rose 0.5 percent as measured by the CPI, matching the recent average.

Median CPI



Source: Federal Reserve Bank of Cleveland via Haver Analytics

The Dot Plot

The FOMC will publish a new Summary of Economic Projections at the upcoming meeting, including a new dot plot. Chair Powell had sent signals that the new plot would show a higher level of rates than the December plot, which showed the median dot at 5.125 percent. Given the inflation results, we suspect that the new plot will indeed involve higher rates. Various versions of the Taylor rule monitored by the Fed suggest that the federal funds rate should be in the neighborhood of six percent. We doubt that the Fed would publish such a view, but we would not be surprised with a reading of 5.625 percent (or a target range of 5.50 to 5.75 percent).

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Review

Week of March 13, 2023	Actual	Consensus	Comments
CPI (February)	**0.4% Total, 0.5% Core**	**0.4% Total, 0.4% Core**	The energy component of the CPI eased 0.6% in February, with a drop in the cost of natural gas offsetting pickups in the prices of gasoline and electricity. The food component increased 0.4%, hefty but much improved from the average of 0.9% in the first nine months of last year. The core component posted another brisk increase, signaling that rapid underlying inflation has yet to show compelling evidence of slowing.
Retail Sales (February)	**-0.4% Total, 0.1% Ex. Autos**	**-0.4% Total, 0.1% Ex. Autos**	Retail sales eased in February, but the change followed a burst in spending in the prior month and the results in total suggest that consumer spending remained on track in early 2023 after slowing late last year. Importantly, the retail control group, which correlates closely with the consumer spending component of GDP, rose 0.5% in the latest month after a jump of 2.3% in January.
PPI (February)	**-0.1% Final Demand, 0.0% Ex. Food & Energy**	**0.3% Final Demand, 0.4% Ex. Food & Energy**	The slippage in the PPI offered some encouragement regarding the fight against inflation, but it also seemed to reflect a heavy dose of statistical noise. The food component fell 2.2%, but the decline was influenced importantly by a swoon of 41.3% in the price of eggs. The energy component eased 0.2% in February, adding to an irregular downward trend that included wide swings in other recent months. Prices excluding food and energy were unchanged on balance. The construction category rose modestly (+0.1%), but this area carries a distinct seasonal pattern (firm in the first month of a quarter, with restrained readings in the following two months). Service prices slipped, but these too often swing widely.
Housing Starts (February)	**1.450 Million (+9.8%)**	**1.310 Million (+0.1%)**	Multi-family housing starts drove the advance in total activity in February, surging 24.0% to 0.620 million units and returning to the top of the range of the current expansion. The latest performance supported the view that demand for rental units remains strong because of affordability issues in the market for single-family homes. Single-family starts rose 1.1% to 0.830 million units. Single-family activity in recent months has bounced around at the low end of the range of the current expansion. The February increase was not strong enough to suggest a breakout from this pattern.

Review (continued)

Week of March 13, 2023	Actual	Consensus	Comments
Industrial Production (February)	**0.0%**	**0.2%**	Industrial production varied across components in February. The manufacturing sector inched 0.1% higher after a jump of 1.3% in the prior month. Factory activity is still 1.5% below the level last fall, but regaining some lost ground rather than softening further in a challenging economic environment is encouraging. Mining output, which eased 0.6%, has slipped since last fall, suggesting that lower energy and commodity prices are weighing on the sector. Utility output rose 0.5% in February after wide swings in other recent months. Changes in this area almost always reflect shifts in weather rather than economic fundamentals.
Consumer Sentiment (March)	**63.4 (-3.6 Index Pts.)**	**67.0 (Unchanged from Feb.)**	Consumer sentiment slipped in early March, reversing a portion of the back-to-back gains in early 2023 and leaving sentiment in the low end of the range of the current expansion. Both the current conditions and expectations components eased in the latest month, with negative news on the banking sector likely contributing to the souring in attitudes. Although attitudes slipped in March, views on inflation continued to improve. The year-ahead measure declined three ticks to 3.8%, well off the recent high of 5.4% in the spring of 2022. The longer-term measure slipped to 2.8% from 2.9%. Longer-term inflation expectations are a bit above pre-COVID readings but are viewed by Fed officials as consistent with stable prices.
Leading Indicators (February)	**-0.3%**	**-0.3%**	Positive contributions from building permits and stock prices were offset by declines in several other components (including consumer expectations and the ISM new orders index), leaving the leading indicators index lower for the 11th consecutive month. The cumulative change pushed the measure 6.6% below the cyclical peak in December 2021.

Sources: Bureau of Labor Statistics; U.S. Census Bureau; Federal Reserve Board; The Conference Board; University of Michigan Survey Research Center; Consensus forecasts are from Bloomberg

Preview

Week of March 20, 2023	Projected	Comments
Existing Home Sales (February) (Tuesday)	**4.20 Million (+5.0%)**	Recent stirring in the index of pending home sales raises the possibility of a pickup in the market for existing homes in February. The expected increase would end a string of 12 consecutive declines, although the projected total is still close to the pandemic low of 4.090 million in May 2020.
Current Account (2022-Q4) (Thursday)	**-$210.0 ($7.1 Billion Narrower Deficit)**	A modest decline in the trade deficit suggests a small improvement in the current account deficit in the fourth quarter of last year. The expected shortfall would translate to 3.2% of GDP, narrower than the reading of 3.4% in Q3 and the recent high of 4.6% in Q1 but outside the range of 1.7% to 2.5% in the year leading up to the pandemic.
New Home Sales (February) (Thursday)	**0.660 Million (-1.5%)**	Lower interest rates stirred sales of new homes around the turn of the year, but a decline in mortgage applications suggests that fewer purchase contracts were signed in February, raising the possibility of a reversal in recent gains.
Durable Goods Orders (February) (Friday)	**0.5%**	The volatile aircraft component will probably show little change after wide swings in the prior two months (up in December and down in January), a view supported by limited orders reported by Boeing. Elsewhere, with manufacturing activity moving sideways or inching lower, bookings are likely to increase only modestly, with most or all of the advance reflecting higher prices rather than real activity.

Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

March/April 2023

Monday	Tuesday	Wednesday	Thursday	Friday
13	14	15	16	17
	NFIB SMALL BUSINESS OPTIMISM INDEX Dec 89.8 Jan 90.3 Feb 90.9 **CPI** Total / Core Dec 0.1% 0.4% Jan 0.5% 0.4% Feb 0.4% 0.5%	**RETAIL SALES** Total / Ex.Autos Dec -0.8% -0.6% Jan 3.2% 2.4% Feb -0.4% -0.1% **PPI** Final Demand / Ex. Food & Energy Dec -0.2% 0.3% Jan 0.3% 0.1% Feb -0.1% 0.0% **EMPIRE MFG** Jan -32.9 Feb -5.8 Mar -24.6 **BUSINESS INVENTORIES** Inventories / Sales Nov 0.3% -1.2% Dec 0.3% -0.6% Jan -0.1% 1.5% **NAHB HOUSING INDEX** Jan 35 Feb 42 Mar 44 **TIC FLOWS** Long-Term / Total Nov $171.5B $213.4B Dec $152.8B $26.7B Jan $31.9B $183.1B	**UNEMP. CLAIMS** Initial / Continuing (millions) Feb 18 0.192 1.649 Feb 25 0.190 1.713 Mar 4 0.212 1.684 Mar 11 0.192 N/A **HOUSING STARTS** Dec 1.348 million Jan 1.321 million Feb 1.450 million **IMPORT/EXPORT PRICES** Non-fuel Imports / Nonagri. Exports Dec 0.9% -3.2% Jan 0.3% 0.6% Feb -0.4% 0.1% **PHILADELPHIA FED MFG BUSINESS OUTLOOK** Jan -8.9 Feb -24.3 Mar -23.2	**IP & CAP-U** IP / Cap.Util. Dec -1.4% 77.9% Jan 0.3% 78.0% Feb 0.0% 78.0% **CONSUMER SENTIMENT** Jan 64.9 Feb 67.0 Mar 63.4 **LEADING INDICATORS** Dec -0.8% Jan -0.3% Feb -0.3%
20	21	22	23	24
	EXISTING HOME SALES (10:00) Dec 4.030 million Jan 4.000 million **Feb 4.200 Million** **FOMC (FIRST DAY)**	**FOMC ANNOUNCEMENT (2:00)**	**UNEMP. CLAIMS (8:30)** **CURRENT ACCOUNT (8:30)** 22-Q2 -$238.7 bill. 22-Q3 -$217.1 bill. **22-Q4 -$210.0 bill.** **CHICAGO FED NATIONAL ACTIVITY INDEX (8:30)** Monthly / 3-Mo. Avg. Dec -0.46 -0.34 Jan 0.23 -0.26 Feb -- -- **NEW HOME SALES (10:00)** Dec 0.625 million Jan 0.670 million **Feb 0.660 million**	**DURABLE GOODS ORDERS (8:30)** Dec 5.1% Jan -4.5% **Feb 0.5%**
27	28	29	30	31
	INTERNATIONAL TRADE IN GOODS **ADVANCED INVENTORIES** **FHFA HOME PRICE INDEX** **S&P CASE-SHILLER HOME PRICE INDEX** **CONSUMER CONFIDENCE)**	**PENDING HOME SALES**	**UNEMP. CLAIMS** **REVISED Q4 GDP**	**PERSONAL INCOME, CONSUMPTION, PRICES** **MNI CHICAGO BUSINESS BAROMETER** **REVISED CONSUMER SENTIMENT**
3	4	5	6	7
ISM MFG INDEX **CONSTRUCTION** **VEHICLE SALES**	**FACTORY ORDERS** **JOLTS DATA** **DURABLE GOODS ORDERS S&P CASE-SHILLER HOME PRICE INDEX** **CONSUMER CONFIDENCE**	**ADP EMPLOYMENT** **TRADE BALANCE** **ISM SERVICES INDEX**	**UNEMP. CLAIMS**	**EMPLOYMENT REPORT** **REVISED CONSUMER SENTIMENT**

Forecasts in Bold.

Treasury Financing

March/April 2023

Monday	Tuesday	Wednesday	Thursday	Friday
13	14	15	16	17
AUCTION RESULTS: Rate / Cover 13-week bills 4.750% 2.15 26-week bills 4.700% 2.29	**ANNOUNCE:** $60 billion 4-week bills for auction on Mar 17 (rescheduled from Mar 16) $50 billion 8-week bills for auction on Mar 17 (rescheduled from Mar) $36 billion 17-week bills for auction on Mar 15 **SETTLE:** $65 billion 4-week bills $55 billion 8-week bills $36 billion 17-week bills	**AUCTION RESULTS:** Rate / Cover 17-week bills 4.750 % 2.74 **SETTLE:** $40 billion 3-year notes $32 billion 10-year notes $18 billion 30-year bonds	**ANNOUNCE:** $105 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:** $105 billion 13-,26-week bills	**AUCTION RESULTS:** Rate / Cover 4-week bills 4.220% 2.43 8-week bills 4.450% 2.85
20	21	22	23	24
AUCTION: $105 billion 13-,26-week bills	**AUCTION:** $34 billion 52-week bills $12 billion 20-year bonds **ANNOUNCE:** $60 billion* 4-week bills for auction on Mar 23 $50 billion* 8-week bills for auction on Mar 23 $36 billion* 17-week bills for auction on Mar 22 **SETTLE:** $60 billion 4-week bills $50 billion 8-week bills $36 billion 17-week bills	**AUCTION:** $36 billion* 17-week bills	**AUCTION:** $60 billion* 4-week bills $50 billion* 8-week bills $15 billion 10-year TIPS **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on Mar 27 $42 billion* 2-year notes for auction on Mar 27 $43 billion* 5-year notes for on auction on Mar 28 $35 billion* 7-year notes for auction on Mar 29 $22 billion* 2-year FRN for auction on Mar 29 **SETTLE:** $105 billion 13-,26-wk bills $34 billion 52-week bills	
27	28	29	30	31
AUCTION: $105 billion* 13-,26 week bills $42 billion* 2-year notes	**AUCTION:** $43 billion* 5-year notes **ANNOUNCE:** $60 billion* 4-week bills for auction on Mar 30 $50 billion* 8-week bills for auction on Mar 30 $36 billion* 17-week bills for auction on Mar 29 **SETTLE:** $60 billion* 4-week bills $50 billion* 8-week bills $36 billion* 17-week bills	**AUCTION:** $36 billion* 17-week bills $22 billion* 2-year FRN $35 billion* 7-year notes	**AUCTION:** $60 billion* 4-week bills $50 billion* 8-week bills **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on Apr 3 **SETTLE:** $105 billion* 13-,26-week bills	**SETTLE:** $42 billion* 2-year notes $43 billion* 5-year notes $35 billion* 7-year notes $22 billion* 2-year FRN $15 billion 10-year TIPS $12 billion 20-year bonds
3	4	5	6	7
AUCTION: $105 billion* 13-,26 week bills	**ANNOUNCE:** $60 billion* 4-week bills for auction on Apr 6 $50 billion* 8-week bills for auction on Apr 6 $36 billion* 17-week bills for auction on Apr 5 **SETTLE:** $60 billion* 4-week bills $50 billion* 8-week bills $36 billion* 17-week bills	**AUCTION:** $36 billion* 17-week bills	**AUCTION:** $60 billion* 4-week bills $50 billion* 8-week bills **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on Apr 10 $40 billion* 3-year notes for auction on Apr 11 $32 billion* 10-year notes for auction on Apr 12 $18 billion* 30-year bonds for auction on Apr 13 **SETTLE:** $105 billion* 13-,26-week bills	

*Estimate