STATE STREET GLOBAL ADVISORS

April 26, 2024
Commentary

Weekly Economic Perspectives

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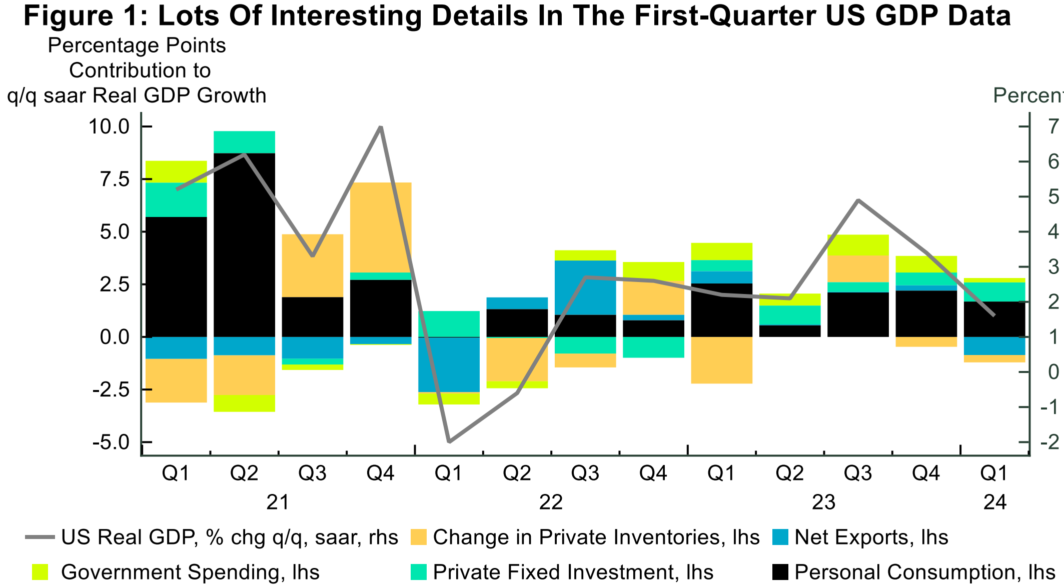
The Economy

The big fiscal stimulus-driven boost to US growth is starting to fade.

US

First quarter real **GDP growth** meaningfully undershot consensus expectations, coming in at 1.6% saar (seasonally adjusted annualized) versus the 2.5% expected. The outcome was very close to our own estimate of 1.8%, but that is not to say that there were no surprises in respect to sector performance. The biggest takeaway in that we see evidence that the big fiscal stimulus-driven boost to US growth is starting to fade, as it eventually had to. Admittedly, one quarter does not make a trend, but the slowdown in government consumption growth and the abrupt deceleration in government investment were notable.

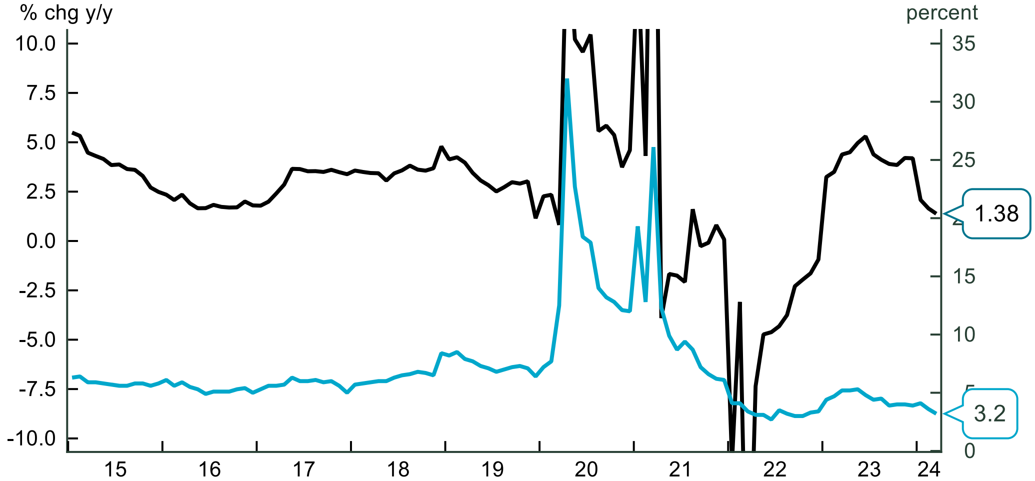
Figure 1: Lots Of Interesting Details In The First-Quarter US GDP Data



Sources: Macrobond, SSGA Economics, BEA
Updated as of 4/28/2024

Personal consumption came in marginally better than we expected, with a somewhat surprising split between goods and services. Goods consumption declined 0.4% saar, the first pullback since the second quarter of 2022. Spending on motor vehicles and parts declined sharply, spending on recreational goods and vehicles declined a little, and spending on “other durable goods” surged. The latter is most likely linked to the unexplained strength in online retail sales in March. We had long expected to see a softening in goods spending, simply as a normalization of consumption patters post Covid, but the initial 2022 correction lower was followed by a rebound in 2023. In retrospect, we link that to surging immigration. It is not clear whether the Q1 pullback is the start of a second corrective wave or just a temporary blip. We see moderate positive growth through the rest of the year, but due to base effects, this equates to notable slowdown in the full-year average relative to 2023. If goods consumption was weak, services consumption came in strong at 4.0% saar growth. Household consumption on services grew 3.4% saar, but this was heavily augmented by an unexpected 17.5% saar surge in spending by non-profit institutions. It seems unlikely for this to be repeated so we suspect overall services consumption cools from here. Indeed, data on Friday showed the personal savings rate down to a very low 3.2%, suggesting that the scope for further dissaving to finance consumption is getting increasingly limited.

Figure 2: Indicators Suggest Slower US Consumption Growth Ahead



US Personal Saving Rate, SA, AR, rhs

US Real Personal Disposable Income, SA, Chained, AR, USD (truncated left scale), lhs

Sources: Macrobond, SSGA Economics, BEA, BLS
Updated as of 4/28/2024

Fixed investment was strong but with notable variation and trend changes across components. For example, non-residential structures investment, which had been growing at double-digit rates in the previous four quarters (including a 30.3% saar burst in Q1 2023) declined 0.1% saar. Manufacturing structures was the only category still experiencing growth, but even there the pace slowed to 13.9% saar from roughly 30% in the prior two quarters and an astonishing 190% in q1 2023. This is perhaps the strongest indication that the fiscal impulse from the CHIPS and IRA packages is slowing. By contrast, residential structures investment was extremely strong, up 14.3% saar, well ahead of what we anticipated given housing starts. To be sure, we've long argued that the housing recession is over based precisely on the visible rebound in residential fixed investment, but the Q1 performance was more than expected so we now wonder whether there will be some payback in Q2. Elsewhere, we were glad to see equipment investment grow for the first time in three quarters, lifted by surging spending on computers but also industrial equipment. Strength in these areas helped offset weakness in transportation equipment.

Finally, **inventories** and **trade** were the biggest detractors from growth during the quarter. Inventories detracted 0.35 ppts from growth and trade detracted 0.86. The latter reflected a surprisingly large increase in imports that we do not anticipate to repeat. In that sense, it is true that the bulk of the "miss" on Q1 growth reflected the performance of these marginal components rather than outright weakness in consumption or investment. But by the same token, some of these very components had also contributed to last year's outsized gains.

The Q1 GDP deflator rose at a 3.1% saar rate and the personal consumption expenditures (PCE) deflator increased at a 3.4% saar. These marked two- and a four-quarter highs, respectively. The deflator data suggested some upside risks for the March **PCE inflation** data released on Friday, but in the event, that came in as expected. Both headline and core PCE deflators rose 0.3% m/m, matching both expectations and the February performance. The headline PCE inflation rate rose two tenths to 2.7% and the core PCE inflation rate was unchanged at 2.8% y/y.

Canada

Retail sales fell 0.1% m/m in February, bucking market expectation of an increase of 0.1% m/m. Core retail sales, which exclude gasoline and motor vehicle and parts dealers, were flat. Real retail sales decreased 0.3% m/m. As February's weak activity was mainly due to lower gasoline sales and consumer savings are strong, it is unlikely that retail sales will be materially affected in the next few months. However, we expect to see a slowdown in consumer spending given softer labor market.

UK

UK private sector continued to recover from last year's recession, supported by strong growth in services. The flash **UK Services PMI** registered at 11-month high of 54.9, up from March's 53.1. Meanwhile, manufacturing contracted as flash **manufacturing PMI** was down to 48.7, from 50.3 in previous month. New business and employment increased across private sector. While selling price inflation eased slightly, cost pressures have increased mainly due to higher wages, adding to concerns that the pace of disinflation might decelerate.

Figure 3: UK Consumer Confidence Rose To Two-Year High

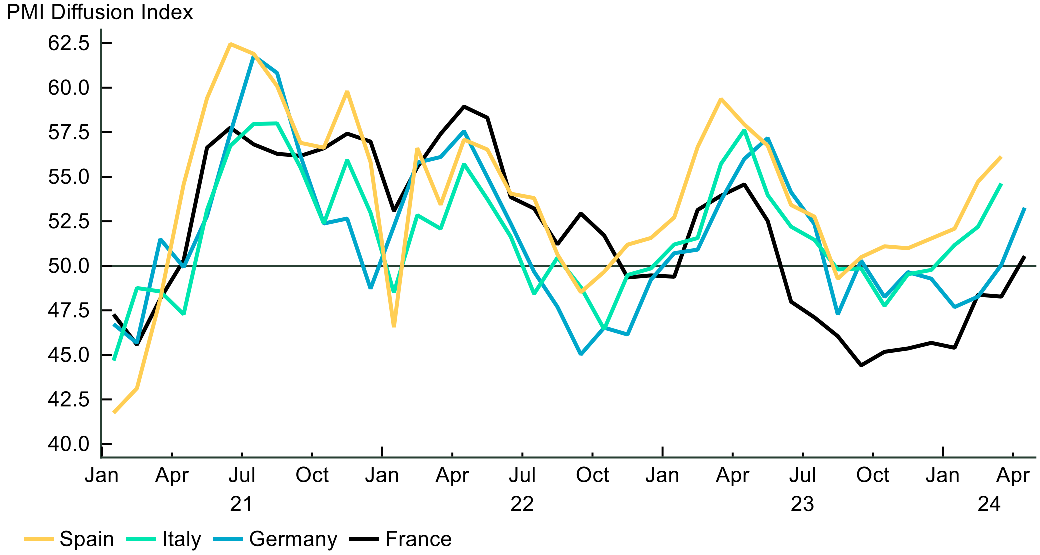
Sources: Macrobond, SSGA Economics, GfK
Updated as of 4/28/2024

The **GFK consumer confidence** index increased more than expected, to its two-year high of -19 in April from -21 in March. The improvement was mainly due to lower energy cost and inflation easing as well as the prospect of further tax cuts. Four measures were up, and one remained unchanged from last month. However, despite the better-than-expected performance, we are a bit concerned about possible pullback down the line given latest views on BoE rate cuts and fiscal challenges.

Eurozone

Manufacturing activity remains in the doldrums, with the regional manufacturing PMI down to 45.6 in April, according to preliminary estimates. But the good news is that the much larger services sectors is experiencing a meaningful revival. The latest readings from Germany (53.3) and France (50.5) suggest that momentum is building. This has long been our expectation and a key reason for our better than consensus view on eurozone economic performance this year.

Figure 4: Much Better News From Eurozone Service Sector



Sources: Macrobond, SSGA Economics, S&P Global
Updated as of 4/28/2024

Japan

The yen is becoming a crucial consideration for monetary policy in Japan.

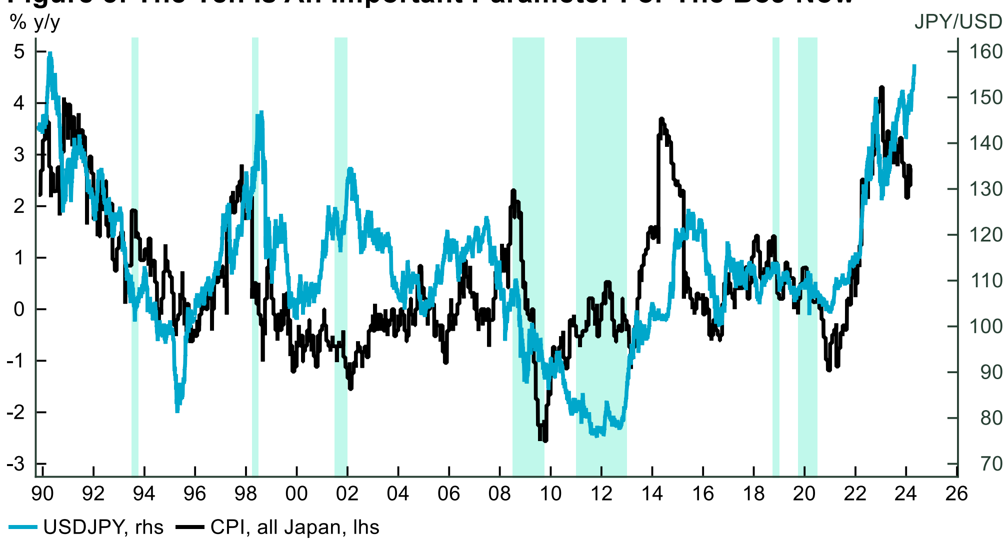
The BoJ held its policy rate as widely expected, but, the focus was predicated on their interest in hiking as a response to weakening yen. In that regard, the outcome was fairly dovish, which effectively means that the yen could continue weakening. In fact, USDJPY slid rapidly to 157.40 after the March PCE data for the US came out very slightly above expectations on Friday. These rapid moves remind us of similar moves in 2022/2023, which warrants an intervention in the FX market from the Ministry of Finance (MoF).

In the Outlook Report, GDP growth forecast for FY 2024 was revised down to 0.8% (from 1.2% in January) and that for FY 2025 was unchanged at 1.0%. Forecast for FY 2026 was introduced at 1.0%.

More importantly, core CPI (all items excluding fresh-food) forecasts were upgraded by 0.4 ppts to 2.8% for FY 2024, and by 0.1 ppts for FY 2025 to 1.9% (same for FY 2026). However, the BoJ core (excluding all food and energy) forecasts were more or less maintained at 1.9% for FY 2024 and FY 2025, while that for FY 2026 is forecasted at 2.1%. There is an upside risk to BoJ's inflation assessment as they seem to have factored in only the expected rise in energy prices as the government subsidies get factored out. **Furthermore, they indicate the BoJ's lack of confidence on demand-driven inflation.**

During the press conference, Governor Ueda mentioned that the main reason for upgrading core-CPI in FY 2024 was higher crude prices, and that the "weak yen is not having a big impact on trend inflation." However, "if FX fluctuations affect underlying inflation, that could be a consideration for monetary policy." Softer data developments in the US are critical for the yen to move towards its fair value, without which there will be upside surprises in Japan's inflation, given a 48% correlation between USDJPY and Japan's headline CPI (figure 4).

Figure 5: The Yen Is An Important Parameter For The BoJ Now



Sources: SSGA Economics, SBJ, Macrobond, Macrobond
Updated as of 4/28/2024

All this means that it is still up to the MoF to defend the yen. There has not been an intervention so far, but we cannot rule one out in the near future. Either way, we hold our interest rate expectations for one more hike in 2024 to 0.25% and a terminal rate of 0.75% in 2025, as the BoJ will have to respond later in the year.

The **Tokyo CPI** surprised to the downside with all measure sharply lower. The headline declined to 1.8% y/y from 2.6% in March, and the core CPI (excluding fresh-food) declined to 1.6% from 2.4%. This was primarily due to the a one-off impact from free tuition fee policy in Tokyo and is not expected to affect national CPI data. However, energy prices rose, primarily due to gas prices that is caused by higher imported fuel prices.

Next week, we expect March retail sales to have risen 2.4% y/y, while the labor market should remain extremely tight.

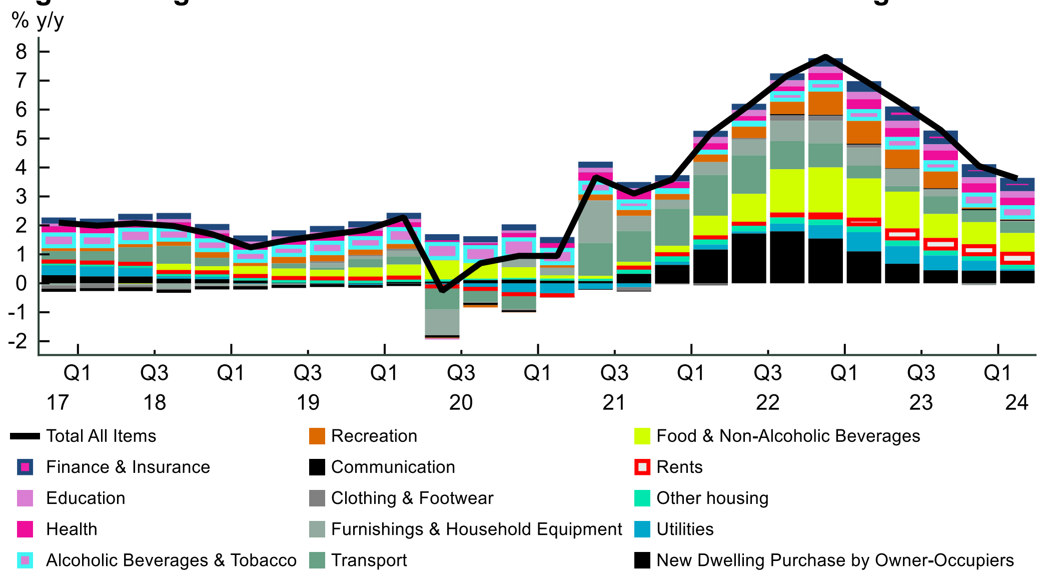
Australia

Headline CPI surprised a tenth to the upside in Q1, coming in at 3.6% y/y. However, we retain our forecasts for two interest rate cuts this year, the first one likely coming in August (70%) or September (30%), for two primary reasons:

1, Leading indicators still point to CPI moving into target range, and
2, The largest contributions came from seasonally strong categories

The largest increases were in education (5.9% q/q), health (2.8%) and insurance & financial services (2.0%). Together, they accounted for 40% of overall annual inflation (1.43 ppts), versus 14% in Q1 2022. By contrast, there were declines in recreation (-0.1%) and clothing (-1.1%) and modest gains in transportation (0.5%) and food (0.9%).

Figure 6: High Contributions To Aussie CPI From Select Categories



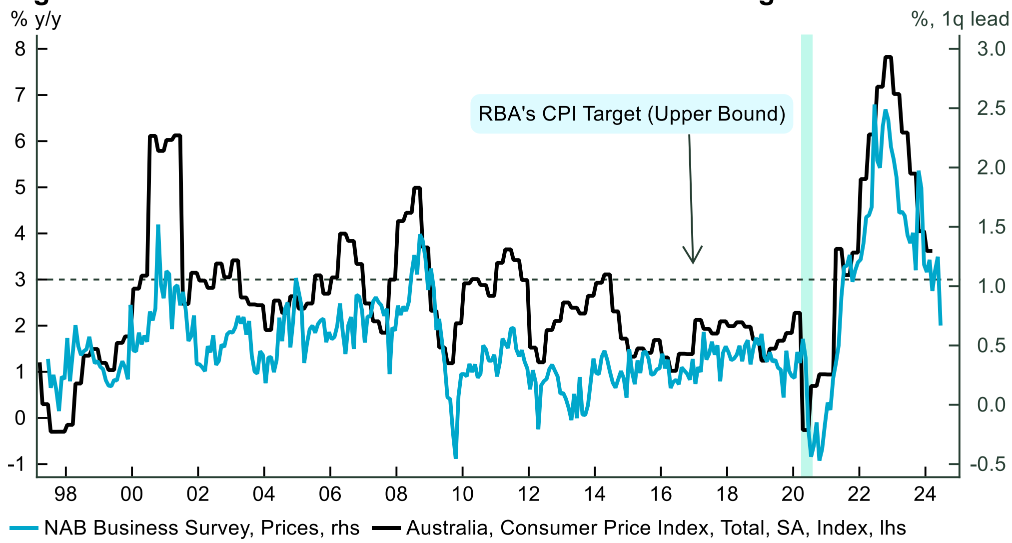
Sources: SSGA Economics, ABS, Macrobond
Updated as of 4/28/2024

The upside surprise was in effect caused by seasonally strong factors in Q1, which were driven by resets typically at the start of a new year. In effect, they led to an sequential acceleration of services prices by 1.3% q/q even if market services prices (excluding volatile items) rose just half of that (0.7%).

Furthermore, rental inflation, after declining a touch in Q4 has recorded a fresh high of 7.8% y/y and a high contribution to overall CPI of 0.45 ppts. Given high demand and poor supply exacerbated by high interest rates, the housing sector requires a structural change. This is especially important given that net migration continues to rise. In this light, we wonder if rental (and hence housing) inflation will cool without interest rate cuts induced resupply.

Finally, leading indicators of inflation, such as the prices metric of the NAB Business Survey indicate that CPI could reach the Reserve Bank of Australia (RBA) target band of 2-3% this year. We continue to expect that inflation could surprise to the downside by Q4 and any meaningful delay to rate cuts could harm the economy by delaying an economic rebound and exacerbating the housing situation. For all these reasons, we still expect the RBA could deliver their first rate cut in August before another in Q4 later this year.

Figure 7: Australia's Inflation Will Reach The RBA's Target In 2024



Sources: SSGA Economics, ABS, NAB, Macrobond
Updated as of 4/28/2024

Next week, we expect retail sales to have remained flat, while building approvals may have rebounded from February.

Week in Review (Apr 22 –Apr 26)

Country	Release (Date, format)	Consensus	Actual	Last	Comments
Monday, Apr 22					
JN	Manufacturing PMI (Apr, prelim)	na	49.9	48.2	Soft.
Tuesday, Apr 23					
US	New Home Sales (Mar, thous)	668	693	637 (↓)	Improved inventory helps sales.
UK	Manufacturing PMI (Apr, prelim)	50.4	48.7	50.3	Lost momentum.
UK	Services PMI (Apr, prelim)	53.0	54.9	53.1	Good.
EC	Manufacturing PMI (Apr, prelim)	46.5	45.6	46.1	Weak.
EC	Composite PMI (Apr, prelim)	50.7	51.4	50.3	Improving.
EC	Services PMI (Apr, prelim)	51.8	52.9	51.5	Good news!
GE	Manufacturing PMI (Apr, prelim)	42.7	42.2	41.9	No good news here.
GE	Services PMI (Apr, prelim)	50.5	53.3	50.1	Good news!
FR	Manufacturing PMI (Apr, prelim)	46.8	44.9	46.2	Weak.
JN	Services PPI (Mar, y/y)	2.1%	2.3%	2.2% (↑)	Price pressures in the pipeline.
AU	CPI (Q1, y/y)	3.5%	3.6%	4.1%	Still on track to reach the target band in 2024.
Wednesday, Apr 24					
US	Durable Goods Orders (Mar, m/m, prelim)	2.5%	2.6%	0.7% (↓)	But down 2.2% y/y.
CA	Retail Sales (Feb, m/m)	0.1%	-0.1%	-0.3%	Disappointing.
GE	IFO Business Climate (Apr)	88.8	89.4	87.9 (↑)	Has bottomed, trying to turn higher.
IT	Manufacturing Confidence (Apr)	89.2	87.6	88.4 (↓)	Trying to put in a bottom.
IT	Consumer Confidence Index (Apr)	96.8	95.2	96.5	OK, but not great.
Thursday, Apr 25					
JN	Leading Index CI (Feb, final)	111.8 (p)	111.8	109.5 (↓)	Rising in line with recovering macro dynamics.
GE	GfK Consumer Confidence (May)	-26.0	-24.2	-27.3 (↑)	Best since mid-2022 but still low historically.
US	Initial Jobless Claims (Apr 20, thous)	215	207	212	Very low.
US	Continuing Claims (Apr 13, thous)	1,814	1,781	1,812	Extremely low.
US	GDP (Q1, q/q, saar, adv)	2.5%	1.6%	3.4%	Weaker than expected, but not that surprising.
US	Pending Home Sales (Mar, m/m)	0.4%	3.4%	1.6%	Improved inventory.
UK	GfK Consumer Confidence (Apr)	-20	-19	-21	Still a long way to strong sentiment.
Friday, Apr 26					
FR	Consumer Confidence (Apr)	92	90	91	In uptrend.
US	Personal Spending (Mar, m/m)	0.6%	0.8%	0.8%	Savings rate down to 3.2%.
US	Personal Income (Mar, m/m)	0.5%	0.5%	0.3%	Solid labor income.
US	U. of Mich. Sentiment (Apr, final)	77.9 (p)	77.2	79.4	Inflation expectations ticked higher.

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

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- Build from breadth
- Invest as stewards
- Invent the future

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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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