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Commentary

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Global Macro Highlights

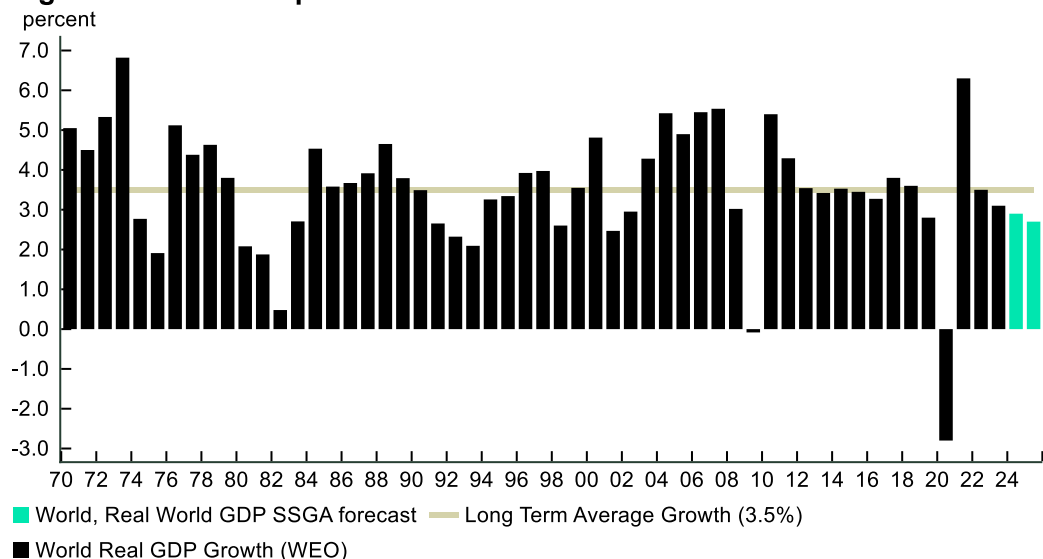
A Gentle Step Down In Global Growth As Rate Cuts Are Set To Broaden

As we put the data finishing touches on 2023 and focus on 2024, an encouraging picture emerges at the global level. The world economy grew an estimated 3.1% last year (PPP weights), slower than the 3.5% advance in 2022 but much better than initially anticipated. Given elevated interest rates, this degree of resilience is notable indeed.

The world’s three largest economies had much to do with this. Bucking earlier expectations of a slowdown, US growth actually improved last year thanks to resilient consumers, a big boost from government spending, and less drag from foreign trade. The economy resultingly expanded by 2.5% in 2023, well ahead of prior year’s 1.9% gain. Meanwhile, on the heels of a much-delayed re-opening, the Chinese economy grew 5.2%, far ahead of the 3.0% increase in 2022. In Japan, growth nearly doubled to 1.9% as much better trade and investment outcomes offset softer consumer spending. Elsewhere, the performance was much less impressive. In Europe, the delayed impact of high inflation and rising interest rates undermined both consumer spending and fixed investment and brought performance to a near standstill both in the UK and the eurozone. Outside of China, the rest of the emerging market universe had a widely varied performance. Resilience in counties like India, Mexico, and Indonesia was countered by notable deceleration in Poland, Colombia, and Malaysia, among others.

The good news is the global disinflation continued and broadened, as we had been expecting. As a result, with very few exceptions (e.g., Japan, Taiwan, Turkey), the global monetary policy tide has already shifted towards careful easing. Among key developed markets, only the Swiss National Bank has actually delivered a rate cut so far, but by the middle of this year, both the ECB and the Fed look likely to join it. From there on, a broadening global easing cycle should help put a floor under global growth, which drifts a little further below long-run averages, but not by much.

Figure 1: Gentle Step Down In Global Growth



Sources: Macrobond, SSGA Economics, IMF World Economic Outlook
Updated as of 3/22/2024

Summary of World Output¹ and Inflation²

(Annual percent change)

	Weight	History					Forecast	
	(2022)	2019	2020	2021	2022	2023	2024	2025
World Growth	100.0	2.8	-2.8	6.3	3.5	3.1	2.9	2.7
Advanced Economies	41.7	1.7	-4.2	5.6	2.6	1.6	1.4	1.4
US	15.5	2.5	-2.2	5.8	1.9	2.5	1.9	1.4
Euro area	12.2	1.6	-6.2	5.9	3.4	0.5	0.8	1.3
Germany	3.3	1.1	-4.2	3.1	1.9	-0.1	0.6	1.1
France	2.3	1.9	-7.7	6.4	2.5	0.9	1.0	1.2
Italy	1.9	0.5	-9.0	8.3	4.1	0.9	0.9	1.2
Japan	3.7	-0.4	-4.2	2.7	1.0	1.9	1.0	1.3
UK	2.3	1.7	-10.4	9.6	4.5	0.1	0.8	1.5
Canada	1.4	1.9	-5.0	5.5	3.8	1.1	1.0	1.4
Australia	1.0	1.8	-2.1	5.7	3.8	2.1	1.7	2.3
Developing Economies	58.3	3.6	-1.8	6.9	4.1	4.1	3.9	3.6
China	18.4	6.0	2.2	8.4	3.0	5.2	4.6	4.2
Advanced Economy Inflation	41.7	1.4	0.7	3.1	7.3	7.3	2.9	2.3
US	15.5	1.8	1.3	4.7	8.0	4.1	2.9	2.3
Euro area	12.2	1.2	0.3	2.6	8.4	5.5	2.4	1.8
Germany	3.3	1.4	0.5	3.1	6.9	6.0	2.0	1.9
France	2.3	1.1	0.5	1.7	5.2	4.9	2.6	1.5
Italy	1.9	0.6	-0.1	1.9	8.2	5.7	1.7	1.8
Japan	3.7	0.5	0.0	-0.3	2.5	3.3	2.2	1.8
UK	2.3	1.8	0.9	2.6	9.1	7.4	2.5	1.7
Canada	1.4	1.9	0.7	3.4	6.8	3.9	2.5	2.2
Australia	1.0	1.6	0.9	2.9	6.6	5.6	3.3	2.7
Developing Economies	58.3	5.1	5.1	5.9	9.8	8.2	6.8	5.2
China	18.4	2.9	2.4	0.9	2.0	0.2	0.4	1.6
Value of World Output (\$ trl)								
At Market Exchange Rates		87.3	85.0	96.5	100.1	104.5	114.1	121.0
At Purchasing Power Parities		135.8	133.5	148.2	163.8	174.8	190.3	202.1

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

A Better Macro Policy Framework for Europe

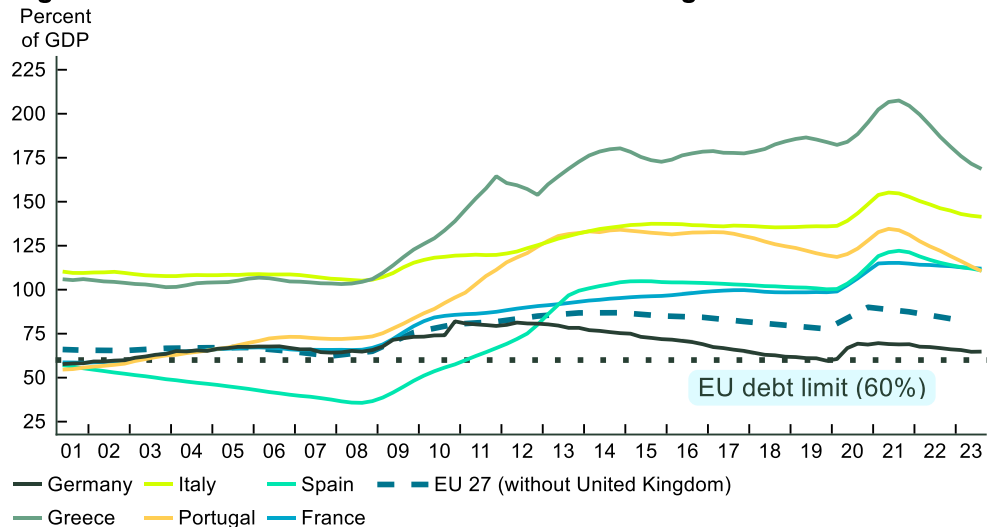
This year brought two important changes to Europe’s macro policy framework: new EU fiscal rules (announced in February) and the new ECB monetary policy framework (announced in March). Elements of what had previously been one-off responses to crises thus become forward-looking features of the macro policy toolbox. Neither are game changers, but they are steps in the right direction that enhance the bloc’s ability to manage crises and strengthen its internal cohesion. They improve the sustainability of the Euro and the European project as a whole.

1. New Fiscal Rules

In early February, the EU agreed to long-awaited reforms of the EU fiscal rules. The reforms are fundamental insofar as they change both the rules themselves and how they are governed. The new rules are simpler, less pro-cyclical, and therefore more credible and more effective than the old ones.

The prior rules emerged from the Eurozone crisis of the early 2010s. Although observers still frequently refer to them by their two nominal limits –3% of GDP budget deficit and 60% debt to GDP—in practice they were highly complex (both the rules themselves and how they were applied). That they were too pro-cyclical, too complex, too formulaic have been among the top criticisms. Their inability to deliver on the ultimate goal of ensuring fiscal convergence (or even preventing further divergence) made it clear that a change was needed.

Figure 2: Government Debt Levels Relative To Target



Sources: Macrobond, SSGA Economics, Eurostat
Updated as of 3/22/2024

The reforms make two fundamental changes. First, they give individual countries more ownership of the fiscal consolidation paths. If previously countries followed one-size-fits-all paths defined by the Commission, the new rules recognize that what is fiscally sustainable can differ among countries. The new fiscal paths will therefore be individually negotiated on the basis of a debt-sustainability assessment that takes a holistic view of a country’s circumstances. Second, the

reforms simplify the rules. If compliance was previously judged on multiple fiscal indicators, the new rules focus on just one – net expenditure. The chief benefit of using this one metric is that it is observable and thus easier to monitor. The overarching idea is that a simpler, looser, and more flexible approach is a better way to manage fiscal risks within the Union.

This is not to suggest that the conservative “Nordics” have capitulated to the profligate “South.” The new rules include a wide range of limits, such as the minimum size of annual fiscal adjustments. What is different is the shift in emphasis: the intent is to reduce micro-management by the Commission. The limits prevent the path-setting exercise from becoming a fiscal free-for-all.

What effect should we expect on economies and markets? In the short term, a drag on growth is inevitable, but not because of the new rules; rather, despite them. Since the EU suspended its fiscal rules in 2020 due to the Covid-19 crisis, member states have run fiscal deficits far in excess of the rules. A fiscal adjustment would have at some point occurred regardless.

In the longer term, the effect is more uncertain but net positive. Most importantly, the reforms strengthen the integrity of the Euro and, by extension, the European Union itself. They do so in three ways: (1) by modernizing the rules to reflect current political priorities; (2) by re-affirming the political commitment to fiscal prudence; and (3) by making it more likely that, in a crisis, calls to support the integrity of the bloc will trump concerns over moral hazard. All else equal, we expect this to soften regional business cycles and reduce the likelihood that countries will drop the Euro. This is good for both European assets and the Euro in the long run.

2. New ECB Monetary Policy Framework

Following a review initiated in December 2022, the ECB announced changes to its monetary policy operational framework on March 13. The intent is to ensure monetary policy responds to changes in the financial system such that it remains “effective, robust, flexible and efficient in the future.”

Unlike the tight liquidity environment that prevailed prior to the Great Financial Crisis, there is a commitment to a demand-driven, ample liquidity system. The ECB will provide as much liquidity as banks request in exchange for appropriate collateral. In this, the ECB is more “generous” than the Fed.

The ECB maintains three policy interest rates. These remain in place, and their roles are unchanged. The deposit facility rate (DFR, now 4.0%) remains the main channel for policy implementation. The main refinancing operations rate (MRO, now 4.5%) remains the rate at which banks access liquidity, but the corridor between it and the DFR will shrink from 50 to 15 basis points. The marginal lending facility, (MLR, now 4.75%) will maintain a 25 bp premium over MRO and is the cost of obtaining overnight short-notice funding.

The commitment to a demand-driven ample liquidity environment and the less onerous funding premium should help reduce volatility in money market rates and reduce banking sector liquidity squeezes. In that regard, the new monetary policy framework works in tandem with new fiscal rules to improve the cohesion of both the eurozone and the European Union.

**Country Macro
Highlights**

Please see country-specific commentary in the sections below.

**US: The Best of Both
Worlds?**

Last December, we wrote in our quarterly commentary that we were “glad to see that, despite the trials and tribulations of the intervening period, the continued 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.”

What has changed in the intervening three months? What has transpired since then can indeed be summarized as “another wave of data resilience.” H2 2023 real **GDP** averaged 3.0% y/y, nearly one percentage point higher than the first-half average as consumer spending improved a little, government spending improved a little more, and investment improved a lot more. Within investment, the story remains quite bifurcated. Private fixed investment is benefiting from a boom in non-residential structures and a revival in residential construction. In Q4, the latter posted its first positive y/y growth in two years. Other parts of private fixed investment are not doing nearly as well: business fixed investment in equipment has declined y/y both in Q3 and in Q4. Government investment is on a tear, up 10.9% y/y during the second half of 2023. The growth benefit stemming from previously approved fiscal packages played a key role in why the US outperformed both consensus expectations and developed market peers. Indeed, the US economy grew 2.5% last year, up from 1.9% in 2022.

Despite this, and even though the unemployment rate was just 3.7% in December, headline **CPI inflation** nearly halved from 8.0% in 2022 to 4.1% last year (annual averages). Progress on core CPI inflation was more modest, from 6.2% to 4.8%, respectively; core PCE inflation moderated from 5.2% to 4.1%. The latter is now showing more pronounced disinflation, with the January reading down to 2.8% y/y.

Such a rare combination of trends should be celebrated. One may be reticent of using grand terms, but 2023 can be fairly described as having brought the best of both worlds for the US economy. After all, strong growth with powerful disinflation is the quintessential soft-landing scenario.

But is there too much of a good thing? We still do not believe so, but we worry there might be. In what way? That wave of renewed resilience evident in the January-February employment and inflation data (for detailed discussions please see commentary in our Weekly Economic Perspectives) is once again threatening the **Fed's** confidence that inflation is progressing sustainably towards the 2.0% target. We have been forced to push back our expectations for the first Fed rate cut from May to June, and because of that, it would be difficult to get all the 150 basis points worth of 2024 rate cuts than we anticipated back in December. We are looking for 100-125 bp now, with comparable odds between the two outcomes.

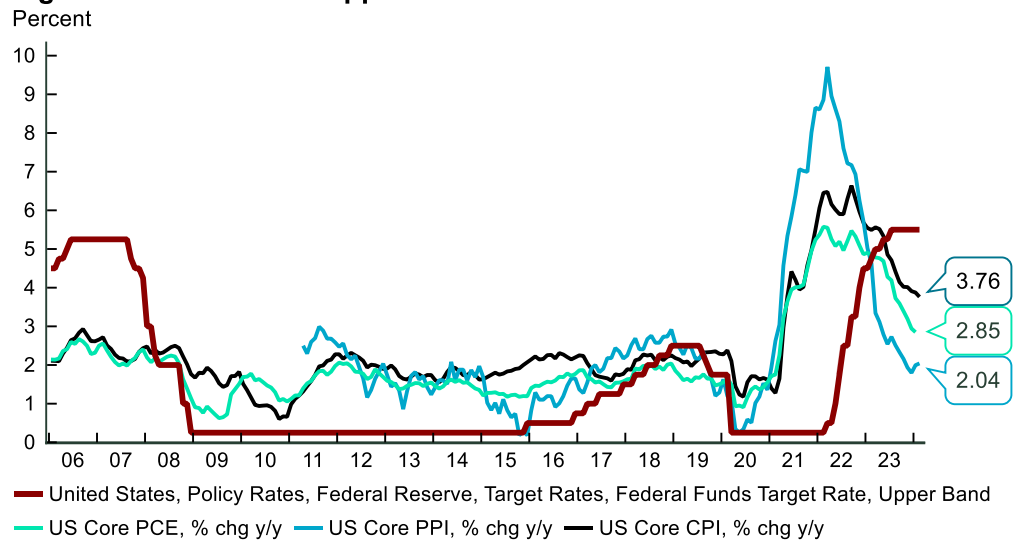
From our standpoint, we think 125 bp worth of cuts this year would be better for two main reasons:

1. Monetary policy works with very long lags and the Fed is now making policy not for 2024 but for 2025
2. The totality of indicators suggests labor demand is actually moderating, wage pressures are easing, and risks to the outlook are growing

As we have argued before, we would prefer to see the Fed nurture the evolving soft landing and that means calibrating policy lower as inflation allows. Despite the upside inflation surprises in January and February, we think progress on inflation so far no longer requires the same degree of policy restrictiveness.

The new dot plot from the March meeting maintained three rate cuts for 2024 but removed one in 2025 (only three now versus four in December). The FOMC has also nudged its long-term neutral rate estimate up a tenth to 2.6%. These changes suggest that the committee agrees that the economy no longer needs as much monetary policy restraint, but that restraint may have to be retained for longer than previously thought. This may well prove to be true, but it is hard to have a high conviction that this will indeed be the case. As to the uptick in the neutral rate, we agree with the move and in fact expect it to move higher still to match our own 2.75% estimate. We see this not so much as a high conviction estimate (certainly not on our part and likely not on the FOMCs part either) but more of a risk management exercise to respond to new, somewhat inflationary trends like supply-chain restructuring and the green transition. Even so, a higher neutral rate (especially a change of such magnitude) should not have any bearing on 2024 rate decisions since the current level of Fed Funds is so far above that estimate.

Figure 3: Disinflation Supports A First Fed Rate Cut In June



Sources: Macrobond, SSGA Economics, BLS, GAC, University of Michigan, BEA, Fed
Updated as of 3/22/2024

For the time being, we pencil in another 125 bp worth of cuts for 2025. This would leave the Fed Funds upper target at 3.0% at the end of next year, close to neutral territory. It is rare that once a cutting cycle begins, the policy rate does not fall

below the estimated neutral rate. However, this cutting cycle is driven by disinflation not by economic weakness and so it can end up being shallower. Since we do not forecast a recession and since we forecast the unemployment rate to only rise to the mid-4.0% by the end of 2025, having the policy rate only approach neutral seems reasonable expectation, especially since we also don't expect core PCE forecast to touch 2.0% y/y until the latter part of 2025.

Regarding **balance sheet policy**, nothing was officially communicated in the March statement, but Chair Powell mentioned during the press conference that the time to slow balance sheet runoffs could arrive "fairly soon". Reading between the lines, we would expect a formal announcement at the May meeting. As we ourselves have done, Chair Powell highlighted the value of "slower for longer" on balance sheet: by moving more carefully, the Fed can avoid triggering undue stress and needing to end QT before it would otherwise choose to do.

There remain two sided **risks** to the macro outlook, although the more time goes by, the more relevant downside risks become. As excess labor demand fades, the corporate refinancing wall approaches, and fiscal cliff risks near, the economy's performance could deteriorate faster than currently anticipated, in which case the Fed has made it clear that they would respond more powerfully. Similarly, the economy's resilience so far cannot be ignored; there is a possibility the lingering fiscal boost from the Chips Act continues to power faster investment growth than we currently pencil in. There remain some upside risks on the inflation front as well, especially in housing, where inelastic supply is being challenged by, among others, resurgent immigration flows.

Canada: Muted Economic Growth

High interest rates continue to present challenges to the economy. We keep our growth forecast for 2024 at a still weak 1.0% and expect 1.4% growth for next year.

After a mild Q3 contraction, Q4 **GDP** growth bested expectations but the details were quite mixed. The economy grew at an annualized rate of 1.0% q/q in Q4. Trade was the largest contributor. Household consumption rose 1.0% q/q, driven by population growth and easing supply chains. Meanwhile, business investment was the biggest drag on performance, with large declines in both residential investment and non-residential structures, machinery, and equipment.

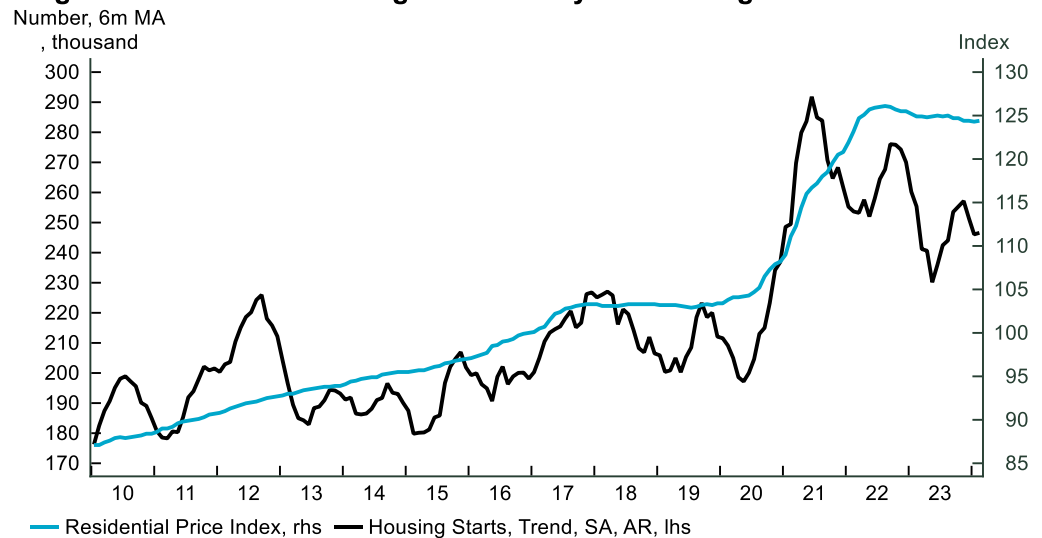
The housing market is expected to pick up steam (Figure 4, page 9). Home sales continued showing signs of recovery. Existing home sales rose decently at 3.7% m/m in January, following a 7.9% m/m increase in the previous month. Housing starts also rebounded more than expected in February. The latest gain was concentrated in the multi-urban starts, which we anticipate will continue to do well given historically high population growth.

February's favorable **inflation** data, especially softer core inflation, was a welcome development. Inflation continued to surprise to the downside as headline print unexpectedly fell to 2.8% during the month, from 2.9% y/y in January. Core inflation measures also decelerated to more than two-year lows. Weighted median, common, and trimmed mean measures all eased by 0.2 percentage points to 3.1% y/y, 3.1% y/y and 3.2% y/y, respectively.

The latest **labor market** report was an upside surprise in the headline rather than the details. After three months of modest changes, employment rose by 37k, all in

part-time jobs. While the unemployment rate inched down 0.1 percentage points to 5.7%, it was driven entirely by a 0.1 percentage point decline in labor force participation rate to 65.3%. This, together with possible seasonal adjustment issues with January job reports, does not suggest a particularly strong labor market. Wage growth slowed from 5.7% to 5.3% but remains elevated.

Figure 4. Canadian Housing Starts Likely To Turn Higher



Sources: Macrobond, SSGA Economics, CMHC, StatCan
Updated as of 3/25/2024

The **Bank of Canada (BoC)** left its overnight rate unchanged at 5.0% while continuing quantitative tightening. The bank highlighted evidence of weaker economic momentum as “final domestic demand contracted with a large decline in business investment.” It also stated that “employment continues to grow more slowly than the population, and there are now some signs that wage pressures may be easing.” Meanwhile, the BoC expects “inflation to remain close to 3% during the first half of this year before gradually easing” and is still concerned about inflation risks. That said, the BoC will sit on the sidelines for the next few months while maintaining its cautious rhetoric. Given the softening in both domestic and external data, we expect 100-125 basis points worth of rate cuts this year.

UK: Better Growth Outlook

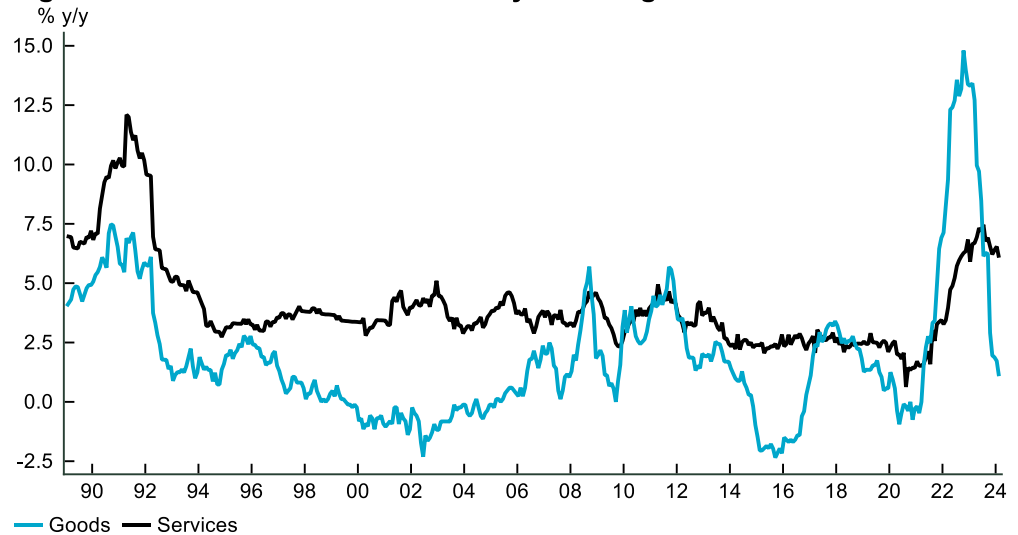
Following a shallow technical recession in the second half of 2023, the UK economy should improve a little this year. We have maintained our 0.8% real GDP growth forecast for 2024 and expect 1.5% growth in 2025 as business investment and household consumption pick up.

Q4 **GDP** growth slightly undershot expectations as large declines in trade and household spending offset investment gains. But, given lower inflation and real income gains, we anticipate that consumer spending will pick up firmly in coming quarters. Business investment and housing activity (which saw large declines last year) should also recover, albeit at a more muted pace. Meanwhile, UK PMIs point to a brighter outlook. Manufacturing production ended the twelve-month period of

contraction, supported by strong new orders. Services experienced another robust expansion in March, driven by rising business and consumer spending.

Inflation surprised to the downside again in February, with the headline down six tenths to 3.4% y/y. The deceleration was broad-based. Importantly, core inflation took a big step down, easing from 5.1% y/y to 4.5% y/y. Given the improved outlook for inflation, we downgraded this year’s forecast by two tenths to 2.5% y/y and expect 1.7% CPI inflation in 2025.

Figure 5. UK Services Inflation Finally Trending Lower



Sources: Macrobond, SSGA Economics, ONS
Updated as of 3/25/2024

The latest data revealed further easing in the **labor market** albeit at a marginal pace. The growth in average total pay (including bonuses) for the three months to January eased two tenths to 5.6% y/y. Growth in regular pay (excluding bonuses) also edged down to 6.1% y/y. However, private sector pay growth remains above BoE forecasts. Meanwhile, labor demand continues to ease with vacancies down for the 20th consecutive period to 908k. The unemployment rate inched up to 3.9% but with the usual caveat that there is “increased volatility of LFS estimates.” We expect wage pressures to ease further in the next few months.

As expected, the **BoE** left the Bank rate unchanged at 5.25% at the March meeting. Unlike previously, there were no votes favoring a hike. The MPC kept their hawkish guidance but seem to be gaining confidence that inflation is moving back to the 2% target. The data will decide when rates are cut, but given the improved inflation outlook, we now expect 100-125 basis points (bp) of cuts this year (up from 100 previously) and think that a June rate cut is possible.

Eurozone: Keeping Hope Alive

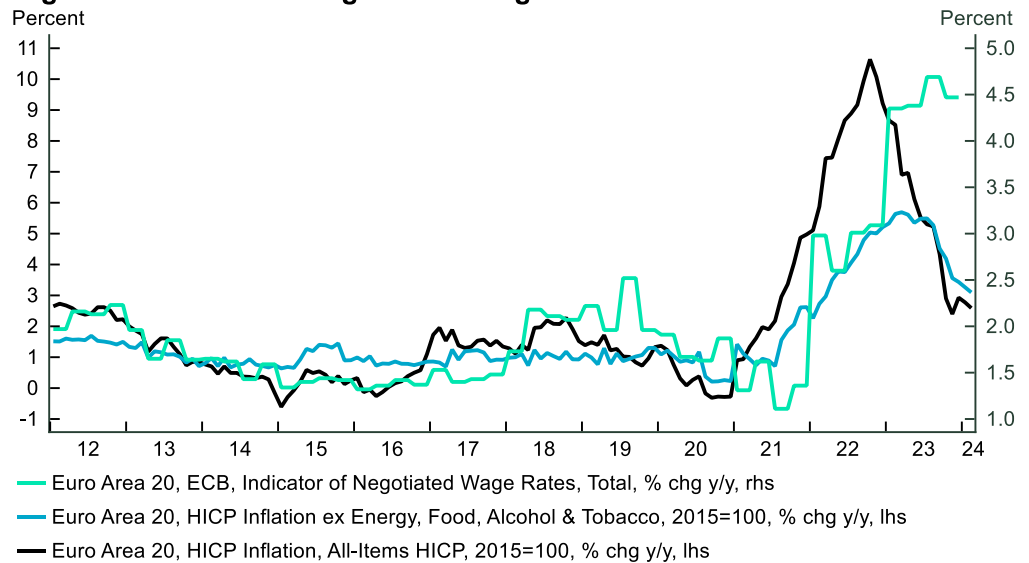
2023 was far from a great year for the eurozone economy, but—with the exception of Germany—neither was it downright bad. The regional economy grew 0.5%, a tenth less than we estimated back in December but down sharply from 3.4% in 2022. We still think revisions may ultimately put that number a little higher, but for now we work with the numbers as reported.

Challenged by high inflation, consumer spending slowed drastically over the course of the year. Fixed investment held up decently well, but inventory accumulation showed and was a drag on performance. Exports were surprisingly weak given the resilience of both US and Chinese growth, but this is a reminder that the eurozone also trades a lot with the rest of UK. In other words, there was little help to be had on the growth side from either corner of the economy.

There were two bright spots in this otherwise underwhelming picture, and they are important ones as they carry the seeds of future improvement. One is the resilience of the labor market, with the unemployment rate touching new lows. The other is the deep disinflation that has occurred over the course of last year, with headline inflation down from an average of 8.4% in 2022 to 5.5% in 2023. On a December-to-December basis, the improvement was even starker: from 9.2% y/y in December 2022 to 2.9% y/y in December 2023.

The combination of steady employment, strong nominal wage gains, and material disinflation, speaks to a delayed yet powerful boost to real consumer incomes in 2024. It is quite likely that a conservative predisposition—especially among German consumers—will limit the positive impact of this on consumer spending. But we doubt it would entirely offset it. So, we still look for above consensus growth of 0.8% this year (down a tenth from December), followed by 1.3% in 2025.

Figure 6: Two Conflicting Inflation Signals For The ECB



Sources: Macrobond, SSGA Economics, Eurostat, ECB

Despite the region’s weak growth and steep disinflation, the ECB has been reluctant to initiate an easing cycle so far due to latent inflationary pressures stemming from the labor market. The ECB indicator of negotiated wages has only

recently peaked and remains historically very elevated. The decision to wait was warranted, but we think the door is open to start dialing back policy restriction and we look for a total of 100 basis points worth of cuts this year. Both the timing and the magnitude are the same as in our December forecasts. There is a chance the ECB may be able to do a little more, but the labor market would have to show some more meaningful pullback in wage inflation for that to happen.

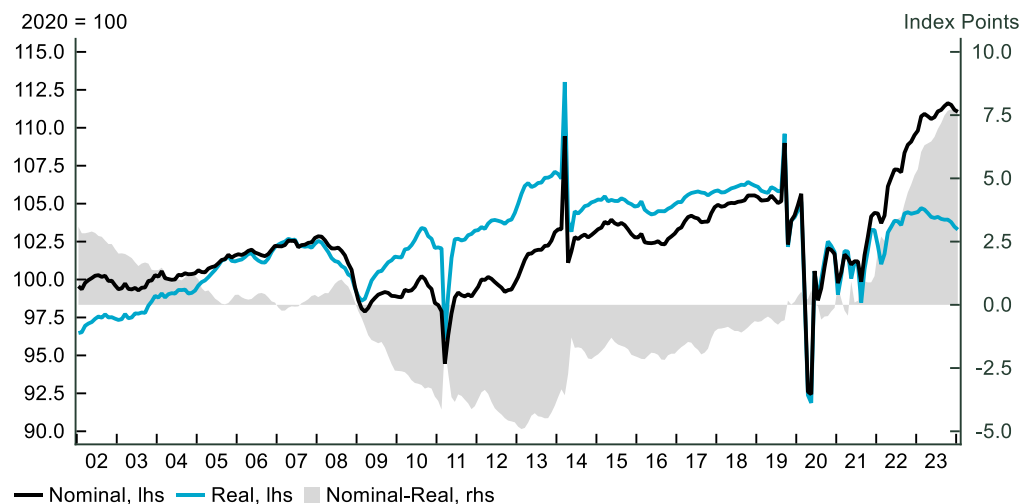
Japan: The Great Normalization

In March, the **Bank of Japan (BoJ)** finally ended Negative Interest Rate Policy (NIRP) and Yield Curve Control (YCC) and began normalizing monetary policy. They also formally ended ETFs and J-REITs purchases. The target range for the uncollateralized overnight call rate will now be 0.0%-0.1%, and there will be a uniform +0.1% interest rate on all Current Account Balances (reserves/CABs).

These moves may seem deceptively small, but they mark the beginning of a great normalization process. If inflation continues to hover near the 2% target and wages continue trending higher, we expect the BoJ to raise the policy rate to 0.25% by December 2024 and then to 0.75% next year. The balance sheet may expand at a smaller pace, or even decline slightly over the medium term, as the BoJ reduces JGB purchases, while the government borrows less.

The economy will benefit from this normalization on higher interest rates, which could add additional interest income, as households are net creditors. This could only improve as the new NISA rules led Japanese investors to move their savings into higher yielding assets already.

Figure 7: Japan's Consumption: Robust Nominally, Depressed Really
Consumption Trend Index



Sources: SSGA Economics, SBJ, Macrobond
Updated as of 3/25/2024

Real consumption may get a shot in the arm from wages in H2. The record *shunto* initial outcome of 5.28% at large firms was above expectations. This number may decline as the results for the 84% ununionized Japanese unfold; still, we expect the final outcome to be above 4.0%, higher than in 2023. Furthermore, we think price effects that had depressed real consumption will fade this year as inflation eases.

As such, the dispersion between nominal and real consumption has risen to an all-time high. So, consumption will benefit from high wage growth, declining price effects and higher interest income.

Capital expenditures and exports—key pillars of growth—are robust. Capex plans tracked by the Japan Construction Research Institute showed record growth for Q2; this is a good leading indicator investment in the GDP accounts. Net real exports will also offer some resiliency; in the first two months of this year, real exports averaged 9.7% y/y, while imports declined 5.0%. We hence expect **GDP growth** to average 1.0% y/y in 2024 and then rise to 1.3% in 2025.

We expect **inflation** to ease this year but remain around the 2% BoJ target over the medium term. CPI inflation is already moderating on base-effects in goods prices, and also declining commodity prices. However, higher services prices offer crucial support in maintaining price pressures; services prices rose sequentially for eight consecutive months through February, the longest in 15 years! Furthermore, inflation could benefit from a weak yen as well. All in all, we expect the CPI to average 2.2% y/y in 2024 and then ease to 1.8% in 2025.

Australia: (Still) Straightjacketed

Australian aggregate demand has cooled and CPI inflation has declined from 7.8% y/y in Q4 2022 to 4.1% in Q4 2023. The Reserve Bank of Australia (RBA) recognizes the improvement but seeks more before entertaining rate cuts.

Interest rates at their peak of 4.35% have worked their way to reduce household consumption, which grew just 0.1% y/y in Q3 and Q4 2023. Resultingly, real GDP growth slowed to 1.6% in Q4, well below the 3.0% average since 2021. That said, the resilient labor market and upcoming income tax relief offer support that should flow into GDP with a lag. We expect real household consumption to remain weak in 2024 at an average of 0.3% y/y before picking to 0.9% in 2025. Exports grew just 4.2% in Q4, as external demand eased. Both exports and imports may decline over the medium term and rebound in H2 2025 aided by monetary easing. We expect GDP growth to average 1.7% y/y in 2024, before picking up to 2.3% in 2025.

The labor market has become crucial to the inflation outlook and, by implication, for the RBA as well. A unique aspect of the current economic cycle is that consumer sentiment has declined to recessionary levels but employment expectations are in good shape (Figure 8, page 14). This divergence may be explained by high inflation and consumers' cautious stance on purchasing major household items.

The labor market has been evolving in line with our expectations, as full-time employment has cooled a touch faster than in prior cycles. However, the labor market may not deteriorate as much as we previously expected earlier and the savings rate could move higher as consumers replenish savings.

The unemployment rate in February declined to 3.7% on excessive seasonal distortions and the return of marginally attached workers. This led the seasonally adjusted full-time employment to rise an eye-popping 116.5k, against a consensus for 40.0k. The growth was thrice without adjusting for seasonality! We expect these aberrations to decline as we move into the year. Still, the unemployment rate could peak at 4.3% (4.5% earlier).

Figure 8: Poor Aussie Consumer Sentiment But Employment Outlook OK



Sources: SSGA Economics, Melbourne Institute of Applied Economic & Social Research, Macrobond
Updated as of 3/25/2024

The strong labor market may not distort disinflation, as the outlook for spending is still benign. The upcoming stage-3 tax cuts are a significant fiscal impulse for H2 2024 and may distort the path of inflation's return into the RBA's target zone. However, inflation will still return to the target of 2-3% y/y over the medium term. Considerable disinflation has already been realized in goods and may accelerate in services. As such, the delta between services and goods inflation has already peaked in Q3 2023. We expect CPI inflation to average 3.3% in 2024 and then decline into the RBA's target to 2.7% in 2025.

All this could mean that the **RBA** will be happy with the job done and allow more time for the economy to realize the lagged effects of higher rates. We think the RBA will be one of the last major central banks to cut rates, as sizeable fiscal stimulus will kick in from H2 via tax cuts. Furthermore, Aussie consumers have been managing higher mortgage rates quite well. The Bank's Financial Stability Review (FSR) found that only 1% of borrowers are in negative equity, and that the majority would be able to service their debt even if interest rates rose by a further 50 bps. In fact, just less than 1% of housing loans are in arrears of 90 or more days, even as 85% mortgages now pay higher variable rates. We expect two interest rate cuts from the RBA in 2024, and another three in 2025, taking the cash rate to a terminal of 3.1%. The first rate cut may happen either in August (70% odds) or September (30%).

The key risk to outlook is an RBA delaying rate cuts beyond when the economy truly needs them. Mortgagees not in stress right now may not remain so in the foreseeable future. In fact, the FSR found that a 0.5 pp increase in unemployment rate would push most affected borrowers into cash flow shortfalls. Hence, it is important for the RBA to not delay cuts in 2024.

Data Calendar

Week in Review (March 18– March 22)

Country	Release (Date, format)	Consensus	Actual	Last	Comments
Monday, March 18					
US	NAHB Housing Market Index (Mar)	48.0	51.0	48.0	Improving trend.
CA	Existing Home Sales (Feb, m/m)	0.0%	-3.1%	3.7%	Uneven performance amid high rates.
EC	CPI (Feb, y/y, final)	2.6% (p)	2.6%	2.8%	As already reported.
JN	Core Machine Orders (Jan, m/m)	-0.7%	-1.7%	1.9% (↓)	In part caused by NOTO peninsular earthquake.
Tuesday, March 19					
US	Housing Starts (Feb, thous)	1,440	1,521	1,374 (↑)	Rebound from weather-impaired January.
US	Building Permits (Feb, thous)	1,496	1,518	1,489 (↑)	Rebound from weather-impaired January.
CA	CPI (Feb, y/y)	3.1%	2.8%	2.9%	Good.
GE	ZEW Survey Expectations (Mar)	20.5	31.7	19.9	Big move higher.
JN	Industrial Production (Jan, m/m, final)	-7.5% (p)	-6.7%	1.4%	In part caused by NOTO peninsular earthquake.
JN	BoJ Target Range (Upper Bound)	na	0.1%	-0.1%	Change in policy.
AU	RBA Cash Rate Target	4.35%	4.35%	4.35%	Slow moving softness.
Wednesday, March 20					
US	FOMC Rate Decision (Upper Bound)	5.50%	5.50%	5.50%	Dot plot still shows 3 cuts in 2024.
UK	CPI (Feb, y/y)	3.5%	3.4%	4.0%	Another downside surprise.
IT	Industrial Production (Jan, m/m)	-0.5%	-1.2%	1.2% (↑)	Weak.
Thursday, March 21					
US	Philadelphia Fed Business Outlook (Mar)	-2.5	3.2	5.2	Prices paid touched new cycle low.
US	Initial Jobless Claims (Mar 16, thous)	213	210	212 (↑)	Very low.
US	Continuing Claims (Mar 09, thous)	1,820	1,807	1,803 (↓)	Very low.
US	Leading Index (Feb, m/m)	-0.1%	0.1%	-0.4%	First increase in two years!
US	Existing Home Sales (Feb, m/m)	-1.3%	9.5%	3.1%	Rebound reflects late-2023 mortgage rate drop.
UK	Manufacturing PMI (Mar, prelim)	47.8	49.9	47.5	Better.
UK	Services PMI (Mar, prelim)	53.8	53.4	53.8	Good.
UK	Bank of England Bank Rate	5.25%	5.25%	5.25%	A June cut looks possible now.
EC	Manufacturing PMI (Mar, prelim)	47.0	45.7	46.5	Weak.
EC	Services PMI (Mar, prelim)	50.5	51.1	50.2	Welcome improvement.
GE	Manufacturing PMI (Mar, prelim)	43.0	41.6	42.5	Very weak.
GE	Services PMI (Mar, prelim)	48.8	49.8	48.3	Improving but weak.
FR	Manufacturing PMI (Mar, prelim)	47.5	45.8	47.1	Surprise downshift.
JN	Manufacturing PMI (Mar, prelim)	na	48.2	47.2	Great!
AU	Employment Change (Feb, m/m)	40.0	116.5	15.3 (↑)	Seasonal issues, but also stronger labor market?
AU	Unemployment Rate (Feb)	4.0%	3.7%	4.1%	Seasonal issues, but also stronger labor market?
Friday, March 22					
CA	Retail Sales (Jan, m/m)	-0.4%	-0.3%	0.9%	Moving sideways.
UK	GfK Consumer Confidence (Mar)	-19	-21	-21	A pause in improving trend?
UK	Retail Sales Inc Auto Fuel (Feb, m/m)	-0.4%	0.0%	3.6% (↑)	Bottoming out.
GE	IFO Business Climate (Mar)	86.0	87.8	85.5	Bottoming out.
FR	Wages (Q4, q/q, final)	0.3% (p)	0.4%	0.5%	Normalizing.
JN	National CPI (Feb, y/y)	2.8%	2.8%	2.2%	Base effects + strong services inflation.

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

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