STATE STREET GLOBAL ADVISORS

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Commentary

Weekly Economic Perspectives

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US inflation likely to downshift, but maybe not as much as expected. Japan's Q4 GDP may surprise to the upside. Aussie January employment may rebound.

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The Economy

Markets digest the rate implications of data signaling economic resilience.

US

After a slew of important releases last week, this was a lighter week on the US data front. There is broadening evidence that consumer sentiment is improving thanks to labor market resilience and moderating inflation. Indeed, the preliminary reading on the **Michigan Consumer Sentiment** index for February came in better than expected. The headline rose 1.5 points on a solid 4.2-point jump in the current situation assessment, while expectations eroded marginally. Long term inflation expectations were unchanged at 2.9% but short term (1 year) expectations rose three tenths to 4.2%, retracing more than half of January's retreat.

Mortgage applications are trying to find a bottom, aided by the one percentage point drop in the 30-year mortgage rate since early November. Mortgage applications rose 7.4% during the week of February 3, with purchase applications up 3.1% w/w and refinancing applications up 17.7% w/w. Activity remains well below year-earlier levels, but appears to have bottomed in both segments. Purchase applications were down 37.0% y/y with refinancing applications down 74.8% y/y during the February 3 week.

The rising cost of credit seems to be finally dampening demand for credit. Overall **consumer credit** rose by a smaller than expected $11.6 billion in December, the least since January 2021. The slowdown was evident across both revolving and non-revolving categories. The former increased by the smallest amount since August 2021 and the latter by the smallest amount since August 2020.

The **federal budget deficit** stood at -38.8 billion in January, a reversal from a surplus of almost $119 billion in January 2022. Notably, interest expenses exceeded defense expenditures during the month. Given ongoing increases in interest rates and given the substantial surge in the level of federal debt, the debt servicing burden is poised to get heavier still.

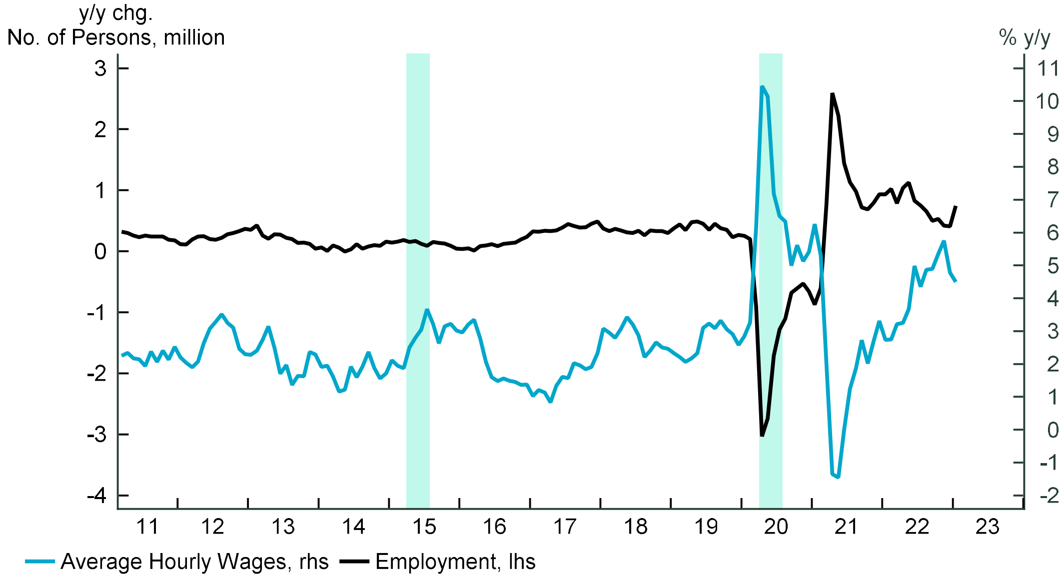
Canada

After a steep drop in December, the **Ivey PMI** rose to an eight-month high of 60.1 on solid employment and improving supplier deliveries. The comforting aspect is the fall in the prices index – to 63.6 from 67.5 in December. However, the employment sub-index remained on a firm footing at 60.5 from 59.5 in December.

The labor market smashed past expectations again, as hinted by the Ivey PMI. The economy added 150,000 jobs–precisely ten times the expectation! Importantly, though, the December job gains were revised down by nearly 30,000 to 69,200. The **unemployment rate** was unchanged at 5.0% but the participation rate jumped to 65.7%. Growth in immigrant-held jobs touched 13.3% y/y (+79,000), while resident-held jobs increased 2.8% (+536,000). The share of immigrants in overall employment rose to 3.4% in January from 3.1% last year. From a sector standpoint, services added 125,700 jobs while the goods sector added 25,400 jobs. Most job gains came in the prime-age group of 25-54 years old (100,000) and also among those aged over 54 (43,000). Industry-wise, most jobs were added by wholesale and retail trade (+59,000) and health care (+40,000). Declines were marked in transportation and warehousing (-17,000). **Average hourly earnings** rose by 4.5% y/y, slowing from December's downwardly revised 4.7% (from 5.2%).

While January employment report may warrant some repricing of the terminal BoC policy rate, it is important to remember that the labor market data has been quite volatile amid downward revisions. Given that wage growth has been decelerating, we continue to expect the BoC to remain on hold. There is a possible case for renewed hawkishness if the January CPI data subsequently throws a surprise.

Figure 1: Canada's Labor Market Remains On Solid Footing



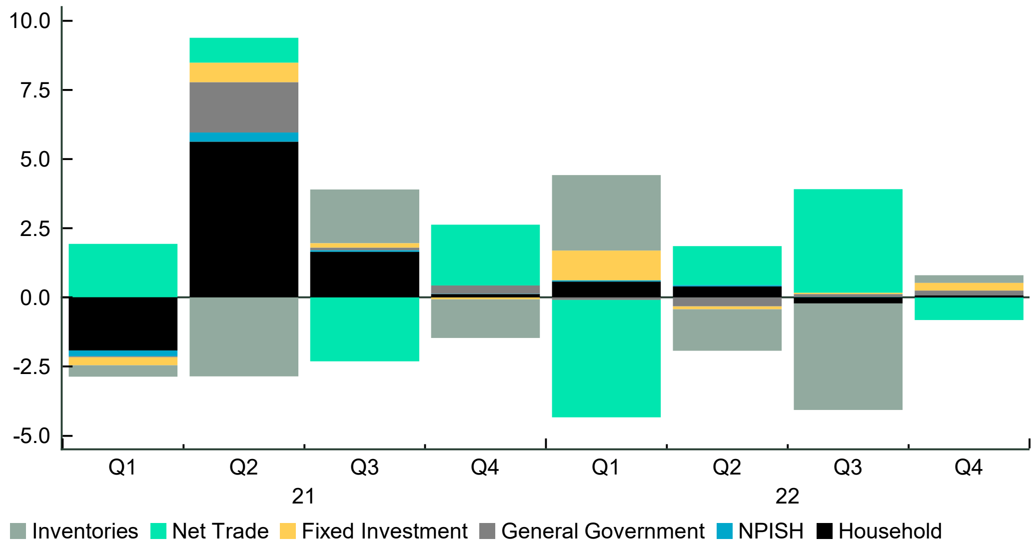
Sources: SSGA Economics, StatCan, Macrobond

Merchandise exports declined 1.2% m/m in December on lower exports of energy products, and imports dropped 1.3%. Resultingly, the **merchandise trade deficit** narrowed to C$160 million. Excluding the US, exports dropped 4.5%, while imports declined 3.8% for a second month. On an annual basis, however, the economy posted a second consecutive surplus in 2022 of C$20.1 billion, more than four times greater than in 2021. However, slowing exports and imports don't bode well for the economy, but we expect the damage to be contained.

UK

It was a not very dramatic end to a very dramatic year for the UK economy. **Real GDP** was flat in the fourth quarter, an outcome slightly better than anticipated and made better still by an upward revision to the third-quarter data. With these, the economy grew 4.1% in 2022 as a whole, indeed, not a bad outcome given all that has transpired over the course of the year in respect to the energy price shock, fiscal policy reversals, and monetary tightening. For our part, we suspect some revisions to the fourth quarter data are likely as the component behavior seems a little odd. However, for the time being, we must report on the data as reported. As such, consumer spending rose a meager 0.1% q/q, but this was better than consensus expectations of a small decline. Fixed investment also did better than expected, up 1.5% y/y, but this upside surprise was essentially offset by a downward revision to Q3 performance. Inventories rose—this was a surprise to us, at least—a development that seems to have reflected an equally unexpected increase in imports. From a contribution to growth standpoint, this was a quarter where no sector made the sort of outsized contributions visible in prior periods (Figure 2 below). The Q4 data, plus the earlier revisions, pose upside risks to our forecast of a 0.7% contraction in UK real GDP this year. Our next forecast update is due by mid-March.

Figure 2: Less Dramatic Moves In UK Q4 GDP
Percentage point contribution to quarterly growth



Sources: SSGA Economics, ONS

Eurozone

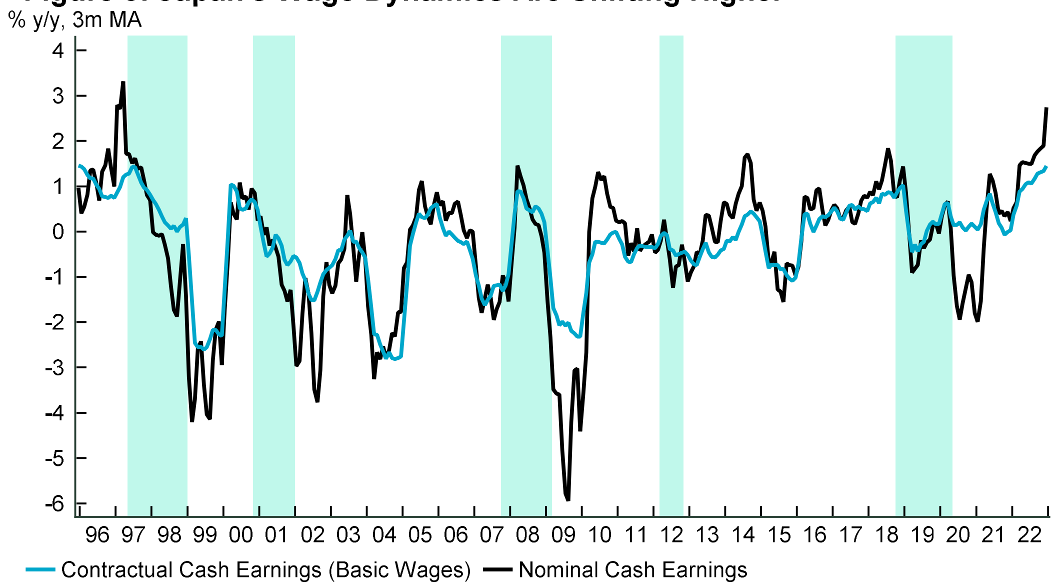
Industrial production was mixed across the region in December. ***Germany*** disappointed with a 3.1% monthly plunge that implies a sizable decline in the eurozone aggregate, but output jumped 1.6% m/m in ***Italy***. The German weakness was exacerbated by an 8.0% plunge in construction output; manufacturing and mining declined a smaller 2.1%.

***French* monthly wages** rose 0.6% q/q in Q4, marking the smallest quarterly gain in a year. Nevertheless, large increases earlier in the year mean that wage inflation has accelerated sharply over the course of 2022. The monthly wage index rose 3.9% y/y in Q4, up from about 1.6% in the previous few years.

Japan

Japanese wage inflation seems to be breaking higher. **Overall cash earnings** rose 4.8% y/y in December, the highest since 1997! Admittedly, most of this reflected one-time factors such as annual bonuses, which resulted in a 7.6% jump in special payments. However, contractual cash earnings (basic wages) also rose 1.8% y/y in December, the most since February 1995! Going forward, we expect wage growth to rise sustainably, supporting the view that monetary policy in Japan will normalize. We expect consumption to pick up from Q2 this year after a more favorable outcome from *shunto* wage negotiations next month.

Figure 3: Japan's Wage Dynamics Are Shifting Higher



Sources: SSGA Economics, Japanese Ministry of Health, Labour & Welfare, Macrobond

However, high-frequency consumption data was weak in December. The **BoJ's Consumption Activity Index** (CAI) fell 1.0% m/m while the November data was downwardly revised to -1.7% from -1.2%. Weaknesses in both goods and services were pronounced, falling -1.0% and -0.6%, respectively. This data was affirmed by the Ministry of Finance's household survey, which showed that December's real spending remained in negative territory for a second month at -1.3% y/y. However, real core spending came in positive at +0.5% y/y. Notable increases were recorded in key components with clothing & footwear (+6.8% m/m), furniture & household goods (+4.0%), while culture & recreation fell (-4.3%) and medical care (-4.2%). Separately, the government's **consumption trend index** (CTI) showed both the headline and the household consumption picked up in December at +0.1% m/m and +1.7%, respectively.

Essentially, these data support our consumption expectation for Q4 2022 at 2% y/y. A 1.7% rise in gross fixed capital formation should take the seasonally adjusted annualized GDP to 2.0%, landing 2022 GDP overall at 1.2% y/y. The critical source of uncertainty is inventory accumulation, which we expect to have dropped on the pick-up in domestic consumption. We will learn more next week.

On Friday, the Nikkei reported that the government would appoint **Dr Kazuo Ueda** as the new governor, an MIT PhD academic economist. Dr Ueda was a member of the BoJ board between 1998-2005 and had voted against exiting negative rates in August 2000. However, his April 2005 paper *"The Effects of the Bank of Japan's Zero Interest Rate Commitment and Quantitative Monetary Easing on the Yield Curve: A Macro-Finance Approach*" concluded that *"**The portfolio rebalancing effect -- either by the BOJ's supplying ample liquidity or by its purchases of long-term government bonds -- has not been found to be significant.**"* The yen strengthened against the USD as market read this as a hawkish signal. We expect the new BoJ leadership to bring about changes in a data-dependent manner and see another modification in YCC this year.

Australia

The **Reserve Bank of Australia** (RBA) raised the cash rate target by 25 bps to 3.35% as expected, but the hawkish guidance took markets by surprise. An entire paragraph affirming its commitment to bring inflation back to the target marked a pivot from the dovish expectations the bank had set in December when it shifted to smaller hikes. Specifically, "*if high inflation were to become entrenched in people's expectations, it would be very costly to reduce later*" and "…***the path to achieving a soft landing remains a narrow one***" surprised us.

The Statement of Monetary Policy strongly reiterated the hawkishness and materially revised inflation and wages, which we have highlighted previously. The statement that the board "*expects that further increases in interest rates will be needed over the months ahead*" stood out. The overall guidance supports our terminal forecast of 3.85% but we fear that the RBA may overreach if the hiking further as 'the path to achieving a soft landing becomes narrow'.

On the other end, the economy is coming off the post-Covid highs. **Retail volumes** dropped -0.2% q/q in Q4 2022 as consumer preferences shifted from retail to more recreational activities. Compositionally, volumes rose +2.1% for food retailing, less so in cafes, restaurants and takeaways at +0.3%. However, spending on household goods fell for the fourth quarter at -2.0%. Perhaps the most significant risk presented from the volumes data was in the deflator, which rose +1.1% q/q, which translated into +7.3% y/y. The rise was strong and reasonably broad-based.

Week in Review (January 30 – February 03)

Country	Release (Date, format)	Consensus	Actual	Last	Comments
Monday, February 06					
CA	Ivey PMI SA (Jan)	na	60.1	33.4	Will the rebound prove sustainable?
GE	Factory Orders (Dec, m/m)	2.0%	3.2%	-4.4% (↑)	OK, not great.
JN	Labor Cash Earnings (Dec, y/y)	2.5%	4.8%	1.9% (↑)	Very encouraging.
AU	Retail Sales Ex Inflation (Q4, q/q)	-0.5%	-0.2%	0.3% (↑)	Contained drop.
Tuesday, February 07					
US	Consumer Credit (Dec, $, bn)	25.000	11.565	33.107 (↑)	Sharp deceleration.
CA	Int'l Merchandise Trade (Dec, m/m, C$, bn)	-0.50	-0.16	-0.22 (↓)	Slowing economy.
GE	Industrial Production (Dec, m/m, sa)	-0.8%	-3.1%	0.4% (↑)	Ouch!
JN	Leading Index CI (Dec, prelim)	97.1	97.2	97.7 (↑)	Mild retreat.
AU	RBA Cash Rate Target (Feb 07)	3.35%	3.35%	3.10%	Hawkish guidance supports our terminal 3.85%.
Wednesday, February 08					
IT	Retail Sales (Dec, m/m)	-0.7%	-0.2%	0.8%	OK.
Thursday, February 09					
US	Initial Jobless Claims (Feb 04, thous)	190	196	183	Low.
US	Continuing Claims (Jan 28, thous)	1,660	1,688	1,650 (↓)	Low.
GE	CPI (Jan, y/y, prelim)	8.9%	8.7%	8.6%	Fine.
JN	PPI (Jan, y/y)	9.7%	9.5%	10.5% (↑)	Still high.
Friday, February 10					
US	U. of Mich. Sentiment (Feb, prelim)	65.0	66.4	64.9	Current situation improved.
US	Monthly Budget Statement (Jan, $, bn)	-55.0	-38.8	118.7	Interest costs on the rise.
CA	Unemployment Rate (Jan)	5.1%	5.0%	5.0%	Super-strong labor market.
UK	Industrial Production (Dec, m/m)	-0.2%	0.3%	0.1% (↑)	Welcome but not game changing.
UK	GDP (Q4, q/q, prelim)	0.0%	0.0%	-0.2% (↑)	Private consumption rose 0.1%.
FR	Wages (Q4, q/q, prelim)	1.0%	0.6%	1.0%	Smallest increase in a year.
IT	Industrial Production (Dec, m/m)	0.2%	1.6%	-0.1% (↑)	Good!

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

Week In Preview (January 30 – February 03)

Country	Release (Date, format)	Consensus	Last	Comments
Monday, February 13				
JN	GDP (Q4, q/q, sa, prelim)	0.5%	-0.2%	We expect 1.2% y/y average growth in 2022.
JN	Industrial Production (Dec, m/m, final)	-0.1% (p)	-1.2%	May come in higher than consensus.
AU	Westpac Consumer Conf Index (Feb)	na	84.3	May come in lower.
AU	NAB Business Confidence (Jan)	na	-1.0	May come in lower.
Tuesday, February 14				
US	NFIB Small Business Optimism (Jan)	91.0	89.8	Price and wage plans important to watch.
US	CPI (Jan, y/y)	6.2%	6.5%	There is some upside risk here.
UK	Average Weekly Earnings (Dec, 3m, y/y)	6.2%	6.4%	
UK	ILO Unemployment Rate (Dec, 3m, m/m)	3.7%	3.7%	
EC	GDP (Q4, q/q, prelim, sa)	0.1%	0.1%	
JN	Tertiary Industry Index (Dec, m/m)	0.1%	-0.2%	Should rebound from last month.
Wednesday, February 15				
US	Empire Manufacturing (Feb)	-18.0	-32.9	
US	Retail Sales Advance (Jan, m/m)	1.9%	-1.1%	Lifted by jump in vehicle sales.
US	Industrial Production (Jan, m/m)	0.5%	-0.7%	
US	Business Inventories (Dec, m/m)	0.3%	0.4%	
US	NAHB Housing Market Index (Feb)	37	35	Putting in a bottom.
CA	Housing Starts (Jan, thous)	245.0	248.6	Should be slowing.
CA	Manufacturing Sales (Dec, m/m)	-1.5%	0.0%	
CA	Existing Home Sales (Jan, m/m)	-2.5%	1.3%	May start rising strongly.
UK	CPI (Jan, y/y)	10.3%	10.5%	
EC	Industrial Production (Dec, m/m, sa)	-0.8%	1.0%	Dragged down by Germany.
JN	Core Machine Orders (Dec, m/m)	2.8%	-8.3%	Rebound expected.
AU	Unemployment Rate (Jan)	3.5%	3.5%	Should come in strong.
Thursday, February 16				
US	Building Permits (Jan, thous)	1,350	1,337 (↑)	
US	Housing Starts (Jan, thous)	1,355	1,382	
US	Initial Jobless Claims (Feb 11, thous)	200	196	
US	Continuing Jobless Claims (Feb 4, thous)	1,688	1,688	
US	Philadelphia Fed Business Outlook (Feb)	-7.4	-8.9	
US	PPI Final Demand (Jan, y/y)	5.4%	6.2%	
Friday, February 17				
US	Import Price Index (Jan, y/y)	1.8%	3.5%	
US	Leading Index (Jan, m/m)	-0.3%	-0.8%	
CA	Teranet/National Bank HPI (Jan, y/y)	na	0.0%	Uptick expected.
CA	Industrial Product Price (Jan, m/m)	-0.1%	-1.1%	May be decelerating.
CA	Raw Materials Price Index (Jan, m/m)	na	-3.1%	Deflationary.
UK	Retail Sales Inc Auto Fuel (Jan, m/m)	-0.3%	-1.0%	
FR	CPI (Jan, y/y, final)	6.0% (p)	5.9%	

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

Economic Indicators

Central Bank Policy Targets

Region	Target	Year/Year % Change in Target Aug	Sep	Oct	Nov	Dec
US	Target: PCE price index 2.0% y/y	6.3	6.3	6.1	5.5	5.0
Canada	Target: CPI 2.0% y/y, 1.0%-3.0% control range	7.0	6.9	6.9	6.8	6.3
UK	Target: CPI 2.0% y/y	9.9	10.1	11.1	10.7	10.5
Eurozone	Target: CPI below but close to 2.0% y/y	9.1	9.9	10.6	10.1	9.2
Japan	Target: CPI 2.0% y/y	3.0	3.0	3.7	3.8	4.0
Australia	Target Range: CPI 2.0%-3.0% y/y	7.3	7.3	7.8	7.8	7.8

Source: Macrobond

Key Interest Rates

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

Source: Macrobond

General Government Structural Balance as a % of Potential GDP

	2015	2016	2017	2018	2019	2020	2021	2022	Forecast 2023	Forecast 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 Sep	Oct	Nov	Dec	Jan	PPI Year/Year % Change Sep	Oct	Nov	Dec	Jan
US	8.2	7.7	7.1	6.5		8.5	8.2	7.3	6.2	
Canada	6.9	6.9	6.8	6.3		9.0	9.9	9.4	7.6	
UK	10.1	11.1	10.7	10.5		18.3	17.5	16.3	14.7	
Eurozone	9.9	10.6	10.1	9.2		41.9	30.5	27.0	24.6	
Germany	10.0	10.4	10.0	8.6		45.8	34.5	28.2	21.6	
France	5.6	6.2	6.2	5.9	6.0	26.1	21.3	18.1	17.7	
Italy	8.9	11.8	11.8	11.6	10.1	41.7	27.7	29.4	31.7	
Japan	3.0	3.7	3.8	4.0		10.3	9.7	9.8	10.5	9.5
Australia	7.3	7.8	7.8	7.8		6.4	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	1.0
Canada	1.7	0.7	0.8	0.7			3.9	3.2	4.7	3.9	
UK	1.5	0.5	0.1	-0.2	0.0		8.9	10.5	3.9	1.9	0.4
Eurozone	0.5	0.6	0.9	0.3	0.1		4.8	5.5	4.3	2.3	1.9
Germany	0.0	0.8	0.1	0.5	-0.2		1.2	3.5	1.7	1.4	1.1
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	1.1	0.5	-0.1		6.6	6.4	5.0	2.7	1.7
Japan	1.2	-0.5	1.1	-0.2			0.9	0.6	1.4	1.7	
Australia	3.8	0.4	0.9	0.6			4.6	2.9	3.2	5.9	

Source: Macrobond

Industrial Production Index (M/M Seasonally Adjusted)

	Month/Month % Change						Year/Year % Change				
	Aug	Sep	Oct	Nov	Dec		Aug	Sep	Oct	Nov	Dec
US	0.0	0.3	0.0	-0.6	-0.7		3.6	5.0	3.4	2.2	1.6
Canada	-0.5	0.4	-0.7	0.1			3.8	4.0	2.3	3.0	
UK	-1.5	-0.1	0.2	0.1	0.3		-6.2	-5.4	-4.2	-4.4	-4.1
Germany	-0.8	1.1	-0.4	0.4	-3.1		1.8	2.7	-0.4	-0.6	-4.2
France	2.6	-0.9	-2.6	2.0	1.1		1.4	1.6	-2.7	0.7	1.4
Italy	2.2	-1.7	-1.0	-0.1	1.6		2.5	-0.4	-1.3	-3.3	0.1
Japan	3.4	-1.7	-3.2	0.2	-0.1		4.2	9.6	3.8	-0.9	-1.2

Source: Macrobond

Unemployment Rate (Seasonally Adjusted)

	Mar-22	Apr-22	May-22	Jun-22	Jul-22	Aug-22	Sep-22	Oct-22	Nov-22	Dec-22	Jan-23
US	3.6	3.6	3.6	3.6	3.5	3.7	3.5	3.7	3.6	3.5	3.4
Canada	5.3	5.3	5.2	4.9	4.9	5.3	5.2	5.2	5.1	5.0	5.0
UK	3.8	3.8	3.8	3.6	3.5	3.6	3.7	3.7			
Eurozone	6.8	6.7	6.7	6.7	6.6	6.7	6.7	6.6	6.6	6.6	
Germany	5.0	5.0	5.0	5.3	5.4	5.5	5.5	5.5	5.5	5.5	5.5
France	7.4	7.5	7.6	7.6	7.3	7.2	7.1	7.1	7.0	7.1	
Italy	8.3	8.2	8.1	8.0	8.0	7.9	7.9	7.9	7.8	7.8	
Japan	2.6	2.5	2.6	2.6	2.6	2.5	2.6	2.6	2.5	2.5	
Australia	3.9	3.9	3.9	3.6	3.5	3.5	3.6	3.4	3.5	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	-4.6	-3.8	-3.4	
Canada	-1.5	-2.4	-1.4	0.0	-0.4	-0.6	0.0	0.1	0.4	-1.6	
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	
Germany	5.3	7.0	8.1	9.1	8.1	6.7	5.9	5.6	3.6	1.7	4.1
France	-3.7	-2.0	-0.4	0.6	0.7	0.3	-0.3	-0.1	-1.8	-3.3	-2.9
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, 2021.

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