February 23, 2024
Commentary

Weekly Economic Perspectives

Contents

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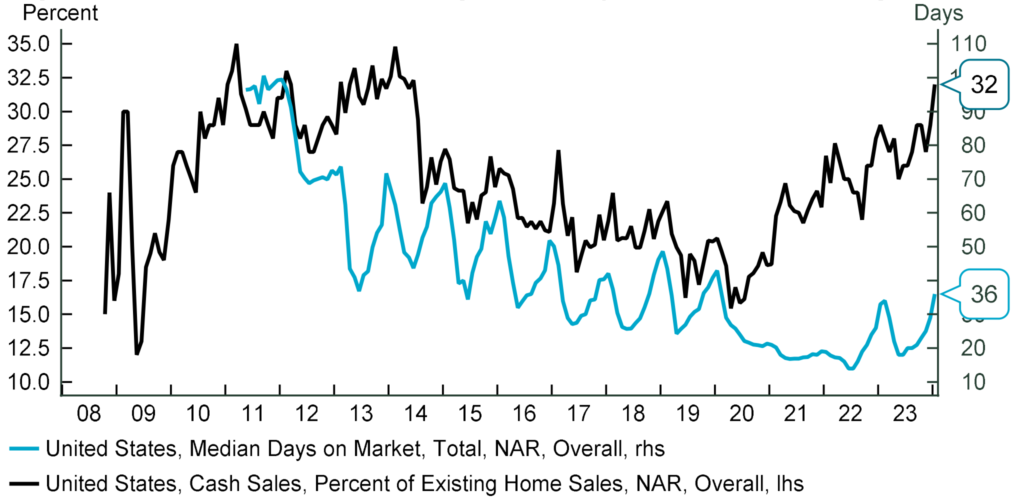
The Economy

Rate cut odds get reduced again on hawkish Fed speak during light-data week.

US

Existing home sales improved modestly in January to cross above the 4.0 million annualized rate for the first time since August. Sales remained 1.7% lower than in January 2023. The supply of existing homes remains tight at just 3.0 months of sales, so prices are rising. The median single-family home sold for 5.0% more this January than a year before; condos sold for 5.7% more. Given elevated mortgage rates, a higher share of those sales are cash sales: 32%, to be precise, the most in nearly a decade. Meanwhile, first-time home buyers are being kept out due to lack of affordability. Only 28% of sales went to first time home buyers, compared with 31% in January 2023. The share of first-time home buyers touched a post-GFC high of 35.9% in April 2020, but since interest rates began rising in 2022 it relapsed and has moved in a tight range close to the bottom of the post-GFC range. Homes are staying longer on the market (36 days) than they've had since January 2020.

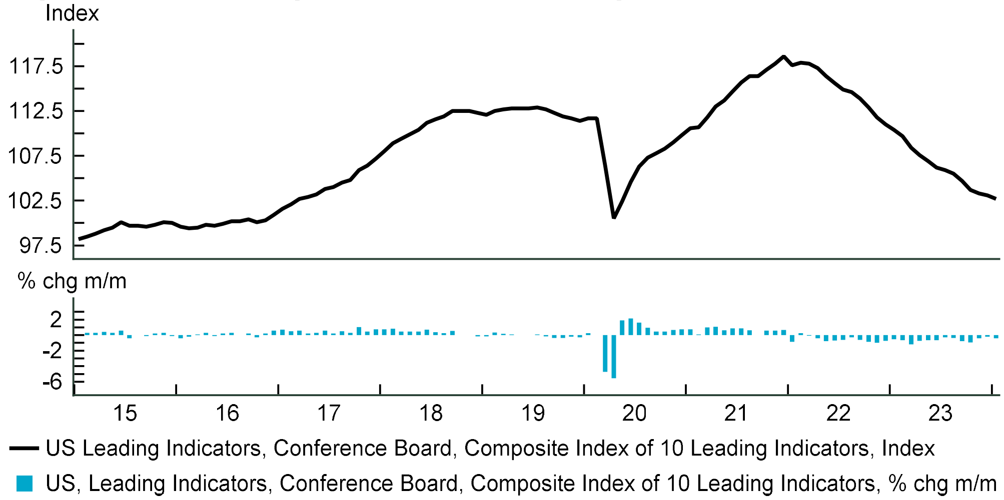
Figure 1: More Cash Sales, Longer Sale Cycle For US Existing Homes



Sources: Macrobond, SSGA Economics, NAR, BEA
Updated as of 2/22/2024

In the past 18 months, we've rarely reported on the index of **leading economic indicators (LEI)**. This was partly because most of the components were already discussed separately, but primarily because the leading index lost some of its leading qualities in the post-Covid recovery. If historical relationships held, the US economy would have been in recession a long time ago. We know that has not been the case. This is a perfect example of core "rule of thumb" macro relationships which Covid has upended. However, we've always been of the view that these relationships aren't dead altogether, but rather, have been altered and delayed. And that is why we think the time has come to once again pay close attention to the leading index. The headline has now declined for 23 consecutive months, a single month short of the record established in 2007-2009. It feels as though we are now of thin ice; further deterioration in the LEI from here on cannot be quite as easily dismissed as not very pertinent. Recession odds rise with every passing month of further erosion.

Figure 2: US Leading Index In Second-Longest Decline On Record



Sources: Macrobond, SSGA Economics, TCB
Updated as of 2/22/2024

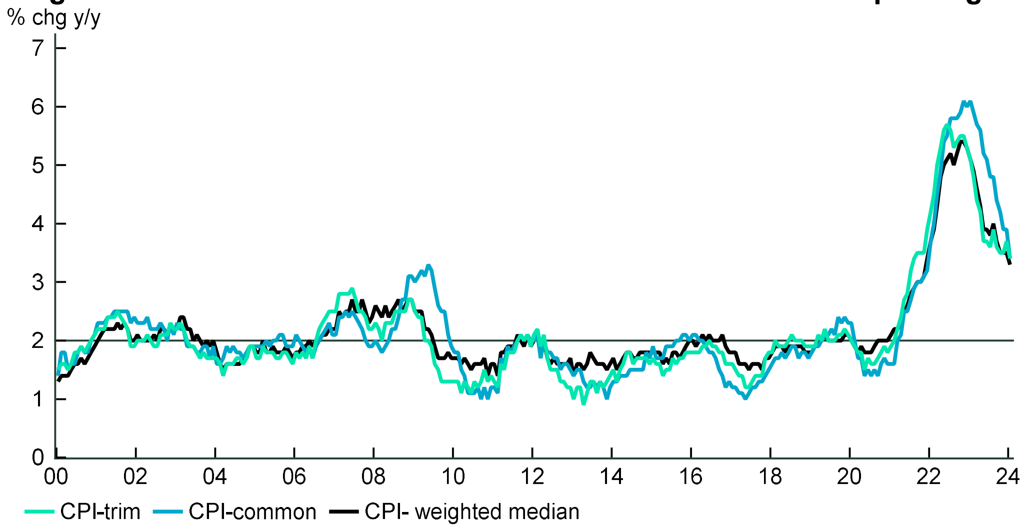
Initial **unemployment claims** continue to hover in the low-200k range, suggesting little genuine stress in the labor market. Meanwhile, continuing claims have shifted higher, suggesting that it is slightly more difficult for those unemployed to get a new job. Still, the uptrend has been well contained. Initial claims dipped to just 201k in the week ending February 17th, while continuing claims edged down to 1.862 million in the week ending February 10. The less volatile 4-week moving average of continuing claims ticked up marginally during the same week, however, to settle at its highest level since December 2021.

The data remains decidedly mixed, but **Fed speak** this week was decidedly hawkish. At their core, the comments were neither out of the ordinary, nor different from what Fed officials had been saying all along. After all, “there is no rush to begin cutting interest rates to normalize monetary policy” (Waller) and rate cuts are likely appropriate “later this year” (Williams, Jefferson). However, from Fed official’s perspective, the hot January inflation data has triggered a bit of a reset in the countdown to that first cut. Specifically, even if proven to have been a mere bump on the road to disinflation (as we anticipate), it would require at least a couple of more data points to demonstrate that. We will get two more inflation prints by the May 1 meeting, so May is still feasible if the data come in convincingly on the disinflation side of the narrative. But the evidence would have to be convincing on prices, or, at least, accompanied by evidence of softening labor demand. We think this is likely but since it is not guaranteed, the risks to our call for a May cut have risen. Still, we would view the odds more like 50/50 rather than the sub-20% priced as of Friday afternoon. We find it telling that the language used in this week’s Fed speeches was hawkish but flexible: the door has certainly not been closed on yet another dovish pivot should the data facilitate it.

Canada

It has been a volatile few months for Canadian **inflation** but January was a downside surprise month, with headline inflation down half a percentage point to 2.9%, well below expectations and the first time in half a year that the print was within the Bank of Canada's band. Prices were flat m/m despite a 0.7% increase in food prices and a 1.1% monthly jump in alcohol and tobacco prices. Offsetting these were a 3.2% m/m plunge in clothing and footwear and a 1.2% m/m decline in transportation prices. Goods and service prices were both flat overall. Core inflation measures took a big step down as well. CPI-common eased half a percentage point to 3.4% y/y while CPI-trim moderated three-tenth—also to 3.4% y/y—while CPI-median eased two-tenths to 3.3% y/y. Not the final proof the BoC has been waiting for before starting the easing cycle, but an important piece of evidence.

Figure 3: Canadian Core Inflation Measures Elevated But Improving



Sources: SSGA Economics, StatCan

UK

Manufacturing activity continues to struggle but the services sector is demonstrating a very welcome degree of resilience that is a positive signal for Q1 GDP growth. The **purchasing managers' index (PMI) for manufacturing** was nearly unchanged at 47.1 in the preliminary February reading, but the components showed quite a bit more movement. On one hand, output contracted at the slowest rate since June, but on the other, employment declined at the fastest rate since June 2020. The 5.2-point plunge in the latter is rather dramatic so we'll wait to see if it is confirmed in the final release. The **purchasing managers' index (PMI) for services** was unchanged at 54.3, with incoming new business and employment metrics both higher. The price metrics generally ticked higher in both surveys.

The **GfK consumer sentiment index** dipped two points to -21 in February, which was a little surprising given the steady improvement of the past several months. Still, this may yet be simple data volatility given the small move, so we are not too worried.

Eurozone

Eurozone manufacturing activity contracted at a faster rate in February, according to preliminary PMI reading, driven largely by Germany. The ***eurozone* manufacturing PMI** retreated half a point to 46.1, which was nonetheless the second-best reading since March 2023. The German index nosedived3.2 points to a three-month low of

42.3. This overwhelmed the 3.7-point jump in the French index, which now sits at 46.8, the highest since March 2023.

German real, calendar-adjusted **GDP** was confirmed to have contracted 0.3% q/q in Q4. A modest improvement in consumer spending was overwhelmed by a big drag in investment and no traction from trade.

Japan

Incoming data remains mixed and continues to challenge the Bank of Japan (BoJ) in their monetary policy maneuver, but their confidence remained unscathed this week.

The value of **exports** rose in January by 11.9% y/y, but volumes (from the BoJ) growth cooled to 1.6%. For imports, both the prices and volumes declined (9.6% y/y & 11.4% y/y respectively). However, the volumes declined significantly from December – exports by 4.6% m/m and imports by 9.7%. Falling imports continue to give us the impression of a continued drag in consumption.

A couple of one-off factors may have caused the decline, but these data are worrying nonetheless. Firstly, Q1 trade data of late have been impacted by seasonal adjustments due to the Lunar New Year holidays in Asia. The Noto peninsular earthquake also may have impacted exports as production was halted at a major auto maker. However, we will still need to take all the data in Q1 into consideration in judging whether exports are rebounding or continuing to slow.

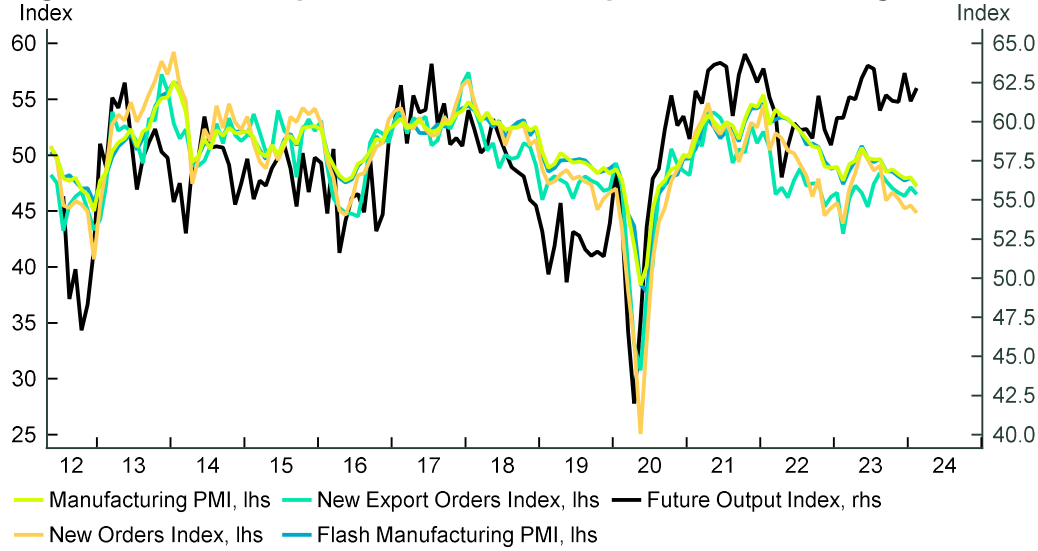
Like in many cases, but with a lag, Japan's manufacturing is slowing, while services exhibit resiliency. The **Manufacturing PMI** eased 0.8 points to 47.2 while the services index eased 0.6 points to 52.5. The survey noted that "a steep reduction in new orders led to production shrinking at the fastest rate for a year." **Two interesting observations here from the PMI data indicate that the index may rebound and, inflation could remain above the average price level between 2010-19**.

Firstly, the input prices PMI metric seems to have bottomed out above levels prevailing in 2010-19. This is closely followed by output prices, so inflation may decline due to disinflation but may remain above the last decade's level.

Second, the "Future Output Index" remains resilient above 60.0 and has been trending higher from April 2022. This is starkly opposed to the headline index, which has been contracting for 16 months (except May 23, 50.6). When smoothed by 12 months, the future index leads the headline with a strong correlation. The headline manufacturing PMI correlates well with machine orders, whose growth is just turning around after declining for a while. Is this what the survey participants observe which is yet to show in the data? Only time will tell but, the takeaway is cautious optimism.

Machinery orders, which also lead capital expenditures well, have rebounded 2.5% m/m in December. Annually, they declined just 0.7% y/y, half as expected. In Q4 overall orders declined 1.0% q/q and were dragged largely by chemicals (-26.0% q/q), IT & communications (-22.7%) and general machinery (-9.1%), but increases were seen in telecommunications (18.1%), wholesale & retails (9.1%). The Cabinet Office looks for a sharp rise of 4.6% q/q in Q1 2024, driven by a sharp uptick in manufacturing orders, similar to our key insight from the PMI data above.

Figure 4: Future Output Bodes Well For Japan's Manufacturing PMI



Sources: SSGA Economics, S&P Global, Macrobond
Updated as of 2/23/2024

The dataflow remained weak but there are some caveats that showcase potential improvement in coming months. Governor Kazuo Ueda maintained his upbeat assessment of inflation and wages and reiterated conviction that a virtuous wage-price cycle is taking shape for the bank to normalize policy. Next week, the national CPI may have fallen below 2% in January, but more importantly, retail sales may have risen well to indicate a view that consumption may improve in Q1.

Australia

The **Wage Price Index** rose 1.0% q/q in Q4 2023, in line with expectations. The outcome was a stepdown from Q3's 1.3% sequential growth but, the annual growth rate was up by a tenth to 4.2% y/y. Crucially, a declining trend in inflation ensured that real wages turned positive for the first time in nearly three years. This should help improve consumer sentiment over the coming months.

The public sector (1.3% q/q) had a better outcome than the private sector (0.9%). The ABS indeed highlighted that the higher outcome in the public sector was due to newly implemented enterprise agreements for workers in the healthcare and education sub-industries.

This data is in line with the Reserve Bank of Australia (RBA) & market expectations, so the case for a rate cut is still alive as the market pricing is in line with our expectation of the first cut in August, as of now. The **minutes** of the RBA's February meeting noted that the recent data flow "*gave them more confidence that inflation would return to target within a reasonable timeframe, while allowing employment to continue to grow.*" This too, is in line with our expectations.

Next week, we expect January CPI to have cooled a touch but remained slightly above 3.0% y/y levels, while retail sales may also have eased.

Week in Review (Feb 19 – Feb 23)

Country	Release (Date, format)	Consensus	Actual	Last	Comments
Monday, Feb 19					
CA	Industrial Product Price (Jan, m/m)	-0.2%	-0.1%	-1.6% (↓)	Still subdued.
CA	Raw Materials Price Index (Jan, m/m)	0.6%	1.2%	-4.9%	Hogher energy prices.
JN	Core Machine Orders (Dec, m/m)	2.7%	2.7%	-4.9%	Looking alright.
Tuesday, Feb 20					
US	Leading Index (Jan, m/m)	-0.3%	-0.4%	-0.2% (↓)	Second-longest decline on record.
CA	CPI (Jan, y/y)	3.3%	2.9%	3.4%	Pleasant surprise.
AU	Wage Price Index (Q4, y/y)	4.1%	4.2%	4.1% (↑)	Real wages above 0%, should help consumption.
Wednesday, Feb 21					
JN	Manufacturing PMI (Feb, prelim)	na	47.2	48.0	May revive on higher future output index.
Thursday, Feb 22					
US	Initial Jobless Claims (Feb 17, thous)	216	201	213 (↑)	Low.
US	Continuing Claims (Feb 10, thous)	1,884	1,862	1,889 (↓)	Low.
US	Existing Home Sales (Jan, m/m)	4.9%	3.1%	-0.8% (↑)	Stirring, but still constrained.
CA	Retail Sales (Dec, m/m)	0.8%	0.9%	0.0% (↑)	Somewhat better.
UK	Manufacturing PMI (Feb, prelim)	47.5	47.1	47.0	Still weak but bottoming.
UK	Services PMI (Feb, prelim)	54.1	54.3	54.3	Very welcome resilience here.
UK	GfK Consumer Confidence (Feb)	-18	-21	-19	Surprising pullback.
EC	Manufacturing PMI (Feb, prelim)	47.0	46.1	46.6	Weak.
EC	Services PMI (Feb, prelim)	48.8	50.0	48.4	Improving, which is great to see.
EC	CPI (Jan, y/y, final)	2.8% (p)	2.8%	2.9%	As already reported.
GE	Manufacturing PMI (Feb, prelim)	46.0	42.3	45.5	Terrible !
GE	Services PMI (Feb, prelim)	48.0	48.2	47.7	Still soft.
FR	Manufacturing PMI (Feb, prelim)	43.5	46.8	43.1	Still very weak, just not as bad as before.
Friday, Feb 23					
GE	GDP (Q4, q/q, final)	-0.3% (p)	-0.3%	0.0%	As reported.
GE	IFO Business Climate (Feb)	85.5	85.5	85.2	Steady.

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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