

U.S. Economic Comment

- Recent inflation developments: PCE price index for March on track for a brisk advance, but oil prices fell in mid-April and longer-term inflation expectations remain contained

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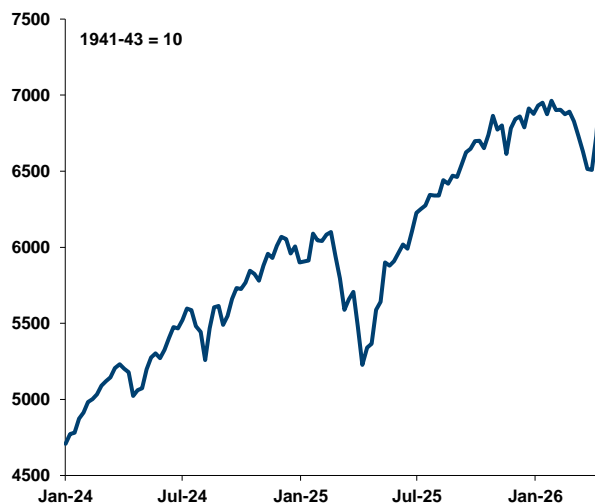
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Headway in the Middle East & Easing Inflation Risks

We make no claim to special insight about the potential timing to an end of the current conflict in the Middle East, but developments this week suggest that both the Trump administration and the Iranian regime may be seeking to deescalate tensions and shift towards a more lasting truce. Importantly, as of writing, the U.S. and Iran have indicated that the Strait of Hormuz is “completely open” (although accounts of this assessment have varied to a degree) and that Israel and Lebanon are testing a short-term cease-fire arrangement. Financial markets responded to the news, with risk assets surging after catching a bid earlier in the week – the S&P 500 has now retraced all ground lost since the inception of the conflict and is currently up more than four percent for the year – while oil prices have dropped from recent highs (charts, below). As per Bloomberg, the spot price for West Texas Intermediate crude (as of writing) fell 10.5 percent versus yesterday’s close to \$84.76, and it is well below the recent high of \$112.95 on April 7. Indeed, the move in oil prices is especially pertinent to the global outlook, as the retreat (if sustained) could suggest that the inflation shock from the war will indeed be transient. Central banks, therefore, can ultimately wait out near-term reacceleration in headline inflation rather than by addressing it through hiking interest rates and introducing further risks to global economic growth.

Provided that this week’s thaw in tensions translates to a more durable peace in the region, we can begin to adjust inflation forecasts to reflect recent pressure as more of a short-term blip rather than a source of sustained pressure. In the context of the U.S., we would look for relatively unfavorable readings on consumer prices possibly through mid-year, especially as the conflict has disrupted supply chains for commodities beyond energy, but we could again project the resumption of a moderating trend in inflation later this year. Moreover, that timeframe (if realized) would imply only modest passthrough from higher commodity prices to core inflation, which would strengthen the case for further easing in monetary policy later this year in support of the labor market (as per our current expectation, cuts of 25 basis points at the September and December FOMC meetings with a year-end target range for the federal funds rate of 3 to 3-1/4 percent).

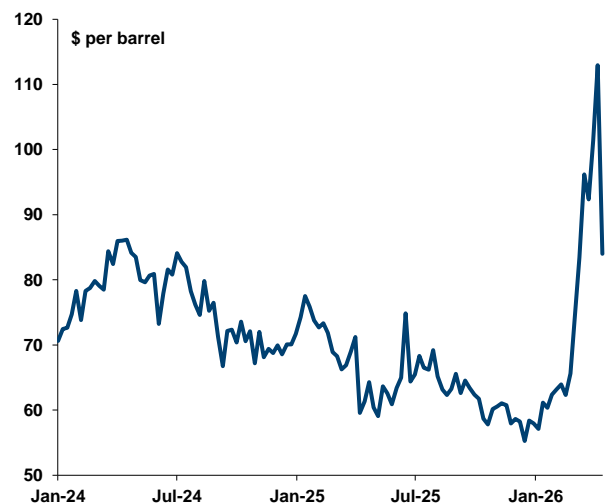
S&P 500*



* Weekly data except for the latest observation which is a midday quote from April 17, 2026.

Sources: Standard & Poor's via Haver Analytics; Bloomberg

Crude Oil Spot: WTI*



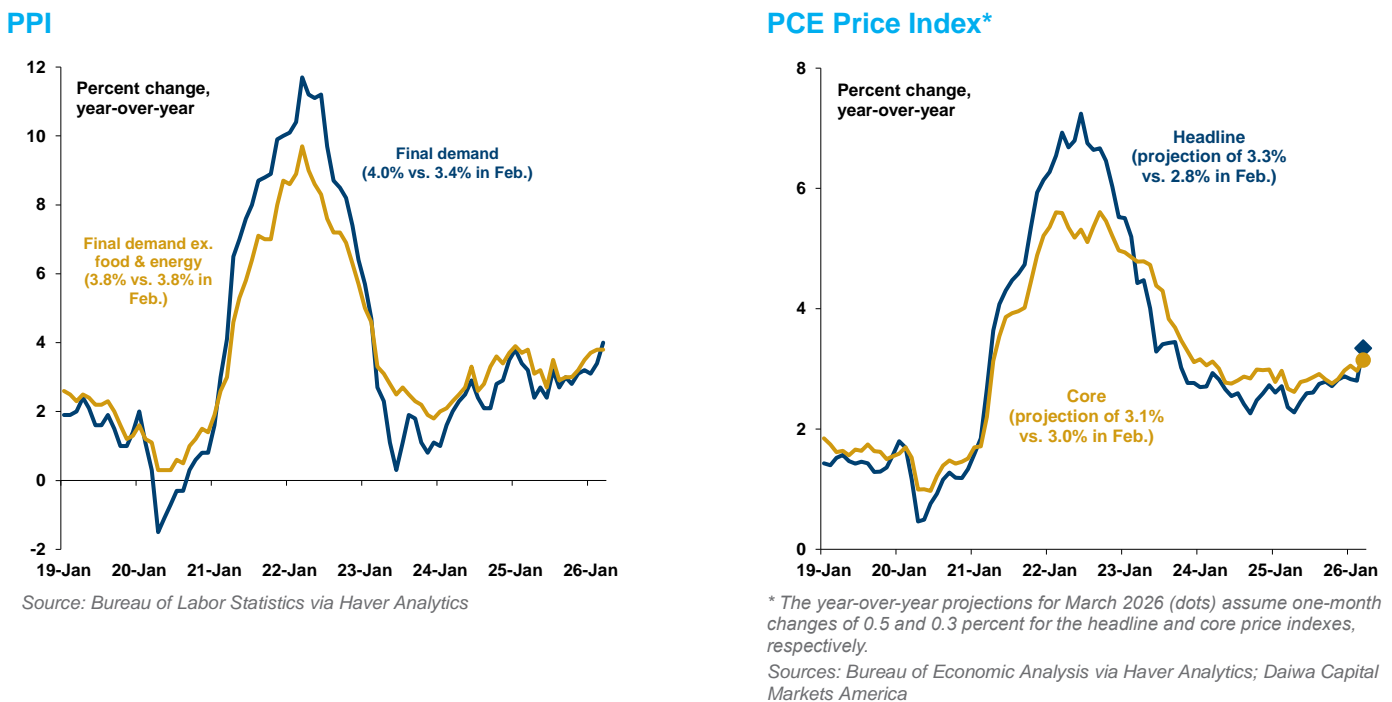
* WTI = West Texas Intermediate. Weekly data except for the latest observation which is a midday quote from April 17, 2026.

Sources: CME Group via Haver Analytics; Bloomberg

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March Inflation & Inflation Expectations

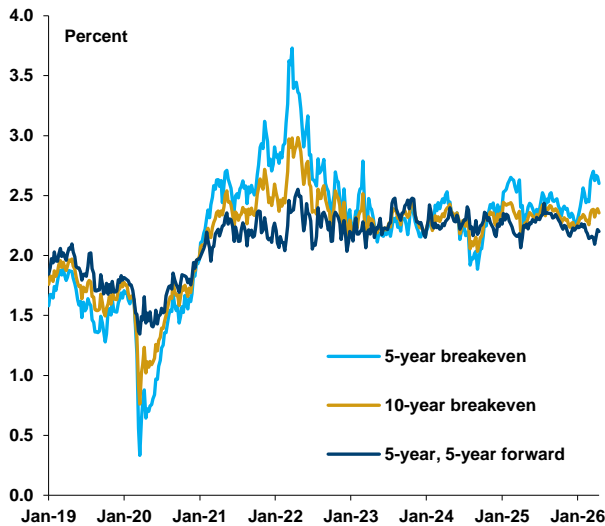
Turning specifically to the near-term price data, March results for the PPI published Tuesday contributed to a further refining of our expectations for the price index for personal consumption expenditures, the FOMC's preferred inflation metric, to be released on April 30. Earlier this month, the CPI helped quantify the immediate impact of the war on consumer prices, with the headline index jumping 0.9 percent in March (+3.3 percent year-over-year versus +2.4 percent in February), and the core rising a more subdued 0.2 percent (+2.6 percent year-over-year, up from +2.5 percent previously). As expected, energy was a key source of pressure, with the broad component rising 10.9 percent (+12.5 percent year-over-year versus +0.5 percent in February) amid a monthly surge of 21.2 percent in the gasoline subcomponent. Evidently, the majority of the burst in the headline was tied to energy (and by extension the Iran conflict), although core inflation still remained stubbornly above 2 percent even as the monthly advance was moderate. Regarding the PPI, the data were markedly better than expected although still indicative of relatively brisk inflation: the headline advanced 0.5 percent month-to-month (versus the Bloomberg survey median of +1.1 percent) and prices excluding food and energy increased 0.1 percent (versus +0.4 percent anticipated), with the results translating to year-over-year changes of +4.0 percent and +3.8 percent, respectively, versus +3.4 percent and +3.8 percent in the prior month (chart, below left). As with the CPI, the energy component was a source of pressure (+8.5 percent month-to-month, and +11.2 percent year-over-year), although the latest change was a bit less severe on account of the early-month survey period for the PPI. Even so, mapping various component inputs of both measures to the PCE price index suggests a firm reading for that gauge. We look for the headline index to round down to 0.5 percent in March and the core to round up to 0.3 percent (+3.3 percent and +3.1 percent year-over-year, respectively, versus +2.8 percent and +3.0 percent in February; chart, below right).



Regardless of the anticipated unfavorable print for the March PCE index, we offer two observations on the possible path forward for inflation. First, should the current cease-fire hold, the month-to-month reading on headline consumer prices for April, and possibly May, will improve to a degree absent a rekindling of tensions (although gasoline prices often adjust downward more slowly than crude oil after a spike and therefore changes will be more restrained than the prior surge). Secondly, even though we have yet to grasp the full extent of disruptions caused by the war (e.g., damage done to natural gas fields and chemicals plants of Gulf allies) and how long they will persist, the stemming of further escalation points to the impact being transient and therefore less of a threat to influence core inflation metrics.

Furthermore, inflation expectations – which influence actual inflation over time – have predictably responded to recent events but not necessarily gotten out of hand. On the point, market-implied inflation break-even rates at the five and 10-year points suggest average yearly inflation of 2.60 percent and 2.35 percent, respectively, as of April 17 versus 2.45 percent and 2.26 percent, respectively, as of February 27 (i.e., before the start of the war), although they have eased from recent highs (chart, below left). More important, five-year, five-year forward break-evens – average yearly inflation in the back five years of a 10-year horizon – is only six basis points higher than it was in late February (currently 2.20 percent), which likely conforms to recent assessments of Fed officials that longer-term inflation expectations remain anchored. By comparison, consumer inflation expectations have been somewhat less favorable, as year-ahead assessments from the University of Michigan Survey of Consumers surged 1.0 percentage point in early April to 4.8 percent (a reading off those seen around the Liberation Day tariff announcement but still well-above pre-pandemic norms) and the longer-term assessment deteriorated as well (3.4 percent versus 3.2 percent in March; chart, below right). That said, these measures often correlate with gasoline prices and news events (such as the tariff announcements) and are somewhat more volatile than market-implied measures of inflation expectations (which we tend to favor alongside surveys of market participants as more reliable metrics). Broadly speaking, the latest developments related to the Iran war have left us more optimistic on inflation, especially given moves today in oil prices, and prospects for further monetary policy easing later this year than we were just a few days ago.

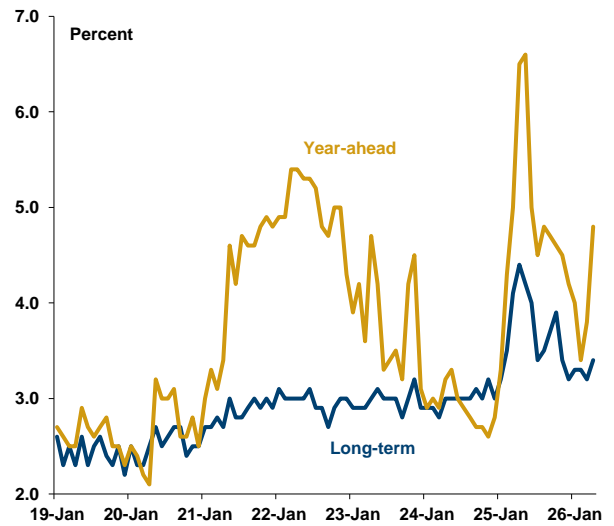
Breakeven Inflation Rates*



* A measure of expected inflation derived from nominal and inflation-linked bonds. The 5- and 10-year rates show expected inflation per year over those periods, whereas the five-year, five-year forward rate shows expected inflation per year in the period beginning five years from now. Weekly data.

Source: Bloomberg

Consumer Inflation Expectations



Source: University of Michigan via Haver Analytics

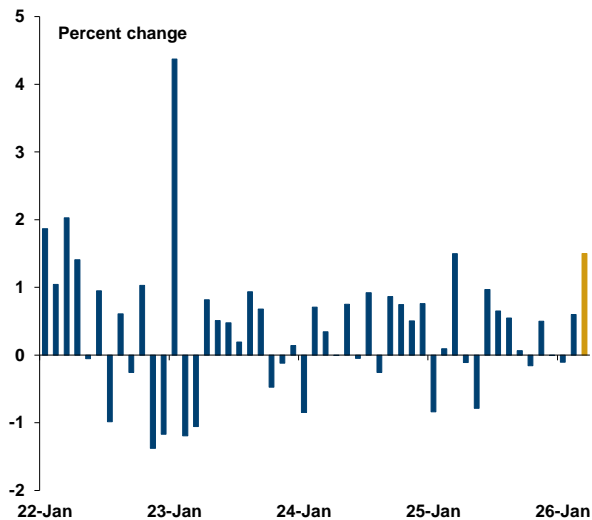
The Week Ahead

Retail Sales (March) (Tuesday)

Forecast: +1.5% total, +1.6% ex. autos, +0.4% ex. autos & gas

A sizable increase in auto sales in March points to a second consecutive brisk advance in the motor vehicles and parts component of retail sales. Moreover, with higher prices at the pump (a result of the current conflict with Iran), the gasoline component could provide a substantial boost to the anticipated increase in total activity. Transactions excluding autos and gas, however, have been tepid recently (average advance of 0.2 percent in the past six months), although we expect a firmer performance in March after winter storms likely constrained foot traffic at retail outlets in early 2026.

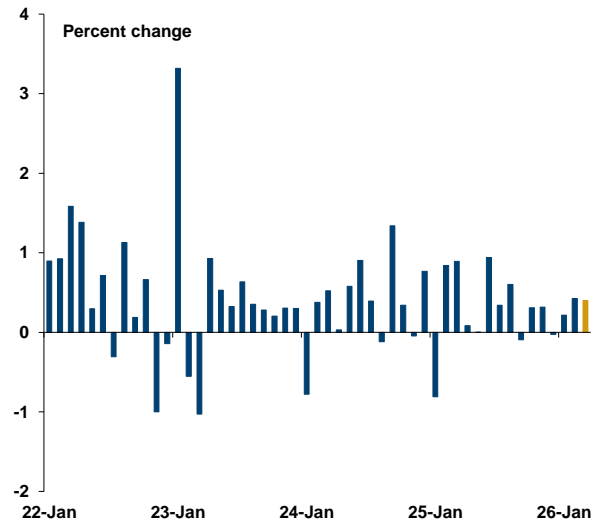
Retail Sales*



* The gold bar is a forecast for March 2026.

Sources: U.S. Census Bureau via Haver Analytics; Daiwa Capital Markets America

Retail Sales Ex. Autos & Gas*



* The gold bar is a forecast for March 2026.

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Revised Consumer Sentiment (April) (Friday)

Forecast: 49.5 (+1.9-point adjustment)

While the revised estimate of consumer sentiment is usually close to the preliminary tally, we could envision some reversal in late April after a 10.7 percent decrease to 47.6 left the University of Michigan metric at a record low. Recall, as mentioned in the official release, 98 percent of interviews were completed prior to the announcement of the temporary ceasefire between Iran and the US (survey period for the first estimate spans from March 24 to April 7). Thus, with consumers perhaps more hopeful of an eventual end to the conflict and subsequent easing in energy prices, the decline in sentiment could be revised to a degree. Concurrently, deterioration in the year-ahead (+1.0 percentage point to 4.8 percent) and long-term (+0.2 percentage point to 3.4 percent) inflation expectations could also be reversed – at least to an extent.

Economic Indicators

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EXISTING HOME SALES Jan 4.020. million Feb 4.130 million Mar 3.980 million	NFIB SMALL BUSINESS OPTIMISM INDEX Jan 99.3 Feb 98.8 Mar 95.8 PPI <table border="1"> <thead> <tr> <th></th> <th>Final Demand</th> <th>Ex. Food & Energy</th> </tr> </thead> <tbody> <tr> <td>Jan</td> <td>0.6%</td> <td>0.8%</td> </tr> <tr> <td>Feb</td> <td>0.5%</td> <td>0.3%</td> </tr> <tr> <td>Mar</td> <td>0.5%</td> <td>0.1%</td> </tr> </tbody> </table>		Final Demand	Ex. Food & Energy	Jan	0.6%	0.8%	Feb	0.5%	0.3%	Mar	0.5%	0.1%	EMPIRE MFG Feb 7.1 Mar -0.2 Apr 11.0 IMPORT/EXPORT PRICES <table border="1"> <thead> <tr> <th></th> <th>Non-Petrol Imports</th> <th>Nonagri. Exports</th> </tr> </thead> <tbody> <tr> <td>Jan</td> <td>0.8%</td> <td>0.5%</td> </tr> <tr> <td>Feb</td> <td>0.9%</td> <td>2.1%</td> </tr> <tr> <td>Mar</td> <td>0.1%</td> <td>1.7%</td> </tr> </tbody> </table> NAHB HOUSING INDEX Feb 37 Mar 38 Apr 34 BEIGE BOOK April 2026: "Overall economic activity increased at a slight to modest pace in eight of the twelve Federal Reserve Districts, while two Districts reported little change and two Districts reported slight to modest declines." TIC FLOWS <table border="1"> <thead> <tr> <th></th> <th>Long-Term</th> <th>Total</th> </tr> </thead> <tbody> <tr> <td>Dec</td> <td>\$100.2B</td> <td>\$117.1B</td> </tr> <tr> <td>Jan</td> <td>\$2.4B</td> <td>-\$38.4B</td> </tr> <tr> <td>Feb</td> <td>\$58.6B</td> <td>\$184.5B</td> </tr> </tbody> </table>		Non-Petrol Imports	Nonagri. Exports	Jan	0.8%	0.5%	Feb	0.9%	2.1%	Mar	0.1%	1.7%		Long-Term	Total	Dec	\$100.2B	\$117.1B	Jan	\$2.4B	-\$38.4B	Feb	\$58.6B	\$184.5B	UNEMPLOYMENT CLAIMS <table border="1"> <thead> <tr> <th></th> <th>Initial</th> <th>Continuing</th> </tr> </thead> <tbody> <tr> <td></td> <td colspan="2">(millions)</td> </tr> <tr> <td>Mar 21</td> <td>0.211</td> <td>1.832</td> </tr> <tr> <td>Mar 28</td> <td>0.203</td> <td>1.787</td> </tr> <tr> <td>Apr 4</td> <td>0.218</td> <td>1.818</td> </tr> <tr> <td>Apr 11</td> <td>0.207</td> <td>N/A</td> </tr> </tbody> </table> PHILADELPHIA FED MFG BUSINESS OUTLOOK Feb 16.3 Mar 18.1 Apr 26.7 IP & CAP-U <table border="1"> <thead> <tr> <th></th> <th>IP</th> <th>Cap.Util.</th> </tr> </thead> <tbody> <tr> <td>Jan</td> <td>0.0%</td> <td>75.7%</td> </tr> <tr> <td>Feb</td> <td>0.7%</td> <td>76.1%</td> </tr> <tr> <td>Mar</td> <td>-0.5%</td> <td>75.7%</td> </tr> </tbody> </table>		Initial	Continuing		(millions)		Mar 21	0.211	1.832	Mar 28	0.203	1.787	Apr 4	0.218	1.818	Apr 11	0.207	N/A		IP	Cap.Util.	Jan	0.0%	75.7%	Feb	0.7%	76.1%	Mar	-0.5%	75.7%	
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(p) = preliminary, (r) = revised

Forecasts in bold. Despite an end to the government shutdown, some economic data are still delayed. We have made best efforts to incorporate revised release schedules from various statistical agencies, although some changes may not be reflected.

Treasury Financing

April/May 2026																																					
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