STATE STREET GLOBAL ADVISORS

May 3, 2024
Commentary

Weekly Economic Perspectives

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The Economy

Softening US macro data warrants cautious Fed approach.

US

The May **Fed meeting** was less hawkish than feared, which, given our own more dovish inclinations, we see as a very good thing. Given the backdrop of a market prone to extreme swings from day to day and media headline careening from boom to stagflation headlines in the span of a single week, the Fed offered a welcome message of consistency and careful approach by holding rates and offering a balanced assessment of the economy.

The biggest news is that balance sheet runoffs will slow at the start of June. The monthly redemption cap for Treasury securities will be reduced from $60 to $25 billion, while the monthly cap for agency debt and agency mortgage backed securities is maintained at $35 billion. This was largely expected and is a prudent step as excess liquidity in the financial system diminishes. The details align with the Fed's ultimate goal of having the balance sheet exclusively comprised of Treasuries, something we had been discussing for a while.

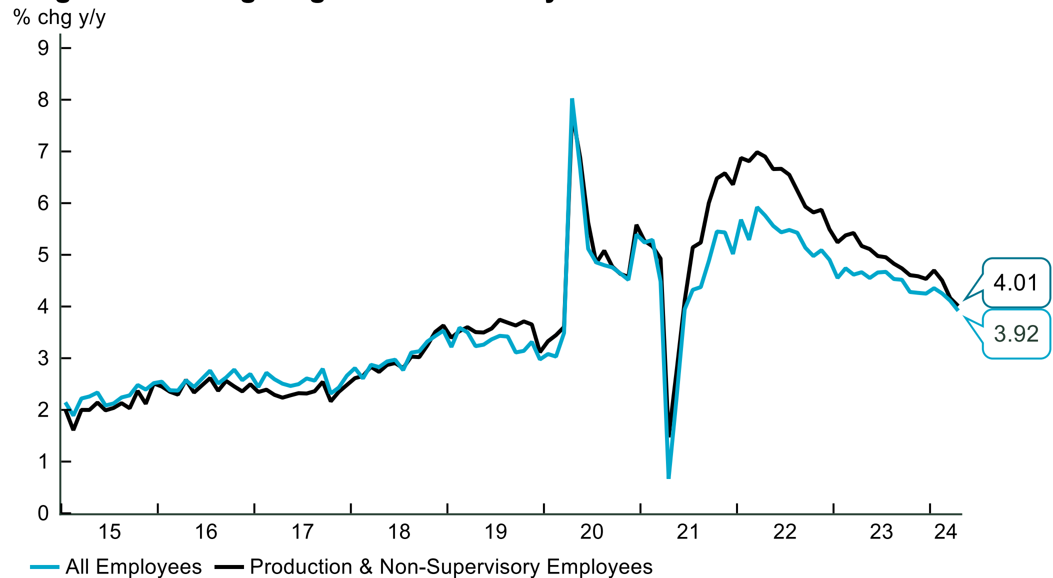
The other important point is that the Committee sees the policy in a good place. Admittedly, the lack of further progress on inflation in recent months has delayed the timing of the first cut *relative to earlier expectations*, but has not put hikes back on the table. Our reading is that the Committee is both ready to hold and ready to cut, depending on how the data evolves, but is not ready to hike.

Where do we go from here? To us, nothing in either the policy statement or the press conference ruled out the possibility of a July cut, which remains our highly non-consensus call. While timing of the first cut has been pushed back relative to earlier expectations, it is important to remember that not too long ago the Fed looked heavily poised to start cutting in May. Delaying to the end of July does not contradict the language used. All else equal, we'd argue that tapering QT at the start of June allows for a natural sequencing for a July cut, with the understanding that the data must play along. On that point, it is no longer just about inflation data, either. Given that the "Committee judges that the risks to achieving its employment and inflation goals have moved toward better balance over the past year", the labor market data will come into greater prominence going forward. As we've long argued, the dual mandate is becoming dual again!

And indeed it should. The wisdom of this renewed focus on labor market indicators was demonstrated almost immediately by the softer than expected April **employment report.** The economy added a smaller than expected 175k jobs in April, the least since October. The unemployment rate ticked up a tenth to 3.9% (although it only marginally rounded higher) and **wage inflation** continued to moderate. This latter fact may well be the most important message in the entire release. It tells a story of a labor market coming into balance, where jobs are being created without causing undue inflationary pressures. Specifically, both total average hourly earnings (AHE) and average hourly earnings (AHE) for production and non-supervisory employees rose a modest 0.2% m/m. The two respective measures of wage inflation stood at 3.9% y/y and 4.0% y/y, respectively, the least since June 2021. Sector-wise, the only notable change relative to recent months was the sharp slowdown in government employment. The public sectors has been adding about 65k jobs a months over the last several months but that plunged to just 8k in April. It

is too soon to say whether this is another indication that the big fiscal impulse is starting to fade, but it aligns with that argument. Still, the move is a little too dramatic and we suspect the number will move higher again.

Figure 1: Easing Wage Inflation Is Key US Labor Market Trend



Sources: Macrobond, SSGA Economics, BLS

Another important message and another piece of evidence towards our “labor demand is slowing” argument is that the **hours data** were very weak. The aggregate hours index (a measure of labor effort in the economy) declined 0.1%. In conjunction with soft wage inflation, the combination speaks to a weak month for labor income.

The latest **Jobs Opening and Labor Turnover Survey (JOLTS)** data shows the process of labor market normalization is well advanced. There were 8.488 million open positions in March, down 325k from February. This is down markedly from over 12 million in March 2022, but still about 1.2 million above 2019 levels. Hiring was down 281k and quits were down 198k; the job opening rate eased to the lowest since February 2021, the hiring rate was the twin-lowest since April 2020, and the quits rate was the lowest since August 2020.

Both **ISM surveys** disappointed this week. The manufacturing ISM dipped 1.1 points back into contraction at 49.2 points in April, with new orders and employment contracting. More surprising was the 2.0-point decline in the non-manufacturing ISM, down to a sixteen-month low of 49.4 and the first sub-50 reading since December 2022. The softening message was confirmed by a 6.5-point plunge in the business activity index (the old headline). The employment metric declined 2.6 points to 45.9, the second lowest reading since the summer of 2020. On the other hand, the price metrics rose in both surveys, though this shouldn’t be too surprising. Higher oil/gasoline prices are directly relevant to the manufacturing prices, while the non-manufacturing price metric has been notably volatile recently. April’s 5.8-point surge follows a cumulative 10.6-point decline in the previous two months.

Canada

No major data releases.

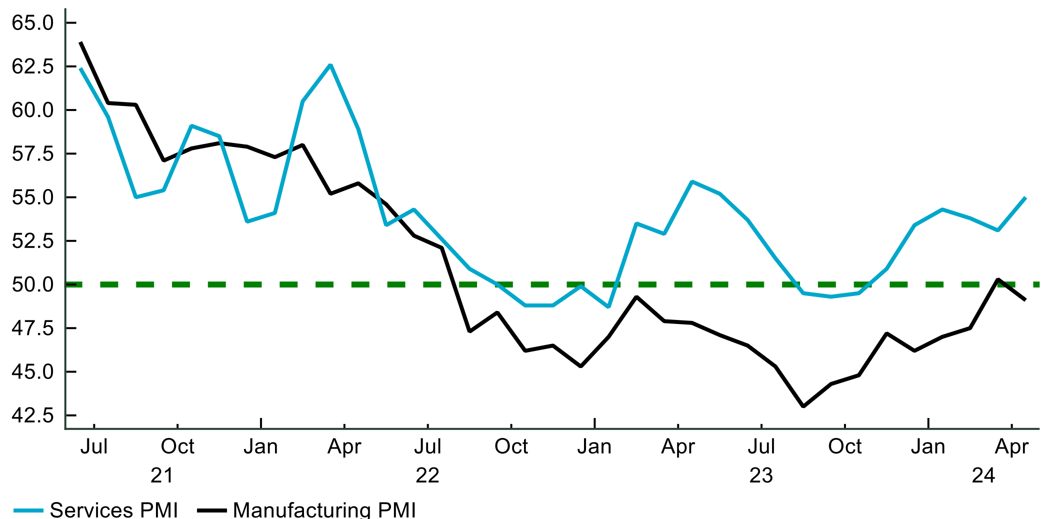
UK

UK manufacturing suffered a renewed downturn in April although the pace of decline was minimal. The UK **manufacturing PMI** fell to 49.1 in April, above the earlier flash estimate of 48.7, but down from March's 20-month high of 50.3. The downturn reflects uncertain market conditions, client destocking and the ongoing Red Sea crisis. While output, new orders and employment all fell, input cost pressures rose at the fastest rate since February 2023. Selling prices also rose in response, at the fastest rate since May 2023.

The services sector expansion continued in April, with activity and new work increasing at the fastest rates since May 2023. The final reading of **services PMI** index rose to 55.0, above the earlier flash estimate of 54.9, and up from 53.1 previously. However, employment rose at the slowest pace in 2024, as job creation was constrained by elevated wage pressures. Business expenses also rose sharply due to stronger wage inflation. Meanwhile, price charged inflation across the service sector eased to a three-year low in April.

Figure 2: UK Manufacturing Back Into Contraction

% Balance / Diffusion Index



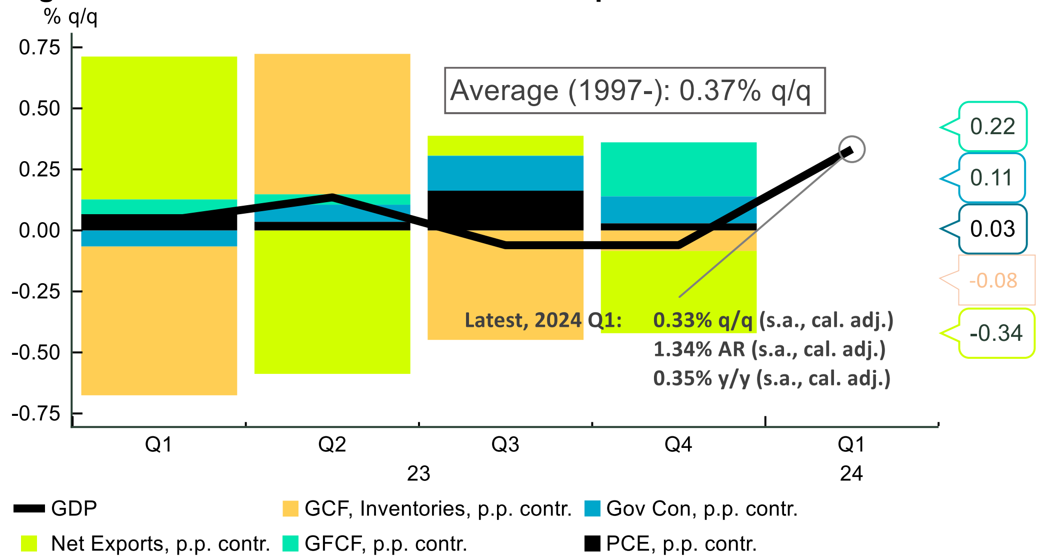
Sources: Macrobond, SSGA Economics, S&P Global
Updated as of 5/5/2024

Mortgage approvals reached 18-month high of 61,6k in March, from an upwardly revised 60,5k in previous month. However, housing prices fell in April as potential buyers are facing high mortgage rates. The **Nationwide house price index** fell 0.4% m/m in April, bucking expectations of an increase 0.1% m/m. In annual terms, the growth rate slowed to 0.6% y/y, from 1.6% y/y the previous month. Deteriorating affordability and higher mortgage rates will continue to create challenges for market in coming months.

Eurozone

Following a “de-minimis” technical recession in the second half of 2023, when **GDP** contracted 0.06% q/q in both Q3 and Q4, preliminary data show a stronger than expected improvement at the start of 2024. Regional growth accelerated to 0.33% q/q, lifted by 0.2% q/q gain in Germany and France and a 0.3% q/q advance in Italy. No sector details are available with the preliminary release. These are not game-changing numbers by any means, but support our more positive than consensus view on Europe.

Figure 3: Eurozone GDP Growth Beats Expectations



Sources: Macrobond, SSGA Economics, ECB
Updated as of 5/5/2024

The latest **inflation** data are well supportive of a first ECB rate cut in June. Headline inflation stands at 2.2% y/y in Germany and France, and just 0.9% y/y in Italy.

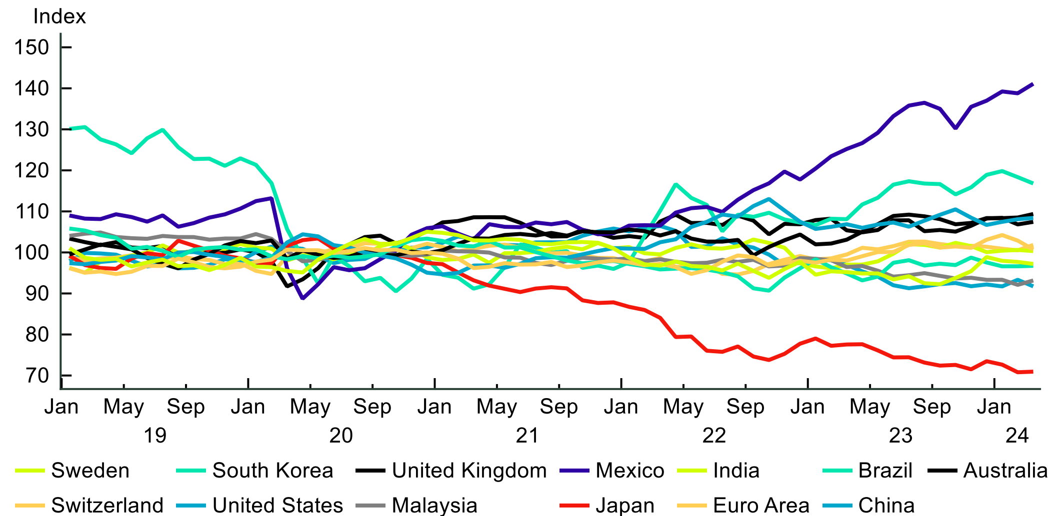
Japan

The yen swung wildly this week and continued to strengthen our conviction that it will be an important parameter for the Bank of Japan (BoJ) this year. After declining to a 34-year low of 162.2 against the USD, the yen rallied sharply back to 156 levels. The Ministry of Finance (MoF) did not confirm an intervention, but the BoJ’s daily current account suggested one. The yen then resumed its weakening path, rising to nearly 158 against the US Dollar on Thursday, before sharply weakening again to 153. This is a second suspected intervention in a weak, highlighting the high volatility that is gripping markets.

We continue to think that the yen faces two-sided risks, as it could appreciate just as quickly on dovish surprises in the US. Case in point, the yen rallied to 152.0 after a dovish outcome in US labor market data on Friday. Still, the yen has remarkably slid since the Covid pandemic, especially when we factor in inflation in Japan and its trading partners (figure 4). Hence, the yen has a potential to mean-revert. All this means that the likelihood of another rate hike from the BoJ is improving and only

depends on the extent to which the yen's weakness will show up in inflation data. While higher inflation from May is still our base case, we have some green shoots in that regard already.

Figure 4: The Yen's Remarkable Slide
Real Effective Exchange Rate Index



Sources: SSGA Economics, BIS, Macrobond
Updated as of 5/3/2024

Consumer sentiment in April disappointed, as it declined to 38.3 from 39.5 in March. We are very concerned that among the sub-indices, the DI for purchasing durable goods and standard of living declined the most by 2.2 points and 1.4 points respectively. We are however relieved to see the labor market and income growth DIs close to their post-pandemic highs. Inflation expectations too picked up in April, as those expecting inflation to rise 5% or above rose 3.2 ppts.
Retail sales disappointed too; they rose just 1.2% y/y, below February's 4.7%. The decline had an impact from Lunar New Year related inbound spending, but the details were weak nonetheless and highlight a remarkable slide in spending on motor vehicles (-16.2% y/y) and apparel (-3.7%). Quite interestingly, spending on fuel rose 7.3%, the highest since August last year and that on food rose 4.1%. Without fuel, sales would have slowed to 0.5% y/y.

In March, Japan's **industrial production** rose for the first time in three months by 3.8% m/m, three-tenths above the consensus. The resumption of production activity in a few automakers (9.6% m/m) played a key role, but production of transportation equipment (18.9%), production equipment (11.6%) and electronics (9.2%) all rose sequentially. However, this jump may not be sufficient to curtail the headwinds to growth in Q1. We are still tracking a potential contraction.

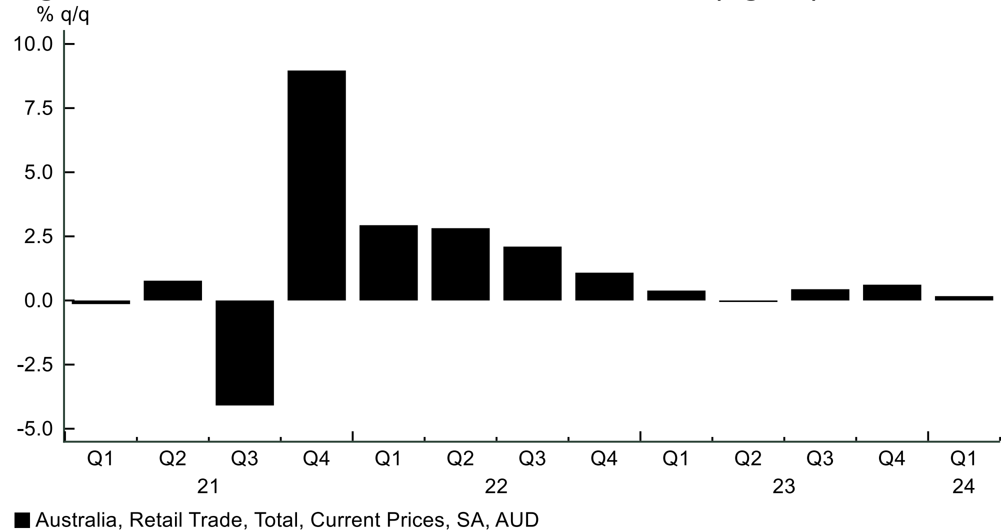
Next week, we expect overall cash earnings may have risen strongly while household spending may have eased.

Australia

We continue to expect two interest rates cuts in Australia this year, on a better data mix that shows higher interest rates have been working well. More validation for our out of consensus view emerged this week; **retail sales** declined 0.4% m/m, below our expectations of remaining flat (consensus +0.3%). Furthermore, the rise

in prior months were also revised down. Except for food (+0.9% m/m), declines were registered in all categories and were pronounced in clothing (-4.3%). The ABS noted consumers were more cautious on discretionary spending. The impact of this print will be a very soft consumer spending impulse in Q1 GDP, to be released only in the first week of June.

Figure 5: Nominal Aussie Retail Sales Have Stalled (Again!)



Sources: SSGA Economics, ABS, Macrobond
Updated as of 5/5/2024

Housing loan approvals rose more than expected at 3.1% m/m, more than twice the consensus. Investor lending continued rising faster at 3.8% and is now at its highest share in overall approvals since 2017. More importantly, the volumes of owner-occupier approvals rose 2.9% m/m, while they rose 3.1% for new construction. While this improvement is welcome, a structural revival in housing is still a long way off and still requires a policy-led rebound.

The current macroeconomic environment in Australia could be characterized with:

1, A labor market that is cooling faster than expected (see Australia section here),
2, Inflation that is moving into the central bank's target (see here) by Q3 and now,
3, An economy whose retail sales have slowed considerably

In such an environment, interest rate hikes are not an imaginable next move. However, to our astonishment, markets are now pricing a 30% chance that the Reserve Bank of Australia (RBA) would hike in August. Perhaps it is an effect of markets' hawkish expectations in the US, or an effect of the RBA's comparatively more hawkish stance so far. This pricing remained in place even after the Fed Chair Powell clarified that the Fed's next move could not be a hike, and even immediately after a softer-than-expected print of US employment. We fundamentally do not agree with it, but still suspect that the RBA next week will retain their hawkishness by not ruling out a hike. Any dovish outcome could be very surprising, but one in the right direction and one we continue to expect.

Week in Review (Apr 29 – May 03)

Country	Release (Date, format)	Consensus	Actual	Last	Comments
Monday, Apr 29					
GE	CPI (Apr, y/y, prelim)	2.3%	2.2%	2.2%	Fine for ECB June cut.
Tuesday, Apr 30					
US	Employment Cost Index (Q1, q/q)	1.0%	1.2%	0.9%	A little higher that desired, due to benefits.
US	FHFA House Price Index (Feb, m/m)	0.2%	1.2%	-0.1%	Surprisingly strong.
US	S&P CoreLogic CS 20-City (Feb, m/m)	0.1%	0.6%	0.2% (↑)	Surprisingly strong.
US	Conf. Board Consumer Confidence (Apr)	104.0	97.0	103.1 (↓)	Labor differential weakened.
CA	GDP (Feb, m/m)	0.3%	0.2%	0.5% (↓)	Weaker than expected.
UK	Mortgage Approvals (Mar, thous)	61.5	61.3	60.5 (↑)	Strong.
EC	GDP (Q1, q/q, adv)	0.1%	0.3%	0.0%	Welcome uptick.
GE	Retail Sales (Mar, m/m)	1.4%	1.8%	-1.5% (↑)	Volatile and still soft.
GE	Unemployment Claims Rate (Apr)	5.9%	5.9%	5.9%	In line.
GE	GDP (Q1, q/q, prelim)	0.1%	0.2%	-0.5% (↓)	Revision was sizable and not good.
FR	GDP (Q1, q/q, prelim)	0.1%	0.2%	0.1%	Fine.
FR	CPI (Apr, y/y, prelim)	2.2%	2.2%	2.3%	Fine for ECB June cut.
IT	GDP WDA (Q1, q/q, prelim)	0.1%	0.3%	0.1% (↓)	Fine.
IT	CPI NIC incl. tobacco (Apr, y/y, prelim)	1.0%	0.9%	1.2% (↓)	Fine for ECB June cut.
JN	Unemployment Rate (Mar)	2.5%	2.6%	2.6%	Labor market is very tight.
JN	Retail Sales (Mar, m/m)	-0.2%	-1.2%	1.7% (↑)	Soft.
JN	Industrial Production (Mar, m/m, prelim)	3.3%	3.8%	-0.6%	Rebound but volatile.
AU	Private Sector Credit (Mar, m/m)	0.4%	0.3%	0.5%	Still remains a key macro risk.
AU	Retail Sales (Mar, m/m)	0.2%	-0.4%	0.2% (↓)	Broad-based decline.
Wednesday, May 01					
US	JOLTS Job Openings (Mar, thous)	8,680	8,488	8,813 (↑)	Labor demand is softening.
US	ISM Manufacturing (Apr)	50.0	49.2	50.3	In the process of bottoming out.
US	Wards Total Vehicle Sales (Apr, mn)	15.70	15.74	15.49	OK.
UK	Nationwide House PX (Apr, m/m)	0.1%	-0.4%	-0.2%	Weakening.
UK	Manufacturing PMI (Apr, final)	48.7 (p)	49.1	50.3	Contracting but at slower-than-expected pace.
JN	Manufacturing PMI (Apr, final)	na (p)	49.6	48.2	Lower than prelim. But, still a good improvement.
Thursday, May 02					
US	FOMC Rate Decision (Upper Bound)	5.50%	5.50%	5.50%	QT taper will start June 1.
US	Initial Jobless Claims (Apr 27, thous)	211	208	208 (↑)	Extremely low.
US	Nonfarm Productivity (Q1, q/q, prelim)	0.5%	0.3%	3.5% (↑)	OK.
US	Factory Orders (Mar, m/m)	1.6%	1.6%	1.2% (↓)	Fine.
EC	Manufacturing PMI (Apr, final)	45.6 (p)	45.7	46.1	Weak.
JN	Consumer Confidence (Apr)	39.8	38.3	39.5	Worrying.
Friday, May 03					
US	Change in Nonfarm Payrolls (Apr, thous)	240	175	315	OK, but softer than expected.
US	Unemployment Rate (Apr)	3.8%	3.9%	3.8%	Wage pressures diminishing,
US	ISM Services Index (Apr)	52.0	49.4	51.4	Weak,
UK	Services PMI (Apr, final)	54.9	55.0	53.1	Strong.
IT	Unemployment Rate (Mar)	7.5%	7.2%	7.4%	Moving around.

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

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* Pensions & Investments Research Center, as of December 31, 2022.

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