STATE STREET GLOBAL ADVISORS

January 26, 2024
Commentary

Weekly Economic Perspectives

Contents

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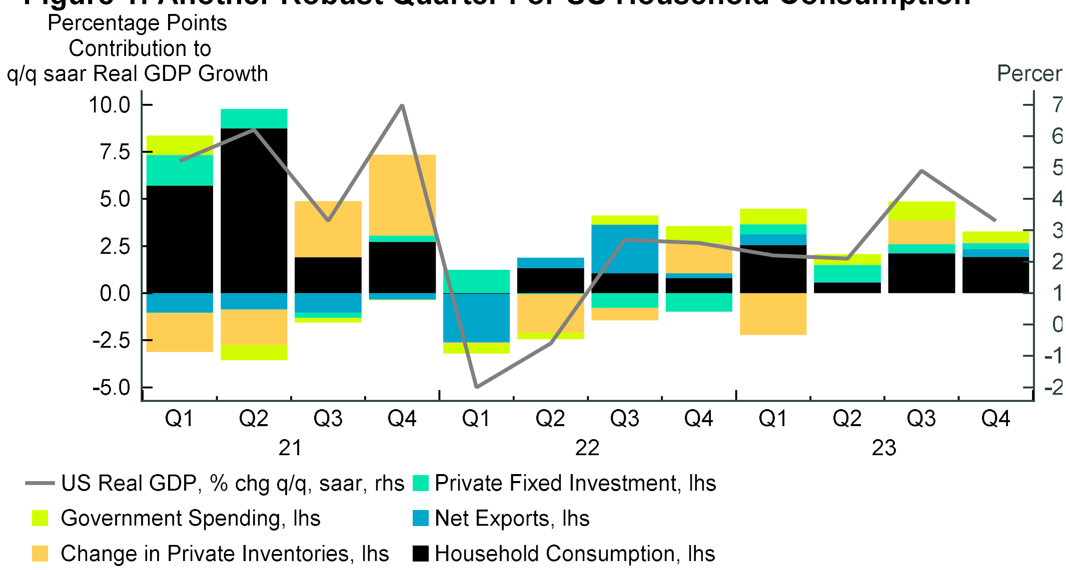
The Economy

Mixed macro data continues as markets ponder timing of rate cuts.

US

The US economy ended 2023 on solid footing, with fourth-quarter **real GDP** growth above expectations at 3.3% saar (seasonally adjusted annualized). For the year as a whole, the economy grew 2.5%, accelerating from 1.9% in 2022. Consumer spending accounted for 1.9 percentage points (ppt) of Q4 growth, on broad gains. For the year as a whole, consumer spending growth did moderate, but only marginally (2.2% versus 2.5% in 2022), supported as it was by disinflation and solid labor incomes. Even so, the steady decline in the savings rate (at a year low of 3.7% in December) and the recent surge in both consumer revolving credit and credit card delinquencies raise questions about the sustainability of this performance. Government spending contributed 0.56 ppt to Q4 growth (the bulk of it from state and local government spending) while fixed investment contributed 0.31 ppt. Notably, residential fixed investment posted a second consecutive quarter of growth, supporting our view that the housing recession has ended. Trade was a surprisingly large contributor to growth, adding 0.43 ppt. Inventories had been a big contributor to growth in Q3 and were expected to subtract from performance in Q4 but they were incrementally additive. It is somewhat odd to see trade, inventories, and spending all contribute positively in the same quarter and we would not be surprised to see a reversal in either trade's or inventories' contribution in Q1, possibly both. We see 2024 as the year in which the US economy joins the global slowdown, with GDP growth easing below trend to around 1.5%.

Figure 1: Another Robust Quarter For US Household Consumption



Sources: Macrobond, SSGA Economics, BEA
Updated as of 1/27/2024

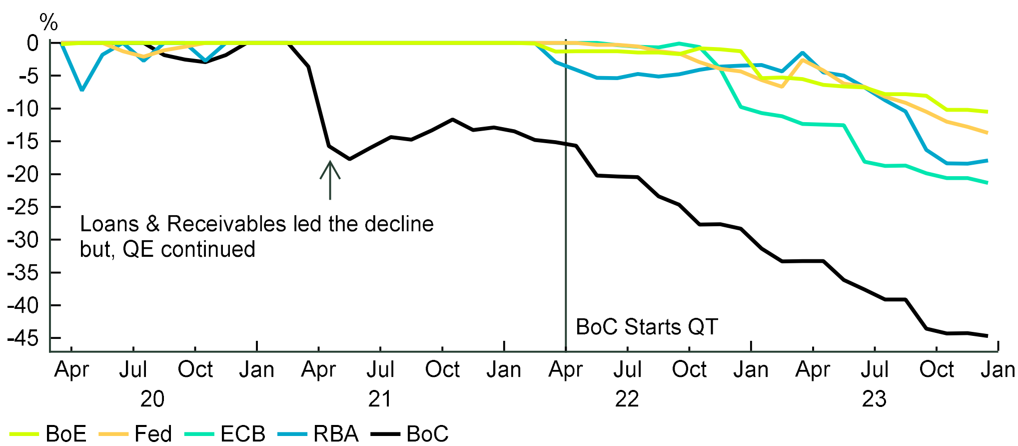
The **PCE inflation** data for December were quite encouraging and, in our view, support the start of Fed cuts in May. Headline PCE inflation was unchanged at 2.6% y/y but core PCE inflation moderated three tenths to 2.9% y/y, the first sub-3.0% reading since March 2021! If prices were to continue rising at December's 0.2% m/m pace for the next few months, core PCE inflation would get quite close to 2.0% y/y by April. A Fed rate cut in May does not seem premature given the inflation backdrop.

The one percentage point decline in the standard 30-year mortgage rate between mid-October to mid-December has helped re-invigorate housing activity. **New home sales** rebounded 8.0% m/m in December, and the November decline was smaller than initially reported. The median price declined 13.8% y/y. **Pending home sales** (sales of existing homes on which the buyer and seller have agreed on a contract but the transaction is not yet complete) also surged 8.3% m/m in December, the largest gain since June of 2020. This lends support to our expectation that as mortgage rates come down, this would also help unfreeze some inventory.

Canada

The **Bank of Canada** (BoC) held its policy rate at 5.0%, continued its ongoing quantitative tightening (QT), and sounded hawkish as we anticipated. In the opening statement governor Tiff Macklem noted that the BoC's deliberations have shifted from *"whether monetary policy is restrictive enough to, how long to maintain the current restrictive stance."* He noted further that economic growth had stalled in the middle of 2023 and with weak demand, inflation is expected to ease further. However, "*if new developments push inflation higher, we may still need to raise rates*." Also, *"inflation remains too high, with persistent strength in shelter and food price inflation"* and emphasized the need to allow more time for higher rates time to do their work." Governor Macklem mentioned that further declines on inflation will be gradual and uneven, as we wrote last week.

Figure 2: The BoC Leading On QT
Drawdown From The Peak Of Central Bank Assets



Sources: SSGA Economics, BoC, RBA, ECB, BoE, Fed, Macrobond
Updated as of 1/26/2024
Note: BoE data is calculated as sum of its weekly data, which represent ~90% of its overall assets

The 2024 inflation forecast was trimmed two tenths to 2.8%. Q4 GDP is estimated to have stalled at 0.0% q/q, saar, following a 1.1% saar decline in Q3. Back in October, both quarters had been forecasted at a positive 0.8%. However, "economic growth will gradually strengthen around middle of 2024". GDP forecasts for 2024 and 2025 were down a tenth to 0.8% y/y and 2.4%, respectively.

We had earlier noted that the BoC is leading global central banks on QT since it was started in April 2022. Although the BoC never explicitly sold its holdings, its balance sheet size is down 44.6% from its peak as of December; compared to just 13.7% for the Fed and 21.3% for the ECB. However, the BoC's plan of running QT till the end of 2024 or H1 2025 are now doubtful due to potential liquidity problems, as the overnight lending rate CORRA traded above the benchmark policy rate of 5.0% which resulted the first liquidity operation by the bank in four years this week.

With this, focus now turns to November GDP data release next week, and from now on, we expect markets to be reactive to weaker growth in keeping rate cut expectations alive, which is a realistic possibility in our opinion.

UK

Manufacturing activity continues to contract, but at a slower pace. The **purchasing managers' index for manufacturing** gained 1.1 point to 47.3 in January, according to preliminary estimate, the best reading since April 2023. Output was weak, declining at a faster rate than in December, however, and so did new orders, so no quick turnaround is in sight. On the bright side, services are doing much better. The **purchasing managers' index for services** gained 0.4 point to 53.8 in January, indicating a decent pace of expansion. In fact, this was the best reading since May. The employment component increased 1.9 points to 51.6, the best since July.

With inflation moderating and labor market conditions still strong, consumer sentiment is slowly but surely improving. The **GfK consumer confidence index** rose three points to -19 in December, reaching its highest level since January 2022.

Eurozone

The January **ECB meeting** was largely a non-event, as we anticipated. All three policy interest rates were left unchanged, with the main refinancing rate, the marginal lending facility rate, and the deposit facility rate unchanged at 4.50%, 4.75% and 4.00%, respectively. The message is that the Governing Council sees the current level of interest rates as appropriate to bring inflation back to target over time and that it intends to keep rates at this level "for a sufficiently long duration". While the APP (asset purchase program) balances are already declining, the Governing Council intend to slow PEPP (pandemic emergency purchase program) reinvestments by €7.5 billion a month during the second half of the year before ending reinvestments altogether at the end of the year. An argument could be made for an April rate cut but we still only see an April cut as a 50/50 probability.

French **consumer sentiment** has convincingly lifted off recent lows, but ***German*** consumer sentiment has not. The former improved two points to 91 in January, the highest reading since February 2022. By contrast, the German GfK consumer sentiment index dropped 4.3 points in the last reading, touching the lowest level since March of 2023.

Japan

Our worries about slowing consumption intensified this week even as the **Bank of Japan** (BoJ) became more confident on wages and prices. We got some soft inflation data after the BoJ's meeting, so we take the meeting's outcome earlier in the week with a grain of salt. To summarize:

1. The BoJ is more confident on inflation, but wants to confirm *shunto* outcome
2. But, inflation data released later highlighted possibly faltering consumption
3. Q4 GDP data could still decline, so a technical recession is possible
4. These events have the potential to push the BoJ's exit further out

The BoJ hinted at raising odds of exiting negative interest rates after strong wage growth in the initial *shunto* negotiations. The statement was largely unchanged, but there is more confidence on wage growth and services inflation. Governor Ueda hinted that **<u>the current easy policy could remain in place after negative rates may be ended</u>.** So there will be policy support in the case of exiting NIRP.

In the press conference, governor Ueda revealed that he *"heard encouraging comments from big companies regarding wage hikes."* Also, he noted that the number of companies that have decided to hike wages this year is higher than this time last year. Furthermore, it is not required that 'all small and medium-sized companies hike wages significantly to allow for a policy change**.**'

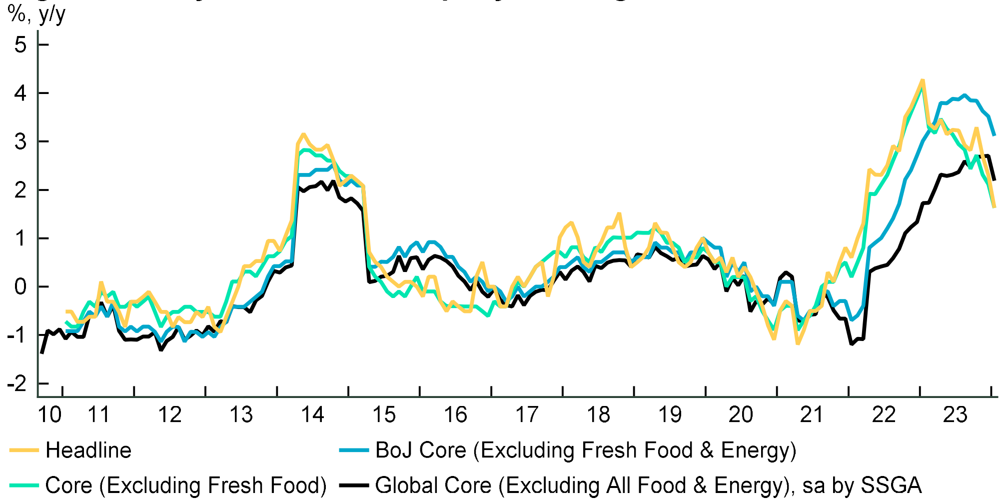
Governor Ueda left everyone guessing whether the policy change may come in March or in April (we are not confident on either). The latter is an easy pick as the BoJ will unveil its 2026 forecasts for the first time. But interestingly, he said that the policy change is possible when there is no update to quarterly outlook, favoring March. At the same time, he also said "we will have more data at April policy meeting compared to March." This is well played, as it is important to confirm two things: one that Q4 GDP would not decline and two, that the first round of this year's *shunto* will confirm a higher wage growth in early March.

In the outlook report, the bank reduced its GDP forecasts for FY 2023 and FY 2024 by two-tenths to 1.8% and 1.2% respectively and maintained that FY 2025 at 1.0%. The CPI forecast for FY 2023 is maintained at 2.8%, but reduced by four tenths to 2.4% for FY 2024. For FY 2025, CPI is expected to be higher by a tenth at 1.8%.

Trade data for December improved. The value of exports surged 9.8% y/y after a 0.2% decline last month, while that of imports declined for the nineth month by 6.8%. Exports to the US surged 20.4%, a rise for 27 straight months and those to China rose 9.6%, the first annual rise since November 2022. More importantly, the seasonally adjusted real exports rose 4.7% y/y, which takes the 3-month average in Q4 to -0.2%, preventing the huge fall that we feared. Separately, imports declined just 1.6%, but the 3-month average is still a decline of 5.4%, so we still worry about domestic consumption in Q4.

Inflation in Tokyo declined sharply and unexpectedly in January. The headline core (excluding fresh-food) declined 0.5 ppts to 1.6% y/y, **below 2% for the first time since June 2022**, while the BoJ's preferred core metric (excluding fresh-food & energy) declined 0.4 ppts to 3.1% y/y, below the consensus of 3.4%**.** As the headline CPI peaked in January last year at 4.3% y/y (1.6% latest vs. 2.4% in December), some degree of base-effects were expected. However, it is quite apparent that **consumption is losing steam**. Sequential declines were large in discretionary categories of recreation (-1.9% m/m) and clothes & footwear (-1.8%). Given announced price hikes in services, including electricity, over the medium-term we still think inflation will bounce back, but near term, the BoJ may lose confidence and could push its exit from NIRP further out this year.

Figure 3: Tokyo CPI Shows Rapidly Cooling Inflation

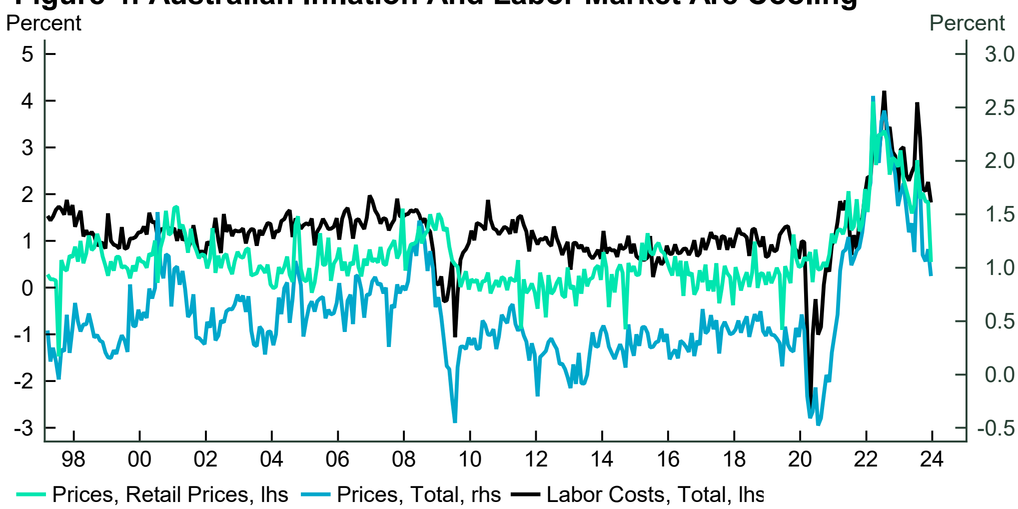


Sources: SSGA Economics, SBJ, Macrobond
Updated as of 1/27/2024

Australia

The **NAB Monthly Business Survey** in December reinforced our macro narrative of cooling inflation and labor market in Australia. Business conditions eased more in December to 6.9, the weakest since January 2022. Confidence is also zigzagging to weaker territory, but improved in December to -0.6 on a better showing in the retail sector, but well below its long-run average. Most important for us, prices (0.9%, 1.2% previous) & labor cost growth (1.8%, 2.3%) declined sharply. Retail prices cooled all the more to 0.6%, down from 1.8%. The survey noted the cooling in the survey's seasonally adjusted price data signals some cooling in the 'underlying pace of inflation'.

Figure 4: Australian Inflation And Labor Market Are Cooling



Sources: SSGA Economics, NAB, Macrobond
Updated as of 1/27/2024

Earlier in the week, we learnt about Prime Minister Anthony Albanese's plan to make changes to the stage 3 tax cuts in favor of better cuts for Australians falling into the middle income category to help ease their high cost of living. While it is not official yet, we think such changes to the legislation may boost consumption more, given the higher propensity to consume for low & middle income households.

Next week, we expect Q4 CPI to have declined to 4.2% y/y, from 5.4% in Q3. Furthermore, retail sales in December may decline after a 2% rise in November.

Week in Review (Jan 22 – Jan 26)

Country	Release (Date, format)	Consensus	Actual	Last	Comments
Monday, Jan 22					
US	Leading Index (Dec, m/m)	-0.3%	-0.1%	-0.5%	22 consecutive declines!
JN	BoJ Policy Balance Rate	-0.1%	-0.1%	-0.1%	Eyeing exit from negative rates, but no rush.
AU	NAB Business Confidence (Dec)	na	-1.0	-8.0 (↑)	Recovery in retail, but broadly still low
Tuesday, Jan 23					
JN	Manufacturing PMI (Jan, prelim)	na	48.0	47.9	Poor underlying details.
Wednesday, Jan 24					
CA	Bank of Canada Rate Decision	5.0%	5.0%	5.0%	Hawkish hold.
UK	Manufacturing PMI (Jan, prelim)	46.7	47.3	46.2	Persistent weakness.
UK	Services PMI (Jan, prelim)	53.2	53.8	53.4	Welcome resilience.
EC	Manufacturing PMI (Jan, prelim)	44.7	46.6	44.4	Bottoming out?
EC	Services PMI (Jan, prelim)	49.0	48.4	48.8	Soft.
GE	Manufacturing PMI (Jan, prelim)	43.7	45.4	43.3	Still extremely weak.
GE	Services PMI (Jan, prelim)	49.3	47.6	49.3	Disapointing!
FR	Manufacturing PMI (Jan, prelim)	42.5	43.2	42.1	Dismal.
Thursday, Jan 25					
US	GDP (Q4, q/q, saar, advance)	2.0%	3.3%	4.9%	Resilient yet again
US	Durable Goods Orders (Dec, m/m, prelim)	1.4%	0.0%	5.5% (↑)	Up 3.7% y/y.
US	Initial Jobless Claims (Jan 20, thous)	200	214	189 (↑)	Still very low.
US	Continuing Claims (Jan 13, thous)	1,825	1,833	1,806	Still very low.
US	New Home Sales (Dec, thous)	649	664	615	Lower mortgage rates help…a lot!
UK	GfK Consumer Confidence (Jan)	-21.0	-19.0	-22.0	Weak, but improving. Disinflation helps.
EC	ECB Main Refinancing Rate (Jan 25)	4.50%	4.50%	4.50%	No urgency for cuts.
GE	IFO Business Climate (Jan)	86.6	85.2	86.3	Oscillating in tight range.
FR	Business Confidence (Jan)	98.0	98.0	98.0	Soft.
JN	PPI Services (Dec, y/y)	2.4%	2.4%	2.3%	Look forward to see rising services CPI.
Friday, Jan 26					
US	Personal Income (Dec, m/m)	0.3%	0.3%	0.4%	Savings rate at year low of 3.7%.
US	Personal Spending (Dec, m/m)	0.5%	0.7%	0.4% (↑)	This lifted Q4 GDP.
US	Pending Home Sales (Dec, m/m)	2.0%	8.3%	-0.3% (↓)	Lower mortgage rates help…a lot!
GE	GfK Consumer Confidence (Feb)	-24.6	-29.7	-25.4 (↓)	Oscillating at low levels.
FR	Consumer Confidence (Jan)	90.0	91.0	89.0	Improving.
JN	Leading Index CI (Nov, final)	107.7 (p)	107.6	108.9	High probability of a recession.

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

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- Build from breadth
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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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