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Commentary

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Contact

Simona Mocuta
Chief Economist
simona_mocuta@ssga.com

Amy Le, CFA
Macro-Investment Strategist
amy_le@ssga.com

Elliot Hentov, PhD
Head, Policy Research
elliott_hentov@ssga.com

Selam Mola
Senior Associate
smola@statestreet.com

Krishna Bhimavarapu
Economist
VenkataVamseaKrishna_Bhimavarapu@ssga.com

**Global Macro
Highlights**

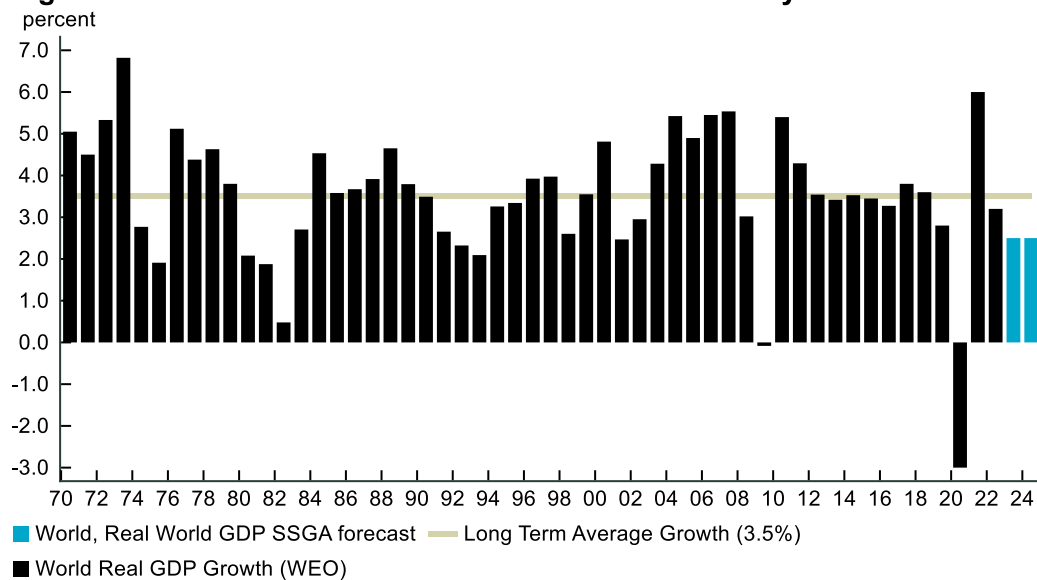
Aside From Inflation, Very Few Things Get Better From Here

This is our unsettling conclusion from the confusing amalgamation of macro data, policy developments, and wild market swings of the past few months. We had been warning for some time that—amid a global monetary policy tightening cycle of almost unprecedented speed and intensity—vulnerabilities were growing under the surface. To quote from our mid-December publication, we were afraid that “something, somewhere, snaps, triggering a chain reaction of financial market stress that then reverberates throughout the real economy, driving an abrupt shift from the appearance of resilience to the threat of failure.”

Three months later, something has clearly snapped. The question now is how severe a fallout from the banking sector turmoil? Much depends on the evolving policy responses and ringfencing measures authorities have already deployed and others that may still be in the pipeline. Big picture, it looks pretty good so far; after all, it was impressive to see how smoothly the acquisition of a global systemically important bank went.

That said, even if the banking flare-up is well contained, this is not the end of the story. The hit to sentiment will linger, whether among consumers, businesses, banks themselves, and investors. We reckon the same is true even for policymakers, who had been, to some degree, experientially testing the limits of tightening. It seems reasonable to anticipate a higher degree of caution, whether in regard to loan making, consumer spending, business hiring and capex deployment, and risk appetite in general. Credit availability, credit demand, and credit quality, all seem poised to deteriorate from here on. Given the surge in the cost of capital, this was already the anticipated direction of travel but recent events hasten the shift. The silver lining here is that weaker demand and tighter credit conditions should help accelerate ongoing disinflation and allow central banks to end the tightening cycle sooner than they otherwise might have. The next big question will be “how long until they start to cut?”.

Figure 1: Weak Growth Ahead For The Global Economy



Sources: SSGA Economics, IMF WEO

Summary of World Output¹ and Inflation²

(Annual percent change)

	Weight	History					Forecast	
	(2021)	2018	2019	2020	2021	2022	2023	2024
World Growth	100.0	3.6	2.8	-3.0	6.0	3.2	2.5	2.5
Advanced Economies	41.2	2.3	1.7	-4.4	5.2	2.7	1.1	1.1
US	15.2	2.9	2.3	-2.8	5.9	2.1	0.9	0.7
Euro area	11.8	1.8	1.6	-6.3	5.3	3.5	0.7	1.1
Germany	3.2	1.0	1.1	-4.1	2.6	1.8	0.3	1.2
France	2.2	1.8	1.9	-7.9	7.2	2.6	0.8	1.0
Italy	1.8	0.8	0.5	-9.0	7.0	3.8	1.1	1.1
Japan	3.7	0.6	-0.4	-4.3	2.2	1.0	1.4	1.1
UK	2.3	1.7	1.6	-11.0	7.6	4.1	0.3	1.2
Canada	1.4	2.8	1.9	-5.1	5.0	3.4	0.5	1.5
Australia	1.0	2.8	1.9	-1.8	5.2	3.7	1.5	2.0
Developing Economies	58.8	4.6	3.6	-1.9	6.6	3.5	3.5	3.5
China	18.9	6.7	6.0	2.2	8.4	3.0	5.0	4.7
Advanced Economy Inflation	41.2	2.0	1.4	0.7	3.1	7.2	5.0	2.5
US	15.2	2.4	1.8	1.3	4.7	8.0	4.0	2.2
Euro area	11.8	1.8	1.2	0.3	2.6	8.4	5.7	2.4
Germany	3.2	1.8	1.4	0.5	3.1	6.9	6.0	2.3
France	2.2	1.9	1.1	0.5	1.7	5.2	4.6	2.5
Italy	1.8	1.2	0.6	-0.1	1.9	8.2	6.2	2.3
Japan	3.7	1.0	0.5	0.0	-0.3	2.5	2.1	1.5
UK	2.3	2.5	1.8	0.9	2.6	9.1	6.8	2.8
Canada	1.4	2.2	2.0	0.7	3.4	6.8	4.2	2.5
Australia	1.0	1.9	1.6	0.9	2.9	6.6	4.2	2.4
Developing Economies	58.8	5.0	5.1	5.1	5.9	9.8	7.2	4.3
China	18.9	2.1	2.9	2.4	0.9	2.0	2.3	2.2
Value of World Output (\$ trl)								
At Market Exchange Rates		86.2	87.7	85.4	97.1	101.6	110.2	116.9
At Purchasing Power Parities		129.7	135.6	132.9	146.6	161.4	175.2	185.7

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

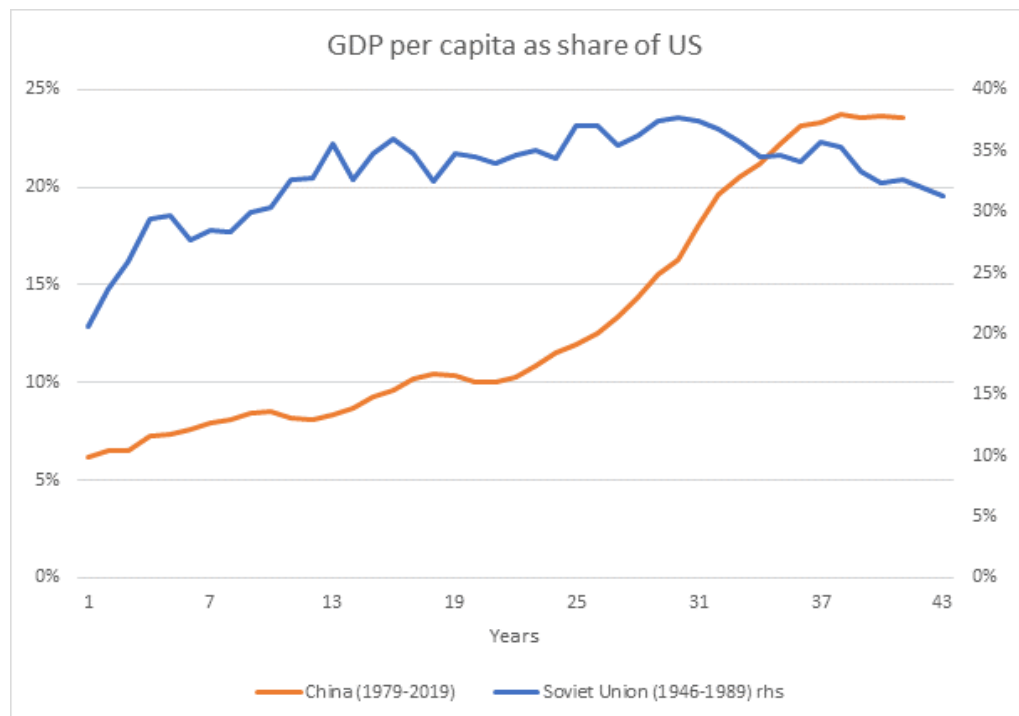
US-China Relations: Echoes of the 1950s Cold War

Russia’s invasion of Ukraine has contributed to increased fears about deglobalisation in general and US-China decoupling in particular. While we have been bullish in the short-term that geopolitical tensions remain well contained, we share concerns that the medium- and long-term trajectory of US-China relations will continue to grow in an adversarial manner. As the experience of recent trade wars, sectoral sanctions, and regulatory interference shows, this will continue to directly impact investor portfolios both through macro transmission channels as well as security-specific implications.

Forecasters frequently draw on the US-Soviet Cold War as a parallel for today’s relationship of the two largest economies. However, China and the US are far more economically integrated and China’s economy is far more diversified than the Soviet Union was at the time. The consequence is that decoupling measures carry great economic pain for all parties. On the one hand, this represents a constraint on policymakers, while on the other, it makes the economy itself a major arena for competition and creates much larger financial tail risks than during the Cold War.

Nonetheless, the Cold War analogy is helpful in imagining the long-term cycle of great power rivalry. In this regard, we are now entering the most heated decade of competition with the greatest potential for accidents or outright confrontation. The main reason is that the challenger (China) to the hegemonic power (US) has reached critical thresholds of wealth and technological sophistication.

Fig. 2. Soviet, Chinese, and US GDP Comparison During Convergence Periods



Source: State Street Global Advisors’ Global Macro Policy; Maddison History Project.

Figure 2 above draws a parallel with the Soviet Union's initial post-WWII economic trajectory. It is less relevant that the Soviet Union started with a higher economic base and therefore had a narrower income differential. More noteworthy and frequently forgotten is that the Soviets had a very strong economic performance from 1945-1960, and Figure 2 shows it largely outperformed the US (itself in a boom) in the early post-war period. At the same time, the Soviet Union delivered great technological progress, e.g. putting the first satellite (1957) as well as providing the first human orbit in outer space (1961). A little bit later the world narrowly escaped oblivion during the Cuban Missile Crisis. Tensions remained high in the 1960s via proxy wars in Africa, Israel/Palestine and Vietnam, but gradually detente took place from the 1970s onward. It is not a coincidence that economic convergence plateaued during that period and the Soviet Union was visibly failing to narrow the gap to the West, including its ability to fund power projection.

A simplistic comparison to today illustrates that China has also achieved a remarkable economic performance over the past four decades. And it has also taken leadership in key technologies of the future, including renewable energy, battery technology, and green transportation. However, the geopolitics make continued rapid convergence toward US levels unlikely. Instead, the current income gap is likely to stabilise as the two economies decouple and the US (and West) increases public investment, especially in domestic research and development. Together with the explicit anti-China targeting by Western policymakers, this raises the chances of miscalculation as global struggles become more of a zero-sum game.

For most of 2023, these trends should be understated, but the coming years will be characterised by greater tensions and repeated crisis potential, starting next year with presidential elections in both Taiwan and the US, as well as the stabilisation of the post-Ukraine War settlement. The only good news here is that the Cold War analogy would suggest if the world can avoid a major crisis in the coming 5-10 years, the geopolitical order could re-stabilise for the better.

**Country Macro
Highlights**

Please see country-specific commentary in the sections below.

US: Reassessment Time

In mid-December, we titled our US forecast commentary “Pushing On A String”. We wrote that we were “somewhat perplexed by FOMC’s continued incremental hawkishness in spite of growing evidence that the inflation tide is turning.” We favored a 5.0% peak Fed Funds rate and rate cuts before year-end 2023. Those views rested on a high conviction call around disinflation, a focus on the lagged but powerful demand-destruction effects of sharply higher cost of capital, and concerns around possible financial market stress in the aftermath of rapid policy tightening. Signs of distress across the financial market ecosystem had—after all—already appeared (UK pensions, crypto, etc.) and it seemed just a matter of time before something else would percolate to the surface. Our view has always been that it is better for central banks to voluntarily pause the tightening cycle before a stress episode unfolds, since it is hard to contain it once it erupts. Moreover, there is the associated risks that, as part of that containment effort, policymakers find themselves forced onto an easing cycle sooner than they’d like.

All economists know that any forecast put on paper is subject to merciless criticism. It is the nature of the job. It is also why we think the numbers themselves are usually less important than the narrative behind them. To us, that macro narrative had been unchanged for some time and was compelling: a growth slowdown accompanied by disinflation, facilitating an earlier and deeper policy pivot than envisioned in the Fed dot plot. Evidently, that narrative came under a lot of scrutiny over the course of February and early March as a string of data releases (and, even more importantly, data revisions!) cast doubt over progress on disinflation. In addressing those concerns, we wrote on March 1 that “we acknowledge considerable risks to our dovish views, but the end of 2023 is still a long way off, and a lot can happen in the meantime.” Indeed!

So, how has our macro view changed in light of recent developments? To be clear, many elements of the view have not changed at all; in fact, they have been further cemented. This is especially true of the disinflation narrative. It is impossible to truly estimate the behavioral changes resulting from recent banking sector turmoil, but directionally at least, these events imply a tightening of credit conditions relative to what would have otherwise been the case. Recent months had already brought ample evidence that the moment of economic “peak euphoria” was well in the past and that a more cautious tone was taking hold among businesses and consumers. Some powerful examples follow. The number of people quitting their jobs peaked in November 2021; while it got almost back to that peak in April 2022, it has since retreated by about 14%. The share of homes sold over asking price spiked to over 60% in April 2022 but dropped to the teens in December-January. Core durable goods orders (non-defense capital goods excluding aircraft) peaked in August 2022. Excluding the composition-driven surge in

April 2020, wage inflation (as measured by average hourly earnings) peaked in March 2022 and has since eased by about 1.3 percentage points.

We expect these trends—all of which tell a story of disinflation—to continue; some may well accelerate. The next few months should bring about material moderation in inflation rates, with headline CPI and PCE dropping below 4.0% y/y by June and core PCE not far above that level. Even if not much credit tightening transpires by then, would further Fed rate hikes seem necessary at that point? We think not. And so, unless the Fed hikes at the early May meeting, its dot plot terminal of 5.25% is likely to remain unrealized. That seems like a lesser problem than running the risks of hiking then only to reverse course soon thereafter. Hence, we think the Fed is done. To be fair, the way we really think about a May hike is the following. Could it happen? Yes. Will it happen? Probably not. Should it happen? Definitely not.

On the basis of ongoing improvements in inflation and softening growth, we do see 50 basis points worth of cuts as warranted before year end, either in the form of two small cuts in November and December, or a larger move in December. The current market pricing of 100 basis points worth of cuts through December strikes us as too aggressive; it would only be warranted if banking sector troubles take a turn for the worse. That said, we also think that the 80 basis points worth of cuts envisioned in the March summary of economic projections (SEP) through end-2024 is too little in the face of our anticipated economic trajectory. We look for at least twice that degree of easing by the end of 2024.

On growth, we had long resisted joining the “recession is inevitable” camp, and the evidence of resilience in the first-quarter data validated that position. Having kept our 2023 growth forecast at 0.4% since September, we’ve actually upgraded that number to 0.9% this round. The upgrade reflects three main factors: a stronger ending to 2022 that provided a higher “launch pad” for the economy (this matters for annual averages), the strong reported spending data through February, and more aid from trade (itself a reflection of better growth prospects in Europe).

Despite this forecast change, we think the odds of recession through end-2024 have risen and now slightly exceed 50%. Indeed, the 2023 growth improvement is fully offset by deteriorating growth expectations in 2024, when we no longer anticipate any improvement in performance. While the labor market starts from a position of strength, delaying the possible recession, we do see a faster pickup in unemployment late this year and beyond, likely approaching 5.5% by late 2024. This further aids disinflation and allows the Fed to calibrate policy rates lower in the face of these dynamics. This is still a fairly modest increase in unemployment by historical standards, implying that even if a recession takes hold, it would be shallow. It could, however, morph into something deeper and more prolonged, and could even take hold much sooner, if certain risk events materialize. Amid the focus on the banking sector, the impending debt ceiling fight has temporarily taken a back seat. Yet it is but one of the many things that could go wrong in coming months.

Canada: Well Timed

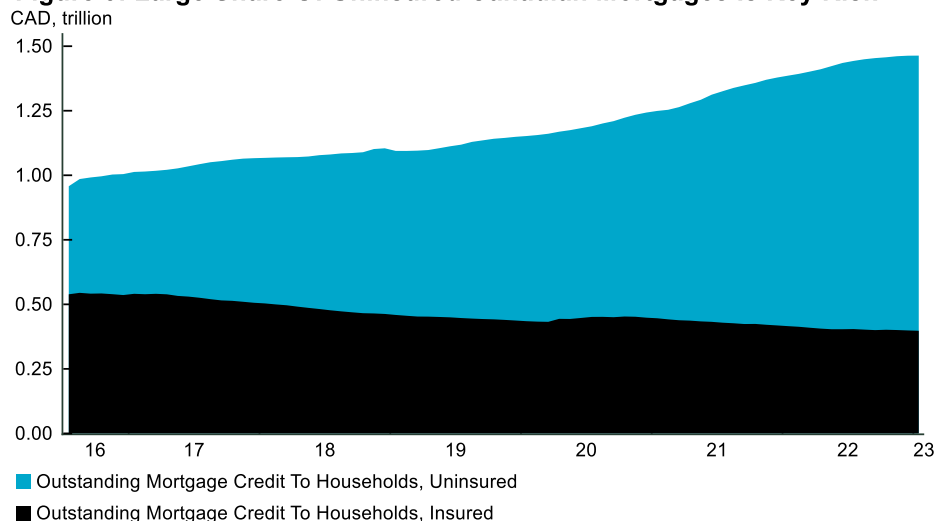
Now that we learned that the risks of high inflation and financial instability are conjoined twins, the Bank of Canada’s decision to pause its hiking cycle in December seems particularly well timed. Since our last update, the economy has looked more resilient, and inflation is moving in the right direction.

CPI inflation eased to 5.2% y/y in February, below market expectations due primarily to base effects. It is on track to ease to 4.2% y/y this year and then drop further to 2.5% in 2024. While falling oil prices aid disinflation in the transportation segment, we worry that food prices (~16% CPI weight) may take longer to mean-revert. Shelter inflation, which has the highest weight in the basket (nearly 30%), rose 6.1% y/y in February, not far off the 7.4% peak this cycle. However, leading indicators such as the Teranet Composite Residential Price Index, suggest a sharp impending moderation.

However, the typical Canadian household continues to struggle with high prices, especially grocery and mortgage servicing. Grocery food inflation is has been in the double digits for months and some sub-components prices such as cereal, fruit juices, and fish actually accelerated. Further, mortgage interest costs, a unique feature of the Canadian CPI basket, rose a whopping 23.9%, 2.7 points more than in January and at the fastest pace since July 1982.

While higher mortgage interest payments will weigh heavy on household finances, we are more worried about the possibility of defaults or foreclosures in case of an adverse turn of events. As of February, home prices fell 11.2% from their May 2022 peak, much more than in other major advanced economies. We are worried about the implications of higher mortgage payments in a weakening housing sector, especially since nearly 72% of mortgages in Canada are uninsured.

Figure 3: Large Share Of Uninsured Canadian Mortgages Is Key Risk



Sources: SSGA Economics, BoC, Macrobond

The flip side to high food and mortgage interest payments is a conspicuous drag on other consumer spending categories. Notably, inflation in recreation is down to just 2.2% y/y after peaking at 7.4% in June 2022, and there is gathering evidence of households scaling back discretionary spending. After rising strongly at 1.4% m/m in January, retail sales were estimated by Statistics Canada to have fallen 0.6% in February. In another report, wholesale activity fell 1.6%, while factory sales fell 2.8% in February.

Nonetheless, the cooling CPI will allow the BoC to pause confidently. We don't expect any further rate hikes in 2023, so effectively, the hiking cycle has ended in Canada. In fact, the BoC didn't even discuss hiking during its March meeting while policymakers saw clear signs that monetary tightening thus far was already "dampening demand".

Furthermore, we expect that if the economy cools as expected or fares worse on account of a global or domestic shock (banking induced?), the BoC will come under pressure to reverse course. Our base case is for a secularly slowing consumption, in which case, we expect the BoC to tread cautiously in light of the above-discussed risks and deliver a rate cut in Q4. As such, we see the policy rate ending this year at 4.25% and get to 3.50% in 2024. So we indeed think risks are skewed to the downside.

However, a key source of optimism is still the labor market. We are not very optimistic about the economy adding many more jobs but expect it not to lose any significant number (absent any strong external shock). This is because labor demand is still robust; in fact, 36.3% of jobs in Ontario were unfilled for more than 90 or more days last year. Furthermore, employment in 6 sub-industries is still below 2019 levels, notably in agriculture (11% below the 2019 level) and accommodation and food services (9% below). We expect these industries to add employment, and investments in agriculture may be of interest given the acute food-price pressures.

In December, we wrote that wages might grow between 5-7% this year, and indeed, February marked the first time wages outgrew inflation in two years. The average hourly wage rose 5.4% y/y, two-tenths faster than CPI. We don't expect it to become a trend, so we don't expect a wage-price spiral.

All in all, we look for 0.5% GDP growth this year. We expect household consumption to grow below the long run average of 3.2%, while exports and imports may contract by Q4 this year. However, we expect that proactive monetary policy may deliver timely support to the stalling economy, allowing growth to rebound to 1.5% in 2024.

UK: Against All Odds?

The UK has been the recipient of a sizable growth forecast upgrade this quarter. Seemingly against all odds—and nearly all forecasts—the economy has not yet entered a recession, not even a technical one. Admittedly, it did contract slightly in the third quarter, but if early estimates hold true, real GDP was merely flat (q/q) during the fourth quarter of 2022. Moreover, high frequency data suggest a surprising, though very welcome, degree of resilience at the start of 2023, with monthly GDP up slightly in January and

purchasing managers indexes (PMIs) signaling a notable improvement in service sector activity in January-February.

Given some additional fiscal aid, given the labor market resilience, given that inflation is now in an established downtrend (despite the upside surprise in February), given the likely influx of tourists (not least from China) this year, given the retreat in regional natural gas prices, and given Bank of England's measured policy tightening, we now expect a small increase in consumer spending this year, versus a slight decline in the previous forecast. This is the most important factor driving the 2023 GDP growth upgrade from -0.7% in the December forecast to 0.3% now. Admittedly, this is an unusually large move from one quarter to the next, and it is well above consensus (-0.5% at the time of this reading). As such, there is a genuine risk that we may yet be forced to revisit and lower these numbers down the line, but to the extent that the UK consumer has demonstrated so much resilience through what is arguably the worst of this crisis, is encouraging.

The apparent resilience in the labor market is critically important to the consumer spending outlook. While the labor market did take a turn for the worse towards the end of last summer, with employment declining for a few months, conditions appear to have stabilized since then. The claimant count unemployment rate continues to incrementally decline, although progress has leveled off recently. And while labor demand appears to be shifting away from full-time toward part-time employment, it is good to see overall employment and the activity rate picking up again. Wage inflation is slowly moderating—something the BoE wants to see—in order to help lower inflationary pressures and bring inflation back to target over time. It will indeed take some time to bring inflation to target. After a 9.1% surge in 2022, we see headline CPI inflation averaging 6.8% this year (same as in the December forecast). A sub-3.0% average is expected in 2024.

Following the December hike that put the bank rate at 3.5%, we wrote that a cumulative 100 basis points (bp) worth of additional hikes seemed appropriate. The BoE delivered 75 bp worth of hikes since then (50 bp in February and 25 bp in March). Given the recent banking sector turmoil, another hike seems less compelling, but remains possible. The BoE remains open minded about the prospect, saying in the March policy statement that “If there were to be evidence of more persistent pressures, then further tightening in monetary policy would be required.” However, the language seems to imply that more tightening is the alternative scenario, rather than the base case. We'd favor a pause in order to prevent unforeseen stresses. We'd also favor a prolong hold at current levels to await a convincing inflation retreat. The BoE may well lag the Fed and BoC in respect to the timing of the first cut, which we do not anticipate until early 2024.

**Eurozone: Doomsday
Averted**

Back in September, when we maintained a positive 2023 growth forecast for the eurozone amid deep concerns around risks of energy supply disruptions, we were generally seen as overly optimistic. When we maintained that forecast in December, the contrast with the slight contraction anticipated by consensus became even starker. Since then, however, with the winter season essentially over and natural gas storage not depleted, sentiment around eurozone's short

term economic performance improved meaningfully. In light of demonstrated resilience and incoming data, what seemed optimistic three months ago no longer seems sufficient. As such, we've nudged the 2023 forecast a little higher, to 0.7%; we are still a touch above the rapidly ascending consensus, but no longer meaningfully so.

The economy performed impressively well over the course of 2022, with growth reaching 3.5%, well ahead of the US. A cushion of excess savings, meaningful fiscal transfers to help households cope with high energy prices, and support from tourism demand, were key factors that allowed real consumer spending to grow 4.3% in 2022 (the most since 2001!) despite inflation exceeding 8.0%. Equally welcome was another year of strong fixed investment growth, which we see not only as a positive to current growth, but a likely driver of future productivity gains.

Evidently, the picture is far less buoyant as we look ahead at 2023. The lagged negative drag from high inflation translates into meager consumer spending growth this year, although we don't anticipate an outright contraction. Tourism inflows should help limit the damage. Investment spending slows similarly – this is a story of broad-based slowdown but no outright contraction in any particular segment of the economy.

The inflation problem remains acute though the worst has passed. We see headline inflation slowing from 8.4% last year to around 5.5% this year before it decelerates more sharply to under 3.0% in 2024. Concerns remain about a delayed wage-price response, but so far, incoming wage agreements have been reassuring in that regard. For the past several months, the ECB has been engaged in a belated rush to tighten policy to fight inflation. It delivered a 50 basis point hike in March, just days before banking troubles spread to Europe. It does not yet appear to be done, but it is nearly done. We see one more 25 bp hike by mid-year and then an extended hold period (assuming market conditions allow it). There remains a reasonable argument to be made that the ECB should perhaps do a little more, say 50 bp of additional hikes, but given percolating risks in the banking sector, a more cautious approach seems best.

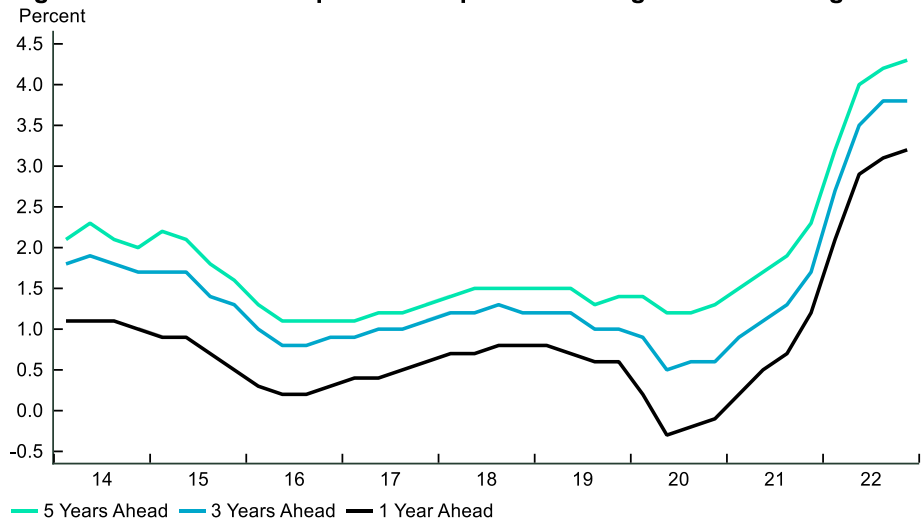
Japan: New Dawn In The Land Of The Rising Sun

Japan could be a vital silver lining to a global economy grinding rather slowly to a halt in the next two years. With an economy that could grow at or above potential and a monetary policy slated to normalize, Japan has an exciting couple of years ahead. Amidst high inflation recently, the Bank of Japan (BoJ) responded cautiously to expectations of policy normalization in that they needed to achieve price stability '*sustainably and stably accompanied by wage increases*'.

We have been expecting a wage growth higher than the consensus of +3.0% at the *shunto* wage negotiations but were pleasantly surprised with a 3.8% outcome at the first round of results (including seniority pay). The 2.3% growth in base salaries (excluding seniority pay) may result in higher scheduled cash earnings, so a structural shift in the underlying wage dynamics may be afoot. Smaller unions (less than 300 members) also had a good outcome at 3.5%. Furthermore, wage growth may continue in 2024 given the declining demography in Japan and persistent price pressures.

Indeed, price pressures remain robust despite the effects of electricity subsidies that dragged the annual headline CPI. The BoJ core CPI (excluding fresh food and energy) rose 0.4% m/m in February, translating into 3.5% y/y, the fastest since 1982 and above consensus expectations. The global core (excluding all food and energy) rose 0.3% m/m, despite a 0.6% drop in headline primarily due to electricity and gas subsidies which caused energy prices to drop 11% m/m. Despite recently announced subsidies and base effects, we expect headline CPI to average 2.1% y/y this year and drop to 1.5% in 2024. Importantly, energy subsidies may fade from February 2024, which may add some basis points to the headline. Services inflation is gradually improving, and we expect its contribution to rise. Case in point, the services PMI in March reached 54.2, the highest level since 2013, and prices charged have risen for ten months. And finally, firms in the BoJ Tankan survey indicate higher output prices in the longer run; all these dynamics suggest the start of a regime shift in price-wage dynamics.

Figure 4: Outlook For Japanese Output Prices: Higher In The Long Run



Sources: SSGA Economics, BOJ, Macrobond

The combination of active price pressures and a better *shunto* outcome supports another Yield Curve Control (YCC) tweak from the BoJ. The central bank's estimate of the output gap may turn positive in April, adding another reason to amend the YCC confidently.

We are biased to widening the target band around the current 10y JGB by 50 bps but a shift to targeting 5y JGB is equally likely. So we expect the BoJ to target the 10y JGB at 0%±100 bps. This move could be interpreted effectively as removing YCC altogether, but we do not think the BoJ will do away with this critical tool that served the policy well. Timing-wise, the move may come in June this year and could be pushed further out if the current banking turbulence gathers steam.

As such, we are confident Japanese banks will not face any turmoil because of their solid balance sheets and a significantly low ratio of government securities held to maturity. However, the US small banks' issues are a cautionary tale as Japanese banks hold nearly YEN 84 trillion worth of JGBs. This is precisely why we do not expect BoJ to exit NIRP in a hurry;

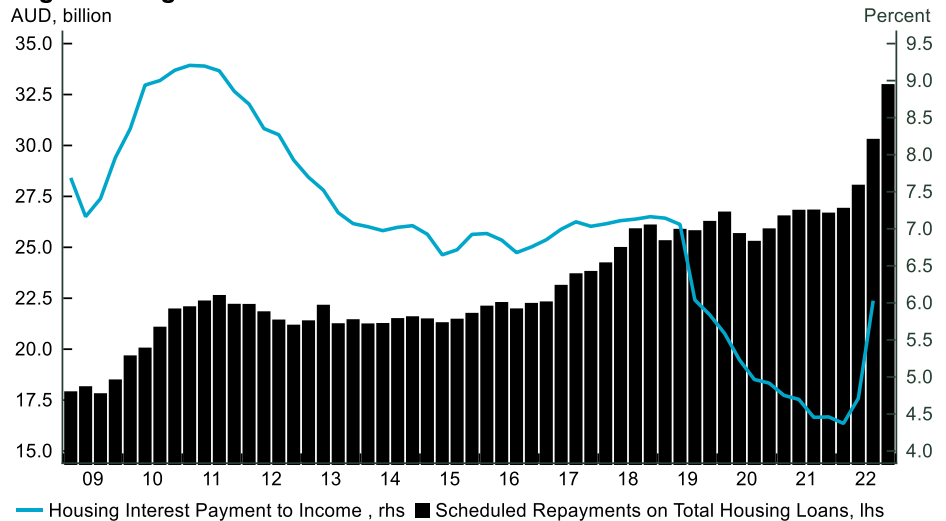
the chances are somewhat low in our thinking. Hence, expanding YCC and still having a target range will help.

Finally, we are optimistic that Japan may grow above its potential in 2023 and carry some momentum into the following year. Aided by better wage prospects, domestic consumption should drive GDP growth to an average of 1.4% y/y this year and 1.1% in the next year. Exports may cool as the global appetite for goods consumption has receded, and China thus far has not lived up to expectations of rapid recovery. Finally, as we had been writing, risks to Japan’s macro outlook stem more from the outside than within.

Australia: Every Cloud Has A Silver Lining

Economic growth this year may be weaker than we thought back in December. We now expect GDP growth to average 1.5% y/y in 2023, primarily due to weakening household consumption as higher interest rates start to bite. Growth may recover to 2.0% next year, likely aided by policy easing. The Westpac-Melbourne Institute’s Leading Index’s six-month annualized deviation from trend-growth remained negative for a seventh month in February, indicating that the growth may slow for extended periods. The ANZ-Roy Morgan Consumer Confidence decreased to 76.5 in the week ended March 19, comparable to the pandemic lows. Plans to purchase a major household item are also near record lows. We expect household consumption to grow at an average of just 1.0% in 2023, against 5.9% in the last two years.

Figure 5: Higher Interest Rates To Burden Aussie Households



Sources: SSGA Economics, RBA, Macrobond

Households will feel the burden of higher interest rates through higher scheduled mortgage payments. In Australia, the typical duration of a fixed-rate home loan is three years, meaning that the benefits homebuyers had during the pandemic have ended. The Reserve Bank of Australia (RBA) noted that a quarter of the fixed-rate loans have already expired. Another 40% will expire by the end of 2023, and nearly 20% by the next year. Nearly

90% of those fixed-rate mortgages rolling over this year will have 30% or higher payments. Hence, the delayed effects of tighter monetary policy will be considerable. This is the primary reason why household consumption will slow in 2023. They also warrant higher financial stability risk if notable borrowers default, which is our biggest fear. Any significant rise in unemployment will exacerbate these risks.

Terminal rate expectations have been volatile in the wake of the recent global banking stress, but Aussie banks' capital buffers are well-positioned to quell any fears. However, earnings risks due to higher costs of deposits and wholesale funding exist. Either way, we do not see a situation where depositors' savings will be put at risk. As Assistant Governor Chris Kent stated, Aussie lenders are "unquestionably strong".

As the lagged effects of outsized hikes are taking shape, we expect the Reserve Bank of Australia (RBA) to be cautious. While we maintain our standing terminal rate call of 3.85% for now, we acknowledge downside risks to that view. The NAB Business Confidence slid 10 points to -4 in February as the outlook remained cloudy. However, the labor market rebounded, putting the onus of the April RBA decision on retail sales (Mar 27) and monthly CPI data (Mar 28) for February. We expect both these data to print softer than consensus as consumers' pain due to higher mortgages may show in retail sales while inflation likely had peaked in Q4.

Price pressures should comfortably ease going forward, as indicated by leading indicators on the component level we track. Housing, which has the highest weightage of 22% in the CPI basket, has a good chance of falling below 0% y/y given that prices are already correcting. We expect headline CPI to average 4.2% y/y in 2023 and fall to 2.4% in the next year.

The employment outlook is pretty much the same as elsewhere. In Australia, though, demand is easing while supply is rising on rising migrants. So some risks of an increase in the unemployment rate exist. Although household consumption will slow materially, the drag on overall growth may be offset by a potential dark horse: exports. Thanks to the global demand in rare-earth metals and enforcing a free trade agreement in the Indo-Pacific region from January. This might serve as a good opportunity for exports to finally rise over their pre-pandemic level, which is still 6.5% higher than in Q4 2022. They don't call it a lucky country without reason!

Data Calendar

Week in Review (Mar 20– Mar 24)

Country	Release (Date, format)	Consensus	Actual	Last	Comments
Monday, March 20					
GE	PPI (Feb, y/y)	14.5%	15.8%	17.6% (↓)	Downtrend slowing.
Tuesday, March 21					
US	Existing Home Sales (Feb, m/m)	5.0%	14.5%	-0.7%	Bounced on lower mortgage rates.
CA	CPI (Feb, y/y)	5.4%	5.2%	5.9%	Moving in the right direction.
GE	ZEW Survey Expectations (Mar)	15.0	13.0	28.1	Banking worries percolate.
Wednesday, March 22					
US	FOMC Rate Decision (Upper Bound)	5.00%	5.00%	4.75%	The Fed should stop here.
UK	CPI (Feb, y/y)	9.9%	10.4%	10.1%	Unpleasant rebound, but still in downtrend.
Thursday, March 23					
US	Initial Jobless Claims (Mar 18, thous)	197	191	192	Very low.
US	Continuing Claims (Mar 11, thous)	1,690	1,694	1,680 (↓)	Very low
US	New Home Sales (Feb)	650	640	633 (↓)	Big downward revision.
US	Kansas City Fed Manf. Activity (Mar)	-2	0	0	Stable.
UK	Bank of England Bank Rate (Mar 23)	4.25%	4.25%	4.00%	As expected.
UK	GfK Consumer Confidence (Mar)	-36	-36	-38	Weak.
Friday, March 24					
US	Durable Goods Orders (Feb, prelim)	0.2%	-0.1%	-5.0% (↓)	Soft.
CA	Retail Sales (Jan, m/m)	0.7%	1.4%	0.0% (↓)	Advance Feb estimate shows a big fall.
UK	Retail Sales Inc Auto Fuel (Feb, m/m)	0.2%	1.2%	0.9% (↑)	Welcome.
UK	Manufacturing PMI (Mar, prelim)	49.7	48.0	49.3	Somewhat surprising reversal.
UK	Services PMI (Mar, prelim)	53.0	52.8	53.5	Welcome resilience.
EC	Manufacturing PMI (Mar, prelim)	49.0	47.1	48.5	Somewhat surprising reversal.
EC	Services PMI (Mar, prelim)	52.5	55.6	52.7	Welcome resilience.
GE	Manufacturing PMI (Mar, prelim)	47.0	44.4	46.3	Somewhat surprising reversal.
GE	Services PMI (Mar, prelim)	51.0	53.9	50.9	Welcome resilience.
FR	Wages (Q4, q/q, final)	0.6% (p)	0.7%	1.0%	In range.
FR	Manufacturing PMI (Mar, prelim)	48.0	47.7	47.4	Soft.
JN	National CPI (Feb, y/y)	3.3%	3.3%	4.3%	Electricity subsidies drag.
JN	Manufacturing PMI (Mar, prelim)	na	48.6	47.7	Still in contraction.

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

Data Calendar

Week In Preview (Mar 27 – Mar 31)

Country	Release (Date, format)	Consensus	Last	Comments
Monday, March 27				
GE	IFO Business Climate (Mar)	91.9	91.1	
GE	Retail Sales (Feb, m/m)	0.5%	-0.3%	
JN	Leading Index CI (Jan, final)	96.5 (p)	96.9	Should remain as is.
JN	PPI Services (Feb, y/y)	1.7%	1.6%	May beat consensus due to more abroad visitors.
AU	Retail Sales (Feb, m/m)	-0.1%	1.9%	May come below consensus.
Tuesday, March 28				
US	FHFA House Price Index (Jan, m/m)	-0.3%	-0.1%	
US	CoreLogic CS 20-City (Jan, m/m, sa)	na	-0.51%	
US	Conf. Board Consumer Confidence (Mar)	101.5	102.9	
UK	Nationwide House PX (Mar, m/m)	na	-0.5%	
FR	Business Confidence (Mar)	na	103	
IT	Consumer Confidence Index (Mar)	na	104	
IT	Manufacturing Confidence (Mar)	na	102.8	
Wednesday, March 29				
US	Pending Home Sales (Feb, m/m)	-2.3%	8.1%	
UK	Mortgage Approvals (Feb, thous)	na	39.6	
GE	GfK Consumer Confidence (Apr)	-31.0	-30.5	
FR	Consumer Confidence (Mar)	na	82.0	
Thursday, March 30				
US	Initial Jobless Claims (Mar 25)	na	191	
US	Continuing Claims (Mar 18)	na	1,694	
US	GDP (Q4, third, q/q, saar)	2.7%	3.2%	
GE	CPI (Mar, y/y, prelim)	8.0%	8.7%	
IT	Unemployment Claims Rate (Mar, sa)	na	7.9%	
IT	PPI (Feb, y/y)	na	11.6%	
JN	Job-To-Applclicant Ratio (Feb)	1.35	1.35	May remain same.
JN	Jobless Rate (Feb)	2.4%	2.4%	May remain same.
JN	Retail Sales (Feb, m/m)	0.0%	1.9%	Will be interesting to see if it rises on confident consumers.
JN	Industrial Production (Feb, m/m, prelim)	3.2%	-5.3%	
AU	Private Sector Credit (Feb, m/m)	0.4%	0.4%	Should come above consensus.
Friday, March 31				
US	Personal Income (Feb, m/m)	0.3%	0.6%	
US	Personal Consumption (Feb, m/m)	0.3%	1.8%	
US	U.of Mich. Sentiment (Mar, final)	63.4 (p)	64.9	
CA	GDP (Jan, m/m)	na	-0.1%	Treading water.
UK	GDP (Q4, q/q, final)	0.0% (p)	-0.2%	GDP may have stalled.
GE	Unemployment Claims Rate (Mar, sa)	5.5%	5.5%	
FR	CPI (Mar, y/y, prelim)	na	6.3%	
FR	Consumer Spending (Feb, m/m)	na	1.5%	
FR	PPI (Feb, y/y)	na	17.9%	
IT	Industrial Sales (Jan, m/m)	na	0.7%	
IT	CPI NIC incl. tobacco (Mar, prelim, y/y)	na	9.2%	
JN	Annualized Housing Starts (Feb)	0.864	0.893	Could remain same.

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

Economic Indicators

Central Bank Policy Targets

Region	Target	Year/Year % Change in Target				
		Oct	Nov	Dec	Jan	Feb
US	Target: PCE price index 2.0% y/y	6.1	5.6	5.3	5.4	
Canada	Target: CPI 2.0% y/y, 1.0%-3.0% control range	6.9	6.8	6.3	5.9	5.2
UK	Target: CPI 2.0% y/y	11.1	10.7	10.5	10.1	10.4
Eurozone	Target: CPI below but close to 2.0% y/y	10.6	10.1	9.2	8.6	8.5
Japan	Target: CPI 2.0% y/y	3.7	3.8	4.0	4.3	3.3
Australia	Target Range: CPI 2.0%-3.0% y/y	7.8	7.8	7.8		

Source: Macrobond

Key Interest Rates

	Apr-22	May-22	Jun-22	Jul-22	Aug-22	Sep-22	Oct-22	Nov-22	Dec-22	Jan-23	Feb-23
US (top of target range)	0.50	1.00	1.75	2.50	2.50	3.25	3.25	4.00	4.50	4.50	4.75
Canada (Overnight Rate)	1.00	1.00	1.50	2.50	2.50	3.25	3.75	3.75	4.25	4.50	4.50
UK (Bank Rate)	0.75	1.00	1.25	1.25	1.75	2.25	2.25	3.00	3.50	3.50	4.00
Eurozone (Refi)	0.00	0.00	0.00	0.50	0.50	1.25	1.25	2.00	2.50	2.50	3.00
Japan (OCR)	-0.02	-0.03	-0.04	-0.01	-0.04	-0.07	-0.06	-0.08	-0.02	-0.01	-0.01
Australia (OCR)	0.10	0.33	0.73	1.28	1.81	2.25	2.58	2.84	3.05	3.10	3.29

Source: Macrobond

General Government Structural Balance as a % of Potential GDP

										Forecast	
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	
US	-2.5	-3.6	-4.1	-5.1	-5.7	-10.8	-9.5	-4.0	-5.3	-6.0	
Canada	0.0	0.1	-0.3	0.0	-0.2	-8.6	-4.0	-2.7	-1.2	-0.6	
UK	-3.6	-2.8	-2.3	-2.4	-2.7	0.5	-3.2	-4.3	-1.7	-0.4	
Eurozone	-0.5	-0.5	-0.5	-0.3	-0.5	-4.3	-3.8	-3.5	-2.9		
Germany	1.2	1.2	1.1	1.6	1.3	-2.9	-3.0	-3.0	-1.8	-1.1	
France	-2.1	-1.9	-1.9	-1.5	-2.1	-5.7	-5.1	-4.5	-4.8	-4.3	
Italy	-0.6	-1.2	-1.5	-1.6	-0.9	-6.0	-5.1	-5.7	-3.6	-3.6	
Japan	-4.2	-4.0	-3.4	-2.5	-2.6	-8.2	-6.3	-7.3	-3.2	-2.3	
Australia	-2.6	-2.2	-1.6	-1.1	-4.0	-7.9	-6.2	-3.5	-3.1	-2.6	

Source: International Monetary Fund, World Economic Outlook

Headline Consumer and Producer Price Inflation

	CPI Year/Year % Change						PPI Year/Year % Change				
	Oct	Nov	Dec	Jan	Feb		Oct	Nov	Dec	Jan	Feb
US	7.7	7.1	6.5	6.4	6.0		8.2	7.3	6.5	5.7	4.6
Canada	6.9	6.8	6.3	5.9	5.2		9.9	9.0	7.4	5.0	1.4
UK	11.1	10.7	10.5	10.1	10.4		17.4	16.0	14.5	13.5	12.1
Eurozone	10.6	10.1	9.2	8.6	8.5		30.5	27.0	24.6	15.0	
Germany	8.8	8.8	8.1	8.7	8.7		34.5	28.2	21.6	17.6	15.8
France	6.2	6.2	5.9	6.0	6.3		21.3	18.1	17.5	14.9	
Italy	11.8	11.8	11.6	10.0	9.1		27.7	29.4	31.7	11.1	
Japan	3.7	3.8	4.0	4.3	3.3		9.7	9.9	10.5	9.5	8.2
Australia	7.8	7.8	7.8				5.8	5.8	5.8		

Source: Macrobond

Economic Indicators

Real GDP Growth (Q/Q Seasonally Adjusted)

	Quarter/Quarter % Change					Year/Year % Change				
	Q4-21	Q1-22	Q2-22	Q3-22	Q4-22	Q4-21	Q1-22	Q2-22	Q3-22	Q4-22
US	1.7	-0.4	-0.1	0.8	0.7	5.7	3.7	1.8	1.9	0.9
Canada	1.7	0.6	0.9	0.6	0.0	3.9	3.1	4.7	3.8	2.1
UK	1.5	0.5	0.1	-0.2	0.0	8.9	10.5	3.9	1.9	0.4
Eurozone	0.6	0.6	0.9	0.4	0.0	4.8	5.5	4.4	2.4	1.8
Germany	0.0	0.8	0.1	0.5	-0.4	1.2	3.5	1.7	1.4	0.9
France	0.6	-0.2	0.5	0.2	0.1	5.1	4.8	4.2	1.0	0.5
Italy	0.9	0.1	1.0	0.4	-0.1	6.9	6.5	5.1	2.5	1.4
Japan	1.1	-0.5	1.2	-0.3	0.0	0.9	0.6	1.4	1.5	0.4
Australia	3.7	0.6	0.9	0.7	0.5	4.6	3.0	3.1	5.9	2.7

Source: Macrobond

Industrial Production Index (M/M Seasonally Adjusted)

	Month/Month % Change					Year/Year % Change				
	Oct	Nov	Dec	Jan	Feb	Oct	Nov	Dec	Jan	Feb
US	-0.1	-0.6	-1.4	0.3	0.0	3.0	1.8	0.6	0.5	-0.2
Canada	-1.2	0.1	-1.3			1.6	2.4	0.7		
UK	0.2	0.1	0.3	-0.3		-4.2	-4.4	-4.1	-4.3	
Germany	-0.4	0.4	-2.4	3.5		-0.4	-0.6	-3.6	-1.2	
France	-2.4	1.9	1.5	-1.9		-2.8	0.5	1.8	-2.2	
Italy	-1.1	-0.1	1.2	-0.7		-1.5	-3.5	-0.9	1.7	
Japan	-3.2	0.2	0.3	-5.3		3.8	-0.9	-0.8	-3.8	

Source: Macrobond

Unemployment Rate (Seasonally Adjusted)

	Apr-22	May-22	Jun-22	Jul-22	Aug-22	Sep-22	Oct-22	Nov-22	Dec-22	Jan-23	Feb-23
US	3.6	3.6	3.6	3.5	3.7	3.5	3.7	3.6	3.5	3.4	3.6
Canada	5.3	5.2	4.9	4.9	5.3	5.2	5.2	5.1	5.0	5.0	5.0
UK	3.8	3.8	3.6	3.5	3.6	3.7	3.7	3.7	3.7		
Eurozone	6.7	6.7	6.7	6.7	6.7	6.7	6.6	6.7	6.7	6.7	
Germany	5.0	5.0	5.3	5.4	5.5	5.5	5.5	5.5	5.5	5.5	5.5
France	7.5	7.5	7.5	7.4	7.2	7.1	7.2	7.1	7.2	7.1	
Italy	8.2	8.1	8.0	8.0	8.0	7.9	7.9	7.8	7.8	7.9	
Japan	2.6	2.6	2.6	2.6	2.5	2.6	2.6	2.5	2.5	2.4	
Australia	3.9	3.9	3.6	3.5	3.5	3.6	3.4	3.5	3.5	3.7	3.5

Source: Macrobond

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

	Q2-20	Q3-20	Q4-20	Q1-21	Q2-21	Q3-21	Q4-21	Q1-22	Q2-22	Q3-22	Q4-22
US	-3.1	-3.2	-3.5	-3.4	-3.6	-3.8	-3.7	-4.5	-3.8	-3.4	-3.2
Canada	-1.5	-2.4	-1.4	0.0	-0.4	-0.6	0.0	0.4	0.8	-1.2	-1.5
UK	-1.1	-2.6	-6.6	-1.9	-0.4	-3.3	-0.4	-7.7	-5.7	-3.1	
Eurozone	1.2	2.1	3.2	3.5	3.1	2.3	1.2	0.4	-1.3	-3.6	1.0
Germany	5.3	7.2	8.3	9.0	8.4	7.4	6.5	5.7	4.1	2.3	4.8
France	-3.7	-2.0	-0.4	0.6	0.7	0.3	-0.2	-0.1	-1.7	-3.8	-3.0
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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Hong Kong: State Street Global Advisors Asia Limited, 68/F, Two International Finance Centre, 8 Finance Street, Central, Hong Kong. T: +852 2103-0288. F: +852 2103-0200.

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Netherlands: State Street Global Advisors Netherlands, Apollo Building 7th floor, Heikerbergweg 29, 1101 CN Amsterdam, Netherlands. T: +31 20 7181 000. State Street Global Advisors Netherlands is a branch office of State Street Global Advisors Europe Limited, registered in Ireland with company number 49934, authorised and regulated by the Central Bank of Ireland, and whose registered office is at 78 Sir John Rogerson's Quay, Dublin 2.

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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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