October 6, 2023
Commentary

Weekly Economic Perspectives

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Contact

Simona Mocuta
Chief Economist
simona_mocuta@ssga.com
+1-617-664-1133

Krishna Bhimavarapu
Economist
VenkataVamseaKrishna_Bhimavarapu@ssga.com
+91-806-741-5000

Amy Le
Macro-Investment Strategist
amy_le@ssga.com
+44-203-395-6590

The Economy

Another week of resilient data pushing bond yields higher.

US

Investors have been pushing the 10-year yield notably higher over the last couple of weeks as each positive data surprise is taken as justification for the "higher for longer" narrative. To be sure, there are multiple reasons that could justify the move higher in yields—not least of them investor preferences themselves—but the reported jump in **job openings** in August is not a convincing one.

We had long highlighted low response rates, large revisions, and apparent residual seasonality in this data set. In fact, given the pattern of the last several months, a jump in August was almost to be expected. But if the same pattern holds, this should be followed by material declines over the following three months. Notwithstanding the August openings data, we believe strongly that labor demand is cooling. Tellingly, despite the big 690k increase in openings in August, neither hiring nor quits showed much movement; quits have essentially normalized back to pre-pandemic levels. And when looking at the breakdown by establishment size, there is an increasingly odd divergence between the sub-10 employees and 10-49 employee segments. The latter has weakened significantly, but despite large swings, the former is not far from its recent high. It is hard to explain the divergent pattern. At the end of the day, we suspect the two series converge lower.

As if to underscore the point about softening labor demand, the **ADP report** showed firms added just 89k jobs in September, about half the expected number and the lowest since an outright decline in January 2021. Admittedly, the ADP data has a rather poor track record in predicting the same-month payrolls report, but at the very least, it sent a cautionary signal to offset the JOLTS buoyancy.

The limitations of the ADP report in respect to near-term predictive power for payrolls were indeed glaring this week: while ADP disappointed, the employment report surprised strongly to the upside. That being said, it is difficult to make sense of the **September employment report**. Different components sent conflicting signals so one needs to decide which to view as signal (and the meaning of that signal) and which are likely noise. There is no question that this particular monthly print painted a very robust picture of the US labor market, but it is hard to reconcile that strength with other data suggesting less buoyancy.

The economy added a blockbuster 336,000 jobs in September—almost double expectations—a massive surprise further accentuated by a large 119,000 revision to the prior two months. These are extraordinary numbers at this point in the business cycle, especially given declining job openings and consumer surveys suggesting less abundant jobs availability. We can't deny the data that has been reported, but we can certainly question it. Time will tell how much of September's payroll strength may be revised away or overtaken by softer releases ahead.

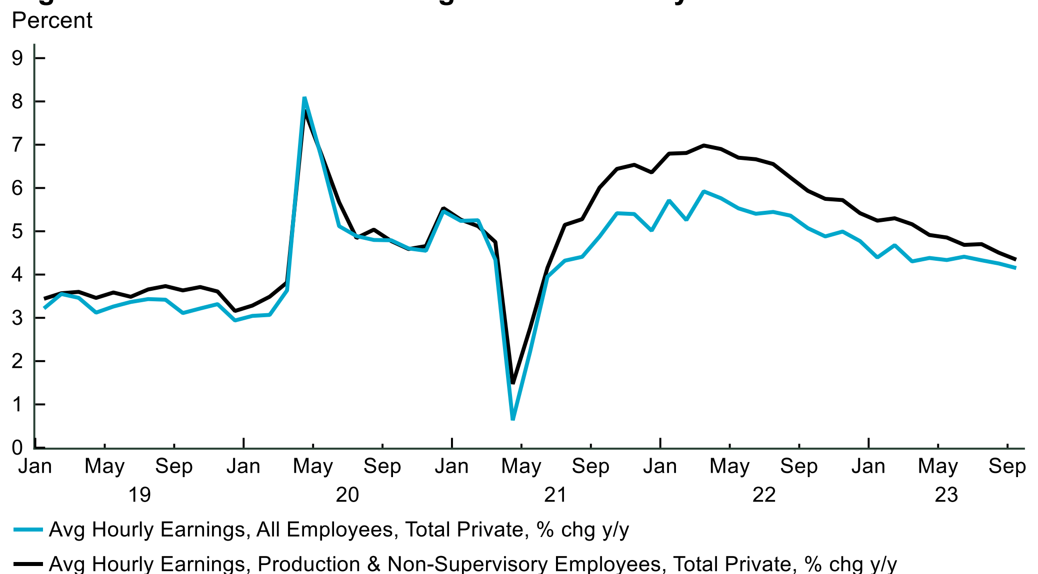
The private sector added 263k jobs, the most since January; 234k of these were service jobs, also the most since January. There was a big resurgence in leisure and hospitality employment, which seems a little suspect. Job growth in this sector had been moderating steadily for months but more than doubled to 96k in September. In fact, this, too, was the largest gain since January and roughly three times the

average that had prevailed between February and August. Hence, we are skeptical about the sustainability of this resurgence, even though this is one of the few sectors that has still not fully returned to pre-Covid employment levels. Gains in trade and transportation also look a little suspect insofar as the last few months have been characterized by offsetting up and down movements (+48k, -48k, +20k, -17k) so we can't take the large 45k gain in September as indicative of a breakout higher. Temporary help declined for the eighth consecutive month.

The household survey painted a far less upbeat picture as employment reportedly increased by just 86k, unemployment was roughly stable, the participation rate unchanged at 62.8%, and the unemployment rate also unchanged at 3.8%. To be fair, should the participation rate ease back following recent gains, the unemployment rate could also inch lower even with slower employment gains ahead. An interesting dynamic to watch for.

The part we liked best was the wage data. We've said this many times in the past: job growth with slower wage inflation is actually a great combination and the exact path to a soft landing. In essence, this is what the September report showed. Average hourly earnings (AHE) rose by a smaller than expected 0.2% m/m, while AHE for production and non-supervisory employees increased 0.4% m/m. These allowed both measures of wage inflation to moderate further, now at 4.2% y/y, and 4.3% y/y, respectively. We do anticipate further—though slower—moderation from here. As that unfolds in coming months, we hope the FOMC take solace from this progress and steps back from the recent hawkish stance. Near-term, though, the policy implications are hawkish: since nothing seems to be breaking, why not hike again, just to take further insurance against persistent inflation? In other words, we hope the Fed is done hiking, and we think they should be done hiking, but worry about one more hike this year.

Figure 1: Moderation In US Wage Inflation Is Key Labor Market Trend



Sources: SSGA Economics, BLS

Manufacturing activity continues to struggle. The **ISM manufacturing index** has now spent the last eleven months in contraction territory, and while September brought about a 1.4-point gain, it still only left the headline at a soft 49.0. On the bright side, production grew for the second consecutive month, and along with it, employment expanded for the first time since May. However, the sustainability of these gains is questionable given the continued contraction in new orders Meanwhile, disinflation signals persist: the prices paid metric relapsed to 43.8, backlogs declined, and delivery times shrank further.

The **non-manufacturing ISM** details for September were mixed. The headline retreated 0.9 point to 53.6, giving back half of its prior month gain. Overall, this is still a solid level indicating continued growth. However, the new orders sub-index plunged 5.7 points to 51.8, the lowest level since December. That December plunged ended up proving anomalous as orders rebounded in subsequent months, so it is too soon to raise the alarm here. Nonetheless, this bears watching. The price metric was unchanged at a still elevated 58.9.

Canada

The Canadian labor market remained strong in September. **Employment** rose larger than expected by 64k (+0.3%) in the month, following August's increase of 40k (+0.2%). The strength was led by a surge in part-time jobs (48k, +1.3%). The unemployment rate was unchanged at 5.5% for the third consecutive month. Wage gains continued to accelerate, with the average hourly wages for permanent employees rose 5.3% y/y, compared with 5.2% in previous month, increasing the chance for another rate hike.

Figure 2: Reaccelerating Canadian Wage Inflation Raises Hike Odds

Sources:SSGA Economics, StatCan

UK

The downturn in manufacturing sector continued in September but its intensity was a little less acute than initially reported. The final reading on the manufacturing PMI was 44.3, up from 39-month low of 43.0 in previous month but still the second-lowest

reading since 2009. Subdued economic outlook and the scaling back in production led to further cuts in employment, purchases, and inventories. Input costs continued to fall quickly while average selling prices rose for the first time in four months.

The services sector contracted for the second consecutive month, with the final reading at 49.3, down from 49.5 in August. New work and business activity continued to decline as consumer spending weakened. Export sales fell for the first time since November 2022, led by lower demand from Europe. Meanwhile, employment declined for the first time in just over two-and-a half years, at the steepest pace since the start of 2021. Input price inflation rate eased to the lowest since April 2021 while the rate of increase in prices charged was the weakest in 29 months.

Eurozone

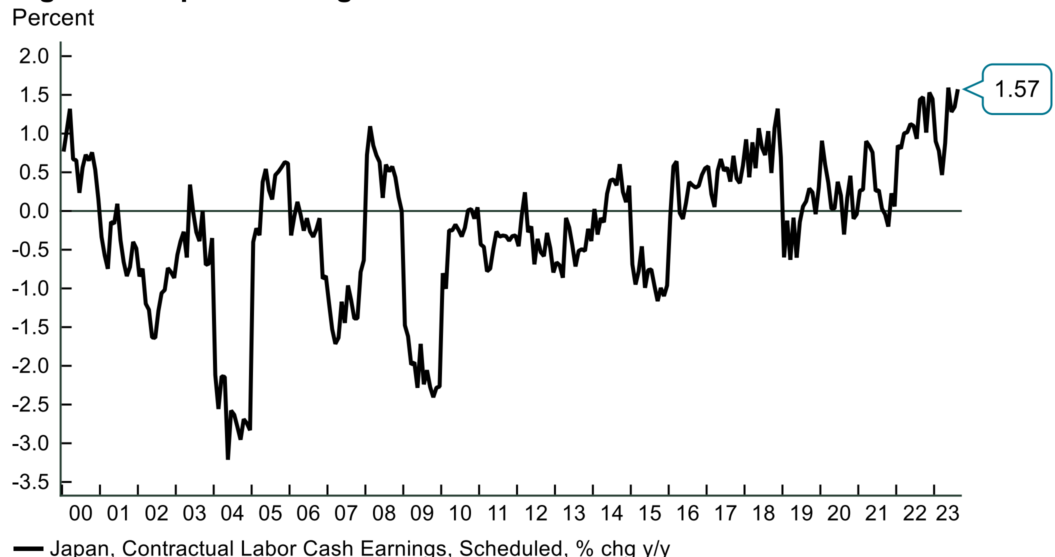
***German* industrial orders** rebounded 3.9% in August, but this follows a double-digit setback in July and still left orders down 4.4% y/y. In fact, aside from June 2023, orders have been consistently declining on a y/y basis since March 2022. This reflects the huge energy-driven hit to German industrial competitiveness following the Ukraine war. The situation remains highly challenging, although there are some incipient signs that the country is slowing rebuilding that competitiveness. The healing process will take years, however; in the meantime, Germany's economic outlook remains rather gloomy despite strong household balance sheets.

The ***Italian*** labor market has reached a bit of a milestone as the **unemployment rate** dropped to its lowest level since January 2009 (7.28%) in August. Despite this, retail sales relapsed 0.4% m/m and stand just 2.4% higher y/y.

Japan

At first glance, Japanese wage inflation has softened, but a closer analysis indicates that the underlying trend remains robust.

Figure 3: Japanese Wage Growth Ex-Bonuses Quite Elevated



Sources: Macrobond, SSGA Economics, MHLW
Updated as of 10/6/2023

Overall labor cash earnings grew just 1.1% y/y in August, unchanged from July's downwardly revised reading. This, however, reflected a 5.4% y/y decline in bonus payments, the first since January 2023 and the largest since January 2021. Admittedly, weaker bonuses could portent slower pay growth in general, but it is notable that the more stable scheduled cash earnings rose 1.6% y/y.

Australia

The **Reserve Bank of Australia (RBA)** chose to keep the cash rate steady at 4.1% once again as it continues to assess incoming data. Unsurprisingly, there were parts of the accompanying statement that leaned dovish and others that had a more hawkish tone. For instance, the assessment that "recent data are consistent with inflation returning to the 2–3 per cent target range over the forecast period and with output and employment continuing to grow" indicates a degree of comfort with the current policy settings. At the same time, "there are significant uncertainties around the outlook" and "some further tightening of monetary policy may be required to ensure that inflation returns to target in a reasonable timeframe". The statement stressed that this "determination will depend on incoming data", which does not seem to imply an imminent move higher. That being said, we do expect that the RBA will do a little more to ensure the inflation downtrend is sustained.

Week in Review (Oct 2 – Oct 6)

Country	Release (Date, format)	Consensus	Actual	Last	Comments
Monday, October 2					
US	ISM Manufacturing (Sep)	47.8	49.0	47.8	Softness persists but moderates.
UK	Nationwide House PX (Sep, m/m)	-0.4%	0.0%	-0.4%	Down 5.3% y/y.
UK	Manufacturing PMI (Sep, final)	44.2	44.3	43.0	Weak.
IT	Manufacturing PMI (Sep)	45.8	46.8	45.8	Weak.
IT	Unemployment Rate (Aug)	7.7%	7.3%	7.5% (↓)	Lowest since 2009!
GE	Manufacturing PMI (Sep, final)	39.8	39.6	39.1	Extremely weak.
FR	Manufacturing PMI (Sep, final)	43.6	44.2	46.0	Very weak.
EC	Manufacturing PMI (Sep, final)	43.4	43.4	43.5	Very weak.
AU	RBA Cash Rate Target	4.10%	4.1%	4.10%	Data dependent and watchful.
Tuesday, October 3					
US	JOLTS Job Openings (Aug, k)	8,900	9,610	8,920 (↑)	Odd rebound.
US	Wards Total Vehicle Sales (Sep, m)	15.4	15.67	15.0	Moving in tight range.
Wednesday, October 4					
US	Factory Orders (Aug)	0.2%	1.2%	-2.1%	Rebound in non-durable goods.
US	Durable Goods Orders (Aug, final)	n/a	0.1%	0.2%	Up 3.0% y/y.
US	ISM Services Index (Sep)	53.5	53.6	54.5	OK.
UK	Services PMI (Sep, final)	47.2	49.3	49.5	Weak.
GE	Services PMI (Sep, final)	49.8	50.3	47.3	Weak.
EC	Services PMI (Sep, final)	48.4	48.7	47.9	Weak.
Thursday, October 5					
US	Trade Balance (Aug, $bn)	-65.2	-58.3	-65.0	Real deficit also shrank, will support Q3 GDP.
US	Initial Jobless Claims (30-Sep, thous)	210	207	205(↑)	Extremely low.
US	Continuing Claims (23-Sep, thous)	1,671	1,664	1,665(↓)	Extremely low.
FR	Industrial Production (Aug, m/m)	-0.4%	-0.3%	0.5%(↓)	Soft.
JN	Labor Cash Earnings (Aug, y/y)	1.5%	1.1%	1.1%(↓)	Bonuses decline but underlying growth better.
Friday, October 6					
US	Change in Nonfarm Payrolls (Sep, thous)	165	336	227(↑)	Remarkably and surprisingly strong.
US	Unemployment Rate (Sep)	3.7%	3.8%	3.8%	Household survey was much softer.
US	Consumer Credit (Aug, $bn)	11.3	-15.6	10.4	Student loan prepayments.
CA	Unemployment Rate (Sep)	5.6%	5.5%	5.5%	Remained strong.
GE	Factory Orders (Aug, m/m)	1.5%	3.9%	-11.3%(↑)	Still weak.
IT	Retail Sales (Aug, m/m)	0.0%	-0.4%	0.4%	Still weak.
JN	Leading Index CI (Aug, prelim)	109.1	109.5	108.2	Trying to bottom.

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* Pensions & Investments Research Center, as of December 31, 2021.

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Netherlands: State Street Global Advisors Netherlands, Apollo Building 7th floor, Herikerbergweg 29, 1101 CN Amsterdam, Netherlands. T: +31 20 7181 000. State Street Global Advisors Netherlands is a branch office of State Street Global Advisors Europe Limited, registered in Ireland with company number 49934, authorised and regulated by the Central Bank of Ireland, and whose registered office is at 78 Sir John Rogerson's Quay, Dublin 2.

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Canada: State Street Global Advisors, Ltd., 1981 McGill College Avenue, Suite 500 , Montreal, Qc, H3A 3A8, T: +514 282 2400 and 30 Adelaide Street East Suite 800, Toronto, Ontario M5C 3G6. T: +647 775 5900.

United States: State Street Global Advisors, 1 Iron Street, Boston, MA 02210-1641.

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