STATE STREET GLOBAL ADVISORS

April 19, 2024
Commentary

Weekly Economic Perspectives

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Contact

Simona Mocuta
Chief Economist
simona_mocuta@ssga.com
+1-617-664-1133

Amy Le
Macro-Investment Strategist
amy_le@ssga.com
+44-203-395-6590

Krishna Bhimavarapu
Economist
VenkataVamseaKrishna_Bhimavarapu@ssga.com
+91-806-741-5000

The Economy

Inflation and geopolitical fears continue to dominate market action.

US

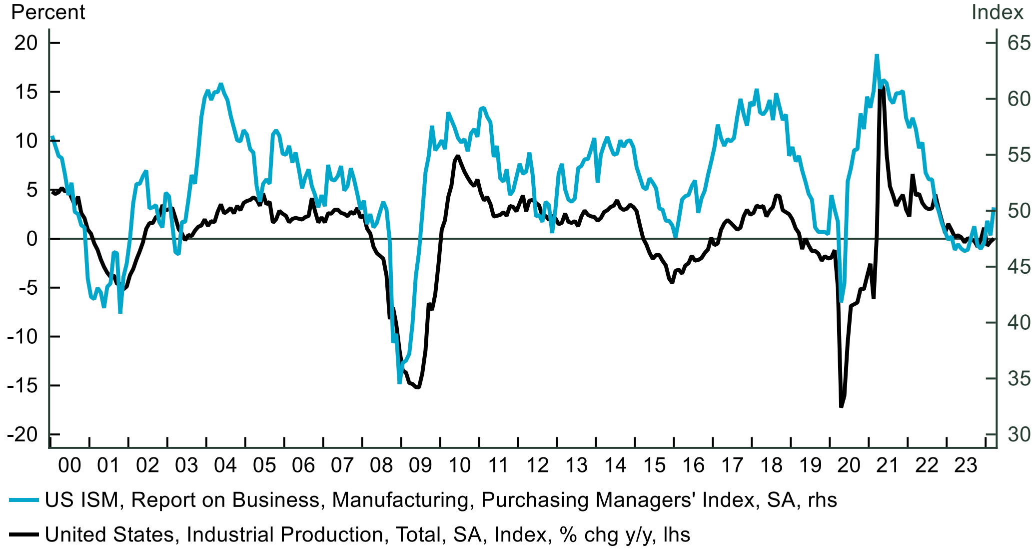
In the midst of a veritable "tsunami of hawkishness", our latest **opinion piece** is a reminder that US inflation and labor market dynamics are in a very different place than they were a year ago. Don't give up on the idea of rate cuts just yet.

The recent back-up mortgage rates—the 30-year fixed mortgage rate crossed back above 7.0% in the week of April 15—has caused the US housing market rebound to stall. The **NAHB (National Association of Homebuilders) index** was unchanged at 51 in April, the first month without any improvement since November. Buyer traffic and current sales improved incrementally, but they were offset by deteriorating expectations about future sales.

In fact, all housing market indicators released this week showed weakness. **Housing starts** missed expectations quite badly, down 14.7% m/m to the lowest level since August. Admittedly, there has been a lot of volatility in the series in Q1 with bad weather weighing on January starts, then a big improvement in February and now another correction lower in March. The retreat was broad-based, with the single-family segment accounting for the bulk of declines. Still, this needs to be put in perspective as single-family starts remained 21.2% higher than in March 2023. The weakness extended to **permits** as well, which plunged 4.3% m/m to the lowest level since July. Notably, single-family permits declined for the first time in fifteen months.

Industrial indicators were mixed. **Industrial production** gained 0.4% m/m in March, following a similar increase in February. The combination marked the first back-to-back improvement in almost a year, adding to evidence that activity in the sector is bottoming out. Still, output was merely flat y/y and down 0.3% y/y for the first quarter as a whole. A bottoming out process is afoot, but true revival is some way off.

Figure 1: US Industrial Activity Is Bottoming Out



Sources: Macrobond, SSGA Economics, Fed, ISM
Updated as of 4/19/2024

The regional Fed manufacturing surveys released this week were mixed but leaning favorable. The **Empire Fed** missed expectations but still improved modestly from March. The **Philly Fed**, which we trust most for a signal, not only bested expectations, but reached its highest level in two years. Still, the details were mixed rather than universally positive for both measures. In fact, there were enough contradictions in those details that we prefer to wait for some more data to decide whether the magnitude of the improvement can truly be trusted. Price metrics rose across the two surveys, but employment indicators were soft. The latter may respond with a delay to what appears to be a pick-up in orders and a build-up of backlogs, but it remains to be seen whether the order revival is sustained.

Last month, our commentary on **retail sales** began like this: “Retails sales have softened of late…although one needs to be cautious about making such trend statements in this world of pervasive revisions.” Well, that caution was certainly warranted as the better-than-expected March data put that softening trend into question. Nominal retail sales rose 0.7% m/m in March and the February gain was revised up three tenths to 0.9%. Performance was mixed across categories and not nearly as strong as the 1.1% jump in control sales (excluding food services, building materials, autos dealers and gas stations) would otherwise suggest. That gain was largely driven by a surprising 2.7% m/m surge at non-store retailers. This is rarely seen strength and it is not readily explained. Meanwhile, there were declines in motor vehicles and parts, furniture, electronics, clothes, and sporting goods. Given these figures are in nominal terms, the implied real retail sales for both March and the first quarter as a whole do not look nearly as impressive. In fact, we see the potential for some disappointment on the consumer spending front in the Q1 GDP update.

Canada

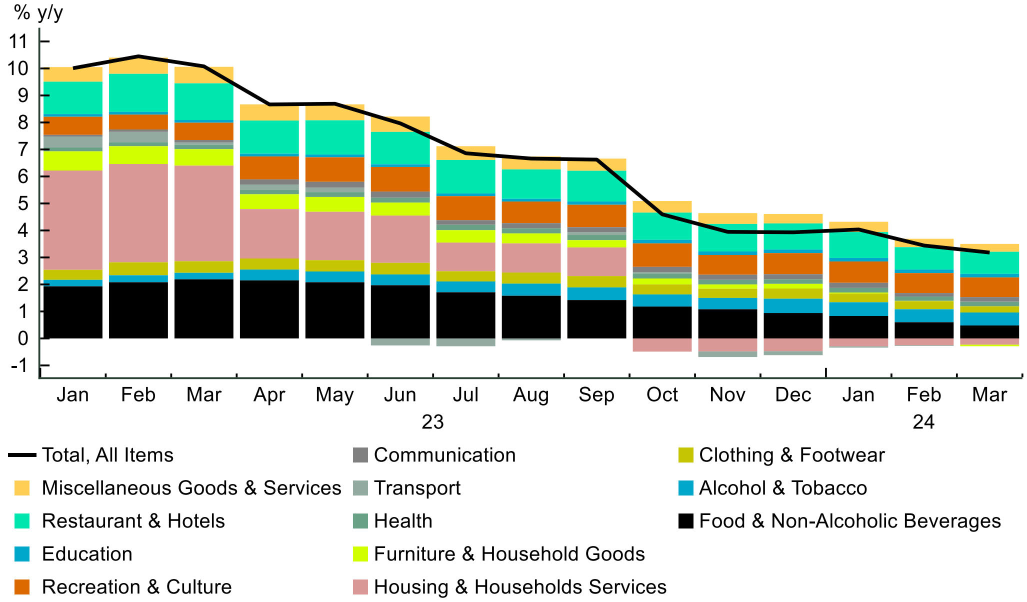
Headline **CPI inflation** ticked up a tenth to 2.9% y/y in March, in line with market expectation. Core inflation measures also moderated further. Weighted median and the common components measures eased by 0.2 percentage points to 2.8% y/y and 2.9% y/y, respectively. The trimmed measure inched down 0.1 percentage point to 3.1% y/y. This is the third month in a row of downside surprise, which further increases the possibility that the BoC will cut rates as soon as June.

UK

The latest data indicates higher odds of a first BoE rate cut in August. The **labor market** data was quite mixed with higher-than-expected wage growth and weaker job market. Growth in average total pay (including bonuses) for the three months to February was steady at 5.6%; regular pay growth (ex-bonuses) eased a tenth to 6.0% y/y. Employment declined by 156k, bucking expectations of an increase of 58k. The ILO unemployment rate for the three months to February also rose more than expected to 4.2%, up from 3.9%. Labor demand continued easing as headline vacancies declined for the 21st consecutive month to 916k.

After two months of downside surprises, headline **inflation** eased less than expected to 3.2% from 3.4% in March. The slowdown was primarily driven by food. Core inflation eased 0.3 percentage points to 4.2% y/y. Goods inflation slowed from 1.1% to 0.8%, while services inflation eased less than expected to 6.0% from 6.1%.

Figure 2: Lower Food Prices Drove UK Inflation Down



Sources: Macrobond, SSGA Economics, ONS
Updated as of 19/04/2024

Retail sales volumes were unchanged in March, following an upwardly revised 0.1% gain in February. The gains in automotive fuel and non-food stores sales volumes were offset by falls in food stores and non-store retailers. Still, sales volumes rose by 1.9% in the three months to March 2024, compared to previous period.

Eurozone

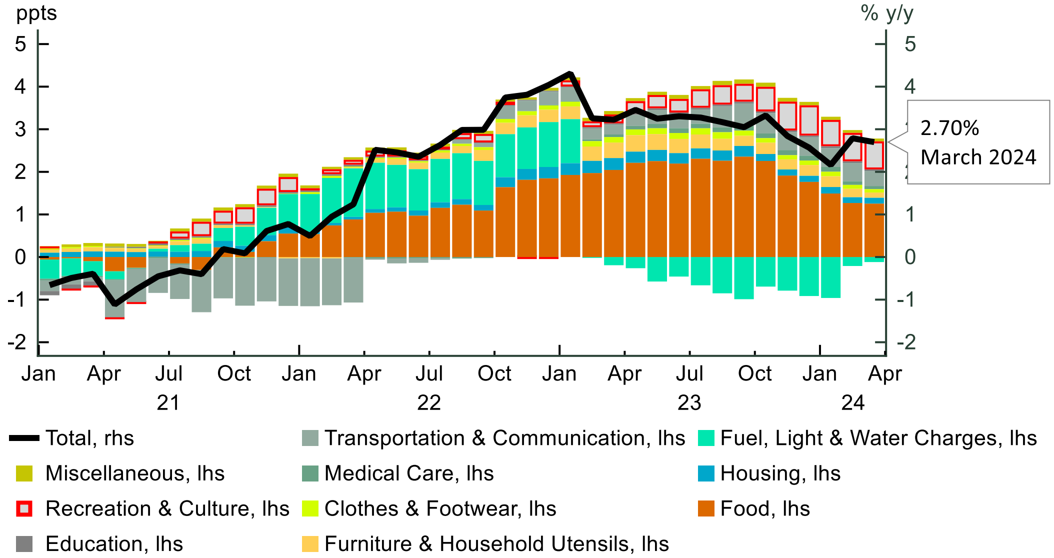
The **Zew index** of ***German*** investor confidence has been steadily improving over the past half a year or so and that improvement accelerated with another big gain in April. While not yet fully back to pre-Ukraine war levels, most of those losses have now been retraced. This adds to evidence of an upturn in German and broader eurozone economic activity.

This improvement should start getting some support from less restrictive monetary policy in the second half of the year. With headline ***eurozone* inflation** down to 2.4% y/y in March and core inflation at 2.9% y/y, the ECB has room to begin calibrating interest rates lower at the June meeting, despite a possibly Fed delay.

Japan

Interesting dynamics on inflation are at play in Japan. **Core-CPI** (excluding fresh-food) rose 2.6% y/y in March, in line with expectations, as solid disinflation in food was balanced by shifting base effects in energy (chart 3). The disinflation in energy is now coming to an end: energy prices declined just 1.7% y/y in March (from a low of -14.3% in September 2023), the least in a year. With the government's subsidies unlikely to be extended, we expect energy to contribute to higher CPI through the rest of this year.

Figure 3: Fuel Prices Rise As Food Prices Disinflate



Sources: SSGA Economics, SBJ, Macrobond
Updated as of 4/19/2024

However, the Bank of Japan (BoJ) preferred core measure (which excludes fresh-food and energy) stalled sequentially, lowering the annual rise to 2.9%, the first sub-3.0% reading since November 2022.

Disinflation may continue in the short-term but price pressures in the pipeline may eventually result in inflation higher than our 2024 forecast of 2.2%. For instance, services CPI has come in strong, and the Teikoku Databank has tracked a rise in 2,806 food times in April, above 2,000 for the first time since October 2023. Also, note that the contribution of recreation has been above 0.6 ppts for six months, as inbound tourist visits finally rose above the pre-pandemic levels in March.

Furthermore, **import prices** have risen 1.4% y/y in March, up from a low of -14.7% in July 2023, so the yen's impact on inflation and economy could be wide ranging this time from adding a tailwind to exacerbating inflation, in which case the **BoJ** could frontload a hike. While the Bank may not make any policy changes, it may emphasize upside risks to inflation, especially from the weaker yen. We anticipate hawkish guidance and maintain our BoJ interest rate forecasts of 0.25% in 2024 and a terminal of 0.75% next year.

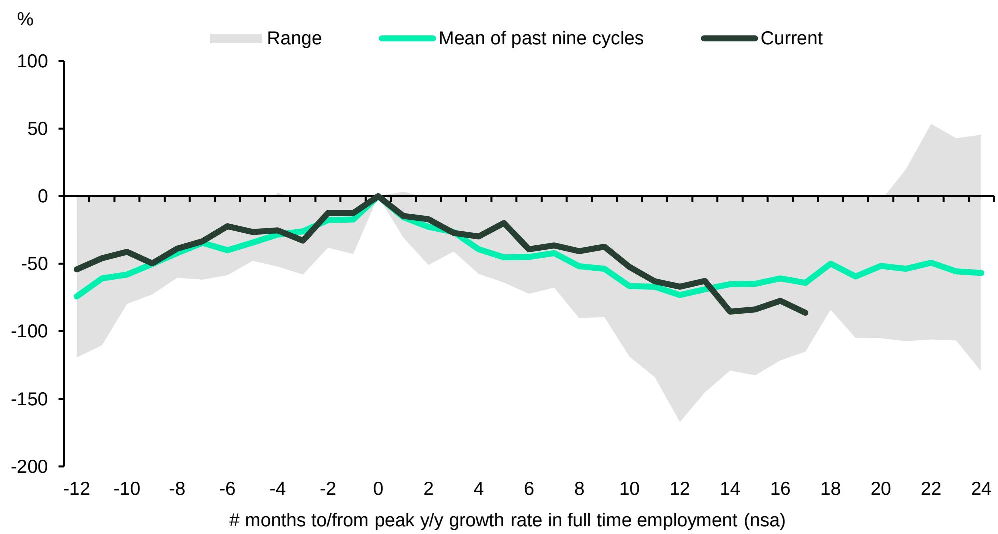
After two contractions, **real exports** (price data deflated by the BoJ) rebounded 3.4% m/m after two consecutive declines in January and February. Real imports too rose sequentially, but on a 3-month annualized basis, they declined 8.0%, so net trade could contribute more positively than we thought earlier to Q1 GDP, which otherwise has been tracking weak due to poor consumption.

The quantum indices tracked by the Ministry of Finance highlight that the external demand has cooled meaningfully, albeit some resiliency in exports to the US. Although volumes to China rose an impressive 3.6% m/m sa, we are unsure if the strength may continue, as on an index level, exports to China have noticeably declined but, those to the US remain elevated (chart 4). **Core machinery orders** with private manufacturers rose solidly by 7.7% m/m sa, way higher than the consensus of 0.8%. The rise was led by a 30% jump in orders for manufacturing electrical machinery. Hence, we expect exports to remain an important growth driver in the next two years.

Australia

The Aussie **labor market** lost 6.6k jobs in March, as opposed to expectations of an increase. We expected seasonal aberrations to lift the outcome in March, but the labor market is cooling faster than historic averages, in line with our call since September. Full-time non-seasonally adjusted employment is now 86% (figure 5, 6) down from its peak, which is more than the average of the nine cycles. It is fair at this point to say that higher interest rates are indeed working in Australia.

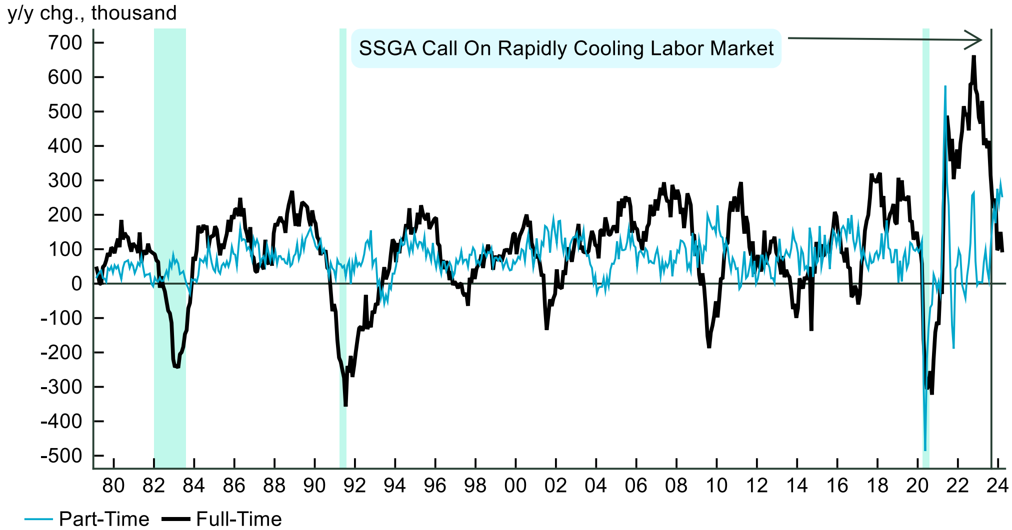
Figure 4: Aussie Labor Market Is Cooling Rapidly



Source: SSGA Economics, ABS, Macrobond
Updated as of 04/18/2024

The participation rate edged lower to 66.6% and the unemployment rate was up a tenth to 3.8%. The ABS noted the persistent volatility issues due to flows, given the low probability of flows between those who are employed to unemployed. While this underscores the strength in the labor market, it is also just the third time that *employment growth was below civilian population growth* in 36-months! All the three occurrences happened in the last four months, supporting our view that labor demand has perhaps been met in Australia.

Figure 5: Australian Part-time vs. Full-Time Employment



Sources: SSGA Economics, ABS, Macrobond
Updated as of 4/19/2024

Next week, we expect Q1 CPI to have declined to 3.5% y/y, the lowest level since Q4 2021, on favorable base effects. This improved data flow may result in a more confident Reserve Bank of Australia, who will remain on track to deliver their first rate cut in August, in line with our ahead of the consensus view.

Week in Review (Apr 15 –Apr 19)

Country	Release (Date, format)	Consensus	Actual	Last	Comments
Monday, Apr 15					
US	Retail Sales Advance (Mar, m/m)	0.4%	0.7%	0.9% (↑)	Surging online sales.
US	Empire Manufacturing (Apr)	-5.2	-14.3	-20.9	Noisy.
US	NAHB Housing Market Index (Apr)	51	51	51	Backup in rates stalls progress.
US	Business Inventories (Feb, m/m)	0.4%	0.4%	0.0%	Building.
CA	Manufacturing Sales (Feb, m/m)	0.7%	0.7%	0.0% (↓)	Modest.
Tuesday, Apr 16					
US	Housing Starts (Mar, thous)	1,485	1,321	1,549 (↑)	Weak, but also noisy of late.
US	Building Permits (Mar, thous)	1,510	1,458	1,523 (↑)	Soft.
US	Industrial Production (Mar, m/m)	0.4%	0.4%	0.4% (↑)	Bottoming out.
CA	Housing Starts (Mar, thous)	243.5	242.2	260.0 (↑)	OK,
CA	CPI (Mar, y/y)	2.9%	2.9%	2.8%	OK.
UK	ILO Unemployment Rate (Feb, 3m)	4.0%	4.2%	4.0% (↑)	Labor market is easing.
UK	Average Weekly Earnings (Feb, 3m, y/y)	5.5%	5.6%	5.6%	Wage growth is higher than expected.
GE	ZEW Survey Expectations (Apr)	35.5	42.2	31.7	Largely recovered post-Ukraine losses.
Wednesday, Apr 17					
UK	CPI (Mar, y/y)	3.1%	3.2%	3.4%	Inflation eased more slowly.
EC	CPI (Mar, y/y, final)	2.4% (p)	2.4%	2.6%	June cut looks fine.
JN	Tertiary Industry Index (Feb, m/m)	0.5%	1.5%	-0.5% (↓)	Volatile.
AU	Total Employment (Mar, thous)	10.0	-6.6	117.6 (↑)	Good outcome, directionally.
AU	Unemployment Rate (Mar)	3.9%	3.8%	3.7%	Good outcome, directionally.
AU	NAB Business Confidence (Q1)	na	-2	-6	Still weak.
Thursday, Apr 18					
US	Initial Jobless Claims (Apr 13, thous)	215	212	212 (↑)	Low,, but how much do they really tell us?
US	Continuing Claims (Apr 06, thous)	1,818	1,812	1,810 (↓)	Low,, but how much do they really tell us?
US	Philly Fed Business Outlook (Apr)	2.0	15.5	3.2	Highest in two years.
US	Leading Index (Mar, m/m)	-0.1%	-0.3%	0.2% (↑)	Declining again.
US	Existing Home Sales (Mar, m/m)	-4.1%	-4.3%	9.5%	Back-up in rates creates complications.
JN	National CPI (Mar, y/y)	2.7%	2.7%	2.8%	There are price pressures in the pipeline.
Friday, Apr 19					
UK	Retail Sales Inc Auto Fuel (Mar, m/m)	0.3%	0.0%	0.1% (↑)	Weak.
GE	PPI (Mar, y/y)	-3.3%	-2.9%	-4.1%	Base effects getting harder.

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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Canada: State Street Global Advisors, Ltd., 1981 McGill College Avenue, Suite 500 , Montreal, Qc, H3A 3A8, T: +514 282 2400 and 30 Adelaide Street East Suite 800, Toronto, Ontario M5C 3G6. T: +647 775 5900.

United States: State Street Global Advisors, 1 Iron Street, Boston, MA 02210-1641.

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