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Commentary

Weekly Economic Perspectives

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Weekly Highlights

RBA belatedly joins global easing cycle while BoJ wrestles with high inflaiton.

US Michigan Consumer Sentiment Index (February)

64.7

Sharp relapse.

US 1-Year Consumer Inflation Expectations (Feb, y/y)

4.3%

Highest since Nov 2023.

US Existing Home Sales (Jan, m/m)

-4.9%

Sharp pullback.

Canadian Headline CPI (January, y/y)

1.9%

In line with expectations.

UK Headline CPI (January, y/y)

3.0%

Higher than expected.

UK Average Weekly Earnings (Dec, 3m/yoy)

6.0%

Higher than expected.

JP Headline CPI (January, y/y)

4.0%

4-year high; another hike nears?

AU: Labor Force Participation (Jan)

67.3%

All time high.

AU: Unemployment Rate (January)

4.1%

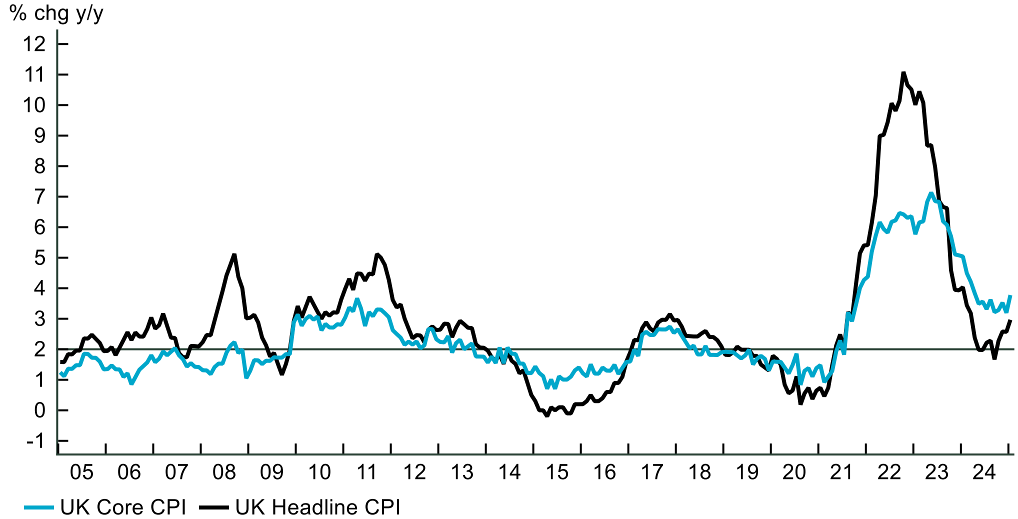
Same as last January.

UK: Inflation Dynamics Better Than They Seem

UK headline inflation reaccelerated to 3% y/y in January, up from 2.5% in December. Though that is higher than expected, the details do not seem too bad. Admittedly, the main upward contributors to January CPI inflation were the strength in food prices, airfares and education, which might have little impact on the MPC's decision-making right now. Still, the headline CPI is likely to oscillate around 3% for much of this year and peak at 3.5% later this year, mainly due to the increase in energy bills which are set to start again in April.

For the BoE, the most important indicator is probably services inflation which reflect domestic pressures, and this is where the data shows improvement. Clearly, services CPI rebounded up to 5.0% from 4.4%%, but that was lower than the BoE expected (5.2%) and mainly driven by larger-than-expected rise in airfares inflation. Christmas price hikes were not properly accounted in December airfares data.

Figure 1: Recent Uptick Not The End Of UK Disinflation



Sources: SSGA Economics, ONS

Pay growth in private sector stood at 6.2% y/y, although the labor market has increasingly weakened. For now, that is enough to keep the BoE tied to their gradual approach for the first half of the year. However, as downside growth risks will gradually outweigh inflation worries, we expect rate cuts to accelerate later this year such that the Bank Rate reaches 3.5% by year-end.

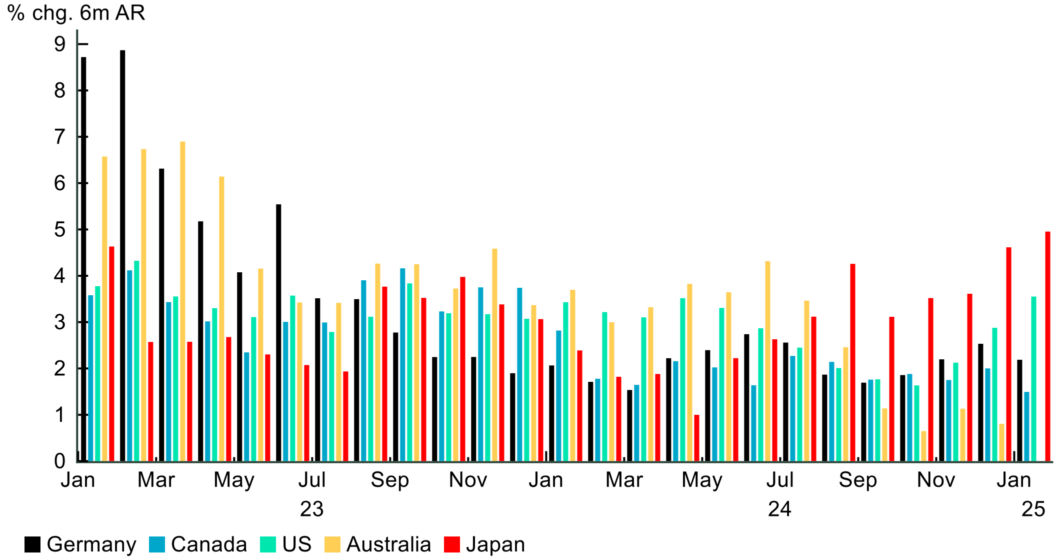
Japan: Two More Hikes This Year

Inflation is increasingly becoming a major problem in Japan. We recently highlighted that its CPI inflation exceeded that of the US in 8 of the last 9 months. This week's data took it to 9 out of 10 months. Furthermore, on a six month annualized basis, Japan's headline CPI remained higher than peers (Figure 2, page 4). Headline CPI jumped 0.5% m/m in January, taking the annual rate to 4.0% y/y, a 2-year high. All core metrics also rose notably.

While such high inflation would easily bring a rate hike anywhere else, the Bank of Japan (BoJ) may not act imminently, as a busy political calendar may prevent a hike in either March or May. However, not hiking beyond that may lead to runaway inflation. For these reasons, we now think the policy rate may be hiked twice this year, likely in June and December (with the usual caveat for a December move to come in January). Nonetheless, we favor a hike sooner.

At the same time, we are also cautious that the global easing cycle has reached an advanced stage, which means the policy rate differential between Japan and the US may dip and cause an appreciation of the yen. Although USDJPY is currently at a comfortable level of 150, the 10y JGB yield has risen to 1.46%, prompting a verbal intervention by Governor Ueda, who said the BoJ could make emergency purchases to control this rise, which led to the yield dropping to 1.42% later. This is another reason why policy rates may not rise imminently. Still, we think two more hikes are perhaps necessary to ease inflation.

Figure 2: Consumer Price Inflation Is Higher In Japan Than Elsewhere



Sources: Macrobond, SSGA Economics, BLS, ONS, SBJ, BUBA, StatCan, ABS
Updated as of 2/21/2025

Food was the primary driver of high inflation, up 7.8% y/y. There were eye-watering surges in categories such as cabbage (192.5%), Chinese cabbage (109.9%), broccoli (83.4%), and rice (the most important of the lot, 70.9%). This strong inflation is a result of tight labor supply and harsh weather, with the government releasing 210,000 metric tons from its emergency stockpiles. Furthermore, the density distribution in the inflation basket has risen, with items representing a growing share of the basket experiencing inflation in the 3-5% range versus 0-1%. This is the primary reason why we favor a sooner than expected hike.

Most importantly, the macro fundamentals needed for another hike are in place. Q4 GDP growth surprised massively to the upside at 0.7% q/q, besting even our above-consensus 0.4% expectation. This was led by a 0.5% q/q jump in consumption, a positive surprise. Exports were up 1.1% while imports fell 2.1%, lifting net exports' growth contribution to a massive 0.7 ppts. This seem unlikely to be sustained.

Quite interestingly, nominal GDP grew 1.3% q/q (or 5.1% q/q saar), leading to a continued wide delta between nominal and real GDP. This strengthens our argument that inflation has become etched in the economy, weighing on demand. Finally, this year's *shunto* wage negotiations are expected to result in sound wage growth.

All of these developments lead us to revise our terminal rate forecast back to 1.0% this year. Our base case is for a hike in June (July earlier) and another in December. However, we favor a hike sooner than later to ensure inflation remains in control and warn that runaway inflation is worse for the BoJ to fight. Market expectations remain moderate, primarily due to expectations of political impedance to higher rates. We believe this mindset is the most difficult to quell in Japan and believe that BoJ can independently set monetary policy.

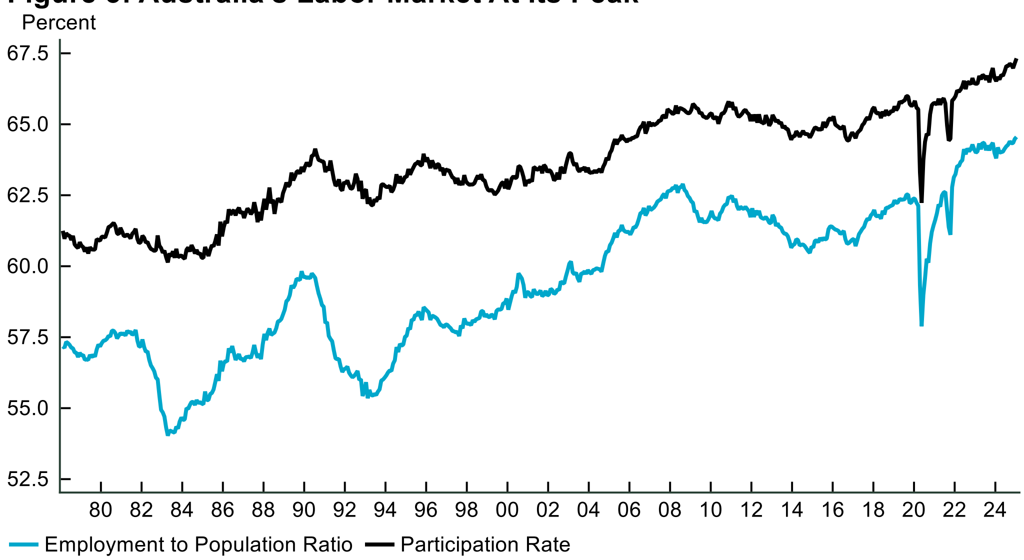
Australia: Next Cut in May

The Reserve Bank of Australia (RBA) finally lowered its cash rate this week. The cut had become consensus, but the action was in the fine print. The Bank admitted that they may have "misjudged" the excess demand in the labor market, in line with the softer than expected inflation print for Q4. Specifically, the statement noted that *"If the inflationary pulse in the economy proves to be as soft as the December quarter data on their own would suggest, it could imply that we had underestimated how much supply-side constraints were contributing to inflation over the past year and how quickly these had now unwound."* The RBA had also noted that escalating trade tensions pose uncertainty to Australia's outlook, as we wrote in a recent blogpost.

We believe the RBA is treading too cautiously ("not giving anything in or out"), and is now running the risk of falling behind the global easing cycle. Important macro forecasts were revised down in line with our expectations, with the Bank now expecting underlying trimmed-mean inflation easing to 2.7% by Q2 (down 0.3 pp). GDP growth too was revised lower by 20-30 bps in the near term, given the softer outlook on consumption and the economy. However, the unemployment rate was also revised down by similar magnitude, in line with our thinking and the Statement that the labor market is perhaps at full capacity.

This fact was only clearer after the release of the January labor market data. The participation rate and the employment-to-population ratio both rose to their all-time-highs of 67.3% and 64.6% respectively (Figure 4). Total seasonally adjusted employment grew by 44k and outpaced both our and the consensus expectations (10k/20k). The unemployment rate printed 4.1%, the exact same level from last year. To be fair, we may have underestimated the labor market's strength.

Figure 3: Australia's Labor Market At Its Peak



Sources: Macrobond, SSGA Economics, ABS
Updated as of 2/21/2025

January is the most seasonal month of the year, and also a month where the marginally attached workers spike, as many Australians would be awaiting to join work in February. However, the data shows a clear step down in that number from the recent years, with fewer people classified as not employed with job attachment by the ABS (4.6% in January 2025 vs. 5.4% in January 2024 and 2023).

These dynamics prevented the unemployment rate from spiking to our forecast 4.2%. But more importantly, despite the rate fluctuating between 3.9% to 4.2% in the last year, wage growth slowed down to 0.65% q/q in Q4, which is the weakest rate since 2022. This supports our analogy that this strong labor market may not be inflationary.

We continue to forecast two more rate cuts this year, one in May and one in Q4. However, if incoming data surprises to the downside, there is a chance we get a cut in April. With this, all eyes turn to Q4 GDP data to be out on March 05. We expect growth of 0.6% q/q or 1.3% y/y, which has also come to be the consensus view so far. Next week, we expect January's weighted CPI to come in at 2.5% y/y.

Week in Review

A summary of the key global data releases from the past week.

Country	Release (Date, format)	Consensus	Actual	Last	Comments
Monday, Feb 17					
CA	Housing Starts (Jan, thous)	252.5	239.7	232.5 (↑)	Lower than expected.
JN	Industrial Production (Dec, m/m, final)	n/a	-0.2%	0.3%	Need to improve.
JN	Tertiary Industry Index (Dec, m/m)	0.1%	0.1%	-0.3%	Need to improve.
Tuesday, Feb 18					
US	Empire Manufacturing (Feb)	0.0	5.7	-12.6	Much better. Surge in prices paid.
US	NAHB Housing Market Index (Feb)	46	42	47	Soft amid high mortgage rates.
UK	Average Weekly Earnings (Dec, 3m/yoy)	5.9%	6.0%	5.5% (↓)	We expect this to come down later this year.
CA	CPI (Jan, y/y)	1.9%	1.9%	1.8%	In line with expectations.
CA	Existing Home Sales (Jan, m/m)	n/a	-3.3%	-5.8%	Soft.
GE	ZEW Survey Expectations (Feb)	20	26	10.3	Notable improvement, will it continue?
FR	CPI (Jan, y/y, final)	1.4%	1.7%	1.4%	Modest.
JN	Core Machine Orders (De, m/m)	0.5%	-1.2%	3.4%	Need to improve.
AU	RBA Cash Rate Target	4.10%	4.10%	4.35%	Next cut in May.
AU	Westpac Leading Index (Jan, m/m)	n/a	0.12%	-0.02%	Recovery has begun.
Wednesday, Feb 19					
UK	CPI (Jan, y/y)	2.8%	3.0%	2.5%	Stronger than expected.
US	Housing Starts (Jan, thous)	1,390	1,366	1,515 (↑)	Weak.
US	Building Permits (Jan, thous, prelim)	1,460	1,483	1,482	Softish.
Thursday, Feb 20					
US	Philadelphia Fed Business Outlook (Feb)	14.3	18.1	44.3	Correction after unusually big prior surge.
US	Initial Jobless Claims (Feb 15, thous)	215	219	214 (↑)	Low and steady.
US	Continuing Claims (Feb 8, thous)	1,868	1,869	1,845 (↓)	Still low.
US	Leading Index (Jan)	-0.1%	-0.3%	0.1% (↑)	Relapsing again.
FR	Retail Sales (Jan, y/y, sa)	--	-0.7%	-0.8%	Weak.
JN	Natl CPI (Jan, y/y)	4.0%	4.0%	3.6%	Highest in 2 years.
AU	Unemployment Rate (Jan)	4.1%	4.1%	4.0%	Not inflationary.
Friday, Feb 21					
US	U. of Mich. Sentiment (Feb, final)	67.8	64.7	67.8	Deteriorating rapidly.
US	Existing Home Sales (Jan, m/m)	-2.6%	-4.9%	2.2%	Big drop but still 2.0% higher y/y.
CA	Retail Sales (Dec, m/m)	1.6%	2.5%	0.2% (↑)	Strong end to the year.
UK	GfK Consumer Confidence (Feb)	-22	-20	-22	Improved but still at very low level.
UK	Retail Sales Ex Auto Fuel (Jan, y/y)	0.6%	1.2%	2.1% (↓)	OK.
UK	Manufacturing PMI (Feb, prelim)	48.5	46.4	48.3	Weakening.
GE	Manufacturing PMI (Feb, prelim)	45.5	46.1	45.0	Weak.
FR	Manufacturing PMI (Feb, prelim)	45.3	45.5	45.0	Weak.
JN	Jibun Bank Japan PMI Mfg (Feb, prelim)	--	48.9	48.7	Weak.

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

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* Pensions & Investments Research Center, as of December 31, 2023.

† This figure is presented as of June 30, 2024 and includes ETF AUM of $1,393.92 billion USD of which approximately $69.35 billion USD is in gold 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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