STATE STREET GLOBAL ADVISORS

September 29, 2023
Commentary

Weekly Economic Perspectives

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Spotlight on Next Week
Robust payroll gains expected in the US. UK housing prices likely to weaken further. BoJ Tankan survey may show improvement. RBA to hold interest rates.

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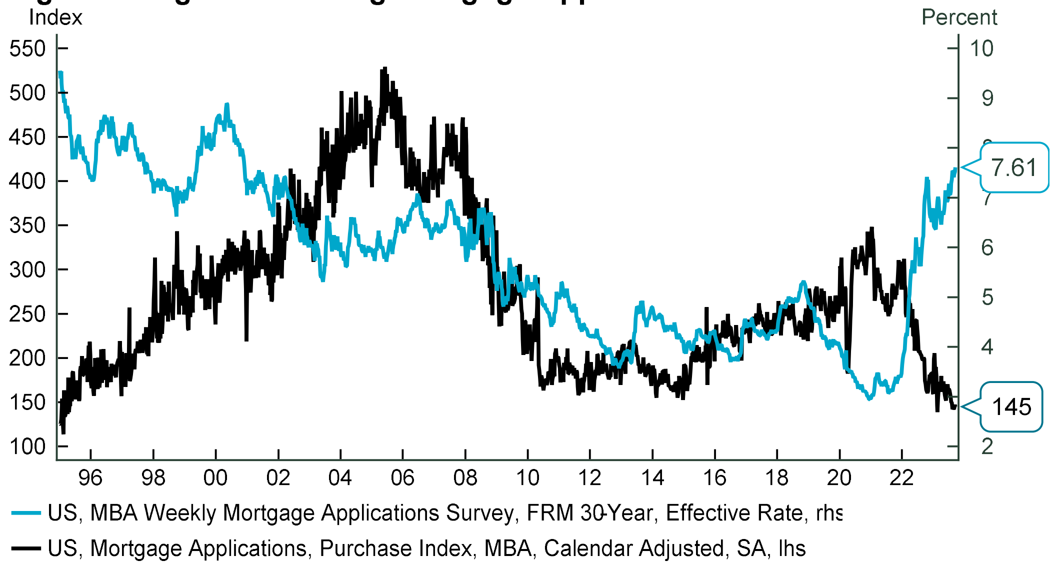
The Economy

Data show disinflation and strain from high rates; US averts government shutdown.

US

With the effective 30-year mortgage rates hitting 7.6%, **mortgage applications** for purchases have dropped to levels last prevailing in the mid-1990s. These rates are a major headwind not just for buyers but also for sellers. One can reasonably wonder “who can afford to buy?”, but an equally relevant question is “who can afford to sell?” if that means giving up a much lower mortgage rate…

Figure 1: High Rates Bring Mortgage Applications To A Standstill



Sources: Macrobond, SSGA Economics, MBA
Updated as of 10/1/2023

New home sales have been pretty volatile lately. They declined a larger than expected 8.7% in August, more than giving back the July increase, to settle at four-month low of 675k (annualized). However, sales were 5.8% higher than in August 2022. **Pending home sales** (existing home sales on which the buyer and seller have agreed on a price but have not yet closed) dropped 7.1% in August and were nearly 19% lower than a year ago.

Given this backdrop, the reacceleration in house prices is more than a little puzzling. To be sure, the lack of supply plays a key role here and the price re-acceleration is definitely a feature of the existing, rather than the new, home market. In the existing home market, sellers have much less ability to tailor offerings to current market conditions (smaller units, less expensive finishes, etc.) so the price elasticity is much smaller. Nonetheless, we suspect that there is a compositional skew that exaggerates the degree of price appreciation shown in the official data. Following a string of declines during the second half of 2022 through early 2023, the **S&P CoreLogic/Case-Shiller composite** 20-city home price index has since experienced steady sequential gains that left the index up slightly (0.1%) in July on a y/y basis. The **FHFA house price** measure is sending an even stronger message of resilience at it rose 4.6% y/y in July, the best showing since February.

Revisions have lifted the estimated **personal savings rate** level over the last several months, but the trend is still downward. The saving rate stood at 3.9% in August, the lowest level so far this year as both personal income and personal spending grew 0.4% m/m. Nominal income was supported by a 0.5% gain in employee compensation; however, real disposable income declined 0.2% m/m, the second such retreat in a row. In real terms, spending only rose 0.1%.

The **PCE inflation** data came in slightly below expectations—which should be very good news for the Fed. Indeed, we had been arguing that end-2023 core PCE inflation forecasts in the Fed's SEP (summary of economic projections) remain too high even after the two-tenth downgrade in September; this data further strengthens that view. Headline PCE prices increased 0.4% m/m while core prices rose just 0.1%. The two respective measures of inflation now stand at 3.5% y/y and 3.9% y/y. For the core PCE, this is the twin lowest y/y reading since June 2021.

The **Conference Board consumer confidence index** dropped a larger than expected 5.7 points in September. Combined with the August decline, it has now completely unwound the gains recorded in June and July. Notably, there was but a marginal improvement in the closely watched labor differential—which measures the difference between those who think jobs are abundant and those who think jobs are scarce. We had anticipated a larger rebound in that metric given its August plunge, but the 0.6-point gain reported was barely noticeable and leaves this metric at its second lowest level since April 2021. This is consistent with job openings data that also signal that labor market demand and supply is coming into closer balance.

Canada

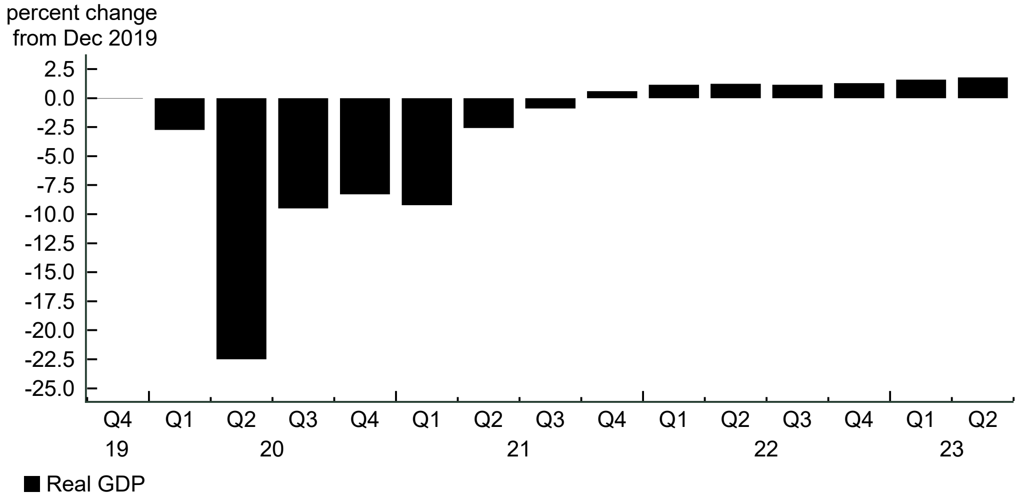
The economy continues to slow. **Real GDP** was unchanged in July, following a 0.2% decline in June, while advance estimate showed modest growth of 0.1% in August. July's performance was weighed by manufacturing, which posted the largest decline in two years (-1.5%) as firms reduced inventories. Transportation and warehousing also contracted 0.2%. Some sectors such as mining and quarrying (except oil and gas) and accommodation and food services, bounced back in July after being hit by wildfires in June. Overall, services-producing industries inched up 0.1% in July, while goods-producing industries declined by 0.3%.

UK

The latest data revisions from ONS showed that the economy has been more robust than previously thought, explaining some of the upward pressure on wage growth and inflation. As of end June 2023, **GDP** was 1.8% higher than in Q4 2019, up from previous estimate of 0.2% lower than pre-covid. While Q1 GDP growth was revised upward to 0.3% from previous estimate of 0.1%, Q2 GDP growth was unchanged at 0.2%. In Q2 2023, household consumption rose 0.5%, revised down from first estimate of 0.7%, but following an upwardly revised gain of 0.7% in Q1 (shown previously as no growth). Real government consumption expenditure rose 2.5% in Q2, down by 0.6% compared to the first estimate. Business investment grew by 4.1%, revised up from a first estimate increase of 3.4%. Export volumes fell by 0.9% in Q2, up from first estimate decline of 2.5% while import volumes increased by 2.2% in Q2, up from previous estimate as a 1.0% increase. While the latest data showed the economy has recovered faster than previously thought, the economic outlook is still gloomy as the impact of interest hikes is feeding through.

Mortgage approvals declined more than to a six-month low of 45,400 in August. Net approvals for remortgaging dropped significantly from 39,300 to 25,000, the lowest since July 2012. Clearly, the combination of higher interest rates is working as expected in dampening demand.

Figure 2: UK's Post-Covid Recovery Faster Than Previously Thought

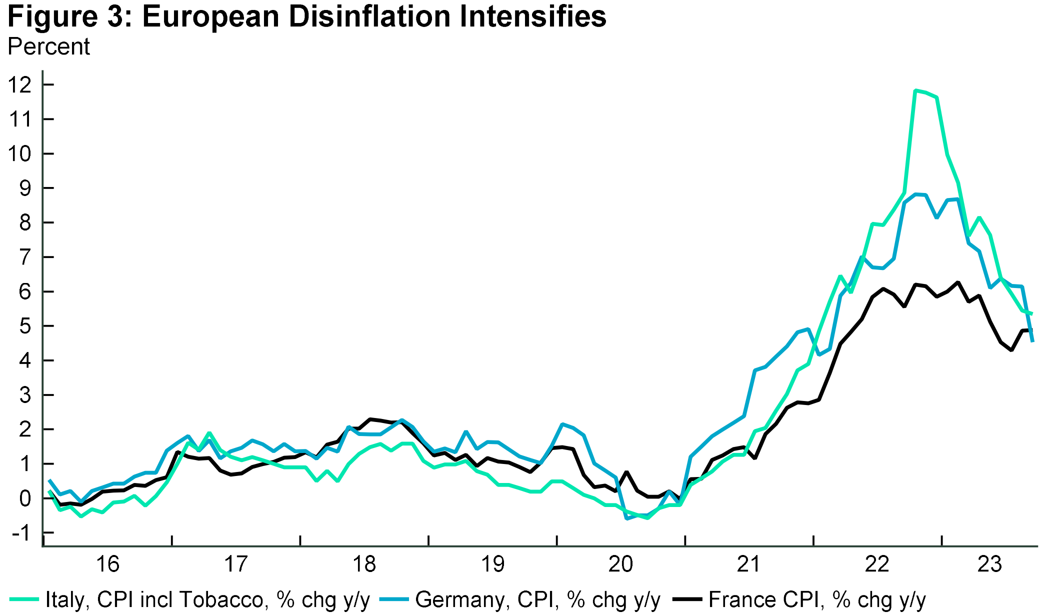


Sources: SSGA Economics, ONS
Updated as of 10/1/2023

Eurozone

We had long held that disinflation in a global trend and that the speed of progress varies across geographies, the direction of travel is similar. The latest inflation releases across key eurozone economies underscore that reality.

Figure 3: European Disinflation Intensifies



Sources: SSGA Economics, INSEE, DESTATIS, Istat

Progress was most visible in Germany, where distortions related to earlier travel subsidies are finally falling out of the base comparison. ***German*** headline **inflation** eased from 6.1% in August to 4.5% y/y in September, the lowest level since February 2022. ***Italian*** inflation inched a tenth lower to 5.3% y/y, while the preliminary ***French*** print for was steady at 4.9% y/y.

Despite moderating inflation, ***German*** **consumer sentiment** remains depressed. The GfK consumer confidence index has been stuck in a very narrow range near -25 for half a year and so far has no signs of improving. In fact, it weakened a little further in October, down 0.9 point to -26.5. This likely reflects a slight erosion in the labor market, where vacancies have declined each and every month since June of 2022. The claimant count **unemployment rate** was unchanged at 5.7%, where it has been since June. This measure may overstate unemployment due to Ukrainian refugees registering for benefits, but the pace of employment gains has slowed recently.

Japan

Price pressures in Tokyo moderated more than expected in September. Seasonally adjusted core **CPI** (excluding fresh food) held steady sequentially, but rose 2.4% y/y, a touch below the consensus and three-tenths lower than in August. Electricity prices led the decline as they fell -25.7% y/y and detracted 90 bps from the headline. These declines largely reflect the moderation in import prices and also, the gasoline subsidies the government extended in August. The BoJ core (excluding fresh food and energy) held up the bargain by ticking up 0.1% m/m, which translated into 3.9% y/y, two-tenths less than in August. The global core (excluding all food and energy, nsa) declined 0.2% m/m but rose 2.4% y/y, two-tenths less than in August.

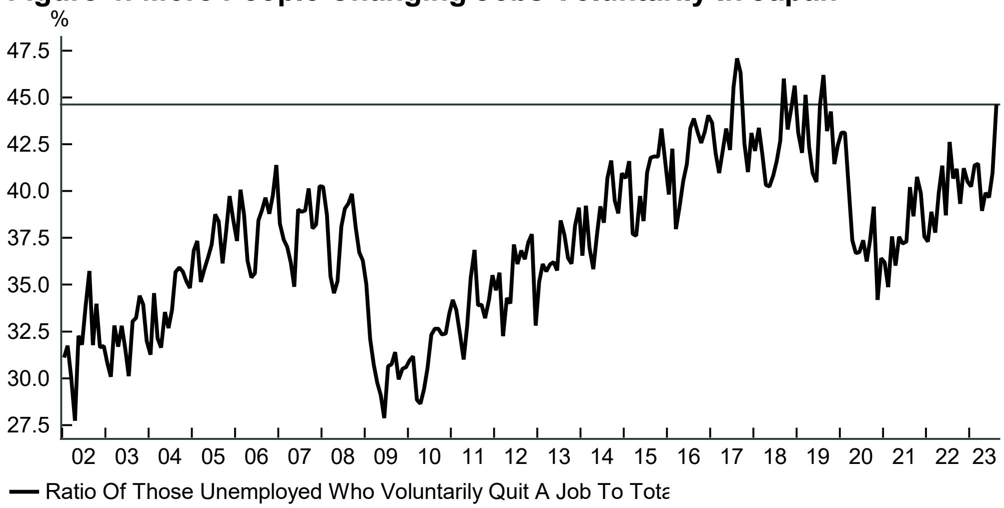
Despite this disinflation, we see price pressures rising in the months ahead, on four reasons. One, energy prices could be volatile; although the government extended electricity subsidies, the magnitude decreased on the margin and could show in October CPI data. Still, eight of the ten major power companies plan on reducing prices in November. Two, and most important for us, price pressure could be spreading to services; a ticket to Tokyo Disneyland will cost 16% more and parcel services of Japan Post will rise 10%. Also, the services PPI in August jumped 2.1% y/y, more than the 1.8% expected.

Three, food price inflation still has strong momentum. From October, the start of the second half of the fiscal, nearly 4500 food items are set to be sold at higher prices. The number is half from last year according to the Teikoku Databank, but still could add to price pressures. We have been tracking fewer restaurant visitors of late, but with the food price gains keeping their momentum, we suspect we could see some upside surprises in the category. And finally, from October again, a new invoicing system nationally aims to collect higher consumption taxes, 10% for most products. And, as the seller requires to invoice these higher taxes to claim credits. Resultingly, we now worry if consumption could slow in the months ahead, which may slow the economy. However, the government is reportedly drawing up a fresh stimulus package that could offer some much-needed relief to Japanese consumers.

Case in point, **consumer confidence** declined for a second month by -1.0 point to 32.2, the lowest level since March. However, inflation expectations for the next year are unchanged with 51.1% participants expecting inflation to rise by 5% or more.

Labor incomes, however, are well supported by a tight **labor market**, as the unemployment rate held steady at 2.7%. Payrolls rose 0.2% m/m, led by personal services. While the recovering services sector is a welcome improvement, the biggest takeaway for us is a higher quits, which marks a change in the cultural thinking that marred the labor market with smaller wage increases. In August, 44.6% of the unemployed people have quit jobs voluntarily in the lookout for higher pay.

Figure 4: More People Changing Jobs Voluntarily In Japan



Sources: SSGA Economics, SBJ, Macrobond
Updated as of 9/29/2023

Separately, **retail sales** remained robust in August and rose 7.0% y/y but, by a smaller magnitude (+0.1%) sequentially. However, the rise is above the market expectations, so there is more momentum in spending than the consensus expected. Tellingly, sales were strong in food (+1.4%), general merchandise (+2.0%) and machinery equipment (+0.9%), while those in autos (-1.9%) declined as a negative payback from July. The balance of data leaves us expecting that the economy is struggling with inflation but, there are pockets of improvements which are not only data related, but also culturally.

Next week we expect the BoJ's September Tankan survey to show an improved sentiment. Otherwise, Governor Ueda's speech on Saturday will be of interest.

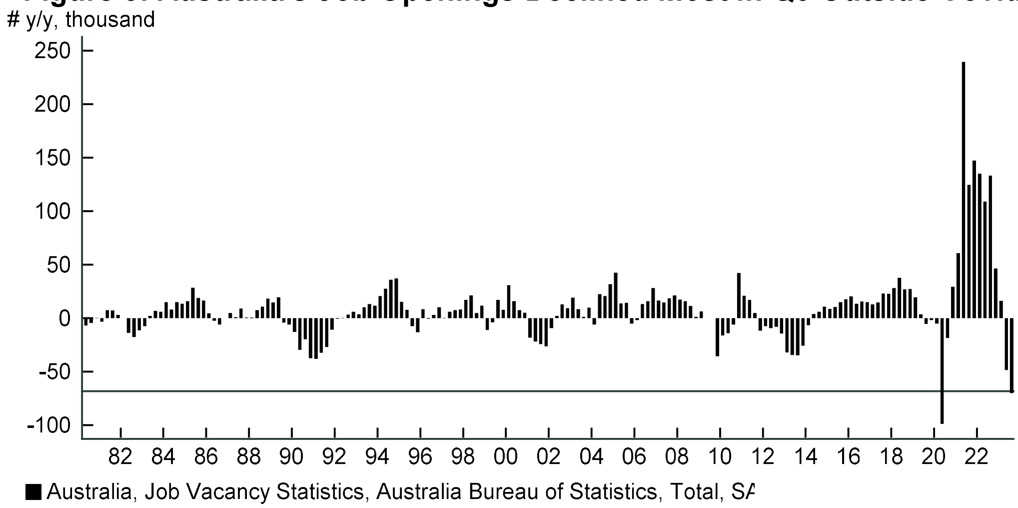
Australia

There is growing data evidence that higher interest rates are indeed working through in Australia, supporting our preference for the peak cash rate target at the current 4.10%. Regular readers will recall our long-standing call that employment is likely cooling more than expectations. Indeed, the ABS showed that **job vacancies** declined 8.9% q/q in Q3 to 390,400, marking the biggest decline as well as the lowest in two years. However, we still see inflation ticking up due to supply constraints and fear they might lead the Reserve Bank of Australia (RBA) into hiking.

Indeed, the **monthly CPI** in August ticked up three-tenths to 0.6% m/m (5.2% y/y), as consensus expected. The rise was caused by higher fuel (+9.1% m/m) and food

(0.9% m/m), while the core metric ticked down three-tenths to 5.5% y/y. However, electricity rebates in Melbourne caused electricity prices to decline 1.3% m/m in August and the ABS noted that such rebates elsewhere could cause downside surprises in the months ahead. Otherwise, rental inflation remained strong at 0.7% m/m and insurance prices also rose 0.7%. Most importantly to us, holiday travel and accommodation prices declined 3.9%, reflecting lower demand.

Figure 5: Australia's Job Openings Declined Most In Q3 Outside Covid



Sources: SSGA Economics, ABS, Macrobond
Updated as of 10/1/2023

Retail sales continued to slow in August as they ticked up “just” 0.2% m/m, a tenth below the consensus. Household goods (-0.5% m/m) led the declines with food sales (-0.3%). However, clothing and footwear (+1.3%) and cafes & restaurants (+0.7%) rose and the ABS noted that spending was boosted by the FIFA Women’s World Cup. Still, the agency’s resumed trend measure rose only 1.3% y/y, the lowest in history (the metric was suspended during Covid).

Next week, we expect the RBA to not hike as data releases in August paint a slowing economy on the balance. However, options for November are still on the table, so we expect a hawkish hold from the RBA next week.

Week in Review (Sep 25 – Sep 29)

Country	Release (Date, format)	Consensus	Actual	Last	Comments
Monday, Sep 25					
GE	IFO Business Climate (Sep)	85.1	85.7	85.8(↑)	Soft.
JN	PPI Services (Aug, y/y)	1.8%	2.1%	1.7%	Re-accelerating?
Tuesday, Sep 26					
US	FHFA House Price Index (Jul, m/m)	0.4%	0.8%	0.4%(↑)	Is there a compositional skew higher?
US	S&P CoreLogic CS 20-City (Jul, m/m, sa)	0.7%	0.9%	0.9%	Is there a compositional skew higher?
US	New Home Sales (Aug, thous)	699	675	739(↑)	Lowest since March.
US	Conf. Board Consumer Confidence (Sep)	105.5	103.0	108.7(↑)	Labor differential quite low.
Wednesday, Sep 27					
US	Durable Goods Orders (Aug, prelim)	-0.4%	0.2%	-5.2%(↑)	Boosted by defense orders.
GE	GfK Consumer Confidence (Oct)	-26.0	-26.5	-25.6(↓)	Soft.
AU	Retail Sales (Aug, m/m)	0.3%	0.2%	0.5%	Modest.
Thursday, Sep 28					
US	GDP Annualized (Q2, q/q)	2.2%	2.1%	2.1%	Household consumption revised lower.
US	Initial Jobless Claims (23-Sep, thous)	215	204	202(↑)	Very low.
US	Continuing Claims (16-Sep, thous)	1,675	1,670	1,658(↓)	Very low.
US	Pending Home Sales (Aug, m/m)	-1.0%	-7.1%	0.5%(↓)	Low, weighed by high mortgage rates.
US	Kansas City Fed Manf. Activity (Sep)	-2	-8.0	0	Soft.
GE	CPI (Sep, y/y, prelim)	4.6%	4.5%	6.1%	Welcome retreat as distortions fade.
IT	Consumer Confidence Index (Sep)	105.5	105.4	106.5	Rolling over?
JN	Jobless Rate (Aug)	2.6%	2.7%	2.7%	Labor market is tight.
JN	Retail Sales (Aug, m/m)	0.5%	0.1%	2.2%(↑)	Moderation after July surge.
JN	Industrial Production (Aug, m/m, prelim)	-0.8%	0.0%	-1.8%	Welcome.
AU	Private Sector Credit (Aug, m/m)	0.3%	0.4%	0.3%	OK.
Friday, Sep 29					
US	Personal Income (Aug)	0.4%	0.4%	0.2%	Driven by wage and salary income.
US	Personal Spending (Aug)	0.4%	0.4%	0.9%(↑)	Real spending only rose 0.1%.
US	U. of Mich. Sentiment (Sep, final)	67.7	68.1	69.5	Inflation expectations still down from August.
UK	GDP (Q2, q/q, final)	0.2% (p)	0.2%	0.3% (↑)	Upward revisions to recent history
UK	Mortgage Approvals (Aug, thous)	48.0	45.4	49.5 (↑)	Weak.
CA	GDP (Jul, m/m)	0.1%	0.0%	-0.2%	Weak.
GE	Retail Sales (Aug, m/m)	0.5%	-1.2%	0.0%(↑)	Weak.
GE	Unemployment Claims Rate (Sep, sa)	5.7%	5.7%	5.7%	OK.
FR	CPI (Sep, y/y, prelim)	5.1%	4.9%	4.9%	Still elevated.
IT	CPI NIC incl. tobacco (Sep, y/y, prelim)	5.4%	5.3%	5.4% (↓)	Still elevated.
IT	Industrial Sales (Jul, m/m)	n/a	-0.4%	0.5%(↑)	Soft.
JN	Annualized Housing Starts (Aug, m)	0.814	0.812	0.778	OK.
JN	Consumer Confidence Index (Sep)	36.2	35.2	36.2	Softening.

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* Pensions & Investments Research Center, as of December 31, 2022.

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