Daiwa Capital Markets

U.S. Economic Comment

- Updated rates forecast: an additional hike in late ’26 before deceleration in inflation ushers in modest easing next year
- Friday data: Unanticipated decline in manufacturing activity weighed on August industrial output
- Q3 GDP update: firm retail sales in August suggest faster economic growth than previously projected

Lawrence Werther
lawrence.werther@us.daiwacm.com
+1-212-612-6393
Brendan Stuart
brendan.stuart@us.daiwacm.com
+1-212-612-6172

A Short Hiking Cycle

This past Wednesday, the FOMC acted unanimously in voting to raise the target range for the federal funds rate by 25 basis points to a range of 3-3/4 to 4 percent. Available data from the CPI and PPI released the prior week suggested negligible (at best) improvement in underlying inflation, as internal Fed projections indicated that the price index for personal consumption expenditures advanced 3.6 percent year-over-year in August (versus +3.7 percent in July) while the core measure rose 3.2 percent (versus +3.3 percent; actual results will be released in the Bureau of Economic Analysis’ Personal Income and Outlays report on September 30). In essence, with price growth tracking well above the Federal Reserve’s target for more than five years, growing discontent within the Committee – and in markets – spurred action. Providing context for the move, Chairman Warsh noted in the opening remarks of his press conference: “Last month in Wyoming, I expressed my commitment to a monetary policy discipline, not to a decision. I defined the standard for action: We must be confident that underlying inflation is moving to our objective, clearly and at sufficient speed.” Evidently, inflation readings in his tenure thus far fell short of that standard. Moreover, given the Chairman’s laser focus on trends, along with his assessment that he “would be hard-pressed to describe broad financial conditions as restrictive,” we suspect that another “dose of accommodation” could be “removed” before year-end (i.e., a further hike of 25 basis points at the December 2026 FOMC meeting, with a year-end target range for the federal funds rate of 4 to 4-1/4 percent).

Even as we hold a tightening bias over the balance of 2026, our core thesis on the current bout of inflation remains unchanged: we view it as a primarily supply-driven phenomenon, which monetary policy is ill suited to address, and thus anticipate that it could show significant evidence of abating in the first half of next year (barring an intensifying energy shock). Indeed, the latest set of inflation forecasts from the September Summary of Economic Projections seemingly align with our view, although assessments of the Committee (excluding those of Chairman Warsh, who again declined to provide forecasts) coalesce around that projection necessitating a four-handle on the policy rate for 2027 (table; median expectations shown above).

Economic Projections of the FOMC, September 2026*

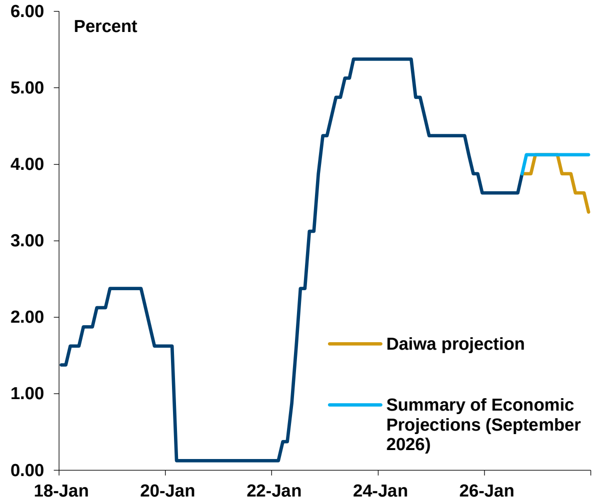
	2026	2027	2028	2029	Longer Run
PCE Inflation	3.7	2.3	2.1	2.0	2.0
June projection	3.6	2.3	2.0	--	2.0
Core PCE Inflation	3.4	2.5	2.2	2.0	--
June projection	3.3	2.5	2.1	--	--
Federal Funds Rate	4.1	4.1	3.9	3.6	3.2
June projection	3.8	3.6	3.4	--	3.1

** Excluding GDP and unemployment. Median projections.*
Source: Federal Open Market Committee, Summary of Economic Projections, September 2026

We are sympathetic to policymakers’ hawkish views given the persistent bout of inflation that has for years defied expectations, and we readily acknowledge that forecasting the policy rate beyond the next meeting or two is highly imprecise (a generous characterization). That said, if trend rather than point estimate is the barometer, and inflation is decelerating next year, then modest cuts may in fact be on the table. Further, we currently view domestic supply and demand as balanced, and the low-hire, low-fire equilibrium in the labor market as generating sustainable wage growth, both of which bode well for a return to 2 percent. And, we see little evidence thus far of second round effects emanating from the latest supply shock (conflict with Iran). As such, we look for modest cuts next year.

Acknowledging that risks are elevated, and that our outlook will evolve (possibly in the coming weeks), we currently expect three cuts in 2027 – reductions of 25 basis points each at the June, September, and December FOMC meetings (year-end 2027 target range of 3-1/4 to 3-1/2 percent; chart, right). Such a scenario assumes solid growth, a low unemployment rate consistent will a fully employed economy, and indication that inflation is on a sustainable path back to 2 percent.

Federal Funds Target Rate*



** The gold and light blue lines show the projected path for the federal funds rate through year-end 2027 from DCMA and the September 2026 iteration of the Summary of Economic Projections, respectively.*

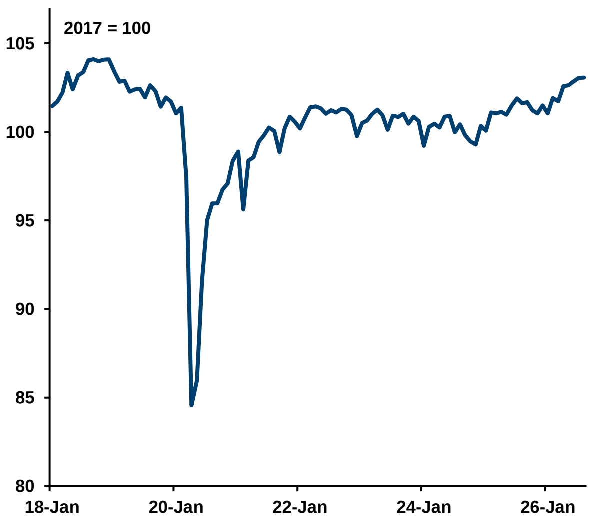
Sources: Federal Reserve Board via Haver Analytics; Daiwa Capital Markets America; Federal Open Market Committee

Downside Volatility in Industrial Production

Recent data on the factory sector have been almost uniformly favorable. Survey data were strong recently, with the ISM manufacturing index signaling expansion for the eighth consecutive month in August (+54.6) and various regional manufacturing indexes published by Federal Reserve district banks indicating similar performances. At the same time, hiring in the manufacturing sector has averaged over 14,000 in the three months ended August versus approximately -4,700 in the previous 12 months, while the average workweek has risen steadily from 40.0 hours in December 2025 to 40.5 hours currently. That in mind, today's lackluster industrial production report for August came as a bit of a surprise – especially as the underwhelming result reflected weakness in the manufacturing component (the headline measure rounded to no change versus +0.3 percent expected; +1.4 percent year-over-year).

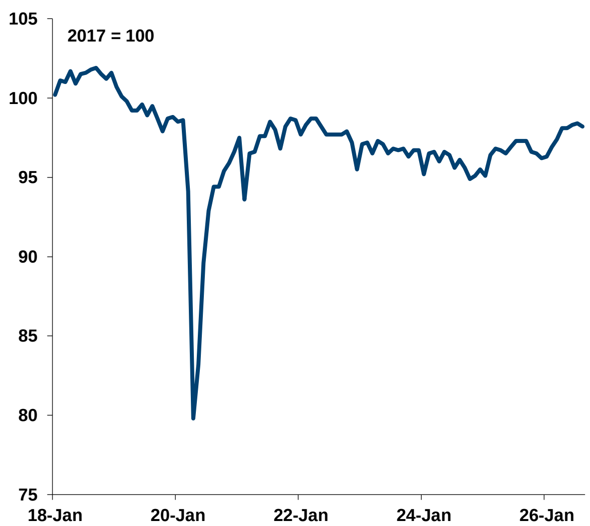
As noted above, weakness was concentrated in the manufacturing component, which posted its first decline in 2026 (-0.3 percent; +0.9 percent year-over-year; charts, below). Factoring importantly into the deterioration, production in the motor vehicle and parts subcategory fell 1.2 percent (-1.0 percent year-over-year) – even as vehicle sales have stirred after a sluggish performance in late 2025 and earlier this year. Moreover, performance across other sectors was mostly soft, with 11 of 19 non-auto industries registering decreases in production (manufacturing ex-autos rose 1.0 percent year-over-year). Notably, computer and electronic products, an area that had reflected robust investment in AI-related infrastructure in prior months and was perhaps due for a pause, dipped 0.5 percent – its first decline since last December (+8.7 percent year-over-year). Thus, we view the latest results as likely downside noise in the upward drift in total factory output rather than a warning sign of a potential reversal.

Industrial Production: Total



Source: Federal Reserve Board via Haver Analytics

Industrial Production: Manufacturing



Source: Federal Reserve Board via Haver Analytics

Turning to the other major components, mining output rose 0.1 percent in August, its fifth consecutive increase (recall that May's result rounded down to no change: +0.039 percent; +0.3 percent year-over-year). For context, after mounting a notable recovery from the COVID-related trough and stalling at a pace approximately in line with what seen just prior to the onset of the pandemic, this sector has firmed up over the past few months. In that regard, higher prices of energy commodities and supply disruptions in the Middle East have provided an opportunity for U.S. producers to increase output and fill a portion of supply gaps in crude oil and liquified natural gas. Utility output, meanwhile, jumped 1.8 percent, the largest one-month shift since December 2025 (+6.2 percent year-over-year). We do caution, however, that this component often displays volatility on a month-to-month basis, with shifts typically reflecting variations in the weather (e.g., above-average temperatures in August) rather than underlying economic fundamentals.

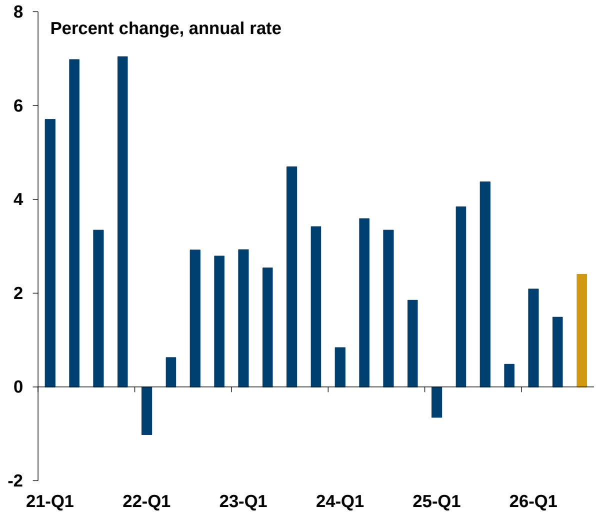
All told, we're inclined to view today's soft performance in industrial production as indicative of more noise than signal.

Consumer Spending an Ongoing Bright Spot in Q3

Although the August report on industrial production was mildly disappointing, data on the consumer sector earlier this week were far more encouraging. Rebounding from a sluggish performance in the preceding month, retail sales jumped 1.2 percent in August, with 12 of 13 categories registering increases. On a year-over-year basis, topline sales advanced 6.0 percent, an acceleration of 1.0 percentage point from the reading in July and among the fastest paces of the past several years – a strong performance underscoring the ongoing resilience of households despite multiple challenges, including affordability issues stemming from brisk inflation and elevated interest rates.

A portion of the latest results reflected a surge of 3.1 percent in sales at gasoline stations (+21.0 percent year-over-year), which was almost certainly the result of higher prices at the pump (the gasoline component of the CPI surged 3.9 percent in August, exceeding the nominal advance in the service station component), but sales elsewhere were favorable – boding well for consumer spending in Q3. On the point, the retail control grouping (sales excluding those from food services and drinking places, motor vehicle dealers, gasoline stations, and building materials, garden equipment, and supply dealers), which correlates with consumers' outlays for goods in the GDP accounts, surged 1.4 percent (+5.6 percent year-over-year) – the strongest advance in almost two years. Resultantly, we adjusted higher our estimate of Q3 real consumer spending to +2.5 percent, annual rate, from +1.7 percent previously, with the revision contributing to an expectation of 2.4 percent GDP growth in Q3 (versus +1.8 percent previously; charts, below). We still anticipate moderation in household expenditures in the closing months of the year given the ongoing drawdown in savings, but the U.S. economy, at least for now, remains on a solid underlying growth trajectory.

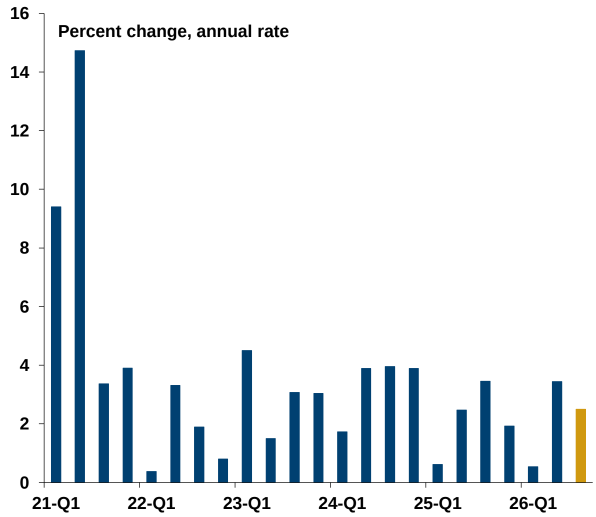
Gross Domestic Product*



** The gold bar is a forecast for 2026-Q3.*

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

Real Personal Consumption Expenditures*



** The gold bar is a forecast for 2026-Q3.*

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

The Week Ahead

New Home Sales (August) (Thursday)
Forecast: 0.620 million (+2.1%)

Housing-related data from the Census Bureau often exhibits marked volatility, with monthly report typically indicating sizable standard errors. With that in mind, following the seemingly outsized 10.5-percent decrease to 0.607 million units, annual rate, in July (±14.0 percent), some payback could be in store for August. The projection, if realized, would leave this series a bit closer to the 26-H1 average of 0.636 million and roughly in line with the pre-pandemic performance.

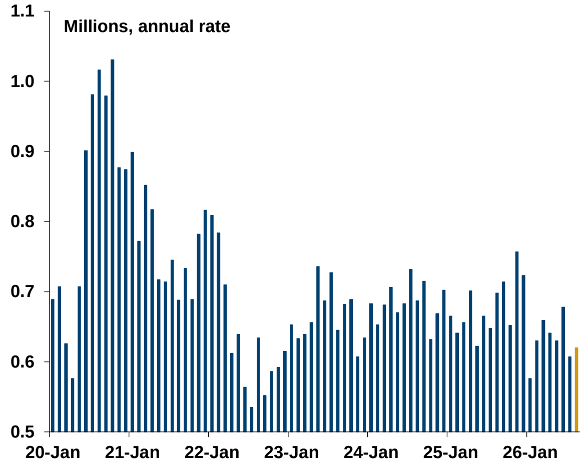
Durable Goods Orders (August) (Friday)
Forecast: -0.5%

The transportation component of durable goods typically introduces significant volatility to total orders, often reflecting wide swings in the civilian aircraft subcategory (range of -51.1 to +167.4 percent in the past six months). That trend, however, may take a breather in August, with aircraft orders at Boeing only modestly lower than the prior month (15 versus 38 in July). Averaging through the noise, total bookings have tilted higher – a performance that could stall in the latest report. Orders excluding transportation have also firmed since the spring of 2025 after moving sideways for much of the past few years.

Revised Consumer Sentiment (September) (Friday)
Forecast: 47.8 (unchanged)

While the revised estimate of consumer sentiment is usually close to the preliminary tally, we perhaps see the potential for a downward adjustment in September. Specifically, considering the further escalation of tensions in the Persian Gulf (e.g., last week's attack on Saudi Arabia's East-West pipeline), and the attendant jump in fuel prices, survey responses could take on a more negative tone (note that the collection period for the revised estimate occurs between September 7 and September 21). On the point of energy prices, updated readings on inflation expectations could bear close watching. As of the preliminary release, the year-ahead metric rose 0.6 percentage point to 4.6 percent while longer-term expectations nudged one tick higher to 3.4 percent – shifts that could deteriorate further.

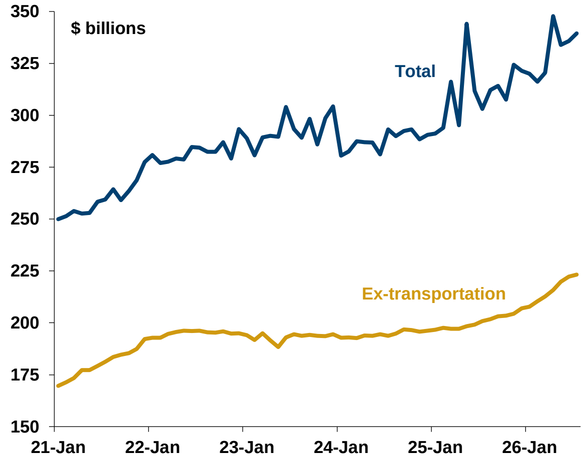
New Home Sales*



** The gold bar is a forecast for August 2026.*

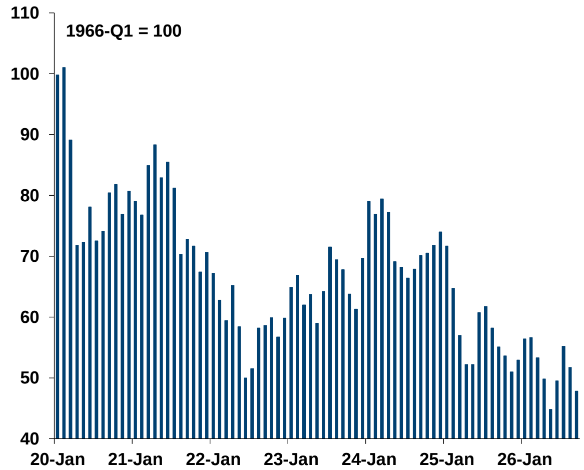
Sources: U.S. Census Bureau via Haver Analytics; Daiwa Capital Markets America

New Orders for Durable Goods



Source: U.S. Census Bureau via Haver Analytics

Consumer Sentiment



Source: University of Michigan via Haver Analytics

Daiwa Capital Markets

Economic Indicators

September/October 2026

Monday	Tuesday	Wednesday	Thursday	Friday
14	15	16	17	18
	EMPIRE MFG July 15.6 Aug 20.6 Sep 7.6 **FOMC MEETING (FIRST DAY)**	**RETAIL SALES** Total / Ex.Autos June 0.3% / -0.2% July -0.5% / -0.2% Aug 1.2% / 1.4% **IMPORT/EXPORT PRICES** Non-Petrol Imports / Nonagri. Exports June 0.2% / -0.8% July 0.3% / -1.6% Aug 0.8% / 0.7% **NAHB HOUSING INDEX** July 34 Aug 35 Sep 32 **BUSINESS INVENTORIES** Inventories / Sales May 0.4% / 2.1% June 0.1% / -1.0% July 0.8% / 0.3% **FOMC RATE DECISION** **TIC FLOWS** Long-Term / Total May $231.2B / $131.3B June $174.4B / $135.5B July -$27.9B / $83.7B	**UNEMPLOYMENT CLAIMS** Initial / Continuing (millions) Aug 22 0.204 / 1.775 Aug 29 0.207 / 1.769 Sep 5 0.206 / 1.730 Sep 12 0.196 / N/A **HOUSING STARTS** June 1.439 million July 1.309 million Aug 1.275 million **PHILADELPHIA FED MFG BUSINESS OUTLOOK** July 41.4 Aug 47.4 Sep 37.8 **PENDING HOME SALES** June -4.8% July -2.6% Aug 0.3%	**IP & CAP-U** IP / Cap.Util. June 0.2% / 76.2% July 0.2% / 76.3% Aug 0.0% / 76.3% **LEADING INDICATORS** June 0.0% July 0.2% Aug -0.1%
21	22	23	24	25
CHICAGO FED NATIONAL ACTIVITY INDEX (8:30) Monthly / 3-Mo. Avg. June 0.06 / 0.01 July -0.08 / -0.04 Aug -- / --			**UNEMP. CLAIMS (8:30)** **CURRENT ACCOUNT (8:30)** 25-Q4 -$221.1 bill. 26-Q1 -$226.8 bill. **26-Q2 -$255.0 bill.** **NEW HOME SALES (10:00)** June 0.678 million July 0.607 million **Aug 0.620 million**	**DURABLE GOODS ORDERS (8:30)** June 0.6% July 1.1% **Aug -0.5%** **CONSUMER SENTIMENT (10:00)** Aug 51.7 Sep(p) 47.8 **Sep(r) 47.8**
28	29	30	1	2
	FHFA HOUSE PRICE INDEX **S&P COTALITY CASE-SHILLER 20-CITY HOME PRICE INDEX** **CONFERENCE BOARD CONSUMER CONFIDENCE** **JOLTS DATA**	**ADP EMPLOYMENT** **REVISED Q2 GDP** **PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX** **INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES** **MNI CHICAGO BUSINESS BAROMETER**	**UNEMP. CLAIMS** **ISM MFG. INDEX** **CONSTRUCTION** **VEHICLE SALES**	**EMPLOYMENT REPORT** **FACTORY ORDERS**
5	6	7	8	9
ISM SERVICES INDEX	**TRADE BALANCE**	**FOMC MINUTES** **CONSUMER CREDIT**	**UNEMP. CLAIMS** **WHOLESALE TRADE**	**CONSUMER SENTIMENT**

(p) = preliminary, (r) = revised

Forecasts in bold.

Treasury Financing

September/October 2026

Monday	Tuesday	Wednesday	Thursday	Friday
14	15	16	17	18
AUCTION RESULTS: Rate / Cover 13-week bills 3.970% 2.64 26-week bills 4.060% 2.74	**AUCTION RESULTS:** Rate / Cover 6-week bills 3.850% 3.16 20-yr bonds 5.420% 2.57 **ANNOUNCE:** $72 billion 17-week bills for auction on Sep 16 $90 billion 4-week bills for auction on Sep 17 $85 billion 8-week bills for auction on Sep 17 **SETTLE:** $72 billion 17-week bills $90 billion 4-week bills $85 billion 8-week bills $58 billion 3-year notes $39 billion 10-year notes $22 billion 30-year bond	**AUCTION RESULTS:** Rate / Cover 17-week bills 4.030% 2.72	**AUCTION RESULTS:** Rate / Cover 4-week bills 3.820% 3.02 8-week bills 3.920% 2.94 10-yr TIPS 2.653% 2.24 **ANNOUNCE:** $171 billion 13-,26-week bills for auction on Sep 21 $75 billion 6-week bills for auction on Sep 22 $69 billion 2-year notes for auction on Sep 22 $70 billion 5-year notes for auction on Sep 23 $44 billion 7-year notes for auction on Sep 24 $28 billion 2-year FRNs for auction on Sep 23	**SETTLE:** $13 billion 20-year bonds **SETTLE:** $171 billion 13-,26-week bills $75 billion 6-week bills
21	22	23	24	25
AUCTION: $171 billion 13-,26-week bills	**AUCTION:** $75 billion 6-week bills $69 billion 2-year notes **ANNOUNCE:** $72 billion* 17-week bills for auction on Sep 23 $90 billion* 4-week bills for auction on Sep 24 $85 billion* 8-week bills for auction on Sep 24 **SETTLE:** $72 billion 17-week bills $90 billion 4-week bills $85 billion 8-week bills	**AUCTION:** $72 billion* 17-week bills $70 billion 5-year notes $28 billion 2-year FRNs	**AUCTION:** $90 billion* 4-week bills $85 billion* 8-week bills $44 billion 7-year notes **ANNOUNCE:** $171 billion* 13-,26-week bills for auction on Sep 28 $75 billion* 6-week bills for auction on Sep 29 $52 billion* 52-week bills for auction on Sep 29 **SETTLE:** $171 billion 13-,26-week bills $75 billion 6-week bills	**SETTLE:** $28 billion 2-year FRNs
28	29	30	1	2
AUCTION: $171 billion* 13-,26-week bills	**AUCTION:** $75 billion* 6-week bills $52 billion* 52-week bills **ANNOUNCE:** $72 billion* 17-week bills for auction on Sep 30 $90 billion* 4-week bills for auction on Oct 1 $85 billion* 8-week bills for auction on Oct 1 **SETTLE:** $72 billion* 17-week bills $90 billion* 4-week bills $85 billion* 8-week bills	**AUCTION:** $72 billion* 17-week bills **SETTLE:** $19 billion 10-year TIPS $69 billion 2-year notes $70 billion 5-year notes $44 billion 7-year notes	**AUCTION:** $90 billion* 4-week bills $85 billion* 8-week bills **ANNOUNCE:** $171 billion* 13-,26-week bills for auction on Oct 5 $75 billion* 6-week bills for auction on Oct 6 $58 billion* 3-year notes for auction on Oct 6 $39 billion* 10-year notes for auction on Oct 7 $22 billion* 30-year bonds for auction on Oct 8 **SETTLE:** $171 billion* 13-,26-week bills $75 billion* 6-week bills $52 billion* 52-week bills	
5	6	7	8	9
AUCTION: $171 billion* 13-,26-week bills	**AUCTION:** $75 billion* 6-week bills $58 billion* 3-year notes **ANNOUNCE:** $72 billion* 17-week bills for auction on Oct 7 $90 billion* 4-week bills for auction on Oct 8 $85 billion* 8-week bills for auction on Oct 8 **SETTLE:** $72 billion* 17-week bills $90 billion* 4-week bills $85 billion* 8-week bills	**AUCTION:** $72 billion* 17-week bills $39 billion* 10-year notes	**AUCTION:** $90 billion* 4-week bills $85 billion* 8-week bills $22 billion* 30-year bonds **ANNOUNCE:** $171 billion* 13-,26-week bills for auction on Oct 13 $75 billion* 6-week bills for auction on Oct 13 **SETTLE:** $171 billion* 13-,26-week bills $75 billion* 6-week bills	

*Estimate