STATE STREET GLOBAL ADVISORS

October 27, 2023
Commentary

Weekly Economic Perspectives

Contents

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The Economy

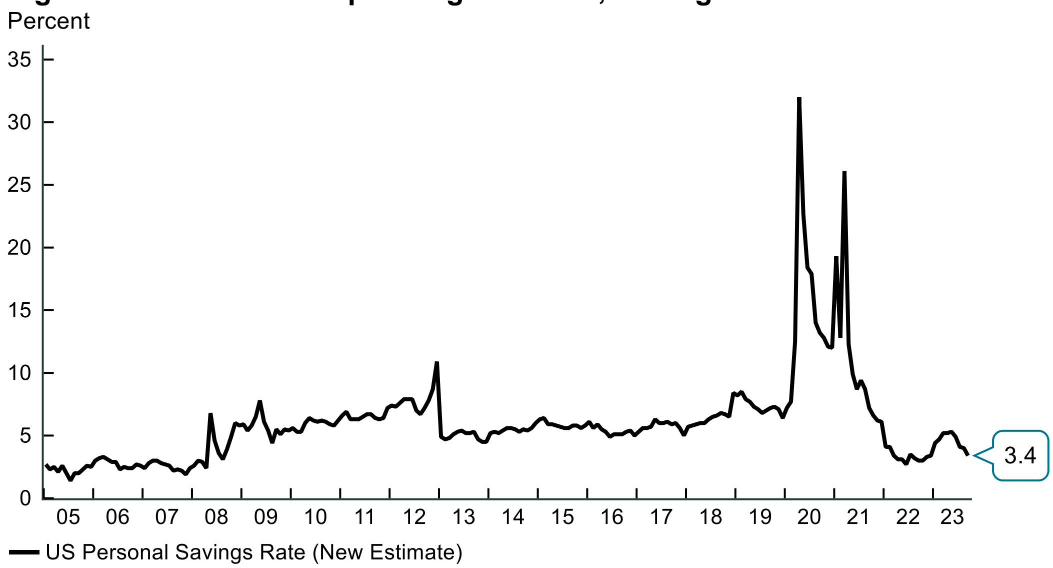
US growth outperformance highlighted by surging third-quarter GDP growth.

US

Real GDP growth surged to 4.9% saar (seasonally adjusted annualized) in the third quarter, managing to exceed even the already elevated consensus expectations leading up to the release. No such outcome would have been possible without consumption doing the heavy lifting. Indeed, household consumption jumped 4.0% saar, on across-the-board gains. Goods spending has exhibited a see-saw pattern this year, with weak quarters followed by surges. Q3 was definitely a surge quarter, with goods spending soaring at a 4.8% saar rate; services spending also jumped 3.6% saar, the best showing since the summer of 2021! All in all household consumption added 2.7 percentage points (ppts) to growth. Inventories were the second largest contributor, adding 1.3 ppts. Fixed investment itself was a little subdued even as residential investment grew incrementally for the first time in two and a half years. Non-residential investment was flat as structures investment growth slowed sharply and equipment investment declined. Government spending added 0.8 ppt to growth and trade subtracted 0.1 ppt. Third quarter real GDP was up 2.9% y/y, bringing the year-to-date increase to 2.3% y/y.

The seemingly inexhaustible American consumer brings to mind the Energizer bunny, but the excess savings battery is starting to run a little low. With nominal **income** up 0.3% m/m in September but **spending** up 0.7%, the personal savings rate dropped 0.6 percentage points (ppt) to 3.4%, the lowest since last November. Real disposable income declined 0.1% for the second consecutive month. Real spending jumped 0.4%, contributing to the impressive surge in consumer spending evident in the Q3 GDP data.

Figure 1: US Personal Spending Resilient, Savings Rate Not So Much



Sources: Macrobond, SSGA Economics, BEA, U.S. Census Bureau
Updated as of 10/29/2023

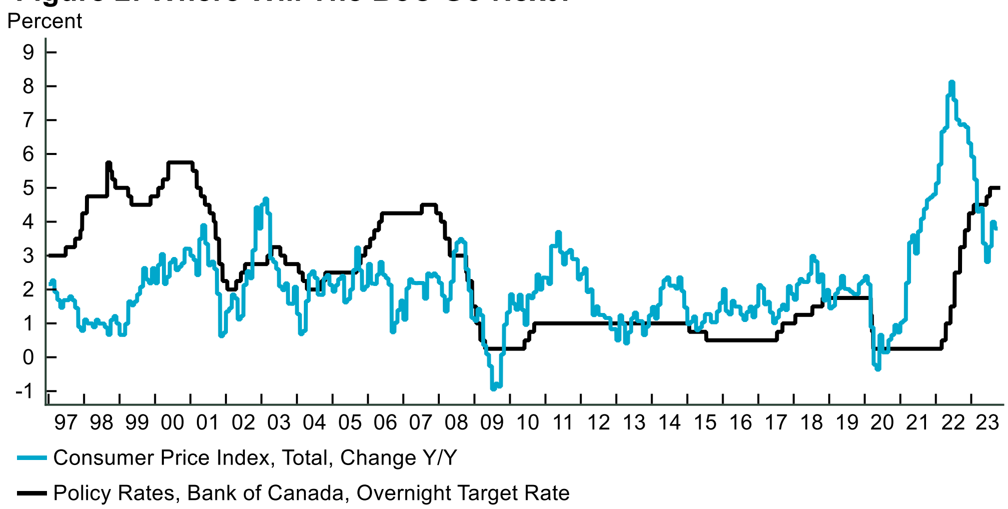
The **PCE inflation** data came in largely as expected. Admittedly, the headline PCE prices increased 0.4% m/m, a tenth faster than expected, but a downward revision to prior data left the y/y inflation measure at 3.4% y/y, just as expected. Core PCE prices increased 0.3% and the core PCE inflation rate moderated a tenth to 3.7% y/y.

While existing home sales remain constrained by the black of inventory, **new home sales** have repeatedly bested expectations in recent months. They did so again in September, when they surged 12.3% m/m—the most in over a year. That being said, a similar increase had originally been reported in May and was subsequently revised to less than half that growth rate. Irrespective of revision risks, however, there is no debating that the new home segment is doing relatively better as builders have some degree of flexibility in respect to tweaking offering to shift towards lower price points in order to accommodate surging mortgage interest rates. Indeed, the median price was 12.3% lower than in September 2023.

Canada

As widely expected, the Bank of Canada (BoC) left its **policy rate** unchanged at 5.0% after softer September CPI data last week. The bank acknowledged growing evidence of weaker economic momentum, reflecting effects of past interest rate increases, but they also noted that "inflation risks have increased".

Figure 2: Where Will The BoC Go Next?



Sources: Macrobond, SSGA Economics, BoC, StatCan
Updated as of 10/29/2023

Indeed, the BoC highlighted that "demand and supply in the economy are now approaching balance" with subdued consumption and weaker business investment. GDP is forecasted to grow by 1.2% this year, 0.9% in 2024 and 2.5% in 2025. Meanwhile, inflation risks have risen with higher oil prices and increasing geopolitical uncertainty. Headline CPI Inflation have moderated recently but inflation in rent and other housing costs remains high. In addition, there was little improvement in core inflation measures. As such, in the latest projection, near-term inflation is expected to be higher than in July forecast although it returns to target about the same time. CPI inflation is projected to be average about 3.5% through mid-2024 before gradually easing to 2% in 2025. Given ongoing persistence in core inflation and high wage pressures, the BoC is still leaving the door open to further hikes.

UK

The downturn in private sector continued in October although the rate of decline was modest. Flash readings of **manufacturing PMI** edged up to 3-month high of 45.2, from 44.3 in previous month but remained well below the threshold of 50. Manufacturing output decreased for the eighth consecutive month, the longest period of contraction since the GFC. Meanwhile, services PMI decreased by one-tenth to 9-month low of 49.2. New work declined modestly, reflecting lower global demand. Backlogs of work also fell, leading to lower employment for the second month running. The only upside is that cost pressures continued easing although selling price inflation for services remained elevated.

Eurozone

After the September ECB meeting, we wrote that the Governing Council hoped to be done hiking. Following the October 26 meeting, we were indirectly told not only they hope but also think they are done since "he Governing Council considers that the key ECB interest rates are at levels that, maintained for a sufficiently long duration, will make a substantial contribution" towards brining inflation back to target. As such, while inflation will still be too high for too long, the burned of proof has now shifted: only if it will prove to be higher for longer than already expected may additional hikes be needed. We side with the Governing Council in believing that enough tightening has already been delivered. As such, the main refinancing operations , the marginal lending facility, and the deposit facility rate have likely peaked at 4.50%, 4.75% and 4.00%, respectively.

Japan

Two important views in markets concerning Japan are now consensus; one, that policy rates globally have nearly peaked; and, two, that global yields still are slated to remain higher for longer, on higher term premia and issuances.

These views challenge the Bank of Japan's (BoJ) resolve in maintaining ultra-easy monetary policy and yet, control the 10y JGB yield through their Yield Curve Control (YCC) policy. The gargantuan policy divergence between Japan and the US has also weakened the yen. As such, the yield hit a fresh high of 0.888% and the yen slid to 150.777 this week. The Bank trialed market pressures under ex-governor Kuroda's leadership, and it resulted in a 0.74% m/m average monthly rise in the BoJ's JGB holdings since 2022 during his term. Excluding the 1.12% decline in March 2023, it would have been 0.87%. However, due to less market pressures, better communication and proactiveness, JGB assets had risen just 0.16% since governor Ueda's term began in April.

In that respect, the BoJ's policy dilemma has a simple solution: a less easy monetary policy, allowing the 10y JGB yield to climb gradually. Hence, we expect the Bank to raise the YCC target to 0.5%/1.0% with a ± 100 bp/± 50 bp tolerance next week, so that the fixed rate bond buying could be become 1.5% effectively, versus the current

1.0%. For us, the risk case is for the policy to be lifted from -0.1% to 0.0%, as it could help stabilize the yen and ease inflation more effectively. While the consensus expects this to happen in early 2024, we cannot rule it out next week, especially after positive news on 2024 *shunto* wage negotiations. Nonetheless, the BoJ could stay pat as consensus expects, in which case we think market pressures could increase.

Another important consensus view is on the return of inflation in Japan; this view was challenged last month when the key core CPI measures moderated on slowing goods prices. These doubts were quelled by a strong October **Tokyo CPI** print this week on accelerating services prices, our long standing forecast.

In the details, the headline jumped 1.0% m/m or 3.3% y/y (2.8% previous) on the back of stronger services CPI, which rose 0.4% m/m or 2.1% y/y. The all-important BoJ core (excluding fresh food and energy) rose 0.4% m/m and held steady at 3.8% y/y. Food prices (excluding fresh food) which helped lift inflation initially, rose 7.4%, a touch below its 9.0% peak in July. However, a sharp jump in hotel prices (+42.9% m/m) due to strong base effects as well as the cessation of travel discounts started in October last year. The base effects will continue till March 2024, adding price pressures. On the other hand, energy prices reaccelerated sequentially (7.4% m/m) but, declined annually. These base effects will peter out by February and contribute to inflation. Hence, inflation certainly will be elevated next year.

Next week, other than the BoJ meeting, we will also learn about the government's comprehensive economic plan, most of which will help ease the rising cost of living. Households are expected to get tax cuts and an extension of energy subsidies and the government will also be focusing on sustaining the wage growth momentum in small and regional firms. Finally, the labor market and retail sales data for September are expected to come in strong.

Australia

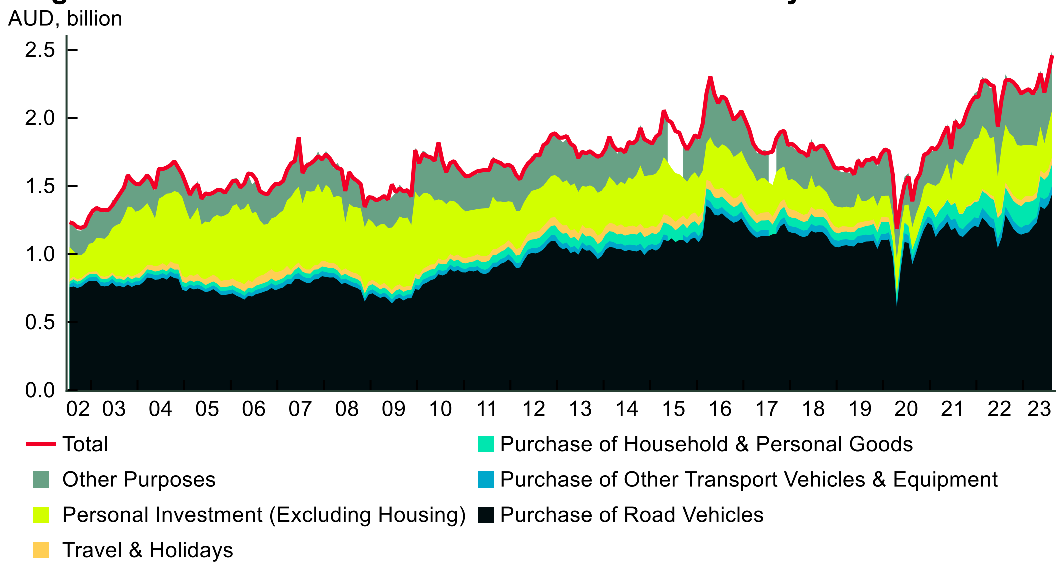
Inflation reaccelerated in Q3, not only more than the consensus but also, in more categories than we expected, allowing leeway for the Reserve Bank of Australia (RBA) to hike in November. Market pricing had showed an 80% probability when governor Michelle Bullock expressed 'low tolerance' on inflation after CPI, but eased to 50% after she downplayed the possibility three days later before the Senate Economics Legislation Committee.

Although we expect the RBA to hike, these dynamics complicate the decision. All this means that the focus now turns to next week's data releases, which may not offer much clarity. The consensus expects retail sales in September to rise 0.3%, and the Q3 retail volumes data on Friday to decline 0.2%. There is a good chance of volumes declining more than expected, which if happens, the RBA could hold off the hiking.

In the details, the headline CPI rose 1.2% q/q (5.4% y/y), exceeding consensus by a tenth, and also above Q2's 0.8%. The trimmed mean metric also rose 1.2% q/q, after an upwardly revised 1.0% in Q2. However, for us the biggest surprise came in the breadth of the increase, as g 57.4% of the basket reaccelerated sequentially. The transport category is the perfect example, whose prices rose 3.2% q/q on the back of a 7.2% jump in fuel prices. However, all sub-categories of the transport group ticked up including motor vehicles, whose prices rose 3.2% q/q.

Our research uncovered interesting dynamics; while the much feared 'fixed rate mortgage cliff' proved elusive so far, fixed term personal financing has been rising and now accounts for 64.5% of personal financing. While fixed term mortgages rose 2.2% m/m in August, personal loans jumped 6.1% and reached an all-time high of A$ 2.5 billion. The catch here is that 'purchase of road vehicles' make up 60% of this rise. So, no wonder transportation prices were a key driver of inflation in Q3.

Figure 3: Fixed Term Aussie Personal Loans Driven By Motor Vehicles



Sources: SSGA Economics, ABS, RBA, Macrobond
Updated as of 10/29/2023

Another major surprise was higher communications prices (2.1%), which rose due to a 1.9% jump in internet and mobile plans, the largest sequential rise since 2000! Furthermore, housing prices also increased 2.2% q/q, on higher rents (2.2%), new home dwelling costs (1.3%), which reaccelerated three-tenths from Q2 and utilities (3.6%). Otherwise, alcohol prices (1.3%) rose on the bi-annual hike in excise duty and tobacco prices (1.7%) rose on the new 5% annual excise indexation. Insurance and financial services prices (1.4%) also jumped on higher insurance prices (2.8%), which were well flagged otherwise. Finally, fruit and vegetable prices (-3.7%) offset higher meals out and takeaway foods (2.1%), which rose on higher minimum and award wages. Higher prices in a few categories due to higher award and minimum wages sure will raise eyebrows during the RBA meeting on November 7th.

On the balance, the reacceleration in CPI is concerning, and the RBA may hike in November, but will need some confirming from retail sales next week. Finally, next week will offer some interesting geopolitical developments as Prime Minister Anthony Albanese will travel to China, the first visit from a PM since 2016. We expect some positive developments.

Week in Review (Oct 23 – Oct 27)

Country	Release (Date, format)	Consensus	Actual	Last	Comments
Monday, Oct 23					
JN	Manufacturing PMI (Oct, prelim)	na	48.5	48.5	Good resilience.
Tuesday, Oct 24					
UK	Manufacturing PMI (Oct, prelim)	44.7	45.2	44.3	Weak.
UK	Services PMI (Oct, prelim)	49.3	49.2	49.3	Weak.
EC	Manufacturing PMI (Oct, prelim)	43.7	43.0	43.7	Very weak.
EC	Services PMI (Oct, prelim)	48.6	47.8	48.7	Soft.
EC	Composite PMI (Oct, prelim)	47.4	46.5	47.2	Soft.
GE	GfK Consumer Confidence (Nov)	-27.0	-28.1	-26.7 (↓)	Weak.
GE	Manufacturing PMI (Oct, prelim)	40.1	40.7	39.6	Very weak.
GE	Services PMI (Oct, prelim)	50.0	48.0	50.3	Soft.
FR	Manufacturing PMI (Oct, prelim)	44.5	42.6	44.2	Very weak.
AU	CPI Trimmed Mean (Q3, y/y)	5.0%	5.2%	5.9%	Broad based rise, RBA on alert.
Wednesday, Oct 25					
US	New Home Sales (Sep, thous)	680.0	759.0	676.0 (↑)	Median prices down 12.3% y/y help clear market.
CA	Bank of Canada Rate Decision (Oct 25)	5.0%	5.0%	5.0%	As expected.
GE	IFO Business Climate (Oct)	86.0	86.9	85.8 (↑)	Soft, trying to tentatively bottom.
JN	Leading Index CI (Aug, final)	109.5 (p)	109.2	108.2	Still, good improvement.
JN	PPI Services (Sep, y/y)	2.0%	2.1%	2.1%	Price pressures remain elevated.
Thursday, Oct 26					
US	GDP (Q3, q/q, saar, adv)	4.5%	4.9%	2.1%	Consumption surge.
US	Durable Goods Orders (Sep, m/m, prelim)	1.9%	4.7%	-0.1%(↓)	Non-defense aircraft orders nearly doubled.
US	Initial Jobless Claims (Oct 21, thous)	207	210	200(↑)	Very low.
US	Continuing Claims (Oct 14, thous)	1,740	1,790	1,727(↓)	Very low.
US	Pending Home Sales (Sep, m/m)	-2.0%	1.1%	-7.1%	Modest pick-up.
EC	ECB Main Refinancing Rate (Oct 26)	4.50%	4.5%	4.50%	Watchfully on hold.
Friday, Oct 27					
US	Personal Income (Sep, m/m)	0.4%	0.3%	0.4%	Real disposable income declined 0.1% m/m.
US	Personal Spending (Sep, m/m)	0.5%	0.7%	0.4%	Savings rate declined six tenths to 3.4%.
US	U. Of Mich. Sentiment (Oct, final)	63.0	63.8	63.0	Inflation expectations jumped.
FR	Consumer Confidence (Oct)	82	84	83	Still very weak historically.
IT	Consumer Confidence Index (Oct)	105.2	101.6	105.4	Sizable pullback.
IT	Manufacturing Confidence (Oct)	96.0	96.0	96.4	Persistent descent.
IT	Industrial Sales (Aug, m/m)	n/a	-0.4%	-0.5%(↓)	Soft.

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- Build from breadth
- Invest as stewards
- Invent the future

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

† This figure is presented as of June 30, 2023, and includes approximately $63 billion of assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated. Please note all AUM is unaudited.

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