STATE STREET GLOBAL ADVISORS

January 12, 2024
Commentary

Weekly Economic Perspectives

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Spotlight on Next Week
US homebuilder sentiment to improve further. UK ILO unemployment rate to increase. Japan's national CPI to remain above target. Aussie employment may cool.

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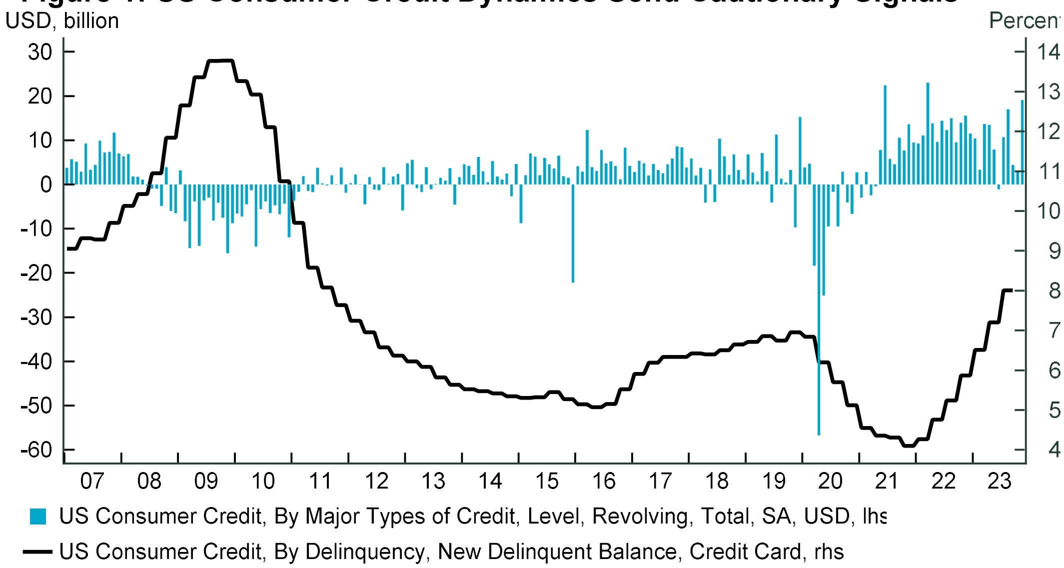
The Economy

A slow data start to the year as market expectations for rate cuts build.

US

Ahead of the resumption of student loan repayments in October, there had been some anxiety around their negative impact on household finances. As repayments initially spiked above required minimums, a more confident mood emerged. The argument was that if consumers can prepay student debt and still consume at the torrid third-quarter rate, they must be in a better financial shape than previously assumed. And yet, the latest data speaks of building vulnerabilities rather than newfound resilience. Admittedly, the US consumer is not a monolithic bloc and the top income percentiles continue to do well. But cracks are widening among lower income brackets. For one, the share of newly delinquent credit card balances has recently reached highs not seen since 2012. With credit card interest rates at 30% or more, delinquent balances can quickly escalate as fees accrue. Meanwhile, revolving consumer credit surged in November. Overall outstanding **consumer credit** increased by the most in a year in November ($23.75 billion), driven by a $19.1 billion surge in revolving credit. In non-seasonally-adjusted terms, revolving credit spiked by a record $41 billion! This suggests that consumption is increasingly credit-financed; a slowdown seems like just a matter of time.

Figure 1: US Consumer Credit Dynamics Send Cautionary Signals



Sources: Macrobond, SSGA Economics, New York Fed, Fed
Updated as of 1/12/2024

The reliance on credit to finance consumption is especially problematic as employment and earnings prospects moderate. We had long highlighted the job openings had become increasingly concentrated among smaller firms as pent-up labor demand at larger firms had been largely satisfied. Now, the **NFIB survey** suggests that even smaller firms plan to scale back hiring. While the headline index of small business optimism ticked up a little in December, hiring intentions eased and the share of firms saying that labor quality is their biggest problem declined sharply.

Aside from a brief period early during the Covid crisis, that metric is now back to the lowest levels since 2018. That said, this seems to be a story of shifting power balance between workers and employers in favor of employers; other indicators in the survey conveyed a more upbeat mood among business owners. Assessments of general business conditions, actual profits, and future sales all improved.

This week's inflation data was mixed, yet the narrative of ongoing disinflation has not changed. **Consumer price inflation** came in a bit stronger than expected, but producer price inflation undershot expectations. Overall consumer prices increased 0.3% m/m in December, a result driven in no small part by a 0.4% increase in energy prices. Gasoline prices reportedly rose 0.2% m/m, a strong showing that belies the sizable declines seen in daily non-seasonally adjusted gasoline prices. Food prices rose 0.2% m/m. Core prices, excluding food and energy, increased 0.3% m/m, in line with expectations. Service prices gained 0.5% on strength in medical care (+0.6% m/m) and airfares (+1.0%). Housing costs increased 0.4%, with shelter up 0.5%. Shelter costs remain an element of obvious "stickiness" in the CPI report and are increasingly at odds with moderated market rents data, even allowing for the very long lags with which market rental info is translated into the CPI. A recent Zillow report helps shed some light on this divergence noting that even for market rents, single family rental growth is much stronger than rental growth in the multi-family unit. The reason is strong demand for single-family rentals as high mortgage rates leave buyers unable to purchase and captive renters. The relative strength in single family rents likely feeds in the CPI estimates for owner equivalent rent (OER) and hence further slow the moderation in rental inflation. On the flip side, with mortgage rates lower and poised to decline further as the Fed starts cutting, the benefit from shelter disinflation may come slower but last longer. Elsewhere, new car prices rose 0.3% m/m and used car prices rose 0.5%. The latter was stronger than suggested by auction data so we could have a pullback in January. All in all, headline CPI inflation accelerated three tenths to 3.4% y/y; core CPI inflation eased a tenth to 3.9% y/y.

Producer prices (final demand) declined 0.1% in December, with November's data also revised lower. The disinflation process that had been running for quite some time on the goods side may be soon ending, but disinflation is intensifying on the services side. Goods prices declined 0.4% m/m, with service prices flat for the third consecutive month, allowing services PPI inflation to ease to 1.8% y/y, the lowest rate since January 2021. Overall PPI inflation stood at 1.0% y/y, core PPI inflation (ex food and energy) stood at 1.8% y/y and super-core PPI inflation (also excluding volatile trade services) stood at 2.5% y/y.

The flow of data through the week did not alter our views on either inflation or Fed path. Interestingly, market pricing for a March cut actually rose late in the week, nearing 80% but we still see a March cut as closer to a 50/50 probability.

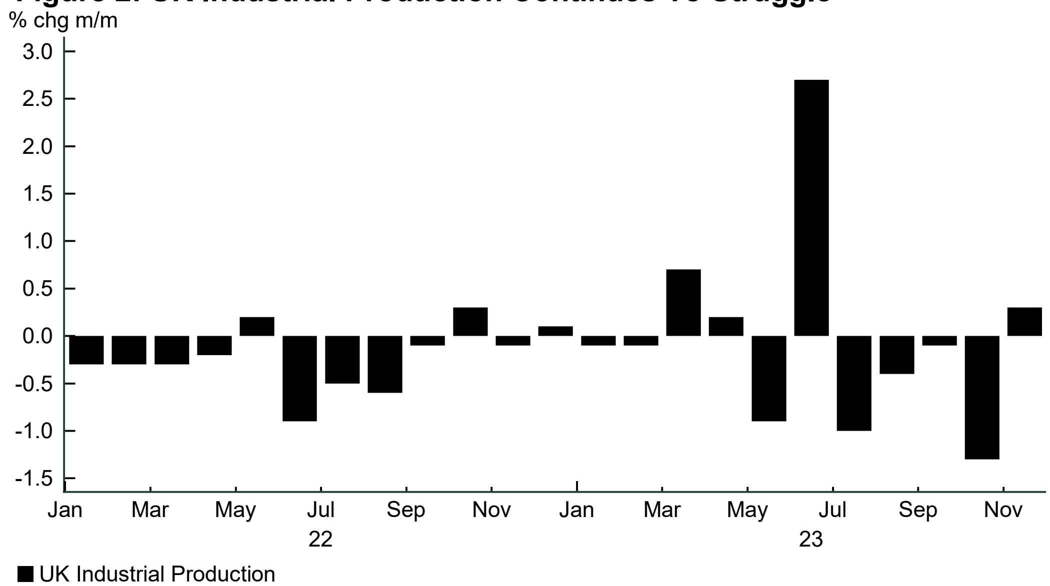
Canada

Building permits contracted 3.9% in November, following an upwardly revised increase of 3.0% in the previous month. Almost all building type components experienced declines in the month. Residential sector fell by 2.8% as the declines in British Colombia and Quebec more than offset gains in the rest of the country. Non-residential sector fell by 5.8%, with falls posted across commercial, institutional, and industrial components.

UK

Industrial activity continues to struggle. Admittedly, the modest increase of 0.3% m/m in November was the first gain in five months but it followed a downwardly revised decline of 1.3% in the previous month. The monthly increase was largely due to higher manufacturing (+0.4%m/m), mining and quarrying (+1.3%m/m) and electricity and gas (+0.2% m/m). Production was down 0.1% y/y.

Figure 2: UK Industrial Production Continues To Struggle



Sources: Macrobond, SSGA Economics, ONS

Eurozone

The flow of eurozone macroeconomic data this week can at best be described as uninspiring. The ***German*** industrial sector continues to struggle. Despite a 0.3% uptick in **industrial orders** in November, they remained 4.3% lower than a year prior. Meanwhile, ***German*** **industrial production** declined for the sixth consecutive month to settle 4.9% below November 2022 levels. ***French*** **industrial production** rose 0.5% in November and has fared better overall, up 0.6% y/y. Still, this is far from a picture of strength. More encouraging news came from ***Italy***, where **retail sales** rose 0.4% in November and the **unemployment rate** eased two tenths to 7.5%.

Japan

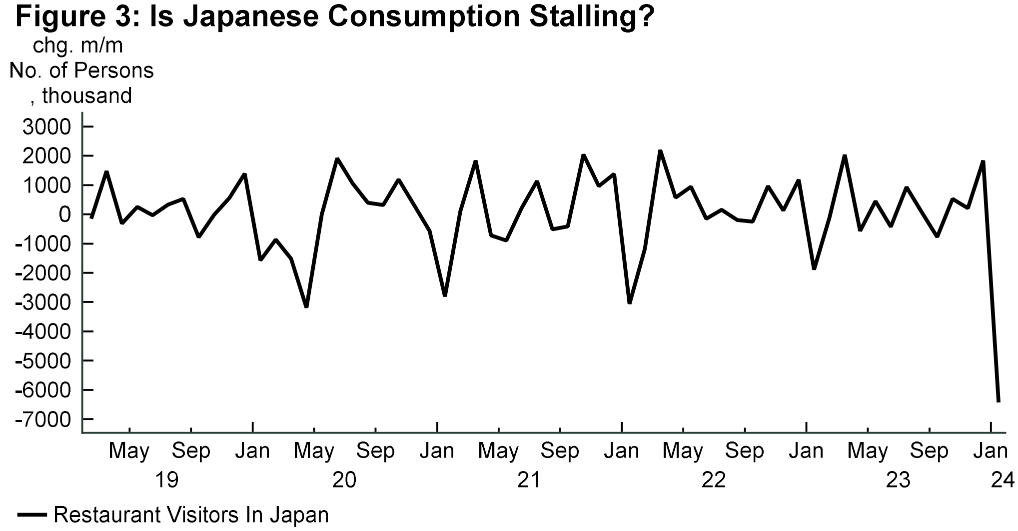
Our forecast of the Bank of Japan (BoJ) normalizing policy in December 2023 did not materialize and the nation's Noto Peninsula was hit by a 7.6 magnitude earthquake on January 01. Nearly 200 causalities were recorded, our hearts go to all those affected by the disaster. According to the 2019 government estimates, the region held a 0.8% share in overall GDP. Although this share is quite small, the BoJ's nimble approach means that the chances of a January move are almost zero now.

Furthermore, in the quarterly report on regional economies released this week, the BoJ showed no improved confidence on wage growth this year. As put by the Nagoya branch manager, *"momentum for wage increases is heightening, though* *some small firms say they find it difficult to increase pay."* We wonder if the BoJ would eventually wait for the preliminary results of this year's *shunto* negotiations in March before normalizing policy. But, are there any costs to this delay?

On a superficial level, there seem to be none—the yen is trading around 145 against the dollar, the 10y JGB yield actually declined 0.53% from the peak of 0.96% on November 01, 2023. So, the impact on markets seems to be contained. However, underneath the surface, the economic momentum seems to be losing some steam.

The **BoJ's Consumption Activity Index** remained anemic in November after declining 0.4% m/m in October. On a 3-month annualized rate basis, it declined 2.5%, after declining 1.8% in October, and aggravates our fear of a technical recession in Q4 2023. The Japan Center for Economic Research (JCER) is tracking a 62.3% chance that Japan enters a recession in the next three months as of October. The JCER considers 67.0% as a 'warning level' and noted that the industries of electronic parts and devices and the manufacture of inorganic and organic chemistry were especially affected, and could be reflecting uncertainty in business conditions overseas. Furthermore, our leading indicators of real exports and imports continue to decline. Finally, restaurant visits have been declining; although this could be the impact of seasonality and the Noto Peninsula earthquake, the drop this time around is very large.

Figure 3: Is Japanese Consumption Stalling?



Sources: SSGA Economics, TableCheck Inc., Macrobond
Updated as of 1/12/2024

The BoJ core metric (excluding fresh food and energy) of **Tokyo CPI** eased a tenth in line with expectations to 3.5% y/y in December, largely reflecting easing food prices. The default core metric (excluding fresh-food) slowed two-tenths to 2.1%, reflecting declines in electricity and gas prices, which turned lower on falling import costs. The good news is that price pressures on aggregate are still holding up; however, just 300 food items are expected to rise in January, down from 7864 in November 2022 and 4758 in October 2023, as tracked by Teikoku Databank. This is vividly visible in the Tokyo CPI data too; on a 3-month annualized basis, food prices stalled at 0.0%, sharply down from 7.3% in November. On the same basis, fuel prices jumped 29.5%, up for a third month. Furthermore, recreation and culture prices jumped 8.9% y/y (or 7.9% 3m AR), so price pressures still have a lot important steam in them, however the macro narrative is clearly reaching a tipping point.

Separately, **total cash earnings** rose just 0.2% y/y in November, much below the consensus of 1.5%. This is the work of a remarkable -13.2% decline in special payments, primarily dragged down by weak manufacturing sector, whose total wages and special payments both declined -0.9% and -26.1% respectively. Manufacturing is important with a 15% share in total employment, but overall the labor market remains firm as cash earnings on a constant sample basis rose a solid 2.0%. However, real wages declined for the 20th month and all indicators point to slowing consumption.

This week the government is discussing how to unfreeze the trigger clause to enable gasoline tax cuts. Gasoline prices have been above 160 yen since September 2021 and while, any reduction will be welcome, we think the government and BoJ need to work more to help revive consumption, in order to support GDP growth. It may be forgotten but, an important consideration for normalization is that the output gap turns positive; however, the **output gap** as estimated by the BoJ and the government widened in Q3. The BoJ's estimate widened to -0.37% from -0.15% in Q2 and that of the Cabinet Office widened. The BoJ further estimates that potential growth expanded to 0.71% (Q2 & Q3 2023) from 0.57% in the past two quarters, further making it difficult for the actual growth to catch up and close the gap.

Australia

Consumer inflation in November eased to 4.3% y/y, down nearly 60 bps, in line with our view but two-tenths below the consensus. The trimmed-mean metric also declined by a large 70 bps to 4.6%. It is however important to note that the CPI rebounded sequentially to 0.3% m/m from an upwardly revised 0.0% (+40 bps) in October. So it is fair to not dismiss price pressures altogether. However, there is some validation for our expectation that the policy interest rate has likely peaked.

Housing prices also rebounded (0.7% m/m) alongside recreation prices (1.0% m/m). Within housing, something to watch for is the 0.9% m/m jump in new dwelling prices and 0.7% rise in rents. Services prices rebounded 0.7% m/m, translating into an annual gain of 4.7% y/y, so the concerns of strong services inflation are still valid. However, disinflation in the goods sector is gaining pace. Prices rebounded 0.2% m/m from -0.1%, translating into 4.0% y/y. Declines in clothing & footwear (-1.7% m/m), fuel (-0.5% m/m) and other categories was offset by gains in food (0.8%) and electricity (0.4%), the rise in the later was below expectations as subsidies in Victoria reduced the magnitude wholly.

The possible disinflation ahead could be delayed by housing, exacerbated by higher cost of materials and demand, which could potentially be a factor that could delay the Reserve Bank of Australia's (RBA) cutting cycle this year. **Building approvals** rose 1.6% m/m in November against expectations of a 2.0% decline. However, the strength was caused by a 7.2% jump in the volatile high-density approvals, while those for detached homes declined -1.9%. Still, the fear of a housing led pick-up in inflation could delay cuts and is the biggest risk in 2024.

Retail sales jumped 2.0% m/m in November, way ahead of the market's consensus for 1.2%. The strength is perhaps overstated by recently introduced seasonal adjustments by the ABS. Compositionally, sales in restaurants & cafes

(0.4% m/m) and of food (0.4%) remained stable, while those of clothing & soft goods (2.7%), household goods (7.5%) and department stores (4.2%) jumped. This composition is typical of yearend sales and hence, we think there is perhaps not much to read into the superficial strength. Next week, we expect the economy to have added fewer than the consensus of 18k jobs in December.

Week in Review (Jan 08 –Jan 12)

Country	Release (Date, format)	Consensus	Actual	Last	Comments
Monday, Jan 08					
US	Consumer Credit (Nov, $, bn)	8.550	23.751	5.779 (↑)	Huge surge in revolving credit!
GE	Factory Orders (Nov, m/m)	1.1%	0.3%	-3.8% (↓)	Weak.
AU	Retail Sales (Nov, m/m)	1.2%	2.0%	-0.4% (↓)	Work of seasonality, and could fall in December.
Tuesday, Jan 09					
US	NFIB Small Business Optimism (Dec)	91.0	91.9	90.6	Mixed but overall encouraging.
CA	Building Approvals (Nov, m/m)	-1.4%	-3.9%	3.0% (↑)	Weakening.
GE	Industrial Production (Nov, m/m)	0.3%	-0.7%	-0.3% (↑)	Weak.
IT	Unemployment Rate (Nov)	7.8%	7.5%	7.7% (↓)	
JN	Labor Cash Earnings (Nov, y/y)	1.5%	0.2%	1.5%	Stable at 2.0% on a constant sample basis.
AU	CPI (Nov, m/m)	4.4%	4.3%	4.9%	More progress needed for rate cuts.
Wednesday, Jan 10					
FR	Industrial Production (Nov, m/m)	0.0%	0.5%	-0.3%	Modest.
IT	Retail Sales (Nov, m/m)	na	0.4%	0.4%	Modest.
Thursday, Jan 11					
US	CPI (Dec, y/y)	3.2%	3.4%	3.1%	No game changer.
US	Initial Jobless Claims (Jan 06, thous)	210	202	203 (↑)	Very low.
US	Continuing Claims (Dec 30, thous)	1,870	1,834	1,868 (↑)	Very low.
US	Monthly Budget Statement (Dec, $, bn)	-87.5	-129.4	-85.0	Very bad.
IT	Industrial Production (Nov, m/m)	-0.2%	-1.5%	-0.2%	Weak.
JN	Leading Index CI (Nov, prelim)	107.9	107.7	108.9	Recession worries are real.
Friday, Jan 12					
US	PPI Final Demand (Dec, y/y)	1.3%	1.0%	0.9%	Services disinflation intensifies.
UK	Industrial Production (Nov, m/m)	0.3%	0.3%	-1.3% (↓)	Weak.
FR	CPI (Dec, y/y, final)	3.7%(p)	3.7%	3.5%	Confirms preliminary estimate.

Source: for data, Bloomberg®; for commentary, SSGA Economics.

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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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Marketing Communication

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