Daiwa Capital Markets

U.S. Economic Comment

- Inflation in January: ending talk of a Fed pivot in the spring
- Housing starts: signs of revival in single-family housing
- Consumer sentiment: modest improvement tied to views on inflation

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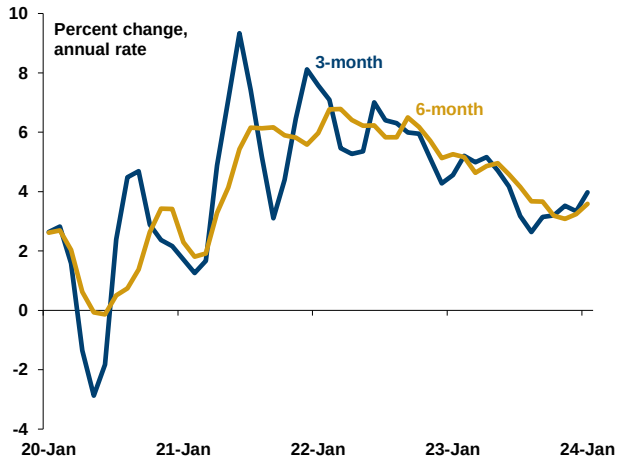
January Inflation

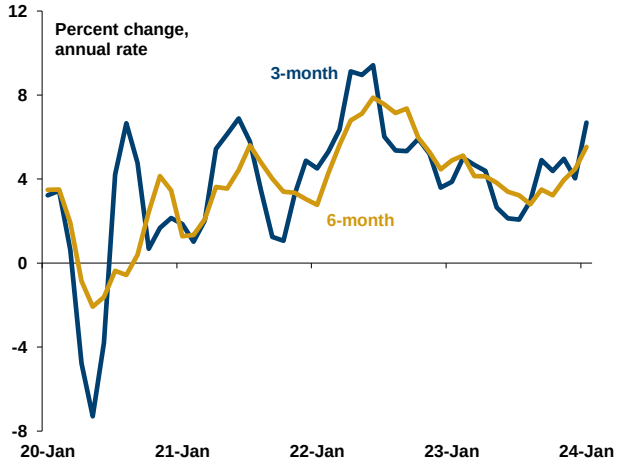
Both the CPI and PPI for January surprised to the upside this week, supporting the assessments of Fed officials that additional evidence is required before a pivot to lower rates. The CPI, the more important indicator for evaluating the Fed's progress toward returning to inflation anchored at two percent, registered an increase of 0.3 percent in the headline index and 0.4 percent in the core component. The three-month annualized growth rate for the core component jumped to 4.0 percent from 3.3 percent, and the six-month annualized growth rate accelerated to 3.6 percent from 3.2 percent (chart, below left). Core goods inflation declined for the eighth consecutive month (-0.3 percent in January; three-month and six-month annualized growth rates of -2.4 percent and -2.1 percent, respectively), but core service prices jumped (+0.7 percent month-over-month). The change in core services excluding housing, currently monitored closely by Fed officials to assess broadening (or lack thereof) in disinflationary developments, surged 0.8 percent. The three-month annualized growth rate surged to 6.7 percent from 4.0 percent in December, and the six-month rate jumped to 5.5 percent from 4.5 percent. Evidently, the latest results halted progress towards the inflation target, likely giving Fed officials pause.

Core CPI



Source: Bureau of Labor Statistics via Haver Analytics

CPI: Core Services Ex. Housing*



** Service prices excluding energy services, rent of primary residence, and owners' equivalent rent components.*

Source: Bureau of Labor Statistics via Haver Analytics

The PPI carried a similar tone, with the total final demand index increasing 0.3 percent and the core (which excludes foods, energy, and trade services – a measure of wholesale and retail margins) surging 0.6 percent. Importantly, this measure, like the CPI, showed emerging pressure in services prices. For illustrative purposes, see next page's chart on final demand services. The month-to-month change of 0.6 percent was the sharpest since a jump of 1.3 percent in March 2022. The change was problematic in that it was large, but it may be transient. In the latest month, healthcare services, which carry a weight of 16.6 percent in the PPI, rose 0.9 percent; the change, in turn, included a spike of 2.2 percent in the costs of hospital outpatient care (about one-quarter of the total healthcare services index; chart, next page). Large increases in this index, which is not seasonally adjusted, often occur in January. The investment services component (which carries a weight of 3.1 percent in the final demand index) also jumped (+2.5 percent), led by a surge of 5.5 percent in portfolio management fees (about 50 percent of the services component; chart, next page). The investment services component doesn't have the pronounced seasonal pattern of healthcare services, but it is highly volatile (a range -2.1 percent to 2.5 percent in the 12 months including January).

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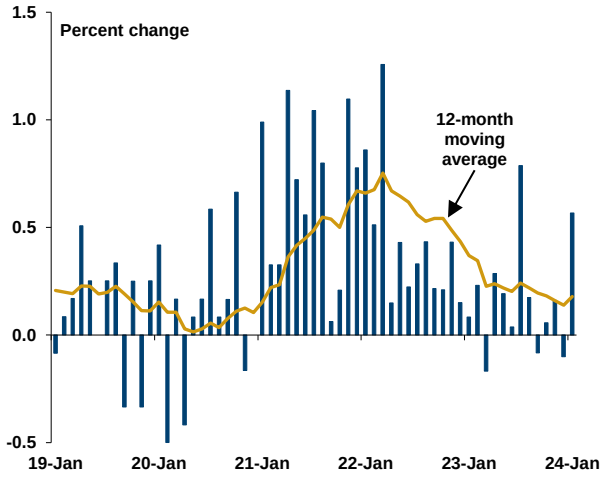
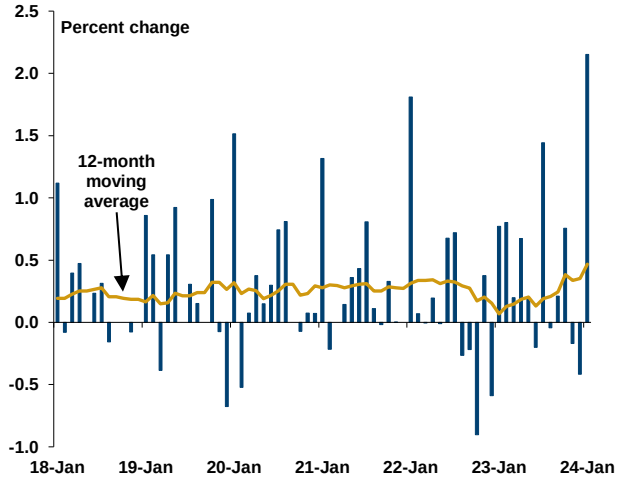
The broad performance of the CPI and the shifts in specific components of the PPI (costs of medical care services and financial services fees) suggest that the price index for personal consumption expenditures, the Fed's preferred inflation gauge, is on track to increase briskly in January (published February 29th; chart). The projected change of 0.4 percent would lead to accelerations in the three-month and six-month growth rates to 2.6 and 2.4 percent from 1.5 and 1.9 percent in December. As with readings on inflation gauges this week, it would be an undesirable development. However, we have argued consistently that the path back to two percent inflation would be nonlinear and that it would require a restrictive stance of monetary policy for longer than anticipated by many market participants. At the same time, the pressure in service prices may be short-lived. The rather unsatisfactory conclusion, in this case, is that we need to see several more months of data before assessing if inflation is slowing further, sticky at the current pace, or reaccelerating.

PPI: Final Demand, Services



Source: Bureau of Labor Statistics via Haver Analytics

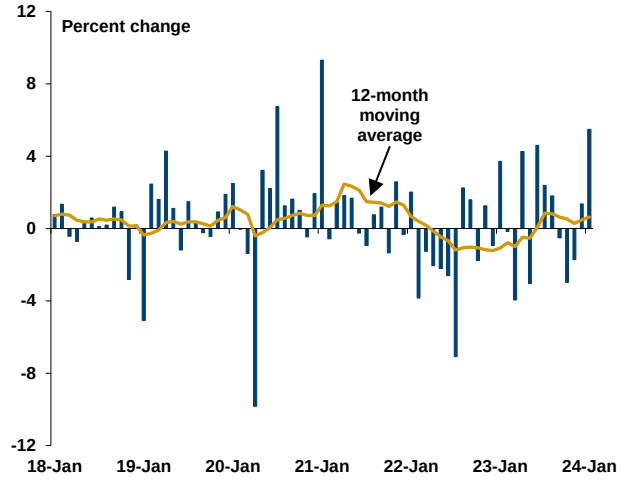
PPI: Final Demand, Hospital Outpatient Care*



** Not seasonally adjusted*

Source: Bureau of Labor Statistics via Haver Analytics

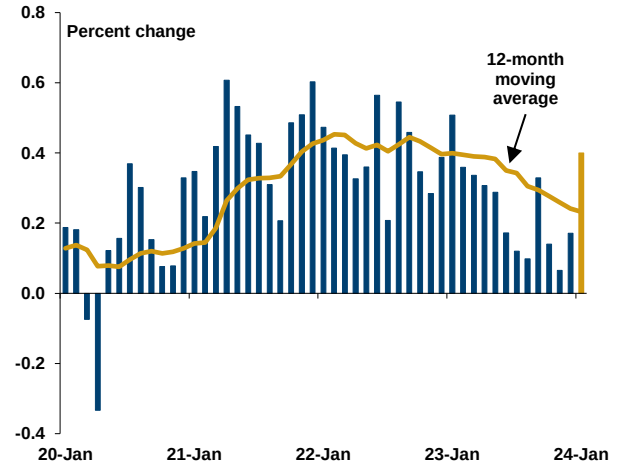
PPI: Final Demand, Portfolio Management*



** Not seasonally adjusted*

Source: Bureau of Labor Statistics via Haver Analytics

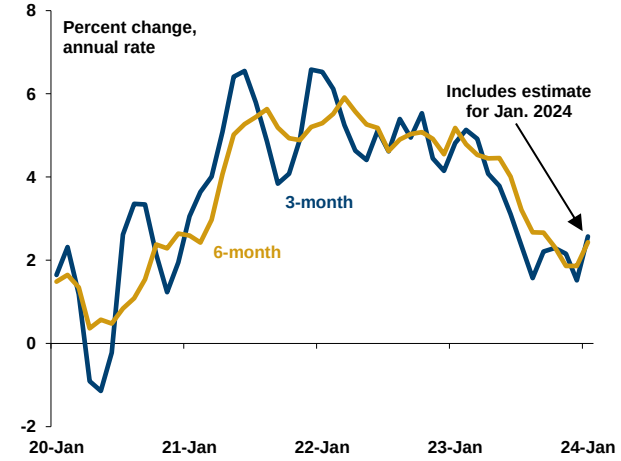
Core PCE Price Index*



** The gold bar is a forecast for January 2024.*

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

Core PCE Price Index*



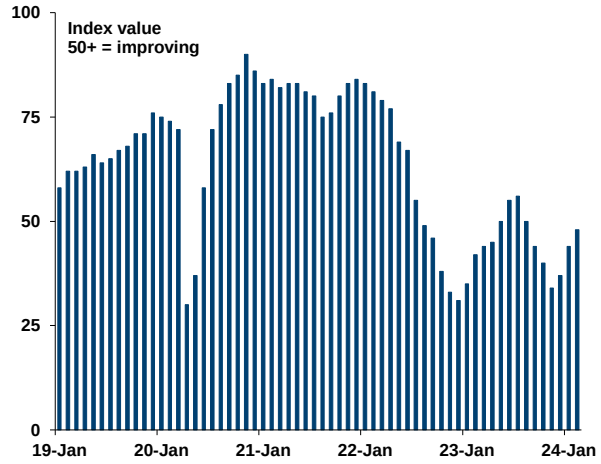
** 3- and 6-month annualized percent change estimates for January 2024 (2.6 and 2.4 percent, respectively) are inclusive of an assumption of a month-to-month increase of 0.4 percent.*

Source: Bureau of Labor Statistics via Haver Analytics

Builder Sentiment & Housing Starts

Two pieces of housing-related data seemingly sent divergent signals this week, with the National Association of Home Builders' Housing Market Index increasing to 48 from 44 in January, while housing starts in January fell (chart on the HMI, right). We don't view the latest indicators as suggesting a brisk pickup in residential construction, or a sharp turn higher in the housing market, but they were modestly favorable – particularly with respect to single-family data. Regarding the housing market index, all three components – views on present single-family sales, views on single-family sales in the next six months, and traffic of prospective buyers – rose in February. That said, the buyer traffic sub index, at 33, remained well below the critical value of 50 which separates increasingly good from increasingly poor conditions in the diffusion index, but the other two components were notably better. The present sales index rose to 52 from 48 in January and a 2023 low of 40 in November, and the forward-looking measure increased to 60 from 57 in January and the 23-H2 low of 39 in November. It appears that builders are perceiving a modest improvement in near-term performance and are anticipating better demand as affordability constraints (high mortgage rates) ease later this year.

Housing Market Index

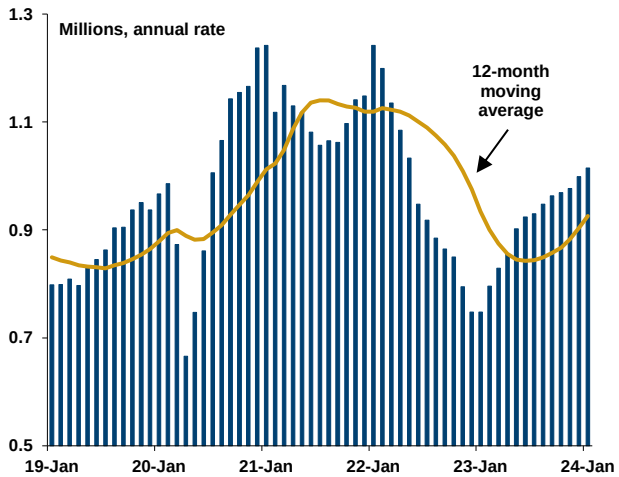


Source: National Association of Home Builders via Haver Analytics

On the surface, the data published today appeared less favorable. Total housing starts dropped 14.8 percent to 1.331 million, annual rate, from of 1.562 million in December (a reading in the middle of the range of the past few years to one near the bottom of that range). Single-family activity eased 4.7 percent to 1.004 million units, an observation in the middle of the range of the current expansion, while multi-family starts plunged 35.6 percent to 0.327 million -- among the lowest readings since the economy emerged from the COVID-related shutdowns. While the results were disappointing, we're inclined to attribute at least a portion of the pullback to inclement weather in January, which also had influences on retail sales and industrial production.

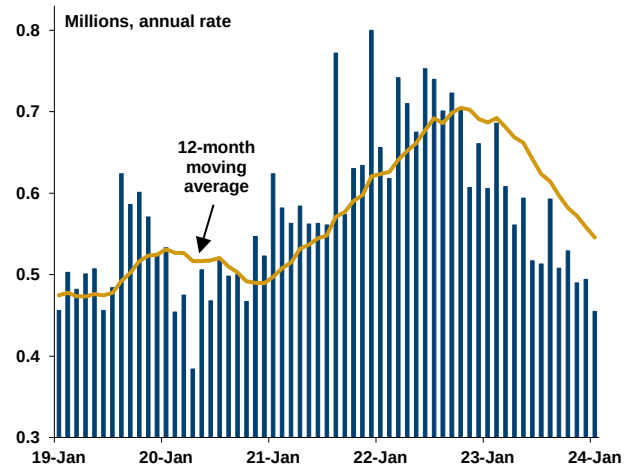
To control for weather-related noise and give a clearer view on the trajectory of residential construction activity, we recommend looking at building permits which usually convert to starts one to several months in the future. Single-family permits rose for the twelfth consecutive month, including an increase of 1.6 percent to 1.015 million, annual rate, in January. Multi-family permits, in contrast, slipped 7.9 percent to 0.455 million. The trend in multi-family permits is negative, but less volatile than in starts. The linear improvement in single-family permits and coinciding decline in multi-family authorizations suggests that preferences are shifting back towards single-family homes after a

Single-Family Building Permits



Source: U.S. Census Bureau via Haver Analytics

Multi-Family Building Permits



Source: U.S. Census Bureau via Haver Analytics

burst of demand for smaller dwellings in multi-family buildings (charts, previous page). Moreover, as single-family building is a larger share of residential construction, it raises the possibility of a boost in coming quarters to a soft sector of the economy.

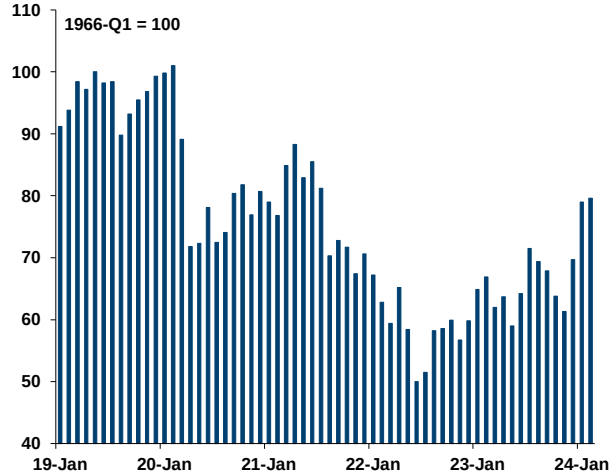
Consumer Sentiment Improves in February

Consumer sentiment has now improved for three consecutive months after dropping in the late summer and fall. The increase in February was modest (+0.6 index point to 79.6), but it followed a combined jump of 17.7 index points in the prior two months. Sentiment is still well below readings that prevailed prior to the onset of the pandemic (an average of 96.0 in 2019, and the current cycle peak of 88.3 in April 2021), but the recent performance suggests that consumer attitudes are emerging from a funk that has persisted for much of the current expansion (chart, below left).

In some respects, subdued sentiment previously had little effect on the economy thus far in the current expansion. Consumer spending was firm in 2023, increasing a 2.6 percent pace on a Q4/Q4 basis. It appeared to slow in January, with the U.S. Census Bureau's retail sales report indicating that activity fell 0.8 percent, but a post-holiday lull and inclement weather may have influenced the results. Thus, even as pandemic-related excess savings have likely been depleted and the job market has softened somewhat, now improving sentiment could support active consumers – at least in the near term. Attitudes as well as financial positions have the capacity to stimulate demand and influence spending."

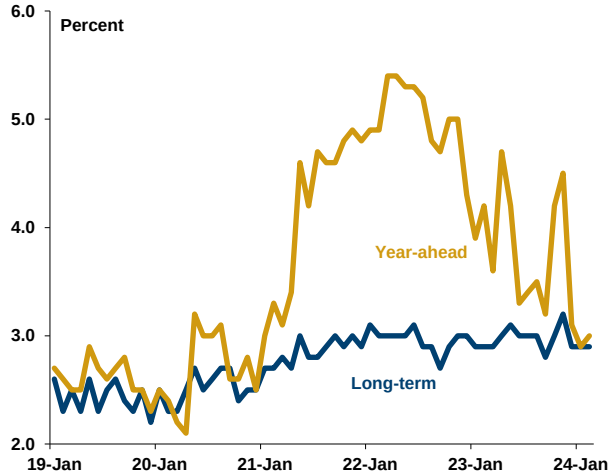
Forward looking views on inflation are likely influencing improved sentiment as well. Although prices of essentials are well above where they were a few years ago, with the food component of the CPI 25.8 percent above the December 2019 level standing out as a stark example (an average annual growth rate of 5.8 percent over that period), consumers are finally perceiving that inflation is moderating. Gasoline prices have fallen from peaks and have settled around $3.00 per gallon and, while food prices have not fallen, grocery bills have stabilized somewhat. With that in mind, although year-ahead inflation expectations increased 0.1 percentage point in February to 3.0 percent and longer-term expectations appear to have settled in the upper 2-percent area (2.9 percent in the past three months versus in the mid-twos pre-pandemic), they have stabilized off recent highs (chart, below right). Provided incremental improvement is realized in the months ahead, all else equal, anchored inflation expectations could support ongoing improvement in attitudes.

Consumer Sentiment



Source: University of Michigan via Haver Analytics

Consumer Inflation Expectations



Source: University of Michigan via Haver Analytics

Note to readers:

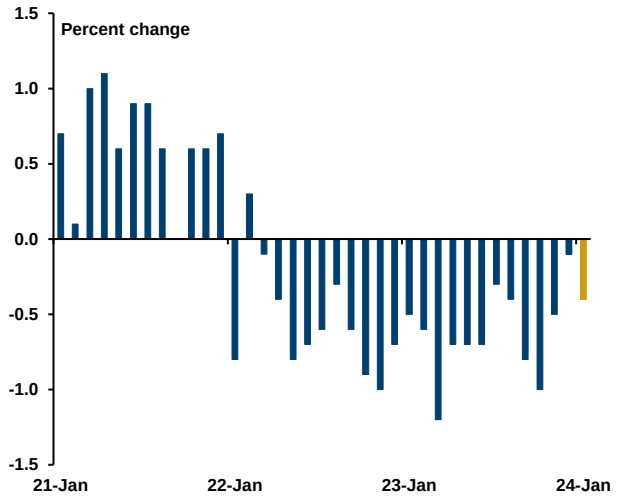
After this week's edition, the next Weekly Economic Comment will be published on March 1, 2024.

The Week Ahead

Leading Indicators (January) (Tuesday)
Forecast: -0.4%

Negative contributions from the factory workweek, the slope of the yield curve, the ISM new orders index, and building permits are likely to be only partially offset by a positive contribution from stock prices. If the forecast is realized, the index will have declined for 23 consecutive months with the projected reading 13.4 percent below the cycle peak in December 2021 (charts).

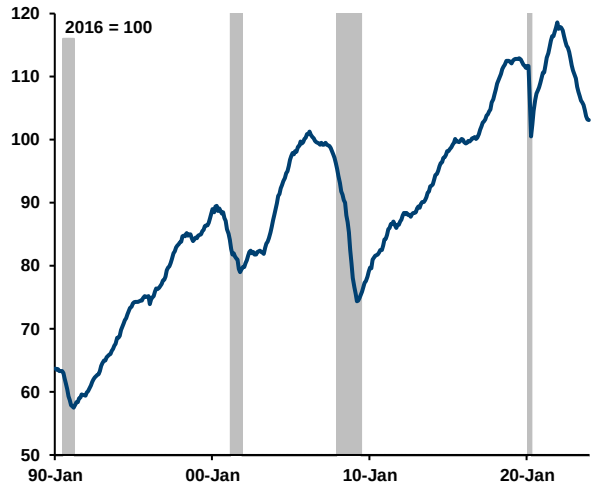
Index of Leading Economic Indicators*



** The gold bar is a forecast for January 2024.*

Sources: The Conference Board via Haver Analytics; Daiwa Capital Markets America

Index of Leading Economic Indicators*



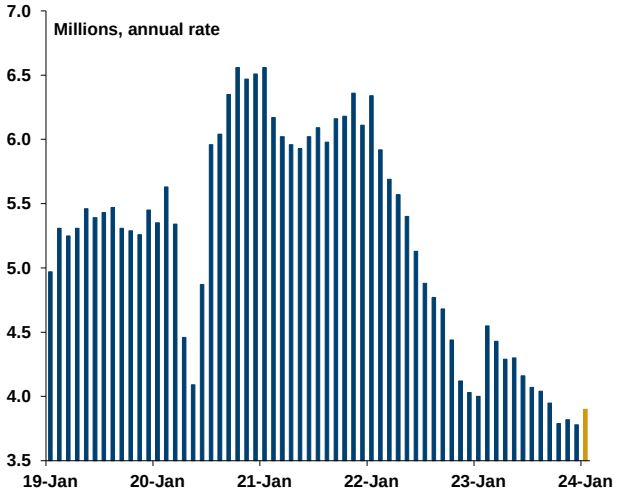
** The shaded areas indicate periods of recession in the United States.*

Sources: The Conference Board, National Bureau of Economic Research via Haver Analytics

Existing Home Sales (January) (Thursday)
Forecast: 3.90 Million (+3.2%)

The pickup in pending home sales in December suggests that the recent dip in mortgage rates led to a pickup in sales of existing homes in early 2024. However, even with the expected increase, tight inventories have continued to support elevated prices and restrain activity in most markets, which suggests that sales will remain in the lower portion of the longer-term range.

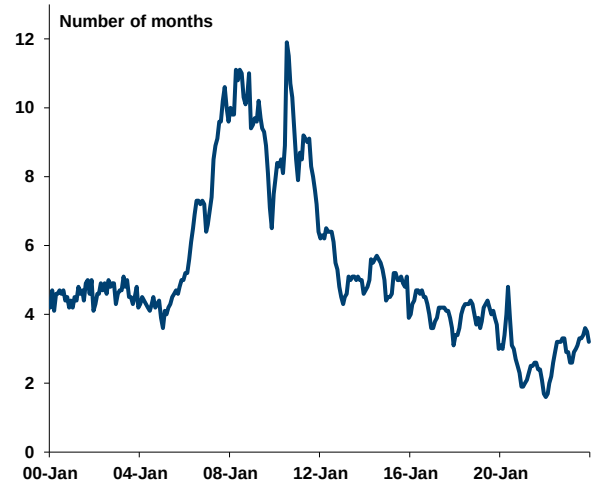
Existing Home Sales*



** The gold bar is a forecast for January 2024.*

Sources: National Association of Realtors via Haver Analytics; Daiwa Capital Markets America

Months' Supply of Unsold Homes



Source: National Association of Realtors via Haver Analytics

Economic Indicators

February/March 2024

Monday	Tuesday	Wednesday	Thursday	Friday
12	13	14	15	16
FEDERAL BUDGET FY2024 / FY2023 Nov -$314.0B -$248.5B Dec -$129.4B -$85.0B Dec -$21.9B -$38.8B	**NFIB SMALL BUSINESS OPTIMISM INDEX** Nov 90.6 Dec 91.9 Jan 89.9 **CPI** Total / Core Nov 0.2% 0.3% Dec 0.2% 0.3% Jan 0.3% 0.4%	**IP & CAP-U** IP / Cap.Util. Nov 0.3% 78.8% Dec 0.0% 78.7% Jan -0.1% 78.5% **NAHB HOUSING INDEX** Dec 37 Jan 44 Feb 48 **BUSINESS INVENTORIES** Inventories / Sales Oct -0.1% -1.1% Nov -0.1% 0.0% Dec 0.4% 0.4% **TIC FLOWS** Long-Term / Total Oct -$24.1B -$85.5B Nov $99.7B $223.3B Dec $160.2B $139.8B	**UNEMPLOYMENT CLAIMS** Initial / Continuing (millions) Jan 20 0.215 1.894 Jan 27 0.227 1.865 Feb 3 0.220 1.895 Feb 10 0.212 N/A **RETAIL SALES** Total / Ex.Autos Nov 0.0% -0.1% Dec 0.4% 0.4% Jan -0.8% -0.6% **IMPORT/EXPORT PRICES** Non-Petrol Imports / Nonagri. Exports Nov 0.2% -0.8% Dec 0.0% -0.8% Jan 0.6% 0.9% **EMPIRE MFG** Dec -14.5 Jan -43.7 Feb -2.4 **PHILADELPHIA FED MFG BUSINESS OUTLOOK** Dec -12.8 Jan -10.6 Feb 5.2	**PPI** Final Demand / Ex. Food & Energy Nov -0.1% 0.1% Dec -0.1% -0.1% Jan 0.3% 0.5% **HOUSING STARTS** Nov 1.512 million Dec 1.562 million Jan 1.331 million **CONSUMER SENTIMENT** Dec 69.7 Jan 79.0 Feb 79.6
19	20	21	22	23
PRESIDENTS' DAY	**LEADING INDICATORS (10:00)** Nov -0.5% Dec -0.1% **Jan -0.4%**	**FOMC MINUTES (2:00)**	**UNEMP. CLAIMS (8:30)** **CHICAGO FED NATIONAL ACTIVITY INDEX (8:30)** Monthly / 3-Mo. Avg. Nov 0.01 -0.24 Dec -0.15 -0.28 Jan -- -- **EXISTING HOME SALES (10:00)** Nov 3.820 million Dec 3.780 million **Jan 3.900 million**	
26	27	28	29	1
NEW HOME SALES	**DURABLE GOODS ORDERS** **FHFA HOME PRICE INDEX** **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** **CONFERENCE BOARD CONSUMER CONFIDENCE**	**REVISED Q4 GDP** **INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES**	**UNEMP. CLAIMS** **PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX** **MNI CHICAGO BUSINESS BAROMETER** **PENDING HOME SALES**	**ISM MFG. INDEX** **REVISED CONSUMER SENTIMENT** **CONSTRUCTION** **VEHICLE SALES**
4	5	6	7	8
	ISM SERVICES INDEX **FACTORY ORDERS**	**ADP EMPLOYMENT** **JOLTS DATA** **WHOLESALE TRADE** **BEIGE BOOK** **CHAIR POWELL MONETARY POLICY TESTIMONY (HOUSE)**	**UNEMP. CLAIMS** **TRADE BALANCE** **REVISED PRODUCTIVITY & COSTS** **CONSUMER CREDIT** **CHAIR POWELL MONETARY POLICY TESTIMONY (SENATE)**	**EMPLOYMENT REPORT**

Forecasts in bold.

Treasury Financing

February/March 2024

Monday	Tuesday	Wednesday	Thursday	Friday
12	13	14	15	16
AUCTION RESULTS: Rate / Cover 13-week bills 5.230% 2.92 26-week bills 5.065% 2.77	**AUCTION RESULTS:** Rate / Cover 42 day CMBs 5.280% 2.73 **ANNOUNCE:** $60 billion 17-week bills for auction on Feb 14 $95 billion 4-week bills for auction on Feb 15 $90 billion 8-week bills for auction on Feb 15 **SETTLE:** $60 billion 17-week bills $95 billion 4-week bills $90 billion 8-week bills	**AUCTION RESULTS:** Rate / Cover 17-week bills 5.215% 3.07	**AUCTION RESULTS:** Rate / Cover 4-week bills 5.280% 2.75 8-week bills 5.270% 2.66 **ANNOUNCE:** $149 billion 13-,26-week bills for auction on Feb 20 $46 billion 52-week bills for auction on Feb 20 $16 billion 20-year bonds for auction on Feb 21 $28 billion 2-year FRNs for auction on Feb 21 $9 billion 30-year TIPS for auction on Feb 22 $80 billion 42-day CMBs for auction on Feb 20	**SETTLE:** $149 billion 13-,26-week bills $54 billion 3-year notes $42 billion 10-year notes $25 billion 30-year bonds $80 billion 42-day CMBs
19	20	21	22	23
PRESIDENTS' DAY	**AUCTION:** $149 billion 13-,26-week bills $46 billion 52-week bills $80 billion 42-day CMBs **ANNOUNCE:** $60 billion* 17-week bills for auction on Feb 21 $95 billion* 4-week bills for auction on Feb 22 $90 billion* 8-week bills for auction on Feb 22 **SETTLE:** $60 billion 17-week bills $95 billion 4-week bills $90 billion 8-week bills	**AUCTION:** $60 billion* 17-week bills $16 billion 20-year bonds $28 billion 2-year FRNs	**AUCTION:** $95 billion* 4-week bills $90 billion* 8-week bills $9 billion 30-year TIPS **ANNOUNCE:** $149 billion* 13-,26-week bills for auction on Feb 26 $63 billion* 2-year notes for auction on Feb 26 $64 billion* 5-year notes for auction on Feb 26 $42 billion* 7-year notes for auction on Feb 27 **SETTLE:** $149 billion 13-,26-week bills $46 billion 52-week bills $80 billion 42-day CMBs	**SETTLE:** $28 billion 2-year FRNs
26	27	28	29	1
AUCTION: $149 billion* 13-,26-week bills $63 billion* 2-year notes $64 billion* 5-year notes	**AUCTION:** $42 billion* 7-year notes **ANNOUNCE:** $60 billion* 17-week bills for auction on Feb 28 $95 billion* 4-week bills for auction on Feb 29 $90 billion* 8-week bills for auction on Feb 29 **SETTLE:** $60 billion* 17-week bills $95 billion* 4-week bills $90 billion* 8-week bills	**AUCTION:** $60 billion* 17-week bills	**AUCTION:** $95 billion* 4-week bills $90 billion* 8-week bills **ANNOUNCE:** $149 billion* 13-,26-week bills for auction on Mar 4 **SETTLE:** $149 billion* 13-,26-week bills $16 billion 20-year bonds $9 billion 30-year TIPS $63 billion* 2-year notes $64 billion* 5-year notes $42 billion* 7-year notes	
4	5	6	7	8
AUCTION: $149 billion* 13-,26-week bills	**ANNOUNCE:** $60 billion* 17-week bills for auction on Mar 6 $95 billion* 4-week bills for auction on Mar 7 $90 billion* 8-week bills for auction on Mar 7 **SETTLE:** $60 billion* 17-week bills $95 billion* 4-week bills $90 billion* 8-week bills	**AUCTION:** $60 billion* 17-week bills	**AUCTION:** $95 billion* 4-week bills $90 billion* 8-week bills **ANNOUNCE:** $149 billion* 13-,26-week bills for auction on Mar 11 $56 billion* 3-year notes for auction on Mar 11 $39 billion* 10-year notes for auction on Mar 12 $22 billion* 30-year bonds for auction on Mar 13 **SETTLE:** $149 billion* 13-,26-week bills	

**Estimate*