STATE STREET GLOBAL ADVISORS

June 2022
Commentary

Global Macro Policy Quarterly

Contents

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Global Macro Highlights

A Monetary Tightening Tsunami Risks Growth Recession…Or Worse

The world has dramatically changed multiple times over the course of the last three years. From pandemic to war, the shocks to the global economy have been varied, intense, and difficult to calibrate. At times, macroeconomic forecasts have had to undergo substantial revisions from one quarter to the next. We are at such a juncture now.

Our audience may recall that when we last published official forecasts in early March, we highlighted that “uncertainty is high, perhaps higher than it has ever been since the early days of Covid”. Nevertheless, an assumption needed to anchor our projections and we worked on the expectation that the acute phase of the Ukraine war would be fairly short-lived, preserving the “opportunity to recover from this shock during the second half of the year”. We also recognized, however, that this was merely an assumption, that “we do not know for sure and things could take a turn for the far worse”. Unfortunately, they did.

That the war continues to rage unabated to this point carries not only tremendous humanitarian consequences, but also critical macroeconomic ones. The most important is that the stagflationary shock to the global economy is considerably more protracted and therefore, impactful, than initially expected. Supply disruptions and an intentional re-orientation of commodity consumption away from Russian sources, further exacerbated by Covid restrictions in China, drove a much more persistent inflation surge. This, in turn, has ignited more tightening by more central banks, much faster than imagined even a month ago. A veritable monetary tightening tsunami is now in motion! China and Japan are the only major exceptions to the trend, and not nearly enough to counter it. A global slowdown is afoot. Whether it ends up being just a “growth recession” or something worse has yet to be determined. It will depend on how the Ukraine war plays out, on whether Covid remains a hindrance to economic activity, on the nimbleness of policy makers, and on the timing of all of this. Needless to say, risks are to the downside.

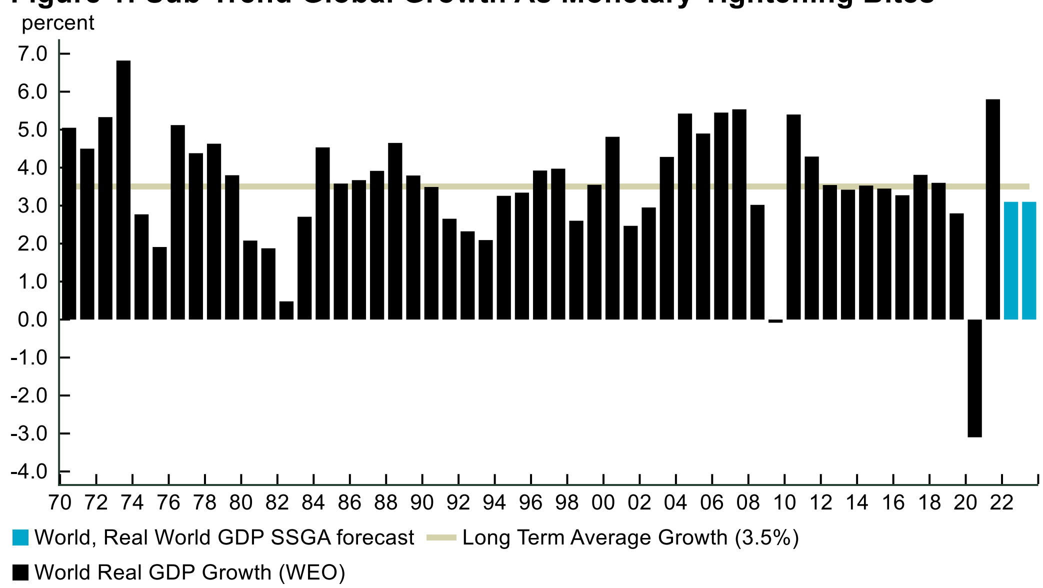
Global growth forecasts have been lowered by five tenths this year and by eight in 2023. It is perhaps the latter change that is even more ominous as it removes the previous expectation of improvement. It also carries more downside risks as the delayed effects of aggressive monetary tightening are felt more powerfully then, especially across developed economies whose central banks are only now tightening in earnest.

Forecast downgrades have been nearly universal. However, Australia and Canada (both commodity exporters with improving terms of trade and resilient domestic economies) were notable exceptions. Somewhat surprisingly given limited US exposure to direct Russian trade, the downgrade to US growth was substantial. The main story here is one of very aggressive monetary policy tightening that’s accelerating the slowdown in demand already underway. To the extent that the US had previously led the global recovery, it now also has less lift from re-opening type dynamics. In fact, the latter are one reason why, despite proximity to war and considerable hit from higher energy prices, eurozone performance holds up reasonably well. Fiscal support to counter the impact of rising utility costs is another. Germany, however, remains an underperformer: its disproportionate reliance on manufacturing is a liability in a world of sky-high energy prices and persistent supply chain problems. That may change in 2023, however. Covid restrictions in China have forced a downgrade there as well. While we recognize further downside risks there, we also believe macro support actions will yield results in the second half.

Inflation forecasts have, once again, been revised sharply upward, with China the lone exception to the trend. It is impossible to disentangle how much of the inflation surge is due to supply versus demand factors, but it is clear that both play a role. So far, signs of normalization in global supply chains have been frustratingly modest. However, there have been improvements and the coming demand deceleration could spark a noticeable lightening of order backlogs in coming months. We remain convinced that inflation will turn lower in a very visible fashion over the coming quarters. We expect to see similar dynamics in wage inflation as economies cool, though, of course, timing will vary from country to country. Eurozone and Australia, for instance, are just now in the process of wage acceleration, but in the UK and US wage inflation seems to have peaked. We are watching the rise in consumers inflation expectations but are not particularly concerned about de-anchoring.

We continue to ponder questions around the global inflation regime. Following three major shocks (trade war, Covid, and Ukraine) we believe firms everywhere are revisiting global supply chain arrangements with an eye toward shortening and simplifying them. This transition process will likely be inflationary, yet it is also fairly slow moving. We suspect that it will also be accompanied by broad technology deployment. In fact, the debate around automation—heavily focused on job destruction just a few years ago—may take a more upbeat tone in a world of apparent labor shortages. Technology deployment will be critical to enhancing productivity and perhaps reversing the long-run erosion seen in developed markets for the last many years. If so, this could put a lid on inflation even as the world moves past peak globalization. See further analysis in the special section below. Additional country commentaries also follow.

Figure 1: Sub-Trend Global Growth As Monetary Tightening Bites



Sources: IMF WEO, SSGA Economics

Summary of World Output[1] and Inflation[2]

(Annual percent change)

	Weight	History					Forecast	
	(2020)	2017	2018	2019	2020	2021	2022	2023
World Growth	100.0	3.8	3.6	2.8	-3.1	5.8	3.1	3.1
Advanced Economies	42.45	2.5	2.3	1.7	-4.5	5.0	2.6	1.8
US	15.8	2.3	2.9	2.3	-3.4	5.7	2.3	1.5
Euro area	12.1	2.6	1.8	1.6	-6.5	5.3	2.8	2.1
Germany	3.4	3.0	1.1	1.1	-4.9	2.9	1.7	2.8
France	2.3	2.4	1.8	1.9	-7.9	6.8	2.9	2.0
Italy	1.9	1.7	0.8	0.5	-9.1	6.6	3.0	2.0
Japan	4.0	1.7	0.6	-0.2	-4.6	1.7	1.2	1.8
UK	2.2	2.1	1.7	1.7	-9.3	7.4	3.8	1.0
Canada	1.4	3.0	2.8	1.9	-5.2	4.6	4.1	2.8
Australia	1.0	2.4	2.8	2.0	-2.2	4.7	4.0	3.0
Developing Economies	57.55	4.8	4.6	3.7	-2.1	6.4	3.5	4.1
China	18.3	6.9	6.7	6.0	2.2	8.1	4.7	5.2
Advanced Economy Inflation	42.45	1.7	1.9	1.4	0.7	3.3	7.2	2.6
US	15.8	2.1	2.5	1.8	1.2	4.7	7.8	2.2
Euro area	12.1	1.5	1.8	1.2	0.3	2.6	6.7	2.1
Germany	3.4	1.5	1.8	1.4	0.5	3.1	6.9	2.2
France	2.3	1.0	1.9	1.1	0.5	1.7	5.1	2.0
Italy	1.9	1.2	1.2	0.6	-0.1	1.9	6.2	2.1
Japan	4.0	0.5	1.0	0.5	0.0	-0.3	2.8	1.5
UK	2.2	2.7	2.5	1.8	0.9	2.6	8.5	5.0
Canada	1.4	1.6	2.2	2.0	0.7	3.4	5.9	2.8
Australia	1.0	2.0	1.9	1.6	0.9	2.8	5.5	3.2
Developing Economies	57.55	4.4	4.9	5.1	5.1	5.5	9.0	5.0
China	18.3	1.5	2.1	2.9	2.5	0.9	2.4	2.3
Value of World Output ($ trl)								
At Market Exchange Rates		80.8	85.9	87.4	85.0	89.9	92.7	95.6
At Purchasing Power Parities		121.7	129.0	134.9	132.0	139.6	144.0	148.5

[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

Politics and Geopolitics

Ukraine War: Does it still matter?

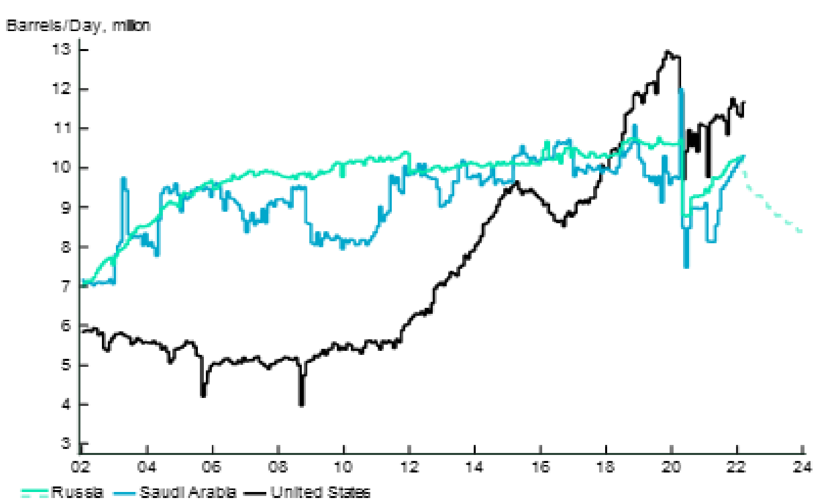
The answer is unequivocally yes, and not only for the humanitarian consequences. It will remain macro- and market- relevant by continuing to deliver stagflationary pressures on the rest of the world economy. Admittedly, the bulk of the commodity price shock is working its way through the system, but a prolonged war would mean there is no price relief in sight as well as further episodic stress.

A rough estimate suggests that commodity consumers are paying close to double the share of income compared to 2019 (across energy, agriculture and metals), thus making 2022 indeed comparable to the 1970s energy supply shock. Notably, this impact is not distributed equally and thus certain regions like Europe are disproportionately hit.

However, looking ahead, what matters is whether further price increases are likely or if any price correction is possible. For this, the Ukraine war continues to be one major driver of supply dynamics. Battlefield developments and their impact on international negotiations are therefore a variable in forecasting future commodity stress. In this regard, the bad news is that absent a military equilibrium, the war will continue to exert negative influence on global energy and agricultural supply.

In plain English, the war is not nearing any equilibrium, which means one party continues to view continuation preferable to a cease-fire status quo. Currently, Russia enjoys momentum by having localized the conflict and being able to leverage its disproportionate firepower. This should eventually reverse later this summer when Ukraine receives and can operate new military supplies as well as take advantage of growing manpower. While the war see-saws on the ground, this means there is equally no relaxation of international tensions, with anti-Russian sanctions and counter-sanctions progressing further. The conclusion is that today's commodity supply from the region is likely to dwindle further, unless other global suppliers can offset the regional contraction. Figure 2 below shows historical production by the world's three largest producers (US, Saudi Arabia, Russia) and the midpoint forecast for Russia's future oil production in event of continued war and sanctions.

Figure 2: Crude Oil Production (mbd)

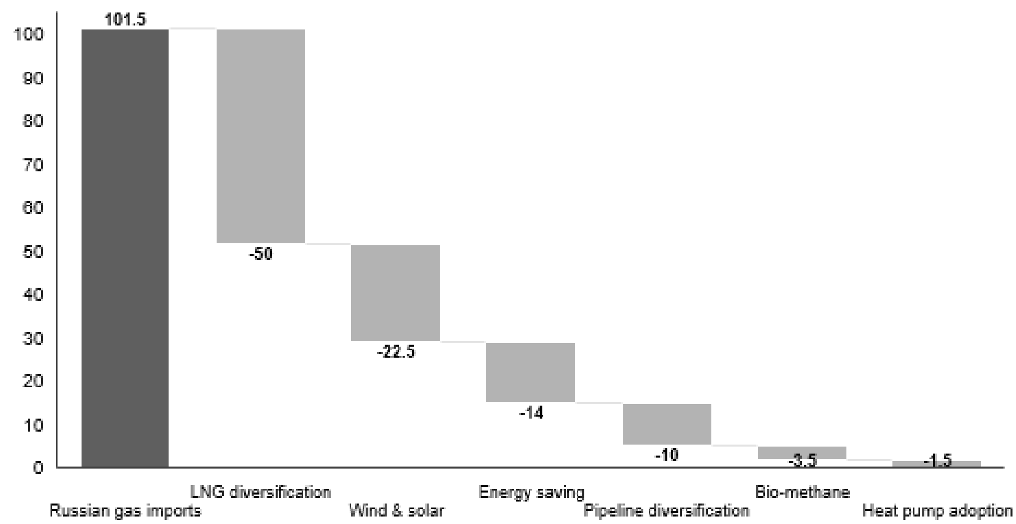


Source: SSGA Economics, Macrobond, EIA, JODI

A full supply offset is highly unlikely in 2022, and probably only conceivable by late 2023, thus underpinning high commodity prices – even if a global recession should lower prices from current levels. Russian oil production is set for a secular decline due to the export control sanctions on capital goods – many of which critical inputs in the oil industry and exacerbated by the fact that Russia's oilfields are relatively old and rely on technological upgrades.

In addition to the gravitational drop on oil production, natural gas supply continues to be prone to disruption. Europe continues to be unable to fully substitute Russian gas at least before the end of 2023 (possibly longer), so that any gas outage would lead to energy rationing and disrupt economic activity. As this is a binary outcome, this becomes difficult to incorporate into our core economic forecasts, so this needs to be accounted for continued downside risks to European growth in H2 2022 as well as European asset prices.

Figure 3: EU Commission Plans to Substitute Russian Gas (BCM) Over 12-month period

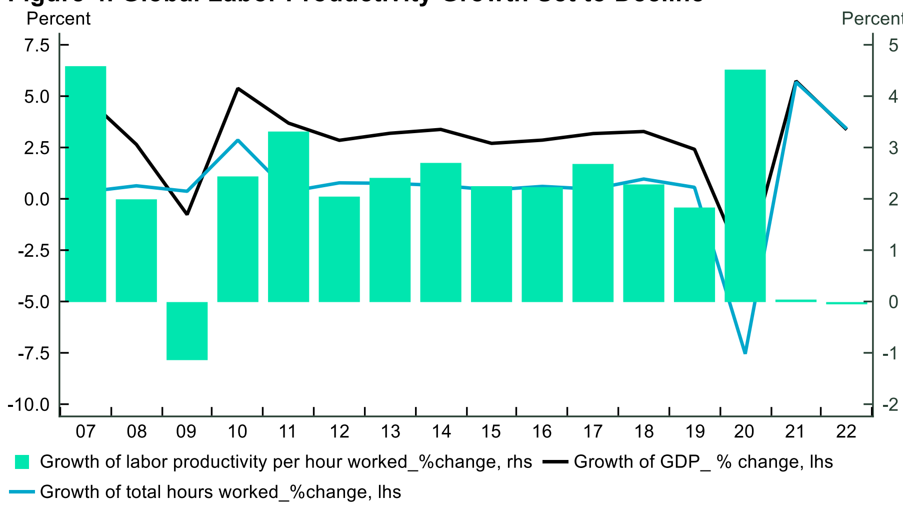


Source: European Commission

World Labor Productivity Growth

Labor productivity growth, defined as GDP per hour worked and the key source of lasting income per capita growth, had been slowing globally even before the onset of the pandemic-induced recession. In 2020, global labor productivity growth reached the fastest pace since the 1970s, however, that increase was driven by a combination of a sudden drop in global GDP and a larger decline in total hours worked (Figure 4). Going forward, lingering effects from the pandemic coupled with negative impacts from the Ukraine war leading to lower consumer demand and declined business investments are likely to weaken labor productivity growth in 2022 and possibly to some extend next year.

Figure 4. Global Labor Productivity Growth Set to Decline



Sources: Conference Board, SSGA Economics

In developed countries, the slowing trend has been underway since the late 1990s and there are no signs of revival for this long-term productivity slowdown in many of these countries yet as shown in Figure 5. US labor productivity growth is still ahead of that in most other developed countries although its expansion of 2.6% in 2020 was driven by the pandemic-related deep downturn. In Canada, strong labor market and significant rebound in total hours worked have more than offset the growth in output although the latter one has been relatively robust, leading to decline in labor productivity growth in the country in 2021 and 2022. In contrast, Japan and European countries including the UK, Germany, Italy, France have experienced weak growth in output per hour during the downturn and they are again going to face with a significant decline in labor productivity growth in 2022, mainly through weaker GDP growth.

Emerging markets (EMs) still have a significant productivity growth advantage over developed economies. However, EMs labor productivity growth rates have been slowing in the aftermath of the global financial crisis and this downward trend is expected to continue post-pandemic. As an example, China’s output per hour growth has declined to 5.8% in 2020 from the average of 7.8% in 2010-2019, but that is still almost five times of many developed countries.

Figure 5. Labor Productivity Growth (GDP per hours worked)

	2010-2019	2020	2021	2022
US	0.9	2.6	1.2	-0.2
Canada	1.0	7.3	-5.6	-0.5
UK	0.7	1.4	1.0	-1.1
Euro Area	0.9	1.0	-0.1	-0.4
Germany	1.1	0.4	0.9	-0.9
France	0.9	0.4	-0.8	-0.8
Italy	0.4	2.3	-1.3	-0.4
Japan	1.2	-1.6	0.9	-2.1
Australia	1.2	-0.7	4.4	2.3
DMs	1.2	1.3	1.4	-0.2
China	7.8	5.8	4.4	5.1
India	6.7	6.8	-1.0	2.9
Brazil	1.0	11.9	-8.1	-2.3
EMs	3.6	6.0	0.2	0.2
World	2.4	4.5	0.0	0.0

Source: Conference Board, SSGA Economics

Ongoing supply chain disruptions, surging prices in energy and commodities will continue to weigh on the global GDP growth, leading to lower productivity growth globally over the coming year. In the long term, developed countries such as the US, Europe, and Japan are proposing investments which could substantially accelerate productivity. If these proposals are well-implemented, they will offer an opportunity to close the productivity gap between DMs and EMs as well as lift overall global labor productivity growth.

Country Macro Highlights

Please see country-specific commentary in the sections below.

US: The “R” Word

Back in March, we described the US economy as undergoing a battle between headwinds (from high inflation, rising interest rates, softish external demand) and resilience (from excess savings, strong housing demand, and supply chain normalization). Since then, the headwinds have intensified, and the sources of resilience have eroded.

Consequently, our 2022 growth forecast has moved from a little above consensus in March (4.0%) to a little below now (2.3%). This is an unusually large downgrade. While driven by many factors, at its core it reflects a much faster monetary tightening pace that shifts the economy from the prior path of a gradual deceleration to one of a more abrupt downshift.

Housing can no longer function as a source of strength in a world of 6.0% mortgage interest rates. And consumer spending can’t provide the same support in a world of $5/gallon gasoline prices. Yes, consumers in the aggregate still sit on substantial amounts of excess savings and there remains plenty of pent-up demand for automobiles, for example. But the sequential dynamics have changed. Look no further than the personal savings rate, which nearly halved between December and April. The last print of 4.4% was the lowest since 2008! The wealth effect, which may not have necessarily buoyed spending per se but has certainly buoyed the consumer mood over the past year, will start to act as a drag amid financial market volatility. Household net worth, which had established seven consecutive record highs starting in Q2 2020 retreated during the first quarter of 2022. A much larger pullback seems inevitable in the second.

There is much less momentum left in the inventory rebuilding cycle given the surge in inventories during the last few quarters. In the context of softening demand, the shift in these dynamics can become more acute, making accurate forecasting extremely difficult. Fixed investment, particularly business fixed investment, has been a bright spot despite weakness in non-residential structures. We expect further gains here but residential investment seems poised to decline. Even growth in business investment will likely slow quite sharply amid weaker growth expectations.

Given this backdrop, the “recession question” has moved center stage. We consider it from two perspectives. The first is whether or not the US economy, given the 1.5% contraction in the first quarter, and the current 0.0% Atlanta Fed GDPNow estimate for Q2, is already in recession. Our estimates suggest not, but we are talking a hairbreadth difference and the scales could still be tipped the other way by the time all the data is in. But whether the Q1-Q2 slowdown episode meets the “two consecutive negative quarters of growth” definition is a matter of mathematical semantics. The slowdown itself is real. The much more important question is whether this stumble, driven primarily by inventories and trade (important, yet more peripheral components of GDP) is followed by a more typical business cycle recession down the line, where it is the core forces of consumer spending and investment that define the recession, in response to higher borrowing costs. This isn't part of the baseline either…yet.

But we are quite concerned that aggressive rate hikes could push us onto that scenario path. Indeed, the Fed's prior brisk walk toward policy normalization turned into a veritable spring with June's 75 basis point rate hike. In addition to the 150 bp worth of hikes so far, the FOMC committee has penciled in another 175 bp by year-end, taking the Fed Funds range to 3.25-3.5%. It then expects two additional hikes in 2023 before unwinding those last hikes in 2024. This is a very hawkish profile, one that leaves the policy rate considerably above the estimated 2.5% neutral level for a very long time. We still believe that evidence of intensifying slowdown and progress on inflation would allow the Fed to pause at 3.0% this year and keep the peak rate this cycle at 3.5%. That would help limit the slowdown.

Inflation has continued to surprise to the upside (hence the hawkishness above). Energy prices have a lot to do with this, but there is no question that inflation is both high and broad-based. Headline inflation at 8.6% and core at 6.0% y/y in May speak for themselves. Still, following an increase of 7.8% in 2022, we see base effects, the demand slowdown, and supply normalization as a powerful disinflationary combo that allows the 2023 average to come down sharply to 2.2%.

Canada: Impressive Resilience

Like other countries, Canada is affected by inflationary pressures arising from the Ukraine war and lockdowns in China. However, the economy remains relatively stable. Canada's dependence of Russia is extremely limited, and surging prices in energy and some commodities are benefiting the economy's terms of trade. And while domestic demand is not shielded from inflation, it is supported by solid household income and savings as well as a strong job market. We only trimmed our 2022 growth forecast by one tenth to 4.1% and kept the 2023 forecast unchanged at 2.8%.

While economic performance was a little softer than expected in the first quarter, there is decent momentum going into Q2. Quarterly GDP grew at an annualized rate of 3.1% in Q1; it would have been better if not for lower export volumes. However, exports are expected to strengthen in the next few quarters with global demand for commodities supporting international trade. Domestic consumption remains robust, with household spending up 3.4%. Government expenditure rose by 1.8% q/q. Business investment in gross fixed capital formation jumped 12.4%.

The labor market remains tight. The unemployment rate touched a new record low of 5.1% in May, driven by a burst of full time jobs growth. Total hours worked were up 5.1% compared with a year earlier. We also started to see wage growth picking up, with average hourly wages up 3.9% y/y in May, compared to 3.3% in April.

Headline CPI inflation reached 6.8% y/y in April, well above Bank of Canada's forecast. Amid sharply higher global energy and food prices, we lifted the 2022 inflation forecast to 5.9%. We see 2023 inflation above 2.5%.

Robust domestic demand and strong labor market with wage growth picking up and broadening across sectors gave the BoC more incentives to increase rates further in the coming months to tame the inflation. Given the increasing risk to growth and the higher probability of 75ps hike in July, we expect the bank will deliver five additional hikes this year.

UK: Faltering

As global events continue to weigh heavily on UK economy, we have trimmed the 2022 growth projection to 3.8 %, from 4.5% in March. This negative outlook reflects a combination of surging inflation, weak business investment, tax increases and adverse global supply shocks, initially caused by Covid and then exacerbated by the war in Ukraine. We also expect growth in 2023 to slow further to 1.0%, down from 2.2% previously.

First quarter GDP growth slightly undershot expectations, but the details were more disappointing than we would have expected. The economy grew 0.8% q/q, slightly below the BoE's expectation of 0.9% q/q and market expectation of 1.0% q/q, down from revised Q4 growth of 1.3% q/q. There was a massive surge in inventories which added almost 4.0 percentage points (ppt) to growth but was essentially offset by an equally large detraction from net trade. Household consumption and gross fixed capital formation added 0.3 and 0.9 ppt, respectively, while government spending detracted 0.4 ppt. The latter reflected large declines in health expenditure following the introduction of the Living with Covid-19 program.

Despite falling short of expectations, Q1 growth is likely to mark a near-term high point. The growth outlook is set worsen given soft business investment, limited scope for net trade improvement, and the sharp deterioration in consumer confidence which will eventually filter through to business sentiment. Indeed, GDP contracted 0.3% m/m in April, worse than expected.

Headline CPI inflation rose to 40-year high of 9.0% y/y in April, mainly reflecting high energy and commodity prices. The Bank of England (BoE) sees consumer price inflation exceeding 11.0% in October! We also made substantial upward revisions to the 2022 and 2023 inflation forecasts, now expected to reach 8.5% and 5.0% respectively.

The labor market may be starting to weaken at the margin. The unemployment rate edged up a tenth to 3.8% in the three months to April, though this is still close to historical lows. Vacancies remain at record highs but the expansion rate is moderating. Wage growth may be starting to slow as well. Growth in total pay, including bonuses, moderated to 6.8% y/y in April from 7.0% y/y in March. Real earnings are shrinking.

Given the labor market and inflationary pressure, the BoE has turned quite hawkish recently. However, the bank also acknowledges that risks to growth have increased. At its meeting in June, the BoE voted by a majority of 6-3 to increase bank rate by 25bps, to 1.25%. It was the fifth time in a row the BoE has raised rates since December. While BoE's rate hike path seems to be more gradual and less urgent than the Fed who raised 75 bps a day ago and other central banks, the BoE said it would act forcefully if inflationary pressure continued to escalate. In views of the growth outlook and moderation in inflation in 2023, we favor three additional hikes this year versus the 5+ currently priced in the market.

Eurozone: Resilience and Vulnerability

In a sense, the eurozone growth forecasts may seem like a puzzle. Given its proximity to the theater war, given its dependence on Russian energy imports and frantic need to diversify those supply sources, given the refugee influx, and given the surge in utility costs, why isn't the hit to 2022 growth more pronounced? Make no mistake, we did lower the forecast by almost a full percentage point to 2.8% this round, but this is higher than the US growth projection. How come?

There are several reasons for this resilience. One relates to "re-opening" dynamics that are by now weak in the US but will play a more supporting near-term role in the eurozone. Another has to do with the fact that European consumers also enjoy a substantial cushion of excess savings; by some metrics, household savings dynamics in the eurozone are even better than the US. Thirdly, compensatory fiscal measures help cushion some of the blow from higher prices. Fourthly, fiscal transfers from the NGEU fund are supportive of investment and growth, especially in select economies. And finally, while the ECB is gearing up to raise interest rates in July, the monetary tightening cycle is not nearly as advanced, nor will it be as dramatic as in the US.

On the other side of the scale is the reality that while the eurozone baseline scenario speaks to resilience, the downside scenario is one of acute vulnerability. This is a scenarios not solely of price pain due to high energy prices, but potentially outright shortages and activity shutdowns should supply interruptions occur later this year (see the geopolitical section above for more on this).

The eurozone inflation spike has proven every bit as vicious as the US one. With headline inflation having crossed the 8.0% mark in May, we've had to make further substantial upward revisions to the inflation forecasts, now seen at 6.7% this year before moderating sharply in 2023. That moderation could yet be delayed

The ECB has maintained a dovish countenance for much of last year. But in recent months, the intensity of the inflation spike has forced a reassessment and, as of the June meeting, a clear guidance that interest rates will start increasing in July. We see a 25 bp hike then, followed by a 50 bp in September and another 50 by year end. This is less than what's priced in the market, but given risks to growth and risks of financial market fragmentation, we would expect the ECB to proceed more cautiously.

Japan:

We downgrade our 2022 growth rate expectations to 1.2% and maintain 2023 growth rate at 1.8%. We expect elevated imports to be the biggest drag on GDP. However, stable consumer spending could be the silver lining as the country recovers from the era of Covid-19 restrictions and invites travellers back; this could boost spending, especially on services.

Earlier, the Q1 2022 GDP was revised to -0.5% q/q saar from -1.0% on better consumption and inventories. Unsurprisingly, this fall in GDP was due to a -1.6 pp contribution from net exports but the better than consensus revision was due to +0.5 pp contribution from inventories. These inventories could be a negative for second-quarter GDP along with the Chinese lockdowns due to Covid-19 resurgence.

We expect the mild uptick in inflation we've witnessed over the last few months to continue and intensify through the rest of the year, leaving average headline CPI inflation at 2.8% this year and 1.5% in 2023. Headline and core CPI stood at 2.5% and 2.1% respectively, in April. This comes on the back of high import costs as Japan imports 60% of its food and almost all of its fuel.

Given the still subdued inflation backdrop and challenging growth environment, the Bank of Japan (BoJ) maintained its dovish stance at the June meeting. It is now a lone holdout among developed market central banks, not altering its policy stance even as the global monetary policy tide has shifted violently into a much more hawkish direction. This has sent the yen to a 23 year low of 135.59 against the US dollar and may have a material impact on public opinion ahead of upcoming upper house elections. It seems unlikely that the BoJ would be able to indefinitely hold on without at least tweaking the policy parameters slightly. We expect it to do so during the second half by increasing the upper limit of the 10y government bond target to 0.50%.

Australia:

In a notable exception to the global trend, we've upgraded Australia's GDP growth this year and next to 4.0% and 3.0.%, respectively. Consumer spending seems poised for continued strength on the back of pent-up demand and strong labor market. Assuming no new mobility restrictions, hugely favorable base effects will lift household consumption growth. Meanwhile, business fixed investment shows no slights of slowdown as yet and the likely moderation in residential investment spending should be manageable. Favorable terns of trade and strong demand for commodities are an added plus.

Inflation is expected to peak at around 7.0% y/y during the second half before moderating in 2023. Although various measures of core inflation remain is the 3.0% range for now, they have unmistakably turned higher as inflation is broadening. Tradeable inflation leads the way at 6.8% y/y in Q1 but non-tradable inflation wasn't that far behind either, at 4.2% y/y. A year earlier, they stood at 0.7% y/y and 1.3% y/y, respectively. A lot has changed since then!

High inflation and favorable growth outlook support the RBA pivot towards (faster) rate hikes. We expect a terminal rate of 3.00% for end of 2022 before a pause may be needed.

Amid rising rates, we expect the housing sector to cool. With the national house price index up almost 24% y/y as of Q4, it seems inevitable that a price correction is in the works. Its severity is hard to predict at this point but we are watching this as a possible downside risk to the outlook.

STATE STREET GLOBAL ADVISORS

Data Calendar

Week in Review (Jun 13– June 17)

Country	Release (Date, format)	Consensus	Actual	Last	Comments
Monday, June 13					
UK	Industrial Production (Apr, m/m)	0.3%	-0.6%	-0.20%	Disappointing.
AU	NAB Business Confidence (May)	n/a	6	10	Slowing down.
Tuesday, June 14					
US	NFIB Small Business Optimism (May)	93.0	93.1	93.2	
US	PPI Final Demand (May, y/y)	10.8%	10.8%	11.0%	
CA	Manufacturing Sales (Apr, m/m)	n/a	1.7%	2.5%	Ok.
UK	Average Weekly Earnings (Apr, 3m y/y)	7.5%	6.8%	7.0%	Moderated.
UK	ILO Unemployment Rate 3Mths (Apr)	3.6%	3.8%	3.7%	Still close to historical lows.
GE	CPI (May, y/y, final)	7.9%	7.9%	7.4%	
GE	ZEW Survey Expectations (Jun)	-26.8	-28	-34.3	
JN	Core Machine Orders (Apr, m/m)	-1.3%	10.8%	7.1%	Rebound in investments.
JN	Industrial Production (Apr, m/m, final)	n/a	-1.5%	0.3%	Low reflecting China slowdown.
AU	Westpac Consumer Conf Index (Jun)	n/a	86.4	90.4	Consumer confidence slowing.
Wednesday, June 15					
US	Retail Sales Advance (May, m/m)	0.2%	-0.3%	0.7% (↓)	
US	Empire Manufacturing (Jun)	3.0	-1.2	-11.6	
US	Import Price Index (May, y/y)	12.2%	11.8%	12.5% (↑)	
US	Business Inventories (Apr)	1.4%	1.2%	2.4% (↑)	
US	NAHB Housing Market Index (Jun)	68	67	69	
US	FOMC Rate Decision (Upper Bound)	1.50%	1.75%	1.00%	
CA	Housing Starts (May, thous)	n/a	287.3	265.7 (↓)	Stronger than expected
CA	Existing Home Sales (May, m/m)	n/a	-8.6%	-12.6%	Weak
EC	Industrial Production (Apr, m/m)	n/a	0.4%	-1.4% (↑)	
FR	CPI (May, y/y, final)	n/a	5.2%	4.8%	
JN	Tertiary Industry Index (Apr, m/m)	0.8%	0.7%	1.3%	In line with expectations.
AU	Unemployment Rate (May)	3.8%	3.9%	3.9%	Tight labor market.
Thursday, June 16					
US	Building Permits (May, thous)	1,785	1,695	1,823 (↑)	
US	Housing Starts (May, thous)	1,707	1,549	1,810 (↑)	
US	Philadelphia Fed Business Outlook (Jun)	5.0	-3.3	2.6	
US	Initial Jobless Claims (11 Jun, thous)	215	229	232 (↑)	
US	Continuing Claims (4 Jun, thous)	1,301	1,312	1,309 (↑)	
UK	Bank of England Bank Rate	1.25%	1.25%	1.00%	More hikes are expected.
Friday, June 17					
US	Industrial Production (May, m/m)	0.4%		1.1%	
US	Leading Index (May)	-0.4%		-0.3%	
UK	Retail Sales Inc Auto Fuel (May, m/m)	-0.6%		1.4%	
EC	CPI (May, y/y, final)	8.1%(p)		7.4%	
JN	BOJ Policy Balance Rate	n/a	-0.1%	-0.1%	No change in policy.

Source: for data, Bloomberg®; for commentary, State Street Global Advisors Economics.

Data Calendar

Week In Preview (June 20 – June 24)

Country	Release (Date, format)	Consensus	Last	Comments
Monday, June 20				
GE	PPI (May, y/y)	33.5%	33.5%	
Tuesday, June 21				
US	Existing Home Sales (May, m/m)	-3.3%	-2.4%	
CA	Retail Sales (Apr, m/m)	0.8%	0.0%	
Wednesday, June 22				
CA	CPI (May, y/y)	7.3%	6.8%	
UK	CPI (May, y/y)	9.0%	9.0%	Remain elevated.
JN	Jibun Bank Japan PMI Mfg (Jun, prelim)	n/a	53.3	Expect improvement.
Thursday, June 23				
US	Current Account Balance (Q1, $bn)	-279.0	-217.9	
US	Initial Jobless Claims (18 Jun, thous)	232	229	
US	Continuing Claims (11 Jun, thous	1,338	1,312	
US	Kansas City Fed Manf. Activity (Jun)	n/a	23	
UK	Manufacturing PMI (Jun, prelim)	53.7	54.6	Weaken.
UK	Services PMI (Jun, prelim)	53.0	53.4	Weaken.
UK	GfK Consumer Confidence (Jun)	-40	-40	No improvement.
EC	Manufacturing PMI (Jun, prelim)	53.8	54.6	
EC	Services PMI (Jun, prelim)	55.5	56.1	
GE	Manufacturing PMI (Jun, prelim)	54.0	54.8	
GE	Services PMI (Jun, prekim)	54.5	55	
FR	Manufacturing PMI (Jun, prelim)	54.0	54.6	
FR	Business Confidence (Jun)	105	106	
JN	Natl CPI (May, y/y)	2.5%	2.5%	Expect upward tick.
JN	PPI Services (May, y/y)	1.7%	1.7%	Expect upward tick.
Friday, June 24				
US	U. of Mich. Sentiment (Jun, final)	50.2	58.4	
US	New Home Sales (May, thous)	640	591	
GE	IFO Business Climate (Jun)	92.7	93	
FR	Wages (Q1, q/q, prelim)	n/a	1.1%	
IT	Consumer Confidence Index (Jun)	103.0	102.7	
IT	Manufacturing Confidence (Jun)	108.5	109.3	

Source: for data, Bloomberg®; for commentary, State Street Global Advisors Economics.

Economic Indicators

Central Bank Policy Targets

Region	Target	Year/Year % Change in Target				
		Jan	Feb	Mar	Apr	May
US	Target: PCE price index 2.0% y/y	6.0	6.3	6.6	6.3	
Canada	Target: CPI 2.0% y/y, 1.0%-3.0% control range	5.1	5.7	6.7	6.8	
UK	Target: CPI 2.0% y/y	5.5	6.2	7.0	9.0	
Eurozone	Target: CPI below but close to 2.0% y/y	5.1	5.9	7.4	7.4	8.1
Japan	Target: CPI 2.0% y/y	0.5	0.9	1.2	2.5	
Australia	Target Range: CPI 2.0%-3.0% y/y	5.1	5.1	5.1		

Source: Macrobond

Key Interest Rates

	Jul-21	Aug-21	Sep-21	Oct-21	Nov-21	Dec-21	Jan-22	Feb-22	Mar-22	Apr-22	May-22
US (top of target range)	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.50	1.00
Canada (Overnight Rate)	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	1.00	1.00
UK (Bank Rate)	0.10	0.10	0.10	0.10	0.10	0.25	0.25	0.50	0.75	0.75	1.00
Eurozone (Refi)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Japan (OCR)	-0.04	-0.04	-0.05	-0.03	-0.05	-0.02	-0.02	-0.01	-0.02	-0.02	-0.03
Australia (OCR)	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.33

Source: Macrobond

General Government Structural Balance as a % of Potential GDP

									Forecast	
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
US	-2.7	-2.5	-3.5	-4.2	-5.2	-6.1	-10.4	-8.0	-5.3	-4.6
Canada	-0.6	0.0	0.1	-0.3	0.0	-0.2	-8.6	-3.6	-2.3	-1.3
UK	-3.9	-3.6	-2.8	-2.3	-2.4	-2.7	0.5	-3.2	-4.4	-2.0
Eurozone	-0.7	-0.6	-0.5	-0.5	-0.3	-0.5	-4.5	-4.0	-3.5	-2.3
Germany	1.2	1.2	1.2	1.1	1.6	1.3	-3.1	-2.6	-2.0	-0.5
France	-2.5	-2.1	-2.0	-1.9	-1.5	-2.1	-5.9	-5.9	-5.3	-3.4
Italy	-1.0	-0.6	-1.3	-1.6	-1.7	-1.0	-6.0	-4.6	-5.2	-3.7
Japan	-5.4	-4.2	-4.1	-3.3	-2.5	-2.5	-8.1	-6.9	-7.3	-3.3
Australia	-2.8	-2.6	-2.3	-1.6	-1.2	-4.1	-7.8	-7.7	-5.4	-3.6

Source: International Monetary Fund, World Economic Outlook

Headline Consumer and Producer Price Inflation

	CPI Year/Year % Change						PPI Year/Year % Change				
	Jan	Feb	Mar	Apr	May		Jan	Feb	Mar	Apr	May
US	7.5	7.9	8.5	8.3	8.6		10.1	10.4	11.5	10.9	10.8
Canada	5.1	5.7	6.7	6.8			16.1	15.9	17.9	16.4	15.0
UK	5.5	6.2	7.0	9.0			10.0	10.2	11.9	14.0	
Eurozone	5.1	5.9	7.4	7.4	8.1		30.8	31.5	36.9	37.2	
Germany	4.9	5.1	7.3	7.4	7.9		25.0	25.9	30.9	33.5	
France	2.9	3.6	4.5	4.8	5.2		20.5	20.2	24.6	25.0	
Italy	4.8	5.7	6.5	6.0	6.8		32.9	32.7	36.9	35.3	
Japan	0.5	0.9	1.2	2.5			9.0	9.4	9.3	9.8	9.1
Australia	5.1	5.1	5.1				4.9	4.9	4.9		

Source: Macrobond

Economic Indicators

Real GDP Growth (Q/Q Seasonally Adjusted)

	Quarter/Quarter % Change						Year/Year % Change				
	Q1-21	Q2-21	Q3-21	Q4-21	Q1-22		Q1-21	Q2-21	Q3-21	Q4-21	Q1-22
US	1.5	1.6	0.6	1.7	-0.4		0.5	12.2	4.9	5.5	3.5
Canada	1.1	-0.8	1.3	1.6	0.8		0.2	11.7	3.8	3.2	2.9
UK	-1.2	5.6	0.9	1.3	0.8		-5.0	24.5	6.9	6.6	8.7
Eurozone	-0.1	2.2	2.3	0.2	0.6		-0.9	14.7	4.0	4.7	5.4
Germany	-1.7	2.2	1.7	-0.3	0.2		-2.8	10.4	2.9	1.8	3.8
France	0.2	1.0	3.2	0.4	-0.2		1.8	19.2	3.0	4.9	4.5
Italy	0.2	2.7	2.6	0.7	0.1		0.0	17.5	4.0	6.4	6.2
Japan	-0.4	0.6	-0.8	1.0	-0.1		-1.7	7.4	1.2	0.4	0.7
Australia	1.8	0.8	-1.8	3.6	0.8		1.4	9.7	4.1	4.4	3.3

Source: Macrobond

Industrial Production Index (M/M Seasonally Adjusted)

	Month/Month % Change						Year/Year % Change				
	Jan	Feb	Mar	Apr	May		Jan	Feb	Mar	Apr	May
US	0.8	1.0	0.5	1.4	0.2		3.2	7.4	5.0	6.3	5.8
Canada	-0.7	0.7	0.9				1.0	3.4	3.3		
UK	0.9	-0.3	-0.2	-0.6			3.3	2.1	0.7	0.7	
Germany	1.4	0.1	-3.7	0.7			0.7	2.8	-3.1	-2.1	
France	1.8	-1.1	-0.4	-0.1			-1.3	2.1	0.1	-0.3	
Italy	-3.3	4.0	0.2	1.6			-1.9	3.4	3.2	3.7	
Japan	-2.4	2.0	0.3	-1.5			-1.6	0.5	-0.8	-3.4	

Source: Macrobond

Unemployment Rate (Seasonally Adjusted)

	Jul-21	Aug-21	Sep-21	Oct-21	Nov-21	Dec-21	Jan-22	Feb-22	Mar-22	Apr-22	May-22
US	5.4	5.2	4.7	4.6	4.2	3.9	4.0	3.8	3.6	3.6	3.6
Canada	7.4	7.1	7.0	6.8	6.1	6.0	6.5	5.5	5.3	5.2	5.1
UK	4.4	4.3	4.2	4.1	4.0	4.0	3.8	3.7	3.8		
Eurozone	7.7	7.5	7.4	7.3	7.1	7.0	6.9	6.8	6.8	6.8	
Germany	5.6	5.5	5.4	5.4	5.3	5.2	5.1	5.1	5.0	5.0	5.0
France	7.9	7.8	7.6	7.5	7.4	7.4	7.3	7.3	7.3	7.2	
Italy	9.1	9.1	9.1	9.2	9.1	8.9	8.7	8.6	8.4	8.4	
Japan	2.8	2.8	2.8	2.7	2.8	2.7	2.8	2.7	2.6	2.5	
Australia	4.6	4.5	4.7	5.2	4.6	4.2	4.2	4.0	3.9	3.9	3.9

Source: Macrobond

Current Account Balance as a % of GDP (Seasonally Adjusted)

	Q3-19	Q4-19	Q1-20	Q2-20	Q3-20	Q4-20	Q1-21	Q2-21	Q3-21	Q4-21	Q1-22
US	-2.2	-1.9	-2.1	-3.2	-3.3	-3.3	-3.4	-3.5	-3.8	-3.6	
Canada	-2.2	-1.6	-3.2	-1.1	-2.0	-0.8	0.1	-0.1	0.2	0.0	0.7
UK	-2.5	0.5	-2.2	-1.4	-1.4	-4.8	-2.2	-2.0	-4.9	-1.2	
Eurozone	3.1	1.6	0.7	1.4	2.7	3.1	3.7	3.2	2.6	0.8	1.2
Germany	7.8	7.4	6.7	5.4	7.3	8.3	8.9	8.0	7.0	6.5	4.9
France	0.2	0.4	-1.1	-3.7	-1.9	-0.7	0.6	0.7	0.4	-0.6	-0.8
Japan	4.3	3.7	4.6	4.2	3.6	4.0	3.4	3.1	3.4	3.5	3.5
Australia	-1.5	-2.5	-2.8	-3.5	-2.2	-2.7	-2.2	-1.4	-0.2	1.2	

Source: Macrobond

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* Pensions & Investments Research Center, as of December 31, 2020.

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