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Commentary

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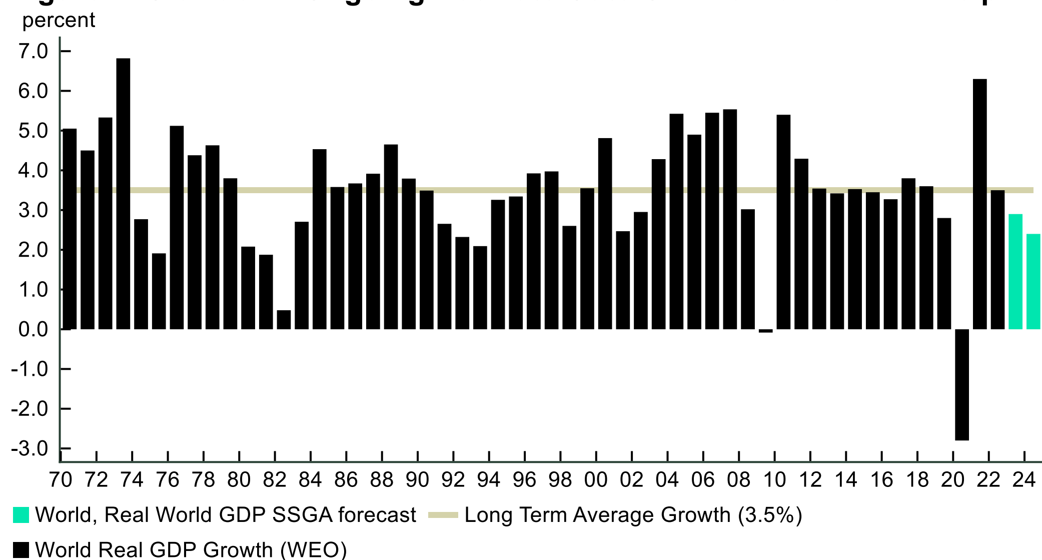
Global Macro Highlights

We approach the end of a very turbulent 2023 on a cautiously optimistic note as (with a few exceptions, such as the BoJ) developed market central banks have come to the end of the tightening cycle and are now signaling that some relief on rates is not too far off. We had long argued that monetary policy nimbleness and a willingness to calibrate rates lower once progress on inflation permits was critical to maintaining a path to a soft landing. As recently as three months ago, that willingness was still in question, but no more. At their December meetings, the Fed and the ECB both signaled in no uncertain terms that, barring truly unexpected events, the next more in rates would be lower. While domestic conditions will dictate the pace at which other DM central banks can join the bandwagon, the direction of travel will be the same for all. In 2023 we described the global disinflation trend as a “different speeds, same direction” phenomenon. The 2024 global monetary easing cycle can be thought of in the same way.

This will not magically solve all challenges but helps put a floor under the ongoing global slowdown and reduce downside risks. Timing remains important and the soft landing is by no means guaranteed. However, the odds of achieving it have improved following the latest developments. The global growth forecasts have been almost unchanged this past quarter, with global growth a tenth better this year and a tenth lower in 2024. US projections have been upgraded again while eurozone estimates have been lowered incrementally. China looks better this year but 2024 is unchanged.

Geopolitical events will be key to watch over the course of 2024. With the US going into an election year, a lot of drama seems assured. Fiscal issues are poised to be central to the debate though meaningful action is a 2025 and later scenario. This is one reason why the outlook for 2025 is quite murky and not very sanguine. But that’s perhaps too far out into the future to worry about right now. For now, let’s enjoy the benefits of the long-awaited monetary policy pivot.

Figure 1: Slowdown Ongoing But Rate Cuts On The Horizon Will Help



Sources: Macrobond, SSGA Economics, IMF World Economic Outlook
Updated as of 12/14/2023

Summary of World Output[1] and Inflation[2]

(Annual percent change)

	Weight	History					Forecast	
	(2022)	2018	2019	2020	2021	2022	2023	2024
World Growth	100.0	3.6	2.8	-2.8	6.3	3.5	2.9	2.4
Advanced Economies	41.7	2.3	1.7	-4.2	5.6	2.6	1.5	1.2
US	15.5	3.0	2.5	-2.2	5.8	1.9	2.4	1.4
Euro area	12.2	1.8	1.6	-6.3	5.3	3.5	0.6	0.9
Germany	3.3	1.0	1.1	-4.2	3.1	1.9	-0.2	0.8
France	2.3	1.8	1.9	-7.7	6.4	2.5	0.8	1.0
Italy	1.9	0.8	0.5	-9.0	7.0	3.8	0.9	0.9
Japan	3.7	0.6	-0.4	-4.3	2.2	1.0	1.9	1.0
UK	2.3	1.7	1.6	-11.0	7.6	4.1	0.4	0.8
Canada	1.4	2.8	1.9	-5.1	5.0	3.4	1.1	1.0
Australia	1.0	2.8	1.9	-1.8	5.2	3.7	2.1	1.6
Developing Economies	58.3	4.6	3.6	-1.8	6.9	4.1	3.8	3.2
China	18.4	6.7	6.0	2.2	8.4	3.0	5.1	4.4
Advanced Economy Inflation	41.7	2.0	1.4	0.7	3.1	7.3	5.1	2.8
US	15.5	2.4	1.8	1.3	4.7	8.0	4.1	2.5
Euro area	12.2	1.8	1.2	0.3	2.6	8.4	5.4	2.4
Germany	3.3	1.8	1.4	0.5	3.1	6.9	6.0	2.0
France	2.3	1.9	1.1	0.5	1.7	5.2	4.9	2.5
Italy	1.9	1.2	0.6	-0.1	1.9	8.2	5.8	2.3
Japan	3.7	1.0	0.5	0.0	-0.3	2.5	3.3	2.6
UK	2.3	2.5	1.8	0.9	2.6	9.1	7.4	2.9
Canada	1.4	2.2	2.0	0.7	3.4	6.8	3.9	2.5
Australia	1.0	1.9	1.6	0.9	2.9	6.6	5.7	3.7
Developing Economies	58.3	5.0	5.1	5.1	5.9	9.8	7.5	4.7
China	18.4	2.1	2.9	2.4	0.9	2.0	0.2	1.0
Value of World Output ($ trl)								
At Market Exchange Rates		86.1	87.3	85.0	96.5	100.1	109.3	115.6
At Purchasing Power Parities		129.9	135.8	133.5	148.2	163.8	178.4	188.8

[1] Real GDP; [2] Consumer Price Inflation
Weight is the share of world GDP on a purchasing power parity basis (IMF *World Economic Outlook)*
Historical data sources: Oxford Economics, IMF. Forecast: SSGA Global Macro and Policy Research

Politics and Geopolitics

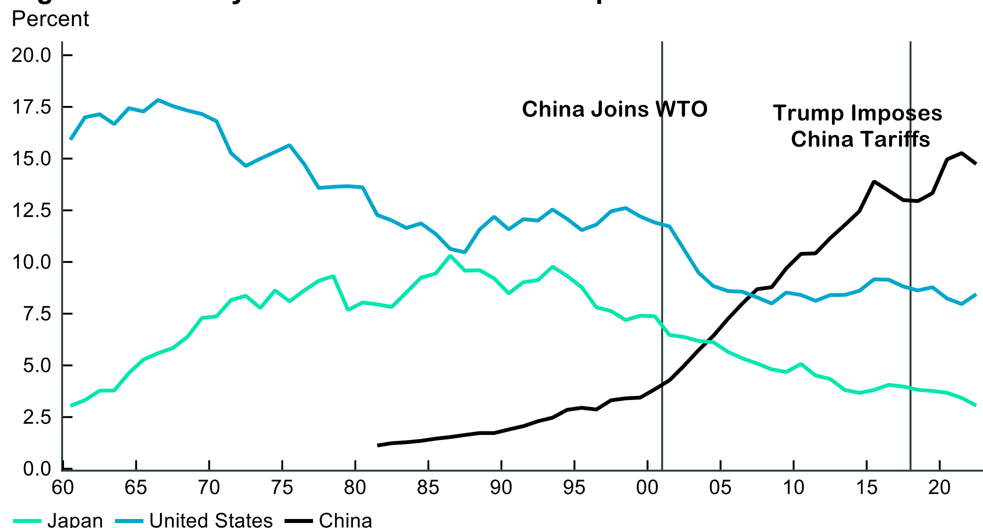
China's Balance of Payments Matter More Than Ever

China's property sector troubles pose limited financial spillover risks but have eviscerated a core source of growth. The property-led drop in capital investment now requires China to pursue structural reforms to create alternatives of domestic demand. Failing that, the economy will need to rely on external demand just to help sustain moderate growth rates.

This is similar to how the country navigated previous downturns. However, this model for growth and crisis response is increasingly running out of steam. China has simply become too big to rely on export-led growth without triggering a pushback from major trade partners. Trade with China has become a sensitive political issue, particularly now that China's export mix is increasingly driven by higher value-added goods. Although export-led growth is a tempting fallback for Chinese policymakers, continuing to rely on it is fraught with political and economic risk. In simple terms, China's major trade partners are not ready for even more Chinese exports. Not only do they exacerbate the political tensions between China and developed economies, any counter-measures its partners take would dampen the positive growth effect that China hopes to achieve.

To illustrate the magnitude of China's weight relative to its historical past, Fig. 1. shows China's goods exports as a percentage of total world exports from 1980, which is roughly the beginning of China's integration into the world economy. By the time China entered the WTO in 2001, China was already an established exporter, although its share of global trade was still relatively low. It was in the years that followed that it became an export powerhouse, and Chinese trade became a controversial point in Western industrial politics. On the back of pandemic-induced domestic weakness (fewer imports) and stimulus-supported foreign demand, China's net goods surplus has only risen further, reaching an all-time high as a share of global trade in 2022. This is not sustainable, and continued rise will coincide with further geopolitical turbulences.

Figure 2: Country Share of World Goods Exports



Sources: Macrobond, SSGA Economics, IMF
Updated as of 12/15/2023

To be clear, China's growing clout in trade is not a side effect of flagging domestic demand, but rather a deliberate policy choice by the Chinese government. The government has in recent years invested in industries that stimulate exports, but has not balanced that with efforts that stimulate domestic demand for imports. This applies not only to goods but also services, with Chinese outbound tourism only reaching half of pre-pandemic levels. The more recent monetary easing in response to weakness in the property sector has added to the trend, as it has reduced exporters' cost of funding.

The targeted support for industries reflects its desire to take a leading role in technologies that are expected to drive the energy transition to a lower carbon world. In particular, China now dominates in the supply chains of solar cells or electric vehicle batteries. But this dominance is not cost-free. Given the centrality of low carbon technology in economic planning, this is triggering China's trade partners to activate a countervailing industrial policy not only to protect domestic industry and workers, but also for national security reasons. Indeed, the threat in areas such as electric vehicles pose an existential challenge to economies in Central Europe. In other words, trade tensions are likely to worsen as a result.

In September, the European Commission announced a probe into Chinese subsidies of electric vehicles. This is a harbinger of future measures, either in the form of explicit tariffs or other penalties aimed at protecting domestic producers. As we witnessed with US tariffs in 2018, cost pressures on exporters can be offset by currency depreciation so trade wars could easily morph into currency wars as well. And given the global geopolitical environment, severe economic imbalances in one of the largest economies of the world could have greater consequences than just trade relations.

Investment Implications

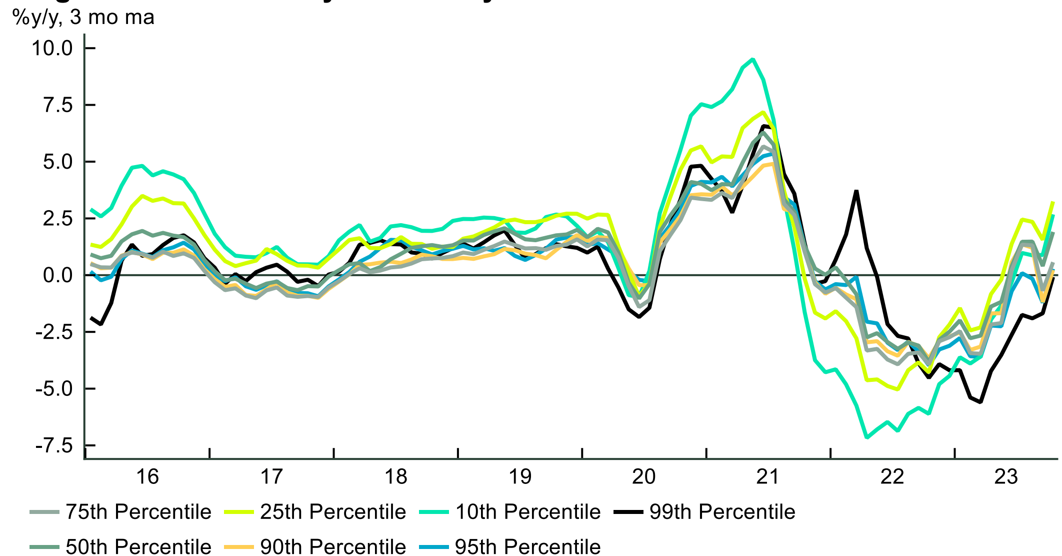
Reliance on external demand implies continued support to the export sector, i.e., further building excess capacity. This is inherently deflationary , both in the broader sense that this growth model is running out of steam and in the specific sense that excess production may end up on global markets at a discount. This should support lower bond yields in China. In turn, this should weaken the real effective exchange rate, especially as a lack of domestic investment opportunities keeps capital outflow pressure high. And any increase in trade tensions is likely to push the RMB lower as a direct mitigator of any measures over the medium term.

Demographics

UK: Will Strong Pay Growth Help Income Inequality?

Income inequality in the UK is significantly higher than in most other developed countries and it has been on the rise post-covid. The problem has been exacerbated by high inflation as real pay, based on ONS Pay As You Earn Real Time Information, has fallen by 7.2% y/y in April 2022 for households in the lowest 10% of the income distribution. Also in 2022, income inequality (measured as Gini coefficient) increased by 1.3 ppts to a three-year high of 35.7%, largely driven by disposable income declines among the fifth poorest households. In particular, median disposable income for the poorest fifth of the population decreased by 3.8% in financial year ending 2022, whereas median disposable income rose by 1.6% for the richest fifth of people. According to the ONS, other measures of income inequality have also risen to highest levels over the 10-year period ending in 2022. There are also growing differences within the UK, with the income gap between London and the rest of the UK at a record high.

Figure 3: UK Real Pay Growth By Income Distribution



Sources: Macrobond, SSGA Economics, ONS
Updated as of 12/17/2023

How can recent strong wage growth help?

Recent strong wage growth has not been evenly distributed across income groups (Figure 3). Since the onset of the pandemic, real pay declined 0.1% per annum for the bottom 10th percentile of earners, despite a reopening-driven pay spike. The 75th and 90th percentile groups saw the sharpest contraction in real wage at -0.3% y/y. In contrast, the 25th percentile saw real pay rise 0.5% per annum.

The national minimum wage has been raised multiple times to help soften the effect of rising cost of living on low-income earners. Looking ahead, the tight labor market and further increases in national minimum wages are expected to increase earnings for the lower-paid workers. Combined with disinflation, this should help narrow income inequality.

Country Macro Highlights

Please see country-specific commentary in the sections below.

US: Just In The Nick Of Time

We are becoming more hopeful again on the macro outlook and that's not just the general mood boost around the holidays. It is a direct response to the Fed's meaningful dovish pivot at the December meeting. As readers of this publication will recall, the hawkish September meeting had us worried about whether "the soft landing can survive the Fed." We wrote back then that "for our part, we continue to believe that sustained, broadening, progress on inflation, will allow the Fed to calibrate rates lower more meaningfully over the course of 2024. However, we fully acknowledge that the latest dot plot has widened the gap between what the FOMC signals it intends to do and what we believe it "should" do next year. The implicit message in the dot plot is that unless something "breaks" in the economy, the Committee is disinclined to pre-emptively calibrate policy rates lower merely on account of better inflation data. We believe that would be a mistake. Over-confidence in the soft landing scenario actually endangers the odds of the soft landing remaining soft."

We are glad to see that, despite the trials and tribulations of the intervening period, the improvement in inflation readings has now gathered enough critical mass to allow the FOMC to forgo a final hike this year and signal three (rather than two previously) cuts in 2024. We still believe there will be more, but it will take time and additional data evidence for the Committee to align with our forecasts. The market, on the other hand, is already there, pricing 150 bp worth of Fed cuts in 2024. As a baseline scenario, this seems the right number. We may get more if the economy slides into recession (a lesser likelihood now), or fewer if yet another wave of data resilience manifests.

A critically important point around the rate cuts is the rationale behind them. The 150 bp that are in our forecast are delivered because the Fed ***can*** (because of lower inflation), not because it ***has to*** (because of sharply lower growth). Better inflation allows the Fed to calibrate policy lower before something in the economy breaks and they are forced into larger cuts. It is a good and preferred pathway as it implies policymakers retaining control and guiding the economy to a soft landing.

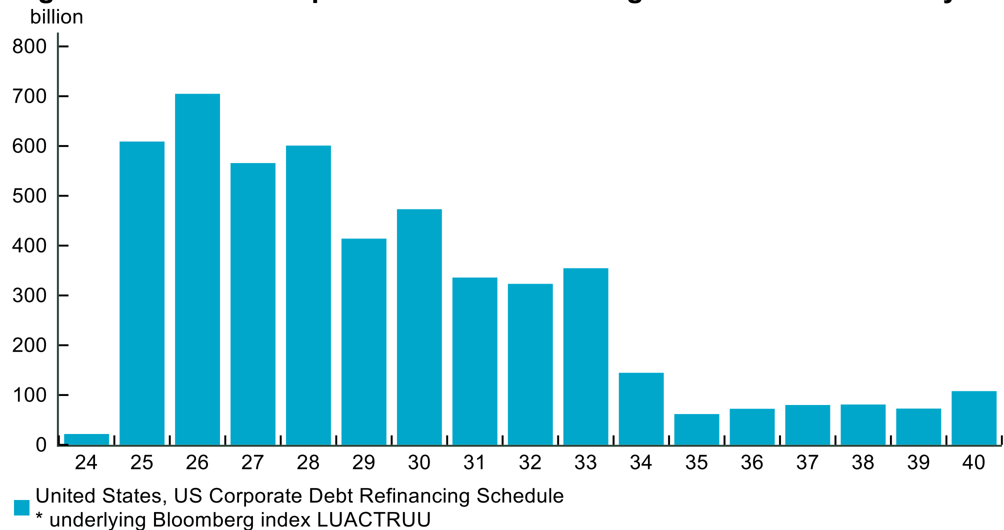
Recession odds have diminished in the near term because the recent repricing of rates helps put a firmer bottom in residential fixed investment, alleviates credit and refinancing costs, slows the accumulation of delinquencies, and extends the labor market runway relative to a more hawkish Fed scenario. Additionally, while very fluid, ongoing budget conversations do not suggest much fiscal restraint at all in the FY2024 budget. However, with elections out of the way and the debt ceiling back onto the scene in early 2025, it would be a mistake to interpret the more benign 2024 risk profile as signaling only blue skies ahead. We may be dodging a recession in 2024, but risks actually increase in 2025. Still, that's far out enough that we'll take the market's cue and ponder that worry at a later time.

As to the specifics, growth projections were upgraded again, up four and three tenths to 2.4% and 1.4%, respectively, for 2023 and 2024. Much of this reflects the puzzlingly strong third quarter GDP print, which, at 5.2% seasonally adjusted annual rate (saar) was the best since late 2021. A surge in consumer spending and

a big inventory buildup accounted for the bulk of its, but neither are sustainable. As such, we'd view the third quarter outcome as more noise than signal vis-à-vis the future direction of the economy.

With the personal savings rate below 4.0%, the resumption of student loan repayments, and COLA (cost of living adjustments) to social security benefits much less generous in 2024 than in the prior two years, we find it hard to believe that consumer spending can sustain its recent growth rate. Admittedly, consumers have enjoyed a powerful boost from the intense disinflation experienced since the summer of 2022; going from over 9.0% CPI inflation to slightly over 3.0% has been a boon for real incomes. However, that tailwind is already fading since the next phase in the disinflation journey will be less about magnitude and more about rotation from headline to core. For consumer spending, it is headline disinflation that matters. A slowdown in consumption therefore seem like a perfectly reasonable expectation, even absent meaningful labor market deterioration.

Figure 4: US 2025 Corporate Debt Refinancing "Wall" Is A 2024 Worry



Sources: Macrobond, SSGA Economics, Bloomberg
Updated as of 12/17/2023

Speaking of the labor market, the FOMC has maintained an impressively upbeat forecast for the unemployment rate, seeing it peak at just 4.1% in 2024 and remaining there in 2025. We suspect that it will go higher than that—and that could well be the Fed's excuse for cutting more next year than they are currently signaling. Our thinking rests on overwhelming evidence of slowing labor demand, seen not only in the moderating pace of hiring but also in job openings, business surveys, and consumers' own perceptions about the degree of labor market tightness. What is more of a wildcard is the behavior of labor supply. All else equal, an argument could be made that merely the aging of the population would continue to exert downward pressure on the participation rate and so put downward pressure on unemployment rate even at the same level of labor demand. However, we suspect we will see some improvement in labor supply, partly as a delayed response to rising migration flows, and partly due to a return to the labor market by some workers in the older age groups. As Covid concerns fade and as COLA adjustments to social security benefits slow markedly, diminished savings may

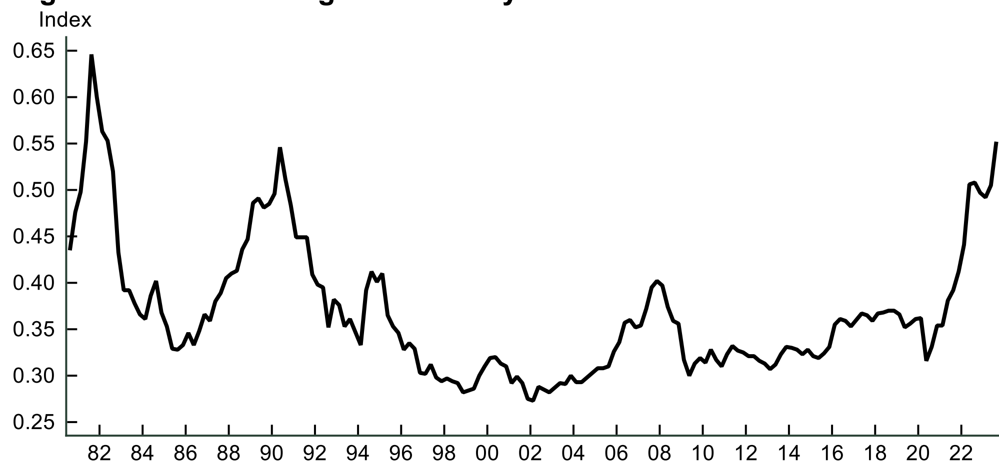
push some people back into the labor market. We aren't expecting any huge influx, but we do expect an improvement. And so, the unemployment rate is probably closer to 4.5% than 4.0% at the end of 2024, which also means that the Fed's dual mandate becomes dual again. After nearly two years when risk management for the FOMC meant exclusively fighting inflation, the Fed will start paying more attention to the labor market and other macro risks such as the 2025 corporate refinancing wall (Figure 3, page 7).

Canada: Inevitable Slowdown

The economy remains on course to avoid technical recession but real GDP growth is expected to slow further in coming quarters. This round, we upgraded our 2023 growth estimates by 0.2 percentage points to 1.1%, and expect 1.0% growth for next year (up 0.4 percentage points from September).

Following a modest expansion in Q2, the economic activity deteriorated faster than expected in Q3. Part of the weakness was driven by forest fires and drought conditions, in addition to interest rate hikes. Exports and slower inventory accumulation were the biggest detractors to growth. Business fixed investment also fell 2.0%, as the decline in non-residential structures, machinery and equipment offset gains in resident investment. Meanwhile, total consumption jumped 2.1%, with large boost from the government spending. Household spending remained unchanged from Q2 as the decline in goods offset the higher spending on services.

Figure 5: BoC Housing Affordability Index



Sources: Macrobond, SSGA Economics, BoC
Updated as of 16/12/2023

Housing activities slowed sharply. High borrowing costs continue to weigh on home sales and push housing affordability to its lowest since 1982 (Figure 4, page 8). On the other hand, housing starts are still well above the pre-pandemic level on a trend basis. However, given lower home sales and higher interest rates, housing starts are likely to trend lower in the next few months.

The labor market showed further signs of easing in November, with the unemployment rate up 0.8 percentage points to 5.8% since the start of 2023. Part

of the increase was due to the higher labor force participation rate, which was driven by increased migration, but employment gains have also slowed sharply over the past few quarters. The job market is likely to remain sluggish in the next few months given weaker domestic demand. Coupled with the increasing labor force, we expect the unemployment rate to rise further to 6.2% on average next year. Meanwhile, wage gains remain elevated, with the average hourly wages for permanent employees up by 5.0% y/y in November.

Headline CPI moderated to 3.1% y/y in October from a 3.8% y/y in previous month, one touch above the BoC inflation-control range of 1-3 %. The slowdown was driven mainly by lower gasoline prices . Goods inflation continues to ease while services inflation remains sticky. Core inflation measures showed further improvement, falling for the second consecutive month. Given the ongoing deterioration in consumer spending and weaker labor market condition, we expect inflation to keep slowing down in the coming quarters.

The Bank of Canada (BoC) left its overnight rate unchanged at 5.0% in its December meeting. However, given persistently high services inflation, the BoC will likely need to see further progress on that and core inflation before it feels confident that inflation is consistently returning to the 2% target. As such, the BoC is likely to sit on the sidelines for the next few months while maintaining a cautious rhetoric. Given the softening in both domestic and external data, 2024 should bring a full percentage point worth of cuts for the whole year.

UK: Tightening Policy Bites

While the revised data showed the economy has recovered faster than previously thought, growth will remain fragile in 2024. This round, we downgraded the 2024 real GDP growth forecast by 0.3 ppts to 0.8% and slightly upgraded the 2023 inflation estimate (up two tenths to 7.4%).

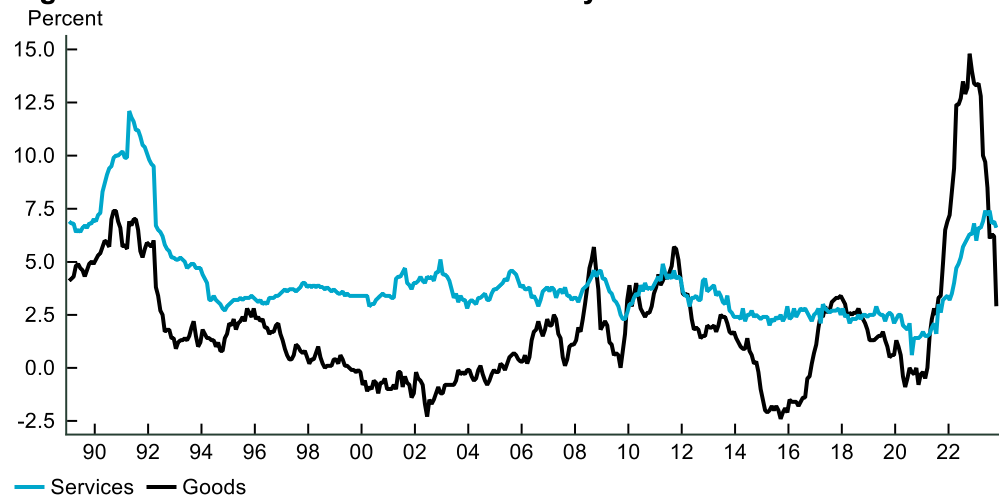
Q3 GDP growth remained virtually flat following a modest expansion in the previous quarter. Higher borrowing costs continued to depress household consumption and business investment. Household consumption contracted during the quarter while weakness in the housing market led to the fourth consecutive decline in residential investment. Further signs of weaker consumer spending have become more apparent. Retail sales volumes declined by 0.3% in October following a contraction of 1.1% in the previous month. GfK consumer confidence had risen again in December, but remained at historically low level.

Meanwhile, the increase in the flash composite activity PMI, from 50.7 in November to 51.7 in December, indicated that the economy is likely to dodge recession in Q4. The rebound was entirely driven by a moderate upturn in services activity, with flash reading of services PMI registering at 6-month high of 52.7 in December, up from 50.9 in previous month. The UK manufacturing sector downturn continued weakening, as flash readings of manufacturing PMI posted 46.4, down from 47.2 in November. Trade remains under pressure, with both imports and exports projected to be down sharply for the rest of the year and next year due to soft global demand and the continuing impact of Brexit. Given the subdued global economic outlook and slow inflation descent, we expect the economy to flatline in Q4, leading to overall growth of 0.4% for the year. As for 2024, downside risks have risen, but we

still expect GDP growth of 0.8% given the moderating inflation and strong wage growth.

Perhaps, the best news since our last update was that both headline and core inflation have significantly decelerated. Headline inflation fell sharply by 2.1 percentage points to 4.6% in October, below both the BoE (4.8%) and market expectations. The fall in core inflation was also larger than expected, from 6.1% y/y to 5.7% y/y. While most of the improvement was driven by lower goods prices, services price pressures have also diminished. Going forward, we expect disinflation trend to continue, albeit at a more gradual pace and see headline print to average at 7.4% this year and 2.9% next year.

Figure 6: UK Inflation Will Ease Gradually



Sources: Macrobond, SSGA Economics, ONS
Updated as of 16/12/2023

The labor market also showed further signs of cooling. Vacancies continue to downtrend while the unemployment rate picked up markedly to 4.2% during August to October, from its low at 3.5%. Given our expectations for softer growth, further labor market easing is likely. Wage growth is also finally starting to show signs of slowing. Annual private sector regular average weekly earnings growth was 7.3% in the three months to October, compared to 8.1% in the three months to July and 7.8% in BoE November Report. We expect that lower headline CPI and ongoing labor market conditions will lower wage pressures further in the next few months.

A tight labor market coupled with expansionary fiscal policy means that monetary policy will need to remain restrictive for longer to get the inflation rate back to the 2% target. However, in their December meeting, the Bank of England (BoE) downplayed the effect of recent fiscal announcement on the policy stance. The BoE also decided to leave the Bank rate at 5.25% for the third consecutive time as expected. As such, we think the current market pricing of 100 basis points worth of cuts in 2024 seems reasonable. Currently, we expect the BoE will start rate cuts in August but if markets prove right with the Fed and ECB moving in either Q1 or Q2 2024, we wouldn't rule out the BoE moving earlier too.

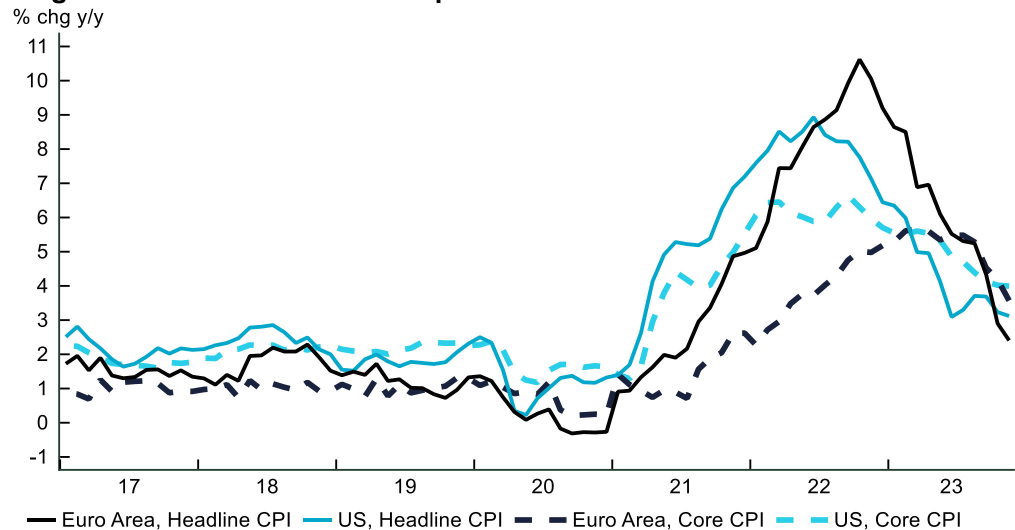
Eurozone: Walking The (Tight) Line

Having made no changes whatsoever to our eurozone forecasts in September, we tweaked them at the margin this time around. 2023 growth estimates were reduced by a tenth to 0.6%, with 2024 projections down two tenths to 0.9%.

With these changes, we remain modestly above consensus. We still do not have a formal recession in the forecast, but these projections are far from genuinely upbeat. While we retain the view that eurozone macro resilience is insufficiently appreciated by investors, the region will battle meaningful fiscal headwinds and an approaching corporate refinancing wall over the year ahead. On the plus side, the drastic disinflation of the last few months speaks favorably to rising real disposable incomes and the record low unemployment rate suggest a tighter labor market than even in the United States. Moreover, given the rigidities associated with European labor markets, we suspect any possible uptick in the unemployment rate will be extremely slow and shallow. With elevated excess savings and household net worth, the European consumers have the money. They just don't have the confidence. Our expectation is that confidence returns as inflation gets closer to target and interest rates begin to decline. That could spur a mild pickup in consumption and lift GDP growth modestly.

The improvement in inflation has been quite remarkable. It is hard to believe that even as recently as 3-4 months ago there was broad skepticism towards the idea that the eurozone would join the US in earnest along the disinflation path. And yet, both headline and core inflation are now lower in the eurozone than in the US!

Figure 7: Eurozone Catches Up On Disinflation



Sources: Macrobond, SSGA Economics, BLS, Eurostat
Updated as of 16/12/2023

Still, we should recognize that the speed of this improvement is somewhat artificial (linked to distortions introduced in changes to energy subsidies over time) and progress will slow markedly from here on (and even reverse temporarily). It is with this in mind, and also with an eye to elevated wage inflation that we see market pricing of ECB cuts as a little too aggressive at the moment. Rather than the 150 bp worth of cuts envisioned by the market, we think 100 is a more reasonable

expectation. It is, of course, possible that we'd get more, but given our no recession baseline, we are more comfortable with the more conservative profile.

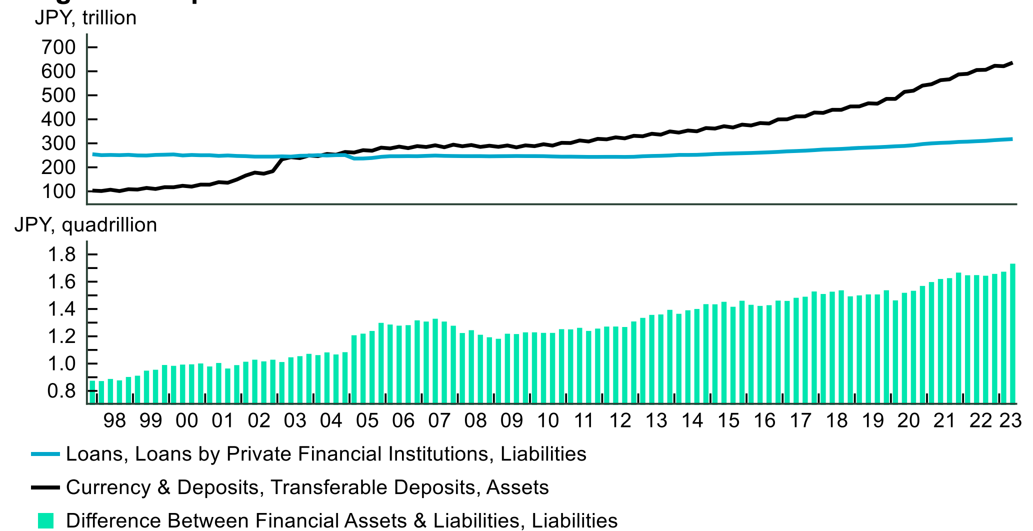
Japan: No Time Like The Present

The time has come for bold policy action in Japan, as the Bank of Japan (BoJ) vies against a narrowing window to normalize monetary policy. There is increasing evidence suggesting that not only should policy normalize, but that the time is now ripe for it. We have four reasons why:

1, More confidence on wage growth & inflation
2, Households will benefit from exiting NIRP
3, Disinflation and wage growth will further help consumption & GDP in 2024
4, The US Fed's earlier than expected easing in 2024 narrows the window for BoJ

The cost of negative or zero interest is a perpetually deferred household consumption. The difference between household assets and liabilities is a whooping 1.7 quadrillion yen! The 636.01 trillion yen held as 'transferable deposits' is twice the loans taken. Clearly, households will benefit from higher interest rates as they are likely to earn more income than pay in interest. **So, household consumption, which dragged growth in Q3 by -2.9% q/q saar, would benefit overall by higher interest rates.**

Figure 8: Japanese Households Have More Assets Than Liabilities



Sources: SSGA Economics, BOJ, Macrobond
Updated as of 16/12/2023

However, government borrowing could become expensive, as the cost of their capital will rise. Furthermore, it will also complicate the BoJ's profits & balance sheet management, as their JGB holdings will lose value. So, how will government finances be managed? Will you believe us if we tell you that the BoJ has an idea?

In this paper released after deputy governor Himino's speech, the BoJ discussed how its balance-sheet and profits could evolve if interest rates were to rise and has

interesting insights. The average residual maturity of the BoJ's holdings is the lowest among major central banks at 6.6 years as of March 2023 (Fed - 8.8). Furthermore, by 2028, 416 trillion yen or 56.6% JGB holdings will mature. In order to moderate the contraction of assets and also to minimize losses, the Bank will have to reinvest the majority of its maturing proceeds, depending on the circumstances. Hence, **the Bank has enough dry powder to cater for a reasonable JGB supply**. Furthermore, the BoJ too amortizes the losses on the JGB securities it holds to maturity, like the Fed. Still, if losses were to arise, the bank had provisions of 6 trillion yen.

On timing, we stick with our earlier forecast for December, next week, for two reasons: one, the Fed made a major dovish pivot and markets may expect more cuts increasingly. And moving in December would also help transit in low volatility. As a risk case, we still think January as the other option; it will help the BoJ to move before widespread expectations of an easing cycle take grip globally. We will be surprised if the first rate move would not come by January.

We are left with the impression that in Japan, short-term interest rates will rise gradually while the long end steepens in 2024. Hence, we think the policy rate on excess savings will rise from -0.10% to +0.10% in 2024. We expect the BoJ to allow sufficient time to decipher how the economy transitions.

Inflation & wages:

Average inflation is set to ease to 2.6% in 2024, from 3.3% this year as food and import price inflation eases. However, services inflation should gain momentum. The government recently announced tax incentives to organizations that raise wages by 7% or more by designating nearly 35% of the wage increases to be deductible from corporate taxes, provided the companies also qualify for credits related to childcare support. Hence, we expect the *shunto* wage negotiations to yield a wage growth of 4.5% or above in 2024.

Growth:

The most crucial aspect for 2024 is that the combination of disinflation, higher wage growth and higher interest income for households will keep the powder dry for households. Indeed, a virtuous price-wage cycle is taking shape. We also expect important tailwinds to households from interest income in the event of higher short-term interest rates. Hence, household consumption could average 1.0% y/y in 2024, just as in 2023. We expect capex to slow to 1.0%, down seven tenths from 2023. Exports may rise 3.8%, below their historic average of 4.4%. All this could mean that GDP could rise 1.0% y/y in 2023.

Risks and conclusion:

As in 2023, the main risk for Japan is from outside Japan. If economic growth in the advanced economies slows sharply, it could potentially stall growth and the normalization process. Furthermore, household consumption needs some support as we have written. Nonetheless, the economic mood is quite strong, and Japan is in a great place to normalize its monetary policy in 2024. As such, business conditions improved for the third quarter this week; manufacturing DI rose to 12 while non-manufacturing DI rose to 30, a 32-year high.

Will there ever be a better time?

Australia:
On Pins & Needles

The Australian economy will remain in a straightjacket of higher for longer (than elsewhere) interest rates in 2024. Inflation will grow slightly below 1.0% q/q, eventually averaging 3.7% y/y in 2024. This will prevent the Reserve Bank of Australia (RBA) from cutting interest rates to the extent other central banks might.

Growth:

Household consumption will average just 0.25% y/y in 2024, way below the historical average of 3.4%. However, it could revert upward in the second half, on moderating inflation and the implementation of Stage 3 income tax cuts, that will be implemented from July 2024 and also, potentially interest rate cuts. As such, the business conditions from the NAB Business Survey declined to the lowest from 2012 to -9.0 in November. Most notable are the declines in consumer facing sectors such as retail, whose conditions index declined a massive 16 points to a historic low outside Covid.

Furthermore, there is potentially another tailwind: fiscal stimulus; as the government now projects a deficit of just A$ 1.1 billion in FY 2023-24, down from A$ 13.9 billion on better tax receipts, that are expected to rise by A$ 65 billion over the next four years. The size of fiscal support will depend on how cost of living evolves; nonetheless, the government could surprise to the upside due to their conservative commodity price assumptions and also because the Federal elections are scheduled for in 2025. The Stage-3 income tax cuts, announced in 2019, will be implemented from July 2024. The Parliamentary Budget Office estimates that these tax cuts will cost the exchequer A$ 20 billion in FY 2024 and A$ 313.1 billion over the next decade, which means households will be better off. Furthermore, population growth has been consistently surprising to the upside, which means consumption may be better than we anticipate. However, inbound migration will slow going forward as the government takes appropriate measures.

Productivity could also rise (as it is usually stationary & mean reverts) going forward as the hours worked could be coming off their recent highs. Year to date, in 2023 hours worked rose 2.5% and are inversely proportional to productivity. So, over time, high unit labor costs will subside. Despite the two side risks to consumption, we expect it to slow as we suspect consumers would want to **restock savings**. The savings rate declined from nearly 20.0% to 3.2% recently.

The dark horse in our growth forecast is capex, specifically non-residential capex. This is primarily because of better mining capex outlook and also, an elevated public engineering orderbook, backed by road and rail construction works in the pipeline. Residential investment could remain subdued for some time till there will be clarity on interest rate cuts.

Finally, goods exports have the potential to slow more than imports as the global economy slows; however, inbound tourism still has not risen to pre-pandemic levels and could add important basis points to growth. All this means that growth could average just 1.6% y/y.

Labor market:

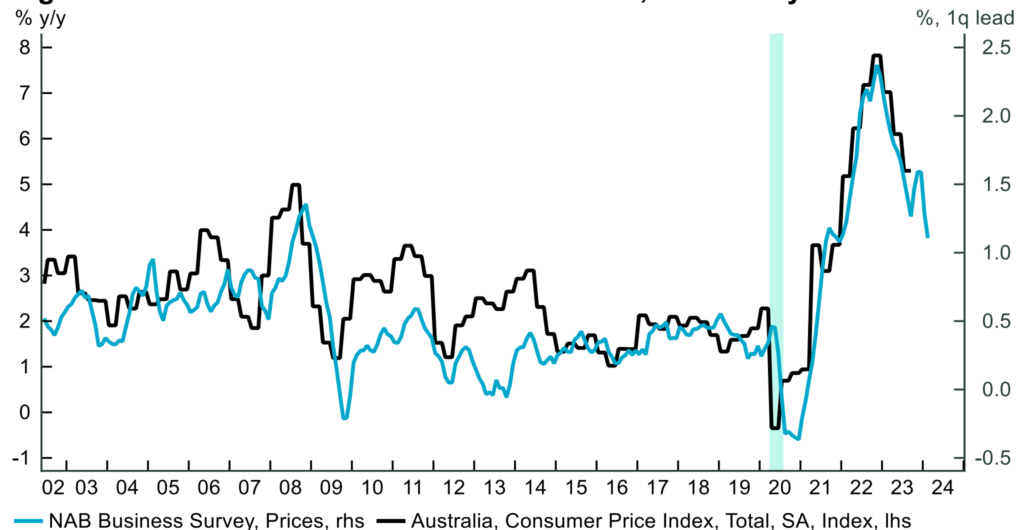
Our conviction in a cooling labor market increased after the release of November employment data. Unemployment rate increased to 3.9% and is now four-tenths above the cycle lows. However, employment growth of 61.5k was way stronger

than the consensus of 11.5k, which can be explained by participation rate of 67.2%, which is another high and also, strong population growth of 48.2k. Full-time employment rose 57.0k for the first time in months caused the bulk of this rise, against our view. This is the 13th month since full-time employment peaked, and our analysis suggests that the cycle starts to show some resilience from now on. However, the hours worked declined -1.4% y/y and is one of the weakest prints post-Covid. Leading indicators such as job openings, advertisements have been normalizing and we still believe the labor market is cooling. Resultingly, the unemployment rate could rise to 4.5% by the end of 2024.

Inflation:

Price pressures have been easing quite modestly in Australia compared to other advanced economies. However, we expect sizeable disinflation in goods, while the adjustment in services could be more protracted that we had earlier thought. For example, rents have been strong all along due to extreme demand for housing in light of strong inbound migration. Furthermore, the gradually waning electricity credits from the government will mean that the disinflation process will not be straightforward. The possibility of El Nino effect could bring food prices under pressure. We expect average inflation to decline two percentage points to 3.7% y/y in 2024. To be sure, reliable leading indicators of inflation are still telling the story of disinflation (Figure 8). Moderating inflation and cooling labor demand would mean that the Wage Price Index could also reverts to its average.

Figure 9: Australia's Inflation Will Come Down, But Slowly



Sources: SSGA Economics, ABS, NAB, Macrobond
Updated as of 16/12/2023

Housing:

Home prices have been resilient to higher interest rates due to low supply and high demand. In the current cycle, home prices declined 5% (as measured by the average of all Proptrack prices), quite similar to that of Canada's, reflecting similar dynamics in both the countries. Housing will start turn a corner as rate cut

expectations take center stage in the second half of 2024. As such, new loan commitments and building approvals had bottomed and are moving sideways.

RBA:

All of the above discussion allows the RBA to comfortably downplay rate cut expectations in 2024. Absent any sharp revival in monthly inflation for November and December, the cash rate very likely has peaked at 4.35%. However, we think the RBA could very well retain its hiking bias and keep expectations in check through H1. We expect the first rate cut to commence in August/September 2024, after the RBA could get a read on the impact of tax cuts on inflation.

Risks:

Although the Fed's narrative should not influence the RBA, any roundabouts on the resilience of the global or even the Aussie economy could lead to the easing cycle starting sooner. However, at the moment, risks are skewed for a longer wait time to cut interest rates as inflation could be returning to target more slower than anywhere else in Australia. The Federal elections in late 2024 or early 2025 and population growth only complicate the RBA's calculus. Essentially, the Australian economy will be on pins and needles in 2024.

Data Calendar

Week in Review (Dec 11– Dec 15)

Country	Release (Date, format)	Consensus	Actual	Last	Comments
Monday, Dec 11					
No major data releases					
Tuesday, Dec 12					
US	NFIB Small Business Optimism (Nov)	90.7	90.6	90.7	Tepid.
US	CPI (Nov, y/y)	3.1%	3.1%	3.2%	Good.
UK	Average Weekly Earnings (Oct, y/y, 3m)	7.7%	7.2%	8.0% (↑)	Welcome improvement.
GE	ZEW Survey Expectations (Dec)	9.5	12.8	9.8	Improving.
JN	PPI (Nov, y/y)	0.1%	0.3%	0.9% (↑)	Good resilience against disinflation in goods.
AU	Westpac Consumer Conf Index (Dec)	na	82.1	79.9	Still at historic lows.
AU	NAB Business Confidence (Nov)	na	-9.0	-3.0 (↓)	Lowest since 2012. Poorest retail conditions.
Wednesday, Dec 13					
US	Monthly Budget Statement (Nov, $ bn)	-317.0	-314.0	-85.0	Wide…
US	PPI Final Demand (Nov, y/y)	1.0%	0.9%	1.2% (↓)	Moderate.
UK	Industrial Production (Oct, m/m)	-0.1%	-0.8%	0.0%	Weak.
EC	Industrial Production (Oct, m/m)	-0.3%	-0.7%	-1.0% (↑)	Weak.
JN	Tankan Large Mfg Index (Q4)	10.0	12.0	9.0	Great resilience but could slow in H1 2024.
Thursday, Dec 14					
US	FOMC Rate Decision (Upper Bound)	5.50%	5.50%	5.50%	Dovish pivot.
US	Retail Sales Advance (Nov, m/m)	-0.1%	0.3%	-0.2% (↓)	OK.
US	Initial Jobless Claims (Dec 09, thous)	220	202	221 (↑)	Still low.
US	Continuing Claims (Dec 02, thous)	1,879	1,876	1,856 (↓)	In gentle uptrend.
US	Import Price Index (Nov, y/y)	-2.1%	-1.4%	-1.8% (↑)	Import prices from China continue falling.
CA	Existing Home Sales (Nov, m/m)	na	-0.9%	-5.6%	Downtrend.
UK	Bank of England Bank Rate	5.25%	5.25%	5.25%	In line with expectation.
EC	ECB Main Refinancing Rate	4.50%	4.50%	4.50%	On extended assessing pause.
JN	Core Machinery Orders (Oct, m/m)	-0.4%	0.7%	1.4%	Good order volume from overseas.
JN	Industrial Production (Oct, m/m, final)	1.0% (p)	1.3%	0.5%	Vital impetus for Q4 GDP, but will it last?
AU	Employment Change (Nov, m/m)	11.5	61.5	42.7 (↓)	Led by full time employment, interesting change.
AU	Unemployment Rate (Nov)	3.8%	3.9%	3.8% (↑)	High participation rate.
Friday, Dec 15					
US	Business Inventories (Oct, m/m)	-0.1%	-0.1%	0.2% (↓)	Calibrating lower?
US	Empire Manufacturing (Dec)	2.1	-14.5	9.1	Weak, with weak details.
US	Industrial Production (Nov, m/m)	0.3%	0.3%	-0.9%(↓)	Recovery after strikes.
CA	Housing Starts (Nov, thous)	260.0	212.6	272.3 (↓)	Weak.
UK	GfK Consumer Confidence (Dec)	-22	-22	-24	Slight improvement.
UK	Manufacturing PMI (Dec, prelim)	47.5	46.4	47.2	Weak.
UK	Services PMI (Dec, prelim)	51.0	52.7	50.9	Pleasant surprise!
EC	Manufacturing PMI (Dec, prelim)	44.6	44.2	44.2	Weak.
EC	Services PMI (Dec, prelim)	49.0	48.1	48.7	Tepid.
GE	Manufacturing PMI (Dec, prelim)	43.2	43.1	42.6	Weak.
GE	Services PMI (Dec, prelim)	49.8	48.4	49.6	Soft.
FR	CPI (Nov, y/y, final)	3.4% (p)	3.5%	4.0%	Downtrend.
FR	Manufacturing PMI (Dec, prelim)	43.3	42.0	42.9	Weak.
JN	Manufacturing PMI (Dec, prelim)	na	47.7	48.3	Matches Covid low.

Source: for data, Bloomberg®; for commentary, State Street Global Advisors Economics.

Economic Indicators

Central Bank Policy Targets

Region	Target	Year/Year % Change in Target				
		Jun	Jul	Aug	Sep	Oct
US	Target: PCE price index 2.0% y/y	3.2	3.4	3.4	3.4	3.0
Canada	Target: CPI 2.0% y/y, 1.0%-3.0% control range	2.8	3.3	4.0	3.8	3.1
UK	Target: CPI 2.0% y/y	7.9	6.8	6.7	6.7	4.6
Eurozone	Target: CPI below but close to 2.0% y/y	5.5	5.3	5.2	4.3	2.9
Japan	Target: CPI 2.0% y/y	3.3	3.3	3.2	3.0	3.3
Australia	Target Range: CPI 2.0%-3.0% y/y	6.0	5.4	5.4	5.4	

Source: Macrobond

Key Interest Rates

	Jan-23	Feb-23	Mar-23	Apr-23	May-23	Jun-23	Jul-23	Aug-23	Sep-23	Oct-23	Nov-23
US (top of target range)	4.50	4.75	5.00	5.00	5.25	5.25	5.50	5.50	5.50	5.50	5.50
Canada (Overnight Rate)	4.50	4.50	4.50	4.50	4.50	4.75	5.00	5.00	5.00	5.00	5.00
UK (Bank Rate)	3.50	4.00	4.25	4.25	4.50	5.00	5.00	5.25	5.25	5.25	5.25
Eurozone (Refi)	2.50	3.00	3.50	3.50	3.75	4.00	4.00	4.25	4.50	4.50	4.50
Japan (OCR)	-0.01	-0.01	-0.03	-0.07	-0.07	-0.08	-0.06	-0.06	-0.06	-0.02	-0.02
Australia (OCR)	3.10	3.29	3.54	3.60	3.83	4.05	4.10	4.10	4.10	4.10	4.29

Source: Macrobond

General Government Structural Balance as a % of Potential GDP

								Forecast	
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
US	-2.5	-3.6	-4.3	-5.1	-6.0	-10.7	-11.4	-6.5	-8.8	-7.6
Canada	0.0	0.0	-0.3	0.0	-0.2	-8.1	-3.3	-1.4	-0.8	-0.4
UK	-2.5	-1.6	-1.3	-1.4	-1.6	0.8	-3.6	-3.8	-3.3	-2.4
Eurozone	-0.5	-0.5	-0.4	-0.2	-0.5	-3.9	-3.5	-2.4	-2.7	-2.4
Germany	1.2	1.2	1.2	1.6	1.3	-2.9	-3.0	-2.1	-2.4	-1.1
France	-2.1	-1.9	-1.9	-1.5	-2.1	-5.8	-5.1	-4.2	-4.3	-4.1
Italy	-0.2	-0.8	-1.3	-1.4	-0.7	-5.6	-4.8	-1.9	-2.1	-3.4
Japan	-4.5	-4.5	-3.7	-3.0	-3.3	-8.1	-5.5	-6.8	-5.7	-3.8
Australia	-2.5	-2.2	-1.5	-1.1	-4.0	-7.9	-6.3	-2.5	-1.6	-2.3

Source: International Monetary Fund, World Economic Outlook

Headline Consumer and Producer Price Inflation

	CPI Year/Year % Change						PPI Year/Year % Change				
	Jul	Aug	Sep	Oct	Nov		Jul	Aug	Sep	Oct	Nov
US	3.2	3.7	3.7	3.2	3.1		1.1	1.9	2.0	1.2	0.9
Canada	3.3	4.0	3.8	3.1			-3.2	0.0	0.6	-2.7	
UK	6.8	6.7	6.7	4.6			-0.6	-0.4	0.2	-0.7	
Eurozone	5.3	5.2	4.3	2.9			-7.6	-11.5	-12.4	-9.5	
Germany	6.2	6.1	4.5	3.8	3.2		-6.0	-12.6	-14.7	-11.0	
France	4.3	4.9	4.9	4.0	3.5		-1.5	-3.0	-2.6	-1.4	
Italy	5.9	5.4	5.3	1.7	0.7		-10.2	-12.2	-14.1	-9.5	
Japan	3.3	3.2	3.0	3.3			3.6	3.4	2.2	0.9	0.3
Australia	5.4	5.4	5.4				3.8	3.8	3.8		

Source: Macrobond

Economic Indicators

Real GDP Growth (Q/Q Seasonally Adjusted)

	Quarter/Quarter % Change					Year/Year % Change				
	Q3-22	Q4-22	Q1-23	Q2-23	Q3-23	Q3-22	Q4-22	Q1-23	Q2-23	Q3-23
US	0.7	0.6	0.6	0.5	1.3	1.7	0.7	1.7	2.4	3.0
Canada	0.5	-0.2	0.6	0.3	-0.3	4.0	2.2	1.8	1.2	0.5
UK	-0.1	0.1	0.3	0.2	0.0	2.1	0.7	0.5	0.6	0.6
Eurozone	0.5	-0.1	0.1	0.1	-0.1	2.4	1.8	1.3	0.6	0.0
Germany	0.4	-0.4	0.0	0.1	-0.1	1.2	0.8	-0.2	0.1	-0.4
France	0.5	0.0	0.1	0.6	-0.1	1.3	0.8	0.9	1.2	0.6
Italy	0.3	-0.2	0.6	-0.4	0.1	2.6	1.6	2.1	0.3	0.1
Japan	-0.1	0.2	1.2	0.9	-0.7	1.5	0.6	2.5	2.3	1.6
Australia	0.2	0.9	0.5	0.4	0.2	5.8	2.3	2.4	2.0	2.1

Source: Macrobond

Industrial Production Index (M/M Seasonally Adjusted)

	Month/Month % Change					Year/Year % Change				
	Jul	Aug	Sep	Oct	Nov	Jul	Aug	Sep	Oct	Nov
US	0.9	0.0	0.1	-0.9	0.2	0.1	0.0	-0.2	-1.0	-0.4
Canada	-0.1	-0.6	-0.1			0.1	-0.5	-0.7		
UK	-1.1	-0.5	0.1	-0.8		1.1	1.5	1.5	0.3	
Germany	-0.5	-0.1	-1.3	-0.4		-1.9	-1.5	-3.8	-3.4	
France	0.5	-0.1	-0.6	-0.3		2.5	-0.4	-0.3	1.8	
Italy	-0.9	0.2	0.1	-0.2		-2.2	-4.3	-2.0	-1.1	
Japan	-1.8	-0.7	0.5	1.3		-2.4	-4.4	-3.4	-0.6	

Source: Macrobond

Unemployment Rate (Seasonally Adjusted)

	Jan-23	Feb-23	Mar-23	Apr-23	May-23	Jun-23	Jul-23	Aug-23	Sep-23	Oct-23	Nov-23
US	3.4	3.6	3.5	3.4	3.7	3.6	3.5	3.8	3.8	3.9	3.7
Canada	5.0	5.0	5.0	5.0	5.2	5.4	5.5	5.5	5.5	5.7	5.8
UK	3.8	3.9	3.8	4.0	4.2	4.3					
Eurozone											
Germany	5.5	5.5	5.6	5.6	5.6	5.7	5.7	5.7	5.7	5.8	5.9
France	7.1	7.1	7.1	7.2	7.3	7.3	7.4	7.4	7.3	7.3	
Italy	8.0	7.9	7.8	7.8	7.7	7.5	7.6	7.5	7.6	7.8	
Japan	2.4	2.6	2.8	2.6	2.6	2.5	2.7	2.7	2.6	2.5	
Australia	3.7	3.5	3.5	3.7	3.6	3.5	3.7	3.7	3.6	3.8	3.9

Source: Macrobond

Current Account Balance as a % of GDP (Seasonally Adjusted)

	Q1-21	Q2-21	Q3-21	Q4-21	Q1-22	Q2-22	Q3-22	Q4-22	Q1-23	Q2-23	Q3-23
US	-3.1	-3.4	-3.8	-3.7	-4.5	-3.9	-3.4	-3.3	-3.2	-3.1	
Canada	0.0	-0.1	0.2	-0.1	0.5	0.6	-1.4	-1.2	-1.0	-1.0	-0.4
UK	-0.8	1.0	-2.4	0.3	-7.7	-4.0	-1.6	0.6	-2.3	-3.7	
Eurozone	3.5	3.1	2.3	1.2	0.4	-1.3	-3.6	1.0			
Germany	9.0	8.3	7.5	6.6	5.7	4.1	2.8	5.0	5.9	6.8	7.2
France	0.9	0.6	0.4	-0.4	-0.4	-1.9	-3.0	-2.7	-1.6	-0.8	-1.0
Japan	4.3	3.7	4.6	4.2	3.6	4.0	3.4	3.1	3.4	3.5	3.5
Australia	-1.5	-2.5	-2.8	-3.5	-2.2	-2.7	-2.2	-1.4	-0.2	1.2	

Source: Macrobond

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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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